

# **Pro-poor Regulation**

## **Challenges and Implications for Regulatory Design**



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# Overview

- Context: the access challenge
- Regulatory policies for better access
- Rethinking subsidies
- Output-based Aid (OBA)
- Pro-poor regulatory process
- Implications for regulatory administration



# Context

- Enormous service gap to basic services
- Lack of access poses serious direct and indirect effects, particularly for the poor
- Key challenge for policymakers and regulators is to raise coverage and improve service delivery



# Regulatory Policies for Better Access

- Market structure
- Price Regulation
- Quality Regulation



# Market Structure

## ■ Competition and free entry vs. exclusivity

- Exclusive contracts are often deemed necessary to benefit the poor through cross-subsidies between users BUT
  - Cross-subsidies benefit those served by formal providers, which typically excludes the poorest
  - Exclusivity can hamper entry

## ■ Strategic Options:

- deregulate entry?
- allow a variety of providers to respond to the needs of the un-served



# Price Regulation

- Regulation is claimed to benefit the poor by protecting them from excessive prices, BUT:
  - Social tariffs for low consumption households assume: (a) low income = low consumption; (b) low-income have connections.
  - Regulation benefits only those served by formal providers, which typically excludes the poorest
  - Regulated prices are often set below the cost of supplying those in distant or high cost locations (disincentive to add connections; unsustainable)



# Price Regulation (cont'd)

- Strategic Options:
  - Avoid price structure that discourages service to some consumers;
  - Off and on-grid differentiation
  - Billing options



# Quality Regulation

Regulation is often claimed to benefit the poor by protecting them from bad service, BUT:

- Standards are often set at levels that unjustifiably increase costs creating another barrier to access
- Standards can be misused as barriers to entry
- Standards that focus on inputs or processes may stifle innovation



# Quality Regulation (cont'd)

## ■ Strategic Options:

- Limit regulation to cases where clearly needed
- Ensure standards are not set at excessive levels (flexibility)
- Focus on outcomes or outputs rather than inputs or processes, to foster innovation and cost reduction



# Rethinking Subsidies

- There are limits to financing some basic services through user-fees alone
  - Affordability concerns
  - Public/merit good characteristics
  - Infeasibility of imposing direct user-fees.
- Traditionally, there was heavy reliance on cross-subsidies (e.g. lifeline tariffs) and financing of inputs in expectation of future service delivery



# Rethinking Subsidies (cont'd)

■ But directing public funding to *inputs* used by public sector service providers often has disappointing results

- Poor targeting of intended outcomes
- Poor accountability for results
- Weak incentives for efficiency & innovation
- Difficult to introduce competition
- No or limited private financing leveraged.

■ Strategic Options:

- Target beneficiaries
- Target aspects of services
- Delivery modes and incentives for efficiency



# Output-Based Aid

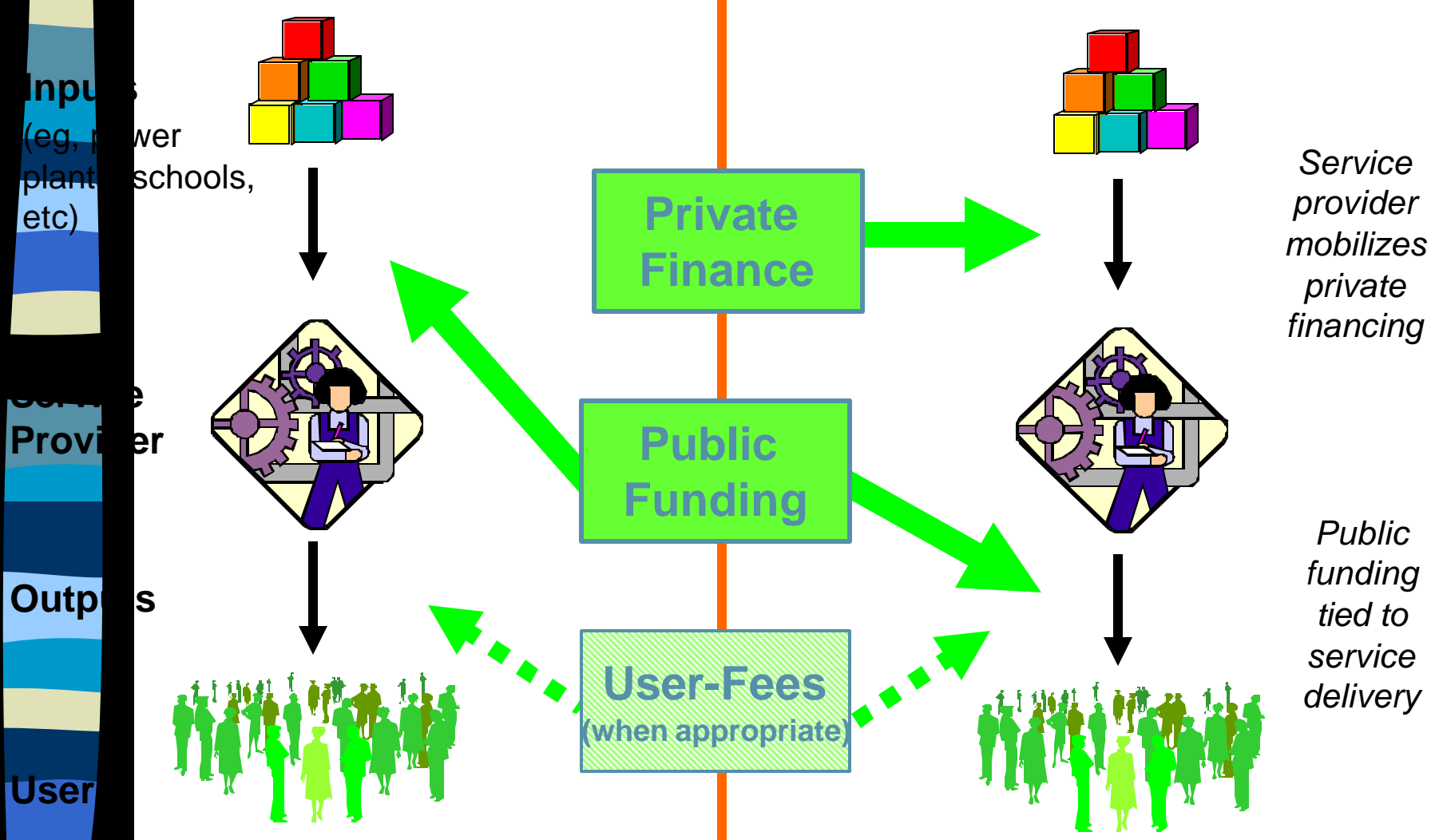
Output-Based Aid (OBA) is a strategy for supporting the delivery of basic services (e.g. infrastructure, health and education) that depend at least in part on public funding where payment linked to service delivery

- Potential benefits:
  - Better targeting of beneficiaries/outcomes
  - Better incentives for efficiency & innovation
  - Opportunities to leverage private financing
  - Mobilization of private capital

# Financing Flows

## Input-Based Approach

## Output-Based Approach



*Service provider mobilizes private financing*

*Public funding tied to service delivery*

Inputs  
(eg, power plant, schools, etc)  
Service Provider  
Outputs  
User

Private Finance

Public Funding

User-Fees  
(when appropriate)



# Key Features of Output-Based Aid

- A developmentally significant outcome  
*(reflected in measurable output indicators)*
  - E.g. connections
- A subsidy element
  - some degree of public funding to complement or replace user-fees
- Contracting-out of service delivery to a for-profit or not-for-profit private entity
- Remuneration (subsidy) linked transparently to performance against the output indicators = risk placed on service provider
  - To ensure sustainability, users will need to pay operating costs and (ideally) a portion of capital costs

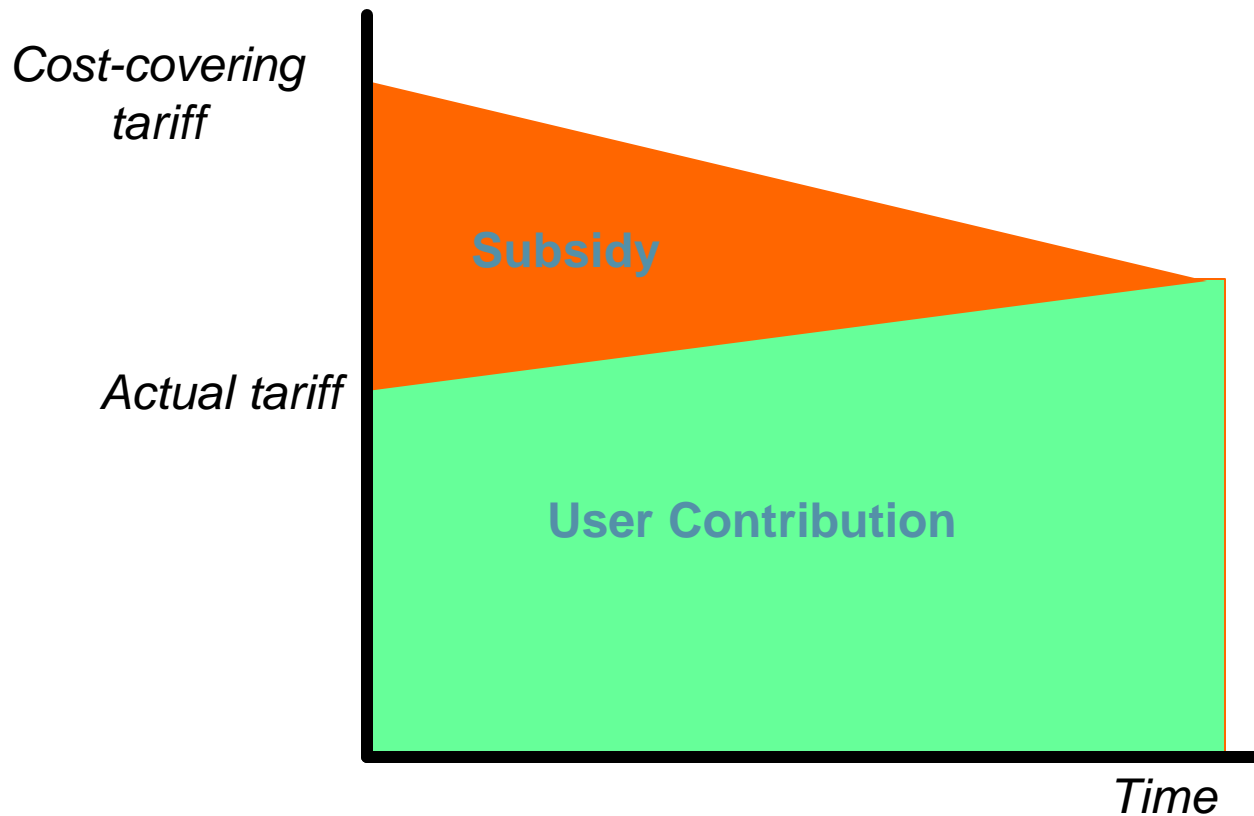


# OBA Schemes May Take Many Forms

- Public funding might be directed to various purposes, including:
  - New connections to network services
  - Easing transition to cost-covering tariffs
  - Ongoing consumption by targeted group
  - Social or environmental targets.
- Contract structure depends on whether competition between suppliers feasible:
  - When feasible, can use vouchers
  - Otherwise, concession-type structures bid on basis of lowest subsidy or similar.
- May be for individual projects, or involve a fund for supporting multiple projects.

# OBA: Transition Subsidies

- Time-bound subsidies might be used to ease the transition to cost-covering tariffs





# OBA Has Wide Application

- Approach applied in many sectors:
  - Telecoms – Chile, Peru, Guatemala, Nepal
  - Electricity – Argentina, Guatemala
  - Water – Chile, Colombia, Paraguay
  - Roads – Argentina
  - Rail – Argentina
  - Health – Haiti, Nicaragua
  - Education – Colombia, Chile, UK.



# OBA: Design Challenges

## ■ Key issues:

- Ensuring funding is justified and sustainable
- Targeting intended beneficiaries/outcomes
- Defining performance requirements
  - Provide opportunities for innovation
  - Ensure basic safeguards
- Designing payment mechanism and structure
  - Credible commitment is critical to private financing
  - Partial up-front payment sometimes necessary
- Ensuring effective monitoring
  - May involve regulators, NGOs, communities, etc.



# Pro-poor Regulatory Process

- Important to ensure regulators' decisions are well informed and perceived as legitimate
- Challenges:
  - Large and diverse group of stakeholders
  - Broad range of issues
  - Need to address political pressures



# Pro-poor Regulatory Process

- Strategic Options:
  - Regular visits to local communities
  - Specialist consultative and advisory bodies
  - Public information campaigns
  - Regional offices
  - Delegate monitoring of service provision and consultations



# Implications for Reform

- Understanding pattern of demand for services in un-served areas
- Market structure (potential for entry)
- Regulatory rules and processes responsive to non-traditional consumer groups
- Targeting and efficiency of subsidies
- Effective consultative processes