The Public/Private Interface: regulatory authorities balancing independence with accountability

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Setting up Independent Regulatory Authorities (IRAs)

- **Policy Objectives**
  - Improve economic efficiency in a market framework shielded from short-term political and administrative risks
  - Avoid the risk of capture by specific interests

- **Context**
  - Privatising former state-owned enterprises
  - Necessity of a sound regulatory framework
  - Ensuring market efficiency and protecting consumers' interest in cases of imperfect competition/monopolistic markets
A Political Challenge

**The choice**
- Self-regulation and competition framework
- Direct Ministerial Oversight
- Independent Regulators

**The rationale**
- Delegating power to a regulator at arms' length from the political system
- Improving the protection of consumer interest in case of market failures or other failures
- Improving transparency and stability
- High quality staff and technical expertise
Towards the "Regulatory State"

- Clarifying the functions of the State
  - Public Ownership General rule making (general rules)
  - Enforcing regulation (applying the rules)
  - Consumer protection (quality/market)

- A challenge to the executive and parliamentary powers
  - A regulator entrusted with regulatory powers, including sanctions, licences, and even some rule making
  - A Government in Miniature?
  - Establishing the legitimacy of a "non majoritarian" institution
The international context

- Trend towards participation of the private sector for the delivery of core services/network industries
- The European dimension
- The impact of the GATS
- OECD Work
Independent Regulatory Authorities in the proposed 2005 OECD Recommendations on Regulatory Quality

**Broad regulatory perspective**
- Establish regulatory arrangements that ensure that the public interest is not subordinated to those of regulated entities and stakeholders
- Ensure that regulatory institutions are accountable and transparent

**Competition dimension**
- Ensure that regulatory restrictions of competition and market openness are limited and proportionate to the public interests they serve
- Periodically review the need for universal service obligations, their effectiveness and the need to maintain restrictions on entry and prices
- Promote efficiency and the transition to effective competition where economic regulations continue to be needed (abuse of market power): separate competitive activities from regulated utility networks, promote non discriminatory access to essential network facilities, promote interconnection of networks, use price caps and other mechanisms to encourage efficiency gains.

**Assessment**
- Use performance-based assessment of regulatory tools and institutions, to assess how effective they are in contributing to good regulation and economic performance
Recent Trends
Independent Regulatory Authorities in OECD Countries

Financial Regulators
Telecommunication Regulators
Energy Regulators
A heterogeneous institutional status

- **Telecom Total**: 23 agencies
  - Ministerial Department: 1
  - Ministerial Agency: 7
  - Independent Advisory Body: 1
- **Total Energy**: 15 agencies
  - Ministerial Department: 4
  - Ministerial Agency: 4
  - Independent Regulatory Authority: 5
- **Financial Total**: 23 agencies
  - Ministerial Department: 0
  - Ministerial Agency: 13
  - Independent Regulatory Authority: 1

**Percentage of agencies**

- 0%
- 25%
- 50%
- 75%
- 100%
Independence
the formal dimension

- The executive structure of the regulator: Single head / board
- Duration, nomination, renewal
  (link with Parliamentary terms?)
- Rules for the staff vs. the sector (hiring, firing)
- The possibility of overturning the decision: appeals

The Brazilian case:
- Structures comparable to other OECD countries
- Different administrative and cultural background
Independence
Independence in practice

- The role of experience, respecting the terms
- The leadership of the first head
- Relations with elected politicians
  (See Mark Thatcher/LSE UK)
- The ability to manage crises
  (e.g. peak in energy prices, energy rationing, currency fluctuations or telecommunication prices)
- Quality of the staff
- The issue of Brazil
  - Nominations to the board
  - Need to have complete boards
  - Role of the public debate in a multi centric democracy
Possibility of Instructions

- **Financial**
  - 27 agencies
  - 5 agencies that cannot be instructed
  - 4 agencies that can receive specific instructions
  - 0 ministerial department

- **Energy**
  - 11 agencies
  - 7 agencies that cannot be instructed
  - 2 agencies that can receive specific instructions

- **Telecom**
  - 8 agencies
  - 16 agencies that cannot be instructed
  - 7 agencies that can receive specific instructions
  - 1 ministerial department
Agencies that cannot be overruled

Agencies whose decisions can be overruled by government

Ministerial department
Appointment of Heads

- One or two ministers
- Government collectively
- Parliament
- Parliament and Government
- Members of the board in charge
- Other
- Missing

Energy

Financial

Telecommunications
Terms of Appointment

Percentage of agencies

- **Over 8 years**
- **6 to 8 years**
- **5 years**
- **4 years**
- fixed term under 4 years or at discretion of the appointer

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Percentage:
- 0% 25% 50% 75% 100%
Financial resources and staffing

**Financial resources**
- Use of central public funds: binding constraints
- Implicit pressure of budgeting ministries
- Control of audit offices
- Fees/Levies on the regulated industry: setting an independent formula?
- Recent Brazil examples

**Human resources**
- A difficult challenge for small countries (multisector regulation)
- Rules for conflicts of interest, cooling off period (OECD Recommendations)
- Need for a specific framework for regulatory authorities?
Financial Resources

- Other (National Bank for specific financial regulators)
- Fees levied on the regulated industry or non-budgetary resources
- Mix of State budget and fees
- State budget only
- Incomplete

Note: Number of agencies of each type financed by type of financing
Functions and powers of regulatory authorities

**Economic functions**
- Enforcing market rules
- Licensing (entry, exit)
- Fixing prices of access to the Grid or the Network

**Managing risks**
- Inspection, Control
- Prudential ratios for financial institution
- Avoiding rupture of service
- Assuring Universal Service Provision
The rule making power

- Normally power of the ministers/cabinet (political trade offs) but views may differ
- In practice some rule making power given to independent regulators technical standards vs. laws:
- A tension between delegating rule making and respecting independence
- But jurisprudential approach: set of precedent decisions $\Leftrightarrow$ rule

Solutions

- Possibility of suggesting official amendments of the existing rules (annual report to Parliament)
- Possibility of proposing rules to Government
The issue of strategic planning and law making

- Not a regulator’s attribute
- Need to separate enforcement from law making
- Need for capacity in the ministries:
  - Example of EPE in Brazil
  - The case of transport (GEIPOT)
- The role of national councils to develop a strategy
- Building consensus in a diverse democracy
The power of sanction

An independent regulator \(\Leftrightarrow\) government in miniature

*Executive power, preparing rules and judging? (settling disputes)*

*Problem vs. the traditional setting of democracies*

**In practice**

- Respect of certain judicial forms for applying sanctions: separating investigation from deciding on the sanction
- Adapt the level of sanctions: Inapplicability of penal law:
- Efficient sanction: to deter from inappropriate behaviour and make it "ex ante" worthless
Link with the judiciary

- The regulators' effectiveness depends on the quality of the judicial environment
- Issue in middle income countries
- Often crucial aspect
- Need to ensure:
  - Consistency
  - Technical expertise for decisions
  - Speed
- Need for a common system of appeal for competition authorities and regulators
- Avoid creating a "regulator of the regulator"
Horizontal Design

Coordination with Competition Authorities

SDBC in Brazil

Coordination among regulatory authorities

- Common doctrine and consistent time frame
- Minimising the burden of compliance
- Regular meetings and public hearings
- Request mandatory opinion (competition, environment)
- Examples: IBAMA / ANEEL, ANTAQ / ANTT, ANATEL / CADE
Horizontal Design and sectoral specialisation

- Single goal, single sector agency: clarity, efficiency
- But "Silo Effect": Risk of non coordination and of regulatory burden stemming from multiple specialised agencies
- Multi-sectoral agency:
  - Minimises the risk of capture,
  - Softens human resource constraints,
- Core issues in Brazil
  - Approach to combined rail/road transport ANTAQ ANTT
  - Convergence TV/Telecommunications/
Balancing Independence with Accountability

- A condition of success
  - "non majoritarian" institutions (Majone)
  - Political credibility of the regulator

- No explicit mechanism for reporting and establishing legitimacy

- Procedural and political aspects
  - Often demanded by the independent regulators themselves (cf dialogue with Parliament)
Ensuring Accountability: How? without undermining independence

Systems of checks and balances

- Transparency and procedural requirements
  Administrative procedure laws
- Dialogue with citizens and Parliament
  Annual report, dialogue with Parliament (expertise)
  Links with consumers' associations
- Substantial judicial/legal review:
Link with the judiciary

- The regulators' effectiveness depends on the quality of the judicial environment
- Issue in some countries transition, middle income
- Often crucial aspect, need to ensure:
  - Consistency
  - Technical expertise for decisions
  - Speed
- Avoid creating a "regulator of the regulator"
Ensuring Accountability and High quality regulation

- **High quality regulation:**
  Subject the regulators' decisions to requirements for high quality regulation:
  - Regulatory Impact Assessment
  - Transparency
  - Predictability

- **Key for industry and for credibility**
- **Cf PRO-REG project in Brazil**
Assessing quality
Performance evaluation

- **OECD recommendations**
- **Several dimension**
  - legal, judicial review
  - accounting/auditing
  - overall economic assessment
  - Recent UK example on capability assessment, Treasury reviews, National Audit Office
Mandatory Release of Periodic Assessment Reports on Achievement of Objectives

- **Financial**
  - Yes, in annual reports only: 52
  - Yes, other: 24
  - No: 3
  - n.a.: 21

- **Telecommunications**
  - Yes, in annual reports only: 52
  - Yes, other: 8
  - No: 0
  - n.a.: 40

- **Energy**
  - Yes, in annual reports only: 24
  - Yes, other: 14
  - No: 10
  - n.a.: 52

Percentage:
- 0%
- 20%
- 40%
- 60%
- 80%
- 100%
Performance Assessment of regulators in Brazil

- Self assessment by regulators
- Role for TCU / CGU
- Role for consumers: IDEC/IADB
- Role for foreign investors: AMCHAM reviews
- National academic studies
- Evaluations by WB/IADB (PPIAF Study)
Conclusion

- Designing independent and effective regulators
- The need for high quality regulation
- No "pre cooked recipe"
- Respect national institutional settings while adopting international standards
- Significant policy turmoil in Brazil, in a moving regulatory environment:
  - *Regulatory authorities have stood the test of time but may need some fine tuning and adaptation*