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Incentive-Based Regulation in the Future: So What (Where Do We Go From Here)?

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The History

- General shift in ideology
 - from expansion to efficiency
 - “new public management”
- Decentralisation of decisions
 - privatisation
 - deregulation
- Regulatory reform
 - incentives rather than decisions
 - market architecture
 - market design



The Theory

- Considerable advances, building on
 - information economics
 - game theory
- Successful in establishing conceptual framework
 - mechanism design
 - principal-agent theory
 - oligopolistic markets
- Less successful in providing practical guidance
 - lack of clear results
 - sensitivity to underlying assumptions
 - difficulties in handling realistic settings



The Practice

- General movement in the same direction
 - decentralisation
 - regulatory reform
- However, considerably variation across jurisdictions
 - speed
 - regulatory design
- Mixed results
 - efficiency, quality, capacity, prices
 - relation between regulation and performance not always clear
- No apparent consensus or convergence
 - lack of (comprehensive) comparative analyses



A Case Study

- Electricity networks
- Multiplicity of goals
 - adequate capacity
 - secure availability
 - cost efficiency
- Complexity of tasks
 - investment versus maintenance
 - adequacy and security versus costs
 - choice of technology
- Regulation requires a combination of
 - clearly defined rights and responsibilities
 - standards on performance
 - economic incentives



Challenges

- Market integration
- Capacity margins
- Aging networks
- Renewable energy
- Energy efficiency
- Energy security
- New technology
- (Political ambitions)
- (Expectation-performance gaps)



Change of Direction?

- Principles of good regulation remain the same
 - incentives rather than decisions
- Gains from further advancement of these principles
 - clarifying rights and responsibilities
 - unbundling monopolistic and competitive activities
 - integrating markets
- Shift in emphasis requires adjustment of incentives
 - from efficiency to security
 - from costs to capacity
 - from price to quality
 - from standardisation to innovation



An Example

- Norwegian electricity networks
- From overcapacity to cost efficiency
 - introduction of revenue caps and yardstick competition
 - reduced investment, cuts in costs
- Continuous development of the regime
 - design, implementation, method, data
 - dialogue with industry
- Current debate
 - need for renewal and expansion of capacity
 - accommodating new renewable energy sources
 - less emphasis on cost efficiency and more on cost coverage?



Conclusion

- Regulation without incentives does not exist
 - not a question of providing incentives, but of providing the right incentives
- Revolutions not called for
 - fundamental principles of good regulation remain the same
- No such thing as a once-and-for-all optimal design
 - path dependence
 - differing goals and constraints
 - many ways
- Success warrants adaptability
 - regulatory process
 - learning from experience
 - adjusting to change
- Pragmatic approach
 - achieving “good enough”
 - avoiding failures