Regulating State-Owned and Municipal Utilities: Information, Incentives and Governance

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Critical Challenges for Policy-Makers

- Aging infrastructure, production inefficiencies, Non-Revenue Water, Collections
- Weak economic incentives for SOEs
- Customer Expectations
- Citizen Expectations

Evidence from Recent Reports
Six Tools for Policy-Makers

1. **Information**—KPIs, hydrology
2. **Institutions**—organizations with legitimacy (evidence-based and politically savvy)
3. **Incentives**—created by every rule or regulation
4. **Ideals**—values that we hold (priorities)
5. **Ideas**—best practice and next practice
6. **Individuals**—People matter (leadership)

- Overstaffing (and lack of professional capacity)
- Non-Revenue Water
- Below-cost Revenues (Prices & Collections)
- Lack funds for capital investments/maintenance
- Political interference (patronage)

A. K. Jha (205) “Institutions, Performance, and the Financing of Infrastructure Services in the Caribbean” WB Working Paper 58
IDB and IWA AquaRating Initiative (in Spanish)

13 Companies from Latin America participating

Rating Areas (plus Reliability of Information):
Access to Service, Quality of Service, Operating Efficiency, Planning & Investment Execution Efficiency, Business Management Efficiency, Financial Sustainability, Environmental Sustainability, Corporate Governance

www.aquarating.org
OECD Study of Water Governance in Latin America (2012—13 nations)

**Policy Gap:** over-lapping/unclear responsibilities

**Administrative Gap:** resource management boundaries

**Information Gap:** data silos, non-transparency

**Capacity Gap:** lack technical skills, professionalism

**Funding Gap:** unstable or insufficient funding

**Objective gap:** lack of coordination

**Accountability Gap:** lack of information/participation

CEPAL Study: Best Practice (Berg, 2013)

- **Regulation** less effective (ineffective?) without supporting institutions
- **Governance Structure** (rules of the game)
- **Substantive Actions** (play of the game)
- **Regulatory System**—many stakeholders (is the regulatory agency an “umpire” or “player”?)
- **System** requires coherence, creativity, communication, consultation, & credibility

http://www.eclac.org/publicaciones/xml/1/49891/Bestpracticesinregulating.pdf
Ultimate Goals

Ensure provision of necessary services in ways that allow economy and society to flourish

– Commercial viability (financial sustainability)
– Availability (Network Expansion & Access)
– Service Quality (Reliability, Customer Orientation)
– Affordability (Targeted Subsidies?)
Scope of “Solutions”

“Inside game” approaches

“Independent” Boards of Directors
Improving management/commercial practices
Introducing strong economic incentives

“Outside game” approaches

Improving governance system (accountability & role clarity)
Reviews of Business Plans & Benchmarking
Prioritization of & Coherence among Objectives
Commercial Practices

Managerial focus on…
- Financial performance
- Staff incentives
- Strategic business plan
- Coherence of objectives
- Best practices in technical efficiency

…within bounds of regulatory rules
Commercial Practices

- Adaptive organization
- Challenging culture
  - Open debates
  - Distributed authority
  - SMART goals (Specific, Measureable, Attainable, Relevant, Time-bound)
Regulatory Practices

• Managerial audits
  – Overcome information asymmetries

• Benchmarking
  – Quantitative and qualitative
  – Transparency
  – Ongoing dialogue with multiple viewpoints and outside views
Clarifying Roles with SOEs

Owners/Citizens

Policy Board/Ministry

CEO and Execs

Regulatory Agency

Operators

Business Board

CEO and Execs

Operator

Customers

For
Price Setting
Quality Targets

For
Financial performance

Outside Game

Communication

Authority

Accountability
Board Roles…

Reflect on outcomes
Refine vision and strategic plans
LR goals while staying in the game
Holding regulator or operator accountable

…outside the political arena
Constraints Facing Regulators

- Law
- Resources
- Values
- Organizational Culture?
- Precedents?
- Functions?
The work of leadership is helping stakeholders, policymakers, and ourselves find the place where reality, our values, and our abilities join together.

Regulator’s Role

The Regulatory Practice

- Engineering
- Economics
- Finance
- Law

- Counsel
- Management
- Relationships

- Politics
- Negotiation
- Dialogue

What is possible?

How can we do it?

What is important?

The Regulatory Practice
Aligning purposes

Ongoing or regular dialogue of operators, key politicians, thought leaders

Where are we?
What do we aspire to for our country?
What are the difficult tradeoffs between good things?
Regulation is dangerous work

• Every change involves someone losing something that is important to him/her

• Regulation is disappointing people at a rate they can endure
Thank You

The Appendix Introduces a “Revisionist” View of Regulation and the Regulatory Functions that provide instruments for improving sector performance.
Appendix: “Revisionist” View of Regulation: Active Player in Conflict Resolution

Future Consumers

Current Consumers

Regulatory Commission

What Regulatory Functions Provide Useful Instruments?

Government

Utilities

“Leadership in Infrastructure Policy”
Ten Regulatory Functions

1. **Issue licenses**: certificates of use, siting approval, contractual arrangements

2. **Set performance standards**: service quality has implications for cost, price, & health

3. **Monitor the performance of regulated firms**: collect and analyze data on costs, revenues, and performance (benchmarking)

4. **Establish the price level and the structure of tariffs**: enable recovery of prudently incurred costs via a *transparent process* that yields coherent prices (that are “just and reasonable”)
Ten Regulatory Functions (2)

5. Establish a Uniform Accounting System: income statements, balance sheets, statements of cash flows, and operating statistics

6. Arbitrate disputes among stakeholders: ensure that facts are well documented and that different interests are well represented.

7. Perform management audits and/or Evaluate Business Plans (often via independent consultancy):
   - Are goals being met?
   - Can targets be met with current prices?
Ten Regulatory Functions (3)

8. Develop human resources: staff training and competitive compensation policy for recruitment and retention of infrastructure professionals.

9. Coordinate Activities with Other Agencies: Water often involves multiple authorities, including water resource agency and environmental protection agency. Make recommendations to Legislature (pro-active or reactive?)
Ten Regulatory Functions (4)

10. Report sector performance and commission activities to appropriate government authorities: providing

- **clarity** in regulatory priorities,
- **transparency** for sector stakeholders, and
- **accountability** to political structures (via clear appeals procedures and inter-governmental coordination)
Sources of Conflict and Sector Performance

1. **Authority Conflicts**: lack of clarity of roles

2. **Cognitive (Factual) Conflicts**: disagreements regarding current or historical facts and causal linkages

3. **Value Conflicts**: conflicting priorities and different weights on outcomes

4. **Interest Conflicts**: stakeholders benefit differentially from decisions

(Shabman, 2005)
<table>
<thead>
<tr>
<th>Conflict Over Facts</th>
<th>Conflict Over Distribution of Gains &amp; Costs</th>
<th>Conflict Over What is Important</th>
<th>Conflict Over Jurisdiction or Authority</th>
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### Addressed By Research
- **Technical Work**
- **Adaptive Work**

### Addressed by Engaging People with Adaptive Challenges in Research And Dialogue

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• From Mark Jamison

www.purc.ufl.edu
"Leadership in Infrastructure Policy"
Informal Survey: Answer the following:

1. **Authority:** Is the regulatory agency used to help resolve key issues or is it by-passed? Are you in the middle of “turf wars”?

2. **Facts:** Has benchmarking been used to improve sector performance? Are contracts and targets based on reality?

3. **Values:** Does the regulatory agency help clarify how the targets reflect goals or stated political objectives?

4. **Special Interests:** Have regulatory decisions been inconsistent due to the influence of special interests (including the political party in power)?
Nine Best Regulatory Practice Principles
(Australia--ACCC)

1. **Communication**  Information to stakeholders on a timely and accessible basis.

2. **Consultation**  Stakeholder participation in meetings promotes legitimacy.

3. **Consistency**  Across market participants and over time (affects cost of capital).
Nine Best Practice Principles (continued)

4. **Predictability**  A reputation that facilitates planning by suppliers and customers.

5. **Flexibility**  Use appropriate instruments in response to changing conditions.

6. **Independence**  Autonomy - free from undue political influence.
Nine Best Practice Principles (continued)

7. **Effectiveness & Efficiency**  Cost-effectiveness emphasized in data collection and regulatory policies.

8. **Accountability**  Clearly defined processes and rationales for decisions. Clear appeals procedures.

9. **Transparency**  Openness of the process.
Evaluate Your Regulatory Commission
(not to be shared)

Nine Best-Practice Principles
Grade Performance: Assign Values to each:
  1 = extremely weak
  3 = not very acceptable
  5 = adequate (or acceptable)
  8 = good
  11 = outstanding

Policy must move beyond the Process to consider Performance Outcomes
Complete Your Survey

What would be a passing score: 50?

Has your score improved significantly in recent years?

Should each principle have equal weight?
  eg. If the first two principles had weights of .5 each, then the weighted score would be the average of those two.

Do the weights stay the same over time?