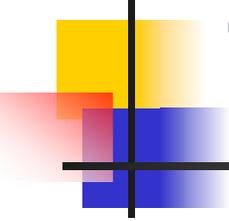


Need for and Goals of Restructuring and Regulatory Power Sector Reform

Issues and Objectives for Restructuring and Regulatory Reform

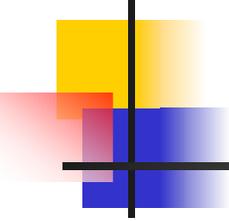
Policy Module A.1

Ron Eachus



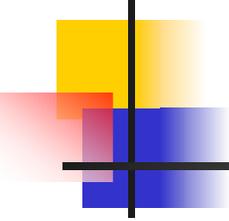
Traditional Utility Structure

- Monopoly utility
- Vertically integrated
- Bundled service and rates
- No retail competition
- Limited wholesale market transactions
- Regulated private utility monopolies
 - Cost of Service based prices
- Unregulated public utility monopolies
 - Often subsidized, non-cost based rates



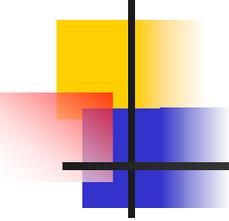
Strategic Drivers for Restructuring

- New generation technology
 - Utilities aren't only enterprises that can build plant
- Lack of capital in governments
- Lack of capital for expansion or upgrade of electricity infrastructure in government owned utilities
 - Growth in demand
 - Tariffs do not cover costs
- Lack of competition and choice
- Increase in information technology enabling more active markets and greater choice
- Electricity is key factor in economic development



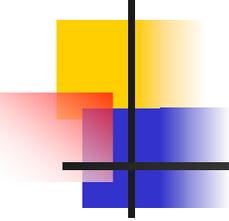
Restructuring Goals

- Typical Goals
 - Increase competition
 - Increase sector efficiency
 - Reduce costs
 - Enable privatization and attraction of capital
 - Maximize the value of sale of public assets
 - Create environmental stability



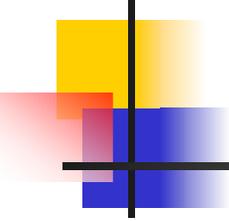
Common Elements of Restructuring

- Unbundling of functions
- Increased competition in generation
- Creation of more competitive wholesale markets
- Monopoly transmission and distribution functions
- Retail choice for some retail customers
- New regulatory responsibilities



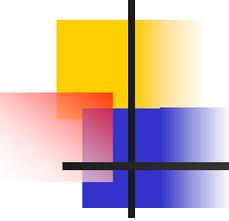
Restructuring is Worldwide

- US
- Europe
- Latin America
- Former Soviet Union
- Nigeria



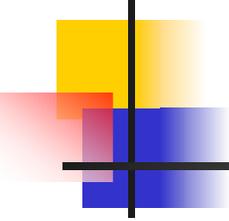
Market Power

- Market power becomes the dominant issue in restructuring
 - Company uses its market share to raise price
 - Company uses its monopoly power to disadvantage others and benefit its own affiliate interest in competitive market
- Unbundling is a counter to market power
 - Separates functions
 - Can be functional or legal separation
 - Requires separate accounting



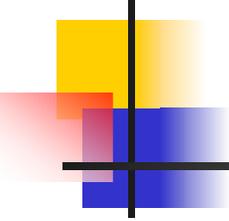
Common Issues

- Amount of retail competition
 - Which customers get third party access when?
- Market Design
 - How many participants?
 - Best mechanism?
 - Degree of monitoring?
- Pace of Privatization and unbundling
- Pre-existing PPA's and stranded costs



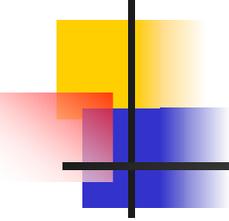
More Common Issues

- Impacts of increased tariffs
- Merging the commercial and technical aspects
 - Relationship of license and tariff to service quality
- Establishing independent, competent regulatory bodies



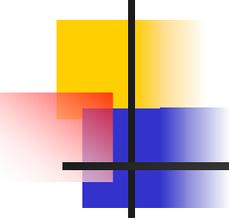
Constraints on Restructuring

- Existing prices may be heavily subsidized
 - Real costs often hidden
 - Beneficiaries reluctant to give up benefits
- Lack of political will to raise tariffs to cover costs
- Preference to use local resources
- Reluctance to reduce work force
- Entrenched corruption
- Significant cultural change
 - Monopolies not used to competition
 - Government utilities transformed into commercial enterprise



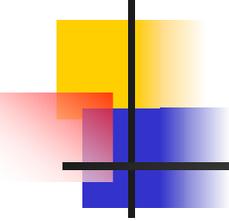
Competition and Privatization

- Competition is a means to an end
 - More efficiency is system
- Privatization is also a means to an end
 - More efficiency
 - More capital
- Competition not required for Privatization
- Economic Regulation can enhance both



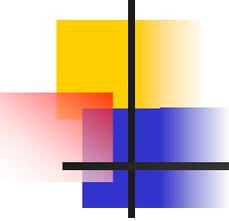
Constraints on Competition

- Competition is not always possible
 - Market failures
 - Natural monopolies
 - Public goods
- Economic Regulation is necessary when
 - No full or fair competition
 - Need to monitor or control activities



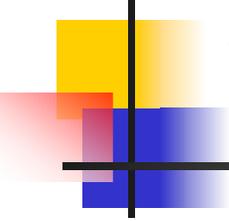
Economic Regulation

- Codified, continuous monitoring of certain parameters when thresholds are exceeded
 - Prices
 - Profits
 - Revenues
 - Service Quality
- Should provide similar incentive to those companies would find in competitive market



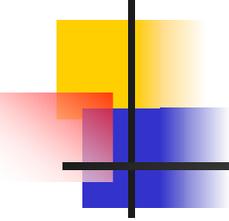
Objectives of Economic Regulation

- Consumer Perspective
 - Protect against monopoly profits
 - Adequate supply at affordable rates
- Utility Perspective
 - Sufficient revenues to cover costs and enable necessary new investments
- Societal Perspective
 - More economic efficiency
 - Minimize negative environmental impacts
 - Universal service



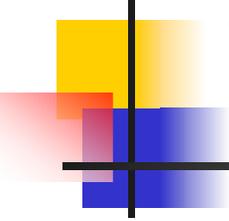
Role of Regulator Changes with Market Structure

- Vertically integrated
 - Price regulated of basket of final products
- Unbundled
 - Each non-competitive element subject to separate regulation and terms of access
 - Networks
 - System Dispatch
 - Captive Retail Supply
- Contestable
 - No direct regulation
 - Monitoring necessary to ensure fair competition and no abuse of market power



Regulation Can Enhance Privatization

- Successful privatization depends upon the quality of the regulator body and method of price control
- Investors will look for:
 - Clear definition of powers and duties
 - Stability and consistency
 - Independence
 - Flexibility for evolution of industry
 - Explicit subsidies
 - Credibility
 - Competence
 - Transparency
- So will the public



What is “Independence”

- Decisions made on basis of a record of information rather than political process
- Decisions made independent of the companies that are regulated
- Decisions made with high degree of integrity and absence of conflicts of interest
- Broad mandate to protect the public interest
- Must be accompanied by adequate accountability
 - Government still provides general direction and budget oversight
 - Public participation
 - Appeals of decisions to court system