

# 1. Introduction

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The global economy is currently in the throes of far-reaching structural change. To an increasing extent, the established economic dominance of Western Europe, North America and Japan is being challenged by the rise of the Asian export-oriented economies, above all China. The apparently unstoppable rise of Asia appears to provide conclusive proof that economic catch-up among poorer societies is both possible and achievable. By the same token, though, the success of Asia serves to throw into even sharper relief the continuing difficulties encountered by the world's other key emerging regions, Africa and Latin America. Over the past two decades, policymakers throughout both regions have striven to emulate Asia's stunning economic trajectory, but with little success. For the most part, these efforts have involved the pursuit of fiscal orthodoxy and trade and market liberalization. While it is true that these policies have broadly succeeded in curtailing inflation, they have yet to stimulate the sustained year-on-year increases in per capita income necessary to close the gap with the rest of the world. As a consequence, the pursuit of economic liberalization, which appeared to have gained hegemonic status by the end of the 1990s, is now being called into question throughout Africa and Latin America. A key focus of the current wave of critical policy evaluation is the nature of economic regulation, whether of public utilities or of other sectors. It is this issue, specifically as it relates to Brazil, Ghana and South Africa, that forms the subject matter of this book.

Before highlighting the present critical debate concerning economic regulation, it is worth recalling the policy path both regions took to arrive at where they are today. During the 1980s both Africa and Latin America were faced with the urgent need to escape from the trap of indebtedness and macroeconomic instability into which they had fallen during the troubled 1970s. As private sector credit dried up, African and Latin American economies were forced to turn to the World Bank and the International Monetary Fund for financial assistance. Such assistance, when it came, was invariably associated with a comprehensive package of policy conditionality. Under the terms of this, recipient countries were obliged to pursue privatization, to deregulate domestic markets and to adopt trade liberalization. These microeconomic reforms were allied to a programme of fiscal retrenchment and a shrinking of the state.

The underlying premise of these reforms was not unreasonable. With their adoption, it was presumed, countries which had long been economic laggards would be obliged to become more competitive and closely integrated into the global trading system. This would ultimately boost productivity growth and raise export performance. In such a manner, the means of escape would be provided from a legacy of low per capita income growth and a tendency towards debt accumulation. With some, though hardly extensive variations, these policies were put into train starting in the 1980s (with Ghana) and the early 1990s (in the case of Brazil). In the case of South Africa, the end of apartheid and the election of Nelson Mandela in 1994 provided the catalyst for a series of liberalizing reforms. These were designed to promote competitiveness and to dismantle the remaining structures of import substitution industrialization. The latter had been established under apartheid as a partial response to global economic sanctions.

As was recognized in all three countries, an essential concomitant of economic liberalization was that markets be regulated effectively. Without such regulation, the benefits of freeing up markets could be lost as inefficiency and outright malpractice gained hold. Nowhere was this danger taken more seriously than in the field of privatized public utilities. As a result, a new or at least highly evolved species of government agency moved into the foreground in the 1980s and 1990s: the utilities regulator. Utilities regulators soon achieved a very high profile given their position in the vanguard of liberal reform. Not surprisingly, they also became the focus of heated political debate. Although most attention has tended to focus on utilities regulators, it should not be forgotten that liberalization also stimulated the development or strengthening of other regulatory bodies, not least in the field of competition policy. Here, the objective was to ensure that as governments vacated their role as direct producers, their private sector successors would not replicate the inefficiencies of nationalized industries. Aside from the creation of regulatory bodies, substantial attention was also paid to legislative reform. Hence initiatives were taken to break down legal barriers to competition and market entry.

Despite the enormous scale of liberalization and regulatory efforts, it seems fair to say that the early hopes of their protagonists have not been entirely borne out in reality. While growth performance in Brazil, Ghana and South Africa could not be characterized as dismal, neither could it be said that all three countries have experienced the step-change in economic performance once thought to be within reach. In all three countries, poverty and inequality remain as ingrained as ever, the product of a failure of growth to accelerate on a sustained or equitable basis. At the same time, in the case of South Africa and Brazil (the most heavily industrialized economies in their respective regions), the apparent promise held out by globalization of a move up the global value chain towards more technologically sophisticated, less commodi-

tized exports has failed to materialize. Instead, the current tendency appears to be towards a reinforcement of the role of traditional, natural-resource-based exports. All of this is occurring at a time when, as has been pointed out, economies across Asia have been reinventing themselves and redefining their position in the international division of labour.

Against this background the central question seems clear: what can economies in Africa and Latin America do to stop the rot and close the gap with the rest of the world? This book, of course, cannot even begin to examine this complex question in totality. However, it does set out to shed light on one particularly important issue: the role that effective regulation might play in attempting to tackle some of Africa's and Latin America's most entrenched economic difficulties. This preoccupation appears especially timely given the political challenge now faced by regulators from governments, the private sector and disaffected elements of civil society. The challenge to the regulators' position stems partly from a generalized perception that globalization is failing Africa and Latin America. More specifically, however, regulators are also suffering from a perception that they may in some way be operationally deficient or that the policy framework itself may be flawed. In this connection, another function of the volume is to evaluate the performance of regulators across different sectors on both continents.

In terms of structure, this book divides into three parts. The first comprises a three-chapter review of some of the most critical regulatory issues now facing emerging market countries. In the first of these chapters, Chapter 2, Hossein Jalilian, Colin Kirkpatrick and David Parker analyse the relationship between the quality of regulation and economic performance. As suggested earlier in this introduction, the pursuit of growth and efficiency has served as a prime justification for the rise of regulatory institutions among emerging market countries. Does, however, such a justification rest on solid empirical ground? Jalilian, Kirkpatrick and Parker suggest that such a foundation exists, at least if the quality of regulatory arrangements is taken into account. The authors employ a large, multi-country data set previously used in World Bank studies. Through cross-sectional and panel data analysis, the impacts on productivity and growth of two proxies for regulatory quality are quantified. The chapter establishes that a strong link does in fact exist between the form and quality of regulation on the one hand and growth (whether in income or productivity terms) on the other. For Africa and Latin America, whose growth performance has been less than sparkling, the implications of this seem clear enough. The mere establishment of regulatory institutions and norms is not enough in itself; attention needs to be paid to quality-related issues such as transparency, predictability and swiftness of operation.

In Chapter 3 Peter Holmes adopts a qualitative rather than a quantitative approach in focusing on a key issue affecting developing economies throughout

the world: the impact of the World Trade Organisation (WTO) on domestic regulatory arrangements. The chapter reveals the surprising extent to which WTO rules, designed to promote non-discriminatory behaviour in trade, intimately affect the nature and scope of a broad range of domestic regulatory activity. Two of the highest-profile areas in which WTO norms have been brought to bear on the domestic policy agenda have been in the fields of intellectual property legislation and sanitary and phytosanitary measures. As Aryeetey and Ahene note in their chapter (Chapter 11), the adoption of such standards has become a key issue in Africa, where agricultural exports remain of critical importance. Although Chapter 3 concedes that the adoption of superior external regulations may play a useful role, it nevertheless sounds a note of warning. In particular, there is concern surrounding the power of the appellate system and the ambiguous nature of some WTO rules.

The theme of external norms impinging on domestic regulation is also taken up by Christopher May in Chapter 4. The chapter focuses on the growth in international intellectual property regulation and its potential implications for poorer societies. While it is conceded that such measures as patent protection can act as a stimulus for innovation within certain countries (thanks to the ability to generate rents that they create), the recent expansion in international intellectual property rights (IPR) legislation may hold a number of dangers for emerging economies. In particular, through effectively increasing access costs to foreign technology, the ability of poorer societies to close the gap with wealthier countries has been impeded. At the same time, May is concerned at the implications of a 'one-size-fits-all' approach to international IPR legislation. This arises from an observation that the technological needs and structural characteristics of developing countries differ markedly from those of developed nations.

Shifting the focus from general to regional considerations, Part II of this volume considers the experience of Brazil, South America's largest economy and the second most populous country in the Western Hemisphere. In Chapter 5 Amann and Baer examine the rise of the regulatory state in the Brazilian context. The recent growth of regulatory institutions in Brazil is seen as the direct result of the crisis encountered by the Brazilian state in the 1980s. Faced with mounting internal and external deficits, the authorities were obliged to embark on a privatization programme and to open up certain 'strategic' sectors to foreign participation. To ensure that privatization and market liberalization delivered efficiency benefits and welfare gains, regulatory agencies were launched across a range of sectors from the public utilities to oil and gas. While Amann and Baer consider Brazil's regulatory institutions generally well designed, a number of problems are nevertheless identified. In particular, the authors are concerned at the implications of recent changes in tariff-setting policy for the long-term viability of private sector utilities' investments.

Attention is also drawn to the growing threat to the independence of regulatory agencies following the election of President Lula in 2002.

Chapter 6, by Andrea Goldstein and José Claudio Linhares Pires, also concerns itself with the rise of Brazilian regulatory institutions but focuses in particular on the electricity, oil and telecommunications sectors. The authors examine the operational track record of the various regulatory agencies, highlighting both their achievements and lingering challenges. Attention is drawn to the success of regulatory bodies in boosting investment in telecommunications and oil exploration and production. Such investment has had very favourable implications, especially in terms of lowering the cost of telecommunications services and boosting self-sufficiency in oil. Still, as the authors stress, a number of problems remain. In particular, concern is expressed as to the insufficient coordination that exists between the various agencies and the unclear definition of their competencies. Goldstein and Pires, like Amann and Baer, are troubled by threats to the independence of regulatory agencies. They also have doubts concerning the design of a mooted new Brazilian antitrust agency.

Whereas Chapters 5 and 6 are primarily concerned with regulated public utilities, Chapter 7, by Edmund Amann, João Carlos Ferraz and Germano Mendes de Paula, focuses on a more 'conventional' sector: the Brazilian steel industry. The authors suggest that, contrary to what might be expected, the privatization of the steel sector has not resulted in the exit of the state as a provider of financial resources. This is because a combination of weak corporate governance regulation allied to complexity and instability in ownership structures has discouraged minority shareholder participation. As a result, lacking a deep and liquid market in their shares, steel companies have largely eschewed equity finance. Instead, given the presence of high real interest rates in private capital markets, enterprises have been obliged to access public sector credits. Thus, as in previous chapters, evidence is offered supporting the view that more effective regulation is required if economic performance is to be improved.

Part III of the book turns its attention to a region of the world, Africa, whose economic challenges are arguably even more pressing than those of Latin America. Chapter 8, by Afeikhena Jerome, focuses on the regulatory experiences of Africa's largest economy, South Africa. As in the case of Brazil – another large, resource-rich economy emerging from a period of undemocratic rule – South Africa has embarked on a programme of privatization. Jerome emphasizes the point that privatization in South Africa has been a relatively slow process. As in Brazil, privatization has strongly divided opinion in society, and opposition to its extension has been substantial. This, incidentally, is a point echoed in Chapter 12, which examines the case of the South African telecommunications sector. Chapter 8, meanwhile, goes on to suggest that the

South African privatization programme should not be rolled back, but rather maintained in place. However, it is argued that this will only be possible if much more attention is devoted to the regulatory framework. In particular, an urgent need is identified to promote improved competition and to upgrade the transparency and accountability of regulatory arrangements.

Chapter 9, by Colin Kirkpatrick, David Parker and Yin-Fang Zhang, also focuses on the issue of privatization and its regulatory aspects. The authors examine the experience of a series of water privatizations throughout Africa, comparing the performance of private utilities with their public sector counterparts. Using data envelopment analysis and stochastic cost frontier techniques, it is established that private sector operators are associated with superior performance indicators. However, with regard to cost, no statistically significant differences were found between the public and private sector. The authors then move on to consider the difficulties that might be associated with water privatization. In particular, they highlight the existence of regulatory weaknesses as well as difficulties associated with technology and transactions costs.

The focus of Chapter 10, by Judi Hudson, contrasts with those of its predecessors in that it is concerned with the impact of regulation on small businesses – an issue also taken up in the Ghanaian context by Ernest Aryeetey and Ama Ahene. Examining the experience of South Africa, Hudson argues that small and medium enterprises have much to contribute in an emerging market context thanks to their capacity for generating local employment and – in the South African context at least – for empowering previously oppressed racial groups. This potential, so Hudson argues, can only be fully realized given the existence of a sympathetic regulatory framework. In South Africa, it is contended that such a framework does not yet exist. Consequently, the chapter calls for a number of regulatory reforms. In particular a lighter regulatory touch is argued for along with simplified rules and, where possible and desirable, the adoption of non-regulatory alternatives.

In a similar vein, Chapter 11, by Ernest Aryeetey and Ama Asantewah Ahene, argues for the development potential of small- and medium-sized enterprises (SMEs). Analysing the case of Ghana with the aid of a large sample survey, the authors investigate the impact of regulation on SME growth. While the importance of the regulatory framework is not discounted, it is contended that other factors may be of greater significance as obstacles to enterprise growth. In particular, the authors highlight the lack of cost-effective access to external sources of finance and limited ambition among entrepreneurs to pursue growth-oriented business strategies. Of course, regarding the former issue, it could be argued that regulatory reform in financial markets might have favourable consequences for the availability of funds.

In Chapter 12, the final chapter, the focus switches away from the low-

technology and capital-starved SME sector back towards public utilities. Examining the case of Telkom, a high-technology, capital-intensive South African telecommunications utility, Oludele Akinboade and Fungai Sibanda chart the regulatory challenges currently faced by the authorities. The Telkom case represents an interesting contrast to the Brazilian experience since the South African utility has only been part-privatized and the market in which it operates subjected to only limited liberalization. As a result of this regulatory compromise, the authors argue that Telkom has entrenched its market position and continues to benefit from a monopoly in regard to long-distance and international calls. Partly due to political obstacles, the arrival of competition in these segments has been delayed. As a result, while Telkom's financial and operational performance has been creditable, consumers have yet to realize the full benefits. Against this background, the authors call for prudent regulation accompanied by progressive market liberalization. Such liberalization would be expected to benefit consumer welfare while imparting a much-needed competitive fillip to the South African economy.

Diverse as Brazil, Ghana and South Africa may be, this book demonstrates that a common challenge will need to be faced if economic performance is to significantly improve. While country- and sector-specific issues will need to be confronted, all the evidence within the following chapters suggests that better growth prospects are fundamentally tied to the implementation of predictable, transparent and technically competent regulation. One key question remains, therefore: can the necessary political will and financial resources be amassed to meet this challenge?