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Utility regulation in Montenegro

I Conceptual basis of regulation

Why regulation?

During last four year, Montenegro has been building the new economic market oriented system. It is more in favor of free market than model of socialistic (planned) market. Basic principles are:

1. Private property in all areas
2. Open economy
3. National treatment of foreigners
4. Protection of property rights and contracts

Determination for private property means privatization and establishment of new private companies. Also, privatization process of utilities as telecommunication, electricity, railways, ports, has been started.

Having in mind fact Montenegro is small state (population of 650.000 citizens), there is question: shall private monopolies replaced current state monopolies in this area? This is the main reason for starting work on regulatory system.

Project has been organized under financing from DFID and operations from consultancy firm »Stone&Webster Consultants«. Project has been started in 1999.

What is essential in utility economic regulation?

Regulation should provide, or main goals of regulations are:

- Protection of consumers from the abuse of monopoly power
- Utilities have incentives to minimize production costs
- Providing for utilities to earn sufficient revenue to cover their costs, finance any necessary investments and earn a reasonable profit.
- Satisfaction of social policy objectives and social distribution for specific parts of society
- Objectives related with realization of regulatory framework

Generally, regulation that promotes competition is more acceptable than one that promotes market's results. This is reason for regulation that will provide more choices for consumers and less connected with influence from Government in terms of consumer's preferences. On the other side, regulation of market's results with higher costs than regulation of structure that provides competition.

Objectives of Government of Montenegro are:

- Utility regulatory framework in Montenegro is compatible with Privatization Plan.
- It is very important to create regulatory framework which will not reject potential investors to invest in Montenegro, and which will not reduce value of companies during privatization process
- Establishment of utility regulatory framework will significantly support privatization process and value of utility companies predicted for privatization.
- Well-established regulatory framework will increase attractiveness to foreign investors and their security into agreements made with Government in terms of their validity in long term.

Global objectives of regulation are presented in following table.

Comparison of regulatory objectives					
Consumer protection	Protect the interests of consumers in respect to prices charged, continuity of supply and the quality of services provided;	Promote the interests of consumers;	Protect the interests of users of railway services;	Protect the interests of customers and potential customers in respect of charges, quality and terms of provision;	Prevent misuse of monopoly or market power; Ensure consumers benefit from competition and efficiency;
Utility efficiency	Promote efficiency and economy on the part of licensees in supplying and transmitting electricity;	Ensure that those providing services are doing so efficiently;	Promotion of efficiency and economy;	Promote economy and efficiency;	Facilitate efficiency in regulated industries;
Utility financing	Secure that license holders are able to finance their licensed activities;	Ensure that those providing services are able to finance them;	Commercial certainty and security; Train operators’ financial position;	Ensure that water companies are able to finance their activities;	
Social welfare	Secure that all reasonable demands for electricity are met;	Ensure that telecom services are provided to meet all reasonable demands;	Protect interests of disabled people;	Various environmental objectives;	
Regulatory framework	Promote competition in the generation and supply of electricity;	Maintain and promote effective competition;	Promote competition; Minimize regulatory burden;	Facilitate effective competition (recently changed to promote);	Promote competitive market conduct; Facilitate market entry;

Regulatory institutions

How regulatory framework should be organized in order to provide higher security for investors?

Three questions are important for this:

1. Ability of future Governments to change adopted regulatory mechanism
2. Discretion rights of politicians inside the regulatory network
3. Effectiveness of institutions, specially of legal system and subordination of the Government

1. Enforced changes in regulatory framework

This needs limitations to the Government by institutions, before all judicial system and its independency, which are actual problems in many states.

Reform of judiciary system in Montenegro has this as main objective.

2. Discretion decision making process

Montenegro is in favor of regulatory independence. Or, in Montenegro independent Regulatory agency was established and it has power to control short-term interests of Government.

3. Legal system – extremely important element of regulatory framework.

In Montenegro private utilities can ask from courts to recall Government decision if they are not according to the legal procedure. Independent judiciary system is necessary for this.

For regulation are important so called **parallel regulatory systems**:

1. Accounting standards:

Process of accounting system reform has been conducted in Montenegro under technical support from USAID. New standards will be compatible with International Accounting Standards (IAS)

2. Regulation of competition – Law on competition has been drafted and it is under procedure.

3. Ecological regulation:

Montenegro is ecological state. We have strong ecological standards.

There are two very important conceptual questions regarding regulation:

1. Regulation by sectors or multisector regulation? Montenegro as small state is in favor of multisector regulation.
2. Independent regulator or Regulatory Agency? Montenegro is in favor of Regulatory Agency.

II Regulation by sectors

2.1. Regulation in telecommunication

Montenegro announced tender for selling Telecom. It needed regulation in this area. Basically, regulations is consisted of three levels:

1. Law on Telecommunication passed Parliament of Montenegro
2. Regulatory Agency was established
3. Regulations by the Law have been drafted

2.2. Law on telecommunication

The Law includes:

1. Conditions for construction, maintenance, security and use of telecommunication networks, buildings and equipment
2. Relations between producers and consumers are defined.
3. Licensing procedure is defined.
4. Management, use and control of radio-frequencies specter
5. Establishment of Regulatory Agency

Objectives of the Law are:

1. Conditions for providing telecommunication services
2. Protection of interests of consumers
3. Provide and encourage competition
4. Encouragement of efficiency in this area
5. Regulation of quality, standards and security of telecommunication services

This Law has been conducted by:

1. Government of Montenegro
2. Ministry of economy

3. Agency for telecommunication

2.3. Agency for telecommunication

Established in December 2000 by Government of Montenegro.

Agency has started to work. It has nine employees.

Agency is independent regulatory authority and functionally is independent from those who use telecommunication network.

Agency provides, between the other:

1. Competition in telecommunication industry
2. Non-discriminatory access to telecommunication network
3. Encourage interconnection of networks
4. Technical licensing
5. Application of international standards
6. Licensing
7. Provide protection from non-regularities related with prices on telecommunication services
8. Provide protection from monopoly power from provider of fixed phone services, in terms of transparency and accountability.

Agency makes reports to the Government.

Reporting system will be changed so Agency will report to the Parliament.

Regulations by the Law on telecommunication which are necessary for full implementation of the Law

Agency has been started this process with invitation to all interested entities and units to be involved in this.

All rules will be compatible with »European Committee Regulations” which is consisted of regulation package for telecommunication”.

Regulations cover following areas:

1. Interconnection
2. Tariffs
3. Licensing
4. Unique maintenance
5. Standardization
6. Protection of consumers

3. Regulation of energy sector

Law on energy sector has been drafted and it has been discussed in the Government.

The experts from USAID and Linclatters, with involvement of domestic experts, drafted Law.

This Law covers privatization and regulation of energy sector.

An act to enable maximum utilization of natural resources of the Republic of Montenegro and to optimize the production and utilization of energy products and services in Montenegro by permitting the introduction of competition into the electric utility industry, by the regulation of all energy and energy service providers, and where appropriate permitting privatization of the republican energy industries, be giving effect to directive no. 96/92/ec of the European Parliament and of the council of 19 December 1996, to establish a body known as the commission for regulation of public interest industries, and to give power to that commission to grant licenses to generate, transmit and distribute electricity and to grant authorizations to construct generating stations, to provide for access to the transmission or distribution system by holders of licenses, holders of authorizations or by qualified consumers, to amend laws in conflict with this act, to provide for a market operator, transmission and distribution system operators, and for related matters.

Establishment of Regulatory Agency has been planed. Agency will be independent authority.

4. Water section regulation

Competition is difficult to implement in the water section and the gains from industry unbundling are limited compare to other utility sectors because:

1. The majority of costs for water utilities are concentrated in the transmission and distribution system
2. Upstream activities are subject to diminish returns whereby new resources are more expensive to develop as cheaper resources are developed first, making competition in these activities more difficult to achieve.

As a result, there is an ongoing requirement for economic regulation of the water sector that is unlikely to be eroded by the development of any form of effective competition.

Regulation is also required in the water section to meet other objectives, as public health, environmental protection, and allocation of scarce water resources between competing users.

Institutional arrangements for water sector regulation

Regulation of private sector participants in the water sector can be undertaken by an independent regulatory agency or through the terms included in a concession contract.

1. Including regulatory arrangements within long-term contracts as a viable option in the water sector because the industry is typified by stable technology and relatively predictable demand.
2. This allows prices (tariffs) to be set by formulae included within a concession (or other) contract.

Independent regulatory agencies are typically used where the regulatory authority is going to have greater discretionary power over tariffs.

1. Regulatory independence is critical to remove discretionary tariff setting powers from political interference.

Water sector regulation in Montenegro

The introduction of private sector participation in the water sector in seven coastal municipalities (through AquaMundo) has increased the importance of addressing the regulatory requirements of the water section.

Price setting occurs at the municipal level.

1. The AquaMundo arrangement envisages that the municipalities will continue to exercise tariff-setting powers.
2. A current consultancy project will assess how the water section, as a whole in Montenegro should be regulated, taking into account the AquaMundo arrangements.

There is currently little regulation of service levels.

Environmental regulation and water quality regulations occur at the Republic level.

A new Concession Law that is currently being drafted will regulate the process by which the private sector may be granted concessions (or leases or management contracts) in the water section.