

POLICY PAPER

Economic Regulation: Recentralisation of Power or Improved Quality of Regulation?

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Abstract: The October 2009 *Government Statement on Economic Regulation* proposes a number of sensible reforms that are likely to improve regulatory performance in energy, airports, telecommunications, postal services and transport. However, the Government Statement also proposes to reduce the independence of regulators by holding them to account through a whole series of additional mechanisms, some of which are informal and lack transparency, while at the same time instructing regulators to take into account evolving/current – possible transient – priorities. There are good reasons for preserving and strengthening rather than undermining regulatory independence. For example, it facilitates investment in long-lived assets with a large element of sunk or irrecoverable investment, a common characteristic of network sectors. The Government Statement's unexplained move to reduce regulators' independence finds no support in either the government commissioned background report prepared by the Economic Intelligence Unit, *Review of the Regulatory Environment in Ireland*, or recent European Union legislation on energy and telecommunications regulation. Indeed, these sources are strongly in favour of regulatory independence. Two, not necessarily mutually exclusive explanations, for reducing regulatory independence are discussed: to remove an anomaly in the Irish political system; and, to assist in the delivery of social partnership. The paper concludes by arguing that some thought might be given to public consultation of the reforms in the Government Statement prior to further implementation.

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I INTRODUCTION

Independent regulatory agencies in Ireland play a pivotal role in determining price, service quality, entry and other competitive conditions in the energy, telecommunications, postal services and transport (buses, airports and taxis) sectors.¹ These regulatory agencies, sometimes referred to as economic regulators, have increased in number since the mid-1990s (Table 1). Between 1996 and 2001, for example, regulators were created for electricity, airports and telecommunications. The scope of these regulatory agencies has typically increased.² For example, the regulation of gas was combined with electricity in 2002, postal services with telecommunications also in 2002. The creation of these agencies reflected the wider regulatory reform agenda, inspired by the OECD (1997; 2001; 2005) and a series of European Union legislative initiatives, particularly in energy and telecommunications (Department of Public Enterprise, 2000). However, there was also a more general expansion in the number and role of government agencies dating from the late 1980s as part of the New Public Management.³ This expansion occurred in agencies with responsibility, not only for regulation, but also the delivery of public services, advice, consultation and so on.

The economic regulatory agencies assumed functions that had previously been exercised by the relevant Minister, although, as discussed below, the functions had been administered in quite a different manner. The Minister, however, still plays an important role in the activities of the regulated sector. Regulated firms, typically the former incumbent monopolist, continue to be state-owned and report to the Minister (Table 1). The Minister also retains responsibility for policy development and has the power to issue policy directions of a general nature to regulatory agencies. Individual decisions on pricing or investment are, on the contrary, the responsibility of the regulatory agency, not the Minister. Of course, the line can be blurred between individual decisions and policy directions of a more general nature.

¹ In some other jurisdictions, such as the UK, the range of activities regulated by independent agencies is larger than Ireland, including, for example, water and railways. However, in these two instances in Ireland the provision of services is retained within the state sector and not subject to oversight by a regulatory agency. Water charges for households were abolished in 1997, although there are moves to reintroduce such charges, while for commercial premises local authorities set water charges and provide the service.

² The Commission for Aviation is an exception. See Table 1, footnote b, for details.

³ For details of the growth in agencies by type see Hardiman (2009, Figure 7, p. 60); Hardiman and MacCarthaigh (2010, Figure 9, p. 386). These sources also discuss the reasons for the growth in these agencies.

Table 1: *Economic Regulators in Ireland: 2010/2011*

<i>Regulator, Year Established and Terminated</i>	<i>Sectors</i>	<i>Public Ownership</i>	<i>Private Ownership^a</i>
Commission for Aviation Regulation (“CAR”), 2001-	Dublin Airport ^b	Dublin Airport Authority	None
Commission for Energy Regulation (“CER”), 1999 ^c -	Electricity, gas	ESB, EirGrid, Bord Gáis	Yes
Commission for Communications Regulation (“ComReg”), 1997 ^d .	Telecommunications, postal services	An Post	Yes ^e
Commission for Taxi Regulation (“CTR”), 2004-2010 ^f	Taxis	None	Yes
Department of Transport (“DoT”), 1932-2010 ^g	Buses	Dublin Bus, Bus Éireann	Yes
National Transport Authority (“NTA”), 2009-	Taxis, buses	Dublin Bus, Bus Éireann	Yes

a. In competition with some or all of the publicly-owned entities. In the case of buses, for example, competition exists mostly on an inter-urban basis, while in electricity competition exists in generation.

b. CAR originally regulated Dublin, Cork and Shannon airports, but in 2004 Cork and Shannon were removed from the ambit of regulation. The Department of the Taoiseach (2009, p. 11) announced that it has been decided that the CAR will be merged with the NTA. As yet, legislation has not been presented to the Dáil. The CAR also regulates air terminal service charges. These are the air traffic control charges imposed by the publicly owned Irish Aviation Authority at Cork, Dublin and Shannon airports.

c. Originally the Commission for Electricity Regulation. The name change to the Commission for Energy Regulation took place when natural gas regulation was added to the agency’s remit in 2002.

d. Originally the Office of the Director of Telecommunications Regulation, changing to its current name in 2002 when it was given responsibility for all telecommunications regulation and postal services.

e. Eircom, the former state-owned telecommunications provider was privatised in 1999.

f. The Commission for Taxi Regulation was dissolved in December 2010 and incorporated into the NTA.

g. The bus licensing function of the Department of Transport was transferred to the NTA in 2010.

Source: Economic Intelligence Unit (EIU) (2009), Department of the Taoiseach (2009), Massey (2007) and information provided by regulators.

Irrespective of whether a Minister⁴ or a regulatory agency makes regulatory decisions, such decisions have the potential to affect not only the competitiveness of the economy, given the significance of regulated activities as inputs, particularly to the traded sector of the economy, but also the well-being of consumers. The scope of economic regulation is largely confined to activities that are, by and large, in the non-traded sector and hence not subject to competition from producers located elsewhere in the EU and beyond.⁵ Important parts of regulated sectors are natural monopolies (e.g. the gas transmission system or the electricity grid) or oligopolies, with high barriers to entry (e.g. electricity generation or mobile phone networks). Hence issues relating to independence, accountability, expertise and governance – to the extent that they affect the quality of regulatory decisions and the evidence is that they do⁶ – are important for the economic development and competitiveness of the Irish economy. Institutions and how they are structured matter.

After the growth of the economic regulatory agencies, government decided to take stock and review progress. It is to be welcomed as good administrative practice. A report was commissioned by the Department of the Taoiseach on the regulatory environment in Ireland, which benchmarked the performance of economic regulators against their peers in other countries and made a series of recommendations to improve the regulatory structure (EIU, 2009). Shortly after this was completed, the government issued its *Government Statement on Economic Regulation* (“the Government Statement”) in October 2009.⁷ While government recognised the importance of the quality of regulation to the economy, the emphasis in the Government Statement is on “... strengthening the mechanisms to assess the performance of regulators and to monitor their delivery on the strategic objectives and priorities set for them” (Department of the Taoiseach, 2009, p. 1). The Government Statement sets out a series of reforms affecting the structure, governance and accountability of economic regulators.

There is always likely to be a tension between the independence of regulators *from* government and accountability of regulators *to* government.⁸

⁴ The term Minister is used for shorthand to include the relevant department, although it is recognised that the Minister and the department may not always agree on policy.

⁵ This is beginning to change. In electricity, for example, interconnectors between Ireland and Great Britain will expose electricity generators in Ireland to external competition from Great Britain and beyond. Increased competition is likely to be accompanied by less regulation.

⁶ This connection is discussed further in Section II below.

⁷ The Government Statement concentrated on the economic regulators which are listed in Table 1 above. The EIU (2009) had slightly wider remit, including financial services and health and safety. However, since the focus of the paper is the reforms proposed in the Government Statement, attention is focused on the economic regulators, with limited reference to other regulators such as the Central Bank and Financial Services Authority of Ireland.

⁸ Government would include not only Ministers but also the Oireachtas.

Getting the balance correct is not easy. Too much control by government may compromise the independence of regulators and the benefits that flow from such independence; too much independence results in regulators that are not sufficiently accountable to government. The purpose of this paper is to examine whether the Government Statement, which is likely to increase the power of government vis à vis regulators, strikes the right balance between regulatory independence and accountability and the implications for the quality of regulation in the activities mentioned above.

The remainder of the paper is divided into five sections. Section II outlines why it is important that regulatory agencies are independent of government (and other interests such as the regulated entities) and how that promotes sensible investment and other decisions by the regulated entities. With that as background, Section III discusses the ways in which regulatory agencies are currently accountable to Ministers as well as the proposals in the Government Statement and initial implementation steps. The Government Statement provides little, if anything, by way of justification or rationale for the proposed erosion of the independence of regulatory agencies through the strengthening of accountability mechanisms. Recourse is made, in Section IV, to the background EIU report referred to above and developments at EU level in telecommunications and energy for an explanation. However, these sources do not provide a clear rationale. On the contrary, to a considerable degree, the movement towards greater accountability to government by regulatory agencies is inconsistent with the views expressed in these two sources. Thus in Section V two possible explanations are presented for greater accountability to government. The paper concludes by arguing that the proposals in the Government Statement are unlikely to improve the quality of regulatory decisions and contain important elements that resemble the regulation of financial institutions prior to the financial crisis.

II A COMPARISON OF TWO MODELS OF REGULATORY DECISION-MAKING: INDEPENDENT REGULATORY AGENCIES VERSUS THE MINISTER

In this section the merits of two models – regulatory agencies and the Minister – for making regulatory decisions are considered. These two models need to be seen in context. Regulatory agencies were created in Ireland as in many other European jurisdictions as part of a broader process of economic liberalisation of a sector (e.g., energy, telecommunications, postal services), usually at the behest of an EU initiative. Prior to liberalisation, the sector may have been dominated by a state-owned vertically integrated monopolist, with

the Minister acting both as the regulator as well as owner. Post-liberalisation the state-owned firm may be privatised and/or broken up, while increased entry and greater competition is encouraged by the regulatory agency as a method of facilitating competition, so as to increase efficiency, raise innovation, encourage new product development and lower prices. In electricity, for example, entry has taken place in generation and supply, while the operation of the transmission system is no longer the sole responsibility of the former vertically-integrated state-owned monopolist, the Electricity Supply Board (“ESB”), but a newly created entity, EirGrid. It was no longer tenable in the post-liberalisation world for the Minister to be both regulator and owner of the dominant player in a particular sector (Ferris, 2001, p. 4).

In discussing the merits of the two regulatory decision-making models, attention is concerned primarily with economic regulations, which have been defined by the OECD (2001, p. 17) as those that “... intervene directly in market decisions such as pricing, competition, market entry or exit.” In terms of the characteristics of an independent regulatory agency reference is made to the Department of Public Enterprise (2000) vision of what powers and procedures should apply with respect to regulatory agencies, which is consistent with various OECD (1997; 2005) statements on principles for regulatory quality and performance, EU guidance and legislation,⁹ and regulatory practice in Ireland (Doyle, 1997; EIU, 2009). In contrast, the Minister as a regulator is not drawn from some model of what constitutes best practice, but rather on what appears to have been the historical record in Ireland.

An independent regulatory agency is likely to exhibit the following characteristics: appointment by the Minister of the most senior posts on merit after an independent selection process, with very narrow grounds for dismissal (e.g., ill health, stated misbehaviour) and with appointment for a sufficiently long period to ensure independence; clear internally consistent statutory goals; open, transparent impartial decision-making, with reasoned published decisions; secure funding; appeal mechanisms – judicial review and, on the merits, in limited specific circumstances to an expert panel or court; and, the Minister’s role is confined in general to policy development with the day-to-day tasks of regulation devolved to the regulatory agency. In contrast, Ministerial regulation is conducted within the confines of departmental structures, with processes that are often opaque often with little or no published reasoning for particular decisions.

⁹ For further details see the discussion in Section IV below on recent EU legislation in energy and telecommunications.

2.1 *Reducing Conflicts of Interest*

When a Minister makes a regulatory decision several sets of considerations are likely to colour his or her judgment, which is illustrated by a request for a price increase by the regulated entities. First, the Minister has political considerations, which are likely to reflect short-term electoral factors. If the sought-for price increase is filed before an election then if it were granted there might be a loss of electoral support for the Minister's party, causing the Minister to defer, reduce or refuse the requested price increase. Second, regulatory considerations, which may be quite vague in legislative terms, but nevertheless if a well argued case for a price increase is sustained then the Minister might be minded to approve the increase. This is particularly the case if the Minister's department does not have the expertise and knowledge to evaluate such requests and so is likely to rely on the regulated entity's expertise and knowledge. Third, ownership considerations, where some or all of the regulated firms are state-owned. Here the Minister as owner may wish to maximise and/or maintain the value of the state-owned firm and so award the price increase even if it is not justified in full. Such increases may also permit the regulated entity to pay wage increases, thus avoiding a possible strike.¹⁰ Fourth, the Minister may have certain policy preferences or desired outcomes which the regulated entity may be able to supply. Hence the Minister's decision to award a price increase or approve an investment, irrespective of its merits, may be conditional, implicitly if not explicitly, on the accommodation of their policy preferences. In other words, there is a form of regulatory barter or exchange.

These conflicting motivations make Ministerial regulatory decisions difficult to predict and this uncertainty is likely to raise costs, as well as distort investment and pricing decisions.¹¹ In contrast, the regulatory agency is much less likely to be subject to such conflicts. The regulatory agency should not consider short-term political considerations, while the strength of the balance sheet of the state-owned regulated firm is of interest only to the extent that it is adequate, consistent with the regulatory agency meeting its statutory objectives.¹² The regulatory agency is less likely to be at an informational disadvantage compared to the Minister, given its staffing of

¹⁰ The latter two roles were pointed out in the Department of Public Enterprise (2000, p. 5) in describing what it calls the traditional model of Ministerial regulation prior to the advent of regulatory agencies.

¹¹ Doyle (1997, p. 7) refers to these as "political risks."

¹² There is an issue that privately owned firms may take on excessive leverage and use its inability to raise additional funds for vital infrastructure investment to argue that it should receive lenient regulatory treatment. One solution to this problem is to allow the regulatory agency to have step-in rights. For further discussion see Gorecki *et al.* (2010).

economic, legal and engineering expertise, plus the information revealed in the extensive consultation process in making regulatory decisions.¹³ Independent regulatory agencies may be better able to attract the required professional expertise. The regulatory agency's decisions are concerned with meeting its statutory objectives and in making decisions in accordance with those objectives it does so within the appropriate time horizon, with its reasoning presented in a published decision. This is more likely to be conducive to regulatory certainty and predictability than regulation by the Minister.

2.2 *Credible Pre-Commitment*¹⁴

In many regulated sectors, such as energy, telecommunications and some aspects of transport such as airport terminals, investment decisions are made with respect to long-lived capital intensive assets with a high element of sunk (i.e., irrecoverable) cost. For example, a combined cycle gas turbine electricity generation plant has a life span of 35 to 40 years, with a cost of capital "... slightly larger than all the non-energy operating costs – labour and materials" (Fitz Gerald, *et al.*, 2005, p. 54). In order to facilitate such investments a stable predictable environment minimises uncertainty. The more uncertain the economic environment the higher the return demanded by the investor to compensate for the increased risk. In some instances investment may not take place at all or be deferred, leading to under-investment. One source of uncertainty concerns the likelihood that once a long-lived capital intensive asset is built, due to action by the state, the owner may only be able to recover variable costs, with little or no compensation for the capital costs, which are sunk.¹⁵ In other words, the sunk costs are expropriated.

The Minister acting as regulator is more likely to expropriate the sunk costs. Examples cited of such behaviour usually refer to Ministers or Governments rather than regulatory agencies.¹⁶ This failure to cover sunk investment costs need not, of course, be explicit; the Minister could just refuse or reduce the requested price increases. The motive may reflect the political considerations referred to above in terms of electoral factors. There is some evidence consistent with this behaviour in Ireland when the Minister was both

¹³ Purchasers of the regulated service are likely to have an interest in low prices and have market expertise and information that they have an incentive to supply to the regulatory agency so as to defeat or reduce a proposed price increase.

¹⁴ For a discussion of pre-commitment see Trillas (2010, pp. 2-5) and references cited therein.

¹⁵ This can and does occur with respect to investments by multinationals in copper, mineral and petroleum extraction, where the host country may offer, initially at least, large investment incentives and then revise the arrangements once the investment is completed, referred to as the obsolescing bargain. See Bersten *et al.* (1978) for discussion.

¹⁶ See discussion and references in footnotes 14 and 15 above.

regulator and owner of ESB and as such could grant or deny requested price increases. Decisions were often deferred for considerable periods. In one case the Minister had not made a decision for seven years, apparently because of the overall profitability of the ESB, after a request for a price increase made in January 1995 (OECD, 2001, p. 282). In another case the Minister, in June 2000, in order to combat inflation, made a commitment that "... electricity prices would not rise later in the year" (Fitz Gerald *et al.*, 2005, p. 60).¹⁷

In order to provide a commitment that the state will not be involved in such opportunistic behaviour, one option is set up an independent regulatory agency that will make decisions taking into account the need to compensate for the full cost of an asset and not just the variable costs.¹⁸ However, for this pre-commitment to be a credible mechanism the regulatory agency must be properly independent, in the terms described above. If this is the case then it will reduce investment risks and thus lower costs, benefiting purchasers of the regulated services and the wider economy.¹⁹

There is a link between reducing conflicts of interest and credible pre-commitment, if regulated entities are retained in public ownership, which goes beyond establishing an independent regulatory agency. The Minister may still, despite the existence of an independent regulatory agency, intervene in favour of the publicly owned regulated entity for reasons alluded to above. This is likely to create regulatory uncertainty and perhaps blunt competition. There is evidence that when the state retains public control in a sector subject to regulation that regulatory outcomes favour the incumbent.²⁰ One way in which the Minister can credibly pre-commit to not making such interventions is to privatise publicly owned entities.²¹ However, in several of the sectors subject to economic regulation – airports, electricity, gas, postal services, buses

¹⁷ As the authors note, "[T]his raised the prospect that new entrants would face unfair competition in the future due to the government's use of its power as shareholder in ESB to restrict price increases" (Fitz Gerald *et al.*, 2005, p. 60).

¹⁸ For a discussion of the importance of pre-commitment in the context of the electricity sector in Ireland, see Lyons *et al.* (2007).

¹⁹ A good example of regulatory independence was the decision by the UK government to switch responsibility in 1997 for setting interest rates from the Minister to the Bank of England. When the Minister had responsibility there was a concern that short-term considerations, such as the electoral cycle, would influence such decisions. However, a credible Bank of England with an inflation target would be immune from such considerations. The markets believed that the Bank would be independent and as a result the UK/German interest differential declined substantially.

²⁰ For details see Edwards and Waverman (2005), which is confined to telecommunications, but the authors argue the results can be generalised to other network infrastructure industries such as gas, electricity and rail. The authors also find that independent regulators can mitigate the impact the presence of a state-owned regulated firm.

²¹ Gorecki *et al.* (2010) considers public policy towards state assets and where the arguments are strongest for such sales.

– government in Ireland has decided not to follow this option; the exception was telecommunications, where Eircom was privatised.²²

2.3 *Lessening Regulatory Capture*

Regulatory capture is when the regulator, whether it is the Minister or a regulatory agency, sees the world from the viewpoint of those firms that are being regulated. In other words, the regulator acts in the interests of the regulated entity.²³ A low evidentiary threshold is likely to be set for price increases; the entry of new firms is likely to be refused or made difficult; and, other regulatory decisions are likely to benefit the incumbent regulated firm(s). Consumers and the wider economy suffer as a result and the objectives of regulation, which are often couched in terms of efficiency and low prices, compromised. While regulatory capture can occur irrespective of the regulatory regime it is more likely to occur when the Minister is the regulator, especially when – as is often the case in Ireland – one of the regulated firms is state-owned.²⁴ The state-owned regulated firm will have constant contact with officials and the Minister, which may take the view that it is important to protect and promote that firm. In other words, the interests of the regulated firm become identified with government policy. It is a variant of, “What is Good for GM is Good for America.”

Of course, it could be argued that there is a limit to such regulatory capture in that there are appeal mechanisms to the Courts from a Minister’s decision.²⁵ However, these appeals are costly, with uncertain outcomes. Furthermore, the case can always be settled by the Minister out of Court with no precedent-setting decision, judicial or otherwise, especially if the settlement details are not made public and there is no third party appeal. There are examples consistent with Ministerial regulatory capture. These include the refusal to licence a rival airline operator to Aer Lingus, the national flag carrier, since requests were made dating back to 1935. Deregulation eventually occurred on the Dublin-London route in 1986.²⁶ More recently the interpretation of the law by the Minister to disadvantage a new entrant in the provision of bus services in favour of the state-owned incumbent, Dublin Bus, was struck down by the High Court.²⁷ As shown in

²² See Table 1 above for details.

²³ For a discussion of regulatory capture see, for example, Stigler (1971) and Peltzman (1989).

²⁴ In Ireland, publicly-owned firms are present in gas, electricity, airports, postal services, buses, while in telecommunications the former publicly-owned firm was privatised.

²⁵ Appeal mechanisms are discussed further in Section III below.

²⁶ See Barrett (2006).

²⁷ See High Court, *Digital Messenger Limited Trading As Swords Express and Minister for Transport and Dublin Bus* [2010] IEHC 311, delivered on 30 July 2010. This judgment may be accessed <http://www.courts.ie/Judgments.nsf/bce24a8184816f1580256ef30048ca50/8f959bc0e75602c88025778b003de28d?OpenDocument>. Accessed 7 September 2010.

Table 1 it was only in 2010 that responsibility for bus regulation was assumed by the National Transport Authority.²⁸

In contrast, regulatory agencies are less likely to be as subject to regulatory capture. Regulators' processes are open and transparent, thus making their decisions more subject to scrutiny and objections by purchasers of the regulated firms' services. Regulatory agencies, unlike a Minister responsible for the state-owned firm, do not have an interest or responsibility as a shareholder in that firm. Hence the regulatory agency is more likely to make decisions in the interests of the purchasers of the services of regulated firms than in the interests of the regulated firms themselves. Nevertheless, regulatory agencies are not immune;²⁹ they may encourage entry and then feel the need to ensure the survival of these entrants, even when they have failed the market test, thus protecting competitors rather than competition. Alternatively, if a regulatory agency has as one of its major objectives promoting the success of the regulated activity then it may identify with those interests as appears to have occurred in financial regulation.³⁰ In other words, the statutory objective of the regulator makes it obliged to act in the interests of the regulated firm(s) usually at the expense of consumers.³¹

If regulatory capture occurs under independent regulation then there is likely to be a difference between *de jure* and *de facto* regulation. *De jure* regulation refers to the legal formal framework of the regulatory agency as set out at the beginning of this section, while *de facto* regulation refers to what actually happens in practice. Thus regulatory capture will result in a

²⁸ Bus licensing rules have become more consumer focused with the announcement of new NTA *Guidelines for the Licensing of Public Bus Passenger Services* by the National Transport Authority in December 2010 which were welcomed by the Competition Authority as clearing the "... way for greater competition in commercial public bus services." (Competition Authority, 2010). However, Barrett's (2011) analysis of the legislation underling the NTA suggests much less cause for optimism.

²⁹ Kay (2010) cites the example of the Interstate Commerce Commission ("ICC") which regulated railways under legislation passed in 1887. The Chairman was familiar with the railway industry having acted for the producers. The US Supreme Court decided a decade later that the rate-fixing agreement between railways was illegal.

³⁰ The Central Bank and Financial Services Authority of Ireland ("CBFSAI") statutory objective was to promote the development of the financial services industry in Ireland, but not in such a way as not to affect its objective of contributing to the stability of the financial system. Subsequently in 2010 the promotional aspect has been dropped as a regulatory objective. The regulatory approach of the CBFSAI is summarised in Honohan (2010, p. 16). It is a case study to which further reference is made below.

³¹ This reflects the possibility that there may be Ministerial capture in the preparation of the legislation. In other words, the regulated entity or interested party is able to lobby the Minister to codify their interests in the legislation and thus bind the regulator. This is discussed further in relation to the CAR in Section 3.3 below.

regulatory regime that is in practice less independent than that suggested by an examination of the statutory provisions relating to its administration.

Independent regulatory agencies have distinct advantages over the Minister acting as a regulator in terms of reducing conflicts of interest, providing a credible mechanism for reducing the risk associated with investing in long-lived capital intensive assets, with high sunk costs and being less subject to regulatory capture. These advantages are, of course, largely theoretical. The question is whether in practice regulatory independence leads to better outcomes. Here the evidence would suggest that the answer is yes. Trillas (2010, p. 20) in a survey of the literature, plus some of their own work, concludes that “[T]here seems to be on balance a positive and significant impact of independence (together with other good governance attributes) on performance, although doubts remain about the magnitude of this effect.” However, to some extent this conclusion may understate the impact of independent regulatory agencies, since varying degrees of regulatory independence are being compared, rather than a comparison between regulatory independence and the Minister acting as the regulator.

III ACCOUNTABILITY OF REGULATORY AGENCIES: PAST, PRESENT AND FUTURE

Regulatory agencies are not, nor should they be, completely independent of government (and other interests). However, exactly how such agencies should be accountable for their decisions and actions is the subject of legitimate debate. Existing accountability mechanisms are first outlined, before attention turns to the proposals in the Government Statement and, finally, to the moves to implement these proposals.

3.1 *The Status Quo Ex Ante*

Regulatory agencies are accountable, not only to the government, but others, in a variety of ways. These include the following mechanisms:³²

- Ministers, on occasion, appoint the commissioners – the decision-makers – to regulatory agencies without an interview/open competition procedure. Two of the current three commissioners of the CER were appointed in this way as were the Chairman of the NTA, although this is not the case for the other economic regulators where the commissioners have to be appointed

³² Much of the current accountability mechanisms are detailed in EIU (2009).

by an open competition run by the civil service and appointments commission;³³

- Although the statutory goals and objectives of a regulatory agency are set by the Oireachtas, given the control of the legislature by the executive in Ireland – discussed below – in effect these are written and formulated by the Minister. However, Ministerial discretion is limited if the Oireachtas is transposing EU legislation;
- The Minister can issue directives to the regulatory agencies concerning the factors to be taken into account in their decision-making process. In some cases this power can only be exercised after public consultation. This has been used in varying degrees: 15 in the case of ComReg; three, CAR; one, CER; and, none, CTR (EIU, 2009, p. 39);³⁴
- Decisions from the regulatory agencies can be appealed. It is important to distinguish between judicial review and appeal on the merits. Under judicial review the Court is concerned with *how* a decision is reached by a regulatory agency (or a Minister), so that only issues of fair procedures and due process are relevant. In contrast, an appeal on the merits is concerned with whether the *right* decision is made in view of the statutory regulatory objectives and the available evidence. Appeals are sometimes made initially to a regulatory panel and then to the Courts, but in some cases directly to the Courts,³⁵ with no expert panel. The appeal mechanisms vary by regulatory agency (EIU, 2009, Table 9, p. 56). ComReg and CAR have been subject to a number of appeals;

³³ The appointment procedure is set out in EIU (2009, Table 8, p. 51), with the exception of the NTA. Here the Chairman and members of the Authority are selected by the Minister with no statutory requirement for an independent, open competition as the appropriate selection mechanism, although there has been some movement in that direction. The Minister for Transport in appointing four of the eight members of the NTA in 2009 did so after inviting “... applications from any person who wished to be considered for appointment.” (Response by Minister for Transport to oral questions in the Dáil, 9 December 2009). The NTA members are, according to the legislation, persons who “... in the opinion of the Minister have wide experience in relation to transport, industrial, commercial, financial, land use planning or environmental matters, the organisation of workers or administration.” There is also an Advisory Council, the composition of which is modelled along the lines of social partnership, which is discussed further in Section 5.2 below. The Advisory Council has, as yet, to be established. Given that the CTR and the CAR – eventually – are to be rolled into the NTA, if the appointment process outlined above is used, then this signals a move away from open transparent appointment processes and thus is likely to reduce regulatory independence. For details see the relevant legislation, the Dublin Transport Authority Act 2008 and the Public Transport Regulation Act 2009, and the NTA website, <http://www.nationaltransport.ie/about.html>. Accessed 21 December 2010.

³⁴ The frequency appears to refer to the period from the inception of the regulatory agency to March 2009 when the EIU report was completed.

³⁵ This is usually the case with Ministerial regulatory decisions.

- Ministers can exercise moral suasion or soft power in terms of indicating what policy or even individual decisions might be, without issuing a policy direction. This occurred with respect to a pricing decision of the CER at the behest of the Minister, discussed below;
- Regulatory agencies appear before Oireachtas committees, sometimes involving robust exchanges as, for example, with respect to the CTR;³⁶
- Regulatory agencies are often funded by a levy on the regulated firms, and thus indirectly on consumers. Regulated firms are likely to question excessive levies and thus promote efficiency.

This is an extensive menu of accountability mechanisms. They differ somewhat from regulatory agency to regulatory agency reflecting the fact that these agencies are to some extent all *sui generis*.

3.2 *The Government Statement Proposals*

The Government Statement can be seen as a response to the EIU (2009, p. 162) recommendation, given the strong case for continued regulation in certain sectors, that “... a restatement of the overall strategy, principles and objectives of regulation would be helpful” (emphasis on original). It proposes a very extensive suite of measures to improve the quality of regulation. After acknowledging the importance of the quality of economic regulation for competitiveness and growth, the Government Statement states that government “... is now strengthening the mechanisms to assess the performance of regulators and monitor their delivery on the strategic objectives and priorities set for them” (Department of the Taoiseach, 2009, p. 1). The proposals also allow the communication of “key Government priorities” to regulators (*ibid*, p. 1). No measures are proposed to strengthen the independence of regulatory agencies.

The Government Statement proposals are:^{37, 38}

³⁶ For details see Gorecki (2009a). However, although the exchanges were robust it is not clear how they held the CTR to account. The Chairman of the Committee discounted the results of a study carried out for the CTR, since the results were not consistent conversations that Chairman had had with a small number of taxi drivers.

³⁷ The paragraph numbers are taken from Department of the Taoiseach (2009) and indicate where further details of the proposal may be found.

³⁸ There some other proposals to improve regulatory decision-making, which are not discussed in this paper. These are as follows: optimal configuration of regulatory agencies through amalgamations (*ibid*, paragraphs 4.3-5.1); greater consumer and industry input into regulatory agency decisions and processes (*ibid*, paragraphs 6.2-6.3); and, other issues such as commission and board structures and concurrent powers under the Competition Act for both regulators and the Competition Authority (*ibid*, paragraphs 2.15, 2.16, 2.17; 3.3).

- More accountability and transparency through increased availability of information and the development of new measures on the performance and activities of regulatory agencies (*ibid*, paragraphs 2.1-2.9);
- Greater political input and direction into the decisions and priorities of regulatory agencies in both the short (*ibid*, paragraphs 2.1-2.9) and longer term (*ibid*, paragraphs 3.1-3.2);
- Development of regulatory technical expertise within government departments (*ibid*, paragraphs 2.10-2.14);
- No change in current system of appeals from a regulator's decisions. Rejection of the idea of a single appeals body (*ibid*, paragraph 2.18);
- Better budgetary scrutiny and cost controls through international comparisons (*ibid*, paragraphs 4.1-4.2).

Some further elaboration on each of these is provided below.

Greater Political Direction

The government proposes greater political accountability of regulators. In this context accountability means that Ministers will have a greater say in setting the priorities, objectives and mandates of regulators than is currently the case. The Government Statement's proposals envisage several mechanisms or conduits through which such influence will be channelled.

These channels include:

- *Statements of Strategy* at least every five years that will not only take into account the regulators' legislative objectives but also "... any policy directions or weighting of priorities communicated by relevant Ministers or by Government in the context of the Annual Regulatory Forum" (Department of the Taoiseach, 2009, paragraph 2.1);
- *Annual Output Statements* relating inputs to outputs as well as reporting progress in meeting objectives set out in the Statement of Strategy. It is to be submitted to the relevant Minister and Oireachtas Committee. The Annual Output Statements "... will also allow for Ministerial directions and priorities communicated by government to be formally incorporated into strategic plans, thereby addressing the need for greater flexibility in the regulatory process in light of changing global markets and economic and technological conditions" (*ibid*, paragraph 2.3);
- *Performance indicators* which "... should be related to the fulfilment of their [the regulators] legislative mandates and to Ministerial directions and statements on priorities ..." (*ibid*, paragraph 2.4);
- *Public Interest Statements* that set out how the regulators have taken into account the public interest objectives set out in legislation (e.g., consumer

protection). However, in doing so the regulator “... will necessarily take account of any communication or direction from the relevant Minister of the policy objectives for the sector and Whole of Government issues raised in the context of the Annual Regulatory Forum” (*ibid*, paragraph 2.5);

- *Annual Regulatory Forum* at which the Taoiseach, Tánaiste and other relevant Ministers and key regulators “... whose work is central to Irish economic performance” will attend (*ibid*, paragraph 2.7). At the Forum the government’s “... evolving priorities relating to the economy, competitiveness and competition issues” will be communicated to regulators (*ibid*, paragraph 2.7). Furthermore “... the identification of clear priorities by Government and by Minister with sectoral responsibility will assist regulators to deploy resources appropriately in line with policy priorities and in the setting of appropriate performance indicators for regulators” (*ibid*, paragraph 2.8);
- *Five Year Reviews* initiated by the relevant Minister of the roles and mandates of the regulators. This reflects the view that the “... role of regulation will evolve over time and it is important that this need is assessed periodically” (*ibid*, paragraph 3.1). Such reviews would consider, for example, “... provide a context within which sectoral amalgamations and broader mergers can be considered in the light of issues such as the changing mandates and converging technologies” (*ibid*, paragraph 3.2).

These arrangements for greater political influence and direction of regulators create a number of channels through which government expresses its preferences as to what regulators should do:

- for Ministers – policy directives, statements on the weighing of priorities and somewhat vague communications; and,
- for government as a whole – statements or expressions on evolving priorities and clear priorities.

The degree to which these preferences are adhered to by regulators is then monitored and, to a lesser extent, enforced through a series of mechanisms from Statements of Strategy to the Annual Regulatory Forum. The Five Year Reviews can be viewed as an accountability or enforcement mechanism in instances where the regulatory agency has not adhered to the preferences of the Minister and/or Government. This is not to deny that regulators should be held to account, but what is envisaged here is a blurring between the legislative goals of the regulators and shorter term considerations and preferences of Ministers which appear to have no statutory basis and may well conflict or compromise the legislative objectives of the regulators.

Developing Regulatory Expertise in Government Departments³⁹

Sectoral regulation requires the development not only of an understanding of the economics, structure and technology of the sector being regulated but also the purpose of regulation, the regulatory regime as well as the intricacies of regulatory economics. These are specialist skills and expertise. To effectively and efficiently monitor and hold to account regulators in the ways described above requires that the Departments responsible for such tasks also develop such skills and expertise. This will also be useful in advising Ministers on the impact of any direction that they may be considering giving to regulators.

The government proposes a number of measures to increase regulatory capacity within Departments. There will be a build-up of “... additional internal expertise through formal training and support for the attainment of relevant qualifications” (*ibid*, paragraph 2.11). Exchanges with regulators will be considered. Structured co-operation between Departments will be utilised. However, the government proposals go further and envisage that Departments will develop training and research capacity relevant to the Irish regulatory landscape within third level institutions. International expertise will also be drawn upon as has been the practice to date in reviewing regulation (e.g., EIU, 2009). It is envisaged that these measures will “... strengthen[ed] the oversight of regulatory arrangements on an ongoing basis ... enhance the policy advice available to Ministers and allow for the effective conduct of periodic reviews” (*ibid*, paragraph 2.13).

Appeals Structures

As noted above, there are typically appeal mechanisms from the decisions of regulators. Regulators’ decisions are important often with long lasting effects. It is therefore important that there is an effective review mechanism not only with respect to procedural and due process issues but also the substance of regulatory decisions. At the present time there are a number of different appeal mechanisms – apart from judicial review – including appeals panels and the Commercial Court.⁴⁰ The government proposes no change to

³⁹ In a series of presentations a former and a present regulators of telecoms and aviation, respectively, have taken this aspect of the agenda forward. See, for example, I. Goggin and C. Guiomard, “Strengthening Regulatory Capacity,” ESRI Policy Seminar, 26 November 2009.

⁴⁰ In some instances the appeals mechanism, for a given regulatory agency has changed through time. For example, in telecommunications, in 2003 ComReg decisions could be appealed to an expert panel and then the Courts; however, ComReg was of the view that this was an inappropriately slow process and the expert panel appeal was abolished in June 2007 so that appeals are made once again directly to the Courts, the situation prior to 2003. For details see EIU (2009, pp. 129-130).

the status quo, specifically rejecting the idea of a single appeals body. This rejection is based on the grounds that "... basis and parameters for potential appeals can vary considerably across sectors, particularly having regard to the requirements of EU law" (*ibid*, paragraph 2.18).

Engaging with Stakeholders

Regulators make decisions that impact on consumers and business. The government proposes to change the way in which the input from these groups impacts on regulatory decisions in two ways. First, there will be greater emphasis on the consumer interest in the regulators' decision-making calculus. Regulators must not only be effective regulators but also act as "champions of the consumer interest" (*ibid*, paragraph 6.2). Second, industry panels or advisory councils will be established for the regulators of energy, telecommunications and transport. Legislation will also provide for regulators to consult with the National Consumer Agency or any dedicated panels it may convene.

3.3 *Taking the Government Statement's Regulatory Reform Agenda Forward*

The Government Statement reforms will in some instances require new legislation, which will be the responsibility of the Minister for Finance and relevant sectoral Ministers. As yet this legislation has not been introduced. Such legislation should, for example, set out how regulators will be required to take into account current/evolving priorities of the Minister, while at the same time conforming to their existing statutory objectives. Nevertheless, in the absence of the necessary legislation, the proposals will be "... pursued in the interim on an administrative basis" (*ibid*, p. 1).

One of the first moves to implement the Government Statement proposals was the holding of the first Annual Regulatory Forum, in February 2010. All the economic regulators were present as were Ministers and senior departmental officials responsible for the economic regulators, together with the Taoiseach and Tánaiste. The Annual Economic Forum is seen as one of the key recommendations of the Government Statement. In terms of the issues discussed at the first forum,

The regulatory system in Ireland is seen as accessible and agile and part of the country's positive environment for business. It needs to be continually adjusted to reflect the changing markets, new technological developments, the climate change agenda and international regulatory environment. It must also support new and green technology and industries in line with the Government's Framework for Economic Renewal (Building Ireland's Smart Economy) (Department of the Taoiseach, 2010a, p. 1).

It further claimed that the regulators will stress test their regulatory systems to ensure that they are sufficiently robust to respond to major shocks. Other steps to implement the Government Statement have also been made such as tendering for a regulatory governance programme (Department of the Taoiseach, 2010b).

Although perhaps not part of the Government Statement, recent interventions by Ministers are consistent with much greater direction and political accountability of regulatory agencies to Minister advocated in the Government Statement. These interventions go beyond general directions to regulators and relate to specific regulatory pricing decisions. In 2009 the Minister responsible for the CER signalled to the CER that electricity prices should be lowered. In a press release the Minister stated:

We have a robust regulatory energy framework in Ireland which is transparent and encourages competition. It is right that we maintain the role of the CER as the decision-maker in terms of pricing. To this end, I am asking the energy regulator to undertake an immediate review of options to bring forward a reduction in electricity prices. Based on current trends I expect a double-digit decrease in electricity and gas prices this year (DCENR, 2009, p. 1).

This was not a formal statutory based direction by the Minister, but rather via a press release. It is an example of what is referred to above as moral suasion. This choice may reflect the fact that the relevant legislation, section 7 of the Energy (Miscellaneous Provisions) Act, 2006, only permits policy directions on “general policy.”

When the CAR was considering in 2009 the airport charges that Dublin Airport Authority (“DAA”) may levy (i.e. maximum charges) at Dublin airport for 2010 to 2014, the Minister issued a general policy direction dated 27 October 2009.⁴¹ The direction was issued after the CAR had published its draft determination on airport charges at Dublin airport in June 2009 and before the CAR’s final determination in December 2009. The Minister’s direction stated that the CAR should ensure that the financial viability of DAA is protected. A list of government policies is mentioned in this regard including that the DAA is operated “... on a commercial basis without recourse to Exchequer Funding or an equity injection by the State and in that context the need to secure lender confidence and raise debt financing on a cost efficient

⁴¹ This does not appear to have been made public by the Minister – there was no press release on the Department of Transport’s website – but portions of the letter were cited in the CAR (2009) final determination on the charges at Dublin airport, while the full text of the letter is available on the CAR website: http://www.aviationreg.ie/_fileupload/2009-10-29_per_cent20Ministerial_per_cent20Direction.pdf. Accessed 8 October 2010.

basis” (cited in CAR, 2009, p. 13). This was widely interpreted as a signal to the CAR from the Minister for the CAR to increase the maximum allowable charges at Dublin airport.⁴²

Furthermore, the statutory mandate of the CAR has been changed such that it is more in tune with the aims of the regulated firm, the airport authority and less with users or consumers. In the Aviation Regulation Act, 2001 Section 33 stated that the objective of the CAR was in making determinations,

... shall aim to facilitate the development and operation of cost-effective airports which meeting the requirements of users ...

However, in the State Airports Act 2004, Section 22 changes the objectives of the CAR so that there are now threefold,

- (a) to facilitate the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users of Dublin Airport,
- (b) to protect the reasonable interests of current and prospective users of Dublin Airport in relation to Dublin Airport, and
- (c) to enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner.

Arguably the addition of objective (c) is either redundant in that it is implied by (a) or it means that the CAR needs to set its rates in such a way that it supports the financial interests of Dublin Airport Authority. Certainly in the three policy directions issued by the relevant Minister since the 2004 Act stress the investment and infrastructure requirements at Dublin Airport rather than users’ interests.^{43, 44}

IV RATIONALE FOR GOVERNMENT STATEMENT PROPOSALS

The Government Statement marks a shift, perhaps substantial, in the balance of power between regulatory agencies and Ministers. It makes regulatory agencies much more subject to the changing political preferences of

⁴² See, for example, O’Leary (2010).

⁴³ These policy directions are dated: 18 August 2005; 3 April 2007; and, as noted in the text, 27 October 2009. These policy directions may be found in the CAR’s website: http://www.aviationreg.ie/2005_Airport_Charges/Default.120.html. Accessed 21 December 2010.

⁴⁴ An examination of the legislative history of the other economic regulators in Table 1 does not suggest a similar evolution. Based on legislation as presented on regulators’ websites and other documentation such as annual reports.

Ministers, whether embodied in the Smart Economy document or the preference for green policies. Such a dramatic shift requires careful consideration and justification. The Government Statement does not provide this, although reference is made to the fact that the performance of the economic regulators has been evaluated (Department of the Taoiseach, 2009, p. 1). Hence reference is made to the EIU (2009) as well as recent EU Directives and Regulations on energy and telecommunications which address the issue of regulatory agency independence. The latter are important in that they set the framework within which national regulatory authorities such as the CER and ComReg must operate.

4.1 *The Economist Intelligence Unit Report*

Many of the proposals in the Government Statement are consistent with the eighteen recommendations of EIU (2009): the Government Statement is a restatement of policy towards regulators; the five year reviews of the mandate of regulators; not extending competition powers to other regulators besides ComReg; the recognition of the importance of multi-member regulatory commissions; the necessity to increase the skill and expertise of departments overseeing regulators; and others. In these cases EIU (2009) sets out a rationale for the proposed changes which need not be rehearsed here.

However, where the Government Statement departs company from EIU (2009) is, on the one hand, holding regulatory agencies to account through a whole series of mechanisms most of which are not recommended by the EIU⁴⁵ and, on the other, ensuring that the regulatory agencies have to take much more cognisance of evolving and current government priorities. These two strands of the Government Statement are, of course, inter-related. The increase in accountability and political direction are likely to be used to ensure that the evolving and current priorities are taken into account by regulators. The independence of regulatory agencies is likely to be compromised. It will also be more difficult for regulatory agencies to comply with their remit as they struggle to meet both statutory objectives and the current/evolving priorities imparted to Ministers and/or the Annual Regulatory Forum.

The EIU does not provide a justification for these Government Statement reforms; indeed, the latter runs counter to the whole thrust of the EIU report, which stresses the importance of independent regulatory agencies:

⁴⁵ The exception is that concerning regular five-yearly formal review of the mandates of the regulatory agencies. The EIU in making this recommendation acknowledges that “[T]here are some risks attached to such a process, such as creating a febrile lobbying environment. Nevertheless, we believe that these are outweighed by the advantages of a regular and fundamental review procedure (*ibid*, p. 171).

The independent status of the regulators is a strength and should be retained. Any attempt to change this would undermine regulatory credibility (*ibid*, p. 12).

In most cases, economic regulation in Ireland follows a generally recognised best practice in being delivered through independent regulatory agencies (*ibid*, p. 163).

... we recommend that the independent status of the relevant regulators should remain unchanged (*ibid*, p. 163, emphasis in original).

The EIU report stresses the importance of the independence of regulatory agencies for two reasons, both of which are discussed in Section II above. First, the EIU points out prior to the move to liberalise markets such as electricity and gas, the Minister and government departments "... were simultaneously responsible for determining policy for the sector, owning the monopoly service provider and regulating the market" (*ibid*, p. 19).⁴⁶ In order to resolve these potential conflicts independent regulatory agencies were created although as the EIU report points out this was often required by EU measures (*ibid*, p. 19). Since in energy, postal services, transport services and infrastructure the state still retains ownership of important regulated assets, the reduction in regulatory independence and the greater degree of Ministerial direction means that these conflicts are likely to re-emerge.

Second, independent regulation is an essential requirement in order to establish "regulatory credibility and commitment" (*ibid*, p. 19). Greater political control, combined with a willingness of Ministers to interfere in specific pricing decisions of regulators means that regulatory credibility and commitment may be compromised. In addition, as part of this discussion the EIU argues that there is trade-off between short-term and long-term gains. Reduced prices in the short term may lead to less entry and competition in the longer, with resultant higher prices. If the regulatory agencies are to pay greater heed to the evolving and current priorities of Ministers then it is likely that there will be a bias towards short-term gains, given the high discount rate of elected representatives.

Viewed in this context the accountability mechanisms outlined in the Government Statement are a step back from independent regulation. A variety of channels, some informal and lacking transparency, are opened by which Ministers can influence the behaviour of independent agencies. Furthermore, the kinds of topics or subject matter that could be the subject of political influence under these mechanisms appear to be very wide indeed. In this respect it should be noted that there already exists Ministerial power to issue policy direction to regulatory agencies which has been used to varying degrees

⁴⁶ See also *ibid*, p. 29, p. 39, p. 52.

depending on the regulatory agency (*ibid*, pp. 39-42). Why this power is not sufficient is not addressed in the Government Statement.⁴⁷

4.2 *EU Energy and Telecommunications Policy*

The EU has played a critical role in the development of regulation in Ireland. It was responsible for the movement towards greater liberalisation of protected sectors such as energy, postal services, telecommunications, and so on. However, its influence is not just a once off call for more liberalisation, but rather an ongoing programme of reform, marked by a series of directives and regulations. Hence, given the influence of the EU, there may be justification for increased political direction and the reduction in the independence of regulators from this source. However, this is not the case. In a series of recent directives, regulations and guidance notes the EU in electricity, gas and telecommunications has made considerable efforts to ensure that regulators are independent, specifically referring to the role of government.

In recent EU reforms of the energy sector, referred to as the Third Package, which came into effect on 3 March 2011, reference is made to the concern that the "... effectiveness of regulation is frequently hampered through a lack of independence of regulators from government, and insufficient powers and discretion" (Directive 2009/72, Recital 33).⁴⁸ The Directive devotes considerable attention to ensuring the national regulatory agencies ("NRAs") such as the CER, are independent stating that, "Member States shall guarantee the independence of the regulatory authority and shall ensure that it exercises its powers impartially and transparently" (*ibid*, Article 4). For example, the NRA must be legally distinct, not seek or take direct instructions from any government or other public or private entity, be able to take autonomous decisions with limitations of length of tenure of top

⁴⁷ The issue was raised in subsequent exchange in the Oireachtas Joint Committee on Economic Regulatory Affairs on 19 January 2010 between a Deputy and a member of the interdepartmental senior official's group on economic regulation. In response to the Deputy's query as to why policy directions were not sufficient, after pointing out that policy directions relate to general policy issues not individual decisions, the official continued, that the regulatory forum "... will focus on issues of competitiveness and cost diversions where they occur. There is ongoing dialogue which allows these issues to be raised with regulators and for regulators to be sensitised in these areas, as long as the political system is not making those individual decisions." Thus it appears there is a necessity to condition regulators to broader policy issues such as competitiveness that for some reason, either before or after the dialogue of the Annual Economic Forum, cannot be set down as a policy direction.

⁴⁸ The full title of the Directive is: Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC.

management. Thus, while it is always difficult to secure independence, these provisions clearly indicate the direction that the Third Package wishes to go.⁴⁹

The European Commission's ("the Commission") interpretative note on the Directive in relation to regulatory authorities, the rationale for independent regulatory agencies is articulated:

The provisions on the independence of the NRA's staff and persons responsible for their management are key requirements because they are aimed at ensuring that regulatory decisions are not affected by political and specific economic interests, thereby creating a stable and predictable investment climate (EC, 2010, p. 6).

In the regulatory reform of the electronic communications network in Directive 2009/140,⁵⁰ recital 13 states that:

The independence of the national regulatory authorities should be strengthened in order to ensure a more effective application of the regulatory framework and to increase their authority and the predictability of their decisions. To this end, express provision should be made in national law to ensure that, in the exercise of its tasks, a national regulatory authority responsible for *ex-ante* market regulation ... is protected against external intervention or political pressure liable to jeopardise its independent assessment of matters coming before it.

Furthermore, in Article 3(a) of the Directive it is stated that "... national regulatory agencies responsible for *ex-ante* market regulation ... shall act independently and shall not seek or take instructions from any other body in relation to the exercise of tasks assigned to them under national law implementing Community law."⁵¹ This emphasis on independence in telecommunications regulation is longstanding (Doyle, 1997).

In sum, the thrust of the Government Statement's move towards less regulatory independence is inconsistent with both the EIU report review of the

⁴⁹ Directive 2009/72 contains extensive provisions relating to the general objectives, as well as the duties and powers of NRAs. The general objectives include "... promoting ... a competitive, secure and environmentally sustainable internal market", "... eliminating restrictions on trade in electricity between Member States", and, "... facilitating access to the network for new generation capacity" (*ibid*, Article 36). The specification of duties and powers in Article 37 is very extensive.

⁵⁰ The full title of the Directive is: Directive 2009/140/EC of the European Parliament and of the Council of 25 November 2009 amending Directives 2002/21/EC on a common regulatory framework for electronic communications networks and services, 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities, and 2002/20/EC on the authorisation of electronic communications networks and services.

⁵¹ Directive 2009/14 also sets out other conditions designed to ensure independence such as the conditions under which the head (or members of a collegiate body) of a regulatory authority can be dismissed and that national regulatory authorities shall have sufficient resources.

regulatory environment commissioned by government and the EU legislation on independence of regulatory agencies in energy and telecommunications.

V TWO POSSIBLE EXPLANATIONS

The discussion so far thus poses something of a puzzle. Government policy is aimed at reducing regulatory independence of the economic regulators. However, there is little or no support for the Government Statement's position in either the EIU report or recent developments in EU energy and telecommunications regulatory policy. Indeed, these appear to argue for the maintenance not the erosion of regulatory independence. This raises the obvious question: why? In this section two possible explanations are offered.

5.1 *Independent Regulatory Agencies are Anomalous*

The Irish political system is highly centralised, according to a number of indicators. Political scientists, for example, classify countries by the degree to which the executive controls the legislature. In these studies Ireland ends at one extreme in terms of executive control of the legislature, with countries such as the Netherlands and Sweden, where the Parliament has a much more important role, at the other end (Hardiman, 2009, pp. 56-7, and Figure 4, p. 56). One graphic illustration of this power was the passage in less than a day of the Credit Institutions (Stabilisation) Bill 2010, a complex piece of legislation that will give the Minister for Finance considerable discretion with respect to credit institutions, for which there was no prior consultation and little discussion or critical examination by elected representatives.⁵² In the area of public finance the share of all taxes accounted for by the national government is an indicator of the importance of the central government vis à vis sub-national levels of government; the higher the percentage of total taxes accounted for by the national level of government the greater the importance of the centre. Figure 1 presents such data for 30 OECD countries for 2003. This shows that Ireland is at one extreme, together with Greece, in terms of the share of all taxes accounted for by national governments. It could be argued however, that this indicator is of limited value, since given the small size of Ireland sub-national governments are inevitably going to be of limited

⁵² The European Central Bank ("ECB") has raised concerns about the legislation so it may be revised, despite being passed into law. The Bill, and explanatory memorandum may be found at: <http://www.oireachtas.ie/viewdoc.asp?fn=/documents/bills28/bills/2010/5810/document1.htm>, while the opinion of the ECB may be found on its website: http://www.ecb.int/ecb/legal/pdf/en_con_2010_92_f.pdf. All accessed 21 December 2010.

importance. However, this argument does not stand up to scrutiny: for several quite small countries such as Iceland (population 400,000) and Denmark (population 5.5 million) sub-national levels of government are quite important despite a small population. Furthermore, there are sound grounds in terms of local autonomy and accountability for subnational taxation (Bird, 2010; Commission on Taxation, 2009, pp. 423-467).

Regulatory agencies go against the grain in a centralised state. They are, in some sense, anomalous or, to use a terms coined for such agencies in Canada, “structural heretics.”⁵³ Regulatory agencies are not only independent but seen to be independent. The simple solution to this anomaly would be to abolish such agencies and reincorporate the regulatory functions within government departments. However, this would be inconsistent with EU policy and would remove the advantages noted above in terms of independent agencies. Thus a compromise is to retain the regulatory agencies, but through the mechanisms outlined in the Government Statement, Ministers are able to exert much greater control over regulatory agencies.⁵⁴

5.2 Delivering on Social Partnership

Social partnership is an interest group accommodation model of economic governance which has been employed in Ireland since the mid-1980s.⁵⁵ Whether the hiccup in reaching an agreement occasioned by the financial crisis spells the death knell of these arrangements is too early to tell. In any event partnership agreements, as they have evolved over time, have come to cover an increasingly wide array of economic and social issues, across virtually all sectors of the economy. Reaching these agreements is a complex bargaining process, in which of the groups represented, primarily organised labour and business, make various trade-offs, given the interests they represent and their objectives.⁵⁶ Government plays a vital role in not only convening and organising such meetings but also in participating in the bargaining process

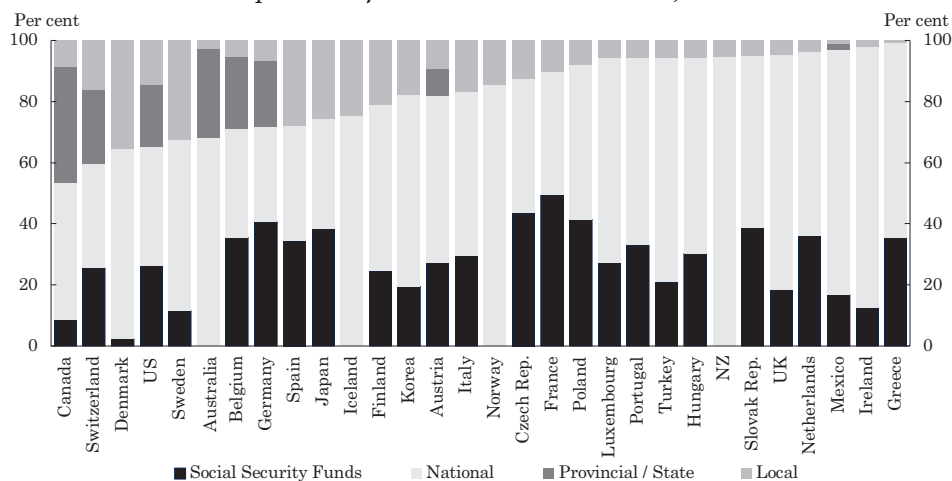
⁵³ See Economic Council of Canada (1979, p. 54) and references cited therein.

⁵⁴ Such an arrangement also has certain political advantages of regulatory agencies in terms of responsibility for unpopular decisions such as approving price increases being assigned to the regulator not the Minister. Furthermore, to the extent that Ministers communicate in a non-transparent manner evolving priorities and policy preferences, which are then reflected in regulatory decisions, there is a danger that Ministers will not be held to account for such priorities/preferences. Ministerial policy directions avoid this problem.

⁵⁵ The first partnership agreement covered 1987 to 1990. For details see Department of the Taoiseach (1987). For a discussion of partnership see Hardiman (2000; 2006).

⁵⁶ This view that it is largely self interest which drives participants is not shared by all commentators. For example, Dermot McCarthy, Secretary to the Department of the Taoiseach takes a more benign view: “[T]he very concept and practice of social partnership reflect, however, imperfectly, the conviction that there is a common good and that mutual obligations should be a powerful influence on behaviour” (McCarthy, 2009, p.96).

Figure 1: *The Tax Burden Share by Level of Government OECD-30, as a Proportion of Total Taxation Revenue, 2003*



Note: For a large number of countries, the OECD has not allocated a large proportion of social security contributions to any particular level of government. For the purpose of this analysis, these contributions have been assigned to the national government. Consequently, some caution should be exercised in interpreting these data.

Source: Australian Treasury estimates reported in Warburton and Hendy (2006) Chart 3.4, p. 37.

and in responding to demands by labour and business for pay and other changes in order to facilitate agreement.

In some instances the social partners demand changes that can only be delivered by regulatory agencies. As noted above IBEC raised the issue of lower electricity prices, while earlier in the decade the Irish Congress of Trade Unions had raised the issue of whether certain groups, including voice-over actors, could be made exempt from competition law. The fact that these regulatory agencies are independent of government means that delivering on any government promises or commitments is likely to take time and may make explicit costs that may have been implicit. If the Minister is responsible for the regulatory decision, then the degree of transparency is likely to be less.

In the case of the issue of electricity prices, in which the Minister requested the CER to lower prices – referred to above – the CER (2009a, p. 4) explicitly drew attention to the cost of the Minister’s intervention in its proposed decision: “[T]he re-profiling is not without risk, as it deviates from established regulatory process creating market uncertainty and introducing unpredictability into regulatory decisions.” In the CER’s final decision, which summarised the various submissions received, several firms expressed concerns as to the impact of the re-profiling on regulatory risk and

predictability. For example, CER (2009b, p. 23) report that: “ESB Networks raised their concern that the re-profiling option significantly distorts the whole framework of unbundling and price regulation that has been developed over the last decade. Further to this it introduces significant additional risk and is likely to increase the perceived Regulatory risk in Irish network infrastructure assets and consequentially increase the cost of capital.”

Equally as part of partnership discussions the ICTU were encouraged to see whether the Competition Authority would consider certain arrangements exempt under the relevant section of the Competition Act. Although the last word as to whether or not a particular set of arrangements is for the Courts to decide, the Competition Authority could have indicated that the arrangements were not in its view a breach of the Competition Act and as a result no enforcement action would be taken. However, the agency refused to adopt this position and instead took the view that the arrangements were anti-competitive. The government is to introduce an explicit amendment to the Competition Act exempting the arrangements from the law.⁵⁷

In both cases, and no doubt in others, if regulatory agencies are subject to greater political direction with respect to current and evolving priorities, which would no doubt include partnership arrangements, then regulatory agencies may be more inclined to adhere to such priorities and perhaps not always note the costs.

The two explanations for the reduction in regulators independence are not necessarily, of course, mutually exclusive. Increased Ministerial control could simultaneously remove the anomaly for Ireland, and advance social partnership.

VI IMPLICATIONS

The Government Statement on Economic Regulation proposes a number of sensible reforms to the regulatory system in Ireland that are likely to improve regulatory performance. These include: developing regulatory expertise in government departments; periodic reviews of regulatory agency mandates and structures; not extending competition powers to regulatory agencies beyond ComReg; the development of indicators to monitor regulatory agency performance; affirming the importance of scrutiny by Oireachtas Committees

⁵⁷ For a discussion see Gorecki (2009b). However, it is not clear that this exemption will be introduced since the EU-IMF (2011, p. 15) bailout programme for Ireland states that, “[N]o further exemptions to the competition law framework will be granted unless they are entirely consistent with the goals of the EU/IMF-supported programme and the needs of the economy.”

of the performance of regulatory agencies; and, structured co-operation between regulatory agencies. However, the Government Statement also, potentially at least, reduces the independence of regulatory agencies by a combination of holding regulatory agencies to account through a whole series of additional mechanisms, while at the same time instructing regulatory agencies to take into account evolving/current priorities. Thus, while there is likely to be some improvement in the quality of regulation, there are also moves to recentralise power.

The first meeting of one of these mechanisms, the Annual Regulatory Forum, provides a flavour of these priorities including paying attention to the climate change agenda and the international regulatory environment, as well as supporting new and green technology and the government's framework for economic renewal, *Building Ireland's Smart Economy* (Department of the Taoiseach, 2008). It is difficult to gauge the practical effect of reducing the independence of regulatory agencies, in part because the legislation required has not been published and in part because there is no record as to the impact of the implementation of the proposals. Hence any conclusions must of necessity be tentative.

It could be argued that the proposals to reduce regulatory independence will be largely symbolic and have little or no practical implications for regulatory decisions. The facts on the ground will not change. Some of the items mentioned at the conclusion of the first Annual Regulatory Forum such as considering new technology are already likely to be taken into account by regulatory agencies. Ministers are already able to give general policy directions to regulatory agencies which have to be followed by the regulatory agency. Furthermore, it is likely to be difficult to formulate legislation that successfully reconciles the need of the regulatory agency to take into account, as yet, unspecified evolving/current priorities of Ministers with the existing expressly stated statutory objectives of the regulatory agency. Thus the implication of this scenario is that regulatory agency independence and performance will be largely unaffected by the Government Statement, but nevertheless the public and private costs of regulation will be increased due, on the one hand, to the raft of mechanisms designed to both increase regulatory accountability and impart the evolving/current priorities of Ministers to regulatory agencies, and, on the other, to the rent seeking behaviour of regulated firms – whether public or privately-owned – as they seek to effect the priorities of Ministers. Hence the advantages of an independent regulatory agency outlined above are unlikely to be seriously undermined, although they may be somewhat attenuated.

There is, however, an alternative scenario which sees the Government Statement as presaging much greater Ministerial direction and intervention.

In this respect the Government Statement cannot be seen in isolation from other policy developments. As noted above, in 2009 Ministers intervened with respect to regulatory pricing decisions. The recent legislation for the NTA permits the appointment of the Chairman by the Minister without any competition for the post. The Government Statement's proposals were not subject to public consultation.⁵⁸ The legislation under which regulators will be required to take into account evolving/current priorities may be no more than regulatory agencies and shall have regard to such priorities; in other words, a somewhat soft policy direction.

The likely impact of greater Ministerial intervention in regulatory decisions will be to make the regulatory agency's tasks more difficult and complex. First, the regulatory agency is likely to face multiple goals, some of which may conflict. This is analogous to the EIU (2009, p.166) concerns about mission creep – "... additional functions and tasks being added at the expense of focus on core [regulatory] objectives." The evolving/current priorities that regulatory agencies might have to face can be illustrated by an examination of the Key Actions in *Building Ireland's Smart Economy*. All regulators when examining new investments would have to have review "... capital investment allocations ... to identify the scope for re-priorisation towards more labour-intensive activities" (Department of the Taoiseach, 2008, p. 10). ComReg would have to show regard for "... equipping second-level schools with 100Mb per second broadband connectivity" (*ibid*, p. 16). The CER would have to take into account the "... increase [in] the production of renewable electricity in a cost-effective manner to meet the new increased target of 40 per cent of electricity from renewable resources by 2020," as well as facilitating the building of an additional 400MW of wind electricity generating capacity over 2008-2010 (*ibid*, p. 17).

⁵⁸ It is, of course, the case that in preparing its report that the EIU consulted extensively with various stakeholders including the regulators, organisations representing business (e.g. Irish Business and Employers Confederation, Small Firms' Association), labour (Irish Congress of Trade Unions), and members of the Oireachtas, while it was well flagged by Government that it was going to undertake such an international benchmarking study. Hence it could be argued that there was little need to consult on the Government Statement. However, it is not clear that the case for no further consultation is compelling. First, as noted above, in some important respects the Government Statement differs from the EIU report. Thus the prior consultation by the EIU in preparing its report may be of limited usefulness with respect to these Government Statement proposals. Second, while many interest groups were consulted by the EIU, not all groups or individuals were consulted with an interest and expertise in public administration and regulation. Third, the Government White Paper, *Regulating Better*, discusses the need to consult more widely before regulating (Department of the Taoiseach, 2004, p. 26). While the Government Statement is not concerned with new regulation it is nevertheless an important policy document concerned with the way that regulation is monitored, structured and administered.

Second, regulatory agencies make decisions that reflect the long run, given the nature of the investments made in energy, telecommunications, and airports. Thus the emphasis is on providing stability and certainty in regulatory procedures and parameters in making major decisions in areas such as prices and investment. However, evolving/current priorities are much more likely to be driven by short-term considerations that may well prove transitory. Hence there is a mismatch in the time horizon used in regulatory decisions, reflecting the need for predictability and certainty by the regulated firms, and the desire of Ministers for immediate short-term considerations to enter the decision-making process. Thus, given the potential adverse impact of such interventions, every attempt should be made to ensure that very careful consideration is given to the costs and benefits and consequences, both intended and unintended of such interventions.

By lessening the independence of regulators and assigning them responsibility for new evolving/current priorities in addition to core responsibilities there is a danger that neither set of objectives will be met. Government policy towards the CBFSAI provides a case example of multiple (and conflicting objectives) and Ministers imparting evolving/current priorities. The CBFSAI was given statutory responsibility for micro-prudential supervision *and* promoting the financial sector. Promoting the financial sector was seen as consistent with a regulatory approach "... which was and was perceived to be excessively deferential and accommodating; insufficiently challenging and not persistent enough. This meant not moving decisively and effectively enough against banks with governance issues" (Honohan, 2010, p. 16). Attempts by CBFSAI to introduce Directors' Compliance Statements despite being approved by the Oireachtas in legislation, were unsuccessful, in part because the relevant Department and Minister conveyed evolving/current priorities that such a move might damage the competitiveness of the sector (*ibid*, pp. 48-51). The high profile received concerning the promotional aspect of the mandate of the CBFSAI, arguably was at the expense of micro-prudential matters relating to the stability of the banking system, and exacerbated the impact of the financial crisis on Ireland. Indeed, the reaction of government to that crisis was to remove the "promotional" aspect of the CBFSAI's mandate, while moves to improve the corporate governance of credit institutions have and are being introduced.

Neither of the posited outcomes of the Government Statement with respect to regulatory independence is likely to improve economic performance, although one is clearly much more damaging than the other. Both reduce the credibility of the pre-commitment that independent regulatory agencies supply, which is vital for sound pricing and investment decisions in regulated sectors. More intervention by Ministers is likely to raise the sceptre of

increased uncertainty occasioned by the conflicting pressures on the Minister in his or her various roles. Regulated firms, whether publicly or privately-owned, are likely to try to put pressure on the Minister to influence a regulatory agency. Such adverse outcomes suggest that some thought might be given to a consultation exercise to give full consideration to these reforms in the Government Statement before they are set in practice and statute.

The election of a new government in February 2011 offers the opportunity to reconsider the proposals in the Government Statement. The Programme for Government does not address the issue. Under the heading 'Regulation,' reference is made only to rationalising regulators "... to strengthen consumer regulation and the consumer interest" (Department of the Taoiseach, 2011, p. 61). This theme was echoed at the Second Annual Economic Forum held in June 2011. However, the EU-IMF bailout package of measures is likely to impact on the proposals in the Government Statement. The package calls for an independent regulator for the legal profession (EU-IMF, 2011, p. 30). The package also calls for, "... based on the results of the assessment of the efficiency of the gas and electricity sectors," a strengthening of the regulatory reform programme so as to improve governance (*ibid*, p. 35). As noted above the EU's view as to the meaning of an independent regulator and its view of regulation are inconsistent with the elements of the Government Statement designed to reduce the independence of regulators. Hence there is likely to be a dialogue between the EU-IMF and the State over regulatory reform and structures.

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