

Regulatory Impact Assessment

This section regularly examines Regulatory Impact Assessment (IA) at three levels: the EU, the Member States and internationally. Contributions aim to cover aspects such as the interface between IA and risk analysis, looking at methodologies as well as legal and political science-related issues. Contributions are meant to report and critically assess recent developments in the field, develop strategic thinking, and make constructive recommendations for improving performance in IA processes.

A New Approach to *ex post* Evaluation in the EU: The Cumulative Cost Assessment

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I. Introduction

The REFIT 2013 Communication¹ lists, among the achievements of the European Commission in the field of Smart Regulation, the two Cumulative Cost Assessments (CCAs) carried out on the steel and aluminium sectors.² CCA is a new term in the domain of EU *ex post* assessment, and this report explains what a CCA and its methodology are.

A CCA is not a new technique to assess *ex post* outcomes of a regulation. Rather, it is a set of existing tools, used in combination to meet the requirements of a new approach to policy appraisal: focusing on *all* policies having an impact on *one* class of addressees, rather than focusing on *all* addressees of *one* policy (or one small set of closely-knit policies) as traditionally done. This change of perspective demands a twist of logic in policy appraisal. In turn, this leads to specific methodological choices to accurately answer the following question: how burden-

some is the EU *acquis* for a given industry/class of addressees?

The novelty of the approach forced the research team responsible for the CCAs to devise a possible methodology, particularly as regards the object of analysis, sampling techniques, and quantification. In the following sections, the methodological choices are described, and the similarities and differences with existing EU tools, such as fitness checks and impact assessments, are highlighted.

II. Objectives and approach

The objective of a CCA is to identify, assess, and where possible quantify, the cumulative costs imposed by EU legislation on a selected industry. Once these costs are quantified, it is possible to understand if and how much the costs of EU regulation impact on the cost structure of a European industry and on its global competitiveness.

The CCA, *nomen omen*, is all about costs. Hence, it does not include the benefit side of rules, nor it assesses the cost-benefit balance of the legislation. Furthermore, it only focuses on a single industry, not on the economy or society as a whole.

While in terms of policy scope the CCA follows an approach similar to a “fitness check”, in the meaning of the 2012 European Commission Communication on Regulatory Fitness (as it considers several legislative acts rather than a single act, and it adopts an *ex post* perspective, rather than an *ex ante* one), in re-

* All Centre for European Policy Studies (CEPS). The CEPS, together with Economisti Associati, was tasked by the European Commission to perform both CCAs. The authors of this report contributed directly to the CCA and would like to express their deepest gratitude to all other colleagues involved.

1 Communication from the Commission Regulatory Fitness and Performance (REFIT): Results and Next Steps, 2.10.2013, COM(2013)685.

2 The Commission states that these CCAs were carried out in 2012. However, they were carried out in 2013. The study on the steel sector can be retrieved here: http://ec.europa.eu/enterprise/sectors/metals-minerals/files/steel-cum-cost-imp_en.pdf. The study on the aluminium sector can be retrieved here: http://ec.europa.eu/enterprise/sectors/metals-minerals/files/final-report-aluminium_en.pdf.

ality its analytical scope is more limited. Fitness checks are to assess the fitness, effectiveness, burdensomeness and coherence of the EU legislation in a given policy area or sector; conversely, a CCA only focuses on the third evaluation criterion, i.e. burdensomeness.

In principle, the assessment of cumulative costs can be performed by adopting a top-down or a bottom-up approach. In the former case, regulatory costs would be assessed on the whole sector by using aggregate data; in the latter, a set of “typical” facilities within an industry is chosen, for which the assessment is performed in depth. The CCAs on steel and aluminium have opted for a bottom-up approach, because of its advantages in terms of accuracy, relevance, and actionability thanks to the higher level of granularity of the information obtained. Thus, to ensure the general validity of the CCA, defining a sample of “representative” facilities becomes a key factor. In the two CCAs performed, the following criteria were considered to define the sample:

1. Geographical coverage;
2. Plant Technology;
3. Plant Capacity;
4. Ownership.

However, the bottom-up approach may also have shortcomings. There are two main reasons for this:

1. Heterogeneity. Existing facilities may not be fully comparable with one another or identifiable *ex ante* via secondary sources. In this case, the preferred bottom-up approach has to be complemented or even substituted with a top-down analysis.
2. Data availability. In some cases, granular data from plants cannot be retrieved, due to i.a. issues of confidentiality. Where retrieval of data from primary sources is impossible, secondary sources should be used.

As mentioned, a bottom-up CCA aims at studying the cost structures of a set of typical plants in the industry under consideration. Once costs structures are defined, it is possible to assess the impact of regulatory costs on these structures, both in terms of operating expenditures and annualised capital expenditures. Furthermore, these cost structures can be compared with the cost structures of comparable non-EU firms. The value added of such an approach, when applied to different industries for the same set of policy areas, lies in the fact that it produces comparable

results and highlights the policy criticalities for each sector.

III. The quantification of regulatory costs

A CCA cannot resort to a consolidated methodology to assess the cumulative cost impact of all EU legislation on a given industry. In uncharted waters, three different approaches are combined:

1. Measurement of administrative costs;
2. Measurement of compliance costs;
3. Measurement of indirect costs.

Administrative costs are those costs incurred by firms to provide information to public authorities and third parties. They are generated by information obligations included in legislative acts. At the EU level, administrative costs are normally measured through the Standard Cost Model.³ In the two CCAs performed, administrative costs, even though significant for some policy areas, represented a relatively small share compared to compliance costs.

The measurement of compliance costs can be done along the same steps; however, its scope is larger. Compliance costs include not only costs due to information obligations, but also to substantive obligations and monetary obligations. Substantive obligations are provisions which require the firm to take actions to adapt its productive process to comply with the legal act. Monetary obligations are provisions which require the firm to bear monetary costs such as costs of allowances, fees, taxes, and levies. An assessment of compliance cost requires identifying the following categories of costs: i) investment costs; ii) operating costs; and iii) financial costs.

Finally, the issue of indirect costs needs to be unfolded. Indirect costs can be defined as costs of regulation which have an impact on producers not as direct addressees, but as counterparts of direct addressees. An example can be energy policies, whose addressees are i.a. electricity producers, which are key suppliers of most industries; or product regulation, whose addressees are the customers of the industry in scope of the CCA. In this respect, clear boundaries need to be set to ensure that the CCA does

3 Annex 1o to the EU Impact Assessment Guidelines, 15.2.2009, SEC(2009)92.

not end up being too broad. First of all, the causation link between the act and the effects must be reasonably short. This means that only indirect effects originating from the most proximate counterparts of the selected industry can be taken into account. Secondly, the indirect effects must be significant, i.e. resulting in a measurable cost differential for the selected industry.

IV. Policy Coverage

The CCAs performed covered 8 policy areas: i) General Policies; ii) Commodity Markets; iii) Competition; iv) Climate Change; v) Energy; vi) Trade; vii) Environment; and viii) Product Policy. These policy areas are very different in nature and in their effects on manufacturers. Broadly speaking, acts falling within the scope of a CCA can be classified in three different categories from the perspective of cost generation:

1. Binding acts which create direct obligations for industry players, and thus impose a direct cost;
2. Binding acts which do not create a direct obligation for industry players, but may create an indirect cost;
3. Non-binding acts and other policies, which may or may not create costs, but affect e.g. the playing field, regulatory certainty, or investment decisions.

This distinction is very important to explain the need for a twofold approach to the policy areas. A distinction is made between those acts that cause costs, be they direct or indirect, through a proximate and clear causal relationship; and the acts which define the sectoral environment and the internal and external competitive constraints. The calculation of regulatory costs is possible only for the first category of acts. For the second, the CCA carries out a qualitative analysis of the threats and opportunities that they cause for industry players.

Despite its limitations, a CCA allows to shed light on the relative cost impact of different policy areas and, most importantly, on their interaction or lack thereof and cumulated effects on different sectors. For instance, the two CCAs on aluminium and steel show in numerical terms how the effect of EU Climate Change policies when coupled with the absence of a fully integrated EU electricity market vary depending on the specific features of an industry. The cost of the EU Emission Trading Scheme (ETS) that is indirectly passed in electricity prices clearly has a more marked effect on electricity-intensive aluminium production than on steel-makers. Conversely, Environmental Policies or the direct cost of ETS weigh much more in the cost of regulation on steel-makers.

Finally, it is worth adding a more 'institutional' consideration. The aluminium sector was among the candidates for a 'fitness check' in the REFIT 2012 Communication.⁴ However, the fitness check did not materialise. Instead, the aluminium sector, together with the steel industry, underwent a CCA, with its more limited focus on costs. A CCA can be seen as another component of the smart regulation strategy, and can actually be inscribed in the recent trend of specialised tools and guidelines which have proliferated after the approval of the 2009 IA Guidelines. As much as DG Enterprise and Industry has developed a "competitiveness proofing"⁵ for assessing *ex ante* impacts on competitiveness, CCA can be considered as the *ex post* complement. The industry may push for being subject to a CCA; however, the final decision is taken at Commission level. The industry may prefer a CCA over a fitness check for two reasons: firstly, the rather logical emphasis on costs; and secondly, and we dare say more constructively, because in a CCA all relevant policy areas can be covered, while a fitness check has a greater depth but a scope limited to a single area.

Through a CCA, for the first time, the European Commission asked itself what is the *overall* regulatory burden originating from the EU *acquis* on a certain industry, without dispersing attention on other evaluation criteria, which sometimes blur results. Answering to this question required a new level of interaction among different Commission DGs having an impact on the selected industries, way beyond the usual standards of Brussels 'silos'.

4 Communication from the Commission, EU Regulatory Fitness, COM(2012)746, 12.12.2012.

5 Commission Staff Workingdocument, Operational Guidance for Assessing Impacts on Sectoral Competitiveness within the Commission Impact Assessment System. A "Competitiveness Proofing" Toolkit for use in Impact Assessments, 27.1.2012, SEC(2012)91.