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I appreciate the opportunity to be here to discuss the importance of transparency and integrity in delivering infrastructure projects efficiently and effectively. There can be no real question that transparency and integrity are essential to legitimacy. Legitimacy in turn is essential to the willingness of charge payers and for tax payers to fund and of investors and governments to finance. We should therefore seek to minimise threats to legitimacy – whether these threats come in the form of dishonesty, generation of perceived excess profits (particularly a particular issue with long term PPP arrangements) or simply bad process or governance.

I come at this issue from the stand point of an economic regulator – but of a public sector organisation, Scottish Water, which is the largest single procurer of infrastructure in Scotland.

Effective economic regulation is a process, perhaps a mind-set, certainly a framework in which appropriate incentives have to be established. It requires full transparency. It does not work effectively when the asymmetries of information become too great or when the regulator becomes too passive or the regulated companies become too complacent. Economic regulation is most often thought of in the context of regulated utilities or situations where there is perceived to be a substantial element of natural monopoly. Today, however, I want to use the term in a wider context – not just the ex-ante setting of prices or the ex-post review of performance and prices but also in situations where regulation is ‘by contract’ – for example a Public Private Partnership, a concession agreement, which is monitored and enforced by the organisation letting the contract. The same principles, it seems to me, apply.

From my perspective, an effective regulatory framework requires:

- Transparency of information;
- Appropriate scrutiny of performance against the ‘regulatory contract’ or the legal agreement;
- Consistency of information used between the regulator and the service provider; and
- Effective Incentives.

I will take each of these in turn.

It is all too easy not to invest sufficiently in the scoping and definition of the information required both successfully to deliver the service required within the agreed budget and to be able to monitor effectively whether the service required is being delivered as intended. The information needs to be comprehensive. It needs to be well defined there can be no dubiety about how a parameter should be measured or reported. It should ensure that the profit earned on a project is clear. All too often there is confusion as to what the true return for a service provider is: it could come in the form of a return

on capital, management fees, overhead claims, scope adjustments, to name but a few.

The definition and collection of such information may be regarded as unduly onerous and, indeed, invasive. But this should be enough to put any regulator (or contracting party) 'on guard' – a company that is intending to deliver a service effectively and with a reasonable profit should only welcome such reporting requirements. Clear progress and ultimately successful delivery could only enhance their reputation: demonstrating both that they are doing a good job and opening further doors in the future. In the absence of this sort of transparency and precision, it becomes much easier for inefficient or unethical behaviour to thrive. It is interesting to speculate whether the widespread corruption alleged at Brazil's Petrobras, where contracts are reported to have been awarded by the state-owned company at inflated prices in exchange for bribes, would have been possible in a fully transparent, regulated procurement regime.

Effective regulation uses this information to monitor progress and delivery. It allows for benchmarking both over time and, if consistently implemented, between projects. What has a particular asset or service cost to deliver previously, in another area, by another contractor? These sound like simple comparisons but they are not. They rely on consistently defined and properly systematised information with a clear and consistent regulatory oversight. The prize is big, but the costs of falling short in the definition, collection and monitoring of information is substantial. It is overspending, scope creep (positively and negatively) and the potential for misbehaviour corporately or by individuals.

An initial response to regulation is for the entity being scrutinised to use two sets of books. Reporting for regulatory purposes can be quite different to the allocations of time and activities that are booked internally. If differences amount solely to a gap between 'stretch' targets and minimum levels of performance required under the regulatory contract or the PPP agreement, then this practice is harmless, perhaps even positive. However, all too often alternative accounting is designed to build a cushion, to lessen the 'hard budget constraint' to which all regulators aspire. This is worrisome. It removes the pressure to perform, it impacts on the ability to monitor effectively and as such to ensure that what we expected to get for our money is actually delivered. In short, that the tax or charge payer gets value for money. Unsurprisingly, regulators can be expected to react harshly when they uncover such behaviour. In 2007/8, for instance, two English water and sewerage companies (Severn Trent and Southern Water) were fined by their regulator and ordered to compensate customers after it was discovered that they had systematically misreported key performance data.

In Scotland we have developed a set of regulatory 'tramlines' to monitor financial performance. They measure the cash-flow of the supplier and represent the financial incentive. In effect, they are a cap and a collar on the returns that can be earned by the service provider. Too high a return would indicate either that the supplier has been very lucky or has overstated costs. Too low and the supplier has probably (assuming an appropriate tender or price setting process has taken place) been unlucky. This cap and collar reduces the risk of a project and the cost of finance and therefore the cost of the desired outcome. The range between the cap and the collar is the incentive

and reward for the supplier to deliver as effectively as possible and to demonstrate its bona fides. There has to be explicit agreement that the supplier will monitor activities in a manner fully consistent with the information framework required by the regulator.

Separately, the monitoring of progress and performance allows for transparent reporting by the supplier that can be confirmed by the regulator (checking consistency of information and perhaps an occasional regulatory audit). The advantages are clear: public confidence, a pressure for progress and delivery within budget.

Economic regulation, whether ex-ante of a utility or by contract, relies on consistent, systematised information, monitoring, benchmarking and reasonable rewards for delivery. It requires thorough preparation and requires vigilance – but there are lessons for the contracting of infrastructure or other services. Benjamin Franklin summarised the value of thorough preparation and vigilance: “It takes many good deeds to build a good reputation, and only one bad one to lose it.”

Alan D A Sutherland

Chief Executive

Water Industry Commission for Scotland