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Regulatory Governance in a Multi-Level Framework

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SUMMARY

1. This report considers the ways and means of optimising relations between levels of government (supranational, national and sub-national) in terms of the quality of regulation. It draws on many OECD studies, though the information they contain has to date been only rarely treated from the standpoint of multilevel governance. Today, however, the growing role of supra- and sub-national levels presents governments with new challenges, to which a suitable regulatory framework could help to provide answers.
2. Theoretical work has highlighted the advantages of getting closer to citizens, which encourages participation and best value for money in public services. However, the experience of some countries, especially federal states, shows that lack of harmonisation can create unnecessary barriers to the movement of goods and services or generate sterile competition between regions. If coordination is lacking, businesses and people alike can get lost in a maze of supererogatory and sometimes contradictory standards. The quality of the regulatory framework is now a decisive factor of competitiveness. Water is a particularly illuminating example of the new situation. Guaranteeing their citizens long-term access to drinking water at a sustainable cost is probably one of the biggest challenges facing both developing and developed countries. Vast investment is required, estimated at over 90 billion dollars a year just to ensure supply. Access to water and who pays what are sources of potential conflict, including in terms of collective security.
3. The search for suitable modes of governance is an ongoing process. In its multilevel dimension, it now poses specific questions. The aim of this study is to describe the issues at stake and to identify certain principles. These include empowering the different players in increasingly complex processes, involving citizens in decision-taking without making the process more cumbersome, improving the quality of regulation and its impact on economic and social development, defining the role of each level in regulatory processes, managing networked competences, and encouraging new forms of cooperation. In the second part of the report, these principles are applied to the water sector.
4. The 1997 OECD report on regulatory reform advised Member States to encourage reform at all levels of government. Regulatory quality at one level may be impeded by poor regulatory methods and practices at other levels, whereas proper coordination increases the benefits of reforms.
5. Giving the players involved some leeway so as to favour innovation and a proper allocation of resources while limiting excessive fragmentation of rights and sterile competition between regions: there are important issues at stake here for governments. Coordinating, ensuring harmony without uniformity, appropriating the means to promote regulatory quality at all levels, guaranteeing the effectiveness of public policy in a multilevel environment: these are the policy challenges of the future.

MULTI-LEVEL REGULATORY GOVERNANCE

6. As a follow-up to the discussion at the expert meeting on regulatory cooperation between levels of government (30 June – 1 July 2003), this note offers some further considerations on the question of multilevel regulatory governance. It is based primarily on the national reports that were produced in the context of the OECD Regulatory Reform Programme, launched in 1998, and should be considered together with other studies conducted by the OECD on multilevel dimensions such as fiscal federalism. In contrast, this subject has never been the subject of specific, in-depth study.

7. Ensuring regulatory quality, i.e. reforming regulations so that they contribute fully to achieving public policy objectives without placing needless restraints on competition, innovation and growth, has become a political priority. The economic and institutional landscape is becoming ever more complex, and economic players and citizens alike are increasingly insistent in their demands. Globalisation and economic interdependence, together with greater market openness, have increased the need for regulation. This has given rise to new, more sophisticated and more participatory mechanisms of regulatory governance. One effect of these changes has been to profoundly transform the role and operation of modern states. Given the scale of these upheavals, the challenge now is to reinvent the state at all levels: national, supranational, global. This multilevel dimension creates complexity in the organisation of institutional relations and calls for systematic analysis so as to systematically take account of the interaction between players.

8. In this context, the multilevel dimension deserves special attention. The country examinations have highlighted the contribution of regulatory reform efforts. Yet there has been little analysis of the degree to which this aspect is taken into account in reforms of the regulatory framework. The success of such an undertaking will depend in part on the capacity of political leaders to promote high-quality regulation at each level of government, and to enhance overall efficiency by instituting appropriate coordination mechanisms.

9. If this issue is to be properly addressed, the regional perspective must also be taken into account. Over the last 20 years, aspirations for greater democracy and more efficiency have sparked a dynamic regionalism in OECD countries. The institutional model and the degree of decentralisation will of course depend on the political, historical and economic factors of each country. Yet in most countries, whether unitary or federal, there has been increasing emphasis on sub-national levels of government as the appropriate level for the deployment of public policies, and in Europe this trend has been accompanied by the simultaneous shift of certain responsibilities to the supra-national level. To these new regional dynamics we must add a profound change in the role of certain States, particularly in Eastern Europe, where the inherited bureaucratic organisation is giving way to more market-oriented systems in which partnerships between the public and private sectors are playing an increasing role.

10. Thus, a clearer allocation of responsibilities and better coordination among different levels of government are becoming strategic issues for the attractiveness of regions, in unitary and federal countries alike. With the multiplication of decision-making centres and competition over the sharing of powers, coordination among the different levels of authority is becoming a key question.

11. This trend is producing some tensions with the centre, and with other entities at the same level. These tensions explain in part why the trend is not linear and why, at the same time, there is a move to re-concentrate some powers for reasons of efficiency. The trend towards developing rules at the sub- and supranational levels, then, will considerably broaden the scope of regulatory policies adopted in recent years.¹

12. The rapid evolution of regulation at the national level thus calls for active management of regulatory policy, and in particular of its multilevel aspect. This could help in seeking concrete answers to the challenges of assuring regulatory quality and recognising that the complementarity of regulations can have a positive effect on the coherence of government action. Awareness of this point is relatively recent. Yet it is essential, for the undeniable success of globalisation in terms of wealth creation, the quality of services, and the efficiency of markets will be optimised only if there are proper regulatory tools in place. However, while the impact of interregional competition in boosting economic development is now clearly recognised, the same cannot be said for another question now emerging, which has to do with competition among legal systems.

13. The meeting on regulatory cooperation between levels of government served to clarify the principal terms of this debate. The new context created by the growing devolution of powers to the sub- and supranational levels posits the need for regulatory networking. As a means of guaranteeing vertical coherence, such networks must fully incorporate the supranational level, but they must also create horizontal linkages between entities at the same level. The emergence of the concept of "regulatory regime", analyzing the interaction between these different levels, reflects this evolution. In the face of these challenges, two kinds of regulatory strategies have been adopted to optimise the cost-benefit relationship: competition and convergence (harmonisation, mutual recognition etc.).

14. On the basis of difficulties or opportunities that countries have encountered, this note suggests some elements for analysis of case studies, solutions, tools and experiences. It illustrates the ways in which the principles of good regulatory governance, namely accountability, transparency, efficiency, adaptability and coherence, have been applied to the specific circumstances of multilevel states. Tackling this dimension in fact requires sophisticated approaches to regulation, in particular to foster the emergence of appropriate regulatory modes.

15. This paper lays no claim to comprehensive coverage of such a complex and many-faceted subject. It merely seeks to identify what "multilevel" is and the scope of the term. The OECD has already looked into the question, especially in country examinations which have highlighted a number of first principles (see Box 1). However, the multilevel dimension is generally treated as a side-issue and, even if it is looming larger, this is the first time it has been the subject of specific study.

1. Regulatory Policies in OECD Countries: From Interventionism to Regulatory Governance. OECD, 2002. This document has been used as a point of reference.

Box 1. Chief conclusions from country examinations

- The challenges posed by multilevel governance:

to better meet citizens' expectations and needs without excessively complicating institutional arrangements (overlapping powers, etc.);

to allow local authorities freedom to experiment and take initiatives by guaranteeing the harmonisation necessary to ensure the free movement of persons and goods (centralised and federal states);

to give priority to functional and not only structural reforms;

to give local authorities the means to achieve their objectives in a context of tight budgets (funding of new mandates);

to draw on broader challenges (construction of economic areas, integration of the *acquis communautaire*).

- The benefit of a high-quality regulatory policy: **recommendations**

to reinforce the role of central authorities in promoting high-quality sub-national regulation: publication of guides, training of local managers, diffusion of evaluation techniques, especially RIA, at local level;

to institute adaptable coordination and cooperation mechanisms;

to forestall conflicts of interest (separation of ownership of a utility from regulation);

to guarantee legal certainty through effective means of control and sanction (easily accessible and rapid justice system, stronger role of independent authorities).

Source : Regulatory reform in Canada, the Czech Republic, Denmark, Finland, France, Greece, Hungary, Ireland, Italy, Japan, Mexico, the Netherlands, Norway, Poland, Spain, South Korea, Turkey, the United Kingdom and the United States.

16. The attached tables offer a summary overview of the various OECD studies on the subject as a way of putting this analysis into context. They highlight the many forms that regulatory tools can take as a means of providing very concrete responses to the problems posed. The glossary serves to define the English and French terminology for some of these concepts.

17. The first part of this report will identify the principles of multilevel governance. A toolkit for the multilevel exercise of government responsibilities should be able to (1) **empower all players in the regulatory process** and optimise the allocation of resources and the transparency of procedures (2) **improve the quality of regulation** and its economic and social impact, and (3) **promote regional networking**.

18. The second part will look at how these principles are applied in the water sector.

PART I: THE PRINCIPLES OF MULTI-LEVEL GOVERNANCE

1. Empowering the players in the regulatory process

19. The emergence of multiple regulations can, if steps are not taken to regulate the situation, be a factor of legal uncertainty and complexity, and hence of cost, for economic operators. It is important, as far as possible (for the constraints are many), to define the roles and responsibilities of each player in the regulatory process (1.1) and to draw the appropriate conclusions (1.2).

1.1 Defining the roles and responsibilities of each player in the regulatory process

A clear definition of responsibilities and the conditions under which they are exercised

20. Globalisation is raising new questions about the attractiveness of regions and about the impact of regulatory quality on competition. In a number of sectors (telecommunications and transportation, for example) deregulation has produced flexibility. In order to optimise its effects, it is worthwhile examining the multilevel dimension, with a focus on interaction between decision-making centres.

21. There is a dual movement under way, involving a growing devolution of powers to entities that have real regulatory autonomy (local governments that are elected, and regulatory agencies or bodies that have statutory independence), together with ongoing globalisation that requires greater coordination.

22. Interdependence and complexity are the two pitfalls that must be avoided in a context where the quality of regulatory responses is clearly a comparative advantage. The application of these policies must be economically profitable, and international comparisons show that regulatory reform is indeed a source of profits. In Australia, there is a clear link between sharp productivity gains and the reform efforts that have been undertaken.

23. By bringing decision-making closer to beneficiaries while promoting horizontal coherence, multilevel governance offers some solutions for managing the decision-making process and for optimising the decisive asset represented by regulatory quality. Yet while coordination is indispensable it is not without cost. If the questions of who regulates what, and why, can be answered as clearly as possible, it will keep the need for coordination to a necessary minimum. This is the price that must be paid for improving the quality of public services without adding to bureaucratic and tax burdens.

24. In the end, the general objective of achieving regulation that is clear, coherent and stable (or at least credible) over time requires some specific adaptations in the case of multilevel government systems. Managing the regulatory decision-making process presupposes answers to these two questions: who are the decision makers, and what are they responsible for?

25. Before making changes to the decision-making process and to regulatory management, these mechanisms must be clearly identified, and the regulatory powers of the sub- and supranational levels established. The objective is to enhance the returns from regulatory policy while minimising its costs.

Identifying responsibilities

26. Institutional organisation is often laid down in the Constitution. As a reflection of a country's political, historic and geographic heritage, this balance is not easy to modify. With the move to decentralisation, it is true that there have been substantial modifications in many countries over the last two decades. As recently as 2003, South Korea embarked on an ambitious decentralisation programme. Yet the potential political cost and the cumbersomeness of constitutional amendment have encouraged the search for other ways of identifying and deploying the appropriate administrative levels. The way is open for innovative thinking to promote new regulatory strategies and to influence behaviour through agreements or transactions to guarantee regulatory quality in regional and institutional settings that are not always coherent.

27. The increasing complexity of the regulatory process has to do with the proliferation of players, but also with the growing diversity of their roles. Thus, direct supervision is disappearing in favour of increasing disjunction between the responsibility for making a decision and that for executing it. In this context, it is particularly important that each level be aware of the perimeters that define its area of intervention and its responsibility. The manner of devolution and the way the exercise of powers is organised will depend on each government, but it is important to ensure that the arrangement is clear and credible over the long term. This is a difficult exercise, because the more complex a process, the harder it is to identify the political advantages of regulatory reform and the risks of failure.

28. Assuring the quality of regulatory processes can avoid certain perverse effects, such as those inherent in the dichotomy between the taking of a decision and exercise of the related responsibility. In Greece, the central government used to set license fees while the communes kept the revenues and so were tempted to require frequent license renewals (Decentralisation in European Union Countries, notes and documentary studies, November 2002). In Germany, in order to ensure equivalent living conditions throughout the Federation, complex institutional arrangements have been introduced to foster cooperation between different levels of government. But, as both federal and *Land* courts of auditors have pointed out, co-financing hardly makes it easier to evaluate the total cost of projects. Local governments bear only a portion of the costs co-financed by the federal government, and if the expected advantage exceeds the outlay they will gladly take up a project while ignoring the real cost-benefit relationship. The authorities have already taken a number of measures designed to impose stricter discipline on the different levels of government, in particular under the domestic stability pact introduced in 2002. This is an important stage in the budget consolidation process, since federal government aid to *Länder* and local authorities amounted to 0.8% of GDP in 2002, or €117.4 billion. (Regulatory Reform in Germany: Consolidating Economic and Social Renewal, OECD, December 2003). The same observations are perfectly applicable to the relationships among local governments.

29. The notion of quality needs to be built into the regulatory process itself. To this end, it is important to ensure information feedback to the entity issuing the regulation. Spain, for example, has developed ways of measuring the cost of specific legislation, while Finland analyses the consequences of a local government's budgetary decisions.

30. On the other hand, there has been very little analysis of the feedback from local regulation into national regulation, reflecting perhaps the need for tools that are appropriate for analysing a dynamic regulatory situation rather than a static one.

Empowerment of central or federal levels

31. The transfer of powers to local entities should not be seen as simply a convenient way of shifting responsibilities. If it were, local entities' resistance to change would make it impossible to optimise the devolution process. For the sake of efficiency, the transfer of powers to different levels of government must be based on their comparative advantage in providing each type of public service. The tools exist but they need to be refined. For example, regulatory impact analysis (RIA) offers a flexible methodological framework for measuring the costs and benefits of a regulation by analysing the potential impacts of the decision. Unfortunately RIA is not widely used at the local level, except in Australia's states, Germany's *Länder* and some Mexican states. Introducing RIA early in the decision-making process would be extremely useful.

32. In fact, even on the occasions when the question of transferring powers is analysed *a priori*, it is done on a static basis. In France, for example, when responsibility for the maintenance of school buildings was transferred to local governments, three elements were under-estimated:

- the legal element: national regulation and jurisprudence have increased concerns for security;
- the economic element: money was needed to rehabilitate the buildings that were transferred and to meet training needs;
- the political element: voters exerted pressure on local officials to spend money on schools. As a direct result of these three factors, costs rose sharply.

33. The Unfunded Mandates Act in the United States offers a similar example for making federal levels accountable.

34. In the United States, federal regulators are supposed to evaluate and budget for the economic costs and expected benefits of a regulation imposed on a local government. If the annual costs exceed \$10 million, the federal government must come up with the money (Unfunded Mandates Reform Act of 1995, which makes RIA mandatory for the entire government). RIA resources are therefore targeted primarily at regulations that have the greatest impact, in other words those likely to impose the greatest cost increases on any sector or region, or to have a negative impact on competition, employment, investment, productivity, and innovation.

35. The entire problem lies, of course, in assessing the economic cost, measured by the costs to the private sector of compliance with the regulation. Despite this difficulty, the very fact of posing the question and undertaking an *ex-ante* evaluation will help in adapting the regulation to the problems identified.

36. Proper management of regulatory policy, so as to maximise the positive effects by adapting the supply of public services to local preferences, can provide some concrete answers.

*The role of local governments*Institutional aspects

37. It is not up to central government alone to manage the transfer of regulatory powers. In Spain, the Constitution calls for a continuous process of decentralising powers in the light of local capacities to exercise them. Thus, a Community may choose to take on full legislative or executive powers or to have the central government or parliament delegate to it certain explicit powers.

38. In Germany, each of the sixteen *Länder* has its own constitution, parliament, government and courts. The *Länder* parliaments have instituted their own RIA tools to ensure the quality of their regulations. These require a systematic quantification of the costs in the local budget. However, these tools cannot yet be considered mature.

39. Adoption of a strategic framework of this kind allows for a more dynamic definition of powers, since local governments are constitutionally responsible if the law, or the Constitution, does not expressly assign a given power to the State. This principle of subsidiarity reflects a real concern for clarity, but it does not always succeed in avoiding overlapping and hence the need for coordination mechanisms. In Germany, while the Basic Law clearly states that authority for all matters not expressly assigned to the Federation lies with the *Länder*, authority in an area like health lies with all three levels of government. This quest for a satisfactory organisation is a permanent challenge for an evolving context. In Denmark, the government set up a commission on structures with the mission of identifying shortcomings in the distribution of tasks between municipal, county and central government levels. Drawing on its work, a regional government reform plan was put to the Cabinet on 28 January 2004. The aim of this study is not to examine how structures have to be adapted to an increasingly complex institutional environment. However, this fundamental point needs to be borne in mind before examining mechanisms that will foster interaction between the central and decentralised levels, whether in a unitary or federal State, and finding evaluation mechanisms along the entire decision-making chain.

Budgetary aspects

40. Budgetary trade-offs are a strategic question. Without real financial means, the regulatory powers transferred to local governments will be illusory. In fact, a State can thereby retain effective control over local governments, even if it no longer has legal authority over them.

41. This risk needs to be taken into account in the budgetary aspect of regulatory policies. For example, in some countries where central government determines the essential elements of local taxation, requiring local government to set tax rates within pre-established limits, the result is to relieve local government of accountability, leading to rising fiscal pressure. It would be well, then, to combine the demands of regulatory quality with proper attention to the efficiency of public expenditure (cf. November 2002 notes and documents quoted above/fiscal relations across government levels- OECD).

42. Several countries have moved in this direction.

- In Great Britain, a portion of local government spending was simply recentralised.
- In Ireland, the local habitation tax was replaced by a lump-sum allocation in 1978.
- In Spain, local government budget shortfalls are a chronic problem despite numerous reforms.
- France has faced a similar problem with reform of the business tax (*taxe professionnelle*). Supplementary State grants are supposed to offset the exemptions accorded to businesses on their investments for 18 months. This shift is part of a continuing downward trend in the share of taxation in local government revenues, and it undermines local governments' accountability for promoting economic activity within their territory (two-thirds of the funds, or €150 billion, come from local taxes, and one-third consists of various State transfers).

43. Several mechanisms can be used to overcome this apparent conflict between empowering local governments and maintaining regional equality.

- The Netherlands has sought a middle path between decentralisation and re-centralisation by moving from complete autonomy for third-tier governments to co-management with a higher-level authority. This approach applies, for instance, to road traffic and land use planning.
- Denmark has allowed greater flexibility in public spending in return for observance of national guidelines.
- In Spain, legislation requires the communes to provide certain minimum services. Yet if some communes encounter financial difficulties, the Autonomous Communities can relieve them of these obligations and can redirect provincial assistance in order to guarantee that these minimum services are provided throughout their territory.
- In Australia, attempts at "re-centring" have been initiated in order to create a national market that has more coherence than a simple summation of regional markets.

44. Any mechanism for optimising regulatory quality in the multilevel context must pay particular attention to financial rules.

1.2 Taking advantage of solid partnerships at the local level (the consequences of this empowerment)

Consultation mechanisms

45. Because local governments are closer to the people they administer, local decision-makers can be allies in adapting regulation to changing needs and circumstances. A jumble of often contradictory regulations can impose major costs on the public.

46. A great variety of solutions have been adopted for involving local governments in defining regulations and how they are implemented. What might be called "cooperative" solutions associate local governments throughout the process, or at one stage of the process (formulation of objectives, for example), and make them responsible for all or a portion of the outcomes. Initially, this approach involves negotiation and may appear inefficient, but over time it will foster better adaptation.

- In Australia, the push for harmonisation and coordination has come primarily from local governments (i.e. the states and territories), through the Council of Australian Governments. As well, the councils of ministers and representatives of the federal and local governments provide for coordination, cooperation and development through a secretariat that is responsible for preparing proposals for uniform or harmonised laws (Office of Regulation Review, ORR). This body reviews intergovernmental regulation (states/territories). In the intergovernmental decision-making process, it intervenes both upstream (validating the draft RIA prior to public consultation) and downstream (validating the procedure). Thus, local and federal RIAs coexist, and they are harmonised by a specific body and by ad hoc regulatory forums.
- In other countries, the initiative lies mainly with the central government, but local governments are consulted when the regulation is being defined (Ireland: Public Management Act and Freedom of Information Act, 1997) or when the conditions of implementation are being decided (Denmark). In Greece, this approach applies only to laws relating to local government and environmental protection.

- In the United States, regulatory officials favour administrative guidance tools for ensuring the conditions for competition. The federal government sets minimum standards and, while local governments must respect them, they can also adapt them by setting stricter or supplementary standards.
- In Germany, the coexistence of two chambers, the Bundestag representing the federal level and the Bundestag representing the *Länder*, means that both can play an important role in preparing legislation and fosters close links with the federal authorities.

Public consultations

47. The legitimacy of a regulation has to do not only with the authority of the body adopting it but also, and increasingly, with the degree of public input. Thus, decentralisation undoubtedly contributes to the democratic process if it serves to reinforce transparency and the consultation of stakeholders. Introducing a true right of public intervention in the regulatory process can maximise the positive effects by ensuring that public services are adapted to local preferences. However, attention needs to be paid to the increased bureaucracy inherent in multilevel complexity. There is a subtle balance between an excessive formalism that induces judicial inflation and a lack of clarity that prevents citizens from identifying the relevant level and telling it what they expect. The position of citizens varies according to their role as users, taxpayers, etc., and the risk that consultation processes might be taken over or even hijacked cannot be ruled out. The public is not "neutral" and nor is the local authority concerned. It may be tempted to satisfy the wishes of its direct electorate, sometimes to the detriment of national objectives.

48. While these points need to be borne in mind, it remains true that better knowledge of users is essential in the process of optimising public governance.

49. This may take place in a more or less formal way. In Macedonia, citizen information centres were created at the time of decentralisation in 2001. The centres were supposed to monitor implementation of the reform, and provided a bridge both to the citizenry and among local governments themselves. They served to enhance the transparency of the process and to involve the public. The process produced proposals and recommendations and contributed greatly to modifying bureaucratic culture. The policy is based on the principle that rules must above all serve the citizens. After an experimental phase, the centres were given official recognition in the "open government" law of 2002. In Belgium, a barometer has been introduced so as to gain a better understanding of what the public expected from each level of government and discussion groups have been organised. Work on standards has begun, drawing on these results, so as to favour comparisons. In 2003, South Korea embarked on an ambitious decentralisation programme under the title "Effective government with the people", based in particular on the spread of a culture of dialogue at all levels of government. Similarly, citizens of the European Union have the right of intervention, and can sue their government for failure to apply a Community directive.

50. Civil society, businesses and individual citizens can all effectively spur the adaptation of regulations to their needs. In short, as implied in the fifth criterion in the OECD checklist for regulatory decision-making, determining the right level of government is a necessary but not a sufficient precondition.

1.3 Ensuring the capacity for accountability and encouraging innovation

51. This question has to do with recognising and coping with regulatory dynamics. The potentially perverse effects of granting regulatory freedom to local governments must be recognised so that effective mechanisms for avoiding them can be put in place.

52. If regulation in a given area is not properly planned, the result may be a plethora of rules that can undermine legal certainty and generate significant costs in terms of the public service payroll. For example, Spain saw an increase of 31.1% in public service staffing at the local level between 1985 and 1997, because of the inherent overlapping of services at the different levels. This cost is probably underestimated, since the consequences of the overlapping have never been subjected to a proper impact study. The freedom to experiment would seem to offer a favourable framework for resolving these difficulties, recognising that local governments are real sources of regulatory innovation. The process then becomes widely disseminated only after the arrangements have matured.

53. With the creation of special zones for structural reforms, Japan has launched a real innovation. Specific legislation defines the programme of structural reforms intended to ease the regulatory burden on a given sector. Municipalities then choose the measures that they want to try out, and they can make their own proposals, as can the prefectures or businesses. For example, in the field of education, a municipality might hire staff that do not have teaching qualifications. Such derogations can then be validated by parliament on a proposal from the Prime Minister, and incorporated into the law governing special legislative zones. They can then be applied by any local government -- and what is most original, by any business -- that so desires. Although initially applied to deregulation policy, the idea is gradually to modernise public policies as a whole.

54. The process has two highly original features:

- *the operative force of the plan* proposed by a local government. If it is consistent with the objectives of the law governing the programme, it must be approved;
- *the local authority's obligation to justify its refusal* to consider a private-sector proposal for simplification.

55. The objectives set by local government must be measurable and they must be subject to evaluation. The government has earmarked the necessary resources to implement this policy.

56. There is an ad hoc body, headed by the Prime Minister, that is responsible for promoting, coordinating, evaluating and monitoring experiments under the programme, and for imposing it on ministries that may be recalcitrant as a result of pressure from interest groups.

57. This experiment seems very interesting from more than one viewpoint. In effect, it combines a strong political will, as expressed through the mechanisms that are to impose it on all ministerial departments, with the obligation to take stakeholders' proposals into account. The three criteria for an effective regulatory system are present here: it has support at the highest political level, it contains explicit and measurable regulatory quality standards, and it provides for a continuing regulatory management capacity (Regulatory policies in OECD countries, 2002).

58. In this way, Japan has created some real laboratories for public innovation. This type of programme is designed to test for potential negative fallout from deregulation, and to experiment with new forms of consensus-based decision-making.

59. The conventional model of regulatory management needs to be revisited. This linear approach is characterised by a pre-established legal framework, standardised implementation procedures, hierarchical implementation controls, and enforcement procedures and jurisdictional control as needed (Lee Metcalf, Regulatory Cooperation in an Interdependent World). Its rigidity makes it ill-suited to a regulatory policy based on networking, where cooperation is a fundamental condition of quality.

2. Improving regulatory quality and its economic and social impact

60. The proliferation of regulatory decision-making centres casts the issue of regulatory quality in new terms. With sub-national and supranational levels now playing an increasing role in producing standards, controlling regulatory inflation means imposing rules on the various sources and forms of regulation.

61. Even in centralised countries, the State is no longer by any means the only source of regulation. In its place, decision-making centres endowed with regulatory powers have multiplied (the State, agencies, independent authorities, supranational bodies etc.). In federal countries, economic agents' insistence on simplicity and clarity sometimes collides with the decision-making autonomy of the component members of the federation. At this point, regardless of their institutional form, States must cope with growing interdependence and with decision-making processes that are complicated both by the number of players and by the many policy areas that must be taken into account (environment, health, etc.).

62. This new reality has a direct impact on the entire regulatory preparation process, and new, more innovative, more cooperative and more persuasive regulatory strategies are needed. Coercion alone is no longer sufficient.

63. In order to contain the potential for negative fallout from the sharing of regulatory responsibilities among different levels (contradictory rules, excessive regulation or regulatory gaps), regulatory quality must be optimised at each of these levels, and possible interactions taken into account. There are two levels in particular that can play a major role in driving and coordinating the process: the State and the supranational level.

2.1 *The new role of the State in regulatory governance*

64. The success of governmental regulation can be compromised by failure to interact with sub-national regulations.

65. Regulatory quality at one level may be offset or cancelled out by poor regulatory policies at another level. This problem can be illustrated by two examples.

- The impact of the Irish government's policy for reducing red tape was severely compromised by the lack of consistency between the central government's demands and those of local authorities. Because the process was not transparent to economic agents, the attempt to improve regulatory quality through simplification plans was counterproductive.
- The deregulation of highway transport in Mexico, undertaken by the federal government in 1989/1990, was undermined when local governments introduced licensing and road safety rules that effectively stripped the national regulation of its substance (Regulatory reform in Mexico, OECD 2000).

66. The State must retain regulatory oversight as an essential function. Yet in the regulatory process, the relationship between States and local governments are all too often dominated by control procedures that focus on legality and not on quality, in the sense of the regulatory impact on third parties. In its relationship with businesses, on the other hand, the State can often succeed through strategies of persuasion and cooperation instead of relying solely on regulation.

67. This approach can also be used in relations with local governments. In fact, what is important is not to accumulate regulations, which impose costs on businesses, but rather to establish clearer regulatory policy objectives and then choose the best instruments for achieving them.

The efficiency of State-initiated policies relies increasingly on the quality of coordination with sub-national levels.

68. States play a major role in ensuring regulatory quality, even at the sub-national level. In Ireland, the government created a public management committee and embarked on a programme to optimise the quality of public services, working closely with local authorities. In Germany, the "Modern State – Modern Administration" programme aims to promote a new concept of the State as facilitator, emphasising better quality and more effective regulation, especially between different levels of government. In Italy, innovation programmes are spearheaded by the minister responsible for reform. Intervention by a major federated state, such as that of the state of Mexico in initiating regulatory reform, can have an identical locomotive effect.

69. In contrast, if national regulations fail to take sufficient account of the conditions under which local governments must apply them, the juxtaposition of rules originating at different levels can generate inconsistencies, while overly detailed regulations can lead to a profusion of formal requirements that have nothing to do with quality. In a context already characterised by a lack of clarity, lead-times for appeals against local government decisions add to the uncertainty. Good results can be obtained by promoting strategies of cooperation and consultation between central and local governments, as Denmark and Greece have done.

70. The State has a number of instruments at its disposal for promoting quality at all levels.

- *Tools designed to optimise the value for money of services provided by local government.* Hungary, for example, has created a legal framework to enable small communes to link up to provide common services that meet government-imposed standards. These "multifunction" associations, currently being discussed in parliament, originated in a set of experiments which showed what they can contribute in areas such as social services, healthcare, roads and employment. The clear objective was to guarantee services of consistent quality and to limit the negative effects of excessive territorial fragmentation. Other countries like Germany have preferred a flexible regulatory approach, like good practice manuals (setting quality standards and leaving it to local governments to choose the means).
- *Technical evaluation*, the cost of which must of course be proportional to the anticipated results. The UK has introduced programmes to optimise the quality of local management. In Spain, the public administration ministry uses local authorities to help introduce EFQM and CAF self-evaluation tools at local government level, including the preparation of case studies with representatives from the different levels of government, conclusion of an agreement with the federation of municipalities and provinces for the introduction of CAF, and training for all staff in use of the tools.

- *Training to enhance the level of technical skills at the local level.* France offers some interesting examples of cooperation between training institutes for central government and regional officials, through networking the country's public administration schools and standardising competitions for senior positions at the two levels of government. In Greece, a local government staff college has been created, attached to the National Public Administration Centre, to enhance managers' skills. In South Korea, the new central directorate is driving government reform and decentralisation, for example amending legislation relating to government organisation. The government has launched several management training programmes in support of this initiative, and the involvement of high-ranking public officials deserves special mention, in particular with the "Senior Executive Service" programme.
- *Promoting simplified regulatory regimes,* where application does not impose a significant enforcement burden on sub-national levels (this difficulty was found in Germany in particular). In France, a law authorising the government to simplify legislation by order² has recently been tabled. Amongst other things, it provides for the simplification of procedures to overhaul building permits issued by local authorities.
- *Promoting innovation.* The Swedish government has created an agency bringing together representatives from the different levels of government, academics and business people with the aim of encouraging the development of "e-public services". One of the agency's explicit objectives is to find new modes of cooperation between central and decentralised levels. In South Korea, the Presidential Committee on Government Innovation and Decentralisation (PCGID) acts as a think-tank to support a reform based on self-regulation, the commitment and involvement of public officials and the promotion of e-government.

Box 2. Examples of coordination through the tool

pulling all regulations together in a single document

Regulatory transparency can be enhanced by combining mapping and a set of prescriptions for a given area.

Vertical coordination between the State and local governments: France's Natural Risk Prevention Plans (PPR).

Coordination of shared powers: the communes are responsible for issuing building permits, while the State does the mapping of areas exposed to natural hazards. The prefect, as the State's local representative, is responsible for preparing the PPR.

The PPR is a tool:

- for steering construction into less exposed areas;
- for providing incentives: compensation payments are reduced if a commune has not adopted a PPR after claiming for two natural disasters;
- for prohibiting construction or prescribing safeguard measures in at-risk zones (the State can take over from the local government if works are not completed within 5 years) ;
- for sanctions;
- for experiment: experimental co-financing programme for feasibility studies.

The PPR allows for:

- territory-wide coordination, covering several communes (the idea of "risk basins"),
- cooperation towards a common definition of guidelines with local governments,
- consultation with the public (public survey) and the competent bodies.

Coordination between the sub- and supra national levels: the anti-noise campaign in France.

The directive on ambient noise evaluation and management (18/07/2004) calls for preparation of "noise maps". In France, zone-specific insulation standards are prescribed when building permits are issued for new sites located near transportation facilities, and tax incentives are offered for upgrading existing buildings. The contractor and the operator are liable to penalties for non-compliance.

2. The new bill continues the work of simplification begun with the law of 2 July 2003.

2.2 *The role of the supranational level*

71. The European Union offers a good example of the role that supranational bodies can play in optimising regulatory quality.

72. In its Member States, more than 50% of regulatory activity is governed by the transcription of European directives into domestic law. In countries such as Poland, the Czech Republic or Hungary, the transposition of European directives has played a major role in changing what were highly centralised systems.

73. Yet local governments still have little involvement in the process. Even where local officials are represented in national parliaments, this is not sufficient. Better interaction between these levels would facilitate the understanding of laws and regulations, and improve the quality of their implementation. In Spain and in Germany, local governments participate in the process of transposing directives. In Germany, this participation is in fact enshrined in the common procedural rules. Moreover, the European Union is gradually equipping itself with tools for optimising regulatory quality, such as regulatory impact analysis (RIA). Since January 2003, a centralised system has been in place for evaluating the impact of regulation. This system replaces the decentralised plans that were used in the various directorates.

74. This question arises with particular force in areas that are sensitive with respect to competition, such as public procurement, where local governments are major players. In France, local governments have not been involved in the transposition of competitiveness directives or the amendment of the public procurement code. Difficulties of application finally resulted in an overhaul of the laws. This remark applies equally to the search for regulatory mechanisms for combating corruption.

75. In terms of regulatory quality, with the growing importance of the sub-national level, the roles of each level -- supranational, national, and sub-national -- need to be redefined. Useful approaches might include clarification and empowerment of each of these levels in the regulatory process.

3. **Regulatory approaches that involve management through networking**

76. A regulatory policy that takes into account the multilevel dimension requires new management strategies and new forms of organisation. It can no longer be designed vertically in centralised states, or through a simple juxtaposition of autonomy, but requires due attention to horizontal interdependence.

3.1 *Progress in "vertical governance"*

Easing the transfer of powers

77. It would seem indispensable to establish a strategic framework prior to the transfer of powers, and to define the necessary support measures. In France, decentralisation increased the number of laws by 40% in 10 years. In Spain as well, the swift transfer of regulatory powers led to a plethora of new regulations. On the other hand, in the case of community-sourced standards, the quality and applicability of the rules were enhanced by establishing legal councils in some of the autonomous communities, with powers equivalent to those of the State Council, consisting in this case of verifying the capacities of local governments to integrate these elements into their legislative and regulatory framework

78. The negative impact of the lack of regulatory quality at the local level goes well beyond the geographic bounds of the entity concerned. In unitary states, regulatory powers often remain with the central government. In these cases the central government will have to share its regulatory expertise with local governments in order to implement policies for regulatory quality more rapidly.

Promoting regulatory approaches that do not lead to cumulative regulatory pileup

The subsidiarity principle

79. Multilevel governance implies a reform of the regulatory process, in the absence of which there is a risk of a damaging accumulation of overlapping rules. Here, the principle of subsidiarity, as applied within the European Union, offers a promising framework for analysis. It provides a coherent approach for dealing with a particularly difficult problem in the multi-level context, the exercise of shared powers. The subsidiarity principle is exercised within strict bounds. It is confined to the field of shared powers between the EU and Member States, and applies only if national regulations are inadequate or if EU intervention would yield value-added through greater efficiency. In each case, all actions that can be taken to avoid centralisation at the European level, through cooperation or coordination, are first examined. If its invocation seems inevitable, it must then be accompanied by specifications as to the impact of the proposed measures.

Examples of cooperation

80. In Mexico, the law deregulating trade offers a further illustration of a process for ensuring coherence among the different regulatory levels:

- a strong political will, shared by all stakeholders (the federal government, the states and municipalities), with commitment at the highest political levels;
- clearly operational objectives: signature of agreements allowing for deregulation of the business environment within the context defined by the law;
- appropriate instruments:
 - a dedicated body, the COFEMER commission. Wielding real powers, its duty is to promote coordination between the central government and local governments, and to encourage the signature of specific agreements among the three coordination levels included in the law. It can also provide technical assistance (with methodology, good practice manuals, training, working groups) ;
 - recognition of the "principle of mutability" through mechanisms that allow constant adaptation (annual meetings to share experience and to learn through mutual cooperation and adaptation on this basis of the plan adopted in 2002 for improving regulatory methods).

81. Despite the great variety of mechanisms for promoting regulatory quality and best practices at all levels of government, horizontal governance still receives inadequate attention. Yet it is even more necessary now, when the complexity of the issues in question is leading to a sharp increase in regulation.

3.2 *The potential and the limitations of the competitive approach*

82. A pragmatic policy is needed, one that takes into account the positive and negative effects of policy choices, and that identifies the most appropriate regulatory approach for each sector. This should produce maximum advantages while minimising potential negative fallout.

83. Interregional competition can be highly profitable. It encourages an optimal cost-benefit ratio and fosters innovation in the provision of public services. Yet it must not result in unproductive regulatory dumping where local governments may indulge in unfair competition in their zeal to attract capital.

84. Hungary has been disadvantaged by the absence of established mechanisms for resolving disputes arising from the fact that municipalities are not dependent on the central government. The State can rely only on voluntary coordination, and the courts have the power to intervene only when regulations are unconstitutional. The time-consuming and cumbersome nature of judicial proceedings has led municipalities into a "race to the bottom" in terms of regulatory constraints, taxation and environmental protection, in order to attract investments. The situation is similar in Mexico, where municipalities have signed concession contracts with glaring defects in order to attract investments.

3.3 *Institutional forms of cooperation: contracts and agreements*

85. In many countries, associations and local authorities have played a major role in promoting regulatory coordination, for example among municipalities and between the different levels of government (Finland, Czech Republic, Greece, Hungary, Mexico, Turkey, France, Italy). In most cases this power is purely advisory. Some countries have created special committees to improve coordination, or have instituted a specific mechanism whereby local governments can submit their comments on measures proposed by the central government (Ireland, Spain). In Canada, the central government and provincial ministers meet to discuss sectoral programmes.

86. Although the approach is cumbersome and runs the risk of giving too much weight to interest groups, cooperation of this kind offers better guarantees that regulations will be appropriate and enforceable. Without denying the advantages and flexibility of this dialogue, there is a clear need for simple mechanisms that will produce efficiency gains.

Cooperation agreements

87. When it comes to coordinating municipal services in Spain, provincial parliaments approve a provincial plan for cooperation on civil works and services that lie within municipal responsibility. The communes and the provinces participate in their preparation and their financing.

88. In France, planning contracts negotiated between central government and the regions reflect the same approach. They make it possible to establish agreement between the State and the regions, and more broadly with local authorities at various levels, on the financial contributions to be made to specific projects. The involvement of local government other than at the regional level still needs to be strengthened, but this type of mechanism is useful in terms of optimising public expenditure.

Box 3. Examples of coordination management tools

Coordination through institutional reorganisation.

- In Italy: complete redefinition of central ministries' powers to ensure coordination, regulation and monitoring of decentralisation policies.
- In Canada: creation of federal agencies for regional development, capitalising on each region's comparative advantages for economic development. Agency initiatives must be consistent with horizontal federal policies.

Coordination through agreements

- In Mexico: SARE programme of administrative unification for simplifying rules for business start-ups. The federal programme can be activated through federal agreements with the states, but also with the municipalities and cities.
- In Canada: a common plan of work defined by the Council of Atlantic First Ministers on transport regulation.

Source : Territorial Reviews: Canada and Italy (OECD 2003).

Cross-border relations

89. In Germany, two distinct situations arise. The *Länder* are able to negotiate contracts with other state governments, and even transfer powers to institutions beyond their borders. For the communes, in contrast, relations with their foreign counterparts are limited to local community affairs. This has led to some difficulties in areas of government responsibility, resolved by the Karlsruhe accord organising agreements between local governments and German, French and Luxembourg public agencies.

90. In Finland, cross-border cooperation has been organised with the local authorities of the Barents and Baltic Sea region of Russia.

91. Local government independence can constitute a problem in promoting coherent regulatory policies, especially in federal states or in areas of cooperation between states. The preference will then be for formulas, such as mutual recognition, that are less demanding in terms of application rules.

The principle of mutual recognition

92. Adopting the principle of mutual recognition is no doubt a minimalist and pragmatic approach. It does not imply convergence towards a common standard, but merely elimination of the cost of regulatory discrepancies, by guaranteeing that they will not become barriers: there is no need to harmonise technical requirements. This principle can lead to economic efficiency gains.

93. Mutual recognition is an effective tool for promoting economic integration within a given area and is hence particularly well-suited to the multilevel dimension. The principle is simple: producers of goods are authorised to apply a single standard in a defined territory. Mutual recognition is an effective way of reducing barriers to the movement of goods and services, as the following two examples show.

94. In Australia, procedural guidelines and standards constitute the principal source of regulation. Australia and New Zealand have adopted the mutual recognition system for interstate commerce and for the registration of real property. While it is not always easy to determine precisely the role that this instrument has played in the notable increase in trade between the two countries, the beneficial effects in terms of economies of scale and lower costs to consumers are undeniable. Moreover, having a common position allows Australia and New Zealand to exert real influence when it comes to the adoption of international standards.

95. This experiment is interesting from more than one viewpoint:

- it establishes a clear objective: the gradual elimination of all exceptions, while recognising the sovereignty of states and the autonomy of entities;
- it is pragmatic: objective rules are identified for justifying regulatory differences. Moreover, while some areas are excluded from the regulatory field, in other areas, where mutual recognition would be beneficial, interim resolutions allow for adjustment prior to application of the principle;
- objective criteria are determined by an ad hoc working group:
 - the requirements are those necessary for achieving the objective,
 - they are proportional to the desired goal,
 - there is no less restrictive means for achieving the objective.

- The process is as follows:
 - the principle is respected from the outset of any procedure,
 - information and training is provided to economic agents, especially professional associations, by means of notice-and-comment. Their support is essential, because the inadequacy of means for guaranteeing application of the standard remains the weak link,
 - constant efforts are made to simplify the process, primarily through the use of new technologies,
 - the cost-benefit ratio for measures taken is assessed and a process may be recentralised, such as the establishment of a national property registration database;
 - national standards are defined and their implementation is assessed on a regular basis.

96. This principle can also be seen at work within the European Union. It ensures the free circulation of products within Community territory, by respecting equivalences in health and safety matters without the need to harmonise all technical requirements. Thus there is no need for a common instrument that would constrain national regulatory systems.

3.4 Issues relating to dispute management

97. One of the weaknesses of this type of regulation has to do with dispute settlement mechanisms. The courts do not feel themselves either empowered or equipped to intervene in terms of regulation.

98. Judicial oversight as it exists in many countries, where it focuses on enforcing standards without taking the economic dimension into account, is hardly an appropriate solution, regardless of the point at which it intervenes in the process.

99. In France, there is a procedure for controlling the legality of local government acts that brings the judicial authority into play *a priori*, since the prefect, the representative of central government at local level, can challenge in court any administrative or financial act that is contrary to law. Yet there is no provision for selectivity in deciding which acts to challenge and this undermines the effectiveness of control, given the discrepancy between the number of acts that must be controlled and the number of persons assigned to that task. Regulatory quality is not the instrument's primary concern.

100. In Spain, control is exerted both *a priori* and *a posteriori*, but this raises the problem of the length of time during which legal uncertainty prevails.

101. In this regard, multilevel governance is no exception to the rule, and the courts are not regulatory bodies. The question then arises as to whether decentralised, horizontal networks are needed to prepare horizontal public policies, addressing the question of indicators and assessment, to identify the cost-benefit ratio of each approach. Such networks could perhaps be regulated by independent authorities.

PART II: THE PRINCIPLES OF MULTILEVEL GOVERNANCE APPLIED TO THE WATER SECTOR

102. The first part of this report served to highlight the specific features of multilevel governance, namely the importance of empowerment and the adoption of new, ad hoc modes of regulation.

103. The second part illustrates how these principles are applied, taking the water sector as an example.

104. The water sector was chosen because it provides an excellent example for illustrating multilevel issues.

1. Water is a public service situated at the point where several public policies converge. It is a limited resource, a factor of production and an environmental asset since pollution generates external costs prejudicial to the general interest. The quality of water regulation is extremely important, especially in its environmental aspects. Water is essential to a country's economic development, and investment, already very substantial, is destined to grow still further as demand increases and resources decline. 1.2 billion people in developing countries do not have access to drinking water, and this number will rise to 3 billion by 2020 if nothing changes, while 2.4 billion do not enjoy even the most basic sanitation. At the same time, global water usage has quadrupled over the last 50 years even though the world's population has only doubled, and it has increased by 31% between 1995 and 2002. The world's available fresh water fell from 17 000m³ a year in 1950 to 7 300m³ in 1995. Colossal investment is needed to meet these challenges. In 1995, total investment in water provision and wastewater disposal (excluding investment by industry) was estimated at 30 billion dollars. This figure should be revised to 74 or even 90 billion dollars a year for water provision alone (not counting renovation and rehabilitation).
2. Water uses local infrastructure which already has a relatively long-standing multilevel dimension. Managing water networks requires cooperation between sub-national and sometimes supranational entities, because the basins from which the resource is drawn are no respecters of man-made borders. Decentralisation and private sector involvement, which vary from one country to another, have generally long been organised, either as a separate policy or as an element of other policies such as housing.
3. The unsuitability of the regulatory framework for water is a time-bomb. Water management costs (extraction, transport, depollution, etc.) are notoriously under-estimated. This regulatory weakness dampens private investment at a time when such investment appears to be essential (despite an increase in the last ten years, private operators still supply only just over 5% of the world's population). Guaranteeing their citizens drinking water will certainly be one of the major challenges facing governments in the years to come. Arid developing countries are of course those most concerned by the problem, but pollution of the resource means that temperate rich countries will not be spared either. A major crisis is in the offing, of which certain border conflicts are only the first symptoms. Water is a subject of social regulation; yet the multiple and frequently contradictory objectives of water policy (environmental, economic, social, etc., see below) do not make the question any simpler to deal with.

105. Responsibilities in the water sector are generally shared between several players and, despite the variety of organisations involved, some principles emerge which can serve as an analytical framework for seeking the best possible match between economic efficiency and service quality. The aim of this study is therefore to identify certain principles of good governance in public/private partnership and to see how they can be adapted for networked multilevel governance.

106. Guaranteeing a supply of water is a challenge for many countries. In order to provide a significant spectrum for analysis, the study focuses on three types of country: two countries where water is scarce (Mexico and Australia), countries where water distribution has been disorganised (former Soviet republics), and a temperate country (France).

107. The study is organised around two main themes: first, the empowerment of the players in the multilevel regulatory process, and second, implementation of these principles in the context of networked regulation. As in the first part, the study does not seek to be comprehensive, but rather to highlight the difficulties and show how reform of the regulatory framework can help to provide answers.

108. The attached table gives an inventory of the organisation and distribution of water in several countries, thus providing a context. It offers a means of comparing the solutions employed by public organisations and provides practical examples.

1. An example of the empowerment of the players in the multilevel regulatory process: the regulation of water, a natural monopoly

109. The aim of regulation in a sector like water is to ensure equal treatment for consumers and to reduce the end-price by using administrative and financial incentives to control quality.

110. Improving legal, institutional and procedural frameworks can help to optimise the governance of a policy shared between several players. Their empowerment in a coherent regulatory framework, through the security it brings, favours the long-term investment that is essential in the sector.

111. The aim is to help raise awareness of the impact of the regulatory framework and the benefits of seeking optimisation (1.1) and to formulate some principles that can guide a reform of this type (1.2).

1.1 The economic effects of changing the regulatory framework: the example of France

112. This case study illustrates the impact of a change to the regulatory framework. It appears to be beneficial to give local government the legal means to conclude delegation agreements under good conditions, even if it means changing modes of oversight to take account of the quasi-monopoly position of many firms in the sector.

Examination of the formal and informal rules influencing local authorities' contractual choices

113. The change to the way public service delegations were regulated in France had a considerable impact. The disappearance in 1982 of State oversight of contracts between local authorities and private firms led to a sharp increase in private management, but procedural constraints were soon reintroduced (in 1992) to combat certain unlawful or borderline practices and limit some firms' abuse of dominant position. Central government thus intervened to ensure proper practice, while local authorities remained free to choose their mode of organisation.

114. A study of the regulation of network utilities by Claude Ménard and Stéphane Saussier, the key conclusions of which are summarised in the box below, measured the impact of this change to the regulatory framework on local authorities' contractual choices.

Box 4. Effects of changing the regulatory framework of public service delegation in France

Objective: to establish a regulatory framework that allows proper practice to be combined with economic efficiency (in particular by leaving local authorities free to negotiate).

Options:

- direct exercise of powers (25% of water distribution in 2002);
- delegation by contract (lease, concession, management: 60% of water distribution in 2002 and 75% of users compared with 54% in 1982). The relationship between the contracting parties is asymmetrical under the regulations since the local authority can unilaterally amend the contract, for public health reasons for example. There are measures to ensure a minimum degree of security for the contracting parties (safeguard clauses, etc.).

The changing regulatory framework

Before 1982: reduced capacity to negotiate; local authorities had to comply with standard contracts.

Law of 2 March 1982: State oversight abolished.

Law of 6 January 1992: public service delegation agreements are subject to notice and competition rules.

Law of 29 January 1993 / Law of 2 February 1995: stricter rules for concession contracts and introduction of specific environmental constraints (term – maximum 20-year renewal, ban on charging entry fees except in a limited number of specified cases).

Law of 8 February 1995 on public procurement and public service delegation: obligation on delegatee to submit a report containing the accounts, a report on all operations relating to performance of the contract, a quality of service assessment and an annex enabling the delegating authority to assess the conditions of provision of the public service.

Measurement of the impact of regulatory changes (study of 73 public service delegation contracts):

- *term of contracts:* statutory limit of 20 years, average term of 12 years;
- *nature of investments:*
 - the limit on the term has caused operators to slash their specific investment. The delegatee was responsible for renewing mains in 45% of cases before 1982, but in less than 20% in 1999. Delegatees focus on operations (delegatees were responsible for renewing rolling stock in 65% of cases in 1982 and in 95% of cases in 1999);
- *professionalisation of contractual relations:*
 - ongoing influence of standard contracts, even after they were abrogated;
 - follow-up of contracts (50% of contracts provide for prices to be renegotiated if there is any significant change to the legislation; 90% provide for an inventory at the beginning and end of the contract, compared with only 10% before 1982);
 - better oversight of delegatees (30% of contracts contain penalty clauses, prohibited in the standard contracts, and 90% of contracts contain water quality clauses).

Source : : Economie publique no. 12 – 2003/1, Claude Ménard and Stéphane Saussier, ATOM, University of Paris 1

115. The research highlights the consequences of greater empowerment of local government, an important element of multilevel governance.

Analysis of the impact of changes to the regulatory framework on local authorities' contractual choices

116. First, it should be borne in mind that the drinking water distribution service must have a separate budget so that the cost of the service provided can be identified and the budget balanced. In addition, other than in exceptional circumstances, public subsidies are prohibited and both capital and operating expenditure must be funded from service revenue.

Changes in the breakdown of investments

117. A distinction can be drawn in the water sector between two types of investment: investment in sites (treatment plants, distribution networks, etc.) and major infrastructure (basin equipment, etc.).

118. The amount that needs to be invested depends on several factors, such as initial water quality, population size and density for capital amortisation, seasonal and permanent water needs, etc. One consequence of the 1982 reform has been to leave most of the heaviest irreversible investment to local government. The ban on renewal by tacit agreement means that the term of contracts is bound to be relatively short, but the nature of this breakdown suggests that it may be too short to give the delegatee enough incentive to make specific investments.

More sensitive oversight of local authorities

119. The mayor is personally, politically and legally responsible for the quality of services and for the prices charged to users. Yet in 1997, the Court of Auditors drew attention to the fact that local authorities exercised insufficient oversight of delegates. Free to negotiate their contracts, local authorities introduced numerous clauses to monitor the delegatee's activity, sometimes neglecting legal clauses that they perceived as being too complex and expensive to apply.

- Thus, penalty clauses, mostly relating to water quality, were introduced to the detriment of legal measures such as provisional public management or termination of the delegatee;
- The partners seek a long-term equilibrium, in particular by introducing renegotiation clauses that are more frequently applied. A 50% change in volumes was needed for such clauses to apply before 1982, whereas the threshold is now 20%.
- Requirements relating to the disclosure of technical and financial information are stricter – fifteen or so in addition to the statutory annual report.

120. The disappearance of State oversight has encouraged contractual innovation: the evolution of standard contracts between 1951 and 1982 bears no comparison with the pace of change since then. These contractual innovations can be explained by the search for measures to contain opportunist behaviour. Opaque contracts opened the door to poor management or even corruption. The corollary to local authorities being given the opportunity to optimise their mode of management is that contracts must be transparent.

121. This case study highlights some characteristics of an investment-friendly regulatory framework in a multilevel context, in particular the need to promote a measure of contractual freedom that favours innovation and the need for a reasonable long-term reward. Its conclusions concur with those of the OECD. It is essential to improve the quality of regulation of concession and licence arrangements in order to increase the quality of water policy regulation (The New Environmental Review – OECD 2004).

122. The question then arises of the ways and means of promoting coherent and transparent regulation, the quality of which can help to secure investment. Increasing the competitive operation of the market is likely to help achieve this objective.

1.2 Encouraging sustainable development and essential investment

123. Preserving both the quantity and the quality of water resources depends largely on the amounts invested. Water distribution is generally undertaken, albeit to differing extents, by firms more or less controlled by public authorities. The relationship is governed by different types of contract within a national, federal or even supranational regulatory framework.

124. A transparent and predictable regulatory framework is essential to encourage the sustainable development of water resources. If it is neither of those things, municipalities may find themselves unable to negotiate under good conditions because of information asymmetry, or else firms may find themselves having to comply with numerous constraints imposed by the public authorities, especially those designed to keep water prices artificially low, which upset the economic balance of the contract and hence deter investment.

1.2.1 Defining a transparent regulatory framework: organising genuine competition

125. Transparency is the corner-stone of an effective regulatory framework, meaning one that is adapted to its objectives, likely to guarantee real negotiation and keep the spectre of collusion at bay.

Restoring economic operators' capacity to negotiate by organising genuine competition

126. The cost of water can be reduced by increasing the amount of competition on the market. Real efforts in this direction have been made in Europe. The opening up of European water markets has made it possible to integrate European standards into technical procurement specifications and facilitated competitive tendering.

127. However, not all obstacles have been removed. In Germany, despite satisfactory results in terms of access to the supply network and to wastewater treatment plants, efficiency is still a problem. Prices for drinking water in Germany are some of the highest in the European Union. Greater competition would help to make services more efficient through greater use of comparative evaluation, extension of the geographical coverage of water infrastructure and the launch of competitive tendering. But the competition has to be genuine. At present, devices such as the fragmentation of markets designed to encourage bids from SMEs prevent foreign firms from bidding, since tenders below a certain amount do not have to be made public within the European Union (Regulatory Reform in Germany: Consolidating Economic and Social Renewal, OECD, SG/SGR (2003)6).

128. In France, the award of contracts to manage and operate public services has sometimes been vitiated by a presumption of corruption and favouritism, on occasion involving local elected officials. The recent reform of the public procurement code seeks to combine transparency (the fight against corruption) with economic efficiency (freedom of choice while preventing abuse of dominant position). The table below can be used to compare measures taken to ensure the transparency of public procurement and public service delegations. It also contains information about the new draft order on public/private partnerships designed to encourage investment in sewage plants in particular.

Box 5. Comparison of public procurement law and public service delegations in France	
The reform of the public procurement code applicable to local authorities in France	Delegations
<p>Contractual freedom within limits: combining proper practice with economic efficiency by giving priority to negotiation.</p> <p>Principles reasserted: free access to public procurement, equal treatment, and transparent procedures.</p> <p>Tenor of the system:</p> <p>Significant features of the new public procurement code are greater formal flexibility and a significant raising of thresholds.</p> <p><i>1) An acknowledged capacity to negotiate</i></p> <p>Freedom to negotiate is confirmed for contracts worth less than 23 000 euros (this should apply to a considerable number of contracts).</p> <p>Local authorities have a choice of procedures for contracts worth between 230 000 euros and 5 900 000 euros excl. VAT:</p> <ul style="list-style-type: none"> • call for tenders • negotiated contract • competitive dialogue <p>All purchases, whatever the amount, are subject to a formal public notice and competitive tendering obligation, but the obligations and procedures change according to the value of the contract.</p> <p><i>1) A general public notice obligation (transposition of EU directives) but more flexible terms and conditions</i></p> <p>For contracts worth less than 90 000 euros, the person responsible has a choice of public notice options.</p> <p>A public call for tenders must be published for contracts worth between 90 000 and 230 000 euros.</p> <p>Publication in an EU journal is compulsory for contracts worth more than 5 900 000 euros excl. VAT.</p> <p>Source: La vie communale et départementale, no. 905B, April 2004</p>	<p>Contractual freedom within limits: limitation on the term</p> <p>Principles asserted: long-term contracts under which the firm is remunerated from operating profits.</p> <p>Tenor of the system:</p> <ul style="list-style-type: none"> • incentive-based public management: the local authority is remunerated according to results; • lease: the infrastructure needed to operate the service is made available in return for a consideration and the local authority funds capital investment; • concession: the firm finances, builds and operates equipment for the local authority. <p>Public/private partnerships (draft order)</p> <p>The new arrangements could apply to certain investments under public service delegations:</p> <ul style="list-style-type: none"> • the local authority can entrust a private sector organisation, for a set period not limited by law, with the design, construction, financing, maintenance and management of public infrastructure. <p>The private sector organisation receives rent.</p> <ul style="list-style-type: none"> • Contracts are approved by the prefect.

129. Where public service delegation is concerned, there is a delicate balance between the profitability of the investment for the private partner and the long-term cost of the service to the community. The new public/private partnership contract is the most recent example of the difficulties encountered in promoting a dynamic and innovative regulatory framework; albeit one that has potential risks for the financial interests of the community. The contract offers access to new sources of private funding in a context of budget savings but transfers commercial or operating risks to the community. The highest jurisdictions of the French State, the Constitutional Council and the Conseil d'Etat, have indicated their reserves as to the risks for local finances (no limit on duration, supplementary agreements without new calls for tender, heavier operating costs).

130. A high-quality public service at a fair cost steered by local authorities needs a regulatory framework that is capable of helping them to enter into contracts that meet their needs and of rectifying information asymmetries, thus making it easier for them to make their choices.

1.2.2 A predictable regulatory framework that encourages a long-term approach

131. If investment is to be encouraged, the parties to the contract need to strike the right financial balance. The price element is of course essential, and municipalities do not always have the freedom to agree a price that is high enough to cover investment and management costs while also encouraging users to economise.

132. The regulatory framework must help towards achieving a price which will preserve sustainable development in the long term without abuse of dominant position.

Unfunded mandates: price reductions imposed by regulation

133. The case of the former Soviet republics is particularly illustrative. Many mandates inherited from the previous regulatory framework are linked to water quality and the level of service. These national standards cannot be amended at local level. Thus, certain categories of users are granted reduced prices (25%, 50% and 100% for veterans, pensioners and the disabled). The proportion of the population benefiting from reduced prices can be as much as 30%, with no connection to their actual poverty level. These mandates may also result from compliance with other restrictive standards. The strict construction and health standards developed in the USSR in the 1980s are still in force and compliance increases the price of the service even if penalties are not really applied.

134. A similar situation exists in Mexico. Water prices are under-estimated and the situation is getting worse. The service and manufacturing sectors pay most of the cost of water, since a federal law of 1992 exempts farmers and users of drinking water in small rural communities from the water extraction charge. There is a special price structure for watering, under which 80% of the price is subsidised. During the oil boom, rising farm subsidies, including for water supplies, resulted in severe environmental damage. Other countries face similar problems. In France, farmers pay 1% of water charges and consume 40%, whereas the rate of cost coverage until the end of the 1950s was around 50%.

A regulatory framework that encourages a more sparing use of water

135. An examination of two countries facing a scarcity of water in a context of climate change in which temperatures can be expected to rise illustrates the impact of a realistic pricing policy. Water prices and sewage treatment charges must be high enough to permit sound management and the development of the service while also protecting the environment.

136. In Mexico, there are few regulatory incentives to use water sparingly because the principal objective is to keep prices low, especially so as to encourage the development of farming. Licence fees are therefore not realistic, for several reasons:

- the federal government subsidy accounts for much of the cost of water,
- licence fees are set by managers and politicians who have no interest in charging realistic prices,
- irrigation subsidies are captured by large farmers producing for export, who are an important lobby group,
- investment has fallen steadily, in 2001 to one-fifth of the 1991 level. Investment in the construction of irrigation infrastructure fell from 80 - 90% over the period 1940-1960 to 60% in the 1980s.

137. True pricing is the corner-stone of the new regulatory framework of the state of Victoria in Australia, a country where farming accounts for 75% of water use. Victoria has been facing worsening drought conditions for the last seven years and water restrictions are already imposed in many towns. Climate change projections are worrying: for the Murray-Darling basin, the temperature is expected to have increased by two degrees in 2030 and by six degrees in 2070. Water resources are expected to decrease by 5%, while the population of Melbourne is expected to increase by one million and that of the state of Victoria by 350 000. The state has recently launched a wide-ranging and ambitious water conservation programme:

- users will henceforth have to pay a price that includes infrastructure and environmental costs so as to encourage them to save water, recycle and innovate;
- since 1 September 2004, the state has introduced financial measures to promote the installation of meters. In France, water authorities use loans and subsidies to support investment in equipment that generates less pollution.

138. Moldavia has introduced incentives for efficient water management and conservation and has earmarked a special budget to guarantee its poorest citizens access to water. In the region, only Kazakhstan has prohibited cross-subsidies between categories of consumers. Within the European Union, true pricing is a real challenge because of the per equation (between water services, between urban and rural dwellers, etc.) introduced by the water industry. In the countries of southern Europe, water prices hardly cover even operating costs. National subsidies, associated with the construction of major works serving almost exclusively to irrigate agricultural land, have been compounded by EU production subsidies.

139. A number of principles can be drawn from these case studies, whose interaction in a multilevel dimension needs to be examined.

2. Implementing these principles in the context of networked regulation

140. With a natural monopoly like water, varied modes of regulation favour a fair and sustainable sharing of the resource.

2.1 Effective steering of reforms

Steering over time: supporting reforms

141. The former Soviet republics are a good example of how uncontrolled decentralisation can lastingly disorganise water distribution. A committee – an organ of the Soviet Union's central government – planned infrastructure and the location of sites. The high level of subsidy blocked any incentive to finance the sector properly. Municipalities may have had operational responsibilities but the regulatory framework was changed without any institutional or economic guidance (after the disappearance of the ministry of communal services there was no longer any agency responsible for policy in the sector, or even for any collection or processing of quantitative or qualitative data). The lack of steering proved to be extremely costly in terms of investment:

- investment decisions were not taken at the right level;
- firms and principals in the sector were too interdependent. The firms, mostly communal, were treated like political organs of the communes, their role being to keep prices down and provide work for municipal employees. In return, the communes appointed and paid the directors and provided funds. The potential for corruption was thus very great.

142. Today, even though the introduction of good governance principles is proving complex, real progress has been made. The authorities are aware of the need to support changes to the regulatory framework and to transfer the means to exercise powers as well as transferring the powers themselves.

Steering in space: trading off different interests

143. As water basins cover several regions, the allocation of resources and the preservation of quality levels need to be managed. This sort of steering is difficult in a federal state because of the desire to seek consensus in a context of sharply diverging interests. High-quality, clear federal rules and real controls are essential in order to ensure compliance with distribution and consumption standards.

144. In Mexico, the federal government has engaged in proactive planning (25-year planning in the 1980s, 1995-2000 plan for Mexico City). But despite these efforts the situation is still very worrying. Growth in water use is not sustainable and investment is half of what it needs to be. The conflict between the federal government and the ambitions of the states themselves is part of the reason for this situation.

- Water basin agencies find it difficult to reach agreement on extraction rules because of the wide variety of interests involved. It is true that in 1991 the federal government entrusted a coordination mission to the Mexican River Basin Board, created in 1989, but the power struggle within the Board generated fierce rivalry between the five states and the national authority (CNA). There was no sufficiently well-identified authority to broker an agreement, even though the interests were clearly in conflict.

- For lack of a proper framework, the integration of initiatives, the coordination of efforts and solutions to conflicts of interest were all delayed. In 1991 one state, Guanajuato, tried to promote an overall strategic vision by passing water legislation and creating a commission to supervise the supply of drinking water and the evacuation of wastewater. But the state was unable to provide the necessary lead. Wastewater treatment came under a different authority and its initiatives met opposition from the CNA, which considered itself to be responsible for planning. Despite these difficulties, 27 states followed Guanajuato's example by passing water legislation, while 13 created commissions. Federal legislation in 2003, drawing appropriate conclusions from these initiatives, further decentralised water management.

145. In Australia, the Council of Australian Governments has developed a national water initiative but responsibility for water management lies with the states. The state of Victoria, in its water plan launched in 2002, clearly indicated that the state government was responsible for steering. Legislation gave local planners the necessary instruments for regulation. For example, the 1989 Water Act authorises the state to constitute reserves if necessary.

2.2 *The contribution of the good governance principles set out in 1997*

146. The assumption and adaptation of the 1997 recommendations – setting clear objectives and strategies, finding institutions and tools for optimising regulation – is a useful option for optimising the regulatory framework.

2.2.1 Setting clear long-term objectives and strategies: what users can contribute

147. Users can be involved in various ways, ranging from mere consultation to real participation in the decision-making process. The danger that interest groups might hijack procedures should not be underestimated, of course, nor should the risk that a community might satisfy its own users to the detriment of national objectives. Nevertheless, "natural monopolies should be controlled in the framework of a regulatory process" (OECD review of Germany, op. cit.), and involving users in the process helps to raise their awareness in a context where water prices are likely to rise. In this sense it helps to consolidate genuine local democracy, since responsibilities are exercised at the grass-roots.

Consulting users

148. Several countries and supranational entities have enabled end-users to participate in regulatory procedures and make their contribution to the decision-making process.

149. Mexico has many forums for dialogue with users, including water boards (*Consejos de Cuenca*), the citizens' water movement initiated by the CNA, a national water council and 26 state councils. The public consumer watchdog also helps to bolster these cooperation mechanisms, though progress still needs to be made.

150. In Australia, Melbourne's strategic resources plan has brought together two hundred industrialists to reduce water wastage. The state of Victoria drew up its new water plan after months spent consulting various organisations and its citizens. The European Union also provides for a high level of involvement. The Water Policy Directive of 23 October 2000 (2000/60/EC) establishes a framework for a Community water policy and requires Member States to achieve a good ecological status for water by 2015.

151. The directive provides for public information and involvement at all stages of implementation. It organises consultation on draft water management plans and sets out a requirement for clear and comprehensible documents to that end. An agreement on the current situation must be reached before the end of 2004 and communicated to the public. The UK has launched a wide-ranging consultation. In France, river basin committees are responsible for organising the consultation and adopting the report.

Financial responsibility

152. In Mexico, users have been given responsibilities relating to controls and maintenance in exchange for a greater share of financing, but major projects are still managed by the CNA.

153. The "polluter pays" principle provides that polluters should bear the cost of measures to prevent and reduce pollution. This introduces an economic dimension into water management and helps to ensure the system's viability. In France, river basin agencies charge users fees for water extraction and disposal. These fees are in fact pollution rights, the level of which is set by river basin committees in each agency. The National Assembly passed legislation in 2001 under which the fees would be calculated according to the pollution impact of the activities concerned and not only in order to finance depollution programmes, but the law has not yet been passed by the Senate.

154. Empowerment in a context of sharply diverging interests means that regulatory institutions must have real powers to make choices between them.

2.2.2 Institutions

155. The example of Mexico's National Water Commission (CNA) highlights the need to avoid fragmenting regulatory bodies and to set them clear, non-contradictory objectives. The CNA has both regulatory functions and environmental, health and safety missions and has quasi-jurisdictional powers. Arbitrating between these different objectives is a very tricky business. The CNA has to:

- define a long-term policy, notably the national water programme, advise the government on matters relating to water use and publish a strategic plan every six years;
- set quality standards, promote and control the development and treatment of drinking water, including through research, and facilitate the access of all users to the resource;
- manage the sector by concluding concession contracts for the services for which it is responsible, collect fees and manage federal water infrastructure;
- exercise oversight as the first instance of appeal (it settles appeals against administrative decisions in 84% of cases).

156. Furthermore, unlike many regulatory authorities, the CNA's senior management is not independent of the political sphere. Its director is appointed by the President and can be dismissed at will, while its budget is funded by central government (72% depends on fees charged to users). The board of directors comprises representatives of various ministries and states and experts. The CNA has a vast workforce (17,167 employees in 2004), a legacy of the past.

Giving regulatory authorities the financial means to do their job

157. The state of Victoria has set up an Essential Services Commission. Since 1 January 2004, the water sector has been subject to economic regulation with the aim of protecting users' long-term interests with regard to the quality/price ratio.

158. Responsibility for managing investment has been given to a trust (320 million dollars has been earmarked for investment over 10 years). From 1 October 2004, this amount will be financed directly from a price increase of 5% for urban users and 2% for farmers and an increase in the maximum amount of concessions.

2.2.3 Tools

159. The matter is urgent because the potential profits are substantial, especially in cities where minimum standards are not respected. Local authorities need to be given benchmarks so as to guide them in their choices throughout the process.

*Facilitating choices upstream*Good practice

160. Local authorities should be helped to choose the right type of contract and to implement a robust accounting system. They can find themselves facing large groups. In France, three firms share a business turnover worth 4.6 billion francs (Vivendi Environnement, 40%; Suez Lyonnaise des Eaux, 22%; Saur/Cise, 16%). Encouraging local authorities to take a professional approach to steering and oversight helps to strike a better balance in the relations between principal and operator.

Gathering information

161. The state of Victoria has drawn up an inventory of available resources and state law provides for a systematic assessment every 15 years. This government assessment means that the resource can be measured and that the 1989 Water Act can be implemented in order to constitute reserves. The state government has also created a database to record all information about water quality.

*Facilitating comparisons*Norms and standards

162. The multilevel dimension can be a powerful incentive for optimising public service quality at better cost, provided that people are able to make comparisons. Canada, for example, has developed standards for measuring the quality of the same service, especially water, provided by several territories. A citizens research institute was created in 2001 for that purpose. However, solving the question of how the citizen is to clearly identify the level of government really responsible for the service remains complex.

163. European directives have defined a framework for a Community water policy in which standardisation plays a key role. The Water Policy Directive of 23 October 2000 establishes the principle of management at river basin level and sets water quality objectives to be achieved by 2015.

164. The measures are organised around two key ideas:

- water must comply with the standards imposed when it is distributed. The new directives establish criteria for pollutant levels and maximum admissible levels (based on medical research);
- water must be kept clean in order to forestall depollution costs (introduction of a self-declared EC labelling system for sanitation products or products in contact with drinking water).

165. Standards and certification are also very important in public procurement because they favour the opening up of national markets under good conditions of legal certainty (the courts recognise standards in the event of a dispute). The water market represents investment worth 100 billion dollars.

166. The quality of the regulatory framework thus acts as a facilitator provided that the bases on which the service is financed are transparent, realistic and balanced. The European directive is a good example: it is highly ambitious but the cost of putting it into practice may well be prohibitive. Compliance will be particularly difficult for the countries of southern Europe. Italy is facing an investment requirement twice that of France. In Spain, wastewater disposal represents one-third of the price of water, compared with a European average of 55%. Germany is the only country to include the cost of replacing equipment and infrastructure in its reckonings.

Comparative tests

167. The Water Policy Directive requires a set of tests to be completed by 2006 so that tools and quality limits defined by national governments can be compared.

Indicators

168. The directive sets common environmental objectives and defines measurement methods and indicators for European watersheds.

Evaluating results

169. The directive requires an evaluation of the cost and effectiveness of the different possible forms of action to restore the resource. It therefore obliges countries to perfect their knowledge of the cost of different uses and of damage. It institutes an ongoing process of assessing and improving the achievement of objectives. A document defining environmental objectives and a timetable for achieving them is due to be drawn up by the end of 2009, giving the reasons for any delays.

170. The UK has used RIA to evaluate the directive from the standpoint of water quality, cost-benefit, regulatory impact and implementation.

Conclusion

171. In 2004, this objective is probably one of the main thrusts of regulatory quality policies for the years to come, as decentralised bodies continue to play an increasingly important role in the conduct of the economy.

172. There are two reasons for this.

- People's needs are increasing, while financial and, above all, natural resources are limited. In this context, there is growing pressure to optimise the quality/price ratio of services (better government at less cost). Decentralising services, bringing them closer to people and meeting their needs more closely, can provide part of the answer. In addition, local authorities are active in highly significant sectors in terms of social issues and competition, of which water supply is probably one of the most notable examples.
- Direct central government intervention and control over the economy is generally diminishing, especially under international pressure. However, governments have to adapt because, in a complex system involving many players, their role as regulator of the economy is still indispensable even if its form has changed.

173. Facing such challenges, the current regulatory framework needs to be revised and adjusted. The massive cost of urgent and necessary reforms like the modernisation of water networks is seriously underestimated. The risks of fragmentation of the public domain, of unequal access to services, of mounting costs and even, in some cases, of the corruption inherent in any decentralisation process have not been sufficiently taken into account. In a context of competing legal systems where regulatory quality is an important factor of competitiveness, all levels of government need to be involved in an ongoing process of reform.

174. Promoting the quality of the regulatory framework (studying policies, institutions and tools) can help to control these developments better.

175. The aim of this study is therefore to offer Member States an analytical framework and to show how useful the multilevel approach can be, especially as regards the provision of public services. It has outlined some avenues for exploration. The development of contracts and standards – what English-speakers term "soft law" – offers a promising panoply of tools. But as the EU Water Policy Directive shows, feasibility and the application of the law and of controls continue to be at the heart of the debate.

176. The next step is to apply the principles identified in a more precise regional case study in order to refine the conceptual framework, culminating in a list of 1997 recommendations adapted to the multilevel dimension.

GLOSSARY

This glossary is intended to define the terminology of multilevel governance in English and French. The words and phrases included in it were selected because they are "*faux amis*" ("false friends", words that appear to mean the same thing in both languages but that in fact do not), or because they have no exact equivalent in the other language, or because they are used in the text in a very specific way that requires explanation. The intent is to facilitate understanding of the studies on this topic, and the work of translators.

This initial list does not pretend to be exhaustive, and it will be supplemented as work on multilevel governance proceeds. It builds upon and carries forward work already undertaken by the GOV division.

Regulatory Impact Analysis (RIA). This is the process of identifying and quantifying all the significant impacts that may flow from adoption of a regulation. Costs are measured on the basis of a cost-benefit or a cost-efficiency analysis, or the impact on businesses.

Regulatory competition: the healthy influence that the interplay between different approaches to regulation can have within a defined territory. Observation of practices and differences of outcomes. To be contrasted with harmonisation.

Decentralisation: transfer of an administrative power from the central government to a local government (elected officials).

Deconcentration: delegation of an administrative power from the central to a local office or agency of a national authority. The central government retains full responsibility and intervention capacity.

Deregulation: complete or partial suppression of regulations governing a given sector, in the hope of improving economic performance.

Regulatory evaluation: measuring respect for laws and regulations in order to obtain information on their impact.

Public governance: optimising the management of institutional capacities and public decision-making. Establishment and strengthening of administrative structures that are effective, efficient, transparent and accountable to the citizens.

Multi-level governance: regulatory strategies and activities including development, execution, reform of regulation between government levels, supranational and sub-national (regions, provinces).

Harmonisation: convergence of legislation towards rules that, if not identical, are at least neutral (eliminating discrimination or direct market intervention).

European law illustrates this concept. A directive responds to the objective of "regulatory harmonisation and similarities in regulations". European states are bound by the declared goal but are free to choose the means for reaching it.

A regulation is a measure of general scope, mandatory and directly applicable. It carries forward the unification of European law.

Unfunded mandate: when a higher (national) level imposes a standard for compliance on a lower level which can only be met through expenditure that is not allocated in a budget or grant.

Best practices: a set of standards for achieving regulatory quality.

Regulatory power: power given to public authorities to adopt and enforce regulations.

Mutual recognition: recognition of equivalent measures intended to facilitate the movement of goods and persons within a given territory. It presupposes a close degree of equivalence and reciprocal confidence in the responsible institutions.

Regulations (*“Réglementation” in French*): Rights given to the State, local government or public authorities to adopt general rules (laws, decrees and orders) which are borne by businesses and citizens (universal and compulsory). This competence is generally based on the constitution and/or the law.

Regulation (*same word in French*): decisions and instruments implemented within the framework of public actions, directly or indirectly, to improve social welfare. Regulation includes laws and regulations but also administrative formalities, code of conduct, etc.

Regulatory reform: changes aimed at improving the quality of regulations (improving the legal quality of regulations and of administrative formalities, or their cost-benefit ratio).

Simplification: covers administrative formalities and bureaucratic practices.

Subsidiarity: In areas which do not fall within its exclusive competence, the European Community shall take action, in accordance with the principle of subsidiarity, only if the objectives of the proposed actions cannot be achieved by the Member States or if its intervention is justified by economies of scale or by the expected impact of the policy (Article 5 of the Treaty Establishing the European Community).

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