

Three Lessons for Improving Infrastructure Performance

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Sanford (Sandy) Berg, Senior Fellow
Public Utility Research Center, University of Florida

I cannot distill forty-six years of teaching, research, and outreach in forty-six minutes, but three themes emerge on a regular basis from my work. These relate to politics, information, and conflict-resolution. PURC has hosted over 3,500 regulators and managers from 153 nations over the past two decades in the *PURC/World Bank International Training Program on Utility Regulation and Strategy*. During the concluding session of each program, participants have shared their reactions to formal presentations and informal networking. Three key lessons they identify can be consolidated into three areas: drivers of regulatory decisions, the importance of quantification, and approaches to the resolution of stakeholder conflicts. In addition, these lessons build upon seven elements affecting the performance of the energy, water, and telecommunications sectors. These elements all begin with the letter “I”, making it easy to remember themes that permeate regulatory systems.

Regulators and operators face the same challenges: creating a sustainable infrastructure system where all stakeholders have confidence in the integrity of the process and have a shared vision of improved infrastructure performance. As PURC’s Director, Mark Jamison, has observed at previous OOCUR gatherings: Many of the lessons tend to be strategic rather than technical in nature – suggesting that many of the important ideas involve how regulators, representatives from government ministries, infrastructure managers, and consumer advocates need to ‘get on the balcony’. Intentionally stepping back from the “give and take” of regulation allows leaders to see how various stakeholders (interest groups) limit or promote reform.

Lesson # 1: Ultimately, institutional and political constraints must be recognized by those implementing public policy. That means that regulators must be *Politically Aware*, not politically active.

Some years ago, my colleague David Sappington was asked by the Federal Communications Commission to serve as Chief Economist. When he returned to the University of Florida after that assignment, I asked him to give a presentation at the PURC Annual Conference and to describe the determinants of regulatory decisions at the national level. He agreed to do so, and his PowerPoints listed four drivers of policy: (1) Politics, (2) Politics, (3) Politics, and finally, (4) Economics. The listing bothered me, yet it reflected reality. First, no matter how dysfunctional the system, no matter how weak is sector performance, someone is benefitting from current arrangements. The beneficiaries, the special interests, are often few in number and have large gains . . . Those bearing the costs of poor service or non-service are many in number

but those per capita costs are small. That is where Political Power enters the equation: the Political Economy of Regulation predicts that the resulting arrangements will favor the few who benefit from subsidies, political patronage or other outcomes.

In addition to power, two other two aspects of Politics are equally important. The second aspect of Politics affecting regulatory decisions reflects the different time horizons of political actors. Politicians tend to focus on the time leading up to the next election: two or three years. However, infrastructure time horizons involve decades. So politics and sound regulatory and managerial decisions can be in conflict. That means that future generations end up bearing the costs of excessively low prices today: deferred maintenance, lack of innovation, and low investment. The third aspect of Politics that influences public policy and the way it is implemented by regulators arises from ideological considerations. It is said that “Seeing is believing.” However, it is also true that “Believing is seeing.” Political ideologies focus on *policy*. Ideologies are somewhat immune to evidence. Ideologies reflect biases that are hardwired into our brains. The technical term is “Confirmation Bias.” We all tend to ignore evidence that differs from our preconceived notions of what works. Note, I am distinguishing between ideology and ideals. The first focuses on the means, whereas ideals are about outcomes. In fact, politicians actually tend to agree on desirable outcomes: efficiency, fairness, growth, and dignity, for example. However, political ideologies create conflicts—where sometimes, the conflicts are artificial or involve purely personal ambitions—not the public good.

The fourth driver of regulatory decisions is one that brings a dose of economic reality to the foreground. *Economics* focuses on benefits and costs, market structures, efficiency, incentives, governance, and financial sustainability. We wear blinders too, but most economists are not particularly ideological—we are more interested in the outcomes and generally are open to evidence that a particular policy option might be more effective in achieving that outcome. Of course, a policy usually is associated with a number of outcomes, including those affecting the environment, vulnerable groups, innovation, a particular region, or economic growth. When different policies have different impacts on these areas, economics requires that we recognize these trade-offs. The priorities we give to different objectives need to get resolved in the political arena: when there is no consensus regarding these priorities (or national ideals), the result can be political polarization. Nevertheless, evidence-based economics at least has *some* role in regulatory decisions.

Thus, the first Lesson about being politically aware underscores the need for studies that address the economic, demographic, and geographic impacts. In addition, transparency gives citizens confidence that the regulatory system is conducting its business in the open. Stakeholder communications become two-way: educating citizens and listening to their concerns. The key role of politics also means that regulators need to cultivate allies who also seek improved infrastructure performance. And, finally, agencies need to establish and publicize their track records. Without public understanding of infrastructure issues, regulators will have difficulty establishing favorable reputations and implementing sustainable policies.

Lesson # 2: Seek Data-driven decisions.

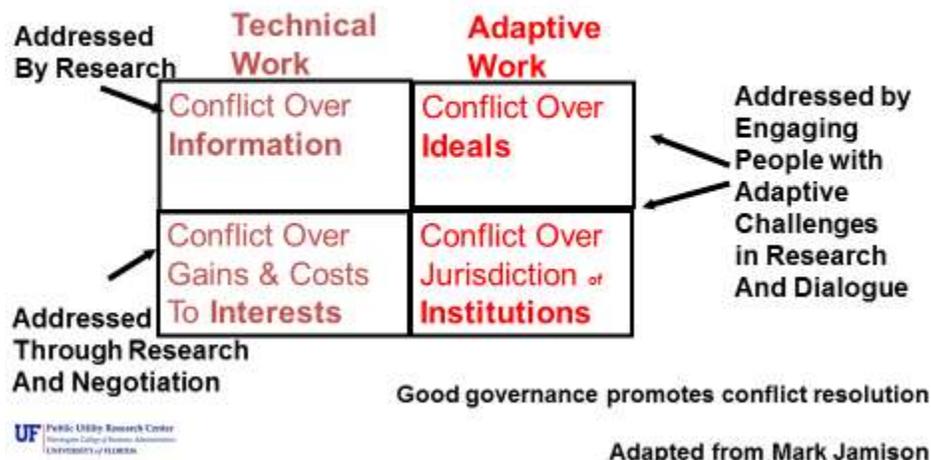
Decision-makers manage what they measure. That means that quantification is central to the regulation and operation of infrastructure firms. Key Performance Indicators (KPIs) serve as metrics that inform policy-makers about the trends and patterns resulting from past policies. In addition, it is said that “The fewer the facts, the stronger the opinion.” So data can reduce the role of ideology in political debates over policy. Of course, some metrics are easy to collect and authenticate. And that means that we should focus on metrics that are important, not those that are easy to collect. OOCUR has a clear role in coordinating data collection in the region, so agencies can identify extent to which performance outcomes that deviate from best practice in the region. That underscores the importance of benchmarking. Certainly, different operating conditions and historical/legal developments will affect these outcomes, but at least the focus is on shared ideals regarding outcomes as reflected in evidence and not on policies based on ideological preferences.

Lesson #3 Conflict resolution and conflict management require decision-makers to identify the source of the conflict and then to apply the appropriate tools for addressing the source.

This theme has been developed over the years by Mark Jamison and Araceli Castaneda at PURC trainings and in their writings on Adaptive Leadership. What are the sources of conflict? Identifying these sources is crucial for the following reason. Regulators can be viewed as continually “fighting fires” (consumers’ complaints, a hurricane recovery, a misguided legislative initiative, or a news headline). Using the correct “fire-fighting equipment” is crucial for success. Leonard Shabman identified four sources of conflicts. Each of the sources requires different tools for addressing the problem.

The first source is **Authority Conflicts**. When there is a lack of clarity of roles and responsibilities of *Individuals* and *Institutions* tasks are likely to create tensions. Second, **Cognitive (Factual) Conflicts** reflect disagreements regarding current or historical facts (*Information*) and causal linkages (*Ideas*). This underscores the value of data collection and authentication. Third, **Value Conflicts** reflect conflicting priorities and different weights on outcomes (*Incentives* and *Ideals*). Sometimes, ideological considerations further complicate the situation. Fourth, **Interest Conflicts** arise because stakeholders benefit differentially from decisions. The Figure below illustrates how factual conflicts can be addressed through research. Evidence can resolve such conflicts. However, most conflicts require negotiation—engaging key stakeholders in discussions. That means that communication becomes a key tool for the development and acceptance of regulatory decisions.

Conflict Resolution Tasks



Recent publications complement these points in the context of governance. Between 2011 and 2014, there were 58 studies of governance—so the importance of formal and informal authority structures is receiving a lot of attention. The OECD has prepared a set of studies on Water Utility Governance that also are relevant for other infrastructure sectors. These studies emphasize efficiency, effectiveness, and trust and engagement in sector governance. In addition, a recent book, *Achieving Regulatory Evidence* (Cary Coglianese, editor), emphasizes that processes matter (e.g. procedures, autonomy, clarity of rules), and substance matters (sound decisions). In addition, the editor notes that style matters. For example, humility counts, since technicians might over-estimate their ability and under-estimate the complexities. Boldness counts to the extent that agencies can be innovative without damaging their legitimacy. Also, agility matters—in the sense that decision-makers are able to adapt to changing threats and opportunities. Thus, adaptive leadership makes regulation more effective: leaders “stir and steer”. They identify emerging issues so those issues can be addressed in a timely manner. Then they ensure that policies are implemented in a manner consistent with their agency’s legal mandate.

Of course, regulators need to recognize the existence of information asymmetries: managers know far more about the ease or difficulty of containing costs and improving performance. Nevertheless, international case studies can help people see how questions are addressed in different settings. As Ralph Waldo Emerson said, “People only see what they are prepared to see.” Past experiences place blinders on us. We tend to discount or misinterpret facts that are inconsistent with our own world view. Cases from other nations remind us that we all wear blinders and need to interact with others to better understand our own situation. A wise person once said: “Don’t believe everything you believe.”

In my opinion, capacity building is essential if support staffs are to have technical skills and motivation to develop evidence-based recommendations. The most dangerous “knowledge” is a principle or idea that is actually false. When we think we understand something, but actually do

not, then we are likely to push forward without a solid grounding in reality. All of us are susceptible to excessive confidence in our own understanding of the way things work. That is one reason why open discussions and thoughtful debate are necessary within any organization. When conflicting ideas are not openly discussed, decisions are likely to be based on inaccurate information and/or inappropriate methodologies. Multiple disciplines (including engineering, economics, finance, accounting, and management) are necessary to bring a wide range of perspectives on individual issues.

Concluding Observations: Here are seven elements that (in my opinion) are necessary for strong regulatory performance:

Information—*Information matters*: the collection and authentication of data is necessary to identify trends, understand current patterns of performance, and determine realistic targets for utilities; technical skills and on-going capacity-building can support such initiatives.

Institutions—*Social Structures and Organizational Cultures matter*: the former reflect cultural norms and customs. Cultural traditions, the rule of law, and political arrangements are the foundations of regulatory systems. For example, the laws that establish roles and responsibilities for stakeholders constrain the various actors in the regulatory arena.

Interests—*Special Interests matter*. Every stakeholder benefits in different ways from regulatory rulings. The sector regulatory commission is one component of the regulatory (and governance) system, which includes the legislature, courts, utilities, unions, and operators; inter-organizational collaboration is essential for improved sector performance.

Incentives—*Incentives matter*: decision-makers behave in accordance with payoffs associated with different outcomes; every regulatory rule rewards or penalizes actions affecting utility performance.

Ideas—*Ideas matter*: each of us brings a conceptual framework to our decisions; new perspectives can serve as catalysts for activities that improve the operation and financial sustainability of infrastructure service providers.

Ideals—*Values matter*: when we are clear about our objectives and communicate those priorities to stakeholders, the resulting dialogue can clarify our goals and promote greater consensus regarding sector objectives. Ideologies, on the other hand, tend to focus on specific policies—which limits discussion.

Individuals—*People matter*: leadership is essential for improved sector performance; no matter how dysfunctional or inefficient current arrangements are, someone is benefiting from them—which implies that overcoming institutional inertia requires strong leadership.

I would argue that individuals are the most important determinants of infrastructure performance. As I wrote in an article in *Utilities Policy*, “*Individuals* operate within the *institutional milieu*, come up with *ideas*, and translate them into action. Individuals gather *information* and devise strategies for dealing with special *interests*. Ultimately, the values [*ideals*] of individuals are the basis for prioritizing . . . sector outcomes and determining the *incentives* that promote the achievement of shared objectives. Each of the seven elements identified here has impacts on governance and performance, but perhaps the most elusive (and important) is *individuals*.”

In conclusion, policies are not self-implementing. Successful implementation requires leadership. Some of the leaders who will make a difference in their nation’s economic and social growth participated in this OOCUR Conference. Hopefully, the discussions equipped them to be more effective when they returned to their nations—to continue the *initiatives* identified during the Conference.