



A LIGHT FOR NATIONAL COMPETITIVENESS

A REFORM PROPOSAL FOR THE MEXICAN ELECTRIC SECTOR

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EXECUTIVE SUMMARY

The electric sector's development is essential for expanding competitiveness in Mexican economy. Nevertheless, the electricity service within the country represents a high cost mainly due to political decisions that have hindered the efficiency of its production. The process is quite expensive because of the lack of incentives needed to operate efficiently in the absence of a competition framework where electric rates do not answer to the market's signals, where operations are made under unacceptable conditions and a noteworthy dependence on volatile energy inputs. These issues have been hidden with the crossed subsidies in the rates established by the government where industrial and commercial consumers are partially paying the costs of residential and agricultural consumers. In order to tackle this problem, the Center of Research for Development (CIDAC) presents a series of policies where the electric industry is virtually disintegrated, thereby creating a wholesale market but keeping transmission and distribution as regulated and segmented monopolies. Unlike the federal government's energy reform proposal, this document considers that the aforementioned measures have to be accompanied by a vigorous strengthening of the Energy Regulation Commission (CRE) in order to avoid opening procedures that will only benefit some private companies. While the hydrocarbon sector's reform impulse would imply upsetting several markets of high added value, an electric reform would affect efficiency of most of Mexican economic activities.

1. INTRODUCTION

Mexico is on the verge of an energy crisis that will endanger its economic development. When considering that the economy has a growth prospective of an annual 3% during the next six years, the number of energy inputs to sustain such activity is not enough: from 2000 to 2011, Mexican society increased its energy consumption to an average 2.08% rate¹, but during the same period, the production of primary energy² decreased to a 0.3% annual rate.³

In order to reverse that situation, President Peña Nieto's administration is keen on setting up an energy reform that, theoretically, would seek to include the private sector in different phases of the production process of oil and gas. Such a controversial issue leads to heated ideological (and even technological) debates. This is precisely why the attention over the energy crisis that Mexico might face, sooner rather than later, has overlooked an essential area of the country's economic competitiveness: the electric sector.

In Mexico, the quasi-mythological link between oil ownership and national sovereignty, in addition to the palliative that both the partial liberalization of electricity in 1992 as well as the elimination of the inefficient LFC (Light and Power electric company) in 2009, produced a vast cloud that has hindered the majority of politicians from seeing the serious problems that the sector is currently going through. If it ends up not being included in the debate, the electric sector faces the risk of being as the energy reform's largest orphan: one that has been abandoned by its father – the State -, who will greatly regret it over the next years.

Despite the fact that it's always been in the shadow of hydrocarbons, the electric sector was seriously addressed by two of the last three Presidents due to its importance for Mexican economy. Thus, both Ernesto Zedillo and Vicente Fox showed an interest on those problems that – since then – the electric sector faced. Knowing that the 1992 reforms on the Law of Electric Energy's Public Services (LSPEE) were insufficient (though they were a step in the right direction, nonetheless), former President Zedillo presented its initiative of reforming the 27th and 28th Constitutional articles on February 1999. Its project acknowledged that even though the 1992 reforms opened up the possibility of private investments on the generation of electric energy, there were still restrictions for its transmission, distribution and commercialization, which also imposed long-term commitments at the expense of the Federal Electricity Commission (CFE). For that reason, he proposed an ambitious attempt for liberalizing the market as several other Latin American countries did. The initiative included modifications such as the creation of a wholesale market regulated by a solid government authority, privatizing some of the State's assets, reducing personnel, among others:

“The new electric sector would have several companies specialized in generation, transmission as well as distribution... competitiveness among the electric industry's activities would be introduced,

¹ 2013-2017 National Energy Strategy. Secretariat of Energy, 2013, p. 3.

² Primary energy is the one that cannot be used directly, that is to say, all energy available in nature before being converted or transformed (e.g. raw fuel).

³ Secretariat of Energy, 2013, *op. cit.*, p.3.

especially regarding generation and commercialization, which would both be subject to a permit regime. Activities that are natural monopolies, such as transmission and distribution, would be object of economic regulations that would simulate conditions of competition”.⁴

This reform attempt was unsuccessful due to a lack of essential political conditions for it to grow further: fear of assuming political costs in the verge of a Presidential election discouraged PRI, who didn't have enough votes to approve the initiative and needed help from some other party.⁵

Vicente Fox's electric reform proposal was less ambitious than the one presented by his predecessor but it kept the intentions of improving the quality of service, decreasing its costs as well as attracting investments towards the sector. Some of the initiative's most important points were the substitution of a single generator and buyer scheme held by CFE for a framework in which different electric generation companies could participate, but also in which several buyers could participate.⁶ Another implementation considered was opening up the generation, conduction, transformation, distribution and supply activities for social and private sectors, in addition to strengthening CRE in order to guarantee fair and transparent procedures. Nevertheless, just like it happened with the 1999 initiative, political opposition to the initiative capitalized on the fear of privatization among consumers. Surveys and polls highlighted that the population didn't agree with the proposal because they feared a price increase and this proposal would represent a political cost for anyone who would support it.⁷ PAN, who only had 41% of Deputies and 36% of Senators, didn't have enough political ability to convince other parties. If roles were inverted, this time PRI didn't support PAN's proposal.

It's worth highlighting that both projects shared two features: they were presented as energy reforms that didn't take into account changes within the hydrocarbon sector and, nevertheless, didn't manage to get the necessary legislative support to become a reality. Beyond the fact that none of these projects were successful, perhaps due to political vendettas, neither Vicente Fox nor Felipe Calderón, later on, tried to include the issue of reforming the electric sector back in the political agenda, as if it were a hopeless patient with nothing left to do for him.

Thereby, if the implementation of an energy sector reform hasn't been an essential part of public discussions – until its appearance on PAN's energy reform initiative – it can be explained due to the political cost it represented on the past. Rifts appearing in the administrations of Zedillo and Fox, as well as social protests held by former workers of LFC during Calderón's tenure are events that have a price that the current administration – or any other whatsoever- doesn't want to pay at all. Decision-makers might be slightly confused regarding the political costs that the proposal

⁴ *Restructuring Mexican electric sector based on the international experience*. Alejandro Tazzer, 2004, p. 91

⁵ By the time of its 1999 internal debate, PRI had 60% of all Senators and 48% of all Deputies. PAN wasn't willing to back up the initiative for a Constitutional reform.

⁶ Tazzer, 2004, *op. cit.*

⁷ According to a 2003 survey carried out by Consulta Mitofsky, those who opposed the initiative did so because they considered that the reform would unleash a rise in electricity bills. In a poll made by Ipsos Bimsa in 2002, 51.2% of those surveyed considered that an increase in electricity bills would "affect them a lot" and, according to a Buendía y Laredo poll carried out in 2003 Vicente Fox's worst Presidential approval ratings happened at the time of his decision to reduce electric subsidies.

might include. On one hand, the political cost for an energy reform that includes the electric sector is marginal when compared to a reform based only in hydrocarbons. On the other hand, benefits for Mexican society are considerably higher.

Peña Nieto's government is now facing a greater problem in energy issues than his predecessors, but also with a completely different conditions and political environment. The victory margin obtained by Peña on the 2012 Presidential elections, the percentage of legislative seats that his party has on both legislative chambers, the political control of PRI governors (who form a large majority in most states throughout Mexico) as well as the ideological affinities with PAN foster the hope that an electric sector reform will finally come together.

If the current administration, the main political parties and decision-makers should include the electric sector within an energy reform, it is important to have the following message in mind: while hydrocarbons are a source of wealth for Mexico, the importance of the electric sector comes across a large scope of activities that affects the lives of almost every Mexican citizen.⁸ Within the industries, the growth of all economic sectors in the country depends on a competitive energy supply that will guarantee a greater added value in its production. Regarding household consumption, an economically growing country that is constantly improving its population's living conditions requires a more intensive use of electricity in order to satisfy its needs. With this context, CIDAC presents a diagnosis for the size of the problem faced by the electric sector in Mexico, exposes the risk of not addressing the country's energy future and, finally, details several guidelines for the electric sector to become an efficient engine for the nation's economic development and growth. The electric sector cannot be out of the most important discussion held in Mexico for several decades and that will affect a large number of generations of Mexicans. An energy reform that doesn't include the electric sector is not a reform at all.

⁸ According to the Secretary of Energy, Pedro Joaquín Coldwell, only 2 million of Mexican citizens have no access to electricity, which would mean that 98.3% of the population has electric energy at its disposal.
<http://www.cronica.com.mx/notas/2013/743854.html>