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Regulating against poverty

Halving absolute poverty by 2015 is the first Millennium Goal. How can regulators contribute to achieving this? Helping to create the conditions for economic growth, though important, is not enough – there is no guarantee that wealth will 'trickle down' to the poorest. Pro-poor regulation involves much more than a preoccupation with correcting market failure. Wider issues such as managing a risk society and social justice need to be seen as equally important goals of regulation.

Opinion is divided and so is evidence (or at least differently interpreted) as to how growth and poverty - as represented by inequality of income distribution - are related. For example, does one have to come first and does it preclude the other? Specifically, it used to be believed that in poorer countries, in the early stages of increased economic growth, inequalities in income would inevitably increase as some people were able to take advantage of new opportunities while others were excluded from the potential benefits. Some people argued that, if growth sufficiently increased average income, this could somehow offset such inequalities

But more recent evidence has not supported the idea (comfortable for economic and political elites of course) that, for overall gain, it is the poor who must feel the pain. Recent research in fact suggests that the economies of more egalitarian societies not only grow faster but are also more likely to lead to poverty reduction, thus creating a virtuous cycle. If so, then policies and practices that help narrow the gap between rich and poor are not only ethically desirable. They also make sound economic sense.

As suggested above, when we analyse regulatory systems we need to ask whose interests they serve and how they work in practice as opposed to on paper. Discussion cannot be confined to technical matters like subsidies and access, vital though these are. Analysts must also be aware of the political environment within which regulation is enacted i.e. the public policy arena, in which power is exercised through a process of conflict, negotiation and resolution between different groups of stakeholders with both diverse and overlapping interests.

We also need to question whether states will make policy rationally and whether non-state actors will be prepared to cooperate in designing and delivering policy. Also, do political leaders really want democratic and pluralist participation? Or will the regulatory process be 'captured' by powerful special interest groups such as large companies?

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Understanding that regulatory policies and procedures are worked out through such processes of bargaining and conflict helps explain why the transfer of regulatory 'best practice' is so seldom successful. It is true that such 'best practice' is almost inevitably not critically self-evaluative. Indeed, even well known problems and failures are typically ignored. But, more fundamentally, it is impossible to create a blueprint for a system that will be socially and politically acceptable (and hence attainable) everywhere. The current favourite model, of privatisation and downsizing of the state, is rejected by many developing country governments or is impossible to attain anyway due to lack of political and institutional resources. Furthermore, it is naïve to suppose that setting up 'independent' regulatory agencies will prevent elites continuing to capture the benefits if mechanisms of accountability are flawed or absent.

Although many governments recognise the need for less wasteful bureaucracy and stifling regulation, this does not mean they are willing to ignore the basic social needs of their citizens. Others prioritise their own political agenda, paying only lip service to aid donors' preferences. And some are simply not equipped to undertake significant reform.

What is poverty?

Before we look in more detail at how regulation might benefit the poor we should consider what we mean by poverty. At one time inadequate levels of income or consumption were thought to be the defining factors but it is now widely agreed that poverty is much more complicated than this, that it can be both absolute and relative and that there is no easy way to identify cause and effect.

Being poor can be thought of as not being able to satisfy one's 'basic needs' i.e. not having a certain minimum level of food, health, education and other essential services. People can be deprived of such things even when there is no general shortage of them, so combating poverty involves ensuring that people can actually access these basic goods and services.

Also, poverty can be absolute or relative. Being in absolute poverty means having less than some pre-defined minimum level of a particular essential. Income poverty, for example, is sometimes defined as having less than the equivalent of one or two US dollars a day to live on. Relative poverty, on the other hand, means having less than most people, for example being in the poorest 10 percent.

Where exactly the poverty line is drawn, or what is considered to be essential for a decent life, is obviously different in different contexts and also changes over time. Recognising this, and also being aware of the problems that follow from making judgements about the (un)desirability of other people's lives, in recent years many agencies have emphasised listening to the views of poor people themselves about what constitutes poverty, or ill-being, for them. Through this, vulnerability, powerlessness and social exclusion have emerged as important aspects of poverty.

Measuring poverty

To judge whether poverty has increased or decreased we need to be able to measure or assess it. Despite the multifaceted nature of poverty being widely recognised, income is still the most commonly used measure. To calculate the 'head count ratio' the number of people below the poverty line is expressed as a proportion of the total population. However this gives no information about how far below the poverty line people are falling. The 'poverty gap' is used to show the depth of poverty by calculating the gap between each poor person's income and the poverty line and taking the average.

The basic needs approach to poverty measurement involves measuring access to such necessities as food, clean water, shelter, education, health services, sanitation, employment and community participation. The main advantage of such measures is that they relate more directly to a person's well-being than does measuring their income since, although it is argued that money enables people to purchase such necessities, this may not be what actually happens in practice. The main problem with basic needs measures is that the information may be difficult and costly to gather.

The Human Poverty Index, developed by the UNDP, brings together three different aspects of deprivation into a single composite index. These are survival (the percentage of the population expected to die before 40), knowledge (the percentage of adults who are illiterate) and standard of living (a combination of the percentage of people with access to health services and clean water and the percentage of children under five who are malnourished).

Obviously the poor are not a homogenous group; their different needs and opinions further complicate regulation. In order to contribute to tackling poverty the regulator needs to understand the various needs and interests of the poor and their different roles in the economy, for example as both consumers and owners of assets such as land or, more usually, labour power. To gather such information requires consultation with poor people. Some developing countries make real efforts to do this – in Ghana regulators hold public hearings, in Jamaica they try to discover views through local churches and in Bolivia town hall meetings are held. But in many other countries there must be concern that regulators get most of their information from industry, politicians, the better off and other elites.

The policy response

Policies aimed at combating poverty tend to be of two main types, depending on what is considered to be the cause of poverty. If low productivity is thought to be the main problem, then policy will focus on promoting livelihoods by expanding economic opportunities and employment for the poor. This might include increasing food staple production, improving agricultural technology, skills development, promoting competition and innovation, microcredit and microenterprise development.

On the other hand, if the intention is to minimise vulnerability to external shocks and to protect the living standards of the non-productive poor, then livelihood protection will be the priority. Policy will focus on ensuring poor people's access to resources and services possibly through targeted subsidies or social assistance programmes. Livelihood protection and promotion are closely related however. If protection is effective then people will be more willing to take on more risky, high return economic activities; if protection is very limited then people will be more likely to stick to safer but less remunerative activities.

Promoting livelihoods

Regulators have an important role to play in promoting livelihoods through the work they do to support and encourage a competitive industrial sector. Competition is the key to understanding structural change in the capitalist system so it is vital to design and implement regulation which encourages and promotes competition as well as efficiently detecting and deterring abuses. For example, by promoting regulation which stimulates both foreign and domestic investment regulators can contribute to faster economic growth.

When looking at how structural change in the economy is related to poverty, as indicated by income inequality, up to now the debate has focused on the transition from an agricultural to an industrialised economy. Our research, in contrast, looked at competitiveness across a wide range of industries which we grouped in four categories according to whether they were low, medium-low, medium-high or high tech industries.

We looked at how competitiveness had increased (in both technology and in trade) in a number of countries over the twenty year period from 1978 to 1997. And we compared these figures with how income inequality had changed in each country over the same time period.

What we found was that the development of high tech industries, especially through exports, contributed most to general economic growth but not to equality of income. This is probably because such industries tend to employ educated, skilled people and not to draw in the previously unemployed. Low tech industries, in contrast, contributed less to growth but did help to reduce inequality. Success in low tech exports often involves linking to global supply chains through an international buyer. In the garment industry workers are often migrants from relatively deprived regions and their employment provides remittances to rural areas. Nevertheless these migrants may not be the poorest who may well be concentrated in the informal sector.

We found that medium-low and medium-high tech industries contributed relatively little to growth, possibly because they involve a lot of imported inputs. However they were both shown to have positive effects on income distribution. But the evidence also indicated that these industries tended to be dominated by relatively few firms and so were less competitive than the high and low tech sectors. Therefore a fruitful goal for regulation might be to make it possible for more new enterprises to get involved, so increasing competition and having even bigger positive effects on income distribution.

In general, when regulators seek to reduce poverty through promoting livelihoods, in order to know where and how they can best intervene in the market, they need to understand their specific economic and political circumstances. They need to be aware of any changes in industrial structure brought about by deregulation and increased competition and the effects on both incomes and employment among the poor. They need to discover the ways in which different industries contribute both to growth and income equality in specific country contexts. Such information can then be used to establish where support can most productively be targeted, which stakeholders may need help in establishing their interests and where resources should be provided to offset any negative social effects.

Protecting livelihoods

Regulators can play an important role in protecting livelihoods by prioritising poor people's access to vital services and considering how such services can be made affordable. Access and affordability are closely linked. If it costs more to expand supply networks than the poor can afford to pay then market driven services will be deficient and subsidies may be needed. Regulators may also face problems in enforcing cross subsidies between richer and poorer consumers, especially when markets are being opened to competition, because new entrants will prefer to serve higher priced, more profitable markets. In such situations economic efficiency and social goals may be opposed.

Improved infrastructure services (power, water, sanitation, telecoms, transport) are essential for economic development. They can also contribute to both livelihood promotion and protection. A study involving 121 countries from 1960 to 2000 concluded that better infrastructure contributed not only to economic growth but also to reducing income inequality.

However infrastructure provision is a serious challenge for many poorer countries. About two million people are estimated to be without electricity for example. A recent report suggests that the annual cost of the necessary investment and maintenance could be as much as US$ 464bn between 2005 and 2010. Meeting the Millennium Development goals on water provision could require annual investment to rise (from US$ 75bn in 2001) to US$ 180bn.

Infrastructure is of course an increasingly important area for the regulator as more and more infrastructure services are privatised. By ensuring affordability and access to services the regulatory body can have a direct impact on poverty. Through understanding the different ways in which the interests of the poor might be best served electricity regulators can choose between supporting, say, small generators or solar power compared with extending the national grid. In the case of water they can consider providing communal water and sanitation systems as alternatives to piped network connection. And, by promoting sound governance and so stimulating investment and entrepreneurship, the regulator can contribute to economic growth. But how well has this worked in practice?

Has privatisation benefited the poor?

The evidence is very mixed. In theory, privatisation introduces better management skills and more capital and so increases efficiency, improves services and leads to growth. When this is successful not only do the enterprises involved make higher profits but also prices fall, output increases and governments receive more taxes and spend less on subsidies thus having more funds available for tackling poverty. Unfortunately, although much has been written about privatisation in developing countries, little of this research has focused on its impact on poverty.

Privatisation can claim some successes – in broadening access to telecoms, for example. But in other infrastructure industries, such as water, examples of success are much harder to find. And sometimes, when success is claimed in terms of reducing prices, other adverse effects on the poor, such as job losses, are ignored. Privatisation which stimulates economic growth can do so at the cost of higher unemployment and increased poverty.

It is important to realise that, in itself, privatisation will not necessarily benefit the poor. Indeed sometimes prices have risen sharply under privatisation. In Chile for example water and sewerage prices increased by 40% in privatised utilities compared to 20% in those areas still under public ownership. A water concession in Cochabamba, Bolivia collapsed when proposed price rises triggered serious civil unrest. Indeed the UN's Second World Water Development Report, published in March 2006, gives a number of examples of political resistance over the previous five years when companies have raised prices significantly after winning large contacts. The report cites Thames Water leaving Shanghai, Saur leaving Mozambique and Zimbabwe and Suez downsizing in Latin America and Africa, as well as major demonstrations in Bolivia, Malaysia, South Africa and Indonesia.

Latin America is often identified as a region where privatisation has benefited the poor but here too the evidence is contradictory and in Argentina very weak regulation has caused problems. There, most residential users benefited from telecoms and electricity prices decreasing but the poor gained the least. And in gas, water and sewerage, where there were widespread losses for consumers, the poor were hardest hit.

Sometimes national efforts to benefit the poorest have been thwarted by the international financial institutions. In Ghana for example the regulators tried to focus on affordability and access to services but the World Bank and IMF imposed automatic price rises for water in line with currency fluctuations, thus undermining their efforts. Similarly, in the Philippines, privatising electricity was made a condition for loans and other assistance, resulting in rushed reform which allowed only the local elite and foreign investors to participate.

When governments contract out the management of infrastructure services to the private sector the opportunity exists to draw up contracts so as to prioritise poverty reduction. However this may not be done - exclusivity clauses, for example, can make community standpipes and private wells illegal. On the other hand service obligations can be built in to ensure services are expanded into poor areas with the threat of financial penalties if this does not happen. However, if only a few firms bid for contracts, they may be able to drive a harder bargain and, with few alternative suppliers in the offing, it may also be difficult to regulate their work effectively. If regulators are unable or unwilling to make poverty reduction a priority then regulation may make poverty worse.

Under state ownership, subsidies often benefited middle income groups because the poorest groups did not have access to mains electricity or piped water. In Uganda US$ 500m a year was spent on subsidising electricity when only 6% of the population had access to it. But some regulators have managed to design subsidies which benefit the poor. In Chile subsidies ensure that no household spends more than 5% of its income on water and sanitation. In rural areas in Peru pay phones, which are mainly used by the poor, are subsidised. Similarly in India public phones have been promoted in both rural and urban areas. In Bolivia cheaper technology is used to provide lower cost water and sewerage services in poor areas and in Brazil no consumers have to pay electricity connection charges. In South Africa every household is entitled to a certain amount of free water every month. In Buenos Aires the cost of water connections is spread over five years at zero interest.

A problem for regulatory bodies in many developing countries is that they are relatively new and so lack the necessary skills and experience. A survey of 13 Asian countries found that 80% of regulators had no access to training and offices were usually understaffed. Sometimes inadequate funding makes it difficult to recruit key professional staff. There may be a lack of political support and a lack of commitment to regulatory independence. Competition may not be sufficiently encouraged. There may be a lack of reliable statistical data on which the regulator can base their activities.

Regulation can also be 'captured' by particular interest groups. For example, in Bangladesh the government refused to allow any more firms to get involved in electricity supply, saying there was already enough competition. It is hard to see who this could have benefited except for those firms already in a dominant position.

In general, research into privatised water, telecoms and electricity supplies in developing countries suggests that competition and regulation are more important in determining whether economic growth and poverty reduction will be achieved than whether ownership is public or private. Indeed, inefficiencies in state regulation have been identified as a primary cause of poor economic performance. In these circumstances we need to see a corresponding investment in improving regulatory governance.

This CRC Policy Brief draws heavily on the CRC Conference Papers below:

Cook, P. and Uchida, Y. *Structural Change, Innovation and Income Distribution* 2005

Minogue, M. *What Connects Regulatory Governance to Poverty?* 2005

Parker, D., Kirkpatrick, C. and Figueira-Theodorakopoulou, C. *Infrastructure Regulation and Poverty Reduction in Developing Countries: A Review of the Evidence and a Research Agenda* 2005

Which are available on the CRC web site at:

http://www.competition-regulation.org.uk/conferences/Brazil/Papers/papers.htm

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