



<b>1. Project Data :</b>
<b>OEDID:</b> L3055
<b>Project ID:</b> P008460
<b>Project Name:</b> Energy Development and Conservation
<b>Country:</b> Hungary
<b>Sector:</b> Oil & Gas Adjustment
<b>L/C Number:</b> Loan 3056-HU
<b>Partners involved :</b> EBRD
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<b>Date Posted :</b> 04/19/1999

**2. Project Objectives, Financing, Costs and Components :**

The Energy Development and Conservation Project is comprised of two separate loans, for sector development and conservation, i.e., Loans 3055 and 3056, respectively. Loan 3055 for energy conservation has been audited (PPAR 16836 of June 24, 1997). This evaluation summary is for Loan 3056, for which the **objectives** are to: (a) improve the energy sector's policy and institutional framework, including appropriate pricing coupled with subsidy elimination, coal mining sector restructuring, and improved power sector investment planning; and (b) develop the oil and gas sector through the restructuring of OKGT (the national petroleum company) and the opening of the sector to foreign financing of high priority investments. The **components** included oil and gas field development, upgrading and enhanced recovery; underground gas storage; pipeline expansion and modernization; exploration and production equipment; modernization of product loading systems; national safety storage; new communications systems; and training and technical assistance in oil and gas operations. The actual total **project costs** of US\$726 million (compared to US\$650 million estimated at appraisal) were financed by a US\$100 million Bank loan, with cofinancing by EBRD for US\$55 million and counterpart funds of US\$577.3 million from OKGT; US\$93.7 million were disbursed from the Bank's loan, after a two-year completion delay due to the reorganization and privatization of OKGT and the late start of two subprojects.

**3. Achievement of Relevant Objectives :**

The institutional and operational objectives were achieved. With some delay, pricing objectives were achieved, except for the wellhead price of locally produced gas, which is still below its economic cost, and the price of coal which is supported by artificially high tariffs. Physical targets were achieved and are performing as expected at appraisal.

**4. Significant Achievements :**

The project's institutional achievements are above appraisal expectations. The Government introduced legal and regulatory frameworks for petroleum exploration and development, as well as for natural gas and electricity. The state-owned OKGT was streamlined and transformed into a private company (MOL Rt), which has started to operate as an international oil company with solid financial standing and ability to mobilize resources from international capital markets. Oil products prices have been liberalized and are now above economic costs. The coal sector has been downsized considerably.

**5. Significant Shortcomings :**

Gas prices remained cost-based and were below the opportunity cost of imported gas or the fuel oil equivalent. Moreover, the gas and electricity tariff structures were suboptimal, with industry subsidizing households. With the integration of coal mines with power plants, the coal price was artificially supported by a high power sale price to the grid. It should be noted, however, that while energy pricing structures remain an issue, the levels in themselves did not hinder the privatization of the power and petroleum companies.

<b>6. Ratings:</b>	<b>ICR</b>	<b>OED Review</b>	<b>Reason for Disagreement /Comments</b>

<b>Outcome :</b>	Highly Satisfactory	Satisfactory	Although the petroleum development component (or almost the entire project funds) was highly satisfactory, particularly the privatization of MOL, important pricing objectives that were beyond the scope of an oil & gas project were delayed and only partially achieved, thus raising issues of covenant overload and quality at entry .
<b>Institutional Dev .:</b>	Partial	Modest	These ratings are equivalent.
<b>Sustainability :</b>	Likely	Likely	
<b>Bank Performance :</b>	Highly Satisfactory	Satisfactory	The project's design imposed energy sector-wide pricing objectives on a petroleum subsector project, and many non-petroleum pricing covenants proved unenforceable.
<b>Borrower Perf .:</b>	Highly Satisfactory	Highly Satisfactory	
<b>Quality of ICR :</b>		Satisfactory	

### 7. Lessons of Broad Applicability :

The key lessons learned are: (a) financial covenants should be used flexibly and revised expeditiously under rapidly changing financial and business environments [e.g., the Bank recognized that the rate of return on assets covenant was no longer relevant, but failed to waive it and hence caused difficulties during the OKGT's privatization process ]; and (b) the reforms sought should be scaled to the type of operation, hence the Bank should not have pursued a comprehensive package of energy sector pricing objectives in an oil and gas project, which resulted in unenforceable covenants .

Two lessons merit special attention . First, significant reforms can be achieved in a short time span if the Borrower is really committed and motivated, and the external environment is favorable . Second, the project's success benefited significantly from the fact that the technical staff on the missions remained nearly unchanged throughout the project cycle, thus resulting in consistent policy dialogue, greater depth and follow -through on recommendations, and more efficient execution of the physical components .

**8. Audit Recommended?** ☐ Yes ☒ No

### 9. Comments on Quality of ICR :

The ICR is satisfactory. The section on "Future Operation", however, could have provided more analytical information on the prospects for sustainability of the broader policy and institutional environment in which the project will continue to operate, instead of simply stating that a follow -up project is unlikely, as if the interest were only in further lending. Moreover, minor but numerous typographical and presentational errors could have been avoided by simple proof-reading and editing .