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Market Reforms and the Energy Sector in South America

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Although energy has always played a central role in our economies, during the last years it has increasingly become a key part in the internal and international agenda of modern countries. This article briefly overviews market reforms in South American countries during the '90s and their impacts on their respective energy markets in the beginning of the 21st century.

Latin America before and after market reforms

Following the economic crisis in the '30s, Latin American countries attempted to rethink their respective economic models, giving a new shape to their economic development structures. The implementation of what would be called the *Import Substitution Model* (ISM) supposed the execution of a series of political-economic measures that included import controls, trade restrictions, overvalued exchange rates, interest rates caps, price regulation and a State's strong participation in the economic through its companies.

The ISM had a decisive impact on growth in almost all Latin American economies during the three decades before the '80s, when regional GDP considerably grew by an average of 4,9%. Despite good economic performances in some countries, such as Brazil or Mexico, the ISM started receiving strong criticism, mainly because of State's role in the economy and rent seeking interest prevailing in these economies[1]. By the second part of the '70s, there were sizeable signs of exhaustion of this model, which became more evident with the '73 and '79 oil shocks and some hyperinflation

[1] In order to deepen the analysis about the rent seeking interest and the interest prevailing in these countries, it is advisable to see the book of Terry Carl, *The Paradox of Plenty*, University of California Press, 1997.

peaks undergone by countries like Argentina or Bolivia. South American economies had been using abundant *oil-dollars*, under the form of private loans to governments, in order to maintain high economic growth and development rates. Once this continuous flow of loans came to an end, national governments were incapable to bear this adverse situation as well as they were unable to access international financing.

The '80s is unfortunately known as the *lost decade* for Latin American countries, and it represents some sort of watershed between two *periods*, between two development strategies and between two types of societies. That of the '80s not only was an economic crisis, but also it put into question the way in which development was conceived for the whole region as well as the role of the State. Macroeconomic difficulties in countries like Argentina, Bolivia or Brazil were particularly sound, characterized mainly by hyperinflation peaks, low growth rate, profit's inequalities, etc. Latin American governments tried to face the critical situation through the implementation of heterodox policies to combat inflation, instead of strengthening their control over fundamentals in order to re-establish the affected economies.

The above mentioned situation founded a major consensus, among political and economic elites -and also among the population- that market reforms were absolutely necessary. The relinquishment of the ISM took place by the early '90s: the State's omnipresence in the production of goods and services, its control over market development and its duties in income redistribution, came to an end in only a few years.

Taking into consideration the experience of the New Industrialized Countries and Chilean reforms in the '70s and '80s, the new economic and political orthodoxy maintained pro-market policies in synchro with the neo-liberal economic point of view. This is the period where the so-called *Washington Consensus* took place, which included: financial liberalization, privatization, trade liberalization, property rights, fiscal discipline, tax reforms, unified and competitive exchange rates, rearrangement of public expenditure, deregulation, and elimination of FDI barriers. These policy *recommendations* assisted also to nation State's restructuring, as long as neoliberalism was anti-State by nature, conceiving it as inefficient and completely corrupted.

Latin American economies openness and reform did not came into existence in a synchronized and unambiguous ways, and this also explains why their results were not homogeneous among States. Some countries, pushed by their need of offering a clear signal, did some kind of overshooting, performing drastic and rapid reforms in order to obtain confidence from international financial markets. In this context, the Argentinean case can illustrate the way in which the government carried out a comprehensive reform process in only a few years.

There is a broad consensus among economic analyst -mainly those attracted by neoliberal orthodoxy- when it comes the time to evaluate the consequences of stabilization macroeconomic policies and structural reforms. Both measures were considered as a great success in boosting Latin American economies' growth, inflation stabilization, foreign debt renegotiation, foreign capital inflows and some fiscal improvements. By the end of the '90s started what some scholars called the *half lost decade,* due to the foreign capital outflows from these economies. This situation left them in a critical situation, particularly in the Argentinean case, which would had faced a sound crisis in the beginning of the new century.

Economic changes implemented in most of these countries during the '90s started to show considerable negative effects. It was particularly evident in the labour market, where the rise of unemployment was a constant. Poverty was another important indicator that grew considerably by the end of the '90s, whose level even surpassed the *lost decade* levels. Finally, income distribution inequalities not only continued been a reality, but it was also worsened.

Economic and political crisis, between the end of the '90s and the beginning of the new century, found a common *responsibility* for that adverse situation: the neoliberal economic model sustained by the Washington Consensus -at least it was so for public opinion and some part of the political elite. While credibility was reduced in these countries, inequalities, poverty, unemployment -among other social indicators- grew. In this context it is necessary to consider the rise to power of a *new* kind of progressive leftist leader, like Chavez, Lula, Correa, Morales, and Kirchner (and his wife).

The consequences on the energy markets in South America

Market reforms and liberalization process in the '90s provide the backdrop for energy market reforms to be carried out. Reforms and the development in South American energy markets differ from country to country. In some cases State's assets in the energy sector were completely alienated, while in other cases there was a progressive and moderate reform in the conditions in which actors participate in those markets, and, finally, in come cases the State's role was strengthened and private sector participation demotivated. For example, in Argentina, Menem's government privatized oil, natural gas and electricity State companies in less than three years, implemented a new organizational structure and a new normative body for these sub-sectors. The Brazilian case was different as it did not completely open its energy market, preferring more gradualism in market reform policies. On the other extreme of this continuum, are cases such as the Venezuelan, where the State's role in the economy as a whole was strengthened, most of the time using the financial resources derived from the oil sector.

Privatization was the most common measure used when analyzing energy markets changes, because it was sustained that privatization would have helped the weak financial situation of many States as well as it would have brought more competitiveness in these sectors (and a raising efficiency) and more investment flows. On the other hand, these measures implied that the State entrepreneurial role be weakened effacting its capability to intervene in sectorial public policies. The State remained with just the regulation function, and in some cases not even this function was properly carried out.

When analyzing the **hydrocarbons sector**, we find that this has certain characteristics that deserve attention, specially for those countries that are abundantly endowed with oil or natural gas. Both industries do not need a significant labour force and most of the value added is found in the refining and commercialization chains, that are activities generally carried out by private enterprises. South American countries did not follow an homogenous strategy in the hydrocarbons sector, and that is why reforms varied from country to country, and also between the oil industry and the natural gas one. In contrast with natural gas sector, it was not considered necessary to vertically divide the oil industry in order to promote competitiveness.

Oil upstream sector remained almost invariably in State's hands, except from the Argentinean and the Peruvian cases. These two countries decided to leave their respective oil companies vertically integrated while allowing a greater participation to the private sector and a sound relevance to market mechanisms. As far as downstream oil sector is concerned, although private participation remained allowed in refining and commercialization activities, in some countries -like Chile or Brazil- State companies continued participating in these sectors (CEPAL and GTZ, 2003).

The **natural gas** industry also presented certain conditions to raise competitiveness, although they are reduced to production activities, as long as transport and distribution activities are characterized by a reduced number of actors (Campodonico, 2001). Natural gas industry reform was very similar to that of oil as far as upstream sector is concerned, while downstream activities followed the pattern of electricity market reform.

The **electricity** industry also underwent significant changes during the '90s. Here again, one of the main objectives of reformers was to improve its market friendliness in order to get more investment and to raise competitiveness and efficiency. As it happened in the natural gas sector, electricity reform implied the creation of a new institutional structure and news regulations, considered accurate for the new context. Regulation changes in the United Kingdom, the US and the European Union had strongly influenced South American reforms. Rudnick and Zolezzi talk about a *Basic Reform Model* in South American electricity sector, aimed at improving competitiveness by implementing vertical disintegration of this industry – among other measures (Rudnick and Zolezzi, 2001).

One important thing to take into consideration is the way in which the electricity market in these countries evolved in the last years. Although most of them use hydroelectricity as the main form of generating their energy, in the '90s the importance of natural gas grew, mainly thanks to the technology findings linked to the Combined Cycle Turbine. In this way, both industries started being more and more intertwined and interdependent, giving a new feature to the regional energy market.

While reforms were carried out in these markets, **Foreign Direct Investment (FDI)** start flowing to them mainly through the acquisition of existent assets. Except from the Venezuelan case -and, in the very last years, Bolivia and Ecuador- most of South American countries gave important incentives to attract private investment, both national or foreign.

Structural reforms consolidation have seen the arrival of new actors to the energy market, which *behaved* differently with respect to the way some actors already present in these markets used to behave. These new actors preferred to acquire existing assets of the State as well as the formation of holdings with other big companies for new projects. These were predominantly US and European energy companies that had decide to internationalize their strategies as a consequence of the process of liberalization underwent in their countries of origin. Following this first period, and after a further expansion of the activities of these companies, the crisis that emerged in some industries and the economic difficulties of some countries, produced a reorganization of the strategies of these companies -mainly those from the US. Latin America played a key role for Spanish multinationals -not just for energetic one. Three out of ten top foreign multinationals in Latin America and the Caribbean were Spanish by 2003, two of them belonging to the energy sector: Repsol-YPF and Endesa.

Nowadays we witness a panorama in which some players come back to their countries of origins, some other have started to sell just part of their participation in the region, and others continue operating there while some State companies regained importance. Despite the massive arrival of multinationals in the Latin American market during the '90s, foreign energy sector companies decided to leave this regional market in the last years. Both hydrocarbons and electricity sector have witnessed this trend, due to macroeconomic and political instability in the region, added to some challenges particular of each sub-sector.

Notwithstanding, the potential benefits that reforms supporters advocated during the '90s, some South American countries could not avoid a series of **energy crisis** between the end of that decade and the beginning of the XXI century. These crisis shed some light on the consequences of establishing weak or inaccurate institutional and normative settings, which was particularly evident in the electricity sector. Not only could not be solved some previous problems with these reforms, but also some previously existing obstacles were just worsened. Added to this, the lessons derived from the California Crisis impacted on South American electricity markets and on the way they have designed their respective regulative bodies and rules.

Added to the energy problems in Chile, Brazil and Argentina, another *critical feature* has arisen in the region, which is characterized mainly by presidents like Morales, Chávez and Correa -and, to a lesser extend, Lugo and Fernández de Kirchner. These governments have been experiencing a reshaping of energy policies in their agenda, mainly through a major involvement of the national state in the energy sector. It seems as if the concept of national sovereignty and the management of energy resources had been intertwined, making these countries more reticent to liberalize or to deepen some measure in the energy sector. Some of these countries have chosen to strengthen their control over their energy markets, by re-nationalizing the previously privatized energy companies, by creating new State-owned energy companies or by tightening the *rules of the game* for private sector participation within their boundaries.

Conclusion

As we have seen, market reforms during the '90s gave a substantive weight to the private sector while producing a sound restructuring of State's activities. Orthodox policies demonstrated to be effective to combat some serious problems in the region, like hyperinflation or low growth rates, although they were less effective to combat poverty, unemployment and social inequalities.

Whereas energy sector reforms have been put into practice, they have involved the foundation of a new institutionalization and a new regulation for the diverse energy sub-sectors, mainly in the cases of natural gas and electricity. Despite the differences in implementing reforms, in terms of schedule and intensity, they all aimed at raising efficiency levels, attracting FDI and meliorating the State's finance through the privatization of its assets. As a matter of fact, privatization was the option most frequently pursued by States during market reforms, mainly in the electricity sector and -to a lesser extent- the natural gas sector, though it was not the case in the oil sector - except from Argentina, Peru and, initially, Bolivia.

Unfortunately energy sector reforms did not bring all the potentialities that neoliberal supporters claimed, although it would not be fair to blame them for the energy crisis that stroke the region.

It is not yet clear the way in which South American countries will face the energy issue, whether in a cooperative or in a unilateral way, in terms of rigid national sovereignty or treating it as a good that needs to be collective managed. What is certain is that it is urgent to find a clear, long-lasting and feasible solution to the energy sector in the region, and it seems improbable to do so without cooperation, flexibility and gradualism among South American governments' intitiatives.

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