Utility Regulators—Supporting Nascent Institutions in the Developing World

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The wave of infrastructure privatizations sweeping the world over the past decade or so has given rise to a new category of professional—the specialist utility regulator. These regulators, charged with administering regulatory frameworks that seek to balance the interests of consumers and investors in technically complex and politically sensitive industries, can have a major impact on the performance of privatized firms, on the cost of investment capital (and thus on infrastructure tariffs), and on the sustainability of reforms. For this reason the development of professional, capable utility regulators should be a key part of reform efforts. While new regulators in any country can expect to face many difficulties, the challenges are particularly daunting for regulators in developing countries. This Note reviews those challenges and presents some of the main strategies for supporting new utility regulators in the developing world.

The regulation challenge

Regulating private infrastructure firms can involve a variety of complex and sensitive tasks. Depending on the design of the regulatory framework, regulators may be responsible for granting licenses and permits, administering tariff adjustment rules, dealing with interconnection disputes between firms, monitoring and enforcing compliance with quality standards and other obligations, and performing other regulatory tasks.

Many of these tasks require regulators to draw on expertise in economics, finance, law, and engineering. Indeed, one of the first crucial tasks in establishing a regulatory institution is appointing the right people, with the appropriate balance of technical ability, integrity, and strength of character to head the agency. But technical expertise alone is not enough. Utility regulation is not undertaken in an academy. Regulators must contend with pressures and demands from diverse stakeholders. Perhaps the most visible and predictable pressure in most countries comes from political authorities, who, to meet short-term political objectives, are often tempted to renege on tariff and other commitments given to investors. This risk is one of the most common rationales for providing regulators with safeguards on their independence. But regulators can also face a range of pressures to favor regulated firms or other interests, whether through bribes or more subtle forms of “capture.” And as if this were not enough, regulators of newly privatized industries must often try to assert and defend a new role in an environment where they are often seen as directly responsible for long-overdue tariff increases and subsidy reductions and where the efficiency and service improvements privatization offers may take some time to become evident.

Challenges of this kind arise in all reforming countries, industrial and developing alike. But developing countries usually face much greater challenges. Most developing countries lack a strong pool of professionals with relevant technical expertise. Many also have a much more limited tradition of independent public institutions; indeed, the governance traditions in some developing countries make it particularly difficult to avoid problems of political interference and corruption. And finally, infrastructure privatization in many developing countries requires regulators to preside over substantial tariff increases for utilities that have a long history of unsatisfactory performance and dissatisfied customers. Newly appointed regulators...
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In all countries, regulating private infrastructure can involve decisions that are both technically complex and politically sensitive. In OECD countries difficult disputes have arisen:

- In the United States, where regulators have been involved in difficult decisions in quantifying the size of stranded costs, which utilities argue are created as a result of the transition to a competitive market in electricity.
- In the United Kingdom, where an electricity price review had to be revisited as a result of soaring share prices and new information that emerged as a company defended itself against a hostile takeover bid.
- In developing countries the heat can be particularly intense where there is a short track record of private investment in infrastructure and where there is substantial involvement by foreign investors. Newly appointed regulators often find themselves embroiled in bitter disputes between investors or between investors and the government. Here are some examples of particularly difficult recent disputes:
  - The energy regulator in a Central European country has been caught between private investors who were promised tariff increases and a government that would prefer to avoid its earlier commitments.
  - Telecommunications regulators in many developing countries must deal with contentious disputes between incumbent operators and new entrants, particularly over interconnection pricing and terms.
  - A provincial water regulator in Latin America has been entangled in a major dispute between foreign investors and the provincial government over tariffs and service standards.

Supporting regulators

Strategies to enhance the sustainability of regulatory regimes and thus potentially depoliticize such thorny issues as tariff increases have received relatively little attention. Indeed, it is sometimes tempting for a government or its advisers to conclude that the hard work is over once new laws have been passed and assets transferred to the private sector. But high-profile regulatory disputes in a growing number of developing countries counsel against such a short-term view (box 1).

A large part of the answer lies in designing regulatory systems that, while drawing on good practices from elsewhere, are properly adapted to the conditions in the country. The uncritical import of models from other countries and the pursuit of “cookie-cutter” approaches are destined to failure. But under almost all conceivable regulatory structures, some authority will have at least some discretion to perform some regulatory tasks. How can these people be supported so as to increase their prospects of success? Experience in a growing number of developing countries suggests that a well-conceived strategy will have three main elements: support by external consultants, training, and arrangements to foster contacts and information sharing between regulators.

Support by external consultants

The early years of a new regulator’s job can be expected to be particularly demanding. To help regulators deal with the challenges they face, it is common to provide them intensive assistance for a period through an international consulting firm. This usually involves having one or more foreign experts (often former regulators) work as resident advisers to provide support on a range of technical and broader issues, and bringing in other experts from time to time as required. Arrangements of this kind usually begin with efforts to help establish the agency and often extend for a year or more. While this form of assistance can be expensive, the right consultants can have a major beneficial impact. The
World Bank and other multilateral and bilateral donors are increasingly supporting and funding these projects as part of stand-alone technical assistance loans or of broader reform programs.

Training

Newly appointed regulators and their staff can derive great benefit from specialist training in the art and science of utility regulation. This involves detailed training in technical topics such as designing tariffs and defining quality standards. But training can also cover a broader range of topics relevant to the regulator's role, such as managing relationships with political authorities, investors, consumers, and other stakeholders. To be effective, such training should usually be undertaken as long as possible before the regulators must take on their new responsibilities. This underlines the importance of appointing regulators well before privatization—something governments too rarely do when consumed by the demands of managing major transactions.

Until recently there was a dearth of training tailored to the needs of newly appointed regulators in developing countries. Regulators could attend existing programs for U.S. or U.K. regulators operating in very different social, political, legal, and economic contexts. Or courses could be developed on a country-by-country basis, with all the costs this involves. But the situation is improving.

While country-specific courses still play an important part—particularly where language barriers exist—there are a growing number of international courses tailored to the circumstances of developing country regulators. One of the first was launched by the World Bank in January 1997, in conjunction with the University of Florida, under the auspices of the International Forum for Utility Regulation (IFUR). This two-week program, offered twice a year, has already trained more than 320 regulators from more than seventy-nine countries (box 2). Regulators from OECD countries and private sector representatives have also attended the course, which draws heavily on cross-sectoral and cross-country examples. The Economic Development Institute of the World Bank has been complementing this program with a series of sector-specific and regional initiatives and is also boosting indigenous regulatory capacity through support to regulatory research and training institutes in such countries as Argentina, Brazil, and Côte d'Ivoire. There are
also a number of commercial offerings for developing country regulators. Funding for attendance at these courses, as well as for the institutions' start-up budgets, often comes from multilateral and bilateral donors.

Contacts and information sharing with other regulators

Like other professionals, regulators can learn a great deal through contacts with peers dealing with similar issues in other jurisdictions. In addition to disseminating technical information and practical insights, such exchanges can contribute to the development of professional norms that help to support regulatory independence. Contacts can be fostered in many ways.

One way is through study tours and participation in international conferences or training programs. An important outgrowth of the IFUR training program, for example, is a strong and growing alumni network sustained by, among other things, an electronic discussion group ("Infrareg") moderated by the University of Florida.

Contacts between regulators can also take a more formal structure. At the bilateral level there is growing experience with twinning arrangements, under which an experienced regulatory body provides support to a less experienced body through regular visits, staff exchanges, and other contacts. But there are limits to this strategy: new regulatory bodies far exceed bodies with long experience, and few of the experienced regulators have the resources to sustain intensive relationships. Regional approaches are also being developed. For example, the Asia-Pacific Economic Conference (APEC) has established the Electricity Regulators Forum to foster exchanges between regional regulators, and efforts have been made to launch a Hemispheric Energy Regulators Conference under the auspices of the Summit of the Americas. Within federal systems it is increasingly common to establish networks of national and state regulators. In the United States, for example, the National Association of Regulatory Utility Commissioners has grown into an important forum for sharing experience on common regulatory problems and also supports a dedicated regulatory research institute. Common to all these efforts is an attempt to allow greater contact between regulators and other stakeholders and to build up a knowledge base for the use of members of the network with sector statistics and details on regulations, legislation, techniques, and best practices.

To facilitate contacts between regulators, the World Bank’s IFUR initiative publishes the *International Directory of Utility Regulatory Institutions*, which contains contact details and brief descriptions for nearly 800 regulatory agencies in more than 180 countries.

**Key lessons**

Policymakers and their advisers ignore the need to build regulatory capacity at their peril. Hard-won reforms can be quickly unraveled by poorly administered regulation. The private sector should be strongly supportive of government efforts to train competent and well-trained regulators, because of the benefits in depoliticizing regulation and ensuring greater certainty in regulatory decisionmaking.

While there is no simple way to rapidly develop indigenous regulatory expertise, there is growing consensus that strategies incorporating all three elements—adequate training, support by external consultants, and contacts and information sharing between regulators—offer the best prospects of success. To take full advantage of each approach, however, policymakers and their advisers must begin the process early, and ensure that adequate resources are dedicated to the task.

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1. See Warrick Smith, "Utility Regulators—Roles and Responsibilities" (Viewpoint 128, October 1997).
2. See Warrick Smith, "Utility Regulators—The Independence Debate" (Viewpoint 127, October 1997).

*Philip Gray, Private Participation in Infrastructure Group*