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TECHNICAL REPORT

Options for and Effectiveness of Internet Self- and Co-Regulation

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Prepared for the European Commission

RAND EUROPE

The research described in this report was prepared for the European Commission. The opinions expressed in this study are those of the authors and do not necessarily reflect the views of the European Commission.

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Executive Summary

This is the final report of the study undertaken by RAND Europe during 2007, *Options for, and Effectiveness of, Internet Self- and Co-regulation*. The study was undertaken at the request of DG Information Society and Media as a contribution to improving the knowledge base for preparing Impact Assessments (IAs) for any future proposed European Union (EU) interventions (or considered non-interventions) involving self- or co-regulation, particularly in Internet-related areas. The final report is based on the analysis of three types of evidence: theoretical and analytical evidence; case study evidence; and the evidence provided by public policy documents.

The Underlying Issue

The information and communication technology (ICT) domains (information technology (IT) and telecom-specific sectors and other areas of activity affected by their development) have always been subject to some degree of technical, economic and/or societal regulation, to fill 'governance gaps' between the economically-motivated activities of key stakeholders and the external consequences for other firms, end-users, public services, etc. Recent changes in market and societal context, together with policy context developments including the Lisbon and 'Better Regulation' agendas, have triggered a reconsideration of this basis. Four developments are particularly challenging:

- market convergence and divergence and changes in competitive and business models, which together reshape market and sector boundaries;
- the evolution of 'hybrid' regulators along sectoral (e.g. UK) or network–industry (e.g. the Netherlands) lines;
- the emergence of new regulatory concerns (e.g. harmful content, intellectual property rights (IPRs), radio-frequency identification (RFID), net neutrality); and
- specific European policy initiatives (i2010, the review of the regulatory framework review, the Interagency Agreement on Better Regulation; new directives relating to, for example, online media services, etc.).

Together, they raise issues germane to policy formulation and evaluation and to cross-cutting review and rebalancing of regulatory roles and responsibilities.

This changing landscape is recognised in requirements for both *ex ante* and *ex post* regulatory impact analysis, assessment and evaluation. Detailed and concrete procedures support a balanced view of the sector-specific and competition-related impacts of regulatory (and other) interventions in the ICT domains. But this development has been strongest in relation to formal or statutory regulation, while much of the governance in these domains is provided by a spectrum of self- and co-regulatory organisations (hereafter referred to as XROs).

Therefore, it is timely to consider what sorts of self- and co-regulatory arrangements exist, what issues they address, what other impacts they produce and, in general, how their existence affects regulatory 'rethinking' and assessment. At a minimum, regulatory impact analysis needs to take into account:

- the pre-existence, structure and performance of XROs involving key stakeholders and/or issues addressed by the proposed regulation;
- the ongoing role and activities of XROs as part of the context for both 'laissez-faire' and statutory regulation; and
- the advantages and risks for strategies that seek to achieve regulatory objectives through explicit reliance on or support for XROs (e.g. by delegating authority, endorsing XRO-produced standards and codes of conduct, or providing monitoring and enforcement support).

The research documented in this report is intended primarily to take stock of the *status quo ante* in relation to XROs and to develop a framework for their incorporation in IA, in order to assist the European Commission in development of a coherent and effective approach to future self- and co-regulation initiatives in the Information Society in 2008 and beyond.

Policy Context and State-of-the-Art

We undertook a detailed analysis of the peer-reviewed literature[1] within and beyond the Internet domain[2] to provide:

- classification schemes (often spectra);
- a conceptual treatment of welfare effects, taking account of interactions with state and other stakeholders;
- the possible mechanisms by which XROs contribute to economic welfare and related policy objectives; and
- key aspects of past or potential operation to be considered in IAs.

These include:

- contextual features;
- competition (in the market and among self- and co-regulators);
- supporting or inhibiting government roles;
- key stages (membership, rules, enforcement, etc.); and
- performance (compliance and welfare impact).

We also reviewed strategy and implementation documents from public sector organisations, non-Internet XROs and stakeholder (industry and civil society) groups, as well as policy analytic papers. Analysis of these documents enabled us to identify:

[1] Particularly economics and political science and including previous case studies.

[2] E.g. fraud prevention; financial services, environmental protection, etc.

- the conditions under which specific XROs are likely to be relevant;
- general and specific assessment criteria;
- the advantages, disadvantages and risks attached to XROs;
- IA difficulties and good practice guidance for obtaining and analysing solid evaluation evidence;
- spill-over and unintended effects;
- the quantifying of costs and benefits; and
- wider advice for IAs, including procedures for specific types of assessments (e.g. competition effects).

This material is presented in detail in the full report as a resource for practitioners in IA.

The Case Study Base

We undertook 21 detailed case studies of Internet XROs during June to September 2007. These describe and analyse the varieties of XROs and their central processes (formation, membership, rule-making, monitoring, enforcement, sanction and self-evaluation) and map them against policy areas, industry needs, geographic scope and extent, etc.

The case studies do not deliver a complete evaluation of Internet XROs *per se* or judge their relative performance. Rather, the purpose was to flesh out the theoretical models (just as theoretical models were used to interpret the case studies), and particularly to build a fuller picture than previously existed of Internet self- and co-regulation, in a public policy context.

The case studies can be classified by the 'degree of self-regulation' involved, from basic informal communication through to the onset of formal regulation. Table 1 describes this (in terms of the extent of government involvement) by analogy with the Beaufort Scale of wind strengths, in a continuum from complete calm (no involvement) to the strongest intervention (hurricane). Specifically, levels 9–11 represent *co-regulation* (i.e. government legislative force behind the regulatory forum), while 0–8 represent the evolution of *self-regulation* from its first beginnings towards the onset of co-regulation.

This broad classification by policy involvement is not perfectly aligned with direct or indirect government *funding*. Such support includes aid to self-regulation by soft law and other policy interventions, including financial assistance to XROs. For instance, governments or the EU may choose to support self-regulatory standard-setting as a genuinely non-regulatory policy, as in scales 2 and 6 above, which may or may not include financial support or co-funding.

In general the situations addressed by future IA (even in the Internet domain) should not be expected to be immediately and directly comparable to one of the XRO case studies. However, the very great diversity that they reveal strongly suggests that a future IA can usefully draw on significant and applicable elements within the case studies. Future IA options should relate to the development of the 'Beaufort Scale' in Chapter 3, which unpacks the types of XRO discovered in the case studies. While the 12 'ideal types' may suggest a microscopic granularity of XROs classification, we consider it to be very much a 'work in progress' to be tested against real XROs and IAs at a level of detail that will need to be tested in practice.

Table 1: A 'Beaufort Scale' of self-regulation

Scale	Regulatory scheme	Self–Co	Government involvement
0*	'Pure' unenforced self-regulation	Creative Commons SecondLife	Informal interchange only – evolving partial industry forum building on players' own terms
1	Acknowledged self-regulation	ATVOD	Discussion but no formal recognition/approval
2	*Post-facto* standardised self-regulation	W3C#	Later approval of standards
3	Standardised self-regulation	IETF	Formal approval of standards
4	Discussed self-regulation	IMCB	Prior principled informal discussion – but no sanction/approval/process audit
5	Recognised self-regulation	ISPA	Recognition of body – informal policy role
6	Co-founded self-regulation	FOSI#	Prior negotiation of body; no outcome role
7	Sanctioned self-regulation	PEGI# Euro mobile	Recognition of body – formal policy role (contact committee/process)
8	Approved self-regulation	Hotline#	Prior principled less formal discussion with government – with recognition/approval
9	Approved compulsory co-regulatory	KJM# ICANN	Prior principled discussion with government –with sanction/approval/process audit
10	Scrutinised co-regulatory	NICAM#	As 9, with annual budget/process approval
11	Independent body (with stakeholder forum)	ICSTIS#	Government imposed and co-regulated with taxation/compulsory levy

# denotes the presence of government/EU funding.
* Option 0 is infrequently found – a pure self-regulatory body with no prior or later approval is close to invisible in practice; it is certainly the case that only the very 'early stage' hybrid of self-regulation can be viewed in this space.

Linking Case Studies, Policy and the State-of-the-Art Together in Impact Assessment

We analysed the degree to which the peer-reviewed and policy literature confirms or qualifies the case-study observations, thereby identifying:

- particularly favourable or unfavourable areas for XROs;
- checklists for linking good practice to policy areas and objectives;
- the 'intervention logic' (impact mechanism) associated with specific arrangements;
- the range and potential severity of associated risks; and
- performance assessment criteria.

Because XROs arise and/or operate at least partially outside government control, they depart in three ways from the normal context of IA:

- they were not necessarily designed to advance particular public objectives, which therefore must be achieved as 'by-products' of their defining *raison d'être*;
- they often rely on voluntary (albeit self-interested) participation and compliance, which differentiates their command of resources, scope and effectiveness from those of similar formal regulatory initiatives; and

- they do not have exclusive power within an integrated legal framework, and thus may face competition from other self-, co- and formal regulatory bodies, or have to cope with patchy legal underpinnings across their geographic sphere of activity.

These features, together with the extreme diversity of XROs and the sensitive dependence of their performance on small details, have led some to doubt the applicability of IA methodology to Internet XROs; this doubt was reinforced by the many roles that XROs might play in IA (i.e. as stand-alone policy options, elements in more extensive policy options or essential aspects of the baseline). Therefore, we paid particular attention to these potential difficulties and provide guidance for IA practitioners as to:

- *how to specify* the options and associated intervention logic;
- *which criteria* to apply at each stage;
- *what evidence* and indicators to use; and
- *where additional risks* or external factors most affect the assessment.

Findings and Recommendations

Public policy and the peer-reviewed literature agree that there is always a price to be paid for regulation in the form of distortion, cost, institutionalisation, agenda creep and so on. This price needs to be offset against the justifying benefit. This may mean extending or shrinking regulation in various areas; rebalancing rule-making and rule-enforcing; and delegating or clawing back responsibility, etc. It is necessary to reassess not only *how* to regulate, but also *whether* and even *why* (if some needs become more pressing or cease to be relevant). Generally, this calls for some evolved form of, or alternative to, regulation. We make six broad findings, which lead to six recommendations for future IA.

Internet XROs are already a fact of life in many areas; the 21 case studies we present portray an assortment of significant, innovative and/or exemplary practices (Chapter 3).

- Research recommendation 1: We recommend that a complete cataloguing be undertaken in association with Member States and industry and consumer groups, based on existing state-of-the-art and full literature reviews, continually updated. This should extend to considering best practice from other regions, notably East Asia and North America.

XROs have high-level endorsement in many places, with the EU taking a lead role across a broad range of sectors. Internet XROs are interesting and particularly dynamic, but the Internet is by no means the most influential domain for XROs. Financial services and environmental regulation, among others, have important lessons for Internet XROs (Chapter 4).

- Research recommendation 2: We recommend that continued attention be paid to other forms of dynamic, technologically-led regulation – particularly where expert scientific opinion needs to be interpreted in the light of valid legitimate public policy concerns.

Alternatives to regulation are generally less controllable, less certain or more limited in their impacts. Crucially, their inputs, activities, outputs and impacts are harder to measure. The wide varieties of XROs 'in the wild' behave very differently depending on, for example, history, government and stakeholder engagement, policy domain and area, resources and competition. One size does not fit all, but it is possible to identify factors that favour success. Successful XROs are products of their

national, European and global environments, their individual founders' design choices and their responsiveness to immediate policy environments and industry sponsors. Therefore, strong predictors of XRO success are the environment and human resources for establishment and ongoing reform. We identify strong correlation between XROs led by experienced personnel who aim to meet market needs and incentives, and their success in adoption, innovation and public safety. By contrast, XROs designed to fulfil a political design without market validation are less successful (Chapters 3–4).

- **Policy recommendation 3:** We recommend that, wherever possible, policy should incorporate analysis of XROs, and should be designed with positive incentives for compliance and innovation by XRO participants.

User involvement is an increasingly important design principle for XROs. The more robust XROs are those whose formation or subsequent governance reform is reflective of multi-stakeholder inputs and dynamics (Chapter 3).

- **Policy recommendation 4:** XROs should be judged against their engagement with potential stakeholders including industrial, academic, government and consumer interests (where appropriate).
- **Regulatory Impact Assessment (RIA) recommendation 5:** The above key dimensions and criteria should be incorporated in RIAs to achieve the coherence, validity and specificity necessary in order to harness effectively the potential of self- and co-regulation, and the potential for soft law and other policy instruments to achieve results that legislation may not achieve directly.

European institutions have been at the forefront of helping innovative XROs to develop, using recommendation, coordination and funding best practice dissemination. This 'soft power' encourages XROs to evolve and spread throughout Member States (Chapters 2–3).

- **RIA recommendation 6:** RIAs need to evolve to reflect the full range of XRO activities and their impacts, as we demonstrate that 'no regulation' is not necessarily the same as the 'do nothing' option utilised in many IAs. Therefore, these options must be clarified.

XROs can contribute alongside, as well as instead of, government-led co- or full regulation. In particular, market actors and other stakeholders may have more information on their activities and the interplay between different types of direct regulation and XROs, and therefore can react faster to environmental changes. Regulatory policy can move beyond a simple distinction between self-, co- and 'full' regulation to embrace the richer variety of forms analysed here, which show a complex and productive interdependence among self-organising control by individual companies, empowered groups of citizen stakeholders, XROs and state actors (Chapter 5).

Consolidated RIA recommendation: The choice of XRO options for consideration in IA is particularly critical. The issues that should be considered in Internet RIA include:

- the benefits of 'unregulation' or 'pre-regulation' judged against the maturing of markets and the political logic of intervention;
- the assessment of these alternatives (in terms of quantifiable costs and benefits);

- incorporating self- and co-regulatory considerations into the 'do nothing' and 'normal regulation' options; and
- ongoing collection and refinement of the available evidence.

Conclusion

There is no 'magic bullet' in Internet regulation; resolving contested policy claims among competitiveness, innovation, public safety and security concerns involves continual political judgement. However, IA provides a tool for clarifying potential costs and benefits, even where political judgement necessitates a decision that may impair competitiveness and/or innovation. This may help in the design of regulatory policies to mitigate, for example, the anti-competitive effects of an otherwise necessary increase in regulation (Chapters 4–5). We by no means discount the need for more regulation in particular policy areas, where the benefits of market-based XROs are outweighed by distortions of competition, free-rider problems, lack of compliance incentives, extra costs in self-regulation or other costs. We conclude that, given a suitable choice of options for assessment and a full understanding of the conditions that lead to XRO success, the IA methodology may be expected to yield satisfactory results when applied to XROs in the Internet domain. Therefore, it should be employed more broadly.