

HYBRID PROGRAM FOR SUPPORT TO THE ELECTRIC SECTOR

(NI-0069)

EXECUTIVE SUMMARY

BORROWER AND GUARANTOR:	República de Nicaragua.		
EXECUTING AGENCIES:	<ol style="list-style-type: none">1. For the investment project: Empresa Nicaragüense de Electricidad (ENEL), and the Comisión Nacional de Energía (CNE) for the Rural Electrification Program.2. For the fast disbursing program: Secretaría Ejecutiva de la Comisión Interministerial de Competitividad [Secretariat of the Joint Ministerial Commission on Competitiveness] (SECIC), through the Unidad de Reestructuración de la ENEL [ENEL Restructuring Unit] (URE)		
AMOUNT AND SOURCE:	AND	<ol style="list-style-type: none">1. For the investment project: IDB (FSO): US\$46.13 million Tentative co-financing: US\$ 2.50 million Local counterpart funding: US\$ 9.03 million Total: US\$57.66 million2. For the fast disbursing program: IDB (FSO): US\$30.0 million Total: US\$30.0 million	
FINANCIAL TERMS AND CONDITIONS:	Amortization period: 40 years Disbursement period: 4 years and 30 months, respectively Interest rate: 1% for the first 10 years and 2% thereafter Inspection and supervision: 1.0% Credit fee: 0.5%		
COMPONENTS AND OBJECTIVES:	The proposed hybrid program is composed of an investment project and a fast disbursing program. The investment project is mainly intended for electric power transmission works, an activity which remains under state authority, as well as the modernization of the Centro Nacional de Despacho de Carga [National Power Distribution Center] (CNDC). It also includes a small pilot component for rural electrification. The fast disbursing program will provide support to the Government of Nicaragua (GNI) in the process of restructuring and privatizing distribution and generation companies resulting from the restructuring of the ENEL. The conditionality for each of the two components is independent, although they complement each other in terms of continued consolidation of the electric power sector reforms.		

The objectives of the proposed hybrid program are as follows:

1. For the investment project: (i) improve the reliability and efficiency of electricity supply; (ii) expand access to electricity and prepare for future connection to the Central American Electric Interconnection System (SIEPAC); (iii) promote private sector participation; and (iv) carry out studies for rural electrification and implement the results in at least two communities not yet connected to the SIN network.
2. For the fast disbursing program: (i) Support the GNI in its efforts to restructure ENEL and to privatize and/or capitalize the distribution companies and generators created as a result of the restructuring; and (ii) provide the GNI with financing and support for ENEL to offset part of the rise in its operating costs in 1998 due to the El Niño phenomenon.

DESCRIPTION:

1. The investment project will include:

(i) rehabilitation and construction of transmission lines and substations and rehabilitation of the water system for the Nicaraguan Plant; (ii) purchase of maintenance equipment and tools, and replacement of protection systems on transmission lines; (iii) installation of metering equipment in the generating stations of the Sistema Interconectado Nacional [National Interconnection System] (SIN); (iv) interconnection of the Isla Ometepe electricity system with the SIN; (v) modernization of the CNDC and its communications system; and (vi) execution of a study for designing mechanisms to promote rural electrification projects, and selection of at least two communities in which to carry out such projects.

2. The fast disbursing program will consist of an operation to be disbursed in three tranches based on the achievement of specific targets relating to the privatization and/or capitalization of the power distribution companies and generators created as a result of the restructuring of the sector.

**ENVIRONMENTAL
AND SOCIAL REVIEW:**

The environmental impact studies carried out indicate that the proposed hybrid program is environmentally and socially viable, having basically positive effects in both areas. It is recommended that an environmental management and action plan be carried out in connection with the investment project (paragraph 3.18), along with environmental audits of the companies to be privatized (paragraph 3.20).

BENEFITS:

The investment project is given top priority because of the potential savings to be had by reducing electricity lost or unaccounted for, thereby improving the operations and financial position of ENEL and supporting modernization of the CNDC, and creating technical conditions with respect to metering and other controls that will enable the CNDC to administer a competitive electricity market. It will also prepare Nicaragua's electricity system for the start-up of the SIEPAC project, both from the standpoint of its participation in the regional electricity market and in terms of the system's infrastructure.

The fast disbursing program will play an essential role in facilitating participation by the private sector and the electric power distribution and

generation segments, while at the same time giving continuity and support to the consolidation of electric power sector reforms initiated under the PRESP.

RISKS:

There are no significant risks inherent in the legal, institutional, technical or environmental aspects of the program. The main risk is that the divestment and privatization of ENEL may not be consolidated or completed soon enough to permit privatization during the present administration, or that INE may not be consolidated as a regulatory agency. These institutional and regulatory aspects could directly affect both the new organization of the sector resulting from the restructuring process and the Empresa Estatal de Transmisión (EET) to be created, inasmuch as the revenues for the latter's operations will come from fees for connection to and use of the transmission system and other services of the CNCD ? fees which must be approved by the INE. To mitigate these risks, assistance will be provided for the GNI in executing the ENEL restructuring, and annual evaluation meetings will be held to review both the advances being made under the restructuring and regulatory process, and the progress of the investment project. The conditionality designed for the fast disbursing component requires specific progress in the restructuring and privatization process which will minimize these risks. Another potential risk could arise from a failure to apply the Gradual Plan on a timely basis to eliminate distortions and the electric power rate structure and the cross-subsidies between various groups of consumers. To minimize this risk, the GNI has undertaken to maintain the average rate levels, which reflect the marginal long-term costs, and beginning in 1999, any cross-subsidy that is maintained will be reflected in a transparent way on the customers' bills. The policy matrix and the conditionality proposed for each tranche will permit monitoring of compliance with the Gradual Plan agreed upon for disbursements. Another potential risk involves the possibility that the co-financing to be provided by the Norwegian Agency for Development Cooperation (NORAD) for interconnection of the Isla Ometepe system with the SIN might not be forthcoming in a timely manner (see paragraph 3.12). Since the amount involved is relatively small and execution is to be over three years, it is expected that ENEL could eventually carry out the works using its own resources.

**ROLE OF THE
PROGRAM IN THE
BANK'S COUNTRY
AND
SECTOR STRATEGY:**

The program is consistent with the Bank's strategy for Nicaragua which seeks to achieve sustained growth with equity by promoting private sector development and the resurgence of productive activities, as well as providing support to improve the reliability of the interconnected electricity system as a means of encouraging private sector participation in the effort to increase generating capacity, which is essential for revitalizing production. It is difficult to imagine new private investment in generating plants ? without transferring all of the risk to a state enterprise ? unless investors can be presented with an electricity network that meets the minimum requirements for reliability and has in place the means for administering and coordinating an open and competitive electricity market. This operation will support consolidation of the reforms being made to the electric power industry under the Programa de Reforma para las Empresas de Servicios Públicos (PRESP).

EXCEPTIONS TO

See the section on procurements below.

BANK POLICY:

PROCUREMENT:

Current Bank policy will be applied for the procurement of goods and construction works. The minimum amounts for which procurements under the investment project will require international competitive bidding will be: US\$300,000 for goods, US\$2 million for construction works, and US\$200,000 for consulting services (paragraph 3.11).

It is proposed that the equipment to replace the existing transmission lines be installed under direct contract (3.10).

In the case of the fast disbursing program, the Bank's new simplified procedures for sectoral loans will apply in this case in accordance with document GN-2001-2.

**POVERTY-
REDUCTION
AND SOCIAL
CRITERIA:**

The proposed hybrid program does not qualify as a poverty-targeted program. However, the rural electrification and the Ometepe Island electric connection components will benefit poor population segments by virtue of their geographic location.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

1. Conditions precedent to the first disbursement for the investment project:

- (a) Signature of the funds transfer agreement between the GNI and ENEL (paragraph 4.1).
- (b) Creation of the project executing unit for the investment component (paragraph 3.3).
- (c) Conditions precedent to the first disbursement of the rural electrification component:
 - (i) signature of the funds transfer agreement between the GNI and ENEL (paragraph 4.1).
 - (ii) placement in operation of the CNE, with budget for 1999 allocated and a project leader appointed (paragraph 4.4).

2. For the fast disbursing program: The contract must specify the conditions for the disbursement of each tranche laid down in the Policy Matrix (see Annex II-2).