

Are regulators the new *Men in Black*? Not when it comes to independence ...

Filippo Cavassini, Faisal Naru and Bill Below call for a fresh look at regulatory independence

The *Men in Black* are a special unit charged with *regulating* Alien activity on planet Earth (at least it is in the film with Will Smith and Tommy Lee Jones). Their job is to operate incognito, working behind the scenes to avoid an intergalactic apocalypse. When uncovered, special technology allows them to eradicate all knowledge of themselves and their function.

To most of us, regulators are a lot like the *Men in Black*, ensuring that trains will run on time, that there is clean water in the tap, that lights switch on, that the broadband is working and that there is cash in the ATM machines. They largely go unnoticed, that is, until something goes wrong, stops working or crashes.

Unlike the *Men in Black*, regulatory agencies do not operate incognito – or they shouldn't. They must be part of a well functioning and transparent governance eco-system that provides these important public services and are held accountable for the performance of their different actors. Being part of this eco-system, however, carries a number of risks.

Different stakeholders – whether regulated industry, government, politicians, consumers or other interest groups – have powerful incentives to influence or capture regulatory policies. The danger of capture is all the more present be-

cause of the proximity of regulator and the regulated.

We need regulators to be independent, just as we need our judges and referees to be independent. However, independence cannot come at the price of accountability or engagement, and regulators need to keep their fingers on the pulse of the market through interaction with industry and consumers. In addition, autonomy should still be compatible with maintaining helpful feedback loops between the regulator and its governmental executive overseers. In a nutshell, regulators must be engaged but not enmeshed, insulated but not insular.

Given the challenging context within which regulators operate, the question is how to limit undue influence in practice and create a strong culture of independence. In the quest for an answer, the OECD first set out to understand how regulatory agencies around the world are structured to be protected from undue influence. The OECD has developed a unique dataset of the formal arrangements for independence of regulators across 33 OECD countries, complemented by detailed *case studies* showing what holds regulators accountable for their performance.

The dataset does not capture cases where regulators conform to established practices but are not legally bound to do so

through a formal or codified requirement. For example, a number of regulators publish forward-looking action plans although they are not required to do so by law. In essence, the dataset reflects the *de jure* situation in OECD countries in relation to the levels of independence, accountability and scope of action in six network sectors. In terms of independence, it shows that Germany and Italy have the highest measures for *de jure* independence (Koske et al., 2016).

The OECD (2016) has conducted a follow-up study in its recently published *Being an Independent Regulator*, which has filled in many of the gaps in our understanding of how *de facto* independence plays out in the daily life of regulators. Forty-eight regulators from around the world participated, representing institutional arrangements including formally independent regulatory institutions, ministerial regulators, and single and multi-sector regulators including those responsible for competition.

The report finds that undue pressure can be exercised at different points in the life of a regulatory agency. For example:

- 88% of the regulators who receive their budgets from the executive receive annual rather than multi-annual budget allocations, which can increase the risk of undue influence and affect their financial independence.
- Most of the regulators have their head appointed by the government's executive branch. In 15% of cases, the appointment is made by parliament. Only eight regulators use a search committee for hiring a new chair.
- Over half the regulators place no restrictions on pre- or post-employment of professional staff, opening the risk of 'revolving doors' and conflicts of interest with industry and the political cycle.
- Only a quarter of the regulators are given a government statement of expectations on their conduct. Such formal public statements can be useful to clarify roles, goals and activities in a transparent and accountable way.

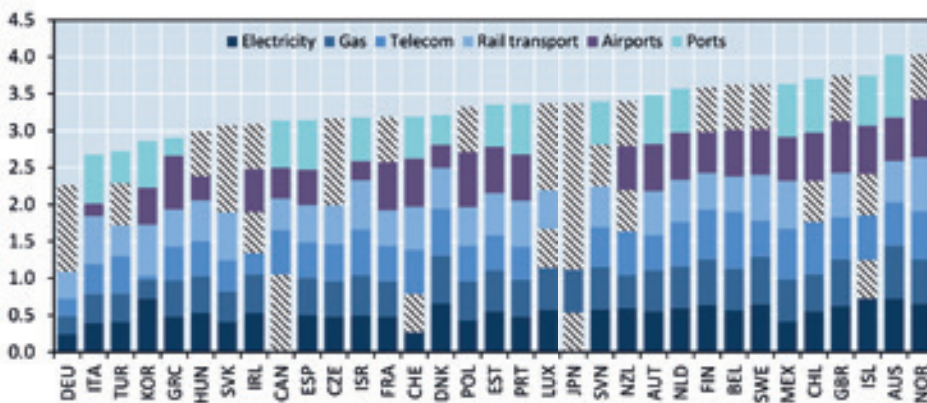


Figure 1. The governance of regulators in six network sectors: levels of independence according to the *de jure* measures in each country. Source: Koske et al., 2016.



A key conclusion of this work is that regulatory independence is not an end in itself, and that it should be seen as a means of ensuring effective and efficient public service delivery by the different market players. Developing a culture of independence is just another way of nurturing better performance.

The task for government institutions and regulators is how to develop this culture of independence that delivers for users. Independence is not a static state achieved once and for all by statute. While institutional design is one part of optimizing independence, it is not sufficient. A regulator can be part of a ministry and yet be more 'independent' than a regulator in a separate body.

Building on the work conducted so far, the OECD has developed a 'pinch point analysis' methodology to highlight the critical events in the life of a regulator where undue influence and pressures can be greatest. Agency finances, staff behaviour, appointment and removal

of leadership, the way in which agency intersects with political cycles, and the interaction with the various actors in the regulatory sphere are pinch points specific to the regulator's environment. They can be amplified when two or more events occur at the same time. An example might be a political election coinciding with a rise in crude oil prices and a change in the head of the agency. It is at these critical points that action needs to be taken in order to protect regulators from undue influence.

Building on this methodology, the OECD is currently developing guiding principles for how regulatory agencies and, more generally, arm's-length bodies, can be protected from undue influence. For instance, multi-year budgets can provide predictability and shield the regulator from short term political concerns or reactions to decisions taken by the regulator. Making the nomination process more transparent can help recruit chairs and agency heads who have the neces-

sary technical skills and credibility to enhance the performance of the regulator. These institutional arrangements would not only make the agency or body more effective but also signal the willingness to protect the regulator from undue influence. This signal is the condition for nurturing a culture of independence that enables the regulator's leadership and staff to behave and act independently.

Being an independent regulator cannot mean adopting the cloak of invisibility and working behind the scenes like the Men in Black. Regulators must fully engage with all stakeholders. Maintaining independence in the midst of significant pressure from all sides requires governance structures aimed at nurturing a culture of independence.

It may not keep the galaxy safe, but it will ensure that regulatory agencies better serve the public good.

For more information see OECD (2016b, 2016c) on 'Independence of regulators and protection against undue influence' and 'Governance of Regulators' Practices'.

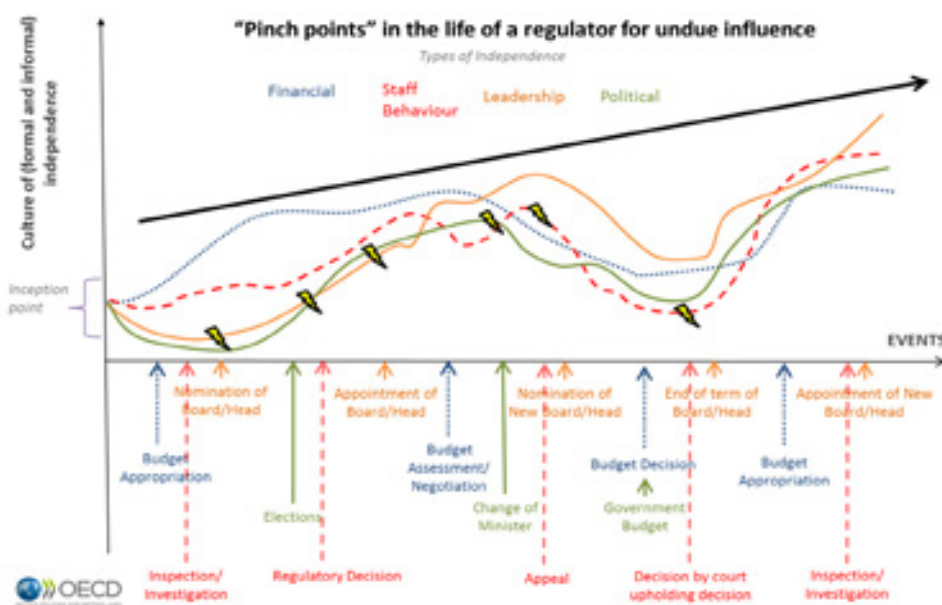


Figure 2. 'Pinch point analysis' methodology demonstrating the level of independence against events in the life of a regulatory agency or arm's-length body. The trend of independence can be positive or negative over time and where there is congruence of events there can be greater avenues for undue influence (OECD 2016a)

References

Koske, I., Faisal Naru, F., Beiter, P. and Isabelle Wanner, I. (2016) 'Regulatory management practices in OECD countries', OECD Economics Department Working Paper no. 1296, Paris: OECD Publishing. <www.keepeek.com/Digital-Asset-Management/oecd/economics/regulatory-management-practices-in-oecd-countries_5jmoqw-m7825h-en#.WAOg-DKZNIY>

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