

TAB F

3. "Privatization of Public Services" by Gabriel Roth

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PRIVATIZATION OF PUBLIC SERVICESby Gabriel Roth 1/Introduction

The purpose of this paper is to present examples of the privatization of public services in developing countries and to draw conclusions that may assist concerned governments and aid agencies. The services considered are education, health, electricity generation, telecommunications, water supply and transport. The examples are taken from a book being prepared in the World Bank. While recognizing the vital roles of the public sector in development, the Bank supports the vigorous encouragement of indigenous private sector enterprises in many countries because of their roles in mobilizing private savings, harnessing entrepreneurship, diffusing economic power, widening consumer choice, and stimulating competition (Clausen, 1985).

1/ The author is a staff member of The World Bank currently on special leave, prior to joining a non-profit group established to provide information and advice on the private provision of public services in developing countries. In this paper he represents his own views which are not necessarily those of The World Bank.

Education

The tradition of private education exists in all known civilizations. When Confucius said that he would teach anybody who bought him a meal, he meant that he did not mind how much he was paid, as long as the principle of payment was accepted. The idea that education should be "free", and supplied by the state, is of fairly recent origin. It became established in Europe and North America in the 19th Century, and was subsequently embraced with enthusiasm in the 20th Century by governments in Africa, Asia, and Latin America, with results that did not always meet expectations. Private education still survives in those countries because the public sector is short of funds, and because the private sector can offer a better product, particularly for specialized purposes and for minorities.

The financing of education raises serious problems, but the provision of "free" services by government employees is not necessarily the best way to deal with them. Education can be provided by private enterprise even if the financing is in the form of government grants or loans. Loan funds are particularly well developed in Latin America where about 20 institutions cooperate internationally through the Pan-American Association of Educational Credit Associations (APICE). If it is felt that grants are more appropriate than loans, it is possible to use education "vouchers" which give the user the right to

purchase education (up to a specified value) from approved institutions. This scheme was used very successfully in the United States for demobilized soldiers after World War II. A similar scheme is now used in Chile; local authorities pay approved non-fee-paying schools a specified amount for each day that a child attends, with the schools being allowed to compete for enrollments. The value of this payment is of the order of US\$100 a year, which may be a fifth or sixth of the fees charged by equivalent private schools in Chile. Nevertheless, the amount is sufficient to enable groups of teachers - and of parents - to establish some new public schools. The Chilean "voucher" cannot be used to supplement fees in private schools. The system was introduced in the 1940s as part of a reorganization that devolved responsibility for the schools from central government to the counties. It was revised in the 1970s. No comprehensive evaluation of the Chilean "voucher system" appears to have been published.

Health

The health sector, like education, has a long history of private provision. Traditional medicine is widespread in Asia, Africa, and Latin America, and the practitioners almost invariably operate on a fee basis. Major problems in the health sector are (a) organization of

health insurance and (b) integration of the traditional and modern sectors.

Health insurance, like education loan plans, is highly developed in Latin America. In some cases, the insurance covers groups of employees; in others, insurance companies cover individuals. However, health insurance can also be found in more primitive societies; in many Indian villages it is traditional for farmers to bring the local practitioner a gift at harvest time, which serves as an "insurance premium" for care for the following year. Similar customs are found in Indonesia. The integration of traditional with modern medicine is found in many countries. In India it is supported in government medical schools. In Ghana, there are government programs to give modern training to traditional birth attendants, who are allowed to charge higher fees to reflect their new skills. Traditional medicine in India and China is more advanced than in Africa, possibly because treatments and remedies are recorded and published, and thus made available to the profession for testing and comment. In Africa, on the other hand, traditional remedies are handed down from one practitioner to another under conditions of secrecy, so the lessons learned get around much more slowly.

As in the case of education, there need be no conflict between governmental financing of services and

private production. Under the National Health Service of the United Kingdom, individuals are encouraged to choose their doctors, who are then paid out of public funds an agreed amount for each person on their lists.

Electricity Generation

A major obstacle to the improvement of electricity supply in developing countries is probably the belief that the industry should be treated as a "natural monopoly" and that electric power has, therefore, to be supplied by the public sector or, at least, regulated by it. It can reasonably be argued that electricity transmission and distribution exhibit such scale economies that they can be regarded as "natural monopolies," but the generation of electricity can be carried out, as in North Yemen, at widely scattered points, either for use by the generating firm, or for sale. There is also the possibility of co-generation (i.e., an industrial process that results in heat and electricity being produced simultaneously), with electric power being sold for use by the public.

In theory, one can envisage a publicly owned and operated "grid" buying electricity from competing suppliers at prices that reflect supply and demand. This does not appear to be happening anywhere in the "Third World" but, in

the U.S., legislation passed in 1978 requires electric utilities to buy power from certain producers if offered at favorable rates. This legislation encouraged the emergence of hundreds of small companies that generate electricity from wind or water power.

One possible source of electricity, available to scores of developing countries, is from the burning of bagasse, which might be described as what is left of the sugar cane after the syrup is squeezed out of it. In its dried form, bagasse is frequently used to provide the necessary fuel for the manufacture of sugar. With suitable upgrading of equipment, it is, however, possible to generate from it more power than is required to make sugar, and this power can be made available to the public grid. In Mauritius, for example, it was calculated that 8 or 9 percent of total electricity used in the island could be met by burning bagasse, instead of importing fuel.

Telecommunications

In most third world countries, demand for telecommunication services far exceeds the supply, as evidenced by the high prices at which telephone lines change hands in cities where such transactions are allowed (about \$1,500 in Lima and Rangoon; double that in Bangkok). A

recent World Bank publication (Saunders et al., 1983) posed the question: "Who or what group has decided that telecommunications investment should be constrained relative to demand by closely regulating and controlling inputs to the sector, its organizational structure, and the internal procedures of telecommunications operating entities, and by imposing numerous restrictions under which operating entities must operate?"

It then answered this question as follows: "From the evidence reviewed it is clear that it is not the subscribers to or users of telecommunications services. In developing countries telephones and other telecommunications services tend to be used for productive purposes that benefit users who, in turn, tend to pay relatively high prices for the service, sometimes in flourishing black markets ... If it is not the users or beneficiaries of telecommunications services who are signaling that sector expansion should be constrained, then, it must be the owners, suppliers, and regulators of the services--which in most developing countries are governments."

In the past, LDC governments have generally made the judgement that food, transport, power, health, etc., were the most pressing needs and should receive appropriate emphasis. So long as telephones were viewed as inessential and largely luxury consumption, investment in the telecommunications sector received low priority.

In the last few years, this perception of the role of telecommunications has been changing, largely because of the explosion of telecommunications activity occasioned by this technological revolution. Modern telecommunications are becoming essential to business activity - initially to compete in the international marketplace, but, increasingly for domestic business activity as well. This revolution, not only in total demand but in the role of telecommunications in the conduct of business, is generating pressure for change in the traditional organization of telecommunications activity and in the priority it receives in the investment schemes. A good deal of discussion and investigation of reform is going on, with many different mechanisms being examined, to make telecommunications entities more flexible, commercial and efficient. Proposals for full-scale privatization are extremely rare, even among the most active reformers, because most governments feel that, even if ultimately deemed to be desirable, full privatization is too large a step to be taken all at once. Instead, some governments are seeking gradual reform in which the consequences of each change can be evaluated before the next step is taken. These reforms include (a) internal reorganization of telecommunications entities, e.g., changes in procurement, pricing, management systems; (b) creation of autonomous or semi-autonomous government entities to replace government ministries; (c) joint ventures and management contracts; and (d) permission to major competitors and users to create alternative systems and interconnect them to the public network.

One example of partial privatization involves a private facility accessing the international telecommunications network and providing services to a limited number of special customers. This is the "Teleport" planned for start-up in late 1986 in the Montego Bay Export Free Zone in Jamaica, with management and financing provided by a US/Japanese joint venture.

The purpose of a teleport (of which there were at least twenty in the U.S. in 1985) is to provide high-speed, high-quality, voice and data lines for companies engaged in telecommunications. The Jamaica Teleport is designed to serve information-intensive enterprises in the Montego Bay Export Free Zone, such as telephone marketing operations, reservation centers and data entry firms. The information between the U.S. and the Teleport will flow on voice and data lines via an American Satellite Corp. satellite and a specially constructed ground station in Jamaica. The price of private leased voice and data circuits will be comparable to U.S. domestic operations which are competitively determined and therefore substantially lower than those normally payable for international services. These low rates are expected to make the free zone's facilities specially attractive to U.S. firms. And many of the users accessing the operators at the Teleport will not realize that their phone calls, placed through the "800" network, will be earning valuable foreign exchange for Jamaica (FZA Review, 1985).

Experience with private sector operation of telecommunications in LDCs has been mixed. In a number of countries, e.g. Botswana, government-owned companies have been managed by foreign private firms, with reasonable success. Private companies owned by foreign interests were once common in Latin America; they operated for several decades, but most were nationalised in the 1960s, for reasons which cannot be pursued here. The Dominican Republic still has a public service supplied by GTE, but even this relationship appears to be getting difficult after many years of relative harmony. The Philippines have a fully private telephone system which is, and has long been, unsatisfactory, for reasons that warrant further study.

The World Bank has been in the forefront of those who believe that the communications revolution requires LDCs to rethink their telecommunications strategy and make appropriate adjustment to meet escalating needs and pressures. Increased commercial orientation for existing PTTs and an increased role for the private sector are important and highly desirable components in this adjustment. But the Bank also urges care, as the problems are extremely complex and the technology is rapidly evolving. Public interest concerns in telecommunications will always be important so there will always be a role for government.

Water Supply

Because of a genuine or alleged reluctance of people to pay for piped water, private investors are chary of supplying the necessary infrastructure. One way of dealing with the problem is to adopt the French system of "affermage" whereby the infrastructure is financed out of public funds, but operated by a private management firm. Such systems are to be found in North and West Africa and in France, where there are sufficient qualified firms to ensure that cities requiring their services can always get bids from qualified firms. There are different ways of bidding: for example, the company might secure a contract by undertaking to provide a package of services at the lowest rate of charge to customers, or it might offer the lowest sum for the right to supply these services at prices determined by government.

For rural areas, the development of private tube wells has been particularly successful in the Indus Valley in Pakistan. In the 1940s, the government of Pakistan installed over 14,000 tube wells, mainly for drainage, although it was believed that improved irrigation would be a useful by-product. However, the Indus basin farmers preferred to have their own wells, and the 14,000 public tube wells were matched by 186,000 small capacity tube wells which were installed by the private sector, 90% with no

subsidy. Assessments by World Bank staff (World Bank, 1983) concluded that the private tube wells had been managed efficiently; imposed a relatively insignificant burden on public resources; produced returns that were economically justified; and did not lead to excessive exploitation of the aquifer. Furthermore, private initiatives produced a remarkable range of ingenious inventions for the use of cheap local materials. For example, a bamboo tube well was developed in Bangladesh which is so cheap that several can be inserted in the same plot. Used in conjunction with an engine and pump made mobile by being mounted on a bullock cart, all the farm area can be irrigated economically. It is not even necessary for every farmer to own a pump; pump contractors emerged to serve pumpless tube wells.

Agricultural production is often constrained due to lack of water, while surpluses exist in neighboring areas. Is there scope for the movement of large quantities of irrigation waters from areas of plenty to areas of shortage? One of the main constraints to activity of this kind is an absence of clear property rights in water. If such rights were clarified, it is conceivable that the movement of water over long distances could do as much to stimulate agriculture in (say) India as it already does in (say) California. A transfer of water on the basis of property rights implies payment to the sellers at freely negotiated prices. This would be consistent with a

recommendation made by World Bank Staff that "a goal of full cost recovery" should be the cornerstone of any Bank involvement in this sector (World Bank, 1985).

A move towards the privatization of domestic water supply by the granting of property rights is reported (Kia, 1981) to have taken place in Kenya. In some regions, villagers had not been paying the small monthly tax which was to be used to help operate and maintain their local water supply systems. Furthermore, frequent acts of vandalism on faucets, drainage facilities, protective fences, and so on, made it financially very costly and physically almost impossible to maintain many of the public standposts. To overcome this, public standposts in a few areas were converted to water vendor operations; a licensed vendor pays a subsidized rate for the metered standpost water and sells it to users by the container (debe) at a slightly higher fee. The results of the switch to kiosks are that vandalism has been greatly reduced, thus saving government funds for repair and replacement costs; a small amount of revenue has been generated; and the rate at which people apply for house connexions has increased; some people presumably felt that if they were going to have to pay for water, it might as well be convenient water.

Transport

None of the above examples are of actual public sector divestiture: The transfer of a "public service" from the public to the private sector is comparatively rare, but there are some transport cases. For example, in Mexico, the port of Tampico was given to the workers when the government tired of paying its deficits. Under worker management, efficiencies increased markedly. However, in 1985, Tampico joined Altamira to become once again a public sector complex.

Road maintenance is now contracted out, with the support of the World Bank, to private firms in countries as dissimilar as Brazil, Nigeria, and Yugoslavia. (Harral et al., 1985)

An interesting example of urban bus divestiture occurred in Buenos Aires where, in 1951, a national enterprise known as "Transportes de Buenos Aires" took over all bus and rail transport operations. However, the services operated by the "Transportes de Buenos Aires" deteriorated rapidly both in quality and financially. By 1959, it was losing the equivalent of US\$40 million per year. In 1962, the situation became intolerable and "Transportes de Buenos Aires" was dissolved. All the

transport services, except the underground railway, were turned over to the private companies that had been operating before 1951. Many of these companies were "Empresas" (route associations) of owner drivers empowered to serve just one route. The Empresas governed routes, fares, and schedules, subject to the rules determined by the regulating authorities. The vehicles used were typically 23-seat buses, which provided a high frequency of service. Competition was provided by the establishment of new Empresas which duplicated the routes of existing ones. The micro-buses still operate profitably and provide a level of service that is widely praised.

A different approach is to be seen in Calcutta where, in 1960, all bus services were vested in the Calcutta State Transport Corporation (CSTC). The CSTC suffered from managerial and financial problems and, in 1966, was paralyzed by strikes. In response to public demand before the 1966 elections, and to its need for ready cash, the government of West Bengal sold permits which enabled 300 private buses to be operated. These operated at a profit, although they charged the same fare (equivalent to about US1/2c per mile) as the money-losing CSTC, and though they had inferior routes. By the late 1970s, some 1,500 full-sized private buses were operating in Calcutta, in addition to about 500 private mini-buses. In 1985, the private buses accounted for about two-thirds of all bus

trips in Calcutta, without subsidy. Meanwhile, the CSTC, which operated similar routes at the same fares, had to be subsidized to the equivalent of US\$1 million a month by a government that is desperately short of funds for other purposes. (A similar co-existence of profitable privately owned buses and loss-making publicly owned ones is to be found in Sri Lanka, and also in New Jersey.)

Conclusions

Of the services examined, telecommunications and electricity generation probably offer the greatest potential for private involvement, because of the intense demand, the comparative ease of collecting payment, and the existing poor levels of service in most countries. Transport is also a fertile field, but one that is already being tilled. Education, health, and water are more difficult, because payment by governments may be required. But, even when services are paid for by the public sector, they can still be contracted out to private enterprise.

There are many examples of public services in developing countries being provided by the private sector, but very few cases have been documented of services being transferred from the public to the private sector, in the sense of ownership being vested in private hands. The

reasons for this are not clear, but it may be hazarded that, as in the U.S., the pressures to retain activities in the "public interest", without being subjected to the bothersome disciplines of markets, are well-nigh irresistible. In the cases where ownership was transferred to the private sector (as in the example of Buenos Aires buses) the divestiture involved the return to private ownership of a concern that had been originally private and was not successfully run after being taken into the public sector. The Jamaica "Teleport", with its low international transmission rates, illustrates a "spillover" into the international arena of the consequences of U.S. deregulation.

It may be that the most painless way of bringing about the private provision of public services in developing countries is to deregulate rather than to divest; to allow the private operation of competitive services, while leaving in the public sector the operations under its control, in the hope that competition would improve them also, or make it easier for them to be wound up.

One may also conclude that a shortage of cash encourages divestiture - not to mention economy in the use of scarce resources - and that governments seeking economic growth should strive to abolish subsidies to failing public services. Subsidies can be designed, as in the case of the schools in Chile, to go to consumers without depriving them of the choice of supplier.

Questions for Discussion

Questions that might usefully be discussed by working groups include:

- a) What, in different sectors, and different parts of the world, are the main obstacles to the private provision of "public services"?
- b) How can these obstacles be overcome?
- c) If public services were privately provided, what would be the appropriate role for government?

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