

## *Chapter 2*

### **Rationale: When and why is independence necessary and why is this guidance needed**

*This chapter provides an overview of when independence may be necessary and factors to consider in creating an independent and structurally separate regulatory body. It also discusses OECD data on the independence of regulators.*

According to the 2012 OECD *Recommendation of the Council on Regulatory Policy and Governance*, independent regulatory agencies should be considered where:

1. there is a need for the regulator to be seen as independent from politicians, government and regulated entities, to maintain public confidence in the objectivity and impartiality of decisions and effective operation for trust in the market;
2. both government and non-government entities are regulated under the same framework and competitive neutrality is therefore required; or
3. the decisions of the regulator can have significant impact on particular interests and there is a need to protect its impartiality.

Table 2.1. **Factors to consider in creating an independent and structurally separate regulatory body**

Factor	Description
Credible commitments over the long term	Establishing a more independent regulator can send an important message to regulated entities about the commitment of government to objective and transparent administration and enforcement of regulation.
Stability	Greater distance from political influences is more likely to result in consistent and predictable regulatory decision-making.
Addressing potential conflicts of interest	Regulatory decisions that have significant flow-on impacts for government, e.g. on budgets or service delivery, or that must be seen to be applied impartially to both government and non-government entities may be better made by entities at arm's length from ministers and ministries.
Development of regulatory expertise	Where there is a need for specialist regulator expertise, which is best maintained in a specialist unit with quarantined resources.

Source: OECD (2014), *The Governance of Regulators*, OECD Best Practice Principles for Regulatory Policy, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264209015-en>.

Other factors to consider in creating an independent regulatory body are summarised in Table 2.1 above, highlighting when and how the creation of an independent regulator presents clear advantages. For example, independence of regulators contributes to the credibility and stability of the regulatory regime. The protection of regulatory decisions from the perception of political influence also enhances trust in the regulator and its decisions. There are different models for independent regulators which could be entirely separate from governments or maintain some institutional

links with a ministry or the executive. These different models can also reflect differences in administrative and institutional contexts. The key determining factor is ultimately the *capacity and capability of the regulator to act independently* within these different models.

### Box 2.1. OECD data and evidence on the independence of regulators

In an effort to better understand what is required for a regulator to be considered independent, the OECD included in 2013 for the first time indicators linked to the independence of regulators in its Product Market Regulation (PMR) database. The PMR Indicators are mostly linked to considerations of *de jure* independence and suggest that there could be some gaps between formal and informal arrangements of independence. The PMR indicators on the management practices will be updated regularly to take into consideration the evolution of the regulators' arrangements and reflect improvements in the methodology. PMR indicators can be accessed at:

[www.oecd.org/economy/growth/indicatorsofproductmarketregulationhomepage.htm](http://www.oecd.org/economy/growth/indicatorsofproductmarketregulationhomepage.htm).

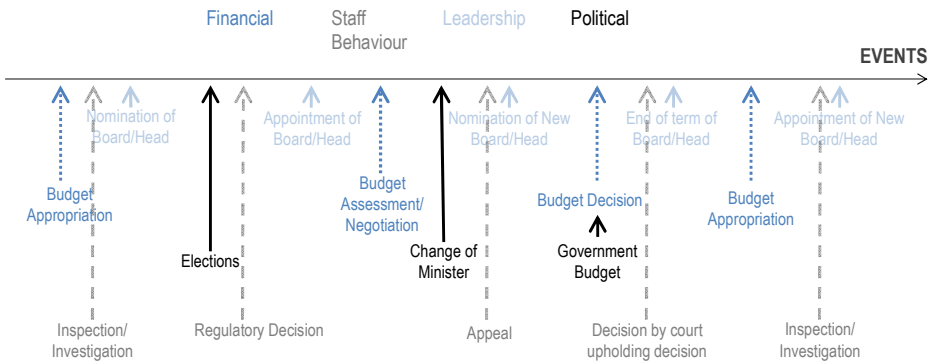
To complement this set of data, further information and experiences have been collected through a survey of 48 regulators across different sectors and 26 countries (OECD and non-OECD), within the work of OECD Network of Economic Regulators (NER). Analysis of the survey data is published in the report *Being an independent regulator* (OECD, 2016a) and provides unique insights into the combined facets of both *de facto* and *de jure* arrangements that impact on the independence of regulatory agencies. For example, the report shows that 88% of the regulators surveyed that receive their funding from the executive are subject to annual rather than multi-annual budget allocations (OECD, 2016a: 79-83). This financial dependence may have an impact on the organisational behaviour and decision making of the regulator.

The report also found that a search committee is used when hiring a new Chair only in the case of eight regulators, with nominations made either by a selection committee composed of the executive, the regulator and experts, or by an external selection panel. In most other cases, the executive nominates the board members. The executive is also ultimately responsible for appointing the board/head for most regulators. In 15% of cases, the appointment is made by parliament (OECD, 2016a: 75-76). Also, almost 50% of the regulators place no restrictions on pre- or post-employment of professional staff. This opens the risk of “revolving doors” and conflicts of interest with industry (OECD, 2016a: 72-73). And only a quarter of the regulators are given a public or formal government statement of expectations, which in addition to a clear definition of regulator role in legislation, can be useful to clarify goals and activities and for accountability and building trust in the regulatory governance of the sector (OECD, 2016a: 53-56).

*Source:* Koske, I. et al. (2016), “Regulatory management practices in OECD countries”, *OECD Economics Department Working Papers*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/5jm0qwm7825h-en>; OECD (2016a), *Being an Independent Regulator*, The Governance of Regulators, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264255401-en>.

How then is this independence established and implemented? *De jure* independence refers to the grounding of a regulator’s independence in law. The extent to which the legislation that establishes and governs the regulator protects its independence is often measured by looking at provisions on budgetary independence, the conditions and process for the appointment and dismissal of the members or head of the regulatory agency, accountability and reporting to the executive, legislature or representatives from regulated industry, as well as whether the executive withholds powers to set tariffs or prices and review or approve contract terms with the regulated entities. These provisions are necessary to formally protect a regulator’s structural independence as they create formal safeguards against undue influence and help prevent attempts to exercise undue control, curtail the roles and responsibilities of the regulator or intervene in exclusive areas of responsibility for the regulator. However, these provisions alone are not sufficient to set up and to preserve safeguards against undue influence in the regulator’s day to day work. The practical implications of formal independence or how it is translated into *de facto* independence in the actions, decisions and behaviour of a regulator are more complex to identify and define.

Figure 2.1. Pinch points: potential entry points for undue influence



Source: Below, B. et al. (2016), “Rara avis? Searching for regulatory independence in its natural habitat”, [www.oecd.org/gov/regulatory-policy/independence-of-regulators.htm](http://www.oecd.org/gov/regulatory-policy/independence-of-regulators.htm) (accessed 21 March 2017).

The task of mapping the different dimensions of independence – and protecting them – is further complicated by the fact that independence is never a foregone conclusion or “done deal”. It is not a static characteristic acquired once and for all, but rather one that is continually under stress. Engagement with stakeholders is an important element of the regulator’s

legitimacy, but it also offers opportunities for undue influence, which evolve along the life of the regulator or throughout the different phases of the regulatory cycle. Some of these “pinch points” where there might be potential for greater undue influence include agency finances, staff behaviour, the appointment and removal of leadership, and how the agency intersects with political cycles (Figure 2.1). In order to navigate these powerful headwinds, regulatory agencies need to build and sustain a strong and institutionally proactive *culture of independence* that will inform their daily practice and behaviour. This guidance points to institutional and practical measures that would contribute to such a culture of independence.



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