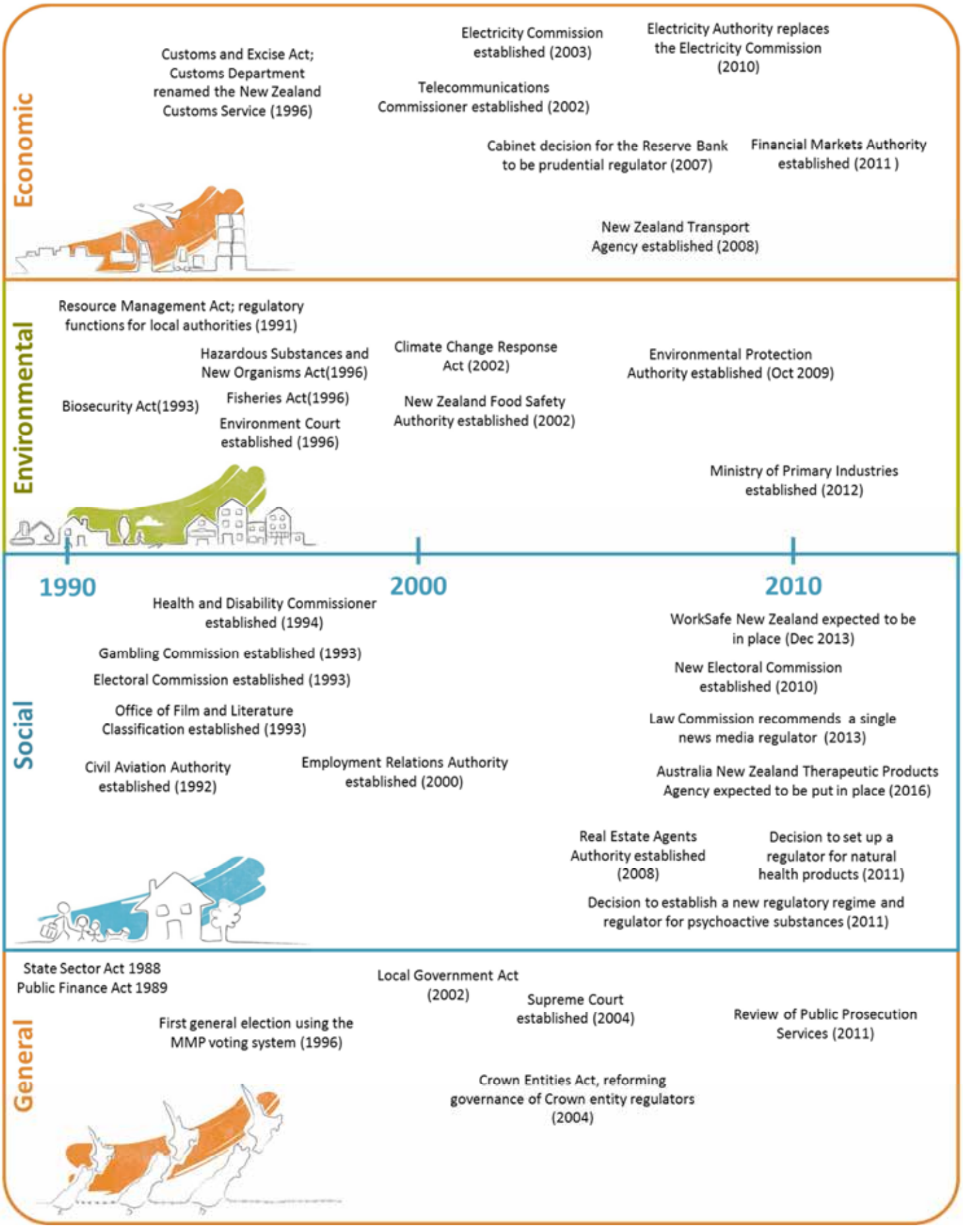
NEW ZEALAND
PRODUCTIVITY COMMISSION
Te Kōmihana Whai Hua o Aotearoa

# Regulatory institutions and practices

Issues Paper
**August 2013**

# Timeline of some recent events in the establishment of regulators



# Regulatory institutions and practices

## Issues paper – August 2013

**The Productivity Commission**

The Commission – an independent Crown entity – completes in-depth inquiry reports on topics selected by the government, carries out productivity-related research, and promotes understanding of productivity issues. The Commission's work is guided by the New Zealand Productivity Commission Act 2010.

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# Contents

**The issues paper** **v**

Key inquiry dates ..... v
Contacts ..... v
Why you should make a submission ..... vi
How to make a submission ..... vi
What the Commission will do with submissions ..... vii

**1 What the Commission has been asked to do** **1**

What this inquiry will include ..... 1
What this inquiry will not include ..... 2
What regulation is in scope ..... 2
What is meant by 'design and operation' of regulatory regimes? ..... 3
The Commission's approach to the inquiry ..... 3

**2 Why this inquiry is important** **6**

Regulation and wellbeing ..... 6
Regulatory failure ..... 8

**3 The regulatory landscape** **10**

The New Zealand context ..... 10
Mapping New Zealand regulation ..... 15

**4 Improving regulatory design and operation** **18**

Clarity of role, functions and duties ..... 19
Overlapping and consistent regulatory regimes ..... 21
Regulatory independence and institutional form ..... 22
Decision-making structures, processes and approaches ..... 26
Decision review and appeal ..... 29
Allocation of risk through the regulatory system ..... 31

Funding and resourcing ..... 32
Regulator workforce capabilities ..... 33
Compliance monitoring and enforcement ..... 35
Engagement ..... 37
Organisational culture ..... 38
Accountability and transparency ..... 41
Performance assessment ..... 43

**Summary of questions** **48**

**References** **54**

**Terms of reference** **58**

**Appendix A Examples of government-funded regulatory activities** **61**

# The issues paper

This issues paper is intended to assist individuals and organisations to prepare submissions to the inquiry into regulatory design and operation. It outlines the background to the inquiry and the matters about which the Commission is seeking comment and information.

This paper is not intended to limit comment. The Commission wishes to receive information and comment on issues which participants consider relevant to the inquiry's terms of reference.

## Key inquiry dates

| | |
|---|---|
| Receipt of terms of reference: | 11 July 2013 |
| Due date for initial submissions: | 25 October 2013 |
| Release of draft report: | February 2014 |
| Draft report submissions due: | April 2014 |
| Final Report to Government: | 30 June 2014 |

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## Why you should make a submission

The Commission aims to provide insightful, well-informed and accessible advice that leads to the best possible improvement in the wellbeing of New Zealanders. The Commission strives to be 'in touch' so that its advice is relevant, credible and workable. The submission process helps the Commission to gather ideas, opinions and information to ensure that inquiries are well-informed and relevant.

## How to make a submission

Anyone can make a submission. It may be in written, electronic or audio format. A submission can range from a short letter on a single issue to a more substantial document covering a range of issues. Where possible, please provide relevant facts, figures, data, examples and documentation to support your views. While every submission is welcome, multiple, identical submissions do not carry any more weight than the merits of an argument in a single submission. Submissions may incorporate material made available to other reviews or inquiries that are relevant to this inquiry.

The Commission seeks to have as much information as possible on the public record. Submissions will be placed on the Commission's website shortly after receipt unless marked 'in confidence' or accompanied by a request to delay release for a short period of time. The Commission can accept material 'in confidence' only under special circumstances. Please contact the Commission before submitting such material, to discuss its nature and how the material should be handled or presented.

Submissions may be sent through the Commission's website www.productivity.govt.nz, or by email or post. Where possible, an electronic copy of submissions should be sent to info@productivity.govt.nz in Word or PDF. Submissions should include your name and contact details and the details of any organisation you represent. If the content of a submission is deemed inappropriate or defamatory, the Commission may choose not to accept it.

The Commission will be undertaking some case studies (see chapter 2). Case studies are invited from interested parties. Box 1 suggests some features of good case studies.

Box 1 **What makes a good case study?**

A good case study is one that:

- provides examination of a regulatory design topic in the context of a real life example or event;
- has a clear and specific focus (rather than attempting to cover a broad range of regulatory issues);
- is candid and revealing;
- is supported by data, facts and information that are in the public domain (or that can be independently verified);
- presents the information in a factual and unbiased manner;
- provides a clear description of the context in which events occurred;
- provides analysis of key events, decision points or processes;
- provides a clear discussion of the results or outcomes associate with the key events, decision points or processes;
- makes a clear link between the event, decision or processes and an observable outcome;
- draws out the lessons that can be taken from the example and highlights how these lessons can be applied in the future.

## What the Commission will do with submissions

Submissions will play an important role in shaping the nature and focus of this inquiry. They will be used to gauge the position and preferences of stakeholders. Where relevant, information from submissions may be cited or used directly in inquiry reports. As noted above, the Commission will publish submissions, unless arrangements have been made with the Commission regarding any confidential content.

# 1 What the Commission has been asked to do

The Government has asked the Commission to examine how the design and operation of regulatory regimes and their regulators can be improved – ultimately to improve regulatory outcomes.

## What this inquiry will include

The Commission has been asked to provide:

- a 'high-level map' of regulatory regimes and regulators across central government, and a typology of how regimes and regulators might be classified or distinguished;
- guidance to inform the design and establishment of new regulatory regimes and regulators; and
- system-wide recommendations on how to improve the operation of regulatory regimes over time.

### Box 2 **Defining regulatory regimes**

Any regulatory regime has three working components – *standard setting* (identifying the regulatory goal or target), *monitoring* compliance with the regulatory standard and *enforcement* when there is noncompliance (Hood, Rothstein, and Baldwin, 2001). Together, these three elements form the basis for controlling the behaviour of individuals and businesses.

In addition, the Commission has been asked to give particular attention to:

- any key features or characteristics of New Zealand's regulatory environment that differ from other jurisdictions. For example, these may include differences in scale, resourcing, or the need to coordinate with overseas regulatory regimes;
- how improvements can be made to the monitoring of regulator performance across central government; and
- other existing work in this area to avoid duplication, such as the State Services Commission's *Reviewing the Machinery of Government*.

See page 59 for the full terms of reference.

## What this inquiry will not include

- The inquiry is not a review of individual regulators, specific regulations or the objectives of regimes (this was explicitly excluded from the inquiry's scope by the Terms of Reference given to the Commission).
- The inquiry is not about improving the policy-making *process* for developing new regulation or regulators.

The Commission has already commented on the policy-making *process* for formulating new regulation in its report *Towards better local regulation*. Recent reforms to the policy-making process, notably the Regulatory Stewardship Programme, are in their early stages of implementation. Time is needed for these programmes to become embedded in the regulation-making process before their effectiveness can be determined. The Commission's view, therefore, is that it can best add value by examining the features that shape regulation to succeed, rather than the process by which these are developed and passed into law.

## What regulation is in scope

There are various definitions of regulation, each displaying varying degrees of specificity and breadth. Black (2002) offers three definitions from the literature, each involving the exercise of some authority to affect behaviour. Regulation is:

- the promulgation of rules by government accompanied by mechanisms for monitoring and enforcement, usually assumed to be performed through a specialist public agency;
- any form of direct state intervention in the economy, whatever form that intervention might take;
- all mechanisms of social control or influence affecting all aspects of behaviour from whatever source, whether they are intentional or not.

For the purposes of this inquiry, the Commission will focus on the regulation that is implemented where the operation of markets fails to produce behaviour or outcomes that are aligned with the public interest. Traditional market failure rationales for regulating arise where there are monopoly or anti-competitive behaviour, information problems (asymmetries), externalities (where the full costs and benefits of a private action are not fully accounted for and spill over to third parties and society) and public goods (goods and services that are not produced by the market, or are under produced).

Ogus (1994) notes that many areas of market failure are remediable, in theory at least, by private law and thus by instruments which are compatible with the market system. However, Ogus also notes that private law cannot always provide an effective solution, and where market

failure is accompanied by 'private law failure' there is a *prima facie* case for regulatory intervention in the public interest.

Because regulation involves the exercise of coercive legal powers, the outcomes of regulation should be justifiable on the grounds of the public benefit. The New Zealand regulation-making framework sets out well-established constitutional and legal principles relating to fairness and the preservation of individual liberty that need to be complied with if regulation is to be supported by society (for example, the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993).

Regulation can be carried out by government or quasi-government organisations. It can also be 'decentred' and carried out by a diverse array of non-state organisations (Black, 2001). These include self-regulatory bodies such as professional bodies, industry groups, certification bodies, trade associations, corporations and industry based certification bodies, community and voluntary bodies. To the extent that any particular activity is regulated by a network or assemblage of regulators, the arrangements can be very complex, potentially leading to overlaps, duplication or gaps.

The Commission will focus on public agencies as regulators. The regulatory instruments used cover the full range of legal and informal instruments through which government seeks to influence or control the behaviour of individuals and businesses – and regulate itself – to achieve desired economic, social and environmental outcomes. Regulation therefore includes primary legislation, secondary regulation (such as Orders in Council), deemed regulations, licences, codes and consents, rules, informal instruments and agreements for achieving compliance.

## What is meant by 'design and operation' of regulatory regimes?

The terms of reference for this inquiry requires the Commission to examine the 'design and operation' of regulatory regimes. We are interested in how the regulatory regime is intended to operate by those who establish it (the institutional settings, the formalised structures, rules, processes, and requirements that are designed), as well as how these are translated into practice (how the regulator actually goes about its business, including the strategies it uses and its culture).

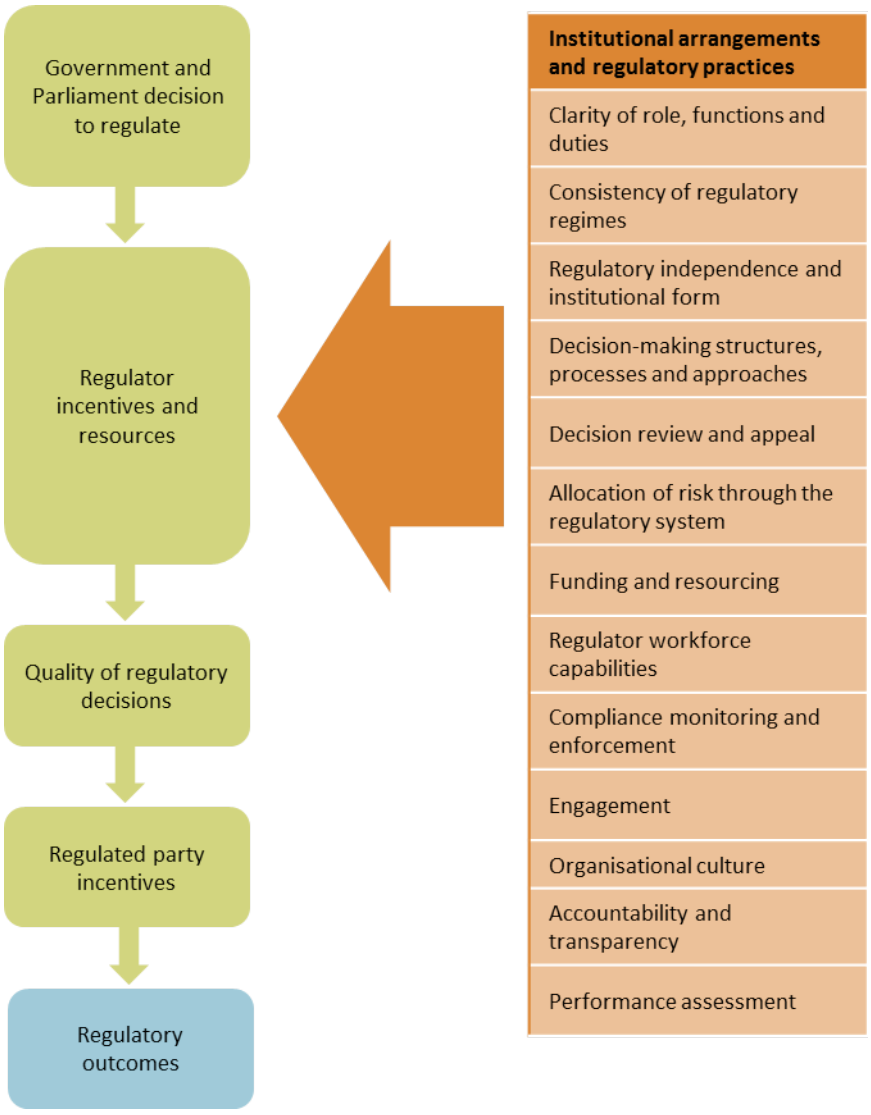
The performance of a regulatory regime depends on both the design and operation of the regulatory regime. In discussing the cause of regulatory failures, Manch (2011) notes that "it's the policy **and** its implementation" – and that the latter is often forgotten.

## The Commission's approach to the inquiry

The institutional arrangements and regulatory practices listed in Figure 1.1 will be examined to determine how generally they can best be used to shape the incentives on regulators to lead to

the best possible decisions. This analysis will form the substance of our guidance and recommendations on how the design and operation of regulations can be improved. The Commission expects that the guidance provided in meeting the terms of reference will have broader relevance to other aspects of government compliance activities.

**Figure 1.1 The Commission's approach to this inquiry**




The government and Parliament decide to regulate, and develop a range of institutional arrangements in the design of the regulatory regime and particularly the regulator.

Regulatory decisions, however, are made in a dynamic environment in which there are differing incentives on both the regulator and on regulated parties to behave in ways that uphold or undermine the regulatory standard. Regulatory decisions can have both intended and

unintended consequences, leading to regulatory outcomes that may, or may not, fully align with what Parliament intended.

**Q1** **What sort of institutional arrangements and regulatory practices should the Commission review?**

**Q2** **The Commission has been asked to produce guidelines to assist in the design of regulatory regimes. What type of guidelines would be helpful?**

To meet the requirements of the terms of reference, this inquiry will identify and classify regulatory regimes and regulators (a 'high-level map'). Different kinds of classifications are likely to reveal different things. For example, a classification based on organisational form is likely to show clear differences and similarities amongst regulators, but it is also likely to reflect the age and style of legislation that establishes the regulator. The inquiry will therefore use several different classifications of regulators.

An important task for this inquiry is to examine the key factors which act as incentives or barriers to regulatory regimes and regulators producing the outcomes intended by legislation. To this end, the Commission will utilise a range of approaches to examine the design features of existing regulatory regimes and regulatory institutions. This will include developing case studies aimed at illustrating how features of regulatory design 'play out on the ground'.

We invite submitters to suggest case studies. The Commission is open to any examples provided in any format. See page vii for advice on good case studies.

# 2 Why this inquiry is important

## Regulation and wellbeing

The Commission's principal purpose is to provide advice to the government on improving productivity in a way that is directed to supporting the overall well-being of New Zealanders, having regard to a wide range of communities of interest and population groups in New Zealand society (New Zealand Productivity Commission Act 2010, s7).

### Box 3 **A day in the life of a New Zealand family**

It's 6 am and the kids barge through the door wearing their safety standard-compliant pyjamas. You reach over and turn on the clock-radio. The local station is playing its regular morning show, the content of which is subject to a code of practice for radio broadcasting.

Scratching your head you rise from your recently purchased mattress (which is covered by the Consumer Guarantees Act), make your way to the bathroom and turn on the light. The light complies with the energy performance standards administered by the Energy Efficiency and Conservation Authority. The price and reliability of the electricity used to power the light comes through a transmission network that is overseen by the Electricity Authority.

You turn on your shower. The quality of water flowing from the tap is regulated by the National Environmental Standard for drinking water, while the Commerce Commission regulates the amount you pay for the gas that heats the water.

You wash your hair with antidandruff shampoo approved for sale by the Minister of Health. The soap runs down a drain built in compliance with the New Zealand Building Code.

Once out of the shower, you dry yourself and reach for the shaving cream, or perhaps some makeup. The packaging proudly proclaims that the product was not tested on animals – a claim subject to scrutiny under the Fair Trading Act. You fill a glass of water and take your daily vitamin tablets – which are regulated under the Dietary Supplements Regulations administered by Medsafe.

Once dressed you make your way into the kitchen to get breakfast for the family – cereal topped with banana. The cereal has its nutritional value printed on the side of the carton. The information complies with the Nutritional Information Requirements of the Australian New Zealand Food Standards Code. The banana is from the Philippines but it poses little

threat to biosecurity due to New Zealand's quarantine regulations.

You tip milk on the cereal. The quality of the milk is regulated under the food safety standards while the price you paid for milk is monitored by the Commerce Commission.

After breakfast you take the kids to school. On the way out of the house you lock the door. Maybe you have recently purchased the house following, amongst others, the prescriptions in the Property Law Act. Or maybe you are renting the property under the conditions set out in the Residential Tenancies Act. Either way, you probably used the services of a real estate agent who was legally bound to act in accordance with the Real Estate Agents Act.

You buckle your children into a car seat that meets the Joint New Zealand/Australian standard and then start your vehicle (which of course has a current registration and warrant of fitness). You then drive (under the authorisation of your New Zealand driver licence) to your children's school– being sure to obey local traffic regulations as you only have 10 demerit points left on your licence!

You drop your children off at school, where their teacher is registered by the New Zealand Teachers' Council as being capable to deliver the New Zealand Curriculum and the newly-elected school board is charged with giving effect to the government's National Education Guidelines. As you drive away, you wonder how the project to earthquake-strengthen the old school hall to the Ministry of Education's building design standards is going.

At work, regulations administered by the Ministry of Business Innovation and Employment promote a safe working environment while the Human Rights Act seeks to protect you against discrimination from your co-workers. Your pay and conditions are covered by the Employment Relations Act which (amongst other things) protects the holiday entitlements you negotiated with your employer.

And all this before smoko – which of course is outside….

Regulations are an important tool for preserving and advancing public interests. When designed well and enforced efficiently and effectively, regulation can play an important role in correcting market failures and improving the efficiency with which resources are used. In doing so, regulation can help achieve broader economic, social and environmental goals that underpin wellbeing. The OECD expresses the importance of regulation as follows.

> Regulations are indispensable to proper functioning of economies and societies. They underpin markets, protect the rights and safety of citizens and ensure the delivery of public goods and services. (OECD, 2011, p.7)

That said, the importance of regulation needs to be balanced with the importance of personal autonomy. There is, at best, weak justification for regulating where personal choices or organised industry action will address identified problems satisfactorily.

Regulation is typically used to control or modify the behaviour of individuals or businesses and is justified in the interests of wider public benefit. However, if regulation has misplaced objectives, is used when it is not needed, or is poorly designed and executed, then it can fail to achieve policy objectives and have unintended consequences that harm the wellbeing of New Zealanders.

## Regulatory failure

Regulatory failure occurs where regulations fail to make outcomes better, or even make outcomes worse, than if there had been no regulation. Ogus (1994, p. 30) explains that:

> …the regulatory solution may be no more successful in correcting the inefficiencies than the market or private law, or that any efficiency gains to which it does give rise may be outweighed by increased transaction costs or misallocations created in other sectors of the economy. In other words, 'market failure' and 'private law failure' have to be compared with 'regulatory failure'.

There are two main ways that regulation can fail: failures of design or failures of operation. Poorly conceived and implemented regulatory arrangements not only fail to achieve stated objectives, but also impose significant costs that can undermine the very purpose of regulatory intervention. Such costs affect business productivity and profitability, the economic circumstances of individuals and families. Ultimately this will harm economic performance and the wellbeing of New Zealand.

### Design failure

When regulation is designed poorly, it is less likely to effectively achieve the desired objectives of the regulatory regime. Examples (drawn largely from Baldwin, Cave, and Lodge, (2012)) include:

- mis-specification of the problem the regulation is trying to solve, so that it is targeted at the wrong behaviours or issues;
- failure to choose the right instrument to address the actual problem, or the right range of instruments;
- under-inclusive rules that mean some behaviours that are intended to be controlled are allowed to escape constraint;
- over-inclusive rules which restrict behaviour that does not need to be controlled;
- over-stringent regulation which reduces the possibilities for innovation or imposes excessive compliance costs;
- over-prescriptive rules that are hard to apply because events are not covered by the exact wording of the provisions.

## Operational failure

Regulatory failures arising from how regulators operate are largely about a failure to maintain confidence in the regulatory regime they administer. Examples (drawn largely from Baldwin, Cave, and Lodge, (2012)) include:

- failure to enforce the regime sufficiently for people to believe they need to comply;
- failure to evaluate performance and adjust practices accordingly;
- failure to develop or follow procedures that satisfy stakeholders' appetites for openness and transparency;
- 'capture' of the regulator, where the regulator ceases to act in the public interest, and instead acts in the interests of particular groups that have influenced them.

## Overarching theme – complexity

Regulatory failure is more likely where complexity is added to regulations to respond to specific incidents. For regulated parties increased complexity can require a greater investment in understanding how to comply, greater effort to navigate compliance requirements, or greater compliance costs. Where this effort appears too great, a significant number of regulated parties, or even many, will choose not to comply instead of incurring the costs.

For regulators, increased complexity can make it harder to identify if a regulatory breach has occurred or to take the correct action. Complexity may make it harder for the regulator to respond quickly, or it may lead to inconsistencies where seemingly similar situations are treated as technically different under the regulations. In the extreme, regulation can become a set of solutions to past incidents that is incoherent, complex and unsuited to present or new challenges.

# 3 The regulatory landscape

"History and tradition build institutions and attitudes; changing times and situations force these to flex or break…our national quirks and individual features… interact with our current values and desires to make the task of designing and running a set of regulations difficult." (Frankel and Yeabsley, 2013)

## The New Zealand context

This section discusses some of the distinctive features that have helped shape the way regulation is designed and operated in New Zealand. The Commission invites submissions on the importance of these features, or other New Zealand specific characteristics, that contribute to the way regulation is designed and operated in this country.

### Heritage, circumstances, culture and values

Beliefs about how risks should be dealt with and beliefs about the role of government vary between countries and lead to differences in countries' approaches to regulation. For example, Tokeley (2013) notes that to reduce head injuries among cyclists, Australia and New Zealand have introduced laws requiring cyclists to wear helmets. However bicycle helmets are not compulsory in Denmark, the Netherlands, the United Kingdom or in most US states. In some countries there is strong opposition to laws requiring cyclists to wear helmets as it is considered a civil liberties issue. In Denmark and the Netherlands there is a strong cycling culture and low levels of helmet use, however, in these countries cycle-ways are often used to separate motor vehicles and cyclists.

Regulation by the government is only one of a number of possible responses to deal with new issues or risks. The choice to regulate as a way of dealing with risk will, in part, depend on the alternatives available. The Commission's previous inquiry into housing affordability, for example, noted that licensing of building practitioners following New Zealand's leaky building problems, was needed in the absence of other mechanisms (such as large established building firms seeking to protect their brand) that could have provided consumers with the information they needed about the quality of builders (Productivity Commission, 2012).

The types of risk faced by societies, along with the perception of risk, can change over time. As a result there can be an increasing demand for regulation to cover new products and services and protection of rights. In the last year New Zealand has introduced a new regulatory regime for psychoactive substances and is considering a new regime for the regulation of natural health products and supplements. A new workplace health and safety regulator is expected to be in place by December of this year and the Law Commission has recommended the

establishment of a single news media regulator to replace the three existing bodies covering print, broadcasting and online media.

Box 4 **Regulators in the news – a wide range of issues**

The following list of news article headlines provides an indication of the wide range of public issues that New Zealand regulators address. The list also notes the regulator named in each news article.

Accident Compensation Corporation – ACC work injury cover may end, Feb 27, 2012

Civil Aviation Authority – Fatal aircrash 'could have been avoided', May 9, 2012

Customs – Customs destroys 729kg of drugs, Jun 26, 2013

Department of Internal Affairs – Internal Affairs cracks down on charities, Sep 23, 2012

Department of Labour – Pike River report: Learn from tragedy, Apr 11, 2013

Medsafe – Warnings over cholesterol drugs possible, Mar 2, 2012

Ministry for Primary Industries – Fonterra reeling from intense media scrutiny, Aug 8, 2013

*Source*: Results from a Google search of the word "regulator" in the national news section of the Stuff news website (www.stuff.co.nz/national).

## Political environment

New Zealand's constitutional and political environment shapes how we make regulations. Our Mixed Member Proportional (MMP) electoral system has made minority or coalition government almost inevitable, with the main governing parliamentary party needing to secure support from other parties for each piece of legislation (Palmer and Palmer, 2004). As a result there can be more discussion, and a broader consensus needed about decisions to regulate, and about the details of regulatory regimes.

Unlike comparable jurisdictions, New Zealand makes extensive use of primary legislation rather than relying on secondary or tertiary regulations (delegated rule-making through those instruments) (Frankel and Yeabsley, 2013). Accordingly there can be higher barriers to maintaining or amending regulatory regimes in New Zealand.

Parliament's select committee system provides for a high degree of public oversight and comment on the legislative process and provides a voice for the public including those being regulated (Frankel and Yeabsley, 2013). However, some have expressed concern at an

increasing use of urgency in Parliament leading to select committee consideration of legislation being bypassed (Geiringer et al, 2011).

## Partnership of two peoples

The Waitangi Tribunal has characterised the relationship between Māori and the Crown as being:

> ….built on an original chapter consensus between formal equals. We do of course have our own protective principle that acknowledges the Crown's Treaty duty actively to protect Māori rights and interests. But it is not the framework. Partnership is. (Waitangi Tribunal, 2011, p. 117-18)

Increasingly, the importance of Māori involvement in regulatory processes is being recognised. As a Treaty partner, Māori have interests in regulatory matters which they seek to have addressed:

> Iwi see economic development as vital for New Zealand, but subject to the constraints of reducing environmental footprints, including through smart technologies and innovation. They look to formal participation in setting strategic priorities at the national level, and involvement at the local level which allows them to ensure that their values and objectives are taken into account in practice. Iwi seek outcomes from water that sustain the physical and metaphysical health and well-being of waterways as a matter of first principle; ensure the continuation of customary instream values and uses; and satisfy iwi development aspirations. (Land and Water Forum, 2010, pp. vii-viii)

Chapter 4 discusses the implications of increasing involvement of Māori in regulatory matters for effective engagement (page 38).

## A small and isolated country

Conway (2011) describes New Zealand as having the "most unhelpful economic geography of any OECD country" (p.5). Our small domestic economy and geographic isolation present twin disadvantages as economies of scale have become increasingly important in some sectors and the benefits that firms obtain by locating near each other can drive productivity growth in some industries.

Given these disadvantages, Conway highlights the need for an exceptionally good regulatory environment because it can help mitigate the impact of economic geography on our economic performance (Conway, 2011).

## New Zealand is a part of a global regulatory system

Many regulatory systems are now global. Governments acting alone cannot address issues of banking and financial regulation, intellectual property, infectious diseases such as severe acute respiratory syndrome (SARS) and worldwide environmental issues such as climate change. There has been a proliferation of international standard-setting bodies and a shift of regulatory

authority away from the nation-state to global regulatory regimes and regulators. The upshot is that New Zealand's regulatory settings are increasingly shaped by global regulators and influences (Ministry of Economic Development, 2010).

Regulatory coordination across countries can have a number of advantages for New Zealand, including:

- facilitating trade and reducing the entry costs and on-going transactions costs across regulatory jurisdictions;
- overcoming issues of scale in administering regulatory regimes; and
- having access to a wider pool of regulatory capacity and capability.

Regulatory coordination can be achieved in a number of ways, from joint regulatory agencies, mutual recognition arrangements through to unilateral recognition of another country's arrangements.

Some examples where New Zealand coordinates with other countries is presented in Table 3.1 below:

**Table 3.1 Examples of regulatory coordination**

| Type of international regulatory coordination | Description | Examples |
|---|---|---|
| Unilateral adoption | Adopting another country's standards and making them New Zealand's standards. | New Zealand's cosmetic products regulations are heavily based on those of the EU.<br>New Zealand has largely adopted Australia's insider trading laws. |
| Unilateral recognition | Recognising another country's standards as being acceptable in New Zealand. | 22 nations' driver licences are accepted.<br>Major vehicle manufacturing nations' standards for automotive systems, parts and components are accepted. |

| Type of international regulatory coordination | Description | Examples |
|---|---|---|
| Mutual recognition | Two or more countries recognising each other's standards as being acceptable in their countries. | Goods approved for sale in Australia or New Zealand can be sold in the other country.<br>Someone registered to practice an occupation in Australia or New Zealand can do so in the other country.<br>China-New Zealand Electrical and Electronic Equipment and Components mutual recognition agreement.<br>Mutual recognition of securities offerings between Australia and New Zealand. |
| Harmonisation | Joint standards, separate enforcement. | Food Safety Australia New Zealand. |
| Joint regulation | Joint standards, joint enforcement. | Proposed Australia New Zealand Therapeutic Products Authority. |

Balancing the costs and benefits of regulatory coordination against the costs and benefits of local tailoring will always be difficult. There are costs to exaggerating our uniqueness and therefore our need for local regulation but regulation that is not 'fit for purpose' in the New Zealand context can impose unnecessary costs on New Zealand consumers and businesses.

Achieving coordination can also prove extremely difficult in practice, as shown by the proposed Australian and New Zealand Therapeutic Products Agency (ANZTPA) which would jointly regulate medicines and other therapeutic products. Despite Australia and New Zealand's common need for safe medicines and our common institutional heritage, the establishment of ANZTPA has been complicated because of each country's unique institutional arrangements, organisational forms, accountability arrangements, governance and operational practices (Nixon and Yeabsley, 2011).

**Q3** **Does New Zealand have (or need) a unique 'regulatory style' as a result of our specific characteristics?**

**Q4** **What influence has New Zealand's specific characteristics had on the way regulation is designed and operated in New Zealand?**

## Mapping New Zealand regulation

Figures 3.1 and 3.2 set out indicative ways that regulatory regimes and regulators could be classified. Of course, there are many other possible classifications. For example, in Australia a regulatory inquiry divided Victoria's 69 regulators of business into 11 themes (safety, food safety, health, transport, gambling, education, environment, animal welfare, construction, a general category and an 'other' category – see Victorian Competition and Efficiency Commission, 2005).

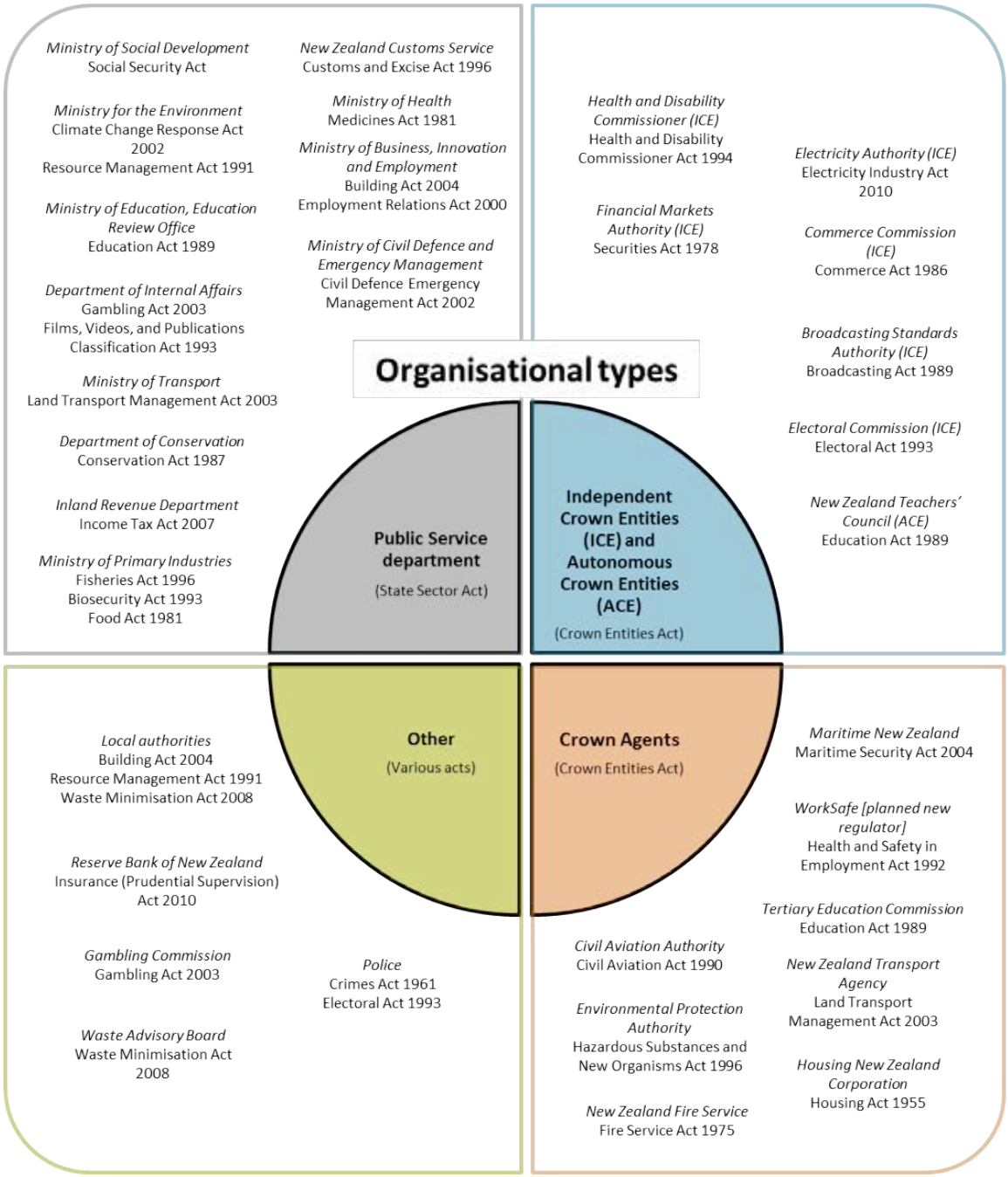
Other classifications could be based around the form of regulation (for example, occupational licensing, market conduct or price setting), the types of market failures the regulation addresses, the size and structures of regulators, the mix of size and structure in the regulatory target group and the age of regulations.

Appendix A provides more detailed information about a selection of government-funded regulators.

The choice between classification approaches may depend on the reasons for undertaking the grouping. For example, if the aim is to look for opportunities to expand coordination, activity-based themes may be most revealing. However, if the aim is to analyse the scope for improving governance arrangements, it would be useful to group regulators into governance categories, as this may assist identification of anomalies.

Q5 **What other ways of categorising New Zealand's regulatory regimes and regulators would be helpful in analysing their similarities and differences? How would these categorisations be helpful?**

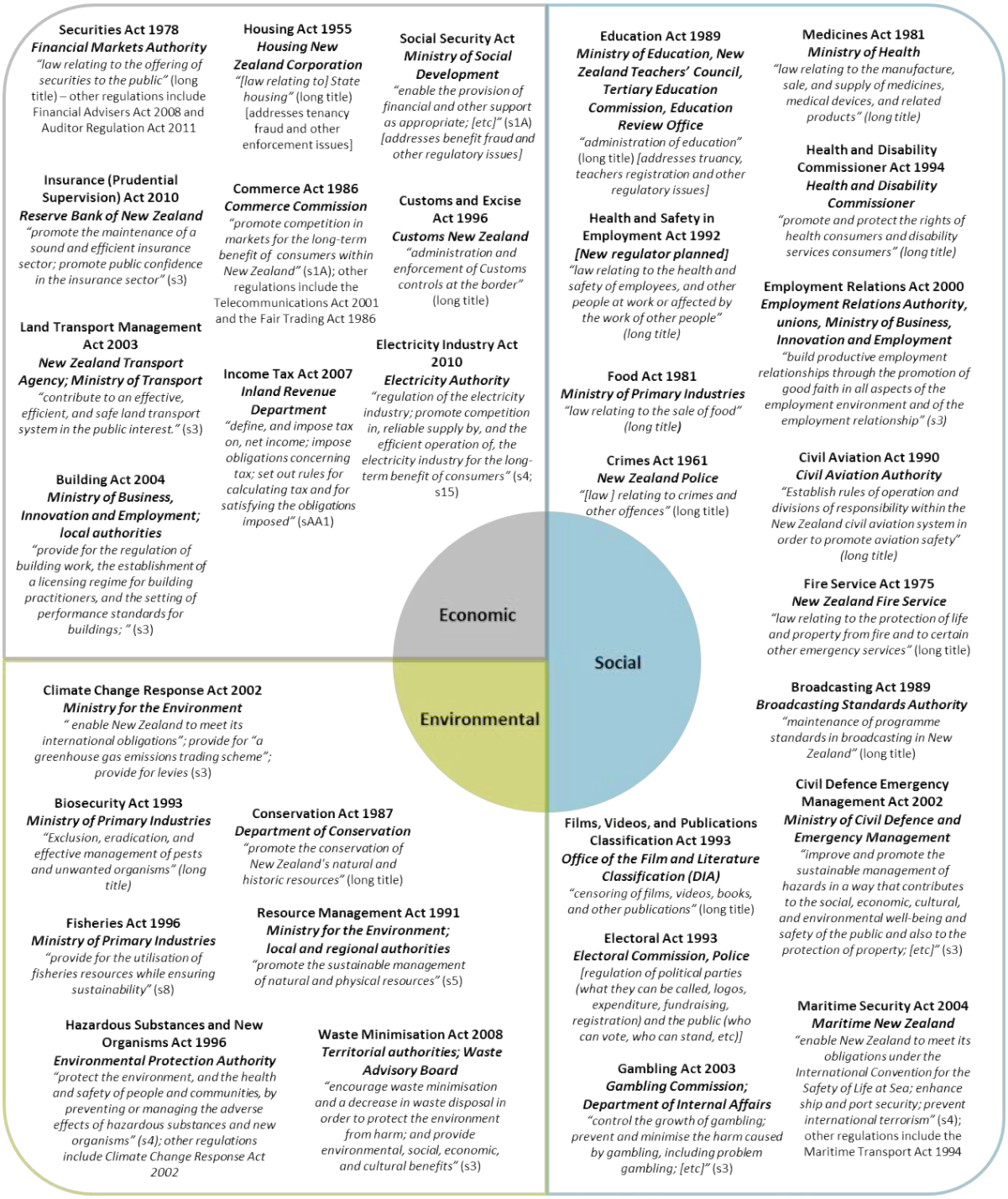
## Figure 3.1 An indicative grouping of agencies with regulatory functions into organisational types




*Notes:*

1. The regimes shown here are examples of New Zealand regulatory regimes only. Ministers can direct public services departments on many matters, whereas Crown entities operate at arms-length from a minister. Independent Crown Entities and Autonomous Crown Entities generally have more independence from Ministers than Crown Agents.

## Figure 3.2 An indicative grouping of New Zealand regulatory regimes into areas



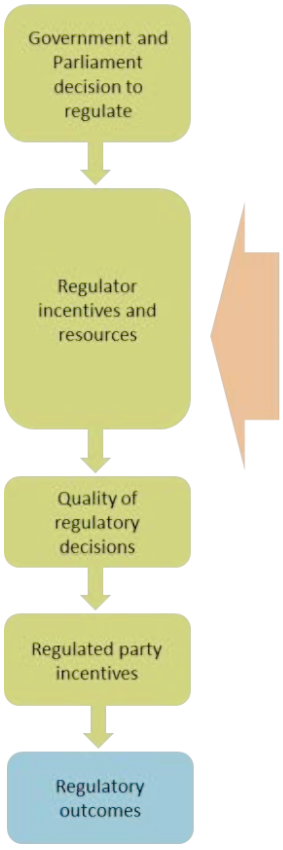

*Notes:*

1. Each regulatory regime lists the name of the legislation, the regulator and the regulation's focus (from the long title or purpose section of the regime's legislation). The regimes are examples of New Zealand regulatory regimes only. Note that many regulatory regimes typically sit across more than one subject area.

# 4 Improving regulatory design and operation

The institutional arrangements and regulatory practices that constitute the architecture of regulatory regimes shape the incentives on regulators, the quality of decision-making, incentives on those regulated and ultimately the success of regime in achieving the desired outcomes. This inquiry is about better understanding what good regulatory design and practice looks like in the New Zealand context and how they can be improved. The Commission has identified the following design and practice features that are critically important to a modern, responsive regulatory regime. Submissions are sought from inquiry participants with experience in the application or operation of these features.

**Figure 4.1 The Commission's approach to the inquiry – detailed view**




| Institutional arrangements and regulatory practices | Brief description |
|---|---|
| Definition of role, functions and duties | Considers clarity of the objectives of the regulation, and assists regulators to understand the boundaries of their authority and prioritise work |
| Consistency of regulatory regimes | Considers consistency with other regulatory regimes including existing legislation and other relevant policies |
| Regulatory independence and institutional form | Considers how to prevent a regulator being used for partisan purposes, considers a range of institutional forms for regulators |
| Decision-making structures, processes and approaches | Considers the way regulatory decisions are made, which will inform the shape of the governance structure of the regulator |
| Allocation of risk through the regulatory system | Considers whether risks are managed by those who have the ability to control them, the right incentives, or take steps to prevent problems |
| Funding and resourcing | Considers whether regulators have sufficient funds to allow them to undertake the functions necessary to achieve regulatory outcomes |
| Regulator workforce capabilities | Considers how to maintain the right kind and amount of capability for regulators to deliver on regulatory outcomes |
| Engagement | Includes gathering information; promoting awareness of obligations; early warnings; understanding community expectations and priorities |
| Organisational culture | Includes learning and consistency; empowering staff to make difficult calls; risk aversion and customer service; potential for professional capture |
| Monitoring and enforcement | Considers the appropriate range of enforcement tools and the appropriate level of discretion to give regulators |
| Accountability and transparency | Considers how regulator is held to account for its use of powers and resources, and provides access to information about conduct |
| Performance assessment | Considers how regulators drive continuous improvement in the way regulation is undertaken |
| Decision review and appeal | Considers ways in which the decisions of public bodies can be scrutinised |

## Clarity of role, functions and duties

Legislation that provides regulatory powers should clearly articulate the underlying objectives of the regulation, ie the outcome the regulation is aiming to achieve.

Clear objectives assist regulators to understand the boundaries of their authority and prioritise areas of work. They also provide a clear focus to hold the regulator accountable for its performance (OECD, 2013). Conversely, vague or unclear regulatory objectives can undermine public confidence in both the regulator and the legislation under which the regulator operates. Further, vague or poorly-specified objectives can make it difficult for regulated parties to understand their regulatory obligations, or conversely, make it easier for them to develop strategies to avoid or minimised compliance (eg 'creative compliance strategies').

**Q6** **Can you provide examples of regulatory regimes with particularly clear or (conversely) unclear objectives? What have been the consequences of unclear regulatory objectives?**

On occasion regulators are tasked with achieving competing objectives that could, theoretically, be met concurrently (OECD, 2013). In such cases regulators may be required to make decisions that involve trade-offs between the stated objectives. Where this occurs it is important that the legislation recognises that the regulator is required to make trade-offs, and that direction is given to assist regulators in making these trade-offs. This direction could come, for example, in the form of discretion to use their judgement in making the trade-off or through government guidance on how trade-offs are to be addressed.

**Q7** **Where regulators are allocated multiple objectives, are there clear and transparent frameworks for managing trade-offs? What evidence is there that these frameworks are working well/poorly?**

Assigning multiple functions to an agency may be appropriate on some occasions – for example, when there are synergies between undertaking a service and the effective implementation of regulations. The New Zealand Fire Service for example, inspects buildings as well as responding to fires. Under such circumstances regulatory outcomes may indeed be promoted by having service provision and regulatory functions undertaken by an integrated entity.

**Q8** **Can you provide examples of where assigning a regulator multiple functions has improved or undermined the ability of the regulator to achieve the objectives of regulation?**

There is a view that where a regulator has multiple objectives or functions these should *complement*, and not *conflict,* with each other (OECD, 2013). For example, assigning a regulator responsibility for 'industry development' can raise questions around the impartiality of the regulator and run the risk that the agency will not allocate sufficient resources to regulatory activities.

However, in some instances, separating conflicting functions into different agencies may not be possible and a single agency may be responsible for both regulation and industry promotion. In these cases, strong internal governance processes are needed to encourage appropriate resourcing of regulatory responsibilities and to align incentives on regulators with the achievement of the desired regulatory outcome.

**Q9** **Can you provide examples of where a single agency is responsible for both industry promotion and the administration of regulations? What processes are in place to align the incentives of the regulator with the desired regulatory outcomes? What evidence is there of success or failure of these processes?**

A key question relating to regulatory design is the extent to which compliance and policy-making functions[1] should be kept separate. For most regulatory regimes in New Zealand primary responsibility for policy development rests with the relevant government department. However, regulators do have a number of important policy roles. For example, regulators often develop *operational* policies that guide the implementation of high-level statutes. This is particularly true for less prescriptive or more principles-based regulatory regimes. Further, where new regulatory functions are to be given to an existing regulator, engagement with the regulator during the design phase can help to identify implementation issues that may appear "on-the ground" when legislation is operationalised. Regulators can also play a role in drawing the attention of departments to areas of existing regulations that require review or are not achieving their intended outcomes.

**Q10** **Are there examples of where regulators have clearly defined policy functions? Conversely, are there examples of where the policy functions of a regulator are not well defined? What have been the consequences?**

[1] Policy functions include, for example, the development of legislation and subordinate legislation, advice to the government on the delivery of government programs and the review of legislation or government programs.

## Overlapping and consistent regulatory regimes

To avoid regulatory gaps, overlap or duplication, agencies developing new regulations should work closely with existing regulators and other government agencies working in related policy areas.

The objectives and functions of regulators should be clear and well defined. Where two regulators are regulating in a similar regulatory area, formal coordination arrangement may be necessary to ensure the boundaries of responsibility are clear, and that procedures exist to solve conflicts should they arise. Regulators should be given clear authority to coordinate in this way in order to remove any questions around the legality of any arrangements (Victorian Government, 2010).

**Q11** **Can you provide examples where two or more regulators have been assigned conflicting or overlapping functions? How, and how well, is this managed?**

**Q12** **Are there examples of where regulators are explicitly empowered or required to cooperate with other agencies where this will assist in meeting their common objective?**

The Commission is also interested in the extent to which regulatory approaches differ between seemingly similar regulatory situations. For example, Conway (2011) illustrates inconsistency in the extent to which regulation promotes competition in New Zealand's network sectors (based on an analysis of OECD indicators of product market regulation).

The Commission is interested in understanding the sources and impacts of inconsistencies in regulatory approaches, in particular:

- the extent to which changing approaches to regulation over time have resulted in inconsistencies between newer and older statutes; and
- the extent to which inconsistencies can be explained by differences in the approaches taken by different policy agencies.

**Q13** **Can you provide examples of where two seemingly similar regulatory areas are regulated under different regulatory structures? What factors have contributed to differences in the regulatory structures?**

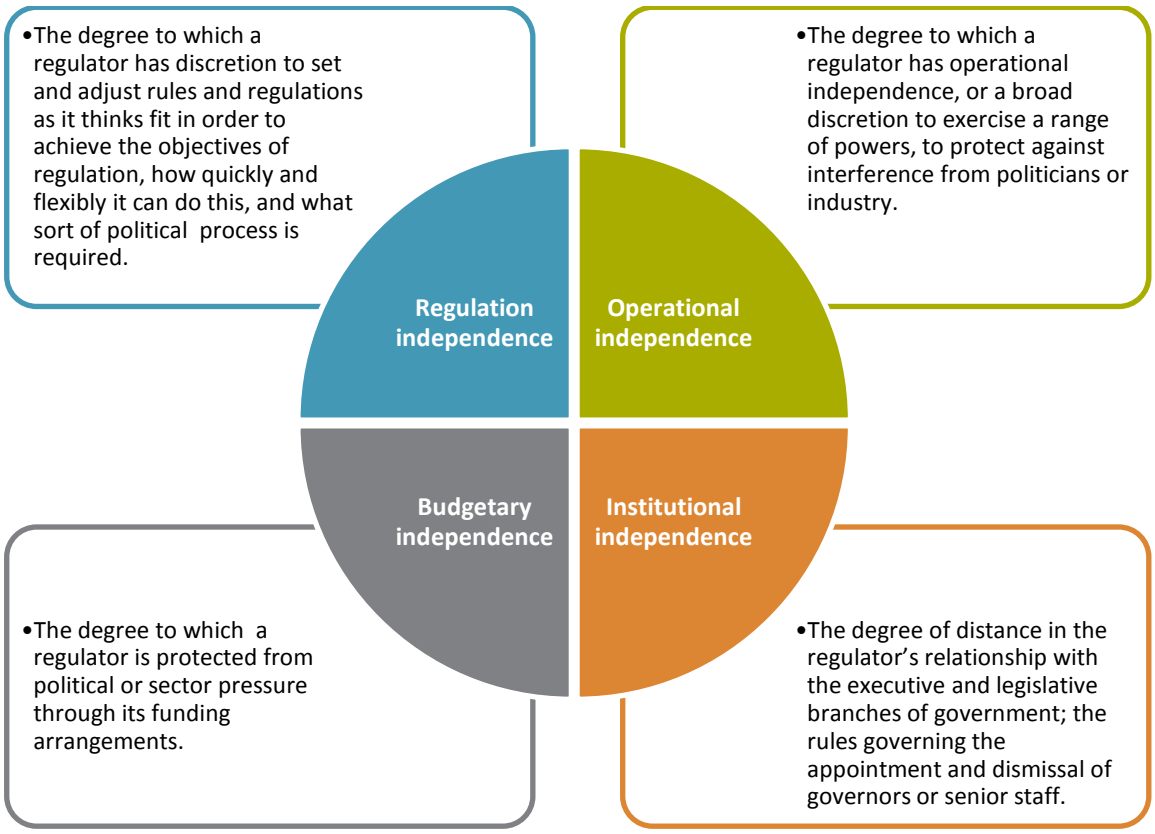
## Regulatory independence and institutional form

In order to be seen as fair and impartial, it is often desirable for regulators to be independent, both from government and from those whom it regulates. 'Independence' is not a binary condition: regulators can be more or less independent in a range of ways.

Independence from those who make the laws prevents a regulator being used for partisan purposes, promotes public confidence in decisions of the regulator, and allows it to work constructively with the sector being regulated.

However, distance from government may increase the risk that the regulator may ultimately serve the needs of the regulated industry, rather than the public – regulatory capture (Stigler, 1971).

**Figure 4.2 Dimensions of regulator independence**




This framework, adapted from the International Monetary Fund (Quintyn, 2004), illustrates that a regulator can be independent from government according to one or more of these dimensions but may have its independence constrained in other dimensions.

There are a number of factors that influence whether formal independence is likely to result in actual independence on the part of the regulator. Hanretty & Koop (2013) for example note that in the context of the European Union regulators this is more likely where there is a strong regard for the rule of law, where the agreement of multiple actors is necessary to reward or sanction a regulator, and in larger countries (Hanretty & Koop, 2013).

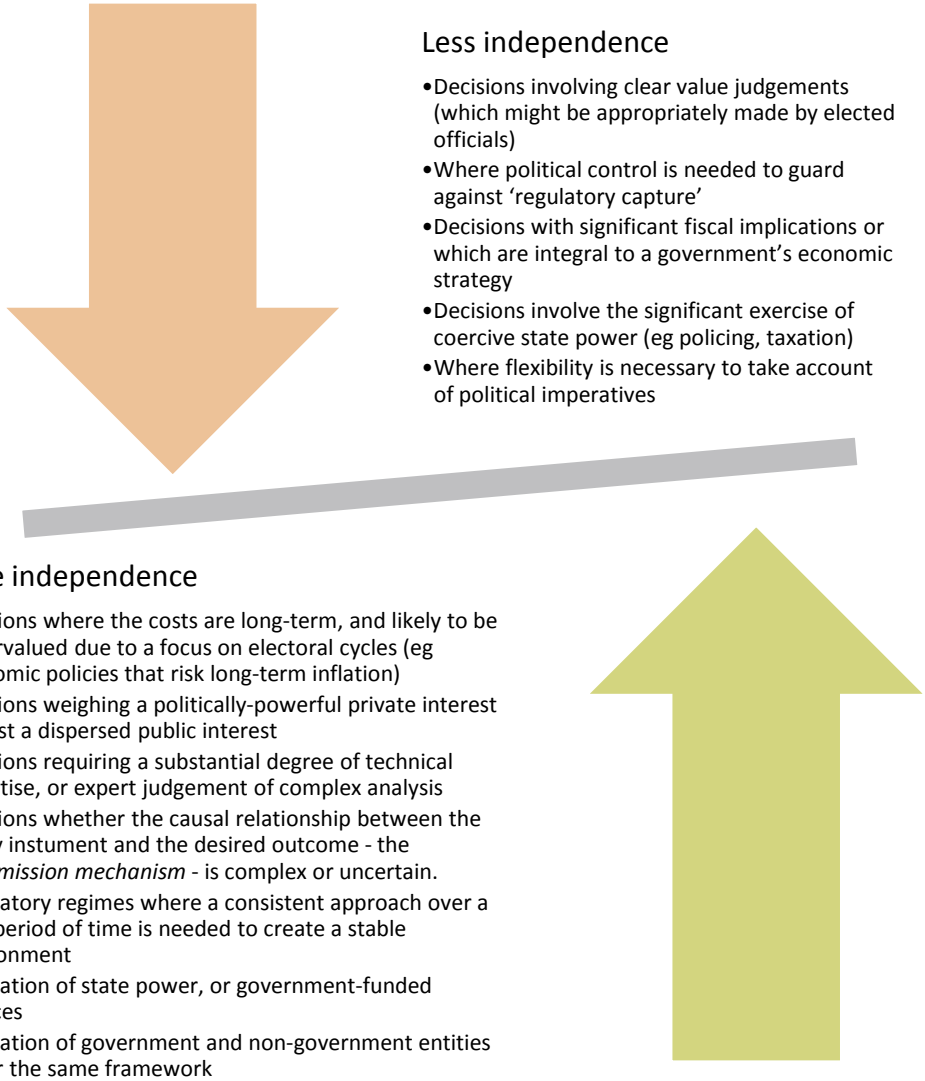
**Q14** **Are the dimensions of regulator independence discussed in Figure 4.3 helpful in thinking about New Zealand regulators?**

**Q15** **Which of these dimensions of independence is most important to ensure a regulator is seen to be independent?**

**Q16** **Can you provide examples of where a lack of independence or too much independence according to one of these dimensions undermines the effectiveness of a regulatory regime?**

Different regulatory regimes may require different approaches to independence depending on their characteristics. Figure 4.3 provides examples of situations where more or less independence may be desirable.

## Figure 4.3 Features indicating a need for less or more regulatory independence



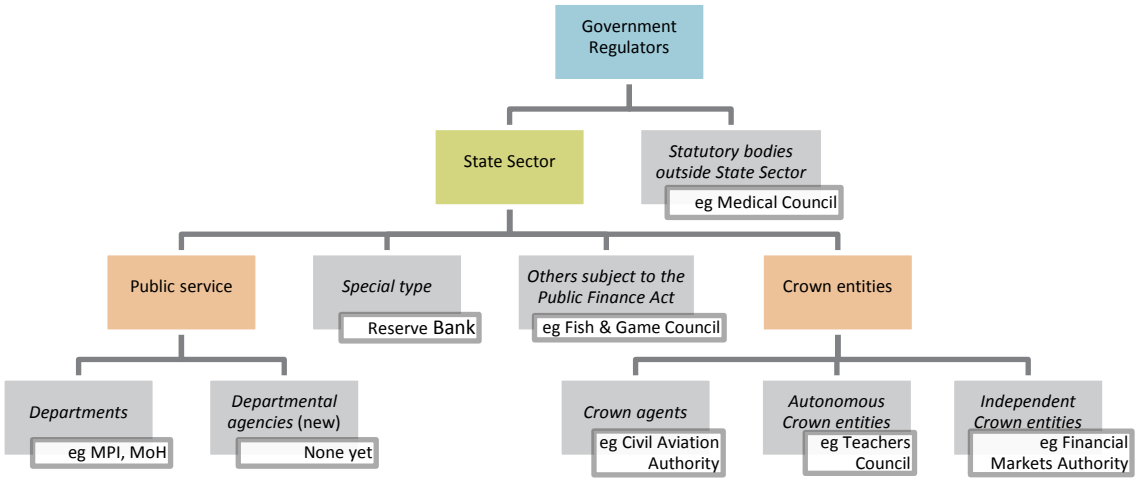

**Q17** **What should be the limits of regulator independence? What sorts of regulatory decisions should be the preserve of Ministers rather than officials?**

**Q18** **Do you agree with the list of features in Figure 4.3 which indicate a need for more or less regulatory independence? What other criteria are missing?**

**Q19** **Is regulatory capture more or less likely in a small country? Can you provide examples of capture in New Zealand?**

New Zealand has a range of institutional forms for regulators established by government. They provide different degrees of distance from Ministers, different governance arrangements, and are subject to different monitoring arrangements.

### Figure 4.4 Institutional forms of government-established regulators




However, even within public service departments the degree of independence will vary from Statutory Officers (such as the Commissioner of Inland Revenue) and business units (such as Medsafe) with considerable independence from Ministers, to regulatory functions more integrated into the department and subject to ministerial control, or ministerial decision based on departmental advice.

In some regulatory regimes, legislation gives private organisations a formal role. The Gas Act 1992 provides for government recognition of an industry body (the Gas Industry Company Ltd) to act as a co-regulator, providing advice to the Minister (who takes decisions about regulations), and overseeing compliance with those arrangements. The Commission is interested in the diverse institutional form of regulators in New Zealand.

**Q20** **Are there other institutional forms for government-established regulators?**

**Q21** **Do particular types of institutional form lend themselves to more enduring regulatory regimes?**

**Q22** **What are the key differences of institutional forms in terms of their regulation, operational, institutional or budgetary independence?**

Particular challenges may apply in situations where the state's activities are being regulated. There is a particular need for regulators of significant coercive state powers to be independent, as in the case of the Independent Police Conduct Authority.

However, there may also be challenges in regulating public services provided directly by the government, or which are substantially funded by the government. Where government is a major participant in a market – such as in health or education – then the risks of regulatory capture may be heightened. In particular there is the potential for the tension between the government's fiscal objectives and its regulatory objectives to be resolved inappropriately where a regulator is insufficiently independent.

Literature on regulation of government activity differentiates between types of oversight. Hood et al (1999) describes them as 'waste-watching', 'quality policing' and 'sleaze-busting'. Relational distance – a separation between the parts of government regulating and being regulated – is important for the effective regulation of government activity by government (Lodge and Hood, 2010).

**Q23** **Are there aspects of regulatory independence that are more or less important in regulating state power or government-provided/funded services?**

## Decision-making structures, processes and approaches

A key design feature for any regulator is the way in which regulatory decisions are made. This will inform the shape of the governance structure of the regulator. Decision-making can be carried out by an individual (single member governance) or by a collective (multi-member governance) (Victorian State Services Authority, 2009).

A number of factors need to be considered when choosing the 'best fit' decision-making model for regulators. (Box 5)

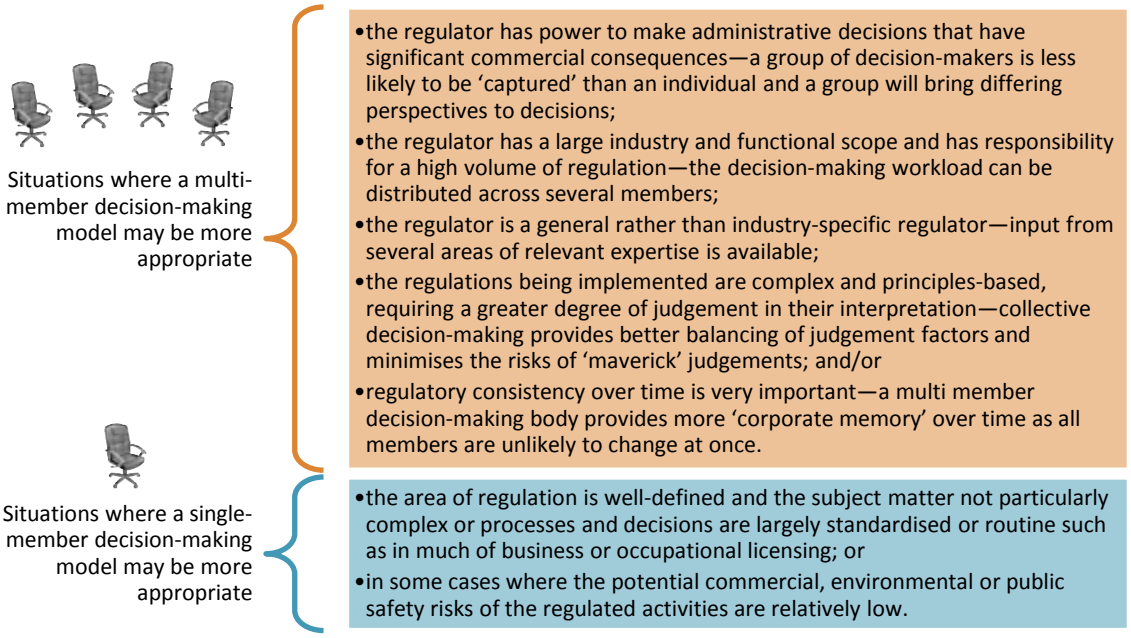
Box 5 **Factors that need to be considered in determining a best fit decision-making model**

- Scope of the regulation administered, including the volume of decisions required to be made
- Complexity of the regulated activities and entities (eg types of commercial arrangements, industry structure and conduct, technology) and the regulatory instruments and tools (acts, regulations, orders, codes, standards, licences etc.)
- Degree of judgement required by and discretion available to a regulator in applying regulation, largely reflecting the degree of prescription of regulations and the regulator's powers
- Risks associated with decisions made under regulation, such as commercial consequences for regulated entities or threats to public safety, taking into account the impact of a risk event and the probability of its occurrence (for example a train crash or an exotic disease outbreak)
- Whether decisions are time critical in their consequences, for example a regulator's exercise of powers in response to an emergency, such as the outbreak of a contagious livestock disease

*Source*: Victorian State Services Authority, 2009

Figure 4.5 illustrates where a single- or multi-member decision-making model may be more appropriate.

**Figure 4.5 When single- or multi-member decision-making models may be appropriate**




Adapted from Victorian State Services Authority, 2009

Whether a single or multi decision-making model, the governance structure for an independent regulator can take the following forms (OECD, 2013):

- Governance board model—the board is primarily responsible for the oversight, strategic guidance and operational policy of the regulator, with regulatory decision-making functions largely delegated the chief executive officer (CEO) and staff – for example, Financial Markets Authority, and Maritime New Zealand;
- Commission model—the board itself makes most substantive regulatory decisions – for example, the Commerce Commission; and
- Single member regulator—an individual is appointed as regulator and makes most substantive regulatory decisions and delegates other decisions to its staff. For example, the Reserve Bank of New Zealand with respect to monetary policy.

**Q24** **Are there other types of governance structure than the three listed above? How well do they work?**

**Q25** **What type of governance and decision-making structures are appropriate for different types of regulatory regime?**

## Decision review and appeal

Review and appeal are different ways in which the decisions of public bodies can be scrutinised. Courts have long had the authority to *review* the process decision-makers follow to ensure it is proper and decisions are exercised within the bounds of the law. Access to judicial review does not need to be specifically provided for in legislation establishing a regulatory regime. *Appeal* rights exist where Parliament expressly provides them. They are an important mechanism to hold decision-makers accountable, and should provide a feedback loop to guide the regulator in the administration of the regime, as well as informing the design of new or amended regimes.

However the distinctions between review and appeal can be blurred. The type of appeal provided for in a regime can vary from something very much like a narrow review of process, through to a *de novo appeal* or *merits review* in which the appellate body re-opens the entire decision, including the possibility of new evidence being provided. Although the starting point for administrative law is that courts will be reluctant to set aside decisions of the executive,[2] some Judges have interpreted the grounds on which a judicial review can be founded in such a way that is 'less deferential' to the executive, and so approaches merits review (Thwaites and Knight, 2011).

Some commentators support broader access to merits review processes. Goddard (2006, p.1) has argued that "the importance and complexity of modern regulatory decision-making strengthens, rather than weakens, the case of merits review", and Round (2006, p.240) concluded that a merits review process was an "essential component of any regulatory best-practice package" on the grounds that it:

- promoted transparency, accountability, and consistency in regulators' decisions;
- diminished the likelihood of regulatory error and its consequential private and social costs;
- clarified the operation of statutes and indicates where amendments may be necessary;
- promoted an environment in which long-term investment decisions can be made with confidence;
- ensured that regulatory outcomes are consistent with policy intentions.

Thwaites and Knight (2011) have cautioned against a blanket preference for merits review processes, and the Legislation Advisory Committee 'Guidelines on the Process and Content of Legislation' (LAC Guidelines) notes countervailing factors that need to be assessed:

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[2] See *Wellington City Council v Woolworths NZ Ltd* [1996] 2 *NZLR* 537, per Richardson P. "on the premise that the wider substantive judgments are made by the popularly elected representatives exercising a broad political assessment..."

> The value of having an appeal right must be balanced against factors such as costs, delay and significance of the subject matter. Generally, the cost and delay of the appeal process will not be justified where the matter in issue is relatively unimportant or where there is an overwhelming need for finality. Furthermore, the right of appeal may not be justified where the primary decision-maker is a body of high quality and expertise. Even then, however, it would usually be more appropriate to limit a right of appeal, rather than deny it altogether. (2013, p. 276)

Where New Zealand provides rights of appeal, the appellate body tends to be a court or specialist tribunal. Specialist tribunals can be cheaper and faster than court processes, and can provide a greater level of technical expertise in assessing the appeal where this is required. However courts will have greater expertise in applying law, and can provide a higher degree of public confidence (Legislation Advisory Committee Guidelines, 2001).

The Commerce Act 1986, Human Rights Act 1993, and Land Valuation Proceedings Act 1948 provide for lay members to be appointed as members of the High Court, which provide specialist expertise in cases relating to those Acts.

There are some efficiencies to be gained from using the existing infrastructure provided by courts, although Frankel and Yeabsley (2013) note that New Zealand tends to make more use of tribunals rather than the courts because of their lower cost.

New Zealand's small size also means a small number of regulatory decisions are reviewed through the courts. Scott notes, with respect to New Zealand's competition law, that there is a small body of domestic case law to serve as a guide, and a reluctance to draw from foreign jurisdictions:

> Not relying on overseas case law leaves market participants very little to draw upon when dealing with possible competition law liability. One can contrast this with intellectual property law where New Zealand courts regularly cite English and European authority […] As for United States law, New Zealand courts appear to almost deliberately eschew it […] This reluctance to refer to overseas case law and literature does harm to NZ's competition law. (2013, pp. 12-15)

The contribution of domestic case law can be further diminished where regulatory regimes change frequently, are distinctive in nature, or where judges are unwilling to provide such guidance. This can limit the effectiveness of review and appeal as a feedback loop for regulators and the designers of regulatory regimes. Goddard argues that where courts do hear regulatory appeals in complex areas:

> There is an understandable tendency to be less willing to provide principled guidance for the future in an area where a Judge feels less confident: most Judges frankly acknowledge that the less familiar they are with a field of law, the more closely they tend to confine their decision to the particular facts and the narrowly specified issues raised by the case in hand. That tendency is very apparent in the regulatory field. (2006, pp. 6-7)

An alternative appellate body to courts or specialist tribunals would be a general tribunal able to hear appeals relating to decisions from a number of regulatory regimes. General tribunals can combine some of the efficiencies offered by courts with the flexibility, expertise and informality of *ad hoc* tribunals. An example of this is the Australian Administrative Appeals Tribunal, which provides merits review of a wide range of administrative decisions made by Australian Government ministers, departments and agencies, including some other tribunals.

**Q26** **How effective and consistent are the review and appeals processes provided for in New Zealand regulatory regimes?**

**Q27** **Can you provide examples where the review and appeals processes provided for are well-matched or poorly suited to the nature of the regulatory regimes?**

**Q28** **What are the advantages and disadvantages of a general merits review body like the Australian Administrative Appeals Tribunal?**

## Allocation of risk through the regulatory system

Regulation can influence how risks are shared between different parties. Risks are best managed by those who have the ability to control them, have the right incentives to make the best decisions, or take steps to prevent problems. A misallocation of risk can impose costs on parties unable to deal with the risks efficiently. Table 4.1 below includes two examples that the Commission has identified in previous inquiries.

### Table 4.1 Examples of misallocated risk

| Example | Consequences |
|---|---|
| Land use decisions and allocation of risk to EQC | The Earthquake Commission (EQC) noted in that the costs of natural disasters are largely determined by the development decisions that communities have made rather than predetermined by natural forces. EQC points to the "difficulty in aligning costs between those who make decisions on land use, particularly local government, and those who bear risks" (EQC, 2011, p. 29). In this case, it is EQC that largely pays for property damage that arises from consents being granted to build on ground likely to be subject to liquefaction. |

| Example | Consequences |
|---|---|
| Allocation of risk between consumers, building practitioners and building consent authorities | The Department of Building and Housing submission to the Housing Affordability inquiry noted:<br>"Residential consumers and building consent authorities bear the brunt of the risk associated with building work that fails to perform, despite having the least control over the quality of that work. Building practitioners on the other hand are able to manage and mitigate risks through the quality of their work… and…while building consent authorities face high risk they do not realise any benefits from risk-taking within the context of a building project, thus creating incentives for building consent authorities to be risk averse" (Productivity Commission, 2012a, p. 159).<br>Subsequent reforms are an attempt to reallocate risk between industry participants. |

As well as being misallocated between regulators, risk can be misallocated between regulated parties and consumers.

Risk allocation is an important feature in regulatory design. The Commission is interested in how well the allocation of risk is considered in the design of regulatory regimes in New Zealand.

**Q29** **Can you provide examples of regimes where risks are borne by a regulator, regulated party, or the public/consumers, but they are not best-placed to manage those risks?**

## Funding and resourcing

Regulators must have sufficient funds to allow them (when operating efficiently) to undertake the functions necessary to achieve the outcomes sought by Parliament. Adequate funding allows regulators to access the right level of suitably qualified staff, conduct an appropriate level of compliance monitoring, utilise appropriate technologies and follow through with prosecutions when necessary.

Funding sources may include money from the government's consolidated fund, cost-recovery fees, fines and penalties, and interests on investments and trust funds (Government of Victoria, 2010). The appropriate mix of funding sources will depend on the circumstances and will be influenced by factors such as:

- the extent to which the regulation benefits the whole community or only selected groups within the community;

- the transaction costs associated with the collection of fees and charges;
- the funding principles adopted by the regulator – eg user pays, beneficiary pays, risk-exacerbator pays, etc.

The use of cost recovery mechanisms is appropriate when it is physically and economically feasible to identify and charge the beneficiaries of regulation (or the parties that give rise to the need for regulation). However, the outcomes of regulation often have the characteristics of a public good – that is, it is difficult or costly to exclude people from enjoying the benefits of regulation and benefit to one person does not detract from the benefit enjoyed by others. Under such circumstances it is more appropriate to fund regulatory activities from the government's consolidated funds, or from a combination of sources.

**Q30** **Can you provide examples of where the mix of funding sources contributes to the effectiveness or ineffectiveness of a regulatory regime?**

**Q31** **Is the mix of funding sources for individual regulators consistent with their stated funding principles?**

How regulators are funded can impact the incentives they face. To promote objectivity and independence, regulators should be clear about who pays for regulatory services, how much and why (the Treasury, 2002). This information should be published in a transparent way that facilitates policy analysis and promotes accountability for the level of efficiency with which regulators are operating (International Monetary Fund, 2007). Further, where funds are provided from consolidated revenue, the independence of regulators should be protected from budget cutbacks that are motivated by political reaction to unpopular decisions (OECD, 2013).

**Q32** **Which New Zealand regulators (or regulatory regimes) provide good examples of open and transparent funding arrangements? Can you provide examples where the transparency of funding needs to be improved?**

**Q33** **Can you provide examples where a regulator's funding arrangements support or undermine its independence?**

## Regulator workforce capabilities

Capability has been defined broadly to include "leadership, people, culture, relationships, processes and technology, physical assets and structures to efficiently deliver the goods and services sought" (the Treasury, 2012, p.37). Because many of these components, such as decision making processes and culture, will be considered separately through this inquiry,

regulator capability is more narrowly defined here to focus on the workforce needs of regulators.

Maintaining the right kind and amount of capability enables regulators to deliver the desired regulatory outcomes.

The Office of the Auditor-General has identified that "Workforce planning is a continuous process of shaping the workforce to ensure that it is capable of reaching organisational goals now and in the future" (OAG, 2009, p.8). Workforce planning is a process – "It involves identifying the type of workforce needed and considering how this might alter as organisational priorities change or external factors affect the supply of workers. It includes establishing short- and long-term recruitment and retention strategies to get the desired workforce in place. The workforce planning process should include periodic evaluation to ensure that planning activities are effective and can be modified as needs change." (OAG, 2009, p.8)

Workforce planning is a way of managing the challenges that regulators face in attracting and retaining skilled staff in competitive international labour markets. Because many regulators rely on very specialised technical skillsets (such as some of the environmental sciences), they can face challenges where there is a shortage of those skillsets.

**Q34** **What approaches are there to identifying, building, and maintaining workforce capability? How effective have they been?**

**Q35** **What restrains or enables a regulator to develop the capability they need in the New Zealand context?**

**Q36** **Where are there gaps in regulator workforce capability? Can you provide examples?**

As well as sourcing or recruiting skillsets, building the abilities of existing or new staff is an essential part of managing the capabilities of a regulator. The Compliance Common Capability Programme (CCCP) is an example of a government initiative seeking to improve this (Box 6).

### Box 6 Compliance Common Capability Programme (CCCP)

CCCP is a voluntary network originally established by the Department of Internal Affairs. It started with (and retains) a focus on qualifications for compliance staff, but over time this has led to a wider focus on people and organisational capability.

The work of the CCCP has led to the creation of three qualifications for compliance staff:

- National Certificate in Public Sector Compliance (Foundation) (Level 3)
- National Certificate in Public Sector Compliance Operations (Level 4)
- National Diploma in Public Sector Compliance Investigations (Level 5).

The CCCP has also released a compliance guide for agencies in New Zealand.

The large range of regulatory agencies in New Zealand can fragment the available capability or workforce. The Commission found in its report *Towards better local regulation* that where New Zealand has a number of small regulatory agencies, or has devolved regulatory powers to a relatively large number of organisations such as local authorities (or district health boards), it becomes harder for any one regulator to meet its capability needs. In these situations, there are sometimes calls to co-locate or merge regulators, to help them to achieve critical mass.

The Commission is interested in the role that changes to institutional arrangements can play in managing capability, relative to other options.

**Q37** **What is the potential to improve capability through combining regulators with similar functions, compared with other alternative approaches?**

**Q38** **When do changes to institutional arrangements work best to improve capability, and when are other solutions preferable?**

## Compliance monitoring and enforcement

Achieving intended regulatory outcomes can be significantly undermined if monitoring and enforcement are done poorly. Yet, regulators can face challenges when formulating enforcements strategies. For example, resources can be thinly spread, noncompliance can be difficult to detect, legal powers can be limited, and enforcement functions distributed across a range of organisations leading to confusion around jurisdiction (Baldwin & Black, 2008).

**Q39** **Can you provide examples of strengths and challenges in the way regulators monitor and enforce regulations? What are the consequences?**

Compliance behaviour is motivated by many factors, and these motivations will vary between different regulated parties in different situations. When designing regulatory regimes, the government needs to consider:

- the impact that different enforcement tools are likely to have on differently motivated individuals and organisations;
- the appropriate range of enforcement tools; and
- the level of discretion to give regulators in using the tools at their disposal.

**Q40** **Do New Zealand regulators have access to a sufficient range of enforcement tools? If not, what evidence is there to suggest that a broader range of tools would promote better regulatory outcomes?**

**Q41** **What sort of regulatory regimes are suited to more (or less) discretionary enforcement?**

**Q42** **Can you provide examples of where a regulator has too much or too little discretion in enforcing regulations? What are the consequences?**

Interest in the use of risk and risk-based approaches to enforcement has grown significantly in recent decades. Risk-based approaches are now a prominent feature of New Zealand's regulatory landscape, having found application in areas such as border security, financial services regulation and food safety (Productivity Commission, 2013).

The central feature of a risk-based approach is the targeting of inspection and enforcement resources based on an assessment of the risk that a person (or firm) poses to the regulatory outcome being sought. This involves a) evaluating the risk that a person will not comply with a regulation; and b) calculating the impact that noncompliance would have on regulatory outcomes (Baldwin & Black, 2008). Such an analysis allows scarce enforcement resources to be targeted at areas with the greatest benefit (ie, areas with the largest 'bang for your (enforcement) buck').

**Q43** **Can you provide examples of where risk-based approaches have been used well? What are the critical pre-conditions for effective implementation of risk-based approaches to compliance monitoring and enforcement in New Zealand?**

**Q44** **What are the challenges to adopting risk-based approaches in New Zealand?**

## Engagement

Effective engagement between regulators, regulated parties and the wider community can promote good regulatory outcomes by:

a) gathering information to inform regulatory decisions;

b) promoting awareness of regulatory obligations;

c) providing early warning of potential problems within the regulatory regime; and

d) assisting regulators to better understand community expectations and priorities.

Engagement can, however, increase both the financial cost and time taken to make regulatory decisions. Further, for some regulators, an obligation to consult with regulated parties can contribute to pressure on them to reach a consensus on issues. Such a consensus can have significant benefits where all affected parties are adequately represented in discussions. However, where consensus is reached between a subset of affected parties, there is a risk that the outcomes will not align with the broader public interest.

When designing regulation the government needs to consider the level and type of engagement that best suits the regulatory situation at hand. For example, regimes that give regulators wide discretionary powers may require stronger obligations to engage with stakeholders. Conversely, prescriptive regimes that provide few discretionary powers may be accompanied by fewer obligations on the regulator to engage (but may require a greater level of engagement during the design of the regulation).

Additionally, in some situations there are specific requirements to consult with Māori or parties that are particularly affected. These situations can place particular demands on the regulator's capability to engage effectively.

The need to consider the appropriate engagement obligations was highlighted in the Commission's recent work on local government regulation. The Commission found that local authorities are often bound by the Local Government Act (2002) to undertake community consultation on issues over which they have very little discretion. For example, despite the fact that local authorities have little discretion in making some bylaws, there is a blanket requirement that all new bylaws or changes to bylaws go through the Special Consultative Procedure (Productivity Commission, 2013).

**Q45** **Can you provide examples of where regulatory regimes require too much or too little consultation or engagement? What are the consequences?**

**Q46** **What are the characteristics that make some regulations more suited to prescriptive consultation requirements than others?**

Engagement tools available to regulators range from formal advisory boards established within legislation, to less formal stakeholder meetings, public submission processes and newsletters. Whether engagement occurs as part of formal legislative requirements, or simply in response to good regulatory practice, is an important consideration for policy makers when designing new regulatory regimes. The use of formal advisory boards, for example, may be beneficial in circumstances where a new regulator is dealing with technical issues that require industry-specific knowledge. However, in other circumstances advisory boards may be unnecessarily rigid or prescriptive.

**Q47** **What forms of engagement are appropriate for different types of regulatory regime? When do formal advisory boards work or not work well?**

As noted in chapter 3, the relationship between the Crown and Māori sits within a partnership framework. This means that when it comes to consultation, Maori are likely to expect to be treated as more than 'just another stakeholder'. Effective relationships with Māori need to take these expectations into account. However, those expectations can pose a challenge for regulators. Māori are not a homogenous grouping and a national-level regulator might find that there are expectations from many iwi that they work together in a partnership manner on regulatory matters. Participating in, and managing conflicts between all of those partnerships can require a high level of capability for all parties involved.

**Q48** **How best can the challenges of working in partnership with Māori be met by regulatory agencies? What models, methods, and approaches are most successful?**

## Organisational culture

Organisational culture has been shown to be a critical component of regulatory performance. For the purposes of this inquiry, we define culture as:

> Shared values (what is important) and beliefs (how things work) that interact with an organisation's structures and control systems to produce behavioural norms (the way we do things around here). (Reason 1997, p. 192, in APC, 2013, p. 64)

By influencing the way that regulators carry out their duties and interact with regulated parties, culture can influence regulatory outcomes. Organisational culture can be influenced by a range of structural factors (including some of those mentioned in this issues paper), but is influenced in particular by the leadership of the regulator.

**Q49** **What elements of a regulatory regime's design have the biggest influence on culture? Why?**

## Consistency of staff approaches to decisions

In its inquiry *Towards better local regulation* the Commission noted that organisational culture, particularly attitudes towards learning and peer review, was critical to maintaining or enhancing the quality and internal consistency of decisions made by council inspectors and consenting staff (Productivity Commission, 2013).

If, for example, the predominant culture sees practice review as challenging the quality of an employee's performance rather than as a learning opportunity, then it is likely that knowledge sharing will break down and it will be harder to develop or maintain a consistent approach.

**Q50** **How well do regulatory agencies ensure consistency of approach between or amongst regulatory staff, so that individual variations are minimised?**

**Q51** **Can you provide examples where the culture or attitude of the regulator has contributed to good or poor regulatory outcomes? How?**

## Empowering staff to make difficult calls

Regulatory staff will typically have a higher level of information about specific cases than those more senior to them. They may also possess specialist expertise. The free, frank, and fearless judgement of regulatory (and particularly inspection) staff is vital for regulators delivering good decisions.

A lot can rest on the professional judgement staff make of the evidence at hand, and their assessment of the validity (or otherwise) of mitigating factors proffered by the regulated party. In situations that may have significantly adverse consequences for regulated parties there can be pressure on regulatory staff to take a softer stance. This can lead them to question their own judgement (where the decision is theirs), or to provide advice on the course of action to take that is weaker than they would have given, absent that pressure.

Although good decision-making processes will help, culture will also influence strongly the kinds of judgements that regulatory staff make – especially for 'line-calls'. Culture is likely to have a significant influence on the scope and strength of advice inspection staff give.

Where the right thing to do is to take strong compliance action, regulatory staff need to be assured and confident that the rest of the regulatory organisation will support them to take that

strong action, or that they will not be 'punished' for advising such a course of action. If not, the consequences can be significant – the likelihood of regulatory failure increases significantly.

**Q52** **Can you provide examples where the culture within a regulator supports or inhibits staff in making difficult decisions, particularly where those decisions may be unwelcome to government, regulated parties or the general public? How?**

## Risk aversion and customer service

Although regulators are in the business of mitigating risk, there is a distinction between managing the regulatory risk and managing risks or costs to their own organisation. A strong culture of risk aversion is likely to work against a culture of customer service. For example, the regulator may fear that delivering a service in the way best-suited to the customer might cost the regulator more, or they may fear this will be perceived as inappropriate differential treatment.

A culture of risk aversion is also likely to lead to a more heavy-handed approach by regulatory staff, which can undermine the cost-effectiveness of the regulation for the community. For example, the regulator may be over-stringent in the application of the rules, so that there are no incidents that might call into question the effectiveness of the regulator (regardless of the compliance costs on the regulated party).

**Q53** **Can you provide examples where a regulator places too much value on managing risks to itself, relative to other priorities (such as the regulatory objective, or customer service)? What are the consequences?**

## Potential for professional capture

Regulators often rely extensively on having a large number of technical staff to carry out specialist regulatory functions. Professions bring with them ways of thinking about problems, and value sets for deciding what the 'right' thing to do is. Often, regulators can draw staff from a single professional background – be they engineers, economists, or public health specialists.

When there is homogeneity in the professional backgrounds of regulatory staff it becomes more likely that the point of view of those professions will be privileged over others, and that other legitimate options or ideas will be passed over.

**Q54** **Can you provide examples of regulators whose approach to their business is largely shaped by their reliance on a particular profession? How might that approach be different if it drew on a wider range of professions?**

## Accountability and transparency

Where Parliament gives powers to individuals or organisations, it is imperative that there is accountability for the exercise of those powers. In an accountability relationship, the party being held to account is obliged to explain and justify its conduct to the other party, which can pose questions and pass judgment, and as a result the party being held to account may face consequences (see Bovens, 2007). Accountability occurs between two parties (eg, between a Minister and Parliament), and an organisation can be accountable to more than one party.

Transparency promotes accountability, in that it provides access to information about a person or group's conduct. For example, the more transparent a regulator is about its processes and decisions, the greater is a stakeholder's ability to hold the regulator to account for its conduct. Together, accountability and transparency act to sharpen the incentives on regulators to perform well. Transparency can also enhance the regulator's ability to defend its actions against criticism.

The OECD's recent report on the governance of regulators describes the basis for the accountability of regulators to Ministers and Parliament:

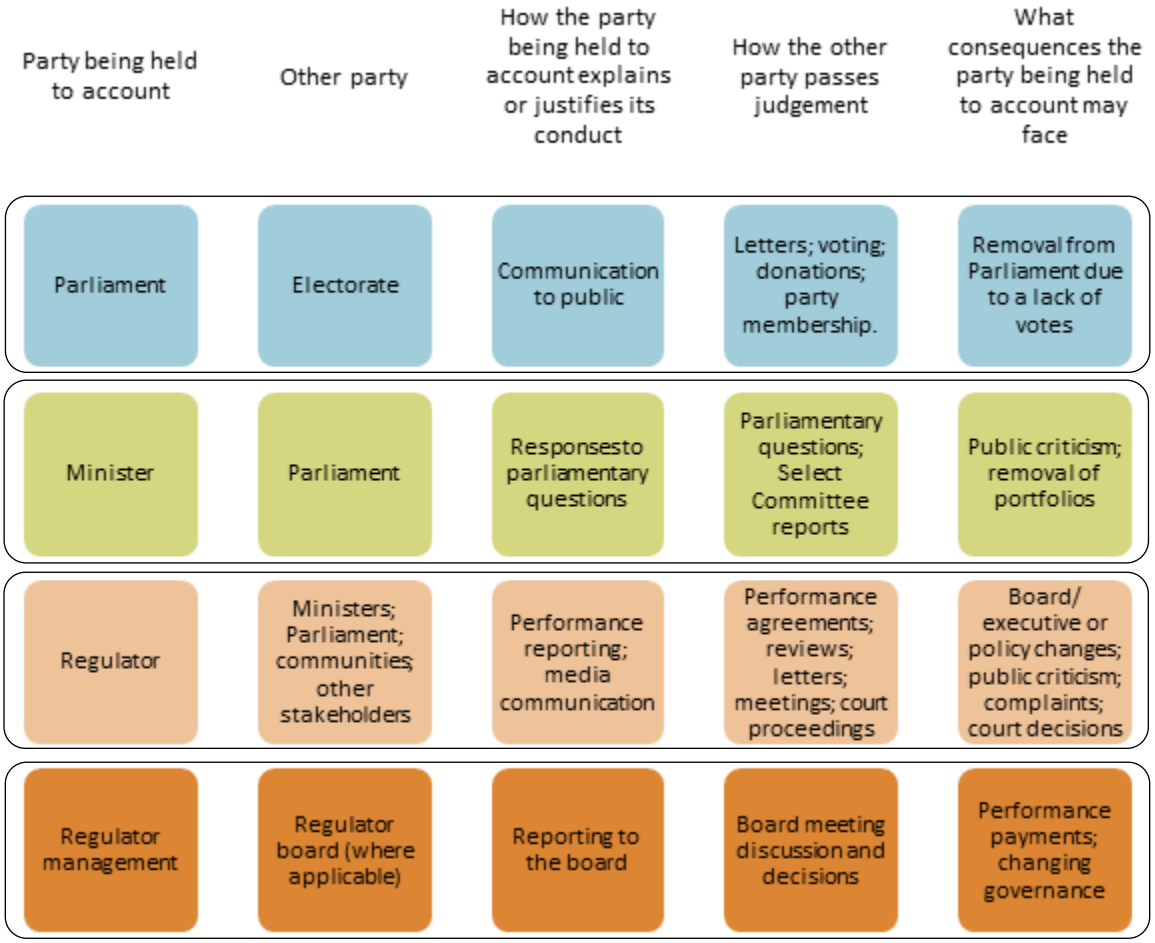
> The regulator exists to achieve objectives deemed by government to be in the public interest and operates using the powers conferred by the legislature. A regulator is therefore accountable to the legislature, either directly or through its Minister, and should report regularly and publicly to the legislature on its objectives and the discharge of its functions, and demonstrate that it is efficiently and effectively discharging its responsibilities with integrity, honesty and objectivity. A system of accountability that supports this ideal needs to clearly define what the regulator is to be held accountable for, how it is to conduct itself and how this will be assessed. (OECD, 2013, p. 50)

Three forms of accountability are important for regulators (Ogus, 1994, drawing on the work of Loughlin):

- financial accountability holds regulators to account for certain standards of financial management, to ensure efficiency of resource use;
- procedural accountability holds regulators to account for the fairness and impartiality of their regulatory procedures;
- substantive accountability holds regulators to account for the effect of their activities, and whether these activities contribute to the desired outcomes of a regulatory regime.

Figure 4.6 sets out some of the accountability relationships in the New Zealand regulatory system. This inquiry focuses on accountability relationships directly affecting the regulator (the bottom two rows in Figure 4.6) rather than the accountability relationships between the electorate, Parliament and Ministers.

**Figure 4.6 Some examples of accountability relationships in the New Zealand regulatory system**




Reflecting the importance of accountability and transparency, the OECD has proposed several principles for the governance of regulators.

- The expectations for each regulator should be clearly outlined by the appropriate oversight body. These expectations should be published within the relevant agency's corporate plan.
- Regulators are accountable to the legislature directly or through their Ministers and should report publicly and regularly on the fulfilment of their objectives and the discharge of their functions, including through a comprehensive set of meaningful performance indicators.

- Key operational policies and other guidance material, covering matters such as compliance, enforcement and decision review, should be publicly available.
- Regulated entities should have the right of appeal of decisions that have a significant impact on them, preferably through a judicial process. Regulators should establish and publish processes for arm's length internal review of significant delegated decisions (such as those made by inspectors).
- The opportunity for independent review of significant regulatory decisions should be available in the absence of strong public policy reasons to the contrary (OECD, 2013).

There are also potential pitfalls to accountability and transparency arrangements. For example, accountability and transparency arrangements may impose significant compliance costs on regulators or drive the wrong behaviours by regulatory staff (Productivity Commission, 2013).

**Q55** **Can you provide examples of how accountability or transparency arrangements improve or undermine the effectiveness of a regulatory regime?**

**Q56** **What types of accountability or transparency arrangements are appropriate for different types of regulatory regimes?**

## Performance assessment

As noted in the Commission's recent report on local government regulatory performance, regulatory staff and decision makers throughout New Zealand routinely gather information about the performance of a regulatory activity, process or system, and reflect critically on this information. When done well, such activities drive continuous improvement in the way regulation is undertaken (Productivity Commission, 2013).

Table 4.2 describes some of the main forms of performance assessment in New Zealand regulatory regimes.

## Table 4.2 Performance assessment in New Zealand regulatory regimes

| | **Performance monitoring**<br>Collection of information on regulatory activities. Often a periodic process rather than a one-off event | | **Evaluation and review** [1]<br>A formal process of gaining knowledge, often with a view to taking action. Often a one-off event using a professional body of knowledge on evaluation procedures | |
|---|---|---|---|---|
| **Types** | In-house performance monitoring (eg, a manager monitoring staff) | External performance monitoring (eg, one agency monitoring another) | Review of an individual case or transaction to assess procedures and fairness of process | Policy reviews<br>Formal evaluation of process or impact of a regulation |
| **New Zealand practices** | Crown entity board monitoring of management performance and staff performance review | Agency performance reporting to Parliament and Select Committee reviews of agencies<br>Department monitoring of Crown entities | Internal case reviews in regulatory agencies<br>Judicial review or review by specialist tribunals<br>Specialist reviewers (eg, Auditor-General, Ombudsman) | Department reviews<br>Specialist reviewers (eg, Auditor-General, Commissions of Inquiry, Taskforces)<br>Some agencies have specialist evaluation staff |

*Source:* Productivity Commission, drawing on Gill and Frankel (2013)

*Notes:*

1. Evaluation and review can occur before or after a regulation is implemented. This table focuses on evaluation and review after implementation. Evaluation and review before implementation includes Regulatory Impact Analysis, Regulatory Review Plans and Annual Portfolio Regulatory Plans by departments. These types of evaluation and review are out of scope for the Commission's inquiry.

Performance assessment can suffer from a range of weaknesses. For example, the Commission recently identified a number of problems with performance assessment in local government regulation:

- There is a weak 'whole-of-system' mindset when thinking about regulatory performance – that is, a lack of focus on how the regulatory regime is performing overall.

- Performance reporting and post-implementation reviews provide few feedback loops to assist councils to improve the way they deliver regulatory functions and to assist central government to improve policy.
- Local government performance measures are often dominated by externally-imposed formal obligations, such as timeliness and transactional measures, with little emphasis and transparency of regulatory impacts and outcomes. This situation is partly driven by statutory reporting requirements and partly by the inherent difficulty of measuring impacts and outcomes.
- Regulatory performance assessment is largely seen by councils as a compliance exercise for central government, rather than as an important means of improving the performance of regulation administered by local authorities.

**Q57** **Are the problems that the Commission identified in the assessment of local government regulatory performance also evident in the assessment of central government regulatory performance? If not, how do the problems differ for central government?**

Gill and Frankel (2013) suggest that lack of feedback loops is a broader problem for regulatory performance assessment. Effective feedback loops should collect the right information on performance, analyse it and put the information into the right format with analysis and commentary, and send the information and analysis to the right people to inform decisions about improving regulatory performance (Productivity Commission, 2013):

**Q58** **Can you provide examples of where performance assessment of regulatory regimes is working well, needs improvement?**

**Q59** **When are feedback loops being used well to improve the performance of New Zealand regulatory regimes? When aren't they?**

## Foreseeing or learning from regulatory failure

Performance assessment also includes attempts to predict and minimise the likelihood of regulation failing. There are examples where New Zealand does not appear to have learnt from past mistakes to improve performance (Box 7).

### Box 7 **Some observations made by the Royal Commission into the Pike River Tragedy**

> This, sadly, is the 12th commission of inquiry into coal mining disasters in New Zealand. This suggests that as a country we fail to learn from the past … (p. 3)
>
> As its inquiry proceeded the commission noted the extent to which the themes identified by inquiries into previous tragedies were repeated at Pike River. History demonstrates that lessons learnt from past tragedies do not automatically translate into better health and safety practice for the future. Institutional memory dims over time (p. 264).
>
> Recurring themes include:
>
> - an insufficient regulatory framework;
> - the health and safety regulator not properly conducting inspections nor ensuring legislative compliance;
> - operators not identifying and managing hazards, including inadequate ventilation and gas management systems;
> - operators not providing miners with proper training, equipment and oversight; and
> - miners not following safe practices (p. 261).

*Source*: Royal Commission on the Pike River Coal Mine Tragedy, (2012)

Learning from other instances of regulatory failure is important for designing regulators that are effective at minimising the risk of regulatory failure. Learning from regulatory failures is not just the role of policy departments – in practice, investigation and learning occurs through independent reviews, academic activity, and good journalism.

Detecting possible noncompliance with regulations and identifying risks of regulatory failure early is a challenge for all regulators.

**Q60** **Can you give examples of indicators or proxies that are effective as early warning signs of regulatory noncompliance or failure?**

A recent Ministerial Inquiry into the employment of a convicted sex offender in the education system noted that:

> There appears to be a gap in the reporting system for those who have legitimate concerns but not enough hard evidence to meet the mandatory reporting threshold or make formal

> complaints to the New Zealand Teachers Council (NZTC) and other authorities about someone's character or fitness to teach. It was clear in this Inquiry that potentially useful information […] was lost because at least one concerned person […] was put off by overly dogmatic bureaucracy and abandoned his tentative concerns when it appeared that they would be dismissed without NZTC follow up. (2012)

The Commission is interested in what provision there is in other regimes for regulator staff or the wider public to raise formal or informal concerns or alerts about a potential regulatory failure.

**Q61** **Can you provide examples of regulatory regimes with effective processes for formally or informally raising concerns about potential regulatory failures? What examples are there of regimes that handle this poorly? What are the consequences?**

# Summary of questions

| | |
|---|---|
| Q1 | What sort of institutional arrangements and regulatory practices should the Commission review? |
| Q2 | The Commission has been asked to produce guidelines to assist in the design of regulatory regimes. What type of guidelines would be helpful? |
| Q3 | Does New Zealand have (or need) a unique 'regulatory style' as a result of our specific characteristics? |
| Q4 | What influence has New Zealand's specific characteristics had on the way regulation is designed and operated in New Zealand? |
| Q5 | What other ways of categorising New Zealand's regulatory regimes and regulators would be helpful in analysing their similarities and differences? How would these categorisations be helpful? |
| Q6 | Can you provide examples of regulatory regimes with particularly clear or (conversely) unclear objectives? What have been the consequences of unclear regulatory objectives? |
| Q7 | Where regulators are allocated multiple objectives, are there clear and transparent frameworks for managing trade-offs? What evidence is there that these frameworks are working well/poorly? |
| Q8 | Can you provide examples of where assigning a regulator multiple functions has improved or undermined the ability of the regulator to achieve the objectives of regulation? |
| Q9 | Can you provide examples of where a single agency is responsible for both industry promotion and the administration of regulations? What processes are in place to align the incentives of the regulator with the desired regulatory outcomes? What evidence is there of success or failure of these processes? |

**Q10** Are there examples of where regulators have clearly defined policy functions? Conversely, are there examples of where the policy functions of a regulator are not well defined? What have been the consequences?

**Q11** Can you provide examples where two or more regulators have been assigned conflicting or overlapping functions? How, and how well, is this managed?

**Q12** Are there examples of where regulators are explicitly empowered or required to cooperate with other agencies where this will assist in meeting their common objective?

**Q13** Can you provide examples of where two seemingly similar regulatory areas are regulated under different regulatory structures? What factors have contributed to differences in the regulatory structures?

**Q14** Are the dimensions of regulator independence discussed in Figure 4.3 helpful in thinking about New Zealand regulators?

**Q15** Which of these dimensions of independence is most important to ensure a regulator is seen to be independent?

**Q16** Can you provide examples of where a lack of independence or too much independence according to one of these dimensions undermines the effectiveness of a regulatory regime?

**Q17** What should be the limits of regulator independence? What sorts of regulatory decisions should be the preserve of Ministers rather than officials?

**Q18** Do you agree with the list of features in Figure 4.3 which indicate a need for more or less regulatory independence? What other criteria are missing?

**Q19** Is regulatory capture more or less likely in a small country? Can you provide examples of capture in New Zealand?

| | |
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| Q20 | Are there other institutional forms for government-established regulators? |
| Q21 | Do particular types of institutional form lend themselves to more enduring regulatory regimes? |
| Q22 | What are the key differences of institutional forms in terms of their regulation, operational, institutional or budgetary independence? |
| Q23 | Are there aspects of regulatory independence that are more or less important in regulating state power or government-provided/funded services? |
| Q24 | Are there other types of governance structure than the three listed above? How well do they work? |
| Q25 | What type of governance and decision-making structures are appropriate for different types of regulatory regime? |
| Q26 | How effective and consistent are the review and appeals processes provided for in New Zealand regulatory regimes? |
| Q27 | Can you provide examples where the review and appeals processes provided for are well-matched or poorly suited to the nature of the regulatory regimes? |
| Q28 | What are the advantages and disadvantages of a general merits review body like the Australian Administrative Appeals Tribunal? |
| Q29 | Can you provide examples of regimes where risks are borne by a regulator, regulated party, or the public/consumers, but they are not best-placed to manage those risks? |
| Q30 | Can you provide examples of where the mix of funding sources contributes to the effectiveness or ineffectiveness of a regulatory regime? |

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| Q31 | Is the mix of funding sources for individual regulators consistent with their stated funding principles? |
| Q32 | Which New Zealand regulators (or regulatory regimes) provide good examples of open and transparent funding arrangements? Can you provide examples where the transparency of funding needs to be improved? |
| Q33 | Can you provide examples where a regulator's funding arrangements support or undermine its independence? |
| Q34 | What approaches are there to identifying, building, and maintaining workforce capability? How effective have they been? |
| Q35 | What restrains or enables a regulator to develop the capability they need in the New Zealand context? |
| Q36 | Where are there gaps in regulator workforce capability? Can you provide examples? |
| Q37 | What is the potential to improve capability through combining regulators with similar functions, compared with other alternative approaches? |
| Q38 | When do changes to institutional arrangements work best to improve capability, and when are other solutions preferable? |
| Q39 | Can you provide examples of strengths and challenges in the way regulators monitor and enforce regulations? What are the consequences? |
| Q40 | Do New Zealand regulators have access to a sufficient range of enforcement tools? If not, what evidence is there to suggest that a broader range of tools would promote better regulatory outcomes? |
| Q41 | What sort of regulatory regimes are suited to more (or less) discretionary enforcement? |

| | |
|---|---|
| Q42 | Can you provide examples of where a regulator has too much or too little discretion in enforcing regulations? What are the consequences? |
| Q43 | Can you provide examples of where risk-based approaches have been used well? What are the critical pre-conditions for effective implementation of risk-based approaches to compliance monitoring and enforcement in New Zealand? |
| Q44 | What are the challenges to adopting risk-based approaches in New Zealand? |
| Q45 | Can you provide examples of where regulatory regimes require too much or too little consultation or engagement? What are the consequences? |
| Q46 | What are the characteristics that make some regulations more suited to prescriptive consultation requirements than others? |
| Q47 | What forms of engagement are appropriate for different types of regulatory regime? When do formal advisory boards work or not work well? |
| Q48 | What elements of a regulatory regime's design have the biggest influence on culture? Why? |
| Q49 | How best can the challenges of working in partnership with Māori be met by regulatory agencies? What models, methods, and approaches are most successful? |
| Q50 | How well do regulatory agencies ensure consistency of approach between or amongst regulatory staff, so that individual variations are minimised? |
| Q51 | Can you provide examples where the culture or attitude of the regulator has contributed to good or poor regulatory outcomes? How? |

**Q52** Can you provide examples where the culture within a regulator supports or inhibits staff in making difficult decisions, particularly where those decisions may be unwelcome to government, regulated parties or the general public? How?

**Q53** Can you provide examples where a regulator places too much value on managing risks to itself, relative to other priorities (such as the regulatory objective, or customer service)? What are the consequences?

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**Q61** Can you provide examples of regulatory regimes with effective processes for formally or informally raising concerns about potential regulatory failures? What examples are there of regimes that handle this poorly? What are the consequences?

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# Terms of reference

## TERMS OF REFERENCE: IMPROVING THE DESIGN AND OPERATION OF REGULATORY REGIMES

### Purpose

1. The purpose of this inquiry is to develop recommendations on how to improve the design of new regulatory regimes and make system-wide improvements to the operation of existing regulatory regimes in New Zealand. The inquiry is not a review of individual regulators, specific regulations or the objectives of regimes.

2. The aim is to improve the design and operation of regulatory regimes over time and ultimately improve regulatory outcomes.

### Context

3. This Government is focused on delivering better regulation. We have improved the processes around introducing new regulation, increased our understanding of the stock of existing regulation, and conducted a number of significant regulatory reviews. There is more that can be done to improve the design and operation of regulatory regimes in light of the recent need to develop new or amended regulatory regimes and regulators to manage instances where regulation has not achieved its intended outcomes.

4. The demands on regulatory regimes are often more complex than in the past. The range of regulatory regimes, the nature of the risks involved, the expectations of the community, and the regulatory tools available to achieve regulatory objectives, are wide and varied. It is crucial that government has a good understanding across regulatory regimes of their issues, challenges, similarities and differences and how to improve their design and operation.

### Scope

5. Having regard to the above purpose and context, the Commission is requested to undertake an inquiry that addresses the parameters set out below.

***An overview of regulatory regimes and their regulators***

6. Develop a high-level map of regulatory regimes and regulators across central government, including their organisational form.

7. Develop a set of thematic groupings which can be used to broadly categorise regulatory regimes by their objectives, roles or functions. For example core objectives might include health and safety, environmental protection, or economic efficiency.

***Understanding influences and incentives on regulatory regimes***

8. Outline and explain key factors which act as incentives or barriers to regulatory regimes and regulators producing the outcomes stated in legislation. For example these factors may include:

    - institutional form of the regulator
    - quality of the regulatory design and clarity of mandate, functions and duties
    - resourcing and funding
    - capability
    - approach to consultation and engagement with stakeholders
    - accountability mechanisms, including the ability to challenge regulatory decisions
    - performance measurement and reporting
    - external monitoring
    - approach to risk management and innovation

9. Undertake a series of case studies to compare and contrast the approaches taken to these factors across different regulatory regimes. A key part of this analysis would be to identify strengths and weaknesses of different approaches taken to these factors to support broader insights into the design and operation of regulatory regimes.

10. This analysis should be undertaken in the context of existing guidance about good practice for the performance of different regulatory functions.

***Recommendations***

11. Develop guidance that can be used to inform the design and establishment of new regulatory regimes and regulatory institutions, and the allocation of new regulatory functions to existing institutions. The guidance should take into account other existing work in this area to avoid duplication, such as the State Services Commission's *Reviewing the Machinery of Government.*

12. Develop system-wide recommendations on how to improve the operation of regulatory regimes over time. The recommendations may include how to both build on strengths and address weaknesses in current practices and may lead to general comments about key differences between regimes within thematic groupings. The recommendations will not be specific to particular regulations or regulators.

13. The Commission should also specifically consider how improvements can be made to the monitoring of regulator performance across central government.

14. In developing the recommendations, the Commission should take account of any key features or characteristics of New Zealand's regulatory environment that differ from other

jurisdictions. For example, these may include differences in scale, resourcing, or the need to coordinate with overseas regulatory regimes.

### Other matters

15. The Commission should prioritise its effort by using judgement as to the degree of depth and sophistication of analysis it applies to satisfy each part of the Terms of Reference.

### Consultation requirements

16. In undertaking this inquiry the Commission should consult with key interest groups and affected parties, including on the selection of case studies in paragraph 9 above. Consultation should include both regulators and those subject to regulation.

### Timeframe

17. The Commission must publish a draft report and/or discussion paper(s) on the inquiry for public comment, followed by a final report, which must be submitted to each of the referring Ministers by 30 June 2014.

### Referring Ministers

Hon Bill English, Minister of Finance
Hon John Banks, Minister for Regulatory Reform

# Appendix A Examples of government-funded regulatory activities

The Commission identified the items in Table 4.3 by searching for Parliamentary appropriations that contained the words "regulation", "enforcement", "monitoring" and "standards" (or variants of these words) in their titles or scope descriptions. The items in the table are a selective sample of regulatory activities and are intended to convey the variety of regulatory activities.

Table 4.3 does not indicate the source of the Parliamentary funding for different regulatory activities, for instance whether the funding comes from general taxation or from levies on regulated parties. Regulatory activities are funded in a range of different ways and this will be an important subject for the inquiry.

**Table 4.3 Selection of regulatory activities funded by Parliamentary appropriations**

| Agency undertaking regulatory activities | Name of appropriation | $m 2012/13 | Description of appropriation (from scope statement) |
|---|---|---|---|
| Commerce Commission | Regulation of Natural Gas Services | 2.2 | Regulation of natural gas services under Part 4 of the Commerce Act 1986. |
| | Enforcement of General Market Regulation | 16.4 | Promotion of fair trading and competitive markets through the administration, enforcement and adjudication activities of the Commerce Commission, and the internal costs of major litigation undertaken by the Commerce Commission in relation to all of its statutory functions. |
| | Regulation of Electricity Lines Businesses | 4.8 | Regulation of electricity lines businesses and Transpower under Part 4 of the Commerce Act 1986. |
| | Enforcement of Dairy Sector Regulation and Auditing of Milk Price Setting | 1.5 | Funding for reviewing Fonterra's milk price setting arrangements, and dispute resolution relating to and enforcement of the Dairy Industry Restructuring Act 2001 and related regulations. |
| | Enforcement of Telecommunications Sector Regulation | 6.0 | The regulation and monitoring of telecommunication services in accordance with the Telecommunications Act 2001. |

| Agency undertaking regulatory activities | Name of appropriation | $m 2012/13 | Description of appropriation (from scope statement) |
|---|---|---|---|
| | Regulation of Airport Services | 1.0 | Regulation of specified airport services provided by Auckland, Wellington and Christchurch International Airports, under Part 4 of the Commerce Act 1986. |
| Crown Law Office | Conduct of Crown Prosecutions | 39.7 | Provision of a national Crown prosecution service that undertakes criminal trials on indictment. |
| | Conduct of Criminal Appeals | 2.9 | Conducting appeals in the High Court, the Court of Appeal and the Supreme Court arising from criminal trials on indictment including Crown appeals. |
| | Supervision of the Crown Solicitor Network | 0.7 | Supervision of the network of Crown Solicitors who deliver prosecution services. |
| Department of Internal Affairs | Regulatory Services | 32.3 | Provision of operational policy advice and services to administer all aspects of the regulatory regime under the Public Records Act 2005, including where the Chief Archivist has statutory independence; services to regulate gambling activity, objectionable material and unsolicited electronic messages, and anti-money laundering and countering financing of terrorism; and the Private Security Personnel and Private Investigators Regulations 2011. |
| Electricity Authority | Electricity Industry Governance and Market Operations | 63.9 | Formulating, monitoring and enforcing compliance with the regulations and rules governing the electricity industry and other outputs in accordance with the statutory functions under the Electricity Industry Act; and delivery of core electricity system and market operation functions, carried out under service provider contracts. |
| Environmental Protection Authority | Compliance and Enforcement | 2.6 | Promotion of compliance and oversight of enforcement for the legislation, regulations, approvals and permits in relation to hazardous substances, ozone-depleting substances, hazardous waste and new organisms. |
| External Reporting Board | Accounting and Assurance Standards Setting | 4.4 | Funding of financial reporting and auditing and assurance standards setting for the purposes of promoting the quality of financial reporting. |

| Agency undertaking regulatory activities | Name of appropriation | $m 2012/13 | Description of appropriation (from scope statement) |
|---|---|---|---|
| Financial Markets Authority | Performance of Licensing and Compliance Monitoring Functions | 12.3 | Performance of statutory functions relating to licensing of market participants and risk-based monitoring of compliance, including with disclosure requirements under financial markets legislation. |
| | Performance of Investigation and Enforcement Functions | 7.0 | Performance of statutory functions relating to the investigation and enforcement of financial markets legislation, including the assessment of complaints, tips, and referrals. |
| | Performance of Market Analysis and Guidance, Investor Awareness, and Regulatory Engagement Functions | 6.2 | Performance of statutory functions relating to market intelligence, guidance, exemptions, investor education, and regulatory and government co-operation and advice. |
| Health and Disability Commissioner, District Mental Health Inspectors and Review Tribunals, and the Mental Health Commission | Monitoring and Protecting Health and Disability Consumer Interests | 12.9 | Provision of services to monitor and protect health consumer interests by the Health and Disability Commissioner, District Mental Health Inspectors and Review Tribunals, and the Mental Health Commission. |
| Land Information New Zealand | Standards and Quality Assurance | 6.7 | Ensuring that the regulatory frameworks that create and protect property rights, and protect the public interest in Crown property management, rating valuations and the land information for which LINZ is responsible, are managed effectively and that delivery against the frameworks is quality assured. |
| | Administering the Overseas Investment Regime | 3.0 | Assessment of applications for consent to acquire sensitive New Zealand assets, monitoring and enforcement. |
| Maritime Safety Authority | Maritime Safety and Marine Protection Services | 2.1 | Development and delivery of regulatory services which are the responsibility of Maritime New Zealand under legislation. |

| Agency undertaking regulatory activities | Name of appropriation | $m 2012/13 | Description of appropriation (from scope statement) |
|---|---|---|---|
| Ministry for Primary Industries | Border Biosecurity Monitoring and Clearance | 78.4 | Biosecurity monitoring and clearance programmes that manage the biosecurity risk associated with international trade and travel. |
| | Assurance | 54.8 | Justifying and delivering assurances to consumers, the public, overseas authorities and other stakeholders that food, food-related products and inputs into the production of food (whether undertaken or produced in New Zealand or imported) are managed, audited, approved, registered and/or monitored in accordance with New Zealand legislation and, for exports, relevant importing countries' market access requirements. |
| | Fisheries Enforcement and Monitoring | 41.8 | Informing, assisting, directing and enforcing adherence to New Zealand fisheries laws, and ministerial servicing. |
| | Standards | 19.1 | Scientific inputs and development and implementation of food-related standards (including as appropriate international and joint Australia/New Zealand standards) and standards related to inputs into food production, imports, exports, new and emerging issues and the domestic market. |
| | Border Biosecurity Systems Development and Maintenance | 17.9 | Development and maintenance of standards and systems that manage biosecurity risk associated with imports and exports. |
| | Response | 5.0 | Investigation of, preparedness for, and response to, food-related events, incidents, emergencies, complaints and suspected breaches of legislation and taking appropriate sanctions and enforcement action. |
| | Animal Welfare Education and Enforcement | 3.6 | Education and enforcement intended to improve animal welfare in New Zealand. |
| | Information | 1.4 | Engagement of, and information for, stakeholders about food safety and suitability, to encourage participation in, and compliance with, the food regulatory programme, and to enable consumers to make appropriate food choices. |

| Agency undertaking regulatory activities | Name of appropriation | $m 2012/13 | Description of appropriation (from scope statement) |
|---|---|---|---|
| Ministry of Business, Innovation and Employment | Health and Safety Services | 51.6 | Provision of information, education and support for workplaces regarding effective workplace health and safety practice, and enforcement action to promote compliance with the Health and Safety in Employment Act 1992 and related regulations. |
| | Hazardous Substances and Amusement Devices Services | 3.6 | Provision of information, education and enforcement services relating to the safe management of hazardous substances in the workplace, and the registration and inspection of amusement devices. |
| | Measurement and Product Safety Compliance and Enforcement | 2.4 | Compliance and enforcement activities to ensure a supportive measurement and product safety infrastructure for business and consumers. |
| Ministry of Health | Regulatory and Enforcement Services | 23.5 | Implementing, enforcing and administering health- and disability-related legislation and regulations, and provision of regulatory advice to the sector and to Ministers, and support services for committees established under statute or appointed by the Minister pursuant to legislation. |
| Ministry of Justice | Collection and Enforcement of Fines and Civil Debts Services | 66.4 | Purchase of collection and enforcement of fines and civil debts services. |
| New Zealand Customs Service | Clearance and Enforcement Services Related to Goods | 64.4 | Provision of services relating to goods crossing the border, including clearance of goods, assessment and audit of revenue, trade compliance and supply chain security assurance, and protection of New Zealand's interests through interventions, audits, investigations and enforcement. |
| | Clearance and Enforcement Services Related to Passengers and Crew | 52.5 | Provision of services relating to passengers and crew crossing the border, including collecting information, clearance of people and their possessions, and protection of New Zealand's interests through interventions, investigations and enforcement. |
| | Information and Intelligence Services | 14.9 | Provision of information, intelligence and risk assessment services to external clients, and the operation of the National Maritime Coordination Centre. |

| Agency undertaking regulatory activities | Name of appropriation | $m 2012/13 | Description of appropriation (from scope statement) |
|---|---|---|---|
| | Clearance and Enforcement Services Related to Craft | 8.7 | Provision of services relating to craft arriving in and departing from New Zealand, including clearance of craft, and protection of New Zealand's interests through interventions, investigations and enforcement. |
| New Zealand Transport Agency | Road User Charges Investigation and Enforcement | 3.8 | Investigating evasion and enforcing of Road User Charges. |
| New Zealand Qualifications Authority | Qualifications Support Structures | 6.1 | New Zealand Qualifications Authority overseeing the setting of standards and New Zealand qualifications. It also includes standard-setting and qualifications-development responsibility, recognition and review of qualifications, records management processes to support the New Zealand Qualifications Framework, and participation in the promotion of the New Zealand qualifications system to key education and immigration partner countries. |
| Office of the Ombudsmen | Investigation and Resolution of Complaints About Government Administration | 8.8 | Investigation, resolution of complaints and the provision of advice relating to central and local government administrative actions, and monitoring compliance with international conventions. |

*Source:* Productivity Commission, from the Treasury Budget 2013 data

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