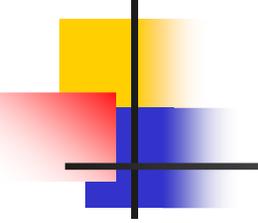


# A New Era in Utility Regulation

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**Ioannis N. Kessides**  
**The World Bank**

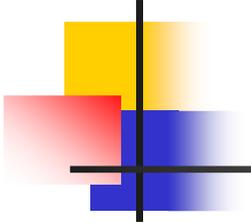
*Turin School of Local Regulation*  
*13 September 2012*



# 1. Historical evolution of regulation

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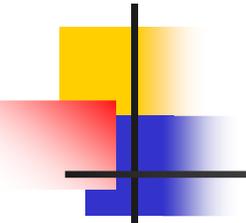
- Profound reassessment of regulatory policy during the last three decades
- Interplay of policy and abstract thinking
- Two key dimensions of regulatory governance: (i) its organizational architecture; (ii) its substantive economic content



## 2. Reforming local governance for international competitiveness

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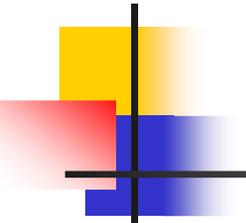
- The importance of reforming local governance in the context of globalization
- Grass-roots entrepreneurial activity is often inhibited by cumbersome local administrative procedures and regulatory barriers
- Historical precedents for regulatory reform-- substantive steps towards total deregulation of some markets and less comprehensive regulation of others



### 3. Improved set of criteria for regulatory intervention

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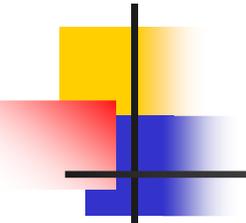
- More precise testing criteria whether public utility style regulation is needed
- The “three-legged test” for regulatory intervention



## 4. Institutional prerequisites of effective regulation

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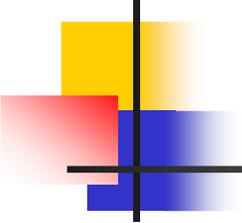
- Coherence
- Independence
- Accountability
- Transparency
- Predictability
- Capacity



## 5. Examples of shortcomings and achievements in regulatory effectiveness

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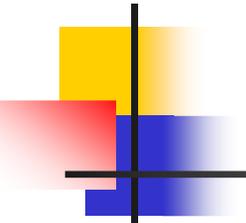
- Romania telecom—lacking coherence
- Latvia—undermining independence
- Brazil—promoting accountability
- Peru—ensuring transparency
- Argentina—undermining transparency and predictability
- Ukraine—coming up short on capacity



## 6. Modern regulatory instruments

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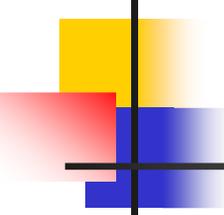
- Where public measures are called for, the types of market intervention that ought to be undertaken are, in many cases, significantly different from those that have been traditionally employed
- Rate-of-Return vs Price Caps
- Hybrid regimes



## 7. Rules governing access to bottleneck facilities

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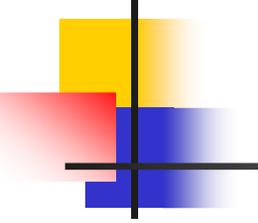
- Examples of bottlenecks or essential facilities: transmission grid (electricity), track (rail), local loop (telecommunications), pipelines (gas)
- Efficient Component Pricing Rule (ECPR) or Parity Pricing
- Laffont-Tirole Ramsey Pricing Rule



## 8. The cost allocation problem

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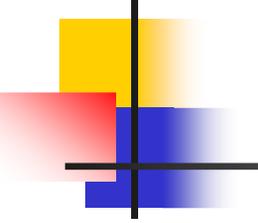
- Prevalence of common fixed costs
- Difficulty of devising an efficient mechanism for allocating such costs
- Shortcomings of fully distributed cost (FDC) allocations
- Demand-based allocation rules



## 9. Economically efficient pricing policies

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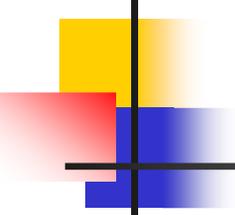
- Persistence of old-style inefficient pricing
- Deviations from efficiency due to political and social constraints
- Alternative pricing rules could address both efficiency and equity concerns
- The benefits of competitive pricing flexibility



# 10. The importance of regulatory commitment

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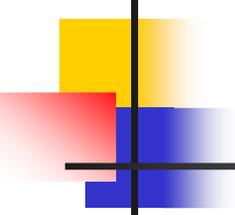
- The regulatory due process
- Economic and political importance of local infrastructure services
- Public resistance to paying the full cost of services
- Scope for opportunistic government behavior
- The importance of regulatory commitment



# 11. Public interest vs capture theory of regulation

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- Market failure and the public interest theory of regulation
- Regulation as a coercive policy instrument
- The representation bias and regulatory capture



## 12. Regulatory design implications

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- Need to construct regulatory bodies that are unlikely to be unduly influenced by any particular interests
- The regulatory due process
- Decentralizing decisions to firms