



Brazilian Electricity Sector and the Economic and Political Crisis¹

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The country faces a political crisis which has been developing like episodes of a great TV series. The final episode is unpredictable, but the impact on the Brazilian economy is obvious: the country faces the strongest economic downturn ever recorded in its economic statistics series.

The strategic macroeconomic variables such as household consumption and investments, have been suffering continuous reductions and there is idle capacity in almost all productive sectors. The political crisis generates uncertainties, which corroborate and feed back into economic crisis, leading economic agents to reduce investments and consumption of goods and services.

Everything indicates that the economic scenario might only have a more consistent forecast base in 2019, with a new President elected

¹ Based on the paper published on Canal Energia website, in 06.12.2017, available at: <https://www.canalenergia.com.br/artigos/53021247/o-setor-eletrico-brasileiro-e-as-criSES-politica-e-economica>

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through general elections. Until there, Brazil will have to get deal with the strong possibility of "new facts" involving the presidency of the Republic. It is believed that we will still have more intense clashes between the Legislative and the Judiciary. In short, new chapters of this unusual series, which more and more constrains the country, are still to come.

In this complex and uncertain short term scenario, the Brazilian Electricity Sector (BES) can be considered an exception, remaining relatively shielded in the face of the political crisis. The main causes that have kept the sector preserved are analyzed below.

First of all, the BES has a traditional and technical consistency accumulated over more than a century of existence. Nowadays no other infrastructure sector in Brazil, can boast such a huge quantity and quality of technical, scientific and intellectual human capital. Additionally, the country has one of the best renewable matrixes in the world, a consistent and innovative expansion model, besides the necessity of expanding the capacity of the entire production chain – distribution, transmission and generation – in a long-term perspective.

The second factor is the security and reliability of the institutional framework, with emphasis on ANEEL (National Electrical Energy Agency), ONS (National Power System Operator) and CCEE (Electrical Energy Trading Chamber). These institutions work according to rules based on specific legislation, which cannot be easily changed by political dynamics and interference. Their top directors have warrants and cannot be freely substituted. Concerning the most qualified technical staff – superintendents and executive managers – the choice follows meritocratic criteria and not political parties indications. In short, they act as State institutions, not Government ones.

This striking feature underpins and gives consistency to a unique regulatory framework in the Brazilian economy, thus guaranteeing a minimum security base for investments in this capital intensive and long term horizons sector. It's worth noting that the transmission auctions carried out recently, which sparked the interest of even

investors with no tradition in transmission, prove this consistency. During the last auction for investments alone, estimated at R\$ 12 billion, there were expressive discounts and the positive entry of EDP, Energisa and Elektro in the transmission segment.

The third factor is the improvement of energy policy and the expansion planning of the entire production chain. Regarding transmission and generation segments, the EPE (Energy Research Company) has great strategic relevance in elaborating studies which guide future investments. The distribution segment on the other hand, is under the responsibility of mostly private economic agents linked to solid groups with tradition in the sector.

The fourth and determinant factor was the decision of the Minister of Mines and Energy, even in a moment of strong political crisis, to uphold his position as head of the MME. The Minister justified that the political instability couldn't impact the Brazilian Power Sector, which would have occurred, had he and his team departed.

It must be highlighted that today the BES has a solid and dynamic governance, with a positive interaction and integration of the institutional framework coordinated by the Executive Secretariat of the MME. The relationship with the agents and their respective associations gained quality in the current management in such a way that the problems, which are not few, are analyzed and solved based on the specific responsibilities and search for balance. A good example of this new and innovative governance is the initiative of a first meeting of CCEE, EPE and ONS with the associations and agents held in São Paulo on June 13. It is, from a governance point of view, a meeting of historical proportions for the Brazilian Electricity Sector.

However, the BES isn't completely exempted from the economic and political crisis. The impacts occur not only on the electricity demand, but can also reflect on investment decisions. The transmission sector is a good example. The last transmission auction wouldn't have had such a great result if it had been held in a moment of worsening political crisis.

In another more sensitive direction, Brazilian Electricity Sector presents structural problems in the wholesale trading model, which

proved to be fragile and inadequate during the most recent hydrology crisis. This is an intricate problem, requiring both short term measures – notably to address the high default rates in the CCEE – and a broader restructuring process. It is important to note that the haphazard solutions to the model's structural issues can be a risk, considering the lack of political stability for the effective implementation of restructuring decisions, since such measures must be approved by a weakened National Congress.

In addition, the BES faces a number of problems mainly derived from the convergence of MP 579⁴ with the hydrology crisis which has occurred since the end of 2012, causing economic and financial imbalances. These imbalances required the application of several regulatory innovations: loans to distribution companies; renegotiation of hydro power plants contracts to mitigate the generation gap of these plants (GSF) transferring most of the risk to consumers; adoption of tariff flags; the reduction of the PLD (imbalances settlement price) ceiling price, among others.

In the face of a range of structural problems, the search for solutions must be carried out with composure and prudence, especially considering what has been proclaimed as a “model change” in this political crisis and instability environment, particularly in the “eye of the hurricane”, that is the National Congress. The Brazilian Electricity Sector model has a unique complexity. Therefore, nothing can and should be done without an extensive analysis and discussion with all the stakeholders and their associations, because even seemingly punctual changes tend to have indirect effects for many agents.

Another, even more sensible, aspect is related to the interest of the Ministry of Finance to obtain extra-budgetary resources through the Brazilian Electricity Sector, in order to mitigate the crisis effects on public finance. The BES already contributed in 2015 through the auctions for the granting of hydro power plants which did not adhere the concession renewal offer under MP 579. If, on the one hand, this mechanism brings a short-term bonus to the Ministry of Finance, on

⁴ This provisional measure implemented on 11-11-2012 and later passed into law, proposes the renovation of concessions for contract for hidroelectric plants and transmission lines.

the other hand it imposes a long-term burden on the regulated market consumers by increasing this energy cost for decades.

The Ministry of Finance, together with the MME, attempted to capture more resources from Brazilian Electricity Sector, just before the whistle blowing of JBS Group's top executives, through what has become known as the "de-entitlement" project. In short, the proposal was to cancel the contracts between the distribution and generation companies, referred to the quota of hydro power plants that renewed the concessions in 2013. This energy would be auctioned once again, possibly with values 3 or 4 times higher, allowing for the reduction of the overcontracting of the distributors, but increasing the price of this energy, without considering the impacts on the default rate and on non-technical losses. From this increase, the Ministry of Finance would receive a bonus and the consumers a long-lasting burden. A very creative proposal, but with a very unequal distribution of bonus and onus.

In summary, the Brazilian Electricity Sector is relatively shielded due to its technical competence, its strategic role in the infrastructure sector and the new governance coordinated by the MME. The risk lies in the possibility of changing its model without a comprehensive and systematic analysis of its impacts, especially considering the current scenario of uncertainties determined by the political crisis. In these terms, changes in the model at this time do not seem to be prudent, not only because of the atmosphere of political and economic insecurity, but also because of the complexity of Brazilian Electricity Sector. The moment is very propitious for the technical and regulatory analysis of the impacts of the technological revolution that the electric sector is going through in the developed world, which is coming to Brazil, such as the diffusion of distributed energy resources, the fast insertion of wind and photovoltaic sources vis a vis the end of the hegemony of hydro power plants, smart grids, electric cars, etc.