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Regulation of public utilities: half-way crossing the river

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The K-shore (Dec-2015)

- 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.

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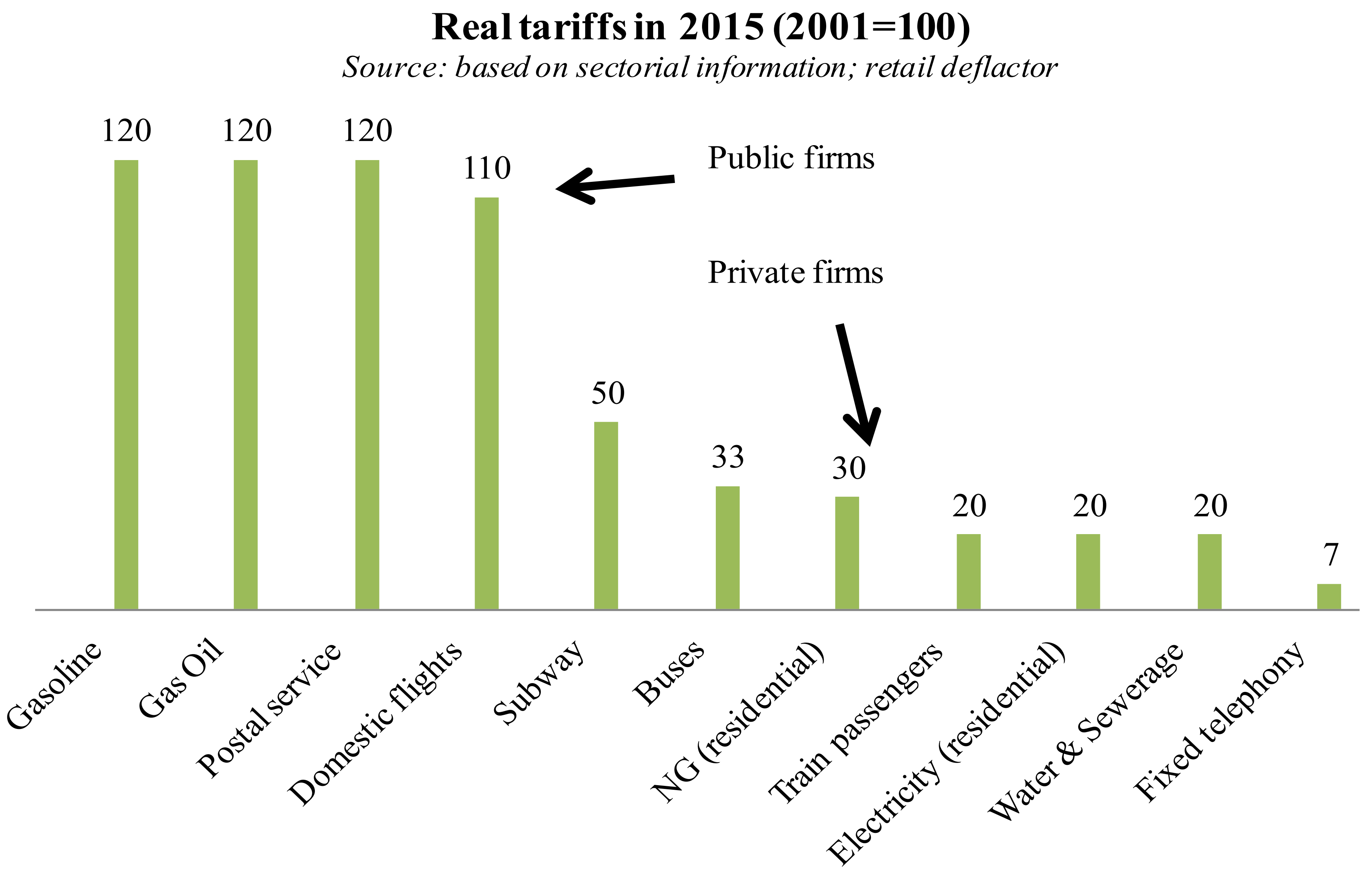
The K-shore (Dec-2015)



Crossing the river (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

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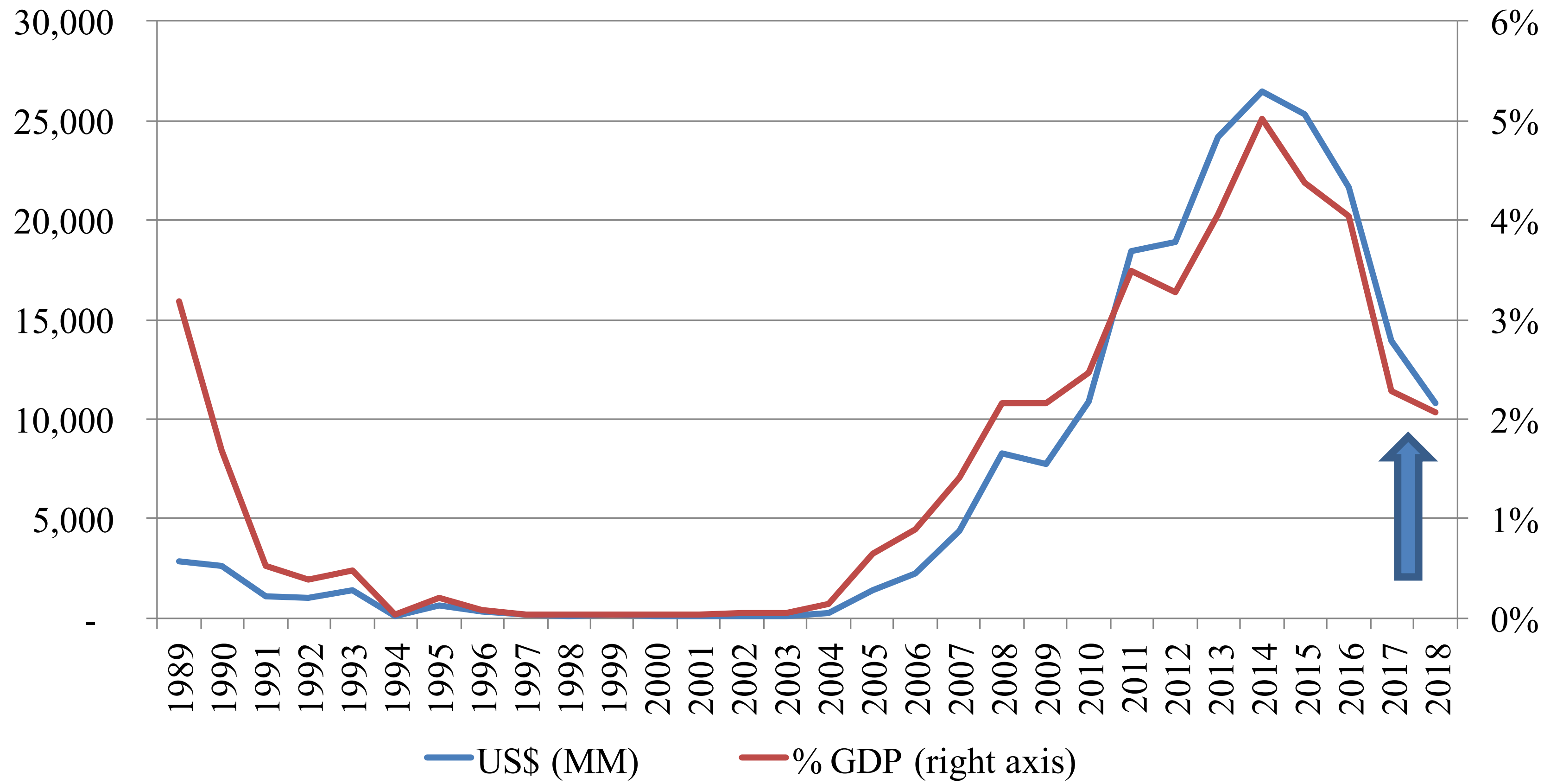
Crossing the river (Dec-2015)

- 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

*Source: Own elaboration based on SIGEP (1989-1995, MECON (1996-2003) and ASAP (2004-2016): Until 2003 it includes YPF, GE, AyEE, Hidronor, AA, FFAA, ELMA, ENTEL, ENCOTEL and OSN. Since 2004 it includes subsidies to public and private firms in the energy, transportation and W&S sectors. * 2019 is an estimation based on xx months.*



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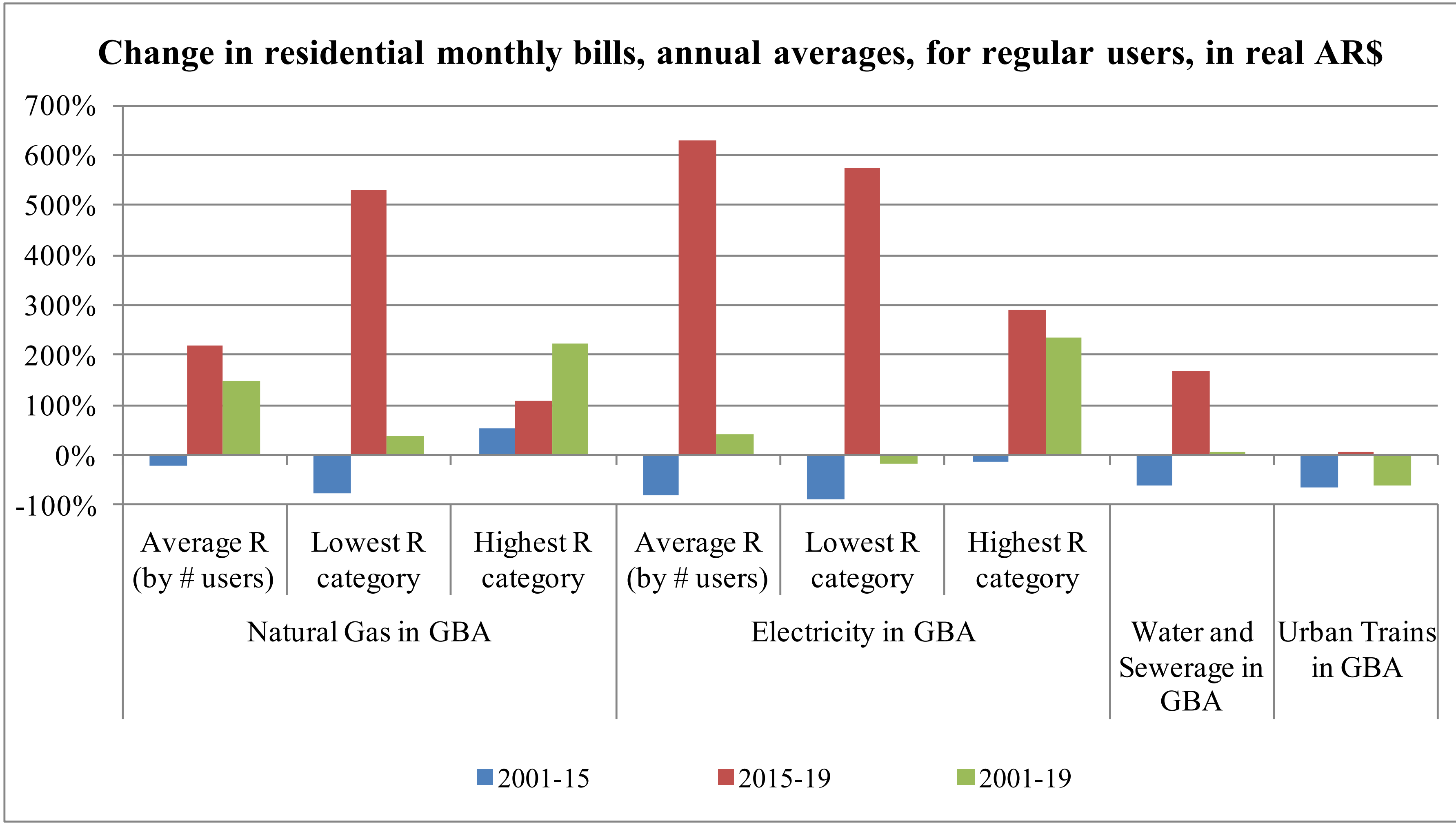
Crossing the river (Dec-2015)



- 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)

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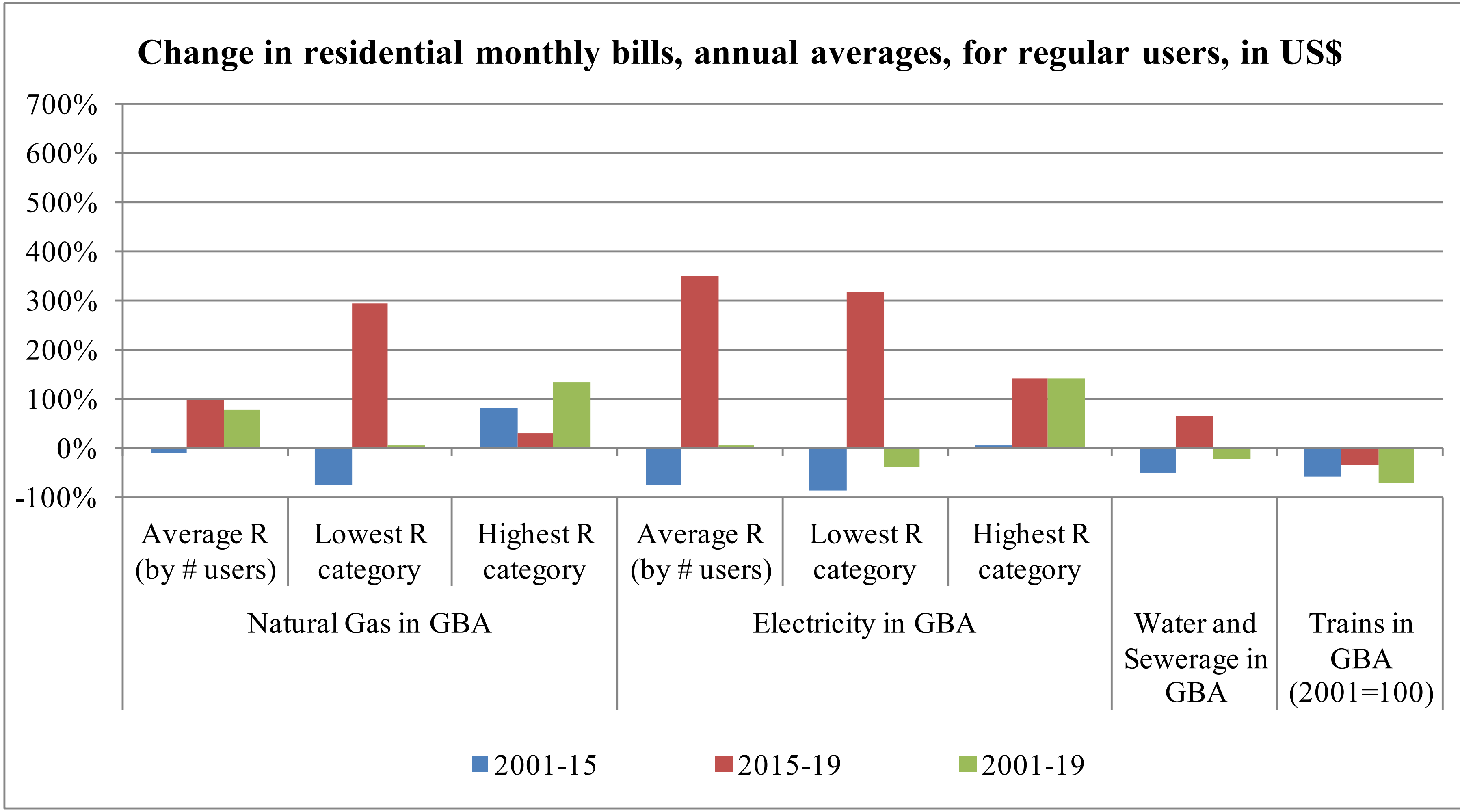
Crossing the river (Dec-2015)



- Which, when measured in current US$, are less impressive, showing remaining adjustments in all cases

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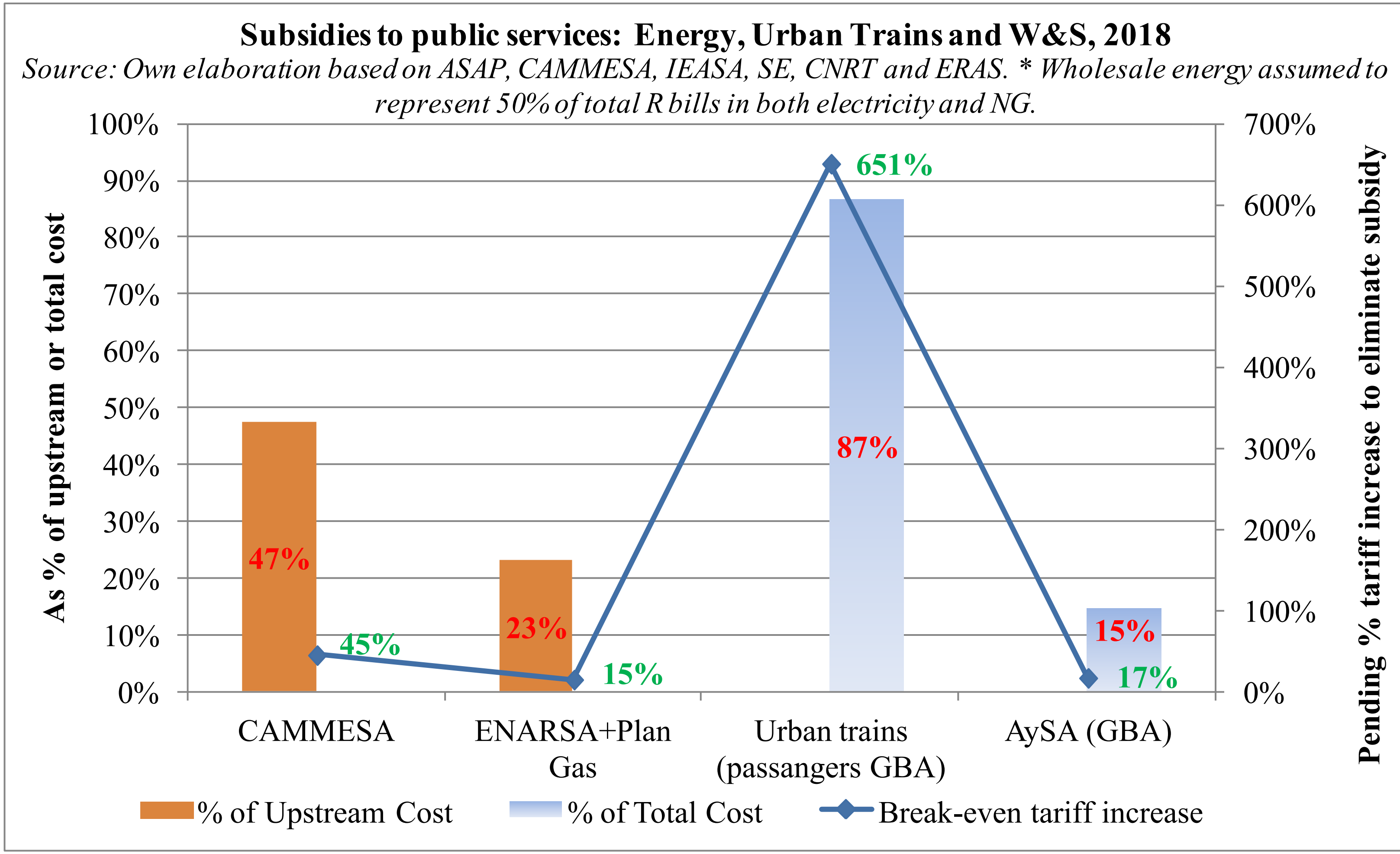
Crossing the river (Dec-2015)



- 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 $\Rightarrow$ + 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**

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Thank you!