RESTRUCTURING CHINA'S INFORMATION POLICY: WTO COMMITMENTS, CHINA'S UNIQUE CIRCUMSTANCES, AND THE "INDEPENDENT REGULATOR" ISSUE

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1. Introduction

Across the globe, governments of emerging economies are financing new investment in telecommunications by the introduction of private capital. These developments are creating the need for effective regulation and there has been an explosion of interest in how to create this in developing economies. A particular concern is how far the US model, with an independent regulator working within a formal legal framework, is either appropriate or sustainable in these very different contexts (12).

Twenty-five years ago, it was typical for the state to have exclusive responsibility for infrastructure investment in almost all countries, except perhaps the U.S. However, since 1980 governments have increasingly found that the growing demands for infrastructure investment have pushed them to involve private finance. In many countries, this fiscal pressure has been supplemented by a growing awareness of the inefficiencies of traditional state-owned monopolies. This trend has a common feature in that it requires governments increasingly to separate policy from regulation and to separate both from the commercial management of services. A major feature of the process is for governments to accept that their policy objectives must be configured to conform to commercial pressures; this means accommodating the needs of private investors (12).

Effective regulation is often taken as synonymous with independent regulation. This is not as simple as it may appear. The concept of regulatory "independence" involves a number of elements and is far from straightforward. Even when formally independent regulatory agencies have been set up, the question remains as to how far their independence is (a) genuine and (b) sustainable. In all circumstances, informal accountability and a clear understanding of the "rules of the game" are crucial for effective regulation. The key issue is whether the government and other relevant parties are willing to observe the spirit of the law and the regulatory process as well as the letter.

The reasons why the development of regulatory agencies is critical for the protection of new private and foreign investors in transitional and developing countries include:

- telecommunications facilities are heavily capital intensive and have long-life assets, many of which are highly specific and non-redeployable;

- telecommunications services have significant economies of scale and scope; and
- telecommunications services are consumed by a high proportion of the population and consumption of (or at least access to) them is very sensitive politically. (12)

2. Regulatory Rationales

Regulation of telecommunications (and utilities generally) as we know it today basically emerged in the U.S. where the original objective was to protect consumers from being exploited by powerful providers of critical services. This perspective remains at the heart of U.S. regulation. Conversely, in Asia, Latin America, Central and Eastern Europe, the main purpose of introducing separate regulatory structures over the last 10-15 years has been to protect investors from unacceptable risks (12).

Risk protection of investors is justified on the grounds that it reduces the cost of capital and hence reduces costs and prices to consumers. Nevertheless, providing confidence to new investors - and particularly to foreign investors - is the main purpose of introducing new agencies for regulation in "emerging market" economies. In consequence, the critical feature of these agencies is independence from government intervention (12).

Experience has shown that the temptation for governments is to use the potential of creeping expropriation by forcing regulated companies with private ownership stakes to hold prices below full economic cost. This is easy to do in countries with even moderate inflation rates (5-10 % per year). Such a policy is more attractive than explicit subsidies to household customers financed out of the state budget - particularly if the investors are foreign. Where it occurs, this gradual expropriation leads to a drying up of further private investment and major costs for governments in re-establishing credibility. The costs of these uncertainties are then passed on to consumers (12)

The consequence is that foreign private investors are likely to see an effective regulatory agency independent of government as critical to protect their interests. An effective regulatory agency with the appropriate powers provides both: (a) credibility for the economic viability of their long-lived investments; and, (b) low-cost monitoring and enforcement institutions. That, however, means a regulator which can maintain a distance from government and whose discretion is carefully bounded (12).

The conventional wisdom is that effective regulation is synonymous with independent regulation and that a regulator without formal independence from government cannot be effective. The argument goes that private investment will not be forthcoming on the scale required unless there is an independent regulator. Sometimes this is relaxed to an "autonomous" regulator, but the implication is that a significant degree of regulatory independence is essential (12).

Investors are aware of these pressures and of the vulnerability of their usually large, long-term, and immobile investments. Unless a government has made a credible commitment to rules that ensure an opportunity to earn reasonable returns, private investment will not flow. Weak credibility will be reflected in higher capital costs and thus higher rates. The long-term nature of

most infrastructure investments makes creating credible commitments difficult, which increases the importance of a reliable regulatory scheme. Once funds are sunk into physical capital, the cash flows providing returns depend on regulatory policies. (10)

It is very difficult to sustain independent regulation when:

- contract and commercial law is under-developed
- competition policy is absent
- the legal process is insecure and/or corrupt; and
- there is little or no separation of political powers (12)

However, the main problem is where political pressures have dominated economic and commercial considerations. In those circumstances, whatever the relevant law may specify, it is extremely difficult to sustain effective regulation or an independent regulator. Where political pressures dominate, an independent regulator following standard economic principles of regulation is likely to be unfeasible (12). The investments involved are large and represent sunk costs so that regulatory risk is very serious. Regulation with clear rules of the game is the standard way in which this problem can be solved. There is no avoiding the problem that the government is both a player and involved in sustaining the process. However, the exercise of regulatory discretion needs to be insulated from short-term political pressures and other improper influences and to be based on competent analysis.

The institution of independent regulators in the form of commissions or agencies is not a new phenomenon. For almost a century, independent regulatory agencies have played an important role in the regulation of network industries in the US. In Europe, independent regulators have been important in the regulation of such diverse areas like the media, competition, the protection of civic rights etc. But many issues remain contentious, particularly the notion of agency independence. Some governments are reluctant to surrender political control over regulatory decisions. And even those who agree on the desirability of independent agencies may question whether they are feasible or appropriate in all country settings. (10)

3. The Concept of an "Independent Regulator"

There is no universally agreed definition of an independent regulator – indeed there are many. Defining an independent regulator proves to be difficult because of the diversity of functions they perform. One Report describes them as follows:

> *"The creation, design and consequences of independent regulatory agencies represent a classic example of delegation to non-majoritarian institutions. They are created by legislation; hence elected officials are their principals. They are organizationally separate from governments and headed by unelected officials. They are given powers over regulation, but are also subject to controls by elected politicians and judges."(1)*

In theory, independent regulators differ from other regulatory institutions with regard to their tasks, their basis of legitimacy, the way they are held accountable to the public and how their relations with both the regulated industry and government are organized. Therefore, an

understanding of the particular characteristics of independent regulators is important to understand their role in the regulation of liberalized markets

What is "independence?" Independence is subject to different interpretations. Some use it interchangeably with autonomy; others perceive greater or lesser differences in meaning between the terms. Typically independence for regulators consists of at least three elements:

- An arm's-length relationship with regulated firms, consumers, and other private interests.
- An arm's-length relationship with political authorities.
- The attributes of organizational autonomy— such as earmarked funding and exemption from restrictive civil service salary rules— necessary to foster the requisite expertise and to underpin those arm's-length relationships (5, 10)

Having a regulatory agency with a reputation for behaving fairly is a good foundation for these attributes. In many cases, this can best be achieved by having a formally independent regulator as in the U.S. and other countries. However, formal legal independence is only a small part of "genuine" accountability and independence, and by no means necessarily the most important part. This is particularly true of emerging economies in Central and Eastern Europe, Latin America, Asia and Africa.

First and foremost, "independence" must be understood as a relative rather than an absolute concept. In any system, the goal can only be to reduce the risk of improper political interference, not to provide ironclad guarantees. Progress must be measured at the margin —and relative to the outcome of a ministry retaining direct control over regulatory decision-making. (10)

Even if there are reasons to doubt that an agency will exercise truly independent judgment in the short term, that may change in the longer term. Concentrating expertise in a body with a specialist mandate sharpens commitment to professional norms, which can be an important source of resistance to improper influences. And as the regulator enters the fray, it will have the opportunity to build a constituency of its own, increasing insulation from political interference.

The discretion in regulatory systems differs widely among countries and industries. At one extreme, U.S. laws typically delegate broad discretion to regulators, often vaguely defining standards as "just and reasonable" and limiting other powers only by reference to broad public interest criteria. At the other end of the spectrum, some countries implement regulation through tightly specified laws or contracts that seek to eliminate discretion. They attempt to deal with all contingencies foreseen at the time an arrangement is finalized. (10)

Most regulatory systems lie somewhere between these extremes. Key policies and principles tend to be defined in laws, licenses, or contracts, which carefully delimit residual discretion through reference to criteria, factors, and objectives. Greater flexibility and discretion are usually more important in industries in which there is rapid technological change, in which the introduction of competition requires continuous adaptation of rules to changing market conditions, and in which high priority is placed on providing incentives for efficient operation. Another consideration is a country's stability and reputation for respecting private property rights: the higher a country scores on these criteria, the more discretion it can retain without

significantly increasing the cost of capital. This consideration is especially relevant for reforming and developing countries, many of which lack a long track record of good performance in these areas. There is also a distinction between regulatory agencies that are truly regulatory and possess actual decision-making powers and agencies that are merely consultative. (10)

4. Benefits of Independent Regulation

In the high growth Asian economies, an independent regulator would provide reassurance in the event of a growth slowdown. For many of these countries, the existence of a formally independent regulator is not essential for supporting private infrastructure finance - they have other features which make them sufficiently attractive. However, a credibly independent economic regulator, if politically acceptable, would be superior not least because it would reduce the cost of capital and thereby, in these capital-intensive industries, reduce the costs of services to users (12).

Why – from a societal point of view – can independent regulatory authorities be beneficial? Why can it be in the self-interest of the legislature to delegate powers to independent regulatory authorities? What are the benefits to the regulated entities of an independent regulator?

The benefits of independent regulators are defended:

- as a necessary condition for the realization of a credible liberalization and privatization process, and for correcting market failure
- as a better fit to overcome the problems of asymmetric information between the regulator and the regulated industry
- as an opportunity for the governmental/legislative body, by delegating regulatory powers to independent agencies, to maximize its own influence, given uncertainties, limited time, resources, etc. (5)

In one European study, the investigation of the relationship between the regulatory authorities and the political authorities showed that only in two cases, Italy and Ireland, did the institutional design of the independent regulatory authorities live up to the ideal conditions regarding financial and organizational autonomy. However, in most of the countries (with the exception of Spain), the independent regulatory authorities enjoyed more financial, organizational and decisional autonomy than is normally granted to institutions within the traditional ministerial hierarchy. Thus, bearing the label "independent" is not without practical implications for the regulatory authorities, but the label is no guarantee of full autonomy.

Even though a regulator is independent by statute, there are a number of areas where that independence can be compromised by government. These include:

- Personnel independence
- Operational Independence
- Enforcement Independence (1)

There are also areas in which they can be compromised by industry. The main themes in this regard are agency capture and asymmetric information. Some authors argue that independent regulators are particularly vulnerable when it comes to agency capture. One reason is that the turnover in agency staff is limited due to the technical specialization of sector-specific independent regulators. The lack of turnover means that many things come to be taken for granted and the staff tends to over-identify with the regulated party. Or, in some cases, the regulated parties may try to "capture" the regulators by bribing them or by promising them well-paid jobs in the future, in order to influence their decisions. Secondly, there is a risk that the industry can use asymmetric information and misinformation to manipulate the regulator. Others, however, argue that the independent sectoral regulatory authorities in general are more likely to be able to match the expert knowledge of the regulated industry and limit the problem of asymmetric information. Finally, there is a risk that the regulator's independence is compromised by the regulator's private interest in the sector, directly or indirectly, e.g. when the regulator holds stocks or is investing in the regulated industry. (5)

There are also benefits to the regulated of having an independent regulator, including:

- more consistency of decision making
- long-term decisions rather than short-term decisions
- more transparency
- better accountability
- more trust between the regulated and the regulator
- freedom from political interference (1)

5. Creating an Independent Regulatory Agency

A formally independent regulator can not alone be sufficient for the introduction of effective regulation. In the end, the government is the ultimate guarantor of regulatory reputation, however independent the law may specify the regulator to be. The government must act in the spirit of the regulatory process and observe the informal as well as the formal rules of the game (12)

Creating an independent agency is especially challenging in countries with a limited tradition of independent public institutions and limited regulatory experience and capacity. There is broad agreement on the kinds of formal safeguards required:

- Providing the regulator with a distinct legal mandate, free of ministerial control.
- Prescribing professional criteria for appointment.
- Involving both the executive and the legislative branches in the appointment process.
- Appointing regulators for fixed terms and protecting them from arbitrary removal
- Staggering terms so that they do not coincide with the election cycle, and, for a board or commission, staggering the terms of the members.
- Exempting the agency from civil service salary rules that make it difficult to attract and retain well-qualified staff.
- Providing the agency with a reliable source of funding, usually earmarked levies on regulated firms or consumers. (10)

Formal safeguards of this kind are especially important in countries with a limited tradition of independent public institutions. But they are not enough. Persons appointed to these positions must have personal qualities to resist improper pressures and inducements. And they must exercise their authority with skill to win the respect of key stakeholders, enhance the legitimacy of their role and decisions, and build a constituency for their independence. (10)

Several options lie between the traditional ministerial model and the delegation of broad discretionary authority to a fully independent agency. These options can form a path of transition to greater independence and delegation of discretionary authority. For example, a dedicated regulatory unit can be created within a ministry, to coordinate regulatory activity and foster the development of technical skills and professional norms. Once such a unit has been created, governments can increase the transparency of regulatory processes and approximate an independent agency in other ways. (10)

Second, an agency can be created with many of the attributes of an independent agency, but with one or more ministers taking part in decision-making. This approach can improve the technical quality of regulatory decision-making, particularly compared with the first option. But as long as ministers retain significant influence, the risk of misuse of regulatory discretion remains. (10)

Third, a more truly independent agency can be created, but with some or all of its powers limited to making recommendations to the minister. A variant is to give the agency decision-making authority but have appeals go to the minister rather than another independent authority. This approach reinforces the separation of professional and political considerations in decision-making and usually provides the agency with greater insulation than under the second option. Political considerations are not excluded from the regulatory process, but the agency can build a reputation for professionalism and balanced judgment, enhancing its authority and reducing the likelihood of being overruled. Models can also be devised in which the minister is permitted to depart from the agency's recommendations or decisions only in narrowly defined circumstances. (10)

6. "Independent" – But Accountable and Answerable

Transparency and predictability is the objective of regulatory governance. It hinges around making regulatory agencies accountable. This accountability operates at various levels. In particular, there is formal accountability, i.e. the formal legal basis within which the regulator operates. This covers the powers and duties of the regulator, and any legal requirements on the regulatory process as well as appeals opportunities for companies and consumers (8, 12).

Commenters note the importance of formal accountability, in particular through the operation of effective and uncorrupt courts enforcing proper and consistent regulatory practice and procedures. This is clearly necessary, as is a proper legally specified assignment of functions between government, regulatory agency and regulated enterprises. Nevertheless, although necessary for effective regulation, formal arrangements may not be sufficient and that informal regulatory accountability - the understandings on the custom and practice of regulation - are at least as important for sustaining effective regulatory governance as the formal legal powers. In formal accountability:

- encourages debate and open discussion
- involves all relevant parties;
- leads to justification by the regulator of decisions and methodologies; and
- generally leads to a clear understanding of the "rules of the game" (12)

Checks and balances are required to ensure that the regulator does not stray from its mandate, engage in corrupt practices, or become grossly inefficient. Striking the proper balance between independence and accountability is difficult, but the following measures to do so have been adopted by a growing number of countries:

- open decision-making and publication of decisions and the reasons for those decisions.
- Prohibiting conflicts of interest.
- Providing effective arrangements for appealing the agency's decisions.
- Providing for scrutiny of the agency's budget, usually by the legislature.
- Subjecting the regulator's conduct and efficiency to scrutiny by external auditors or other public watchdogs.
- Permitting the regulator's removal from office in cases of proven misconduct or incapacity. (10)

Among the sources of accountability is unambiguous primary legislation limiting the discretion of the regulator, the existence of an appeal mechanism and formal rules prescribing the use of fair and acceptable procedures and justification of methods and decisions by the regulator.

7. Appeals

There is no single appeal mechanism that will fit all independent regulators. They are too different, with different responsibilities. The ability of stakeholders, both those being regulated and those on whose behalf the regulation is being carried out, to challenge decisions made by a regulator is an important route of holding the regulator to account. An appeal procedure should be seen as complementary to other accountability mechanisms. Of course independent regulators have a job to do. Stakeholders should not be able to use an appeal mechanism merely to delay a decision that a regulator has made. (1)

Appeal mechanisms fall largely into two groups. First, an internal appeals mechanism or tribunal system, and second, where appeals may be made to a ministry or through the court system. The latter process may be too burdensome for some to use. The cost of court procedures may be prohibitive for many stakeholders and so it may be appropriate to establish an independent complaints reviewer, ombudsman or consumer advocate. These offices can investigate complaints of maladministration or failure to meet published standards of service, quality, speed and performance. Another alternative is a mixed, two-stage appeal. The first stage is an internal review, and if the appellant is still not satisfied, an independent panel, which makes a recommendation to a designated appellate body, further reviews the case. (1)

8. Bounded Independence: The U.S. Federal Communications Commission

Exercising its authority over interstate commerce, Congress adopted the Communications Act of 1934 (the "Communications Act"), which established the FCC as an independent regulatory body responsible for regulating interstate and foreign communication "by radio and wire" in the "public interest." In practice, the FCC has exclusive regulatory power over matters involving use of the domestic non-governmental radio frequency spectrum. Such spectrum is considered to be inherently interstate, as radio wave transmissions are not confined by state boundaries. Wire communication, by contrast, has traditionally been subject to both FCC and state regulation, depending upon whether the activity is interstate/international (FCC) or intrastate (state).

Because the "public interest" is not specifically defined by federal law, the broad mandate gives the FCC significant range and flexibility in developing rules and policies. This broad mandate is typical of the approach that Congress takes to regulatory legislation. The laws set out general policies and directions, and regulators are left to decide upon the rules that will implement the policies. In this way, expert regulators are making decisions about implementation, not legislators who have a broad but general focus on relevant matters.

The FCC is formally (or at least nominally) "independent" of the executive branch. In international parlance, it would be external to a Ministry. But in the bargain it has traded a single master for several, leaving it nominally "independent", but highly constrained.

The flexibility given to the FCC is subject to an elaborate system of "checks and balances" that are intended to permit the public, both directly and through its elected representatives, to exert influence on the FCC's decisions. These constraints include the following:

- The scope of its jurisdiction – those matters on which it may rule – is limited by its constitutive legislation. Some attempts to expand this by claiming "ancillary jurisdiction" have been rejected by the courts. It shares jurisdiction in intrastate telecommunications with the states, and with the Department of Justice Antitrust Division with respect to antitrust-related issues.

- If it wants to extend or transform its jurisdiction (e.g., over the Internet), it must go back to Congress to change the law (although it does have some discretionary power to forebear from regulating)

- Its overall policies are set by Congress in legislation, such as the Telecommunications Act of 1996, to which it must conform. For example, its migration from a regulatory agency to one which promotes competition, reflect the politics of the time (indeed, some of the most aggressive promoters of reliance on markets even question the continued need for the FCC).

- The President nominates the five FCC Commissioners, each of whom serves a five-year term, which is subject to renewal at the discretion of the President. The terms are staggered so that no more than one Commissioner's term expires each year. The nominees for Commissioner are typically "know quantities," with proven political loyalties and a public track record, who are unlikely to make any surprising decisions.

- The President's nominees must be interviewed and confirmed by the Senate. This confirmation process provides the legislature with a say in the composition of the FCC's decision making body. The Senate does not typically reject a President's nominee, but the threat of rejection can guard against the possibility that a President will nominate an individual with extreme views that are inconsistent with the views of the public, as expressed through their election of Senators,

- Congress decides the size of the FCC's budget each year through its fiscal appropriations process. The budget is contained in legislation, which must be adopted each year. Budget decisions are made after hearings are held. At various times, Congress has used its control over the budget to limit the FCC's activities. For example, budget legislation in a particular year may specifically prohibit the use of funds for certain activities or proposed policy initiatives. Congress also may reduce the FCC's total budget if it wants to slow or limit the FCC's activity generally. The FCC is properly described as "a creature of Congress."

- The ability of the FCC to self-generate and implement entirely new policies is constrained by limited resources and the overt desire of Congress to be the ultimate policy-setter.

- Various committees within the Congress also have responsibility to "oversee" the activities of the FCC and to consider new laws that affect communications activities. When a legislator on such a committee has concerns about a particular FCC action or proposed action, he may convene a hearing to question the regulators or, in some cases, to rebuke them in a public setting. These hearings may be used for several purposes. One is to allow Congress, when it is considering a new law (or the need for a new law), to learn about the subject on which it may legislate. Another is to permit Congress to hold a public discussion with Commissioners and FCC staff members. At these hearings, legislators may express the views of their constituents and also may expose the regulators to views of other panelists that Congress wants to be expressed.

- The President, members of Congress, and members of other Executive Branch agencies meet privately with Commissioners and FCC staff members to express their views.

- In its proceedings, the FCC is legally bound to comply with the federal Administrative Procedures Act, which sets out extensive rules for proceeding in an orderly, public process including submission of testimony from all interested parties and the issuance of a reasoned written decision.

- Any interested person may appeal an FCC decision to the federal courts. Such judicial review is made available under the terms of the Communications Act and in accordance with the provisions of the Administrative Procedure Act (the APA), which sets out various procedural standards for federal administrative agencies, such as the FCC. The court will consider whether the FCC has acted consistently with its

authority under the Communications Act, and in a reasoned manner, based upon the evidence before it, and not arbitrarily or capriciously.

- The FCC's actions are subject to the Freedom of Information Act, which requires agencies to release virtually all documents to anyone submitting an appropriate request and to the Sunshine in Government Act, which requires federal agencies to hold their meetings in public, after reasonable notice to the public of the times, places, and agendas of such meetings. This permits the direct involvement of interested individuals and entities in regulatory action. (9)

Even though the FCC is considered by some to be the extreme end of the spectrum with respect to "independent regulators," it is clear that its powers are narrowly circumscribed by its jurisdiction, structure, funding, oversight, procedures, transparency and appeals processes. So the risk that the FCC would run amok and do something well outside the mainstream of current political thought is effectively zero. And if it did, there are plenty of mechanisms to bring it quickly back into line. So, very roughly speaking, the "independent" FCC must walk a fine line between politics, check and balances, and doing its job, complex as the process may be.

The U.S. has had over 70 years to develop this intricate system (of which Rube Goldberg might be proud), which has grown and evolved organically, in a larger context (the creation of the initial regulatory bodies in the late 19th and early 20th centuries, the expansion of sectoral regulators in the 1930s, the focus on deregulation in the 1980's, etc.). To expect a country with a different history, different culture, different legal and market situation, etc. to suddenly adopt the FCC model wholesale may be to ask more than is reasonable – or workable. That leaves the question, are there other choices?

9. Multiple Models of "Independent Regulation"

Part of the trouble determining the effects of regulatory independence is due to the fact that these effects depend both on how regulatory independence is practiced as well as a number of contextual factors. In a study of regulation of telecommunications in five countries, Levy and Spiller (1996) concluded that in order to understand the success and failure of different regulatory designs, attention must be paid to the importance of the match between the regulatory design and the inherent structures and institutions, administrative and legal capabilities, etc. of the country in question. The specific institutional and organizational design of the regulator can be of great importance, because stated independence is no guarantee of de facto autonomy in the regulatory process. (5)

In light of this, the question arises as to whether the presence of a formally independent decision-making regulator is the only way in which private sector investment in telecommunications can be achieved; or, if there are other feasible solutions. Even in OECD countries, formally independent regulatory agencies are rare outside Anglo-Saxon economies. (12)

It appears that formally established independent regulatory agencies are likely to be the most secure way to achieve effective regulation in countries where there is a body of well-established commercial law, effective courts of law and experience with competition policy. The question is

whether the U.S.-model independent regulator route is the only or best way in Central and Eastern Europe, and developing economies in Asia, Latin America and Africa.

Transparency and predictability of regulation with a clear assignment of functions can be achieved in other ways and may, in some or all developing countries, be better achieved by a less ambitious approach than fully independent regulation. The critical point is that a successful regulatory agency is one that has a reputation for acting fairly. An advisory regulator that makes fair and justifiable recommendations, uses fair and acceptable procedures and operates in a transparent and predictable way is better than a formally independent, decision-making regulator that does not act impartially.

In some emergent economies a formally independent regulator may well be perceived by politicians as too much of a threat. In such cases, the choice may in practice be between: (a) an advisory, non-decision making regulatory agency with limited formal legal independence; and, (b) a formally independent, decision-making regulator which the government ensures one way or another will not act against its wishes. In case (a), provided the agency can publish its recommendations and publicly present its case to appropriate bodies (e.g. committees of the legislature, the media etc), it is likely that in any substantive sense it is more genuinely "independent" than in case (b). At least it would force the government to justify itself as and when the recommendations were rejected, but without the threat that it will have to accept any recommendation, however politically problematic. (12)

Effective regulation is bound up intimately with the reputation of the regulatory agency. Regulatory reputations take time to build up and can be quickly lost. Such regulatory reputation implies considerable informal as well as formal accountability. The judgment of all of these is involved in creating and sustaining a reputation for fair and effective regulation. If, as appears to be the case in some countries, implementing a US style regulator is too challenging, then effective regulation may well require the establishment of arrangements, possibly transitional, that provide for regulation through other mechanisms, including, for instance, through openness and public debate. (12)

The case for such a transitional arrangement is that:

- It gives countries the opportunity to work-out their own preferred methods of achieving a long-run sustainable structure compatible with the local economic, political and legal environment.

- It enables the embryonic regulatory institutions to build-up expertise, reputation and credibility before they are given full decision-making responsibility. This reduces the gamble for governments.

- It enables both the regulated enterprises and the regulator to gain experience with the content and process of regulation, possibly by working with an increasingly effective and influential advisory regulator. (12)

These features also (a) operate to reduce the risks of serious mistakes being made once the full-blown regulatory system goes live; and, (b) enable problems and deficiencies to be resolved early on and without either inflicting serious costs or seriously damaging the credibility of the regulators (12).

The situation seems to call for a cautious treatment of so-called 'best practice' models, allowing for adaptive responses that are rooted in local conditions and assume variations in political and bureaucratic culture. Transferred 'best practice' models demonstrate clear adaptive variations in different countries, and it is likely that the 'blind' importing of these models from developed economies will be counterproductive where no account is taken of differences in legal infrastructure, bureaucratic culture, market realities and political values. (6) It is necessary to recognize that national systems are 'path-dependent", i.e., their existing possibilities for change are restricted and shaped by prior institutional formation, for example, through colonial systems, decolonization processes and types of political regime.

Regulation is seen, not as a narrow exercise in rule application and adjudication, but as a crucial part of the whole range of neoliberal market reforms, which include privatization and reshaped state-market mechanisms such as contacting and public-private partnerships. What this means is that regulation must always be analyzed and evaluated in a political context. Adopting unmodified "foreign" models overlooks unique traditions of administrative culture and a diversity of national adaptations. The literature on policy transfer as it relates to more general market-oriented governance reforms in developing economies is still fairly sparse, but what there is tends to the conclusion that reforms are largely rhetorical; blueprints are borrowed, but honored in the breach more than the observance, with considerable local variation in reform trajectories, where such can be said to exist. (6)

One should be wary of the dangers of attempting to impose universalist models of political economy that take no account of cultural relativism. Desirable objectives are unlikely to flow from the unthinking application of notional models which are themselves embedded in other systems of economic, social and political thought and practice. (6)

10. China, the WTO, and Telecommunications Regulation

China, as it has moved at a very modest pace towards opening up its telecommunications markets, has not seen the level of aggressive participation some in the country had expected. Foreign investors have been cautious. They have also been seriously constrained by the investment rules China has put into place. China is clearly perceived as sending mixed signals to potential investors. There are a variety of reasons for this, which include concerns about protections for national operators, the absence of a real competitive market, uncertainty about China's policies, the absence of a telecoms law, limitations on control, issues around national security, and minimum criteria for investors. The rules are unknown, and the risk is consequently perceived as high.

The reason China needs a trusted regulator backed up by a state-level commitment to fair play and open, competitive markets is not because the WTO Agreement requires it, but because it must address the legitimate concerns of investors if it sincerely wants them to come. And

beyond that, if it truly believes in the benefits of market competition, the playing field must be kept level so that its economy can realize the full gains of its market opening.

China, however, has been very resistant to the phrase "independent regulator," apparently imagining some renegade agency outside the control of the state and the party, which would be inconsistent with their culture and their guiding governmental policies. However, as a review of the idea of an "independent regulator" has shown, the implementation can come in many forms, some of them much more consistent with China's unique circumstances. For China, to focus on the "independent regulator" is to shoot at the wrong target. The real target is substantively addressing the concerns of foreign investors. If that can be done, the formal structure matters much less. If that can't be done, the formal structure doesn't matter at all.

10.1 The WTO Agreement on Basic Telecommunications

On February 15, 1997 the General Agreement on Trade in Services (GATS) of the World Trade Organization concluded its negotiations on basic telecommunications services. 69 governments, including the USA, European Union, Japan, India, Pakistan, Korea, and Malaysia, comprising more than 90% of global telecommunication revenues, made commitments to open up their respective telecommunication markets beginning January 1998. Commitments involved three basic areas: 1) market access, 2) foreign investment, and 3) acceptance of certain regulatory principles intended to make market openings meaningful. 53 governments permit foreign ownership or control of telecommunications to varying degrees; 65 governments committed themselves to observe the regulatory principles contained in the WTO reference paper. (7)

The WTO Agreement on basic telecom services was based on 20 years of experience with the liberalization of telecommunication markets around the world. The negotiators recognized that incumbent telephone monopolies enjoy certain structural advantages that can nullify or minimize competition, even when markets are legally open. In addition to opening markets, therefore, the negotiators sought to define certain aspects of the regulatory environment in the signatory countries that would be required to make competition effective. In particular, the WTO agreement defined 6 basic regulatory principles, including establishment of an "independent regulator", which should be "separate from, and not accountable to," any supplier of services. Decisions and procedures of the regulator should be impartial. (6)

10.2 China's WTO Commitments Regarding Independent Regulation

In its WTO accession negotiations, China committed to separate relevant regulatory authorities from, and not make them accountable to, any service suppliers they regulate, except for courier and railway transportation services (Working Party Report). In addition, as part of the whole package, China also subscribed to Annex 1 of the Schedule of Specific Commitments on Services: Reference Paper. The Paper contains a special section on Independent Regulators. Section 5 reads in its entirety:

5. Independent regulators

The regulatory body is separate from, and not accountable to, any supplier of basic telecommunications services. The decisions of and the procedures used by regulators shall be impartial with respect to all market participants.

The document is silent on the question of the "independence" of the regulator relative to governmental structures. This means that the standard for compliance with WTO "independent regulator" obligations is quite limited. The issue, then, is less one of compliance and more one of what will make investors feel comfortable entering a market.

China is perceived as having a giant market with solid prospects for future growth. International investors understand that the process of economic liberalization will continue, although the precise pattern in China is difficult to predict because of lack of transparency in the internal debate over new initiatives. International perceptions are influenced by the presence of a credible independent regulatory agency. Such a sector agency provides a signal for private investors, particularly foreign investors. In turn, economies with credible regulatory agencies can attract capital more easily since investors have an opportunity to earn a reasonable real rate of return. (3)

Those with the most access to the state decision-making process gain from the non-transparent favor-granting process. Concerns about regulatory commitments can dampen an enterprise's willingness to undertake significant investments to reduce costs. At present, China's legal system is evolving, and its regulatory structure has limited independence, which can lead to a weak ability to make commitments. (15, 16)

Prior to 1998, China's telecom sector was regulated by two separate ministries: the Ministry of Posts and Telecommunications (MPT) for the operators and the Ministry of Electronics Industry (MEI) for equipment manufacturers. Both ministries served as both regulator and operator, making policies while operating large business enterprises. In 1998, MEI and MPT merged to form the Ministry of Information Industry (MII). Subsequently, China Telecom, the country's monopoly carrier, was divested from MII as part of an effort to separate government from enterprise. Under the new regulatory regime, MII makes industrial policy (such as planning the electronics/IT manufacturing sector and formulating preferential policies for the software and IC industries) and regulates the telecom services sector (through the Telecom Administration Bureau). It also allocates spectrum, licenses network access equipment and develops standards. (14)

Because of the way the Chinese economy is managed, most strategic sectors (including telecom) are still owned and operated by the government. (14) Generally speaking, with the rapid expansion of the Chinese economy, corporate governance has become a high priority both for the government presiding over the transition to a more market based economy, and the businesses and shareholders at the core of market development. In 2003, the government set up a new commission, the State Assets Supervision and Administration Commission (SASAC) to divide the ownership and regulatory functions of State Owned Enterprises. The government has made capital market development and financial market stability primary goals, and has recognized the value of improved transparency and governance in attaining them.

Under the current system, all directors or senior management members of large SOEs are appointed by the Party's Organizational Department. The new management teams of China Netcom and China Telecom, for example, were appointed by the central government. Zhang Chunjiang, president of China Netcom, used to be a vice minister of MII and still enjoys a vice ministerial status. Large SOEs have to gain approval from the central government for major management decisions such as listing overseas or partnering with foreign companies. (14)

The central government is aware of the need for an independent, transparent and professional regulatory body for the IT/telecom industry. A report submitted by an MII study group, for example, concluded that establishment of an independent regulatory body for the telecom sector is a global trend. The independent regulator acts with a mandate by law and is free from interference by enterprises and policy-makers, the report noted; its mandate is to execute state laws and policies, regulate the telecom market, create conditions for effective competition between operators, settle disputes arising from market operations and competition, follow industry developments, and advise policy-making. The report recommended the creation of an independent regulatory organization such as the China Insurance Regulatory Commission. (14) In August 2001, China reestablished the State Informatization Leading Group. The group has an executive body called State Council Informatization Office. Some have suggested this group could be the precursor to a high-level regulatory body that sits above individual ministries regulating the telecom and cable industries. (14)

10.3 China's Legal Framework for Telecommunications

China does not yet have a Telecom Law. According to Chinese legislative procedures, the MII has primary responsibility for drafting the law; the draft will then be submitted to the State Council Legislative Affairs Office for review. After the draft passes that review, it will then be submitted to the National People's Congress for three readings. So far, the process has dragged on for several years. Reportedly, delays in getting the draft submitted to the NPC in part have been due largely to the uncertainty of the shape of the future regulator. In the meantime, the MII regulates the telecom and IT manufacturing industry, while SARFT (State Administration for Radio, Film and Television) regulates cable TV networks. (14)

In the absence of a telecom law, the main instrument of regulation in the telecom area is the Telecom Regulations, promulgated by the State Council in September 2000, and a series of decrees issued by MII, the industry's watchdog for now. Article 1 of the Regulations says the purpose of drafting the document is to "regulate the telecom market order, maintain the lawful rights and interests of telecom users and operators, safeguard security of telecom networks and information, and promote the healthy development of the telecom sector". Article 4 states that the supervision and regulation of telecom services shall abide by the principles of "separating government from enterprise, breaking up of monopoly, encouraging competition, and promoting development" and "openness, fairness and impartiality". "Independent regulator" was not mentioned in the Telecom Regulations, although "separation of government from enterprise" suggested a related concept. (14)

Debates have been going on among government officials and researchers as to what model the future regulator will follow. A report published in Communication World, a publication of the

MII, may shed some light on the shape of the future regulatory body. According to Xu Junqi, a researcher with MII's Telecom Research Academy, the draft Telecom Law will contain provisions on the legal status and composition of an independent telecom regulatory body, as well as the qualifications and tenure of the chairman and vice chairmen of the body. He suggests that the body be modeled after the China Securities Regulatory Commission (CSRC), which is directly under the State Council. This new body, he suggests, will have the following characteristics:

- A legal status similar to the CSRC, with sufficient funding and independent power to hire

- Collective decision-making, with one chairman and four vice-chairmen, each for a term of five years. The chairman and vice-chairmen will be nominated by the premier of the State Council and appointed by the National People's Congress (or its Standing Committee when the NPC is in recess)

- A national body with branches in eight regions (Northeast China, North China, Northwest China, Central China, Central-southern China, Southwest China, Southeast China, and Southern China). It may also set up offices in provincial cities where there is no branch. (14)

This new independent body, according to the researcher, will be a transitional one. Ultimately, it will be directly accountable to the NPC. However, at the present stage, creating an independent body under the State Council would be a more viable option because 1) compared with the MII, the new body will be a semi-independent administrative organization with independent hiring and budgeting power, which will reduce interference from other government departments and increase its impartiality and authority; 2) it will address the conflict between industrial policy-making and telecom market regulation; 3) a national regulatory body with eight branches will help straighten up the division of responsibilities between the telecom regulatory authorities and local governments; and 4) the CSRC model provides an example to follow. (14) An open question remains whether or not this new body will bridge the jurisdictional boundaries between the MII and SARFT. (16)

The biggest uncertainty is the extent of liberalization – not just to foreign investors but also to private Chinese investors – of the Chinese economy at large and the telecom sector in particular. (3) China's constitution states that public ownership must be the predominant form of ownership for China. Chinese policy also stipulates that strategic sectors such as telecom, civil aviation, banking, insurance and railways must remain state-owned or controlled. (14, 16)

China's strategy of economic development is currently based on the idea of a "market economy with Chinese characteristics." This means using market forces to improve the efficiency of production while retaining a managed, predominantly state-owned economy. China's leaders want to achieve "an economic system that integrates the basic system of socialism with the market economy in an organic way whereby, under macro-regulation and control by the state, the market mechanism plays a fundamental role in the disposition of resources and [the state achieves] a high degree of balance between efficiency and fairness."

An open door and free market in telecommunications and information services would attract more investment, improve efficiency, and stimulate development. But it might also undercut the central government's ability to build up national enterprises in that sector and work against its desire for a more geographically balanced distribution of wealth.

Although the WTO agreement requires its country members to create an independent telecom regulatory agency, it doesn't give a clear definition for the meaning of "independent". Generally speaking, there are four basic models:

- Establish a regulatory agency under a government ministry, or regulate directly through related government departments, such as Japan and South Korea.

- Set up an independent agency, but with oversight by related government departments, such as the Federal Network Agency (formerly RegTP) of Germany and Ofcom (formerly Oftel) of UK.

- Set up an independent agency that is not within a single government department, such as the FCC in the U.S. and the Telecommunications Regulatory Authority (ART) in France.

- Have no telecom regulation agency. Use antitrust and consumer protection laws to regulate telecom operators, such as New Zealand. (2, 13, 18)

The history of telecommunications regulation in almost all these countries is that the model has evolved with the various development phases of the telecommunications market, and continues to do so. In many cases, the role of regulator has been transformed from "industry regulator" to "market competition promoter". The emphasis on regulation has moved to consumer protection, information transparency, competition implementation, and frequency management, and away from "market entry, exit, and price regulation". China is still very early in its competition phase. When China sets up its telecom regulatory agency, it could learn from such international experience. (13, 18)

11. Conclusion

Emerging economies inviting foreign investment in their telecommunications sector need to provide prospective investors with assurance that their investments will have an opportunity to grow and be profitable in an environment which is open, competitive and fair. There are a number of factors which create such an environment. A major element, in the eyes of investors, is a legal and regulatory framework which is transparent, fair, consistent, predictable and accountable. For many, this idea is embodies in the image of an "independent regulator." In addition, a limited form of such a regulator is mandated by WTO commitments.

A review of the practices of existing "independent regulators" shows that they come in many different forms. The example most often cited, the United States Federal Communications Commission, far from being truly "independent", is in fact highly constrained and bounded by law, structure, administrative processes, appeals, etc. It works to the extent that it does because

it has evolved a practice and a context over some 70 years. Other countries have different histories, different forms of government, different policies and different approaches. To expect to be able to drop the FCC model wholesale into emerging economies with totally different contexts and have it work is highly unrealistic. (4)

Institutions define the formal and informal rules within a society. Since new telecommunications initiatives are embedded in existing institutions, there must be consistency; otherwise, the new agency or set of laws will not promote change. This needs to be taken in consideration when considering when drafting an appropriate set of regulatory arrangements consistent with current Chinese institutions. (15)

China has the opportunity to shape its own model of regulation, consistent with its own policies and practices. (4, 13) If it wants foreign investment in its telecommunications sector, it must focus not on the concept of "independence" but on addressing the specific issues which give investors confidence. If it does that, it will almost automatically have gone well beyond its minimum legal obligation under its WTO commitments. This does not have to be done as a single, radical step, although China could make that choice, to move ahead aggressively.

Even if the ministry or executive power has withdrawn completely from regulatory decisions, a transition strategy may still be appropriate. Delegating broad discretionary powers to an untested agency poses risks, particularly in countries with limited regulatory experience and capacity. The broader the agency's authority, the more enticing a target it will be for those with incentives to undermine its independence. And lack of detailed standards -- like those that have taken more than a century to develop in the United States -- can create uncertainty and risk for investors. The prudent course is to take the time to carefully define a new agency and ensure that it has access to adequate resources and other support.

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