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Utility Regulators—Decisionmaking Structures, Resources, and Start-up Strategy

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Governments creating specialized regulatory agencies must make decisions on a wide range of issues. Questions relating to the independence and responsibilities of such agencies are considered in two companion Notes.[1] This Note focuses on a third set of issues, relating to decisionmaking structures, resources, and start-up strategy. Like the other two Notes, it emphasizes the situation of developing countries.

Decisionmaking structure

The design of an agency's decisionmaking structure encompasses issues relating to the number of decisionmakers, the basis for selecting them, the roles accorded to stakeholders, and the regulatory and appeals processes.

TABLE 1 DECISIONMAKING STRUCTURES—INDIVIDUAL VERSUS COMMISSION
Strengths and weaknesses

Characteristic	Individual	Commission
Speed of decisionmaking	☑	☐
Accountability for decisions	☑	☐
Resource demands	☑	☐
Predictability of decisions	☑	☐
Invulnerability to individual preoccupations	☐	☑
Invulnerability to improper influences	☐	☑
Potential to reflect multiple perspectives	☐	☑
Potential to stagger terms to enhance stability and weaken links with particular governments	☐	☑

Note: The √ indicates which structure is stronger on each characteristic.

Number of decisionmakers

Many countries entrust decisionmaking authority to a commission or board of three to five members; others prefer a single individual. Each approach has its strengths and weaknesses, and the choice often depends on a country's traditions and conditions (table 1). Agencies responsible for several industries usually choose a commission.

Selection of regulators

When agencies are to be independent, the goal should be to select regulators with the personal qualities needed to exercise independent judgment and resist improper pressures or inducements. The selection is critical, particularly for new agencies that have yet to establish a reputation for competence and reliability.

Qualifications and disqualifications for appointment are usually set out in the law establishing the agency. Disqualifying factors generally include having a financial interest in regulated firms, which creates a conflict of interest and, in some countries, being related to the president or ministers. A common qualification required is significant experience or training in economics, finance, law, public administration, or industry.

It is sometimes suggested that some or all appointees should have industry-specific technical expertise or long experience in the regulated industry. But this requirement is unnecessary and in some cases undesirable. It is unnecessary because such technical expertise will be available from agency staff or consultants. It is undesirable if it ends up excluding professionals

with broader perspectives relevant to economic regulation or if it unduly restricts the pool of candidates. It is particularly inappropriate for multi-industry regulators, because requiring expertise in each industry be represented on the commission could crowd out appointees with broader perspectives. It could also result in the expert for each industry becoming the de facto regulator for that industry and thus the loss of the potential benefits of a commission approach.

Another view is that the decisionmaking body should be composed of representatives of consumers and regulated firms rather than technical experts. Although it is important for stakeholders to participate in the regulatory process, there are several reasons why including them on the decisionmaking body is inadvisable:

- In most industries, attempting to identify single representatives of consumers and the industry is not feasible. Residential, industrial, and rural consumers all have different and sometimes conflicting interests, and interests are likely to vary within these groups across regions or income classes. Regulated firms can also have different and sometimes conflicting interests in regulatory decisions. So, a representative approach can result in pressures to create very large decisionmaking bodies, which would increase delays and reduce individual accountability.
- Decisions of representative bodies hinge on their composition and voting rules. If the composition and voting rules favor one interest over another, decisions can be expected to be biased accordingly. If the interests of consumers and utilities are equally balanced, and the casting vote is left to a representative of the government, short-term political considerations can be expected to dominate regulatory decisionmaking.
- Representative bodies internalize bargaining and the exchange of concessions between interests, at the expense of a more open and transparent evaluation of competing social interests.

The executive branch usually plays the dominant role in the appointment process, but the legislature often also has a role, such as in confirming appointments. Involving both branches of government is especially important in systems in which the executive does not necessarily control the legislature; it provides a check against partisan appointments and helps to legitimize regulators' authority.

Stakeholders' roles

To ensure that a regulatory agency makes decisions that are well informed and accepted as fair and legitimate, consumers, regulated firms and other stakeholders must have the opportunity to present their views. For the reasons noted above, their participation in the decisionmaking body is inadvisable. But there are several other options.

Open regulatory processes. Those with a significant interest in a regulatory decision are usually permitted to present their views to the agency before the decision is made. In the United States, the process for doing so is usually formal hearings, often criticized for being too legalistic, costly, and slow. Regulators in the United Kingdom initially adopted much more informal processes, but the trend now is toward greater formality. Countries such as Argentina and Bolivia are experimenting with open processes that more closely reflect local traditions.

Consultative or advisory bodies. Some countries have created special consultative or advisory bodies, usually organized on an industry-specific basis, to advise the regulator and other public authorities. These bodies are usually part-time and composed of representatives of consumers, utilities, and industry experts. Special consumer councils can be especially important in countries that lack effective advocacy of consumer interests.

Regulatory process

Decisionmaking processes range from formal hearings, as in the United States, to more informal processes, such as those in the United Kingdom. Wherever the balance is struck, the

focus should be on transparency in decision-making, which reduces opportunities for improper influences and underscores the fairness and legitimacy of decisions.

The regulatory process usually involves three main steps: providing people with an interest in a decision opportunity to present their views, publishing the decision and the detailed reasons for reaching that decision, and providing stakeholders an opportunity to challenge the decision through an appeals process.

The appeals process is important to ensure that the regulator does not stray from its mandate and that it remains accountable. Two closely related issues need to be considered in designing an appeals process.

Appellate body. If the regulatory agency is to be independent, the appellate body should also be independent. In most countries, appeals of regulatory decisions go straight to the courts. But, in some countries, there is an intermediate step in which appeals go to a body that is expected to have more technical expertise than the courts and that may also be able to respond more quickly. In the United Kingdom, for example, the antitrust agency hears appeals relating to license amendments. In Bolivia, a special superintendency hears appeals from sector regulators.

Grounds of appeal. The grounds of appeal are usually limited to errors of fact or of law, including failure to follow a required process. Appellate bodies are generally not permitted to reconsider the merits of the decision and substitute their own judgment.

Resources

An agency's effectiveness is determined largely by the adequacy of its resources, both human and financial.

Human resources

Utility regulation requires personnel with a mix of skills in such fields as economics, finance, law, and engineering, and the character and integrity to resist improper pressures and inducements. People with these attributes are scarce in many reforming countries, and those who do have them will often receive attractive job offers from privatized utilities. So, to attract and retain well-qualified staff often requires exempting agency staff from restrictive civil service salary rules.

There is no magic formula for determining the number of staff required by an agency. It all depends on the responsibilities of the agency, the climate in which it must discharge those responsibilities, and its strategies for performing those tasks. In the United States, staff size ranges from less than 40 in the public utilities commissions responsible for multiple industries in the smaller states to more than 1,000 in the Federal Energy Regulatory Commission. As a general proposition, "small is beautiful." Overstaffing can dilute an agency's professional focus and increase the direct costs of regulation. It can also increase the indirect costs of regulation if staff make unnecessary demands on utilities to justify their jobs. For these reasons, a sound general principle is to keep the permanent agency staff as small as possible, engaging consultants to assist with specialized tasks.

Regulatory agencies increasingly contract out tasks to private firms or consultants, such as the analytical work underpinning tariff adjustment and similar decisions and the compliance audits of regulated firms. But the agency must retain—and be seen to retain—responsibility for its decisions, to avoid undermining the legitimacy of its actions. It must also ensure that the contractor is not subject to improper influences or inducements from regulated firms or other sources.

Funding

Regulatory tasks, like other government functions, were traditionally funded from general tax revenues. Now, most regulatory agencies obtain their income from levies on consumers. These levies may be charged to consumers di-

rectly, but are more often collected indirectly by imposing a levy or license fee on regulated firms and allowing them to pass the cost on to consumers through tariffs. In OECD countries, this approach is usually seen as part of a cost-recovery strategy: it reduces demands on general tax revenue and imposes the financial costs of regulation on the primary beneficiaries (consumers). In many developing and transition economies, by contrast, earmarked funding is often viewed primarily as a means of ensuring that agencies have a reliable source of income and thus as a safeguard of agency independence.

To prevent levies from becoming too burdensome, the law establishing the agency usually sets a cap on levies, often defined by reference to industry turnover or some other indicator. The cap is 0.5 percent for telecommunications regulators in Argentina, Peru, and Venezuela; 1.0 percent for the energy regulator in Colombia; and 2.0 percent for the water regulator in Peru. The cap establishes the maximum levy, and actual levies are set each year to cover a budget approved by the legislature. When an agency is responsible for more than one industry, a different levy is usually set for each industry that covers the costs of its own regulation and contributes to costs shared across industries.

Start-up strategy

Utility regulators should be established as long before privatization as possible, even if their formal powers do not come into effect immediately. This allows regulators time to familiarize themselves with their new responsibilities, to establish their offices, and to undertake any necessary training. It also provides assurance to consumers that their interests will be protected after privatization and gives potential investors an opportunity to assess the regulatory system before formulating proposals.

Most new regulatory agencies can expect a challenging infancy. Besides mastering complex technical issues, regulators must define new and often difficult working relationships with political authorities, regulated firms, consumers, and other stakeholders. In countries in which the requisite skills are scarce, regulatory experience is limited, and there is little tradition of independent public institutions, the challenges can be daunting. And life is not made easier for a regulator if privatization remains politically contentious and if the first public evidence of its effects is a price increase allowed by the regulator.

To meet these challenges, regulators must have adequate training—not only in such traditional disciplines as law, finance, and economics, but also in negotiation analysis, media relations, and the like. Regulators may also need technical support during the first months in office. Such support is often provided by consultants acting to some degree as "shadow" regulators.

No less important, newly appointed regulators benefit from contacts and exchanges with more experienced regulators from other countries. Some of these contacts occur on an ad hoc basis, through visits and participation in conferences. But there is also an encouraging trend toward systematizing such contacts, for example, through a "twinning" arrangement between a new regulator and a more experienced foreign regulator. These arrangements can provide a basis for exchanging staff and materials or providing other forms of support and advice. There has also been a recent trend toward creating "networks" of regulators, such as the International Forum for Utility Regulation sponsored by the World Bank.

[1] Warrick Smith, "Utility Regulators—The Independence Debate" (Viewpoint # 127, October 1997) and "Utility Regulators—Roles and Responsibilities" (Viewpoint # 128, October 1997).

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