

## What Constitutes Good Regulation?

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## Outline.....

- Our Starting position ....Competition ahead of Regulation!
- Promoting Competition in the Water Industry.
- Why and what to Regulate.
- What are the Features of Good Regulation?
  - In the context of .....industry structure, institutional arrangements and regulatory practice.

## Starting position ....Competition ahead of Regulation!

- Competition where possible and practical will:
  - deliver efficiencies
  - empower customers
  - provide normal profits for service providers
  
- Regulation is only necessary where:
  - competitive markets are weak,
  - market forces are non-existent, and
  - cost-benefit analysis justifies intervention.
  
- Market failure per se does not warrant intervention
  - Regulation can be imperfect and expensive.
  - Choice between imperfect markets and imperfect regulation

## Promoting Competition in the Water Industry

### **Competition for the Market**

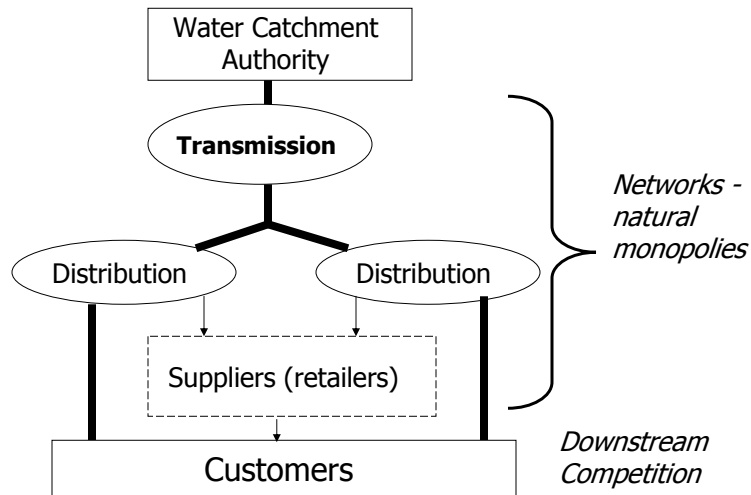
- Concession contracts - Competitively bid or Negotiated.
- Advantages (over direct regulation):
  - greater involvement of market forces through the bidding process
  - lower establishment costs
  - fewer concerns about the use (or abuse) of government powers

### Competition for the Market

- ❑ Disadvantages of concession contracts
  - Incompleteness of contract - high cost of renegotiations.
  - Parties may feel they are vulnerable to opportunism.
  - Less flexible to change – requires all parties to agree
  - Regulator (when established within the concession contract)
    - may not be independent, and
    - regulatory decision making process may not be transparent.

- ❑ **Yardstick Competition (Competition by Comparison)**
  - Key issues: Selecting the number of **appropriate comparators**, and the **basis** for comparisons
  - Role of regulator – must have the powers
    - to publish comparative performance
    - to provide incentives for improvements
  - Light-handed regulation possible – lower regulation costs

## Why & what to Regulate



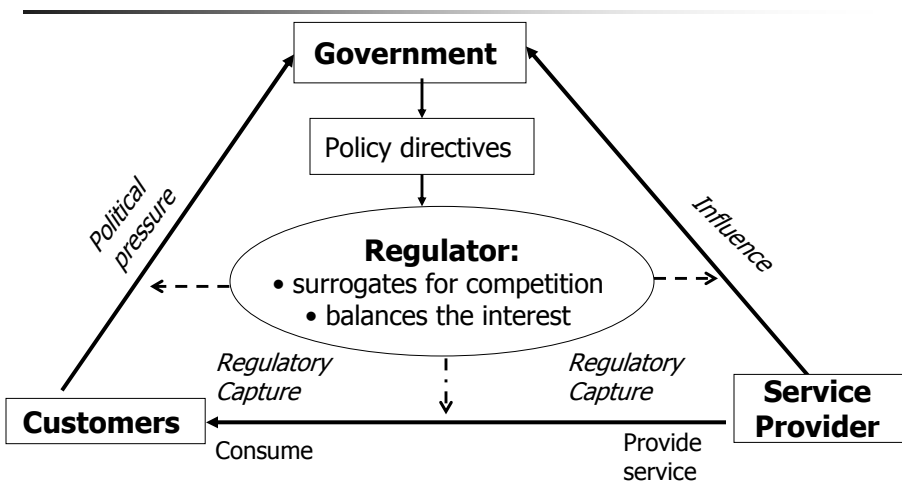
## Why & What to Regulate

- ❑ Water network systems are **natural monopolies**
- ❑ They are characterized by large sunk investments and economies of scale
  - Uneconomic to duplicate
  - Parties may feel they are subject to opportunistic behavior
- ❑ Presence of natural monopolies **may** provide a justification for regulation.
  - If left unregulated the natural monopoly may operate inefficiently and may abuse its market power

# Why Regulate the Water Industry?

- Therefore where regulation is needed, the role of the regulator is to surrogate for market forces and seek outcomes that are consistent with those from a competitive market.
  
- In addition the role of the regulator is to :
  - Implement government policies
  - Balance interests of all parties

# Role of Regulator – To Balance Interests of Parties



## Features of Good Regulation

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### Industry Structure

- ❑ Four (basic) players in establishing a regulatory regime:
  - Government; regulator; service provider; customers
- ❑ In the past, Government, regulator and the service provider were subsumed into one agency (vertically-integrated body)
- ❑ With deregulation, good regulation is supported by:
  - **separating** Government from service provider,
  - establishing a separate **independent** regulator

## Features of Good Regulation

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- ❑ Under a separation model,
  - The Government's role is to set broad policy objectives;
  - The service provider's role is provide services efficiently
  - The regulator's role is to regulate prices, monitor services, issue directives, administer licenses, etc.

## Features of Good Regulation

### **Institutional arrangements**

#### **□ Structure of Regulator**

- Should the regulatory agency be headed by a one-person regulator or by a commission?
  - Trading off efficiency, quickness of decision-making against checks for balance
  - Good regulation appears to favor a commission approach
- Appointment of regulators and job tenure?
  - Good regulation supports the appointment of regulators by the President/Parliament
- Multi-sector regulators vs industry-based regulator?
  - Trading off efficiency for industry knowledge but the latter can be exposed to regulatory capture.

## Features of Good Regulation

#### **□ Good regulation is supported by the separation of government and regulators**

- But this still requires regulators to be accountable
- Regulators must provide annual reports.
- Separating government and regulators:
  - Encourages government's making decisions according to national interest, not service provider's interests.
  - Minimises political interferences (especially with transparency)
  - Encourages confidence in fairness of regulator's decisions (depends on regulator credibility).
  - Encourages regulators to act independently.

## Features of Good Regulation

### Regulation in Practice

#### **Low compliance costs**

- High at commencement but should get lower over time
- Move from heavy to light-handed regulation over time

#### **Transparency**

- Regulator must have powers to consult (not just communicate)
- Public Process – opportunities for all to input
- Transparency of regulator's decision- making processes
- Regulator to fully disclose analysis and evidence
- Regulator to provide written reasons for decisions

## Features of Good Regulation

### Regulation in Practice

#### **Powers to act independently**

- Independent of policy makers
- Avoid regulatory capture
- Build confidence in & credibility of the regime
- Establish the managerial will to regulate – without fear or favour
- Establish a proper Code of Conduct

#### **Minimise scope for regulatory discretion**

- Role, responsibilities and objectives to be clearly articulated
- Balance between too much and too little regulatory discretion

## Regulation in Practice

### **Powers to take strategic approach**

- Take along term view (beyond one regulatory period)
- Powers to provide transitional arrangements

### **Powers to foster competition**

- Powers to nurse growth of competition
- Powers to withdrawal regulation – when & where necessary

## Regulation in Practice

### **Apply pressure on regulators to be efficient in their operations**

- Regulatory cost must be subject to oversight & challenge
- Regulatory agency to be staffed by professionals with right administrative, analytical, commercial, legal and technical skills (not political appointees)

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## **Regulation in Practice**

- ❑ **Regulator's decisions are subject to appeal**
  - Use of appeal panels – adopt modern approach to dispute resolution
  - Appeal to courts an option
  - Basis for appeal – merits vs due process