Issues in Restructuring, Privatization, and Regulation of Infrastructure Industries

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Of Counsel, Le Boeuf, Lamb, Greene and MacRae
Drivers of Restructuring and Privatization

A. Sector Specific Rationales

1. Inefficiency
2. Political Interference
3. Labor Problems
4. Capital Deprivation
5. Inadequate Rate Support
6. Poor Management
Drivers of Restructuring and Privatization

B. Macro-Economic Rationales

1. Government Debt Burden
2. Inability to Raise Capital to Meet Rising Demand
3. Access to World Capital Markets
4. Pressing Social Needs
Restructuring Models
Electricity and Natural Gas
Model: Competitive Capacity Market

1. Competitive Bidding/Negotiation For Generation
2. Monopsony Power
3. Reliance on Revenue Stream of Distribution Company/or State Guarantees
4. Long-Term Take or Pay Contracts
5. Contractual Assignment of External Risks (E.G. Fuel Prices, Currency, Fluctuation)
Restructuring Models
Electricity and Natural Gas
Model: Competitive Energy Sector/Distribution Company

1. Competitive Energy Market
2. Competitive Capacity/Hedge Market
3. Multiple Distribution Companies
4. Distribution Monopolies who buy Energy for Resale to End
5. Reliance on Financially Viable Distribution Companies
Restructuring Models
Electricity and Natural Gas
Model: Competitive Energy Sector/Open Retail Market

1. Competitive Energy Market
2. Competitive Capacity/Hedge Market
3. Distribution Function Limited to Wires/Degree of Unbundling
4. End Users Free to Pick Own Suppliers
Restructuring Models
Telecommunications
Model: Monopoly

• All Services Rendered by Single Provider
• No Competition Allowed
Restructuring Models
Telecommunications
Model: Monopoly Local Loop, Competitive Other Services

• Competition in Long Distance
• Competition in Wireless
• Other Competitive Services
Restructuring Models
Telecommunications
Model: Full Competition

• Competition in Local Loop
• Full Access to All Facilities
• Easy Entry/Easy Exit
Privatization Models

1. State Assets Retained/ Incremental Capacity Open to Private Investment
2. Sale of Majority/Minority Status in State Company
3. Privatization of All Competitive Assets/Essential Bottleneck Facilities Retained By State
4. Everything Privatized/ Assuming It can Be Privatized
Tensions in Privatization

1. Maximize Revenues From Sale of Assets vs. Market Optimization
2. Maintaining Social Objectives in Market Environment
3. Incentives for Productivity Gains vs. Mere Cost Cutting
4. Leverage of Developing Countries in World Capital Markets
Fundamental Choices in Regulation
Fundamental Policy Choices in Regulation

- Economic Efficiency vs. Social Considerations
- Rule Based vs. Contract (Concession) Based
- Rate of Return (Cost Based) vs. Price Cap
- Regulation of Monopoly Services
- Anti-Trust vs. Proactively Competitive Approaches to Market Formation
- Deliberative vs. Administrative Decision
- Centralization vs. Decentralization
Fundamental Policy Choices in Regulation

Economic Efficiency vs. Social Considerations

- Are results of market acceptable to society?
- Key social considerations
  - Universal service (e.g. rural, poor)
  - Environment
  - Economic development
  - Resource preferences
- Privatization does not change social expectations.
## Fundamental Policy Choices in Regulation

<table>
<thead>
<tr>
<th><strong>Rule Based</strong></th>
<th><strong>Contract Based</strong></th>
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<tbody>
<tr>
<td>Regulator Can Change Rules</td>
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<td>Procedural Safeguards</td>
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<td>Ability to Adjust to Changed Circumstances</td>
<td>Pressure to be Correct from Start</td>
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<td>Short Term Uncertainty</td>
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<td>Politically Stable</td>
<td>Political Stability Dependent on Concessionaire’s Flexibility</td>
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Fundamental Policy Choices in Regulation

Rate of Return vs. Price Cap

Rate of Return Formula
(Capital Investment - Depreciation)ROR + Expenses

Price Cap Formula
(Cost Basis)RPI (-x?)
Fundamental Policy Choices in Regulation

**Rate of Return**
- Fact Intensive
- Regulatory Review of Management
- Direct Review of Profits
- Factors May or May Not Be Internalized
- Rates May or May Not Have Specific Terms in Time

**Price Cap**
- Theory Intensive
- Clear Boundary Between Management and Regulation
- Indirect Review of Profits
- Internalization of Many Factors (But Not All)
- Rates May or May Not Have Specific Terms in Time
Fundamental Policy Choices in Regulation

1. Proactively Competitive Approaches to Market Formation
2. Deliberative vs. Administrative Decision-Making Process
3. Centralization vs. Decentralization
### Investment in Infrastructure Projects with Private Participation by Sector (1999 US$ Billion)

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Source: PPI Project Database
**Investment in Infrastructure Projects with Private Participation by Region**

(1999 US$ Billion)

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Source: PPI Project Database