

# **Market Reform: The Complicated Process of Choosing Regulatory Priorities**

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The purpose of this handout is to summarize some of the issues raised by this exercise. We realize that the groups had inadequate time to complete their evaluations, but many decisions are made in haste and with only minimal time to think through the problem. We hope that discussions on this topic will continue throughout the two weeks. Sharing experiences with one another is an important aspect of the Training Course.

## **Identifying Priorities**

In this case, we gave the groups ten objectives. Some objectives were left out. For example, the balance of trade can be affected by equipment imports. Also, regional development might be an important feature of the political landscape. Some might have assigned this objective as Objective 5 (Infrastructure Development). Others might not see any difference between that objective and having a high percentage of households connected to the service (Objective 6). Such observations illustrate the difficulty of prioritizing objectives unless clear definitions are established. Similarly, some might view rapid innovation (Objective 8) as part of economic efficiency (Objective 4). Others might have broken economic efficiency into technical/engineering efficiency, cost minimization (which brings input prices into the equation), and allocative efficiency (where output prices approximate the marginal costs of production--short run or long run?). Others might argue that Objective 10 (Robust competition) implies Objective 4 (Economic Efficiency)--when the segment of the industry is not a natural monopoly. This overview shows how important it is that performance objectives be carefully defined, since otherwise the potential for legitimate disagreement is high!

## **Defining Objectives**

Groups probably spent some time trying to define priorities. For example public acceptability is subject to many interpretations. Is acceptability related to fairness? If so, is fairness to be cost-based (customers pay the costs associated with service delivery) or need-based (since income-distribution concerns are important in many situations). Acceptability may apply to fairness for customers today and to future customers, so some trade-offs over time may become significant. In particular, how should fixed costs be shared across customers and over time?

Also, some of the objectives are complementary to one another, while others compete with one another. Some terms need to be defined: what is reasonable profit for Objective 3? Since high service quality requires resources, how much reliability is appropriate (Objective 7)? Do low prices (Objective 2) imply below-cost prices?

## **Weighting Priorities**

Groups might have had difficulty reaching consensus due to different conceptions of how the weights were to be applied. Do the priority points represent some *absolute* weight? Is it an *average* across a set of sectors and policies (allowing regulators to make some trade-offs over time)? Alternatively, should the weight be viewed as a *marginal* weight? That is, should we take as a starting point how well the regulatory process has already promoted these objectives, and view the weights as forward-looking--applying only to the next decision. For example, public acceptability might be given a substantial *average* weight (because of the importance of this

objective in ensuring the long term sustainability of the regulatory process). However, looking ahead, economic efficiency might be given substantial *marginal* weight, since a slight drop in public acceptability could be tolerated in a particular country, given the high level of acceptability achieved to date.

Weights are likely to depend on the stage of economic development. Also, participants from regulated firms might have a very different perspective on what regulators ought to value. The ability to attract and maintain capital is a fundamental issue facing firms, so people who focus on financial outcomes might be less willing to compromise in favor of political realities--arguing that regulators need to have a longer time frame than the next election. Credibility with the international investment community tends to be emphasized by executives who are trying to bring together the capital required for massive infrastructure investments.

### **Process for Reaching Consensus**

The groups had to reach some consensus on weights to be given the objectives. Our experience with other training courses suggests that some groups voted on what weights should be used while others just took averages of the points to be reported. In some cases, people who were more shy or quiet were not given the air time to provide input into the process. Valuable insights were lost. In other cases, leadership was exercised in positive ways, enabling everyone to have their say and to contribute to the final weighting scheme.

In theory, when a regulatory commission consists of several individuals, a variety of perspectives will be presented, and the consensus that emerges will have benefited from the insights of each commission member.

If a single Director makes regulatory decisions, those providing information and assistance play a role similar to those of other commissioners. One lesson from this exercise is that reaching consensus on complicated issues is a difficult task.

### **Revealing Priorities**

Regulators (and private decision-makers) need to know the priorities placed on their objectives so that the outcomes of alternative policies can be evaluated and the policies ranked in terms of those impacts. However, revealing the exact weights to others may be detrimental in the bargaining process, since such information is valuable from the strategic standpoint. This may explain why legislation and regulatory decisions seldom specify the weights to be given various objectives.

### **Application to Strategic Negotiation Exercise**

The exercise for this session did not involve a concrete situation where people could quantify different objectives or link outcomes to particular policies. In the concluding days of the Training Course, we will return to the issue of priorities. A negotiation case will be handed out next week. Read it in advance of the session so that you will be able to apply the lessons from the negotiation plenary sessions. In that Exercise, you will be assigned a role to play and be *given* the priority points your character places on different outcomes. As this session suggests, obtaining those weights can be a very complicated (but useful) exercise. Understanding your goals and those of other stakeholders is crucial to achieving results that meet your objectives.