What the U.S. Can Learn from the Latin American Power Development Model

The World Turned Upside Down

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At the academy, the view has been for several years that the UK experience will set the model for the U.S. deregulation. And in regulatory theory, in the U.S., this may ultimately be the case, outside of the strongest traditional integrated utility bastions.

Glancing up over the scholarly journals, however, practical observers of industry realpolitik see a different model: oligopoly. FERC has mainly focused on the use of market power by home team suppliers to limit local competition. The reality (as Leonard Hyman recently observed) is more likely to be one of coalescence at the local market level of three of four energy providers—major pipeline and power companies reaching into service territories and vying with the local gas and electric distributors which will be bulking up. The larger issue, Hyman suggests, is whether, as in the department store and banking fields, the energy market will go at least regional and possibly national. He suggests that these are the probable growth patterns for emerging growth companies.

Not veddy "British economist," that. But very like the outlines of the strategies emerging South of the Border, where a mixture of privatization and demand growth is giving the opportunity for bold and suggestive play to the strategies which the larger utilities and the forward vertically integrating oil companies are undertaking. In fact, to see the future profile of their would-be hegemony, U.S. regulators would be wiser to look South than East.

The key trends in Latin America, which are now distinguishing it from Asia (and perhaps preserving it from the fate facing isolated Asian IPPs, which depend on state utilities as customers) are the following:

- Driving the development process are national privatizations in the form of concessions, which, in turn, may ultimately prove to be the seed beds of individual privatizations;

- Many Latin nations have been proceeding with the privatization of distribution and transmission systems along with or in advance of generation

- Production of new sources of power at the margin may well be from transported hydrocarbons from remote sources. Gas and oil transportation concessions thus have become a converging basis for power competition.

Against this background, many of the largest U.S. competitors—both combination utilities and oil companies—have begun to inveigh against host country strategies of individual BOOT competitions. They have marked out regions in which they will at least be dominant and in the best case will be monopolist. In some cases, that is the stated goal.

In pursuing this strategy, paradoxically, one of their worst enemies from a business return standpoint, is the application of the U.K. model. A pure economic dispatch model can be very harsh on such a strategy. It will tend, over time, to penalize the existing facilities—those who bet on an acquisition strategy. In the near term, it will confront new development with daunting challenges from fully depreciated existing capacity. A rapidly declining price curve confronting a demand curve not rising steeply enough can be a strategic problem—see Argentina if you doubt it.

In a nation with exploding demand, the issue may be whether energy transportation is priced to facilitate new market entrants, rather than simply to be equitable in the way in which it provides open access. If it is not, monopolists may have their way with the market. The more remote the market from an energy transmission standpoint, the truer this will be. Countries like Brazil, engaged in a crabwise movement to entice private capital into new facility investment, leave each potential player with uncertainties as to exactly what type of regulated transmission market it will find itself in.

In short, the view from the academy of multiple short-term marginal cost suppliers competing through deliveries into a price-transparent grid, may be supplanted in reality in Latin America by a model of a few substantial mini-monopolies providing all forms of regional service and drawing on—or competing with—outside sources only at the margin. Introduction of retail open access does not by any means put a lock on the case and the nostrums of the academy may be anachronistic burdens on needed developments.

The Latin American experience to date tends to confirm Hyman's vision of the power business going the regional/national way of banking and mass retailing, rather than the model of franchising by multiple competitors. The energy commodity is too homogeneous, in many cases even with its new bundling potentiality, to provide a Pizza Hut, a Burger King and a Taco Bell on the same power switch. A central commissary (ISO) that allows competitors to offer fries with their pizza may not modify this situation.

This suggests that U.S. strategies over the longer pull may well emulate those being implemented as South America (and indeed that some utilities are already beginning to do so). The elements of this strategy—which may, incidentally, become an objective of PUHCA reform legislation, are:

- Integration at the retail level of gas and electric activity
- Greater focus on the value of acquisition of distribution and transmission (notwithstanding open access)
- More emphasis on a broad range of projects in a regional setting

Three corollaries which major Latin American competitors have noted to their strategy of seeking to create businesses, not simply projects, which have yet to be fully reflected in contemporary form in the American scene are:

- The need for becoming a high profile good corporate citizen;
- The value of intense marketing in terms of overall corporate acceptance;

- The importance of integration of energy businesses: discos; gencos; gas

Each of these activities goes beyond the good corporate public relations and the specialized product branding which thus far have characterized the U.S. market. The implication: managing the U.S. national market through a series of competitive regional subsidiaries is a challenge leading power privateers must gear up further to meet.

The skirmishes in New England over transmission priority and siting should be seen as the precursor of competing efforts to implement a Latin American strategy in the region. Power privateers focused on a series of individual projects should take note. Would-be major market entrants should take note of the greater challenge that lies beyond the asset auction doors if they are to optimize the value of their position.

The day is coming when North America must be understood as South America. The tune of the American Revolution: "The World Turned Upside Down."

ABOUT THE AUTHOR

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