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## Is There Still a Role for Independent Regulators?

### Haverá (ainda) um Papel para Reguladores Independentes?

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#### **ABSTRACT**

Although regulators have been around for three decades, their Independence is still not fully understood as an administrative institution in the governance of modern states. Neoclassic approaches support their existence, in addition to valuable contributions made from the perspective of transaction costs, institutional economics and political economy. To improve the trade-off between independence and accountability of regulators, several conditions for the appointment and functioning of regulators have been put forward, but this remains a hot topic. The authors discuss the integration of regulators in the democratic organization of the State, address their legitimacy, and discuss the powers and duties inherent to independence, consistent with the requirements of legitimacy and accountability. Finally, they define the requirements for regulators to be appropriately integrated in State institutions and suggest a “triangle” to support independent regulators.

Keywords: Economic regulation; independent regulators; regulators’ accountability; regulators’ legitimacy.

**JEL Classification:** L51; K23; H10.

#### **RESUMO**

Embora proliferando há três décadas, a independência dos reguladores ainda não é completamente compreendida como uma instituição administrativa na governação dos Estados modernos. Tem fundamentação na teoria neoclássica, mas a economia institucional e dos custos de transação, bem como as perspetivas da economia política também têm dado contributos relevantes. Para melhorar o trade-off entre independência e responsabilização, têm sido propostas várias condições na nomeação e funcionamento dos reguladores, mas o debate mantém-se aceso. Os autores debatem a integração dos reguladores na organização do Estado, a sua legitimação, e discutem as competências e deveres compatíveis com essa legitimação e com a sua responsabilização. Finalmente, definem condições necessárias à

adequada integração dos reguladores nas instituições do Estado e propõem um “triângulo” para suportar a regulação independente.

Palavras-chave: Regulação económica; reguladores independentes; entidades reguladoras; organização do Estado.

## 1. THE ROLE OF INDEPENDENT REGULATORS IN STATE ADMINISTRATIVE ORGANIZATION

Independent economic regulation dates from the 19th century but become particularly important in the 1980s with the proliferation of regulators – or independent administrative authorities (IAA), as they are called in State administration – in democratic societies and developed or developing economies (Rosanvallon, 2008; Tucker, 2018).

The fundamentals of neoclassical economic theory, resorting to a whole theory on incentives, imperfect information, and to the reasons behind market failures, but also some developments of the behavioural economics, such as intertemporal inconsistency, have been used to explain the need for these IAA as agents of economic policy, as a means of overcoming issues related with commitment and sub-investment, information asymmetry, competitive neutrality in relationship-specific assets' contexts, with long lifecycles and strong economies of scale and scope – basically, in the public utilities (Amstrong and Sappington, 2007; Bawn, 1995; Edwards and Waverman, 2006; Gilbert and Newbery, 1988, 1994; Laffont and Tirole, 1986; Majone, 1996; Waverman and Koutroumpis, 2011). The independence of these IAA has been duly grounded to face the risks of capturing and influencing the different stakeholders, including those of regulated companies and political power (Dal Bo, 2006; Stigler, 1971).

However, the existence of the IAA with the power to decide key aspects of markets that provide essential services and have a high impact on the well-being of the population, without that power deriving from traditional sovereign bodies in representative democracies, has raised the issue of their legitimacy in state administration. A common approach in the literature has been to present these independent regulators as an institutional response from the State to deal with the State's own failures, deriving from the limitations of economic policy, assuming that the delegation of power in technocratic bodies<sup>1</sup> allows that better decisions are taken than those by “political” bodies (Bénassy-Quéré et al., 2019), which is in accordance with the theory on transaction costs, according to which the state's own institutional arrangements meet the needs to respond more and more efficiently to social contexts in constant change (Williamson, 1985; 1998), as well as with the new institutional economy, according to which only after institutions have been correctly designed and the property rights have been defined is it possible to discuss the governance of the said institutions and analyse the short-term decision of economic agents (Williamson, 2000).

When confronting technocratic decisions – by the IAA – and political decisions – by executive bodies democratically elected – some authors have focused on the conditions in which decisions made by the IAA are better than those taken by political bodies, mostly considering the nature of those decisions and the control mechanisms of said decisions. Several elements contribute to this line separating which decisions should be made by which institution, namely, the technicality of the decision, the stability of social preferences

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<sup>1</sup> The idea of the regulator as a technocrat is associated with the creation of this figure, namely in the economic field, to overcome market failures. Considering the link with overcoming State failures and the consequent integration in the democratic organization of the State, the characteristics required for regulators go beyond their technocratic ability, and include, at least, their independence from a hierarchy structure dependent on political power, since it is from the combination of these two features that one might derive the superiority of certain decision making.

related with regulated activity, the ability that voters have of seeing the results, the risk of intertemporal inconsistency of decisions, the impact on intra and intergeneration surplus distribution, and the need to consider incompatible goals or the involvement of pressure groups (Alesina and Tabellini, 2007; Maskin and Tirole, 2004; Tucker, 2018).

Obviously, these criteria do not always allow for a clear separation of which decision should be made by which institution. However, not only do they help to set a rationale for the allocation, but they also allow for the definition of intermediary institutional solutions, as when political institutions define the objectives and delegate decisions to attain those objectives on technocratic institutions with operational independence. This is what has mostly happened with the IAA in more developed economies (Bénassy-Quéré et al., 2019).

In any case, the existence of a rationale to accept more efficient decisions by IAA in specific circumstances may provide the right behavioural incentives and resolve the issue of operational optimization in public governance, though it does not resolve the (never ending) tension between independence and accountability in the legitimation of IAA, which appears almost as a “foreign body” in the administrative organization of a democratic State built on the principles of the Social Contract and the separation of powers inherited from 19th century Enlightenment. This never quite understood “foreign body” has been increasingly questioned, both due to people’s decrease in confidence in governing bodies and to the pressure resulting from poor economic results over more than a decade in a large number of economies in which this model has been in place (Tirole, 2016; Tucker, 2018). This makes the questioning on legitimacy particularly relevant in order to make it compatible (as best as possible) with its inherent independence, especially since, after the global financial crisis at the end of the last decade, we now find ourselves in a new crisis, this time caused by the Covid-19 pandemic.

## 2. THE (DEMOCRATIC) LEGITIMACY OF INDEPENDENT REGULATORS

Given the fast change in social and economic conditions, hindered or sped by the current pandemic, to question whether economic regulation makes any sense requires a prior answer to the wider issue of regulation in general and its legitimacy in the context of a country’s political governance. Moreover, it requires a prior answer to the issue of the democratic legitimacy of its existence and statutes, in the two aforementioned contexts.

We must recognise that, in the field of political science, these matters have not been deeply analysed, the issue of their legitimacy and their need or merit or their action remaining open for discussion. Additionally, many of these discussions often occur in tense environments due to specific situations, ignoring or belittling the debate on the referred topics.

Interestingly, in an important publication, Laffont and Tirole (2000), when discussing in depth the fast development of telecommunications, almost at the end of their book (p. 279), ask: “Toward the demise of regulation?”

In a paper published in “Finance & Development”, by the International Monetary Fund, Frieder (2020, p. 5) acknowledges (only now?) that “The COVID19 pandemic strikingly illustrates the intersection of politics, economics and other considerations”.

Stating that the “Political Economy is about how politics affects economy and the economy affects politics” (p. 6) (thus showing the deep link between the two, the play on adjectives and nouns reinforcing the conceptual blending), the author recalls that Adam Smith, David Ricardo and John Stuart Mill defined themselves as “political economists”, history, namely 20th century history, being responsible for the separation of the two fields.

Frieder (2020) advocates that, in the past 50 years, political economy has become increasingly important, both in economic and in political science, but his statement that “politicians can be thought of as analogues to firms, with voters as consumers or governments as monopoly providers of goods and services to constituent customers” (p. 7) shows that he still considers the idea that the economic model is prevalent (though only at an initial stage) and that political principles are subordinate to economic reasoning. This adds to the need for an analysis of the legitimacy of regulation, particularly economic regulation, from a wider perspective of the democratic process and its governance.

This debate is framed by Tucker (2018) from a point of view of inevitable change of State organization, which Tirole (2016) calls “a new concept of State”, motivated by the answer to two questions: Do government structures work and help people to live good and happy lives, with realistic expectations and opportunities? In democratic countries, are governments in touch with and shaped by people’s motivations so that their representatives may limit, supervise and reform “non-elected governing bodies” (i.e. IAA)? The surprise evidenced by the author in regard to the fact that these societies show little interest in debating and setting principles for a new governing geometry reinforces the importance of this issue in the context of Political Economy and not simply of Economy.

Barak Obama<sup>2</sup> offers a similar perspective: “Our regulatory system must protect public health, welfare, safety and our environment while promoting economic growth, innovation, competitiveness, and job creation... It must identify and use the best, most innovative, and least burdensome tools for achieving regulatory ends”.

But is this not a demanding set of possibly conflicting goals when, in regulation, you forget the key financial issues, typical in a government plan? The regulatory system is then more and more viewed from a political perspective. What is its legitimacy in representative democracy?

Rosanvallon (2008), in a remarkable text on the IAA, historically describes how these bodies were a response to the loss of confidence in parties, namely in the USA, in relation to the decisions on the railroads at the end of the 19th century.

It is from this distrust of the democratic process based on parties, whose specific interests are opposed to the construction of the common good, that Rosanvallon refers to a double legitimacy, which explains the emergence of the IAA.

By advocating and explaining this legitimacy, in a chapter curiously named “Une révolution encore indéterminée”, he considers two types of institutions, the two first figures of this double legitimacy: the independent administrative authorities of “surveillance et de régulation” and the constitutional courts.

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<sup>2</sup> Quoted in “The regulation of tomorrow: Rulemaking and enforcement in an era of exponential change”, Deloitte University Press, 2015.

He considers that the first benefit from a legitimacy of impartiality, due to the way they were created and are composed. He refers in particular that “Elles ont été soit des créations du pouvoir législatif soucieux de limiter et encadrer un pouvoir exécutif jugé très partisan, soit suscitées pour le pouvoir exécutif lui-même, prêt à se dépouiller d’un certain nombre de ses attributions pour restaurer une crédibilité affaiblie ou se décharger des tâches pour la gestion desquelles il n’estime pas disposer de compétences nécessaires” (p. 22).

The quote is purposefully long to evidence the way the IAA are formed and the reasons underlying the way that, something deriving from two sources: the Parliament, and due to the distrust of government’s partisan perspective (even when ruling with absolute majority?); and the government and its attempt to self-constrain, either because it strategically wants to regain legitimacy or because it acknowledges that, due to its structure, it does not have the adequate and sufficient competences to meet society’s wishes.

It is also evident that this double source for the creation of the IAA will eventually influence its composition while adding a new requirement to base the legitimacy of these authorities: their technical and scientific skills which, on their own, do not ensure their legitimacy, as we will see later in the text.

Curiously, the way Rosanvallon describes the legitimacy of the Constitutional Court appears to be an example of that potential distrust of Parliament towards the government, as it conveys the potential distrust of parliamentary decisions.

In our opinion, this distrust, if combined with the distrust of partisan priorities over society’s needs, has special importance in the case of absolute majorities.

Therefore, according to Rosanvallon, the function of the Constitutional Courts is to “encadrer la production législative en la soumettant à une contrainte renforcée de généralité par rapport à l’expression majoritaire. Leur proximité est liée au caractère réflexif de leur intervention” (p. 22).

The combination of the features of the two types of IAA leads to two essential features being required of them: impartiality and reflection, the latter being implicit in the technical and scientific skills required to declare that legitimacy.

There is yet another requirement that Rosanvallon adds to the two mentioned earlier: proximity (p. 268 onwards) which is the key requirement to overcome the issue of the “contrainte renforcée de la généralité par rapport à l’expression majoritaire”.

As Rosanvallon refers (p. 10), the majority principle became both a justification to represent the will of the people and a decision technique, blending both without considering their different character. This has led to a distortion of democracy.<sup>3</sup> In fact, democracy in this general sense should express society in general. The blending of the two aforementioned principles leads to the majority becoming confused with the total, the more so that a part stood for the whole and the elections stood for the whole mandate.

Proximity meets that need to pay attention to each and every one, an attention to specificity, a policy of presence rather than representation and a democracy of interaction (p. 265).

It is obvious that a deep discussion of this issue is not possible in this paper. Noteworthy is the fact that the IAA and, therefore, Regulators may find their legitimacy in considering

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<sup>3</sup> This becomes a means to not give an advantage to anyone and place all voters in the same position so that the value of each member of the community is not questioned.

democracy a dynamic process, in constant change, in which all citizens may and should be active agents. That is democratic utopia, for sure, which irrevocably assumes an ethic reflecting a policy of attention (p. 280).

Important authors that should be mentioned here are (Rosanvallon, p. 282) Nussbaum (2006, 2007), who urges others to recognise the philosophical contribution of literature (and not just of technical and the so-called pure science), due to the complexity of characters and situations, and Wittgenstein (1965), who has constantly fought what he described as the “*désir constant de généralisation*” and “*mépris pour les cas particuliers*”.

Rosanvallon even considers that Wittgenstein, by inviting philosophers to base their research on firstly paying attention “*au sol raboteux de l’ordinaire*” (an expression that philosophers have long discussed in the field of democratic ethics), creates a wider redefinition of democracy in terms of “conduct” rather than a simple structure, and thus pushing regulation, and in particular, economic regulation, to the field of Behavioral Economics, and, consequently, to the field of Ethics.

Rosanvallon considers, then, that the IAA’s legitimacy is grounded on three elements: impartiality, reflection, and proximity, which he describes in three separate chapters: the legitimacy of impartiality, the legitimacy of reflexivity and the legitimacy of proximity. We consider that the three “legitimacies”, in terms of a really democratic regulation, cannot be separated because there is no impartiality if there is no proximity (as some will be ignored) and if there is no reflection – the key to any technical and scientific decision.

These are the requirements (and they are neither few nor easy) that underlie the legitimacy of the existence and the action of an IAA. An IAA that does not comply to them, cannot justify its existence (Rosanvallon 2008, p. 3).

Rosanvallon even adds another requirement, a more operational one, which he calls legitimacy and the idea of procedural justice (p. 270), stating that “*la légitimité des agents publics est fonction des qualités de “justice procédurale” attachés à leur comportement*”, considering it “*l’entrelacement de l’impartialité et de la proximité*”.

It is important to realize that the claim goes beyond the formality of “delegated legitimacy”, a result of a formal action by a state authority, rather describing behavioural requirements, in line with Tucker’s (2018) ideas when he states that a regulator’s credibility,<sup>4</sup> its active principle, depends on a wide public discussion and acceptance, and its legitimacy depends on the right balance with the three powers of the State<sup>5</sup> through careful delegation, constant surveillance and public debate. He adds that credibility requires legitimacy.

In the search for legitimacy in the framework and organization of the State, Tucker (2018) states that a modern constitutional state is based on two “triangles”: that of functions and values, whose apexes are Democracy, Rule of Law and efficient administration of Government (Figure 1); and the triangle of the institutional form, the separation of powers, whose apexes are the Judicial power, the Legislative power and the Executive power.

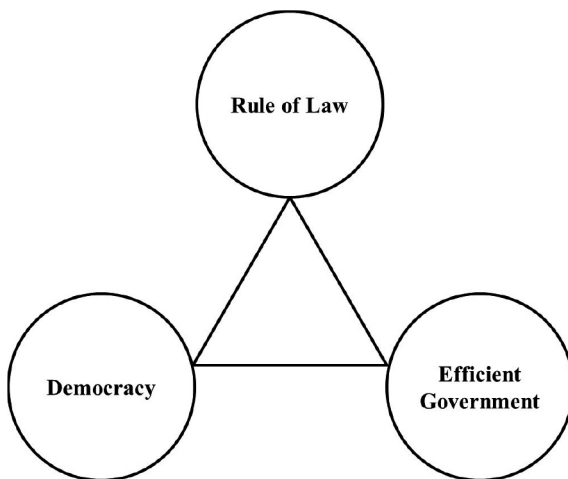
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<sup>4</sup> Here, Tucker refers to the national banks, but in a context that can be applied to other IAA and to independent regulators.

<sup>5</sup> Legislative, judicial and executive branches.

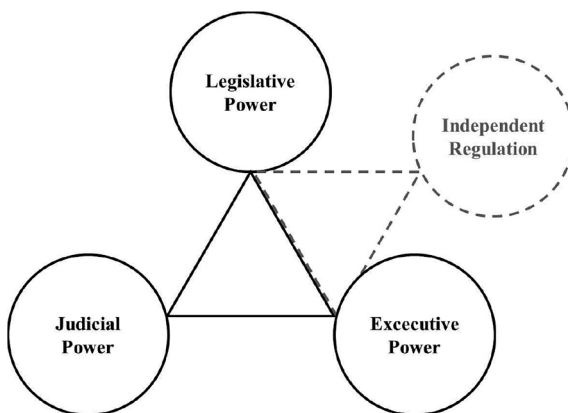
However, this balance may be jeopardized by the division of the executive power between elected representatives and non-elected technocrats, squaring this latter triangle into a rhombus (see Figure 2).

Figure 1: Triangle of Functions and Values



Source: Tucker (2018).

Figure 2: Triangle of Institutional Form



Source: Tucker (2018).

In the attempt to resolve the framing of this “foreign body” in the structure of the State, either to directly reinforce its legitimation, or to indirectly attempt to meet all the legitimacy requirements mentioned above, several proposals have been put forward and measures implemented, namely to the creation of IAAs, to the appointing its directors, and regarding the resources and IAA’s functioning, among others. However, almost all are just tools to support the independence of the IAA (OECD, 2016).

### 3. INDEPENDENCE: POWER OR DUTY?

We will now focus on the adjective “independent”, which is in the name of these Authorities and whose scope and interpretation seem to be at the core of the combination between these authorities and the institutions supporting modern democratic societies.

Having already established that, from the perspective of the dynamic construction of a democracy, regulation has a role in that construction, it is important to discuss whether the reasons listed for its existence and its usefulness might become reasons against its existence, if those requirements are not met or if its procedural construction is incorrect or insufficient.

We consider that the biggest danger lies in the interpretation and use (rather, abuse) of the concept of “independence”.

First of all, independence cannot mean anonymity, silence, or being above the organization of the State, since the actions of an IAA requires a constant interaction with state sovereign bodies, regulated economic agents, citizens (the ultimate beneficiaries of its actions) and all other stakeholders (OECD, 2016; Tirole, 2016). Moreover, this independence must be necessarily limited by its mandate, conflict of interest resolution mechanisms and the supervisory power of state sovereign bodies (Tirole, 2016).

Noteworthy is the reference to the speech given by Cathryn Ross, then Chief Executive of OFWAT, at the 2016 RPI Annual Westminster Conference, with the title “The purpose and functions of economic regulation”, in which she started by clarifying what is meant by “independent economic regulation”. It is important to point out that our concern with independence is not restricted to economic regulation but to all types of regulation, as evidenced in our rationale. Ross starts with an interesting phrase: “Independence: Yes, but it is not a vacuum”. It is true that she immediately focuses on independent economic regulation, considering that there lies a paradox: “Regulation exists because the sectors they regulate matter – not only to their customers, but also to our economy and society more widely”, adding that “The political salience of sectors we regulate mean it shouldn’t be surprising when politicians take a keen interest” (p. 2).

Both observations, though in different contexts, place regulation and its action in the field of politics, as they should, thus making the need for legitimacy important.

It also raises another issue, in the specific level of Economics: is economic regulation (and should it be?) a sectoral regulation? Or is it, in terms of a global response to society, which is also a stakeholder, an integrated regulation? And how can we separate it from governmental politics?

These issues should be discussed, and we will return to them later.

Let us then go back to the potential issue of the “distortion” of independence. Here, Ross fills that “vacuum” she referred to in the beginning when she recognised “our legitimacy underpins our independence...”, adding that “I think our legitimacy is closely linked to our accountability” and concluding with a careful “broad accountability”. That is, “accountability” is not only for stakeholders (and here there is already a generalization in view of “classical” regulation) of the regulated sector, but to society in general, being “judged” for all the consequences that derive from that regulation, at the risk of accountability in political terms and in terms of supervision, whose functions remain not entirely separate from regulation. In fact, this confusion is increased by the fact that there are several IAA with both functions.

Noteworthy is to ensure that “independence” is not misused. But how can we ensure that its compositional structure and its behaviour is compliant?

As Ross states, the regulator is accountable, not only before regulated companies and their consumers, but also before a wide range of stakeholders, investors, NGOs, and, this being a key, “how externalities, such as environment impacts are dealt with”.

This is obviously another challenge to clarify the possible or preferable scope of economic regulation adoption.

This concern with accountability is similar to Rosavallon’s question (p. 259): “*Qui gardera les gardiens?*”, a question everyone asks, especially in view of a misunderstood status of independence.

In any case, Tirole (2016) suggests that the legislative (parliamentary) qualified majority should have the power to suspend IAA leaders, not based on specific, politically sensitive decisions but based on the overall behaviour of these authorities. Without questioning the legitimacy of action of elected political bodies (mandated to govern the State), the issue lies in establishing the limit between a globally negative assessment of a regulator because it does not comply with the competences of its mandate, does not deliver the expected results to society, and a negative assessment that results from dissonance between what the political decision would be and the regulator’s technocratic decision.

It is important to realize that it is exactly because those decisions tend to be different in specific moments and considering (with due distancing) that the decision taken by the technocrats are more correct, that is at the basis of creating the IAA; therefore, the tension between political power and the IAA is natural and inevitable. Moreover, there tends to exist greater hostility from political power towards the IAA in certain stages of the electoral cycle, hostility that is easily followed by voters, given the referred limitations to assessing the regulator’s action (Tirole, 2016).

We acknowledge that the issue will remain unresolved and this is not the place to discuss it further. As Rosavallon said “*Elle n’a pas de solution logique et soulève les mêmes difficultés formelles que la notion d’auto-fondation*” (p. 259).

For now let us express agreement to Constant (1991): “*On ne peut donner une garantie à la garantie elle-même*”.<sup>6</sup>

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<sup>6</sup> Cap. XV, Des garanties contre les abus du pouvoir préservateur (Constant, 1991). See Rosavallon, p. 260.

This is an issue that derives from the binomial independence/accountability and that is difficult or impossible to resolve; a binomial which political science can and should always consider in its quest to improve the dynamic democratic process.

It is true that the several conditions listed in the literature to “balance” that binomial must include a transparency in its action in which all stakeholders and society in general see the action as being in conformity with those conditions, which requires ethically irreproachable behaviour from the institution and, as a consequence, will lead to society’s trust in it.

This trust, from our perspective, is a necessary condition for the legitimacy of the regulator’s action, which must be kept and conquered again at every new action.

However, if the regulator does not have that behaviour but does not break any law or regulation, is it possible to question the existence of an Independent Authority?

In a specific study on airport regulation in the United Kingdom, and in face of a group of tests he considered might question the quality of that regulation, though the regulator had not considered it as such, Littlechild (2018) stated: “This is not surprising: regulators commonly have difficulty in conceiving that their services might not be needed”. The author goes further, suggesting that this assessment should be extended to other regulated sectors to avoid over-regulation. Tucker (2018) also draws attention to the risk of over-regulation through super-powerful non-elected citizens.

Noteworthy here is to again mention Rosanvallon, who contributed to defining the scope of independence, which is referred in his texts as a requirement for impartiality in the regulator’s decision. And you cannot be impartial if you depend on one of the parties!

Rosanvallon sums up what being independent entails in a sentence (p. 149): “Les membres de tels organismes peuvent même considérer qu’ils ont un “devoir d’ingratitude”, ... pour être à la hauteur de leur tâche. C’est une situation aux antipodes de celle de l’ élu...”.

The author draws the attention to impartiality, which is a quality and not a statute, it must be constantly built and validated (p. 152). He emphasizes that this validation is based not only on the IAA composition but also on its collegiality and, in particular on its decision-making processes.

From our own experience, the effect of collegiality, one primarily based on difference<sup>7</sup> rather than homogeneity in skills and in background knowledge, is key to impartial, reflected decision-making.

On the other hand, it is crucial to resort to public consultation on regulatory decisions, previously submitting the draft decision and its grounds to public scrutiny in a document that describes “the probable decision”. This document that is made available for public consultation should be written after collection and analysis of data, collected in proximity, duly reflected by the IAA’s services that process them and approved (with impartiality) by the decision-making body. At a later stage, the final decision should be published with a report on the referred consultation and an analysis of all contributions.

It is important to ensure free participation of each individual and group, and the current communication means may improve that. The regulator should take all contributions into account for its final decision.

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<sup>7</sup> Rosanvallon (p. 149) refers that “La diversité corporative est souvent plus important qu’une simple compétence pour prendre une bonne décision”, and even claims that, as a consequence, the Independent Administrative Authorities have an advantage over the common ruler decision-maker.

Collegiality has a key role here, since, as Rosanvallon states, the instances of regulation are not what he calls “congrès d’ambassadeurs!”, but “réunions de personnes sans mandat”, in which members have equal voice and are recognised by the others as competent, thus creating a type of “collective intelligence” due to the rational conditions of a “délibération rationnelle” (p. 148).

The IAA decision-making process is therefore a critical element to its balanced independence, which may condition the regulator’s own existence due to it not being needed any more, as suggested by Littlechild (2018). This careful consideration of the extension of regulatory activity is evident in Khan’s (1981) words “If I were asked to offer one single piece of advice to would-be regulators, on the basis of my own experience, it is that as they perform their every single regulatory action they ask themselves: «Why am doing this? Is it really necessary? »”, which shows extreme care in not abusing the independence that is especially awarded to the IAA.

#### 4. WHICH GOVERNANCE STRUCTURE FOR REGULATION?

For now, we will not discuss the issue of continuity for regulation institutions but rather focus on an issue prior to the current challenges to economic regulation, an issue raised by the high geographical and interdisciplinary inter-penetration of economic decisions as referred above by Ross. In fact, since economic decisions have relevant environmental and social consequences, and given the possible inequality of income and living conditions at national level and in comparison, with other countries also heavily influenced by the current financial (supervisory and regulatory) conditions, does it still make sense to have an autonomous economic regulation in other fields, for example, in the environmental and financial fields?

And does it make sense that there are environmental and financial regulations separate from economic regulation?

These are political economy issues, or economic policy issues, quoting Frieder (2020) once more, i.e., an issue regarding the position of regulatory bodies in the general context of the government. But which government: the national government or the European one (in the case of Portugal)?

In regard to this last question, and in theoretical terms, the principle of subsidiarity will allow for resolving the conflict, but the first issue remains.

This is an open question, even in the name given to regulatory authorities, whose name, in general, includes the word “Authority”. The concept of Authority implies<sup>8</sup> “the power to make decisions/ the right to command and control other people/ quality (...) that someone has that causes other people to obey them”.

This description evidences the potential clash with the executive power, or even with the legislative power, showing the double legitimacy Rosanvallon mentions.

Hence, the issue is more an issue of State organization than that of “governance structure for regulation”, which cannot be discussed without first referring to that issue. That

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<sup>8</sup> Collins Cobuild, Collins Birmingham University English Language Dictionary, London, 1987, p. 84.

is a core issue in Political Science, evidencing that the issues on the support for regulation, supervision, among others, remain because they have not been sufficiently studied.

Though this is not a topic for our paper, we must point out that the basic conditions for economic regulation are relevant and must not be forgotten.

Considering that these will be discussed, and scenarios will be created that allow for adequate economic regulation framing, the discussion on the future of sectoral regulation implies a prior choice (also dynamically open to change) between specific sectoral autonomy and, alternatively, the integration in a more global institution with sectoral specificities but whose decisions are integrated decisions. Keeping the sectoral regulators independent in terms of sectors require appropriate coordinated decisions in areas that are clearly connected.

In this respect, it is especially important the role that Competition Authorities have, which, in the more classical perspective, is still almost exclusively *ex post*, making the relations with sectoral Authorities more difficult, especially when regulating and supervisory accountabilities intermingle, as was the case of the failed SONAE's takeover on Portugal Telecom.

Considering the characteristics that legitimize the Regulator, which we have already mentioned, it seems clear that the emergence of the behaviour of economic agents in the way markets function drives the debate to the regulatory process itself. In fact, it has become a compulsory reference for the governance model, namely when taking into consideration the reaction of economic agents to fast changes.

In fact, this optimization of the regulatory procedure will be key to better reconcile this "independent power" with political power, because it will make it more visible to society the possible merits of the existence of independent regulators.

The urgent debate between (sectoral) regulation *ex ante* and (competition) regulation *ex post* becomes especially relevant. There is a growing trend to migrate from the first to the second approach.

Its seminal (and still decisive) role in the field of economic regulation is clearly evidenced by Littlechild (2018) in the abstract of his paper: "Regulators are often required to assess the extent of competition in a market and to promote competition or a substitute of it...".

This statement implicitly reflects that competition is the final (sometimes the initial) objective of economic regulation, at least in most situations in which regulation is required. Obviously, this presupposes that there is no specific regulation in a market<sup>9</sup> where there is competition.

Therefore, an efficient regulation, together with basic favourable conditions, may lead to the loss of the object of regulation and, consequently, determine that the regulator (because it is no longer necessary) is eliminated in that specific market or, more commonly, of several markets, given the restrictive (and controversial) definitions of market that regulators commonly use. This means that an efficient regulator may "commit suicide" as a body, which may lead to the issue of "distortion" referred to by Littlechild (2018), when he states that regulators tend to not recognise their uselessness.

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<sup>9</sup> It is increasingly harder to define a market, both in terms of geography and product, i.e., neglecting other basic conditions of supply and demand!

On the other hand, the Authority that decides whether there is competition is the Competition Authority, which, in this sense, assesses the activity of the sectoral Regulator. But where are its capacity and legitimacy to do that?

A statement by Littlechild is crucial here, as the author questions the model of perfect competition as a reference and adds that: “Interpreting competition as a rivalrous discovery process calls for lighter handed regulation”.

To consider competition as a dynamic process rather than an equilibrium, in which market agents continuously try to adapt to change, or even add more advantages through changes strategically introduced, may jeopardize the “classical” binary view of regulation: *ex ante* vs. *ex post*

We fall into the “soft regulation”, a field which has not only the role of behavioural economics underlying but also those of technological development and relevant aspects of social organization that the more classical paradigm of competition clearly forgets and that most university syllabus also neglect.

Noteworthy is this context is to emphasize that the dynamic perspective of the market is closely linked to the substitution of market concentration (both of supply and of the dangerous and sometimes neglected demand), a clearly structural variable, if seen from a statistical point of view, but whose development analysis may lead to a dynamic perspective, the valuing of entry barriers, with the seminal appearance of the concept of contestable market, and with it, the concept of potential competition. A contestable market is one where there are not barriers to entry and to exit, a key and rather forgotten feature (Baumol and Willig, 1981).

In this type of market, the structure (measured by concentration, for example) will not be an obstacle to competition, though here, for the concept to be effective, rather than perfect information, the required is information symmetry (or little asymmetry) so that new competitors enter the market (Baumol et al., 1988).

In terms of dynamics and of a closer link with the actual functioning of markets, the requirement that no entry and exit barriers exist can (and should) be replaced by the possibility of “low” barriers (meaning, that can be easily overcome), very similar to an earlier perspective, by Clark (1961), who proposed the concept of “workable competition”, which later led to the dynamic perspective on competition.

In fact, Clark (1963), though he advocated the dynamic vision, considers it still imperfect, since, as it consists in identifying the development trajectories which clearly do not tend to have static, full and definable equilibrium, it does not have to be limited to examining the discrepancies between the real values and static level, but impose (p. 225) a normative change. But his contribution goes much further (Silva, 1991) as he considers the static theory, used as an irrefutable norm, as a theory of irresponsibility, ignoring social responsibilities, because society is not merely the result of a mechanical sum of independent results. And he refers with astonishment the position of people who shows social commitment, leaving out this concern in economics, claiming “business is business”.

So, we can see that Littlechild’s position has historical grounds, almost a century old, introducing economy’s social accountability and the ethical obligation that economic agents must take on that accountability. The role of the behaviour of economic agents is made evident here, as well as the ethical principles guiding that behaviour. Isn’t it this paradigm that appears, either in the context of the UN Sustainable Development Goals (SDO) or

especially in a concept that is emerging and has gained relevance – ESG Environment, Social, Governance – as a reference to the functioning of economy and to company behaviour, and in particular, of their managers?

Why have the ideas of some authors not become relevant, authors with continuous, deep and differentiated approaches in the context of economy's historical development and companies' organization? Is this not the reason behind the current profound inequality in living conditions and income, perhaps even behind environmental degradation?

Yet would the world have otherwise reached this level of production and product and service diversity available today? But at what price?

And today, can the “regulatory system” that Barak Obama speaks about or the “oversight” Littlechild (2018) mentions overlook these issues?

Regulation should also be discussed in this context, setting aside assumptions that development eliminates, with not always desirable consequences, at least in the long run.

Laffont and Tirole (2000) do discuss the topic from the traditional “internal” logic of economic regulation, confronting regulation with anti-trust policy, and refer that, in dealing with this confrontation, they feel that “competition policy should be given a more prominent role in the overall process”.

And though they opt for complementariness rather than incompatibility of “anti-trust enforcement and regulation”, they recognise that “their coexistence may jeopardize the coherency of the oversight institution”.

This concern leads us to a different debate that does not question the existing types of economic regulation, but rather which type of institution should implement those actions, one (regulation) linked to ex ante decisions and the other (anti-trust) linked to ex post decisions.

Though there is the concern to further the conditions and governance of good regulation (in the general sense) in the field they call “industry”, it is clear that the question does not include any concern with the democratic legitimacy of regulation but rather with the best way to exercise the regulation.

The subliminal question regarding the relation between sectoral regulation and competition regulation is the argument that the former should disappear when markets are already competing. Overlooking the issue of finding the criteria to verify that existence, which marks the transition from an ex ante to an ex post regulation, you can even question, as others have hypothesized, that the rapid change in the basic conditions of supply, and even of demand, will lead to a dynamic that will create a market that is dynamic in terms of competition, thus making ex ante regulation not relevant, at least one with the characteristics and the more classical regulation procedures.

As mentioned in a document published by Delloite University Press (see footnote 2), in the section entitled “It's tough to be a regulator today”, namely on the argument that ex ante regulation may hinder innovation, they mention five trends to assess that discussion: an exponential technological change, the emergence of new business models, the decrease in entrance barriers in supply and demand that new technologies provide, what they call “The ‘ignore until large’ phenomenon” (which ignores the principle of incipience) and the birth and death of negotiating ecosystems.

## 5. THE TRIANGLE AT THE BASIS OF INDEPENDENT REGULATION AND SOME FINAL REMARKS

Since we have already discussed the issue of legitimacy, the implications of independence and the changes in the scope of (economic) regulation, it is time to focus on the conditions that may support independent regulators.

As made evident, there are conditions linked to the appointment of regulators - among personalities acknowledged for their competence, involving more than one state authority, imposing periods of mourning, individual, long and lagged mandates - to how regulators work - requiring collegiality, transparent and participated decisions, types of relation with political power and other authorities, compliance with the inevitable principle of legality within the mandate appointed by the state authorities - to conditions for operational, administrative and financial autonomy - requiring autonomous funding from the State Budget, the ability to select human resources with the adequate skills and general management authority - to the clarity in regards to the mandate - defining clearly the objectives of the policy, the degree of freedom of decision and the separation between regulatory (independent) decisions and assistance to political power - and lastly, to accountability - before the citizens, the economic agents of the regulated field, the executive power and the legislative power (OECD, 2016).

In our opinion, all of these conditions may be grouped into two main ones:

Firstly, the “Transparency and Participation” condition regarding their decisions, which is a counterpart of the independence, since there is no control mechanism that citizens can use in the democratic delegation process, which exists in the case of elected political power. This condition, considered in its general sense, encompasses all the duty of traceability in the decision-making process and in compliance with administrative procedures, taken to a much higher level than what is in place for elected political decision-makers, but which in these cases, needs not be as demanding because there is the referred control mechanism of the decisions of the mentioned political decision-makers.

Secondly, the condition “Adequate Resources”, so that the decisions made by the regulators may be made with competence and impartiality; this includes material, financial and human resources, as well as all conditions for selecting, recruiting, appointing and retaining human resources, a key condition for the activity of the IAA. This is an indispensable condition for independence, as well as for recognition and credibility before all stakeholders, also a condition for the legitimization of these bodies.

However, even when these (1) functional and (2) institutional conditions are met, you cannot exclude the possibility that the regulator behaves in a deviant manner, which leads us back to the question: who controls the regulators?

It is true that the conditions for transparency and participation already allow for a decentralized control by all stakeholders, as well as, together with the adequate resource conditions, for decreasing the risk of that type of behaviour. However, it is also true that separation between the regulator's abusive decision and its legitimate decision is not always evident. This legitimate decision is different from the correct decision as viewed by the citizens and by political power, in particular when the political power behaves according to short-term interests, or even media-shaped public opinion, not having the courage to sacrifice political careers to take responsibility for unpopular decisions, as stated by Tirole (2016).

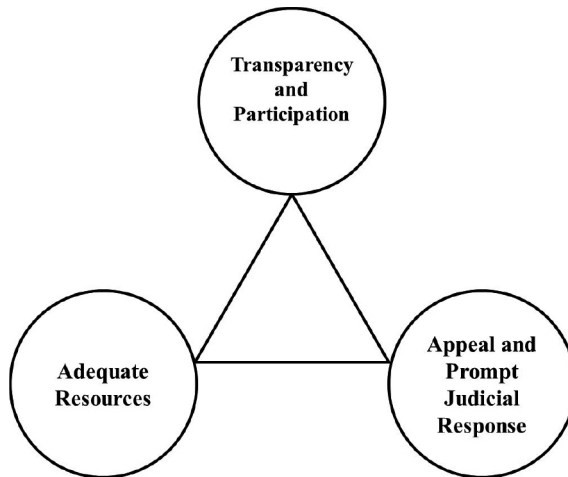
Thus, we believe it is crucial to add one additional condition to support for an independent regulator (more) compatible with the administrative structure of modern societies' democratic governments.

We remind the idea that a regulator cannot be someone anonymous, silent and above the system. We also note the systematic use of judges' independence requirement as one of the cornerstones of non-elect State power.

Thus, we consider that a third condition for "Appeal and Prompt Judicial Response", on the decisions of independent regulators whenever a stakeholder believes there has been deviant behaviour, together with transparency and participation, and adequate resources, would be a third apex of a triangle supporting independent regulation without compromising the triangle of the separation of powers, which emerged with the French revolution.

We suggest that a third triangle be added to the two proposed by Tucker (2018) which structured the thought on modern constitutional states – Democracy/Rule of Law/Efficient Governance (Figure 1) and separation of powers Legislative $\Delta$ Judicial $\Delta$ Executive (Figure 2) – in order to avoid the squaring of the latter triangle forced by the proliferation of IAA in "modern States". This third triangle (Figure 3) is crucial to the support of these Authorities– Transparency and Participation $\Delta$ Adequate Resources $\Delta$ Appeal and Prompt Judicial Response.

Figure 3: Triangle of Independent Regulation



This Judicial response, of appeal, should not focus primarily on the substance of the regulator's decision, but above all on the compliance to the requirements for grounds, transparency, participation, procedure and pondering in the decision-making process. Obviously, this requires resorting to experts on the matters in question and to comparison with comparable decisions by other regulators. However, to consider the multiple and legitimate interests at play could lead the judge to becoming a political decider, thus distorting the reasons for including the IAA in State administrative organization.

Probably, this concern explains why legislators in several democratic states have created courts specialized in Regulation and Competition, which will be able to respond (more) promptly to (technically complex) appeals on the decisions by independent regulators.

Unfortunately, perhaps due to lack of understanding the role these courts have, their scope of action has not always been defined so as to encompass basic regulating decisions. This is the case of Portugal, in which the action of this court is restricted to penalty matters while the actual decisions on regulation are the responsibility of administrative courts.

We believe that the failure of this apex of the triangle compromises the whole structure of the IAA within the framework of State governance.

If we add failures in the other apexes, for example, failures due to the conditioning of resources imposed by political power and by IAA's deviant behaviour, and the hostile, populist and easy criticism by specific social actors often motivated by political agendas, namely political power itself, tarnishing the prestige and credibility of regulators - you can question if maintaining these Authorities in State organization still makes sense.

The flaw of any piece of the puzzle clouds the image and may even compromise the perception others have of the IAA.

We aim in this study to have contributed to raising awareness towards the need of continuing to analyse the grounds, critical thinking, and explanation of the IAA, following Tirole's suggestion in one of the sub-chapters of his 2016 book: "Explain, Don't Complain."<sup>10</sup>

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<sup>10</sup> English version, published in 2017, of the original words "Un peu de pédagogie..."

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