

## **THE ENERGY AGENDA: THE EXPECTED, NEW, AND MISSING FACTORS**

- The Energy Agenda is valued as a relevant contribution, especially in those actions aimed at unblocking the projects and improving the conditions for their development.
- The Agenda was cautious in the most controversial issues, which is not advisable because what we need is precisely an open, honest discourse for a well-grounded debate with the public opinion and the political world.
- It will be essential to rely on objective and transparent information, and for the authority to act with leadership to guarantee the proper conditions and regulatory framework so that there is enough safe, efficient and sustainable energy.

The government made public its Energy Agenda, which envisages a series of actions and measures aimed at unblocking the electricity investment and improve the operation of the energy sector. Designed on seven core ideas, it puts special emphasis on encouraging a bigger role of the State, increasing competition and reducing electricity prices, fostering the use of own resources, improving the transmission system, promoting energy efficiency, increasing investment on infrastructure and advancing in land management and active civic engagement. Therefore, it establishes specific measures and goals to be achieved in fixed terms, which deal not only with the power system but also with the gas, firewood and gasoline markets.

### **CONTENT OF THE AGENDA**

The objective of the Agenda is being able to ensure that the country has “reliable, sustainable, and inclusive electric power, at reasonable prices, with a diversified electric grid, balanced, and which guarantees the country higher sovereignty levels in its power requirements”.<sup>i</sup> Its main concern is to reverse the price increase of electricity in the last couple of years, and which should be attributable, so it says, to a series of factors such as conflicts regarding the use of the land, increasing citizen questionings, the absence of long-term planning, competition problems at the generating level and the lack of investment on transmission, among others. This leads the

government to promote “a change of paradigm in energy matters”, where the State plays a more active role in the long-term strategic planning of the sector.

This diagnosis had already been anticipated by the Ministry of Energy, who stated that the existing model (based on private initiative and the regulatory and subsidiary role of the State) was designed to supply sufficient electricity at reasonable prices and under competitive conditions, all of which, in his opinion, are not fulfilled today, thus demonstrating that the market did not work. However, evidence shows that the current regulatory framework has allowed multiplying the power generation by 4 in the last 25 years, providing the necessary supply even under very adverse conditions (like the power supply cut from Argentina, droughts and fuel price increases). This framework has been improved over the years in order to attend public interest aspects, such as safety of the system, protection of people’s health and the environment, energy efficiency and the promotion of non-conventional renewable energies, among others.

Accordingly, the problems that trouble the country today concerning energy matters do not derive from the model itself, but rather from the difficulties faced by developers to carry out the projects (either incumbent or new actors), which entail reticence to sell energy in long-term contracts and the consequent high price of the electric power. All of that deserves specific actions, but not necessarily radical changes to the existing model. This is why the improvements proposed by the Agenda are valued and, especially, the actions aimed at unblocking the projects and improving their development conditions.

The Agenda sets out very specific goals and objectives, that is:

- Reduce the electricity marginal costs by 30% in the Central Interconnected System (SIC, in Spanish) from an average of US\$151.36 per MWh in 2013 to less than US\$105.96 per MWh in 2017.
- Reduce by 25% the power supply bidding prices of the next decade for regulated customers, in relation to the last bidding’s prices (US\$128.2 per MWh).
- Raise the existing barriers for Non-conventional Renewable Energies (NCRE), to comply with the law imposing a 20% injection of NCRE by 2025.
- Foster the efficient use of energy, setting a 20% saving goal by 2025, considering the expected growth in power consumption by then.
- Design a price stabilization system that effectively reduces the fuels’ price volatility to which households are exposed to.

- Turn ENAP (National Petroleum Company) into a strong company, so as to become a solid actor with leadership in the country's energy challenges; therefore, a corporate government regime will be proposed and its financial balance will be strengthened through capital investment.
- Develop by 2015 a long-term Energy Policy validated by the Chilean society, through a regional and participative process.

The announcement of the Agenda caused great expectation due to the diagnosis shared for a long time regarding the problem created by the lack of projects to guarantee the electricity supply at competitive prices. In this context, several proposals had already been discussed in previous proceedings and were picked up by the Agenda, while others were new ones.

#### **EXPECTED ANNOUNCEMENTS**

Within the expected announcements, certain relevant actions or measures are worth highlighting. For example, promoting the use of LNG in the short term, which would allow using the existing plants and eventually encourage new projects.

It also proposes to strengthen the government departments in charge of granting permits, and create a Project Management Unit in the Ministry of Energy, which should help to accelerate the processing and develop follow-up and management capacities for energy projects.

The Agenda establishes procedures to advance in land planning matters, for the development of both hydroelectric and other power generating sources, thereby generating indicative information to facilitate decisions regarding the localization of projects. This should help rationalize the multiplicity of protection and standards categories, as well as the role of the great number of institutions involved in this process.

The interconnection between the Central Interconnected System and the Northern Interconnected System (SIC-SING, in Spanish) is promoted, which would allow using plants with idle capacity in the SING (gas and coal) and serve as a backup for both systems.

Proposals for the supply biddings of regulated customers are also included, which envisage the redesign of the bidding conditions and the regulation of the supply without contract, which should increase competition and facilitate the entry of new actors to the market.

The Agenda also considers a series of measures to foster energy efficiency, aimed at reaching an ambitious goal. This includes expanding the development of energy efficiency projects, support municipal energy management, education campaigns and evaluating regulatory modifications.

Finally, the concept of total associativity is incorporated, which picks up the idea of creating mechanisms allowing the community to receive benefits from energy projects installed in their land. Here, in such controversial issues like local contributions, we missed a more specific proposal –there is only a generic one- which would settle once and for all the inequity of the costs and benefits affecting the communities where the projects are installed.

#### **NEW ANNOUNCEMENTS**

A couple of announcements were surprising, some of them being better evaluated than others. Regarding the natural gas distribution market, it proposes a regulated rate fixing, based on the model of efficient company. It should be noted that this sector is currently regulated by the Law of Gas Services (*Ley de Servicios de Gas*), which establishes a maximum limit to economic yield<sup>ii</sup>, indicating that if it is exceeded, the Court for the Defense of Free Competition may request the Ministry of Economy to fix the rates of the gas supply and associated services. In this context, the announcement completes the existing regulation; however, if we want to advance towards a rate fixing system, as set out by the Minister, we should at least analyze the competition factors of this market justifying such regulatory modification.

We were also surprised by the proposal of building a new LNG regasification terminal with ENAP's participation, and the bidding of ENAP's LNG available in the Quintero terminal, both with the purpose of increasing the presence of gas in the grid.

In turn, ENAP would receive a capitalization of US\$400 million, which seeks to improve the debilitated financial position of the state-owned company, whose debt amounts to US\$4 billion, forcing it to pay interests for US\$200 million each year. This transfer of financial resources should go along with a new system of corporate government, which allows to depoliticize the decision making process, although it is probable that the capitalization will materialize first. It would be advisable to address the indebtedness problem with private capital contributions for specific projects with positive rate of return, but the Agenda does not deal with this matter.

Another new subject on the Agenda includes the proposal to disassociate the revenues of the distributing companies from their electricity sales, which seeks to generate incentives for the distributors to promote energy efficiency among its clients. This system, which is called

decoupling, was originally implemented in California in 1981 and it has extended to other states with different modalities. Concerning its eventual implementation, it should be necessary to make a deep analysis of the effectiveness of this measure and, of course, safeguard the investments' rate of return.

A redesign of the short-term bidding conditions is also proposed, in order to incorporate non-conventional renewable energies (NCRE). Ideally, this should entail the association of intermittent and continuous NCRE to deliver energy adapted to the load curve, or the search for mechanisms that enable the incorporation of NCRE in the distributors' biddings without transferring such high cost to the final consumer. Therefore, if this measure is implemented, it is essential to give priority to achieving the minimum possible cost for users.

#### **SILENCED ANNOUNCEMENTS**

We noticed the absence of a more explicit support in the Agenda to the use of coal and hydrop resources of the southernmost region. This is not a minor detail, considering that explicit objectives were set regarding a price reduction (to lower by 30% the marginal costs of the Central Interconnected System by 2017 and reduce by 25% the price of power supply biddings), which requires the development of the most efficient power generation sources.

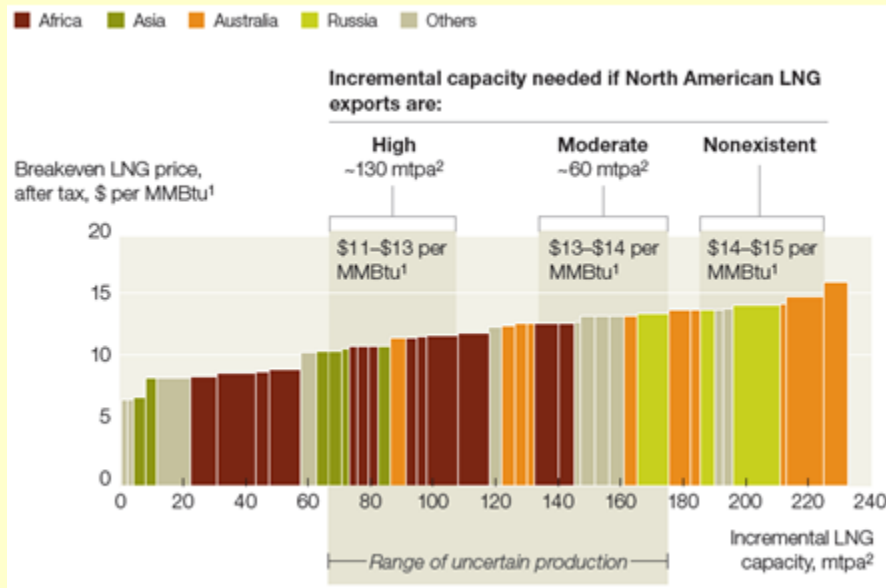
The Agenda indicates that thermoelectric-based generating projects in the Works Program of the National Energy Commission (CNE, in Spanish) will be supported, which is positive. It is nonetheless surprising that it avoids to talk openly about coal. Coal is and will be one of the main energy sources in Chile and the world, because of its key features. Particularly, it is an abundant resource (representing 65% of the global reserves of fossil fuels), globally distributed (40% of the reserves are located in North America, Russia and China), its transactions are made at competitive prices (it meets the cost structure) and its availability, considering proved reserves only<sup>iii</sup>, is enough for more than 100 years. Consequently, we should frankly speak about the convenience of using coal to meet the energy price reduction goals.

Instead, the Agenda seems to give priority to a greater participation of LNG in the national energy grid, hoping it will allow reducing current electricity prices. It is true that, in the short-term, the alternative that can be implemented most rapidly is to promote a more intensive use of LNG in the plants available, thus allowing to immediately face the upcoming energy shortage. However, it is a bit too much to bet on the long-term gas-based generation, which would respond to an excessively optimistic view regarding future gas prices, as derived from the last projections of the CNE which estimates a LNG price of US\$10.16 per million BTU by 2020.<sup>iv</sup> On the contrary,

international estimates indicate that gas will not be available at such low prices; we will probably observe prices over US\$12 per million BTU, which imply costs 30% higher than those of coal.

**IN THE BEST SCENARIO (OF HIGH EXPORTS FROM NORTH AMERICA) THE VALUE WILL REACH BETWEEN US\$11 AND US\$13 PER MILLION BTU**

Chart 1: Estimated Gas Prices



Source: Global Gas Markets: The North American Factor, McKinsey Quarterly, February 2014.

On the other hand, taking advantage of the country’s hydric potential would result in a significant reduction of the generation costs. The Agenda proposes to support the hydroelectric development with institutional improvements and progress concerning hydroelectricity land planning (mapping and analysis of basins), in addition to promote the development of projects confirmed in the Works Program of the CNE. However, it avoids assuming explicit postures in relation to the use of hydric resources in the southernmost region, which leads to the question if it makes sense for the authority to keep bypassing the promotion of economic energy sources and privilege instead other more costly sources explicitly.

Finally, the nuclear option is the main missing factor. This energy source should not be discarded in a country whose energy requirements will duplicate in 15 years and where self-supply

alternatives are limited. It should not be forgotten that this generation source has competitive costs when dealing with large-scale operations and a clean technology that does not generate contaminant emissions. The latter deserves to resolutely advance in order to take grounded decisions concerning the nuclear option whenever necessary, which requires at least to complete the surveys initiated some years ago, as well as training the human resource and obtaining public acceptance.

In brief, the Agenda was cautious in the most controversial issues, which is not advisable because what we need is precisely an open, honest discourse for a well-grounded debate with the public opinion and the political world.

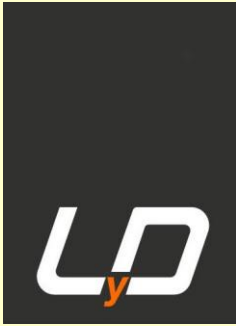
The former is particularly important in view of the proposal of elaborating a State Energy Policy “with social, political and economic validation”, as proposed in the Agenda for the short-term (2025) and the medium and long-term scenario (2050), which supposes to revise the existing standards, guidelines and legislation. The specific mechanisms to achieve the necessary consensus are still unknown, but it will certainly be essential to rely on objective and transparent information, and for the authority to act with leadership to guarantee the proper conditions and regulatory framework so that there is enough safe, efficient and sustainable energy, which is needed to sustain the socioeconomic development that the country requires.

## **CONCLUSIONS**

The Energy Agenda is an important contribution which embraces a wide range of energy matters. In the immediate future, there is no doubt that the most relevant is to promote and unblock energy projects that are scarce today; therefore, we value the measures like promoting the use of gas, supporting the hydroelectric and thermoelectric generation of the Works Program, redesigning the bidding conditions for regulated customers, bidding of publicly-owned lands, creating a Project Management Unit in the Ministry of Energy, and making progress in local contribution and land planning matters. The remaining proposals are rather secondary in terms of allowing us to overcome the current energy obstacle, although they are still relevant since they respond to other objectives, such as institutional strengthening, energy information and education, R&D and human capital development, NCRE promotion and energy efficiency, among others.

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<sup>i</sup> Energy Agenda, page 11.



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<sup>ii</sup> Decree Law Nº 323 and its modifications thereafter. It stipulates maximum yield of 5 percentage points above the industry's capital cost, which in turn cannot be less than 6%.

<sup>iii</sup> It refers to discovered volumes with 90% probability of being extracted in a profitable way.

<sup>iv</sup> Source: *Fijación de precio de nudo de corto plazo*, SIC, Final Technical Report, CNE, April, 2014.

**FURTHER INFORMATION**

<http://www.minenergia.cl/documentos/estudios/2014/agenda-de-energia-un-desafio-pais.html>

<http://www.lyd.com/centro-de-prensa/destacados/2014/05/agenda-energetica-para-chile/>

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