

Public Private Partnerships
and the Poor

Private Sector Participation and the Poor

3 - Regulation

Series Editor: M. Sohail

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3 - Regulation

Halcrow Management Sciences



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Halcrow Management Sciences (2002)
Public Private Partnerships and the Poor
Private Sector Participation and the Poor:
3 - Regulation
WEDC, Loughborough University, UK
Series Editor: M Sohail

ISBN Paperback 1 84380 011 X

This document is an output from a project funded by the UK
Department for International Development (DFID)
for the benefit of low-income countries.
The views expressed are not necessarily those of DFID.

Designed and produced at WEDC

About this series

The purpose of the project *Public Private Partnerships and the Poor in Water and Sanitation* is to determine workable processes whereby the needs of the poor are promoted in strategies which encourage public-private partnerships (PPP) in the provision of water supply and sanitation services. One of the key objectives is to fill some of the gaps which exist in evidence-based reporting of the facts and issues around the impacts of PPP on poor consumers. This series of reports present the interim findings and case studies of an analysis of both the pre-contract and operational phases of a number of PPP contracts. A broad view of PPPs has been taken and situations where the public sector is in partnership either with formal private sector companies, or with small scale local entrepreneurs, or with NGOs employed in a private sector capacity have been included.

M. Sohail
Series Editor

Acknowledgements

The series editor gratefully acknowledges the many different people who have willingly contributed in knowledge, opinion and in time to the development of this work.

Special thanks to the people from low-income settlements of case locations who have contributed to the research and provided their perspective on the issue. We feel greatly indebted to them.

Contents

| | |
|---|-----------|
| 1. Introduction and context..... | 1 |
| 1.1 Statement | 1 |
| 1.2 Background | 1 |
| 1.3 Future dialogue | 1 |
| 2. The regulatory process | 3 |
| 2.1 Overview | 3 |
| 2.2 A resume of regulation | 4 |
| 2.3 Alternative regulatory arrangements | 5 |
| 2.4 Scope of regulation..... | 5 |
| 3. Practical experiences in setting up regulation in a low-income environment..... | 9 |
| 3.1 The process of creating a new regulatory body | 9 |
| 3.2 Information management | 10 |
| 3.3 Relationship between regulator and operating company | 11 |
| 3.4 Regulatory pitfalls | 12 |
| 3.5 Strategic planning of water services | 14 |
| 3.6 Updating strategic plans | 14 |
| 4. Dialogue on regulation in low-income environments | 17 |
| 4.1 Regulatory aspects affecting all, including low-income customers..... | 17 |
| 4.2 Key questions for feedback..... | 18 |
| 5. Selection of past projects | 21 |
| 5.1 Data gathering | 21 |
| 5.2 Recurring themes | 22 |
| Appendix A: Selection of past projects | 23 |

1.

Introduction and context

1.1 Statement

This report by has examined a number of projects and drawn upon our experience of regulation and PSP in the water sector. We have attempted to detail the role of the regulator and identify recurring themes in relation to regulation and the poor. We do not attribute findings to any specific project or contract, and highlight the shortcomings not as criticisms, but in the interest of sharing of knowledge and improving services to the poor in the long run.

1.2 Background

This report is a continuation of reports entitled '*PSP Strategy and the poor*' in April 2000, which identified the principal stages of PSP involvement in the water sector, and examined the key themes in servicing the poor that arise at the planning stage. Another report '*Private Sector Participation and the Poor: 2 – Implementation*' looked at the procurement and implementation stages of PSP contracts, and identified the key themes and constraints faced in putting PSP arrangements into place. It discussed the ability to accommodate pro-poor issues in their work, contrasted water services with other sectors that have secured better access to the poor and identified the additional resources required to promote pro-poor issues.

This report is the third in this sequence and examines the regulation of water services with particular relevance to the poor. It therefore completes a set of three reports that together cover the three principal steps of planning, implementation and regulation of PSP water service delivery

1.3 Future Dialogue

The purpose of this report is to create a framework for future dialogue, as we believe it is essential for this project to include the views and experiences of a wider audience, in order to further the understanding of regulation and to benefit the poor.

Furthermore, unlike the stages for planning and developing strategy and procuring services through contract, the regulation of PSP arrangements has no fixed short-term delivery date. It is an on-going and evolving process and we structure this report to reflect this reality.

To promote the communication of ideas, this report includes a number of questions, firstly in Section 3 relating to practical experiences in setting up regulation in a low-income environment, but principally Section 5 where we set key questions for feedback.

2.

The regulatory process

2.1 Overview

This report is not intended to be a manual on water sector regulation but seeks to explain the relationship between the Regulator and the Utility in the context of issues concerning the poor. In this section we present a general background to regulation in the water sector and highlight some of the key challenges to be faced by governments and regulators when implementing private sector involvement in the water services. We make observations on aspects of the regulatory process, which can facilitate protection of poor and other vulnerable customers.

Regulation is a necessary component of any private sector participation in monopoly services as it aims to secure the proper performance of obligations (on all sides), fair play and protection of customers at large. Water customers comprise a wide spectrum of economic and social groups each with differing needs, expectations and financial circumstances. Poor and other vulnerable customers can represent a small proportion of the customer base yet warrant a disproportionately large amount of regulatory attention, if they are not marginalised.

The transition from public to private sector delivery in any service, fundamentally changes the role of government. Under public sector provision the Government acts as service provider, financier, custodian of assets and guardian of the public interest. Conversely with private provision Government necessarily distances itself from service delivery acting as standard setter, paymaster and supervisor of the contract(s) with the private sector which itself assumes Government's former role in service delivery plus making a profit.

This is a significant change in role for Government and full transition can take several years. Whilst Governments may be very capable of managing specific contracts for procurement of goods and services, developing to regulate long term operating contracts for providing essential services (with all the related financial, technical, environmental and social components) can be a steep learning curve. This has been amply demonstrated in the UK by many regulators including Ofwat. Several years have been needed to acquire sufficient information capability and legal capacity to effectively exert regulatory influence outside the central financial and service delivery areas. Thus, despite its high priority, achieving improvements in the delivery of social obligations and protecting vulnerable customers can take several years.

Understanding that acquiring this capacity and that changing government's role from provider to regulator takes several years before it becomes effective may hold a key as to why regulators have made little progress in promoting pro-poor measures in the early years.

Furthermore, with some exceptions, the driving forces behind private sector involvement in water services are invariably financial rather than social, especially where inward investment is needed and contracts are awarded on the basis of price. The PSP process generally seeks to maximise the degree of commitment (both financial and technical) of the private sector and an over zealous regulatory regime (even if it could be established within the time frame) could seriously undermine that commitment at a key stage.

2.2 A resumé of regulation

Common protection of customers' collective interests through government organised regulation of private companies is well established in the UK, early examples being crude controls on the profits and standards provided by toll road and subsequently the canal and railway companies. During the late 19th century there was a large increase in the number of private companies involved in the monopoly provision of essential public services such as water, gas and electricity. Excessive profits, declining standards and abuse of monopoly power stimulated regulatory intervention and established the key tenets of modern regulatory principles – customer protection, price controls and service standards.

Although regulation through controlling excessive profit and penalising poor performance evolved over the last hundred years, it has only relatively recently been developed to provide an incentive regime based on achievement selected output targets (rather than activity targets). Modern incentive-based regulation embraces pricing, service standards, future planning and long-term sustainability and combines incentives, penalties and periodic rebasing of the initial contract conditions (licence) at the request of either party. The regulatory framework may also include controlling abuse of monopoly power, unfair discrimination between customers and encouraging efficiency.

Underpinning regulatory effectiveness, (irrespective of the sector), ensures independence of action of the regulator and the absolute separation of the roles of service provider, regulator and political processes.

In the drive to attract the private sector the importance, and indeed the true value, of regulation can be underestimated when promoting PSP in the water sector. Whilst it is generally recognised that wide-ranging regulation is essential for the proper administration of a PSP contract, the early regulatory regime invariably focuses on price-sensitive contract deliverables such as investment activity, enforcing service standards and payments to the PSP company. Only when these fundamentals are satisfactorily in balance can regulatory attention turn to protection of poor and other vulnerable customers both in terms of standards and prices.

Regulation is therefore a codified process, enabled by a broad regulatory framework, which sets out the rules under which both service provider and regulator must operate.

This quasi-legal nature of regulation results in processes being open to scrutiny and challenge by all parties and constrains the regulator to act wholly within the capacity and authority given to him under the relevant legislation or contract provisions.

Unless the regulatory framework properly contemplates issues in relation to services to the poor and confers on the regulator authority for acting, it is unlikely that pro-poor policies can be implemented in the early stages of a PSP contract.

2.3 Alternative Regulatory Arrangements

There are two alternative routes to establishing regulatory processes for the first time. The first involves setting a single national regulator covering an entire sector with a multiplicity of private sector providers (as in Ofwat in UK), whilst the second involves creating separate regulators on a contract by contract basis (as in EtoSS in Buenos Aires). In either case the regulatory powers may be restricted to a specific service as Ofwat in UK or can extend to cross various utility sectors as in the Office of Regulator General in Melbourne, Australia.

In the Water Sector, the single national (or regional) regulator is appropriate where major changes are implemented and normally requires creating a dedicated regulatory office with effective institutional capacity. The process is enabled by legislation which ties existing laws with operating licences. Such national (or regional) regulation provides opportunities for ensuring universality and consistency of standards, comparisons between providers and for extensive customer involvement, in order to show how well utilities are meeting targets and levels that can be achieved. **This approach can be relatively inflexible and cumbersome for one-off PSP contracts that are frequently used in emerging economies.**

Conversely local regulation of individual contracts can be tailored to specific circumstances and is therefore more easily able to accommodate local needs and priorities. Whilst existing national legislation for say service standards or customer protection will prevail, the contract between Government (or municipality) and the private operator will define the respective obligations and regulatory mechanisms.. **While local regulation is comparatively easy to implement, it can result in greater focus on interpreting and applying contract terms rather than pursuing the wider regulatory principles.** Additionally the smaller scale of local regulatory operations can result in institutional constraints and insufficient attention being directed to secondary issues such as protecting vulnerable groups or the poor. Equally there is no way for a local regulator to compare performance on a like-for-like basis with other utilities. The operator commands all information on operational performance but this can be checked by independent auditors on behalf of the regulator.

2.4 Scope of Regulation

Regulation in the water sector is wide-ranging and covers all performance aspects of water services delivery. For each of the services provided, i.e. water supply (including water quality), wastewater (including environmental standards) and stormwater these include the following

- Setting or adjusting the allowed prices of services
- Monitoring performance in key areas and making interventions where necessary
- Representing customers and taking up grievances with service providers
- Assessing quality and environmental performance through monitoring and enforcement of standards
- Representing national interests in connection with setting appropriate and affordable standards of service and determining overall water strategy (which may cause a revision to the PSP)

The provision of water services impinges upon many other governmental activities – such as public health, social welfare, environment, and general economic development. In consequence and to facilitate good governance, governments may choose to combine regulation of several activities under a single umbrella. Such organization may regulate performance of all aspects of service provision in several sectors. This combining of regulatory responsibilities facilitates an integrated approach to setting standards and fosters a close linkage between performance standards and prices to customers across the board. By definition such regulatory arrangements require considerable institutional capacity but they can become cumbersome and bureaucratic especially if they are to exert pressure on utilities to meet the standards or implement tariff policies.

Equally governments may create individual regulators for separate sectors. In some cases regulatory separation exists even within a sector, for instance by separating regulation of environmental & health standards from regulation of prices, standards & performance. Whilst this approach may allow individual regulators to focus on their specific issues, in the water sector it risks the pursuit of high cost policies which are above customers' price expectations. Self- regulation in the public sector has led to many levels of service falling below the standards, but with no publicity.

Finally where PSP is adopted locally on an ad-hoc basis, for instance where individual municipalities or regions engage a private sector operator, regulation more closely resembles contract supervision than sector regulation. Such local regulators have to work within the ambit of other national regulators in relation to activities such as environmental protection, health or economic development. In these circumstances the utility may face regulation by several separate bodies and the nominated regulator under the PSP arrangement assumes the role more of a contract supervisor involved in performance monitoring, payment and price setting.

Because water sector PSP in emerging economies to date has largely been implemented on a local basis at municipal or regional level this latter arrangement is more common. Arguably it is less capable of dealing with more complex issues such as protecting poor customers than the single or cross-sector arrangements described earlier.

Irrespective of the regulatory arrangements, setting standards, prices and monitoring services to the poor would fall within the ambit of economic regulation. As far as services to the poor are concerned the scope of economic regulation includes:

- Tariff setting through periodic price reviews or triggered by significant changes,
- Performance monitoring including financial, operational and customer service issues,
- Payment of fees and incentives (or penalties) to the private company,
- Ensuring that the contractual provisions are met (including insurance, indemnities and guarantees),
- Taking regulatory actions in the event of performance failure including the settlement of disputes and termination in extremis,
- Monitoring service provision performance including expansion, new supplies, environmental compliance and issues relating to customer management or disconnection for non payment.

3.

Practical experiences in setting up regulations in a low-income environment

This Section identifies some of the key challenges faced by regulators (or contract supervisors) in setting up and administering PSP arrangements. It draws upon the consultants' practical experience in creating contract supervisors (regulators) under water sector PSP programmes in low-income environments. Most of the cases relate to concession or management contracts under which regulation is effected locally through a contract framework as opposed to national policy. We draw out some recurring messages from past projects and pose questions to a wider audience as to how the policy impinges on provision of services to the poor.

3.1 The Process of Creating a New Regulatory Body

The PSP contract typically becomes effective some two months or so after conclusion of negotiations and award and signature of the contract(s) with the operator. This is effectively the date which the operating contract commences. The regulator is required to be up and running. This time lag between completing negotiations and commencing operations is needed to legally establish and enable any joint ventures, to register the operating companies and to put in place the financial infrastructure for operations. Preparation and mobilisation of the private operator's staff and other technical resources also takes place at the same time. Similar preparation will take place in the public water utility and in the government office responsible for supervision (i.e. the regulator). **Depending upon the scope and scale of the PSP operations it is debatable whether two months is adequate.**

Question 1.

Is it realistic to expect the regulator to be created and mobilised within some two months? Are pro-poor issues left behind in the rush to get the PSP arrangements up and running?

By commencement, the regulator must be constitutionally established, legally enabled, adequately staffed and have sufficient capacity to effectively supervise the contract. The PSP arrangements require that most of the utility's functions (operations, maintenance and customer management), staff and statutory obligations associated with delivering water services become the responsibility of the private operator. Both transition and ongoing operations are necessarily complex. Equally creating and resourcing the contract supervisor (regulator) is correspondingly

demanding – particularly at inception. As a result the regulatory and institutional arrangements can vary widely between utilities.

A large part of the regulator’s responsibilities involve performance monitoring, payment certification and ensuring the proper development of the water services infrastructure (including extensions to provide services to low-income communities). The regulator therefore has an indirect responsibility for setting service standards and for ensuring financial sustainability through periodic tariff and performance target adjustments. In many cases these responsibilities may be jointly shared with other government bodies such as a water resources agency or planning agency who have a wider water sector planning remit. **Whilst there is no “typical” institutional relationship world-wide, it is common for the overall regulatory functions to be split between several bodies.**

Question 2.

Do the poor need a separate regulatory institution to provide customer representation, or should they remain included within the overall regulatory function?

3.2 Information Management

Initially, as a result of the successful bidder’s due diligence at tender stage and open access to planning and operational records, the operator will command considerably more information about the technical and commercial performance of the water services systems than the regulator. It takes time for the regulator to collect sufficient information to be on a level footing. **This initial imbalance (known as “Information Asymmetry”) arises from the following reasons, and is widespread in all emerging regulatory regimes and therefore can be more detrimental in low-income environments:**

- it can take two or three years to plan and implement performance improvements through investment or strengthened operations. The implementation period can be much longer where the service standards are abysmal or where assets are run down.
- the skills available to the regulator can be less experienced in regulatory process than those of the operator (with experience in similar contracts elsewhere) which can reduce the regulatory impact.
- the onus for data gathering and reporting rests with the operator whilst the regulator is confined to requesting and reviewing reports to inform regulatory action.
- the regulator can assess performance only at macro level, whilst the operator has access to management and commercial information for local areas.
- there is little consistent cost and performance data in low-income environments for use as a yardstick against which to set standards or assess the performance. Historic data from the former public utility will likely have doubtful reliability

whilst external comparisons with peer utilities of similar size are questionable. Global benchmarking data may be used for comparing past performance but such comparisons can be statistically flawed and all situations are different.

The consultants' experience of similar emergent regulatory regimes worldwide, suggest that it could take at least five years for newly created regulators to acquire sufficient robust information to make a significant impact on performance or outcomes.

The problem of information asymmetry initially hampered regulatory effectiveness following water privatisation in UK in 1989 where it took some ten years of regulatory monitoring together with several political initiatives to effectively exert regulatory pressure on the private companies. The balance has moved significantly in favour of the regulator with the successful implementation of a rigorous price determination in 1999.

Question 3.

How can robust information on services for the poor be collected more expediently to reduce 'information asymmetry' and improve regulation effectiveness?

Private sector involvement in water services is growing rapidly in many low-income environments with many water sector PSP projects under consideration in Africa, Asia and Latin America. From the regulatory perspective, African Development Bank in association with DfID established a pan-African utility performance benchmarking project. We suggest that there could be merit in new regulators in Africa (and in other regions) accessing information from that project and developing a forum for sharing experiences on cost and performance information for water services in the region. If this proves valuable there may be merit in adopting similar projects in other regions. **We would caution however that using comparative data to contrast performance between similar organisations could have limited value in establishing targets for out-performance.** The unambiguous and consistent preparation of data is not simple and may be subject to interpretation.

Question 4.

How can best practice on pro-poor regulatory policies be shared throughout different regions?

3.3 Relationship between regulator and operating company

It is widely accepted that effective regulation is essential in order to successfully extract the full benefits of private sector participation in delivering water services. This requires a clear delineation of roles and responsibilities of customers, regulator and the private operator with transparent relationships between the parties.

Establishing this relationship in an even-handed manner whilst preserving independence and ensuring fairness to all parties can pose a particular challenge for regulator. This challenge is heightened where regulation concerns a small number of single sector providers. Notably contract supervisors (as regulators of single operators) can be open to criticism from one party or another for bias.

An effective working relationship, albeit within strict limits of contractual responsibility and legal authority, depends on trust and understanding between individual personalities on opposite sides of the fence. Regulators as governmental bodies are publicly accountable and must conform to constitutional standards. Successful regulation seeks balanced outcomes including protection of customers at large. It is not in the customers' interests for private operators to be under-funded and therefore unable to perform properly.

Question 5.

How can community groups and NGOs use their voice to promote these effective working relations to the benefit of the poor?

3.4 Regulatory Pitfalls

The consultants have identified the following regulatory pitfalls where relationships between the water services provider and the contract supervisor (or regulator) have been too comfortable, are poor, or have broken down:

- **By-passing the Regulator:** On a concession in Latin America the private concessionaire has bypassed the regulator on a number of key issues in order to deal directly with government. The credibility of the regulator has been undermined bringing into question the effectiveness of the regulatory mechanisms.
- **Distrust of foreign private management:** A management contract in the Caribbean was frustrated due to antagonism amongst members of the supervising board to the presence of a foreign private manager. The board was obstructive, and this impaired the ability of the manager to perform, leading to the ultimate early termination of the contract.
- **Lack of Finance:** One PSP arrangement failed because the promised donor funding did not materialise due to macro-economic circumstances. This meant that the operator was unable to implement the investment programme and hence deliver the agreed performance improvements.
- **Failure of the State to fulfil its obligations:** The operator appointed for a PSP contract in Africa was unable to deliver the agreed performance improvements because the State-owned asset holding company failed to deliver its contractual commitment to fund the renewal of major plant. This resulted in financial stress to the operator.
- **Ineffective relationship between Regulator and Government or Utility (regulatory capture):** Where a regulator's sphere of activity is confined to a

single supplier, or where external pressure and accountability is absent, a regulator can become over-familiar with the interests of one party or another. With the commercial advantage weighed towards the operator, the regulator can, by stealth, become dependent upon the operator for information which may result in a perceived cosy relationship between regulator and regulated. Such a situation can arise for instance where there is a split between the organisation responsible for providing bulk water (under government ownership) and that responsible for distribution to consumers (under PSP). An example of such an arrangement existed in southern Africa where the private distribution operator depended upon bulk supplies from several state owned water boards. Although these boards were in effect governmental, in reality they operated autonomously with little regulatory pressure and as effective monopolies with a free hand in setting tariffs and standards. This undermined the performance of the PSP operator. Similarly in Eastern Europe municipality based regulators have been criticised in audit for procedural failings.

- **Micro management:** There are examples where the regulatory/supervisory body has become too closely involved in day-to-day management of the utility rather than focusing on key strategic issues such as service provision to low-income groups. This can introduce considerable additional bureaucracy for the operator and hampers both the operator's progress and regulatory process. Furthermore, by blurring the role of "provider" and "client", the "regulator" may reduce its ability to enforce the contract.
- **Political interference:** There is an inherent danger that political imperatives, for instance price pressures, conflict with the principles of good regulation founded on proper process. In one example political pressure was placed on a concessionaire to serve areas which are not financially viable, without initially allowing tariff adjustments and cross subsidisation from other customers. In UK political imperatives have prevailed on several occasions by imposing one-off windfall taxes on profits, or encouraging the regulator to zealously pursue price reduction against the longer term sustainability interests of the water sector.

Question 6.

Given the range and severity of potential pitfalls, can the regulator prevent external influences from damaging initiatives on pro-poor services?

In practice however, a pragmatic balance has to be struck between the various pressures. In the early days of a PSP regime the regulator invariably focuses on the following key issues:

- establishing a professional working relationship with the private operator and a mutual understanding of the sector issues whilst striking a balance between antagonism and an over-comfortable relationship.

- adhering to the legal and contractual powers and responsibilities described in the law, licence or contract, but focusing at all times on key issues that affect customers or potential future customers.
- establishing numerical bases for determining whether levels of service are improving or getting worse.
- periodically reviewing and updating the operator’s plan to ensure that it is continually relevant – especially in relation to connections, expansion and provision of new services (including those to low-income customers).

Question 7.

How can the poor feature more prominently in the professional’s list of “key issues”?

3.5 Strategic Planning of Water Services

In theory, the process of implementing PSP provides an opportunity for strategic planning of water services, indeed a base-line strategic plan is needed to define the operator’s performance and the monitoring arrangements. **However the consultants’ experience in PSP in low-income environments suggests this is not always effective. Historically, there can be insufficient data and a lack of expertise for realistic planning which together with entrenched attitudes, can prefer crisis management to properly based strategic planning.** As a result the base-line plans upon which contracts can be founded are frequently ill-informed or subject to so many caveats that they are deemed unreliable. Although revised plans by the PSP operator can be given priority, such planning may lose a year.

Question 8.

Is the current vogue for pro-poor policies in water sector PSP simply a legacy of inadequate and inappropriate planning in the past?

3.6 Updating Strategic Plans

A further difficulty in strategic planning of water services is that strategic plans can rapidly get out of date due to material changes in supply and/or demand, in demographics, service standards or operating cost. **As a result it is generally accepted that rolling plans are needed with major update every three to five years.**

This creates particular difficulties for regulators, as each revised plan has a cost and tariff implication requiring regulatory (and occasionally political) approval. Experience indicates that tariff negotiations present the greatest potential for political interference and disputes between the parties and can distract from issues such as service provision to low-income customers.

Key regulatory issues to be addressed in approving updated strategic plans and periodically reviewing tariffs include:

- achieving a financial balance between inflow and outflow of funds including loans & revenues and capex, opex, operator fees, incentive payments, dividends and profit repatriation.
- the amount of funding available from external sources
- striking a balance between price increases and service enhancements or expansion
- setting achievable efficiency improvement targets over the period
- setting standards and establishing the cost impact of service enhancements

In assessing and approving updated strategic plans, the regulator may need to recognise and adjust for the tendency of operators to seek gold-plated, fail-safe solutions at higher cost (and higher reliability) in preference to lower cost (and higher risk) alternatives. Unless corrected in the regulatory process, this tendency can overstate prices and hence the tariff impact and systemically cause regulators to lower their horizons for service enhancements or expansion of services to low-income areas.

Question 9.

How can a tendency for gold-plated, fail-safe solutions be stopped? How can a lowering of expectation in expanding services to the poor be avoided?

4.

Dialogue on regulation in low-income environments

In Section 2 we outlined the general regulatory principles and noted how institutional and information constraints, together with an early focus on achieving a balanced approach to driving water sector strategy, can distract regulatory attention from improving service provision in low-income areas. In Section 3.4 we identified specific examples where regulatory effectiveness has been less than desirable. In this section we seek feedback from a global readership on how regulatory effectiveness can be improved and better serve the interests of low-income areas.

4.1 Regulatory aspects affecting all, including low-income customers

We identify below the key regulatory functions that have an impact on customers in low-income areas. Against each we have noted particular issues for regulators in relation to their duties of promoting improvement in water services to low-income customers.

4.1.1 Planning

- participating in and providing information to other government agencies to develop water policy relating to coverage and standards of service in low-income areas
- negotiating and agreeing with the regulated utility, appropriate service levels and improvement priorities for services to low-income areas
- developing a reporting regime for assessing the regulated utility's progress against agreed targets
- promoting competition and issuing licences to new entrants or secondary providers
- periodically agreeing medium term outputs, funding and tariffs with the regulated utility

4.1.2 Enforcement

- monitoring the regulated utility's performance against agreed targets

- invoking regulatory actions in the event of performance failure
- applying incentive and penalty mechanisms to reflect the regulated utility's progress in achieving targets
- liaison with other government agencies and supporting other initiatives for improving services to low-income areas

4.1.3 Consultation

- liaison with customers, including those in low-income areas to assess service levels and priorities for implementing improvements
- consultation with customers in low-income areas as to whether standards reflect their needs and preferences
- consultation with customers generally over whether current standards are adequately defined and appropriately measured
- consultation over tariffs and whether prices reflect service levels and services delivered

4.1.4 Customer representation

- promoting the interests of customers in low-income areas
- settling disputes between customers and the regulated utility
- protecting customers by setting prices appropriate to service levels and services delivered

4.2 Key questions for feedback

- For each of the identified key regulation activities impacting on customers in low-income areas we seek dialogue and feedback from practitioners as follows:

4.2.1 Planning

- a) do existing national or regional policies relating to service standards, coverage and access in low-income areas exist and if so are these appropriate?
- b) are the service standards, targets and priorities stated in the initial PSP contract:
 - realistic?
 - achievable?
 - sufficiently well defined?
- c) should any additional standards of service or indicators of performance be developed?
- d) do the reporting arrangements provided by the regulatory regime adequately inform the regulator in terms of:
 - progress against targets?
 - customer satisfaction?

- costs and benefits to customers?
- e) do market mechanisms and the licensing of new entrants as secondary providers:
- achieve their objective by improving service provision in low-income areas?
 - increase choice to customers in low-income areas?
 - create uncertainty for the regulated water utility and reduce its commitment to improving service or coverage to low-income areas?
 - provide an opportunity for community involvement?
 - achieve expectations and attract sufficient new entrants?
- f) should secondary providers be subject to the same degree of regulation and meet the same quality standards as the regulated utility?
- g) do periodic price reviews and agreement of medium-term development plans:
- provide an opportunity to fundamentally revise any shortcomings in the original PSP contract?
 - provide a realistic mechanism for re-basing the contract in terms of improving services to low-income areas?
 - address the key issues?

4.2.2 Enforcement

- a) do progress reports from the utility to the regulator realistically represent the position in the field?
- b) are the contract targets for the regulated utility relevant and achievable
- c) can actual (or the threat of) regulatory action against the utility realistically provide an impetus to improve performance if progress is bad
- d) in connection with using incentives and penalties to stimulate progress:
- is there an adequate basis on which to levy penalties or award incentives?
 - is there an optimal balance between the two?
 - how large should the incentives and penalties be in relation to total cost?
 - should incentive payments be funded from revenues or externally?
- e) can the regulator collaborate with other government agencies (e.g. housing or environment) to stimulate service improvement to low-income areas.

4.2.3 Consultation

- a) are there adequate mechanisms for regulators to communicate with customers generally?
- b) are the mechanisms for customers in low-income areas adequate for them to collectively communicate with regulators?
- c) are customers generally (especially those in low-income areas) sufficiently informed of the technical, legal and financial processes to be able to effectively participate in a consultation process?
- d) when consulting customers over future choices, can the regulator provide them with sufficient financial and technical information for them to provide positive input relating to:
- service levels?
 - tariff levels and structures?

4.2.4 Customer representation

- a) is the regulatory framework readily accessible to customers in low-income areas?
- b) does the regulator have adequate authority and institutional capacity to cope with representation from smaller groups (or is he pre-occupied with key contractual issues?)
- c) what pressures can customers in low-income areas exert upon the regulator if he fails to adequately represent their interests?

- d) are the formal regulatory processes appropriate to settlement of customer disputes in low-income areas or is a more informal approach more likely to be effective?
- e) where the regulators have secured special arrangements for customers in low-income areas, what commitments can customers give to honour the agreement?

5.

Selection of past projects

5.1 Data gathering

In order to gather more evidence on regulation and the poor we examined a number of past projects in order to note any recurring themes relating to serving the poor.

This search drew upon information available to Halcrow but was not as widespread as it might have been. This may in part be due to consultants' work mainly representing regulatory intentions, rather than actual regulatory practice. However, it is hoped that with future participation, insights of differing regulation practice can be sought to further this data gathering.

Additionally, acquiring the full body of knowledge on regulatory practice takes times to develop, as unlike the PSP strategy and PSP implementation stages, regulation has no fixed short-term completion point, but is an on-going entity.

Nevertheless, the occurrence of some basic regulatory themes is represented in the table below, and the complete research is contained in Annex A. Our sample is not statistically representative, and will benefit from being opened to a wider forum to allow greater participation and views from different perspectives.

Regulation and the poor – Summary of recurring themes

| No | Project | Is the regulator independent? | Is regulation fixed to the terms of the PSP Contract? | Is their flexibility for pro-poor regulation? | How is information gathered for those without a supply? | What authority does the regulator have for pro-poor issues? |
|----|--|-------------------------------|---|---|---|---|
| 1 | Buenos Aires Water and Sewerage Concession | ✓ | ✓ | - | part of 30 year programme | needs govt. support |
| 2 | Guyana – water and sanitation sector study | ✓ | ✓ | not yet in place | not yet in place | not yet in place |
| 3 | Nigeria Water : PSP Options Study | ✗ | - | - | - | - |
| 4 | Greater Negombo water sector PSP | | ✓ | | work on-going – not yet defined | |

| No | Project | Is the regulator independent? | Is regulation fixed to the terms of the PSP Contract? | Is their flexibility for pro-poor regulation? | How is information gathered for those without a supply? | What authority does the regulator have for pro-poor issues? |
|----|--|-------------------------------|---|---|---|---|
| 5 | Astana Water and Environment Development Project Zaparozhzhia Municipal Water Service Development, Ukraine Rostov-on-Don Strategic Plan, Russia Chisinau Water and Wastewater Rehabilitation Project, Moldova Ukraine Municipal Utilities Development Programme, Ukraine | ✓ | ✘ | Probably not | Via elected representatives | Can limit charges to poor households |

Legend

✓ = Yes

✘ = No

- = Uncertain / not defined

Appendix A – Selection of past projects

| | |
|--|---|
| Name of Project: | <i>Buenos Aires Water and Sewerage Concession</i> |
| Date: | 1994 |
| Description of Halcrow Commission: | <i>Advise on the award of the concession with particular reference to the regulatory framework of the concession</i> |
| Theme 1: Who is the Regulator? Is it independent? What is the (regulatory) financing structure? | EToSS (consists of about 5 individuals) Yes – in theory 30 year concession – concessionaire has to fund OPEX and CAPEX and gets revenue directly from customers on the basis of its original “bid” and allowance for tariff increases as laid down in the regulatory framework. |
| Theme 2: Is Regulation fixed to the terms of the PSP Contract? Is there flexibility for the Regulator to be pro-active in promoting new services to the poor? | Yes Yes – but there is no explicit arrangement for this in the contract so it would have to be negotiated with the concessionaire and could/would need a tariff revision. Expansion into “barrios marginales” – poor areas - has already happened. |
| Theme 3: How does the Regulator gather information / stay in touch with people? For existing customers? For those without a supply? | similar to the Ofwat approach in the UK There exists a 30 year programme which allows for expansion into new (usually poor areas) but we do not have the information to hand |
| Theme 4: What authority does the Regulator have to act on pro-poor issues? | Without the tacit support of the Government it is unlikely that the Regulator would be able to act in a pro-poor manner |

| | |
|--|---|
| Name of Project: | Guyana – water and sanitation sector study |
| Date: | 1999 - ONGOING |
| Description of Halcrow Commission: | 1 Advise on setting up a National Water Policy for Guyana 2 Advise on regulatory framework for the new Potable Water and Sewerage utility (Management contract) |
| Theme 1: Who is the Regulator? Is it independent? What is the (regulatory) financing structure? | Public Utilities Commission Yes – in theory The Utility presently runs at a substantial loss , indeed DFID/World Bank/IDB have offered financial assistance for transition period to “full cost recovery”. Contract has yet to be let. The key however will be a management contract under a Regulatory Framework which is currently being finalised. |
| Theme 2: Is Regulation fixed to the terms of the PSP Contract? Is there flexibility for the Regulator to be pro-active in promoting new services to the poor? | Regulation will be fixed to the terms of the Contract.. A major part of Halcrow’s studies to date have included how best to supply services to the poorer people – particularly in the hinterland which takes up about 80% of the country. The chosen “solution” will no doubt take this into account. How much flexibility the Regulator will have later will depend on the final “contract” |
| Theme 3: How does the Regulator gather information / stay in touch with people? i. For existing customers? ii. For those without a supply? | N/A yet as regulator not yet in place |
| Theme 4: What authority does the Regulator have to act on pro-poor issues? | N/A yet as regulator not yet in place |
| Any other comments: | None |

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|--|---|
| Name of Project: | Nigeria Water: PSP Options Study |
| Date: | 1997 |
| Description of Halcrow Commission: | Advise Federal Ministry on PSP options for the Nigerian water sector, based on a sample of 6 state water agencies. |
| Theme 1: Who is the Regulator? Is it independent? What is the (regulatory) financing structure? | The Federal Ministry of Water Resources and Rural Development has overall responsibility for regulation of the water sector, although the individual state/local governments had the real control over how their Agency was operated. A great deal of political interference is prevalent in the Nigerian water sector, so there is little chance for independence. As the water agencies do not collect a great deal of revenue from customers, they are entirely reliant on local govt grants |
| Theme 2: Is Regulation fixed to the terms of the PSP Contract? Is there flexibility for the Regulator to be pro-active in promoting new services to the poor? | To the best of our knowledge there are as yet no contracts in place. The process is most advanced in Lagos but it is not yet finalised. |
| Theme 3: How does the Regulator gather information / stay in touch with people? <ul style="list-style-type: none"> ▪ For existing customers? ▪ For those without a supply? | Through the State Govt/Administrator (Military in 1997) although it was those customers with the greatest political clout who had the greatest influence on the Ministry. The Halcrow team saw evidence of wells being sunk in the middle of nowhere (but near politicians properties/village), when whole townships were going without. |
| Theme 4: What authority does the Regulator have to act on pro-poor issues? | Pro-poor issues would apparently only be addressed when it was politically expedient to do so. |
| Any other comments: | None. |

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|--|--|
| Name of Project: | Greater Negombo water sector PSP |
| Date: | 2000 - ongoing |
| Description of Halcrow Commission: | Lead consultant to assist in the preparation for and implementation of PSP in Greater Negombo. |
| Theme 1: Who is the Regulator? Is it independent? What is the (regulatory) financing structure? | <p>The Regulator has yet to be established, the Water Services Regulatory Commission Act has however been drafted. Calls for the establishment of a body to be responsible for “.....regulation of tariffs, standards and consumer protection”. New Regulator will regulate the whole of the Sri Lankan water industry.</p> <p>The President will appoint the three individuals who will act as regulators based on nominations from the Public Service and Judicial Services Commissions.</p> <p>The proposed structure will be financed by customers, such a regulatory charge will be identified on customers’ bills.</p> |
| Theme 2: Is Regulation fixed to the terms of the PSP Contract? Is there flexibility for the Regulator to be pro-active in promoting new services to the poor? | It is expected that any PSP contract will be signed before the regulatory framework is up and running. In this interim period it has been proposed that the Operator will be regulated through the PSP Contract. This decision has yet to be finalised however and details are patchy. |
| Theme 3: How does the Regulator gather information / stay in touch with people? i. For existing customers? ii. For those without a supply? | Yet to be decided |
| Theme 4: What authority does the Regulator have to act on pro-poor issues? | Yet to be decided |
| Any other comments: | None |

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|--|---|
| Name of Project: | Astana Water Supply and Environmental Infrastructure Development Promect. Funded by TACIS for EBRD. |
| Date: | 1999/2000 |
| Description of Halcrow Commission: | Strategic plan, priority and medium-term investment plans, identification of PSP options, definition of a management contract concept.. |
| Theme 1: Who is the Regulator? Is it independent? What is the (regulatory) financing structure? | Municipal anti-monopolies committee Independent of the utility |
| Theme 2: Is Regulation fixed to the terms of the PSP Contract? Is there flexibility for the Regulator to be pro-active in promoting new servcies to the poor? | No Probably not |
| Theme 3: How does the Regulator gather information / stay in touch with people? ▪ For existing customers? ▪ For those without a supply? | Utility operational and accounting data supplied with applications for tariff adjustments. Standard economic indices and statistics. Theoretically through elected representatives |
| Theme 4: What authority does the Regulator have to act on pro-poor issues? | Presidential decrees etc limiting total utility service charges in terms of household income. |
| Any other comments: | None |

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| Name of Project: | Zaparozhzhia Municipal Water Service Development and Investment Programme, Ukraine. Client EBRD. |
| Date: | 1999/2001 |
| Description of Halcrow Commission: | Sub-consultant to C Lotti & Associati providing specialist input on institutional and organisational re-structuring for a corporate partnership. |
| Theme 1: Who is the Regulator? Is it independent? What is the (regulatory) financing structure? | Tariff committee of the regional (Oblast) administration Independent of the utility |
| Theme 2: Is Regulation fixed to the terms of the PSP Contract? Is there flexibility for the Regulator to be pro-active in promoting new services to the poor? | No Probably not |
| Theme 3: How does the Regulator gather information / stay in touch with people? ▪ For existing customers? ▪ For those without a supply? | Utility operational and accounting data supplied with applications for tariff adjustments. Standard economic indices and statistics. Theoretically through elected representatives |
| Theme 4: What authority does the Regulator have to act on pro-poor issues? | Presidential decrees etc limiting total utility service charges in terms of household income. |
| Any other comments: | None |

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|--|--|
| Name of Project: | Rostov-on-Don Strategic Plan, Russia. Funded by DFID and associated with other World Bank projects. |
| Date: | 2001 |
| Description of Halcrow Commission: | Strategic plan, priority and medium-term investment plans, consideration of PSP options. |
| Theme 1: Who is the Regulator? Is it independent? What is the (regulatory) financing structure? | Tariff committee of the regional (Oblast) administration Independent of the utility |
| Theme 2: Is Regulation fixed to the terms of the PSP Contract? Is there flexibility for the Regulator to be pro-active in promoting new services to the poor? | No Probably not |
| Theme 3: How does the Regulator gather information / stay in touch with people? ▪ For existing customers? ▪ For those without a supply? | Utility operational and accounting data supplied with applications for tariff adjustments.. Standard economic indices and statistics. Theoretically through elected representatives |
| Theme 4: What authority does the Regulator have to act on pro-poor issues? | Presidential decrees etc limiting total utility service charges in terms of household income. |
| Any other comments: | None |

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|---|---|
| Name of Project: | Chisinau Water and Wastewater Rehabilitation Project, Moldova. Client EBRD. |
| Date: | 1997/98 |
| Description of Halcrow Commission: | Sub-consultant to C Lotti & Associati providing specialist input on institutional and organisational re-structuring for a corporate partnership |
| Theme 1: Who is the Regulator? Is it independent? What is the (regulatory) financing structure? | Municipality (subject to central government controls and approvals). No. |
| Theme 2: Is Regulation fixed to the terms of the PSP Contract? Is there flexibility for the Regulator to be pro-active in promoting new services to the poor? | No Probably not. |
| Theme 3: How does the Regulator gather information / stay in touch with people? <ul style="list-style-type: none"> ▪ For existing customers? ▪ For those without a supply? | Utility operational and accounting data supplied with applications for tariff adjustments. Standard economic indices and statistics. Theoretically through elected representatives |
| Theme 4: What authority does the Regulator have to act on pro-poor issues? | Presidential decrees etc limiting total utility service charges in terms of household income. |
| Any other comments: | None |

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|--|--|
| Name of Project: | Ukraine Municipal Utilities Development Programme, Ukraine. Funded by DFID for EBRD. |
| Date: | 2000/01 |
| Description of Halcrow Commission: | Promotion and development of management contract concept. |
| Theme 1: Who is the Regulator? Is it independent? What is the (regulatory) financing structure? | Tariff committee of the regional (oblast) administration Independent of the utility |
| Theme 2: Is Regulation fixed to the terms of the PSP Contract? Is there flexibility for the Regulator to be pro-active in promoting new services to the poor? | No Probably not |
| Theme 3: How does the Regulator gather information / stay in touch with people? ▪ For existing customers? ▪ For those without a supply? | Utility operational and accounting data supplied with applications for tariff adjustments.. Standard economic indices and statistics. Theoretically through elected representatives |
| Theme 4: What authority does the Regulator have to act on pro-poor issues? | Presidential decrees etc limiting total utility service charges in terms of household income. |
| Any other comments: | None |

