Power Plant Rehabilitation Project

Summary of the Operation Performance Evaluation Review

January 2004

THE PROJECT

In November 1997 the Bank signed a US$ 27.8 million loan financing the rehabilitation of two 300 MW units at the power plant. This 3,000 MW gas-fired facility makes up 27 per cent of the country's power generation capacity and accounts for one-quarter of total electricity generation. The total project cost was estimated at US$ 45.1 million. The project was implemented by the country's Ministry of Power, Industry and Electrification (MPIE), responsible for the generation, transmission and distribution of electricity. The MPIE was transformed into a state joint-stock company in May 2001. The principal predicted benefits of the project were to reduce specific fuel consumption and to increase plant output and availability.

PROJECT RATIONALE

The main rationale of the project was to introduce state-of-the-art steam turbine technology in two turbine units of the power plant. The operation was also expected to promote the development of a commercially managed and efficient power sector, and to support the country's move towards a market economy. The borrower was interested in upgrading the country's mainly old and outdated power generation infrastructure to make it more efficient.

The Bank considered this first entry into the power sector as an opportunity to play a role in the sector's move from state ownership towards more privatisation. The project was expected to prompt the MPIE to take a more commercial approach to the sector, and to facilitate the implementation of an institutional reform programme. The Bank was the first IFI to invest in the country's power sector with the intention of pushing for sector reforms, thus paving the way for future additional outside investment.

OVERALL ASSESSMENT

PED assigned a *Partly Successful* performance rating to this project. The overall transition impact was rated *Marginal*. The main reasons for this low rating were the lack of sector reforms, the rigidity of the payment system and the fact that, despite the newly corporatised structure of the entities in the electricity sector, key decisions are still being made at senior ministerial levels.

The project and sector financial performance was *Marginal* despite some progress on recent tariff increases. The Company's performance was rated *Good* as the project has provided opportunities for improved technical performance and for improved future procurement. The fulfilment of objectives was rated *Marginal/Good.* Again, the technical objectives were achieved, but the transition related aims for sector reform were only limited. The environmental performance of the sponsor was rated *Good* and the extent of environmental change was *Some.* The project has contributed to a more efficient fuel use and higher productivity.

Additionality was rated *Verified at Large* since no other lenders were willing to provide similar long-term financing to the country at that time. Bank handling was rated *Marginal/Good* due to the poor timing and implementation of technical cooperation (TC) assignments, as well as major delays in decisionmaking during project implementation. The Bank's investment performance was rated *Marginal* considering the Bank's standard fixed sovereign lending margin.

TRANSITION IMPACT AND BANK'S ADDITIONALITY

PED rated the overall transition impact as *Marginal*. The project has prompted piecemeal reforms, but power sector restructuring is still at a very early stage and lacks a coherent and credible legal and regulatory framework. The only noticeable change in sector organisation has been the conversion of a public utility, which was run as a ministry, into a state-owned and government-controlled vertically integrated holding company. This move also permitted the corporatisation of the power station covenanted by the Bank. The management and staff of the power station gained substantial skills from this process, but there is no mechanism in place to disseminate the knowledge gained from this experience across the sector at large. The standards of business conduct and corporate governance remain low, and the prospects for commercialisation, market liberalisation and private sector involvement are limited.

Given the poor investment climate in the country, the absence of credible reforms and the formidable risks involved in long-term lending to the country's power sector, it is unlikely that other sources could have been used to fund the project. The Bank was the first IFI to invest in the country's power sector. Another benefit was the project's TC support for institution building (for example, financial accounting, tariff setting).

BANK HANDLING

The key weakness of this project has been the delayed execution of TC studies that should have been carried out prior to project implementation. The World Bank's sector study takes a more cautious view and suggests that a well prepared sector reform would have been much more useful.

MAIN ISSUES AND LESSONS LEARNED

The optimal level and structure of TC support should be determined early. Investment operations justified on account of potential transition effects should be bundled with sufficient TC resources to initiate and sustain the desired reform process. Resources should also be allocated to assisting the client in designing and implementing the necessary steps towards transition, notably in cases where transition implies an organisational restructure. TC should facilitate achieving covenant compliance. This is particularly important in low transition countries.

A narrow approach towards TC can constrain a project. The TC focus on a project should not be oblivious to the sector's requirements. While the Bank's project approach may facilitate continued engagement with the authorities, there is a risk that lagging sector reform hampers progress on the project level. Effective coordination with all IFIs is particularly important in cases where a major sector reform is imperative.

Sequencing and conditioning of future Bank involvement should be determined. Pilot projects should include criteria for Bank support to subsequent projects. It is particularly important to define reasonable and effective transition milestones which must be reached to ensure continued Bank support.

The necessary framework for meaningful corporatisation covenants should be created. When the Bank covenants the corporatisation of a public enterprise, it should make sure that this step yields the desired results - that is, the withdrawal of the government from the company's business and improved corporate governance and performance. As a minimum, care should be taken to ensure that appropriate framework conditions are in place, or are being prepared, to bring about effective changes in organisation and company management.

Operational financial covenants should be tailored for utilities. Financial covenants should be operational and proportionate to the conditions under which a business is run. The targets should be set at levels that can be reached (taking account of binding and not so binding constraints) and against which realistic performance improvements can be measured. In low transition countries, the focus should be on selected indicators of financial strength in cutting edge areas (for example, cash revenue collection and self financing capability); a plethora of targets is not ideal. Financial targets geared towards high standards prevailing in competitive markets make little sense if a supportive incentive framework is missing. Moreover, the Bank should ensure that an appropriate financial accounting and reporting system is established, and that performance monitoring draws on transparent and reasonably accurate financial data.

Tariff covenants should address financial needs. Tariff covenants and supporting TCs should address financial needs. They should help allocate expenditure among customers and promote the management of the electricity load in an efficient way. Least-cost expansion planning and the estimation of long run marginal costs are different issues that should only be raised through covenants if they rank high on the agenda of reforms with large transition effects (which is not often the case).

Rehabilitation projects need careful evaluation and planning. The integration of new equipment and its operation into existing (out-of-date) facilities is a complex task and involves great technical and operational risks. Therefore, rehabilitation projects require careful planning and adequate resources should be allocated to support the process of introducing new technologies and changes in plant management.