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## INTRODUCTION AND FUTURE ACTIVITIES

The recently published *Review of Regulatory Governance in South East Europe* confirms that substantial steps have been taken in South East Europe (SEE) to enhance the capacity to produce high quality regulations, and that useful institutions have been established throughout the region to this end.<sup>1</sup> The Regulatory Governance Initiative (RGI) has followed this process closely since its launch in 2001.<sup>2</sup> Throughout this period, regional RGI seminars have offered a forum for sharing best practices and successes along with challenges and difficulties in improving the institutional environment for investment, competitiveness and an efficient public sector.

The RGI builds on the *Regulatory Quality Concept*, which is the backbone of the OECD *Regulatory Reform Programme*.<sup>3</sup> Adopted in the 1997 OECD *Report to Ministers on Regulatory Reform*, the concept stands on two pillars: (1) economic development through liberalisation, privatisation, selective de-regulation and re-regulation, and (2) good governance using efficient, transparent and accountable government policies and establishing institutions to protect consumers and achieve social and environmental goals. In this way, the RGI attempts to transfer knowledge and experience from OECD countries to reform-oriented policy makers in SEE.

### Building sectoral regulators in South East Europe

SEE countries are deeply involved in the process of privatising former state-owned enterprises. However, in many cases, the key challenges of balancing natural monopoly and consumers' interests, and strengthening and modernising regulatory systems to make them compatible with modern European standards, remain. The existing entities do not operate as truly independent regulatory authorities, and resource constraints limit the scope of their missions. Many countries do not have a co-ordinated institutional framework for creating and operating these independent regulators.

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<sup>1</sup> The report was published under the South East Europe Compact for Reform, Investment, Integrity and growth ("Investment Compact") of the Stability Pact. It is based on the OECD Questionnaire on Regulatory Governance, which has been completed by SEE governments on a self-assessment basis.

<sup>2</sup> The RGI is part of the *Investment Compact* of the *Stability Pact*, which is a framework agreement on international co-operation among 40 countries, organisations and regional groupings to develop a shared strategy for ensuring stability and growth in SEE. The seminar in Prague built on the launching seminar on *Foundations for Investment: Progress and Challenges in Regulatory Reform in South East Europe* (Thessaloniki, October 2001), the seminar on *Regulatory Governance and Network Industries* (Sarajevo, April 2002), the seminar on *Regulatory Transparency: The Use of Public Consultation to Improve the Investment Climate* (Thessaloniki, November 2002), and the seminar *Regulatory Governance: The Use of RIA to Foster Economic Efficiency and Policy Coherence* (Sofia, January 2003). Additional information on the Initiative, as well as the proceedings from RGI seminars, are available at [www.oecd.org/regreform](http://www.oecd.org/regreform).

<sup>3</sup> Since 1998, the OECD *Regulatory Reform Programme* has documented reform efforts that boost sectoral efficiency and innovation, enhance economy-wide flexibility and potential growth, increase consumer choice and welfare, and improve government effectiveness in maintaining high standards of environmental, consumer and safety protection.

Authorities tend to be established in an ad-hoc manner, often resulting from international obligations or commitments. SEE countries are therefore facing the challenge of switching from the initial phase of emergency to the development of short to medium-term, coherent strategies for the restructuring of utilities sectors.

A report on *Independent Regulators in South East European Countries* has been prepared by the OECD Secretariat to support the discussions at the seminar and is released as a separate document. This report discusses the main institutional features and policy challenges faced by regulators in SEE when building sectoral regulators in key economic sectors. In particular, transforming utility sectors often requires significant private investment, which will only take place in a sector open to market competition and characterised by stable, transparent and predictable regulations. The report suggests short- and long-term initiatives from which SEE governments can choose in order to improve the institutional set-up of their independent regulators. Based on the experience of Central Eastern European countries in effective market reforms, policy-makers in SEE should consider the following priorities:

- Establishing, developing and implementing strong and well-designed policies and related action plans for the reform of key economic sectors;
- Reinforcing the role and capacities of the government in implementing market reforms and promoting good governance;
- Progressively separating policy functions from regulatory enforcement and the functioning of the utility sectors;
- Accelerating the restructuring of state owned enterprises to ensure transparency and accountability and improve economic, social and environmental performance; and
- Establishing a market-based sector to promote investment before market opening.

In the longer run, governments should give reference to the similar principles that could apply to OECD countries including:

- Strengthening of the independence and the authority of the sectoral regulators;
- Clarifying the institutional framework and the functional responsibility;
- Strengthening of the framework for accountability;
- Monitoring the performance of the independent regulators.

As was also indicated in the discussions at the seminar, the paper stresses the importance of sequencing reforms in order to address potential market failures and to reconcile conflicting interests. At the early stage of the process, governments must design, implement and monitor a national policy for the reformed sector that will provide clear objectives and medium/long-term guidelines for all stakeholders. They must ensure that a sound regulatory framework is implemented either before or simultaneously with the privatisation process. In addition, this framework should include proper rules to foster competition and assure that consumers' interests are addressed.

## **RGI Work Programme 2003/2004**

At the 2003 Ministerial Conference of the Investment Compact *Pushing Ahead with Reform: Removing Obstacles to FDI in South East Europe*, ministers recognised the importance of achieving further significant progress in the areas of regulatory reform, public and private governance, and combating corruption more effectively and encouraged further work in these policy areas. Ministers agreed that these areas should have a more central role in government policy and indicated that the 2004 meeting at the ministerial level will be devoted to review progress achieved in these areas. Based on this mandate, the RGI will work to support the main targets for the 2004 Ministerial Conference. In addition, the Work Programme 2003/2004 will be centred on two *regional seminars*:

1. The seminar, *Barriers to Business Creation and Development*, will take place in Bucharest 10-11 December 2003 with the support of the Romanian Government. Government formalities are important tools to support public policies in many areas such as taxation, safety and environmental protection. Administrative regulations can also create benefits for enterprises by setting market frameworks in which commercial transactions can take place in a pro-competitive and low-cost environment. There is a risk, however, that administrative regulations can impede innovation or create unnecessary barriers to trade, investment and economic efficiency, and even threaten the legitimacy of regulation. The cumulative effect of too many administrative regulations and formalities from multiple institutions and layers of government is to slow down business responsiveness, divert resources away from productive investments, reduce transparency and accountability, hamper entry to markets, reduce innovation and job creation, and discourage entrepreneurship. The preparation of the seminar will be co-ordinated with the Foreign Investment Advisory Service (FIAS), which is a joint service of the International Finance Corporation and the World Bank.
2. The seminar *Reforming the Administrative and Judiciary Environment* (1st half 2004) will discuss mechanisms to improve the overall administrative and legal environment in SEE countries. To be effective in achieving policy objectives, regulation must also be adequately applied and enforced with proper appeal mechanisms for all stakeholders. By taking a more holistic approach, the seminar supplements past RGI seminars, which have considered a range of specific tools and institutions available to assure that the process of designing and developing regulations is transparent, efficient and accountable, and that the quality of the resulting regulations is systematically assured.

## SUMMARY REPORT<sup>4</sup>

The seminar focused on the establishment and institutional design of independent regulatory authorities in key policy areas such as network industries (telecommunications and energy) and financial markets with the aim of improving the foundations for a sound and competitive regulatory environment conducive to investment in SEE countries. The relationship with competition authorities and their design were also addressed. In this process, governments progressively separate their policy functions from regulatory enforcement and the operation of network companies. A major theme of the seminar was how countries can build or rebuild these market-based institutions in order to assure high quality regulation that is efficient, transparent and accountable. In particular, presentations and discussions focused on the policy implications of designing independent institutions in relation to the rest of the governance system (i.e. with the ministries, the parliament or the judiciary). The seminar also highlighted the importance of setting up proper horizontal relationships, particularly in relation to the competition authorities. Discussions were based on concrete lessons from the experience learned in SEE and OECD Member countries.

**Mr. Jaromir Privratsky**, Ministry of Foreign Affairs (Czech Republic), **Mr. Panagiotis Karkatsoulis**, Ministry of the Interior, Public Administration and Decentralisation (Greece), and **Mr Josef Konvitz**, Regulatory Management and Reform (OECD) opened the seminar, which brought together more than 60 senior representatives from SEE countries, OECD Member countries and international organisations.

**Mr. Jaromir Privratsky** welcomed the participants and expressed his wish for a fruitful discussion. He expressed his appreciation for the possibility of exchanges between OECD and non-OECD countries, and stressed the fact that the Czech Republic has already taken up many OECD recommendations, like in the case of sectoral regulators.

**Mr. Panagiotis Karkatsoulis** expressed his satisfaction with the progress of the Regulatory Governance Initiative in SEE countries, which now share the opinion that regulatory reform along OECD guidelines is needed to attract investment and build a sound economy. Economic reforms in these countries have started to include privatisation in utility sectors and regulation for consumers, investment, market discipline and universal service. Independent regulators facilitate this process, as they provide a stable regulatory framework and clarify the various roles of government. It is important that their set-up is integrated in a wider design ensuring horizontal co-ordination and accountability.

**1. Mr. Josef Konvitz** stressed that the distinct features of the OECD are its multidisciplinary, its continuous effort to foster a policy relevant dialogue among countries. Policy advice and advocacy should rely on its extensive experience of assessing reforms over the last twenty years across Member countries. Mr. Konvitz emphasised that work on independent regulators is in line with the wider OECD work on regulatory management and reform, which in 2002 led to the publication *From Interventionism to Regulatory Governance*, which takes stock of lessons drawn from country studies and concluded that there is a need “for comprehensive reviews of the independent regulatory bodies to identify problems and develop consistent solutions”.

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<sup>4</sup> Special thanks to Fabrizio Gilardi, University of Lausanne, for preparing this report.



## ***Session 1. The challenges of ensuring privatisation and market competition in public utilities***

This session tackled the issue of privatisation and liberalisation in the context of a move towards a modernised regulatory framework. Experience in many OECD countries, including transition countries such as Poland, Hungary, Slovenia and the Czech Republic, as well as many SEE countries, shows that the sequencing of reforms is crucial. The first stage is often corporatisation, which involves separating the policy-making process of the government from the operation of services, through establishing state-owned entities, and then operating these state-owned companies in a commercial way by adopting current market prices and reducing cross-subsidies. This needs to be accompanied by a national strategy, such as a national energy policy or a national strategy for developing telecommunications, and a clear legal framework for commercial law. A market setting needs to be established before privatisation can be properly implemented. This may involve vertical and horizontal splits in fully integrated monopoly network infrastructure industries inherited from the past, and establishing institutions that properly ensure competition and consumer protection. This also requires establishing a stable and transparent climate for investment supported by transparent processes and public consultation.

**Ms. Maria Vagliasindi**, European Bank for Reconstruction and Development (EBRD), discussed regulatory policy challenges for utility sectors across SEE countries. While theory highlights that ownership and regulation should be separated (notably through privatisation and the establishment of independent regulators) to avoid conflict of interests for the state: transition countries are hampered by the inadequacy of the physical and institutional infrastructure, leading to low levels of access and reliability of services to business. Privatisation, which is one of the main aspects of regulatory reform, is a means to attract (foreign) investment, but also to impose payment discipline on firms. Privatisation needs to be accompanied by regulatory reform leading to the establishment of a good regulatory framework. Relevant reforms include the introduction of competition and the establishment of independent regulators. Competition reduces the need for regulation, but on the other hand only good regulation can lead to a competitive environment. Independent regulators are needed to prevent inappropriate government intervention, and data from selected countries show that sectoral regulators do make a difference in terms of service access and reliability.

**Mr. Stéphane Jacobzone**, Regulatory Management and Reform Division (OECD), summarised the key arguments of a paper contributed by **Mr. John Nellis**, Centre for Global Development (Washington, DC).<sup>5</sup> The paper addresses institutional and regulatory issues of privatisation in transition economies. It argues that the consensus held by many countries up to the mid 1990s that mass and rapid privatisation was the optimal solution is no longer valid. Country experiences and empirical research contributed to different views and a new consensus to emerge, including the need to embed privatisation in appropriate legal and economic institutions that promote, monitor and increase the transparency of market operations. An appropriate regulatory framework should be in place in advance of privatisation, but on the other hand it can be very costly to postpone divestiture until all instruments are in place. A second-best option would be to set up the regulatory framework at the same time as the privatisation process. Privatising first and settling regulatory issues later is the worst-case scenario.

**Mr. Pavel Calski**, Treasury Department (Poland), described the privatisation process in public utilities in Poland since 1990. Privatisation has not progressed uniformly in all domains. In some sectors, such as banking, privatisation is advanced and complete. In others, such as oil, insurance and steel, the privatisation process is advanced and still continuing. In still others, such as electricity and

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<sup>5</sup> Mr. Nellis was unable to attend the seminar.

gas, privatisation is in its early stages. Finally, the power grid, as well as the gas, oil and telecom networks will remain in public ownership over the long-term. More specifically, in the power sector, some objectives have been achieved, in particular the privatisation of power plants and distribution companies, while others, including the introduction of competition and the enhancement of competitiveness, are still in progress.

*Mr. Charles Kovacs*, Business and Industry Advisory Committee to the OECD (BIAC), presented business perspectives on the privatisation of the public utilities and network industries. The regulatory environment is an important determinant for the flow of FDI, and is a factor upon which governments have leverage. The attitude of investors is not the same in public and network utilities. In public utilities, investors are concerned with stable returns, the predictability of regulation, and the nature of the regulator. In network utilities, on the other hand, investors are concerned with high returns, as technology changes very rapidly, the regulators' attitude towards new entrants, and fees and taxes, such as for licenses. More generally, the regulatory environment is evaluated by investors according to the extent of consultation, the transparency of rules, the nature of the political agenda, the likelihood of sudden changes in regulation, and how regulation addresses the issue of fairness of the "playing field".

*Mr. Robin Simpson*, Consumers International (UK), highlighted the challenges of privatisation and market competition in public utilities from the consumers' perspective. The main challenge is to ensure that privatisation and competition bring efficient and sustainable services to all consumers at affordable prices. This implies that privatisation and competition are means rather than an end. There is a continued need for regulatory guidance, notably from sectoral regulators, with the problem being that long-term gains are accompanied by short-term losses for some consumers. There may also be a conflict between efficiency, affordability and sustainability. For example, as prices are sometimes increased, due notably to sustainability requirements, this can lead to affordability problems. The major difference between EU and Central Eastern European (CEE) countries is that while prices have generally gone down in the former, they have gone up in the latter, although there are reasons to believe that the situation will improve.

The following **discussion** firstly highlighted the importance of the sequencing reforms. If benefits are to be seen, regulatory structure reform should precede privatisation. However, the establishment of a new regulatory framework takes time, and political concerns may also contribute to delays. Similarly, the political logic may prevent the establishment of a sustainable approach to regulation, as costs are concentrated in the short term despite the need for long term investment. The capacity of regulators to implement and enforce regulation is also very important. The second major theme was the issue of affordability. On the one hand, affordability for all should not be a key objective for regulation, as it is more linked to social policy than to consumer protection. On the other hand, affordability is an important issue, especially in poor countries. There may be a tension between affordability and other objectives, as tariff increases are often justified and are in fact not a good indicator for the quality of regulatory governance. Affordability is also linked to universal service, where one of the problems is how to enforce a transparent approach whose consistence, for example for financing mechanisms, can be relatively easily evaluated.

### ***Session 2. Setting up independent regulators: addressing institutional design issues in a coherent policy framework***

The session emphasised that establishing an open market framework requires building a new institutional infrastructure, with new institutional arrangements for regulatory governance, clarifying the various roles of the government, the regulators and the courts. In this model, rule making and policy development remain the core remit of the ministries while the enforcement of regulation is

devolved to an independent regulator. Designing a proper system of appeals to courts is also an important feature of this environment. The provision of services is then secured through independent commercial companies. The regulators need to be integrated within a supportive political, economic and social environment. They will need to be given specific powers, and the opportunity to be truly independent, while still remaining accountable to the broader policy framework. The general setting of the framework needs also to take into account the current status of European regulation.

**Mr. Stéphane Jacobzone**, Regulatory Management and Reform Division (OECD), presented an overview of independent regulators in OECD countries. These institutions have been established during the privatisation and liberalisation process to improve the efficiency of markets, protect consumers, clarify the various roles of the state as an owner and a regulator, and to improve stability and transparency. Independent regulators can help to attract high-quality staff into regulatory matters. They also contribute to (foreign) investment by providing a more predictable regulatory environment, where the possibility for political discretion has been reduced. Differences exist amongst independent regulators across sectors, and some countries have chosen the alternatives of ministerial oversight and self-regulation. Independent regulators have recently been established in network industries after having been tested in the banking and financial markets as well as, in some countries, for competition authorities. In SEE countries, few independent authorities exist in telecoms, energy and financial services, while independent competition authorities exist in all countries. A general problem is the lack of resources, both human and financial, and has a crucial impact on the actual degree of independence of the regulator. Co-ordination across regulators is important, especially with respect to competition authorities, but is more accomplished in CEE than in SEE countries. A final issue is accountability. It is pointed out that, although accountability is a central condition for success, there is usually no explicit mechanism to establish it in SEE countries.

**Mr. Christian Hocepiéd**, DG Competition (European Commission), reported EU activities in monitoring and improving regulatory governance by telecom regulators. The Commission has played an important role in promoting the delegation of tasks to sectoral regulators in its member states, notably through various liberalisation and harmonisation measures, guidelines and notices, and recommendations, despite the fact that there was no formal requirement for the establishment of sectoral regulators. All member states have now established an independent regulator for the telecom sector. The Commission has developed assessment criteria for regulators along four main dimensions, namely independence from market players, effectiveness of powers and resources, transparency and timeliness of decision-making, and efficiency of appeal procedures. The idea underlying these dimensions is that regulatory structures should contribute to attracting investment, promoting choice and competition, and protecting users. The new framework for national regulatory authorities keeps the same requirements, but improves the definition of policy objectives, encourages more extensive consultation to increase transparency, and advises using general, rather than individual, authorisations. Remaining issues are the lack of a pro-active approach by many regulators, the small size of some authorities, incentives for regulators to stop their activities as soon as competition is strong enough, and incentives for firms to co-operate with regulators.

**Mr. Daniel Trnka**, Unit for Co-ordination of Regulatory Reform and Reform of the Central State Administration (Czech Republic), presented the Czech project of harmonising independent regulator statutes, which started in October 2002 and is almost complete. The main basis for the project was encouraging advocacy amongst ministries and regulators willing to implement the OECD recommendations included in the *Report on Regulatory Reform in the Czech Republic*. Sectoral regulators were created in the early 1990s without a common framework, whose creation is the aim of the project, which will lead to a new law. Regulators covered by the project are in energy, telecoms, securities, mining, and radio and TV broadcasting. In addition, other possible candidates are financial markets, railways and nuclear security. The reorganisation of sectoral regulators is divided into five

parts: the statute of the regulator in the state structure; relationships with other authorities; administrative procedures such as decisions and appeal mechanisms, management and organisation, in particular appointments and renewals and human resources; and financing of the regulator, which should be based on own resources.

*Mr. Marian Slifierz*, Energy Regulatory Authority (Poland), stressed that the establishment of a sectoral regulator was a shock for the leaders of the public sector, and that further regulatory reform still faces many obstacles. The Energy Regulatory Authority is not independent but should be considered autonomous. It consists of a head office plus nine regional offices. Although it is governed by a board, the responsibility for the regulator's actions lies with the President only. The Authority has five main functions. The first function is licensing. The regulator can change licensing conditions only in specific cases, and can withdraw and issue promises for licenses. The second function is tariff approval, where decisions are taken on the basis of costs, and no approval is necessary if a market is fully competitive. The remaining three functions are energy planning, settlement of disputes and response to complaints. In addition, the authority has other duties, such as research, training and international co-operation.

The **discussions** focused on the major themes. Firstly, concerns relating to the possibility of assuring the independence of regulators in poor countries were raised, as independence depends essentially on the availability of human and financial resources. Secondly, the need to learn from the experience of Western and CEE countries was widely acknowledged among SEE countries. Thirdly, the issue of the sequencing of reforms was again taken up. Although most countries agree that reform of regulatory structures should precede privatisation, several problems may prevent countries from doing so.

### *Session 3. Country experience roundtable*

In this session, SEE government representatives were invited to give reference to progress made in modernising the regulatory framework in their country, with regards to network industries. In particular, the countries were asked to report on experiences with (1) establishing independent regulatory authorities in network industries and financial services, (2) approaching the issues of independence and accountability, (3) undertaking concrete steps to ensure transparency, consistency and due process in regulating utilities in order to foster private investment, and (4) balancing competition and market opening with consumer protection.

In **Romania**, two authorities are competent for competition policy. The first is a government body, while the second is a competition council that makes decisions on infringements of competition law. Sectoral regulators also exist, notably in the fields of stock exchange, energy and coal. Their main objective is to promote economic efficiency. The energy regulator was set up in 1999 to enforce rules decided by the ministry while having the power to issue secondary legislation. Its independence has evolved over time. It is currently situated under the Ministry of Industry, with which it has good, although informal co-operation. Transparency is promoted through public hearings but consumers, due to their lack of organisation, are not very effective in making their voice heard.

In **Bosnia and Herzegovina**, sectoral regulators exist for telecoms, energy, finance, banking and competition. The telecom authority issues licenses for telecom operators and TV and radio stations, and aims at promoting competition. The energy regulator enforces state-level law with the aim of attracting foreign investment, and there are plans for the restoration and privatisation of the sector. Two sectoral regulators exist for banking, one for Bosnia and the other for Herzegovina, but an umbrella authority is to be established. In **Moldova**, a new authority for telecoms and informatics was established in 2000. Its mission is to facilitate the development of infrastructure, to ensure good

conditions for investment and to enforce universal service obligations. It also drafted important regulations, notably on GSM mobile telephones, domain name administration, and fixed telephone networks.

In **Albania**, sectoral regulators were established after privatisation. In some cases, regulators have been functioning for several years but they have only recently begun to play a significant role. This is due, in part, to the initially low professional capacity of the regulators' staff. Independence is very important, and is related mainly to the professional status of the top staff, as well as on autonomy concerning budget. It was also stressed that media and telecom regulators are separate, and that operations are co-ordinated within the competition authority. **Serbia** expressed concerns over the possibility of achieving independence of sectoral regulators in poor countries. The need to learn from CEE and Western countries was also stressed.

#### *Session 4. Independence and financing of regulatory authorities*

This session discussed how to ensure the independence of regulatory authorities. Independence needs to be established both in relation to political power and to specific economic interests of the regulated firms and entities. It can be achieved in different administrative cultures, and under various constitutional constraints and ways of delegating power across government agencies. It involves creating legal rules for the governance of regulators, such as nominations, presence of a board, statute and pay schemes, and also the financing arrangements of these regulators. The risk of capture from specific interests also needs to be addressed as existing or past monopolistic enterprises may carry strong political weight.

**Prof. Marie-Anne Frison-Roche**, Institute of Political Studies (France), emphasised that sectoral regulators are quite unusual for France, as there is no tradition of independent regulators. The first sectoral regulator was the Financial Securities and Exchange Commission, established in 1967, but it was the economic liberalisation processes that allowed sectoral regulators to become institutionalised, as well as to establish a proper independent competition authority in 1986. Sectoral regulators now exist for telecoms, electricity, competition and media, among others. Chairmen of independent regulators are appointed by the President, the Senate or the Parliament, dismissal is not possible, and the mandate is non-renewable. The governing authority is a board rather than a single person. Independent regulators' decisions can be amended only by courts. To enhance independence, it is important that the regulator has legal personality. The first regulator that will have such status will be the Financial Regulatory Authority, has been established by law in 2003. The budget of the regulator can be part of the total budget of the state or can come from taxes imposed on regulated firms. The telecom regulator has the right to levy fees, but in practice its budget comes from the government. The freedom to allocate the budget, on the other hand, is comparable to that of private firms, so that regulators can, for example, hire professionals at the same salary level as the private sector.

**Mr. László Balogh**, Financial Services Authority (Hungary), stressed that before 1999, the Hungarian financial supervision was characterised by a high level of fragmentation, with several levels of operative independence, appeals against decisions, different approaches to regulation and poor co-ordination. The establishment of a single regulator was organised to promote an efficient and coherent supervision of the financial sector. An effort was also made to comply with new international standards such as those developed in the Financial Stability Forum, the Basle committees, IAIS and IOSCO. The basic objectives of the Financial Services Authority are a smooth functioning of market operations, consumer protection, establishing market confidence, enhancing transparency and fighting crime. Independence of the regulator is ensured by having an independently elected president, with a six-year renewable term, and by budgetary, administrative and regulatory autonomy. Accountability and transparency are promoted through regular reporting to the government and control by the audit

office, and new steps will include the establishment of a supervisory council as well as reporting to parliamentary commissions.

*Mr. Jaroslav Vitek*, Energy Regulatory Office (Czech Republic), explained that the energy regulator was established in 2001 in order to promote competition and consumer protection. Its independence is low, as it belongs to the central state administration, and its revenues depend on the annual budgetary income of the government. The Chairman is appointed by the government for five years, and can be dismissed only under specific conditions. The energy regulator is currently advising the government about the type of relationship it should have with the government.

*Mr. Mindert Mulder*, Independent Post and Telecommunications Authority (OPTA) (Netherlands), discussed how independent regulators can promote competition. Effective regulatory reform requires a mix of rules that provide the right incentives to the market and a good governance model, including independent and accountable regulators. OPTA was established in 1997 and consists of a commission appointed by the ministry for a fixed term. Appointments are based on merit, and dismissal is possible only in special cases. OPTA is a separate institution which employs its own staff and has its own budget, which must be approved by the ministry. It publishes an annual report plus a number of strategic notes on future actions. Its duties include supervising the main aspects of telecom regulation and an advocacy role as well as provides an expert opinion on draft legislation. While the ministry cannot interfere with individual decisions, it may issue policy guidelines. Court review is the main check on OPTA activities, but may slow down the decision-making process. Furthermore, judges often lack the necessary competence on competition matters.

The **discussion** revolved around four main issues. Firstly, the relationship between independence and the transparency of decision-making was addressed. Transparency is seen as enhancing independence, and improving the clarity of the objectives of the regulator is thus important. It is also important that the regulator announces action plans on a regular basis. Secondly, the appropriateness of a single framework for all independent regulators was also discussed. In France, for example, regulators are very similar despite the lack of a common blueprint, and in the Netherlands all regulatory authorities tend to require expertise for senior staff.

The third issue was the co-ordination between sectoral regulators and competition authorities. In France, sectoral regulators report relevant information to the competition authority, which in turn may ask their advice. In Hungary, a memorandum of understanding exists between the competition and financial authorities, but so far there have not been many cases where co-ordination was needed. In the Netherlands, on the other hand, there are plans for merging telecom and competition regulators. Fourthly, the procedures of appealing to courts were discussed. No single model exists. In France, there is a single specialised judicial court for all regulators, which is not part of the regular administrative court system. In Czech energy regulation, on the other hand, the first step is appealing to the regulator's chairman. Appeals can then be directed to the administrative or civil court and finally to the constitutional court. This will not change under the new framework. The last issue was the independence of regulators from the regulated industry. Here, it was argued that multi-sector regulators can more effectively insulated from industry influence than sector-specific agencies.

### ***Session 5. Balancing independence with accountability***

This session discussed the challenge of balancing regulators' independence with accountability. This requires establishing a dialogue between the regulatory authority and politically accountable, elected officials. At the same time, independent regulators themselves need to be accountable and responsible to the policy objectives which initially justified their establishment. This can be obtained in various ways, through due process procedures, public consultation and reporting, by allowing for

appropriate appeal mechanisms to the courts, and even through instituting a direct dialogue with the Parliament. Accountability can also be ensured through performance assessment. National audit offices or international comparisons also contribute to assessing the performance of independent regulators.

*Mr. Simon Oates*, Department of Trade and Industry (United Kingdom), discussed a number of ex ante and ex post mechanisms to enforce and assess the accountability of regulators. Operational accountability refers to the fact that regulators are responsible for their decisions and is enforced through appeals procedures, through transparency instruments such as consultations, briefings, and regulatory impact analysis, through consumer representation in statutory consumer councils, and through corporate governance instruments. The assessment of performance represents another mechanism ensuring accountability under which the output of the regulators is judged against their statutory objectives. The regulators themselves provide a self-evaluation in their annual reports. In addition, parliamentary scrutiny can also be exercised through specific committees. Further, the National Audit Office examines the performance of regulators in terms of economy, efficiency, and effectiveness. Finally, the Better Regulation Taskforce, which is an independent advisory body, also keeps an eye on regulators' activities.

*Mr. Vassilios Kondylis*, Hellenic Committee of the Telecommunications and Post (Greece), described how the independence of Greek regulators is balanced against accountability. Independent regulators are a new institutional form in Greece, whose legal status was clarified only in 2001 by a constitutional revision. Independence has two components. Functional independence is ensured as regulators are bound only by the Constitution and EC and Greek laws, but not by ministerial instructions. In addition, they usually have administrative and financial autonomy with their own staff and budget. Personal independence, on the other hand, derives from the fact that members of regulators are protected from influence from both elected politicians and regulated firms. The government does not exercise any form of direct control or supervision on regulators, although it has the power to introduce rules on their internal functioning. Regulators are accountable to Parliament through annual reports that must be approved by a special permanent parliamentary committee. Parliamentary control consists also of its power to appoint regulators' members and of the option to revise the statutes of those regulators that are not constitutionally recognised. Finally, regulators are also kept accountable through judicial control and through transparency mechanisms such as public consultations.

*Ms. Alexandra Stepnowska*, Office of Telecommunications and Post Regulation (Poland), explained that the Polish telecommunications and post regulator is legally separated from both regulated operators and ministries. Its president is appointed by the Prime Minister on the basis of a motion of the Minister of Infrastructure, who is competent for telecommunications. Dismissal is possible but only if strict conditions are fulfilled. The budget of the regulator is part of the general state budget but can be administered autonomously. Accountability is ensured through reports to the Prime Minister, the obligation to answer questions from the Parliament and through several publications, including annual reports and a periodical bulletin. Decisions can be appealed in administrative procedure.

The **discussion** addressed three main issues linked to independence and accountability. The first was parliamentary scrutiny, for which there was a concern for the capacity of parliamentary committees to do their job properly, both in terms of the attention paid to supervisory issues and expertise. The second issue was how independence can be achieved in terms of human and financial resources. It was stressed that the independence of lower-level staff is as important as that of the head of the regulator. A difference also exists between formal and actual independence. The third point was linked to accountability mechanisms, and more precisely to the extent to which these may prevent

regulators to work efficiently. On the one hand, a concern was expressed that accountability requirements might give regulators incentives to act in a populist manner. On the other hand, questions were raised concerning the effects of strict accountability mechanisms such as appeals, as well as coordination with competition authorities, on the capacity of regulators to act timely. Furthermore, the accessibility of consultation and appeal mechanisms was discussed. It seems that consumers usually underutilise appeals, even when they have the right to do so.

### ***Session 6. Preparation of regulatory reform action plans***

During this session, SEE countries discussed the preparation of *Regulatory Reform Action Plans*. The region has invested heavily in improving efficiency, transparency and accountability of the regulatory reform regime. Relative to other aspects of the transition process, however, state reform for rebuilding its regulatory capacities has been lacking. The process needs to be accelerated, and the session discussed how this can be done in the framework of the 2003/2004 Work Programme of the Regulatory Governance Initiative (RGI).

**Mr. Josef Konvitz**, Regulatory Management and Reform (OECD), presented the main issues and problems related to the work program of the RGI. Several difficulties are associated with reforms, including the fact that benefits are expected in the long term, while resistances have to be overcome in the short term. To achieve this, commitment by political leaders, for example in the form of a ministerial declaration, is essential. They have to communicate a clear sense of the direction that is to be taken as well as short-term objectives and plans. A step in this direction would be the preparation and implementation of Action Plan, which will define measurable and pragmatic short-term objectives for regulatory reform agendas in individual SEE countries. Two further regional seminars will take place during 2003 and the first half of 2004. A seminar on *Barriers to Business Creation and Development* is expected to be organised at the end of 2003, while a second seminar on *Reforming Administrative and Judiciary Environment* should take place in the first half of 2004.

In its role as the regional co-chair of the Investment Compact, **Romania** stressed that high-level political support is needed to accelerate the reform process in SEE countries. The Romanian delegate proposed to establish a *Steering Group on Regulatory Governance*, which will include representatives from all SEE countries, business sector representatives, investment agencies, donors and the international community. The Steering Group prepare for the 2004 Ministerial Meeting of the Investment Compact, which is expected have regulatory governance as a main issue. The preparation, implementation and monitoring of Regulatory Governance Action Plans, which will signal the commitment of the region to improve the regulatory environment facing foreign and domestic investors, will be an essential part of this process. Romania proposed to host the next RGI seminar and the first meeting of the Steering group both of which will take place in December 2003.

All represented countries welcomed this initiative. Serbia stressed that it is time to move forward in this area, and that ministerial support is needed also to gather a larger number of representatives at meetings. This statement was supported by Bosnia & Herzegovina. **Slovenia** added that in some countries, governments do not realise the importance of regulatory reform issues, and some pressure is therefore needed to push them to act. **Albania** highlighted that regional co-operation is essential and strongly supported the idea of a formal ministerial commitment. **Greece** expressed its support for the initiative, and advised that the action plan include clear evaluation instruments and be developed in advance of the ministerial declaration. It was also suggested to include decentralisation as part of the seminar on the reform of the legal and administrative environment. **Croatia** stressed the need to more fully include expertise from academia. **Mr. Konvitz** closed the discussion emphasising that the RGI fully supports the Romanian proposal and will work in co-operation with SEE government representatives to prepare for their future regulatory governance agenda.

## ***Session 7. Regulators and competition authorities***

The transition to a market economy requires a number of institutional changes in order to encourage competition in network industries. However, even if these markets are restructured in favour of competition, and market entry is liberalised, competition is not necessarily guaranteed. The networks at the core of many network industries (e.g. the transmission and local distribution grids in electricity and natural gas) possess significant, durable market power. This session explored the pros and cons of various institutional approaches to providing both regulation and competition law enforcement. The need to coordinate the work of regulators and competition authorities was discussed, especially in situations where regulation and competition law enforcement functions are split between them.

**Mr. Gary Hewitt**, Competition Division (OECD), provided an overview of the different institutional options for the relationship between regulators and competition authorities. He stressed that competition is difficult to introduce and maintain in an industry where the firm with substantial market power is also vertically integrated, so that its competitors are dependent on it. In such a context, the four main functions of regulation are retail price regulation, access regulation, technical regulation and competition protection. The question is how these functions should be allocated among regulators and competition authorities. Three main models can be identified. The first involves a full division of labour, namely separating the regulatory from the competition protection functions. This solution has the advantage to include consistent application of competition law and appropriate skills to carry out ongoing ex ante regulation. Its drawbacks are the necessity for the competition authority and the regulator to co-ordinate and the risk of redundancy in sectoral expertise.

The second model combines regulation and competition protections in a single agency and comes in two variants. In the first, the regulator does everything, while in the second the competition authority is in charge of both regulation and competition protection. The choice between these two options depends on the prospects for full competition in the regulated sector. In the last model, the regulator and the competition authority have concurrent powers to apply competition law. Some competition among regulators could prove beneficial, but more legal uncertainty is introduced. A final issue was the choice between single-sector and multiple-sector regulators. The latter option seems to have a number of advantages over the former.

**Mr. Alberto Heimler**, Autorità Garante della Concorrenza e del Mercato (Italy), advanced that one of the main distinctions between regulators and competition authorities is that the former carry out ex ante regulation, while the latter are mostly concerned with ex post regulation. In addition, competition authorities decide on a case by case basis ex post, while regulators develop general regulations ex ante. Two tradeoffs between independence and political accountability and between independence and expertise can be identified. These are unequally relevant for regulators and competition authorities. For the latter, independence (supplemented with judicial review) is all that is needed, as authorities apply precise laws on a case by case basis, and when political decisions are needed, they should be taken directly by the ministry. For regulators, on the other hand, independence should be accompanied by stronger accountability mechanisms, as they pursue multiple objectives among which trade-offs exist. Regulators and competition authorities should be kept separate, because the nature of regulation and the kind of expertise required are different. Co-operation is however very important. In Italy, the relationship between regulators and competition authorities is characterised by functional separation (with the exception of the Bank of Italy for banking supervision) and bilateral co-operation, though this is not stated by law.

**Mr. Andrej Plahutnik**, Competition Authority (Slovenia), emphasised the constraints of small countries in which the necessary resources cannot always be found. Three elements are important.

First, the legal framework must be clear, non discriminatory and user-friendly. Second, capacity-building is a critical issue, but regulators should start their activities even with insufficient resources. Thirdly, implementation should be transparent and without exemptions. Separation is needed between competition authorities and sectoral regulators. The former should have competencies over all sectors, while the latter should deal with technical matters. *Mr. Tibor Szanto*, Competition Authority (Hungary), explained that the Hungarian competition authority is independent and enforces competition law across all sectors. It played a role in the building of sectoral regulators, notably through competition advocacy. There is a full division of tasks between regulators and the competition authority. As goals are partly similar, however, competencies overlap to a certain extent, which makes co-operation essential.

*Mr. Mindert Mulder*, Independent Post and Telecommunications Authority (OPTA) (Netherlands), shortly presented the Dutch experience, which is particular in that a merger between the OPTA and the competition authority is planned. So far, the two regulators have co-operated but it is difficult, for example, to mobilise competition instruments when telecom law is insufficient so that this involves many transaction costs. In the new organisation, a single regulator will exist but with several distinct units.

In the following **discussion**, a major point was the insistence on the fact that no single best solution exists. In particular, even though sectoral regulators may be unwilling to roll back regulation when full competition is achieved and thus giving all powers to the competition authority, keeping the sectoral regulators may have some advantages. However, the process of establishing sectoral regulators has only just started in many SEE countries and arguments of this kind are still too nascent. At early stages of regulatory reform, such as in SEE countries, competition authorities are often too weak to bring competition to the market in these specific sectors, so that sectoral regulators are needed. In a more mature and competitive market, however, a rationale might exist in favour of a single regulatory unit with a single approach and culture to foster competition. There, competition authorities might be in a better position to avoid unnecessary regulation.

## AGENDA

**Thursday 12 June, 2003**

**Chair**

**Mr. Panagiotis Karkatsoulis, Ministry of the Interior, Public Administration and Decentralisation (Greece)**

**9:00 – 9:30**

***Registration***

**9:30 – 10:00**

Welcome by Mr. Jaromir Privratsky, Ministry of Foreign Affairs (Czech Republic)

Introduction by the Chairman Mr. Panagiotis Karkatsoulis

Opening statement by Mr. Josef Konvitz, Regulatory Management and Reform (OECD)

**10:00 – 12:30**

**Session 1: The challenges of ensuring privatisation and market competition in public utilities**

Privatisation and liberalisation are the first steps in moving to a modernised regulatory framework. This has been the experience in many OECD countries, including transition countries such as Poland, Hungary, Slovenia and the Czech Republic, as well as many SEE countries. The first stage is often corporatisation, which involves separating the policy-making process of the government from the operation of services, through the establishment of state-owned entities, and then operating these state-owned companies in a commercial way using market prices and reducing cross-subsidies. This needs to be accompanied by a national strategy, such as a national energy policy or a national strategy for developing telecommunications, and a clear legal framework with commercial law. A market setting needs to be established before privatisation can be properly implemented. This may involve vertical and horizontal splits in fully integrated monopoly network infrastructure industries inherited from the past, and establishing institutions that properly ensure competition and consumer protection. This also requires establishing a stable and transparent climate for investment supported by transparent processes and public consultation.

***Speakers:***

- ***Ms. Maria Vagliasindi***, European Bank for Reconstruction and Development (EBRD)
- ***Mr. Pawel Calski***, Treasury Department (Poland)
- ***Mr. Charles Kovacs***, Business and Industry Advisory Committee to the OECD (BIAC)
- ***Mr. Robin Simpson***, Consumers International (United Kingdom)

**A coffee break will be organised at the Chairman's discretion**

**12:30 – 14:00**

**Lunch**

**14:00 – 16:00**

**Session 2: Setting up independent regulators: Addressing institutional design issues in a coherent policy framework**

An open market framework requires building a new institutional infrastructure, with new arrangements for public governance, clarifying the various roles of the government. Rule making and policy development remain the core remit of the ministries while the enforcement of regulation is devolved to an independent regulator. The provision of services is then secured through independent commercial companies. Setting up sectoral regulators is one of the key and most difficult challenges to accomplish this process. These regulators need to be integrated within a supportive political, economic and social environment. They will need to be given specific powers, and the opportunity to be truly independent, while still remaining accountable to the broader policy framework. The general setting of the framework needs also to take into account the current status of European regulation (“Acquis Communautaire”).

***Speakers:***

- ***Mr. Stéphane Jacobzone***, Regulatory Management and Reform (OECD)
- ***Mr. Christian Hocepiéd***, DG Competition Unit (European Commission)
- ***Mr. Daniel Trnka***, Unit for Co-ordination of Regulatory Reform and Reform of Central State Administration (Czech Republic)
- ***Mr. Marian Slifierz***, Energy Regulatory Authority (Poland)

**16:00 – 16:30**

**Coffee break**

**16:30 – 18:00**

**Session 3: Country experience roundtable**

Government representatives from SEE countries are invited to give reference to progress in modernising the regulatory framework in their country with regards to establishing sectoral regulators in network industries. In particular, country delegates could give reference to:

- What has been your country’s experience in establishing independent regulatory authorities in network industries and financial services?
- How have the issues of independence and accountability been referred to?
- What concrete steps have been made to ensure transparency, consistency and due process in regulating utilities in order to foster private investment?
- What incentives have been given to competition, market opening, while ensuring consumer protection?

**18:00 Closing of the day by Mr. Panagiotis Karkatsoulis**

**Cocktail to be held at the Staropramen Brewery**

**Friday 13 June, 2003**

**Chair**

**Mr. Alberto Heimler, Autorità Garante Della Concorranza e del Mercato (Italy)**

**9:00 – 10:45**

**Session 4: Independence and financing of sectoral regulators**

Ensuring the effective independence of regulatory authorities is a challenge. Independence needs to be established both in relation to the political power and to the specific economic interests of the regulated firms. Independence can be achieved in different administrative cultures, and under various constitutional constraints and ways of delegating power across government agencies. It involves creating legal rules for the governance of regulators, such as: nominations, presence of a board, statute and pay schemes, and also the financing arrangements of these regulators. The risk of capture from specific interests also needs to be addressed as existing or past monopolistic enterprises may carry strong political weight.

**Speakers:**

- **Prof. Marie-Anne Frison-Roche**, Institut d'Etudes Politiques de Paris (France)
- **Mr. László Balogh**, Financial Services Authority (Hungary)
- **Mr. Jaroslav Vitek**, Energy Regulatory Office (Czech Republic)
- **Mr. Mindert Mulder**, Independent Post and Telecommunications Authority, OPTA (Netherlands)

**10:45 – 11:00**

**Coffee break**

**11:00 – 12:30**

**Session 5: Balancing independence with accountability**

Setting up independent regulators involves balancing independence with accountability, as politically accountable ministries will have to forego certain powers. This balancing also requires establishing a dialogue between the regulatory authority and politically accountable, elected officials. At the same time, independent regulators themselves need to be accountable and responsible to the policy objectives, which initially justified their establishment. This can be obtained in various ways, through due process procedures, public consultation and reporting, by allowing for appropriate appeal mechanisms to the courts, and even through instituting a direct dialogue with the Parliament. Accountability can also be ensured through performance assessment. National audit offices or international comparisons also contribute to assessing the performance of independent regulators.

**Speakers:**

- **Mr. Simon Oates**, Department of Trade and Industry (United Kingdom)
- **Mr. Vassilios Kondylis**, Hellenic Committee of the Telecommunications and the Post (Greece)
- **Ms. Aleksandra Stepnowska**, Office of Telecommunications and Post Regulation (Poland)

**12:30 – 13:45**

**Lunch**

**13:45 – 14:30**

### **Session 6: Preparation of Regulatory Reform Action Plans**

The session will encourage governments in South East Europe to discuss the preparation of regulatory reform *Action Plans*. The region has invested heavily in improving efficiency, transparency and accountability of the regulatory reform regime. Relative to other aspects of the transition process, however, state reform for rebuilding its regulatory capacities has been lacking. The process needs to be accelerated, and the 2003/2004 Work Programme of the RGI will be discussed.

*Speakers:*

- *Mr. Josef Konvitz* (OECD)

**14:30 – 14:45**

**Coffee break**

**14:45 – 16:45**

### **Session 7: Regulators and competition authorities**

As discussed in the introductory session, the transition to a market economy requires a number of institutional changes in order to encourage competition in network infrastructure industries. However, even if network infrastructure markets are restructured to favour competition, and market entry is liberalised, competition is not necessarily guaranteed. The networks at the core of many infrastructure industries (e.g. the transmission and local distribution grids in electricity and natural gas) possess significant, durable market power. Where this is the case, well targeted regulation can be implemented to ensure that prices are kept in line with costs and to provide incentives to lower these costs over time.

This session focuses on exploring the pros and cons of various institutional approaches to providing both regulation and competition law enforcement. The session discusses the need to coordinate the work of regulators and competition authorities in situations where regulation and competition law enforcement functions are split between them, and also how to ensure efficient co-operation between the two types of institutions from a government-wide perspective. The session will offer practical examples of how of such relationships can be organised.

*Speakers:*

- *Mr. Gary Hewitt*, Competition Division (OECD)
- *Mr. Alberto Heimler*, Autorità Garante Della Concorranza e del Mercato (Italy)
- *Mr. Andrej Plahutnik*, Competition Authority (Slovenia)
- *Mr. Tibor Szanto*, Competition Authority (Hungary)

**16:45** Closing of the seminar by Mr. Alberto Heimler

Closing remark by Mr. Daniel Trnka

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## Regulatory Policy Challenges in Utilities across SEE

*Ms. Maria Vagliasindi, European Bank for Reconstruction and Development (EBRD)\**

The appropriateness of the regulatory rules in public utilities, such as telecommunication, electricity, water and transport, can matter enormously, removing one significant obstacle to the development to the growth and expansion of business, as well as to regional trade and integration. The establishment of an appropriate regulatory framework is particularly relevant for countries belonging to South and Eastern Europe (SEE). Many countries in the region are still in the process of overcoming the severe infrastructure bottlenecks caused by war conflicts and inadequate maintenance that have characterised the region. The development of predictable and transparent regulatory frameworks would ensure users' access to competitively priced and high quality services, as well as engender investment in infrastructure sectors.

The current regulations and their enforcement across SEE do not appear fully reflect recent international trends towards increasingly pro-competition rules, unbundling of services and more open entry. To create the appropriate incentives in these directions, a priority is to de-monopolise and privatise the existing public utilities and introduce competitive forces where "natural" monopoly conditions no longer exist, with appropriate regulation limited to those areas where competition alone is not able to generate desirable outcomes.

This requires embarking in a set of broad reforms, including privatisation, competition and regulatory rules. Utilities privatisation has proven to be an effective means of attracting private investors and, importantly, a way of attracting foreign direct investment (FDI), particularly when privatisation has occurred through the selection of a strategic investor by open international tenders. Some of the arguments for private ownership – such as the need to access capital to meet growing demand and improve quality of service – are even stronger in SEE, and the discipline provided by private ownership is even more needed. The scale of losses and non-collection in some of the utilities sectors (particularly the energy sector) is very high. A private firm owned or managed by a foreign strategic investor will have a stronger incentive to enforce payments discipline. It will also have the technical knowledge and finance required for essential metering programmes, computerisation of billing and other measures that can help improve payments performance.

The specific regulatory regime that is adopted for privatised utilities encompasses several forms of regulation. The establishment of an independent regulator is a key regulatory challenge vital for the settling of market disputes and policy and other regulatory issues. If the regulator is not independent, the government is still able to interfere even if the network utility is privatised. Network industries are typically capital intensive and the needed investment is sector specific; that is, it cannot easily re-allocated and can be viewed as 'sunk'. As a consequence, a fair return on capital is guaranteed only if the private investment plan for the utility is successfully implemented over sufficiently long time horizons that permit the private owner to recoup the sunk investment. This requires as a precondition the existence of a stable regulatory framework. Insecurity, lack of transparency and predictability represent critical problems that could potentially deter investment. Institutional reforms are needed to support private investment through a system of credible and effective regulation. Few countries across

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SEE have set up independent regulatory agencies and even when such agencies have been established there is a lack of awareness of their existence and their effectiveness.

In the absence of competition, regulation is needed to provide incentives for productive and allocative efficiency, passing benefits on to consumers. However, regulation simply cannot replicate all the pressures of the market and it is unrealistic to expect it to do so. Competition has brought dramatic changes though reduced tariffs and introduction of new services: companies discover and provide what customers want. For instance, industrial customers have secured customised metering and billing arrangements. To be successful in enhancing competition, privatisation requires a number of complementary institutional changes, including restructuring to create scope for competition, including unbundling. There are also a number of regulatory reforms needed to ensure effective competition. Interconnection is a critical one. If the regulator fails to understand interconnection it can distort market entry signals, invalidate investments and allow/encourage the abuse of dominant positions to the detriment of consumers. In most cases, access liberalisation has taken the form of regulated Third Party Access (TPA); that is, a legal obligation to provide network access under non-discriminatory conditions. Regulated TPA is necessary to allow entry of new operators into a competitive market, as well as to allow consumer choice of supplier. Without regulated TPA, liberalisation of entry and termination of legal monopoly status is unlikely to lead to actual entry as potential entrants face hold-up costs, due to discriminatory rates or contracting hurdles directed at entrants by incumbents. Similarly, without regulated TPA, legal provisions for consumer choice of supplier will not result in actual consumer choice; the lack of entry by new operators means that consumer options are not expanded; even legally unconstrained consumers will continue to contract with incumbent suppliers.

The ideal sequencing of reforms embraced by the most reform-minded government in the region is to set in place an adequate regulatory framework before privatising utilities, as well as using privatisation to design the most appropriate market structure, introducing competition as early as possible in the process.

## **Privatisation in Public Utilities in the Polish Energy Sector – Achievements and Plans**

*Mr. Pawel Calski, Ministry of the Treasury (Poland)*

### **Privatisation Objectives**

Implementation of the state privatisation policy will lead to completion of the core ownership transformation processes in the Polish economy by 2005 making the ownership structure of our country more similar to that of EU member states, where public ownership remains at the level of 10 – 20 per cent. The primary goals of the privatisation policy in 2003 and next year is to increase effectiveness of privatised entities, improve their competitiveness, support restructuring processes and work on development of the capital market.

### **The power sector**

The electricity sector has seen considerable changes since 1989 when reform and commercialisation began. It was then owned by the Treasury and managed jointly with the coal sector. Reform started with the separation of electricity from coal issues, the removal of regulatory functions to the (now) Ministry of the Economy, the creation of around 40 joint stock companies for generation and 33 distribution companies, and the reorientation of international grid connections from Eastern to Western Europe. Grid management and system operation were vested in the Polish Power Grid Company (PSE) which became the “single buyer” for the sector. A substantial investment programme followed to update old, inefficient and heavily polluting plant.

A *power exchange* has been set up: the Polish Power Exchange (PPX) started operation in July 2000 as a voluntary market following the (Scandinavian) Nordpool model. Potential participants include the 36 generators, 33 distribution companies, 41 licenced traders and eligible customers under the liberalisation schedule. PPX is owned by the Treasury and others including the PSE. The market operates on a next day basis, with 24 markets corresponding to each one hour time period for the next day. A futures market commenced in 2001, although trading has so far been relatively limited, and also there are plans to start a current day market. The volume of electricity that can be traded through the exchange amounts to 30%

On April 2, 2002 the Council of Ministers adopted the document „Implementation estimate and correction of *Assumptions of the Polish energy policy until 2020*”. The consolidation and privatisation program for the sector, elaborated by the Ministry of the Treasury, envisages:

- Consolidation of lignite mines with lignite-fuelled power plants such as Bełchatów and Turów or Opole power plant (hard coal-fuelled),
- Transformation of the already existing Southern Power Company (Południowy Koncern Energetyczny S.A.) into the Polish Power Company (Polski Koncern Energetyczny S.A.) through contribution of the Dolna Odra S.A. power plant and thermal power plants: Gorzów S.A., Łódź S.A. and Tychy S.A.,
- Consolidation of distribution companies in order to establish competitive entities. The launch of privatisation in distribution companies will depend on prior privatisation of the generation sub-sector companies. Establishment of regional distribution groups is envisaged in the distribution sub-sector. The Ministry of the Treasury will conduct successive privatisation of new companies created as a result of distribution companies consolidation,

- Separation of electricity trading from distribution companies in the form of subsidiaries,
- Privatisation of generators and groups of distributors by sale of majority Treasury blocks of shares (public offering – I stage – minority blocks of shares).

### **The gas sector**

The lines for changes in the gas sector have been outlined in the government document “Implementation Estimate and Correction of Assumptions of the Polish Energy Policy until 2020”.

On August 13, 2002, the Council of Ministers adopted the „Restructuring and privatisation program for the gas sector” elaborated by the Ministry of the Treasury. The program defines the „border conditions” for solutions in particular spheres of the sector:

- PGNiG S.A. (Polish Oil and Gas Company) will be the entity responsible for gas transmission, warehousing and bulk trading, as well as for servicing of the long-term contracts,
- not later than in 2004, a minority block of shares in PGNiG S.A. will be made available by way of public offering to individual investors and long-term institutional investors on the Warsaw Stock Exchange and/or foreign capital markets through a share offer and / or capital expansion;
- activity in the area of gas distribution and retail trading will be conducted by six distribution companies separated from PGNiG S.A. structures,

### **Oil and fuel sector**

Ownership transformation in the Polish oil and fuel sector are implemented in accordance with the „Restructuring and privatisation program of the oil sector” verified by the Government in September 2002.

The primary goal of the oil sector restructuring and privatisation remains strengthening of the market position of entities from that sector, ensuring their long-term sustainable growth and providing national energy security while protecting consumers’ interests. Development of the Polish petrochemical industry, providing raw material for the Polish bulk chemicals sector has become a priority in that process. The Program will provide detailed solutions for particular companies from the sector, including the ownership transformation methods and timetables. The basic role of Nafta Polska S.A. is to supervise restructuring processes, conduct privatisation of entities sector-wise and market monitoring.

Taking into consideration the advancement of privatisation processes in Rafineria Gdańska S.A., the decision regarding the future of RG S.A. and determination of the chemical sector strategy will allow to make final resolutions concerning further privatisation of PKN Orlen S.A.

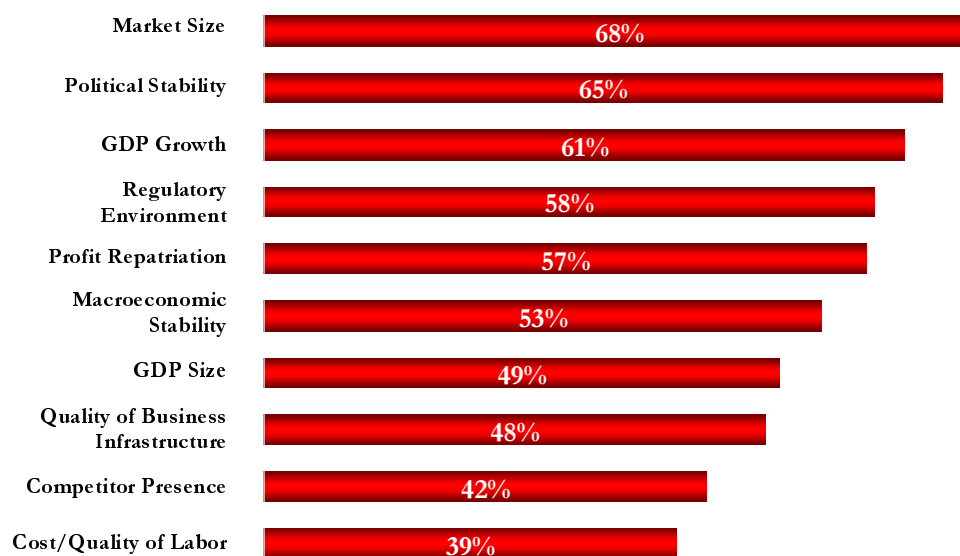
## Business Perspectives on the Privatisation of Public Utilities and Network Industries

*Mr. Charles Kovacs, Business and Industry Advisory Committee to the OECD (BIAC)*

The Global Business Policy Council



### Top determinants of FDI



*Source: FDI Confidence Index, December 1998, A.T. Kearney*

### Main Elements of Business Cost Model for Investment Decisions

- Purchase Price/Cost of Investment
  - Cost of Financing
  - Taxation\*
  - Value of Incentives\*
  - Assumed Cost Impact of Identified Risks\*
  - Operational Costs\*
  - Raw Materials
  - Labor
- Logistics, Utilities, etc.

(\* Decided or greatly influenced by Host Government)

### **Main Characteristics of Public Utilities**

- Stable Technology
- Usually very expensive
- Single Delivery
- Highly regulated

### **Investor Concerns**

- Stable Returns
- Regulatory Criteria - Predictability
- Nature of Regulator
- Ministerial
- Independent
- Prospects for Competition

### **Main Characteristics of Network Utilities**

- Rapidly evolving Technology
- Lower Cost of Entry
- Multiple Delivery
- Less rigid Regulatory Environment

### **Investor Concerns**

- High Returns
- Regulators Attitude towards New Entrants
- Fees and Taxes

### **Investors' Check List for Evaluating Regulatory Environment**

- Extent of Consultation in Drafting and on Implementation of Rules
- Extent of Transparency
- Explicit or hidden Political Agendas
- Propensity towards Sudden Changes
- Clarity of Regulations
- Cost of Compliance with Regulations
- Fairness, "Level Playing Field" issues

## **The Challenges of Ensuring Privatisation and Market Competition in Public Utilities**

*Mr. Robin Simpson, Consumers International*

### **Introduction**

I have named my presentation: “The challenges of ensuring *that* privatisation and market competition in public utilities *bring efficient and sustainable services to all consumers at affordable prices.*” For my first thesis is that:

- Privatisation and competition are means not ends and they are limited by practicalities of the particular sectors and sub-sectors under consideration.

My other theses are that:

- The structure of the industry itself is important; a frequently overlooked factor
- That industry specific regulatory structures should be envisaged for the foreseeable future. Leaving regulation of utilities to general competition offices has not been shown to be successful
- Economic efficiency and environmental sustainability measures both lead to price increases in the Central & Eastern European countries (CEECs) in the short run. But in the long run they will bring benefits, particularly to the poor

Liberalisation of utilities is now bringing price reductions in the EU but in the CEECs it tends to bring price increases. This apparent contradiction is due to the closer approximation of prices to costs in the EU, whereas the CEECs have had very low priced utilities. The CIS countries had only 5% cost recovery in the early '90s and the Central European countries also priced services below cost. Prices are moving closer to costs throughout the region and the most painful part of the process may be over for some countries (e.g. gas price rises of 50% in Slovakia in 1999). Russia envisages 100% cost recovery by 2004 for municipal services and other sectors like Czech electricity have also been planning full cost recovery for around now.

### **Gainers and losers**

It is important to be realistic regarding how much domestic consumers can afford to pay, for they are the major losers, business consumers tend to gain. Generally, connection charges are falling as user charges rise, bringing gains to those domestic consumers who cannot obtain connections. This has led to the reduction of waiting lists and the corruption that goes with them, particularly in the telecoms sector. Consumers can also lose through over valuation of privatised companies or contracts as the high capital costs get absorbed into user charges.

### **Scope for competition**

Competition varies by industry and is almost impossible in the water and sewerage market. There is scope for competition **for** the market through concession and lease systems, however, but contracts must be carefully constructed and the bidding system must be transparent and competitive in what is a very oligopolistic sector dominated by just a few EU based companies. The electricity sector has more scope for competition, particularly the generation sector, but the EU system is not as liberal as may appear at first sight. The gains to consumers up until 1998 in the UK were almost entirely due to regulatory intervention, France remains a almost total monopoly (EDF is the world's largest utility

company) and the German energy market is rapidly becoming concentrated with the only regulation coming from the Federal Cartel Office. These giant companies are active in the CEECs, for example the German electricity company RWE is dominant in the Czech gas sector. Unbundling is of key importance in the energy sector as it separates natural monopoly from contestable markets within the different sub-sectors.

The telecoms sector has seen major improvements in coverage in recent years. The participation of foreign (EU) participation in Poland and Romania has not brought the improvements that were hoped for and price levels remain high in the region due to continuing monopoly practices, which are less and less justified in technological terms. This raises questions about the role of national regulators. There are grounds for optimism following EU accession and the promising developments in terms of universal service obligation in the EU. But greater competition is needed.

One major lack in the EU *acquis* is District Heating schemes which are prevalent throughout the CEECs, very much as monopolies. There is a major need for reform in this sector, including such basic matters as individual accounts and physical heat controls, dispute resolution, ending the practice of collective cut offs for individual non-payment. Some systems have gone into decline and closed. Consumer organisations could bring practical expertise to bear in this sector.

### **Forward strategy**

A future strategy must bring together matters of industry structure, regulatory structure, charging systems and affordability. The EU *acquis* should not be too rigidly applied to industry structure. It may be, for example, that vertical integration in electricity is justifiable in some CEECs (as the OECD has recognised) and special attention needs to be drawn to the special role of mobile phones in the region. In some CEECs, mobiles are a competing product, while in Western Europe they are an additional product. Regulators need to have the underpinning of clear commercial law and transparent practice and clear tie-up with competition legislation. Instances of premature privatisation and weak regulation around the world indicate what can go wrong when the preparation has not been completed before privatisation.

The reconciliation of cost recovery and affordability is a major part of the charging strategy. Cost recovery can actually release resources for cross-subsidy for universal service obligations. Cost recovery may not necessitate major tariff increases if it concentrates first on raising payment levels. In order for this to happen, privileged exemptions from payment need to be reduced (such as those allowed to civil servants and governments themselves) plus non-payment by individual consumers. Widening the payment base will reduce the need for tariff increases. And if all consumers have to pay something then there are greater incentives for conservation and repair. Efficiency incentives can also reduce tariff increases. In the end however, tariff increases are likely and there needs to be special provision to help the poor. But the poor will be beneficiaries of improved service, as they now receive the worst service.

**Consumer participation:** There is increasing consumer representation on regulatory bodies in the region, although it is seldom on a systematic basis with the possible exception of Hungary. For it to succeed in the development of policy, it needs to be accompanied by technical briefings. An interesting development is the suggested involvement of consumer organisations in tenders for public utility concession procedures. Transparency International has also been invited. Another potential useful role for consumers is in individual dispute resolution, CI have proposed that specialist services be developed in the region for such disputes. In one collective dispute, the Bulgarian Consumers Federation has taken action against Sofia city claiming non-observance of the concession by the water concession holder.

Consumers of course have responsibilities. If they do not pay their bills, the services will deteriorate further. There is plenty of evidence that they are prepared to pay if they find that the system operates fairly, for example with few privileged exemptions and regulated tariffs and reasonable profits. There is no serious evidence that consumers want something for nothing.

## **Setting up Independent Regulators: Political challenges and institutional design** *Lessons from the OECD experience*

*Stéphane Jacobzone, OECD*

Setting up an independent regulator represents a policy challenge and also raises a number of important design issues. This presentation offers an overview of the main lessons from the OECD experience in setting up independent regulators. The presentation is oriented to the specific challenges faced by SEE countries, and is designed to accompany the OECD Secretariat background paper on independent regulators in SEE countries, that was distributed at the conference.

### **Objectives and context**

The general objective of an independent regulator is to improve economic efficiency in imperfect markets, where only second best equilibrium can be reached due to market imperfections. The regulator shields public intervention from short-term political and administrative influence, as well as helps to avoid the risk of capture by specific interests. This is especially pertinent for network and financial industries, where strong private interests prevail, including those of (specific) investors, unions and other stakeholders.

South Eastern European countries need a sound regulatory framework to support the privatisation of former state-owned enterprises. Monopolistic or oligopolistic markets are dominant in network industries or financial services. This is why it is important to strengthen market efficiency and to protect consumers' interests. In addition, independent regulators are necessary to attract foreign direct investment, in order to reduce the potential for conflicts of interests.

This is part of the transition from the "Owner State" to the "Regulatory State", where there is a need to clarify the various functions of the state, as: owner of enterprises and banks; as preparing and enforcing the general rules; as well as protecting consumers in terms of quality and good market functioning. In this context, independent regulators contribute to reducing the conflicts of interest within the state. As the state is often the owner of some large enterprises, which are the incumbents in liberalised markets, and at the same time in charge of the overall consumers' interest, there are clearly competing priorities within the public administrations. A solution to some of these difficulties is to set up independent regulators, and also to manage the state assets in separate funds, possibly attached to a ministry that would be different from the one in charge of the policy area where independent regulators operate.

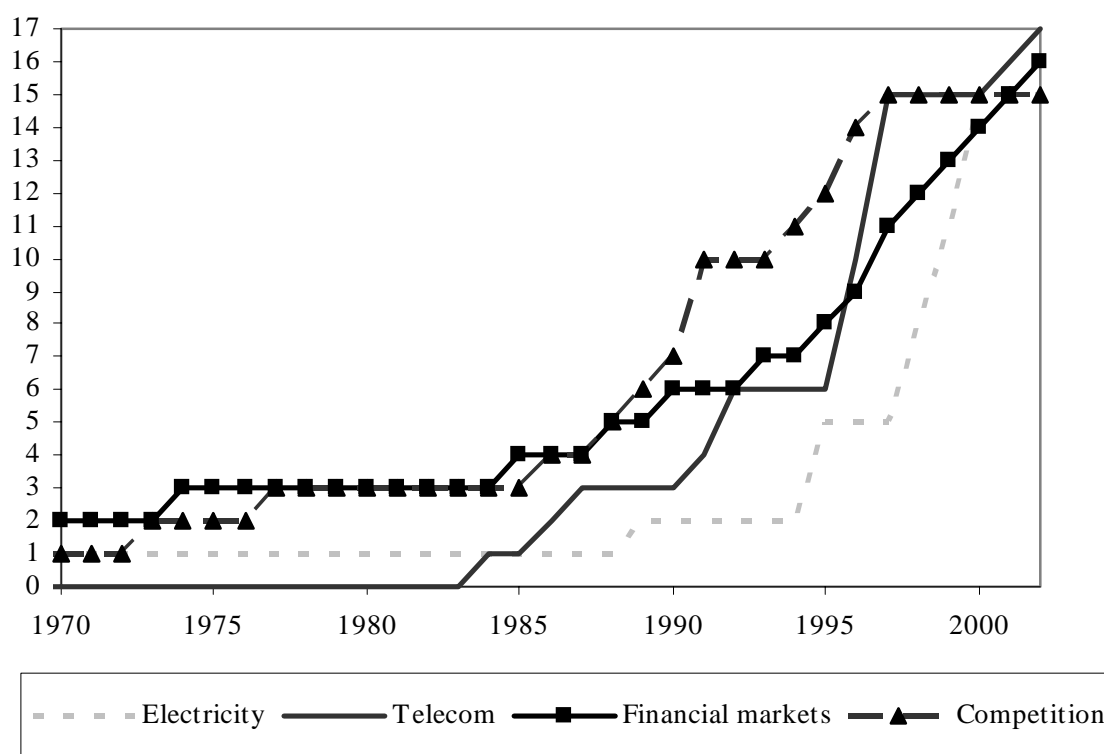
However, independent regulators represent a challenge to the executive, parliamentary and judiciary powers. An autonomous administrative agency is created, that is entrusted with regulatory powers, including sanctions, licences and even some rule making capabilities. The independence of regulators is certainly limited, as it remains always possible to change the regulatory framework by law, albeit with a significant cost. The multiplicity of powers and functions held by certain regulators has led some analysts to qualify them as "Governments in Miniature" due to the quasi-executive, judiciary and rule making powers that they enjoy. Their legitimacy needs therefore to be established, even though it cannot be ratified by-democratic majority voting.

### **Different approaches across sectors**

Independent regulators represent a revolution for network industries in many OECD countries. They have been set up as part of a process of corporatisation and privatisation that has taken place, notably in Western Europe. These independent regulators existed already some time ago in the

financial sectors, as Central banks have often enjoyed a greater degree of independence from central administration. It has also often been the case that financial regulators were located within the central bank. In another crucial field, competition authorities also represent a form of independent regulatory body, as they enforce competition law. Setting up independent regulators has been a more recent move in the fields of health and environment, triggered by the need to appeal to an independent and high level of expertise, with a certain integrity and independence from the political context.

***The increasing number of Independent Regulatory Bodies  
in EU Member States, Norway and Switzerland***



*Note:* in many countries, agencies performing these regulatory tasks may have existed before, but not as an independent regulatory body. *Source:* Gilardi, 2003.

Independent regulators now exist in most SEE countries, in most sectors. For example, competition authorities exist in all countries, independent regulators for energy, financial services or telecommunications also exist in a majority of these countries. However, some of these agencies are very small, which could be a challenge to their independence, and their ability to enforce regulation with a high level of expertise.

**The legal and practical aspects of independence, including financial resources and staffing**

Independence needs to be supported by a number of legal provisions, that would include the design of the executive structure of the regulator, be it a single person, or a board. A board is supposed to ensure a greater level of independence, and also continuity in decision making, over time. It is crucial to specify the rules for setting a term to the board or the chairman, for nominating these

individuals, and possibly renewing their mandates. The terms need to be long enough, and the nomination should come from the highest level of political authority. The rules for hiring and firing are also important, as in many cases regulators can only be dismissed in cases of misconduct or criminal action, but not for disagreeing on policy matters with the political power.

In practice, experience and the ability to overcome crises are crucial assets. In reality, the independence of the institution is influenced by the level of leadership the Chair has, and this needs to be carefully considered when setting up an independent regulator. The crises, such as a peak in energy prices, or difficulties on the financial markets are also often a crucial test for the regulator, to exert its independence and leadership. The quality of the staff also matters, but is also a function of the financial and human resources that can be made available to the regulator to perform its mission.

The financial resources are often relatively small compared with the overall state budgets. The use of central public funds often involves binding constraints in terms of the use of these funds, and might lead to implicit pressures from budgeting ministries. These budgets are also accompanied with a control by audit offices. In some sectors and some countries, however, regulators can be authorised to receive fees and levies directly from the industry being regulated. In certain cases, the formula for computing these fees can even be set by law, thus greatly strengthening the independence of the regulator in practice.

Human resources are also an issue to be considered, as regulators often operate within the rules of the civil service. They require staff with a high level of technical expertise, comparable to what is required in the market, although some of the rules for civil service remuneration might prevent them from offering competitive rates. In addition, finding this technical expertise might be difficult in very small countries, which might be a strong reason for implementing multisector regulation.

The rules for avoiding conflicts of interest are also very important in reducing the risk of capture. They might usefully derive some elements from the OECD Recommendations on the topic which have been adopted recently. Finally, the location of the regulator might be important, in terms of offering some distance from the political power. In some OECD countries, independent regulators are located outside the capital city, even if this can also pose difficulties in terms of staffing.

### **The powers of the regulators**

The powers of the regulators are directly derived from their functions, which include for "economic" regulators, the functions of enforcing market rules, licensing, and fixing prices of access to the Grid or to the network. These economic regulators may also perform risk management, with inspection, control, making sure that prudential ratios for financial institutions are being respected, avoiding any rupture of service, or ensuring universal service provision.

The rule-making power is often held by the ministers, but in practice, a certain share of this power can be delegated to independent regulators. These regulators often have a high level of technical expertise, which enables them to define technical standards and norms. In certain countries, this rule-making power is only exerted under the authority of the ministries, as regulators can propose rules, which will only be enacted if endorsed by the political authorities. However, depriving regulators from the rule-making power might create more difficulties. Regulators that would be deprived from the rule-making power, might be tempted to exert this power through using a quasi judicial approach, by applying the rule of precedent (as a set of precedent decisions equals a rule in practice).

The power of sanction is a quasi judicial power, which, in the context of the separation of the executive, rule making and judicial functions, needs to be exerted and implemented in a way that respects rules for due process and a fair and open judicial approach. The investigation function needs to be separated from the department in charge of deciding on the sanction. The level of the sanction needs also to be defined in a way that will deter recurrence, while remaining enforceable. The penal law is often of limited use in the field of regulatory decisions, as it may not offer the appropriate economic penalties/disincentives to potential violators.

### **The horizontal design**

The horizontal design involves several forms of coordination between regulatory bodies. The coordination can be achieved when various regulators or regulatory bodies share a common doctrine, have a consistent time-frame for decision making, and also coordinate to reduce the burden of complying with regulatory standards.) Regular meetings and public hearings can also contribute to better coordination, while the official request of a mandatory (and public) opinion from another regulator also helps to strengthen the link for fields such as "competition" or the "environment".

The relationship with competition authorities is a special and important case, when setting up independent regulators. Often, independent regulators have complex and conflicting objectives and perform their tasks "ex ante"; while competition authorities have a more narrowly defined mandate, with an "ex post" approach when enforcing the competition law (except in the case of mergers, where pre-approval might be required).

Coordination is also enhanced via regional and international (coordination) agreements. A number of energy groups have been created, including ERRA, CEER, and SEEREF, where regulators in SEE countries can exchange their experiences. Similar institutions exist also for telecommunications. In addition, the European Union now also has a group of "Independent Regulators".

### **Balancing Independence with Accountability**

Balancing independence with proper mechanisms to ensure accountability is a condition of success: regulators are "non majoritarian" institutions, which need to be supported by mechanisms to reinforce their political credibility. In many cases, no explicit mechanism exists for reporting and establishing the legitimacy of independent authorities. Therefore, they need to be implemented and their specifications be worked out for each individual case. The possibility of being fully accountable is also often demanded by regulators themselves, for example through instituting the possibility of a dialogue with Parliament.

Accountability can only be ensured via a system of checks and balances, which involve transparency and specific procedural requirements, as well as the possibility of a being subject to a substantial judicial review. The judicial review would involve a complex mix of expertise and coordination, where turnaround on significant regulatory decisions should be higher, for example, for fast-moving markets (as short delays need to be respected for significant regulatory decisions on fast-moving markets). However, one should also avoid transforming the court in a sort of second level regulator, if the court's decision is to be substituted to the regulator's decision.) These appeal mechanisms also depend on the judicial and legal tradition of the country, and differ in countries with Roman or German law, where administrative courts often prevail.

Accountability can also be enforced via a direct dialogue with citizens and Parliament. An annual report is often prepared by regulators and presented officially to Parliament or specialised

Parliamentary Committees. Ensuring a corresponding level of technical expertise in the Parliament is also often a difficult task, if the regulator's decisions are to be properly discussed and scrutinised. The dialogue with citizens can be organised via discussions with consumers' associations or other non-governmental organisations.

Accountability can only be ensured via high quality regulation, which might require a full regulatory Impact Assessment (RIA) (for transparency and predictability in decision making), and is key in obtaining private investors' confidence and recognition from the regulated Industry. The OECD 1995 criteria for high quality regulation, adopted in Council, might serve to guide countries in setting up high quality parameters for the independent regulators.

#### **The OECD criteria for high quality regulation: 1995 Council Recommendation**

1. Serve clearly identified goals
2. Sound legal basis
3. Benefits versus costs, considering distribution of effects
4. Minimise costs and market distortions
5. Promote innovation through market incentives
6. Clear, simple and practical for users
7. Consistent with other regulation
8. Compatible with competition trade and investment facilitating principles at domestic and international levels

i.

Quality needs to be assessed. This can be the case either through judicial review, or through assessing the performance of the regulator. The performance needs to be understood in a broad economic sense, and not only according to the use of public funds or resources following certain standards. Regulators need to live up to their missions, which is to contribute to balanced growth and prosperity in the specific sectors where they have been entrusted with regulatory powers.

#### **Conclusion**

Setting up independent regulators has been a fast learning process in SEE countries. In many countries, the formal tools have been implemented in the past five years. However, they would also require a more transparent legal practice as well as a more efficient administrative environment in order to deliver their full economic benefits. The way forward is to better assess the performance of regulators over time. The issue of good coordination with competition authorities is also a crucial one, as these relatively new institutions need to be able to find pathways and institutional mechanisms for cooperation. These often need to be explicitly designed ex ante, and to be formalized to offer a transparent and harmonious setting for private investors. The specific session on the topic will offer more insight than this general introduction and overview.

## **How the EU Monitors and Improved Regulatory Governance by the Independent Telecommunications Regulators**

*Mr. Christian Hocepiéd, Competition DG (European Commission)*

The EU telecommunications Directives entrust a key-role to national regulatory authorities (NRA) for the regulation of the telecommunications markets. Their main tasks are a) ensuring the availability of a universal service throughout the EU (and dealing with user's complaints in this area), b) regulating market access (granting of licences, numbering blocks and frequencies) and c) dispute settlement. Since 1998 the EU-Commission examines in the framework of its annual implementation reports how the EU NRAs are implementing their duties. This yearly exercise has proven a powerful tool to improve regulatory governance by NRAs.

The Commission has developed a checklist of criteria and questions to assess regulatory governance. The first criterion it assesses is the effective independence of the NRA. The Commission checks among others the following indicators: *Are staff seconded from operators/equipment providers to the NRA? Is there a 'revolving door' between the NRA and the incumbent as regards staff? In those Member States where the Government retains ownership or significant control of the incumbent, an additional indicator was the structural separation between the Ministry/department responsible for the holding by the State in the incumbent and the different bodies to which the NRA's tasks. In particular, do the structures in place ensure that regulatory decisions are not influenced by ownership considerations? Do officials from the bodies to which NRA tasks have been assigned participate directly or indirectly in the management of the incumbent, or vice versa?* A problematic issue is where the Government continues to control the incumbent operator. Experience in the Member States concerned showed that it is difficult to design structures which can guarantee that regulatory decisions are not influenced by State ownership considerations. In its 2000 report, the Commission stated that this is particular-ly difficult as regards NRAs which competence covers both telecoms and broadcasting.

The second assessment criterion is whether the NRA's powers are exercised effectively in all areas of competence. Does the NRA exercise its powers of initiative? Is the NRA sufficiently resourced to enable it to act? Which sanctions can it impose (injunctions, fines, periodic penalty payments)? Are the NRA decisions effectively enforced? An issue which was often highlighted in the reports is the lack of powers of certain NRAs to intervene on their own initiative. Such power is required under the Directives since entrants could hesitate to complain to the NRA as long as they are dependent from the incumbent for the quality and the timeliness of their service. Lack of proactivity and/or powers on the part of NRAs in nearly all Member States for the implementation of local loop unbundling was highlighted in the 2001 Report. As regards the resources there is an inherent difficulty in smaller Member States. A solution are multisectoral regulators, i.e. regulators competent also for other sectors (e.g. Post as regards Germany, Belgium, Ireland, Greece), energy (Luxembourg) or integration in the competition authority (the Netherlands). Other means to increase the critical mass of NRAs is co-operation in the Independent regulators Group (IRG) and the European Regulators Group (ERG).

The idea that NRAs could bring about the desired market result via sanctions only proved wrong in the case of local loop unbundling. If an incumbent has no incentive to cooperate with its competitors, he can find hundreds of apparently legitimate reasons to delay access. NRAs need bargaining tools more than sanctions. For example the power to authorise incumbents to launch new services was used successfully to induce incumbents providing equivalent wholesale products to competitors in order to be authorised to start their service.

A third criterion of good governance is transparency - are the tasks allocated to the NRA(s) clearly defined? Does the NRA make public consultations prior to making its decisions? Does the NRA publish a “management plan” about future initiatives? Does the NRA explain the reasons of and objectives pursued by its decisions?- and timeliness : does the NRA grant licences c.q. settle disputes within the foreseen time-periods ? Powers are clearly defined when an independent and autonomous body or agency exercises the full range of powers including those relating to licensing, interconnection, access, price controls, frequency assignment and numbering (Germany, Greece, Ireland, Austria, the Netherlands except for frequencies, Portugal). This is less the case when the independent body exercises regulatory powers to a greater or lesser extent with the relevant ministry. The EU Commission warned in its 2000 report that the dispersal of powers inevitably leads to a reduction of the regulatory certainty required by the market, in particular in cases where decisions by ministries relating to licensing or price controls may be seen by the market as being influenced by political considerations. The Commission concluded that the overall performance of the independent body may quite simply be improved through the transfer of all regulatory powers from the ministry, as has been the case for example in Greece.

Finally, the fourth criterion used by the Commission is whether efficient appeal procedures are available. The risk that NRAs maintain regulation for the sake of maintaining their competence, budgets and powers cannot be excluded if they are not fully accountable.

The New EU Regulatory Framework which applies since 25 July 2003 builds largely on the findings of the implementation reports. It strengthens among others transparency of NRA procedures. For example Article 4 of the Framework Directive provides that appeal must be possible on the merits. Article 6 introduces a requirement for public consultation of minimum one month on draft measure. Until now, NRAs often only consulted more shortly and/or only on policy and preparatory documents and not on the draft final measure. Finally, a procedure is foreseen allowing the Commission to reduce the list of markets to be regulated by NRAs.

## **Initiative for Better Regulation: Unified Statute and Functioning of Independent Sectoral Regulators**

*Mr. Daniel Trnka, Government Office, Czech Republic*

The project aimed to find a general framework for functioning of independent sectoral regulators has started in October 2002. There were three main reasons for starting the project. It was one of the recommendations of the OECD following the peer review of regulatory reform in the Czech Republic, new legislation was being prepared in some sectors like telecommunication or financial regulation and finally, there was a pressure from some of the regulators that came up with an idea to fulfil this particular recommendation. Other regulators and some ministries unanimously approved the project and the value it should have for their work.

During a preliminary meeting among ministries, regulators and the Government Office, representatives of many regulators identified some common problems all of them have to face. Regulators were created in the Czech Republic since 1989 in some sectors without any common framework. This results in many ungrounded differences among them. The best examples are the Czech Telecommunication Office and the Energy Regulatory Office. These two authorities, despite their very similar functions in their respective sectors, have different positions in our state administration system. To name some other problem, there is still deeply rooted feeling of superiority of the ministries in relation to regulators. This leads to overlooking of regulators during the legislative activities or problems in advocacy of regulators' proposals and opinions in the Government.

Although the Unit for Co-ordination of Regulatory Reform of the Government Office is a sponsor of the project, it acted only as a coordinating body of this horizontal project in which all regulators and some selected ministries took part. A working group composed of their representative has been meeting once a month to discuss issues and details of the final proposal. Since the working group had more than 20 members, efficient, interactive work would have been impossible. That is why the background materials for WG meetings were prepared in small groups of experts on particular issue (organisation, legislative procedures, financing, etc.).

The initial goal of the project was to prepare a concept paper for the Government which should serve as a basis on which the particular laws covering existing regulators would be adjusted and new legislation for newly created regulators would be prepared. However, the Government, especially the Prime Minister became more interested in the project and charged the Unit with a task to prepare a draft of the new act on state regulatory authorities and to submit it to the Government. This should be a *lex generalis* serving as a framework law that the particular legislation governing statute and functioning of regulators should be driven by. As it will be necessary to amend many laws starting with the Act on Energy and finishing with the Act on Budgetary Rules, it will be necessary to prepare a separate Act amending all these particular laws.

The authorities that the new proposal should deal with are: the Energy Regulatory Office, Czech Telecommunication Office, Czech Securities Commission, Czech Mining Office and Council for Radio and TV Broadcasting. Other possible candidates are the State Office for Nuclear Security, the Railway Office (which is still part of the Ministry of Transport) and the currently prepared regulator of financial markets.

The law should cover the following issues:

- Statute of regulators – their position in the state administration hierarchy including formal procedures for legislation- and policy-making processes, their general competences;

- Regulators' relations with the Government (they will have the right to provide the Government with their comments on newly prepared legislation and to inform the Government about the needs for new legislation), ministries (there will be "partnership" rather than superiority), the Parliament (which will have a controlling competence through the adoption of the annual report) and also the Office for Protection of Competition;
- Administrative procedures – regulators' decisions and administrative actions, appeal mechanism;
- Management and organisation – appointment and removal of the top management, human resources management (which will be driven by the Civil Service Law);
- Financing – budgeting, enabling of regulators' own resources, audit.

The law has been submitted to the inter-ministerial comment procedure. The necessity of a specialised law has been put into question. Presently the draft is being adjusted according to received comments and will be resent again for comments. The Government will decide whether to prepare a paragraph wording of two new laws (general and amending) or only the amending law and general framework document adopted on the Government level.

## Regulatory Challenges - Poland

*Dr. Marian Slifierz, Energy Regulatory Authority (Poland)*

The regulatory reform, which started with the approval of the Energy Law was a decisive step in the transformation of the Polish power sector from the centralised command economy to free market liberal solutions. However, this target has not been achieved until now. I would like to underline the fact that Polish regulatory reforms have crossed the point of no return.

The power sector in the early 90ties consisted of vertically integrated state owned utilities managed by administrative methods. Regulation is a necessary, but not sufficient tool of the regulatory reform. Another target, which has not been met until now is the privatisation of assets, removal of other obstacles in the introduction of market mechanisms, like: Long Term Power Purchase Agreements, passive resistance of pressure groups and the cautious approach of investors.

The size of the power sector in Poland places it on the 7<sup>th</sup> position in the European Union + 25, so the developments in this in this field have significant influence on the situation of energy sectors in Central Europe. What is also important is the fact that Poland is one of the major energy transit countries in EU +25, so that the regulatory framework of the Polish energy sector can positively or negatively affect the creation of the Internal Energy Market and West – East energy bridge.

Legal framework of regulation consisting of three – level legislation:

- Primary – the Energy Law and relevant acts
- Secondary – the ministerial ordinances
- Tertiary – decisions of the President of the Energy Regulatory Authority

It must meet the requirements resulting from the Polish accession to the European Union. After last amendments the Energy Law is fully compatible with EU standards and gives a solid base for creating conditions for competition. The situation in this respect in all sub-sectors remains far from satisfactory.

Regulatory practice in Poland can be characterised as “business friendly “thus not creating artificial barriers for newcomers and leaving approval of tariffs only where it is necessary.

Effective regulation is a necessary but not sufficient condition for full operation of the market mechanism. A complex set of actions must be undertaken to give room for competition, to minimise the risk of monopolistic practises, and what is the most important, to elaborate incentives for higher efficiency. In the Polish specific conditions there are still many obstacles on the road to market solutions, like Long Term Power Purchase Agreements, unfinished privatisation, passive resistance of different pressure groups, political upheavals etc.

However we are far from being fully satisfactory with the state of regulation in Poland I hope that our six-year experience will be interesting for all those who have started or who are going to start the introduction of regulation.

## Legal and Financial Conditions for an Effective Independence of Regulatory Authorities (The French Experience)

*Prof. Marie-Anne Frison-Roche, Institute for Political Studies (France)*

I would like to explain the French experience of building regulatory authorities with an effective level of independence. The intention here is not to discuss the idea of independent bodies itself or to explain why France decided to give up a traditional system of regulation through central government in order to adopt this new and historically unusual system of independent administrative bodies.

Rather I would like to focus on the recent nature of the French organisation: France is a useful model for other countries looking to build regulatory agencies, given that France succeeded in creating a new system of independent regulatory bodies outside of such a tradition. By doing so, the French experience is also an example of a successful acculturation of foreign tradition from England and US.

### **Preliminary: The New French Organisation of Independent Regulatory Bodies**

In fact, France only decided to create its first independent administrative body in 1967, the *Commission des Opérations de Bourse* (Securities and Exchanges Commission). This body is based on the American model of the *Securities and Exchange Commission*. Not until 1978 did France create the second body, the *Commission Nationale Informatique et Libertés*, overseeing the protection of privacy against the threat of computerisation and technology. The idea is only to protect individual freedom and not to organise a sector. In this sense, this body has the power to limit the firms' actions but not really to build and regulate an economic area.

In the 1980's, the European Community opened the key sectors with directives of liberalisation, obliging the European States to choose between State-owned enterprises and the power to regulate the sector. For States, the first way is to keep the control of State-owned enterprises but to give the power to regulate to an independent agency. The basic reasoning is that there would be the existence of a conflict of interest for the State if, at the same time, the government had the power to regulate the sector and were the owner of a firm in competition with other firms. Facing this choice, France preferred to keep its state-owned enterprises and give the regulatory power to administrative and independent bodies. It did it for this reason. The independent regulatory bodies were the only way to avoid privatisation.<sup>6</sup>

For example, the French State was obliged to liberalise the telecommunication sector, in July 1996. In the same month, the French Parliament opened the sector, transformed France Telecom (the State-owned operator) into a private enterprise and created the *Autorité de régulation des télécommunications* (Telecommunications Regulatory Authority). It became the principal model for the other bodies because it was the first independent agency in charge of a specific sector. Its function is to open this sector to competition, but at the same time its function is also to create and maintain a balance between this competition and other goals, such as energetic autonomy, environmental protection and social rights. Ten years after, a European directive required France to create a regulatory authority for the electricity sector, the *Commission de régulation de l'électricité* (Electricity Regulatory Commission), created on February 10<sup>th</sup> 2000. Since January 3<sup>rd</sup> 2003, this commission has overseen the gas sector as well, and therefore it is now known as *Commission de régulation de l'énergie* (Energy Regulatory Commission).

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<sup>6</sup> In England, the evolution has been based on an inverse reasoning because England built independent bodies without European constraints, because they thought it was the best way to obtain regulatory efficiency, and included it in its privatisation programme to obtain fresh money.

France set up many other independent bodies, such as *Conseil de la Concurrence* (Competition commission) or *Conseil supérieur de l'Audiovisuel* (Media Commission), both in 1986 but the global conception of the conditions needed for an effective independence emerged in 1996, with the creation of the Telecommunications Regulatory Authority.

In France, the independence of the regulator is at the same time an ambition and a problem. It is a problem because, in the political tradition, only the democratic and elected powers may decide what to do for the common good, through sectors, such as media, energy or public rights; in this sense, independent bodies which decide on these matters wouldn't be legitimate. But their independence is also an ambition because this is the only way to keep state control of crucial firms, especially firms which control the essential infrastructures, and to avoid the conflict of interests noted before. That is why we continue to have difficult discussions in France about the principle of independence for regulatory bodies. But, while this idea is accepted, it is quite difficult to implement it because independence, after all, is a question of spirit. In this sense, some people continue to think it would be sufficient to find very honest people, with a sense of general interest, such as we could find them among civil servants. But the new requirement of independent bodies is also rooted in a suspicion of men and human nature ... This is why the regulatory system needs legal rules in order to permit people to be moral more easily. The system's goal is to increase the possibility of regulators to be moral, i.e. not to be partial toward powerful bodies, neither Government nor regulated firms.

### ***The Rules for Creating Independent Spirit within Regulatory Agencies***

#### *The rules of regulator nomination*

The legal procedures to choose the regulator or the members of the regulatory body depends on whether the conception of independence, is political or technical. By the first means, the regulator would be independent because the person who appointed him is himself independent and politically powerful. By the second means, the regulator would be independent because he is himself technically competent, no matter who appointed him. Obviously, France prefers the first conception ... The French rules don't give professional or technical requirements that the regulator must have (on contrary, the German system does) but rather who precisely has the power to appoint the regulators. Generally, the members are appointed by presidents of political bodies, such as the president of the *Assemblée Nationale*, the président of the *Sénat* (Senate), or the président of the *Conseil économique et social* (Economics and social counsel); often, the chairman of the regulatory Authority is appointed by the *Président de la République* himself. The idea is the regulator obtains legitimacy and independence because the people who appointed the members expressed a political will and have no interest in the regulated firms.

#### *The power to stay, the prohibition to continue and the negative incentive to anticipate*

To be independent, people must have the power to take a decision without fear of reprisals. The regulator must have the power to displease and to continue to use his power. To allow that the members of the Regulatory Authorities cannot be dismissed. I would like to stress the fact that France, as a new convert, is more radical than the US system. Under the US system, in order to let the newly elected President of United States choose the chairman of the regulatory agencies, the tradition is for the last chairman to step down and to become again a simple member of the body, thus allowing the new president to choose a new chairman from his political party. This isn't the case in France.

To be independent, people must have no hope of having a sort of return on investment, for the time of regulatory power exercised. Independence from the government means the mandate must be

non-renewable. Independence from the regulated sector means the member of the Authority is not allowed to enter the regulated sector just after leaving the agency. Under the French legal system, we have both requirements. It is a big issue in France, because while the first requirement is not a negative incitation for potential regulators, the second is more problematic and Authorities with a wide jurisdiction have fewer good candidates.

#### *A collegial organisation for an independent regulator*

The third legal provision to implement independency is to favour a board organisation over a single man as regulator. As you know, England preferred to appoint a person as regulator, with full powers, in order to increase his personal authority. France, as the US, has always preferred a more bureaucratic organisation.

Choosing between a personal regulator or a board organisation requires us to ask the question: where does the independence and the authority come from? In the former system, they come from a personal credit of a person who appears as the best because nobody knows the sector and the economic rules as well as he does. It is a personal authority and a personal independence. If we believe this, we must choose between old academic people (as England did) or previous professionals from the regulated firms (as US did). But this system appears very dangerous because if the single regulator fails one time, he will lose the confidence of the government and the regulated firms. In the more bureaucratic conception, a board is independent because its work is based on impersonal rules, for example the motivation for its decisions, rather than on personal genius. The more impersonal the regulator is, the more independent the body is from the sector and the government which are not able to judge it so quickly. England changed its conception, two or three years ago and adopted administrative bodies, with boards.

For the same reasons, independence is easier with a quite neutral chairman, chosen among technicians or high administration.

#### *A direct and unique submission to the courts as balance between independence and accountability*

Because independence does not mean lack of control, but instead demands accountability, a big issue is how to hold regulators accountable without limiting their independence. I don't want to speak about accountability (I know you will discuss it later) but just say that the independence forbids the control of the regulator's decisions directly by a minister. Perhaps, it is more difficult to ensure during the transition between old and new regulatory systems. But the principle of independence requires it because political power, by definition, has discretion.

The French system eliminated the power of ministers to amend a regulator's decision. This must be done before the courts.<sup>7</sup> The choice is between ordinary courts or special courts. We have another difficulty in France because the judicial system is built on the duality of two orders, the judicial courts order and the administrative courts order. The French system is quite incoherent because, in some cases, laws give jurisdiction to a judicial court (the Appeals Court of Paris) and, in other cases, to an

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<sup>7</sup> As an exception, the merger control is made by the Minister of Economics and Finance I don't know if I have to speak about this, but we can admit the power to control mergers is a power of regulation, and a great power of regulation. If we admit the merger control must be not a political intervention but a power of economic policy, it is more efficient to give this powerful function to an independent body more than to a minister, who par exemple could be tempted to preserve national interests more than market interest.

administrative court (Council of State). It is difficult to find a rational reason to explain why, for the same regulator, one decision may be attacked before the one court, and another type, before the other. I think it is not a good example to follow ...

### *The independence through the legal personality of the Regulatory agency*

To be independent means not only to have the power to decide but the power to open a file, to start a procedure of sanction, to go before the courts, etc. Doing this requires a legal personality. If the regulator doesn't have this legal personality, legally it is the State who can sue for example. As in England, *La Banque de France* (The Bank of France) has a legal personality, directly recognised by the case law<sup>8</sup> and the *Code de commerce* (Commerce Code) but the other administrative regulators don't have it. It will change in a few weeks with a new Regulatory Authority: The *Commission des Opérations de Bourse* and the *Conseil des Marchés financiers* will be merged into a new institution, entitled The *Autorité des Marchés financiers* (Financial Markets Authority), which will have a legal personality. The bill is in discussion before the French Parliament and we are waiting for the outcome before the end of this year. It is already the case for the German financial authority but in France, we have a fierce debate because it is unusual in public Law. The French Government has decided to propose it because it is a symbolic manifestation of regulator independence.

But we must be careful also because, in the future system, the financial regulator would alone be liable for its actions. What happens if it isn't rich enough?

### **The Rules for Creating Material Independence**

#### *The amount of budget*

The amount of regulatory Authority's budget isn't a big issue, because regulatory work is quite cheap. For example, out of a total State budget of 273 Billion Euros, the budget of the Telecommunication Regulatory Authority is only about 14 Million Euros. No Regulator complains about being too poor to regulate the sector.

But we can be less happy than regulators are. Because there must be a relationship between independence and professional competence. The source of independence is the power to decide to ask for information about this or about that. As the source of independence is in knowledge and in information, dependence comes from the lack of knowledge or the impossibility to decide for itself to collect new information, by investigation. In consideration of this, we may distinguish between regulatory Authorities with their own economic and technical studies, and their own inquiries department, and the others. Only the first are really powerful and independent, and only a few agencies have these capabilities. The *Commission des Opérations de Bourse* (Securities and Exchange Commission) has it, but not the *Conseil de la Concurrence* (Competition council) for which the investigations are made by the Ministry of Economics and Finances. If the regulators don't have the material ability to have direct and self-governing information, they are too dependant on public and private expertises.

#### *The sources of budget*

This is a more difficult question because somebody who receives money must say Thank You, and an independent regulator shouldn't say this to anybody! France organises two possible sources of

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<sup>8</sup> Tribunal des Conflits, June 16th 1997, RFDA 1997, p.823, Arrighi de Casanova conclusions.

funds , taxes on regulated firms, for example for the Financial Authority (*Commission des Opérations de Bourse* , and with the same system, the next Financial Authority, named *Autorité des Marchés Financiers* ) and as part of the total public budget, for example for the Energy Regulator.

It is common to pretend the first solution is better because it prevents the temptation of the Government to use the budget weapon against regulators, to give less than they need or to punish them for an unpleasant decision by giving less money. Following this logic, the Telecommunication Act, in 1996, had planned for taxes on regulated firms to fund the Telecommunication Authority. But in fact, the regulator has never imposed these taxes on the regulated firms and continue to be financed by the State budget.

#### *The use of budget*

This is the most concrete form of independence for a regulator, to do what he needs with his budget. The new tendency in France is to offer to regulators the same freedom to use their money as the private firms have. For example, the next *Autorité des Marchés Financiers* will have the same discretion to hire professionals, with private status and also at the level of private sector salaries. The goal is to obtain a financial regulator as competent as the regulated firms. This is the real condition of an independent regulator.

## The Independent Financial Supervisor: Experience of Hungary

*Mr. László Balogh, Financial Services Authority (Hungary)*

The Hungarian Financial Supervisory Authority (HFSA) has been one of the first among the independent market supervisory entities in Hungary. Its establishment was more of a first attempt to follow the institutional design of other financial services regulator institutions in Europe rather than part of a broader public governance reform. However, the experiences gained about the functioning of this supervisory body may be instrumental when the need of independent regulators of other regulated markets emerges. In case of financial regulators major international standard setting bodies<sup>9</sup> have already elaborated core principles in the late 1990's about the requirements of operative independence (institutional, budgetary, political, administrative etc.) for the sake of maintaining financial sector stability. A major emphasis was given to these key principles after the 1997-1998 global financial crisis. The IMF and the World Bank when having launched their Financial Sector Assessment Project in 1999, one of the key elements in assessing the financial sector vulnerability in member countries was the existence and extent of operative independence of the financial regulators in national markets. The key argument is that regulatory independence, shielded from daily political influences, is a key requirement for long-term financial sector stability. Internationally new or renewed financial regulators have been established or redesigned.

In response to international market trends, to the acceleration of mergers and acquisitions in the financial sector, to the spreading of financial groups and the blurring of clear borderlines between traditional banking, capital market and insurance activities and products, the need for an efficient and comprehensive supervision emerged. Taking into account the Hungarian financial sector's openness and the important foreign presence therein (65% in the banking sector) it was clear that the prevailing global trends would reach the country very rapidly. These factors and the introduction of universal banking largely influenced the Hungarian Government's decision in 1999 to establish a single financial supervisor based on the former Hungarian Banking and Capital Market Supervision, the State Insurance Supervision and the Pension Fund Supervision. The present HFSA supervises credit institutions, investment firms, investment funds, financial service providers, insurance companies and unions, exchanges and clearing houses, and pension funds.

The experience of Hungary cannot and should not be generalised. The specific history of its supervisory authorities, its financial sector, the legal background and the administrative institutional set-up largely contributed to this specific decision. However some elements may deserve attention and some conclusions may be drawn.

### *Background*

The key motivation in the decision was the imperative **need for consolidated supervision**. In Hungary by the end of the 1990's the largest banks and insurance companies, in most cases under foreign control, have built up their own financial group involving investment firms, financial service providers, and pension funds etc. These financial groups are dominating the national market. The financial products offered by them have become increasingly complex and multifaceted. This process went hand in hand with the spectacular liberalisation of cross border capital movements in the course of recent years. Consolidated supervision presupposes very targeted, rapid and efficient information exchange and co-operation between sectoral supervisory authorities. Once this is difficult to achieve for a number of reasons, consolidated supervision remains very theoretical.

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<sup>9</sup> Basel Committee on Banking Supervision, IAIS, IOSCO.

The former three sectoral supervisory authorities represented to a certain extent a fragmented supervisory force vis-à-vis the financial industry in Hungary as a whole. Their relative weight remained less than optimal, even in the largest segment, banking. While the financial industry in Hungary itself has become more and more integrated following international trends, supervisory activities remained largely on stand-alone basis. Consolidated supervision in theory was a prerequisite, but due to institutional weakness and lack of regulatory backing that remained more of an objective to be achieved rather than effectively implemented until 1998. The lessons of the well-known Postabank case in 1998 also pointed to the need of a strengthened and a genuine consolidated supervisory authority.

### *The New Single Supervisor*

At the end of 1999 Hungary opted for the integration of former sectoral supervisory institutions. In the Hungarian case the ever-growing presence of financial groups with combined business activities on the domestic market clearly motivated the decision. The accentuated need for an effective consolidated supervision, the recognition that there is a need for an evident shift from a compliance type supervision to a risk based and proactive supervisory attitude largely contributed to the establishment of the Hungarian Financial Supervisory Authority as from April, 2000. The appearance of universal banking and its supervision was also an additional supporting factor. The expectation was that as a result of a scale of economy some efficiency gains could be realised at the end of the day, although that was not the primary objective.

The institutional reform itself had two important aspects:

- Strengthening the operative independence of the new institution compared with that of the three former bodies in order to respond the new challenges of the financial sector supervision, and
- To gain the maximum benefit of the integration in approximating the separate sectoral supervisory information, analysis and knowledge.

After three years since its establishment<sup>10</sup> in both aspects clear improvement can be demonstrated.

### *Features of Independence*

Supervisory/regulatory independence is a key prerequisite for long-term financial market stability, sheltering the agency from eventual political fluctuations and non-professional influence. In the Hungarian case the merger of the former supervisory institutions also contributed to the increased operative independence of the new institution. As far as institutional independence is concerned, formerly the heads of the former Insurance Supervision and the Pension Fund Supervision were appointed (and removed) by the Minister of Finance, they did not have any fixed term nomination. The President of the Banking and Capital Market Supervision was appointed (and could be removed) by the Prime Minister. The President of the integrated supervisory authority (HFSA), however, is appointed by the Parliament upon the proposal of the Prime Minister for six years fixed term and cannot be removed only in specific cases pre-determined by the law. Whenever he or she would be removed that has to be explained publicly.

As far as **relations with the Government** are concerned, the HFSA is part of the public administration and is functioning under the supervision of the Government. The HFSA is obliged by

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<sup>10</sup> The Hungarian Financial Supervisory Authority was established as of April 1<sup>st</sup>, 2000.

law to report on yearly basis to Government, however the Law explicitly provides that the HFSA cannot be instructed in its operation, it has to perform its duties on the basis of relevant laws and regulations. This provision gives an opportunity for the HFSA to operate on professional basis, whenever a supervisory decision is taken it should not be influenced by daily political considerations.

The HFSA is also accountable to the competent Parliamentary Commission, its yearly report is also submitted to the Commission. This Commission is entitled to ask at any time the President to appear before it and prepare and submit reports in his competence.

**Budgetary autonomy** is an important aspect of operative independence. Since January 2002 the HFSA is fully financed by the market. The market participants are levied with a certain formula and they are contributing to the cost of supervision. The rates (formulas) of the fees to be paid are not decided by the HFSA, but they are either set by the sectoral laws or by Government Regulation.

An important feature is to **what extent staffing, human resource management is free of administrative limitations**. In case of the HFSA it is part of the public administration, its professional employees are civil servants. In this context their salaries are regulated by the Law on Civil Service, no competitive salaries can be established to the staff. The real challenge is that people who are supervised in the financial sector are earning much higher, and the best quality experienced professional people cannot be recruited, mostly at the mid managerial level. Some compensation can be found when bonuses are established. Although the level of bonuses is still far from the market level it is somewhat higher than the average civil service level. One other difficulty is the overall number of the employees, to increase the number of employed experts a very complex and long lasting administrative procedure has to be followed, the HFSA being an organisation falling under the rules of the law on public finances.

Although the HFSA can issue supervisory decisions binding for individual institutions, it cannot issue **regulation** with general bearing. That means that all regulatory type of regulation has to go through the government administrative procedures, and sometimes highly technical regulations are issued either by the Government or the Ministry of Finance. It may take several months to order a change in the data reporting requirements of supervised institutions, or to modify some formulas in capital calculations. A well defined, non-policy type regulatory power would highly contribute to the efficiency of the HFSA's supervisory work.

The Act on the HFSA provides for the appropriate participation in the financial regulatory work. The HFSA has the right to propose with the Ministry of Finance any sector related regulatory changes, to take part in preparatory discussions of this kind and according to the law it has to be invited to the different levels of meetings in preparations of financial regulatory changes. The decision remains with the Minister of Finance or with the Government.

**Appeals against supervisory decisions:** before the merger any supervisory decision of both the Insurance and the Pension Fund Supervision could be appealed with the Minister of Finance (unlike in the banking and capital markets). With the single regulator all supervisory decisions (including insurance and pension funds) are firm and final and they can only be appealed before the Court. The Court may only consider whether the HFSA acted in conformity with the relevant laws and regulations or not.

### *Experience*

The integration of the markets has already led to a situation when the same products can be offered in almost any institution irrespective of its subsectoral belonging. Some insurance products can

easily be obtained in a bank, investment type products are present with an insurance company etc. It seems now much easier, within an integrated supervision, to follow the risk features of these products, the commercial attitude of the institutions offering them and the consumer information attached to the same product. The single supervisor has to pay special attention to the equal treatment of all sub-sectors: their might not be supervisory bias vis-à-vis any of the participants of the markets. In the functional set-up key managers had to put aside their former professional-sectoral background to achieve this impartiality.

Although market participants were somewhat sceptical about the merger of the financial supervision, after the experience of the first 3 years they very well received the step. The general attitude of the "new" supervisory authority when it seeks more contacts and professional dialogue with the institutions on issues that have relevance for the sector as a whole is welcome. The different ways and means to communicate with the market and with players on the market, however, still needs to be more precisely defined and fine-tuned.

There is, obviously, a better overview of the industry, regulatory deficiencies and inconsistencies. The HFSA is better positioned to initiate legislative modifications. Its views have become more credible. In Hungary the sectoral laws remained in place separately, however important loopholes and deficiencies, and inconsistencies were discovered. The single supervisor, however, has worked to achieve legal and supervisory consistency. It turned out that the HFSA is more credible to suggest regulatory or legislative modifications. These efforts led to an improved regulatory background leaving room for much less regulatory arbitrage.

#### *Summary*

#### **Institutional autonomy:**

- President elected by the Parliament for fixed six year term
- Supervisory decisions cannot be appealed at higher administrative body
- Right of appeal with the court only
- Recent step: HFSA cannot be instructed, it should only act under rules and regulations

#### **Budgetary Autonomy**

- No contribution from Government Budget
- Self financing authority - fees paid by the industry
- Fees to be paid by the sector: established by the Government
- Recent step: autonomy in deciding the structure of expenses according to needs

#### **Administrative Autonomy**

- Supervisors are civil servants
- Supervisory liability is with the President of the Authority
- Income level of the staff is over civil servants' but much lower than the market level
- New step: getting closer to the market in income level + some exemptions from civil service practice

### **Regulatory Autonomy**

- Regulations issued by the Government or the Minister of Finance in the form of decrees
- Active involvement of the HFSA
- Process is slow, inflexible, burdensome
- Supervisory resolutions are made public
- Supervisory Guidelines are issued -legally not binding, well received by the industry
- Unresolved: Power for the Supervision to regulate

### **Accountability**

- Accountability to the Government
- Control by the State Audit Office
- Regular reporting to the Government
- New Steps: Regular reporting to the competent parliamentary commission
- Accountability to the industry
- Establishment of the Supervisory Council – Advisory body for the President

### **Prevailing Aims of the HFSA:**

- Preventive supervision
- Risk based approach
- Regulatory power
- Service provision for the industry
- More transparency in its functioning
- Be in permanent dialogue with financial institutions
- To be closer to market developments
- Improve public financial awareness
- Fair and neutral treatment of all sub-sectors

## **Introduction of Energy Regulatory Office as a Regulatory Body in Electricity, Gas and Heat Industries in the Czech Republic**

*Mr. Jaroslav Vitek, Energy Regulatory Office (Czech Republic)*

The main aim of the presentation was to introduce the Czech Energy regulatory office (ERO) as a state body that was established in 1/1/2001 by the act 458/2000. Because of its existing only two and half years there are a lot of tasks that are being solved now and that should make the functions of our office more effective and better applicable.

The primary objective of the Energy Regulatory Office is defined as a support of business competition and a protection of consumers' interests in such energy industry areas where competition is not possible, aiming to satisfy all the adequate requirements for power supplies. Energy regulatory office is a central body of the state administration, which has its own chapter in the national budget. This option has its advantages and disadvantages. Advantages are related to not being directly affected by the market agents and having a fluent and stable flow of income. Disadvantages are related to low independence from the Government. As the Energy regulatory office can't possess assets (according the Czech laws the state bodies can just hold assets in free leasehold) and as the ERO depends on the annual budgetary income, the Government probably can affect deeply the Energy Regulatory Office normal activities.

The Office is supervised by its Chairman, which is appointed by the government for a period of five years. The Chairman of Energy Regulatory Office has to report about activities of Energy regulatory office (yearly) not to the Ministry or the Government but to the Parliament. The Chairman can be released from the position by the government before the end of the period, for which he was appointed, only in a case of his illness preventing him from accomplishing his tasks, serious breaking of his duties, committing a criminal act, or his resignation from the position. There are still big disputes whether it is better to have the head of the office as one person or as a commission. In my opinion the better solution is to have a commission.

As concerns employees in order to prevent the independence the employees are incompatible with any other professional activity in the sector during their employment in ERO and the leading employees for a period of time after the mandate (usually a couple of years). Because of this, the former leading employees receive a financial compensation during the period of incompatibility.

In the end I would like to remark that in Czech republic is preparing new law on state regulatory authorities that should find a common framework for functioning and statute of sectoral regulators (that means also for Energy Regulatory Office).

## Summary of DTI Presentation on Accountability of UK Regulators

*Mr. Simon Oates, Department of Trade and Industry (UK)*

Independent regulation in the UK is based on the rationale that the delegation of day-to-day management of the regulatory environment to a body independent of Government insulates decisions from short-term political factors. The result is a greater degree of regulatory certainty – a requirement for ensuring that private finance can be attracted to the regulated sectors.

The more stable the regulatory environment – the cheaper and easier it is for regulated utilities to cover their investment needs by lowering investors' perception of risk and lowering the cost of capital.

Stability also benefits consumers through reduced price volatility, and stable operating environments are most attractive to potential new entrants, maximising the potential for new entry to the market.

Independence of regulatory bodies from Government provides a baseline for stability of the regulatory system, but this must be further enhanced by enabling regulators to build a reputation for consistency, and through **appropriate accountability mechanisms**.

Accountability mechanisms enhance stability through the introduction of checks and balances to the power of the regulator, and by increasing the legitimacy of their decisions. The building blocks of accountability in the UK system are:

- Appeals
- Transparency
- Corporate Governance
- Parliamentary Scrutiny

These mechanisms fall broadly into two categories:

### **Operational Accountability**

Regulators are accountable to a number of stakeholders on for their day-to-day operational decisions through:

- **Judicial Review** - allows a Court to nullify a decision of the regulator that has not been made in accordance with relevant law, or is manifestly unreasonable. All decisions of the regulator are open to Judicial Review.
- **Appeals** – regulators' decisions on license modifications and the setting of price caps can be reviewed by the Competition Commission following a referral by the regulator, if the regulated firm registers disagreement with the regulator's decision. **Transparency requirements** – Key elements of good practice in transparency include:
  - Consultations;
  - Regulatory Impact Assessments; and
  - City Briefings

- **Consumer representation** – statutory independent Consumer Councils have been created to give consumers a stronger more coherent and independent voice.
- **Corporate Governance** – When the UK regulators were first established the responsibility for all of their functions and duties rested with the Director General of the regulator alone. This has now changed, so that the majority of regulators now operate under the direction of a board. Movement to a board structure is seen as desirable: boards ensure a wider range of expertise within the decision-making process; increase transparency and accountability of decision-making as board decisions are reached through a process of discussion with decisions open to challenge and scrutiny by board members.

### **Performance Accountability**

The second set of accountability mechanisms assesses the regulators success in delivery of their statutory objectives – their Performance. Broadly there are three categories:

- **Annual Reports** – Each of the industry Acts requires that the regulators submit an annual report to the Secretary of State in which they are required to detail their performance and activities in relation to their statutory objectives. The Secretary of State must in turn lay a copy of this report before each House of Parliament.
- **Parliamentary Scrutiny** – Parliament plays an important role in holding regulators to account for performance of their duties at a strategic level. Most Parliamentary scrutiny takes place in select committees, which may call the regulators before them. Further performance accountability is brought to bear by the National Audit Office and Public Accounts committee (a select Committee) to which it reports. The National Audit Office (NAO) scrutinises the Economy, Efficiency and Effectiveness of all public bodies which spend central Government monies – (including the regulators).

**Independent Scrutiny by the BRTF** – Better Regulation Task Force, an independent advisory body set up in 1997, has examined and reported on the performance and operation of regulators. The Task Force's terms of reference are: "To advise the Government on action to ensure that regulation and its enforcement are transparent, accountable, proportionate, consistent and targeted."

## **Balancing Independence and Accountability: The Greek Example**

*Dr. Vassilios Kondylis, Hellenic Committee of Telecommunications and Post (Greece)*

The analysis of the Greek example of achieving a balance between independence with accountability shows that it is necessary to understand:

- First, the reasons for creating Independent Authorities (IAs) [Independent Regulators IRs] in the Greek legal order,
- Second, the means of ensuring independence, and
- Third, the means of balancing independence and accountability.

### ***A. The reasons of the creation of IAs***

Generally, the establishment of IAs was a common practice during the last decade in the Hellenic Republic. However, it has been a difficult and controversial issue for many years. The creation of some of the IAs was a choice made by the Legislature as a result of transposing and fully implementing EC Law, in the domestic legal order, as it has happened in the Radio-Television, the Telecommunications, the Post, the maritime transport, the energy sector etc.

But the constitutional issue of their existence and their recognition in the Greek legal order was definitely resolved by the recent constitutional revision completed in April 2001 (new article 101 A), after a long discussion before Parliament.

The result of all the discussions held in the Parliament and of the scientific analysis for a long period of time is that the phenomenon of IAs was considered as a political and legal hybrid for three main reasons, related to the particularities of the Greek legal order.

First, the necessity of creating new institutions for the better protection of civil rights of the individuals, considered (the rights) as threatened by the technological ‘evolution’, if not ‘revolution’. Thus, we created the IAs for assuring, amongst other reasons, the secrecy of communications and for data protection.

The second reason is the, to put it this way, ‘political difficulty’ of effectively managing / handling some sensitive and competitive sectors of public life. In that way, by this creation was ‘neutralised’ a sector of the state activity, assumed by the IA. For instance the National Council of Radio and Television (NCRT).

The necessity of ensuring transparency of the functioning of the Public Administration (PA) and full justification of its actions in some sensitive sectors of state activities led to the quasi-justicialisation of those sectors:

- The better protection of the human rights (Data protection Authority),
- The exercise of control and supervision of big sectors of the PA, protecting the impartiality of the PA as the Mediator and the High Counsel of selection of personnel (ASEP),
- Many IAs are responsible for the efficient and effective functioning of the Market, or some sectors of the Market: Competition Authority (CA), National Commission of Telecommunications and the Post (NCTP-EETT), Regulatory Authority for Energy (RAE), Regulatory Authority for Domestic Maritime Transport Sector (RADMTS),

- Some of the IAs combine different characteristics because they work / function as institutions for the protection of the Human Rights, as a mechanism for the supervision of a large sector of the PA and as a regulator of the Market, at least a special sector of the Market, as the NCRT.

Article 101 A of the Hellenic Constitution provides specifically for five IAs (ASEP, NCRT, Mediator, Data protection Authority, IA for assuring the secrecy of communications) and contains a special delegation of powers / transfer of competencies to the Legislature to create more IAs. So the Legislature has created RAs as IAs competent for special sections of economic activity (for instance, telecommunications, energy, maritime transport, and the application of competition law).

Today, RAs, as EETT and the IA for the protection of the secrecy of communications, have executive/ administrative, consultative, competencies, they control or supervise a special sector of economic or State activity, and provide opinions to the Minister that is competent for this special sector of State activity. In addition, only the EETT and the IA for the protection of the secrecy of communications enjoy a delegation of powers to create new rules (secondary legislation) within the legal framework set up by the Legislature.

### ***B. The means of assuring independence***

The constitutional recognition of IAs, and the establishment of some principles related to their existence is already a great step in assuring independence. Paragraph 1 of article 101 A of the Constitution provides for the setting up (establishment) and the operation of an IA, and requires that its members should be nominated for a mandate and enjoy functional and personal independence. The law 3051/2002 has set the mandate of those IAs of up five (5) years. Other laws provide also for a five year mandate of other sectoral regulators (EETT, CA, RAE, etc.).

#### *Functional independence*

Functional independence means that, when the members of an IA exercise their competencies, only the Constitution, EC Law and the laws of the Hellenic Republic bind them. They must not apply laws whose contents do not conform to the Constitution or EC Law. Besides, hierarchical control or supervision by the competent Minister is absolutely excluded for the five IAs constitutionally recognised and is also excluded for those created by the Legislature who provides for their functional independence. The acts of the IAs are enforceable if the Law provides that they have enforceable effect. At the same time, this is an essential safeguard for accomplishing their mission.

The functional independence is related to the administrative and the financial autonomy.

The administrative autonomy means, amongst others, that the IAs have their own personnel. Generally, the largest part of their personnel is young, highly qualified and competent.

The degree of their financial autonomy is different, depending on their statutory law: Some of them have their own Budget (Data protection Authority, EETT, RAE, CA) some other not (RADMTS, Mediator, National Counsel of Radio and Television).

#### *Personal independence*

Personal independence means that the members of an IA are senior civil servants during their mandate, and they are independent from governmental control or any other direct or indirect influence. They are also independent from influence coming from any interested group of individuals or undertakings; this is the case of EETT, the Competition Authority, etc.

Usually the President and the Vice-Presidents serve on a full time basis and they must not exercise any other professional activity or assure other tasks during their mandate. There is only one exception to that, according to which they are allowed to teach at a University or a High-level School.

The functional and the personnel independence don't mean that a unique IA regulates a sector of state activity. For instance, matters of competition are divided in more parts: The CA is not equally involved in the regulation of anti-competitive conduct in every sector (maritime transports, energy matters, telecommunications). CA is not involved in the Greek telecommunications market, as is the case with similar agencies in other countries. But an informal co-operation between the two agencies (EETT and CA) is established.

### ***C. The ways of balancing independence and accountability***

#### *Absence of any ministerial and governmental control*

According to article 101 A of the Constitution, the Government or the competent Minister do not exercise any control or supervision over the IAs. That applies to the five constitutionally recognised IAs whereas for the rest IAs, the rule is more or less the same, but the Legislature can differentiate.

For instance, the Law provides that the Minister of Commerce supervise the Acts of the CA. Also, the Law provides that every October, EETT, as the other IAs do, must prepare and submit to the President of the Parliament a report with its proceedings that must also be sent to the Minister of Transport. This is the minimum required with regard to the official communication with the Minister.

Nevertheless, the Parliament can change the degree of independence of IAs, those not constitutionally recognised. So, it can change their competencies (add new or take some of them back), in any case respecting the EC Law. It can also provide again for ministerial control. Until now we have seen only cases of law clauses enlarging the cycle of matters belonging to an IA competencies to manage.

In spite of the lack of any ministerial and governmental control on the acts and the members of the IAs, the Government has powers to introduce rules concerning the status of the IAs' personnel, the procedures governing the conclusion of their contracts, matters related to their economic management, the salaries of their members of the IAs and of their personnel, etc.

#### *Parliamentary supervision*

##### *Parliamentary supervision is organised in two levels.*

First, the members of the IAs are nominated by a special Committee of the Parliament according to a procedure described in the Parliament Regulation Act, in accordance with the revised article 101 A par. 2 of the Constitution. The choice is made by decision of this Committee unanimously or, if it is not possible, with majority of 4/5 of its members. We have used this procedure some times till now.

Second, a particular form of parliamentary supervision refers also to the control that the Parliament exercises over the independent authorities (especially those mentioned in article 101 A par. 3). On an annual basis (October) each IA submits to the President of the Parliament a report of its activities in the preceding year with its proceedings.

The Special Permanent Committee on Institutions and Transparency examines the report and publishes its findings, which include the opinion of the minority. This Committee must approve those

reports, otherwise the IA will be in a very delicate position and the disapproval of report can be a drastic, although indirect, measure of pressure on the IA that theoretically can be a reason of demising for not enjoying the confidence of the Parliament. But due to the quality of the IAs' work and also to the unanimous nomination of the IAs' members, we have never faced such a problem until today.

#### *Judicial control*

The administrative courts and, among them the Council of State, have jurisdiction in actions brought by a natural or legal person, or a Minister against the acts of an IA provided that this act is an enforceable administrative act producing legal effects. The Council of State can annul such an act.

Also the Court of auditors controls a posteriori the implementation of the Budget of IAs that enjoy financial autonomy (EETT, RAE, CA, etc).

#### *Social control*

The IAs' activity is under social control: Their administrative acts must be well motivated and well reasoned, their regulations are published in the Official Journal of the Republic and the Official site of the IA, before taking some measures in a sector, some of the IAs carry out public consultations (for example EETT and RAE do often so), etc. So, IRs are accountable and responsible to the policy objectives, which initially justified their establishment. But the Law doesn't provide for a performance assessment that also ensures the accountability of RAs.

#### **Conclusion**

As the institution of IAs in the Hellenic Republic is not very old, we tried to ensure their functional and personal independence and to balance independence with accountability of the IAs consistently with our constitutional legal order and our obligations under EC Law.

We can affirm that the enrichment of our legal order with the institution of the IAs helps us not only to deal with difficult matters of the administrative activity (Civil servants nominations, control of the administrative activity, Radio and Television matters) but also to face new and difficult problems due to the technological development (Data Protection, secrecy of communications), and the protection of effective competition (totally or partially in different sectors as telecommunications, energy, maritime transports), etc.

## **The Establishment of a National Regulatory Authority in Poland**

*Ms. Aleksandra Stepnowska, Office of Telecommunications and Post Regulation (Poland)*

The new independent Polish NRA – Urząd Regulacji Telekomunikacji (Office of Telecommunications Regulation) was established on 7 October 2000 after the new Telecommunications Law entered into force. It took over the National Radiocommunications Agency, State Telecommunications and Post Inspection and most of the responsibilities of the Ministry of Post and Telecommunications.

The next stage of the governmental reform resulted in further structural modifications of the authority. From 1 April 2002 the Office of Telecommunications Regulation was replaced by the Office of Telecommunications and Post Regulation (URTiP), thus widening the scope of its activities.

*President of the Office of Telecommunications and Post Regulation*

President of the URTiP is a Polish regulatory authority competent for telecommunications activities, frequency management and the monitoring of compliance with electromagnetic compatibility requirements, as well as for postal market issues.

President of URTiP is a central-level administration authority, who is in charge of the work of the URTiP together with his Deputies and the General Director. President is appointed for the 5 years term by the Prime Minister at the request of the Minister of Infrastructure. Deputies of the President of URTiP are appointed and dismissed by the Prime Minister at the request of the President of URTiP.

President of URTiP can be dismissed by the Prime Minister only under the following conditions:

- Gross violation of the Telecommunications Law,
- Criminal offence committed,
- Serious illness,
- Resignation.

The head of the regulator reports annually to the Minister of Infrastructure.

URTiP is legally separated from the incumbent and other market operators. The regulator is also independent of the Ministry of Treasury, i.e. the body responsible for holding State shares).

*Competencies of the President of URTiP*

Tasks and responsibilities of the head of the telecommunications regulator include, in particular:

- Duties concerning the regulation of telecommunications market and frequency management, as well as the monitoring of compliance with the electromagnetic compatibility requirements;
- Collaboration with the minister competent for posts and telecommunications in drafting legal acts within the competencies of the President of the URTiP;
- Assessment of the operation of telecommunications and postal services markets and telecommunications equipment market;

- Intervention in matters related to the functioning of the market of telecommunications services on its own initiative or brought to its attention by the parties concerned, in particular by users and operators, including issuance of decisions on these matters;
- Creating conditions for the development of the domestic radiocommunications service by securing the necessary frequency assignments for Poland and access to satellite-orbital resources;
- Overall regulation of the postal market;
- Duties related to national defence and security in terms of communications;
- Co-operation with international telecommunications organisations and competent foreign national authorities;
- Ruling on the professional qualifications in telecommunications; and
- Inspiring and supporting scientific research.

#### *The structure of the Office of Telecommunications and Post Regulation*

URTiP consists of 10 Departments, President's Bureau, Classified Information Protection Unit, Internal Audit Unit and 16 Regional Branches. Core departments include the following: Department of Telecommunications Market, Department of Telecommunications Technology, Department of Frequency Resources Management, Monitoring Department, Department of the Postal Market, Department of Defence Affairs. The URTiP also has 16 regional offices and two consultative bodies that assist the President of the Office: the Telecommunications Council and the Postal Services Council.

#### *Staffing and financing of the URTiP*

The staff in the URTiP comprises civil servants. The total number of employees is 641, including the regional offices.

The President of the URTiP manages its financial activities in accordance with the principles applicable to budget-funded units. The expenses of the URTiP are covered by the state budget in the amount fixed each year in the Annual Budget Act.

#### *International Co-operation*

The URTiP is responsible for co-operation with international and regional telecommunications organisations and competent foreign NRAs and institutions with similar competencies. The URTiP as a Polish NRA cooperates with:

International Telecommunications Union (ITU), Universal Postal Union (UPU), European Conference of Postal and Telecommunication Administrations (CEPT, including CERP), European Telecommunications Standards Institute (ETSI), Satellite Organisations (e.g. EUTELSAT, INMARSAT, INTELSAT), European institutions related to the negotiation process and adjustment of Polish regulation to the EU requirements (the European Commission and its committees, Independent Regulator's Group, European Regulator's Group).

## **Session 7: Regulators and Competition Authorities**

*Gary Hewitt, OECD*

**Prague, June 13, 2003**

### **I. Introduction**

Corporatisation, privatisation and liberalisation are sometimes repeated like a magic mantra for economic success, but they could end up producing corruption, high prices and disillusion with economic reform. How can such a fate be avoided? By carefully thinking through and applying three fundamentally important policies. They are: appropriate restructuring before privatisation; implementation of efficiency enhancing regulation; and consistent application of competition law.

In this presentation I am going to focus first on the restructuring issue. This is because of its great importance and because it provides a good entry into noting what will likely be needed in the way of regulation and competition law enforcement when network infrastructure industries are being transformed in the interest of promoting greater efficiency. After briefly introducing the four basic regulatory and competition enforcement tasks, I will then discuss four different approaches to allocating those tasks to the competition authority and one or more regulators. My presentation will conclude with some brief summary remarks.

I will concentrate on providing an overview of this topic and leave it to the other panellists to provide actual examples of various institutional alternatives.

### **II. Restructuring**

When a country decides to corporatize and perhaps privatise it should carefully consider making appropriate vertical and horizontal splits. The vertical splits should be directed at isolating networks in which a monopoly seems unavoidable. Two examples are separating electricity generation and gas production from transmission and local distribution grids. Making such vertical splits could involve some loss of synergies, for example in planning and co-ordinating the addition of new electricity generating capacity. But failure to make the splits can also produce major difficulties in introducing competition in activities where there is ample room for more than one competitor.

Appropriate horizontal splits are also advisable and happily carry few risks. By horizontal splits I have in mind things like putting gas and electricity under separate ownership. This would facilitate competition between gas and electricity as energy sources and would also tend to promote competition in electricity generation. By horizontal splits, I also refer to things like ensuring different ownership of the various electricity generating plants, or putting local electricity distribution grids under separate ownerships. Incidentally, the latter type of horizontal splits, combined with requiring all the separated entities to adopt the same standardized accounting rules, would greatly facilitate efficiency enhancing yardstick regulation, i.e. would allow the regulator to compare performances and regulate accordingly.

Despite the efficiency enhancing attractions of appropriate pre-privatisation restructuring, governments will be under heavy pressure to sell integrated monopolies intact. This is because quick sales at politically attractive high prices are much easier to arrange if the power to set prices well above costs, i.e. market power, is sold along with bricks and mortar. The problem is that society as a whole will lose more from the exercise of market power than the private shareholders and employees of privatised monopolies will gain. And by the time this is fully realised it may well be too late. The

people willing to pay the most for market power are typically those most able to hold on to it, i.e. those best placed to tilt the government towards sacrificing the public interest.

Governments would be wise to look to other countries' experiences before too quickly believing that important synergies would be lost through restructuring prior to privatisation.

To simplify the rest of my presentation and to amplify why it might be advisable to restructure before privatising, I will henceforth focus on the electricity industry and will assume there is a monopoly running the country's transmission and distribution grids, and it has been permitted to keep the bulk of the country's generating capacity. I will further assume that entry into generation is permitted and at least the larger customers are permitted to choose their generator. Any such independent generators must of course purchase access to the transmission and distribution grids in order to supply their customers.

Before going on, let me note that if the government has merely corporatised and has not proceeded to privatise, much of what I am going to say is still relevant.

### **III. Efficient regulation and application of competition law - Four basic tasks**

Under the assumptions I have just made there are basically two things that can go wrong. First, as monopoly owner of the transmission and distribution grids, the vertically integrated electricity company, I'll call it "Universal Electric" or "Universal" for short, will probably charge a great deal for the electricity it sells to final consumers. Second, Universal may adopt all kinds of practices designed to stop independent generating companies from competing with it. Among the most obvious such practices are:

- a. charging discriminatorily high access prices, i.e. higher prices to competitors than it implicitly charges to itself;
- b. requiring higher quality standards for independent generators than it applies to itself or than are necessary;
- c. tying up necessary inputs by various exclusive arrangements, e.g. agreeing to buy natural gas to make electricity only if the sellers enter into very long term contracts or explicitly agree to sell only to Universal;
- d. targeted predatory pricing – to make new entrants suffer such severe losses that they are driven out of business before they can become well enough rooted to win financial support from investors willing to back new more efficient competitors;
- e. making price setting agreements with independent generators, or dividing up the market for example by agreeing that only Universal will sell to the largest companies while its competitors exclusively sell to the smaller ones;
- f. reinforcing the anti-competitive agreements just described by building and always maintaining excess generating capacity, including meeting competition clauses and most favoured purchaser clauses in its sales contracts, and/or organising an industry association to discuss matters of mutual interest; and
- g. merging with any particularly challenging, i.e. efficient, new generating company.

This list could be lengthened or made more specific but it suffices to show how difficult it will be to assure competition and a good deal for consumers in an industry where there is substantial market power *and* the firm having such power is vertically integrated so that its competitors are dependent on it. Perhaps it is clearer now why appropriate pre-privatising restructuring deserves very careful consideration.

To offset the market power inherent in monopoly ownership of the electricity network and to prevent various anti-competitive practices, the government might resort to four basic policies:

1. “retail price regulation” – capping the retail price of electricity;
2. “access regulation” – ensuring non-discriminatory access to the transmission and distribution network, and setting access prices so that generators which are at least as efficient as Universal are not squeezed out of business – note – only access regulation will be needed if the network alone enjoys significant market power, i.e. with reasonably free entry into electricity generation, there will be no need for supplemental “retail price regulation”;
3. “technical regulation” – setting and monitoring standards so as to assure the network’s integrity as well as to address various safety, and environmental protection concerns; and
4. “competition protection”- controlling anti-competitive conduct and mergers.

Identifying the necessary tasks is relatively easy. Deciding who should do what is not.

#### **IV. Institutional Issues and Options**

It is unlikely that the institutional decisions will be made in a vacuum. In particular there will be a team of experts that can be tapped in the ministry that used to run the electricity sector. Mostly this will consist of engineers, accountants and economists who should be well able to conduct technical, retail price, and access regulation. There may also be a competition authority that has expertise in applying competition protection throughout the rest of the economy and could presumably do so as well for the electricity sector. Both former ministry officials and competition authorities could lay claim to having expertise relevant to access regulation.

I will take as given, but am willing to be corrected, that technical regulation has little in the way of important synergies with competition protection. It therefore seems likely that this task will not be confided to a competition authority, though competition authorities may want to monitor technical regulation to ensure that standards are not used as a means of excluding certain competitors.

Turning then to retail price regulation, access regulation and competition protection, where should these be located? Should they be clumped together with the technical regulator? Should they be given to the competition authority? Should they instead be split in some way? In theory there are many possibilities, but in practice there appear to be just four commonly used approaches. I will consider each of them in turn, and comment on their advantages and disadvantages.

##### **1. Full division of labour, i.e. separation of the regulatory and competition protection functions**

I list this first simply because it is currently the most common institutional set-up, perhaps because it exists by default as soon as a regulator is set up in a country which also has a competition authority. The three functions we are focusing on are allocated as follows: retail price regulation and

access regulation go exclusively to a regulator and competition protection exclusively to the competition authority. The regulator has no powers to enforce either the general competition law or one customised to apply to the electricity sector, and the competition authority abstains from using its abuse of dominance powers to require access to essential facilities or to prohibit high prices (not all general competition statutes contain that power in any event).

The advantages of the division of labour approach are:

- a. merger review, detection and prosecution of cartels, and the assessment of the pro- and anti-competitive effects of various vertical agreements and arrangements are among the most difficult areas of competition law. These are the domains where the accumulated expertise of a competition authority most needs to be brought to bear.
- b. since there is only one competition law being applied throughout the economy by a single authority, there will be little risk that different competition provisions will be applied to competing enterprises in a way benefiting one set of competitors over another
- c. legal certainty is improved as regards competition law enforcement because exactly the same law is being applied throughout the economy. Consequently, more jurisprudence will accumulate faster and courts of appeal will learn more quickly and thoroughly how to apply competition law.
- d. the envisaged division of labour allows the development of two different institutional cultures each best suited to its own set of functions.

Retail price regulation and access regulation require large staffs of engineers and accountants, extensive sector expertise, and a hands-on *ex ante* approach. All that contrasts rather starkly with what one typically finds in competition authorities. These are mostly rather small agencies composed, on the professional side, of lawyers specialised in competition law and economists steeped in industrial organisation. Neither the lawyers nor economists in a competition authority are necessarily well acquainted, on an ongoing basis, with the detailed operations of any particular market.

Regulators are typically engaged on a day to day basis with the companies they regulate. In general competition authorities only inform themselves concerning a particular market when there is a complaint or an important event such as a merger. If they find a problem, they apply, with the exception of merger review, some form of *ex post* remedy or sanction or structural or behavioural remedy requiring minimal ongoing monitoring to enforce.

The corporate culture in a competition authority is generally one that sees markets as only exceptionally requiring outside interference, i.e. for the most part tending on their own to produce satisfactory results. A competition official's basic mandate is to remove private constraints on competition, prevent mergers that could threaten effective competition from developing and/or continuing, and to lobby governments to remove unnecessary government restraints on competition.

Things are quite different within a regulator. Here the mandate is to supply an ongoing substitute for competition in a market that cannot function well if left to its own devices. While competition law seeks to unlock a market's potential or prevent it from being lost in the first place, regulation seeks to produce directly what the regulator thinks is a satisfactory outcome, including a price that does not yield supra-competitive profits.

Another important cultural difference has to do with the number of objectives competition authorities and regulators typically have. Regulators are typically assigned a considerably broader range of goals than competition authorities are given, so regulators tend to become more adept at trading off conflicting goals.

The advantages of the full separation approach come at a price. It risks duplicating hard to acquire sectoral knowledge. In addition, it may happen that a second best remedy is applied because neither regulators nor competition authorities can apply remedies reserved to the other, and neither is willing to leave the problem to the better equipped office. To deal with these problems, regulators and competition authorities should be encouraged, perhaps even required to co-operate with one another, take account of each other's views and defer to the other to take action in appropriate circumstances. Some have even worked out formal agreements concerning their voluntary co-ordination. Example: in Canada the Competition Bureau and the broadcasting and telecoms regulatory have signed an interface agreement specifying their division of labour and how they will co-operate.

There may be instances where co-operation, co-ordination and deference are seen as inadequate. This may be why certain countries have opted to combine economic and access regulation together with competition protection within a single agency. There are two possible variants of this approach.

**2. A regulator exclusively exercises all *four* of the basic tasks, i.e. the competition authority has no jurisdiction in the regulated sector, except perhaps to engage in competition advocacy**

Note that the exception concerning competition advocacy is far from trivial in nature. Competition authorities should always be consulted before regulatory regimes are adopted or reformed.

**3. The competition authority exclusively exercises all the regulatory tasks with the possible exception of technical regulation**

With this option there may or may not be regulators in the affected sectors, but if there are, they are confined to technical regulation.

Examples of giving regulatory functions to competition authorities can be found in Australia where the Australian Competition and Consumers Commission (ACCC) is involved in regulating the electricity, gas and telecommunications sectors and also applies the competition law to those sectors.

Letting either a regulator or a competition office undertake all functions has, at least in theory, advantages mirroring the disadvantages of the division of labour approach, i.e. sectoral knowledge is acquired and used efficiently and the most appropriate remedy is, at least in theory, applied. The same could be said of their disadvantages. These tend to mirror the advantages proposed for the separation approach. This is especially true in the case of multi-function regulators whose mandates include enforcing sector specific rather than economy wide competition laws. Customised competition law risks decreasing legal certainty and ending up in a situation where competing firms are treated differently, for example as regards merger review or the control of predatory pricing.

Which of the exclusive jurisdiction models works best, i.e. giving all the functions either to a regulator or to the competition authority, could depend critically on what the prospects are for competition to develop. In telecommunications for example, there is increasing evidence that control of the fixed line local loop may not grant much in the way of market power. This is because mobile telephony, telephony offered over cable TV networks, and perhaps in future, telephony using the electricity network may provide sufficient competition to the fixed line telephone firm. If competition

is indeed likely in the future, it might make more sense to give the combined functions to a competition authority than a regulator simply because the authority will have less to lose from the eventual winding up of the regulation. At least some of the staff that becomes redundant can be employed in the expanded competition related work.

It is interesting that at a Spring 2003 OECD meeting,<sup>11</sup> Kanwaljit Kaur from the Australian Treasury (which is charged with policy developments in the regulation and competition fields) commented that, in the early years of the ACCC combining regulatory and competition protection functions in certain sectors, it was maintained that the ACCC's competition culture had a lot of influence on the access regulation practised by the ACCC. In fact the regulation was accused of having too much of a consumer bias. More recently, the access regulation function has had to be distanced somewhat from the other parts of the ACCC.

Some commentators question whether a competition authority having access to both regulatory and competition law instruments will simply use the one best suited to the job. I too question this. Would the competition authority not instead prefer to rely most often on regulatory instruments since these are more likely to obtain the desired result quickly and in a visible way likely to build public and political support for the authority? There is still one more institutional set up that I have not yet dealt with.

#### **4. The regulator has concurrent power to apply all or parts of the country's general competition law**

The U.K. is the most prominent example of this (except, notably, for merger review), but Spain also apparently has it. It has roughly the same advantages and disadvantages as the second approach except for the drawback of a certain amount of legal uncertainty concerning who will actually apply the competition law in the sector. On the other hand, some might argue that it is good to have some competition among competition authorities – one could fill in where the other may have failed.

People attracted by concurrency should take a close look at all the things the U.K. did to ensure that concurrency works well there, i.e. things like adopting common guidelines, and encouragement of moving staff among the regulators and competition authority.

Interestingly the closest we have come to concurrency in the other direction, i.e. competition offices and regulators both have regulatory powers, is the situation where competition offices could approximate price and access regulation using their abuse of dominance provisions. There is also a type of concurrency in countries where the competition office may in fact have the power to end regulation in a particular sector. For instance, in Mexico, telecommunications sector regulation can only be applied if a concession holder has substantial market power in some relevant market. The Mexican Federal Competition Commission is charged with determining whether a concession holder has such power.

#### **Multiple versus single sector regulators**

It might be argued that I have under-emphasised the advantages of competition authorities over regulators in what I have said so far because I have not mentioned their inherently multi-sector nature which could yield important advantages. I see no reason to assume, however, that regulators could not

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<sup>11</sup> the OECD Special Group on Regulatory Policy meeting held in Paris on March 27-28, 2003 which addressed the topic "Independent Regulators, Political Challenges and Institutional Design"

have similar multi-sector scope. This is why I have tried to avoid the term “sector” regulator because that implies each regulator is charged with a single sector.

It is true that multi-sector authorities have certain advantages over single sector ones, but I only have time to list rather than expand on some of them.

- a. lower risk of capture by regulated entities since more must be captured

When a regulator is first set up it is closely watched by the public and by politicians, but their interest will wane with the passage of time provided nothing scandalous happens. But the owners of the companies being regulated have an ongoing strong interest in the regulation. They also possess an enormous information advantage over regulators and by opposing them can attract the interest of politicians that might take steps to reduce regulatory independence. Self-interested regulators will want to work out a live and let live arrangement with the companies regulated rather than engage in constant confrontation. This is especially true of regulators that aspire to some day move on to lucrative positions within the companies they once regulated.

- b. no need to define jurisdictional boundaries – such boundaries could lead to a good deal of legal uncertainty insofar as different rules apply within each or are at least differently applied

- c. greater chance that competitors will be subject to consistent regulation – as where electricity and gas are combined within the same regulator.

This point could become more important if technological convergence such as what is occurring in telecommunications and broadcasting spreads to other sectors.

- d. greater probability that the work of the regulator will attract academic and other critical attention.

When it makes decisions for example about applying access regulation in one sector, a multi-sector agency could be expected to apply the same methodology later on to other sectors. People involved in any particular regulated sector will be interested in closing monitoring and contributing to important developments regardless of the sector where they arise.

- e. synergies including those of an administrative nature are more thoroughly reaped

- f. perhaps a better chance that regulation will be rolled back to make room for competition as soon as that is viable – at least the winding up of regulation will not mean death for the whole organisation

## **V. Summing Up**

In deciding institutional set-up and divisions of labour, countries should bear in mind the need to:

- a. capture as much in the way of synergies as possible while reducing co-ordination costs between different institutions and respecting institutional comparative advantages arising out of different cultures;

- b. increase the chances that competition will be encouraged rather than suppressed by regulation;
- c. ensure competing enterprises are subject to essentially similar regulation so that one is not artificially advantaged over the other;
- d. provide legal certainty including through reducing jurisdictional conflicts between agencies and the chances they will issue conflicting decisions;
- e. reduce the danger of regulators being captured by the companies they regulate;
- f. ensure decision-making is timely and transparent, while protecting confidential, commercially sensitive information;
- g. provide appropriate channels for appeal from regulatory or competition office decisions;
- h. ensure decision-makers are independent of direct political control while remaining adequately accountable to elected politicians; and
- i. facilitate international co-operation in matters crossing national boundaries.

The most efficient institutional set-up could well vary from country to country and sector to sector. It could even change through time as technological developments alter the prospects for greater competition in a market.

I risk being accused of institutional bias by adding as a closing note that whatever distribution of functions is made, the competition authority should be explicitly mandated to engage in competition advocacy covering: privatisation; restructuring network infrastructure industries; assessing the need to set up and continue various regulations; and determining the best ways to deal with problems associated with stranded costs and universal service obligations that sometimes inhibit introducing competition in certain markets involving network infrastructures.

An argument can be made that the more a decision has a unique as opposed to repetitive aspect, the greater the need for the general economic and analytical expertise usually found in a competition authority. In contrast, the more a series of decisions amount to repeated consideration of highly similar cases, the greater the need to arrive at a general rule and then to apply it consistently so as to promote predictability for affected businesses and consumers. In such situations, the application work should probably be given to a regulator, but the competition authority should be invited to contribute to developing the general rule.

## **Regulation and Antitrust: The Trade-Offs to be Solved in the Institutional Choice**

*Mr. Alberto Heimler, Competition and Trade Authority (Italy)*

The common feature of regulation is that it is a highly technical matter, quite often addressing markets where products, technology and participants are rapidly changing. For efficient regulation a close monitoring of all these developments is necessary.

Not all regulations are equal. Some apply a law ex-post to specific cases; others regulate markets ex-ante with provisions of a general nature. Quite often regulation requires continuous monitoring of market outcomes.

There are a number of trade-offs to be solved when deciding on the institutional choice. The first is between independence and political accountability. The second is between independence and expertise. The solutions to these trade offs differs according to the characteristic of regulation. I will distinguish decisions on specific cases and those that provide general guidance to regulated entities.

When regulation applies well-specified legal provisions to specific cases, of course independence is required, so as to ensure fairness and the absence of privilege. If the provisions of the law are clearly spelled out, so that there is no trade-off between alternative objectives, no political accountability is necessary. All that matters is to follow the law. On the other hand whenever a trade off between alternative objectives is necessary, for example a national interest objective being superimposed on an antitrust law based on competition principles, than it is best that the national interest objective, like in Germany, be not pursued by an administrative authority or by the judge, but by the Minister himself, so that he might be politically accountable for what he decides.

When no trade offs are envisaged leaving decision making to a judge, the most independent decision maker, can be the best solution, but a judge lacks expertise and is not organised to take decisions that require a monitoring on market outcomes. This is why an administrative authority that brings the case in front a judge is often necessary (private action can be insufficient to bring all cases to Court because of lack of incentives for action due for example to free riding and to the high cost involved in bringing cases to Court). In some cases, the administrative authority can also be the decision maker, of course subject to judicial review. An integrated institution, that is both enforcer and decision maker, can be very appropriate for setting the right incentives for action and increasing its cohesiveness and visibility. In any case a judicial review of decision making is necessary, so that fairness and objective application of the law is assured. A Ministry, especially a sectoral Ministry, would take decisions that are not necessarily coherent with other decisions taken for other sectors: the system will lose predictability and will make control (by the public at large) much more difficult.

When regulation regulates markets ex-ante, anticipating controversies, the issue is different. The characteristics needed are independence, technical expertise and, when the objectives pursued by regulation are multiple, some political accountability. In order to provide for ex-ante regulation, the law is usually much more general and some technical discretion is left to the regulator. Legal provisions have to define the objectives that the regulator has to pursue. The regulator is not there to solve without any guidance possible tradeoffs between contrasting objectives, for example competition and the protection of the environment. If there are multiple objectives he needs priorities that in turn need to be defined either by the law or by the government. Sectoral regulation can be done by Ministries, but not when the Ministry has also a stake in the regulated company. In such cases independence is important. Certainly a judge cannot perform ex ante regulation of a general type (not related to a specific case). An administrative authority is the best, but when it pursues multiple objectives, the priority on these objectives needs to be politically determined (government/parliament).

If priorities cannot be given then I guess such decisions cannot be delegated. Furthermore to enhance control and reduce the possibility of capture the sectoral mandate of these regulators needs to be wide.

Some reflections on the Italian experience and on the functional separability between antitrust and sectoral regulators. In my opinion coherence and transparency are important both for antitrust and for regulation. This implies that antitrust and regulation is kept separate and that regulators are given a broad mandate. They need to cooperate, but final responsibility has to be given to the body functionally in charge.

In the enforcement of general competition rules in different sectors, competition authorities take into account the economic characteristics and specificities of each market. Regulatory authorities usually have sectoral expertise and may have a good reputation with enterprises, so that a sectoral division of task could *prima facie* be considered efficient.

However, because of rapid technical progress and of the removal of a number of regulatory line of business restrictions, it is becoming increasingly difficult to identify a stable subset of markets that should be excluded from the jurisdiction of the economy-wide competition authority without creating conflicts of jurisdiction between the sectoral and the general antitrust authority. Indeed especially in mergers where almost always a number of different markets not all subject to regulatory supervision (or to the supervision of the same regulator) are affected, should the regulator also be in charge of enforcing the antitrust law, there would be an overlapping of jurisdiction with the antitrust authority that might lead to conflicting decisions.

In this regard the general approach of assigning regulatory tasks to sectoral regulatory agencies and tasks of competition law enforcement to the antitrust authority involves several advantages. First of all it strongly reduces the possibility of conflicting decisions. Furthermore it guarantees a consistent interpretation and enforcement of the antitrust rules. Finally, it significantly simplifies the institutional framework with respect to the international co-operation aspects of competition policy.

Maintaining the general antitrust functions with the antitrust authority does not eliminate the need to enhance co-operation with sectoral regulators. Indeed the antitrust authority could greatly benefit in its enforcement action from the sectoral expertise of regulators. However in order to make such co-operation more efficient it is necessary to constrain the activity of the sectoral regulator to the goal of promoting competition. In such a way not only regulation would be market oriented, but also the relationship with the antitrust authority would be based on common and accepted principles.

A final word on the other possibility, that is for the antitrust authority to absorb regulatory functions. The system would be the right one if the transition from regulation to competition would be short, so that creating a new institution would be a waste of resources and would delay the full move of the sector to competition. However following the Australian example and having too broad a mandate for an antitrust authority would risk of blocking its decision making, leading to possible jamming of cases and proceedings.

## **Regulators and Competition Authorities**

*Mr. Andrej Plahutnik, Competition Protection Office (Hungary)*

It is true that a competition is the best regulator of the market, but it should be clear that a competition is not something that happens (effectively) by itself and that there are lots of elements and influences that affect competition. Although recognising that a competition is very important category, it is clear that it is also a very sensitive category that should be protected.

There are different models and different ways of introducing and/or performing efficient competition policy and protection. One of the most important issues arises already out of the link between competition policy and its protection. It is hardly to expect that these two elements could exist and be (successfully) performed independently; both elements rely upon each other and successful combination can bring to an efficient competition.

As there are economies with a different level of development it is normal that there is a different level of efficient competition policy and protection, dependent also on the level of a competition culture and the awareness of an average consumer in a country.

When certain general principles are adopted and elaborated in a national legislation there is still a lot of playground for specifics of a country providing that such specifics would not negatively affect general rules.

There are two generally applied distinctions from general application of competition rules that represent certain exemptions to certain branches or to certain interests (what can be even more harmful as granting special treatment to certain industries).

There are different ways of special treatment of certain industries and/or companies, depending on a legal framework in certain country.

In some systems certain industries have a special treatment that is differential than a treatment of other industries; sometimes competition authorities are not competent over such industries and competencies are granted to sector regulators, also for typical competition issues.

System, under which a sector regulator is competent not only over technical issues, but also over competition issues may have certain advantages, but also disadvantages. It is true that a technical regulator has better overview over certain sector than a competition authority, but on the other hand there is always a question what kind of treatment is applied. When competencies are divided and when sector regulators may decide about competition issues too, it is always a question of the same treatment.

Is there a guarantee that all industries would be treated equally? Is there not a danger that one industry would be supported on behalf of other industries, with assistance of a technical regulator? Is there a danger of too many exemptions from applying general competition rules because of interests of certain industries, sometimes also because technical regulators could identify the interests of certain industries (and much worse: of »national champions«) as public or national interests.

There are different ways of regulating an industry. The most common way is that a competition authority is competent over all sectors of economy. The advantage of a system is an application of competition rules equally, having in mind general economic (public) interest, one of potential disadvantages is hidden in specifics of certain industries that competition authorities might not be fully

aware of. A solution to solve the problem of general knowledge of competition officials and specifics of different industries could be found in a co-operation between competition authority and sector (technical) regulators in order to achieve the best results.

Competition authorities and technical (sector) regulators should accept each other as partners, not as competitors; unfortunately that is not always the case.

One of the problems that could arise from different treatment by competition authorities and technical (sector) regulators can be seen in different understanding of market power.

Competition regulators usually estimate a market power through individual or collective market dominance, whereas technical regulators (usually in the field of telecommunications) estimate the »significant market power« that is not equal to market dominance.

The evaluation of a market power is very essential, but a treatment of so recognised market players is much more important, because it can bring substantially different results.

There is another potential obstacle to apply competition rules equally to all sectors (and sometimes companies). When in some economies certain sectors (so called sensitive sectors, usually financial services and newly liberalised sectors like telecommunications and energy) are either exempted from competition rules or treated by sector (technical) regulators instead by competition authorities, there is in some systems an element of public (or even national) interest that is observed when deciding about competition issues. This specific element is applied mostly (almost exclusively) in merger control.

It is always an open question whether such criteria (i.e. public interest) is applicable in competition law, especially taken into account new developments in the global economy. There is lots of cross-border effects, that might seem harmful to domestic industries, but in majority of cases they contribute to, not only consumers welfare, competitiveness of domestic industry that would not be as competitive when the competitiveness would not be challenged by the threats from outside, the threats of potential competitors, by threats of potential competition.

To conclude, introduction of an efficient competition policy and protection is not an easy job. It requires very clear identification of the situation, needs, tools and the ways how to perform it. Sometimes, a communication to the public is more simple and easy than communication to the ones that, at the end of the day, have the same goal, general welfare.

Especially for economies that are »newcomers« in facing competition issues it is very important to choose the right model - to decide upon a legislative framework that will enable a competitiveness of a domestic industry under general competition criteria (competition advantage should be resulted by actions of a company respecting general rules, and not resulted by interventions of a state).

Choosing the wrong model (sometimes certain systems are non-selectively recognised as ideal, and the problem is usually not in the country chosen as a model) can bring non-adequate results - a lot of resources can be involved, yet results can not be appropriate.

Each economic system, each country, has to decide by itself which system is appropriate; it is the only way to meet the needs. Nobody can do that instead of national institutions: they should be able to identify the needs and the way how to fulfil the needs. Anything else is the matter of technicalities (or perhaps not; when not, there is a necessity for technical assistance).

## **Regulators and Competition Authorities – Hungarian Experience**

*Mr. Tibor Szántó, Hungarian Competition Office (HCO) (Hungary)*

This presentation reflects the point of view of an official from the competition authority. One has to bear in mind that it can differ from someone from a regulatory body – this is also a reflection of cultural differences.

- HCO is independent from the Government
- Reports directly to the Parliament
- Applies competition law through all sectors of the economy. The Law has also provisions concerning unfair competition – it is not in the competence of the HCO, applied by the courts

Activities consist of:

- Enforcement of the Competition Law
- Competition advocacy
- Enhancing competition culture

### *Building sectoral regulators*

- Competition advocacy has a central role
- The traditional aim of advocacy
- Maximising consumer welfare through choosing the optimal regulatory decision
- Including a special one
- Finding the optimal place of competition law enforcement
- Risk: concentrating too much on that issue and losing the global context

### *Let's recall some issues*

- Fields of regulation
- Economic regulation
- Access regulation
- Technical regulation
- Competition protection
- Institutional options
- Full division of tasks
- Only regulator
- Competition authority exercises regulatory tasks
- Concurrent powers

### *General practice in Hungary*

Basically: full division of tasks. In principle it can be characterised like this, however there are a lot of particular solutions inside a certain sector that are closer to a different method.

Competition Law enforcement is in the sole responsibility of the HCO

Scope of the Act:

- “This law shall apply to the market conduct of an undertaking ... except where regulated otherwise by statutes.”

### *Boundaries of competition law*

- There is no clear wording in any law that

The competition law could not be applied in a certain sector, or

Those provisions generally falling in the competence of the HCO could be applied by another body in a certain sector

BUT: the HCO can't step in at every possible issue

Market conduct is the buzzword for clarifying the limits of competition law

### *Market conduct*

- An outcome which is a result of an autonomous decision of an undertaking – ie. it hasn't been influenced by a public policy priority through a legislative or a regulatory measure.
- Conduct of an undertaking is complex in nature
- It can be comprised by both market- and regulated conduct as a mixture

### *The division theory in practice*

- Access and economic regulation has similar policy goals as competition policy
- Overlapping competences is a potential problem
- Either parallel intervention, or
- Parallel avoidance of intervention is possible
- Co-operation is unavoidable
- Clarifying the competences – case by case basis
- Providing help for each other
- Consultation, expert advise, etc.

### *Co-operation issues*

- Clarifying competences

- Adopting common approach about the link between certain provisions of each others laws
- Deciding on a case by case basis on the optimal intervention relating to problem emerged
- Giving help for the partners' enforcement activity
- It is a two way issue, not necessarily only from the regulator to the competition authority
- Exchange of confidential information
- Co-operation can't be based on public information solely
- The method should be made public

*Example 1 – electricity*

- Special provisions in the Electricity Law concerning acquisition of control between licensees
- The energy regulator applies those provisions
- The regulator should ask for the opinion of the HCO
- Among the principles of making the decision there is one mentioning the risk of jeopardising competition
- However the last provision of this chapter clarifies that this procedure is without prejudice of the merger control activity of the HCO

*Example 2 - Telecommunications*

- Overlapping competences can be found mainly in the field of abuse of dominance
- Harmonisation with EU law: applying the concept of undertaking with Significant Market Power (SMP)
- SMP designation and the enforcement of related obligations is the competence of the regulator
- The HCO criticised this solution finding it unnecessary based on the argument that the merger control provisions of the Competition Law can ensure the same result without duplicating the procedures. The responsible ministry found that there would not be enough empirical evidence at the early stage of liberalisation for proving the possible adverse effects of a potential merger. Hence there is a need for a separate procedure and setting some market share thresholds for clarifying the prohibited concentration levels. *Lessons from Hungarian examples*
- Price regulation vs. enforcement of competition law
- Regulated interconnection price and capped retail price – maximised prices
- How to tackle price squeeze strategy?
- Carrier selection as a regulatory obligation
- It is not clear whether the incumbent should provide it with all of its packaged offers or not?
- Is it a violence of Communication Law or Competition Law?

## **Privatisation, Regulation and Ensuring Competition in the Croatian Public Utilities Sector and Network Industries**

*Dr. Nevenka Cuckovic, Institute for International Relations (Croatia)*

Thank you Mr. Chairman.

Allow me just to give you a rather brief snapshot on what was happening in Croatia at the front of the privatisation, regulation and ensuring competition in the public utilities sector and network industries. Croatia has started to privatise the state owned public utilities relatively late, at the end of 1990s and in this respect could be considered as a late comer as compared to the advanced transition economies which are soon to be the full members of the EU. However, this situation also had considerable advantages, such as being able to learn from the other transition experiences, both favourable and unfavourable ones. Also the regulatory framework was in place before the privatisation started so there were less undesired and uncontrolled developments in this field.

It should be also mentioned that the public utilities enterprises remained outside of the mainstream privatisation process on the basis of governmental decree from 1991 by which they were nationalised (declared 100 per cent state-owned) due to their strategic importance. The privatisation of public utilities requires the separate privatisation legislation approved by the Parliament for each state monopoly. So far, the parliament adopted the laws on privatisation of state owned monopolies in telecommunications, oil and gas industry and energy production and distribution. The participation of strategic foreign partners is precisely stipulated by the legislation and the Government decides in principle about the level of the participation of a foreign partner in ownership structure. The state however intends to hold a golden share in the ownership structure of public utilities designated for privatisation.

The privatisation of public utilities in Croatia started in 1999 with the privatisation of state owned monopoly in telecommunications - Croatian Telecom (HT). The Law on Telecommunications and the Law on Privatisation of Croatian Telecom (Hrvatski Telekom - HT) that were adopted prior to privatisation, regulate the status of both domestic and foreign investors into the sector.

Foreign investment was welcome as the government primarily sought the strategic partner in privatisation process of the Croatian Telecom (HT). As a result of that, after the international bidding, Deutsche Telecom initially bought 35 per cent in 1999 and additional 16 percent in 2001, thus becoming a dominant owner.

The competition of both domestic and foreign telecom operators is not possible in the fixed telephony until the monopoly status of HT expire (end of 2004), while the regulated competition is possible in mobile phones providers' market. HT has so far introduced 3 mobile telephone networks. The enforcement of the regulation and conditions that the new entrants to the market have to comply with is under the jurisdiction of the Telecommunication Council, which is an independent regulatory body responsible to the Parliament. The Department of Post and Telecommunications at the Ministry of Transport, Maritime and Communications is in charge of licensing of all the companies providing services in this sector.

While preparing for the liberalisation of the market that will start by the end of 2004, the continuous rebalance of tariff structure is in process.

The privatisation of national telecommunication enterprise had several positive effects on the consumer prices and also on general availability and variety of services offered. The most tangible

improvement was actually in the access of services. The number of waiting days for a fixed telephone line reduced dramatically, especially when compared to the beginning of 1990s (from a year to few days), thus providing an increase of number of fixed telephone lines per capita. Also, the connecting fees have reduced from more than 1000 Euros at the beginning of 1990s, which, for instance, I myself paid at that time, to around 70 Euros in the year 2000.

However, a lot more remains to be done on competition front in order to ensure better services and respect of the consumers' interests. In spite of privatisation, the new dominant owner is indeed exploiting the benefits of the monopoly status at the market, while it exists (i.e. till end of 2004 when the competition in fixed telephony would be introduced). I suppose it is the same everywhere in the region, as we have just heard from presented experiences here. This particularly refers to the prices of domestic impulses, which happen to be one of the highest in transition economies. While the prices of international calls have dropped significantly, they still do not reflect the levels of the main telecom competitors in the region, for instance in neighbouring Slovenia or Hungary, and DT is trying to exploit the potentials for profits there too. On the other hand, the prices of domestic calls have increased substantially in order to bring them closer to the real costs, as these calls were in the past substantially subsidised from the revenues from international calls. Nevertheless, the increase of prices was far too high, and high profit rates one year after DT got a dominant owner status, proves that. Also, the Croatian Telecom tried to do introduce extra fees to the consumers, which Deutsche Telecom could not possibly do elsewhere, such as charging consumers for itemising telephone bills etc. Fortunately, the Telecommunication Council reacted to that and both government and parliament rejected such practices. The line usage monthly fee, which consumer pays regardless the usage of service, is also a great issue of public controversy and under continuous criticism from Consumer Protection Council. Such practice is rare in the mature market economies and the case is presently in front of Supreme Court.

As for the situation on the other public utilities sectors, such as the oil and gas industry and energy production and distribution, the basic laws that regulate the entry of new companies and tariff structures were adopted in 2001. The laws took special attention of EU principles and directives, as a part of process of harmonisation of legislative systems between Croatia and EU (what is one of the requirements of the Stabilisation and Association Agreement with the EU). The privatisation laws on privatisation of INA (state oil and gas monopoly) and HEP (energy production and distribution state monopoly) were adopted in April 2002, but their privatisation has not been completed yet.

As for the competition in the sector, it is still strictly regulated. Government authorisation is required for all the investors, foreign and domestic, that want to engage in energy production and/or distribution. The authorisation and licensing is granted by the Croatian Energy Regulation Council, which is an independent regulatory body in charge for energy sector, responsible to the Parliament.

However, most of the present regulation still protects the dominant status of the HEP (state monopoly) from the competition in energy supply and distribution, and the consumer's choice of the new supplier is still rather theoretical, as the HEP has to approve the usage of its transmission infrastructure. The detailed procedures for regulating establishment and expansion of the new entrants to the market are yet to be adopted by the government, what would hopefully ensure more competition in providing the service for the benefit of the consumers.

I will stop at this point and could tackle some of the issues mentioned later. Thank you Mr. Chairman.

## Macroeconomic Stabilisation and Structural Reform in BiH

*Mr. Dragisa Mekic, Ministry of Foreign Trade and Economic Relations (BiH)*

Ladies and Gentlemen,

It is a great pleasure for me to have the opportunity on behalf of the Ministry of Foreign Trade and Economic Relations of Bosnia and Herzegovina to greet the all participants of the Regulatory Governance Seminar.

Macro-economic stabilisation and structural reform are the key elements of economic reforms and priorities identified to Bosnia and Herzegovina are the followings:

- Accelerated *privatisation* is crucial to creating a competitive environment,
- The development of the private sector,
- Public finance reforms – improvement and transparent governance,
- Banking and capital markets reforms,
- Improving the business environment,
- Stimulating foreign and domestic investment,
- Develop social protection policies and eliminate poverty,
- Integrate into Euro-Atlantic structures.

Generally speaking, some progress has been made on the economic front in Bosnia and Herzegovina. Although it was slower than neither the International Community nor we ourselves would have desired. New significant legislative acts have been approved in the field of communication, energy, finance and competition.

The new Communications Law ensures the establishment a single economic space in communications sector reinforcing the CRA. **Communication Regulatory Agency - CRA** is an independent body in Bosnia and Herzegovina. Our intention is to privatise the public telecommunication operators through sale to strategic partners. CRA issuing countrywide license supports the development of single economic space in Bosnia and Herzegovina and promotes competition in communications sector. The CRA issued licenses to all three fixed line network operators and providers. We are in phase to complete the process of issuing the third GSM license to create competitive mobile phone market and reduce mobile phone costs.

CRA is also responsible for issuing TV and radio stations licenses and monitoring of their work.

The legal framework for the regulations of the energy sector has been completed. A State level **Law on Transmission of Electric Power, Regulator and System Operators** has been adopted, as electricity laws for both Entities. This was precondition for implementation of the WB Power III programme and foreign investment in sector. Law proposes establishing **Energy Regulatory Agency** on State level. We are in process of adoption Action Plan to restructure and privatise energy sector.

In February 2003 a seven member **Indirect Tax Policy Commission** has been established. Attention has been focused on the introduction of State level VAT and Customs reform. The

Commission is charged with drafting legislation establishing a State level **Indirect Tax Administration**. The Commission should complete its work by end of July 2003.

The main institution in the field of FDI in BiH is Foreign **Investment Promotion Agency (FIPA)**. FIPA was established in July 1999 as government agency acting within Council of Ministers. It is specialised in providing services to foreign investors, improving country's image regarding FDI and attracting new investors. **The Investment Guarantee Agency (IGA)**, an independent commercially based agency owned by the government of BiH, provides a Leverage Insurance Facility for Trade (LIFT).

Status changes in a bank, mergers, amalgamations or divisions of a bank shall require the prior written authorisation of the Entity **Agency for Banking (Federation BH and Republic of Srpska)**.

The Law on Competition was adopted in 2001 (Official Gazette of BiH No. 30/01). The Law defines anti-competition practices of economic agents, which may affect the prevention, restriction or distortion of competition, to be: (i) contracts, certain contractual clauses, explicit or implicit agreements, concerted practices, decisions of associations of businessmen and other associations, (ii) monopolistic practices, (iii) concentration. The unofficial system of support the particular enterprises will be harder to sustain as the Bosnia and Herzegovina Competition Law adopted in October 2001 is implemented. The 2003 State Budget has for the first time earmarked funds (just over 300.000 EUR) for the **Competition Council** on State level. The Competition Council is independent body. Competition Law defines also the market competition bodies on the Entity level- Offices for Competition and Consumer Protection.

Thank you for your attention.