

**Ofcom's consultation in relation to
"Better Policy Making; Ofcom's approach to Impact Assessments"**

Submission by Sky

1. The draft guidelines are not fit for purpose

- 1.1 The draft guidelines are insufficiently detailed and rigorous to stand alone as either guidelines to inform stakeholders of the approach that Ofcom intends to follow when undertaking impact assessments and/or as an internal guide to be used by Ofcom when undertaking impact assessments.
- 1.2 The draft guidelines fall well short of the level of guidance contained in other published guidance on regulatory impact assessment, such as the Cabinet Office publication, "*Better Policy Making: a Guide to Regulatory Impact Assessment*" dated January 2003 ("Cabinet Office Guide") and US guidance such as the Office of Management and Budget's "*Memorandum for the heads of departments and agencies*" of March 2000,¹ and the update to that memorandum ("*Circular A-4*") of September 2003.² The draft guidelines are also considerably less detailed than the guidelines on this subject published by Oftel.³
- 1.3 In respect of most issues with which they deal, the draft guidelines provide only a cursory statement about how Ofcom intends to address the issue. For example, the draft guidelines lack detail with respect to quantification and/or valuation of costs and benefits. Most other guidance on impact assessment typically devotes significant attention to this issue, including a description of the economic methods that can be used to quantify and value costs and benefits. For example, the Cabinet Office Guide contains three and a half pages on this subject in the main part of the guide, as well as a nine page annex.
- 1.4 Furthermore, some issues which are routinely discussed in guidance on impact assessment – such as discounting future costs and benefits – are not discussed at all in Ofcom's draft guidelines.
- 1.5 The draft guidelines also fail completely to address the importance of gathering evidence and how to gather evidence (see section 3 below).
- 1.6 Accordingly, the draft guidelines should be elaborated upon significantly in order to meet their intended purpose(s). As part of this task, Ofcom should

¹ <http://www.whitehouse.gov/omb/memoranda/m00-08.pdf>.

² <http://www.whitehouse.gov/omb/circulars/a004/a-4.pdf>.

³ See: "*Regulatory option appraisal guidelines: assessing the impact of policy proposals*", Oftel, June 2002; and "*Guidelines for assessing the costs and benefits of regulatory action*", Annex 4 in "*Proposals for implementing Oftel's Strategy: 2000/01 Management Plan*" Oftel, April 2000.

consider adopting an external review process similar to that which US authorities used when reviewing the US guidelines on this topic.⁴

2. The need for quantification and /or valuation⁵ of costs and benefits

- 2.1 As Ofcom recognises implicitly,⁷ cost benefit analysis lies at the heart of any regulatory impact assessment. Meaningful cost benefit analysis is, however, dependent on quantification and, if possible, valuation of costs and benefits. In the absence of quantification and/or valuation, choice of regulatory options becomes, to all intents and purposes, subjective – both in terms of selecting the best option and ensuring that the benefits of the selected option exceed its costs – thereby negating one of the key purposes of undertaking a regulatory impact assessment.
- 2.2 In practice, rather than acknowledging the need to aim to quantify and/or value costs and benefits, these issues are downplayed in the draft guidelines. There are two references to the “*difficulty of quantifying costs and benefits*”⁹ before the issue of the desirability of quantification of costs and benefits is discussed; and the only discussion of the desirability of quantifying costs and benefits in the draft is itself qualified by the statement “...*benefits in particular may be hard to quantify.*”¹⁰
- 2.3 As discussed in the examples below, Ofcom has, in the past, not included estimates of costs and benefits in regulatory impact assessments where (a) such estimates would not have been difficult to obtain and (b) such estimates were critical to the development of the particular policies. There is a tendency by Ofcom in regulatory impact assessments simply to list a range of different factors that Ofcom considers should be taken into account when choosing a policy option. For example, in Ofcom’s recent consultation on “*Recognised Spectrum Access as applied to Radio Astronomy*” dated 6 April 2005 there is no evidence of any attempt by Ofcom to measure the costs and benefits identified. This is in spite of, for example, one of the “*costs/risks*”

⁴ US guidance was reviewed by leading academics and practitioners in the field of cost benefit analysis and regulatory impact assessment, as well as by other government agencies, before it was issued. See page 1 of *Circular A-4, op. cit.*

⁵ Ofcom should recognise in its draft guidelines the difference between quantification and valuation. Often these two concepts are used interchangeably even though they have different meanings. It is often possible to quantify the impact of a regulation or policy where it is not possible to value it. For example, it might be possible to state that 5000 people will benefit from a particular policy, even if it is difficult to establish the overall value of the benefit that they receive. While not as useful as valuation, quantification assists in making policy evaluation somewhat less subjective. In the example above, if the estimated costs of the policy are £1m, an estimate of the number of people affected at least allows the judgment to be made, for example, that the benefits need to be worth at least £200 per person, on average, for the policy to be worthwhile. (See, for example, page 2 of the U.S. “*Circular A-4*” (*op. cit.*) on the use of such “threshold analysis.”)

⁷ In “Stage 5” (paragraphs 5.16 – 5.25 of the draft guidelines) Ofcom places the process of choosing the best option within a cost/benefit framework.

⁹ Paragraphs 5.1 and 5.17 of the draft guidelines.

¹⁰ Paragraph 5.18 of the draft guidelines.

being identified as “*financial impact on radio astronomy and reduction in funds for research.*” If such an impact constitutes a cost or risk of the policy, it would be reasonably straightforward for Ofcom to place a value on the financial impact (or, at the least, to provide a reasonable range for such an impact).

- 2.4 A further example is the impact assessment contained in Ofcom’s consultation document on Digital Replacement Licences (“DRL”). In this context, it is disappointing to find this impact assessment used in Ofcom’s draft guidelines as an example of where an alternative method of evaluating options had to be used because of the difficulty in quantifying costs and benefits.¹² In fact, most of the “*advantages*” and “*disadvantages*” listed in respect of the options considered by Ofcom were amenable to quantification and/or valuation. For example, the table at paragraph 226 of the DRL consultation document listed the following, among others, as advantages and disadvantages of the options:

*“Likely to be **less costly** overall than full DTT rollout.”*

*“Does not take into account the **extra costs** to consumers of using TV platforms other than DTT.”*

*“Leads to **greater consumer costs** in non-DTT areas than in DTT-covered areas.”*

*“DTT is likely to be **cheaper** for consumers than other TV platforms.”*

(Emphasis added throughout).

No estimates of these costs, or cost savings, were provided by Ofcom. Yet, it is readily apparent that such extra costs and cost savings, are amenable to quantification and/or valuation. For example, in relation to the first factor quoted above, it would have been straightforward¹³ for Ofcom to provide an estimate of **how much** less costly the policy in question would have been than full DTT rollout. At the very least, Ofcom ought to have provided some indication of its estimates of the order of magnitude of such costs and cost savings.

¹² The RIA in this case also suffered from the significant flaw that it failed to consider policy options at an appropriate level of detail. In particular, the consultation did not examine in sufficient detail the availability of alternative digital television services in the geographic areas served by analogue terrestrial transmitters whose conversion to digital is unlikely to be commercially rational.

¹³ This could have been achieved in a number of ways – for example, by deducting an estimate of the costs of the policy from the estimated costs of full DTT rollout; or by establishing how many fewer transmitters would be converted under the alternative policy and evaluating the costs saved by not converting those transmitters.

The process undertaken by Ofcom in the DRL consultation did not, therefore, provide any comfort that Ofcom is committed to basing its policy on a thorough evaluation of costs and benefits.

- 2.5 It is also open to question whether the difficulty of quantifying and valuing costs and benefits is a legitimate reason not to attempt to do so. Ofcom engages with many issues that are intrinsically “difficult”.
- 2.6 Accordingly, the draft guidelines should provide firmer statements which commit Ofcom, at a minimum, to seeking to evaluate the impact of its policies in quantitative terms, and to value costs and benefits wherever possible (taking into account the issue of proportionality). This should be reinforced by greater detail on how Ofcom will evaluate costs and benefits as set out above.

3. Evidence-based decision making

- 3.1 One glaring omission from the draft guidelines is the absence of guidance in relation to collecting the information needed to undertake impact assessments. This is starkly at odds with Ofcom’s commitment to “*evidence-based*” interventions in its regulatory principles.¹⁵
- 3.2 Gathering appropriate evidence is, clearly, a critical part of policy making in general, and preparing regulatory impact assessments in particular. The Cabinet Office Guide emphasises the importance of gathering evidence, particularly at an early stage in the policy development process, stating:

*“Start consulting **informally as early as possible** to get the greatest benefit from the process and inform your **initial RIA**.”* (Emphasis in original.)¹⁶

- 3.3 Such early informal consultation is important because it will enable Ofcom to include reasonably well developed evaluations of the options that it is considering in any subsequent formal consultation documents. It is more efficient to seek consultees’ views on reasonably well developed evaluations at the formal consultation stage, than to seek information on the costs and benefits of options only at the formal stage. It also helps avoid the pitfall of regulators basing judgments on their own beliefs – for example, by merely asserting that the costs involved are small, or the benefits significant – which may not be well informed. Indeed, in a regulatory impact assessment undertaken by Ofcom concerning regulation of electronic programme guides, Ofcom asserted that the costs of a particular proposal would be small.¹⁷ This

¹⁵ See, for example, Figure 2.2, “*Ofcom’s regulatory principles*”, at page 9 in “*Ofcom’s Annual Plan 2005/06*”.

¹⁶ See “*Section 3: “Consultation”* in the Cabinet Office Regulatory Impact Assessment Guidance: http://www.cabinetoffice.gov.uk/regulation/ria/ria_guidance/index.asp.

¹⁷ See the Regulatory Impact Assessment in “*The Regulation of Electronic Programme Guides*”, Ofcom, February 2004. Ofcom did not consult Sky about any of the statements about the cost of modifying its EPG prior to publishing the Regulatory Impact Assessment.

was not, in fact, the case – an error that could have been avoided by consulting with Sky at an early stage.

- 3.4 Clearly, consultation with relevant parties is not the only way of gathering evidence. Other methods include reviewing literature, precedents, surveys and modeling.¹⁸
- 3.5 Accordingly, the draft guidelines should be amended to include a section describing how Ofcom will gather evidence and a commitment to follow such procedures. This would be consistent with Ofcom’s duty under section 3(3) of the Communications Act 2003 and would assure stakeholders that Ofcom intends to act on its stated principle of being an evidence-based decision maker.
- 3.6 A strong commitment to seeking evidence to inform regulatory impact assessments would also act as a counterweight to the view espoused in Ofcom’s draft guidelines that costs and benefits may be hard to quantify. There is a risk that such a view can be taken to mean that it is difficult for *Ofcom itself* to quantify costs and benefits, thereby absolving Ofcom of the need to attempt to do so. In many instances, however, those outside Ofcom are likely to be able to assist in informing estimates of costs and benefits and, therefore, Ofcom needs to make full use of such resources in order properly to evaluate its policy proposals.

4. Analysing distributional impacts

- 4.1 Ofcom states that:

“The distributional impacts which the different options would have should also be taken into account.”¹⁹

- 4.2 Whilst distributional impacts are a relevant consideration of any regulatory impact assessment, it is important to note that such consideration is contingent upon adequate cost benefit analysis. If an adequate cost benefit analysis is not conducted, policies may be chosen which (i) have desirable distributional consequences but which impose unacceptable cost burdens (e.g. burdens which are disproportionate to the value of the distributional benefits) and/or (ii) do not reflect the most cost-effective way of meeting the desired distributional objective. Ofcom should therefore clarify in the draft guidelines that distributional impacts should be considered as a complement to, and not a substitute for, adequate cost benefit analysis.

5. Proportionality

- 5.1 Ofcom states that:

“A key principle is that an Impact Assessment should be proportionate to the likely impact of the proposals. This means that the more substantial and

¹⁸ See: *“Impact Assessment; A Europe Economics Handbook*, Europe Economics, April 2005.
¹⁹ Paragraph 5.21 of the draft guidelines.

wide-ranging the impact on stakeholders, the more comprehensive the Impact Assessment should be."²⁰

5.2 A policy need not have a substantial **and** wide ranging impact on stakeholders in order to justify a comprehensive impact assessment; either of these should constitute sufficient grounds for a detailed impact assessment. For example, a policy proposal that has a substantial impact on a small number of firms would warrant a detailed impact assessment.

5.3 Accordingly, Ofcom should amend the draft guidance to read:

*"A key principle is that an Impact Assessment should be proportionate to the likely impact of the proposals. This means that the more substantial **and/or** wide-ranging the impact on stakeholders, the more comprehensive the Impact Assessment should be."* (Emphasis added.)

6. Cost to Ofcom of implementing options

6.1 In the section which deals with choosing the best regulatory option, Ofcom states that:

*"Another important consideration is the cost to Ofcom of implementing an option...Ofcom has a limited budget...and this may make it impossible to pursue an option which has significant implementation costs."*²¹

6.2 This would appear to mean that Ofcom would consider not adopting a policy which is likely to have significant and clear net benefits to the UK on the basis that it did not have the budget to implement that policy. Yet Ofcom has the ability, under section 38 of the Communications Act 2003, to set its budget at the level required to meet the costs of carrying out its statutory duties. It would, therefore, be inappropriate for Ofcom to decline to set a budget which prevented it from pursuing policies which accord with its statutory duties and which are likely to have clear net benefits. Accordingly, this statement should be deleted from Ofcom's draft guidelines.

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²⁰ Paragraph 5.1 of the draft guidelines. A similar statement is included at paragraph 1.5 of the draft guidelines.

²¹ Paragraph 5.24 of the draft guidelines.