"The globalisation of utilities liberalisation: Impacts upon the poor in Latin America"

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Abstract

This paper provides a brief overview of the global trend towards the market liberalisation of public utilities, looking at the background and experiences of nations in Latin America. The focus in on the impacts that market reforms have had upon the poorer sections of Latin American society, including the terms and conditions to which governments and consumers have been subject to. The paper outlines some of the risks that reforms can pose for nations, looking specifically at the experience of Argentina since the economic crisis of 2001, before asking whether such liberalisation reforms are appropriate for Latin America, and what lesson can be learnt.

Keywords: Utilities, Liberalisation, the Poor, Latin America.

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Introduction

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In economic terms, globalisation is shorthand for global capitalism and the extension of global markets (Birdsall, 2002). The liberalisation and privatisation of public utilities in Latin America have created huge new markets for foreign investors. This review paper aims to outline the main issues and arguments surrounding the reform of public utilities in Latin America, focussing upon the impacts this has had on poorer consumers. Although the paper draws heavily on research undertaken on the electricity sector in Argentina, data from other industries and countries is also used to highlight differences in reform processes and corresponding consumer impacts.

Public utilities are services such as Water, Telecoms, Gas and Electricity. Liberalisation simply refers to the process of opening up an industry to market forces, ‘marketising’ a particular sector, which normally involves privatisation and the introduction of competition whenever possible. Such policies are often loosely termed ‘market reform’, or just ‘reform’. There are various types of reform however, and the way in which a newly reformed utility is structured has different outcomes and impacts on consumers.

However, it is important to remember why these industries underwent reform in the first place. In Latin American, the reform of many utilities took place at a time of economic crisis. From the early 1980s many Latin American economies were suffering from high inflation and crippling external debts. The state-led economic growth of the post-war modernisation era was faltering, and many state-owned and operated utilities were inefficient and loss-making, often with tariffs kept unrealistically low for political reasons (Gabriele, 2004). In an attempt to reduce the fiscal debt burden of many Latin American governments, utilities were highlighted as an important area for market reform where savings could be made, and investments were needed (Stiglitz, 2002).

The reform of utilities in economic development policy constitute an important part of the ‘Washington consensus’, a set of economic policies that are often defined as ‘neo-liberal’, emphasising the superiority of markets to deliver the most efficient distribution of resources (Leys, 1998). The Washington-based International Financial Institutions (IFIs), most importantly the World Bank and the International Monetary Fund (IMF) form the core of the consensus with their western Government backers (most importantly the U.S Government). In broad terms, the consensus promotes the tenets of privatisation, liberalisation and minimal state involvement in industry. It is argued that economic development is facilitated through the trickle-down of benefits from more efficient private sector management of the economy, which will improve revenues to government who are better able to redistribute wealth through 'targeted' subsidies (i.e. a welfare system), and not by operating the industries themselves (Bacon and Besant-Jones, 2002, Gülen and Foss, 2003).

The Latin American Experience

Latin America has been the major recipient of utilities reform policies. Between 1990 and 1998, private investment in all utilities totalled US$236.5 billion, accounting for nearly 50% of all such investments in the developing world (Estache et al, 2000). Chile is often cited as the first 'developing' country to implement market reforms in the utilities sector. However, unlike most other Latin American nations, Chile's reforms (first conceived in the early 1980s) were developed and introduced internally, and over time with no direct involvement from the IFI's. Chile's experience is often cited as an example of how economic liberalisation can be successful in a developing economy. For example, in 1988 when the electricity sector was privatised in Chile, 29.4% of households within the lowest 10% income bracket had no access to electricity. This rate had fallen to 7% by 1998 (Estache et al, 2000). However, this improvement cannot be attributed solely to sector reform, as wider economic growth and an increase in disposable income was equally, if not more important.

From the late 1980s other Latin American nations began widespread reform of their public utilities, upon advice from the IFI's and in the wake of emerging successes in the reform of utilities in many developed nations. After Chile, Argentina was the first country to rapidly implement such policies across a range of public utilities, with the first of the enabling legislation passed in 1990. Other Latin American nations soon followed, with markets beginning to open up in Peru (1993), Colombia (1994), Bolivia (1995) and Brazil (1995) to name a few.

Proponents of utilities reform argue that all consumers will benefit from lower tariffs, resulting from the passing through of lower costs made from the savings of more efficient private sector management (Megginson and Netter 2001, Shirley and Walsh 2000, World Bank 2000). In a competitive market, such as that for electricity generation, it is generally regarded that efficiency gains are more likely to be made, as producers have stronger and more direct incentives to lower costs (Murillo 2001). Importantly, it is often argued that with liberalisation come investments in technology and an increase in *technology choice* for consumers, which has the potential to benefit all consumers.

In addition to serious operating inefficiencies, one of the key failures of many state utilities in Latin America has been a lack of investment in distribution infrastructure. This means that increasing numbers of urban and peri-urban consumers (The majority of whom are often poorer rural migrants) are without formal access to water, gas or electricity. Similarly, inefficiencies in the state telecoms often meant a waiting list of several years to obtain a new telephone connection. However, the logic of market reform suggests that large amounts of foreign capital will invest in network extension and the formalization of grid connections, in order to increase the market size and maximize consumer payments (Foster and Wodon 2002). For many low-income consumers, the promise of a formalized connection to water and energy supplies is welcomed, as this is likely to result in significant improvements to both the quality and safety of supplies.

Piped water and sanitation means less exposure to water-born diseases, and formalized electricity supplies greatly reduces the risk of fluctuating currents and electrocutions from illegal connections. As well as making much needed infrastructure investments, it is held that the reformed market is more likely to deliver a higher quality of service. Indeed, this has been the case more often than not in western markets, such as from the pioneering reforms in the UK. Irrespective of whether infrastructure investments result in increased quality of supply, pro-market reformists argue that a formal connection may be an aspiration of poorer consumers, and so will simply supply the demand.

However, perhaps the most important issue with regard to reform and the poor concerns the removal of state subsidies. Reformists argue that direct subsidies for each service are a less effective way of benefiting the poor than 'targeted' state subsidies. By targeted subsidies, it is meant wealth redistribution through a central welfare system rather than by distorting the efficiencies of cost-based pricing within each utility. (Bacon and Besant-Jones, 2002, World Energy Council, 2001, Gülen and Foss, 2003). A study in Honduras showed how electricity subsidies based on consumption levels were not only inefficient, but actually increased inequality. The subsidy was given to those who consume less than 300kWh per month, which applies to 85% of consumers. In addition, 80% of the overall subsidy went to those who consume more than 100kWh per month, so it appears that the poor were not necessarily worse off under this system, but that they received no extra benefits from subsidies, perpetuating inequalities (Cuesta and Gonzalez, 2003). Ultimately, although state subsidies in many countries benefit the poor, it shouldn't be assumed that they always do, and evidence exists to show how subsidies have often gone those with most political influence.

In addition to the aforementioned theoretical benefits of utilities reform for low-income residential consumers, a number of potential and actual drawbacks have also been highlighted. Those opposed to reform argue that there exists a risk that private ownership of public utilities may result in tariff *increases* as investors will be keen to maximise short and medium-term returns, especially if significant investments have been made to infrastructural improvements. This concern reflects issues of institutional capacity, namely that of national governments and their regulatory bodies (where they exist) to effectively act in the public interest, upholding and ensuring contractual agreements and tariff caps, where they exist (Azpiazu 2002, Dubash 2002, Palast, Oppenheim & Macgregor 2003).

Contrary to the idea that market liberalisation logically leads to market expansion (i.e. investments in new distribution networks), some critics have argued that market reform, if left unregulated, is likely to benefit established customers and networks. This argument is based on the idea that private utility operators may discriminate amongst consumer groups, depending upon the perceived likely returns from supplying them. This could result in 'cream-skimming' certain consumers or 'red-lining' certain neighbourhoods based upon whether they are more or less likely to yield profitable returns to investment. Consequently, low-income areas and consumers are more likely to be perceived as a high risk / low return market. This fear is greater when government and regulatory capacity is weaker, and where reform legislation and policies have been rushed through quickly and/or without a transparent concessions contract award process.

Without state intervention, the reformed Argentine electricity market would have failed to supply hundreds of thousands of low-income consumers. In order to help finance the huge investments in improving, extending and formalising the electricity grid to low-income areas, the two privatised distribution companies in Buenos Aires (which operate as regulated monopolies) came up with a '4-year plan' with the federal and provincial governments. The agreement stated that the state would reimburse the distribution companies for the losses they had incurred from electricity theft (which accounted for over one-quarter of total production at the point of privatisation) since taking over the system. In addition to this bail-out, the state also agreed to provide significant tax breaks in order to formalise the thousands of illegal grid connections. In effect, the state subsidised the cost of doing something that reformists said the market would provide.

In strictly economic terms, where connection formalisation takes place the transition from illegal to formal (paying) status in supplies of water and energy constitutes a clear welfare loss for the consumer. The majority of consumers with illegal utility supplies under the state systems were low income residential[2], and so it can be argued that the formalisation of supplies increased inequality (Birdsall & Nellis, 2003). Although a number of studies have identified a willingness to pay for a formalised connection to water and energy amongst low-income groups, it has been the case that reforms negatively affect at least a marginal group of consumers, mainly those with the lowest incomes less able to pay for a service they once obtained for free.

With regard to its impacts on the poor, the nature of the pricing and payment systems of liberalised utilities are of fundamental importance. The structure of the tariff system determines how the benefits of utilities reform are distributed among different consumer groups (Powell and Starks, 2000). In a liberalised market, utilities set prices to reflect the marginal cost of production in order to maximize economic efficiency. Unless there is a policy to dictate otherwise, such as the introduction of a 'lifeline' tariff, this is likely to mean consumers pay less per unit the more they consume, given that distribution costs decline relative to increases in the quantity (and of voltage for electricity) of supply. Not only does such a pricing structure reduce any economic incentives for the end-use efficiency of resources, it leads to an inequitable distribution of benefits as low-income groups tend to consume less water and energy per capita. Consequently, if reform is to benefit the poor, tariff policy must be designed with their needs in mind.

From the point of view of private distributors, one of the 'dangers' of supplying a metered service to low-income areas is a low or unreliable level of payment. As the cost of water and energy to low-income households will constitute a greater proportion of their domestic budgets, many poorer consumers have difficulties with payment. Many privatised water and energy distributors have tried to reduce the risk of non-payment by investing in a system of pre-payment meters. Pre-payment metering simply cuts supply to consumers once their credit is spent. This system has been most controversial for water supply to low-income groups, and has been associated with outbreaks of cholera where they were installed in townships in South Africa. Alternatively, some supply companies have preferred to opt for a system of credit-financing for low-income groups which is more flexible in that is leaves the decision to consume up to the consumer. However, social problems associated with increased debt and the charging of interest to low-income groups has been blamed on credit-financing systems, which have received criticism from consumer watchdogs.

Privatised water utilities have attracted the most controversy in Latin America. In Cochabamba, Bolivia, foreign owned water companies increased tariffs by up to 200%, ostensibly to fund much needed infrastructure improvements. These increases were however spread to all consumers equally, meaning that the poor were forced to spend up to half their income just on water bills. This unsustainable policy was only terminated after public outrage led to widespread street protests in March 2000 (Public Citizen, 2001). Similar circumstances resulted from the privatisation in 1995 of water services in Tucuman, Argentina. Again, in order to cover the cost of required investment, the concessionaire was granted to increase tariffs by 68% across all consumers. Initial public disapproval turned to resentment after outbreaks of turbid water. Residents reacted with a non-payment campaign that led to financial crisis for the concessionaire, and the election of an anti-privatisation local government. Attempts to renegotiate the contract by introducing a social tariff structure failed, as public confidence had been lost (Estache et al, 2000)

Argentine Utilities after the 2001 Economic Collapse

Argentina's experiences with utilities liberalisation provide important lessons of the shortcomings in globalising economic policies with regard to public services. In 1991, the Argentine peso was pegged to the US dollar in an attempt to reduce the risk of inflation, stabilise the currency and to give confidence to foreign investors; crucial to achieving the wider liberalisation project. By fixing the peso to the dollar, investors were guaranteed

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[2] However, it should not be assumed that all energy theft under the state-owned systems was made by low-income

revenue in local currency with equal worth to their dollar investments. However, this policy backfired when the currency was left to float on the market after the economic crisis of December 2001, subsequently loosing 70% of its value. This has proved damaging to the utilities sector in particular, as the gap in value between company revenues and their dollar denominated debts and foreign operating expenses makes covering their costs very difficult and new investments impossible.

In Argentina, the utilities sector reform is a highly political issue with significant media and public attention. The Argentine government froze utility tariffs after the 2001 economic crash and currency devaluation. Initial marginal increases allowed by the government resulted in public protests, and the dilemma of utility tariffs remains a key issue in national political debate.[3] Although the situation is different for every country, the Argentine experience shows the dangers of exposing the utilities sector to the volatilities of global investment and finance markets.

Public and Private support for utilities reform in Latin America

As services providing basic needs to all consumers, public faith that utilities liberalisation will not expose their access and affordability to the whim of the market or corporate profiteering is very important if reform is to work at all. Experience in Latin America has shown that public perceptions of privatisation cannot be ignored when it concerns such basic services as water and energy. Data from a survey conducted in spring 2001 by Latinobarometro and published in the *Economist* (July 28th -August 3rd 2001) show how negative public perceptions of privatisation are on the increase throughout Latin America. 63% of people surveyed in 17 Latin American countries disagreed or strongly disagreed with the statement *"The privatization of state companies has been beneficial. . ."* These sentiments are indicative of a growing trend in general public disapproval of privatisation policies, where the same survey question received 57% disagreement in 2000 and 43% 1998 (Birdsall & Nellis, 2003). It should be noted that public disapproval, whilst increasing as a percentage in

consumers, as some large multinational corporations were also found guilty after reform.

3 In September 2003, the president of the new centre-left government denounced the IMF's insistence that the government increase utility tariffs as a pre-condition for the signing of an important debt repayment package. In a characteristic attack he accused the IMF of lobbying on behalf of big business and stated *'This government will not give the green light to any commitments to hike rates',* and *'will not accept any repayment schedule that undermines Argentines' dignity'* (Buenos Aires Herald, 6-9-2003)

all 17 countries, grew faster in some nations such as Argentina, Brazil and Colombia, but less so in others most notably Chile, Ecuador and Venezuela.

Ironically, a corresponding private sector apprehension towards utilities reform has occurred in Latin America in recent years. In the case of Argentina, as already mentioned, global water and energy corporations have suffered since the currency devaluation, incurring huge losses. In Argentina and elsewhere, many foreign owned utilities have sought to rescind their contracts with Latin American governments when market conditions have become unattractive. The World Bank's International Court for the Settlement of Investment Disputes (ICSID) is currently arbitrating a number of cases brought against sovereign governments in Latin America by western utility corporations for either cancelling contracts in the wake of public disapproval (as in the case of water supply to Cochabamba, Bolivia), or attempting to block contract re-negotiations that would allow tariff increases, as is the case with Aguas Argentinas owned by the French corporation, Suez. This trend highlights corporate unwillingness to get involved with the reform of public utilities, as increasing public disapproval could (and has) lead to government intervention, and associated risks such as organised public non-payment campaigns.

Is reform appropriate for Latin America and what has been learnt?

Utilities liberalisation in many Latin American countries highlight failures of a reform process that has worked in many western nations. Although observers have speculated differently as to why this has happened, a few important issues have become clear.

The contexts within which reforms have taken place are significant. Unlike in most western nations that have reformed their utilities, the majority of Latin American countries implemented changes at a time of political and economic weakness, and often very rapidly. This meant that the reform agenda was dominated by concerns for much needed investments and narrow economic efficiencies to revive loss-making public utilities. Social and environmental concerns were secondary considerations, if they were considered at all. The priority of governments at the point of crisis is to 'turn the lights back on', and so the terms and conditions upon which reforms promise this to happen are less of a concern. Clearly, a reform process provides a 'window of opportunity' for governments, business and consumers alike. When market liberalisation is first considered as the means to improve a public service, governments are hoping to attract private investment, skills and technology to improve ailing utilities, whilst business views the process of liberalisation as a potentially lucrative opportunity to expand their markets and revenues on the best terms possible. Consumers hope that the reforms will lead to cheaper and better quality services, although imbalances between consumer groups often mean that greater benefits will be received by high-consumption large industrial and commercial consumers who are more able to influence the reform process than residential consumers, least of all the low-demand poorer consumers.

Like all deals and contracts, the terms upon which reform processes are signed have the potential to benefit one group more than another. Arguably, governments are less likely to strike a favourable deal in the context of economic and social crisis, giving private investors greater bargaining powers. The important point here is that market liberalisation is not bad per se., but that the devil is in the detail. A reform process undertaken by a willing government and population, after open debate and with transparent contracts is more likely to result in greater environmental and social benefits. On the contrary, a process that is rushed through behind closed doors is subject to public suspicions of corruption or mismanagement. This has often been the case in Latin America where critics argue that given the context in which reform mostly took place, state utilities were often significantly undervalued and sold off quickly without ensuring a good deal for the taxpayer.

Despite the failings of many reform programmes in Latin America, the IFI's continue to prescribe similar privatisation and liberalisation policies as the panacea to the economic woes of most developing countries. The World Bank has recently acknowledged the failings of certain market liberalisation experiences, and has shown a willingness to reconsider such policies. The IMF however continues to argue that failures generally result from too little liberalisation, as opposed to too much. In considering the pros and cons of utilities reform in Latin America, it is clearly important to judge each process on its merits, as the way in which, and the resulting structure of reformed utilities vary significantly between industries and countries. However, recent events in Argentina highlight the potentially damaging consequences of the private foreign ownership of utilities. Not only does foreign ownership lead to a repatriation of profits, that are not re-invested (at least not in Argentina's experience) and hence constitute a national welfare loss, it means governments come under pressure from foreign utility corporations to 'renegotiate' contracts or simply increase tariff rates when the market conditions turn against them. If not carried out carefully or incrementally, reform effectively strips sovereign governments of control over key public services.

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