

Privatization and Regulation of Public Services in Argentina:

Some cases of “state capture”?

Pedro E. Andrieu and Alicia Calvo

Dr. Pedro Enrique Andrieu: Av del Libertador 2778 p1 – 1425 Buenos Aires, Argentina

Phone/Fax (54 1) 4807 4641 peandrieu@yahoo.com

Director, Program of Studies on State and Public Policies Modernization in Argentina,
11/E101

Consultant Professor, Honor Chair of Public Policy & Administration, and Doctoral Seminar,
School of Economic Sciences, University of Buenos Aires, Argentina

Professor, Public Policy & Administration, School of Economic Sciences, National University
of La Plata, Argentina

Dr. Alicia Calvo: Av. Cordoba 2120, 1120 Buenos Aires, Argentina

Phone/Fax (54 1) 4370 6102 aliciacalvo@mail2web.com

Researcher, Program of Studies on State and Public Policies Modernization in Argentina,
11/E101

Professor, Chair of Sociology of Organizations, School of Economic Sciences, University of
Buenos Aires, Argentina

Summary: Since the mid 1940s Argentina had a long history of inflation at an average rate of 25% a year, which went up to around 100% in 1975 and exploded into hyperinflation in 1989, the main causes being budgetary deficits including notably the ones of public enterprises. In 1990 a program of federal state reform and privatizations was enacted and implemented in a hurry, without an ethics law and the appropriate regulatory rules being in place as of yet in most cases. The paper intends to summarize what happened in public utilities in general and water and sewage and electricity in particular; and in the public regulatory entities in charge of controlling the observance of the established rules and contracts as well as the people that run them and their actions. After an analysis of several cases, their actors, strategies and consequences, based in documents and interviews, it was found that the “State Capture” could be proved and the results show how some private groups as well as some labor unions were grossly benefited while the real income of some consumer groups, specially those of lower incomes, were damaged because of the generalized increase in the pricing of services. Unfortunately services back in state hands are not doing any better

Privatization and Regulation of Public Services in Argentina: Some cases of “state capture”? ¹

Pedro E Andrieu and Alicia Calvo

Table of Contents

Proclaimed objectives and attained results

**The main goals of State owned utility companies privatization was to have a
better service quality and the reduction of the public expenditure.**

**“State Capture” began with the writing of the Contracts and went on during the
subsequent re-negotiations**

**After the 2001/2002 economic crisis many actors changed, but other groups
continue capturing the State**

How things went on during the privatizations

State Capture and corruption in the Control Agencies

The studied cases: justification

A bit of history

Water and Sewage

Power supply and distribution

Privatization of the electric sector

SEGBA privatization

Differences between the Technical Specification Sheets and the Contracts

Regulation and control

EDESUR

EDENOR

Results of Privatizations

Privatization and Regulation of Public Services in Argentina:

Some cases of “state capture”? ²

Pedro E Andrieu and Alicia Calvo

A privatization process can't be less corrupt than the elite that carries it out³

Introduction

In this paper we study the main aspects of the privatization of public utilities companies in Argentina. We'll review the initial conditions of the privatization process and then, show the discrepancies (*gaps*) between the proclaimed goals and the actual situation thereafter.

We intend to summarize the advances of a study about what happened in public utilities in general and water and sewage and electricity in particular; the public entities in charge of controlling the observance of the established rules and contracts as well as the people that run them and their actions.

After an analysis of several cases, their actors, strategies and consequences we found that the “State Capture” could be proved and the results show how some private groups were grossly benefited while some weak social groups, especially those of lower income, were in the end damaged.

Some preventive actions should help to minimize the danger of corruption and capture: the broadcasting of crystal-clear information about the companies and the consumers' influence. Organizations that provide information and protect users' rights should help controlling corruption and capture, denouncing actions that, even if they are formally “legal” according to the laws at the time in the end they become “illegitimate”, because they injure the whole society.

Proclaimed objectives and attained results

The main goals of State owned utility companies' privatization was to have a better quality of services and the reduction of the public expenditure intended to compensate for its deficits.

Suffering the effects of hyperinflation (2400% per annum), President Carlos Menem took office in 1989. Less than two months later, the Economy Ministry announced a massive plan to beat the inflation and modernize de State, based in three great pillars: the creation of an up-to-date regulation for labor relations; the discussion of a new industrial normative (in order to attract foreign capitals and repatriate national ones) and the Federal State Reform to shrink its huge Public Administration by the way of reducing it to its' essential functions, in part by transferring some social services to the provinces.

In the particular case of public utilities and services, the economic context hindered not only the modernization of equipments and the broadening of the networks, but even the mere maintenance. The quality of the services was very poor and precisely that circumstance was the main argument to convince the unions and the people in general of the importance of selling them or put the companies under private firms' administration. It was affirmed than the new owners or managers would give a better quality service, and that it was to be paid by the real users and no more by the National Treasury.

Although most public services had been privately owned in the beginning, a massive nationalization was conducted between 1940 and 1950. Later on, the Administration built or bought several other companies, like airlines, steel factories, oil refineries, guns, ammo and military planes builders and shipyards. Several attempts had been made to sell part or all of them, but the opposition shown by unions and society in general prevented any change.

In the hyperinflation context, people changed their minds and the so called "grandmother jewels" were sold or granted in concession to be managed by private firms.

First to go was the National Telephones Company (July 1990) and next, Aerolíneas Argentinas, the public airlines (November 1990).

The economic conditions of the country were so bad that, in order to attract investors, many benefits were offered to them and, in some cases, interested investors could define even the price structure and the relative profits.

The Technical Specifications Sheets drafts of the diverse contracts (written by very competent technicians employed in the State owned firms) were quite severe about equipment investment, maintenance and repairs. There was also determined the minimal parameters of quality of each service, that increased as time went by.

At the same time (or some months later), a Regulatory Entity was created for each service. Its role was to assess the accomplishment of the obligations derived from the contract. If any deviation occurred, the Entity had the power to punish the private firm with sanctions that oscillated between a warning, a small or heavy fine and the canceling of the contract.

The State-owned services-providers were sold or granted in concession after a bidding process.

“State Capture” began with the writing of the Contracts and went on during the subsequent re-negotiations

The poor quality of some services during such a long time afterwards shows that the Agencies created to regulate the activities didn't perform their duties accurately.

To begin with, the strict Technical Specification Sheets were modified at the moment of writing the Contract with the winner of the bid.

The weakness in the control can be detected mainly by the inexistence of regulatory frames (or their very tardy, limited and precarious formulation) and the presence of shaky regulatory agencies, which were established mostly after the assets had been transferred.

Only two utilities-supplier companies were given to private firms after the corresponding had been passed by Congress; the rest of them were sold or conceded by means of Executive Decrees only.

After the 2001/2002 economic crisis many actors changed, but other groups continue capturing the State

After a month of negotiations to form a new Government, a new Administration took office. The devastating economic crisis and the subsequent huge devaluation caused that the private firms lost many of their previous advantages.

Seeing that it was practically impossible to recover them, despite the changes introduced *via* re-negotiations, many decided to lower costs by lowering the services' quality.

Some flagrant breaches of contracts were penalized with billionaire fines and even the rescission of the contract. That derived into the constitution of new firms and the apparition of new investing groups, most of them with solid attachments to members of the Government. The behavior patterns of their predecessors were repeated: asking for fares and charges' raises; re-programming, deferment or simply suspension of the stipulated works, as well as greater Government subsidies.

Some older groups sold all or the greatest part of their property and/or left the country or the branch of activity.

As we'll show later, corruption, under the form of “State Capture” has been present in the privatization-process of services and utilities providers. It has been functional and efficient to affect directly their actual working order and has favored individuals and investor-groups to the detriment of services quality, other firms, the National Treasury and the whole society.

How things went on

The Technical Conditions Sheets required that, in order to take part in the bidding process, consortiums had to be formed, including a local company; a foreign Bank that would provide Argentine Foreign Debt Bonds as means of payment for the purchase, and a foreign operator with well-known expertise in the business. In all cases, the winner consortiums included a local company, which had been a Government contractor in the same or other branch of activity.

The State owned companies were handed over without any of its debts, which remained in the government books. In most cases, previous to the actual transfer of the firms, the Government assumed the political cost of increasing rates and fares.

The payment was made partly in cash but mostly with Argentine Bonds, strongly devaluated. In some cases (Aerolíneas Argentinas is the most illustrative) planes, buildings and other assets were sold or heavily mortgaged in order to collect cash to pay for the company.

The “natural monopolies”, which had been dismantled by the Technical Conditions Sheet and the Contracts, were gradually reconstituting during the subsequent stages of re-negotiation or re-composition of owner- or manager-consortiums.

State Capture and corruption in the Control Agencies

The concept of “State Capture” was first seen in Marx works⁴ and was presented in modern economic theory by George Stigler⁵, who proposes that a private firm can use the State’s coercive power (or public power) in order to get extraordinary benefits.

This *positive* theory, conceived in Chicago, was used by the Toulouse School to give it a *normative* form, with the “*principal-agent*” model. This theory challenges the Chicago school view, because it neither takes into consideration the information asymmetry and focuses only in the supply-side (the provider) nor analyzes the demand side (the regulator)⁶. The principal-agent theory, instead, helps to explain the controller’s discretionarily, that is, the true source of extraordinary revenues, as well as how the firms can influence the regulator.

Some of the actions tending to “capture” those charged of redacting the Technical and Economic Specification Sheets, the final contract or even the control Agencies’ members are: personal relationships, co-operation with Congress or Executive committees, placement of family or friends in public service key positions or making legal donations to political parties and politicians. The manipulation of mass media is also important: the “capturers” may make press statements, give interviews leaking false data, and organize massive actions (demonstrations, boycotts) or publicity

campaigns. From the legal point of view, they can promote actions against laws or rules or press charges against public servants.

The studied cases: justification

We analyzed two providers of *essential and strategic* services: the former Obras Sanitarias de la Nación (water and sewages) and SEGBA (generation, transportation and supply of electricity in the Buenos Aires metropolitan area).

Obras Sanitarias de la Nación (afterwards “Aguas Argentinas”) was granted in concession by a decree. It was one the biggest firm to be privatized round the world. It was also the first to be re-nationalized. It could have been divided in three companies (water supply, sewages operation and rain water drainage), or, due to its geographical extent, in two zones in order to establish competition by comparison. Notwithstanding it was handed over as a whole.

SEGBA was first divided in three separate companies (generation, transportation and supply) to break a monopoly considered “not natural” and after, the direct provision to users was separated in North and South zones. A Congress Law granted its operation for a period of 95 years and it is still managed by private companies.

Both organizations supply network services and in both cases the distribution is a “natural monopoly” and the covered area is very vast: it was divided in the electricity firm and kept united in the water and sewage company.

Also, both are essential utilities and, especially in the more densely populated cities, water supply depends fundamentally of electric power provision.

The Electric Power Regulation Agency (ENRE) was created by the same Congress Law that ordered its privatization and sketched its regulatory framework. The ETOSS (charged of the control of the water and sewage operation) was created by a decree and its members collaborated in the writing of the Technical Conditions Sheets for the subsequent bidding.

A bit of history

Water and Sewage

The water and sewage operation, except for a brief period of private administration at the very beginning, had been always a Government business. In 1792, a system of public faucets was installed in the city of Cordoba. Since 1822 a law ordered the construction of a network to supply fresh water in Buenos Aires city. In 1869 began the service of sewage in Buenos Aires and along the

first decade of XX century the supply was extended to the capital cities and to the main cities of the different provinces.

In 1940 the Buenos Aires city services were combined with those belonging to the adjoining 14 provincial districts, forming a unified system. It was based on three technical conditions: a) the supply of secure water; b) taking advantage of the topography of the area, the sewages used gravitation to collect 70% of effluent liquids, and c) the rain-water gutters had their final destination in the Río de la Plata river.

In the period 1950-1970, when the State took charge the production of a large number of goods and services, lack of funding hindered the expansion the water and sanitation networks and lowered the quality of services. The situation continued to decay both because the lack of investment and maintenance and the growing number of inhabitants. The cleaning-up plants were overloaded and untreated effluents caused environmental contamination.

In 1990 the privatization of OSN was decreed and the winner of the bidding process was the consortium called "Aguas Argentinas", with the main shareholders being the local group Soldati, the Galicia y Buenos Aires Bank, and the Suez-Lyonnaise des Eaux Dumez, from France, as the technical operator. At the time 8.6 million people were users of the service and many more lacked it at all.

The bidding system was based on a reduction of the current service charges at the time. The bidding process should be won by those offering the lowest fees. The winner had to pay nothing to have the right to operate the system. It was also exempt of paying the levies to the State during the whole extent of the Contract (30 years). The Regulatory Agency was called ETOSS.

Said Contract established a series of goals of investment and expansion, in order to supply with the services to the whole of the service area population as well as the cleaning-up of effluents and the decontamination of water-courses. Five-year plans had to be presented to show how the objectives were to be fulfilled.

The rates would have two moments for revision: ordinary and extraordinary. The ordinary revisions were to be discussed during the presentation of each five-year Plan, from the second five-year period on. A special clause of the contract established that the rates –set at the beginning of the contract– might not be increased (only decreased) in the first 10 years. The extraordinary rate revision could take place only if the manager or the Regulation Agency had detected an increase or diminution of operation costs of more than 7%.

The private administration began on May 1, 1993.

Less than a year after beginning operations, Aguas Argentinas asked for a raise in the rates to compensate the deficit suffered in the first year. The ETOSS informed that the firm hadn't met the expected goals and had to be fined. Notwithstanding, in June 1994, Ministry of Economy officers authorized the ETOSS to modify the contract. New investments were added and, in exchange, both rates as well as connection and infrastructure fees were raised in percentages varying between 38.5 and 42%. There was no stated explanation or justification -legal, technical or economic- of said raises and changes.

The following year, ETOSS informed that AA hadn't carried out the works that served as foundation for the raises. AA was fined, but never paid. The raises in fees and charges caused that many of the poorest users couldn't pay and thus were considered delinquent accounts.

Anyway, the ETOSS continued to assess the operating firm and by the end of the fourth year AA had not made promised investments worth more than US\$ 450 million.

Those breaches of contract ought to be considered before granting raises in fees and charges, and the amount past due should lead to a diminution of fees.

In February 1997, the Government decreed another revision of the Contract "to adopt measures that solve the problems related to the Contract execution", without explaining the nature or identity of said problems. The ETOSS members were not present during the bargaining, carried out by Public Works Department Secretary (within the Economy Ministry) and Natural Resources and Sustainable Development Secretary (within Nation's Presidency) with AA members.

A statement made by AA president, accusing the ETOSS of performing a "too severe" control, could explain the absence of the Regulation Agency members. Even more, the AA members stated that "due to the bidding needs" they had promised too ambitious goals.

Nevertheless the "revision" ended in modifications of such extent that can be considered a new contract. It amounted to a violation of the legal system, for a new bidding process is necessary in order to write a new contract. The main modifications were the following: a) investment deferment, new works schedule, and suspension of some improvements; b) reformulation of fees and charges diagram and economic regulation system and c) reprogramming of the five-year periods, extending the first one until December 31, 1998. This last aspect allows AA to profit of the benefits issued of this "negotiation", especially transforming a revision of fees and charges that had not to be done before

May 1998 in order to *reduce* prices, in an extraordinary revision with raise of prices, due six years later.

Needless to say that the French and Spanish Governments lobbied in favor of the operator's interests (Lyonnaise des Eaux and Aguas de Barcelona, a firm being a subsidiary one of the firsts one). The management of the AA local group, although strong, had no longer the fluid relationship with national Government members.

Between the beginnings of the private operation and 2002 the average fees were raised by 88%, much more than the rest of goods and services. The regulatory framework and contract suffered countless modifications. Even more: the method to change the Contract was drastically reformulated, and lost the "exceptional" quality that was its main expected quality.

In 2002 the National Congress passes the Law 25,561 declaring the national "Economic Emergency" that, among other things, established the end of the "convertibility system" that tied the Argentine peso to the US dollar; the "freezing" of fees and charges of public services and a thorough revision of all public services contracts. The remittance of US dollars to the operators' respective main offices was drastically reduced.

The discussion about the operation of AA was open until March 2006, when an Executive decree terminated the Contract with AA and established the "Agua y Saneamientos Argentinos Sociedad Anónima" (AySA) company, mostly State funded, which operates the service to this date.

There is a new regulatory framework and a new Control Agency (ERAS), which three directors are selected by the National Government, the Mayor of Buenos Aires City and the Governor of Buenos Aires Province. It is very difficult to imagine the degree of freedom of the directors, who are charged to control the same Government that appointed them. Moreover, substantive aspects, like establishing goals of expansion and fees or charges, are out of their reach, because the Application Authority (the Liquid Resources Secretary) determines the charges, and its Director chairs the Planning Agency that sketches the expansion goals. No consumers' participation or universal access to water is assured.

Nowadays a mediocre service is provided and the inclusion of new users is very slow. The fees and charges are heavily subsidized by the National Treasury.

As a conclusion, while all government claims to AA related to fees and charges were fully justified from a contractual point of view, the really important claim in social terms was related to the very small extension of service to new areas of the Buenos Aires Metropolitan area, where unacceptable high percentage of population of medium and low income level was lacking both water and sewage service

after many decades of state service. The wide expectation was this problem was to be solved with the privatization. It was not at all. Neither is it with the service back in state hands,

Electric Power supply and distribution

By the end of XIX century the supply of power and electricity by several small utilities was widespread around Buenos Aires City. The operation was in private hands, especially German and British companies. They were granted concessions to build power stations and supply power to homes and industries for periods of 25 years at most, in concurrency conditions. They were closely related to their main customers, the tramways lines..

Afterwards, Argentine investors associated with foreign firms and between 1899 and 1910 they created more than 15 companies that supplied power and energy in provinces like Buenos Aires, Tucumán and Mendoza. At that time, fusion and acquisition of firms showed the presence of Spanish (SOFINA), Belgian (Société Générale de Belgique) and Italian (Compañía Italo Argentina de Electricidad) companies.

The implementation of alternate electric power technology in the 1920's impelled the extension of the networks with decreasing costs and, in the process, the German, British and Argentine operators were pushed out of the market.

During the stage of economic concentration of the sector, the control of light and power companies was in charge of several provincial or district authorities. The regulatory framework was decentralized and weak and concessions to operate were granted by different provincial or municipal authorities.

The 1929-1930 crisis caused the Argentine Peso devaluation, as in the entire region. The Government banished the exit of foreign currency and so, the payment of dividends to shareholders of the foreign companies was in fact stopped. Controversies surged and regulation through concessions showed to be inefficient. Each company bargained its own Contract and fees. In 1934 the Argentine and Belgium Governments signed an agreement to liberate the currency transfers to that country. The revenues increased during that period due, mainly, to the raise of the demand (in particular, industrial) and foreign operators compensated the lower income in their European facilities. The nationalization of the service was discussed, but no agreement was reached. In some cases, the bribes given to the City Council members avoided the rescission of contracts and included clauses that favored the company, in exchange of a fees and charges diminution.

Only in 1939 the government of Buenos Aires Province began to sketch the first electric sector policies, including the big foreign firms as well as the small co-operatives operating in isolated towns

and villages. The Law, notwithstanding, only referred to technical aspect of the service and did not define a general method to calculate fares. Its main contribution was the creation of two entities, one technical and the other consultative, to assess and to give advice to the different cities within that Province. This Law did not change the regulatory framework of light and power supply, which continued to be a decentralized system, operated by foreign capital firms with no State control.

In 1943, the military Federal Government analyzed the concessions in Buenos Aires and the rest of the country and soon after declared the services utilities of public utility subject to expropriation, at the same time that created the first country-wide Control Agency (Dirección Nacional de Energía), which was charged of the assessment of sources of hydroelectric energy in order to lower the production costs and encourage the consumption without using non-renewable resources, namely oil, very scarce in the country at the time.

The expropriations took place between 1943 and 1948, but not all foreign companies were nationalized. In 1949 the Government re-oriented its economic policy, reducing public expenditure and changing its attitude towards the foreign firms.

During Perón's administration, the second five-year plan stopped the nationalization process of light and power companies, but did not created agencies charged of regulation or control of the foreign firms that supplied the service.

The power demand grew between 1950 and 1980, due to the heavier industrial consumption in the provinces. This claimed for an expansion of the system. In 1958 the mixed society SEGBA was created and it was nationalized in 1961. The tendency marked by this nationalization deepened and several state-owned companies were created. The power and electricity was mostly produced by thermal generation until 1980, when a strong tendency to build hydroelectric plants began.

The national electric system shows two different stages: a) the period 1960-1980, with a strong growth of power consumption between 3.6 and 12.5% per annum, and b) from 1980 to 1992, which registers a lower growth of demand, due to the economic difficulties.

Privatization of the electric sector

When during the Menem's Administration was passed the State Reform Law, legal dispositions were taken in order to privatize the power sector. The structure of the electric market was defined in 1991, dividing it in wholesalers and final consumers.

At the same time the generation, transportation and distribution, formerly united, were separated. The Electric Wholesaler Market was organized in 1992, and is defined as the contact point between supply and demand of power and light in real time.

That same year CAMMESA (regulation and management agency of the Electric Wholesaler Market) was created to coordinate the supply operations, the setting of wholesale prices and the management of economic transactions made through the SADI (Argentine system of interconexión). CAMMESA is owned equally by the National State and four private associations (20% of the shares each).

The Law No. 24065 created the "Electricity Regulation Framework" and, at the same time that declares that all activities of generation, transportation and distribution are subject to privatization, establishes that generation of electric power by privately owned utilities is a "general interest service", different to transportation and distribution which are considered "public services", with a more strict connotation.

Before its privatization in 1992, SEGBA was divided vertically in several business units that originated four generation companies and three distribution firms. The high voltage SEGBA transmission lines were combined with those belonging to Hidronor and Agua y Energía, thus creating a new company, Transener, responsible for high voltage electric energy transmission all over the country, privatized the following year.

Besides, the transformation of electricity (from 30,000 W to 220 W) and local distribution to users in the Buenos Aires metropolitan region was divided into two areas: North and South (in charge of EDENOR and EDESUR companies, respectively).

SEGBA privatization

Before privatization, SEGBA had a debt of US\$ 4820 million; 374 million were transferred to the private firms and the rest was taken care of by the Federal Government. The operation in both areas was conceded for a period of 95 years, divided in sub-periods, the first during 15 years and the rest, 10 years each.

The final users were categorized as follows:

- Small demand, lower than 10 Kw.
- Medium demand, with average maximal consumption for 15 consecutive minutes equal or bigger than 10 Kw and lower than 50 Kw.
- Big demand, with average maximal consumption for 15 consecutive minutes equal or bigger than 50Kw.

The fees and charges were determined by the “cost-plus” system.

Differences between the Technical Specification Sheets and the Contracts

After the bidding process was completed, the Contracts of operation were written. There are substantive differences between the first and the second specifications.

In the Technical Sheets, no definition is made about the tax system to be applied, except in the chapter that says that the operators “shall have the same tax treatment applied to the other public services”. In the Contract it is specified that “taxes and other levies can be transferred to fees or prices, in their exact incidence”. In other words, all taxes are indirect, for in the end they are handed over to the final users.

Referring to the Maintenance and Investment linked to the supply of the service, the Contract only states that the firms have to perform the actions conducting to guarantee “a service of good quality”, as defined in the Sub-Annex 4, and extend or expand the facilities when needed or when asked by the Regulatory Agency (ENRE). These definitions of obligations are quite lax and imprecise. Analyzing the Sub-Annex 4 we find that the quality standards are based on controls and measurements provided by the controlled firm. This is a very important difference compared to the Technical Specification Sheets, which in its Annex 4 brings a detailed check-list of maintenance of the facilities and the transmission lines, as well as a list of improvements to be done.

As for the personnel of all kinds, the Technical Specification Sheets state that, at the privatization moment, EDENOR and EDESUR had 7001 and 7741 agents, respectively. Thirty days before the firms were handed over, the operators had to specify the name, category, age, seniority and wages of the workers to be retained. This item is completely omitted in the Contracts.

There are other items not present in the Technical Specification Sheets but however they are specified in the Contracts, the most important of those is the one referred to the fees and charges. The operator can ask the Regulation Agency for a raise in fees if it shall bring technical or economical improvements in the service, both to the users and the firms, but only two years after the beginning of the operation.

Regulation and control

The electrical local distribution network is a natural monopoly, and prices and quality levels are regulated. As distribution is defined a “public service”, the operators have to guarantee the supply of power and the level of quality required by the users.

There is an incentive system and each period is more demanding than the precedent one. The breach of the conditions allows the Control Agency to penalize the operator with warnings or fines.

This control model assumes that, if the fines are related to the damages caused to the users, the operators shall make optimum investments. This basic principle is quite controversial, because it is possible (and actually happens) that the operator considers cheaper to pay the fines and continue supplying a poor quality service instead of making great investments and solving the problem for good.

Although the penalization system is very important to assure the contract obligations, this kind of regulation can be “captured”, lobbying during the Congress analysis to get lax regulations and mild fines, or “pressing” the Congressmen to fix higher fees and charges using the argument that “quality costs”.

EDESUR

This operator, mainly of Chilean funds, began its performance giving service to those still needing the service, placing counters and trying to avoid the energy theft. At first, the increase in the number of users did not cause inconveniencies because the State-owned company left a great degree of redundancy in the medium and low tension lines. The investment in solving the problems that appeared with the raise of the number of users was null. The firm paid small fines and went on. The system deteriorated.

The fees and charges (measured in U\$S due to the convertibility law) in addition to the increasing number of users, gave excellent revenues, shown in the outcome statements of the first five years.

The consequences of seeking maximum income in detriment of service quality exploded on February 16, 1999, when a blackout left about 150,000 users of Buenos Aires City without power for 11 days, in the middle of a heat-wave.

Notwithstanding the various announcements the situation continued, but neither EDESUR's Chairman nor its CEO agreed to give explanations either to the National Congress' Consumers Defense Committee or the Parliamentary Commission of Privatizations Control (twice).

Charges were pressed both by users and authorities, and the ENRE penalized EDESUR with two fines totaling about US\$ 70 million (10% of the firm yearly gross income). Two years later, ENRE's President and two EDESUR directors were subpoenaed by Federal Justice. ENRE's President was accused of negligence and lack of control of the company. EDESUR executives were accused of

ravages and of affecting the normal supply of electricity service, explicitly defined in the Penal Code. They were declared guilty.

EDESUR changed deeply after that blackout. The shareholders sold their parts, other investors came in (like the Spanish ENDESA), but still is the most penalized power distributor.

Nowadays the company is heavily subsidized by the Government in order to keep low the home users' fees. The medium and big users (business and industries) pay higher fees and charges.

EDENOR

This company is in charge of the power supply in the northern area of the country. It began operating on August 5, 1992 and the bigger investor was EDF (Électricité de France) the first among other European shareholders.

As happened with EDESUR, EDENOR's performance was acceptable at first and the firm had high revenues. It was penalized with fines of various amounts, because of Contract breaches, each time bigger and more frequently. The country's economic crisis and the exit of the convertibility model were used to justify the diminution or the cancellation of fines.

In the summer of 2005 the economy performed better and the Kirchner Administration hardened its position, especially with the suppliers of power and water, because of the complaints of users lacking electricity and water during a high-temperature period. The Government began an investigation that resulted in heavy penalizations to EDESUR, EDENOR and Aguas Argentinas.

The firms pleaded that it was not due to lack of investment but an extraordinary demand. The Government demanded the operators to inform why the situation occurred. In the meantime, more incidents took place and finally the private companies were compelled to pay not only the new heavy fines but also the previous ones, suspended during a transitory agreement with the Government.

EDENOR restructured its debt and got a waiver for 44% of the total amount, but later on signed an agreement that allowed a 15% raise in the fees of industrial users plus a 5% to make especial works.

In 2005 a new actor enters the stage: the Dolphin Group, belonging to a local family with close ties to the Government. The Dolphin Group, member of Pampa Holding, had bought a 65% of EDF shares.

The family holding also controls Transener and other power generation firms.

EDF, on its side, had pressed charges against the National Government at the CIADI (World Bank Agency to solve differences) for US\$ 960 million. But most of its shares were bought by Dolphin, which rapidly complied with the Government demand of retiring the charges at the CIADI.

The appearance of the Dolphin Group is of great significance. Not only attained their goals of partially displace EDF, the most expensive operation in the electricity distribution, but also they are a new and powerful actor in all the power chain: generation, transmission and distribution.

The division made before the privatization is now erased and the new investors, close to the Government, controls all the three stages. Thus, the operator improved its financial and economic position and it is able to develop any strategy: to be a main actor in the energy market or to get a substantial profit.

As of June 2007, Pampa Holding (owned by the same local family that owns the Dolphin Group) announced that they had fully absorbed EDENOR.

Fees and charges are nowadays heavily subsidized by the National Treasury.

Results of Privatization Process

The most evident result of the privatization process is the handing over state owned sectors of the economy, which are still generally considered strategic in Argentina to private firms. At first, the winners were ancient and well established local companies, former State contractors and purveyors. Afterwards those local firms began to associate with foreign enterprises, even in non-controlling situations to enter markets with huge revenues. The most relevant example is the CEI-Citicorp Holding, composed, among others, by the Citibank and the local República Group. This Holding entered the markets of transportation and distribution of gas, the generation and distribution of power and light, the telephone companies and the iron and steel sector.

The participation of foreign government-owned firms was so intense that many satirized the Argentine privatization process saying that through it “the Argentine State is owned by foreign States”.

But after the 2001/2002 crisis and in the last five years in particular the foreign investors retired and new local firms appeared. Some experts call those new actors “*grands bourgeois K*”, not because their ideology but due to their sudden prosperity and the connections with the Kirchner Administration.

Other of the results was the dismissal or voluntary exit of workers of the State-owned service suppliers. They had had stability in their positions as public servants, but they had lost those rights when private firms began operating. The average reduction of labor in privatized firms is about 57%, which means undoubtedly that the state corporations had during long periods of time an excessive payroll, item that nobody questions seriously.

The lax or null control allowed the firms to improve the services, specially the electric ones that were extremely poor before the privatizations, and to make great and quick profits during the first years

after the privatizations without very important investments. The Regulators had neither independence nor stability in their positions. In the rare cases of efficient Technical Controllers, they were unheeded and even dismissed, arguing that renegotiations and modifications were “politic affairs” and had to be lead by politicians.

If privately owned or operated, public services require regulation. The dangers of capture and corruption of the controller really exist, but the costs of not regulating are even bigger. The making of prevention policies and mechanisms is a must.

Two actions could help minimize this peril. First, to improve the information about the firms and their markets and to share it crystal clear. Second, to encourage the users’ participation. The consideration¹ of their interests during the regulation process might counterbalance the weight of companies or politicians.

The presence of foreign investors brings many benefits, but also several conflicts. This increases the State responsibility as regulator. The Bi-lateral Investment Treaties grant the foreign parties some additional rights and the possibility of choosing the forum where they can solve controversies. Thus they elude the local jurisdiction and go directly to international Courts. The demands affect heavily the State finances.

This problem become more acute because of the 2001/2 default crisis and the subsequent devaluation initially of more than 400%. The most deep social crisis followed, and the country reached unknown levels of unemployment and poverty. Bad time for raising utilities fares. Ever since the crisis the government has refused to authorize fare increases, which indeed violates the contracts with the private firm. Instead of raising fares the government keeps giving discretionary subsidies to the private electric firms without any public knowledge of the reasoning behind them. Moreover all the reserves in the electric generation system badly needed to sustain regular growth in demand as well as stationary picks, which the country had reached for the first time in many decades at the end of the 1990s are gone, and having to face the emergency the national government is building new utilities in a hurry, all of them based in oil and or gas imports at prices that keep growing in international markets, since oil and gas reserves which also reached their historical peaks at the end of the 1990s, allowing for exports, are also gone, the country is again importing.

The only exceptions to this grim panorama being the as of yet the unfinished building of the third nuclear generation station that after the many years since its interruption, apparently will in the end

1

cost more than building a new one of similar capacity... and the inauguration also after a delay of many years the last step of the Yacireta dam. There are no new hydroelectric utilities under construction. And the service keeps deteriorating because of lack of due maintenance in the distribution grids.

In closing, unhappily enough if privatizations did not reached the expected results en several areas, the utilities and other service back in state hands are not doing at all a better job. The most scandalous example being the national airline, also back in state hands, in permanent crisis, and with levels of poor service unknown before.

The only benefit brought by this long and painful process is that consumers realized their power and many associations were created in order to defend the interest of public services users. This kind of association must become equally demanding as it relates to public services quality, prices, etc, before public or private utilities or corporations, Argentineans or foreign ones, and beware of political or whatever propaganda

We wish this tendency to prevail. Thus, the final consumer will have a voice and, maybe, could change or minimize the capture of the state possibilities, be it in favor of private interests, or of political, economic or labor groups taking control of state public utilities or enterprises.

Finally, only continuity in policies and management, and in the economic, financial and social environment of the country could provide the necessary conditions for investment and development of public services as needed, be it in private or state hands. Nothing important and durable is possible to be reached in a country where governments originate economic, financial and or social crisis, and when having to face them, decree the state of emergency allowing it to no comply with its debts and other legal and contractual obligations, while at the same time requires the citizens, the enterprises or the corporations, be it national or foreign ones, to fully comply with their duties.

¹ This paper is based on all documents and reports, mainly internal ones, most of them never published, and interviews under reserve of identities, collected at the time of preparation of Dr. Alicia Calvo Doctoral Dissertation under the same title, Dr. Pedro E. Andrieu being its Director

² This paper is based on all documents and reports, mainly internal ones, most of them never published, and interviews under reserve of identities, collected at the time of preparation of Dr. Alicia Calvo Doctoral Dissertation under the same title, Dr. Pedro E. Andrieu being its Director

³ Stiglitz, Joseph E., 2002. *Globalization and its Discontents*. WW. Norton & Co. New York & London.

⁴ Boehm, Frédéric, 2005. "Corrupción y captura en la regulación de los servicios públicos". *Revista de Economía Institucional*. Vol.7, no.13, Dec., p. 245-263.

⁵ Stigler, G. J., 1971. "The Theory of Economic Regulation", *Bell Journal of Economics and Management Science* 2, 1.

⁶ Laffont, J. J. y J. Tirole, 1991. "The Politics of Government Decision-Making: A Theory of Regulatory Capture", *Quarterly Journal of Economics*, Noviembre, 1088-1127