

Lessons from the 12th PURC/World Bank International Training Program on Utility Regulation and Strategy June 10-21, 2002

During each two-week course, participants identify some of the key lessons learned during the two weeks. These basic principles of best-practice regulation are not as precise as physical laws-rather they reflect practitioners' consensus based on experience and principals of sound government. The 70 participants in the June 2002 course shared their reactions to formal presentations and informal networking during the concluding session of the course at the University of Florida. Lessons are presented in the order they were suggested rather than according to the topical outline of the course: (1) Market Structure Reform and Regulation of Network Industries, (2) Financial Analysis for Utility Regulation, (3) Principles and Application of Incentive Regulation, (4) Non-Price Aspects of Utility Regulation, (5) Managing the Introduction of Competition in and for the Market, (6) Rate Structure, and (7) Managing the Regulatory Process.

This slightly annotated list contains points made by regulators, utility managers, policy-makers from government ministries, and representatives of consumer groups. The energy, dedication, and expertise they brought to the sessions promoted the exchange of ideas during lectures and creative problem-solving in the team exercises. We are grateful for the way participants gave of themselves, so that the group could fully benefit from the learning environment. The participant observations (in italics below) suggest strategies that promote improved performance by regulatory agencies suppliers affected by infrastructure policies.

- 1. Seek Consistency Across Sectors:** Because legal issues often cut across sectors, regulators must take a broad view of infrastructure developments and seek consistency when situations in network industries are comparable to one another. Examples of regulatory tools that apply to capital intensive firms include benchmarking, targeted subsidies, cost of capital estimates, and the role of price signals in promoting efficiency. Workshops and discussions among national and regional regulators can reduce jurisdictional disputes and improve the investment climate. There is no simple set of universal rules for sustainable regulation. However, regulators must establish objectives and then prioritize them so stakeholders are fully aware of why particular decisions were made.
- 2. Reward creativity within commissions:** The regulatory process must be a creative process if it is to be effective. If, on the other hand, the process becomes excessively bureaucratic and hierarchical, problem-solving initiatives will be stifled and staff will learn that pushing reports back and forth establishes job security. Regulatory managers may tend to establish rigid processes that focus on procedures-without adequate consideration for the content of decisions and the incentives reflected in new rules. Over-emphasis on process may insulate the commission from some complaints, but it can set a tone that discourages both internal and external innovation. Commission budgets and internal processes draw upon professional skills to promote good agency performance. Regular meetings on wider issues help organizations develop techniques for thinking strategically about regulatory issues. The recruitment and retention of professional staff requires that the commission have plans in place for training new hires and maintaining the skills of more experienced professionals. We all wear intellectual blinders of one kind or another-based on our discipline world-view (engineering, accounting, economics, law, or management). Given the interdisciplinary nature of infrastructure problems, teams will be needed to identify creative policy options and to select the most effective incentives.
- 3. Apply appropriate economic** Economic concepts can be complicated and subject to different

concepts:

interpretations. Nevertheless, it is better to have a rough estimate of the right concept than a precise calculation of an arbitrary number. An example would be gauging opportunity costs when determining price signals, rather than calculating some fully distributed cost through arbitrary cost allocations. The latter can result in price signals that distort marginal consumption decisions. On the other hand, the accounting numbers might be quite appropriate for determining the level of revenues. Similarly, identifying and providing incentives for appropriate levels of service quality requires a deep understanding of underlying production technologies and of consumer preferences. Markets are basically a "discovery" process, so there must be some flexibility to allow firms to discover what consumers actually value.

4. Seek credibility:

From the standpoint of the investment community, credibility requires transparency and consistency. Investors are not donating their financial resources to a "good cause," rather they seek returns commensurate with the risks. A credible regulatory system will be perceived as involving lower risks than a regulatory system that is neither understood by stakeholders nor based on well-defined principles. One strategy for establishing a good reputation requires that the agency actively educate different market participants about regulatory objectives. Of course, if the rules are not clearly communicated to stakeholders or elected politicians are at odds with agency decisions, the best analyses can be stymied by political unrest and changes in the law. Nevertheless, the regulatory commission still has a mandate to do the best it can within the institutional constraints it faces.

5. Promote consultation:

Periodic consultations among regulators in a nation can give greater consistency to regulatory decisions. In addition, stakeholder participation helps market participants become aware of a broader set of perspectives than would otherwise be the case. Note that the education process is two-way: (1) affected parties better understand the facts, law, and anticipated outcomes from alternative scenarios; (2) regulators gain additional information that would otherwise be unavailable. Agencies will make decisions on incomplete data; they should avoid using inaccurate information when evaluating alternative policies.

6. Consider a range of policy options:

There exists no single, easy solution to regulatory problems. Each nation has different legal requirements, institutional situations, and experience. Thus, regulators are in a position to manage (not solve) complex problems by anticipating the impacts of alternative policies. The rule must be robust in terms of system performance under alternative (realistic) scenarios. Even without simple solutions, the agency should include simplicity as an objective—given the uncertainties of excessively complex incentive schemes. Regulators must continually evaluate the impacts of existing rules. One can argue that process matters, but "performance counts". The key issue is how to "count" (quantify) performance. Any regulatory rule creates incentives, so the outcomes must be carefully monitored to ensure that rules are accomplishing their intended results. Just arguing that firms should always seek appropriate cost containment misses the point that we often do not know what is possible until we are under some pressure to achieve targets. This point applies to both government agencies and utilities.

7. Establish a reputation for promoting public awareness:

Regulators must be visible and able to communicate their work to a wide mix of constituencies. When citizens do not understand what the agency does or how the agency seeks to promote the public interest, they cannot be partners in the system. Without citizen support, agency funding is called into question. Thus, the vision for the future must be communicated to the populace. In particular, regulatory commissions can be a point of hope for those not currently receiving infrastructure services.

8. Benefit from the experiences of others:

While there is no single recipe that will work in all countries, principles have been developed that are applicable across sectors and nations. These principles can be learned, but international experience provides a continual stream of new insights regarding how regulatory governance and policies affect cost containment and the introduction of valued new services. Active pursuit of new ideas and strategies that can make a difference is probably the best indicator of regulatory performance. Sadly, regulators are often preparing to "fight the last war," when the objective situation has changed. Using old tools to address new issues is likely to result in an appearance of continuity, but effectively-the issues end up being resolved in courts (after long lags) or commercial opportunities (for new services or suppliers) are shelved.

9. Begin serious benchmarking:

Benchmarking can be applied to regulators across countries and to firms in different operating environments. Few of us really want to be evaluated in terms of our performance relative to others. Yet comparisons help us understand our own strengths and limitations-so we can improve what we do and how we do it. The same process applies to regulatory commissions and to firms in network industries. Even though circumstances may differ across entities, comparisons across entities and over time help us identify high and low-performing organizations. The enemy of the good is the ideal: if data collection is delayed, scorecards will also be delayed. Citizen expectations are driven by political promises, national visions, cross-national comparisons, personal experiences with suppliers, and the media. Balancing infrastructure objectives (related to service quality, system expansion, and prices) requires some national agreement on priorities-a consensus that must be tempered by reality. Completely satisfying all stakeholders is impossible, but establishing a record of progress on key objectives at least means that (over time) the regulatory system gains legitimacy among the citizenry. So benchmarking performance over time is central to the creation of a sustainable process.

10. Participate in networking opportunities:

Every organization needs mechanisms for the sharing experience and information. Internally, teams can bring together different disciplinary skills and diverse personalities. Externally, meetings and workshops with those in comparable situations can stimulate new ways of thinking about regulatory issues. Regular workshops represent one way to remain aware of the need for potential changes in regulations. Similarly, networking across countries promotes the exchange of ideas regarding best practice and a sense of professionalism within a regulatory commission. There may be nothing new under the sun, but we sometimes are looking in the wrong direction. Being open to new ideas means that decision-makers are less likely to always rely on what was done in the past.

11. Seek win-win policies:

Too often, outcomes are viewed as being zero-sum games. Some

believe that if the firm is better off, then consumers must be worse off. That is not true. While regulators must retain some distance from the various stakeholders, the agency need not view itself as battling with one or another market participant. In particular, there are significant benefits from creating a positive working relationship between regulator and utilities. The various parties are more willing to listen to the needs and concerns of others, helping to shape a policy framework that rewards strong performance and passes some of the benefits on to consumers.

12. Nurture independence:

Complete insulation from politics is both impossible and inappropriate. Regulatory commissions are part of national administrative frameworks implementing the law. And the legal framework can change with elections and new citizen concerns. Nevertheless, if regulators can avoid being captured by politicians and bureaucrats in other agencies, they are more likely to promulgate policies that promote strong sector performance over the long term. Otherwise, decisions will tend to be based totally on the impacts on tomorrow's headlines rather than the impacts in future years. Given the capital intensity of many infrastructure investments (and their long lives), sound decisions by suppliers require consistent and predictable policies-so risks can be evaluated and risk mitigation strategies developed by managers.

13. Prepare carefully for interactions with the media:

Regulators need to develop good relationships with the press-regardless of the political orientation of the particular newspaper, radio program, or television station. Investigative reporting may seek to sensationalize their stories or put spins on the news that result in one-sided characterizations of the issues. Nevertheless, the regulatory commission must attempt to present facts clearly, identify core issues, tell the whole story (and why it is important for average citizens), and avoid jargon. By being accessible to all elements of the media, a regulatory commission signals that it is prepared to defend decisions and to listen to different voices.

14. Participate regularly in new learning experiences:

A regulator must learn from others (regulators in other countries, academic consultants, and utilities). We all bring limited perspectives to our professional activities. Other stakeholders will have access to advanced analytic tools. However, regulation is a potentially draining profession where talented (but underpaid) professionals find themselves fighting fires with obsolete fire-fighting equipment. Identify local universities that have the capacity to offer regulation as a specialty: recruit their students, work with faculty, and create workshops that can energize the operations of regulatory organizations. When opportunities for continuing education arise, commissions need to take full advantage of them. Workshops need not be highly formal gatherings. Rather, they can be designed to identify issues that remain unresolved and to reach agreement on those items that be taken off the table. If some participants are not contributing to the substance of the discussions, they should be identified and asked to provide suggestions for addressing the issue that precipitated the initial concerns. One could argue that if a group is not part of the solution, it is part of the problem.