Self-regulation in telecommunications didn’t fail – it was never really tried.

A common feature of public discourse on telecommunications regulation is that “self-regulation has failed”. This paper outlines the motivations and legislative framework for self-regulation in the industry. It then describes the way that the framework has operated, and identifies the common criticisms of it. The paper concludes that the criticisms are not of self-regulation as such, but of the way it has been implemented. It suggests that the original motivations remain valid and that a drift to a more interventionist regulatory approach would be counter-productive.

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(The views in the paper are the author’s own and do not represent the position of vividwireless)

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Background

Industry evolution
The Australian telecommunications industry underwent a twin set of changes from 1975 to 1997.

The first strand of these changes was the migration of the former national monopoly provider from a department of state, to a statutory authority, to a statutory corporation and then finally a fully privatized entity.

The second strand was the gradual removal of the monopoly position of that provider with first some deregulation of customer premises equipment (CPE), then further CPE deregulation and competition in value added services. This was followed by the entry of additional network operators (one fixed, two mobile) which was accompanied by an effective full deregulation of the services market. Finally in 1997 there was full deregulation (i.e. removal of barriers to entry) in the carrier market.

Accompanying these changes were reforms in the regulatory structure. The statutory authority had been empowered with full regulatory authority but was also subject to complaint management by the Commonwealth Ombudsman. The start of value added services competition was accompanied by the creation of the first external regulator, the Australian Telecommunications Authority (AUSTEL). This was replaced in 1997 by the Australian Communications Authority (the ACA). This was a two fold change. Radiocommunications regulation was added through merging with the Spectrum Management Authority. Interconnection and network access issues were carved off to the Australian Competition and Consumer Commission (the ACCC) as part of a process of making that body an economy wide economic regulator. Subsequently the ACA was merged with the Australian Broadcasting Authority to create the Australian Communications and Media Authority (the ACMA) in 2005.

As this progress continued two issues were confronted. The first was the need to migrate the dispute resolution function from the Commonwealth Ombudsman as part of corporatisation and then privatization and to create the same impost on all providers. The second was how to provide the same kind of “service standards” across industry as Telecom Australia had imposed on itself.

The industry itself took the lead on both of these. The three carriers co-operatively built the Telecommunications Industry Ombudsman (TIO). Industry also met as the Network Interworking Industry Forum (NIIF) and prepared technical documents for network interconnection.
The Telecommunications Act 1997\(^1\) (the Act) formalised both these elements. The first required all carriers and service providers to be members of the TIO scheme. The second created a framework for “self-regulation” in which the TIO also featured.

**The legislative scheme**

The framework for self-regulation in the Act is somewhat complex. In reality the only place in the entire Act where the words “self-regulation” appears is in section 4 of the Telecommunications Act 1997 (the Act) as the statement of regulatory policy, which reads:

> The Parliament intends that telecommunications be regulated in a manner that:
> (a) promotes the greatest practicable use of industry self-regulation; and
> (b) does not impose undue financial and administrative burdens on participants in the Australian telecommunications industry:
> but does not compromise the effectiveness of regulation in achieving the objects mentioned in section 3.

Regulatory policy is presumably something that is directed at those whose job it is to implement policy, that is regulators and policy officials. That is, the parliamentary invocation to “promote the greatest practicable use of industry self-regulation” was an obligation placed on regulators not industry.

There can be no doubt that this was the intent, as the Explanatory Memorandum accompanying the Bill said;

> The Bill also contains a statement to the effect that the Parliament intends that telecommunications be regulated in a manner that promotes the greatest practicable use of industry self-regulation and does not impose undue financial and administrative burdens on participants in the industry, but does not compromise the effectiveness of regulation in achieving the objects of the legislation (see clause 4). This is intended to guide the telecommunications regulators in the performance of their functions and the exercise of their powers.\(^2\)

As we will see this is not the way regulators or others interpreted the clause, and when people say “self-regulation has failed” they seek to blame industry not regulators.

There appear to be three main reasons why the emphasis was placed on self-regulation, being:

1) Self-regulation was more consistent with the overall deregulation agenda inherent in the reforms;

2) Industry was demonstrating an eagerness and capacity to undertake the functions as demonstrated in forming the TIO and the NIIF; and

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\(^1\) In 1999 parts of the 1997 Act were excised into the Telecommunications (Consumer Protection and Service Standards) Act as part of the political process of selling Telstra. As a consequence there are items that would now be found in the 199 Act that were in the original TA 1997.

3) There was a perception that self-regulation would be more adaptive to innovation and change.

What was not part of the policy was the idea that self-regulation was offered to industry as a sop, and that the alternative of direct regulation was not being pursued as a concession and that direct regulation was therefore a threat.

The Act established a process under Part 6 for the development and administration of industry codes and industry standards. The simplified outline in the Act provides the easiest summary of these provisions.

*The following is a simplified outline of this Part.*

- Bodies and associations that represent sections of the telecommunications industry may develop industry codes.
- Industry codes may be registered by the ACMA.
- Compliance with an industry code is voluntary unless the ACMA directs a particular participant in the telecommunications industry to comply with the code.
- The ACMA has a reserve power to make an industry standard if there are no industry codes or if an industry code is deficient.
- Compliance with industry standards is mandatory.  

Section 113 of the Act gave examples of matters that might be dealt with by codes. While this list was included by way of example the industry actually set about developing codes on almost all items on the list almost immediately.

As we will see much is made generally of the concept of industry codes as core elements of the concept of “self-regulation”. There are two particular elements of Part 6 that need to be better understood, and these are the powers of the regulator (ACMA) in relation to codes and the powers of the TIO in relation to codes.

Section 114 of the Act provides that;

*If the Telecommunications Industry Ombudsman consents, an industry code or industry standard may confer functions and powers on the Telecommunications Industry Ombudsman.*

It took until mid 2000 before any agreement was reached with the TIO as to what these powers might be. A typical clause (from the Mobile Number Portability Code) invoking this power reads;

*Under section 114 of the Telecommunications Act 1997 and, subject to consent by the Telecommunications Industry Ombudsman, the Code confers on the Telecommunications Industry Ombudsman the functions and powers of:*

(a) receiving;
(b) investigating;
(c) facilitating the resolution of;
(d) making determinations in relation to;
(e) giving directions in relation to; and

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3 Section 106 *Telecommunications Act 1997*
(f) reporting on complaints made by the end users of carriage services about matters arising under or in relation to the Code, including compliance with the Code by those industry participants to whom the Code applies.

Technically does not expand the powers of the TIO in any way. The TIO exists to receive, investigate, resolve and report on complaints. The only extra part is the power of the TIO to investigate and report on compliance with the code.

To the extent the legislation and enforceable code rule does anything it is to empower the TIO to report to the regulator, now the ACMA, on code compliance. The carriers and service providers as owners of the TIO scheme could provide that direction to the TIO independently of the legislative structure, an act that could have been required of them by the regulator. This arises because the ACMA also has responsibilities to report on code compliance under section 105 of the Act, and powers to direct carriers and service providers under section 581 that would suffice to direct the carriers and providers as owners of the TIO scheme to provide that information.

Understanding the concept

What “self-regulation” is meant to mean was not otherwise spelt out in the legislation or the explanatory memorandum. It is perhaps more instructive to look at the over-all policy development process.

The regulatory reforms that culminated in the 1997 regime were all elements of deregulation. The primary deregulation occurring was deregulation on the prohibitions to entry in the market. The industry had otherwise been lightly regulated as the key provider had been first a Department of State and then a Statutory Authority. Indeed the provider itself wrote By-Laws.

The push to deregulation had many antecedents, but as a global exercise one of its foremost promoters was the US economist Milton Friedman. Friedman has been described as an “evangelist” of the free market and supposedly advanced the proposition that “The only workable type of regulation…was self-regulation.”4 This view is apparently to be found in the book Friedman wrote with his wife, Free to Choose. What Friedman actually said in that book in a chapter titled “Who Protects the Consumer” is that;

> The criticisms of the invisible hand are valid... The question is whether the arrangements that have been recommended or adopted to meet them, to supplement the market, are well devised for that purpose, or whether, as so often happens, the cure is worse than the disease.5

The book then proceeds to detail a list of cases where the cure is claimed to be worse than the disease, before returning to a general discussion which starts;

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Perfection is not of this world. There will always be shoddy products, quacks, con artists. But on the whole, market competition, when it is permitted to work, protects the consumer better than do the alternative government mechanisms that have been increasingly superimposed on the market.\(^6\)

They proceed to give examples of how consumer choice would drive poor performers out of business and the importance of brand, or the role that independent testing houses or government information provision can play. The only real problem – or potential failure of the market – the book admits is that of monopoly. The cure for that is not regulation but removal of barriers to entry and of trade restrictions.

This is the philosophical or theoretical underpinning of the regulatory policy of self-regulation, that the market is of itself a regulator that protects the consumer.

However, you would not recognize that from the review of industry self-regulation undertaken by the Government in 2000. The report by the Taskforce on Industry Self-Regulation in Consumer Markets was given terms of reference that stated:

* Self-regulation includes those regulatory regimes which have been generally developed by industry (sometimes in cooperation with government but enforced exclusively by industry). Self-regulation excludes explicit government legislation and regulation as well as regulation developed by government and handed over to industry for implementation, although for the purposes of this Taskforce it could include co-regulation, where a scheme is developed by industry with some government involvement but industry is fully responsible for its implementation.

Examples of self-regulation include:

* individual businesses choosing to adopt a standard;
* private institutions regulating themselves by a set of rules; and the
* introduction by industry participants of an industry-wide regulatory code.

Self-regulation could also include professional bodies’ codes of conduct, industry service charters, guidelines and standards, as well as industry based accreditation and complaint handling schemes.

Self-regulation is increasingly being used as an alternative to quasi-regulation and government legislation and there is some overlap between them. Identifying best practice in self-regulation, and identifying the limits of self-regulatory schemes, has important implications for the government’s approach toward a more efficient regulatory framework for both businesses and consumers. The role of government in encouraging self-regulation also has an impact on compliance costs, flexibility and the coverage of self-regulation.

The Government is committed to providing a competitive market environment while attempting to reduce the regulatory burden on Australian business. Industry self-regulation is often a more flexible alternative to direct government regulation.

However, it is necessary to ensure that self-regulation does not itself become a burden to industry with onerous compliance costs, particularly for small

\(^6\) ibid P.222
businesses. It is also necessary to minimise the anti-competitive potential of industry self-regulatory schemes by ensuring that such schemes do not set up barriers to entry to the industry, nor stifle innovation or competition amongst industry participants. Self-regulation is not appropriate in circumstances where other forms of regulation are able to provide better outcomes at a lower cost. This view of “self-regulation” is not the deregulatory version of Friedman, but a voluntary process of regulation under which industry “regulates itself”.

A more useful taxonomy can be inferred from the work of Ayers and Braithwaite (1992). They distinguish between concepts of “no regulation”, “self regulation” (which they also call “private regulation”), “enforced self regulation” and then “command regulation with discretionary punishment” and “command regulation with non-discretionary punishment”. More particularly they advance a theory of a “pyramid” of regulatory responses built on a game-theoretic approach that considers the extent of regulatory intervention to be resolved as a bargain between regulated firms and the regulator. This conception has as its genesis the idea that it is industry that seeks less regulation to avoid the costs. This misstates the policy intent, however. The burden of regulatory cost may be initially borne by regulated firms, but its consequences are ultimately felt by consumers, and overall economic welfare.

A more recent and sophisticated view has been prepared by Ofcom in which they distinguish between four “types” of regulation, being;

No regulation Markets are able to deliver required outcomes. Citizens and consumers are empowered to take full advantage of the products and services and to avoid harm.

Self-regulation Industry collectively administers a solution to address citizen or consumer issues, or other regulatory objectives, without formal oversight from government or regulator. There are no explicit ex ante legal backstops in relation to rules agreed by the scheme (although general obligations may still apply to providers in this area).

Co-regulation Schemes that involve elements of self- and statutory regulation, with public authorities and industry collectively administering a solution to an
identified issue. The split of responsibilities may vary, but typically government or regulators have legal backstop powers to secure desired objectives.

**Statutory regulation** Objectives and rules of engagement are defined by legislation, government or regulator, including the processes and specific requirements on companies, with enforcement carried out by public authorities.\textsuperscript{10} Ofcom notes that in reality these operate as a continuum. They also adopt a view similar to that of Ayers and Braithwaite that regulation should proceed via a process of incentives to pursue lower impact regulatory solution. (Ofcom has very similar regulatory policy and objects clauses in its legislation to those applying in Australia).

Ofcom propose a five step process for deciding between self-regulatory and co-regulatory approaches.

1. Do the industry participants have a collective interest in solving the problem?
2. Would the likely industry solution correspond to the best interests of citizens and consumers?
3. Would individual companies have an incentive not to participate in any agreed scheme?
4. Are individual companies likely to “free-ride” on an industry solution?
5. Can clear and straightforward objectives be established by industry?\textsuperscript{11}

Even this latter typography needs a little explanation. Firstly, Ofcom itself considers the relevance of “best practice guides” but does not include them explicitly as, absent of enforcement mechanisms, they are just a feature of no regulation. This perhaps undervalues such guides and in particular their usefulness to agencies designed to help inform a market. An example of this would be a “standard form contract” that was entirely voluntary in its application but would be something consumers could be educated to seek. An Australian example is the standard contracts provided by some industry associations to members, such as in both the real estate and motor trades industries.

The second element that is passed over is the role of standards. It is common to think of standards as being part of formal regulatory mechanisms, such as the A and C ticks in telecommunications. But standards play an important role in industry co-ordination and consumer protection. The standards in the computer industry (e.g. USB, Ethernet) are voluntary standards that it is in the interests of industry and consumers to follow. In other markets standards are specifically included by private contract. For example a contract for building works will usually specify building standards to be applied to the works, not all of these are mandated by the planning laws.

From this brief survey it can be seen that a regulatory policy that “promotes the greatest practicable use of industry self-regulation” means one that promotes the greatest possible use of no-regulation or industry self-enforced practices. In this depiction the mechanism


\textsuperscript{11} *ibid* P.16
of “registered codes” introduced in Part 6 of the Act is an additional mechanism of regulation, not the principle mechanism of self-regulation.

**Implementation**

**From self regulation to co regulation**

Three things happened almost simultaneously with the commencement of the regime in 1997;

1. Consumers moved to seek codes be written that covered all the matters that had been provided as examples of the subject matter in codes.
2. The industry body ACIF decided that all consumer codes would be registered with the ACA.
3. The ACA started to use the term “co-regulation” to refer to the whole regulatory regime rather than self-regulation.

Each of these had their own consequences.

The first saw a large body of work commencing writing codes while there wasn’t a matching exercise in defining what the objectives of these codes might be. The absence of an agreement on the reason for writing codes led to a disjunction between those (usually consumer representatives) seeking to use the code process to restrict the activities of service providers and those (usually industry representatives) seeking to ensure the code did little more than restate existing legal interpretation.

The second resulted in there being no incentive or motivation for really constructing a compliance regime within the association because, once registered, codes became effectively enforceable by the ACA. There was hence no benefit to a provider in becoming a code signatory or perceived use by ACIF in monitoring compliance.

The third result was the complete subjugation of the “code process” to being an agency of regulation. In the DBCDE Review of Consumer-related Industry Code Processes Issues Paper the first question posed was “In what circumstances is a consumer-related industry code the most appropriate form of regulation?” This reflects the erroneous conclusion that codes are necessarily part of regulation.

**Accusations of collusion**

In areas other than consumer-related codes the question of whether providers gathering together to discuss possible restrictions on certain conduct or on terms of engagement resulted in concerns of potential collusion in breach of the Trade Practices Act. In particular Telstra would regularly raise this concern at the Telecommunications Access Forum (TAF) and OneTel raised this concern (in fact threatened legal action) in an ACIF Mobile Number Portability committee.

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12 Department of Broadband Communications and the Digital Economy Review of Consumer-related Industry Code Processes Issues Paper April 2009 P.6
It is noteworthy that the area of mobile premium services specifically faces these concerns. A private enforcement regime on content and marketing these services would require agreement by all network operators to terminate relationships with “transgressing” content providers. That industry found reaching such a potentially anti-competitive agreement difficult is not, therefore, surprising.  

In general, in an industry where competition was being declared as successful because of the number of new entrants, and where a motivation for competition was service innovation, existing providers were justifiably concerned about the implications of acting co-operatively to limit the scope of possible innovation.

While technically both the TAF and ACIF had appropriate ACCC authorizations, the concern that industry should not be co-operating to limit innovation was shared by code developing participants.

**The role of consumers**

Consumer advocates came to the code development process largely unprepared. Firstly, they were unprepared in terms of their detailed knowledge of important operating characteristics of providers that were relevant to code operation. This made their ability to argue points weaker.

Secondly they were unprepared in having an expectation that code development was going to be a process of dramatically limiting provider flexibility or of adding significant obligations to providers. In particular consumer advocates erred in even bringing to discussion some matters into the self-regulatory framework. A significant case is probably the approach to “unfair contracts” as there was a fundamental void between consumer advocates interpretation of “unfair” and industry’s. It is instructive to note that while the telecommunications industry has been heavily criticised over its response to this issue, the Australian Consumer Law is introducing unfair contract prohibitions across the economy.

Thirdly consumer advocates were not well prepared for the specific skills called upon in code development work. Much emphasis has been placed on the relative numbers on committees, but the difference in voices heard was as much due to the greater skill development of the industry advocates than of the consumers.

**The process of writing**

The process of writing codes is resource intensive and was under-resourced. Committees had to “learn by doing” in developing a language and structure for codes, there was no existing template. Where committees were making their own decisions different

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13 Raiche provides some of the history of the development of the rules for mobile premium services. There were factors other than the “restrictive” nature of the TISSC scheme at play, including a significant “counter-insurgency” by the TIO asserting its rights in relation to receiving complaints. Holly Raiche *From Public Services to Services to the Public: Inventing telecommunications consumers* Telecommunications Journal of Australia vol 59 no 3 2009

14 This was described by the last CEO of CTN as the “last straw”, see Raiche 2009 *op cit*
committees applied different meanings to the same terms and even misused terms. Further, because of the decision made about registration, the process was dependent upon instructions from the ACA about how codes should be drafted. This instruction was often incomplete or conflicting and often not resolved until code registration.

More significantly though, committees did not break code writing into the two stage process of agreeing first what conduct or behaviour was being sought or prohibited before then writing how that would occur. This often resulted in committees negotiating from positions rather than from principle.

Finally committees regularly got bogged down on points of disagreement. Rather than “parking” areas of disagreement and continuing with the rest of the work before trying to resolve the differences, the matter of difference occupied all available meeting time.

All three of these can be sourced to the fact that ACIF had not prepared itself to take an active role in committee development rather than merely providing a forum.

The role of the TIO
The role of the TIO in relation to codes was problematic from the start. Firstly, the TIO tried to directly contribute to all code drafting while dragging the chain on agreeing how the “conferral of powers” regime would work.

Secondly, the TIO decided to be too active in the process of code writing rather than sticking to problem definition. Just as the ACA (see below) started to be very prescriptive on how code rules had to be written to be enforced, so too did the TIO. However, in practical reality the Ombudsman never “enforces” code rules. The primary focus of the Ombudsman is as an alternative dispute resolution scheme. As a consequence, in the vast bulk (over 95%) of disputes the Ombudsman never makes a ruling on the dispute in relation to anything, leaving the outcome to the provider and consumer.

At best the Ombudsman can report on the number of “potential code breaches” that an individual provider might be generating. This information is shared with the ACMA to guide their potential enforcement action.

The Ombudsman’s role in self-regulation has been far more effective in dealing with “systemic complaints”. The high point of this was the approach the Ombudsman took to the question of termination payments in mobile phone contracts. In this case the Ombudsman put industry on notice that he was dealing with them as systemic complaints. He then found that termination payments that were not “cost based” and hence constituted penalty payments for breach of contract, which are generally not allowed in law. The TIO notified providers that he would find for the consumer in EVERY case of a complaint on the grounds the charges were potentially unlawful and certainly unfair. Termination payment structures were changed across industry without a code or regulation.

15 The most common misuse was to refer to industry participants as C/CSPs for “carrier or carriage service provider” which failed to distinguish well between the separate roles, carrier and service provider, that a firm could be fulfilling.
When the unfair contract issue came up the Ombudsman could have pursued exactly the same strategy. His reason for difference was that in the case of contracts the TIO would have needed to rely entirely on the unfairness, but fairness is a core issue that the TIO was created to monitor. The TIO had felt on firmer ground with termination payments as these were potentially unlawful, not just unfair.

**The role of the ACMA and the ACCC**

The ACMA and ACCC played confused roles in code development. Staff members who attended meetings were sought for advice on likely approaches of their organization but could not commit for them. Partly this weakness resolved around the error in not breaking the code process into two stages of problem clarification followed by solution development.

**Extra law or safe harbours**

The prospect of codes only being additional restrictions on providers resulted in great reluctance of firms to agree to anything. Firms themselves mostly believed in the idea that competition itself was the process of “regulation” and that interference by codes would limit this ability.

The conversation about competing on customer service is usually described as being one of aspiration, having better customer service than a competitor. In reality though this translates to the opportunity for customers to choose products of a lower quality in return for a lower price. The difficulty with this is how that variation in quality is successfully communicated to customers.

There are ways this could occur by the development of quality standards that could be referred to in product documentation, or by processes of codes that create “safe harbours” as opposed to extend prohibition. An example of the latter would cover the need to describe new products using ordinary language. A code that established the use of, say, “Unlimited” could be useful. But its use should be in finding ways to authorize its use, not prohibit it. A Code that said “so long as you use the words consistent with this document the ACCC will not take action for misleading or deceptive conduct” would be useful.

A similar provision would be useful in areas like implementing the unfair contracts provisions of the new Australian Consumer Law. Such provisions are clearly co-regulatory not self-regulatory but have dramatic value to industry and consumers above more prescriptive rules.

**Is any regulation necessary?**

Friedman as we’ve noted claimed that regulation wasn’t necessary. He argued that the only case of market failure was monopoly, and the cure for it was competition. Against this view there are generally arraigned four contending views\(^\text{16}\), being

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\(^\text{16}\) These were the four views fundamentally advanced by discussants at the conclusion of the ACCAN “Responsive Regulation and Policy” seminar in Sydney on 28 September 2009 http://www.accan.org.au/event_full.php?id=9.
1. The need to constrain firm self-interest or address greed. This is fundamentally a belief that corporations themselves frame the world. Its best spokesman was J.K. Galbraith who wrote that economy actually operated like a giant planning machine run by corporations, not like a market at all.

   *We have an economic system which, whatever its formal ideological billing, is in substantial part a planned economy. The initiative in deciding what is to be produced comes not from the sovereign consumer who, through the market, issues the instructions that bend the production mechanism to its ultimate will. Rather, it comes from the great producing organizations which reaches forward to control the markets that it is presumed to serve and, beyond, to bend the consumers to its needs.*

2. The need to address social not just economic goals. This more frequently comes from the media side of the communications industry, but it includes the communications as “essential service” doctrine.

3. The need to address the small group of customers that providers will not compete for. The typical example is the disabled, or the poor. A more nuanced version is that competition for the special equipment might be weaker and therefore more open to higher pricing.

4. The need to deal with the tendency of firms to “mislead.” This is an extension of Galbraith’s earlier work that demand was a construction of suppliers not really something in the market. Its more modern version is that marketers manipulate customers, ultimately leading to marketers consciously creating confusion for consumers.

Each of these criticisms of the standard competition model can be further explained, often by resort to a component of heterodox economics. For example “behavioural economics” deals with the decision making of real humans, not of hypothetical satisfaction maximisers sometimes called *homo econimus*.

It is possible to create institutional designs of the marketplace to adjust for each of these weaknesses. Additionally, those designs can be just as effectively managed by light touch rules or even self-reinforcing rules.

Self-reinforcing rules are rules whereby the provider is “rewarded” for compliance. Typically that means process of competition drives the providers to actually try to outperform each other, and this can be facilitated by regulators or consumer advocates taking the effort to reward or acknowledge the good performers not just punishing or shaming the bad.

An example here is an industry association provided standard form contracts in the motor vehicle industry. This industry was renowned in the 1970s for deceptive contracts. The industry association introduced a standard contract that was well designed to ensure the customer was aware of all the variable terms. Active promotion of the contract means

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18 John Kenneth Galbraith *The Affluent Society*
that many consumers ill only buy from traders who use that contract, hence creating the incentive to use it.

“Name and shame” has been a popular theory for attempting to modify the behaviour of firms. It fails in two regards. The first is the simple principle of human behaviour, if you reward behaviour it will be replicated, if you punish behaviour you cannot tell how the behaviour will change other than the temptation of the disciplined to avoid the discipliner. The second is that the consumer audience hears more that the industry as a whole is failing than it hears that an individual firm is failing, hence publicizing the failures can actually damage the efforts of those investing in being good.

Perhaps the greatest claim of Friedman’s deregulatory polemic was the idea that the market drives out poor quality r high prices, writing;

If one storekeeper offers you goods of lower quality or of higher price than another, you’re not going to continue to patronize this store. If he buys good to sell that don’t serve you’re needs, you’re not going to buy them.\textsuperscript{19}

There is a scenario that can be described in which competition might not work this way, and it ultimately revolves around misleading conduct. For the model we assume that there are two providers in competition, and there are three elements that completely describe their products, these are the price, the quality and the amount the user doesn’t really know about the product. This last element of “uncertainty” can be a combination of intentional misleading by the provider, intentional complexity designed by the provider to make customer assessment of quality difficult, uncertainty created by the customer not having a sufficiently high marginal benefit to justify the additional search, and the complete inability to research the quality of after sales service at point of sale.

For simplicity we will assume that the providers have a choice between only two states, one where they minimize user uncertainty and one where they maximize it, which we can call Truth and Lie for simplicity. That means we have a game between the providers with 4 strategies that have different pay-offs which (in standard game theory approach) we can model as follows.

\begin{center}
\begin{tabular}{|c|c|c|c|}
\hline
 & Truth & Lie \\
\hline
Truth & R, R & S, L \\
\hline
Lie & L, S & P, P \\
\hline
\end{tabular}
\end{center}

\textsuperscript{19} Friedman \textit{op cit} P. 222
Where $L$ stands for temptation to Lie, $R$ for Reward for truthfullness, $P$ for Punishment for mutual lying and $S$ for Sucker's payoff. This description means that we could have a version of the Prisoner's Dilemma, a game where the joint pay-off is greatest from both telling the truth, but the maximising strategy results in both lying.

To be defined as prisoner's dilemma, the inequalities $L > R > P > S$ must hold. This condition ensures that the equilibrium outcome is defection, but that cooperation Pareto dominates equilibrium play. In addition to the above condition, if the game is repeatedly played by two players, the condition $2R > L + S$ should be added. If that condition does not hold, then full cooperation is not necessarily Pareto optimal, as the players are collectively better off by having each player alternate between Cooperate and Defect.$^{20}$

If these conditions of payoff are met then providers have a disincentive to ensure customers are fully informed, that is, they both have an incentive to follow the strategy “Lie”. Let’s examine the inequalities. Firstly it is reasonable to assume that over time an industry with truthfulness will result in higher trust from customers and a higher propensity to spend. Hence it is likely that $R > P$. If we have an industry in which one firm lies and the other is truthful, then the liar will receive greater return because customers as part of the uncertainty (e.g. a poorer quality of after sales service) can be translated into lower prices and hence greater market share and overall profitability, so certainly $L > S$.

Whether the other conditions will occur is more contingent on the actual state of the market. While a repeated strategy of one lying and the other being truthful might pay off well for the truthful party, at all “decision points” lying and being the only liar will be superior to the long run truthfulness position. That is $L > R$. Similarly to be the only liar as opposed to an industry of liars is likely to be harshly punished, hence $P > S$.

Therefore, though the pay-off for firms is greater by the whole industry developing a reputation for trust the outcome can be the reverse. The empirical evidence seems to be (or is asserted to be) that the telecommunications industry is behaving as if the prisoner’s dilemma conditions apply.

This is perhaps the single greatest justification for the conduct of self-regulation in the mode of “private regulation”. It is to develop the co-operation that will not occur through the market alone.

It also reflects the reason why external regulation might be ineffective, as strategies of punishing providers who mislead, or trashing the industry reputation as a whole, or even simply “name and shame” only work to re-enforce the hierarchical values between the pay-offs to create the dilemma. In fact, the strategy that works best for an external regulator is to increase the value of $S$. Regulators can do more to promote competition and outcomes for consumers by publicly praising the truthful than by punishing the liars.

$^{20}$ To deal with concerns of plagiarism I note that this discussion of the Prisoners’ Dilemma has been drawn from the Wikipedia entry [http://en.wikipedia.org/wiki/Prisoner's_dilemma](http://en.wikipedia.org/wiki/Prisoner's_dilemma). This should not be interpreted as relying on Wikipedia as an authoritative “source".
Criticism of the self-regulation framework has tended to take the idea that the framework is really co-regulation as a given. The above discussion hopefully has focused on the need to recognize that no-regulation and self-regulation have a legitimate place.

However, accepting the presumption of co-regulation, there are residual concerns over “consumer related” codes. The core criticisms are that the codes aren’t developed correctly, that there is low compliance, that they aren’t enforced and that even were all these to be fixed they are still inadequate.

Each of these is addressed in turn.

Not developed correctly

The first criticism is that codes don’t address consumer concerns sufficiently because in the development process committees or other writing exercises are dominated by providers. Part of this criticism should be deflected to the consumer representatives who do not usually pursue good strategies in committees for getting their views across.

Mostly, however, this view is a variety of the fallacy that we can infer from the fact that the code didn’t include something asked for by a consumer representative that that view was not considered. Consideration of a comment does not have to result in acceptance, and usually there are very good reasons for the rejection.

There is no fundamental evidence that changing the committee structure or the governance model would result in outcomes any different to those already experienced.

The two examples most often cited have been the consumer contracts code and the mobile premium services code. Both of these had fairly unique features. This is not the place for a full review of either. Both had significant interference in their early stages from a member of the Australian Communications Authority. This interference tended to create a false impression in the minds of some that the outcome would be predetermined.

The practical reality is that the rest of the codes, including industry response to requests from consumers for a single Telecommunications Consumer Protection Code, have been achieved through a co-operative approach.

Low compliance

Low compliance is often claimed, but the evidence is not compelling. The first source is the failure to sign up to codes, but as noted earlier there is no practical benefit or reason for providers to do so if a code is registered. The second supposed evidence is the volume of TIO complaints and the notional recording of potential code breaches.

The latter is no evidence at all. In fact, even high TIO complaint volumes are not necessarily evidence of poor customer service. It can be evidence of a well functioning process of ensuring consumer concerns can be reviewed by an independent party.

Finally there is a yawning gap between occasions where a code may be breached because an agent employed by a provider did not follow instructions and an accusation of failure to comply. The Australian Standard on compliance even acknowledges that the best corporate compliance program can’t guarantee that breaches won’t occur. It is the
response to these breaches that counts. In particular, some codes like mobile premium services will rely on the consumer complaint process to identify the rogue agent that needs to be dealt with. It should be noted that the Australian Government’s proposal for web-page blocking of Refused Classification material is a complaints driven process.

**Not enforced**

There is a strand of opinion that codes can’t be working because there has been little enforcement action. This makes an assumption that there have been actionable breaches, of which there is, as noted, little evidence.

This argument is like trying to argue a law against murder was ineffective because no murderers have been locked up, while ignoring the inconvenient truth that there aren’t bodies.

**Still misleading**

The final complaint is that clearly the whole regime is not working because the industry as a whole still misleads its customers with its complex price plans, hidden charges and poor service. These criticisms may be valid, but they are not arguments for increased direct regulation because it is hard to devise a direct regulation scheme that would not just crush innovation and drive smaller providers from the market.

As discussed in the nature of the problem, it is only more genuine self-regulation that can address the incentive for providers to mislead; neither increased co-regulation nor direct regulation will work. The idea that the threat of direct regulation acts as an incentive to firms to act by self-regulation is largely invalid as the cost of regulation is borne by consumers not industry.

**Optimal regulation**

Self-regulation has not failed in telecommunications, it hasn’t really been tried. One of the reasons for poor customer service outcomes for consumers has been the co-opting by the regulator of the self-regulatory processes and their conversion into enforced regulation.

The recent review of “consumer-related codes” by the Department asked questions about the actual “code development” process devoid of any more detailed consideration of the regime. It would appear that the best prospect for reform is to restate the self-regulatory objective and be explicit that the machinery of registered, enforceable codes is an instance of co-regulation (or, at best, enforced self regulation).