

## **Suggestions for Improving Regulatory Practice and Sector Performance<sup>1</sup>**

**By Sanford V. Berg  
Distinguished Service Professor  
Director, Public Utility Research Center—University of Florida**

*Spare us from cowardice that shrinks from new truths;  
Spare us from laziness that is content with half truths; and  
Spare us from arrogance in thinking that we know all truth. (Anon)*

It is easy to visit a country for a day or a week and present ideas for improving regulatory performance. It is much harder to be one of the professionals sifting through the various suggestions, separating initiatives that are cost-effective from ideas that will only distract staff from other essential activities. I admire commissioners and government officials who translate principles into regulatory practice. Regulators face a difficult task in balancing the claims of many stakeholders (including suppliers, customers, and government agencies) with varying amounts of political power.

Once I viewed regulation primarily as the application of technical expertise to determine appropriate cost of service, set prices, and establish incentives. I have learned that regulation involves many more activities: public education, inter-agency negotiation, stakeholder arbitration, and agency management. I can think of no more difficult job in a developing country than to lead an agency that regulates an infrastructure sector. The leaders of regulatory commissions set the tone for all the work conducted at the agency. The agency, in turn, influences the performance of the sector, in this case water and wastewater. However, many other factors affect industry performance (and public perceptions), so my suggestions are categorized on the basis of how they relate to these factors.

The suggestions listed here range from being easy to implement to requiring significant adjustments within organizations. I am not an expert in constraints faced by regulators in each country, but the following are typical: agency funding limitations, lack of legal authority, political instability, and absence of stakeholder support. The flow diagram presented below outlines the main factors influencing outcomes in infrastructure sectors, including water and wastewater. Except for agency governance and policies creating incentives, most factors affecting network industry performance are outside the regulatory domain, but they both influence and are influenced by regulation. Ultimately, the legitimacy and credibility of the regulatory system depends on how closely sector performance matches realistic national objectives.

---

<sup>1</sup> An earlier version of this paper was presented at the Conference of the Association of Water Regulators of the Americas (ADERASA), Santa Cruz, Bolivia--September 26, 2002.

Regulatory governance is one of the two elements under the direct control of commissions. Government agencies are often created in the context of a crisis or changed perceptions regarding the status quo. It is naive to think that a new government agency will *solve* the problems that precipitated its creation. Agencies are created to *manage* problems—to balance the interests of competing groups and gain the trust of the citizenry. A poorly conceived regulatory scheme can impede a government's realization of its objectives and priorities. Therefore, when creating a new regulatory or competition commission, policymakers should give careful thought to regulatory governance in terms of both commission design and processes.

A recent World Bank Note offers a framework for comparing regulatory commissions (in this instance, those with responsibility for telecommunications in Middle Eastern nations).<sup>2</sup> The author asks

1. How were the regulatory authority and its mandate established? (Detailed legislation? Specific responsibilities? Clarity in roles?)
2. What kind of governing body is the regulatory authority? (Sector specific, collegial board, separated from political and business interests?)
3. How autonomous is the regulatory authority's decision making? (Specific appeal procedures?)
4. Does the regulatory authority have enforcement power? (Clearly defined? Access to information? Ability to establish fines and sanctions? Award, enforce, and revoke a license?)
5. How much job security do commissioners and key staff have? (Appointment process? Term of office? Clear rules for dismissal? Does staff recruitment allow competitive hires?)
6. Does the regulatory authority have financial autonomy? (Funding sources? Full control? External audits?)
7. Does the regulatory authority use transparent decision making processes? (Publish drafts for comment? Publish decisions and justifications? Issue annual report? Hold public consultations?)

Outsiders (external stakeholders, including potential investors) evaluate each regulatory commission in terms of how the seven questions are answered. For example, an agency's design relates to the clarity of its role in relation to other government institutions: specifically to the division of responsibility between the competition commission, the government ministry responsible for developing broad policies, other sector regulators, and agencies in other jurisdictions.

---

<sup>2</sup> Mohammad A. Mustafa, "Benchmarking Regulators," *Public Policy for the Private Sector*, World Bank Group, June 2002.

At the January 2002 PURC/World Bank International Training Program on Utility Regulation and Strategy, participants identified a number of lessons. These are expanded upon below. The participant observations are linked to qualities of the regulatory process that promote sustainable systems.

1. **Consultation:** *Consider all stakeholders and their key concerns when making decisions.*

Suggestion: Promote the creation of Citizen Advisory Boards at the local level. Such councils educate opinion leaders and obtain feedback regarding consumer perceptions. These groups will not parrot the “regulatory line” but can provide feedback on draft decisions. Members of these boards are likely to be opinion leaders who can help educate others regarding the trade-offs that must be made to maintain the financial sustainability of suppliers. Quality choices and decisions regarding the expansion of service both require input from citizens. Note that unserved citizens should be included on such boards to give a voice to those currently without service.

2. **Creativity:** *Regulators should avoid excessive attention to process and pay attention to the content of rules. Policymakers need to identify a wide range of policy options that promote the achievement of objectives. Note that excessive bureaucratic hierarchy can stifle internal discussions and debates. The organization must balance the benefits from a clear internal structure of accountability against the benefits from having greater fluidity and flexibility. Flexibility is needed to ensure that information flows are smooth and not blocked by “gatekeepers” who exploit their positions in the organizational structure.*

Suggestion: Stimulating creativity and cost-effective initiative requires an organizational culture that rewards those who have a high impact on agency performance. Develop an Award for Excellence that underscores the commission’s commitment to encouraging initiative. Professional staff can be recognized this way. The Florida Public Service Commission has the Gerald R. Gunter Award (named in honor of a deceased Commissioner) that is presented at the commission and at the next annual PURC conference.

Suggestion: Quality of service is one of the areas where combining indicators may be necessary to obtain an overall performance index. When commissions adopt a goal, some reward should be given for movement toward achieving the goal. A pass/fail approach reduces incentives to make incremental improvements. Placing weights on the different objectives requires careful analysis, but some ranking of objectives is necessary if utilities are to direct their resources at the most important quality targets.

Suggestion: Review ways to make private sector participation work for the poor. The Public-Private Infrastructure Advisory Facility of the World Bank (<http://www.ppiaf.org>) has a new publication titled *New Designs for Water and Sanitation Transactions*. Assign a staff professional to examine the document and identify ways to initiate pro-poor

programs. Examine other studies produced by the Water and Sanitation Program (<http://www.wsp.org>)

3. **Expertise:** *Economic concepts can be complicated and subject to different interpretations, so organizations must continually be in a learning mode.*

Suggestion: Assign a top staff professional to organize a regular series of lunch or afternoon workshops. Anyone who has attended a training program should share key lessons from that experience. When analysts have some preliminary results, these can be shared informally before people get too attached to specific conclusions. Invite a local university researcher or a consultant to critique a methodology that the commission is using. The purpose of such workshops is to promote internal discussions. In addition, open technical workshops with utility experts can identify the issues that need to be resolved in a more formal regulatory process. When methodologies can be critiqued and improved, the resulting studies are likely to be based on reality rather than on concepts that lack empirical counterparts.

4. **Credibility:** *Investors seek transparency and consistency in the regulatory process since cash flows will be driven by future decisions.*

Suggestion: There is no simple way to create credibility—it is the outcome of citizens comparing actual performance with the stated objectives. In addition, perceptions regarding fairness of the regulatory process influence public acceptability of the regulatory system. The key is to communicate with various stakeholder groups. Actual performance data is more convincing than rhetoric. Data collection and analysis form one basis for credibility. Another is adherence to announced schedules. When targets and dates keep changing in a (seemingly) random way, market participants lose confidence in the agency.

Suggestion: Require the submission of financial plans by utilities. These pro forma projections can be incorporated into benchmarking initiatives, but only after evaluating the numbers and the associated projected performance. Local citizens should have access to this planning tool and can take some ownership of the plans or raise concerns. When the regulator is seen as supporting local participation, government gains credibility.

5. **Coordination:** *Given the common issues facing network industries, sector regulators should consult with counterparts in other commissions and with environmental regulators.*

Suggestion: Decisions made in isolation can create tensions across different government agencies. Jurisdictional disputes (national, state and local) and ministerial disputes (development agencies and environmental regulators) require some forum for debate and resolution. Politics is about power, but it is also about performance. If a commission focuses on the latter, other participants may decide that it has earned the authority to act. Interagency rivalry is a sure way to dissipate energy and lose the goodwill of key stakeholders.

Suggestion: In the water sector, there is generally a division of responsibility between the Resource Management Agency, the Sector Regulator (price and quality), Infrastructure Development Agency (funding special projects), and the Environmental/Public Health Regulator. Clearly, these groups need to coordinate their activities if rulings are not going to be at cross-purposes. Consistency can be achieved only by coordination at the highest levels. If no interagency mechanism for collaboration exists, help create one.

Suggestion: Donor organizations and national development agencies need to recognize the importance of follow-up. It sometimes happens that outcomes are not monitored carefully once funds are disbursed. The sector regulator needs to take initiative to ensure appropriate reports on performance. Preparing data submissions for benchmarking comparisons would seem to be a minimal requirement for receipt of external funding.

6. **Predictability:** *Although there are no easy solutions to regulatory problems, the application of core principles and methodologies promotes consistency in decision making. If the division of responsibility among different government agencies is unclear, the resulting decisions are likely to conflict, leaving policy implementation up to the courts or to the group with the most political power. Consistency of decisions over time gives stakeholders, including investors, some confidence that facts and the law, not political pressures, form the basis of regulatory decisions.*

Suggestion: When the law is unclear, the affected agencies need to bring the issue back to the legislature. Clearly, revisions in the law will affect the relative power of different agencies. Consider the alternative: Is it better to have battles between agencies or to support a strong agency in helping it improve sector performance? The goal of a commission is to improve sector performance, and that may require a reduction of formal power.

7. **Accessibility:** *Regulators, in their role as educators, must be visible to the general public as they communicate their work through meetings and the media. Citizen participation can help governments set priorities for infrastructure sectors. In addition, citizens are more likely to accept regulatory decisions when there are formal mechanisms for their participation in regulatory decision-making.*

Suggestion: In some cultures, a regulator can take on the trappings of a judge. However, implementing ministerial policy is very different from interpreting the law. Regulators should not discuss an ongoing case in public, since listeners might interpret particular statements as reflecting premature judgments. However, the broad vision of the agency and perceived challenges need to be communicated to stakeholders. Thus, regulators could take advantage of call-in radio talk shows, letters to newspapers, and other forums for communicating the vision of the commission. If citizens do not understand the role of the commission, they are not likely to find sectoral outcomes acceptable.

8. ***International Collaboration:*** *Regulatory problems are similar across a wide range of national situations so participation in joint activities can promote the sharing of experience and knowledge.*

New regulatory agencies could look at NARUC (National Association of Utility Regulatory Commissioners), SAFIR (South Asia Forum for Infrastructure Regulation), and similar organizations to identify mechanisms that promote useful collaborations. Such an agency might create a series of committees (Rate Design, Accounting, Cost of Capital, Groundwater Protection) to be staffed by professionals at the national commissions. These committees would prepare joint reports that focus on current issues (using the Internet for sharing drafts and obtaining comments). In addition, an agency could focus on a limited set of collaborative projects that strengthen the capabilities of individual regulatory commissions. Benchmarking would seem to be a prime candidate for such cooperation, given the difficulty of evaluating the performance of water utilities in the absence of comparisons. (See below.)

9. ***Performance Benchmarking:*** *Just as indicators can be developed to compare the performance of firms in a country (or across countries), international investors are developing scorecards for regulators to evaluate their performance.*

Suggestion: The World Bank has a “Benchmarking Water and Sanitation Utilities” Project at [http://www.worldbank.org/html/fpd/water/topics/bench\\_network.html](http://www.worldbank.org/html/fpd/water/topics/bench_network.html). The site outlines the data to be collected, formats, and how it can be shared. To date, countries from Latin America and the Caribbean are not making information available. This initiative would seem to clearly fall under an agency’s general mandate to promote collaboration and the sharing of information. There is no doubt that comparing utilities in similar situations is not easy. Furthermore, poorly performing utilities do not like to be identified, nor do commissions wish to be perceived as overseeing poorly performing utilities. Nevertheless, without benchmarking, commissions are at a severe information disadvantage relative to individual water utilities.

10. ***Continuous Learning:*** *Regulators need to devise mechanisms for sharing experience and information—through regular in-house workshops, conferences, and training programs.*

Suggestion: Each commission could begin discussions with a local university to create specialized degree programs or certification programs. Alternatively, a commission could coordinate an initiative similar to that begun by the Telecommunications Regulators Association of Southern Africa (TRASA). Seven universities in Southern Africa have joined together, along with international partners (including PURC/University of Florida) to develop and deliver ten course modules via the Internet. The result will be an international master’s program in Telecoms and ICT Policy and Regulation ([NetTel@Africa](#)). The network is being designed to promote capacity building and knowledge exchange. Clearly, such an initiative would take significant effort, but international funding agencies should be interested in such initiatives if the

Johannesburg Conference is any indication of global commitment to expanding access to clean water.

*11. **Neutrality:** Because regulators balance the interests of government ministries, utilities, and consumers, they must develop positive working relationships with each group.*

Suggestion: Some years ago, the Energy Regulator in Ontario held a series of monthly dinners with key stakeholders in the province. These were informal, but were designed to identify issues before they became politically charged. Care must be taken that such meetings are not viewed as creating cozy relationships between regulators and utilities or other groups. Avoid getting into verbal battles with representatives of customer groups, utilities, or others. Name-calling has occurred in some countries, much to the detriment of the regulatory process.

*12. **Independence:** While total autonomy is impractical, regulators need to be insulated from daily politics so decisions can promote long-run financial sustainability of the sector.*

Suggestion: Independence is earned as much as it is granted. When stakeholders understand the benefits of taking a long-term (rather than short-term) approach to problem solving, the commission can adopt policies that create value for everyone. Short-term actions generally just redistribute wealth, but long-term actions can create wealth and lead to win-win outcomes. It is necessary to educate others to take a “hands-off” approach to the sector (giving the commission authority to address issues).

*13. **Transparency:** If the regulatory process is transparent and the public has access to commission reports, stakeholders will understand the basis for decisions. In addition, the commission will be less likely to promulgate arbitrary rules.*

Suggestion: New regulatory commissions need to win the respect of all affected groups; otherwise, stakeholders will go around the commission. They will go to political power brokers or government channels utilized in the past. Transparency promotes direct participation by those affected by decisions. In addition, by adopting clear and open regulatory procedures, sector regulators set a standard for other government agencies. Citizen confidence will not be based on short rulings that are not explained. Despite the complexity of the issues, the facts and the objectives must be carefully delineated to provide a basis for decisions.

*14. **Accountability:** Just as reports to appropriate government agencies help policy-makers understand sector developments, information provided to the press is a crucial activity if the public is to be aware of progress toward meeting sector objectives.*

Suggestion: Review the press releases from your regulatory commission. Compare them with the news reports that actually went to press. Are there ways to structure news

releases and interviews in ways that help commissions educate the public. Compare what your organization presents to the legislature with what other commissions provide the executive and legislative branches. Do your annual reports present comparative statistics that would persuade readers that sector performance has improved or that changes in the law would be required to strengthen regulatory authority? Are there executive summaries or pamphlets that are widely distributed? Again, this is a way agencies can promote the sharing of “best practice”? To what extent is the commission web site a useful resource for opinion leaders, politicians, utilities, consumer associations and other groups?

15. **Humility:** *Regulators should acknowledge that they are not all-knowing and have much to learn from consultants, universities, utilities, and colleagues in other countries. The key is to be a good “consumer” of information provided by outside groups.*

Suggestion: Even as a regulator demonstrates expertise, he or she needs to avoid jargon. Citizens certainly respond favorably to statements reflecting confidence and certainty. However, arrogance is not so easily forgiven. Regulators should adopt a tone of openness to new ideas and of incremental movement toward key objectives. Promise only what you can deliver. Deliver on your promises.

### **Concluding Observations**

There is no simple recipe for regulation. However, the elements described above are ingredients. Each country has its unique problems and opportunities. Answers to the following questions provide clues as to where regulatory commissions might focus their energies in the coming years.

What political issues are most important at present?

1. Lack of political vision by national leaders
2. Absence of water as a national priority.
3. Lack of a popular consensus on the nature of water/sanitation problems
4. Lack of a popular consensus on preferred policy options
5. Other

What regulatory issues are most important at present ?

1. Inadequate legal (regulatory) framework for monitoring and providing incentives
2. Inadequate legal framework for addressing water resource issues
3. Absence of political support for rate rebalancing
4. Other

What stakeholder issues are most important at present?

1. International capital market perceptions
2. Lack of trust of municipal utility managers who fear loss of power
3. Lack of trust of utility employees who fear loss of jobs or added responsibilities
4. Other

Agencies can help others by sharing information about their most successful initiative (or new project), say in the past two years:

1. What was the policy?
2. How was the policy selected? (legislative mandate, executive order, regulatory ruling)
3. How did you develop a coalition to support the policy initiative?
4. How is its success being communicated to key stakeholder groups?
5. How can others learn more about the program (web pages? reports?)

Finally, here are few additional questions that might stimulate renewed attention to the content of regulations as well as to the regulatory process itself.

1. To what extent is your organization engaged in Benchmarking activity that compares utility performance within the sector or over time? Have you submitted data to the World Bank Water System Benchmarking Program?
2. What do you see as the basic strengths and limitations of alternative forms of regulation (rate of return, price caps, quality of service, system expansion mandates)
3. How useful is the accounting and financial information you obtain from water utilities? What information needs are not currently being met?
4. Pricing: What is the nature of current subsidies? How effective are they? Do you have plans for moving to alternative (targeted) subsidy programs?
5. If your organization were given funds to hire three more professionals, what skill would be most important to fill gaps in your current mix of staff (accounting, engineering, business, information systems, law, economics, other)?
6. Has your organization developed links with local universities for recruiting new professional staff and for organizing workshops or training?

As I noted at the beginning, outsiders have lots of ideas. Ideas are cheap. Implementing ideas can be costly. My hope is that one or two suggestions will plant the seeds for change in one or more agencies. That, after all, is the goal of networking: sharing ideas, debating their importance, selecting some that might be effective, trying them out, and sharing those experiences at a future gathering.

<http://www.purc.org>