

## **Regulatory capture revisited – Is there an anti-corruption agenda in regulation? Lessons from Colombia and Zambia<sup>1</sup>**

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### **Abstract**

*Corruption is a threat to efficient and effective water and sewerage service delivery. This paper examines regulatory processes in the water sector and the problem of regulatory capture. It provides an overview of the concept of capture and the risks of corruption in regulation; then, potential measures to control corruption are presented. It is further argued that good regulation is actually a key element for reducing corruption in the sector as a whole. In an empirical section, the institutional regulatory frameworks in Zambia and Colombia are analyzed based on these considerations. The question asked is in how far the regulatory framework in these two countries is able to prevent identified risks of corruption; or whether an explicit anti-corruption perspective could safeguard the independence of the regulator both from narrow political interests and from the regulated industry. The paper concludes with some lessons learnt and avenues for further research.*

### **Keywords**

*Corruption, Regulation, Regulatory Capture, Zambia, Colombia*

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# REGULATORY CAPTURE AND WHAT CAN BE DONE AGAINST IT

Economic regulation of natural monopolies, such as water providers, seeks to enhance efficiency. Be it private or public, regulation has to guarantee the financial viability of the regulated utility while aiming to protect consumers from monopoly abuse with respect to price and quality. Inherently, regulation is thus a task of balancing different interests. Most would agree that such regulation should therefore be ‘independent’. In a paper published by the World Bank, Smith (1997) defines ‘regulatory independence’ as “*arm’s-length relationships with politicians, firms, and consumers*”.

But regulators and politicians responsible for enacting regulations may abuse their power in order to foster their own goals, which is precisely the definition of corruption: an abuse of entrusted powers for private gains. Regulators and politicians may also be used to foster the goals of other interests able to pay for it; this is usually known as regulatory or state capture.<sup>2</sup> Indeed regulation can be undermined by corruption at various levels. We classified the many corruption risks in regulatory processes into three categories according to their level of incidence in table 1: political corruption, administrative corruption, and intra-state corruption. The former two involve both private and public actors, while the latter is happening within the realm of public institutions only, be they political or administrative.

<b>Political corruption</b>	<ul style="list-style-type: none"> <li>▪ <b>Political opportunism</b> (extortion): Abuse of political power to extort private or political benefits from regulated firms</li> <li>▪ <b>State capture</b> (by private actors): Strategic exertion of influence on legislative powers by private interests in the design of Laws for private gain</li> </ul>
<b>Administrative corruption</b>	<ul style="list-style-type: none"> <li>▪ <b>Regulatory opportunism</b> (extortion): Abuse of regulatory power to extort private or political benefits from regulated firms</li> <li>▪ <b>Regulatory capture</b> (by private actors): Strategic exertion of influence by private interests on the design of regulations and regulatory decisions for private gain</li> <li>▪ <b>Fraud</b>: Economic crime involving some kind of trickery, swindle, deceit, manipulation or distortion of information, facts or expertise</li> </ul>
<b>Intra-state corruption</b>	<ul style="list-style-type: none"> <li>▪ <b>Regulatory or state capture</b> (by public actors): Abuse of legislative or regulatory powers to obtain undue political or private benefits</li> <li>▪ <b>Embezzlement</b>: Systematic theft of administered (entrusted) funds and other resources</li> <li>▪ <b>Clientelism</b>: Politicians promise to provide clients with benefits (often jobs) in exchange for votes and political support</li> <li>▪ <b>Fraud</b>: Economic crime involving some kind of trickery, swindle, deceit, manipulation or distortion of information, facts or expertise</li> </ul>

**Table 1 Types of corruption in regulation**

Source: Author; definitions of fraud and embezzlement are in part taken from Andvig et al (2000).

<sup>2</sup> Marino Tadeo Henao, a Colombian lawyer, described capture as follows: “*It’s not the corruption that violates rules, but the corruption that makes rules*” [Translated from Spanish by the author].

But how can corruption happen? Much can be explained by the various principal-agent-client relationships in regulation and the resulting informational advantages at various levels. Asymmetric information creates scope for informational rents, but also for strategic manipulation of information and collusion of actors for narrow private interests. As discussed more in-depth in Boehm (2009: 48), the most important information problems in regulation arise between:

- (i) regulators and regulated utilities,
- (ii) regulators and the legislative,
- (iii) experts and non-experts within the regulatory agency, and
- (iv) users and the whole system

Having a clear idea of where the problems are and where they stem from is an important step towards thinking of measures that could be implemented to counteract them. For instance to look more closely at the four different levels of asymmetric information mentioned above already helps in directing attention to what needs to be done to reduce certain risks. Using this approach, table 2 below summarizes and extends the recommendations developed in Smith (1997: 11-12), Krause (2009: 54-55) and Boehm (2009). Additionally, of course, we need an understanding of the given institutional context and political economy of a country. The measures in table 2 are not seen as *panacea* nor as one-size-fits all solutions, but should be understood as a guideline for potential measures.

<b>Information problem between:</b>	<b>Potential measures</b>
<b>Users - Rest</b>	<ul style="list-style-type: none"> <li>✓ Strengthen Users and Civil Society               <ul style="list-style-type: none"> <li>▪ Open regulatory processes for civil society participation</li> <li>▪ Management of complaints</li> <li>▪ Help users in organizing their interests (financial and technical support)</li> <li>▪ Provide and foster open platforms for discussion</li> <li>▪ Assist existing civil society organizations in the sector</li> <li>▪ Raise interest and conscience of the media</li> <li>▪ Intensify exchange of information and cooperation between regulators and universities (access to data)</li> </ul> </li> </ul>
<b>Politics - Regulator</b>	<ul style="list-style-type: none"> <li>✓ Safeguarding regulatory independency from politics               <ul style="list-style-type: none"> <li>▪ Distinct legal mandate</li> <li>▪ Professional criteria for appointment</li> <li>▪ Executive and legislative branches involved in appointments</li> <li>▪ Terms of appointed regulators shouldn't coincide with election cycles</li> <li>▪ Protection from arbitrary removal, e.g. by clearly specifying the causes for removal</li> <li>▪ Reliable funding independent from the general budget</li> </ul> </li> <li>✓ Improve information on regulatory actions               <ul style="list-style-type: none"> <li>▪ Information on regulatory decision-making processes</li> <li>▪ Provide regular reports to government</li> <li>▪ Internal and external control of regulator's budget (e.g. Supreme Audit Institutions, external auditors etc.)</li> <li>▪ Clear appeal processes</li> </ul> </li> </ul>

<b>Regulator - Firms</b>	<ul style="list-style-type: none"> <li>✓ Clear and standardized accounting rules for regulated firms</li> <li>✓ Train regulatory accountants in forensic accounting</li> <li>✓ Data collection and use <ul style="list-style-type: none"> <li>▪ Centralized &amp; standardized management of information</li> <li>▪ Yardstick competition and Benchmarking</li> <li>▪ Data on demand structure, ability &amp; willingness to pay, etc.</li> </ul> </li> </ul>
<b>Within Agency (government or water provider)</b>	<ul style="list-style-type: none"> <li>✓ Internal anti-corruption strategy <ul style="list-style-type: none"> <li>▪ Risk map</li> <li>▪ Rotation of experts in vulnerable positions</li> <li>▪ Introduce whistleblowing systems</li> <li>▪ Clear revolving door regulations and adequate staffing</li> <li>▪ <i>Fair</i> remuneration and good working conditions (intrinsic motivation)</li> <li>▪ Traceable, verifiable and reproducible expert decisions</li> <li>▪ Internal and external audit procedures</li> <li>▪ Foster an open culture of discussion</li> <li>▪ Training</li> </ul> </li> </ul>

**Table 2                    Examples of potential anti-corruption measures in regulation**

*Source:* Based on Boehm (2009) and complemented with information from Smith (1997) and Krause (2009)

The table may be summarized as follows: With respect to asymmetric information between users and the rest of the system, the key is to improve access to good quality and relevant information to users and civil society and to enhance their capacity to make use of this information. When it comes to the asymmetric information between regulators and the legislative, the statement made by Ugaz (2001: 9) captures the most important point: *“Independence should not be confused with lack of accountability.”* While it is of course important to shield the regulator from political interference, it is just as important to make sure the regulator is being held accountable for its actions.

Regarding problems of information between regulators and regulated utilities, it all comes down to data. The more the regulator knows about the regulated industry the better. However, it is important to assure that this data is publicly available and accessible in order to avoid collusion between regulator and regulated industry. A fundamental problem we encounter here is the issue of business secrecy that may reduce transparency about such key information as the costs of regulated utilities. In an excellent contribution, Al’Afghani (2009) argues that irrespective of the model of ownership of the utilities or the type of regulation, freedom of information laws could be used as a tool to enhance transparency, which is, however, subject to limitation as the laws contain clauses which exempt certain information from being disclosed.

Finally, at the level of the agency itself, various anti-corruption measures can be implemented, starting with an internal risk analysis and a strategy to build integrity from top-down and bottom-up, recognizing the importance of leadership and intrinsic motivation.

# IS THERE AN ANTI-CORRUPTION AGENDA IN REGULATION? LESSONS FROM COLOMBIA AND ZAMBIA

## 1.1 Research Methodology

It is difficult if not impossible to measure corruption. But we know that corruption actually is (also) a governance problem. And we can measure governance institutions. If certain institutions are in place and working well, we can assume that they go along with lower levels of corruption, or at least make corruption a bit more difficult. The international NGO Global Integrity follows this approach. In their reports they look whether certain institutions, laws and regulations are in place (*de jure*), and ask experts for the perception regarding their degree of implementation (*de facto*).

The methodology followed here is inspired by this approach. For the countries considered, desk studies provided a first insight regarding the regulatory framework. Then, we looked at measures and processes aiming explicitly or implicitly at reducing corruption. For the sake of clarity, we clustered the identified measures and processes from table 2 into the well-known categories of good governance and anti-corruption:

- (1) **Organizational design:** The regulatory framework (external design) and the agency itself (internal design) have to be designed in a way to foster both independence of the regulator and its integrity. In table 2, these are mainly the measures identified at the levels “politics-regulator”, and “within agency”.
- (2) **Accountability Framework:** Accountability implies being held responsible for the tasks that have been entrusted to a person or organization. Obviously, transparency and participation are important preconditions for accountability. But additionally, detected corrupt behavior has to be punished. In table 2, the relevant measures can be found mainly in the categories “users-rest”, “regulator-firms”, and “politics-regulator”.
  - a. **Transparency:** Information is power and power can be abused. In turn, if asymmetric information is one of the main underlying factors fostering corruption then improving access to information will limit opportunities for corruption.
  - b. **Voice & participation:** Participation leads to a competition of interests, reducing potentials for capture. Transparency is of course a pre-condition for such an effective participation. Information must be used and voiced and requires capacity, channels and processes to do so.
  - c. **Sanctions:** Impunity undermines the best efforts put into prevention. Sanctions do not only need to be formal ones, such as those provided by criminal or civil law, contractual or administrative sanctions. There are also informal, social punishments, such as public naming and shaming in reports or media.

Although there are inevitably overlaps between these categories, we find them helpful for structuring our research. Note that potentially many of these measures of “good” regulation are likely to reduce corruption risks in the sector as a whole.

The research started with a desk study reviewing the relevant policy documents, websites, and literature. Then, the findings were validated and complemented through open informal expert interviews during field research in order to get an idea of the *de facto* implementation and the effects of these institutions. We aimed at triangulating our results by interviewing various stakeholders. The case study on Colombia was carried out in the years 2006-2007; then reviewed and updated based on new publications (especially Krause, 2009), and an ongoing undergraduate thesis in economics supervised by the author at the Universidad del Norte in Barranquilla. The interviews carried out in Lusaka, Zambia, between 19 and 23 of July 2010 were facilitated by German Technical Cooperation (GTZ).

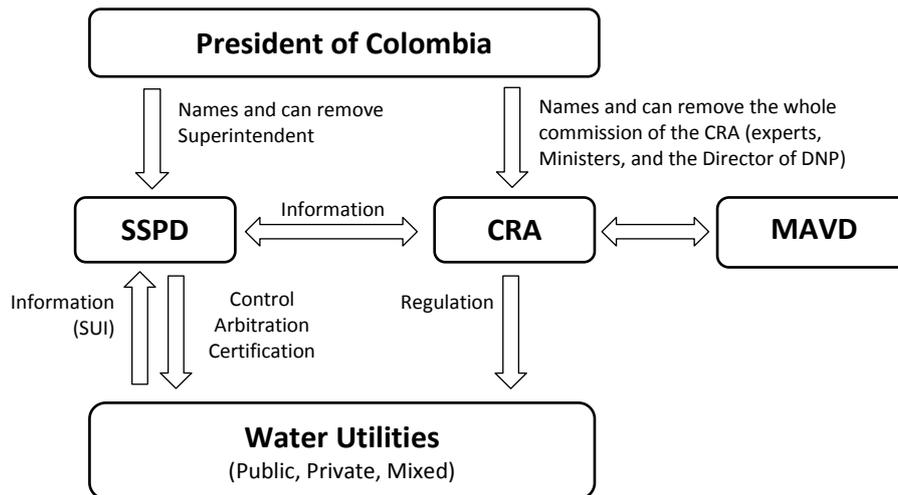
## 1.2 Colombia

Colombia is rich in water resources. Nevertheless, we find a pronounced difference in access to drinking water between urban and rural areas. According to the Colombian Department of Statistics (DANE, 2005) in 2005, 94.3 % of the population has access to treated water in urban areas, while in rural areas only 47.3% can count with a connection.

In Colombia, the Constitution from 1991 introduced the foundation for a new scheme of public services, followed by the Law 142 in 1994 where the institutional design of the public service sectors, including water, is laid down. The President delegates the function of economic regulation to the Water Regulator (*Comisión de Regulación de Agua potable y Saneamiento Básico*, CRA). The CRA belongs to the Ministry of Environment, Housing and Territorial Development (*Ministerio de Ambiente, Vivienda y Desarrollo Territorial*, MAVD). Interestingly, the functions of providing information, certification, arbitration, as well as control and monitoring of utilities in all public services (water, energy, and telecommunication) are delegated to another central institution, the Superintendence (*"Superintendencia de Servicios Públicos Domiciliarios"*, SSPD).

Additionally, on local levels, the mayors have the task to divide the population of their municipality into six socio-economic levels (stratification) in order to allow lower-income groups 1 to 3 to receive a cross-subsidy on tariffs, while level 5 and 6 pay an overcharge. Level 4 pays a cost-covering tariff.

Regarding water service provision, we find in Colombia a wide spectrum of different arrangements. Some utilities are public (e.g. Medellin and Cali), some private concessions (e.g. Tunja and Soledad), and some are mixed schemes (e.g. Cartagena and Barranquilla). In rural areas, we also find community-based water providers.



**Figure 1 Organizational Structure of Colombian Water Regulation (simplified)**

Source: Author

One of the main challenges in Colombia is the high degree of informality of the great majority of utilities and the immense number of regulated entities. Indeed, there are at least 1500 public and private entities responsible for water service provision in urban areas, and more than 12.000 providers in rural areas. All are subject to central regulation by the water regulator. This heterogeneity adds to the complexity and the challenge of the task delegated to the CRA.

### 1.2.1 Organizational Design

What has been done in Colombia to favor independent regulation? While the CRA belongs to the line ministry, the MAVD, the Law 142 gives the regulator the statute of an independent organization. Article 69 of this law differentiates between *administrative*, *technical*, and *financial* independence. Administrative independence means that other administrative bodies, amongst them the line ministry, cannot interfere within the administrative decisions of the CRA, for example regarding the staff, its training, internal control etc. Financial independency is achieved by acquiring own funds through contributions levied on the regulated utilities. A priori, this should shield the regulator from political pressure through the general budget. However, as Krause (2009: 113) notes, the budget from the regulator is still part of the budget of the ministry, and may thus be subject to revision by the ministry. Technical independence, finally, means essentially that the CRA shall have the required technical expertise upon which it can base decisions, and that these decisions are not subject to revision by other public entities, including the Ministry.

But the regulator is not independent of the political sphere. Indeed, the commission of the CRA is composed by seven members: the Minister of MAVD, the Minister of Social Protection, the Director of the Department of Planning (DNP), and four experts. The SSPD has the right to assist to meetings of the commission, but has no vote. Decisions are taken by simple majority, and no ministry has veto power. At least theoretically, the experts in the commission therefore have a majority. However, the experts hold political posts too. They

are designated by the President of Colombia for a period of four years—just as the President. Also, as Krause (2009: 113) noted, there are no legal requirements concerning the professional background or experience of these experts, and the President can remove them from office without having to explain reasons for the removal. This is also the case, of course, for the Ministers and the Director from the DNP sitting in the commission. Note moreover that the CRA does not involve other interests such as users or the private sector. The potential scope for political influence on regulatory decisions in Colombia is thus quite high. The problem may however not be so acute, as noted by Krause (2009: 115), since the political interests with highest stakes in influencing regulatory decisions are the mayors at local level, and they have only limited possibilities to influence decisions at central level.

Concerning internal safeguards against corruption, article 44 of law 142 provides guidelines concerning conflicts of interests, rules for disqualification and for incompatibilities. Article 44.1 prohibits any person having some ties with the regulated industries from participating in the regulatory decision-making processes. Former employees of the regulated utilities are disqualified in article 44.2 from working for the regulator for a period of one year after having terminated their work for the utilities. Relatives of employees from a regulated firm are disqualified from working for the regulator as well. Article 44.3 relates to the prohibition of conflicts of interests for public officials and elected officials, for example resulting from economic interests in the regulated industry (excepted are mayors, governors or ministers in cases of joint ventures). Bribes and other forms of corrupt behavior (law 190 from 1995) are also subject to penal law. Sanctions include prison up to 8 years, monetary fines and exclusion from public offices up to 8 years. Moreover, all Colombian institutions have to implement a standardized system of internal documentation and control. The CRA also implemented trainings and workshops for their staff to make them aware of the legal consequences of misbehavior, their rights and obligations as public officials and the processes of internal audits.

Note however, as in many other countries around the world that Colombian laws and regulations are of high quality (*de jure*) while their *de facto* level of enforcement is unfortunately quite low, especially outside the central administration and the big cities. According to the Global Integrity Report 2009, Colombian anti-corruption laws are very strong, while the degree of their enforcement ranges from very weak to moderate. The same Report scores the civil service regulations overall as very weak. Also, the period of disqualification of one year appears quite low to effectively block revolving door practices. Nevertheless, interviews conducted at the CRA showed a high degree of commitment. The public officials working at the regulator are very well aware of their social role and perceive themselves primarily as protectors of user interests. The issue of corruption is not downplayed. For example, during the interviews it was reported that expensive watches were once sent to the regulatory experts for Christmas. But this was counterproductive—the watches were sent back and have rather augmented vigilance among the regulators. Interestingly, in regulatory daily praxis at the water regulator, it has become an informal rule to never be alone during contacts with managers from regulated utilities although there does not exist any written rule requiring this. Visits to regulated utilities are therefore always undertaken in teams. This shows a sensitization of regulatory staff to the issue of corruption, but at the same time points out that the internal measures preventing corruption may not

be sufficient. It was reported that the CRA will start implementing a risk management system based on internal audit reports in 2010. This will be an important step forward.

It should be mentioned that consultants working on a contractual basis for the regulatory agency escape the regulations applicable to public officials. In particular, these external consultants can switch from the regulator to the regulated industry and vice-versa without any time constraints. This of course may create problems since such consultants depend financially both on the regulated sector and the regulator. They may thus have an incentive to avoid critical recommendations vis-à-vis the regulated utilities or may even influence regulatory decisions in favor of the interests of the regulated utilities. The potential problem is not negligible: the proportion of public officials is relatively small, while there are a relatively high number of consultants working for the CRA. The ratio of consultants to public officials at the time the interviews were conducted in 2008 was 43/45. An anti-corruption strategy at the level of the regulatory agency has to consider the role played by these consultants.

### **1.2.2 Accountability Framework**

With respect to transparency, it is important to note that Colombian water tariff regulation relies strongly on the costs of services. This approach gives a high strategic value to cost information reported to the regulator by the utilities. They may provide information to the regulator in a way that favors their interests, which is just another, subtle, way of capturing the regulatory process. And indeed, according to an interview, a major problem encountered by the regulator in Colombia is that when asking for data, utilities tend to 'tailor' the information favoring their own interests. For example, depending on the nature of the information requested, a regulated utility may declare higher or lower costs.

To deal with the problem of regulated utilities tailoring information in urban areas, the so-called Unique System of Information (*Sistema Unico de Información, SUI*) was implemented. The system is under the responsibility of the SSPD. In this system, the regulated utilities have to complete standardized forms concerning technical and accounting details and data. Detailed information is available online to all public entities involved in public service sector regulation, and is also accessible to governmental control agencies, such as the Supreme Audit Institution, for instance, and to user committees at municipal level (*Comités de Desarrollo y Control Social de los Servicios públicos Domiciliarios*). Other users and interested parties can access aggregated reports on the SUI website.

This system of information certainly presents some advantages for efficient information management and reduces the arbitrariness of provided information by the regulated utilities, since the utility ex ante, does not know for what purpose the information will be used. It facilitates control by the SSPD and users and mitigates the problem of asymmetric information. However, the information is still provided by the utilities and of course it cannot be ruled out that it is manipulated. Also, side-agreements with public officials working for the SUI are not excludable. Corruption would in this centralized system, have a tremendous impact at various levels. The high stakes in manipulation of information may increase the incentives to actually try to abuse the system. Therefore, it becomes important to think of additional anti-corruption strategies in such settings.

Remember also the huge number of utilities providing water services in Colombia. Beside the immense effort (and related costs) of controlling all regulated entities, the smallest providers in rural municipalities often do not even have adequate cost accounting, which renders effective control almost impossible. For these smaller providers it is often impossible to provide the information required by the SUI. Of course, such a situation impedes accountability and opens scope for corruption. It is thus important to increase the knowledge of local entities and develop their capacities to manage information through continuing training. Currently, efforts are also being undertaken to develop a simplified version of the SUI for smaller providers.

There are other aspects that could potentially improve transparency in the sector such as the regular reports of the CRA and SSPD to the control agencies and the general public. The websites of both the CRA and the SSPD could be more user-friendly, though. For benchmarks and reports to become effective, they must be publicized and brought into the public debate in order to exert some type of pressure or social sanction. This is not yet happening.

With respect to user participation in regulatory decision-making processes and water service delivery in general, two aspects have to be highlighted: firstly the user committees at municipal level; and secondly, processes that aim at increasing user participation in decision-making through regulatory hearing both in Bogotá and in other cities.

At local level, the Law 142 stipulates that there must be at least one user committee in every municipality. But implementation lags behind. The most recent figure we could get is reported by Krause (2009: 111) and dates from 2005 where there were 632 committees active in the water sector. According to the Colombian Department of Statistics (DANE), there are currently 1099 municipalities in Colombia. The members of the user committees do not receive payments for this work and will be active for two years. The number of users in these commissions is defined by dividing the population of the respective municipality by 10.000, but at minimum there must be 50 users. Their tasks are to participate in controlling the utilities, help users in voicing complaints, and monitor the socio-economic stratification for the cross-subsidies. An elected representative of the user committees can assist at board meetings of public utilities. Interestingly, however, user committees cannot assist board meetings of utilities with mixed-ownership. This raises the legitimate question of why this shouldn't be allowed as well, for whether it is public or private, the point is that utilities provide a public service. The SSPD provides technical support, training, and access to the detailed data gathered by the SUI. Nevertheless, Krause (2009: 111) estimates that these committees have little significant impact beyond assisting users in filling complaints. The critical monitoring of the cross-subsidy scheme is far beyond their capabilities, since they lack the necessary legal and accounting knowledge, and do not have access to the internal cost-information of the providers.

On national level, the Constitutional Court, in its sentence C-150 from 2003, highlighted the importance of direct participation of users of public service sectors in the process of adopting new regulations. The decree 2696 from 2004 stipulates minimum requisites for achieving such participation in national regulatory processes. Information regarding laws and regulations, the names of the commissioned experts, and administrative processes and

deadlines, has to be made publicly available. Information is published on the internet, but can also be mailed to interested persons upon request. Additionally, the CRA implemented a process of public participation in all regulatory decisions. Proposals of changes in regulatory issues have to be made public in advance permitting to formulate concerns, questions and commentaries. Currently these proposals have to be publicized at least 30 days before a decision can be made. The CRA has to collect, sort and analyze each entry, and has to comment on each input within a determined delay. Experts also visit municipalities and organize public hearings where they present regulatory proposals and receive comments. These, again, have to be considered in the internal decision-making process. It is however not easy to know whether or to what extent this participation really influenced decisions. During interviews at CRA in 2006 it was mentioned that there is, in fact, little active participation during these hearings. Krause (2009: 112) mentions that while water utilities indeed use these public hearings to discuss technical details and influence regulations, he concludes that the user committees, or other users attending these hearings, actually do not have the necessary legal, technical, and economic capacity to effectively participate.

To conclude, the Colombian approach to managing information (SUI) and to fostering participation of users in regulation are interesting steps forward towards improving transparency and accountability—particularly considering the large proportion of informal providers who are thereby enabled to make comments and to call attention to their particular problems that would otherwise remain unknown. However, regarding user participation, it remains questionable whether it is an example of real ‘participation’, or only ‘consultation’. Participation would require that user groups (and other stakeholders) are officially included in regulatory decision-making, for example, by giving them a place in the regulatory commission and thus the possibility to assist meetings between regulators and regulated utilities. They must also have the capacity to really defend their interests.

And the potential of effective user participation is huge. Krause (2009: 174) carried out case studies in four Colombian cities; Manizales, Tunja, Villavicencio, and Santa Marta. Amongst others, he assessed the local governance dimensions of civil society participation, security situation, and corrupt practices. He finds that Manizales, the city with the strongest organized civil society, paired with an “entrepreneurial policy” tradition, is also the best performing city and has apparently also almost no problems with clientelism and corruption.

### **1.3 Zambia**

Compared with other countries in Sub-Sahara Africa, Zambia is highly urbanized with more than 40% of the population living in urban areas. Just as Colombia, the country has abundant water resources, but safe drinking water only reaches around 47% of the urban population and more than half of the urban population has no access to adequate sanitation.

Beginning in the early 1990s, the water sector in Zambia underwent profound reforms that completely, but slowly and incrementally, changed the institutional structure of water and sanitation services (see NWASCO, 2004, and Kayaga/Franceys, 2008). At the very heart of the reforms were the commercialization of urban water utilities and the introduction of a regulatory institution for urban utilities only, the National Water Supply & Sanitation Council

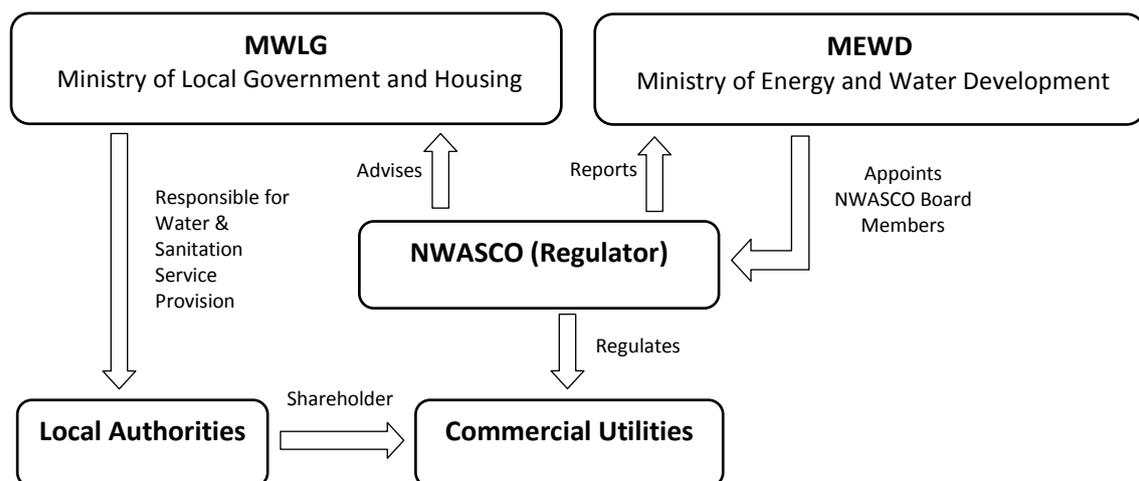
(NWASCO). The commercial utilities are however not privatized; they are still owned by the Local Authorities as shareholder.

### 1.3.1 Organizational Design

There are two key aspects in the Zambian regulatory system fostering the independence of the regulator from political interference. Firstly, water services and sanitation are responsibility of the Ministry of Local Government and Housing (MLGH) at central level and of the Local Authorities at the level of the municipalities. The reforms however chose to place the regulatory agency, NWASCO, under the Ministry of Energy and Water Development (MEWD). It is the MEWD that appoints the board members of NWASCO and it is through this ministry that NWASCO reports to parliament.

Situating the regulator outside of the responsible ministry ensured a clear separation between policy and regulatory functions and enables NWASCO to keep distance from the instances it regulates. Indeed, the Ministry of Local Government (MWLG) is present in water provision through the Local Authorities being shareholders of the commercial utilities. The experience to date shows that this scheme is essential to secure the independence of regulator, NWASCO. The energy regulator and the telecommunication regulator, in turn, are placed under their respective responsible ministries and indeed do not appear to work as independently and effectively as NWASCO.

But this scheme has also created tensions between both ministries since MLGH feels the involvement of the other ministry as interference into own affairs; particularly because the other ministry is also related to water. These tensions are a permanent threat to NWASCO’s independence and constitute a risk to what have been achieved so far. Arguably, it could have been a better option to have NWASCO report directly to parliament, or through the ministry of finance, and not through MEWD.



**Figure 2 Organization of Water Sector Regulation in Zambia**

Source: Author

Secondly, expenditures of NWASCO are covered through license fees of 2% of the commercial utilities' turnover. These fees cover most of the costs of the regulator's operation with the remainder being covered by donor funds. Through the license fee, NWASCO's independence is strengthened as it is shielded from political interference through the threat of budget cuts.

The *internal* structure and rules of NWASCO are also designed in a way to secure its independence. As mentioned before, NWASCO Board Members are appointed by the Ministry of Energy and Water Development, which has no political stake in water and sewerage service provision. In addition, the NWASCO Board is composed in a way that represents different interests involved in the water sector. In contrast to the Colombian regulatory commission, the Board of NWASCO also has to include representatives from the users and the private sector as well as a representative of the two ministries, MLGH and the MEWD. This composition in itself makes capture of the board more difficult: the more interests involved, the more difficult it becomes for one interest to influence decisions made by the governing board.

Also, board members do not depend financially on their position on the board. Although they are paid, one board member observed during the interview that actually their opportunity costs for assisting board meetings are higher than what they are getting paid for their board position. Indeed, they have other jobs, either in government or in the private sector and time spent at NWASCO is time they have lost in their 'normal' position. Therefore it is less likely that a board member will sell votes for financial reasons or will cede independence because of pressure from the political side: he does not depend financially on this position.

But perhaps even more important from an anti-corruption perspective is that board members hold their positions largely because they actually want to, not because they are paid. Their intrinsic motivation to drive reforms further and to improve water and sewerage services is strong. Financial motives, i.e. external motivation, can merely be outbid; internal motivation in turn is much more difficult to undermine. During an interview, a board member stated that if faced with some irregularities related to the boards' decisions, he would resign – resigning would have no adverse financial impact for him.

Various aspects help to mitigate capture of NWASCO staff members, or experts. First of all, they are recruited through transparent processes in the market, and their salaries are comparable to well-performing private sector firms.<sup>3</sup> Differentiated payment schemes in public administration for higher-risk positions such as procurement officials or regulators are controversial among anti-corruption practitioners. On the one hand differentiated payment may reduce corruption risks through raising the opportunity cost of getting fired in case of detection and by making corruption more costly, since bribes are likely to have to be higher. But in countries where corruption and especially impunity is widespread, it is questionable whether this strategy in itself is a good way to fight corruption. Of course, salaries that

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<sup>3</sup> Without reaching salaries as high as those paid by the energy regulator, which rather are raising the question if this high salary may not rather compensate staff for their lack of political independency in their decisions.

enable staff to live decently are also an issue of human rights and not only of anti-corruption. On the other hand, differentiated schemes may lead to envy and demotivation of other public officials.

Just as for the board members, it is interesting to look into issues that may help raise the intrinsic motivation of the staff to do a good job. While fair payment is one aspect, it is noteworthy that, just as in the Colombian case, NWASCO has a lean structure with only 16 staff members. This appears to stimulate a sense of ownership and pride of belonging to the regulator. The experts are very well aware of their crucial role for the sector's efficiency and effectiveness in service delivery, and the strong pro-poor orientation of NWASCO further helps in strengthening the social value of the experts' job. The independence from political interference given to them by the design of the regulatory framework as described above is something they are proud of and ready to preserve. The relative success of the Zambian regulatory approach has led NWASCO to become a role model for other regulators in Sub-Saharan Africa, coming along with invitations to conferences to share their knowledge and visits from foreign delegations with the aim to learn from the Zambian experience. This also helped in developing a strong sense of honor of being part of this institution. Finally, internal awards and trainings further foster the motivation of the staff.

To conclude it can be safely stated that both board members and staff are quite independent in their positions. The highest risk in Zambia is pressure exerted from the political side, since private sector interests are (almost) absent from the sector. Opportunities for such pressure are, however, reduced to a minimum by the measures introduced. Not at least, it can be argued that the relatively strong financial and technical support by donors, mainly by Ireland, Germany, and later Denmark, also helped in shielding NWASCO from political interference. The actual importance of this external factor and the sustainability of the institutional reforms achieved will be tested when foreign assistance will withdraw little by little their support to NWASCO. Hopefully, the checks and balances introduced by reforms will protect the institutional system.

For this reason, the accountability framework as discussed in the next section may be the key to safeguard what have been achieved so far at the organizational level, and enable effective bottom-up resilience to arbitrary intents to change the policies from the top.

### **1.3.2 Accountability Framework**

The lean structure is also applied to rules and procedures. Zambia opted for a very simple and clear regulation by inserting standards contained in the service licenses provided to commercial utilities for a ten-year period. These transparent, simple and clear procedures limit the scope for discretion and abuse through regulatory decisions. Also, all decisions are publicly available, even board meeting notes can be made available upon request.

NWASCO is very well aware of the importance of the media as a pressure group in favor of good regulation. In order to enhance media coverage on water issues, and to increase the quality of media reports, NWASCO has a public relations officer whose main task is to foster media attention and provide journalists with information and advices. The interviews

revealed that the media have gained confidence in NWASCO and now sometimes even ask NWASCO to check the technical accuracy of information before publishing an article in press. As reported by GTZ (2006), transparency in regulating water tariffs was improved under the new tariff model which gives less discretionary power to the regulator and makes tariff adjustments more predictable for the commercial utilities. Water users have to be involved in the tariff adjustment process. Indeed, commercial utilities have to hold consultative meetings with users before applying for tariff adjustments. These meetings also receive significant coverage by the media. The minutes of these consultations are an integral part of the proposal for tariff adjustment submitted to NWASCO. This participation of users and the open discussion of water tariffs limit the risks of capture and the politicization of water tariffs.

But the main regulatory instrument for transparency and accountability is the annual report of NWASCO. There, the performance of the CUs is assessed, benchmarked and published in a very simple way using red, yellow and green light to signal the level of compliance with the regulatory standards. Thanks to this simplicity and the good working relations with journalists, the reports receive a strong coverage by the media and include vivid discussions. This assures that benchmarking does not remain unobserved and introduces some kind of competitive pressure between commercial utilities despite their monopolistic. From an accountability perspective, this media attention provides some social sanction to bad performers. Consumers, but also shareholders of commercial utilities and other stakeholders, question what is not working well and why performance cannot be improved. This pressure, in turn, is not only an important driving force for efficiency but also reduces the scope for corruption by putting a stronger focus on the efficient use of available resources.

Of course, the effectiveness of this exercise depends strongly on the quality of information provided. And unfortunately this is perhaps the weakest point in Zambian regulation. Although the quality of underlying data was improved with the introduction of the NWASCO Information System (NIS), the lack of capacities and perhaps political will at the level of commercial utilities implies that the accuracy of the information provided to the regulator may be compromised. Indeed, accountancy is still a major problem in commercial utilities, which creates space for discretion, abuse of funds and manipulation of the information provided to NWASCO. The flipside of NWASCO's lean structure is that an in-depth verification of the information provided by the utilities is not possible. Due to this important problem, the pressure exerted through the benchmarking may not only lead to positive outcomes but may increase the incentives for manipulating or hiding information.

Unfortunately organized civil society is not very active in the Zambian water sector. In order to foster the participation of users in sector, NWASCO therefore created Water Watch Groups (WWG) at community levels in order to establish a direct link between regulation and users (NWASCO, 2004). These WWG are somehow mediators between commercial utilities and users. They are composed of volunteers who educate users on their rights and obligations, and also assist users to resolve complaints vis-à-vis their service provider. Moreover, the WWG provide feedback directly to NWASCO about these activities. Without a doubt, the WWG helped in facilitating and resolving complaints within reasonable time

periods. Complaints are now increasingly taken serious by the commercial utilities. Arguably, this also helped reduce petty corruption in the sector, such as paying for connections or repairs or fraud by users who manipulate meters. For instance, it is quite common to pay for a connection to the electricity grid, while this type of bribe is almost absent for water connections. One possible explanation is that complaints in the water sector are effectively treated while this is not the case in the electricity sector.

Another weak point with respect to corruption in the water sector is at the level of the commercial utilities—particularly the political abuse of the board for ‘political engineering’, as one interview partner framed it, as well as misuse of funds and assets for private purposes. Although corruption within utilities and water service provision are outside the scope of this paper, it is interesting to see what the regulator has done to limit the problem. On the one hand, NWASCO introduced guidelines for good corporate governance making the different roles of the board and the management clear. Indeed, many of the problems arising in the utilities can be explained by an unclear division of labor and responsibilities, enabling board members of the utilities to interfere in day-to-day management of utilities, use utility resources for private gains, or schedule as many board meetings as possible perhaps in nice locations, in order to pocket the sitting allowances.

On the other hand, NWASCO also tries to foster sound accounting techniques in commercial utilities. For instance, accountants at utilities theoretically have to be accredited at the Zambian Institute of Chartered Accountants (ZICA) and are required to use robot accounting systems. Also, utilities must be audited by external agencies. However, interviews showed that both measures are not effectively enforced. Many accounting departments in the utilities are still very weak, and are not able to pay for qualified accountants. And for the good ones staying in badly paid positions, one may ask why they do so. In addition, external audits are not a panacea. In the worst case even external audit reports can be bought. One interview partner highlighted that external audits may be rather “blinding”, suggesting a false impression of compliance with standards and due processes.

Regarding sanctions, NWASCO’s approach is pragmatic: if irregularities at utility level are reported or detected, the hint being usually weak performance results, then NWASCO issues a directive to the utility. The next steps would be a Special Regulatory Supervision (SRS), where NWASCO increases the monitoring of the utility’s management and can assist utility board meetings in order to see how internal decisions are taken. The ultimate sanction that NWASCO can apply is the suspension of the license which would lead to the dissolution of the board (Mbilina, 2007). These measures provide some checks to abuses of the powers conferred to the utility board especially by Local Authorities. However, it seems that the problem of political interference in commercial utilities still remains and may even have increased during the last years.

## LESSONS LEARNT

This paper reviewed the concept of regulatory capture from the perspective of what can be done to limit it based on a risk analysis. It presented an array of measures to reduce different types of corruption in regulatory processes, preventing capture and ultimately safeguarding the independence, effectiveness and efficiency of regulation. It then presented two country cases and examined regulatory processes through an anti-corruption lens.

The bottom line and the answer to this papers' question is that there is no anti-corruption agenda in regulation, at least not an explicit agenda. However, many of the measures introduced in order to safeguard the independence of the regulator implicitly deal with risks of corruption. Interviews also showed, especially in Zambia, that implicitly the issue of corruption was kept in mind at the time reforms were designed. The analysis helped to identify some lessons learned and gaps, that may assist in framing informed reform options. The first lesson is that the anti-corruption lens helps in shedding light on weak spots of regulation. The 'criminal' look at processes and the admittedly slightly cynical and paranoiac view leads to asking questions focusing on central issues and critical problems. For example, problems that were attributed to lack of capacities or ominous resistance to obviously 'good' reforms often actually can be attributed to governance failures or corruption.

The second lesson can be learned from Zambia. Reforms that have been introduced are encountering threats from changing political agendas. While this is not path-breaking news, it highlights the importance of promoting dynamics that reduce these threats. This can best be achieved by integrating as many interests and checks and balances as possible into the system. Multi-stakeholder initiatives involving government, private sector, civil society, but also foreign driving forces such as bilateral and multilateral donors, help in binding the hands of corruption and raising the costs of inverting the path of reform.

The Zambian experience also shows that good regulation and progress are possible even in corrupt environments. The key to this success can be identified in the use of a simple framework that is easily understood by all stakeholders in the sector. Also, the power of data and information being made public cannot be overly emphasized. Here, both Zambia and Colombia are in a sense more advanced than regulators in many industrialized countries. In Colombia, however, there is still scope for better use of the available information, especially by the media. Again, building coalitions with other stakeholders such as users, media and possibly donors are important to shield the regulator from blatant capture and abuse.

Furthermore, good quality regulation has an important role to play in mitigating corruption risks at various levels in the whole sector. For instance, regulation can mimic the pressure normally exerted by the forces of competition. The benchmarking in Zambia leads to ask why certain utilities underperform despite operating in basically the same environment—although there are of course complaints by utilities that the benchmarks are arbitrary and do not take into account important differences among utilities. Nevertheless, even this debate would not happen without the benchmarks: It leads to the necessity to *explain* or, in other words, to be accountable for the services utilities provide or fail to provide efficiently.

Also, the involvement of users in regulatory processes and the monitoring of the handling of user complaints by the utilities are likely to have reduced the scope for petty corruption related to connections and repair work. Indeed, the experience in Zambia and the case study findings from Krause (2009), point to the huge potential of having well organized and strong user participation on local levels. In Colombia, the case of Manizales reported by Krause (2009) also points to the benefits of strong user participation.

Although not really new neither, the tremendous importance of good quality data must be highlighted. The heart of the job of a regulator is to know the sector it regulates as good as possible. In Zambia, the mere presence of the regulator and his analytical work on the sector has clearly helped in shedding light—that is, information—on areas that were previously covered by a veil of opaqueness and silence conducive to corruption. The information needed for regulation is also required for a better management and accountability of utilities towards users. However, it is important that the regulator shares the information with the public in a way that can be used. If not, it may be just a matter of time until a new corrupt equilibrium finds its place between utilities and regulators, or among utilities, politicians and regulator. The costs again will be carried by the users, and especially the poor.

A further important lesson that can be learned both from the Zambian and Colombian case is that small but highly professional agencies seem to foster the intrinsic motivation of the staff. In turn, the role of such intrinsic motivation cannot be overstated when it comes to its anti-corruption effects. While the efficacy of higher salaries alone are rather mixed (the briber can always outbid the salary anyway), a strong sense of integrity and the social importance of the work carried out, together with a fair remuneration, may be one of the strongest shields against capture.

But the analysis also showed that the absence of an explicit anti-corruption agenda could be the reason why more targeted measures are lacking both in Zambia and Colombia. We miss an effective system to deal with hints by whistleblowers and their protection, for example, by giving them the possibility to denounce anonymously. A regulator discovering a corruption case may fear to speak out openly about it, especially when colleagues may be part of the deal. But since corruption is an insider deal, especially at the higher levels considered here, we desperately need a way to collect such insider information, either by casual witnesses, or corrupt partners themselves that for whatever motives decide to behave opportunistically and denounce the others.

In addition, after experiences such as the ENRON case, it is obvious that traditional cost auditing may not be enough to discover fraudulent accounting practices due to the almost endless creativity of the perpetrators navigating between legal loopholes and illegal ways to manipulate information. Training in forensic accounting for regulators or the announcement of periodic, random, forensic auditing of books could help in raising the costs of fraud to the regulated utility.

Finally we wish to highlight again that the present paper has an exploratory character. The future research agenda is to develop a set of de jure and de facto criteria in order to assess

the status quo of regulatory frameworks in more countries, for example through a questionnaire that can be sent to different stakeholders of regulation. Such indicators could then be used to inform reforms and to measure progress. They could help us in improving our understanding of what works and what doesn't work, and why, in our struggle against corruption.

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