



LIQUIDATION OF *LUZ Y FUERZA DEL CENTRO*

Embassy of Mexico

Fact Sheet

October 2009

On October 11th the Government of Mexico announced the liquidation of the state-owned electrical utility company *Luz y Fuerza del Centro* (LFC) that served Mexico City and a few municipalities from the surrounding states of Mexico, Hidalgo, Morelos and Puebla. This decision was taken after an objective and rigorous economic and technical analysis of the company was carried out, which identified severe structural problems that had made it not only financially unviable, but also a significant and ever increasing burden for the tax payer.

A Highly Deficient Operation

Luz y Fuerza del Centro, along with the Federal Electricity Commission (CFE), which is also state-owned and run, were responsible for generating, transmitting and distributing electricity in Mexico, with the former providing electric power to greater Mexico City and the latter serving the rest of the country. However, the difference between the two public utilities could not be greater in terms of productivity, efficiency and financial health. Thus, while LFC had one person working on its distribution network for every 291 users, the CFE has one such worker per 627 users. The CFE sells 2,500 megawatts per hour for every worker that it employs, while LFC sold only 730 megawatts per hour per worker. Also, by the time it was closed down the LFC grid was losing almost a third of the electricity it generated, transmitted or distributed, compared with 10% for CFE. Not surprisingly, these inefficiencies resulted in severe imbalances and over the past nine years, because of LFC's inability to generate its own income and reduce financial costs, annual subsidies to the company had quadrupled, reaching \$42 billion pesos (\$3.2 billion USD) this year, which the government had to cover with tax-payers' money.

Some of these imbalances can be attributed to the significant labor costs that LFC increasingly had to bear and the way that these were distributed. Of the \$240 billion pesos (\$18.2 billion USD) in labor liabilities, only

\$80 billion pesos (\$6.1 billion USD) went to current employees, while \$160 billion pesos (\$12.1 billion USD) went to retired workers. Moreover, most workers were able to retire before the age of 50 (the retiring age for most of the workforce in Mexico is 65), receiving a pension worth on average 3.3 times the average compensation package of current workers, and for every percentage point of salary increase for current employees, pensions rose almost twice as much. This meant that LFC had unsustainable obligations and did not have the financial reserves to pay for pensions.

Consequences

The efficiency and productivity problems faced by LFC had a significant negative impact on the economy in central Mexico, as they discouraged investment, the opening of new businesses and the creation of jobs. During 2008 LFC was unable to respond to 927 requests for connection to the power grid, which is equivalent to almost 10% of the demand in Mexico City or to a denial of service to two cities the size of Acapulco. At the same time, these denials of service had become a source of corruption by forcing companies to pay bribes for new connections, while others had to invest millions of dollars to compensate for deficiencies in the electricity supply.

As a result, and notwithstanding the many attempts over the years to reform LFC and



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boost its productivity, the government had to subsidize this company as its annual deficit increased year after year. In 2009 alone, the subsidy was almost equivalent to the total budget of Oportunidades, the largest and most important poverty-alleviation program that the government operates and that benefits over 25 million Mexicans, or twice the annual budget of the National Autonomous University of Mexico (UNAM), one of the largest universities in the world. If the government had continued subsidizing LFC, by the end of the Administration of President Felipe Claderón the total amount of resources transferred to LFC would have been over \$300 billion pesos (\$22.7 billion USD) an amount equivalent to the cost of building 1.2 million low-income houses.

Clearly, this situation could not continue, especially given the current challenges faced by Mexico as a result of the international economic crisis. For that reason, and in strict adherence to the law, the Government of Mexico decided to liquidate Luz y Fuerza del Centro.

Protecting Worker's Rights

The decision to liquidate LFC does not imply in any way the privatization of electric utilities. The generation, transmission and distribution of electricity in greater Mexico City and throughout the country will continue to be a State-run operation, as established in the Constitution and the laws governing this industry.

This decision cannot be in any way construed as an attack on trade unions or workers rights. The severance payments will be made according to the terms established in the

Federal Labor Law and the company's Collective Bargaining Agreement. Moreover, unionized workers who voluntarily accept the terms offered before November 14, 2009 will receive an additional payment, making the average severance package equal to three years' salary. Moreover, some of LFC's active workers could be re-hired to work at the new company, while the Government will facilitate the swift reentry of former LFC employees into the job market by providing training courses and guidance to help them use their compensation wisely, and through self-employment and business-creation programs. As for the 23,000 LFC retirees, they will continue to receive their current pensions.

Implementing the Liquidation

The decree issued by the government states that personnel from the CFE will ensure that the services previously provided by LFC continue uninterrupted. The liquidation of LFC will:

- ❖ Reduce the high cost to taxpayers of subsidizing a company with low standards of quality and efficiency.
- ❖ Channel public resources that until now had been used to subsidize the company to priority areas such as poverty alleviation, healthcare and education.
- ❖ Ensure that consumers are charged strictly in accordance with their consumption of electricity.
- ❖ Improve the electrical infrastructure and the quality of service in order to promote growth and facilitate the setting-up of companies, factories and businesses in central Mexico, while improving their competitiveness, thereby creating more and better paid jobs.



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The liquidation of LFC will substantially improve customer service and provide a more efficient electricity supply through better infrastructure, as is the case in the rest of the country. In this way, this measure will provide large benefits not only because the subsidies used to keep LFC going can now be used for social priorities, but also because a higher quality electricity service with increased capacity will contribute to foster growth, competitiveness and employment in central Mexico.

With this decision the Federal Government renews its commitment to pushing through the fundamental changes that the country needs.