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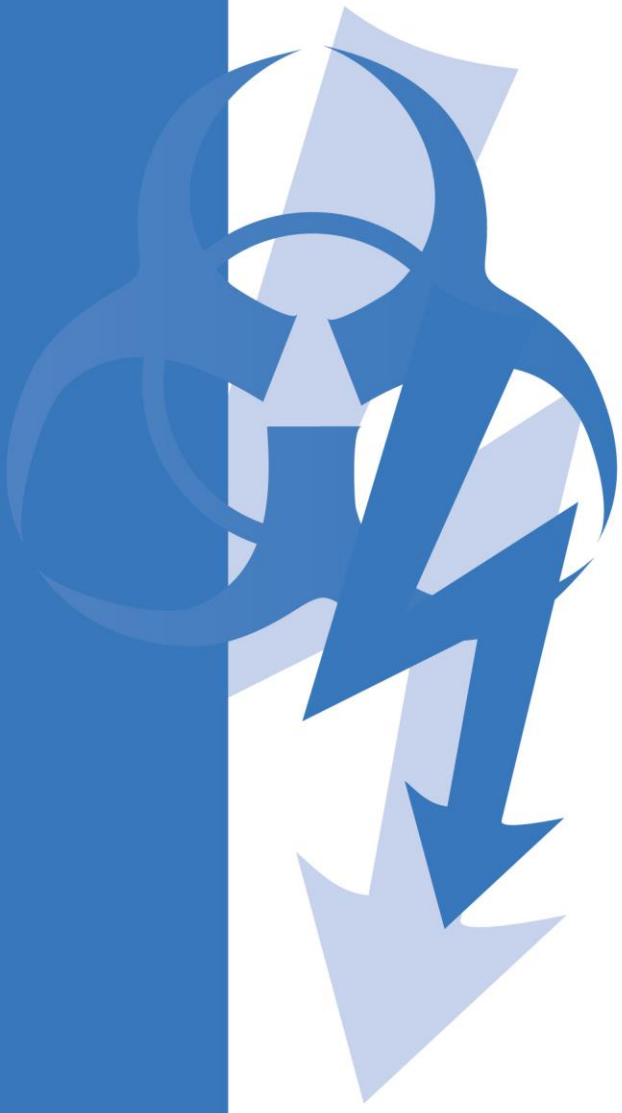

Regulatory agencies under challenge

Sebastian Eyre, Eva Heims, Christel Koop, Martin Lodge, Lindsay Stirton and Frank Vibert

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Independent agencies

No fixed boundaries

Frank Vibert*

Introduction and summary

Independent expert and regulatory agencies are widely perceived to constitute the hallmark of modern systems of regulation. Their 'independence' and positioning in systems of governance varies according to different traditions of public administration and law. But, in one way or another, they are set at a distance from central government. For example, in the UK, the 'Littlechild' model of economic regulation aimed both to provide a surrogate for market processes and to insulate regulated industries from day to day interference by ministries.

The pivotal role of the independent agency has however come under challenge – particularly in the case of economic regulation. In recent years governments seem to have become re-involved in core regulatory functions, re-inserting their own views on, for example, investment objectives and pricing policies (in the energy sector) and industry structure (in the case of banking).

Against this background this paper first describes the basic rationale for the independent agency. It later cites its underpinnings, that of organisational theory. The decision taking setting for complex issues of public policy is typically badly structured. Independent agencies promise to structure this setting in ways that are better suited to problem solving. They segment, specialise and disaggregate. Organisational theorists received support from the application of doctrines associated with the so-called New Public Management (NPM).

The paper turns secondly to look at the practical challenges to models of independence. In practice the institutional arrangements informed by NPM have major weaknesses. In addition, the role of the economic regulator has broadened radically in ways that have brought regulators closer to the traditional concerns of governments.

Thirdly, the paper offers a perspective on this apparent conflict between theory and practice – particularly as it applies to economic regulation. It suggests that the fundamental issues are about distinguishing between the different rationalities involved in public policy and how they are best organised. The case for an arm's

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length relationship between government and expert bodies remains. But we need to accept shifting boundaries in a 'loose coupling' between central government and agencies.

The examples given in this analysis refer mainly to UK experience and in particular to the 'Littlechild model' of regulation. However, UK experience has a wider relevance to other settings.

Theory: giving structure to the decision setting

Many decisions that have to be taken on matters of public policy are routine, repetitive, incremental and boring. However, important decisions are often anything but. In these cases the setting for the choices and decisions to be made is complex. It is generally regarded as badly structured, albeit in different ways. Herbert Simon (1977: 241) regarded 'virtually all' interesting issues in public policy as ill-structured.

The badly structured

Views on what exactly it is that makes the setting for important public policy decisions badly structured are summarised in the table below (along with the authors associated with them). Each of the leading categories, such as the contestability of relevant concepts and the uniqueness of settings, refer to a different aspect. The different characterisations are not at all mutually exclusive. They are additive.

Table 1 Characterising the decision setting: the badly structured.

The essentially contested: key concepts are contested (Gallie 1956: 167–9).
The wicked: each situation has unique features (Rittel and Webber 1973: 155–69).
The ill structured: information is missing and incomplete (Simon 1977: 241).
The ambiguous
- **Context:** the situation is open to multiple interpretations (March 1994).
- **Meaning:** different actors attribute different meanings to the same concepts (Abbot 2001).

The indeterminate: policy effects are often conjectural (Elster 1989).

There are two ways of reacting to this diagnosis. The first is to accept that policy making is a highly imperfect business because decision making takes place in conditions of ambiguity and uncertainty. This lies behind well known descriptions of the policy process as a 'garbage can' (Cohen et al. 1988), or as revolving around the intelligence of 'continual adjustment' (Lindblom 1965). The second is to think about how policy makers and decision takers go about trying to introduce a better structuring for otherwise ambiguous and uncertain settings. For example, they can attempt to reduce complexities through an ordered and sequential search for information and chase missing information by using specialised bodies.

Approaches to better structuring

The table below summarises suggestions that have been made for achieving a better structuring of decision making settings (Simon 1977).

Table 2 Structuring the policy setting

Content prioritising

Priority fixing:

Procedures for identifying what is the most important.

Ordering/sequencing:

Reducing complexity and indeterminacy by investigating in steps or an order or sequence.

Hierarchy:

Ensuring error detection at the highest level.

Content specialisation

Segmentation or streaming:

Channeling particular types of problem to specialist and expert bodies offering continuity of attention.

Disaggregation:

Breaking up large problems into subsets of smaller problems.

Loose coupling.

Non hierarchical ways for improving diagnostics, reducing ambiguities and indeterminacies.

Other

Attention directing:

Mechanisms (normative and procedural) that draw attention to when to address a problem, and what, where and how to address.

The case for independent agencies fits fairly neatly into the logic of specialisation shown in table 2 above. Decision taking is entrusted to expert bodies with segmented responsibilities. They are able to draw on specialised knowledge from the natural and social sciences, to disaggregate large problems into smaller, to approach difficult issues in an ordered sequence of investigation and to give the areas of difficulty their continuous attention.

There are a variety of more specific reasons that can be (and are) offered for the growth in numbers and ubiquity of independent agencies. They help politicians avoid blame in complex areas of policy; they enhance the credibility of policy; they provide (relative to politicians) more trustworthy information to the public; they mitigate 'role strain', they help correct for bias in democratic politics. Each has its own logic in its own context. They are perhaps best considered in relation to each other, across the different contexts, in the idea of the regulatory 'space' (Vibert 2014). At the same

time, each can be seen as symptomatic of the basic organisational advantages that flow from the segmentation and specialisation shown in table 2 above.

NPM

The so-called New Public Management (NPM) utilised many of the claims derived from the theoretical case for specialised bodies. As Hood says, it was all about disaggregation and 'hands on management' (Hood and Jackson 1991). Independent agencies seemed to fit into the category of those organisations that would 'row' rather than 'steer' (Osborne and Gaebler 1992). Central government departments and ministers could steer and agencies could be free to manage. In particular, in the case of the UK, the Littlechild model of economic regulation puts forward the idea of an economic regulator free from central government interference with a tightly defined remit to promote competition that conveniently overlapped with NPM distinctions (Littlechild 1983). Part of the attraction of NPM was precisely that it gave a rationale for independent agencies from a public administration perspective.

Practice

Alas, the real world has intruded. Firstly, the prescriptions of NPM oversimplified the theoretical arguments. Secondly, the specialist and segmented role of independent agencies has proven difficult to circumscribe amid the many demands for policy consistency and co-ordination between actors (Koop and Lodge 2014).

The credibility loss of NPM

The distinctions between steering and rowing, and between policy and administration made by NPM have not proven robust in practice.

Policy

Firstly, the policy making process is much more diffuse than allowed for by NPM. Policy cannot simply be assumed to reside with Ministers and central government departments who steer. There is no simple way of 'hard wiring' their policy objectives into the terms of reference of agencies as continuing debates about the monetary and growth goals of independent central banks amply demonstrate. In practice, Independent agencies have themselves a significant role in policy making and sometimes the lead role. They carry their own epistemic authority (Haas 2007). This means that when 'truth speaks to power' those with power must listen to those with expert knowledge and take their views into account.

Other actors are involved as well – such as NGOs. Policy making is an iterative process between many actors. For example, currently in the UK energy sector there is a debate about whether or not the UK has a secure margin to prevent interruptions in supply at times of peak demand. The regulator has its expert view, NGOs may have their views based on the need to phase out fossil fuels and politicians will have their

views based on their assessment of electoral retribution if interruptions were to occur. The industry, which has most at stake, has its own view as well. None of these voices can be ignored. A government faces electoral punishment if it loses any reputation it may have for 'competence', the advocacy of NGOs cannot be suppressed in the days of social media and, even if its views are self-serving, the industry itself remains the key stakeholder.

Resources

Secondly, the distinctions of NPM obfuscated an important debate about the nature of public service in a post-Weberian world where the ability of public servants to stand above partisan fray and discern the general public interest is lost in a decentred maze (Black 2001). Is it the case that government departments and decentred agencies remain tied together by an attenuated, but shared sense of public 'service' and the 'public good'? Or possibly, it is more congruent with the facts to point to the different professionalisms that characterise both the agency world and central government departments, the rivalries and sharing that takes place between them (Abbott 1988), and their search for their own professional entrepreneurial opportunities (Burt 2010).

In practice there are two factors that cut across public administration and provide for a varying degree of coherence. The first is the observance of shared epistemic standards by professionals in the same field. For example, economists talk to other economists across government and agencies, and share certain important tools of analysis such as cost benefit assessments and simulation tests. Other professional fields share their own special brands of expertise and speak their own language.

The second cross cutting factor is the need for financial resources. Independent agencies can avoid direct financial dependence on governments where they are self-funded through levies. However, their decisions have financial consequences that may involve the public purse or have other consequences for the public realm.

The connection between the regulator and public finance is explicit in the case of a body such as NICE (National Institute for Health and Care Excellence) charged with weighing the costs of medical interventions against the benefits. But it exists over many other fields. For example, the decision of an air safety regulator that allows for runways to be used more intensively for take-offs and landings will have consequences for the adequacy of the surrounding public infrastructure.

In today's world the need for public and private finance is often the glue that holds together public administration. Sometimes expressed in the form of performance targets, finance ties together those who steer, those who row and those who are the targets of agency attention (Vibert 2011).

Agency failure

Thirdly, agencies (both domestic and international) can, and do, fail in their task – from child care to finance. For example, the IMF failed to identify and forewarn of the 2008 international financial crisis. 'Failure' can be defined or interpreted in many ways. The root issue, however, is that experts are prone to certain types of cognitive error associated with the world of professionals. They are sensitive to 'context' – to the institutional objectives of their own agency and to the role they play within that agency. They can misdiagnose situations and what is a suitable response (Vibert 2014). They are subject to intellectual fashions and to the influence of 'thought leaders'. They are uncritical about their own processes and come under pressure to arrive at convergent views, or a common diagnosis, at the expense of the dissenting voice. The institutional processes by which agencies encourage convergence and handle dissenting views remains an under-researched area. When agencies fall down, governments come under pressure to intervene. They hope to achieve credit from intervention that will outweigh any blame if they too get it wrong.

In short, agencies are not just free to manage or governments free to steer. There is a much greater degree of hand-in-hand working between the world of agencies and the world of central government than NPM allowed (Thatcher 2005). A leading example is provided by the Financial Stability Oversight Council (FSOC) in the US established by the Dodd-Frank Act in 2010 in order to reduce systemic risks in the financial sector. It is chaired by the Secretary of the Treasury, brings together the key regulatory agencies, such as the SEC (Securities and Exchange Commission) and FDIC (Federal Deposit Insurance Corporation), as well as the chair of the Board of Governors of the Federal Reserve Bank and it reports to Congress.

The broadening role of the economic regulator

The interdependence of the world of the agency with the world of central government has been underscored by other real world developments. In particular, in the world of UK economic regulation, the clarity and restraint of the original Littlechild model has been lost. It has gone for three main reasons.

From competition to the constitutive

Firstly, organisational objectives for economic regulators have been extended well beyond the promotion of competition. Market organisation objectives (the 'constitutive' role) include such goals as security of supply, the resilience of 'critical' infrastructure, stability and 'sustainability' (Shearing 1993: 67–79). They have all risen in salience. Although the wider set of goals are sector specific, there is perhaps a common concern around sector vulnerabilities to external shocks – including those arising from the interconnections between financial markets, rapid changes in energy prices and the energy mix, and concerns about cyber security.

Defining the consumer

Secondly, regulatory attitudes towards representing the consumer have also changed (Dewatripont and Tirole 1994). Competition by itself does not ensure that consumers bother to obtain and sort through the information they need to make sensible choices for themselves. Consumer representation attached to Independent agencies has also proved to be problematic. As a result regulators have increasingly stepped in to make informed decisions on behalf of the consumer, to simplify choice and to help conceptualise issues (such as obesity or the carbon footprint) on behalf of consumers. Regulators have moved from creating conditions 'sufficient' for consumers to be able to make choices (a 'satisficing' role) to a trustee role, or, to acting in the 'best interest' of the consumer (a role that tries to 'optimise' conditions for consumers). The many different conceptions of the 'representation' role familiar from political science apply also to the representation role in markets (Shapiro et al. 2010). The role of the regulator in representing missing voices – whether they be the voice of consumers, shareholders, or vulnerable social groups has become generally a much more activist one.

From micro to macro – the systemic

Thirdly, the Littlechild model took a micro-economic view of the role of the regulator. The focus was on the individual firm and consumer. The 2008 financial crisis has made abundantly clear that a micro focus can miss the big picture. Many systems are 'complex' in the sense that one cannot draw conclusions about the whole on the basis of the behaviour of individual units within the whole. The same need for a systemic approach applies to other important sectors of economic activity from telecoms to energy and to the regulatory world itself.

What each of these extensions of the role of the agency mean is that the permeability of boundaries between an independent agency and the central government world of Ministerial oversight has become much more visible. Politicians feel that they have their own legitimate view of system roles, of market organisational objectives and what is best for the consumer. Central government, Ministers and politics are back in.

Politics back in: in what role?

The fact that the decision making role of independent agencies is proving to be more closely linked to the world of politics than some organisational theorists inferred, should not come as too great a surprise. The ancient doctrine of the separation of powers never involved complete separation between the different branches of government. Systems of social coordination are 'interdependent'. The term distinguishes between dependence in the sense of subordination and dependence in the sense of mutual reliance (Baldwin 1980: 471–506). The key question is whether there is a way of characterising the interdependence, or mutual reliance, between politics and agencies that illuminates relationships at the boundary. Boundary

relationships have two aspects – a horizontal relationship and a vertical or hierarchical.

The hierarchical: error correction

The suggestion from organisational theory shown in table 2 above is that a hierarchical form of organisation is better suited to error detection while 'loose coupling' is better suited to diagnosis (March 1999: 194). What this means within an organisation is that specialised departments, or subsidiaries, may be better able to understand the unique features of their own part of the external world, but that they may lack an appreciation of the broader operating environment where Board direction may be required. This suggestion can be applied outside a single organisation to the organisation of government.

If politics is seen as 'hierarchy' then this would suggest that boundaries should be drawn in a way that leaves Ministers out of the business of diagnosis and involved only when they detect 'error'. This is also consistent with the view that, in cases of dispute between systems, the role of politics is to provide for 'authoritative resolution'. It is consistent too with a principal/agent view of relationships, with the Minister the principal and the regulator, or expert body, the agent.

The difficulty with thinking about boundaries in this way is that Ministers will detect alleged 'errors' by agencies at breakfast, lunch and tea. They will be intervening whenever political points can be scored.

The horizontal: loose coupling

Table 2 above suggests that we should think about horizontal relationships in terms of what James March (1999) calls 'loose coupling'. The term can be interpreted to imply three features about horizontal boundary relationships. These would cover firstly, connections that are designed to be consistent with a substantial, but not complete, degree of separation and with a particular focus on the diagnostic advantages of agencies; secondly, boundary shifts from either side since the agency may be involved in redrawing boundaries as much as politicians; and thirdly, relationships that can respond to outside developments beyond the control of either politics or the agency (for example, from technology or consumer behaviour).

Perspectives

The picture given in this brief sketch of the theoretical advantages of independence can be viewed as one version of an often repeated clash between the world of rationalist theory and the world of practice. However, the arguments made by Herbert Simon (1977) and James March (1999) do not fit into such a dialectic. The questions

raised by fluctuating boundaries between the two worlds of the expert and the politician raise critical questions about both theory and practice.

Dual processing and cognition

Simon (1977) offers a particular account of 'dual processing' that distinguishes between an exhaustive search for evidence and our use of heuristics, or short cuts, such as favouring the familiar. Short cuts save on time and effort and, according to Simon, are what we often rely on in everyday decision taking.

The world of expert bodies is consistent with this type of dualism. Regulators are involved in an exhaustive search for information relevant to the continuous attention they give to their tasks. Politicians, on the other hand, can rely on the short cut methods of politics for decision taking. For example they may just look at what is pertinent at a particular moment to party debate (Page 2012).

Dual processing, however, remains a challenge. It is a challenge both to political scientists still attracted to the search for an 'ideal type' of unified rationality implicit in theories of 'reflective equilibrium' or 'deliberative' democracy, as well as to social scientists looking for a unity through concepts of the 'social construction' of framing and investigation.

Key questions remain, both about the characterisation of dual process and about how to bring together the heuristics of politics with the rationality of exhaustive search (Chaiken and Trope 1999).

The cognitive and context

It was mentioned above that a key and possibly *the* key source of regulatory failure stems from cognitive failures of various kinds. Simon's dualism leads in the direction of looking for the sources of cognitive error in the use of heuristics. However, the advantages of segmentation and specialisation included in the account of the 'better structured' underestimate the importance of cognitive failure associated with organisation and context. For example, as referred to above, many regulatory and expert organisations provide settings that are designed to encourage a convergence of views among experts. This has its own dangers.

The difficulty in diagnosing the sources of cognitive failure lies in part in the transition from the world of lab experiments to the situations in which experts actually work in their professional settings and the roles they are expected to play in those settings (Snyder and Stukas 2007: 363–88). For example, it is not clear how far some well established cognitive biases, such as loss aversion, apply in different professional settings. Thus, loss aversion may apply to an individual investing his or her own money. It is not clear that it applies to the same person in a regulatory setting making decisions that have implications for other peoples' money.

Differentiation and the regulatory space

The advantages of specialisation shown in table 2 on better structuring do not necessarily justify treating the world of expert and regulatory bodies as one world. Rather, the inference might be that we are moving to many different specialised and segmented worlds, with their competing professionalisms. Possibly we need to distinguish more clearly between a central bank and a child care agency. On the other hand, concepts such as 'confidence' (confidence in the credibility of central banks and confidence in the professional expertise of child care agencies) are possibly symptomatic of an over-arching unity to an expert, professionalised space. In analysing the reasons for the growth in the number and variety of intermediaries, perhaps an analogy might be made between the growth of intermediaries in systems of social coordination and the growth of intermediaries in financial markets.

Hierarchy again

Table 2 on better structuring offered a place both for loose coupling, including networked relationships, and hierarchy (taking the most important decisions at the highest level of decision taking). The connection between loose coupling and hierarchy referred to above, involved a theoretical distinction between error correction (the role of hierarchy) and the processes of diagnosis where loose couplings are best. This, does not seem an entirely satisfactory way of characterising the relationship. Hierarchical relationships are not there simply for error correction. They connect ideas about what is most important in public policy to bodies that are the most important in terms of overarching public authority.

From a more practical perspective, the connection between the horizontal and the hierarchical has been traditionally expressed in public administration terms by associating the world of regulators with the world of networks and fellow expertise, while hierarchy is associated with the terms of reference of the regulator set by politicians. However, this manner of distinguishing between and connecting the two worlds also seems unsatisfactory. It underestimates the extent to which matters that are of the highest importance will sometimes emerge, not as a result of being identified through terms of reference, but as a result of the processes of diagnosis and investigation themselves. It also underestimates the importance of some of the shortcomings of hierarchy, such as distance from those affected by a policy, that expert and regulatory bodies may in part overcome by being closer to those affected by policy.

What this means is that we need a much more clearly elaborated model of the relationship between diagnostic processes and hierarchical decision taking. In particular the connection cannot just depend on prior designations by politicians of what is important. In this context, one area that has to combine both diagnostic processes and ideas about 'importance' is the appeals procedures of the law (Perry

1991). The law follows a sequential process of investigation in order to determine what is important in a case. It also uses a rather more vague criterion of 'ripe timing' to decide when interventions need to be made at the top. Possibly there are analogies to be drawn. For example, what has to be decided at the top in politics could perhaps be more explicitly related to a sequential process of investigation and to more developed criteria for 'ripe timing' or the 'essential juncture' (Abbot 2001).

Conclusion

Independent agencies in the form of specialised bodies that are substantially separate from central government and ministers have a basic advantage in 'better structuring' the decision taking setting. Thus, from a problem management perspective, both politicians and agencies have a continuing interest in an arm's length relationship. However, at the same time, the worlds of agencies and central government are interdependent. Boundaries between agencies and politics are permeable and will undergo constant adjustments. Regulation is all about boundary adjustments between systems. Characterising those boundaries remains a challenge both to the world of research and to the world of practice.

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What brings the Government back in?

Comments on the notion of boundaries and independent regulation

Sebastian Eyre

Does political interference reinforce the need for regulatory independence?

There are a number of reasons why governments have been brought back into the regulatory space. However, in doing so, governments have succeeded in preserving some of the boundaries that were put in place in line with the Stephen Littlechild model. This model never denied governments the ability to make strategic decisions. It, in fact, suggested that governments were required to make those strategic choices – and for regulators to work within their statutory duties.

Governmental incursions into the regulatory space since those early days of utility reform reflect a growing acceptance that regulators are one of many critical actors within the wider regulated industry network. What might at first sight be interpreted as an erosion in regulators' influence can, on second sight, be seen as a result of activities by other independent regulators. Furthermore, a closer look at those incidents where governments have intervened suggests that these were arguably in areas where regulators would have struggled to act within their existing primary duties.

Motives for intervention are transitory and set the boundaries between government and regulators

So what then prompted governments to intervene? Three particular reasons can be highlighted.

Government interventions were prompted by systematic market failure

The kind of systemic risks to the integrity of markets that were caused by the financial crisis and its aftermath were always going to be tackled by governments – and not by regulators. That governments acted should not therefore come as a surprise. Furthermore, the continued existence of many aspects of financial regulation can be explained by their continued relevance, especially in the commodity markets which are prone to boom and bust (but did not collapse in 2007). In those markets, collateral requirements have been raised. In addition, previously lightly regulated markets are now included in the same kind of regulatory requirements applicable to those highly complex markets held responsible for the financial crash.

One example of such a response is energy. European regulation is overseen by the European energy regulator ACER. This regulator receives the most comprehensive set of European energy trading data that has ever been assembled. Together with the Financial Conduct Authority and energy regulation by ACER, the centrality of independent regulation has continued to persist in energy markets.

A second market failure related motive for government intervention is price externalities. The drive towards reducing carbon emissions and the development of climate change related targets are clearly a matter for government (in the UK, the Department for Energy and Climate Change) and the European Commission. Such targets cannot be derived from the existing regulatory framework governing economic regulation. Furthermore, the sustainability-related primary duties of Ofgem are not sufficient to develop the kind of structures that are required to encourage investment to address climate change.

A third source of market failure can be generated by the type of market structure adopted at the time of privatisation. In the UK, rail is a case in point. Here, governments are always likely to intervene, especially in an industry where government becomes the key customer for rail services. Under such circumstances, it is never likely that regulators will appear independent, regardless of whether they are 'supported' by 24 separate statutory objectives.

Politicians respond to prices (when it looks like they will not go down)

The prices paid by consumers for utilities are always a political issue. Any government's performance is judged by their response to rising prices, especially in energy. The sustained super spike in international energy prices in coal and gas during 2007-09 was driven by factors that were largely outside government's control, such as Chinese economic growth, Japanese gas prices and a rise in investment in renewable generation. When prices spike, parliamentary enquiries, opposition motions and calls for investigations are never far away. In UK energy, the government did respect the regulator, despite piling on the political pressure. Given that political mood, another regulator, the Competition and Markets Authority, intervened (in 2015).

Absent in debates about prices has been a supposedly neutral, authoritative voice about market dynamics. Regulators have, as yet, failed to explain movements in prices, although this may be changing. Ofgem has developed supply market indicators that try to provide an account of market conditions, which includes the impact of government levies on price levels, such as the Energy Company Obligation in the UK that obliges large companies to deliver energy efficiency measures to domestic consumers.

The failure of industry to perform as expected prompted intervention
Finally, governments intervene when industries are seen to continuously fail. Industries generating large numbers of complaints, whether about misspelling, mis-selling or poor product quality, will witness inevitable political reaction. In such circumstances, political pressure will be applied and boundaries will be moved.

Regulatory landscape changes

Boundary changes in independent regulation are not just a product of political responses to perceptions of market and industry failures. A further source of boundary change is the wider context of regulation ('the regulatory space') – independent regulators do not operate on their own in isolated silos, but interdependently with other regulators.

Regulatory Networks and the CMA muddy the waters
One of the key changes is the regulatory space is that regulatory independence is being challenged by other independent regulators. In the UK, the Competition and Market Authority (CMA) has many of the characteristics of a lead regulator. From 20013 onwards, it has had the ability to remove a regulator's concurrency powers and take over the investigation of cases. Furthermore, it is encouraged by government to challenge other regulator's policies, if the CMA thinks that these measures are reducing competition.

A further potential source of reducing regulatory independence is the development of the UK Regulatory Network (UKRN). This network might potentially be seen as a source for the development of common solutions to common problems, for example, in setting price controls or in tackling technical issues, such as the assessment of the cost of capital.

Regulators are not independent of the power of ideas
Regulatory activities are never independent of ideas. However, responding to changing ideational fashions suggests that regulators are able to exercise their own choices. The independent regulator has at least been given technical discretion to use economic theory and econometric techniques with industry-specific problems. However, as ideas about regulation change, ideas about what and how to regulate also change. This can be seen with Ofwat's new approach to regulation that uses ideas found in transaction cost economics for price control and that places a great deal of emphasis on legitimacy as a regulatory goal. Similarly, there has been a growing interest in applying regulatory models by regulators in other jurisdictions. One critical example here is PJM and Texan energy markets which have been cited by Ofgem and the European Commission.

The legal structures are still in place and should not be dismissed

Do boundaries shift that much – and does it matter all that much? The case of UK energy prices offers an insightful example. Politicians – and government – became involved as prices were rising. This certainly led to a politicisation of regulatory decision -making; however, the solution to address rising prices was developed by the regulator, Ofgem. The adopted solution – a drastic reduction in the number of tariffs that energy companies were allowed to offer – was accompanied by a further series of measures to facilitate comparison among different energy tariffs. This response was challenged by the Competition and Markets Authority and much of Ofgem's work is likely to be unwound. Unusually for a market investigation by the CMA, remedies were designed to mediate in the relationship with the Department of Energy and Climate Change and with Ofgem. The dynamics clearly suggest that boundaries are in flux, but with the additional twist that the independence model has been re-affirmed.

Therefore, this short contribution suggests that despite powerful political reasons for intervention, the key elements of regulatory independence have remained intact. One reason for this survival is the underlying legal template. Most regulated sectors continue to be licensed and a licence provides an important legal buffer against intervention. Licence-change is a slow and relatively open process – conditions that inhibit short-term political interference.

The constraints imposed by licences are supplemented by industry agreements between licensees and monopoly networks. These agreements are mediated by a contract in the form of a code that provides for a degree of flexibility. Price control continues with innovation in energy and water methodologies. Finally, and critically, the notion of independent regulation has remained pivotal for attracting relatively cheap investment into the UK's utility infrastructure.

However, this does not mean that there has been no change. There has been a decline of confidence in the extent to which markets offer effective problem-solving capacities. There has also been a decline in the importance of the Austrian school of economics that characterised the early years of utility liberalisation in the UK.

In conclusion, it is important to move beyond the observation that boundaries between governments and regulators have changed and towards a better understanding of the driving forces behind those interventions which ultimately change the boundaries between Government and regulators.

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Closing time? Regulatory agencies and consumer engagement in economic regulation

Eva Heims and Martin Lodge

Regulatory agencies were the future once (cf. Majone 1997). Gone are the days when regulatory agencies appeared to be the universal remedy for all policy problems in economic and other fields of regulation, especially of the 'badly structured' kind (Vibert 2015). Regulatory agencies were promoted as universial remedy for problems of political interference in regulated industries, of ensuring expertise judgement in regulatory affairs, or of reducing the ability of industries to capture the political agenda. Similarly, gone are the days where 'modern' regulatory methodologies, such as the price-capping RPI-X formula in the regulation of utilities, were regarded as promising a low cost incentive scheme to encourage efficient industries.

The loss of faith in the 'agency remedy' can be traced to three central criticisms. Firstly, concerns about 'independence' have focused on the appropriate relationship between agencies and politicians, as well as between regulators and the regulated industry. There have always been concerns about unelected 'big beasts' in regulatory offices or, in contrast, about timid decision making in light of private investor pressure. Further debates have focused on the ways in which 'technocratic' decision making has been standing in the way of politicians' grand designs. Others have pointed an accusing finger at the ways in which politics has sought to entrench its views, whether directly through appointment or procedural guidelines, or indirectly through wider political 'mood-setting'. Equally, long-standing concerns about regulatory 'capture' continue to form part of the debate about the fallibility of regulators (cf. Peltzman 1989; Carpenter and Moss 2014).

Secondly, concern has also been raised about the role of the consumer. As noted by Vibert (2015), competition has not brought about the kind of markets where consumers appear to make 'efficient' choices; this has encouraged some regulators to become increasingly prescriptive in the ways in which companies are supposed to package their products and/or ensure that potential customers make informed choices. This concern stands alongside a more long-established concern about the role of consumer representation in regulatory industries.

Thirdly, there has been increasing disillusionment with the established tools of economic regulation, most of all the once widely celebrated RPI-X mechanism. This mechanism was supposed to avoid the problems of US-type rate-of-return

regulation (Averch Johnson effect). But it is widely accused of having become a cumbersome process that encourages second guessing and gaming among regulators and regulated industries alike without any evident superior outcomes, while putting considerable strain on the relationship between regulator and regulatees.

As regulatory agencies have increasingly become part of the problem rather than the solution, the theme of 'consumer engagement' has been put forward. In contrast to the previous era where there was broad agreement on the contours of agency 'independence' and the application of price-capping methodologies, there is little agreement as to what consumer engagement might actually imply. For some, consumer engagement offers the promise of negotiated settlements. For others, it is mostly a way of encouraging regulated industries to become more responsive to their customers' interests. Consumer engagement is advocated by those interested in deliberative and participatory process and by those interested in reducing the role of regulatory agencies and the bureaucracy surrounding price reviews and other key regulatory decision making processes.

Besides some instances of negotiated settlements in North America (Doucet and Littlechild 2009; Littlechild 2008, 2009), the call for customer engagement has been particularly prominent in the case of the UK. Different economic regulators have experimented with processual innovations to encourage direct engagement between regulated industries on the one hand, and customers and other affected parties on the other. One sector where this call for more consumer engagement has been particularly prominent is water. The contrasting examples of Scotland, and England and Wales, offer critical insights.

In both cases, consumer engagement was to take a prominent role in recent price review processes that were completed in 2014. Industry structures did vary – Scotland's water sector is organised through a publicly-owned provider with (some) retail competition, whereas England and Wales have private and 'public interest' companies organised in regional monopolies. In Scotland, consumer engagement reflected a tripartite agreement between company, regulator, and consumer organisation that was to engage directly with the company, whereas the English and Welsh experience involved consumer negotiations organised at the company level. Whereas the Scottish regulator signalled its principle willingness to accept a negotiated agreement that the customer body and the company could agree to, the scope for agreement in the case of England and Wales was smaller. In the English and Welsh experience, customer challenge groups included other regulators, whereas in the Scottish case, the environmental and drinking-water quality regulators were consulted, but not involved in the customer body as such. In Scotland, the regulator (WICS, Water Industry Commission for Scotland) provided the consumer group (the 'Customer Forum') with background information to

inform negotiations (see 'WICS Notes', e.g. WICS 2012), whereas Ofwat decided to play a more detached role to encourage a decentralised 'discovery process', given also the highly diverse nature of different water companies under its jurisdiction.

In the end, WICS did accept the agreement between customer representatives and company, while Ofwat mostly revised the various customer agreements, usually leading to 'tougher' settlements on companies. Whereas participants in the Scottish process, with the exception of consumer organisations, praised their experience (Customer Forum 2015), enthusiasm for consumer engagement in the other parts of Britain was dampened by the experience of the intervention by Ofwat after companies had extensively engaged with their customer challenge groups (cf. CC Water 2015). Although many water companies and challenge groups in the English and Welsh context found this engagement process beneficial and rewarding in their direct interactions with each other, their perception of its overall value was significantly hampered by the seeming lack of respect for these processes on the part of the regulator.

What do these contrasting experiences tell us about the future of regulatory agencies?

It offers one insight into the changing role of the consumer in regulatory processes. Whereas most recent attention has been placed on behavioural impact-influenced interventions to supposedly enhance the quality of consumer choice, the process of customer engagement moves consumer representation away from existing consumer protection bodies or from regulatory agencies themselves to the level of the firm. At first sight, this seems to usher in a new era of regulation, putting the relationship between firms and consumers at its heart, at the expense of the previously prominent role of regulatory agencies. However, at second sight, agencies have not lost their central role despite the increased prominence of consumer engagement. The experience in the Scottish water domain suggests that the efficient secret of the process was the fancy footwork performed backstage by WICS. This could have been by providing information to the customer representatives or by shepherding the various parties along during the process – while needing to persuade its own members that this process did not represent an abdication of regulatory competencies. In other words, regulatory agencies remain central in this process rather than being sidelined by emerging alternative decision making arenas.

However, it might still be argued that customer engagement leads to different kinds of outcomes. This argument has certainly been made in the case of Scotland where the eventual settlement was seen to have been tougher on Scottish Water than WICS had envisaged at the outset of the process. There is also the possibility that

the company will strive more seriously to meet the regulatory demands of the last price review because of its ownership of these demands, having itself negotiated them with the customer body. The Scottish process also established a different kind of customer research in an area where customer preferences are rarely ever fully formed. Again, however, it might be questioned whether the same can be said about the English and Welsh experiences.

Finally, as Vibert (2015) suggests, regulatory agencies were once seen as a persuasive institutional arrangement to address 'badly structured' problems. Mick Moran (2003) similarly noted that the era of the regulatory state gained attraction exactly because of its promise to establish synoptic and consistent control that would move beyond the informalities of the earlier era of regulation via 'club government'. A move towards consumer representation and negotiated settlements might be seen as a different answer to the challenge of the 'badly structured'. Instead of a reliance on disciplined econocrats doing methodologically ever more complex calculations to remove arbitrary political decisions, customer engagement processes offer the possibility of locally adaptive discovery processes. Rather than operating as judge-type econocrats, the role of regulators might appear to have become increasingly one concerned with boundary spanning, namely, the bringing together and sustaining of consultative processes. Boundary spanning offers a different answer to the problem of the 'badly structured' by promoting the possibility of higher degrees of intelligence in decision making through decentralised information processing. Unfortunately, it is unlikely that boundary spanning will turn the 'badly structured' into the 'well structured' when it comes to entrenched conflicts that generate identifiable winners and losers. In addition, customer representation will always face its own problems of legitimacy. Negotiated settlements require the involved consumer body to directly represent 'what customers want' in the negotiation process. Other arrangements – such as the English and Welsh experience – require consumer groups to assess the responsiveness to consumers and the overall quality of consumer research used by regulated companies. As is the case with the tension between independence and accountability where regulators are concerned, the inherent tension between 'real influence' of customer bodies and their representativeness is here to stay.

Furthermore, it is unlikely that the traditional core attractions of the 'agency model', namely to instil the 'logic of discipline' into regulatory decision making will fade away (cf. Roberts 2010). International investors will continue to be more interested in 'consistency' rather than responsiveness to decentralised negotiations. In other words, mobile international finance is unlikely to be enamoured of increased customer engagement if this leads to less predictable regulatory decisions. Similarly, customer representation will always face the problem of organising sufficient expertise and representative legitimacy. Regulatory agencies are arguably well placed to respond to these two challenges by promising

'consistency' and expertise – and they are also well placed to argue their case. In other words, even if regulatory agencies may have lost the glamour of hyper-modernity, they most certainly are not ready to be consigned to the dustbin of history.

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Regulators – order of the court or disorder of the town council?

Lindsay Stirton

Are economic regulators, such as Ofgem, more like a court or a town council? Both are `independent' of central government, but the extent and character of that independence is quite different. Or, to put the question in a slightly more sophisticated and jargon-laden manner – should we think of regulatory agencies as a kind of `dependent judiciary', as Richard Posner (1977: 480) asserts. Detaching such a characterisation from the interest group framework that Posner develops, we can see a model of regulatory agencies as a `creature of Congress' (in the language of US politics), with less independence perhaps than the federal courts in which Posner serves, but nonetheless making reasoned, right- and fact-based determinations on disputes between parties, between rival providers, say, or between the interests of providers and consumers.Or should we, as Tony Prosser (1997: 34) has argued, think of regulators as `governments in miniature', dealing with complex, multi-faceted questions in a more deliberative, consensus-seeking way?

Such questions are at the heart of Vibert's analysis of regulatory agencies (especially in the field of economic regulation), and in the Littlechild tradition in particular. In fact, Vibert's brief review of regulatory practice in the UK, suggests that regulatory agencies may be seen as both court and council, with the latter role acquiring greater significance over time as experience of post-privatisation economic regulation accumulated. Thus, following Vibert's analysis, as the role of economic regulation broadened to one of constituting markets as understanding of `the consumer' grew more complex and as systemic concerns grew in salience, the idea of an adjudicative, judge-like role has lost traction and the town council model has perhaps gained greater acceptance. Why would these two things – changing views of the regulatory task and changing views of appropriate agency characteristics – seem to track one another?

From the point of view of legal theory, these things are not at all surprising. A seminal contribution is Lon L. Fuller's (1978) magisterial (yet unfinished) article 'The forms and limits of adjudication' first circulated around 1957–58. For Fuller, adjudication was a distinctive form of social ordering, characterised by the presentation of proofs and reasoned arguments. This, even more than authoritative determination from a judge is what defines adjudication, and distinguishes it from other ways of making decisions. 'Adjudication is, then, a device which gives formal and institutional expression to the influence of reasoned argument in human affairs' (Fuller 1978: 366).

This understanding goes well beyond some interpretations of what it is to be court-like, and intentionally catches inquisitorial as well as adversarial juristic traditions, as well as the broader range of functions that judges are too rarely understood to undertake (Bell 1987). It is at this level that the comparison between courts and regulatory agencies is to be at all plausible or analytically useful.

Hand in hand with Fuller's analysis of the *forms* of adjudication was an emphasis on the *limits* of this form of social ordering. Certain types of problems of decisions, he argued, were unsuited to adjudication, because it was impossible to preserve the character of the affected party's participation through proofs and reasoned arguments. Fuller had in mind what he called *polycentric* problems – multi-dimensional problems which yield multiple solutions, because the way that one dimension of the problem is disposed, in turn, has implications for all the others.

In fact, Fuller saw the problems of regulation and administrative law (in the North American sense) as classic polycentric problems. 'It is in the field of administrative law that the issues dealt with in this paper become most acute', he argued (Fuller 1978: 355), adding that it was regrettable that no one, 'seems inclined to take up the line of thought suggested by a remark of James M. Landis to the effect that the CAB [The Civil Aeronautics Board] is charged with what is essentially a managerial job, unsuited to adjudicative determination or to judicial review' (ibid.)[1]

If the kind of decisions regulators are charged with is less amenable to proofs and reasoned arguments, does this mean that rationality has little part to play within this broader understanding of the regulatory task? Do we have to trade order in court for the rumpus of some of the more disorderly town council meetings? Not necessarily. The contrast presented at the outset of this comment leaves room for a more deliberative model of decision making, in which rationality plays a role, not so much in the presentation of proofs and reasoned arguments, but in the requirement that judgements that are presented as being right 'all things considered' or defended 'in the public interest' are subjected to rational scrutiny and must be defended as such in the face of rigorous questioning. This is arguably the most public aspect of what Jon Elster (1998) has called the 'civilizing force of hypocrisy': the requirement that decisions must be defended in public in front of an audience means that 'the language of reason' replaces the 'language of interest', not exactly eliminating self interest, but forcing those who would advocate a particular decision or course of action to come up with arguments that withstand critical scrutiny.

To return, then, to the question posed at the outset of the discussion: the more complex

[1] It should be obvious from the context that Fuller's critique is intended beyond the often repeated criticism of the cumbersome procedure that US administrative agencies often took to rate setting or other regulatory decisions.

the regulatory task environment becomes, the more we might expect that regulatory agencies approach Prosser's 'governments in minature' rather than Posner's 'dependent judiciary'. That has been the direction of development since Littlechild's original proposal for BT to be regulated by a body, similar to the (now defunct) Office of Fair Trading, headed by an individual of similar standing to a High Court judge.[2] But while such a direction of development may be unsurprising, that does not mean that the court-like understanding of regulatory agencies has been rejected with any degree of finality. Regulation, like other areas of policy, is not necessarily immune to the politics of austerity that have seen the reduction or elimination of the social obligations of government in other areas. It may be that the kind of broader agendas that have forced regulators into the mould of governments in miniature are themselves subject to such retrenchment that the higher ambitions of accommodating multiple objectives are abandoned. Conversely, it may be that under greater pressure, yet more complex trade-offs assert themselves. Either outcome is plausible.

As Vibert suggests, independent arm's length bodies continue to have significant advantages in terms of 'better structuring' the decision setting, and serve the needs of both politicians and the officials who staff them. To better understand the continuing if evolving role of independent agencies, one has to go beyond one-dimensional characterisations of 'independence'. In drawing on a venerable tradition in organisation theory, Vibert contributes to an emerging and potentially interdisciplinary research agenda. Here, I would argue that legal theory has a contribution to make. To the catalogue of 'badly structured' decisions which Vibert draws from organisation theory, we could add 'the polycentric'. But while Vibert seems to be arguing that independent agencies have a contribution to make in (essentially) bringing structure to problems, Fuller's analysis of polycentricity perhaps suggests that the precise contribution of independent agencies (on the model of governments in miniature rather than a dependent judiciary) is finding solutions despite an absence of logical or rational structure.

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[2] Interestingly, the 'government in minature' view may have been baked into the original institutional design, in which Oftel was established as a non-ministerial government department.

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Independence and the boundaries between regulators and regulatees

Christel Koop

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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