

# Effective regulation in an imperfect world: The role of legitimacy

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Learning Initiatives on Reforms for Network Economies

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# Why should we care?

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- Most of the people here are not from regulatory agencies
- Why would we want the regulatory agencies to work?
  - Think traffic lights
  - Would you want
    - a system that works well, or
    - one that randomly gives off signals, or
    - No traffic lights at all?



# Expectations . . .

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- Regulatory agencies should be
  - Independent of operator
  - Independent of government
  - Based on expertise
  - Based on procedural legitimacy, and
  - Effective



# In practice. . .

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- Regulatory agencies tend to be
  - Not always fully independent of operator, e.g.
    - Government owns all/part of operator
    - Employees seconded from operator
  - Not independent of government
  - Lacking in human resources
  - Arbitrary, and
  - Semi-dormant (inaction as best defense)



# Usual responses to criticism are

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- Special circumstances of
  - Stage of development
  - Unique national circumstances
  - Larger objectives of universal service, maximizing privatization proceeds, etc., etc.
- It's someone else's fault
  - Legislation did not make agency truly independent
  - Not enough resources were made available

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# Objective of this presentation is

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- ❑ To trigger innovative thinking about achieving results under non-optimal conditions
- ❑ To emphasize legitimacy over formal independence
- ❑ To show how a legitimacy strategy can create independence and show results



# Outline

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- What is independence?
- Necessary conditions of independence
- Legitimacy: the way to win independence
  - Expertise
  - Procedural legitimacy
  - Public interest
  - Showing results
  - Communication



# Independence

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- What is it?
- Why should regulators have it?





# Maximal definition

- ***An effective regulator should be independent from those it regulates, protected from political pressure, and given the full ability to regulate the market by making policy and enforcement decisions. The regulator should have the authority and jurisdiction to carry out its regulatory and enforcement functions effectively and unambiguously. And the regulator must be adequately funded from reliable and predictable revenue sources.***
  - ***US Federal Communications Commission, 1999***



# Minimal definition

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- The regulatory body is separate from, and not accountable to, any supplier [. . .]. The decisions of and the procedures used by regulators shall be impartial with respect to all market participants.
- Adapted from Fourth Protocol of the GATS, Regulatory Reference Paper, 1997, article 5.



# Regulator-government relations

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- Insulation from day-to-day interference by politicians is basic element of good public administration practice
  - Political accountability for policy setting
  - Admin/legal accountability for implementation
- Additional insulation for some agencies
  - E.g., Attorney-general; Anti-corruption bodies
  - Do regulators fall within this category?



# Independence for regulators?

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- Not in all cases
  - Example of Nordic countries
- Yes, when overall governance is poor
- Basic (not sole) rationale of regulation in developing countries (=countries with poor governance) is protection of investors from arbitrary takings
- Analogy: dike to protect island of good governance from ocean of bad governance



# Necessary conditions (details in regulatory design unit)

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- Specified appointment procedures
- Removal procedures
  - Hard to remove; easy to appoint
  - Accountability through transparency
- Reporting relationship
  - “Line” Ministry?
  - President/Prime Minister?
  - Legislature?
- Financial autonomy
  - Certainty; ability to plan; invest in expertise
  - Prevent use as instrument of pressure



# Sufficient conditions (emphasis now)

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- Legitimacy: the way to win independence
  - Expertise
  - Procedural legitimacy
  - Showing results
  - Communication
- Legitimacy building=dike maintenance



# What is legitimacy?

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- Acceptance of the existence and the power of an entity by those who can affect it or are affected by it
- Distinguished from powers and duties set out in formal legal documents
- A subjective category that resides in the eyes of others
  - Possibly captured by Telecom Regulatory Environment survey



# Legitimacy in whose eyes?

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## □ Government

- “Line” Ministry
- President’s/PM’s office
- Finance/Industry
- Legislature/Judiciary

## □ Private

- Incumbent/new entrants
- Public/“opinion leaders”





# Expertise

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- Important, but inadequate by itself
  - Because application of expertise under conditions of imperfect knowledge always involves judgement
  - No justification for sector regulation without expertise



# Procedural legitimacy

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- Essential ingredient of legitimacy
  - Reinforces expertise-based claims
  - Generates new information; improves information quality
  - Creates conditions for “buy-in” by stakeholders, reducing appeals
  - “Appeal-proofs” regulatory decisions, increasing likelihood of winning if appealed



# Procedural legitimacy

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- Legal requirement in many countries
  - India: requirement for consultation papers and open houses in TRAI legislation
  - USA: Administrative Procedures Act
  - Sri Lanka: Commission may hold public hearings and conduct public-notice proceedings
  - In most countries judiciary will ask whether natural justice/due process principles have been followed in review/appeal/writ proceedings



# Achieve results

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- Apply limited resources to
  - High-yield (e.g., interconnection), and/or
  - Winnable (e.g., where incumbent is obviously at fault), and/or
  - Easily explainable problems (e.g., not interconnection)
- Win your battles
  - Winning can be defined in various ways!
- Tell the world about them



# Communication

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- “How do they know you’re expert/ procedurally legitimate/ doing good if you don’t tell them?”
- Source of informal power
  - “Sweet talking,” “jawboning” and “framing”
  - Affect the symbolic environment of government--the media
  - Key to public support

