Independence and the boundaries between regulators and regulatees

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Independent regulation has become a key element of public administration in most parts of the world (e.g. Jordana et al. 2011). Yet, the boundaries between regulators and central government are, as Vibert sets out, not absolute. Though there are good reasons to create independent regulatory agencies (IRAs) – including specialisation, credibility, and trustworthiness (see Majone 1996; Vibert 2007; Roberts 2010) – Vibert argues that the regulatory process is not, and can never be, completely separated from the political process. Firstly, political independence raises questions of legitimacy, policy consistency and coordination – questions which deeply affect politics (cf. Majone 1999; Rossi and Freeman 2012; Koop and Lodge 2014). Secondly, the notion of independence hinges on a distinction that does not actually hold – namely, the distinction between politics and administration (and between 'steering' and 'rowing') (cf. Montjoy and Watson 1995; Svara 1999). The activities of governments and agencies are, in practice, highly interdependent and cannot neatly be distinguished: IRAs participate in regulatory policy making; the two branches are governed by cross-cutting professional standards; they strongly depend on each other's resources; and agency failure is obviously government business.

In addition, Vibert points out, the boundaries vary over time and across countries; in other words, they are not fixed. For instance, in the UK, interdependence has come to be more pronounced recently as a consequence of changes to the model of economic regulation. The objectives of economic regulators have increased in salience, and have been extended well beyond the promotion of competition. Also, consumers have become more prominent as representatives in, and the focus of, the regulatory process, and the microeconomic approach of regulators has been complemented with a macroeconomic one, particularly but not exclusively in the area of financial regulation after the 2008 crisis.

This piece seeks to complement Vibert's analysis by looking at the second dimension of agency boundaries – that is, the regulator-regulatee dimension. Though most studies of regulatory independence focus on agencies' insulation from politics, the notion of independence refers just as well to agencies' position vis-à-vis the regulated sector. Such independence is considered to be important from the perspective of avoiding so-called regulatory capture, where regulation serves the private interests of the industry rather than the public interest. Although some take the position that capture is completely inevitable – Stigler (1971: 3), for instance, famously argued that 'as a rule, regulation is acquired by the industry and is

designed and operated primarily for its benefit' – most accept that independence can take us a long way in preventing agencies from becoming too close to their regulatees.

Yet, as the success of regulation critically depends on 'resources' provided by the regulated sector, agency independence is not absolute. Three types of resources can be distinguished: financial resources, information, and legitimacy. Firstly, the activities of IRAs often rely on financial resources provided by the regulated sector. Except for general regulators such as competition authorities and environmental regulators, which are typically financed with taxpayers' money, IRAs tend to depend fully or partially on (annual or other) fees paid by regulated companies. Secondly, IRAs need information on companies and the sector as a whole – information on how the sector works, the products and the production process, production costs and potential cost savings, and other factors that matter for (the implications of) regulatory policies and decisions. Such expertise cannot be fully established within the agency; it partially needs to be provided by the companies themselves (see Coen 2005). Thirdly, IRAs need legitimacy in the eyes of their regulatees because regulatory decisions are, by nature, about motivating behavioural responses. As Black (2008: 148) puts it, '[t]hey require not only that others accept them, but that they will change their behavior because of what the organizations or standards say'. Having binding investigative and decision making powers is not sufficient; legitimacy helps IRAs ensure compliance, and helps them secure it more quickly and effectively.

To acknowledge and satisfy these dependencies, the regulated industry is involved in the regulatory process in various ways. Firstly, the regulated sector normally plays an advisory role, with companies being asked for information, feedback and their opinion in individual cases as well as in general consultation procedures (see Pagliari and Young 2014). Secondly, in some cases, the sector participates in the decision making, with industry representatives sitting on the agency's executive board. More often, though, representatives are found on advisory and/or supervisory boards. In addition, IRAs tend to have executive board members with extensive experience in the industry. Thirdly, the industry may take part in the implementation of regulation; for instance, by means of so-called enforced self-regulation or management-based regulation, where companies apply more general regulatory principles to their own situation (Coglianese and Lazer 2003; Gilad 2010).

This is not to say, though, that the road to capture is left wide open. The statutes of IRAs typically include provisions on conflict of interest – to guide the decision making process and to avoid excessive revolving-door behaviour – and stipulations aimed at some balance of power, such as guarantees to include or consider consumer interests.

The way in which the regulated sector is involved, and the extent to which it is involved, vary over time and across sectors and countries. For instance, in his study of regulation of over-the-counter derivatives, credit rating agencies and hedge funds, Pagliari (2012) finds that financial market regulators have reduced their reliance on sectoral involvement in regulation in the aftermath of the financial crisis. Moreover, as in the case of government-agency relations, the boundaries between regulators and regulatees may be traced back to national policy making traditions, with some countries having more corporatist traditions than others. Finally, as Coen (2005: 377, 388) points out, the resources granted to IRAs by government and parliament matter for regulator-regulatee boundaries as understaffed agencies have a greater need to attract information and expertise from the sector.

Having briefly assessed the relations between regulators and regulatees, we may conclude that their boundaries resemble those between governments and agencies – they are neither absolute nor fixed. And even more than in the case of government-agency relations, we lack knowledge of the boundaries and the conditions under which they vary and change. Given that the location of the boundaries will affect regulatory policies and decisions, the topic shall be put on the regulatory research agenda.

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