

Insufficient service provision from public-private associations



Public-private associations have not produced a more efficient service or increased access by the more disadvantaged sectors. The case of water and sewerage provision demonstrates that the regulatory framework has to serve the public interest and not just the private interest in making a return, and that mechanisms to ensure management transparency and civil participation are necessary. In 2006 the Government decided to re-nationalize this service.

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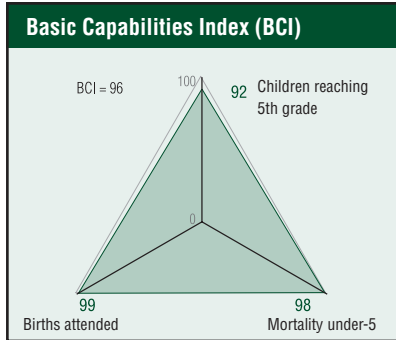
Throughout Latin America during the 1990s there was a process of economic liberalization and public sector contraction. International finance institutions such as the International Monetary Fund and the World Bank promoted, among other measures geared to making States more efficient, the privatization of public services. During President Carlos Menem's administration (1989-1999), Argentina was one of the countries that most echoed this initiative, privatizing the majority of essential public services.

Public-private associations are still advocated as an efficient model to finance the expansion of essential public services to all sectors of the population. However several examples could be used to show that privatization does not in itself guarantee increased efficiency in public service provision and even less access to services for the most vulnerable sectors. One of these examples is the case of Aguas Argentinas S.A.

We will examine the privatization of its predecessor Obras Sanitarias de la Nación (OSN), the company charged with providing water and sewerage services for Buenos Aires city and 17 districts of the Buenos Aires conurbation, and analyze some causes of this privatization's failure.

In 1989, a law passed by the National Congress declared that the provision of public services was in a state of emergency and authorized the Executive to transfer public assets to private companies.

One of the main arguments in support of privatizing the public water and sewerage services, and indeed most essential public services, was the State's apparent inability to provide them efficiently. In the case of OSN, the lack of investment during preceding years had prevented both the maintenance and expansion of water and sewerage networks. The concession for this service was placed in private hands with the intention of remedying the situation.



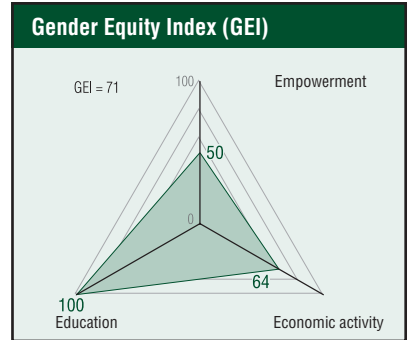
In 1993, after a public tender process, the Aguas Argentinas S.A. consortium, with Suez and Vivendi multinationals among its main shareholders, undertook service provision.

The concession contract set 30 year investment and service expansion goals requiring the extension of water supply services to approximately 1.7 million people and sewerage systems to almost two million people. In this way the service was to be extended from covering 70% of inhabitants at that time to supply almost the entire population within the area. Also central to the contract were sewerage treatment goals with a view to the gradual elimination of water-course contamination by liquid effluent.²

Return before service

During the concession's first ten years, drinking water networks were indeed extended and the number of people connected to the service increased. However, as clear criteria for the extension work had not been incorporated in the contract, the company's priorities were based on potentially higher economic return and almost completely ignored the social aspirations of the project. On top of this, successive modifications to the original plan of improvements and expansion were made substantially reducing the goals that the company had committed itself to at the beginning of the concession (ETOSS, 2003).

As a result, the work undertaken was chosen on the basis of minimum cost and maximum profit in terms of investment recovery. In fact, much more expansion took place in relatively wealthy zones than



in areas inhabited by the more vulnerable and less well-off sectors of society. The same phenomenon happened with the extension of sewerage networks, which was also in the main directed to zones of greater purchasing power.

Health crisis risk

Sewage treatment plants were also not developed as specified in the original contract, which exacerbated one of the principal environmental contamination problems of the zone. The postponement of these projects caused concentrated contamination around the main sewerage discharge points polluting both river basins and neighbouring coastal areas. A particular problem highlighted in a report by the Buenos Aires City Ombudsperson is the health risk to people in the south of the city due to unofficial connexions combined with collapsed parts of the network. This situation could result in a health crisis with outbreaks of cholera, hepatitis and other diseases caused by drinking water contamination.³

Rate increases

According to the Tripartite Body of Sanitary Works and Services (ETOSS), the average rate bill for the service increased by 88% between the beginning of the concession and 2002, far in excess of inflation during that period. At the same time, although invoicing systems were established incorporating cross subsidy schemes between different zones and types of building that were geared to favouring those users with the least resources and to universalizing the service, the original concession contract did not explicitly include the provision of a lower rate for poorer

1 This report is based on the study *Evaluation of direct foreign investment impacts on human rights: Aguas Argentinas S.A. case study*, carried out by Centro de Estudios Legales y Sociales (CELS) and Asociación Civil por la Igualdad y la Justicia (ACIJ) with the support of the Canadian organisation Rights & Democracy.

2 The contract signed by Aguas Argentinas S. A., its subsequent modifications and the regulatory framework of the concession can be accessed at: <www.etooss.org.ar>.

3 *La Nación*, 25 April 2006.



sectors. Only in 2001 was the Social Rate Programme created with the objective of lessening the effect of the economic crisis on less well off groups. But even then the company remained entitled to cut services in the event of bills not being paid.

Regulations “à la carte”

It was possible for such situations to develop because the repeated contract and legal framework modifications, implemented by Executive decrees and resolutions, ended up nullifying many of the concession’s initial objectives.

Even the mechanism provided for modifying the contract was itself drastically reformulated, losing its original characteristic of being only for use in exceptional circumstances. The nature of the contract modifications demonstrates that their principal objective was to benefit Aguas Argentinas, reducing company risk to almost zero. In fact, while normally there is a proportional relationship between the profitability of an economic activity and its degree of risk, in this case it became a case of greater profitability for less risk.

The accounts of the company itself show that between 1994 and 2001 there was an average profit on shareholders’ equity of 20.3% while during the same period the average profit made by Argentina’s 200 biggest companies represented 3.5% of annual sales. The disproportion is also evident looking within the sector where for example in the USA equivalent profit percentages are between 6.5% and 12.5% and in the UK between 6% and 7% (Aspiazu and Forcinito, 2004).

A lack of appropriate regulation has also allowed the company’s debt to exceed what was anticipated in the original tender and rise to levels above accepted international norms for this type of company. In 2002 this situation became critical when, due to the peso devaluation and the freezing of rates, the company’s profit in dollars – the currency in which it had contracted its international debts – was substantially reduced.

Aguas Argentinas failed to fulfil the contractual objectives and obligations that it had undertaken. The company was repeatedly sanctioned for this; however it only paid 42% of the consequent fines (ETOSS, 2003). In addition, the system for the application of fines was itself modified during contract renegotiations reducing the size of future fines and providing relief for those already imposed.

Re-nationalization

In early 2002 the National Congress passed an Economic Emergency Law (Law No. 25561) providing for, among other things, the abandonment of the currency convertibility regime, a rates freeze for public services and the complete renegotiation of public service concession contracts, including the one with Aguas Argentinas. The renegotiation of the

water and sewerage service concession contract remained in process until March 2006, when the national government decided to cancel the contract with the company and re-nationalize the service.

The State’s share of responsibility

From what has already been said it can be seen that Aguas Argentinas was to a significant degree responsible for the failure of this model. However as one of the intrinsic characteristics of the public-private association model is the alliance between a private company and the State, it is appropriate to examine the State’s responsibilities as counterpart to the company in this concession.

It is evident that the benefits obtained by Aguas Argentinas from the successive contractual renegotiations and modifications of the concession’s regulatory framework would not have been possible without the approval of public officials responsible for authorizing them. Although judicial investigations into this have for the most part produced no proof, there are clear indications that some corruption may have been involved. There is broad agreement that the contract modifications were made in the interests of the company and had a seriously negative impact on consumers and the population in general. The control mechanisms themselves were successively modified, each time reducing their powers and sanction capacity. On top of all this there were repeated delays in the implementation of decisions contrary to company interests (Defensor del Pueblo de la Nación, 2003).

There were several factors underlying the authorities’ permeability to the demands of the company, one of them being that the economic power of multinational companies such as Suez or Vivendi translates into substantial political power during concession negotiations with the government. The activities of this type of company have such an impact on local economies that it is difficult to disregard their requests and risk the possible withdrawal of their investment.

Unfavourable international context

Another underlying factor was that Argentina, along with many other developing countries, had ratified bilateral agreements for the promotion and protection of investments. In general these agreements grant foreign investors the right to seek redress from host States in international courts. The decisions of these courts have traditionally favoured investors’ interests, leaving States to pay millions in indemnification. Thus the presentation of such claims has provided companies with a means of applying political pressure by using the possible suspension or definitive withdrawal of them as currency to obtain favourable concessions. This was a factor in the case of Aguas Argentinas. Right up to the cancellation of the contract, the company and the Government had been attempting to reach an

agreement in the framework of the concession contract renegotiation and the company’s claim presented to the International Centre for Settlement of Investment Disputes was one of the most important tools used in the negotiation.

Conclusions

The Argentinean experience of privatizing water and sewerage public services raises some issues that should be taken into account when assessing the appropriateness of using a public-private association model. One fundamental aspect is that the asymmetry of negotiation capacity between the two parties in the model makes a successful outcome less likely. If the commercial interests of the company prevail over the public interest, the purpose for which the association was originally formed becomes seriously distorted.

Finally, irrespective of the model adopted, the existence of a regulatory framework that is formulated by – and can only be modified by – Congress, an efficient judicial system, truly independent watchdog bodies, mechanisms that ensure management transparency and sufficient civil society participation will all undoubtedly contribute to achieving the objectives of any management scheme for an essential public service. ■

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