Independent Regulators

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Outline of Presentation

- Introduction
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- Evolution of empirical literature
- Latin America and Caribbean
- Reforming the institution: the case of Spain
- Conclusions

Introduction

- Independent regulatory agencies were born in the US in the XIX century and introduced in Europe by the UK in the 1980s.
- After that, they have been promoted by the EU in their liberalizing directives, the World Bank and others.
- The original UK government inclination was to give responsibility for regulating BT to the OFT.
- The director of OFT argued that it was too big a task and that OFT was ill suited for the continual monitoring that regulation requires.

Introduction

- All EU contries and many Latin American countries have created relatively independent regulatory agencies.
- These agencies have different degrees of independence relative to government.
- Regulatory independence has advantages and disadvantages.

Related Literature I: Regulatory Independence

- Advantages of regulatory independence:
  - commitment,
  - expertise
- Drawbacks:
  - coordination with the rest of government (Bernstein),
  - especially with distribution conflicts
- Independence does not solve, but it relocates, the commitment problem due to asset specificity and ratchet effect.

Regulatory independence

- The Posen critique: independence is endogenous.
- NIE and Pablo Spiller emphasize commitment problem (basic vs detailed regulatory engineering) but not independence
  - Spiller and Vogelsang giving more importance to licencing in the institutional endowment of England,
  - Divided governments, more prone to regulatory independence than centralized governments
  - in private conversations Spiller doesn't see real regulators as particularly independent

Related Literature II: the horizontal and vertical scope of agencies

- Horizontal issues: Scope economies versus regulatory innovation and yardstick incentives.
- Vertical issues: checks and balances, commitment to sanctions, versus coordination.
- Multi-sectoral versus convergent agencies.
- Scope and capture:
  - A big agency makes revolving door more difficult.
  - Two agencies makes capture more expensive.

Related Literature II: the horizontal and vertical scope of agencies

- Incentives in the public sector are less powerful (Dixit, 2002) because
  - More than one principal
  - More than one objective
  - Multidimensionality of effort
- Since formal incentives are more difficult in the public sector, career concerns are more important.
- Incentives from carreer concerns are reinforced by focused agencies (Tirole, 1994).

Evolution of the empirical literature

- Initially, the impact of independence was analyzed through exogenous dummy variables based on the legal existence of independent agencies.
- Next, indices were introduced to account for a variable level of legal independence.
- Gradually, endogeneity of independence and the practice of independence were recognized.

Latin America and Caribbean

- Using the database compiled by Montoya, it can be shown that the independence of telecoms regulatory agencies in Latin America (1990-2004) was fragile.
- The heads of regulatory agencies were vulnerable to political change to varying degrees.
- Still, more independence was associated to slightly higher network penetration.

Turnover Rate

Table 4. Duration of TRA's heads by law vs. Turnover Rate (only countries with duration prescribed by law). Period 1990-2004.

	Country	Legally prescribed (years)	Legally prescribed (months)	Turnover Rate (months)	Accomplishment
	Latin America (17)	*4*	*54*	*32*	*60%*
1	Argentina	5	60	16	27%
2	Barbados*	4	48	24	50%
3	Belice	6	72	72	100%
4	Bolivia	5	60	40	67%
5	Brasil	5	60	24	40%
6	Colombia	1.3	16	13	81%
7	Costa Rica	4	48	22	46%
8	Dominican R.	4	48	21	44%
9	Ecuador	4	48	20	42%
10	El Salvador	7	84	22	26%
11	Honduras	4	48	18	38%
12	Jamaica	5	60	60	100%
13	Paraguay	5	60	22	37%
14	Peru	5	60	66	110%
15	Surinam	5	60	42	70%
16	Trinidad and Tobago	3	36	18	50%
17	Uruguay*	4	48	48	100%

*The years by law in are 5 and in 6, but we only count 4, from its creation in 2001 to the final year of our simple, 2004.

Source: Computed by the authors

Rankings

Table 5. Ranking IR1, LPI1 and LPI2. 1990-2004 average.

#	*Country*	IR1	*Country*	LPI1	*Country*	LPI2
1	Argentina	0.647	Peru	0.581	Peru	0.947
2	Bolivia	0.487	Bolivia	0.577	Jamaica	0.793
3	Panama	0.459	Argentina	0.490	Colombia	0.774
4	El Salvador	0.441	Brazil	0.478	Bolivia	0.710
5	Peru	0.428	Venezuela	0.468	Argentina	0.590
6	Brazil	0.422	Jamaica	0.460	Panama	0.563
7	Paraguay	0.416	Honduras	0.443	Venezuela	0.557
8	Chile	0.400	Mexico	0.415	Belice	0.550
9	Ecuador	0.387	Paraguay	0.408	Paraguay	0.508
10	Nicaragua	0.371	Colombia	0.385	Costa Rica	0.485
11	Costa Rica	0.370	Panama	0.380	Mexico	0.448
12	Venezuela	0.314	Belice	0.350	Brazil	0.411
13	Belice	0.300	Barbados	0.265	Nicaragua	0.385
14	Honduras	0.286	Ecuador	0.260	El Salvador	0.354
15	Colombia	0.281	Trinidad and T	0.240	Trinidad and T	0.340
16	Trinidad and T	0.279	Uruguay	0.227	Chile	0.333
17	Barbados	0.264	El Salvador	0.221	Barbados	0.299
18	Jamaica	0.253	Chile	0.200	Dominican R.	0.258
19	Dominican R.	0.249	Costa Rica	0.185	Uruguay	0.227
20	Mexico	0.229	Nicaragua	0.181	Guatemala	0.225
21	Uruguay	0.187	Dominican R.	0.125	Ecuador	0.193
22	Guatemala	0.183	Guatemala	0.091	Honduras	0.143
23	Surinam	0.047	Surinam	0.023	Surinam	0.023

Source: Montoya & Trillas (2007) and authors calculations

Table 1. Parameter estimates for main lines per 100 inhabitants. 23 countries. 1990-2004. Panel Data, country fixed effects.

Regressors	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*
LPI1	6.561***					12.307***				
z	7.78					7.34				
LPI2			2.165 ***					7.67 ***		
z			4.47					5.93		
LPI3				5.525***					8.783***	
z				7.07					7.39	
PI					.6962**					4.489*
z					2.28					1.65
IR1		5.268***			4.152***		8.997***			-.771
z		6.55			4.43		7.23			-0.13
Density	.1809***	.113***	.1867***	.1143***	.124***	.163***	.051	.1502***	.0632**	.1614*
z	7.42	4.02	7.23	4.16	4.36	6.20	1.55	4.77	2.02	2.25
GDPpcpppr	.0023***	.0025***	.0024***	.0025***	.0023***	.0018***	.002***	.0013***	.0022***	.0014*
z	8.51	9.14	8.21	9.01	8.32	5.88	7.82	3.12	7.75	2.10
R-sqr	0.5443	0.5222	0.4897	0.5312	0.5299	0.4779	0.4899	0.2823	0.5057	0.2975
N-obs.	344	344	344	344	344	344	344	344	344	344
Instruments	---	---	----	----	----	*efi, staff*	*efi, staff*	*efi, staff*	*efi, staff*	*efi, staff, polconiii* (weak)

Spain's reform to merge network regulatory agencies with competition policy authority

- One of the first reforms of the PP government in February 2012.
- The previous government had appointed presidents of CMT and CNE for 6 years at the end of its term in office.
- The proposal merges all non-financial reguatory agencies (telecom, energy, postal, transport, media) AND the competition policy authority.
- The new agency will have less independence than the previous agencies.
- Very similar to a consulting report commissioned by Telefónica.
- Suspicion of legislative capture.
- But regulation had been controversial and was in need of reform.
- A closer look is necessary, based on
  - economic analysis,
  - specific characteristics
  - international comparisons

Background

- Some competences are devolved to government, eg number portability.
- Some of the work of the current agencies is not mentioned in the proposal, eg market monitoring.
- Staff (around 550 people) will belong to civil service, at least in part.
- Government will appoint senior executives and have the final say on pay levels and structure.
- Funding will be from government budget instead of consumer fees, as it is now.
- Agency will have a 9 member board, and president will be one of them for three years on a rotating basis.

Background

- CNE (energy) and CMT (telecom) exist since the mid 1990 and have survived political change.
- But they have been controversial, and the appointments have been political.
- The Competition Authority was reformed in 2007, making it more powerful and transparent.

Specific characteristics of Spanish regulated industries

- 1) The largest regulated firms in Spain are a result of privatization with dispersed shareholdings through succeessive IPOs.

- 2) These same regulated firms have agressively expanded internationally, most notably in Latin America, but also in other regions. Policy to support national champions.

- 3) Regulated firms in Spain exhibit a larger proportion of politically connected board members than firms in other industries and in other countries.

Specific characteristics of Spanish regulated industries

- 4) The Spanish government has legally recognized a debt with the electricity firms called the “tariff deficit.” This is a huge €25b distributive conflict.

- 5) There is abundant anecdotal evidence of regulatory instability in Spain.

- 6) There is no well established procedure in Spain to produce policy change or regulatory reform.

Specific characteristics of Spanish regulated industries

- 7) In railways, motorways and airports there are well known examples of white elephants (that constitute some of the biggest government failures in Europe).

- 8) Spain is a substantially (although not completely) decentralized country, also in regulation. Some regions even have their own competition policy authority.

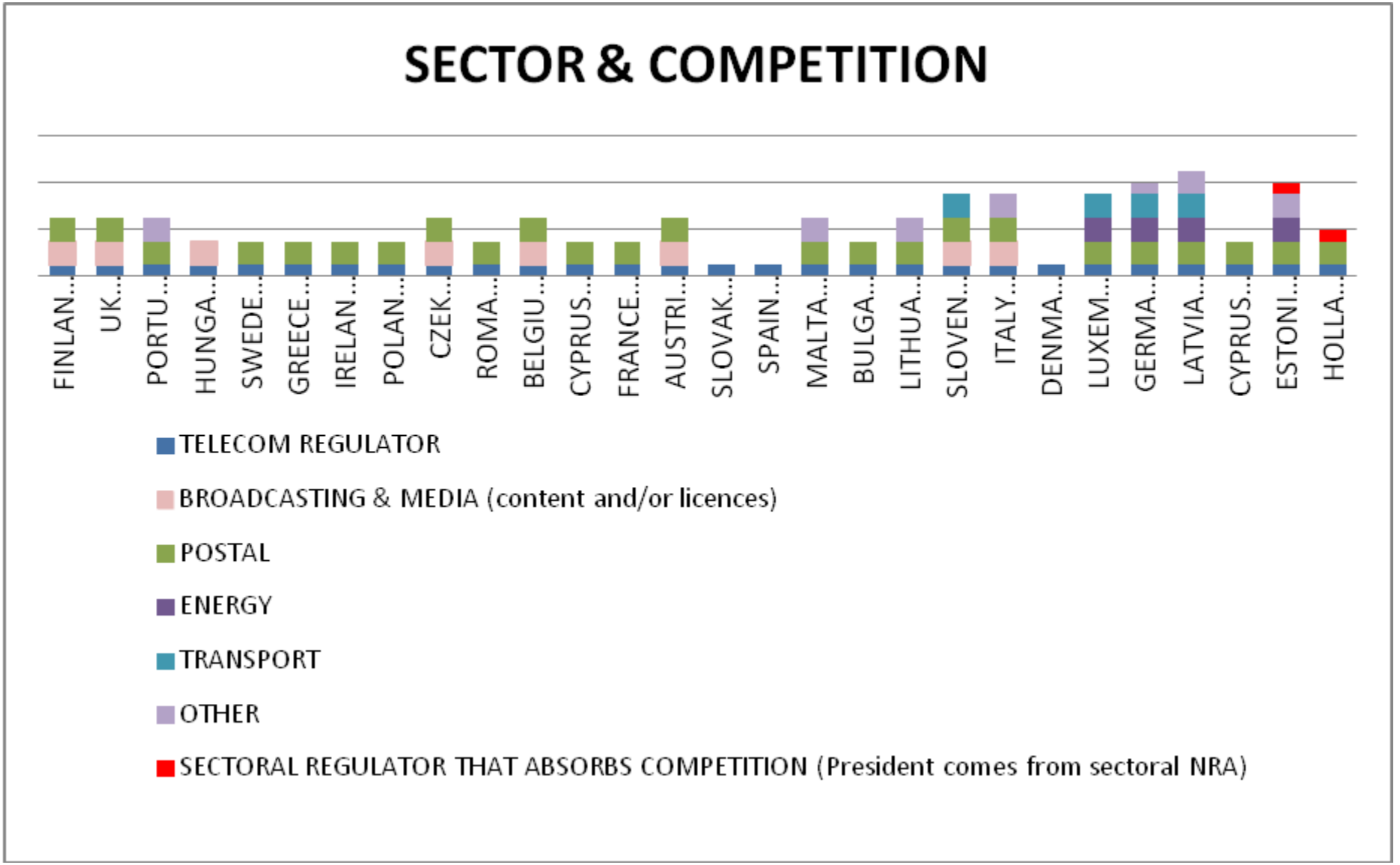
Evaluation

- There is an optimal degree of regulatory independence that depends on
  - asset specificity,
  - coordination needs,
  - distributional issues.
- Each industry requires a different level of optimal independence, not a homogeneous, low level.
- Firms in Spain mainly try to collude with politicians: politicians control better regulatory rents with only one agency.
- The cost savings alleged by government do not make much sense:
  - They come from not creating agencies whose functions someone has to take
  - Part of them could be achieved with convergent regulators.
  - Do not substitute for a good cost-benefit analysis.

Evaluation

- No country the size and development level of Spain has merged all sectoral regulators with the competition authority.
- Similar cases: Estonia and Holland since 2013.
- NZ had a common electricity+antitrust agency but the electricity regulator was subsequently spun off.
- Germany and US states have multi-sectoral regulators, but they are not merged with competition authority.
- UK, France, Italy, have convergent regulators in telecoms&media and, separately, in energy.
- The EU has been progressively pressing for more, not less regulatory independence.

Graph 2: Scope of telecom regulators in the EU



Source: CMT

Conclusions and final comments

- There are advantages and disadvantages to regulatory independence.
- Some countries (Latin America, Spain…) have found it difficult to make regulatory independence self-enforcing.
- Most studies show a positive impact of independence on performance, but the empirical studies have many problems with definition, measurement and endogeneity.
- Independent regulators: a great idea for a small number of tasks in a limited time period (Vickers: hedgehog vs fox).

Conclusions and final comments

- Regulatory agencies are too homogeneous: little regulatory innovation and experimentation.
- More attention should be given to incentives and behavioural economics inside agencies.
- The right institutional economics (Aoki): how regulatory agencies fit in the overall institutional environment.
- Independent regulators were not a key issue in the Littlechild report and are not a key issue to P.Spiller, but have become a key issue to many academics and international institutions.
- Colin Mayer's "Firm Commitment"
  - Regulation promotes too much homogeneity
  - Many regulatory objectives could be achieved with firms oriented towards broader objectives than shareholders' profits.

Thanks!

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