

Regulating infrastructures in the tropics

Debates about regulatory governance of logistics infrastructure need a focus on regulatory capacity argue **Martin Lodge, Chris van Stolk, Daniel Schweppenstedde** and **Julia Batistella-Machado**

Infrastructures are at the heart of social and economic life. How, then, when faced by depleted public finances, can states promote the development of infrastructures? This is a question that is relevant for both OECD and non-OECD states. How to design regulatory regimes to support the development of infrastructures is at the forefront of international debates, especially as experiences over the past few decades have often ended up in disappointment and acrimony and as new state-backed investors, especially from China, have come to play an increasingly prominent role.

So how can regulation contribute to the development of infrastructures? The orthodox answer to this question has been to emphasize 'credible commitment'. Given the threat of potential administrative expropriation once an investment in these fixed assets has been made, investors seek assurances that make any such attempt at expropriation costly to national governments. This recipe – based on the seminal work by Bruno Spiller and Brian Levy (1994) – builds on what has come to be known as the 'time inconsistency' problem. In other words, commitments made today are not necessarily secure, as preferences change. Regulation therefore needs to address the demands of investors seeking assurances that their investment is 'safe', and the legitimate concerns of democratically elected governments.

Brazil represents a paradigmatic case for the study of regulatory recipes. The theme of credible commitment has been prominent in Brazil in the area of logistics infrastructures (ports, roads, rail and airports). While ownership and industry dynamics vary somewhat, what combines all of these sectors is the lack of investment, the presence of bottlenecks impeding development, unsatisfactory regulatory experiences and political contestation over questions of ownership, in addition to differences across different states. Furthermore, the initiatives

of various administrations to attract investment and infrastructure expansion have had, at best, moderate effects. Long-term concessions were signed, either with very limited performance-related oversight (roads) or were prone to more generous renegotiations (airports). In rail, it was producers who developed infrastructure to transport their own freight.

The political volatility surrounding Operation Carwash (Operação Lava Jato) since 2014 has added further questions about long-term stability, especially as industry parties with long-standing interests in the logistics infrastructure sector are also deeply involved in the 'car wash' scandal that has gripped Brazil (and has increasingly affected other Latin American countries). To attract investment and develop infrastructure, the current interim administration launched another major initiative, called PPI (Programme for Investment Partnerships). The PPI was established as a priority project of the Presidency. It acted as a Secretariat to organize and prioritize schemes, and it was meant to promote investment into Brazilian logistics infrastructures. Further measures were taken to make concessions more credible by establishing 'hard-nosed' terms for concession renegotiation. In addition, legislative proposals are going through the parliamentary process to enhance regulatory agency governance, especially in terms of agency leadership and decision-making.

Capacity deficits

In this context, questions about 'credible commitment' and other orthodox recipes for attracting 'new investors' and 'competition' offer limited insight. Instead, one should focus more extensively on the underlying deficits in regulatory capacity (Lodge 2014):

► **Analytical capacity deficit:** there was a distinct lack of strategic overview in the Brazilian contest. There

was little deliberation of inter-modal considerations, project proposals were said to represent administrative and political convenience rather than strategic rationales, and there was also no examination of wider regional development concerns.

► **Co-ordination capacity deficit:** there was a distinct problem of multi-organizational sub-optimization within a highly fragmented administrative landscape consisting of the Presidency (Casa Civil), cross-cutting ministries (Finance and Planning), sectoral ministries and regulatory agencies. Responsibilities and role understandings remained contested with most participants identifying sectoral ministries as the 'weak link'. In addition, there were concerns about the legitimacy and accountability of regulatory agencies on the one hand, and past micro-management by the presidential centre on the other.

► **Oversight capacity deficit:** there was a general enforcement problem in Brazilian regulation in that regulators were usually unable to enforce sanctions in timely ways. In addition, the resources of regulators were limited, so that their actual performance measurement remained ad hoc (and similarly patchy was the overall learning across different government agencies). These limits were partly caused by initial concession contracts, and partly a result of unpredictable budgetary allocations. In contrast, the national audit office, the TCU, became increasingly dominant and acted as a quasi meta-regulator. This, in turn, increased risk aversion in the sector and also biased attention towards the TCU's (anticipated) concerns.

► **Delivery capacity deficit:** there was little faith in the durability of concession arrangements over time. Concession holders had limited incentives to fulfil the requirements of their concessions, and regulators (and ministries) were said to lack the capacity to manage processes of renegotiation.





tiation in view of strong political and industry interests.

Questions about how to improve the landscape of regulatory governance are therefore central to strengthening the development of logistics infrastructures that might actually add to sustainable social and economic development more generally. But what would the ingredients of such a capacity enhancing strategy look like?

Towards 'disciplined discretion'

One proposal for the development of concessions is to rely on 'special purpose vehicles'. Given agreed legal frameworks, these vehicles include high prestige project-specific organizations to support the actual delivery of a concession. Such vehicles come with the advantage of not requiring major institutional re-arrangements, but they do include the disadvantage of not supporting more long-term capacity building. Nor would they address the overall strategic and analytical deficits.

Another proposal would be to establish a new organization to develop long-term infrastructure plans and thereby establish clearer role understandings between long-term strategy, political priorities (Presidency), sectoral interests (ministries) and contractual development and oversight (regulatory agencies). In a context that already suffers from a hyper-complexity of governmental organizations, adding complexity seems unlikely to be a viable option, regardless of the inherent danger that any organization tasked with the long-term will quickly be sidelined by the political priorities of the day.

A third proposal involves 'coordination protocols'. Accordingly, protocols (memorandums of understandings) would be established that provided regulatory agencies with legitimate scope in concession design and oversight. Such a device would possibly reduce the scope for presidential

and ministry-level scepticism, and it would also allow regulators to play a more confident role in developing and maintaining their capacity in analysis and oversight. It would, however, without support from the very top, run the risk of gridlock. It would also require additional measures to enhance the capacity of sectoral ministries.

More generally, what could be done in terms of enhancing the overall capacity within the Brazilian executive when it comes to regulation and logistics infrastructures? Considerable individual capacity exists, but organizational capacities are, at best, patchy. Believing that formal codification will address future challenges is problematic – as with all things in life, regulation does not last forever. It is therefore important to foster 'disciplined discretion' – a commitment to be predictable when exercising direction responsibly.

A number of ways of developing such capacity for disciplined direction exist:

- › One is to take procedural instruments seriously. This means not just complying with the required competition of Regulatory Impact Assessments (RIA), but also ensuring that there are internal processes in place that encourage meaningful quality-checking.
- › Another is to set better incentives so that concession holders can no longer rely on a well entrenched 'gambling culture' that their ambitious bids can easily be renegotiated on more benevolent terms. It also involves more extensive benchmarking of concession performance.
- › A third capacity building measure is to enhance engagement by moving beyond traditional (stale) consultation processes, and to directly engage stakeholders with concessions. Such processes might be troubled by adversarial relationships, or the lack of stakeholders where concession hold-

ers are the sole users of the infrastructure. Nevertheless, there would be scope for learning and using external resources to support regulators.

› A final capacity enhancing measure would be to support challenge functions that would force proposals to be carefully examined, allow learning across projects, and also reduce the predictability of regulatory oversight activities vis-à-vis their regulatees.

None of these proposals promise an easy and quick 'win' for Brazil. However, it is by investing in these processes of regulatory governance that capacity can be enhanced. It has long been argued that the regulation of infrastructures requires both commitment (to attract long-term investment) and flexibility (to deal with changes over time). These two goals of commitment and flexibility are often seen to be in opposition to each other. However, by investing in regulatory capacity, it is possible to support 'disciplined discretion' in regulation and therefore produce sustainable social and economic development.

carr and RAND Europe were awarded a grant by the UK Foreign Office under its Prosperity Fund scheme to research into the regulatory governance of logistics infrastructures in Brazil.

References

- Levy, B. and Spiller, B. (1994) 'The institutional foundations of regulatory commitment', *Journal of Law, Economics & Organization* 10 (2): 201–46.
- Lodge, M. (2014) 'Regulatory capacity' in M. Lodge and K. Wegrich (eds), *The Problem-solving Capacity of the Modern State*, Oxford, Oxford University Press, pp. 63–85.
- Martin Lodge** is director of **carr**, **Julia Batistella-Machado** is a **carr** researcher, **Chris van Stolk** is Vice-President of RAND Europe, **Daniel Schweppenstedde** is an analyst with RAND Europe.