

# **Some Thoughts on Privatization and the Drivers of its Income Distribution Consequences**

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# Overview

- **A bit of history on the topic**
- **Some comments on the papers**
- **Some additional thoughts**
  - **Some context**
  - **Back to the facts: how good are our diagnostics?**
  - **Safety net meet the public service demand**
  - **Regulation matters**
  - **Taxes are part of the income distribution problem**
  - **Politics matter to the poor**
  - **Other little details that matters**
- **Conclusions**

# **A bit of history**

- Peruvian food, privatization and the poor**
- The poor, the public providers and their regressive supply and pricing systems**
- Cavallo, his reforms and the poor in 1994**

**vs.**

**Duhalde (Menem's VP when Cavallo was Menem's Economy Minister), the same reforms but many more the poor**

# **Some Comments on the papers (1)**

## **The Argentina Story**

- Very impressive paper in terms of scope and coverage, with a lot of value added**
- Maybe stops too early; the post Tequila effect after 97 offers a lot of new insights on the political economy of privatization**
- Misses maybe on the transport vs. utilities story (more later on this)**
- Could do more on tariff structure story**
- Points to weakness of regulation but may not be doing enough with it**
- Will return to Argentina's experience later...**

# **Some Comments on the papers (2)**

## **The Bolivia story**

- Really good policy oriented paper: informative, highly readable and creative (the causality story is particularly interesting)**
- Forgets a bit about some of the gains from technological revolutions (gains in the telecom sector accrued even when no privatization)**
- Regulation has sometimes been more process than meat**
- The inter sectoral conflicts have been an issue (e.g. the transport law sitting for 5 years in Congress)**

# **Some Comments on the papers (3)**

## **The Cross-country story**

- **Very useful overview paper**
- **Very useful conceptualization of the issues**
- **Not much to add...**
- **Except for missing important references**
  - **including many quoted in the papers by LatAm researchers**
  - **Most importantly all the work on the political economy of reform which drives many of the distributional issues (e.g. Spiller and his students)**
  - **...may be representative of the fact that North America politics often lag Latin America on some key policy issues—including the social ones--...**

## **Some context: How much Private Investment in Infrastructure in Latin America?**

- \$240 billion in private infrastructure investment in 1990-98 (the peak for FDI)**
- 1/4-1/3 of annual investment needs in infrastructure**
- this is \$53/person/year (cts15/day), ...the private sector will want to recover**
- this is still a lot for the poorest and requires public policy commitments to mitigate the risks of exclusion from the benefits of infrastructure expansion**

# Back to the basic facts

- **Basic diagnostic issues:**
  - **Need systematically to distinguish between access and affordability issues more carefully both ex-ante in reforms and in renegotiations**
  - **Need to have a better grasp of the expenditure patterns of the poorest**
    - ...but standard HHC/ES or LSMS won't tell you
    - For instance, transport matters much more than usually thought to the poor (they often have 2-3 jobs and transport costs matter to them...)

# Example: the affordability problem in Argentina

	<b>Cost of subsistence consumption</b>	<b>Monthly bill</b>
<b>Electricity</b>	\$10 (100kWh per month)	\$10
<b>Gas</b>	<i>Summer: 50m<sup>3</sup>/mo. @\$10</i> <i>Winter: 150m<sup>3</sup>/mo. @\$24</i>	\$10-24
<b>Telephone</b>	<i>Public: 100 mins/mo. @\$2.5-10</i> <i>Private: 100mins/mo. @\$13</i>	\$10-\$13
<b>Transport</b>	<i>Bus: 10 trips/wk @ \$3/trip</i> <i>Rail: 10 trips/wk @ \$1.4/trip</i>	\$64-120
<b>Water</b>	<i>Water: \$5 minimum tariff</i> <i>Sewerage: \$5 minimum tariff</i>	\$5-10
<b>Total</b>		\$99-177

# General Safety vs Public Services Needs

- **Welfare system design usually does not take into account cost of infrastructure services**
- **Social welfare payments are known to be pro-cyclical in nature (see Bolivia)...not a great idea..**
- **Government ‘workfare’ and housing subsidy schemes are often not eligible for expansion of services incorporated in concession contracts**

# **Regressive Taxes Contribute to the Social Problem**

## **Look at Argentina..again**

- **Infrastructure sectors transformed from fiscal drains to cash cows during 1990s**
- **Accumulation of national, local, indirect and direct taxes absorb a high proportion of turnover ...which tend to be regressive...and most are subnational...**
  - **Telecom 40%-50%**
  - **Energy 30%-40%**
  - **Water 20%-30%**
  - **Transport 10%-20%**
- **...and subsidies...are poorly targeted**

# Regulation matters also to the poor

- **Regulators drive the progressivity or regressivity of public services net of taxes tariffs**
  - **Evidence from a CGE model of Argentina, regulation yields annual welfare gains accruing to the poor equivalent to .3% of GDP**
  - **For gains to be redistributed, one of the basic job of a regulator should be and is to measure efficiency gains and to redistribute them...**
    - **THIS IS NOT DONE IN MOST LDCs**

# Exple 1: Evidence on the effectiveness of Argentina's regulation in redistributing rents

- It's about the effectiveness of the tariff revision process

	<b>Elect</b>	<b>Gas</b>	<b>Water</b>	<b>Telecom</b>
<b>Annual efficiency gain (TFP measures)</b>	<b>1%</b>	<b>2.9%</b>	<b>1.9%</b>	<b>3.9%</b>
<b>Annual change in real average tariff</b>	<b>-0.75%</b>	<b>-0.8%</b>	<b>+1.75%</b>	<b>-0.6%</b>

## **Exple 2: How much do distribution and regulation matter to the effectiveness of reforms for Internet access**

$$\ln H_{it} = a_0 + a_1 \ln Y_{it} + a_2 \ln P_{it} + a_3 \ln L_{it} + a_4 \ln C_{it} + a_5 \ln H_{it-1} + a_6 \ln G_{it} + a_7 \ln PSD_{it} + a_8 \ln RQLITY_{it}$$

**where, for a generic country i in year t:**

- H: per-capita number of Internet hosts or users,**
- Y: per-capita GDP,**
- P: internet access cost, defined as the sum of 30 3-minutes local calls plus monthly phone subscription rates,**
- L: per-capita digital fixed telephone lines,**
- C: per-capita Personal Computers.**
- G: GINI coefficients**
- PSD: privatized or not**
- RQLITY: Regulation quality**

**=> Gompertz diffusion model**

- Estimated for 1990-99 with mostly ITU data through GLS**

# Results on Internet hosts

- **reductions in inequality significantly improve access to Internet**
- **regulation matters more than privatization**
- **And also:**
  - **Overall, rejection of diffusion model**
  - **GDP/capita matters (0.7 elasticity)**
  - **Access to phone lines matter (0.6 elasticity)**
  - **PC access/capita matters (0.9 elasticity)**
  - **Internet access costs matter (-0.3 elasticity) ... less significant statistically but strong enough for regulators to need to think about it!**

# **Politics drive the distributional impacts**

- **Laffont, Spiller and others show the impact of politics on regulation in Latin America**
  - **Regulation is about the allocation of economic rents**
- **Major issue:**
  - **Widespread corruption issues, in particular in construction related business**
  - **Unaccountability of Congresses**
  - **Lack of transparency**
  - **Unaccountability or manipulation of media**
  - **Weakness on this front of multilaterals**

# How else could the poor lose?

- **Increase in effective tariff due to reduced tariff evasion**
- **Restricted access to substitutes (mandatory connection)**
- **May have to pay for improved quality (common in water)**
- **May be offered a quality they are not interested in**

# Conclusions

- **There is plenty of scope for win-win in infrastructure reform ... but:**
  - 1. The specific design of regulation and of its implementation agency are much crucial than reformers think (the deal is the easy part)**
  - 2. And so is the design of related government policies:**
    - We need countercyclical safety nets
    - We need progressive taxes => check on subnational gvt...
  - 3. ...Ultimately, what Latin America's experience shows:**
    - Macro matters more to real results
    - Politics matter to both real and our perception of results