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From privatisation to re-nationalisation: What went wrong with privatisations in Argentina?

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Abstract: We analyse the privatisation process in Argentina. Beginning with a very ambitious program, a weak regulatory environment was created because of lack of experience and as a result of the lobbying power of the newly created enterprises. Numerous exclusive privileges were assigned to these sectors, making them the most profitable industries during the 1990s. As the economy crashed in 2001 and the local currency was devalued, a new government took office, which renegotiated all contracts. This resulted in re-privatisation and re-nationalisation of many services. We review the pro- and anti-privatisation arguments using empirical evidence from Argentina. We also provide an in-depth study of the three sectors where this negotiation was most intense: the railways, water and sewerage and postal services.

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I. Introduction

The role of the state in the provision of public services has dramatically changed over recent decades. Underdevelopment was generally tied to a lack of basic infrastructure, and the poor dynamism of the local private sector contributed to the view that the state should manage the provision of utilities and public services. The considerable participation of the state in Latin America is a consequence of import-substitution-industrialisation (ISI) which was the major development strategy from the 1950s to the end of the 1980s. In this context, the state not only encouraged investments but it also participated directly in economic activities (Baer, 1994). In particular, the government was involved in the provision of almost all public utilities. Over time the management of state-owned enterprises (SOEs) deteriorated due to: (a) the use of state enterprises as macroeconomic policy instruments; (b) political pressure to overemploy labour; (c) corruption and (d) the use of public enterprises to borrow more than they needed on the international market (see Amann and Baer, 2005).

At the beginning of the 1990s a strong consensus emerged regarding the benefits of privatisation.³ In particular, privatisation was perceived to promote enterprise efficiency, to reduce fiscal deficits, to increase consumer surplus and to create a competitive environment where there was a monopoly structure (see, for instance, IFC, 1995). Latin American policymakers were gradually persuaded of these benefits and initiated a massive process of privatisation.

³ Argentina, like many other Latin American countries which had experienced the debt crisis of the 1980s and were forced to renegotiate the debt with creditor banks and the IMF, was pressured to adopt neo-liberal policies, which included the privatisation of public enterprises.

Argentina provides one of the most dramatic examples, because of the scale of its privatisation process (it included every public service managed by the state: electricity, postal services, telecommunications, television, railways, water and sewerage, and “strategic” sectors such as petroleum and gas) and the speed with which it was carried out. Fifteen years after privatisation started, a substantial controversy arose over its impact. While Sirtaine et al. (2005) concluded that, contrary to public perceptions, the financial returns to private infrastructure concessions had been mediocre, other authors found that privatised enterprises were extremely profitable (Aspiazu, 2002). Moreover, while some studies concluded that households benefited from this process and efficiency gains occurred in most sectors (*e.g.* Chisari, Estache and Romero, 1999), opposite conclusions were drawn from different lines of research (*e.g.* Basualdo *et al.* 2002).

After the 2001 crisis, a renegotiation of all privatised concessions began. In many cases, this process led to cancellation of the existing concession contracts, which resulted either in re-nationalisation or in a new privatisation. The purpose of this paper is to review the overall process, discussing the arguments in favour of and against privatisation using empirical evidence from Argentina.

The criteria used to evaluate individual privatisation outcomes vary across sectors, but the analysis also needs to be framed within the general process as well. Individually, general performance can be judged according to the following criteria: (a) whether the firm fulfilled what was stipulated in the concession contract (eg investment in new infrastructure, increase in the number of clients); (b) whether more efficient services were provided (eg lower prices, better quality); (c) whether a competitive market environment was created for the future development of the sector; and (d) whether the fiscal burden, which was attributed to state management, was actually reduced. An analysis of the best-

known cases may contribute to an understanding of what went wrong with privatisations and what can be done to achieve their original goals. With that objective in mind, we analyse those sectors where re-nationalisation or re-privatisation occurred, e.g. railways, water and sewerage and postal services.

The paper is organised as follows. Section 2 presents two views about the process: one sees it as the result of state mismanagement and draws positive conclusions, while the other emphasises the “institutional capture” of the state by the newly created private enterprises. Section 3 presents the basic regulatory principles and facts. Section 4 concentrates on the renegotiation process which is presently continuing. The following sections examine individual cases: railways (Section 5), water and sewerage (Section 6) and the postal service (Section 7). Conclusions and a general evaluation of the drivers of success and failure of privatisations in Argentina are presented in Section 8.

2. The privatisation process: two views

2.1 Pro-privatisation arguments

Privatisation of SOEs was one of the key components of the “Washington Consensus”, a term used to summarise the neo-liberal economic policies of the late 1980s and the beginning of the 1990s⁴. In certain economic circles privatisation was viewed as a solution to many Latin American problems. For instance, the IFC (1995) stated that the

⁴ John Williamson (1990) summarised the contents of this consensus: 1. fiscal discipline; 2. redirect public expenditure; 3. tax reform; 4. financial liberalisation; 5. adopt a single, competitive exchange rate; 6. trade

fact “[T]hat privatisation can deliver a wide range of material *economic benefits* is now a view so widely held that it scarcely needs elaboration”. This optimism was based on the premise that privatised enterprises would achieve multiple objectives, such as:

1. providing resources for the state’s fiscal needs and reducing the fiscal burden of SOEs;
2. improving efficiency and quality of services in infrastructure sectors (see Savas, 1987; Boycko, Shleifer and Vishny, 1993; and Shapiro and Willig, 1990);
3. aligning tariffs with costs and favouring an efficient allocation of resources;
4. extending coverage and access in the case of public utilities;
5. creating a new business environment and stimulating the adoption of modern technology (see Adam, Cavendish and Mistry, 1992);
6. increasing domestic stock ownership (Suleiman and Waterbury, 1990);
7. attracting domestic and foreign investment (Vernon, 1991).

Some empirical studies have shown that, after being privatised, many SOEs increased real sales, becoming more profitable and increasing investment and employment (Megginson, Nash and Randerborgh, 1994; Adam, Cavendish and Mistry, 1992). However, at the time privatisations were carried out, they were adopted largely on faith, not empirical evidence⁵.

In Argentina, which experienced a prolonged economic crisis in the 1980s, a new consensus emerged regarding the role of the state in the mismanagement of public services

liberalisation, 7. eliminate barriers to foreign direct investment, 8. privatise state-owned enterprises; 9. deregulate market entry and competition; and 10. ensure secure property rights.

and its impact on the fiscal situation. According to this view, the lack of the right incentives, because of non-profit-oriented management, was responsible for the poor performance of SOEs. Consumers would be better served because “privately owned companies have greater incentive to produce goods and services in the quantity and variety which consumers prefer” (Beesley and Littlechild, 1994, p.17). Regarding the inefficiency of SOEs in Argentina, FIEL (1987) stated:

“... State-owned companies suffered huge operating deficits as a result of the application of political fares and the high costs derived from high public wages. Adjustment attempts led to a lack of maintenance and divestment. Losses were covered by the National Treasury with a severe incidence on public finances.”

In this context, the Peronist government, elected in 1989⁶, rapidly adopted neo-liberal policies. The State-Reform Bill (Ley 23,696) declared several public services subject to privatisation, and it authorised the national government to undertake the necessary steps to carry this out.

2.2. Arguments against privatisation

⁵ Most privatisation knowledge was based either on the UK experience or that of a few developing countries (eg. Chile).

⁶ President Carlos Menem was in office for two consecutive periods: 1989-1995, 1995-1999.

Other authors (e.g. Basualdo *et al.*, 2002) explain the process from a different perspective. They emphasise the similarities between the policies implemented under the Menem administration and the last military government (1976-1983). Privatisation was the result of increasing pressure to accomplish two different objectives: servicing the external debt and subsidising domestic capital. From 1976 to 1989 national firms were promoted by receiving subsidies and favourable contracts with the state, mainly in road construction and the building industry. The nature of these holdings gave them the name of “*patria contratista*” (in Spanish, national firms that contract with the State). Other methods used to favour these groups included nationalisation of the external private debt which occurred in the aftermath of the 1982 debt crisis (Schvarzer, 1998). As a result, the fiscal deficit increased, becoming the government’s main preoccupation and the cause of macroeconomic instability. Foreign capital was generally excluded from the distribution of resources during the 1980s. For instance, in 1988 Argentina suspended all external debt payments.

In order to resolve this conflict between national and foreign capital, privatisations benefited three different groups (Basualdo *at al.*, 2002): the “*patria contratista*”, who contributed to management and local lobbying; foreign and domestic banks, which provided undervalued government bonds that were recognised at their nominal value; and foreign firms which provided technology and management knowledge. Management of the SOEs resulted in a qualitative jump for these actors as the groups’ profits and political power increased. Aspiazu (2002) showed that from 1993 to 2000, 26 concessionaires among the 200 biggest national firms received 56.8 per cent of the total cumulated mass of profits. A weak regulatory framework was created to allow extraordinary profits (see Basualdo 2001 and the section on regulation below). Ramal (2005) interpreted this process

as one of “original capital accumulation”, as new groups appropriated public enterprises as a way of raising the value of their capital, in the same way as bureaucrats appropriated SOEs in the ex-Soviet countries.

A different perspective is used to analyse the “failure” of state enterprises. It is not government management *per se* that caused the dysfunction of SOEs in the 1980s, but deliberate mismanagement to make public opinion and political actors more favourable to privatisation⁷. A documented example of this was telephones: their management before privatisation was plagued with corruption and services significantly deteriorated (Seoane, 2003) while at the same time tariffs were increased substantially to set a “competitive” floor to concessionaires.

Petrecolla, Porto and Gerchunoff (1993) state that the objective was to create quasi-rents, where before there had only been financial losses, for attracting capital investors. Not only were profit rates excessive, but gains in the value of assets were exorbitant. For instance, local economic groups, which obtained the concession for gas distribution and telephone companies, made a 20 to 40 per cent average annual profit rate by selling their participation in the newly created firm a few years later (Basualdo, 2001). On the other hand, stock options given to SOE employees in the privatisation process quickly lost their value. As a result, income and wealth inequality rose during the 1990s.

Moreover, as these enterprises constituted a traditional shelter for more combative labour unions, privatisation resulted in a deterioration of their influence. Suleiman and

⁷ Petrecolla, Porto and Gerchunoff (1993) put it in this way: “ ... [C]ontrary to what happened in other national privatisation experiences, and in spite of what had been recommended by experts and by the international organisations with previous experience in this area, the operation did not include cleaning up the firms in order to reestablish their productive capacity. On the contrary, the performance of public firms to be privatised worsened in the period before privatisation(...) [T]he authorities ended up using the situation of quasi-collapse of the firms and the consequent deterioration in the provision of public services as an argument, widely accepted, in favor of massive privatisation.” (p.71)

Waterbury (1990) associated the political objective of privatisations with reducing union power. From this perspective, private management of the SOEs was extremely successful. According to FIEL (1987): “Prior to privatisation, employees working at SOEs were approximately 290,000. The big employers were the railroad companies (94,000), telecommunications (46,000), post (37,000), YPF (the oil company) (37,000), Segba (metropolitan energy company) (22,000) and Gas del Estado (10,000). After the privatisation process, estimates indicate that over two-thirds were fired (almost 200,000).”⁸

3. Regulation

In many cases, public utility enterprises constituted natural monopolies. As concessions transferred the management of the SOEs, the market structure remained mostly intact. Thus regulation was intended to attenuate market failures usually associated with such a market structure, and to provide guidance for attaining competitive markets results. Technical aspects of regulation practices were extensively studied by FIEL (1999) and CEER (2001). Opinions varied as to whether the regulatory framework was weak and if so, what were the causes of this.

On the one hand, the size and the speed of the process, plus the fact that little international empirical evidence was available, determined that the regulatory agency was created at the same time as the privatisation process. In many cases, the future concessionaires provided the research expertise for the construction of the new regulatory

⁸ It is worth mentioning that dismantling of the labor union power resulted in the emergence of a new political force: “*piqueteros*” (unemployed workers who blockade roads as their main way of protesting), which was decisive in the 2001 political crisis.

framework. Moreover, there was no explicit coordination among regulatory agencies (Petrecola, 2001).

Other authors emphasise that the weak regulatory environment was the result of the “institutional capture” of the state (Aspiazu, 2002). A major example of this was the indexation that concessionaires were allowed to apply to tariffs, while the Convertibility Law explicitly prohibited this⁹. Many other “regulatory asymmetries” existed, in proportion to the lobbying power of each group. FIEL (1999) concludes that agencies in sectors where fewer firms existed tended to favour the concessionaires. The actual power of the regulatory agencies varied for different sectors. In many cases, the agencies were excluded from re-negotiation processes, as this was done between the concessionaire and the government. On the other hand, the regulators had the ability to apply pecuniary fees for breach of contract or for consumer rights violations.

The regulatory agencies were created with certain autonomy with respect to the national government, although closely linked to the concessionaire. In many cases, they were financed by fees paid by the public service users.

In general, a price-cap mechanism was used to set tariffs, and they were adjusted by a price index (United States general price index), minus some efficiency factor, plus a new investment factor. In some cases, an additional term was considered to reflect price variations in input materials (eg gas and electricity). This system created some incentives for firms to increase productivity growth, and the state was able partially to translate these gains into consumer surplus. Nevertheless, the weak regulatory environment allowed

⁹ While the Convertibility Law was sanctioned on April 1991 and indexation was explicitly prohibited, another Law (Decreto 2585/91) allowed telecom companies to follow the United States evolution of prices as a main reference. In turn, this was applied to other public services. The legal interpretation of this “exception” was that the Convertibility Law referred to indexation *only in local currency*, as no mention to other currencies was in the Law.

multiple tariff adjustments which undermined those gains (Petrecolla, 2001 and Thwaites Rey and López, 2001). On the other hand, water transportation and railways had a hybrid mechanism that was mainly based on the cost structure.

4. Renegotiation of contracts

After the devaluation of the peso in 2002, and the economic crisis that followed it, the deterioration of the privatised public services was evident. Two different events contributed to the renegotiation of contracts in 2002 (Ley 25,561, Emergencia Pública y Reforma del Régimen Cambiario). On the one hand, a different government attitude (as a result of massive popular mobilisation which included consumer protests) was expressed by the Duhalde and (mainly) Kirchner presidencies. On the other hand, firms' profits decreased considerably and their financial situation made them vulnerable.

The devaluation affected both the revenues and the costs of the privatised enterprises. On the one hand, the devaluation had a considerable impact on the real value of public utilities' tariffs. The general consensus in the post-devaluation governments was that tariffs had been set too high and that profits were excessive in the 1990s. The Duhalde government froze those tariffs indexed in dollars in order to keep inflation low. In Table 1 we calculate the average tariffs in dollars in 2001 (pre-devaluation) and 2002 (post-devaluation). Figures 1 and 2 show the tariffs in dollars for the period 1993-2006 for each of the sectors in Table 1. On average, tariffs were reduced to one third of their pre-devaluation prices in dollars. As Figure 1 shows, the value of electricity and natural gas tariffs rose in 2003 but remained stable in the following years. Telephone and water and sewerage bills were not adjusted in any of the following years (Figure 2 plots the value in

dollars for these sectors' tariffs). As a consequence, the revenue loss in dollars was never recovered in the post-devaluation period.

[INSERT TABLE 1 ABOUT HERE]

[INSERT FIGURE 1 ABOUT HERE]

INSERT FIGURE 2 ABOUT HERE]

On the other hand, provided that many enterprises used imported inputs and had debts denominated in foreign currency, the devaluation considerably increased variable costs. At the same time, the financial crisis increased the risk of investing in Argentina, disrupted the payment system and collapsed the demand for public utilities. In turn, this had a significant restraining impact on investment plans. However, labour costs remained fixed for a long time after the devaluation. Overall, it is difficult to quantify the effect that the devaluation and the crisis had on the profitability of the privatised enterprises, although in general every privatised firm showed negative profits in the last quarter of 2001 and in 2002¹⁰.

As a result, several firms re-evaluated their strategies on the continent, and abandoned public utility enterprises. In general, these decisions were tied to the global strategy followed by the foreign firms which controlled them. For instance, French firms occupied the third position in terms of foreign investment in Argentina, but they were leaders in leaving the country. First, France Telecom sold its participation in Telecom Argentina S.A., one of the two giant privatised telephone companies. Second, Suez left Aguas de Santa Fé and lost the concession of Aguas Argentinas S.A., water and sewerage

¹⁰ For instance, Edenor S.A. one of the two biggest privatised electricity companies (see below) showed losses due to the devaluation and crisis of about US\$ 330 millions, which was bigger than the accumulated gains from its constituency. (own calculations based on information provided by interviews in Edenor S.A.). Aguas Argentinas S.A., water and sewerage for the City of Buenos Aires (see also below) declared a loss of US\$ 400 associated with the devaluation (Press Office, Aguas Argentinas S.A.).

of Buenos Aires¹¹ in 2006. Third, Electricité de France abandoned the control of Edenor (electric services in Buenos Aires)¹². On the other hand, Spanish investors had a long-term interest in the region (for instance, they control the very profitable petroleum company) and had a friendlier attitude toward the government.

Many public utility enterprises used coercion (cutting production and quality) as a negotiation tool¹³, while the government offered greater subsidies and financing of dollar-denominated debts to settle disputes in its favour. In the meantime, the state financed all new infrastructure investment in critical sectors. The concessionaires have claims with the International Centre for Settlement of Investment Disputes, the World Bank's arbitration body, demanding some \$16 billion in compensation from the state for “pesification” and the rate freeze (The Economist, January 25, 2005)¹⁴.

5. Metropolitan Commuter Passenger Railways in Buenos Aires City

At the end of the 19th century, railways constituted the most important instrument for unifying and modernising Argentina. Until their nationalisation by President Juan D.

¹¹ In February of 2003 the water and sewage concession in the capital of the Phillipines, of which Suez owned over twenty percent, was terminated. In March of 2003, blaming a “global financial pitch”, Suez backed out of a contract they had won in Ho Chi Minh City to provide Vietnam’s first build-operate-transfer water treatment plant. In January 2004, Ondeo, Suez’ water management subsidiary, pulled out of what was to have been a ten year contract to manage water services for all of Puerto Rico. In 2005, a Suez subsidiary in Bolivia administered water and sewerage in La Paz and El Alto. Massive popular protests in the latter city were generated by the firm’s actions (Hacher, 2004).

¹²Electricité de France is also involved in other developing countries: in Latin America (Brazil and Mexico), Asia (China, Laos and Vietnam) and Africa (Egypt and Ivory Coast).

¹³ In August 2005, the City of Buenos Aires suffered a gigantic blackout, mostly in the area operated by Edenor S.A. The enterprise blamed the tariff freeze for necessitating the use cheap maintenance inputs (Clarín, August 25th 2005). See also below for the performance of railways after the devaluation.

¹⁴ For a list of pending cases see <http://www.worldbank.org/icsid/cases/pending.htm>

Peron in 1948¹⁵, their services were oriented exclusively toward the agricultural-export sector. After they became state-owned, new roles were assigned to the existing railway structure: (a) it contributed to the continuous rural-to-urban migration; and (b) it was the most used daily transport method for commuters to the new industries in Buenos Aires. Felder (1994) claims that the state subsidised this kind of transportation in order to lower the cost of the labour force by setting low tariffs and (supposedly) high quality of services.

Urban transportation in Buenos Aires was never characterised by conscious planning, although the Argentine suburban passenger system is among the largest in the world, generating more traffic than New York City and in the same league as Paris or London (Kogan and Thompson, 1994). However, railways were no exception to the chaotic situation by 1989: services were 50% of the level obtained in 1965 and a daily subsidy of US\$ 2 millions was provided for its functioning (FIEL, 1999).

A serious attempt to start privatisation was made by President Alfonsín (1983-1989), although opposition coming from the Peronist party aborted the action. Ironically, it was the Peronists who undertook the most ambitious privatisation process when they reached government. In August 1989, Annex 1 of State-Reform Bill (Ley 23,696) stated that railways and subways were to be partially or totally privatised. In March 1991 a new enterprise (Ferrocarriles Metropolitanos S.A., FEMESA) was created to operate all the metropolitan services in Buenos Aires City, which cover 899 km of lines, 267 stations and 1,800 trains carrying over 1 million passengers each business day. The government-designated packages are shown in Table 2.

[INSERT TABLE 2 ABOUT HERE]

¹⁵ The nationalisation merged more than 15 private railways into size relatively-independent companies with track networks.

Other inter-urban services were offered to provincial governments in case they were important for the local economies. Those not accepted by the provinces would be abandoned. In practice, this constituted the end of the inter-urban services (nearly 70% of these services were discontinued) except for the Province of Buenos Aires (a provincial firm was created to administer inter-urban services, Unidad Ejecutora del Programa Ferroviario Provincial) and the Provinces of Salta, Río Negro and La Pampa.

The concessions in the City of Buenos Aires had the following characteristics (Benedetti, 2002 and FIEL, 1999): 1. The services were privatised through a ten-year concession (twenty years for Metrovías S.A.) with an option to renew for the same time at the end of the contract (no limit on the number of renewal times); 2. The concessionaire rented the railroad infrastructure from the state, which maintained its property, and it had exclusive management; 3. Each service constituted a monopoly, and could charge for the use of the line by other concessionaires; 4. The state defined an investment plan for each line and some maintenance and quality standards; 5. Depending on the supply and demand projections, a subsidy was offered by each potential concessionaire; 6. Concessions were given to those who offered the lower net present value for subsidy plus investment costs.

As mentioned earlier, the mechanism of tariff determination in this sector is a hybrid one, where tariffs are set in accordance with the cost structure. However, tariff increments are contemplated if the concessionaire surpasses some reference quality indexes six months prior to the adjustment. FIEL (1999) found that this procedure was not transparent and numerous conflicts for tariff determination emerged.

The first years of privatisation showed an improvement in the quality and quantity of services, which attracted passengers who had been crowded out (FIEL, 1997 and CEER, 2001). The amount of the subsidy diminished to one third of the historical amount in the

first three years, although it would rise again. In this respect, we see great variation in performance. Some services (eg Subway, Metrovias S.A.) changed from receiving a subsidy to paying a positive amount to the state, while others were unable to make this transition. At the same time, lines which passed through wealthier geographical zones acquired modern cars while the poorest regions had the same or lower quality trains.

With the economic crisis, the demand for metropolitan railway services diminished considerably. Whether this was the result of high levels of unemployment (and consequently lower demand) or a deterioration in the quality of services is difficult to determine. However, several NGOs, labour unions and government agencies denounced the critical state of several services. In 2004, with regard to Transportes Metropolitanos S.A. (San Martín and Roca lines), the National Auditor-General¹⁶ concluded: “ [There is evidence of] a constant deterioration of the enterprise situation [due to] an increment in the level of debt and to a deficient economic-financial management, which generates doubts with respect to the future of the service”. Moreover, between 1996 and 1998, the firm “distributed excessive profits in spite of the serious level of indebtedness”. Besides, the firm did not honour its obligations in terms of investment and maintenance: investment plans were suspended or delayed, which led to the necessity for more maintenance which, in turn, did not occur. The number of functioning cars diminished, resulting in overcrowded services. Also, infrastructure investment procedures were not transparent in the selection of providers.

A lack of control over the goods administered by the concessionaires generated several claims of fraud that included the disappearance of electronic ticket machines and locomotives. In the aftermath of the economic crisis, metal parts and window glass

disappeared from the railroad cars because of their resale value. These claims are now in the justice system.

In 2004, Concession 4 (Transportes Metropolitanos Gral. San Martin S.A.) was terminated and the state (with technical assistance from other concessionaires) took over the operation of this service (Decreto 798/04, Resolución Secretaría de Transporte 408/04). In April 2005, Transportes de Buenos Aires (TBA), the concessionaire of the Mitre and Sarmiento lines declared it could not service its debt. TBA blamed “tariff freezing, the suspension of the adjustment mechanism [suspended in 2002] and the increments in taxes” (Pagina/12, April 23rd 2005) for this situation, despite the increments in the subsidy provided by Presidents Duhalde and Kirchner.

In 2004, the national government re-acquired control over inter-urban (long distance) services. In Decreto 1261/04, it mentioned that the rail policies of the Menem administration had led to the “economic and social destruction of numerous villages” and “the closure of factories” which contributed to an “increase in the unemployment rate”. In 2005, only a few services were provided as a result of this nationalisation (Buenos Aires–Rosario, Buenos Aires–Córdoba, once a week each), although there are plans to increase the quantity of services.

6. Public water and sewerage services for Greater Buenos Aires

Poverty reduction and improvements in quality of life are associated with access to drinkable water. A public enterprise, Obras Sanitarias de la Nación (OSN), was responsible for water and sewerage provision during most of the last century. Since it constituted a

¹⁶ The following web site has a summary:

considerable burden to the Treasury, this service was included in the privatisation scheme. The publicly-owned firm was broken-up geographically into several firms. In order to accelerate privatisation, the government opted to award the right to provide the service under a concession contract rather than sell the utility, keeping the fixed assets under public ownership. A single private firm would operate the service for thirty years. In Buenos Aires, the concession was awarded to Aguas Argentinas S.A., a consortium headed by the French firm Lyonnaise des Eaux-Dumez (later Suez) in December 1992 (transfer occurred in May 1993; see FIEL, 1999).

The government's regulatory role is in hands of the Ente Tripartito de Obras y Servicios Sanitarios (ETOSS). This agency is financed by a user fee levied on consumers and governed by a directorate appointed to a six-year term, with the option of one renewable term. FIEL (1999) emphasised that the **management was** selected because of their political orientation rather than their technical background (regulators were appointed by the municipalities, or local governments). This resulted in many of the agency's decisions favouring the concessionaire. For instance in 1994, ETOSS decided to apply an excessive tariff increment in advance for future investment, without considering the consequent growth in the number of clients (Resolución ETOSS 81/1994; see Figure 2 for the evolution of the average residential tariff). In 1995 a new increase was approved because the new geographical zone served by Aguas Argentinas had a lower client/inhabitant ratio than expected (Resolución ETOSS 83/1995), following the *ad hoc* criteria of maintaining a constant global revenue policy.

According to Azpiazu (interviewed in Hacher, 2004), residential water rates increased 88.2 per cent between May 1993 and January 2002 although there was “no

relationship between this rate and the consumer price index (inflation rate), which was 7.3 per cent for the same period.” In turn, this provided the company with a 20 per cent average annual rate of return, far higher than is “acceptable or normal” for the water industry in other countries. In the United States, for example, water companies earned between 6 and 12.5 per cent in 1991. In the United Kingdom a reasonable rate of profit for the sector is between 6 and 7 per cent. In France, 6 per cent is considered a very reasonable return on investment (Seoane, 2003). Yet this rate of increase did not translate into higher quality or quantity of service. In 1997, the company was found to have failed to complete 45 per cent of its contract commitments for improvement and expansion of services, resulting in massive pollution. Aguas Argentinas’ low investment policy resulted in the exclusion of 840,000 and 930,000 inhabitants from access to potable water and sewerage respectively (Ramal, 2005).

Van der Berg (2000) has pointed out that the tariff structure was set to be favourable to existing users and skewed against new connections. For that reason there were difficulties in expanding the services to the poor and the contract had to be renegotiated to meet its coverage targets. Catenazzi (2001) has pointed out that the logic of Aguas Argentinas was to concentrate on maintenance of the existing infrastructure, because adding new users (mainly poor and with dubious payment capacity) represented a small portion of revenues. This author remarked that breach of the contract should have occurred in the first renegotiation (1997).

Others blamed the pesification of tariffs and the devaluation that changed the “rules of the game”. Aguas Argentinas S.A. declared a loss associated with the devaluation of about U\$S 400 million (Press Office, Aguas Argentinas S.A., personal interview).

Moreover it showed that 95% of its debt was denominated in dollars which made its financial situation especially vulnerable.

Table 3 shows the evolution of net profits before and after the devaluation. It shows that positive profitability returned in 2003, but at a much lower rate of return. Carlos Vilas, who represented the government in ETOSS, pointed out that Aguas Argentinas only provides maintenance because “water is not a profitable business”¹⁷. In 2006, the state cancelled the concession and re-acquired control of Aguas Argentinas (Decreto 303/2006). Moreover, ETOSS was dissolved in 2007 and a new regulatory agency is being created.

[INSERT TABLE 3 ABOUT HERE]

7. Postal services

In 1997 (Decreto 840/1997) the postal services, one of the most emblematic public services, was privatised and the firm Grupo Macri, associated with British technical expertise, gained control of this sector. Correo Argentino S.A. won a 30-year concession as provider of the official mail in Argentina. In this case no improvement in the quality of the service was observed, while prices increased considerably. From 1999 the private firm stopped paying the fee stipulated by the contract. In November of 2003 (Decreto 1075/2003) the state cancelled the concession and regained control. This sector underwent the latest privatisation, but it also existed for the shortest time.

¹⁷ Página/12, June 27th 2005.

In this case, privatisation was undertaken where other private postal services were already competing in the market: two large firms (OCA S.A. and Andreani S.A.) with national scope, and many informal and locally established firms existed.

According to the National Auditor-General, the concessionaire only paid for the first two periods (September 1997 to February 1998, March 1998 to August 1998). In the following periods, it only discounted from the fee services provided to the state, and the auditors recommended rescinding the contract. At the same time, the standard service price increased several times during the concession with no improvement in quality. All of the above contributed to the cancellation of the concession and to the re-nationalisation of the postal services.

9. Conclusions: What went wrong with privatisations?

The privatisation of public services was intended to replace state management by market-oriented enterprises, which would realise certain general objectives related to the well-being of the population and behave competitively in monopolistic environments. Given the vicissitudes of the economy at the time the process started, the government was more preoccupied with alleviating the fiscal situation than in creating an adequate regulatory framework. Moreover, policy-makers were closely related to the private sector, which depended on the state for its own survival. That is, these private firms were either unable to survive without favourable regulatory rules (because they were inefficient) or they were unwilling to operate in Argentina with reduced profit margins. As a result of their link with the regulatory agencies, some of the privatised public utilities were extremely

lucrative (e.g., telephone companies, petroleum, etc.) while others depended totally on the state for their profitability (e.g., railways, water and postal services).

Some of the original objectives of privatisation were achieved. In particular, productivity increased considerably (amid massive layoffs) and new technologies were adopted by newly privatised firms (mainly in telecommunications). Considerable investment took place only in highly profitable industries. Tariffs were set in line with costs structures, which in many cases contributed to the generation of efficiency gains. In general, the privatisation concessions did not alter the market structure; that is, they transformed a public monopoly into a private one (an exception was the telecommunications).

After the devaluation of 2002, privatised firms discontinued their investment plans and only provided services to established clients, awaiting a restoration of their previous profit levels. Services deteriorated to before-privatisation levels and public discontent emerged. Since increasing prices was not politically viable, the government started a renegotiation process with the intention of achieving the original objectives, that is, increasing efficiency and consumer gains.

To answer the question posed in the title, two main considerations need to be taken into account. First, in some sectors the privatisation goals themselves were not attainable. In water and sewerage, for instance, the firm has no incentive to expand the service to the poorest population stratum. As occurred in other cases, the state financed investments in infrastructure, while the firm only administered services to already existing clients. In the railways, a sector with a long history of deficits and considerable demand fluctuations, the quality of services depended on the amount of subsidies provided by the state. Profit-oriented management of public utility companies might not be compatible with the original

welfare objectives. Moreover, concessionaires acquired SOEs in a context of real exchange rate appreciation and non-tradables profitability. This context was dramatically changed with the devaluation in 2002, and this made profits in pesos non-competitive internationally.

Second, the “institutional capture” of the state was mainly responsible for the weak regulatory framework. A strong government, not captured by private concessionaires, is a necessary condition for efficient regulation. The extraordinary profits obtained in the past decade were the result of both a lack of experience and the involvement of the newly created enterprises in the regulation of their markets. Moreover, failure to fulfil the contracts led to concession cancellation only after the political climate toward privatisation changed.

As this article has shown, the process of privatisation was deeply flawed because: 1) the state was in too much of a hurry to obtain the income from awarding the concession contracts and thus help its short-term fiscal adjustment; 2) the very high rates of return for the concessionaires resulted in their becoming powerful lobbyists whose aim was to maintain these rates, while they had little incentive to improve efficiency. The final verdict with regard to the Argentinean experience is that a successful privatisation of public utilities can only occur with a strong and independent regulatory authority, allowing for a reasonable long-term rate of return.

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Table 1 – Public utilities’ fees, 2001 and 2002

	2001	2002
Telephone (1)		
Monthly rental	13.3	4.4
Local call (2 minutes or fraction)	0.0469	0.0156
Drinkable water and sewerage (2)		
Price of each m ³	0.33	0.11
Average bill per month, per connection	13.13	4.56
Electricity (3)		
Residential price, fixed charge	4.66	1.57
Residential price, per Mwh	0.0755	0.0248
Natural gas (4)		
Residential price, fixed charge	7.74	2.58
Residential price, per m ³	0.150	0.0504

Source: (1) Telefonica S.A. residential prices for a fixed line. (2) Aguas Argentinas S.A. residential tariffs. (3) EDENOR S.A. residential tariffs. (4) METROGAS S.A. residential tariff.

Note: figures are in US dollars.

Table 2
Passenger rail structure in Greater Buenos Aires

#	Line	Concessionaire	Started	Duration (as in contract)
1.	Mitre (188.9 km)	Trenes de Buenos Aires (TBA)	05/27/95	10 years
2.	Sarmiento (176.1 km)	Trenes de Buenos Aires (TBA)	05/27/95	10 years
3.	Urquiza (28.2 km) and Subway(43.9 km)	Metrovías S.A.	01/01/94	20 years
4.	Roca (304.5 km)	Transporte Metropolitano Roca S.A.	01/01/95	10 years
5.	San Martin (57.8 km)	Transporte Metropolitano Gral San Martín S.A.	01/05/94	10 years
6.	Belgrano Norte	Ferrovías S.A.	01/04/94	10 years
7.	Belgrano Sur	Transporte Metropolitano Belgrano Sur S.A.	01/05/94	10 years

Source: FIEL (1999) and others.

Table 3
Net Profits – Aguas Argentinas S.A.

	2000	2001	2002	2003	2004
Exchange rate	1.00	1.00	3.17	2.97	2.95
Profits (thousands \$)	85,061	161,211	-832,726	148,122	13,839
Profits (thousands U\$S)	85,061	161,211	-262,966	49,887	4,687

Source: Poder Ciudadano, Banco de datos de Empresas de Servicios Públicos

http://www.poderciudadano.org/up_downloads/temas/65_1.pdf?PHPSESSID=4f0333dc07110ce1054a488b6c0df859

Figure 1
Electricity and Natural Gas, residential fees. 1993=1

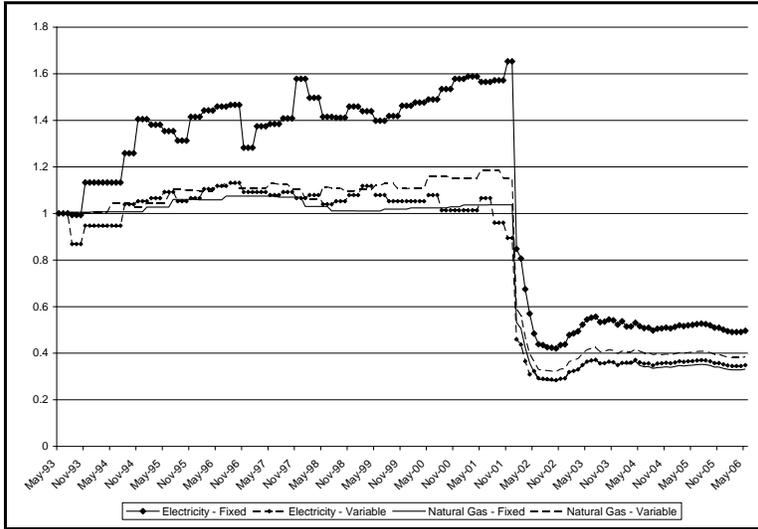


Figure 2
Local call and water, residential fees. 1993=1

