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IDA13

Progress Report on Implementation of IDA Guarantee Pilot Program

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ACRONYMS

ABB	Asea Brown Boveri
ADB	Asian Development Bank
AfDB	African Development Bank
BOAD	*Banque Ouest Africaine de Développemen* (West African Development Bank)
BOT	Build Operate Transfer
BOOT	Build Own Operate Transfer
CAS	Country Assistance Strategy
EDFI	*Electricité de France Internationale*
GOCI	Government of Cote d'Ivoire
GRC	Guarantee Review Committee
IPP	Independent Power Producer
PFG	Project Finance and Guarantees Department
PPA	Power Purchase Agreement
PRG	Partial Risk Guarantee
UEB	Uganda Electricity Board

EXECUTIVE SUMMARY

i. The pilot program to provide IDA guarantees to help promote private sector investment was approved by the Executive Directors in November 1997.[1] The pilot was initially limited to US$300 million which was increased to US$500 million in December 2000.[2] It was agreed at the time of its approval that when commitments under the Partial Risk Guarantee (PRG) program approached US$300 million, a review would be submitted to the Executive Directors as a basis for consideration of its continuation. Commitments are still below that mark – they have now reached US$91.2 million with US$190 million in the pipeline for approval in FY2002. A review is being carried out at this time as the basis for continuing the IDA guarantee program during the IDA13 replenishment. In this context, this *Progress Report on Implementation of the IDA Guarantee Pilot Program* is being prepared as a background paper for the IDA13 replenishment to give Deputies the basis for continuation of the program during IDA13.

ii. This review indicates that there is general agreement among the parties directly involved—clients and Bank Group staff contacted in the course of this review—that the IDA guarantee program has demonstrated its value. IDA guarantees can assist the financing of projects that enhance economic growth, thereby supporting poverty alleviation efforts, and can further the sector reform process. In certain circumstances, IDA guarantees can play a unique role, not feasible with any other available instrument, in facilitating private investment in countries that could not otherwise attract such investment. They have the potential, therefore, to be a useful element of the Bank's private sector development strategy. On this basis, this review concludes that it would be reasonable to continue the IDA guarantee program during IDA13.

Background

iii. The IDA guarantee program is limited to Partial Risk Guarantees (PRGs). Under this instrument, IDA provides a guarantee for lenders to private investment projects against debt service defaults that result from nonperformance of government obligations defined by contract between the government and the private company responsible for the project. Such obligations are agreed on a case-by-case basis but could include protection against sovereign risks, generally political and natural non-insurable force majeure affecting government obligations, convertibility and nonperformance of government contract commitments with respect to the project (e.g., payment for goods and services, supply of inputs). The guarantee is intended to be used as an instrument of last resort to help fill financing gaps in cases where lenders would only be prepared to participate with such sovereign risk coverage.

iv. While supporting the initiation of the program, the donors required that: (i) duplication of instruments across Bank Group entities be avoided; (ii) scarce resources be used efficiently; (iii) potential IDA guarantees be firmly grounded in IDA's mission of support for poverty reduction by fostering sustainable economic growth and cost-effective public and social expenditures; and (iv) IDA guarantees should complement and reinforce ongoing reforms, not substitute for them. All

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[1] A Proposal for IDA Guarantees in IDA-Only Countries; IDA/R97-135 of October 31, 1997.

[2] Enhancing the Use of World Bank Guarantees as an Operational Tool, A Review of the World Bank Guarantee Program; R2000-215; IDA/R2000-215 of November 27, 2000

these requirements have been incorporated in the design of the program, although further work is needed in some areas, as discussed below.

v. Two IDA PRGs have been approved. These are the Azito Power Project in Cote d'Ivoire (US$30.3 million PRG, approved on December 10, 1998) and Haripur Power Project in Bangladesh (US$60.9 million PRG, approved on June 1, 2000). The rate of actual usage (in terms of IDA commitments) of the program is expected to progressively increase: the pipeline includes about a dozen possible projects, the most proximate of which are the Bujagali hydroelectric project in Uganda (possible PRG of US$115 million) and the Phu My 2.2 Power Project in Vietnam (possible PRG of US$75 million), which are expected to be presented to the Executive Directors in FY02. These activities thus far provide sufficient experience to form a judgment as to the value of the program and measures to make it more effective and efficient.

Catalyzing Commercial Financing

vi. Experience to date indicates that this program has been successful in generating difficult-to-secure commercial financing with a relatively limited enhancement by IDA. In this respect, sponsors, governments, lenders, as well as staff of the Bank, IFC and MIGA agree that the PRG program fills a critical gap in countries where there is little, if any, commercial lender interest because public sector risk is significant and other instruments are not available. The PRG has been instrumental in stimulating significant private investment in IDA countries, which could otherwise not have taken place. The PRG program has helped mobilize a total of over US$400 million on the two projects already in execution and would further help attract another US$1 billion if the Bujagali and Phu My 2.2 projects materialize as expected. This will have been done with a total IDA commitment of US$281 million, or about 20 percent of the total cost of the projects.

vii. In the case of the Azito project, the sponsors and lenders, including IFC, determined that there was no alternative to filling the financing gap and IDA was called upon to consider a PRG in conjunction with an IFC B loan. In the case of the Haripur project, a PRG has been relied upon to help mobilize financing where there is little commercial bank interest without extended political risk coverage. In the cases of Bujagali and Phu My 2.2, discussions with lenders and sponsors during project preparation suggested that no substantial long-term commercial financing would be available for these projects in the absence of IDA PRGs. With PRG cover, it should be possible to secure lending on much better terms than otherwise possible. Comparison is difficult since it is unlikely that commercial lending beyond short-term credits would have been available to any of these projects but, with the PRG, tenors from 12 (Azito) to 16 years (envisaged in Bujagali) seem feasible. Margins have ranged from 275 basis points (bp) over LIBOR in the case of Haripur to 350 bp for Azito, including the IDA 75 bp guarantee charge. Bujagali margins may be somewhat higher because of the longer tenor and high country risk, but this must be compared with the alternative of no commercial financing and little prospect of the project materializing. If the decision is taken to make an IDA PRG available at an early enough stage so that it can be reflected in the bidding documents it would make it easier for the country to fully capture the financial benefit of improved terms made possible by the PRG. In the case of power projects, for example, this would be reflected in lower tariffs.

Achieving Development Objectives

viii. The primary objective of the IDA guarantee program was to develop an instrument that would facilitate the mobilization of private investment, thereby contributing to the achievement of country development objectives as reflected in the CAS. There are two dimensions to this: (i) to achieve a positive impact on overall growth and poverty alleviation; and (ii) to facilitate sector reform, which is essential to the achievement of sustained growth and poverty alleviation. Progress on sector reform is not only desirable in general but in specific cases may be important to the viability of the project, e.g., improvements in financial management capacity of the national power company that will ensure its ability to pay for power purchased.

ix. The two operations examined here are for power generation, and the two others in the immediate pipeline are also in the power sector, although in the area of distribution privatization. The reason for this is straightforward: most of the foreign direct investment (FDI) in non-export sectors where IDA is engaged is for power generation, although there has been some activity in water and roads, and this is expected to increase in the future. CAS objectives for the power sector generally focus on: (a) the relationship of reliable power supply to growth and investment and thus to employment generation; (b) the alleviation of the high cost to the economy of load shedding and investment in private backup generation capacity; and (c) the extension of service to small enterprises, to rural areas and to the poor in general. At the sector level, the principal issues are improving financial performance, promoting competition to improve efficiency and lower costs, instituting an effective regulatory structure, and generally ensuring good sector management. A full evaluation of PRG performance in furthering these objectives is not possible, since the program is relatively recent, but some conclusions can be drawn.

x. The two PRG operations to date have a reasonably good record in regard to supporting achievement of policy objectives. They will make major contributions to the expansion of the countries' generation capacity and will thus significantly enhance GDP growth and the extension of electricity service. In addition they have been important in furthering efforts toward sector reform, including financial strengthening and sector unbundling to permit private sector entrance. They have helped ensure that governments take the measures needed to meet contractual payment and convertibility commitments.

xi. When linked to sector reform, the PRG has demonstrated that it can play a useful role in supporting this process. In many cases, where the reform process is still in an early stage, the Bank is the only party that has sufficient leverage and technical capacity to secure commitments for reform and ensure that it is an integral part of project development. The PRG, with a counter guarantee, is the instrument through which the Bank can play this role in the case of private sector operations. It is a role that neither the sponsor nor other members of the Bank group are normally in a position to play. There are limits, however, to the effectiveness of guarantees to achieve policy reform, and it best serves as a complement to other more suitable instruments such as regular lending operations, which should normally be used to carry the burden of conditionality.

xii. The opportunities to use PRGs are likely to become increasingly important as CASs place more emphasis on the role of private investment in the development process. The power sector has led in the introduction of private investment but—as will be discussed below—there are attractive possibilities in other sectors that are now being explored. The potential for increased capital flows

that will bring improved efficiency and service levels should be fully exploited by the Bank, and the PRG is therefore likely to prove to be a "niche" instrument of great utility in achieving country as well as private sector development objectives. The Bank's private sector development strategy puts emphasis on an output-based approach to the provision of public services. The guarantee program—by mitigating a variety of risks associated with private participation in public service provision—can facilitate private investment in such schemes.

Management of the IDA Guarantee Program

xiii. The pilot PRG program has highlighted some important issues relating to the coordination among Bank Group members and the use of IDA guarantees in blend countries.

xiv. *Coordination.* The coordination issue among the Bank, IFC and MIGA has received the most attention to date and much has been done to improve the coordination process. A coordination strategy was presented in the Board paper "*Enhancing the Use of World Bank Guarantees as an Operational Tool*". Three principles were proposed to provide guidance on the use of PRGs and IFC and MIGA instruments. The PRG was to be considered in cases where one or more of the following conditions prevails:

- The transaction is in a sector in the early stages of reform, where there is high risk of reversibility and where the involvement of the Bank is seen as essential for the viability and private financeability of the project;

- The operation is large and risky and Bank influence and remedies are likely to be desirable from a risk management perspective; and

- The operation is highly dependent on government support and/or undertakings so that having the explicit counter-guarantee and clout of the Bank would be useful in mobilizing private financing.

xv. In addition, the paper proposed a number of administrative measures designed to improve coordination and cooperation among the Bank Group parties. With the adoption of these principles and measures, cooperation and coordination have improved, but further efforts are called for given the importance of ensuring that the Bank Group is regarded as an efficient and useful partner. The rule that provides for early consideration of the use of a PRG and formal endorsement of such use by the Bank-wide Guarantee Review Committee (GRC) will help ensure that the instrument is used appropriately and can be introduced at an early stage when inclusion in bidding documents can ensure that the full benefits of its use accrue to the country.

xvi. *Blend countries.* The IDA PRG program is limited to IDA-only countries. There are a number of blend countries where IBRD currently does not lend (e.g., Pakistan, Nigeria). These are generally countries in transition that can offer attractive private investment prospects, but the limitation on the availability of IDA guarantees prevents them from taking advantage of an instrument that could make important projects feasible. In fact, during the period they are not considered creditworthy for IBRD lending they have no access to guarantees at all. While there is no intention to change the parameters of the IDA Guarantee Program at this time, this will be revisited in the context of further experience with the program.

Client Response

xvii. Although experience thus far is limited, all the sponsors, lenders and country officials contacted viewed the PRG program as a valuable instrument in supporting private investment projects in IDA countries. The principal issue raised has been the need for better coordination and communication within the Bank Group to facilitate the project preparation process. Much of the concern, however, dates from before the introduction of the GRC mechanism, which has now improved coordination. A number of other issues have been raised, but these refer to design elements of the program and not to its inherent value. They include such questions as the treatment of guarantees in relation to a country's IDA allocation and the need for a government counter-guarantee.

The IDA PRG Pipeline

xviii. As noted, to date most PRG operations have been in the power sector, and that is likely to be the case in the immediate future as well. There is growing interest, however, and a variety of initiatives are underway to expand use of the instrument in the power sector and many other sectors. In addition to generation, at least four operations to support power distribution privatization—a key element of sector reform—are being considered (Uganda, Tanzania, Malawi and Armenia). Initiatives are underway in the transport sector, including airport privatization in Madagascar, railways privatization in Tanzania and Zambia and a gas pipeline in Mozambique. Opportunities are also being explored for a number of promising approaches: wholesale operations (e.g., BOAD in West Africa as a wholesaler for private infrastructure development), and water sector and bank privatizations, as well as output-based provision of public services.

Conclusions

xix. The PRG has a unique ability to facilitate the mobilization of private investment and to do so on a basis which can enhance the achievement of CAS development objectives. It is, thus, consistent with the Bank's private sector development strategy. Although its use has been constrained by limited private sector interest in investing in IDA countries and lack of knowledge of the instrument both within the Bank and among potential beneficiaries, there is growing interest in the program. With the continuation of on-going promotional efforts, the IDA PRG program can become an important tool in mobilizing private investment for poorer countries at low cost in terms of Bank resources.

xx. Continuation of the program during IDA13 will mean that it is likely that IDA resources over and above the initial subscriptions (that were used for the initial pilot) will be needed. This review concludes that it would be reasonable to extend the program during the IDA13 period using IDA's general resources, up to a maximum of US$1 billion, given the rate of usage, and the pipeline for IDA guarantees. Based on the experience during IDA13, mainstreaming of guarantees could be considered in subsequent replenishments.

I. INTRODUCTION

1. The pilot program to provide IDA guarantees to help promote private sector investment was approved by the Executive Directors in November 1997.[3] The pilot was initially limited to US$300 million, which was increased to US$500 million in December 2000.[4] It was agreed at the time of its approval that when commitments under the PRG program approached US$300 million a review would be submitted to the Executive Directors as a basis for consideration of its continuation. Commitments have now reached US$91.2 million, with US$190 million in the pipeline for approval in FY2002. The review of the pilot is being carried out at this time as a basis for considering the continuation of the IDA partial risk guarantee program during IDA13.

2. This review indicates that there is general agreement among the parties directly involved—clients and Bank Group staff contacted in the course of this review—that the IDA Guarantee program has demonstrated its value. IDA guarantees can assist the financing of projects that not only enhance economic growth, thereby assisting poverty alleviation efforts, but also further the sector reform process. IDA guarantees can play a unique role, not feasible with any other available instrument, in facilitating private investment in countries that could not otherwise attract such investment. IDA guarantees have the potential, therefore, to be a useful element of the Bank's private sector development strategy. Thus, the review concludes that it would be reasonable to extend the pilot program through IDA13 subject to a ceiling on aggregate guarantees of US$1 billion.

II. DESCRIPTION OF THE GUARANTEE PROGRAM AND ACCOMPLISHMENTS TO DATE

3. The IDA guarantee program is limited to Partial Risk Guarantees (PRGs). Under this instrument, IDA provides a guarantee for lenders to private investment projects against debt service defaults that result from nonperformance of government obligations defined by contract between the government and the private company responsible for the project. Such obligations would be agreed on a case-by-case basis but could include protection against sovereign risks generally, political and natural non-insurable force majeure affecting government obligations, convertibility and nonperformance of government contract commitments with respect to the project (e.g., payment for goods and services, supply of inputs).

4. The proposal to provide IDA PRGs was based upon the perception that there was a need for a broader range of risk mitigation instruments to attract private capital in poor countries where policy reforms were being implemented but where a track record of government dealing with the private sector generally did not exist. Prior to the approval of the IDA guarantee program, only enclave projects in IDA countries could receive IBRD guarantees. Under the pilot, IDA guarantees were made available in IDA-only countries to support projects on which IBRD enclave guarantees

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[3] A Proposal for IDA Guarantees in IDA-Only Countries; IDA/R97-135 of October 31, 1997.

[4] Enhancing the Use of World Bank Guarantees as an Operational Tool, A Review of the World Bank Guarantee Program; R2000-215; IDA/R2000-215 of November 27, 2000

were not available, and where neither MIGA nor IFC could provide sufficient support. Guarantees were expected to be used for large and complex projects. MIGA and IFC would be the preferred source of insurance and finance for such projects, but could be complemented by IDA PRGs where necessary to make such projects feasible. The Board paper presenting the original concept [5] stated that:

> *"A guarantee product for IDA-only countries would present potential benefits for both the countries and IDA. Benefits for the countries include increased levels of investment and the fiscal savings and efficiency gains that can flow from private capital."*

5. The pricing for IDA guarantees has been consistent with IDA's service charges on credits—a 75 basis point (bp) guarantee fee during periods when the guarantee is callable. There is flexibility to charge higher fees, although this has not been done to date. During periods when the guarantee is not callable, a commitment fee of 25 bp may be charged,[6] all guarantees to date have been callable since effectiveness, therefore, no commitment fee has been charged. In addition, consistent with the approved policy for private sector projects,[7] IDA has charged the borrowers initiation fees of 0.15 percent to cover project preparation and development costs and a processing fee of up to 0.50 percent of the PRG facility to cover costs of hiring external consultants, out-of-pocket and other expenses. The guarantees are non-accelerable to ensure that the government's obligations to IDA would match the originally scheduled debt service obligations on the loan if the guarantee were called. As a matter of policy, it was decided that IDA guarantees should require government counter guarantees. It is within IDA's discretion to demand immediate payment of any amount paid out under the guarantee or to give different repayment terms to the country.

6. The authority to issue guarantees under the pilot program was limited to the resources derived from initial subscriptions to IDA, income on such subscriptions, or reflows of credits from initial subscriptions. On this basis, the ceiling for guarantee commitments was US$757 million. In addition, IDA's capacity to issue guarantees with resources derived from such reflows is restricted under its Articles of Agreement to "special case" situations.[8] The Executive Directors determined that operations that require political risk coverage in privately sponsored projects, where IFC and MIGA cannot provide the needed support, would be considered "special case" situations.[9]

7. Additional subscriptions to IDA and their income and reflows can only be used for guarantees if—and to the extent—authorized by IDA Board of Governors' resolutions on such additional subscriptions. The IDA Board of Governors in its IDA12 resolution authorized IDA to provide financing in the form of guarantees under that replenishment subject to decisions by IDA's Executive Directors: (a) that IDA's pilot guarantee program was deemed useful and effective; (b)

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[5] "Overview of World Bank Guarantee Activities": SecM97-209; IDA/SecM97-83; IFC/SecM97-22; MIGA/SecM97-9 of March 19, 1997.

[6] As IDA's commitment charge is currently set at zero, the proceeds would be passed on to the government after the guarantee expired without being called.

[7] "Proposal to charge fees for processing World Bank guarantees and other support to project finance operations", dated August 15, 1997.

[8] IDA Articles of Agreement, Article 5, Section 5.

[9] "A Proposal for IDA Guarantees in IDA-Only Countries".

that IDA guarantees fit within the context of an overall private sector development strategy; and (c) setting out the terms and policies applicable to such guarantees. While no authorization is presently being requested for the use of IDA resources for guarantees during IDA12, such authorization will be needed if the program is continued during IDA13, and thus should be included in the IDA13 Replenishment.

8. While supporting the initiation of the guarantee program, the donors required the following aspects to be taken into consideration: (i) avoiding duplication of instruments across Bank Group entities; (ii) using scarce resources efficiently; (iii) firmly grounding potential IDA guarantees in IDA's mission of support for poverty reduction; and (iv) ensuring that IDA guarantees complement and reinforce ongoing reforms, rather than substitute for them.

9. In light of this, the guarantee program has the following features:

- Projects supported would be consistent with IDA's development mission as expressed in the Country Assistance Strategy (CAS); specifically that these projects create real economic benefits for the country and, through economic growth, contribute to poverty reduction;
- Operations would be designed to leverage IDA resources to secure private capital in line with the Bank's private sector development strategy;
- IDA guarantees would complement other instruments, not replace them; they would be used when IFC and MIGA support was not sufficient or not available; and
- IDA guarantees would be used in countries with a commitment to policy reform and an ongoing process of macro and sectoral reform; the projects supported should be consistent with and help enhance the ongoing reform process.

10. IDA PRGs have now been approved for two projects: the Azito Power Project in Cote d'Ivoire (US$30.3 million PRG, approved on December 10, 1998) and Haripur Power Project in Bangladesh (US$60.9 million PRG, approved on June 1, 2000). The pipeline includes about a dozen projects, the most proximate of which are the Bujagali hydroelectric project in Uganda (possible PRG of US$115 million) and the Phu My power project in Vietnam (possible PRG of US$75 million). It is currently expected that the projects will be presented to the Board in FY02. These activities, though limited, nonetheless provide evidence of the value of the program thus far and possible modifications that might make it more effective and efficient.

11. This paper will first review the experience to date with the Azito, Haripur, Bujagali and Phu My Projects and then analyze that experience from the following perspectives:

(a) **Catalyzing Commercial Financing**: how has the guarantee program performed in catalyzing private investment in IDA countries; what is its contribution toward improving the terms and conditions of commercial lending available to the country?

(b) **Achieving Development Objectives**: how has the program supported sectoral policy reform efforts; how has it contributed to growth/poverty alleviation objectives; how is conditionality used to support these objectives and is it effective; how does the program contribute to institutional development?

(c) **Management of the Program**: what are the coordination issues between the Bank, IFC and MIGA and how are these being handled; what issues arise regarding pricing and costs, the counter-guarantee, blend countries, and IDA country allocations?

(d) **Client Response**: how do clients, sponsors, government institutions and lenders view the program; what are the positive and negative elements and what are their suggestions for improvement?

12. The paper will then review the IDA guarantee pipeline and prospects for new applications of IDA guarantee business.

III. OPERATIONAL EXPERIENCE[10]

13. The first IDA guarantee operation, the **Azito Power Project** in Cote d'Ivoire, consists of a 300 MW gas-fired power station and a 225 kV transmission line. The project helped fill a critical power shortage in 1999 and provided greater security in the future for a generation system that was predominantly (about 60 percent) hydroelectric. Asea Brown Boveri (ABB) and Electricité de France Internationale (EDFI) developed the project on a Build Own Operate Transfer (BOOT) basis under a 24-year Concession Agreement.

14. The CAS objectives related to the power sector are to promote improved efficiency, better service and wider access, with private investment as the main vehicle for achieving these goals. This is being accomplished through the establishment of a regulatory and legal environment and a responsive institutional framework to encourage private sector participation. Bank Group involvement in the energy sector in Cote d'Ivoire has helped to lay the institutional, economic and financial foundation for sound sector development. The reform process was well advanced at the time Azito was approved, and the financial health of the sector was good, with adequate tariffs and good financial performance indicators. Azito Power Project was the second Independent Power Producer (IPP) in Cote d'Ivoire.

15. The total financing cost of the project was around US$224 million, consisting of an equity component of about US$44 million, subordinated debt of US$20 million, senior debt of US$140.7 million and cash from operations of US$19.7 million. The senior debt was composed of IFC A and B loans (US$32 million and 30 million, respectively), a Commonwealth Development Corporation syndicated loan of US$47.8 million and the IDA guaranteed facility of US$30.3 million with a 12 year maturity. The margin on this facility was 275 basis points over LIBOR plus IDA's 75 bp guarantee fee.

16. The IDA guarantee which is provided to lenders for the IDA facility is limited to sovereign risks and covers:

(a) payment obligations of the Government of Cote d'Ivoire (GOCI) relating to Concession Agreement commitments to purchase power and supply gas, and installment payments due under the agreement relating to the transmission contract;

[10] See Annex I for summary financing plans for the four projects discussed in this Section.

(b) availability and convertibility of foreign exchange;

(c) changes in law which would have a material and adverse effect on the IPP;

(d) political force majeure events, including nationalization and expropriation; and

(e) natural force majeure events affecting the Government's obligations including the transmission system following completion.

17. IDA's Guarantee Agreement is underpinned by an Indemnity Agreement, under which GOCI counter guarantees IDA. The guarantee carries the standard charges (described in paragraph 5 above).

18. The IDA guarantee was considered critical to the completion of the financing plan for the project and instrumental in obtaining the longest possible maturity period for commercial financing for Cote d'Ivoire. No other alternative to the guarantee was available to catalyze such long-term financing. The US$30 million IDA guarantee, therefore, helped catalyze over US$200 million in financing—including long-term commercial financing at substantially better than prevailing market terms for the country. In addition, the PRG, by making investments in private generation feasible, reinforced sector reform and restructuring efforts by solidifying the role of the private sector in power. Despite recent political and economic difficulties, the IPP continues to receive monthly tariff payments and the guaranteed commercial lenders have thus far received all due loan payments. Through supervision, IDA is continuing its efforts to ensure that the country meets its contractual obligations.

19. The **Haripur Power Project** in Bangladesh consists of a 360 MW gas-fired combined cycle power plant being developed on a Build Own and Operate (BOO) basis by an IPP—AES Haripur Ltd., a subsidiary of AES. The project would be the first in a series of private projects designed to eliminate severe electricity shortages, improve efficiency, provide the basis for increased growth and expand service beyond the current low level of 15 percent of the population.

20. The project is consistent with the CAS objectives of supporting the emergence of a privatized and competitive power sector. The sector reform process is now underway and focuses on improving the operational and financial performance of the sector utilities. The Government has prepared a sector policy framework that ultimately foresees the privatization of distribution. In the interim, management and systems improvements were launched. The initial results were positive and the Bangladesh Power Development Board has continued to improve its performance in terms of system loss and collection efficiency, although the same is not true for the Dhaka Electric Supply Authority. The sustainability of these reforms will depend on privatization of the sector. The Haripur project, by bringing in the private sector and focusing attention on the importance of sector reform, represents an important step in this direction.

21. The total financing cost for the project was US$183 million. AES Haripur provided equity of US$73.6 million plus US$8.5 million in revenue from operations. Debt financing of US$97.9 million is being provided by AES, the senior sponsor (US$37 million), and a commercial loan facility of US$60.9 million supported by an IDA PRG. Financial closure was reached in April 2001. The PRG carries the standard terms and conditions approved for the program. In addition to

the PRG, IFC A and B loans were originally expected for this project, however, IFC and the sponsors were unable to reach agreement on the commercial terms and conditions of the financing and ultimately the senior sponsor provided substitute financing in the form of a facility financed on its balance sheet.

22. Bangladesh has very limited access to international loan and credit markets and the PRG was critical to catalyzing commercial financing. The overall 15-year term of the PRG commercial package was the longest to date for Bangladesh, which helped make possible the low tariff levels provided for under the Power Purchase Agreement. With the IDA PRG, lenders agreed to a margin of 200 bp over LIBOR.

23. The IDA PRG covers the following risks:

(a) Breach of contract by the Government with respect to its payment and gas supply obligations, and Government and/or third party legal action in Bangladesh to impede the agreed dispute resolution mechanism;

(b) Political force majeure, including expropriation;

(c) Changes in law and events making the Project Agreements unenforceable or void or having a material adverse effect on the ability of the company to pay or the lenders to receive payments of any guaranteed amount;

(d) Currency convertibility or transferability; and

(e) Natural force majeure events, limited to the Bangladesh utilities' obligations to construct and operate the power interconnection system and gas pipeline.

24. The most significant risk associated with the project was ability of the Bangladesh utility to meet its payment obligations, given its poor financial capacity. The Government's guarantee was designed to mitigate this risk. In addition, priority for payment was given to Haripur and the three other IPPs approved before Haripur and the Government agreed not to contract any further IPPs unless the Bangladesh utility could demonstrate that it could comply with a minimum debt service ratio of 1.2. Finally, a debt service reserve account has been established to provide additional protection against payment risk.

25. The PRG has contributed to the sector reform process by, in the first instance, establishing a framework for policy dialogue with the Government and raising the awareness of the need to accelerate the reform process. The commercial discipline imposed by private participation in the sector should help particularly with regard to improving financial performance and moving toward the privatization of distribution. The PRG has also contributed to institutional development by improving the awareness and skill base of the Government and sector utilities in the areas of financial engineering, financial management and commercial lending requirements. In fact, Bangladeshi officials report that the experience gained in negotiating the Haripur project made it far easier to negotiate Meghnaghat, the next IPP. These skills should help to facilitate private investment in the country in the future.

26. The forthcoming **Bujagali Hydroelectric Project** in Uganda would consist of a 200/250 MW run of the river power plant to be developed on a BOOT basis (30-year PPA) on the Nile River. The sponsor would be a wholly owned subsidiary of AES Corp. The project would help alleviate a severe power shortage by increasing installed capacity by over 50 percent when completed. Only three percent of the population has access to the power grid and the country has one of the lowest per capita electricity consumption rates in the world. The country's power grid has experienced daily load shedding during peak demand periods, although this has now been reduced with the recent commissioning of some additional capacity.

27. The principal CAS objective is poverty reduction through rapid economic growth and improvement of services to the poor. The inefficient and inadequate supply of power has been a major impediment to growth and poverty reduction. The quality and reliability of power are some of the most binding constraints to private investment in Uganda. Thus, World Bank efforts in the power sector have aimed at: (a) the unbundling and divestiture of the Uganda Electricity Board (UEB) with increased private sector participation to improve efficiency and expand service; (b) the provision of adequate and reliable power at least cost to meet the demands of economic growth; and (c) increased access of rural households to electricity, including areas isolated from the national electricity grid.

28. The total financing cost of the project is estimated at US$602 million, of which the sponsor's equity contribution and cash generation would amount to US$133 million. Senior debt would amount to US$469 million, of which about US$115 million would be guaranteed by an IDA PRG. In addition to some small credits, the balance would consist of US$235 million in export credits, a US$60 million IFC A loan and a US$55 million AfDB loan.

29. The precise scope of the guarantee has not yet been formulated, but it is expected that it will cover standard sovereign risks, including the Government's payment obligations under the Implementation and Power Purchase Agreements; convertibility and transferability of foreign exchange; discriminatory changes in laws and regulations; and political and natural force majeure. The most significant sovereign risk is payment, given the poor financial performance of the sector to date. The proposal for dealing with this issue is the privatization of distribution, and a possible IDA PRG is contingent on the government taking satisfactory measures to accomplish this.

30. The processing of the Bujagali project has been closely linked with progress in increasing power tariffs and the privatization of distribution. A 70 percent tariff increase has now been adopted, but privatization—although at an advanced stage—is not likely to be in place until early CY02, and the Bujagali project may have to proceed before this is finally completed. If so, the Bank and IFC have stipulated that, as a condition of approval, sufficient progress will have to be made on the privatization process to ensure that it will be concluded.

31. This would be the first hydroelectric project with financing assisted by an IDA PRG. Given the long payback period of such an operation, it is hoped that the debt's tenor can be increased to help structure a suitable financing plan. The aim is to obtain a 16-year term with 4-1/2 years of grace. In addition, lenders initially requested a margin of 300 to 325 bp over LIBOR, which is higher than was made available in the cases of Azito and Haripur. This reflects the longer tenor and grace period, as well as the degree of risk assigned to lending to Uganda. In the absence of an IDA PRG, however, no substantial long-term commercial financing would be available to Uganda for this project.

32. The proposed project has provided an impetus to accelerating the sector reform process, through tariff increases and the privatization of distribution, and has been essential to putting the sector on a sound financial basis. At the same time, proceeding with this project will of course depend on IDA being satisfied that all conditions precedent, including safeguards, are fully met.

33. The **Phu My 2-2 Power Project** in Vietnam would consist of a 715 MW combined cycle plant with gas to be sourced from the Nam Con Son Gas Project. The sponsors' consortium is led by EDFI, and includes the Sumitomo Corporation and the Tokyo Electric Power Company. The project would be developed on a 20-year Build Operate Transfer (BOT) basis.

34. The CAS objective for the power sector is to develop a modern sector that can supply Vietnam's rapidly growing economy. Thus far, Vietnam has not suffered from the kinds of serious power shortages that have affected Uganda or Bangladesh, but power demand is now growing at 15 percent per annum and private investment will be essential if economic growth is not to be constrained. Within the power sector, Vietnam has moved toward corporatization with the creation of seven distribution companies as independent accounting units and has established the legal basis for BOT operations in the infrastructure sectors; however, the full legal and institutional framework for the corporatized/privatized power sector is not yet in place. In response to the need to put the sector on a sound financial footing to accommodate projects such as Phu My, the government is now gradually increasing the level of power tariffs, which had deteriorated in real terms with the devaluation of the Dong.

35. The total financing cost of the project is estimated at US$480 million, of which the sponsors' equity contribution would be US$140 million. The debt financing plan is not yet complete but is expected to total US$340 million, including an IDA PRG facility of US$75 million and ADB facilities of US$100 million, of which US$85 million is expected to be from the ADB PRG facility. The sponsors have been in discussion with various multilateral, bilateral and export credit agencies regarding the balance of the financing. The Japan Bank for International Cooperation is expected to be the main source of funding.

36. IDA has been active in the power sector in Vietnam since 1995 and the fourth project it has financed (rural energy) is now in execution. The dialogue on the reform of the power sector has been carried out in the context of these operations. The principal objectives have been improved management of Electricity of Vietnam, transmission/distribution loss reduction, improved financial performance and extension of electric service to the rural sector where only 50 percent of the population has service. The Phu My PRG is being done in the context of other operations and the Bank's dialogue with Vietnam but. As in the case of Haripur, support for private sector involvement has helped advance the reform process and given the Bank an additional opportunity to spur progress.

IV. REVIEW OF THE IDA GUARANTEE PROGRAM TO DATE

Catalyzing Commercial Financing

37. Although IDA-only countries are making progress in reforming and restructuring their economies, they continue to face great difficulty in attracting foreign private financing, particularly debt financing. In sectors such as power, where private risk capital is now identifying attractive investment opportunities, the perception of political and economic risk makes it difficult to secure the commercial debt needed to undertake projects. The purpose of the IDA PRG was to help overcome this obstacle by providing sovereign risk coverage and so to make feasible the participation of commercial lenders. It is one of a range of instruments tailored to meet the needs of private investors and lenders in a wide variety of circumstances. These, of course, include various IFC and MIGA instruments. The IDA PRG, however, is designed to help secure commercial financing for projects in high-risk countries when other instruments are not available or when more formal World Bank commitment is needed to help overcome the perceived risks of lending. Other multilaterals have followed the Bank in developing similar instruments.

38. The IDA PRG has been instrumental in stimulating significant private investment in IDA countries, which could otherwise not have taken place. The PRG program has helped mobilize a total of over US$400 million for the two projects already in execution, and it would further help attract another US$1 billion if the Bujagali and Phu My projects materialize as expected. This will have been done with a total IDA commitment of US$281 million, or about 20 percent of the total cost of the projects.

39. While the program is relatively new and experience is still limited, it has demonstrated that the IDA PRG can be the essential ingredient in producing a feasible financing plan in high-risk IDA countries. In the case of the Azito project, the sponsors and potential lenders, including IFC, determined that it would be essential to have and IDA PRG in conjunction with an IFC B loan to fill the financing gap. Similarly, in the cases of Haripur, Bujagali, and Phu My, PRGs have been relied upon to help mobilize financing where there is little if any commercial bank interest without extended political risk cover.

40. With such cover, it has been possible to secure lending on much better terms than would otherwise be feasible. Commercial lending beyond short-term credits would not have been available to any of these projects, but with the PRG tenors from 12 (Azito) to 16 years (Bujagali) are feasible. Margins have ranged from 200 bp over LIBOR in the case of Haripur to 275 bp for Azito (plus, of course, the IDA 75 bp guarantee fee). Bujagali may be somewhat higher but this must be looked at in the context of lending terms and country risk, and compared with the alternative of no commercial financing and little prospect of the project materializing.

41. In the case of Azito, the only comparator available is the IFC “B loan” which is enhanced by IFC’s umbrella. The PRG terms were comparable with those: the tenor of the PRG facility was 12 years compared with 10 for the B loan and the margin was 275 bp over six month LIBOR plus the 75 bp guarantee fee, compared with a margin 350 bp for the B loan. Commercial bank interest in the B loan was enhanced by the availability of the PRG. Although a B loan is not part of the financing package for Haripur, another IPP in Bangladesh—the Meghnaghat Project—had support

from an ADB Complementary Financing Scheme, which is equivalent to an IFC B loan. The tenor and margins on this US$20 million facility were 12 years and 350 bp compared with 15 years and a margin of 200 plus 75 bp on the PRG facility.

42. The value of the PRG for IDA countries, therefore, is its ability to secure commercial financing on terms that keep projects affordable in circumstances where such financing might not be available at all. While the IDA PRG has in all cases an impact on the tariff because it enables mobilization of long term financing at acceptable rates, the maximum benefit is obtained if a decision is taken to make an IDA PRG available at an early enough stage so that it can be reflected in the bidding documents. This makes it possible for the country to fully capture the financial benefit of improved terms made feasible by the PRG. The same would, of course, be true for all other World Bank Group risk mitigation instruments. In the case of power projects, for example this would be reflected in lower tariffs.

Achieving Development Objectives

43. The primary objective of the IDA guarantee program is to develop an instrument that would help facilitate the promotion of private investment, thereby contributing to the achievement of country development objectives as reflected in the CAS. The Bank's private sector development strategy puts emphasis on an output-based approach to the provision of public services. The guarantee program—by mitigating a variety of risks associated with private participation in public service provision—can facilitate private investment in such schemes.[11] It can also support the establishment and maintenance of a policy and regulatory framework that will encourage private sector participation since, with its counter guarantee, the PRG enhances incentives for government performance. There are, therefore, two dimensions to the development agenda: (i) to achieve a positive impact on overall growth and poverty alleviation through improved service delivery; and (ii) to facilitate sector reform, which is essential to the achievement of growth and poverty alleviation. Progress on sector reform is not only desirable in general but in specific cases may be essential to the viability of the project. A full evaluation of results is not possible, since the program is relatively recent, but some conclusions can be drawn from experience to date.

44. Both operations examined here are for power generation and the two other projects in the immediate pipeline are also in the power sector, although in the area of distribution privatization. The reason for this is straightforward: most of the foreign direct investment in non-export sectors where IDA might be engaged is for power generation, although there has been some activity in water and roads and this is expected to increase in the future. CAS objectives for the power sector generally focus on: (a) the relationship of reliable power supply to growth and investment and thus to employment generation; (b) the alleviation of the high cost to the economy of load shedding and investment in private backup generation capacity; and (c) the extension of service to small enterprises, rural areas, and the poor in general.

45. At the sector level, the principal issues are improving financial performance, promoting competition and private investment to improve efficiency and lower costs, instituting an effective regulatory structure, and ensuring good sector management. The first issue tends to be the highest priority in IDA countries. Low tariffs, poor financial management and the inability to charge or collect for the electricity provided to both the public and private sector in many countries mean that

[11] The guarantee could also secure government subsidy payments to contractors to provide service to low income users.

governments must subsidize public power companies, which serve mostly the wealthiest segment of the population, thus diverting scarce resources from poverty alleviation programs. These factors also greatly increase the risk that the sector will not have the capacity to pay the IPP. Financial performance, together with the convertibility risk, has been a major impediment to the privatization of power generation.

46. *Promoting Growth*. The projects reviewed here all represent major additions to national generation capacity in countries that face severe power shortages, which constrain economic growth. The increases in capacity range from 27 percent in Cote d'Ivoire to 50 percent increase in Uganda and around 12 percent in Bangladesh. In addition, the electricity sectors in these countries serve only a limited percentage of the population (3 percent in Uganda, 15 percent in Bangladesh, 40 percent in Vietnam and 60 percent in Cote d'Ivoire) and very few of the poor. The projects will make major contributions to economic growth and lay the foundation for extending service to a larger percentage of the population. They are estimated to add 0.3 percent to one percent to GDP growth. Thus, by making these projects feasible the IDA guarantee program has made an important contribution to the achievement of CAS objectives.

47. Overcoming constraints in infrastructure and other sectors that are important contributors to economic growth will depend increasingly on mobilizing private investment. Progress in accomplishing this in IDA countries is still slow, but if experience in the power sector is any guide, it will depend initially at least on the provision of coverage against sovereign risks by multilateral lenders and insurers. There are numerous possibilities for investment, including privatization of railways, ports facilities, pipelines and water concessions. Private participation in these sectors should enhance service delivery and output. Privatization as well as financial sector reform are areas where private investment could be stimulated if appropriate sovereign risk coverage were available. Instruments that can do this effectively in a range of country circumstances will, therefore, be important to the achievement of the Bank Group's private sector development strategy.

48. *Sector Reform*. The IDA guarantee program has played a useful role in supporting the achievement of essential reforms, particularly where they represent risk factors for the project itself. In the case of Azito, the sector was financially sound so that only risk mitigation measures were deemed necessary. The existence of contractual commitments to the project, backed up by the counter-guarantee on the IDA PRG have undoubtedly provided an incentive to the government to fulfill its responsibilities during a difficult economic and political period.

49. In Bangladesh, where the power sector is poorly managed and financially weak, the operation has helped spur further reform action. Similarly, in Uganda, the prospective project has spurred reform. Both operations are opening the sector to private investment and focusing attention on the major deficiencies in sector management. In both countries they are instrumental in producing policy decisions to accelerate the reform process by unbundling and privatizing commercial activities. In the case of Bujagali, processing the PRG will depend on progress in privatizing distribution. In the case of Haripur, measures were taken to improve the sector's financial performance, including management changes and the installation of improved information, billing and collection systems. A draft electricity law was submitted to Parliament and a new transmission company was created. In addition, measures to mitigate the risk of non-payment and over-commitment of foreign exchange in the IPP program were agreed to. In the case of Vietnam, sector management is adequate and there has been slow but steady progress on the

reform process. The leverage in its ongoing power sector program has enabled the Bank to proceed with the Phu My 2.2 PRG within the agreed framework.

50. One difference between the operations in Uganda and Bangladesh has been with respect to handling the sequencing of sector reform measures. In both cases, there is a good political foundation for the projects. They are badly needed and there has been clear and strong support for private investment in the power sector, since the public companies have failed to provide adequate service. The decision to turn to the private sector has required for the first time that the governments seriously address their own shortcomings in sector policy and management. Because circumstances differed, however, the sequence of policy actions has been different in the two countries.

51. In Bangladesh the government formulated a policy framework for the sector and began to make improvements in its financial management. The project (and the other IPPs in the package) thus led to initiation of the reform process. It got the Bank 'a seat at the table', which enabled it to influence the direction of policy reform and—with the backing of the counter-guarantee to the PRG—has clearly established the government's responsibility for carrying through the sector reform measures needed to ensure the financial soundness of the project. The actions taken to move the reform process forward—together with the risk mitigation measures outlined above—were considered to be an acceptable basis for proceeding with Haripur even though the reform process had not been completed. In Uganda, where the Bank has ongoing projects and has been deeply involved in the sector reform dialogue for many years, there has been agreement upon the privatization of distribution as a solution to the sector's persistent financial problems. It has, therefore, been possible for the Bank to define the conditions regarding progress on tariff levels and the privatization of distribution with sufficient flexibility to avoid serious disruption of the project schedule.

52. The PRG operations to date have a reasonably good record of supporting policy objectives, despite the fact that it may be difficult in some instances to use guarantees to establish policy reform conditionality. During the preparation process efforts to achieve up front action can seriously delay the transaction and prejudice the investor. Once the Board has formally committed the guarantee, it cannot be retracted because of failure of the government to comply with policy conditionality. Nevertheless, where appropriate, conditionality has been applied and guarantees have been used to deal with essential sector reform issues. While each country and sector situation must be evaluated on its own merits it is possible to establish some guidelines. In all cases there should be agreement on the basic outlines of, and timetable for sector reform. But this must be handled flexibly. Actions critical to the feasibility—particularly the financial feasibility—of the project should be taken up front as conditions of approval of the guarantee. Finally, other more suitable instruments such as regular lending operations should be used to carry the burden of conditionality where this is feasible. In all cases, of course, measures should be taken to assure that the foreign exchange needed to service project debt is likely to be available. If used in this way and linked in a realistic fashion to reform, guarantees can play a useful role in advancing the policy agenda.

Management of the IDA Guarantee Program

53. The IDA PRG program has disclosed a number of issues relating to its management within the Bank Group. The most significant of these are: (a) coordination among Bank Group members; (b) pricing of guarantees; (c) the counter guarantee; (d) availability of the IDA PRG in blend countries; and (e) treatment of the guarantee *vis à vis* the country IDA allocation. As discussed below, measures have already been taken to address some of these issues.

54. *Coordination*. As noted, the Bank Group has developed a variety of instruments to assist its clients in dealing with a broad range of country and commercial circumstances. There is a potential for overlap—and therefore some competition among the instruments—and they differ in cost and attractiveness to the parties, depending on the circumstances of the deal.

55. It can be difficult to make an *ex ante* judgment as to which combination of instruments is best suited to accomplishing project objectives and securing a suitable commercial financing package. The different parties involved may have their own preferences for instruments. In some cases, this may have resulted in differing positions among the parties including within the Bank Group, which has complicated the negotiation process, produced delays and has opened the door to possible maneuvering by sponsors or lenders to secure preferred instruments. Experience to date indicates that the management of the process can be complex. To deal with this, the process of coordination among the Bank, IFC and MIGA has been reviewed in depth and measures have been taken to improve it. A strategy for coordination was presented in the Board paper "*Enhancing the Use of World Bank Guarantees as an Operational Tool—A Review of the World Bank Guarantee Program*".[12]

56. From the Bank Group perspective the key question is whether and when a PRG should be put on the table. To address this issue, the Bank Group's policy, as delineated in the November 2000 paper, is to consider the use of a PRG when its features (explicit counter-guarantee, potential application of Bank remedies, linkage to the Bank's sector dialogue) can help ensure the achievement of policy objectives. Three considerations are to be applied to provide guidance on the use of PRGs:

- The transaction is in a sector in the early stages of reform, where there is a high risk of reversibility and where the involvement of the Bank is seen as essential for the viability and private financeability of the project;

- The operation is large and risky and Bank influence and remedies are likely to be desirable from a risk management perspective; and

- The operation is highly dependent on government support and/or undertakings, so that having the explicit counter-guarantee and clout of the Bank would be useful in mobilizing private financing.

57. In addition, the paper proposed a number of administrative measures designed to improve coordination and cooperation among the Bank Group parties. These include ongoing consultation to promote coordination, sharing of project pipelines, training of task managers, a coordinated

[12] Document R2000-215 of November 27, 2000

approach to the market, early management arbitration, review at an early stage of all joint operations by the Bank-wide Guarantee Review Committee (GRC) and its clearance before a PRG is offered in a bidding document. With the adoption of these guidelines and processes, cooperation and coordination have improved. Early consideration of a PRG and formal endorsement of its use by the GRC goes a long way toward minimizing internal disagreements and ensuring that the instrument is used appropriately. Experience under the pilot indicates that continued emphasis on coordination is essential given the importance of ensuring that the Bank Group is regarded as an efficient and useful partner.

58. A number of lessons on the dynamics of this process have been learned in the course of the pilot. Early introduction of the PRG so that it can be taken into account in the documents will enable the country to better capture its subsidy benefits. If, however, the prospect of a PRG is introduced in circumstances where it is not needed, it may become difficult to interest the parties in other instruments. Thus early market soundings will be important to determine as soon as possible the feasibility of securing commercial financing and what, if any, World Bank Group enhancement may be needed. In some cases, PRGs and B loans can be mutually supportive. In the Azito Project a combination of an IFC B loan and an IDA PRG was utilized to fill the financing gap. Participation in the PRG was made conditional for commercial lenders on participation in the B loan. Thus, the two instruments have been used together effectively to achieve financing plan targets with a reasonable mix of World Bank Group enhancements.

59. If the prospects for such financing without IDA involvement are judged to be marginal, the financial negotiation process should not be complicated by pursuing instruments that are unlikely to materialize, particularly in cases where project risk considerations suggest the need for a PRG. Where early soundings of commercial lenders clearly indicate that there is little if any interest in a B loan, an early decision should be made on the desirability of pursing the B loan option in the interests of facilitating and simplifying the negotiation process. The GRC consideration and endorsement process will be critical in arriving at a common position in such circumstances.

60. The Haripur Project and the Kelanitissa Project—an IPP in Sri Lanka—illustrate the complexities of coordinating a package of Bank Group financial support instruments. In the case of Haripur, in addition to the PRG, IFC A and B loans were originally part of the financing plan; ultimately negotiations between the IFC and the sponsors failed and a sponsor facility was substituted for IFC support. In this circumstance, the GRC concluded that the Bank should proceed with a PRG. In Kelanitissa, the same package (A and B loans and a PRG) was offered, but the project was ultimately financed by the ADB, which offered a package of a direct loan and a PRG facility. The sponsor saw this as a simpler and more attractive solution.

61. While the establishment of the GRC and other coordination processes has generally been successful in achieving effective coordination, it is probably impossible to entirely eliminate the potential for competition between the IFC instruments, MIGA instruments and an IDA guarantee facility.[13] Nevertheless, they comprise a range of instruments all of which may be relevant to

[13] MIGA has not been involved in any joint operations thus far. Although not a formal member of the GRC, it participates fully in its deliberations as an observer and normally shares in its recommendations. At least one operation in the pipeline—a guaranteed credit line for the West African Development Bank (BOAD) to support smaller-scale private infrastructure projects—envisages joint IDA—MIGA collaboration. BOAD would set up a specialized guarantee unit with technical assistance from MIGA to help identify and evaluate requests for MIGA and/or PRG cover.

meeting the needs of IDA countries. Agreed procedures should continue to be refined based on experience to coordinate instruments in order to secure a reasonable financing package, to use IDA's influence to improve the sectoral policy framework, and to facilitate the negotiating process for private sector operations.

62. *Pricing and Costs*. Currently, IDA guarantees carry standard IDA credit terms—a 25 bp standby fee and a 75 bp guarantee fee. This fee structure is based on the principle of equivalent loan and guarantee pricing, which also applies to IBRD guarantee pricing. There is flexibility to charge a higher fee although to date this has not been done.

63. Experience to date is too limited to draw any definitive conclusions on the cost of guarantees. The Azito operation was prepared quickly, while Haripur took more time. Most such transactions are potentially complex, if only because of the multiple parties involved, and the legal work is significantly more complicated than for most loans. On the other hand, procurement work is less demanding. Costs associated with the guarantee are currently covered in part by the processing and initiation fees and there is no basis for revision of these fees at this point.

64. There is one case where an increase in the guarantee fees may be justified. As noted above, the country can capture much of the subsidy element of the guarantee if bidders can reflect it in their costing and pricing of the project. Thus, raising the cost of the PRG to the sponsor would simply result in its being passed on to the ultimate consumer. Under these circumstances, increasing the cost of the PRG would be detrimental to the country. If, however, the PRG is introduced subsequent to the bid phase (if, for example, estimations of lenders willingness to participate without IDA sovereign risk coverage turn out to be unduly optimistic) and the subsidy is not, therefore, fully reflected in the reduced costs and tariffs, then a higher than minimum charge might well be justified as one way to ensure that the subsidy element is not captured by the private investor. Each case must be evaluated on the basis of its merits, but the option of charging higher than IDA terms is available.

65. *The Counter-Guarantee*. Some country officials have questioned whether IDA should require a government counter-guarantee. In fact, the Asian Development Bank offers political risk guarantees similar in scope to a PRG, which may not require a counter guarantee.

66. One of the major reasons for providing the PRG instrument is its usefulness when IDA's influence is needed to advance the implementation of sector reforms. When such reforms are linked to performance of government commitments, for example in the case of payment obligations under power purchase agreements, the counter-guarantee reinforces the commitment and provides an additional incentive to the government to improve sector performance. The counter-guarantee, therefore, should be viewed as an essential component of the instrument and should continue to apply.

67. *Blend Countries*. The pilot for IDA PRGs was limited to IDA-only countries. There are, however, a number of blend countries where IBRD currently does not lend (e.g., Pakistan, Nigeria). These are generally countries in transition that can offer attractive private investment prospects, but the limitation on the availability of IDA guarantees prevents them from taking advantage of an instrument that could make important projects feasible. In fact, since they are not currently considered creditworthy for IBRD lending, they have no access to guarantees at all. While there is

no intention to change the parameters of the IDA Guarantee Program at this time, this will be revisited in the context of further experience with the program.

68. *IDA Country Allocations*. The proposal for the pilot IDA guarantee program suggested that during the initial phase of the guarantee program an incentive should be provided in the form of flexibility on country IDA allocations to accommodate sound projects that were good candidates for guarantees. This was generally to be considered for "high case" countries, although other criteria were not excluded. As a launching policy this was reasonable, although a constrained IDA allocation has not been an issue with any of the initial operations. The value of PRGs for supporting private sector investment in the appropriate circumstances has now been sufficiently demonstrated so that special allocations should not be needed.

69. Whether countries should be prepared to use their IDA allocations to stimulate private investment rather than for directly poverty-related operations is a matter of the country's development policy, taking into account the strategic value of the investment. One consideration is that the direct cost of the guarantee is borne by the developer while the country is in a good position to realize the benefit of the IDA subsidy. In addition, as pointed out above, public subsidies going to inefficient infrastructure supply are a very real and substantial drain on resources available for poverty alleviation. Thus far, countries that are dealing with severe power shortages that threaten growth prospects, and power companies that absorb substantial public resources have been prepared to use the instrument. This is an issue that should be explored in the CAS in cases when the use of the PRG is under consideration.

Client Response

70. Since only a few PRG operations have reached a point that would provide a basis for informed comment, this assessment has been based on a limited number of interviews. The comments provided, however, are generally consistent and so should give a fairly accurate indication of clients' views. The overall reaction is positive on the PRG, but less so on the process of dealing with the Bank Group in the case of some of the initial transactions. Sponsors, lenders and country officials consistently express the view that the PRG program is a unique and valuable instrument for supporting private investment projects in IDA countries. No major issues have been raised with the design of the PRG, although some suggest minor modifications in its terms and conditions.

71. Country officials generally view the PRG as an attractive instrument given its low cost and usefulness in securing private financing. There is feeling on the part of some country officials that a counter-guarantee should not be required because the IMF regards it as a contingent liability. But there may not be a full understanding that it is the government's contractual obligation not the counter-guarantee that creates the contingent liability in the view of the Fund. Other officials express understanding of the usefulness of the counter-guarantee. A concern of country officials, as well as sponsors, on dealing with the Bank was in regard to its efforts to establish sectoral and risk management conditionality. While this differs little from normal Bank practice, the negotiation of, and compliance with conditionality in a PRG has potential to perhaps endanger a deal dependent on meeting a private investor's schedule.

72. The principal issue raised by sponsors, government and lenders has been the need for better coordination and communication within the Bank Group to avoid impeding the project preparation process. Sponsors, particularly, have commented on the difficulty of dealing with the Bank Group, the lack of communication and differing agendas between the Bank and the IFC. To a large extent, however, these reactions are based on activities that took place before the full implementation of the GRC coordination mechanism, which addressed the problems of clear-cut decision-making responsibility within the Bank Group and expeditious resolution of problems.

73. From the sponsors' perspective (shared to some extent by the countries) there is a tendency for the Bank to shift conditionality goalposts. To avoid this, the Bank (particularly the Regions) will have to be prepared to recognize the limitations of guarantee operations in advancing the policy agenda, and concentrate on issues directly related to reducing the risk of default, as well as transactional issues such as governance, transparency and procurement.

The IDA Guarantee Pipeline

74. As noted, the four PRG operations approved or under development to date have been in the power sector. There is growing interest, however, and a variety of initiatives are underway to expand use of the instrument in the power sector and many other sectors. In addition to generation, at least four operations to support the privatization of power distribution—a key element of sector reform—are being considered (Uganda, Tanzania, Malawi and Armenia). Initiatives are underway in the transport sector, including airport privatization in Madagascar, railways privatization in Tanzania and Zambia and a gas pipeline in Mozambique. Opportunities are also being explored for a number of promising approaches: wholesale operations (e.g., the BOAD operation in West Africa mentioned in footnote 13), and water sector and bank privatizations. (The current IDA guarantee pipeline is summarized in Annex II.)

75. There is growing interest in the IDA guarantee program even though it is still in the pilot phase and its use has been restricted by lack of knowledge of the instrument both within the Bank and among potential beneficiaries. It has also, of course, been hampered recently by reduced private sector interest in investing in IDA countries. While the power sector is at the cutting edge of privatization, the Bank's private sector development strategy aims to help promote increased private investment. Instruments such as the IDA PRG, which can effectively fill an important niche, should be available to support this effort. Through the continuation of promotional efforts and its regularization, the IDA PRG program can become an important tool in mobilizing private investment for poor countries.

Conclusions

76. The PRG has a unique ability to facilitate the mobilization of private investment and to do so on a basis which can enhance the achievement of CAS development objectives. It is, thus, consistent with the Bank's private sector development strategy. Based on performance to date and the increasing interest in using the IDA PRG tool, this Report concludes that it would be reasonable for the IDA13 Replenishment to continue the IDA guarantee program in IDA-only countries up to an aggregate amount of US$1 billion. This would imply that IDA's general resources may need to be used for IDA guarantees during the IDA 13 period.

Annex I – Financing Plans for Azito, Haripur, Bujagali and Phu My 2-2 Power

- Cote d'Ivoire: Azito Power Financing Plan (US$ million)

Cinergy Holding	33.00
Industrial Promotion Services	11.00
Total Equity	**44.00**
Senior Debt	
IFC A	32.44
IFC B	30.33
IDA PRG	30.33
CDC Guarantee	47.96
Total Senior Debt	**141.06**
Subordinated Debt	
Fixed IFC/CDC	10.08
Convertible IFC/CDC	10.07
Total Subordinated Debt	**20.15**
Cash from Operations	**18.00**
Total Project Costs	**223.21**

- Bangladesh: Haripur Power Financing Plan (US$ million)

AES Equity	73.30
Total Equity	**73.30**
IDA PRG	60.90
AES Debt	37.00
Total Debt	**97.90**
Cash from Operations	**8.50**
Total Project Costs	**179.70**

- Uganda: Bujagali Power Financing Plan (US$ million)

AES Equity	117.12
Total Equity	**117.12**
IFC A	60.00
ECA	235.00
IDA PRG	115.00
AfDB	55.00
Other	3.49
Total Debt	**468.49**
Cash from Operations	**16.00**
Total Project Costs	**601.61**

- Vietnam: Phu My2-2 Financing Plan (US$ million)

Base Equity	100.00
Base Project Debt	300.00
Base Project Funding	**400.00**
Stand-by Equity	40.00
Stand-by Project Debt	40.00
Stand-by Project Funding	**80.00**
Total Project Funding	**480.00**

Annex II : PRG Operations Under Development and Evaluation – September 2001

Region	Country	Project	Sector	Expected Approval Date	Description
AFRICA	CAMEROON	Privatization Water Project	WATER	TBD	Guarantee to support the privatization of SNEC. IDA partial risk guarantee is being considered for the project.
	MADAGASCAR	QMM Mineral Sand Project	MINING	TBD	IDA partial risk guarantee to support an investment in the Mineral Sand Project.
	MADAGASCAR	Airport Privatization & Redevelopment Project	TRANSPORT	TBD	Partial privatization of several airports on a BOT or BTO basis. IDA partial risk guarantee is being considered for the project.
	MALAWI /TANZANIA	Electricity Utility Privatization	POWER	TBD	Privatization of an electric utility. IDA partial risk guarantee is being considered for the project.
	MOZAMBIQUE	Airport Privatization	TRANSPORT	TBD	Privatization of Maputo International Airport following the air transport sector reforms/liberalization. IDA partial risk guarantee will be considered in the bid package to invite private sector participation.
	MOZAMBIQUE	Sena Line	MINING / ROAD	TBD	Rehabilitation and operation of the Sena Line in Mozambique. IDA partial risk guarantee is being considered for the project.
	MOZAMBIQUE	Pande Gas / Maputo Steel	OIL & GAS	TBD	Development and construction of a 700 km pipeline from Central Mozambique to Mozambique/ South African border to supply gas to South Africa. IDA partial risk guarantee will support this project.
	TANZANIA	Tanzania Railways Project	RAILROAD	TBD	The project consists in the restructuring of a railroad. IDA partial risk guarantee is being considered for the project.

Region	Country	Project	Sector	Expected Approval Date	Description
AFRICA (CONT.)	WEST AFRICA	BOAD	Infrastructure	TBD	A Partial risk guarantee is being considered for this project. BOAD will act as wholesaler of guarantees for smaller projects in member countries.
	ZAMBIA	Zambia Railway Project	RAILROAD	TBD	The project consists of the restructuring of a railroad. IDA partial risk guarantee is being considered for the project.
	UGANDA	Bujagali Hydro Power	POWER	FY2002	Use of an IDA partial risk guarantee in support of the hydro power project is in underway.
EAST ASIA AND PACIFIC	VIET NAM	Phu-My 2-2 Power	POWER	FY2002	An IDA partial risk guarantee for a BOT gas-fired power project is being developed. The guarantee was offered as part of the bidding package and now the negotiation is underway.
EUROPE AND CENTRAL ASIA	ARMENIA	Electric Distribution Privatization	POWER	TBD	An IDA partial risk guarantee for privatization of two electric distribution companies is being developed.

GLOSSARY

Basis Points over LIBOR: LIBOR is the London Inter-Bank Offer Rate, an internationally recognized benchmark interest rate, which is used to establish contractual interest rates. A basis point is one hundredth of a percentage point; therefore, for example, 50 basis points is .50 or one half percent.

Callable Guarantee: the provision of a guarantee under which the Bank, by virtue of non-performance of contractual obligations undertaken by the government may be called upon by the private lender to repay any amounts due under the loan.

Counter-Guarantee: when the Bank provides a guarantee, it requires a counter-guarantee from the host country government. The counter-guarantee is a further demonstration of the government's commitment to meet government undertakings for the project. The counter-guarantee of the government to the Bank is provided through an indemnity agreement, whereby the government indemnifies the Bank for any payments made by the Bank under its guarantee.

Enclave guarantee: IBRD may provide a partial risk guarantee for a project in an IDA-only country if the project is expected to generate foreign exchange outside the country and where IBRD would not cover the risk of payment for the output. Enclave guarantees are normally **non-accelerable**; IBRD's payment obligations to the lenders under such guarantees are limited to the annual principal and interest obligations originally scheduled under the guaranteed loan.

IFC A and B Loans: IFC A Loans are directly funded by IFC. B Loans are syndicated by IFC, which thereby provides "lender-of-record" umbrella coverage to private sector lenders. Although IFC does not guarantee the syndicated lenders, its lender-of-record umbrella provides a degree of currency transfer protection.

Loan Tenor: the period of time over which a loan must be repaid.

Nonaccelerable: a feature of a guarantee which, in the event of a default, limits the liability of the guarantor to the annual principal and interest obligations originally scheduled rather than to the entire amount of the loan.

Partial Risk Guarantees: PRGs ensure payment in the case of debt service default resulting from the nonperformance of contractual obligations undertaken by governments or their agencies in private sector projects. A PRG is triggered by debt service default resulting from government noncompliance with one or more of its obligations as stipulated in agreements with the project company.