

ADERASA Regional Initiative to Support Development of Water Regulators Concept Paper

Motivation

During the last decade, most countries in the Latin American region introduced regulatory frameworks for the water and sewerage sector and created regulatory entities to oversee and enforce them. Reforms were introduced in Chile and Argentina in the early 1990s, spreading to Bolivia, Colombia and Peru in the mid 1990s, and to Nicaragua, Panama, Paraguay, Uruguay and Venezuela towards the close of the decade. In Brazil and Mexico, systematic adoption of regulation has been limited to a handful of states, while in Costa Rica, a longer standing regulatory tradition was already in place. As a result, it is estimated that by the year 2000, about 40% of urban water consumers in Latin America enjoyed some form of regulatory protection.

For a variety of reasons, the water sector has proved relatively difficult to regulate effectively in comparison with other infrastructure sectors. A clear illustration of this is provided by the incidence of renegotiation in water concessions, which stands at 88% within 2 years, compared with close to zero incidence of renegotiation in the electricity and telecommunication sectors.

There are a number of reasons why the water sector presents a particular regulatory challenge. First, water is the utility sector with the least scope for competition, necessitating a more labor intensive form of natural monopoly regulation, without the possibility of relying on the market to reveal information about costs. Second, the water and sewerage services present a particularly complex and multi-dimensional array of quality issues, that complicate the regulatory process. Third, in many countries, water services have been completely decentralized and there has been comparatively little private sector participation in the water sector. As a result, regulators often find themselves trying to apply modern regulatory techniques to a highly atomized and politicized sector of old-style municipal utilities.

History of World Bank Technical Assistance

The World Bank has actively supported the creation of regulatory frameworks for the water sector throughout Latin America since the early 1990s, including in a number of the countries that are now founding members of ADERASA. The typical approach was to provide resources through sector reform Technical Assistance operations, which supported the drafting of sector laws and regulations and the establishment of regulatory agencies. These resources were primarily used to finance one-off consultancy studies needed to launch the process, and were complemented by global and regional training programs, such as those developed at the University of Florida and the Universidad Argentina de la Empresa, that provided introductory overviews to the principles of regulation.

These initiatives have played a very important role in laying the legal and institutional foundations of the new regulatory entities in Latin America. However, experience has shown that developing regulatory culture and practice in a region that lacks any regulatory tradition is a much slower and more challenging process than originally supposed, requiring sustained input over a number of years. In many countries laws and institutions exist, but regulators lack the necessary tools to put the model into practice.

To some degree, this reflects the limitations of traditional forms of technical assistance to the sector. On the one hand, regulatory consultancies have tended to be short-lived in nature, leaving behind a report or a model but not necessarily the capacity to make effective use of it. On the other hand, international training programs have been very effective in raising the awareness and understanding of regulatory staff, but have not yet gone far enough to enable regulators to actually adapt and implement the techniques which they have learned. Moreover, in both cases, there has necessarily in the early stages been a strong reliance on north-south transfer, with the

concomitant problems of translating regulatory models across very different political and institutional environments.

As many of the original Technical Assistance operations draw to a close, there is a clear need to sustain support for the development of water regulation in the region. However, traditional World Bank lending operations no longer constitute such an appropriate vehicle for doing this, given that the initial investment in reform has been made, and there is no longer the need for such large volumes of finance. Moreover, it would be desirable to explore and develop alternative vehicles for technical assistance that address some of the shortcomings of the first generation activities, bringing a more sustained impact on institutional capacity.

Formation of ADERASA

In October 2001, representatives of 10 Latin American regulatory entities (including Argentina, Bolivia, Chile, Colombia, Costa Rica, Nicaragua, Panama, and Peru, plus observers from the Dominican Republic and Venezuela) convened in Cartagena, Colombia to form a regional association of water regulators: ADERASA (Asociación de Entes Reguladores de Aguas de las Américas).

The stated objectives of ADERASA are to promote cooperation and coordination of efforts in the development of the water sector in Latin America by facilitating exchange of experiences and collaboration around common initiatives in the field of regulation.

The formation of ADERASA was based on an Memorandum of Understanding between the eight founding countries. The member countries have initiated a process for establishing the legal identity of the Association, which will require that its statutes be ratified by the Congresses of two separate member countries. Colombia and Bolivia are currently exploring the possibility of doing this. This step will be key to assuring the longer term sustainability of the Association.

During its first year of existence, ADERASA has established a pattern of annual meetings. The Second Annual Meeting took place in Santa Cruz de la Sierra, Bolivia in September 2002, and was attended by approximately 100 staff from the member countries, as well as representatives from Brazil, Honduras, Paraguay, and Venezuela which are currently exploring membership of the Association. At the Second Annual Meeting, the Presidency of ADERASA passed from Colombia to Bolivia, and Chile was elected to hold the Presidency in the following year.

Given the enormous challenges that remain for water sector regulators in the region, ADERASA aspires to develop a more substantive program of activities in order to strengthen and improve regulatory culture and practice in the region. For this purpose, the Management Committee of ADERASA has requested financial support from the World Bank in order to finance this initiative and provide advisory input. The program of support outlined in this Concept Paper was presented at the Second Annual Meeting of the Association, and received widespread endorsement. The description provided below fully reflects the comments received by Members of the Association.

Designing Second Generation Technical Assistance

There are at least two reasons to think that ADERASA could potentially provide an excellent channel for strengthening and sustaining water regulators in the region.

First, ADERASA brings together countries at very different stages in the development of a regulatory framework, ranging from Chile and Argentina with some 10 years of experience, to Nicaragua and Venezuela with recently created regulatory entities. This creates many opportunities for south-to-south exchange, which reflects the difficulties of practicing regulation in a developing country context, and is therefore likely to be more fruitful than traditional north-to-south exchange. It should also help to accelerate the development of regulatory institutions in the

more recently reforming countries, who will be able to take advantage of lessons already learned elsewhere in the region.

Second, many of the regulatory tools that need to be developed to improve the practice of regulation in the region, such as financial models and regulatory accounting guidelines, are generic in nature. This means that they can more cost-effectively be developed on a regional level, saving on the costs of 'reinventing the wheel' in each specific country, and accelerating the process of regulatory development in the countries that have reformed more recently. Moreover, some regulatory tools—in particular, an accurate and consistent regional database on benchmarking parameters—constitute regional public goods that are best developed at a supranational level.

Activities to be Supported by the Regional Initiative

In the light of these considerations, ADERASA is requesting grant assistance for a multi-year [two or three] regional initiative to establish itself as a lively and supportive forum for the discussion of regulatory challenges, and the development of regulatory solutions. The initiative comprises the following four activities.

(A) Regional Working Groups on Specific Regulatory Tools.

In order to promote the development and application of key tools to support the day-to-day practice of regulation, the program would support the creation of Regional Working Groups to work on the development of a number of key regulatory tools. At the Second Annual Meeting ADERASA established three such Regional Working Groups and one Regional Network and identified which countries would take the lead on each one. These reflect the topics considered to be highest priority by ADERASA and are as follows:

- a) Regional Working Group on Benchmarking (Leader: Argentina). Although regulators in Latin America have been promoting the adoption of cost based tariffs, in most cases they have no real tools at their disposal for assessing whether these costs are efficient. The creation of a consistent and accurate regional database on utility performance parameters would greatly assist regulators in detecting and eliminating inefficiencies, thereby ensuring that customers do not pay higher tariffs than are really necessary. Given the international public good nature of this kind of information, a regional approach would be particularly appropriate.
- b) Regional Working Group on Regulatory accounting (Leader: Chile). Many regulatory decisions are ultimately based on accounting data, and can only be as good as the quality of that information. However, in most Latin American countries there is no regulatory control over accounting practices. As a result, regulators often lack the kind of detailed information on cost structures, because this is not generated by standard financial accounts. Moreover, the lack of regulatory rules, means that accounting information is often inconsistent both across time and across companies. Hence the development of regulatory accounting guidelines and associated protocols for auditing and certification, would greatly contribute to the quality of regulatory decisions across the region.
- c) Regional Working Group on Tariffs (Leaders: Nicaragua and Colombia). Although a number of Latin American water regulators have now gone through their first tariff revisions, few have developed their own financial models to serve as an analytical basis for the tariff review process and a tool for assessing the sensitivity of tariffs to changes in investment targets or financial assumptions. Instead, many rely on the results of financial studies contracted by the regulated utility, which is a significant handicap when it comes to tariff negotiations. Hence, the adoption of a standard financial model which is adapted

to the needs of regulatory process, and has the flexibility to adapt to local peculiarities, would greatly facilitate tariff revisions. The tariff-setting group will also consider in its agenda, the issue of subsidies and how they impinge upon tariff design.

- d) Regional Network on Consumer Issues and Public Relations (Leader: Peru). A significant critique of the regulatory model adopted in Latin America has been that it does not provide adequate channels for consumer participation, particularly given that the region does not have many well-resourced or well-organized consumers groups to act as a counterweight to the industry lobby. This group would concentrate on developing best practice guidelines for consumer issues in regulation. Topics to be covered include procedures for handling consumer complaints, how best to conduct public audiences, how to involve consumers in regulatory decision-making, and more broadly how to increase public visibility by engaging effectively with the media.

The Regional Working Groups would bring together the technical staff responsible for these topics in each of the regulatory entities, together with an outside expert facilitator with extensive international experience in the corresponding field. They would seek to pioneer a new approach to technical assistance designed to blend training, peer exchange, distance education and learning-by-doing. The Regional Working Groups would meet physically a couple of times each year, and remain in regular contact in between times by telephone and email.

The Regional Network on Consumer Issues and Public Relations would operate along similar principles, but due to the nature of the issues would not require such an intensive level of technical activity. In particular, an expert facilitator would not be used, although the group would draw upon occasional input from experts in the field. The main emphasis of the Regional Network would be to connect professionals within each regulatory agency working in this field, with a view to identifying best practice and identifying actions required to bring all members up to this level.

In the case of the Regional Working Groups, the expert facilitator would not be a traditional consultant in the sense that his or her role would not necessarily be to do the work, but rather to guide the technical staff through the process of solving the problems for themselves. Hence, the expert facilitator would at the outset impart training on the practical implementation aspects of each topic, and supply detailed information of how similar issues have been addressed in countries outside the region. Thereafter, he or she would help the technical staff to define a work program comprising concrete steps that would take the region from its current level of practice in the field, to a best practice level adapted to regional requirements.

Depending on the magnitude and complexity of the task, different elements of the work program would be assigned either to different members of the Regional Working Group or in some cases to the expert facilitator. Each participant would be responsible for completing the task assigned in preparation for the next working meeting. However, they would remain in contact with each other and with the expert facilitator as necessary via email. The expert facilitator would effectively provide a long distance helpdesk service, responding to difficulties encountered by group member in the implementation process, and proactively remaining in touch with group members.

Each Regional Working Group would have as its objective to develop, pilot and disseminate a workable regulatory tool for agencies in the region in each of the different areas identified above.

- (i) Development. During the development phase—estimated to around 12 months—the group would work on the design of the corresponding regulatory tool. The process would initiate with an intensive training program on the corresponding topic, and require participants to reviewing existing practice and international experience, as well as identifying the specific needs and constraints of the region, outlining an implementation plan and developing a detailed design of the regulatory tool; be it a regulatory accounting template, the architecture of a financial model, or an information system for benchmarking indicators.

- (ii) Piloting. The next stage—with an estimated duration of around 12 months—would be to test the design by piloting it in at least two countries participating in the group. This will involve calibrating the regulatory tool to each of the pilot countries by collecting and inputting the corresponding country-specific data, and integrating the tool within the existing processes of the regulatory entity. At the end of the piloting process, the Working Group will reconvene to distill the lessons of the experience and make the necessary adjustments to the design of the regulatory tools.
- (iii) Dissemination. The final stage—of about 6 months duration—would involve disseminating the regulatory tool to all regulatory agencies in the region and promoting its wider adoption beyond the pilot countries. Once the regulatory tool has been refined to the satisfaction of the Working Group, a number of dissemination activities would take place. These would typically include the posting of the regulatory tools and associated guidelines, protocols and background documentation on the ADERASA website, and showcasing of the tool and pilot experiences at the ADERASA annual meetings. The pilot countries would also make themselves available for visits from other interested countries to see how the tool was functioning in practice.

(B) Virtual Round Tables.

In order to permit a more continuous and interactive exchange of experiences between the regulators in the member countries, the program would support a series of virtual Round Tables between regulatory agencies that could be held 4-6 times per year. A variety of technological options are being explored including tele-conferencing, video-conferencing (taking advantage of the network of video-conferencing facilities that exist in the World Bank Resident Missions in most of the member countries), and Internet-based discussion groups. The Round Tables would take the form of a ‘clinic’ whereby each country could share recent developments and challenges in the regulatory field and request comments and ideas from other participants. On an occasional basis, the Round Tables could also be used to survey current regulatory practice on some specific topic of immediate interest, with a view to identifying best practice and areas of potential improvement.

Table 1: Methodology of Regional Working Groups

Phase	Technical Staff	Expert Facilitator
Phase I: Develop tools	<p>Present detailed review of existing practice in the area in their respective agencies.</p> <p>Define a concrete work program for developing a regional best practice regulatory tool.</p> <p>Work on the detailed design of the regulatory tool</p>	<p>Provide detailed training on practical implementation aspects of the regulatory tool, together with lessons of international experience.</p> <p>Assist Working Groups in defining a concrete work program.</p> <p>Provide standby helpdesk support to members working on the design of the regulatory tool, and in some cases perform certain components of the task.</p>

Phase II: Pilot tools	<p>Calibrate regulatory tool with data from two pilot countries, and ensure integration of the tool into existing regulatory processes.</p> <p>Refine the design of the regulatory tool in the light of the pilot experiences.</p>	<p>Visit pilot countries to advise on the piloting process, and provide standby helpdesk support.</p> <p>Assist Working Groups in refining the design in the light of results from the pilot.</p>
Phase III: Disseminate tools	<p>Post regulatory tool and associated materials on the ADERASA website.</p> <p>Present regulatory tool and pilot experiences to ADERASA annual meetings.</p> <p>Facilitate site visits to pilot countries by other interested countries.</p>	<p>Provide standby helpdesk support to countries interested in adopting the regulatory tool.</p>

(C) Development of Web Materials

In order to facilitate the permanent exchange of information among ADERASA members, the program would support the development of an association website. The ADERASA website would act as a portal leading into the websites of each of the member agencies. In order to minimize maintenance costs, the ADERASA website would focus on trying to improve the materials offered on each of the member agency websites, to bring these up to a uniformly high level, and ensure that they contain the kind of materials that are of greatest interest for sharing among member agencies. The ADERASA page itself would also post the outputs of annual meetings and working groups, as well as a quarterly electronic newsletter. The possibility of establishing chat facilities for continuous exchange between the members of the various Regional Working Groups would also be explored.

(D) Program of Annual Meetings

The annual meeting of ADERASA will continue to be the main forum for bringing together water regulators from around the region to discuss issues of common interest and learn about regulatory developments within the region and beyond. In order to allow regulators in the region to benefit from learning about international experience, the program would provide resources to support the participation of two distinguished speakers. These may be current regulators or regulatory specialists from outside the region, or other regional experts who are not associated with regulatory agencies but who have a valuable perspective to bring (academics, lawyers, consumer associations).

(E) Institutional Sustainability

In order to be sustainable in the long term, it is key that the institution be established on a solid legal and financial basis. Therefore the program makes provision for the services of a consultant whose main responsibility will be to work towards the legal and financial solidity of ADERASA, by managing the process of legal incorporation, and developing a business plan and membership structure for the Association.