The Debate on the Reform Of the Electricity Sector

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On the eve of the celebration of the eighty-second anniversary of the signing of Mexico's Constitution, President Zedillo sent Congress a bill to change its Articles 27 and 28 to completely open up the electricity sector to private investment. The February 2 evening announcement was broadcast on all Mexican television channels and radio stations. The significance of the proposed changes merited the coverage: if the bill passes, it will put an end to the state's vertical monopoly exercised through the Federal Electricity Commission (CFE) and the Light and Power Company of Central Mexico (LyFC).

The proposal is actually a consequence of significant changes in the sector already initiated with changes to the Public Electric Services Law in 1992 and its regulatory legislation in 1993, changes also incorporated into the North American Free Trade Agreement which came into effect in January 1994. Making these proposals meant opening the doors to private enterprise in the creation of new electricity generation capacity in different forms: self-generation and small and independent production. Other mechanisms for financing joint ventures had also been implemented such as Built Lease and Transfer (BLT) and Built Operate and Transfer (BOT), as well as others outside the budget like the Public Spending Deferred Impact Registration Projects (PIDEREGAS) which have attracted both foreign and domestic capital.

However, the February 1999 presidential proposal goes much further because it means going from a model of partial privatization to virtually total privatization by opening up the electricity sector to domestic and foreign business interests. With this new model, production, transportation, distribution and commercialization would be separated and competition introduced into electricity generation and commercialization.

Activities which are still natural monopolies like transmission and distribution would be regulated to simulate competition. The only area that would continue to be considered a public service would be energy distribution. Electricity generation would be divided among different companies, most of which would be privately owned. Transportation and distribution networks would be leased to private companies but their rates would be regulated. Electricity prices to captive consumers would also be regulated.[1] All this requires important changes in the existing regulatory framework such as amending Articles 27 and 28 of the Constitution and regulatory legislation, as well as formulating new administrative directives and rules for the electricity industry.[2] The Mexican people are now discussing all these issues.

The Pros

Political and economic actors wasted no time in making their reactions known when a possible privatization was announced, generating a polemic that has tended to polarize around those who sing the praises of the market on the one hand and the defenders of state interventionism on the other. We could almost say that there are no Mexicans without an opinion on

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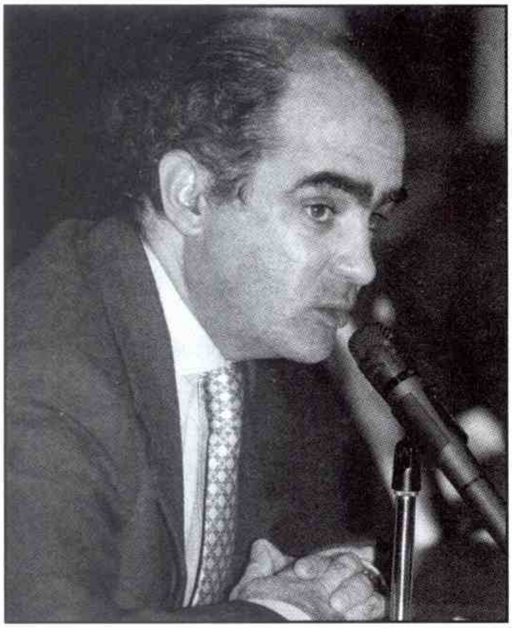

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Minister of Energy Luis Téllez wrote the reform bill.

the matter since the electrical industry, like the oil industry, has been an important factor in the conformation of national identity and, of course, in the Mexican state's role in the economy.

Besides the president and the Ministry of Energy, the Businessmen's Coordinating Council (CEE), the National Chamber of Manufacturers (CANACINTRA) and, although without an open, official position on the matter, the Confederation of Mexican Workers (CTM) all favor the reform proposals and the government's reasons for making these constitutional changes. Of course, they do have slightly different arguments to support the measures, but they all agree that energy supply must be guaranteed and are optimistic about the bill getting through Congress this year.

The Mexican Electrical Workers Union (SME) heads significant opposition to the measure.

THE GOVERNMENT'S REASONS

One of the most important arguments that the president's office has made is related to the approximately 250 billion pesos in investment needed to expand and modernize the electricity system in the next 6 years given that, in accordance with official estimates, demand will grow no less than 6 percent.[3] Guaranteeing future electricity supply has become the standard that legitimizes privatization and a matter of national sovereignty. In the words of Minister of Energy Luis Téllez, "Sovereignty means that our country makes sovereign decisions to ensure that we have electricity."[4] Making the discussion on supply a question of sovereignty has given the latter the characteristic of guaranteeing the general public and industry access to the consumption of a good, in this case electricity.[5]

The specter of future energy scarcity seems to be foreshadowed in continual blackouts in different cities throughout the country, the scenario for national disaster that the government presents as a warning of what would happen if the necessary investment is not made. This touches directly on the interests of the public.

The proposal justifies and sets executive policy on the role of the state: a large state is not necessarily strong, much less if it substitutes itself for private enterprise. It also argues that state guidance will continue although it will be reduced to controling the transmission network, which can be leased to private capital. Public monies previously earmarked for this kind of utilities can now be used for educational and social concerns.

Another merit attributed to the reform is that, as private investment comes in, the electricity sector will automatically be efficient, under the assumption that it can only be modernized if handed over to private capital. Given the negative reaction that President Zedillo's proposal sparked in some sectors, particularly unions, and before an exhaustive evaluation of that response, the president attributed their rejection to "ignorance and dogmatism."[6]

Business associations have closed ranks around the executive because they know that investment opportunities in an attractive industry are greater, which is why we can say their position is more a matter of urging the government to guarantee electricity supply to make sure "companies' competitiveness is not negatively affected." Theirs is a frontal attack, particularly against the Mexican Electrical Workers Union (SME), whose membership works for the Light and Power Company of Central Mexico (LyFC), whom they accuse of blocking the modernization of the sector. According to the CCE, the LyFC union is plagued with work place irregularities, sinecures, corruption, etc., totally incompatible with a modern, productive, competitive Mexico.[7]

Opinions in the Senate, an important political institution, are divided along partisan lines. Generally, however, there is resistance and concern around total privatization. This was clear the last time the minister of energy appeared before the Senate, when neither Institutional Revolutionary Party (PRI) nor National Action Party (PAN) members were totally convinced by his proposed regulatory legislation. In fact, some members of the party in power have had to move from frank opposition to the measure to more conciliatory proposals. For example, the PRI congressional caucus supports the state retaining 40 percent of electricity generation and allowing private capital to invest only in new hydroelectric plants.[8]

CTM General Secretary and Labor Congress President Leonardo Rodríguez Alcaine (also leader of the SUTERM, the Federal Electricity Commission's union) has not hidden his support for President Zedillo's bill, although at first, unfamiliar with the official proposal's details, he wavered. In an interview in which he was asked about the blackouts in different Mexican cities, Rodríguez Alcaine said, "That's a lie. It's not true. And I'm going to make a call right now to get the exact information so as not to stick my foot in it."[9]

The Cons

Just as in other countries, opposition to the proposal comes from electricity workers unions, those directly affected by the reform. The first to oppose the measure was the SME: 15,000 of its members will be laid off when the reform goes into effect. Although SUTERM leader Alcaine does not support the SME, the majority of his union does and the two unions have developed alternative reform proposals.

Together with these unions, the PRI Current for Renewal and many academics agree that the sector's companies can be modernized if they remain in the hands of the state under autonomous management. They have also manifested their rejection of total sale or leasing of the electricity generation plants and the physical assets of the transmission grid. They do, however, favor incorporating private capital, just as has already been happening, in joint generation projects and independent production.

Despite the traditional alignment of the party in power, the PRI Current for Renewal has displayed its concern with regard to two questions: 1) continued state guidance of the sector, and 2) giving priority to domestic capital. The latter consideration makes sense given statements by the minister of energy himself who said that domestic investors were not very experienced in this area, basically making a preferential invitation to foreign capital. Despite these discrepancies, the current does close ranks around the government by accepting the executive argument about its financial inability to maintain the industry's rhythm of growth and development.

Other actors base their arguments on the failure of previous privatization experiences in Mexico, mentioning the banks, highways and even railroads, which have not only not benefited the nation, but also have not meant lower prices for their services. In any case, they have given rise to corrupt practices which the citizenry now has to pay for (one example is the Savings Protection Bank Fund, Fobaproa).[10] They also point to the

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fear that privatization of the electricity sector will set a precedent and create the constitutional and political conditions for privatizing Petróleos Mexicanos (Pemex), the national oil producer and the country's most important company.

It is no simple matter to have an objective opinion since the arguments for and against depend on where you are standing, despite the fact that some questions can be answered regardless of class and party interests. For example, to what extent are we still talking about a strategic sector? Has the most appropriate model been selected for the Mexican situation?[11] There is no simple answer. The factors are multifaceted. But here we will mention a few of the elements needed for a future analysis.

Taken on its own, the proposed reform is an excellent planning exercise,[12] an attempt to create a more advanced model for the sector similar to those of England and Wales. However, this does not take into consideration the enormous differences between the electricity systems of those countries and Mexico. Four problems could arise out of applying measures as radical as the ones proposed:

1) *Profits from the electricity sector benefiting only the few*. Víctor Rodríguez says that it is a fact that electricity systems make a profit, but that both its size and its distribution depends on the model of organization and the kinds of regulations applied. None of the existing models has proven better than any other in terms of short- and long-term economic efficiency.

When the reform goes into effect, profit distribution would become unequal because intense vertical reintegration and industrial concentration, whether legal or illegal, would occur among firms seeking a bigger share of the pie.[13]

2) *Increased risks to electricity supply*. The experience in other countries has shown that reforms of this kind do not necessarily guarantee long-term electricity supply. Different countries have had overcapacity problems that have spurred them to slow down investment, merge companies and eliminate less profitable power plants, so that generation capacity has not kept pace with the growth of demand.

3) *Higher electricity bills*. Competition in electricity generation does not necessarily lead to low prices. Although it is argued that competition and the creation of a wholesale market will make it possible to lower utility bills, the fact is that international experiences suggest a multiplicity of factors behind those drops in prices and that they were not due exclusively to the competition among producers. Actually, an effective mechanism for benefitting small and medium-sized consumers with lower electric prices on a wholesale market has not yet been discovered.

4) *More disequilibria and lags in energy policy*. Although much could be said about this, we will only point out that the important increase in gas consumption required by the electricity industry will be supplied with imports from the United States since government investment in exploration, development and processing of natural gas will be limited. The model proposed is very dependent on the United States since we have a single client for our oil, and we will be buying increasing amounts of gas because our production is insufficient for the country's needs.

CONCLUSION

Although the scenario seems complicated because of the different positions and proposals, there also seem to be more accessible solutions for resolving the situation of the electricity companies: for example, raising rates and allowing the companies to capitalize before implementing more radical proposals, like privatization.

No one doubts that it is difficult to step outside the process of globalization, which includes changes in the energy sector. Neither is it easy to sidestep pressure from economic groups promoting privatization and the dismantling of state control in sectors where it has historically played a leading role. However, there is room for decision making and we have to find it, since the ultimate responsibility for all these decisions lies in our national elites.

As the debate continues between two extreme positions, we must urge that the protagonists leave room for considering alternatives that would make it possible to balance state participation and the market. This would be a more appropriate option given the social and historic reality of a country like Mexico. **VM**

Notes

[1] Víctor Rodríguez Padilla, "Propuesta de reforma eléctrica cuestionable," *Momento económico* (Mexico City) (April 1999).

[2] Comisión Reguladora de Energía, *Infocre*, year 2, no. 1 (Mexico City) (February 1999), pp. 3-4. See also "Iniciativa de decreto para reformar los artículos 27 y 28 de la Constitución Política de los Estados Unidos Mexicanos, en materia de energía eléctrica," *Gaceta Parlamentaria* (4 February 1999).

[3] Opponents of privatization strongly question this figure saying it has no basis in fact. In addition, the same official sources put estimated investment requirements for 1997-2006 at 198.862 billion pesos in the Ministry of Energy's publication "Prospectiva del sector eléctrico 1997-2006" (Mexico City: September 1997).

[4] *La Jornada* (Mexico City), 4 February 1999.

[5] To justify this scenario, its supporters mention a CFE study predicting blackouts this summer because of excess demand and talking about a deficit of between 199MW and 675MW. For winter, the study predicts a deficit of between 133MW and 447MW. *Reforma* (Mexico City), 16 February 1999. We should mention that recent news items report the minister of energy saying that combined cycle plants are being started up to ensure electricity supply.

[6] *La Jornada* (Mexico City), 23 February 1999.

[7] *La Jornada* (Mexico City), 16 April 1999 and *El Financiero* (Mexico City), 20 April 1999.

[8] *La Jornada* (Mexico City), 29 April 1999.

[9] *Reforma* (Mexico City), 16 February 1999.

[10] See the article by Mexican economist Francisco Sevilla, "Mexico's Savings Protection Bank Fund and the Financial Crisis," in *Voices of Mexico*, no. 46, (January-March 1999), pp. 53-58. [Editor's Note.]

[11] I mention here only a few of the aspects developed more broadly in Víctor Rodríguez' article mentioned in endnote 1.

[12] Secretaría de Energía, "Policy Proposal for Structural Reform of the Mexican Electricity Industry" (Mexico City, 1999).

[13] In the Mexican case, the possibility of private monopolies is not far off given the regulations themselves. In effect, the secondary regulatory bill submitted to the Senate proposes, among other things, the disappearance of LyFC, the break-up of the CFE, the licensing of private companies to manage hydroelectric plants and the possibility of carrying out monopolistic practices after opening up to private capital.