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# “Best practices” are not always best for emerging energy markets

**Summary:** Regulations built for mature economies are often ill-suited to emerging markets. Policymakers should embrace situationally appropriate regulatory designs rather than copying so-called “best practices.”

**Why it matters:** Regulators in emerging markets must improve energy reliability, grow supply, and add large quantities of wind and solar in an environment characterized by limited financial and institutional resources. And yet proponents of development and reform tend to prescribe regulatory strategies from rich countries that aren't facing the same challenges, with generally poor outcomes.

## The problems with “best practices”

Funders and advisors often counsel energy policymakers in emerging markets to introduce competition and to privatize and unbundle sprawling state enterprises, or to establish complex checks and balances to rein in state-owned or private companies. Such prescriptions contain important insights — competition can reduce costs, state-owned companies are rarely efficient, and regulatory capacity is crucial — but they often fail in implementation because:

- **“Best practices” don’t address the central problem.** In 2005, Nigeria attempted to fix its power sector by unbundling its state power company into 18 smaller companies, hoping that private companies would buy them and boost their performance. However, these companies were unattractive to investors because the regulated tariff structure precluded cost recovery.<sup>1</sup> The biggest need in Nigeria’s power sector wasn’t to squeeze out cost efficiencies through private ownership and competition; it was to put in place the basic infrastructure, systems, and pricing to allow cost-recovering, reliable electricity provision.
- **Identified “best practices” may depend on missing institutional prerequisites.** Norway touts its model of separate policy, regulatory, and operational functions as the key to its success in the oil sector. But Nigeria actually beat Norway to the punch, separating administrative functions in its oil sector one year before Norway did.<sup>2</sup> Unfortunately, Nigeria achieved poorer results. The reality is that Norway’s mature *political* checks and balances, which were not in place in Nigeria, played a crucial role in its oil success story.<sup>3</sup>
- **Regulatory capacity to manage market forces may not yet exist.** Market competition reduces costs to consumers only when the regulator is capable of preventing the exercise of unilateral market power. This is a particular concern for electricity markets, which are uniquely vulnerable to market power problems due to capacity constraints, relatively inelastic demand, limited energy storage, and the need to match supply and demand at every location in the system and point in time.<sup>4</sup>

## Skillful regulation is situational

Skillful regulation tailors its approach to the most pressing problem and to the particular context. A pragmatic regulatory approach that achieves broad goals for the energy sector is far superior to a “best practice” that might be more efficient in theory but fails under real-world conditions. A tailored and flexible regulatory approach can:

- **Avoid excessive demands on the regulator.** Realizing that a bid-based spot market would strain its regulator’s market monitoring capability, Chile made the wise decision in the 1980s to implement a simpler cost-based spot market.<sup>4</sup> Many emerging electricity markets today would be similarly well-advised to resist the “best practices” siren song that calls for implementing competitive spot markets. More suitable near-term goals might include least-cost dispatch, adequacy of transmission and distribution infrastructure, improved ability to operate the grid, and pricing to consumers that allows cost recovery.
- **Consolidate capability in the sector.** Efforts to harness competition, unbundle state-owned companies, or develop administrative checks and balances may spread limited sectoral talent too thin. In the oil sector, countries like Malaysia and Angola eschewed an independent regulator and consolidated talent within a national oil company, with reasonably positive results.<sup>2</sup>
- **Introduce market mechanisms situationally.** Market mechanisms can play an important role in unlocking energy supply where central planning and state-owned enterprises have failed to do so. In 1979, China partially opened its coal sector to non-state players selling at market prices because constrained coal supply was throttling economic growth.<sup>6</sup> Similarly, in the face of natural gas shortfalls, India created a parallel, market-driven track for gas exploration and production in 1999.<sup>7</sup> These hybrid markets were incremental approaches that addressed bottlenecks and improved market functioning.<sup>8</sup>

## Why advisors often resort to “best practices” thinking

- **Best practices prescriptions require less work than deep, situational analysis.** It is relatively easy for advisors or consultants, who often hail from abroad, to describe “advanced” regulatory models and exhort countries to imitate them. Situational prescriptions, by contrast, require a deep, concrete understanding of the key problems to be solved in a particular context at a particular time, and how they can be addressed given institutional endowments and political incentives.
- **Best practices prescriptions evade responsibility.** If you believe that success hinges on faithful adherence to best practices, and you have accurately described these practices, failure to achieve desired results can only be attributable to your client’s failure to properly follow your advice.
- **Best practices prescriptions may be what the client wants!** The influence of outsiders isn’t the only reason energy reform plans can seem so imitative of countries with mature energy markets. If you’re a policymaker in an emerging market context, it’s only natural to want to mimic the apparent success of others. Everyone wants “the best” for their own country, even if it isn’t actually best in context.

## Learning from others while charting one's own path

The point is not that emerging economies have nothing to learn from more established ones. Rather, it's that "best practices" dogmatism tends to hinder rather than support this learning and growth. Emerging market policymakers and regulators should be encouraged to absorb nuanced lessons from elsewhere about the promise and pitfalls of different regulatory approaches (such as, for example, California's failure to curb unilateral market power during its electricity market restructuring)<sup>9</sup> while charting a path of continuous improvement that is well-adapted to their local situation.

### Endnotes

1. Mark C. Thurber, Ifeyinwa M. Emelife, and Patrick R.P. Heller, "NNPC and Nigeria's oil patronage ecosystem," in Victor, Hults, and Thurber, eds., *Oil and Governance: State-owned enterprises and the world energy supply* (Cambridge University Press, 2012).
2. Mark C. Thurber, David R. Hults, and Patrick R.P. Heller, "Exporting the 'Norwegian Model': The effect of administrative design on oil sector performance," *Energy Policy* 39, 2011.
3. Mark C. Thurber and Benedicte Tangen Istad, "Norway's evolving champion: Statoil and the politics of state enterprise," in Victor, Hults, and Thurber, eds., *Oil and governance: State-owned enterprises and the world energy supply* (Cambridge University Press, 2012).
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5. Frank A. Wolak, "Long-term resource adequacy in wholesale electricity markets with significant intermittent renewables," *Environmental and Energy Policy and the Economy* 3, 2022, [http://web.stanford.edu/group/fwolak/cgi-bin/sites/default/files/wolak\\_eepe\\_final.pdf](http://web.stanford.edu/group/fwolak/cgi-bin/sites/default/files/wolak_eepe_final.pdf).
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7. S. Dhar and P. Shukla, *Natural Gas Market in India: Evolution and Future Scenarios* (New Delhi: Tata McGraw Hill, 2010).
8. Mark C. Thurber and Joseph Chang, "The policy tightrope in gas-producing countries: Stimulating domestic demand without discouraging supply," conference paper from the National Bureau of Asian Research Pacific Energy Summit, Jakarta, Indonesia, February 21-23, 2011, [https://www.nbr.org/wp-content/uploads/pdfs/programs/PES\\_2011\\_Thurber\\_Chang.pdf](https://www.nbr.org/wp-content/uploads/pdfs/programs/PES_2011_Thurber_Chang.pdf).
9. Frank A. Wolak, "Diagnosing the California electricity crisis," *The Electricity Journal*, August/September 2003.