

Myths and facts of infrastructure reform in Argentina in the 1990s: some current implications

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LAURIN Workshop

**“Public Utilities Reform in Latin America:
Regulation, Institutional Needs, and Distributional Effects”**

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Content of Talk

1. Where do we come from? Privatization and performance in the 1990s
2. Where are we? Summary of regulation developments since devaluation: Duhalde and Kirchner administrations
3. What Next? Renegotiation: Analysis and Proposal

Where do we come from? Privatization and performance in the 1990s

Privatization in the 1990s

- *Privatization process without precedents, carried out in a short period of time and following different goals:*

- Increased operation efficiency,
- Elimination of operational deficits / higher fiscal receipts / cancellation of public debt,
- Convincing political signal to buy reputation,

- *Reforms were different in various sectors (energy vs. telecom vs. transport vs. water), both regarding reform of market structure, institutional building, regulation mechanism, etc., sometimes explained by context and sometimes not*

- Design of energy reform (natural gas and electricity) praised internationally
- Design of transport and sanitation services much more problematic

Myths and Realities of the 1990s

Myth 1.

Indexing tariffs with US inflation violated the Convertibility Law, hurting users by more than US\$ 10 Billion

Truth: incorrect counterfactual; forgets 1991-1994

Myth 2.

Telecom tariffs strongly increased in the 1990s vis-à-vis the 1980s, and were the highest worldwide

Truth: incorrect focus on residential users, and base (hyperinflation)

Myth 3.

Higher price of natural gas at wellhead since 1994 (post-deregulation) and Edesur blackout in 1999 demonstrate abandonment of government responsibilities, calling for a stricter regulation

Truth: these are cases of success, not failure

Myths and Realities of the 1990s: additional cases

Myth 4:

Public utilities achieved artificially high ROR through continuous renegotiations that eliminated commercial risks

Truth: incorrect to generalize (diversity of results by sector and firms; renegotiation concentrated in some areas)

Myth 5:

Privatizations contributed to high unemployment rates in Argentina

Truth: claim based on direct employment on privatized firms, forgets outsourcing, entrants, and lower prices for industrial users

Myth 6:

Privatizations were detrimental to income distribution in Argentina

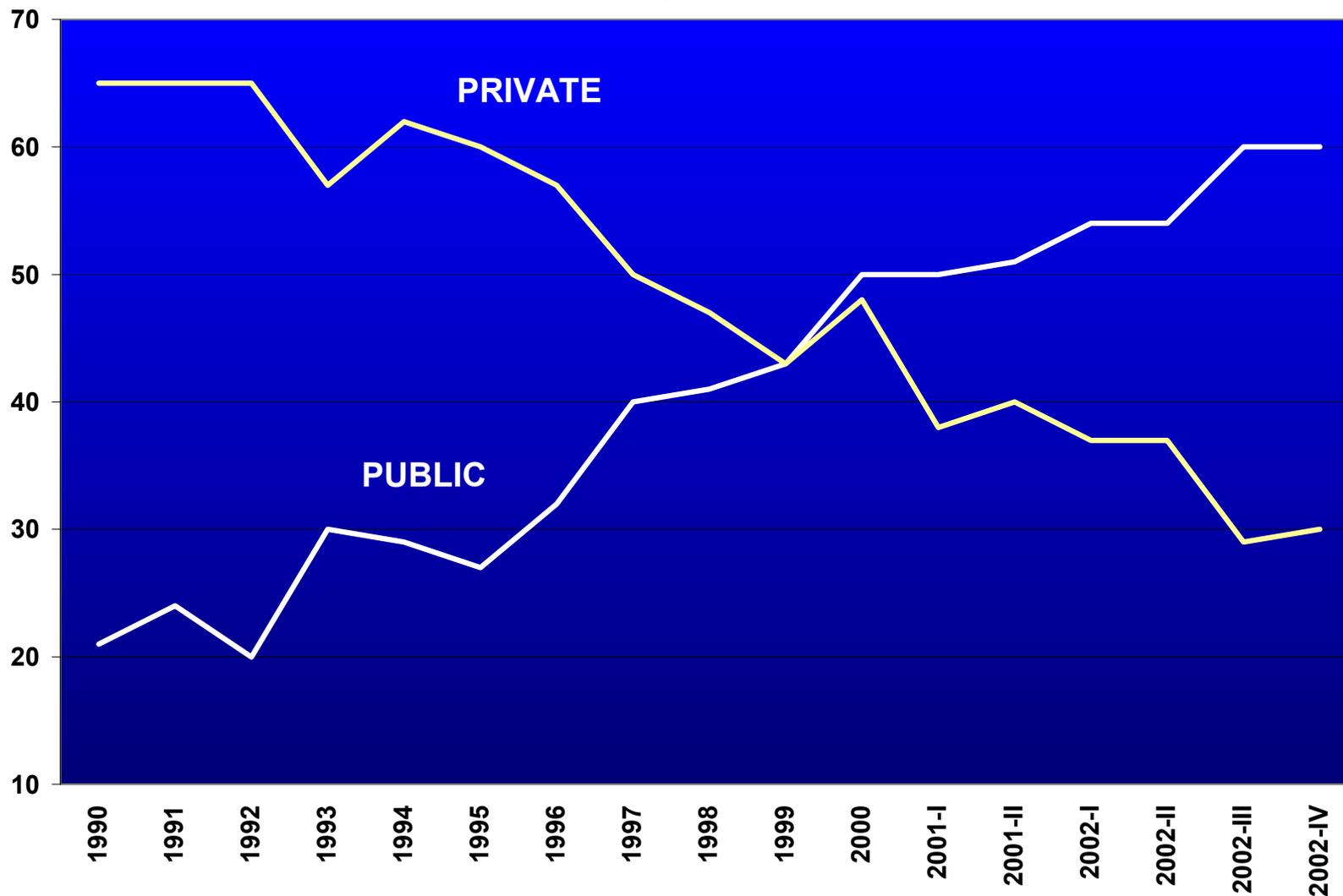
Truth: inconsistent with evolution of access and elimination of deficits paid by non-users also

But performance evaluation is mixed

- Different stories depending on structural-cum-design issues
- As expected: Incentives for cost minimization resulted in big efficiency gains from past status quo
- Major achievements in access, except in sewerage. Reforms in water supply related to improved health indicators
- Observed quality (reliability) improved substantially
- Mixed results in prices depending on competition (electricity generation, ports) and design. Good results in electricity and gas, not so good in telecom and water; poor in railway concessions (passengers)
- Commercial service of poor quality in general
- “Excess” contract renegotiation in water and transport, but not in energy and telecom

Scottish Flag

Would you say that a better country is one where the vast majority of things are made by public enterprises or private enterprises?



***“Scottish Flag”*: Explaining Users Dissatisfaction**

- a. Myths are believed as true by most people (lack of credible and transparent information as main failure)
- b. Regulators not aggressive enough to transfer gains to consumers
- c. Privatization vs. Liberalization explanation
- d. Cost of Capital: two-digit WACC
- e. US CPI indexation in a deflation crisis
- f. Taxes and political economy of taxing services

**Where are we? Summary of regulation
developments since devaluation: Duhalde
and Kirchner administrations**

Developments under the Duhalde administration

- Jan-02/Nov-03: Dollar went from 1 \$ to 2.9 \$ (3,8 \$ in Jun-02), IPM +115%, IPC +40%, PBI -10% in 2002, +8% in 2003, Poverty from 20% to 55%, unemployment +20%, etc.
- Jan-02: Law 25.561 (freezes rates in \$, even energy upstream; delegates renegotiation to the Executive until Dec.2003)
- Feb/Nov-02: Decrees create the “Commission for Renegotiation of Contracts of Public Works and Services”, set rates in US\$ for foreigners or external trade, postpone deadlines, threat firms and stock holders (should abandon legal claims to qualify for renegotiation), etc.
- Dec-02/May-03: Courts rejected adjusting T+D rates in natural gas and electricity (up to 9%, with generous “social tariff”), and renegotiation (smaller canon) with Airports concessionaire

Developments under the Kirchner administration

- Confusing speeches by top government officials. Two examples:
 1. “We will revise the profitability of public utilities during the 1990s and their losses post-devaluation to decide the rate of adjustment case by case”
 2. “The question is not whether to increase rates or not, but instead how it should be done, analyzing the previous fulfillment of contracts”, etc.
- “Inaction” (extension of renegotiation delegation until Dec. 2004) and growing conflicts (counterclaims) between the Executive and regulated firms
- Cancellation of two concessions (Postal Service and Radio Electric Space Control)

Developments under the Kirchner administration II

- Government reveals preference for direct control of investments (fiduciary funds in Telecom, expansion in water and sewerage), subsidize firms instead of raising tariffs (passenger transportation, new gas pipeline, electricity generators), direct contracting (new gas pipeline), multiple prices (energy), etc.
- Overall, evidence of new vs. old investment discrimination (opportunism and confiscation of quasi-rents)
- Energy crisis in March 2004 (insufficient production of natural gas to generate electricity; exports of natural gas to Chile and electricity to Uruguay restricted; Government reinitiates imports of natural gas from Bolivia and buys fuel oil from Venezuela); confrontation approach chosen by main government officials (“crisis is due to lack of investment since 1996”)
- Threats of no renegotiation unless claims at ISCID are dropped

Pending Conflicts at ICSID (November 2003)

Number of cases	Countries
1	16 countries (Algeria, Saudi Arabia, Bolivia, Peru, Philippines, Venezuela, etc.)
2	6 countries (Chile, Jordan, Kazakhstan, Morocco, Mexico and Pakistan)
3	3 countries (Congo, Ecuador and Egypt)
23	Argentina

70% involve public utilities post-devaluation, including provincial concessions; number grows monthly (5 new cases between November 03 and April 04); estimated amount (speculative) > US\$ 20 B

What Next?

Renegotiation: Analysis and Proposal

Doubts and certainties about the government's strategy

Several doubts:

- Basically about what is the true reason for “inaction” and the degree of improvisation / awareness of damage caused

Some certainties:

- Revising the execution of contracts in the 90s is OK but independent of interpreting / adapting contracts to new post-devaluation environment; contracts post-2002 should be viable both for existing or eventually new companies
- In several sectors the contractual execution was never questioned: widespread revision of the past seems an excuse
- Subsidizing certain groups of users does not require segmentation of markets and counter-reforms

Questions to be addressed for renegotiation

(The problem is quite complex: what, who, when, how, etc.)

- a) Which contractual terms are negotiable? The overall tariff level? Subsidies? Tariff structure? Price-cap adjustment? Exclusivity? Quality? Security? Environmental obligations? Taxes? Should changes be permanent or transitory?
- b) Who should command the renegotiation process (guidelines and final approval) and who should execute it (details)? Who should regulate utilities afterwards, sector secretaries, autonomous sector-specific regulatory bodies or a centralized regulator?
- c) When does each dimension need to be defined? Can tariffs be adjusted immediately and other dimensions of the contracts later?
- d) How should the capital base be computed? Historic value? Replacement value? Market value? What is a “reasonable rate of return”? What is nondiscriminatory? Does the financing structure and external debt matter regarding rate increases? What is legally viable? What is acceptable in terms of reputation building? What is fair? What is politically feasible? What solution will attract future investments?

What should a "reasonable" government do?

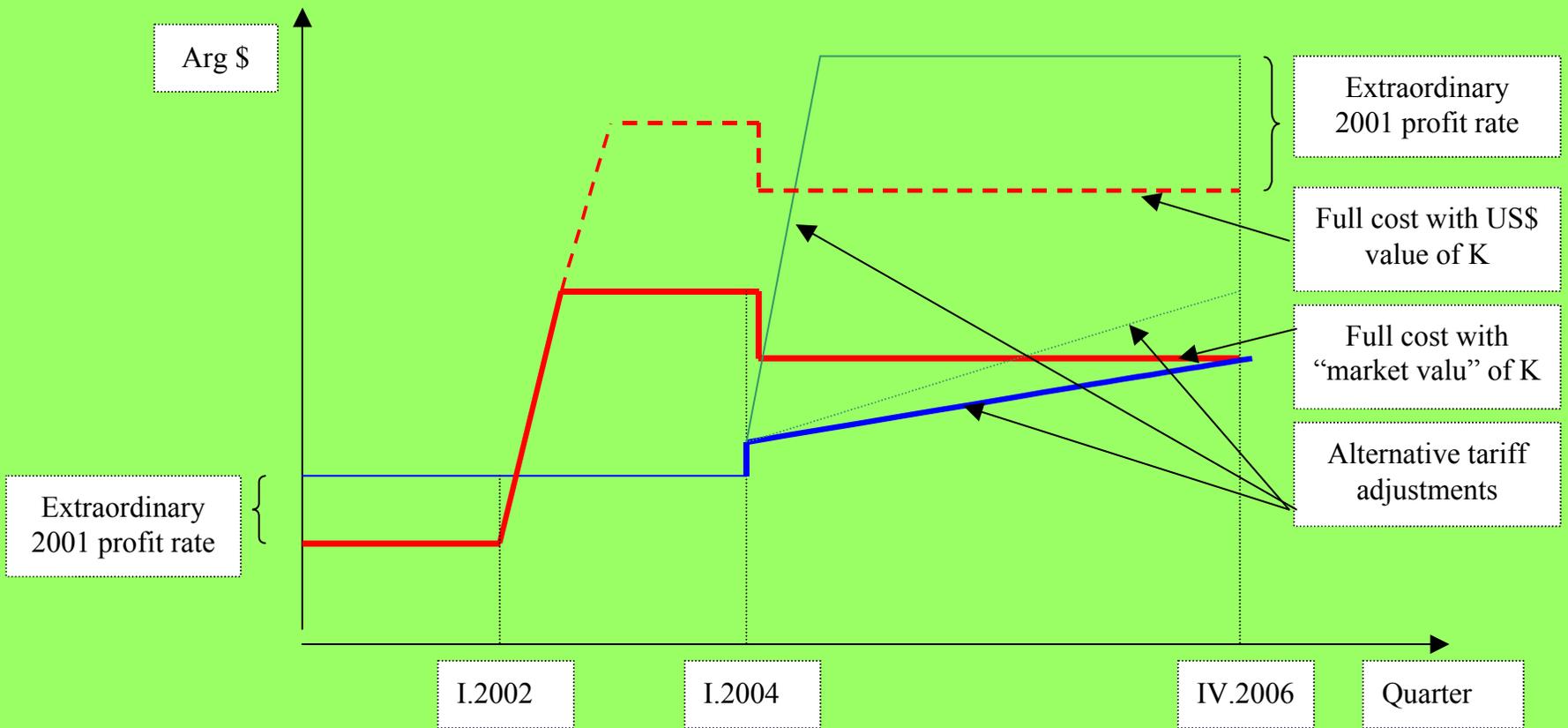
Minimize the “destruction of value” post-devaluation, begin evolution towards sustainable rates in a compatible way with economic, social, political and legal context, trying to mimic competitive markets

Main legal restrictions:

- Law 25.561 (Economic Emergency)
 - i. art.8 freezes rates in \$ (even though they were often set in US\$)
 - ii. art.9 has 5 “vague” criteria for renegotiation:
 - a) impact on competitiveness and distribution of income,
 - b) quality and/or investment plans,
 - c) interest of customers,
 - d) reliability of service, and
 - e) profits of firms;
 - iii. art.4 forbids (foreign currency) indexation,
- BITs (non discrimination against foreign investors, granting fair or compensatory treatment, without covering commercial risk)

Judicial security, non discrimination and fairness

- With incomplete contracts, and considering the magnitude of the crisis, all these concepts are quite similar, and are respected with an efficient regulation, directed to reply the behavior of competitive markets
- In my view:
 - a) Dollar-denominated rates were instrumental \Rightarrow respect the “spirit of contracts”, replicating if possible competitive outcomes (some subsidies OK if explicit)
 - b) Cost of capital of utilities in the 1990s computed the risk of devaluations not leading to default (risk based on sovereign debt issued in US\$) \Rightarrow capital base is much lower than historic US\$ cost of investment



The government should define:

- the starting point (current tariff and costs),
- the “final point” (to be reached in x years), and
- the trajectory during the transition (tariffs, quality, mechanism, etc.)

“Reasonable” proposal I: Key principles

“pick the blue line”

1. Define efficient cost of provision of services
2. Allow reasonable profitability on capital base priced at “market value” and new investments
3. Defer non vital investments and improvements of quality
4. Design gradual transition with accent in social viability (social tariffs to indigent and unemployed via fiscally neutral tax reductions, without horizontal cross subsidies according to the user's sector or among firms of different size), preferably using automatic triggers
5. Reply the main features observed in competitive unregulated markets (the “spirit of contracts”)
6. Maintain path toward gradual deregulation of potential competitive segments in all industries

“Reasonable” proposal II: Instrumentation

Combine central coherence with decentralized / transparent instrumentation, feasible within less than 6 months

- a) Executive sets parameters that guide activity of Regulators (how to value the capital base, ROR allowed, tax reductions for social tariff schemes, postponement of investments, absence of new exclusivities or cross subsidies, etc.)
- b) Regulators –assisted by multilateral organisms– elevate proposals to the Executive after consultations and public hearings; Congressmen can participate at any time
- c) According to proposals, modified or not, Executive unilaterally sets new contractual terms, including temporary evolution of rates and compensations due to transition (since January 2002)
- d) Companies retain right of continuing with legal and arbitration claims (ICSID) and government retains right to analyze previous contractual execution and fulfillment (eventually penalize or terminate contract)

“Reasonable” proposal III: Central Results

1. “Renegotiation” (unilateral adaptation) should be like a ROR revision within a price-cap regime, for each sector
2. Tariff adjustments of different sizes by sector and firm according to profits obtained in 2001 (prospective), technology, delay of investments, etc., paced over time credibly and with social tariffs
3. Regulated companies suffer losses in US\$ over their previous investments, but achieve profitability over future ones and could renegotiate their US\$ debts
4. Reasonable chance of not losing international litigations for discrimination and violation of BITs
5. Gradual return to process of deregulation in competitive segments, pointing to strengthen the future political support to reforms

Tentative lessons from the Argentina case

- Widespread dissatisfaction with reforms partly rests on “myths”, and current policy exploits such dissatisfaction
- But there were real mistakes, which have to be more strictly judged looking ahead (“*enough learning already*”) to avoid the true risk of “*reversion of reforms*” provoked
- Avoiding regulatory risk through rigid contracts (US\$ tariffs) was a fiction; 1990s contracts were in fact incomplete (applicable only in the absence of major macro disruption); rigid rules without solid institutions reduce risk only marginally
- Rescue of reforms requires stopping discrimination (foreign vs. domestic investors, regulated vs. unregulated sectors, old vs. new investment), which then would respect the spirit of contracts and fit international best practice (avoid “excessive opportunism”)

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The current energy crisis: insufficient supply or excessive demand of natural gas post-devaluation?

Restricciones de gas por insuficiencia de transporte

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Volumen (MM m ³ /día)	21.4	2.2	5.1	8.1	2.4	0.9	8.4	7.1	1.5	4.3
Restricc./Gas Entregado (en %)	35.9	3.6	7.9	12.2	3.5	1.3	10.7	8.8	2.0	5.8
Temperatura Media GBA (en C)	12.2	11.8	10.5	11.9	13.4	12.7	12	11.4	12.9	10.9

(1) Vol. Promedio de restricciones a Grandes Usuarios de gas para el trimestre Junio-Agosto.

Fuente: Informes anuales de ENARGAS

Capacidad de transporte y extensión de redes de distribución, 1993-2002

	1992	1994	1995	1996	1997	1998	1999	2000	2001	2002
Capacidad de transporte (MM m ³ /día)*	74.7	86.4	90.2	95.4	100.5	107.2	112.02	119.52	123.82	123.82
Crecimiento anual		7.5%	4.4%	5.8%	5.3%	6.7%	4.5%	6.7%	3.6%	0.0%
Extensión redes de distribución (mil km)**	67.4	82.0	86.7	89.2	92.4	96.8	98.8	103.0	108.5	111.8
Crecimiento anual		10.3%	5.7%	3.0%	3.6%	4.7%	2.1%	4.2%	5.4%	3.0%

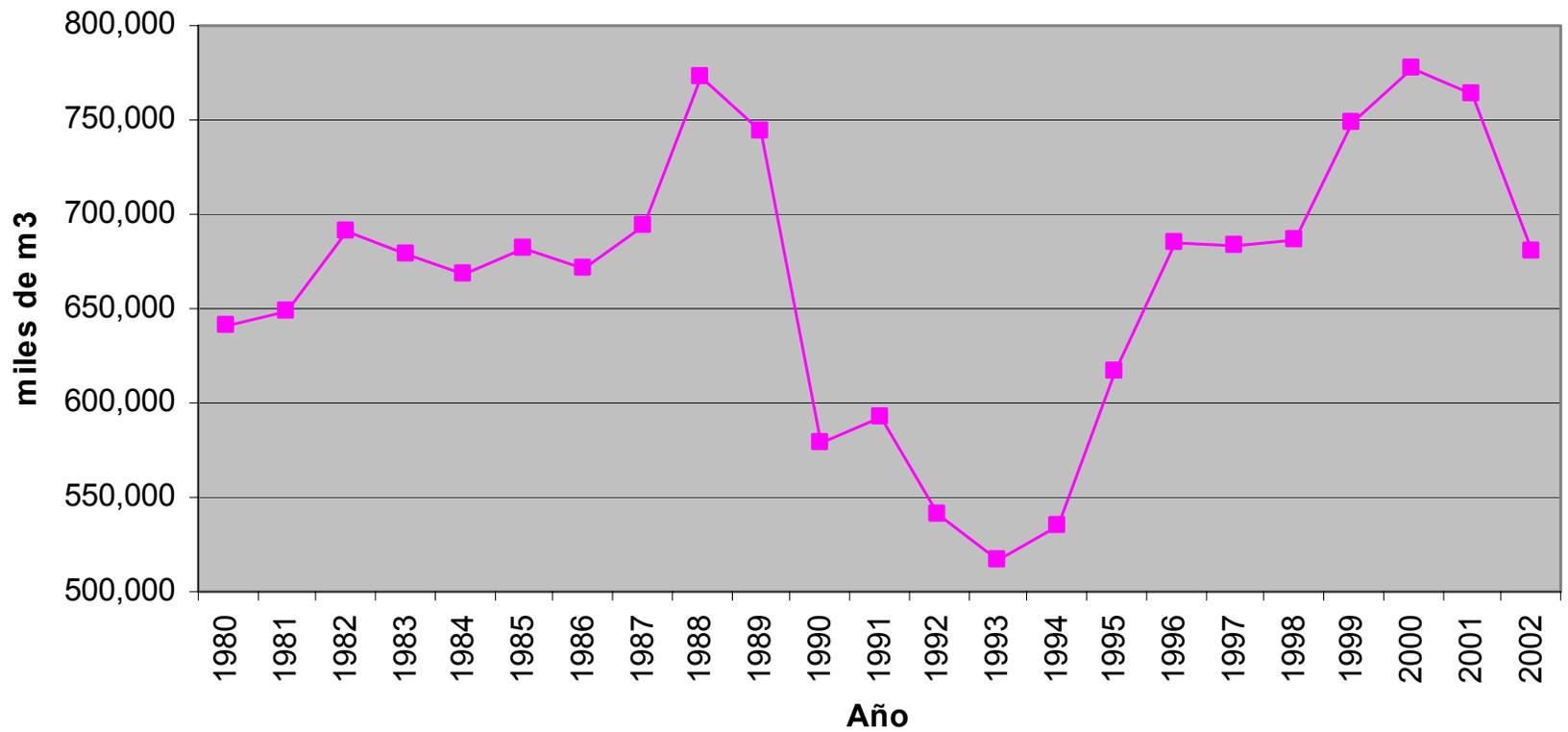
* Incluye capacidad de transporte para exportación y gasoductos propios de las distribuidoras.

** No se incluyen cañerías de subdistribuidores.

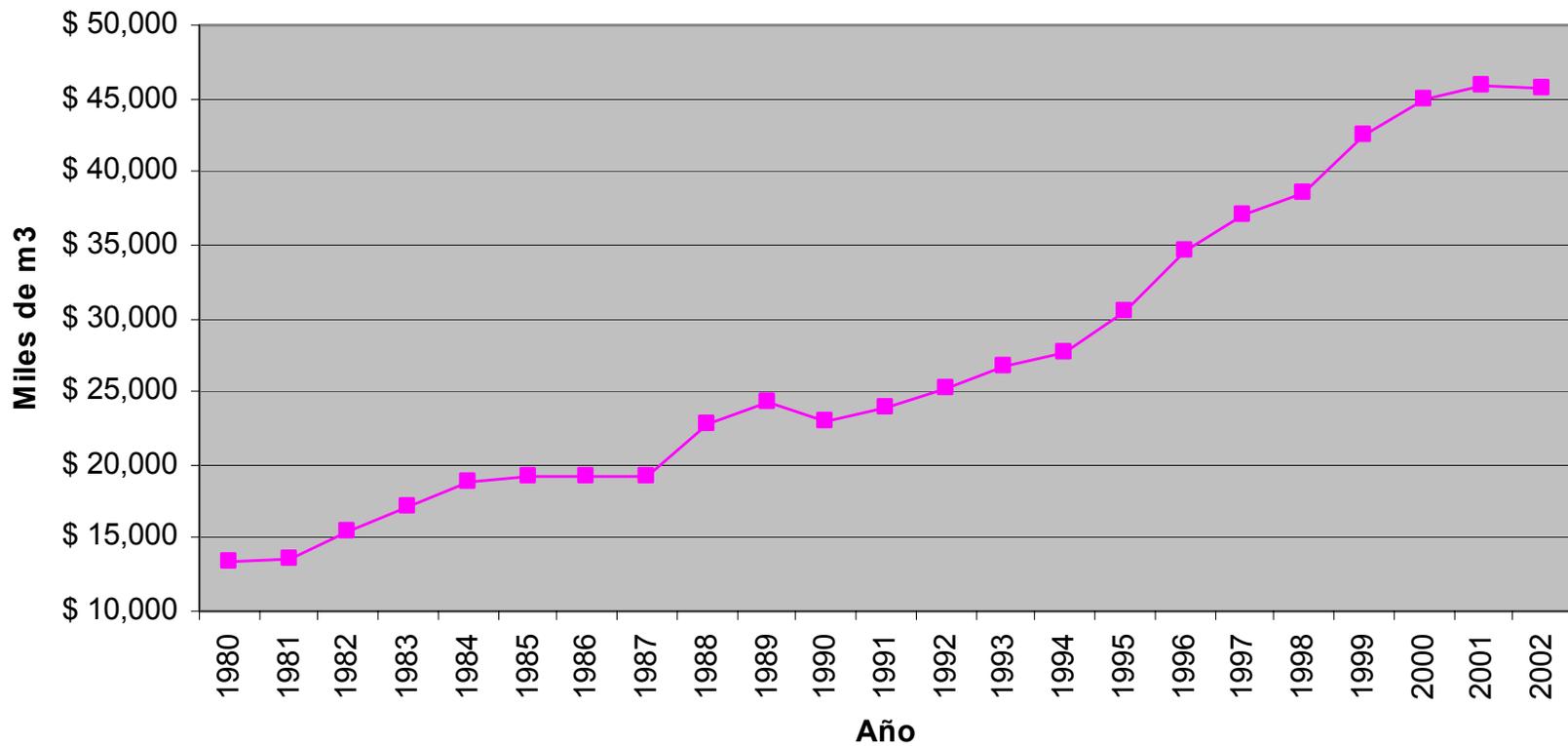
Evolución del precio del gas (contratos) cuencas (en \$ / MM BTU)

Año	Cuenca			Argentina	Inflación (IPIM)
	Austral	Neuquina	Noroeste		
1993	0.97	0.97	0.97	0.97	100.0
1994	0.97	1.17	1.08	1.11	99.8
1995	0.97	1.27	1.18	1.18	106.3
1996	0.96	1.32	1.22	1.22	109.6
1997	0.97	1.33	1.21	1.23	109.7
1998	0.97	1.31	1.16	1.21	106.2
1999	0.94	1.28	1.10	1.18	102.2
2000	1.03	1.42	1.18	1.29	106.3
Var.93-96	-1.0%	36.2%	25.8%	25.8%	9.6%
Var.93-00	5.9%	46.3%	21.8%	33.4%	6.3%
Var.93-99	-2.9%	32.4%	13.0%	21.9%	2.2%
Var.95-00	6.5%	11.9%	0.0%	9.4%	0.0%
Var.95-99	-2.3%	1.3%	-7.2%	0.0%	-3.8%
Var.99-00	9.0%	10.5%	7.8%	9.5%	4.0%
Fuente: Enargas.					

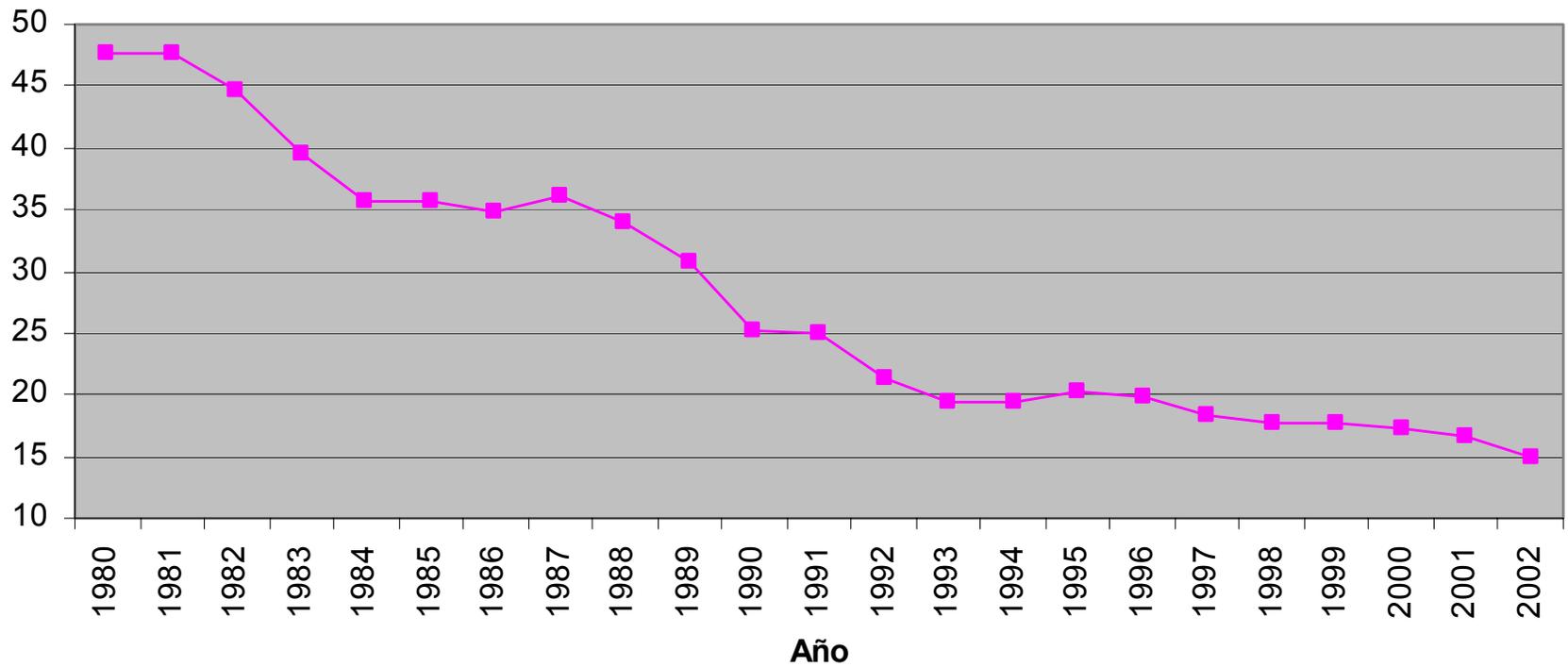
Reservas comprobadas de gas natural



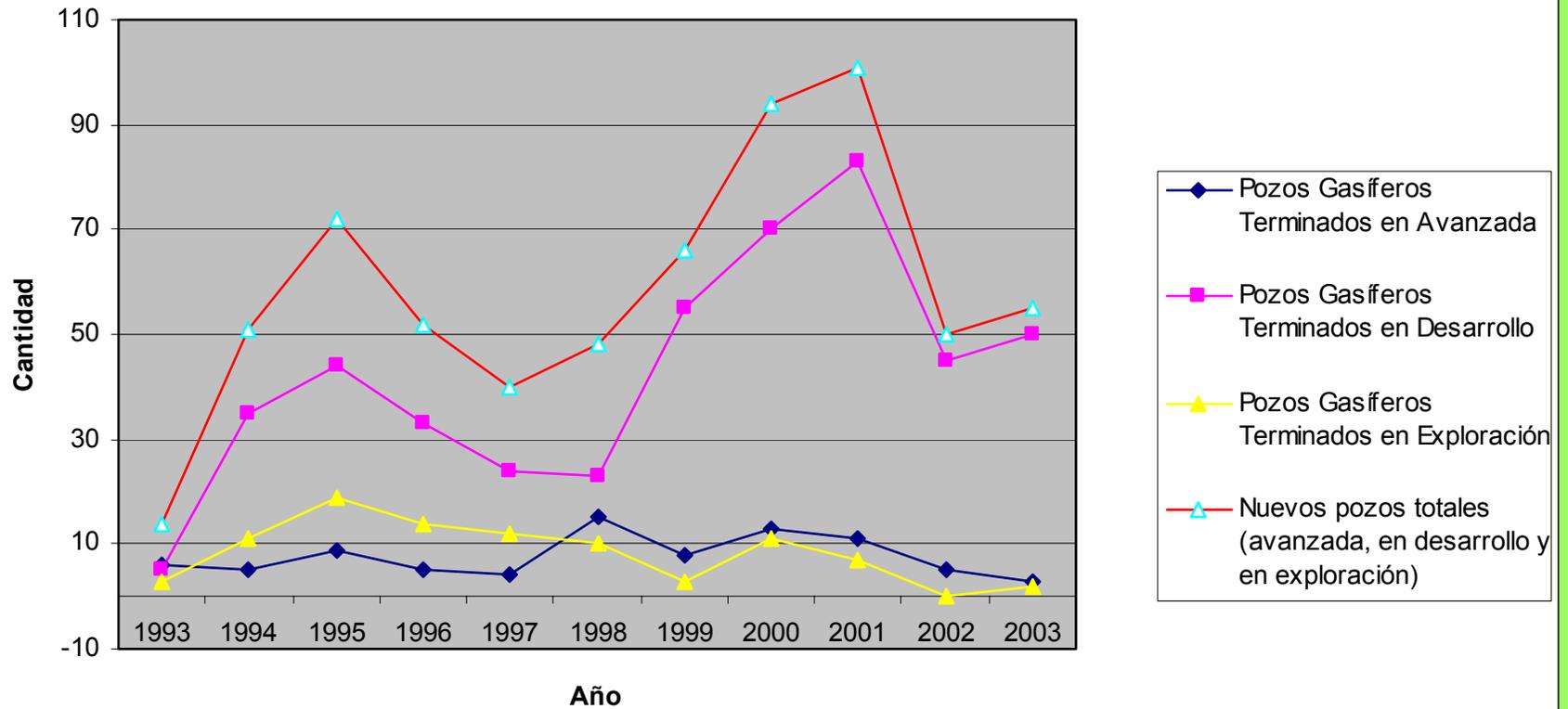
Producción anual de gas natural



Relación Reservas/Producción, Gas natural



Nuevos pozos de gas natural terminados, 1993-2003



Evolución de la demanda de gas natural, 1993, 1998, 2001, 2003 y primeros 2 meses de años siguientes

	Residencial	Comercial	Entes ofic.	Industria	Centr. Elec.	SDB	GNC	Exportación	Total
			<i>Consumo total (en miles de m3)</i>						
año 1993	5,637,257	866,727	590,778	7,747,277	5,931,452	293,811	760,489	-	21,827,791
enero-febrero 94	414,785	88,239	54,088	1,276,114	1,107,277	31,766	129,492	-	3,101,761
año 1998	5,877,402	948,901	277,160	9,909,620	8,548,320	287,019	1,411,854	1,242,222	28,502,498
enero-febrero 99	416,278	92,519	27,981	1,355,259	1,677,209	31,141	283,803	375,789	4,259,979
año 2001	6,717,209	1,008,269	351,854	9,626,612	8,897,951	334,500	1,850,565	3,384,315	32,171,275
enero-febrero 02	416,278	92,519	27,981	1,355,259	1,677,209	31,141	283,803	534,941	4,419,131
año 2002	6,655,864	987,221	353,394	9,797,259	7,783,935	371,738	2,040,319	3,187,069	31,176,799
enero-febrero 03	424,539	107,849	33,883	1,581,037	1,289,986	40,695	371,944	488,244	4,338,177
año 2003	6,910,523	1,031,449	390,695	10,689,111	8,750,873	417,298	2,639,988	3,861,137	34,691,074
enero-febrero 04	427,093	112,270	34,269	1,916,874	1,842,523	46,002	464,824	744,290	5,588,145
			<i>participaciones dentro del total</i>						
año 1993	25.8%	4.0%	2.7%	35.5%	27.2%	1.3%	3.5%		100.0%
enero-febrero 94	13.4%	2.8%	1.7%	41.1%	35.7%	1.0%	4.2%		100.0%
año 1998	20.6%	3.3%	1.0%	34.8%	30.0%	1.0%	5.0%	4.4%	100.0%
enero-febrero 99	9.8%	2.2%	0.7%	31.8%	39.4%	0.7%	6.7%	8.8%	100.0%
año 2001	20.9%	3.1%	1.1%	29.9%	27.7%	1.0%	5.8%	10.5%	100.0%
enero-febrero 02	9.4%	2.1%	0.6%	30.7%	38.0%	0.7%	6.4%	12.1%	100.0%
año 2002	21.3%	3.2%	1.1%	31.4%	25.0%	1.2%	6.5%	10.2%	100.0%
enero-febrero 03	9.8%	2.5%	0.8%	36.4%	29.7%	0.9%	8.6%	11.3%	100.0%
año 2003	19.9%	3.0%	1.1%	30.8%	25.2%	1.2%	7.6%	11.1%	100.0%
enero-febrero 04	7.6%	2.0%	0.6%	34.3%	33.0%	0.8%	8.3%	13.3%	100.0%
			<i>Variación anual promedio</i>						
1993-1998	0.8%	1.8%	-14.0%	5.0%	7.6%	-0.5%	13.2%		5.5%
E-F 1994-1999	0.1%	1.0%	-12.3%	1.2%	8.7%	-0.4%	17.0%		6.6%
1998-2001	4.6%	2.0%	8.3%	-1.0%	1.3%	5.2%	9.4%	39.7%	4.1%
E-F 1999-2002	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	12.5%	1.2%
1993-2001	2.2%	1.9%	-6.3%	2.8%	5.2%	1.6%	11.8%		5.0%
E-F 1994-2002	0.0%	0.6%	-7.9%	0.8%	5.3%	-0.2%	10.3%		4.5%
2001-2002	-0.9%	-2.1%	0.4%	1.8%	-12.5%	11.1%	10.3%	-5.8%	-3.1%
E-F 2002-2003	2.0%	16.6%	21.1%	16.7%	-23.1%	30.7%	31.1%	-8.7%	-1.8%
2001-2003	1.4%	1.1%	5.4%	5.4%	-0.8%	11.7%	19.4%	6.8%	3.8%
E-F 2002-2004	1.3%	10.2%	10.7%	18.9%	4.8%	21.5%	28.0%	18.0%	12.5%

Fuente: Elaboración propia en base a ENARGAS.