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Geneva, 25–26 February 2013

**Report of the Multi-year Expert Meeting on
Trade, Services and Development on its first
session**

Held at the Palais des Nations, Geneva, on 25 and 26 February 2013

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I. Chair's summary

A. Opening statements

1. Opening the meeting, the Deputy Secretary-General of UNCTAD said that the Doha Mandate called on UNCTAD to continue its work on services. Such work included providing assistance to policymakers and regulators in developing countries in meeting the challenges of regulating the infrastructure services sector (ISS), comprising the following segments: energy, telecommunications, water, transport and financial services. Good infrastructure services supported the development of all sectors of the economy, including the services sector. As ISS was a major catalyst of countries' social efforts and a tool for the achievement of the Millennium Development Goals (MDGs), it was essential that a critical assessment be carried out to determine whether ISS had been sufficiently leveraged towards the achievement of the those Goals, and what role it could play in helping achieve post-2015 sustainable development goals.

2. Reaping the potential economic and social benefits of ISS would not be possible without the parallel development of targeted, effective measures and sound regulatory and institutional frameworks to underpin a healthy operation of the sector while addressing multiple public policy goals. UNCTAD research and the past cycle of multi-year expert meetings had confirmed that regulatory parameters should be tailored to specific sectoral and local conditions. In this light, the sharing of examples of good practices and lessons learned should prove to be useful. He encouraged participants to propose specific ideas for policymakers and regulators, particularly those in developing and least developed countries, as they took steps to build regulatory and institutional capacities and improve the quality of their infrastructure services.

3. The Director of the Division on International Trade in Goods and Services, and Commodities introduced the note of the secretariat (TD/B/C.I/MEM.4/2) and outlined the main issues for deliberations in respect of attracting and sustaining investment; benchmarking performance, regulation and innovation; ensuring universal access and enabling institutional frameworks.

B. Attracting and sustaining investment through enabling regulations and institutions

4. Participants said that there was a large investment gap, as demand tended to grow faster than governments' abilities to finance the expansion of supply capacity. Private investment had increasingly become an important mode of financing. Various options to bridge the global investment gap included foreign investment, public-private partnerships, innovative funding mechanisms such as project bonds, and regional integration to share the same infrastructure.

5. Promoting competition through liberalization and privatization, supported by the establishment of an independent regulatory agency, was a common approach of many countries. In Turkey, steady economic growth since 2001 had boosted demand for energy, necessitating the expansion of energy supply capacity. Turkey had resorted to promoting competition by liberalizing the generation, wholesale and distribution segments, while maintaining a monopoly in transmission. The country had started to liberalize in 2001 with the establishment of the Energy Market Regulatory Authority, followed by the privatization of public companies and unbundling of the industry. This had led to increased private participation and investment in the liberalized segments. The development of generation

and wholesale markets had enabled transactions at market prices, allowing cost recovery (to reflect higher oil and gas prices).

6. Greater investment to diversify energy sources and ensure a sustainable energy supply was pursued through a variety of instruments in Turkey. Partial purchase guarantees at predetermined price were used to promote the development of nuclear energy. The country had also sought to increase the use of renewable energy in power generation by using feed-in tariffs, including extra feed-in guarantees for the use of domestically manufactured generation equipment.

7. While some experts recognized there was a general case for introducing competition in the formerly monopolistic ISS, others maintained that privatization was not an end but a means to an end, and not the only means. In this regard, a set of criteria could be useful in deciding whether to keep an ISS public or to privatize it:

- (a) Whether the private company had the best management capabilities;
- (b) Whether the State retained the ability to discipline or regulate the sector;
- (c) Whether privatization was the best way to access capital;
- (d) How risks were allocated between the private company and the government;
- (e) Whether the regulator had the ability to design and implement adequate incentives to achieve public policy objectives;
- (f) Whether the reform would be financially and socially sustainable;
- (g) Whether the regulator had the capacity to manage post-privatization politics in the sector;
- (h) Whether there was a conflict of interest between maximizing the treasury and the public interest in the sector;
- (i) Whether privatization would effectively introduce competition;
- (j) What skills were required in the sector – entrepreneurship and risk taking were common only to private companies.

8. Since the role of States had been transformed from one of services providers to one of regulators, building enabling institutional and regulatory frameworks had become important in underpinning competition and meeting multiple public policy objectives. In particular, ensuring regulatory coherence between sector-specific regulatory agencies and competition authorities had proved to be a salient issue. In Germany, an independent, regulatory body governing multiple sectors – Bundesnetzagentur – played a pivotal role in ex ante regulation, including pricing, of access to the network segment, namely transmission and distribution, to ensure effective competition. The body was responsible for network access. Ex post competition regulations were ensured by a competition agency. Its independence and neutrality were underwritten by a legal mandate, a separate budget allocation, a transparency obligation, a court-like regulatory process and autonomy in implementation. The body was also in charge of a network plan.

9. Peru provided a unique model in the regulation of ISS, especially in the protection and promotion of competition, including intellectual property issues, and in consumer interest. The National Institute for the Defence of Competition and the Protection of Intellectual Property, commonly known by its Spanish acronym INDECOPI, was a competition regulatory body, conducting ex post regulation with full legal and budgetary autonomy. Its relationship with sectoral regulatory agencies was governed by the principle of additionality, so that in the event of conflict, regulatory agencies prevailed (except for

the telecommunication sector, where a sector-specific regulatory agency also served as a competition agency).

10. In Australia, ongoing regulatory reform efforts in respect to heavy vehicles, rail safety and maritime transport were expected to generate savings benefits. While Australia had inherited a complex system of regulatory overlays, the number of regulators in the country had been steadily decreasing over the past several years. A reduction in the total number of regional and local regulators (500) to 4 larger regulatory bodies had been achieved. Involving the industry in discussions at each stage of development and decision-making was a key to success. It was also important for regulations to move from prescription to performance.

11. Public-private partnerships had risen in prominence as a result of governments seeking to bring innovative technical and managerial solutions to traditional public procurement without changing ownership, and to bring private capital to finance infrastructure projects. Effectively managing public-private partnerships was a key challenge. For instance, findings from the research presented to the meeting suggested that strong legal institutions and efficient regulatory processes, well-prepared infrastructure projects and sound contract regulations were among the key factors in attracting successful infrastructure investment. Between 1985 and 2004, some 30 per cent of contracts awarded in Latin America, particularly for water and transportation, had required renegotiations, even when the contracts had resulted from competitive bidding. Sound regulatory and institutional frameworks dealing with project preparation, negotiations and evaluations were important in reducing the incidence of contract renegotiations. Regulations proved to be particularly effective when embedded in contracts. Output-based contracts, such as those using performance benchmarks, could prove to be a better framework for contract management and execution.

12. In Italy, to give further impulse to public-private partnerships in ISS, special tax treatment had been introduced to facilitate the issuance and placement of bonds and other debt by companies involved in ISS projects. This included a deduction of the interest rate received from the underwriter and treatment of interest paid by the contract holder on the project bonds as interest paid on bank financing. The new regulation also sought to address infrastructure financing through tax reimbursement. Such reimbursement was to be extended to all infrastructure projects under public-private partnerships, including railway networks and airport infrastructure not covered by the existing scheme. For infrastructure projects without such fiscal support, a reimbursement of one third of the new income taxes generated by such works would be provided to the contract holder and the project company.

13. Regional integration was a means of encouraging investment to deal with increased energy demand and energy security goals. In Turkey, regional cooperation had been explored to optimize energy supply by building established cross-border electricity connections with neighbouring countries.

C. Benchmarking performance of the infrastructure services sector

14. Benchmarking performance in ISS had become common, as incentive regulation was being increasingly adopted towards achieving progressive liberalization and privatization. Countries had turned to benchmarking to improve service quality, enhance accountability and improve overall efficiency, including State-owned enterprises and public-private partnerships. According to one expert, benchmarking could be defined as the process of improving performance by a systematic comparison of performance metrics with reference standards. Its benefits lay in giving operators incentives to be efficient and innovative, improve quality of services, enable a fairer recovery of costs and increase transparency. Regulators had used benchmarking mainly for setting prices, measuring

quality of service and improving the performance of firms, while operators had also applied the method to improve performance and reduce costs. Benchmarking performance required countries to overcome information asymmetry, monitor and compare performance, set targets, detect inefficiencies and identify best practices.

15. In computing the performance matrix, it was critical to assess explanatory factors that justified the performance level attained, such as market structure, and historical, social, environmental, regulatory and local factors. For instance, research presented to the meeting suggested that the relative performance of railway services, as measured by a composite index comprised of intensity of use, quality of services and safety, was correlated with the amount of public subsidies and investment in infrastructure, not with the governance structure (unbundled or not) or the level of market liberalization. Benchmarking also involved setting the reference values against which performance would be measured and which should correspond to best practices in the market. Ensuring data reliability and accuracy, including through auditing, was critical, and a major challenge.

16. The analysis for benchmarking could prove to be complex. Care would be needed to compare the “comparables” and control the sensitivity of measurement to various factors, for instance the ownership structure of firms. Several experts were of the view that when it came to benchmarking the performance of operators, in principle no distinction should be made between private and public operators. Applying the same benchmarks to public and private enterprises might not be adequate, as cost structure, incentives and the accounting system concerned could differ. While those benchmarks might indeed operate in different frameworks, optimal performance in the provision of public services should be the ultimate goal.

17. One expert highlighted the importance of conceptualizing performance, as infrastructure could be understood as a complex social and technical system. A critical aspect of benchmarking was being cognizant of what was being measured, namely the performance of the system or that of specific actors. While ISS might be unbundled, all segments of the sector functioned as a system in which various technologies, institutions and actors interacted and affected overall performance. Thus, sector performance should be seen as the result of the governance of the system or the interplay of many actors. Regulation aimed at particular actors could have a perverse impact on the entire system’s performance.

18. Severe constraints, such as the lack of data-collecting capacity, expertise, experience and domestic market/sector knowledge remained key challenges, particularly in developing countries. In Mali, the Electricity and Water Commission had developed a set of functional criteria for benchmarking the performance of service providers drawing on the experience of other regulators, in particular the African Forum for Utility Regulators, in setting quality of service standards as well as minimum criteria for minimum service levels. The guidelines addressed regulatory information and accounting requirements needed for performance benchmarking. As such requirements were implemented as part of the licensing conditions, they were mandatory and had force of law. The information collected allowed the regulator to verify the achievement of regulatory objectives and investigate operator compliance with contractual obligations.

19. In several member States of the Economic Community of West African States (ECOWAS) – where a State monopoly existed – it was difficult to employ benchmarking measures at the national level. However, comparing the performance of vertically integrated State-owned enterprises at the regional level had proved to be a solution to the difficulties associated with national benchmarking. The unavailability of data was an obstacle to effective benchmarking, which partly stemmed from the historic presence of State monopolies hesitant to divulge data. An effective means of tackling the problem was to make it a licensing requirement for national operators to provide the relevant data to the

regulators. Information asymmetry was another challenge. Frequently, a lack of access to information technology infrastructure was yet another constraint. For regional comparison, a fourth challenge related to the diverse development and conditions among ECOWAS members, which made cross-country comparisons difficult.

20. To overcome such capacity shortcomings, all forms of cooperation – both at North–South and South–South levels – were needed to promote networking and knowledge sharing, support capacity-building and encourage the dissemination of best practices.

D. Stimulating innovation and adapting regulation to changing markets

21. A key function of regulation was to create an environment that enabled innovation in ISS and to adapt services to the changing needs of markets and consumers. Since innovation could significantly alter the way in which infrastructure services were provided, regulators should keep abreast of technological and market developments in order to continue to provide the adequate regulatory framework. This bidirectional relationship between innovation and regulation called for significant attention.

22. One speaker said that innovation did not take place naturally in regulated utilities for several reasons, including because they tended to minimize risk rather than to maximize profits, which tended to be the case with private entities. Moreover, regulated companies tended to be protective of their revenue streams. It might therefore be difficult to expect them to champion public policy objectives such as energy efficiency, as reduced energy consumption would inevitably reduce a company's revenues. Regulators had used rate payers' funds to promote innovation, which, however, tended to be specific and narrowly focused. Such innovations tended to focus on the interests of their constituency. If utility incentives were insufficient or difficult to implement, an alternative could be to open the market to competition and allow entrepreneurs with more appetite for risk to enter the market.

23. The case in point was the relative lack of interest of some regulated operators in smart metres. They might not be interested in investing into smart metres, unless a more accelerated depreciation schedule was agreed, given that their technological life was considered shorter than their physical life. However, regulators would question whether it was appropriate to socialize the risks associated with innovation if their benefits were privatized. If regulation tended to be an inhibition to innovation by creating risk-adverse entities, several steps could be taken to counter this, such as creating incentives for innovation by allowing providers and consumers to benefit from shared savings, and setting productivity expectations by using the revenue-cap pricing method. Several criteria could be used to determine optimal regulatory incentives, as opposed to subsidies. For example, regulatory incentives should be competitively neutral and of a short-term nature, with a deadline to end the incentives in the absence of expected innovation.

24. Experts observed that difficulty in adapting regulations to innovation and markets had been demonstrated in the financial services area. Financial innovations emerged as a result of developments in financial theory, technological innovation and statistical tools, which led to transformations in risk management and pricing techniques, giving rise in turn to a range of new financial products. The financial sector developed new innovative derivative products, including securitization and structured products, which allowed banks to transfer liabilities off the balance sheet, and allowed them to increase leverage and take greater risks. These new products were largely unregulated, partially owing to mismatches in regulatory governance and to the extreme complexities of those products, which made adequate pricing and risk assessment very difficult. A moral hazard problem was created also in the form of "too big or interconnected to fail" banks, which gave financial institutions an incentive to become bigger and thus take larger risks.

25. The growth of financial innovation, new products and financial engineering skills largely outpaced the adaptation of existing regulations, regulatory skills and regulatory institutions. Risks were thus externalized and cumulated in the financial system, creating systemic risks. Ongoing financial regulatory reforms at the national and international levels were aimed to ensure appropriate risk management to keep financial innovations under control. At stake was the design of a regulatory framework that would maintain the right balance between financial innovation and effective regulation, and internalize the risks and costs associated with innovation. This called for strengthening microprudential and macroprudential regulations, as well as institutional frameworks by broadening and aligning regulatory scope, such as for shadow banks.

E. Ensuring universal access

26. Universal access to infrastructure services remained an important public policy objective being pursued by regulators, and was directly relevant to MDGs, in particular poverty reduction. Universal access focused on availability, access and adaptability of services. Regulatory measures were required to extend the network to the unconnected and make such services more affordable to those already connected. Such measures had taken the form of allocating subsidies for the use of key infrastructure services to targeted consumers, such as the poor and rural households, subsidizing the production and distribution of such services and imposing statutory universal services obligations on services providers.

27. The experience of Bangladesh was illustrative of measures taken in support of universal service with respect to ISS. Universal access policies took the forms of development of infrastructure at the Government's initiative, subsidies for the poor and various incentive regulations involving the private sector. In financial services, the regulator (the Central Bank) maintained universal services regulations requiring domestic banks to build a certain number of branches in rural areas. Further, it allowed any customer to open a bank account at low cost, which increased the number of bank accounts accessible to the poor. In transport services, the Government was in charge of transport network development, including in rural areas. In telecommunications, the private sector played a key role in providing universal access, while the regulator had introduced a social obligation fund to finance universal access policies. For water, under government responsibility, 98 per cent of the population had access to improved water sources, which was achieved by the construction and use of hand pumps.

28. As regards electricity, universal access remained key, as only 53 per cent of the population in Bangladesh enjoyed access to that service. Private participation started in the generation segment, but the transmission and distribution segments were operated by State-owned enterprises. With the increased cost of power generation using imported oils, governments faced the challenge of increased subsidies. The Government sought to establish commercial power plants with the requirement that providers sell 30 per cent of the amount of electricity generated to the Government at a fixed price so that it could be provided to the poor at an affordable price.

29. In Latin America, the use of subsidies had required regulators to face a tradeoff between efficiency and social inclusion in the energy and water sectors. In those countries, research showed that general consumer subsidies were provided for energy (electricity and gas) while there was asymmetry in the level of consumption and access to energy. Such non-targeted subsidies could cause market distortions. A solution to the problem might be to use specific subsidies to promote energy efficiency and social inclusion.

30. As regards water, access to drinking water remained a key challenge in terms of inequality, as 70 per cent of those without access were indigenous people and/or poor.

Tariff policy components with regard to drinking water should include sustainability, efficiency and equity. To achieve social inclusion, investing in a mass transit infrastructure was indispensable.

31. Targeting subsidies in the energy sector could be a tool to promote universal access. Several experts said that well-established companies often benefited from these subsidies. For example, Kenya taxed kerosene at a lower level under the assumption that kerosene was primarily used by the poor as fuel. However, the primary beneficiaries of the subsidy proved to be large companies. In another example, while Kenya charged a lesser rate for entities that only used a subsistence level of energy, even large farmers benefited. It was therefore important to design subsidies in a way that intended benefits were indeed captured by the targeted groups.

32. As regards financial services, statutory provisions, such as those listed below, had been found on financial inclusion:

- (a) The requirement that the number of branches that a bank could be licensed to open was linked to the number of branches that the bank should open in rural areas;
- (b) Mandatory lending to small and medium-sized enterprises;
- (c) The obligation to provide a particular amount or percentage of a bank's credit (lending quotas) to low-cost housing for poor households;
- (d) A priority-sector lending policy such as agricultural loan commitments;
- (e) A scheme of different interest rates allowing loans at a much lower interest rate with easy repayment rates and no profit margins for people living below the poverty line;
- (f) Prohibiting the denial of basic financial services to poor clients;
- (g) Prohibiting the practice of "red lining" (not servicing particular areas because of the large number of poor people);
- (h) Community re-investment law.

33. Particular modes of finance had contributed to improved universal access. In Indonesia, for example, Islamic microfinance facilitated access to banking services for micro and small enterprises, and for the poorest communities. Islamic microfinance was based on Islamic banking and cooperatives. The former provided core financial services such as banking, capital market and insurance while the latter – known as Baitul Mal wa Tamwil – provided microfinance services for the poor. Challenges faced by the Islamic microfinance system included a lack of adequate human capital and of prudential regulation, including effective supervision, and financial sustainability. To overcome these challenges, efforts were being made to strengthen capacity, improve the cooperation mechanism among financial institutions, enhance self-regulation and supervisions at the regional level and promote harmonization of policies and regulations between banks and cooperatives.

34. The experience of Kenya suggested that mobile money could be a useful tool for increasing access to financial services. The share of the Kenyan population having access to commercial bank accounts had increased from 20 per cent in 2007 to approximately 50 per cent in five years, largely owing to the proliferation of mobile banking.

F. The way forward

35. The multi-year expert meeting provided a useful platform for exchanging experiences, best practices and lessons learned with regard to ISS. The discussions

contributed to a better understanding of the key elements involved in building and operating best-fit national regulatory and institutional frameworks in ISS. Many participants expressed appreciation for UNCTAD's work on regulatory and institutional frameworks and the note of the secretariat. They called on UNCTAD to continue facilitating exchanges of experience and lessons learned, and invited UNCTAD to further deepen its work, as appropriate, in new areas emerging from the deliberations as they related to ISS.

II. Organizational matters

A. Election of officers

(Agenda item 1)

36. At its opening plenary meeting, the multi-year expert meeting elected the following officers:

Chair: Mr. Peter Mulrean (United States of America)

Vice-Chair-cum Rapporteur: Mr. Carlos Fidel Martín Rodríguez (Cuba)

37. In the absence of Mr. Mulrean, Mr. Martín Rodríguez, Vice-Chair-cum Rapporteur, took the Chair during the second informal session and presided until the meeting closed on 26 February.

B. Adoption of the agenda and organization of work

(Agenda item 2)

38. At its opening plenary meeting, on 25 February 2013, the multi-year expert meeting adopted the provisional agenda for the session (TD/B/C.I/MEM.4/1). The agenda was thus as follows:

1. Election of officers
2. Adoption of the agenda and organization of work
3. Trade, services and development: the regulatory and institutional challenges
4. Adoption of the report of the meeting

C. Outcome of the session

39. Also at its opening plenary meeting, the multi-year expert meeting agreed that the Chair should summarize the discussions.

D. Adoption of the report of the meeting

(Agenda item 4)

40. At its closing plenary meeting, on 26 February 2013, the multi-year expert meeting authorized the Vice-Chair-cum-Rapporteur, to finalize the report after the conclusion of the meeting.

Annex

Attendance*

1. Representatives of the following States members of UNCTAD attended the expert meeting:

Algeria	Kazakhstan
Angola	Kenya
Bangladesh	Kuwait
Barbados	Lao People's Democratic Republic
Belarus	Madagascar
Benin	Mali
Burundi	Mauritius
Canada	Mexico
Central African Republic	Myanmar
China	Nicaragua
Cuba	Nigeria
Dominican Republic	Peru
Ecuador	Russian Federation
Egypt	Saudi Arabia
Estonia	South Africa
Ethiopia	Spain
France	Switzerland
Greece	Thailand
Haiti	Turkey
Indonesia	United Arab Emirates
Iran (Islamic Republic of)	United Republic of Tanzania
Iraq	United States of America
Ireland	Venezuela (Bolivarian Republic of)
Italy	Viet Nam
Jamaica	Zimbabwe
Jordan	

2. The following intergovernmental organizations were represented at the session:

African, Caribbean and Pacific Group of States (ACP)
African Union Commission
European Union

3. The following non-governmental organizations were represented at the session:

General category
Village Suisse ONG

* This attendance list contains registered participants. For the list of participants, see TD/B/C.I/MEM.4/INF.1.