



Regulation, Markets and Poverty

Edited by
Paul Cook
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THE CRC SERIES ON COMPETITION, REGULATION AND
DEVELOPMENT

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Preface

The Centre on Regulation and Competition (CRC) was established in 2001 with core funding from the UK Department for International Development, to conduct research into issues of competition, regulation and regulatory governance in developing countries. To carry out this research, CRC has worked with an extensive network of partners both in the United Kingdom and overseas. This Elgar series provides a valuable opportunity to disseminate the research findings and conceptual studies to as wide an audience as possible.

This book draws together the main components of research conducted over the past five years, and focuses on the key policy implications that have emerged from our theoretical and empirical analysis. Each of the main chapters has been formed by drawing on a specific set of CRC's working papers and has been written in a uniform style by Sarah Mosedale, in conjunction with the principal authors of these papers, with the exception of Chapters 11 and 12, which were written by Derek Eldridge and Brian Goulden. This has been done to provide a textbook suitable for students of regulation and competition, policy-makers and practitioners wanting a clearly written synopsis of CRC's latest research, the major policy considerations and references to the more conceptual and technical issues that each chapter draws upon.

This book presents in a non-technical manner the results of conceptual and empirical research into competition, regulation and regulatory governance and identifies areas that warrant further investigation. It is anticipated that by presenting a book in this way for a wide spectrum of readers, collectively engaged in research, policy and practice, it will have contributed to the setting of a sharper and more relevant research agenda.

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1. Introduction

For more than 25 years, developing countries in Africa, Asia and Latin America have been pursuing, in various ways and with varying degrees of intensity, economic liberalization. For many of them this took place under externally driven programmes of structural adjustment, in which the World Bank and the International Monetary Fund (IMF) directed governments in implementing fiscal and exchange rate reform, trade liberalization, domestic market liberalization and privatization.

Countries undergoing structural adjustment did not initially recognize how important regulation is for economic liberalization. Indeed, regulatory and competition policy was conspicuously absent from the policies prescribed by the World Bank and the IMF. Initially, privatization was often pursued without much thought to the regulatory framework that would be needed, even where state-owned monopoly utilities had been converted to private sector monopolies (Cook et al., 2004a). There were only a handful of developing countries that had competition agencies, even in the limited anti-trust sense, by the end of the 1980s (Gray and Davies, 1993).

With the spread of economic liberalization across the world and the underlying structural changes that were taking place within economies, it became increasingly obvious that attention needed to be paid to regulation and competition. Without regulation the potential advantages of liberalizing markets were in danger of being diminished, both in terms of improved efficiency and welfare. Even in developed countries that had embarked on various market-oriented reforms within government, and had privatized utilities and outsourced numerous public services, it became evident that there was a lack of public accountability and that new forms of regulation were needed to monitor market abuse and protect consumers. In developing countries the scope of regulation and competition policy needed was wider because of the urgent social and economic problems they faced. If regulation restricted itself only to ensuring efficiency and competition in the private sector, it would be unlikely to have a direct positive impact on the poor.

As a consequence new forms of regulation have been emerging that cover health, environment, industry, employment and so on. In particular, in recent years there has been considerable interest in the regulation of privatized industries in the fields of telecommunications, energy, transport and water. The expected benefits of privatization in these fields were predicated

on the existence of a well-functioning market process. However, in practice, privatization has often resulted in monopoly and regulation has been needed in order to protect consumers from potential monopoly abuse. To meet this challenge new dedicated industry regulators have been established, bringing with them new and innovative methods for regulation that attempt to improve efficiency and safeguard consumer welfare.

Although competition had previously been neglected, recent years have seen a new impetus to promote competition policy, largely in the anti-trust tradition. The introduction of new and in some cases revised competition law, and the establishment of competition agencies to monitor and enforce legislation and act as advocates for the merits of competition, has become a prominent feature of most countries' reform agendas.

Judging how effective these changes have been depends as much on understanding the premises on which they have been based, as on finding ways to test their outcomes empirically. Our research has attempted to do both. We have examined the concepts and theories that have driven reforms and the particular contexts that have influenced and conditioned them. And we have used various approaches, both quantitative and qualitative, to investigate how well reforms have worked in practice.

The notion of competition is central to economic theory. But there are widely differing views as to what it means and how it works and contributes to development. The concept of 'perfect competition' has survived as a standard model for analysis and has profoundly influenced policy-makers concerned with the regulation of competition. This neo-classical perspective on competition is built around the notion that the ideal market is best understood as a state of equilibrium created by forces of demand and cost structures that primarily determine which enterprises survive or fail. In other words, the emphasis has been on the effects or end results of competition rather than on the underlying behaviours that characterize the competitive process.

This view of competition has not gone unchallenged. A variety of alternative perspectives express their fundamental dissatisfaction with the equilibrium concept of competition. Drawing on Schumpeter's analysis (Schumpeter, 1934, p. 17), these alternative perspectives largely reflect the view that competition cannot be perceived in terms of a state of equilibrium, characterized by different market structures such as monopoly and perfect competition. Instead, the organizing concepts of equilibrium and optimization evident in the neo-classical approach are rejected in favour of viewing competition as a process of change caused by the different ways that enterprises behave. This alternative way of understanding competition has different implications for policy, which are explored in later chapters of the book.

We distinguish between various types of regulation. One is the regulation of businesses, that is, controls over private and non-state activities. Another is regulation inside government, that is, the controls exerted within and between government agencies, and between levels of national government. International regulation also exists (the regulation of national governments by supranational organizations), as does self-regulation, which involves less formal methods than legislative or administrative rule-making. These various aspects of regulation and the corresponding policy implications are also the subject matter of later chapters.

Our research demonstrates that the analysis of competition and regulation must extend beyond their economic principles. Not only are ideological issues involved in competing views on the best or most appropriate relationship between the state and the market process, but it is also clear that regulatory and competition policies emerge from political and bureaucratic processes that are influenced by a wide range of factors. Therefore we assert the importance of legal and political analysis. Regulation in all its guises is fundamentally concerned with rules governing the actions and relationships between agents, and it is the law that has traditionally policed these boundaries and resolved disputes. In turn, regulatory institutions and their practice have been shaped by, and evolved from, a whole range of governance factors. These include the variety of government institutions involved in rule-making and implementation, public policy processes, the significance of political interactions and relationships, and last but not least, the systems of public values that provide the underlying setting for regulation and competition.

The research that has been undertaken by the Centre on Regulation and Competition that has led to this book has reflected our desire to examine critically the new wave of approaches to regulation and competition. It is clear from the research embodied in the various chapters of the book that models of regulation and competition derived from developed country practice have predominantly been rooted in sophisticated levels of economic, social, administrative, legal and political institutionalization, which are largely absent or less developed in developing countries. When working out new forms of regulation and competition policy there is a need to ground them in the economic, political and administrative realities that exist in the country concerned, since a naive transfer of models will merely provide new opportunities for inefficiency, patronage, clientelism and corruption (Cook and Minogue, 2003).

The research that forms the backbone of this book has also tried to address issues of regulation and competition in the context of poverty in developing countries. We argue that better regulation and competition play an important part in improving both the performance of enterprises and

the delivery of essential services, and that these are integrally related to a pro-poor development process. Addressing poverty, in its absolute and relative forms, has been an important aim for us.

Our research into the connection between regulation, competition and poverty has focused on how regulation and competition policies can impact on poor people. For example, we ask whether or not regulation can help the poorer in society access essential services and infrastructure such as water. Potentially, regulation and competition could help such people not just by protecting their welfare but also by promoting it through providing opportunities to engage in productive activities in ways that will make them better off. But it is important to realize that this is far from guaranteed. The effects of regulation and competition may simply bypass the poor or indeed make their situation even worse. The potential welfare effects of regulation and competition are not confined to poverty reduction alone, but also relate to more general distributional issues. Better regulation and more competitive markets might also contribute to reducing the high levels of income inequality found in a significant number of developing countries.

Our research also recognizes the importance of focusing attention on the *capacity* to regulate. It is not enough to just develop models and instruments for regulation, particularly when regulatory and competition agencies are new and set in political and administrative systems with weak governance mechanisms. It is also necessary to consider the human and managerial attributes that shape those organizations, determine whether or not they are likely to be effective and take appropriate action. A failure to address capacity building is likely to have widespread repercussions.

The final motivation for this book has been our desire to make the fruits of five years of research in the Centre on Regulation and Competition available to a wider audience. We have already published three academic books detailing this research and anticipate publishing a further four. But we believe the implications of our work are too important to be restricted to that necessarily small, specialist audience that is willing and able to wade through large quantities of detailed econometric and other analysis. For this reason Sarah Mosedale wrote a series of Policy Briefs drawing on the Centre's research, which tried to make our ideas, arguments and conclusions available to the much larger audience that we knew was interested in, and we hoped might benefit from, our work. The positive response these received encouraged us to believe that a book organized along the same lines would also be welcomed. The result is what you now hold in your hands.

Following the introduction, the book is organized into five parts. The first part, comprising three chapters, deals with competition and competition policy. These chapters are based primarily on research in these