

**STRENGTHENING OF PROVINCIAL REGULATORY AGENCIES AND
SUPPORT FOR PRIVATIZATION OF THE WATER SUPPLY AND SANITATION SECTOR**

(TC-98-06-32-6)

EXECUTIVE SUMMARY

EXECUTING AGENCY: Ente Nacional de Obras Hídricas de Saneamiento (ENOHSA)

BENEFICIARY: Provincial regulatory agencies

OBJECTIVES: The main objective of the proposed program is to strengthen regulatory capacity in the water supply and sanitation sector at the provincial and local level. The specific objectives are: (i) to strengthen the agencies' capacity in terms of rate regulation; (ii) to develop mechanisms for community and consumer participation; (iii) to promote the development of alternative dispute resolution mechanisms; and (iv) to facilitate the participation of private capital in financing the required investments.

This cooperation is an integral part of the effort to accomplish the purposes of the program in support of reform of the water supply and sanitation sector (AR-0175), which is being processed separately. It is hoped that at least six provincial regulatory agencies will be strengthened.

SOURCES OF FINANCING:	Modality	Grant (Window I)
	Beneficiary	US\$2.1 million
	MIF	<u>US\$1.9 million</u>
	Total	US\$4.0 million

EXECUTION TIMETABLE:	Term for execution:	36 months
	Term for disbursement in full:	39 months

EXCEPTIONS TO BANK POLICY: None

SPECIAL CONTRACTUAL CONDITIONS: As a condition precedent to the first disbursement, the executing agency must present evidence that the respective operating regulations have been put into effect (see paragraph 4.2)

Within the first six months of execution, ENOHSA must present to the Bank evidence of having commissioned

the studies for the development of financing mechanisms to increase the participation of private capital in the investment programs of sector companies (see paragraph 4.8).

To evaluate the effectiveness of the operation, the executing agency must present progress reports to the Bank in the 12th and 24th months after the effective date of the technical-cooperation agreement, describing in detail the progress made toward the agreed indicators (see paragraph 4.10).

I. COUNTRY ELIGIBILITY

- 1.1 On November 30, 1993, the Donors Committee declared Argentina eligible for all modalities of MIF financing.

II. BACKGROUND

- 2.1 The Argentine water supply and sanitation sector has been undergoing an institutional transformation since 1980, when the services that had been performed by Obras Sanitarias de la Nación were decentralized to the provinces. This process was carried further in 1989 when the national government launched a series of political and administrative reforms in all sectors of the economy, including public services. These reforms included the State Reform Act (No. 23,696) and the Economic Emergency Act (No. 23,697), which laid the legal bases for private-sector participation in the provision of services.
- 2.2 The policy of expanding private enterprise's participation in the water supply and sanitation sector has led to the signing of concession contracts with private companies in Metropolitan Buenos Aires (1993) and in parts of the provinces of Corrientes (1991), Santa Fe (1995), Tucumán (1995), Formosa (1996), Santiago del Estero (1997), Córdoba (1997), Salta (1998), and Mendoza (1998), placing Argentina in a leading position in the region in terms of the depth of the institutional transformations under way. 1/ Similar transfers are in preparation in other provinces, notably Buenos Aires, where services are expected to be let under concession in the near future. In addition, about 10 municipalities have independently turned over their services to private concessionaires. It is estimated that today private operators are servicing more than 50% of the national population. 2/
- 2.3 Concurrently with those processes, regulatory agencies have been created in Metropolitan Buenos Aires and in the provinces that have let their services under concessions. However, most of these new entities exhibit weaknesses and deficiencies that limit their capacity and undermine the economic and social sustainability of the new system. In contrast with the success of the concessions-granting process, it has proved more difficult to establish regulatory frameworks and entities that are acceptable to and

1/ The Tucumán concession encountered political and legal difficulties that caused the concessionaire to rescind the contract.

2/ The Argentine Republic has a federal system of government consisting of 23 provinces and the city of Buenos Aires. The population numbers today about 34.3 million inhabitants, of whom about 30 million (87%) live in urban areas.

acknowledged by the government, service providers, and service users, which shows that this is a slower process requiring significant effort and support. In addition, the diversity of the institutional arrangements adopted for delivery of these services has generated ambiguities in the roles to be played by the provinces and municipalities. The provincial agencies often mingle regulatory with operational functions in areas not covered by the concessions, and in some cases limit their action to controlling water quality and resolving minor conflicts. In other cases, the regulatory agencies confine themselves merely to overseeing the legality and fulfillment of contracts, but have no capacity to function as an effective counterpart in the regulation and operation of services.

- 2.4 The concession contracts concluded so far have introduced limitations in the regulatory scheme, such as: (i) contracts are signed by the granting authority, which is therefore the party that must renegotiate and verify contract performance. In these cases, the regulatory agency acts as no more than a technical adviser to the granting authority, and has only limited functions of control and penalization; (ii) in this setting, it is not entirely feasible for the regulatory agency to be independent, and the problem is not one that can be solved simply with personnel training and upgrading programs; and (iii) inasmuch as the granting authority is both a party to the contract and the leading player in any renegotiations, the system is highly susceptible to political change and the intervention of the provincial legislature.
- 2.5 Accordingly, the need to strengthen the regulatory scheme has been identified as a priority for development of this sector. The provinces that stand to benefit the most from the establishment or strengthening of their regulatory agencies are Córdoba, Chubut, San Juan, Santiago del Estero, Corrientes, La Pampa, Neuquén, Santa Cruz, Formosa, Salta, and Jujuy.
- 2.6 To accomplish the purpose of improving regulatory capacity in the provinces, it has been proposed that this technical-cooperation operation be processed as a complement to the program to support reform of the water supply and sanitation sector (AR-0175), which was approved on October 28, 1998.
- 2.7 The Bank has been supporting the state's regulatory function through technical-cooperation operations similar to the one proposed here. In 1994, 1997, and 1998, operations using MIF resources were approved to strengthen the regulatory frameworks and agencies of the provinces of Mendoza, Santa Fe, and Buenos Aires, respectively. The strengthening of the regulatory framework in Mendoza has been completed with satisfactory results. The present operation is intended to strengthen regulatory functions in the less-populated provinces that have not yet addressed this aspect successfully.

III. THE PROGRAM

A. Objective

- 3.1 The main objective of the proposed program is to strengthen regulatory capacity in the water supply and sanitation sector at the provincial and local level, as part of the general approach of supporting greater private-sector involvement in the provision of services and financing of investments. The specific objectives are: (i) to strengthen the capacity of the regulatory agencies in terms of rate regulation; (ii) to develop mechanisms for community and consumer participation; (iii) to promote the development of alternative dispute resolution mechanisms; and (iv) to facilitate the participation of private capital in financing the required investments.

B. Program components

- 3.2 To accomplish the aforementioned objectives, MIF and local counterpart resources will be used to carry out the following activities:

1. Strengthening of regulatory capacity (US\$3.6 million)

- 3.3 This component will establish and/or strengthen the regulatory capacity of an estimated six provincial agencies in aspects relating chiefly to rates, information systems, and personnel training. The program will also finance the equipment needed for efficient performance of the activities assigned to the agency, including monitoring service providers in smaller communities.
- 3.4 **Development of rate-regulation methods and models.** The establishment or redesign of rate-regulation systems will be supported through: (i) the development of price and rate parameters that reflect agreed service-quality standards and are consistent with the plans for investment and extension of coverage; (ii) development of commercial rate systems based on metering; and (iii) definition of the regulatory authority's role in the implementation and oversight of service quality and the proposed rate scheme and level.
- 3.5 **Development of information systems.** Support will be provided for the implementation of systems for the collection, processing, management, and circulation of information on business and service units in the areas of marketing, technology, operations, finance, accounting, administration, and customer service.
- 3.6 **Staff training.** Staff training programs will also receive support, with emphasis on rate-regulation methods and procedures and the reduction of information asymmetries. Support will take the form

of medium-term shadow management consultancies and agreements for cooperation between Argentine regulatory agencies and those of other countries. Mechanisms will be developed to support continuing and long-term training for personnel, specifying areas of concentration and funding requirements.

- 3.7 **Regulation of small-scale providers.** An analysis will be undertaken of the situation of smaller communities, which are commonly excluded from core concession areas. Mechanisms will be developed for promoting services and their regulation in keeping with local characteristics and conditions. Consideration will be given to innovative schemes for integration, outsourcing, and delegation of regulatory functions.
- 3.8 **Equipment.** The program includes financing for the computer equipment required to implement and maintain the information systems and economic evaluation models.
- 3.9 **Community participation and customer service.** This component will develop and strengthen mechanisms for participation by consumers and the community. Each regulatory agency will receive support for defining public information policies, public relations, handling complaints, and the periodical publication of information on service quality. Consideration will also be given to setting up independent committees to deal with customer affairs, investigate complaints, and draft reports for the public and the regulatory agency. Seminars will be used to educate the community about the regulatory function, participation by the private sector, and the development and financing of services.
- 3.10 **Alternative dispute resolution mechanisms.** Arbitration mechanisms will be developed for settling conflicts, mediating disputes, and interpreting contracts independently of the regulatory agency. Specialized technical intervention mechanisms will be considered for resolving conflicts in matters of rate regulation and verification of contract performance.
- 3.11 **Regulatory independence.** The program will address the definition and applicability of measures to make regulatory agencies more independent, and will consider the advisability of promoting multi-sectoral regulatory schemes and establishing regulatory and control bodies at the municipal level.
- 3.12 **Coordination with environmental regulatory agencies.** Under this component, the program will define the scope and necessary levels of coordination in the monitoring of environmental standards and the powers entrusted to the provincial environmental agencies. Standards and procedures will be adjusted to harmonize the environmental authority of these agencies and ensure the protection of public health and the environment.

2. Private-sector participation in service delivery (US\$270,000)

- 3.13 Support will be provided for sectoral studies on business organization at the provincial, subregional, and municipal levels, the design of strategies for participation by private enterprise, and possible operating arrangements.

3. Participation of private capital in investment plans
(US\$130,000)

- 3.14 Under this component, legal documents and instruments, such as standard contracts and formats for project analysis and documentation, will be developed, with an eye to allowing private-sector access to the bank credit system proposed under the program to support reform of the water supply and sanitation sector (AR-0175), and expediting the respective financing. 3/
- 3.15 More sophisticated financial instruments will be devised to increase private-capital financing of sector investments. The possibility will be evaluated of expanding the trust arrangement proposed under program AR-0175 to attract more cofinancing resources. A study will be done of the alternative of raising funds on the capital market by issuing bonds, in order to obtain longer amortization times and increase risk diversification.

IV. EXECUTION

- 4.1 Execution of the program will be entrusted to Ente Nacional de Obras Hídricas de Saneamiento (ENOHSA), an agency attached to the Secretariat for Natural Resources and Sustainable Development under the Office of the President. ENOHSA is also the executing agency for the program to support reform of the water supply and sanitation sector (AR-0175), which is being processed separately. ENOHSA is hence in an excellent position to promote, guide, and coordinate the activities proposed here.
- 4.2 During the development of the aforementioned investment program, ENOHSA will identify the provincial regulatory bodies that require strengthening and, in agreement with the respective provincial authorities, will formulate an appropriate program for strengthening them. The provincial agencies targeted under this operation will be those in the provinces for which projects are presented to program AR-0175 for financing. ENOHSA will have operating regulations, which will serve as a guide for the definition of eligible activities, restrictions on the financing of

3/ This activity is different from the ones normally financed under the MIF's line of activity for concessions.

some components, and the procedures for processing requests for financing. Approval of the final version of these regulations will be a condition precedent to the first disbursement.

- 4.3 The strengthening programs will be tailored to each agency and will be based on an institutional diagnosis of the agency's specific needs, to be conducted by specialized consultants commissioned by ENOHSA. This diagnosis will be performed within a given time frame (about one month) and will yield a specific strengthening plan and proposed terms of reference for the respective consulting services. The strengthening plan, once prepared, will be presented to the Bank for approval.
- 4.4 The strengthening plan will include measures for the institutional improvement of the agency. The ceiling on financing with MIF resources for any given regulatory agency will be US\$250,000. The minimum counterpart contribution required in each case will be 57% of the cost of the strengthening. Consulting firms and consultants will be hired in accordance with procedures established by the Bank. International competitive bidding will be required when the amount involved is over US\$200,000.
- 4.5 Once the strengthening plan for a given agency has been approved and launched, ENOHSA will transfer the technical-cooperation resources following the Bank's disbursement procedures. ENOHSA will see to it that the participating agencies - or the respective provinces - make the counterpart contributions specified in the financing agreement signed in each case.
- 4.6 Regarding the component on support for private-sector participation in service delivery (see paragraph 3.13), ENOHSA will coordinate with provincial and municipal authorities to plan and conduct the sectoral studies to assess the current institutional situation and formulate customized options for bringing about change in each specific case. The maximum amount of financing for any single province will be US\$90,000.
- 4.7 Once the institutional strategy has been worked out, the provincial authorities will have the option of approaching the MIF's line of activity for concessions to obtain financing for legal, financial, and technical consultants to advise in the preparation of bid documents, contracts, and the transfer of functions to the private operator.
- 4.8 The component for development of financial mechanisms to increase the participation of private capital in the investment programs of sector companies (see paragraphs 3.14 and 3.15) will be carried out by ENOHSA directly through consultants who are to be hired within the first six months of the proposed cooperation program.
- 4.9 To expedite the aforementioned studies, ENOHSA has asked for recognition of expenditures already incurred or to be incurred

before approval of this operation. The amount would be credited to the local counterpart and would not exceed US\$50,000.

- 4.10 To evaluate the effectiveness of this operation, ENOHSA should present to the Bank, at 12 and 24 months after startup, progress reports describing in detail the progress made toward the indicators agreed upon in the simplified logical framework (see Annex I). These reports will make it possible to incorporate any adjustments that may be required to make the program more effective.

V. COST AND FINANCING

- 5.1 The total cost of the program is estimated at US\$4 million, with the MIF contributing up to US\$1.9 million, on a nonreimbursable basis, as set forth in the following table:

ACTIVITY	MIF (US\$)	LOCAL (US\$)	TOTAL (US\$)
1. STRENGTHENING OF REGULATORY CAPACITY Methodologies for rate regulation, information systems, staff training, regulation of small-scale providers, equipment, participation by community and customers, dispute-resolution mechanisms, regulatory independence, coordination with environmental agencies	1,550,000	2,050,000	3,600,000
2. SUPPORT FOR PRIVATE-SECTOR INVOLVEMENT	245,000	25,000	270,000
3. PARTICIPATION OF PRIVATE CAPITAL	105,000	25,000	130,000
TOTAL	1,900,000	2,100,000	4,000,000

- 5.2 Part of the counterpart resources will be provided in the form of remuneration for the counterpart personnel of the regulatory bodies and ENOHSA during the periods of time spent by that personnel on program activities, including the proposed training, data collection, and strengthening of the agency. Fifty percent of the local counterpart contribution must be in cash. The local contribution will also include secretarial services, offices, office supplies, communications, transportation, and the necessary logistical support for carrying out this operation.
- 5.3 MIF resources may be used to finance equipment up to 20% of the total cost of strengthening for each regulatory agency. In addition, beneficiary agencies must put up at least 30% of the total cost of proposed equipment. Similarly, the public relations and information work will be limited to 10% of the total cost of each agency's strengthening plan. The amount of the revolving fund to cover eligible expenditures chargeable to the program will be 10% of the total amount of the financing.

VI. JUSTIFICATION AND RISKS

- 6.1 The Bank's operating strategy in Argentina identifies the following areas as priorities: (i) intensification and consolidation of modernization of the State; (ii) reduction of poverty and improvement of the quality of life; and (iii) increasing productivity and fostering greater competitiveness of national production. The proposed program conforms to this strategy by promoting the strengthening of sectoral regulation and encouraging greater participation by private enterprise in service delivery.
- 6.2 The proposed operation complements efforts made in the Argentine sanitation sector under three earlier MIF-financed technical-cooperation operations, which sought to strengthen sector regulatory agencies in Mendoza (1994), Santa Fe (1997), and Buenos Aires (1998). The operation to strengthen the regulatory framework in Mendoza has been concluded with results that appear to be satisfactory.
- 6.3 The resources allocated for this operation are limited and may not suffice to accomplish the stated purposes for all the regulatory bodies that are to be strengthened as required under the sector reform support program (AR-0175). If this budgetary constraint materializes, ENOHSA (the executing agency for both programs) could use funds from the AR-0175 program to ensure, by way of loans, that the activities identified as necessary are carried out.

VII. TARGETS AND EVALUATION OF RESULTS

- 7.1 By the time the program is completed, at least six regulatory agencies are to have been strengthened in their capacity to perform properly the functions assigned to them by law, with the necessary qualified staff and instruments for the efficient performance of their tasks. In addition, the studies and activities called for in the components described above are to have been concluded, with tangible results. Annex I contains a simplified logical framework for the program, summarizing the principal activities, expected results, and time frames within which the various activities are to be carried out.

VIII. EXCEPTIONS TO BANK POLICY

- 8.1 None

IX. SPECIAL CONTRACTUAL CONDITIONS

- 9.1 As a condition precedent to the first disbursement, the executing agency must present evidence that the program's operating regulations have been put into effect (see paragraph 4.2).
- 9.2 Within the first six months of execution, ENOHSA is to present to the Bank evidence of having commissioned the studies for developing financial mechanisms to increase private-capital participation in the investment programs of sector companies (see paragraph 4.8).
- 9.3 To evaluate the effectiveness of the operation, 12 and 24 months after the effective date of the technical-cooperation agreement, the executing agency must present to the Bank progress reports on the operation, describing in detail the progress made toward the agreed indicators (see paragraph 4.10)

X. ENVIRONMENTAL AND SOCIAL CONSIDERATIONS

- 10.1 The legal and institutional framework for environmental matters in Argentina is, on the whole, deficient, basically because the three levels of government (federal, provincial, and municipal) have different jurisdictions over natural resources and the application of standards and regulations is not coordinated. As noted in paragraph 3.12, this operation will promote greater coordination and a better definition of functions among the regulatory agencies responsible for environmental protection and for drinking water and sanitation services.
- 10.2 This operation, which complements the sector reform support program (AR-0175), is expected to enhance the delivery of a service that will improve the hygiene and health conditions of the beneficiary populations and prevent contamination of the bodies into which waste water is discharged. The CESI considered and approved this Donors' Memorandum at its August 28, 1998 session.
- 10.3 In addition to the direct benefits of improving service efficiency and quality, the operation will promote greater community and customer participation in aspects related to service delivery (see paragraph 3.9), better information systems and customer service (paragraph 3.5), and appropriate mechanisms for rate setting and monitoring (paragraph 3.3).

**Strengthening of Provincial Regulatory Agencies and Support for
Privatization of the Drinking Water Supply and Sanitation Sector**
(TC-98-06-32-6)

es: To strengthen regulatory capacity in the water supply and sanitation sector and support private-sector participation in service delivery and the financing of investments
es: (i) to strengthen the capacity of regulatory agencies in the area of rate regulation; (ii) to develop mechanisms for participation by the community and customers; (iii) to develop alternative dispute-resolution mechanisms, and (iv) to facilitate the participation of private capital in financing the required investments.

Component	Activities	Results/Indicators
Strengthening of regulatory capacity		
Technologies and models of rate regulation	Establishment or revision of rate-regulation schemes based on (i) price and rate parameters that reflect agreed standards of service quality, and (ii) rates based on metered consumption. Definition of the role of the regulatory authority in the implementation and oversight of the proposed scheme and rate level.	Rate schemes developed in six regulatory agencies Time per agency: 12 months Total time: 36 months
Information systems	Implementation of systems for gathering, processing, managing, and circulating information on business and service units in the areas of marketing, technology, operations, finance, accounting, administration, and customer service.	Information systems implemented in six regulatory agencies Time per agency: 12 months Total time: 36 months
Staff training	Staff training programs, with emphasis on methods and procedures for rate regulation and reduction of information asymmetries. Medium-term shadow management consultancies and cooperation agreements between Argentine and foreign regulatory agencies.	Development and commencement of training courses Time: 1 to 3 months Total time: 36 months
Regulation of small-scale providers	Evaluation of situation of small communities. Development of mechanisms for promotion and regulation of service suited to local characteristics and conditions.	Regulation mechanisms implemented in 4 to 6 agencies Time per agency: 12 months Total time: 36 months
Procurement of equipment	Financing of computer equipment required to implement and maintain information systems and economic evaluation models.	Computer equipment installed in 4 to 6 agencies Time per agency: 6 months Total time: 36 months

Component	Activities	Results/Indicators
Community participation and customer service	Development and strengthening of mechanisms for participation by users and the community. Definition of the regulatory agency's policies on public information, public relations, handling of complaints, and the periodic publication of information on service quality. Possible creation and organization of independent committees to deal with matters of concern to customers, investigation of complaints, and preparation of reports for the public and the regulatory agency. Community training seminars on the regulatory function, private-sector participation, and development and financing of the services.	Participation mechanisms in place in 6 regulatory agencies Time per agency: 12 months Total time: 36 months
Dispute-resolution mechanisms	Development of intermediate arbitration mechanisms and alternative solutions to settle conflicts, mediate disputes and interpret contracts. Consideration will be given to mechanisms for specialized technical intervention for conflict resolution in matters of rate regulation and verification of contract performance.	Dispute-resolution mechanisms developed in 4 to 6 regulatory agencies Time per agency: 12 months Total time: 36 months
Regulatory independence	Definition and applicability of measures to make the given regulatory agency more independent. Analysis of advisability of promoting multisectoral regulatory schemes and formation of regulatory and control bodies at the municipal level.	Measures to increase independence Time per agency: 24 months Total time: 36 months
Coordination with environmental regulatory agencies	Definition of scope and necessary levels of coordination in the monitoring of environmental standards and the powers entrusted to the provincial environmental agencies. Adjustment of standards and procedures to harmonize the environmental authority of these agencies and guarantee the protection of public health and the environment.	Coordination arrangements set up in 6 regulatory agencies Time per agency: 3 months Total time: 36 months
Private sector participation in service delivery		
Strategic studies	Sectoral studies of business organization at the provincial, subregional, and municipal level, definition of strategies for participation by private enterprise, and possible operating arrangements.	Studies commissioned and completed in 3 provinces Time per study: 10 months Total time: 36 months

Component	Activities	Results/Indicators
on of private capital in investment plans		
isms to facilitate participation	Development of legal documents and instruments, such as standard contracts and formats for documents and project analyses, to facilitate private-sector access to the bank credit system proposed under the program of support to reform of the water supply and sanitation sector (AR-0175) and expedite the respective financing.	Documents and formats designed. Total time: 6 months
isms to increase participation	Development of more sophisticated financial instruments to increase the participation of private capital in the financing of sector investments. The possibility will be evaluated of expanding the trust arrangement proposed under program AR-0175 to attract more cofinancing resources. A study will be done of the alternative of raising funds on the capital market by issuing bonds, in order to obtain longer amortization times and increase risk diversification.	Evaluation and study completed. Total time: 12 months

PROPOSED RESOLUTION

ARGENTINA. NON REIMBURSABLE TECHNICAL COOPERATION FOR THE
STRENGTHENING OF THE PROVINCIAL REGULATORY ENTITIES AND
SUPPORT TO THE PRIVATIZATION PROCESS OF THE WATER
AND SEWERAGE SECTOR

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized, on behalf of the Multilateral Investment Fund, to enter into such agreements as may be necessary with the Ente Nacional de Obras Hídricas de Saneamiento (ENOHSA) and to adopt such other measures as may be pertinent for the execution of the plan of operations referred to in Document MIF/AT-with respect to a technical cooperation, the purpose of which is the Strengthening of the Provincial Regulatory Entities and Support to the Privatization Process of the Water and Sewerage Sector.
2. That up to the amount of US\$1,900,000 is authorized for the purpose of this resolution, chargeable to the Technical Cooperation Facility of the Multilateral Investment Fund.
3. That the above mentioned sum is to be provided on a non-reimbursable basis.