

Regulation and Regulatory Bodies

Once PP contracts have been signed and sealed, giving the private sector the responsibility for financing and delivering the services, the government needs to make preparation for monitoring the following issues:

- legal barriers inherited from past regulatory regimes that need to be sorted out,
- privatized services are natural monopolies, which come with risks of abuse of dominant position such as abusive pricing,
- safety cutbacks are likely to be an easy way to reduce costs.

These responsibilities are to be included in the mandate of the economic regulators. This is not the only responsibility of these regulators. In addition, the government needs to monitor compliance and enforce the contractual commitments – investment, quality and service obligations – of the private operators.

From this government monitoring need, a new term “regulation” has emerged over the past 20 years or so, which is common to all types of transfers from the public sector to the private sector. Regulation encompasses actions aiming to ensure that the services transferred are performed in compliance with the law, the specifications and obligations of all kinds for which the operator is held responsible.

The difference between a maintenance contract for a section of earth road and privatizing the telecommunications system for an entire country, but also between that same earth road and a motorway concession, is such that it may seem audacious to use the same vocabulary for both cases. However, a sufficient number of principles, such as dealing with the issues listed above, are common to all regulation mechanisms to justify using this term.

To learn more about the basic principles of regulation, the following publication may be consulted:



Privatization and Regulation of Transport Infrastructure, Guidelines for Policymakers and Regulators, Antonio Estache and Gines de Rus, World Bank Institute, 2000 (cover and table of contents)



Evaluating Regulatory Decisions and Sector Outcomes in Infrastructure Industries Results from Africa and Other Developing Countries. Jon Stern. PPIAF Working paper no. 3. 2007.

Developing a Regulation Capacity

If it is clear that there is a need to develop a major regulatory capacity within countries, in practice, developing the regulatory capacity involves two main risks. The first risk is having the regulators controlled by the operators, and being lenient in the case of conflict. The second is having the regulator controlled by the users or customers, and imposing demands not covered by the contract.

Cumbersome regulations tend to dampen innovation and efficiency, as it is difficult to regulate for the many circumstances that might arise. Light handed regulation relies on a number of checks and balances, including:

- Information disclosure on pricing policy or decisions made;
- Pricing principles which have to conform to pre-set conditions;
- A requirement to competitively tender all significant work;
- Compliance with all safety, environmental, planning and commercial legislation;
- A procedure for dispute resolution.



Managing Performance of a Highway System in the 21st Century,
Dr. Robin J. DUNLOP-PIARC XXI World Road Congress (Kuala Lumpur)1999, page 3

Developing a Regulatory Body

The most common commitment device is the creation of an independent regulatory authority, free from the risk of control by politicians, the government, the operators or the users of the service. Clearly, this authority must not only be financially autonomous but also accountable for its decisions.

There is a risk that the gains from PPP development do not reach the people simply because governments are ignoring the importance of their role to ensure the fair distribution of the gains through the creation of independent regulatory institutions.

It is very difficult to find details of what such a regulatory body could be, since its structure and functions will be in direct connection with the type of PPP envisaged.

In most countries, the solution has been to create units within the responsible Ministry (usually Transport or Public Works) that monitor concessions or other contracts with private operators. The main disadvantage is that in the case of disagreement with the government, conflicts of interest emerge quite quickly. Various experiences in Latin America suggest that the lack of transparency in the decision-making process of these monitoring units often creates tension which is widely reported by the press. This then becomes a source of political debate about the PPP development process.

An incompetent or controlled regulator is the best indicator that the outcome of PPP development will be unfair. Previous experience shows that unfairness tends to favor the investors and operators, rather than the users, when contracts are poorly designed and this often results in conflict.



Privatization and Regulation of Transport Infrastructure Antonio Estache, World Bank, 1999, pages 24-35

What organization to set up to ensure regulation?

There are now over 200 independent regulatory agencies around the world and all EU member states have them.

In particular, studies of these provide no information on how and why regulators have improved the performance of infrastructure industries in meeting consumer, investor, and development outcomes. The studies cannot explain the following:

- What works well and what works badly
- How infrastructure regulatory agencies can improve their performance
- The role and importance of regulatory agencies relative to industry structure, the actions of the regulated companies, and of government
- The role of infrastructure agencies in helping (or hindering) the finding of good solutions to problems and crises

However, these questions are discussed with useful commentary in detail in the;



Handbook for Evaluating Infrastructure Regulatory Systems (Brown, Stern, and Tenenbaum 2006), hereafter referred to as **the Handbook**

The Handbook discusses in detail the issues arising from ex post evaluations of infrastructure regulatory agencies, including the following:

- The type of evaluation (basic, mid-level, or in-depth)
- Who should carry it out and how
- The purpose and uses of regulatory evaluations
- Evaluation tools (including model terms of reference and questionnaires)
- An annotated bibliography and a summary of previous evaluation work in this area.

The key characteristics of infrastructure industries that, in combination, require economic regulation are as follows:

- They are highly capital intensive with very long-lived assets, which are typically sunk assets in the sense that they cannot be sold or reused.
- They have considerable economies of scale, particularly where there are monopoly networks, as in electricity and water. These features often create a natural monopoly in transport.
- The outputs of infrastructure industries—the services they provide—are consumed by and necessary to the welfare of all citizens as well as being crucial inputs for all businesses.

These characteristics have the following consequences:

- Consumers need protection against market abusing behavior by monopoly providers.
- Investors need protection against strategic behavior by governments that have a strong incentive, once investments have been installed, to keep prices no higher than operating cost levels.
- In fact, both governments and existing consumers have an interest in keeping current prices low.

However, maintaining low prices may be at the expense of unconnected consumers and deterring further investment in viable projects. In developing countries, particularly in Africa, the prosperous urban populations are usually connected to energy, water, and telecom networks while the majority—often the overwhelming majority—of the poorer rural populations is not connected.

The key purposes of regulation are summarized in the Handbook's three Meta-Principles of regulation as being:

- **Meta-Principle 1: Credibility:**
Investors must have confidence that the regulatory system will honor its commitments.
- **Meta-Principle 2: Legitimacy:**
Consumers must be convinced that the regulatory system will protect them from the exercise of monopoly power, whether through high prices, poor service, or both.
- **Meta-Principle 3: Transparency**
The regulatory system must operate transparently so that investors and consumers know the “rules of the game”.

There are many variations in the type and form of regulatory agencies. Nevertheless, all regulators and quasi-regulatory agencies (such as concession monitoring agencies) should observe the three recommended Meta-Principles of infrastructure regulatory systems listed above.