



<b>1. Project Data:</b>		<b>Date Posted :</b> 09/23/2003	
<b>PROJ ID:</b> P076905		<b>Appraisal</b>	<b>Actual</b>
<b>Project Name:</b> Energy Sector Reform Loan	<b>Project Costs (US\$M)</b>	454.55	454.556
<b>Country:</b> Brazil	<b>Loan/Credit (US\$M)</b>	454.55	454.55
<b>Sector(s):</b> Board: EMT - Power (85%), Central government administration (5%), Renewable energy (5%), Oil and gas (5%)	<b>Cofinancing (US\$M)</b>		
<b>L/C Number:</b> L7120			
	<b>Board Approval (FY)</b>		
<b>Partners involved :</b>	<b>Closing Date</b>	12/31/2002	12/31/2002
<b>Prepared by :</b>	<b>Reviewed by :</b>	<b>Group Manager :</b>	<b>Group:</b>
Richard L. Berney	Fernando Manibog	Alain A. Barbu	OEDST
<b>2. Project Objectives and Components</b>			
<b>a. Objectives</b>			
The projects specific objectives were to : (i) restore the normal functioning of the power sector in the context of a power supply crisis; and (ii) address the immediate regulatory problems that were the underlying cause of the crisis in the power sector.			
<b>b. Components</b>			
This was a single tranche sector adjustment loan Key areas of reform were :			
<ul style="list-style-type: none"> <li>• Management of the energy crisis to avoid rolling blackouts and minimize economic and social cost of supply shortages.</li> <li>• Regulator reforms to increase electricity tariffs up to cost recovery levels .</li> <li>• Market reforms to improve competitiveness of wholesale power and gas supply markets .</li> <li>• Improve application of environmental regulations</li> <li>• improve access to electricity by low income consumers .</li> </ul>			
<b>c. Comments on Project Cost, Financing and Dates</b>			
The project was put together shortly before a national election that the opposition party appeared likely to win .The government requested a single tranche loan to help support the Brazilian Real at a time when it was under heavy external pressure due to the uncertainty over the likely government policies in the case of a change in government . The Government needed the money immediately . It was also concerned that a second tranche could be held hostage to the new government's possible changes in policy direction . This uncertainty might, of course, have been a rational for making the project in two tranches, to ensure that the new Government was interested in maintaining the reform process.			
<b>3. Achievement of Relevant Objectives:</b>			
The overwhelming majority of the objectives were achieved . Twenty conditions of loan effectiveness were met before Board presentation . These actions were sufficient to restore the normal function of the sector, address the sector's immediate regulatory problems, increase tariffs, start a process to improve low income consumers' access to electricity at affordable prices, and strengthen the role of environmental institutions .			
<b>4. Significant Outcomes/Impacts:</b>			
A market based rationing system was implemented . It provided incentives for large consumers to reduce their consumption and also protected the poor, minimal use households . The Government instituted a process to resolve the financial disputes between generators and distributors that had threatened to stalemate the system . The Government contracted 2000 MW of new combined cycle gas generators to get over the worst problems until rainfalls returned to normal in the mostly hydro -based system. Regulatory and market reforms were introduced, including the introduction of an auction based wholesale market, dividing the main federal agencies into separate legal entities for generation, transmission and distribution, and eliminating the subsidization of large industrial consumers. The poor were protected through the introduction of national rules for discounts to households with low consumption levels, and through the calling for mandatory new connection targets .			

**5. Significant Shortcomings (including non-compliance with safeguard policies):**

The single tranche meant that the technical assistance project, which was originally expected to be brought to the Board at the same time as the Adjustment Loan, was put on hold. The Bank had no leverage to ensure that the dialogue would continue with the new government. The single tranche and lack of a companion TA project made it difficult to establish an effective monitoring system. This monitoring program is particularly important because this loan was intended to be the first in a series of loans for the sector. Fortunately, the new government was anxious to continue the sector reform dialogue with the Bank, and as a result, has agreed to proceed with the technical assistance project. While environmental institutions were strengthened, it is as yet too early to determine the actual improvement of performance on the ground.

None of the twenty conditions of loan effectiveness related to gas supply issues were implemented. This may have been another casualty of the decision to make this a single tranche operation, since the government was not ready to make any specific commitments in this area in the time available. Since this loan was advertised as the first in a series of energy sector adjustment loans, the expectation was that this issue would be addressed in due course.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
<b>Outcome:</b>	Satisfactory	Satisfactory	
<b>Institutional Dev.:</b>	Modest	Substantial	Substantial institutional changes were implemented, including wholesale electricity auctions, reorganizing federal agencies, and tariff reforms.
<b>Sustainability:</b>	Likely	Likely	
<b>Bank Performance:</b>	Highly Satisfactory	Highly Satisfactory	
<b>Borrower Perf.:</b>	Highly Satisfactory	Highly Satisfactory	
<b>Quality of ICR:</b>		Satisfactory	

**NOTE:** ICR rating values flagged with '\*' don't comply with OP/BP 13.55, but are listed for completeness.

**7. Lessons of Broad Applicability:**

- The political will necessary to produce significant power sector reform often requires a major crisis. The Bank needs to maintain a low-key power sector dialogue with governments even when they are not in ready to undertake serious reforms, so as to establish the intellectual and technical foundations for reform when the crisis arises.
- It is extremely useful to complement adjustment operations with small technical assistance loans to help maintain the sector dialogue.
- Market incentives, such as the trading of electricity quotas on official exchanges, can minimize the disruption caused by imbalances in the supply and demand for power.

**8. Assessment Recommended?**  Yes  No

**9. Comments on Quality of ICR:**

An excellent ICR, covering all aspects of the project. It would have been useful, to discuss the macro-economic conditions that made this large single-tranche loan particularly attractive to the government.