

# Water Services in the Metropolitan Area of Buenos Aires: How Does State Regulation Work?

Mariela Verónica Rocca\*

## Abstract

This article studies the State regulation of drinking water and sanitation services in the Metropolitan Area of Buenos Aires. Its main objective is to find continuities and ruptures in State regulation in the transition from private management (1993-2006) to renationalization and State management (since 2006).

We use the concept of “State capacities” (both administrative and relational) to assess regulatory performance. In terms of administrative capacities, we examine the correspondence between the design and the resources of the agencies, as well as the differences between their formal functions and actual practices. Regarding relational capacities, we consider the policies of the National Executive Power (NEP) and its interaction with both the water and sanitation companies and the regulatory and control agencies.

Our analysis is based on official documents, legislation and statistics, company balance sheets and reports, newspaper articles and semi-structured interviews.

**Keywords:** drinking water and sanitation services - State capacities - State regulation – renationalization.

## Introduction

After the crisis of the Welfare State, State intervention in public utilities was dramatically restructured worldwide. The State no longer acted as the supplier of public utilities and offered their management to private operators. In that way the State limited its role to regulatory and control functions. The rationale underlying this restructuring was that the operation of public utilities would recreate competition in the market rather than replace it. Following these assumptions, the production and supply of water and sanitation services were transferred to private operators but competition was not fostered in the sector. In most of the cases, the monopolistic nature of the service was maintained.

Said nature called for a strong State regulation of the supply as the utilities were now in the hands of private operators. However, the regulatory architecture was not as effective. As a result, private companies made extraordinary profits in a context characterized by: asymmetric information problems, the lack of

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\*PhD in Social Sciences, University of Buenos Aires (UBA). Postdoctoral Fellow, Conicet – FLACSO. I want to thank Ruth Felder who read and edited early drafts of this article. Her comments and suggestions were invaluable. I remain responsible for the errors and omissions in the argument and in the text.

transparency and accountability in decision-making, corruption and weak regulatory agencies. The well-being of the population and environmental protection were overlooked (Hall 2002; Hall & Lobina 2002, 2006; Lobina & Hall 2003; Castro 2004 and Vargas & Seppälä 2004).

In countries where the water supplies have undergone this process, increased rates in the services were justified as a means to finance investments that did not ultimately materialize. In addition, recurrent contract renegotiations have resulted in cancellations or delays in mandatory investments. Infrastructure investments have been limited to maintenance and improvements mainly take place in the commercial aspects of the supply (Castro 2004).

At the beginning of this century, several international water operators were exiting the Latin American region. As a consequence, several public utilities were renationalized (Ducci 2007). In the Metropolitan Area of Buenos Aires, the concession was rescinded in March 2006 and the company Argentine Water and Sanitation Services Inc. (AWSS) [*Agua y Saneamientos Argentinos S.A.*] was created by the State.

The article focuses on a) the creation of AWSS and its performance (e.g. financial results, coverage levels, investments, among others) and b) the regulatory design that accompanied the renationalization and how it works (e.g. the regulatory framework, the price structure, and the regulatory agencies). We also examine the continuities and ruptures in regulatory practices from the period of private operation (May 1993-March 2006) to the present.

From a sociopolitical perspective, we use to the concept of “State capacities” (both administrative and relational) to analyze State regulatory performance. To assess administrative capacities we discuss the correspondence between the design and agencies’ resources and the differences between formal functions and actual agencies’ practices. We also examine the policies of the National Executive Power (NEP) and its interaction with AWSS and the regulatory and control agencies to evaluate relational capacities. In addition, we identify existing power resources to understand actors’ behavior, their strategies and their influence on service operation. We recognize the State’s power resources as a) the legal framework to manage the service, b) the negotiation skills with non-State actors and c) the political objectives of the service. With respect to social actors, we identify a) their alliance capabilities and b) their cooperative or confrontational positions towards State agencies.

The analysis is based on official documents, legislation and statistics, company balance sheets and reports, newspaper articles and semi-structured interviews.

This article is organized into five sections. In Section 1, we discuss the concept of State capacity. Section 2 focuses on the creation of AWSS: the legislative debate and the formal aspects of its design. Section 3 characterizes the new regulatory framework and compares it to the previous scheme. Section 4 examines how State regulation currently works. Finally, Section 5 concludes.

## 1. State Capacities under Discussion

When structural reforms were implemented around the world, the literature began to focus on the importance of the State regulation of markets. Scholars have argued that State regulation is necessary but that regulatory interventions are not always effective. That is why many authors have developed theoretical arguments and empirical studies about the nature of the necessary State capacities to adequately fulfill the regulatory responsibilities (Oszlak & Orellana, 1991; Tobelem 1992; Hilderbrand & Grindle 1994; Grindle 1996; Hall 2002; Mizrahi 2004, etc.).

Based on general arguments of the above-mentioned studies, this article also draws from Palermo (1998), Alonso (2007) and Repetto (2007) who call attention to the need to study the political dimensions of State regulation in addition to considering administrative capacities. In their view, the examination of actors' interests, resources and strategies sheds light on the actors' voice and veto power in public policy definitions. Political dimensions are of a relational nature and refer to the "specific interactions between State and social actors in certain policy networks" (Alonso, 2007: 13). Likewise, Palermo (1998: 12) points out that "[...] political analysis is essential for studying State capacities, because [...] politics] will be the main support for decision and design".

Administrative capacities include competences and skills associated with State bureaucracy and its performance. Organizations require a qualified staff and "a professional ethos that promotes a prestigious public sector career" (Alonso, 2007: 20). In addition, it takes into account inter-institutional relations and the coordination between technical and political levels. Relational capacities refer to the relationship between State agencies and socio-economic actors. Regarding the institutional and organizational context, the relational analysis focuses on social actors' veto opportunities and the State's actions to discourage them (Alonso, 2007). Social actors' preferences, interests and power resources must also be contemplated in order to analyze the possibilities and limits of State policies. Alonso (2007: 33) says "[...] the historical path of a particular political arena determines institutional changes. [This historical path] does not only illuminate pre-existing institutional arrangements but also shows how much capacity [each actor, including the State] has [...] to adapt, block or interact with in the process of setting of new rules".

To study administrative capacities, Alonso's analytical proposal includes the notion of "capacity gaps". Taking into consideration other authors' concepts (Oszlak & Orellana 1991; Tobelem 1992; Palermo 1998), the author (2007) classifies possible capacity gaps at two different levels: a macro-institutional level that refers to the existence or absence of an institutional framework (formal and informal rules that encourage certain actors' behaviors) and a micro-institutional level at which organizational capacities are considered. Alonso (2007) distinguishes three kinds of capacity gaps in the macro-institutional environment and two in the micro one.

We identify the following gaps in the macro-institutional environment: 1) political-institutional gaps, 2) gaps in inter-agency relationships, and 3) gaps in the public service career. The first one refers to the institutional framework (the political regime, the Constitution, the regulatory structures, and the informal rules based on cultural patterns) that can restrict or facilitate policy execution. An analysis of these capacities allows us to distinguish possible incompatibilities between proposed objectives and implementation. The second type of gap is linked to coordination failures as a result of agencies' ambiguous or overlapping responsibilities. These situations lead to an inefficient use of resources and adversely affect policy implementation. The key to coordinate the agencies' work is to assess the adequacy of the legal framework (formal and informal rules) that rules their activities. The last type of gap is related to the difficulty of consolidating stable and competent administrative bodies in light of governmental changes. The professionalization of agencies is seriously hindered by political discontinuity, inappropriate incentives for government officials and unrestrictive rules. These conditions lead to the constant rotation of technicians and professionals.

Alonso (2007) recognizes two gaps in the micro-institutional environment: one in internal organization and the other in skills and knowledge. The first category refers to the distance between the formal organization (organization chart) and informal networks. A big difference between them can seriously affect an agency's performance. Another aspect that must be analyzed is the formalization of procedures in technical manuals. Accurate manuals help to improve the quality of the task distribution system, the flow of information between different subunits and the decision-making structures (Alonso, 2007). The lack of adequate funding, equipment or physical space can seriously reduce the agency's capacities. The second type of micro-institutional gap refers to deficits in information and skills (e.g. managerial abilities and professional competences) that tend to shape a hostile institutional environment (Alonso, 2007).

As we mentioned before, the analysis of the relational dimension includes the study of the existing resources. State capacity depends on its own resources and on those of other actors. Thus, the analysis of available resources should be considered together with the way in which actors evaluate them and consequently develop their strategies. In this line, Alonso (2007) classifies power resources in four types: a) structural-economic resources, which refer to the structural context where actors interact; b) organizational resources that enable collective action; c) institutional resources – rules, institutions and practices that create the conditions for leverage in different political arenas; and d) information resources, which are related to the control of information flow.

To explain the logic of action and exchanges between the State and social actors, Alonso (2007) uses the concept of "policy network" that refers to the embodiment of previous political decisions where resource exchanges occurred. Policy network analysis does not only offer insights about power configurations and reconfigurations, but also makes it possible to evaluate the effect these interactions have on the outcome of new policies.

Taking these two dimensions into account, Section 3 will address the study of the Argentine State's capacity to regulate drinking water and sanitation services in the Metropolitan Area of Buenos Aires. Capacity gaps will be identified with particular emphasis on two issues. First, we will study the correspondence between the regulatory framework and the agencies' resources. Then, we will analyze the concordance between formal functions and the actual practices of the agencies. The study of the relational dimension will take into account the NEP's decisions by stressing the interaction between the State and social actors, their power resources and strategies. We present the indicators selected for each dimension in the Methodological Annex. Before explaining the results of this analysis, the following section describes the creation of AWSS.

## **2. The Creation of Argentine Water and Sanitation Services**

In May 1993, a thirty-year concession for the drinking water and sanitation services of the Metropolitan Area of Buenos Aires was granted to the private company Argentine Waters Inc. (AW) [Aguas Argentinas S.A.]. The consortium was comprised by Suez Lyonnaise des Eaux-Dumez (25.4%), Aguas de Barcelona S.A. (12.6%), Meller S.A. (10.8%), Banco Galicia y Buenos Aires (8.1%), Compagnie Generale des Eaux S.A. (7.9%), Anglian Water Plc. (4.5%) and the Stock Ownership Program (10%). This concession became one of the largest worldwide with almost ten million residents in an area of approximately 1,800 square kilometers. According to the concession contract, AW was not only responsible for improving the quality, pressure and continuity of the supplies, but also for maintaining and extending the facilities. By the end of the concession, the company agreed to increase the number of residents served with drinking water by 71% and to raise sewage services by 96%.

During AW's management, numerous regulatory changes altered the original contractual clauses and authorized increases in rates that largely exceeded the domestic CPI for the purpose of financing investments. As these investments did not materialize, these new rates ultimately pushed up AW's profits. Between 1993 and 2002 rates grew by 88%. The average bill was AR\$14.56 in May 1993, reaching AR\$27.40 in January 2002 (during these years inflation was close to zero or even negative) (ETOSS 2003). In addition, fixed costs charged to bills made the pricing structure highly regressive. In May 2002, the cost of water and sanitation services represented 1.3% of the income of those in the highest deciles and 9% of the income of those in the lowest deciles.

Only 58% of the mandatory investment goals were met during the first five-year period (1993-1998) under private management. In contrast, 1999-2000 investments met 100% of the commitments specified in the contract for the first two years of the second five-year period (1999-2003). This occurred because planned adjustments in investment commitments were delayed for two years and works were approved ex-post. The execution level fell to 62% in 2001 and to 19% in 2002, which represents 37% of the promised investments for the period 2001-2002. From 1993 to 2002, the expansion in drinking water service coverage only reached 79% of the population against 88% estimated in the contract. The sewage service only reached 63%, when 74% had initially been

estimated. The treatment of sewer fluids registered the largest level of noncompliance, standing at 7%, while the contract had been set at 74% for 2002. Investments in infrastructure renewal fell short of the goal to reduce the high number of leaks. Low water pressure problems affected almost 70% of the water supply network (ETOSS 2003).

By contrast, AW's profitability showed a significant increase between 1994 and 2001. The company's profits averaged a 20% growth. This percentage reveals the privileged situation in which its operations took place since it was considerably superior to the 11.21% estimated in its bid and to those considered acceptable in the United States (6.5%-12.5%), the United Kingdom (6%-7%) and France (6%) (Phillips 1993). In addition to these exceptional profits, AW borrowed internationally, taking advantage of interest rate differentials between Argentine and international interest rates during most of the 1990s. Its large external debt would be highly consequential in the following decade. Azpiazu et al. (2005) explained that at the beginning of 2002 the company's debt was about US\$ 650 million (almost 20 times its net equity) with payment commitments of US\$ 215 million for that year and US\$ 109 million for 2003.

Given the serious social, political and economic turmoil in late 2001, in January 2002, provisional President Eduardo Duhalde put an end to the Convertibility regime (a regime with a nominal exchange rate fixed at AR\$ 1 = US\$ 1) and allowed the currency to depreciate.<sup>1</sup> Likewise, the so-called Public Emergency and Reform of Exchange Regime Law (No. 25,561) was enacted in 2002. It mandated the "pesification" of several dollarized prices and prohibited indexation clauses from being included in the Public Administration's contracts. The NEP was also authorized to renegotiate contracts, including those of the privatized public utilities. Rates would not change until contracts had been fully revised.

The renegotiation of AW's contract gave the State the chance to change a number of policies that had preserved the company's benefits without considering the interests of the consumers. As we previously explained, AW's performance was characterized by its non-fulfillment of investment commitments, high profitability and a discretionary endowment policy. Nevertheless, the company demanded large compensations from the Argentine government in order to maintain its original economic stability. The concession contract included a specific clause that would compensate the company should any changes in costs or other variables affect its balance sheets. To this end, AW filed a petition with the World Bank's International Centre for Settlement of Investment Disputes (ICSID). To strengthen its position in the negotiation, the company counted with the support of the French government and multilateral lending agencies.

From the beginning of the renegotiation process, the rescindment of the contract was no option for the government. The NEP wanted AW to keep the concession but it would participate in the development of the services'

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<sup>1</sup>The Argentine economy defaulted on January 3, 2002 when the country could not meet its external debt payments.

infrastructure. On May 11, 2004, the State and AW signed a letter of intent that guaranteed favorable conditions to negotiate the final contract. Both parties were committed to making new investments and freezing the rates until December 2004. The NEP also agreed to suspend fines totalling AR\$10 million and AW withdrew its petition before the ICSID. In this regard, the Argentine external debt negotiation was a key factor that explained the outcome of the agreement. As it was necessary to resolve the *default*, AW's irregular service conditions were left aside. The company's interests were preserved in exchange for the French government's support with the International Monetary Fund Board.

Once the letter of intent had expired and in accordance with the debt swap in 2005, the renegotiation process froze. Eventually, AW's shareholders lost interest in running the company as a result of the new contract conditions and unfavorable economic-financial results. Suez was exiting Latin America and beginning to invest in gas and electricity markets in China, Algeria and some countries in the Persian Gulf. Nevertheless, AW's foreign shareholders decided to sue the Argentine State in local courts and continued to challenge it before the ICSID. On July 30, 2010, the ICSID ruled in favor of the claimants (Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A.). It pointed out that the Argentine State had not offered a "fair and equitable treatment" of the company's investments. To date, the ICSID's finding has not concluded. The amount of money Argentina will have to pay has yet to be determined. While the claimants have to estimate their losses, Argentina can request the revision or annulment of the award.

When negotiations with AW to sign a new agreement failed, the government attempted to find new investors to replace Suez. But the company's large external debt and the freeze on rates imposed by the government in 2002 discouraged potential investors. Thus, in 2006 the government rescinded the concession contract (Decree No. 303/06, March 2006). Rather than admitting that negotiations had collapsed the NEP justified the annulment claiming excessive nitrate levels and insufficient coverage that affected consumers' rights and health. Indeed, sanitary risks related to excessive nitrate levels and insufficient coverage already existed when the letter of intent was signed in May 2004. But these claims were only considered a cause for rescission as there was no alternative but to keep the company running.

Decree No. 304/06 and Law No. 26,100, formally created AWSS, a State-owned public limited company (90% of the shares belong to the State – non-transferable capital – and 10% to the employees, through a Stock Ownership Program). The partnership would last for 99 years and this period could be reduced or extended at an extraordinary shareholder meeting. AWSS maintained AW's organizational structure and also kept all its assets and workers. Its working plan and budget fell under the supervision of the Ministry of Federal Planning, Public Investment and Utilities (MFPPIU) [*Ministerio de Planificación Federal, Inversión Pública y Servicios*].

### **3. The New Regulatory Framework for Water Supply and Sanitation Services**

Before analyzing the new regulatory scheme created in February 2007 (Law No. 26,221), we briefly describe the framework existing during the private management period. From 1993 to 2007 service regulation and control functions were carried out by the Tripartite Water Sanitation Agency (TWSA) [*Ente Tripartito de Obras y Servicios Sanitarios*]. Its creation by decree rather than law reduced its legitimacy and independence. Its independence was especially affected by the way in which its authorities were appointed. As the government could appoint the members of the board, the agency was subject to political pressure. Furthermore, the members could sit on the board for six years with the possibility of one re-election and without any legal restrictions regarding a previous or later job in the concessionaire company. This last aspect created the conditions for pro-company behavior. In addition, as a part of the TWSA's financial resources were derived from a percentage of the rates, the TWSA had no incentives to force the company to reduce them. Finally, the risk of capture was extremely high because it had to monitor a single company with no competition whatsoever. As a result of this weak design a political and institutional capacity gap was clearly visible.

Section 4 explains how the effectiveness of its regulatory actions was seriously limited. The TWSA had serious difficulties imposing sanctions and coordinating its action with that of the political levels of government. The Natural Resources and Sustainable Development Secretariat (NRSDS) [*Secretaría de Recursos Naturales y Desarrollo Sustentable*], which was subordinated to the NEP, regularly interfered with its functions. During the post-Convertibility renegotiation process, the TWSA's role was limited to advising the Renegotiation Committee but it was excluded from the design of the negotiation strategies. When the concession ended, the TWSA did not intervene in the drafting of the decree that cancelled it, nor did it participate in the establishment of a regulatory scheme for the renationalized services.

The new regulatory framework of 2007 ratified the State's responsibility for the supply, maintenance and expansion of the service. It also recognized access to water as a human right and established principles of efficiency and equity as complementary aims. In addition to previous regulatory objectives, it set new goals – efficient delivery, fair and reasonable rates, awareness of water conservation, among others.

Although the regulatory framework was established by law and not by decree, legislative participation and debates were limited. The NEP succeeded in its strategy to obtain urgent congressional approval of the bill. At the end of December 2006, the bill was approved in the Senate with 32 affirmative votes and 13 negative ones. In February 2007, after a brief discussion, the Lower Chamber passed it with 133 affirmative votes and 75 negative votes.

In this new regulatory design we can distinguish three areas: 1) a policy and supervision area, 2) a control area and 3) an audit area. The first one is integrated by the MFPPIU, the Secretariat of Public Works (SPW) [*Secretaría*

*de Obras Públicas*], and the Undersecretariat of Hydric Resources (UHR) [*Subsecretaría de Recursos Hídricos*]. The control area comprises the Water Services Agency (WSA) [*Ente Regulador de Agua y Saneamiento*] and the Planning Agency (PA) [*Agencia de Planificación*]. The audit area includes a Supervisory Committee, composed by two representatives of the National Controller General Office (NCGO) [*Sindicatura General de la Nación*] and one member of the Water Labor Union (WLU) [*Sindicato Gran Buenos Aires de Trabajadores de Obras Sanitarias*]. The National General Audit Office (NGAO) [*Auditoría General de la Nación*] and a group of auditors are both in charge of the external audit.<sup>2</sup>

As to the competence of the authorities, the MFPPIU (through the SPW) is responsible for the creation of regulations (regulatory framework, concession contract, among others) and the approval of action plans and company budgets. The UHR, acting as the implementation authority, is in charge of service policy execution and of regulation and control. Among other tasks it has to: a) comply and enforce the regulatory framework and the concession contract, b) set rates, c) approve AWSS's plans d) overview the company's annual reports, and e) verify rate revisions and action plan adjustments.

The political and institutional capacity gap which could be identified in the TWSA persists in the new regulatory agency. Even though the WSA was established as an autarkic organization, its independence is limited by the MFPPIU. As was mentioned, the UHR has the authority to set rates and expansion goals and to impose sanctions on the company for not meeting its performance standards. Unlike the TWSA, the WSA only has control functions. It is in charge of service quality controls, regulatory accounting, benchmarking implementation and can only impose sanctions on managers.

Although the WSA's board maintains a tripartite composition, the number of representatives on its board has fallen from two to one per jurisdiction. The mandates of these representatives have been reduced from six to four years, but the possibility of reelection for one period has not been eliminated. As board members are appointed by the NEP (two of them require the recommendation of the governments of Buenos Aires City and of Buenos Aires province, respectively), the WSA's management could be swayed by the specific political commitments of its managers. In addition, the president of the board holds a permanent position. From a strictly institutional point of view, this change implies more dependence on the NEP's decisions. Yet, from a political perspective, it guarantees the president's affinity with the NEP's policies.

Regarding the user's participation, the faculties of the Users' Auditing Committee were just as restricted as those of the previous Users' Commission. Not only was it created in the WSA's sphere but its recommendations and opinions were not binding. The new framework also set up four types of controls

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<sup>2</sup>The control of the Argentine State is held by two offices: the National Controller General Office [*Sindicatura General de la Nación*] and the National General Audit Office [*Auditoría General de la Nación*]. The first is in charge of controlling the efficiency of government bodies and is under the sphere of the Executive. As it is responsible for external control, the National General Audit Office collaborates with Congress when writing reports for the Legislative Branch.

over the WSA: a) auditing control in charge of the NCGO; b) an anti-corruption control, under the responsibility of the Anti-corruption Office; c) user defense, exercised by the Ombudsman; and d) management and patrimonial control headed by the NGAO. Finally, its main funds were derived from a percentage (2.67%) of the rate, as was the case of the TWSA.

The PA's role consisted of coordinating the expansion and improvement of the service. This included the development and control of projects, plans, and environmental impact studies. This new agency also had to establish quality goals, approve expansion applications, provide or facilitate public access to service information. Like the WSA, it was an independent and self-financing agency but the fact that its board was presided over by the UHR Undersecretary undermined its independence. The two other board members were nominated by the Governments of Buenos Aires City and the Province and were elected by the NEP. With the exception of the president, board members were appointed for a four-year period with the possibility of reelection for one additional term.

Resources to cover the PA's operating costs largely originated from a percentage of its rates and had to be shared with the WSA. Management and patrimonial control also fell under the responsibility of the NCGO and the NGAO. Unlike the WSA, there was no formal opportunity for users to participate. They were indirectly represented by municipal authorities, who participated in an Advisory Commission.

This formal regime of multiple authorities presented a regulatory fragmentation problem which arose from an inter-agency gap. Some functions between government bodies and control agencies overlapped, in practice reducing the WSA's and PA's faculties. In addition, the new regulatory design tended to centralize decisions in the hands of the Minister of Federal Planning, Public Investment and Utilities.

### **3.1. Service Quality and Coverage**

AWSS provided services in Buenos Aires City and 17 districts of Buenos Aires Province. The company's activities comprised the collection and purification of raw water; the transport, distribution and commercialization of safe drinking water; the collection, transport, treatment, and the disposal and commercialization of sewage, including the drainage of industrial waste. The supply had to comply with standards of continuity, regularity, quality and universality.

As in the previous scheme, proper service standards (coverage and quality) were established in the contract under the name of "binding instrument" (Resolution No. 170/10) and in the regulatory framework. In the event of a quality failure, AWSS had to report it to the WSA immediately and implement the necessary actions to restore the required standards. If unplanned service interruptions occurred, the supply had to be restored as soon as possible. Planned cuts had to be informed if the interruption extended longer than

expected; emergency supplies had to be announced to the affected users. Unlike what happened under private management, AWSS had no obligation to provide a minimum level of water pressure. With regard to sewage effluent treatment and quality, AWSS had to respect UHR standards. Unlike AW, if there was a delay in service payment, the new company could not cut off services to residential and public users.

To guarantee the performance of the services, the new framework mandated the implementation of the Improvement, Operation, Expansion and Maintenance Plans. As occurred with AW, these plans were to be reviewed and evaluated every five years by the MFPPIU. Similarly, a fiduciary fund was created to finance infrastructure expansion. If AWSS did not fulfill these plans, neither sanctions nor contract cancellation would be applied. Rather, AWSS had to work to restore the execution of the plan. As to the sanction regime, two types of penalties were in effect: 1) penalties related to company actions and 2) penalties regarding the performance of the company's top officers. If the delivery was interrupted, the UHR would oblige the company to restore coverage. In case the managers did not abide by their obligations, the WSA was entitled to apply warnings. The UHR could suspend the managers while the NEP had the authority to fire them.

### **3.2 The Rates and the Economic Regime of the Argentine Water and Sanitation Services**

Regarding the economic regime, at least one annual review had to be carried out in order to review and eventually adjust expansion plans. If an extraordinary situation affected the finances of the company, AWSS could request UHR intervention to minimize the negative impact.

Two rate regimes existed: a flat rate and a metered rate. The cadastral system included a bi-monthly basic rate (BBR) composed by: a discount coefficient "K", a zonal coefficient "Z", a general rate for services "TG", a covered built-up area coefficient "SC", and a quality factor of the building "E" added to one-tenth of the total surface of the ground "ST". At the same time, the BBR had a default base value according to the type of user (bi-monthly minimum basic rate)  $[BBR = K * Z * TG * (SC * E + ST / 10); BBR \text{ minimum}]$  (Azpiazu & Forcinito, 2004). In addition to the value-added tax (VAT), a 2.67% was added to this minimum rate to finance control agencies. Metered rates combined the physical size of the building with actual consumption. The rate of the volume of consumed water was added to the bi-monthly minimum charge.

While both regimes had to guarantee universal service and address health and social objectives, no provisions encouraged a rational use of water or a more equitable rate. Only a social rate program had been implemented for vulnerable populations. The rates maintained the same structure as that existing under private management, including fixed charges, which made them highly regressive. By 2009 these charges represented 19% of AWSS's revenues. Although the service was renationalized, the rates remained frozen from the beginning of the renegotiation process in 2002. This situation implied that by

December 2010 AWSS's own current revenues covered only 49% of its current expenses. The rest of its expenditures were financed by State transfers.

### **3.3 Regulating and Controlling Information**

Information about quality, operation and maintenance had to be available to the UHR and control agencies. AWSS was obliged to publish four types of reports: 1) a report on service standards, 2) an annual report, 3) periodic reports, and 4) additional reports. Its report on service standards had to state the objectives that the company had achieved and the activities pursued in each area. The annual report was to be submitted to the UHR and assessed by external auditors. It had to present the company's results (investments, costs and expenses, operations, among others). It not only contained data about its financial situation but also provided information about its actions for the following two years. There were two kinds of periodic reports: a) a monthly technical report on service standards in which production, work execution, and service standard indicators were set; and b) a semiannual report in which concession revenues and expenditures were reported. Finally, additional reports containing specific information had to be submitted upon the request of the UHR and control agencies.

The new framework also stipulated that the UHR, PA and WSA had free access to AWSS's accounting, economic, financial, commercial, and contractual information. These agencies and the company had to produce a regulatory accounting system to monitor the financial aspects of the concession. AWSS was also obliged to provide sufficient data for benchmarking studies.

In short, the way the new regulatory framework was created evidenced the absence of a broad debate about the best design for the service. Contrary to accepted criteria, this fragmented scheme ultimately concentrated the functions in the MFPPIU and left the newly created agencies without much real power to carry out their limited roles. In some cases, the existing regulatory mechanisms maintained or even deepened the irregularities arising during the private management period. The following section will focus on these regulatory flaws.

## **4. Regulation and Control: How Does It Work?**

Before assessing the State regulation of AWSS, we present some aspects of the implementation of the prior regulatory scheme. As was mentioned in Section 3, although the drinking water and sanitation services continued to be a monopoly, regulation was extremely lax. Regulatory flaws cannot be explained in terms of the agency's design problems. Rather, TWSA's performance was principally affected by the joint capture of AW and the NEP through the NRSDS. This secretariat assumed TWSA regulatory function from 1998 to 1999. In most cases, the NRSDS lifted penalties that had been imposed by the TWSA for political reasons without taking into account the technical reasons for the fines. The NRSDS not only became responsible for the rate policy and work plans, but also for the appointment of the national members on TWSA's board.

In addition, AW also benefited from constant modifications in the contract. Fifteen months after the beginning of the concession and although rate increases had been forbidden in the contract during the first ten years, the TWSA authorized an increase to guarantee investment goals. This adjustment demonstrated how opportunistic AW's offer in the bidding process had actually been. In February 1997, the NEP established a new contract modification which excluded the TWSA by decree. The result of this revision was virtually implied in a new contract. Among other changes, note: 1) the incorporation of an exchange rate insurance that eliminated monetary devaluation risk for AW; 2) the replacement of the infrastructure tax for two others (a fixed indexable payment that included an environmental aspect which was not in the original contract, and the other tax to be paid by new users); 3) a change in the threshold for cost adjustments (from 7% to 0.5%); 4) the incorporation of an annual extraordinary rate revision; and, 5) the delay or cancellation of investment requirements and fines. In July 1999, the NRSDS introduced new changes in the rate regulations and the penalty regime which also benefited the company. Fines were reduced and the TWSA's control faculties weakened. Later in January 2001, AW and the TWSA signed an agreement act that approved the second quinquennial plan and a 10.5% rate increase.

With regard to the internal organization capacity gaps, the TWSA showed a high rotation among its top managers. Until 2005, managers remained in their positions, on average, half of their term (three years). Such instability, which hampered their professionalism, was linked to the influence political authorities exercised on the appointment of board members. Finally, skill and knowledge gaps also affected its regulatory functions. Even though the contract renegotiation of July 1999 introduced new regulatory tools (a new formula to calculate rates, regulatory accounting, benchmarking, among others) to improve regulation and control over the company, they were not put into practice. With the NEP's consent, AW repeatedly refused to release information in that regard.

During the post-Convertibility renegotiation, the TWSA made important advances to overcome this gap. Many of these regulatory instruments were enforced, which allowed it to carry out a detailed follow-up of AW. In contrast to the previous period (1993-2001) TWSA's performance was only then influenced by the NEP. As AW changed its position in the renegotiation and decided to leave the country, the concurrence of the government's and company's interests ended. The situation of regulatory capture became evident when the NEP decided to rescind the concession contract (March 2006). The regulatory agency had to repeal its own ruling that to some extent contradicted the NEP's arguments to rescind the contract (excessive nitrate levels in the water). Only six months earlier, in Resolution No. 95/05, the TWSA had recognized a decline in nitrate levels and reduced AW's penalties.

Following the renationalization of the supplies, the implementation of the new regulatory framework did not produce significant changes in the existing regulatory regime. It is paradoxical that the WSA was named regulator even though it only exercised control functions. In addition, we can identify an internal organization gap. As the creation of the two agencies (the WSA and the PA) did

not provide enough financing for their activities, their performances deteriorated. To cover their budget deficit, both agencies had to appeal to MFPPIU for contributions, which in some cases were submitted through AWSS. In 2008, AWSS advanced the WSA and the PA AR\$ 1,450,000 and AR\$ 1,050,000, respectively (AGN, 2009).

In addition to these budget problems, other gaps in the organizational structure existed. The WSA officers interviewed for this study stated that staff cuts had been put into practice. Since 2003, the agency was seriously affected by the reduction of its staff and the disbanding of its technical teams. A comparison between the WSA's and the PA's staffs and the TWSA's agents revealed a reduction of about 20%. Unlike the TWSA's performance – which was not optimum – the WSA's operation showed a lack of coordination between political and technical areas. To a certain extent, these differences may have been linked to the unionization of the technical staff that joined the WLU and the consequent improvement in their working conditions. Moreover, as the WSA's managers worked independently of each other, the scope and depth of their studies were undermined.

In addition, some of the interviewees said that political rather than technical considerations were at stake in the creation of the two new agencies. The principal objective to divide them was a balance of power between the WSA's president and the UHR's Undersecretariat in charge of the PA. As a result of this tension, the working climate was seriously affected. Some of the WSA's officers argued that they had no knowledge of PA's activities because, in practice, expansion plans were set by the company.

Concerning skill and knowledge gaps, the scarce information submitted by the company limited the WSA's control. The agency had formally received AWSS's annual budgets from 2008 but it had been unable to make any recommendations. Its participation had become a mere formality because AWSS's budget depended on prior congressional approval. The company did not submit its financial information to the WSA but it did send it to the MFPPIU. Interestingly, this information was forwarded to the WSA by the Ministry, which lacks the technical capacity to analyze it.

Users' participation (Users' Auditing Committee) was still subordinated to the WSA. As mentioned above, user associations were formally excluded from participating in plans to expand coverage at the PA so their demands and proposals were voiced, in some cases, by municipal mayors, who represented them at the agency. According to the statement made by some representatives of user associations, the Auditing Committee was not working because it had no funds. In the new regulatory scheme, the WSA was not obliged to finance the Auditing Committee's activities. However, they pointed out that AWSS had interceded with the MFPPIU's authorities to restore resources from the UHR and not from the WSA. They also stated that associations were holding regular meetings with AWSS's board and estimated that this bond would strengthen.

In sum, the new framework had produced a fragmented regulatory regime with a centralized political decision structure. There was a political-institutional gap in

both agencies. Even though they were created by law, their performance was extensively influenced by the NEP. As was pointed out earlier, the members of their boards were appointed by the NEP and the presidents were connected to the NEP's authorities. In this sense, an inter-agency relations gap was also recognized. The UHR's role questioned the agencies' relevance and independence. As the Undersecretary was also the PA's president, the PA was less autonomous than would be expected of an autarchic and decentralized agency. In addition, the WSA's competence was reduced to control functions because regulatory competences were conferred to the UHR.

As was explained, many of the internal organization and information gaps of the period under private management persisted, and in some cases increased. Budget deficits, staff reductions, conflicts of interest between the authorities, the lack of coordination between managerial, technical and political areas seriously impacted on the working climate and the dynamic of both agencies.

## **5. Final Comments**

Considering the notion of State capacity, this case shows more continuities than ruptures in the regulatory performance of the Argentine State between 1993 and 2011. The deficiencies of the regulatory framework and significant regulatory capacity gaps explain the absence of a clear regulatory strategy. Managerial changes were not accompanied by the necessary redefinition of regulatory parameters. Predictably, regulatory design and implementation problems existing under private management acquired new significance after the renationalization. The logic behind the new regulatory framework is unclear. Service management and regulatory competences were centralized in the hands of the MFPPIU, suggesting a regulatory scheme based on political control. At the same time, two decentralized control agencies with several design and performance limitations were created. Assuming that these agencies were created for mere reasons of formality, and taking into account that a centralized regulatory regime makes them unnecessary, questions arise about the nature of the regulatory regime that calls for such a formality. Underlying this institutional framework, problems may arise about service sustainability. As we pointed out, AWSS's own current revenues do not cover half of its current expenses. Furthermore, infrastructure investments (which grew by 384% from 2007 to 2009) were financed with State transfers. Although these transfers are reasonably necessary to recover the supplies, AWSS's dependence on them must gradually be reduced in order to avoid operational difficulties. In this sense, as the rates have been frozen since 2002 it will be necessary to find the best way to readjust them without neglecting the protection of the most vulnerable sectors of the population. Regarding the rate regime and structure, a more equitable access to the services must be guaranteed. On the one hand, the rate structure must be revised in order to reduce its highly regressive effect. On the other, the rate regime must promote a rational use of the resource by implementing micro-measuring devices, along with other criteria, considering the payment capacity of the users. As access to water and sanitation is recognized as a human right, the existing institutional

architecture of supply, regulation and control should be reshaped to fully guarantee the quality and expansion of supply in the future.

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### Interviewees

Dr. Carlos María Vilas, president of the WSA.

Mr. Alberto Muñoz, president of the consumers’ association “Union of users and consumers” [Unión de Usuarios y Consumidores].

Mr. Américo García, former member of the Users’ Commission of the TWSA and member of the consumers’ association “Union of users and consumers” [Unión de Usuarios y Consumidores].

Members of the WSA technical staff.

A lawyer representing AW.

An officer of the Unit of Renegotiation. .

An officer of the NGAO.

Members of the National Argentine Attorney General's Office.

Members of the National Judicial Power.

Total interviews: eleven (11)

### Methodological Annex

Regulatory capacity		
Administrative dimension		
Indicators	Regulatory structure implementation	*Regulatory sequence: regulatory framework approval, agency creation and company transfers.
	Design	*Creation (law/decreed). *Authorities’ appointment. *Financing. *User’s protection and participation.
	Sanction capacity	*Implementation, effectiveness and collection of fees.
	Contractual renegotiations	*Frequency. *Contents: rates/expansion goals.
	Information	*Information access. *Implementation of regulatory instruments.
	Internal structure	*Staff and resources. *Authorities’ rotation. *Managerial staff relationships.

	Capture risk	*Overlapping functions. *Political capture.
Sources	*Official documents, legislation and statistics, regulatory framework, TWSA/WSA's reports. *Semi-structured interviews. *Specialized bibliography	
Regulatory capacity		
Relational Dimension		
Indicators	State's power resources	*Legal powers to manage the service. *Negotiation skills with non-State actors. *Political objectives regarding the service.
	Social actors' power resources	*Alliance capabilities. *Cooperative or confrontational positions towards State agencies.
	Action logic	*Voice and veto power in public policy definitions.
Sources	*Official documents, legislation and statistics, regulatory framework, companies' balance sheets and reports, TWSA/WSA's reports and legislative debates. *Semi-structured interviews. *Newspaper articles. *Specialized bibliography.	

## Glossary of Acronyms

AW: Argentine Waters Inc. [Aguas Argentinas S.A.]

AWSS: Argentine Water and Sanitation Services Inc. [*Agua y Saneamientos Argentinos S.A.*].

ICSID: International Centre for Settlement of Investment Disputes.

MFPIIU: Ministry of Federal Planning, Public Investment and Utilities [*Ministerio de Planificación Federal, Inversión Pública y Servicios*].

NEP: National Executive Power.

NGAO: National General Audit Office [*Auditoría General de la Nación*]

NCGO: National Controller General Office [*Sindicatura General de la Nación*]

NRSDS: Natural Resources and Sustainable Development Secretariat [*Secretaría de Recursos Naturales y Desarrollo Sustentable*].

PA: Planning Agency [*Agencia de Planificación*].

SPW: Secretariat of Public Works [*Secretaría de Obras Públicas*].

TWSA: Tripartite Water Sanitation Agency [*Ente Tripartito de Obras y Servicios Sanitarios*].

UHR: Undersecretariat of Hydric Resources [*Subsecretaría de Recursos Hídricos*].

WSA: Water Services Agency [*Ente Regulador de Agua y Saneamiento*]

WLU: Water Labor Union [*Sindicato Gran Buenos Aires de Trabajadores de Obras Sanitarias*].