

Chapter 7

THE ROLE OF IFIs AND BILATERAL DONORS

7.1 Identifying Trade Opportunities and Facilitating Inter-Country Agreements

The IFIs like the World Bank Group and the Asian Development Bank as well as bilateral development assistance programs of US, UK, Canada, Japan and Germany have been involved in the energy sector programs of South Asian countries for several decades and are well placed to undertake sector analysis in each country and identify electricity trade opportunities which, *prima facie*, would be attractive to the concerned governments, and persuade the relevant countries to pursue these opportunities further. The IFIs are uniquely placed to play the part of honest broker and facilitate the parties to reach the initial Inter-Country Agreements articulating the specific interest of the parties, constituting high level decision making bodies and working groups to carry out and review further detailed analytical and technical work to arrive at key decisions.

In 2004 the World Bank carried out an analysis of the power sector of Central Asian Republics, identified their export potential, reviewed the power sector in potential markets and demonstrated how the Central Asia-South Asia electricity trade could be a win-win situation for both. This has led to the Inter-Country Agreements and further action towards the realization of the CA-SA 1000 project. The Asian Development Bank had similarly been active in promoting the Turkmenistan-Afghanistan-Pakistan pipeline project and the trade between Central Asia and Afghanistan. The USAID SARI-E Program in South Asia has carried out a large number of studies to identify and analyze various electricity and gas trade opportunities and trade related issues in South Asia.

7.2 Structuring Project Investments

IFIs have a major role in appropriately structuring the bilateral and multilateral trade projects based on their experience relating to similar projects in other parts of the world. In South Asia and Central Asia most of the countries with hydropower export potential do not have the public resources for investment in the generation and transmission facilities of the export project. They have little access to commercial sources and capital markets. Even their ability to borrow from the IFIs is limited by country allocations of scarce IFI funds and prudent lending limits adopted by these institutions. Under these circumstances investment projects may have to be structured on a Public-private-partnership basis involving foreign private sector (especially from within the region if available and willing), local private sector, the IFIs with equity and debt positions and the government. Some degree of the government's joint ownership is desirable, especially in respect of hydropower projects and transmission lines, as they involve interaction with various aspects, such as land acquisition, right of ways, rural development issues, flood control and irrigation in all of which the government is deeply involved. In addition some amount of equity by the government in the company would enable it to get dividend income from the exploitation of its major natural resource, in addition to royalties on the use of water, tax on electricity exports and corporate tax on profits. Soft fund windows of the IFIs could be used to lend to such governments for investment as equity in the PPP

project dedicated for export.⁸¹ The private partners should have management and operational control and the percentage of shareholding necessary for this purpose. The presence of the IFIs with some equity and debt would make it easier for the private owners to raise debt from the commercial market and on more favorable terms. It also provides comfort to both the importer and the exporter. The structure of the Theun Hinboun Project and Nam Theun 2 Project in Laos illustrates the type of structure considered appropriate for such export projects (see Appendix 1). In the Sangtuda I Hydropower Project which will export about 670MW is sought to be structured on similar lines with the majority shareholding being with RAO UES, and remaining shares being distributed among the government and the IFIs, when they formally decide to participate.

7.3 Structuring of Transmission and Trading Facilities.

If a dedicated transmission corridor has to serve multiple exporting countries (and possibly multiple exporters from some of those countries) and multiple importing countries (and possibly multiple buyers in some of them), then its ownership structure and operating arrangements have to ensure independence from and neutrality towards all participants in the trade. Decision making on whether to allow new buyers and sellers and whether to expand the capacity of the corridor and how to pay for it have to be taken also in a manner fair to all. For this, structuring of the transmission corridor ownership and operation and the arrangements for trade regulation have to be designed with a neutral party suitably embedded in the decision making structures. The IFIs (through their participation) may have a role in helping to structure these arrangements and to ensure their fair working.

In order to develop a multilateral electricity trading market functioning on the basis of synchronized operation of all participating system, a great deal of work has to be done by way of harmonizing grid codes, regulatory regimes and evolution of common system operation and control rules. In section 6.12 we have suggested SAARC Energy Center as the locus of this work and also cooperation with UCTE. The IFIs and bilateral aid programs need to support such initiatives with technical assistance programs and also enable cooperation with UCTE. Similarly the IFIs may have a useful role in helping the countries which wish to accede to Energy Charter Treaty, with the associated review process, and helping the countries in the task of making appropriate changes/reforms to their laws and policies to conform to the Charter principles.

7.4 Promoting Strategic Sector Reforms in Participating Countries

IFIs and bilateral programs have a major role in promoting strategic sector reforms to enable and foster trade in the participating countries, through technical assistance, sector studies and provision of adjustment loans and or investment loans for related investments. Such strategic reforms include separation of transmission function and its independent operation, third party access to wires services, adoption of transparent pricing policies for transmission services and wheeling services, tariff reforms to minimize cross subsidies and remove the subsidy burden from the utilities to the state

⁸¹ In the South Asia Region all the countries with export potential are small low-income countries eligible to borrow from the soft funds window. In appropriate cases soft loans blended with regular loans could be considered.

budget, introduction of time of day tariffs, operational efficiency improvements in metering, billing and collection, and improving the content, competence and accountability of sector regulation. Financing of export project(s) may be linked to advancing the domestic sector reform agenda.

7.5 Building capacity for export transactions and Evolution of Export/import Contracts and Dispute Resolution Mechanisms

The IFIs have an important role in building the capacity of the governments, public and private sector energy entities in the smaller economies such as Nepal, Bangladesh, Sri Lanka, Tajikistan and Kyrgyzstan to negotiate, monitor, and enforce export trade contracts. The IFIs and other donors may also an important role in more or less standardizing the template for export/import contracts or supply/purchase contracts with a fair and proper allocation of risks among the parties and with fair dispute resolution mechanisms, and a similar contract template for transmission services in trade projects.

7.6 Supporting Transmission and Distribution Expansion

Increasing the power transfer capacity even within the country is a major need before a country embarks on external trade involving large take or pay contracts. Such projects enhancing power transfer capacity enables the optimal use of the existing generating capacity and the transfer of the imported power to any part of the country. Financing or co-financing such major expansions of transfer capacity should have priority in the IFI lending plans. A similar focus on the distribution capacity expansion to reduce losses and facilitate the efficient absorption of the imported power would be of equal importance.

7.7 Risk Mitigation

IFI lending and guarantees and insurance arrangements with MIGA would reduce a range of risks to the project and the sponsors and the trade participants. Involvement of IFIs in a electricity trade project would discourage the transit countries from disrupting supply on political grounds. MIGA insurance suitably tailored to the project could provide a cover for most cases of transit country and supply disruption risks. IFI presence in the project with equity and debt would discourage non adherence to contracts thereby reducing risks all around.⁸² World Bank's guarantee mechanism when properly designed can mitigate a range of risks. Examples will include Brazil-Bolivia gas Pipeline project and Mozambique-South Africa gas pipeline project. The full set of instruments at the disposal of the World Bank could be used for risk mitigation purposes in complex electricity trade projects. The instrument of Adjustable Program Lending can be used effectively to support the evolution of the regional market stage by stage, as is sought to be done in the Energy Community of the South Eastern Europe. It is a flexible instrument which had been used for power market/power pool related lending operations (West African Power Pool, South African Power Pool, and Greater Mekong Sub-regional Power Trade).

7.8 Priority in the Country Assistance Strategies

The IFI country assistance strategies and country lending and non-lending programs could be reoriented to give high priority for regional energy trade integration programs,

⁸² It is interesting to note that the Integrated Energy Policy Report of the expert Committee of the Planning Commission of India (August 2006) suggests that for pipeline projects for import of gas, one should get equity and debt from multilateral agencies for risk mitigation.

especially in the South Asia region where regional integration is negligible. Regional trade strategy and financing preferences should be suitably incorporated in the country strategies.

7.9 Coordination among IFIs and bilateral Donors

Given the nature of the countries in which export projects would be located, it will be essential for all relevant IFIs and bilateral donors to participate in a well coordinated manner. Such a coordinated approach would not only enable these large projects to proceed by overcoming allocation limitations and by spreading the risk of large investment among many parties, but will also create a tremendous synergy which will benefit all the participants and the project.