

Private Sector Development in Electric Power: A Review of the World Bank Group's Experience

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We are very pleased to welcome all of you this workshop and thank you for this opportunity to present the findings of our evaluation study to such a distinguished group.

First, let me introduce the evaluation groups that prepared our study, explain the study's objectives, and present its main findings and recommendations.

The World Bank Group (WBG) has three evaluation groups, namely, the Operations Evaluation Department of the World Bank (OED), the Operations Evaluation Group of the International Finance Corporation (OEG), and the Operations Evaluation Unit of the Multilateral Investment Guarantee Agency (OEU). OED is an independent unit which reports directly to the World Bank's Board of Executive Directors. OED's goal is to objectively assess the results of the Bank's work, and to provide accountability in the achievement of the Bank's objectives. OED assesses what works and what does not, and evaluates what the lasting contribution of the Bank is to a country's overall development. OED also seeks to improve the Bank's work by disseminating lessons learned from experience.

At this workshop, we will be discussing the main findings and lessons from the joint OED, OEG and OEU study, which evaluated the WBG's performance during the 1990s in promoting private sector development in the electric power sector (or PSDE for short). The study is based on an evaluation of the WBG's PSDE assistance in 80 countries, through the Bank's analytical and advisory work, 154 Bank projects, 29 mature IFC investment operations, and 8 mature MIGA projects. In addition to reviewing this portfolio, we also conducted a literature review, country case studies, extensive interviews, and a survey.

Why was this study done, and what are its objectives?

During the 1990s, the Bank issued policy statements in support of promoting private participation in the electricity sector. In 1993, the Bank, with IFC support, issued the Electric Power Lending Policy. This linked the WBG's support with country commitment to reforms in the power sector. Specifically, this meant commercializing and corporatizing public power utilities and establishing arms-length regulation. In practice, the Bank's approach to power sector reform went beyond that mandated by the 1993 policy. By the mid-1990s, this lending policy had evolved such that private sector participation became a clear goal. By this time, the Bank promoted among its country clients a power sector reform approach that included commercialization, corporatization and regulation, as well as unbundling, private investments in generation, private investments also in transmission and distribution, and opening up market competition, including the establishment of power pools. In 2001, the Bank issued an energy sector strategy that had four main goals: to promote private sector

development, to achieve macro-fiscal balancing, to protect the environment, and to help the poor directly.

But what actually happened? Following OED's methodology, which assesses performance and outcomes in relation to original objectives, the study was done in order to find out to what extent the WBG achieved these PSDE policy and strategic goals. The study asked the following specific questions: how did the WBG's role change during the 1990s in response to the rapidly changing role of private investors in the electricity sector? Did the WBG's financial and advisory assistance support its own stated objectives? What have been the results? What broad lessons can be learned from that experience? And how can these lessons guide the WBG's future business practice in the electricity sector?

These lessons are particularly important today, as energy issues continue to make the headlines. Investment requirements in the power sector are huge; for example, an OECD study done this year cites requirements in the order of US\$10 trillion globally. During the 1990s, the Bank drastically decreased its financing for infrastructure, in the expectation that the private sector will handle the brunt of required investments. From a high level of US\$3.2 billion in 1996, the Bank's energy lending collapsed to US\$440 million in 1999, and has recovered slightly in recent years. The expected interest in private investments did not materialize, however. This year, the Bank has enunciated a new Infrastructure Plan, which envisages the financing of projects at regional, national and sub-national levels along the spectrum of public and private involvement.

But how can this be done – in a situation where most WBG country clients remain in the early stages of reforming and deepening private sector involvement in their power sectors? The challenges are very significant. First, where should the Bank Group start in the long and complex process of reforming and promoting private involvement in the power sectors of developing countries? And second, having left or stayed away from emerging markets in droves, how can the private sector be brought back in?

Based on the evaluative evidence, how has the WBG performed in promoting PSDE?

One general finding is that the PSDE assistance of the Bank, IFC and MIGA produced different results, and the quality of outcomes depended on the objectives that they pursued and on the types of assistance that they provided.

IFC and MIGA focused on private sector transactions to provide new generation capacity for addressing shortages, and achieved good project-level outcomes overall. But good outcomes alone of individual private sector projects cannot ensure good outcomes at the overall sector level, as the Bank's experience has shown.

The Bank pursued multiple and complex objectives that tried to transform the overall structure and ownership of power sectors in some 70 countries. The Bank employed a diverse set of lending and advisory instruments across all geographic regions. At

the project level, the Bank's PSDE outcomes were mostly disappointing, because the Bank underestimated the complexity and time required for reforms to achieve outcomes that are lasting and equitable. The Bank obtained poor or mixed project results where reforms were weak in the first place, or where initially successful reforms were later reversed.

In a few cases, the Bank achieved good results, but only in situations where country ownership and sustained political commitment existed, reforms have advanced, and PSDE programs were properly implemented. In these countries, there were already local champions, clear road maps and early PSDE successes, and the Bank came in later on to facilitate the reform process rather than design it in the first place. At the overall sector level, evidence on positive gains from PSDE has been emerging in these few countries where outcomes have been systematically monitored. PSDE has delivered results in some Latin American countries and in Eastern European countries seeking accession to the European Union. There, shortages have been reduced, energy access has increased, service quality has improved, fiscal gains have grown, and financial subsidies have declined.

Based on the Bank Group's experience, what are study's main findings and lessons?

One main message is that PSDE is a work in progress because the power sector reform process is complex. It takes time and is resource-intensive. And it requires phasing and careful sequencing to create the conditions for sector transformation.

The study points out that there is no single blueprint for sector reform and PSDE. It is an evolving menu of options covering various combinations and sequences of reform steps driven by country-specific objectives and conditions.

The study asked these questions: where do you start power sector reforms? Should we privatize first, as a way to achieve commercial operations? Or should we deal with governance and commercialization issues first, in order to pave the way for private involvement later?

There were no single conclusions on these questions, since the evidence on the timing and sequencing of PSDE is ambiguous. There are countries where jumping right away to privatization has led to positive changes in the power sector. But there are others where this did not lead to sector improvements. In some countries, substantial efficiency gains were achieved where good public governance and the right tariff structures were put in place first. However, there are also many countries where decades of Bank support for the incremental reform of public monopolies had little or no success.

The study indicates that power sector reforms should be means and not ends in themselves, and the Bank's experience with unbundling offers lessons in this area. In the late-1990s, the Bank considered that the best way to achieve power sector reforms was to unbundle, privatize and establish a competitive power pool, almost regardless of the size of the countries and their utilities, their level of development, and the

extent of disarray in the sector. A recent internal review in the Europe and Central Asia Region of the Bank, however, revealed that the application of a standard, sophisticated model in all situations did not produce the desired results. It proved unrealistic to believe that restructuring and privatization could somehow overcome legal, political, attitudinal and payment obstacles and be immune to destabilizing macroeconomic factors. The key lesson is that it is of primary importance to improve commercial performance, as well as corporate and sectoral governance, regardless of sector structures and ownership. Whether privatization is the best immediate option to achieve these goals depends on country circumstances.

Notwithstanding these findings, there is evidence from other regions that sector performance in countries that actually unbundled and privatized did improve, at times to the point of sound commercial performance. Private participation led to better pricing, lower losses, higher collections and greater access. Yet Bank assistance to establish regulatory bodies proved to be very slow capacity-building exercises that became ends in themselves, with very few successful examples, most of them recently in Latin America. What is more likely to be observed are instances of ineffective regulators due to poor legislation, lack of autonomy, weak technical skills and politicization of decisions.

Another finding of the study is that poverty reduction and environmental mainstreaming have not been intrinsic components of sector reform and PSDE strategies. By mainstreaming the environment, we mean proactively “doing good”, in addition to “doing no harm”. To date, PSDE has focused mostly on sector efficiency and macro-fiscal objectives, and much work remains to integrate poverty reduction and environmental mainstreaming into the design of power sector reform and PSDE strategies. One emerging finding from OED’s review of two renewable energy projects is that local private investments in renewable energy – which are often intended to improve energy access by the poor -- can be undermined by the lack of regulatory transparency and predictability that has resulted from the failure to take renewables into account while reforms were being designed. It is also very important to build a constituency for reforms through civil society participation, which is critical to the sustainability of those reforms.

Independent power producers (or IPPs) have had a critical role to play in relieving supply bottlenecks, in leveraging public sector financing capacity, and in demonstrating early wins. In the right country, sector and contractual conditions, they have yielded good development outcomes. In some cases, however, IPPs have reduced the pressure on country leaders and policymakers to pursue further reforms. Moreover, IPPs that were not complemented by a parallel reform program in transmission and distribution can lead to an imbalance between generation and transmission & distribution capacity. This can jeopardize earlier gains that were achieved in the generation subsector, since the sustainability of private investment in generation depends crucially on collecting the cash from the final consumer.

What future role should the WBG play?

Overall, the WBG's advice and assistance in PSDE continue to be in demand even in the current global environment of reduced private capital flows, heightened macroeconomic and political risks, and low interest from sponsors or investors. In particular, the WBG has an urgent and crucial role to play in slow-reforming and low-income countries whose high political risk and regulatory deficiencies make them less attractive to investors.

The report's main message is that PSDE can deliver expected benefits and good sector efficiency outcomes where countries were politically committed, reforms have advanced, and PSDE programs were properly implemented. Thus, the study recommends that the WBG should continue to support PSDE as a key objective, within a continuum ranging from fully public to fully private electricity service provision. However, in doing so, the study makes the following recommendations for the WBG.

- First, the WBG should provide more detailed operational guidance to staff on when and how to continue promoting PSDE. The 1993 power sector lending policy laid out what to do, but not how to do it. Although the policy is basically sound, it did not give enough importance to the political economy of reforms and proved too optimistic, thus leading to problems in its implementation. Operational guidance is especially needed in five areas: (1) how to re-ignite private interest in developing country power sectors; (2) how to balance public and private investments; (3) how to select the sequence of reforms and PSDE interventions that will work best in a particular country and sector situation; (4) how to incorporate the expansion of energy access for the poor and environmental considerations into the WBG's PSDE and power sector reform agenda; and (5) how to achieve much stronger coordination for the Bank, IFC and MIGA, within the framework of Country Assistance Strategies.
- Second, the WBG should foster greater integration of poverty reduction and environmental objectives into the design of future PSDE strategies, in addition to traditional macro-fiscal and sector efficiency objectives. This calls for a greater focus on reforming and facilitating private investments in the distribution subsector. Specifically, this requires actions to improve cash collection, reduce losses, address corruption, achieve better targeting of subsidies, expand the access of the poor in rural areas, and privatize distribution where and when circumstances permit. This also means that the WBG should maximize the involvement of the local private sector in decentralized energy project, including renewable energy.
- Third, the WBG should also encourage operational innovations to ensure greater consistency between its practices and instruments and its PSDE goals, including public-private partnerships, and more systematic monitoring and evaluation of impacts.

The study that we are disseminating and the proceedings of the Manila workshop could inform the implementation of both the 2001 energy strategy and the new Infrastructure Plan. But the WBG's support is small compared to the private flows that occurred during the 1990s. Moreover, the WBG's PSDE assistance is a "work in progress". It requires learning-by-doing. Countries should set clear objectives and take the lead, and where WBG advice can be of use, it should draw from lessons of experience in other countries in similar circumstances. Therefore, we would be grateful – through this workshop – to learn from your experiences related to power sector reforms and promoting private investments in the electricity sector of developing countries.

Thank you.