



Political Economy of Telecom Regulation in Jamaica



This policy brief looks at the evolution of telecommunications markets and regulation systems in Jamaica over time and links it to political compulsions and changes in the socio-economic milieu. This evolution might help to gain some insights into the general experience of developing countries.

Introduction

The case study of the Jamaican telecommunications market illustrates how privatisation creates incentives for efficiency and reinvestment while competition leads to enhancement of consumer welfare through lower prices. While the surpluses generated from private monopoly fund the investment needed for modernisation of telecommunication networks, competition drives down prices and makes telecommunication services available to all. Evolution seems to follow an inevitable process with state control, which occurs because of the distributional compulsions facing governments in developing countries, preceding privatisation and competition.

The Jamaican case also illustrates the superiority of regulation by contract over regulation by legislation. The latter is potentially unstable as laws can be amended or struck down by the legislature. Regulation by contract is defensible through the judiciary and is more stable. This is illustrated by the Jamaican case where the transition from the former to the latter also led to a rise in investments.

The introduction of competition in the telecommunications sector not only led to improved performance over monopoly provision of services but also resulted in lower prices, wider choice of services, wider access and faster expansion in capacity and healthy competition between players in the market. But how does such a competitive telecommunications market evolve in a developing/emerging economy? The case study of Jamaica, which is the subject covered in the next section of this policy brief, does provide us with some broad answers though the specifics might vary from country to country.

Evolution of a Telecommunications Regime

Prior to 1987, telecommunications were entirely controlled by the state in Jamaica. Subsequently, privatisation was not welcomed by the Jamaican Government but forced upon the socialist regime by the loan conditionality attached to the World Bank's structural adjustment programme. Neither the Jamaica Labour Party (JLP) nor the People's National Party (PNP) administration had a policy to include utilities in their privatisation programme.

As late as 1986, Prime Minister Seaga announced in his budget that the Government would not divest ownership of the telecommunications system and that it would be operated in the public interest. This announcement was made despite the fact that merger discussions were taking place between the publicly owned Jamaica Telephone Company Limited (JTC) and Jamaica International Telecommunications Company Limited (JAMINTEL), 51 percent owned by the state with the rest owned by Cable & Wireless (C&W) of the UK. The merger was completed and a new company, Telecommunications Corporation of Jamaica (TCJ) was formed.

The conditionalities imposed by the World Bank required a drastic reduction in public expenditure and foreign indebtedness. The required reduction in public expenditure paved the way for privatisation. Beginning with privatisation, three distinct regulatory periods saw the gradual emergence of the elements of competition and independent regulation: the period of monopoly control by C&W and ministerial regulation, 1987-1996; the introduction of competition by the competition authority during 1996-2000 and the phased liberalisation and operation



of an independent regulator which commenced in 2000.

Privatisation of the telecommunications industry, which began from 1987 onwards, required the development of protective instruments. This was especially true in the case of public utility companies, which required a durable and stable regulatory contract because of the large sunk costs incurred by them and the immovable nature of their assets. Because the Parliamentary form of government could always change its laws by majority vote, a separate regulatory mechanism based on long-term contracts, which provided protection to companies was required.

It was believed that such long-term contracts would protect the rights of the private investor over the returns from his/her investment and, therefore, act as an incentive for private investments in the utility.

Moreover, if the contracts were provided in the form of licenses, the courts would uphold them as the judiciary is independent of the legislature. Thus, it is seen that the telecom sector in Jamaica developed relatively well after 1987, as shown by rapid investment and growth of output because licensed contracts constrained the ability of Government to set rates with political considerations in mind. The details of the process

of industrial restructuring, which accompanied privatisation are discussed in Box 1.

In the first stage (privatisation with monopoly control) such long-term contracts/exclusive licenses ensuring monopoly by C&W for most forms of telecommunication were provided for 25 years (with an option to renew for another 24 years). A cost plus tariff structure was also instituted which did not assure productive efficiency. A simple regulatory mechanism was instituted for price adjustment and dispute resolution. If the Government did not agree to a proposal from the private firm for tariff increase then the dispute could be settled through arbitration. License violation could be appealed in the Supreme Court.

The second stage (competition among firms) started in the late 90s with C&W coming to an agreement with the government about ending its exclusivity (see Box 2 for description of market forms that marked the transition from monopoly to a competitive market). The cost plus return method, which was indifferent to efficiency, was replaced by an incentive price cap regulatory method, which provided competitors the incentives to minimise costs and maximise efficiency in order to reap higher profits.

The Minister was still empowered to provide some instructions of a general nature to the multi-sectoral regulator Office of Utility Regulation (OUR) and to determine the types and number of licenses (see Box 3 for an idea of the nature of the regulatory process). This implied that there was still some scope for regulatory capture.

The last stage of evolution of the telecommunications market (liberalisation and operation of an independent regulator) itself was a phased process. In phase one, the private operators were invited to bid for two mobile phone licenses, one to utilise GSM technology and the other to use CDMA technology.

A third license for mobile telephony was later awarded. In this phase, the minister was also empowered to issue cellular, reseller (data, internet and international voice), free trade zone service and carrier licenses.

During phase two, the minister's powers to grant licenses were extended to include domestic carrier and service

Box 1: Industry Restructuring and Privatisation in Jamaica

Under the industry restructuring agreement the two shareholders, C&W and the Government of Jamaica (GoJ) undertook to pool their shares in the two operating companies (JAMINTEL and JTC) to create a new company, TCJ, later renamed C&W Jamaica Ltd. On the commencement of restructuring in May 1987, the shareholding was: GoJ 82.7 percent, C&W 9.4 and the public 7.9 percent; GoJ's holding was further reduced in October. Finally, in September 1988, GoJ offered 126,500 ordinary TCJ shares, approximately 13.1 percent of the issued capital of the company, to the public and retained 40 percent of the equity with C&W owning 39.6 percent.

The terms of the offer were as follows:

- 126.5mn out of the 965.7mn issued ordinary shares were offered to the public. Each share having a par value of US\$1 and a book value of \$1.19 was offered to the public at 88 cents, a discount of 12 cents.
- 21mn shares, approximately 2 percent of the issued share capital were reserved for employees under an Employee Share Option Plan (ESOP).
- 51,000 residential customers of JTC were accorded priority to acquire up to 1,750 shares per residential account, approximately 105mn ordinary shares.
- Pursuant to the shareholders' agreement, application for the listing of TCJ's shares on the Jamaica Stock Exchange was to be made prior to the commencement of any public offer.
- Intrinsic to the offer was the underwriting of the shares; the underwriters agreed to take up half of the share offer.

Box 2: Jamaica as an Illustration of Transitional Competition Forms

The Jamaican case sheds some light on the nature of transition from private monopoly to a competitive market in telecommunications in a developing country.

Transitional competition in Jamaica was characterised by three types of entry:

- facilities based entry which provided for mobile or fixed operators, such as cable television or electricity distribution companies: this type of competition creates conditions for effective competition, reduces the demand for regulatory intervention and pressurises the incumbent to upgrade services;
- resale entry, whereby the third party entrant paid the incumbent for the right to sell the incumbent services: resale provides the easiest and quickest way to introduce effective competition through low cost entry, efficient use of scarce resources in existing infrastructure and opportunities for small investors to service niche markets without having to put out the outlays for heavy capital investments in infrastructure; and
- mixed entry whereby the new entrant leased some facilities (transmission and switches) and provided switches in order to provide services: this latter approach is sometimes described as entry through unbundled network services.

Note that almost all these forms of competition did not involve long gestation periods or large investments in physical capital. Thus, they were ideal for facilitating a quick transition.

provider licenses for voice facilities, resale of the incumbent switched domestic voice facilities, as well as voice-over-the-internet access and facilities for licensed cable operators. Several of these licenses were issued. In the final phase, all market segments were liberalised including the market for international facilities based operators. As a result of this development, in 2004 the Government decided to award licenses to two international cable operators to lay new submarine cable networks to Jamaica. Overall, as a result of liberalisation, the minister issued over 350 licenses.

The evolution of the telecommunications regime in Jamaica suggests that institutional needs change over time. In the beginning, the pursuit of social goals resulted in policies like cross subsidisation under state control. Later the need for fiscal restraint resulted in privatisation.

However, the conversion of the state-owned Telecommunication Company into a private monopoly suited the Government well as it could get a higher price from divestiture of its assets. Flexible pricing schemes were not possible because of the large contracting costs. However, the establishment of a monopoly implied higher profits, higher reinvestment and fast growth of the asset base. A monopoly could also be controlled so as to provide for some cross-subsidisation. The third stage saw competition after a healthy asset base had been developed and this led to a fast increase in coverage.

Comparison of the State Regime, Private Monopoly and Competitive Regime

The empirical evidence on telecommunications privatisation and regulation in various countries, which covers the period starting from the eighties,

observes a lack of conclusive evidence about whether private utility monopolies are better than public utility monopolies. This is because private monopolies might be more efficient, but in pursuance of the profit motive they might not pass on the gains from such efficiency to the consumer. However, since private monopolies are characterised by lower leakages the scope for technological improvement is greater.

It is, however, competition and not privatisation of a monopoly which results in wider access and variety. It also implies that the producer's gains from efficiency are passed on to consumers. This is because when firms are competitive they have no choice but to charge consumers the lowest possible prices.

Private regimes generate more investment than state regimes provided the regulatory system is well designed and certain environmental conditions are satisfied. The design of a good regulatory system should provide a mechanism to constrain regulatory discretion and resolve conflicts that arise in relation to the detailed rules governing pricing, market entry, interconnection and technical monitoring.

The Jamaican case illustrates that three fundamental types of regulatory checks are needed for private investment increase – contractual provisions, which specify the “do's and don'ts” for regulators, restraints which provide stability in regulation by hindering a unilateral reversal or amendment of the overall regulatory framework by the executive and the introduction of institutions which can safeguard these restraints.

Such a regulatory mechanism encourages private investment in telecommunications. Investment in this sector is important as the sector is capital intensive, exhibits economies of scale and displays a lot of technological dynamism.

Investment is also important as this sector provides services that are meant for household consumption and affect household welfare directly. In a country characterised by economic growth, investment in the telecommunication sector too has to grow.

The evolution of Jamaican telecommunications also offers a chance to analyse the effectiveness of the three main classes of market regimes characterising this evolution. The state controlled regime with its leakages was the worst regime and saw very little increase in coverage or capital. From 1973 to 1990, the number of telephone lines increased only by about five percent, from 85487 to 89753 lines.

In the second stage (private monopoly) the monopoly rents earned by C&W led to considerable investments and a vast increase in net assets in the telecommunication industry.

Even in 1995 the total gross investment in the telecommunication system was 11050mn Jamaican dollars. This was probably higher than the real value of gross investment in 2005, which was of a nominal value of 12,376mn Jamaican dollars. The last regime (competition among firms) saw competition leading to lower prices and a vast increase in the subscriber base. Teledensity increased from 234.1 per 1000 in 1994 to 3090 per 1000 in 2005 – an overall growth of 1200 percent at the rate of 26 percent per annum.

The empirical comparison of the functioning of the three regimes highlights the fact that a private monopoly is good for spurring investment in the telecommunications industry because of the surpluses generated by it. Private competition on the other hand is good for providing access to consumers as competition drives prices down. Both regimes have their uses and are better than a state regime.

Conclusion

The case study of the Jamaican telecommunications market illustrates how privatisation creates incentives for efficiency and reinvestment while competition leads to the enhancement of consumer welfare through lower prices. While the surpluses generated from private monopoly fund the investment needed for modernisation of telecommunication networks, competition drives down prices and makes telecommunication services available to all. Thus,

Box 3: The Nature of Regulation in Jamaican Telecommunications

In the case of Jamaica, the Office of Utility Regulation (OUR) acts as the immediate competition authority which is mentioned above. The Telecommunications Act of 2000 sets out the principles of liberalisation and the provision of a universal service.

A major feature of the Act is the requirement of the telecommunications industry to be regulated by the OUR. The Act requires the OUR to refer cases of “substantial competitive significance” to the Fair Trading Commission.

The Act also empowers the Minister to give directions to the OUR “of a general nature” if it is in the public interest and the OUR is required to comply with such directions.

evolution seems to follow an inevitable process over time with state control, which occurs because of the distributional compulsions facing governments in developing countries, preceding privatisation and generation of competition.

However, the seeming inevitability of such evolution is actually conditional on key regulatory changes. The use of long-term regulatory contracts in the form of licenses created favourable conditions for private investment in Jamaica by ruling out Parliamentary interference and assuring private players the right to returns on their investments. If other countries are to reap the benefits of successful privatisation and generation of competition, such regulatory changes are called for.

This Policy Brief is published as a part of the Competition, Regulation and Development Research Forum (CDRF) project with the support of Department for International Development (DFID), UK and International Development Research Centre (IDRC), Canada. It is based on inputs from paper entitled *Reforming and Privatising the Telecommunications Sector in Jamaica: Experiences of a Small Developing Country* written by Cezley Sampson and Faye Sampson. The views expressed herein are those of the authors and do not necessarily reflect the views or position of CUTS International, CUTS Institute for Regulation & Competition or the CDRF project and its associated advisers.

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