

3. Supporting Sector Financial Viability and Affordable Access for the Poor

Highlights

- ❖ The financial performance of the electricity sector in many country clients is weak, adversely affecting their ability to provide adequate and reliable electricity services, and to organize investments to expand access.
- ❖ The Bank Group, through its strategy documents and analytical work, has consistently and comprehensively raised issues and proposed strategies to improve the financial viability of countries' electricity sectors.
- ❖ Overall, efforts to improve financial viability through development policy operations and components of investment projects have not yielded positive results. This points to the need for new approaches to address this issue, which is a major constraint for expanding electricity access.
- ❖ The Bank Group produced sound analytical work on affordability of electricity access for the poor, but this is not adequately reflected in its country strategy documents and project monitoring and evaluation frameworks.
- ❖ The Bank Group made some significant pilot contributions to addressing the affordability of electricity connections through project components and output-based assistance.

As discussed in chapter 2, the World Bank provided a range of support to country clients in developing and reforming their electricity sector policy and institutional frameworks, and improving capacity for sector planning and management. This chapter examines the overall impact of the World Bank's upstream work related to policy and institutional frameworks and capacity and on the financial viability of electricity sectors, which have impacts on the adequacy, reliability, and affordability of electricity services.

Commercial Viability of Institutions and Financial Viability of the Electricity Sector

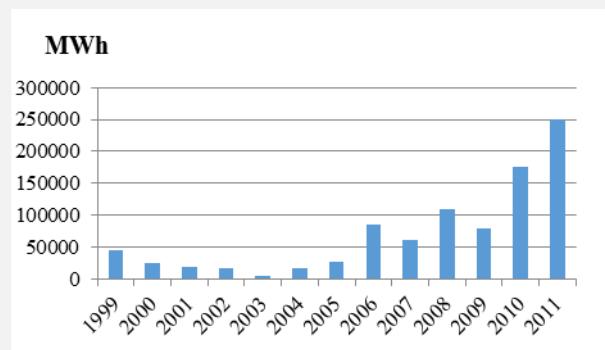
Maintaining the commercial viability of electricity utilities is essential for the provision of adequate and reliable electricity services, regardless of whether the service delivery agents are under public or private ownership. Commercial viability entails the ability to generate sufficient income to meet operating payments and debt commitments, and to allow for growth while also maintaining service standards. Several Bank Group government clients regulate electricity services and set retail tariffs below full cost recovery (operating costs and capital costs), citing concern

about the affordability of service for the poor. Inadequate revenues limit the ability to make needed investments on a timely basis for access expansion (generation, transmission, and distribution) and to support required operations maintenance. In time, these factors lead to the progressive deterioration of service reliability and performance efficiency, including technical and nontechnical losses, extended service restoration times after outages, chronic power supply inadequacy from insufficient generation capacity, and downgraded performance of existing generation plants (box 3.1).

Box 3.1. Financial Performance and Adequate and Reliable Services

Poor financial performance of the electricity sector sets up a vicious cycle by causing deterioration in the reliability and quality of electricity services, which in turn negatively affects the sector's finances. Undercapitalization and structural operating deficits caused by insufficient tariffs, lagging budget transfers, network losses, power theft, and poor bill collection perpetuate inefficiencies by preventing the sector from investing in required maintenance of aging assets and new capacity. The resulting impacts on the adequacy (persistent and widespread power shortages) and the quality and reliability of electricity supply (frequent and long-duration service interruptions) prevent consumers of all categories from realizing the potential welfare and economic gains from electricity use. Considerable country-based evidence points to the adverse impact of poor financial performance on broader access outcomes. For instance, the link between lack of financial viability and available electricity supply from existing infrastructure is evident in Senegal's recent experience. Financial losses for Senelec, the country's national utility, increased by a factor of 14 between 2004 and 2010 because of delays in needed generation investments, poor operational efficiency, and fuel supply difficulties, and undelivered energy jumped by a factor of 12.5 during the same period.

Figure B3.1.1. Senegal: Unserved Electricity Demand, 1999–2011



Source: World Bank, Project Appraisal Document for the Senegal Electricity Sector Support Project.

Note: MWh = megawatt hours.

In many countries where the Bank Group operates, the financial condition of the electricity sector remained weak for years. In a sample of 40 countries covering all

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regions and levels of income and electricity access, three-fourths of the national or leading power utilities reported net financial losses (net income after taxes) in 2013. For low- and medium-access countries (16 of the 22 in the sample were in Sub-Saharan Africa), 82 percent of utilities reported net losses; in high- and universal-access countries, 67 percent of utilities had losses. Thus, financial distress is spread across all categories of countries (table 3.1; appendix L). Sector finances in some countries (Bangladesh, India, Senegal, and Vietnam) deteriorated in recent years—in some cases rather sharply. The Bank Group provided substantial policy and institutional support to these countries through investment projects and development policy lending.

Table 3.1. Profitability Status (Net Income after Tax) of Leading Electricity Sector Utilities in Selected Countries

Net income after tax	2000	2010	Number of Countries			
			2013			High- and universal-access countries
			Total	Sub-Saharan Africa	Low- and medium- access countries	
Profit	4	14	10	3	4	6
Loss	36	26	30	13	18	12
TOTAL	40	40	40	16	22	18
Unprofitable (%)	90	65	75	81	82	67

Source: Utility annual reports; Bank Group documents.

Note: Where multiple utilities exist, data for the most prominent utility is used (details in appendix L).

Support for Improving Sector Financial Viability

The World Bank's support for improving the overall financial viability of client electricity sectors comes through two channels: development policy operations (DPOs) and financial management components in investment loans, sometimes accompanied by financial covenants. The Bank deployed DPOs mainly in medium-, high-, and universal-access countries, and to a far less extent in low-access countries.

The use of financial covenants in investment lending is generally restricted to utility performance, such as payment collection, reduction of commercial losses (metering, for example), and cost rationalization. Covenants such as tariff-setting for addressing policy issues, though once prevalent, are less frequently used now.

Development policy operations provide quick-disbursing budget support to governments for achieving specific policy and institutional reforms – typically drawn from the government’s reform program – that are considered critical to achieving sustainable improvements in the sector’s financial performance. All DPOs require prior actions, which are reform measures to be fulfilled by the government before the operation is cleared and the funds disbursed. Prior actions in support of electricity access tend to focus on the adoption of cost-recovery tariffs, payment collection, and reduction of commercial losses (such as metering), cost rationalization, and government subsidy transfers. DPOs are either freestanding operations, a series of freestanding but independent operations, or programmatic series. In contrast to a freestanding series, DPOs in a programmatic series are linked by flexible indicative actions or triggers to respond to the country’s circumstances. In most DPOs, financial viability or sustainability of the electricity sector (or national utility) was explicitly included as a development objective, but almost all DPOs contained key performance indicators related to sector financial performance.¹

World Bank Effectiveness in Improving the Commercial Performance of Service Providers and Overall Financial Viability of Electricity Sectors

The World Bank’s efforts at improving the commercial performance of service providers and the overall financial viability of the client electricity sectors during the past 15 years did not measured up to expectations. Among the sample of case study countries, the experience of financial components and covenants in investment operations was positive in Kazakhstan, but was not encouraging in Senegal and Vietnam.

The Kazakhstan Electricity Transmission Project and a series of follow-on projects helped the national utility reverse a pattern of losses in the late 1990s and display financial viability from 2002 to 2012.² Policy and technical assistance components in these projects promoted cost recovery for its services, including setting a cost-reflective transmission tariff, eliminating administratively imposed tariff discounts, improving payment collections, reducing accounts receivable, and divesting non-core businesses. Meanwhile, Senegal’s Electricity Sector Efficiency Enhancement Project, with provisions for a new electricity tariff mechanism and a series of financial covenants (including debt service coverage, return on assets, and accounts receivable) could not prevent a serious deterioration of Senelec’s finances (IEG, 2013). In retrospect, the covenants were not sufficiently elaborated during project preparation, and the government lacked an overall strategy to address the sector’s deep-seated structural problems related to tariffs and budget transfers and long-term investment decisions, particularly for generation. Similarly, a long series of

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Bank-supported investment projects in Vietnam that included time-bound measures related to tariffs and financial performance did not make headway in these matters because of excessive political implementation risks (IEG, 2014c).

Interviews and discussions with the Energy and Extractives Global Practice staff suggest that financial covenants and policy activities operate on different time lines and with different stakeholders, making it difficult to seamlessly combine the actions required under investment projects and DPOs. With investment loans, the point of maximum leverage on reform-related issues occurs before Board presentation and quickly dissipates as attention is focused on the physical investment portion of the project.

The Bank Group funded 25 DPOs in 13 countries during FY2000–2014 that addressed the electricity sector alone or in combination with other sectors.³ These DPOs represented total commitments of \$6.6 billion, of which \$5 billion was for actions related to the electricity sector. A list of DPOs and their ratings is in appendix M. Most of the DPOs were in high- and universal-access countries. Only three DPOs were in low-access countries, accounting for \$87 million in commitments for the electricity sector. Seventeen of the DPOs belonged to programmatic series of two or more operations, and the rest were one-off interventions. Reforms related to transparency, governance, and accountability also became more common than in the past. For example, the Bangladesh Power Sector Development Credit supported enhanced governance and accountability in addition to more typical measures such as tariff adjustment, payment collection, and budgetary transfers to the national utility (table 3.2).

Table 3.2. Development Policy Operations with Financial Objectives in the Electricity Sector, FY2000–2014

DPOs	All countries	By country income group		By electricity access							
						Low access	Medium access	High/universal access			
		No.	\$, billions	No.	\$, billions	No.	\$, billions	No.	\$, billions		
Freestanding	15	2.9						3.8			
Programmatic series	10	2.1	4	0.5	21	4.4	3	0.1	8	1.0	14
TOTAL	25	4.9									

Source: World Bank Business Intelligence.

Note: Commitment amount is specific to the electricity sector.

Seventeen of the 25 DPOs were rated. Of the 17 DPOs in 10 countries, nine had overall outcome ratings of moderately satisfactory or better, and the remaining seven were rated moderately unsatisfactory or worse. No DPOs were in a low-access country. Only four of the 17 projects had a low or moderate rating for risk to development outcome. Overall, medium-access countries had a better proportion of favorable outcome and risk ratings (table 3.3).

Table 3.3. Ratings for Development Policy Operations with Financial Viability Objectives, FY2000–2014

Electricity access level	Number of DPOs rated by IEG	Overall development outcome: moderately satisfactory or better	Risk to development outcome: low or moderate
		Number of DPOs	Number of DPOs
Medium	7	5	3
High/universal	10	4	1
ALL	17	9	4

Source: IEG Implementation Completion Report Reviews.

The focus of DPOs on improving the financial performance of electricity sectors was appropriate and in line with the Country Assistance Strategies (CASs) and Country Partnership Strategies (CPSs), but despite these efforts, few country clients showed improvements in sector finances. The relatively poor performance of electricity sector DPOs (only 50 percent were rated moderately satisfactory or above) contrasts with the generally good performance of all DPOs (81 percent were rated moderately satisfactory or above, with large variations across the regions) based on Operations Policy and Country Services findings (World Bank 2004) and IEG's review of DPOs as part of this study. The World Bank's own findings and guidance note on DPOs note the critical importance and fragility of country ownership of reforms; they also note the role of the Bank in building and sustaining such ownership through continuous policy dialogue, policy notes, and analytic and advisory activities (among others), and through ensuring that program design is simple, can be monitored, and directly complements governments' own reforms (World Bank 2004). DPOs pose higher risks of achieving development results in the electricity sector than in other sectors – only four of 17 DPOs had low or moderate risk to development outcome, and hence warrant particular care in design and implementation.

Most of the DPOs reviewed by this evaluation experienced delays or only partially fulfilled reform commitments. The DPOs that yielded the most notable results in the past 15 years were in Turkey and Brazil, both middle-income countries with universal access. On average, the performance of DPOs in low- and medium-access

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and low-income and lower-middle-income countries is unimpressive, especially regarding key performance indicators that directly relate to electricity sector financial issues.

Shifting political commitment to reforms involving financial stabilization and recovery objectives was evident in Bangladesh, the Dominican Republic, and Senegal. This commitment is often fragile and can be eroded by new elections, changes in government, macroeconomic crises and external shocks, or an abating sense of urgency after a severe crisis was weathered, and after having acquired sizable financial support from the Bank. The value of political commitment was clearly shown in Turkey and Brazil, but note that the strength and diversity of their economies helped to maintain that commitment.

As illustrated by the experiences of Bangladesh and Senegal, the longstanding nature of electricity sector financial viability issues in many countries and their lack of financial and technical resources point to the need for continuous Bank Group engagement to help countries put their sector finances in order and put them on the road to adequate, reliable, and affordable electricity access. In the best of cases, where government commitment and follow-through is demonstrated, it takes five to 10 years for sector reforms to take hold.

Experience suggests that reform covered by one-off DPOs should be designed to be complementary with other Bank operations, whether through investment lending or technical assistance. For instance, in the Dominican Republic, the freestanding sector DPO should have been accompanied or preceded by parallel investment operations by the Bank (or other development agencies) to address the high risks stemming from the poor technical condition of the power infrastructure and overdependence on high-priced imported oil for electricity generation.

Programmatic DPOs, by contrast, displayed flexibility. A programmatic approach is especially useful when the government's medium- and long-term reform direction is clear, but the timing and details of implementation need to be flexible.

Programmatic DPOs generally fared better than multi-tranche operations (all the programmatic DPOs received moderately satisfactory IEG-validated outcome ratings as in Bangladesh, Ghana, Tonga, and Turkey). Multi-tranche operations are prone to noncompliance with agreed actions and loan cancellations, as in Senegal. They are considered more rigid since the tranche release conditions are predetermined and require waivers from the Bank if the conditions are not fully met.

The Bank's large lending volumes in Turkey and Brazil (in support of complex reforms involving large retail tariff adjustments) provided a strong incentive for the government to comply with all major policy conditions. However, in the Dominican Republic, the sector DPO provided support that was too inadequate to motivate the government or defray the costs of reform. In Senegal, the heavy front-loading of fund disbursement while back-loading the restructuring conditions greatly reduced the government's incentives to meet the tough second-tranche release conditions.

Affordable Access for Inclusive Development and Shared Prosperity

The need to recover operating costs and financing costs for capital expenditures to ensure financial viability of the electricity sector competes with the need to keep electricity access and consumption affordable for the poor. High costs for connection and service can discourage low-income households from gaining access to electricity even if they are within reach of the distribution network. Common practices for subsidizing connection costs include partial or complete subsidy, delayed monthly payment for a long period, treating connection costs as capital costs, or a combination of these approaches (World Bank 2010a). The World Bank usually supported such subsidy schemes where governments administer them with their own funds; direct use of Bank funds has been limited and generally involves arrangements where governments use IDA funds for grants to utilities to cover capital costs associated with distribution, metering, and connection to poor households. Recently, output-based aid (OBA) approaches aim to combine these schemes with pre-agreed targets for performance-based subsidy (World Bank 2010a), and the Bank embraced such pilot projects in several poor countries. Regarding monthly payments for consumption, these are found to be less of an obstacle because the costs of alternatives, such as kerosene or batteries, are comparable to most grid-supplied electricity tariffs for small consumers (Golumbeanu and Barnes 2013).

Among the 35 case study countries examined by this evaluation (appendix C), the World Bank discussed affordability of electricity in 19 CASs/CPSs during FY2000-2014, which include 10 of the 18 low- and medium-access countries and nine of the 16 medium- and universal-access countries in the sample. Of the countries that raised affordability matters, seven low- and medium-access and all of the high- and universal-access countries also proposed specific strategies or actions for addressing them. However, the discussions of affordability focused more on consumption aspects instead of connection cost issues, with only five strategies referring to them (including the Democratic Republic of Congo, Ethiopia, and Lao PDR). Also, the World Bank actively partnered with the Global Partnership on Output-based Aid

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(GPOBA) to support and undertake pilot projects in eight countries (seven of which are low- and medium-access countries).

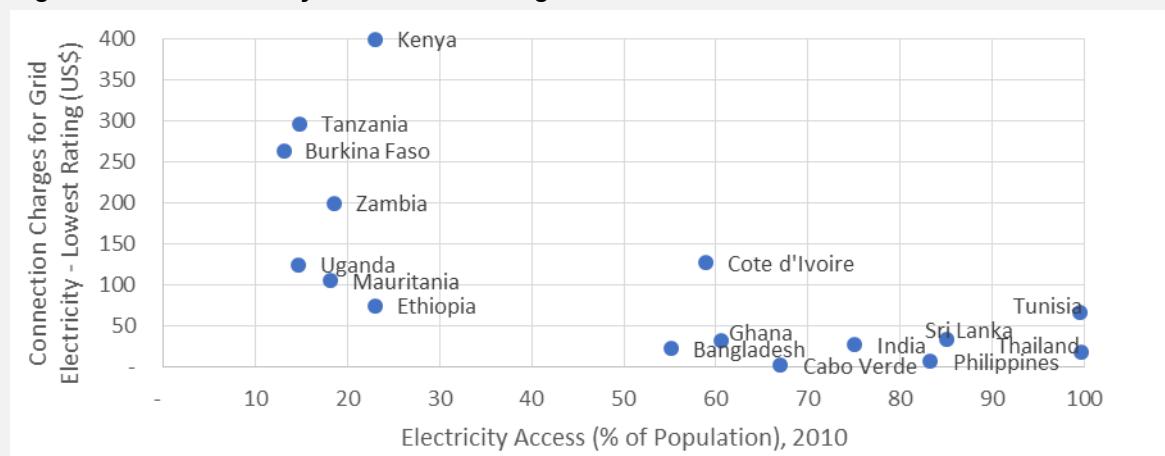
Although the Bank Group devoted considerable effort to identifying, analyzing, and following up on issues of affordability and inclusion in the countries where it operates, more effort is needed to cover all countries, since many still require support for paying the connection costs, even in some universal-access countries. Illustrative experiences and findings from the World Bank's interventions to address connection cost affordability are discussed in the next sections.

In Vietnam, the costs of providing electricity to communities (extending power networks at medium and low voltages) was shared by local, regional, and national governments. An effective partnership between the national state utility (Electricity of Vietnam) and local operators and communities, as along with multiple funding sources (customers' contributions; community funding; district, province, and central government budgets; international donors; and others) helped increase rural households' access to electricity from about 60 percent in 1995 to 94.5 percent in 2008 (IEG 2014f). This is a different institutional arrangement than is found in most Sub-Saharan African countries, where funding for electricity expansion is mainly provided through government-sponsored projects to national power companies. The Bank Group contributed to this effort with its continuous engagement in Vietnam's electricity sector during the period.

Box 3.2. Connection Costs and Electricity Access: An Issue of Shared Prosperity

High connection costs and electricity tariffs can discourage low-income households from gaining access to electricity. In practice, monthly payments for consumption are less of an obstacle because the costs of alternatives, such as kerosene oil, candles, and batteries, are comparable to most grid-supplied electricity tariffs for small consumers. However, connection charges – depending on the extent and period in which they are recovered – can deter poor households from obtaining available service, and can have a dramatic dampening effect on electrification rates. This is a key issue for the Bank Group's goal of shared prosperity, given the linkages between electricity access and poverty and welfare.

For a grid connection, the costs include the house wiring and utility charges. The grid connection charges for small residential consumers vary considerably across countries – from modest (often subsidized) sums of \$10–20 to \$200 or more in some countries, as shown in the figure B3.2.1. To obtain service in many cases, the consumer is expected to reimburse the utility for the entire 20- or 30-year capital cost of an electricity service that often was designed not for subsistence consumers, but for users of larger amounts of electricity.

Figure B3.2.1. Electricity Connection Charges: Selected Countries, 2010

Source: Golumbeanu and Barnes 2013.

In Lao PDR, the Bank Group supported the Power to the People program, which successfully targeted poor rural households (box 3.3) through a combination of appropriate connection subsidy and extended repayment.

Box 3.3. Lao PDR's Power to the People Program for Poor Rural Households

The Power to the Poor (P2P) program, implemented by the Lao PDR national utility Electricité du Laos together with the Ministry of Energy and Mines, subsidizes connections and finances indoor wiring for poor rural households. The program, supported by the World Bank's Rural Electrification Adjustable Program Loan (P075531), uses participatory methods and targets poor, female-headed households. Eligible households receive a basic low-voltage connection that is sufficient for two light bulbs and a small electrical appliance, such as a radio. Households make an average upfront payment of about \$24 and can obtain an interest-free credit of up to \$87 to cover the costs of installation and indoor wiring. The credit is paid back over three years in installments of about \$2.50 as part of the household's monthly electricity bill. Both the repayment of the interest-free credit and electricity consumption are at the same level as their expenditures for vastly inferior traditional energy substitutes (such as batteries, diesel lamps, and candles). In the villages where P2P was implemented, it helped more than 90 percent of the vulnerable and disadvantaged families connect to the grid, which is 20 to 40 percent of the total number of families in the villages. Strong government commitment to the welfare of its people and the high motivation of the national utility's staff for implementation were crucial to the success of the program and the fast expansion of access to grid-supplied electricity in the country.

Source: World Bank 2012b.

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In Rwanda, capital subsidy policy combined with low-cost electrification technologies and improved procurement practices contributed to significant access results. Lower costs combined with a capital subsidy allowed the number of connected households to double in the targeted urban and peri-urban areas during the period 2010–2011 (World Bank 2013e).

In Zambia, the power utility benefits from a World Bank project to reduce connection charges.⁴ Under the project, a government subsidy of about \$120 covers 75 percent of the cost of a basic household connection. The utility receives the subsidy in the form of materials and equipment to be used to connect a certain number of low-income households. In the initiative's pilot areas, the number of households requesting a connection doubled from the previous volume of requests.

Output-based Aid Approach with GPOBA

This evaluation reviewed the experience of GPOBA, whose objective is to promote access to basic services, including energy, for the poor through the application of a specific OBA model for provision of targeted subsidies. IEG identified nine electricity projects piloted by GPOBA, which mostly built on existing IDA operations. These were mostly in low- and high-access countries—Bangladesh, Bolivia, Ethiopia, Ghana, India, Kenya, Liberia, and Uganda—and targeted the poor with connection subsidies that supported initial access instead of consumption. They also provided financial incentives for utility companies to extend their services to the poor. As pilots, the projects were relatively small, with four pilots under \$5 million, three between \$5 million and \$10 million, and the remaining two between \$10 million and \$15 million.

Projects in Bolivia and Bangladesh showed successful results, though there were some issues with targeting the poor. In Bolivia, a project to increase electricity access in remote rural areas through the partial subsidization of off-grid SHSs and solar lanterns was well integrated with the government's priorities and, despite a slow start, exceeded its planned targets. A follow-up IDA project is expected to expand the program and ensure continued support for the servicing and maintenance of these systems (World Bank 2013c). A similar project in Bangladesh was also successful. By taking advantage of the falling cost of solar panels and strong consumer demand, the subsidy could be reduced over time and the program far exceeded its original targets; it is now being sustained and expanded with a follow-on IDA project (World Bank 2013b). Targeting was an issue, however; a GPOBA-funded report found that about one-third of the households that purchased the system tended to be the higher-income households in the villages where the solar

systems were offered, which tended to be the more prosperous of the off-grid villages in the country (Asaduzzaman and others 2013).

The project in Ghana aimed to enable the supply of solar panels to remote rural areas by providing microcredit to households. The GPOBA pilot project design provided insufficient incentives to motivate utilities and suppliers to prioritize poor households; thus, the lack of access to working capital stalled the project. Since GPOBA's approach requires that suppliers be paid after work is completed and certified, contractors lacking access to working capital found it hard to finance up-front connection costs. The project began to progress only after a special effort by the project team to engage local banks to provide credit to interested private companies. Although the project eventually succeeded, the business model was sustainable given the continuing lack of access to working capital and trade finance. In Ethiopia, only about one-fifth of the targeted number of households were connected. Major impediments included a two-year moratorium on new connections (in response to electricity supply constraints) and a new government policy to limit its procurement to local suppliers, which restricted the supply of electricity meters. Also, serious local capacity limitations delayed compliance with GPOBA's technical, safety, and administrative requirements. Although the Bank Group provided assistance to help the utility address these issues, no significant improvements could be observed before the closing of the project (World Bank 2014c). The India-Mumbai Slum Electrification project also had an unsatisfactory outcome. The project, which aimed to replace illegal and unsafe connections with legal and safe ones, failed because consumers were unwilling to pay for anything beyond basic electricity access, including safety. In this case, the expectations of beneficiaries and project sponsors were not aligned.

The Energy Sector Management Assistance Program and GPOBA also funded a comprehensive overview and analysis of the financial and technical issues associated with electricity connection charges, solidly grounded on data collected from every utility in Africa. The analysis concluded with practical, actionable strategies for lowering these costs and enhancing their affordability for the poor (Golumbeanu and Barnes 2013).

Conclusions

The Bank's efforts to address financial viability issues in country clients are notable, but their effectiveness is poor. Countries did not sustain the initial reform actions, and some even partly or fully reversed (as in Bangladesh and Senegal). Financial viability issues are deeply rooted and structural, but the Bank's efforts and

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instruments were inadequate in addressing the political economy aspects surrounding the issues. At best, multi-tranche DPOs only helped delay the reversal of the initial reforms.

Country ownership and commitment are key. This commitment is often fragile and can be eroded by changes in government, macroeconomic crises and external shocks, or an abating sense of urgency after a severe crisis was weathered, and after the government availed itself of sizable financial support from the Bank. The value of political commitment was clearly shown in Turkey and Brazil, but note that the strength and diversity of their economies were clearly helpful to stay the course.

Continued Bank engagement tends to improve stakeholder awareness of financial viability for expanding electricity access. The longstanding nature of financial viability issues of the electricity sector in many countries and their lack of financial and technical resources point to the importance of continuous Bank engagement to help countries put their sector finances in order and put them on the road to adequate, reliable, and affordable electricity access. In the best of cases, where government commitment and follow-through is demonstrated, it takes five to 10 years for sector reforms to take hold.

The Bank produced sound analytical work and pilot interventions on affordability as a barrier to new electricity connections. Affordability issues in the electricity sector are covered in about two-thirds of the sample CAS/CPS documents but, with a few exceptions, there is little focus specifically on connection costs. The Bank Group supported the implementation of some well-designed pilot interventions for ensuring affordability of connections in a targeted manner (Lao PDR, Vietnam, and Zambia). However, there is no ready means of tracking the performance of these schemes beyond the end of the projects. The pilot projects implemented by GPOBA showed some positive results, but these instruments are yet to be mainstreamed into Bank Group projects.

Notes

¹ IEG considers key performance indicators evaluable when baseline value, original (or revised) target value, and actual value achieved at completion are present.

² Kazakhstan, Electricity Transmission Rehabilitation Project, P065414; Project Appraisal Document (PAD) 19620 and Implementation Completion Report (ICR) 1120.

³ See the list of development policy operations (DPOs) in appendix R.

⁴ Zambia, Power Rehabilitation Project (1998-2005), P035076.