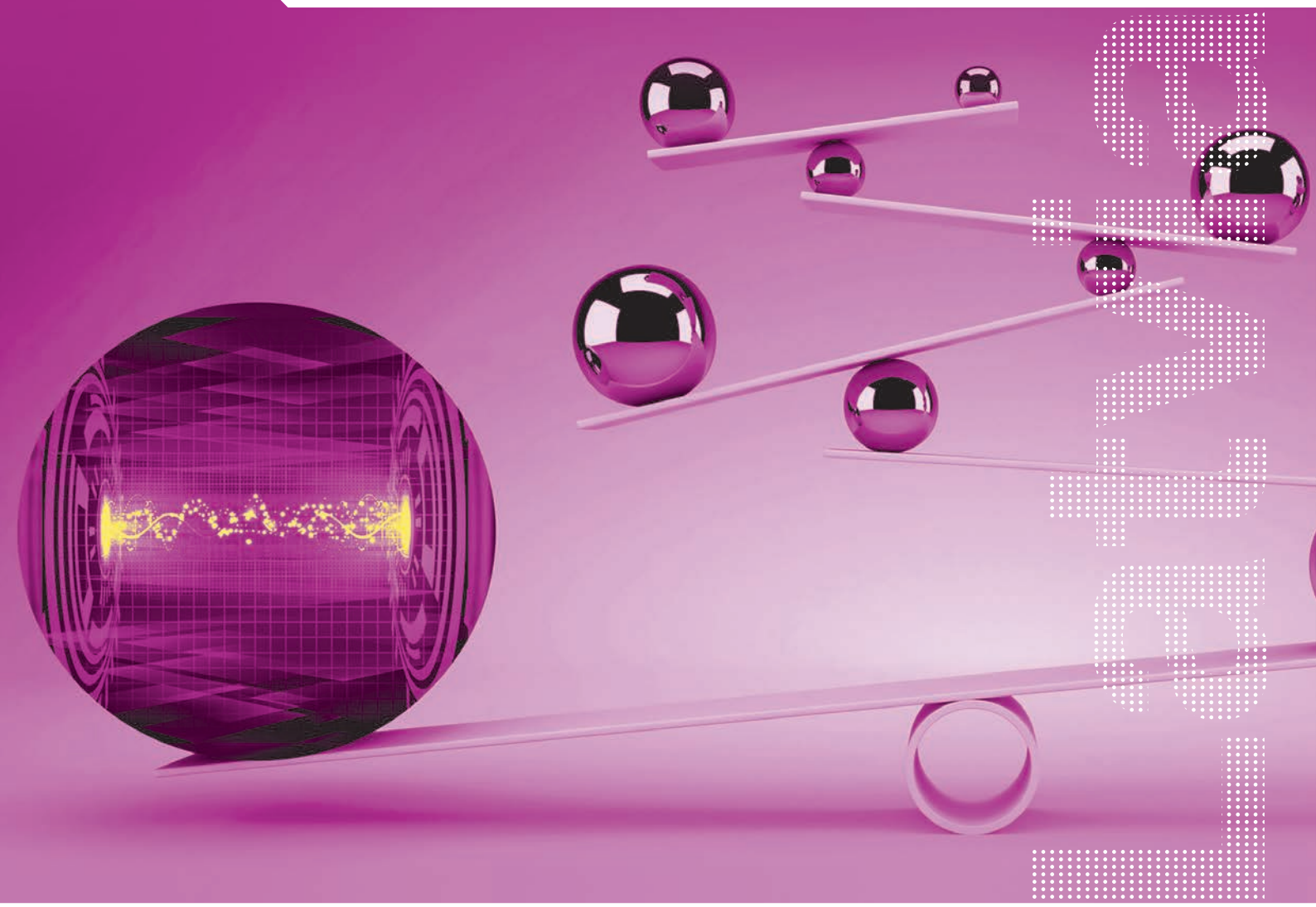
The Governance of Regulators

Progress Review of Latvia's Public Utilities Commission

DRIVING PERFORMANCE



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Foreword

Economic regulators exist because the sectors they regulate matter – to consumers, public and private investors, policy makers and the wider economy and society. They are instrumental in delivering good regulatory outcomes in sectors such as energy, transport, e-communications and water. They do so through balancing diverse and often competing interests, with the ultimate aim of creating a regulatory framework that allows for stability, predictability, fairness and better outcomes.

To demonstrate and improve a regulator's effectiveness, it is important to continuously assess the impacts of regulatory actions and decisions. An on-going dialogue on the regulator's performance, both internally and externally, can strengthen internal systems and processes and lead to the improvement of regulatory practices and frameworks. In this way, it builds confidence not only in the regulatory system, but the public administration as a whole.

To support regulators in this process, the OECD has developed a framework to assess organisational performance and governance structures, based on the *OECD Best Practice Principles on the Governance of Regulators*. The framework analyses regulators' internal and external governance, including their organisational structures, behaviour, accountability, processes, reporting and performance management, as well as role clarity, relationships, distribution of powers and responsibilities with other government and non-government stakeholders.

The OECD carried out a review of the Public Utilities Commission (PUC) of Latvia under the OECD's Performance Assessment Framework for Economic Regulators (PAFER), with the report *Driving Performance at Latvia's Public Utilities Commission* published in 2016 (OECD, 2016[1]). The current progress report fulfils the 2017 legal requirement for the PUC to conduct an independent review of its activities every three years. Building on the in-depth assessment and recommendations of the initial PAFER review, the PUC invited the OECD to carry out this review.

The current report covers the four-year period 2016 to 2020, and it allowed the OECD to understand how the PUC put the 2016 OECD recommendations into practice. The review sheds light on the follow-up mechanisms and monitoring activities that regulators put in place consequent to a PAFER review. It attests to the continuous nature of the reviewing process: a progress reviews can assess if recommendations need adjusting given the dynamic context in which the regulator operates and the recommendations' practical feasibility. In addition to assessing the progress made by the PUC in implementing the OECD recommendations, the report also highlights a few new areas of focus for the regulator going forward.

This report is part of the OECD work programme on the governance of regulators and regulatory policy, led by the OECD Network of Economic Regulators (NER) and the OECD Regulatory Policy Committee, with the support of the Regulatory Policy Division of the OECD Directorate of Public Governance. The Directorate's mission is to help government at all levels design and implement strategic, evidence-based and innovative policies that support sustainable economic and social development. The report was presented to the OECD Network of Economic Regulators for comments and approval at its 16th meeting in April 2021 and was declassified by the Regulatory Policy Committee by written procedure.

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Abbreviations and acronyms

CC	Competition Council
CoM	Council of Ministers
DSO	Distribution System Operator
EAD	Economic Analyses Department (PUC internal department)
EECC	European Electronic Communications Code
EU	European Union
IIAS	The System for Input and Processing of Merchant's Information *(Informācijas ievades un apstrādes sistēmas)*
iREG	Indicators of Regulatory Policy and Governance
MoU	Memorandum of Understanding
NRA	National Regulatory Authority
OECD	Organisation for Economic Co-operation and Development
PAFER	Performance Assessment Framework for Economic Regulators
PUC	Public Utilities Commission
RGMCG	Regional Gas Market Coordination Group
TSO	Transmission System Operator

Executive summary

The Public Utilities Commission (PUC) is Latvia's multi-sector economic regulator for energy, electronic communications, postal services, water management, waste disposal service and deposit system service. It was established in 2001, following a legislative reform aimed at liberalising the utilities sectors in Latvia.

Following an in-depth peer review of its governance and performance by the OECD in 2016 (OECD, 2016[1]), the PUC invited the OECD to carry out an independent progress review of the implementation of recommendations put forward in 2016.

The progress review finds that the PUC has made substantial advances in implementing the recommendations put forward in the 2016 review, in the interest of increasing the effectiveness of its regulatory activities and final outcomes for consumers and the economy. The PUC has updated its internal processes and procedures, but, importantly, it has also successfully advocated for legislative changes and implemented reforms in several areas. The main changes implemented at the PUC since 2016 relate in particular to the following four areas: a new fee-setting process; the introduction of incentive-based regulation; a new process for the selection of Board of Commissioners; and the establishment of the Advisory Council.

The breadth and scope of the 2016 recommendations required the PUC to co-operate with a number of stakeholders. In particular, for reforms requiring legislative change, the PUC worked closely with the Ministries of Economy and Finance and with the parliament. In this regard, the PUC was able to advocate for change in a positive political context, given the momentum that came with Latvia's accession to the OECD during 2016. However, it is to be noted that the PAFER review and its recommendations did not form part of Latvia's official OECD accession process.

Role and objectives of the PUC

Previous recommendations focused on the clarification of goals and priorities of the regulator, as well as on the introduction of incentive regulation and the establishment of a consultative council for the formulation of the regulator's strategy. Significant progress has been noted.

Assessment of progress on key recommendations and suggestions for way forward

- The PUC now has a stronger focus on goals and outcomes, and it developed strategic directions that meet the interests of network users. This can be further strengthened by measuring progress against key performance indicators.
- The PUC is better equipped with the introduction of incentive regulation and its new power to amend tariff proposals. It should now try to fine-tune the efficiency incentives it sets to increase their impact.

- The PUC established the Advisory Council in 2020 in response to OECD recommendations, which provides a mechanism to develop and oversee the implementation of PUC's strategic framework. Going forward, the PUC will need to manage expectations around the work and function of the Council.

Input

Previous recommendations focused on the regulator's fee setting process, the impact of its salary cap and a total awards approach to increase job attractiveness. Strong progress has been noted already at the PUC in these areas.

Assessment of progress on key recommendations and suggestions for way forward

- The PUC successfully advocated for a new fee setting process that is more robust and reduces potential influence from the government or ministries over the fee. To continue this positive progress, there is a need for clear criteria and procedures for fee revision in order to ensure a cost-reflective fee level in the long term.
- The competitiveness of PUC salaries has improved. In 2016 the PUC implemented a new bonus system for staff members, with financial and non-financial incentives. Moving forward, the PUC should assess the impact of the current salary cap on its ability to attract and retain talent for senior positions.

Process

Previous recommendations focused on the introduction of staggered terms for board members and their remuneration during the cooling-off period, further utilisation of the PUC's multi-sector model and more regular exchanges with parliament. The PUC made significant progress, although the degree of progress differs between areas.

Assessment of progress on key recommendations and suggestions for way forward

- The PUC advocated for a more robust process for the selection of Board members with staggered terms and a maximum of two confirmations or renewals in one calendar year, an important improvement that strengthens the continuity and institutional memory within the PUC.
- Staff mobility within the PUC takes place on a case-by-case basis. An overarching mobility strategy and streamlined practices on topics such as *ex ante* impact analyses and *ex post* reviews will allow the PUC to fully leverage its multi-sector model.
- The PUC presents an action plan and annual report to parliament, but the current level of engagement and available time remain limited. Moving forward, the PUC should endeavour to increase the level of engagement, for example by developing more regular and strategic exchanges with parliament and parliamentary committees, to further demonstrate its value.
- Advancement on the recommendation to amend the remuneration of Board members during the two-year cooling-off period is limited. A proposed amendment to existing legislation that includes a compensation mechanism could help secure the PUC's ability to recruit board members from diverse backgrounds.

Output and outcome

Previous recommendations focused on the development of a performance assessment matrix and the employment of data-driven tools for enabling stakeholder communication and consumer choice. More efforts are needed in these areas.

Assessment of progress on key recommendations and suggestions for way forward

- The PUC assesses progress against objectives, but does not apply performance indicators. It could further explore the development of a performance assessment matrix with key indicators, to measure progress and communicate with stakeholders on its performance. This will allow the PUC to increase transparency and accountability.
- There are limited comparison tools for e-communications and energy. Going forward, the PUC should aim to increase the availability of data-driven tools and consumer education platforms which make use of extensive data.

1 Implementation of the 2016 PAFER recommendations

This chapter provides an overview of the main legislative and regulatory changes in the sectors regulated by the PUC, as well as offers an extensive analysis of the progress made by the regulator in implementing the 2016 OECD recommendations made under the PAFER framework analysis.

In addition, it outlines the main lessons learnt by the regulator in the process of implementing the OECD recommendations, including the wide-ranging co-operation with internal and external stakeholders.

Introduction

The Public Utilities Commission of Latvia (PUC) is the national multi-sector economic regulator for energy, electronic communications, postal services, water management, waste disposal service and deposit system service. The PUC was established in 2001, following a legislative reform aimed at liberalising the utilities sectors in Latvia. The OECD performed a review of the PUC under the OECD's Performance Assessment Framework for Economic Regulators (PAFER), with the report *Driving Performance at Latvia's Public Utilities Commission* published in 2016 as part of the work programme of the OECD Network of Economic Regulators (NER) (OECD, 2016[1]).

Following a legislative requirement enacted in 2017, the PUC is required to carry out an independent review of its activities every three years. Building on the in-depth assessment and recommendations of the initial PAFER review, the PUC has invited the OECD to carry out this external review. The current progress review covers the four-year period from the completion of the previous PAFER report in 2016, to December 2020.

The progress review finds that the PUC has made substantial advances in implementing the recommendations put forward in the 2016 review, in the interest of increasing the effectiveness of its regulatory activities and final outcomes for consumers and the economy. The PUC has updated its internal processes and procedures, but, importantly, it has also successfully advocated for legislative changes and implemented reforms in several areas. The main changes implemented at the PUC since 2016 relate in particular to the following four areas:

- **New fee-setting process**: since 2017, the level of the fee is set directly in legislation, and is calculated as a percentage of the net turnover of public utilities. This allows the PUC to have more independence from the executive in setting the regulatory fee, and also provides more predictability to the regulator and the industry;
- **Introduction of incentive-based regulation**: the PUC introduced incentive-based regulation in a number of energy sectors, with the aim to increase sector efficiency, service access and quality of supply;
- **New process for the selection of Board of Commissioners**: a more robust board selection process, which also accounts for the staggering of board members' terms, is in place and will be applied from 2021, when the terms of all current Commissioners are due to expire;
- **Establishment of the Advisory Council**: a new forum, which brings together representatives from ministries, the utilities, consumer groups, and fellow regulatory authorities, was established in 2020 in order to provide consultative opinions to the PUC on the development and implementation of its strategic priorities.

The breadth and scope of the 2016 recommendations required the PUC to co-operate with a number of stakeholders. In particular, for reforms requiring legislative change, the PUC worked closely with the Ministries of Economy and Finance and the parliament for their implementation. In this regard, the PUC was able to advocate for change in a positive political context, given the momentum that came with Latvia's accession to the OECD during 2016. However, it is to be noted that the PAFER review and its recommendations did not form part of Latvia's official OECD accession process.

The progress review is structured into three sections. The first section provides an overview of main changes in the regulated sectors between 2016 and 2020. The second section is an overall assessment of the progress in implementing the 2016 OECD recommendations and includes a number of areas for further improvement. It also includes insights from a detailed review of two particular areas, the regulator's finances and its regulatory processes, where the current practices at the PUC are analysed in-depth. The third section concludes the report with some lessons learnt and way forward.

Overview of sectors under PUC's responsibility

A number of changes have taken place in the sectors regulated by the PUC between 2016 and 2020. Sectors have undergone major reform, either due to European legislation (such as Electronic communications, Postal services and Energy), and/or as an effect of national or regional policy and sector priorities (such as Energy). The role of the PUC in the process of transposing European legislation into the national framework depends on the type of EU law. In case EU legislation is transposed into national legislation, the PUC can submit recommendations on draft law prepared by the ministries and participate in discussions with the government and the parliament. In other cases, the PUC takes EU legislation into account when issuing normative acts and regulations, which follow its own consultation process.

In addition, due to its multi-sector model, as well as the fast changes in the sectors it regulates, the PUC co-operates and co-ordinates its activities with a number of national policy makers and other public bodies, as well as fellow European regulators.

Energy

The Latvian energy strategy focuses on gas market integration among the Baltic countries and Finland. The objective of establishing a merged common market between Latvia, Estonia, Finland and Lithuania started in 2015 with the creation of the Regional Gas Market Coordination Group (RGMCG). The main aims of the RGMCG are to improve market liquidity and competition, ensuring affordable gas prices and high quality service. The implementation of implicit capacity allocation model at the cross-border interconnection points between Latvia, Estonia and Lithuania happened in 2017. In 2018 the TSOs of Latvia, Estonia and Finland signed of a Memorandum of Understanding (MoU)[1] on principles for harmonisation of capacity management, establishment of single balancing zone, a regional gas market model and the principles for inter-TSO compensation. In the same year, the National Regulatory Authorities (NRAs) of Finland, Estonia, and Latvia signed an MoU to facilitate co-operation and co-ordination between the NRAs in order to facilitate the creation of the regional gas market, which provides for the possibility for other NRAs to join. The common tariff and market area, which became operational from 1 January 2020, is the first of its scale (currently three countries) in the EU.

The Latvian gas market was unbundled in 2017, by separating the activities of the vertically integrated incumbent ("Latvijas Gaze"). The unbundling resulted in the establishment of a separate transmission system and storage operator ("Conexus Baltic Grid") and a distribution system operator ("Gaso"). On 21 July 2020 Augstsprieguma tīkls, the state-owned electricity TSO, became the majority shareholder in Conexus Baltic Grid through the acquisition of Gazprom's share (AST, 2020[2]).

Changes in the electricity sector structure and governance stem from EU Network Codes as well as the implementation of the EU's Clean Energy Package (EC, 2020[3]), which is a comprehensive mechanism designed to facilitate a clean energy transition and the implementation of the Energy Union strategy goals.[2] To this end, the PUC co-operates closely with the relevant government departments, as well as with a number of European NRAs, to enact more effective market coupling mechanisms.

Electronic communications

The PUC has been working with the Ministry of Transport in the transposition of EU legislation[3] in the e-communications sectors (the European Electronic Communications Code). To this end, the PUC has been reviewing and updating its regulatory rulebook for the sector. While Latvia has not met the statutory deadline for the full transposition of the Code (December 2020), the PUC has been working with the Ministry of Transport towards its finalisation. The main changes in the sector are aimed to increase investment in high capacity networks (such as 5G), to promote competition, to develop an internal market

across the EU states, and to enhance consumer protection. The legislative and regulatory changes related to the Code are expected to come into effect in 2021.

At national level, in 2019 and 2020, the PUC worked closely with the government authorities in the assessment of the merger between the telecoms incumbent and the largest mobile operator.

Postal services

New EU[4] legislation aims to improve cross-border parcel delivery services, in particular for individuals, micro-enterprises and small businesses (including in remote or sparsely populated regions), and for individuals with disabilities or limited mobility, in order to improve access to public tariff lists for a limited number of cross-border parcel delivery services. This has not involved a change in the remit or activities of the PUC in the postal services sector.

Water management

A new national law[5] in 2016 that defined tasks of service providers, municipalities and regulatory authorities, including the PUC, in relation to the provision of water management services.

Deposit system service

Following an amendment to the Packaging Law in 2019 (Saeima, 2019[4]), the PUC became the regulator of a newly introduced[6] deposit-return system for beverage containers as of 1 July 2020. It is envisaged that the deposit system will become operational on 1 February 2022. The PUC has already adopted several regulations in preparation for the launch of the deposit system (for instance, methodology for the calculation of deposit system producer administration fee).

Waste disposal service

In the waste management sector, the PUC approves a tariff for municipal waste disposal at a landfill for solid waste. This now includes a cost-reflective tariff, according to the “polluter pays” principle.

Overall assessment of the 2016 recommendations

The current review assesses progress made by the PUC against OECD recommendations put forward in the initial 2016 PAFER review (OECD, 2016[1]). The assessment focuses on internal and external governance arrangements according to the four dimensions of the Performance Assessment Framework for Economic Regulators (PAFER): Roles and objectives; Input; Process; Output and Outcome.

Roles and objectives

The Roles and objectives dimension within the PAFER framework focuses on: i) the mandate, functions and powers of the regulator, ii) the interaction of the regulator with other bodies and the executive; iii) the existence of a set of clearly identified strategic objectives, targets or goals; and iv) the regulator’s independence. The PUC has made significant progress on recommendations in this area, most notably through the introduction of incentive-based regulation in the energy sector and the establishment of an Advisory Council. To strengthen progress in this area further, the PUC could focus its attention towards the development of a matrix that links its strategic objectives with performance indicators.

Recommendation: Focus on high-level goals and outcomes

The 2016 review recommended that the strategic framework start with high-level goals, such as consumer welfare and competition, and that it include key outcomes that the PUC aims to achieve over the medium term. The Annual Action Plan could act as the implementing tool for the medium-term strategy. The review also recommended the PUC to develop a matrix on how the regulator plans to make use of its different functions and powers to achieve the envisaged goals, with intermediate performance indicators.

Assessment of progress

The PUC now has a stronger focus on goals and outcomes, which it could strengthen by measuring progress on its strategic objectives against key performance indicators.

The PUC's planning for the period 2014-16 focused more on functions than on outcomes, and did not always set clear priorities. In response to the 2016 review, the PUC refocused the strategic objectives in its 2018-2021 strategy. The PUC's Operational Strategy 2018-2021 sets as a high-level strategy objective "to ensure the availability of public services of appropriate quality at economically justified prices" and defines three strategic priority directions in line with the outcomes it wants to achieve (see Figure 1.1). This is a positive evolution from the previous objectives that were more focused on functions and activities of the regulator.

Figure 1.1. Strategic priority directions

Comparison of the strategic priority directions for the periods 2014-16 and 2018-2021

Source: (OECD, 2016[1]), Driving Performance at Latvia's Public Utilities Commission, OECD Publishing, Paris; PUC (2018), The Public Utilities Commission's Operational Strategy 2018-2021.

Based on the strategic priority directions, the PUC develops an Annual Action Plan that as of 2019 consists of both an operational and a strategic part, and sets yearly strategic priorities that it aims to achieve. For 2020, the priorities are: i) to reduce the administrative burden; ii) efficiency incentives through methodologies; and iii) availability and accessibility of public services (PUC, 2020[5]). The PUC develops the yearly priorities in an internal working group, and consults these publicly with stakeholders through a meeting. Based on the strategic priorities for the year, the PUC sets actions and deadlines in the strategic part of the annual action plan.

Going forward, to build upon the momentum of becoming more outcome-focused, the PUC could further invest in efforts to measure its progress and improve the accountability. The regulator did not yet advance on the recommendation to create a matrix on how the PUC plans to make use of its functions and powers to achieve goals (see *Recommendation: develop a performance assessment matrix that links goals and priorities to outputs and outcomes*). This matrix could identify intermediate performance indicators to measure the progress on the strategic objectives. The PUC could consider using the momentum of the establishment of the new PUC board in 2021 to pursue this recommendation further.

Recommendation: clarify goals and priorities

The 2016 review recommended using the strategic planning framework to clarify the PUC's goals and priorities. If the PUC intends to pay particular attention to consumer welfare, this should show as a clear priority in its strategic framework. Furthermore, the regulator could clarify how it will balance consumer welfare and the interests of the public utilities. The review recommended the PUC to move away from a utility-centric approach towards an outcome-focused approach that takes into account current and future consumers.

Assessment of progress

The PUC developed strategic directions that meet the interests of users, but could explain further how it balances the different interests and priorities it sets for itself.

The new PUC strategy defines more concretely its priorities and goals, and shows more emphasis on the interests of users of public services. The PUC's new strategy lists three strategic priority directions that meet the interests of users. The three directions focus on the outcomes the PUC aims to achieve, which are the availability, affordability and quality of services. For each of the strategic priorities, the PUC lists a number of key objectives it wants to achieve. The PUC stresses that these priorities need to be balanced, as overemphasising one could jeopardise the progress on other priorities (PUC, 2018[6]).

To continue the already positive progress on this recommendation, the PUC could explain more clearly how it will balance the consumer and public utility interests in its decision-making. Further guidance on how the PUC weighs the different interests could for example explain the meaning of the concept of 'economically justified prices', which becomes all the more important in the context of introducing incentive regulation for a number of regulated sectors.

Recommendation: ensure that regulatory functions are fit for purpose

The 2016 review recommended that the PUC's functions could be amended so that they are fit-for-purpose, and that they enable the PUC to deliver upon the ultimate goals of increased competition and consumer welfare. It assessed that the PUC mostly relied on cost-plus regulation, which lacks an incentive mechanism to improve the efficiency of operators. Also, it highlighted that the PUC lacked the power to amend tariff proposals, but only had the power to accept or reject and ask for a revision. Incentive regulation could benefit efficiency, service access and quality, while the power to amend tariff proposals could increase the PUC's impact on the determination of tariffs.

Assessment of progress

The PUC is better equipped for its designated functions; it now faces the task of fine-tuning the efficiency incentives in order to increase the impact of the new regulatory approach.

Since the review, the Latvian Parliament (Saeima) enacted legislative changes that enhanced the PUC's powers and functions:

- through an amendment to the Law on Regulators of Public Utilities on 13 February 2020, the PUC now has, among other powers,[7] the power to amend tariff proposals in case the operators does not provide a justification for the costs, or if any of the costs are economically unreasonable. The amendment also gives the PUC the power to impose requirements on the financial accounting of costs, assets and investments (Saeima, 2020[7]);
- through amendments to the laws regulating the tariff methodologies in regulated sectors, the PUC is able to introduce incentive regulation in the energy sector (Saeima, 2019[8]) (Saeima, 2019[9]) (Saeima, 2020[10]) (Saeima, 2020[11]) (Saeima, 2020[12]). As of 2020, incentive regulation was introduced in electricity distribution, electricity transmission, natural gas distribution, natural gas transmission and natural gas storage. The efficiency score for each utility is based upon: 1) an efficiency plan prepared by the utilities, and 2) negotiations between the utility and the regulator, which are based on comparative analyses with other operators within Latvia and abroad. The PUC obtained support from the European Commission on a project to improve the incentive regulation for energy utilities. At the time of writing, cost-plus regulation is still in use for heat supply, water supply and municipal waste disposal at a landfill. The cost-plus regulation will also apply to the expected new deposit system service.[8] Out of these sectors, only in the heat supply sector did the PUC take steps towards the introduction of incentive regulation, by considering possible revisions to the regulatory framework.

To make most use of the incentive regulation, the PUC could further develop and fine-tune the efficiency incentives it sets, to ensure their accuracy and objectivity, and to increase the effectiveness of the new system. The PUC could also assess the effectiveness of the new system through *ex post* evaluations (see Box 1.6).

Recommendation: assess how to participate in policy-making process

The 2016 review recommended that the PUC assess how it can continue to participate in the policy-making process without becoming the main adviser or analytical source of the executive. It assessed that the PUC is actively involved in the policy-making process by issuing opinions on policy proposals and providing expert advice and analysis. An overly active participation could pose a disproportional burden on the regulator's resources and the PUC could risk losing sight of its core regulatory functions and independence. The review proposed that the PUC could issue its opinions publicly to draw attention to them and signal the PUC's independent role more clearly.

Assessment of progress

The PUC provides valuable input to ministries during the policy development process and the drafting of related legislation, whilst maintaining adequate resources to execute its functions. However, it did not assess how to continue participating in this process without losing sight of its independent role.

The time spent by the PUC to contribute to policy making varies depending on the topic, but the mechanisms through which it engages in policy making have not evolved since the 2016 review. In addition to its function of formulating opinions to the policy-making process, the PUC can also submit draft laws and regulations to the Ministry of Economics, as it for example did for the legislative requirement for the rotation of the board (see *Recommendation: Advocate for staggered terms for Board*). The PUC's opinions are not publicly available, but can be requested on the website of the Cabinet of Ministers.

To advance on the recommendation, the PUC could analyse and reflect on how its function of contributing to the policy-making process can proceed without confusing policy and regulatory functions. The regulator should also consider releasing opinions publicly in certain cases to signal its independent role in the process.

Recommendation: set up appropriate mechanisms to oversee implementation strategic framework

The 2016 review recommended the PUC to create appropriate institutional mechanisms to develop and oversee the implementation of the strategic framework. In order to do so, the PUC could consider establishing an advisory board, which would consist of representatives of parliament, other regulators such as the competition authority and the consumer authority, the regulated sector and consumers. The PUC could complement the advice by such an advisory board with public consultation of its strategy and an internal steering group.

Assessment of progress

The PUC established the Advisory Council in 2020. Going forward, the PUC will need to manage expectations around the work and function of the Council.

Following an amendment to the Law on Regulators of Public Utilities as of 26 February 2020, the PUC established an Advisory Council (Saeima, 2020[7]). The law states that the Council's decisions "are purely advisory in nature",[9] thus preserving the independence of the PUC. The core members of the Council are also defined in law (the Ministry of Economics, the Ministry of Finance, the Ministry of Transport, the Ministry of Environmental Protection and Regional Development, the Competition Council and the Consumer Rights Protection Centre). In addition to the core members, the by-laws of the Council specify membership further (adding the Chamber of Commerce and Industry, the Employers' Confederation, the Association of Local and Regional Governments and the Consumer Rights Protection Association), with the possibility of other organisations joing as well.

The Statute of the Advisory Council was approved by the PUC in May 2020, with representatives nominated by their respective authorities in June 2020. The Advisory Council was formally established and held its first meeting on 4 September 2020 (PUC, 2020[13]). The first Head of the Council is a representative from the Ministry of Economics, while the Deputy Head is a representative of the Latvian Chamber of Commerce. The Council is to meet at least twice a year. The second meeting took place in December 2020.

The Council can provide recommendations in two main areas: the regulator's operational strategy "by providing recommendations regarding the strategic work directions of the Regulator and by examining the progress of the implementation of the strategy of the Regulator and work improvement possibilities", as well as "in matters related to policy making and implementation thereof, and preparation of the relevant laws and regulations or planning documents in the regulated sectors" (Saeima, 2020[7]).

In order to discharge its functions, the Council has a range of tools at its disposal:[10]

- To request and receive PUC-produced publicly available information;
- To provide assessments or opinions to the PUC;
- To invite representatives of the PUC and other institutions, associations foundations representing the interests of consumers, providers of public utilities, local government and social partners to participate in the Council meeting as experts;
- To establish working groups, organise consultations, surveys;
- To share information about its activities on the PUC website.

The PUC acts as secretariat to the Advisory Council, but the regulator is not involved in the debates or decision-making process. Nonetheless, the PUC retains control over the membership of the Council with the PUC Chair having the responsibility to approve its composition.[11] The Council composition provides a balanced mix of representatives from ministries, industry, consumers and employers. Going forward, the

PUC will need to ensure that there is balanced representation among the sector actors, as well as among the sectors.

The Council provides a platform for consultation and stakeholders appreciate its establishment. However, there is scope to increase role clarity and expectations of the Advisory Council among stakeholders. Given its secretariat function, the PUC is perceived as the driver the agenda of the Council. The PUC should manage the expectations of the Council members on the PUC's involvement in setting the Council's priorities, as well as in terms of the input expected from the Council.

Given the wide span of possible action of the Council, there is scope for the PUC to make ample use of the expertise of its members. For instance, on strategic direction, the PUC can consult with the Council on how the PUC can enhance its engagement approach with the parliament or fellow regulatory agencies in a manner that enhances the PUC's independence. Further, given the varied composition of the Council, it can also become a privileged space for sharing information and building common ground among the different actors in the regulated sectors. However, the Council should not become involved in the regulator's day-to-day operations and regulatory decision-making.

Input

The input dimension within the PAFER framework focuses on the extent to which the regulator's funding and staffing are aligned with the regulator's objectives, targets or goals, and the regulator's ability to manage financial and human resources autonomously and effectively. Since the review, the PUC has implemented a number of strong positive changes through adjustments to the fee setting process and the salary cap, as well as a new performance evaluation system that offers financial and non-financial incentives. Continuing this progress, the PUC could advocate for clear procedures and criteria for fee revision, to ensure a fee level that is cost reflective.

Recommendation: Advocate for alternative fee setting process

The 2016 review recommended advocating for an alternative fee setting process that would limit conflicts of interests and potential undue influence. The state of play in 2016, when the Cabinet of Ministers could set the actual fee below the ceiling specified in legislation, presented the risk of undue influence in a context of large state ownership in the regulated sectors. Alternatives to this situation included a fee set in legislation, or a fee set by a parliamentary committee or independent panel based on a PUC proposal.

In practice, the fee level posed a constraint on the PUC's resources, as revenues were declining and the PUC faced new tasks. The level of the regulatory fee decreased from 0.2% to 0.17% during the financial crisis in 2008, and had not grown by 2016. It became increasingly difficult for the PUC to perform its functions given i) an overall decrease in turnover of regulated entities, ii) new regulatory tasks and functions stemming from EU regulations and iii) new responsibilities in district heating, water supply, sewage and municipal waste disposal at landfill in 2009.

Assessment of progress

The new fee setting process is more robust and reduced the executive's influence over the fee, but there is a need for clear criteria and procedures to ensure the right fee level in the future.

Following the OECD recommendation to revise the fee setting process in 2016, the PUC successfully advocated for an amendment to the Law on Regulators of Public Utilities to set the fee level directly in legislation. As a result, as of 22 November 2017, the Council of Ministers (CoM) is no longer able to amend the actual fee level below a certain threshold. Therefore, the risk of potential undue influence is lower, as any changes to the law will undergo parliamentary scrutiny in the Saeima. The fee increase also improved the level of financial resources available to the PUC, and the fact that fees are based on the turnover in

the calendar before last enhances the predictability of fee revenues. As of 1 January 2018, the fee level is 0.2% of the turnover of the regulated public entities (Saeima, 2000[14]).

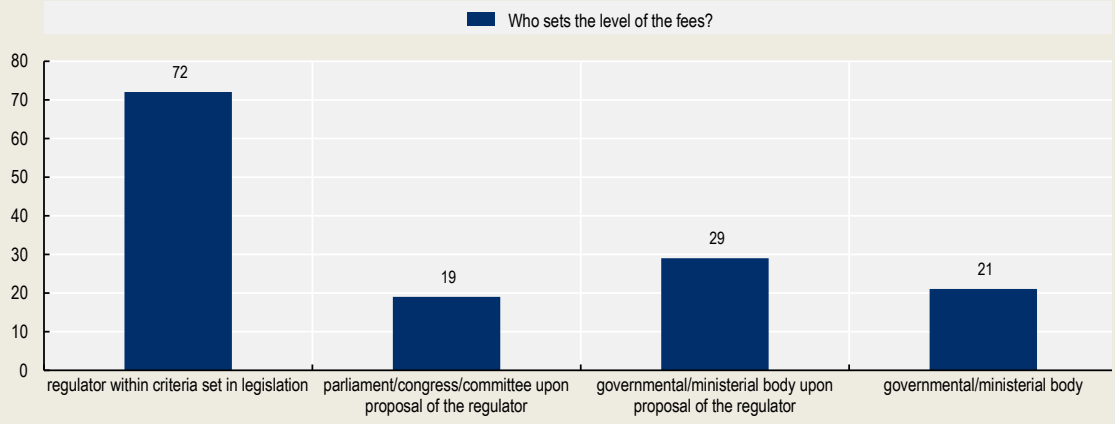
Additionally, the OECD review recommended introducing an additional mechanism for allocating potential overpayments. Without such a mechanism, there would be a need to revise the primary legislation every year if payments exceed the costs of the PUC's activities.[12] In accordance with this recommendation, the amendment to the law includes a provision that rules that any overpayments will be deposited in a special account of the regulator at the State Treasury. Funds in this account can be used to fund the PUC's activities in subsequent periods in accordance with the PUC's approved budget.

Box 1.1. Who sets the level of the fees?

When defining the funding sources and procedures of economic regulators, it is important to consider situations that could compromise the integrity of the functions of the regulator. While funding arrangements differ substantially between countries, there is a trend that regulators usually either set the level of the fee themselves or propose it. This can be an important safeguard to prevent potential undue influence through the regulator's funding.

The 2018 OECD database on the Indicators on the Governance of Sector Regulators brings together data on the governance of economic regulators, including the funding arrangements that they have in place. The data shows that for a slight majority of the regulators covered in the database (51%), the regulator is able to set the level of the regulatory fee within criteria as set in legislation (see Figure 1.2). In another 13% of cases is parliament, congress or a committee the party that decided upon the level of the fee based upon a proposal by the legislator. When government or a ministerial body is responsible for deciding upon the level of the fee (35% of the cases), this is in a majority of cases based upon a proposal of the regulator. Only in 15% of the cases does government or a ministerial body decide upon the fee without a proposal of the regulator.

Figure 1.2. Most regulators set or propose the level of the regulatory fee



Source: 2018 OECD Indicators on the Governance of Sector Regulators.

The legislative changes improve the financial independence of the PUC, but there is still scope for undue influence through the fee revision process. The current fee level is set in legislation, and the CoM can no longer decide upon a fee level below a legislative ceiling. However, any proposal by the PUC to revise the fee level would require the co-operation of the Ministry of Economics, as the ministry needs to prepare an

amendment for examination in the CoM in that case. In a context of strong public ownership in the regulated sector, with the Ministry of Economics and other ministries as shareholder of regulated companies, this could provide for a potential conflict of interest when considering fee revisions. The practice in Latvia also diverges from international good practice (see Box 1.1 above).

Box 1.2. Setting the "right" fee

For regulators that are funded through fees paid by the industry, it is essential to have an appropriate cost-recovery mechanism to ensure the "right" fee level. This may be particularly important in a context of large state ownership in regulated sectors. In essence, a cost-recovery mechanism should ensure that the fee level reflects the costs of running the operations of an efficient regulator. A structurally lower level of fees could result in an underfunded regulator that is not able to exercise its functions completely, while a structurally higher level of fees poses an unreasonable burden on the entities that need to pay the fee, usually the regulated industry.

There are certain safeguards to ensure that the burden of fee payments on Latvian regulated companies is not too high. In case the fee revenues exceed the budget of the PUC as approved by the Saeima, the excess revenues are deposited in the account of the regulator at the Treasury. Funds in this account can be used to fund the activities of the PUC in subsequent years in accordance with its approved budget. If the funds in this account exceed 25% of total fee revenues in the year before last, the excess in funds results in a deduction in fee payments by the public utilities in the respective year. This ensures that fee payments do not structurally exceed the regulatory budget. However, there do not seem to be sufficient safeguards to ensure the fee level is not too low.

The fee level that funds the operations of the PUC is not frequently revised, and a cost-recovery mechanism to ensure that the fee level reflects the costs of the regulator seems to be lacking. There is a need for a mechanism to safeguard that fee revenues will remain sufficient to finance the operations of the regulator, as future developments in markets and the functions of the regulator may affect the fee level needed to match the costs of the regulator. A clear example of such a development is the COVID-19 pandemic. As the pandemic affects sector revenues, the pandemic also results in a decrease in the fee revenues that are available to fund the PUC's activities. Since the fee revenues in a given year are based on the sector revenues two years prior to that year, this impact is expected to materialise in the year 2022. An effort by the PUC to advocate for a fee increase in response to this impact has so far not been successful.

In this context, the PUC could advocate for further legislative change, to ensure cost-reflectiveness of the level of the fee. This could be ensured through a clear definition in legislation of the criteria that are used to determine the appropriateness of the fee level, as well as a periodic assessment of the fee level based on the regulator's projected costs and functions. To enable an accurate assessment of the fee level, the legislation could also prescribe the level of analysis that the PUC is expected to provide to substantiate projections of future cost levels of the organisation and sector revenues.

Source: Saeima (2000), Law of Regulators of Public Utilities, https://likumi.lv/ta/en/en/id/12483; Saeima (2017), *Grozījumi likumā "Par sabiedrisko pakalpojumu regulatoriem" [Amendments to the Law "On Regulators of Public Utilities"]*, https://likumi.lv/ta/id/295590-grozijumi-likuma-par-sabiedrisko-pakalpojumu-regulatoriem-.

The legislation currently lacks criteria to evaluate the fee level and ensure sufficient funding in the long term. As circumstances, such as market actor revenues and the scope of the regulatory activities, may change, this could potentially lead to a fee level that is too low or too high, and consequently under- or overfunding of the regulator. Moreover, the legislation does not specify the level of detail and analysis the PUC needs to provide to support a request for fee revision. To continue its progress on this

recommendation, the PUC should ensure a cost-reflective level of the regulatory fee by advocating for clear procedures and criteria for fee revisions (see Box 1.2 above).

Recommendation: Investigate impacts of the salary cap

The 2016 review recommended investigating the long-term impacts of the salary cap, set at 4.05 times the average monthly salary in Latvia, as it could weaken the ability of the PUC to keep up with industry developments and retain talent in the long term. Based on an analysis commissioned by the PUC in 2015, this remuneration system led to a significant gap in salaries for senior positions compared to the regulated sector (of 20-40% below salaries in the regulated sector for top positions). Junior positions were less affected by the salary cap, as their salaries were above the median salary in the industry. The review also recommended discussing any challenges and opportunities with similar public institutions as the salary system was unified across public institutions.

Assessment of progress

The competitiveness of PUC salaries has improved following a legislative reform in 2018 that changed the salary cap, but the impact of the salary cap on the PUC's ability to attract and retain talent for senior positions remains unclear.

In 2018, the Saiema approved an amendment to the Law on Remuneration of Officials and Employees of State and Local Government Authorities which changed the PUC's remuneration system. The PUC was actively involved in the creation of this amendment through the issuance of an opinion and the call for a debate, highlighting possible clarifications and improvements. The salary for PUC staff members is now indexed to salaries in the energy and electronic communications sectors, which are higher than the national average salary[13] (Saeima, 2018[15]), instead of the general economy. PUC salaries cannot exceed 4.05 times the average base monthly salary across these two sectors.

The PUC participates in an annual remuneration survey by the Korn Ferry consulting firm, which makes in a comparison for each of the different PUC staff levels with the corresponding market salaries. The survey finds that the competitiveness of PUC salaries differs according to the level of staff, and the competitiveness of salaries is negatively correlated with the staff level. Indeed, the survey suggests that for lower staff levels PUC salaries are above market salaries, while for more senior staff levels PUC salaries are lower than market salaries. However, job attractiveness is not only affected by the level of salary, but also by non-financial aspects such as the work-life balance and the quality of work. The overall effect of the salary cap on the ability of the PUC to attract and retain talent for senior positions is therefore unclear and could be explored further.

Recommendation: Develop total rewards approach to retain staff

The 2016 review recommended developing a "total rewards" approach to increase job attractiveness. The financial incentives that the PUC offers its staff members (salaries, bonuses and benefits) can be supplemented by non-financial incentives in terms of professional development, work-life balance, an enabling environment and the quality of work. The PUC can modify the total rewards it offers in terms of both financial and non-financial incentives to meet the demands of staff and position itself as an attractive employer.

Assessment of progress

The PUC implemented a new bonus system since 2016, with financial and non-financial incentives.

As of 2016, the PUC introduced a new performance evaluation system, which provides both financial and non-financial incentives. The bonus system applies to all staff, including the Board members. Based on the evaluation of their performance in the past year, employees can receive a financial bonus of 55 to 75%

of a monthly salary, as well as 6 to 10 additional days of annual leave (see Table 1.1). In practice, it happens very rarely that an employee receives an evaluation "Improvement needed", while a majority of staff receive are evaluated as "Very good" (see Figure 1.3). The system contributes positively to the work-life balance and is likely to increase job attractiveness.

Table 1.1. Staff receives both financial and non-financial incentives based on performance

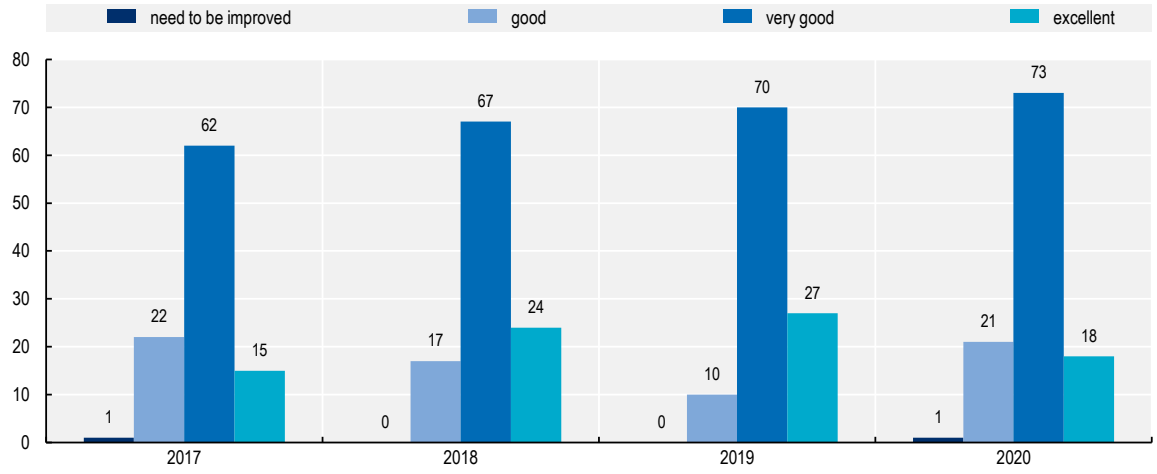
Financial bonus and additional annual leave offered for different levels of performance

	Financial bonus	Additional annual leave
Need to be improved	no incentive given	no incentive given
Good	55% of monthly salary	6 extra days of annual leave
Very good	65% of monthly salary	8 extra days of annual leave
Excellent	75% of monthly salary	10 extra days of annual leave

Source: Information provided by the PUC.

Figure 1.3. Most staff members score "very good" on their evaluation

Staff performance PUC 2017-2020



Source: Information provided by the PUC.

Process

The Process dimension of the PAFER looks at the existence and effective use of regulatory tools and decision-making processes, as well as the extent to which the regulatory processes and organisational management support the regulator's performance. The PUC made significant advancements on the 2016 recommendations for this dimension, with a more robust Board appointment procedure, and an enhanced and more transparent engagement and decision-making process.

Recommendation: Advocate for staggered terms for Board

The 2016 OECD report recommended that the terms of the Board members be staggered to avoid a significant impact on continuity and institutional memory within the PUC in case a large part of the Board would leave at the same time. The Board is the decision-making body of the PUC and comprises of five Commissioners, of which one of which is elected as Chairman. In 2016, the process dictated that all Commissioners were appointed at the same time, with terms strictly limited to five years, and one possibility of re-appointment.

Assessment of progress

There is a new robust process for the selection of Board members, that further staggers Commissioners' terms, and allows for maximum two Commissioners to have their terms confirmed or renewed in one calendar year.

In response to the 2016 recommendation, the PUC advocated for legislative changes, which were enacted in February 2020.[14] The new process for the selection and appointment of Commissioners will be implemented in 2021, when the terms of all current Commissioners are due to expire. As per the new process, the Commissioner appointments will be timed so that in a period of 12 calendar months maximum 2 board members will end their term, thus avoiding significant disruption the composition of the Board. The new framework allows an extension of term time from 5 to 7 years.

In January 2021, the Chairman was removed from office by the parliament before the end of term, following his resignation due to appointment in another public position.[15] An interim Chairman was selected to hold the position until the appointment of the new Board of Commissioners in July 2021.

In addition, the nomination procedure has been amended to give more prominence to the State Chancellery and the Saeima.[16] Candidates will be selected by the Cabinet of Ministers through an open competition. The assessment of candidates will be conducted by a special Committee led by the State Chancellery (including representatives from the State Chancellery, the Ministry of Finance, Ministry for Transport, Ministry for Environmental Protection and Regional Development, and also representatives of associations if invited by the State Chancellery). The competition process organised by the Chancellery involves three rounds, as follows:

- assessment of candidates' conformity in accordance with the relevant laws and regulations;
- candidates' evaluation with regards to their technical, legal and regulatory knowledge of matters under the PUC regulatory remit;
- independent assessment of candidates by external party on key competencies: strategic vision, decision making, achieving results, value awareness, managing change and team management.

At the end of the process, the candidate selected by the Committee on the basis of the highest score will be recommended to the Cabinet for approval in the Saeima.

These positive improvements will strengthen the continuity of the Board and allow for coherence in the long-term strategic decision making of the PUC.

Recommendation: Remuneration of Board members after the end of term

The 2016 review suggested that while post-employment restrictions are in line with OECD practice, the lack of post-term compensation at PUC could have a significant impact in terms of diversity of background in the recruitment of Commissioners. By law, PUC Commissioners are restricted from occupying a position within any of the sectors regulated by the PUC for two years after the end of their term. Former Commissioners are not entitled to receive compensation from the PUC during this "cooling off" period. The OECD review assessed that this could have the potential to deter qualified candidates from accepting a nomination for the PUC's Board, in particular given the size of the country and the multi-sector nature of the regulator. In addition, by comparison, the Board members of the Latvian financial regulator receive compensation for at least six months after the end of their term.[17]

Assessment of progress

There has been timid advancement on the process of amending the remuneration of Board members during the two-year cooling-off period.

In June 2020, the State Chancellery put forward a proposal to amend the "Law on Remuneration of Officials and Employees of State and Local Government Authorities". This proposal includes a provision on a compensation mechanism for the PUC Board members after they leave office. At the time of writing, the amendment had not yet been discussed in the parliament.

Recommendation: exploit even further the multi-sector model and facilitate mobility across sector departments

The 2016 review recommended that the PUC take more advantage of the multi-sector approach, by facilitating mobility of staff across departments, as well as through more enhanced collaboration with the Economic Analyses Department (EAD) and the Legal Department.

In addition to the Board and the Office of the Executive Officer, the PUC has eight different departments, which are further divided into Divisions. There are three departments which cover the sectors that the PUC regulates (Electronic Communications and Post Department, Energy Department, and Water Management and Waste Disposal Services Department), with the other five offering cross-sectoral and cross-institutional support. This framework allows the PUC to share knowledge and exchange experience internally, thus bringing benefits to the institution and the regulatory-making process.

Assessment of progress

Staff mobility within the PUC is shown to take place on a case-by-case basis, but the regulator lacks an organisation-wide mobility strategy.

No formal mechanisms or organisation-wide strategies are in place for enabling staff to build up their skills and to facilitate cross-organisational transfers. However, the PUC is open to staff taking new positions across the regulator – to this end, some new positions were advertised only internally. In addition, PUC demonstrated organisational agility by re-deploying staff across departments as needed during the COVID-19 crisis, in response to emergency needs.

Between 2016 and 2020, 14 positions have been filled through internal recruitment, which represents 25% of the vacancies in this 4-year period. PUC has a well-defined training and development programme for staff who have changed their department or area of expertise.

In addition, as part of the process of developing regulation, co-operation between departments happens at an informal level (through informal knowledge-sharing meetings, or presentations on upcoming projects/priorities to the Board, which are attended by all Heads of Departments). As per PUC internal procedures, ahead of the launch of a consultation or public proposal, all relevant PUC sector departments must comment on and approve the document. This is done at a working level basis, without a formal structure in place.

Recommendation: Introduce more regular and formal exchanges between parliament and the PUC

The previous OECD assessment found that an enhanced and more formalised engagement with Saeima would strengthen the PUC's accountability and performance – both in terms of the internal workings of the regulator, but also with regards to the trends and challenges in the sectors that it regulates.

Assessment of progress

The PUC presents its Annual Action Plan and the Annual Report to the Saeima. However, the current level of formal engagement on the performance of regulator is limited.

As a consequence of this recommendation, the PUC advocated for legislative changes which allow for an annual formal presentation by the regulator of its budgets and upcoming activities in the Saeima. Since 2018, the PUC presents to the parliament its Annual Action Plan, which includes the operational and strategic objectives of the PUC for the coming year. This is complementary to an existing requirement for written submission of the annual report and audited accounts.

This represents a positive development, as it is an opportunity for the PUC to directly improve its relationship with the Saeima, but also to indirectly raise the profile of the PUC as the meetings are publicised and a number of stakeholders follow them. In addition, the process of presenting the Annual Action Plan is not designed as a "feedback session" with the Saeima – rather, the PUC informs the executive and legislative branches of its annual priorities, and retains autonomy from the parliament and the government in preparing its Action Plan. On the other hand, PUC could benefit from a two-way dialogue with the Saeima on the development of the organisation's Operational Strategy, which ultimately is transposed into the Action Plan.

The PUC has also been invited in the Saeima's Committees[18] to provide evidence on a number of issues related to the sectors regulated by the PUC. This is a positive practice, as it allows the parliament to consider the view of the independent regulator, in addition to the government's when developing legislation.

Nonetheless, the time dedicated for the formal discussion in the parliament is limited. Going forward, the PUC could seek to create more meaningful opportunities to engage with the Saeima (for example, increase the number of instances the PUC addresses the Saeima plenary), or expand its engagement with parliamentary forums (for instance through discussions with a number of parliamentary committees). In this way, the PUC could further demonstrate the value it brings to the sectors it regulates and to the wider economy.

Stakeholders have a high degree of trust in the PUC's actions and its decision-making process. Nonetheless, given the level of maturity of the regulator, and the trust it enjoys by the other sector actors, there is scope for the PUC to initiate engagement with stakeholders beyond the minimum legal requirement (both with the government and parliament, but also fellow regulatory agencies).

Box 1.3. Engagement and transparency in decision making

The PUC has a long-standing practice of using several mechanisms to engage with external stakeholders and ensure transparency in decision making: public consultations, public hearings, access to Board meetings, public presentation of information on the website, public explanations on how stakeholder comments were taken into account, etc. In addition, the PUC manages the expectations of stakeholders in relation to the level of engagement, and presents different engagement mechanisms in its recently published "consultation procedure".

The PUC does not publish an annual or bi-annual schedule of planned consultations. Such a document would give market actors (both government and regulated entities) visibility and certainty over upcoming changes and priorities of the regulator.

Beyond the national level, the PUC also engages with the industry in the energy sector through the Baltic Electricity and Gas Markets Forums. These meetings are organised by rotation by the three sector regulators from Latvia, Estonia and Lithuania, with regulators from Finland, Sweden and Poland permanently invited. The forums bring together representatives from TSOs, DSOs, ministries and regulators. In addition to discussions on specific projects, the Baltic Forums offer the opportunity of exchanges and knowledge sharing on general regulatory matters.

Source: PUC, 2020.

Zoom-in: regulatory tools

The purpose of this section is to explore in detail the regulator's use of regulatory tools, specifically the *ex ante* impact analyses and *ex post* reviews, which will be analysed in the context of the OECD data collected through the *Indicators of Regulatory Policy and Governance* (OECD, 2017[16]).

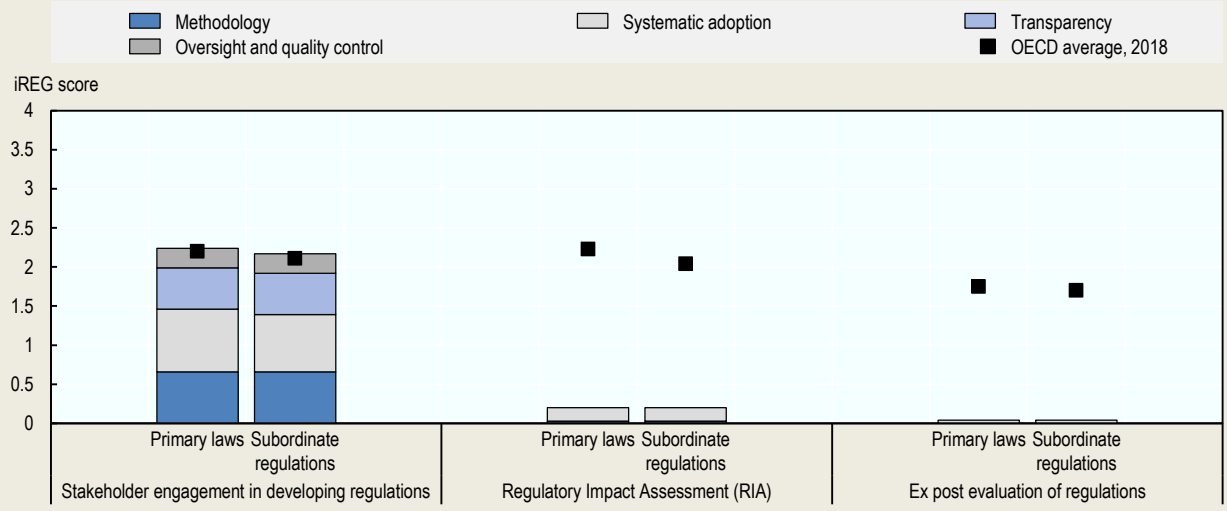
The PUC issues regulations on the basis of its mandate enshrined in primary legislation. The legislation[19] requires the PUC to conduct cost-benefit analysis or other *ex ante* impact assessments on all acts subject to public consultation, and specifies the general procedure that must be followed for the analysis. However, the legislation does not clearly define the threshold or characteristics of *ex ante* or *ex post* assessment, and only a selective number of issues are mandated for public consultation. Adequate regulatory impact assessment tools are important in the current context at the PUC, where the regulatory approach in the energy sector is shifting from cost-plus to incentive-based regulation.

Box 1.4. Indicators of Regulatory Policy and Governance: overall government practice in Latvia

The *Indicators of Regulatory Policy and Governance (iREG)* present up-to-date evidence of OECD member countries' regulatory policy and governance practices, and cover elements such as stakeholder engagement, regulatory impact assessment and ex post evaluation.

The results presented in the OECD Regulatory Policy Outlook 2018 assess overall practice in Latvia across government, and do not zoom in on practices in the sectors that the PUC regulates. Latvia scores below the OECD average in the 2018 *Indicators of Regulatory Policy and Governance* (OECD, 2017[16]) in the area of regulatory impact assessment, with no single document provided by the government that comprehensively articulates the requirements of regulatory policy. The OECD suggests that there is a need in Latvia for the government to lead on the introduction of a threshold test for the preparation of in-depth impact analysis, as well as for the exploration of ways to improve quantification of the impacts of regulatory changes (OECD, 2018[17]).

Figure 1.4. Indicators of Regulatory Policy and Governance (iREG): Latvia, 2018



Note: The more regulatory practices as advocated in the OECD Recommendation on Regulatory Policy and Governance a country has implemented, the higher its iREG score. The indicators on RIA for primary laws only cover those initiated by the executive (70% of all primary laws in Latvia).

Sources: Indicators of Regulatory Policy and Governance Surveys 2014 and 2017, http://oe.cd/ireg ; OECD Regulatory Policy Outlook 2018, OECD Publishing, Paris, https://doi.org/10.1787/9789264303072-en.

Currently, the PUC is developing a broader framework/methodology for economic impact assessment that would assess the financial and economic costs of regulatory decisions across all the sectors it regulates. The framework is currently tested for assessing the impact of change in tariffs in the gas and electricity distribution sector, and is expected to be completed by the end of 2021. The methodology under work includes wide-ranging data, such as the effect of inflation, household and state budgets, and the effects of other movements in the market (for instance for gas: other energy players such as heat energy producers, effect of companies in other industries, etc.).

Box 1.5. *Ex ante* assessments at the PUC

All draft regulations prepared by the PUC which are subject to public consultation process include an *ex ante* impact analysis. Furthermore, for some of the sectors that it regulates follows the EU regulatory framework in relation to the *ex ante* assessments. For instance, in the electronic communications sector, the PUC is required by European directives[1] to perform *ex ante* market reviews in order to determine the level of competition, and impose additional obligations on players with significant market power as part of the process of issuing new sector regulations.

Energy sector

The Energy Department prepares *ex ante* impact assessments for new regulatory initiatives, as well as for tariffs. The PUC does not have one single framework for the completion of impact assessments; rather, the regulator uses a number of methods, depending on the specific regulation/tariff in question. The methods are as follows, and are used either in isolation or together, depending on circumstances:

- Soft benchmarking: used especially in area of district heating, where similar companies operate, as well as in the tariff-setting process when assessing personnel costs;
- Careful precedent setting: due regard is given to areas that create regulatory irregularities or which are not specifically prescribed in regulation;
- Comparison of welfare gains: used for deciding between alternative regulations;
- Assessment of tariff impact on other regulated/unregulated sectors
- Simulations: method employed as part of the national framework for natural gas storage.

The advantage of having a number of methods in place for the performance of *ex ante* assessments is that these can be tailored and applied in a “mix-and match” fashion, depending on the subject matter of the consultation. However, the lack of a pre-defined minimum assessment represents a concern. This not only has the risk of reducing acceptance of the PUC’s regulatory decisions by the market, but also reduces the availability of data for the PUC in the decision-making process. It is advisable that the PUC develops clear thresholds for each type of analysis used as part of the *ex ante* assessments. In the meantime, given the absence of pre-defined standards to follow when carrying out *ex ante* assessments, the regulator should ensure that its assessments explain the regulatory intent (why the PUC made the decision) and that they follow the due process, both in term of internal decision making but also consultation with affected parties.

Other regulated sectors

As highlighted above, regulatory impact assessment tools for the electronic communication sector are strongly influenced by European legislation (*ex ante* market analysis), which is aimed at promoting effective competition across the Union.

In the postal services, the areas of regulatory intervention where *ex ante* is allowed is identified specifically by legislation,[2] and relates to quality of supply parameters and pricing. As part of the *ex ante* assessment, the PUC performs in-depth data analysis on the information received from the market players through regular reporting.

In the water management sector, the PUC sets the end-user tariff.

In municipal waste disposal at a landfill service, the tariff methodology includes a number of *ex ante* assessment tools that are pre-determined in national legislation. The main *ex ante* evaluation tool used in water management and municipal waste disposal at a landfill service is soft benchmarking, which is set under a methodology similar as the benchmarking done for the energy sector.

1. The European Electronic Communications Code (EECC) mandates *ex ante* regulation of the electronic communications sector for the PUC; https://eur-lex.europa.eu/legal-content/en/txt/?uri=uriserv%3aoj.l_.2018.321.01.0036.01.eng.
2. Methodology for the Calculation of the Universal Postal Service (published in the official "Latvijas Vēstnesis", https://likumi.lv/ta/id/261053-universala-pasta-pakalpojuma-tarifu-aprekinasanas-metodika, in LV).
Source: PUC, 2020.

Box 1.6. *Ex post* reviews

Ex post reviews are conducted by the PUC regularly. As the PUC is a multi-sector regulator, the qualitative and quantitative criteria which trigger an *ex post* review differ depending on the regulated sector.

Energy sector

There is no set threshold (either time-dependent or otherwise) on what triggers an *ex post* review of regulation is needed. Generally, *ex post* assessments are conducted in one of two cases:

When breaches/violations of regulations have occurred: this is done as part of the penalty-setting process, and looks at the impact of the particular rule breach on the market or the service quality;

Targeted identification of unwanted behaviours by providers or end-users: this is done as part of the yearly performance assessment of the utilities. More specifically, this mechanism examines whether the market conditions have changed to an extent that exiting stimuli stipulated in regulations have ceased to balance the interests of the operators with those of the end-consumers.

Electronic communications

EU legislation[1] mandates the PUC to conduct regular market reviews in order to identify deficiencies in specific market segments, and impose relevant remedies or amend, maintain or withdraw regulations. As part of the work for completing the Electronic Communications Code, the PUC is working on a methodology to establish a common assessment scenario.

In addition, for this sector, the responsibility for *ex post* review is shared with the Competition Council (CC). The PUC and the CC have routine consultations and collaboration about the state of the sector.

Postal services

No *ex post* reviews are conducted for postal services.

Water management and Municipal waste disposal at a landfill service

The PUC performs an analysis of the annual report of the providers, as well as comparisons of the data presented in the annual report with the pre-approved tariff data. The *ex post* evaluation methodologies set quantitative criteria for the deviation of yearly performance indicators; more specifically, tariff costs and service volumes are used to assess whether any changes in level of approved tariff are needed.

[1] Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services" (https://eur-lex.europa.eu/LexUriServ/Lexuriserv.do?uri=oj:c:2002:165:0006:0031:en:pdf).
Source: PUC, 2020.

The OECD asserts that *ex post* evaluations play a vital role in the cycle of regulation, (OECD, 2020[18]) and recommends that they should focus on whether the underlying policy objectives of the regulation have been achieved, and thus go beyond the evaluation of the financial implications. From the review of the PUC's regulatory assessment tools, it is not apparent that the *ex post* evaluations in all sectors fulfil this requirement.

In addition, the regulatory regime should have a clear and coherent link between *ex ante* and *ex post* evaluation, so that evidence-based policy making is observed throughout the regulatory cycle. This can also ensure a more clear linkage between the regulator's objectives, its regulatory decisions, the appropriate methodology that supports the decision-making, as well as the market data and information needs. Whilst a "one-size-fits-all" approach would be difficult to apply across the PUC due to its multi-sector responsibilities, a clearer methodology for each regulated sector on how *ex post* reviews fit into the regulatory cycle would be beneficial.

Furthermore, considering the significant legislative changes in the sectors regulated by the PUC, especially in the context of changes mandated by EU legislation, it is advisable that the PUC considers undertaking an exercise of "stock review". This is particularly important to ensure that the transposed legislation is compatible with any older regulations, and that any defunct or redundant rules as removed as necessary.

Output and outcome

The Output and outcome dimension of the PAFER framework focuses on the existence of a systematic assessment of the performance of the regulated entities, the impact of the regulator's decisions and activities, as well as the extent to which the measurements are used. The PUC made modest progress on the recommendations in this area, with a performance assessment matrix lacking, and data-driven tools for enabling consumer choice still in development.

Recommendation: develop a performance assessment matrix that links goals and priorities to outputs and outcomes

The 2016 OECD review recommended the PUC to develop a mechanism that would link goals and priorities to outputs and outcomes and to improve the usage of indicators to measure performance.

Assessment of progress

The PUC has not developed a performance assessment matrix that would allow for a specific mapping of goals and priorities against outputs and outcomes.

Instead, the PUC developed a regular monitoring system. The 2018-2021 strategy is translated into an Annual Action Plan which includes both strategic and operational objectives. The strategic part of the Plan is subject to a quarterly assessment of performance, with overview from the Board of Commissioners. The

operational objectives are discussed in weekly operational meetings, to ensure supervision of progress. However, no measure in the form of key indicators is applied. The creation of an assessment matrix with clear performance indicators should be undertaken in tandem with the actions discussed in section *Recommendation: Focus on high-level goals* and outcomes. In that way, it becomes clear how the high-level goals are supported by specific functions of the regulator, and in turn, how these can be measured and reported on regularly.

The development of performance indicators is challenging for most regulators in OECD countries. The size of the task is further exacerbated for a multi-sector regulator, especially when functions evolve at a fast pace. The PUC can employ a number of strategies in order to overcome this. For instance, different sets of indicators can be developed for the different sectors that the PUC regulates, as it may be challenging to develop a set of indicators that fits all of the sectors. In addition, the PUC can make use of the varied expertise of the newly-established Advisory Council and seek their input in relation to the indicators they deem important to use in the matrix.

Recommendation: use performance data and information to communicate with key stakeholders

The 2016 report recommended the PUC to enhance its use of data in order to improve communication with stakeholders. The recommendation suggested that the PUC focused on data that it already holds, as well as the development of key performance data. The aim of this recommendation was to improve the transparency towards stakeholders.

Assessment of progress

The PUC enhanced transparency through more external communication. However, it is difficult for stakeholders to grasp how the PUC performs in the absence of key indicators.

The PUC has not yet developed a data management strategy. However, it started an audit of data already collected, which would enable the regulator to establish potential new uses for data it holds, as well as determine the need for additional data from the markets.

In order to facilitate and systematise the collection of data from market players, the PUC launched in 2016 an electronic information submission system (IIAS).[20] While the IIAS covers data collection from all sectors, the launch of the system was accompanied by the issuance of the “information submission rules”[21] for the energy sector, to ensure that consistent and relevant data is received from the operators in the energy sector.

Furthermore, the PUC seeks to identify possible needs of market participants. When sending out calls for submission of standard data, the PUC also disseminates a questionnaire that allows regulated companies to raise potential issues and to flag areas for improvement (in 2019 the main topics were customer education and shortening the switching process between suppliers). The results of the questionnaire are not translated however in easy-to-grasp or analytical communication by the regulator.

Finally, whilst the PUC made steps on improving communication with stakeholders (i.e. presentation of Annual Report to the Saeima), the PUC can make use of more structural and data-driven reporting for all stakeholders. More specifically, there is a need for analysis and presentation of data in plain language, so that non-specialised stakeholders (such as consumers) can understand clearly changes in the markets or impact of PUC regulatory decisions.

The data collected by the PUC is published and made available to the public, depending on the sector, as follows:

- *Water management and municipal waste disposal at a landfill sector*: the performance data of regulated entities is published annually on the PUC website.[22]

- *Electricity and gas supply*: changes in the reporting to the public can be seen from the 2018 to the 2019 report, when the PUC started to focus on more simple, accessible language and on the enhanced use of infographics and visual aids.[23] In addition, in 2020 the PUC started sharing information on customer claims, similarly aided by infographics and advice for enhancing proactive consumer action.[24] PUC has not determined what is the impact of such measures on consumer information and education, and it is advised that such an exercise is undertaken by the PUC.

Recommendation: Use of data to develop choices for consumers

The 2016 OECD review recommended that the PUC use its data and analysis in order to develop choice tools for consumers. This is particularly important in certain sectors (such as energy or telecommunications) where consumers do not make choices solely based on cost, but are also influenced by quality of service or other user-tailored services.

Assessment of progress

There are limited information comparison tools for e-communications and energy. There is a need for more data-driven tools and consumer education platforms, making use of available data.

The PUC needs to advocate for implementation of legislation that allows it to take more action in the sphere of comparison tools. For instance, the EU Directive 2019/944 would give the PUC more powers over the supervision of development of comparison tools in the energy sector.

Lessons learnt and way forward

PUC has made significant progress in implementing key recommendations identified in the 2016 OECD review, including in areas requiring the mobilisation of the executive and legislative branches of the Latvian state. This progress attests to the organisation's willingness to strive to improve its performance. It also highlights its capacity to embrace opportunities offered by the context of Latvia's accession to the OECD, although the PAFER review and its recommendations were not part of the official OECD accession process. The regulator also instated a monitoring mechanism of the recommendations of the review, to enhance visibility of progress by the senior management team and to ensure adequate follow-up of on-going efforts.

The progress review shows that while the review is a snapshot of a given moment in time, its follow-up should be seen as a continuous process to ensure desirable outcomes. Monitoring of the implementation process can help assess if recommendations remain feasible in practice, or whether adjustments need to be made to account for the dynamic context in which the regulator is active. Finally, this progress review can help shed light on areas for future attention.

Follow-up mechanism

Following the 2016 recommendations, the PUC created a mechanism that distinguished two families of recommendations, depending on agency for their implementation: a first family that would necessitate legislative changes, and dialogue and action by the executive and legislative branches, and a second family that could be driven independently by the PUC.

The legislative changes have been pursued in line with the formal procedure, which required the PUC to send proposals for reform to the Ministry of Economics. These proposals required the approval of the Cabinet of Ministers, the Saeima Economic, Agricultural, Environmental and Regional Policy Committee and, finally, the approval of the Saeima. To achieve the implementation of these recommendations, the

PUC's Legal department, Board members, Executive Director and other units were involved in preparing, supporting and presenting PUC proposals to this wide array of actors.

Regarding the reforms that could be driven independently by the PUC, the regulator established a dedicated working group, consisting of staff and senior management.[25] In assessing the implementation of measures, the working group consulted with relevant departments and the Board members. In addition, where appropriate, the PUC made use of external experts and conducted public consultations. For instance, the process of implementing incentive-based regulation involved representatives from the PUC's Energy and Economic Analyses departments working together, to explore and analyse the experience and lessons learnt of other regulators abroad. In addition, the PUC organised two seminars with a guest expert from the Italian regulator ARERA on specific aspects of incentive regulation.

The PUC also shared its experience of an in-depth independent review with national regulators, as well as in the international fora it takes part in (for instance, the Energy Regulators Regional Association, the Council of European Energy Regulators and the Network of Regulators of Electronic Communications).

Continuous process

Monitoring the implementation of recommendations is important to assess the progress and practical feasibility of recommendations. While the context in which the regulator operates is factored into the recommendations of the 2016 review, this is not a guarantee that all recommendations will under all circumstances result in the desired outcomes. First, the regulator operates in a dynamic context. This means that recommendations may become outdated. Changes in the context of the regulator may require adjustments in the approach of the regulator to make it is still effective in the new context. Second, the implementation process could also bring to the forefront additional complexities, which can create a discrepancy between the theoretical and practical feasibility of recommendations.

It is therefore essential to acknowledge the continuous nature of the performance assessment of economic regulators. The legal requirement for the PUC, to perform an assessment every three years, also considers this aspect. It provides necessary safeguards to continue the strong improvements seen in the PUC's governance so far. Recommendations should not be seen as a final assessment, but more the start of a continuous conversation on performance and progress. The instrument of a progress review could assist this process, by providing an accountability mechanism and provide an opportunity to highlight the areas to focus on moving forward.

Areas of focus going forward

The progress review highlights a number of areas that the PUC could focus on moving forward, to ensure the continuity of its strong progress. The main areas of focus going forward are:

- Performance assessment: continuing to improve the measurability and accountability of the PUC's progress. This could be done by reporting on a set of key performance indicators linked to its strategic objectives, as well as through expanding its engagements with the Saeima.
- Predictability in fee-setting and revisions: ensuring the right fee level in the longer term by advocating for clear procedures and criteria for fee revisions, to build upon on the successful advocacy for a new fee setting process.
- Use of regulatory management tools: streamlining practices on topics such as ex ante impact analyses and ex post reviews across all sectors to leverage the PUC's multi-sector model. In doing so, PUC could take into account the OECD recommendation for Latvia to explore ways for improving the quantification of impacts (OECD, 2018[19]).
- Management of human resources: further encouraging staff mobility across sectors, taking full advantage of the PUC's multi-sectoral responsibilities.

- Data-driven regulation: developing data-driven tools and better utilising available data in all areas of the regulator's activities.

Notes

[1] Lithuania is not yet part of the TSO MoU due to lack of agreement on the TSO compensation mechanism. Lithuania remains as a fully separate entry-exit system.

[2] The Clean Energy Package addresses five key dimensions:

- Energy security
- Internal energy market
- Energy efficiency
- Decarbonisation of the economy
- Fostering research, innovation and competitiveness

[3] Directive (EU) 2018/1972 of the European Parliament and of the Council, of 11 December 2018.

[4] Regulation (EU) 2018/644 of the European Parliament and of the Council of 18 April 2018 on cross-border parcel delivery services (OJ L 112, 2.5.2018.).

Commission Implementing Regulation (EU) 2018/1263 of 20 September 2018 establishing, pursuant to Regulation (EU) 2018/644 of the European Parliament and of the Council, forms for the submission of information by parcel delivery service providers.

[5] Law on Water Management Services, ("Ūdenssaimniecības pakalpojumu likums"; in LV https://likumi.lv/ta/id/275062-udenssaimniecibas-pakalpojumu-likums).

[6] Law on Regulators of Public Utilities" (Law, Chapt. I, Sect. 2(7); in force from 25.02.2020.: https://likumi.lv/ta/id/312479-grozijumi-likuma-par-sabiedrisko-pakalpojumu-regulatoriem-) and to Cabinet Regulation Nr. 1227 "Regulations Regarding Types of Regulated Public Utilities" (https://likumi.lv/ta/id/314182-grozijums-ministru-kabineta-2009-gada-27-oktobra-noteikumos-nr-1227-noteikumi-par-regulejamiem-sabiedrisko-pakalpojumu-veidiem-; in LV).

[7] Other powers include the powers: to lay down quality requirements and determine compensation in case of inadequate quality; to impose economic of legal obligations or incentives to facilitate service provision in line with the quality requirements; to determine the methodology for the calculation of tariffs and the procedure for application of these tariffs; and to approve the total costs for the service provision.

[8] The deposit system service is expected to become operational as of 1 February 2022.

[9] Law on Regulators of Public Utilities, Chapter II, Section 15bis (3).

[10] By-laws of the Advisory Council, s5.

[11] By-laws of the Advisory Council, s10.

[12] Under the old fee setting process, excess fee revenues above the regulator's costs were set aside for the next year, and the fee for the next year was reduced to take into account the excess payments.

[13] The 2019 PUC annual report presents a national average salary of 1 076 euro in 2019, while the average salary in the e-communications sector is EUR 1 726 and in the energy sector EUR 1 366 (PUC, 2020[20]). The average of both sectors (EUR 1 546) is therefore 43.7% higher than the national average salary.

[14] Law On Regulators of Public Utilities, Section 7.

[15] Law on Regulators of Public Utilities, Article 41(3).

[16] Law on Regulators of Public Utilities, Chapter II, Section 7.

[17] Former members of the Board of the Latvian financial regulator, the Financial and Capital Market Commission, receive post-employment compensation for 6 months, plus the equivalent of 1-3 months' salary, depending on the length of service.

[18] Between March 2020 and March 2021, the PUC participated in 30 meetings of the Saeima's Committees: 25 at the Saeima Economic, Agricultural, Environmental and Regional Policy Committee, 2 at the Public Expenditure and Audit Committee, 2 at the Budget and Finance (Taxation) Committee and 1 at the Public Administration and Local Government Committee.

[19] Procedure for assessing the initial impact of a draft legislative act, Instruction of the Cabinet of Ministers, No. 19 in Riga on December 15, 2009 (protocol No. 88 § 103), https://likumi.lv/doc.php?id=203061.

[20] PUC, The System for Input and Processing of Merchant's Information (IIAS), https://www.sprk.gov.lv/en/content/iias.

[21] Decision No. of the Council of the Public Utilities Commission No. 1/36, Riga, December 21, 2017 (protocol No. 46, p. 18) Information submission rules in the energy sector, https://likumi.lv/ta/id/296146-informacijas-iesniegsanas-noteikumi-energetikas-nozare.

[22] Water management sector performance reports (in LV): https://www.sprk.gov.lv/index.php/content/nozares-raditaji-0.

Municipal waste disposal at a landfill sector performance reports (in LV): https://www.sprk.gov.lv/index.php/content/nozares-raditaji.

[23] PUC, Electricity market interactive infographics website: https://infogram.com/2-el_majsaimniecibas_q4-2019-1h7j4dpvwky94nr?live.

[24] PUC, Website news page, *Last year, disagreements in energy were most often caused by non-reporting of meter readings* (in LV): https://www.sprk.gov.lv/events/pern-domstarpibas-energetika-visbiezak-radusas-skaititaju-radijumu-nezinosanas-del.

[25] The composition of the working group could change according to the topic, to ensure the relevant staff members are involved.

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Annex A. At a glance: progress on the 2016 Recommendations

2016 Recommendations	Assessment of progress	Status
Role and objectives		
Focus on high-level goals and related outcomes and align functions with these outcomes	The PUC now has a stronger focus on goals and outcomes, which it could strengthen by measuring progress on its strategic objectives against key performance indicators.	Moderate progress on recommendation
Clarify goals and priorities	The PUC developed strategic directions that meet the interests of users, but could explain further how it balances the different interests and priorities it sets for itself.	Good progress on recommendation
Ensure that regulatory functions are fit-for-purpose	The PUC is better equipped for its designated functions; it now faces the task of fine-tuning the efficiency incentives in order to increase the impact of the new regulatory approach.	Good progress on recommendation
Assess how best to continue participating in the policy making process without losing sight of the PUC's core regulatory functions and the PUC's independence	The PUC provides valuable input to ministries during the policy development process and the drafting of related legislation, whilst maintaining adequate resources to execute its functions. However, it did not assess how to continue participating in this process without losing sight of its independent role.	Limited progress on recommendation
Set up appropriate institutional mechanisms for developing and overseeing the implementation of the strategic framework	The PUC established the Advisory Council in 2020. Going forward, the PUC will need to manage expectations around the work and function of the Council.	Moderate progress on recommendation
Input		
Advocate for an alternative process for setting the regulatory fee which guarantees adequate accountability, minimises the risk of conflicts of interests and prevents potential undue influence	The new fee setting process is more robust and reduced the executive's influence over the fee, but there is a need for clear criteria and procedures to ensure the right fee level in the future.	Moderate progress on recommendation
Further investigate the possible long-term effects of the salary cap on the capacity of the regulator to attract, retain and develop talent	The competitiveness of PUC salaries has improved following a legislative reform in 2018 that changed the salary cap, but the impact of the salary cap on the PUC's ability to attract and retain talent for senior positions is remains unclear.	Good progress on recommendation
Develop a "total rewards" approach to attract and retain staff	The PUC implemented a new bonus system since 2016, with financial and non-financial incentives.	Recommendation implemented fully
Process		
Advocate for staggered terms for Board members	There is a new robust process for the selection of Board members, that further staggers Commissioners' terms, and allows for maximum two Commissioners to have their terms confirmed or renewed in one calendar year.	Recommendation implemented fully
Exploit even further the multi-sector model and facilitate mobility across sector departments	Staff mobility within the PUC is shown to take place on a case-by-case basis, but the regulator lacks an organisation-wide mobility strategy.	Moderate progress on recommendation
Introduce more regular and formal exchanges between Parliament and the PUC	The PUC presents its Annual Action Plan and the Annual Report to the Saeima. However, the current level of engagement is limited, given the breadth of	Good progress on recommendation

2016 Recommendations	Assessment of progress	Status
	topics and length of the reports.	
Remuneration of Board members after the end of term	There has been timid advancement on the process of amending the remuneration of Board members during the two-year cooling-off period.	No progress on recommendation
Output and outcome		
Develop a performance assessment matrix that links goals and priorities to outputs and outcomes	The PUC had not developed a performance assessment matrix that would allow for a specific mapping of goals and priorities against outputs and outcomes.	No progress on recommendation
Use performance data and information to communicate with key stakeholders	The PUC enhanced transparency through more external communication. However, it is difficult for stakeholders to grasp how the PUC performs in the absence of key indicators.	Moderate progress on recommendation
Use data to develop choices for consumers	Since the last review, there are limited information comparison tools for e-communications and energy. There is a need for more data-driven tools and consumer education platforms which make use of extensive data.	Limited progress on recommendation

Annex B. Methodology

Measuring regulatory performance is challenging, starting with defining what to measure, dealing with confounding factors, attributing outcomes to interventions and coping with the lack of data and information. This annex describes the methodology developed by the OECD to help regulators address these challenges through a Performance Assessment Framework for Economic Regulators (PAFER), as well as how it was adapted for a follow-up review. It first presents some of the work conducted by the OECD on measuring regulatory performance. It then describes the key features of the PAFER and presents a typology of performance indicators to measure input, process, output and outcome. It finally provides an overview of the approach and practical steps undertaken for developing the present follow-up review.

This Annex summarises the methodology developed by the OECD to assess regulatory authorities' governance arrangements, drivers of performance as well as their performance measurement matrices. The methodology was prepared based on the experience of regulators participating in the OECD Network of Economic Regulators. The framework was applied to 12 regulatory bodies, and the present report is the first application of a follow-up review. The reviews up to date, spanning a number of sectors and countries, include: Colombia's Communications Regulation Commission (OECD, 2015[1]), Latvia's Public Utilities Commission (OECD, 2016[2]), Mexico's three energy regulators (OECD, 2017[3]); (OECD, 2017[4]); (OECD, 2017[5]); (OECD, 2017[6]), Ireland's Commission for Regulation of Utilities (OECD, 2018[7]); Peru's Energy and Mining Regulator (OECD, 2019[8]); Peru's Telecommunications Regulator (OECD, 2019[9]), Peru's Transport Infrastructure Regulator (OECD, 2020[10]), Ireland's Environmental Protection Agency (OECD, 2020[11]), and Portugal's Energy Services Regulatory Authority (OECD, 2021[12]). The methodology has been adapted since its first application to learnings throughout the review process and is adjusted to take into account specific needs and contextual characteristics of each regulator, sector and jurisdiction.

Analytical framework

The analytical framework that informs this review draws on the work conducted by the OECD on measuring regulatory performance and the governance of economic regulators. OECD countries and regulators have recognised the need for measuring regulatory performance. Information on regulatory performance is necessary to better target scarce resources and to improve the overall performance of regulatory policies and regulators. However, measuring regulatory performance can prove challenging. Some of these challenges include:

- *What to measure*: evaluation systems require an assessment of how inputs have influenced outputs and outcomes. In the case of regulatory policy, the inputs can focus on: i) overall programmes intended to promote a systemic improvement of regulatory quality; ii) the application of specific practices intended to improve regulation, or, iii) changes in the design of specific regulations.
- *Confounding factors*: there is a myriad of contingent issues that have an impact on the outcomes in society which regulation is intended to affect. These issues can be as simple as a change in the weather, or as complicated as the last financial crisis. Accordingly, it is difficult to establish a direct causal relationship between the adoption of better regulation practices and specific improvements to the welfare outcomes that are sought in the economy.
- *Lack of data and information*: countries tend to lack data and methodologies to identify whether regulatory practices are being undertaken correctly and what impact these practices may be having on the real economy.

The OECD (2014[13]) *Framework for Regulatory Policy Evaluation* starts addressing these challenges through an input-process-output-outcome logic, which breaks down the regulatory process into a sequence of discrete steps. The input-process-output-outcome logic is flexible and can be applied both to evaluate practices to improve regulatory policy in general, and also to evaluate regulatory policy in specific sectors, based on the identification of relevant strategic objectives. It can be tailored to economic regulators by taking into consideration the conditions that support the performance of economic regulators (Box A B.1).

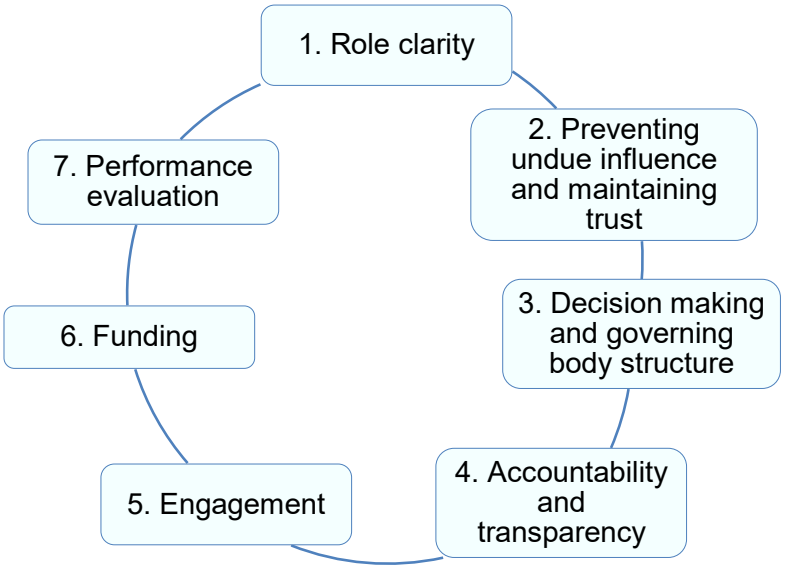
The OECD Best Practice Principles for Regulatory Policy: The Governance of Regulators (OECD, 2014[14]) identifies some of the conditions that support the performance of economic regulators. They recognise the importance of assessing how a regulator is directed, controlled, resourced and held to account, in order to improve the overall effectiveness of regulators and promote growth and investment, including by supporting competition. Moreover, they acknowledge the positive impact of the regulator's own internal process on outcomes (i.e. how the regulator manages resources and what processes the regulator puts in place to regulate a given sector or market) (Figure A B.1).

Box A B.1. The input-process-output-outcome logic sequence

- Step I. Input: indicators include for example the budget and staff of the regulatory oversight body.
- Step II. Process: indicators assess whether formal requirements for good regulatory practices are in place. This includes requirements for objective setting, consultation, evidence-based analysis, administrative simplification, risk assessments and aligning regulatory changes internationally.
- Step III. Output: indicators provide information on whether the good regulatory practices have actually been implemented.
- Step IV. Impact of design on outcome (also referred to as intermediate outcome): indicators assess whether good regulatory practices contributed to an improvement in the quality of regulations. It therefore attempts to make a causal link between the design of regulatory policy and outcomes.
- Step V. Strategic outcomes: indicators assess whether the desired outcomes of regulatory policy have been achieved, both in terms of regulatory quality and in terms of regulatory outcomes.

Source: (OECD, 2014[13]).

Figure A B.1. The OECD Best Practice Principles on the Governance of Regulators



Source: Adapted from (OECD, 2014[14]).

The two frameworks are brought together into a Performance Assessment Framework for Economic Regulators that structures the drivers of performance along the input-process-output-outcome framework (Table A B.1).

Table A B.1. Criteria for assessing regulators' own performance framework

References	Strategic objectives	Input	Process	Output and outcome
Best Practice Principles for the Governance of Regulators	• Role clarity	• Funding	• Maintaining trust and preventing undue influence	• Performance evaluation
			• Decision making and governing body structure	
			• Accountability and transparency	
			• Engagement	
Institutional, organisational and monitoring drivers	• Objectives and targets	• Budgeting and financial management	• Strategy, leadership and co-ordination	• Performance standards and indicators
	• Functions and powers	• Human resources management	• Institutional structure	• Performance processes and reports
			• Management systems and operating processes	• Feedback or outside evidence on performance
			• Relations and interfaces with Government bodies, regulated entities and other key stakeholders	
			• Regulatory management tools	

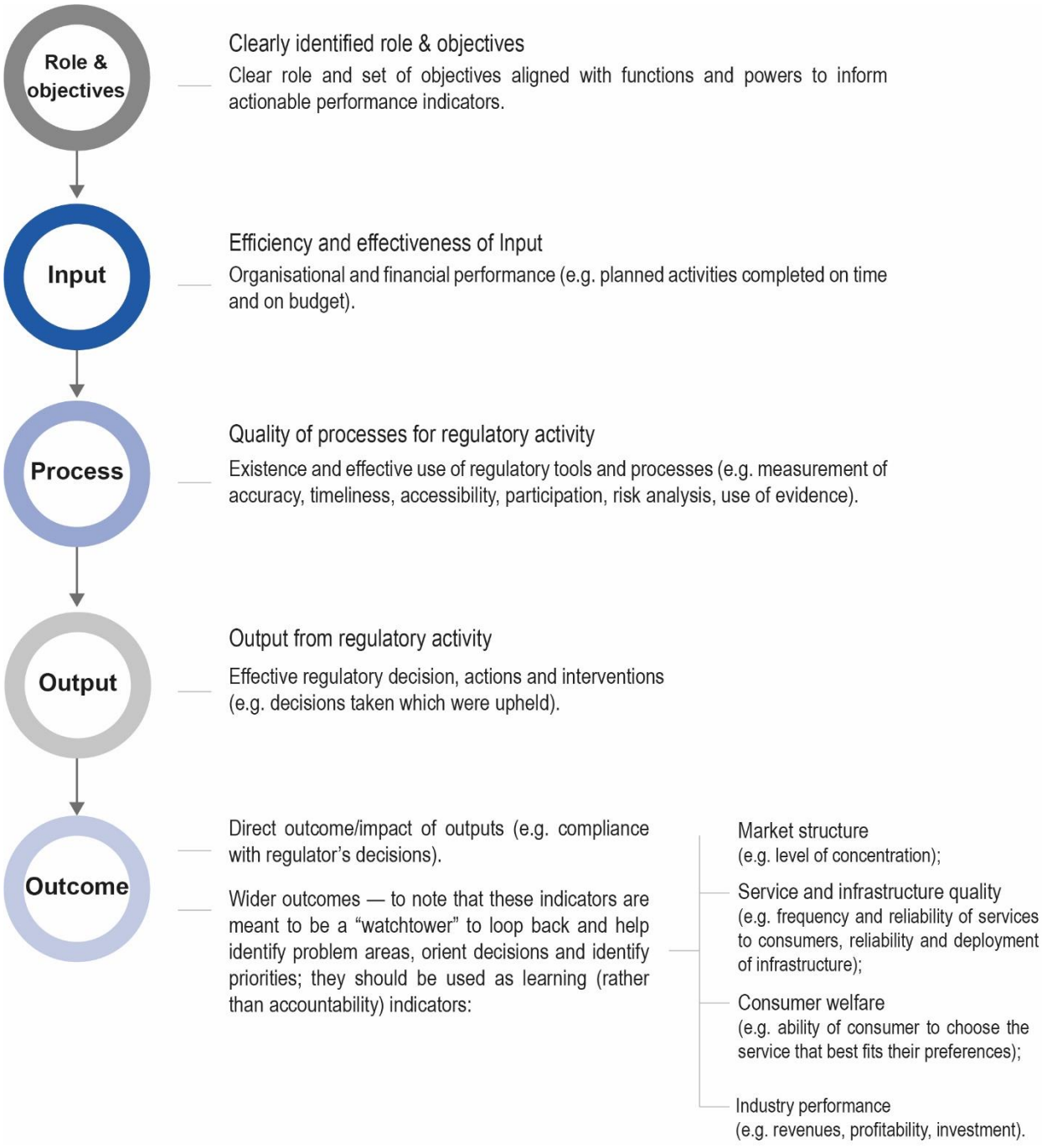
Source: OECD Analysis.

Performance indicators

For regulators, performance indicators need to fit the purpose of performance assessment, which is a systematic, analytical evaluation of the regulator's activities, with the purpose of seeking reliability and usability of the regulator's activities. Performance assessment is neither an audit, which judges how employees and managers complete their mission, nor a control, which puts emphasis on compliance with standards (OECD, 2004[15]).

Accordingly, performance indicators need to assess the efficient and effective use of a regulator's inputs, the quality of regulatory processes, and identify outputs and some direct outcomes that can be attributed to the regulator's interventions. Wider outcomes should serve as a "watchtower", which provides the information the regulator can use to identify problem areas, orient decisions and identify priorities (Figure A B.2).

Figure A B.2. Input-process-output-outcome framework for performance indicators



Notes: This framework was proposed in the initial methodology for the performance assessment framework for economic regulators (PAFER) discussed with the OECD Network of Economic Regulators (NER). It has been refined to reflect feedback from NER members and the experience of other regulators in assessing their own performance.
Source: (OECD, 2015[1]), Figure 3.3 (updated in 2017).

Approach

The analytical framework presented above informed the data collection and the analysis presented in the report. The present report looks at the internal and external governance arrangements of Latvia's Public Utilities Commission (PUC) in the following areas:

- ***Role and objectives***: to identify the existence of a set of clearly identified objectives, targets, or goals that are aligned with the regulator's functions and powers, which can inform the development of actionable performance indicators;
- ***Input***: to determine the extent to which the regulator's funding and staffing are aligned with the regulator's objectives, targets or goals, and the regulator's ability to manage financial and human resources autonomously and effectively;
- ***Process***: to assess the extent to which processes and the organisational management support the regulator's performance;
- ***Output and outcome***: to identify the existence of a systematic assessment of the performance of the regulated entities, the impact of the regulator's decisions and activities, and the extent to which these measurements are used appropriately.

Data informing the analysis presented in the report was collected via a desk review and a fact-finding mission:

- ***Questionnaire and desk review***: PUC completed a detailed questionnaire which informed a desk review by the OECD Secretariat. The Secretariat reviewed existing legislation and PUC documents to update its understanding on the *de jure* functioning of the regulator, and to inform the fact-finding mission. This questionnaire was tailored to PUC for a follow-up review process of the PUC's progress, based on the findings of the OECD 2016 PAFER report (OECD, 2016[16]), methodology already applied by the OECD to other regulators since 2015 and on the participation of PUC to former OECD data collection exercises such as the 2018 Indicators on the Governance of Sector Regulators.
- ***Fact-finding mission***: the fact-finding mission focused on meeting PUC internal teams as well as external stakeholders. The mission took place between 7 and 16 December 2020, and it was a key tool to collect and complete the *de jure* information obtained through the questionnaire with the *de facto* state of play and progress on recommendations. The work of the fact-finding mission tailored the PAFER methodology to PUC features. Information collected was completed and checked with PUC for accuracy. The mission took place via videoconference due to COVID-19 travel restrictions.

During the fact-finding mission, the team met with PUC's leadership team as well as a number of staff from across the institution. In addition, the team met with government institutions and external stakeholders, including:

- Ministry of Finance of the Republic of Latvia
- Ministry of Economics of the Republic of Latvia
- Economic, Agricultural, Environmental and Regional Policy Committee of the Saeima
- Competition Council of Latvia
- State Audit Office of the Republic of Latvia Consumer Rights Protection Centre (PTAC)
- Meetings with industry representatives - Augstsprieguma tīkls (electricity TSO) and Conexus Baltic Grid (gas TSO/storage operator)
- Latvian Chamber of Commerce and Industry (representative holding the position of Deputy Head of the PUC Advisory Council).

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The Governance of Regulators

Progress Review of Latvia's Public Utilities Commission

DRIVING PERFORMANCE

Regulators act as "market referees", balancing often competing interests of stakeholders in the sector, including governments, current and future actors in the markets, and consumers. At the same time, markets are changing at an unprecedented pace due to new technologies, the international drive toward carbon-neutral economies, shifts in consumer needs and preferences, and, most recently, the profound changes brought by the coronavirus pandemic. Assessing the performance of economic regulators must therefore be a continuous process.

This progress review evaluates the changes put in place by Latvia's Public Utilities Commission since the previous OECD performance assessment review in 2016, in the interest of increasing the effectiveness of its regulatory activities and improving final outcomes for consumers and the economy.

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