Styles of Regulation: The Choice of Approach to Utility Regulation in Central and Eastern Europe

JON STERN
London Business School & NERA
1. INTRODUCTION

Since 1990, the countries of Central and Eastern Europe have been under considerable pressure to develop explicit regulatory institutions. Initially, the main pressure for this policy came from the World Bank and other international lending agencies. Indeed, the requirement for an independent regulator was often included as an explicit loan condition by lending agencies. Subsequently, and in practice more importantly, there was the pressure for transparent regulation arising from the need to provide an effective basis for private investment and privatisation. More recently, there has been the impetus from desired accession to the European Union (EU) and the need to meet the terms of the relevant EU Directives.

Before 1990, in all CEE economies, the economic regulation of utilities (including energy, telecommunications, etc) was not at all recognised as a separate activity. It was carried out along with policy and the ownership/management of the state-owned enterprises by the relevant Government Ministries. Indeed, the regulation of eg investment and prices was not recognised as at all separate from policy or from the running or financing of the enterprises. The dominant forces involved were typically the Communist Party leadership and the senior managers of the relevant enterprises (the nomenklatura) who paid little weight to commercial factors.  

As a result of these factors, the CEE countries have had to start from the very beginning in developing regulatory functions for utilities – just as in the financial sector and other parts of the economy. In addition, there has been considerable competition from supporters of different regulatory models. Thus, not surprisingly, USAID assistance has tended to promote the US model of rule-based, legally-driven regulation; UK assistance and companies has tended to promote independent but less formal regulation; Continental European countries and companies have tended to urge caution on the development of explicit, independent regulatory institutions, and so on.

Perhaps more importantly, potential foreign investors and privatisation purchasers have also been active lobbyists for their preferred style of regulation and, even more so, for their preferred degree of liberalisation. The energy and other companies

\[\text{See Cave and Stern (1998) for further discussion of the pre-1990 arrangements.}\]
involved in activities in CEE countries, not surprisingly, also tend to advocate the style of regulation of their home country. This tendency does, though, have some interesting exceptions, as we shall demonstrate below.

In consequence, we can see that, over the last decade, CEE countries have seen a competition among external forces over the relative merits of the various different approaches to utility regulation as used in Western Europe, North America and elsewhere.

Within the CEE countries, there have been internal pressures both to maintain the power of Ministries and to reduce their powers, particularly for line-Ministries (what were previously the sponsoring Ministries). There has also been the need to develop fair relationships with powerful foreign investors and the fear that new specialist regulatory agencies would be subject to regulatory capture. In addition, the various agencies in the CEE countries have been able to observe the debates and choices of the existing EU members as regards utility regulation and their responses to the various EU Directives.

The internal pressures have interacted in interesting and complicated ways with the external forces in the choice of regulatory style adopted. We are now seeing the results of the "regulatory design competition". Hungary and Poland now have independent energy regulators and the Czech Republic has made considerable progress in developing an Energy Law that would establish an independent regulator. Interestingly (and perhaps surprisingly), less progress has been made on establishing independent regulation for telecommunications. The reasons for this are very interesting and will be discussed later in the paper.

In consequence, we can now provide some evidence on the results of the competition between regulatory models in Central Europe. We can also identify some common patterns among options that have been chosen and point out models that have not been chosen. These issues provide the theme for this paper.

In Section 2, we discuss the main models in the main EU countries and elsewhere. In Section 3, we outline the choices of regulatory institution made in CEE countries, concentrating on energy and telecommunications in the three main Central European countries. In Section 4, we discuss the reasons for the patterns observed and, in Section 5, we compare these choices with the main models discussed in Section 2. Section 6 provides a short conclusion.

Appendix A provides some observations on regulation in CIS counties, primarily electricity regulation, including comments on EBRD (and other) regulatory league tables. The Appendix raises a number of questions prompted by the examination of
CEE utility regulation, many of which are deliberately left less than fully answered. A key issue is whether and how far it is sensible to use the same definitions and criteria for describing regulatory institutions in (say) Georgia or Kazakhstan as for (say) Hungary and Poland. Speculations on these and related topics may be of interest to some readers but are best relegated to an appendix.
2. REGULATORY MODELS

The main models for utility regulation can be summarised as follows. The listing starts with the most ambitious in terms of autonomy and progresses through to the classic Communist framework mentioned above.

1) The US Model of Regulation

The US model of utility regulation is generally seen as the epitome of independent regulation, with its emphasis on specialist regulatory institutions operating within a highly rule-based and legalistic framework. It is explicitly adversarial with an emphasis on public hearings. The resulting structure is locked into a system of administrative law in which the courts (up to and including the Supreme Court) play a major role. Indeed, the courts and legal concerns can take over the substance of regulation as well as its form.²

US regulation is often perceived (particularly in the Central European countries) as a very resource intensive system, dominated by lawyers and requiring large numbers of lawyers and other experienced professionals (economists, accountants, etc) to make it run. Accusations of regulatory capture are often made about the US system. The existence of this self-contained world of well-paid regulatory professionals is again perceived in Central European countries as one reason why regulatory capture can arise.

2) The UK Model

The UK model is also a model of independent regulation, but based on small, specialist regulatory Offices. Relative to the US model, it is less formal in its processes and requirements. Thus, the law courts play a relatively minor role, with most appeals being handled by the Competition Commission (as successor to the Monopoly and Mergers Commission). The less legally dominated approach leads to more rapid and less resource intensive regulation, but provides less clearcut security to regulated companies and may be less predictable.

In addition, particularly from the Central European perspective, UK regulation appears to be less divorced from the policy process (eg the government can choose the single person regulatory office head).

² This picture is truer at the Federal level than at the state level where direct political accountability by Regulatory commissioners can lead to less pure outcomes.
3) **The German Model**

For electricity and gas, Germany has so far decided not to have a sector-specific independent regulatory agency.

For the critical issues of network access and pricing (including the requirements of the EU Electricity and Gas Directives), in Germany it is the Federal Cartel Office that carries out regulatory functions eg for dispute resolution under the Competition Law. For electricity, there is an Associations Agreement negotiated by the industry and its associations and registered with the Cartel Office. The initial version of this expired in September 1999 and a new version has recently been agreed.

Regulation of electricity distribution and retail supply (and the appropriate methodology) is still the responsibility of the Federal Ministry of Economy and the corresponding Länder agencies.³

The German system would seem to require even fewer resources and to be less subject to dangers of regulatory capture. It does, however, require a strong and well-established competition agency. For economies where the dangers of cartel behaviour by the existing players are strong, there are obvious risks of anti-competitive behaviour and exclusion of new entry. Indeed, many such accusations have been made against Germany and there have been some high profile court cases (eg Enron and access to Stadtwerke Ludenscheid).

For telecommunications, Germany has an independent regulatory agency (as required by the relevant EU Directives. Many observers suggest that energy will follow suit and that an electricity (or energy regulator) will be developed in the near future.

4) **Ministerial Regulation – the Continental West European Model**

This model is that where a government department regulates (and typically sponsors) a state-owned monopoly utility. This is the pre-1989 England and Wales model with the Department of Energy regulating the CEGB, in association with the Treasury. It was the standard West European model in the period 1960-90 and was adopted in many countries.

³ Australia has a similar system, with the ACCC responsible for economic regulation of electricity, particularly network access and pricing. The States are responsible for customer prices and technical aspects of regulation. Again, there is a voluntarily agreed network code, approved by the ACCC.
The archetype of this approach is conventionally taken as the relationship between EdF and the French government where EdF was “regulated” under a Planning Contract (Contrat du Plan) with the French government. However, the French authorities have published a draft Electricity Act, which is proceeding (slowly) through the legislature. This draft Act provides for an independent electricity regulator responsible for network access and pricing. The French government has already established an independent telecommunications regulator. It remains to be seen, however, how independent the French electricity regulator will be in view of the dominant position of EdF in the French electricity market.

Perhaps more relevantly for CEE countries, Austria currently retains the key features of the Continental European model. There is no independent regulatory agency and, for electricity, the regulation of all aspects of network access and pricing fall to the Ministry of Economy. The Competition Authority is also a department of the Ministry of Economy.

For CEE countries, this model represents least change on their pre-1989 arrangements. It can also be defended as the one appropriate to commercialised, publicly-owned utilities operating in a market economy. It continues to link policy and regulation and readily allows the continuation of continued explicit and implicit subsidies and cross-subsidies. It is also the model that is most conducive of protection of domestic incumbent companies. However, although well-suited to building-up universal network and supply coverage (the policy objectives in the past), this model is not well-suited to the current tasks of increasing efficiency, reducing costs and supporting the introduction of competition.

5) Central and East European Communist Countries Pre-1989

Regulation of utilities here can be taken as a heavily distorted variant of the West European model. The worst distortions arose from the fact that the utilities did not operated in a commercialised way. In particular, their investments were largely determined by the Central Plan and the Plan physical output targets, and were funded out of the central budget. Tariffs were at best only intended to cover operating costs in toto, included little or no depreciation or profit element and households were heavily cross-subsidised by industrial customers.

By 1989, this model was discredited and the question was what should replace it. Apart from the strongest opponents of reform (eg Belarus), it was clear that this

---4---

4 EdF has frequently been accused of benefiting from hidden subsidies. It has consistently defended itself strongly against such accusations and none of the investigations by eg EU bodies has found against EdF.
model was no longer viable. Hence, the question was whether to go for the minimal change option of the West European Ministry-regulation option (model 4) or for one of the more radical options.

In practice, as we shall see, at least for electricity, the answers to the choice between Model 4 or one of Models 1-3 primarily reflected attitudes to:

(i) the desired degree of liberalisation and competition;

(ii) the chosen role for private investment; and

(iii) the degree to which CEE governments wanted to continue to allow regulation to be affected by policy concerns.

The choice between Model 1, 2 or 3 reflected additional factors, which we will discuss in Section 4.
2. **REGULATORY CHOICES IN THE COUNTRIES OF CENTRAL AND EAST EUROPE**

In this section, we will mainly discuss the regulatory choices made in the electricity industries of CEE countries, as this is the area where there has been most activity. We will, however, briefly discuss telecommunications where, perhaps surprisingly given EU developments, there has been less progress on regulation, even though there has been much more liberalisation and privatisation activity than in electricity or gas.

The discussion will concentrate on the three main reforming Central European economies - Hungary, the Czech Republic and Poland. There have, though, been some interesting recent developments in, Bulgaria and Romania, which we will also discuss.

On paper, there appears to be considerable development of regulatory institutions in some of the CIS countries. However, it is far from clear whether the practice of regulation in the very difficult economic circumstances of countries like Georgia or Kazakhstan corresponds at all closely to what one would expect in Central Europe, let alone Western Europe. We will discuss this issue briefly at the end of this section.

2.1. **The Central European Countries: Electricity**

3.1.1 **Hungary**

Hungary was the first CEE country to pass a law introducing an independent regulator in the energy sector. The Hungarian Energy Office (HEO) was established to regulate electricity and gas under electricity and gas laws enacted in 1994.

The HEO is responsible for issuing and amending licences. On prices, it establishes pricing criteria and rules, but it is the Minister of Industry who actually decides the prices. The Hungarian government has more than once over-ruled HEO tariff change recommendations. Similarly, it is the Ministry and not the HEO that approves or makes the formal proposals to the Government or the Parliament on power station approvals.

The degree of independence of the HEO is limited by the following features:

- There is no fixed term for the HEO's Chief Director;
- The Chief Director and other directors are appointed by the Minister of Industry and Trade but not with a fixed term of office;
• There are no specified dismissal (or appointment) criteria or procedures for the Chief Director or the other directors;

• The HEO does not have an independent revenue source. Its budget is part of the Ministry of Industry's budget;

• The pay of HEO staff is fixed on Civil Service pay scales;

• The HEO has no rights to issue general decrees; and

• There are no specific appeals mechanisms eg via the national competition agency or the courts, although all regulatory decisions will be subject to general appeal rights under Hungarian law.

From the above, it can reasonably be argued that the HEO is essentially a Ministry regulator masquerading as a UK style regulator. A more charitable interpretation is that it is a UK-style regulatory office but with heavily circumscribed powers. It certainly has none of the procedural or other characteristics of the US system.

Certainly, foreign investors who have purchased share stakes in the Hungarian electricity and gas distribution companies and in electricity generation companies have regularly and increasingly vociferously voiced their disappointment with the Hungarian energy regulatory system. Both EdF and Gaz de France (GdF) have been among the vocal complainers. However, this dissatisfaction with the regulatory safeguards did not prevent a sizeable number of foreign energy companies from submitting bids in the 1998 generation tender.

In terms of the typology of the previous section, the HEO has few if any of the features of the US or German models. The aspects of "new-style" regulation adopted owe most to the UK office system. In particular, Hungary (like other CEE countries) has adopted a licensing approach, with licences for fixed periods setting out the rights and obligations of the regulated companies. The licenses are the key document in the monitoring and enforcement of regulation. This approach has been adopted in spite of the legal difficulties involved in developing complex regulatory licences in a framework of Continental Law where simple permit licences are the norm.

---

5 This is an ongoing and fascinating story whose various episodes are well-chronicled in the FT East European Energy Newsletter.

6 France and Francophone countries usually use Franchise Concessions where the associated Cahiers de Charges cover the material usually included in UK-style licences. There are no licenses or equivalents in US or German regulatory systems.
In practice, however, the HEO has found that its powers are highly circumscribed and that real regulatory power remains with the government. This includes the issue of how the EU Electricity and Gas Directives will be implemented in Hungary.

3.1.2 Poland

Poland’s energy regulator, the Office of Energy Regulation (OER), was established by the 1997 Energy Law. It is in operation, but its first tariff ruling is not due until 2000. Indeed, the OER regulatory activities so far seem to be very low profile and, unlike the HEO, not to have achieved much publicity. However, this may be because there has so far been very little privatisation in the Polish electricity industry and even less involvement of foreign investors.7

The Polish Energy Law establishes a very UK-like regulator. The OER has far more of the attributes of a formally independent regulator than its Hungarian equivalent. Among the key features of its governance are:

- The Chairman of the OER is the legal person who makes regulatory decisions.
- He/she has a 5 year fixed period appointment and can only be recalled within their term of office for serious incapacity or (specified) misdemeanours;
- The OER is financed out of licence fees;
- The staff of the OER are not paid on Civil Service pay scales but on rates decided after “consideration” of pay scales in the fuel and energy sector; and
- Appeals on OER decisions can be lodged before the Anti-monopoly Court while the OER is explicitly subject to the Administrative Proceedings Act.

In addition, the OER is explicitly responsible for regulatory decisions not just on granting licences8, but also on prices and investment. (For the latter, it has to approve “development plans”.) The OER can also decide whether or not there is sufficient competition in any market segment to allow the ending of tariff regulation.

7 Poland has considerable amounts of spare generating capacity, albeit much of it inefficient and/or environmentally unsound, and is exporting cheap electricity eg to the Czech Republic.
8 The official English translation of the Energy Law uses the word “concession”, but it is in fact a UK-style licence not a French-style franchise concession.
There are, however, a number of ways in which the powers of the OER are potentially reduced. The main ones are as follows:

(i) The OER cannot decide its own procedures or organisational structure (and hence the number of staff). These are laid down in an Ordinance issued by the Prime Minister. Similarly, it is a Prime Ministerial Ordinance that sets out OER staff pay principles.

(ii) The OER is obliged to carry out energy regulation “in compliance with the assumptions of state energy policy”.

(iii) The OER does not appear to have the power to issue general decrees or guidance. Thus, licence exemption criteria are laid down by the Ministry of Economy.

(iv) Pricing criteria in the Law are very loosely defined – there is a reference to prices covering “reasonably justified costs”, but there is no definition of these. Nor is there any requirement that prices should allow the expectation of a reasonable rate of return or even that they ensure the financial viability of regulated enterprises. Indeed, there is no reference to anything other than operating costs or “costs of development” in the coverage of reasonably justified costs.

(v) More importantly, it is not the OER that lays down the criteria for price regulation. This is to be done by an Ordinance issued by “the Minister of the Economy, in consultation with the Ministry of Finance, and after taking advice from the Chairman of the OER”. Other key methodological issues are also to be set out in Ministry Ordinances.

It is still unclear whether the Government will actively use its powers to limit the autonomy of the OER through its powers (and duties) with regard (a) to the key methodological secondary legislation; and, (b) through laying down energy policy.

The primary law ducks many of the key regulatory issues (eg on OER procedures, tariff regulation criteria, etc). If it chose to do so, the Government could use its secondary legislation powers so as greatly to limit the autonomy of the OER. On the other hand, the Government could effectively delegate these powers to the OER. For instance, it could choose to request the OER to prepare the key Ordinances and wave them through. Similarly, it could choose to give only very general policy principles.

---

9 Polish Energy Law, April 1997, Article 46.
The outcome of this process is still very unclear. The only straw in the wind is that the OER Chairman appointed towards the end of the term of the previous Government remains active and in post. This shows a degree of commitment to good regulatory practice and continuity.

Summarising, the Polish OER looks essentially like a UK-style regulatory office and, in practice, could turn out to act like one. However, it could, if the Government so chose, be rather closer to an out-house Ministerial regulator with limited autonomy. In any event, it has few if any of the characteristics of either the US or the German styles of utility regulation.

### 3.1.3 The Czech Republic

The current basis for energy sector regulation in the Czech Republic is a law enacted in 1994 under which the Ministry of Economy is responsible for all aspects of regulation except price regulation. Price regulation is the responsibility of the Ministry of Finances under a general price regulation law, enacted in 1991.

The 1994 Energy Act was passed hurriedly to fill a legal vacuum. Its defects became clear very rapidly and there have been discussions on amending or replacing it for some years. The pressure for a new energy law grew substantially with the need to provide for the incorporation of provisions of the EU Electricity and Gas Directives into Czech Law to meet accession requirements.

The 1994 Act reflected the attitude of the Klaus government towards regulation. Prime Minister Klaus was adamantly opposed to specialist regulatory agencies, which he believed were, in the context of Transition Economies, bound to be subject to complete regulatory capture. He expressed this hostility strongly and publicly. On the other hand, the Ministry of Finance was seen as the general and impartial guardian of the public interest. However, the Ministry of Finance was not equipped to cover other aspects of utility regulation so, for electricity, regulatory responsibilities were divided between the Ministry of Finance and the Ministry of Economy.

In addition, Prime Minister Klaus continued to fight publicly as well as privately against increases in energy prices to households. It was clear that the development of an independent regulatory agency was part of a programme which included substantial price increases (particularly to households) and privatisation. But, the

---

10 It is not co-incidental that Mr Klaus had been Minister of Finance in the CSFR Government before the CSFR split into separate countries at the end of 1992.
only privatisation allowed in the energy sector under the Klaus Government was the 1992 30% voucher privatisation.¹¹ No sales of strategic share stakes or IPOs were allowed in the electricity or gas industries (unlike in telecommunications).

In addition, the Czech progress on energy price rebalancing (ie raising household energy prices towards economic costs) has also been significantly less in the Czech Republic than in Hungary, Poland, or some Baltic and Balkan countries. At end-1997, household electricity prices in the Czech Republic were 3.9 US cents/kWh as compared to 6-7 cents in Romania, Latvia, Hungary and Poland and over 13 cents in the EU. Household electricity prices remain some way below operating costs (4-5 cents/kWh. The slow progress on price reform has become the major impediment to further privatisation and liberalisation of the Czech network energy industries.¹²

Hence, it is not surprising that pressures to unify regulation and establish a separate specialist regulator came to nothing under the Klaus Government. The continued political unwillingness to sanction household energy price increases has continued under the Socialist-led government that took office in 1997. However, the new Government has come out publicly in favour of an independent energy regulator and expects to present a new Draft Energy Act to the Czech Parliament by early-2000. This new Act will provide for (i) an independent energy regulator and (ii) the incorporation of relevant EU energy legislation (including the liberalisation elements of the Electricity and Gas Directives) into Czech law.

The style of regulation that has existed up to now in the Czech Republic is clearly a minimum change on pre-1989 arrangements where regulatory issues are clearly and fully subordinated to policy issues – both energy policy and also prices policy. The development was less than even to the West European Ministerial model of regulation, as there remained significant limits on the degree of commercialisation of the energy companies.

The position began to change in 1998 with the establishment of a separate Regulatory Department within the Ministry of Industry and Trade. The Director of the Regulatory Department reports directly to the Minister and is the key interface with the Ministry of Finance on energy prices, preparing the proposals for changes

¹¹ Distribution companies had some of their shares transferred to Municipalities and private investors (particularly foreign energy companies) have since purchased some of the Municipally-owned shares. This process is called “wild privatisation”. To stop it, the current Socialist-led government has used CEZ and Transgas, the dominant electricity and gas companies to repurchase these shares. This backdoor renationalisation seems likely to cause some interesting regulatory and privatisation conflicts.

in regulated prices. In addition, it is the regulatory Department and its Director who have been leading the process to prepare the new Energy Act.

The proposed regulatory arrangements for electricity and gas in the Czech Republic are not dissimilar to those for Poland. Again, the intention is to have an independent agency with a Chairman, protected against arbitrary dismissal and protected funding (from licence fees). The regulator would issue licences and be responsible for price regulation.

There will clearly be major debate about the precise boundaries of responsibility between the Ministry of Industry and Trade and the new regulatory agency. The proposals that have been under discussion in 1999 would, in some respects, provide more regulatory autonomy than the Polish Energy Law. For instance, under the current proposals,

(i) the regulator would have powers to issue general decrees and decisions; and

(ii) it would be the regulator who would lay down and issue pricing principles and methodologies.

But, current proposals, as in Poland, relegate some key issues for private investors to secondary legislation.

It remains to be seen where the outcome arises in the draft law, let alone the eventually enacted law. Nevertheless, in terms of the style of regulation, the Czech Republic again seems to be opting for a model that appears to be that of the UK office, but retains many of the attributes of the West European Ministerial regulation model. As in other Central European countries, this appears to reflect the ambivalence over early moves to liberalisation, over the introduction of genuine competition and, in particular, to the potential role of powerful foreign investors in the energy industries. We will discuss this further in Section 4 below.

Again, we see no evidence that the US-legally dominated model holds any attractions or, perhaps more surprisingly, of any moves towards adopting the German model – with one interesting exception.

The exception concerns some Ministry of Finance arguments for their opposition to a specialist energy regulator. The Ministry of Finance has, on occasion, suggested that Ministry of Finance price regulation plus general competition policy oversight would be a good model for the Czech Republic. They have, secondly claimed that this would correspond to the successful German regulatory system.
One problem with this approach is that Ministry of Finance price regulation is far more practical if there are few companies and prices to regulate – for instance one or more vertically integrated monopolies. It makes much less sense if there is considerable competition in generation and/or supply and many companies. But, the Government view is to encourage competition and the Ministry of Finance has argued the case for competition rather than regulation to the extent of suggesting that the establishment of an independent regulator could impede the development of competition. Nevertheless, these arguments seem to be increasingly left behind and the case for a UK-style regulator currently seems to be gaining ground.

2.2. Central Europe – Telecommunications

So far, none of the three main Central European countries has a fully independent telecommunications regulator.

Under a 1993 Act, Hungary established a Communication Authority. However, like the energy regulator, the Ministry retains decision-making powers on tariffs and shares the responsibility with the Authority on interconnection rates and frequency allocation. The Head of the Authority reports to the Minister of Transport and Communications.

In the Czech Republic, the Czech Telecommunication Office was set up under the Telecommunications Act of 1992. It is, however, a Department within the Ministry of Transport and Communications and wholly financed from the general budget. The position is similar to that for energy, except that the regulatory reform proposals that have so far been circulated seem not to involve creating an independent regulator with significant powers.

In Poland, telecommunications regulation is still carried out by the relevant Ministry, but a new telecommunications law is being prepared for presentation to the parliament by the end of 1999.

The lack of development of independent regulation for telecommunications is, at first sight, surprising for two main reasons.

The first reason is that, in general, reform has been faster in telecommunications than in energy. We now find competing mobile operators, competition in value added services, privatisation of major shares of the incumbent fixed-line operator (Hungary and the Czech Republic) and some limited competition in fixed line services (Hungary and Poland).
The second reason is that the EU Telecommunications Directive, unlike the Energy Directives, explicitly require an independent regulator – albeit, a regulator independent of the incumbent fixed line telephone company. This is consistent with having a Ministry regulator. However, under the Directives, the conditions under which the regulator must operate are quite stringent and so most EU countries have adopted a telecommunications regulator independent of government and reporting to the parliament. The list of countries adopting this includes France, Italy, Netherlands – and both Austria and Germany.

In terms of style of regulation, in CEE countries, we have so far seen Ministry-based regulators, but the signs are that, if there were to be a second stage of reform, that would most likely take them in the direction of UK-style regulatory offices, operating license-based regulatory systems. This, however, reflects developments in the Continental European members of the EU.

We discuss in more detail in Section 4.2 and in the Conclusions why CEE counties have so far been able to make extensive progress in telecommunications reform without an explicit regulator.

One recent significant development affecting the development of regulation in CEE countries is the EU programme for "twinning" regulators for EU countries with regulators in potential accession countries. So far, this appears primarily to have affected telecoms, but it is likely to spread to other industries. Interestingly, Poland has chosen to twin with OFTEL and the Swedish telecoms regulator while the Czech Republic has chosen to twin with the German regulator. This programme may well become important in the future both for disseminating a central EU view on appropriate regulatory developments and the perspectives of existing EU members. Indeed, as the twinning is carried out by competitive tender, so the programme could well continue the competition between models of regulation in a new guise.

2.3. Other CEE Countries – Electricity

Some other CEE countries have established more or (usually less) embryonic electricity and/or energy regulators. Latvia and Lithuania are examples. However, they are very small countries where regulation effectively has to be “umbrella” regulation of all the major utility services. As such, and given the inherent problem of genuinely separating regulation from policy and management in small countries, they are rather less interesting for lessons on the style of regulation.

In recent months, however, Bulgaria and, in particular, Romania have taken major steps forward that raise interesting perspectives on the choice of regulatory style.
In Bulgaria, there is a new regulatory agency called the State Commission for Energy and Energy Efficiency (SCEEE). It has 7 members. The State Agency for Energy and Energy Efficiency is a separate body responsible for energy policy (including restructuring, privatisation and investment). The two new agencies were established in a law finally enacted in July 1999.\textsuperscript{13}

The SCEEE is limited in its powers. For instance, it sits under the authority of the Council of Ministers, it can only make recommendations on tariffs and prices and the Council of Ministers sets the regulations for granting licences. This is all rather like the Hungarian energy regulator. However, there are two key differences:

(i) For electricity, it introduces mandatory third party access to transmission and distribution systems. (Poland has the former but not the latter. Hungary and the Czech Republic have neither.)

(ii) The style of regulation incorporates some significant US elements eg the regulatory agency is a \textit{Commission} not an \textit{Office}. In addition, sittings of the commission will normally be in public, but there is the right to hold closed sittings.\textsuperscript{14}

In Romania, the Government has established an independent electricity and heat regulator, the NRAE. This was done by an Emergency Ordinance issued in late 1998. The intention is that the Ordinance will be replaced by an Act, drafts of which have been prepared but not yet enacted.

The NRAE looks, from the 5 page Ordinance, to be a classic UK-style independent regulatory office. Thus, it is headed by a President who has a fixed term and cannot be easily dismissed; it is responsible for decisions on all aspects of regulation (including prices and tariffs); it has budgetary independence; it is responsible for setting pricing methodologies, etc. On paper, the NRAE is, potentially (depending on the detailed provisions in the law), much more radically independent than any other CEE regulator.


\textsuperscript{14} According to the FT EEE Newsletter report, the pressures for independence and for open meetings came primarily from the World Bank. It will be interesting to see what happens in practice, particularly when World Bank and IMF surveillance of Bulgaria is relaxed.
The other interesting feature is that the NRAE is obliged to work jointly with the Competition Office on price regulation. Both the “calculation approach” for regulation of natural monopoly elements and the actual setting of intermediate and final prices. Indeed, on these issues, the NRAE acts “upon advice” of the Competition Office. Other than the use of the competition agency for appeals in Poland, this appears to be the only extant example of a significant role for competition agencies in utility regulation in CEE countries.\(^{15}\)

For both Bulgaria and Romania, the question of how these agencies will work in practice is a major one. They are both countries where reform has lagged and where ambitious plans have not been followed through or have failed to deliver the expected results, for one reason or another. They are also countries where the commercial and legal frameworks are under-developed and also where the political and institutional structures are not obviously geared to the separation of powers and functions - an issue at the core of independent regulatory theory and practice.

It is clear that external pressures have been critical for Bulgaria and Romania in the regulatory choices made. This raises the questions: (a) whether the reforms will be fully implemented; (b) whether they will “stick”; and, (c) how far they will operate as their domestic and foreign advocates intend. The Philippines and various Latin American countries have in the past enacted regulatory frameworks closely modelled on the US model. However, in practice, they operate very differently and often very unsatisfactorily.\(^{16}\)

On the other hand, both countries desperately need private and foreign investment to help refurbish and develop their electricity industries and both are heavily dependent on IMF and World Bank programmes. The governments of both also (a) currently seem to be serious about unbundling their electricity industries and introducing competition and (b) very committed to taking the necessary steps to be eligible to join the EU. Effective reform of the electricity industry (and other utilities) with a functioning, transparent regulatory system would undoubtedly help in this.

We will discover in due course which of these sets of forces is the more powerful.

\(^{15}\) See Government of Romania Emergency Ordinance for the establishment, organisation and operation of the Regulation Authority in the field of energy, 1998.

\(^{16}\) A key question is whether the courts are reliable. All regulatory systems – but particularly US-style regulatory systems - are vulnerable to corruption in the law courts. See Stern and Holder (1999) and the references cited therein.
The initial developments in Bulgaria are very discouraging. The Bulgarian Government voted in Spring 2000 to dismiss all but one of the SCEEE Commissioners less than one month after it had completed its first major task. The 1999 Law states that Commissioners can only be dismissed for serious misdemeanours. Nevertheless, the Bulgarian Government has dismissed the five Commissioners without giving any reason - and the Commissioners have accepted their dismissal without fighting it. One Commissioner, Slavtcho Neykov was reported as saying that it was not his position to criticise the decisions of his superiors.\textsuperscript{17} So much for the commitment of the Bulgarian Government to independent regulation and the enforcement of its new energy law.

\textsuperscript{17} See FT East European Energy Report, June 2000, p 32.
3. REASONS FOR CEE UTILITY REGULATORY CHOICES

3.1. Electricity

Considering electricity on its own, it seems that the main determinant of the regulatory choices made by the Central European countries is the degree of liberalisation chosen. Hence, the most independent regulatory agency for electricity is that in Poland, the country where the network elements have been most clearly separated from generation and where there are large numbers (over 30) of generation and of distribution companies. Similarly, Romania’s policy seems to be strongly competitive with a high degree of liberalisation. This again fits with the chosen regulatory model of a strongly independent regulator of the UK type.

Conversely, the Czech Republic has been slow hesitant about introducing independent regulation. It is also the country that has done least to separate generation from transmission and, in CEZ, has the most traditional-style electricity company. CEZ is still 70% state-owned and appears not to have given up its ambitions to regain control of the distribution companies.

Hungary is in an intermediate position. It is the one Central European country that has significantly privatised generation and distribution. It had previously established reasonable numbers of separate generation and distribution companies. But, MVM, the transmission company, has so far managed to maintain the ownership and management of the large nuclear plant of Paks, even though the transmission licence specifically prohibits the transmission company from operating in generation. Indeed, MVM appears not to have given up its ambitions to be active in generation in the Hungarian market.

Hence, both the Czech and Hungarian electricity industries remain dominated by powerful, state-owned companies which are seen as the basis for building up national champions and limiting the power and influence of large foreign energy companies. Hence, it is not surprising that there are mixed feelings towards a strongly liberalising approach – or towards independent regulatory agencies with real powers.

---

18 CEZ is currently in the process of separating transmission (but not dispatch) into a separate company from generation.

19 CEZ has acted for the Czech Government in buying-up distribution company shares that Municipalities had sold to outside interests so that the Government can regain control of the privatisation process. In so doing, CEZ made it clear that they hoped that they would not be excluded from the privatisation process. See FT East European Energy Newsletter July 1999.
In addition, these attitudes are accompanied by a desire to build-up a local capitalism and an inherited corporatist tradition\textsuperscript{20} that predates Communism. These are shared with other Continental European countries – Austria and Germany as well as France. None of these three countries have been or are at the forefront of electricity liberalisation or of the establishment of independent regulatory bodies.

A particular issue here is the attitude towards new entrants. Corporatist (and statist) models of organisation present a series of potentially high hurdles for new entry. Conversely, separating policy from regulation and developing independent and separate regulation is usually (and rightly) seen as encouraging towards new entry. In electricity, new entry typically refers to generation although it can also affect wholesale and retail supply and trading activities. Hence, for countries with either surplus and/or high cost generating capacity, openness to new entry is a real threat to incumbent producers. In consequence, given the links between foreign investment and new entry, it is not surprising that major pushes to establishing an independent regulator have arisen in CEE countries have arisen when they have realised the imperative to bring in foreign capital and recognised the implications in terms of attitudes towards new entry.

3.1.1. Electricity Prices

The key point about the introduction of effective economic regulation in CEE and CIS countries is that it involves substantial increases in electricity and other utility service prices, particularly in household prices. This is in contrast to Latin America, much of Asia (including China but excluding India) and some of Africa where commercialisation, liberalisation and competition plus regulation are leading to reductions in prices. Of course, in EU countries, the various electricity reform programmes plus regulation have led to reductions in prices (viz the UK) or are now doing so (as in Germany).

\textsuperscript{20} The corporatist reference here includes what political scientists classify as 'statism' (as in France) as well as corporatism involving tripartite relations between government, large firms and unions (as found in Austria and Germany).
In CEE countries, the government's attitude towards prices, particularly household prices, seems to be an important explanatory factor in whether or not countries are prepared to accept an independent regulator. Countries where governments are most unwilling to accept increases in prices are also likely to be those least willing to accept an independent regulatory agency.

Hungary's household electricity price in 1989 was already rather higher than elsewhere in Central Europe. Poland has a government that has been more prepared to raise household prices as part of its economic reform programme. In addition, the faster and more sustained growth of GDP and living standards in Poland mean that such increases are more sustainable in both economic and political terms. These are the Central European countries that have made most progress in introducing effective and independent regulation. However, it is worth noting that the Hungarian government's interventions in the regulatory process have been most notable in the area of energy prices in general and household prices in particular.

The conjecture set out above is also supported by the fact that the Czech government and the Slovak government (particularly under Meciar) have been noticeably hostile to price increases, especially to households, and they have also made much least progress among CEE countries in establishing independent regulatory institutions. Similarly, it is no co-incidence that Romania and Bulgaria have instituted major
regulatory reforms at the point where economic circumstances (and the international financial institutions) have forced them to implement significant energy price increases to households.

Nevertheless, the story is not quite so simple. The highest CEE electricity prices are in Slovenia, a country (albeit a small country) which is only now introducing regulatory reform. Russia and Kazakhstan have energy regulators (of a kind) but, as shown in the table above, have relatively low electricity prices, although the Kazakh nominal price is comparable to that in much of CEE countries. That, however, again raises the question of whether and how far the regulatory agencies in the CIS counties are comparable to those in Western and Central Europe.

3.1.2. Political and Legal Arrangements

Separating regulation from policy and establishing independent regulatory institutions requires:

- Effective political and economic institutions;
- Separation of powers, particularly between the executive and the legal system;
- A well-functioning legal system and sound courts;
- A good commercial law framework and some competition policy basis;
- A supply of well qualified staff able to carry out the various functions; and
- A functional commercial framework.

In short, considerable sophistication is required in political and legal thinking and practice, particularly as these concern commercial activity.

This line of argument concerning the existence and sustainability of independent regulatory institutions is the one emphasised by Pablo Spiller and his co-authors. Indeed, the 1998 paper by Bergara, Henisz and Spiller find that, controlling for other factors, well-defined and credible political institutions are sizeable and statistically significant predictors of regulatory effectiveness world-wide (as proxied by generation capacity) and that the best single predictor is judicial independence.

Elsewhere, I have emphasised the importance of the supply of potential regulatory staff as a key factor in whether or not countries can (and are willing to) establish
independent regulatory agencies.\textsuperscript{21} This is particularly important for the small countries, of which the CEE and the CIS has many.

In the context of this paper, it is clear that the degree of political and legal sophistication and effectiveness is important. The core Central European countries score more highly on these factors than the Balkan or Baltic states. Moreover, Poland and Hungary both made significant advances in these areas before 1989 eg the abolition of central planning and the incorporation into Polish law of the pre-1939 Commercial Code. That was not the case in the CSFR, let alone the Balkan or Baltic states. In addition, there is likely to be some correlation between the degree of political and legal sophistication and the potential supply of human capital resources of the type needed to support independent regulation.

The real difference, however, is with countries like Ukraine, Kazakhstan and the other new CIS states. Under Communism, these were not only controlled from Moscow, but they had never previously existed as independent functioning states with their own political and legal systems and structures. Unlike the core Central European countries, they had little commercial or industrial history except that under the USSR. Hence, it is not surprising that introducing effective regulation (in general and not just for utilities) creates such severe difficulties - both in providing legitimacy to the regulatory institutions and to finding the necessary trained human resources.

Leaving aside the new CIS countries, the political and legal problems of introducing genuinely independent regulation in the various CEE countries are relevant for the fear that independent regulatory institutions will be subject to regulatory capture. Such fears are particularly manifest with electricity, which (together with coal mining) was such a crucial and well-protected part of Communist states. This fear is more relevant, the less developed are the intermediate political and social institutions of a "civil society"

The factors discussed above are not unimportant in helping explain the differences between CEE countries approaches to regulation, but, as will become clear in the next section on telecommunications, seem to me less important than some of the underlying economic factors.

\textsuperscript{21} See Stern (1994).
3.2. Telecommunications

At the start of Section 4.1 on electricity, we suggested that it was the degree of liberalisation that was the main determinant of the progress in introducing explicit and independent regulatory institutions. This seems eminently plausible. However, it does not apply at all to telecommunications where considerable liberalisation, competition and privatisation have already been introduced but there are no currently functioning independent CEE telecom regulators. How can this difference be explained?

The answer seems that the high demand for telecom services coupled with the low penetration rate\(^{22}\) provide the basis for profitable activities and system expansion that can proceed in the absence of an independent regulator. Given the economies of scale available, the potential for the sales of new services and the general excess demand for lines and service, a regulator is not needed even to support foreign investment in fixed or mobile telecoms provided that governments do not intervene in a damaging way. So far no CEE government has done so, not least because the development of an efficient and modern telecoms industry is so crucial to the economic development of the countries. In this context, all CEE countries seem effectively to have recognised the need for new entry, typically involving foreign firms, even if this is combined with some transitional protection of local incumbents.

The relative neglect under Communism of "unproductive" telecoms relative to "essential industry" electricity has thus greatly eased the regulatory needs for telecoms. As pointed out in Cave and Stern (1998), the potentially high profits available means that there has been no shortage of potential strategic partners, of bidders for franchises, or of potential privatisation purchasers.

Unlike electricity, where CEE demand has been stagnant or slow-growing, the buoyancy of telecom demand has been so far been sufficient to obviate the need for explicit regulatory institutions to support strong private and foreign investment growth. As a result, there is now the development of competing fixed as well as mobile services with the real possibility of competition between networks eg at the local loop as well as the trunk network level. This is not the case for electricity.\(^{23}\)

\(^{22}\) 9-17 fixed lines per 100 inhabitants in 1991/92 rising to 15-24 per 100 in 1995 as compared to 50 lines per 100 inhabitants in the UK in 1995.

In fact, the lack of development of independent regulatory agencies for telecommunications in Central Europe and many other Transition Economies is not so surprising.

The reasons why are as follows:

(i) There is strong demand for telecom services, particularly among business users.

(ii) There is a willingness to pay because services are being expanded in terms of range and quality.

(iii) The combination of (i) and (ii) means that the incumbent companies are profitable and can readily finance new investment. In addition, because of strong growth in demand they can improve labour productivity without requiring large-scale redundancies.

(iv) Foreign investment is needed to allow for the introduction of modern telecom technologies and marketing techniques.

(v) Competition (primarily via mobile) and privatisation (primarily via sales of strategic stakes to foreign partners) is supported by the growth in demand and willingness to pay by customers. This also brings in foreign capital and expertise.

The consequence is that there is less need for regulation to ensure the effective working of telecoms markets, to foster new entry or to support privatisation. Independent regulatory agencies might help improve the economic and technical efficiency of services, but, in Transition Economies, they do not seem critical for supporting private investment and competition in telecommunications. For electricity, gas and water, effective and independent regulatory agencies do seem critical to support commercialisation, private investment and competition (as has also been found in West European countries).24

---

24 See Cave and Stern (1998) and Stern (1999) for further elaboration of these arguments.
5. COMPARISON WITH OECD REGULATORY MODELS

In Section 2, we outlined four main models that were competitors for the design of CEE and CIS regulatory systems. These were:

1) The US rule and court based model
2) The UK regulatory office model
3) The German competition agency based model
4) The Continental European Ministry-based model

Considering the CEE countries, the US model has not been adopted anywhere. Only Bulgaria has even in principle adopted any of the key features of the US model for electricity and then only in a relatively minor way (the use of public hearings).

The main reasons for this seem to be as follows:

There is dislike of entrenching a permanent, rule based system at this stage of transition;

- The human resources available to run such a system are simply not available and have better uses;
- The model depends on a well-entrenched 200 year old Constitution which enforces considerable separation of powers. These look particularly alien in CEE countries;
- There is resistance to a heavily law (and lawyer) driven system which is accompanied by under-developed and inadequate commercial law frameworks and courts;
- It requires a more complete withdrawal by governments from the utility sector than these countries (or other European countries) are willing to accept.

The German competition agency model has also not been adopted in any CEE country. This is at first sight somewhat surprising given the German (and German company) involvement in Central Europe. However, there are good reasons why this is so. The main ones seem to be:

- Unlike the German Federal Cartel Office, competition agencies in CEE countries are relatively weak and not yet well-established or well-staffed.
CEE competition agencies are more like fair trade enforcement agencies than West European competition, merger and monopoly agencies; 25

- Unlike Germany, there is no established tradition of competition law or of using competition policy to achieve micro-economic policy objectives or in regulation;
- This model depends on voluntary agreements between the various companies and major consumers which may well be difficult to achieve in CEE countries;
- The model is very corporatist and inimical to new entry or foreign investment. All CEE countries recognise the need to reduce somewhat the power of their incumbent utilities and bring in foreign investment; and
- The model is under pressure in its own home countries and does not apply in Germany for telecoms, where there is a powerful, interventionist and independent regulator.

The Continental West European Ministry based regulator is used for telecoms (eg in Hungary and the Czech Republic) but has not been adopted anywhere for electricity other than by default. In essence, electricity regulation has tended to develop along the lines of UK-style offices in those countries where regulatory reform has been or is being undertaken (Hungary, Poland, Czech Republic, Bulgaria and Romania). Otherwise, the regulatory arrangements are more the continuation of Communist arrangements rather than the specific choice of the Continental West European model. This is particularly so for slow-reforming CIS countries. Slovakia also fits this view although with some characteristics of the Continental model that are necessary for supporting a more developed commercial and market utility sector.

One reason for this is that Ministries in CEE countries are relatively weak and understaffed, particularly in less developed CEE and CIS countries. The key linkages under Communism were between the Communist Party and the top management of key companies. In the 1990s, Ministry officials are not well-paid and the best of them have many - rather more attractive - alternative employment opportunities.

In consequence, the UK regulatory office model seems to be the main model chosen for electricity by the active reformers. In particular, it is very noticeable how the UK licence framework has become the dominant regulatory instrument in CEE countries for telecoms as well as electricity and gas. The licensing model is not used for US or in

most Continental West European countries and does not easily fit into the framework of Continental Law.

The dominance of the UK model should not be over-emphasised. We saw in Section 3 how the Polish and particularly the Hungarian regulatory office framework for electricity retained considerable intervention powers for Ministries. Indeed, it could well be argued that the Hungarian model is a hybrid with the Continental European model.

The main reasons for adopting the UK office approach seem to be:

- By having a single office head and a small staff, it greatly economises on the resources needed for regulation;
- It fits well with the introduction of competition over networks as required by the EU Electricity and Gas Directives;
- It allows the Government a greater degree of influence eg by the choice of the Head of the Office; and
- It is more able to evolve to meet the needs of changed circumstances than the US or German models.

There are costs to this approach. It can lead to regulatory unpredictability and uncertainty (as US critics argue). But, the attractions of it in CEE countries are clear, particularly given the potential demand for and supply of staff experienced in regulation. In addition, particularly given the pressure from the EU Telecommunications Directives, it is a model that is becoming rather more common in Western Europe.
6. CONCLUSIONS

In Stern (1994), I analysed developments in economic regulation in CEE countries in terms of the demand for and the supply of regulatory services. The argument was that the demand for regulation is related to the need to attract private investment into infrastructure industries like energy and telecoms relative to the desire of the government to retain control over the utilities, while the supply was largely determined by the availability of the specialist human resources needed to operate regulatory institutions (as well as run companies and staff Ministries). However, Stern (1997) suggested that countries with fast growing demand and a secure macro-economic position (like China and the Asian "Tigers" pre-1987) feel much less need for explicit and independent regulation because they are perceived to offer sufficiently good (and secure) market prospects to investors. Hence their governments feel much less need to introduce independent regulatory institutions than countries where there are major investment needs but slower growth or a less secure macro-economic reputation.

These conjectures are useful in considering the lessons from the CEE competition between regulatory models reported in this paper. The two main findings from this paper are:

(i) in those CEE countries which have embarked on serious reform, they have typically chosen, for electricity, to adopt UK-style regulatory offices (albeit with significantly more Ministry involvement than in the UK); and

(ii) there has been little development of independent regulatory institutions for telecommunications in CEE countries, in spite of much higher investment rates and much more liberalisation and privatisation.

The telecommunications experience seems clearly to demonstrate the force of the second conjecture. In almost all CEE countries, there has been major expansion of fixed line systems, substantial investment in one or more mobile networks, considerable privatisation activity and unbundling of incumbent telephone companies, etc. And yet, outside the Baltic States, there is not a single independent telecoms regulator.\(^\text{26}\)

\(^{26}\) EBRD Transition Report 1998 lists Hungary as having an independent telecoms regulator. My understanding is that the Hungarian Communications Authority has no decision making powers on tariffs; it shares most of its key responsibilities with the Ministry of Transport, Communications and Water Management; it is partially funded from the state budget; and the head of the Authority reports to the Minister of Transport, Communications and
The only way of reconciling these facts is that the current and prospective profitability of this rapidly growing industry, plus its general importance for the development of the countries, mean that investors do not feel the need for independent regulatory institutions to protect their sunk investments. In addition, sufficient numbers of high-quality Western strategic investors have bid sufficiently large amounts for franchises for CEE governments not to need to introduce regulatory frameworks with independent regulatory agencies to attract sufficient private investment.

Strong growth in demand and high profitability is palpably not the case for electricity (or gas or water and sewage). The impact of the demand factors identified above is shown most clearly in the Hungarian case, where a first attempt at privatisation of electricity and gas distribution companies in 1993 failed largely because of uncertainties over the regulatory framework, leading to the enactment of the Electricity and Gas Laws. Moreover, perceived weaknesses in the regulatory framework by US and UK companies led to most of the privatisation tenders going to French, German and Belgian companies. The requirement to have a strong regulatory foundation for electricity (and gas) privatisation in these slow-growing markets is again the apparent driving force behind the recent renewal of activity in regulation in the Czech and the Slovak Republics, Bulgaria and Romania.

However, this does not answer why the UK model seems to have emerged as the winner in the CEE regulatory design competition. The answer to that seems to be that it is the way in which some form of independent (or semi-independent) regulation can be set up while economising as far as possible on regulatory resources. The supply factors for regulation have largely determined the style of regulation adopted.

Time and again, the main practical concern in CEE and other countries when establishing new regulatory agencies is the number of people required - particularly high-level staff - and the cost of the agency. There are other contributory factors, notably the ability of Ministries and Governments to maintain an influence on regulatory offices unless the laws establishing them rule this out - and, so far, the main enacted electricity or energy laws have actually or potentially allowed considerable Ministerial powers.

Thus, the evolutionary process has been for Ministries in CEE countries to relinquish their role in economic regulation when the demand for regulation required it (e.g.

Water Management. This seems to me to be just as much a Ministry regulator as the Czech Telecommunications Office which EBRD (rightly) do not classify as an "independent" regulator.
because of privatisation or high private investment needs in relatively slow-growing sectors), but for the style of regulation to allow for considerable future change and a continued Ministerial involvement eg on household prices and the protection of perceived national strategic interests as well as requiring a small regulatory sector. The US model is not consistent with this approach; the German electricity regulation model requires a stronger competition agency than CEE countries have (and this model is anyway not obviously a long-term runner) and the Ministry regulation model does not address the regulatory risk issues faced by investors in CEE electricity industries. Hence, we observe in Hungary and Poland the adoption of small UK-style offices with some Ministry regulation safeguards, a pattern that looks to be followed in the Czech Republic.

These are the proposed explanations for past choices. For the future, the question arises as to whether and how far the new energy regulation offices will become (or be allowed to become) genuinely independent in practice, particularly on tariff regulation. The Hungarian Energy Office has not been allowed to be so. For telecommunications, the question arises as to when the new market arrangements will require a more developed regulatory entity.

In more general terms, it might be expected that EU accession would boost the development of regulatory institutions. However, it is easy to exaggerate the specific influences of EU requirements. Regulatory practices in existing EU counties do, however, provide examples of working models to which CEE countries readily refer and on which they draw. This is likely to be enhanced by the "twinning" programme which the EU has recently instituted.
APPENDIX A. REGULATION IN CIS ECONOMIES

It is very difficult to assess the development of regulation in CIS countries. Apart from Russia, they are all new countries having to start almost from scratch in introducing their own political and legal institutions, particularly the set of institutions needed to support private sector, market-based commercial activities. Russia may not be a new country in this sense, but it faces an equally daunting task in devising and implementing an institutional framework suitable for a private enterprise economy.

Some of these countries have introduced regulatory legislation for utilities (eg the Kazakh Law on Natural Monopolies). In addition, the prices and investment of the electricity, telecommunications and other utility service industries are regulated by someone – by a Ministry or a Committee or the President or whoever. Nevertheless, it is difficult to conceive of any of the embryonic new regulatory institutions operating comparably to those in Hungary or Poland, let alone those in Western Europe, North America or Australasia.

The commercial, legal and institutional capabilities in the CIS countries are much weaker. The availability of people to staff such agencies is also very limited and the demand for people with these skills is enormous. Hence, one would expect it to be very hard to sustain independent regulatory institutions. Indeed, the question arises as to whether and how far it makes sense to develop them rather than improved Ministry-based regulation, particularly in the smaller and poorer CIS countries.

These thoughts are partly prompted by statements that are sometimes made about progress in utility and regulatory reform and how some CIS countries are performing. Thus, the 1999 EBRD Transition Report Spring Update classifies the electricity industries of Georgia, Kazakhstan and the Russian Federation along with Hungary as at the highest of 5 stages of reform, defined as:

“Reform progressing radically through unbundling, independent regulator, divestiture and concessions and nascent competition in wholesale supply.”

In contrast, Poland (along with the Ukraine) is classified at Stage 4.

In the light of the discussion earlier, the relative rankings of Hungary and Poland may seem debatable. Much weight seems to be given to Hungarian privatisation as wholesale competition is far from “nascent” (MVM has so far resolutely refused Third Party Access (TPA) to its network, which it has the powers to do under the 1994 Electricity Law) and, in practice, Hungarian regulation is, as we showed above,
far from independent. Conversely, the Polish government has been far more effective at separating transmission from generation, the Polish Energy Law makes TPA mandatory and the new regulator, at least on paper has far more independence. But, Poland has done little on privatisation and although TPA is mandatory, Hungary appears to be making faster progress in actually implementing proposals for more open access.

The discussion above illustrates the difficulties of making these generalised comparisons. Much depends on the implicit weightings used by the authors. The difficulties grow enormously, however, when the comparisons are made not between countries that are relatively similar in their institutional endowment, commercial sophistication and income per head, but between countries which are very different. Poland and Hungary are very similar on all these factors. Poland (or Hungary) is vastly different on these indicators relative to the Russian Federation let alone Georgia.

This discussion may seem beside the point in a paper devoted to the subject of styles of regulation. That is not so. Comparisons like those in the EBRD Spring 1999 Transition Report Update are not uncommon. Observers are attempting to assess new utility (and other) regulatory institutions on the same basis and criteria as for Central European and OECD countries. But, that seems to me to be a highly doubtful exercise. Given the nature, strength and human capital availability for regulation, it seems unhelpful rather than helpful to lump together for comparison the regulatory structure and style of all CIS countries with those of CEE countries.

This, however, immediately raises the question of whether in 1999, 10 years after the fall of the Berlin Wall, it still makes sense to lump together all these countries as “economies in transition”. It may well be that the concept of the single process of “transition” is now increasingly unhelpful rather than helpful, not just in thinking about regulation, but much more widely. That, however, raises much wider and more difficult questions than can be addressed in this paper.
References


