

Good Practices in Water & Sanitation Utility Regulation

PRESENTATION OF STUDY INFORMATION

20 November 2005

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1. Study Approach and Findings
2. Input from Expert Panel (Annex)

Objectives

1. Identify good practices in water regulation to deal with three conditions:
 - Transitional situations
 - Decentralized environments
 - Public participation
2. Panel discussion objective is to:
 - Review study results to date
 - Obtain expert opinions and suggestions that will be useful to USAID Missions.

Study Approach

- At a high level (project budget of \$25,000) identify water regulators that are broadly involved in either transitional or decentralized environments.
- Select nine countries for study on the basis of (1) clear evidence of significant progress in water sector reform; (2) geographic representation, (3) alternative approaches to tariff setting and (4) recommendations from experts concerning good regulatory practices.
- Collect available documents about the regulatory methods and tools used by the regulators in the sample.
- Conduct phone interviews with the regulators to better understand their situation and approaches to regulation.
- Compile results of the above research in this presentation for expert review.
- Create final slide deck incorporating inputs from the panel. Country notes and reference documents that may be useful to USAID Missions available on CD.

Country Regulators

Abu Dhabi - Regulation & Supervision Bureau *

Chile - Superintendent of Sanitation Services (SISS)

Colombia - Water Regulatory Commission (CRA)

Laos - Water Supply Authority of Lao P.D.R.

Lithuania - National Control Commission for Prices *

Mozambique - Water Regulatory Council (CRA)

Senegal - SONES - Contract Regulator and State holding Company

Ukraine - No central regulator

Zambia - National Water Supply and Sanitation Council (NWASCO)

* Multi-sector regulator

Country Comparisons (Extracted from Interview Notes and Background Documents)

Abu Dhabi	- Regulates economic and quality activity for both electricity and water.	
	- Several private generators . Desalination companies.	
	- One State transmission company and two Discos.	
	- Total staff of 25; uses ROR techniques with an annual maximum revenue limit.	
Chile	- Regulates 13 regional water and sewer companies and about 50 smaller water only companies.	
	- Reform initiated in 1977 and included transition from a government run sector to the current private sector situation.	
	- Approximately 140 person staff; uses a competitive utility approach and ROR to tariff setting.	
	- Tariff subsidies to poor provided by government, not the utility.	
Colombia	- Has regulatory responsibility for over 1,300 water and sewer utilities.	
	- Most utilities are government owned and operated, but larger utilities use various PSP options.	
	- The water regulator (CRA) defines a standard tariff setting methodology	

Other Country Information

1. The Abu Dhabi regulator monitors both economic and quality matters.
2. Chile has adopted a direct subsidy approach that limits the water companies responsibility for social welfare.
3. Colombia currently uses a uniform approach to regulation, cost recovery and tariff structure independent of utility size but is considering alternative approaches.
4. In Laos all but two of the 18 regulated water companies recover economic costs and one company is close to recovering depreciation based on current cost.
5. In Mozambique the regulator only regulates water companies that have some form of PSP.
6. Ukraine has no central regulator; each local government regulates its water company based on an Order from a central state committee.

Interview Questions

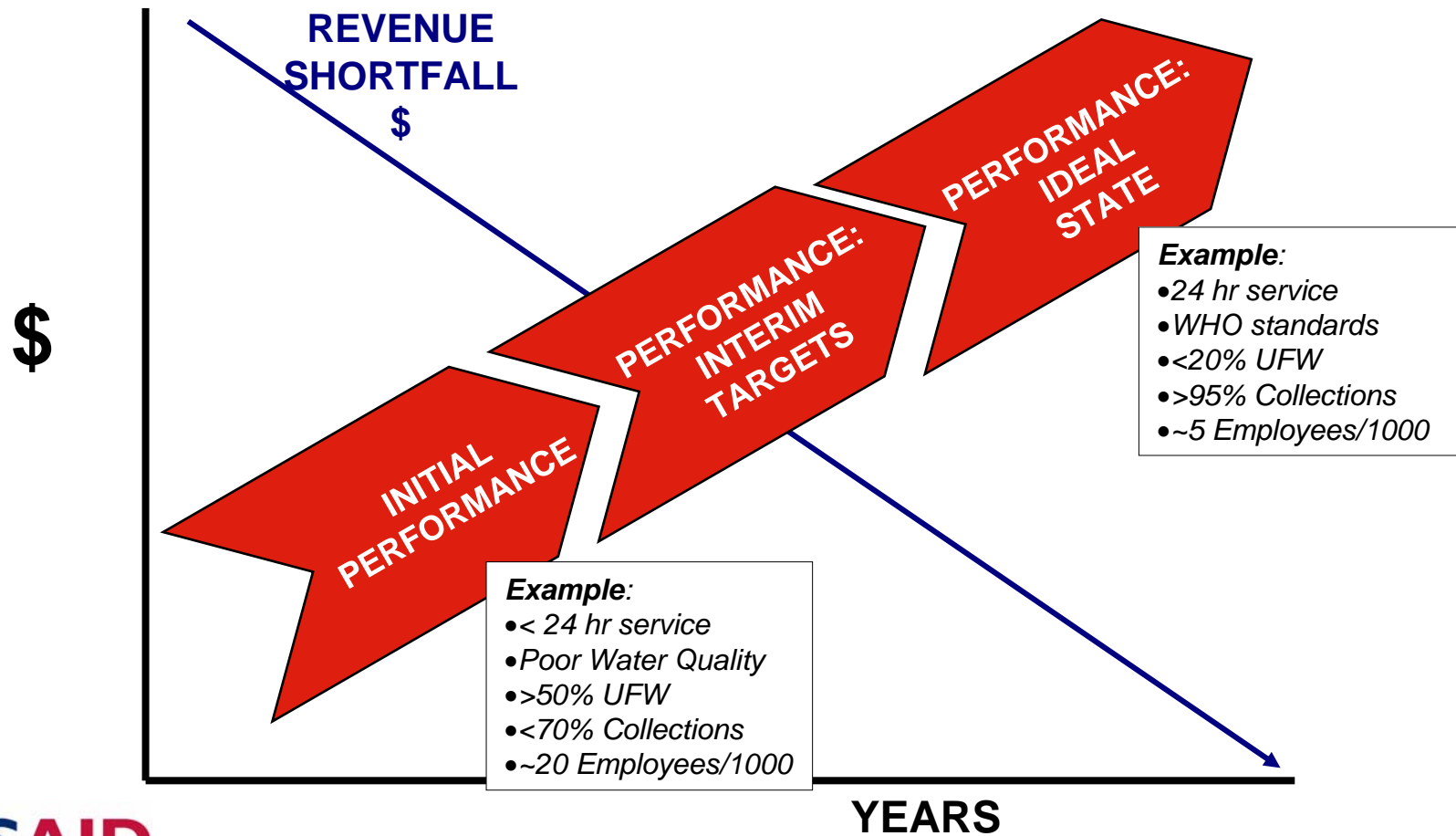
- Q1: How do you deal with revenue shortfalls during the transitional period?
- Q2: How do you set performance improvement targets during the early stages of transition?
- Q3: How do you regulate large numbers of autonomous utilities?
- Q4: What methods do you use to involve the public in the regulatory process?

Preliminary Findings

1. All regulators have put in place a form of economic cost recovery as a basis for regulation of the sector.
2. Most regulators allow transition arrangements that enable utilities to begin with recovery of O&M costs, but move predictably toward full economic cost recovery in lock step with progressive performance improvement.
3. Progressive improvement targets appear to have a direct effect on reducing revenue shortfalls during the transition period.
4. Limiting the number of performance targets appears to result in clearer signals, sharper management attention, and more meaningful improvements.
5. Financial incentives must be significant, relative to baseline expectations, to be effective.
6. Regulators have difficulty finding tools to effectively regulate numerous small utilities.

Q 1 – How do you deal with revenue shortfalls during the transition period?

Progressive Performance Targets Need to be Embedded in the Glide Path to Economic Cost Recovery



Q 1 – How do you deal with revenue shortfalls during the transition period?

1. All of the regulators in the sample have a policy of achieving full cost recovery.
2. Most of the countries in the sample have a strategy of reducing cash transfers to water companies with the intent that efficiency gains and tariff increases will make-up for the declining subsidies.
3. In Abu Dhabi the subsidy is based on the difference between willingness to pay and total revenue requirements.
4. In other countries the interim approach is to recover O&M expenses and required debt service charges and forgo recovery of depreciation.
5. In most respects, Chile and Laos have already achieved full cost recovery but marked differences exist in service levels.

Q 1 – How do you deal with revenue shortfalls during the transition period?

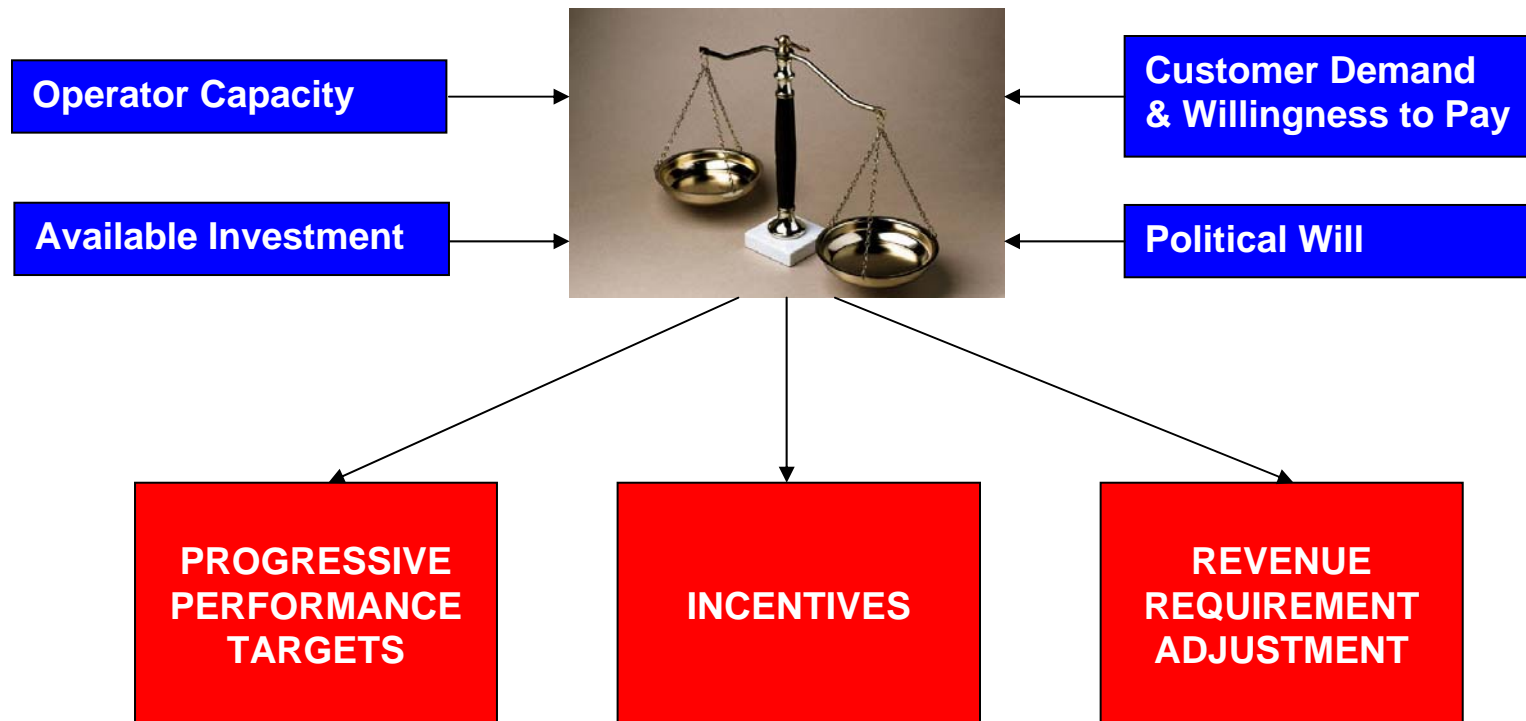
6. In Senegal and Lithuania the transition period included significant capital investments to improve water and sewer services.
7. In Zambia the initial concept was to provide water companies with sufficient working capital at the date of reform; This was unsuccessful and debt swaps with the electric company and continued financial transfers were needed.
8. In Ukraine local governments (owners of water companies) are required to increase tariffs to achieve economic cost recovery; if they do not, the difference must come from local government sources.
9. In Senegal the private operator was able to obtain deficit financing from local sources to finance the transitional period revenue shortfall.
10. In Mozambique and Zambia (both low GDP/capita countries) donor funds also were used to finance a portion of operating expenses.

Questions for the Panel on Transitional Strategies

1. Are there other documented examples of successful turn-around situations? What was the regulatory approach in these situations?
2. What factors should be considered in determining the optimal length of time to achieve full cost recovery?
3. What methods have been most effective in financing revenue shortfalls during transition:
 1. Declining state subsidies
 2. Forgo non-cash expenses (depreciation)
 3. Deficit financing
 4. Debt swaps
 5. Recapitalization
 6. Other

Q2 - How do you set performance improvement targets during the early stages of transition?

Regulators Must Consider Several Factors When Designing Interim Performance Targets



Q2 - How do you set performance improvement targets during the early stages of transition?

1. Most of the countries in the sample use some form of benchmarking to measure water company performance and set progressive performance targets.
2. Chile uses a competitive utility approach and sets performance targets based on multiple measures of a best-in-class utility.
3. All of the other countries in the sample use a phased approach that provides for improvements to be made in increments.
4. In Senegal and Mozambique, regulators focus on a few performance measures (collection % and UFW), which in turn, seems to focus management attention.
5. In other countries the regulator has focused on multiple performance measures.

Q2 - How do you set performance improvement targets during the early stages of transition?

6. In Senegal the private operator has a significant financial incentive to improve UFW and has invested needed time and money to address the problem.
7. In Mozambique, the UFW incentive was not perceived to be significant and results have not been as dramatic.
8. In some countries, incentives to meet or exceed performance targets result in additional compensation to the water companies and/or private operators.
9. In other countries, indirect incentives are related to job retention and seem to have little or no effect on performance.

Questions for the Panel on Performance Setting

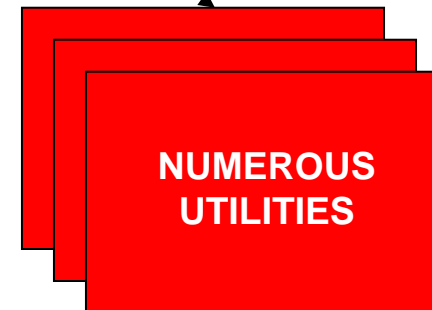
1. Are there other documented examples of regulators using interim progressive performance targets during transitional situations?
2. Can you describe the analytical and other factors used by the regulators to set performance targets during the transition process?
3. Is it better to focus on a few performance measures or multiple performance measures?
4. How significant do the incentives need to be in order to motivate the utility to achieve interim performance measures?
5. What kinds of incentives exist for progressive performance improvement work for public sector utility employees?

Q3 – How do you regulate large numbers of autonomous utilities?

Administrative Capacity Needs Have to be Considered When Regulating Numerous Small Utilities

Regulator Activities:

- *Tariff Review*
- *Monitoring*
- *Standard Setting*
- *Enforcement*
- *Complaint Monitoring*



Q3 – How do you regulate large numbers of autonomous utilities?

1. This question only applies to Colombia, Laos, Lithuania, Mozambique and Ukraine.
2. In Colombia there is a wide variation in the degree to which municipalities comply with regulatory requirements. One province arranged for multiple small systems to be managed by a few private companies.
3. In Laos the regulator only regulates water companies that operate in urban centers but promotes community approaches in rural areas.
4. In Mozambique the regulator only regulates water companies that have some PSP. The regulator is considering publishing tariff guidelines for smaller communities to use.
5. In Ukraine there is no central regulator but all local governments are required to comply with national tariff guidelines; if the tariffs do not cover costs the local government must provide a subsidy.

Questions for Panel Regarding Numerous Small Utilities

1. What are your thoughts on the approaches used by the countries in our sample to regulate numerous small utilities?
 1. Indirect regulation with guidelines
 2. Do not regulate – promote community based organizations
 3. Promote consolidation
 4. Elimination of state subsidies
2. Do you think it would be wise to empower the economic regulator with the ability to issue grants and low interest loans as incentive tools?
3. Are there other approaches to regulating numerous small utilities in a country that should be considered?

Q 4 – What methods do you use to involve the public in the regulatory process?

All the regulators share some type of information with the public. This ranges from posting rights and responsibilities on a website (Abu Dhabi) to publishing service standards in public buildings (Senegal), to utility data in annual reports (Laos).

Some regulators seek feedback in the form of satisfaction or affordability surveys. Mozambique and Chile have formed partnerships with municipalities to obtain feedback. Laos uses participatory field studies.

Zambia supports involving water watch groups in setting and monitoring service standards.

Chile and Colombia involve consumer groups in tariff setting through public hearings. Zambia and Mozambique are working towards this. Progress depends on the development of credible associations and linkages to academic institutions as the ability to analyze cost of service and other financial data is critical.

There are some instances, as in Marinilla, Colombia, of community involvement in developing management contracts and negotiating for services.

In Senegal and Mozambique, urban standpipes are managed by community members with oversight from the operator; in Laos, rural communities are involved in choosing technical options. Community managed systems serve most of rural Colombia. These are legally empowered to set tariffs, but lack institutional support.

Other methods for gaining public trust

Laos was exemplary in terms of action to gain public trust in the regulatory process. The regulator demonstrated:

Transparency: Making information public about utility performance, tariff methodologies, performance targets and strategies for achieving them.

Emphasis on efficiency: Indicators for lost water, labor utilization and financial management were developed, along with strategies and incentives for improvement. Tariff increases were not viewed as a substitute for improvement in these areas.

Residential customers are not penalized for the non-payment of government agencies: The 2005-7 tariff review notes that “poor revenue collection performance is generally attributable to non-payment by government agencies. We do not believe that tariffs should be increased to compensate for non-payment by this sector and no adjustments have therefore been made.”

Affordability is taken seriously, even where data is limited.

Q 4 – What methods do you use to involve the public in the regulatory process?

Multiple levels of Public Participation

	Providing Information			Consult/ Surveys	Complaint Handling		Involvement/ Collaboration			Community Management
	Rights/ Legislation	Service Standards	Annual Reports		Customer Contracts	Complaint Mediation	Monitoring Service Standards	Public Hearing /Tariffs	Developing management contracts	
Abu Dhabi	X		X		X	X				
Chile	X	X	X	X		X		X		
Colombia	X	X	X						X	X
Laos	X	X	X	X					X	X
Lithuania	X		X			X				
Moz'bique	X	X		X			X			X
Senegal	X	X						X		X
Ukraine	X	X			X			X		
Zambia	X	X	X	X	X	X	X	X		

Next Steps

Compile a data base on CD of reference material collected as part of the study including:

- Charter/mission statements of regulators
- Case studies and reference documents
- Tariff policies and guideline documents used by regulators
- Accounting guidelines published by regulators.

Consider follow-up activities including:

- Developing training materials
- Technical assistance to regulators in the design of transitional plans
- Regulatory networking, especially regionally

Input from Expert Panel

Expert Panel Members

- Eric Groom World Bank Washington (Chair)
- Antonio Estache World Bank Washington
- Simon Gordon-Walker WRc Plc. London
- Greg Houston NERA Sydney
- Alain Locussol World Bank Washington
- Tim Irwin World Bank Washington

Q1: How do you deal with revenue shortfalls during the transitional period?

1. It is often important to fix corporate governance problems before good regulation is effective. The regulator's role during transition may need to be a partnership (e.g., involved in governance and management issues) rather than the traditional long-run role of economic regulation in developed countries.
2. There is no major revenue gap in many situations IF the utility is properly governed and managed.
3. A well-run utility with good corporate governance typically has low UAW, enumerates all customers, bills most water delivered, and collects most bills.
4. By promoting fundamental things like increasing collection and stopping losses (theft, leakage, etc.), regulators can improve the quality and reliability of service, strengthen management capacity and close cash-flow gaps in the early periods.
5. During transition, regulators can function in an advisory role to help water utilities: (a) prepare business plans, (b) improve business processes, including metering, billing, and collections, (c) determine asset condition, (d) develop information and reporting systems, and (e) obtain financing.
6. Whatever regulators do during this period, subsidies should be linked to utility performance.

Q2: How do you set performance improvement targets during the early stages of transition?

1. A common transitional goal is to require operating income to match operating costs (operational breakeven).
2. First, assure there is governance and management in place that demands accountability, and provides rewards based on merit.
3. Establish a mechanism for resetting progressive performance targets that are built into PSP contracts.
4. If allowed under civil service rules (or perhaps with changes) regulators can function as technical auditors to authorize bonuses based on results.
5. Allow sufficient autonomy to hire, fire, reward, and penalize employees.
6. Tariff and subsidy design can be powerful incentives for improved performance by directing financial rewards to specific outcomes that affect performance targets, monitoring, and reward/penalty systems.

Q3: How do you regulate large numbers of autonomous utilities?

1. Do not micro-manage – one option is to act as an arbitrator where local disputes arise.
2. Recognize limitations -- do not try to set prices if you don't have the resources.
3. Make regulation consistent with the political and social culture of the country. Do not try to regulate centrally if citizens look to local officials for solutions.
4. Indirect regulation using guidelines can work if coupled with benchmarking and public annual reporting that “names and shames” poor performers.
5. Allow peer pressure from reporting to force change. Rely on citizen's demand for improved service to force political action.
6. Do not force consolidation. Let it occur from the bottom-up.
7. Promote community based organizations in small communities. For the smallest villages, consider using NGO's in a management role.
8. Consider establishing regional regulators.

Q4: What methods do you use to involve the public in the regulatory process?

1. The regulator can play a valuable role in conducting willingness to pay surveys, especially in transition. This is a key input to the business plan.
2. Regulators should develop a relationship with customers through town hall meetings and other events that provide an opportunity to interact with customers.
3. Regulators can ensure transparency by, for example, publishing public-private participation contracts on the Internet, and encouraging public input in the design of PSP.
4. Regulators should insist that consumer and NGO participants provide a high degree of scientific evidence to support recommendations, for example, in the form of customer surveys, benchmarking data, or realistic financial assessments.