How do we Regulate the Regulator?

Recent events in the United States challenge the notion of regulatory independence. For example, Florida Governor Crist attempted to direct Florida Public Service Commission decisions on electric pricing and renewable energy. In Illinois, former Governor Blagojevich pressured a chairman of the Illinois Commerce Commission into resigning. The Maryland legislature's disbanding of the Maryland Public Service Commission over the governor's veto is a case study in political interests trumping good government.

These are troubling scenes for a country often credited with developing the notion of an independent utility regulator. Perhaps the problem is that politics has a diminished regard for government. Indeed the awkward relationship between politics and government is why independent regulatory agencies were developed in the first place - namely that long term infrastructure investments are lacking when political interests can behave opportunistically, that the necessary interdependence of utilities and government easily leads to corruption, and that political actors lack the technical expertise to effectively regulate complex enterprises.

Perhaps we have just forgotten how to regulate regulators. Regulatory independence is really about regulatory governance, which defines lines of authority, accountability, and communication involving four main bodies: citizens, regulatory agencies, service providers, and courts.

The line of authority runs from the citizens of the country, who are represented in this process by policymakers - legislatures, governors, and the like - down through the regulators and stops at the service providers. The policymakers' primary functions include understanding and representing citizens' interests, designing a regulatory system to address those interests, and reflecting on outcomes to determine whether the system is working. Given these policymaker actions, regulators make decisions regarding prices, quality, market structure, and incentives. Then, given the regulators' decisions, the service providers determine how to provide service. The courts intervene to ensure that rules and laws are properly understood and followed.

Accountability runs in the opposite direction of authority. Service providers are held accountable by regulators, who monitor efficiency, service availability and quality, innovation, and the like. The regulator is held accountable by the policymakers for service affordability, availability, etc. Note the alignment between authority and accountability: The policymakers' functions do not include the work of making outcomes happen, for example, by deciding investment, prices, technologies, etc. This is for good reason: If we hold operators and regulators accountable for outcomes, we must also allow them the authority to decide how the outcomes are accomplished.

Communication runs in both directions to provide direction and feedback. The lines of communication should be respected. It is tempting for stakeholders to engage in forum shopping, bypassing the regulator or maybe encouraging the regulator to play the role of
policymaker. Exceptions can be acceptable, but when they become the norm, the lines of authority and accountability break down.

What's to be done? Education is important. Policymakers, regulators and operators need to understand the consequences of stepping outside their roles. The political uncertainty surrounding one politician’s interference in the regulatory process apparently led to the cancelation of millions of dollars of infrastructure projects and the loss of jobs.

Clarifying roles is also important. There are few well-designed forums for policymakers and regulators to discuss outcomes and assess how the system could be improved. Perhaps a state should develop an experiment in which laws do more than establish and direct the regulator, but also define the forum for policymakers to reflect, hold regulators accountable, and improve transparency for policy deliberations.