THE UNIVERSITY OF
MELBOURNE

Melbourne Regulation and Design Network

Policy Brief

The Regulatory State: Faults, Flaws and False Assumptions

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February 2025

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1. The Regulatory State

In most democratic nations the 'regulatory state' has become so pervasive that almost every aspect of life, especially commercial life, is impacted by regulation and regulators. At the same time societal and political expectations pull regulators in different directions. Despite this attention, and their importance, most regulators suffer from chronic flaws and false operating assumptions. Consequently, many regulators face a continuing stream of criticism from a diverse array of mostly conflicting voices and a cycle of inquiries into their perceived shortcomings.

The almost exclusive focus on a regulator's performance in these criticisms is misplaced. Certainly, these agencies deserve close attention, but they should not be the *only* focus. Instead, attention should be paid to the entire *regulatory system*; that consists of (*inter alia*): (i) government, (ii) parliament, (iii) business, (iv) professions, (v) civil society, (vi) the legal system, (vii) other public regulators, and (ix) those engaged in private regulation[2]. Moreover, it is important to emphasise that responsibility for the design of a regulatory system rests with government and parliament (as the architects of these systems). It must also be recognised that the 'front line' of all regulatory systems are the regulated persons/ entities themselves. Those regulated have responsibilities and duties under the law. Indeed, they are 'duty holders' who are crucial to the success of regulatory systems; as airlines are to aviation safety. What's more, society expects those regulated to obey the law and act ethically.

Where there are regulatory failures, the blame is usually not exclusively that of the regulators. Instead, failures (perceived or actual) often result from chronic flaws in the design and structure of the regulatory system (not to mention the breach of law and community trust by those who broke the rules in the first place). Accordingly, there is a need to better understand how regulators operate within that broader system, and how they are governed and held to account. To this end, we need to understand their design, structural, and operational characteristics; and how these characteristics frequently malfunction. In turn, these malfunctions have a profound impact on the sector or industry (a **domain**) seeking the benefits of regulation.

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[2] See Steurer, R. (2013). Disentangling governance: A synoptic view of regulation by government, business and civil society. Policy Sciences, 46(4), 387–410. https://doi.org/10.1007/s11077-013-9177-y.

2. Systemic Flaws in Regulatory Systems

2.1. Executive Summary

Twelve Flaws in Regulatory Systems
1. Regulatory systems (in their entirety) are rarely properly designed; and if they have been, the design quickly becomes out-dated. Moreover, the design stage invariably concentrates on the creation of the regulator and the drafting of its rulebook; resulting in haphazard and polycentric regulatory structures, not coordinated regulatory systems. 2. Regulators very often lack precise and meaningful role clarity in their governing statutes (or foundational documents). 3. It is often unclear how independent a regulator is (or should be); and where they are nominally independent, very often that autonomy is (in practice) diluted. 4. Regulators are by design monopolies; yet their monopolistic tendencies are not countered by the regulators themselves, nor by their government or parliamentary overseers. 5. Many regulators suffer from sub-optimal *internal* corporate governance structures. Meaning that ongoing operational improvement feedback loops are often ineffective (or non-existent). 6. Regulators often have poor *external* accountability structures, usually because of ineffective external oversight bodies, especially parliamentary committees. This means that many (powerful) regulators, are not, in practice, being properly held to account or assessed by an elected branch of government. Again, this means improvement feedback loops are ineffective (or non-existent). 7. Measurements of regulatory effectiveness are immature, lack uniformity and consistency, and often focus on *outputs*, not *outcomes*. Rarely do assessments reference the achievement of regulatory objectives (that should serve as performance benchmarks). 8. There is insufficient recognition that, in addition to legitimacy, 'regulatory credibility' is foundational for a regulator to be effective. Regulatory credibility is the level of confidence that the regulatory system achieves its purpose. 9. Regulators often must administer overly complex, voluminous, out-of-date, and/or frequently conflicting legislative regimes. This complicates and constrains a regulator's work. 10. There has been a failure to optimise the efficacy of all participants within regulatory systems; especially those regulated who are 'duty-holders'. 11. Regulators are usually operationally overburdened and budget constrained; they are frequently: (i) asked to do too much with too little; and (ii) given evermore responsibilities by governments and legislatures. 12. There is too little internal and external understanding of the unique cultural and motivational drivers of regulatory officials; that is the 'bright' and 'dark sides' of the concepts relating to Public Service Motivation (PSM).

2.2. Twelve Systemic Flaws in the Regulatory State

Regulation has become "a key tool for achieving the social, economic and environmental policy objectives of governments that cannot be effectively addressed through voluntary arrangements and other means"[3]. As such, "regulators are… important actors in the national governance infrastructure"[4] and are increasingly assuming greater powers, functions, and responsibilities. Indeed, regulators now constitute a "vast white-collar police force" that reflects the "ascendency of the regulatory state"[5].

Despite this status, and the ever-growing importance of regulators in the "national governance infrastructure", the following flaws commonly disrupt and distort their work:

1. Regulatory systems (in their entirety) are rarely properly designed; and if they have been, the design quickly becomes out-dated. Moreover, the design focus invariably concentrates on the creation of the regulator and the drafting of its rulebook. Over time this has resulted in multiple regulators forming haphazard and polycentric regulatory structures instead of carefully designed regulatory systems[6]. Accordingly, the architects of the regulatory system (government and parliament) need to properly design the entire *system* and, thereafter, regularly examine and improve upon it. This requires recognition: (i) of the role of *all* other institutions and participants in the regulatory system; and (ii) that the system must fit within a broader network of supporting and interlocking regulatory systems. Most of the following flaws flow from the failure to properly design *regulatory systems* in the first place.

An example of a regulator within a *regulatory system*

[3] OECD, The Governance of Regulators, 2014 (*OECD 2014*) p. 19.
[4] *Ibid*.
[5] Coglianese, Cary and Kagan, Robert (eds.) Introduction to Regulation and Regulatory Processes (Ashgate Publishing, 2007), p. xiii; Yeung, Karen, 'The Regulatory State', in Robert Baldwin, Martin Cave and Martin Lodge (eds), *Oxford Handbook of Regulation* (Oxford, 2010), Chpt. 4.
[6] Leading Baldwin et. al. to observe that "regulatory regimes are said to have become more polycentric, fragmented, and 'decentred' as responsibilities have been spread vertically and horizontally across governmental systems", Baldwin, Robert, et al. *Understanding Regulation: Theory, Strategy, and Practice*, Oxford University Press, 2012 (*Baldwin 2012*), p. 338.

2. (Astonishingly) regulators very often lack sufficient and precise role clarity. Rarely do regulators have a clear, unambiguous articulation of their regulatory goals or objectives in their governing statutes (or foundational documents). Nor do they have precise and workable expectations from government or parliament (as representatives of the community). This results in a chronic expectations' gap. Moreover, imprecise, including vacuous, broad, competing or conflicting role articulation leads to internal confusion, inconsistent decision making, and strategic ambiguity. It also leads to poor levels of external understanding of a regulator's purpose and functions. All this results in confusion and unrealistic (and conflicting) expectations by the regulated population, politicians, the media, and the broader community.

3. It is often unclear how independent a regulator is (or should be) both in: (i) determining its objectives and outcomes, and (ii) the operational means of achieving them. Moreover, where they are (at least nominally) independent (or need to be), avenues to compromise that autonomy usually exist (such as tied funding, leadership appointments and re-appointments, biased reporting mechanisms, and/or budget dependency).

4. Regulators are, by design, the exclusive holders of their public service functions and powers; in other words, they are monopolies within their jurisdiction. Within a jurisdiction there are no alternative or competing agencies with the same responsibilities[7]; accordingly, there is (in most cases) no risk of losing 'market share'. This means, unlike much of the private sector, there is no competitive tension continuously driving improvement, innovation, and efficiency[8]. Instead, many regulators (like many other public service institutions) suffer from organisational and operational challenges inherent in monopolistic corporations. And whilst this may be a statement of the obvious, it is not obvious that it is addressed by regulators and governments (who rarely, if ever, see themselves in this light).

   The history of monopolies reveals that the absence of a competitive dynamic means that: (i) demand side forces are supressed and muted (in the case of regulatory systems, the 'demand side' are the beneficiaries of regulation, such as the community), (ii) the drive for efficiency is supressed, (iii) bureaucracy reigns, (iv) management becomes unrepresentative and unresponsive, and (v) distorted and (sometimes) unfair and selfish outcomes result (including regulatory capture). Ordinarily monopolistic challenges are countered with specific public oversight and regulatory solutions (such as price control regulations for modern corporate monopolies)[9]; yet countervailing mechanisms are rarely (if ever) adopted in relation to regulators (this conclusion is further explored immediately below in the context of *internal* governance and *external* accountability).

[7] Of course there could be some overlapping responsibilities; especially in federal systems; there could also be a degree of (but not complete) competition coming from foreign jurisdictions.

[8] Institute for Government, "Parliament and regulators: How select committees can better hold regulators to account", 2024 (*Institute for Government 2024* – see https://www.instituteforgovernment.org.uk/sites/default/files/2024-04/parliament-and-regulators.pdf), p. 10.

[9] *Ibid*; where it was noted that "In the absence of competitive pressures that in the private sector might spur innovation or force a failing organisation to close, oversight acts as a discipline on the performance of regulators."

5. Many regulators suffer from sub-optimal *internal* corporate governance structures; meaning that ongoing operational improvement mechanisms and feedback loops are often ineffective (or non-existent). A recurring example of this in commission-led regulators is the blurred (and confused) lines demarcating executive (including CEO) responsibilities from those of the governing commission[10]. This then limits a regulator's ability to make the best possible decisions in relation to the constant trade-offs it must make as regards priorities pursued, tools deployed, jurisdiction covered, and cases enforced; this is the 'regulator's dilemma'.

6. Closely related to (but distinct from) the *internal* flaw recognised above, regulators often have poor *external* accountability structures. This is usually because external oversight bodies, especially parliamentary committees, are ineffective in their important governance functions[11]. In the case of parliamentary committees, they are frequently used not for the purposes of holding powerful unelected agencies to account, but for prosecuting *ad hoc* political issues. Moreover, rarely do parliamentary committees holistically and consistently review a regulator's effectiveness and its adherence to its mandate; nor do they apply consistent regulatory performance methodologies (see flaw 7).

   Again, the consequences of the monopolistic nature of regulators (explored in flaw 4) increases the need for meaningful external oversight[12]. Alarmingly, the combination of significant powers delegated to a regulator and the lack of, or deficiencies with, parliamentary oversight of these monopolies means they: (i) are not properly held to account by a democratic branch of government; and (ii) effectively sit outside the executive branch. Consequently, many regulators constitute a separate, fourth branch of government. Ultimately, this undermines the core constitutional (and democratic) concept of 'responsible government'[13] and the democratic legitimacy of the regulator (this important conclusion is explored further in the 'false assumptions' below).

7. The current measurements of regulatory effectiveness utilised by regulators, or their overseers, lack uniformity and consistency. Moreover, regulators are often required to report on generic criteria or (potentially perverse or unhelpful) *output* data (not *outcomes*). Instead, to entrench (and incentivise) a regulator's improvement feedback loops the assessment of, and the reporting on, the achievement of its objectives is required[14]. Accordingly, this flaw is closely related to the absence of effective internal governance (flaw 5) and external oversight (flaw 6).

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[10] Enriques, Luca and Hertig, Gerard, "Improving the Governance of Financial Regulators" in European Business Organization Law Review 12: 357-378, 2011 (*Enriques & Hertig 2011*), p. 366.

[11] Institute for Government 2024,

[12] Enriques & Hertig 2011, p. 365.

[13] Where executive agencies are responsible to Parliament (in Westminster systems) or Congress or the President in the American system.

[14] Enriques & Hertig 2011, p. 375.

8. There is insufficient recognition of the foundational need for a regulator to have 'regulatory credibility'.[15]. To be effective, regulators must be more than legitimate, this is a threshold requirement, but for the reasons stated in the flaws above this too is often in question. In addition to legitimacy, regulators must be: (i) credible within the regulatory system; and (ii) credible and trusted by the community at large. Regulatory credibility (that includes, but is not limited to, credible deterrence) is the belief and confidence in the effectiveness of the regulatory system (generally), and in the regulator (specifically), by affected stakeholders including the regulated population. Put simply, it is the level of confidence that the *regulatory system* works in achieving its purpose (hence why its regulatory objectives need to be clearly articulated – see flaw 2).

   Here, the Organisation for Economic Co-operation and Development (**OECD**) advises that "how a regulator is established, directed, controlled, resourced and held to account… *builds trust* in the regulator and is crucial to the overall effectiveness of regulation.".[16] Accordingly, one critical factor to achieving this trust and credibility is the regulator's own governance and oversight arrangements (flaws 5 and 6).

   Again, regulatory credibility, in addition to legal and democratic legitimacy, is crucial to bringing confidence to a sector's participants (especially those regulated) and beneficiaries (e.g., consumers) that the regulatory system is achieving its purpose. For example, that the airlines are safe, workplaces are hazard free, the banking sector is prudentially sound, the environment is not being polluted, etc. Thus, credible regulation enhances the overall integrity, utility, and usability of the underlying domain.

   In addition to bringing confidence to the overall integrity of the sector, regulatory credibility influences behaviour by participants within that sector, especially those regulated. Here, the 'soft power' of regulatory credibility acts as an *incentive* to comply (and possibly even become regulatory agents); meanwhile, the 'hard power' of credible deterrence acts as a *disincentive* against breaking laws.

9. Regulators often must administer overly complex, voluminous, out-of-date, and/or frequently conflicting legislative regimes (triggering the perennial debate for-and-against principles-based regulation). These legislative regimes are also often incomplete, have definitional constraints (particularly as regards the extent of a regulator's jurisdiction), and lag sectoral and technological developments. This complicates and constrains a regulator's work, diminishes a regulator's credibility, and makes it more difficult for those regulated to comply. Accordingly, meaningful and timely law reform is needed to ensure that the rule book is up to date, not overly complex, and appropriately empowers the regulator. The failure to do so is a fundamental failure of governments and legislatures (the designers and builders of regulatory systems).

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[15] '*Regulatory credibility'* (or a 'credible regulatory system') builds on the narrower, constituent concept of 'credible deterrence'; that is commonly utilised by regulatory and law enforcement agencies. Whilst 'credible deterrence' aims at "deterring misconduct" in the relevant regulatory system (and is thus a 'disincentive'), 'regulatory credibility' is where the regulatory system is believed and understood by stakeholders and the community to live up to its purpose(s) and deliver its functions.

[16] OECD 2014, p. 15 (original emphasis).

10. In many regulatory systems there has been a failure to optimise the efficacy of all participants within the system. In particular, there has been a failure to co-opt those regulated as ('on the ground') agents for the achievement of the system's regulatory objectives. There are important exceptions to this, such as safety regulation in the nuclear and aviation industries. For example, in aviation airlines, plane manufacturers, pilots, engineers, and (even) passengers usually subscribe to the regulatory goal of 'safe airline travel'; indeed, all these actors have mostly become agents of a clear regulatory purpose[17]. These exceptions stand in stark contrast to the deficient collaboration in most other regulatory systems.

    In large part, the failure to co-opt those regulated as regulatory 'agents' results from the failure: (i) to optimise a regulator's credibility (see flaw 8); and (ii) to identify and articulate regulatory objectives that can be clearly understood and supported by the participants and stakeholders within the regulatory system (flaw 2).

11. Regulators are frequently asked to do too much with too little and are being given evermore responsibilities by governments and legislatures (often without commensurate funding support). This means that even if regulators are highly capable, they are invariably capacity constrained, especially in terms of resourcing and budget. This constraint also exacerbates the 'regulator's dilemma' (see flaw 5) by increasing the opportunity costs of perennial trade-off decisions.

12. There is too little understanding (internally and externally) of the unique cultural and motivational human-capital challenges within regulators. Specifically, greater understanding is needed of how:

    a. The concepts of Public Service Motivation (**PSM**)[18] apply to regulators;
    b. PSM concepts can be optimised within a regulator (including by leveraging the agency's regulatory objectives[19] and public interest purpose); and
    c. PSM drivers interact with regulators' "desire to increase their personal power, their prestige and their career chances, while at the same time minimising the legal and reputational risk connected with the discharge of their duties."[20]

[17] This is not to say that the market and or consumer protection of the aviation industry has reached the same level of regulatory collaboration as apparent with airline safety.
[18] Perry J., Lois R. Wise, The Motivational Bases of Public Service, *Public Administration Review*, 50, 367-373.
[19] Again, highlighting the importance of statutory objectives and the need for their clear articulation.
[20] Enriques & Hertig 2011, p. 362.

2.3. The Consequences of the Twelve Systemic Flaws

Whilst all the identified flaws are systemically important and require policy responses, the first flaw, the failure of governments and parliaments to properly design (and update) regulatory systems, is 'first amongst equals'. If this specific flaw is not addressed the continuing (defective) cycle of regulatory reform (primarily) focused on the regulator, and not the broader system, will continue. Borrowing from medical science, the current *ad hoc* nature of 'regulatory failure' inquiries only identifies where the symptoms are manifesting (often with the *regulator*) and not the root-cause (very likely a design fault or a chronic failure more broadly within the *regulatory system*).

Unfortunately, when the failure to properly design a regulatory system is combined with poor governance and oversight, and inconsistent and *ad hoc* performance reviews, there is little hope that the ongoing cycle of criticism and inquiries will be broken. Until such time as this cycle is broken the real deficiencies in regulatory systems will remain untreated and only the symptoms will be addressed. History is therefore set to repeat.

3. False Assumptions

These flaws also reveal several erroneous assumptions applied to regulators (and regulatory systems) by policy makers, commentators, the media, and (not infrequently) regulators themselves; these false assumptions follow.

First, (with reference to flaw 2) is the assumption that all regulators are invested with a clear and precise mandate. To the contrary, and despite the OECD's guidance that the "legislation that grants regulatory authority… should clearly state the objectives of the legislation"[21], it is common to observe complexity, complication, competition, conflict [22], tension, and/or imprecision[23]. Objectives are also often co-mingled with statutory duties or mandatory considerations (such as to have regard to economic growth[24], cost to business[25], or competition[26]) that add further tension and confusion. All this has led to the sobering observation that "[t]he problem with legislative objectives is that they seldom provide the kind of guidance that will allow for straightforward decisions"[27], nor does it allow for a regulator to clearly determine its public interest purpose or help resolve the regulator's dilemma of constantly having to make trade-offs.

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[21] OECD (2014), p. 31.

[22] For example, financial regulators face such complexity and tension in their goals and objectives (see Armour, John, and others, 'The Goals and Strategies of Financial Regulation', *Principles of Financial Regulation* (Oxford, 2016; online edn, Oxford Academic, 20 Oct. 2016).

[23] When analysing multiple objectives, it is useful to categorise them as either: (i) complementary; (ii) competing; or (iii) conflicting.

[24] See the UK's statutory Growth Duty, https://www.gov.uk/government/publications/growth-duty. https://assets.publishing.service.gov.uk/media/66476caebd01f5ed32793e09/final_growth_duty_statutory_guidance_2024.pdf.

[25] For example ASIC, see Australian Securities and Investment Act (ASIC Act), s.2(a).

[26] For example ASIC Act, s2A and the UK Financial Conduct Authority, see https://www.fca.org.uk/publications/corporate-documents/approach-competition.

[27] Baldwin 2012, p. 342.

Moreover, it is not uncommon for there to be *no* explicit statutory objectives given to regulators who, instead, must 'reverse-engineer' these from their statutory powers and functions. In all these cases, a regulator's ability to achieve its statutory purpose will, by definition, be constrained since it lacks a precise one[28]. This has led to the stark conclusion that "regulators are seldom, if ever, involved in the mechanical transmission of statutory objectives into results on the ground"[29].

Clarity around the purpose of the regulatory system and the regulator's specific role(s) are basic prerequisites for a regulator to be effective. To this end, the OECD observed that "unless clear objectives are specified, the regulator may not have sufficient context to establish priorities, processes and boundaries for its work. In addition, clear objectives are needed so others can hold the regulator accountable for its performance."[30] Yet (and astonishingly) such clear expectations are rarely enacted.

Conceivably, wide, competing or conflicting regulatory objectives could be made manageable *if* there were institutional and governance structures that legitimised the regulator's exercise of the wide discretion needed to operationalise them.[31] This would require structures that provide a direct link to democratic institutions; meaning a regulator's discretion would need to be overseen by, and/ or be responsible to, either parliament or an elected government[32]. In other words, there needs to be a chain of responsibility linking regulators to at least one of the (democratic) branches of government. Unfortunately, because of the flaws set out above[33], these compensating structures rarely exist.

Without the ability to 'self-correct' imprecise, generic, or wholly missing regulatory objectives a strategic vacuum and an expectations' gap in the regulator results. The strategic vacuum follows because regulatory objectives are needed to identify strategic goals; which are the unambiguous starting point of any strategic plan. Moreover, the gap created by the absence of precise objectives is very often filled with a multitude of, often inconsistent, non-official external expectations. Therefore, it is hardly surprising that regulators are constantly criticised for 'not doing their job' since their 'job' is not clearly defined. This is a profound design fault that also limits the ability to assess a regulator's effectiveness (explored further below).

Second (and in relation to flaw 3), it is incorrectly assumed that most regulators should be, or are in practice, independent. Whilst many regulators are designed to be independent, at least on paper, it is often unclear whether this was because of deliberate intent (for instance, because the regulator's decisions need to be free of political influence[34]), or because of a 'cookie-cutter' approach to its original design.

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[28] OECD (2014), p35.
[29] Baldwin 2012, p29.
[30] OECD (2014), p. 31.
[31] See also OECD (2014) pp. 31 and 32.
[32] Baldwin (2012), p.18.
[33] Especially flaws 2, 3, 5, 6, and 7.
[34] OECD (2014), Chpt. 2, 'Preventing undue influence and maintaining trust'.

Helpfully, New Zealand[35] has developed a framework for identifying the different levels of independence that could be granted to a regulator; this system distinguishes between:

1. Governmental agents - who must *give effect* to government policy when directed by the government (usually the responsible minister or department).
2. Autonomous governmental agencies - who must have *regard* to government policy when directed by the government.
3. Independent governmental agencies - who are *generally independent* of government policy[36].

What type, or degree, of independence required ought to depend on the importance of, and need for, the regulator to withstand political direction or influence. This will differ for each regulator and regulatory system. The OECD has advised that complete independence (i.e., #3 in the New Zealand framework) is required when the integrity of a regulator needs to be protected because:

1. The perception of independence is required to engender public confidence in the objectivity and impartiality of the regulator's actions and decisions,
2. Both government and non-government entities fall within the regulator's jurisdiction, and/or
3. The regulator's decisions can have a significant impact on particular interests and its impartiality needs to be secured[37].

The OECD further observes that it is more prevalent that market (i.e., economic) regulators are independent since "the government itself may be a stakeholder e.g., as a shareholder or market player, and therefore there is a greater need for an independent regulator"[38]. Nevertheless, it can be observed that many regulators with economic or market mandates are independent of government even though the government is not (or no longer is) a significant "shareholder or market player" in the relevant regulated sector[39]. This then begs the question whether that degree of independence is warranted; it also begs the question whether there was sufficient consideration of what level of independence was needed when regulator was first designed.

Furthermore, it is accepted best practice that law enforcement agencies be independent of government in order that prosecutions are free from political interference. This then begs the further question whether enforcement (an 'independent' function) should be co-mingled with 'government agency' functions (such as industry, market, and/or economic development)[40].

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[35] See https://www.publicservice.govt.nz/system/crown-entities.
[36] And are more like a further 'branch' of government (see false assumption #4 below).
[37] OECD (2014), p51.
[38] OECD (2014), p49.
[39] For instance, many large Australian corporations are no longer government-owned or controlled; e.g., Telstra, Qantas, Commonwealth Bank.
[40] The UK Financial Conduct Authority, the UK Competitions and Markets Authority, ASIC, the Hong Kong Securities and Futures Commission, the Dubai Financial Services Agency, and the Monetary Authority of Singapore are examples (amongst many others).

Moreover, where regulators are established as independent agencies, that independence is often ill-defined in legislation[41]. It is also, as a practical matter, illusory (or able to be compromised) in many situations via a combination of a regulator:

1. Being dependent on the government for funding;
2. Being subject to government direction, guidance, or statements of expectations;
3. Being subject to government oversight or review; and even if not effective this oversight provides a direct means for political pressure or influence to be exerted; and/or
4. Having senior officials' whose appointment, continued employment, re-appointment, compensation, and/ or promotion is at the government's discretion[42].

Accordingly, there needs to be greater consideration of the extent to which the objectives, purpose, goals, duties, and functions of a regulator requires its powers to be aligned with, or independent of, the government. Put simply, there is no one-size-fits all model. And where independence *is* required, it is necessary to ensure that this autonomy is not, as a practical matter, illusory.

Third (and with reference to flaw 7), despite the existence of accounting standards that enable commercial enterprises to report on their performance, there is no universally accepted framework to assess regulatory effectiveness. Instead, it is common to see different frameworks being applied at different times. Whilst these may be useful for their stated, near term, purpose they do not enable consistent and enduring evaluations necessary for continuous improvement. They are also flawed since they: (i) do not necessarily afford a regulator with a platform for long term strategy setting; and (ii) suffer from subjective bias from the surrounding environment (including the prevailing political and/or economic context). It is a stark observation that regulators (unlike their private sector peers) lack meaningful historical and consistent performance comparisons[43].

In addition, the assumption that output metrics accurately reflect the achievement of regulatory objectives does not always hold true. Instead, outside a narrow set of regulatory systems (such as road and aviation safety), *outputs* do not directly correlate to the achievement of regulatory *outcomes*[44]. Whilst these output metrics measure activity levels (and may be useful inputs) they are not necessarily good indicators of the *achievement* of regulatory goals[45]. Here, the OECD warns against an excessive reliance on output reporting saying, "objectives for regulatory officers that relate to the numbers of prosecutions achieved or the number of inspections carried out, are not likely to drive the overall outcome of the regulator."[46]

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[41] ASIC is an example: its enforcement powers are not subject to ministerial direction, but other functions are pursuant to the *Australian Securities and Investments Act 2001* (Cth).

[42] Unlike judges who are appointed until a statutory retirement age (or for life in some jurisdictions of the United States).

[43] The author has developed a protype regulatory effectiveness methodology that assesses a regulator's capability, capacity, and coverage with its regulatory objectives – the 'ROCCC' framework (this is pending publication).

[44]For example, the 2018-19 Royal Commission into Misconduct in the Financial and Superannuation Industry noted that "*the number of proceedings filed, or infringement notices issued, will say little about ASIC's enforcement culture unless the decisions behind those numbers are evaluated", see* Final Report, Vol 1 p474.

[45]See further, Sparrow, 'The Character of Harms', CUP, 2008, Chapter 6 – Puzzles of measurement and Baldwin 2012, Chapter 16 – Accountability, Procedures and Fairness.

[46] OECD (2014), p108.

Here (and with reference to flaw 2, and the first false assumption) it must be highlighted that the absence of precise and meaningful regulatory objectives, that ought to act as performance benchmarks, greatly limits the ability to consistently assess a regulator's effectiveness.

Fourth (and with reference to flaws 5 and 6), even though assumed to be so, there is little effective and consistent oversight of (powerful and monopolistic) regulators by parliament or other public bodies. This conclusion is alarming when coupled with the prior observation that reporting and assessment mechanisms are ineffective. It also raises profound issues that go beyond good governance; it raises constitutional questions of whether regulators sit outside the perimeters of responsible government that require the executive to answer to the legislature.

In many democratic common law jurisdictions, the regulatory state emerged from the delegation from the executive branch of significant swaths of its functions to independent or autonomous regulators. At the same time, the executive branch neither has, nor (seemingly) wants to exercise, oversight responsibility for these agencies. These regulatory agencies then stand apart from the traditional executive branch; in other words, there is a separation of regulators from the rest of the executive.[47] thereby creating the *Regulatory Branch*.

In practice, ministers often distance themselves from 'ministerial responsibility' over regulators by emphasising their independence (and thus separation). Indeed, regulators are often described by ministers and their departments in a similar way to the judiciary; distinct and apart. This further indicates the *de facto* separation of the Regulatory Branch from the rest of the executive.

The same analysis can apply to rule making functions delegated to regulators from the legislature. Here parliamentary oversight or review of such powers is often limited or ineffective (for the reasons explored in flaw 6); leaving the administrative law courts as the only, but *ad hoc*, check-and-balance. Moreover, parliaments have also been ineffective in holding regulators to account for their executive-like functions.[48]. This all indicates that the Regulatory Branch has not only separated from the executive, but the chain of responsibility to parliament has been broken.

This conclusion is not new; indeed, a 1937 presidential committee in the United States reviewing the structure of the US administration observed that the (then) dozen or so independent regulatory commissions were:

> "[I]n reality miniature independent governments set up to deal with the railroad problem, the banking problem, or the radio problem. They constitute a headless 'fourth branch' of the Government, a haphazard deposit of irresponsible agencies and uncoordinated powers. They do violence to the basic theory of the American Constitution that there should be three major branches of the Government and only three. The Congress has found no way of supervising them, they cannot be controlled

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[47] Here it is important to distinguish (the unintended) *separation* of many regulators from executive branch (and other branches) of government, from their (intended, but often nominal) *independence*. These two concepts are not the same: constitutionally, agency independence is combined with effective oversight and accountability; yet with separation there is *no* oversight of these powerful bodies.

[48] Institute for Government (2014).

by the President, and they are answerable to the courts only in respect to the legality of their activities.”[49]

Despite the passing of nearly 90 years, this constitutional “violence” not only largely holds true; it has spread and multiplied across the globe. Moreover, constitutional ‘checks-and-balances’ remain mostly absent; there is still little or no constitutional recognition, let alone effective mechanisms, to provide and account for this new branch. Even though many regulators may now be answerable to parliamentary committees (in line with parliament’s oversight of the executive), this oversight mechanism is largely (if not entirely) ineffective[50] for a variety of (internal and external) reasons (mostly because these forums are used more for political agendas instead of meaningful oversight). The failure of parliamentary committees to perform their oversight roles means that the existing constitutional mechanisms for holding the executive to account does not extend to the Regulatory Branch. Consequently, the Regulatory Branch, with its considerable powers and monopolistic tendences, is effectively left unaccountable. It can therefore be argued that many regulators are no longer ‘agencies’ since they have stopped being agents of a superior (democratic) arm of government; instead, many are now standalone (undemocratic) government institutions.

This impacts not only a regulator’s credibility; it diminishes its democratic legitimacy. Since such legitimacy *“*depends on a government’s ability to satisfy citizens’ interests and concerns as well as to serve community needs and values*”*[51] it is hard to see how this can be achieved if the chain of responsibility from the Regulatory Branch to superior democratic institutions has been broken.

A further consequence of the “headless” and separate “fourth branch” is that it does not have a direct voice to the legislature to seek appropriations and law reform. As a result, regulators usually suffer from chronic underfunding (flaw 11) and deficient legislative regimes (flaw 9). Accordingly, it can be concluded, at the very least, that regulators are the orphans of government.

Fifth (and with reference to flaw 8), regulators are not automatically endowed with external credibility merely because of their power, authority, and legal legitimacy; instead, they must proactively establish it as a strategic priority. Credibility requires external awareness, understanding, and (ultimately) confidence that a regulator will do what it is established to do (and use its powers in that endeavour); this is especially so for the regulated population. Credibility is necessary for a regulator to achieve its objectives since credibility is a foundational component for its effectiveness. The more credible a regulator the more effective it will be, with a virtuous cycle ensuing since, in military terms, regulatory credibility is a ‘force projector’ and a ‘force multiplier’.

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[49] The President’s Committee on Administrative Management, “Administrative Management in the United States January 1937”, United States Government Printing Office, Washington 1937 (retrieved from https://babel.hathitrust.org/cgi/pt?id=mdp.39015030482726&view=1up&seq=1&q1=fourth).

[50] Institute for Government (2014).

[51] Schmidt, Vivien A., 'Conceptualizing Legitimacy: Input, Output, and Throughput', *Europe's Crisis of Legitimacy: Governing by Rules and Ruling by Numbers in the Eurozone* (Oxford, 2020; online edn, Oxford Academic, 23 July 2020, https://doi.org/10.1093/oso/9780198797050.003.0002, accessed 31 Jan. 2025), p. 26.

4. Conclusion

The systemic flaws and false assumptions identified in this paper are sobering and result in unreconcilable expectations on regulators and damage to their credibility. They also reveal deep long-standing constitutional anomalies in the operation of regulators within government; specifically, a failure to properly oversee regulators and hold them to account. This impacts regulators' democratic legitimacy, credibility, and operational effectiveness. It also means that most regulators do not benefit from an architecture that supports operational success; indeed, many are designed to fail. Accordingly, we should not be surprised that many regulators suffer from rolling legitimacy and credibility crises accompanied by a stream of inquiries. Only when these flaws, and false assumptions, are addressed will there be any hope of positioning regulators (and regulatory systems) for success.