

Utilities Privatization and the Poor: Lessons and Evidence from Latin America

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Paper has the following objectives:

- Overview of the utilities privatisation experience in Latin America
- Channels through which the poor might either lose or gain from privatization
- Policy options available to decision makers

Introduction

- Dramatic growth of Latin American countries pursuing utility sector liberalization policies that rely on increased private sector participation
- Private sector in infrastructure is producing secondary distributional effects: many of the improvements in potential access are combined with changes in pricing and financing rules under which the private sector operates. Subsidies tend to disappear.
- Average nominal tariffs have declined with privatisation in many instances. But to guarantee the financial viability of service providers and incentive them to expand service coverage where it is most needed often increased the financial burden, especially on the poor.

3 facts make the authors questioning that privatisation harms the most vulnerable:

1. infrastructure are generally part of a wider set of reforms and the status of the poor reflects the interactions with multiple policy factors
2. middle income households are the ones that most benefit from public sector subsidies
3. privatisation, if properly designed and implemented, provides an opportunity to end the exclusion of the poor

Privatization can affect the actual costs faced by poor households through several channels:

Microeconomic linkages:

1. the cost of increasing formality: effective price paid increases because privatisation increases revenue collection and discourage informal connections
2. the cost of tariff level adjustment: average tariff level increases because the service provider has to be self sufficient and finance quality related investments. Competition and effective regulation should serve to lower costs and tariffs.
3. the costs of tariff structure adjustments: if not properly adjusted, the marginal tariff faced by poor household could increase
4. the cost of increasing the price of substitutes: as the poor only have access to utility services through alternative goods, provided by the private sector, privatisation is a not a transition from public sector to private sector provision, but from informal private sector provision to formal private sector provision. Privatisation may reduce the need for the poor to access alternative services.
5. the cost of increasing the price of complements: investments could be required to develop a certain service (for ex water is pumped through electricity) and thus increasing costs. Additionally, when investment is required to connect to the network, the poor can find it harder to access to the service
6. the costs of improved quality of service: privatisation can increase quality and diversity of the service offered: but this can be reflected by higher tariffs.

Macroeconomic linkages

- Economic growth: relative price changes for infrastructure services can influence consumption baskets especially where no safety nets are in place to address specifically the needs of the poor.
- Reduction in employment: workforce and wages reduced soon after privatisation.
- Reallocation of public expenditure: reduction of subsidies during transition as a result of fiscal adjustment

Measuring the expected effects of reform: effects of privatisation on the poor depend on the particular situation of a country and the details of the reform process.

In order to understand and measure the potential impact, it is necessary to understand whether

- the poor are the main beneficiaries of the subsidies
- poorer households are connected to the service

Measurement of the impact of privatisation has not been undertaken by governments in developing countries for many reasons:

- difficult to rule out the interplay of some political economy factors
- information needed to consider trade-off between infrastructure provision and the poor are simply not available: it would be really useful to have a household level surveys

Is there a case for a special welfare policy for infrastructure?

The authors discuss, departing from the case of Argentina, whether given the unlikely prospect of a general welfare policy in most countries, there is a real case for welfare policies in the infrastructure.

Linking welfare programs to changes in the utility industries is quite complex.

Tailoring welfare programs to the utility industries allows benefits to be linked or conditioned on the consumption of utility services. Note however, that this does not necessarily entail that a utility regulator designs or even administers the welfare program. Tailoring welfare programs to the utility industries is desirable for 3 reasons:

1. policy makers may be interested in guaranteeing that household consume a minimum amount of a service rather than simply guarantee that they have sufficient resources to purchase the service
2. the general public may care about the actual consumption of certain goods by poor households, not necessarily their income level
3. introducing distributive considerations into a reform process, perhaps by designing a special welfare program, may be unavoidable for political reasons.

The alternative is to tackle the distributional impacts of utility reform through more general welfare policies aimed at alleviating poverty, and therefore should not be addressed directly in the utility industry or be part of the concerns of the regulator.

Guidelines to protect the poor: 3 spheres of public policy can be distinguished

1. Privatisation strategy

- Need to undertake reform that reinforces competition. Competition is good for all consumers, including the poor: the only drawback that competition may have is that it forces the elimination of cross-subsidies, which may hurt the poor. Availability of services and drop in tariffs may compensate the effects of the elimination of cross-subsidies.
- Investment and quality targets that are set at the time of privatisation
 - a. Connection targets set prior to privatisation
 - b. Connection targets must specify geographic area and type of consumer to be reached.
 - c. Quality standards should be set leaving some flexibility in the contract to allow the company, the regulator and users in the future to agree to a different price quality combination

- Important to eliminate any legal obstacle that may prevent more innovative or alternative projects from being implemented
 - Problem of defining an affordable price in the contract
 - Attention should also be paid to the way a contract or company is tendered in the privatisation process.
2. Regulatory policy
- Tradeoff between strict regulatory rules (to lower susceptibility to corruption) and greater discretion that can provide margin in tariff design so that regulators can make pro-poor decisions
 - Regulators should be open to new and innovative approaches to solve investment and operation issues related to the poorer users (for example by fostering participation)
 - Regulators should promote competition when possible
 - Regulators should promote the use of new and innovative tariff structures which may benefit low income users
3. Social policy
- If special welfare programs are to be created in the utility industries, criteria for defining subsidies are the following
 - a. Governments can provide the funds from general tax revenues
 - b. Raise by charging certain customers a price higher than the cost of service
 - c. A fund can be established whereby all companies must make a contribution according to some proportional rules
 - d. Eligibility of subsidies through categorical variable and geographical zones
 - e. Ideally the subsidy should be directed to those goods with the highest difference between willingness to pay and costs (connection and network expansion subsidies should be favoured over consumption subsidies)

Conclusion

There is the need not only of a political commitment to privatise, but also institutional and regulatory reforms that make the poor better off as a result.

Privatization is not a substitute for responsible, redistributive welfare policies

Questions:

1. Do you agree that competition is good for all consumers in utility services, including the poor and that the only drawback that competition may have is that it forces the elimination of cross-subsidies? Are the benefits from competition mentioned by the authors (possible tariff reduction, increase range of available goods and services) sufficient to believe that competition is also good for the poor?
2. Can you think about any creative ways that could be used to make private sector provision of services more accessible to the poor? (For example, pre-paid phone-cards for cellular phones) Could we apply the same kind of idea to other services?
What do you think are the most important variables (possibility to control the expenditure, for example by buying a pre-paid card, easiness to pay for the service, etc.) when thinking about structuring a service for the poor?
3. Do you agree that subsidies should be directed to those goods with the highest difference between willingness to pay and costs? This would mean that connections or network expansion subsidies should be favoured over consumption subsidies. Does it make sense?