

Economic Regulation of Utilities in the Caribbean

Why do we need regulation?

In most activities, competitive forces ensure that prices for goods and services trend towards the cost of providing them plus a margin for the supplier. The size of this margin will depend upon the extent of the competition – if many potential suppliers compete to provide a particular product or service, then the margin is small, but if only one or a few suppliers are willing or able to provide that service, then the margin is likely to be larger. Utility services are characterised by large capital investments, economies of scale in service, and high barriers (technical, legislative, financial) to entry. In particular, some utility activities (e.g. network operation, system control, etc.) can only be done by a single entity, and many others (e.g. generation, water production, sewerage treatment, customer service, metering and billing, etc.) have such economies of scale that it is unlikely that there will be more than one supplier of these services in a small market. Economic, or price and service quality, regulation, is not required when the service is provided by Government entities – it becomes more necessary as the service provider moves out from direct Government control, and is absolutely essential to control the activities of independent service providers seeking to make profits. In general, the remit of an economic regulator includes:

- setting the rates levied by the regulated entities for certain prescribed services, to ensure that they are fair and reasonable;
- monitoring and regulating customer service standards achieved by the utilities, to ensure a balance between consumer and producer interests;
- hearing and determining any serious customer complaints against the utility organisations (if unresolved by the utility organisations themselves)
- providing relevant information (operational and financial) on the industries it regulates to consumers, Government, and other stakeholders

How are utilities regulated in Montserrat and elsewhere in the Caribbean?

In Montserrat, electricity, water, and sewerage services are provided by state-owned enterprises - Montserrat Electricity Services Ltd ('Monlec') and Montserrat Water Authority ('MWA') that operate under specific legislation. Prices and service levels are set out in that legislation, and any change requires an explicit decision by Government. As a result, price setting has become deeply political.

In other Caribbean countries economic regulation is carried out by separate bodies, with varying degrees of independence from ministerial decision. Some of these are shown in the table below:

Country	Body	Remit	Comments
Bahamas	Public Utilities Commission	Electricity, telecommunications, and water and sewerage services	Established 2001. So far only telecoms are covered. www.pucbahamas.gov.bs
Barbados	Fair Trading Commission	Electricity, telecommunications, natural gas, water, sewerage services	Established 2001. Water, and sewerage to be covered shortly www.ftc.gov.bb
Belize	Public Utilities Commission	Electricity, water and telecommunications	Established in 1999. www.puc.bz
Guyana	Public Utilities Commission	Electricity, water, telecommunications	Seems less independent of Govt than most. GPL tariffs already determined in its licence. No website.
Jamaica	Office of Utilities Regulation	Electricity, water, sewerage, telecoms, public transport by road, rail & ferry	Established in 1995. www.our.org.jm
Trinidad & Tobago	Regulated Industries Commission	Electricity, water and sewerage	Established 2000. Replaced the former Public Utilities Commission. www.ric.org.tt

What are the advantages of independent economic regulation?

For the companies

- greater likelihood of utility organisations moving towards cost recovery. Long-run financial sustainability is more achievable if pricing is based on economic and longer-term social considerations, rather than political ones;
- improved credibility of utility companies among investors and financiers. Even when privatisation is not on the agenda, as in Montserrat, utility companies benefit from the lower risk profiles that independent regulation brings;
- allowing long-term investment planning. Utility organisations can plan over the long term without fear that politicians will postpone rate-increases;
- greater transparency of decision-making. Regulatory bodies usually have to publish justifications of their decisions. This means that companies can predict with greater certainty how regulation will affect them; and
- allowing the right to appeal. Ministerial pricing decisions, however unfair to a utility company or to consumers, are not normally open to appeal; those made by regulatory bodies normally are.

For other stakeholders

- increased ability to penalise monopolistic companies. Some utility companies, such as Cable & Wireless in several Caribbean countries, operate almost without economic regulation. Independent regulation can act as a significant controlling force on their behaviour;
- improved customer protection. Regulators usually have a primary role of protecting consumers, and act as arbiters of customer complaints;

- opportunity to introduce performance incentives. Incentive regulation, which is being introduced in Barbados this year, encourages companies to reduce their costs, just as they would have to in a competitive market;
- better information flow from companies. Utilities must normally provide regulators with a variety of performance information, much of which is published; and
- possibility of introducing greater competition. This is probably not relevant to water or electricity in Montserrat, but is relevant to other “natural monopoly” areas.

For Government

The advantages to the companies and the customers of those companies outlined in the preceding sections are obviously advantages to Government as well. In addition, the Government can look forward to some more immediate advantages:

- removing the conflict of interest between ownership and regulation of water and electricity utilities. The owner of the utility would prefer high prices and lower service standards – the regulator would prefer the converse.
- freeing up time - politicians (and their support teams) can free up precious time for other concerns; and
- non-involvement in the complaints process. Politicians in small countries are often caught up in the customer complaint process. A separate regulatory body removes this burden from them.

What are the potential disadvantages?

The speed with which the idea of independent economic regulation has swept the world implies that it has few drawbacks. However, two commonly cited worries are:

- loss of political control over prices. Political fears over the effect of possible price rises on vulnerable sections of the community can be addressed through cross-subsidy mechanisms, or direct support to the poor. In the long-run, more transparent and predictable price-setting mechanisms will benefit consumers; and
- the cost of regulation. This has been problematic in Barbados, where the public hearings of the Public Utilities Board have run for years in some cases. Barbados has now switched to a Fair Trading Commission with executive powers, to avoid this problem. Elsewhere, the costs of regulation have not proved excessive.

A large number of governments have now come to the conclusion that the advantages of separate economic regulation far outweigh the disadvantages.

Developing an effective regulatory agency for Montserrat

In Montserrat, we are merging our state-owned electricity and water providers into a single new organisation, Montserrat Utilities Ltd. As the predecessor companies operate under specific legislation, we will have to replace the existing Electricity Supply Act and water Authority Act with a new Utilities Act, covering the provision of electricity, water,

and sewerage services. This also provides the opportunity to create a new entity, the Public Utilities Commission, to regulate activities and prices of the new company.

Mission and strategic direction

The primary purpose of the PUC is to balance the requirements of customers and the regulated utilities. The overall direction of the PUC will be set by Government (and may include such conflicting aspirations as affordability, reliability, financial and environmental sustainability, transparency, equity between customers and customer groups, etc.) but once these have been set, the PUC operates independently.

Responsibilities and powers

Ideally, the roles and responsibilities for the PUC should include:

- setting the rates levied by utilities for certain prescribed services, to ensure that these are fair and reasonable;
- monitoring and regulating customer service standards achieved by the utilities, to ensure a balance between consumer and producer interests;
- hearing and determining any serious customer complaints against the utility organisations (if unresolved by the utility organisations themselves)
- advising the Minister of Communications and Works on any issues relating to public utilities referred to it by the Ministry of Communications and Works or other Ministries.

In order to carry out these roles effectively, the PUC should have the following powers:

- to set all rates, fees and charges within the monopoly activities of the utilities;
- to set and monitor customer service standards, and to fine the utilities if they fail to meet their targets (or to force them to recompense consumers directly);
- to require the utilities to provide performance information, in whatever manner requested by the PUC;
- to investigate the costs entailed in providing utility services;
- to appoint committees or external experts to examine and report to it on any matter arising out of its powers and duties under its Act.

Current proposals are for a PUC made up of five persons as follows:

- A Chairman, with expertise in economics, and ideally some knowledge of economic regulation
- Two consumer representatives (probably one domestic, one commercial)
- Two representatives of Government (probably one from Finance and one from the ministry responsible for the service under discussion – electricity, water, sewerage)

The PUC would only convene for short periods and for specific purposes - perhaps three or four weeks a year to review tariff applications, a few days each quarter to hear any complaints that were not able to be resolved by the utility, etc. It is not intended that the PUC should consider itself to be more important than the utility, but rather independent of both it and Government with a very specific job to do.

Transparency

International experience has demonstrated that transparency of both the operation and decisions taken by of the regulator are critical to its acceptance and successful operation. In order to achieve it is recommended that:

- the PUC should, where possible, make all its reports public. This should include both the outcomes of its deliberations and the basis of its decisions; and
- the PUC should provide an annual report to the Government. This report should also be made public.

Guidance by Government

The Government of Montserrat would retain power through four other main levers:

- ownership - The Government will continue to retain control of strategic decisions in relation to the two utility organisations. This will primarily be manifested through the Permanent Secretary's status as Chairman. In this way the Government will retain control over business plans, in particular over investment strategies or plans to expand or withdraw services.
- non-economic regulation – the Government will continue to retain control over some other forms of regulation, such as building standards, resource allocation, and safety standards. In many cases it may choose to adopt international guidelines, such as WHO guidelines on water quality standards.
- social policy - Responsibility for matters of social policy will remain within Government. Specific sections of the community that may have difficulties meeting the costs of the services should be identified and supported by welfare agencies as appropriate.
- strategic direction of the PUC - the Government may wish to instruct the PUC to adopt policies which support its strategic aims (e.g. environment, social / economic development, etc.), through the provision of guidance on issues of strategic importance.

Funding the PUC

Current plans are that the costs of the PUC is met by the regulated companies. This is common international practice, and generally is a very small percentage of turnover.

Transitional arrangements

Most Governments are reluctant to cede power to an untried institution. For these reasons, we recommend a transitional approach to appeals over regulatory decisions. For a fixed initial period, say for three years, the Government itself could act as the appeals body. This would reduce its concerns and allow the PUC to build up credibility. After this transitional period, appeals could be channelled through the High Court, ceasing direct Government involvement.

About the author:

Thomas Yeung has been appointed by the British Government to complete the merger between Monlec and MWA. He has worked in and for utilities from the UK, Europe, Asia Pacific, and the US on mergers and corporate change, and has a particular interest in industry and regulatory reform. This paper draws upon his own experience from the UK and Australia and includes some material from KPMG.

About utilities on Montserrat:

Montserrat Electricity Services Ltd ('Monlec') is currently responsible for electricity on the island, and water and network sewerage is provided by the Montserrat Water Authority ('MWA') Together, they employ about 75 staff, and had a combined annual revenue of EC\$13.2 million in 2005 (US\$4.9 million). See www.mul.ms for more about the companies and the merger process.