Electricity in Mexico: When doing the right thing is not enough

23rd IAEE North American Conference

VI Congreso Anual AMEE

October 21, 2003. Mexico City.

Electricity restructuring: Skepticism and even rejection replaced initial enthusiasm

- Some processes were implemented in a dogmatic way with an emphasis on privatization.
- There is not a clear trend in overall results.
- In some cases, structural issues and physics of electricity were not properly addressed.

Lessons from international experience

- Separation of the monopoly and competitive segments of electricity is not easy.
- Private ownership can be too costly or not feasible if there are no strong regulatory institutions and credibility.
- Capacity requirements, forward contracting and RTP may solve market power problems.
- Retail competition is not always justified for residential or small consumers.

The Mexican Case

- The Mexican power industry is organized as a vertically integrated State owned monopoly.
- Electricity supply is considered a general interest public service and all the activities necessary to provide it are exclusively reserved to the State.
- Private individuals or corporations can produce electricity for self-supply or participate as independent producers selling electricity to the State.
- There are two State entities that provide the public service.

Privatization in Mexico is not a feasible solution for the power sector

- There are situations that would affect the sale price of State assets and create uncertainty over revenues.
- There are no conditions for the operation of a private network monopoly.
- Public funds would have to keep flowing to the sector.
- If the problems are solved, then there's no clear jutificiation for privatization.

A hybrid model in Mexico can attain most of restructuring efficiency gains if the right structure is implemented

- Legal separation of regulated and competitive activities.
- Independent and strong regulatory agency.
- Independent system operation and open access to networks.
- If any, clear and direct subsidies.

But ... does it solve public ownership problems?

- Rates don’t reflect the actual cost of electricity
- Lack of incentives to improve efficiency
- Lack of investment due to budget constraints.

- Rates are set by the regulator
- Subsidies are direct and transparent
- Competition in generation and in commercialization for big consumers

Budget constraints come from ...

- Impact of electricity public entities budget balance on the federal government overall budget.
- Conflicting interest due to government's limited resources and multiple priorities.
- The need for a direct or indirect government guarantee for loans.

Several solutions have been proposed to reduce the impact on the federal budget

- To treat power sector entities differently in the government accounting system.
  - This has no real effect because financial markets will make the proper adjustments to valuate risk.
- To use new financial schemes.
  - Only equity instrument do not affect public finances.

Regarding the conflict of priorities it has been suggested …

- To change corporate governance structure of power sector entities.
  - No real solution here, because any decision affecting the federal budget would need government and congress approval.
- Private participation in power sector entities’ equity.
  - It would help to keep decisions aligned with the sector needs.

As to the need of government guarantee for loans ...

- The need for such guarantee would be less if:
  - Equity instruments are used.
  - There is an adequate industry structure.
- It would also depend on the quality and credibility of regulatory institutions.

Only private investment can relax the power sector budgetary constraint

- It would help solve public ownership problems.
- The government doesn’t need to give up control over power entities.
- It implies a new exclusivity paradigm based on corporate control not property.
- It would require Constitutional amendments and legislative reforms.

luis.fonseca@cfe.gob.mx
slopezm@cfe.gob.mx