

**The London School of Economics and Political Science**

**The Political Economy of Regulatory Stability in Argentina**

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## **Declaration**

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## **Abstract**

Beginning in 1989, Argentina committed itself to a wide-ranging program of utility privatization and the establishment of new regulatory regimes. Following the international best practice, the design of these regimes involved the creation of independent regulatory agencies and the delegation of important regulatory powers to these agencies.

At the time these reforms were introduced, there was a reasonable amount of consensus that both privatization and the change in the locus of regulatory power were policy changes that had arrived to stay. Moreover, the expectation was that utility regulation would become more stable than in the past.

In this thesis, however, it is demonstrated that these expectations were unfounded. Using deductive reasoning, it is proposed that although delegation to independent regulatory agencies is an important condition for developing stable regulatory policies, equally important for that purpose is ensuring that governments cannot easily reverse that delegation or manipulate its terms. It is also hypothesized that, in the case of Argentina, whether or not this second requirement can be satisfied depends on the legal instrument policy-makers use to define the key features of a regulatory regime. The final claim is that, given the country's institutional endowment, the way regulatory policy is defined has an important consequence. It is less likely to be reversed, and therefore be stable and predictable, if key features of the policy are defined in a statute, than if they are contained within other legal instruments that can be passed – and changed – unilaterally by the executive.

To test these hypotheses, the thesis uses three case studies: telecommunications regulation between 1990 and 2001; electricity regulation between 1992 and 2001; and utility regulation – across sectors – between the passage of the Economic Emergency Law in January 2002 and April 2003.

I declare that this thesis consists of 76,969 words (excluding references).

Paolo Franco Benedetti

I dedicate this thesis to the memory of my dearest father Franco Benedetti.

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## **Chapter I**

### **Introduction**

## **1. The core elements of this thesis: puzzle, research questions, and hypotheses.**

Beginning in 1989, Argentina committed itself to a wide-ranging program of market-oriented reforms to open up the economy and reduce government intervention. A key element of this program was privatization of all the utilities under the national government's authority, including telecommunications, gas, electricity, and water. The program aroused interest all over the world. In fact, it was referred to as one of the broadest and most rapid in the Western Hemisphere, as well as one of the most ambitious and quickly undertaken by the economies that implemented structural reform programs from the end of the sixties.

As in other countries, privatization of utilities in Argentina coincided with the design and establishment of new, sector-specific regulatory regimes. This encompassed defining, on one hand, new formal rules governing prices, subsidies, entry, interconnection, etc. – that is, the structure of regulatory incentives. On the other hand, and perhaps more important, it also involved defining new frameworks within which regulatory decisions would be made.

The design of these new frameworks – or the sectors' regulatory governance in Levy and Spiller's (1996) terms - was a choice variable in the hand of the Argentine policy-makers. The choice, however, was a constrained one. It should be noted in this regard, that some sort of utility regulation existed before privatization. Specific ministries, or offices within the ministries, regulated the public companies, and government officials enjoyed a great deal of discretion in this respect. One of the problems with this scheme, nevertheless, was that its capacity to develop time consistent – and hence

credible – regulatory policies was seriously limited. Indeed, given the fact that in Argentina government officials usually had very short time horizons, they had strong incentives to use their discretion and change the policies over time in order to adapt them to new contingencies. This, in turn, resulted in the government being unable to refrain from renegeing on explicit or implicit agreements.

Reformers in Argentina acknowledged that this was a significant problem. They were aware of the fact that, when the success of a policy relies ultimately on the response of rational actors – who act on the basis of what they think the government will do tomorrow –, and where governments do not have a binding commitment holding them to an original plan, even adaptations made with the collective good in mind can hinder policy-makers from reaching their objectives. And the reason for this is no mystery: actors anticipate their future moves and act accordingly.

At the beginning of the nineties, thus, if the government wanted to guarantee a successful privatization program, it needed more than to put in place regulatory incentive structures that promoted welfare, facilitated investment, encouraged efficient pricing, and assisted the introduction of new services and technologies. There was also a need for new governance structures that made regulatory policy much less changeable than in the past.

Faced with these challenges, the reformers in Argentina decided to take a close look at the international best practice in the field. And the latter, it is important to note, was strongly shaped by the experience in the United Kingdom. In that country, when the Conservatives arrived to power in 1979 there was a generalised dissatisfaction with



the performance of the utilities, there were pressures over public sector borrowing requirements targets, and desires to extend competition and share ownership. In this context, the government embarked on a programme of privatisation of utility suppliers. The dates on which at least a majority of shares in the suppliers was sold were, among others: BT, 1984; British Gas, 1986; the water and sewerage companies, 1989; the twelve Regional Electricity Companies, 1990.

With privatisation came the establishment of new regulatory regimes, which had many elements in common, and hence, as argued by Thatcher (1998), it can be said to be one regime. Many of these elements, moreover, were based on provisions in statutes, beginning with the privatisation legislation. The main statutes were, among others: the Telecommunications Act, 1984, the Gas Act 1986, the Electricity Act 1989, the Water Act 1989, and the Water Resources Act 1991.

Under the new regime, it was established that public suppliers (including the former monopolists) were to operate under licences that set out the conditions and obligations governing their operation. It was established, moreover, that the enforcement of these licenses would not be direct responsibility of ministers – as it used to be before privatisation – but mostly of newly created industry regulators, or Director Generals (DGs). To this purpose, industry specific regulatory agencies were created. They were: Oftel (the Office of Telecommunications), Ofgas (the Office of Gas Supply), Offer (the Office of Electricity Regulation) and Ofwat (the Office of Water Services).

In all four industries, the statutes placed relatively the same duties on the DGs. There were two primary duties that related to securing supply and some form of “universal

service” to ensure: that supply of the service met “all reasonable demand” or all demand “as far as practicable”, or, in water, that water and sewerage functions were “properly carried out”; and that suppliers were able to finance the provision of such services. In electricity and gas there was a third primary duty: to promote/secure competition in generation and supply of electricity, and in the supply and shipping of gas.

The statutory duties provided industry DGS with wide discretion over the economic regulation of the industries under their supervision. Three reasons accounted for this. First, it was established that each regulator should exercise his/her powers “in the manner that he considers is best calculated”. Second, the duties themselves were very broadly defined: there were few guidelines as to how the regulators were to interpret the statutory wording and few specific examples. Third, the duties were liable to conflict, leaving the regulators the choice of which duty to give priority.

The discretion of the industry DGs was increased by their considerable institutional autonomy in making “general” decisions. In this sense, it should be noted that few controls were established regarding DGs overall approach to regulation: the legislation stipulated that the ministers could only issue “general directions” as to the priorities and considerations the DGs should use in reviewing their sectors and in collecting data; more specific directions were limited to well defined situations, such as national security and foreign relations in telecommunications. During their term of appointment, moreover, the DGs were granted considerable security of tenure: dismissal by the Secretary of State required evidence of “incapacity or misbehaviour”.

Complementing these provisions, DGs were also granted the power to appoint the staff of their offices, number of staff, and terms of employment.

Finally, in order to secure that DGs made a good use of their discretion, it was established, among other things, that: they should submit an annual report to the minister and that he/she would submit it to Parliament; they could be called to give evidence by select committees of Parliament; their work would be subject to scrutiny by the national Audit Office; they would submit annual Appropriations Accounts that could be subject to a “value for money” audit by the Comptroller and Auditor General; and their decisions fell within the competence of the Parliamentary Ombudsman. Adding to this, in telecommunications, water and electricity the statutes require the DGs to establish bodies to represent consumers<sup>1</sup>.

The design of these institutional arrangements discussed above did not go unnoticed for policymakers in Argentina and their advisors in multilateral organisations<sup>2</sup>. Proof of this is that privatisation in Argentina not only involved the change in the ownership of the utilities but also a radical shift in the locus of utility regulation. Like in the UK, and in some cases through statutes (e.g., gas and electricity) and in some others through a presidential decree (e.g., telecommunications and water), this shift involved the creation of industry specific regulatory agencies and the delegation to them of key regulatory powers that previously were in the hands of government officials. Also like in the UK, the creation of these agencies involved the establishment of other relevant

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<sup>1</sup> This description of the British experience draws, mainly, on Thatcher (1998a, b). For a more in depth one, see, in addition to this works, those by Helm (1996), Amstrong et al. (1994), Corry et al. (1994), Prosser (1997), Veljanovski (1993).

<sup>2</sup> Thatcher (2005; 2004), Jordana and Levi-Lafour (2005) and Gilardi et al. (2006) show that in the late eighties, and particularly during the nineties, the British model became the state-of-the-art in the design of the governance features of utility regulatory regimes not only for policymakers in Argentina but also for their counterparts in Western Europe as well as in other parts of the world.

provisions also aimed at developing regulatory commitment. Although they are discussed in more detail in subsequent chapters, it is worth reviewing them briefly.

First, and in order to guarantee that regulatory agencies would operate at an arm's length relationship with political authorities, it was established that regulators would be appointed to fixed terms, that they would be required to possess relevant technical expertise and professional experience in the field, and that their terms would be staggered. These provisions were complemented by setting up institutional arrangements to ensure that regulators also operated at arm's length from private interests. It was established, in this regard, that the regulatory agencies would not only be separated from regulated firms but also that regulators would be prohibited from holding a position or an interest in a firm subject to their control.

Regulators, furthermore, were also granted attributes of institutional autonomy to underpin the arm's length relationships discussed above, as well as to foster and retain technical expertise. Among other things, this involved providing the regulators with reliable sources of funding and endowing them with enough managerial flexibility to carry out their duties. Regulators had the right to require information from operators, and to impose sanctions on them for not complying with their obligations. Finally, in order to guarantee that regulators did not stray from their mandates and remained accountable for their actions, policy-makers established more or less specific rulemaking procedures, mechanisms for appealing regulatory decisions, and arrangements for securing that regulators provide relevant information and advice to interested parties.

At the time these reforms were introduced, there was a general agreement among both international and domestic observers that the delegation of important regulatory powers to independent agencies had arrived to Argentina to stay and, equally importantly, that it was a move in the right direction. According to them, these policies would finally free utility regulation from the short-term interests and volatile preferences of Argentine politicians. Utility regulation there, the argument followed, would then be less likely to suffer from the problems that characterized it before privatization, notably routine and often arbitrary changes in the rules of the game.

But were these expectations realistic? Would the setting up of new regulatory regimes in line with the best international practice allow the government in Argentina to break with the past and create an environment of regulatory policy stability and, hence, credibility? That is, would delegation of important regulatory powers to independent experts prevent politicians in that country from interfering with utility regulation affairs? Was delegation a policy commitment that, contrary to many others in the country's history, Argentine politicians would maintain?

In answer to these questions, in this thesis I first hypothesise, and then demonstrate, that while delegation is an important, perhaps even necessary, condition for sustaining commitments over time and developing stable regulatory policies, it is not by itself sufficient. I show that delegation increases the credibility of regulatory commitments only if it is nested in political institutions that make it durable, and that when designing the utility regulatory frameworks in Argentina, policy makers in that country sometimes seemed to ignore – or underestimate – this crucial aspect of regulatory policy. That is, in some sectors they did little to protect the delegation of

regulatory authority to independent agencies from reversal. I argue, moreover, that particularly relevant in this regard was the legal instrument used to define the key features of the newly created regulatory frameworks. I contend that politicians were able to refrain from messing with delegation only in those sectors where the key features of the newly created regulatory regimes were defined in a statute. In those sectors where the new rules of the game were defined in a presidential decree or resolutions, in contrast, politicians faced little constraints to renege on their previous policy commitments. And the reason for this, I show, is no mystery: given Argentina's institutional endowment, policy defined in statutes is likely to be far more stable than policy that can be introduced and changed unilaterally by the executive.

## **2. Methodological considerations.**

Having briefly presented the problem, prime research questions and hypotheses of this thesis, in what follows I address the issue of how these hypotheses are generated and, equally important, tested. In subsequent pages, thus, my aim is to make explicit the main features of the research design that frames this investigation.

The first matter to note is that the object of this thesis is not to provide a complete explanation for why a specific outcome occurred at a particular time and place – the type of explanations that historians typically seek<sup>3</sup> – but to provide what Hall (2006)

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<sup>3</sup> Hall (2006:25) notes that the events historians seek to explain are typically the product of a long chain of causal factors in which one development conditions another. Thus, the explanations that they typically advance are distinguished by the ambition to identify the full set of causal factors important to an outcome, establishing not only why the outcome was likely but why it happened at a particular time and place. Hall points out, however, that historians are unusually attentive to the importance of context – namely to how factors interact to generate an outcome and to the spatial or temporal specificities affecting the value of each factor. In the causal chains cited in their explanations, moreover, contingent events that do not themselves seem predictable often figure prominently. Based on a similar observation, and in line with Eckstein (1975), Levy (2001:13) argues that historians' work is normally

calls a “theory oriented explanation”. Therefore, my aim is to identify the causal factors conducive to a broad class of events. That is, what I seek is to identify the relevant variables that can be said to cause such outcomes in a general class of times and places, independently of the other factors that might contribute to the relevant causal chain in any one case.

## 2.1. Theory Building

Faced with the task of providing a theory-oriented explanation, some scholars would argue that the best way is by adopting an inductive approach to theory building and, in particular, to hypothesis formation. In their view, the hypotheses posited in this thesis should not be developed prior to the analysis of the empirical material but in the course of interpreting it<sup>4</sup>. In my view, however, this approach is not well suited for the purpose of my work. I agree with those who contend that building theory in a pure inductive fashion often leads to the development of ad hoc hypotheses and explanations that, to make things worse, can hardly be falsified (King et al. 1994, Geddes, 2003).

In this thesis, therefore, I address the issue of theory building and hypothesis formation using an approach that, in my view, minimises this sort of problem. Therefore, before going to the empirical material, I begin by formulating a theory or

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idiographic. That is, in contrast to political scientists – who are normally nomothetic – historians are not interested in discovering generalisable theories but they are concerned with particular and discrete events. Unlike political scientists, thus, historians are more interested in a case rather than in cases that enable them to test theories, discover the links between variables, and rule out competing theories of explanation.

<sup>4</sup> As noted by Steinmo et al. (1992) and Thelen (1999), this approach to theory building and hypothesis development is often adopted by historical institutionalists and, in particular, by those who adhere to what Hall and Taylor (1996:939) term the “cultural approach” to institutions.

model that, drawing on specified assumptions and using deductive reasoning, identifies the principal causal variables said to have an important impact on the phenomena I seek to explain. From this theory or model, I then derive logically sound and clear predictions about the patterns that will appear in the observations of the world if the theory is valid. The most important of these predictions are specified as hypotheses.

From the discussion above, someone could assume that theory building in this thesis follows a rational choice approach. And to a certain extent, he would be right. Indeed, not only do I use deductive reasoning to generate the predictions and hypotheses in this work – the hallmark of rational choice – but also, as it becomes apparent in the next chapter, I assume that the relevant actors have a relatively fixed set of preferences or tastes, and behave instrumentally so as to maximise the attainment of these preferences.

I emphasise, moreover, the role of strategic interaction in the determination of political outcomes. That is to say, I postulate that an actor's behaviour is likely to be driven, not by impersonal historical forces, but by a strategic calculus. This calculus is deeply affected by the actor's expectations about how others are likely to behave as well. In my view, institutions structure such interactions by effecting the range and sequence of alternatives on the choice-agenda or by providing information and enforcement mechanisms that reduce uncertainty about the corresponding behaviour of others.



It is important to note, however, that although my approach to theory building draws on rational choice, it is quite different to the strongest versions of it. First, although my interest is to find some general law-like statements, I work at the level of mid-range theory that the strongest versions of rational choice often hold in contempt<sup>5</sup>. Second, I do not treat an actor's preferences as entirely exogenous. That is, where feasible, I relax the traditional "instrumental rationality" assumptions, and try to figure out, within a given context, what would make sense for an individual to seek<sup>6</sup>. This strategy of contextualising preference formation, naturally, leads me to the incorporation of something that the stronger versions of rational choice often lack: detailed and fine-grained knowledge of the precise features of the political and social environment within which individuals make choices and devise political strategies.

The third difference between my approach to theory building and the strongest versions of rational choice is related to the issue of microfoundations. As noted by Thelen (1999), for the more radical rational choice analysts "micro-foundational" precludes dealing with collectivities. In my work, however, I deal with them. And this, I believe, does not mean that my work is not micro-foundational. In line with Scharpf (1997), I believe that to stand on microfoundations – whether dealing with individuals or a composite actor – entails two key requisites. First, the analysis must be actor-centred in the sense that the players are assumed to be capable of making purposeful choices among alternative courses of action. Second, it has to empirically

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<sup>5</sup> As noted by Thelen (1999:373), the strongest versions of rational choice often avoid focusing on a limited range of cases that are unified in space and/or time and aspire to produce more general (even universal) theoretical claims. Scholars working with this approach consequently use historical examples not so much for their intrinsic importance but to demonstrate how widely applicable their theoretical claims are. Thelen argues, however, that this has begun to change. In her view, more and more rational choice scholars now formulate their hypotheses and conclusions at the same, mid-range level as other school of thoughts in political science – notably, historical institutionalism.

<sup>6</sup> This strategy has been advanced by some rational choice scholars, such as Bates et al. (1998), Ferejohn (1991) and Levi (1994), who have recognised the difficulties of defining the preferences in general, *ex ante* to a particular application.

demonstrate that the actors to whom certain strategic behaviour is attributed are in fact players in the first place. In other words, and particularly when dealing with aggregations, the analyst needs to do more than impute (actor-centred) motives and strategies to them; he has to show that these actors were cohesive and strategic. Finally, in this thesis I am not interested in producing an elegant theory at the expense of explaining real observed events in detail – as it is common among rational choice scholars (Thelen, 1999:374). That is, I attach particular importance to contextualizing the theory (assumptions and propositions) and providing empirical evidence that the effects predicated by the hypotheses are in fact being produced.

## 2.2. Theory testing

For many years, when faced with the challenge of testing their theories, and when the number of cases to work with was relatively small, most political scientists favoured the adoption of the comparative method as defined by Lijphart (1971, 1975) and a succession of other scholars (see Collier, 1991). As noted by Hall (2003, 2006), in its conventional form this is essentially the statistical method writ small. That is, most of the scholars that adhered to this method assumed that the basis for causal inference lies in the correlation to be found across the cases, between a few causal variables and the relevant outcomes<sup>7</sup>. Bennett and Elman (2006:457) argue, in this sense, that users of this method commonly direct their investigations to inferring systematically how much a cause contributes on average to an outcome within a given population.

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<sup>7</sup> According to Collier et al. (2004: 94-95) causal inference in the conventional form of the comparative method is established through 'intuitive regression'.

But is this the most appropriate method for testing the predictions and hypotheses posited in this thesis? To answer this question, it is important to bear in mind that the choice of a methodology is conditioned by the state of the world as we perceive it, and notably by the character of the causal relations in the cases to be investigated<sup>8</sup>. As Hall (2003, 2006) notes, although the object of enquiry is to propose and test some specific inferences about causal relations, every methodology produces valid inferences only when certain assumptions about the general structure of those causal relations are met.

In this regard, and as pointed out by this author, Wallerstein (2000) and Ragin (2000), if the conventional comparative method is to produce valid causal inferences, we need to make several assumptions. The first is unit homogeneity. This is to say that, other things being equal, a change in the level of a causal variable,  $x$ , will produce the same change in the level of the outcome variable,  $y$ , across cases. Second, that there is no systematic correlation between the independent variables included in the analysis and other explanatory variables omitted from it. Third, that all the relevant interaction effects among independent variables have been captured by interaction terms and, in most cases in which is used, that the value of an independent variable in one case is unaffected by the values that these other variables take in the other cases. Finally, although there are techniques available for coping with reciprocal causation between the dependent and independent variables, it is common simply to assume that the latter are unaffected by the former.

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<sup>8</sup> Bennett and Elman (2006:456) argue, in this respect, that “scholars have beliefs about what the social world is made of and how it operates, and these beliefs influence their choices about how to construct and verify knowledge statements about the world.”

Today, however, there is a certain degree of agreement among social scientists that our ontologies have changed. Indeed, our conceptions of how the world works now acknowledge that in most issues/areas of the social and political world – including that studied in this thesis – causal structures generating the relevant developments contain more causal variables than we used to believe. Few would question, moreover, that in these issues/areas the interaction effects among causal variables are often very complex and multiple<sup>9</sup>. Equally important, everybody seems to accept that sequence now looms so large as a component of the causal impact of a variable that it has become difficult even to think in terms of a world in which variables have a homogeneous impact regardless of when they occur in relation to other sets of developments<sup>10</sup>.

This is not to say, of course, that the conventional comparative method is inadequate for establishing valid causal inferences. As Hall (2003, 2006) notes, there are still some areas/issues of the political world where we can get some leverage from the conventional comparative method – notably, those where the interaction effects are manageable or where it is thought that an outcome is determined by a small set of structural variables operating with great force, and with analogous effects across cases. What the discussion above suggests, however, is that there are other issues/areas of the political world where our new ontologies do challenge this method and the adoption of alternative types of enquiry better-suited to these new ontologies is needed<sup>11</sup>.

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<sup>9</sup> For an in depth discussion on this issue, see Ragin (1987).

<sup>10</sup> As Hall (2003, 2006) notes, in political science most of these findings have been advanced by the rational choice and the path dependence literature.

<sup>11</sup> Hall (2003, 2006) is not alone in pointing out that causal complexity poses serious challenges to the comparative method in the conventional form and, more generally, to a statistical world view. See among others: McKeown (1999), Ragin, (1987, 2000, 2004), Gerring (2001), and Collier et al. (2004).

In recent years, fortunately, many political scientists have taken note of this problem and, more importantly, have begun to propose methods of hypothesis testing aimed at solving it. Within the camp of small-n research designs, the most appealing of these methods – and, hence, the method I adopt in this thesis – is what Hall (2003, 2006) terms “systematic process analysis”<sup>12</sup>. Briefly, advocates of this approach argue that political outcomes are invariably the result of an unfolding process. Good theory, their argument follows, often generates many other hypotheses about what we should see in the province of the world of our interest that go well beyond simple correlations between a given set of independent variables and a given set of outcomes. Most of the time, good theory also generates predictions about the processes whereby the independent variables operate on the world so as to lead to those outcomes. Therefore, capture of the causal complexity of the phenomena needs both an assessment of the correlation between explanatory and dependent variables and a demonstration of the presence of the processes specified by the theory. As Hall (2003) notes, this is not simply a search for “intermediate” variables. The point is to see if the multiple actions and statements of the actors at the relevant stages of the process whereby one set of developments lead to another are consistent with the image of the process implied by the theory under scrutiny.

Since this method requires a detailed analysis of each of the cases used to assess the validity of a theory, its adoption naturally limits the number of cases I can work with. And I am aware, in this regard, that this can be problematic for some of my colleagues. Indeed, for some political scientists the only way to effectively test the

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<sup>12</sup> This type of enquiry, Hall (2006) notices, is similar in key respects to George and Bennett’s (2005) process-tracing. In my view, it also closely resembles Collier et al.’s (2004: 252-56) causal process observations.

adequacy of a theory is to analyse the universe of cases to which this theory is meant to apply or, at least, a large sample of those cases. Working with a few cases is widely regarded to be useful for generating new hypotheses or providing detail that others can use to inform statistical analyses, but provide too limited amount of data to test/confirm causal theory (Achen and Snidal, 1989; Njolstad, 1990; King et al., 1994; Liberson, 1992, 1994; Geddes, 2003; Beck, 2006a,b)<sup>13</sup>.

To a certain extent, this view on case studies does have a point when referring to works that address the issue of hypothesis testing in the correlational terms of the conventional comparative method. As it has already been discussed, those works use the cases they work with simply to establish the correspondence between ultimate “causes” and eventual outcomes. The observations they use to assess the adequacy of their hypothesis, as a result, are often less numerous and informative than those that can be mustered from a large number of cases. Recall, however, that in this thesis I do not assess the validity of a theory in the terms of the conventional comparative method. That is, I regard case studies not only as a terrain where I can inspect the correspondence between the variables reflecting ultimate ‘causes’ and those representing final outcomes, but also the process whereby those causal factors operate on the world so as to lead ultimately to those outcomes. As a result, my cases contain far more numerous and diverse observations against which to test theory than if I used case studies just to search for correspondence between a small set of variables. And this is far from irrelevant for establishing the validity of my theory. It is widely known

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<sup>13</sup> This view is often advocated by those scholars who prefer the use of statistical methods applied to a large number of cases. From their perspective, small-n designs lack, among other things, the degrees of freedom that large-n designs provide for considering a substantial number of causal variables, and the interaction effects among them.

that we gain confidence in a theory not only when it conforms to increasing numbers of observations, but to increasingly diverse kind of observations.

This takes us to the issue of the number of cases and the criteria used to select them. It should be noted in this regard that according to some authors, much can be learned from establishing whether the process is present in a single case – provided that the theory being tested is formulated in terms that apply to a wide range of cases and spell out the relevant causal process in detail (Becker, 1992; Mahoney, 2000). In their view, even when applied to a single case, systematic process analysis would offer grounds for drawing valid causal inferences<sup>14</sup>.

I believe, however, that we can never consider all the factors that might provide explanations beyond the reach of the theory we are using in a particular study. So, if we apply this method to a single case, there is always the danger that the outcomes we explain may actually attributable to a different set of variables. Thus, I agree with Hall (2003) that if we intend to generalise from the case analysis, and if we want to increase our confidence that the causal process observed is not idiosyncratic to one of our cases, it is desirable to apply systematic process analysis to more than one case, even if the number examined must be small to accommodate the gathering of an extensive set of observations, and to draw comparisons across cases<sup>15</sup>.

In this thesis, therefore, the validity of hypotheses is assessed not just in one but in three cases. In selecting these cases I put particular attention on ensuring that they

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<sup>14</sup> Bennett and Elman (2006: 459) argue that for some scholars “a single ‘smoking gun’ piece of evidence may strongly validate one explanation and rule out many others”.

<sup>15</sup> A similar argument can be found in Bennett and Elman (2006), Gerring (2004), and Kaarbo and Beasley (1999: 387).

show some variation in the value of the dependent variable. And the reason for this is obvious. Without variation in the values of the dependent variable, one cannot make any causal inferences about the phenomenon because the same explanatory variables may be present in cases in which the phenomenon is absent (King et al., 1994).

Allowing for the possibility of variation in the dependent variable, however, does not imply that I picked the cases on the value of the dependent variable. Although I agree with Collier et al. (2004) that investigating cases where an outcome is known can sometimes provide a good opportunity to gain detailed knowledge about the phenomenon under investigation – notably when the cases are used to test claims of necessity and/or sufficiency<sup>16</sup> – I also agree with those who claim that this strategy can sometimes lead to “wrong answers”. In this sense, I join authors such as Achen and Snidal (1989), Geddes (1990), and King et al. (1994) in noting that picking cases on the basis of outcomes often opens the door to selection bias problems. That is, there is always the risk of selecting cases with any variety of unusual causal paths for reaching a high (or low) value on the outcome. Then, the probability of coming out with a distorted picture – one that artificially diminishes the evidence for a theory or exaggerates the evidence for it – is increased<sup>17</sup>.

In this thesis, thus, I selected the cases on the values of ultimate independent variable postulated by my theory. As a result, it is only during the research that I discover the values of the dependent variable and then make my initial causal inference by examining the differences in the distribution of outcomes on the dependent variable

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<sup>16</sup> On this issue, see also Dion (1998), Braumoller and Goertz (2000), Goertz and Starr (2003), and Bennett and Elman (2006).

<sup>17</sup> Even some of those who advocate picking cases on the dependent variable do not entirely dismiss the selection bias critique. In their view, however, this critique is often overstated. See Collier and Mahoney (1996), Collier et al. (2004), George and Bennett (2005), and Bennett and Elman (2006).



for given values of the explanatory variables. As noted by King et al. (1994) the great advantage of this selection procedure is that it causes no inference problems. This is because this procedure does not predetermine the outcome of our study, since it does not restrict the degree of possible variation in the independent variable.

Finally, and before turning to the structure of this thesis, it should be noted that the empirical information in the three cases is presented in the form of narratives. The preference for narratives is due not to the unavailability of other forms of presenting my results, but to particular strengths of the narrative form. As pointed out by Büthe (2002: 486), the most important of these strengths is that narratives, in addition to presenting correlations at every step of the causal process, can contextualise these steps in ways that make the entire process visible rather than fragmented into analytical stages. Moreover, this author argues, narratives allow for the incorporation of nuanced detail and sensitivity to unique events, which are sometimes necessary to understand the particular manifestation of an element of the theory, but which is beyond it<sup>18</sup>.

The narratives here presented, of course, simplify "reality" by designating some elements as important and omitting many more as not significant. And, to this purpose, the theory from which I derived my hypotheses resulted extremely useful. Indeed, it not only provided me with a framework that organises what to expect in the province of the world of my interest, but also emphasises the questions that are worthwhile asking, the factors that are likely to have high explanatory potential and, equally important, the type of data that would generally be useful in supporting or

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<sup>18</sup> On the merits of narratives for testing theory and establishing causal inferences see, among others, Levi (1997), Bates et al. (1998), Kiser and Hechter (1998), and Goldstone (1998).

invalidating specific explanations. The theory, then, provided me with the criteria for what could be considered salient to write narratives that are useful as a test of my arguments<sup>19</sup>. It allowed me, moreover, to ensure equivalence, in the sense that each narrative contains the same (or at least functionally equivalent) elements<sup>20</sup>.

To conclude, I should also make clear a couple of points. First, against Hall's (2006) advice, the narratives in this thesis are not used to assess an alternative or competing theory – which would entail providing a second set of narratives, similarly structured by the underlying theory of an alternative explanation of the same phenomenon<sup>21</sup>. In my view, however, this is not a serious problem. As noted by Büthe, alternative narratives are often a rhetorical device in support of the primary, favoured explanation<sup>22</sup>. Moreover, as Fiorina (1995:92) argues, meaningful alternative explanations are much more likely to be advanced by others whose “perspectives and commitments” allow them to argue as strongly as possible in support of those alternatives.

Second, to build the narratives my main sources of information were basically three. Since this is a study about the stability of regulatory policy in Argentina, the first source was the legislation that politicians used defined the policies in question as well

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<sup>19</sup> As suggested by Büthe (2002:487), in the narratives I only provide information that is extraneous to the model insofar as it affects salient elements and is needed to understand the relationship between these elements or to appreciate contingencies of a particular process.

<sup>20</sup> For a more in depth discussion on this issue, see Kiser (1996), Büthe (2002) and Pedriana (2004).

<sup>21</sup> In Hall's (2006:30) view, if the investigator's principal theory is not tested against other theories, it becomes increasingly difficult to falsify the theory using the observations drawn from the narratives, and the risk of affirming a false theory increases. Equally important, there is always the chance that the use and assessment of just one theory will advance a research program at the cost of neglecting others that may offer more purchase over some issues. In line with Elster (2000), Hall argues that this is one of the drawbacks of the analytic narrative approach advanced by Bates et al. (1998).

<sup>22</sup> As Büthe (2002:489) notes, the interpretative freedom of the author makes it unlikely that less convincing alternative narratives would be accepted as sound evidence of the failure of alternative explanations.

as the legal and institutional framework within which regulatory decisions were made. As it is discussed in detail in subsequent chapters, this included not only laws passed by Congress but also different types of presidential decrees as well as resolutions passed by ministers or other relevant authorities such as secretaries of state and regulators. The second source of information was the work by other scholars and practitioners that have studied utility regulation in Argentina. Although most of this work does not cover the specific issue of the political economy of regulatory stability, it provided me with a great deal of detail on regulatory policy in that country. Finally, I also made intensive use of press articles. In particular, I used press articles that appeared in four different daily newspapers: Clarín, La Nación, Cronista Comercial and Ambito Financiero. The first two of them are, reportedly, the most read newspapers in the country. The second and the third, meanwhile, are specialized newspapers that mostly cover economic and financial news.

Having said that, it is important to note that although during the course of my research I conducted several interviews, the information I acquired through them had serious reliability problems. Although I do not deny the possibility that these problems resulted from errors in the way I conducted the interviews, I believe that at root of this problems were three elements that, according to Berry (2002), are quite common in elite interviews. First, in many cases interviewees told me stories that were impossible to confirm. Second, they were often talking about their work and, as a result, they had a tendency to tell me stories that contained excessive personal bias or, even worse, that were built with the clear purpose of justifying their actions. Third, many of my interviewees also exaggerated their role in the events they were telling me about. For

building the narratives in this thesis, therefore, I decided not to use the information I acquired following this data-collection methodology.

### **3. The structure of the thesis**

The structure of this thesis, naturally, is strongly determined by the research design discussed above. It should not be surprising, then, that the next chapter is exclusively devoted to the presentation of the theory from which I generate the predictions and hypotheses that in subsequent chapters are brought to bear on the empirical material. Among other things, there I discuss the reasons why, given Argentina's institutional endowment, the legal instrument used by policy-makers to define regulatory policy makes all the difference for the stability of that policy and, as an extension, for the durability of the policy reforms introduced in the beginning of the 90s.

Chapters 3 and 4, present the first of three case studies analysed in this work. They comprise an in depth study of telecommunications regulation in Argentina between privatisation of the industry in 1990 and the last days of Fernando de la Rúa's government in December 2001. As discussed in the previous section, the main reason for picking this case was that in this sector the key features of the regulatory regime were defined in a presidential decree – one of the two possible values of the ultimate explicatory variable identified by my theory. If the hypotheses and predictions posited in this thesis are valid, thus, the narratives in these chapters should show that delegation of important regulatory powers to independent experts in this sector was an easily reversed arrangement and, as a result, that telecommunications regulatory

policy continued to be a domain where policy-makers introduced changes whenever their preferences dictated it.

In chapter 5, I analyse the case of the electricity industry between its privatisation in 1992 and December 2001. As it will be shown in this chapter, the design of the regulatory regime in this sector showed important similarities with the design originally put in place in the telecommunications sector. In contrast to the latter, however, the legal instrument used to define its key features was not a presidential decree but a statute – the other possible value of the ultimate explicatory variable identified by my theory. If the hypotheses and predictions offered in the theoretical chapter of this thesis are valid, then, the analysis of this case should reveal that, in contrast to what happened in the telecommunications sector, policy-makers in the electricity sector had more incentives to maintain its original policy commitments. Put differently, the analysis of this case should reveal that the reforms introduced in the Argentine electricity sector in the beginning of the 90s not only were more difficult to be reversed but also that they were considerably more stable.

Chapter 6 is the last of the empirical chapters. In it I analyse the case of two key regulatory policies that the Argentine government simultaneously introduced in January 2002 as a reaction to the major economic crisis of the time. The first of these policies, which were defined in the so-called Economic Emergency Law, established that the tariffs of all the utilities and infrastructure services in the country would remain frozen for as long as the crisis situation lasted. The second established that the contracts of all utilities and infrastructure companies operating in the country would be renegotiated. In addition, it stipulated that the institutional arrangement and the

rules governing that process would be defined by the executive in presidential decrees. This chapter – which covers the time period of the first days of 2002 through April 2003 –, thus, does not test for the impact that the choice of the legal instrument has on the stability of delegation. That is already discussed in detail in the previous three chapters. Instead, this chapter puts under scrutiny a more general, and equally relevant, contention of this thesis: that in Argentina regulatory policy defined in a presidential decree is likely to be far less stable than regulatory policy defined in statute. Following this prediction, then, the narrative in this chapter should show that, since it was defined in a statute, the freezing of tariffs was a policy subject to fewer changes than the renegotiation of contracts.

Chapter 7, finally, advances the major conclusions of this research project. In the first part it summarises the major assertions advanced in this thesis as well as the findings in each of the empirical chapters. The second part discusses the normative implications of these findings not only for the design of regulatory policy in Argentina but also for the design of economic policy and economic reform in general.

## **Chapter II**

### **The Institutional Determinants of Regulatory Stability in Argentina**

## **1. Introduction**

At the beginning of the '90s, policy-makers in Argentina decided to delegate important regulatory powers to independent agencies. As advanced in the previous chapter, the main thrust of this thesis is that they sometimes seemed to ignore that it was critical to adapt the new system to the structure and organization of the country's institutions in order to gain the outcomes they expected. I also foreshadowed that the choice of the legal instrument used to define the key features of the newly created regulatory regimes was particularly relevant. I argued that it was this choice that explains why in some sectors the new status quo became stable while in others it opened the door to constant changes in the rules of the game.

Before these propositions are empirically tested, they need to be more precisely defined. Also, the reasoning behind them needs to be clearly established. This chapter, then, proceeds as follows. Section 2 discusses why delegation of regulatory policy to independent experts can be a "solution" to the time inconsistency problems that characterise economic regulation. It is argued, however, that since there are many circumstances that make it tempting to revoke delegation, the effectiveness of this solution depends on whether it is costly to revoke. In section 3, it is argued that the costs of revoking policies – including delegation – depend on the structure and organisation of a country's institutions. In section 4, the degree of policy stability provided by the structure and organisation of Argentina's institutions, and the role played in this sense by the legal instrument used to define a policy, is analysed. Finally, section 5 concludes and presents a set of hypotheses that will then be empirically tested.



## 2. Delegation and Credibility

For government policies ranging from utility regulation to monetary policy, the importance of credibility for eliciting optimal responses from private actors is well known. However, it is also well known that credibility is difficult for governments to acquire. In this sense, there are several circumstances under which government policy commitments are not credible. The most important, undoubtedly, is time inconsistency, which arises if politicians announcing a certain policy today have an incentive to deviate from the policy at some point in the future.

The problem is that, when the success of the policy relies ultimately on the response of rational individuals, and where policy-makers do not have a binding commitment holding them to an original plan, even adaptations made with the collective good in mind can hinder policy-makers from reaching their objectives (Kydland and Prescott, 1977: 473-474; Barro and Gordon, 1983). This is because, it is claimed, rational actors anticipate the future moves of policy-makers and act accordingly<sup>1</sup>. Thus, when monetary policy is time-inconsistent, and hence not credible, private sector actors protect themselves and write contracts that build in high inflationary expectations. Similarly, when utility regulatory policy is time-inconsistent, private actors do not invest or, if they do so, investment inefficiencies arise on several fronts. This limits the social value of the enterprise<sup>2</sup>.

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<sup>1</sup> The problem of time inconsistency here analysed is the policy equivalent of imperfect commitment in incomplete contracting. See Milgrom and Roberts (1992).

<sup>2</sup> For an in depth discussion on the effects of time inconsistency in utility regulation, see Spiller (1996a, 1996b), Levy and Spiller, (1996), and Bergara et al. (1998).

As argued by Keefer and Stasavage (1998), in the light of time inconsistency, and in order to generate credibility, one alternative for governments is to build a reputation for sound policy by engendering the expectation that certain policies will be followed in the future on the basis of actions that have been observed in the past<sup>3</sup>. But building reputation is a difficult task, particularly for governments (Shepsle, 1991; Majone, 1997). Moreover, there are circumstances where this mechanism alone fails to prevent renegeing (North and Weingast, 1998).

A second alternative is for governments to give up their discretion and delegate policymaking competencies to independent agencies (Shepsle, 1991; Dixit, 1996; Dixit and Nalebuff, 1991; Majone, 1997)<sup>4</sup>. The latter, it is often claimed, are not only better equipped to make more informed policy decisions than elected politicians – who often lack the expertise to design policies or the capacity to adapt them to changing conditions or particular circumstances – but also have different incentives. Indeed, either because of their preferences or their legal mandate, or both, independent agencies normally do not suffer from the short-time horizon that the democratic process often imposes over elected politicians – namely, the next election. Because of this, their capacity to credibly commit themselves – and to reduce election-induced uncertainty about the future course of policy - is larger than that of democratically accountable and elected bodies (Gilardi, 2002).

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<sup>3</sup> For an in depth discussion about the effects of reputation on credibility see Drazen (2000: 166-215) and relevant chapters in Persson and Tabellini (1994: 99-189).

<sup>4</sup> The relation between delegation and credibility has been extensively studied in the central banking literature. In addition to the seminal work of Rogoff (1985), see Cukierman (1992), Cukierman et al. (1993), Alesina and Summers (1993), Alesina and Gatti (1995), Eijffinger and Schaling (1997), Al-Marhubi and Willet (1995), Cukierman and Webb (1995), Jensen (1997), and Moser (1999).

From the above discussion, it is easy to understand why many predicted that delegation of utility regulation to independent experts in Argentina would finally improve the stability and credibility of the regulatory policy in that country. Indeed, not only was the recipe working soundly in other countries – notably the US and the UK –, but it also seemed to be well founded on theoretical grounds.

### 2.1. The problem of delegation

To a great extent, the prediction above was based on the assumption – relatively common in the literature on this topic - that once a policy is adopted it cannot be undone<sup>5</sup>. This, however, is an unrealistic assumption<sup>6</sup>. Indeed, as the literature on transaction costs and institutions emphasizes, while parties may have strong incentives to strike a bargain, their incentives are not always compatible with maintaining it (North and Weingast, 1998).

As noted by Heller et al. (1998), there are many circumstances that make it tempting for governments to renege on their policy commitments and to introduce policy changes. First (and most obviously), an altogether new leadership often faces different benefits and costs from individual policies: different leaders normally represent differing constituencies, whose interests are likely to vary. Second, even if the individuals in power do not vary, coalition realignments – a change in the government's base of support – can also provide a motive for introducing policy changes. Indeed, as long as political leaders care about maintaining their hold on

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<sup>5</sup> In his seminal paper, for example, Rogoff assumes that the costs of doing away or overriding a monetary institution is infinite.

<sup>6</sup> This has been noted, among others, by Keefer and Stasavage (1998) and Moser (1999).

power, modifications in their supporters' preferences will induce them to alter their policy stances. Third, the introduction of policy changes can also become a tempting alternative when the value of the status quo is altered. These alterations can be originated in an external change in the economic environment. In this regard, if the set of policies in place maintains the dire straits, then the net value of policy change increases greatly. Finally, the value of the status quo can sometimes change "internally" due to the accumulation of the leadership's own decisions or because new – and sometimes better - information about the policy in question becomes available<sup>7</sup>.

This does not imply that the delegation of powers is revoked every time one or more of the circumstances discussed above are present. Neither is it to say that delegation to independent agencies is only a short-term solution to the problems of time inconsistency. As Heller et al. (1998) argue, it is not sufficient for the occurrence of policy changes that politicians perceive them as desirable. In the first place, politicians must believe that they can identify plausible alternatives that correspond to their preferences. That is, they must know – politically and technically – how to accomplish their policy objectives. Second, and more importantly, they also need to have the means to enact policy change<sup>8</sup>.

### **3. Institutions and policy change**

In the literature that analyses the central variables that affect political leaders' ability to institute changes to the status quo, an often-heard claim is that "institutions matter".

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<sup>7</sup> As Heller et al. (1998) notice, while the first and second possibilities stem from changes in the government support coalition, the third and fourth consist of changes in the values of the status quo itself.

<sup>8</sup> This point is also made by Heller and cCubbins (2001).

Institutions, it is argued, set the context for political decision-making and create incentives for political leaders that shape and constrain their actions. In different contexts, thus, institutions might make the introduction of policy change more feasible or might hinder it – binding policy-makers to keep a given policy and, hence, “stacking the deck” in favour of maintaining the policy status quo (Heller et al., 1998:147).

As pointed out by Drazen (2000:133), there are important differences between policies, or promises, which have no legal backing compared to those that have been formalised through legislation<sup>9</sup>. The primary difference, according to this author, is that policies formally embedded in legislation normally have penalties attached to them so that there are explicit costs associated with not following them. Secondly, they make noncompliance more visible and hence more costly.

Drazen’s argument closely resembles that advanced by Lohmann (2003). According to her, a policy formalised through legislation enjoys some degree of credibility because the act of institutional creation (or formalisation) of that policy automatically provides an audience that can and will monitor the integrity of the institution. This audience, moreover, will impose “audience costs” on the policy-maker who dares to interfere with it (Lohmann, 2003:100). Put differently, creating an institution draws a “line in the sand” that focuses the expectations of an audience. The line in the sand is a public focal point that allows people to coordinate their beliefs about trigger-punishment strategies that will be executed in the event of an institutional defection. In the case of monetary policy, for instance, the dismissal of a central banker, a

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<sup>9</sup> Moe (1990a:240) makes a similar claim.

devaluation, the failure to achieve a monetary target – all these being institutional defections – generate an audience cost. According to Lohmann (2003:101), voters may vote the policy-maker out of office; wage-setters may write high inflationary mark-ups into nominal wage contracts; financial markets may engage in destabilising speculation or shift investment capital to other countries; cooperative understandings with other policy-makers on other dimensions of public policy may break down (the defecting policy-maker experiences a “loss of political capital”). In sum, Lohmann’s argument is that it is the audience cost – or the threat of a punishment – that makes the policy maker’s commitment to the policy credible<sup>10</sup>.

It is important to note, however, this chapter is concerned with factors that constrain a policy-maker to change a given policy, in a way that is fully legal, whenever circumstances make it tempting. This, of course, is distinct from the issue of compliance.

There is a growing literature that claims that formalizing a policy through legislation enhances its credibility because, in general, there are quite explicit institutional costs a policy-maker must face for changing that legislation. Within this literature, perhaps the most striking work is that of George Tsebelis (1995, 2000, 2002). According to him, policy outcomes are the results of two factors: the preferences of the actors

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<sup>10</sup> To illustrate her claim, Lohmann (2003:101) suggest comparing two situations. First, a man and a woman sit together in a restaurant, and the man ask the woman how she would feel about marrying him. Second, a man and a woman stand together in a church in front of an audience of relatives; a priest asks each of them in turn whether they want to marry the other; and each of them says yes. In the first situation, there is no audience, and it is easy for the man and the woman to disagree on the question of what exactly, if anything, was promised. In the second situation there is an audience, and there is a line in the sand, and these two ingredients explain why the degree of commitment is higher in the second situation than in the first. Similarly, a policymaker who moves his or her lips might *ex post* wriggle out of a policy promise, saying that she or he was misinterpreted or misquoted. By way of comparison, a policymaker who dismisses a central banker because the latter refused to do the policymaker’s bidding can hardly argue that it was all just a big misunderstanding.

involved and the prevailing institutions. In his view, given that the identity of players and their preferences are variable while institutions are more stable, policy outcomes will vary depending on who controls political power as well as where the status quo is. For developing his propositions, he focuses on the more stable part of the interaction and tries to assess the outcomes focusing only on institutions, with limited knowledge of the identity of actors that produce them. He then makes predictions about the consequences for policy stability of the number of actors involved or their relative positions, without knowing exact numbers or locations.

In a nutshell, Tsebelis' basic argument is that in order to change any given policy, or to change the legal status quo, a certain number of individual or collective actors have to agree to the proposed change. He calls such actors veto players. Veto players, as well as the points in which they are located, are generally specified in a country by the Constitution, or by the political system. Every political system has then a configuration of veto players, that is, a certain number of veto points, with a certain number of veto players positioned at these points, who have specific ideological distances among them, with each having a certain cohesion.

According to Tsebelis, all of these characteristics affect the set of outcomes than can replace the status quo (the winset of the status quo, as he calls the set of these points). The size of the winset of the status quo has specific consequences for policymaking (or, more accurately, for legislation and legislating). In this sense, he contends that significant departures from the status quo are likely to be far more difficult – and policy stability greater – in countries where decision makers have to face a large number of veto points, with a large number of veto players (positioned at these

points), and where the degree of congruence among these veto players is small. Conversely, in countries where decision makers have to face a small number of veto points with few veto players positioned at these points, and the degree of congruence among these players is large, introducing significant change to the status quo is likely to be easier – and, hence, policy far less stable.

In a similar vein, Cox and McCubbins (2001) contend that polities can be located on one particular point of the continuum between decisiveness – that is, the ability to enact and implement policy change – and resoluteness – the ability to commit to maintaining a given policy. As Tsebelis, these authors also claim that a country's location on this continuum greatly depends on its basic political institutions, which generate not only a certain separation of powers (or veto players), but also a certain separation of purpose (or the degree to which veto players have similar preferences and political incentives, and are accountable to the same groups, pressures and demands). Drawing on previous works by public choice scholars like Buchanan and Tullock (1962), they argue that as more actors must be taken into account in a policy logroll, and as more diverse are the preferences of these actors, it becomes increasingly difficult to ensure that every party to the negotiations receives sufficient value to accept the deal. Put differently, changing policy becomes increasingly costly, and hence the polity becomes more resolute when the number of parties to a negotiation, and also when the diversity in their preferences, increases. In contrast, changing policy becomes easier, and the polity more decisive, as the number of parties to a negotiation, and as the diversity of their preferences, decreases.



In sum, as it has been argued in previous pages, there are many circumstances that might make it tempting to political leaders to renege on their policy commitments. Following the above discussion, however, it can be argued that political leaders' capacity to actually do so depends on the structure and organisation of a country's institutions. Indeed, since the latter determines the number of veto points, the number of players positioned at these points, and the distance among them, it also determines the costs of withdrawing or manipulating the policy in question. One should then expect that in countries with more veto players in the political system, with more divergent preferences, it is harder on average to overturn delegation. This leads to more credibility.

#### **4. Institutions and Policy Stability in Argentina: The stability of policies defined in Statutes**

What do the structure and organisation of Argentina's institutions tell us about policy stability in that country? Do they enhance the credibility of policy or, on the contrary, do they provide incentives for political leaders to enact policy change whenever they perceive that is optimal to do so?

According to the country's constitution, Argentina is a federal republic consisting of twenty-three provinces and a semiautonomous federal capital. It has a bicameral legislature and, drawing on Shugart and Haggard (2001), its political system can be characterised as a "pure presidential" democracy. The president, who cannot dissolve

the legislature and has discretionary powers to appoint Cabinet ministers<sup>11</sup>, is directly elected via a modified version of the double complement rule for a four-year term<sup>12</sup>. Although the president can seek re-election for one four-year term, he or she must wait four years prior to seeking a third term in office<sup>13</sup>. Within the Legislature – which cannot shorten the tenure of the president – the 257 members of the Chamber of Deputies are elected using closed list proportional representation, from multimember districts (the 23 provinces and the federal capital) also for fixed four-year terms<sup>14</sup>. One half of the chamber, however, is renewed every two years, with every district renewing one half of its legislators (or the closest equivalent). The Senate, meanwhile, is composed of 72 members, with every province (and the federal capital) represented by three senators elected for six year terms with two seats going to the plurality winner and one going to the second finisher<sup>15</sup>. Elections for senators are staggered and one third of the provinces renew their senators every two years.

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<sup>11</sup> The 1994 constitutional reform introduced the institution of the cabinet chief. Like the remaining Cabinet ministers and other executive officials, he or she is appointed and can be removed at the president's discretion. Unlike the case with other executive officials, however, the cabinet chief can also be removed by Congress (via a vote by an absolute majority of the members of both the Chamber of Deputies and the Senate).

<sup>12</sup> This mechanism for electing the president was established in the 1994 constitutional reform and stipulates that, if in the first round no candidate receives either (1) over 45% of the valid vote, or (2) a minimum of 40% of the valid vote and at the same time is more than 10% ahead of the second place candidate, then a runoff is held between the top candidates from the first round. Before the 1994 reform, the president was elected for a six year term via an electoral college within which majority of the votes was required for election. Electors were selected from 24 multimember districts using the same proportional representation formula and threshold as for the election deputies.

<sup>13</sup> Before the 1994 constitutional reform the president could only seek re-election after sitting out for one term.

<sup>14</sup> Each of the 24 districts receives a number of deputies in proportion to its population, with the following restrictions: 1) that no district receives fewer than five deputies, and 2) that no district receives fewer deputies than it possessed in the previous democratic period.

<sup>15</sup> Prior to the 1994 constitutional reform, all of the country's provinces and its federal capital were represented by two senators, who were elected indirectly for nine-year terms by the provincial legislatures using the plurality formula (except in the federal capital where they were selected via an electoral college). By lottery, two-thirds of the Senate began in 1983 with either three- or six-year initial terms, with no province having two senators on the same cycle.

As other constitutions, the Argentine constitution also structures the policymaking process by defining: the stages a bill has to go through to become government policy; the actors who take part in the process; and the powers these actors have to influence policy outcomes. These structures depend, of course, on the type of legislative input required. If the introduction of new policy does not need constitutional amendments, the ordinary policymaking procedure for passing new legislation – or, alternatively, for introducing changes to the existing legislation – requires that a majority in the Chamber of Deputies, a majority in the Senate, and the president of the Republic agree on an alternative to the existing policy.

At a first glance, thus, Argentina appears to be a country with a relatively large number of veto players. In Cox and McCubbins' (2001) terms, it can be argued that its constitutional structure generates a relatively high separation of power. However, as these authors contend, whether or not this division of powers provides the basis for policy resoluteness greatly depends on the degree of separation of purpose showed by the country's polity. That is, it depends on the relative degree to which the executive and the majority in the Legislature have similar political preferences and respond to precisely the same set of actors and interests<sup>16</sup>.

As argued by Shugart (1995), Shugart and Haggard (2001:96), and Samuels and Eaton (2002), all presidential systems have an inherent tendency to generate division of purpose<sup>17</sup>. However, the extent to which they actually do so is variable. In this

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<sup>16</sup> See also Samuels and Eaton (2002).

<sup>17</sup> This point illustrates these authors' disagreements with some of the recent literature on "veto players", which tends to treat regime type as on the same level of theoretical importance as other

sense, according to these authors, in presidential systems the institutional combination most conducive to unity of purpose – and, hence, to more decisive governments – is concurrent presidential and legislative elections, a party centred electoral formula, a unicameral Congress elected congruently with the president’s constituency, and full renewal of seats at each election. This combination generates presidential majorities more so than other possible combinations. Furthermore, even when there is no presidential majority, this format at least increases the likelihood that legislators are chosen out of a process in which the same national issues that dominate the presidential campaign are likely also to play a major role in their own election<sup>18</sup>.

On the contrary, the institutional combination most likely to produce a separation of purpose – and hence resolute governments – is non-concurrent legislative elections (especially all-midterm), a candidate-centred electoral formula, a federalist upper house, and staggered legislative elections. In the authors’ view, these institutions promote a separation of electoral incentives of legislators from issues that dominate the presidential campaign. Presidents under such formats, moreover, are unlikely to enjoy legislative majorities or are likely to enjoy them only through part of their terms.

Where does Argentina lie on this continuum between systems that produce division of purpose and those that produce unity of purpose? Again, like with separation of

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variables. In their view, on the contrary, the differences between regimes are fundamental and should be considered theoretically prior to the introduction of other variables (Samuels and Eaton, 2002:5).

<sup>18</sup> One very important factor that affects separation of purpose is the party system. In this sense, Shugart and Haggard (2001:94) point out that all of the conditions facilitating unity of purpose can be undercut if the party systems is too fragmented to deliver either unified government or at least stable legislative coalitions supporting a given president.

powers, the country's institutions are conducive to a high degree of division of purpose<sup>19</sup>. As discussed above, not only does the country have a bicameral Legislature and employ a mixed electoral system with staggered elections in both houses, but also, only portions of the Legislature are elected concurrently with the president, and both the Chamber and the Senate are highly malapportioned<sup>20</sup>. As a result of this combination, the Argentine president has been unlikely to enjoy stable majorities in both chambers of Congress. Indeed, as shown in Table 1 below, since redemocratization in 1983, only between 1995 and 1997 has the party of the president controlled a majority in both chambers of Congress<sup>21</sup>. Most of the time, thus, the distribution of institutional power fits the definition of a divided government (Mustapic, 2002:25)<sup>22</sup>.

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<sup>19</sup> Shugart and Haggard (2001), and Samuels and Shugart (2003), build an index for twenty-two presidential systems that ranks countries according to the degree of separation of purpose in their polity. According to that index, Argentina belongs to the group of countries with the highest separation of purpose and it is only surpassed by Russia and Brazil.

<sup>20</sup> The most striking feature in this last respect is the overrepresentation (in proportion to their population) of the smaller provinces and the underrepresentation of the largest ones. According to Jones (1998), for example, the least populous provinces (Catamarca, La Pampa, La Rioja, San Luis, Santa Cruz and Tierra del Fuego) contain 3.9% of the population, yet possesses 11.7% and 25% of the seats in the Chamber and the Senate respectively. In contrast, the country's most populous province (Buenos Aires), while accounting for 38.7% of the national population, only holds 27.2% of the Chamber seats. As pointed out by Jones (1998), if the 257 Chamber seats were allocated based purely on population (with each province receiving one seat at the minimum as in the United States), then the province of Buenos Aires would have 99 deputies instead of the 70 it currently possesses. For further evidence supporting this conclusion, see Jones (2001) and the excellent work of Samuels and Snyder (2001).

<sup>21</sup> It should be noted that since 2003, the president's party has controlled a majority in both chambers of Congress.

<sup>22</sup> However, Shugart and Haggard (2001:93) note that the changes introduced in the 1994 constitutional reforms may have moderately reduced the likelihood for separation of purpose. They contend that the shortening of the terms for both president (from six to four years) and Senate (from nine to six years) somewhat reduces both the amount of time any given president will face legislators elected before he was elected as well as the share of such holdover seats. In their view, moreover, the move from indirect to direct election of senators should encourage greater unity of purpose. Before, senators only had to please provincial party leaders. Now they have to please voters in their provinces, which may tend to broaden their interest in national issues to the extent that these matter to voters more than to provincial party leaders.

**Table 1. Percentage of seats of president's party in Congress**

President	Legislative period	Chamber of Deputies	Legislative period	Senate
Alfonso (UCR) (1983-1989)	1983-1985	50.8	1983-1986	39.1
	1985-1987	51.6	1986-1989	39.1
	1987-1989	45.4		
Menem I (PJ) (1989-1995)	1989-1991	47.2	1989-1992	56.3
	1991-1993	45.1	1992-1995	62.5
	1993-1995	49.4		
Menem II (PJ) (1995-1999)	1995-1997	51.0	1995-1997	55.1
	1997-1999	46.3	1997-1999	55.1
De la Rúa (ALIANZA) (1999-2001)	1999-2001	48.2	1999-2001	29.1
Duhalde (PJ) (2002-2003)	2001-2003	47.5	2001-2003	56.5

\*Source: Molinelli, Palanza and Sin (1999) for the period 1983-2001, and my own calculations for the period 2001-2003.

The division of purpose shown by the Argentine polity is also a result of the relatively poor degree of cohesion shown by the country's principal political parties (i.e., the Partido Justicialista and the Union Cívica Radical). As has been discussed elsewhere, this is not only the result of the political system – party unity tends to be higher in parliamentary systems than in presidential systems (Diermeier and Feddersen, 1998; Laver and Shepsle, 1996) – but also of the structure of incentives derived from electoral institutions. Party cohesion typically reflects the relative importance of the party label vis-à-vis the personal reputation of individual candidates in achieving elective office and pursuing successful political careers (Cain et al., 1987; Cox and McCubbins, 1991). To the extent that personal characteristics influence the chances to win legislative office, individual legislators enjoy a greater degree of independence from party leaders. On the other hand, if winning elective office depends primarily on the party label, individual legislators face little incentive to act independently of their parties. In this sense, while single member districts, candidate centred formulas, and the plurality system are said to encourage the cultivation of a personal vote, large district magnitude, party centred formulas and closed lists make individual politicians more dependent on the party label (Cain et al., 1987; Shugart and Carey, 1992).

Argentina has a mixed structure of incentives for party unity derived from electoral institutions. On the one hand, the electoral formula in the country is party centred and the lists are closed. As discussed above, the combination of party centred formulas and closed lists should render politicians seeking office in Congress highly dependent on the party label. On the other hand, however, the country's constitutional provisions stipulate that each of its provinces is a plurinominal district. As a result, the principal political parties have decentralised organisations and democratic rules of competition for the election of their authorities and candidates. Hence, provincial branches of the principal political parties normally enjoy a significant amount of autonomy in regard to activities such as the creation of party lists and the formation of electoral alliances at the district level<sup>23</sup>. As Jones (2001,) argues, this is not to say that in Argentina the national party is not an important actor in the electoral process at the district level, or that there is a low level of party discipline in the Argentine Congress. On balance, however, the provincial party level organisations are dominant and, as a result, the parties are only weakly cohesive in the Legislature<sup>24</sup>. Even when governing parties control an important share of seats in the Legislature, the level of responsiveness of legislators to the president (or to national party leaders) is normally low and, therefore, so is the ability of the latter to advance his legislative agenda.

From the discussion above, it follows that the structure and organisation of Argentina's institutions not only generates a relatively high division of powers but

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<sup>23</sup> For further analysis on this issue, see Jones (1998, 2001); Spiller and Tommasi (2003); Jones et al. (2002); Mustapic (2002); and De Luca et al. (2002).

<sup>24</sup> Mark Jones has constructed a Party Centralisation Index to capture how responsive legislators are to national party leaders. The index centres mostly on the sources of leverage that party leaders have that stem from the electoral system. However, it also takes into account other incentives such as leaders' control over the appointment of legislators to committees and control over the legislative agenda. According to this index, Argentina is the country in Latin America where legislators are the least responsive to national party leaders. For more details, see Jones (2005).

also of purpose. According to the predictions offered by the literature on policy change reviewed earlier in this chapter, it should then be quite difficult to use the ordinary policymaking procedure to introduce and radical changes to the legislative status quo. Policy resoluteness, therefore, should be a feature of the Argentine political system.

#### 4.1. The case of the decrees of urgency and need and its effects on the stability of policy defined in statutes.

It should be noted, however, that not all changes to the statutory status quo in Argentina are introduced following the ordinary policymaking procedure. Like in other presidential democracies, presidents in that country have been given the power to occasionally introduce or modify policies through the so-called “decrees of need and urgency” (DNU). According to Article 99.3 of the 1994 Constitution, the president can resort to this type of decree – which have immediate legal effects – “only when exceptional circumstances make it impossible to follow the ordinary lawmaking process” and “insofar they do not regulate penal, fiscal, electoral or political party matters”<sup>25</sup>. As for the rules of approval, the constitution provides that the chief of cabinet must submit the DNU within 10 days to a permanent bicameral committee, which must send its opinion to the floor for a final decision. As noted by Negretto (2004:552), although the Constitution does not establish what happens if Congress fails to act, it has become a convention that the rule of tacit approval

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<sup>25</sup> Before the 1994 Constitution, DNUs were a paraconstitutional practice. As Negretto (2004:551) notes, however, their appearance on the Argentine political stage was relatively recent. In fact, the first decree of this kind was the one that launched the so-called Austral Plan in 1985 during Raul Alfonsín’s administration.



applies. According to this rule, a decree becomes a new law unless the legislative Assembly explicitly rejects the measure. That is, mere inaction by Congress implicitly ratifies the decree as valid law<sup>26</sup>.

Does the president's power to pass DNU's challenge the predictions about policy stability in Argentina discussed above? Put differently: does the existence of this type of legal instrument neutralise the impact that we should expect from the high degree of division of power and purpose in that country? How does that impact on the durability of policy relating to the delegation of power to independent regulatory agencies?

From the work of Gabriel Negretto (2004), the answer to this question would be that, since DNU's substantially enhance the ability of the executive to introduce policy changes that legislators might have not initiated and might not have approved in the absence of this instrument, the existence of this type of decrees not only weakens the vertical and horizontal accountability of the political system but also, and consequently, the stability of the statutory status quo<sup>27</sup>. He argues, in this sense, that one feature of DNU's is that they are a very powerful form of agenda power. Indeed, they allow the executive to produce an immediate change in policies that had been passed by ordinary policymaking procedures without the Assembly having the

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<sup>26</sup> In July 2006, Congress voted a law (26.122) regulating the approval of decrees of urgency and need. It should be noted, however, that this law did not introduce any major change to the status quo. Indeed, it confirmed that the chief of cabinet must submit the DNU within 10 days to a permanent bicameral committee and that the latter must send its opinion to the floor for a final decision. The new regulations, moreover, did not establish any deadline for Congress to decide. They specified that a DNU applies unless the legislative assembly explicitly rejects the measure.

<sup>27</sup> Some scholars have even claimed that the use of this legal instrument is an absolute impediment to the consolidation of democracy in that country. See, in this regard, the work of O'Donnell (1994), Haggard and Kauffman (1995) and Przeworski (1991).

opportunity to discuss *ex ante* its merits. The Assembly, therefore, is forced to take action *ex post*, choosing not between the status quo ante and a proposal but between a new policy and the reversionary outcome that would obtain when the decree is rejected or amended after it produces legal effects<sup>28</sup>.

In the view of Negretto (2004), another important reason why the existence of DNUs seriously undermine the stability of policy defined in statutes is originated in the fact that, following the rule of tacit approval, the only way the Argentine Congress can oppose a DNU is by following the ordinary policymaking procedure and passing a new statute. As he notes, the ability of Congress to do such a thing is, however, very limited.

Negretto advances two reasons for this: First, although the country's constitutional and electoral rules make unified government a very unlikely event, the chances of having a minority president in both chambers is even rarer. Indeed, the president's party has always enjoyed either a majority or a large plurality in at least one chamber of Congress. In the chamber of deputies, in particular, since 1983 Argentine presidents have had a level of representation above 45%. Considering that the absence of opposition in at least one chamber is sufficient to prevent the formation of an opposition coalition in Congress, one could then deduce that the chances of Congress of opposing a DNU by means of a new statute are relatively weak.

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<sup>28</sup> In this respect, Negretto (2004:536) argues that if legislators prefer the status quo to a decree but the latter to the reversionary outcome, the decree will stand. In addition, even if legislators prefer the reversionary policy to the decree and they are able to repeal it, the decree will also stand if the costs of rejection outweigh the costs of acceptance. Note in this regard that a similar argument is developed by Moe and Howell (1999a:145) regarding executive orders in the US.

The second factor identified by Negretto as limiting Congress's ability to oppose DNUs is related with the president's veto power. As he notes, presidents in Argentina not only have the power to veto an entire bill but also to promulgate the items or articles of the bill with which they agree while vetoing and returning to the originating chamber for reconsideration the vetoed portions. As in other pure presidential democracies, an override of any presidential veto requires a two-thirds majority in both chambers. That is, only if the two chambers of Congress approve the same bill again by two thirds of the vote is the president constitutionally bound to promulgate it into law. Therefore, even in the rare event that opposition forces are able to gather a majority in both chambers and pass a bill repealing or amending a decree, the president can always veto their decision. In that case, he only needs the support of one-third of the members in one chamber (86 deputies or 24 senators) to uphold his veto against the will of the majority in the Congress. Put differently, the president can ultimately defend his policy preferences with the disciplined behaviour of only a minority of one of the chambers.

Negretto's arguments seem not only very well constructed but also appealing. And so does the evidence he presents to support his claims. He shows that between 1983 and December 2001, presidents in Argentina issued 315 DNUs<sup>29</sup>. According to his data, on 249 occasions (79% of the cases) Congress chose not to vote on DNUs. On 41 occasions (13%) Congress chose to ratify the executive's policy. That is, on 290 occasions (92%) Congress implicitly or explicitly approved the DNUs passed by the executive. Only in 25 of 315 DNUs (7.9%) did Congress choose to pass a bill

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<sup>29</sup> According to that data, Alfonsín signed a total of 11 DNUs, Menem 255 (in both terms), and De la Rúa 49. Note, however, that existing data on Argentina's DNUs is shrouded in controversy due to large discrepancies on its estimated count. For other estimates, see Ferreira Rubio and Goretti, (1998); Mustapic (2002); Molinelli et al. (1999); and Kim (2006).

modifying or abrogating the president's initiative. As the author notes, however, on 9 of these occasions the executive vetoed those bills. Interestingly, Congress overrode none of these executive vetoes.

In the light of discussion above, should one then arrive to the conclusion that presidents in Argentina have an unlimited capacity to change the statutory status quo according to their preferences? Put differently, does the existence of DNUs completely neutralize the effects on stability of policy one would expect given the high division of power and purpose of Argentina's polity? In what follows, it will be argued that the answers to these questions are not precisely what one would expect following Negretto's claims. I will argue that although it is true that DNUs give presidents some leverage in the policymaking process, this leverage has important limits.

Following Negretto's analysis, one should not expect the executive in Argentina to ever seek policy by statute. Recall that, according to this author, while it takes a disciplined majority in each house of Congress for a president to successfully have statutory policy, it takes merely a disciplined third in any one house of Congress for that same policy to survive in decretal form and become permanent law, with the added value that it happens faster and without risking an amendment. The empirical record, however, clearly suggests that it would be wrong to expect such a thing. Indeed, between 1983 and 2001, DNUs in Argentina only accounted for 38.5% of all legislative changes initiated by the executive<sup>30</sup>. Put differently, presidents

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<sup>30</sup> This percentage is obtained computing the 315 DNUs signed by the presidents during that period (Negretto, 2004), and the 503 (out of 1004) substantial bills they submitted to Congress (Calvo and

implemented far fewer policies by DNUs than with the consent of Congress<sup>31</sup>. Equally relevant in this respect, this trend has occurred despite the fact that, on average, it has not been easy for the executive to obtain legislators' approval to its legislative initiatives. Indeed, for the 1004 substantial law initiatives that presidents submitted to Congress during the 1983-2001 period<sup>32</sup>, the average rate of approval was 51% (Calvo, 2007; Calvo and Aleman, 2006)<sup>33</sup>. Case study evidence also shows that this last percentage includes many initiatives that suffered extensive amendments in the Legislature (Llanos, 1998, 2001; Magar, 2001a, 2001b; Etchemendy and Palermo, 1998)<sup>34</sup>. It becomes clear, therefore, that when seeking changes to the statutory status quo, and even though DNUs give them a substantial leverage in the policymaking process, presidents in Argentina do prefer to resort to ordinary mechanisms of legislative initiative over extraordinary ones.

In recent years, several political scientists within the new institutionalism have theorized about determinants of this choice. In the view of some of them, presidents

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Aleman, 2006). If, alternatively, Kim's (2006) figures were computed – he estimates the total number of DNUs for that period in 243 – the percentage in question would drop to 32.5%.

<sup>31</sup> The percentage of decrees (out of the total number of changes introduced by the executive to the statutory status quo) varies substantially across administrations. Using the estimates of DNUs in Negretto (2004) and the estimates of substantial bills initiated by the executive and passed by Congress in Calvo and Aleman (2006), it follows that this figure averaged 6% during Alfonsín's presidency; 47% during Menem's first and second terms; and 51.5% during Del la Rúa's. Using the estimate of DNUs in Kim (2006), the percentages are: 5% for Alfonsín, 37.7% for Menem (first and second terms), and 54.4% for De la Rúa.

<sup>32</sup> Calvo (2007) and Calvo and Aleman (2006) obtain this number by deducting from the total of executive initiatives (2,909) those bills where the executive: informed Congress of the promulgation of an executive decree; requested authorisation for the president to leave the country; requested the confirmation of presidential appointees; and requested the ratification of good will international treaties.

<sup>33</sup> Calvo (2007), shows that the variation in the rate of approval of presidential initiatives ranged considerably both across and within administrations. According to his data, Raul Alfonsín (1983-1989) and Fernando de la Rúa (1999-2001) got between 30% and 80% of their proposed bills approved. Carlos Menem (1989-1999), meanwhile, had between 20% and 60% of his initiatives. For an alternative method for measuring executive legislative success in Argentina – and, of course, different results - see Saiegh (2005), and IADB (2006).

<sup>34</sup> Calvo (2007) claims that in the period 1983-2001, of those presidential initiatives that Congress approved, between a third and a half were heavily amended in committee.

normally opt for extraordinary mechanisms of legislative initiative – like DNUs in Argentina, *medidas provisionarias* in Brazil, or executive orders in the U.S. – in situations of Congressional gridlock or when they have a difficult time in persuading Congress to pass their legislative agenda. By doing so, politically weak presidents – who, according to these scholars, are more likely to appear during divided government – not only can find ways of bypassing an uncooperative Legislature, but also they can enjoy the privilege of position taking, framing policy questions, or directly delivering promises made to key constituencies<sup>35</sup>. Meanwhile, a second group of scholars argue that the main problem with this view – and the predictions it advances – is that it ignores the constraining effect of Congress. They note that while presidents may want to issue more decrees during times of divided government, they may be restricted from doing so because it is easier for an opposition-controlled Legislature to repeal the president’s decree initiative<sup>36</sup>. Presidents, therefore, should pass more decrees during times of relatively greater consensus between the executive and the Assembly and, particularly, during unified government<sup>37</sup>.

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<sup>35</sup> For a more in depth discussion on this view – commonly referred as the “unilateralist” or “evasion” hypothesis see Cox and Morgenstern (2002), and Ferreira Rubio and Goretti (1998).

<sup>36</sup> Most of the authors within this group acknowledge that when Congress passes a law amending or revoking one of the president’s unilateral actions, the president can react by resorting to his veto powers. However, drawing on the work of Neustad (1990), Sala (1998), and Moe and Howell (1998a, 1998b), among others, these authors note that this is not cost free. More precisely, they note that if Congress overturns a presidential unilateral action by legislation, and the president is forced to resort to his veto powers, the president’s “professional reputation” may be severely damaged and a legislative history may be established that prevents him from taking this sort of action in the future. It is normally assumed, therefore, that if a president is likely to have his unilateral actions overturned by Congress, he will probably refrain from issuing them.

<sup>37</sup> Scholars who share this view – commonly referred as the “delegation” or “constrained unilateralism” hypothesis – often argue that the use of decree powers can also be seen as a rational strategy on the part of the legislature. Drawing on delegation theory and on principal-agent models, they claim that legislators can derive benefits from having the president assume direct responsibility for policy, notably when such policies represent the preferences of legislators and are unpopular. For a more in depth discussion on this view see, among others, Carey and Shugart (1998, 296), Figueredo and Limongui (2003), and Reich (2002). Note, moreover, that these works have clear parallels to those by Epstein and O’Halloran (1999), Kiewiet and McCubbins (1991), McCubbins, Noll, and Weingast (1987, 1989, 2005).

In contrast to the case of other presidential democracies where the empirical evidence does not provide conclusive support for either of these theoretical constructions<sup>38</sup>, in the case of Argentina the empirical record seems to confirm that there is a link between the propensity to use executive decree and the difficulty the executive experiences in persuading legislators to pass its legislative agenda. Indeed, Calvo (2007) and Calvo and Aleman (2006) show that there is a statistically significant negative association between changes in the success rate of presidents' legislative initiatives and the issuance of DNUs. Interestingly, however, their statistical analyses do not provide support for the notion that minority presidents are stalemated by Congress or, more generally, that the levels of partisan support presidents have in the Legislature affect the approval probabilities of their initiatives. According to these authors, what do affect these probabilities are the electoral cycle and the public approval of the president's performance. More precisely, their results show that: a) presidents are more successful during the honeymoon year and suffer markedly during their last year as lame ducks; b) presidents are more likely to get Congress to vote their initiatives when their popularity is high. In the light of these results, and by transitivity, one could then conclude that presidents in Argentina are more likely to introduce changes to the statutory status quo by means of DNUs when their popularity is low and during their last year in office.

Also in support of the claim that presidents in Argentina are more likely to introduce policies by extraordinary mechanisms of legislative initiative when they face a hostile

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<sup>38</sup> The use of executive orders in the US has been studied in Moe and Howell (1999a, 1999b), Gleiber and Shull (1992), Gomez and Shull (1995), Shull (1997), Howell and Lewis (2002), Cooper (2001, 2002), Howell (2003, 2006), Mayer (1999, 2001), Deering and Maltzman (1999), Krause and Cohen (1997, 2000), Mayer and Prize (2002), and Moe and Howell (1999a, 1999b). The use of *medidas provisórias* by Brazilian presidents, meanwhile, has been analysed by Reich (2002) and Pereira et al. (2005). Finally, case study evidence on other presidential democracies where the executive can also resort to extraordinary mechanisms of legislative initiative can be found in Carey and Shugart (1998).

Legislature is a recent paper by Kim (2006). According to this author, when issuing a DNU, presidents anticipate the likelihood that Congress will reverse executive action by legislation. Within this framework, Kim hypothesizes, presidents should be more inclined to flex their decree muscles when the potential for conflict in the Legislature is high and the risk of taking unilateral action is low. And this, the author predicts, is more likely to happen when the marginal difference in the number of seats held by the majority and opposition is relatively small<sup>39</sup>.

Kim (2006) also argues that in order to better analyse the president's limits to unilateral action, one should not only focus on the interaction between the executive and the legislative, but should also consider the role of the courts. He contends that DNUs can always raise doubts about whether the president has overstepped the bounds of his legal authority and the courts, hence, can rise up and strike down president's actions. Therefore, when issuing a decree, the president's perception of judicial veto also plays an important role in his decision. The author predicts, then, that when the preference of the majority opinion in the judiciary is unlikely to be in his favour, the chances of a president's decree being declared "unconstitutional" by the courts is higher, and one should not expect that the president will risk passing it. In contrast, when the president faces amicable judges, the constraints on his ability to exercise his unilateral decree power falls, and the chances of observing and increase

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<sup>39</sup> According to Kim (2006), divided government and the saliency of opposition in the legislature can be one and the same in a relatively polarised two-party system. However, this may not necessarily be so in a multiparty setting with relatively unstable coalitions and/or low party discipline.



in the amount of legislation he passes using extraordinary mechanisms of legislative initiative should increase<sup>40</sup>.

Kim's hypotheses seem well supported by the empirical evidence presented in his work. Indeed, his statistical analyses reveal that there is a significant negative relationship between the marginal difference in the size of the pro-government and opposition parties in each chamber and the number of DNUs issued by the executive. More precisely, these analyses show that between 1982 and 2000 a 1% increase in the difference of pro-government and opposition coalition in the two legislative chambers have led to about 9% to 11% corresponding decrease in the number of DNUs passed.

Kim has also found evidence that the dynamic of executive decrees is also constrained by opposition in the courts. Indeed, he shows that the percentage of different cases decided by the courts against the government is closely related the number of DNUs passed<sup>41</sup>. His analyses reveal, more precisely, that in the period between 1982 and 2000, for each 1% increase in the share of Supreme Court decisions that went against the government on decree related cases, the number of DNUs decreased by approximately 3%. In addition, they show that for 1% increase in the proportion of Supreme Court decisions that went against the government on cases related to important decrees and government appeals, the number of DNUs decreased again by about 2.5%. Similarly, a 1% increase in the proportion of Supreme Court decisions

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<sup>40</sup> Although Kim does not theorise on the determinants of the decisions taken by the courts, it is pretty obvious that he adheres to those who regard court decisions as derived not from strict legal principles and law but from the individual policy preferences of the judges.

<sup>41</sup> Kim uses data on rulings to measure opposition in the courts – collected by Helmke (2005) – because, he claims, data for the distribution of seats in the Supreme Court does not have enough variation in the period between 1982 and 2000.

overturning pro-government decisions in the lower courts resulted in approximately 4% decrease in the DNU issued by the president. Interestingly, Kim's analyses also show that after accounting for opposition in the Legislature and the courts, the divided government variable is not significant.

Therefore, it can be concluded that Negretto and others do have a point when they claim that DNUs in Argentina give presidents a strong proactive power to change the statutory status quo and that this can be a source of instability for those policies defined in statutes. The discussion above, however, clearly suggests that these claims need some important qualifications. First, not all the changes introduced by the executive in Argentina to the statutory status quo are by means of DNUs. As the empirical evidence reveals, DNUs only explains less than 40% of the changes to the statutory status quo initiated by the executive. The remaining 60% are changes introduced by statute and, consequently, with the prior consent of Congress. Second, and closely related, reliance on DNUs does not derive from the mere existence of the presidential authority to use them but is rather contingent upon the political environment. More precisely, it is contingent upon the level of presidential legislative success and the degree of political opposition the executive faces both in the Assembly and in the judiciary.

In Argentina, in sum, the existence of DNUs can result in less stability in policies than one would expect from a simple look at both the country's division of power and purpose and the ordinary policymaking procedures. What the discussion above suggests, however, is that the power of the president to impose his or her policy

preferences using DNUs does have limits. To a certain extent, defining policies in statutes can still be considered a useful mechanism to prevent policy instability. As it is discussed in the next section, this point becomes even clearer when policy defined in other types of legal instruments is considered.

4.2. When the president governs alone (or almost): the stability of policies defined in other types of legal instruments.

It is important to note that in Argentina policies defined in statutes – or, alternatively, in legal instruments of equal weight, such as DNUs – only represent a small fraction of the universe of policies in force. Indeed, most policies are defined in other types of legal instruments. Among others, these instruments include regulatory decrees (which fill out the details necessary of the implementation of laws passed by a legislative Assembly), administrative decrees (which regulate matters of exclusive competence of the president as chief of an administration or matters delegated to him by the Assembly) and resolutions (which regulate matters of competence of ministers or secretaries of state or, again, which have been delegated to them by the Legislature)<sup>42</sup>.

Do these alternative legal instruments enhance the credibility of policy? Do they “bind” policy-makers to maintain the policy defined by them? Do they, on the contrary, provide incentives for the political leaders to enact policy change whenever

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<sup>42</sup> Several students of presidentialism have argued that in parliamentary democracies, relatively more policies are defined in statutes. They note that those political systems produce governments that normally enjoy a strong legislative backing and that, therefore, do not face much difficulty – relative to governments in presidential systems – in persuading Congress to pass their legislative initiatives. See Shugart (1999); Shugart and Carey (1992); Shugart and Haggard (2001); Samuels and Eaton (2002); Samuels and Shugart (2003).

they perceive that is optimal to do so? How does the stability of policies defined in regulatory decrees, administrative decrees, and resolutions compare with those defined in statutes? Should one expect these instruments to be a good source of commitment?

To answer these questions it should first be noted that, contrary to policies defined in statutes, those defined in regulatory decrees, administrative decrees, or resolutions not only can be introduced unilaterally by the executive, but can also be revoked or amended in the same way<sup>43</sup>. That is, when introducing or changing legislation defined in these legal instruments, the executive can act without the Assembly having the opportunity to discuss *ex-ante* the merit of the proposal<sup>44</sup>. When introducing or changing this type of legislation, therefore, the executive becomes the only veto player in the policymaking process. This has far-reaching implications. As it has been discussed earlier in this chapter, single veto players not only lack formal constraints that limit their ability to initiate policy change but also, and equally important, they can select any point within its indifference curve. It would then follow that policy defined in regulatory decrees, administrative decrees, and resolutions should be easier to introduce and, after that, changed – *vis-à-vis* policy defined in statutes. Policy

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<sup>43</sup> It is important to note here that, at least in legal terms, policy defined in regulatory and administrative decrees can only be changed by means of another presidential decree. Policy defined in resolutions, meanwhile, can be changed either through a presidential decree or another resolution – in this case, issued by the relevant minister or secretary of state. What the law strictly prohibits, however, is the use of a resolution to change policy defined in a decree.

<sup>44</sup> Like with DNUs, this factor alone provides the executive with a strong form of agenda control. Indeed, once one of these alternative legal instruments is enacted, legislators are presented with a *fait accompli*. They are then left in the position to choose between the new policy and the reversionary outcome that would obtain if the new policy is rejected or amended, rather than between the status quo *ante* and the proposal. In this scenario, if legislators prefer the status quo *ante* to the new policy but the latter to the reversionary outcome, the new policy is likely to stand. Moreover, even if they prefer the reversionary policy to the new status quo and they are able to repeal it, the new status is also likely to stand if the costs of rejection outweigh the costs of acceptance – as it is often the case with measures whose effects are immediate and imply radical departures from the status quo.

defined in these legal instruments is therefore likely to be far less stable than policy defined in statutes.

From the analysis in the previous section, however, it becomes clear that this prediction needs to be taken with caution. Like with DNUs, the fact that the executive can legislate by these alternative means without the prior consent of Congress does not mean that the latter, or the courts, inescapably have to tolerate the new status quo. That is, changes to the status quo introduced using regulatory decrees, administrative decrees, and resolutions can also trigger *ex post* legislative or judicial responses that the executive probably anticipates and, consequently, that are likely to play a role in his decision. Put differently, just as it happens with DNUs, there are probably limits to the capacity of the executive to introduce policy changes by means of these other types of legal instruments<sup>45</sup>.

The obvious questions here are: What is the chance that the Assembly or the judiciary become *ex post* veto players of policy changes introduced using legal instruments such as regulatory decrees, administrative decrees and resolutions? How strong are the limits on the executive when introducing policy changes using these legal instruments? Are these limits similar to those presidents face when they consider the option of introducing changes to policy defined in statutes using DNUs?

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<sup>45</sup> Like with DNUs, these limits are probably present despite the fact that the executive has important formal powers to eventually impose its policy preferences. Recall that if legislators pass a bill repealing or amending a presidential action, the president is empowered to veto their decision. The president, moreover, only needs the support of one-third of the members of one chamber to uphold his veto against the will of the majority in the Congress.

As discussed above, one particular feature of DNUs is that they allow the president to introduce changes to policy previously defined in statutes. When issuing a DNU, therefore, the president is normally entering into a risky business. First, he is probably interfering with issues that legislators consider important and on which – overcoming major collective action problems and enormous transaction costs – they had reached agreement<sup>46</sup>. Second, it is quite likely that the preferences that the executive is imposing are contrary – or at least, divergent – from those of Congress. Recall in this regard that what the empirical record reviewed in the previous section suggests, is that there is a link between the propensity to use DNUs and the difficulty the president experiences in persuading legislators to pass his legislative agenda.

Interestingly, this is not the case with other types of legal instruments the executive can use to introduce policy changes. In fact, regulatory decrees, administrative decrees and resolutions are not normally used to introduce changes to policy previously defined in statutes, since the legality of this could be easily challenged in the courts, but to introduce policy which the constitution defines as the exclusive competence of the executive or, alternatively, which legislators previously delegated to the executive. It is important to note here that, contrary to what happens in other presidential democracies such as in the US, in Argentina, when the Legislature delegates policymaking powers to the executive, it rarely attempts or manages to insert substantial policy details in the legislation that creates that delegation<sup>47</sup>. Equally

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<sup>46</sup> These costs not only stem from the division of purpose that characterises the Argentine polity but also from the internal organisation of Congress as an institution. In relation to this second issue, Moe and Howell (1999a:146) note that each Congressional decision faces a maze of obstacles: a bill must pass through committees and floor votes in the House and the Senate; it must be endorsed in identical form by both houses; and it is threatened along the way by party leaders, rules committees, holds, and other roadblocks.

<sup>47</sup> For an analysis of the US case, and more generally, for very useful theoretical insights into this issue, see, among others, Fiorina (1982), McCubbins and Schwartz (1984), McCubbins (1985), McCubbins,

important, it seldom puts in place effective institutional arrangements to detect actions of the executive that do not respect the terms of the delegation of powers<sup>48</sup>. As a result, the executive in Argentina is often left with substantial discretion in formulating and implementing the policy that it has been delegated. To a certain extent, when the executive introduces policy using these legal instruments, it is interfering with policy definitions that are unlikely to be a source of conflict with the Legislature. Consequently, the chances of the Assembly becoming an *ex post* veto player is probably lower than when introducing policy changes using DNUs.

However, Congress is not the only actor that is less likely to become an *ex post* veto player when the executive legislates with regulatory decrees, administrative decrees and resolutions. Indeed, the same can be said about the courts, and notably, the Supreme Court. The reasons for this are twofold. First, contrary to DNUs, the use of regulatory decrees, administrative decrees and resolutions do not require the executive to invoke the existence of exceptional circumstances that justify their passage<sup>49</sup>. And if one takes into account that the main challenge by a court against DNUs is that the exceptional circumstances invoked by the executive could not be verified, it is reasonable to conclude that, when there is no need to invoke exceptional

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Noll and Weingast (1987,1989, 2005), Ferejohn (1987), McCubbins and Page (1987), Horn and Shepsle (1989), Moe (1984, 1989, 1990a, 1990b), Kiewiet and McCubbins (1991), Moe and Wilson (1994), O'Halloran (1994), Lupia and McCubbins (1994), Horn (1994), Epstein and O'Halloran (1994, 1999), Bawn (1995, 1997), Huber and Shipan (2000, 2001), and Huber et al. (2001).

<sup>48</sup> Although the reasons for this have yet to be studied in more detail, some authors have recently advanced some hypotheses. According to Spiller and Tommasi (2003, 2007), the main reason why Congress in Argentina often makes broad delegation to the executive and seldom puts in place effective Congressional oversight mechanisms is that legislators often see their job as a temporary stop in their political career. According to these authors, these "amateur" legislators have little incentive to specialise, to acquire specific policy or legislative expertise, and to develop strong Congressional institutions. Eaton (2003), argues that Congress in Argentina has serious problems in detecting shirking by the executive because in that country the information that legislators need in order to do so is very difficult to acquire.

<sup>49</sup> Recall that the 1994 Constitution established that the president can resort to this type of decree only when exceptional circumstances make it impossible to follow the ordinary lawmaking process.

circumstances, the chances of a court challenge of policy changes introduced using these legal instruments should be considerably slimmer<sup>50</sup>.

The second reason why the courts are less likely to become an *ex post veto* player of policies introduced using regulatory decrees, administrative decrees, and resolutions, is better understood if one assumes that judges not only base their decisions on legal principles and law but also – and sometimes exclusively - on their policy preferences and, notably, on strategic and institutional considerations<sup>51</sup>.

It should be noted that when dealing with cases involving DNUs, the courts are often faced with the job of having to resolve a conflict between the executive and Congress. In most cases this is centred on the limits of the powers and competences of the former vis-à-vis the power and competences of the latter. This, of course, is not an easy task. Judges acknowledge that their decision can trigger reprisals. If, for instance, their decision inhibits the executive from imposing its preferences, the executive can react by not implementing the measure effectively<sup>52</sup>. Alternatively, the executive can choose to punish the courts with more aggressive policies such as court packing, budget cuts, or impeachment.

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<sup>50</sup> This argument is probably appealing for those working with the perspective of traditional legal studies, who look to formulaic legal interpretations to predict court outcomes.

<sup>51</sup> There is recent literature concerning judicial decision making, mostly referred to the US case, that shows that this is a legitimate assumption. See among others Ferejohn and Shipan (1990), Rosenberg (1991), Ferejohn and Weingast (1992), Eskridge and Ferejohn (1992), Gely and Spiller (1990, 1992), Spiller and Spitzer (1992), George and Epstein (1992), Schwartz (1992), Spiller (1992), Zuk et al. (1993), Cameron (1994), Schwartz et al. (1994), Epstein and Walker (1995), Epstein and Knight (1996), Gillman and Clayton (1999), Howell (2001; 2003), and Ferejohn, Ronsenbluth, and Shipan (2004).

<sup>52</sup> As noted by Moe and Howell (1999a, 1999b), this is far from irrelevant. If the executive refuses to cooperate – or more likely, if it purposely acts very slowly, ineffectively, or in ways that alter or distort the judicial intent – the policy pronouncements of the courts threaten to be empty, and their integrity and social standing as a political institution can be put seriously at risk.



The discussion above does not imply that when dealing with cases involving DNUs – or more generally, with cases that involve a conflict between the executive and the Legislature – the courts will always rule in favour of the executive. First, non-compliance with a court ruling can be very damaging for the professional reputation of a president. Second, and more important, most of the other reprisals that the executive can use to punish the courts (i.e. court packing or impeachment) cannot be implemented unilaterally. That is, the executive needs the consent of Congress to implement these reprisals. And strategic judges, obviously, are probably aware of this reality. They are likely to know that: a) most of the policies introduced using a DNU can be seen as an usurpation of legislative powers by the executive; b) if these policies were passed through that legal instrument, it was probably because the preferences of the Legislature were not aligned with those of the executive and, hence, the latter had difficulties in defining them in statutes; c) that if they rule against the executive, and the latter tries to take reprisals, the Legislature has all the powers – and probably the motives – to stop it. When dealing with cases involving DNUs, in sum, strategic judges have good reasons to believe that they are freer to rule according to their preferences – even if this means ruling against the interest of the executive – without being punished.

Interestingly, the same cannot be said about policies defined in regulatory decrees, administrative decrees and resolutions. As noted above, when the executive legislates using these legal instruments, it is normally dealing with policies outside the jurisdiction of Congress or that, to a greater or lesser extent, legislators had empowered the executive to define. When dealing with cases involving controversies

about the legality of policies introduced by these legal instruments, consequently, judges probably anticipate that if they rule against the executive, and the latter tries to punish them for doing so, Congress faces little incentives to come to their rescue. In the light of this, it is reasonable to predict that when dealing with these cases, the executive's threat of reprisals will probably be more credible than in cases involving controversies about the legality of DNUs, and also as a result, that judges – assuming that they behave strategically – will probably be less likely to rule according to their preferences if these are against the executive<sup>53</sup>.

At this point, it can be concluded that both the assembly and the judiciary are in a weaker position to oppose policy changes through regulatory decrees, administrative decrees, and resolutions than when the device is a DNU. It is reasonable to expect, then, that when introducing policy changes using these legal instruments, the limits and constraints that the executive faces are likely to be less effective than the limits presidents face when he considers the option of using DNUs. It follows that for the executive is relatively easier or less costly to change the policy status quo when this is defined in a regulatory or administrative decree, or a resolution, than to change the status quo of policy defined in a law, even if this change is introduced using extraordinary mechanisms of legislative initiative. In the light of this, and equally important, it can also be concluded that policies defined in these other instruments,

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<sup>53</sup> This argument concerning the courts as *ex post veto* players when considering regulatory decrees, administrative decrees and resolutions is in the vein of recent examination of the strategic approach to judicial decision-making. Briefly, this approach contends that the higher the fragmentation in the executive and legislative branches of government, the higher the probability the courts will rule against power holders, and the more the courts will be involved in policymaking. With reference to judicial decision-making in the U.S., this argument is advanced in Gely and Spiller (1990, 1992), Ferejohn and Weingast (1992), Bednar et al. (2001), and Ferejohn (1999, 2002). When studying judicial decision-making in Argentina, this argument is used in Helmke (2002, 2005), Iaryczower et al. (2002), and Chavez (2004). With regard to other national cases, see Epstein, Knight, and Shetsova (2001), Vanberg (2000), Scribner (2002), Barros (2002), and Rios (2007).

provide relatively more incentives for the executive to enact policy change whenever it perceives that is optimal to do so. That is, they make the introduction of policy changes relatively more feasible.

Of course, this is not to say that policies defined in these three legal instruments are invariably easier to change than policies defined in statutes. Although highly unlikely given the division of power and purpose that characterises the Argentine polity, it can happen that on certain policies, or during particular periods of time, the preferences of the executive and the Assembly become aligned<sup>54</sup>. In those circumstances, it should not be surprising that both parties agree to introduce changes to the status quo, provided it is considerably different from the proposed situation. And if the legal instrument used to enact those changes is a DNU and not a statute, it is probably because legislators acceded to the use of that legal instrument. In those circumstances, moreover, it is pretty unlikely to see the courts stepping in. Indeed, they will probably anticipate that such behaviour is likely to trigger reprisals that nobody – particularly Congress – will try to impede.

In certain occasions, meanwhile, it can also happen that when introducing changes to the status quo using regulatory decrees, administrative decrees or resolutions, the executive is interfering with policy that, although Congress previously put it in its hands, it contains substantial policy details or includes effective procedural instructions – aimed at ensuring that the executive makes the sort of decisions that the enacting coalition of Congress approve. If, in addition, the executive imposes policy changes contrary to the preferences of Congress, the likelihood that the latter becomes

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<sup>54</sup> This is likely to happen during times of severe crisis.

an ex post veto player will probably increase – vis-à-vis changes that the executive introduces to policy that Congress previously delegated to it in broad terms and that was not filled with procedural instructions. In those cases, moreover, it is also more likely that the courts will step in. Indeed, judges will probably anticipate that if they rule against the executive, and the latter tries to take reprisals, the Legislature will probably come to their rescue.

It is important to bear in mind, though, that circumstances that could make the introduction of changes to policy defined in a statute more feasible than the introduction of changes to policy defined in regulatory decrees, administrative decrees, and resolutions, in Argentina are the exception rather than the norm. Therefore, one can safely predict that the structure and organisation of the polity in that country normally result in that policies defined in statutes are likely to be more stable than policies defined through other legal instruments and, hence, better equipped to “stack the deck” in favour of maintaining the policy status quo.

## **5. Conclusion**

In this chapter I have claimed that for sustaining inter-temporal commitments and developing stable utility regulatory policies, delegation to independent experts is only part of the solution. Since there are many circumstances that might make it tempting to reverse this policy, it is equally important to ensure that governments cannot easily renege on their policy commitments.

Drawing on recent developments within new institutionalism, it is contended that the structure and organisation of a country's institutions plays a crucial role in satisfying this second requirement. First, this is because it moulds the number of veto players whose agreement is necessary to introduce changes to the status quo – that is, the division of power in the polity. The second reason is that it shapes the divergence of preferences among these players – that is, the division of purpose in the polity. And both factors, in turn, determine how costly it is to change policy and, hence, how stable policy in that country is likely to be.

It is then argued that from a simple look to the structure and organisation of Argentina's institutions, one could be tempted to conclude that Argentina is a country where policies should enjoy a relatively high degree of stability. Indeed, when policy changes are enacted through ordinary policymaking procedures, the country's institutions require political leaders to gain the consent of numerous veto players whose preferences are rarely homogeneous.

I then pointed out, however, that this conclusion would only be correct if the sole legal instrument available to define policy in Argentina were statutes that, in addition, could only be changed by means of another statute – that is, with the involvement of both the executive and legislative branches of government. This, however, is not the case. What a closer look to the rules of the game reveals is that, in the first place, statutes in Argentina can be changed unilaterally by the executive using extraordinary mechanisms of legislative initiative (i.e. DNUs). In the second place, and more

importantly, only a small portion of the policies in place in that country are defined using this legal instrument.

The chapter then discusses the implications of these two matters for policy stability in Argentina. In line with some authors, I have argued that the power of the executive to introduce unilateral changes to the statutory status quo does pose a threat to the stability of policies defined in statutes. Challenging their view on this issue, however, I have shown that, since there are important limits to this power, the gravity of this threat should not be exaggerated.

What does constitute a real hazard to policy stability in Argentina is the tendency to allow the executive to define policy through other legal instruments, such as regulatory decrees, administrative decrees, and resolutions. This is for two reasons. Firstly, when legislating by these legal instruments, the executive acts without the need to obtain the prior consent of other veto players – notably, the Assembly. As claimed with regard to DNUs, this feature alone provides the executive not only with the opportunity to act as a single veto player, but also with a strong form of agenda control – leaving other veto players in the position to choose not between the *status quo ante* and the proposal, but between the new policy and the reversionary outcome that would obtain when the new policy is rejected or amended. Secondly, and equally important, when legislating by these legal instruments, the chances of observing either the Assembly or the judiciary becoming *ex post* veto players are normally remote. The limits and constraints that the executive faces are thus likely to be less effective than the limits presidents face when he considers the option of using DNUs to introduce

changes to policy defined in statutes. It follows, therefore, that for the executive is relatively less costly, and hence easier, to change policy when this is defined in a regulatory or administrative decree, or a resolution, than to change the law by any means, including extraordinary mechanisms of legislative initiative.

In the light of this, the following hypotheses can be advanced. First, given the structure and organisation of Argentina's institutions, the stability and credibility of a policy there is to a great extent governed by the choice of the legal instrument used to define it. Second, that stability in the delegation of important regulatory powers should hold only in those industries where the key features of the regulatory regime were defined in a statute. In these industries one should expect that the legal instrument used to define the key features of the regulatory regime made the political costs of introducing policy changes relatively high for the executive and, therefore, politicians stuck to the original agreement. Finally, in industries where the legal instrument used to define the key features of the newly created regulatory regimes was a regulatory decree, an administrative decree or a resolution, one should expect that politicians faced few constraints to renege on their previous policy commitments. In these industries, therefore, delegation of important regulatory powers to independent experts was probably only a temporary policy and regulation returned to be a domain where policy-makers introduced policy changes whenever their preferences dictated it.

## **Chapter III**

### **Telecommunications Regulation during Menem years: 1989-1999**



## **1. Introduction**

In the previous chapter I concluded that the delegation of regulatory powers to independent agencies was not necessarily irreversible. More precisely I hypothesised that in those sectors where the legal instrument used to defined the key features of the newly created regulatory regime was a presidential decree, or other legal instrument that could be changed unilaterally by the executive following ordinary mechanisms of policymaking, the executive could introduce changes to the status quo without facing significant challenges of other veto powers. In those sectors, therefore, delegation of important regulatory powers to independent experts was likely to be only a temporary policy. Regulatory policy in those sectors, thus, was likely to be returned to the control of government officials.

As stated in the introduction of this thesis, to test these deductively derived assertions this chapter presents an in-depth investigation of the telecommunications regulatory framework during Carlos Menem's administration. Since in this sector the key features of the regulatory regime were defined in a presidential decree, if the hypotheses discussed above are valid, the narrative presented in this chapter should confirm that delegation of regulatory powers to independent experts was, contrary to what policy-makers originally expected, a policy that not only did not become a permanent feature of the policy landscape but also one that did not contribute to create an environment of regulatory policy stability.

The chapter proceeds as follows. Section 2 briefly reviews the basic features of the privatisation process and of the regulatory regime policy-makers originally put in

place in the early 90s. Section 3 analyses the stability of the rules of the game during Carlos Menem's first and second administration (1989-1995 and 1995-1999, respectively). For purposes of clarity this section is divided into five subsections, each analysing a particular time period: 1990 to 1992; 1992 to 1993; 1993 to 1996; 1996 to 1997; and 1997 to 1999. Section 4 concludes.

## **2. The privatisation of Telecommunications in Argentina: Basic Features and the Design of the Regulatory Regime**

### **2.1. Privatising under difficult economic conditions**

As Hill and Abdala (1993:12) argue, one of the most remarkable aspects of the 1990 privatisation of telecommunications in Argentina "is that it happened at all". In 1987, faced with a large government deficit, with a need for additional investment in the telecommunications sector, which neither the major public telecommunications company (ENTel) nor the government could finance, and with a high level of corrupt and irregular practices within the firm, Alfonsín's (1983-1989) new Minister of Public Work<sup>1</sup> advocated the liberalisation of the supply of telecommunications. His plans not only included the introduction of new private management but the partial privatisation of ENTel. The liberalisation process was initiated by three executive decrees that allowed the Secretary of Communications to issue permits to private telecommunications service providers<sup>2</sup>.

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<sup>1</sup> Rodolfo Terragno.

<sup>2</sup> Decrees 1651/87, 1757/87, and 1842/87.

Given the high level of political uncertainty, and ENTel's administrative problems and internal corruption, the government decided to sell the company through negotiations, inviting a potential investor to evaluate the company and discuss the terms. The government planned to keep control of the company by retaining 51% of the shares, while 9% of the shares were to be transferred to workers for free, and 40% would be sold to a new investor who would be responsible for the management of the company.

The government entered into a preliminary agreement with Telefónica of Spain. Under the terms of the agreement, the partially privatised company would have had a complete monopoly over the provision of all types telecommunications services in the country – including cable TV but not cellular telephone and public telegraph – for 25 years with an option to extend this monopoly another 10 years.

However, even though there was popular support for the partial privatisation of ENTel, the government was unable to persuade Congress to approve its project (Hill and Abdala, 1993:12; Llanos 2001:82). The government's party, Unión Cívica Radical (UCR), had lost the 1987 Congressional elections and the opposition party, Partido Justicialista (PJ), held a majority in the Senate. According to Hill and Abdala (1993), this opposition, which actually resulted in a rejection of the government's project in Congress, was due, on the one hand, to some members ideological objections to privatisation and, on the other hand, to some members objections to the actual terms of the deal, particularly the lack of competition and adequate regulation. In these authors' view, moreover, the opposition party also anticipated winning the

1989 presidential election and, therefore, was unwilling to support any action that could help the ruling party's candidate<sup>3</sup>.

By the time of the election of Carlos Menem in 1989, Argentina was in the midst of a severe economic crisis. Its severity prompted the moderate wings of the two major political parties to build an informal coalition in order to bring the new government quickly and give it the power it needed to address the accelerating economic deterioration. The primary goal of Menem's government was to take advantage of the opportunity presented by the shift to cooperative politics in Argentina and demonstrate its ability to transform the economy.

The privatisation of telecommunications provided the new government an excellent opportunity in this respect. The rationale for its selection was clear. First, it could provide a quick fix for the government's dwindling coffers. Second, and as discussed earlier, it had been on the previous government's privatisation agenda. For a president eager to make clear that his new pro-market convictions were to be taken seriously, the failed attempts of his predecessor constituted an unavoidable point of departure (Gerchunoff and Torre, 1998: 122).

There were other more objective reasons, though. As pointed out by Urbiztondo and Gómez-Ibáñez (2002), during the 1970s and in the late 1980s, the government used the prices for publicly provided services such as telecommunications as a tool in its fight against inflation. That led to growing deficits and a collapse in investment by publicly owned companies. In the case of ENTel, the combination of low tariffs and

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<sup>3</sup> For a better review of this failed attempt to privatise ENTel, see Molano (1997) and Margheritis (1999).

the company's inefficiency caused its operating deficit to increase to roughly US\$ 1.5 billion per year by 1989. According to Shaikh et al. (1996), in 1990 ENTel contributed 1.7% to GNP and employed 45,000 people. Its line-per-employee (72.2) and revenue-per-employee (US\$32,000) ratios indicated that the enterprise was overstaffed in comparison with the telecommunications companies of other major nations. Quality of service was poor and declining. Completion rates for domestic long distance calls were below international standards for mature networks. Repair time was slow and digitalisation of the network amounted to a modest 13.4 percent. Demand was not satisfied and backlogs were growing. Clandestine connections and under-the-table payments to some labour groups were common. In sum, the government's claim that consumers stood to gain from privatisation was fairly credible. As Rhodes (2002) argues, "ENTel's service at that time was so bad it was hard to imagine anything that would make it worse".

The momentum for this sale was thus derived from the country's economic crisis, the company's disastrous performance, and a rare political opportunity. This gave the whole process its own dynamic; the fact that the completion of the sale was central to the government's attempt to establish its credibility imposed a discipline on the actors involved and limited the influence of the sale's critics. However, this also resulted in the fact that the sale conditions and the need for a regulatory regime were secondary to the completion of the transaction (Hill and Abdala, 1993; Gerchunoff and Canovas, 1995; Manzetti, 1999; Abdala and Spiller, 1999).

Following the passage of the State Reform Law on August 17<sup>th</sup> 1989, the new government moved quickly to start the privatisation process. The need for speed

determined that the privatisation would be implemented through presidential decrees rather than through statutes, which would have posed the risk of being caught up by interest groups in the Congress<sup>4</sup>. Moreover, in anticipation that both governmental and outside political resistance to the sale of ENTel would grow over time before defining its principles, a very tight timetable was set for the bidding process and for the accompanying institutional reforms<sup>5</sup>.

As pointed out by Torre and Gerchunoff (1999:9), the establishment of such a tight timetable had both positive and negative consequences. On the positive side, it evidenced the government's commitment to privatise ENTel. Moreover, it helped to limit the ability of those who oppose the privatisation to articulate a sound opposition to the process<sup>6</sup>. On the negative side, however, and taking into account that most of the critical aspects of the privatisation had not been defined, it weakened the government's bargaining position with potential buyers.

The executive decrees initiating it and laying down its principles were issued almost a month later after the passage of the State Reform Law. These decrees modified portions of the 1972 National Telecommunications Act that were incompatible with the privatisation, striking out its provisions that had reserved exclusive rights to the government to provide and control telecommunications services<sup>7</sup>. An interventor was

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<sup>4</sup> It should be noted that the State Reform Law explicitly allowed the executive to privatise using presidential decrees.

<sup>5</sup> Decree 731/89. As stated in this piece of legislation, the government's intention was to complete the sale in a period of 180 days.

<sup>6</sup> According to Corrales (1998), opponents of privatisation included, first, public sector workers (including company managers) who feared that de-nationalisation would probably lead to job cuts. Second, unions. Third, major businesses that supplied state enterprises and received lucrative public contracts. And fourth, Congressional representatives and party leaders responsive to the aforementioned constituencies. Teisman (2002), analyses other tactics used by the government to break their opposition.

<sup>7</sup> Decrees 59/90, 60/90, 61/90, and 62/90.

appointed to oversee the privatisation process<sup>8</sup>, and she and her team immediately began to work on preparing the company for sale<sup>9</sup>.

The “*Pliego de Bases y Condiciones para la Privatización del Servicio Público de Telecomunicaciones*” (Document of Terms and Conditions for the Privatisation of Telecommunications Services), together with the transfer contracts, laid out the conditions for the sale of ENTel<sup>10</sup>. Following the provisions in the Pliego, ENTel was broken up both functionally and geographically. Functionally, it was separated into basic, international and competitive services, the latter two comprising telex and data transmission services and naval radio communications. Basic services were divided geographically into the northern and southern regions. Four new stock companies were created to provide all of these services. Two of the new companies were established exclusively to provide basic services for a period of seven years, with an option for three more – contingent on the achievement of a set of required targets<sup>11</sup>. After the end of this period, the companies would continue to have a license to operate, but it would no longer be exclusive. The third company, which was also granted an exclusive license for the same period of time, was created to provide international services. The fourth, finally, was created to offer competitive services

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<sup>8</sup> The person chosen by president Menem was Maria Julia Alsogaray, a well known advocate of privatisations in Argentina and the daughter of Alvaro Alsogaray, a leading figure of the center-right *Unión de Centro Democrático* (UCeDé).

<sup>9</sup> The legal, technical and financial advisers for the privatisation were selected competitively among both local and international firms. The World Bank provided financial assistance and technical advice. As pointed out by Shaikh et al. (1996), the privatisation of ENTel was one of the conditions of the *Public Reform Loan* that the Bank made to Argentina.

<sup>10</sup> The Pliego was contained in executive decree 62/90.

<sup>11</sup> Initially, the interventor wanted to break the company into seven units before the sale and, therefore, create a kind of benchmark competition. However, consultants from US investment bank Morgan Stanley recommend it be divided into just two regions in order to achieve the goal of attracting investors (Rhodes, 2002).

throughout the country<sup>12</sup>. The ownership of the last two companies was split equally between the first two. The government auctioned blocks of 60% of the two companies established to provide basic services through open international competitive bidding.

Between the publication of the Pliego and the date of transference, numerous modifications were introduced to the conditions of the sale. These modifications weakened the credibility of the government and this, in turn, resulted in a sharp decrease in the number of participants in the bidding process (Hill and Abdala, 1993; Schvarzer, 1993; Abdala and Spiller, 1999). Of the fourteen potential purchasers who bought the bidding documents, seven submitted applications for prequalification. However, only three actually submitted bids for ENTel. A consortium led by the Spanish Telefónica de España won the bidding process for both regional monopolies, but was allowed to purchase only one. A group headed by Bell Atlantic came in second, but at the last minute it had trouble raising the funds, and its place was taken by a consortium between STET and France Telecom.

The transfer contracts were signed on November 8<sup>th</sup> 1990. The shares in the northern company, henceforth known as Telecom Argentina, went to the consortium operated by France Telecom Cable and Radio, and STET. The shares in the southern company, henceforth known as Telefónica de Argentina, went to the consortium operated by Telefónica of Spain<sup>13</sup>. The government retained 40% of the shares in the two

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<sup>12</sup> For further details on the process of privatisation, and the design of the regulatory incentives – such as rate setting procedures, performance standards, barriers to entry and interconnection – see Gonzalez Lanuza (1992), Hill and Abdala, (1993), World Bank (1993), Shaikh et al. (1996), Abdala and Spiller (1999), and Manzetti (1999).

<sup>13</sup> As pointed out by Rhodes (2002), in total, 35 corporations, 83% of which were financial institutions, were part of the winning consortia.



companies, 25% of which was to be sold to the general public, 5% to telephone cooperatives, and 10% to ENTel employees<sup>14</sup>.

The winning consortia paid a total of US\$1.65 billion for their 60% of the companies, offering a combination of cash and Argentine government bonds<sup>15</sup>. As argued by Urbiztondo and Gomez-Ibañez (2002), the assertions of those who claimed that the price paid was too low seemed to be confirmed when the government gained US\$830 million from the sale of another 30% of Telefónica de Argentina's stock on the New York and Buenos Aires stock exchanges in 1991, and US\$1.2 billion for the sale of another 30% of Telecom Argentina's stock in 1992.

## 2.2. The regulatory regime

As commonly pointed out, the most serious shortcomings in the privatisation of ENTel were in the design and implementation of the regulatory regime (Hill and Abdala, 1993; Gerchunoff and Canovas, 1996; Guasch and Spiller, 1999; Abdala, 1994; Urbiztondo, 1999). In that sense, although the Pliego outlined the basic rights and obligations of the privatised companies and provided for general regulatory principles and the establishment of a regulator, little was done to implement a regulatory regime before privatising. More specifically, although the Pliego had committed the government – and in particular the Secretariat of Communications in the Ministry of Public Works – to develop and issue the details of the regulatory

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<sup>14</sup> With the objective of breaking union leaders' opposition to privatisation, unions were given responsibility for administering employee-owned shares (Murillo, 2000).

<sup>15</sup> It should be noted that, at that time, these bonds were traded for about 19% of their face value. The US\$1.65 billion counts the bonds at their market rather than their face value.

framework by February 1990, these details were not issued until just three days before final bids were to be submitted.

According to Hill and Abdala (1993:20-21), there were two reasons for this delay. First, and as it has been already discussed, at the beginning of the bidding process the government placed higher priority on rapidly completing the sale than on developing a strong regulatory regime. Second, the Secretary of Communications and most of his staff did not support the government's privatisation plans<sup>16</sup>. Believing that the privatisation team would not succeed, they did not approach the task of developing and implementing a regulatory framework with any sense of urgency.

The Decree 1185/90, which was finally passed in June and was drafted by a joint Argentine/World Bank team (Hill and Abdala, 1993), provided the legal basis for a regulatory agency and regime. It included and extended the regulatory principles outlined in the Pliego and created a telecommunications regulatory agency, the Comisión Nacional de Telecomunicaciones, henceforth known as CNT.

This decree placed three obligations on the regulators, in no particular order of importance: a) to assure the continuity, regularity, equality and generality of the services; b) to promote the universal character of the basic telephony service at fair and reasonable prices; and c) to promote fair and effective competition in the supply of those services not subject to exclusivity.

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<sup>16</sup> The Secretary of Communications, Julio Guillán, had been the leader of the telecommunications workers' union.

In relation to the allocation of roles and responsibilities, the new legislation provided that political authorities would retain responsibility for broad and long-term policy – notably, defining the legislative framework, deciding issues of sector restructuring, public investment, taxation, subsidies, and managing inter-governmental relations. The regulator, meanwhile, was delegated a much more detailed and specific mandate. Formally, the powers and responsibilities originally delegated to the regulators included<sup>17</sup>:

- a) Awarding or cancelling licenses, authorisations and permits – with the exception of exclusive licenses;
- b) Modifying the conditions of authorisations and permits;
- c) Modifying the conditions of licenses – subject to obtaining the consent of the licensee, and the approval of the Executive office for exclusive licenses;
- d) Advising the Executive office on whether or not new services supplied in the telecommunications market should be introduced under an exclusive license;
- e) Deciding whether exclusive regimes should be extended;
- f) Inspecting and verifying as to whether the conditions contained in the licenses, authorisations and permits were met;
- g) Reviewing and approving investment plans for operational compatibility, minimum quality of service, and interconnection of networks as well as the standards and rules for interconnection;
- h) Addressing consumer complaints;

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<sup>17</sup> Several months later, in December 1990, a presidential decree (2798/90) marginally amended and expanded this list.

- i) Preventing anticompetitive behaviour, particularly as a result of cross subsidies<sup>18</sup>;
- j) Verifying that requirements for competitive procurement were met;
- k) Approving tariffs in cases where rates had to follow guidelines set in a license;
- l) Imposing fines and penalties on firms for not complying with their obligations;
- m) Facilitating the settlement of disputes between sector operators, and between operators and consumers.

At the time of the establishment of the new regulatory regime, the declared intention of policy-makers was to set up a regulatory agency at an arm's length relationship with both political authorities and with regulated firms and other private interests. In that sense, the decree provided that CNT was to be headed by five commissioners<sup>19</sup>. All of them would be appointed by the executive – although one on the recommendation of the Federal Council of Telecommunications, which represented the provinces. Commissioners would be appointed for five year terms, with the possibility of being re-appointed for one additional term, and their terms would be staggered. The executive was also to designate one of the commissioners as president of the commission. The decree 1185/90 also established that CNT's authorities could be removed by the Executive Office and that the latter would not be forced to consult other branches of government before taking such a decision<sup>20</sup>.

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<sup>18</sup> It should be noted that at the time of the creation of the new regulatory agencies, responsibility for the enforcement of the 1980 competition law was allocated to the Comisión Nacional de Defensa de la Competencia.

<sup>19</sup> In December 1990, however, a presidential decree (2728/90) increased the number of commissioners to six.

<sup>20</sup> Article 18 of the Decree 1185/90. It should be noted, nevertheless, that the legislation required the participation of two agencies, directly controlled by the Executive Office, in the removal process: the *Sindicatura General de Empresas Públicas* and the *Procuración General del Tesoro de la Nación*.

Regarding the institutional arrangements set up to ensure that regulators were at arm's length from private interests, the decree provided that the regulator would be separated from regulated firms. Moreover, the legislation included explicit rules prohibiting regulators from holding a position or an interest in a firm subject to their control. These prohibitions extended to the commissioners' immediate family and were complemented by restrictions on previous and subsequent employment<sup>21</sup>.

Policy-makers explicitly intended to ensure that the regulatory bodies would have the institutional autonomy required for their independence from both government and business, as well as to foster and retain technical expertise. This involved: providing the regulatory agency with reliable sources of funding, permitting regulators to impose sanctions on operators for not complying with their obligations, and endowing them with enough managerial flexibility to carry out their duties. In this regard, the decree 1185/90 provided that CNT would be responsible for annually elaborating its own budget, which would be included in the national budget for its discussion in Congress. Moreover, it stipulated that the agency's budget would be financed both through a levy imposed on regulated firms operating in the sector and license charges to users of the radio spectrum. The levy was set up as a percentage (0.5%) of operators' income. These funds were to be deposited in an account at the *Banco Nación* and administered by the regulatory agency. Any funds not used by the agency in performing its assigned tasks would be used to develop both public and official telecommunications and broadcasting services<sup>22</sup>.

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<sup>21</sup> Article 14 of the decree 1185/90.

<sup>22</sup> These arrangements were set up in articles 10 and 11 of the decree 1185/90.

The sanctions that CNT could apply, meanwhile, included warnings, fines, total or partial cancellation of exclusivity, and the cancellation of licenses, authorisations or permits<sup>23</sup>. The regulator was also given powers to contract external consultants, design its own organisational structure, decentralise/delegate tasks, etc.<sup>24</sup>. Additionally, it was formally endowed with an important degree of flexibility to recruit and remove its own staff.

Finally, the decree also established certain institutional arrangements to ensure that the regulator remained accountable for its actions. It stipulated, in this sense: that regulators' decisions could be subject to appeal not only to courts but also to the relevant political authority – which had the power to modify those decisions<sup>25</sup>; that the regulatory agency would have the obligation to publish information and advice to all interested parties<sup>26</sup>; and that the regulator's accounts and performance would be scrutinised internally by *Sindicatura General de Empresas Públicas*, and externally by the *Tribunal de Cuentas de la Nación*<sup>27</sup>.

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<sup>23</sup> Article 6 (l) of the decree 1185/90.

<sup>24</sup> It is important to note in this regard that, although the agency would be responsible for proposing its own organisational structure, Article 19 of the decree 1185/90 established that the latter would be subject to approval by the Executive office.

<sup>25</sup> The arrangements for appealing CNT's decisions were stipulated in article 33 of the Decree 1185/90.

<sup>26</sup> Regarding the powers of the regulators to publish the information supplied to them by operators, Article 32 of the decree 1185/90 the decree established that firms would be entitled to ask the regulator to keep their information confidential, but it would be up to the regulator whether to keep it as such or to release it.

<sup>27</sup> Benedetti and Petrecolli (1999) argue that although these arrangements were advances in the right direction, policymakers should have complemented them with other key safeguards of accountability such as: obliging the regulator to publicise their decisions and to give reasons for them, requiring it to produce an annual report on the agency's activities, and imposing the duty to carry out public hearings before deciding on important issues. The authors note that, on the issue of public hearings, Article 30 of the decree strangely established that, only after January 1994, it was up to the CNT whether to carry out a public hearing when considering issues "with severe social repercussion". The article in question also stipulated that only those parties authorised by CNT were allowed to take part in that procedure.

### 3. Regulatory stability during the Menem years (1990-1999).

#### 3.1. The early days (1990 – 1992)

The first incarnation of CNT was staffed entirely by former employees of the Secretariat of Communications and ENTel. In fact, some of them became executive officers of the newly created regulatory agency<sup>28</sup>. According to Hill and Abdala (1993:25), this group had no experience in regulation and little vision as to the role of a regulator. Moreover, they were not associated with the moderate portion of Menem's party that backed reform and had neither supported the privatisation nor expected it to succeed<sup>29</sup>. In these authors' view, this would explain why the regulatory authorities did little to put the regulatory framework outlined by the decree into action.

As a result, important decisions were not taken, and the work of the authority began to pile up<sup>30</sup>. Moreover, the CNT's methods of decision-making were problematic. Although the legislation provided few incentives for the regulators to follow an open and transparent process, their decisions were rather idiosyncratic and made on the basis of personal relationships (Hill and Abdala, 1993:25-27).

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<sup>28</sup> CNT's first board of director was composed by Raúl José Otero (president), Jorge Angel Aguirre, Humberto Garuti, Mahamad Chain - all of them appointed in the presidential decree 2068/90. In December 1990, the board was completed with the appointment of Armando Achem in representation of the Federal Council of Communications – appointed in the decree 2714/90. Also in December, and when the executive augmented the number of commissioners to six, Alfredo Parodi was appointed to complete the list (Decree 2729/90).

<sup>29</sup> See also Rhodes (2002).

<sup>30</sup> It soon became clear that the newly appointed regulators were not willing – or lacked the capacity – to address issues such as imbalances in rates between services, develop standards and processes for issuing licenses, issue licenses in time, effectively address consumer complaints, or review and verify whether the companies were meeting the performance targets set for them under their contracts (Hill and Abdala, 1993).

In early 1991, the Ministry of Public Works was merged with the Ministry of Economy. This brought CNT under the purview of the new Minister of Economy, Domingo Felipe Cavallo. As inflation had begun to accelerate again, Cavallo's priority was to restore macro economic stability. Therefore, the problems generated by CNT's sluggishness were not at the top of the minister's agenda.

The introduction of the Convertibility Law in March 1991, however, changed the situation. The main component of this law was the anchoring of Argentina's exchange rate to the dollar in a one-to-one convertibility scheme. In response to accelerating inflation, moreover, another part of the law banned all price indexing formulas that were linked to the Argentine Consumer Price Index (CPI). As pointed out by Urbiztondo (2002), this made the telecommunications tariff formula void since it was governed by a price-cap formula that adjusted prices relative to the Argentine CPI<sup>31</sup>.

As explained by Hill and Abdala (1993:25), the repeal of the indexing formula meant that the nominal price of telephone services was frozen and subject to erosion by inflation. Under the terms of the Pliego and transfer agreements, any modification of the terms of the exclusive licenses was subject to compensation. However, CNT's authorities did nothing to replace the existing indexing formula. They argued that, despite being frozen, telecommunications tariffs were high enough.

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<sup>31</sup> More precisely, the Pliego established that during the two years following the transfer, the companies could adjust their prices monthly to keep pace with changes in the CPI. In addition, it provided that during that period they could increase their real prices every six months if CNT determined that real price increases were needed to provide licensees a 16% rate of return on their investment. For the next five years, meanwhile, the Pliego established that prices would be governed by a "price cap" formula. The maximum increase allowed would be the change in the CPI less 2 percentage points. Finally, if the companies were granted an extension in their licenses, it was instituted that the price cap would be the CPI less 4 percentage points.



In response to CNT's inaction, the companies refused to participate in the preparation of the prospectuses for the public sale of the government's remaining shares in the companies. Eventually, this forced the government to negotiate. Nevertheless, it was the Ministry of Economy – and not the CNT – who carried out the negotiations with the companies. The solution finally reached was to modify the formula from Argentine pesos to U.S. dollars<sup>32</sup>. That is, tariffs would be expressed in dollars and would be adjusted each semester according to changes in the U.S. PPI<sup>33</sup>.

### 3.2. The first round of changes (1992 – 1993).

CNT's poor performance and failure to act was also having implications outside the telecommunications sector. It undermined the credibility of the government's privatisation program among investors and, hence, the political feasibility of future privatisations of other state-owned monopolies. In December 1991, therefore, the Under-Secretariat of Communications was recreated in the Ministry of Economy and Public Works, thus bringing CNT under closer scrutiny by the economic authorities<sup>34</sup>.

One month later, following the publication of a World Bank report that highlighted the deficiencies of the regulatory agency, the government instituted an administrative intervention of CNT, replacing its president and commissioners with an interventor and four deputy interventors<sup>35</sup>. It should be noted that, in Argentina, administrative

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<sup>32</sup> The new tariff formula was established in the decree 2585/91.

<sup>33</sup> Since domestic inflation did not converge to international standards until the second half of 1992, and cumulative inflation since the beginning of convertibility had been 62.2%, the firms took the changes in the formula as a violation of their licenses, and initiated (unsuccessfully) legal actions in an attempt to get the cumulative difference according to the old formula (Artana et al., 1996 and Artana et al., 1998).

<sup>34</sup> German Kammerath, was appointed Under Secretary.

<sup>35</sup> Jose Palazzo was appointed interventor and José Sanchez Elías, Federico Pinedo, Elizabeth Remedi and Ricardo Fernandez, deputy interventors. Decrees 136/92, 349/92, 748/92 and 749/92.

interventions are normally used only in extraordinary cases – generally where mismanagement has taken place – and for limited periods of time. Thus, by choosing to administratively intervene CNT for a period of twelve months, the government intended not to create a bad precedent, and signalled that this was an exceptional circumstance.

According to Hill and Abdala (1993:27), unlike the commissioners they replaced, the interventors were associated with the political coalition supporting economic reform and, in particular, with Minister Cavallo. Motivated by beliefs in the value of economic liberalisation and competition, they were faced with two main tasks. First, they needed to address the pressing backlog of regulatory decisions left by the agency inaction in the first year. Second, they had to chart out CNT's future strategy for the long term, and ensuring the availability of the resources to implement this strategy. Although the short-term issues inevitably dominated CNT's agenda during the first months of the intervention, some actions to foster the agency's regulatory capacity were also undertaken. In collaboration with the World Bank, the Under-Secretariat of Telecommunications formulated a plan for developing CNT's administrative, organizational, and regulatory capacity.

Despite the progress on many fronts, the uncertainty surrounding the whole regulatory regime – and the decisions made within it – was not eliminated. Although the administrative intervention of the regulatory agency was extended twice for another 180 days<sup>36</sup>, officials at the Ministry of Economy were aware that the intervention of

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<sup>36</sup> Decree 1095/92 and 760/93.

the agency was a transitory arrangement and, if they wanted to gain more control of the sector's regulation, they would have to achieve it through other means.

Encouraged by its success with the stabilisation and reform program, the economic authorities gained increasing formal control of the regulatory agency. In October 1992, following the approval of the *Ley de Administracion Financiera y Sistemas de Control*, they severely limited CNT's access to the funds raised to finance its activities (FIEL, 1999). Similarly, in April 1993, and with the intention of curtailing the power of provinces in regulatory decisions, they sought a presidential decree that partially changed the institutional arrangements for appointing CNT's authorities<sup>37</sup>. As discussed above, the decree 1185/90 provided that one of CNT's commissioners would be appointed by the executive following the proposal of the Federal Council of Communications. The new legislation, instead, granted more discretion to the executive in the appointment process<sup>38</sup>. It stipulated that the executive would be entitled to choose one of the three candidates proposed by the Council<sup>39</sup>.

In October 1993, the administrative intervention controlling the CNT finally came to an end and new regulatory authorities were appointed following a rather *ad hoc* open call and contest<sup>40</sup>. These changes, nevertheless, came along with another important

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<sup>37</sup> Most of the provinces, even those controlled by the ruling party, had a rather conflictive relationship with the national economic authorities.

<sup>38</sup> Decree 761/93.

<sup>39</sup> The decree also established that, unlike other commissioners who would be appointed for a period of five years, renewable for one additional term, the commissioner representing the Council would be appointed for just one year, renewable for four additional terms.

<sup>40</sup> By means of the presidential decree 2161/93, Rinaldo Colomé was appointed president of the regulatory agency. Its board of directors was completed with the appointment of Carlos Alberto Killian, Isaac Rubén Salmun, Roberto Carlos Door, Henoch Aguiar and Héctor Mario Carril – the last one on behalf of the Federal Council of Communications. In June 1994, Rinaldo Colomé exchanged positions with the Subsecretary of Communications, Oscar Gonzalez (Decree 961/94). This exchange of positions was another indicator of the government's disregard for the rules of the game regarding the appointment and removal of regulators and, above all, for the independence of the regulatory agency.

transfer of CNT's responsibilities in favour of the economic authorities<sup>41</sup>. Indeed, the presidential decree 2160/93 established that it would now be the responsibility of the newly created Secretariat of Public Works and Communications – in the ambit of the Ministry of Economy – deciding on critical regulatory issues such as:

- a) policy definition in the telecommunications sector in Argentina;
- b) approval of compatibility standards, quality requirements, and interconnection rules;
- c) definition of rates, rights, and fees in the field of telecommunications in Argentina (and, consequently, a substantial portion of CNT's funds);
- d) advising the Executive on whether new services supplied in the telecommunications market should be introduced under an exclusive license;
- e) the award and cancellation of licences (provided in competition);
- f) the extension of the exclusivity regime (when such extension is contemplated in the license);
- g) the regulation, control, fiscalisation and verification of the conditions under which licenses are granted;
- h) the amendment of licenses (when the possibility of introducing them is contemplated in the license, and subject to the consent of licensees – and approved by the executive in the case of exclusive licenses);
- i) all the issues referred to international agreements, treaties, and services;

This decree also introduced other important changes in the regulatory governance of the sector. First, it cancelled some of requirements originally set up in order to ensure

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<sup>41</sup> Decree 2160/93.

that regulators were at an arm's length relationship with operators<sup>42</sup>. Second, it considerably limited the attributes of institutional autonomy and managerial flexibility originally endowed to the regulatory agency. It was established that CNT's budget would need to be approved by the Secretariat of Public Works and Communications before its inclusion in the national budget. Moreover, it was also decided that the agency's powers to contract external consultants would be subject to the Secretariat's consent. Finally, the decree 2160/93 also limited the regulator's powers to carry out public hearings. In this respect, it established that in order to do so, it would first need to obtain the Secretariat's authorisation.

### 3.3. The second round of changes (1993 -1996)

By the time all the changes discussed above were introduced, however, the industry's main concern had changed. Beginning in the early 1990s, the newly privatised companies began to face competition on international calls from call-back services<sup>43</sup>. With the increasing penetration of these services, its providers were gradually cream-skimming the licensees' market and, thus, making the tariff structure unsustainable<sup>44</sup>.

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<sup>42</sup> More specifically, although the new legislation also included explicit rules prohibiting regulators from holding a position or an interest in a firm subject to their control, similar to those originally stipulated in the decree 1185/90, these prohibitions did not extend any more to the commissioners' immediate family, nor were they complemented by restrictions on previous and subsequent employment.

<sup>43</sup> With call-back, a customer in Argentina who wanted to make an international call would dial an exchange in the United States signalling the number without completing the call. The original number would be left, and the U.S. exchange would then place the call at the cheaper U.S. rates. Although call-back services were cumbersome to use, frequent callers found them worthwhile, given the high tariffs of international calls in Argentina.

<sup>44</sup> Note that for many years the telecommunications tariff structure in Argentina used long distance communications to subsidise the development of local networks and the universal service. Since the technology available did not allow competition, the introduction of these cross subsidies was out of the question. At the end of the 1980s, moreover, when the country was in the grip of hyperinflation, the structure of cross-subsidies in favour of urban residential customers became even more exaggerated as the government decided to protect low-income customers from the sharp decline in real earnings (Navajas and Porto, 1990; and Porto and Navajas, 1989). Thus, when the sector was privatised in 1990, the tariff structure in place was plagued by distortions that, in most cases, did not respond to an

As discussed earlier in this chapter, the introduction of the Convertibility Law in 1991 led to a significant change in the tariff formula. This change was only accepted by licensees under the condition that they would be allowed to change the structure of prices set up at the time of privatisation. In April 1992, a presidential decree ratified that agreement and established that the rebalancing of tariffs – which was also contemplated in the privatisation Pliego – should be instituted in June that year<sup>45</sup>. More than two years later, nevertheless, no advance had been made in this matter.

As pointed out by Abdala and Spiller (1999:56), two factors help to explain regulators' reluctance to introduce changes to the tariff structure. First, they acknowledged that what was at stake was an important and politically costly transfer of rents from residential users (who made an intensive use of local calls and by a large majority lived in the city of Buenos Aires) to commercial and professional users as well as to users located in the rest of the country (who made an intensive use of long distance and international calls). Second, regulators took into account that it was unlikely that the economic authorities would accept changes that could introduce an alteration in inflation rates and, hence, affect their stabilization efforts.

In October 1993, the new regulatory authorities formally authorised the use of the call back<sup>46</sup>. This was the perfect excuse for the companies to increase their pressure for fulfilment of the rate adjustments agreement of 1991. The pressures proved to be

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economic rationale (FIEL, 1999; Urbiztondo and Gomez-Ibañez, 2002). At that time these distortions were so prominent that the accounting company Price Waterhouse recommended the government to rebalance the tariff structure before privatising. However, since that could have jeopardised the feasibility of the whole process, the government opted not to introduce major changes to the tariff scheme and left these changes for later (Rhodes, 2002).

<sup>45</sup> Decree 506/92.

<sup>46</sup> Less than a year before, the CNT had banned its use arguing that it constituted an abusive use of the basic telephone service. The decision, nevertheless, was never implemented due to the extremely high cost of enforcing it.

effective. In fact, the Undersecretary of Telecommunications and the companies started negotiations on a rebalancing proposal presented by the latter. In September 1994, press information reported that they had reached an agreement. Immediately thereafter, however, a consumer organisation filed an *acción de amparo* – a measure similar to an injunction – demanding that the government should be prohibited from instituting any change in the tariff scheme until the government plans were openly discussed in a public hearing. The presiding judge granted a preliminary injunction to give himself time to study the case. This decision eventually resulted in the intervention of the Economic Minister and the holding of the first public hearings in the sector since its privatisation (Rhodes, 2002).

As Argued by Artana et al. (1998), the proposal put forward by the companies was very unsatisfactory both from an efficiency and a welfare point of view. In short, it ‘solved’ the required rebalancing (too high international and long distance domestic charges and too low rental charges and local call rates) with a modest reduction in the former, and a similar increase in the latter. However, it also disguised a big increase in tariffs by proposing a segmentation of the main metropolitan area (Buenos Aires) whereby local calls would be classified as short distance domestic calls, i.e., reducing the geographical definition of urban area.

Once it became public, the proposal aroused a wave of criticisms and suspicion not only from well-informed analysts but also from important interest groups – notably, consumer organisations and opposition legislators – which used the hearings carried out in November in the cities of Buenos Aires and Mendoza as a good opportunity to loudly voice their opposition to the proposed adjustment. With economic arguments

being relegated to a second place, press coverage of the dispute was, in general, favourable to the case against adjustment. Given the proximity of the next presidential elections, and fearing that any resolution of this rather conflictive issue could negatively affect its electoral prospects, the government decided to postpone any decision on the issue at stake until after the elections.

As the discussions on the rebalancing gained public relevance strong disagreements on the issue began to appear within the government, particularly, between the regulators vs. officials in the Ministry of Economy (Abdala and Spiller, 1999). While the latter favoured an increase in local calls to compensate reductions in long distance and international calls, the former contended that the rebalancing of tariffs did not necessarily require an increase in local calls. In their view, companies should not be compensated for a cut in the price of international calls, since these cuts were a natural product of the competition that resulted by technological advances (such as the call back). Officials in the Ministry of Economy, conversely, feared that any rebalancing with adverse effects on the revenues of companies would be perceived as a form of expropriation.

In May 1995, the tensions between the regulators and the Ministry of Economy culminated in the resignation of a couple of CNT's commissioners, including its president. Almost immediately, and with the purpose of gaining complete control of the agency, officials in the Ministry of Economy obtained a presidential decree that established the second administrative intervention of the regulatory body<sup>47</sup>. The argument used to justify this decision was that, with the resignation of its president,

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<sup>47</sup> Decree 702/95. This decree also established the appointment of Raul Agüero as Interventor.



the regulatory body was headless. The presidential decree that stipulated the administrative intervention of the agency also provided another important change in the rules of the game. It established that appeals to CNT's decisions would now be decided directly by the Minister of Economy.

Based on the negative experience of the 1994 hearings, the Undersecretariat of Communications, which fell under the Control of the newly created Secretariat of Energy and Public Works of the Ministry of Economy, decided to take direct control of the rebalancing process and hired the international consulting firm National Economic Research Associates (NERA) to complete a report on issue. This report was presented by mid 1995 and, in it, the consultants strongly criticised the licensees' rebalancing proposal, arguing that its approval would have generated an important increase in the companies' profits. Moreover, they advanced a new technical proposal for adjusting rates with seven different options, depending upon the constraints that one could include in the adjustment process (Nera, 1995).

These options were discussed in a second round of public hearings, which took place in January 1996. Immediately thereafter, the Minister of Economy issued a resolution ordering the secretary of energy and public works to make a decision on the adjustment rates, after the companies had chosen one of the options of the NERA report. This resolution, which could be construed as a direct government involvement in fixing rates<sup>48</sup>, was never implemented, though.

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<sup>48</sup> The Pliego explicitly provided that the government was not entitled to fix or change (or even propose a change to) tariffs.

### 3.4. The third round of changes (1996 – 1997)

Since his appointment in 1991, the relationship between President Menem and his minister of economy had never been free of conflict. Menem was a politician and his background lay in Peronism – a tradition of populism, protectionism, open state purse-strings and state nannyism, especially in creating industry and providing jobs<sup>49</sup>. Cavallo, meanwhile, was an economist and his practice was almost the opposite: economic and fiscal rigour, opening of the markets, privatisation, etc. Despite the minister's constant clashes with other ministers and leading members of the ruling party, this was the formula that defeated hyperinflation at the start of the 1990s and then brought three years of spectacular growth. As argued by Corrales (1997), Menem needed Cavallo, and that explains why he repeatedly backed his awkward subordinate and, as discussed above, granted him vast discretionary powers over economic policy.

Shortly after the re-election of President Menem in May 1995, this began to change. The Mexican crisis that started in the last months of 1994 had strong spillover effects on the Argentinean economy. As it happened in other emerging markets, Argentina entered into a sharp recession in 1995 and unemployment reached unprecedented levels. In this context, the economic authorities were forced to introduce several unpopular measures such as cuts in social spending. Although by the end of that year growth resumed again, unemployment remained high and, for the first time in many years, voters were showing discomfort with the management of the economy. In August 1995, to make things worse, an intense fight started between the president and Cavallo over the control of the post office privatisation process. Since then, not only it

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<sup>49</sup> For an in depth discussion on Menem's relationship with the values and ideas of traditional Peronism, see Szusterman (2000).

became clear that Cavallo no longer enjoyed the favour of the president but also that his dismissal was a simple matter of time<sup>50</sup>.

As in the past, the telecommunications sector was affected by the ups and downs in the relationship between the president and his subordinate. In March 1996, shortly after the minister ordered the secretary of energy and public works to make a decision on the rebalancing of tariffs, the president removed the Under-Secretariat of Communications, and consequently CNT, from the Ministry of Economy. By means of a presidential decree, the office was upgraded to the rank of a Secretariat reporting directly to the president<sup>51</sup>. With the clear objective of curtailing Cavallo's powers, moreover, it was established that the newly appointed Secretary of Communications would not only have all the roles and responsibilities previously in the hands of the Minister of Economy, but additionally, he would be responsible for:

- a) advising the executive on the definition and execution of telecommunications policy, supervising its enforcement and proposing an adequate regulatory framework;
- b) providing assistance, together with the regulatory bodies, in the control of telecommunication services' operators;
- c) generating proposals on the optimal mechanisms for protecting consumers' rights;
- d) preparing projects on regulatory legislation;
- e) and co-ordinating the implementation of telecommunication policies established by the executive.

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<sup>50</sup> In July 1996, finally, Cavallo was forced to resign and a new minister of economy was appointed.

<sup>51</sup> Decree 245/96.

Complementing these changes, two months later, another presidential decree restored to CNT many of its original roles and responsibilities – which, as already discussed, had been cut in 1993 in favour of the Minister of Economy<sup>52</sup>. It should be noted, however, that this last decree did not represent a return to the allocation of regulatory roles and responsibilities between political officials and regulators instituted at the time of privatisation. Indeed, the new configuration of regulatory powers left the former with a much bigger stake in regulatory policy than in 1990. That is, although the last round of changes reversed the cut in regulators' powers established in 1993, this did not come along with a limitation in those regulatory powers that political authorities had increasingly taken over since the creation of the regime.

The changes did not end there. In April 1996, a presidential decree established a comprehensive modification of the structure of the national bureaucracy<sup>53</sup>. Among other changes, it provided the fusion of CNT with the postal services' regulator (*Comisión Nacional de Correos y Telégrafos*) and the creation of the National Communications Commission (CNC). Despite new directors being appointed<sup>54</sup>, the regulatory agency continued to be run through administrative intervention.

Once in the ambit of the president, the executive expanded the role of political authorities in the regulation of telecommunications even further. In addition to the powers already granted to the Secretary of Communications, and by means of two presidential decrees, the executive established that it would also be this secretary's responsibility to institute the prime regulation for the provision of telecommunications

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<sup>52</sup> Decree 515/96.

<sup>53</sup> Decree 660/96.

<sup>54</sup> Alberto Gabrielli was appointed as president.

and postal services<sup>55</sup>. According to the new legislation, that comprised instituting the prime regulation of: interconnection; quality of service; use of the radio electric spectrum (as well as rates, rights and fees for its use); management of satellite services; imposition of sanctions against independent operators; provision of accounting and cost information by licensees and their related firms; and customers' rights and obligations (of both basic and mobile telephony). Furthermore, the decrees in question also granted the Secretariat responsibility for deciding on other critical regulatory issues such as granting and cancelling licenses (provided in competition), authorisations and permits; proposing the tariff policy for regulated services, and approving the tariffs of those provided under exclusivity or without effective competition; approving interconnection rules; representing the country with international telecommunications institutions; and setting up the procedures for carrying out public hearings and other consultation mechanisms. Last but not least, it was also established that it would be the task of the Secretary of Communications "to instruct CNC about the regulatory policies to follow" and "*intervene*" in the agency's organisation<sup>56</sup>.

As discussed above, the May 1996 presidential decree had given back the regulator's original role and responsibilities. Thus, most of the legislative changes introduced thereafter during the year, resulted in a potentially conflictive duplication of responsibilities between the political and regulatory authorities. In January 1997, however, the executive introduced a major cut in the role and responsibilities of the regulatory agency<sup>57</sup>. More specifically, it was established that CNC's regulatory functions would now have to be pursued *in conformity* with the policies defined by

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<sup>55</sup> Decrees 1260/96 and 1620/96.

<sup>56</sup> Decree 1620/96, Annex II, point 7 and 14.

<sup>57</sup> Decree 80/97.

the executive through the Secretariat of Communications. Moreover, it was explicitly provided that in most regulatory issues – notably, the critical ones – CNC would act as a mere advisory body to the Secretary of Communications.

The changes to the status quo introduced by this last presidential decree also affected other critical components of the sector's framework within which regulatory decisions were made. First, it was established that CNC would now be headed by eight members – one president, two vice-presidents, and 5 commissioners. The president, vice-presidents and four of its commissioners would be appointed for a period of five years, with the possibility of being re-appointed for one additional term. The commissioner appointed in representation of the provinces, meanwhile, would continue to be appointed by the executive for a period of one year, but with the possibility of being re-appointed for one additional term – and not any more for four terms, as established in April 1993 in the decree 761/93. Second, it was stipulated that the agency's budget would need to be approved by the Secretary of Communications. Third, it was decided that CNT's accounts and performance would now be scrutinised externally by the Auditoría General de la Nación.

### 3.5. The rebalancing of tariffs and its aftermath (1997-1999).

While all the changes discussed above were taking place, officials in the newly created Secretariat of Communications decided to adopt a more decisive approach to implementing the much delayed adjustment in tariffs. One of their first actions was to repeal the ministerial resolution issued in February that ordered the sector's authorities to make a decision on the adjustment rates, after the companies had chosen

one of the options of the NERA report. In September 1996, moreover, a consultation document was published on the issue.

Shortly after its publication, however, consumer organisations and other interest groups strongly criticised the mechanism on the grounds of the short period of time (one month) that they were given to submit responses. In reactions to these critiques, the Secretariat's authorities opted to establish a new mechanism for the rebalancing to take place. This new mechanism did not differ much from that adopted in 1994. That is, in line with the provisions of the Pliego, it was established that the government could not propose any adjustment but, instead, it could only evaluate and decide on proposals made by the companies (with the final consent of the firms).

In October 1996, the licensees presented a new rebalancing proposal, which closely resembled one of the alternatives suggested in NERA's report. In a nutshell, the new proposal included an 80% increase in the rental charge; an average increase of 50% in local call rates; the adoption of larger differentials for peak hours tariffs; a decrease between 15% and 59% in national long distance calls; a decrease of 55% in international calls; and the elimination of free minutes embodied in the low tariff structure, which was compensated with the creation of a low user scheme to protect low-income consumers.

A public hearing was carried out to discuss the proposal in December 1996. The hearing was carried out in Posadas, a provincial capital located 1000 km away from Buenos Aires. Although by carrying it out there the Secretariat authorities sought to

avoid the pressure of pro-urban interest groups, the hearing ended up being a heated reiteration of old arguments by both the opponents and supporters of the rebalancing.

As discussed above, as 1997 started, the last round of changes in the sector's governance were already in place<sup>58</sup>. The government decided to put an end to this lengthy and extremely conflictive process and go ahead with the adjustment. In February, it established a new tariff scheme by means of the presidential decree 92/97. This introduced some modifications to the proposal discussed in the last public hearing. As pointed out by Abdala and Spiller (1999) and Artana et al. (1998), these amendments were intended to make the adjustment less abrupt and, therefore, reduce the expected political opposition to the rebalancing. Among other things, they made the increase in the residential rental charge and in the price of local calls considerably lower than those requested by the firms. It should be noted, however, that with the exception of short distance interurban calls, the reductions in the prices of both interurban and international calls were in general less sharp than those proposed by the firms.

Contrary to the expectations of many government officials, the introduction of the new tariff scheme was not the end of this story. In a few weeks, there were dozens of lawsuits demanding the interruption of the adjustment in telephones rates, with a few demanding the opposite. Contributing to generate a rather confusing situation, the judges' responses to these demands were far from homogeneous. In fact, although

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<sup>58</sup> On the last day of January, moreover, the government decided to put an end to CNC's administrative intervention and appoint new directors: Roberto Catalan was appointed CNC's president (Decree 88/97), Roberto Uanini first vice-president (Decree 89/97), and Hugo Zothner second vice-president (Decree 90/96). The board was completed with the appointment of Federico Luján de la Fuente (Decree 1648/96), Alberto Jesús Gabrielli (Decree 48/97), Patricio Feune de Colombi (Decree 68/97), Antonio Salim Name (Decree 91/97), and María Alarcia in representation of the Federal Council of Communications (Decree 358/98).



most of them decided that the rebalancing was illegal and, therefore, companies should not charge according to the new tariff scheme, a judge in Córdoba ruled in favour of the adjustment<sup>59</sup>. The reaction of the companies to this situation was not uniform. The northern company (Telecom) decided to go ahead with the adjustment, while the southern one (Telefónica) did not send out any bills in Mendoza and Buenos Aires in reaction to the legal actions and possible fines. By mid year, the situation was rather chaotic and all the relevant actors waited for a Supreme Court ruling. It soon became clear, however, that this ruling would be postponed until after the October parliamentary election<sup>60</sup>.

The presidential decree introducing the new tariff scheme did more than to trigger the involvement of the courts. Motivated by its salience and the proximity of the next legislative elections, opposition legislators also moved rapidly to capitalise on the popular discontent with the new tariff scheme and introduced several bills that provided the rejection of the decree 92/97. Moreover, they called the Secretary of Communications to explain the provisions of the decree before the Communications Committee both in the in the Senate and the chamber of Deputies<sup>61</sup>. Although in more moderate terms, legislators of the ruling party also questioned the tariff adjustment<sup>62</sup>. In this sense, while some of them advocated the amendment of the decree in question, most did not favour challenging the executive's decision. Instead, they chose to sign a

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<sup>59</sup> For a more detailed review of the judicial decisions on this matter, see Artana et al. (1998) and Vispo (1999).

<sup>60</sup> See *La Nación* 16/04/97, 24/12/97, 05/02/98, 06/05/98; and *Ambito Financiero* 27/03/97, 16/04/97, 27/08/97, and 29/08/97.

<sup>61</sup> Seven months later, in September 1997, Kammerath was called again to the lower chamber's Communications Committee. On that occasion, he was required to explain the developments in the implementation of the rebalancing of tariffs and in the process to award PCS licenses, which was also the object of an intense legal battle. See *La Nación*, 18/09/97.

<sup>62</sup> Most of the peronist legislators who opposed the new tariff scheme belonged to those districts negatively affected by the rebalancing (notably, Capital Federal and Buenos Aires). See *La Nación*, 14/02/97; 28/02/97; 01/03/97 and *Ambito Financiero* 13/02/97.

statement where they committed to create a legislative committee that would study and propose a rapid liberalisation of the market<sup>63</sup>.

The limits to Congress' action to reverse the changes introduced by the executive became evident when the session to discuss the decree failed due to the lack of quorum. In fact, only 68 out of 257 members of the Chamber of Deputies were present to discuss the issue<sup>64</sup>. In the light of this result, it became rather obvious that the legislative manoeuvres of those legislators who opposed the changes in the tariff scheme were basically publicity stunts. That is, they were opportunities to voice their disgust with those changes while showing that they attempted to change them. Knowing beforehand that their proposals would not succeed, their intention was not only to increase the salience of the issue but also to exploit it when campaigning in the subsequent election<sup>65</sup>.

In August 1997, the Bicameral Committee of State Reform and Monitoring of Privatisations (*Comisión Bicameral de Reforma del Estado y Seguimiento de las Privatizaciones*) made public its complaints regarding the presidential decree that introduced the rebalancing<sup>66</sup>. It should be noted, however, that the majority of its members did not focus their critiques on the provisions of the decree but on the fact that the executive had neither informed the committee about its plan to introduce

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<sup>63</sup> See La Nación 04/03/97 and 05/03/97; and Ambito Financiero 11/02/97 and 09/04/97.

<sup>64</sup> More than half (39) of those who were present that day, represented the City or the Province of Buenos Aires. Moreover, just 9 belonged to the ruling party.

<sup>65</sup> According to Rhodes (2002), the rebalancing of tariffs was an issue very present in the electoral campaign of opposition parties in 1997 legislative campaign and helps to explain the peronists defeat in those legislative elections.

<sup>66</sup> The creation of this bicameral committee was provided in the State Reform Law in 1990.

changes to the contracts signed at the time of privatisation, nor had it required its opinion in this respect<sup>67</sup>.

A few months after the new tariff scheme was introduced, and despite the fact that it was already being implemented in most provinces, all the relevant actors knew that the future of the decree 92/97 depended on a decision of the Supreme Court. Given the composition of its members, few believed that Argentina's highest tribunal would rule against the preferences of the executive<sup>68</sup>. Indeed, on several occasions, government officials expressed their confidence in obtaining a favourable decision<sup>69</sup>.

In May 1998, the Supreme Court finally arrived to a decision on the rebalancing of tariffs<sup>70</sup>. Briefly, the Court ruling provided not only that the presidential decree that established the new tariff scheme was legal but also that the judiciary was not entitled to intervene in the setting of tariffs, since that would result in an invasion of the jurisdiction of another branch of government. In its ruling, moreover, the Supreme Court argued that the rebalancing had been introduced following a legal procedure, which allowed all interested parties to present their view, and, therefore, the executive had not exceeded the limits of its powers.

As expected, the decision was gladly received by the government and, particularly, by the licensees. In the last months, some judges had gotten tough with the companies and had imposed substantial fines on them for charging according to the new tariff

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<sup>67</sup> See *Ambito Financiero* 25/08/97.

<sup>68</sup> Five out of nine of the Supreme Court's judges had been appointed by Menem.

<sup>69</sup> See *La Nación* 03/09/97.

<sup>70</sup> Before that, the Attorney General was consulted on whether the Supreme Court should resolve the dispute. As contended by Urbiztondo (2000), the Attorney General's reply was not clear and gave rise to further uncertainty.

scheme<sup>71</sup>. The Supreme Court cancelled those fines. In contrast, those who did not welcome the validation of the rebalancing were, once more, consumer organisations, the ombudsman and opposition legislators, who decried the Court's lack of independence from the executive<sup>72</sup>. However, confronted with the Supreme Court's decision that ratified the new tariff scheme, their room for manoeuvre was rather limited. The only way left to them to overturn the provisions of the decree 92/97 was getting Congress to pass a law annulling it.

As in early 1997, many legislators of the ruling party still opposed the rebalancing of tariffs provided in the decree 92/97. Indeed, press information indicated that almost half of the peronist bloc in the Chamber of Deputies was ready to vote for the rejection of the decree in question<sup>73</sup>. Their dissatisfaction was not only limited to the changes in tariffs, but also with the performance of regulatory authorities. In fact, many of them pointed out that, despite the decree 92/97 explicitly requiring the regulators to carry out a regular assessment of the impact of the rebalancing on licensees' earnings, almost a year and a half after the new tariff scheme had been instituted, the government had failed to produce this study. Moreover, influenced by the increasing profits that both Telefónica and Telecom had been reporting since the changes in the tariff scheme, many legislators suspected that the impact was far from being neutral.

Given this challenging scenario, president Menem personally urged peronist legislators of both chambers not to reverse the government's tariff policy<sup>74</sup>. A week

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<sup>71</sup> See La Nación 06/05/98 and Ambito Financiero 08/05/98.

<sup>72</sup> See Ambito Financiero 08/05/98; and La Nación 09/05/98.

<sup>73</sup> See La Nación 14/05/98.

<sup>74</sup> See La Nación 13/05/98.

after the Court's decision, the Secretary of Communications had appeared before the Chamber of Deputies and had strategically announced that, before arriving to any conclusion regarding the impact of the rebalancing on licensees' revenues, the *Auditoría General de la Nación* – which reported to Congress – would have the opportunity to audit all the relevant figures<sup>75</sup>. In practice, knowing beforehand that the *Auditoría* did not have enough expertise and resources to carry out that task properly, this gave the executive the perfect excuse for even further delaying a resolution of this issue. However, it seems that these manoeuvres were enough to neutralize peronist legislators' intents to reverse the rebalancing. In fact, the issue almost disappeared from the legislative agenda. As pointed out by Rhodes (2002), consumer organisations' attention, meanwhile, turned towards the form in which telephone companies would collect payments from those who refused to pay or had not received their telephone bills during the controversy<sup>76</sup>.

As 1998 ended, the most conflictive regulatory issue that the government had addressed was left behind. In March 1998, moreover, the government had also been able to decide on the extension of licensees' exclusive rights and had, through the Liberalisation Plan, instituted the prime features of the future opening of the market<sup>77</sup>.

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<sup>75</sup> See *La Nación* 05/06/98.

<sup>76</sup> The majority of consumers with overdue bills were clients of Telefónica, which did not send bills for two or even three billing periods in the Capital Federal and the province of Mendoza between February and October 1998. Telecom, meanwhile, had about 25,000 customers with overdue bills (Rhodes, 2002).

<sup>77</sup> Both the extension of the exclusivity period for two additional years and the provisions of the Liberalisation Plan were established in the Presidential Decree 264/98. Briefly, the Plan stipulated that, by the end of 1999, and before the complete liberalisation of the market in November 2000, the government would grant two more licenses to provide fixed, local and long distance telephony services. The number of operators that could compete for those licenses was, however, strongly restricted. Indeed, the plan provided that these new licenses would be granted only to consortiums composed of companies that were already providing telecommunications services in the country and were not controlled by Telefónica or Telecom. In practice, that provision limited the number of potential entrants to just two consortiums. Meanwhile, the number of operators that could only enter the national and international long distance market before the complete liberalisation of the market was also strongly restricted. In fact, following the provisions of the Plan, only three operators – in addition

For telecommunications authorities, thus, the months before the October 1999 presidential elections were perhaps the least conflictive in almost a decade.

Nevertheless, the lack of significant conflicts did not mean that they remained inactive. Between January and December 1999, and assisted by the newly created UnderSecretariat of Communications, the Secretariat of Communications instituted a new numbering plan and carried out the bidding process for the selection of PCS operators<sup>78</sup>. In addition, and following the provisions of the Liberalisation Plan, public telephony was liberalised, new licenses for the provision of basic telephony were granted, and, once the technical aspects of the process were set up, the long distance market began to operate in competition. Furthermore, a new universal service regulation was established<sup>79</sup>, and, almost two years after the formal deadline had expired, a report on the impact of the rebalancing on licensees' revenues was finally published<sup>80</sup>.

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to the four that could also provide basic telephony – would be granted a license to provide this service. The plan, finally, also established the complete liberalisation of public telephony, a partial liberalisation of the mobile services, and the introduction of several “social” targets regarding the provision and operation of telecommunication services, notably, in rural areas. For an extensive review and analysis of the 1998 Liberalisation Plan, see Celani (2000) and Chambouleyron (1999).

<sup>78</sup> Originally, the Secretariat of Communications did not allow the participation of Telefónica and Telecom. This, however, was later reversed by the courts and, finally, these companies were allowed to participate.

<sup>79</sup> Resolution S.C. 18.971/99. It provided the creation of a Universal Service Fund through a levy imposed on operators. Initially, that levy would be 0.6% of operators' revenue and, from then on, it would gradually increase to reach 1% in 2004.

<sup>80</sup> The report concluded that the impact of the rebalancing on licensees' revenues had been almost neutral. More precisely, it concluded that the new tariff scheme resulted in an increase of just 0.3% and 0.06% in Telefónica's and Telecom's revenues, respectively.

#### **4. Conclusions.**

Having presented an in-depth analysis of the stability of the rules of the game governing the regulation of the telecommunications sector between 1990 and 1999, one question that naturally follows: what does this case study tell us about the hypotheses advanced in the second chapter of this thesis?

I believe that what the study of the telecommunications sector during Carlos Menem years unambiguously reveals is that those hypotheses do depict a valid representation of the story. Indeed, as predicted, in December 1999 the rules of the game governing telecommunications regulation in Argentina were only a pallid and rather distorted picture of the rules originally put in place shortly after the privatisation of the sector. Indeed, while in the beginning of the 90s the sector's key regulatory powers were in the hands of an agency designed according to the recipes favoured by the development consensus, almost a decade later most of these powers were back in the hands of government officials and few of the arrangements originally established to safeguard the independence, autonomy, and accountability of the regulatory agency remained in place. Regulatory policy, moreover, was as unstable, and hence, time inconsistent, as it used to be before privatisation.

The analysis of this case also reveals that the policy commitments of the early 90s were not kept because it was pretty simple for the executive to renege on them. As predicted, two factors accounted for this. On the one hand, since the sector's rules of the game had been defined in a presidential decree, the executive only needed to pass another decree for introducing changes to the status quo. That is, it never required the

consent of other veto players – notably Congress. On the other hand, as the analysis of the case clearly shows, once these changes were enacted neither Congress nor the judiciary were able to step in and force the executive to play by the rules it originally established. Indeed, of all the significant changes that the executive introduced to the status quo during the time period covered in this chapter, only one – the rebalancing of tariffs – was close to be reversed by these other veto players. Even in this case, however, the executive was able to ultimately impose its policy preferences.



## **Chapter IV**

**Telecommunications regulation during De la Rúa years (1999-2001).**

## **1. Introduction.**

In December 1999, a new government came to office. As it is discussed in this chapter, most of its officials believed that the problem with the regulatory reforms undertaken by the previous administration was not in their titles but in the way they were implemented. And to illustrate this point, many took the case of telecommunications. They admitted that the privatisation of the sector in the early 90s had resulted in a dramatic improvement in the performance of the industry. In their view, however, the improvements in performance could have been even more remarkable if, among other things, regulatory policy in that sector had been less politicized and unstable. Therefore, by the time the new government took power, one of its policy commitments was to break with the past and refrain from constantly interfering with the rules of the game governing telecommunications regulation in Argentina.

But would the government be able to maintain this commitment? Following the hypothesis in this thesis, the answer to this question should be that, since the rules of the game in the sector were still defined through presidential decrees, it would be very unlikely to see the new government keeping its original promise. Put differently, if the hypotheses in this thesis are valid, the following case study should corroborate that, like in the previous nine years, and despite the new government original intentions, telecommunications regulation between 1999 and the last days of 2001 was also subject to the changing whims of the executive's preferences and, therefore, to constant changes in the rules of the game.

Of course, these assertions need to be tested empirically. And in order to do so, this chapter proceeds as follows. In the next section I analyse some relevant background. Among other things, I discuss the determinants of Fernando de la Rúa's victory in the 1999 presidential elections, and the political and economic challenges that his government faced immediately upon taking office. In section 3, I discuss the issue of the stability of the rules of the game in the telecommunications sector between December 1999 and December 2001. Like in the previous chapter, this discussion is divided into subsections. In the first the focus is on the time period between December 1999 and September 2000. In the second, I analyse the events between October 2000 and September 2001. In the third, finally, I discuss the circumstances that surrounded the last couple of months before the president's resignation in December 2001. Section 4 concludes.

## **2. Background**

On 24 October 1999, Fernando de la Rúa was elected president defeating Eduardo Duhalde of the Peronist Party (PJ) by a margin of 49% to 38%. De la Rúa won the election at the head of a coalition, known as the Alianza, between his own centrist Union Civica Radical (UCR) and the new center-left Front for a Country in Solidarity (FREPASO). Former economics minister Domingo Cavallo, running on the centre-right Action for the Republic party ticket, finished third with 10%.

As argued by Levitsky (2000), two developments were critical to this outcome. Over the course of the 1990s, fears of a return to hyperinflation faded and economic

stability was increasingly taken for granted. As a result, issues linked with the quality of democracy – devalued by a sector of the electorate during Menem’s first years in office – gained salience. The emergence of these new issues such as corruption, education, and judicial independence, reshaped the dynamics of political competition, largely at the expense of the Peronists. Because Menem fared poorly on most of these issues (particularly corruption), his image began to erode<sup>1</sup>.

A second and closely related development pointed out by Levitsky (2000), was the resurrection and unification of middle-class opposition. The UCR and FREPASO, which had been viewed as incapable of governing in the early mid 1990s, undertook two critical strategic changes in this respect. First, aware that they could not build a winning electoral alternative in opposition to the reforms introduced by Menem, leaders of both parties announced that they would not seek to undo these reforms<sup>2</sup>. Second, the UCR and FREPASO formed the Alliance in August 1997, which ended the Peronist’s electoral ‘hegemony’ virtually overnight. With the bulk of the anti-Peronist vote united, the Peronist’s capacity to win elections with 40-45% of the vote was suddenly brought to question. Indeed, six months after its formation, the Alliance defeated the PJ by 46% to 36% in the 1997 legislative elections.

The October 1999 elections marked the consolidation of the aforementioned trends. De la Rúa, who was the heavy favourite from the outset, managed to effectively present himself as a post-Menemist alternative, combining a promise of economic

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<sup>1</sup> In line with Levitsky (2000), Lewis (2002) argues that the 1999 Alliance victory can be attributed, first, to its acceptance of the broad feature of convertibility and, second, to the promise of clean politics.

<sup>2</sup> Although the most important component of this promise was not modifying the provisions of the Convertibility Law, it also included maintaining the provision of public services in private hands and not reversing the advances made in the previous decade in trade liberalisation, the deregulation of financial markets, etc.

continuity with a clean government appeal. With his victory, many thought that there were real reasons for optimism regarding the future of the country. As Levitsky (2000) points out, for the first time in many years it seemed that Argentina had finally gotten its economics and politics right.

Reality, however, indicated that the new administration faced major challenges and, most importantly, significant shortcomings to address them (Corrales, 2002; Murillo, 2002). Economically, the prospects for the new government were not encouraging. Among the market reformers of the 1990s – and justified by the hyperinflation of 1989-91 which called for drastic measures – Argentina adopted the most inflexible exchange rate under the Convertibility Law of 1991<sup>3</sup>. This law obliged officials to uphold a fixed exchange rate vis-à-vis the U.S. dollar and banned the central government from printing money. This system, however, came with two tradeoffs. First, it purchased credibility because the government would not play dirty tricks with exchange rates. However, this was at the expense of competitiveness, and so the price of Argentine goods became expensive relative to the prices of Argentina's trading partners. Second, it injected predictable rules, that is a non-changing exchange rate, at the expense of flexibility in fiscal and monetary policy. This made the country's economy more susceptible to external shocks (Corrales, 2002; Mahon and Corrales, 2002).

As argued by Corrales (2002), fixed exchange-rate regimes require impeccable fiscal accounts, very low deficits and low debt standards. Starting in 1997, however, Argentina began to fail in this regard. Rather than taking advantage of the economic

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<sup>3</sup> As argued by Corrales (2002:31), while the use of inflexible exchange rates to stabilise prices is not uncommon, Argentina's approach was extreme.

boom that year to lower the national debt and deficits, Argentina went on a spending and borrowing spree. This was because in 1997 President Menem decided to seek reelection to a third term, even though he faced formidable institutional and political obstacles<sup>4</sup>. Yet, Menem thought that with a good dose of populism – which meant increasing spending and slowing down reforms – he could manipulate political institutions and the public opinion to his advantage.

As pointed out by Corrales (2002:33) Menem's quest for reelection against all institutional odds unleashed a spending race between the president and the leading Peronist governors who rejected his reelection plans. With an executive in desperate need for allies, and a group of party leaders desperate to contain him, fiscal prudence vanished. Everyone lost interest in fiscal austerity and in pushing for much needed reforms such as revamping the tax bureaucracy, introducing competition in the provision of public services, liberalising labour markets, and reforming the revenue-sharing system between the federal government and the provinces. In the light of these developments, economic officials recommended raising taxes, decreasing expenditures, and using privatisation proceeds to make payments on the rising debt. But no one at the top cared. The only recourse left to economic officials was thus to increase the already high levels of public debt and to delay payments to public-sector suppliers. This, of course, only served to restore the "credibility deficit" that had plagued the state in the 1980s. Once again the government was in the business of cheating private agents, repeating the predatory behaviour of the previous decade. When the aftershocks of the Russian financial crisis hit Argentina in mid-1998, the concern of sceptical business leaders began to turn into widespread pessimism. When

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<sup>4</sup> It should be noted that the 1994 constitution explicitly prohibited the president's reelection beyond a second term. Adding to this, the Argentine public was adamantly opposed to the idea.

De la Rúa took office in December 1999, the country had already entered into recession.

In political terms, the context in which De la Rúa took office was also very challenging. In the 1999 elections his coalition emerged four deputies short of a majority in the lower house of Congress. In addition, the Senate was still controlled by the Peronists, and a pro-Menem majority dominated in the Supreme Court. Unlike his predecessor, and to make things worse, the new president controlled neither the major labour unions nor many of the provincial governments<sup>5</sup>. Finally, because the new government was based on a coalition rather than a single party, everything indicated that policymaking would require constant negotiations between the UCR and FEPASO. As pointed out by Manzetti (2002), because these parties had never discussed how to turn an electoral partnership into a coherent government program, these negotiations were likely to become difficult and differences between the two parties were likely to arise over time<sup>6</sup>.

In sum, although De la Rúa was elected for the explicit purpose of taking the country through “post-adjustment” politics – i.e. increasing transparency, fighting institutional corruption, investing resources in social policy – Menem’s legacy threw Argentina back to the adjustment stage. The new government was thus forced to regain the trust of investors that Menem destroyed in his last couple of years in office. Given the institutional and political constraints that it faced, however, its capacity to generate bold policy responses was rather limited.

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<sup>5</sup> In fact, the PJ dominated 14 out of 24 governorships, including those of the three largest and most populated provinces (Buenos Aires, Córdoba, and Santa Fe).

<sup>6</sup> To make things even worse, the UCR’s party apparatus and most of its leaders in Congress were followers of one of De la Rúa historical rivals: the former President Raul Alfonsín.

### 3. Telecommunications regulation: new government and new preferences.

Within the new economic authorities, there was a sort of consensus that the results of the reforms introduced in the early 90s in the telecommunications sector were mixed. On the one hand, they admitted that the privatization of the industry had resulted in many positive outcomes. They were aware, that between 1991 and 1997, the telecommunications sector had attracted almost 20% of private investments in Argentina (Celani, 2000). As a consequence, the density of the service in 1999 (21 lines per hundred inhabitants) more than doubled the 1990 figure (10.2 lines per hundred inhabitants)<sup>7</sup>. Moreover, while in 1990 only 13% of the network was digitalised, in 1999 that figure reached an impressive 100%<sup>8</sup>. Several indicators showed improved quality of service. Indeed, while in 1990 the average waiting time for repairs was 23 days, in 1999 it was just 2 days. Similarly, while in 1990 the average time to install a new line was 23.5 months, in 1999 it was less than 15 days (Chambouleyron and Viécens, 2002).

Many experts and government officials considered that these achievements were at the cost of high tariffs and therefore outstanding profits by the licensees (Levy and Spiller, 1996; Abdala and Spiller, 1999; Abeles et al., 1998, and Celani, 2000)<sup>9</sup>. In their view, better results could have been achieved had the regulatory framework been

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<sup>7</sup> The increase in the density of the service can also be explained by the progressive reduction in connection charges. In 1990 the commercial and professional connection charge reached US\$ 2627. The residential connection charge was US\$ 1050. In October 1998, all these charges had been reduced to US\$ 150 (Abdala and Spiller, 1999:63).

<sup>8</sup> The digitalisation of the networks allowed the provision of services – apart from the simple transmission of voice – such as Internet, data transmission and other added-value services.

<sup>9</sup> According to Abdala and Spiller (1999), the average profit (as a percentage of their net worth) that Telefónica and Telecom obtained during the period between 1991 and 1998 was 11.78% and 10.50% respectively.



less unstable and less subject to political considerations, notably in terms of investments, tariffs, and quality of service (Rozenwurcel and Cruces, 1998).

In contrast to the previous government, and in order to lower business costs and make the country's economy more competitive, the winning coalition announced that their efforts would be focused on reducing telecommunication and other utility tariffs, introducing more competition in their provision, and on fostering more transparency and predictability in their regulation. In response to those who feared that this could lead to a rejection of the rule of law or an interventionist approach to regulation, they insisted that the new government would respect the existing rules of the game and that they would make no unilateral change in those rules<sup>10</sup>. They stressed that neither privatisation nor the key institutional arrangements established in the early 90s would be reversed. On the contrary, they made clear that if any change occurred, it would be with the consent of all relevant stakeholders and only with purpose of strengthening the existing regulatory regimes – which, in their view, included granting the regulators more autonomy and independence as well as improving the accountability arrangements in place<sup>11</sup>.

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<sup>10</sup> These fears increased when shortly after the elections some rumours indicated that, inspired in the British experience, the new government was considering a one-off tax levied on the privatised utilities based on the extraordinary profits they obtained during the 90s. In the last days of October, however, the newly elected president emphatically rejected those rumours. See *Ambito Financiero* 27/10/99.

<sup>11</sup> See *Ambito Financiero* 28/10/99.

### 3.1. Towards decree 264/00

Fernando de la Rúa took office on the 10<sup>th</sup> of December, and, three days after, appointed a new Secretary of Communications<sup>12</sup>. Moreover, and by means of a presidential decree, it was established that the Secretariat of Communications (and consequently CNC) would no longer be under the jurisdiction of the Presidency but of the Ministry of Infrastructure and Housing<sup>13</sup>. The decree in question also listed the roles and responsibilities of the Secretariat. Surprisingly, and in contrast with what had been announced during the electoral campaign and the transition period, the provisions of the decree did not grant the regulatory body more powers, autonomy or independence. On the contrary, it confirmed that most of the key regulatory responsibilities would remain in the hands of political appointees – in particular, the Secretary of Communications. A few days later, and with the only exception being the director appointed to represent the provinces, all the remaining directors of CNC were forced to resign and new ones were appointed<sup>14</sup>.

As mentioned above, one of the objectives of the incoming government was to reduce telecommunications tariffs. With this motivation in mind, a few days after taking office, a cut of 19.5% in the subscription charge for commercial users and a 5.5% reduction in the cost of urban calls for a limited group of residential users was negotiated with operators. In April, moreover, the government announced that

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<sup>12</sup> Enoch Aguiar.

<sup>13</sup> Decree 20/99.

<sup>14</sup> At that time, the commissioner on behalf of the Federal Council of Communications was José Horacio Rufeil. His term ended in July 2000 and, from then on, his position remained vacant. The new authorities, appointed in the presidential decree 96/99, were Carlos Tristán Forno (president), Carlos Alberto Killian (first vice-president), Raúl Manuel Lisaguirre (second vice-president) and Guillermo Gustavo Klein. In July 2001, although there were still four positions vacant, the government appointed just one more commissioner: Diego Martín Nazareno (decree 1282/01).

telecommunications tariffs would not be further adjusted in line with United States' Consumer Price Index.

Although the new authorities presented these agreements as an important achievement of the new administration and as evidence of a change in the relationship between the government and telecommunication operators, industry experts and consumer associations did not share this view. Indeed, although they welcomed the government's intention to cut telecommunications (and other utilities) tariffs, they objected that the reductions in question were actually minor<sup>15</sup>. They pointed out that if operators had agreed to lower their tariffs and not to adjust their tariffs according to the US's inflation, it was simply because the government had promised to compensate them in future tariff revisions<sup>16</sup>.

In reaction to these critiques, telecommunications authorities responded that, for the first time in the many years, tariff reductions were being introduced not only for long distance calls but also for local calls. They announced, however, that the real reduction in tariffs would come along with the liberalisation of the market scheduled for November that year and that would involve, among other things, redefining the regulations governing licensing, interconnection, universal service, and use of the radio spectrum<sup>17</sup>.

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<sup>15</sup> See La Nación 15/12/99, 16/12/99, 17/12/99, 18/12/99 and 19/12/99; and Ambito Financiero 15/12/99.

<sup>16</sup> See Ambito Financiero 10/04/00.

<sup>17</sup> In April, and following the passage of the Resolution S.C. 170/00, the Secretary of Communications issued four consultation documents on these issues.

A variety of positions emerged as soon as the government made this announcement. On the one side of the spectrum, potential entrants to the Argentine telecommunications market advocated a dramatic reduction of entry barriers, which, they claimed, involved an important reduction in interconnection charges and setting up a more flexible and entrant-friendly licensing regime<sup>18</sup>. In their view, this would result in more competition in the market and, hence, in an expansion of investments, better quality of services and lower prices<sup>19</sup>.

On the other end of the spectrum, incumbent companies claimed that, since there were many cross subsidies still in place, a simple reduction of entry barriers – such as a cut in interconnection charges or a more flexible licensing regime – would result in a cream-skimming of the market by new entrants. And this, they claimed, would seriously compromise their ability to finance the provision of service to the less attractive segments of the market (notably, low income consumers and less populated areas of the country)<sup>20</sup>. In their view, therefore, if the government was considering the option of reducing entry barriers in the direction demanded by potential entrants, it first needed to introduce changes to the existing rules of the game governing universal service as well as to the mechanisms to fund it<sup>21</sup>.

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<sup>18</sup> At that time, the interconnection charge was fixed at \$ 0.0235. New entrants demanded reducing it to \$ 0.01. See *Ambito Financiero* 06/06/00.

<sup>19</sup> See *La Nación* 17/05/00 and 06/06/00, and *Ambito Financiero* 05/06/00 and 06/06/00.

<sup>20</sup> See *Ambito Financiero* 05/05/00 and 07/06/00.

<sup>21</sup> Incumbents argued that in order to keep providing the service to the non-profitable segments of the market, all operators' contribution to the Universal Service Fund should be increased from 0.6% of their revenue to 3%. See *La Nación* 06/06/00. New entrants, meanwhile, argued that these demands were not justified. They claimed that if they were to contribute to the fund, their contribution should never exceed 1% of their revenue. See *Ambito Financiero* 06/06/00.

It is important to note, however, that telecommunications companies were not the only stakeholders that had serious differences on how the de-regulation process should be implemented. Something similar happened within the government. Indeed, while the Minister of Infrastructure<sup>22</sup> supported many of the incumbents' arguments and demands, the Secretary of Communications seemed to be more receptive towards entrants' claims<sup>23</sup>.

The president's trip to the United States in mid-June triggered several events that, once more, demonstrated the telecommunications regulatory regime's fragility. The trip was scheduled for June 10<sup>th</sup> and, taking into account that most of the potential entrants to the market were American firms, the Secretary of Communications regarded the trip as an excellent opportunity to announce the government's policies for the sector. Therefore, a couple of days before that date, he passed a set of resolutions that drastically redefined the regulatory incentives that the previous government had set up for licensing, use of the radio spectrum, interconnection, and universal service<sup>24</sup>.

In contrast to the Menem administration's model of managed deregulation, the new arrangements were clearly entrant-friendly, although they perhaps overemphasized assistance to entry while insufficiently attending to incentives for maintenance and expansion of the network<sup>25</sup>. The life of those regulations was extremely short,

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<sup>22</sup> Nicolás Gallo.

<sup>23</sup> They estimated that the amount of investments that such an opening of the market would trigger could reach four billions dollars. See *Ambito Financiero* 06/06/00.

<sup>24</sup> Resolution S.C. 259/00, 260/00, 261/00, and 262/00.

<sup>25</sup> For a detailed review of these regulatory arrangements, see Spiller (2000) and Urbiztondo (2002).

however. Indeed, the day after they were passed, the Secretary of Coordination of the Ministry of Infrastructure passed a resolution that revoked them.

The whole situation was likely to turn into a fiasco. The president, however, did not leave the country with empty hands. A few hours before his departure, he signed a decree that ratified the scheduled date for the opening of the market (November 8<sup>th</sup>), and set up a deadline (thirty days) for the ministries of economy and infrastructure to introduce all the relevant regulations<sup>26</sup>. The ministers were not given free hands, though. The decree was accompanied by a presidential instruction that comprised, in three annexes, a draft of the regulations in question and which were the same that had been introduced just a few days before by the Secretary of Communications<sup>27</sup>.

The reactions to these events were almost immediate. In the view of potential entrants, the president's decision to postpone a final pronouncement regarding the regulatory incentives that would be in place from November, not only introduced serious doubts about the government's commitment to open the market but also opened the door to the lobby of incumbent companies<sup>28</sup>. The latter, meanwhile, announced that if the government ratified the regulations drafted in the presidential instruction, they would challenge them in the courts and before international tribunals<sup>29</sup>.

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<sup>26</sup> Decree 465/00.

<sup>27</sup> It should be noted, however, that the presidential instruction did not comprise the draft of regulatory regime for the radio spectrum.

<sup>28</sup> See *La Nación* 14/06/00 and 15/06/00; and *Ambito Financiero* 14/06/00.

<sup>29</sup> See *Ambito Financiero* 03/07/00; and *La Nación* 04/07/00.

The problems for the government did not end there. Motivated by the salience that the conflict increasingly gained, several opposition legislators presented a set of bills that, among other things, provided for a more direct role of the legislative branch in the sector's regulation<sup>30</sup>. Although everybody acknowledged that there was little chance for any of these bills to be passed, the government was forced to promise that before implementing the deregulation process it would submit its proposal to the *Comisión Bicameral de Reforma del Estado y Seguimiento de las Privatizaciones* and this Commission would be allowed to present a non binding opinion<sup>31</sup>.

The government presented a new draft of the regulations in the last days of July. By that time, it was no secret that, given the open conflict between the Secretary of Communications and the Minister of Infrastructure on how the deregulation process should be implemented, much of the responsibility for the preparation of this draft – and for its negotiation with the companies – lay in the hands of the Secretary of Competition and Consumer Affairs<sup>32</sup>. Everyone acknowledged that his view on how the deregulation of the market should be implemented did not differ much from that held by the Secretary of Communications. That is, he also advocated a radical opening of the market rather than a gradual introduction of competition. As officials in the Ministry of Infrastructure, however, he believed that if some of the provisions drafted in the presidential instruction were not amended – notably, those which were openly assisting entry at the expense of incumbents – little could be done to avoid the judicialisation of the issue.

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<sup>30</sup> See *Ambito Financiero* 29/06/00 and 06/07/00.

<sup>31</sup> See *La Nación* 21/06/00.

<sup>32</sup> Carlos Winograd.

As announced in June, the draft of the new regulations was submitted for review to the *Comisión Bicameral de Reforma del Estado y Seguimiento de las Privatizaciones*<sup>33</sup>. Although initially everything indicated that those who supported the government's proposal in that committee were in clear minority<sup>34</sup>, in the second week of August seven out of twelve of its members voted a report backing the government's plans<sup>35</sup>.

Having obtained this important clearance, in the first days of September – that is, almost two month later than the date formally provided –, President De la Rúa passed decree 764/00. As expected, it introduced new rules of the game for licensing, use of the radio spectrum, interconnection and universal service. As demanded by incumbent companies and officials in the Ministry of infrastructure, these new rules somehow reduced some of the asymmetries provided in the June regulations. However, it is important to note that, as advocated by the Secretary of Communications, the new regulatory incentives introduced by the decree 764/00 resulted in a much more entrant-friendly regime than the one in place<sup>36</sup>.

The content of the new regulations showed that the Secretary of Competition and Consumer Affairs had been playing a crucial role in the latest regulatory developments. All the relevant stakeholders – and notably, the president – publicly

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<sup>33</sup> The draft was also submitted to the *Sindicatura General de la Nación* (SIGEN). However, since that auditing body was directly controlled by the executive, everybody took for granted that its opinion would be favourable to the executive's proposal. This proved to be correct.

<sup>34</sup> See *La Nación* 25/07/00, 27/07/00, 03/08/00, and 08/08/00; and *Ambito Financiero* 26/07/00, 27/07/00, 02/08/00, and 07/08/00.

<sup>35</sup> Surprisingly, only a couple of those votes were from legislators belonging to the president's coalition. The remaining five votes came from opposition members. See *La Nación* 09/08/00 and 10/08/00; and *Ambito Financiero* 10/08/00.

<sup>36</sup> For a detailed review of the regulatory incentives established in the Decree 764/00, see Urbiztondo (1999), and Chaumeil and Acuña (2001).



agreed that his intervention had made possible to achieve what looked like a Pareto-improving situation. Nobody ignored, nevertheless, that his intervention had been rather *ad hoc*. In fact, it was not contemplated in any of the sector's legislations<sup>37</sup>.

That would not be the case any more, though. Indeed, in addition to the changes discussed above, the decree 764/00 stipulated that, in the future, any amendment to the regulations it advanced would have to be introduced by means of a presidential decree, and with the prior and joint intervention of the Communications Secretariat and the Competition and Consumer Defence Secretariat. Adding to this, the decree also established a list of regulations that, starting in November 2000, these Secretariats would be responsible for jointly designing, enforcing, and interpreting<sup>38</sup>.

To the surprise of many in the industry, the regulations listed in the decree were far from irrelevant. With regards to licensing, for instance, the decree stipulated that it would be the joint responsibility of both Secretariats designing the auctions for frequency allotments, identifying the existence of cross subsidies, modifying the general structure of rates, and monitoring the existence of effective competition in the market, among other things. With regards to interconnection, these responsibilities would include calculating the prices of the network elements and functions associated with interconnection, determining and updating the essential facilities' referential prices, establishing the methodology for calculating long run incremental costs, and setting up the regulations for the number portability scheme. With regards to universal

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<sup>37</sup> It is important to point out in this regard that the Competition and Consumer's Affairs Secretariat was created in December 1999.

<sup>38</sup> Without prejudice to these provisions, it was established that the Ministries to which both Secretariats respectively report could, through a single resolution, resolve other matters that both Secretariats should resolve jointly.

service, it was decided that both Secretariats would be responsible for determining the distributions of funds among the different universal service categories and programs, calculating the net cost of the services provided, designing the auctions for the assignment of unserved areas, and determining the criteria for estimating the non-monetary benefits of the scheme. Finally, it was established that with regards to the management of the radio spectrum it would be the joint responsibility of these Secretariats: designing the auctions for frequency allotment, determining the reference economic value for the frequency bands to be auctioned, and setting up the safeguards for avoiding concentration.

Complementing these changes, and since the Secretariat of Competition and Consumer Defence lacked the resources to take on the duties delegated to it, a new assignment of funds was established. The decree 764/00 provided, in this sense, that, as from January 1<sup>st</sup> 2001, and of the total incomes earned from the control, supervision, and verification rate established in the decree 1185/90<sup>39</sup>, 30% would be assigned to the Competition and Consumer Defence Secretariat, and the remaining 70% to the Communications Secretariat and CNC<sup>40</sup>.

### **3.2. Dancing with the crisis.**

Argentina was facing very complex political and economic problems by the time the telecommunications regulatory regime was being redesigned. The October resignation of Vice-president Carlos Alvarez made it painfully clear that the coalition that had

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<sup>39</sup> In addition to this, it was established that the Competition and Consumer's Affairs Secretariat would receive 30% of the income earned from the rates, fees, tariffs, and charges that the government received for the use of the radio spectrum.

<sup>40</sup> The decree, however, did not provide how the funds would be shared between the Communications Secretariat and the CNC.

brought De la Rúa to the presidency was almost broken. On the economic front, meanwhile, the recession that started in late 1998 had been eroding the country's already precarious fiscal base, weakening its ability to service its large foreign debt. Making the fiscal bleeding even worse, international creditors, who were worried by the falling of solvency indicators, began raising interest rates. In the context of the currency board instituted in 1991, the government could not intervene with stimulative policies and it had no option but to introduce public-spending cuts and tax rises. Its bet was that the contractionary effect of a such squeeze would be outweighed by the boost to confidence from putting the public finances in order, allowing interest rates to fall. As 2000 ended, however, it was clear that the government had lost the bet. Faced with these serious problems, in March 2001 De la Rúa decided to replace the Minister of Economy with the orthodox economist Ricardo Lopez Murphy. Two weeks later, however, Lopez Murphy was forced to resign and the president's desperate response was to bring back Menem's economic czar, Domingo Cavallo.

Telecommunications companies, and particularly incumbents, regarded these developments with concern. Month after month, the country's brewing economic crisis was resulting in a decline in the sector's level of activity, which combined with the deregulation of the market, was impacting negatively on both their revenues and profits. To make things worse, one of Cavallo's first measures was to introduce an increase in the taxes paid by utilities<sup>41</sup>. Like their counterparts in other sectors, telecommunication operators were not allowed to pass on these tax increases to customers<sup>42</sup>.

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<sup>41</sup> Among other things, Cavallo re-imposed employer contributions on utilities and brought forward the payment of the income tax corresponding to 2002.

<sup>42</sup> When the sector was privatised in the early 90s it was established that any increase in the taxes paid by licensees could be passed on to consumers.

Although operators fiercely opposed these measures, their room for manoeuvre was rather limited. That is, although they could have chosen to challenge them in the courts, they acknowledged that, given the high discretionary powers in the hands of the executive, the cost of adopting that defiant strategy could far exceed any benefit. The companies' tactic, thus, was to accept those increases as long as the government formally committed to compensating them in future tariff revisions or by adopting other operator-friendly policies<sup>43</sup>.

But as the economic crisis became worse, the national government was not the only one who desperately needed to collect more funds to address the imbalance in the public accounts. Regardless of their political colour, both provincial and local governments faced a similar problem and, like their national counterpart, they also regarded the telecommunications sector as a potential source of these much-needed funds. In May 2001, the lower chamber passed a bill which amended article 39 of the 1972 Telecommunications Law and stipulated that municipalities in all the country would be entitled to impose a levy on telecommunication operators for the use of their aerial, terrestrial and subterranean space<sup>44</sup>. According to the project, the levy would be set up as a percentage of operators' income – up to 1% for the use of the subterranean space, and up to 2% for the use of the aerial and terrestrial space – and could not be passed on to the end users. Three months later the bill was also approved in the Senate.

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<sup>43</sup> Within this framework, telecommunications firms managed to defer the introduction of the multicarrier system for long distance calls and of the number portability regime.

<sup>44</sup> Article 39 of the 1972 Telecommunications Law banned the imposition of local taxes on laying telecommunication wires.

With the approval of both chambers, it was the president's choice whether to enact the bill or to veto it. It was not an easy decision for the president, though. On the one hand, he had already assured legislators, provincial governors and local authorities that he would not obstruct the bill's passage. On the other hand, however, he acknowledged that not using his veto powers was likely to result in an open conflict with telecommunications companies, who fiercely opposed the imposition of a new tax on them<sup>45</sup>. The potential costs of this were not to be underestimated. First, as a result of the liberalisation process initiated less than a year before, the government was expecting the companies to expand their investments and, as a result, to lower their tariffs. Ratifying legislators' plans, of course, could easily jeopardise these expectations. Second, although reluctantly, telecommunications companies were cooperating with the government to tackle the latter's financial needs. Endorsing the legislators' initiative would probably lead companies to question – or even worse, reverse – their cooperation. Government officials finally did not ignore that telecommunications companies had fairly strong arguments to successfully challenge the bill in question in the courts. In fact, the imposition of this levy not only violated the provisions of the 1990 privatisation Pliego but also contradicted a 1997 Supreme Court ruling on that precise matter.

In September, President De la Rúa passed the Decree 1194/01, which established a total veto of the bill providing the introduction of a levy on telecommunications companies for the use of municipalities' aerial, terrestrial and subterranean space. As expected, telecommunications companies welcomed the president's decision. In

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<sup>45</sup> See *La Nación* 11/05/01 and *Ambito Financiero* 11/05/01.

contrast, it was intensely opposed by legislators, provincial governors and local authorities, who accused the government of capitulating to the lobby of operators<sup>46</sup>.

Although the government had been able to neutralize Congress's action, that would not be the case for too long. As the crisis intensified, antiestablishment feelings multiplied and opinion polls showed that public support for privatisation had fallen to its minimum. In an attempt to capitalise on these sentiments, many blamed the government for talking much about the need to adopt a more robust approach to regulating the privatised utilities but, in practice, doing little. In their view, the government's alleged respect for the rule of law was just an excuse to justify its inaction.

### 3.3. The last days of the victim

By October 2001, economic indicators continued to worsen and the government seemed more and more powerless. Voters had punished it in the last legislative mid-term elections by voting for the opposition, abstaining, or deliberately spoiling their ballots to express their anger. The opposition Peronists emerged dominant (though not a majority in both houses of Congress)<sup>47</sup>. There were rumours that the president would have to step down early. At this point, few wanted to cooperate with a government that everyone had shunned.

The judiciary was not an exception. In the first days of September, a court ruling had already suspended the implementation of the Calling Party Pays (CPP) system for

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<sup>46</sup> See La Nación 22/09/01 and 02/10/01.

<sup>47</sup> For an in depth analysis of this election, see Szusterman and Bavastro (2003).

calls made between mobiles, on the grounds that consumers had not been given the opportunity to express their view on the decision<sup>48</sup>. Shortly after the October legislative elections, moreover, another court ruling established that telecommunications tariffs could not be adjusted any more according to the United States' Consumer Price Index on the grounds that it violated the provisions of the 1991 Convertibility Law. Although that piece of legislation explicitly banned any form of inflationary indexation, the timing of the decision – almost ten years after the institution of the adjustment arrangement – made many observers suspect that the ruling was politically motivated. Acknowledging that the government was too weak to come to their rescue, telecommunication companies had no other choice but to publicise their discontent and appeal to the Supreme Court<sup>49</sup>.

The bad news for telecommunications companies would continue. In the last days of November, the lower chamber voted a bill that established that calls would be metered and charged on a per minute basis<sup>50</sup>. The initiative in question, which could have resulted in an average 30% reduction in the cost of local calls, implied a major change in the sector's tariff arrangements. Although in other circumstances this would have provoked immediate reactions from both operators and the government, as December began they both had other more urgent concerns.

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<sup>48</sup> The implementation of the CPP system for calls made between mobile phones was a demand of companies providing mobile communications and was originally instituted in the first days of May 2001. A couple of weeks later, however, and due to problems with operators during its implementation stage, the Secretary of Communications decided to suspend its implementation. In July, finally, operators reached an agreement with the sector's authorities and the system was re-established. See *Ambito Financiero* 30/08/01.

<sup>49</sup> See *Ambito Financiero* 10/10/01.

<sup>50</sup> Since privatisation calls had been metered in units of 120 and 240 seconds – for peak and off peak calls, respectively.

Appointed as a “saviour”, Cavallo tried every possible gimmick to address the country’s dramatic economic situation. He first tried ‘heterodox’ measures to try to get growth. As argued by Bambaci et al. (2002), the minister’s bet was that his mere presence would boost enough confidence into financial markets, so that Argentina would no longer need to signal commitment through fiscal austerity and could concentrate on increasing competitiveness and growth. Since he was politically constrained to cut spending, he tinkered with industrial policy and, fatally, with the currency board itself, so that the peso was pegged for exporters half to the dollar, half to the euro. The timing for doing so, however, was disastrous. By raising the idea of devaluation, it spooked foreign investors, who demanded an even higher risk premium for holding Argentine bonds and, hence, driving up interest rates and deepening recession.

Cavallo then tried to restore investors’ confidence by courting the IMF, promising zero deficit and redoubling his efforts to negotiate a mega debt swap. This failed too. The minister lacked the support of Washington and the IMF, which were convinced that Argentina’s fixed exchange rate had to go and had already announced that there would be no bailout if Argentina got over its head. Also, the ruling party interfered with the minister’s efforts, blocking the use of tax revenues to guarantee public debt and criticising his spending cuts. Therefore, he could do little to convince investors not to desert the country. To make things worse, day after day savers were emptying their bank accounts. Determined to continue making debt payments, however, the government ousted the Central Bank’s governor and eased the bank’s reserves requirements. The next move was to tap previously sacrosanct central-bank reserves rolling over obligations with the private pensions funds to do so.



These actions triggered a bank run. In response to it, Cavallo made his last, desperate, throw. On December 1<sup>st</sup>, he imposed a ceiling of \$1,000 a month on bank withdrawals. As pointed out by Schamis (2002), with this measure the rules that had governed the economy since Menem's first term back in 1991 were definitively broken. The so-called "*corralito*" adversely affected businesses' and individuals' access to their bank accounts. From a commercial perspective, it severely hampered companies' cash flow activity. Firms in almost every industry experienced difficulties in collecting payments and meeting obligations, leading to a virtual collapse in the chain of payments.

In such a situation, it is not difficult to understand why the change in the telecommunications tariffs that were derived from the bill approved by the lower chamber just a few days before went almost unnoticed. Devaluation and default now seemed inevitable and, along with them, the rupture of contracts and the introduction of new and drastic changes in the sector's rules of the game. The Argentine public, moreover, was understandably angry and, in their search for whom to blame, everyone regarded as being part of the establishment came at the top of their list. Telecommunications operators, of course, were no exception.

The rest of the story is pretty well known. The economic measures weakened the government past the point of no return. Unrest broke out in the streets, as crowds in the poorer suburbs looted supermarkets while middle class groups in the city of Buenos Aires marched on the streets banging pots and pans. On December 20-21, and after 30 people lost their lives in the disturbances throughout the country, first minister Cavallo, then the rest of the cabinet, and finally president De la Rúa resigned.

#### **4. Conclusions.**

The main conclusion drawn from chapter 3 is that, as predicted by the hypotheses in this thesis, when Carlos Menem's administration left government in December 1999, the regulatory regime governing telecommunications regulation in Argentina was strikingly different from that originally put in place shortly after the privatisation of the sector. Regulatory policy, moreover, was almost as volatile – and, hence, time inconsistent - as it used to be before privatisation. The question that obviously follows here is: Was regulation of telecommunications between December 1999 and the last days of 2001 also featured by regular adaptations to the changing preferences of the executive and, hence, to constant changes in the rules of the game? Put differently, did telecommunications regulation during the de la Rúa's years show the same features than during the years of his predecessor?

The evidence in this chapter shows it certainly did. In December 2001 telecommunications regulation was governed according to rules substantially different not only from those established in the early 90s but also from those in place in December 1999. Among other things, while in December 1999 telecommunication operators were allowed to adjust their tariffs following the US's consumer price index and to pass tax increases through to tariffs, in December 2001 this was not the case anymore. The most important difference, however, could be found in the rules that defined the framework within which regulatory decisions were made. Indeed, while in December 1999 the sector's key regulatory powers and responsibilities were almost

exclusively in the hands of the Secretary of Communications, in December 2001 the latter had to share them with the Secretary of Competition and Consumer Affairs.

The narrative presented in this chapter shows, moreover, that telecommunications regulatory policy during De la Rúa's years was highly volatile and politicized. Undoubtedly, the best example of this was the rather chaotic way the government implemented the liberalization of the market in 2000. As it has been discussed, given the sharp differences among government officials on how the telecommunications market should be liberalized, it took the government several months, and an embarrassing policy reversal, to finally put in place the rules of the game governing the process.

Therefore, the findings in this chapter confirm that although the government elected in October 1999 was committed to break with the past and create an environment of stability in the telecommunications sector, the fact that the key features of the sector's regulatory regime were still defined in presidential decrees had the result that the incentives the government faced were not compatible with maintaining this commitment. Consequently, and as predicted by the hypothesis in this thesis, telecommunications regulatory policy between December 1999 and December 2001 was almost as volatile as it had been in the previous nine years.

## **Chapter V**

**The political economy of electricity regulation (1992 – 2002).**

## **1. Introduction**

The theory in this thesis not only offers predictions about regulatory regimes defined in presidential decrees – like the one established in the telecommunications sector - but also about those defined in statutes. Concretely, it hypothesises that, given Argentina’s institutional endowment, regulatory regimes defined in statutes are more costly to be changed and, therefore, they are likely to be more stable than regulatory regimes defined in other legal instruments that, following ordinary policymaking procedures, can be changed unilaterally by the executive.

To test these hypotheses, this chapter analyses the case of the electricity sector between 1992 and the last days of Fernando de la Rúa’s government in December 2001. As it is shown below, the regulatory regime adopted in this sector showed close similarities to that adopted a couple of years before in the telecommunications sector. Indeed, as in the latter, it also involved the delegation of key regulatory powers to a newly created industry-specific regulatory agency and the setup of institutional arrangements to safeguard the regulator’s independence, autonomy and accountability. Unlike the telecommunications sector, however, the crucial components of these sweeping transformations were introduced using a statute and not a presidential decree.

Therefore, if the predictions and hypotheses in this thesis are valid, and in contrast to what happened in telecommunications, regulatory policy in electricity sector should have been more stable. As a result, by the end of President De la Rúa’s term the sector should have still been organised and governed following institutional

arrangements similar to those put in place in the early 90s. Following with the research design adopted in this thesis, this evidence should also corroborate that the relative stability of the rules of the game in this sector was not the consequence of the stability in the government's preferences but of the causes identified by my theory. That is, the evidence in this chapter should confirm that if the government chose not to renege on its original promises it was basically due to the difficulties that doing so involved.

This chapter proceeds as follows. The first half, presents relevant information regarding the privatisation and reform of the electricity sector in Argentina. This involves discussing, among other things: a) the situation of the electricity industry before the introduction of the 1992 reform; b) the political environment within which this reform unfolded; c) the transformations that policy-makers introduced in both the internal organisation of the industry and in its regulatory governance; and finally, d) the effects of these transformations on the performance of the Argentine electricity industry. The second half of this chapter, meanwhile, analyses the issue of the stability of the rules of the game. In order to do so, I not only assess to what extent the electricity regulatory regime in December 2001 resembled that originally established in 1992 but also whether the results of this assessment are consistent with the predictions of the theory in this thesis. Finally, section 9 concludes.

## **2. The electricity industry in Argentina before the 1992 reforms.**

By the end of the 80s, the structure of the electricity industry in Argentina – which accounted for almost 1.7% of the country's GNP - consisted of six public enterprises

(constituting 74% of capacity), several utility companies owned by provincial governments (constituting 14% of capacity), a number of cooperatives and hundreds of small self generators (constituting 12% of capacity)<sup>1</sup>. The three largest public enterprises were: Servicios Eléctricos del Gran Buenos Aires (SEGBA), Agua y Energía Eléctrica (AyE), and Hidroeléctrica Norpatagónica Sociedad Anónima (HIDRONOR). SEGBA, which was the largest state owned company in the sector and was consolidated and nationalised in 1958, generated and distributed electricity in Capital Federal and the greater Buenos Aires, covering almost a third of the country's population and over 40% of the electricity demand. AyE was the second largest firm and was formed in 1957. It operated 131 hydroelectric and thermal plants, and transmitted and distributed electricity to almost 400 localities, covering virtually the entire country. Finally, HIDRONOR was created in 1967 to tap the hydroelectric resources of Northern Patagonia. It managed large hydroelectric stations in the Comahue region and transported energy to Buenos Aires<sup>2</sup>.

The three enterprises were administratively dependent on the Secretariat of Energy and Combustibles (SEC), which was created in 1960 and was given the responsibility for regulating the electricity industry at the federal level<sup>3</sup>. Since then, the SEC's responsibilities had been expanded to include: granting and managing service concessions under federal jurisdiction, setting technical norms, proposing tariffs for approval of the executive, promoting the interconnection of electricity systems, keeping statistical databases, and planning the electricity supply system

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<sup>1</sup> See Givori and Damonte (1991).

<sup>2</sup> For a brief review of the history of these companies, see Bastos and Abdala (1996).

<sup>3</sup> The SEC changed status in an alternating fashion, from Under-Secretariat to Secretariat and back again (Bastos and Abdala, 1996:61)

(Bastos and Abdala, 1996:61). The provincial companies were regulated by the respective provincial government.

The generation plants and the high voltage transmission systems of the different regions were almost totally integrated, forming the basis of the Sistema Interconectado Nacional (SIN)<sup>4</sup>. This was developed basically as a 500 kV system and the purchase and sale of electricity produced by its member companies was regulated by the Despacho Nacional de Cargas (DNC). The DNC, curiously, depended on AyE – which also was responsible for investments in transmission.

As noted by Bastos and Abdala (1996:64), the organisation of the system was based on the idea of minimising the total cost of load dispatch. That is, a merit order for the dispatch of power from the generating stations was established, based on information supplied by the generators and the actual demand conditions. The nature of the generation source was also taken into account. The DNC, by means of a computer program, determined the amount of generated electricity, power availability, entry order of the system, final demand forecast and the expected interchanges among the companies; then it calculated the energy tariffs and compensation for stand-by power according to the model. Tariffs could be adjusted with changes in fuel oil prices. Both energy and power were paid at the generation site, leaving transmission costs (mainly losses) to be paid by the purchasing agents.

Despite the advantage of having a diversity of considerably developed generation sources (hydro, thermal and nuclear) and a well established high-voltage

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<sup>4</sup> The SIN started to operate in 1973, when the first interconnected line linked the Litoral (coastal) electricity system with that of the greater Buenos Aires region.



interconnected system, by the end of the 80s the performance of the electricity sector in Argentina – the third largest in Latin America – showed several indicators of deterioration. First, the system's installed generating capacity significantly exceeded demand from 1975 on<sup>5</sup>. This was a result of expansion plans based on the observed demand growth rate in the 1960s. However, due both to obsolescence and to the lack of adequate routine maintenance, not all of the excess capacity was available. The unavailability of the interconnected system – which was a result of both the obsolescence and the lack of adequate routine maintenance – increased from a low of 15.9% in 1981 to 34.4% in 1988 and 1989<sup>6</sup>. Non-technical losses (electricity theft, meter tampering, etc.) were also exceedingly high. Values were from 16 to 18% until 1982, and increased subsequently to 22% in 1989-91<sup>7</sup>.

Second, total investments in the sector averaged US\$7000 per kW of demand increase during the period from 1970 to 1991. This figure was several times larger than typical values worldwide – ranging from US\$1800 to US\$2000/kW. In the view of Dutt et al. (1997) and FIEL (1992), these investment levels partly resulted from the high investment requirements per kW of installed capacity, and because of excessive expansion generating capacity. According to Bastos and Abdala (1996: 53), the high unit costs of investments was caused by the financial losses due to the immobilisation of the capital that was already invested and to the unfavourable conditions for renegotiating the contracts<sup>8</sup>.

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<sup>5</sup> The excess capacity was over 40% during most of the 1980s. See Bastos and Abdala (1993) and Dutt et al. (1997).

<sup>6</sup> The unavailability of thermal power plants was particularly high, with values in the range of 40-50% during 1988-91. See Bastos and Abdala (1993).

<sup>7</sup> See and Dutt et al. (1997).

<sup>8</sup> According to these authors, another source of over-investment was the way in which the projects were planned and financed. Hydroelectric projects generally had soft financing from international lending institutions and, at the time of ex-ante evaluations, the numbers were all positive because of favourable

Third, the construction of many power plants was delayed, due both to slower demand growth than anticipated and to periods of national financial crises. In this respect, it should be noted that while construction plans were made assuming the availability of low-interest loans, actual capital costs turned out to be much higher. This, combined with the aforementioned delays, led to considerable cost overruns. Moreover, the costs of hydro and nuclear power plants compared with natural gas-fired plants were estimated incorrectly, and as a result most of the capacity addition was in hydro and nuclear, implying higher costs overall<sup>9</sup>.

Fourth, the electric companies as a whole operated at a loss for most of the 1970s and 1980s, with high financial carrying charges making a significant contribution to the deficit (Bastos and Abdala, 1996:55-60). As noted by Bastos and Abdala (1996), in the 1970s and early 1980s, as fuel costs in Argentina soared, the real price of electricity fell by almost one quarter. Givori and Damonte (1991) show that the average long-run marginal cost for the 1980s was approximately 38 US\$/MWh at the 500kV level. The authors demonstrate that this figure was well above the average revenue for the period. Note, that average (nominal) wholesale electricity prices were around 30 US\$/MWh at the end of 1982. They dropped to 25 US\$/MWh by 1985, to less than 20 US\$/MWh by 1987, and were around 15 US\$/MWh by 1989. In the view of Spiller and Martorell (1996), these problems were a result of the fact that the Electricity Law of September 1960 did not stipulate a methodology for computing tariffs. The law, furthermore, was extremely confusing in its treatment of return of capital, for it used different and contradictory terms like “Reinvestment Fund”,

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loans conditions. In most cases, however, the financial calculations in the implementation phase differed considerably from the original ones.

<sup>9</sup> Henisz and Zelner (2003:8) estimate that unnecessary investment in Argentina’s electricity sector during the 20 years preceding the Menem presidency amounted to US\$ 25 billion.

“Reserve Fund”, “Amortization”, “Interests on Capital”, “Interests and financial expenses in issuing debt”.

Last, but not least, regulatory policy was extremely volatile. The best example of this probably involved tariff setting. As career professionals were slowly displaced by staff enjoying the favour of the government of the time, tariffs became fixed according to a multitude of political considerations and bore little relation to costs. A study by Navajas and Porto (1990) shows the diversity of criteria applied over time to tariff structures and average tariff trends. This study found that ten different tariff criteria were applied during the period from the creation of SEGBA in 1958 to 1988. According to the authors, most of the tariff schemes put in place during that period featured elements not attributable to economic efficiency. In 1973 (and repeated in 1975, 1983 and 1984), for example, while prices were increasing rapidly, the tariffs applied incorporated income redistribution criteria.

### **3. The politics of the electricity privatisation and reform**

For the Menem administration, the problems discussed above, which became very obvious during the summer outages of 1988-89, were a clear illustration of the need to introduce changes in the sector<sup>10</sup>. Initially, the government flirted with proposals to keep the sector in public ownership<sup>11</sup>. By 1991, however, following the

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<sup>10</sup> During that summer, a combination of low water flows in the hydro systems and poor availability of many thermal and nuclear plants meant that electricity had to be rationed for many months (Gomez-Ibañez and Rodriguez Pardina, 2003).

<sup>11</sup> In the beginning, the government believed that the essential problem of the electricity industry in Argentina was that the existence of several corporations limited the benefits of vertical integration and scale economies. To address this problem, in the second half of 1989 it was announced that, as part of the State Reform Law, the government would create the “Federal Electricity Company” (*Empresa Federal de Energia Electrica*, or EFEE). The company would merge AyE, HIDRONOR, SEGBA and other federal power generating companies, and would be a type of holding company with the legal

appointment of Domingo Cavallo as Minister of Economy and the introduction of the Convertibility Law, these proposals were abandoned. In the eyes of the new economic authorities, the performance of the industry would not improve unless both its regulatory incentives and governance were fundamentally changed.

I have stated earlier that the privatisations undertaken during the first couple of years of Menem's government –telecommunications probably being the best example – were propounded while the government was confronted with two major challenges. One was a severe economic crisis. The second involved a serious credibility problem that emerged from the fact that the government was trying to resolve the crisis by adopting the very policies that he and his political movement traditionally repudiated. Privatisation at that time was therefore aimed directly at macroeconomic stabilisation and reaffirming the new government's commitment to market oriented policies. Moreover, it was marked by a sense of both political and economic urgency that probably explains why the government could not afford to make better considered decisions that might have improved the quality of the policy. As the privatisation of ENTel clearly illustrates, the priority of the government was to

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status of a state-owned enterprise. It was also announced that SEGBA's distribution services would be given in concession. A few months later, in November 1989, the government signed the Federal Electricity Pact with 20 provinces. This specified that the national government would have jurisdiction over the SIN, DNC, federally owned generating stations, bi-national power entities, international electricity transactions, and the hydroelectric projects that were subject to prior agreements with the provinces. The Pact, moreover, ratified the intention to create EFEE. In this respect, it stipulated that among its other functions, the company would be responsible the setting of wholesale prices and implementing compensation mechanisms for revenues and expenditures for all SIN members. According to the pact, once EFEE absorbed AyE, SEGBA and HIDRONOR's, electricity generation, transmission and distribution activities were going to be separated. Four regional companies were to be formed from the pool of power plants. Transmission and dispatch functions would be in the hands of a so-called Grid Company (*Empresa de la Red*), while five distribution companies would be set up, in which provincial governments would hold shares. These changes would be complemented with a reform of the sector's institutional setting. Indeed, the Pact contemplated the creation of a Federal Energy Cabinet, which would be responsible for the main political-administrative decisions for the sector, with EFEE as its executive arm. It also stipulated that the bridge between the institutional and management spheres would be made via agreements, i.e., "Annual and Multi-annual Management Agreements" between EFEE and the SEE (with the supervision for CFEE). Most these reforms, however, were never implemented (Bastos and Abdala, 1996:69-71).

respect tight deadlines, instead of safeguarding important economic issues such as increasing the productivity or competitiveness of the industries subject to reform.

The introduction of the Convertibility Plan in March 1991, and the improvement of the economic indicators that followed, substantially altered the context for policy choices within which privatisations in Argentina unfolded. As argued by Torre and Gerchunoff (1998), the gravity of the problems that ravaged the first year and a half of Menem's administration – notably the economic crisis and the lack of political credibility – lessened significantly. The government was no longer operating in a context dominated by urgency and, consequently, its capacity to choose policies and to influence their content and the timing of their implementation increased<sup>12</sup>. The new economic authorities, moreover, had an overall negative opinion of the privatisations advanced during the first year of government. In their view, the government's imperative to collect funds quickly and gain credibility had given buyers a great leverage. This, they believed, had resulted in many sales of state owned companies with the guarantee that all the benefits of monopoly would be maintained. According to members of the new economic team, the terms under which privatisations had occurred also explained why they had been surrounded by a whiff of corruption.

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<sup>12</sup> This is not to say that privatisation lost momentum in this new environment. On the contrary, it received a new boost from the logic established by the convertibility plan. The commitment to non-devaluation and the refusal to print money meant that public sector finances were in a straitjacket. Only fiscal or commercial policies, or structural reforms like privatisations, were now available in order to strengthen the fiscal situation. Additionally, it soon became evident that one of the long-term problems of convertibility would be a growing imbalance in the current account. As policymakers realised, a large capital inflow would thus be needed to cover this imbalance and the sale of state assets could be an important source of this inflow.

When macroeconomic stability was achieved, officials in the Ministry of economy made explicit their intention to depart from the previous phase of privatisation. According to them, this would involve not only focusing on the impact of privatisation on the productivity and efficiency of the industries subject to reform, but also making substantial improvements in the privatisation procedures. In this last respect, the economic authorities clearly expressed their wish for Congressional involvement in the privatisation decisions.

The desire to allow legislators' participation in the new phase of privatisations represented a big innovation in the government's privatisation policy. The reasons that motivate this desire, however, were more complex than simply drawing a dividing line with the previous phase. It is important to note that the 1989 State Reform Law had declared a state of emergency affecting all state entities, enterprises and societies. The law, nevertheless, had only authorised the executive to implement its privatisation plans by means of presidential decrees in a limited number of enterprises<sup>13</sup>. For all the remaining enterprises, the State Reform Law required that new laws had to be passed. It follows that if the government was now expressing its wish for Congressional involvement in the privatisation decisions, it was not only because it wanted to improve the transparency of the policy – which probably it did – but also because that involvement was mandated by the State Reform Law.

By mid 1991, however, officials in the Ministry of economy were aware of the fact that, in contrast to what happened in July 1989, Congress would not accept to authorise the executive to implement the new privatisations by means of decrees.

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<sup>13</sup> The list of these enterprises was advanced in an annex accompanying the law in question.

This had two reasons. On the one hand, following the outcomes of first phase of privatisations, legislators had already learnt that this equalled allowing the government to implement its privatisation plans in a unilateral fashion. On the other hand, in the last couple of years the distribution of power between the two branches of governments had changed significantly. As noted by Llanos (2001), in July 1989 the president enjoyed a large majority in Congress<sup>14</sup>. By mid 1991, in contrast, the size of the president's majority in Congress was significantly smaller. Indeed, his support came mainly from his own party, which controlled an absolute majority in the Senate but only a relative one in the lower chamber. Within the Peronist camp, moreover, party discipline was strong but not automatic. Therefore, in order to pass new legislation through the regular legislative channels, the president needed to persuade small allied parties – notably in the chamber – as well as his own rank and file.

Therefore, by mid-1991, both government and legislature acknowledged that a dialogue between the two branches would be needed for any future privatisations. In practical terms, that meant accepting Congress' participation in the writing of the policy. Put differently, if the executive wanted to continue implementing its privatisation agenda, it would have to be by means of laws. It was not a surprise, thus, when in June the executive submitted to Congress the bill for the privatisation of electricity. Neither was it a surprise that this bill, instead of comprising a mere declaration of “subject to privatisation”, advanced a detailed set of provisions

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<sup>14</sup> This majority was a result of the agreement with the radical party for the transfer of mandate from President Alfonsín to President Menem. Following that agreement, the Peronists accepted to assume the presidential office before the expected date (December 10<sup>th</sup>), but in return obtained the commitment of the Radicals – who had a majority in the lower chamber – to facilitate the approval of all economic laws that the new president would send to Congress from July to December, when the changeover of Congressional seats was to take place.

stipulating precise guidelines for the restructuring of the sector and the main features of a new regulatory regime.

#### **4. The transformations in the electricity sector**

By the time the executive submitted the bill for the privatisation of electricity to Congress, legislators were already aware of the executive's new plans for the sector. Indeed, shortly after taking office in April 1991, the newly appointed Secretary of Energy, Carlos Bastos, managed to convince President Menem to sign a couple of decrees advancing the guidelines that would govern the restructuring of the electricity industry in the country<sup>15</sup>. Following those guidelines, it became clear that the chosen solution was to make competition possible in those activities where it was deemed feasible and desirable.

As noted by Bouille et al. (2002), legislators did not oppose the executive branch's reform proposal. However, they introduced several changes to it. Some of these changes were major and, perhaps more important, they were out of line with the preferences of the executive. Proof of this was that, once the legislative process was completed and the bills had passed through the Congressional chambers, the executive made use of its partial veto power. Many of the amendments introduced by Congress, however, remained (Llanos, 2001).

The changes to the status quo introduced by the Law 24.065 – and the norms that regulated its provisions – were, nonetheless, remarkable. Indeed, they not only

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<sup>15</sup> Decrees 634/91 and 856/91.



opened the door to the privatisation of the sector but also, and perhaps even more important, they resulted in a radical reform of the structure and organisation of the electricity industry in Argentina and in a sweeping transformation in the sector's governance.

#### 4.1. The reforms in the sector's regulatory incentives.

Partially following the models adopted for the electricity sector in Chile and the United Kingdom, and aiming at allowing competition where possible, the new statutory framework for electricity separated the industry vertically in its activities: generation, distribution, and supply (or trading). Under the reformed structure, electricity generation was considered to be a service of general interest, was separated horizontally, and became essentially unregulated. Moreover, it was decided to organise it as a risk oriented activity with no need for generators to obtain permission prior to building or adding generation facilities.

Electricity transmission, meanwhile, was classified as a public service. Following the new legislation, the companies operating in this activity would be considered regional monopolies and were obliged to supply access to transmission lines as long as they had capacity to spare, for which they were allowed to charge a fixed transport fee<sup>16</sup>. In order to limit the monopsonistic and monopolistic power held by the transmission network, concession holders in this activity were banned from buying and/or selling electricity power<sup>17</sup>. Moreover, an open access mechanism was adopted, according to which the concession holders would not be accountable for

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<sup>16</sup> For a more in depth discussion of the new arrangements governing electricity transmission, see NERA (1998), Pistonesi (2001:54-55) and Rodriguez Pardina (2002).

<sup>17</sup> See Petrecollo and Romero (2003:27)

expanding the system, i.e. their responsibility would be limited to the operation and maintenance of the existing installations on a non-discriminatory basis<sup>18</sup>. The so called “Public Contest” mechanism was adopted for this. That is, transmission expansion was to be determined by negotiated third party access<sup>19</sup>.

Electricity distribution, finally, was also classified as a public service to be provided under monopolistic conditions. As in transmission, the law required “open access” for distribution facilities, and operators were placed under a public utility obligation to supply all the energy demanded within their concession areas. It was established that distributors could buy their energy either directly from a generator for a contracted price, or in the producers’ market at a three-month “stabilised” spot price intended to approximate what would prevail in a free market. Under the new framework, furthermore, operators became responsible for any expansion necessary to meet the demand within the area of their concession. In order to prevent the vertical re-integration of industry, it was established that firms operating a distribution network would not be allowed to generate electricity<sup>20</sup>.

Complementing these provisions, the Law 24.065 created the concept of a wholesale electricity market, called MEM (Mercado Eléctrico Mayorista)<sup>21</sup>. “Active agents” of the MEM were to be the hydroelectric generation companies, the transmission company, and the distribution companies. Thermal generation companies and large

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<sup>18</sup> See Urbizondo et al. (1999).

<sup>19</sup> For a more comprehensive review of the regulation of transmission expansion in Argentina, see Artana et al. (1998:17), Abdala and Chambouleyron (1999), Littlechild and Skerk (2004a,b), Pistonesi (2001), Gomez-Ibañez and Rodriguez Pardina (2003), and Rodriguez Pardina (2002).

<sup>20</sup> For a more detailed discussion on the regulations governing electricity distribution, see Pistonesi (2001:55-56).

<sup>21</sup> This market covers most of the country and more than 90% of electricity demand – apart from the far south, which has its own interconnected market (MEMSP). See Pollitt (2004).

consumers, could become agents of the MEM subject to authorisation by the Secretary of Energy. The law, however, did not define the precise rules governing this market. Instead, it specified that their enactment would be the responsibility of the Secretary of Energy<sup>22</sup>.

In April 1992, pursuant to the Law 24.065, the Secretary of Energy passed Resolution 61/92. It established that the transactions in the wholesale electricity market between buyers and sellers of electricity could take two forms: through a “contract” or “futures” market, and a “spot” market. In the wholesale market agents could make contracts for the future purchase/sale of electricity, with quantities, prices, and conditions freely negotiated among the parties. In the spot market, electricity demand and supply would be matched with an hourly and seasonal price. It was established moreover that the coordination of supply and demand would be done by an independent system operator, CAMMESA (Compañía Administradora del Mercado Mayorista Eléctrico, Sociedad Anónima). This system operator would implement the operating rules issued by the Secretary of Energy, and would be responsible for the dispatching activity (via the Dispatch Management Agency – Organismo Encargado del Despacho), controlling exchanges in the bulk market as well as the operations through the transmission network, and performing settlements for all participants in the market<sup>23</sup>.

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<sup>22</sup> Also it was established that technical dispatch for the Argentine Interconnection System (Sistema Argentino de Interconexión) would be under the National Transmission Dispatch (Despacho Nacional de Cargas – DNDC) and that the Secretary of Energy would determine the rules and regulations to be followed by the DNDC in the performance of its duties.

<sup>23</sup> It was also determined that CAMMESA’s would be incorporated as a private law not-for-profit stock company and that it would be owned in equal proportions by the Secretariat of Energy and the associations of generators, distributors, transmission carriers and large users. Furthermore, the new rules provided that the newly created company would have a board of 10 members, to which each share holder would appoint 2 members. It was also established that the Federal State would appoint the Secretary of Energy to that board. He would also be the president of the corporation. The final member would be appointed with the assent of three of the associations subject to the veto of the Secretary of

In the spot market, the price was to be based on the system's short term marginal cost of production, which would result from the cost of the last unit called on to generate electricity. The price, however, would have an additional component set by defining reference market price at the load centre, which would be located at Ezeiza, near Buenos Aires<sup>24</sup>. The wholesale market agents would supply and demand electricity at various "nodes" of the national electricity grid. The electricity price at each of these nodes would then differ from that at Ezeiza by a "node factor". The magnitude of the node factor would be determined – both hourly and seasonally - by the electricity transmission cost between the load centre and the node in question<sup>25</sup>. Complementing these provisions, it was also established that each generator would have an additional payment for the capacity offered to the system. This capacity surcharge would depend on the system's risk of failure and the economic cost of energy not supplied. To guarantee quality and that generators invest in additional capacity to meet demand in the long term, it was stipulated that the compensation would also include additional features such as frequency control, voltage stability, the willingness to stop generation when requested to do so by CAMMESA, etc<sup>26</sup>.

The pricing of distribution and transmission was determined by the regulatory framework. In both segments, basically, the tariffs were set in U.S. dollars and the regulation put in place was a version of the standard price capping formula, with tariffs reviewed every five years. In between reviews, it was established that prices

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Energy. CAMMESA's decisions, finally, would be made by majority voting but should include the Secretary of Energy – who would also possess veto power over all corporate decisions.

<sup>24</sup> Ezeiza is where the high voltage transmission lines from the South connect to the ring that supplies the metropolitan area.

<sup>25</sup> These arrangements are reviewed in more detail in see Dutt et al. (1997) and Gomez-Ibañez and Rodriguez Pardina (2003).

<sup>26</sup> For a more in depth analysis of the functioning of the MEM and the role of CAMMESA, see Alves Ferreira (2002), Pistonesi (2001), and Gomez-Ibañez and Rodriguez Pardina (2003).

could increase by  $PI - X$ , where  $PI$  would be a weighted average of the consumer (33%) and producer (66%) price indexes in the US, and  $X$  would be set on the expected productivity trends and investment needs<sup>27</sup>. Finally, and in order to ensure that companies did not trade-off quality for prices, an explicit specification of the penalties was clearly spelled out in the concession contracts (Estache and Rodriguez Pardina, 1999).

#### 4.2. The reforms in the sector's regulatory governance.

As argued earlier in this chapter, the reforms introduced by the Law 24.065 not only also resulted in a radical reform of the structure and organisation of the electricity industry in Argentina but also in a sweeping transformation of its regulatory governance. Drawing on the experience of the U.K., it was established that the general supervision and regulation of the electricity industry – and in particular, of the distribution and transmission companies with concessions from the national government - would be the responsibility of an independent regulatory agency, the *Ente Nacional Regulator de la Electricidad*, henceforth known as ENRE<sup>28</sup>. According to the Law 24.065, the agency, which was finally set up in 1993, would be responsible for the enforcement of the objectives that the law prescribed for the sector, and which included<sup>29</sup>:

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<sup>27</sup> As noted by Estache and Rodriguez Pardina (1999), in practice transmission charges covered three components. First, a connection charge (a fixed charge differentiated according to voltage). Second, a capacity charge (also fixed to cover all operational and maintenance of the existing equipment). And third, an energy charge (reflecting the difference between the value of the energy received at the receiving node and the value of energy at the sending node). As for distribution, the main components were an energy charge (based on seasonal electricity costs reviewed every three months), a loss charge (corresponding to losses and equivalent to 11% of the distributor's purchases), the connection and transmission costs, the cost of the capacity in the wholesale market, and a fixed distribution charge (differentiated for small and large users).

<sup>28</sup> Article 54 of the Law 24.065.

<sup>29</sup> Article 2 of the Law 24.065.

- Adequately protect consumers' rights;
- Promote the competitiveness of both electricity production and demand markets, and encourage investments in long term supply;
- Promote the development, reliability, equality, free access, no discrimination and generalised use of the services and of the electricity transport and distribution installations;
- Regulate electricity transport and distribution activities, ensuring fair and reasonable tariffs;
- Promote efficiency in the transport, distribution and supply of electricity by establishing the appropriate pricing systems;
- Encourage private investment in generation, transport and distribution activities, ensuring market competitiveness where appropriate.

According to the law, ENRE would operate under the framework of the Secretary of Energy. To avoid conflicts of jurisdiction, however, the legislation established a relatively clear allocation of roles and responsibilities between the Secretariat of Energy and ENRE. In this respect, it was stipulated that the government – through the Secretary of Energy – would retain responsibility for: a) defining and implementing broad and long term policy for the sector; b) promulgating the rules and regulations governing the wholesale electricity market; c) monitoring state owned generation companies; d) awarding concessions for the utilization of hydroelectric resources within inter-provincial waterways (in collaboration with provincial authorities); and approving foreign electricity trade contracts.

Meanwhile, article 56 of the Law 24.065 stipulated that the functions and obligations placed on regulators comprised: a) defining the technical, safety and operating standards; b) determining and approving the basis for tariffs for the sector's transmission and distribution companies; c) supervising the compliance of regulated transmission and distribution entities with established laws, regulations, and operating criteria – including quality of service and environmental standards; d) administering the system of penalties and bonuses designed to control quality; selecting new concessionaires; e) guarding against anticompetitive behaviour in the market; f) and undertaking the resolution of disputes in the sector.

Like in telecommunications, it was the policy-makers' declared intention to set up the regulatory agency at an arm's length relationship both with regulated firms and other private interests, and with political authorities. The Law 24.065, therefore, not only established that the electricity regulatory agency would be separated from regulated firms but also included explicit rules prohibiting regulators from holding a position or an interest in a firm subject to their control<sup>30</sup>. To safeguard its independence from the government, moreover, the new legislation established that ENRE was to be headed by five commissioners, who would be appointed by the Executive Office – two of them following the proposal of the Federal Electricity Council (*Consejo Federal de la Energía Eléctrica*)<sup>31</sup>. Before appointing them, the law provided that the Executive Office would be required to communicate the reasons for its decision to a Congress Committee composed by members of the two chambers, which would have to submit an opinion on the Executive's choice within

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<sup>30</sup> Article 60 of the law 24.054.

<sup>31</sup> Articles 57, 58 and 59 of the law 24.065.

30 days. The Law, however, clearly established that the Executive would not be formally constrained by the Committee's opinion.

The legislation also provided that commissioners, who were appointed to five-year terms with the option of indefinite renewal, would be required to possess relevant technical expertise and professional experience in the field and that their terms would be staggered<sup>32</sup>. It also stipulated that regulators could only be removed by the Executive Office for specific and serious causes<sup>33</sup>. Before making any decision in this respect, however, the Executive Office had to communicate the reasons to the Congress Committee involved in the appointment process. As with appointments, the latter was empowered to submit a non-binding opinion on the Executive's decision.

ENRE was also endowed with those attributes of institutional autonomy required to underpin the arm's length relationships discussed above. First, the agency was provided with a reliable source of funding. The legislation provided that the agency's budget would not be financed through public funds, but largely through control and inspection fees levied on the regulated companies, and allocated proportionately to each company based on their gross revenues from regulated activities, and through fines imposed on regulated firms for violations of the legislation or the company's license/concession<sup>34</sup>. The legislation also stipulated that the agency would be responsible for annually preparing its own budget, which should specify among other

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<sup>32</sup> Complementing the provisions described above, and in order to foster regulator's independence and expertise, the presidential decree 1398/92, which "regulated" the law 24.065, established a more detailed mechanism for appointing ENRE commissioners. It provided that, before running an open call and contest for filling the positions, the Secretary of Energy would be responsible both for defining the profile required for each of positions, and for determining which posts were to be filled by candidates proposed by the Federal Electricity Council. It also stipulated that a Selection Committee – composed by field experts – would be responsible for preparing a shortlist of applicants. It was established that the Secretary of Energy would only be authorised to appoint short-listed applicants.

<sup>33</sup> Article 59 of the Law 24.065.

<sup>34</sup> Article 66 of the Law 24.065.



things the amount of the levy imposed on each operator<sup>35</sup>. Also with the objective of ensuring the autonomy of the newly created regulatory agency the legislation formally endowed regulators with the power to “demand from regulated firms the documents and necessary information to monitor compliance with norms and regulatory requirements”<sup>36</sup>. Equally important, the Law 24.065 allowed ENRE to impose sanctions on firms for not complying with their obligations<sup>37</sup>.

Complementing the provisions discussed above, the Law 24.065 also provided regulators with the managerial flexibility to carry out their duties as well as to foster and retain technical expertise. ENRE was given the power to contract external consultants, design its own organisational structure, decentralise/delegate tasks, etc. Additionally, regulators were also granted an important degree of flexibility to recruit and remove their own staff. To this end, ENRE’s authorities were unambiguously exempted from civil service rules, including salary restrictions<sup>38</sup>.

The Law 24.065 also established a set of institutional arrangements to ensure that ENRE did not stray from its mandate and would remain accountable for its actions. First, it provided that regulators’ decisions could be appealed not only to courts but also to the Secretary of Energy<sup>39</sup>. It was stipulated, moreover, that the latter would have the power to modify those decisions<sup>40</sup>. Second, it was established that

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<sup>35</sup> The levy imposed on each operator would be proportional to their income and the method for setting it was specified in article 67 of the law 24.065.

<sup>36</sup> Article 56 (n) of the Law 24.065.

<sup>37</sup> Article 56 (o) of the Law 24.065.

<sup>38</sup> Article 64 of the law 24.065.

<sup>39</sup> The appeal arrangements for ENRE’s decisions were provided in articles 75 and 76 of the law 24.065.

<sup>40</sup> This has been claimed to imply that in conflicts between a regulator’s decision and the government, the regulator is likely to be defeated (Estache, 1997). In a similar vein, Rodriguez Pardina (1998) argued that, since most regulators do not want their decisions to be challenged, these arrangements are likely to limit regulators’ independence and produce a bias in their decisions towards the preferences of

regulators would have the obligation to publicise their decisions and, in addition, to make explicit the reasons for them.<sup>41</sup> Regulators were also required to produce an annual report and submit it both to Congress and to the Executive Office<sup>42</sup>. Third, regulators were mandated to publish all the information demanded by third parties and to provide them with relevant advice<sup>43</sup>. In addition, it was also established that once ENRE's budget proposal was published and comments by all interested parties were allowed, it would have to be incorporated in the national budget in order to be approved by Congress<sup>44</sup>. Fourth, the Law 24.065 posed an obligation on regulators to carry out public hearings before making important decisions<sup>45</sup>. This was to ensure that ENRE made open decisions and that all concerned parties had the chance to be heard through the decision-making process. It is important to note, in this regard, that although the legislation did not provide a clear definition of "important decisions", it did offer a tentative list of the matters that would require the adoption of such a consultation mechanism. Among others, this list included: mergers, tariffs, and investment authorisations. In addition, and in order to secure that consumer interests were adequately represented, the regulator was required to establish a mechanism for ensuring consumers' representation in all those public hearings carried out to discuss

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the political authorities. He also points out that since the government was formally allowed to modify almost any decision taken by the regulator, these appeal arrangements ended up undermining regulators' authority in whole regulatory process, and hence their accountability.

<sup>41</sup> Article 56 (p) of the Law 24.065.

<sup>42</sup> Article 56 (q) of the Law 24.065 established that the annual report should not only cover the activities carried out during the year but also suggestions of measures to be adopted in the public interest.

<sup>43</sup> Article 56 (ñ) of the Law 24.065.

<sup>44</sup> Commenting on these arrangements, Urbiztondo et al. (1998: 14) contend that linking the agency funding with the income of the regulated firms often creates a serious incentive problem, since regulators may increase tariffs as a means of augmenting their budget. Nevertheless, they also point out that the requirement to authorise third parties to comment on regulators' project as well as its inclusion in the national budget – in order to allow its discussion in Congress – ameliorated this problem.

According to them, a similar effect was obtained by requiring the levy imposed on operators to be a fixed sum – and not a percentage of their income.

<sup>45</sup> Article 74 of the Law 24.065.

regulatory decisions likely to affect their interests<sup>46</sup>. Last, Law 24.065 provided that the regulators' accounts and performance would be scrutinised internally by *Sindicatura General de Empresas Públicas* and, externally by the *Auditoria General de la Nación* – an auditing body under the jurisdiction of Congress.

## **5. The implementation of the reforms and their outcomes.**

As argued by Gomez-Ibañez and Rodriguez Pardina (2003:304), the government acted quickly once it put in place the legal framework of the reforms. The power sector under the control of the national government was first divided into “Business Units”, consisting of one or more power plants for future generation companies, and areas to be covered by future distribution companies. It was decided that each Business Unit would then be privatised through sealed bids and that minimum base prices would not be set. In some cases, nevertheless, the valuation would be used to set a minimum cash price. It was also determined that most of the payment would have to be made in terms of titles of Argentina's external debt, the highest value offered determining the winning bid. As noted by Dutt et al. (1997:37), the guiding principle was that power plants would be sold outright and hydro plants would be sold as concessions of thirty years. This was in order to retain long-term control of the associated water rights. The distribution and transmission companies, would be privatised as a single entity – for reasons of scale – and they would be sold as ninety-five years concessions.

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<sup>46</sup> Article 56 (j) of the Decree 1398/92.

SEGBA was the first company to be privatised within this framework. In 1992 it was broken into five generation firms and 3 distribution companies. The distribution companies created were EDENOR S.A., EDESUR S.A. and EDELAP S.A. The first two were the largest and represented more than one-third of all electricity customers in the country. Their privatisation raised one-third of the total privatisation proceeds from the sector. The privatisation of AyE, meanwhile, began in early 1993 as its power stations were separated and sold off. Most of HIDRONOR's assets, finally, were privatised in mid 1993, when the concessions to operate one national transmission grid and five regional grids were granted<sup>47</sup>. The national government retained only two nuclear plants and two dams, which collectively supplied about one-third of the power to the wholesale market. For dispatching and other purposes, nevertheless, they were treated the same as private generators.

Meanwhile the provincial governments sold most of their electricity distribution and transmission facilities under similar terms. The provinces of San Luis, La Rioja, Tucumán, and Formosa were the first to grant concessions for the distribution of electricity. In 1996, the province of Buenos Aires privatised ESEBA, the second biggest company after SEGBA. Before transferring it, the province divided ESEBA into three firms: EDEA, EDEN and EDES. The provinces of San Juan, Jujuy, Entre Ríos, Salta, Catamarca, and Mendoza later replicated the process. By 2001, thus, more than 80% of the generation, all of the transmission, and 60% of the distribution sector in Argentina were transferred into private ownership. The result was that around 70% of the population was served by private companies (Pollit, 2004).

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<sup>47</sup> The break up and privatisation of AyE and HIDRONOR resulted in the creation of 22 new generators (Galiani et al., 2005).

The privatisations raised \$3.1bn for the central government and associated privatisations by the provinces raised a further \$2.1bn. As noted by Pollitt (2004), the initial privatisations attracted a large amount of foreign interest with many of the firms passing into foreign ownership soon after the initial offering. AES of the U.S., ENDESA of Spain and TOTAL FINA ELF of France, for example, became major players in the generation sector. The operation of the national transmission grid was granted to TRANSENER, which was a consortium led by the British Company NATIONAL GRID. In distribution, EDESUR was taken over initially by ENERSIS of Chile and then ENDESA of Spain. EDENOR and EDELAP were taken over by EDF of France and AES, respectively.

In 1991, generation was initially in the hands of four major state-owned companies with a combined market share of 77.3%, with the largest company (SEGBA) having a market share of 23.3%. By 2002 there were more than 40 generation companies operating in Argentina, and the share of the largest four private companies was 40.5%. The largest private firm had a share of 12.3 % (Pollitt, 2004:7)<sup>48</sup>. By 2002, moreover, the principal buyers of electricity were around 35 distribution companies that had exclusive concessions to retail the electricity to households and other small users in the areas they served. In addition, over two thousand industrial firms were allowed to buy power directly on the wholesale market, bypassing their local distribution companies.

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<sup>48</sup> Pollitt (2004:10) notes that although the market shares of the leading firms have increased since 1992, in 2002 the market remained less concentrated than in most European and North American countries.

## 5.1. The performance of the Argentine Electricity Sector following the 1992 reforms: lights.

Several indicators show that the performance of the Argentine electric industry improved enormously between the 1992 and the end of 2001. One of these indicators is, unquestionably, investment (notably in generation and distribution). Between the beginning of 1992 and the end of 2001, investments in the industry totalled around US\$ 7.5bn in fixed assets (Pollitt, 2004:13). In generation, a good deal of these investments had two aims. One was to replace or upgrade old thermal equipment. This, in turn, not only resulted in improved efficiency, but also in the reduction of breakdowns. Between 1992 and 2001, the average availability of these plants increased from 48% to 80%. Second, investments also contributed to the improvement in the system's overall installed capacity. During the period under analysis, this increased from 13,267 MW to 22,831 MW, mostly in the form of thermal (combined-cycle) plants<sup>49</sup>. As a result of these advances, the number of units delivered by generation companies increased from 45.800GWh in 1992 to 81.300GWh in 2001 (Romero and Petrecolli, 2003:28).

In distribution, the investments resulted in an increase in the total number of electricity customers to 9.835m in 2001 - SEGBA's descendants (EDENOR and EDESUR) had almost half of that number (4.34m). This represented an increase of 11% from 1993 and, among other things, was the result of an ambitious plan to

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<sup>49</sup> Quoting a work by Romero (1999), Murillo and Finchelstein (2004) point out, however, that although the increase in installed capacity was significant, it did not reach the levels of the 1970s and 1980s. The authors also contend that a big share of the increase in installed capacity during the 1990s was a result of the investments made by only a few firms. According to their figures, the investments made by just eight business units account for 93% of the increase in installed capacity between 1995 and 2002.

connect 650,000 shanty town households to the electricity network between 1994 and 1998 via collective meters (Pollitt, 2004:13).

The high rates of investment in the industry were accompanied by a relatively good financial performance of most of the companies involved<sup>50</sup>. In distribution, although SEGBA descendants experienced losses during the first couple of years of their concessions, after this the average post-tax rate of return on assets was not only positive but also reasonably high: EDENOR and EDESUR's average post tax rate of returns on equity, for example, was around 9% between 1995 and 2001<sup>51</sup>. Something similar could be said about the profitability of operators in transmission. Indeed, between 1994 and 2001 TRANSENER's average post-tax rate of return on assets was almost 7%<sup>52</sup>. In generation, meanwhile, although operators were doing much better than before privatisation, the profitability of their investments were more modest than in transmission and distribution. In 2000, for example, the average post-tax rates of return on shareholders' funds in the sector was 4.6% (Pollit, 2004:14)<sup>53</sup>.

To a certain extent, the companies' strong financial performance reflected the large efficiency improvements in the industry. These improvements could be seen in both the sharp decrease in generation plant unavailability discussed above, and in the important progresses achieved in labour productivity<sup>54</sup>. Benitez et al. (2003), report that, in generation, GWh per employee rose by 17.4% between 1992 and 1999. In

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<sup>50</sup> See Estache (2004).

<sup>51</sup> See Uniren (2004:268-291).

<sup>52</sup> Ibid.

<sup>53</sup> This number, despite being respectable by international standards, could be considered low if the risk associated at that time with investment in Argentina is taken into account. In this respect, in TRANSENER's price review in 1998 the country risk premium was estimated to be 4.89% p.a. in real terms (Pollit 2004:14).

<sup>54</sup> As noted by Estache (2002: 11) a good share of the efficiency increases came from reductions in employment. In this sense, Ennis and Pinto (2002:50) show that employment in SEGBA and its successor companies fell from 21,535 in 1987/90 to 7,945 in 1997 – a fall of 63%.

distribution, according to these authors, that figure reached 31.5%. Pollitt (2004:15), meanwhile, claims that the labour productivity of ENDESA (the second largest generator by the end of 2001) improved from 13 to 35GWh generated per employee between 1995 and 2000. He also shows that sales per employee in the two largest distribution companies (EDESUR and EDENOR) improved from less than 2GWh per employee in 1993 to 5.7GWh in 2001<sup>55</sup>. In a similar vein, Romero and Petrecolli (2003:29) show that, in those companies, the number of connections (clients) per employee increased more than 100% between 1993 and 2002<sup>56</sup>.

The most quoted achievement of the 1992 reforms, however, was their impact on electricity tariffs. There seems to be an agreement that the new rules resulted in the elimination of the large fluctuations in the real value of tariffs seen in the 1980s (Pollitt 2004:13), and also in a sharp reduction of electricity prices, notably on the wholesale market. In that market – despite a sharp increase in electricity demand<sup>57</sup> – the nominal US dollar price of energy fell almost 70% between 1992 and the last months of 2001 (Pollitt, 2004; Mateos, 1999). As a result of this fall, which, in the view of most analysts, resulted from the intense competition in the generation market<sup>58</sup>, large industrial consumers who purchased directly from that market enjoyed important price reductions, which in certain cases reached 50%<sup>59</sup>.

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<sup>55</sup> Following the findings in Newbery and Pollitt (1997) and Domah and Pollitt (2001), Pollitt (2004:15) claims that these numbers compare very favourably with experience in the UK, where labour productivity was less over a longer period.

<sup>56</sup> The number of connections per employee in 1993 and 2002 was 417 and 932, respectively (Petrecolli and Romero, 2003:29).

<sup>57</sup> Electricity demand grew at an average annual rate of 6.14% between 1992 and 2001 (Cammesa, 2002), compared with 2.5% in the previous decade (Gomez-Ibañez and Rodriguez Pardina, 2003).

<sup>58</sup> Pistonesi (2001:61-64), however, argues that although competition in the generation contributed to the reductions experienced in the spot market, in particular after 1995, another cause was the entrance to the market of a couple of hydroelectric units planned before the reforms and built with public funds (Piedra del Aguila and Yacyretá).

<sup>59</sup> As noted by Bour (1999), the reductions were generally not as large as those in the spot market because many of the large customers bought part of their electricity on long-term contracts.



Consumers who got their power from the distribution companies, meanwhile, also enjoyed savings, though not as large as those experienced by large customers. According to ENRE's 2001 annual report, between 1992 and 2000 the nominal average tariff of EDENOR, EDESUR, and EDELAP – the three distribution companies that had succeeded SEGBA – fell 17.7%, 13.7%, and 13%, respectively. According to the same source, these drops amounted 24.0%, 24.1% and 22.8% in real terms.

Last, but not least, quality of supply also improved significantly between 1992 and 2001. In distribution, both technical and non technical losses in Greater Buenos Aires fell from above 22% in 1992 to almost 10% in 2001. In that area of the country, and reflecting significant improvements in metering and bill collection to reduce non-technical losses (i.e. theft), the number of hours of supply lost per year was 21 in 1988, 16.8 in 1993/94 and dropped to 5 in 2001<sup>60</sup>. Blackouts, in addition, had become the exception rather than the rule. Indeed, between 1992 and 1997, the annual amount of energy not supplied because of blackouts fell from 125 GW-hour to 8 GW-hour<sup>61</sup>. In the transmission system, meanwhile, power outages also experienced a sharp reduction. In the TRANSENER's transmission system, for instance, the rate of own failures per year was 1.48 in July 1994 and 0.57 in 2002 – well below the limit of 2.50 set in the concession contract<sup>62</sup>.

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<sup>60</sup> See Pollitt (2004:16).

<sup>61</sup> See Gomez-Ibañez and Rodriguez Pardina (2003:307).

<sup>62</sup> See Pollitt (2004:16)

5.2. The performance of the Argentine electricity sector following the 1992 reforms: shadows.

From the discussion above, the reader could get the impression that the reforms put in place in 1992 were designed following the best international practice and also that they managed to deliver the benefits predicted by its advocates. Although that picture is quite accurate, it is not complete. The system also presented some weaknesses and failures.

One of the most criticised aspects of the reforms put in place in 1992 was its impact on rural and low income consumers. In this respect, it should be noted that despite the increase in the total number of electricity connections, this increase materialised mostly in urban areas, and notably in the greater Buenos Aires area. In rural areas, in contrast, private carriers saw little or no profit in connecting the most isolated settlements. This, combined with the fact that there was a legal ban on the establishment of cross-subsidies, made it difficult to expand or maintain basic access to electricity for these settlements (Ruchansky and Bouille, 2003). By the end of 2002, and despite the fact that in 1995 the Secretary of Energy launched a scheme to serve these areas<sup>63</sup>, only 70% of the rural population in Argentina had access to electricity – compared to 98% in urban areas<sup>64</sup>.

Regarding the issue of the impact of the reforms on low income consumers, there is a strong consensus that the new system led to a sharp increase in the number of poor

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<sup>63</sup> The aim of that scheme was to connect 314,000 rural users. By the end of 2001, however, only a fraction of those connections were actually in place. As noted by Pollit (2004:24) and Bouille et al. (2002), the main problem for the implementation of the scheme was the unwillingness of provincial governments to contribute with subsidy payments.

<sup>64</sup> See Bouille et al. (2002)

households with electricity supply (Bouille et al., 2002; Ruchansky and Bouille, 2003). In the Greater Buenos Aires area, the percentage of households within the poorest income deciles with access to electricity rose sharply in comparison with that observed in the 80s<sup>65</sup>. Ennis and Pinto (2002:30) show that within the first decile (the poorest) only 65% of the population had access to electricity services in 1985/86. According to these authors, in 1996/97 that number had climbed to 99%<sup>66</sup>. As the authors note, this increase is likely to have had a positive impact on the social welfare of these households as they often need electricity for both heating and pumping water.

The consensus ends, however, when the discussion focuses on the social impact of electricity tariffs. In this sense, some authors have pointed out that although reforms resulted in important efficiency improvements and, consequently, lower tariffs in the wholesale market, captive customers only received a small cut of the efficiency gains and the tariff reductions achieved in that market<sup>67</sup>. Tariff reductions for residential consumers, hence, were far behind those experienced by large industrial customers. Moreover, not all groups among residential customers benefited proportionally from the savings achieved: customers with the highest incomes enjoyed greater tariff cuts than the poor.

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<sup>65</sup> As mentioned earlier in this chapter, much of this increase in service coverage resulted from the plan put in place by SEGBA's successors between 1994 and 1998 to connect shanty town households to the electricity network. For a more detailed discussion on this issue, see Haselip et al. (2005:6-8).

<sup>66</sup> Households within the second and third deciles also benefited from the increase in the number of connections to the service. According to data reported by Ennis and Pinto (2003:30), in 1985/86 only 80.49% and 87.45% of the households within these deciles had access to the service. In 1996/97, 99.60% and 99.79% of the households belonging to the second and third decile were connected to the service.

<sup>67</sup> See Flacso (1999), Arza (2002), Gerchunoff et. al. (2003), Pistonesi (2001:68), Ruchansky and Bouille (2003)

Three factors are said to have accounted for this. First, when SEGBA was split into generation and distribution companies, the new distribution companies were committed to purchase a significant amount of electric power – almost 50% of their consumption – at a flat price (40 US\$/MWh) that soon significantly exceeded the price in the spot market<sup>68</sup>. Second, and as discussed previously in this chapter, the regulatory framework provided that electricity distribution tariffs would be adjusted, among other things, following a weighted average of the consumer and producer price indexes in the US. Contrary to what many expected, between 1995 and 2001 inflation in the US had been greater than in Argentina. Last, and as noted by Estache (2002:14), the new rules of the game provided that – in order to reflect economies of scale and to promote allocative efficiency – distribution costs would decline with increases in the quantity and voltage of the supply. As a result, low electricity consumers, who generally happen also to be the poorest, only benefited from a fraction of the price declines experienced by high demand consumers, who generally happen also to be those with the highest income<sup>69</sup>.

## **6. Regulatory stability in the electricity sector**

In spite of the problems discussed above, there is some degree of agreement that almost a decade after the introduction of the reforms in the electricity sector, its outcomes have showed more lights than shadows. In the view of most experts, this outcome could be attributed not only to privatisation but also to the design of the regulatory regime put in place by reformers in early 90s.

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<sup>68</sup> This measure, which was in place for 8 years, was intended to attract private investors by reducing the risk of energy price fluctuations (Haselip et. al., 2005:5; Pistonesi, 2001:51-52; and Dutt et al., 1997:44).

<sup>69</sup> Pistonesi (2001:75), in addition, argues that these pricing arrangements in distribution did not promote a rational and environmental-friendly use of electricity, since they fostered consumption.

Although I do not deny the possibility that the relatively good performance of the electricity industry in the decade that followed the reforms of the sector in 1992 can be attributed to those reforms, I believe that it would be unfair to attribute them the sole responsibility. It is important to note, in this sense, that between 1992 and December 2001 not a single change was introduced to the legislation originally used by reformers to define the key features of the electricity regulatory regime. The implications of this were far from irrelevant. Indeed, when President De la Rúa left office, the sector's regulatory governance was exactly the same as specified in the 1992 Electricity Act. Regulators, as a result, were not only key actors in the sector's regulation but also they still enjoyed most of the powers and responsibilities originally granted to them. The institutional arrangements originally put in place to safeguard their independence, autonomy and accountability, moreover, were exactly the same as those established in the early 90s.

Adding to this, the structure of regulatory incentives governing the organisation and functioning of the electricity industry looked pretty much the same as the structure of regulatory incentives put in place at the time the sector was transferred into private hands. In December 2002, thus, the electricity productive chain in Argentina was both vertically and horizontally unbundled and the regulatory principle of incompatibility between functions still applied. The same was true of third party access to transmission and distribution networks as well as entry into power generation. Like in the early 1990s, moreover, distribution and transmission were classified as public services and remained regulated activities. They were operated as concessions and these were awarded in open bidding processes.

Generation, meanwhile, was considered to be a service of general interest and remained essentially unregulated. Also as envisaged by reformers in 1992, competition among generators occurred in the wholesale market. The latter was still managed by CAMMESA, which planned the operation of the interconnected system for six-month seasonal periods, so as to meet the expected demand with a reserve agreed between the parties (economic load dispatching). The wholesale market was still divided in two segments, namely a spot and a contract market. In the latter, distributors and large consumers could enter into supply agreements with producers and brokers, at prices freely settled in the respective contracts. In the spot market, meanwhile, electricity demand and supply were matched with an hourly and seasonal price.

The retail market remained divided into a regulated segment and another open to competition among suppliers, which included large consumers. The regulated segment guaranteed monopoly to the distributor that had been granted the concession and who had the obligation to supply any required demand under the terms of the concession contract. Like in the early 1990s, finally, the pricing of distribution and transmission in the last days of 2001 were set in US dollars and the regulation set maximum prices with total pass through of costs of energy and with an indexation to the US' price index.

#### 6.1. Are regulatory regimes defined in statutes more stable?

The evidence above clearly shows that the regulation of the electricity sector between 1992 and December 2001 exhibited a degree of policy stability

unquestionably higher than that observed in the telecommunications sector. But can this be taken as conclusive evidence that, in Argentina, regulatory regimes defined in statutes are more stable than regulatory regimes defined in other legal instruments?

In order to answer this question, it is important to recall that, following the research design adopted in this thesis, for establishing valid causal inferences using one or a small number of cases, one not only needs to show how highly correlated the ultimate explanatory and the dependent variables are, but also that the process specified by the theory – whereby the independent variable operates so as to conduce ultimately to the outcomes – is also present. Thus, for establishing the validity of the hypotheses in this thesis, one needs to prove both that the electricity regulatory regime in place in the last days of 2001 closely resembled that established at the time of the reform of the sector, and also that this occurred despite the executive sometimes favoured changing its original policy commitments. That is, one also needs to present evidence showing that if the electricity regulatory regime remained stable, this was despite the presence of pressures in the opposite direction.

The best way to show this is to present evidence confirming that there were episodes where policy-makers attempted to introduce changes to the status quo but failed. The reader should be aware, however, that this sort of evidence is probably scarce. Indeed, if the propositions in this thesis are valid, policies defined in a statute should not only be stable because changing them was costly but also because policy-makers strategically anticipate this and, thus, rarely attempt to change them<sup>70</sup>.

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<sup>70</sup> For a more in depth discussion on how strategic anticipation affects the observation of expected behaviour, see Ferejohn, Rosenbluth and Shipan (2004:18) and references therein.

The second way is to present episodes where one can legitimately claim that, since the location of the status quo was very distant from policy-makers' preferences, the latter probably felt tempted to change the location of the status quo but finally refrained due to the high costs that this alternative involved.

The remainder of this chapter, therefore, analyses three incidents which clearly demonstrate that the electricity regulatory regime remained stable despite pressures for change. The first two of these episodes clearly fits into the second category of evidence discussed above. That is, they were occasions where one can legitimately assume that the executive most likely considered – and favoured – the option of introducing changes to the status quo but finally refrained. The remaining episode, meanwhile, is a clear example of an incident where the executive unsuccessfully tried to enact changes.

## 6.2. Episode 1: The 1999 Buenos Aires Blackout

During the early morning of February 15, a fire broke out at the recently opened Azopardo 2 Substation, owned by EDESUR, the power distribution company for the southern half of Capital Federal and Greater Buenos Aires. This was in the course of works intended to connect it to the existing 132 kV grid. The fire resulted in 156,540 customers in Buenos Aires being left without power and a huge infrastructural and social chaos<sup>71</sup>. Although by that night almost 100,000 customers were reconnected, it was not until February 24 that the incident was finally resolved.

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<sup>71</sup> People with disabilities and the elderly were trapped in powerless high-rise apartments, and traffic snarled. While temperatures averaged between 30 and 35 degrees, almost 600,000 inhabitants were without refrigeration for food, without air conditioning or fans, and even without water and plumbing – because electric pumps could not operate.



The incident – the worst in the history of Argentina and comparable to the Auckland crisis of February 1998 – triggered a generalised mood against EDESUR. Contributing to this was the finding that the power cut was not the result of an ‘act of God’, but of faulty facilities in EDESUR’s distribution system. In addition, the company handled the situation poorly. First, it never provided adequate information about the causes or nature of the problem. Second, its repeated promises about when service would be re-established were not met (Ullberg, 2002).

The distribution company, however, was not the only one blamed for the incident. The failure also raised questions about the efficacy of privatisation of the electricity industry and the regulatory arrangements introduced by the government in the early 90s. In this sense, there was a group that claimed that the incident was a clear demonstration of the failure of privatisation and more generally, of the market oriented model adopted by the Menem administration. Less radical, there was a second group – which included most opposition parties, many legislators, and consumer groups –, that argued that the problem were the institutional arrangements originally put in place to safeguard ENRE’s independence and autonomy. In their view, these arrangements had resulted in a regulatory agency that was a mere extension of the privatised companies and looked out for their interests before those of consumers. They claimed that the government needed to introduce important changes in the industry’s regulatory governance to prevent similar events from happening again. For many in this group, these changes included increasing Congress’ influence on utility regulation issues and more precisely, the creation of a “Super Ente”. This was conceived as a supra regulatory agency within the orbit of

Congress with ample authority to formulate, interpret and enforce regulatory norms across all the utilities<sup>72</sup>. There was a third group, finally, that placed its critiques not on the governance aspects of the industry but on its regulatory incentives. Among other things, this group called for the abandonment of regulation based on “results” or “performance”, and its replacement for another more based on “instruments”.

In this context, and given the proximity of the October 1999 presidential elections, the government probably also believed that some changes to the status quo were needed in order to ease the public’s discontent. Needless to say, the changes that the government probably considered did not include the reversal of privatisations or other of the more radical measures discussed above. Following the experience in the telecommunications sector, however, one cannot reject the possibility that, as the crisis developed, government officials seriously considered the alternative of “punishing” ENRE, for example, curtailing its independence or taking over many of the agency’s roles and responsibilities.

However, the problem with this alternative was that since it required amending the Electricity Act, it would necessarily entail giving Congress a say in this process<sup>73</sup>. And for several reasons, the executive most likely wanted to avoid this. First, in the legislative elections of October 1997, the Justicialista Party had lost the majority of votes in the lower chamber of the Legislature. Since then, therefore, the executive’s

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<sup>72</sup> As noted by Abdala (2001), the proposal to create a Super Ente was introduced long before these events. The occurrence of the blackout, however, revived the discussion on the issue as well as the bills that contemplated it.

<sup>73</sup> In the light of the hostility the courts had been showing since it became apparent that the government party would lose the next presidential elections, the alternative of passing a DNU was probably not even considered.

capacity to pass legislation had been seriously compromised<sup>74</sup>. Second, the executive clearly acknowledged that for Congress to provide its consent to changes they would have to include granting Congress a greater role in the day-to-day regulation of the sector. And this was something that the executive was not ready to accept. Third, even in the unlikely event that both parties managed to come to an agreement, implementing it would have probably taken more time than the urgency of the problem allowed.

The government, however, did not remain inactive. In the light of the difficulties of introducing changes to the status quo compatible with its preferences, it opted for putting pressure on the regulators to act tough on EDESUR. Regrettably for the latter, this was an effective move. Indeed, with its room for manoeuvre severely constrained, and knowing that its own survival was at stake, ENRE had no choice but accede to this pressure<sup>75</sup>. On February 22, the agency resolved (Resolution 292/99) that in compensation for the power cuts, the company would have to pay fines and indemnities much higher than those established in the concession contract: \$90 to those residential users who had been left with less than 24 hours without service, and \$100 per day plus \$3.75 per hour to those which service was cut for more than 24 hours<sup>76</sup>.

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<sup>74</sup> As noted in the previous chapter, in February 1999 Menem was still flirting with the idea of running for re-election. That was a major source of conflict within the ruling party and greatly contributed to limiting the government's capacity to pass legislation in Congress.

<sup>75</sup> Previously, on February 17, ENRE had passed resolution 222/99, which charged EDESUR for the outage and instructed the company to pay indemnities to the affected customers. A couple of days later, it had also dictated another resolution (291/99) in which it directed EDESUR to re-establish service within 24 hours.

<sup>76</sup> The argument used by the regulator to justify these huge penalties was that the penalties for power cuts provided in the concession contract were meant to apply to "normal" outages, and that the outage in question had several features that made it exceptional.

EDESUR's reaction to this resolution was quite negative. In the opinion of the company, ENRE's decision was not only an overreaction aimed to ease the pressure from the public, the mass media, and the government, but also it was clearly illegal. The company noted, in this sense, that according to the concession contract, the compensation it was obliged to pay should be approximately \$6 per day for the average residential customer, irrespective of numbers of days the customer had been left without service. In line with the opinion of some experts, moreover, it criticised that the scheme of penalties imposed by ENRE explicitly violated the regulatory framework because, among other things: a) it maximised the number of users who would be compensated instead of adjusting compensation to real costs; b) it included compensation to users affected for less than 10 hours; it was discontinuous at 24 hours (jumping from \$90 to \$193.75); and it was independent of historic use – resulting in a situation in which users with low and high rates of usage were equally compensated. Based on these critiques, and after a failed attempt to offer its own compensation scheme<sup>77</sup>, EDESUR's major shareholder, the Chilean ENERSIS, declared that the company would appeal ENRE's resolution and that it would not pay the penalties the regulator had imposed on the company.

For the government, the company's refusal to pay the penalties was not necessarily bad news. Indeed, when the president of ENERSIS declared that EDESUR would not pay any fines or indemnities that were not considered in the concession contract, the debate gradually shifted from the efficacy of privatisation or the performance of the regulator to whether the government should cancel EDESUR's concession (Ullberg, 2002:61).

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<sup>77</sup> The compensation scheme offered by the company was somewhere in between the penalties provided in the contract and the penalties imposed by ENRE.

By the end of March – that is, almost a month after the blackout – everything indicated that the fate of EDESUR had already been decided. It became public knowledge that although the government was aware of some of the legal flaws in ENRE's decision, it had decided to support the position adopted by the regulatory agency – which, as discussed above, the government itself promoted when it realised the institutional costs of introducing significant changes to the status quo. It also became known that the Secretariat of Energy had drafted a presidential decree annulling EDESUR's concession and that, if the firm insisted on refusing to pay the fine assigned by ENRE, President Menem was ready to sign it.

But, as Urbiztondo (2003) notes, luck was on the government's side. During the first days of April, the majority of shares in ENERSIS were bought by the Spanish ENDESA. The latter not only proceeded to change the management of EDESUR but also realised that the fastest road to reconciliation with the Argentine government and public was to accept a more flexible standard regarding ENRE's resolution. On April 20, thus, the company notified the regulatory agency that it had decided to renounce its appeals and that it would accept paying all fines, ordinary and extraordinary. With this decision, and more importantly, with the rules that defined the regulatory framework intact, the crisis concerning the Buenos Aires blackout seemed to be over.

### 6.3. Episode 2: The ENDESA case

Although the acquisition of ENERSIS by the Spanish electric company ENDESA marked the culmination of the crisis that followed the Buenos Aires' blackout, the deal was not free of problems. In what follows it is shown that these problems were at the origin of another episode where, although politicians felt tempted to introduce significant changes to the electricity statutory framework – and even took some steps in that direction – the fact that this framework was defined in a law passed by Congress prevented those changes to materialise.

To understand this second episode, it is important to note that in, April 1999, before gaining control of ENERSIS, the Spanish ENDESA was already a major shareholder in one of the distribution companies operating in Buenos Aires. In partnership with the French EDF and ASTRA, it had a major share of EDENOR, the concessionaire with the exclusive franchise to distribute electricity in the northern areas of the city. After acquiring 60% of the Chilean firm – which, as previously discussed, had a majority share in EDESUR – the company both helped to terminate the crisis that resulted from the Buenos Aires' blackout in February 1999, and also turned into a major shareholder in the company with the exclusive franchise to perform electricity distribution in the southern areas of the city.

The existence of a single group controlling both EDENOR and EDESUR, however, was in clear violation of provisions of the electricity regulatory framework. Indeed, with the aim of preventing the concentration in the supply of electricity distribution services, the rules governing the privatization process of these companies had

explicitly established that: 1) bidders could not participate in more than one bid for each concession contract; 2) a bidder could bid for both concession contracts but only when participating with the same affiliates in each offer; 3) the owners of class “A” shares in one of the concessions could not own those shares in the other. To preserve these limitations, moreover, Article 6 of EDESUR and EDENOR’s concession contracts stipulated that at the end of each management period, the rules governing the call for bids should be organised under similar arrangements. Article 32 of the Electricity Act, meanwhile, established that only with the express authorisation of the ENRE could two or more distributors merge or consolidate into one group, or a distributor could acquire shares of another distributor. It also stipulated that before making any decision, ENRE would have to allow third parties to express their view on the issue at stake in public hearings, and determine that the transaction in question would not negatively affect the service or the public interest, or to infringe other provisions of the law. It should be noted that among the responsibilities the Electricity Act granted ENRE was to prevent firms in the industry from engaging in anticompetitive or discriminatory conducts as well as promoting competition in the electricity market.

ENRE, however, did not seem to be very concerned about these provisions. Indeed, although a proceeding was started to determine whether the acquisition of ENERSIS by ENDESA affected the public interest or infringed the provisions of regulatory framework<sup>78</sup>, no further action was taken in this regard. It was pretty clear, in this respect, that ENRE wanted to avoid making a decision at all costs. And the reason

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<sup>78</sup> Originally, that proceeding (4409/97) had been started in October 1997 when ENDESA Desarrollo S.A. (a subsidiary of ENDESA) acquired 2,96% of ENERSIS’ capital, and ELESUR S.A. (a subsidiary of ENDESA Desarrollo) acquired 86.19% of the shares of CHISPAS (which owned 29,04% of ENERSIS).

for this was no mystery: any challenge to the transaction would probably revive the crisis that had followed the Buenos Aires blackout and, with it, the voices questioning the efficacy of the regulatory agency<sup>79</sup>. With the presidential elections getting closer and political pressures growing, regulators knew that this time it would be very difficult for the government to stand by their side.

In September 1999, Congress passed the Competition Act, which, in addition to creating the Competition Tribunal and instituting the control of merger and acquisitions, established that “*all attribution of competition issues related to the purpose of this law and given to other organisms or state entities shall be repealed*”. For ENRE, the passage of this law was a good opportunity for trying to get rid of the obligation to continue the proceeding it had started and, ultimately, for making a decision on the issue at stake. In November, therefore, the agency declared itself incompetent to resolve on the case and referred it to the Competition Commission.

However, regulators’ strategy to wash their hands was unsuccessful. On 7 December – three days before the change of government –, the Competition Commission also declared itself incompetent and referred the case back to ENRE. The argument the Commission used for doing so seemed reasonable: the acquisition of ENERSIS by ENDESA had taken place several months before the passage of the Competition Act and, therefore, it was ENRE’s responsibility to make a decision<sup>80</sup>.

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<sup>79</sup> Recall that ENDESA had agreed to pay all the fines that had been imposed on EDESUR following the Buenos Aires blackout in February 1999.

<sup>80</sup>The Competition Commission also argued that at the time the transaction had taken place the existing legislation – notably, the Electricity Act – clearly established that it was ENRE’s duty to prevent anticompetitive, monopolist or discriminatory behaviour in the electricity industry.



The Competition Commission's decision to refer the case back to ENRE was very welcomed by the new government, and particularly, by the incoming economic authorities. Like many in the industry, the latter believed that ENRE's reluctance to make a decision on the ENDESA case not only put its independence from the outgoing government into question, but also showed that the interaction between utility and competition regulators needed to be redefined. Soon after taking office, therefore, Minister Jose Luis Machinea announced that addressing this problem would be one of the government's first priorities and that some important changes to the status quo would probably be introduced.

And it seems that he really meant it. In February, the newly created Secretariat of Competition and Consumer Affairs of the Ministry of Economy had already drafted a bill that clearly revealed the preferences of the new economic team in this respect<sup>81</sup>. On the one hand, the bill advanced a set of provisions aimed at reinforcing the independence, autonomy, and accountability of all the utility regulatory agencies created during the previous government. On the other hand, it stipulated that before deciding on issues that could have an impact on competition, utility regulators would need to involve the Competition and Consumer Affairs' Secretariat, and the latter would be entitled to give a non-binding opinion. The bill also contemplated that appeals from those decisions would no longer be heard by sectoral authorities, but by the economy-wide competition regulator, the Competition Tribunal<sup>82</sup>.

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<sup>81</sup> As an advisor to the Secretary of Competition, the author of this thesis participated in the drafting of this bill.

<sup>82</sup> Following the Competition Act, the Competition Tribunal was supposed to replace the Competition Commission.

The bill, however, never reached Congress. And accounting for this were two reasons. First, a group within the executive opposed limiting the government's discretion on regulatory decisions and, more important, resigning that discretion in favour of the competition regulator. In the opinion of this group, which was led by the Minister of Infrastructure and Public Works, the bill was a covert attempt by the economic team to meddle in the regulatory affairs of sectors that, in December 1999, had been deliberately left out of its jurisdiction<sup>83</sup>. The second factor concerned the chance of the bill being passed by Congress. As the economic officials soon realized, these were rather weak. And this weakness not only lay in the fact that the opposition party controlled a comfortable majority in the Senate. It also resulted from the fact that most legislators – including many that belonged to the ruling coalition – were still convinced of the need to expand Congress' participation in regulatory decisions. The reform proposal of the Secretary of Competition, they believed, did not contemplate any significant advance in this respect<sup>84</sup>.

The fact that the bill in question never progressed beyond the executive branch, however, did not mean that the ENDESA case was left unresolved. On April 11, Minister Machinea passed a resolution (M.E. 266/00) that confirmed what only the electricity regulators seemed to ignore: that it was ENRE's responsibility to decide on the participation of ENDESA in both EDENOR and EDESUR. Two months later, moreover, the Competition and Consumer Affairs Secretariat made public a report containing its opinion on the case<sup>85</sup>. It argued that having one company controlling

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<sup>83</sup> These sectors included, among others, telecommunications, water, transport, and ports.

<sup>84</sup> The only role that the bill contemplated for Congress was in the appointment and removal of regulators. More specifically, it stipulated that legislators would be entitled to issue a non-binding opinion on the executive's appointment and removal decisions.

<sup>85</sup> Resolution 266/00 had explicitly required the Secretary of Competition to issue its opinion on the case.

both electricity distribution concessions in Buenos Aires could open the door to three different but interrelated problems. First, the report claimed, it could jeopardize electricity regulators' use of the yardstick competition mechanism<sup>86</sup>. Second, it could negatively affect competition in the generation market<sup>87</sup>. Finally, it could also endanger the prospects of developing a competitive electricity commercialization market, in case the government decided to fully liberalize it in the future<sup>88</sup>. In the light of these problems, the report concluded, ENRE should require ENDESA to divest its assets in one of the distribution companies, and should leave it to the firm to decide in which company it would keep its participation and in which company it would sell<sup>89</sup>.

Although resolution 266/00 had explicitly established that the opinion and recommendations of the Competition Secretariat would have a non-binding character on ENRE's decision, it seems that the latter did not dare to challenge them<sup>90</sup>. On August 10, ENRE passed a resolution (480/00) concluding that the acquisition of ENERSIS by ENDESA had resulted in a situation clearly incompatible with the provisions of the electricity statutory framework. It also ordered ENDESA to disinvest all its shares in either of the two distribution companies. The regulator,

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<sup>86</sup> The report claimed that both theory and international experience showed that this mechanism could provide regulators with comparable information on the efficiency and productivity levels of similar firms, and therefore it could be an important tool to set prices and determine productivity improvement requirements at the time of tariff reviews.

<sup>87</sup> It was argued that given the magnitude of the electricity distribution market in Buenos Aires, the main risk associated with having one company controlling it was that this the company could use its market power to benefit those companies in the generation sector in which it had some sort of interest.

<sup>88</sup> For an in depth review of the case and of the Competition Secretariat's report, see Petrecolla and Romero (2002).

<sup>89</sup> The participation of the Competition and Consumer Affairs' Secretariat in this case and in other competition advocacy initiatives is discussed in detail in Winograd, Celani, and Kim (2004).

<sup>90</sup> The Competition Secretariat's report reflected the view of most electricity experts and industry stakeholders. However, the main reason why ENRE probably preferred to follow the report's recommendations was that these reproduced the preferences of some of the most influential figures within the government. Indeed, a few days after the report became public, the country's Vice-President and the Minister of Economy openly announced their support for the conclusions and recommendations that the report advanced. See Clarín 17/06/00.

however, was not alone in bowing its head down. In March 2001, and following several months of negotiations, ENDESA announced the divestiture of its participation and interest in EDENOR, and the transfer of all its shares in this company to the French EDF. This announcement, naturally, marked the conclusion of the episode<sup>91</sup>. Once more, and despite the pressures in the opposite direction, the rules of the game defining the electricity regulatory framework remained intact.

#### 6.4. Episode 3: The decree 804/01

Other events were making the news in Argentina by the time ENDESA announced its divestiture in EDENOR. As discussed earlier, at this point the country's financial and political situation was worsening day after day. On March 20, moreover, amid a wave of cabinet resignations and national protests that were threatening to force the president's resignation and a call for early elections, President De la Rúa appointed Domingo Cavallo as his third minister of economy in three weeks. A few days later, Congress enacted the newly appointed minister's "competitiveness law". This law, on the one hand, allowed the government to introduce a set of measures aimed at cutting costs for Argentine businesses, such as raising tariffs on consumer goods to protect the local industry and lowering tariffs on capital goods to encourage investments. On the other hand, the law also granted the president the power to rule by decree for a one year period on a broad series of matters relating to the economy, including reforming the tax system and restructuring state agencies.

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<sup>91</sup> Formally, the case ended four months later, when the competition authorities passed a resolution (Res. 70/01) that gave the green light to the deal.

In most business and political circles, there was the belief that the appointment of Cavallo and the passage of the Competitiveness Act was likely to result in the introduction of important changes to the status quo. In the electricity industry, however, this suspicion was almost a certainty. The main reason for this was simple: the same day De la Rúa invited Cavallo to return to the ministry of economy, cabinet ministries were reorganised and Carlos Bastos was named Minister of Infrastructure and Housing, which included the Secretary of Energy and Mining. As everybody in the industry acknowledged, Bastos was not only the chief architect of the reform and privatisation of the electricity industry in the early 1990s but also – and particularly since he'd left office in 1996 – a strong advocate of advancing several steps forward in the deregulation of the industry<sup>92</sup>. For most people in the electricity business, therefore, the question was not if the government was going to introduce changes in the rules of the game but when it would do so and how far it would try to go.

The answer to this question came pretty soon. On June 16<sup>th</sup>, less than three months after the new economic authorities took office, the government issued presidential decree 804/01. Although this decree, which was followed shortly by Resolution 135/01, comprised just fifteen articles, the changes to the status quo it introduced were substantial and had effects on most of the industry's activities<sup>93</sup>. Among other things, it established that self-generators and co-generators would be re-categorized as MEM agents, and traders would be recognised as new participants in the MEM, with no restriction as to their marketing scope<sup>94</sup>. It also changed the methodology for

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<sup>92</sup> See Bastos (1999).

<sup>93</sup> For a detailed review of the reforms provided in the decree 804/01 see Cont and Urbiztondo (2001).

<sup>94</sup> The decree established, moreover, that an actor would be considered a trader "if he or she sells or buys energy in the wholesale electricity market on behalf of third parties, carrying out commercial activities according to the conditions." Note that in 1995 traders had already been admitted to MEM. The rules that had made this possible (Decree N° 186/95), however, established that their transactions

spot price calculation from variable production costs and seasonal declarations of costs to an energy price calculated hourly and based on the free bidding of generators and traders. Finally, it completely redefined the existing arrangements for deciding, building, and financing transmission expansions.

With the exceptions of some electricity experts who, like Bastos, believed that the best way to consolidate and deepen the achievements of the original reforms in the electricity sector was to further reduce the interference of the public sector in the industry's affairs, very few supported the new regulations. Within the industry, the main opposition was from generators and distributors. The resistance of the first group stemmed from the fact that the new rules ruled out one of the sector's strongest demands: relating capacity payments to capacity availability. Distributors, meanwhile, contended that by allowing traders to fully participate in the wholesale market, the government was raising the uncertainty facing the revenue of distribution companies and the likelihood of mis-pricing, as well as encouraging large customers to inefficiently by-pass the distribution network. This, the argument followed, would probably result in compensatingly higher prices for regulated customers<sup>95</sup>.

The fiercest resistance to the decree, however, came from the Federal Electricity Council and the provinces, including those under the control of governors who belonged to the ruling coalition. This was for two reasons. The new transmission expansion rules introduced in the decree 804/01 substantially modified some of the

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needed to have the form of commercialization in block ("en bloque"). Following the decree 804/01, this was no longer required.

<sup>95</sup> These arguments were not new. Indeed, they had already been raised by distributors every time the government expanded the definition of large users. Note in this respect that in 1992 the energy market had been liberalised only for customers with demands greater than 5MW. By the time decree 804/01 was passed, this threshold had already been reduced to 30KW. For a detailed analysis of this topic, see Urbiztondo et al. (1999) and Pollit (2002:23).

regulations that Bastos himself had established in the early 90s, which the Council and the provinces had always criticised. However, they also involved the repealing of most of the regulations that had been passed to replace them<sup>96</sup>. In contrast to the regulations originally put in place, these regulations had granted the Federal Electricity Council and, hence, the provinces, vital powers in the identification, proposal, and financing of new transmission lines. By revoking them, thus, the decree seriously compromised the Council's influence in the sector.

Second, the government introduced these changes by using a presidential decree based on the special emergency powers given to Minister Domingo Cavallo for managing the economic crisis. The law that created those powers, however, provided for the delegation of certain legislative competencies to the executive branch. And since none of the faculties referred explicitly to the capacity to legislate on the electricity regulatory framework, this created a fear among most provinces that – at instance of Cavallo and Bastos – the government might next use those powers to abolish the Federal Council itself (Littlechild and Skerk, 2004b:46).

By the time the government passed the new regulations, Bastos probably acknowledged that the Federal Electricity Council and provinces would strongly oppose the provisions of decree 804/01 and that, since the Council mirrored the political complexion of Congress, the latter would try to have a say in the process. He probably even anticipated that the Senate, where the opposition party controlled a comfortable majority, would vote in favour of revoking the decree, as it did on July 25<sup>th</sup>. What most likely he never expected, however, was that most of the legislators

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<sup>96</sup> For a detailed review and analysis of the rules governing transmission expansion in Argentina – including those instituted by decree 804/01 – see Littlechild and Skerk (2004a, 2004b).

belonging to the ruling coalition not only disliked the executive's new policy but were also seriously considering the possibility of voting against it.

In this challenging context, and with the clear intention of showing that he was ready to introduce some amendments to his proposed policy, Bastos passed a resolution (MIV 259/01) postponing the implementation of the reforms introduced in decree 804/01 and resolution MIV 535/01 for five months. It soon became clear, however, that legislators' plans did not contemplate the possibility of negotiating with the minister. On September 12, and with the overwhelming support of deputies from government and opposition parties, the lower chamber voted the bill passed by the Senate a couple of months earlier<sup>97</sup>. Although there were discussions between Bastos and the Federal Council to consider a way forward – that did not contemplate re-establishing the provisions of the decree 804/01 –, the resignation on December 19<sup>th</sup> of De la Rúa, Cavallo, and Bastos marked the end of those discussions. As in the two episodes previously discussed in this chapter, the status quo once more had prevailed.

## **7. Conclusion**

The theory presented in the second chapter offers a clear prediction about the stability of regulatory regimes defined in statutes in Argentina. In short, this prediction is that, in contrast to regulatory regimes defined in legal instruments that can be changed unilaterally by the executive following ordinary policymaking procedures, regulatory regimes defined in statutes are considerably more costly

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<sup>97</sup> Law 25.468.



changed and, hence, more stable. Put differently, in sectors where the key features of a regulatory regime are defined in a statute, policy-makers have more incentives to maintain its original policy commitments.

This chapter supports this prediction. The evidence here presented shows that, in contrast to what happened in the telecommunications sector, in the last days of 2001 the electricity regulatory regime still had the same regulatory governance than that originally put in place in 1992, and also a pretty similar structure of regulatory incentives to that established by the sector's reformers during the early years of Carlos Menem's first presidency. It shows, moreover, that this outcome was explained by the simple fact that, during the period under analysis, no change was introduced to 1992 Electricity Act – the piece of legislation where the key features of the electricity regulatory regime had been established.

Equally important, the empirical information in this chapter demonstrates that the relative stability of the electricity regulatory regime cannot be attributed to the lack of pressures in the opposite direction. That is, although the location of the status quo was generally relatively close to the preferences of the executive, there were several episodes where the latter clearly wanted to introduce changes. The evidence in this chapter shows, however, that even when this happened, the status quo prevailed. As predicted, this outcome occurred either because the executive finally opted not to advance with the changes given the high costs this alternative entailed, or because when it tried to introduce these changes other veto players - whose consent was required - stepped in and prevented them from materialising.

## **Chapter VI**

**The political economy of utility regulation in the days of crisis (January 2002 – April 2003).**

## **1. Introduction**

The theory in this thesis uses predictions about the stability of the regulatory regimes put in place in Argentina in the early 90s as particular instances of the stability of regulatory policy in general. Indeed, based on the same assumptions and rationale used to derive the hypotheses about the stability of regulatory regimes, in chapter two I have also hypothesised that, given Argentina's institutional endowment, regulatory policies in that country are likely to be more stable when they are defined in statutes than when they are defined in legal instruments that, following ordinary policymaking procedures, can be changed unilaterally by the executive – i.e. regulatory decrees, administrative decrees and resolutions.

To test the validity of this hypothesis, this chapter analyses the case of utility regulatory policy during Eduardo Duahde's administration (January 2002 to April 2003). More precisely, it analyses the stability of two regulatory policies introduced in the so-called Economic Emergency Law, which was passed by Congress in the first days of January 2002. As discussed in detail below, the law in question established that utilities' tariffs would be frozen and, in addition, they would not be pegged anymore to the dollar but would be switched to pesos at par. Second, it stipulated that, in order to adjust them to the country's new economic situation, and in particular to the devaluation of the national currency, the contracts of all the utilities and infrastructure operators in the country would be renegotiated. In this last respect, the Economic Emergency Law provided that the rules governing this process would be exclusively defined by executive branch. Implicitly, this meant that the legal instrument defining these rules would be either presidential decrees or resolutions.

Although few noticed it at the time, from the moment the Economic Emergency Law was passed, and since it was quite explicit on the new rules of the game governing utilities' tariffs, it became clear any change to these rules would need the introduction of changes to the Economic Emergency law itself. It became clear, moreover, that this would not be the case for introducing changes to the rules governing the contract renegotiation process. Accounting for this, there were two reasons. First, the Economic Emergency Law avoided any definition about these rules. Second, since the law implicitly established that these rules would be defined in presidential decrees or resolutions, any change to these rules would simply require the passage of new decrees or resolutions.

In the light of the discussion above, in subsequent pages I examine if, as predicted by the hypothesis in this thesis, there was an important difference in the stability of the rules governing the tariffs utilities charged and those governing the contract renegotiation process. More precisely, I will examine whether it was far more difficult for the executive to change the freezing and pesoification of tariffs than changing the rules governing the renegotiation of contracts.

This chapter proceeds as follows. Section 2 discusses the background to appointment of Eduardo Duhalde as president and to the passage of the Economic Emergency Law. Section 3 analyses the establishment of the rules governing the contract renegotiation process. Section 4, the longest of this chapter, reviews the issue of the stability of the new rules of the game. Finally, section 5 concludes.

## **2. Duhalde's arrival to power and the passage of the Economic Emergency Law.**

### **2.1. The appointment of Eduardo Duhalde**

In the past, it would have taken a lot less than the events of December 2001 to interrupt the constitutional order. Indeed, the eruption of a major political and economic crisis would have been a signal for members of Congress to stay at home. This time, however, legislators stayed at their desks and met in a special session to fill the power vacuum left by De la Rúa and reach a settlement of the crisis. What were the processes and mechanisms that explain this behaviour? What made the 2001 crisis different?

As argued out by Schamis (2002), the first key difference was that, despite the looting and the unrest, the army showed no desire to step in. So bleak had the economic outlook become and so bloody had the last experiment with military rule been that generals had no choice but to remain in their barracks. The second key difference was the new Constitution, especially the quasi-parliamentary innovations in it. Under the old Constitution of 1853, the order of succession was fixed, extending downward from the president through the vice-president, the head of the Senate, the leader of the Chamber of Deputies, and finally the chief justice of the Supreme Court. The electoral calendar was fixed as well. Political parties and Congress had no say in the process. In contrast, the 1994 Constitution allows Congress to deal with the incumbent president's resignation by calling an election or naming a new chief executive. In other words, in the context of a serious political crisis, the new constitution immediately delegates power to Congress.

For a brief moment, thus, Argentina turned into a quasi-parliamentary regime (Corrales, 2002:38). As claimed by Schamis (2002:91), therefore, what happened immediately after De la Rúa's resignation was the kind of high-level bargaining that is typical of parliamentary systems after an election has been held or a prime minister steps down after a vote of no confidence.

Congress initially chose Adolfo Rodríguez Saa, the governor of San Luis province. His eight days in office, however, were a brief but grotesque caricature. The Peronists chose Rodríguez Saa as a stopgap; many of them wanted fresh presidential election in March. Rodríguez Saa, moreover, lost the support of his party by showing signs of wanting to stay longer, and that of the public, by appointing officials tarred by corruption allegations. His fate was sealed by citizens of Buenos Aires who, for the second time in two weeks, unseated a president by taking to the streets to bang pots and pans in protest. At this point, two things seemed obvious. First, that no arrangement would be stable unless all the camps within the Peronist party came together to support it. Second, that the country needed time before it should be asked to face another electoral campaign.

The resignation of Rodríguez Saa forced the Peronists to rethink. Parliamentary negotiations followed and legislators finally chose Senator Eduardo Duhalde, an experienced politician who was the main leader of the largest faction in the Partido Justicialista, as the new interim president. In contrast to Rodríguez Saa, Duhalde won the support not only of Peronist legislators but also of those who belonged to the alliance that had brought De la Rúa to power a couple of years before. The new

president was elected by 262 votes, with only 21 against. Moreover, he was appointed not for two weeks but for two years.

## 2.2. The Economic Emergency Law

Upon taking office in January 2002, the main problem that the new administration confronted was containing the country's economic crisis and, along with it, quelling the tide of popular unrest. The most pressing decision that the new president had to take in this respect was what to do with the currency board that had pegged the peso to the dollar.

As the PJ candidate for president in 1999, Duhalde had embraced an anti-market rhetoric and ran on a populist platform. Almost two years later, his language and ideas did not seem to have changed. He surprised no-one when in his acceptance speech he told Congress that he would reverse the economic model in place during the 90s with another in which the state would adopt a more interventionist and protectionist approach. In Duhalde's view, this not only included confirming that Argentina would formally default on its foreign debt – as declared on December 23 by the then president Adolfo Rodríguez Saá – but also scrapping the currency peg.

Therefore, a few days after taking office, Duhalde sent Congress the Public Emergency and Exchange Regulations Reform Bill, which Congress transformed into law (25.561) almost immediately. The new legislation, henceforth known as the Economic Emergency Law, introduced a dramatic delegation of legislative powers to

the national executive and also established a radical modification of the Argentine economic policy and institutions in place for nearly 11 years.

Among other things, the law declared a state of social, economic, administrative, financial, and foreign exchange public emergency, delegating (for 180 days) to the executive branch the necessary powers to: a) revamp the financial and banking systems, as well as the foreign exchange market; b) reactivate the economy, increase employment and improve income distribution; c) create the economic conditions for sustainable economic growth consistent with public debt restructuring; and d) regulate negotiation of a new repayment schedule of outstanding obligations liabilities affected by the new foreign exchange system that would replace the currency board<sup>1</sup>. Within this framework, moreover, the law explicitly empowered the executive to establish the system that was to determine the new peso to foreign currency exchange ratio, and to issue foreign exchange regulations. It also gave way to the possibility of issuing currency in excess of the reserves held<sup>2</sup>.

In line with these modifications, the law also compelled the executive branch to adopt such measures as might be necessary to soften the effects of devaluation. The law specified that all debts under US\$100,000 would be shifted into pesos, at the one-to-one exchange rate<sup>3</sup>. In order to compensate financial institutions for potential losses

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<sup>1</sup> Even though these powers might be described as political and programmatic goals, their broad nature enabled the executive to adopt comprehensive rules and measures.

<sup>2</sup> Indeed, it stipulated that the Central bank could now purchase foreign currency with its own resources or by issuing the necessary pesos, and sell it at the prices established according to the system defined by the National Executive Branch.

<sup>3</sup> This provision applied, provided that such debts were the result of (a) purchase-money-loans, (b) loans for home construction, repair and/or expansion, (c) personal loans, (d) loans for purchasing automobiles secured by a pledge, and (e) loans granted to those individuals or legal entities that qualify as micro, small and medium-sized enterprises. Financial liabilities not meeting the aforementioned requirements were kept in their original denomination, even though the Executive branch was empowered to alter any such rules in order to adapt such liabilities to the new economic conditions.



suffered as a result of this measure, the executive was empowered to adopt compensatory measures, including the issue of guaranteed foreign currency-denominated government securities.

Also with the aim of cushioning the impact of devaluation, the contractual relation between private parties as regards the agreed-upon consideration was also radically altered. Under the law, all money payments due and payable as from the day of the enactment and arising from those contracts that were denominated (or that provided for adjustment) in US dollars or any other foreign currency were to be settled in pesos at the one to one exchange rate<sup>4</sup>. Complementing these provisions, all forms of price indexation, inflation adjustment, cost variation, and any other form of automatic adjustment of debts, taxes, prices and rates for goods, works and services were to be banned.

Finally, and particularly relevant for the purpose of this chapter, the Economic Emergency Law also established that utilities' tariffs in Argentina would not be pegged to the dollar anymore, or partly indexed to the United States inflation, but would be switched to pesos at par, and frozen. In addition, the executive was to be authorised to renegotiate the contracts of all utilities. In order to do so, the law stipulated, government officials had to consider: (1) the impact of tariffs over the competitiveness of the economy and the distribution of income; (2) the quality of the services and the investment plans, provided they were contemplated in the pertinent

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<sup>4</sup> Those payments were to be considered as a sum to be debited with a value established through negotiation within 180 days. During this term, the contracting parties were to restructure their obligations, so as to equitably share the effects of devaluation. Any differences between the amounts prepaid and such amounts would be settled once the terms were agreed upon. In case no agreement could be reached, the parties were authorized to resort to mediation and, eventually, to the appropriate courts.

contract; (3) users' interests and service access conditions; (4) the safety of the involved systems; and (5) the profitability of the companies.

### **3. The establishment of the rules governing the contract renegotiation process**

#### **3.1. Utilities' first reactions to the new rules of the game**

The pesoification and freezing of tariffs introduced in the Economic Emergency Law, of course, was strongly opposed by utility operators. They were aware that as a result of these measures, their revenue base would be denominated in pesos and, since the latter was likely to experience a sharp devaluation, it would become increasingly difficult or even impossible for them to finance their imports and service their debts – which in most cases were denominated in foreign currencies. Equally difficult, they noted, would be to raise capital abroad to cover their investments commitments, which according to the law could not be altered. They also predicted a drop in demand for their services, because devaluation was likely to result in inflation. This in turn would lead to a fall in consumer welfare<sup>5</sup>.

However, operators' reactions to the new rules of the game were far from being homogeneous. More precisely, although they all loudly opposed the unilateral pesoification and freezing of tariffs<sup>6</sup>, and demanded the prompt establishment of arrangements to compensate them for the negative impact of these measures on their

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<sup>5</sup> Chisari and Ferro (2005) and Urbiztondo (2003) analyse in more detail the technical aspects of these challenges.

<sup>6</sup> See *Ambito Financiero* 04/01/02.

finances<sup>7</sup>, there was a first group that immediately threatened to initiate legal actions and, if necessary, to leave the country<sup>8</sup>. A second group, meanwhile, adopted a less confrontational approach and called for an immediate and comprehensive renegotiation of contracts. In the view of this second group, the country's economic conditions demanded, among other things, the prompt establishment of new (and more relaxed) investment requirements and quality standards, as well as extensions in licenses and concessions<sup>9</sup>.

The government did not seem to be touched by operators' demands and threats. In a clear intent to delay the starting of negotiations, all the top positions in the relevant Secretariats (i.e., communications, energy, and transport) were left vacant, and it was not even clear which would be the location of these secretariats within the government structure<sup>10</sup>. Adding to this, and despite the growing pressures from the firms and foreign governments<sup>11</sup>, important officials made public their view that allowing any type of tariff increases in the short term would almost certainly trigger an inflationary spiral in all the prices of the economy. This, they claimed, was the last thing that they were willing to tolerate<sup>12</sup>. Finally, and to make things even worse, some government officials began to spread the rumour that part of the establishment,

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<sup>7</sup> In this respect, the alternatives most heard during those days included: the launching of an exchange-rate insurance to allow them to get the dollars (at the one-to-one exchange rate) they needed to send abroad, and the set up of a new tariff scheme adjusted to local inflation. See *Ambito Financiero* 03/01/02 and 07/01/02, and *Clarín* 04/01/02 and 05/01/02.

<sup>8</sup> See *Ambito Financiero* 03/01/02 and 07/01/02, and *Clarín* 05/01/02.

<sup>9</sup> See *La Nación* 06/01/02 and 07/01/02, and *Ambito Financiero* 07/01/02

<sup>10</sup> See *Clarín* 16/01/02.

<sup>11</sup> The Spanish Minister of Economy, Rodrigo Rato, in a clear reference to the freezing and peso-ification of utilities' tariffs, had claimed before a commission of the European Parliament that "if the Argentine government wanted to regain the confidence of the investment community, it should have changed the rules of the game with the consent of all relevant stakeholders". In a similar vein, the French Minister of Foreign Relations, Huber Vedrine, formally demanded his Argentine counterpart an effort to secure "that French companies have the opportunity to continue investing in Argentina". See *Ambito Financiero* 07/01/03 and *La Nación* 08/01/02.

<sup>12</sup> See *Clarín* 05/01/02.

and particularly banks and utilities, were plotting against the executive's economic plan in order to force it to institute the complete dollarisation of the economy<sup>13</sup>.

The government's initial inflexibility towards the demands of utilities did not last long, though. Press information revealed that Argentina's access to international aid would be denied if the government refused to commit itself to secure an adequate treatment to the foreign investments in privatised firms<sup>14</sup>. Needless to say, even if the anti-utilities rhetoric and measures proved to be very popular in the public opinion<sup>15</sup>, declining fresh money from abroad was something that the new authorities could not afford. By mid January, the government announced that within the next few days, a commission would be created within the Ministry of Economy charged with renegotiating contracts with utilities.

This news, however, brought little comfort to utilities. On the one hand, they were too vague. Indeed, the government did not specify how the commission would be composed, what would be its powers, with which procedures and deadlines it would work, etc. On the other hand, government officials kept on insisting that under no circumstance would the renegotiation process result in a reverse of the measures most questioned by utilities: the pesoification and freezing of tariffs<sup>16</sup>.

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<sup>13</sup> See Clarín 11/01/02.

<sup>14</sup> See Ambito Financiero 09/01/02.

<sup>15</sup> According to an opinion poll carried out in those days by Julio Aurelio & Asoc., 52% of the public agreed with the prohibition to increase the tariffs of utilities. See La Nación 06/01/02.

<sup>16</sup> On January 24<sup>th</sup>, the government stopped the seasonal increase in electricity tariffs, which was contemplated in the 1992 Electricity Act and which should have been implemented from February 1<sup>st</sup>.

### 3.2. The setting up of the contract renegotiation process' legal framework

As Duhalde's first month in office ended, the country's economic outlook continued to worsen. His government then had no choice but to back away from flirting with unorthodox measures and to move closer towards adopting a "coherent" plan urged upon it by the IMF and sundry outsiders, including the US government. On February 3, Jorge Remes Lenicov, the Minister of Economy, announced an important shift in the government strategy. The new economic plan involved not only floating the peso but also transforming a largely dollarised economy into one that would work in pesos<sup>17</sup>. In this sense, it was decreed that all dollar loans – and not only those of less than 100,000, as provided in the Economic Emergency Law – would be turned into pesos at par. Moreover, breaking the president's original promise to repay dollar savings in dollars, it was established they would be paid back in pesos, converted at an exchange rate of 1.4 pesos to the dollar and indexed to inflation. To cover the mismatch in the treatment of deposits and loans (around US\$ 20 billion), the government announced that the banks would be compensated with government bonds.

The official hopes were that the plan would stop the country's economic and political implosion and lay the foundation for recovery. Critics, however, were far less optimistic. In their view, the new measures were too generous to debtors at the expense of creditors and tax-payers. They also argued that their success required both a monetary discipline and a fiscal austerity that the new government could hardly deliver for several reasons. First, government officials had already rejected the possibility of introducing much needed reforms in the central government's and the

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<sup>17</sup> Following the passage of the Economic Emergency Law the government had instituted an officially manipulated dual exchange rate.

provinces' finances. Second, the Central Bank lacked both genuine independence and an inflation target. Third, the predictions in the new budget bill that the executive submitted to Congress looked too optimistic<sup>18</sup>. In short, their prediction was that the peso would continue to depreciate and, as a result, inflation would take off.

The pessimism of some observers regarding the prospects of the government's plan was also grounded on political considerations. In their view, although the new president could count on the support in Congress of most of his party and much of the opposition, this situation was not likely to last long. Opposition legislators, and in particular those who belonged to the Alianza, had already announced that, despite the fact they would assist the new government in finding a way out of the convertibility regime, their support would not be unconditional. To a certain extent this was understandable: it was not their government but that of their traditional rivals.

Things did not look much better in the Peronist camp. It was no mystery that the arrival of Duhalde to the presidency had intensified the internal conflicts within this party. Because Duhalde was a declared enemy of former President Carlos Menem, nobody expected the latter to encourage his followers in Congress – around fifteen in both chambers – to make things easy for the new authorities. There was also a group of Peronist provincial governors with presidential ambitions who would hardly see the point of associating their political prospects with that of an administration with pretty low chances of succeeding<sup>19</sup>.

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<sup>18</sup> It forecasted inflation of 15% in 2002, a 5% fall in GDP and a fiscal deficit of 3 billion pesos.

<sup>19</sup> The governors of the provinces of Cordoba and Santa Cruz – Jose Manuel de la Sota and Nestor Kirchner, respectively – were the most salient figures of this group.

To complicate things even further, President Duhalde still faced the noisy hostility of much of the middle class, which had helped to bring down two of his predecessors, and he had been embroiled in a political battle against the Supreme Court, which had declared the freezing of deposits unconstitutional<sup>20</sup>.

Of course, the utilities were among those who distrusted the new economic plan. Like most analysts, they believed that inflation was likely to burst and, with their tariffs frozen, the problems in their finances would worsen to a point of no return. Therefore, they increased their demands on the government to speed up the renegotiation process.

Faced with these pressures, by the end of the first week of February the president finally received the top representatives of several foreign firms<sup>21</sup>. A week later, he went one step further and signed a presidential decree (293/02), in which he instituted the key features of the framework within which the renegotiation process would finally take place. Among other things, the decree established that, in the following 120 days, the Minister of Economy would have to submit a proposal to the president that was to comprise the renegotiated contracts and licenses of all the utilities and infrastructure operators under the national government purview. Also, a Contract Renegotiation Commission would be created in order to assist and advise the minister on the preparation of the proposal. In this regard, the decree provided that the commission's composition would be decided by the president within the following 30 days, that it would be presided by the Minister of Economy, and that it would be the latter's responsibility to institute the commission's organizational and operative rules.

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<sup>20</sup> That prompted Duhalde's Congressional allies to start impeachment proceedings against the court.

<sup>21</sup> See La Nación 07/02/02.

Finally, it established that both the special committee created in Congress to follow up the implementation of Economic Emergency Law and the *Comisión Bicameral de Reforma del Estado y Seguimiento de las Privatizaciones* would have to be informed about the renegotiation proceedings and they would be allowed to issue non binding opinions.

Adding to this, on February 26, president Duhalde signed another decree (370/02) in which it was established that, in addition to the Minister of Economy, the Contract Renegotiation Commission would be composed by: a coordinator general and a cabinet of four advisors (who could be removed discretionally by the minister); the Secretary of Legal and Administrative Affairs of the Ministry of Economy; the Secretaries of Energy, Transport, Public Works, Communications, and Competition Affairs; a representative of the national Ombudsman; and a representative of the consumer associations.

During the first days of March, finally, the Minister of Economy passed a resolution that set the starting date of the negotiations (March 18<sup>th</sup>), and also demanded each of the firms that would take part in those negotiations to submit a report to the Renegotiation Commission with a detailed description of the effects that the Economic Emergency Law had on their finances and a proposal for adapting their contracts and licenses to the new economic scenario<sup>22</sup>.

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<sup>22</sup> Resolution ME 20/2002.



#### **4. Utility regulation under the new rules of the game**

##### **4.1. In the beginning all was confusion**

The setting up of the rules that would govern the contract renegotiation was, in principle, good news for the companies. In fact, since the day after the Economic Emergency Law had been passed, they had been demanding the establishment of those rules. The truth, however, is that when the contract renegotiation process started, utilities had other, more important concerns.

The country's economic prospects looked darker than ever. On March 21<sup>st</sup>, during a presidential summit in Mexico, President Duhalde was notified that Argentina should not expect to get any sort of external aid for at least the following three months<sup>23</sup>. Following this warning, and despite the fierce intervention of the monetary authorities, the peso was soon trading close to 3 to the dollar.

In addition, and as the economic crisis worsened, the honeymoon between the executive and its supporters in the Legislature was coming to an end. Good evidence of this was that in the first days of March, the executive decided to veto some of the provisions of the budget bill voted by Congress, and the increasing difficulties of the executive in convincing legislators to pass the reforms demanded by the financial community and, in particular, by the International Monetary Fund. These reforms included, among other things, the repeal of two populist anti-bank laws and watertight

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<sup>23</sup> See Cronista 22/03/02.

measures to cut public spending - particularly by provinces<sup>24</sup>. Adding to this, the same day the contract renegotiation process started, legislators from the ruling party announced that, despite the executive's opposition, they were considering the introduction of a bill that established that the decisions of the *Comisión Bicameral de Seguimiento y Control de las Privatizaciones* on the renegotiation of contracts would be binding<sup>25</sup>.

To make things even worse, on March 24<sup>th</sup>, Metrogas (the largest gas distribution company in the country) announced the default on its US\$ 420 million debt<sup>26</sup>. Although the government's first reaction was to claim that this was an isolated case, and, most likely, part of the firm's strategy in the contract renegotiation process<sup>27</sup>, in the following days it became clear that this was a rather optimistic expectation. In fact, the steps of the gas distributor were soon followed, among others, by CTI (an operator of mobile telephony), Central Puerto (an electricity generator), Telecom Argentina (one of the two operators of basic telephony), and Aguas Argentinas (the water and sewerage provider in the Capital Federal and most of the greater Buenos Aires).

In all these cases, the justification provided by the firms was fairly similar. Briefly, they argued that they were not only highly indebted but also that their debts had not been modified by the pesoification of debts introduced earlier in 2002<sup>28</sup>. Defaulting,

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<sup>24</sup> See Cronista 22/03/02.

<sup>25</sup> See Cronista 19/03/02.

<sup>26</sup> Metrogas' most important shareholders were British Gas and Repsol-YPF. According to its representatives, only 10% of the company's debt had been contracted with local creditors and, thus, was converted to pesos. The remaining 90% had been contracted abroad and, consequently, was nominated in foreign currencies. See La Nación 26/03/02, and Clarín 27/03/02.

<sup>27</sup> See La Nación 26/03/02.

<sup>28</sup> With liabilities close to US\$ 3.2 billion, Telecom (controlled by France Telecom and Telecom Italia) was the biggest corporate debtor in Argentina. In 2002 its financial obligations amounted US\$ 1.2

they claimed, was then the only alternative left to them in order to preserve the cash flow required for securing the provision of services. What very few admitted in public, nevertheless, was that another critical element in the decision to renege on their financial obligations was the belief that, contrary to the government's expectations, the economy would continue to decline and that, despite the advances made in the contract renegotiation process, the government had no real intention of introducing significant changes to the status quo.

Several events contributed to this scepticism. In the telecommunications sector, for instance, the newly appointed secretary – the fourth since the beginning of the year – was someone with no prior experience in regulatory matters<sup>29</sup>. During the first days of April, moreover, the economic authorities passed a resolution (38/2002) regulating the provisions of the Economic Emergency Law. Among other things, this resolution established the suspension of all tariff revision processes and placed an order on all bodies and agencies of the public administration to refrain from adopting decisions that could affect prices charged by utilities in any way. It was pretty obvious that the objective of these measures was interrupting the seasonal reviews of electricity and gas tariffs which, according to the legislation introduced at the time of privatization, had to be carried out every three months in the electricity sector and twice a year in gas. Although some days later, in response to operators' fierce opposition, the Ministry of Economy passed another resolution (53/2002) allowing those reviews, few believed that this policy reversal reflected a sincere change of preferences.

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billion. In the case of CTI, its debt amounted almost US\$ 1 billion. Aguas Argentinas (owned by Suez-Lyonaise des Aux y Aguas de Barcelona) and Central Puerto's financial obligations, meanwhile, were close to US\$ 670 and 306 million, respectively. See Cronista 19/03/02, 22/03/02, 01/04/02, 02/04/02, and 03/04/02; and La 03/04/02, and 10/04/02.

<sup>29</sup> See Cronista 09/05/02.

## 4.2. A new start?

Confirming the worst fears of the utilities, in the last week of April, once again, the country was staring at an economic and political abyss. As shown by an opinion poll published those days, there was an increasingly popular belief that president Duhalde would be unable to finish his mandate and, furthermore, that another episode of popular unrest, similar to the one that preceded De la Rúa's fall, was around the corner<sup>30</sup>. On April the 23<sup>rd</sup>, by jibbing at a plan to convert frozen bank savings into ten-year government bonds, Congress sealed the resignation of the Minister of Economy, who a week earlier had returned empty-handed from meetings with IMF officials and G8 finance ministers.

In the light of these events, the president showed signs of wanting to abandon the search for an IMF deal<sup>31</sup>. Before that happened, however, the provincial governors of Duhalde's own party stepped in and forced him to agree a 14-point plan, which included most of the measures demanded by the Fund<sup>32</sup>. The governors, moreover, forced the president to agree with them on a new economic minister. After turning down the president's first choice, the man finally appointed, on April 26<sup>th</sup>, was the ambassador before the European Union, Roberto Lavagna.

The appointment of the new minister and the promises comprised in the governors' plan seemed to bring fresh air to a government whose mishandling of devaluation did

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<sup>30</sup> The opinion poll was carried out among businessmen, diplomats, academics, and analysts by the Centro de Estudios Nueva Mayoría. According to its results, 62% of respondents believed that president Duhalde would end his days in office before the expiration of his term, while around 78% responded that another episode of social unrest was likely to happen in the near future. See Cronista 15/04/02.

<sup>31</sup> See Cronista 24/04/02.

<sup>32</sup> See Cronista 25/04/02.

much to increase its costs. In fact, a few days later the IMF agreed to roll-over a \$130 million payment due, and the Inter-American Development Bank revamped loans to the country totalling US\$ 690 millions. Congress, meanwhile, began to take steps to put in place some of the preconditions demanded by the Fund to sign a new deal. In addition, most provincial governors ratified their promise to cut their deficits by 60% and to cease printing their own quasi-currencies to pay their workers and meet other obligations.

Despite the fact that during those days another couple of firms had defaulted<sup>33</sup>, and that the new economic plan made no reference to utilities problems, operators agreed with the plan's spirit and most of the policy initiatives that it comprised. Also contributing to their enthusiasm was the appointment as Secretary of Economic Policy of someone highly familiar with their problems<sup>34</sup>. For some operators, this choice was not accidental. In their view, it was a good indicator that, thanks to the pressure of international financial institutions and foreign governments, something was about to change in the government's strategy towards them.

Lavagna's first decisions in office seemed to confirm those optimistic expectations. Indeed, a week after his appointment, the Secretariat of Energy authorized a 50% seasonal increase in electricity wholesale prices, establishing that part of this increase would be financed through a 15% increase in residential electricity bills. More precisely, it was established that in the period between May 1<sup>st</sup> and July 31<sup>st</sup>, the

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<sup>33</sup> These companies were Transener (an electricity transporter controlled by the local PeCom and the British National Grid) and Ciesa (which, together with Enron, controlled the gas transporter Transportadora Gas del Sur). Their debts were US\$ 470 and 220 millions, respectively. See Cronista 24/04/02.

<sup>34</sup> The man chosen was Enrique Devoto, who had been in the ENRE's board of directors since its creation in 1993.

wholesale price of one MW/h would increase from \$20,74, the price in place since November 2001, to \$30.

Although in US dollars the new wholesale electricity price was less than one-third of the price before devaluation – and considerably less than the price in place in other countries – the decision to adjust electricity prices triggered strong critiques. In the view of consumer associations, for instance, not only it was illegal because it contradicted the freezing of tariffs established in the Economic Emergency Law but also because it represented a clear breach of the government’s promise to maintain the new status quo. Equally negative was the opinion of a vast majority of legislators, who struck back on May 9<sup>th</sup> and voted a bill in the lower chamber which stipulated that, for as long as their contracts were renegotiated, utilities would not be allowed to disconnect those customers who could prove their inability to pay<sup>35</sup>.

The critiques and reprisals, however, did not seem to change the new economic authorities’ plans. On May 14<sup>th</sup>, Lavagna met with most of the utility operators. In that meeting, the first between a Minister of Economy and the companies since the change of the monetary regime, the firms were told that although the government’s top priority was clinching an agreement with the IMF, finding a solution to the utilities’ problems was also in the new economic team’s agenda. The minister assured operators that if the bill recently approved in the lower chamber passed the filter of the Senate, he would suggest the president vetoing it<sup>36</sup>. Moreover, he guaranteed them that, despite some recent changes in its composition<sup>37</sup>, he had no intentions to

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<sup>35</sup> See La Nación 10/05/02.

<sup>36</sup> See Cronista and La Nación 15/05/02.

<sup>37</sup> One of Lavagna’s first decisions was to change the coordinator of the Renegotiating Commission. In the place of Jose Barbero he appointed Alfredo Biagosch.

interfere with the work of the Renegotiation Commission, which by that time was already at the stage of analysing the information provided by operators as well as their proposals<sup>38</sup>. On the contrary, he promised, in order to foster the commission's capacities he would now allow sectoral regulators to participate in its proceedings<sup>39</sup>. Last, but not least, the minister ensured electricity generators that the seasonal increases recently introduced would not be reversed, and announced that by the end of May a similar adjustment would take place in wholesale gas prices<sup>40</sup>.

#### 4.3. Not all that shines is gold

After the meeting with the minister, and despite the fact their problems were as serious as before, utilities thought that they had a reason to be less pessimistic about their future. As discussed in the subsequent pages, however, they soon realised that one swallow does not make a summer.

On May 15<sup>th</sup>, the Secretary of Economic Policy revealed that the government would propose the utilities a two months extension of the deadline originally established for the completion of the renegotiation process<sup>41</sup>. For operators this announcement was like a bucket of cold water. Indeed, it not only involved a major change in the rules of the game of the contract renegotiation process but also it seriously challenged the credibility of the promises made to them by the minister just a couple of days before –

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<sup>38</sup> There was a rumour that the new economic team was considering extending the Commissions deadlines by three months.

<sup>39</sup> Several days before, it was announced that the Secretariat of Energy had opened an open contest for filling the vacant positions in the board of directors of the gas and electricity regulatory agencies. By that time, there were 3 of those positions in ENRE and 4 in ENARGAS. See La Nación 09/05/02.

<sup>40</sup> It should be noted that the same day he took office, Lavagna instructed the gas regulator to reject the adjustment proposals made by gas generators. See La Nación 26/04/03.

<sup>41</sup> See Cronista 16/05/02.

recall that one of these promises was to respect the schedule originally set up. Moreover, they were aware of the fact that postponing the deadline would almost certainly involve two more months without significant changes to the status quo.

Utilities acknowledged, nevertheless, that they did not have much room to impede the postponement. Indeed, since the Commission's original schedule had been established in a presidential decree, if the government wanted to introduce amendments to that schedule it could do it by simply signing another decree.

For some companies, however, this did not imply that they should wait for things to happen. Before doing so, they believed, it was worth trying to negotiate and obtain something in exchange. On May 15<sup>th</sup>, thus, they proposed the government to allow a general increase in tariffs on account of the increases that would necessarily result from the contract renegotiations<sup>42</sup>.

As it has already been discussed in this chapter, this was not the first time that utilities proposed an adjustment of their tariffs. For some government officials, however, there was something new in the proposal in question: for the first time the companies were trying to install the belief that the natural outcome of the contract renegotiation process would be an increase of tariffs. And this, they judged, was something that the government should not allow to happen. Following their reasoning, therefore, the government's response to the proposal should be much more categorical than a routine announcement confirming that no decision regarding the adjustment of tariffs would be made before the conclusion of the contract renegotiation process.

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<sup>42</sup> See La Nación 18/05/02



The herald chosen in this occasion to pass the message was the Renegotiation Commission. On May 22<sup>nd</sup>, the body made public a provisional report on the case of one of the companies, whose concession contract was subject to renegotiation: Aguas Argentinas<sup>43</sup>. In it, and among other things, the commission contended that its analysis of the case suggested that, contrary to what the company had been demanding, an increase in tariffs was not needed in order to continue with a normal provision of the service. The commission stated that, despite its problems, the company should not experience major difficulties in covering its operational costs and, therefore, the government should not allow it to suspend any of its contractual obligations (notably, investments)<sup>44</sup>.

As soon as they took notice of the commission's report, many analysts suspected that the government's message to the companies was not simply that the outcome of the renegotiation process was still open. In their view, the report also indicated that it was not in the government's plans to compensate them for the effects of the measures introduced in the Economic Emergency Law. Utilities, of course, shared this impression and acted accordingly.

As May ended, at least five companies had already presented lawsuits against the Argentine government before the International Centre for the Settlement of Investment Disputes (ICSID), an international arbitration tribunal linked to the World Bank<sup>45</sup>. Following the publication of the Renegotiation Commission's report, it

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<sup>43</sup> The firm was the water and sewerage provider in Capital Federal and greater Buenos Aires.

<sup>44</sup> See Clarin 23/05/02 and 24/05/02

<sup>45</sup> These companies were: CMS Energy, LG&E, Metrogas (British Gas), Camuzzi Gas del Sur and Camuzzi Gas Pampeana (Camuzzi International), and Sempra Energy International. According to

became known that there were many others seriously considering taking the same course of action<sup>46</sup>. Adding to this, on the last week of May the body that grouped electricity generators, Ageera, initiated legal action against the Secretariat of Energy before a local court demanding the annulment of the pesoification of their incomes<sup>47</sup>. It was the first time since the adoption of the Economic Emergency Law that operators implemented their threat to judicialise the conflict.

Whether because of these pressures or simply because the government realized that the companies had misunderstood its true intentions, on May 28<sup>th</sup> the Vice Minister of Economy revealed that the government had decided that, starting from June, gas, electricity, and international calls' tariffs would be increased and that these increases would be on account of the increases that would necessarily result from the contract renegotiation process. He also announced that the increases in question would not need the approval of Congress and that the government was also contemplating adopting other measures, such as the cancellation of the debts that some utilities had acquired to the Argentine state<sup>48</sup>. He warned, nevertheless, that the conclusion of the renegotiation process would probably have to wait until an agreement with the IMF was clinched.

Utilities, naturally, were delighted with the Vice Minister's words. Indeed, although they confirmed their suspicion that the deadline for the conclusion of the renegotiation process would be postponed – the government was calculating that it would not be

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ICSID's procedures, once a company presents a lawsuit against a country, a six-month negotiation period between the parties follows. If no agreement is reached during that period, the company can demand an international arbitration.

<sup>46</sup> See Cronista 24/05/02.

<sup>47</sup> The pesoification of generators' income had been introduced by means of two resolutions (Re. SE 2/2002 and Re. SE 8/2002) in the second week of March.

<sup>48</sup> See La Nación, Clarín, and Cronista, 29/05/02.

able to come to an agreement with the IMF before October or November – they seemed to dispel the fear that the government had no serious intentions to introduce changes to the status quo. The question that naturally arose among the companies, nevertheless, was whether this was another of those announcements that would be reversed a few days later or, on the contrary, the government had finally committed itself to address utilities’ problems.

Unfortunately for the companies, it would not take much time until they knew the answer to this question. On May 29, following the instructions of President Duhalde, Mr. Lavagna publicly rejected the possibility of any imminent change in utilities’ tariffs<sup>49</sup>. The only justification he provided for this was that it was impossible to make a decision on this issue before sealing an agreement with the international financial institutions and, in particular, with the IMF.

Yet, this was not the only bad news for the companies. On May 29 Alfredo Biagosch the coordinator of the Renegotiation Commission, resigned. Although Biagosch was among those who strongly opposed the introduction of tariff adjustments, utilities regretted his departure because they feared that it would be used by the government as a justification for introducing further delays in the renegotiation process. In the light of future events, these suspicions were justified. The government waited three long weeks to appoint a new coordinator<sup>50</sup>.

Furthermore, on June 12, the lower chamber passed a bill establishing that utilities would not be allowed to interrupt the provision of services to institutions involved in

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<sup>49</sup> See La Nación, Clarín, and Cronista, 30/05/02.

<sup>50</sup> Decree 1040/02. The person chosen was Miguel Sanguinetti.

security, education, or social assistance activities, even if these defaulted in payment<sup>51</sup>. In the eyes of the companies, this equalled to obliging them to provide their services to those institutions for free.

Finally, on June 26, four days after the deadline for the completion of the renegotiation process had expired, the president signed a decree which, amending the provisions of the decree 293/02, established that all operators who presented claims before another body beside the Renegotiation Commission would be excluded for the renegotiation process<sup>52</sup>. The government's implicit objective with this new legislation was pretty clear: putting an end to the waterfall of claims presented before the Centre for the Settlement of Investment Disputes.

#### 4.4. The firsts attempts to authorize tariff increases

On July 2<sup>nd</sup>, unexpectedly, Duhalde announced that the presidential elections would take place six month earlier than the date originally scheduled, and that the new president would be taking office in May 2003. Although his officials denied suggestions that the IMF had demanded this as a condition for clinching an agreement, the fact was that a few days after the announcement was made, the IMF let the country delay a nearly \$1 billion debt repayment due that month.

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<sup>51</sup> On that same date, the chamber of deputies also voted a bill establishing a much more flexible scheme for refinancing the debts of utility consumers. The bill, moreover, stipulated that those consumers whose service had been cut due to lack of payment would have to be reconnected free of charge. Finally, it obliged utilities to accept all the bonds and certificates issued by the national state and the provinces – which in some cases were trading at half of their nominal value. See La Nación, 13/06/02 y Clarín 13/06/02.

<sup>52</sup> Decree 1090/02.

Duhalde's decisions to advance the date of the presidential elections and to shorten his term in office were well received among utilities. In their view, these decisions revealed that the government was desperate to clinch an agreement with the IMF and, therefore, that it would have to accept some of the latter's demands. However, few dared to predict if the adjustment of tariffs would be on the list of demands that the government was ready to look at.

It did not take much time for the companies to find out that the issue of tariffs was indeed on that list. On May 6<sup>th</sup>, and at the instance of the Minister of Economy, the president signed a decree vetoing the law in which legislators had established that utilities would not be allowed to interrupt the provision of services to institutions involved in security, education, or social assistance activities<sup>53</sup>. Two days later, moreover, Mr. Lavagna announced that, starting in August, the executive would allow utilities to introduce a staggered adjustment in tariffs<sup>54</sup>.

The news about an imminent increase in utilities' tariffs triggered strong reactions. Indeed, the same day the minister announced this, the national ombudsman resigned from the Renegotiation Commission, blaming the government of giving up to the pressures of the companies, foreign governments, and international financial institutions<sup>55</sup>. Similar allegations, meanwhile, were raised by consumer associations, who threatened to challenge the increases in the courts – on the grounds that they

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<sup>53</sup> Decree 1172/02. Surprisingly, one of the arguments used by the executive to justify the veto was that the bill voted in Congress violated the provisions of the concession contracts. According to the executive, in those contracts consumers were not categorized according to the activities they were involved but according to their consumption characteristics. Accompanying the veto, however, the president signed another decree (1174/02) in which it was established that utilities could interrupt the provision of services to institutions involved in security, education, or social assistance activities but only after giving them a 30-days-notice.

<sup>54</sup> See Clarín and La Nación, 09/07/02.

<sup>55</sup> See Clarín 09/07/02.

violated the provisions of the Economic Emergency Law and that no public hearings had been carried out to discuss them and a great number of legislators —, and a great number of legislators, who insisted that any change to the status quo had to be discussed in Congress<sup>56</sup>.

These critiques did not seem to affect the minister's plans. On July 18<sup>th</sup>, Lavagna confirmed that the decision to adjust utilities' tariffs had already been taken. He stated, moreover, that maintaining the freeze on tariffs would equal to "hiding the dirt under the carpet" and that it would force a future administration to increase tariffs all of a sudden. In addition, he also pointed out that the adjustments that the government was about to authorize were the only way to avoid a rapid degradation of utilities' services<sup>57</sup>.

The discussion soon turned on to how the increases would be introduced. In this respect, the economic team had already made it clear that, given the unpopularity of the measure and the increasing lack of support that the executive was facing in the Legislature, the adjustment would have to be implemented by means of a presidential decree. In their view, moreover, it would also be necessary to minimize the politisation of the debate that would probably follow the presentation of their adjustment proposal. They thus supported carrying out the discussion on the issue at stake by means of a consultation document rather than through public hearings.

Not surprisingly, consumer organizations and most legislators strongly opposed these plans. They insisted that any change to the status quo would need to be discussed with

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<sup>56</sup> See Clarín and La Nación, 13/07/02.

<sup>57</sup> See Clarín and La Nación, 19/07/02.

all interested parties in public hearings and that the government should not by-pass Congress. What few expected, however, was that immediately after the economic team revealed how they would introduce the changes, some important government officials – who had reluctantly agreed to the plan of uplifting the freeze on tariffs – also raised similar claims<sup>58</sup>. By the first week of August, and as the disagreements within the executive seemed to increase, the general impression among observers was that the likelihood of an adjustment of utilities’ tariffs before the presidential elections was getting more and more remote<sup>59</sup>.

On August 9<sup>th</sup>, however, Mr. Lavagna decided to grasp the nettle and, unexpectedly, he sent a letter to all the companies involved in the contract renegotiation process. Somehow changing the rules of the game in place, this letter notified all the participants in the contract renegotiation process that, within the next five days, each of them would have to inform the Renegotiation Commission the precise tariff “emergency adjustment” they were demanding. It specified, moreover, that once those demands were analyzed by the Commission and before any decision in this respect, utilities’ demands would be discussed with all interested parties in public hearings. No reference was made to the role of Congress in that process.

These seemed to be good news for the companies but forced them to face a difficult dilemma. As they publicly admitted, if they presented a realistic demand, the government would probably consider it exaggerated. In such scenario, the companies evaluated, the government might use the general public discontent against them – which would probably increase in the light of these demands – and once more freeze

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<sup>58</sup> The most prominent figure among these officials was the Cabinet Chief, Alfredo Atanasof.

<sup>59</sup> See La Nación 07/08/02.

all negotiations<sup>60</sup>. If, on the other hand, they opted for cooperating with the government and requested what they believed that the government wanted them to demand, the prospects did not look much better<sup>61</sup>. First, both their shareholders and creditors would certainly consider that request insufficient. Second, even if the government granted them such an increase, their leverage in future negotiations with the authorities would most likely be damaged. Indeed, it would probably be very difficult for them to convince the government about the need of further adjustments or of advancing in the contract renegotiation process<sup>62</sup>.

The economic team took notice of the dilemma that utilities were facing and, at the last minute, decided to do something to “persuade” the companies to choose the cooperative alternative. On August 16<sup>th</sup>, thus, Lavagna signed the resolution ME 308/02 that, among other things, softened the provisions of the presidential decree 1090/02. As discussed above, this decree had established that those operators who presented claims before another body but the Renegotiation Commission would be automatically excluded from the renegotiation process. Furthermore, the resolution 308/02 established that the government would not present claims or impose fines against those operators that could prove that, due to the impact of the measures provided in the Economic Emergency Law, they could not comply with the non-

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<sup>60</sup> The results of an opinion poll carried out during the first week of August by IBOPE supported this hypothesis. According to it, and despite the fact that most respondents declared they were satisfied with the quality of the service provided by utilities, 51% of them supported their re-nationalisation. During the 90s, those who favoured that alternative never went beyond 25%. See La Nación 15/08/02.

<sup>61</sup> Government officials had already revealed that the increase they would authorise would not exceed 10%.

<sup>62</sup> See Clarín 14/08/02 and 17/08/02, and La Nación 15/08/02.



essential investments or the quality standards specified in their licenses or concession contracts<sup>63</sup>.

The minister's gesture, despite being another change in the rules of the game governing the contract renegotiation process, was appreciated by utilities. It soon became evident, however, that this would not be enough to convince them to submit adjustment demands in line with the government's preferences. Proof of this was that half of the companies decided to shift the responsibility of quantifying the adjustment to the government and, instead of demanding a precise adjustment figure, they only submitted a general assessment of the losses that, in their view, the Economic Emergency Law and the crisis had caused on their finances<sup>64</sup>. The other half, meanwhile, did present a precise tariff adjustment request. Their demands, however, were far beyond the figure that, in the view of observers, the government was expecting the companies to ask. In fact, according to press information, none of the companies within this second group requested an adjustment of less than 24%. In some extreme cases, the figure demanded reached 173%<sup>65</sup>. The majority of operators, however, demanded an increase similar to the inflation in retail prices, which at that time, and according to the figures generated by the National Institute of Statistics and Censuses (Indec), was close to 35%<sup>66</sup>.

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<sup>63</sup> Other provisions of the resolution ME 308/2002 further regulated the rules governing the contract renegotiation process and, in particular, they expanded the powers that the Renegotiation Commission would have vis-à-vis sectoral regulators in that process.

<sup>64</sup> See Clarín 18/08/02.

<sup>65</sup> See Clarín 17/08/02 and 24/08/02.

<sup>66</sup> A good number of them also demanded a cut in the taxes that consumers paid with every utility bill. As noted by the companies, this demand was aimed at cushioning the impact of the proposed adjustments. See La Nación, 21/08/03.

These demands from the utilities were not well received by the government. President Duhalde, for example, claimed that expecting tariff increases of 60% or 70% was completely “absurd” and “foolish”<sup>67</sup>. In a more diplomatic fashion, Minister Lavagna stated that operators’ demands were “excessive” and that the government would only authorise increases below 10%. In contrast to what would have happened in previous months, however, the companies’ requests did not trigger a reprisal by the government. On the contrary, given its need to clinch an agreement with the IMF, the government had no option but to ignore the companies’ rebuff and reaffirm its commitment to address utilities’ problems.

Within this context, on August 14<sup>th</sup>, the Ministry of Economy passed a resolution comprising a measure that had been demanded by operators almost since the date the contract renegotiation process started: the authorization to request the confidentiality of all the commercially sensitive information and documentation that they submitted to the Renegotiating Commission<sup>68</sup>. Two weeks later, moreover, the economic authorities set up a schedule for the public hearings in which they intended to discuss the announced adjustments<sup>69</sup>. These hearings were to begin on September 25<sup>th</sup> and would continue until the first week of October. It was also decided that, once the consultations ended, the Ministry would have eight working days to come out with a decision<sup>70</sup>.

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<sup>67</sup> See Clarín 18/08/02.

<sup>68</sup> Resolution M.E. 317/2000.

<sup>69</sup> According to that schedule, the first public hearings would be carried out to discuss the introduction of emergency tariff adjustments in the electricity sector. The introduction of adjustments in the telecommunications sector, meanwhile, would be the object of the last hearing. See La Nación 27/08/02.

<sup>70</sup> This announcement triggered the resignation of Sanguinetti as Coordinator of the Renegotiating Commission and his replacement by Gustavo Simeonoff. The later was the fourth coordinator since the creation of the Commission. According to press information, the resignation of Sanguinetti was a direct consequence of the refusal of the sectoral regulators to chair the hearings. And that refusal, also according to the press, was because regulators were unhappy with the secondary role that the

Complementing these measures, on September 16th, the president signed the decrees 1834/02 and 1839/02. Reversing what had been established at the time of privatization in the early 90s, the first stipulated that the contracts of those operators that had entered the process of reorganization (*concurso preventivo de acreedores*) or had filed a liquidation petition would not be cancelled, provided that they continued fulfilling the service obligations stipulated in the contract<sup>71</sup>. The decree 1839/02, moreover, further regulated the provisions governing the contract renegotiation process. As utilities had been demanding, it introduced more precision on matters such as the information that the companies should include in their renegotiation proposals and the steps that would follow in the case they could not reach an agreement with the government in the first instance. Finally, the decree also extended the deadline originally set up for concluding the renegotiation of contracts – which had already expired more than two months before – to 120 days, and granted the Minister of Economy the power to extend it for another 60 days.

Utilities did not make a big deal out of these last changes, although they clearly represented more amendments to the rules of the contract renegotiation process<sup>72</sup>. And there were two reasons for this. On the one hand, operators were aware that, as a result of the constant changes in its composition, the Contract Renegotiation Commission was a long way from having completed the analysis of the 59 contracts under review. On the other hand, and perhaps more importantly, utilities realised that postponing the conclusion of the contract renegotiation was probably the only way to

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authorities had given them in the contract renegotiation process. See *Ambito Financiero* and *Clarín* 11/09/02.

<sup>71</sup> Another reason why operators greatly appreciated the provisions of this decree was that, according to the Argentine legislation, when a company enters the process of reorganisation it can interrupt servicing its debt.

<sup>72</sup> See *Clarín* 18/08/02 and *La Nación* 18/09/02.

prevent Congress from entering into the discussions. It is important to note that in the last two weeks of August the upper chamber had made three attempts to vote a bill that stipulated that Congress would have the final say on the outcome of the renegotiation process<sup>73</sup>.

#### 4.5. The judiciary steps in.

By mid September, the prospects for utilities looked better – or more accurately, less bad – than at any previous time in 2002. Not only had the government become more receptive to operators' demands but also the economy seemed to stop shrinking. Indeed, since June the peso had hovered close to 3.60 to the dollar, central bank reserves had been rising, and inflation remained restrained<sup>74</sup>. Starting in July, moreover, the government's budget had begun experiencing small surpluses. In this scenario – referred by several observers as an economic *veranito*, or Indian summer – there may even have been hopes that the government was going to get its own way with the adjustments of utilities' tariffs. But, as it soon became evident, changing the status quo would not be that easy.

On September 24th, in response to a joint presentation made by the consumer organizations and the ombudsman of the Capital Federal<sup>75</sup>, a judge ordered the suspension of the public hearings called to discuss changes in utility tariffs and prohibited the government from authorizing any adjustment in utilities tariffs outside the contract renegotiation process provided in the Economic Emergency Law. In her

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<sup>73</sup> See La Nación 19/08/02 and Clarín 30/08/02.

<sup>74</sup> Although in nominal terms the peso had already fallen by 260% since January 2002, consumer prices had increased by only 40%.

<sup>75</sup> See La Nación 23/09/02.

ruling, the judge also questioned the legality of the procedure that the government had adopted to call to the public hearings – such as not publishing it in the Official Bulletin. Moreover, she stated that following the Economic Emergency Law, the hearings should have been the corollary of the contract renegotiating process and not the starting point. Finally, she argued that taking into account that the Minister of Economy had already announced the measures that would follow the hearings – i.e., an increase in utility tariffs –, carrying them out appeared to be a mere formality<sup>76</sup>.

The same day the ruling became public, of course, the economic authorities announced that they would appeal against it and that they would do it on the grounds that the introduction of a tariff emergency adjustment and the renegotiation of contracts were two different issues that, precisely because of this, could be addressed separately. They also revealed that in its appeal the government would argue that, in an emergency situation, the introduction of a tariff adjustment could not be subject to the same requisites and procedures than those in force during normal times<sup>77</sup>. In the minister's team, however, they were aware that this announcement would not bring much comfort to operators and international financial institutions. They all knew, in this sense, that the case would probably end up in the hands of the Supreme Court and, given the functioning of the judiciary in Argentina, it could take several months, or even years, before the Court reached a final decision.

On October 11<sup>th</sup>, thus, Lavagna signed resolution M.E. 487/02. As some expected, this resolution insisted on the introduction of emergency tariff adjustments. Surprisingly, however, the resolution did not authorise these adjustments in all the

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<sup>76</sup> See La Nación, Clarín and Ambito Financiero, 25/09/02.

<sup>77</sup> See La Nación 25/09/02.

utilities under the national government purview – as in the original plan – but only in the electricity and gas sectors. According to officials in the Ministry of Economy, the reason for limiting the tariff adjustment only to these sectors was twofold. On the one hand, the rules defining the key features of the regulatory framework in those sectors – defined in the Laws 24.065 and 24.076 – explicitly contemplated the possibility of allowing changes in tariffs in case of exceptional or unforeseen events<sup>78</sup>. In the view of economic officials, the freezing of tariffs and the devaluation of the national currency clearly fitted into that type of event. On the other hand, those rules had been established in laws which, they argued, the Economic Emergency Law had not revoked. In their view, then, an emergency adjustment in gas and electricity tariffs could be authorised within the framework of those laws. That is, there was no legal obligation to do it within the framework of the contract renegotiation process.

Consumer organizations and their allies, obviously, strongly opposed the government's new plan and the inclusion in Resolution 487/02 of a provision establishing that any tariff increase would exclude low income consumers did not seem to help to neutralise their anger<sup>79</sup>. Neither did it seem to help the decision taken by the electricity and gas regulators to discuss operators' adjustment proposals in public hearings<sup>80</sup>. This was because, in the view of consumer organizations, the issue at stake was simple: any change in tariffs adopted outside the framework of the

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<sup>78</sup> Article 46 in both laws.

<sup>79</sup> Resolution M.E. 487/02 defined as low-consumers those who had a bi-monthly consumption below 300kW of electricity and 500 cubic metres of gas. According to the economic authorities, these thresholds would exempt almost 42% and 32% of electricity and gas residential consumers, respectively, from the increases.

<sup>80</sup> On October 22, ENRE set the date for the hearings to discuss electricity operators' emergency adjustment proposals for the third week of November. On the same day, ENARGAS called for a hearing to discuss gas operators' proposals on November 18<sup>th</sup>. See La Nación 22/10/02.

contract renegotiation process openly violated the provisions of the Economic Emergency Law and, consequently, it was illegal.

At the time of signing Resolution 487/02, Lavagna almost certainly expected that consumer organizations would resist the government's new plan for adjusting tariffs. What he probably never anticipated, however, was that operators did not seem to like it much either. By the first week of November, only one of the electricity distributors – EDESUR - had submitted a tariff adjustment proposal. According to press information, the main reason for this was that most firms were reluctant to participate in a process in which, in the best case, they could only get a 10% increase in tariffs. They believed that such an increase would not only be insufficient to repair their much damaged finances but also, if they accepted it, the strength of their claims before the international tribunals could be jeopardised<sup>81</sup>.

Lavagna's new plan, moreover, did not seem to have the approval of the IMF. Indeed, a few days after it became public, the latter issued a press release in which it stated that, among other things, the Argentine government needed to reaffirm its political commitment to address the problems of utilities. According to press information, moreover, fund officials were convinced that the government should authorize a tariff increase well beyond 10% and, furthermore, that it should not be limited to the energy sector<sup>82</sup>.

It was in this rather hostile environment that the government decided to raise the bet.

On the last days of October, it announced that the adjustment of tariffs would not only

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<sup>81</sup> See Clarín 06/11/02 and 07/11/02, and Ambito Financiero 07/11/02

<sup>82</sup> According to that information, the adjustment of tariffs demanded by IMF was around 30%. See La Nación and Clarín, 29/10/02.

be introduced in gas and electricity but also in water. It was revealed, moreover, that since in that sector the regulatory framework did not contemplate the possibility of authorizing emergency tariff adjustments, the latter would be introduced by December within the framework of the contract renegotiation process<sup>83</sup>. Adding to this, on the first week of November, the Secretary of Energy announced that the gas and electricity seasonal adjustments would not take place and, therefore, tariffs in both sectors would remain the same as in the winter<sup>84</sup>. This was good news for energy operators and, more precisely, for generators. Indeed, generation prices during the summer had normally been between 5 and 10% lower than in winter. The decision to suspend the seasonal adjustment, thus, was nothing but a masked increase in those prices (Haselip, 2005).

The government, however, would not be the only one to raise the stakes. Consumer organizations and the Buenos Aires' ombudsman decided that, given the fact that the government would not listen to their arguments, the only way to make it desist from its plans was to bring the Judiciary into the discussions. On November the 7<sup>th</sup>, therefore, they requested the latter to suspend the public hearings called to discuss operators' adjustment proposals<sup>85</sup>.

Although in the following week President Duhalde stated the hope that the Judiciary would not put more obstacles in the way of executive's plans and would therefore allow the regulatory agencies in the energy sector to hold the public hearings<sup>86</sup>, his pleas did not seem to be very effective. On November 15<sup>th</sup>, a judge presented an

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<sup>83</sup> See Clarín 24/10/02.

<sup>84</sup> See Ambito Financiero 31/10/02 and Clarín 06/11/02.

<sup>85</sup> See Clarín 08/11/02.

<sup>86</sup> See Clarín 17/11/02.



injunction suspending them. The argument used to justify this decision was not new: following the provisions of the Economic Emergency Law, an adjustment in tariffs could not be introduced outside the framework of the contract renegotiation process.

#### 4.6. Trying with DNUs.

It soon became clear that the ruling suspending the hearings would not be enough to make the government give up its plans. Indeed, on November 20<sup>th</sup>, the Contract Renegotiation Commission sent a letter to all electricity and gas operators requesting them to submit all the information required to conclude the second phase of the renegotiating process<sup>87</sup>. According to that letter, once the companies complied with this request, the commission would promptly launch the third phase of the process during which, as provided in the Resolution M.E. 20/02, their renegotiating proposals would be discussed.

This did not make much sense for gas and electricity operators. The activity of the Renegotiation Commission had been very limited in the last months and, therefore, its members were far from ready to make any significant progress in the renegotiation process. In the light of this, many of them began to wonder whether by means of the letter, the government was subtly letting them know that it had decided not to insist anymore on the introduction of emergency tariff adjustments.

They soon realized that that was not the case. Indeed, a few days after the letter, economic officials announced that the government would soon insist on the

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<sup>87</sup> Recall that according to Resolution M.E. 20/02 this phase should have concluded in May.

introduction of emergency tariff adjustment in those sectors and that, in order to increase its chances of success, this time it would define them in a decree of urgency and need. It also became public that, during a meeting with provincial governors of the government party, president Duhalde had obtained the promise that, although PJ legislators would not vote for a law ratifying such a decree, they would at least refrain from vetoing it.

When everything suggested that the signature of the decree was imminent, on November 24<sup>th</sup>, almost four million people – mostly in Capital Federal and greater Buenos Aires – were left without electricity service for four hours<sup>88</sup>. Although it was soon determined that the origin of the blackout had been a failure in an electricity sub-station operated by TRANSENER (the electricity transporter, which was controlled by the British National Grid and the local Pecom), few believed that explanation. There was the suspicion – particularly among the general public – that the electricity companies were blackmailing the government<sup>89</sup>. Press information revealed that the government was seriously considering the possibility of postponing the signing of the decree introducing the tariff adjustment<sup>90</sup>.

The rumour, understandably, caused concern among the companies. This concern, however, would not last long. On November 30<sup>th</sup>, Duhalde signed the decree of urgency and need 2437/02. As expected before the blackout, it authorized an average increase of 9% and 7% in electricity and gas tariffs, respectively. Moreover, it established that low residential consumers would not be affected by these transitory adjustments.

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<sup>88</sup> See *La Nación y Ambito Financiero* 25/11/02

<sup>89</sup> See *La Nación* 25/11/02.

<sup>90</sup> See *Clarín* 26/11/02.

To certain extent, the reactions to the decree were predictable. Utilities – and, in particular, those operating in the energy sector – claimed that, although the tariff increases indicated that the government understood their problems, the adjustments authorised were clearly insufficient compensation for the effects of the change in the rules of the game introduced by the Economic Emergency Law as well as to secure the continuity and quality of the services<sup>91</sup>.

Consumer organizations and their allies, meanwhile, strongly opposed the introduction of changes in gas and electricity tariffs and anticipated that they would challenge them in the courts<sup>92</sup>. As they had already done in reaction to the executive's previous attempts to increase tariffs, they claimed that the decree openly violated the provisions of the Economic Emergency Law. They also claimed that, if the adjustments were as urgent as to justify the use of a decree of urgency and need, the executive would have devoted much more effort and resources to conclude the contract renegotiations process. Instead, they argued, the government had constantly changed the rules of that process and, partly because of this, the advances made in that respect were almost null.

In addition, consumer organizations and their allies claimed that, since no public hearings had been called to discuss the adjustments, the decree 2437 also violated both article 42 of the Constitution as well as the procedures established in the electricity and gas regulatory frameworks. Finally, they contended that by introducing the tariff adjustment by decree, the government had the clear intention of bypassing Congress, where the opposition to the tariff increases was obvious. Proof of this, they

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<sup>91</sup> See La Nación 04/12/02.

<sup>92</sup> See La Nación, Clarín, and Ambito Financiero, 01/12/02

pointed out, was the fact that the decree was signed by the president the same day the Legislature began its extraordinary sessions<sup>93</sup>.

The arguments discussed above were pretty strong. In fact, by the end of the first week of December, the question most observers were asking was not if the judiciary would challenge the decree 2437 but when it would do it. And the answer to this question came out pretty soon. On December 10th, the same day gas and electricity operators started to send bills incorporating the increases, a judge ordered to suspend the adjustments in Capital Federal. Two days later, another judge decided to extend the suspension to the rest of the country.

The reasons on which the judges based their decision were in line with the arguments discussed above. According to them, the decree violated consumers' right to participate in the adoption of important regulatory decisions. Second, it also violated the provisions of the Economic Emergency Law that compelled the government to discuss utilities tariffs within the framework of the contract renegotiation process. Third, it presented invalid arguments to justify the need and urgency to authorize the adjustments. The judges stated, in this sense, that the circumstances invoked by the government to justify the supposed urgency and need were nothing but a result of the latter's inability to conclude the renegotiation process in time. In their opinion, thus, the use of a decree of urgency and need usurped the sphere of responsibility of the Legislature, and was also intending to turn that legal instrument into one of mere convenience.

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<sup>93</sup> The constitution in Argentina establishes that, during extraordinary sessions, legislators can only discuss and vote on bills submitted by the executive branch. Among other things, that means that during this period legislators cannot veto a presidential decree.

#### 4.7. Insisting on DNUs

The decision to suspend the tariff increases provided in the decree of urgency and need 2.437 was a hard blow for the government's plans. By then, however, officials had other more important concerns. In November, the government had decided to play a game of chicken and announced that it would stop paying its obligations to multilateral institutions<sup>94</sup>. According to Argentine officials, failure to reach an agreement with the IMF after ten months of negotiations was the main reason for this decision.

As many analysts pointed out, this was certainly a high-risk strategy for a country still reeling from a catastrophic economic collapse. By defaulting on its debt to financial institutions, Argentina risked, in effect, cutting itself off from its last resource of outside financing. But it was not just the Argentineans who had much at stake. The deadlock with Argentina was uncomfortable even for an organisation like the IMF. Indeed, given the size of the country's payments<sup>95</sup>, letting it go further along the road to full-scale default with the multilateral institutions would seriously dent the IMF's credibility because its own financial structure meant it could not afford to see a big borrower halt all repayments. Perhaps it could even affect the World Bank's credit capacity.

On January 17<sup>th</sup>, following a couple of weeks of feverish negotiations, the Fund announced that it had come to a transitory agreement – until after the presidential

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<sup>94</sup> While in default to its private creditors since December 2001, the country had continued to service its debts to international financial institutions (which owed almost a third of the total public debt).

<sup>95</sup> Argentina was the World Bank's fourth biggest debtor, with around 7% of its loans. At the Inter-American development bank, the concentration of loans to Argentina was even bigger.

elections – with the Argentine government<sup>96</sup>. Although there would be no new money, the Fund would lend enough (6.6 billion) to ensure that the country would not default on its debts to the international financial institutions.

Initially, it was claimed that the agreement did not comprise any “meaningful obligation” on the Argentine government. It soon became evident, however, that this was not entirely true. Indeed, a few days after the agreement was clinched, press information revealed that both in the Letter of Intention and in the Memorandum of Understanding the government had committed itself to, among other things, insisting on the introduction of emergency tariff adjustments<sup>97</sup>.

Utilities received this news with scepticism. In their opinion, with the agreement already signed and a presidential election less than three months away, the government would have little incentive to bind itself<sup>98</sup>. Consumer organizations, paradoxically, shared this view. In their opinion, however, the main reason why the government would refrain from fulfilling the commitment was that it simply had no legal power to do so<sup>99</sup>.

It soon became evident that the predictions of both groups were wide of the mark. On January 23<sup>rd</sup>, Duhalde signed the decree of urgency and need 120/2003. In it, it was established that, for as long as the contract renegotiation process lasted, the executive would be allowed to introduce provisional tariff adjustments in order to secure the continuity, quality and security of services. The decree also provided that these

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<sup>96</sup> On January 17<sup>th</sup>, Argentina was due to repay the IMF \$1 billion, a payment that the government had threatened not to make.

<sup>97</sup> See Clarín 18/01/03, 19/01/03, and 20/01/03.

<sup>98</sup> See La Nación and Ambito Financiero 20/01/02.

<sup>99</sup> See Clarín 22/01/03.

adjustments would be comprised within the contract renegotiation process and that they would be taken into consideration in future agreements between the government and the companies. Moreover, it was established that the exercise of this prerogative by the executive would not be limited or conditioned by the provisions of any existing norm governing concession contracts. Although the decree did not mention it explicitly, it was pretty evident that by “any existing norm governing concession contracts” it was referring, on the one hand, to articles 8 and 9 of the Economic Emergency Law and, on the other hand, to those provisions of the gas and electricity regulatory framework that required carrying out public hearings prior to the adoption of changes in tariffs. The decree 120/2003, however, did not introduce any tariff adjustments. Those were established three days later in the decree of urgency and need 146/2003, which reinstated the tariffs increases stipulated in the decree 2437.

As expected, the publication of the decrees 120/03 and 146/03 triggered the filing of several injunctions against them and a fierce debate on whether the courts should allow the government to implement them. It was in that heated scenario that the executive seized the opportunity to introduce some more changes. On February 3<sup>rd</sup>, Lavagna issued a resolution establishing that the term for the Ministry of Economy to submit to the president the proposals for the renegotiation of contracts would be extended for another 60 business days<sup>100</sup>.

In practical terms, this meant that the renegotiation process would hardly be concluded during Duhalde’s term in office. Although this new change in the rules of the game was not good news for utilities, they decided to accept it because they had

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<sup>100</sup> Resolution M.E. 62/2003.

already discounted that possibility. Contributing to this was that, following the letter announcing the launching of the third phase of the contract renegotiation process, they had not had further news from the commission. In addition, most operators believed that in the last months the government had been more open to their demands than ever before. In the telecommunications sector, for instance, the government had already allowed operators to increase the cost of calls made from fixed lines to mobiles by 8%<sup>101</sup>. Moreover, on the same day the contract renegotiation process was extended, the Ministry of Economy passed two resolutions that authorised operators to pass on to consumers the tax increases introduced by Cavallo in 2001. This last measure, it should be noted, opened the door for the end of the freeze in long distance and international call tariffs<sup>102</sup>.

By the second week of February the issue of the tariff increases in gas and electricity filled the cover pages of most newspapers. Consumers began to receive gas and electricity bills that included the tariff increases introduced in decree 146/03. Furthermore, Lavagna announced that it was very likely that, after the presidential elections, further increases in gas and electricity tariffs would be introduced<sup>103</sup>. The Secretary of Communications meanwhile revealed that, depending on the fate of the tariff increases in gas and electricity, a 10% adjustment in telecommunications tariffs would probably follow<sup>104</sup>.

In the light of these events and announcements, consumer organizations urged the courts not to delay the decision on the legality of latest adjustments. And it seems that

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<sup>101</sup> Resolution S.C. 48/2003. Note that in October 2002, The Secretary of Communications (Res. S.C. 205/2002) had denied operators to introduce a similar change in the cost of those calls.

<sup>102</sup> Resolutions M.E. 72/2003 and 75/2003.

<sup>103</sup> See La Nación 08/02/03.

<sup>104</sup> See La Nación 10/02/03.



their demand was listened. Indeed, on February 17<sup>th</sup>, a judge presented the first relevant injunction<sup>105</sup>. However, contrary to what those who opposed the adjustment were expecting, he did not order the suspension of the tariff increases nor did he declare them illegal. In fact, the judge only ordered the government to present a monthly report on the progress of the contract renegotiation process as well as on the level of fulfilment of contractual obligations by the companies<sup>106</sup>.

Both for the government and the companies, by omitting any reference to the validity of the decree 120/3 and of the tariff increases, the magistrate was implicitly endorsing them<sup>107</sup>. They did not have much time to celebrate, though. On February 25<sup>th</sup>, another judge ordered the government to suspend the tariff increases. Adding to this, on March 4<sup>th</sup>, a third judge presented an injunction that not only declared the adjustments invalid but also revoked the decree of urgency and need that had authorized the executive to introduce them.

In these two rulings, the arguments raised by the judges were very similar to those advanced less than two months before to dictate the invalidity of the decree 2437/02. That is, they also claimed that tariff adjustments could only be authorized following the provisions of the Economic Emergency Law and, consequently, within the contract renegotiation process. The judges also considered that the Constitution clearly provided that only in exceptional circumstances could a law passed by Congress – like the Economic Emergency Law – be changed by the executive by means of a decree of urgency and need. According to them, the needs and demands of the companies could not be used to invoke those circumstances. Moreover, they

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<sup>105</sup> The judge in question was Guillermo Rossi.

<sup>106</sup> See La Nación 19/02/03.

<sup>107</sup> See Clarín and Ambito Financiero, 19/02/03.

contended, the executive had never been denied the possibility of changing the provisions of the Economic Emergency Law following the regular legislative procedures – that is, with another statute. In their view, the establishment of the tariff adjustments by means of the decree of urgency and need 146/03 was thus an unjustified invasion of Congress' powers by the executive.

In the months that followed the judges' rulings, and as the electoral campaign advanced, the issue of utilities progressively vanished from the public agenda. Of course, as they had been doing since the early days of 2002, utilities continued complaining about the negative effects that the combination of the economic crisis and the Economic Emergency Law had had on their finances as well as about the minimum progress made by the government in the contract renegotiation process<sup>108</sup>. International financial institutions, meanwhile, continued demanding a solution to utilities' problems from the Argentine authorities. Neither utilities nor international financial institutions believed, however, that their complaints and demands would result in immediate changes to the status quo. In this sense, and as the government finally announced by mid April, those changes would have to wait until a new government came to power<sup>109</sup>.

## **5. Conclusion**

In the introduction of this chapter it was argued that, if as predicted by the hypotheses posited in the second chapter of this thesis, regulatory policies defined in statutes are more difficult to change – and, hence, less volatile – than policies defined in legal

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<sup>108</sup> By the end of April, at least thirty-eight companies had already initiated actions against the country before the ICSID.

<sup>109</sup> See Cronista 18/04/03.

instruments that the executive can change unilaterally by ordinary policymaking procedures, then the pesoification and freezing of tariffs, which was explicitly established in the Economic Emergency Law, should have been more stable than the rules of governing the contract renegotiation process, which were defined in presidential decrees and resolutions.

The narrative in this chapter strongly supports the validity of this prediction. It shows that once the rules governing the contract renegotiation process were defined, it did not take much time before the executive started to change them. The changes involved, first, the composition of the Contract Renegotiation Commission. As a result, the Commission had 4 different coordinators during the time period under study. Second, the provisions establishing which operators were allowed to participate in the renegotiation process, and third, the information requirements that operators were required to submit were also modified in this way. The most critical changes, however, concerned the deadlines under which the Contract Renegotiation Commission had to work. As it has been shown, in March 2002 it was established that the Commission would have 120 days to submit to the Minister of Economy a proposal comprising the renegotiated contracts and licenses of all the utilities and infrastructure operators participating in the contract renegotiation process. In September 2002 – more than two months after the original deadline had expired – and in February 2003, however, that deadline was extended 120 and 60 days, respectively. As a result of these changes in the rules of the game, by the time president Duhalde left office in May 2003, no single utility contract had been renegotiated.

On the other hand, the narrative in this chapter shows that, although in the first months following the passage of the Economic Emergency Law the executive strongly rejected the possibility of introducing tariff increases, the need to clinch an agreement with international financial institutions – notably, the IMF – forced it to change its mind. As predicted, however, this change in the executive’s preferences did not lead to policy changes similar to those governing the contract renegotiation process. Indeed, although the executive made several attempts to lift the freezing and authorise tariffs increases, the last two of these attempts by means of decrees of urgency and need, none of them materialised. The reason for this was the same in all the cases: a hostile judiciary stepped in and ruled that if the executive wanted to allow tariff increases it would first need to conclude the contract renegotiation process, or alternatively, persuade Congress to change the provisions of the Economic Emergency Law – in particular, the provision that instituted the freezing of tariffs.

## **Chapter VII**

### **Conclusions**

## **1. The main arguments and findings in this thesis**

This work started with a simple observation: in the beginning of the nineties, and in order to develop regulatory commitment, policy-makers in Argentina decided to follow the prescriptions of the “development consensus” and they privatized all the utilities under the national government’s purview. Like Ulysses pinning himself to the mast of his ship to avoid the call of the sirens, they also gave up their regulatory powers and delegated them to independent experts. New regulatory agencies were created in each of the sectors where these reforms were introduced and, in line with the best international practice, institutional arrangements were put in place to secure that these agencies operated at arm’s length from political authorities and other interests, and also to secure their autonomy and accountability. At the time these reforms were introduced, many believed that, like in other countries that followed the same policy recipe, the shift in the locus of regulatory power would result, among other things, in a drastic improvement in the stability – and hence credibility – of utility regulatory policy in Argentina.

In this thesis, however, I have argued that these expectations were not realistic. Using deductive reasoning, I have theorised that while for sustaining intertemporal commitments and developing stable utility regulatory policies delegation to independent experts is an important and perhaps even necessary condition, it is not by itself sufficient. Indeed, since there are many circumstances that might make it tempting for governments to reverse this policy, equally important, is to ensure that policy-makers cannot easily undo delegation or manipulate its terms.

I have contended, moreover, that the organisation of a country's institutions plays a key role in this last respect because it can make the introduction of policy change more feasible or, on the contrary, it can hinder it. In line with recent developments within new institutionalism, I have argued that this is because the organisation of a country's institutions not only determines the number of veto players whose agreement is necessary to introduce changes to a given policy, but also the divergence of preferences among these players. Both elements, in turn, determine how costly is to introduce, change or amend policy. Indeed, as the number of veto players increases, and the more their preferences diverge, the harder it is to enact a change in legislation.

In the case of Argentina, I have noticed, a simple analysis of the structure and organisation of the country's institutions would suggest that policies there should enjoy a relatively high degree of stability: at first sight, ordinary policymaking procedures require political leaders to gain the consent of numerous veto players whose preferences are rarely homogeneous.

However, a closer look at the rules of the game in that country reveals, first, that not all policy changes are introduced by ordinary policymaking procedures. That is, statutes can sometimes be changed without the involvement of both the executive and legislative branches of government. Second, statutes are not the sole legal instrument to define policy. Put differently, statutes can also be changed unilaterally by the executive using extraordinary mechanisms of legislative initiative (i.e. DNUs), and they only represent a small portion of the policies in place in that country.

Both elements, I have claimed, do pose a threat to policy stability in Argentina. And the reason for this is similar. When the president introduces changes to the policy status quo with a DNU – in cases where the status quo was defined in a statute –, or with a legal instrument that is not a statute – where the status quo was defined using a regulatory decree, and administrative decree or a resolution –, it can act without the Assembly having the opportunity to discuss *ex-ante* the merit of the proposal. In these cases, therefore, the executive becomes the only veto player in the policymaking game. And this, as it has been discussed, not only means that it can initiate policy changes whenever its preferences dictate so but also that it can select any point within its indifference curve.

In addition, I have argued that, despite this similarity, these elements pose threats of varying severity to policy stability. When changing the statutory status quo with a DNU – the easiest way –, the executive is normally intervening in policies on which Congress has voted and, thus, with policies on which the latter has defined preferences. Moreover, it is quite likely that the policy preferences the executive is trying to impose are contrary to, or at least divergent from, those of the majority in Congress. In contrast, when the executive introduces policy changes through a non-statutory device (a regulatory decree, an administrative decree or a resolution), it modifies policy that either the constitution defines as the exclusive competence of the executive or, alternatively, that Congress previously delegated to it. To a certain extent, then, the use of these alternative legal instruments is unlikely to be a source of conflict with the Legislature. As a result, the chances of the latter tolerating the new status quo are probably higher than when a DNU is used to change a statute.



I have noted, moreover, that the courts are also more likely to avoid stepping in when policy changes are introduced using these legal instruments than when the executive introduces changes to the statutory status quo using a DNU. Accounting for this is the fact that when dealing with controversies involving policy changes introduced using DNUs, the courts are less exposed to the risk of reprisals by the executive than when dealing with controversies involving policy changes introduced in regulatory decrees, administrative decrees and resolutions.

Based on these arguments I have posited two hypotheses. The first is that, given Argentina's institutional endowment, the stability and credibility of a policy in that country is, *ceteris paribus*, governed by the choice of the legal instrument used to define it. More precisely, since it is relatively easier or less costly for the executive to change the policy status quo when this is defined in a non statutory device than when it is defined in a statute – even if the changes to the statute were introduced in a DNU –, policy defined in the latter is likely to be more stable than policy defined in the former. That is, policies defined in statutes are less prone to be changed than policies defined in other legal instruments that can be passed unilaterally by the executive.

Closely related, the second hypothesis I have put forward in this thesis is that policy-makers' original expectation that delegation of important regulatory powers to independent agencies was a policy that had arrived to stay and that it would result in more stable and credible regulatory policy was not legitimate for all the industries where this institutional arrangement was established but only for the industries where the key features of the regulatory regime were defined in a statute. In those industries

where the legal instrument used to define the key features of the newly created regulatory regimes was a regulatory decree, an administrative decree or a resolution, meanwhile, politicians probably faced little constraints to renege on their previous policy commitments. In these industries, therefore, the institutional arrangements set up at the time of privatisation - including the delegation of important regulatory powers to independent experts - were likely to be only temporary. Regulatory policy in these sectors, then, was likely to continue being a domain where policy-makers introduced policy changes whenever their preferences dictated it.

To test these hypotheses, I have presented an in-depth investigation of three case studies. As noted in the introductory chapter, these cases were not selected on the value of the dependent variable but on the value of the variable that the theory identifies as the ultimate independent variable. Thus, it is only during the presentation of each of the cases that I have discovered whether the dependent variable takes the values predicted by my theory. Also as discussed in the introductory chapter, the empirical information in the three cases analysed has been presented in the form of narratives. This not only has allowed me to present correlations at every step of the causal process but also, and equally importantly, to contextualise these steps in ways that make the entire process visible rather than fragmented into analytical stages.

The first of the three cases covered in this work comprises the study of the telecommunications industry between its privatisation in 1990 and the last days of Fernando de la Rúa's government in December 2001. Its analysis shows that during the first presidency of Carlos Menem, and only a few years after the sector was privatised and a new regulatory framework was put in place, the sector's regulatory

agency was intervened, its authorities were replaced (twice), its financial autonomy was severely limited, and many of its key powers were curtailed and transferred to the Under-Secretariat of Communications. These changes, however, were just the first of many more to come. Indeed, the analysis of the case also shows that during Menem's second term in office – and mostly between 1995 and 1997 - the executive also adjusted the sector's rules of the game to its changing preferences. Proof of this is that during that period, the government established the second intervention of the regulatory agency and appointed new regulators, changed the jurisdiction of the regulatory body (from the Ministry of economy to the presidency) and, following a rather confusing and contradictory process, it further transferred regulatory powers in favour of the sector's political authority (by that time the secretary of Communication). In addition to these changes, the regulatory agency was merged with the postal regulator, its financial autonomy was even more restricted, and the institutional arrangements originally put in place to secure its autonomy and accountability were, again, substantially modified. Therefore, by the time Carlos Menem left government in December 1999, the rules of the game that governed telecommunications regulation in Argentina were only a pallid – and rather distorted – image of those put in place almost a decade before.

What the analysis of the telecommunications experience reveals, moreover, is that it would be wrong to attribute all the blame for constantly changing the rules of the game just to President Menem's style of government and his contempt for keeping his policy commitments. Indeed, the analysis of the case shows that despite being a strong critic of the sector's poor stability, President De la Rúa also gave in to the temptation to adjust the rules governing the regulation of the telecommunications

industry. During his first days in office, his government not only established that the Secretary of Communications would keep all the regulatory powers that the previous government had already granted it, but also that all the regulatory decisions concerning the telecommunications industry would now be transferred to the jurisdiction of the newly created Ministry of infrastructure and public works. As for the previous government, the new authorities also forced the resignation of most of the agency's directors and appointed new ones more identified with its political and economic project. Less than a year later, moreover, and together with the introduction of a contentious liberalisation of the telecommunications market, President de la Rúa established that, in the future, any decision involving the application of the regulations governing the aforementioned liberalisation would require the prior intervention of the Competition and Consumer's Affairs Secretariat. In order to allow the latter to take on this task, a new redistribution rule of the funds originally assigned to the regulatory agency was adopted.

The analysis of the telecommunications sector between 1990 and the last days of 2001, thus, leaves no room to doubt. It confirms that, in Argentina, defining a regulatory regime in a presidential decree was a poor arrangement to prevent the government from reneging from its original policy commitments and, thus, to develop a more stable and credible regulatory policy. Put differently, the analysis of this case corroborates that establishing the rules of the game in this legal instrument not only allowed the executive to distort or undo most of the institutional arrangements put in place in the beginning of the 90s but also to play with the rules of the game governing telecommunications regulation almost at will.

The second case studied in this thesis comprises the analysis of the electricity sector between its privatisation and regulatory reform in 1992 and the last days of 2001. Following the methodological approach adopted in this work, this case was chosen because the design of the regulatory regime in the electricity sector showed strong similarities with that originally put in place in the telecommunications sector – notably, in terms of regulatory governance – but with the key exception that the legal instrument used to define it was a statute and not a decree. Thus, what I expected to confirm in the study of this case was that in this sector the key features of the regulatory regime were relatively costly to be changed and, consequently, the government was less able to renege on its original policy commitments than in the telecommunications sector. Put it differently, I was examining the hypothesis that, contrary to what happened in the telecommunications sector, in the electricity sector delegation of important regulatory powers to independent experts was a policy much more likely to become a permanent feature of the policy landscape.

Like in the analysis of the telecommunications experience, the evidence from this case study also provides strong support for the hypotheses posited in this thesis. Indeed, it shows that almost a decade after the regulatory reforms in this sector had been introduced, the legislation used to define the key features of the regulatory regime was still in place and in its original form. By the end of 2001, as a result, the electricity market was not only organised under relatively the same structure as provided in the 1992 Electricity Act but it was also governed by the same institutional arrangements reformers put in place when the industry was privatised. Indeed, in 2001 regulators in the electricity sector still had most of the powers and responsibilities

originally granted to them<sup>1</sup>. Moreover, the institutional devices that had originally been established to safeguard their independence, autonomy and accountability remained untouched.

The analysis of the electricity case shows, in addition, that in this sector the stability in the rules of the game and the durability of the policies established in the early 90s could not be attributed to the lack of pressures in the opposite direction – which would somehow jeopardise the strength of the hypotheses in this thesis. On the contrary, it reveals that there were at least three episodes where the status quo prevailed despite the fact that the government felt tempted to change it, or tried to do so but failed. As has been discussed, an incident where the government probably considered introducing changes but finally refrained – given the high cost that this strategy involved – occurred in the aftermath of the blackout that in 1999 affected more than a 150,000 customers of EDESUR in the city of Buenos Aires. The episodes triggered by the ENDESA case and, notably, by the decree 804/01, meanwhile, are clear examples of incidents where the government disliked the status quo and unsuccessfully tried to change to it.

Finally, in the last case analysed in this thesis, I sought to confirm that, in Argentina, regulatory policy established in a presidential decree is likely to be less stable than regulatory policy established in a statute. This, it is important to note, is distinct from the question of whether the legal instrument used to define a regulatory regime determines its durability.

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<sup>1</sup> The analysis shows that the few policies that were subject to change were those whose definition the Electricity Act had delegated to the executive. These policies – which, among others, included the regulatory incentives governing transmission expansion –, had been originally established in presidential decrees or in resolutions, and not in statutes.

To test this hypothesis I analysed two critical policy measures introduced by the government in January 2002 in the so-called Economic Emergency Law. The first of them established that all utility tariffs would remain frozen for as long as the then current economic emergency lasted. The second provided that the executive would be allowed to renegotiate the contracts of all the utilities and infrastructure operators in the country in order to accommodate them to the new economic situation, and that the rules governing this process would be defined by the president in presidential decrees or, alternatively, in other legal instruments that could be unilaterally passed by the executive. My prior expectation when studying this case, which covers the period between the first days of 2002 and April 2003, was, then, quite simple: I expected to find that the freezing of tariffs, since it was defined in a statute, was a policy that enjoyed considerable more stability than the rules governing the contract renegotiation process.

The empirical evidence in this case once more provides strong support for my predictions. Regarding the contract renegotiation process, it confirms that allowing the executive to define the terms of the contract renegotiation process in a decree (or in any other non-statutory measure) did not help to promote the stability and credibility of the process but opened the door to constant, and often arbitrary, changes in the rules of the game. As a result, by the time President Duhalde left office in April 2003, and even though none of the 59 contracts under review had been renegotiated, the rules governing the process were substantially different from those originally put in place. By that time, moreover, the high uncertainty that resulted from the instability of the whole process made it impossible to predict what would be the outcome of the process or, even worse, when an outcome would be reached.

The empirical evidence offered by this case also shows that as predicted, utility tariffs in April 2003 were the same as those in place during the last days of 2001. It shows, moreover, that this outcome could not be attributed to the lack of pressures in the opposite direction. Indeed, the analysis of the case reveals that the executive tried to lift the freezing of tariffs at least four times. Since it was pretty obvious that Congress would never provide its consent to such an unpopular measure – the legislative support that President Duhalde enjoyed during his first days in office having vanished rapidly –, the four attempts were introduced in legal instruments that the executive could pass unilaterally. The last two of these attempts, moreover, were introduced using extraordinary mechanisms of legislative initiative – that is, decrees of urgency and need. All these efforts, however, invariably failed. As the study of the case reveals, every time the executive authorised a change in tariffs, or that passed legislation that opened the door to those changes, defiant judges stepped in and exercised the judiciary's veto powers.

## **2. Final remarks**

Before concluding, I would like to emphasise that the findings in this thesis should not be taken as a plea for eliminating discretion in the regulation of utilities and, hence, for defining all aspects of utility regulation in Argentina in highly specific statutes. And there are two reasons for this. First, I believe such alternative is unattainable. Contract theory is quite emphatic when it notes that regulatory rules



represent, at best, incomplete contracts<sup>2</sup>. That is, no matter how precisely these rules are defined, there will always be questions of interpretation as well as room for judgement on enforcement policy. Discretion, thus, cannot be eliminated entirely. Moreover, and even if this was not a problem, it is unrealistic to expect the Argentine Congress to write the highly-specific and technically complex rules required for eliminating discretion in utility regulation. As we have seen in this work, the combined result of incentives created by several features of the Argentine political institutions – notably, the electoral institutions – considerably limit legislators’ ability to specialise. As a result, they often lack the capacity or the expertise needed to design most of the policies that utility regulation nowadays requires.

The second reason why the findings of this thesis should not be seen as a plea for eliminating regulatory discretion and defining all aspects of utility regulation in Argentina in highly specific statutes stands from the fact that, in that country, this alternative can entail costs as severe – although different in nature – as those associated with defining all the components of a regulatory system in presidential decrees. It is important to bear in mind that in Argentina regulatory rules defined in statutes, especially when they contain a great deal of detail, are not easily changed. As a result, they can make it difficult to adjust to unforeseen developments, including changes in technology, information, and market conditions. Due to their rigidity, moreover, these sorts of rules can also make it difficult to provide incentives for efficiency. And this, in turn, can not only undermine the effectiveness of the rules in question but also its sustainability – and, hence, its credibility.

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<sup>2</sup> On the issue of contract incompleteness see, among others, Collins (1999:160-72), Laffont and Tirole (1991), Williamson (1996), Stern (2003) and Spiller (1996a).

When designing regulatory regimes in Argentina, consequently, it is important to recognise that there is not one legal instrument that both promotes the stability of those rules and allows the flexibility to change them when this change is justified. Therefore, Argentine policy-makers have to accept that while some of the components of regulatory regimes have to be defined in statutes, others have to be established in legal instruments which are less costly to change. The question, obviously is: which components of the regulatory regime need to be defined in statutes and which, on the contrary, need to be defined in alternative legal instruments such as regulatory decrees, administrative decrees or resolutions?

Although my intention here is not to offer recipes or magic potions, I believe that the findings in this thesis suggest that, in Argentina, presidential decrees or resolutions are probably the most adequate legal instruments to define those regulatory rules that demand some degree of discretion – and, hence, flexibility – in the hands of those in charge of implementing them. One could reasonably argue that these rules comprise those governing the implementation of policies that require a high degree of adaptation to changing market conditions, or which are critical for providing incentives for efficient operation. In most utilities, these rules are likely to comprise what Levy and Spiller (1996) term “regulatory incentives” or the “detailed engineering” of a regulatory regime. According to these authors, this encompasses the rules governing pricing, subsidies, market entry, interconnection, and the like.

Statutes, meanwhile, are probably the most adequate instrument to define those components of the regulatory regime where some degree of policy stability is needed or, alternatively, where the lack of flexibility is likely to produce no harm. I believe,

therefore, that policy-makers in Argentina should consider the option of using statutes when defining those components of the regulatory regime that have a key role in moulding how the regulatory discretion specified in the rules defined in presidential decrees or resolutions is managed. And one could argue that these components are, basically, what Levy and Spiller (1996) call the governance structure or basic engineering of a regulatory regime. As most of the literature on this topic recommends, the objective when designing them should be to minimise the misuse of regulatory discretion<sup>3</sup>.

Statutes, then, are probably the best choice for clearly establishing the main objectives to be pursued by those individuals or agencies in charge of implementing – or, when needed, adjusting – the regulatory policies defined in presidential decrees or resolutions; for designating who will be those individuals or agencies; and for establishing their roles and responsibilities. They are probably also the best choice for establishing the institutional arrangements needed to secure that these individuals or agencies: a) are insulated from short-term political pressures and other improper influences – that is, that they are independent; b) have the resources to foster the development and application of technical expertise- that is, that they are autonomous; and c) do not stray from their mandate, engage in corrupt practices, or become grossly inefficient – that is, that they are accountable and transparent.

The more important advice that this thesis has to offer, however, goes far beyond the issue of which legal instrument should be used in Argentina when designing regulatory regimes or when instituting new regulatory policy. I believe, in this sense,

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<sup>3</sup> On this issue, see the literature review in Correa et al. (2006) and the references therein.

that the findings in this work clearly show that there are no magic formulas for implementing successful policy reforms and that, as recently argued by some new institutionalist scholars, a policy's chances of success can not be judged abstractly on its theoretical or technical attributes without considering the institutional context in which is applied (Tommasi, 2004; IADB 2006; and Spiller and Tommasi, 2007).

Now that Argentina's enthusiasm for the so-called Washington consensus has waned and Argentine policy-makers seem to be searching for a new development paradigm, it is thus very important that they abandon the tendency to think of policies first and institutions later. They need to understand that policies and institutions are inseparable and that, for policy reforms to work, it is not sufficient to simply adopt what *ex-ante* appear to be technically correct policies. Neither it is to merely replicate policy solutions that have worked in other countries. Put differently, if policymakers in Argentina – and probably elsewhere - want to avoid failed reforms and dashed expectations, they need to recognise that the success or failure of any policy reform will ultimately depend both on the specific content of the reform itself as well as on how well the new policies fit into the country's institutions.

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#### *1.1. Legislation*

##### Laws:

Chapter III and IV: 23.696, 23.928 and 19.798.

Chapter V: 15.336 and 24.065

Chapter VI: 25.561 and 24.076

Chapter VII: 26.122

##### Presidential Decrees

Chapter III and IV: 1651/87, 1757/87, 1842/87, 731/89, 59/90, 60/90, 61/90, 62/90, 1185/90, 2068/90, 2728/90, 729/90, 2798/90, 2585/91, 136/92, 349/92, 506/92, 748/92, 749/92, 1095/92, 760/93, 761/93, 2160/93, 2161/93, 761/93, 961/94, 702/95, 245/96, 515/96, 660/96, 1260/96, 1620/96, 80/97, 88/97, 89/97, 90/96, 92/97, 1648/96, 48/97, 68/97, 91/97, 264/98, 358/98, 20/99, 96/99, 264/00, 465/00, 764/00, 1194/01, 1282/01.

Chapter V: 634/91, 856/91, 1398/92, 186/95, 804/01.

Chapter VI: 293/02, 370/02, 1040/02, 1090/02, 1172/02, 1174/02, 1834/02, 1839/02, 2437/02, 120/2003, 146/2003.

##### Resolutions:

Chapter III and IV: S.C. 18971/99, S.C. 170/00, S.C. 259/00, S.C. 260/00, S.C. 261/00, S.C. 262/00.

Chapter V: S.E. 61/92, ENRE 222/99, ENRE 291/99, ENRE 292/99, M.E. 266/00, ENRE 480/00, S.D.C.yC. 70/01, M.E. 135/01, MIV 259/01, MIV 535/01.

Chapter VI: M.E. 317/00, S.E. 2/02, S.E. 8/02, M.E. 20/02, M.E. 38/02, M.E. 53/02, ME 308/02, M.E. 487/02, S.C. 48/2003, M.E. 62/2003, M.E. 72/2003, M.E.75/2003

## *1.2. Press Articles:*

As explained in the introductory chapter, to build the narratives in this thesis, in particular those presented in chapter four, the second part of chapter five and chapter six; I made use of hundreds of press articles. These articles appeared in the following Argentine newspapers:

- La Nación
- Clarín
- Cronista Comercial
- Ambito Financiero.

## *1.3. Publications by government bodies in Argentina*

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