Independent economic regulation: A reassessment of its role in sustainable development

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Received 6 March 2007; received in revised form 30 May 2007; accepted 3 June 2007

Abstract

The established ‘standard’ model of economic regulation is characterised by independent economic regulators undertaking specialised tasks. There is a clear perception that the roles and responsibilities of regulators are and should be reduced to the execution of the core function, i.e. economic regulation. We argue that this needs to be reassessed in the context of sustainable development in which the integration of economic, social and environmental policy objectives are fundamental. The established model is particularly confronted by problems of regulatory policy indivisibility (social, economic and environmental matters are intertwined at technical levels) and information asymmetry (regulators often have more knowledge of environmental and social effects of economic regulation than government). We propose a ‘revised standard’ model in which economic regulators are more clearly integrated into the regulatory state’s system of governance. Economic regulators retain their independent core specialism but at the same time are encouraged to use their knowledge and expertise to address the social and environmental implications of their core decisions. This is achieved not by extending their decision making powers but by encouraging and facilitating a direct engagement by regulators with the appropriate public authorities on social and environmental decision making. The onus is not only on regulators to engage but also on government which should welcome and encourage such engagement. Although there is some evidence in Britain that the model reflects actual practice, it needs to be more deeply and widely embedded and institutionalised. This can be achieved by high level governmental commitment including specification in sustainable development strategies and principles of good regulation.

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Keywords: Utility regulation; Sustainable development; Regulatory governance

1. Introduction

The need for modern industrial society to be sustainable is widely recognised. The notion of ‘sustainable development’ has wide currency and its promotion is high on the agenda of many governments, governmental and non-governmental organisations. A whole raft of institutions, policy ideas, programmes and instruments have been established and are in force; many more have been conceived and are on policy agendas. ‘Policy integration’, that is the integration of economic, environmental and social ‘pillars’, is fundamental to sustainable development (OECD, 2002a, p. 10). Sectors such as energy, transport and water have a substantial impact on the environment and provide socially important services. Economic regulators have become established as leading public bodies in the governance of these sectors and their activities impact substantially on sustainable development. It would seem therefore that policy integration has to apply to the work of the regulators.

A ‘standard’ model of economic regulation characterised by specialisation and independence has become established. There is a clear perception that the model stresses above all the reduction of the roles and responsibilities of economic regulators to a single and separable specialised core task, i.e. economic regulation (the control of monopoly power and the promotion of competition) and its independent execution. Central questions of this
paper therefore are: should independent economic regulators strive to integrate economic, environmental and social objectives in order to contribute to sustainable development, and if so how?

This has been prompted by a new policy in Britain: a statutory duty on the energy, water and rail regulators to contribute to the achievement of sustainable development.1 There have been increasing concerns about sustainable development generally, notably climate change and, in the sectors, increasing action by the regulators on environmental and social matters (Owen, 2004; Owen, 2006). The pressure for the duty arose from concerns that the economic regulators were excessively focused on the control of monopoly power, the development of competitive markets and lower prices which can clash with sustainable development objectives, notably environmental protection. Owen, 2006 argues that, although economic objectives have been prioritised, there have been social and environmental objectives since the inception of modern utility regulation in Britain (in the 1980s). If legitimate social and environmental objectives are to be achieved the implementation of economic regulation must be seen in the context of these objectives and a sustainable development duty is appropriate.

The literature on policy integration focuses primarily on the extent to which it has been part of governmental agendas and how it can be achieved in specific circumstances (OECD, 2002a). However, as Lafferty and Hovden, 2003 note, much of the literature does not explore the concept in depth and assumes that policy integration is primarily about ‘balancing’ the three pillars in decision making processes. They explore the concept more extensively and distinguish three key features of policy integration: comprehensiveness, aggregation and consistency (Lafferty and Hovden, 2003, p. 8).

Comprehensiveness means ‘the incorporation of environmental objectives into all stages of policy making in non-environmental policy sectors’ and implies that policy integration applies to all units and activities of public administration, not just the top level (Lafferty and Hovden, 2003). This can mean big changes as decision-making in many lower level administrative units is often based primarily on economic rationales and sometimes governmental rules exclude decision-making based on any other reasoning (Rao, 2000, p. 349). Aggregation and consistency involve ‘an attempt to aggregate presumed environmental consequences into an overall evaluation of policy, and a commitment to minimise contradictions between environmental and sectoral policies by giving principled priority to the former over the latter’ (Lafferty and Hovden, 2003, p. 9). Rather than balancing environmental objectives with others, priority should be given when nature’s limits have been reached and ‘potentially irreversible damage to life-support systems’ is being faced (Lafferty and Hovden, 2003, p. 10).

The application of policy integration to all stages of policy making implies that economic regulators should also engage with policy integration for sustainable development and that a statutory duty appears to be an appropriate way to require them to do it. However, much of the literature on economic regulation and the modern state suggests that there is a problem in expecting policy integration to be directly addressed by the economic regulators.

Policy separation, functional and sectoral specialisation are fundamental to the modern regulatory state and the creation of independent regulators and have added to the policy separation intrinsic to the departmentalisation of government (Kavanagh and Richards, 2001). The parallel rise in executive agencies is also perceived to add to policy fragmentation (Talbot, 2004, p. 4). In the ‘standard’ model of economic regulation specialist and independent economic regulators focus primarily on economic regulation (monopoly and promotion of competition). Independent regulatory agencies have a degree of discretion and there are mechanisms by which government and legislators can control agencies (Knott and Hammond, 2003, pp. 143–144). The new duty of sustainable development presents particular problems of agency discretion. Just what are agencies expected to do and how should they respond? Duties placed on agencies can help set boundaries but they are not always clear, there is often much space for discretion (Graham, 2000). Agencies might not always have the means or will to establish priorities to make bold initiatives. New requirements can provide ‘opportunities and headaches’ for regulatory agencies; there are opportunities to develop new ideas and approaches but how should they behave with a new concept on the horizon? (O’Riordan and Voisey, 1998, p. 37). All of this creates difficulties in setting priorities, a fundamental aspect of policy integration; economic, environmental and social objectives can and often do clash and trade-offs are required.

A ‘top-down’ notion of policy integration can be conceived which would not involve economic regulators directly engaging with sustainable development. Regulators operate within constraints set by government or other agencies (e.g. taxes, emissions trading quotas, subsidies for sustainability and poverty policy). Establishing priorities, such as the necessary environmental constraints on human activity, setting parameters and trade-offs, are inherently political matters and are made by democratically elected politicians in government rather than technocratic regulators. Within this standard model of economic regulation, objectives other than economic are not the responsibility of the economic regulator and a statutory duty to contribute to the achievement of sustainable development does not seem appropriate.

We argue that this top-down policy integration is not sufficient to enable effective policy integration of social,
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