

**PROJECT INFORMATION DOCUMENT (PID)  
APPRAISAL STAGE**

Report No.: PIDA4003

<b>Project Name</b>	Electricity Supply Accountability and Reliability Improvement Project (P133446)
<b>Region</b>	EUROPE AND CENTRAL ASIA
<b>Country</b>	Kyrgyz Republic
<b>Sector(s)</b>	Transmission and Distribution of Electricity (80%), Energy efficiency in Heat and Power (20%)
<b>Theme(s)</b>	Other accountability/anti-corruption (50%), Other urban development (50%)
<b>Lending Instrument</b>	Investment Project Financing
<b>Project ID</b>	P133446
<b>Borrower(s)</b>	Kyrgyz Republic
<b>Implementing Agency</b>	Severelectro OJSC
<b>Environmental Category</b>	B-Partial Assessment
<b>Date PID Prepared/Updated</b>	22-Apr-2014
<b>Date PID Approved/Disclosed</b>	23-Apr-2014
<b>Estimated Date of Appraisal Completion</b>	23-Apr-2014
<b>Estimated Date of Board Approval</b>	25-Jun-2014
<b>Decision</b>	

**I. Project Context**

**Country Context**

1. The Kyrgyz Republic, with a multi-ethnic population of around 5.5 million, is one of two low-income countries in the Europe and Central Asia (ECA) region. The economy remains characterized by significant informality, reliance on few sectors (gold, agriculture, and re-exports), and remittances. Such structure amplifies the impact of economic and political shocks which have abounded in recent years and have affected growth and stunted poverty reduction. Average growth rate during 2009-2013 was less than four percent, including recessionary -0.5 percent in 2010 following political and social disturbances of that year. The latest shock, a landslide at the country's largest gold mine, Kumtor, resulted in a 0.1 percent contraction in 2012 and an exceptionally strong 10.5 percent growth rate in 2013 as the mine returned to normal operations. Around 38 percent of the population lived below the national poverty line in 2012. Still, growth in the non-gold economy has been robust, with growth rates in the range of five to six percent in the last three years, while the bottom 40 percent of the population appears to benefit more from growth; the consumption of the bottom 40 percent of the population increased by 5.8 percent during 2006-2011 compared to a 2.5 percent growth rate of consumption of the mean.

Prospects for the medium term remain favorable, especially if the neighboring countries in the region continue growing. GDP growth is expected to moderate at five percent during the next few years, as remittances, credit to private sector and strong investments continue to fuel domestic demand. Remittances and exports will benefit from the slight recovery in Russia's growth rate and the robust expansion in Kazakhstan, while the banking sector remains sound and should be able to support growth in case opportunities emerge. At the same time, China is becoming an increasingly important source of investment, including in transport and energy, estimated to reach around US\$3 billion over the next few years. The stronger capital inflows will finance the current account deficit, which is expected to remain relatively high. Inflation is estimated to remain between five and seven percent for the next few years. Still, strong reliance on few sectors keeps risks elevated, including from a slowdown in key partners, lower gold prices as well as global food and energy price spikes.

Improving efficiency of government spending will be critical for growth, inclusion, and stability. The budget deficit averaged above 4.5 percent of GDP during 2009-2013, one of the highest in the ECA region, as the authorities attempted to offset the effects of volatile growth. Current trends are not sustainable and the medium-term fiscal framework envisages a gradual reduction in the deficit to below three percent of GDP by 2016. Tax policy and administration reforms may strengthen revenues; however, most of the adjustment needs to come from expenditures. Meanwhile, public investments need to remain high to address infrastructure bottlenecks, and social inclusion policies need to be promoted to strengthen cohesion. These competing priorities can be tackled through improved efficiency of public expenditure. The World Bank's Public Expenditure Review is providing recommendations that could generate savings, while improving quality of public services in education, health, pensions, social protection, and energy as well as cross-cutting themes such as the wage-bill and public investment management and intergovernmental relations.

Poor governance, especially corruption and lack of voice in governing institutions, was the fundamental cause of political upheavals in 2010. Improving governance and enhancing transparency and accountability in the public sector are strongly demanded by the general public and are at the heart of the National Sustainable Development Strategy 2013-17 (NSDS) of the Government. Given the significant role of the energy (particularly power) sector in the Kyrgyz economy, improving the management in energy enterprises and enhancing transparency of their activities is a key reform area under the NSDS.

### **Sectoral and institutional Context**

The power sector in the Kyrgyz Republic is largely state-owned and operated by six joint stock companies that are responsible for power generation, transmission and distribution. The companies consist of one generation company, the Electric Power Plants, one transmission company, the National Electricity System of Kyrgyzstan, and four regionally divided distribution companies: Sevelectro (SE), Vostokelectro, Oshelectro and Jalalabatelectro, providing 52, 22, 20 and 5 percent of total domestic consumption respectively.

The power sector is relatively large and has significant growth potential. It accounts for about four percent of GDP and 16 percent of industrial production, and its performance is critical for the growth of the Kyrgyz economy. The sector has a significant unrealized potential for export. Other advantages of the power sector are relatively low cost of power generation, reliance on clean sources of energy, and the near universal access to power supply.

However, the sector faces a number of key challenges that need to be addressed in order to sustain growth and macroeconomic stability. These challenges include: (i) power supply reliability; (ii) financial viability; and (iii) governance in the sector.

**Poor supply reliability and service quality:** Assets in the power sector are dated and in poor condition due to insufficient investments and severe under-spending on maintenance and rehabilitation. Most generation assets are on average 34 years old, and are near or beyond the end of their useful lives. Fifty percent of the transmission substations are more than 25 years old, and 18 percent of the lines are more than 40 years old. The four distribution companies reported that 28 percent of their 0.4-10 kV power lines were in poor condition and SE reported that 85 percent of its low voltage distribution lines and electrical equipment was in urgent need of repair.

In addition, the significant increase in power consumption in 2009-2012 has begun to strain the capacity of power sector assets. The growth in consumption is especially significant in winter months when demand is highest. From 2009 to 2012, winter consumption grew 62 percent, while summer consumption grew 16 percent. In recent years, there have been frequent emergency shut-downs of transmission and distribution facilities because of equipment congestion and overloading, especially in Bishkek. Without major investments and sector reforms, the situation is expected to aggravate in the near future. Deficit between peak (winter) demand and available generation capacity could emerge in 2015 and grow to 650 MW by 2020, 900 MW by 2025 and 1,300 MW by 2030 (World Bank, Power Sector Note for the Kyrgyz Republic, 2013).

The condition and strained capacity of power sector assets result in poor supply reliability and quality. The four distribution companies combined reported an average of 43 outages per day between 2009 and 2012. SE alone reported an average of 20 outages per day during the winters of 2010 to 2012, and 15 outages per day on an annual basis. The poor condition of assets also causes voltage and frequency fluctuations. The fluctuations affect end-users in a number of ways ranging from poor quality of lighting (from low voltage), to damaged electrical appliances (from fluctuating or excessive voltage).

**Lack of sector financial viability:** The financial condition of the power sector has improved in recent years, but there is still a large gap between costs and cash collected. Costs per kWh of gross generation have consistently been higher than cash collected per kWh in recent years. From 2007 to 2012, the sector's actual costs incurred per kWh (not adjusted for under-spending on maintenance) were, on average, 35 percent higher than the average cash collected from domestic end-users. The gap between costs and cash collections is predominantly the result of exceptionally low tariffs, which fail to reflect recurrent expenses let alone the full cost of power supply. The revenue-expenditure gap also has significant fiscal and economic consequences for the country. In 2012, the quasi-fiscal deficit of the sector accounted for 2.1 percent of GDP.

Some portion of the gap between tariffs and cost of power supply is attributable to high levels of technical and non-technical losses. Reported total losses were 22 percent of net generation in 2012, and the actual losses were likely higher (due to lack of metering and poor management information systems). In the distribution network, total reported technical and non-technical losses accounted for 18 and four percent respectively of power injected to the distribution network in 2012. Total losses in SE amounted to 1,300 GWh (or 22 percent) of net injected power in 2012.

Poor sector governance: Underlying the sector challenges are the weak governance of the sector and the lack of transparency and accountability in its operations. At the sectoral level, some of the key governance issues include: (i) overlapping roles and responsibilities in sector policy-making, ownership and regulation; (ii) sub-optimal contractual and settlement arrangements, which impede transparency and accountability of flow of funds and electricity, and undermine incentives for sector companies to improve operational and financial performance; (iii) unpredictable expenditure planning, which is done on a year-to-year basis, and largely in a reactive manner rather than by prioritizing investments based on transparent criteria and forward-looking sector planning; and (iv) an ambiguous regulatory environment, including absence of clearly defined and transparent mechanisms for setting tariffs. At the company level, manifestations of poor governance include deficient internal control systems, inadequate corporate resource management and customer information systems, which are largely based on manual entry and are not integrated, aggravating issues related to lack of accountability, transparency and data reliability.

The Government recognizes the importance of addressing these challenges in the power sector and has adopted a Power Sector Development Strategy for 2012-2015. Key measures of the strategy include: (i) further improvements in efficiency and transparency of sector operations; (ii) development and adoption of a medium-term tariff policy that would need to be accompanied by properly designed social protection schemes; and (iii) a number of important energy investments. In order to operationalize the implementation of the strategy and coordinate donor support in the sector, the Government has also developed a more detailed Action Plan for Reforming the Energy Sector in 2013-14. In addition, the Government has started implementing some modest governance improvement measures, such as the opening of an escrow account for power export proceeds in 2011, and the establishment of the Fuel and Energy Sector Transparency Initiative (FESTI) in 2011 in an attempt to improve management and governance within the sector by ensuring greater public participation and transparency.

The proposed Electricity Supply Accountability and Reliability Improvement Project will help address these three sector challenges by: (i) improving power supply reliability in the service area of SE through investments in strengthening of the distribution infrastructure and resulting reduction of losses and power outages; (ii) enhancing the quality of services to customers through providing SE with better information management tools for faster and more effective response to service interruptions and customer complaints; (iii) improving the financial viability of SE through reduction of technical and non-technical losses in its service area; and (iv) strengthening governance and internal controls in SE through provision of access to real time and reliable corporate and commercial information and institutional strengthening.

The proposed project will enhance citizen engagement by strengthening customer orientation and responsiveness of SE. The incorporation of management information systems and business process re-engineering will facilitate customers' communication with SE through a single 24/7 customer call center, and ensure that the customer inquiries and complaints are executed in a timely, accountable and transparent manner while minimizing the risk of mistakes and intentional wrongdoings. In addition launching of customer satisfaction surveys will provide feedback on customers' perception of service quality and help to continuously improve customer focus in business operations.

By focusing on the service area of SE, the project ensures that benefits accrue to the largest share of customers, given that SE is the largest distribution company serving more than 40 percent of all

residential customers in the country and delivering more than 50 percent of total electricity consumption.

The project will leverage the Bank's engagement in the energy sector of the Kyrgyz Republic, which is focused on helping the Kyrgyz authorities to strengthen governance and accountability in the sector, and enhance its financial viability. In particular, the project will build on: (i) the recently completed Power Sector Policy Note, by helping implement some of the key recommendations of the Note; (ii) the governance reforms that the Government has committed to implement under the development policy operations, including the establishment of a performance monitoring framework, and periodic collection and publication of key financial and operational performance indicators; and (iii) the ongoing technical assistance provided by the Bank to develop a transparent tariff setting methodology, which will also help enhance the financial performance of SE, and improve transparency and accountability in the broader power sector.

## II. Proposed Development Objectives

The proposed development objective is to improve the reliability of electricity supply in the project area and strengthen the governance of Severelectro's operations.

## III. Project Description

### Component Name

Distribution Infrastructure Strengthening

### Comments (optional)

This component will help improve power supply reliability and reduce losses in the distribution network by supporting priority investments to strengthen the distribution infrastructure of SE.

### Component Name

Customer Service and Corporate Management System Improvement

### Comments (optional)

This component will provide SE with information tools to improve quality of services provided to its customers and to enhance overall efficiency of its performance.

### Component Name

Institutional Strengthening and Project Implementation Support

### Comments (optional)

This component will involve implementation support for project management and TA to SE to improve its business processes, strengthen its governance and make the company more customer focused

## IV. Financing (in USD Million)

Total Project Cost:	20.17	Total Bank Financing:	19.70
Financing Gap:	0.00		
<b>For Loans/Credits/Others</b>			<b>Amount</b>
BORROWER/RECIPIENT			0.00
International Development Association (IDA)			19.70
Free-standing TF for ECA			0.47
Total			20.17

## V. Implementation

The project will be implemented by SE. Within SE the day-to-day project implementation will be conducted by the Project Implementation Unit (PIU). The core staff of the PIU has been appointed based on terms of references approved by the Bank. Throughout the implementation of the project, the PIU will also draw on relevant experts of SE (engineers, IT staff, service quality centers' staff, etc.).

The project will be overseen by the Project Steering Committee, which has been established by the order of the Ministry of Energy and Industry.

## VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	x	
Natural Habitats OP/BP 4.04		x
Forests OP/BP 4.36		x
Pest Management OP 4.09		x
Physical Cultural Resources OP/BP 4.11		x
Indigenous Peoples OP/BP 4.10		x
Involuntary Resettlement OP/BP 4.12	x	
Safety of Dams OP/BP 4.37		x
Projects on International Waterways OP/BP 7.50		x
Projects in Disputed Areas OP/BP 7.60		x

### Comments (optional)

The project triggers two safeguards policies of the World Bank: Environmental Assessment (which by definition includes social assessment as well) and Involuntary Resettlement. The involuntary resettlement is triggered due to limited resettlement impacts associated with one of the new substations that will be constructed under the project. As part of OP 4.12, the project has prepared a Resettlement Action Plan for the substation site to identify the profile of individuals that would be impacted, and to describe the actions that would be used to address impacts in terms of involuntary resettlement, termination of lease, job and income losses.

## VII. Contact point

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