

The Philippines and Azerbaijan

The Effects of Private Sector Participation and Privatization in the electric power sector and the Modality of ODA Loans

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Outline and Objectives

This thematic evaluation analyzes the impact which private sector participation and privatization policies in the Philippines and Azerbaijan had on project effects in ODA loan projects. The evaluation examines these policies from both public and private perspectives and makes recommendations regarding the modality of ODA loans under private sector participation and privatization policies. In the Philippines, the electricity supply has become stable through the boost in transmission capacity, and project effects increased after private sector participation and privatization. Effects of the projects were highly satisfactory in both public and private aspects. In Azerbaijan, public participation and privatization policies are still in a transition period. Although electricity charges were raised accompanying the introduction of a beneficiary-pays principle, its impact on collection rates is not yet known. Therefore, it is difficult to measure an increase of project effects and impacts from public and private aspects. Three areas were recommended for the use of ODA loans: to improve

infrastructure bottlenecks, to provide assistance in establishing an environment that will promote fair competition among private enterprises (systems, frameworks, and regulatory bodies), and to promote effective use of resources in recipient countries.

Project Name	Loan Agreement	Loan Amount	Final Disbursement
Philippines Luzon Grid Transmission Projects Associated with Private Power Projects	March 1997	14,972 million yen	July 2004
Philippines Leyte Bohol Interconnection Project	March 1997	8,086 million yen	July 2004
Azerbaijan Severnaya Gas Combined Cycle Power Plant Project (1) and (2)	February 1998/ October 1999	39,021 million yen	May 2004/ December 2004

*Please see pages 77, 76, and 102 for individual evaluations of the above projects.

Evaluation Methodology

Focusing on ODA loans provided for the electric power sector in the Philippines and Azerbaijan, this thematic evaluation (a) analyzes the impact private sector participation and privatization policies had on the project effects and (b) assesses private sector participation and privatization policies from public and private perspectives. Taking into account the findings of this analysis, the evaluation then (c) analyzes the involvement of Japanese companies in the private sector participation and privatization projects in those countries, and makes recommendations on the modality of ODA loans under private sector participation and privatization policies.

(a) To evaluate the impact of private sector participation and privatization policies on the project effects, the following factors were taken into consideration: 1) the changes in various indicators (duration/number of power outages, etc.) in the sector, and 2) the impact of changes in power charges accompanying private sector participation and privatization on the financial and technical sustainability of the executing agency.

(b) To evaluate private sector participation and privatization policies from both public and private perspectives, the evaluation items used to judge the "public aspects" were: ① electricity charges,

② stable supply, ③ future outlook for stable supply, and ④ contribution to economic growth and poverty reduction. The evaluation items used for assessing the "private aspects" were: ① efficiency and ② sustainability of the business entity (see Table 1).



Control room at a thermal power plant (Azerbaijan)

Table 1. Evaluation Criteria for Private Sector Utilization and Privatization Policies

Perspective	Evaluation Item	Evaluation Criteria
Public Aspects	① Electricity charges	Have charges decreased or increased?
	② Stable supply	Have power outages / power loss declined?
	③ Future outlook for stable supply	Can supply meet future electricity demand increases?
	④ Contribution to economic growth and poverty reduction	Were there contributions to economic growth and poverty reduction?
Private Aspects	① Efficiency	Has the business entity succeeded in reducing costs?
	② Sustainability of the business entity	Is the financial condition of the business entity stable?

(c) To analyze the involvement of Japanese companies in private sector participation, interviews were conducted with trade companies, manufacturers, electric power companies, and financial institutions in public-private partnerships (PPP). The level of involvement in PPP as well as issues were identified from the interviews.

After reviewing areas in the electric power sector where assistance through ODA loans seems to be appropriate, and after discussing future consideration for the formation of ODA loan projects, this report recommends areas where ODA loans should be prioritized.

Evaluation Results

(1) The Philippines

- (a) Impact on project effects: In the Philippines, both projects examined were transmission line construction projects. At the time of the evaluation, the state-owned transmission company TRANSCO was managing these projects. At the beginning of these projects, however, National Power Corporation (NPC), as a responsible body for all power generation, transmission and distribution in the Philippines, held a prominent position in the supply of electricity. Organizational changes took place after the Electric Power Industry Reform Act was enacted in June 2001, and the NPC's electric power generation, transmission, and distribution divisions were completely separated, and TRANSCO assumed responsibility of the transmission division. A boost in transmission capacity resulted in the stable supply of electricity, and the financial structure of TRANSCO also improved following the transfer of liabilities. Therefore, improvement in effectiveness and sustainability were evident after private sector participation and privatization.
- (b) Evaluation from public and private perspectives: Although the fee increase in electricity was a negative factor, electric power supply became stable; electric supply was meeting demand and duration / number of power outages decreased. It was also inferred that these improvements contributed to economic growth and poverty reduction. Although plans for commissioning the transmission division to a private company have not progressed, based on TRANSCO's business performance, it is inferred that private sector participation and privatization policies were having a positive impact on areas such as effectiveness and the evolution of a business mentality. Therefore, the policies increased the effects in both public and private aspects.

(2) Azerbaijan

- (a) Impact on project effects: In Azerbaijan, the evaluation covered a power generation project, which at the time of the evaluation was managed by Azerenerji. Azerenerji is a state-owned electric power company, which was reorganized in 1996 as a joint stock company with future plans for privatization. The distribution division of the company for a period was commissioned to a private company under a policy to utilize private sector enterprises. However, collection of electricity charges did not proceed as set out in the agreement, therefore the distribution division reverted back to Azerenerji. In January 2007, the government raised electricity charges and adopted a policy to promote autonomy and efficient management in Azerenerji to enable its transition from a subsidized business to a business able to recover electric power generation costs. The country is gradually promoting private sector participation and privatization but it has just commenced fundamental reforms to electricity charges on a beneficiary-pays principle, and the impact of these reforms on project effectiveness and sustainability is hard to be measured at this stage.
- (b) Evaluation from public and private perspectives: In Azerbaijan, private sector participation and privatization are being considered across the entire electric power sector (generation, transmission, and distribution) and, as stated above, commissioning the distribution division to a private company in part was introduced for a period but operations did not proceed according to plan. While the monopolistic structure of Azerenerji is recognized at present, the government is making the transition to a policy aimed at promoting autonomy of the company through a beneficiary-pays structure rather than a structure dependent on government subsidies. In 2007, electricity charges increased with the introduction of the beneficiary-pays system. A protection policy which takes into account the increased financial burden for the lower income segments is also being discussed, but as yet has not been decided

(as of February 2007). The collection rate of electricity charges is vital for financial stability improvement. Although efforts are being made, the impact increased electricity charges will have on the collection rate is not yet known. Private sector utilization and privatization in Azerbaijan are still in a phase of transition and, therefore, it is too early to judge these policies from public and private perspectives.

(3) Involvement of Japanese Companies

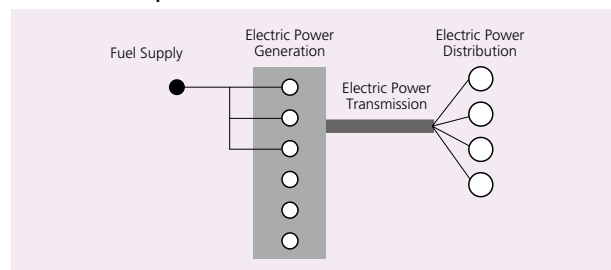
Interviews at Japanese companies found that the electric power sector is an area of interest for private companies. On the other hand, the interview survey identified areas of risk such as the legal and tax systems, a blowout in initial costs, and the uncertainty of raw material procurement in those countries.

Recommendations on the Modality of ODA Loans

Areas of assistance: The following are areas where ODA loans are needed in the electric power sector to ensure public interests:

- ① Improvement in bottlenecks in infrastructure networks (transmission feeder line divisions, etc.)
- ② A fuel supply division with non-competitive components (oil and gas pipelines, etc. to supply fuel to thermal electric power stations)
- ③ Methods of power generation which effectively utilize the country's own resources (such as thermal electric power generated by geothermal power and natural gas in the Philippines, etc.)

Figure 1: Conceptual Diagram of Projects for which ODA Loans are Requested



Future consideration: To ensure that a fair competitive environment is established through private sector participation and privatization policies and to ensure that any negative aspects identified in those policies are not aided or abetted when providing ODA loans, attention should be paid to the following points:

- ① Clarify the vision and the rules in private sector participation and privatization.
- ② Establish regulatory bodies to ensure fair competition.
- ③ Consider the low income segments of society.

Recommendations:

- ① For network-type infrastructure improvements such as electricity grids, a well-balanced network is required. Therefore, the use of ODA loans to eliminate infrastructure bottlenecks in operations is desirable.
- ② An environment promoting fair competition among businesses is required to demonstrate policy effects in countries where private sector participation and privatization policies are introduced. Therefore, it is desirable to use ODA loans to assist in the establishment of such an environment (systems, frameworks, regulatory bodies, etc.).
- ③ In cases where countries have access to their own resources, it is desirable to utilize ODA loans for projects which make broad, effective use of those resources.