Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 22-Dec-2022 | Report No: PIDC33831

Public Disclosure Authorized

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Dominican Republic	P178570	Electricity Reform for Sustainable Growth Development Policy Loan 2 (P178570)	P175874
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
LATIN AMERICA AND CARIBBEAN	Mar 31, 2023	Energy & Extractives	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Dominican Republic	Ministry of Finance		

Proposed Development Objective(s)

The Development Objective is to establish the policy foundations for: (i) strengthening sector governance, (ii) enhancing climate resilience and social and environmental sustainability, and (iii) improving the financial self-sufficiency and operational performance of the electricity sector.

Financing (in US$, Millions)

SUMMARY

Total Financing	300.00

DETAILS

Total World Bank Group Financing	300.00
World Bank Lending	300.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

1. The proposed Electricity Reform for Sustainable Growth Development Policy Loan 2 (P178570, DPL2), in the amount of US$300 million, supports the efforts of the Government of Dominican Republic (GoDR) to implement a comprehensive reform in the electricity sector to address one of its most important and long-standing development

challenges. The proposed operation is the second in a series of two IBRD loans, which aim to establish the policy foundations for: (i) strengthening sector governance, (ii) enhancing climate resilience and social and environmental sustainability, and (iii) improving the financial self-sufficiency and operational performance of the electricity sector. Together, these reforms are expected to support inclusive and resilient economic growth and put carbon dioxide (CO_2) intensity on a declining path, in line with the three dimensions set forth in the World Bank Development Committee paper "From COVID-19 Crisis Response to Resilient Recovery - Saving Lives and Livelihoods while Supporting Green, Resilient and Inclusive Development (GRID)" (2021). The Board approved DPL1 for US$400 million on March 31, 2022 with the same program objectives.

2. The challenges facing the electricity sector in the Dominican Republic (DR) are multifold. *First*, the country is highly reliant on fossil fuels for power generation, with 84 percent coming from coal, oil and gas. *Second*, persistently high losses in power distribution continue to pose a significant burden on public finances, which amounted to 1 to 2 percent of Gross Domestic Product (GDP) during 2014-2021. *Third*, sector governance faces significant efficiency, accountability, and transparency issues.

3. The reforms supported by this DPL series are strongly aligned with the GoDR's Electricity Pact (*Pacto Electrico*). The Electricity Pact (the Pact) is a reform roadmap, which resulted from an unprecedented process of years of consensus-building among a broad range of stakeholders. This process serves as the basis for the implementation of the Pact's complex and socially sensitive reforms. The Pact includes commitments to improve service quality, achieve cost-reflective tariffs, introduce private sector participation in electricity distribution, and increase renewable energy use, among others.

4. Since the approval of DPL1, major developments in the global and country context have impacted on the political economy underpinning some of the reforms. *First*, the war in Ukraine has led to significant increases and volatility in global energy prices. Natural gas, oil and coal prices are determinant in setting electricity tariffs in the DR. *Second*, the country has also faced high inflation, with food prices increasing by 12.3 percent *year-on-year* (y-o-y) in July 2022 and 8.6 percent y-o-y in September 2022. *Third*, in September 2022, Hurricane Fiona brought torrential rain and powerful winds forcing 12,500 people from their homes and leaving 709,000 people without power. Climate events underline the country's vulnerability to climate change and the need to improve resiliency of the power sector.

5. Amidst significant global uncertainties, the Government has reiterated its strong commitment to the Electricity Pact and the electricity sector reform program remains on track. There has been significant progress in key reform areas related to: (i) strengthening sector governance, (ii) enhancing climate resilience and social and environmental sustainability, and (iii) improving the financial self-sufficiency and operational performance of the electricity sector. The prior actions (PAs) under this second operation are largely consistent with the Indicative Triggers identified under DPL1 with some adjustments due to the aforementioned changes to the socio-economic circumstances.

6. The GoDR's macroeconomic policy framework is deemed adequate for the proposed operation. The DR's economy showed remarkable resilience during the last years. A sound recovery from the COVID-19 pandemic has been supported by the successful implementation of a COVID-19 pandemic response package which included fiscal, macroprudential, and supervisory measures, along with monetary easing aimed at sustaining economic activity. The upfront fiscal consolidation in 2021 and the unwinding of the temporary COVID-19 measures contributed to the stabilization of the debt-to-GDP ratio by reducing the fiscal deficit by nearly 5 percentage points in terms of GDP from its peak in 2020. The external position remains sound with the current account largely financed by foreign direct investment (FDI) and a continued accumulation of reserves. Likewise, the financial sector remains resilient, credit growth rebounded and Non-Performing Loans (NPLs) declined. The GoDR temporarily expanded social programs in response to the food and fuel price hikes, while maintaining strong spending controls in other areas and proactively reducing debt service costs over the medium-term.

Relationship to CPF

7. **The proposed operation is fully aligned with the objectives of the World Bank Group's (WBG) Dominican Republic Country Partnership Framework (CPF) for FY22-26** approved by the World Bank's Board of Executive Directors on March 31, 2022, and supports two of the CPF objectives under the first High Level Outcome 'Improved access to quality public service delivery.' 'The DPL contributes to *Objective 1.1: Improved fiscal space and public spending efficiency* by improving the energy sector's financial viability through the roll-out of an ambitious electricity tariff reform program while improving the targeting to ensure fiscal efficiency. It is also aligned with *Objective 1.2. Enhanced efficiency in electricity* by improving the efficiency and reliability of the electricity sector.

C. Proposed Development Objective(s)

8. The Development Objective is to establish the policy foundations for: (i) strengthening sector governance, (ii) enhancing climate resilience and social and environmental sustainability, and (iii) improving the financial self-sufficiency and operational performance of the electricity sector.

Key Results

9. The proposed DPL series aims to improve governance of State-Owned Enterprises (SOEs) as the country implements the unbundling of the Dominican Corporation of State Electricity Companies and the establishment of a framework to set and monitor key performance indicators, including the reduction of distribution losses for Electricity Distribution Companies. The DPL series would also support the Dominican Republic's climate mitigation and resilience goals by enabling at least 500 Megawatt (MW) of private-led investments in renewable energy and the implementation of at least one national program on energy efficiency. Finally, it is expected that the reform of the social protection program BonoLuz will enable about 900,000 poor and vulnerable families, including female-headed households, to receive support to make basic electricity services affordable to them.

D. Concept Description

10. The proposed DPF is the second in a series of two operations structured around three pillars:

- <u>Pillar 1: Strengthening sector governance</u>: This pillar comprises measures aimed at updating the institutional and legal framework governing the energy sector and improving the governance in the electricity distribution segment.
- <u>Pillar 2: Enhancing climate resilience and social and environmental sustainability</u>: This pillar includes reforms aimed at increasing renewable energy generation, which will contribute to reducing generation costs through competitive procurement of renewable energy (RE) and reducing reliance on fossil fuels generation, thereby improving the resilience of the energy system to climate change. The pillar also includes measures for technical standards for electric vehicle charging stations to facilitate the decarbonization of the transport sector. Meanwhile, it also supports measures aimed at promoting the implementation of energy efficiency measures to reduce Greenhouse gas (GHG) emissions. In addition, the pillar also supports measures to improve the targeting and coverage of the social protection system to ensure affordability of electricity services for the vulnerable population, including and especially female-headed households.
- <u>Pillar 3: Improving the financial self-sufficiency and operational performance of the electricity sector</u>: This pillar includes regulatory measures that will improve the quality and reliability of electricity services, thereby

contributing to reduce energy consumption and GHG emissions, as well as other measures to improve the financial viability of the sector, which will allow the distribution companies to be better positioned to provide offtake arrangements for variable renewable energy projects.

E. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

11. Policies supported under Pillar 1 are expected to have indirect positive impacts on social and poverty outcomes. Policy reforms aimed at strengthening energy sector governance, operational performance of sector entities, and promoting renewable energy and enhanced resilience against climate change are expected to have indirect positive impacts in the short to medium-term. The adoption of international agreed standard for the state ownership would maximize value for society, through an efficient allocation of resources. Prior actions supported under Pillar 2 are expected to have a positive impact on social and poverty outcomes in the country. Other reforms supported under this pillar which aim at supporting climate mitigation measures in the power sector are expected to have indirect positive impacts on social and poverty outcomes once investments in low-cost renewable energy and energy efficiency are implemented. Policies supported under Pillar 3 are expected to have indirect positive social impact. Enabling the distribution companies to recover the full cost of efficient service adjusting the distribution companies' annual revenue and the optimization of the cost-of-service delivery would have a positive impact on energy provision by promoting the financial sustainability of the electricity distribution companies and improving the quality of service.

Environmental, Forests, and Other Natural Resource Aspects

12. The environmental analysis of the DPL found that most of the policies supported under Pillar 2 are expected to have significant positive effects on the environment and climate change and support the country's actions toward its Nationally Determined Contributions (NDC) commitment. Policy measures under Prior Action 1 aim at strengthening the electrical system planning by incorporating energy efficiency, environmental policy and land use planning objectives which will in turn promote environmental sustainability and decarbonization. Prior Actions 4, 5, and 6 promote and incentivize the development and use of renewable energy projects, transitioning to a lower carbon electricity mix, contributing to climate change mitigation by improving energy efficiency and reducing fossil fuel consumption. Prior Action 4 will strengthen Ministry of Energy and Mines (Ministerio de Energia y Minas, MEM)'s institutional capacity, which will be essential for the ongoing electricity reform and the country's commitment to the Electricity Pact. Prior Action 5 will promote the development of renewable energy projects, which will reduce the country's reliance on fossil fuels, and contribute to positive environmental and health benefits through the reduction of GHG emissions, black carbon, and other particulate matters. Prior Action 6 will strengthen the legal and regulatory framework for energy efficiency, supporting the implementation of energy efficiency projects and contributing to a reduction in GHG emissions. Potential negative environmental effects related to the development or construction of renewable energy and energy efficiency projects are expected to be mitigated through the country's environmental regulatory framework. No environmental effects are expected from the implementation of measures supported under Prior Actions 2, 3, 7, and 8.

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APPROVAL

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