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LATIN AMERICAN COMPETITION FORUM

**Session I - Electricity Markets in Latin America: Regional Integration
and Competition Issues**

-- Call for Country Contributions --

16-17 September 2014, Montevideo, Uruguay

The attached document is circulated in preparation for the discussion under Session I of the Latin American Competition Forum at its forthcoming meeting to be held on 16-17 September 2014 in Uruguay. Delegates are requested to send written contributions for that session to the Secretariat by 21 August 2014 at the latest. Advance notice of contributions by Friday 11 July 2014 would be useful.

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LATIN AMERICAN COMPETITION FORUM



**12th Latin American Competition Forum
16-17 September 2014 • Montevideo • Uruguay**

Session I Electricity Markets in Latin America: Regional Integration and Competition Issues

CALL FOR COUNTRY CONTRIBUTIONS

Introduction

1. This request for contributions is circulated in preparation for the discussion to be held in Session I of the 2014 Latin American Competition Forum. Session I is entitled: **“Electricity Markets in Latin America: Regional Integration and Competition Issues”**. You are invited to make a written contribution for this session.

2. In this call for contributions we identify some topics that you may wish to address in your written and oral contributions. Please note that this list is neither prescriptive nor exhaustive. You are free to raise other relevant issues that reflect your experiences of the sector. Please prepare a concise and synthetic contribution, even if that ignores some of the questions.

3. To assist the OECD Secretariat in planning the session, please inform us by **11 July 2014** if you intend to submit a contribution. The contributions themselves should be sent by email (as a Word document in electronic format, 5 pages maximum in Spanish or English) to Erica Agostinho [Erica.Agostinho@oecd.org] and copied to: Ania Thiemann [Ania.Thiemann@oecd.org] by **21 August 2014** at the latest. Country contributions will be circulated to participants through the LACF website (www.oecd.org/competition/latinamerica). Furthermore, if you have any **relevant regulation on market integration of electricity markets**, please submit a copy to the Secretariat before **28 July 2014**.

1. Background: competition in electricity markets

4. Competition issues in network industries in general, and in the electricity sector in particular, tend to be well understood. A large amount of research and empirical work discusses the issue, including within the Secretariat, where there have been a number of relevant OECD roundtables and discussions on the topic (all are listed in the bibliography in the Annex). In addition, please also refer to the OECD Council 2001 *Recommendation Concerning Structural Separation in Regulated Industries*, further amended by the OECD Council on 13 December 2011 to address the role that corporate incentives to invest can play in assessing the desirability of structural separation in regulated industries.

2. Regional integration in electricity markets

5. Taking into account the existing volume of work, the Secretariat does not propose to reconsider again the salient features of competition in the electricity sector. Rather the Secretariat background note proposes to focus on the issue of *regional integration in electricity markets* and its application to Latin America and the Caribbean (LAC).

6. Future economic growth of the LAC region will be dependent on meeting energy demands among other factors. Rising energy needs in the LAC region will require a concomitant development of the energy sector in order to achieve sufficient economic growth in the next two decades. However, the region faces problems in the electricity sector such as regular power shortages, energy security (securing enough power during peak-load periods) and energy efficiency. In particular, the quality of supply and lack of efficiency in electricity is uneven across Latin America, and remains problematic in some parts of the region¹.

7. The literature as well as several international examples seem to demonstrate that regional market integration may help solve some or all of these challenges, helping thereby lift the region out of the middle-income trap. Market integration can be an effective solution to enhance both the security of supply and the efficiency of electricity networks. In this context “market integration” should be understood as the *regional or cross-border interconnection of two or more formerly independent national electricity grids* as opposed to (domestic) vertical integration of different levels of electricity supply (such as generation, transmission and distribution).

8. Based on the current organisational set-up, several scenarios seem likely: (1) private transnational power companies take the lead of this process, linking the different countries where they are currently doing business; or (2) the largest state-owned electricity companies expand to neighbouring countries and/or launch new forms of association with other state-owned enterprises; or (3) neighbouring governments agree to expand or create intersections.

9. The Secretariat background paper will argue that moving towards yet deeper integration, along the lines of the Nordic “Nord Pool” exchange model, for instance, could be an efficient tool to prevent frequent power shortages², or ensure improved infrastructure development and increased social welfare for Latin American consumers, while securing the energy requirements for long-term economic growth.

10. The Secretariat background paper will review the main arguments in favour and against regional market integration of the electricity sector in Latin America from a competition perspective, including through appraising case studies from other regions of the world. In addition, it is expected that country contributions will supplement the background information and form the basis for a roundtable discussion. The Annex identifies a number of relevant topics for this discussion.

¹ McDonald, D. A., Ruiters G. (2012) ‘Alternatives to Privatization’, HSRC Press, Chapter 16: Chavez, D., Alternatives in the electricity sector in Latin America pp. 453-491.

² McDonald, D. A., Ruiters G. (2012) ‘Alternatives to Privatization’, HSRC Press, Chapter 16: Chavez, D., Alternatives in the electricity sector in Latin America pp. 453-491.

ANNEX. QUESTIONS FOR CONSIDERATION IN COUNTRY CONTRIBUTIONS

The roundtable on electricity will be mainly devoted to the topic of regional integration, but there will also be room for a broader discussion on competition issues in the Latin American electricity sector, especially those that would need to be addressed in order to ensure successful regional integration. In order to allow for as useful a discussion as possible, we invite the attending jurisdictions to address the following questions:

1. General questions

1.1 Regional integration

- What is the experience of integration in SIEPAC and CAN member countries, and in the Southern Cone? How has the role of the Competition Authority and/or the other regulators evolved in light of the regional integration? Was the integration accompanied by shared (cross-border) responsibilities among regulators?
- Have you experienced any difficulties with market integration from a competition point of view? If so, what were they, and what solutions did you apply?
- If your jurisdiction is outside of the LAC region, have you had any experience of regional market integration in the electricity sector? What were the main issues from a competition point of view?

2. Specific questions of relevance for regional market integration

2.1 Liberalisation

Liberalisation, fully or partially, is likely to be one of the prerequisites of regional market integration. The experience of liberalisation is therefore of interest in this context. One issue to consider is the case of conflicts of interest which can occur³ where the state has remained active in the electricity sector in competition with the private sector. This can happen where the regulator 1) favours state-owned enterprises (for instance in Colombia or Brazil); 2) demands that generation companies meet social obligations not related to their main purpose, without appropriate compensation for the relevant costs (for instance in El Salvador or Guatemala); or 3) forces private investors to participate in joint ventures with the state (as in Argentina).

In this context, we would like to ask:

- What have your experiences been with market liberalisation in the electricity sector?
- Did you enforce structural separation in the vertical chain (for instance between generation and transmission; distribution and retail)? If yes, why and how did it work, and if not, what were the reasons for your decisions?
- How did you tackle issues of potential conflicts of interest?

³ Millan, J. (2005), 'Power Sector Reform in Latin America: Accomplishments, Failures and Challenges', *Economic and Political Weekly*, vol. 40, No. 50., pp. 5291-5301.

2.2 *Regulation*

The role of the regulator is a central aspect of liberalisation, and would be primordial in the case of regional market integration.

- What sort of relationship is there between the Competition Authority and the domestic Electricity Regulator? Can they interact on electricity competition matter, and if so, are the boundaries of their respective powers clearly defined? If they do not interact, then why not, and should they be able to do so?
- Does the Competition Authority have the power to take independent action over energy matters, such as enforce competition law, launch market studies, do advocacy work? Is there a difference in treatment between the generation, transmission and retail segments in this respect?
- How would you expect to see the role of your national Competition Authority change in a regionally integrated market compared with its current role in the domestic electricity market?
- Which model for regulation would you consider adequate for a regionally integrated market? Would you consider the EU Single Market regulation in the energy sector as a model? ⁴
- Do you currently have any instruments in place to allow for cross-border integration of network markets? Would telecoms regulation be a useful proxy?

2.3 *Pricing*

Price regulation can affect market integration among countries. If prices differ significantly among (neighbouring) countries it can lead to cross-subsidisation between countries in the regional market. The expectation of market-driven reforms was to reduce electricity prices, and to reduce historic pricing distortions (especially cross-subsidisation). One of the problems is that electricity prices have often been kept artificially low, not covering the cost of electricity generation and supply, so in these cases reforms would lead to higher prices, if the market mechanisms were allowed to operate freely.

Hence many countries still apply price regulation in order to ensure the “affordability” of electricity. As a consequence in some countries electricity prices remain too low to cover costs and to attract private investment, and the sector still suffers from persistent cross-subsidisation among domestic and industrial customers.

There are different regimes to ensure the “affordability” of electricity supply, for example:

- price regulation : default tariffs (France), price caps (Slovakia)
- targeted regulation (the concept of vulnerable consumers, UK)
- through competition: no regulation (Czech Republic)

Several Latin-American countries (Argentina, Chile, El Salvador, and Peru) have introduced performance based regulation for setting multi-year tariffs and monitoring compliance with service quality standards by distribution companies.

⁴ See http://ec.europa.eu/energy/gas_electricity/internal_market_en.htm for European progress towards a single European electricity market.

- The conditions and costs of electricity supply can differ within a country as well, so applying unified price regulation can distort supply conditions among different regions of a country. What pricing mechanisms currently exist in your domestic electricity market? Do you have locational/regional pricing setting?
- Does the competition authority intervene in price setting decisions?
- How would you ensure that price setting in an integrated market is a good reflexion of supply and demand factors?
- Would you consider introducing mechanisms to ensure or impose ‘social’ tariffs? What would be the competition consequences of such mechanisms?

2.4 *Dealing with market power*

Market power is the most frequently cited competition problem in electricity markets by the literature. In many countries historic incumbents still have a very strong position. In others, vertical integration between retail supply and generation may be considered an efficient response to imperfections in wholesale markets by the domestic regulator, but they may also create market power problems (and so in such cases policymakers are confronted with a trade-off).

The possible solutions to address market power (both in mergers, and in abuse of dominance cases) are behavioural remedies (prevent firms from using their market power) or structural remedies (e.g. increasing competition by forced divestiture)⁵.

- Have you already intervened in cases of market power/abuse of dominant position in your domestic electricity market?
- What mechanisms do you currently have in place to supervise the market and the industry? Would they be adequate in case of regional integration? What other instruments would you need?
- Has there been co-operation with market regulators on market power issues? Was it successful? Which problems have you encountered?
- Would an integrated market have a sufficiently strong regulator to deal with such issues?

⁵ It seems that the European Commission prefers behavioural remedies, though sometimes they may be less effective than structural ones.

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