Energy sector loan II project

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The Second Energy Sector Project–ESL II, was supported by Loans 3107-PAK and 3107-1-PAK for US$250 million approved in FY89 and US$28 million approved in FY91. The loans were closed in FY95, three years behind schedule, and US$16.4 million was canceled. Cofinancing was provided by the Japan Export-Import Bank (JEX) for US$150 million. The Implementation Completion Report (ICR) was prepared by the South Asia Regional Office. A summary of the Borrower's report is included as Appendix B and JEX's comments are included in Annex C.

The project objectives were: (a) to continue the process of sectoral adjustment, initiated under the first Energy Sector Loan (ESL I), through policy and institutional reforms (including, *inter alia*, the establishment of an operationally independent distribution wing within WAPDA–the national water and power utility; the financial restructuring of OGDC–the national oil company; and the organizational and financial restructuring of KESC–the Karachi power utility); (b) to support the implementation of the energy sector's US$5 billion Core Investment Program (CIP) for FY89-91 (75 percent in power, 23 percent in oil and gas, and 2 percent in coal); (c) to mobilize resources for the CIP through rationalizing all energy prices (i.e., power, coal, oil and gas), mobilizing private sector financing and coordinating access to the credit and capital market; and (d) to support Pakistan's macroeconomic adjustment program by facilitating an adequate level of imports. The loan was a hybrid operation with half of the loan amount to be disbursed against general imports and the other half (the investment component) against equipment and services required by the energy enterprises (two in power and three in oil and gas) to carry out part of their CIP. A broad range of policy and institutional actions (accounting for as many as 40 non-standard covenants and 10 separate studies), dealing with: (i) resource development; (ii) pricing, resource mobilization and resource management; (iii) institutional development; and (iv) environmental aspects, were envisaged under the loan.

The loan met its main **physical objectives**, albeit with delays ranging from two to four years. Total energy investments by public sector entities in FY89-91 slightly exceeded appraisal expectations (by about 7 percent), whereas private investments were somewhat lower than forecast (due to delays in finalizing the financing of the large Hub River power project). Close and regular consultations between the Borrower and the Bank regarding the CIP resulted in a more realistic matching of financial resources with the sector entities' implementation capacity. However, some important **institutional and policy objectives** were only partially met; in particular, the structure of electricity prices remains unbalanced, residential gas prices were not brought to fuel oil parity, and the restructuring of KESC was delayed. Other institutional objectives were met with significant delays, often after the closing date of ESL II. More recently, the Government has accelerated the pace of reform in the power sector, leading to agreements for the construction of 3,000 MW of new private generation capacity and the recent privatization of WAPDA's 1,500 MW Kot Addu thermal plant.

In light of the above shortcomings, OED rates project outcome as marginally satisfactory and institutional development impact as modest (instead of highly satisfactory and substantial respectively in the ICR). Sustainability is rated as likely (as in the ICR) because of the Government's recent progress in implementing sector reform, particularly in the power subsector; however, it still could be endangered if important outstanding issues (such as KESC's finances) are not tackled expeditiously. OED rates Bank performance as satisfactory (instead of highly satisfactory in the ICR): although the Bank's role in promoting sector reform was positive, particularly in the power sub-sector, the design of this operation was complex

and excessively ambitious, resulting in high preparation and supervision costs and the need to waive key covenants on energy pricing and privatization of energy entities.

Lessons drawn from this project relate to: (i) the importance of keeping the number of policy covenants within a manageable number, lest they may not be properly supervised and/or require frequent waivers; (ii) the need to involve both the central Government and implementing agencies very early in the design of an operation with a significant policy content; and (iii) the benefits of designating a single agency (in this case the Energy Wing of the Planning Ministry) to coordinate implementation of policy components.

The ICR is of good quality; in particular, it includes an operational plan, as well as detailed Borrower and co-financiers' comments.

An audit of the project is currently underway.