



Private investment in infrastructure in Asia: Rethinking regulatory governance

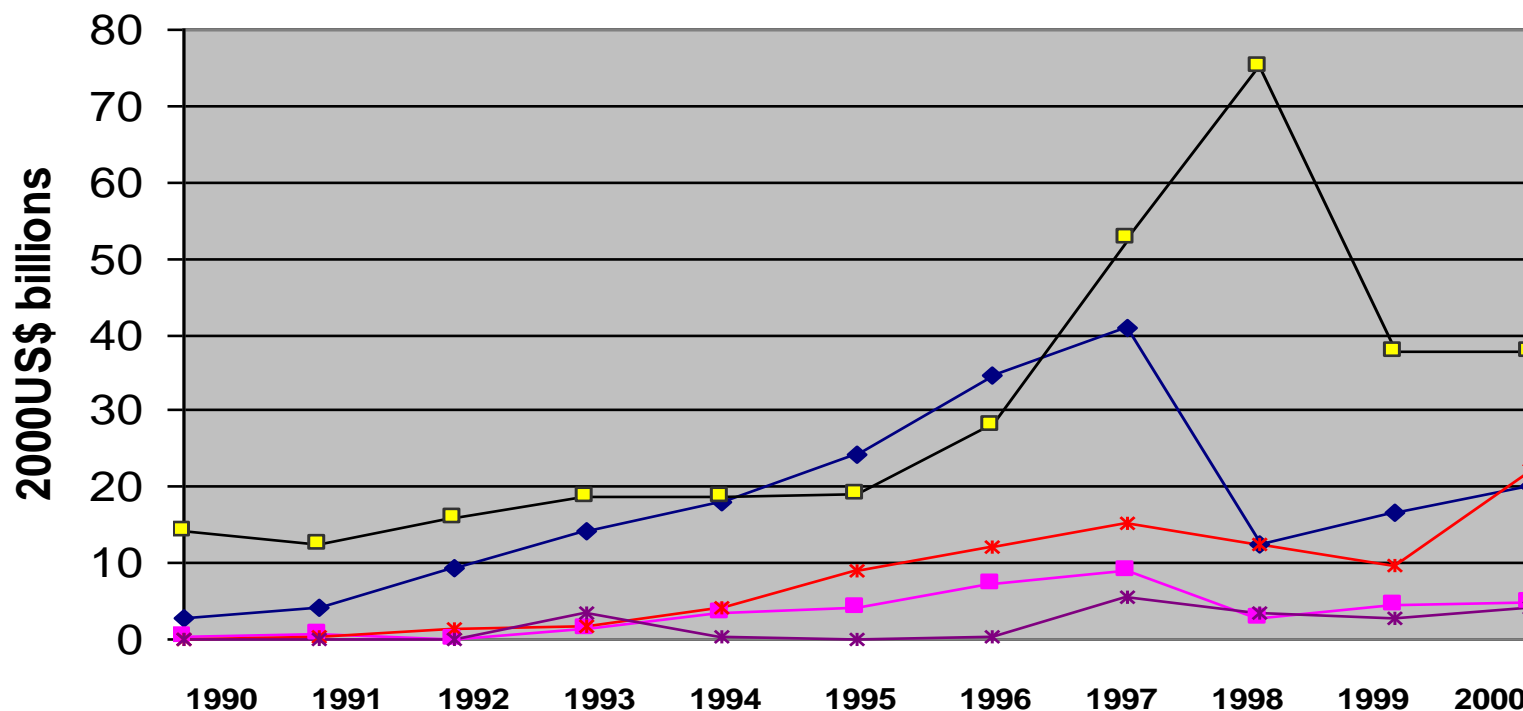
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Private investment in infrastructure in developing countries, by region, 1990-2000

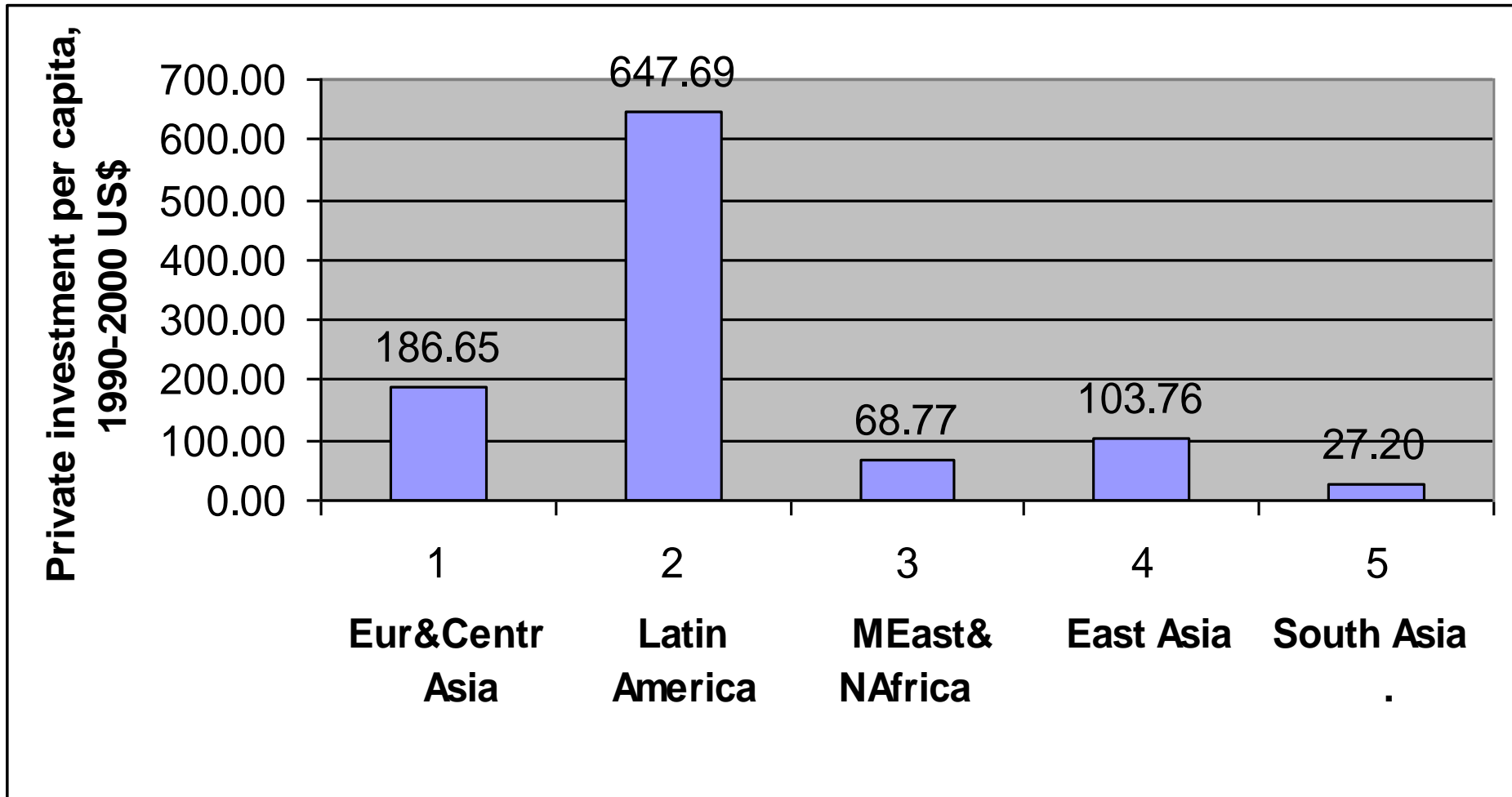
(World Bank PPI database)



- ◆ East Asia and Pacific
- Latin America and Caribbean
- ◆ South Asia
- * Europe and Central Asia
- * Middle East and North Africa

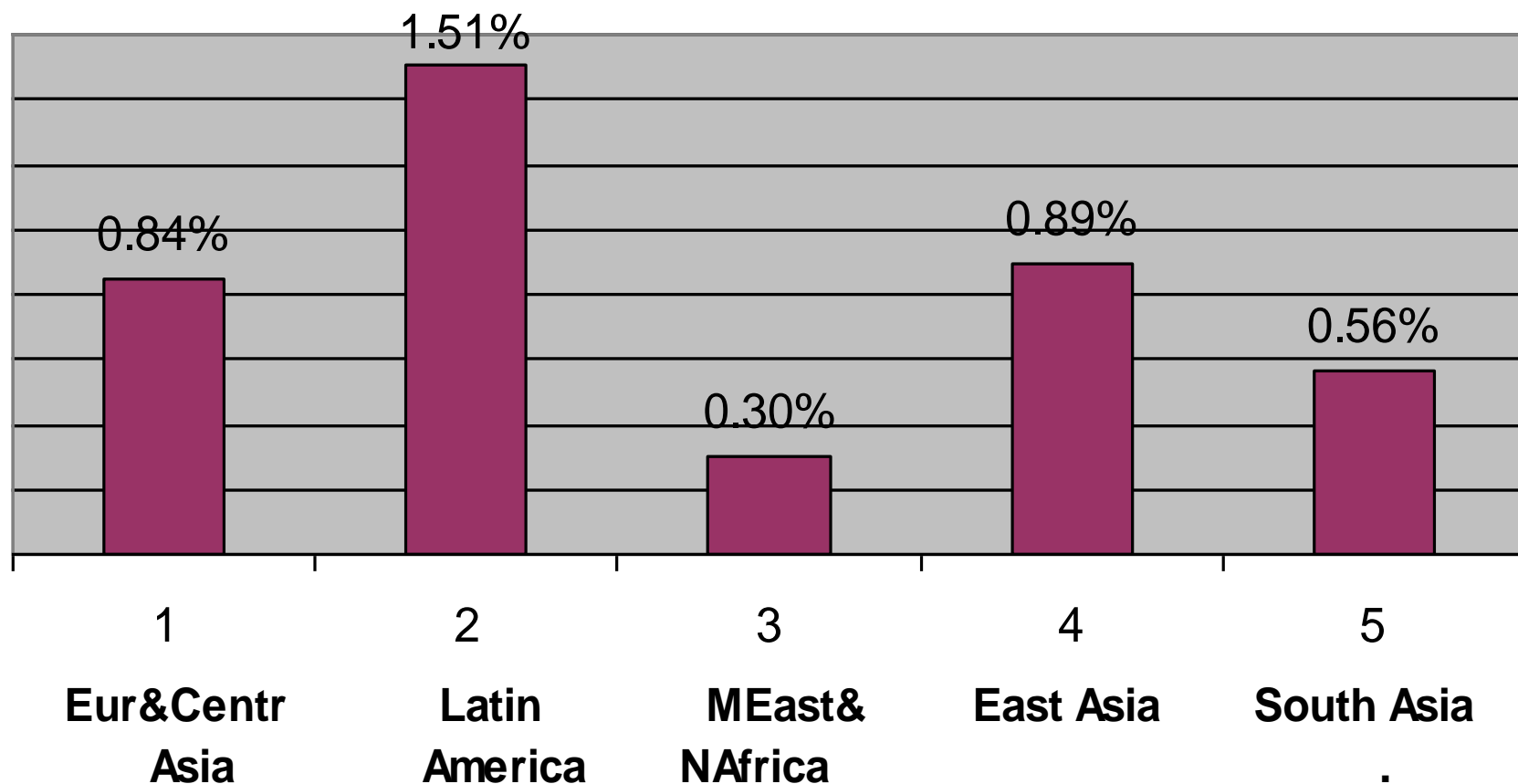


Private investment in infrastructure in developing countries, by region, 1990-2000, per capita





Private investment in infrastructure in developing countries, by region, 1990-2000, as % of annual GNI





Part of the problem lies in slow policy reform...

- Asian countries have neglected the underlying policy reforms seen in Latin America and Europe.
- Most private investment in other regions came from divestiture and reforms to create competitive markets, but in Asia most private investment in infrastructure came from greenfield investments to meet growing demand. State-owned monopolies and interventions were left largely untouched,
- This pattern is now changing. In 1999, for the first time, revenues from divestitures exceeded greenfield projects in Asia.



...and part of the problem is in inadequate regulatory governance.

- A 1998 survey found a trend toward independent regulators in ADB countries, but an “absence of any well-established independent regulatory agency with a reputation for fair and effective regulation....”
- Governments will have to work hard and visibly to establish a policy environment that sustains market incentives and investor trust.
- This calls for a broad governance agenda.



Widespread agreement that independent regulators are at the heart of regulatory governance for liberalized sectors

- International organizations recommend independent regulators – OECD, World Bank, IMF, regional development banks
- Trade agreements: the WTO Telecommunications Agreement
- European Union countries must have “functionally separate” regulators



Why are independent regulators so attractive?

In sectors characterized by a mix of competitive and natural monopoly activities, independent regulators are meant:

- as an alternative to a mix of policy, regulation, ownership, and industry promotion tasks inside line ministries;
- To shield market interventions from political and commercial interference, and so appropriately allocate risks and establish market incentives;
- To improve transparency;
- To deepen expertise and technical skills;
- To enhance stability and commitment to optimal long-run policy based on consumer welfare.



But independent regulators are no panacea during the complex transition to market competition...

- Most independent regulators are very recent even in developed countries. We know little about the performance over time of independent regulators, or how performance is tied to design or to the wider governing environment.



...and much care is needed in designing
“independent” regulators.

- Independent regulators pose potential problems with capture, complexity, rigidity, cost, fragmentation of competition policy, and accountability.
- We already can see that governments tend to rely too much on under-equipped and unsupported independent regulators to carry out tasks that are beyond their capacities.



Risks of poor performance are even higher in transitional countries...

...due to the phase of economic development...

- Higher poverty rates mean more emphasis on universal service obligations, usually met by former monopolies and used, often reasonably, to justify privileges and special relationships.
- Shortages of expert skills, which mean that staff are drawn from the regulated industry.
- Lower public sector pay relative to private sector, combined with poor conflict of interest controls such as revolving-door controls. Research has shown that regulatory leniency is tied to future employment contracts.
- Less experience with other autonomous agencies such as central banks, competition offices, and auditors.
- Closer ties between industry and government due to state-led development phase.
- Newer formation of the nation requires more balancing between ethnicities and regions.



Risks of poor performance are higher in developing countries (2)...

...and due to fewer checks and balances on regulatory behavior:

- The transparency framework is usually not as well developed
- Inefficient judicial review functions under a weaker rule of law.
- Consumer interests are poorly organized, in line with a weaker vigilant civil society in general.
- Parliaments carry out less oversight of performance.
- Competition authorities are weaker or nonexistent.



There Is No Single Institutional Model to Govern a Competitive Utility Market

- “Independence” is an insufficient guiding principle for regulatory governance.
- The most important characteristic of an effective regulatory system is *credibility* among investors, producers and consumers.
- Credibility is based on a reputation for neutrality and efficiency, and consistent respect for market principles.



Reformers might focus on a few core governance principles:

- Commit to ethics. A reputation for honest regulation is the bedrock of credibility.
- Adopt clear and simple rules for the sector. Policies and standards must be unmistakably clear.
- Maximize sunshine.
- Staff well.
- Strengthen external checks-and-balances by consumers, competition authorities, courts and parliaments.



In implementing these principles, countries should adjust several interacting institutions and procedures:

- The independent regulatory body
- The ministerial policy body
- The role of the competition authority
- The role of the judiciary and other dispute resolution procedures
- Ethics and conflict of interest procedures
- Transparency and consultation procedures
- Accountability and oversight procedures by ministers and parliaments



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- 1. Adoption, at the highest political level, of programs of policy reform aimed at sharpening competitive pressures in target sectors.**
 - Clear mission statement in law to serve consumer interests by encouraging open competition, adherence to competition principles, and customer choice (no general “public interest” mandate)
 - Coherent and transparent policy frameworks that establish concrete objectives and the path for reaching them,
 - Stability in underlying legislation, with few major revisions in transition phase (optimal contract commitment versus flexibility to rebalance interests of market actors)
 - Governing institutions set up before privatization



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2. Efficient, flexible, and co-ordinated regulatory systems

- Clear allocation of responsibilities, based in law, among the several bodies responsible for sectoral policy, market regulation, competition policy, and dispute resolution. Overlaps defined and resolution is clear.
- Coordination and referral procedures at the working and policy level between the relevant institutions
- Close monitoring by an outside policy or parliamentary body of the fit between regulatory regimes and sectoral needs.
- Convergence between related sectors (electricity and gas) is reflected in institutional coordination and adaptation



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3. Efficient scope of regulatory bodies

- Industry-specific, sector-wide, and multi-sector scope is defined by the need for a specialized body vis-à-vis efficiencies from shared activities, treatment of common issues such as valuation of capital, reduced risk of regulatory capture, and avoidance of distortions due to regulatory inconsistencies across related or converging industries. This will depend in part on whether the related industries are liberalizing at the same speed.



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4. Accountability for results

- Regular public reports showing progress against mission statement
- Periodic parliamentary oversight, assisted by expert parliamentary staff to correct information disadvantages
- Establishment of consumer advisory body or other consultative committees with formal powers to advise, question, and publish reports
- Independent review of market results and regulator's performance (by independent advisory body or the competition authority?)



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- 5. Effective autonomy: Low risk of influence of market decisions by political interests, low risk of capture by incumbent and dominant firms**
- Adequate tenure for regulators (5-8 years?)
 - Clear mission statement oriented to maximising consumer welfare and consumer choice
 - Generalized agencies (multi-sector) are less susceptible to capture than are specialized agencies
 - Appointments of agency heads are made for defined period, non-renewable, with clear and limited removal criteria such as corruption
 - Appointments are made by the prime minister and approved by the parliament
 - *Ex ante* review of regulatory decisions by ministries is highly limited or non-existent; *ex post* review limited to procedural issues



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5. **(continued) Effective autonomy: Low risk of influence of market decisions by political interests, low risk of capture by incumbent and dominant firms**
 - Budgets are earmarked, or set outside of the ministry, or financed through levies on end-users, network users, or license holders (government auditing procedures apply)
 - Clear accountability for defined market results
 - Transparency in explaining the reasons for decisions and their relation to consumer welfare
 - Staffing is independent of ministry (secondments are clearly transitional in nature)
 - Oversight by competition authority reduces risk of capture



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6. Clear authority of the regulators

- The powers of the regulator and its room for discretion must be defined clearly by specifying decision criteria, factors, and goals
- Substantial information collection authority is needed vis-à-vis market actors
- Inspections, sanctions and other quasi-judicial functions must be clear, convincing and efficiently wielded, either by the regulator or by a third party
- Criteria for licenses, concessions and other forms of regulation by contract must be clearly defined in advance
- Procedures for amending licenses and concessions must be clearly defined in advance



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7. Efficient governance of the regulator

- Efficient decision and dispute resolution procedures within the autonomous regulator (If a commission is appropriate, how should it be structured for credible and rapid decision-making? 3-5 commissioners seems to be international best practice)
- Clear lines of decision with minimal pre-decision reviews by separate bodies



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8. Professional credibility of regulators

- Professional competence and integrity are key to choice of regulators
- Vigorous conflict of interest provisions are in place
- Oversight by ethics body against clear ethical standards
- Revolving door policies are established
- Pre-set period of appointment, with no re-appointment



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9. Impartiality and transparency in procedures, instruments, and reasoning for decisions

- Maximize sunshine
- Explicit public consultation procedures at the policy development phase to which all interested parties have equal access. No lobbying behind closed doors.
- Defined role of advisory bodies with sunshine provisions for their operation
- Clearly defined communications with the incumbent firms
- A defined set of instruments for decisions is necessary, with clear procedures for each. A range of options should be available so that the regulator can respond to changing economic situations, but in taking any actions the regulator must be held accountable.



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9. (continued) Impartiality and transparency in procedures, instruments, and reasoning for decisions

- Licenses and concessions must be used only in non-competitive markets; in competitive markets, general regulations are preferred.
- Regulatory impact analysis should be used and made public to assess market impacts of decisions.
- Publication of all decisions and full rationales for decisions
- Vigorous oversight of industry self-regulation



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10. Adequate technical capacities of the regulator

- Sufficient human expertise on generation and transportation in areas such as technology, accounting, economics, and law
- Number of employees proportional to tasks and market
- Recruitment and pay uses market practices rather than civil service rules
- Ability to hire external expertise



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11. Efficient dispute resolution

- Appeals rights are structured to avoid paralysis or costly delays by litigation (restricted to undue process or to substantive issues?)
- Dispute resolution is functionally separate from ministry and regulatory body (independent appeals body)