

VOLUME II:
COUNTRY
PROFILES

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vol. 2

PROFILE OF ENERGY SECTOR
ACTIVITIES OF THE WORLD BANK IN
EUROPE AND CENTRAL ASIA REGION



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*Energy Sector Activities of the World Bank in Europe and Central Asia Region is published in two volumes. This document (Volume II) contains individual country profiles. A separate document (Volume I) contains the overall profile including a description of the World Bank's objective and strategy in the energy sector, the work program, and the organization and staff of the Energy Department.

A L B A N I A

COUNTRY INFORMATION

Albania has a largely rural economy with agriculture generating 56 percent of output, and industry and construction 21 percent. After an output decline of nearly 33 percent between 1990 and 1991, recovery has been due to the government's commitment to a strong program of macroeconomic stabilization and structural reform. With assistance from the international community, Albania achieved a substantial progress in macroeconomic stabilization, with major cuts in the government budget deficit and a corresponding decline in inflation. On the structural side, wide-ranging reforms were implemented which dismantled many of the controls of the previous regime, including early privatization of virtually all small enterprises and agricultural land, the abolition of almost all price controls, the unification and floating of the exchange rate, and sweeping liberalization of the trade and payments regime which removed practically all restrictions in these areas. The supply response of these economic reforms — largely private-sector driven — was impressive, and Albania achieved growth rates which were among the highest in Europe, in range of 8 to 9 percent per annum during the period 1993-96. Nonetheless, the country remains by far the poorest in Europe.

While the achievements on the macroeconomic policy and structural fronts were impressive, institutional development remained weak in Albania. Progress was especially lacking in the area of governance, as reflected in the generally weak judicial implementation capacity and inefficient public administration. The financial sector remained largely unreformed, with the formal banking sector dominated by insolvent state banks, and domestic financial intermediation undertaken mostly in the informal financial sector. These institutional and structural weaknesses contributed in no small part to the crisis which erupted in early 1997.

By the end of 1996, the domestically-financed fiscal deficit had reached over 10 percent of GDP, basically undoing all the progress made on the fiscal side since transition. With the collapse of the pyramid schemes in late 1996 and early 1997, the crisis changed in nature. The Government in Tirana lost control of large parts of the country, widespread looting occurred, a large number of weapons were stolen and general insecurity started to prevail which severely disrupted economic and social activities. In April 1997, following a request made by the authorities in Albania, a multi-national force led by Italy was deployed on the ground and helped improve the security situation in the country, while OSCE was mandated to provide assistance in restoring political stability and consolidating democracy in Albania.

THE BANK GROUP'S STRATEGY

An initial assessment of the situation in Albania has been completed by the World Bank, the European Commission, and the EBRD, in consultation with the IMF. Establishment of a credible and effective government with full authority over the country and restoration of public security are considered main prerequisites for post-crisis financial assistance. The recovery program includes, first of all, institutional strengthening, including at the local level, as well as development of independent judiciary system and judicial implementation capacity. In the area of economic and social policies, it is necessary to achieve medium-term sustainability of budgetary and external accounts, control inflation, prevent illegal financial activities as well as strengthen the functioning of the formal financial system. The important objectives of the

ALBANIA — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1993 (millions)	3.4			
GNP per capita (US\$)	333	405	623	789
Annual GDP Growth (%)	9.6	9.4	8.9	8.2
GDP Inflation (%)	85	22.5	7.8	12.7
Total Debt/GDPmp (%)	66.3	43.7	29.3	29.6

ALBANIA — ENERGY SECTOR INDICATORS

Energy Resources

Gas Reserves	70 bcf
Oil Reserves	24 mln tons

IEA Primary Energy

Consumption 1.19 MTOE

Electricity consumption per
capita (1995) 635 kWh/yr

Installed Power Generation
Capacity 779 MW

BANK'S TEAM

ARNTRAUD HARTMANN,
COUNTRY DIRECTOR
(H12-021, X80523)

HENK BUSZ,
SECTOR LEADER
(H5-055, X32300)

RICHARD HAMILTON,
SR. ENERGY ECONOMIST
(H5-107, X32344)

ENAR WENNERSTROM,
SR. FINANCIAL ANALYST
(H5-103, X32741)

recovery program are: alleviation of poverty, addressing shortages, improvement of health and educational sectors, resumption of privatization and private economic activities, reduction of unemployment, establishment of land market and ensuring continuation of agricultural production. The program also is addressing issues of poor infrastructure and its management and financing.

ENERGY POLICIES AND ISSUES

Albania's energy resources comprise: oil, natural gas, coal, wood and other biomass, peat and hydropower. Remaining proven recoverable oil reserves are estimated at 27 million tons. There are also limited remaining recoverable natural gas reserves estimated at 1.63 billion cubic meters. Production of most of the remaining oil and gas will require enhanced recovery methods. Minable coal reserves in seams thicker than 0.4 meters are 350 million tons, but they are not economic. The standing stock of wood in the forest estate is about 80 million cubic meters; there is much wood and other biomass available for fuel use outside the forest estate, but estimates of the annual sustainable supply vary widely. Peat resources are estimated at 158 million tons, virtually all of which are located in a single deposit near Maliq. Use of peat as a household fuel was investigated but found not to be feasible because of high ash content and marginal economics. While Albania's hydropower potential has not been precisely established, it is thought to be more than three times as large as the amount already developed, which produces 4,000-5,000 GWh in a normal hydrological year. Albania's energy resources have been sufficient to supply the country's needs and enable it until recently to be a net energy exporter. From 1982 to 1989, domestically produced crude oil and fuelwood were the main sources of supply at about 1.2 million toe each per year. Hydropower generation increased by 1986 to about 1 million toe with

the commissioning of the Komani hydropower station. Coal production increased to over 0.5 million toe, but natural gas production fell to about 0.2 million toe as a result of a gas field fire. After 1989, the sharp contraction of the economy combined with the effects of insufficient previous maintenance and outdated equipment led to a virtual collapse of energy production in Albania. Production of oil, coal and natural gas fell by 53 %, 91 % and 78% respectively between 1989 and 1994. Fuelwood production estimates for this period are uncertain, with a reduction in officially allowed supply thought to have been largely offset by increased illegal cutting. Hydropower was the only source of supply that was maintained at a satisfactory level after 1989, but it too was at risk because of insufficient maintenance and variable rainfall.

Prior to 1993, Albania was a net exporter of energy. By 1994 net imports reached 13 % of total consumption, mainly because of greatly increased imports of diesel oil and to a lesser extent gasoline and kerosene.

BANK GROUP'S STRATEGY REGARDING THE ENERGY SECTOR

Immediate priorities are to repair damages incurred during the early part of 1997 and to continue work on the Power Transmission and Distribution Project. The institutional features of the project will need to be amended to adjust to the post-crisis circumstances. The overall objectives are: rehabilitation and strengthening of existing energy capacity, reduction in "non-technical" power system losses and improvement in bill collection, institutional strengthening, sector restructuring and privatization.

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Effective Date	IDA Credit/ Revised Amount US\$ mln	Project Cost US\$ mln	Closing Date	Task Manager
Power Loss Reduction (LN No. 26770)	The main objectives are to: (i) reduce non-technical electricity losses (mainly due to theft of electricity) thereby reducing uneconomic use of electricity and increasing electricity revenue; and (ii) support institutional reform and strengthening in the power subsector. The project would indirectly reduce technical electricity losses by relieving pressure on overloaded transmission and distribution facilities.	06.09.95	5.0	8.731	12.31.97	R. Hamilton
Power Transmission and Distribution (LN No. 28260)	The project objectives are to: (i) improve the overall standard, reliability and efficiency of electric power supply and enhance the efficiency of electricity interchanges with neighboring countries; (ii) reduce unbilled electricity consumption; (iii) establish a regulatory framework; (iv) begin the process of privatizing the power sector in an efficient and non-disruptive way; (v) ensure the financial viability and institutional strength of KESH and the distribution enterprises of Elbasan, Shkoder and Vlore; and (vi) encourage energy conservation and efficiency in electric appliances and buildings.	03.25.96	29.50	116.6	06.30.01	R. Hamilton

ENERGY PROJECTS UNDER PREPARATION

Project	Project Description	FY	Proposed Amount (\$m)	Status	Project Manager
Third Power (AL-PE-43177)		2000		Initial stages of preparation.	R. Hamilton

ARMENIA

COUNTRY INFORMATION

Armenia has made huge strides in reforming its economy and in establishing a suitable policy framework. The stabilization program, sustained since Spring 1994, has brought down the budget deficit to 8.4 percent of GDP in 1996, a sixth of the 1993 figure. Annual inflation has fallen to under 6 percent in 1996—the lowest in the FSU. And after years of collapse, GDP grew by 5.4 percent in 1994, by nearly 7 percent in 1995, and by 5.8 percent in 1996. However, poverty remains severe — particularly in urban areas, where 30% of households were classified as poor or very poor in 1995. At US\$20 per month, real wages are only a third of their 1992 levels. Moreover, the economic crisis and the collapse of public finances have translated into a dramatic deterioration of quality of basic social services, a drop in school enrollment, and curtailed access to health and education by the poor.

The country faces the dual task of consolidating the advances of the first phase of reforms — macroeconomic stability, open and competitive markets, improved financial discipline and an emerging private sector—while moving ahead on the difficult task of completing the transition and building the supporting institutions needed for a vibrant market economy. The Government's program has three overarching objectives: (a) to consolidate macroeconomic stability and maintain creditworthi-

ness; (b) to accelerate the growth and development of the private sector and lay the basis for sustained growth; and (c) to ensure the social sustainability of the reform process and preserve Armenia's stock of highly-skilled human capital.

ARMENIA — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1994 (millions)	3.7			
GNP per capita (US\$)	560.0	620.0	730.0	830.0
Annual GDP Growth (%)	-15.0	5.4	6.9	5.8
CPI (% growth rate)	3731.9	5273.4	176.7	14.7
Total Debt/GDPmp (%)	30.2	30.7	32.9	38.7

BANK STRATEGY AND OBJECTIVES.

The Bank's strategy for the next three years builds on the progress achieved since the limited CAS (presented to the Board in February 1995). Because of resource constraints (both lending and budgetary), the strategy focuses on being selective in Bank interventions, hence reducing Bank activities in certain sectors — agriculture, housing — which, while important, are not considered key bottlenecks. The strategy builds heavily on the findings of our recent poverty assessment, and focuses IBRD/IDA resources on support for overall economic reforms, and on investments in basic infrastructure and key social services. The strategy reflects the Government's priorities, which match the Bank's own views.

The objectives of the Bank's country assistance strategy are to:

- Foster the rapid development of the private sector by promoting further structural reforms, strengthening the financial system and the regulatory framework, and alleviating key infrastructure bottlenecks in energy, transport and water.
- Support social sustainability and the alleviation of poverty through the strengthening of the social safety net, and through improvements in the quality of and access to basic health and education services.

The proposed strategy envisages a mix of lending, guarantees and non-lending services to achieve the above two objectives. Based on prospects for sustained GDP growth and on expectation of a gradual easing of regional tensions, Armenia has been deemed creditworthy for modest amounts of IBRD lending over the CAS period.

KEY SECTOR ISSUES AND POLICIES

With an energy import dependence of about 90% of primary energy consumption, and the unreliability and high costs of energy transport through neighboring republics following the

collapse of the Soviet Union, the Government of Armenia has placed a high priority on improving the security of energy supply and the efficiency of its consumption. The key sector issues affecting the achievement of these objectives are: (i) a collapse in economic (paying) demand, particularly from industrial and other commercial consumers which historically consumed about 75% of Armenia's power generation; (ii) a collapse in Armenia's power export markets; (iii) a need to moderate increases in electricity tariffs to mitigate the adverse social impact on the population which now consumes 50-55% of electricity supply (about 30% of urban households are classified as poor and spend less than US\$50 per month on their basic needs of which a typical energy bill is about US\$10-15); (iv) the growing level of external debt and arrears for gas and nuclear fuel imports (estimated to be US\$80 million as of April 1, 1997) resulting mainly from non-technical losses and non-payment; (v) the lack of financing needed to arrest and reverse the deteriorating condition of energy infrastructure (about US\$1.7 billion is needed over the next 15 years in the power sector alone); (vi) inadequate management capacity, incentives and tools to commercialize sector enterprises (including insufficient metering, accounting and auditing systems); (vii) restricted energy import options — the bulk of imports have to come through Georgia because of the trade embargo by Azerbaijan and Turkey; (viii) the assessment by the G-7 that nuclear power plants of the VVER-440 type (as in Armenia) are intrinsically unsafe and should be retired as soon as possible, and Armenia's agreement to retire its nuclear plant no later than end-2004; and (ix) the untested legal and regulatory environment for private investment in the power sector.

Government's Sector Strategy: Recognizing that foreign private investment will be the main source of significant financing to meet the

large investment needs in the sector, the Government's strategy is to deepen energy sector reforms started during 1995/96 by building on the interrelated achievements of improved quality of supply and improved payment discipline. Over the next three years, the Government intends to: (i) strengthen the regulatory capacity of the Energy Commission; (ii) introduce IAS-based accounting for sector enterprises (by April 1998); (iii) implement a Financial Rehabilitation Plan for the power sector to restructure the stock of receivables and payables and prevent the growth of new arrears; (iv) implement a sector privatization strategy with assistance from international financial advisers.

The Government's commitment to sector reforms is demonstrated by: (i) the adoption of an Energy Law in June 1997 which consolidates the separation of power generation, transmission and distribution facilities, establishes an independent Energy Commission responsible for issuing licenses and setting market rules and regulated tariffs, and separates the policy-making and ownership role of the state; (ii) increase in electricity tariffs — since 1994, average retail electricity tariffs have been increased from 1.4 US cents/kWh to 4.2 cents/kWh at present, covering direct operating costs and an allowance for commercial losses and debt service; (iii) raising gas tariffs — in a first step towards restoring reliable gas supply to households, gas prices were recently set at US\$100/thousand cubic meters for households and US\$78/tcm for large consumers (based on a border price of US\$65/tcm); (iv) improving tariff collections from less than 50% in 1995 to an average 63% in 1996, and 70% in the second quarter of 1997; (v) consolidating the 57-60 electricity distribution companies created after the unbundling of the vertically-integrated power utility into a single company for Yerevan and 10 regional distribution companies; (vi) com-

ARMENIA — ENERGY SECTOR INDICATORS

Energy Resources

Oil Reserves (million tons) —	
Gas Reserves (bcm) —	

Energy Consumption

(1995, mtoe)	2.02
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Power Generating Capacity

(installed)	3,500
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pleting the separation of generation enterprises from transmission; and (vii) adopting a financial rehabilitation plan and privatization decree.

THE BANK STRATEGY FOR THE ENERGY SECTOR

The proposed lending program envisages two investment operations focused on alleviating priority infrastructure bottlenecks and improving the environment for the private sector. The *Electricity Transmission and Distribution Project (FY98)* seeks to reduce technical losses in the power system, through the rehabilitation of distribution networks, and upgrading of metering, dispatch and communication capabilities. This project also supports actions to strengthen financial discipline in the power sector and to build capacity in sectoral institutions. A follow-up *Power and Gas Restructuring Project* including a partial risk guarantee component for privatization of power facilities and lending for gas sector rehabilitation is envisaged for FY99.

BANK'S TEAM

JUDY O'CONNOR,
COUNTRY DIRECTOR
(H12-113, x38513)

JONATHAN WALTERS,
TEAM LEADER
(H5-243, x32468)

DAVID CRAIG,
SECTOR LEADER
(H5-077, x33560)

SALMAN ZAHEER,
ENERGY ECONOMIST
(H5-249, x39477)

JANN MASTERSON,
OPERATIONS ANALYST
(H5-110, x35005)

SUREKHA JADDOO,
ADMINISTRATIVE ASSISTANT
(H5-236, x32363)

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Board Approval Date	Loan/Credit Amount (\$m)	Closing Date	Task Manager
Power Maintenance Project (C2666-AM)	<p>The project seeks to: (i) arrest and reverse the deterioration of three thermal generation units and three hydro power generation units, and improve their availability (reduce unscheduled down-time); and (ii) strengthen the electricity load management and dispatch capability of the national dispatch center and arrest further deterioration of the electricity distribution system.</p> <p>Project components are: (a) maintenance of two existing 200-MW thermal units at the Hrazdan power plant, one 150-MW thermal unit at the Yerevan power plant, two units at Gyumush hydropower plant and one unit at Kanaker hydropower plant, both on the Sevan-Hrazdan hydropower cascade; (b) strengthening and maintenance of the electricity dispatch communications and distribution systems; and (c) technical assistance for project implementation and upgrading the electricity dispatch system.</p>	12.08.94	14.5		J. Masterson

ENERGY PROJECTS UNDER PREPARATION

Project	Description	Proposed Amount	FY	Project Manager
Power and Gas Restructuring (AM-PE-54885)	Investments include rehabilitation of power and gas infrastructure in support of establishing efficient markets and facilitate privatization (transmission and distribution, dispatch, metering, financial and accounting systems). The project includes also technical assistance for market reforms and privatization of the electricity and gas industries.	30.0	1999	J. Walters
Electricity Transmission and Distribution (AM-PE-8276)	The project will include the following components: (i) System Metering between generation, transmission and distribution companies (to support new commercial arrangements) and within the distribution companies (to permit internal control of electricity and revenue flows); (ii) Transmission System Rehabilitation: This component will rehabilitate and upgrade five (out of 14) 220 kV transmission substations (Ekhegnadzor, Zovuni, Marash, Shaumian-2, and Vanadzor-2); (iii) Distribution System Rehabilitation: This component will rehabilitate a part of the electricity distribution networks in the capital Yerevan, Lori, Shirak, Taush, Gegharkunik and Aragarsotn; (iv) Working capital for natural gas procurement to help maintain reliable electricity supply while commercial arrangements under the new structure of the power sector are consolidated and commercial losses are reduced (supported by the project); and (v) Technical Services (and related equipment) to help commercialize project beneficiaries (in accordance with the Energy Law) and to facilitate project implementation and supervision.	51.7	1998	S. Zaheer

A Z E R B A I J A N

COUNTRY INFORMATION

The undeclared war in Nagorno-Karabagh with ethnic Armenians has generated a huge population of refugees and displaced persons. Currently, nearly 20 percent of the national territory remains under occupation, and about 900,000 people (out of its population of 7.5 million) are refugees or internally displaced persons (IDPs). From August 1991 till June 1993, there were four changes of government. President Heidar Aliyev, who was confirmed in his position by an election held in October 1993, has faced periodic threats to his government, including two coup attempts. However, the situation has stabilized significantly during the last three years and the active expanding presence of the foreign oil companies is a good indicator in this regard. By the end of 1995, measured GDP stood at only about 34 percent of its 1988 value. All sectors of the economy were hard hit. Between 1989-1994 agricultural and industrial output have declined by 30 and 60 percent respectively. The cut-off of transport links to Azerbaijan's traditional markets in September 1994 (due to fighting in Chechnya and internal conflict in Georgia) compounded the deterioration of external trade and intensified output contraction.

the deep water portion of Guneshli which are located offshore Azerbaijan in the Caspian Sea. Numerous agreements (Shakh Deniz, Karabagh, Lenkoran-Talysh, Dan Ulduzu, Ashrafi, Apsheron, Oguz, Nakhchevan structures) have since been concluded with international oil consortiums, which are expected to lead to investment and production on a schedule about two to three years behind the AIOC contract.

Azerbaijan's medium-term prospects for economic and social development are potentially very promising. While full development of the oil resources offshore of Azerbaijan will require acceptance by the riparian states of a framework for development rights to Caspian oil and major new export pipelines will have to be built through neighboring countries to transport oil from Azerbaijan to international markets, the potential economic effect of the oil development now in prospect is enormous. Current projections suggest that export earnings from the oil expansion program could rise rapidly to equal total 1995 merchandise exports by the turn of the millennium, and lead to a doubling of GDP thereafter. Total oil reserves are estimated at 4.0 billion barrels, and production could peak at 700,000 bpd in 2010 in the AIOC contract area alone. Other projects recently agreed could eventually push production well beyond 1.0 million bpd.

AZERBAIJAN — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1993 (millions)	7.4			
GNP per capita (US\$)	730			480
Annual GDP Growth (%)	-23.1	-15.7	-13.3	-5.6
GDP Inflation (%)	714.5	1330.5	608.7	20.3
Total Debt/GDPmp (%)				10.3

Oil and gas production has gone down from 13.8 mmt in 1987 to 9.3 mmt in 1995 due to problems of infrastructure, poor production practices, and depletion of old oil fields. In September 1994, SOCAR (Azerbaijan's state oil company) signed a thirty year Production

Sharing Agreement (PSA) with a consortium of international oil companies (Azerbaijan International Operating Company — AIOC) to develop the oil fields of Chirag, Azeri, and

THE BANK GROUP'S ACTIVITIES

The following projects have been approved: Petroleum TA Project (\$20.8 million equivalent), Greater Baku Water Supply Project (\$61.0 million equivalent), Institution Building Technical Assistance Project (\$18.0 million equivalent), Rehabilitation Credit (\$65.0 million equivalent), Gas System Rehabilitation Project (\$20.2 million equivalent), Farm Privatization Project (\$14.7 million equivalent), and recently signed Structural Adjustment

Credit. A Pilot Reconstruction Project is under preparation to assist the Government in rehabilitating the war-torn regions of the country. Among these, below is a brief description of the two energy sector projects under supervision:

ENERGY SECTOR POLICIES AND ISSUES

Export Pipeline: It was announced in 1995 that the "Early Oil" from the Azerbaijan International Operating Company (AIOC) Project would pass through two routes, namely Georgia and Russia. AIOC is now considering options for the "Main Export Pipeline" and is considering Georgia, Russia, and Turkey alternatives. Many factors including environmental concerns of oil shipment through the Bosphorus and security concerns in Chechnya affect this highly delicate issue. Azerbaijan's development is closely related to the timing of the start of the oil flow.

Caspian Sector Boundaries: The applicable legal regime for the Caspian Sea is not entirely clear because the four successor states namely: Azerbaijan, Kazakstan, Russia, and Turkmenistan of the Former Soviet Union (FSU) have not agreed on its international boundaries. This issue directly affects rights over offshore oil in the Caspian.

Gas Sector Issues: The Government's decision in April 1996 to stop imports from Turkmenistan due to for balance of payments problems has resulted in a cut-off of gas to large parts of the country which has led to a more expensive or environmentally damaging fuels, such as electricity and fuel wood. The Government realizes that increase in gas supply and improvement in gas distribution are priorities and is looking for ways to do so.

BANK'S STRATEGY FOR THE ENERGY SECTOR

The Bank's activities in the energy sector have been constrained by the limited IDA funds and other obligations of the Government where obtaining financing is more difficult. With the

same token, due to the quite active involvement of the private sector, particularly in upstream activities, the presence of the Bank in oil and gas projects has been limited except the two projects under supervision (see below). However, the areas where there is limited or no private sector interest such as the "gas chain" have also been recognized by the Government and are in need of rehabilitation. The Gas System Rehabilitation Project which is under supervision is an appropriate start in this regard.

AZERBAIJAN — ENERGY SECTOR INDICATORS

Energy Resources

Oil Reserves (mln tons)	1000
Gas Reserves (BCF)	30,000

Primary Energy Consumption

(MTOE)	15.44
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Installed Power Generating Capacity	5,240 MW
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BANK'S TEAM

ISHRAT HUSAIN,
COUNTRY DIRECTOR
(H3-161, x81415)

PEGGY WILSON,
CONSULTANT
(H5-045, x82336)

PETER THOMSON,
SECTOR LEADER
(H5-093, x34261)

PATRICIA HACKMAN,
CONSULTANT
(H5-020, x80457)

PETER POLLAK,
PRINCIPAL ENERGY
SPECIALIST
(H5-081, x81065)

MASKAT IDENOV,
CONSULTANT
(H5-210, x39396)

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Board Approval Date	Revised Amount	Closing Date	Task Manager
Petroleum TA Project (C27080)	As the Bank's first operation in the country, the Project is providing technical assistance to the State Oil Company of Azerbaijan Republic (SOCAR) in the following areas: (i) rehabilitation of the producing section of the Guneshli field; (ii) rehabilitation of other old fields; (iii) legal studies on the status of the Caspian Sea; (iv) gas processing facilities; (v) management information systems; and (vi) training	04.20.95	20.8	11.30.99	Peter Pollak
Gas System Rehabilitation Project (C29230)	This project will support reforms in the organization of the gas sector and help to initiate badly needed rehabilitation of the dilapidated gas transmission and distribution system and foster the transition of the gas parastatal into a modern and efficient gas utility through four main components: (a) metering; (b) cathodic protection rehabilitation; (c) analytical equipment; (d) corporatization support.	09.19.96	20.2	06.30.01	Peggy Wilson

ENERGY PROJECTS UNDER PREPARATION

Project	Development Objectives	Proposed Amount	FY	Task Manager
Pilot Reconstruction (AZ-PE-35770)	The proposed project would include, among others (water supply, agriculture, landmine clearing, etc.) the following component: repair of electric power supply in Fizuli, Agadam, Terter, Geranboy, Gazakh and Nakhichevan.	21.6	1998	Peter Pollak
Reconstruction (AZ-PE-49619)	To be defined after a peace is achieved in the Nagorno-Karabakh conflict.	72.0	2000	Peter Pollak

BELARUS

COUNTRY INFORMATION

Before the breakup of the Soviet Union, Belarus enjoyed a trade surplus, a budget surplus, and one of the highest standards of living in the Soviet block. With the breakup, demand for Belarussian exports dropped sharply, and GDP declined by nearly 50 percent since 1989. The government responded to these economic problems with policies intended to prevent a decline in real wages and employment, but this only exacerbated the problems. Partly as a result of the expansionary policies undertaken to maintain output and incomes, inflation averaged about 2,000 percent a year in 1993 and 1994, and dropped to 244 percent in 1995.

To help control inflation, since 1993, the government has maintained the budgetary fiscal deficit at 2-4 percent of GDP. It has done so through the elimination of budgetary subsidies and modernization of a value added tax and a progressive personal income tax. In July 1994 all national wholesale and retail trade margins were abolished and prices of food products were liberalized by December 1994. Prices of rents and public utilities were increased in June 1995 to recover about 60 percent of the costs of providing services. Also in 1995, the government reinforced its budgetary policies with tighter monetary controls. Subsequently, average inflation declined from 30-40 percent per month in early 1995 to 3-5 percent per month from May 1995 onwards.

In September 1995, the government agreed on a stabilization program with the IMF. However, implementation of structural reforms — including measures to liberalize domestic prices and trade, promote competition through the entry of foreign companies and demonopolization, improve corporate governance, accelerate the privatization of state enterprises and housing, and begin the privatization of land — has slowed. Only 6 percent of large

and medium enterprises and 11 percent of small enterprises have been privatized.

In May 1997 Belarus signed the agreement with Russia on the creation of the Federal State. It is still unclear what economic agreements will support the major political document.

THE BANK'S GROUP STRATEGY

The Bank's overall objective in Belarus is to support the country's efforts to move to a market economy and restore growth by promoting the development of an efficient, competitive private sector and by supporting the provision of physical and social infrastructure. The Bank has provided support to Belarus in the form of lending, technical assistance, and aid coordination initiatives.

The Bank has extended three loans to Belarus: Institution-Building Project, Rehabilitation Loan, and Forestry Development Project. The Bank has also undertaken several technical assistance and other institution building activities. The Bank will continue to assist the government's reform efforts, concentrating on the areas of social protection, private enterprise development, urban water supply, agriculture and energy.

ENERGY SECTOR POLICIES AND ISSUES

Belarus remains highly dependent on imported energy and has made little progress toward diversifying its exports and entering new markets. Also, inadequate cost recovery from energy consumers together with foreign exchange shortages have contributed to the sharp increase in arrears on payments for gas imports to Russia since mid-1995. In early

BELARUS — BASIC INDICATORS

Population mid-1993 (millions)	10.2			
	1993	1994	1995	1996 (estim)
GNP per capita (US\$)	2,870			2,170
Annual GDP Growth (%)	-10.7	-12.6	-10.1	-5.0
GDP Inflation (%)	1097.1	1967.0	646.5	70.0
Total Debt/GDPmp (%)	702.1	94.3	15.7	6.8

half of the gas which it imported. As a result, it accumulated arrears with Russia amounting to US\$600 million. The official external debt, including penalties on arrears, now exceeds US\$2.0 billion. However, a major debt cancellation agreement with Russia in early 1996, when implemented, would reduce the total debt by about half.

B O S N I A A N D H E R Z E G O V I N A

COUNTRY INFORMATION

The conclusion of the Dayton-Paris Peace Agreement in December 1995 ended Europe's most destructive war of the last fifty years. An estimated 250,000 people were killed, more than 200,000 wounded, and 13,000 permanently disabled of a pre-war population of 4.3 million. Under the Agreement, Bosnia and Herzegovina is an internationally recognized country consisting of two entities: the Bosnia-Croat Federation (Federation of Bosnia and Herzegovina) and Republica Srpska. There is a State Government responsible for foreign affairs, customs and foreign trade policies, monetary management, and inter-entity matters on communication and transport. All other responsibilities, including defense, energy, social services and social welfare, have been devolved to the Federation and the Republica Srpska separately.

The war shattered the economy, destroyed much of the country's infrastructure and brought productive activity almost to a standstill. The country's pre-war GDP of about US\$9 billion has shrunk to about US\$2 billion, and its per-capita GDP declined from about US\$1,900 to about US\$500. As of October 1, 1996 GDP per capita had recovered to US\$815. About 65% of the 900,000 workers employed in 1991 are currently unemployed. Wages and salaries are low and many people still receive some form of humanitarian assistance.

THE WORLD BANK ASSISTANCE STRATEGY

In 1996 the Bank provided an across-the-board support program in which highly front-loaded IDA resources were used as "seed capital" to attract donor resources in support of emergency reconstruction projects in a wide range of sectors. Sixteen projects were supported by grants and credits totaling \$358 million; they helped begin critical reconstruction and recovery in agriculture, health, education, housing, water, transport, heating, power, as

well as the critical areas of landmine clearing, employment creation, and credit lines for small businesses and entrepreneurs. Non-lending services were supported including policy dialogue, technical advice and aid coordination. Damage assessments in fourteen economic sectors, prepared by the World Bank, the EU, and EBRD, in conjunction with Bosnian authorities, have become sector strategies that serve as the "blue-print" for the donor-supported reconstruction program in these sectors. The Bank also prepared the first post-war economic studies: two Country Economic Memoranda, a Private Sector Assessment and an ongoing Public Expenditure Review.

The objective of the FY98-99 CAS period is to help the Country move from reconstruction to sustainable recovery and growth. Sustainable policies are needed to achieve high economic growth and, eventually, creditworthiness. In short, they are essential to prepare the country for the time when donor assistance is gradually scaled back. The strategy is designed to support the overall objective of sustainability in three thematic areas: (i) strengthen the institutions of macroeconomic management, in particular, sound fiscal management; (ii) make the transition to a market economy, with focus on enterprise and banking privatization; and (iii) deepen the sustainability of reconstruction.

Further policy-enhancing investment or adjustment operations are envisaged to support institution-building at the State and Entity level, as well as key reforms in the areas of public

BOSNIA AND HERZEGOVINA — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1993 (millions)	4.0			
GNP per capita (US\$)	—	—	501	
Annual GDP Growth (%)			33	50
CPI (% growth-YR95=100)				
Federation	—	780	-40	8
Republica Srpska	—	1061	204	-9
Total Debt/GDPmp (%)	—	143	167	116

finance, privatization and trade liberalization. Future Bank operations will support reconstruction in the following sectors: energy and transport network infrastructure, education, agriculture and others essential to economic recovery. Limited IDA resources will continue to make partnerships with other donors essential. Mobilizing co-funding for future operations, and coordinating strategies — e.g., eventual exit from those sectors where other donors are more fully engaged or have greater comparative advantage — will be important elements of their partnership.

ENERGY SECTOR POLICIES AND ISSUES

- **Electric Power.** In 1990, BH generated 13,090 Gwh of electricity at plants located on its territory. Electricity consumption was 11,181 Gwh. The system comprised 13 hydropower plants with a total capacity of 2,034 MW and 12 thermal power plants with a total capacity of 1,957 MW. As of January 1, 1996, 58% of total generating capacity in the Federation area (comparable data are not available for the Republica Srpska) was reported to have been damaged. Part of the remaining capacity is out of operation due to destroyed transmission lines or lack of coal. About 60% of the transmission network and control system is seriously damaged, including transmission facilities and interconnection lines to neighboring countries and the UCPT. The distribution network is largely destroyed.
- **Coal.** In the 1980's, the coal mines in BH produced approximately 18 million tons annually, of which 10 million tons were brown coal and 8 million tons were lignite. Production was concentrated in areas near Tuzla and Zenica in both open pit and underground mines. Coal production dropped to 1.5 million tons in 1994, less than 10% of the pre-war level. Much of the mobile mining equipment has been dis-

mantled beyond repair. There is an acute lack of critical materials such as fuel, tires and spare parts. The number of people employed has decreased from 26,000 to about 7,000. Present production costs appear to be at or above the world market level of coal prices adjusted for quality.

- **District Heating.** In 1991, BH had a district heating system in most major towns and cities with a population in excess of about 25,000 inhabitants. The systems were generally run by municipally-owned district heating enterprises. Cogenerated heat was provided only by the combined heat and power plants in Tuzla and Kakanj as well as by local industries. The remaining heat was generated by local heat-only boilers. Currently, the DH system in major cities such as Sarajevo, Banja Luka, Bihac and Mostar are only partly operational. In Sarajevo, the system has been damaged due to shelling and freezing of the pipes in the network. Building intervals in residential dwellings (pipes, radiators and valves) have incurred substantial damage, also due to the corrosion associated with non-usage, lack of fuel, rusting and freezing.
- **Natural Gas.** The gas system in BH was developed starting in 1975 under the Bank's Sarajevo Air Pollution Control Project. Russian gas is supplied via Hungary and the Federal Republic of Yugoslavia. As of 1992, the gas supply network consisted of 182 km of transmission mains and offtake pipes. Consumption peaked in 1990 with 610 million cubic meters, constituting 8% of the total energy consumption in BH. At the beginning of the war, use of gas upstream reduced supply coming into Sarajevo to such an extent that gas use for industry and much of the district heating system became impossible. Gas assumed major importance and many improvised connections and appliances were made following the

destruction of heating and power systems. As of late 1995, the total number of household connections in Sarajevo was estimated at around 89,000, and gas consumption constituted 70% of all energy consumption.

THE BANK'S STRATEGY REGARDING THE ENERGY SECTOR

The proposed strategy for the sector would include restoration of services to acceptable levels; reconfiguration of electrical power network to optimize the system; sector restructuring (including closing uneconomic mining capacity and privatizing services) and introduction of the regulatory framework that would facilitate attracting potential investors; and improvement of the financial situation.

Energy Projects under Implementation

BANK'S TEAM

CHRISTIAAN POORTMAN,
COUNTRY DIRECTOR
(H4-023, x33011)

HENK BUSZ,
ENERGY SECTOR LEADER
(H5-055, x32686)

RICHARD HAMILTON,
SR.ENERGY ECONOMIST
(H5-107, x32344)

WEIGONG CAO,
CONSULTANT
(H5-213, x32691)

MARIE-THERES SCHURRER,
CONSULTANT
(SARAJEVO RM)

AHMET GOKCE,
PROCUREMENT SPECIALIST
(SARAJEVO RM)

HEINZ HENDRIKS,
SR.MINING ENGINEER
(F 8K-194, x82887)

KISHORE NADKARNI,
SR.FINANCIAL ANALYST
(H5-023, x32698)

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Approval Date	Amount - IDA Credit (US\$m)	Closing Date	Task Manager
Emergency Electric Power Reconstruction Project (C29030)	The project's objectives are to: (i) restore electricity service to acceptable levels in major cities and for vital industries throughout BH. Initial reconstruction would target mainly critical power plants (including hydro plants and thermal cogeneration and power-only plants), principal substations and major transmission lines; (ii) increase coal production in the most efficient mines to supply the fuel necessary for the thermal power plants; (iii) reconfigure the electric power network, taking into account BH's need for significant independence from Belgrade and security of electricity supply; (iv) enhance the electricity enterprises' institutional capacity and improve their finances; and (v) support power and coal sector restructuring. In addition, the project would establish a procurement monitoring and audit unit for all Bank/IDA financed, cofinanced or administered projects.	07.30.96	35.6	12.31.98	W. Cao
Emergency District Heating Reconstruction (T24034)	The project's objectives are to: (i) restore district heating service in Sarajevo as soon as possible by reconstructing both the district heat supply system as well as building internal heating installations, and by doing project preparatory work for the same in Banja Luka; (ii) mitigate the risk associated with a single source of gas supply by ensuring that the oil-firing capability of the Sarajevo district heating system is fully operational. This would enable BH to potentially reduce its gas consumption through fuel switching by Toplane-Sarajevo (from gas to fuel oil), which would enhance the country's strategically important security of energy supply; (iii) strengthen Toplane-Sarajevo's institutional capacity and (iv) initiate network improvements. The project would also enhance energy efficiency and energy conservation and reduce environmental pollution by enabling disconnection of about 34,000 flats from self-made gas connections in Sarajevo.	05.20.96	20.0	03.31.98	M.-T. Schurrer

ENERGY PROJECTS UNDER PREPARATION

Project	Project Description	Proposed Amount (\$m)	Status	Project Manager
Emergency Gas System Reconstruction (BA-PE-44391)	The project will finance (i) reconstruction of the transmission pipeline as well as the distribution system in Sarajevo, including conversion of tens of thousands of self-made connections into industry standard connections; (ii) institutional strengthening; and (iii) improvement of sector finance.	15.0 (IDA).		M.-T. Schurrer
Second Electric Power Reconstruction (BA-PE-45483)	The project will finance rehabilitation of hydro and thermal power stations and transmission and distribution networks.	25.0 (IDA).	Preappraisal has been completed.	R. Hamilton

B U L G A R I A

COUNTRY INFORMATION

The transitional recession in Bulgaria was deeper and longer than that of most other transitional economies. Bulgaria's external trade flows and output suffered a severe downturn. Output declined for five years, and growth did not resume until 1994. The 30% cumulative decline in output was followed by a rapid increase in unemployment which reached nearly 20 percent, one of the highest levels in Eastern Europe. External events—the Gulf War, the disintegration of the Council for Mutual Economic Assistance (CMEA), and embargoes on neighboring countries and important trading partners—accounted for some of the output decline. Political instability, uneven implementation of reforms, and 'stop-go' cycles in macroeconomic policies also contributed significantly to the severe downturn and slow recovery.

Bulgaria's initial reform program in 1991 was bold and ambitious, including comprehensive price, trade and foreign exchange liberalization, restitution of land and urban property, initiation of privatization, and demonopolization of segments of the large enterprise sector. Strong stabilization policies were initially successful in containing budget deficits and inflation. And the newly liberalized environment for private business fostered an unprecedented entry of new private firms, primarily in services and trade. Periods of tight macroeconomic policies have been followed by a rapid loosening of policies, leading to high and variable inflation. Erratic macroeconomic policies have also led to dramatic exchange rate depreciations. Both high inflation and large exchange rate movements have undermined credibility in economic management. This situation deteriorated sharply in 1996. The public began to lose confidence in the Bulgarian banking system which had remained state owned and was financing the losses of the state owned enterprises. This loss of confidence resulted in large withdrawals of deposits and a sharp decline in

the value of the Lev as the public sold Leva to buy hard currency. This situation continued to spiral downwards until January 1997 when the ruling Socialist Government was forced from power by strikes and protests. New elections were held in April 1997 and a market-oriented government came to power and in July 1997 put into place a currency board. The currency board has greatly helped to stabilize the country with inflation falling sharply and the Lev stable against the German mark. However, the Government must deal rapidly with some of the underlying structural problems or the achievements of the currency board could be put into question.

BULGARIA — BASIC INDICATORS				
Population mid-1993 (millions)	8.9			
	1993	1994	1995	1996 (estim)
GNP per capita (US\$)	1,110	1,163	1,340	1,190
Annual GDP Growth (%)	-1.5	1.8	2.6	-7.5
GDP Inflation (%)	51.1	71.6	62.6	123.0
Total Debt/GDPmp (%)	180.1	213.3	96.5	184.4

BANK'S STRATEGY

The Bank's primary objective in Bulgaria remains largely unchanged: to facilitate the country's transition to a market economy in order to achieve long-term growth in a sustainable, non-inflationary environment. The Bank's assistance is focused on five areas:

- facilitating the transition to a market economy and the expansion of private sector activity through *structural reforms*; primarily enterprise reform (especially privatization) and banking reform;
- supporting *macroeconomic stabilization* to lower inflation further and sustain a viable balance-of-payment position;
- establishing *financially viable and effective social sector policies and institutions*, including a social safety net;
- rebuilding and rehabilitating Bulgaria's *infrastructure* and improving the environment; and
- *improving the effectiveness of the Bank's operations* through improvements in public

BULGARIA — ENERGY SECTOR INDICATORS

Energy Resources

Oil Reserves (mln tons)	Neg.
Coal Reserves	
2.5 bil tons (lignite)	

Energy consumption per
capita 2,438 kgoe

Power Generation Capability
13,000 MW

BANK'S TEAM

KENNETH LAY,
COUNTRY DIRECTOR
(H8-093, X33000)

DAVID CRAIG,
ENERGY SECTOR LEADER
(H5-041, X32589)

JAMES MOOSE,
PRINCIPAL ENERGY
ECONOMIST
(H5-071, X33563)

administration and project preparation and identification.

ENERGY ISSUES AND POLICIES

The Bulgarian economy is characterized by a high degree of energy intensity combined with a lack of energy resources. For example, the World Bank Atlas shows that the country has had an energy intensity ratio of one dollar of GDP used per kilogram of oil equivalent used. This compares with \$4.4 per kilogram in France or \$3.5 in the UK. This relatively high energy intensity is due to the fact that: 1) Bulgaria's economic strategy until 1990 centered on energy intensive industries; 2) the technology used in Bulgarian industry is generally less energy efficient than technology used in the West; 3) there are high losses in certain energy subsectors, such as, district heating; and 4) households use energy ineffectively due to poor insulation and weatherization of housing. The economy is also characterized by a lack of energy resources with the only significant resource being a large high sulfur lignite deposit which is used to generate electricity. To offset the country's lack of resources, Bulgaria constructed a large nuclear complex with six reactors at Kozloduy on the Danube. This nuclear plant produces about 45% of the country's electricity, but its older reactors are considered unsafe by many experts.

The previous Government developed a comprehensive strategy for energy development. The strategy proposed rehabilitation of existing facilities, further price increases and energy conservation measures, as well as substantial new investments. The investment costs of this program totaled about US\$2 billion. However, the program involved the operation of all units of the Kozloduy nuclear facility until the end of their operational lives and possibly investment in an unfinished nuclear facility, which was started almost a decade earlier. As

the continued operation of some units of the Kozloduy nuclear facility poses risks and it is unclear whether construction of a new nuclear facility fits into a cost investment plan, external financial support for much needed improvements to Bulgaria's energy sector was not forthcoming.

The new market-oriented Government is preparing a new strategy which will involve a larger role for the private sector but is not yet complete.

ENERGY SECTOR STRATEGY

In the energy sector, the Bank has three main objectives. First, support the rehabilitation of Bulgaria's energy sector, especially the electricity and district heating subsectors, to improve efficiency and lower costs. Second, assistance financing priority investments in electricity generation to enable the phasing out of old nuclear facilities. Third, encourage the Government to increase and depoliticize energy prices, especially electricity prices, so that these prices are aligned with economic costs. This would help to reduce energy consumption and allow the National Electric Company (NEK) to fund its needed rehabilitation and safety investments and the district heating companies to cover costs. Fourth, privatize the commercially attractive parts of the sector. Further support is planned for the heating subsector and in power. First, a District Heating Study has been prepared for the financial and physical rehabilitation of a part of this sector and it identifies the key issues to be addressed under the proposed Loan. If an appropriate strategy can be agreed, a District Heating Loan is planned for FY99 to address structural problems in the heating service sector. Finally, an Adaptable Lending Loan is planned to rehabilitate and privatize certain existing electricity power stations. This operation is currently scheduled for FY99-FY2000.

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Effective Date	Revised Amount	Closing Date	Task Manager
Energy Project (LN No. 35630)	The objectives of the project are to: (a) improve the operating efficiency and reliability of the power system; (b) reduce the need for electricity imports or other high cost electricity sources to meet peak demand; (c) realign electricity tariffs to rationalize the consumption of electricity, reduce pollution associated with electricity production and mobilize resources for NEK; (d) improve voltage and frequency control; (e) enhance the operational and organizational efficiency of NEK; (f) improve and depoliticize the electricity tariff setting mechanisms; and (g) improve the safety of the Belmeken and Chaira dams.	08.11.93	93.00	12.30.99	J. Moose
District Heating Pilot (Amendment to Water Companies Restructuring Project) (LN No. 37390)	This component is a pilot operation designed to provide essential information on consumption of district heat. This information will be used to: a) design comprehensive system rehabilitation project; b) improve system operations; and c) assist consumer decision-making by providing them with information on the quantity of heat they use.		12.00	06.30.02	J. Moose

ENERGY PROJECTS UNDER PREPARATION

Project	Project Description	Proposed Amount (\$m)	Status	Project Manager
District Heating (BG-PE-8314)	The project will assist with the rehabilitation of the Sofia and Pernik District heating systems and add cogeneration capacity to these systems.	100.0	Project preparation is under way.	J. Moose
Restructuring/Adaptable Lending (BG-PE-08321)	The project will support the restructuring and privatization of the NEK - probably through one or more guarantees of PPAs.	100.0	Project preparation is under way.	J. Moose

C R O A T I A

COUNTRY INFORMATION

Croatia is the second richest of the former Republics of Yugoslavia, with a GDP of about US\$19 billion in 1996. The structure of output is similar to that of a Western economy, with manufacturing accounting for only 30 percent of GDP¹, agriculture for 10 percent, and services for 60 percent. Exports and imports of goods and services total the equivalent of 90 percent of GDP, making Croatia one of the most open economies in Central Europe. An estimated 70 percent of trade is with Western economies.

THE BANK GROUP'S STRATEGY

The Bank will remain cautious in moving ahead with an assistance program, carefully monitoring the regional situation, which is still a cause for concern. However, the GOC has made progress over the last year to maintain and further its standing with the international community, as well as advance its difficult economic reform program. In the absence of a major deterioration in the region's geopolitical situation, the time appears to be right for major international and bilateral efforts to assist Croatia.

CROATIA — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1993 (millions)	4.5			
GNP per capita (US\$)				3,830
Annual GDP Growth (%)	-2.5	6.0	2.6	4.8
GDP Inflation (%)	1532.4	92.4	8.0	3.2
Total Debt/GDPmp (%)	53.2	22.9	23.5	31.7

Croatia's enterprise sector has experienced a profound transformation over the past five years. The private sector share in sales of employment, which was less than 5 percent in 1990, had grown to about two-thirds by 1995. This evolution is

due to the full liberalization of entry requirements, after independence and to the privatization of about half of the "socially-owned" enterprise sector. Despite the initial success of stabilization, a number of developments indicate that the macroeconomic situation remains unsettled. Domestic demand, particularly consumption, has been the main driving factor of growth. Consumption growth, in turn, has been fueled by a substantial rebound in real wages, which has grown by some 40 percent since the beginning of 1994. Croatia needs to achieve and sustain higher growth rates in order to recover its pre-independence GDP level and accommodate growing demands from the society. This prospect is not unrealistic, if regional tension continue to subside, and the much-needed increase in investment levels is made possible by a swift implementation of structural reforms on the fiscal and supply side.

The excellent dialogue has already been established, both on the economic front and in several major sectors, to implement a broad-based strategy that assists Croatia in bringing its economic reform program to fruition. The Bank's assistance strategy envisions a broad-based assistance program emphasizing the three main themes of the government's reform program: reforming public finance, encouraging private sector growth, and rebuilding and upgrading infrastructure. Because of high resource needs due to the effects of war, the need for the restructuring, and scarce external savings, the Bank envisions some front-loading of its effort over the next few years, followed by a gradual decrease as Croatia regains fuller access to international financial markets.

ENERGY POLICIES AND ISSUES

Primary energy products in Croatia are coal, fuel wood, crude oil, natural gas, and hydropower. Natural gas and hydropower production grew over the last few years, while oil and coal production declined. The primary energy production is not sufficient to meet total energy demand, although in some subsectors produced energy is exported. In 1995, 62.2 percent of energy demand was satisfied from domestic sources. In 1995 energy consumption per capita equaled 1,625 kgoe.

The major part of the Croatian energy sector is organized in two capital-intensive companies — INA and HEP — joint-stock companies fully owned by the state. Energy producing enterprises include thermal power plants, hydropower plants, public and industrial heating plants, petroleum refineries, NGL plants, and gasworks. All existing transmission lines have been affected by the war and still need reconstruction and repairs. In the long-term perspective, Croatia's fuel sources are not sufficient for general consumption or for electricity generation, so imports and regional cooperation are needed to satisfy current and future demand.

BANK'S STRATEGY WITH REGARD TO ENERGY ISSUES

Since 1992, the Bank has supported the rehabilitation of power transmission and distribution systems through the Emergency Reconstruction Project. It is also supporting power sector restructuring, privatization and establishment of a new regulating framework through the Enterprise and Financial Sector Adjustment Loan. The power and heat supply sector offers scope for constructive Bank involvement since: (a) rehabilitation and development of this sector are critical to the construction of the Croatian economy; (b) investment requirements are large; and (c) the sector is facing other issues, such as restructuring and privatization, financial problems and energy pricing defects.

¹ Major subsectors include: shipyards, textiles, oil, chemicals and agroindustries.

CROATIA — ENERGY SECTOR INDICATORS

Energy Resources

Gas Reserves	38.9 mcm
Oil Reserves	20.0 mcm
Coal Reserves	39.9 mln tons
of which lignite:	33.3 mln tons

Energy consumption per capita

1,625 kgoe

Power Generation Capability

3,670 MW

BANK'S TEAM

MS. ARNTRAUD HARTMANN,
COUNTRY DIRECTOR
(H12-021, x80523)

MR. HENK BUSZ,
ENERGY SECTOR LEADER
(H5-055, x32686)

MR. WEIGONG CAO,
CONSULTANT
(H5-213, x32691)

C Y P R U S

COUNTRY INFORMATION

Since 1974 hostilities, Cyprus is divided into Greek and Turkish parts separated by UN buffer zone. The Greek Cypriot economy is small and prosperous, but highly susceptible to external shocks. Industry contributes 25 percent to GDP and employs 26 percent of the labor force, while the service sector contributes 70 percent to GDP and employs 62 percent of the labor force. After surging 9.7 percent in 1992, economic growth slowed to 1.6 percent in 1993 — its lowest level in two decades — because of the decline in tourist arrivals associated with the recession in Western Europe, Cyprus' main trading partner, and the 1994 and 1995, as inflation fell from 4.6 to about 3 percent.

There are currently three project under supervision (US\$ 71.6 million total). None of them are in the energy sector, and there are no projects in energy sector under preparation.

CYPRUS — BASIC INDICATORS

	Greek Area	Turkish Area
GNP per capita (US\$ 1995)	13,000	3,900
Inflation Rate (CPI)	3%	215%
GDP Real Growth Rate (1995)	5%	0.5%
Unemployment Rate (1994)	2.7%	1.6%
Power Producing Capacity	550,000 kW	
External Debt (1994)	\$1.4 bln	

The Turkish Cypriot economy has less than one-third the per-capita GDP of the south. Because it is recognized only by Turkey, it has difficulty arranging foreign financing, and foreign firms have hesitated to invest there. The economy remains heavily dependent on agriculture and

government service, which together employ about half of the work force. Moreover, the small, vulnerable economy has suffered because the Turkish lira is legal tender. Economic growth sharply dropped during 1994 because of the severe economic crisis affecting the mainland, and inflation soared to 215%. To compensate for the economy's weakness. Turkey provides direct and indirect aid to nearly every sector; financial support has risen and now equals in value about one-third of Turkish Cypriot GDP.

C Z E C H R E P U B L

ECONOMIC CONDITIONS

After growing at a rate of 6 percent in 1995, the economy grew at slightly over 4 percent in 1996. A low growth of no more than 3 percent is expected this year and unemployment rates remain low as well. Inflation has remained at levels below 9 percent and is expected to be at 9-10 percent in 1997. The key negative development of 1996 was the deterioration of the current account from a deficit of 3 percent of GDP in 1995 to a deficit of 8.6 % of GDP in 1996. Foreign direct investment decreased from about US\$2.5 billion in 1995 to about US\$1.4 billion in 1996. The deterioration in the external accounts has been the result of strong growth of internal absorption, partly due to increases in wages and other incomes, at rates above productivity gains. Railway workers obtained an increase in wages of 17% in February 1997, the benchmark against which other public sector wage negotiations were framed. Government fiscal accounts registered a deficit of 0.13 percent of GDP in 1996, but fiscal accounts deteriorated in 1997. Future economic development will depend on the extent and effectiveness of enterprise restructuring, the degree of continued reorientation of exports to market economies and particularly on the decisiveness with which the structural deficiencies of the financial sector are addressed.

ROLE OF THE BANK GROUP

Following the "Velvet Revolution" in November of 1989, Czechoslovakia began a systematic transformation aimed at radically changing its command economy into a market economy. The transformation was unique in the country's history and was strongly supported in free elections that took place in June 1990. The newly elected Government launched its economic transformation program at the beginning of 1991. Instead of imposing a detailed timetable for this transformation, the authorities decided first and foremost to remove the obsta-

cles that impeded the spontaneous evolution of the markets and private property.

To support the Government's program, in June 1991 the Bank prepared a SAL for US\$ 450 million equivalent, conceived as part of the response from the international community to support Czechoslovakia's reforms. The SAL was cofinanced by the EXIMBANK (Japan) in the amount of US\$ 200 million. The international support also included an IMF arrangement (SDR 620 million stand-by) as well as financial assistance from the G-24 countries. The SAL was designed as a balance of payment support during the early years of the transformation and disbursed in tranches. Following the dissolution of the Federation in December 1992 the third tranche was to be partially disbursed to the Slovak Republic. The objectives of the SAL — supporting policies in price and trade liberalization, privatization and commercialization of state-owned enterprises, deregulation and competition — were generally achieved. The same was true for the financial sector — supporting legal and institutional reform measures, as well as the preparation of restructuring efforts in the banking sector.

In general, the program supported by the SAL was successfully implemented by the Czechoslovak authorities in 1991-92 and after the dissolution of the Federation in 1993 by the Czech and Slovak Republics. When the loan had closed in mid-1993, both countries had advanced in their path towards market economy. Thanks to the reform policies, the private sector expanded and now plays a major role in both economies, producing about 60 percent of GDP in 1996. Income and employment levels have been rising since the initial decline in 1990-93. With increased access to the international markets, both countries have been hesitant to commit themselves

to further operations by the Bank over the last few years.

ENERGY SECTOR ISSUES AND POLICIES

Within the scope of the SAL mentioned above, the Bank established energy policy conditionalities for the country. In general, the Bank's strategy was to support institutional and regulatory reforms, combined with competitive pricing. In 1992, a comprehensive Energy Sector Review was prepared for Czechoslovakia. At the same time, and due to the similarities of the issues involved, a Joint Environmental Study was compiled at the request of the Government. The study was a joint effort of the Federal, Czech and Slovak Governments, the European Community, the United States and the Bank.

The main energy policy goals identified in the Energy Sector Review were to:

- Maintain the level and relative structure of energy prices;
- Establish a regulatory framework for natural monopolies to ensure efficient operation, long-term pricing and promote private sector participation;
- Establish a schedule for liberalizing prices of tradable energy products;
- Promote energy conservation and efficiency;
- Reform the taxation policies applicable to energy to encourage conservation and to reduce environmental problems;
- Rationalize the power sector investment program to ensure least cost development;
- Restructure the coal sector by closing high-cost mines and promoting privatization of the remaining mines;
- Diversify crude oil and natural gas sources and strengthening the strategic role of the CFSR in the European energy network; and
- Implement measures to reduce the level of air and water pollution created by the energy sector, and encourage the use of less polluting fuels.

Most of these issues, with a varying degree of success, have been tackled in the meantime by the Government in both the Czech and the Slovak Republics. Energy prices have been raised and are closer to economic levels, both for gas, power and district heating. This has contributed to some energy conservation, although some price discrepancies and cross subsidies among consumer categories are still present. On the institutional side, the Government has unbundled the power and gas sectors, with strict separation between generation and distribution functions. Furthermore, a small Regulatory Agency has been established at the Ministry of Industry and Trade to regulate gas and power prices to final consumers. A broad-based Energy Law was enacted in 1994, pending detailed secondary legislation for its full implementation.

BANK GROUP ASSISTANCE IN THE ENERGY SECTOR

As an instrument to assist implementing the strategies above, in 1992-93 the Bank prepared the Power and Environmental Improvement Project — Loan 3474-CZ. Initially conceived for both parts of the Federation, it was redirected to the Czech Republic only, with an indication that an energy sector project for the Slovak Republic could follow at a later stage. This operation has not yet materialized and does not seem realistic at this stage.

BANK'S TEAM

ROGER GRAWE,
COUNTRY DIRECTOR
(BUDAPEST RM)

HENK BUSZ,
ENERGY SECTOR LEADER
(H5-055, X32686)

JULIUS WILBERG,
SR. FINANCIAL ANALYST
(H5-079, X37151)

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Board Approval Date	Loan/Credit Amount	Closing Date	Task Manager
Power and Environmental Improvement (LN No. 34740)	<p>The objectives of the project are to: improve power plant efficiency; reduce air pollution in northern Bohemia, thereby improving the environment and health of the local population; modernize the transmission system; and facilitate interconnection of the CEZ and German power grids. These objectives will be accomplished in the context of overall reform of the energy sector. To this end, the project will:</p> <p>(a) reduce total consumption of pollution-causing lignite through power plant efficiency improvements; (b) curtail power plant SO₂ emissions by means of flue gas desulfurization; (c) reduce dust and fly-ash pollution from power plants; (d) increase the reliability, efficiency and economy of the CEZ transmission system; (e) assist in improving investment planning and corporate management & organization.</p>	05.26.92	246.0	06.30.99	J. Wilberg

E S T O N I A

COUNTRY INFORMATION

The Bank's overall objective is to support Estonia's efforts to accelerate structural reforms and to undertake efficient investments in high priority sectors. This objective will be pursued through a combination of lending operations, analytical sector work and aid coordination.

ENERGY SECTOR POLICIES AND ISSUES

Estonian Government has issued an energy policy and strategy statement, which gives high priority to the energy sector as a pivotal component in its economic reform program. The basic objective of the energy policy is to provide reliable energy at the lowest possible cost, which will be attained through greater efficiency, reliability, diversity, environmental protection (including conservation), attraction of capital, and competition in sector activities. To attain these objectives, the Government's institutional structure will be modified in line with the new political and economic framework of the country applying the following key principles: separation of the policy making and regulating roles from those of ownership and management of enterprises, clear allocation of responsibilities and accountability among its agencies, decentralization of energy activities to the municipal level where possible, and sale to the private sector of those enterprises whose activities are not considered of strategic importance. In order to protect the consumer, the regulatory function of the Government will be carried out by autonomous agencies with transparent procedures in those cases where monopoly conditions still exist.

BANK'S STRATEGY

In line with its policy, Estonia's energy strategy has established the following priorities, in sequence of implementation: (i) to improve efficiency and reliability of existing systems through reduction of losses; (ii) to improve the diversity of energy fuels through the exploitation

of indigenous resources in order to reduce high-cost fuel imports and dependence on only one main fuel supplier (Russia); (iii) to rehabilitate existing facilities in order to improve efficiency and reliability; and (iv) to promote investment in new plants only when other priorities have been addressed. Within this strategy, the highest priority is for investments in the DH sector which is inefficient and most heavily dependent on imported oil and gas. To support this strategy, a National Energy Conservation Program was initiated during 1992 with the aim of converting small heat-only-boilers (<2 MW) in towns and counties throughout the country to use lower-cost, indigenous fuels and to promote end-user efficiency improvements in buildings. This program is currently being supported by a number of donors (EBRD, Swedish Government, Danish Government, G24) as well as through budgetary allocations of the Government. The proposed project represents further support for rehabilitation of DH systems in Estonia's major cities.

BANK'S TEAM

BASIL KAVALSKY,
COUNTRY DIRECTOR
(WARSAW RM)

HENK BUSZ,
ENERGY SECTOR LEADER
(H5-055, X32686)

CAROLYN GOCHENOUR,
PROGRAM TEAM LEADER
(H5-105, X39681)

PENTTI ARO,
DISTRICT HEATING AND
POWER ENGINEER
(H5-207, X87136)

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Board Approval Date	Loan/Credit Amount	Closing Date	Task Manager
District Heating Rehabilitation Project	<p>The Project would reduce fuel costs and import requirements, bring about energy efficiency and economy in major DH systems; improve environmental conditions in affected areas; and support the strengthening and restructuring of DH institutions and development of the energy sector. The Project would include support for:</p> <p>(a) conversion and replacement of small boilers in small towns and counties to use local fuels; (b) rehabilitation of DH systems in Tallinn, Tartu and Parnu; (c) improvement of Iru (CHP, Tallinn) Power Plant; and (d) institutional support program for restructuring energy agencies and for further development of the energy sector.</p>	05.26.94	US\$ 38.4 million	12.31.99	C. Gochenour

GEORGIA

COUNTRY INFORMATION

The economic decline in Georgia has been dramatic, even in comparison with other FSU countries. Since 1990, widespread conflicts in Abkhazia and South Ossetia have magnified the economic crisis resulting from the disintegration of the Soviet command economy in December 1991. The cumulative decline in recorded output for the period 1990-1995 is estimated at more than 70%. Lax fiscal and monetary policies led to large budget deficits and high inflation. Diminishing exports, due to shrinking export markets and falling domestic output, and deteriorating terms of trade driven mainly by the increasing costs of energy imports, quickly led to the accumulation of significant external debt and payment arrears. Throughout 1993 and 1994, much of industry was functioning at only 20% of capacity; heavy disruptions in agriculture took place; and tourism was shut down. The country was precariously dependent on EU and US humanitarian grain shipments. Georgia is still suffering from an energy crisis, as it is having problems paying for the necessary energy imports.

Georgia is pinning its hopes for recovery on reforming the economy along open market lines, reestablishing trade ties and on exploiting its advantageous geographical position by developing international transport through the key Black Sea ports of Poti and Batumi.

reform the economy, including: stricter monetary control; fiscal reforms with new tax measures and reduction of subsidies; strengthening the financial sector; acceleration of privatization process; further liberalization of prices, foreign exchange and trade regimes; and maintenance of a minimum social safety net. Implementation of the program has been supported by the IMF and the World Bank. Achievements have been impressive, with sharp reductions in inflation, stabilization of the currency, and renewed economic growth.

THE BANK GROUP'S POLICY

The World Bank's lending experience in Georgia dates from FY95, but already ten projects have been approved. Seven projects are under implementation, two have closed, and one recently approved is not yet effective. Three operations were approved in FY95: an Institution Building Credit of US\$10.1 million equivalent (July 5, 1994), a Municipal Infrastructure Rehabilitation Credit of US\$18 million equivalent (November 8, 1994), and a Rehabilitation Credit of US\$75 million equivalent (March 30, 1995; closed). Following strong implementation of the Government's 1995 economic reform program supported by the Rehabilitation Credit, a Structural Adjustment Credit of US\$60 million equivalent (April 18, 1996; closed), aimed at deepening structural reforms, was approved, along with a Structural Adjustment Technical Assistance Credit of US\$4.8 million equivalent (April 18, 1996) to facilitate implementation of these reforms through provision of technical assistance. Two investment projects were approved in FY96, one in the transport sector in the amount of US\$12 million equivalent (January 18, 1996) to cover urgent rehabilitation needs, and the other in the health sector in the amount of US\$14 million (April 25, 1996) to assist in the implementation of the Government's ambitious health sector reform

GEORGIA — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1993 (millions)	5.4			
GNP per capita (US\$)				850
Annual GDP Growth (%)	-25.4	-11.4	2.4	
GDP Inflation (%)	11778.4	9350.5	162.7	40.2
Total Debt/GDPmp (%)		89.4	40.7	34.5

The severe economic decline has been caused largely by the break-up of economic ties with other FSU republics and by ethnic and civil strife Georgia has suffered since independence. A cease-fire went into effect in South Ossetia in 1992, and in Abkhazia in 1994, improving the political situation. The government introduced a program to stabilize and

program. Three operations were approved in FY97: an Agriculture Development Project of US\$15 million equivalent (March 25, 1997), an Oil Institution Building Technical Assistance Project of US\$1.4 million equivalent (April 8, 1997), and a Power Rehabilitation Project of US\$ 52.3 million equivalent (June 3, 1997). Georgia is also benefiting from the GEF-funded Black Sea Environmental Program.

ENERGY SECTOR ISSUES AND POLICIES

Power Sector. The main objectives of the Government policy in the power sector in the short-term are to increase power supply and improve collection of payments, the two major premises for resolving the current energy crisis which is constraining economic recovery and causing hardship to the population. The first objective is to be achieved mainly through rehabilitation projects, which would recover the production capacity — lost by lack of maintenance and improper operation of the existing facilities — and improve supply efficiency. Several rehabilitation projects have already been initiated or are under preparation, all financed by the international multilateral and bilateral agencies. The second objective — improved collections — would also lead to immediate improvement in power supply by enabling more financing of fuel and electricity imports. Furthermore, improved collections are the necessary element to any sustainable strategy to arrest the energy crisis and recover the sector.

The Government of Georgia, with assistance from various multilateral and bilateral agencies — including World Bank — has been developing a reform strategy for the sector, which addresses its institutional, financial, and structural problems and which is aimed at creating an environment conducive to privatization of the power sector. The main objectives, principles and policies of this strategy are outlined in the Government's Letter of Sector

Development Policy (LSDP), which states that the reform of the power sector will be based on: (i) corporatization, commercialization and decentralization (unbundling) of the power industry; (ii) implementation of commercial practices and enforcement of payments; (iii) economic pricing of electricity with due regard to poor residential users; (iv) establishment of a legal and regulatory framework to promote competition and private sector participation, including instituting an independent regulatory agency; (v) optimization of the use of resources by fostering least cost development plans; (vi) focusing investments in the short and medium term on the economic rehabilitation of existing facilities and completion of economically viable but partially completed projects; (vii) promotion of efficient use and conservation of electricity; and (viii) protection of the environment in electricity, production and use. The sector has already been unbundled into distribution, transmission and generation enterprises, most of which have been corporatized. A new electricity law was enacted in mid-1997, codifying a new power industry structure, promotion of competition, private ownership, and establishment of an independent regulatory agency. The regulatory agency has been set up, and the Government is initiating privatization of distribution and generation companies.

Oil Transport. On October 9, 1995 it was announced that Georgia would be the one of two transit countries (along with Russia) for "Early Oil" from the first phase of exploitation of crude petroleum under the Caspian Sea by the Azerbaijan International Operating Company (AIOC), a consortium of 12 oil companies. The Georgian International Oil Corporation (GIOIC) was created on November 11, 1995 as a state-owned enterprise to act as AIOC's counterpart in Georgia. In the first year of its existence, GIOIC has developed significant capacity, but much remains to be done

BANK'S TEAM

JUDY O'CONNOR,
COUNTRY DIRECTOR
(H12-113, x38513)

JANN MASTERSON,
OPERATIONS ANALYST
(H5-110, x35005)

DAVID CRAIG,
ENERGY SECTOR LEADER
(H5-041, x32589)

AKIN ODUOLOW,
PRINCIPAL ENERGY
SPECIALIST
(H5-099, x32295)

JONATHAN WALTERS,
TEAM LEADER
(H5-243, x32468)

VLADISLAV VUCETIC,
POWER ENGINEER
(H5-247, x33977)

MANUEL DUSSAN,
CONSULTANT
(H5-215, x33256)

SALMAN ZAHEER,
ENERGY ECONOMIST
(H5-249, x39477)

SUREKHA JADDOO,
ADMINISTRATIVE ASSISTANT
(H5-236, x32363)

if Georgia is to realize its full potential as a transit country. In particular, Georgia is one of the transit options for major export pipelines, i.e. development of large-scale export from the Caspian region beyond Early Oil. In addition, other oil developers in the region — such as Chevron developing the Tengiz field in Kazakstan — are considering Georgia as one of their transit options. However, substantial institution building will be needed if GIOC is to provide the Government of Georgia the technical support it needs in any negotiations for a major export pipeline.

Gas Sector. The Government intends to reform the gas sector along the similar principles as in the power sector: vertical unbundling of the activities (production, transmission, distribution), open access, development of new legal and regulatory framework, financial rehabilitation and privatization of the industry. The investment priorities are rehabilitation of the physical infrastructure, and exploration and development of new gas fields.

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Effective Date	Revised Amount	Closing Date	Task Manager
Power Rehabilitation Project (C29580)	(i) Rehabilitation of a 300-MW unit (unit 10) at the Gardabani thermal power plant, operated by the Tbilisres joint-stock company; (ii) Increase in working capital at the Tbilisres joint stock company to finance the increase in fuel reserves at the Gardabani thermal plant; (iii) Technical assistance to Tbilisres	06.03.97	52.3		V. Vucetic
Oil Institution Building (C29440)	Components: (a) A feasibility study (by international consultants collaborating with Georgian counterparts) of a major oil export pipeline from Baku, Azerbaijan to Supsa, Georgia and of related terminal and storage facilities at Supsa. (b) A training fund of US\$ 250,000 to finance Georgian participation in formal training courses in Georgia and abroad, and on-the-job training in international companies in the oil industry. (c) Negotiations advisors. (d) Project management services to be provided in kind by GIOC.	04.08.97	1.3		J. Walters

ENERGY PROJECTS UNDER PREPARATION

Project	Project Description	Proposed Amount (\$m)	FY	Status	Project Manager
Power Sector and Gas Restructuring (no task ID yet)	Investments include rehabilitation of power and gas infrastructure in support of establishing efficient markets and facilitate privatization (transmission and distribution, dispatch, metering, financial and accounting systems). The project includes also technical assistance for market reforms and privatization of the electricity and gas industries.	30.0	1999	At the initial stage of preparation.	J. Walters

HUNGARY

COUNTRY INFORMATION

Hungary experimented with market-type reforms much earlier than other formerly centrally planned economies. These efforts were successful in building up some of the basis of the legal and institutional framework for a market economy. However, the authorities did not respond appropriately to the emergence of internal and external disequilibria. Up to early 1993, the welfare system was left virtually intact, and two-thirds of the state's assets remained to be privatized.

In March 1995 the Government announced a set of measures aimed at stabilizing the economy, including substantial cuts in fiscal expenditures, increases in fiscal revenues, devaluation of the forint, followed by a pre-announced crawling peg, and a strict wage policy. These measures contributed to a significant improvement in the country's external position, as indicated by a reduction in the current account deficit to US\$2.5 billion in 1995 (5.6% of GDP). Despite a strong fiscal contraction, the slow recovery in GDP has been sustained. The stabilization program is being sponsored by an IMF Stand-By Loan, which was approved in March 1996. The stabilization measures have included structural reforms, including an acceleration of the privatization of state-owned banks and companies.

HUNGARY — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1993 (millions)	10.2			
GNP per capita (US\$)	3,350			4,180
Annual GDP Growth (%)	-0.6	2.9	1.5	0.2
GDP Inflation (%)	21.3	19.5	24.1	21.0
Total Debt/GDPmp (%)	90.0	87.7	86.3	78.8

Hungary's economy shrank by more than 18 percent by 1995, reducing real national income to its late 1970's level. With all the other Central European economies, Hungary's economy began to grow again in 1994. The long awaited bottoming-out of output appears to be broad-based. Production

has recovered in all sectors of the economy except mining, which is still undergoing a deep restructuring. On the demand side, private consumption has begun to rise mainly due to income gains from small business activities and wage increases in the public sector. Unfortunately exports have not yet provided the primary stimulus to recovery in Hungary. Economic growth in 1994 was based, to a larger extent than in the other countries, on expansionary fiscal policies and is therefore more fragile. More specifically, the downsizing of the state sector will have to be at the center of the Government's reform agenda over the next few years. Growing tension has emerged between a private sector that is trying to exploit the opportunities of the new environment, and a public sector that has been slow to adjust the old budgetary and incentive structures to the new system.

THE BANK GROUP'S STRATEGY

The rapid macroeconomic deterioration and the slow down of structural reforms have prevented us from maintaining a strong program of financial assistance with Hungary. In FY96-99, given Hungary's current needs, the Bank's emphasis will be on helping to design the second phase of structural reforms. In particular, the Bank's program of support would have the following broad objectives: (i) to help Hungary maintain macroeconomic stability and accelerate its growth to facilitate EU accession; (ii) to strengthen and privatize Hungary's financial sector and enterprises; (iii) to reform social policies and develop human resource capacities; (iv) to improve environmental management; and (v) to attract private infrastructure finance and direct investment.

The full range of Bank lending and non-lending instruments would be directed towards supporting these objectives, including: policy discussions, a research program (DEC), coordination with the IMF, ESW, Bank adjustment lending, investment lending and, possibly, sin-

gle currency loans, and enhanced supervision via the Budapest Hub, as well as the administration of international and bilateral (trust) funds, and coordination with NGOs and collaboration with IFC and MIGA in key areas.

On the lending front, the Government's March 1995 emergency package, if followed up, as planned, with appropriately deep structural measures mid-year (supported by an IMF Standby) provides the basis for a major program of Bank adjustment lending. Several pieces of economic and sector work (a CEM, a Private Sector Assessment, and a review of Agricultural Policy and a soon-to-be-completed Poverty Assessment) provide us with the underpinnings for the design of adjustment programs.

We will also continue to work on a lending program of medium-sized investment projects and seek to catalyze private sector financing for infrastructure projects through, inter alia, contractual compliance guarantees. But, it may not be easy to develop a pipeline. Public investment has been severely squeezed due to fiscal stringency, reducing counterpart funding for possible Bank-supported projects. In addition, Hungary's high level of public debt suggests that wherever possible, private sector financing, not sovereign debt, should be its financing vehicle of choice. Hungary's desire to integrate quickly with Europe has also led to its emphasizing the development of deeper financial ties with European institutions such as the EIB and EBRD, both of which are very active in the infrastructure sectors. Thus, in many sectors where the Bank might normally be a central player, our involvement is likely to remain modest in Hungary. Deeper involvement is likely in sectors such as environment, municipal investments, and human resources, and more difficult areas as railroad restructuring. These factors jointly give rise to an investment lending program which will essentially try to complement the efforts and involvement

of the European financiers and domestic investment, and, given Hungary's already very high debt burden, will purposefully remain modest in size.

ENERGY SECTOR ISSUES AND POLICIES

The main domestic energy resource is coal; other energy resources are very limited, including hydropower, low temperature geothermal water and others. In the aggregate, imports accounted for 48% of energy requirements in 1995. The share of imports is bound to increase given the declining production of the coal mines. Over the 1990-1995 period, energy demand declined from 29.1 MM toe to 25.0 MM toe. Energy intensity, at about 0.9 kgoe/US\$ of GNP is still high by international standards. In recent years the Government has liberalized imports and eliminated price controls on coal and petroleum products. Significant sales taxes are in effect for gasoline and diesel oil. Regarding the grid industries tariffs are regulated: (i) with respect to electric power and natural gas, the Government sets the tariffs; and (ii) with respect to district heating, the Government sets the producer prices (prices vary from plant to plant as they are cost-based) and the municipalities, usually the owners of the distribution systems, the retail prices. In recent years the Government's strategy has been characterized by: (i) a reduction of the State's role in the sector to the minimum and necessary levels; (ii) diversification of the mix of imports; (iii) price liberalization; (iv) assertion of environmental priorities in the sector; (v) involvement of the public in energy investment decisions; and (vi) improvements in energy efficiency. An important objective of the above strategy has been to integrate Hungary into the Western European energy system, in preparation for joining the EU.

HUNGARY — ENERGY SECTOR INDICATORS

		Self-reliance
Coal Reserves		75%
Hard Coal	0.7 bln tons	
Brown Coal	1.0 bln tons	
Lignite	3.0 bln tons	
Oil Reserves	10 MM toe	22%
Gas Reserves	38 MM toe	42%
Installed Power Generation Capability	7,350 MW	

BANK'S POLICY REGARDING THE ENERGY SECTOR

Since 1983 the Bank has made eight loans for energy related activities in Hungary, including two for the development of hydrocarbon resources; three for energy conservation, and three for power projects. In recent years the Bank has been supportive of the Government's efforts to restructure the power sector and privatize the power utilities, which by mid-1996 had yielded US\$1.3 billion (for about a third of the sector's assets). The Bank has consistently supported the integration of the CEN-TREL member countries into the UCPT network. Terms of Reference for in-depth inter-connection studies were offered by the Bank at several meetings of the relevant European Union and OECD committees.

BANK'S TEAM

ROGER GRAWE,
COUNTRY DIRECTOR
(J10-133, x34252)

WEIGONG CAO,
CONSULTANT
(H5-213, x32691)

HENK BUSZ,
ENERGY SECTOR LEADER
(H50-055, x32686)

MARC HEITNER,
PRINCIPAL ENERGY
SPECIALIST
(H10-033, x85836)

RICHARD HAMILTON,
SR. ENERGY ECONOMIST
(H5-107, x32344)

HELMUT SCHREIBER,
SR. ENVIRONMENTAL
ECONOMIST
(H3-107, x36910)

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Effective Date	Revised Amount	Closing Date	Task Manager
Energy Development (LN No. 30560)	Project objectives are to support: (i) significant improvements in the policy and institutional framework of the energy sector including appropriate pricing, coupled with subsidy elimination, restructuring of the coal mining sector and improved investment planning in the power subsector; (ii) development of the oil and gas sector through gradual restructuring of the national oil and gas company (OKGT), opening up the sector to foreign investment, an improved petroleum taxation and regulatory framework, and financing of priority investments; and (iii) preparation of an updated energy conservation program and financing of related investments.	08.25.89	95.11	12.31.97	R. Hamilton
Energy and Environment (LN No. 37050)	The Project would support Hungary's reform program by mitigating the country's dependence on energy imports from a single source; by increasing efficiency, reliability and flexibility in the production of electricity and heat; and by establishing the necessary basis for strong interconnections with the Western European Power Pool. In addition, the Project would support continued environmental improvements in the power sector, and assist in improving institutional capabilities.	04.15.94	100.00	12.31.99	R. Hamilton
Quick Start Gas Turbine (LN No. 42050)	The project will finance about 200 MW of gas turbine power generating capacity to be installed at two distinct locations in Hungary.	07.22.97	60.00	06.30.99	M. Heitner

ENERGY PROJECTS UNDER PREPARATION

Project	Project Description	Proposed Amount (\$m)	FY	Status	Project Manager
GEF Biomass Project	The originally proposed project scope includes the modernization of the district heating systems and conversion of heat sources to use of biomass, with consideration of cogeneration.		1999	At the initial stage of preparation.	H. Schreiber (ESCRE)

R E P U B L I C O K A Z A K H S T A N

ECONOMIC CONDITIONS

Kazakhstan has undergone a difficult, but dynamic transition process since independence in December 1991. Annual inflation is down from over 1600 percent to less than 20 percent in prospect for 1997, output growth is up from minus 18 percent to 1.5 percent estimated for 1997, and budget and balance of payments deficits have been brought under control. A basic legal framework for the development of a market economy has been put in place. Almost all prices have been liberalized, with the exception of utility prices, which are being adjusted rapidly toward full cost recovery levels. Quantitative restrictions on trade have been virtually eliminated, tariffs are low, and tariff levels and dispersion are being reduced as Kazakhstan actively pursues membership in the WTO. Interest rates have been liberalized, in conjunction with a sweeping program to restructure banks and strengthen supervision and prudential regulation. Much of the economy has already been privatized, with rapid privatization of utilities and very large scale industry now in train. Kazakhstan embarked earlier this year on a sweeping program to reduce the size of the government and restructure it to better meet the needs of a market economy.

This impressive institutional transformation however has taken place against the background of large economic dislocations, marked by a sharp decline in GDP. Real GDP and wages in 1996 were an estimated 40 percent lower than their 1991 levels. Fixed investment flows have declined in real terms to about 30 percent of their 1991 levels. Wage and pension arrears are estimated at about

US\$1 billion and social dissent is increasing. At this stage, recovery in output is a critical factor for the sustainability of reforms and the successful transition to a market economy. Furthermore, with the framework of laws now in place for a market economy, the development of a system for administering them in a stable, predictable, transparent fashion remains to be addressed.

ROLE OF THE BANK GROUP

A Country Assistance Strategy (July 31, 1997), which was developed jointly with the IFC, targets Bank Group support to a limited number of niche areas in private sector development and social protection and social service delivery. These niches represent areas which the Government and the Bank Group believe have substantial policy content with high development payoffs and in which the Bank Group is either a lender of last resort and/or has a clear comparative advantage. In support of private sector development, these niche areas include analytical support on private sector development issues, legal reform, support for the development of agricultural support services and investment in agriculture and related activities, public sector reform, and infrastructure sector reform. In support of social protection and social service delivery, key niches include support analytical work on poverty, gender and labor markets, pension reform, and health sector restructuring. Non-lending services feature prominently in the strategy, reflected the Government's increasing demand for advice and Bank Group investment in this area during the past three years.

ENERGY SECTOR ISSUES AND POLICIES

The energy sector is central to the process of transforming Kazakhstan's economy. First, structural reforms in the sector are *sine qua non* for reform of the industrial sector. Currently, the energy sector accounts of about

REPUBLIC OF KAZAKHSTAN — BASIC INDICATORS

	1994	1995	1996
Population mid-1994 (millions)	16.8		
GNP per capita (US\$)	1,732	1,440	1,309
Annual GDP Growth (%)	-17.8	-8.9	1.1
Average Annual Inflation (%) (GDP deflator)	1,651	164	38
Total Debt/GDPmp (%)	10.0	12.5	13.3

30% of industrial output. Second, the energy sector, in particular, the oil subsector, represents the country's most promising source of exports and economic growth in the medium term. With the level of developed and producing reserves and the current pipeline of approved foreign investments in the sector, oil production could feasibly be doubled by the year 2005 from about 1% of proven reserves (about 22 million tons in 1996) to close to 2% of proven reserves (40 million tons per year). Lastly, unlike many other sectors of the economy, foreign investments into the energy sector have met with greater success. Foreign investments in 1997 are projected to reach US\$500 million; and this figure excludes major projects such as the Caspian Pipeline Consortium (CPC) and the Caspian shelf which alone is projected to attract about \$100 million. The Government has made great progress, particularly in the past three years, in formulating policies and setting up an appropriate framework of laws and regulations and, in the case of the subsectors with non-tradable outputs, in ensuring that macroeconomic conditions also are favorable to the earning and repatriation of adequate returns to investors' investments.

In March 1997, the Ministry of Oil and Gas was dissolved, and a new successor organization, National Oil and Gas Company "Kazakhoil", was established to take over the state's interests in the petroleum sector. In particular, Kazakhoil is reported to have taken control of the country's privatization efforts in the oil and gas sector, an effort previously assigned to the State Property Committee. The Government's restructuring of the sector has resulted in the divestiture of part of their equity interest in sector entities to foreign strategic investors through management contracts and partial ownership of the enterprise. The petroleum sector however would require an additional influx of foreign investment if Kazakhstan is to realize its potential and ambi-

tion to become one of the world's largest oil producers. Although important issues have been resolved with regard to CPC and an oil-swap agreement has been signed with Iran, it is expected that there will still be transport constraints on the country's ability to diversify export markets. Thus, delays in the flow of external financing would remain because of uncertainties about potential access to transport facilities for export of crude oil and natural gas to international markets. Furthermore, it remains to be seen whether the privatization program in the oil and gas sector will lead to efficient and financially viable enterprises and whether the restructuring of the sector will create the environment and provide incentives for organizations to be commercial. Many of these enterprises are still burdened with the responsibility for the staffing and financing of social services in their respective municipalities.

On the mining side, after a number of false starts that confused and alienated some foreign investors, the Government has pushed ahead with a large-scale process of privatization, which in the case of existing enterprises, has largely taken the form of management contracts. To date, Kazakhstan has nearly completed the process of selling off its open-pit coal mines. However, the underground mines in the Karaganda Basin in central Kazakhstan are still state-owned and are facing a financial crisis.

BANK GROUP ASSISTANCE TO THE ENERGY SECTOR

The Bank began its energy sector program of assistance to the Government in 1992 by designing a comprehensive program of technical assistance requirements in the sector and by mobilizing donor financing for such a program. This assistance was undertaken in conjunction with the Technical Cooperation Program under which the Bank initiated and completed work on a broad range of sector

REPUBLIC OF KAZAKHSTAN — BASIC INDICATORS

Energy Resources

Coal Reserves	22 billion tons
Oil Reserves	2.1 billion tons
Gas Reserves	1.6 trillion cubic meters

Energy consumption per capita

(kg of oil equivalent per person), 1994	3,710
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Installed Power Generation Capability

17,500 MW

BANK'S TEAM:

KIYOSHI KODERA,
COUNTRY DIRECTOR
(H3-001, X33544)

PETER THOMSON,
ENERGY SECTOR LEADER
(H5-093, X34261)

PETER POLLAK,
PRINCIPAL ENERGY
SPECIALIST
(H5-081, X81065)

BRENDA MANUEL,
CONSULTANT
(H5-242, X37915)

MAKSAT IDENOV,
CONSULTANT
(H5-210, X39396)

PATRICIA HACKMAN,
CONSULTANT
(H5-020, X80457)

policy issues covering petroleum legislation and taxation, energy pricing and petroleum sector restructuring. Since then, the Bank has provided support to the Government in developing a package of price, taxation and institutional reforms in the oil sector. This package was adopted under the Anti-Crisis Program and was implemented by the Government under the Structural Adjustment Loan (LN 3900-KZ). Supported by the elements of this Loan, the Bank's petroleum subsector strategy is being implemented through an inter-related program of investment lending and technical assistance operations. The Petroleum Technical Assistance (PTA) Project (LN 3744-KZ) supports initiatives to strengthen the management of the petroleum subsector and create the conditions necessary for the effective mobilization of foreign investment resources into the subsector. The Uzen Oil Field Rehabilitation Project (LN 4061-KZ) established that the rehabilitation of the large, mature field is viable using methods and yardsticks familiar to potential investors.² The Uzen Project was designed to: (i) finance the initial investment to rehabilitate the field and prevent further sharp deterioration of its physical condition; (ii) support the implementation of the investment program and expand knowledge of the operating and environmental condition of the field, including initiating a program to remediate past environmental damage; and (iii) support the training of Uzenmunaigas staff and strengthening of management systems. Other aspects of Uzen's rehabilitation program, including the systematic promotion of the field to outside investors and the restructuring and privatization of Uzenmunaigas, is being implemented under the PTA Project.

In the gas subsector, the Bank has assisted the Government in obtaining grant-financing for the elaboration of key investment issues in the subsector. Future Bank assistance in the gas subsector would focus on institutional and reg-

ulatory reforms to strengthen the incentives for efficient operations and investments and support private foreign financing. In 1994, the Bank identified a number of problems in the power subsector relating to the inefficient use of electricity and heat, pollution emissions, replacement of old and obsolete equipment, cost recovery and the financial viability of institutions in the subsector. In the past three years, the reliability of the subsector's performance both in provision of power to industry and heat to the population has deteriorated sharply. The subsector will require major investments in order to meet the challenges of maintaining a reliable and efficient power sector while mitigating its adverse impact on the environment.³ The financing of these investments may continue to present difficulties, given the limited prospects for generating revenues in foreign exchange, problem in collecting payments and the sector's low capacity to self-finance investments.

² In August 1997, the China National Petroleum Company (CNPC) has been awarded exclusive rights to negotiate a joint-venture agreement for the rehabilitation of the Uzen field.

³ There are agreements with foreign firms to purchase the giant Ekibastuz-1 and Karaganda-2 power plants, and a joint-venture has been established to build a new power plant in the Aktyubinsk region of western Kazakhstan. Many foreign companies have been involved in privatizing the power subsector, including the regional power distribution companies and the national power transmission grid, but the agreements with these firms are facing increasing problems. After an impasse with contract negotiations, the Government's framework agreement with ABB Power Grid Consortium, to operate and manage the electricity transmission grid in Kazakhstan, has been annulled. Privatization of regional electric companies are moving slowly with only one company, Almatyenergo, being sold to the Belgian utility, Tractebel.

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Effective Date	IBRD Loan Revised Amount US\$ mln	Project Cost US\$ mln	Closing Date	Task Manager
Petroleum Technical Assistance (LN No. 37440)	The Project consists of an institutional development component and a project preparation and implementation support component. The institutional development component includes: (a) advisory services for foreign investment negotiations and promotion; (b) support for petroleum industry restructuring and corporatization; and (c) petroleum industry training and training management. The project preparation and implementation support component includes: (a) pipeline feasibility studies; (b) assistance for a natural gas investment strategy; and (c) project implementation support.	09.08.95	15.7	17.5	12.31.98	P. Pollak
Uzen Oil Field Rehabilitation (LN No. 40610)	The Project will assist in rehabilitating the second largest oil field in the country by helping assess and improve the condition of reservoirs, clean up existing environmental damage and strengthen future environmental management of the oil field. The Project will also assist Uzenmunaigas, the oil field's operator, to reorganize into commercially viable corporate units, to privatize and to train staff in modern oil field operating practices and management. Related assistance in privatization and foreign investment promotion and negotiation is being provided under a complementary Petroleum Technical Assistance Project.	01.16.97	109.0	136.0	12.31.00	P. Pollak

L A T V I A

COUNTRY INFORMATION

The Latvian Government has taken steps to restructure the sector to respond better to the needs of a market economy by decentralizing district heating services, privatizing the oil sub-sector, commercializing the electricity and natural gas monopolies and introducing targeted subsidies directed to consumers and not energy enterprises. However, the sector still suffers from a number of institutional difficulties and a deep financial weakness. The inability of energy consumers to make timely payment for services has led to accumulated arrears to sector enterprises and created a rather complicated inter-enterprise debt situation. As at the beginning of April 1994, the combined accounts receivable for the electricity and natural gas monopolies, Latvenergo and Latvijas Gaze, was estimated at Lats 128 million (US\$233 million equivalent) down from a peak of about Lats 145 million (US\$264 million equivalent) in the third quarter of 1993. Also, sectoral restructuring and the ensuing

shift in responsibilities between the various institutions in the sector has led to a lack of clarity in institutional boundaries. The delay in the emergence of a strong institution to take sector leadership has often given a perception of an institutional leadership vacuum in the sector.

The energy sector has been identified as one of the priority sectors to be rehabilitated during the transition period. The Government is in the process of formulating an energy policy which would be based on the strategic objective of providing long-term reliable energy services at the lowest economic cost with due regard to environmental concerns and security of supply. Based on the preliminary proposals presented to the donor meeting in Paris in May

1994, the specific objectives of the policy are: (i) optimal economic utilization of energy resources; (ii) increased use of renewable indigenous energy resources; (iii) efficient performance and maintenance of existing facilities; and (iv) diversification of fuel choice and supply.

In line with these objectives, the Government has undertaken a number of projects and studies, supported by several multilateral and bilateral agencies (EU-PHARE, EBRD, BITS, USAID, etc.) to: (i) improve efficiency and reliability of existing energy systems through improved operations and rehabilitation of existing facilities; (ii) improve the diversity of fuel choice through the development of indigenous energy resources — mainly hydropower, wood products, and peat — in order to reduce the high cost of fuel import, and (iii) introduce public awareness campaigns to inform and educate citizens on the sectoral issues.

Given Latvia's dependency on energy imports, security of supply is a major concern of the Government. The power sector is especially concerned about the need to increase domestic electricity production to ensure that electric power is not a constraint to future economic growth. There is little economic justification for building new power plants, given current low electricity import prices and the considerable excess power generating capacity in neighboring Estonia and Lithuania. Dependence on Russia for natural gas imports is also a major concern, thus the Government's emphasis on fuel diversification. However, the Government has adopted the prudent policy of investing in energy efficiency and conservation rather than new power generation facilities in the short term when electricity imports are relatively cheap.

Within the sector strategy, a high priority is accorded to investments in the district heating

LATVIA — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1993 (millions)	2.6			
GNP per capita (US\$)	2,010			2,310
Annual GDP Growth (%)	-14.9	0.6	-1.6	2.0
GDP Inflation (%)	71.5	38.3	24.0	15.3
Total Debt/GDPmp (%)			12.8	13.0

sub-sector which is a major energy user, and provides a basic human need given Latvia's climatic conditions. It is estimated that 30 percent of Latvia's energy resources are used for the provision of space heating and hot water for households and public buildings. The size of the district heating sub-sector in overall fuel use and the proportion of the population subject to district heating systems establish it as a priority for rehabilitation.

BANK'S ENERGY ASSISTANCE STRATEGY:

As part of the energy sector lending program and to further extend sector and policy reform into different energy subsectors, the Government has requested World Bank financing for energy conservation and efficiency measures in the district heating (DH) sector and for support in the implementation of comprehensive energy sector restructuring, commercialization and privatization, introduction of a suitable regulatory framework, improvement in energy pricing policies and institutional strengthening. The investments to be supported by the Bank would be expected to lower energy import requirements and production and operating costs and thus make energy services more affordable and reduce the need for Government subsidies. The selected investments would focus on increasing operational efficiency and plant rehabilitation, rather than construction of new facilities where existing capacity is sufficient, conversion of plant to use domestic fuels, and environmental improvements. High priority would be given to investments in the DH and power sectors and the associated institutional and financial strengthening of the responsible agencies. For large energy investments, a regional approach would be required to prevent duplication of capacity and resource misallocation. Energy investments would also address environmental problems.

BANK'S TEAM

BASIL KAVALSKY,
COUNTRY DIRECTOR
(WARSAW RM)

HENK BUSZ,
ENERGY SECTOR LEADER
(H5-055, x32686)

CAROLYN GOCHENOR,
PROGRAM TEAM LEADER
(H5-105, x39681)

PENTTI ARO
DISTRICT HEATING AND
POWER ENGINEER
(H5-207, x87136)

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Project Description	Board Approval Date	Revised Amount	Closing Date	Task Manager
Jelgava District Heating Rehabilitation Project (LN No.38900)	The project would have the following main objectives: (a) to extend the life, and increase the operating efficiency, of the Jelgava District Heating System through rehabilitation and introduction of modern technologies and materials; (b) to improve environmental conditions in affected areas by improving the efficiency of fuel use, facilitating the elimination of low-stack coal-fired boilers in residential areas, reducing wastage of water in DH systems; (c) to support the strengthening and restructuring of the Jelgava District Heating Company (JDHC) through consultancy and advisory services, training and provision of equipment and software; and (d) to act as a pilot project for DH system rehabilitation, from soviet-type constant flow system to western European technology, for other locations within Latvia.	05.23.95	14.0		C. Gochenour
Rehabilitation Loan	About US\$ 22.8 million under this Loan was allocated for imports of fuel oil and natural gas. A co-financing arrangement for the Rehabilitation loan provided an additional US\$ 35 million from the Japanese Eximbank. Of this amount, US\$ 23 million was allocated for natural gas.	10.22.92	45.0		C. Gochenour

ENERGY PROJECTS UNDER PREPARATION

Project	Project Objectives	Amount	FY	Status	Project Manager
Riga/Daugavpils District Heating Rehabilitation Project (LV-PE-8530)	The project includes (a) rehabilitation of district heating systems in Riga and Daugavpils and (b) support for strengthening of district heating enterprises.	30.0	1999	Project preparation is under way.	C. Gochenour

LITHUANIA

COUNTRY INFORMATION

Soon after its declaration of independence, Lithuania launched a market-based economic reform program that has so far achieved substantial results. Price liberalization, voucher privatization, trade opening, legal reform, institutional development, and social safety net enhancement either have been implemented or are under implementation. Policies in the real sector have been underpinned by a front-loaded stabilization effort under an IMF Extended Fund Facility (EFF) arrangement (and two preceding Stand-by operations): a currency board was introduced, financial markets were freed, the capital account was thrown open, and fiscal deficits were brought under control. A second generation of adjustment problems has now emerged that threatens the results achieved so far, and raises serious doubts about the medium-term growth prospects of the country. Barring a major additional policy initiative backed by foreign resources, Lithuania's current stabilization program, the anchor of its development strategy, could become unsustainable. The erosion in the banking system's capital base (estimated at over Lt 1 billion, or about half the size of the money base) has compromised the bulk of the system's deposits.

The country is experiencing serious banking problems, with critical spill-overs to the rest of the economy. In the short-term, a sharp liquidity contraction has forced enterprises to start accumulating energy, tax, social insurance and wage payment arrears, as an alternative means of financing; this, in turn, has put tremendous pressure on the fiscal accounts. In the medium-term, financial disintermediation, confidence-driven reductions in investment (especially foreign), and risk-related increases in term interest rates will all dampen growth prospects.

THE BANK GROUP'S STRATEGY

The main objective of the Bank's Country Assistance Strategy for Lithuania is to raise the living standards of the Lithuanian people by supporting policies and investments that will put the economy on a fast and sustainable growth path, based on a dynamic private sector operating in a competitive market economy. Macroeconomic sustainability and a sound and efficient financial system are thus core elements of the CAS, which also emphasizes the need for structural improvements in the social safety net and in infrastructural services, especially energy. Within that objective, the level and composition of the Bank Group's assistance will be continuously adapted to the evolving development challenges faced by the Lithuanian economy. At present, those challenges call for greater reliance on adjustment lending, coupled with selected, complementary sectoral investment projects. The current CAS calls for a lending program with two to three relatively small operations per year, expanding the program as the sectors' absorptive capacity develops and their needs grow. But as the need for adjustment lending had become obvious, the \$80 million Structural Adjustment Loan was approved in 1996. The following reasons were taken into consideration: first, a SAL is an appropriate means to design a comprehensive package of actions that can address simultaneously the recent financial sector crisis and its underlying sectoral imbalances; second, a SAL focuses valuable additional policy attention on, and support for, the development objectives already pursued by the ongoing (and envisaged) investment operations, while exploiting useful cross-sectoral synergies. Finally, the SAL provides funding that is essential to implement

LITHUANIA — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1993 (millions)	3.7			
GNP per capita (US\$)	1,320			2,290
Annual GDP Growth (%)	-15.1	1.2	2.7	1.6
GDP Inflation (%)	413.1	57.4	37.2	30.2
Total Debt/GDPmp (%)		11.8	12.2	16.0

necessary reforms, especially in the banking and energy sectors.

ENERGY SECTOR POLICIES AND ISSUES

Distortions in the energy sector are probably the single most serious threat to Lithuania's macro-economic balance. Outdated technology, inefficient pricing, weak payment enforcement, and direct political intervention drive public energy companies into chronic financial deficits, and provide little incentive for profit-driven management or energy conservation. In the short run, the energy sector faces the immediate problem of financing its working capital requirements. Up until the end of August 1996, the sector suffered from late or non-payment of debts from final domestic consumers of around Lt 380 million, representing an average 51 days worth of billing. This problem is compounded by the Government's failure to pay the accumulated production subsidies due to LPC for the difference between tariffs and production costs in district heating during the 1994-1996 period. LPC's own estimate of this subsidy-related debt is Lt 772 million. As a result, the sector is in arrears with its own input suppliers, most of which are foreign (e.g., Lt 106 million in overdue payments are owed to Russian companies for gas deliveries).

Medium-term prospects are not significantly better as the seim's level of operational efficiency remains inadequate. In the end, financial viability will have to be based on cost rationalization, rather than on continuous price increases, for Lithuania's average household to be able to afford basic energy consumption, for its industries to have access to reasonably—priced energy inputs, and for the country's energy exports to remain competitive.

THE BANK'S POLICY WITH REGARD TO THE ENERGY SECTOR

The reform package proposed here is centered around two objectives: restoring the immediate

financial viability of the energy sector, and achieving major efficiency gains through commercialization, institutional reform and, where feasible, privatization. Those objectives complement and support the on-going World Bank—supported Power Rehabilitation Project for Lithuania, which deals directly, and at the firm level, with the restructuring and efficiency—enhancement of LPC.

Restoring financial viability will be achieved with three instruments: a timebound program for the elimination of customer arrears; efficient pricing coupled with subsidy rationalization; and a plan for the settlement of external arrears. Under the SAL, the Government's program envisages that, by second tranche: (i) all accounts receivable for electricity and heat (by both budgetary and non-budgetary organizations and private agents) will be reduced to no more than 30 days worth of billing; (ii) accounts receivable for gas by state and municipal budgetary organizations (except LPC) will be reduced to no more than 30 days worth of billing; (iii) accounts receivable for gas by all other consumers (except LPC) will be reduced to no more than 45 days worth of billing; and (iv) a law will be enacted obliging the Ministry of Finance to withhold from its regular transfers to state and municipal budgetary organizations the necessary amounts to assure that those organizations' debts to LPC and Lithuanian Gas do not exceed 30 days worth of billing. Efficient pricing and subsidy rationalization will be the second instrument in restoring the financial viability of the energy sector. The Energy Law (1995) has established the framework for an Energy Pricing Commission (EPC) to regulate price-setting in the sector, but the Commission was until recently not fully operational. As part of the SAL-supported reform program, a pre-defined pricing methodology has been developed and the Commission is being staffed to fulfill its required regulatory functions. Implementation

of the price setting formula should then be undertaken by March 1997, together with the introduction of adequate legislation to establish the independence of EPC. In addition, during the 1995 heating season, the authorities introduced a consumer subsidy scheme whereby the state compensates households that spend more than 15 percent of their income on heating (and 5 percent on hot water), within certain limits in terms of family size, square footage of the property, and metering availability.

Under the proposed reform program, the Government will also increase energy prices to cost-recovery levels, will do away with all producer subsidies, and will keep subsidization to the minimum possible and exclusively focused on poor residential consumers.

BANK'S TEAM

MR. BASIL KAVALSKY,
COUNTRY DIRECTOR
(WARSAW RM)

MR. HENK BUSZ,
ENERGY SECTOR LEADER
(H5-055, x32686)

MR. MARC HEITNER,
PR. ENERGY SPECIALIST
(H10-033, x85836)

MR. MANTAS NOCIUS,
OPERATIONS OFFICER
(VILNIUS RM)

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Effective Date	Revised Amount (\$m)	Closing Date	Task Manager
Power Rehabilitation (LN No.37370)	Improve the operating efficiency of the electricity system, thus reducing the amount of imported fuel needed for its operation; improve the safety, reliability, and flexibility of the electricity system, thus reducing power disruptions and facilitating economic load management; provide support for the restructuring and commercialization of LPC (formerly LSPS), the national electricity agency, and for strengthening sector institutions.	11.21.95	26.40	06.30.99	O. Gourlay

ENERGY PROJECTS UNDER PREPARATION

Project	Project Description	Proposed Amount (\$m)	FY	Status	Project Manager
Energy/District Heating Efficiency (LT-PE-8552)	Rehabilitation of district heating systems in Vilnius.	30.0	1999	Project preparation is under way.	M. Heitner

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

COUNTRY INFORMATION

Since it became independent state in 1991, FYR Macedonia has undergone four major economic shocks. First, annual transfer from the former federal government, totaling 5-10% of GDP on a net basis, were discontinued as the SFRY broke up. Second, foreign exchange reserves totaling over US\$1 billion held at the National Bank of Yugoslavia in Belgrade were lost. Third, valuable export markets and sources of raw materials were lost with the dissolution of SFRY and the economic sanctions imposed by the UN on the Federal Republic of Yugoslavia (Serbia and Montenegro). Fourth, the embargo by Greece, which lasted from February 1994 to October 1995, disrupted trade through the port of Thessaloniki and made exports and imports more difficult and costly. Primarily as result of these shocks during the period 1990-1994, real GDP fell nearly 35%.

In 1994, the Government began a new economic policy involving strict budgetary discipline, strong incomes and monetary policies and restructuring. As a result the economic situation has significantly improved. The fiscal deficit has been cut (from 12% of GDP in 1992-93 to about 1% for 1995)., the country has made significant progress in normalizing its external debt situation, inflation has dropped sharply and economic output appears to have hit bottom in 1995. With the help of IDA, the Government has also begun to tackle difficult structural issues associated with moving to a market economy and is rationalizing and, where feasible, privatizing its socially owned enterprises and bringing discipline to its financial sector. Reforms in the enterprise sector are focusing on restructuring and reducing costs at the largest loss-making enterprises and the two largest utilities, power and railways.

THE BANK GROUP'S STRATEGY

Since the FYR of Macedonia joined the World Bank and IDA in February 1993, the Bank has been working with the Government to assist productive sector development; support stabilization and structural reform with analytical inputs and adjustment lending; and strengthen the social safety net through investment lending and technical assistance.

In April 1995, a US\$24 million loan was approved by the Bank for a Transit Facilitation Project to help reduce transportation costs and strengthen road management capabilities. In May 1995, IDA approved a US\$85 million for a Financial and Enterprise Adjustment Credit to ease the country's economic situation. Also in May, a US\$14 million social Reform and Adjustment Credit was approved to assist in the social dimensions of the economic reform program.

In May 1996, an IDA credit for US\$8 million was approved for a Private Farmer Support Project that will strengthen agricultural support and technical services to private farmers in order to increase their productivity and income. Also in May, the Bank approved a US\$12 million loan for a Private Sector Development Project that will improve the credit access of entrepreneurs and private farmers. In June 1996, a US\$17 million credit was approved to help finance a Health Sector Transition Project that will enhance the quality of basic health services and increase cost-effectiveness, fiscal sustainability and patient choice within the health system.

FORMER YUGOSLAV REPUBLIC OF MACEDONIA — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1993 (millions)	2.1			
GNP per capita (US\$)	820.0	790.0		920.0
Annual GDP Growth (%)	-12.7	-6.5	0.0	1.2
GDP Inflation (%) (average year)	428.8	121.8	16.3	2.4
Total Debt/GDPmp (%)	0.0	0.0	0.0	28.24

FORMER YUGOSLAV
REPUBLIC OF MACEDONIA
— PRIMARY ENERGY
SOURCES 1994
(10³TJ)

Domestic	
Hydro power	2.4
Lignite	51.2
Firewood	10.9
Geothermal	0.5
Total Domestic	65.0
Net Imports	
Electricity	0.3
Coke/Coal	6.2
Petroleum	32.6
Natural Gas	0
Total Imports	39.1
Total Energy Use	104.1

BANK'S TEAM

AJAY CHHIBBER,
COUNTRY DIRECTOR
(H3-035, X84219)

HENK BUSZ,
ENERGY SECTOR LEADER
(H5-055, X32686)

JAMES MOOSE,
PRINCIPAL ENERGY
ECONOMIST
(H5-071, X33563)

SAM O'BRIEN-KUMI,
SR. ENERGY ECONOMIST
(H5-075, X32690)

ENERGY SECTOR POLICIES AND ISSUES

FYR Macedonia is short of energy resources. It has lignite, which is mostly used to generate electricity, and hydropower which together are sufficient to make the country more or less self-sufficient in electricity, though it exchanges electricity with surrounding countries. It also has limited geothermal resources. However, it totally lacks oil, gas or high quality coal resources. As a result it imports around 40% of its energy consumption. Most of these imports are crude oil or petroleum products. There are also small imports of coke for the steel mills and the country is also just beginning the importation of Russian natural gas. Energy imports amounts to about 11-16% of total imports.

The energy sector is currently largely owned by the Government. Energy prices are set by the Government and, unlike other economies in transition, they generally cover costs.

BANK'S STRATEGY WITH REGARD TO THE ENERGY SECTOR

Based on discussions with Government officials, a general strategy has been formulated: to rely primarily, though not solely, on market mechanisms and to shift away from a "centrally planned" approach. The strategic principles are:

- Energy prices should cover operating costs with a margin to fund future investments.
- Energy sector companies should be able to finance themselves from internal and outside funding sources and should not rely on Government financing.
- Energy companies should operate as commercial entities and can be partially, or in some cases wholly, privatized.
- The country should rely on domestic energy sources where economically feasible.
- Energy conservation will be encouraged through cost based pricing of energy and the restructuring of the economy, which should lead to reduced energy intensity.

ENERGY PROJECTS UNDER PREPARATION

Project	Project Description	Proposed Amount	Status	Task Manager
Power Project (MK-PE-42399)	The project includes (a) rehabilitation of hydropower plants; (b) completion of an energy management system; and (c) distribution network improvement.	61.5 DM	Project is awaiting Board approval.	J. Moose

M O L D O V A

ECONOMIC CONDITIONS

Moldova's independence in 1991 brought with it considerable economic disruptions. There was a significant breakdown of traditional trade linkages and payment systems and a traumatic exposure to world prices. By 1994, the combination of a large terms-of-trade shock (30 percent of GDP in 1992 prices), a decline in the demand for its exports, and severe weather (droughts, hurricanes and floods) had crippled the country. Almost three-fourths of industry was at a standstill, agriculture was declining, and GDP was just over 40 percent of its 1990 level. Inflation soared, cresting at about 2,200 percent in 1992. In the armed conflict between the Moldovan regions on the left and right banks

of the Nistru River, discord over economic policies was aggravated by ethnic tensions. A ceasefire was declared in 1992, and since then there has been slow progress towards a mutually acceptable resolution to the problem, with some resumption of production, trade and transport between the two regions.

Since 1993 Moldova has rapidly stabilized its economy and has started structural reforms. Moldova's most visible economic policy success has been financial stabilization, supported by the IMF (through an STF, two stand-by arrangements and an EFF). A new currency was introduced in 1993, and monetary and fiscal policy tightened. Inflation fell to an annual rate of around 15 percent in 1996, one of the lowest rates in the FSU. The Government's initial round of structural reforms, supported by a Rehabilitation Loan and then by a first Structural Adjustment Loan, focused on three areas: (i) privatizing, restructuring and demo-

nopolizing enterprises; (ii) strengthening the legal and regulatory framework in the financial sector; and (iii) liberalizing prices and trade.

The reforms have moved Moldova's economy towards improved flexibility and responsiveness, but the agenda is still incomplete. 1996 was a particularly difficult year, when economic and political factors converged to subdue the pace of reforms. Adverse weather conditions were an exogenous shock that contributed to a 10 percent drop in GDP. At the same time, a volatile election season resulted in some slippage in the reform program. The new Government in Moldova is now working to combine progress in financial stabilization with a second generation of structural reforms aimed at revitalizing the economy through imposing payments discipline and promoting private sector led growth. There is a consensus on the need to improve payments discipline, and the energy sector is increasingly being singled out as a key problem.

ROLE OF THE BANK GROUP

Moldova joined IBRD on August 12, 1992, MIGA on June 9, 1993, and IDA on June 14, 1994. The Country Assistance Strategy (CAS) of April 1996 presents a three-pronged assistance program aimed at supporting private sector development, strengthening public institutions and financial discipline, and improving social services and safety nets. The Bank's assistance program in Moldova has combined policy-based lending with investment operations, technical assistance and ESW. Quick disbursing loans have included the US\$26 million Drought Recovery project and the follow-up US\$60 million Rehabilitation Loan, both approved in 1993, as well as the US\$60 million Structural Adjustment Loan approved in late 1994, and the US\$100 million Second Structural Adjustment Loan and Credit, approved in September 1997. Investment

MOLDOVA — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1993 (millions)	4.4			
GNP per capita (US\$)				600
Annual GDP Growth (%)	-1.2	-31.2	-3.0	-7.5
GDP Inflation (%) (average year)	1065.8	280.1	36.2	28.0
Total Debt/GDPmp (%)	6.2	5.4	4.9	14.8

lending began in 1995 with the US\$30 million Pre-Export Guarantee Facility, which offers political risk insurance designed to attract working capital loans from abroad. The investment lending program accelerated in 1996 with the approval of the US\$35 million Private Sector Development Project, the US\$10 million First Agriculture Project, and the US\$10 million Energy Project. The first IFC investment in Moldova (US\$10 million in INCON, a major agro-processor) was approved in December 1996. Expansion of investment lending continued in 1997, with the US\$16.8 million General Education Project, approved in April 1997 and the US\$9 million Second Private Sector Development Project, approved in June 1997. Although US\$110.8 million in investment lending has been committed to date, disbursements have been delayed by a number of factors including the slowdown in structural reform in 1996, unfamiliarity with World Bank procedures, and a chronic shortage of counterpart funds.

The lending program has been complemented by a portfolio of grant-funded technical assistance projects, ranging from the preparation of public procurement legislation to the development of modern enterprise accounting standards and the design of health care reforms. The country assistance program includes an active non-lending services program which mixes short policy notes on issues of immediate importance with longer term in-depth macroeconomic and sector studies.

ENERGY SECTOR ISSUES AND POLICIES

Lack of reform in the energy sector has been a serious impediment to both stabilization and growth. Lack of financial discipline has contributed to mounting external arrears, while the lack of assured and high-quality supply of power has held back industrial growth. The Government's program under the Second Structural Adjustment Credit and Loan aims to

resolve these issues by taking action in three areas: (i) restoring the energy sector's financial equilibrium and stopping the build-up of energy-related external debt, through debt management and price adjustment; (ii) ensuring domestic financial discipline, hard budget constraints and better quality of energy services for consumers through creating an appropriate regulatory system and demonopolizing and privatizing the electricity, gas and oil industries; and (iii) ensuring that these reforms do not deprive poor households of a minimum supply of energy, through measures to mitigate the impact of energy price increases on poor and vulnerable groups.

A debt management plan adopted by the Government outlines a set of actions to restore the financial viability of the key enterprises operating in the sector: Moldenergo (electricity), Moldovagas (gas supply), Termocom and Temocomenergo (district heat). These actions include price adjustments, improvements in payment collections, write-off of uncollectable receivables, mutual payment cancellations and the repayment of debt with interest over a period of five years. In 1997, Government increased energy prices twice — in March and in June. The new prices were intended to fully cover costs, including debt repayment, but because of the high subsidy element for privileged groups, they still do not fully cover costs. Government is determined to completely eliminate cross subsidies, which will involve raising the electricity and gas prices for households above those charged high-volume customers in order to reflect the higher cost of service. Government is making an effort to ensure that end-user collections for electricity and gas will rise steadily, and will reduce subsidies to privileged groups, in an effort to resolve the financial difficulties faced by the energy sector.

BANK'S TEAM:
ROGER GRAWE,
COUNTRY DIRECTOR
(BUDAPEST RM)

LASZLO LOVEI,
LEAD SPECIALIST
(H-091, x32772)

MANUEL DUSSAN,
CONSULTANT
(H5-215, x33256)

HERNAN GARCIA,
PRINCIPAL POWER ENGINEER
(F 2K-120, x38662)

JANN MASTERSON,
OPERATIONS ANALYST
(H5-110, x35005)

Government is putting into place a transparent and predictable regulatory system, independent of short-term political interests. It has already established the National Energy Regulatory Agency (NERA) as a state organization and issued a resolution spelling out its main responsibilities and structure and providing for its financing until it becomes self-supporting through a system of license fees. NERA has developed generic/model licenses for electricity and gas services and in early 1998 will begin issuing specific licenses to all the entities in the natural gas and electricity subsectors that are eligible for licenses. Government will transfer the regulatory responsibility for district heating to the municipalities in 1998.

Privatization will begin once the regulatory framework is fully in place. In July 1997 the Government adopted a detailed plan for the de-monopolization and principles of privatization of the electricity industry. The plan calls for restructuring the industry in order to develop competition among generators, and to de-monopolize wholesale electricity trading. The Government expects that by end-1998 a majority of the shares of electricity generation and low-voltage distribution companies will be sold to private investors. Privatization of the gas industry and the oil trading subsector is expected to proceed even faster.

BANK GROUP ASSISTANCE TO THE ENERGY SECTOR

The Bank initially provided assistance to the Energy Sector through an Institutional Development Fund grant (US\$380,000) for Institution Building for Energy Sector Reform which closed in November 1997. The ongoing Energy Project (US\$10.0 million) includes the following components: (a) overhaul of Chisinau No. 2 combined heat and power plant; (b) repair of leaky gas distribution points; (c) gas meter installation; (d) upgrade

of accounting and billing systems; and (e) project implementation assistance. Technical assistance in the area of energy sector privatization was provided to the Agency for Enterprise Restructuring (ARIA), with financing from the Netherlands Government. USAID is also financing reform, restructuring and privatization technical assistance. Privatization of the energy sector is a major component of the Second Structural Adjustment Loan and Credit, approved by the Board of Executive Directors in September 1997. As mentioned above, an IBRD loan of US\$10 million was approved in 1996 for the Energy I project focused on metering of gas consumption. The Energy II project preparation is expected to start in early 1998.

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Board Approval Date	Loan Credit Amount (US\$ mln)	Closing Date	Task Manager
Energy Project (LN No. 40200)	The project is a limited, targeted intervention by the Bank intended as a first step in moving the energy sector toward better economic and financial management. The objectives of the project are to: (a) strengthen the financial management and accounting systems that are needed in order to place gas and electricity sales on a commercial basis, and establish Moldovagas and Moldenergo as financially viable energy enterprises; and (b) improve the measurement of consumed energy and the efficiency of electricity production in order to reduce losses and waste of costly imported fuels.	05.23.96	10.0	06.30.00	J. Masterson

ENERGY PROJECTS UNDER PREPARATION

Project	Project Description	Proposed Amount (\$m)	FY	Status	Project Manager
Energy II (MD-PE-40558)	The project includes: (a) upgrade of power system control and data acquisition (SCADA) facilities; (b) commercial metering equipment for the power system; (c) upgrade of electrical substations; and (d) technical assistance for institutional reforms.	45.0	1999	Board presentation is scheduled for April 1999	H. Garcia

P O L A N D

COUNTRY INFORMATION

For six consecutive years Poland's economy is growing (on average 6.5 percent in 1995-1996). Fiscal deficit averaged 2.6 percent of GDP in 1994-96. Inflation (Dec-Dec) was gradually reduced to 18.5 percent in 1996. Capital inflows rose to over 2 percent of GDP in 1996. Savings and investment have increased over the past four years, albeit to a still limited 18 and 20 percent of GDP, respectively, in 1996 from 15 percent for both in

1992. The private sector's share in the economy has risen to 63 percent. While growth has originated mainly in the new private sector, performance has been satisfactory in many state-owned enterprises as well, as they now face a credible hard budget constraint. However, many large, socially-sensitive or politically powerful state-owned

enterprises (in the coal sector, in steel, chemicals) have avoided major restructuring; their losses continue to hamper the underlying growth potential of the economy.

Prospective EU accession within the next few years is likely to result in a significantly better environment for growth, with expanded markets and access to still greater capital flows. It will also pose risks that should be carefully managed. Sustaining growth in the future and, over time, making the economy fully competitive in an extended unified market will require continued progress in increasing savings and investment, in strengthening human capital, and in completing the structural reform agenda.

THE BANK GROUP'S STRATEGY

The Bank Group's assistance will concentrate

on the areas that are key to Poland's medium-term performance, but that remain very difficult in view of the social ramifications of the necessary reforms (social security, completion of privatization, particularly of problem firms, de-monopolization and privatization of infrastructure, etc.) as well as on areas where consensus is more widespread, and institution building is the main hurdle.

The Bank will work with the Government on a number of issues to improve the environment for the private sector, such as: strengthening legal and regulatory frameworks, continued transfer of public productive assets to the private sector, financial sector development, increased private sector participation in infrastructure development, and strengthening human capital growth. In the area of managing the transformation of the state in support of the market economy, the Bank is supporting Government in its efforts to establish sound public finances, to reduce the fiscal burden of large, loss-making state-owned enterprises, to enhance market institutions and productivity in agriculture. Achieving environmental sustainability and enhancing social sustainability of reforms remain important areas for Bank's assistance.

ENERGY SECTOR — POLICIES AND ISSUES

- **General:** The new Energy Law, approved on April 10, 1997, became effective as of December 4, 1997. This could bring Poland to the forefront of advanced energy sector legislation, provided the following actions are taken: (i) the energy regulatory authority is reinforced to be fully operational; and (ii) within two years: the phase-out of Government price controls. Prices for network fuels (gas, electricity, district heat) range between 50% and 80% of economic costs. Prices for coal are near import parity price.
- **EU Accession and eventual membership**

POLAND — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1996 (millions)	38.6			
GNP per capita (US\$)	2,240	2,400	2,800	3,200
Annual GDP Growth (%) of which:				
private sector	3.8	5.2	7.0	6.0
public sector	9.6	1.6	18.3	15.6
GDP Inflation (%) (average year)	-1.7	7.9	-3.2	-6.0
Total Debt/GDPmp (%)	30.6	28.4	27.0	19.7
	86.0	69.5	56.2	51.5

calls for actions to comply with *EU Acquis Communautaire (AC)*. Needed investments in the energy sector alone are estimated at a minimum of US\$ 5 billion to meet EU requirements.

- **Environmental:** Major issues of air pollution (electricity, district heat, petroleum products), water pollution (coal mines, refineries) and solid waste disposal (coal mines and power plants). Revisions of our emission standards to ensure consistency with EU standards and Poland's international commitments (Second Sulfur Protocol) are yet to be issued.
- **Hard Coal:** *Over-capacity* of 30-35 mln tons per annum. About 1/3 of mines should be closed down. *Over-employment* of about 45% across the sector. Decisive restructuring is impeded by *social concerns*. *Regional development effort* still in its infancy. Saline water —, and solid waste disposal, as well as coal-bed-methane emission and land subsidence, are major environmental problems.
- **Gas:** Polish Oil and Gas Company (PGNiG) is the last remaining fully integrated monopoly in the energy sector. It was finally commercialized by end 1996 and is now implementing a restructuring program under which production is being split between transmission and distribution, and remaining ancillary services are being privatized.
- **Oil:** Restructuring finally approved after six years of difficulties but implementation slow. Water pollution from refineries is significant problem. EU AC requires build-up of storage (up to US\$2 billion).
- **Electricity:** Investment program for generation rehabilitation during 1995-2005 is about US\$11.0 billion, of which US\$2.0-4.5 billion for pollution control equipment. Because of inflation concerns, real price increases are unlikely during next two

years, reducing the power sector's cash flows while hampering access to external financing. Power privatization (a stated Government policy) could be hampered by: (i) absence of an agreed privatization action program; (ii) failure to adopt sound secondary regulatory legislation; (iii) local feelings against foreign investors; (iv) the continued electricity price controls despite rising coal prices (coal represents 60-70% of power production costs); and (v) uncertainty about the proposed new electricity market ("pool" market).

- **Heat:** The heat subsector offers the best opportunities for: (i) major energy savings (25-40%) on supply and demand side and reduction of related environmental pollution; and (ii) third-party/private financing schemes. The share of efficient and environment-friendly cogeneration of district heat (i.e., combined with electricity production) is too low (up to 30%). Many cities still rely on heat produced by small, old, inefficient and highly polluting heat-only-boilers. Large investments in overdue modernization are required. However, modest real price increases have so far constrained the subsector's cash flows necessary to finance modernization. Consumers subsidies in 1996 were at about 6% on average for Poland. Average bill for heat and domestic hot water is 10-14% of average net income for typical Polish household. Average total utility bill covering heat, domestic hot water, electricity, gas, cold water and wastes is 20-25%. This explains the reluctance of the Ministry of Finance to increase utility prices.

BANK'S STRATEGY WITH REGARD TO THE ENERGY SECTOR

Overarching Goals of Bank Strategy in Relation to Poland's Energy Sector: Cooperate with Poland to have the country achieve ener-

POLAND — ENERGY SECTOR INDICATORS

Energy Resources

Gas Reserves (proven)	130 bcm
Gas Reserves (probable)	640 bcm
Oil Reserves	
Coal Reserves	300 bln tons
of which recoverable:	65 bln tons

Consumption per capita

Energy	2.55 toe/capita
Electricity	3,459 kWh/capita

Power Generation Capability

33,100 MWe

BANK'S TEAM:
 BASIL KAVALSKY,
 COUNTRY DIRECTOR
 (H12-021, X80523)

HENK BUSZ,
 ENERGY SECTOR LEADER
 (H5-055, X32686)

RACHID BENMESSAOUD,
 SENIOR ENERGY PLANNER
 (H5-095, X32696)

CHRISTIAN DUVIGNEAU,
 PRINCIPAL OPERATIONS OFFICER
 (H5-077, X32696)

JULIUS WILBERG,
 SENIOR FINANCIAL ANALYST
 (H5-079, X37151)

gy security through cost-effective supply, at socially acceptable prices, and in environmentally sustainable ways through: (a) support of policy and institutional changes to enable Poland to achieve international competitiveness in the sector and to meet the requirements for EU Accession; (b) services and lending operations in support of the sector's orientation towards a market-based structure, fostering of privatization and improving efficiency; (c) support of measures to reduce social hardship resulting from price adjustments and sector restructuring.

The Bank will continue policy dialogue and support of improvements of policy, legal and regulatory framework, including new Energy

Law, the establishment of Energy Regulatory Agency, demonopolization, phasing out general subsidies in gas and district heat, and introduction of transparent, predictable pricing policies. The subsectors (coal, gas, electricity, district heat, oil) are at different stages of restructuring and all require substantial investments to become internationally competitive, meet environmental standards, and comply with the EU Acquis Communautaire. The Bank coordinates with the Government fostering an efficient and effective process of restructuring and privatization in the subsectors through demonstration operations.

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Effective Date	Revised Amount	Closing Date	Undisb Begin FY (\$m)	Total Disb FY97 (\$m)	Task Manager
Energy Resources Development (LN No. 32150)	The project objectives are: (a) to improve the energy-related convertible currency earnings of Poland by (i) increasing domestic production of natural gas and (ii) encouraging energy conservation for all forms of energy and fuel substitution through supporting energy price reform; (b) contribute to a reduction of environment pollution related to energy use; and (c) improve the competitive, regulatory and financial framework of the sector entities by supporting the implementation of appropriate restructuring programs for the coal, gas, power and heat sectors.	11.14.90	250.00	06.30.97	.00	11.73	J. Wilberg
Heat Supply Restructuring (LN No. 33770)	The project's objectives are to: (a) support implementation of comprehensive energy sector restructuring, commercialization and privatization of restructured enterprises introduction of a consistent regulatory framework between network subsectors, and achieve significant further improvement in energy pricing policies; (b) extend the life of existing district heating assets through rehabilitation and introduction of modern technologies and materials; (c) enhance energy conservation in the district heating sector through financing appropriate investments; and (d) reduce environmental pollution through investments in energy-efficient equipment and systems as well as by supporting programs to replace small coal-fired boilers by gas-fired boilers.	05.21.92	202.50	06.30.99	45.53	36.28	R. Benmessoud

ENERGY PROJECTS UNDER IMPLEMENTATION (CONTINUED)

Project	Development Objectives	Effective Date	Revised Amount	Closing Date	Undisb Begin FY (\$m)	Total Disb FY97 (\$m)	Task Manager
Power Transmission (LN No. 3959)	The project's objectives are to: (a) improve the reliability of the existing high voltage grid through rehabilitation and reinforcement; (b) enhance security of power supply in Poland by interconnecting the Polish power grid with that of Western Europe, thus improving Poland's power trade and wheeling capability; (c) improve the network's operational performance and control through transmission loss reduction and improved dispatching, thereby enhancing energy conservation and efficiency; (d) reduce environmental pollution; and (e) enhance PPGC's institutional capabilities. The project takes place within the framework of supporting the Government's energy sector restructuring program, particularly as it relates to further improvement in energy pricing policies and introduction of a sound regulatory framework.	03.08.96	160.00	12.31.01	140.30	17.42	R. Benmessaoud
GEF Coal to Gas Conversion Project (C28665)	The project objectives: (a) it would demonstrate interfuel substitution and technological innovation to improve overall energy efficiency throughout the heat supply chain as a means of reducing CO2 emissions; (b) the project would build up the local institutional capability to make judgments during project analysis about capturing global externalities, such as CO2 emission abatement; and (c) it would establish the organizational structure for implementing already selected pilot projects and replicating the GEF concept with other investment projects yet to be identified nationwide and to be funded under this project.	06/16/95	26.00	12/31/00	25.6	0.3	R. Benmessaoud
Katowice Heat Supply (LN No. 38090)	(a) Enhance energy conservation and efficiency in the district heating sector; (b) extend the life of existing district heating assets through rehabilitation and introduction of modern technologies, thereby significantly reducing capital expenditures and operating and maintenance costs; and (c) reduce environmental pollution through investments in energy-efficient equipment and systems as well as by supporting a program to eliminate coal-fired heat-only boilers. The project would support implementation of the Government's ongoing energy sector restructuring program.	12.19.94	45.00	06.30.00	35.87	2.85	R. Benmessaoud

ENERGY PROJECTS UNDER PREPARATION

Project	Project Description	FY	Proposed Amount (\$m)	Status	Project Manager
Renewable Energy/GEO (PL-PE-37339)	The project is designed to replace coal-based heat generation in homes and other buildings with geothermal heat to be distributed by means of a district heating network. The goal is to reduce air pollution in the area of the Podhale region.	1999	50.0	Project Appraisal Document has been prepared.	C. Duvigneau
Rybnik Power Generation Rehabilitation Project (PL-PE-45201)	The project's objectives are to: (a) support improvement in the efficiency and environmental performance of Poland's electric energy supply; (b) help ensure Poland's compliance with international environmental treaties and protocols on a least-cost basis; and (c) support the operational and financial strengthening of one power generation company (Rybnik power plant in Upper Silesia).	1999	80.0	Project preparation is under way.	R. Benmessaoud

ROMANIA

COUNTRY INFORMATION

The Government that came to power in November 1996 has shown a strong commitment to macroeconomic stabilization and to quicker, more substantial economic reforms. In mid-February 1997, agreement was reached with the IMF on a stabilization program which included: (i) liberalization of the foreign exchange market; (ii) a sharp tightening of monetary policy; (iii) elimination of directed credits from the National Bank of Romania; and (iv) a public sector income policy. Furthermore, the new Government committed itself to liberalizing various controlled prices and undertaking state enterprise restructuring and privatization. Significantly, this stabilization program is being underpinned by ambitious and much needed structural reforms supported by Bank adjustment operations.

exports to rise a little and imports to fall further. Overall, real GDP may decline by 1 to 2 percent in 1997.

The greatest risk to the medium-term outlook would be posed by inadequate progress on structural reforms. In that situation, the fiscal deficit would be unlikely to improve and could hover around 5 percent of GDP for some time. Without the private sector having the confidence to invest, export and output response would be muted. Indeed, real GDP growth could be some 2-3 percentage points lower each year on average than in the main scenario. Poverty would not be curtailed; the unemployment rate could remain above 10 percent; and pressures on social security spending would intensify. Inflation would not be brought down to the single digit range as targeted. Worse still, if progress on structural reforms were to stall completely, monetary control could be undermined, exposing the country to another bout of high, debilitating inflation.

The new Government is aware that challenges facing Romania are daunting. Indeed the Government, in its "Development 2000 Program" prepared shortly after it took office, set three priorities for its economic and social policies. The first is to draw the economy back from the brink of high inflation and put in place a stable macroeconomic environment. The second priority, to be addressed at the same time, is to continue with substantial structural reforms to curtail the role of the state and allow the private sector to develop. Such reforms must be accompanied by measures to protect poor and vulnerable groups during the transition. And the third longer term priority is to gain accession to the European Union through the upgrading of sector-specific legislative and institutional frameworks.

ROMANIA — BASIC INDICATORS

	1994	1995	1996
Population, mid-1995 (million)	22.7		
GNP per capita (US\$)	1480	1450	n.a.
Annual GDP Growth (%)	3.9	6.9	4
GDP Deflator (%)	139	35.7	45.6
Total Debt/GDP (%)	18.3	18.7	26.4

As a result of Government actions, the fiscal picture is expected to be difficult given the overhang from previous years in the short-term. Previous quasi-fiscal operations, especially directed

credits from the NBR have been explicitly brought on-budget in 1997. Other pressures, including the recent fall in the exchange rate, will push inflation up further in the short term. Even with tightened monetary policies, the average inflation rate in 1997 is projected at a little over 100 percent, but will be curtailed to an annualized rate of 30 percent by the end of the year. The restructuring and privatization of enterprises, including lay-offs, will reduce demand in the economy and likely increase short-term unemployment. Other structural reforms, including those in agriculture and energy, could cause short-term output dislocations. The trade deficit should improve, with a devaluation in the exchange rate helping

THE BANK GROUP'S STRATEGY

The Bank Group's Strategy addresses the Government's priorities and the imperatives defined in the Bank's recent poverty assessment. The strategy is three-fold:

- In the near-term, the Bank will provide advice and financing for the ambitious program launched by the new administration;
- In the medium-term, priority will be given to advice and financing for the EU accession-related sector program; and
- Expansion of the development assistance management role and strengthening partnership with the EU, foreign and domestic foundations, private businesses and NGOs.

The Bank expects to devote about one-third of administrative resources earmarked for Romania to assist the Government in promoting structural reforms and private sector development. This will be achieved mainly through an integrated package of adjustment operations and in coordination with MIGA and IFC. Approximately 35% of our administrative resources will be allocated for fighting poverty and developing human capital. The Bank has launched an assistance program that includes measures to increase social protection spending to protect the most vulnerable groups (i.e. children, displaced workers and rural pensioners). Furthermore, the Bank will provide assistance to the Government to strengthen public institutions, and address environmental issues, in order to help accelerate Romania's accession to the EU.

In the energy sector, the strategy of the Bank and the Government of Romania (GoR) is to:

- Continue with the rehabilitation and modernization of existing supply infrastructure, and institutional reform;
- Improve operational and managerial efficiency, and quality of service to customers, commensurate with EU standards;
- Ensure financial viability of sector;

- Establish pricing on economic cost of service principles, and mechanism for automatic adjustment;
- Establish and adopt an investment program based on economic criteria;
- Demonopolize power generation through sectoral restructuring;
- Create an independent national power transmission grid company and allow the participation of private investors and independent operators;
- Establish a clear and transparent regulatory system; and
- Attract private investments and independent operators. For the petroleum and mining sector, the strategy of the Bank and the GoR is to
 - enhance the independence and transparency of sector regulation through additional legislation and institutional building; and
 - improve efficiency by introducing competition in the sectors.

These strategies will be implemented under the ongoing operations in the sectors and through non-lending services.

ENERGY POLICIES AND ISSUES

Romania has considerable reserves of primary energy (e.g., oil, gas, coal and lignite). Reserves of natural gas are 510 million tons of oil equivalent (TOE). Proven reserves of lignite include 600 million TOE, hard coal is 330 million TOE, and oil is 200 million TOE. The total hydropower potential is about 40 terawatt-hours (Twh) per year, of which 12 Twh per year is already developed. Uranium deposits exist but the level of reserves is not published. However, the Government's nuclear power development program is based on using it as the main source of fuel. Oil, shale and geothermal reserves are known to exist, but their extent is unknown. Renewable energy resources in biomass and fuel wood are abun-

dant, while geothermal wind and solar energy are of relatively less significance. Romania's installed power generating capacity is 21,808 MW. Hydropower capacity accounts for 28%; lignite and coal-fired for 42%; and oil and gas-fired for 30%. Total installed thermal capacity is 14,829 MW, of which 38% is in cogeneration. The energy sector remains inefficient in spite of efforts made since 1990 to improve its performance.

There are three major entities in the energy sector in Romania: PETROM, the national oil exploration and production (E&P) company; ROMGAZ, the national gas E&P, transmission and distribution company; and RENEL, the power utility company in charge of generation, transmission and distribution of electricity. Difficulties in the energy sector include:

- (a) Lack of Commercial Orientation: Management and financial systems are still weak, overstaffing and excessive government controls constrain sector efficiency;
- (b) Declining Production. Although demand has decreased by about 20% since 1989 largely as a result of decline in industrial production, the current supply of oil and gas has not been sufficient to meet this demand. Oil and gas production and electricity generation has decreased substantially since 1986 due mainly to weak management and financial systems, poor pricing policy, lack of commercial orientation, overstaffing and excessive government controls;
- (c) Dilapidated Plants and Equipment: The infrastructure of ROMGAZ and PETROM is obsolete and of poor quality. In addition, they have suffered from poor maintenance due to their inability to mobilize hard currency to import spare parts. As a result, there are high conversion and technical losses in energy production and supply contributing to a high energy intensity. In the electricity sector, although Romania

has an installed capacity of about 22,000 MW, difficulties are encountered to meet the peak demand of about 9,000 MW due to : (i) plant design and construction deficiencies; (ii) use of low quality fuels; and (iii) inadequate operations and maintenance practices.

- (d) Arrears. ROMGAZ is mandated to purchase gas from PETROM, and the gas in turn is purchased by RENEL. RENEL is a major customer of ROMGAZ and its main debtor. Heavy industry is RENEL's main electric consumer and local governments are RENEL's main thermal energy consumers. If RENEL's customers delay paying their electricity and thermal energy bills, RENEL is forced to delay payments to its suppliers. The inter-enterprise arrears problem became acute in 1993, during which RENEL's receivables rose to about 4 months of its electricity and thermal sales revenue. This situation has created a blockage within the energy sector. While the entities have tried to find creative ways to settle their obligations among themselves, e.g. through various compensation schemes, this has not generated cash and has therefore resulted in greater fiscal obligations;
- (e) Financial Weaknesses: Financial management is weak due to the absence of appropriate financial and cost accounting systems, trained human resources and commercial orientation. State-owned enterprises also suffer from : (i) lack of appropriate incentives; all but 5% of the net profit goes to the state; and (ii) the absence of autonomy to set and implement corporate policy as it applies to key areas such as electricity pricing, investments, resource mobilization and managerial appointments. To compound these financing problems, electricity price adjustments were infrequent and insufficient during a period of high inflation, and RENEL's management of its working capital is highly unsatisfactory.

Since 1992, RENEL has been responsible for servicing the debt of the Cernavoda nuclear power plant. Consequently, RENEL continues to experience cash flow constraints that in turn have forced RENEL to borrow short-term loans to meet its operational costs.

Mining in Romania has a long tradition of large scale employment and strong involvement of the trade unions. It is an important economic sector providing coal for power generation, and has been the mainstay of economic activity in several areas of the country particularly Jiu valley and Gori. The mining activities are conducted by six Regies Autonomes (RA) and the industry has two main parts: (i) coal mining which includes lignite (soft coal) and hard coal (of a higher thermal quality); and (ii) mining of metallic and non-metallic ores, including copper, gold, lead, zinc and uranium. The majority of the mining activities is uneconomic and has no prospect of recovery, despite Government subsidies. The industry has continuously contributed significantly to the enterprise losses, reaching a level of about 15 percent of economy-wide enterprise losses in 1996. Of immediate concern is the need to stop the economic and financial losses and establish a sound economic basis for the sector. This would require: (i) development of an appropriate legal, regulatory and institutional framework for restructuring the sector, including promotion of private investment in the sector; (ii) identification of uneconomic mines and development of appropriate institutions and procedures for closing the mines; (iii) implementation of mine closure and environmental programs; and (iv) design and implementation of a social labor deployment and regional development program.

The Bank has agreed to provide some assistance to the Government in achieving these objectives and is currently designing an invest-

ment program with advisory component that would include: (i) closure of the uneconomic mines and redeployment of the labor and assets from these mines; rehabilitation of the viable mines; development and implementation of model mine closure and privatization programs; (ii) restructuring of the industry and the entities involved by developing appropriate legal, regulatory, institutional and environmental framework that would promote efficiency of operation and attract external investments to the sector; and (iii) revitalization of the economy of the sector by developing and implementing social assessment and regional development programs.

BANK'S TEAM:
KENNETH LAY,
COUNTRY DIRECTOR
(H8-093, X33000)

DAVID CRAIG,
SECTOR LEADER
(H5-041, X32589)

RAGHUVVEER SHARMA,
PRINCIPAL FINANCIAL
ANALYST
(H5-076, X32302)

AKIN ODULOWU,
PRINCIPAL ENERGY
SPECIALIST
(H5-099, X32292)

VARADARAJAN ATUR,
SENIOR FINANCIAL ANALYST
(H5-101, X32305)

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Effective Date	Revised Amount	Closing Date	Task Manager
Petroleum Sector Rehabilitation Project (LN No. 37230)	The project objectives are to assist the (GoR) in achieving the goals of its petroleum sector strategy to: (i) promote private sector investments in the petroleum sector; (ii) strengthen institutional capabilities; and (iii) establish a suitable regulatory framework that will facilitate development of an efficient and commercially-oriented petroleum sector. PETROM, ROMGAZ and CONPET in improving its operational efficiency and financial management; and in implementing abatement measures to address environmental pollution in the sector.	08.9.94	175.6	12.31.99	A. Oduolowu
Power Sector Rehabilitation Project (LN. No. 3936)	The project objectives are to: (a) support the GoR's program of power sector reform in accordance with its overall economic reform objectives; (b) meet the demand for electricity and thermal energy in an economic manner by rehabilitating thermal generation capacity; and (c) lay the foundation for the future development of the sector in an institutionally, economically and environmentally sustainable manner.	1.24.96	110.00	06.30.00	R. Sharma

R U S S I A

COUNTRY INFORMATION

Russia's transition to a market economy has been very difficult, involving changes significantly more disruptive than those experienced by most Bank borrowers. Viewed over the span of several years, however, it is clear that a major economic transformation has taken place. Over 70 percent of GDP is now produced in the private sector, prices and trade have been essentially liberalized, the monthly rate of inflation has dropped to below 2 percent on average for the past 12 months, a trade surplus of \$24 billion was recorded in 1996, and Russia has returned to the international capital markets with two Eurobond issues of \$1 billion and DM 2 billion, respectively. The process of reform has been made substantially more difficult by the continuing economic recession. The impact of GDP on household welfare has been partially offset by a sharp decline in military and other non-productive expenditures, resulting in an increase in the share of private consumption in GDP. A few sectors of the Russian economy, especially those dealing with finance and trade, have expanded during the transition, but large portions of the economy remain stalled in a web of slack production, depressed investment, and inter-enterprise arrears. Manufacturing industries, particularly engineering products and textiles, have been the most affected by the economic recession, while export-oriented sectors such as energy and metallurgy have been relatively more successful.

Overall, the macroeconomic situation remains quite fragile. The biggest challenge has been to control the budgetary deficit (7.7 percent of GDP in 1996) in light of a continuing inability of the federal government to collect tax revenues, which fell to less than 12 percent of GDP during 1996. Two fundamental factors which have had the most important effect on the disappointing trend in tax collections are: (i) serious distortions in the overall tax structure,

and (ii) the lack of an effective tax administration. Poor revenue performance has undermined orderly fiscal management and led to severe sequestration of expenditures, contributing to an increase in budget arrears and non-payment of wages and pensions. On the expenditure side, further reduction of subsidies for agriculture and coal continues to be a priority, as well as rationalization of federal budget transfers to regions, which are costly and poorly targeted. Analysis of recent trends suggests that zero economic growth will be the

most likely outcome for 1997. Thereafter, growth is expected to increase in 1998 and could approach an annual rate of 6 percent as a medium-term trend. In order to set the stage for rapid growth, an intensification of structural reforms will be essential.

THE BANK GROUP STRATEGY

- **Non-lending Services.** The Bank Group will need to strengthen its capacity to respond in key reform areas such as private sector development, restructuring and regulatory reform for natural monopolies, and financing of education and health services.
- **Expanded Adjustment Lending.** Fast-disbursing adjustment lending would be made available through a combination of: (i) SALs linked to the EFF program to address key reforms in private sector development (privatization, competition, banking, natural monopolies, etc.) as well as fiscal issues relating to the sustainability of the financial stabilization program (tax reforms, expenditure rationalization, inter-governmental fiscal relations); and (ii) free-standing SECAL operations addressing

RUSSIA — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1993 (millions)	148.7			
GNP per capita (US\$)	2,770	2,320	2,230	2,400
Annual GDP Growth (%)	-8.7	-12.6	-4.3	-6
GDP Inflation (%) (average year)	1453.0	4452.6	161.2	19.5
Total Debt/GDPmp (%)	0.0	—	25.4	32.8

BANK'S TEAM:
MICHAEL CARTER,
COUNTRY DIRECTOR (MOSCOW)

DAVID CRAIG,
SECTOR LEADER
(H5-063, x32589)

C. MCPHERSON,
ENERGY ADVISER
(F 5P-160, x32854)

PENTTI ARO,
CONSULTANT
(H5-207, x87136)

CAROLYN GOCHENOUR,
PRINCIPAL FINANCIAL ANALYST
(H5-105, x39681)

PATRICIA HACKMAN,
CONSULTANT
(H5-020, x80457)

MICHAEL HANEY,
CONSULTANT
(H5-246, x33680)

JANET KOCH,
PROGRAM
TEAM LEADER
(H5-065, x80385)

VLADIMIR LITVAK,
CONSULTANT
(H5-239, x35124)

PETER POLLAK,
PRINCIPAL ENERGY SPECIALIST
(H5-081, x81065)

WILLIAM PORTER,
PROGRAM TEAM LEADER
(F8K-296, x36978)

JEFF PROCAK,
OPERATIONS ANALYST
(H12-087, x37615)

GARY STUGGINS,
PROGRAM TEAM LEADER
(H5-069, x32607)

VADIM VORONIN,
HEAD; ENERGY UNIT
(MOSCOW RM)

ANGELA WALKER,
CONSULTANT
(H5-208, x31276)

MARGARET WILSON,
ENERGY ECONOMIST
(H5-049, 82336)

issues such as social protection, coal sector restructuring, and agriculture reform. Beyond the immediate reform agenda, a possible second round of SECALs and/or SALs could address issues such as energy pricing and taxation, longer-term pension reforms, and/or strengthening of regional and local fiscal management.

- Greater Emphasis on Regional Investment Projects. Investment lending at the regional and local levels would seek to improve the creditworthiness of participating entities, especially in the context of large infrastructure operations (e.g., water and sanitation, district heating, urban transport, highway rehabilitation.) Participation would be conditional on demonstrated commitment by the participating entities to reforms needed to improve long-term creditworthiness (e.g., improvements in cost recovery, administrative reforms, more efficient utilization of existing assets), so that they can rely on commercial financing sources and internal cash generation to meet the bulk of their investment needs in the future. Experience indicates that projects of this type can perform successfully (provided the initial start-up delays are resolved expeditiously), but they are expensive for the Bank to prepare and supervise effectively, at least until the implementing agencies gain greater familiarity with Bank operations.
- Integrated Approach to Private Investment Financing. IFC, MIGA and the Bank would position themselves to move forward more aggressively with an array of policy advice, technical assistance, and financial instruments (including loan and equity financing from IFC, political risk guarantees, mobilization of co-financing, etc.) to support high priority private sector investments, especially in natural resources, manufacturing, banking, and consumer industries.
- Environment and Institution Building

Operations. Bank and EDI support has been instrumental in mobilizing international support for high priority environmental issues, including programs with international and/or global implications, and support for environmental activities (including access to the GEF) will continue to be an important part of the assistance strategy. In addition, the Bank will participate selectively in high priority institution building programs (e.g., legal reform, financial sector development, science and technology), although given the highly variable performance of such projects to date, Bank project funding will be considered only after all other avenues of support (e.g., non-lending services, grant financing) have been exhausted.

GOVERNMENT'S PRIORITIES FOR STRUCTURAL REFORMS IN THE ENERGY SECTOR

The Government has identified accelerating reforms in the *Energy, Infrastructure and Environment* sectors to improve creditworthiness of participating entities, especially at regional and local levels. Greater involvement of the private sector will be facilitated where possible as one of the key areas of structural reforms for closer cooperation with the Bank Group.

While there has been substantial liberalization of prices and trade in the energy sector, the policy framework needed to maximize long-term growth and profitability remains highly deficient in a number of respects. In the oil sub-sector, many of the production associations have focused on short-term revenue maximization in order to generate financial resources needed to consolidate ownership control of existing assets, which has contributed to the declining trend in both production and investment. Moreover, the tax regime and the legal framework applicable to foreign investment strongly discourage needed invest-

ment in the sector. In gas sector, there is a need to improve the regulatory regime to encourage the growth of private production and distribution companies. In electricity, the focus over the immediate terms is improving the financial viability of entities participating in the sector. Efficiency gains through improving dispatch is expected to reduce fuel costs considerably. In coal subsector, there is a need for substantial restructuring and down-sizing of the current industrial structure and accelerated privatization in order to improve profitability and efficiency of the remaining coal producing enterprises, while ensuring that the social impact on households and communities affected by mine closures is adequately addressed.

RUSSIA — ENERGY SECTOR INDICATORS	
Energy Resources	
Oil Reserves (mln tons)	6700
Coal Reserves (mln tons)	365000
Gas Reserves (bcf)	1717000
Energy Consumption	
(mtoe)	569.53
Power Generating	
Capacity (MW)	214690

ENERGY PROJECTS UNDER PREPARATION

Project	Project Description	Proposed Amount	Status	Project Manager
District Heating (RU-PE-38551)	The overall objective is to support the Government's program of reform for housing and communal utilities aiming at reducing the financial burden on municipalities associated with the supply of heat. The project will support a range of investments aimed at reducing the cost of heat supply (including rationalization of demand) and a reform agenda directed towards improving efficiency and cost recovery.	300.00	Early stages of the preparation.	G. Stiggins

ECONOMIC AND SECTOR WORK

	Task ID	FY	Task Manager
Power Sector Restructuring	RU-SR-51313	1998	G. Stiggins
Oil Sector Review		1997	C. McPherson
Oil Transport		1997	C. McPherson
Policy Dialogue in Oil Sector		1998	C. McPherson

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Effective Date	Original Amount (\$m)	Closing Date	Task Manager
Energy Efficiency Project (LN No. 38760)	The principal objectives of the project are: (a) to increase the efficiency of energy use within Russia; and (b) to support the government's reform program through technical assistance. Specifically, the studies will focus on gas sector structure, regulation, and pricing.	12.26.96	106.50	06.30.01	G. Stuggins
Greenhouse Gas Reduction Project (LN No. 28311) - GEF financed	The principal objectives are: (i) to assess the release of methane and CO to the atmosphere and propose methods for its reduction; and (ii) to identify and appraise projects to the decrease methane and CO emissions by increasing the efficiency of gas use.	12.19.95	3.2	12.31.97	G. Stuggins
Oil Rehabilitation (LN No. 36230)	Help to: (i) retard the rate of decline of oil production and exports in the near term; (ii) strengthen the managerial and technical capabilities as well as (iii) the financial viability of selected oil producing enterprises through the TA component and by example, assist the Government; (iv) mobilize additional financial resources for the sector through commitments to co-financing and through the demonstration effect of the project; (v) provide support to Russia's policy reforms in the upstream oil sector which are essential pre-requisites to private sector investment: i.e. price and tax reform; acceptable petroleum legislation; clarification of institutional responsibilities; and international tendering programs.	11.15.93	610.00	12.31.97	W. Porter
Oil Rehabilitation II (LN No. 37680)	The principal objectives of the Project are to: (i) slow the rate of oil production decline in Western Siberia and thus strengthen the Russian Federation's ability to earn foreign exchange in the near term; (ii) transfer international technical, environmental and managerial practice to the operation of oil fields in Western Siberia; (iii) promote a more efficient and environmentally sustainable use of Russia's petroleum resources; and (iv) through policy consultations, support Government efforts to promote sector reforms conducive to attracting equity and loan finance and international participation necessary to reverse the oil production decline.	05.25.94	500.00	12.31.98	W. Porter
Emergency Oil Spill Mitigation Project (LN No. 38720)	The objectives of the Project are to assist Komineft and the Russian Federation to: (i) stabilize the oil in the spill area prior to the 1995 spring thaw to minimize the amount of oil released during runoff and prevent ecological damage in the Pechora River Basin; (ii) continue cleanup in an environmentally appropriate way and minimize, to the extent possible given the limited time available and difficult site conditions, damage to the impacted areas and people; (iii) support safe pipeline operations in the near term and evaluate the need for a replacement pipeline investment project for the longer term; and (iv) identify and implement other measures to mitigate against future oil spills.	06.29.95	99.00	03.31.98	W. Porter
Coal SECAL (LN No. 40580)	The principal objectives of the program supported by the SECAL are to: (i) reduce the impact of the coal sector on the federal budget by supporting the decrease, and eventual elimination, of subsidies; (ii) promote the long term sustainability of the coal sector through establishment of a competitive, commercial industry; (iii) support a restructuring program to reduce the size of the industry to increase efficiency; and (iv) cushion the impact of the restructuring on coal miners, their families and affected communities.	07.02.96	500.00	12.31.97	J. Koch

ENERGY PROJECTS UNDER IMPLEMENTATION (CONTINUED)

Project	Development Objectives	Effective Date	Original Amount (\$m)	Closing Date	Task Manager
Coal SECAL II (LN No. 42620)	Coal SECAL II will help the Government deepen the achievements of the first Coal Sector Adjustment Loan through a program directed toward: (a) separation of state management functions and commercial activities in the industry and improvement of sector governance; (b) continued reduction and improved management of coal subsidies, aiming at the eventual elimination of coal subsidies; (c) development of a strengthened and more targeted social safety net for affected workers, their families and communities; and (d) establishment of a more efficient and sustainable industry and promotion of an accelerated privatization program.	12.19.97	800.00	12.31.99	J. Koch
Coal Sector Restructuring Implementation Assistance Project (LN No. 40590)	As a companion project to Coal SECAL I and II, this project aims to enhance the effectiveness in implementation of the coal sector restructuring program through assistance to the Government, affected people and organizations. Specifically, the project has the following objectives: (a) improvements in management of the restructuring process through increased participation of stakeholders as well as enhancement in transparency and transparency and openness; (b) in the short run, filling critical skill gaps in a number of key areas which are essential to design the details and implement the restructuring program effectively; and (c) in the long run, strengthen the country's institutional capacity to sustain reform.	07.25.96	25.00	12.31.99	J. Koch
Electricity Sector Reform Support (LN. 4181-RU), (formerly Power Sector Reform Support):	The project would finance Russian and foreign advisors to work with the various sector entities and government agencies on implementation of the reform agenda. The project would support: (a) the government in further refining and developing its concept for reform and elaborating a detailed implementation plan; (b) the government in carrying out the activities necessary to implement the plan; and (c) the development of electricity sector entities. 1997.	Approved by the Executive Directors on 5 June (IBRD).	40.00		G. Stiggins

S L O V A K I A

COUNTRY INFORMATION

Slovakia has registered one of the best macro-economic performances in Central Europe (CE) since its independence from the Czechoslovak Federation. Inflation has declined to 6%, and is currently one of the lowest among transition economies. Real GDP grew by 6.9% in 1996, following growth rates of 6.8% and 4% in 1995 and 1994, respectively. The recovery has been driven by the private sector, which increased its participation in the GDP to more than 75% in 1996, and has

been accompanied by a significant reduction in the rate of unemployment—from a peak of 14% in 1994 to around 10% in 1996. The ratio of gross fixed investment to GDP has been maintained above 30%—the highest in CE—raising prospects of further capital accumulation and growth.

The reported success was due to the stabilization package of 1993, which included a fixed exchange rate, a strict fiscal policy, and moderate wage increases. Expenditure cuts led to a sharp decline in the ratio of expenditures to GDP—from 58% to 47% between 1992 and 1995. This fiscal contraction was more than offset by a significant growth of exports and fixed investment. Exports grew by 25% per year in 1994 and 1995, driving GDP growth in those two years. The strong export performance was due to the competitive levels of the exchange rate, the strong output activity in foreign markets, and initial progress at enterprise restructuring. Fixed investment replaced exports as the main source of GDP growth in 1996, increasing its share in the GDP to an impressive 36%.

The main question faced by Slovak policy-makers is whether this impressive growth performance is sustainable. The answer to this question may be positive, provided the Government will correct the macro-economic imbalances that emerged in 1996, and complete the structural reforms initiated in the early 1990s. A central issue is to reverse the recent deterioration in the current account, which shifted from a surplus of 2% of GDP in 1995 to a deficit of more than 10% of GDP in 1996. This shift was due to a sharp slowdown in the growth of exports to only 4% in 1996, combined with a strong 25% increase in imports.

In the structural area, continued loss-making activities at the level of enterprises, and the large volume of classified loans held by the major banks, is particularly worrisome. A large group of inefficient enterprises caused aggregate gross losses of 8.8% of GDP in 1996 among the highest ratios among Visegrad countries. Removing these structural bottlenecks and solving other institutional and regulatory problems, could yield significant efficiency gains, and allow Slovakia to maintain growth performance with somewhat lower investment ratios and a sustainable current account. This is particularly noteworthy for the energy sector.

Slovakia faces the challenge of sustaining the impressive growth performance achieved after independence, while preparing the economy for EU accession. The measures required to eliminate large macro-economic imbalances, increase micro-economic efficiency, and sustain growth would coincide to a large extent with the economic requirements for EU accession. The capacity to cope with competitive pressures within the Union assumes, *inter alia*, a diversified industrial base, and robust enterprises and financial institutions. Finally, the ability to take the obligations of membership

SLOVAKIA — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1996 (millions)	5.4			
GDP/capita(US\$)	2,250	2,570	3,230	3520
Annual GDP Growth (%)	-3.7	4.9	6.8	6.9
Consumption Growth: total(%)	-1.7	-3.4	2.9	12.1
privt.(%)	-1.5	0.0	3.4	7.2
Inflation based on CPI Growth (%)	23.2	13.4	9.9	5.8
Ratio of Total Debt/GDP (%)	30.0	34.9	33.6	41.2

assumes full compliance with the *Acquis Communautaire*— the set of rules and regulations applicable to all Member States. (Slovakia – CEM, 1997; pp.vii to ix)

In July 1997, the EU Commission in July 1997 declared Slovakia not yet ready for starting EU accession negotiations because it “does not fulfill in a satisfying manner the political conditions set out by the European Council,” whereas it “could largely satisfy the economic criteria” (EU Commission, July 1997).

THE BANK GROUP’S STRATEGY IN SLOVAKIA

Over the past two years, the Bank has not been as active in Slovakia as in other CE due in part to difficulty maintaining a dialogue during the past two years. Similarly as in other countries in CE, the Bank could play an important role with respect to the continuation of macro-economic reforms, advice on trade policy, social policies, support for financial sector reform and urgent enterprise reform. The Bank could also contribute to sector specific reforms, notably in agriculture, infrastructure, energy and in particular with regard to the environment. In 1996, the Government requested that the Bank become involved in environmental improvements and help develop a related lending program, i.e. in an area which is heavily affected by the energy sector. EU accession requirements and meeting the *EU Acquis Communautaire* requirements has placed a new emphasis on various economic distortions. The Bank could contribute to both non-lending and lending services in different areas.

SLOVAKIA’S ENERGY SECTOR — POLICIES AND ISSUES

- General: Slovakia has a sound energy strategy and policy statement (“Energy Conception for the Slovak Republic to the Year 2005”) which was adopted by the

Government in August 1993, and in updated form, in September 1995. Slovakia’s energy objectives include introduction of more competition, enhanced security of supply, energy efficiency and environmental protection. The strategy calls for (a) reliance on a regional energy strategy and systematic planning of energy at each level; (b) establishment of a legal framework that will prefer environmentally advantageous primary energy resources; (c) diversification of primary energy inputs; (d) optimization of the extraction and use of domestic primary energy resources; and (e) extension of the capacity of the gas transit systems and development of natural gas utilization across the country. The EU Commission considered this strategy to be in line with EU policies. A New Energy Law (NEL) has been drafted to replace the existing laws from times before the creation of Slovakia. The most recent version of the draft NEL focuses on the network fuels.[check]

- EU Accession: Slovakia must comply with the *EU Acquis Communautaire* to gain EU membership. In addition to aligning legal and regulatory frameworks and environmental standards, energy sector investments alone are estimated to be at a minimum US\$ 2 billion to meet EU requirements. Generally speaking, investment requirements to modernize the sector and meet environmental and security standards of energy storage and to introduce economic energy efficiency measures could cost US\$150 to 200 million per year (about 1 % of GDP) over the next 15 years.
- Environmental: Major difficulties resulting from energy sector activities are air pollution (electricity, district heat, household heating with coal, urban transport); water pollution (lignite mines, refinery); and disposal of solid waste (from lignite mines, thermal power plants) and nuclear waste.

SLOVAKIA — ENERGY SECTOR INDICATORS

Total Primary Energy Imported (% of total primary energy supply) (TPES)

89%, including
nuclear fuel
imports

Consumption per capita

Energy 3.30 toe/capita
Electricity 5530 kWh/capita

Energy Intensity (TPES/GDP)

0.94 toe/'000US\$
(0.19 in OECD)

Power Generation Capability

7,116 MWe

nuclear: 1760 MWe

hydro: 2387 MWe

BANK'S TEAM:

ROGER GRAWÉ,
COUNTRY DIRECTOR
(H12-OYY, X34252)

HENK BUSZ,
ENERGY SECTOR LEADER
(H5-055, X32686)

CHRISTIAN DUVIGNEAU,
ENERGY PROGRAM LEADER AND
PRINCIPAL OPERATIONS OFFICER
(H5-077, X32696)

HELMUT SCHREIBER,
ENVIRONMENTAL PROGRAM
LEADER AND SENIOR
ENVIRONMENTAL OFFICER
(H3-107, X36910)

ALBERTO CRUZAT,
SENIOR TELECOMMUNICATIONS
SPECIALIST
(F4K-188-X82675)

ISTVAN DOBOZI,
SENIOR ENERGY ECONOMIST,
(H5-251, X32147)

- **Lignite & Coal:** Approximately 20% of solid fuels comes in the form of lignite from local mines which are expected to continue to operate as the only significant domestic hydro carbon source. The remainder is imported from neighboring countries. Restructuring of the lignite sector seems unavoidable and its regional consequences will have to be addressed. The EU has indicated that state-aid to the lignite/coal sector needs to be reviewed, and lignite pricing and import taxes on coal need alignment.
- **Gas:** The domestic gas market is relying on over 95% on imports, with Russia as the sole foreign supplier and Nafta Gbely as the domestic supplier. Slovakia is a strategic transit country for gas from Russia to the EU and the Balkans. Slovakia's energy strategy provides for: (a) a strengthening of the gas transit through an additional (fifth) pipeline, (b) the modernization and expansion of the existing gas network and supply also into more remote areas of the country (network extension from presently about 10,500 km supplying about 850 municipalities, to 17,000 km supplying 1300 municipalities in 2010), and (c) establishment of seasonal and strategic gas storage facilities in addition to the ones in the west of the country (presently 1.7 billion m³). Slovensky Plynarenski Priemysel (SPP), the dominant gas company in the country, is considered a strategic enterprise. Gas pricing, controlled by the Ministry of Finance (MoF) and Ministry of Economy (MoE), is heavily distorted. Whereas industrial enterprise pay close to economic costs, households pay either 50% plus a fixed charge or 85% of the tariff for industrial consumers, depending on quantities consumed. The low household prices need adjustment in order to also cover the cost of connection which is much higher than for industry.
- **Oil:** There is almost 100% dependence on imports of crude mostly from Russia, and some high quality products from the EU. Slovakia is a strategic transit country for crude from Russia to the EU (Druzhba-pipeline, operated in Slovakia by Transpetrol A.S.). The domestic market (presently requiring 5 million tpy) is dominated by Slovnaft and controls production, trade, refining and distribution. A small company Petrochema Dubova, operates a specialized refinery. The state-owned Slovnaft refinery (capacity 5 million tpy) needs a technology upgrade to meet environmental standards for operations and products. Oil storage capacity in Slovakia needs to be built up to 90 days of consumption based on OECD/IEA and *EU Acquis Communautaire* requirements (presently 45 days). At present the oil sector is protected by a tax regime, unallowable for EU membership.
- **Electricity:** Electricity is largely supplied by Slovenske Electrarne a.s. (SE), a quasi monopoly supplier that controls most generation capacity, the transmission system and international power trade. SE is also in charge of long term planning, system optimization, trade, and relations with the West European Grid UCPTÉ. Three regional distributors, West-, Middle-, and East Slovakia Electricity Enterprises or ZSE, SSE, VSE, assure direct links with customers. Total domestic electricity supply was 26,000 GWh in 1995, plus 3,900 GWh imports of less 2,500GWh exports. Losses of the system amounted to 2,115 GWh or 7.1% of the total. Generation takes place in plants with an installed capacity of 7,116 MW, including hydro (33%), nuclear (25%), and thermal (42%), the latter partly lignite, partly coal— and partly oil/gas fired. The Government's strategy recognizes the system's shortcomings, and therefore intends to: (a) improve

the efficiency of power generation, transmission, and distribution; (b) stimulate efficient energy use; (c) introduce more realistic electricity prices and re-evaluate the tariff system, (d) stimulate the use of renewable energy resources; and (e) liberalize the markets for primary energy and electric power in compliance with the EU and the European Energy Charter. Investments would help to modernize generation capacity, transmission grid and distribution systems, increase generation from new or refurbished independent, private power producers, and enhance the mutual support between Slovak and neighboring power grids. New links with Poland and Austria are planned. The most important issues, as underlined by the EU Commission, relate to regulation, power pricing and transparency of transfer prices, as well as a need for market liberalization.

- Nuclear: 100% of Nuclear Fuel has to be imported and comes predominantly from Russia, as there is no uranium mining or fuel fabrication in Slovakia. The Jaslovské Bohunice Nuclear Power Plant (NPP), with two first-generation VVER 440-230 reactors and two second-generation VVER 440-213 reactors is located in western Slovakia. In 1995 it provided almost 50% of total power generation. A second plant, located near Mochovce in central Slovakia will have two VVER 440-213 reactors and a total capacity of 880 MW. It is expected to start up in 1999. Bohunice is presently upgraded and will likely meet European safety standards. The construction of the Mochovce plant is being done by a consortium of Russian and CE companies. Slovakia has been requested to impose standards equivalent to EU safety standards. Nuclear waste storage is under study.
- Hydro: The hydro-power potential in Slovakia is significant and presently only

utilized by about 60%. Stations under construction or planned utilization could reach 62% by 2000 and 74% by 2010. Hydro power generation presently covers about 20% of total power generation. Small hydro plants (under 10 MW) are discussed under renewable energy resources. Substantial modernization and upgrading is needed in some of the large hydro plants.

- Renewables: The Government's energy strategy recognizes the country's dependence on imports and environmental damage from lignite. It therefore pursues renewable energy resource (RER) development as an important source of primary energy for Slovakia. The Government intends to develop small hydro power, biomass, geothermal, and solar energy, as well as use of waste heat, with the long term objective of substantially increasing the share of RERs within primary energy use (present use is estimated below 2%). RERs should be promoted on strategic grounds and the funds allocated to the sector should be balanced with the expected benefits. Slovakia's objective to develop RERs is in line with EU philosophies. The Bank is involved in helping to develop RERs in the country.
- District Heat: District heating (DH), generally a municipal responsibility in Slovakia, is mostly undertaken by utilities who supply heat to households and industry. Few cities obtain their heat from CHPs whereas the rest obtain it from industrial CHPs, or from heat-only-boilers (HOBs). Overall heat consumption in 1995 was about 250 PJ, with 145 PJ going to industry, and 105 PJ to households. Municipal district heat and CHP development in Slovakia have a significant potential, but are impeded by the low prices for electricity and gas (and relatively high prices for coal). This makes it hard for CHPs to compete. The

BANK'S TEAM (CONTINUED):
MARC HEITNER,
ENERGY CONSULTANT

MANGESH HOSKOTE,
POWER SECTOR
SPECIALIST/ESMAP
(F2K-146, 31347)

HANS ROLAND LINDGREN,
INDUSTRIAL ENVIRONMENTALIST
(X32565)

PETER KALAS,
ENERGY AND ENVIRONMENTAL
SPECIALIST
(H3-155; X 85647)

DUANE KEXEL,
ENERGY ECONOMICS
CONSULTANT

ANKE MEYER,
ENERGY SPECIALIST
(F2K-174, X 39962)

ARTURO ROA,
ENERGY CONSULTANT

FRANK SADER,
FIAS
(R 2-009, X33921)

SVETOSLAV TINTCHEV,
TELECOMMUNICATIONS
SPECIALIST
(F4K-174,X37560)

BJOERN WELLENIUS,
PRINCIPAL
TELECOMMUNICATIONS
SPECIALIST
(F4K-250, X 82663)

JULIUS WILBERG,
SENIOR FINANCIAL ANALYST
(H5-079, X37151)

R. PETER WRIGHT,
TELECOMMUNICATIONS
SPECIALIST
(F4K-232, X81764)

Government intends to continue to develop DH systems and CHPs

the use of Renewables, and an industrial energy efficiency project).

BANK'S STRATEGY WITH REGARD TO THE ENERGY SECTOR OF SLOVAKIA

The energy sector in Slovakia, governed by centralized state control, has experienced only limited privatization, and is operating under a regime of relatively low prices in the network fuels, price distortions and uncertainties. As a result, potential private investors hesitant to invest in the sector. These shortcomings, among others have been pointed out by the EU Commission. In these areas the Bank can help from the Region and from ESMAP with technical support, focused advice, and related lending operations. In addition, one of the priorities under EU Accession Measures is to address the shortcomings on the environmental side, an area for which the Slovak Government has requested the specific cooperation of the Bank. The energy sector is to a large extent responsible for the still significant air pollution in a country that wants to promote tourism. Slovakia and the Bank have therefore agreed that Bank support will focus on environmental cooperation, including energy related environment projects, to help meet environmental standards consistent with International Protocols and Treaties.

The Bank should be ready to support the above lending operations proposed recently by the MoEN. There may also be opportunities for privatization in the context of the proposed GCI Project. The next mission should explore with the Government the possibilities for non-lending support to the energy/environment sector, notably with respect to (i) sector regulation, (ii) sector rationalization, (iii) energy pricing and (iv) air pollution. Experience from other countries (e.g. Poland) could be valuable in this context. The independent and neutral position of the Bank with emphasis on rational economic criteria, could help resolve some of the divisive political issues in the sector.

In line with above mentioned priorities, a major focus of Bank activities could be energy and the environment. In 1996, the Ministry of the Environment (MoEN) requested that the Bank to develop an energy efficiency and conversion project with GEF support and a focus on greenhouse gas and air pollution reduction. The MoEN has also agreed to conduct a study on green house gas emissions in the context of the Global Carbon Initiative (GCI), and has offered to prepare a GCI Project (e.g. refurbishment of a combined heat and power plant or conversion of a heat plant to CHP, including

ENERGY PROJECTS UNDER PREPARATION OR PROPOSED

Project	Project Description	FY	Proposed Amount (\$m)	Status	Project Manager
Energy and Environment Project	The objective of this project is to convert a heat only boiler in one of the Slovakian Cities to a Combined Heat and Power Operation (CHP) possibly using biomass. This could be a demonstration project for similar operations to follow.	00	70.0	Interest in such a project was expressed in July 1997 by Ministry of Environment and the Ekofund.	H. Schreiber/ C. Duvigneau
Industrial Energy Efficiency and Environment Project (Credit Line)	The objective of this project is to improve energy efficiency and reduce air pollution in various industrial operations in the Slovak Republic.	00	50.0	The MoE has made a first request for consideration of a number of sub-projects	H. Schreiber/ C. Duvigneau
Power Plant Rehabilitation Project	This project would modernize and help privatize a power plant in the Slovak Republic to serve as a demonstration project for the sector.	01	75	This is based on a former project discussion.	C. Duvigneau
GEF Greenhouse Gas Reduction Project.	The objective of this project is to reduce Greenhouse gases through energy conservation and efficiency measures for industrial and municipal energy customers.	99	40.0	The MoEN, with local consultants, has identified a number of sub-projects which have been reviewed and are being refined.	H. Schreiber/ C. Duvigneau
Telecommunications II Project.	This project will focus on sector regulation, privatization and frequency spectrum to cover multi-year investment slice.	2000	75	Needs Identification Discussions. Interest has been expressed.	A. Cruzat

NON-LENDING SERVICES

EU Accession related:	Regulatory Framework, Complementary Legislation for draft Energy Law.	98	0.15	to be discussed with MoE	t.b.d.
EU Accession related:	Subsector Pricing Studies	99	0.10	to be discussed with MoE	t.b.d.
EU Accession related:	Strengthening of Administrative Capacities to assure compliance with environmental laws.	99	0.10	to be discussed with MoE	t.b.d.
EU Accession related:	Power Sector Network Linkages		0.10	to be discussed with MoE	t.b.d.
	Global Carbon Initiative (Greenhouse Gas Reduction Potential) Study	98	0.15	Agreed with MoEN in July 1977	Peter Kalas
	Needs Assessment - CAS Policy Note	98		not yet started	t.b.d.

SLOVENIA

COUNTRY INFORMATION

1. After the decline of Slovenia's economy in the unfavorable climate prevailing during the last years of the former Yugoslavia, a stabilization program, one of the first priorities of the new independent State, was implemented in 1991/92. It included creation of a new currency (the Tolar), tight monetary policy and balanced Government Budgets, as well as measures to liberalize trade to promote growth. The program was successful in reducing inflation from over 500% in 1990 to 32% in 1993 and to single digit levels now. After an initial contraction (cumulative GDP reduction by 13 % between 1990 and 1993), GDP growth resumed in 1993, driven initially by rapid expansion of private consumption and subsequently by an expansion of foreign demand. Between 1993 and 1996 GDP growth averaged 3.8% per year, albeit with declining trend.

2. Three factors explain the recent relatively low growth of the economy: *First, the large size of the state in the economy, and the related tax pressures on the private sector, reduced domestic resources available for savings and investments. General government expenditures amounted to 46% of GDP in 1996, well above that of fast growing middle income countries. Second, low growth is linked to the*

limited role of the financial sector in transforming available savings into long term investment finance. Despite considerable progress achieved in restructuring State-owned banks, as part of the program supported by the EFSAL, delays in privatization of banks and limited entry of foreign banks have resulted in low competition in the sector:

real lending rates have remained in the 11%-13% range over the past years, raising the cost of investments financing by enterprises in the domestic market. *Thirdly, low growth can also be linked to the persistence of structural weaknesses inherited from the previous system and resulting low productivity growth.* Significant progress was made in privatizing SME enterprises and some large enterprises, but many large industrial enterprises and utilities are still state-owned. As a result, the share of private sector in GDP accounts for only 45% in Slovenia (1996). Moreover, many privatizations have taken the form of manager-employee buy-outs with resulting insufficient capitalization. These problems have contributed to low levels of direct foreign investments and slow growth of new technologies.

3. There is broad consensus within the Slovene society to achieve *EU Accession*, but views diverge among various socio-economic groups concerning the speed of accession and the shape of economic policies during the pre-accession period. Nevertheless, as it sets its sights on accession to the EU at the turn of the century, the overarching development objective for Slovenia is to achieve faster, sustainable growth. Increasing domestic savings, attracting foreign capital, increasing investment rates and raising productivity through increasing participation of the private sector, are at the core of a fast growth scenario for Slovenia.

THE BANK GROUP'S STRATEGY IN SLOVENIA

4. Since 1993, the Bank's program in Slovenia has been very modest, with limited project support. The Slovenian Government requested a stronger involvement of the Bank which was agreed in 1996. Cooperation will (a) focus on areas where the Bank has a comparative advantage and the country sees its priorities

SLOVENIA — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1996 (millions)	2.0			
GDP/capita (US\$)	6,650	7,180	8,230	9,160
Annual GDP Growth (%)	1.7	5.1	3.7	2.8
Consumption Growth: total (%)	13.3	3.0	5.7	2.2
privt. (%)	15.6	3.9	5.6	3.0
Inflation based on CPI Growth (%)	32.3	19.8	12.6	9.7
Ratio of Total Debt/GDP (%)	14.8	15.8	16.0	21.8

but has difficulties attracting impartial advice and funding; (b) work on the basis of a partnership between Bank staff and Slovene experts, and (c) maximize complementarity between Bank Group activities and other international and bilateral donors. Based on the Government's requests, the Bank's assistance program would focus on six key priorities, four of which are of direct relevance in the energy/environment sectors: (a) supporting the state asset management and privatization program; (b) supporting the development of the private sector, (c) creating conditions to attract domestic and foreign private investments in infrastructure, and (d) supporting the integration of the Slovene economy in the European Union.

SLOVENIA'S ENERGY SECTOR — POLICIES AND ISSUES

- **General:** Slovenia has a sound Energy Strategy and Policy statement which was approved in 1995.[check]. A draft New Energy Law (NEL) is being prepared to replace the existing energy law of 1981. The most recent version of the draft NEL is dated June 1997 and focuses on the network fuels (gas, electricity and district heat). Even the latest version is not yet determined on a clear regulatory approach but offers alternatives and options for approaching regulation. While the draft NEL is a move in the right direction, it does not provide for critical elements of effective regulation, institutional autonomy, transparency and operational accountability. A particular problem is the lack of clear procedures and mechanisms for determination of transfer prices between generators, producers, or importers, transmission company and distributors. FIAS/ESMAP support for infrastructure regulation is addressing some of these issues and the work needs to be continued.
- **EU Accession and eventual membership** calls for actions to comply with *EU Acquis Communautaire (AC)*. Significant legal and regulatory reforms and liberalization are needed in the energy sector. In addition, investments to meet with the conditions under the EU Acquis Communautaire are estimated at a minimum to amount to US\$ 400 million to meet EU requirements. Generally speaking, investment requirements to modernize the sector and meet environmental standards, as well as security standards of energy storage (oil and gas), as well storage for nuclear waste, and to introduce economic energy efficiency measures, could cost US\$ 100 million per year (almost 1% of GDP) during the next 15 years.
- **Environmental:** Major issues of air pollution (electricity, district heat, household heating with coal); water pollution (coal mines, refinery); disposal of solid waste (from coal mines, thermal power plants) and nuclear waste; subsidence from coal mining and oil/gas exploitation.
- **Coal:** Government considers this a priority resource as it is indigenous. The underground (!) Velenje lignite mine in the north produces about 4 million tons per year (tpy) of lignite (10 kJ/kg), which is consumed to over 95% in the Sostanj mine-mouth power plant. Mines at Trbovlje and Hrastnik in the center of the country produce sub-bituminous coal (17 kJ/kg) at about 1 million tpy. The environmental problems of coal combustion are recognized: the Government intends to increasingly limit coal to power generation where pollution control can be centralized. The state aid and subsidies flowing in the sector directly and indirectly have been significant, and although declining, are little transparent. They are being justified on social grounds, but social issues of over-employment in the sector should be

**SLOVENIA — ENERGY
SECTOR INDICATORS (IEA)**

**Total Primary Energy Imported
(% of total primary
energy supply) (TPES)**

57%

Energy Resources

Gas Reserves

(proven) 300,000 toe

Oil Reserves 185,000 toe

Lignite Reserves

650 million t

of which recoverable:

225 million t

Sub-Bitumin Coal Reserves

not available

of which recoverable:

57 million t

Consumption per capita

Energy 2.60 toe/capita

Electricity 5375 kWh/capita

Energy Intensity (TPES/GDP)

0.30

(0.19 in OECD)

Power Generation Capability

2,395 MWe

of which belonging to Croatia

316 MWe

DH Capacity at Substations

1992 MWt

addressed directly. A closure program is underway to cut highly uneconomic capacities of sub-bituminous coal in the center and in the south. High quality, low-sulfur hard coal is imported at the rate of about 350,000 tons

- **Gas:** The domestic gas market is relying to almost 100% on imports, which are well diversified: from Algeria, via Italy, as well as from Russia via Austria. Geoplin Company is in charge of gas imports and transmission, selling to local distribution companies. The transmission network (920 km) was built in the mid-1970s was designed for 1.3 million m³ and needs expansion and upgrading. Gas storage is limited leaving little flexibility in trade. Geoplin is a monopoly in trade and transmission but third party access (TPA) is considered by the Government. The market is strongly influenced by subsidized coal prices and Government decisions on fuel choices of state owned customers. Due to economic contraction in the early 1990s and preference for coal in power production, gas consumption has fallen to slightly less than 0.6 million tons of oil equivalent (toe) in the mid-1990s. In order to allow for sound resource allocation, energy pricing across the entire energy sector needs rationalization.
- **Oil:** Almost 100% dependence on imports of crude (and some high quality products). Crude comes via the Croatia-owned Adria Pipeline originating in the port of Krk Island, or via the Druzhba Pipeline from Russia through Austria. The market (presently about 2 million tpy) is dominated by three companies (Petrol Trgovina, Istrabenz and Nafta Lendava) in charge of production, trade, refining and distribution. Little competition between the two main distributors (Petrol and Istrabenz) in different parts of the country. The only domestic refinery, Nafta Lendava, jointly

owned by Petrol (55%) and the state (45%), needs technology upgrade to meet environmental standards for operations and for products, but the economic feasibility is doubtful. At present it is protected by a tax regime which is in contradiction to the EU regulations. OECD/IEA and EU Acquis Communautaire require build-up of storage to a level of 90 days of annual average consumption.

- **Electricity:** Electricity is supplied by a desegregated structure at rate of about 12 to 14 thousand GWh/year. Generation takes place in eight generation companies with an installed capacity of 2,080 MW, including hydro (36%), nuclear (15%, excludes Croatian owned capacity) and thermal (49%), the latter partly lignite, partly coal— and partly oil/gas fired. Transmission is assured by Electro Slovenija (ELES), which is also in charge of long term planning, system optimization, trade, and relations with the West European Grid UCPT. Five regional distributors assure direct links with customers. The Government's strategy recognizes the system's short-comings and, therefore, intends to (a) improve the efficiency of power generation, transmission, and distribution, (b) stimulate energy efficiency in use, (c) introduce more realistic electricity prices (although they are higher than in most other CEE countries), and re-evaluate the tariff system, (d) stimulate the use of renewable energy resources, and (e) liberalize the markets for primary energy and electric power in compliance with the EU and the European Energy Charter. Investments would help to modernize generation capacity, transmission grid and distribution systems, increase generation from new or refurbished independent, private power producers, and enhance the mutual support between Slovene and neighboring power grids. The most important issues as

underlined by the EU Commission relate to regulation, power pricing and transparency of transfer prices, as well as need for market liberalization.

- **Nuclear:** The Krsko Nuclear Power Plant (NPP) with a capacity of 632 MW is located near the Sava River in south Slovenia near the Croatian border. It is jointly owned (50/50) with Croatia. Construction started in 1974 and commercial operation in 1983. The NPP uses a two-loop Westinghouse pressurized water reactor (PWR) with one steam turbine and two steam generators. Operational records and nuclear safety compare well with best plants in IEA Member Countries. Further improvements were introduced in a program of Regulatory Compliance started in 1994 and completed in 1996. Long-term availability is affected by the reduced life of the steam generators requiring replacement soon, and by insufficient nuclear waste storage capacity. Additional storage capacity is needed before year 2000. The Government's long-term aim is to shut down the plant at the end of its design lifetime. Given the high dependence on the plant at this time, alternative conventional capacity would have to be developed, as no NPP is being envisaged.
- **Renewables:** Energy Strategy of the Government recognizes the dependence on imports and the environmental damage from coal and lignite. It therefore pursues renewable energy resource (RER) development, as "the most important source of primary energy for Slovenia and a national reserve". It intends to develop hydro power, biomass, geothermal, and solar energy, as well as use of waste heat, with the long term objective to substantially increase the share of RERs within primary energy use. RERs should be promoted on strategic grounds and the funds allocated to the sector should be balanced with the

expected benefits. Slovenia, in recognition of its tourist potential and its natural beauty, is the only country in the CEE with such explicit endorsement of RER development, which is in line with EU philosophies.

- **District Heat:** District heating (DH), generally a municipal responsibility in Slovenia, is mostly undertaken by utilities who supply heat to households and industry. Ljubljana and Velenje obtain their heat from combined heat and power plants (CHPs) whereas five other cities obtain it from industrial CHPs. In all other places with DH supply there are heat-only-boilers (HOBs). With less than 2000 MWt capacity, about 9000 TJ heat production and a distribution network of about 440 km, the DH sector is relatively small when compared to other CEE countries as it only covers about 15% to 20% of housing stock (mostly large apartment blocks). CHP development in Slovenia has a significant potential but is undermined by the low prices for electricity and gas (and relatively high prices for coal). This makes it hard for CHPs to compete. IEA estimated that on the basis of the 1995 electricity tariffs, the additional CHP potential was 104 MWe whereas with a 15% electricity tariff increase the potential could be 264 MWe. The Government intends to continue to develop DH systems and CHPs.

BANK'S STRATEGY WITH REGARD TO THE ENERGY SECTOR IN SLOVENIA

5. The energy sector still suffers from overly centralized state control (rather than being developed based on independent regulation), does not yet benefit sufficiently from private know-how and capital as private participation is still very limited, suffers from relatively low prices in the network fuels, price distortions and uncertainties, which make potential private investors loath to come in. These shortcomings, among others have been pointed out by the EU Commission as well. In these areas the Bank

BANK'S TEAM:
ROGER GRAWÉ,
COUNTRY DIRECTOR
(H12-0YY, X34252)

HENK BUSZ,
SECTOR LEADER
(H5-055, X32686)

CHRISTIAN DUVIGNEAU,
ENERGY PROGRAM LEADER
AND PRINCIPAL OPERATIONS
OFFICER
(H5-077, X32696)

HELMUT SCHREIBER,
ENVIRONMENTAL PROGRAM
LEADER AND SENIOR
ENVIRONMENTAL OFFICER
(H3-107, X36910)

BERNI BARATZ,
SENIOR ENVIRONMENTALIST
(H3-133, X32333)

ALBERTO CRUZAT,
SENIOR
TELECOMMUNICATIONS
SPECIALIST
(F4K-188-X82675)

ISTVAN DOBOZI,
SENIOR ENERGY ECONOMIST,
(H5-251, X32147)

MARC HEITNER,
SENIOR ENERGY SPECIALIST
(H10-033, X85836)

MANGESH HOSKOTE,
POWER SECTOR
SPECIALIST/ESMAP
(F2K-146, 31347)

GORDON HUGHES,
SENIOR ENVIRONMENTAL
ECONOMIST
(S3-075, X33584)

BANK'S TEAM, CONTINUED:
HANS ROLAND LINDGREN,
INDUSTRIAL ENVIRONMENTALIST
(H3-103 X32565)

PETER KALAS,
ENERGY AND ENVIRONMENTAL
SPECIALIST
(H3-155; X 85647)

NAUSHAD KHAN,
SENIOR PROCUREMENT
SPECIALIST,
(H3-114, X32699)

PIOTR KRZYZANOWSKI,
SENIOR ENVIRONMENTAL
SPECIALIST
(H3-105, X 33638)

DUANE KEXEL,
ENERGY ECONOMICS
CONSULTANT

ANKE MEYER,
ENERGY SPECIALIST
(F2K-174, X 39962)

NJERI MUHOHO,
FINANCIAL ANALYST
(H5-201, X32158)

ARTURO ROA,
ENERGY CONSULTANT

FRANK SADER,
FIAS
(R 2-009, X33921)

SVETOSLAV TINTCHEV,
TELECOMMUNICATIONS
SPECIALIST (F4K-174,X37560)

BJOERN WELLENIUS,
PRINCIPAL TELECOMMUNICATIONS
SPECIALIST
(F4K-250, X 82663)

JULIUS WILBERG,
SENIOR FINANCIAL ANALYST
(H5-079, X37151)

R. PETER WRIGHT,
TELECOMMUNICATIONS
SPECIALIST
(F4K-232, X81764)

can help from the Region, from ESMAP and through FIAS with technical support and focused advice, as well as with related lending operations. In addition, one of the priorities under EU Accession Measures (point (d) above) is to address the shortcomings on the environmental side. The energy sector is to a large extent responsible for the still significant air pollution in a country which wants to promote tourism with priority. Slovenia and the Bank have therefore agreed that Bank cooperation should focus on helping the country to meet environmental standards equivalent to the EU and consistent with International Protocols and Treaties, such as the second sulfur protocol.

6. In line with above mentioned priorities, a major focus of Bank activities has been and continues to be energy and the environment, with a successfully completed energy efficiency credit line of 1988 (to former Yugoslavia), and a credit line of 1996 for coal-to-clean fuel conversion for households and small boiler owners (Environment Project). During July 1997, the Ministry of the Environment and the Ecofund indicated to the Bank their interest to develop a similar credit line with a focus on greenhouse gas reduction and energy efficiency. This would allow also to address some of the issues related to EU Accession directly or indirectly. They have also agreed to carry out a substantial study on green house gas emissions in the context of the Global Carbon Initiative (GCI), and have suggested to prepare a GCI Project (e.g. refurbishment of a combined heat and power plant or conversion of a heat plant to CHP, including, if possible, renewable energy resources). FIAS and IENPD have provided cross-sectoral advice on legal, regulatory and institutional changes for private and public infrastructure in support of state sector restructuring, focusing on BOT schemes, concession systems and guarantee schemes to allow non-recourse financing.

7. The Bank should be ready to support the above lending operations proposed recently by MOE. There may also be opportunities for privatization in the context of the proposed GCI Project and the FIAS/IENPD work. Apart from the ongoing FIAS/IENPD work, no energy sector work is scheduled at this time. The next mission should explore with the Government the possibilities for non-lending support to the energy/environment sector, notably with respect to (i) sector regulation, (ii) sector rationalization, (iii) energy pricing and (iv) air pollution. Experience from other countries (e.g. the Poland experience) could be valuable in this context. The independent and neutral position of the Bank with emphasis on rational economic criteria, could help resolve some of the divisive political issues in the sector.

ENERGY SECTOR PROJECTS AND ESW UNDER IMPLEMENTATION

Project	Development Objectives	Effective Date	Revised Amount	Closing Date	Undisb Begin FY (\$m)	Total Disb FY97 (\$m)	Task Manager
Yugoslavia Energy Conservation and Substitution Project (LN No. 2790-YU)	The project objectives were: (a) promote energy efficiency in industry, primarily in Slovenia, through subloans for energy conservation and substitution; (b) support the development of technical capabilities for energy audit work. The project was later amended to include two additional objectives: (c) promote environmental conservation and improvement (amendment of 90/06/12); (d) restore infrastructure damaged by flooding which occurred in November 1990 (amendment of 91/05/20).	88/01/04	US\$88.00	94/06/30 extended from: 92/12/31	.00	88.00	Richard Hamilton
Completed 96/01/30							
Environment Project (LN No.)	Air Pollution Component: The objective is to reduce ambient concentrations of particulate matter (PM10) and SO2 along with health damage associated to air pollution. This is to be achieved by providing loans to households and small boiler house operators to convert to cleaner fuels from polluting fuels. Geographical Information System Component: The objective is to collect, organize and manage information for development and land-use planning, particularly in areas of Slovenia that experience rapid development.		DM 34.6	01/06/30			Helmut Schreiber
ESW: FIAS ESMAP	Cross-sectoral advice on legal regulatory and institutional changes for private participation in infrastructure. Support of state sector regulation, restructuring, focusing on BOT schemes, concession systems and guarantees. Special focus on the legal and regulatory framework of the energy sector.			Autumn 1997			Frank Sader/ Mangesh Hoskote
ESW: FIAS ESMAP	Training Workshop on Private Participation in Infrastructure		10/1997				Mangesh Hoskote

ENERGY PROJECTS AND ESW UNDER PREPARATION

Project	Project Description	FY	Proposed Amount (\$m)	Status	Project Manager
Energy and Environment Project (Credit line)	Credit line building on the experience of the Environment Project, but with a stronger focus on energy efficiency and use of Renewable Energy Resources (it might be used for water or waste water as well).	99	40.0	Interest in such project had been expressed in July 1997 by Ministry of Environment and	Helmut Schreiber/ Christian. Duvigneau
Energy Efficiency and Greenhouse Gas Reduction Project	The objective of this project would be to convert a heat only boiler in one of the Slovenian Cities to Combined Heat and Power Operation (CHP) possibly using biomass. This could be a demonstration project for similar operations to follow within the country.	2000	70.0	Interest in such project had been expressed in July 1997 by Ministry of Environment and Ekofund.	Helmut Schreiber/ Christian. Duvigneau

ENERGY PROJECTS AND ESW UNDER PREPARATION (CONTINUED)

Project	Project Description	FY	Proposed Amount (\$m)	Status	Project Manager
ESW: EU-Accession Support	Cross-sectoral advice on legal regulatory and institutional changes for private participation in infrastructure. Support of state sector regulation, restructuring, focusing on BOT schemes, concession systems and guarantees. Special focus on the legal and regulatory framework of the energy and telecommunications sectors.	98	0.15	continuation of FIAS/ESMAP work	Frank Sader/ Mangesh Hoskote
EU-Accession Support	Strengthening Institutional Capacities & Skills in the areas of Competitive Bidding for Private Infra structure Projects. Special focus on energy and telecommunications sectors.	99		continuation of FIAS/ESMAP work	Mangesh Hoskote
EU-Accession Support	Subsector Pricing and Tariff Studies	98	0.10	to be discussed with MoE	Christian Duvigneau
EU-Accession Support	Sector Restructuring and Privatization Study	98	0.15	to be discussed with MoE	Christian Duvigneau
EU-Accession Support	Strengthening of Administrative Capacities to assure compliance with environmental laws.	99	0.15	to be discussed with MoE	Helmut Schreiber/ Christian Duvigneau
	Global Carbon Initiative (Greenhouse Gas Reduction Potential) Study	98	0.15	Agreed with MoEN	Helmut Schreiber/ Christian Duvigneau
	Needs Assessment / CAS Policy Note	98		to be agreed with Government	

A J I K I S T A N

COUNTRY INFORMATION

Tajikistan stands out among the FSU countries because of its narrow economic base, reliance on agriculture, and widespread poverty. Since the break-up of the FSU, the country has suffered political instability, civil war, a severe macroeconomic crisis, a large debt overhang, and a deterioration of institutional capacity. Income has fallen by 60 percent in the past four years and foreign exchange reserves are virtually nil. Before independence, aluminum production and cotton fiber accounted for 50 percent of GDP. Independence was declared in September 1991 — amid the collapse of the Soviet Union — and was almost immediately followed by an outburst of political and ethnic strife. Although elections were held shortly after independence and again in 1992, long-festered political and ethnic rivalries erupted into a civil war that lasted from mid 1992 through early 1993. Gradually, however, the Government, with continuing military support from Russia, has been able to reestablish its control over most of the country. With a cease fire in place since September 1994, a new constitution was adopted by referendum in late 1994 and presidential elections were held with Imamali Rahmanov elected as head of state. In February 1995, elections for a new parliament (*Majles Oli*) were held. Nonetheless, sporadic fighting continues particularly in the Eastern and Southeastern part of the country and along the border with Afghanistan.

The economic and human cost of the transition from the Soviet era has been very high for Tajikistan. In addition to the disintegration of trade and payments relations within the FSU, the civil war resulted in the death of about 50,000 people, the displacement of 850,000, and extensive damage to the country's infrastructure — especially in the southern and eastern parts of the country which historically is the poorest area. Further, severe flooding in

1992 and 1993 caused major damage to infrastructure and productive assets and, therefore, additional disruption of economic activity. These events contributed to the emigration of an estimated 500,000 non-Tajiks, who comprised a significant share of the skilled labor force. Tajikistan's recent economic performance reflects the impact of these events. Production fell by an estimated 60 percent during the period 1991-95 with agriculture and industry affected the most. Most industrial firms are currently operating at less than one-third of their capacity, and agricultural production — which accounted in 1991 for about one-third of GDP and about 50 percent of employment — is only about 30 percent of its 1991 level. These output declines are among the largest experienced by FSU economies during this period. The financial sector also deteriorated rapidly — largely because of the poor performance of state-owned enterprises — with no prospect for most loans being repaid.

THE BANK GROUP'S STRATEGY

The situation in Tajikistan confronts the Bank Group with difficult choices. On the one hand, the depth of the present economic crisis combined with the widespread poverty, reconstruction needs, and the favorable dialogue with Government argue for aggressive Bank Group involvement. Carefully crafted involvement developed in active collaboration with other donors, could — in the near term — yield significant improvements in both economic performance and enhanced implementation capacity. On the other hand, the country's continuing political uncertainty, uneven record of implementation of policy reform,

	1993	1994	1995	1996 (estim)
Population mid-1993 (millions)	5.8			
GNP per capita (US\$)				330
Annual GDP Growth (%)	-11.1	-21.4	-13.0	-7.0
Inflation (CPI, % change)	7,344.0	1.1	2,223.0	183
Total Debt/GDP (%)	—	115.8	142.6	112.3

weak institutional capacity, and our limited knowledge all contribute to a very risky environment and argue for gradual engagement— On balance, the obvious need and the strong desire of Government to work with the Bank and the Fund are compelling. The Bank's FY96-98 program allows considerable flexibility in responding to the pace of political stabilization and economic reform as a means of minimizing risks.



TURKEY

COUNTRY INFORMATION

Over the course of the 1990s, Turkey's political environment has become increasingly difficult. With a succession of weak coalition Governments, short-term considerations have tended to divert attention away from the implementation of policies with a longer-term focus. The troubled security situation in southeastern Turkey also complicates domestic politics and foreign relations, and places heavy financial demands on the government. Due to the wide-ranging liberalization of the economy in the 1980s, economic growth has been quite robust, with per capita income growth averaging about two percent annually in recent years. This income growth performance is lower than in other middle-income countries. Moreover, the volatility and high inflation characteristic of Turkey's economic growth have increased the inequality of income distribution. Turkey's social development indicators (e.g., infant mortality and female literacy) are also behind those of comparable economies. The Government's financial difficulties in recent years have squeezed social outlays, while capacity constraints have also limited their effectiveness.

Against this backdrop, general elections held in December 1995 failed to yield a single majority party in Parliament. The minority center-right coalition (ANAP-DYP) Government that finally emerged in March 1996 fell within three months. It was succeeded in June 1996 by an Islamist-centrist coalition (RP-DYP) with a small majority. The RP-DYP Government came under increasing pressure from secular elements due to the perceived threat of growing Islamist activism to Turkey's secularist traditions, and it resigned in June 1997. The new Government is a three-way coalition, involving centrist and socialist parties (ANAP-DSP-DTP). It does not have a majority in Parliament and relies on support from another socialist party (CHP) outside the Government. The next scheduled elections are in late 2000.

Economic policy developments have mirrored closely the political situation. Thus, the sharp adjustments achieved in the fiscal and external payments positions following the currency crisis of 1994 were largely reversed in 1996. The fiscal deficit doubled to eight percent of GDP, due largely to the ballooning deficit of the social security system (two percent of GDP). The external current account deficit also doubled to over two percent of GDP, and was financed mainly by short-term capital inflows drawn by high interest rates. Turkey's external debt rose to US\$80 billion, 43 percent of GDP, including over US\$20 billion in short-term debt. Despite the financial imbalances and political uncertainty, real GDP grew by seven percent in 1996 for the second successive year, encouraged by Turkey's accession to a customs union with the European Union (EU), and rapidly expanding business opportunities in the Former Soviet Union (FSU) countries. Inflation also moderated to 80 percent in 1996, down from 89 percent in 1995.

Developments in 1997 continue to be mixed. The RP-DYP Government announced an ambitious fiscal program for 1997, with a balanced budget targeted mainly the strength of large increases in privatization receipts. However, by the time of its resignation in mid-1997, the budget was badly off-track, and headed for a deficit of more than 10 percent of GDP for the year as a whole. Privatization had stalled, while expenditures were running well in excess of planned outlays due to pension fund deficits and generous increases in public sector wages and salaries, and agricultural subsidies.

The new Government has installed a highly experienced economic team and given immediate priority to preventing any further deterioration in the fiscal situation, and to dampening turbulence in the financial markets. A number

of early actions have been taken, notably much-delayed increases in the petroleum consumption tax and a range of public sector prices, the adoption of a new protocol restricting Treasury access to central bank finance, and increases in interest rates on agricultural loans. Despite these and other planned measures, the budget deficit in 1997 will likely exceed 8 percent of GDP. Inflation has also been accelerating in recent months, reaching 99 percent by the end of 1997. Developments in the external sector were more favorable in 1997, largely due to a strengthening of export performance which is also helping to maintain overall GDP growth momentum at an annual rate of 6 percent. Official foreign currency reserves rose to about US\$19 billion at the end of 1997 from US\$16.5 billion at the end of 1996.

A stronger policy effort will be required in 1998. In addition to the problem of inflation, bunching of external bond and domestic public debt repayments has created a spike in public debt service obligations in 1998. The Government needs to introduce a broad-based program of stabilization and structural reform, beginning with a 1998 budget that provides for a substantial cut in the fiscal deficit and reduction in inflation. To be credible, the program would need to include politically-difficult reforms such as social security and agricultural subsidies.

THE BANK'S GROUP STRATEGY

Turkey joined the Bank in March 1947 and has been one of the Bank's most important clients. Over time, however, Bank lending to Turkey has declined, from an average of US\$800 million in the 1980s to an estimated US\$250 million for FY93-97. To some extent, this reflects Turkey's increased access to international capital markets and reduced dependence on official aid agencies, including the Bank. It also reflects the constraints on the

Bank's ability to provide comprehensive support in Turkey's increasingly uncertain political and policy environment. By the end of the 1997 fiscal year (July 1, 1996 - June 30, 1997), Bank commitments to Turkey exceeded US\$12 billion for 128 operations.

Learning from experience, the Government and the Bank have adopted a new assistance strategy for FY98-00 that places particular emphasis on developing a program that is more robust with respect to political and policy uncertainties, and on strengthening institutional frameworks, which would reduce the likelihood of policy reversals and improve implementation. Other key elements of the new assistance strategy are to:

- increase significantly the share of administrative resources for activities aimed directly at social development and poverty alleviation; shift the focus of investment activities to poorer regions; and catalyze private involvement in previously state-run activities especially through guarantees;
- increase support for economic management through technical and advisory services, with an emphasis on improving Government's capacity to design and implement reforms; and provide a firm basis for participatory approaches to poverty alleviation and social development; and
- sustain recent improvements in project portfolio performance through a Government-Bank Portfolio Improvement Program to resolve critical implementation bottlenecks; increase frequency of Portfolio Performance Reviews; and delegate responsibility for them to the Resident Mission in Turkey.

ENERGY POLICIES AND ISSUES

Turkey's most important domestic source of energy is hydroelectricity, which accounts for 40% of total electric power generation and

3% of primary energy supply. The exploitable hydropower potential is estimated at 31,000 MW, of which 10,500 MW has been developed and another 3,200 MW is under construction or planned to be developed by 2000. Abundant deposits of low quality lignite also exist, estimated at 6.4 billion tons, most of which are of low calorific value and high sulfur content. These deposits account for 36% of power generation and 16% of primary energy. There are also limited quantities of low-quality, high-sulfur hard coal and of oil and gas. Proven hydrocarbon reserves consist of 250 million barrels of oil and 0.5 billion cubic feet of natural gas. Domestic production of hydrocarbon accounted for 10% of their domestic demand in 1994. This proportion is not expected to increase substantially because of the limited prospects for Turkey's geology. A greater utilization of domestic lignite and coal is severely constrained by environmental considerations. The balance of domestic energy demand is met, and is likely to be met in the future, by fuel imports, especially crude oil and petroleum products (35 million tons in 1995 which together constitutes 33% of primary energy supply); as well as natural gas (8 billion cubic meters-bcm- in 1996). Energy imports cost approximately 2% of GDP in 1996. Approximately 5.5 bcm of natural gas is currently imported from the Russian Federation on the basis of a long-term take-or-pay contract; and 2.4 bcm from Algeria through the liquefied natural gas (LNG) terminal at Thrace. With regard to crude oil, Turkey had depended on a major source of supply from Iraq through the Iraq-Turkey crude oil pipeline. Following the suspension of pipeline operations in 1990 under a United Nations resolution regarding the embargo on Iraq, Turkey has had to pursue alternative sources for reliable crude supply.

Turkey presently has an installed power generation capacity of about 21,000 MW (40%

hydro, 60% thermal, mainly based on local coal/lignite) and an extensive transmission and distribution network which provides access to electricity for almost 100% of the population. Electricity consumption has been growing at an annual average of 10% over the last decade and the power system is capable of meeting its peak power demand of 13,000 MW. The demand for electricity is forecast to grow at an annual average of 8% over the next 15 years, as a consequence of economic growth and the low levels of per capita electricity consumption (1300 kWh in Turkey compared to, for e.g., 3459 Kwh in Poland). This will require annual investments of US\$3 billion, comprising on average, US\$1.9 billion for generation, US\$400 million for transmission system extension and reinforcement, and US\$700 million for distribution system strengthening.

Recognizing these problems, the Government of Turkey (GOT) is taking a two-pronged approach to sector development, one aimed at revamping the policy and concomitant legal/regulatory framework to attract a much larger level of private sector investments; and the other aimed at privatizing existing power infrastructure. The Government's strategy for the development of the power sector is as follows: (a) public sector thermal generation plants will be separated and privatized on a Transfer-Of-Operating-Rights (TOOR) basis; (b) distribution facilities and services serving urban areas will be transferred to the private sector also on a TOOR basis in order to strengthen and expand the distribution networks; (c) the national transmission grid and load dispatching facilities, which will remain in the public sector, will be separated (from generation) providing equal access to all generators; and the transmission system will be strengthened and expanded; (d) new investments for the sector, particularly for generation capacity expansion, will mainly be mobilized

BANK'S TEAM:
AJAY CHHIBBER,
COUNTRY DIRECTOR
(H4-175, X84219)

PETER THOMSON,
SECTOR LEADER

RAGHUVVEER SHARMA,
PRINCIPAL FINANCIAL
ANALYST
(H5-076, X32302)

AKIN ODUOLOWU,
PRINCIPAL ENERGY
SPECIALIST
(H5-099, X32292)

from the private sector, through Build-Operate-Transfer (BOT); Build-Own-Operate (BOO) and other independent power producer (IPP) mechanisms; and (e) a transparent regulatory framework will be set up to regulate the various entities; and competition will be introduced wherever possible (e.g. generation).

The Turkish authorities have already begun the implementation of the sector development strategy. Ten thermal power plants, with a total installed capacity of 4253 MW have been awarded to private sector consortia on a TOOR basis; and four additional thermal plants (total capacity 3580 MW) and all the major existing hydro power stations (9000 MW) are proposed to be transferred to private sector. Furthermore, twenty-five distribution areas which are also to be transferred to the private sector on a TOOR basis (150 bids have been received for the 25 distribution areas), and winning investors for seven of these distribution areas have been announced.

BANK'S STRATEGY FOR THE ENERGY SECTOR

The current Bank's portfolio includes two loans, one in the power subsector, the TEK Restructuring Loan for US\$300 million, and one in the oil and gas sector, the Baku-Ceyhan Oil Pipeline Technical Assistance Study Loan for US\$5 million. The objectives of the TEK Restructuring Loan are to support: (a) the corporate restructuring and privatization of TEAS and TEDAS in the context of the Government's SEE Privatization Program; and (b) the implementation of an agreed medium-term least costly investment program for the power subsector in both the public and private sectors during the period 1991-1996. The project is at an advance stage of implementation. The only items remaining to be procured under the loan are distribution SCADA systems for four regions in Turkey.

The objectives of the Baku-Ceyhan Oil Pipeline Technical Assistance are to: (a) identify and evaluate technically viable and environmentally sustainable pipeline routes for the export of up to 45 mt per annum of crude oil from Baku in Azerbaijan to the international markets through Ceyhan in Turkey, under various throughput assumptions; (b) conduct optimization studies of the routes so identified to arrive at the most robust pipeline route and configuration which merits further and more detailed technical, financial and economic evaluations; and (c) recommend a realistic commercial structure for constructing and operating the selected pipeline. The study is expected to be completed by the end of the first quarter of 1998.

The Bank is currently preparing a project, the proposed National Transmission Grid Project whose objectives are to: (a) ensure adequate transmission system capacity to meet 8% p.a. electricity demand growth; and (b) facilitate private sector participation in the sector. Consultants have been appointed to assist TEAS, the borrower, in the preparation of the project. The project is expected to be presented to the Board by the end of June 1998.

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Effective Date	Revised Amount	Closing Date	Undisb Total Begin FY (\$m)	Disb FY97 (\$m)	Task Manager
TEK Restructuring Project (LN No. 3345)	The project objectives are to support: (a) the cooperate restructuring and privatization of TEAS and TEDAS in the context of the Government's SEE Privatization Program; and (b) the implementation of an agreed medium-term least costly investment program for the power subsector in both the public and private sectors during the period of 1991-1996.	04.27.92	300.0	12.31.97	140.1	40.0	R. Sharma
Baku-Ceyhan Oil Pipeline Engineering Technical Assistance Project (LN. No. 4089)	The following are the project objectives: (a) identify and evaluate technically viable and environmentally sustainable pipeline routes for the export of up to 45 mt per annum of crude oil from Baku in Azerbaijan to the international markets through Ceyhan in Turkey, under various throughput assumptions; (b) conduct optimization studies of the routes so identified to arrive at the most robust pipeline route and configuration which merits further and more detailed technical, financial and economic evaluations; and (c) recommend a realistic commercial structure for constructing and operating the selected pipeline.	3.20.97	5.0	06.30.98	5.0	0.5A.	Oduolowu

ENERGY PROJECT UNDER PREPARATION

Project	Project Description	Proposed Amount	Status	Project Manager
National Transmission Grid (TR-PE-48852)	The National Transmission Grid Project would consist of: (a) financing a time slice of the transmission system investment for the Turkish Electricity Generation & Transmission Corporation (TEAS); and (b) technical assistance to facilitate private sector investments in the power sector, including (i) separating TEAS's transmission grid and load dispatch facilities into a separate company (GRIDCO); (ii) developing and implementing a transmission policy; and (iii) institutional development of GRIDCO.	US\$200.0	Early stages of preparation.	R. Sharma

TURKMENISTAN

ECONOMIC CONDITIONS

With the breakup of the Former Soviet Union (FSU), Turkmenistan's economy was hit hard by the loss of access to European gas markets through Russian gas pipelines, and large and persistent arrears owed to it by its major FSU gas customers (Georgia, Armenia, Ukraine, Azerbaijan). Over 1993-95, real GDP fell by over 30 percent, gas production declined by three-fifths, and real minimum monthly wages by an estimated 80 percent. With proven gas reserves of about 2.9 trillion cubic meters (tcm) and production capacity in excess of 60 billion cubic meters (bcm) per year, Turkmenistan has the potential to be a significant player in the international gas markets.

In the medium-term, Turkmenistan's growth prospects rest on growth in demand for natural gas exports, and the recovery and development of production potential in oil. There are, at present, no prospective capacity constraints on gas production: in the short-run, and within fairly wide limits, Turkmenistan can expand the output of gas, which accounts for approximately 50 percent of GDP, with the turn of a valve. The binding constraints in the near-to-medium-term output growth and export earnings are thus the willingness and the capacity of Turkmenistan's main customers to pay in cash and the physical transport capacity to move gas to export markets.

ROLE OF THE BANK GROUP

Three projects have been prepared over the past five years, namely: Institution Building Technical Assistance Loan (IBTA) in the amount of \$25.0 million; Urban Transport Loan in the amount of \$34.2 million, Water Supply and Sanitation Loan in the amount of \$30.3 million. A Health Project is expected to be presented to the Board in FY98.

ENERGY SECTOR ISSUES

Gas Payments Arrears: All of the approximately \$1.2 billion gas payments arrears from Turkmenistan's main customers at the end of 1995 were successfully rescheduled, and payments are reportedly on schedule for these. Negotiations are underway to reschedule or collect some \$340 million in new 1996 arrears. With each of its major FSU gas export customers expected to return to growth in 1997 and with gradual growth acceleration expected thereafter, export volumes and payment rates for these customers should gradually improve.

Turkmenrozas: Turkmenistan has recently entered into a joint venture with GazProm, called "Turkmenrozas", which is expected to strengthen its ability to collect and to re-enter the European gas market through swaps with GazProm.

Gas Export Pipeline: A natural gas pipeline from Turkmenistan through Iran to Turkey, and eventually to Europe has been a hot political issue for the past 3-4 years. If materialized, the pipeline could carry as much as 30 bcm a year. Unocal, on the other hand, is interested in constructing a gas pipeline from Turkmenistan through Afghanistan to Pakistan and possibly on to India. Progress on both projects, however, is constrained by the political uncertainties in the region.

BANK STRATEGY IN THE ENERGY SECTOR

Bank's involvement in the energy sector in Turkmenistan has been very limited except for the "Energy Sector Review" which was completed in 1993. Since then, only recently has the Government expressed an interest in Bank's presence in terms of technical assistance in the gas sector. The response to this request was reflected in the Country Assistance Strategy (CAS) in 1997 in the form of an ESMAP TA study.

BANK'S TEAM:
KIYOSHI KODERA,
COUNTRY DIRECTOR
(H3-001, x39649)

PETER THOMSON,
SECTOR LEADER
(H5-093, x34261)

PETER POLLAK,
PRINCIPAL ENERGY
SPECIALIST
(H5-081, x81065)

SHIGERU KUBOTA,
SR. ENERGY SPECIALIST
(F 8K-228, x32806)

HELEN SYMS,
CONSULTANT
(H5-245, x87886)

The ESMAP Natural Gas Investment Strategy Study:

Description: This study is expected to start in September 1997 and is planned to assist the Government in developing an economical-based, strategic policy for the natural gas sector, focusing on the country's sector reform and the identification of economically high priority projects. Within the context of Turkmenistan's overall energy situation, the study should pursue the following objectives: (i) establish the required sector policy for the gas sector development; (ii) determine the required institutional reform; (iii) identify economically high priority investments and financial options.

U K R A I N E

COUNTRY INFORMATION

Ukraine is the second largest European country in land mass and the fourth largest in population. It has a well-educated, highly skilled labor force. Agriculture accounts for 20 percent of GDP. A good mineral resource base (coal and iron), diversified industries (46 percent of GDP), and a well-developed infrastructure provide a firm base for future growth.

Basic economic structures require a major overhaul for Ukraine to become internationally competitive. Production is too energy intensive, and the economy relies on imports of oil products and natural gas from Russia and Turkmenistan for about half its energy needs. Close to one million people are employed in the world's highest-cost coal industry.

Between 1990 and 1993 agricultural production fell 20 percent, industry contracted 45 percent, and construction declined 54 percent. Open unemployment remained limited, but disguised unemployment (in the form of forced leave and part-time work) became widespread, affecting 3-5 million workers. Real wages dropped 63 percent between 1990 and 1993.

The situation started improving following the mid-1994 elections. Efforts were made to control public finances — the budget deficit was

cut to less than 5 percent of GDP in 1995. Monetary policy was tightened — the quarterly growth rate of broad money was reduced from 93 percent in the fourth quarter of 1993 to 8 percent in the fourth quarter of 1995. Mass and small-scale privatization started. Actions were taken to liberalize the economy —

most domestic prices were freed, all quantitative restrictions on imports were lifted, and all export quotas were eliminated.

THE BANK GROUP STRATEGY

The World Bank's strategy in Ukraine calls for a graduated expansion of the lending program in line with the intensity of the reform effort. This approach will allow the Bank to respond promptly in support of broader and deeper reforms while avoiding burdening Ukraine with debt that would not contribute to economic recovery and improved creditworthiness. The Bank will continue to provide Ukraine with a high level of non-lending services and engage the Government and civil society in an intensive policy dialogue under all scenarios.

If the stabilization program remains on track, as evidenced by continued IMF support to Ukraine, the Bank will provide a base case of non-adjustment lending, not exceeding US\$580 million. Strong reforms in the areas of ownership change and liberalization are needed to move to a high case of adjustment and project lending, ranging from US\$1,400 to US\$3,100.

Decisive action in liberalization, privatization, and land reform would trigger the high case. In addition to the base program, Ukraine would have access to an ownership and liberalization program of more than US\$800 million. The ownership and liberalization program includes two adjustment loans, the Enterprise Development Adjustment Loan (EDAL) and the Agriculture Sector Adjustment Loan (AGSECAL), two projects in support of export development and the extension of agriculture services, and a guarantee for the import of agriculture inputs. Once it achieves the high case Ukraine would also have access to an expanded program providing an addi-

UKRAINE — BASIC INDICATORS

	1993	1994	1995	1996 (estim)
Population mid-1993 (millions)	51.551			
GNP per capita (US\$)	2,210	1,913	1,632	1,180
Annual GDP Growth (%)	-14.2	-23.5	-11.8	-8.5
GDP Inflation (%)	3333.6	961.3	398.5	74.5
Total Debt/GDPmp	3.2	31.5	23.2	17.2

tional US\$1700 million, provided additional systemic and project reforms are put in place. Thus, fast deep reforms would allow lending of up to US\$3100 million. The expanded program would include three adjustment loans in support of public, financial and coal sector reforms totaling US\$900 million. These loans would be complemented by projects supporting the development of the wholesale electricity market, the development of financial institutions, the restructuring of the coal industry, and the rehabilitation of thermal power plants. A significant part of the Bank's non-lending services is geared to dealing with implementation issues.

ENERGY SECTOR ISSUES AND POLICIES

Although Ukraine's energy intensity was already high in international comparison in 1990, energy consumption decreased less than GDP over last six years. Despite large coal and significant gas and oil reserves, half of the primary energy consumption has to be covered from abroad: in 1996, Ukraine imported 71 billion cubic meters of natural gas, 15 million tons of crude oil and oil products, and 11 million tons of coal, at a total cost of about US\$8 billion (representing 42% of Ukraine's total import bill).

In order to reduce the energy intensity of the economy, domestic prices need to reflect the true cost of energy, production subsidies should be phased out, and energy bills should be paid in full. In addition, energy suppliers should be exposed to competitive pressures to reduce costs and improve service quality. During 1995, the Government achieved significant progress in the area of energy prices, however, this led to a rapid build-up of accounts receivable. Following a number of Government decrees stipulating that non-paying enterprises should be cut-off, the payment collection ratio reached 80% by the end of 1996 (several thousand enterprises received

reduced or no gas and electricity supplies). However, the bulk of the improvement in overall collection performance during 1996-97 materialized through barter schemes, and the share of cash collections remained low (less than 30%). The fear of unemployment and political pressure prevented the cut-off of supplies to the largest enterprises.

The best way to ensure that prices move in tandem with costs and bills get paid in time is to demonopolize and privatize the coal, gas, oil, and electricity industries, and create competitive energy markets. Ukraine's progress to date is summarized below:

Coal: Prices and trade have been liberalized, and the viable part of the coal industry has been corporatized. In mid-1996, the Government adopted a program of closing more than 100 loss-making mines over a period of 4-5 years (production has already been stopped in 24 mines). The program includes a number of measures to mitigate the social cost of restructuring. The funding of these measures, however, has been inadequate to date.

Gas: The Government has eliminated state guaranteed imports, and licensed a number of private gas importers/suppliers. Gas prices, however, are still determined by the Government, and customers cannot choose among gas suppliers. Furthermore, the gas transportation system is operated by the largest domestic gas producer, Ukgazprom, and access to the system for other (potential) producers is heavily constrained.

Oil: Oil products prices have been liberalized, and the Government has decided to open oil exploration, production, refining and marketing to foreign investors. However, the lack of a satisfactory legislative basis and stable regulatory regime hampers the ability of the sub-sector to attract badly needed investments.

UKRAINE — ENERGY SECTOR INDICATORS

Energy Resources

Oil Reserves (million tons)

190

Coal Reserves (million tons)

52,000

Gas Reserves (bcm)

1,400

Energy Consumption (1995, mtoe)

156.64

Energy Consumption per capita

(1995, kgoe) 3,000

Power Generation Capability

(installed) 53,000 MW

BANK'S TEAM:
PAUL SIEGELBAUM,
COUNTRY DIRECTOR
(H2-025, x80752)

LASZLO LOVEI,
LEAD ENERGY SPECIALIST
(H5-091, x32772)

PENTTI ARO, DISTRICT
HEATING AND POWER
ENGINEER
(H5-207, x87136)

JEFFREY BALKIND,
SR. ECONOMIST
(H5-021, x89116)

ISTVAN DOBOZI,
SR. ENERGY ECONOMIST
(H5-251, x32147)

CAROLYN GOCHENOUR,
PROGRAM TEAM LEADER
(H5-105, x39681)

HEINZ HENDRIKS,
SR. MINING ENGINEER
(F 8K-194, x82887)

JOHN STRONGMAN,
MINING ADVISER
(F 8K-162, x35530)

VLADISLAV VUCETIC,
POWER ENGINEER
(H5-247, x33977)

SALMAN ZAHEER,
ENERGY ECONOMIST
(H5-249, x39477)

Although work was carried out on a new Petroleum Law (with Bank/USAID assistance) in 1994, the draft law has not been adopted yet.

Power: The reform process is the most advanced in this sub-sector. The previous eight vertically integrated monopolies have been broken up into generation, transmission and distribution companies. A competitive electricity market and a transparent, autonomous regulatory regime has been established with assistance from the Bank and several other donors. The privatization of generation and distribution companies was scheduled to start in early 1998.

Nuclear Safety: The G-7 and Ukraine signed a Memorandum of Understanding (MOU) on the closure of the Chernobyl Nuclear Power Plant on December 20, 1995. In the MOU, Ukraine agreed to close the remaining two units of the Chernobyl plant by the year 2000, and the G-7 agreed to assist with the mobilization of resources to finance closure costs, additional nuclear safety measures, and the completion of two new nuclear reactors (Rovno 4 and Khmel'nitsky 2) in the framework of a least cost investment program.

BANK'S STRATEGY IN THE ENERGY SECTOR

The Bank's technical assistance and lending operations have so far been focused on the power and coal industries since these demonstrated the most commitment to reform. Lending commitments in these two sub-sectors total US\$746 million (83% of this amount was approved by the Board in the last quarter of 1996), and three additional loans with a total value of about US\$600 million are under preparation. Project implementation has been slow due to the inexperience of Ukraine with the Bank's procurement and disbursement procedures, and delays in compliance with essential legal covenants. Three additional projects aimed at rehabilitation district heating networks and energy savings in public buildings

are also under preparation. Finally, subject to agreement on further reforms in the gas sub-sector, the Bank has expressed its willingness to finance the rehabilitation of the gas transmission and distribution system.

ENERGY PROJECTS UNDER IMPLEMENTATION

Project	Development Objectives	Effective Date	Revised Amount (\$m)	Closing Date	Task Manager
Hydropower Rehabilitation and System Control Project (LN No. 38650)	The main development objectives are: (a) to improve the efficiency, safety, and environmental performance of the hydropower plants; (b) to increase hydropower generation capacity; (c) improve the quality of electricity supply by upgrading load and frequency control which would also improve the safety of nuclear plants; and (d) reduce fuel costs by facilitating the economic dispatch of thermal generating units.	04.11.95	114.00	12.31.00	V. Vucetic
Coal SECAL (LN No. 41180)	The main development objectives are: (a) to support balance of payment and budget financing needs in 1996-1997, including part of the fiscal costs of restructuring the coal sector; (b). to transform the coal sector into a self sustained sector; (c). to improve the productivity of the coal sector.	12.27.96	300.00	12.31.97	J. Strongman
Electricity Market Development (LN No. 40980, 40981)	The main objectives are to: (i) support the development of competitive electricity market; (ii) improve recording and billing of electricity flows at key wholesale market delivery points; (iii) improve the financial position of companies; and (iv) ensure that electricity demand is met at market clearing prices. (Loan was suspended on July 29, 1997.)	01.31.97	317.00	12.31.99	I. Dobozi
Coal Pilot Project (LN No. 40160)	The central objective is to mitigate the social and environmental consequences that arise from mine closures, as part of an overall Government restructuring program for the sector. The project seeks to: (i) test ways to implement mine closures safely, with due regard to technical, environmental, economic, financial and social aspects; (ii) ensure that mine workers are afforded opportunities to either transfer to other jobs in the sector or exit the industry with reasonable compensation and a choice of assistance for seeking other employment; (iii) transfer social assets to municipal management and support their rationalization, while helping to ensure that the most vulnerable groups are adequately protected in terms of access to services; and (iv) through monitoring and feedback, gain experience from the Pilot Project for subsequent operations.	08.28.96	15.81	12.31.99	J. Balkind

ECONOMIC AND SECTOR WORK		
	Task ID	Task Manager
Ukraine Gas Strategy	UA-SR-51524	Laszlo Lovel
Technical Assistance Coordination in Power Sector	UA-LL-55489	Istvan Dobozi

ENERGY PROJECTS UNDER PREPARATION

Project	Project Description	Proposed Amount	Status	Project Manager
Krivoy Rog Power Rehabilitation (UA-PE-9109)	The project includes rehabilitation of several units in a major coal-fired thermal power plant to extend service life, increase efficiency and to reduce environmental impact.	170.00	Project preparation has been on hold since the suspension of Electricity Market Project.	I. Dobozi
Gas Distribution Rehabilitation (UA-PE-9118)	The project will (a) support conservation of gas use by upgrading and increasing the use of customer metering; (b) reduce gas distribution operating costs through the rehabilitation of gas distribution systems; and (c) support the commercialization of gas distribution companies.	100.00	Project preparation is under way.	L. Lovei
Kiev District Heating Improvement Project (UA-PE-44832)	The project will (a) rehabilitate and introduce technologies and materials to the heating system in Kiev and (b) support the commercialization and strengthening of project district heating companies.	200.0	Appraisal has been completed.	C. Gochenour
Kiev Public Buildings Energy Efficiency Project (UA-PE-55739)	The project would (a) support public initiative in improving energy efficiency in schools, hospitals, kindergartens, and public administration buildings and (b) support the government's policies to establish sustainable mechanisms for implementing and maintaining energy conservation programs.	30.0	Project preparation is under way.	C. Gochenour
Sevastopol Heat Supply Improvement Project (UA-PE-55738)	The project would support (a) the introduction of a decentralized heating service in Sevastopol and (b) development of a new heating enterprise.	30.0	Project preparation is under way.	C. Gochenour
Dniester Hydropower Pump Storage (UA-PE-40565)	The project will include (a) completion of three units of the Dniester Hydropower Pump Storage project; (b) strengthening of the transmission system (including switch yard construction/improvement); and (c) address further priority upgrades of the dispatch control and communications systems needed to improve control of system frequency, system voltages, power interchange and dispatch.	260.00	Project has been reserved.	I. Dobozi
Coal Mining Improvement (UA-PE-40561)	The objective of the project is to support the development of viable coal mining companies by (a) improving the working conditions and motivation of staff; (b) reducing environmental impact of mining and improving the living conditions in coal mining areas; (c) reducing unemployment in municipalities by coal mining restructuring; and (d) improving the management of viable mines. The project will include mine safety and health improvement, environmental improvements, social mitigation and technical assistance and training.	100.00	Project preparation is under way.	H. Hendriks