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PRIVATISATION AND POVERTY: THE DISTRIBUTIONAL IMPACT OF UTILITY PRIVATISATION

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PRIVATISATION AND POVERTY:
THE DISTRIBUTIONAL IMPACT OF UTILITY PRIVATISATION

1 INTRODUCTION

In recent years the emphasis of donors and governments has shifted so that greater attention is now paid to the poverty impact of economic policies in developing countries. Whereas previously the focus was on macroeconomic reforms, effectiveness is now considered in terms of the impact of policies on the poorest. This is clearly demonstrated by the World Bank's shift from Structural Adjustment Programmes to Poverty Reduction Strategies. Similarly, the IMF provides Poverty Reduction and Growth Facilities (PRGFs) which replaced Enhanced Structural Adjustment Facilities (ESAFs) in 1999.

However, despite this shift in emphasis, in many respects the policies prescribed by the International Financial Institutions (IFIs) are strikingly similar to the structural adjustment reforms. The underlying neo-liberal focus is unchanged. Thus, the emphasis on markets and 'efficiency' remains. Rather than reassessing policies in the light of their poverty impact, many have made a seamless transition presumably on the basis that what was considered to be good macroeconomic policy (although this is also open to question) will also be good for poverty reduction.

Privatisation is one of the core policies that have endured since the days of adjustment programmes, yet the impact of privatisation on poverty has so far been neglected in World Bank analysis. The distributional impact of privatisation transactions will depend on the nature of the enterprise in question. The greater the market share and the more essential the product, the more far reaching will be the impact of privatisation. Sales to foreign, rather than domestic, investors will also generate international equity considerations. It is for this reason that this paper concentrates on utility privatisation. While many of the poor in developing countries do not have access to utility services, we need to examine the relative distributional impact of privatisation to consider whether the policy is likely to relieve or exacerbate the quality of life of those on very low incomes. An examination of the distributional effects of utility privatisation is essential if the policy is to have a place in a poverty reduction strategy.

2 THE WORLD BANK AND IMF

Privatisation has been a central component of donor-funded aid programmes since the late 1980s when the World Bank voiced its dissatisfaction with government efforts at public sector reform. In 1983, with the publication of the Berg Report, attention focused on the poor performance of the extensive public sector in Africa. The emphasis initially was on reform of the public sector but, increasingly frustrated with recidivism, policy advisors began to look at privatisation as a means to 'lock in' the gains from reform. Thus privatisation became popular because it was difficult to reverse.

Privatisation acquired its own momentum and became a panacea for all that was wrong with the economies of industrialised and developing countries. (See Bayliss and Cramer 2001 for a review of the evolution of the World Bank's policy position on privatisation.) Towards the end of 2001, the World Bank is debating its Private Sector Development Strategy. This presents a further evolutionary step in the position of privatisation. Although the term 'privatisation' has been largely dropped in favour of 'private sector participation', the concept is the same. In the latest strategy, the Bank proposes broadening the remit of the private sector further to encompass delivery of basic services, and expanding the scope of the divisions of the World Bank that deal directly with the private sector, namely the International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA).

Thus privatisation has become increasingly elevated in terms of the significance attached to it by the World Bank. Furthermore, privatisation has featured prominently in the conditionality arrangements that the World Bank and IMF establish with developing country governments. Privatisation is often a condition for the release of aid funds and has been tied to eligibility conditions for debt relief by the World Bank and IMF. In the electricity sector, privatisation forms a key part of policy conditionality (Bayliss 2001a). In the water sector, privatisation or cost recovery policies are a component in a number of IMF conditionality packages (Grusky 2001).[1]

Despite the shift of focus from macroeconomic performance to poverty, privatisation remains a core policy. Poverty Reduction Strategy Papers (PRSPs) are littered with commitments to privatise. For example, the Government of Uganda says in its PRSP that "In the long run privatisation will transfer the need for major investment expenditures on to the private sector"

(Uganda PRSP[2]). In Mauritania, "emphasis will be placed on completing reforms related to the liberalization and privatisation of services in the telecommunications, energy and air transport services" (para 138, Mauritania PRSP[3]). In Burkina Faso, the government aims to implement the "privatization of existing state interests in order to facilitate the entry of new firms, resources, and technology into various segments of the market" (Para 4.2.1.2.2Burkina Faso PRSP[4]).

Privatisation also features in the conditions set for poor countries to qualify for debt relief under the Heavily Indebted Poor Countries (HIPC) initiative. To qualify for debt relief, recipient countries have to demonstrate commitment to implement prescribed structural reforms and draw up a PRSP. Both of these usually incorporate privatisation. Delays in implementation can slow up aid disbursement, for example:

- In Mozambique, the World Bank and IMF agreed in August 1999 that the government had met the requirements for receiving close to $3.7bn in debt relief from its external creditors under the Heavily Indebted Poor Countries (HIPC) initiative. The relief was granted because of the government's reform policies which included wide ranging privatisation.[5]

- In Honduras, debt relief under HIPC was delayed for six months while the IMF demanded more progress on electricity privatisation (Oxfam 2000). It is reported that in Tanzania debt relief was held up by complications in the privatisation of the National Commercial Bank (WDM 2000).

The need to meet conditions for aid and debt relief then becomes a primary incentive for developing country governments to privatise. As a consequence of its connection to aid disbursement, privatisation is often rushed, with more attention focused on securing the deal than on the interests of the end users. Competitive tendering may be compromised and alternatives ignored in the rush to privatise to meet donor conditions. For example, in Cameroon it was reported that the rapid privatisation of the water utility, Sonec, the sole bidder, French MNC, Suez Lyonnaise, was carried out in order to meet the requirements for debt relief.[6]

Privatisation, then, is often a crucial requirement for the disbursement of aid funding. Arguably such an approach may do little to reduce poverty while delaying aid spending because governments' failure to privatise may exacerbate poverty. Conditionality-driven privatisation can deflect attention from the overall priorities of improving services. The next section critically assesses the Bank's attempts to link privatisation to poverty and considers why such a policy remains a core component of poverty reduction strategies.

3 HOW MIGHT UTILITY PRIVATISATION REDUCE POVERTY?

Although it is a key policy of PRSPs, the links between privatisation and poverty are rarely spelt out. However, piecing together strands from the World Bank and wider literature, there appear to be five ways in which privatisation might be expected to reduce poverty.

Firstly, at a very general level, privatisation is supposed to contribute to **growth** and growth is required to reduce poverty. While few would question the benefits of economic growth, the positive impact of privatisation on growth has yet to be empirically established (Cook and Uchida, 2001).

Secondly, privatisation is widely associated with **development of the private sector** (Adam et al 1992; World Bank 2001). On the Bank website, privatisation is located under *Private Sector Development* (PSD) and the arguments for PSD are deemed to apply to privatisation. While a developed private sector is associated with lower levels of poverty, it is far from clear that privatisation will play a part in creating this.[7] As with the growth argument above, the link between PSD and poverty is not in question. What is in dispute is the degree to which privatisation will lead to both PSD and (or) growth.

The Bank literature is noticeably hazy when it comes to the details of how privatisation will develop the private sector (Bayliss 2001b) but two key themes emerge: a) privatisation is supposed to increase the number of players who have a stake in making sure that the private sector operates effectively (Kikeri et al 1994); and b) privatisation is supposed to develop the private sector by encouraging investment (Kikeri et al 1992), acting as a signal of government support for private-sector-led growth and development.

However, such accounts of privatisation and PSD fail to reflect the realities of the operations of the private sector and the circumstances in developing countries. Rather than operating effectively, privatisation can create an environment where the private sector will attempt to stifle competition and will flout regulation where possible in order to maximise profits. In the absence of effective regulation where governments have valid sanctions against private firms, the state will be powerless to prevent market abuses. Thus it is not privatisation that will develop the private sector; rather it is the government, through effective regulation.

In Latin America there is evidence to suggest that privatisation may have provided a positive signal to investors (Ramamurti, 1996). However, for many developing countries (eg in Africa) lack of investor interest has been a common feature of privatisation programmes. Instead of encouraging investment, privatisation has left governments offering increased concessions to entice investors to acquire their assets – often to meet the requirements of donors.

Such measures might include offering tax holidays; for example, the American firm AES has made a request to the government of Honduras to be allowed to operate under free trade zone conditions for the construction of its power generation plant, which would make it exempt from all types of general taxes, income tax and other charges (Financial Times, 3.1.01). In Uganda, AES asked the Ugandan Government to guarantee prompt reimbursement of its value added tax (VAT) claims by the Uganda Revenue Authority (URA) during negotiations for the Bujugali power plant.[8] Arguably, government concessions and guarantees are a greater attraction for investors than a commitment to private sector led growth.

Lack of investor interest has been a major stumbling block in some cases and pursuing privatisation in such circumstances has been difficult. Transactions have been painfully slow. Enterprises which have been in a limbo state of 'being privatised' for several years have rapidly declined (Bayliss 1998).

Low investor interest raises a number of issues when it comes to privatisation: efforts at competitive tendering fall down where there are few investors; extensive concessions may have to be offered; tariff increases may be imposed in an effort to generate a commercial return – none of which is conducive to the development of the private sector. A developed private sector will not spontaneously emerge as a bi-product of privatisation without specific targeting (Bayliss 2001b).

Thirdly, privatisation is expected to provide **fiscal benefits**. This is to be achieved by both raising revenue for the government and by removing the burden for governments to finance investment (Campbell-White and Bhatia 1998). The theory is that this should allow governments to spend more on services for the poor. For example:

"Urban power, water, sanitation and telecommunications require large investments, even if efficiency is improved. But much of this funding can come from the private sector – indeed, privatisation can be a source of revenue for cash-strapped governments"
(World Bank 2000, p144)

A similar argument is presented in the private provision of infrastructure. For example the Executive Vice President of the World Bank's IFC, Peter Woicke, when signing the agreements for an IFC sponsored power generation plant at Kipevu in Kenya, said that the private sector financing of the plant would "*enable the Government of Kenya to conserve limited public resources for other priorities, such as education and healthcare.*"[9]

These arguments ignore one of the fundamental contradictions of privatisation policy. Private firms – being profit maximisers - will only invest where they expect to make a commercial return. This means that they will only want to invest in profitable activities and will be reluctant to buy loss-making enterprises. Investors will be attracted to the enterprises that bring in revenue for the government and the government could end up worse off if left with just the loss making enterprises. For example, in their study of African privatisation, Campbell-White and Bhatia (1998) found that the enterprises that had been sold had not been a financial drain on government resources.

Where the revenue stream is in question, firms may withdraw from investment projects. For example, in Zimbabwe, in 1999, UK firm Biwater withdrew from a proposed private water project because the project's intended beneficiaries (consumers) were too poor to pay a tariff to accommodate the profit margin that Biwater was seeking. The Biwater country manager for Zimbabwe, Richard Whiting, summed up the conflicting objectives of private versus social goals:
"Investors need to be convinced that they will get reasonable returns,…The issues we consider include who the end users are and whether they are able to afford the water

tariffs…From a social point of view, these kinds of projects are viable but unfortunately from a private sector point of view they are not,". [10]

Alternatively, firms seek guarantees from governments that they will be paid. In infrastructure, private companies will ensure that investments are recouped with a profit margin. In power generation projects, private investors often will not invest without a power purchase agreement (PPA) in place under which the publicly owned utility agrees to purchase all the output of the plant at a price fixed in foreign exchange for a period of 20 to 30 years.

These agreements have proved crippling for governments. In the case of the Enron-owned Dabhol power project in India, the terms of the PPA have been so onerous for the Maharashtra State Electricity Board (MSEB) - due to currency devaluation and the high cost of fuel used - that it has defaulted on payments. Enron has called in its sovereign guarantee and the Government of India has met payments but on the basis that it will be compensated by withholding funds from the Maharashtra state budget. Private provision of infrastructure here has not helped the fiscal position and a number of similar cases can be found in Asian countries (Bayliss and Hall 2000).

In the case of the Kipevu Independent Power Producer referred to by Woicke above, the project is underwritten by an 20 year power purchase agreement whereby the state-owned utility has contracted to pay "140% of what is required" into an escrow account to ensure that the investors (including the World Bank's IFC) will be paid.[11]

In such infrastructure projects, governments are entering into agreements that are more like debt than equity because of the terms of negotiated contracts which specify the amount to be purchased at a price fixed in US$. This is not a good basis for using the private sector for infrastructure (Wells 1999). Rather than providing finance that can be directed to supporting the poor, such privatisation policies can be a drain on the government's fiscal capacity. Fourthly, privatisation is intended to **improve the performance** of enterprises by focusing attention on financial performance and by removing the enterprise from state control. Furthermore, improvements in the supply of key services such as water, electricity, transport, can have downstream benefits for the wider economy through, for example, improved production processes.

There is, however, no unequivocal evidence that the private sector does perform better than the public sector.[12] While private ownership may bring better management skills and better incentives this is by no means inevitable. Foreign firms with no experience in infrastructure development may be unlikely to bring better management than state owned enterprises (Wells 1999).

There are numerous cases of utility privatisation failures. For example, in Puerto Rico, four years after a subsidiary of the French multinational, Vivendi, took over management of the water authority, PRASA, the Office of the Comptroller issued an extremely critical report, condemning the contract for failing on all grounds including deficiencies in maintenance and repair; financial reports were late or not submitted at all; consumers queries were not responded to; some received no water but were always sent monthly bills; PRASA work crews did not know where to look for the aqueducts and valves they were supposed to be working on.[13] Furthermore, the financial situation of the PRASA deteriorated to such a degree that the state had to provide subsidies. On several occasions the Government Development Bank had to step in with emergency funding.[14]

There was a similar picture in Trinidad, where in 1994, the government contracted out the management of the islands' water authority, WASA, to the UK water company, Severn Trent. One of the central features of the original Business Plan submitted by Severn Trent was that they would make WASA financially viable by the end of the three year contract period but the deficit for 1998 actually increased over 1997 to $378.5 million.[15] In April 1999 Severn-Trent's contract expired without renewal and WASA was taken back as a public sector responsibility.[16] WASA has since taken on new local managers, and is reportedly planning significant investments.[17] While such evidence can be regarded as anecdotal and similar cases may be found of failures in the public sector, the point is that the private sector is not always superior (for more examples of privatisation failures in the water sector see Hall 2001).[18]

The electricity sector also boasts a number of privatisation disasters, the most notable being the Dominican Republic where privatisation, in 1999, was presented as a way of putting an end to the blackouts that had crippled the nation for the many years. However, towards the end of 2001, blackouts are on a much higher scale than under state ownership. Business owners have refused to pay higher prices for an even worse service with the result that whole communities are now disconnected. Civil unrest has escalated and several demonstrators have been killed in the past year.

Finally, privatisation can make a considerable dent in poverty because it is tied to the **release of aid funds**. In Guinea for example, the government received $67m for investment in the water sector because it undertook a lease agreement with the private sector for management of the capital’s water supply. In an assessment of the counterfactual by Menard, Clarke and Zuluaga[19], the supply of aid from the World Bank is considered to be a major benefit of privatisation.

In Cartagena, Colombia, privatisation of the water supply was one of the last policies to be implemented by the outgoing mayor. The incoming mayor had vociferously opposed privatisation and planned to reverse the policy on taking office. However, after a four hour meeting with the World Bank where he was told that privatisation was a condition for the release of aid funds, privatisation was reinstated on the policy agenda (Nickson 2001a).

The relationship between privatisation and release of aid funds is arbitrary, often based on some widely criticised views of World Bank economists. By making privatisation a component of policy conditionality, donors set about ensuring that the policy has positive results. The underlying impact of privatisation is obscured by the inflow of funds and the private sector is heralded as a source of finance.

4 WHY MIGHT PRIVATISATION INCREASE POVERTY?

Private firms are interested in profit. They are not interested in social objectives. For the World Bank this does not present a conflict. Rather they see the mission as being the need to harness the dynamism and efficiency of the private sector to make it operate for the social good.

This may be valid in a competitive market where the energy of profit maximisation may need to be directed into innovation and efficiency for a firm to survive. However, where there is any kind of market power exercised by a single or group of enterprises, the implications for the social good come into question. This section outlines the main ways in which firm behaviour may mean that privatisation has an adverse distributional outcome.

4.1 Cherry picking

In the name of profit maximisation, private firms are selective about their operations. They will be selective about the type of investment that they undertake and about the customers that they serve.

Investment in infrastructure, for example in a water supply programme in a developing country is not the most attractive proposition for the private sector for the reason that it requires extensive up-front investment and takes many years to recoup the cost, let alone make a profit. Such investment projects are possibly incompatible with the short-term demands of private capital. To accommodate this, privatisation projects have been designed so that private firms only acquire an interest in the aspects of service delivery that make quick profits, leaving the longer-term, less financially attractive responsibilities for investment with the government.

For example, in Guinea and Cote d'Ivoire, private operators were given responsibility for billing consumers for water while the government owned a separate company which owned and maintained the infrastructure. In Guinea, the private firm made a profit while the state owned enterprise continued to make losses. This may not be due to the nature of ownership but because the private firm had adopted the profitable aspect of the business and would not take on the loss-making component that stayed with the government.

Private firms are also selective in the type of consumer they take on. In the energy sector in Africa for example, private firms prefer to supply high-load industrial users but this has implications for other consumers:

"*One … possible consequence of private power participation in a small economy is that independent power generation may remove high-load factor customers from the grid system. This is likely to result in increasing the cost of serving the remaining customers and thus in more defections, with higher costs and lower system reliability to be borne by the economy in general.*" (Chiwaya 1999 p305).

Private firms also demonstrate selectivity in their disconnections of non-payers. The usual pattern with electricity and water privatisation is a rapid expansion in the level of billing and installation of meters. Increasing connections is a lesser priority and investing in the network infrastructure is at the bottom of the list.

For example, in Guinea, after privatisation of the water supply, the proportion of consumers with meters for their water increased rapidly from about 5 percent to 98 percent for private and 100 percent for government users. However, the progress in expanding the number of users with connections to safe water through the network was much slower, increasing from 38 percent in 1989 to 47 percent in 1996 (Brook Cowen 1999).

In Georgia, the privatised electricity distributor, Telasi, now owned by the American firm AES, was disconnecting users at the rate of 1,000 a month when it took over the operation in 1999. Despite privatisation, blackouts are still common. For many of the city's 400,000 households, privatisation has brought little tangible gain apart from replacement of their old meters with new individual meters and re-wiring. This has brought higher costs which they can no longer avoid.[20]

The end of informal connections can represent a considerable welfare loss to poorer users. Although there is little data, evidence from Colombia (Velez (1996), cited in Estache et al 2000) estimates that the implicit subsidy from non-payment by informal or illegal connection in the main urban centres of Colombia in 1992 accounted for 6% of all subsidies in the electricity sector and 24% of all subsidies in water and sanitation. Furthermore, this subsidy was highly progressive with more than 72% and 73% of the subsidy benefiting households in the five poorest deciles of the income distribution in the electricity and water sector respectively.

4.2 Prices

The relationship between privatisation and prices can be complex. Privatisation often coincides with other policy measures to contribute to financial sustainability. When considering the impact of privatisation on tariffs it can be difficult to isolate the impact of ownership change.

Price increases are often needed in developing countries to make utilities financially sustainable and price increases can occur under public ownership.[21] While, in theory, this is a separate issue, often financial sustainability is a prelude to privatisation. Furthermore, financial sustainability does not have to rely on the notion of 'full cost recovery' as both external subsidies and internal cross subsidies can be provided on an equitable and sustainable basis.[22] However, privatisation in World Bank and donor funded programmes often go hand-in-hand with the removal of subsidies and this can increase prices.

Many of the poor do not have access to networked services so the cost of connection may be at least as important as the tariff level. In some of the poorest regions, the connection tariff is so high that it is prohibitive for poorer consumers, for example in Buenos Aires unconnected customers in the poorest regions were asked to contribute almost 20% of their income to water connections (Estache et al 2001).

In Guinea, the cost of connections meant that service expansion was constrained. On average, prices were higher than in most other African countries. Productive capacity in the water sector increased substantially because of World Bank assistance but demand lagged far behind supply because of the cost of connections (Menard, Clarke and Zuluaga 2000).

There are numerous cases of prices increases accompanying privatisation and the reasons are not always clear. This section explores some reasons why privatisation might be associated with higher prices.

Firstly, in order to attract investors, private firms are sometimes guaranteed rates of returns on their investments. For example, in Ecuador, EMELEC, an American private electricity provider operating a long-term contract, was guaranteed a return of 9.25%. From the early 1980s, the government and EMELEC had a disagreement mainly over the concession terms that guaranteed EMELEC this net annual return on invested capital, which was to be earned by EMELEC through government set electricity rates. In 1982 the government refused to set rates that would allow EMELEC to earn such a rate of return on investment. The company is planning to pursue the case through the American courts.[23]

In Bolivia, in September 1999, the Bolivian government awarded a 40-year concession for the water and sanitation system of Cochabamba (and a related investment project called the Misicuni Project), to an internationally owned consortium, Aguas del Tunari. The company increased water tariffs sharply in December 1999, provoking popular protests. One of the main reasons for the huge increases in water prices was that consumers were being charged for the cost of the Misicuni project which water users in Cochabamba were requested to cover in advance.[24] Furthermore, the concession agreement provided for a guaranteed 15 per cent real return, to be borne by the consumers of Cochabamba (Lobina 2000).

Secondly, governments may increase prices prior to privatisation in order to attract investors to the privatisation programme as the investment will appear more profitable. This was the case in the privatisation of water in Buenos Aires and this was emulated in the Manila water privatisation.

Thirdly, where institutional and regulatory capacity are weak, governments may not be in a position to keep control over prices. In Guinea the price of water increased substantially after privatisation. The reason for the price increases is not clear but one factor seems to be that weak regulatory capacity undermined the effectiveness of monitoring of prices by the government (see below). Price increases have led to higher commercial losses as tariff increases lead to more defaults on bills and stronger incentives for illegal connections. In 1996, 58 percent of bills went unpaid (Brook Cowen 1999).

4.3 Employment

While the precise impact of privatisation on employment may vary across industries, most evidence points towards reductions in employment after privatisation. This is best summarised by the International Labour Organisation (ILO):

"the privatisation and restructuring processes in water, electricity and gas utilities have in general resulted in a reduction of employment levels, sometimes affecting up to 50% of the workforce. Employment cuts appear to be more severe under certain forms of privatisation, such as the contracting out of certain parts of the industry and total privatisation or where there is a combination of privatisation and restructuring. Moreover, employment increases after privatisation are rare and usually follow periods of large-scale retrenchment" p1 ILO 1998 Chapter Two (using ILO data from member states for the water electricity and gas sector as well as information provided by unions and companies).

Privatisation and restructuring seems to have had no clear impact on wages but there appears to be some evidence (although research on the subject is limited) of privatisation increasing the disparity between pay levels within enterprises as demonstrated by payments to directors of privatised water and electricity utilities.

Although there was no evidence of brutal wage adjustment, wages have been changing with elaborate remuneration mechanisms for skilled employees and more basic mechanisms for poorly skilled workers. Remuneration mechanisms are becoming more complex and thus sometimes less transparent (ILO 1998).

There has been little post privatisation expansion in employment in water, gas and electricity according to the ILO. Some have voiced concern that the strategies for private companies are to rely on workforce reduction to provide ever increasing profits and dividends to shareholders. According to the Utility Workers Union of America, little new work has been created and " *the tendency with restructuring is for the same work to be done with fewer people in a non-union setting at lower levels of wages and benefits*" (p23, ILO).

Extensive retrenchment, coming on top of downsizing of the civil service places great strain on other aspects of the economy as more workers struggle to exist in the 'informal sector'. Efforts to stem increasing unemployment, for example through employment guarantees have not been enforced (Campbell-White and Bhatia 1998).

The reduction in employment needs to be balanced against some appalling conditions under public ownership. In some parts of sub-Saharan Africa, public sector employees have not been paid for long periods of time. The retrenchment package from privatisation can provide at least a transitory income source. While this is not a basis for promoting privatisation, state ownership may also do little to alleviate poverty.

4.4 Institutional capacity

A strong regulator is needed to ensure that privatisation does not neglect the interests of the poor but in most developing countries, regulation – and state capacity generally - is weak. The World Bank line is that where states are weaker, there is a need for greater openness and more privatisation so that competition will act as a regulator (eg WDR 1997, World Bank 2001) but this is unlikely to emerge as weak states often correspond with weak and monopolistic markets. Weak regulation can affect the poor in many ways, such as higher prices, non-payment of tax, transfer pricing, poor service quality, service cutbacks.

In Guinea, weaknesses in regulation led to overcharging by the private water company – a fact only discovered in the course of a World Bank audit - and the government regulator was powerless to make the private operator comply with financial disclosure requirements which meant the regulator had no way of verifying costs and the basis for tariffs (Menard, Clarke and Zuluaga 2000). Thus the private firm was earning more than twice the agreed amount but the regulatory body was not able to discover the fact without a World Bank audit. It is not clear whether this was an oversight by the private firm or part of a deliberate policy to conceal information from the regulator.

Stronger regulation can keep prices low but at a cost to the private investor. In Hungary the government has forced private firms to keep prices low.[25] In the UK, efforts by the regulator to keep prices low in the water sector have meant that private firms have made less profits and are looking for means to exit from the sector (eg Hyder and Wessex Water).

Even where the regulatory framework provides for sanctions against firms, these may not be taken up. In South Africa, the privatised water company in Dolphin Coast sought to renegotiate their contract in June 2001. In April the company, Siza, had refused to pay the scheduled R3,6m lease payment due to the municipality of KwaDukuza. The municipality was faced with the option of renegotiation of the contract with Siza or calling in the 'performance bond' which in reality is rarely a viable option for the regulator in developing countries when dealing with a large multinational company. Opting for renegotiation, the water prices in the municipality will immediately increase by 15% to restore profitability.[26]

Evidence from Cartagena suggests that the municipality has limited capacity to direct the private operator of the water supply. According to a paper by Nickson (2001a) the municipality has little awareness of the possibilities for pro-poor measures within the private sector. It seems that municipality staff lack experience in project management. They did not show any ability to carry out a tendering procedure but instead responded to a proposal from the eventual private sector partner to the joint venture. The negotiations were conducted in secrecy and there was little effort to integrate the needs of the poor.

The capacity to monitor and regulate the private partner is further limited by the transitory nature of the municipal staffing system. The municipality is the major shareholder in the venture yet the mayor changes every three years and this '*produces an almost complete lack* *of institutional memory on the part of the municipality' and this provides superior knowledge which 'soon translates into a power imbalance within the ppp*' (Nickson 2001a p33).

Evidence from Cote d'Ivoire and Senegal indicates that there is tension rather than cooperation between the regulator and the private operator. The private operators seem to be lax when it comes to complying with regulatory demands and the regulator has limited enforcement capacity. In 1987 the contract between the government of Cote d'Ivoire and the private water company, SODECI, was renegotiated. SODECI made substantial concessions: the authorities managed to negotiate a 20 % reduction in fees with the private operator just by suggesting that they might allow other companies to bid for the contract. This suggests that SODECI has enjoyed substantial rents over the course of the contract (Kerf 2000).

Privatisation is widely associated with cronyism and corruption (Lewis 1994; Hall 1999) and can therefore contribute to a consolidation of economic and political power in an interest group that rarely represents the poor. Privatisation has been used as a political tool to reward supporters and to dissipate political opposition, for example from trade unions. Where the policy is carried out to support a political elite, the process can undermine democratic pluralism, yet democratic processes are crucial to maintaining checks on both the private and the public sector as demonstrated by the recent corruption trial over a water concession in Grenoble, France (Hall and Lobina 2001).

5 CONCLUSION

The above discussion shows that the impact of privatisation on poverty can be complex. On the one hand, low-income consumers may benefit from privatisation if the private firm is willing to extend the service and they can afford to be connected to the network, and if the service provided is more reliable. On the other hand, the poor may lose out from privatisation if it results in price increases, if illegal connections are abolished and non-payers are disconnected and if employment levels fall. On a macro level, a government's fiscal position may deteriorate if it has to provide concessions to attract investors, pay the substantial costs of privatisation and it is left with loss making enterprises. The position taken by different parties on the policy impact of privatisation depends on their view of the above factors.

As with other policies, the impact of privatisation needs to be assessed in its economic, historical and social contexts. In many developing countries, there is no effective social safety net. Public sectors have implemented a kind of welfarism through, for example, tolerance of illegal connections to utility services and over- staffing in public enterprises. Such policies are now widely condemned as inefficient but their removal constitutes a significant welfare loss to many.

If policies are to be poverty focused they need to be reconsidered at a fundamental level rather than rehashed changing just the language to recognise the needs of the poor. Blanket privatisation needs to be abandoned in favour of a case-by-case approach where the overall objective (such as universal service delivery for example) is the starting point. From this point, alternative options can be considered and evaluated. Privatisation is just one possible option. Public sector reform and corporatisation are others. Such approaches may be far better suited to meeting the needs of the poor.

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