

WHAT MAKES A COMMUNICATIONS REGULATOR INDEPENDENT AND WHY IT MATTERS

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Editor's Note

In the twenty-first century, communication flows have become worldwide. Guidelines for regulating communication networks are drawing global attention. Many countries are trying to create "independent" regulatory agencies to free regulators from pressures by stakeholders who want regulations that support their interests. In the past, there has been agreement in democratic nations that circulation of political information must be unimpeded. But there has been little specific agreement about the essential features of genuinely independent regulatory agencies.

Irene Wu's research addresses the issue, based on a survey of communication regulatory agencies in eighteen countries. The survey was designed to determine which practices have been widely adopted to ensure independence. Additionally, she studied relevant decision-making procedures in four countries. Wu concluded that regulatory agencies must deal with three main constituencies: other government institutions, the communications industry, and communication consumers. Independence requires that these agencies be protected from pressures by other government institutions and the communications industry and be free to serve as advocates for consumer interests. Chapter 31 reports the essence of her findings.

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The interconnective tissue of the body politic—news reports on national leaders, the messages between community activists, the symbolic assertions of power, the expressions of ideology, and the protests of the counter-culture—all rest on the telecom infrastructure, television networks, and Internet. . . . As the world moves from the industrial to the information age, governing the communications market will become more important. In the next five to ten years, countries all over the world will solidify the institutions responsible for policy and rules for communications services—telecommunications, Internet, and media—and define such institutions' relationships with other parts of government, industry, and consumers. This change is occurring now because of two major shifts, one conceptual and one technological.

First, governments accepted and implemented the idea that a competitive paradigm for communications markets was more economically beneficial than a monopoly model. With multiple players in the markets, more debates and conflicts occur that need to be resolved. One way to frame this challenge is to distinguish between *policy* and *regulation*. The policy maker is expected to broker agreement on broad objectives, and every brokered agreement could be unique from the next depending on political circumstances. The regulator that is independent from direct political pressure is expected in similar cases to reach similar conclusions. The challenge, however, becomes how to design a regulatory institution insulated from the vagaries of politics that is still consistent with democratic notions of accountability and majority rule.

Second, the shift from analog to digital technologies makes services that were once discrete—television programming and print publishing, for example—all physically reducible to data that can be sent over Internet protocol (IP) networks, sparking a redefinition of these services and the institutions that govern them. Regulators decide how such services are defined, who can offer them, who can use them, and assign any scarce resources such as radio spectrum that may be necessary to make the services available. This is a transformative moment in communications policy; researchers have an opportunity not only to contribute to the literature, but also to influence concrete institutional arrangements that govern telephones, televisions, radios, and Internet service worldwide.

The Advent of This Study

. . . What general characteristics or specific functions should regulatory institutions have? . . . The key goal that countries with new regulators aim for is an "independent" regulator, which reflects the current policy literature's suggestion that such regulators, insulated from political interference and pressure from industry players, are more likely

to make good decisions that reflect the public interest. Many countries must establish independent regulators in order to fulfill World Trade Organization commitments.

. . . In 1990 there were only 14 communications regulatory agencies in the world. Since then, the number has roughly doubled every four to five years. As of 2007, there were no less than 148 such authorities.¹

Globally, there has been a rise of regulatory agencies in a range of countries across a range of sectors—finance, electricity, water, gas, general competition policy. . . .

. . . I organized a survey of regulators for 18 countries chosen because they recently had significant improvement in their communications network development and FCC staff corresponded with them regularly. Where markets have separate regulators for telecommunications and broadcast, efforts were made to include both, although responses were not received in all cases. This survey was combined with a previous four-country study by Cathleen Hsu and me on ethics and decision-making processes, which drew on information collected in correspondence, materials, and interviews with regulatory officials.² The working strategy that shaped the construction of the survey was that among this group of good regulators, it might be possible to identify a useful set of characteristics, which could then be the basis of recommendations to other countries in the process of organizing their regulators. The survey questions reflected a mix of issues based on concerns raised in the literature and on practical regulatory experience.

The 18-country survey had three sets of questions related to regulatory independence. . . . The first related to the relationship between regulator and industry. The consensus among scholars and practitioners is if communications operators—telecommunications companies, television broadcasters, and Internet service providers—are still owned by the government, then the regulator is likely to be hostage to their concerns. The second set was on the relationship between regulator and other parts of government, such as the communications ministry, competition authority, and legislature. Unlike with privatization, among practicing regulators there is no consensus that separating regulation and policymaking enhances regulatory independence. The survey results suggest that among good regulators, this distinction is commonplace. A third set of questions related to regulator and consumers. The scholarly research focuses on what regulators should be independent *from*; there is very little work on what regulators should be independent *for* and accountable *to*. However, many of the most admired regulators are advocates of the long-term benefit of the consumer. . . .

Why Is It Important to Have an "Independent" Communications Regulator? What Makes a Regulatory Agency Independent?

Historically, communication services are run by monopolies, whether state-owned telecommunications operators or state-owned public broadcasters. As governments privatized and competitors entered these markets, regulators were established to set technical standards, settle disputes, allocate scarce resources, and other tasks. Theory suggests that governments establish *independent* regulators to make commitment to reforms easier and reduce investor risk, which should boost market growth.³ Researchers have focused on whether the regulator is independent *from* industry players, usually the historic incumbent monopolist. . . .

There is less international consensus around additional characteristics that may improve a regulator's independence. . . . Research emphasizes the need to protect the regulator from political pressure from other state institutions.⁴ For example, in an ideal world, a regulator faced with license applications from a number of different firms will use the same criteria to evaluate each application and not be influenced by the number of politicians calling in favors from the head of the regulatory agency. . . .

Stern and Holder's 1999 study identifies effective participation by interested parties in decisions and transparency in the regime to reduce the likelihood of unfairness and incompetence.⁵ Not discussed in the literature, however, is the practical challenge of making transparent decision-making procedures work. The problem is not in the mechanics; publicizing notices and information is made easier every day with the Internet. Instead, the challenge is in transforming the culture of participation among firms and consumers who are affected by regulation. When regulators first begin asking comments from the public on proposed rule changes, frequently, parties are reluctant to participate. Why they are reluctant is fertile ground for further work—is it fear of retaliation, lack of resources, reluctance to share information, or lack of confidence in the process? This study includes a survey of four markets' decision-making process that can serve as a foundation for future comparative work.

Both Min and Stern and Holder identify the contestability of a regulator's decision as a characteristic of an independent regulator. In general many scholars argue that if a regulator's decision can be contested successfully, that is a demonstration of the independence of the regulatory regime. This makes sense because frequently regulators, thought of as "captured" by the industry they regulate, make decisions considered inordinately in favor of the incumbent operator. Therefore, the opportunity for small, innovative, or foreign operators to contest the decision successfully is considered a mark of

a regulatory regime independent of the incumbent. However, if a regulatory decision were favorable to the competing operator and an incumbent operator were able to successfully contest such a decision, contestability appears no longer a mark of the regulator's independence, but instead a reflection of regulatory capture. For this reason, this study focuses on identifying whether the regulator has procedures in the decision-making process to enhance fairness and transparency as a basis for accountability, rather than the process of afterward contesting decisions.

What Is the Regulator's Relationship with Other State Organizations?

The 18-country survey shows that while many countries separate the policy-making organization from the regulatory organization, many do not. Three aspects of the survey are relevant to examining the regulatory relationship with other state institutions: the terms and conditions of the leadership, the scope of the regulatory authority to issue licenses, and the source of the regulator's budget. The first indicator of the relationship between the regulatory and other state institutions is how the leader of the regulatory organization is selected and dismissed. . . . The regulatory organization has greater independence if the leader's position is protected, by custom or by law, for a specified period of time or for life, no matter what decisions are taken. However, in some instances the leader can be dismissed if others in the state are dissatisfied with the decisions of the organization. Half of the countries surveyed have regulatory agencies with an independent leader. In these countries, having a predetermined term of office of between three and seven years often serves as a clear time frame that insulates the leader from pressures on day to day decisions. The one exception is Hong Kong, where a custom may be developing that the leader serves until he or she retires from civil service. If this custom is preserved, it serves as even greater source of independence than the common pre-set term of office.⁶

A second indicator is the clarity of the regulator's authority. . . . For example, one area where regulators typically have great influence is in issuing licenses for market entry. For wire line telecommunications licenses, where scarce resources are not usually at stake, many independent regulators have exclusive authority to issue licenses, whereas in other countries, the ministry that reports directly to the political leadership has an exclusive or partial control in the issuing of licenses. In 11 of the 18 countries examined, the regulator has the exclusive right to issue wire line licenses. Only in six countries did the ministry retain the whole or partial right to govern entry into the wireline market. The one exception in this set is New Zealand, since no licenses are required for firms to provide wireline service;

neither regulator nor ministry is involved. Licensing of wireline telecommunications service is only one of many areas of possible authority for regulatory organizations. If other areas were examined, a different range of responses on the relationship between the regulator and ministry's relationship might be uncovered.

A third indicator of the regulator's independence is the source of its budget. . . . Greater independence is possible if the regulatory organization has nearly complete control over how fees and funds are raised for its own operations. In other instances, the organization's budget is allocated and approved by institutions that may seek to use the budget process to influence regulatory decisions. Some organizations are funded both by their own fees and by a politically allocated budget. Seven of the surveyed bodies raise their entire budget from regulatory fees. In four countries, substantial funds are raised through fees, but also some portion of the budget must be allocated through the national budget process, which subjects them to political review. In Korea, the broadcast regulator's entire budget is raised from fees, but the telecom ministry has its funds allocated through the national budget.

At least based on these three indicators, four countries' regulators have very robust independence from other state institutions (in Brazil; Canada; Hong Kong, China; and Nigeria). Brazil, Canada, and Hong Kong do indeed have regulators with strong reputations for independence. Brazil and Hong Kong are especially known for their exceptionally vigorous regulatory efforts to break up and erode the market power of their respective incumbent telecommunications monopolist in the 1990s.⁷ Nigeria's regulator is more recently established. Successful license auctions conducted in 2003 have established its reputation as independent and resourceful.⁸

What Is the Regulator's Relationship with Industry?

In the survey of eighteen countries, two sets of data were relevant to the regulator's relationship with industry: privatization of operators and regulator staff relationship with industry. The first indicator of the regulator's relationship with industry is if any state-owned incumbent operators were privatized. Greater independence is possible if the state responsibility is first to the consumer without any interest in the profitability of a state-owned operator. A second indicator is whether there is a revolving door for the staff to move between the regulator and the industry. Greater independence is possible if staff serve their entire careers in the regulatory organization; they are less likely to be influenced by other interests. In other instances, staff move frequently between the regulatory organization and industry

or other parts of the state. However, a tradeoff is that regulators benefit from the market and technical knowledge of staff drawn from the industry. Frequent interchange of staff between industry and regulatory agency has its benefits, therefore, but it may have a dampening effect on the regulator's independence. . . .

. . . [F]or some of the surveyed countries, privatization is recent. This is true of Korea, which privatized Korea Telecom only in 2002. In other markets, such as Hong Kong, Spain, and the United States, the incumbent operators have been private for a long time. On the other hand, many countries listed as not having private incumbent operators have partially privatized. This is true, for example, for Australia, India, and Sweden.

Regulator's Relationship with Consumers

If a regulator is independent *from* industry interests and insulated *from* political vagaries, what is it *for*? One answer is that an independent regulator is an advocate for the long-term interests of the consumer, and the first step to acknowledging this objective is to have consumer interests represented within the regulatory agency. How this occurs varies widely among different states and the survey results reflect this diversity. In telecommunications, there are two major areas of consumer interest: handling of consumer complaints and concerns and universal service or universal access to services. These two areas are not equally important in all countries. . . .

In Brazil and the United States, overseers for universal service policy are organized inside the regulatory institution. In other instances, institutions other than the regulator are responsible. For example, in Australia, Hungary, and India, bodies other than the regulator handle consumer complaints.

The idea that an independent regulator should be *for* consumers, in addition to being independent *from* policymakers and industry, is a new contribution of this study. One critique of independent regulatory agencies is that they are too unaccountable to the public; this criticism is especially cogent in newly democratic states still in the midst of building political institutions responsive to the broader public rather than a privileged elite. If researchers investigate whether regulators that take long-term consumer welfare as their primary goal are more effective, some progress can be made in answering this critique.

In politics, representation is valuable. While in many countries there may be hundreds or even thousands of companies under the purview of a regulator, often there are easily millions of consumers. As a practical matter, customer-oriented interpersonal skills, a body of specially tailored

information, and other expert techniques are necessary to handle direct interaction with consumers. The presence of these offices and representatives for consumer interests in these governments, therefore, reflects official recognition that consumers have interests distinct from other constituencies. If the political goal of regulating an industry is not to maximize its growth, but rather to improve the long-term quality of life of the citizens, then having an office devoted to their concerns—whether represented by a consumer office, a universal service office, or some other form—may serve as a useful indicator of whether its organizational resources are aligned with its objectives.

Transparency in Decision-Making Procedures

Beyond the organizational arrangements discussed here, the regulator's independence and credibility can be affected by the rules that govern its everyday interaction with others, whether state institutions, firms, or consumers. Transparent decision-making rules can increase confidence in a regulator's fairness. Clear ethics guidelines for regulatory staff can enhance the organization's integrity. In 2002, Cathleen Hsu and I undertook a study of the decision-making process and ethics rules in the communications regulators for Canada, Hong Kong, United Kingdom, and our own institution, the FCC in the U.S., regulators which all have strong reputations for integrity.⁹ While these four markets have quite different styles of government, their communications regulator's decision-making procedures and ethics rules share remarkable similarities. . . .

All four regulators follow a basic three-stage rulemaking framework.¹⁰ In the first stage, the regulator releases a consultation paper which identifies a problem, proposes new rules, and asks the public for opinions. In the second stage, the regulator receives comments on the consultation paper. While there is always at least one round of comments, often it is followed by additional rounds known as "reply comments," to allow the public to critique the initial comments. In the third stage, the regulator releases the final decision paper, which includes the new rules, a discussion of how they serve the public interest, and responses to public comments. For all four regulators, the consultation paper, comments and reply comments, and the final decision paper are available to the public at each stage, unless there are special arrangements requested to keep information confidential. This three-stage process guarantees basic transparency by ensuring the public are aware of possible regulatory changes, are given an opportunity to voice their views, and [are] informed of the final decision and the reasoning behind it. . . .

Ethics Rules for Integrity

An agency's transparency and impartiality in decision making could be jeopardized if its employees are influenced or are perceived to be influenced by gifts from outside sources, financial and personal conflict of interest, or post-employment prospects. Generally, there are four approaches to ensure ethical standards: (1) avoidance of activity, (2) disclosure of activities, and (3) divestment or resignation from positions that pose conflicts, or (4) recusal, or quarantine, from an area of the regulator's work.

Gifts

All four countries prohibit regulatory staff from receiving gifts that are improper or appear improper; in addition they all have criminal codes on bribery. The challenge in ethics rules related to gifts is in what exceptions can be made. Here, among the four countries, there are variations. . . .

Often there are support systems or specified procedures for staff who find themselves in a situation where a potential conflict or appearance of impropriety might arise. . . .

Conflict of Interest

The three main types of conflict of interest arise from pecuniary, personal affiliations, and family interests. Ethics rules come into effect when a regulatory employee participates in proceedings that involve close associates or family members, companies in which the employee holds stock, or companies about which the employee has gained confidential information through personal affiliations. The primary approach to prevent conflicts of interest is to require regulatory staff to disclose financial and personal interests in categories that could give rise to conflict. Often this leads to a requirement to divest of these interests if there is or appears to be a conflict. . . .

Post-Employment

Post-employment guidelines aim to prevent any suspicion that an official might be influenced by the hope or expectation of future employment with outside firms and the risk that a particular firm might gain an improper advantage over its competitors by employing someone who had access to information on the competitor through official capacities. . . .

. . . A regulator's independence *from* the policymaker and independen[ce] *from* industry is reflected not only in its organization arrangements, but also in the rules and procedures that govern its everyday interaction with these constituencies. The decision-making rules govern the regulator's everyday

working relationship with firms, other state institutions, consumer groups, and other interested parties. Ethics rules govern the regulatory staff's everyday working relationship with the employees of firms and other interested parties. . . .

Conclusions

There is tension between commitment and flexibility that all states face in creating and implementing communications policy and rules. *Policy* describes the decisions a state reaches by brokering the interests of various political groups. Once agreement is reached on a major policy, *rules* are needed for the state to implement the policy. The institutions that are responsible for developing these rules are often regulators. Given that the effectiveness of the regulatory institution depends largely on its independence—its ability to render similar decisions for similar cases—what indicators can be used to characterize a regulator as independent? In the main, these indicators reflect the regulatory institution's relationships with three other groups: other state institutions, industry, and consumers.

Relationship with Other State Institutions

While there should be some means to keep the regulator accountable to the public, an independent regulator has some measure of insulation from political winds. These can include:

- a leader who cannot be dismissed for unpopular decisions
- a leader with a guaranteed term of office
- scope of authority that is clearly distinct from the policy-maker
- funding which is independent of political review

Relationship with Industry

While industry can be a great source of market knowledge and technical data, the regulator must be independent from industry in order to be perceived as fair by other state institutions and consumers. Two markers of independence from industry include:

- privately owned incumbent telecommunications operator
- minimal exchange of staff between the regulator and regulated firms

Relationship with Consumers

Consumer interests are usually widely dispersed in the market and, therefore, their views are more easily overlooked both in the policy-making and rulemaking process. Regulators seeking to balance this against the strength of industry and other state institutions' views may make special

efforts to collect and reflect consumer interests. Two indicators include a dedicated office to consumer affairs and a dedicated office to universal service, an important issue for consumers.

In addition to these indicators, there are systemic processes that regulators can use to mediate relationships with other state institutions, industry, and consumers, such as decision-making processes and ethics rules. In several well-established independent regulators, there are common elements in decision-making and ethics rules which help them manage their relationships with interest groups in a transparent manner. In decision-making, they had in common a three-step process which involved public notice of proposed rule changes, opportunity for all parties to provide written, public comments, followed by a written, public decision that includes the reasoning of the regulator.

In ethics rules, they had in common rules for gifts, conflicts of interest, and post-employment, which require regulatory employees to avoid certain activities, disclose other activities, divest or resign from positions that presented conflicts, and quarantine themselves from certain areas of regulatory work.

Table 31.1 summarizes how the surveyed regulators use these measures which can enhance their independence. The first three indicators, A–C, bear on the regulator's relationship with other state institutions; the next two, D and E, are relevant to its relationship with industry; F and G reflect its relationship with consumers, and the final columns, H through K, reflect its overall decision-making and ethics rules.

In no instance did any single regulator adopt the most independent option for all of the traits that were examined in this paper. However, nine of the countries have regulators that used most of the tools outlined in this paper: Australia, Brazil, Canada, Hong Kong, Hungary, Nigeria, Sri Lanka, Sweden, and the United States. Among the eighteen countries in the first survey, most had regulators with the sole authority to issue wireline licenses and offices that represented consumer interests. At least half had independent leadership and independent funding.

In democratic systems especially, demand for independent regulatory decisions must always be balanced against the need for all institutions to be accountable to the public. Which traits of independence are suitable for any one regulator to adopt will vary, depending on the state's institutional endowments and political culture. However, some combination of these traits is likely essential in establishing a regulatory institution perceived by all as independent. . . . These concerns affect not only economic growth, but also the evolution of political and social networks around the world that depend on the cell phone, television, the Internet, and other emerging technologies.

Table 31-1 Indicators of independent regulators: Summary of 18-country survey (A-G) and 4-country survey (H-K)

	Other State Institutions			Industry		Consumers			All Relationships				
	A. Independent Leader	B. License issued by regulator only	C. Independent Funding	D. Privatized incumbent telco	E. Little staff mov't between reg and industry	F. Consumer office	G. Universal service office	H. 3-step decision-making process	I. Gift rules	J. Conflict of interest rules	K. Post-employment rules		
Australia	•	•				•	•						
Brazil	•	•	•	•		•	•						
Canada	•	•	•	•		•	•						
Hong Kong	•	•	•	•		•	•					•	•
Hungary	•	•	•	•		•	•					•	•
India					•	•	•						
Italy	•				•	•	•						
Japan				•	•	•	•						
Jordan					•	•	•						
Korea					•	•	•						
Malaysia					•	•	•						
N. Zealand					•	•	•						
Nigeria	•				•	•	•						
Singapore					•	•	•						
Spain	•				•	•	•						
Sri Lanka					•	•	•						
Sweden	•				•	•	•						
U.S.	•				•	•	•						
U.K.												•	•

These countries not surveyed

These countries not surveyed

Not included in this survey

Notes

1. International Telecommunications Union 2007.
2. Wu and Hsu 2002.
3. Levy and Spiller 1994, North 1978.
4. Min 2000, 14-15.
5. Stern and Holder 1999.
6. Cowhey and McCubbins 1995, 17.
7. For more on Hong Kong, see Yan and Pitt 1999 and Ure 2000. For a discussion of Brazil, see Mariscal and Rivera 2005.
8. For more information, see Doyle and McShane 2003.
9. This section on decision-making and the following section on ethics rule draw heavily on Wu and Hsu 2002.
10. Please note that the CRTC has a separate rulemaking process for broadcasting issues. Unlike its rulemaking process for Telecom issues, if the broadcasting issue is a matter of great public importance, public hearings are held in place of the three-stage consultation process.

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