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Shahab, Naima Binte

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Government Interference in Power Sector Regulation: A Case of Pakistan

Naima Bintaey Shahab
National Defence University
Islamabad, Pakistan
nbshshab@hotmail.com

Abstract: In December 2016, five independent regulatory authorities viz. National Electric Power Regulatory Authority (NEPRA), Pakistan Telecommunications Authority (PTA), Frequency Allocation Board (FAB), Oil and Gas Regulatory Authority (OGRA) and Public Procurement Regulatory Authority (PPRA) were transferred from the Cabinet Division to their respective line ministries in Pakistan. This step was soon followed by amendments to the 1997 Nepra Act, made to the effect of aligning Nepra's policies with the broader socio-economic policies of the government. This paper recounts the history of Nepra's conflict with the federal government, and presents the case for and against regulatory independence, based on a review of selected theoretical and empirical literature. It also describes the policy issue from the perspective of the Institutional Analysis and Design Framework.

Keywords: *IAD Framework, Regulatory Governance, NEPRA, Pakistan.*

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1. Introduction

Until December 2016, administrative control of five independent regulatory authorities viz. National Electric Power Regulatory Authority (NEPRA), Pakistan Telecommunications Authority (PTA), Frequency Allocation Board (FAB), Oil and Gas Regulatory Authority (OGRA) and Public Procurement Regulatory Authority (PPRA) was vested in the Cabinet Division, according to Schedule II of Rule 3(3) Distribution of Business Among the Divisions. The authorities would have continued to enjoy this administrative privilege but for a provision in the said Rule for the Prime Minister to modify the distribution of business or the constitution of the division from time to time, and it was this escape clause precisely that led to the decision of transferring all five regulators to their respective line ministries (Kiani, 2016).

While the decision was still a proposal and was set to be on the agenda of the December 16, 2016 meeting of the Council of Common Interests, it was opposed in writing by the Chief Minister of Khyber Pakhtunkhwa. This led to official withdrawal of the proposal from the agenda, but did not preclude its discussion on the CCI forum. However, no sooner had it been presented than Sindh jumped into the opposition bandwagon. Joint opposition by the two provinces led the government to roll the proposal up for the while, urging the provinces to give it another thought before the next CCI meeting. A few days later, the Prime Minister's legal advisors brought to his knowledge his powers, under the 1973 Rules of Business, to modify the distribution of business as laid out in Schedule II. Accordingly, and in spite of provincial opposition, a notification was

issued by the cabinet division transferring the control of these authorities from the Division to the Ministries (Kiani, 2016).

The decision was subsequently challenged in the Lahore and Peshawar High Courts both of which ruled against it, suspending the notification in February 2017. It was never implemented (Hussain, 2017). The interests behind the proposal, but, were not to be discouraged. It had been contended upon the government's earlier notification that administrative control of regulatory authorities was irrelevant to their independent functioning. Nepra, for example, would continue to act independently so long as it was governed by its own constitution, regardless of its administrative position. So, in the next CCI meeting, the government took the more decisive step of proposing amendments to the 1997 Nepra Act, also known as the Regulation of Generation, Transmission, and Distribution of Electric Power Act, 1997 (Khan, 2017).

The text of the proposed amendments has not been made public though reports of the same have been circulating in the print and electronic media since December last. The underlying theme is to regulate the regulator i.e. bring Nepra under the control of the Ministry of Water and Power (MOWP) so its actions can be aligned with the policies of the government and to deprive it of its administrative, as well as operational, autonomy and independence. Key amendments proposed to this effect are:

1. To authorize the federal government to issue binding directives to Nepra;
2. To clip enforcement powers of the regulator with respect to government-owned companies;
3. To dispense with the licensing regime in respect of all non-hydel power projects;
4. To reconstitute the authority such that provincial representation is done away with and appointments are made on merit-basis by the federal government;
5. To introduce independent appellate tribunals for dispute resolution instead of referring matters to the high courts and Supreme Court as under the original Act.

2. Nepra's History of Conflict with the Federal Government

In the year 2000, Professor Malcolm K. Sparrow began the first chapter of his book *The Regulatory Craft: Controlling Risks, Solving Problems, and Managing Compliance* with the following words:

> "Regulators, under unprecedented pressure, face a range of demands, often contradictory in nature: be less intrusive – but be more effective; be kinder and gentler – but don't let the bastards get away with anything; focus your efforts – but be consistent; process things quicker – and be more careful next time; deal with important issues – but do not stray outside your statutory authority; be more responsive to the regulated community – but do not get captured by industry" (Sparrow, 2011).

The statement accurately sums up the dilemma surrounding regulatory governance in Pakistan, for it is similar pressures that have weighed down upon Nepra, for example, and obstructed its effective functioning.

The grounds for the creation of a power regulatory authority were first made with the government's strategic plan to privatize the power sector in 1992. The object of this independent authority was to be the transparent and judicious regulation of the power sector in Pakistan. It was meant to complement the establishment of a competitive energy market through effective economic and social regulation. Initially, it was not under the administrative control of the

government. But, in subsequent years, it was first attached with the Ministry of Water and Power, and later with the Ministry of Law and Justice, before being transferred to the direct and centralized control of the cabinet division where it nevertheless retained its autonomy as per the 1997 Act (Malik, 2007).

Pricing has always been the bone of contention between Nepra, the government, and government-owned companies (Malik, 2007). Nepra never did agree with the tariffs proposed by the government or two of its largest energy enterprises – the Water and Power Development Authority (WAPDA) and the Karachi Electric Supply Company (KESC). As a result, the tariffs set by the regulator were always disputed. Recently, however, a combination of two developments has led to a corresponding heightening in tensions between the two camps.

One, the coming into power of a party committed to macroeconomic development. With a relatively good historical record of investing and delivering in major development projects, the Pakistan Muslim League-Nawaz (PML-N) was trusted to solve Pakistan's energy crisis. The crisis, however, seems no closer to resolution than it was in 2013 before the PML-N had taken its widely-touted initiatives. Old problems may have disappeared but their place has been taken by new ones and the scene continues to be rampant with complications. With the electoral term nearing its end, the PML-N is groping for as many feathers for its proverbial hat as it can manage, and if Nepra stands in the way of this exercise, then Nepra best be brought to book.

Two, the China-Pakistan Economic Corridor, this megaproject has catapulted Pakistan to the centre of a regional economic revolution. It has brought power projects worth billions of dollars into Pakistan – the fate of which is in the hands of the regulator. It is important for the government to have its way at this junction of history – to ensure that there is an endless inflow of investments and investor confidence. To that end, licensing and other regulations conditional to economic and social well-being come out as obstructions. It is both a concern for the party and the state to make the best of this opening and, therefore, the former has moved through the latter to satisfy these concerns.

One example of the challenging relationship between the government and the regulator is the dispute on the power to impose surcharges. Repeated attempts by the government to impose surcharges in the name of tariff rationalization, tariff equalization, financing cost, debt servicing, or simply to discharge "public service obligations" have been hampered first by the regulator and later by the courts. The MOWP has protested that the government's inability to have a decisive say in this affair has led to confusion regarding the status of surcharges in the tariff-setting regime. Nepra has resisted all such calls as will ultimately lead to rise in end-user tariff and, for that reason precisely, has incurred the government's ire (Kiani, 2017).

3. Perspectives on the Proposed Amendments

Proponents of the amendments (largely from within the government) argue that far from weakening Nepra, the amendments seek to strengthen it. Their contention is that the proposal delegates 26 new powers withheld from the regulator under the original Act (Wasim, 2017). In fact, a spokesperson of the Ministry of Water and Power has said that, with the amendments, all operational powers will be transferred to Nepra whereas the role of the government will be limited to the policy level. They also reiterate the need for meritocracy by supporting the government position that appointments and tenures ought to be based on qualification and performance rather than experience alone. The underlying theme of the pro-amendment perspective is that the regulatory policies of Nepra need be aligned with the broader socio-economic policies of the government. The government, it is contended, should have a say in matters pertaining to public interest and the stability and sustainability of the power companies it

owns (Hussain, 2017). It is also contended that the driving force behind the proposal is the need to adapt Nepra to meet the challenges of a competitive market. However, it is unclear why the same is required by means of amendment to an Act that ensures it already.

On the other end of the spectrum are those who argue against the amendments. They hold that the whole idea of the proposal seems to be to turn Nepra from a quasi-judicial forum to an advisory body of the MOWP, and from an independent power system to a surrogate revenue-gathering system (Kiani, 2016). Not only, according to them, is it against various rulings made by the high courts and Supreme Court in Pakistan itself, but it is against international best practices as outlined by the Organization for Economic Development and Cooperation (OECD). Finally, the move marks a regression and reversal in the process of institutional development in the Pakistani polity.

4. Literature Review

According to Batlle and Ocana, regulation can be defined as "a series of principles or rules (with or without the authority of law) used to control, direct or manage an activity, organization or system". The rationale for regulating performance is simply to improve unregulated performance. It is a "compromise" between prohibition and no control at all. Regulation by governments, or agencies of the government, is not to discourage or disable the actors in an environment, rather it is meant to encourage and enable them to act in a way that necessarily leads to general welfare (Batlle & Ocana, 2013).

Regulation may be social or economic (Batlle & Ocana, 2013). Social regulation includes quality assurance, safety standards, and environmental impact control. Economic regulation, which is the focus of this paper, includes principles and rules for imperfect competition, pricing, licensing, and investment. Regulation is ultimately meant to benefit both consumer and producer. To that end, the regulatory body is under obligation to regulate all such entities and activities as may pose a threat to the same. In the case of the electricity market, it designs rules for the producers so that they may not end up setting prices at a rate unacceptable for, or unfair to, the consumers. Independent regulatory bodies also regulate the behaviour of the government which, depending upon the direction it takes, can be harmful for the consumer (as in the case of imposing additional surcharges to discharge 'public service obligations) and for the producer (as in the case of actions precluding recovery of investment).

Ever since the 1990s, when the practice of establishing regulatory authorities first started spreading from Europe, the trend has been for the independence of such entities (Thatcher, 2002). It is this same trend that is reflected in literature on the subject – it may be argued that developments in the real world were a product of development in academia. In Pakistan, too, the reforms brought in under the 1992 Power Sector Reforms Program were part of this wider trend.

In order to build a case for or against regulatory independence, it is first essential to define what is meant by independence. Independence, in this case, is the absence of "undue influence". The United Kingdom's Better Regulation Taskforce defined the term thus in the year 2003: *A body which has been established by Act of Parliament, but which operates at arm's length from Government and which has one or more of the following powers: inspection; referral; advice to a third party; licensing; accreditation; or enforcement* (OECD, 2013).

By this degree, Nepra would qualify as an independent body even if the controversial amendments were approved. This is because absolute, unfettered independence is not a condition according to this definition. All that need be is for the regulator to be at *arm's length* from the government. This means that all but individual executive orders may be issued with the sanction

of the line ministry – in this case, the Ministry of Water and Power. As for the latter part of the definition, it does little to establish the independence of Nepra in the event of amendments to the Act. For example, the amendments promise to give greater inspection powers to Nepra, but slash on its authority to license projects and enforce tariffs.

The Organization for Economic Cooperation and Development or OECD's guidelines for regulatory governance comprehensively address the question of the need and nature of regulatory independence. According to this document, independence is conditional to the context (OECD, 2013). It is recommended when the said has to be established for reputational reasons in order to win over public and investor confidence. It is also recommended when the power sector consists of private and public companies operating under the same legal framework, to impartially monitor regulatory policy implementation. Also, in the event of political instability, it helps to have the regulator far from the scene of chaos lest it should spill into areas governed by the regulator.

On the other hand, absolute independence is not recommended in cases where policies relevant to the regulator – including regulatory policy itself – are not fully developed. Integrated and centralized structures are more conducive to transitions than loose and decentralized ones.

Regulatory independence entails political independence and independence from stakeholders (Batlle & Ocana, 2013). The rationale behind political independence is to save the regulator from unnecessary political pressures, especially as comes from short-term electoral concerns of politicians. Regulatory policies meant, among other things, to ensure stability cannot afford to overlook the long term in favour of the short. The rationale behind independence from stakeholders, on the other hand, is to ensure that those who are regulated have limited, if any, influence over regulatory policy. The situation that results from the absence of such independence – one which is the extreme case of the regulator being subdued to the regulated – is known as regulatory capture.

Nigeria shares similarities with Pakistan when it comes to the power regulator's independence. Like Pakistan, the government in Nigeria has excessive sway over the regulator (Omonfoman, 2016). This is a limitation to the latter's effectiveness. It has been noted that "the ability of the Regulator to regulate the industry without creating regulatory risks, following "orders from above" and caving in to the demands of Market Operators that are not fair to the consumer, is vital for the sustainability of the power sector reforms".

Omonfoman of the Nigerian energy conglomerate Aieto Group prescribes the following to this effect(Omonfoman, 2016):

1. Appointment of regulatory body commissioners on the basis of qualification and experience – this would include doing away with the culture of political balancing which ends up in the appointment of commissioners from across the political spectrum, whether or not they are technically eligible.
2. Amendment of the act governing the regulatory body to ensure that little, if any, opportunity is left for the government to assert itself in matters that ought to be in exclusive jurisdiction of the regulator. Officials of the regulator, according to Omonfoman, should not be answerable to political heads but to the regulatory authority itself.
3. Omonfoman also calls for a broader dispute resolution mechanism. However, he does not elaborate upon the nature of this mechanism. As is evident in the case of Pakistan, there is ample scope within a dispute resolution mechanism for dispute. Will state courts have jurisdiction over matters pertaining to the regulator, or will independent tribunals be

established? What will be the highest court of appeal? Can executive orders of the authority be appealed against in the legislature, and so on.

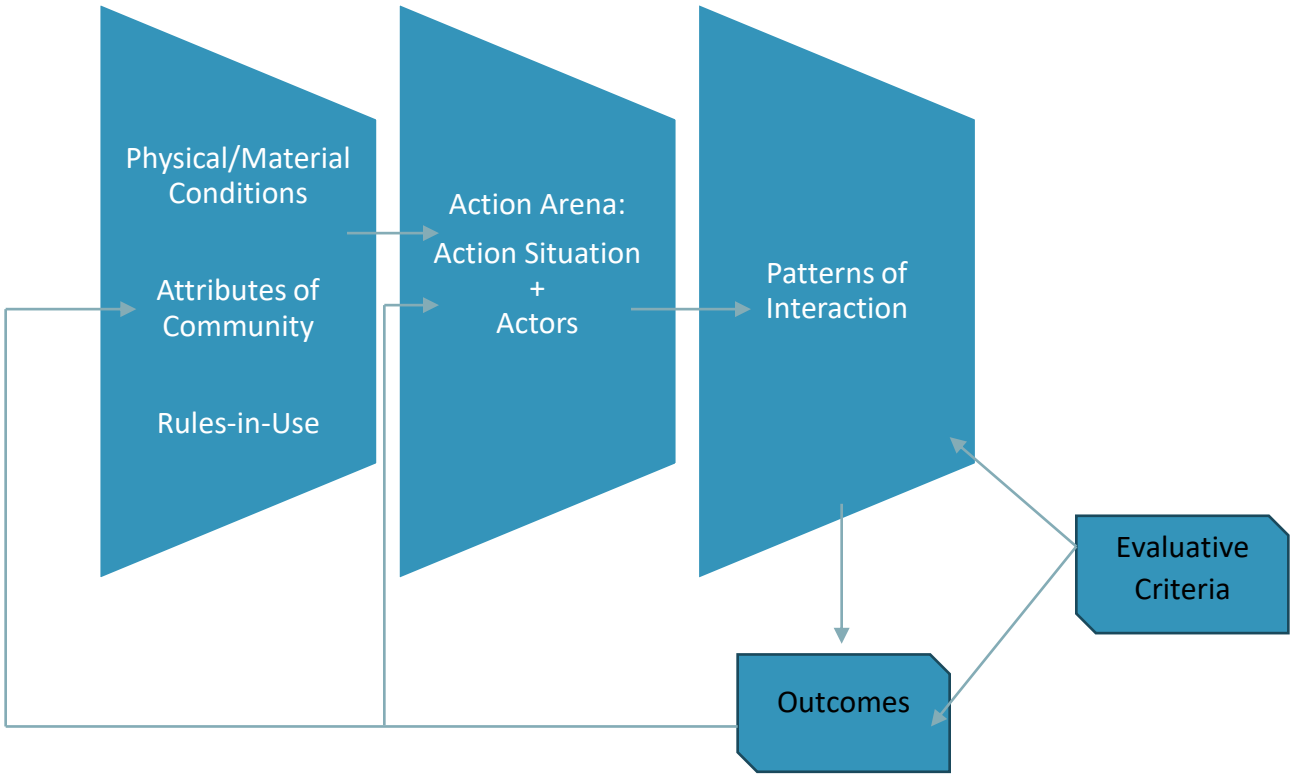
4. Establishment of an inter-agency committee to "resolve over-lapping functions and harmonise technical roles". This will lead to uniformity in power and power regulatory policy. This suggestion was attended to, to an extent, by the 2013 National Power Policy which laid provision for the establishment of an Internal Coordination Committee between multiple Ministries for integrated planning to be overseen by the Council of Common Interests (CCI).
5. Insulation of regulatory agencies against politics such that they remain non-partisan, apolitical, and independent at all times.

5. Methodology

Longitudinal and cross-sectional data were briefly drawn on to inform the analysis. Empirical findings from the case of Pakistan were placed in the IAD framework in order to bridge the gap between the theory and reality of regulatory institutions.

6. Power Sector Regulation and the IAD Framework

The Institutional Analysis and Development Framework by Ostrom, Gardner and Walker is a conceptual map with several tiers (Ostrom, 2007). It can be represented cyclically and, as such, there is no start and end to the process except that which the person using the framework may choose to identify. Below is a diagram of the IAD framework:



The IAD framework was chosen to analyse the problem at hand because the latter is of a non-technical nature and, therefore, the result of a conflict. Technical problems such as a loose

regulatory framework due to lack of legislators well-versed in regulatory laws or regulatory best practices are not the result of a conflict – though they may lead to it as they arguably have in this case. Non-technical problems on the other hand always and essentially result from, and lead to, conflict. Contrary to technical problems, they are of a subjective nature. They are not due to a lack of anything – be it expertise, infrastructure, policies or finances – but due to disagreements as to how, or to what end, the same can be utilized. In other words, conflict.

What the IAD framework does is deconstruct conflict – though this depends upon where one looks at it from. If one looks at it from what comes out as the first stage in the cycle it may as well seem to construct the same. In any case, it lays out a host of antecedent variables that result in a pattern of interaction in which the conflict is embedded. In the following sections, conflict surrounding regulatory independence in Pakistan is placed in the IAD framework and analysed accordingly.

6.1. Action Arena

It helps to begin the analysis with what comes out as the second stage in the diagram above, since other stages can then be understood in terms of cause and effect in relation to this stage. An additional benefit of starting here is that it defines the very actors who are of prime importance to the analyst. It is also the unit of analysis identified by the developers of the framework.

The Action Arena delineates the theatre of action. It marks what may be loosely referred to as the territorial boundaries (hence the word arena) in which the action takes place. These boundaries are by no means definite; they only set broad contours. However, they do help narrow things down and bring clarity to the picture. In this case, the action arena is the power sector of Pakistan.

The action arena further consists of actors and an action situation. The actors are those individuals, organizations, or departments within organizations that take or influence decisions pertaining to matters in the action arena. Nepra, the Ministry of Water and Power, public and private sector power companies, the government (particularly the federal Cabinet and Council of Common Interests) are the actors. Each of them has stakes in the arena and in the situation, and attempts to steer the latter in the direction suited to their respective bureaus. In addition to interests, actors also have values, resources, information, and procedures – the nature of which determines the extent to which they exercise control over the process and decisions.

Independence for Nepra, for example, is stake, interest, and value all at once. Nepra's resources are legal – the powers accorded to it under the 1997 Nepra Act, financial – the finances available to it for the discharge of its duties, and political – the leverage it enjoys in the sector viz-a-viz other actors. Information here refers to that knowledge which can help actors influence policy decisions. By this definition, it is difficult to suggest which actor holds sway without a comprehensive understanding of the degree to which each is informed. Finally, *procedures*, the Council of Common Interests has the constitutional mandate to host deliberations and pass decisions on all matters related to the regulator. As such, it clearly holds monopoly insofar as decisions can be affected by procedural dynamics.

The action situation, meanwhile, is the specific interaction that has given rise to the problem. In this case, it is the move to amend the Nepra Act. It is from this context that the conflict has arisen and the patterns of interaction will flow.

6.2. Patterns of Interaction and Outcomes

Actors interact at three levels as identified by the IAD framework.

At the *operational level*, actions are governed by the incentives available to each actor. Interactions at this level produce outcome directly in the physical world i.e. it includes the decisions that guide the day-to-day functions or *operations* of the actors. In this case, the pro-amendment camp is acting in response to the incentive of a power regulator well-integrated with the vision and strategy of the government, while the anti-amendment camp is acting in response to the incentive of an independent power regulator.

At the *policy/collective choice level*, actors interact to discuss and collectively resolve policy problems within the structure and procedures prescribed by higher order interactions at the constitutional level.

At the *constitutional level*, as hinted above, actors interact to develop the legal framework within which all subsequent interactions take place. This would include the Constitution of Pakistan that delegates powers to various institutions and officials, parliamentary procedures and codes-of-conduct, and standard-operating-procedures of the Council of Common Interests.

The "problematic", as Ostrom calls it, seems to have originated at the second level – the level of policy or collective choice – in this case. Interactions among the actors therefore are affected by the constitutional level and, in turn, affect the operational level.

The outcome is a draft of amendments to the 1997 Nepra Act.

6.3. Evaluative Criteria

According to the IAD, policies may be evaluated based on the following, inter alia:

- Economic efficiency – which in this case is not very high considering net benefits are flowing disproportionately in favour of the government or pro-amendment camp
- Conformance to general morality – clearly, this depends upon one's definition of morality, but in view of international best practices and earlier rulings of the provincial and apex courts, it may be inferred that the policy does not exactly conform to regulatory morality
- Adaptability – again, if reduction in the independence of the regulator is set to result in greater burden on the consumers and give rise to general discontentment, then it is not sustainable in the wrong run and does not have the seeds to adapt to the responses it is likely to elicit.

6.4. Physical Conditions and Attributes of the Community

Physical and material conditions are features of the action arena that develop in the course, and as a product, of repeated interactions but are also always there at the start of each new process involving policy discussion and decision. The outcomes of one event set the context for the next event and so on in a cyclical manner till conditions, attributes, and rules are established. Of these, rules are not discussed in this paper due to a lack of academic as well as journalistic literature on the subject. The other two are explained below.

The most outstanding feature of the action arena, the characteristic feature of the power sector of Pakistan, is the energy crisis: the shortage of power estimated at 4000 megawatts on average and 7000 to 8500 megawatts at its worst. Other features are a shortage of capital and a transmission and distribution infrastructure resulting in losses worth Rs. 145 billion annually.

The function of these conditions in the IAD framework is that they considerably constrain the behaviour of actors and the options available to them in an action situation. Given the crisis mentioned above, the conditions in this case are clearly disablers rather than enablers.

Attributes of the community include, inter alia, the norms of interactive behaviour within and among corporate actors, homogeneity of their preferences, and political, social, and economic factors relevant to their co-existence. In the power sector of Pakistan, defining attributes of the power sector are a lack of coordination and cooperation, and a stark heterogeneity of preferences.

7. Conclusion: Policy Prescriptions

The IAD framework does not have much prescriptive power for its role is mainly descriptive. However, based on its description of the process of causes and effects of policy adoption, one can prescribe the following for the problem at hand.

Laws, or amendments to laws, do not stand on their own. They are internalized as part of a complex process laid out in the IAD framework. Proposed amendments to the Nepra Act may not upset the regulatory balance just yet. However, they will if like steps are taken in the future until the exception becomes norm. This is because each outcome has a twofold effect on the action arena and the conditions, attributes and rules triad. If it becomes frequent enough, it has the capacity to change the institutional outlook altogether.

If it is the patterns of interaction that immediately precede outcomes, then it is these patterns that must be worked into for the outcomes to improve. This is to say that the various for a– National Assembly, Cabinet, and CCI – where stakeholders or their representatives interact be made more efficient and effective in terms of the results they are meant to deliver. Similarly, controlling the incentives, too, can be effective insofar as that incentive is the actor's motivation for going for a certain response. The government's incentive to pay-off longstanding debts is one such example.

In addition, there are other – say, cognitive or social factors – affecting the developments at each stage. Provided they are taken and addressed as seriously as the more explicit incentives that drive actors and determine their actions, they can have an equally effective impact on shifting the nature of outcomes. For example, belief systems and past experiences have an impact on patterns of interactions, while personal and organizational interests have a significant impact on the action situation.

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