

From Privatization to Re-nationalization: What went Wrong with Privatizations in Argentina?

WERNER BAER & GABRIEL MONTES-ROJAS

ABSTRACT *The privatization process in Argentina is analysed. Beginning with a very ambitious programme, 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-privatization and re-nationalization of many services. The pro- and anti-privatization arguments are reviewed, using empirical evidence from Argentina. An in-depth study is also provided of the three sectors where this negotiation was most intense: the railways, water and sewerage and postal services.*

1. Introduction

The role of the state in the provision of public services has changed dramatically 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-industrialization (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 owing to: (a) the use of state enterprises as macroeconomic policy instruments; (b) political pressure to overemploy labour; (c) corruption; and (d) the

Werner Baer, University of Illinois at Urbana-Champaign, 218 David Kinley Hall, MC 706, 1206 S. Sixth Street, Champaign, IL 61820, USA. Email: wbaer@uiuc.edu. Gabriel Montes-Rojas, University of Illinois at Urbana-Champaign, USA, and City University London, UK.

Research for this article was supported by the Tinker Foundation. We are in debt to Diego Petrecollo, Santiago Urbitzondo and Marcelo Ramal for helpful discussions in Argentina and to an anonymous referee for constructive comments and suggestions.

ISSN 1360-0818 print/ISSN 1469-9966 online/08/030323-15

© 2008 International Development Centre, Oxford

DOI: 10.1080/13600810802264456

use of public enterprises to borrow more than they needed on the international market (see Amann & Baer, 2005).

At the beginning of the 1990s a strong consensus emerged regarding the benefits of privatization.¹ In particular, privatization 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 policy-makers were gradually persuaded of these benefits and initiated a massive process of privatization.

Argentina provides one of the most dramatic examples, because of the scale of its privatization 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 privatization started, a substantial controversy arose over its impact. Although Sirtaine *et al.* (2005) concluded that, contrary to public perceptions, the financial returns to private infrastructure concessions had been mediocre, other authors found that privatized enterprises were extremely profitable (Azpiazu, 2002). Moreover, whereas some studies concluded that households benefited from this process and efficiency gains occurred in most sectors (e.g. Chisari *et al.*, 1999), opposite conclusions were drawn from different lines of research (e.g. Basualdo *et al.*, 2002).

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

The criteria used to evaluate individual privatization 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 (e.g. investment in new infrastructure, increase in the number of clients); (b) whether more efficient services were provided (e.g. 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 privatizations and what can be done to achieve their original goals. With that objective in mind, we analyse those sectors where re-nationalization or re-privatization occurred, e.g. railways, water and sewerage and postal services.

The paper is organized as follows. Section 2 presents two views about the process: one sees it as the result of state mismanagement and draws positive conclusions, whereas the other emphasizes 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 continuing at present. 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 privatizations in Argentina are presented in Section 8.

2. The Privatization Process: Two Views

2.1 Pro-privatization Arguments

Privatization of SOEs was one of the key components of the “Washington Consensus”, a term used to summarize the neo-liberal economic policies of the late 1980s and the beginning of the 1990s.² In certain economic circles privatization was viewed as a solution to many Latin American problems. For instance, the IFC (1995) stated that the fact “[T]hat privatization 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 privatized 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 *et al.*, 1993; Shapiro & 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 *et al.*, 1992);
- (6) increasing domestic stock ownership (Suleiman & Waterbury, 1990);
- (7) attracting domestic and foreign investment (Vernon, 1991).

Some empirical studies have shown that, after being privatized, many SOEs increased real sales, becoming more profitable and increasing investment and employment (Megginson *et al.*, 1994; Adam *et al.*, 1992). However, at the time privatizations were carried out, they were adopted largely on faith, not empirical evidence.³

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 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 & 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 1989,⁴ rapidly adopted neo-liberal policies. The State-Reform Bill (Ley 23,696) declared several public services subject to privatization, and it authorized the national government to undertake the necessary steps to carry this out.

2.2 Arguments Against Privatization

Other authors (e.g. Basualdo *et al.*, 2002) explain the process from a different perspective. They emphasize the similarities between the policies implemented under the Menem

administration and the last military government (1976–83). Privatization was the result of increasing pressure to accomplish two different objectives: servicing the external debt and subsidizing 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 nationalization 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, privatizations benefited three different groups (Basualdo *et al.*, 2002): the “*patria contratista*”, who contributed to management and local lobbying; foreign and domestic banks, which provided undervalued government bonds that were recognized 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. Azpiazu (2002) showed that, from 1993 to 2000, 26 concessionaires among the 200 biggest national firms received 56.8% 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 privatisation.⁵ A documented example of this was telephones: their management before privatization was plagued with corruption and services deteriorated significantly (Seoane, 2003), while at the same time tariffs were increased substantially to set a “competitive” floor to concessionaires.

Petrecolla *et al.* (1993) stated 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 also 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 20–40% 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 privatization 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, privatization resulted in a deterioration of their influence. Suleiman & Waterbury (1990) associated the political objective of privatizations 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)".⁶

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 have been studied extensively by FIEL (1999) and CEER (2001). Opinions varied as to whether the regulatory framework was weak and, if so, what the causes of this were.

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 privatization process. In many cases, the future concessionaires provided the research expertise for the construction of the new regulatory framework. Moreover, there was no explicit co-ordination among regulatory agencies (Petrecolla, 2001).

Other authors emphasize that the weak regulatory environment was the result of the "institutional capture" of the state (Aspiazu, 2001, 2002). A major example of this was the indexation that concessionaires were allowed to apply to tariffs, while the Convertibility Law explicitly prohibited this.⁷ Many other "regulatory asymmetries" existed, in proportion to the lobbying power of each group. FIEL (1999) concluded 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 renegotiation 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 (US 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 (e.g. 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 multiple tariff adjustments, which undermined those gains (Petrecolla, 2001; Thwaites Rey & López, 2001). On the other hand, water transportation and railways had a hybrid mechanism that was based mainly 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 mobilization, 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 privatized 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, the average tariffs in dollars in 2001 (pre-devaluation) and 2002 (post-devaluation) are calculated. 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.

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 privatized enterprises, although in general every privatized firm showed negative profits in the last quarter of 2001 and in 2002.⁸

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 that controlled them. For instance, French firms occupied the

Table 1. Public utilities' fees, 2001 and 2002 (in US dollars)

	2001	2002
<i>Telephone</i> ^a		
Monthly rental	13.3	4.4
Local call (2 minutes or fraction)	0.0469	0.0156
<i>Drinkable water and sewerage</i> ^b		
Price of each m ³	0.33	0.11
Average bill per month, per connection	13.13	4.56
<i>Electricity</i> ^c		
Residential price, fixed charge	4.66	1.57
Residential price, per MW h	0.0755	0.0248
<i>Natural gas</i> ^d		
Residential price, fixed charge	7.74	2.58
Residential price, per m ³	0.150	0.0504

Sources: ^aTelefonica S.A. residential prices for a fixed line; ^bAguas Argentinas S.A. residential tariffs; ^cEDENOR S.A. residential tariffs; ^dMETROGAS S.A. residential tariff.

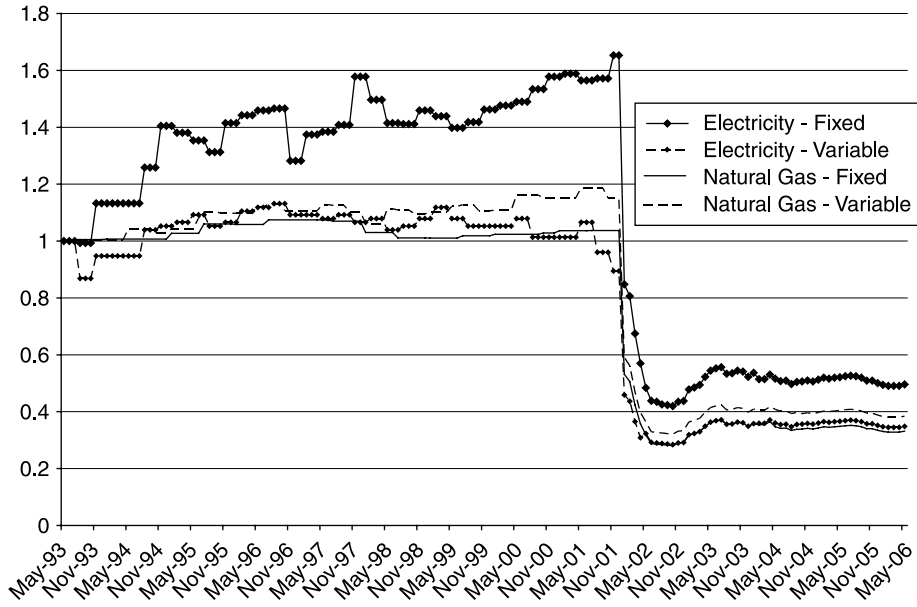


Figure 1. Electricity and Natural Gas, residential fees. 1993 = 1.

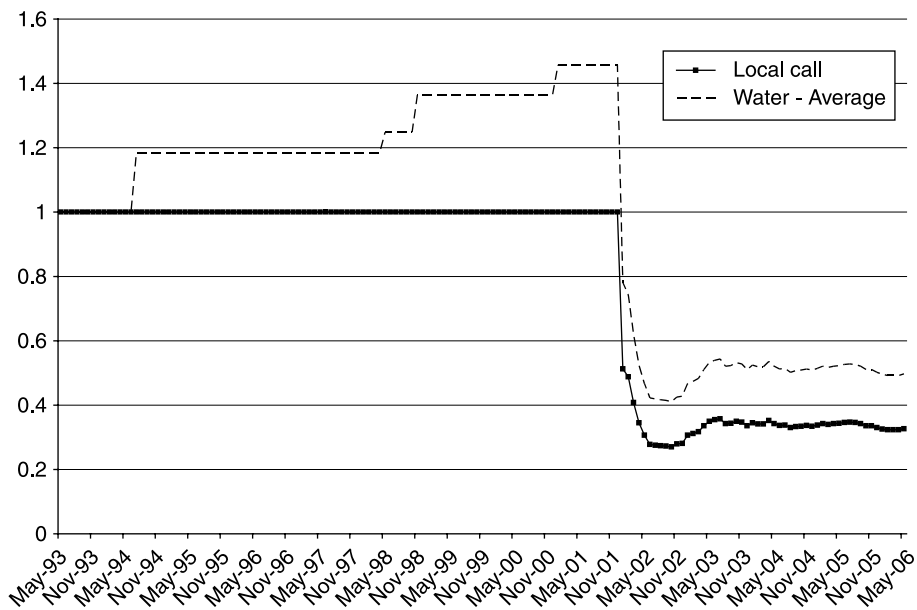


Figure 2. Local call and water, residential fees. 1993 = 1.

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 privatized telephone companies. Second, Suez left Aguas de Santa Fé and lost the concession of Aguas Argentinas S.A., water and sewerage of Buenos Aires,⁹ in 2006. Third, Electricité de France abandoned the control of Edenor (electric services in Buenos Aires).¹⁰ 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 towards the government.

Many public utility enterprises used coercion (cutting production and quality) as a negotiation tool,¹¹ 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 US\$16 billion in compensation from the state for "pesification" and the rate freeze.¹²

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 modernizing Argentina. Until their nationalization by President Juan D. Peron in 1948,¹³ their services were oriented exclusively towards 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 subsidized 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 characterized 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 & 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 million was provided for its functioning (FIEL, 1999).

A serious attempt to start privatization was made by President Alfonsín (1983–89), although opposition coming from the Peronist party aborted the action. Ironically, it was the Peronists who undertook the most ambitious privatization process when they reached government. In August 1989, Annex 1 of the State-Reform Bill (Ley 23,696) stated that railways and subways were to be partially or totally privatized. 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 1800 trains carrying over 1 million passengers each business day. The government-designated packages are shown in Table 2.

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

Table 2. Passenger rail structure in Greater Buenos Aires

No.	Line	Concessionaire	Started	Duration (as in contract) (years)
1.	Mitre (188.9 km)	Trenes de Buenos Aires (TBA)	27 May 1995	10
2.	Sarmiento (176.1 km)	Trenes de Buenos Aires (TBA)	27 May 1995	10
3.	Urquiza (28.2 km) and Subway(43.9 km)	Metrovías S.A.	1 January 1994	20
4.	Roca (304.5 km)	Transporte Metropolitano Roca S.A.	1 January 1995	10
5.	San Martín (57.8 km)	Transporte Metropolitano Gral San Martín S.A.	5 January 1994	10
6.	Belgrano Norte	Ferrovías S.A.	4 January 1994	10
7.	Belgrano Sur	Transporte Metropolitano Belgrano Sur S.A.	5 January 1994	10

Source: FIEL (1999) and others.

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; FIEL, 1999). (1) The services were privatized through a 10-year concession (20 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 6 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 privatization showed an improvement in the quality and quantity of services, which attracted passengers who had been crowded out (FIEL, 1999; CEER, 2001). The amount of the subsidy diminished to one-third of the historical amount in the first 3 years, although it would rise again. In this respect, we see great variation in performance. Some services (e.g. Subway, Metrovías S.A.) changed from receiving a subsidy to paying a positive amount to the state, whereas others were unable to make this transition. At the same time, lines that 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 non-governmental organizations (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-General¹⁴ 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, which 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 Martín 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” (Página/12, 23 April 2005) for this situation, despite the increments in the subsidy provided by Presidents Duhalde and Kirchner.

In 2004, the national government reacquired 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 nationalization (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. As it constituted a considerable burden to the Treasury, this service was included in the privatization scheme. The publicly owned firm was broken-up geographically into several firms. In order to accelerate privatization, 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 30 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 the 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 6-year term, with the option of one renewable term. FIEL

(1999) emphasized 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% 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% average annual rate of return, far higher than is “acceptable or normal” for the water industry in other countries. In the USA, for example, water companies earned between 6 and 12.5% in 1991. In the UK a reasonable rate of profit for the sector is between 6 and 7%. In France, 6% 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% of its contract commitments for improvement and expansion of services, resulting in massive pollution. Aguas Argentinas’s 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 US\$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 provides

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 (thousand US\$)	85 061	161 211	− 832 726	148 122	13 839
Profits (thousand US\$)	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.

only maintenance because “water is not a profitable business”.¹⁵ In 2006, the state cancelled the concession and reacquired control of Aguas Argentinas (Decreto 303/2006). Moreover, ETOSS was dissolved in 2007 and a new regulatory agency is being created.

7. Postal Services

In 1997 (Decreto 840/1997), the postal service, one of the most emblematic public services, was privatized 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, although prices increased considerably. From 1999 the private firm stopped paying the fee stipulated by the contract. In November 2003 (Decreto 1075/2003) the state cancelled the concession and regained control. This sector underwent the latest privatization, but it also existed for the shortest time.

In this case, privatization 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 paid only for the first two periods (September 1997–February 1998 and March 1998–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-nationalization of the postal services.

8. Conclusions: What went Wrong with Privatizations?

The privatization of public services was intended to replace state management by market-oriented enterprises, which would realize 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 unwilling to operate in Argentina with reduced profit margins. As a result of their link with the regulatory agencies, some of the privatized public utilities were extremely lucrative (e.g. telephone companies, petroleum, etc.), whereas others depended totally on the state for their profitability (e.g. railways, water and postal services).

Some of the original objectives of privatization were achieved. In particular, productivity increased considerably (amid massive layoffs) and new technologies were adopted by newly privatized 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 privatization 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, privatized firms discontinued their investment plans and provided services only to established clients, awaiting a restoration of their previous profit levels. Services deteriorated to before-privatization levels and public discontent emerged. As 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 privatization 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 changed dramatically 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 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 towards privatization changed.

As this article has shown, the process of privatization 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; and (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 privatization of public utilities can occur only with a strong and independent regulatory authority, allowing for a reasonable long-term rate of return.

Notes

¹ Argentina, like many other Latin American countries that 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 privatization of public enterprises.

² John Williamson (1990) summarized the contents of this consensus: fiscal discipline; redirect public expenditure; tax reform; financial liberalization; adopt a single, competitive exchange rate; trade liberalization; eliminate barriers to foreign direct investment; privatize state-owned enterprises; deregulate market entry and competition; and ensure secure property rights.

³ Most privatization knowledge was based either on the UK experience or that of a few developing countries (e.g. Chile).

⁴ President Carlos Menem was in office for two consecutive periods: 1989–95 and 1995–99.

⁵ Petrecola *et al.* (1993) put it 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 privatization ... [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).

- ⁶ It is worth mentioning that dismantling of the labour 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.
- ⁷ While the Convertibility Law was sanctioned in April 1991 and indexation was explicitly prohibited, another law (Decreto 2585/91) allowed telecom companies to follow the US 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.
- ⁸ For instance, Edenor S.A., one of the two biggest privatized electricity companies, showed losses due to the devaluation and crisis of about US\$330 million, 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, declared a loss of US\$400 associated with the devaluation (Press Office, Aguas Argentinas S.A.).
- ⁹ In February 2003 the water and sewage concession in the capital of the Philippines, of which Suez owned over 20%, was terminated. In March 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's water management subsidiary, pulled out of what was to have been a 10-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).
- ¹⁰ Electricité 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).
- ¹¹ 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 of cheap maintenance inputs (Clarín, 25 August 2005). See later for the performance of railways after the devaluation.
- ¹² For a list of pending cases, see <http://www.worldbank.org/icsid/cases/pending.htm>.
- ¹³ The nationalization merged more than 15 private railways into size relatively independent companies with track networks.
- ¹⁴ The following web site has a summary: http://www1.hcdn.gov.ar/dependencias/ari/Informes/informe_ferrocarriles.pdf.
- ¹⁵ Página/12, 27 June 2005.

References

- Adam, C., Cavendish, W. & Mistry, P. S. (Eds) (1992) *Adjusting Privatization. Case Studies from Developing Countries* (London: James Currey).
- Amann, E. & Baer, W. (2005) From the development to the regulatory state: the transformation of the government's impact on the Brazilian economy, *The Quarterly Review of Economics and Finance*, 45, p. 421–431.
- Azpiazu, D. (2001) Inequidades normativas, rentas de privilegio y asignaturas pendientes, *Enoikos*, 17, pp. 14–19.
- Azpiazu, D. (2002) Privatizaciones en la Argentina. La captura institucional del Estado, *Realidad Económica*, 189, <http://www.iade.org.ar/modules/noticias/article.php?storyid=422>.
- Baer, W. (1994) Privatization in Latin America, *The World Economy*, 17, pp. 509–528.
- Basualdo, E. (2001) Las privatizaciones en la valorización financiera de los grupos económicos, *Enoikos*, 17, pp. 14–19.
- Basualdo, E., Aspiazu, D., Abeles, M., Arza, C., Porcinito, K., Pesce, J. & Schorr, M. (2002) *El Proceso de Privatización en Argentina, la Renegociación con las Empresas Privatizadas* (Quilmes, Argentina: Universidad de Quilmes Ediciones).
- Beesley, M. & Littlechild, S. (1994) Privatization: principles, problems and priorities, in: K. Bishop, J. Kay & C. Mayer (Eds) *Privatization and Economic Performance* (Oxford: Oxford University Press).
- Benedetti, A. (2002) Argentina ¿País sin ferrocarril? *Realidad Económica*, p. 185.

- Boycko, M., Shleifer, A. & Vishny, R. (1993) *A Theory of Privatization* (Cambridge, MA: The MIT Press).
- Catenazzi, A. (2001) Privatización y universalidad. La posprivatización de Obras Sanitarias de la Nación, *Enoikos*, 7, pp. 59–65.
- CEER (2001) *Las Empresas Privadas de Servicios Públicos en la Argentina. Un Análisis de su Contribución a la Competitividad del País* (Buenos Aires: UADE).
- Chisari, O., Estache, O. & Romero, C. (1999) Winners and losers of privatization and regulation of utilities: lesson from a general equilibrium model of Argentina, *The World Bank Economic Review*, 13, pp. 357–378.
- Felder, R. (1994) El estado se baja del tren: la política ferroviaria del gobierno menemista. La reestructuración de los ferrocarriles: particularidades, perspectivas, *Realidad Económica*, p. 123.
- FIEL (1987) *The Failure of Statism. A Proposal for Reform of the Argentina Public Sector* (Buenos Aires: Sudamericana-Planeta).
- FIEL (1999) *La Regulación de la Competencia y de los Servicios Públicos. Teoría y Experiencia Argentina Reciente* (Buenos Aires: Sudamericana-Planeta).
- Hacher, S. (2004) *Argentina Water Privatization Scheme Runs Dry*, available at: <http://www.corpwatch.org/article.php?id=10088>
- IFC (International Finance Corporation) (1995) *Privatization: Principles and Practices* (Washington, DC: IFC).
- Kogan, J. H. & Thompson, L. (1994) Reshaping Argentina's railways, *Japan Railway & Transport Review*, 2, pp. 23–29.
- Meggison, W., Nash, R. & van Randerborgh, M. (1994) The Financial and Operating Performance of Newly Privatized Firms: An International Empirical Analysis, *Journal of Finance*, 49, pp. 403–452.
- Petrecolla, A., Porto, A. & Gerchunoff, P. (1993) Privatization in Argentina, *The Quarterly Review of Economic and Finance*, 33, pp. 67–93.
- Petrecolla, D. (2001) Defensa de la competencia, *Enoikos*, 17, pp. 49–52.
- Ramal, M. (2005) Al rescate del proceso privatizador. La naturaleza de la “nueva reforma del Estado”, Quilmes, Argentina, Universidad Nacional de Quilmes.
- Savas, E. S. (1987) *Privatization: The Key to Better Government* (Chatham, NJ: Chatham House).
- Schvarzer, J. (1998) *Implantacion de Un Modelo Economico: La Experiencia Argentina Entre 1975 y El 2000* (Buenos Aires: AZ Editores).
- Seoane, M. (2003) *El Saqueo de la Argentina* (Buenos Aires: Sudamericana).
- Shapiro, C. & Willig, R. (1990) Economic rationales for the scope of privatization, in: E. Suleiman & J. Waterbury (Eds) *The Political Economy of Public Sector Reform and Privatization* (London: Westview Press).
- Sirtaine, S., Pinglo, M. E., Guasch, J. L. & Foster, V. (2005) How profitable are infrastructure concessions in Latin America? Empirical evidence and regulatory implications, *Trends and Policy Options* (Washington, DC: The World Bank).
- Suleiman, E. N. & Waterbury, J. (1990) Introduction, in: E. Suleiman & J. Waterbury (Eds) *The Political Economy of Public Sector Reform and Privatization* (London: Westview Press).
- Thwaites Rey, M. & López, A. M. (2001) Los fines de la regulación. “Oportunistas” y clientes en el sistema, *Enoikos*, 17, pp. 20–26.
- van der Berg, C. (2000) Water concessions. Who wins, who loses and what to do about it, *Public Policy for the Private Sector*, p. 217.
- Vernon, R. (1991) A technical approach to privatization issues: coupling project analysis with rules of thumb, in: R. Ramamurti & R. Vernon (Eds) *Privatization and Control of State-owned Enterprises* (Washington, DC: Economic Development Institute, The World Bank).
- Williamson, J. (Ed.) (1990) *Latin American Adjustment: How Much has Happened* (Washington, DC: Institute for International Economics).

Copyright of Oxford Development Studies is the property of Routledge and its content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.