Promoting Efficient and Effective Regulatory Institutions

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1. Introduction

Indictors of "good regulation" positively affect performance in infrastructure sectors (empirical studies).

High performance of a sector is perhaps the best indicator of sound regulation. . . although

- limited funding for the agency,
- lack of legal authority to obtain benchmarking data,
- poor operator governance, or
- political interference

So we cannot judge the regulator solely on the basis of *sector performance*—the entire regulatory system needs to be accounted for.

Nevertheless, an undue emphasis on process should be avoided as well.

Evaluating Effectiveness Using Systems of Regulatory Governance

- Extensive rankings of agencies have been prepared for states in both Brazil and India
- Comparisons use indicators related to
  - Legal systems
  - Regulatory autonomy
  - Capacity-building
  - Tariff design
  - Financial sustainability of the agency
  - Regulatory strategies towards key stakeholders
- The development and application of methodologies is a "growth industry".

Regulatory Governance & Sustainable Systems

A Recent survey of water sector reform from the World Bank (Ehrhardt, et. al., 2007) identified regulatory and governance issues as being central to the success of public and private water utilities.

- **coherence** (consistency of objectives: pricing, service quality, and network expansion),
- **predictability and credibility** (facilitating long term planning), and
- **Legitimacy/accountability** (promoting customer acceptance of performance outcomes).

Ehrhardt, David, Eric Groom, Jonathan Halpern, and Seini O'Connor (2007). "Economic Regulation of Urban Water and Sanitation Services: Some Practical Lessons," Water Sector Board Discussion Paper No. 9, April, iii-28.

Threats to Success

Coherence: Threatened by excessive institutional fragmentation—potential inconsistency in objectives (eg. Environmental vs. Energy Regulators)

Predictability & Credibility: Threatened by agencies with no track records and absence of professional capacity;

Legitimacy & Accountability: Threatened by lack of internal expertise and public acceptance.

Sound Laws & Good Governance

Sustain institutions that are

- Less likely to make mistakes
- More likely to correct mistakes speedily;
- Less likely to repeat mistakes;
- More likely to develop procedures and methodologies that involve participants and to develop good practice;
- More likely to copy and implement best practice from other countries.

Cubbin & Stern (2006) *World Bank Economic Review.*

1. World Resources Institute Good Governance Indicators: Transparency, Participation, Accountability, and Capacity

WRI: *The Electricity Governance Toolkit: Benchmarking Best Practice and Promoting Accountability in the Electricity Sector*

Sixteen policy indicators & Fifteen regulatory indicators

Social and environmental implications of processes

For example, the "Effective functioning of the legislative committee"

1. Disclosure of interests
2. Active committee
3. Reasoned reports
4. Proactive committee
5. Public consultations
6. Transparency of submissions to committee
7. Transparency of committee reports
8. Reporting by executive

Level of detail required for data collection seems excessive

Applications to India: Elevating form over substance

2. Regulatory Governance: Autonomy, Decision Making, Decision Tools, Accountability—Assessment and Measurement of Brazilian Regulators

Regulatory Governance in Infrastructure Industries: Assessment and Measurement of Brazilian Regulators (April 2006), PPIAF-World Bank.

Twenty-one of the regulatory agencies in Brazil

Ranked based on agency design and regulatory processes

1. Autonomy
2. Decision-making
3. Decision tools
4. Accountability/control

Total of 96 questions

Information on processes

Weights given the many factors

Focus on process rather than substance or sector performance

3. World Governance Assessment (WGA) - Surveying Local Stakeholders

United Nations University in 1999 and Overseas Development Institute in London since 2004

16 countries are evaluated in their large study: 6 principles in 6 areas

Country reporter who interviews leaders from ten stakeholder groups:

1. Government
2. Parliament Civil Service
3. Business Media
4. Religious Organizations
5. Legal and judicial field
6. Institutions of higher education
7. Non-governmental Organizations
8. International Organizations

"Examines rules rather than results"

Focuses on political morality rather than economic efficiency

4. Actors, Arenas and Policies

Inter-American Development Bank Research Department Working Paper

"Stories" that emerge from different perspectives

Key socioeconomic interests:

1. Political Actors (key socioeconomic interests)
2. Mechanisms utilized by socioeconomic actors in their political demands (including campaign contributions and media campaigns)
3. Venues: arenas of the policymaking process (including political institutions)
4. Policy domains (policy areas—time frames, institutions, and historical context)

"The Political Economy of Productivity"

5. Institutional Assessment: Sector Laws, Policies, Administration, and Performance

World Bank-funded study by Saleth and Dinar

Comprehensive questionnaire administered to country experts, specialists, and policymakers

Water Law, Water Policy, & Water Administration

Link institutions to actual sector performance.

Beyond issues of accountability, transparency, and inter-agency conflict resolution to <u>outcomes</u>

- ***physical***, ***financial, economic efficiency*** & ***equity performance*** & ***progressiveness of water institution*** (adaptive capacity, scope for innovation, openness for change, and the ability to handle future water challenges)

"Evaluating Water Institutions and Water Performance"

6. Drivers of Change: Sector Governance and Political Economy

UK Department for International Development funded the Overseas Development Institute

Evaluating how donor groups can evaluate governance in the water sector, including: How can understanding be translated into strategies and actions?

Importance of incentives in determining sector outcomes:

1. Who determines who gets what, where, and how?
2. What are the incentives that influence these actors?
3. What are the external factors that interact with these incentives?
4. How do these change over time?

Key issues include government effectiveness, financial management, transparency, engagement of civil society, and pro-poor policies.

7. Infrastructure Regulatory Systems

Handbook for Evaluating Infrastructure Regulatory Systems,

World Bank book by Brown, Stern, & Tenenbaum (2006)

The "Gold Standard"

Three types of evaluations (time and scope)

Institutional design, the regulatory process, market structure, and other features of the electricity industry

Substance of rules and Incentives, as well as process

Sector Performance

"Regulatory Governance and Sector Performance: Methodology and Evaluation for Electricity Distribution in Latin America," Andres, Guasch, Diop, and Azumendi (2007)

Resources, Legal Mandate, and Agency Values

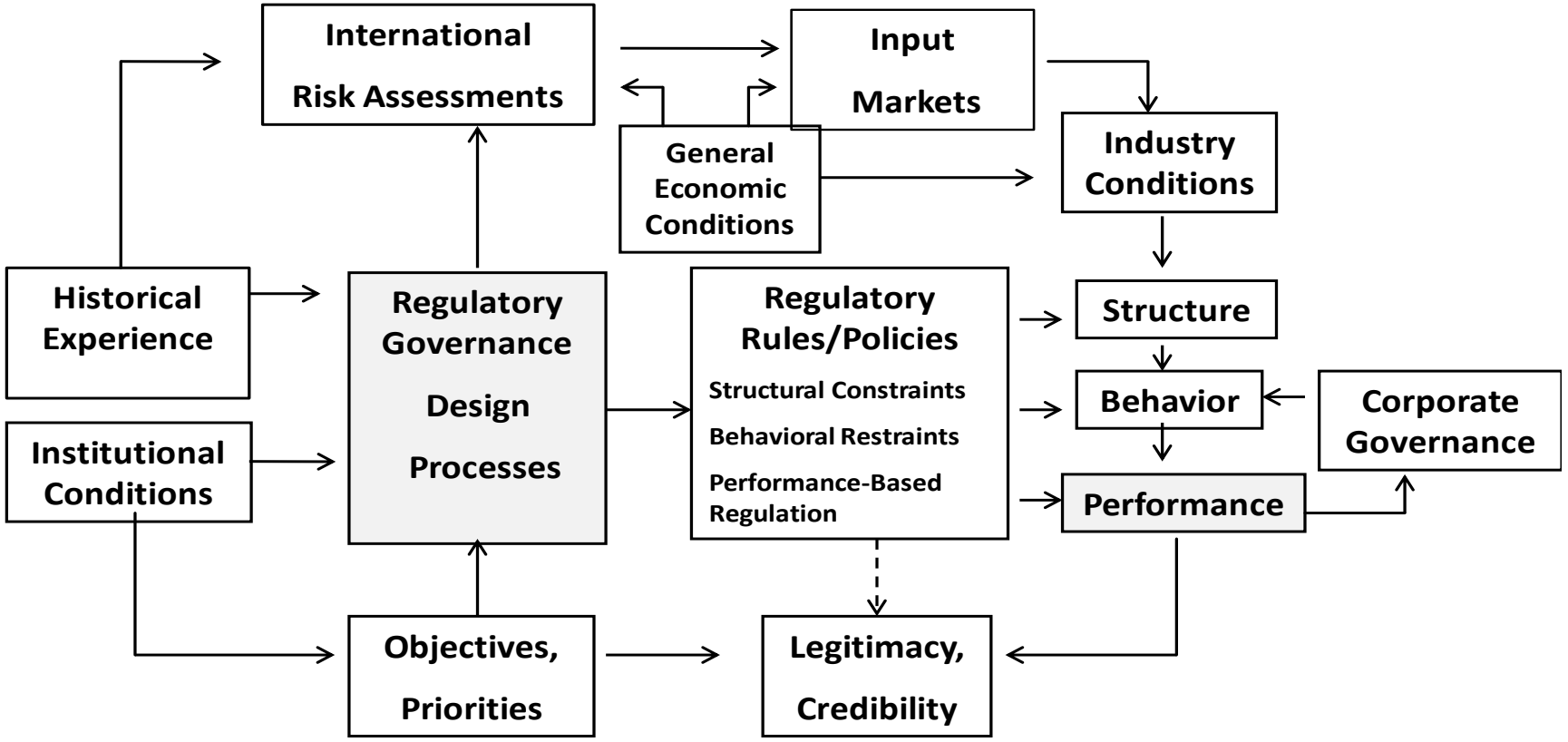
Many Factors affect Infrastructure Performance

- Design of regulatory institutions (autonomy and clarity in responsibilities),
- Regulatory Process (transparency/participation),
- Incentives and Clarity of Rule-making

Perceived legitimacy of regulatory institutions depends on views of investors, multilateral banks, and donors ,

Credibility of the agency in the eye of citizens (both those receiving service and those as yet un-served) depend on performance vs. promises

Figure 1. Factors Affecting Sector Performance and Regulatory Credibility



Berg, 2002

Engaging the Public and Policy-makers

- ***Coherence*:** Set tariffs according to the required output and levels of service quality—with Reality-based business plans.
- ***Creativity*:** Support incentives for cost-containment & new technologies. Evaluate Social tariffs and subsidies.
- ***Communication*:** Serve as a catalyst for bringing stakeholders together. Communicate strategically, without being political.
- ***Collaboration*:** Promote interactions with related agencies and organizations; regulatory networking strengthens capacity.
- ***Credibility*:** Seek transparency and consistency in the regulatory process since cash flow will be driven by future decisions. Document past trends, define baselines, and identify reasonable targets—based on current best practice.

Benchmarking Regulators and Operators

"The fewer the facts, the stronger the opinion." (avoid rhetoric)

"Operators can only manage what they measure." (internal incentives for firms)

Regulators can only provide incentives for good performance if trends are understood

- Current performance has been quantified
- Realistic targets are set
- Benchmarking is necessary, but not sufficient, for sound regulatory decisions

Credibility, *Legitimacy*, *Transparency* and *Efficiency* (BST)

Many methodologies help us evaluate performance.

Institutions are Dynamic

- Laws are words on paper: laws do not solve problems, they establish programs and institutions
- Institutions require clear mandates, resources, and shared values.
- Information: "You manage what you measure."
- Professionalism: experience and expertise are not acquired overnight: recruit, train, retain.
- Balance: stability/continuity/predictability vs flexibility (responding to changes).
- What problem is a new institution designed to address? (if it is not broken, do not try to fix it).

Concluding Observations

The *Credibility* and *Legitimacy* of an agency depend on the acceptance and understanding of the regulatory process by consumers and other stakeholders (including the un-served).

The impact of infrastructure reform depends on national circumstances: income distribution, growth, and the legal system.

Legitimacy depends on accomplishments: a track record

Sound incentives (and targeted programs) promote poverty reduction and network expansion.