

Tailoring regulatory institutions to local needs and resources

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Leading change in emerging markets



Regulatory risk?

- Effective regulation was seen as key to infrastructure reform and attracting private investment
- It was hoped that regulation would insulate tariff-setting from opportunistic political interventions – thus enabling cost-recovery and more predictable revenue streams

Some now argue that regulators are actually exacerbating the problems they were meant to solve

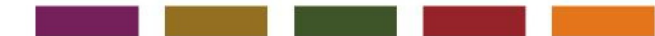
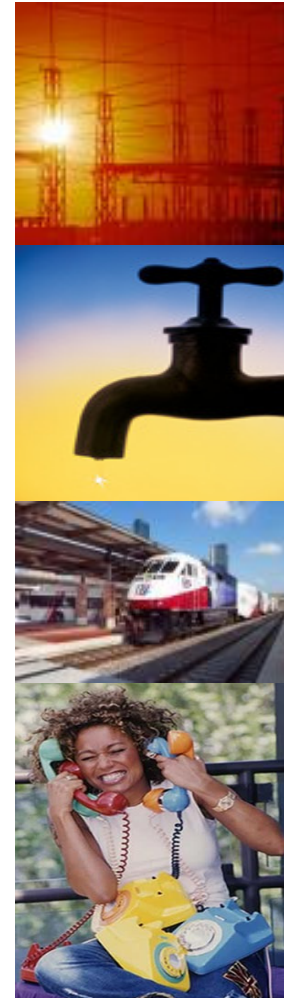
They argue that regulators lack true independence, are unaccountable and make non-credible, inconsistent decisions

Regulatory risk undoubtedly exists (cf. partial risk guarantees) but also instances where regulators reduce risk



Time to re-assess

- **We now have up to 15 years of experience with infrastructure regulatory agencies in developing countries**
- **Have these regulators**
 - protected consumers and facilitated affordable and quality infrastructure services through improved efficiencies, reduced costs and effective standards?
 - promoted financial viability of utilities and provided incentives for new investment?
- **To what extent has regulatory independence helped achieve the above objectives?**
- **Do we need to consider new regulatory models which respond to developing country challenges and are more effective in meeting the above objectives?**



Evaluating regulatory systems

Regulatory governance

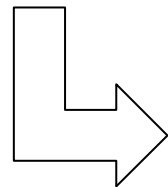
Legal design and institutional arrangements of regulatory system and processes of regulatory decision-making

Regulatory substance

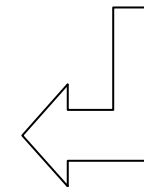
Content of regulation
licences, tariffs
supply & service standards

Credibility, legitimacy, and transparency of regulatory decisions

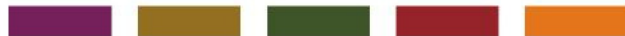
Quality & robustness of regulatory decisions



Impact on sector



Competitively priced, reliable infrastructure services
Financial viability, new investment



Adapted from Brown, Stern, Tenenbaum & Gencer, 2006



Widespread model: “independent” regulator

e.g.

“AFUR recommends that the following key principles form part of an initial framework for utility regulation in Africa:

- Minimum regulation necessary to achieve policy and sector objectives;
- Adherence to transparent decision-making and due process requirements;
- **Independent or autonomous regulation where possible;**
- Accountability towards government, investors and end-users
- Non-discrimination when not in conflict with policy prerogatives of government;
- Protection of investors against physical and regulatory expropriation; and
- Promotion of competition by limiting anti-competitive behaviour.”

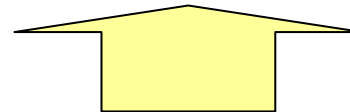
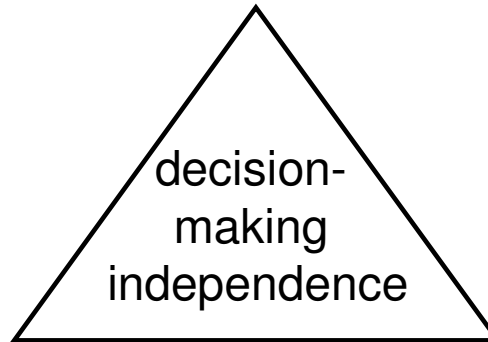


A Framework for Utility Regulation in Africa 2003



Independent regulation

No government entity other than a court or pre-designated arbitrator can overrule regulator's decision



Legal protection

Regulator protected from dismissal without due cause

Institutional and managerial independence

Regulatory institution outside ministry

Regulator has control over professional staff

Financial independence

Earmarked, secure, adequate source of funding

Not all regulators in Developing Countries are independent



Experience with “independent” regulation is mixed

Lack of regulatory commitment

- Some regulators only advise the Minister who makes the final decision
 - “Independent” regulators often also need informal Ministerial approval
 - In many cases, tariff setting is still highly politicized
 - Political difficulties when prices are not revenue sufficient & need to rise
 - Government departments undermine regulators?
 - Members of regulator boards are frequently replaced despite legal protections
- Gap between “law” and “practice”

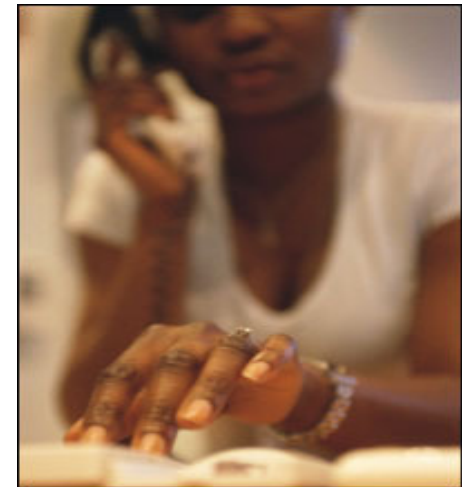


But also evidence of growing independence of regulatory agencies in some developing countries

Regulatory independence further compromised by

institutional & human resource constraints

- Most regulators only a few years old - > fragile
- Distracted by governance and management issues & spend insufficient time on regulatory substance
- Political appointments
- Broad and vague mandates
- Unstable policy environment / incomplete reforms
- Resource constraints
- “Quality people scarcer than money”



Consequence is arbitrary or inconsistent decision-making



Regulatory challenges

Independent regulation requires strong regulatory commitment and competent and empowered institutions and people

What do we do when these are absent or when regulators are disempowered?

How do we best build regulatory capacity?
Should we be exploring alternative regulatory models?



Responding to these regulatory challenges

1. Expand efforts to build institutional & human resource capacity

- Quality & relevant training
- Peer review and learning networks
- Mandatory, independent reviews of regulators
- Building the demand-side for regulatory transparency and participation

2. Choose level of regulatory discretion commensurate with local context of regulatory commitment and capacity

- Regulatory objectives, processes and methodologies specified in legislation
- Prior specification of an initial price path
- Detailed, low discretion price setting rules
- Specified supply and service standards
- Mandated use of advisory or expert panels
- Regional advisory expert panels



1a. Capacity building

Credibility, quality and impact of regulatory decisions depends in large measure on competence of regulatory staff

Train, train, train.....

- Fly-in, once-off regulatory training courses with standard curricula can be ineffective.
- Regional training and education centres can provide sustainable capacity building that is relevant to developing country needs while bringing in international expertise when warranted

Peer review and learning networks (CEOs / professional staff) offer in-depth insights, knowledge sharing and experiential learning around key issues faced by regulators in developing countries



Tremolet & Shah, 2005



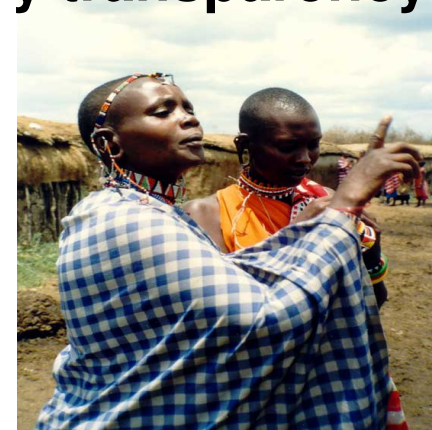
1b. Independent assessments of regulators

Pre-scheduled, periodic, in public domain

- Mandated in primary or secondary legislation
- *Ex post* evaluation, includes recommendations
- Should cover both regulatory governance and regulatory substance
- Should include impact of regulator's actions and decisions on sector outcomes
- Performed by a panel of independent national and international experts
- Hasn't been mandated anywhere in Africa, but examples of ad-hoc assessments
- Rating / benchmarking across regions?

1c. Building the demand-side for regulatory transparency

The best guarantee for ensuring legitimate, credible and transparent regulatory institutions is to build demand among stakeholders

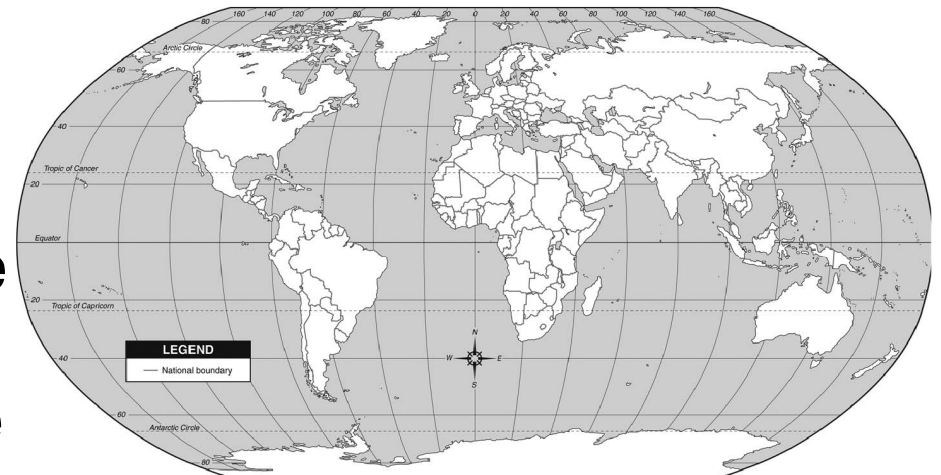


Developing country regulators increasingly under scrutiny by media, civil society, political parties and parliamentarians

2a. Match level of regulatory discretion to country context

Where there are doubts about regulatory commitment and challenges in capacity regulatory decision-making discretion can be constrained through.....

- Regulatory objectives, processes and methodologies specified in legislation
- Prior specification of an initial price path
- Detailed, low discretion price setting rules
- Specified supply and service standards



Developing countries have different regulatory traditions

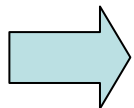
Anglo model

- **Independent regulatory agencies**
- **Considerable regulatory discretion** in setting tariffs and service standards
- But bounded and accountable
- Common law (case law precedents)
- Appeal system often uses ordinary courts

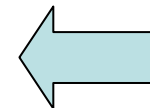
Francophone model

- **Regulatory contracts** (e.g. concession contracts)
- Pre-specified tariff regimes
- **Low levels of discretion**
- Civil law
- Contract renegotiation (e.g. for “adverse government action” or “unexpected constraints”)

Key issue in regulatory design is level of discretion



Increasingly we see hybrids of the two models



2b. Mandated use of advisory regulators / expert panels

- **Weak advisory regulator**

- Advice is confidential
- No obligation on Minister to explain rejection or modification of recommendations
- Little or no public consultation
- No separate earmarked budget

- **Strong advisory regulator**

- Regulator's advice must be public
- Ministerial policy directives to regulator must be public
- Regulator has public consultations
- If Minister fails to respond within specified time, recommendations adopted
- Minister must explain publicly rejection or modification of recommendations
- Separate, earmarked funding
- Pre-scheduled, periodic regulatory assessments
- Role could be specified in primary or secondary legislation

Expert panel could substitute for independent regulator / regulatory contract
or could be used in support: e.g. arbitration



Brown, Stern, Tenenbaum & Gencer 2006



Advisory regulators compared with separate independent agency

Characteristic	Weak Advisory	Strong Advisory	Independent, Fully Functioning
Location	Inside or Outside Ministry	Inside or Outside Ministry	Outside Ministry
Budget	Within the Ministry Budget	Separate Protected Budget	Separate Protected Budget
Decision Making Authority	Confidential Advice to Minister	Public Advice to Minister	Full decision authority without Minister's approval
Minister's Policies Directives to Regulator	Given Confidentially	Given Publicly	Given Publicly
Consultations with Affected Parties	None or Private	Private and Public	Private and Public
Transparency of Decisions	Unwritten Private	Public Written – decision – views of parties – rationales	Public Written – decision – views of parties – rationale



Source: B. Tenenbaum / World Bank



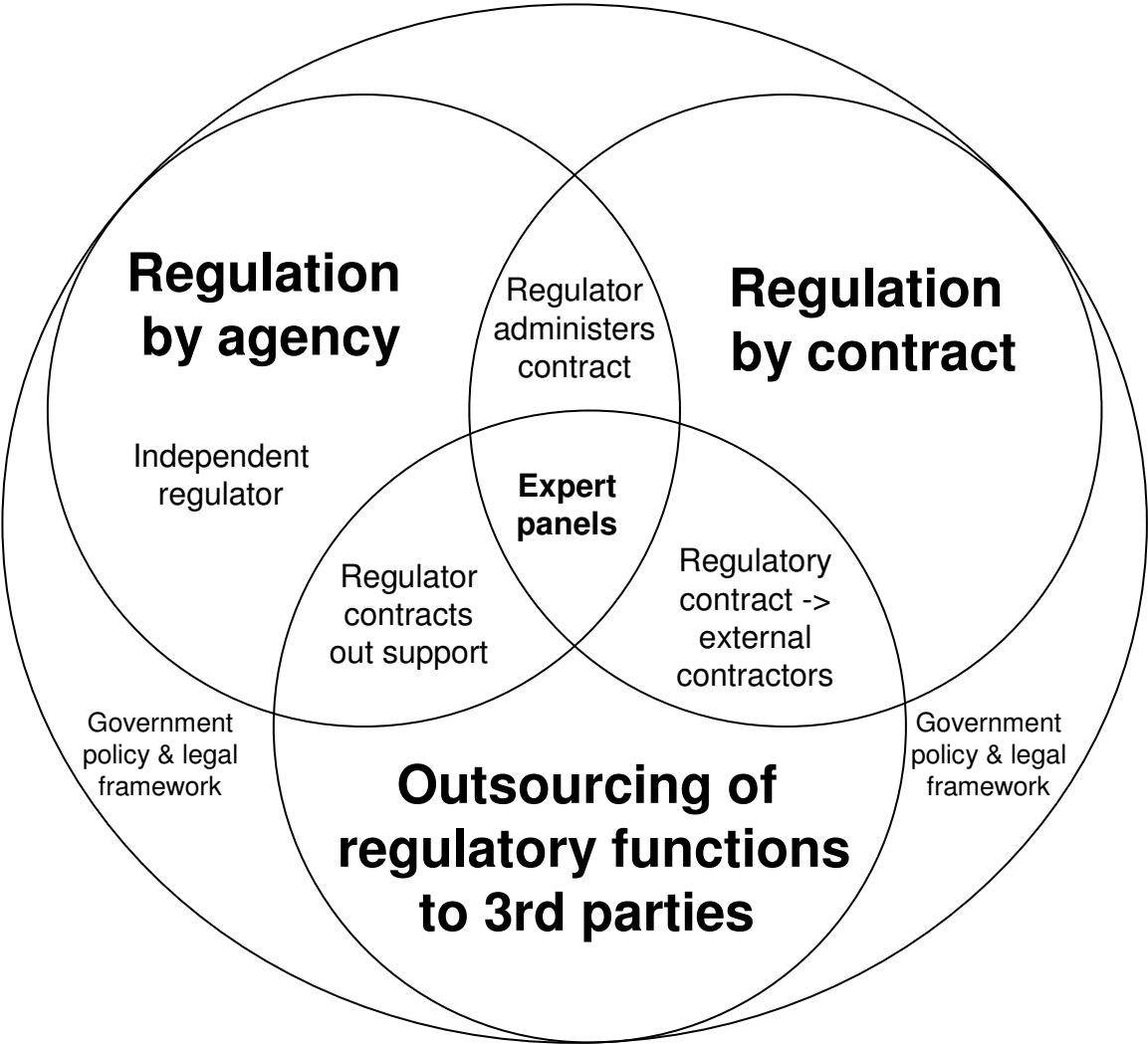
2c. Regional regulators

- **In principle.....**
 - Certain decisions on pricing and interconnection of regional networks could be contracted-out to a regional regulator
- **In practice.....**
 - Governments and regulators often unwilling to cede “sovereignty” (telecoms an exception?)
 - Regional institutions face huge challenges in terms of political commitment, institution building and resources

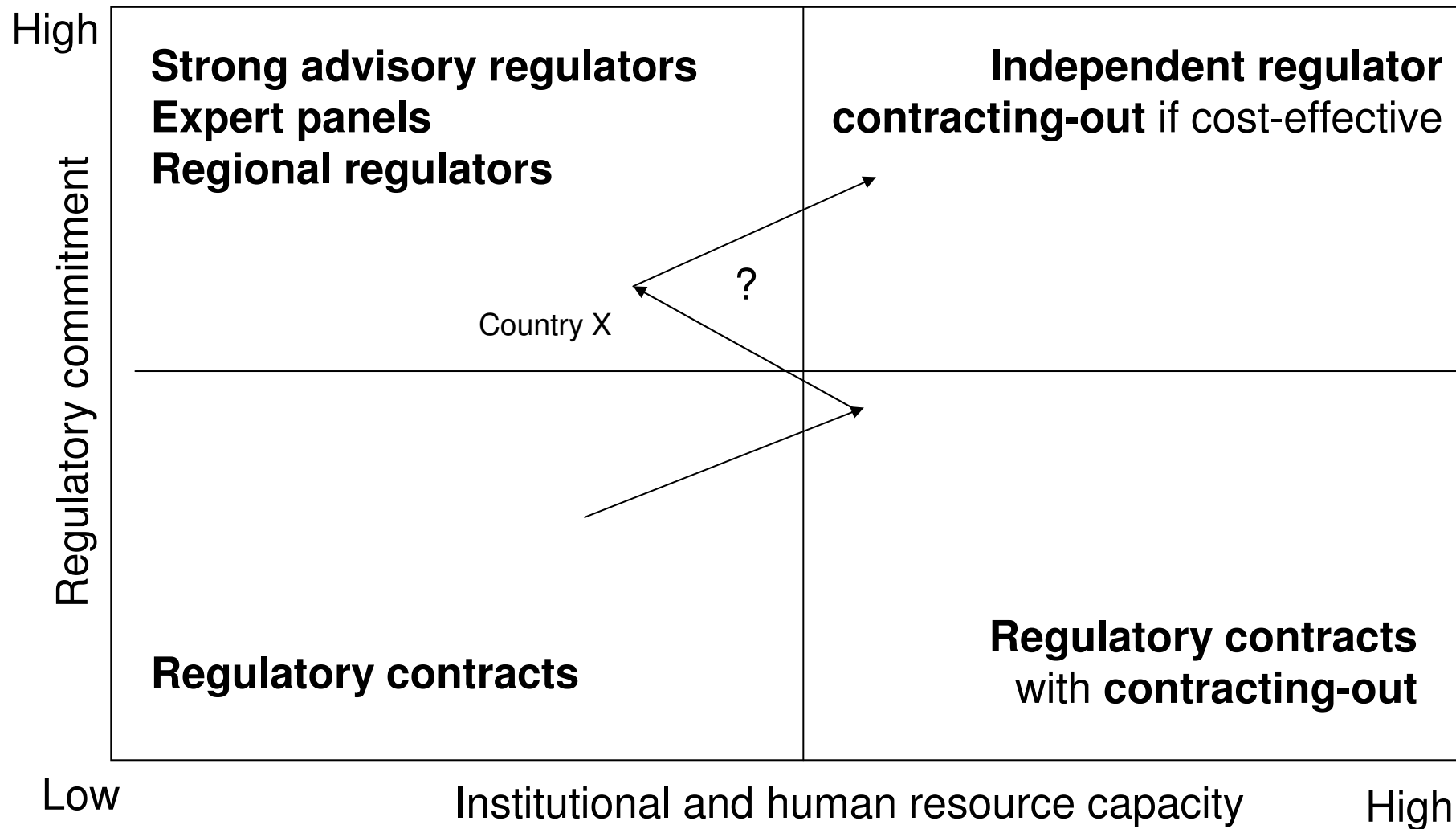
One option is to create regional expert panels to support national regulators



Hybrid regulatory systems increasingly evident

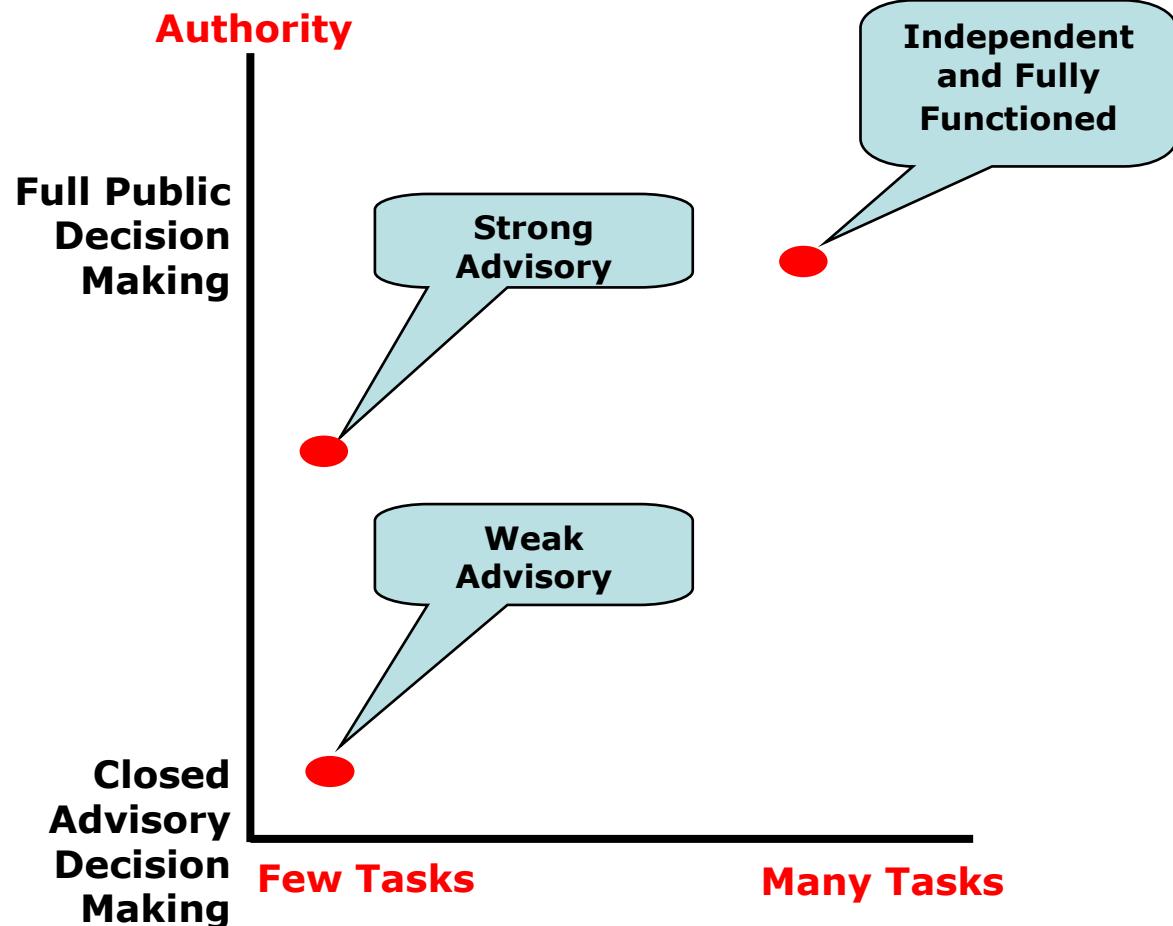


Best-fit between country context and regulatory options



Managing the transition: regulatory functions

- May make sense to focus initially on only a limited number of functions where quick gains can be made
 - build capacity in a focused way
 - earn public confidence
- e.g. price may be embedded in regulatory contract – but regulator could focus on improvements in quality of supply and customer service



Source: diagram - B. Tenenbaum / World Bank



Summary / conclusion



- **Regulatory independence is means to an end, not an end in itself**
 - Consumers want quality services, competitively priced
 - Improved efficiencies and lower costs
 - Financially viable utilities and incentives for new investment
- **Challenges being experienced with “standard model” of independent regulatory agencies**
 - political expediency & lack of regulatory commitment
 - Institutionally disempowered, capacity challenged
- **Regulatory governance structures and processes should constrain arbitrary administrative action**

Key question is how much regulatory discretion

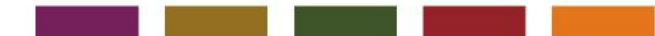


Summary / conclusion



- **Continue building case for independent and accountable regulation and empowering regulatory agencies**
- **But transitional and hybrid regulatory models also need to be explored**
 - Regulatory agencies – regulation by contract – outsourcing
- **Match level of regulatory discretion with country context of regulatory commitment and institutional capacity**

Reducing regulatory discretion doesn't necessarily reduce independence
Decision-making process is legally defined
Improves chance for credible, transparent, consistent decision-making





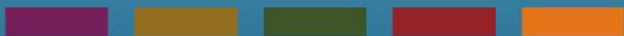
The Management Programme in Infrastructure Reform & Regulation (MIR) is an emerging centre of excellence and expertise in Africa. It is committed to enhancing knowledge and capacity to manage the reform and regulation of the electricity, gas, telecommunications, water and transport industries in support of sustainable development.

Prof Anton Eberhard

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