I. Project Context

Country Context

The Republic of Vanuatu is an archipelago of 82 volcanic islands covering a total area of about 12,200 square km - of which about a third is land. The country has been a democratic republic since gaining independence from the United Kingdom and France in 1980. Vanuatu’s population is approximately 249,850 people; almost evenly distributed among the six administrative provinces. The national household count stands at an estimated 50,740, of which about 12,470 households (25 percent) are located in urban areas and the remainder 38,270 (75 percent) are dispersed in rural areas.

Vanuatu has become one of the fastest growing economies of the Pacific region. The economy has experienced strong and sustained growth mainly driven by tourism, construction, and aid inflows. The per capita GDP is estimated at US$ 3,039 (US$ 4,939 at Purchasing Power Parity (PPP)). Yet, the cost of basic infrastructure services is high and affects the business environment in the country. For instance, although Vanuatu ranks 80 in the “ease of doing business” indicator reported by The World Bank which analyzes a total of 183 economies, it ranks at 124 in the “getting electricity” indicator mainly due to the high dependency of imported petroleum fuel resulting in high electricity prices and cost associated with obtaining a new connection. The recently finalized Vanuatu National Energy Road Map notes that affordable access to energy is a key enabler for social and economic development and country has embarked on that next stage of energy sector reforms.
II. Sectoral and Institutional Context

In Vanuatu, electricity service is delivered through three types of models: (a) independent “main grid systems” in main population centers; (b) isolated “mini-grids” in lesser population concentrations but where a grid supply system is still a technically and economically competitive option, and (c) decentralized energy service systems.

Independent main grid electricity supply is largely restricted to the two major population centers of Port Vila and Luganville, as well as small parts of the islands of Malekula and Tanna. The private sector is responsible for generating and supplying electricity under concession agreements with the government. However, the concession areas (and the grid) cover only a limited area which mainly reaches urban and business districts in each of the four islands. Outside the concession areas, the Department of Energy, Mines and Mineral Resources (DEMMR) is responsible for electrification.

An estimated 27 percent of the Vanuatu population has access to electricity. Access rates in the main urban centers - Port Vila (on Efate) and Luganville (on Espiritu Santo) - are about 75 percent, dropping off considerably in rural areas with much smaller loads per customer and a far lower population density. Twenty (20) percent of the rural population has access to electricity. Electricity generation is predominantly from diesel fuel. A priority for the government is to diversify away from diesel fuel to reduce electricity costs (increase affordability), improve energy security and realize climate change benefits.

The sector is governed by two key legislative acts; the Electricity Supply Act (Chapter 65, 1972) and the Utilities Regulatory Authority Act (Act No. 11 of 2007). The Electricity Supply Act (Chapter 65, 1972) (i) provides authority for the Minister of Lands and Natural Resources (MLNR) to enter into concession contracts with private partners on the government’s behalf; (ii) grants electricity supply and distribution exclusivity to contracted Concessionaire(s); (iii) assigns certain legal rights to customers, the general public, and the Concessionaires; (iv) establishes penalties for violations; and (iv) grants authority for the MLNR to make regulations that give effect to the Act’s provisions and the concession contracts. The Utilities Regulatory Authority Act (Act No. 11 of 2007): (i) establishes the Utilities Regulatory Authority (URA) and outlines its basic functions; (ii) assigns specific ‘Grantor’s’ rights under the concession contracts to the URA; (iii) establishes penalties for violations; and (iv) endows the URA with the power to set tariffs, establish safety and reliability standards, and discharge other regulatory functions; and (v) empowers the Minister of Lands and Natural Resources (in the case of electricity) to make regulations that give effect to the Act’s provisions.

The private sector utility, UNELCO, a subsidiary of the Suez Energy Group, has acquired the rights to generate and distribute electricity within the three main urban concession areas, Port Vila and parts of the islands of Malekula and Tanna. In Port Vila, the concession is in force until the year 2031 and provides exclusive rights to generate and supply electricity within a 15 km radius of the city boundaries. The Efate main grid system serves about 10,338 consumers. The system has an installed capacity of about 26.5 MW (21.9MW of which is diesel-based) and a peak load of about 11 MW. Generation is predominantly sourced by diesel which is currently being partly blended with coconut oil (CNO). UNELCO has also 3MW of installed wind capacity.

The concession for service provision in Luganville, which was held by UNELCO, expired on December 31, 2010. The Government of Vanuatu (GoV) re-tendered the concession through a transparent, competitive international bidding process and selected VUI, a subsidiary of the Pernix Group Inc. as the next concessionaire for Luganville; however for now VUI is supplying the concession area under an operating agreement with the GoV. The concession agreement is pending.
finalization. The concession at Luganville serves roughly 2,339 customers, of which 1,400 are residential users. Of the total generation capacity of 4.1MW, 3.5MW is supplied by the Sarakata Hydroelectricity Plant and the remainder by diesel units located within Luganville.

The URA regulates prices, service standards and market behavior in the electricity sector and it is also tasked with protecting the long-term consumer interest. The URA oversees and applies the provisions established in both the Electricity Supply Act and the concession agreements between each concessionaire. The current pricing arrangements involve the determination of a base tariff level which varies with fuel, labor and material prices. Fuel prices are passed through to consumer tariffs. Electricity retail tariff levels are high in the concession areas, in part due to high costs of imported diesel fuel. Electricity prices are amongst the highest in the Pacific region.

The Vanuatu National Energy Road Map (NERM) prepared in 2013, outlines the priorities for the energy sector and sets out ambitious targets for increasing access and affordability and energy security for the country, with a strong focus on renewable energy. The NERM also identifies a number of policy, legislative and regulatory reforms to create the enabling framework for investment in the sector. This Project builds upon gains already made by supporting further sector reforms and by ensuring effective energy market regulation.

III. Project Development Objectives

The Project aims to provide technical assistance to the Department of Energy, Mines and Mineral Resources (DEMMR) and the Utilities Regulatory Authority (URA) of Vanuatu in the development and execution of their work programs.

IV. Project Description

Proposed components: Project Financing, totaling US$2.75 million over a 2-year period, would support the following components:

Component 1: Policy Support (DEMMR) US$1.25 million. This support would be geared towards planning and the implementation of policy, legislative and regulatory reforms and appropriate institutional arrangements. It would consist of advisory assistance and capacity-building for the DEMMR in the following areas:

- Plans, policy, legislation, regulations, compliance framework and institutional arrangements (consultant and advisory services, workshops and communication); and
- Capacity Building - build capability in Vanuatu, within the Government and the DEMMR to support the development of plans, policy, legislative and regulatory arrangements, and monitoring and compliance framework to support renewable energy and energy efficiency investments.
- Preparation of the SREP Investment Plan, including an energy sector overview and a renewable energy technologies assessment.

Component 2: Regulatory Support (URA) US$1.50 million. The component would finance consultant services for the work program (sector regulator, legal and regulatory specialists, economist/market analysts), and provide on-the-job training, mentoring, and formal training (in country and overseas, including training/internship arrangements) for the URA. The component also comprises a program of
advisory assistance and capacity building for URA in the following areas to address continuing as well as emerging regulatory challenges:

- Energy and water regulation (consultant and advisory services and communication - media, publication and presentations and URA website content management - and workshops); and
- Capacity Building: build capability in the URA through on the job training, seminars and workshops for URA staff on energy and water sector regulations.

V. Financing (in USD Million)

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<th>For Loans/Credits/Others</th>
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VI. Implementation

The DEMMR and the URA will share technical responsibility for Project implementation in line with their functional responsibilities. The DEMMR will implement Component 1. The URA will implement Component 2. A Project Agreement between the URA and the World Bank and a Subsidiary Agreement between Ministry of Finance and Economic Management and the URA will formalize the current arrangements between the GoV and the independent regulator. The project will be implemented from 1 July, 2013 to 30 June 2015.

VII. Safeguard Policies (including public consultation)

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VIII. Contacts

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