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Electricity: Plans to beef up Eletrobras give cause for concern

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ByAlastair Stewart

Energy and electricity are pet subjects of Dilma Rousseff, Brazil's president-elect.

Indeed, it was her work as mines and energy minister that caught the eye of President Luiz Inácio Lula da Silva. She succeeded in attracting investment to the sector and averting a repeat of the electricity rationing that traumatised the country in 2001 and 2002. The president adopted her as his heir apparent, so propelling her into her new job.However, Ms Rousseff's plans to beef up federally owned Eletrobras, with a market capitalisation of $16bn, Latin America's biggest electricity company, are causing concern.

In the past, Mr Lula da Silva said he wanted the company to become the electricity sector's Petrobras, the state-controlled firm that dominates national oil production. Analysts see Ms Rousseff continuing this process at Eletrobras, so as to have greater control of electricity supplies.

"These plans hark back to the military dictatorship, where the state takes on all the risks of strategic projects," says Adriano Pires of CBIE, an energy consultancy. "The problem is that such a move may create more uncertainty among private investors and be used by the government to keep prices low," he adds.

Eletrobras has always played a strategic role in energy policy. Nonetheless, the company's shares jumped sharply in October, when it briefly seemed that Ms Rousseff's main rival in the presidential race, José Serra, had a chance of winning and Eletrobras would be more profit-driven under his administration.

Under Ms Rousseff, "the model appears to be for Eletrobras to get increasingly involved in big generating and transmission projects, leaving smaller generation projects to the private sector," says Felipe Mattar, an energy analyst at Barclays Capital.

A pointer to policy, according to Mr Pires, was the April auction of Belo Monte, expected to be the world's third largest hydroelectric power station.

No private utilities chose to bid on the project to build and operate the 11,200 megawatt capacity dam, judging the government-set maximum price they could charge for energy as too low.

Undeterred, the government sold the rights to a consortium led by local construction company Andrade Gutierrez - but with Eletrobras as the leading stakeholder, project underwriter, and dam operator.

According to Mauricio Tolmasquim, head of the government's EPE research agency, Belo Monte was a one-off - a huge strategic project.

"We know that we need private utilities to meet Brazil's fast-growing electricity demand over the next decade and beyond. They can be no question of crowding out," says Mr Tolmasquim, who is a close adviser to Ms Rousseff on energy.

The fast-expanding economy is hungry for energy. The EPE estimates electricity consumption will grow by 50 per cent to 633,000MW hours in 2019. That will require investments of R$175bn ($103bn) in power generation alone.

The good news, according to Mr Tolmasquim, is that power plants under construction will ensure energy needs are met until 2014, even if the economy sustains 7 per cent growth.

Furthermore, the construction of three huge hydroelectric dams, alongside the addition of thermal, wind and biomass generating capacity, mean that approximately 71 per cent of energy needs until 2019 are also catered for.

"Energy will not be an impediment to growth over the next decade, as it was in the last," he says.

However, challenges remain. Indeed, Anglo-Australian miner Rio Tinto is flirting with the idea of building a mooted 480,000 tonnes a year aluminium smelter in neighbouring Paraguay, rather than Brazil, because it can guarantee an abundant long-term supply of cheap energy thanks to surplus hydroelectric capacity.

First, the Brazilian government must decide quickly on whether to allow utility companies to renew 50-year generating and distribution contracts that run out in 2015, or to put them out to tender. Uncertainty on this issue hampers energy companies in their long-term planning.

Meanwhile, although the three vast Amazon dams under construction, Santo Antonio, Jirau and Belo Monte, have environmental approval, the Rousseff administration faces a tough task obtaining licences for hydro projects as the environmental lobby grows stronger.

Brazil has the world's largest river network and hydroelectric power accounts for 85 per cent of generation. Its share will remain at that level over the next decade because of the large dam projects, says Mr Tolmasquim, but the government expects energy from renewable sources and nuclear power to become more important over the longer term.

Mindful of the risks represented by dry spells, such as the current one in the Amazon region, the Lula administration also plans to increase oil- and gas-fired capacity. That capacity will continue to grow, adds Mr Tolmasquim.

The country could also reform energy taxes. Although its dams produce some of the world's cheapest energy, an average tax burden of 45 per cent accumulated on energy from generation to home delivery is one of the highest, according to Instituto Acende Brasil (IAB), a local think-tank. PwC estimates that taxes are roughly seven times higher than in the UK.

But tax reform is unlikely in the immediate future, according to Claudio Sales, head of IAB.

"It is too easy to tax energy bills. Everybody pays but nobody really notices. Politicians are loath to change a deal like that," he says.