Regulation of public utilities: half-way crossing the river

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Privatization & deregulation in the 90s:
- the grammar was correct, with good results in general, but
- imperfections & highly deteriorated macro context (2001-02 crisis) favored a counter-reform

The “K counter-reform” (2003-15) included:
- tariff freezing,
- cost-plus spiking fiscal subsidies,
- cross-subsidies,
- regulatory discretion & institutional degradation,
- investment contraction & quality deterioration,
- spiking marginal costs,
- systemic energy crisis, reversed energy trade balance, etc.
Real tariffs in 2015 (2001=100)

Source: based on sectorial information; retail deflator

<table>
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<th>Public firms</th>
<th>Private firms</th>
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<tr>
<td>Gasoline</td>
<td>Gas Oil</td>
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<td>Postal service</td>
<td>Domestic flights</td>
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The K-shore (Dec-2015)
Overall task: Four dimensions of “normalization”

1. reduce fiscal subsidies (higher tariffs)
2. attract investment
3. minimize distributive (& political) impact
4. avoid inflationary shock

Strategy chosen:

1. Strongly increase energy prices (wholesale, upstream) & T&D margins, & W&S tariffs
2. Smaller increases of public transport & (fixed) telecom tariffs
3. Contractual normalization:
   • Only for T&D energy concession contracts (RTI –integral price-cap revisions), including pass-through of upstream prices and periodic (not automatic) inflation adjustment
4. New social tariff for 30% poorest users of all public services
• 2015-2018: fiscal subsidies fell by US$ 15 billion/year or 2.3% of GDP

• In 2018, small reduction due to devaluation (increasing peso prices of upstream energy not paid by final users –i.e., PPA CAMMESA contracts, imported NG, “New Plan Gas” for non-conventional NG production, etc.

Subsidies to public utilities (in MM USD and as % of GDP), 1989-2018

In constant pesos, huge hikes in residential energy tariffs (particularly in electricity and for low-demands), currently tripling real values of 2001 (as price of upstream NG also tripled in US$ –from 1.3 to 5 US$/MMBTU)
• Which, when measured in current US$, are less impressive, showing remaining adjustments in all cases
• In 2018 fiscal subsidies still were 47% & 23% of upstream costs of electricity & NG, and 87% & 15% of total costs of urban trains and W&S

• Their full elimination would require further tariff increases:
  • 45% in electricity; 15% in NG; 651% in urban trains; & 17% in W&S (GBA)
Crossing the river (Dec-2015)

• Forgotten elements:
  
  • Cost and limited effectiveness of attracting investment by fixing prices instead of adopting credible competitive rules whenever possible (upstream electricity & natural gas)
    – with one exception: commercial aviation (with excellent results: opening the market ⇒ + entry + coverage – prices)
  
  • Repressed inflation: artificially low tariffs and exchange rate in dec-2015 increased the size of pending tariff adjustments (tradable energy) and its inflationary impact
    – inflationary pressures remain strong when relative-price corrections are not combined with a fiscal contraction, no matter the financing source
  
  • Macroeconomic consistency required to avoid significant real exchange rate shifts (which bring excessive volatility to regulated tariffs)
How to reach the other side of the river?

• Fiscal discipline and macro-stabilization: KEY

• Restore correct price signals to both supply and demand, re-designing:
  
a) social tariffs as focalized lump-sum transfers to the poor (and lower middle-class?) and

b) taxes to account for externalities instead of distorting competition, including:

  • Eliminate cross-subsidies among R users originated in multiple fixed and variable distribution charges (energy, and electricity in particular)

  • Converge to unregulated (and thus uniform) upstream prices of energy (NG in particular), and

  • Reestablish contractual rules to stop cost-plus fiscal subsidies (applying to public & quasi-public firms as AySA and urban trains)

• More generally, current efforts to cope with the inherited “K counter-reform” need to be inserted into a new master-plan of consistent structural public utilities’ reforms
Thank you!