Energy + Power RISK MANAGEMENT

LATIN AMERICA **By Caitlin Randall**

Latin America's power markets are following the worldwide trend to deregulation. But the process of liberalisation is slowing up as the region's countries face political and economic difficulties

Staggered start stalls

The race to liberalise Latin America's electricity sector has slowed to a measured crawl, say analysts. Brazil and Mexico, two of the region's biggest power markets, are facing new challenges in turning largely government controlled power industries over to private hands. And even Chile, far-and-away the frontrunner in the liberalisation race, which started its privatisation process in 1982, has had its share of difficulties this year.

"If you had a continuum showing liberalisation and privatisation in Latin America, Chile would be on one end [having made the most progress] with Mexico and Brazil way on the other end," says Andrew Campbell, a Latin American utilities analyst with SG Cowen Securities, a New York investment bank owned by Société Générale Securities Corp.

Ironically, it is Venezuela, where the election last year of President Hugo Chavez had many foreign investors worried the rug was about to be pulled out from under them, which has seen recent progress in the privatisation process. During his election campaign, Chavez said he would respect existing contracts with various foreign companies, but indicated a number of these would be revised.

According to Campbell, a new law enacted in September in Venezuela "provides a framework for competition in the generation sector and for tariff setting in the distribution sector". He adds that although it is a "baby step", it is "a step in the right direction".

In Brazil, with the first flurry of strategic acquisitions and initial privatisations now complete, "this is when the real work begins," says Andrew Jacobyansky, a vice-president and senior analyst with international ratings agency Moody's Investor Service in New York. Brazil started privatising its power sector in 1995 with the sale of the state-owned electricity distribution company Espírito Santo Centrals Eléctricas. Since then the government has auctioned off more than $20 billion in electricity assets, mostly on the distribution side, say analysts.

But now, the pace has slowed as Brazil confronts political controversy over hydroelectricity sales, project finance difficulties and its economic problems.

Average annual growth in electricity use is around 7% in Latin America compared with 1%–2% in the US and Europe

In January 1999, the loss of international investor confidence and massive capital flight brought Brazil to the verge of financial collapse and to the brink of its third debt default in two decades.

The economic picture since then has improved considerably, according to Brazil's Central Bank. It cites prices climbing at only 8% this year after the Real's devaluation and a economic contraction of around 4% with growth expected to resume next year. But investors remain wary, analysts say.

"Brazil's privatisation process is not so much stymied as re-grouping in response to the difficulty in getting project financing," says Moody's Jacobyansky.

"I've heard talk of new projects, but still no evidence of investment. But the Bolivia-gas pipeline could spur some development," adds Jacobyansky, referring to a 2,000 kilometre natural gas pipeline under construction that will stretch from Santa Cruz de la Sierra in Bolivia to Porto Alegre in southern Brazil. For power generators, gas is not only the cleanest hydrocarbon fuel available, but also the capital cost of using gas is lower than other energy sources.

Analysts also say the 30% drop in the value of country's currency left the Brazilian government unwilling to link electricity tariffs to dollar pricing. With the Real's depreciation against the dollar there would be no hope of recouping capital or variable costs if revenue was not dollar-linked Instead, the government has frozen tariffs in nominal terms.

This move has effectively reduced electricity rates to a very low $20 per megawatt hour (MWh), compared with around $35 per MWh in the UK, and scared off potential investors, says Sandra Boente, a senior utilities analyst with Salomon Smith Barney in New York.

She adds that given the government's position on rates, its own forecasts for a 4,000 MW increase in electricity generation by 2002, are hardly realistic.

Boente also notes that political opposition to the sale of state-owned hydroelectric plants has delayed privatisation in the generation sector.

"In a sense you're selling off control over the flow of rivers and reservoir capacity," she says. "Brazil does not have a water policy in place and the opposition is stalling [further privatisation] until the government comes up with a viable policy. It's very hard to imagine this happening in the next three months, which would allow next year's privatisations to proceed," she adds.

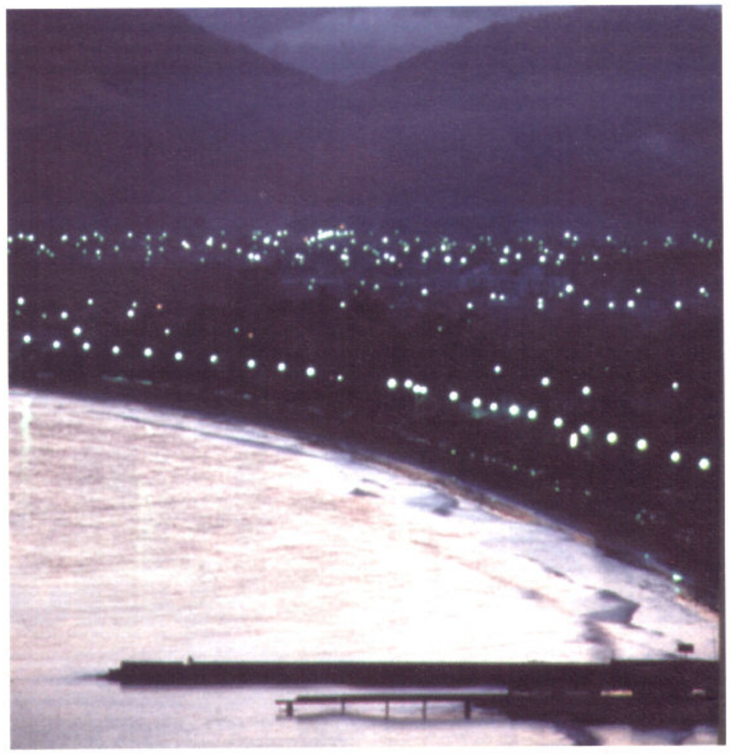
More than 90% of Brazil's energy is generated by waterpower, according to a report – *Fundamentals of the Global Power Industry* – by the international consultancy Arthur Anderson. The report also notes that around 23% of potential dam sites are being used, but the rest are a long way from centres of power consumption complicating electricity transmission.

In late July, however, the US power company Duke Energy gave the slow-moving electricity privatisation programme a boost when it acquired Brazil's 11th largest generating company, Companhia de Geração de Energia Eléctrica Paranapanema.

It is Brazil's second major electric generating company privatisation, following Geradors do Sul

Energy Power RISK MANAGEMENT

Brazil nights: forecasts for a 4,000 megawatt increase in electricity production by 2002 are unrealistic



do Brasil in 1998, which was purchased by the Belgium energy group Tractabel. Duke paid $680 million for the controlling interest in Paranapanema, according a company statement.

Meanwhile, Mexico is also struggling to privatise its own electricity distribution, generation and transmission sectors.

Rachel Dyer, a Latin American specialist with the consultancy group Wood MacKenzie in Edinburgh, says Mexican President Ernesto Zedillo earlier this year sent reforms to the Mexican Congress, which would open the electricity market up to private investment. The government projects that over the next 10 years it will need $35 billion in new investment to meet its electricity infrastructure needs.

Dyer says the reforms are an important step forward, but she adds there is still no structure in place to develop privatisation further and there is also political opposition to liberalisation.

SG Cowen's Campbell adds: "Privatisation means lay-offs and is not necessarily a politically popular thing to do in an election year. Even once you have the legislative green-light, you're still facing a number of complex steps before anything is sold off." Mexico's general elections are slated for July 2, 2000.

In Chile, which serves as a model for the rest of the region and other countries as well, the problems are at a different level.

"Chile's problems are really second generation stuff," says Moody's Jacobyansky. More specifically, a drought-induced energy crisis prompted the government to impose stiff fines on regulated power producers if electricity supply did not meet demand. Furthermore, heightened competition in the country's northern grid also made power generation less profitable.

Reflecting such troubles, Moody's recently gave the country's biggest power generator Empresa Nacional de Electricidad (Endesa) a negative rating outlook. Endesa-Chile, which provides approximately 50% of the country's electricity, was deemed by international rating companies as too highly levered, with the company carrying a significant debt burden that jumped 20% in 1998. This is despite Endesa-Spain's involvement. The Spanish power company recently arranged a debt-refinancing package for Endesa-Chile with eight international banks.

In May, Endesa-Spain paid $3.5 billion to double its shareholding to 64% in Chile's Enersis, Latin America's largest quoted electricity distributor and raised its ownership in Endesa-Chile to 60%. The increased shareholding is expected to result in drastic budget cuts for the Chilean power producer aimed at lifting the Santiago-based company's profitability. In fact, says Moody's, Enersis and Endesa-Chile have targeted $500 million in savings by 2003.

"There's nothing to stop these markets from being completely liberalised," says Wood Mackenzie's Dyer. "It's just a long way down the line easily 10 years." But she and others note that with average annual growth in electricity use at around 7% in Latin America, compared with1%-2% in the US and Europe, the region remains alluring. ■

Latin America powers up

Increasingly, as the deregulation and privatisation processes in Latin America progresses, the region's power companies will form links with their counterparts in the US.

In October, for example, the Mexican state-owned electricity utility, the Comisión Federal de Electricidad (CFE) joined the Californian Power Exchange (CalPX) based in Pasadena. It is the first Mexican company to participate in CalPX's spot electricity markets.

CalPX chief executive officer, George Sladoje, says: "The CFE's entry into CalPX's day ahead market will further increase trading volume and opportunities for generators to supply energy to Mexico."

Initially the Mexican utility will trade just the electricity for the Baja area in the north-west of Mexico through CalPX. There is already a transmission link to the electricity pool in Tijuana and the Imperial Valley on the California-Mexico border. But Sladoje hopes CalPX can start to serve other regions in Mexico next year through transmission links in Arizona. The exchange is also watching the development of a possible transmission link with Guatemala closely, he says.

Such international member firms help to establish CalPX prices as the benchmark in the West of the US.

Severin Borenstein, director of the University of California Energy Institute and member of the CalPX Board of Governors, says: "I'm very pleased to see the CFE joining CalPX. It represents one more step for CalPX in expanding beyond California to become the regional power market for western North America. As more volume moves through CalPX, it becomes a more reliable benchmark for power prices in the West." ■

Jane Locke