INTER-AMERICAN DIALOGUE'S
LATIN AMERICA ADVISOR ▸ ENERGY

FEATURED Q&A

What is the Future of Energy Integration in Central America?

Q First proposed in 1987, the Central American Electricity Interconnection System (SIEPAC), a plan to create a more robust regional transmission grid in Central America, is scheduled to become operational this year. In order to allow economies of scale to occur, the aim is to harness the transmission project to create an integrated regional electricity market known as the Mercado Eléctrico Regional (MER). What are the potential benefits and downsides of the MER? What challenges does the integrated market face? What steps do the region's governments and institutions need to take to bring it to fruition?

A Juan Miguel Cayo, senior energy specialist for Latin America and the Caribbean at the World Bank: "SIEPAC was designed to bring the benefits of integration to the six countries and improve their national power systems. Due to the relatively small size of the power system in each of the region's nations, the opening of the regional market was seen as a means for creating a larger market that enhanced competition among power producers and for providing security of supply to all individual countries at the same time. The goal is for the regional market to gradually allow qualified agents to buy or sell electricity no matter where they are located in the Central American region. Additionally, a regional market with clear and uniform rules is expected to offer incentives for building larger and more efficient power plants, sparking investments that would help reduce the costs of electricity in the region and strengthen the reliability of its electricity systems. However, as the national markets evolve towards integration and increased trade, there are still important barriers remaining that hinder the full implementation of the Regional Electricity Market. Power integration is much more than simply building trans-

Continued on page 3

Facing Power Crisis, Venezuela Rations, Imports Electricity

Venezuela will increase electricity prices by as much as 200 percent after power failures last week, Electricity Minister Ali Rodríguez said Monday. Colombia has pledged to supply electricity to the country for as long as the crisis lasts. See story on page 2.

File Photo: Venezuelan Government.

Inside This Issue

FEATURED Q&A: What is the Future of Energy Integration in Central America?.............1

Facing Power Crisis, Venezuela Rations, Imports Electricity..................................2

Procon Asks Brazilian Regulator to Intervene in Eletropaulo 2

Japan Lending $1.5 Billion to Venezuela in Five-Year Oil Deal 2

Endesa Launches Smart Grid Pilot Project in Brazil 2

Colombian Lawmakers Approve Royalties Reform 3

Peru's Humala Pledges More Energy, Mining Collaboration with Chile..........................3

U.S. Senate Blocks Bid to End Ethanol Subsidies 3

Political and Economic News: Mexico, Brazil, Colombia, Honduras and More 4-5

ENERGY SECTOR BRIEFS

Japan Lending $1.5 Billion to Venezuela in Five-Year Oil Deal

Japan will lend $1.5 billion to Venezuelan national oil company **PDVSA** in exchange for three million barrels of crude oil over the next five years, Agence France-Presse reported Wednesday. "We have 54 nuclear plants and more than 30 are not in use because of the accident at Fukushima, so this agreement with Venezuela is very important to us for thermo-electric energy in Japan," said Takashi Kondo, the spokesman for the Japanese embassy in Caracas.

Endesa Launches Smart Grid Pilot Project in Brazil

Italy's **Enel** and its subsidiary **Endesa** announced June 10 that they have begun installing 100 remote power meters in Brazil as part of a pilot project to develop smart grids in Latin America. **Coelce**, Endesa's subsidiary in Ceara state, is implementing the project, which will test a remote management system developed by Enel. The system is based on a model in use in Italy, where Enel has installed more than 30 million smart meters. Brazil is the first Latin American country to begin developing regulations for remote power management, the company said. [See related Q&A in the Nov. 22-26, 2010 issue of the *Energy Advisor*.]

Cálidda Gas to Invest Up to $1 Billion in Peru in Long Term

Cálidda Gas Natural del Perú plans to invest as much as $1 billion over the next 12 to 14 years in order to reach a goal of supplying 1.6 million families with natural gas in Lima and Callao, CEO Mario Trujillo told state-run news agency Andina in an interview Wednesday. The company expects to have 75,000 customers by the end of the year.

Power Sector News

Facing Power Crisis, Venezuela Rations, Imports Electricity

Venezuela's government announced Monday that it will increase prices for electricity by as much as 200 percent to counter higher demand, Dow Jones reported. The announcement came after power failures affected parts of western Venezuela on Friday and Saturday. Bills will increase some 200 percent for customers using 20 percent more power as compared to 2009 levels, said Electricity Minister Ali Rodríguez. Factories will be required to cut consumption by 10 percent and install their own generators, while government offices have new guidelines for electricity usage. "Demand is excessive," said Rodríguez. "All Venezuelans need to make an effort to use electricity in an efficient manner." Customers will also be rewarded with discounts for cutting their electricity consumption. Hospitals, oil companies and water distributors are among those exempt from the new rules. Colombia announced Tuesday that it has begun to deliver electricity to Venezuela under a plan that will be in place "as long as the energy crisis in Venezuela" continues, local daily *El Universal* reported. The delivery began on Monday from Colombia's northern department of La Guajira to the Venezuelan state of Zulia, the Colombian Ministry of Mines and Energy said in a statement. The most recent outages affected several border states and Maracaibo, the country's second-largest city, after a transformer failed in Zulia state on Friday. Other transformers exploded early Saturday, disrupting 3,000 megawatts of power and affecting Zulia, Trujillo, Mérida, Tachira and Barinas states. On Sunday, Venezuelan President Hugo Chávez accused his political opponents of sabotaging the power grid and blaming his government for the blackouts. "Sabotage, we have to be vigilant," Chávez said in a phone interview with the Telesur television network, the AP reported. Chávez, who was speaking from Cuba where he was recovering from surgery to treat a pelvic abscess, said "a group of the right-wing, anti-nationalist opposition that is willing to do anything," is sabotaging the power grid. Chávez did not present any evidence of sabotage. Blackouts over the past several months have affected wide swaths of the country, from the western border with Colombia to eastern areas where hydroelectric dams produce approximately a third of the country's power supply. The problems have continued since 2009 despite billions of dollars in investments in improving the power grid. Aixa López, director of the Committee for People Affected by Power Outages, said some blackouts have lasted as long as 20 hours and have repeatedly affected Caracas and at least 10 of the country's states. [Editor's note: See related Q&A in the April 25-29 issue of the *Energy Advisor*.]

Procon Asks Brazilian Regulator to Intervene in Eletropaulo

Brazil's consumer protection agency, Procon, said Monday that it has asked electricity regulator Aneel to assume administrative control of utility **Eletropaulo** after the state of São Paulo experienced major blackouts last week and in February, Dow Jones reported. The agency said that Eletropaulo, a subsidiary of **AES Corp**, has failed to improve its services despite more than 18 million Brazilian reais ($11.4 million) in fines.

Despite more than $11.4 million in fines, Procon says Eletropaulo has failed to improve its services.

Large numbers of consumers have complained about the company's service and the company has "systematically refused" to reimburse customers whose appliances have been damaged by the outages, Procon said. In a statement Tuesday, Eletropaulo said that it has invested 2.5 billion reais over the course of five years in a bid to improve service. The same day, the company announced that it is collaborating with **Trilliant**, a smart grid communications company, and **GE Energy** to research and develop a smart meter project in São Paulo. The venture would "connect GE smart meters' advanced technology through Trilliant's wireless communication network to AES Eletropaulo's meter data management center—improving system monitoring, identifying problems before they occur and reducing the duration of interruptions in energy supply," GE said in a statement, adding that Aneel is studying a time-of-use rate proposal, which would vary rates according to when energy is consumed. "Smart meters empower consumers to have better control over their energy use and costs," said Roberto Vengoechea, general manager for digital energy in Latin America for GE Energy Services. "This project with AES Eletropaulo is a clear sign of GE's commitment to Brazil and our local expansion. We will double our activities in the region this year."

Oil & Gas News

Colombian Lawmakers Approve Royalties Reform

Colombia's Congress approved reforms June 9 to more evenly distribute mining and oil royalties as the country looks to increase its exports of oil and other commodities, Reuters reported. President Juan Manuel Santos' royalties reform package aims to centralize the management of royalties to more evenly distribute approximately $3 billion annually across the country. The measures are designed to reduce inefficiency and corruption, but resource-rich regions of Colombia have balked at the reforms. As much as 30 percent of royalties will be saved and the reforms would reduce the percentage that commodity-producing regions receive, from 70 percent to 25 percent, said Finance Minister Juan Carlos Echeverry. "Today we're creating a new country that's going to have the possibility to develop," he said, Reuters reported. "We'll have savings to combat Dutch disease, we're going to have resources for the whole country." The royalty reforms were the second major fiscal reform package lawmakers approved this week. The day prior, legislators passed a bill to amend the constitution requiring the government to be fiscally sound.

The reforms reduce the portion of revenues that commodity producing regions receive from 70 percent to 25 percent.

Peru's Humala Pledges More Energy, Mining Collaboration with Chile

Peruvian President-elect Ollanta Humala continued his tour of South America Wednesday, meeting with Chilean President Sebastián Piñera in Santiago, state news agency Andina reported. The visit is Humala's first time in Chile. The two leaders, who lean toward opposite ends of the political spectrum, discussed energy and mining collaboration as well as ways to encourage capital flows between the two countries, Bloomberg News reported. Peru will export gas and electricity "without discriminating" against neighboring countries, and will sell more energy to other countries once its own "supply problem" is resolved, Humala said in a speech from the presidential palace. [See related Q&A in the May 21-27 issue of the *Energy Advisor*.]

Piñera and Humala (L-R)

Photo: Andina.

Biofuels News

U.S. Senate Blocks Bid to End Ethanol Subsidies

The U.S. Senate on Tuesday voted against advancing a measure that would end a tar-

Featured Q&A

Continued from page 1

mission lines and interconnection facilities. Its success will depend on several conditions: political, institutional, regulatory and physical. At present, these conditions are not fully in place. Political conditions are not clear and decisive actions still need to be taken; institutions are weak; regulatory conditions are not completed yet and important obstacles remain; and there is weak power supply. While Central America should pursue its power integration, each country needs to focus on strengthening its domestic market, while simultaneously working to strengthen the supranational institutions and removing obstacles at both the regulatory and commercial levels, to promote the materialization of a truly enhanced power market. The consolidation of the regional regulatory and institutional framework and the creation of a strong regional power market will not succeed if it will be based on weak, inefficient and vulnerable national power sectors. Achieving a strong integrated market based on weak national markets is a mirage."

A Jorge Asturias, subregional coordinator for Central America for the Latin American Energy Organization (OLADE): "The regional electricity market is a seventh market superimposed on the six national markets, which will operate based on the following premises: a) regional electricity trade can take place in a regional contract market and a spot market; b) all MER agents with the exception of the transmission companies can purchase and sell electricity freely and will have open access to the transmission

Continued on page 6

iff and subsidies for ethanol producers, Reuters reported. The Senate voted 59 to 40 against a bill sponsored by Senator Tom Coburn (R-Okla.) that would have eliminated the 45-cent subsidy for ethanol producers and 54-cent tariff for ethanol imports. Dianne Feinstein (D-Calif), who co-sponsored a similar bill with Coburn, pulled support for the measure in protest of the way that Coburn introduced the bill. "I believe if it weren't for the process we would have 60 votes," said Feinstein. Prior to the vote, she expressed interest in working with a bi-partisan group of senators who have introduced legislation that would tie the tax break to the price of oil rather than repeal it altogether. The White House has said that it supports a reform of ethanol policy, but not a complete repeal of the tariff and subsidy, which cost about $6 billion annually. [Editor's Note: See related Q&A about how changes to the subsidies would affect Brazil in the May 30 -June 3 issue of the *Energy Advisor.*]

Political News

Rousseff Appoints Salvatti to Key Administration Post

Brazilian President Dilma Rousseff on Friday appointed the country's fisheries minister, Ideli Salvatti, as her administration's head of institutional relations, a key position, Agence France-Presse reported. The appointment of Salvatti was Rousseff's second appointment last week of a woman to a critical administration post. Last Tuesday, Rousseff appointed Sen. Gleisi Hoffman to replace Antonio Palocci, her embattled chief of staff. Palocci has been accused of influence peddling, which he denies. Salvatti, who like Hoffman is a member of the ruling Workers Party, is known for her temper. But in her new position, she will be responsible for coordinating relations with the administration and political allies as well as opposition parties. "We can't believe it," an unnamed member of the Workers Party told Brazilian daily newspaper *O Globo*. "It's like putting an angry elephant inside a porcelain shop." On Friday, Salvatti attempted to calm fears about her temper, saying "I do not know if I will be the little Ideli of 'peace and love' but I would like to be the Ideli who listens more and negotiates more." Her mention of "peace and love" was a reference to the campaign of former President Luiz Inácio Lula da Silva, who moderated his tone to win the presidency in 2002.

Salvatti

File Photo: Brazilian Government.

Approximately 70 Percent of Guns Seized in Mexico Came From U.S.

Approximately 70 percent of the guns recovered by Mexican authorities fighting the country's brutal drug war originated in the United States, according to a report released Monday by three U.S. senators, the Associated Press reported. Authorities in Mexico seized 29,284 guns in 2009 and 2010, with 20,504 of them coming from the United States, according to data provided by the Bureau of Alcohol, Tobacco, Firearms and Explosives. More than 15,000 of those were made in the United States while some 5,000 were manufactured elsewhere but had moved through the United States before ending up in Mexico. The rest were of "undetermined origin due to insufficient information provided." In 2009, a U.S. report said that 87 percent of the weapons recovered in Mexico had originated in the United States. It was unclear why the percentage had changed, but the new report appeared to include more gun-trace reports, reflecting a reporting system in Mexico that has become easier for authorities to use. On Saturday, before the new report's release, Mexican President Felipe Calderón blasted the weapons industry in the United States. "I accuse the U.S. weapons industry of [responsibility for] the deaths of thousands of people that are occurring in Mexico," Calderón said in a speech to Mexican-Americans in San Jose, Calif., the AP reported. "It is for profit, for the profits that it makes for the weapons industry." Calderón also backed calls to reinstate the ban on sales of assault weapons in the United States, saying how its expiration in 2004 may have led to an increase in violence in Mexico. "You can clearly see how the violence began to grow in 2005, and of course it has gone on an upward spiral in the last six years." The report, released by senators Dianne Feinstein (D-Calif.), Charles Schumer (D-N.Y.) and Sheldon Whitehouse (D-R.I.), called for background checks at gun shows, a prohibition against importing weapons not used for sporting and reinstating the assault weapons ban. "This report outlines common sense measures that will help protect our border and our communities by keeping dangerous weapons out of the hands of Mexican gangs and drug cartels," Whitehouse said in a statement.

> "I accuse the U.S. weapons industry of [responsibility for] the deaths of thousands of people that are occurring in Mexico."
>
> *— Felipe Calderón*

Economic News

Argentine Economy Continues Fast Growth, Inflation Still High

Argentina's economy is poised to grow between 7.5 percent and 8 percent this year, President Cristina Fernández said in a speech Wednesday. In the past 12 months, from May to May, the economy grew 9.9 percent, she added. International investors have worried for years that Argentina's high government spending amid the economic boom will lead to runaway inflation. Congressional representatives from the four opposition parties on Tuesday stated that inflation in Argentina in the last twelve months reached 23.5 percent, among the highest in Latin America, and that in the month of May consumer prices rose 1.5 percent, MercoPress reported. Argentina's controversial state statistics agency, INDEC, said on Wednesday that the official inflation rate was 0.7 percent in May, half the estimate of private economists.

Honduras Outlook Improves with Economic, Political Stability: S&P

New York-based ratings agency **Standard & Poor's** on Tuesday revised its sovereign foreign currency credit rating outlook for Honduras to positive from stable, Reuters reported. S&P cited rising external liquidity and progress in strengthening fiscal balances for the move. "Economic recovery, renewed ties with external creditors, and growing investor confidence since the election of the administration of President Porfirio Lobo in 2010 have contributed to growing foreign exchange reserves and reduced fears about the sustainability of the de facto fixed exchange rate," S&P said in a statement. The current 'B' rating is five notches below investment grade.

Unemployment in Latin America May Fall Below 7 Percent This Year

Unemployment in Latin America and the Caribbean should fall below 7 percent in 2011, according to a joint report released Tuesday by the United Nations' Economic Commission for Latin America and the Caribbean and the International Labor Organization. The strong economic recovery of Latin America and the Caribbean will make it possible to bring down unemployment significantly from 7.3 percent in 2010 to between 6.7 percent and 7.0 percent in 2011, the report states. Countercyclical policies implemented during the global recession, such as infrastructure investment, emergency employment projects, stimulation for social programs and companies, among others, all contributed to employment gains. However, the report authors caution that policies implemented during the crisis were often the result of "short-term reactions, rather than the consequence of an institutionalized countercyclical approach." In 2010, the relatively strong regional recovery pushed up the urban employment rate by 0.8 percentage points to a record high of 55.2 percent. At the regional level, the urban unemployment rate fell from 8.1 percent to 7.3 percent by the end of 2010, which signalled a return to pre-crisis levels. The region's urban unemployment rate has been constantly falling since 2002, when it was above 11 percent. In Brazil, Chile, Nicaragua and Uruguay, formal employment, considered an indicator of longer-term economic stability, rose by around 6 percent, while in Costa Rica, Mexico, Panama and Peru formal employment climbed by between 3 percent and 5 percent. The improvements have been uneven, however, as the north of Latin America and the Caribbean, in particular, continue to suffer from relatively high unemployment.

Bárcena

File Photo: ECLAC.

Colombian Banking Association Criticizes Tax on Withdrawals

Colombia's banking association on Monday said the decision by the administration of President Juan Manuel Santos to extend a tax imposed on bank clients for withdrawing money will hinder the banking sector from strengthening. The National Association of Financial Institutions (ANIF) said the extension of the 0.4 percent tax until 2017 was a significant error, reported Caracol Radio. "We shouldn't be surprised that the ratio of credit to GDP remains stalled in Colombia at levels of 35 percent as compared to 70 percent in Chile; even including corporate bonds, Colombia reached only 42 percent as compared to 86 percent in Chile," said the organization. ANIF also rejected the notion that despite the increase in housing prices that the country is nearing a mortgage bubble. Mortgages in the county grew 16.4 percent over the 12-month period through March, however, the ratio of mortgages to GDP is 3.5 percent.

> "We shouldn't be surprised that the ratio of credit to GDP remains stalled in Colombia at levels of 35 percent."
>
> *— ANIF*

POLITICAL & ECONOMIC BRIEFS

China to Lend Ecuador $2 Billion This Year: Report

China has agreed to loan Ecuador $2 billion this year, local daily *El Comercio* reported Tuesday. The first payment of $1 billion has already been transferred, and the second $1 billion loan will arrive in the second half of the year, according to the report, which cited unnamed finance ministry officials. The new loans, which will finance public works projects primarily, make China the biggest creditor to Ecuador. The Andean nation now owes China $6.5 billion.

Colombia Passes Labor, Judicial Reforms in Step Toward FTA

Colombia passed several labor and judicial reforms on Monday in the hopes of diminishing opposition to the stalled free-trade agreement with the United States, Reuters reported. U.S. Trade Representative Ron Kirk said the Andean country has completed the second phase of an action plan to improve labor rights, which was slated to be completed by June 15. The administration has said it will submit the FTA legislation to Congress once an agreement is reached on the Trade Adjustment Assistance program.

Mexico to See $1.5 Billion Foreign Investment in Auto Sector

Mexico will announce foreign investment of about $1.5 billion in the automotive sector in the next month, Economy Minister Bruno Ferrari said Monday. About half of the total will come from Japan, but Ferrari declined to name the companies in an interview with Reuters. "I was actually concerned that [the earthquake and tsunami] was going to slow down those investments. But on the contrary, they are speeding up their investments," said Ferrari.

Featured Q&A
Continued from page 3

system; c) MER generation agents can install power plants in any of the member countries and sell energy at the regional level; d) the MER is a market with its own rules, independent of the national markets, which makes energy transactions using the regional transmission grid (RTR) and the national networks. The points of connection between the MER and national markets are the nodes of the RTR. The design and regulations of the regional market provide a regulatory framework that allows and promotes long-term firm power trade among Central American countries and facilitates the development of regional generation plants. However, the market regulations have several obstacles to achieving this goal; for example, the existence of vertically integrated state-owned companies in Costa Rica and Honduras that may limit generators from other countries from accessing their domestic markets. The operation of long-term firm regional contracts is not compatible with the application of rules that give priority to the domestic demand in the case of energy shortages. (Two countries maintain explicit norms that give priority to domestic demand.) The application of price controls and generalized subsidies in some countries could reduce the opportunities for long-term contracts and short-term transactions in the regional market. It is important to establish a proper coordination mechanism between bilateral agreements like the electric interconnection between Guatemala-México or Panama-Colombia and the MER regulations. The application of the MER will be strengthened by a second protocol signed in 2007 and ratified by five countries (it is waiting for the ratification of the National Congress in Costa Rica)."

A **Angel Baide, independent energy consultant:** "The benefits of the MER are those of greater competition, which will produce lower prices for consumers. The downsides are only for governments and state-owned companies, mainly in Costa Rica and Honduras, which will lose their dominance of the power sector. They now have to step back and let private agents take advantage of the institutional and regulatory infrastructure created by SIEPAC. It seems governments were reluctant partners in SIEPAC. The original design presents the MER as 'a seventh market, superposed to the six national markets.' But, the MER makes sense only if it is to become the single electricity market for the region. Also, the treaty defines 'regional' transactions as those where the parties are in different countries. However, the goal being that of a single integrated market, all transactions are the same, they are all regional! The narrow definition has led to problems now that project costs begin to be charged to regional transactions, because there are too few of them, leading to high unit costs which discourage trading. The MER operation rules reflect the best standards. However, there is no obligation for national system operators to use this fine machine. They can keep the national markets segregated, and avoid global optimization. Governments must introduce rules obliging each national system operator to elevate each day to the regional system operator all buy and sell bids received in the national market. Only in this manner will there be an integrated regional dispatch optimizing the use of generation and transmission resources in the region."

> "The downsides are only for governments and state-owned companies, mainly in Costa Rica and Honduras."
>
> — *Angel Baide*

The Energy Advisor *welcomes responses to this Q&A. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.*

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