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The Role of Government and the Private Sector in Fighting Poverty

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FOREWORD

Governments and the private sector have important roles in fighting poverty and advancing economic development. Recent experience suggests that the most promising innovations in fighting poverty are hybrid formulas which combine the best of both public and private sectors.

Investing in human capital (or, in the social areas such as education, health, nutrition and population) promotes economic growth and reduces poverty.

The traditional approach to investing in human capital (at least in the Western world during the last century) has been for the public sector to assume major responsibilities. But in the past decades, social programs have come under heavy financial pressure. In about half of the countries for which data are available, public expenditures on education and health fell as a percentage of GDP between 1980 and 1985. This trend is likely to persist in many countries given the continuing constraints on public budgets. It is, therefore, imperative that the role of the private sector in financing and providing social services be expanded.

This paper is intended to put together the recent literature on the role of Governments and the private sectors in investing in human capital. Each country, given the initial conditions and background, commands its own optimal and feasible mix of public and private sectors. Recognizing this, the paper can only suggest the rather general sketches of a complex picture. Hopefully, policy makers and task managers will find these sketches herein helpful to them in completing the more detailed picture specific to their countries and/or projects.

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EXECUTIVE SUMMARY

Governments and the private sector have complementary roles in promoting development and in fighting poverty. After decades when government intervention was prescribed as the panacea for all market failures, the world events at the turn of the 1990s led by the demise of central planning have highlighted the failures of government and have shifted the pendulum away from the public sector. Experience now suggests that both the public and private sectors have indispensable roles to play in addressing poverty. Indeed, the most promising innovations in reducing poverty are hybrid formulas which combine the best of both sectors.

The traditional economic justifications for governments subsidizing and delivering social services include: (i) benefits flow not only to individuals but also to society at large (externalities); (ii) small private providers may operate inefficiently (scale economies); (iii) capital markets for the social sectors are not well developed (if not absent); and (iv) public expenditures on social services are used to redistribute income (equity).

These reasons, while valid for some social services, are not without substantial qualifications. For example, strong consumption externalities may characterize primary education but not higher education. There is also no evidence that hospitals in developing countries experience significant scale economies. For example, a comparison of the unit costs of five Malaysian general hospitals of comparable quality indicated no perceptible downward trend in the unit costs of inpatient days as the size of the facilities increased.

For equity purposes, public expenditures on social services have been regarded as a method of income redistribution, particularly if services are financed by progressively collected revenues. Evidence, however, consistent with public choice theory, indicates that progressive redistribution has not always taken place. Uniformly low prices has meant that the most costly services (higher education, tertiary care), consumed mainly by the rich, are subsidized the most. This leaves the poor without access to even the most basic services.

Even in the absence of the capital markets for social services and if social services are characterized by public-good features, this does not necessarily justify having the state monopolize their provision. Indeed, except when substantial scale economies exist or when demand is so low to warrant a natural monopoly, monopoly provision is sub-optimal in efficiency terms. Examples of inefficiencies found in public monopolies include disproportionate expenditure on less cost-effective interventions such as tertiary care or higher education, high unit costs, and an inability to ration according to need.

Selective private sector expansion may be expected to correct current imbalances and government failures, as well as to mobilize additional resources for social sector investment.

This suggests the need for a radical restructuring of the roles of government and the private sector. Specifically, it suggests reducing the role of governments and expanding the role of the private sector in promoting growth and meeting the human resource needs of the population.

However, although private sector expansion may relinquish governments from certain tasks, it also imposes new responsibilities. In particular, it demands that governments develop incentive mechanisms to promote cost control, quality assurance, and access for the poor.

This paper examines the relative roles of the private and public sectors in the implementation of a *two track strategy* to reduce poverty. This is composed of: (i) *sustained broad-based economic growth* that makes efficient use of labor, the main asset owned by the poor; and (ii) *investment in people or human resources* by ensuring access to basic social services of adequate quantity and quality. Evidence suggests that both these tracks have high pay-offs in terms of reducing poverty. Both facilitate employment and raise the incomes of the poor, enabling them to participate in the development of the economy.

The challenge to policy is to come up with an appropriate mix of public and private interactions that can effectively promote development, and, in particular, reduce poverty. Even though the mix will vary depending on the socio-economic conditions of each country, some general guidelines about the roles of government and the private sector can still be developed and presented in this paper.

TRACK 1: SUSTAINING BROAD-BASED ECONOMIC GROWTH

Poverty cannot be reduced by taking a short-term, piecemeal approach. Rather, it requires a comprehensive approach that integrates both macroeconomic and sectoral policies. The first track involves bringing about and sustaining growth, and, in particular, a pattern of growth that reduces poverty.

The experience of the last decade has led to a rethinking of the role of governments and the private sector in promoting growth and development. The emerging consensus favors encouraging private sector initiatives, reducing the presence of government, and allowing market forces to operate; in short, *a market-oriented approach to development.* The consensus is built on evidence that suggests, in general, a strong link between investment in human capital and less government on the one hand and improvements in economic performance on the other.

Brazil is a recent vivid example, having recovered from economic shambles and nearing an "economic miracle". The recovery continues to depend less on government and more on private initiatives, as the government's share of investment has dropped from 30 percent in the 1980s to barely 11 percent in the 1990s. This pattern of development is reinforced by quality investments in human capital. According to one analysis, education accounts for 20 percent of the growth.

The importance of human resources in sustaining economic growth is also demonstrated by the East Asian success stories. A recent World Bank study of economic growth in east Asia found that the single largest determinant of growth was primary education. Another study of 90 countries confirmed the strong and robust positive association between school enrollment and average rates of growth.

Investment in human capital has high returns for society. It raises their productivity, decreases the number of days they are ill and prolongs their potential working lives. Governments and the private sector would focus their efforts on guaranteeing people --especially the poorest-- access to basic social services of adequate quality. This requires that targeting is improved to ensure that programs reach their intended beneficiaries, that adequate resources is provided to meet recurrent costs, and that efficiency of management and responsiveness to local needs be improved.

SOCIAL SAFETY NETS

Promoting growth and the right pattern of growth can take time and some groups of people may suffer in the transition. Various safety nets measures such as compensation schemes, social investment funds, retraining, public work programs, food subsidies, etc., are necessary to protect the vulnerable populace.

These schemes can be funded by private sources (private funds, charitable contributions), a mix of public and private sources (shared by taxation, employers, workers), or public sources (general taxation). Even if governments finance the schemes, the private sector can play a part in delivering the services. Indeed, the success of the drought relief in Botswana in the 1980s was partly due to the fact that private traders and retailers distributed the food. Experience tends to suggest that the private sector could play an increasing role even though this is an area traditionally reserved for the public sector.

TRACK 2: HUMAN RESOURCES DEVELOPMENT

The second track in the strategy to reduce poverty is to invest in people. This not only enriches people's lives (considered and end of development in itself), but also lays a foundation for long-term economic growth (a means of development).

Both government and the private sector have critical roles to play in human resources development. It is useful to make a distinction between provision and financing. The possible combinations of public and private provision and financing can be represented diagrammatically. The table shows that the private sector can function as both the financier and the provider of social services; alternatively its activities can be restricted to either financing or provision.

Three potential advantages associated with increasing the role of the private sector can be identified: first, the private sector may alleviate fiscal or budgetary constraints and mobilize additional resources for investing in human resources; second, the private sector may improve the efficiency of delivering social services; and third, the private sector may increase equity by releasing public resources to be targeted toward the poor.

These factors suggest reducing the role of governments in meeting the human resource needs of population groups who can afford to pay coupled with more intensive targeting of public resources toward the poor. Cost recovery strategies are especially warranted for services that do not exhibit "public-good" characteristics and for which private demand is strong at current prices.

A. EDUCATION

Education enhances people's productivity and their potential for achieving a higher standard of living.

Public/Private Mix in Social Service Provision and Finance

		PROVISION	
		PUBLIC	**PRIVATE**
FINANCE	**PUBLIC**	Government funding and provision	Government services contracted to private providers
	PRIVATE	Government Services funded (wholly or partly) by direct user fees, insurance, and donor agencies	Private services funded (wholly or partly) by private insurance, direct user fees, and donor agencies

Source: Adapted from WHO, 1991.

It also provides non-market benefits, such as better child health and reduced fertility. As such, it is a great anti-dote to poverty and a stimulant of economic growth. Yet, after decades of remarkable progress, more than a billion adults remain illiterate in the developing world and enrollment rates have remained extremely low in many countries.

The case for involving the private sector in education, like other social sectors, rests on the imperative of: a) sustaining adequate investment in human capital in the face of tight budgets; and b) increasing efficiency and equity in the face of potential government failures.

It may be expected that the more a school depends on private financing, through fees collected from students or contributions from local communities, the more likely the school is to use resources efficiently. When people share directly in the cost of a service, they are more likely to monitor costs closely and to guard against waste. Furthermore, private financing at higher levels of education may also provide incentives for students to complete their study programs more quickly and behave more like investors in selecting their degree.

Increasing the reliance on the private sector may also enhance equity by releasing public resources to be targeted to the poor. In most countries, excess demand typically exists in higher education and sometimes also at the secondary level. Charging user fees in such circumstances would not substantially reduce demand for education but these private contributions could be used to expand access at all levels. Students from poor families could be protected by loan schemes and scholarships.

These arguments concerning efficiency and equity are supported by empirical evidence. Studies of private and public schools in Tanzania, Philippines, the Dominican Republic, Thailand, and Colombia, found that students from private schools outperform students in public schools in verbal and mathematics tests (sample selection bias and student background held constant), and that the unit costs of private schools are less than those of public schools. Moreover, data from Asia show a negative relationship between the extent of private financing and the share of cumulative public spending on education accruing to the 10 percent best-educated students in a generation.

These factors suggest a policy package composed of three elements:

- *reallocating government spending on education toward those educational levels with the highest social returns --primary education or general education-- and recovering the public cost of higher education;*
- *developing a credit market for education, together with selective scholarships, especially in higher education; and*
- *decentralizing the management of public education and encouraging the expansion of the private and community-supported schools.*

Within this policy framework, the government has an important catalytic role to play in improving the way the market for educational services works. This entails establishing complementary institutional arrangements, such as setting up national assessment systems to generate information about school performance and lifting prohibitions against non-governmental suppliers of education. Governments may also provide financial and technical support to private schools if necessary. For example, the National Education Trust Fund in Tanzania, established by the government, in collaboration with the World Bank and the Norwegian government, has provided funds for private secondary schools to help meet their capital and teacher training costs.

B. HEALTH

Despite marked improvements over the past decades, enormous health challenges still persist. Health care systems in many developing countries are inadequately equipped to meet these challenges. Given that health care costs account for 8 percent of total world product (and about 5 percent for the developing countries) and are rising faster than income in many cases, the immediate policy issue is better spending.

Increasing private sector involvement in the provision and financing of health care can be expected to increase efficiency by creating incentives for cost-sensitive consumer/provider behavior, for competition among providers, and for the decentralization of management structures. For example, a selective user fee policy may deter over-utilization, signal to consumers the relative importance of different types of care, and encourage the appropriate use of different levels of the health system; a dismantling of the state monopoly over drug procurement and distribution may reduce waste arising from theft and spoilage; and competition between different types of providers may create incentives to improve the quality of service provision. In addition, private sector participation may release public funds to extend cost-effective services to underserved population groups.

These arguments are not without empirical support. For example, in Malawi, greater managerial efficiency has led to mission hospitals being designated as district hospitals, and in Zimbabwe, the introduction of by-pass fees at hospitals has reduced over-loading and so increased the internal efficiency of the health system. In Chile, private hospital care has been expanded while government subsidies have been targeted toward the poor.

These factors suggest a policy package of three key elements:

- *fostering an environment that enables households to improve health;*
- *recovering costs for tertiary care and less cost-effective interventions and redirecting government expenditures toward financing a package of public health services and a package of essential clinical services; and*
- *promoting diversity and competition in the delivery of health care services.*

Promoting competition entails the following key steps:

- encouraging the development of social or private insurance (with incentives for equitable access and cost containment) to cover clinical services outside the essential package;
- encouraging suppliers (both public and private) to compete to deliver clinical services and provide inputs, such as drugs, to publicly- and privately-financed health services; and
- generating and disseminating information on provider performance, on essential equipment, on drugs, on the cost and effectiveness of interventions, and on the accreditation of institutions and providers.

Within this policy framework, the government's role as coordinator, facilitator, and supervisor of private sector activities is critical to address six potential problem areas: over-provision; cost escalation; moral hazard and adverse selection; failure to promote public health and equity; attraction of professionals out of the public sector; and poor quality of private medical practice. Government involvement may include the prohibition of certain insurance practices, the creation of incentives for cost-sensitive provider/consumer behavior (for example, capitation payments, co-insurance), training programs, tax relief for private providers located in rural areas, and the subsidization of preventive services.

C. POPULATION

As a whole, the world's population is growing by about 100 million new additions each year. Most of the population increase is concentrated in low-income countries. This poses a serious challenge to developing countries, particularly in terms of their capacity to sustain adequate investments in human capital. Slower population growth will not solve the problems, but it may reduce the pressures and buy additional time to work on solving the problems.

Governments and the private sector have important roles to play in stabilizing population growth. First, it is often argued that population stabilization is a merit good, therefore governments would take initiatives for providing leadership and resources to ensure access to safe services. In effect, women's health and reproductive health services not only helps women reduce the health risks from mis-timed and unwanted pregnancies, it has also been shown to be an efficient means of improving the welfare of the poor, particularly of children. For example, studies of Malaysia show that the decline in fertility between the 1970s and early 1990s was accompanied by a closing of the gap in per-child resources between the lowest and highest quintiles of families.

Second, the private sector may have a lot to offer in terms of improving the quality of services at low cost. For example, an analysis of five Peruvian family planning NGOs found that they were able to deliver high quality services at considerably lower cost than the government, despite having high administrative expenses.

Third, increasing reliance on the private sector may expand overall access to population stabilization services and allow for higher public investments in underserved areas. For example, a Colombian NGO, Profamilia, provides for most of the country's contraceptive needs, freeing the government to focus its effort on the rural poor, and attempts to promote private sector participation through social marketing schemes has expanded overall access in at least 30 countries.

Lastly, private sector involvement in women's health and reproductive health services may enable governments to keep a safe distance from politically sensitive issues, while ensuring adequate provision of services.

These factors suggest a need to restructure the public/private mix in the regulation of fertility. Even though market failures and welfare considerations imply a need for continued government involvement (for example, markets for contraceptives and information may be flawed, depriving groups such as the rural poor of the services they need), government's main responsibility is to promote an efficient public/private mix rather than to deliver and finance services *per se*. A three-part policy is recommended:

- *ensure that population policies are integrated within the country's broad set of social and economic goals;*
- *recover costs for programs that serve those who can afford to pay and target public resources toward the poor; and*
- *promote diversity in the delivery of women's health and reproductive health services programs.*

The latter recommendation involves four key steps:

- incorporating the private sector into strategic planning;
- reforming laws and regulations which inhibit private sector participation;
- promoting women's health and reproductive health services through advertising campaigns and educational programs; and
- providing financial and technical assistance to private sector agencies.

D. NUTRITION

Dietary deficiencies of calories, protein, vitamins and minerals are responsible for low productivity, learning disabilities, mental retardation, poor health, blindness, and premature death. The most vulnerable to these consequences are children under the age of three and pregnant and lactating women. Investments in nutrition can simultaneously eliminate the debilitating potential effects of malnutrition and allow the poor to become more productive.

Malnutrition is, in most cases, a disease of poverty. Hence, the public sector has a role of ensuring access to nutritional services, especially for the poor. However, as in other sectors, government monopoly over the provision of nutrition activities can be sub-optimal in efficiency and equity terms. For example, an evaluation of a government School Milk Programme in Kenya found it to be highly cost-ineffective, mainly due to the monopoly power of the Kenya Cooperative Creameries Ltd. Many other government programs have failed where the private sector has succeeded in terms of targeting resources to the most needy. Hence, actions to increase the participation of the private sector may help developing countries to address malnutrition in the short and the long term.

The private sector, especially experienced NGOs and Community-Based-Organizations (CBOs), have a particularly important role to play in the implementation of projects and the delivery of services. The experience of these organizations with communities places them in a strong position to promote recipient participation and affect behavioral changes amongst the poorest groups. Indeed, the success of an early World Bank assisted project in Thailand depended largely on the participation of CBOs in the design and implementation of the project.

In terms of food procurement, there are indications that the private for-profit sector may be better equipped to deal with logistics, such as transportation, storage, and distribution. Moreover, it may be more cost-effective to design feeding programs whereby entitlements are determined through public bodies (for example, health clinics or schools) with the actual food acquired in private markets. For example, the Honduras Social Investment Fund chose a food coupon program that was administered through the health system, while the coupons could be redeemed through participating retail food outlets.

A strong complementarity between the public and private sectors is the most effective way to reach the goal of eliminating micronutrient deficiencies and energy-protein malnutrition. Policies could ensure that:

- *nutrition programs are integrated into a broad set of economic and social programs that address both the causes and consequences of malnutrition;*
- *public resources are targeted toward the most cost-effective interventions for women and children most at risk from malnutrition; and*
- *complementarities are forged between the public and private sectors in the delivery and financing of services.*

Within this policy framework, however, governments could establish mechanisms to facilitate and coordinate private sector activities. In the case of the for-profit sector, it could provide incentives to stimulate appropriate provider behavior. For example, legislation that requires micronutrient fortification of basic foodstuffs such as salt could be combined with incentives to encourage compliance (for example, tax relief, import licenses, loans for equipment, subsidies on fortificants, and positive press coverage).

CONCLUSION

The events in the past decade, from the collapse of central planning to the debt crisis in Latin America, have exposed the astounding costs of government failure. The world has learned to rely more on markets and less on government to reduce poverty and promote development.

This is not to insinuate that there is no longer a role for governments. On the contrary, at all levels, there is a need to make better use of existing human, natural, and financial resources currently available in developing countries. Governments, NGOs, local communities, and the for-profit private sector need to work together to make better use of these resources. *Governments could do more of what they do best, and less of what the private sector does better*.

Increasing the involvement of the private sector advances the World Bank's objectives of reducing poverty in many ways. First, it improves economic efficiency. Second, it redirects government efforts away from competing with private goods and services and so frees up tax revenues for funding social programs that benefit the poor. Finally, it simplifies regulations, privatizes, and broadens access to credit through reform of collateral, hence lowering the cost of doing business for small farmers and entrepreneurs where most of the poor are concentrated.

The Bank is supporting developing countries to promote private sector development. The strategy has three themes:

- improving the business environment by supporting macroeconomic stabilization and procedural, regulatory, and legal reforms;
- restructuring the public sector by supporting redirecting public spending and encouraging the private sector to compete in the delivery and financing of services; and
- reforming the financial sector by supporting the development of efficient financial systems that mobilize savings and channel them to the most productive uses.

Each country has its own range of government and private sector initiatives available to fight poverty. However, the general principle remains that, given a country's constraints, governments can best help reduce poverty by fostering an environment that maximizes the vitality and dynamism of the economy, by providing safety nets and certain required investments, and by letting the private sector do most of the rest. After all, it is the people, not the government, who will, in the final analysis, improve their own welfare.

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INTRODUCTION

Governments and the private sector have complementary roles in fighting poverty and in promoting development. This paper discusses each of these roles particularly with regard to reducing poverty.

Despite the remarkable progress made by developing countries in improving the lives of their people over the past few decades, poverty remains pervasive and has even increased in many countries.[1] More than one billion people, one fifth of the world's population, live on less than one dollar a day, a standard of living attained two hundred years ago by the Western industrial countries.[2] Moreover, both the number and the proportion of poor people have increased in various countries in Sub-Saharan Africa, in the Middle-East and North Africa, and in Latin America. Poverty has also increased in the countries of Eastern Europe and the former Soviet Union (Sandstrom, 1993).

The challenge of reducing poverty is, obviously, overwhelming, but by no means impossible.[3] Experience suggests a "two-track strategy" composed of (i) sustained broad-based economic growth that makes efficient use of labor, the main asset owned by the poor, and (ii) investment in people or human resources by ensuring access to basic social services of adequate quality and quantity. Evidence suggests that both these tracks have high pay-offs in terms of reducing poverty. Both facilitate employment and raise the incomes of the poor, enabling them to participate in the development of the economy.

The success of this strategy depends on each and every actor in society. Specifically, both the government and the private sector have indispensable roles to play.

The dichotomy between government and the private sector has influenced policy thinking in the past century. The two sectors have long been regarded as competing paradigms in mobilizing human energy. After decades when government intervention was prescribed as the panacea to all market failures, the world events at the turn of the 1990s led by the demise of central planning have highlighted the failures of government and have shifted the pendulum away from the public sector. As this century is drawing to an end, we are learning how the private sector can contribute to reducing poverty.

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[1]Poverty is commonly defined as the inability to attain a minimal standard of living, interpreted to encompass not only consumption of food, clothing, and shelter, but also access to education, health services, clean water, etc. (World Bank, 1990a).

[2]The estimates are based on data accounting for 80 percent of the population in the developing countries. The head-count index is used to indicate the percent of the population that is poor. It is based on a poverty line in 1985 PPP (purchasing power parity) dollars of $370 per person per year. This level may also be interpreted as a measure of absolute poverty (World Bank, 1990a).

[3]The poverty gap measure suggests a much less intimidating task. The poverty gap indicates the transfer required to raise the incomes of the poor above the poverty line. Expressed as a percentage of total GDP in the developing world, it is only 4 percent.