



The political economy of utility regulation: The case of Vanuatu

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What I mean by political economy

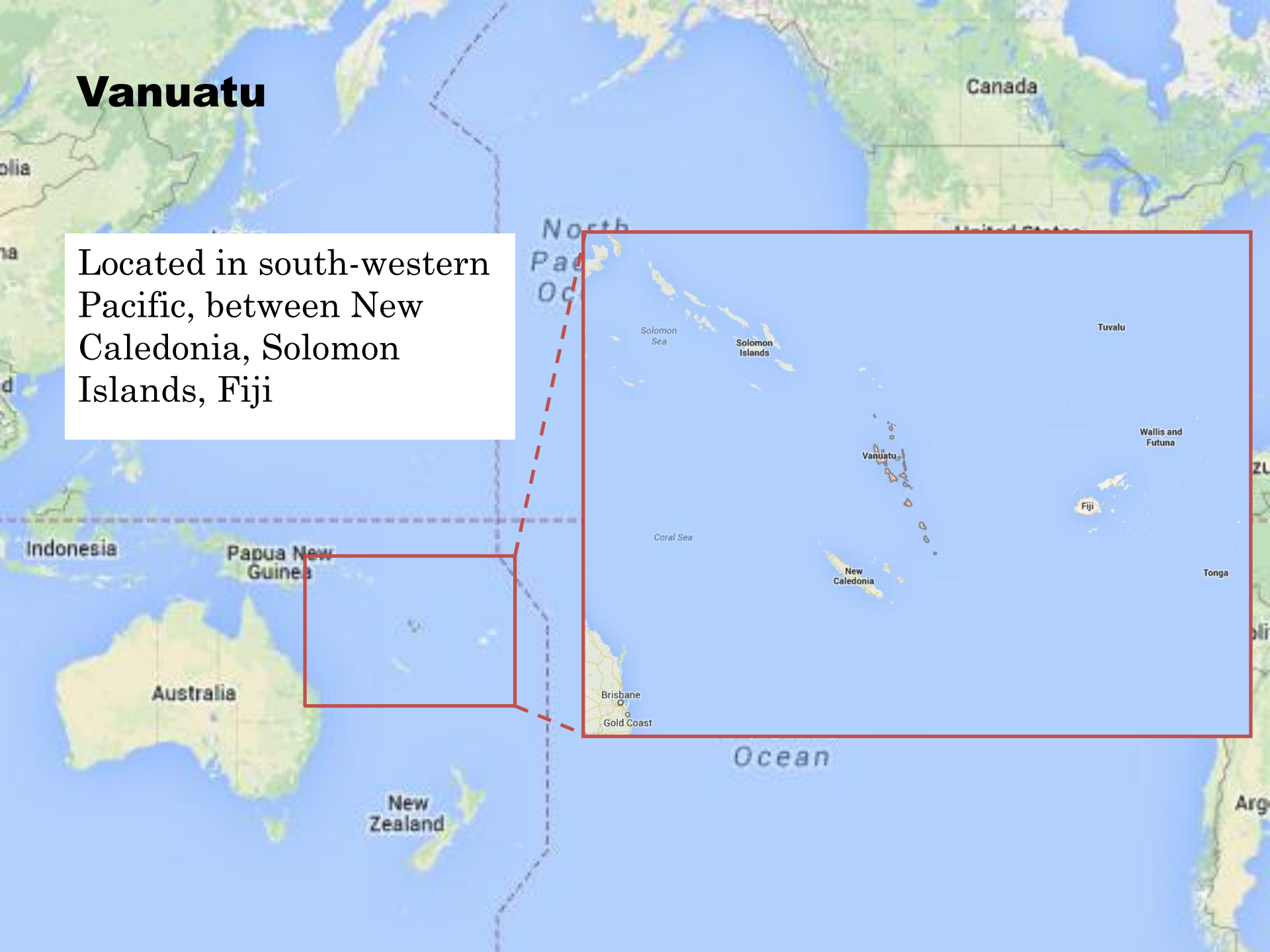
- This talk will examine:
 - How the successful establishment of an independent regulatory agency is impacted by the political, economic, and social characteristics of a “small” nation
- And draw conclusions on:
 - How to successfully establish independent institutions in “small” contexts
 - How can external aid be most effectively used to support independent agencies

What I'm going to cover

- Brief background on the economic and political situation in Vanuatu
- The story (so far) of the URA
- Review some specific challenges recently faced
- Reflections on “small” contexts
- Draw conclusions on:
 - Establishing independent agencies
 - Implications for effective external support

Vanuatu

Located in south-western Pacific, between New Caledonia, Solomon Islands, Fiji



Basic economic facts



- Archipelago of 83 islands, 65 inhabited, 17 islands with regular internal flight connections
- Total population 234,000
- 25-30% urban population
- GDP US\$ 828 million
- Per capita US\$4,800 (164th in world)



Political situation

- Gained independence in 1980
- Unicameral 52-seat parliament
- Highly fragmented party system
- No differentiation on policy
- MPs regularly “cross the floor”
- Frequent motions of no confidence, resulting in reshuffles and changes of Government
- Stable democratic and judicial institutions

Electricity

- Private electricity supply by UNELCO in Port Vila since 1930s
- 4 electricity networks supplied by private operators
- Diesel-dominated generation mix
 - Diesel 75%
 - Copra oil 9%
 - Wind 8%
 - Hydro 7%
- Overall the service reliability is good, but prices are high
- 80% of population has no access to mains electricity

Water

The background image is a collage. The top left shows a large, cylindrical, corrugated metal water storage tank. The top right shows a blue vertical pipe in a field of tall green grass. The bottom left shows a close-up of red and blue water valves and pipes. The bottom right shows a blue metal sign on a stand that reads 'WATERWORKS' and 'HEAD'.

- Good quality supply in Port Vila, concession contract with UNELCO
- Other urban centres supplied by Govt through Public Works Department
- Many smaller providers for mini-grids, subdivisions etc.
- PWD network is aging (some dating from WWII) and quality is variable

The URA

- The Utilities Regulatory Authority is the economic regulator of electricity and water sectors in Vanuatu
- Established by Utilities Regulatory Authority Act of 2007
- Our purpose is to balance the interests of customers, utilities, and government in order to:
 - Ensure the provision of safe, reliable and affordable electricity and water services
 - Maximise access to water and electricity throughout Vanuatu
 - Promote the long-term interests of consumers
- URA has the power to set maximum prices, safety and reliability standards
- Also plays an advisory role to Government on issues related to electricity and water

The case for independent regulation

- In Vanuatu we have both private (electricity) and Govt (water) provided services
 - Historically, private providers deliver good quality at a high price, Govt suffers from under-investment and poor service
- In both cases, long-term interests of consumers are not best served
- Independent regulator provides a focal point of resource and expertise, with key powers to protect consumers
- Multi-sector scope gives some scale benefits

Examples of issues we deal with

- Design of feed-in tariff scheme for solar home systems
- Advise on PPA negotiations between IPPs and UNELCO (geothermal and solar farm)
- Advise on World Bank GPOBA connection subsidy scheme
- UNELCO need bridge repair to access water source but PWD do not respond
- Municipal doesn't pay bills for street lighting, UNELCO wants to increase tariff to cover costs
- PWD wants to outsource management of water service, but Ministry of Finance wants the revenue
- UNELCO wants to install pre-payment meters, but has no business case
- Local solar panel company puts out radio ads saying "Vanuatu has 2nd highest electricity prices in the world. OUCH"
- PWD can't afford to fix leaks because their electricity bill is so high, no budget has been allocated for water services, and Ministry of Finance won't give more

Reflection 1:

**“Small”
does not mean
simple**

Reflection 1: “Small” does not mean simple

- Most of the same market issues arise in a “small” market as in a large one
 - Plus a lot of other issues specific to “small” markets
- Difference is that government and regulatory agencies have only a fraction of the resource
- Therefore, any resource that does exist gets over-used
- Also, all issues arise at once: the to-do list starts off long, so prioritisation is crucial to success

2012 – a challenging year

- Strained relationship and legal battles with UNELCO
- Breakdown of relationship with Government
- Govt chose not to extend URA CEO contract, position vacant until October 2013

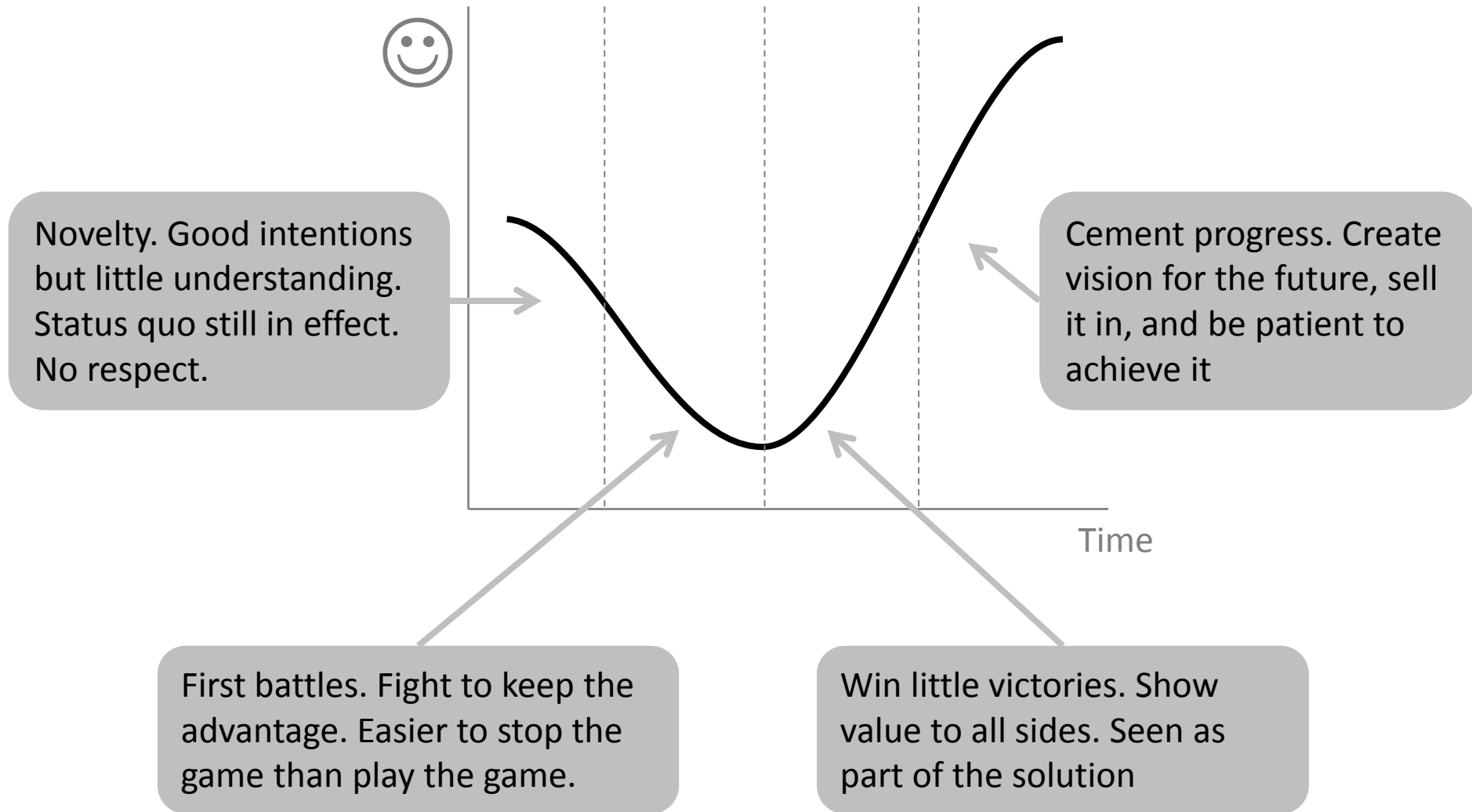
Attempt to amend the URA Act

- Small group of ministers, officials and private sector drafted amendment to URA Act
 - URA not informed and kept out of process
- Proposed act included:
 - Significant constraints on URA power
 - Procedural obstacles
 - Weakening anti-competitive protection
 - Guaranteed transfer of PPA price of geothermal energy to consumers, regardless of level
- Presented to Parliament in September 2012, just after departure of URA CEO

A lucky escape...

- Opposition MPs boycotted parliament due to procedural issue
- Elections followed the next month
- Followed by a vote of no-confidence four months later
- This allowed time to properly respond and re-draft the amendment

Reflection 2: Regulatory Acceptance J-curve

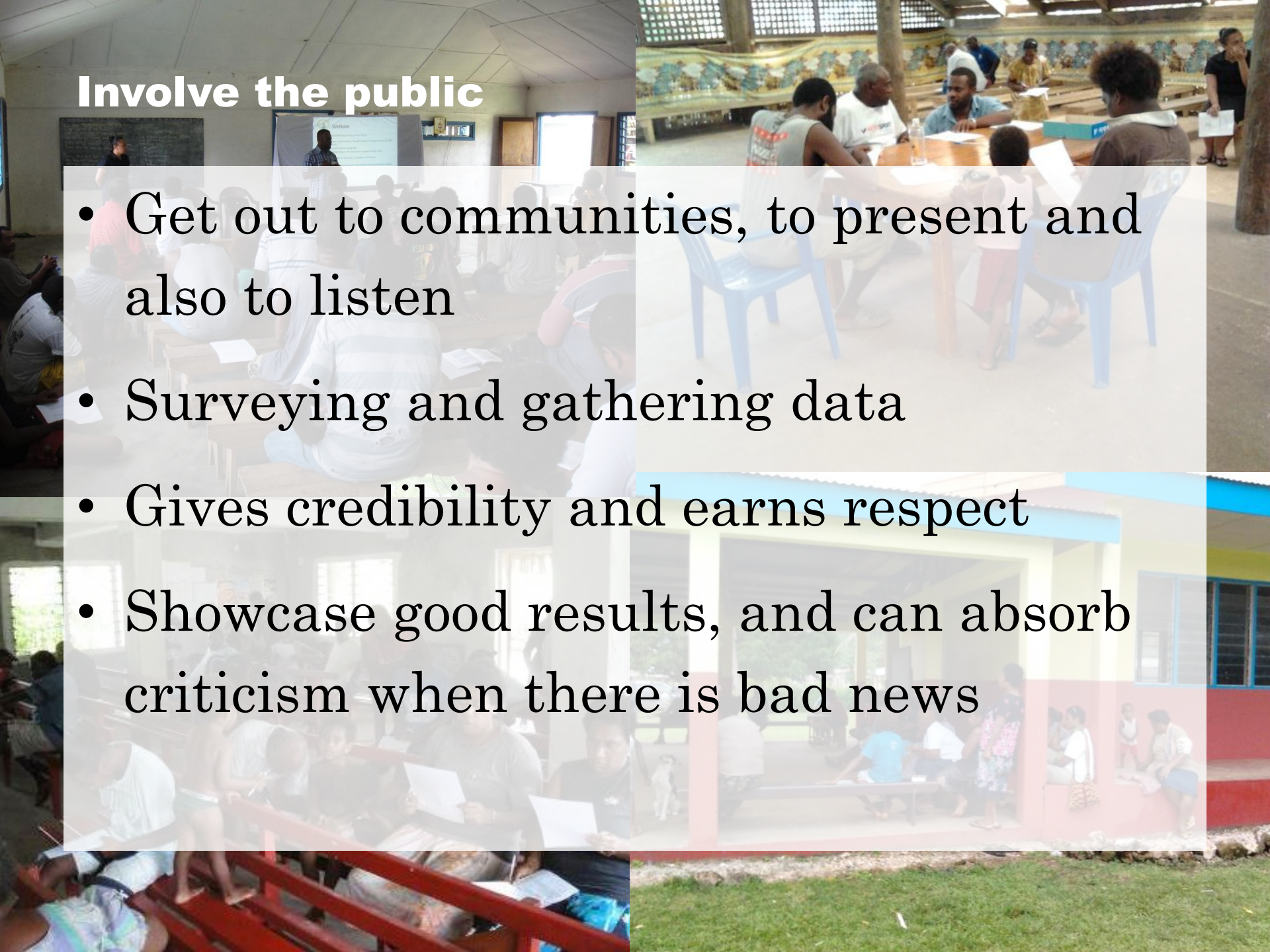


How to survive the J-curve

- Strictly maintain independence
 - Be pragmatic to deliver results
 - Demonstrate flexibility, transparency and even-handedness
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- Understand the networks of influence
 - Ensure doors remain open
 - Do the leg-work (draft the letter, take it to be signed, deliver it, draft the response)

Involve the public

- Get out to communities, to present and also to listen
- Surveying and gathering data
- Gives credibility and earns respect
- Showcase good results, and can absorb criticism when there is bad news



Reflection 3:

**“Small”
does mean
close**

Reflection 3: Small does mean close

- Everyone knows everyone
- There is a culture of favours and gifts
- Influence is an easy commodity
- There are myriad interests that can challenge an individual's independence
- Institutional strength and transparent processes must be built

External support is very useful in establishing independence

- Successful end-state is:
 - Local team and leadership
 - Strong framework that withstands legal challenge
 - Robust and transparent decision-making processes
- There are unlikely to be in-country resources that can build this by themselves
 - Lack of expertise
 - Lack of funds
 - Large amounts of influence and vested interests
- External support is required through the early stages of institutional establishment and development

Conclusion 1: 3 phases of agency development

1: Infancy

Situation:

- Incumbent vested interests are very strong
- Legal framework new and untested
- Doing everything for the first time

Independence relies on the individual

2: Transition

Situation:

- Challenges to the institution, rather than its decisions
- Adjustments required to the framework
- Local team beginning to form

Independent structure is becoming established

3: Maturity

Situation:

- Challenges to decisions, but not to the institution
- Stable framework and robust transparent processes
- Local team and leadership

Independence maintained through structure, framework and processes

Conclusion 2: 3 phases of external support

1: Infancy

Key challenges:

- Build network to get things done
- Be pragmatic and flexible to show value
- Get hands dirty doing the leg-work

Need: Do-er

Pick the right people, give them the power they need, and stick with them

2: Transition

Key challenges:

- Build capacity of local team
- Adapt legal framework through tests
- Put in place solid and transparent processes

Need: Coach

Focus on capacity building, process and framework development

3: Maturity

Key challenges:

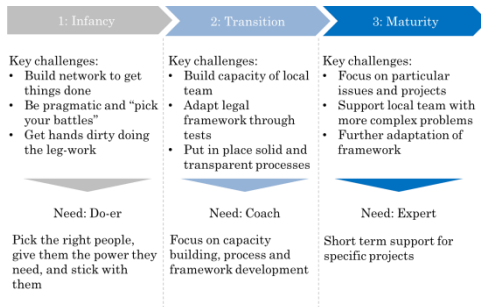
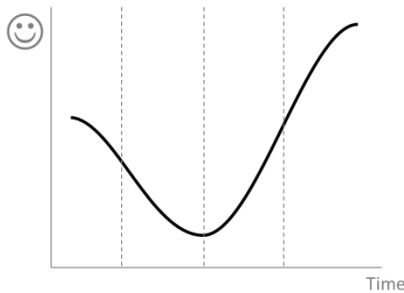
- Focus on particular issues and projects
- Support local team with more complex problems
- Further adaptation of framework

Need: Expert

Short term support for specific projects

In summary

**“Small”
does not mean
simple**



- Remember: Small doesn't mean simple, but does mean close
- Be prepared to navigate the J-curve
- Design external support based on the needs of the situation

Where next for the URA?

- In 2012 we hit the bottom of the J-curve
- Key relationships have been re-built
- We haven't seriously tested the relationship since, although more challenges are on the way
- We are emerging from “Infancy”, and the focus now is on:
 - Building a strong local team
 - Tweaking the legal framework
 - Establishing financial independence

Thank you

- For further information:
- www.ura.gov.vu

