ELECTRICITY SECTOR PROGRAM

(GY-0048)

EXECUTIVE SUMMARY

BORROWER AND GUARANTOR:	The Cooperative Republic of Guyana	
EXECUTING AGENCY:	Ministry of Finance	
AMOUNT AND SOURCE:	IDB Fund for Special Operations	US$45 million
	Total:	US$45 million
FINANCIAL TERMS AND CONDITIONS:	Amortization period:	40 years including a 10 year grace period
	Disbursement period:	2 years
	Interest rate:	1% p.a. during the grace period, and 2% p.a. in remaining 30 years
	Inspection and supervision:	1.0%
	Credit fee:	0.5%

OBJECTIVES: The proposed loan would support the privatization of the Guyana Electricity Corporation (GEC), the state electric utility, through the implementation of a public-private joint venture for the creation of a new GEC and related sectoral, policy and regulatory reforms.

DESCRIPTION: The reform program supported by this loan includes three main components. First, the implementation of the specific public-private joint venture transaction aimed at improving the existing technical, financial and operational performance, enhancing the quality and reliability of supply, and expanding and diversifying the available sources of finance. Second, the implementation of policy, legal and regulatory reforms and the introduction of an environmental regulatory framework for sector operations, promoting an enabling environment consistent with this joint venture. Third, maintaining a satisfactory macroeconomic and policy framework.

In a joint venture, the government sells the state-owned enterprise either in whole or in part to another corporation or consortium of companies by transferring the shares of the utility to a new entity. The state contributes the assets of the state-owned enterprise and the investor contributes

his own assets, including capital and technology to the new company. The new structure defined by this combination of assets is the joint venture. The joint venture supported by this sector program will bring in much needed private capital to improve and expand existing facilities as well as specialized management skills. Further, this approach would directly free scarce public sector resources for basic infrastructure and social sector investments.

The loan will provide fast-disbursing balance-of-payments support equivalent to US$45 million. The loan will be disbursed in three tranches of US$15 million, US$20 million, US$10 million upon fulfillment of the first, second, and third tranche conditions, respectively. These conditions are contained in the policy matrix, policy letter and the legal documents. An action plan, identifying the responsibility for implementing the policy conditions, means of verification to determine compliance as well as the expected output, will guide program execution. A parallel MIF project will support the implementation of the first and second components of the sector program.

ENVIRONMENTAL CLASSIFICATION: The Environmental Management Committee (EMC), at its meeting of September 7, 1995 (29/95), classified this as a Category III operation. An Environmental Summary detailing the environmental aspects of the sector program and the parallel MIF project has been approved by the EMC. The recommendations are contained in this document.

BENEFITS: The main benefits will be derived from a more efficient allocation of resources in the sector, a greater contribution of private financing toward the sector and the economy, and from the enhancement of the competitive position of the country's productive sectors. The privatization of the GEC and the successful implementation of the proposed sectoral reforms are expected to lead to a more effective and efficient management of the company and pave the way for the continued development and expansion of the sector and consequently, the Guyanese economy.

The proposed joint venture is expected to allow for improvements and much needed investments to the system; elimination of government financial responsibilities to the GEC and mobilization of additional resources for other uses; and removal of institutional and financial constraints to the efficient development of the sector.

Over the longer term, the Government of Guyana (GOG) may realize cash contributions from dividends and tax revenues from a profitable new GEC, and by selecting to sell its appreciated shares. Also, disbursement of shares to the Guyanese public and business community can contribute to a wider ownership base in the GEC enhancing prospects for capital market development.

Finally, the proposed program would also play a major role in safeguarding and enhancing environmental quality by introducing an environmental institutional and regulatory framework for the sector.

RISKS:

The potential for domestic political opposition and private sector reluctance to invest in Guyana at this time pose risks to this operation. However, these risks have been considerably reduced over the last months. First, the Guyanese public and business community have repeatedly requested the GOG to proceed with the privatization of the GEC to improve service and unleash the country's growth potential. Secondly, the permanent technical support provided by the Bank and specialized firms throughout the process has increased investor confidence in the reform program. This has been recently confirmed by the interest shown by at least 10 potential investors and a significant number of Guyanese investors during an international workshop organized by the GOG to present the information memorandum with details of the proposed transaction and sector reforms.

Privatization continues to be a very sensitive issue in Guyana, making this a very risky operation. The opposition to the reforms--supported by the proposed program-- could mount from within the GOG. Nevertheless, the three tranche design of this operation considerably reduces this risk and enhances the Bank's ability to monitor and support the implementation of the program over a substantial period of time, reducing the likelihood of policy reversals. Moreover, the actual receipt of offers from bidders has been included as a first tranche condition, ensuring that Bank resources are disbursed only when the GEC privatization is basically irreversible.

A successful partnership with a private operator would require a sound regulatory framework in place, preventing monopoly abuses, protecting the rights and interests of consumers, and ensuring a reliable and safe supply of power. At present, Guyana does not have an effective regulatory agency to support the

achievement of these objectives. To mitigate this risk, the regulatory framework is expected to be structured as simply as possible, relying in the short term on a regulatory contract establishing a detailed relationship between the public sector and the new GEC. In parallel and in order to establish a capable and committed regulatory agency, MIF technical assistance has been included to support the agency in the administration of the contract effectively in the short run, and subsequently, in the regulation of the sector as a whole.

The success of the proposed program also depends on the continued existence of an adequate macroeconomic framework. Guyana has recently returned to macroeconomic stability and must continue to exercise a cautious monetary and fiscal policy to ensure such stability endures. Maintenance of a sound macroeconomic framework has been included as a condition for each tranche release.

THE BANK'S COUNTRY AND SECTOR STRATEGY: The Bank's strategy for Guyana is set out in the Country Programming Paper approved by the Board of Executive Directors in August, 1995. The Bank lending program for the country supports debt alleviation, human resource development, infrastructure enhancement, and improvement of natural resource management. Accordingly, this operation is consistent with the Bank's strategy.

POVERTY TARGETING: On the basis of the established Bank methodology, this policy-based operation is not considered to be poverty-targeted. The successful implementation of the reform program, however, is expected to have indirect positive impacts on low income groups (see paragraph 5.10).

SPECIAL CONTRACTUAL CONDITIONS: The program will be governed by a loan contract. The special conditions of the contract are set forth in Annex III-3.

EXCEPTIONS TO BANK POLICY: Two exceptions to Bank policies are requested: (i) a procurement exception with respect to purchases of petroleum and petroleum products, enabling Guyana to purchase these products in amounts greater than US$5 million without requiring international competitive bidding (ICB) (see paragraph 4.9); and (ii) a waiver on the Bank's limitation of six months on retroactive financing, to permit financing of import bills incurred during the previous twelve months (see paragraph 4.11).

I. INTRODUCTION

1.1 Despite some recent improvements, the electricity sector, key to Guyana's economic recovery, continues to face periodic power shortages and significant unmet demand. Technical assessments of key institutional, organizational and financial issues of the GEC have confirmed its own diagnostic regarding the weak institutional, financial and regulatory conditions in which the corporation operates. The key obstacles are an ineffective separation of policy, regulatory and operational functions, insufficient financial viability, weak managerial capabilities, excessive labor costs, facilities far beyond their normal useful life, a lack of capital investments for rehabilitation and upgrading, and an inadequate legal framework.

1.2 The GEC has not generated enough internal capital for investment, and until recently, as required government funds to meet its basic rehabilitation needs, and a share of its operating costs. The estimated level of investment requirements to meet the expected economic growth and to ensure a sustainable, reliable and efficient supply of electricity in the country far exceed the availability of either own government resources or any other support from the Inter-American Development Bank (IDB) or other multilateral institutions.

1.3 The GOG is faced with the challenges of improving the technical and operational performance of the GEC with the current low human resource capacity in the country, and financing the rehabilitation and expansion required to meet the needs of a growing economy at a time when public resources are scarce.

1.4 To meet these extraordinary challenges, the GOG has decided to privatize the GEC through a public-private capitalization/joint venture scheme 1/ under which 40 percent ownership of the GEC and management control would be transferred to a strategic private investor, 20 percent would be allocated to Guyanese private investors, with the GOG retaining the remaining 40 percent. The success of this scheme rests on the existence of an investment climate that promotes the participation of potential private investors while at the same time preventing monopoly abuses, protecting the rights and interests of consumers, and assuring a reliable and safe supply of electric power.

1.5 The proposed program is designed to support the GOG in the implementation of the specific capitalization/joint venture transaction and related sectoral, policy and regulatory reforms, consistent with this joint venture. A successful joint venture is

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1/ Throughout this document, joint venture and capitalization will be used interchangeably to refer to the transaction for the privatization of the GEC.

expected to bring in much needed private capital to improve and expand existing facilities as well as specialized management skills. Further, this approach would directly free scarce public sector resources for basic infrastructure and social sector investments. The legal, regulatory and environmental reforms are necessary conditions for the effective implementation of the joint venture.

1.6 The proposed reform program would be supported by a loan equivalent to US$45 million at concessionary rates, financed from the Bank's Fund for Special Operations (FSO) and would provide fast disbursing balance-of-payments support in three tranches of US$15 million, US$20 million and US$10 million, respectively. Multilateral Investment Fund (MIF) grant resources equivalent to US$990,000 would be used to finance a parallel technical cooperation project.

1.7 This document presents a reform program for the modernization of the electricity sector in Guyana. Subsequent to the introduction presented in this section, chapter 2 presents the frame of reference. Chapters 3 and 4 explain the objectives and components of the sector program and detail financing and implementation aspects, respectively. A discussion on the program's viability and risks follows in chapter 5.

II. FRAME OF REFERENCE

A. Macroeconomic Framework

2.1 Following nearly two decades of economic decline, Guyana embarked in 1988 on an Economic Recovery Program (ERP). The GOG entered into an International Monetary Fund (IMF) structural reform program consisting of fiscal, monetary and exchange rate policies. Stabilization of inflation and the exchange rate was followed by dramatic improvements in economic growth and in the current account. Ancillary measures in trade, finance and the public service helped consolidate structural reforms. The economy has achieved a remarkable compounded growth rate in excess of 7 percent since 1990, led by the traditional rice and sugar subsectors, as well as forestry and gold mining. The economy is about to complete its sixth consecutive year of positive economic growth in 1996, at a rate of 7.5 percent.

2.2 The unfolding of Guyana's external debt strategy in May 1996 has been undoubtedly the major economic achievement of 1996. The external debt of Guyana, which had surpassed US$2 billion in 1995, or 3 1/3 times Gross Domestic Product (GDP), was considered unsustainable by all reasonable measures. The Paris Club, joined on an exceptional basis by Trinidad and Tobago, granted Guyana Naples Terms, consisting of a 67 percent stock of debt reduction and topping-up for equivalent relief of all previously rescheduled debts. Total debt relief for Guyana is estimated at US$585 million, an amount perhaps greater than the combined value of all foreign aid received to date by the country. Aside from wiping the slate clean of past arrears and bringing scheduled debt service in line with actual payments, the agreement resulted in a sustainable debt scenario in the medium term. Although increasing from 25.5 percent in 1995 to 26.2 percent of current revenue in 1996, the external debt service ratio is expected to decline to 19 percent by 1999.

2.3 The second major accomplishment of 1996 has been the reduction of fiscal constraints owing to domestic macroeconomic stability that sharply reduced treasury yields, and in turn interest payments on internal debt from 19.4 percent in 1995 to 13.5 percent of current revenues in 1996. By the year 2,000, the combined internal and external debt service of central government is expected to fall below the critical threshold of 25 percent of current revenues.

2.4 In other policy areas, Guyana has so far managed to balance high growth rates with continuing macroeconomic stability. By year end 1996, the rate of inflation is expected to fall from 8.1 to 6.7 percent and treasury yields from 15 to 10 percent. Although the real exchange rate appreciated by 3.6 percent in 1996, the nominal exchange rate remained stable in terms of its level, daily fluctuations, and trading spreads, and the volume of cambio market

purchases increased about 25 percent from the previous year. The unification of the foreign exchange market is near completion, awaiting only the abolition of foreign exchange surrender requirements for sugar and certain gold exports expected in December 1996.

2.5 With the exception of the external debt and fiscal burdens, the key development challenges still facing Guyana consist of the pervasive weakness of public sector capacity, and the required rehabilitation of physical, social and policy infrastructure. However, in light of recent economic developments and the release of significant budgetary resources, the GOG is now better positioned than ever to address these fundamental issues. Guyana's growth relies to a large extent on preferential access to export markets or on exhaustible resources with unknown national reserves. The sustainability of economic growth is therefore best addressed in the context of the implementation of a second generation of structural reforms designed to extend the economy's high growth trajectory for a few more years.

B. Guyana's Development Objectives and Prospects

2.6 Despite the improvement of most macroeconomic indicators and the positive outlook for debt service, persistent structural imbalances remain, particularly in the rehabilitation of physical, social, and policy infrastructure and the pervasive weakness of capacity in the public sector.

2.7 First, although the transition from a centralized and controlled economy to a more open and market-based system is under way, additional financing is necessary for rehabilitation and expansion of infrastructure, both physical and social. These investments must be accompanied by policy measures such as the elimination of existing legislative and regulatory barriers, measures to diversify economic activity and the tax base, and to encourage both domestic and foreign private sector participation in the economy. Although the ERP increased economic growth and reinserted Guyana into the international commercial and financial community, it has not been sufficient to reverse the effects of twenty years of economic mismanagement.

2.8 Second, public sector reform needs to be at the top of the policy agenda. As a result of long-standing wage and employment policy distortions, the proliferation of closed ministries, semi-autonomous agencies, project implementation units, and other such agencies have segmented government and drained the civil service of human capital. The GOG needs to take stock of these trends, make fundamental decisions concerning civil service reform, and redefine responsibilities among such agencies with the view to enhancing autonomy, efficiency, and accountability, strengthening management, and eliminating redundancies. The GOG needs also to focus on core activities and better mobilize internal and external resources for development.

C. Private Investment Climate

2.9 Private investment, both foreign and domestic, is governed by the Guyana Investment Policy of 1988. There are no restrictions on the repatriation of capital. Foreign-based companies and their subsidiaries may borrow in Guyana only with the express approval of the Bank of Guyana. In order to promote foreign investment, the government has taken steps to liberalize the licensing regime; create a free market in foreign currency; remove price controls and subsidies; and is working with the support of multilateral institutions to standardize future investment incentives. It has also established a "one stop" investment office -- the Guyana Office for Investment (GO INVEST)--to advise foreign investors on business opportunities, respond to inquires and facilitate the establishment of enterprises.

D. Privatization Framework

2.10 Privatization remains a sensitive issue in Guyana. In the early stages of the ERP, the GOG carried out a number of important privatizations, particularly the national telephone company Guyana Telephone and Telegraph (GTT). In the gold industry, Canadian firms formed a joint venture with the GOG to operate and manage the OMAI mine. In the bauxite sector, a US firm has invested in a 50 percent joint venture agreement with the government in the Aroraima company.

2.11 The new government pledged to continue the basic reforms of the ERP and issued a national policy on privatization in July 1993. The "white paper" indicated that the GOG would adopt a privatization strategy for 16 of the remaining 26 eligible state enterprises. However, delays in the privatization program resulted from weak commitment, technical difficulties, the low absorptive capacity of the private sector coupled with the fact that foreign participation was not encouraged, and attempts to redefine the ongoing program. As a result, the authorities were non-compliant with the IMF program to bring ten companies to the point of sale in 1994-95, requiring extensions into 1996.

2.12 Having overcome a series of legal and financial tangles, the Privatization Unit has brought six public companies to the point of sale in 1996, including the National Edible Oil Company, Guyana Stock Feeds, Guyana Co-Operative Insurance Service, Guyana National Printers, Guyana Stores, and the National Bank of Industry and Commerce. The GOG values these companies at about US$84 million. Aside from these, the privatization of Linmine, a bauxite producing company, as well as two dozen other smaller companies are currently underway.

2.13 The public-private joint venture for the GEC, supported by the proposed sector program, would represent the single most important privatization initiative the current administration has promoted so far. The significance of the GEC privatization can be measured not

only in terms of the investment resources that would be secured for rehabilitation and expansion of the system, but also on the basis of the improved prospects for the country to achieve its full growth potential.

E. The Electricity Sector

2.14 The GEC is the only public utility in charge of the generation, transmission, distribution and commercialization of electricity in Guyana. Electricity supply is based on thermal generation, which uses imported petroleum fuels, with a total nominal installed capacity of about 89 Megawatts (MW) and only 66 MW of effective but unreliable operating capacity. Due to almost non-existent capacity reserve margin and the poor conditions of the distribution systems, black-outs, scheduled and unscheduled, have become commonplace, while businesses that require stable electric supply have had to incur the costs of auto-generation or are suffering the consequences of unreliable power. An estimated 88 MW of auto-generation exists in Guyana, not including the sugar and bauxite industries.

2.15 The key sectoral obstacles are an ineffective separation of policy, regulatory and operational functions, insufficient financial viability, weak managerial capabilities, excessive labor costs, facilities far beyond their normal useful life, a lack of capital investments for rehabilitation and upgrading, and an inadequate legal framework. These obstacles persist despite the relatively high tariff levels. Current average electricity tariffs equivalent to US$0.14 per KWh are slightly higher than long run marginal cost estimated at US$0.13 per kWh and no major increases are foreseeable in the near future, except to protect tariffs from inflation erosion.

2.16 **Current laws and regulations.** The Electric Lighting Act of 1890 (amended in 1973), the Electricity Act of 1957 (amended in 1974), the Public Corporations Act of 1988, and the Public Utilities Commission Act (PUCA) of 1990 amended in 1991 are the primary pieces of legislation governing the electricity sector in Guyana. A Public Utilities Commission (PUC) was created by the PUC Act of 1990, designed as an independent agency to regulate the GEC, GTT, and potentially other utilities. The original Act grants the PUC specific authority to regulate the electric utility sector. However an amendment in 1991 removed the authority of the Commission to review and specify electricity tariffs. PUC relations with the GEC have focused primarily on addressing consumer complaints regarding the reliability and quality of service.

2.17 **Technical aspects.** The installed capacity of the GEC accounts for about one half of Guyana's total installed capacity. The remainder includes autogenerating facilities that are mostly owned by industry which has been unable to secure reliable service from the

GEC or remains unconnected. In recent years, most Guyanese industry, businesses and some private residences have come to depend upon their auto-generation as a primary source of energy rather than a backup. Notwithstanding the former, the GEC has been unable to supply reliable electricity to its remaining customers and has been forced to engage in planned and unplanned load-shedding.

2.18 The existing units are diesel except those at Kingston station, located in Georgetown, which is the only steam plant of the GEC system. Power stations generate at 60 hertz (Hz), except for Kingston and Versailles which operate at 50 Hz. The GEC acquires the majority of its fuels from the GOG which purchases the fuel from Venezuela under a country-to-country agreement. The Guyana National Energy Agency (GNEA) is the government entity responsible for procuring refined petroleum products and the GEC purchases its fuel from the GNEA. The company currently relies on the government to negotiate its pricing arrangements.

2.19 GEC's main transmission system operates at 69 Kilovolts (kV), but interconnections between substations at 13.8 kV still exist. Since the system operates at both 50 and 60 Hz, a frequency converter station at the Sophia site converts generation from 50 to 60 Hz as required. Both transmission and distribution lines are in need of servicing and metering problems and illegal connections are prevalent.

2.20 **Future investment needs.** As a result of an indicative expansion plan, preliminary estimates of future investment needs conclude that as much as a further 150 MW of generating capacity will be needed in the next decade to meet future demand growth and to compensate for likely retirement of some existing generation. These increases are in addition to six 5.5 Mw Wartsila units already committed for delivery. The indicative expansion plan has also determined that approximately US$17 million will be needed to satisfy the expansion plan of the transmission system; in addition, about US$20 million will be required to fix and expand the distribution systems.

F. Bank Strategy in Guyana

2.21 The Bank's country strategy has been devised to support the GOG's key development challenges to maintain a sound macroeconomic environment; the external debt burden must be reduced and the public sector made more efficient; the quality of both health and education needs to be improved; and given the important implications for the country's productive capacity and efficiency and the integrity of its natural resource endowment, Guyana must restore the infrastructure that has eroded following years of economic decline. Improvements in all these areas are necessary conditions for sustained development.

2.22 The Bank lending program places increased emphasis on supporting GOG policy in health, education, electricity, finance and agriculture. The main objectives in these areas include debt alleviation, human resource development, infrastructure enhancement, and improvement of natural resource management. In all these sectors, the weakness of the public sector is the primary cause of poor project execution and needs to be addressed. The Bank also intends to support a reduction of poverty indirectly through its social sector lending and directly, through further support for a community driven social investment fund.

2.23 The proposed program is directed at the electricity sector, in fulfillment of the Bank's strategy in that area. Improvements in the electricity sector will unleash the potential for economic growth and promote a more active private sector participation. The operation also supports specific measures to improve the weak existing public sector management skills by promoting private management of the electric utility with the corresponding technology transfer. The program will also indirectly contribute to the other objectives in the Bank strategy by reducing the need for public investment resources in the sector, increasing the availability of budgetary resources for improvements in other priority sectors.

G. Bank Experience and Relations with Other Multilateral Organizations

2.24 Bank supported energy sector programs (163/IC-GY and 853/SF-GY), totalling almost US$35 million to date, have focused on rehabilitating GEC systems, including its installed capacity. These programs have not achieved their original objectives, mostly due to a lack of managerial skills and some opposition to program components. The joint venture and related reforms supported by this sector program are expected to bring in needed private capital to improve and expand existing facilities as well as specialized management skills. Further, this approach would directly free up scarce public sector resources for rehabilitation and investments in basic infrastructure and in the social sectors.

2.25 **Other multilateral and donor support.** The sector has not received much support from other multilateral agencies and donors in the recent past. In 1979, the Caribbean Development Bank financed the construction of a transmission line. However, cost overruns and GEC's inability to cover its local contributions resulted in only the partial completion of this project. More recently, donations of diesel generating units from Brazil and Japan have also been received.

III. THE SECTOR PROGRAM

A. Background and Recent Policy Developments

3.1 Several reform options and strategic directions were analyzed to overcome the obstacles cited previously. These reform options included, among others, the privatization of the GEC, and as a second best alternative, its corporatization. Corporatization of the GEC, followed by the introduction of competitive independent power producers (IPPs) was initially considered as a possible approach to expanding the generation needs of Guyana.

3.2 Corporatization itself would have required that GEC be run as an efficient commercially oriented business, fully accountable for its performance to its Board of Directors and ultimately the government. The corporation would have had to be run as an independent autonomous enterprise with the same legal requirements of private firms, and as such, would be subject to the same standard commercial, tax and labor laws and commercial accounting procedures. Also, an arm's length relationship would have had to be established with government in terms of policy and operating procedures, with its suppliers, requiring an effective separation of the government's policy role from the role of provision of electricity services.

3.3 Under the most optimistic scenario, corporatization could have resulted in a regulated, autonomous, financially viable and considerably downsized company, with the ability to contract and service its own debt and issue equity, and with reasonable costs for the same class of customers, thus also, making it attractive to potential private companies. The corporatization approach, however, would have posed considerable risks, particularly since a strong regulatory framework along with a stable management team would have been required, with the additional potential for future policy reversals. More importantly, much needed public resources would still have been required to upgrade existing facilities and expand capacity with the corresponding impact on the country's indebtedness.

3.4 Until recently, GOG contributions were required in support of the GEC's operating and investment needs. The estimated level of investment requirements to ensure a sustainable, reliable and efficient supply of electricity in the country in the medium term far exceed the funding availability from Government's own resources, the IDB or other multilateral support. In recent months the GOG has determined that the economies of scale required to disaggregate the electricity sector do not exist in Guyana. Instead, the GOG has decided to pursue a process of capitalization, in which a strategic investor will be selected to form a partnership with the GOG in running, planning, managing, operating and investing in a vertically integrated GEC.

3.5 This change in strategy should actually provide greater benefits than would have the corporatization option. Not only are all the goals envisaged according to corporatization achievable under this more active scheme; additionally, the proposed joint venture has the advantage of bringing in needed capital to upgrade and expand existing facilities as well as management capabilities and technology transfer.

B. Program Objectives

3.6 The proposed loan would support the privatization of the GEC, the state electric utility, through the implementation of a public-private joint venture for the creation of a new GEC and related sectoral, policy and regulatory reforms.

3.7 The reform program supported by the proposed loan would include three main components. First, the implementation of a public-private joint venture for the GEC aimed at improving the existing technical and operational performance, enhancing the quality and reliability of supply, and expanding and diversifying the available sources of finance. Second, the implementation of policy, legal and regulatory reforms as well as the introduction of an environmental regulatory framework for sector operations. Third, the maintenance of a satisfactory macroeconomic and policy framework.

3.8 A brief background for each of these components as well as the proposed policy reforms in the order they appear in the policy matrix (Annex III-1) are presented in the following sections. The reforms and their role in the context of the GOG's overall program are presented in the policy letter presented by the GOG (Annex III-2). The policy conditions and an action plan for their implementation are contained in Annexes III-3 and III-4, respectively. Annex III-5 presents a MIF Technical Cooperation Project designed to support the timely implementation of the policy conditions and other related actions.

C. Public-Private Joint Venture for the Guyana Electricity Corporation

3.9 Several operational and financial factors have contributed to the poor performance of the GEC, the state electric utility. The GEC has not generated internal capital for investments, and has required GOG funds to meet its basic rehabilitation needs, and to cover operating costs. In order to finance the expansion and rehabilitation required to meet the current shortfall and to cope with the surging demand resulting from economic growth, the GOG has determined that it will be necessary to expand and diversify the available sources of finance through a joint venture with the private sector.

3.10 Prior to the selection of a capitalization scheme for the GEC, top GOG officials analyzed the main advantages and disadvantages of the following options which reflect the level of risk assumed by the

investor in ascending order (from lowest to highest): a joint venture with a strategic investor, a long term concession with a strategic investor, and a management contract. Based on this assessment, the GOG decided to pursue a joint venture with a strategic investor.

3.11 In a joint venture, the government sells the state-owned enterprise either in whole or in part to another corporation or consortium of companies by transferring the shares of the utility to a new entity. The state contributes the assets of the state-owned enterprise and the investor contributes his own assets (capital, technology) to the new company. The new structure defined by this combination of assets is the joint venture.

3.12 A joint venture has numerous advantages. The investor is given a permanent stake in the success of the utility, encouraging perpetual investment and improvements to the system; operational and investment decisions become removed from direct political intervention; this option attracts the most competitive bids from the private sector as it is the most familiar in the sector and provides the longest horizon for cost recovery; GOG financial responsibilities to the GEC are eliminated; GOG may realize cash contributions from dividends in the new GEC by selecting to sell its appreciated shares and by receiving tax revenues from a profitable new GEC; and disbursement of shares can contribute to a wider ownership base in the GEC.

3.13 Because of the informational and strategic advantages of receiving, and ultimately being able to select from bids that are offered in a competitive environment, the joint venture by way of an international competitive tender is generally considered to be the preferred method for governments seeking to maximize revenue or investment commitments and acquire an infusion of management know-how. Many, if not the majority, of utility sales that invite foreign investment have been joint ventures.

3.14 **Progress to date.** During a well-attended investors' workshop in mid-October, 1996, potential strategic investors, Guyanese private investors and the public were presented with an information memorandum detailing the GOG proposal for the capitalization of the GEC. The proposal, selected by the Guyanese Cabinet, would entail apportioning ownership shares of the new GEC as follows: 60 percent for private investors and 40 percent for the GOG. The sixty percent ownership stake in the new GEC is expected to be offered to the private sector in exchange for equity contributions to the new company. Of the 60 percent, 40 percent will be maintained by a core strategic investor to be responsible for management, with the remaining 20 percent ultimately being apportioned to private investors throughout Guyana. The equity funds to rehabilitate and expand the GEC system will be provided as needed to meet load growth.

3.15 The mechanics of the transaction include two distinct components. First, the strategic investor will, through the bidding process, provide a commitment to the GOG to contribute a specified amount of equity into the new GEC in exchange for an initial 50 percent ownership share and management control. The remaining 50 percent will be retained by the GOG. Since both ownership structure and tariffs have been predetermined, investors will bid for an investment plan. The selected strategic investor will be the one that offers the highest investment value for this ownership share. Proceeds of such shares will accrue to the benefit of the GEC and be used by the company and new management in serving operational problems, and expansion of generation, transmission, distribution and commercial services. No proceeds will accrue to the GOG.

3.16 Second, a 20 percent shareholding interest will be reserved for Guyanese private investors, and will be issued by way of an initial public offering (IPO) at an appropriate time after the strategic investor assumes responsibility and management of the new GEC. Once the public offering of these shares is completed, the shareholdings of both the GOG and the strategic investor will be reduced to 40 percent each, as selected by the GOG Cabinet.

3.17 In order to achieve the objectives of the privatization program, in particular, the elimination of the financial and administrative burden on the Government, and the redeployment of scarce public resources, the Government will not increase its 40 percent ownership share in the new GEC. Moreover, public enterprises will be excluded from acquiring shares through the IPO of 20 percent to be allocated to Guyanese private investors in the new GEC or subsequent placements of any unsubscribed shares (see policy letter, Annex III-2).

3.18 The selected ownership structure does not provide a majority stake to any single investor. However, because one of the most important benefits of this capitalization program is the introduction of management expertise into the new GEC, the core strategic investor will have formal management control of the new GEC with a minimum 51 percent voting majority at the Board level. Also, the GOG and Guyanese private investors will have a 49 percent maximum representation on the Board. This arrangement ensures that the new GEC will be run by utility management with a fiduciary responsibility to private investors and that the GOG will have the opportunity to present its concerns and advocate its policies within a conventional commercial framework for corporate governance and control.

3.19 The investor will be expected to execute a **management contract** whereby operating control of the utility will be given to the strategic investor. Management of the new GEC will issue debt as needed with the goal of establishing and maintaining an optimal capital structure for the company. In addition to the management contract, the GOG, the strategic investor, and the new GEC will

enter into a **shareholders' agreement** which will not only deal with matters concerning their relationship as shareholders of the new GEC, but will also govern their common objectives in such capacity. This agreement will obligate the parties to comply with the new regulatory regime, including applicable legislation, the regulatory contract or license, and the management contract.

3.20 The GOG has anticipated that the new GEC will be granted the exclusivity of franchise, that is, there will be a moratorium on development of IPPs for ten years. At this time, a policy will be developed that invites IPP participation. Private power projects will not compete with the new GEC, but rather, will arrange for the sale of their power to the new GEC on negotiated commercial terms.

3.21 Moreover, the GOG has announced its intention to waive its entitlements to dividends for a 10-year period and to exempt the strategic investor from the 15 percent withholding tax on the repatriation of profits and from other levies in respect of custom duties. The rehabilitation and expansion needs of the sector in the next five years as well as efficiency indicators/key priorities for new generation (expected to keep up with peak and reserves), transmission and distribution (reduction in line losses, metering and distribution replacement program), and for commercial operations and management have been included in a business plan. This plan was presented to interested bidders and was made public during the investors' workshop (see paragraph 3.14). Compliance with these sector development indicators will be eventually monitored through the regulatory framework (see paragraph 3.41), which will incorporate mechanisms for public disclosure.

3.22 **Sequencing of the proposed transaction.** In the first stage of the capitalization process, the interest of potential investors was canvassed through broad public advertisement and direct contact. As a result, almost 40 foreign investors expressed their interest in participating in the process. Subsequent to the GOG announcement of the selected privatization approach (see paragraph 3.14), about 30 investors remain interested. At a recent workshop, an information memorandum with details of the proposed transaction, and a request for expressions of interest (pre-qualification) documents were submitted to potential investors, who will have until November 22, 1996 to submit documentation in fulfillment of the pre-qualification criteria. This memorandum was also made available to the public who took part in the workshop. An offering memorandum is currently being prepared, and will be later submitted only to pre-qualified investors. Ultimately, four or five bids are expected. A GOG Review Committee will evaluate the bids, award the contract and the winning bidder will proceed to put together its financing package.

3.23 **Proposed Actions.** The proposed program would support the competitive selection of a strategic investor for a new GEC. **Prior to Board presentation**, an offering memorandum including details of

technical, financial, legal and environmental aspects of the transaction and bidding terms and conditions would be issued and made available to pre-qualified investors. Also, a strategy for offering of 20 percent of the shares to the Guyanese private sector would be included in the offering memorandum. The receipt of bids from pre-qualified investors has been included as a **first tranche condition**.

3.24 **Second tranche conditions** include the selection of a winning bidder, contract award and financial closing underway; and an implementation plan for the sale of 20 percent of the shares in the new GEC to Guyanese private investors. **By third tranche**, management and operational responsibility would have to be transferred to selected strategic private sector partner; and the objectives and timetable of the implementation plan for the sale of the 20 percent equity participation in the new GEC to Guyanese private investors would be complied with. In order to facilitate the public placement of shares of the new GEC in the market, a review of the related financial sector legislation, regulation and procedures will be undertaken under the MIF project.

D. Diagnosis of the Legal and Regulatory Framework

3.25 Because the new GEC will function as a monopoly within a sector that underpins Guyana's aggregate economic development, regulation will be required to prevent monopoly abuses, protect the rights and interests of consumers, and assure a reliable and safe supply of electric power.

3.26 An analysis of the recent history and current status of power sector regulation in Guyana reveals the existence of broad weaknesses in the regulatory framework relative to the majority of regulatory systems: weak legal foundation, ineffectiveness of the PUC, and lack of autonomy of the regulatory agency. This section provides a brief review of each of these issues and presents the proposed recommendations for establishing a workable and effective framework for regulating the Guyanese power sector in preparation for, and consistent with, the proposed joint venture for the GEC.

3.27 **Weak legal foundation:** The strength and effectiveness of any regulatory regime is largely dependent on the supporting legal framework. The existence and operation of a regulatory regime must be supported by law. The enabling legislation establishes the regulatory authority as a legally recognized entity, defines the basic objectives and functions of the authority, and lays the groundwork for the ongoing performance of regulatory activities. As the foundational document supporting the regulatory regime, the language of the enabling legislation must be clear to guarantee that all legal mandates are consistent with the fundamental objectives of power sector regulation.

3.28 Although Guyana has enacted a series of statutes establishing a regulatory commission and broadly outlining rules and procedures for governing the electric power industry, some functions for which a regulatory agency would normally be assigned responsibility, have not been allocated to the PUC. The legislative language assigning responsibility for some functions to the PUC has not been sufficiently precise and well-defined to prevent political institutions from insinuating themselves into the process. The result is that either legislative authority is clearly misplaced, or there is confusion as to where authority lies and how the basic objectives of the legislation are to be carried out.

3.29 **Commission ineffectiveness:** In those areas where the PUC has been clearly assigned legislative authority, it has failed to effectively perform its responsibilities. There are two basic problems: first, in some areas--such as tariff-setting (before the 1991 PUCA Amendment) and review of capital investment plans--the PUC lacks the technical skills and expertise to conduct the required functions. This is due in large part to the lack of professional, and technical support staff. Staffing is a severe structural problem at the PUC. The Commission has not had the budget to hire its own professional staff and has not been able to acquire the requisite expertise. The PUC has not made requests for professional staff through the appropriations process and the budget allocated by the Ministry of Finance (MOF) has not allowed for personnel additions.

3.30 In other areas--such as setting of performance standards and regulatory enforcement--the PUC has not successfully conducted the required functions. This is due less to a lack of technical capacity within the GEC, and more with a lack of leadership and institutional will to perform the required functions and to make and enforce difficult decisions. Part of the problem may be that the Commission has thus far focused most of its efforts and resources on regulation of the GTT.

3.31 **Autonomy of the regulatory agency:** One of the most important requirements for effective power sector regulation is that the regulatory agency be established in a way that provides it with sufficient autonomy and independence from government interference in its day-to-day affairs. Ministries and other government agencies most often do not have the requisite technical expertise and industry knowledge to perform regulatory functions. Most importantly, autonomy from the political process is necessary to facilitate difficult and politically unpopular decisions, such as approval of cost-reflective tariffs.

3.32 While countries have differed in the extent to which they have insulated their regulatory agencies from political interference, investors have consistently displayed a strong preference for an agency sufficiently shielded from shifting political concerns. Private investors will require that the agency operate under a

statutory mandate that clearly defines and protects its authority and provides for appeal of regulatory decisions to a court system that is also independent of political influence.

3.33 The regulatory process in Guyana reflects considerable participation by political institutions. This is true in concept and, to a lesser extent, in practice. The PUCA states clearly and directly that the Commission is to function in an advisory capacity to the Minister. Other power sector legislation grants significant authority in regulatory matters to political agencies, in particular, the offices of the Prime Minister and President.

3.34 Even in those instances where regulatory functions and procedures have not been politicized through legislative decree, the vagueness and imprecision of much of the statutory language has at least left the door open for ongoing political involvement. In practice, the political institutions have generally not exerted their authority to full potential. The GEC develops recommendations and submits them for the Cabinet's review upon recommendation of the Minister. Although the Cabinet may become significantly involved in particularly important decisions, it typically approves recommendations without discussion. Thus, while the Minister and Cabinet have been empowered to take on a large role in the regulation of the electric power sector, without sufficient resources for meaningful review, it has generally deferred to the recommendations of the GEC.

3.35 The net effect of the three core problems identified in this section--weak legal foundation, ineffectiveness of the PUC, and potential for political interference--is that the PUC has thus far played a very minor role in the regulation of the GEC. Instead, the GEC has been regulated in two other ways: first, by the GEC itself; and, second, by political institutions.

3.36 While this system has at least been workable while the GEC has been fully owned and operated by the government, it will be impossible to maintain this system after capitalization. Self-regulation of the GEC by utility management with a fiduciary responsibility to private investors should be unacceptable to the people and GOG. Ongoing regulation of the GEC by political institutions will be unacceptable to investors.

3.37 **Proposed Actions.** In order to address these weaknesses while at the same time putting in place a streamlined regulatory arrangement in order to avoid regulatory burden, and to ensure greater reliance on market-based incentives, the proposed program would support the establishment of: (i) a detailed regulatory contract; (ii) a strong legal foundation for regulation; and (iii) an effective regulatory agency. The implementation of these activities will be supported with MIF resources.

1. <u>Detailed regulatory contract</u>

3.38 As part of the capitalization program, a license and/or a regulatory contract--clearly delineating the rights and responsibilities of the new GEC and its customers for a fixed period of time--would be established between the GOG and the strategic investor. The regulatory contract should serve the purpose of standard-setting by specifying the terms and conditions relating to each of the four major regulatory functions: licensing, tariff setting, specification of performance standards, and review of capital investment plans.

3.39 The implementation of the proposed new regulatory framework requires various amendments to the Electricity Act and the creation or certain additional regulations to such statute, which may take some time. In the meantime, a regulatory contract will be executed between the GOG and the new GEC in order to provide for such rights, obligations and regulatory procedures. Such regulatory contract will expire by mutual consent when the legislation is harmonized.

3.40 **Progress to date.** Criteria to be included in the regulatory contract has already been included in the information memorandum. On **licensing**, the franchise area has been defined, and the extent to which the GEC will be subject to competition- or, alternatively, assigned exclusive rights to provide service- within its defined franchise area has been agreed. The regulatory contract will define the new GEC's obligation to provide service to customers requesting service within its franchise area. With regard to **tariff-setting**, the contract would define a process by which tariffs are to be adjusted annually.

3.41 On **specification of performance standards**, service standards and sector development indicators (see paragraph 3.21) will be incorporated, encouraging efficient and reliable service through the acquisition of resources at the lowest practical cost and cost-effective management and operations. Regarding the **review of capital investment plan**, the contract would either specify an indicative business plan or a fixed pattern of investment over a defined period of time (or a combination of the two). In any case, the new GEC investment plan will be required to satisfy load growth.

3.42 Given that it is impossible to anticipate all contingencies that might arise, and because it is extremely costly to attempt to completely specify all contingencies that can be anticipated within a formal contractual document, there must always be some recourse for settling disputes involving issues not properly accounted for in the contract.

3.43 **Prior to Board presentation**, criteria for detailed regulatory contract including licensing, tariff setting, specification of

performance standards, review of capital investment plan, and proposed mechanism for arbitration and dispute resolution will be incorporated in the offering memorandum. Also, the basic structural form of regulation, including organizational design and funding mechanism, and any required modifications to enabling legislation to harmonize the legal framework with the contract will be included in the offering memorandum. **For second tranche**, the license and/or detailed regulatory contract is to be signed and ratified by Parliament. **Third tranche conditions** require satisfactory compliance with license and/or contract conditions. Support for the successful implementation of these measures would be provided by the MIF technical cooperation project.

2. Strong legal foundation for regulation

3.44 There are three steps to strengthening the power sector legal foundation. First, the PUCA, the primary component of the PUC enabling legislation, should be amended in order to more properly allocate regulatory responsibilities. Second, other statutes impacting the power sector should be amended and reconciled in order to reduce the uncertainty resulting from both vague and sometimes conflicting decrees. Third, legal mechanisms should be instituted for insulating the regulatory process from the political process.

3.45 The primary piece of power sector enabling legislation must allocate responsibility for the four basic regulatory functions to a regulatory agency. Because of the weakness of the existing PUC, the legislation should minimize the standard-setting responsibility of the agency. The revised PUCA should be consistent with the legal principles and agreements incorporated in the regulatory contract, formally allowing the agency to begin taking on this role as issues and disputes arise throughout the life of the regulatory contract. After the contract expires, and the power sector in Guyana begins to be regulated within a more traditional process, the regulatory agency should maintain complete and unambiguously defined authority for applying the standards specified in all power sector regulation, and monitoring and enforcing compliance with its decisions.

3.46 Currently, several statutes impact the power sector and contain clauses that are inconsistent with sound regulatory development. Some of the changes required includeeliminating GEC's role in regulating itself and the aggregate power sector, eliminating the Prime Minister's direct control over the GEC, revising all legislation granting the Prime Minister or President authority to regulate activities in the power sector. An option the GOG could consider is consolidating all of these laws within one updated PUCA. Since there is a great deal of redundancy between these statutes, this may produce the most optimal result.

3.47 Regulatory functions should be performed by a government institution that is fully independent from any other part of the government. Full institutional independence means the regulatory agency will have a source of legal authority which is clear and complete, and a source of funding not subject to the direct authority of a GOG entity. The MOF can authorize an overall budget, but the PUC should have increased resources at its disposal, be able to control these resources within its budget, and establish its own staff policies. The PUC should be neither attached to a minister, headed by a minister, nor be required to consult with, or obtain the approval of, a GOG authority in undertaking its activities.

3.48 **Progress to date.** The GOG has announced that the most immediate change to the existing framework will be the enactment of a new Electricity Act, clarifying the mandate and powers of the new GEC, establishing a new tariff system and effecting various other changes. It is expected this new statute will be in the course of preparation with the offering memorandum, and that its salient provisions will be summarized therein. The further drafting of the new Electricity Act is expected to take place prior to or immediately after the selection of a strategic investor and other interested parties. The GOG has also announced its intention to modify, as needed, other power sector laws.

3.49 Prior to **Board presentation**, the proposed enabling legislation consistent with public-private joint venture for new GEC, including the separation of policy, regulatory and operational functions will be specified in the offering memorandum. By **second tranche**, new legislation consistent with the proposed public-private joint venture will be enacted and taken effect. As in the case of the regulatory contract, MIF technical cooperation resources would be used to support the preparation of this legislation.

3. <u>Effective Regulatory Agency</u>

3.50 The proposed contractual mechanism will temporarily displace most regulatory functions, significantly reducing the burden on the PUC with respect to both standard-setting and, to a lesser extent, adjudication. However, for the Guyanese power sector to function effectively, a capable and committed regulatory agency must participate. Despite the strategy to alleviate the burden on the regulatory agency, a well-functioning institution should be in place in the short term. Even the most detailed and carefully drafted regulatory contract will require administration. The same is true of new legislation. It is inevitable that in the course of conducting even the most precisely prescribed procedures, unforeseen issues will arise and disputes will need to be resolved. Hence, a regulatory agency must administer the process of regulation.

3.51 Prior to **Board presentation**, the basic structural form of regulation, including organizational structure and financing of agency, and any required modifications to enabling regulatory legislation will be specified in the offering memorandum. To support these efforts, a program to strengthen the regulatory agency will be prepared with MIF resources. **Prior to second tranche**, and in order to consolidate the functions of the regulatory agency, enabling regulatory legislation consistent with the regulatory contract would be enacted and taken effect, and a program to consolidate the functions of the regulatory agency would be underway. **By third tranche**, the regulatory agency to administer the detailed contractual obligations is expected to be operational for the electricity sector. MIF resources would also support these efforts.

E. Introduction of an Environmental Regulatory Framework

3.52 The enactment of the Environmental Protection Agency (EPA) Act in May 1996 provides the legal framework for environmental management and protection of the country's natural resources. This Act calls for the establishment of an EPA, responsible for environmental regulatory aspects applicable to all sectors. Once the EPA becomes fully operational, it will be responsible for regulating environmental aspects of the electricity sector. These will include establishing, monitoring and enforcing regulations by means of a comprehensive set of preventive and corrective measures for environmental management and quality control, and mechanisms for enforcement of environmental regulations, norms and standards, and for public disclosure.

3.53 A comprehensive framework for environmental management of electricity sector operations is critical for an orderly structuring of the proposed joint venture. However, since the EPA will not be fully operational prior to the GEC capitalization and given that clear rules of the game for all aspects related to the GEC will be sought from potential strategic investors and the private sector in Guyana, a basic structure for an environmental regulatory framework for the electricity sector has been proposed (see paragraphs 3.56-3.57).

3.54 It is expected that positive impacts, both on the socio-economic components and on the natural assets of the environment, will arise from the implementation of a more competitive and efficient operation, the upgrading of the existing services to customers, the reduction of outages and of unmet demand, and finally the introduction of environmental standards for electricity sector operations.

3.55 **Progress to date.** An analysis of the environmental institutional and regulatory framework and an environmental audit of GEC's activities have been undertaken to examine issues and identify measures for improvements in the sector. In light of the minimal

environmental regulatory capacity, agreement to implement a self regulatory framework has been reached. The information memorandum, including details of the environmental institutional and regulatory framework, summary results of the audit, and mitigation costs was made public at the investor workshop. Also, the preparation of basic regulations to be included in the offering memorandum is currently underway.

3.56 **Proposed Actions.** In keeping with the objectives of self-regulation and based on the results of a comprehensive institutional analysis, EPA's responsibilities vis-a-vis the electricity sector will be twofold: (i) the implementation of a self-regulatory system and a set of environmental rules and regulations for environmental protection as well as specific Environmental Impact Assessment (EIA) procedures for future activities; (ii) the monitoring of electricity sector activities and operations on the basis of these rules and regulations. The responsibilities of the new GEC will also be twofold: (i) the introduction of environmental management procedures in its operations and planning activities; and (ii) conducting of environmental monitoring by independent specialized firms according to guidelines and regulations issued by the EPA and the reporting on the results of that self-analysis.

3.57 Given that the EPA should remain a small agency, it is proposed that the review/audit of the reports to be submitted by the new GEC and other electricity sector operators will be contracted out to a private sector agency with proven experience on regulatory matters. The expenses incurred by the EPA for this audit/review will be financed by each of the regulated operators.

3.58 Potential strategic investors will seek clarification from the GOG on the scope of the pre existing liabilities and environmental standards and monitoring measures that will apply for operations of the new GEC. To address these concerns, the GOG has carried out a preliminary environmental audit. As a result of this audit, an Environmental Action Plan for the GEC has been prepared. This plan is intended to draw together the key items identified which require priority attention by the GEC and the strategic investor. It is not intended to be a comprehensive list of actions for environmental improvement.

3.59 Suggested responsibilities and tentative timetables for implementation have been included in the action plan, in addition to estimated costs and proposed sources of finance for each action. Provisional cost estimates for potential upgrades to plant, equipment and facilities have been identified where possible within the scope of the audit, whereas costs for management issues, would normally fall under operational costs for the new GEC and strategic investor. Due to the dynamic nature of the transaction, more specific details--in particular the treatment of pre existing liabilities--will be worked out during negotiations between the GOG

and the selected strategic investor. This commitment has been included in the policy letter (see Annex III-2; also paragraph 3.62). MIF resources will be used to provide technical support to the GOG during the negotiation with the strategic investor.

3.60 Prior to the **presentation of this operation to the Board**, basic proposed environmental regulations and criteria for EIA for the sector will be developed and specified in the offering memorandum. These basic regulations would be included in the regulatory contract and/or license before **second tranche**. Mitigation measures under the responsibility of the new GEC have been estimated to cost between US$900,000 and US$2 million. These measures as well as the corresponding responsibilities will be included in the offering memorandum **prior to Board presentation**. The proposed MIF technical cooperation funding would also support activities to allow the EPA to be operational for the electricity sector by **third tranche**.

F. General Framework

3.61 As evidenced by the recent agreement with the IMF and the successful debt reduction deal reached with Guyana's creditors, the overall framework is adequate. The GOG has submitted a policy letter, in which the Senior Minister of Finance sets out the overall reform program to be implemented under the proposed loan, including objectives, description, and policy measures to be undertaken. Progress to date is presented in chapter 2 of this document.

3.62 **Proposed Actions.** The proposed program needs to be implemented in a favorable macroeconomic setting and policy framework. For both **second and third tranche**, a macroeconomic policy framework consistent with the objectives of the program must be maintained. Also, satisfactory progress must be achieved in the implementation of the overall reform program as set out in the Policy Letter (Annex III-2).

IV. PROGRAM FINANCING AND IMPLEMENTATION

A. Program Financing

4.1 Fast disbursing resources equivalent to US$45 million would come from the Fund for Special Operations. The Bank programming for the country identified the need to support the proposed amount and terms on the basis of the country's balance of payments requirements and the scope of policy reforms. In keeping with the GOG-IMF program under the Enhanced Structural Adjustment Facility, loan resources will be used to support the GOG's fiscal efforts.

4.2 Fast disbursing balance-of-payments support to be disbursed over a two-year period would be provided in three tranches: the first one equivalent to US$15 million would be disbursed upon satisfactory compliance of the Board presentation and first tranche conditions; the second and third tranches of US$20 million and US$10 million, respectively would be disbursed upon satisfactory compliance of the policy conditions as set forth in the policy matrix, policy letter, and action plan.

B. Program Implementation

1. The Borrower and the Executing Agency

4.3 The Borrower will be the Cooperative Republic of Guyana and the MOF will be the primary executing agency. Activities outside the scope of the MOF--as in this case of the PUC for regulatory aspects and the EPA for environmental aspects--will be directly coordinated by the MOF with the respective agencies.

4.4 In order to coordinate the overall analysis and decision making process for the capitalization of the GEC, a high level Steering Committee was appointed in early 1996. This Committee has been responsible for setting the overall strategic direction, prepare terms of reference, evaluate proposals for the various preparatory activities, and review and validate the technical output. Bank management and technical staff have supported the GOG throughout the decision making process in this initiative.

4.5 The Executing Agency will be responsible for the overall coordination and execution of the program. MIF technical cooperation resources will be used for the required technical advisory services to support the GOG's decision making process.

2. Records, Audit and Control

4.6 For each disbursement, the Executing Agency will provide documentation showing the goods imported during each period, the country of origin, and the date and value of the transaction. For purposes of accounting and control of those transactions, the

Borrower shall open a special account in the BOG, keep accounting records of the project, prepare and forward the applications for disbursements, present lists of the transactions considered eligible and maintain all relevant supporting documentation. The Borrower shall present to the Bank, within 90 days following the disbursement of each tranche, a statement of account for such tranche, prepared in accordance with terms of reference agreed with the Bank and certified by a firm of independent public accountants designated by the Borrower and accepted by the Bank.

3. Environmental Classification

4.7 The EMC, at its meeting of September 7, 1995 (29/95), classified this as a Category III operation. An Environmental Summary detailing the environmental aspects of the sector program and the parallel MIF project was approved by the EMC on October 22, 1996. The recommendations are summarized in chapter 3, section E of this document, and also in Annex III-5.

4. Disbursement, Procurement and Retroactive Financing

4.8 Proceeds from the loan will finance the FOB cost of eligible imports, or the CIF cost, when freight is eligible. Disbursements of the tranches will be made against import documentation provided by the MOF. With the exception of local currency expenses, guns and other goods used by the armed forces, luxury items, and imports financed through medium and long-term loans, the usual restrictions contained in the IDB negative list of imports will apply. These restrictions will be included in the loan contract.

4.9 Procurement of goods with funds provided by the loan will be carried out in accordance with standard Bank procedures. For amounts above US$5 million, ICB will be required. In the case of petroleum and petroleum products, imports above US$5 million from individual suppliers do not always follow the letter of Bank procedures, even though they follow acceptable commercial practices, and are effectively done at market prices. Based on the recommendation by the Country Office and on experience in administering previous sector loans, it is recommended that ICB for imports above US$5 million be waived for imports of petroleum and petroleum products. Nevertheless, these imports will have to be from Bank member countries, follow acceptable commercial practices, be done at market prices; also, payments to be financed must take place within the period established in the loan contract.

4.10 Public sector procurement for amounts under US$5 million will be done in accordance with established national procedures. The Country Office will be responsible for ensuring that these procedures are applied consistently with Bank rules and regulations. Private sector procurement under US$5 million will be acceptable if products are originated in member countries and follow commercial practices. This procurement will be done,

whenever possible, on the basis of price quotes from at least two suppliers from Bank member countries.

4.11 The relatively small size of Guyana's economy may pose a problem to justify imports for disbursement despite the import growth experienced in recent years. The potential problem is compounded because the Bank and the World Bank are preparing to disburse ongoing sector adjustment loans. Hence, the limitation on eligible imports could be reduced by providing more flexible conditions to the Bank's retroactive financing policy. In accordance with established Bank policy for sector loans, eligible expenditures are recognized for the purpose of retroactive financing, up to six months prior to the loan contract date. In view of the above, a waiver of Bank policy is requested to extend the period of retroactive financing to twelve months prior to the loan contract date. Nevertheless, total retroactive financing will be limited to 50 percent of the total loan amount. The date of the expenditure for the purpose of applying this condition would be the value date of the remittance to the foreign payee.

5. Inspection and Supervision

4.12 An inspection and supervision fee of US$450,000--equivalent to 1.0 percent of IDB Bank financing--will be deposited in the Bank's accounts to cover general inspection and supervision expenses. In addition to the supervision missions to be undertaken by the project team and the permanent contact and technical support to be provided by the Country Office, the Bank will establish procedures to ensure that the program is implemented in a satisfactory manner. The Executing Agency is committed to provide to the Bank all required information to that end.

6. Ex-post Evaluation

4.13 Evaluation mechanisms have been built into the design of the program to ensure that the proposed objectives are met in a satisfactory manner. The regulatory contract will concentrate on monitoring and assessing the new GEC's performance in an environmentally sound manner. Therefore, the GOG has decided not to conduct an ex-post evaluation of the program.

C. Policy Conditions and Fulfillment of Requirements for Submission to the Board of Executive Directors

4.14 The proposed policy conditions are presented in Annex III-3. The sector loan proposal would be considered by the Board of Executive Directors once the offering memorandum, currently expected to be issued on November 26, 1996, is submitted to pre-qualified investors.

D. Technical Cooperation

4.15 To date, technical support has been financed with resources from the Japan Special Fund (ATN/JF-5120-GY), administered by the IDB. Advisory services have included project preparation activities ranging from an assessment of capitalization options for the GEC to the technical, financial, legal and environmental aspects of the proposed transaction, and related sector reforms.

4.16 Recently, the GOG has decided to finance the remaining technical and financial studies necessary to complete the transaction with their own resources. Nevertheless, the Bank is financing technical, legal and environmental support required for the preparation of the offering memorandum with remaining Japan Special Fund resources.

4.17 Given the scope of works necessary to implement the program, additional technical support will be required to successfully develop and implement policy, legal and regulatory reforms as well as the introduction of an environmental regulatory framework for sector operations supported by the sector program. Thus, a MIF technical cooperation project (TC-95-07-33) is proposed in Annex III-5.

V. VIABILITY AND RISKS

A. Benefits and Risks

1. Benefits

5.1 The main benefits will be derived from a more efficient allocation of resources in the sector, a greater contribution of private sector financing of the sector and the economy, and from the enhancement of the competitive position of the country's productive sectors.

5.2 The successful privatization of the GEC and implementation of the proposed sectoral reforms are expected to lead to more effective and efficient management of the company and pave the way for the continued development and expansion of the sector and consequently, the economy. The improvements in the enabling environment would allow and promote private sector investment at a time when public resources are scarce.

5.3 The proposed program would additionally complement and deepen the GOG's current adjustment program in several important ways. As cited previously, these benefits would include improvements and much needed investments to the system; elimination of GOG financial responsibilities to the GEC and mobilization of additional resources for other uses; and removal of institutional and financial constraints to the efficient development of the sector.

5.4 Over the longer term, the GOG may realize cash contributions from dividends and tax revenues from a profitable new GEC, and by selecting to sell its appreciated shares. Also, disbursement of shares to the Guyanese public and business community can contribute to a wider ownership base in the GEC enhancing prospects for capital market development.

5.5 Finally, the proposed program--which supports the introduction of an environmental institutional and regulatory framework--would also play a catalytic role in safeguarding and enhancing environmental quality in sector operations.

2. Risks

5.6 The potential for both domestic political opposition and private sector reluctance to invest in Guyana at this time constitute risks to the success of the program. Nonetheless, these risks have been considerably reduced over the last months. First, the Guyanese public and business community have repeatedly requested the GOG to support the privatization of the GEC to improve the existing situation and unleash the country's growth potential. Secondly, the permanent advisory support provided by the Bank and other technical specialists throughout the process has increased

investor confidence in the reform program. This has been recently confirmed by the interest shown by at least 10 potential investors and a significant number of Guyanese investors during an international workshop organized by the GOG to present the information memorandum with details of the proposed transaction and sector reforms.

5.7 As stated previously, privatization continues to be a very sensitive issue in Guyana, making this a very risky operation. The opposition to the reforms--supported by the proposed program--could mount from within the GOG. Nevertheless, the three tranche design of this operation considerably reduces this risk and enhances the Bank's ability to monitor and support the implementation of the program over a substantial period of time, reducing the likelihood of policy reversals. Moreover, the actual receipt of offers from bidders has been included as a first tranche condition, ensuring that Bank resources are disbursed only when the GEC privatization is basically irreversible.

5.8 A successful partnership with a private operator would require a sound regulatory framework in place, preventing monopoly abuses, protecting the rights and interests of consumers, and ensuring a reliable and safe supply of power. At present, Guyana does not have an effective regulatory agency to support in the achievement of these objectives. To mitigate this risk, the regulatory framework is expected to be structured as simply as possible, relying in the short term on a regulatory contract establishing a detailed relationship between the public sector and the new GEC. In parallel and in order to establish a capable and committed regulatory agency, MIF technical assistance has been included to support the agency in the effective administration of the contract, and subsequently, in the regulation of the sector as a whole.

5.9 The success of the proposed program also depends on the continued existence of an adequate macroeconomic framework. Guyana has recently returned to macroeconomic stability and must continue to exercise a cautious monetary and fiscal policy to ensure such stability endures. Maintenance of a sound macroeconomic framework would be a condition for each tranche release.

B. Impact on Low-Income Groups

5.10 On the basis of the established Bank methodology, this policy-based operation is not considered to be poverty-targeted. Nevertheless, the reform program is expected to have indirect positive impacts on low-income groups with a more efficient allocation of resources and reliability of electricity supply, expected to result from a successful program implementation.

GUYANA: ELECTRICITY SECTOR PROGRAM (GY-0048)
POLICY MATRIX

ES	ACTIONS ALREADY TAKEN	BOARD PRESENTATION/FIRST TRANCHE	SECOND TRANCHE	THIRD T
IVATE JOINT VENTURE FOR THE GUYANA ELECTRICITY CORPORATION (GEC)				
echnical enhance iability sify the of ne	Steering Committee appointed to coordinate overall analysis and decision making process. Based on an assessment of various ownership and management options for the GEC, Cabinet selected a joint venture (capitalization) scheme, offering 60% private ownership stake in a new GEC in exchange for equity contributions. Selected equity structure for the new GEC: 40% to be offered to a strategic core investor to be responsible for management; 20% to be offered to Guyanese private investors; and 40% to be retained by GOG. Draft information memorandum detailing technical, financial, regulatory and environmental aspects of selected option to be presented in international workshop to potential strategic investors, identified by broad based public advertisement and direct contact.	Offering memorandum including details of technical, financial, legal and environmental aspects of the transaction and bidding terms and conditions issued and made available to pre-qualified investors. Strategy for offering of the shares to Guyanese private investors (20%) included in the offering memorandum. Receipt of bids from pre-qualified investors *	Winning bidder selected, contract awarded and financial closing underway. Implementation plan for the sale of 20% of the shares in the new GEC to Guyanese private investors agreed.	Satisfactory tran management res and operations t strategic private Compliance wit implementation and timetable.
POLICY, LEGAL AND REGULATORY FRAMEWORK				
pport e.	Agreement on modifications to existing legislation to support public-private joint venture for the creation of a new GEC and the effective separation of policy, regulatory and operational functions.	Proposed enabling legislation consistent with public-private joint venture for new GEC, including the separation of policy, regulatory and operational functions specified in the offering memorandum.	New legislation consistent with the public-private joint venture enacted and taken effect.	
ent, effective atory ctor.	The GOG has offered to grant exclusivity of franchise to the new GEC for at least five years, that is, no independent power producers (IPPs) will be allowed during this time period. It has also announced its intention to waive its entitlements to dividends for a 10-year period and to exempt the strategic investor from the 15 percent withholding tax on the repatriation of profits. Draft provisions for regulatory institution including organizational structure and financing of agency prepared. Agreement to strengthen institutional capacity of PUC, including contracting of monitoring activities and plan prepared.	Criteria for detailed regulatory contract including licensing, tariff setting, specification of performance standards, review of capital investment plan, and proposed mechanism for settlement of disputes incorporated in offering memorandum. Basic structural form of regulation, including organizational design and funding mechanism, and any required modifications to enabling legislation specified in the offering memorandum.	License and/or detailed regulatory contract signed and ratified by Parliament. Enabling regulatory legislation enacted and taken effect, and program to consolidate functions of regulatory agency under implementation.	Satisfactory com license and/or de regulatory contra Regulatory agen administer detail obligations opera electricity sector.

s to be fulfilled prior to the disbursement of the first tranche.

GUYANA: ELECTRICITY SECTOR PROGRAM (GY-0048)
POLICY MATRIX

ES	ACTIONS ALREADY TAKEN	BOARD PRESENTATION/FIRST TRANCHE	SECOND TRANCHE	THIRD T
ulatory ctricity	EPA Act granting the EPA responsibility for regulation and management of environmental aspects enacted. Environmental audit and institutional assessment completed. In light of minimal environmental regulatory capacity, agreement to implement a self regulatory framework and terms of reference for preparation of basic regulations to be included in the offering memorandum reached. Environmental action plan for the new GEC with responsibilities clearly assigned agreed. Environment point of contact designated within the GEC.	Basic proposed environmental regulations and criteria for Environmental Impact Assessment for the electricity sector specified in offering memorandum. Key recommendations in environmental action plan for the GEC including implementation costs and responsibility incorporated in the offering memorandum.	Basic environmental regulations included in license and/or regulatory contract.	Environmental r framework (EPA for the electricit
FRAMEWORK				
y of jectives ic	The GOG has been implementing a macroeconomic stabilization and structural reform program supported by the IMF. Key measures include broadening the tax base and improving tax administration, improving the efficiency of public expenditure, and reduce the size of the public sector. The economy is about to complete its sixth consecutive year of positive economic growth at an estimated rate of 7.3 percent. Debt reduction agreement reached with the Paris Club and Trinidad and Tobago considered to be the major economic achievement of the year with total debt relief estimated at US$585 million.	Maintenance of a macroeconomic policy framework and financing plan consistent with the objectives of the program.	Maintenance of a macroeconomic policy framework and financing plan consistent with the objectives of the program.	Maintenance of macroeconomic framework and consistent with t of the program.
progress es and easures.	The Policy Letter, signed by the Senior Minister of Finance, sets out the overall reform program being implemented under the proposed loan, including the program objectives and rationale and major reforms to be carried out.	Satisfactory progress in implementing the overall reform program as set out in the Policy Letter.	Satisfactory progress in implementing the overall reform program as set out in the Policy Letter.	Satisfactory prog implementing th reform program the Policy Letter

N AMOUNT: US$45 million to be disbursed in three tranches: Board presentation and first tranche (US$15 million); second tranche (US$20 million); and third tranche (US$10

IN REPLYING QUOTE DATE
HEREOF AND No. ....

MINISTRY OF FINANCE
Main & Urquhart Streets,
Georgetown,
Guyana.

GUYANA

ELECTRICITY SECTOR PROGRAMME

POLICY LETTER

November 4, 1996

Mr. Enrique V. Iglesias
President
Inter-American Development Bank
Washington, D.C.

Dear Mr. Iglesias:

The Ministry of Finance wishes to confirm the request made by the Government of Guyana to the Inter-American Development Bank to finance the Electricity Sector Programme, currently being implemented by the Government. This policy letter presents our major economic achievements and development challenges, and sets out the overall programme, an integral part of the Government's reform efforts to promote private investment and to create a strong foundation for growth.

Economic achievements and development challenges

Since 1988, Guyana has been addressing its macroeconomic imbalances through the implementation of a structural adjustment programme, which has been supported by the International Monetary Fund, the Inter-American Development Bank, the World Bank, the Caribbean Development Bank and bilateral donors. The key objective of the programme has been to establish the basis for sustainable growth and poverty reduction in the context of financial stability.

Significant progress in financial stabilization and in the implementation of structural reforms over the recent years has improved conditions for private investment and saving, encouraged economic diversification, and supported strong economic growth. In the public sector, deficit reduction has been complemented by restructuring and downsizing. Liquidity management has relied increasingly on market-oriented instruments, institutional conditions for financial sector intermediation have been improved, the exchange rate was unified, and the exchange and trade system has been liberalised. The incentives framework for the private sector has been strengthened through less state intervention in agricultural, industrial, and commercial activities. The major economic achievement of 1996 has been the successful unfolding of Guyana's external debt strategy to reduce the country's debt and debt service obligations.

The primary objective of the Government's programme is to build on the progress made to date and establish a lasting foundation for satisfactory and sustainable economic growth. The main building blocks to facilitate this objective are a comprehensive upgrading of the country's economic and physical infrastructure expected to be undertaken in partnership with the private sector, and the development of its human capital. The Government is committed to addressing these problems through maintaining a sound macroeconomic framework, accelerating market-oriented sectoral reforms, and providing a stable environment that promotes private sector participation. The Government's programme will also give due emphasis to addressing more effectively the deterioration in social conditions.

Privatization programme

The Government of Guyana remains committed to continue its privatization programme aimed at improving the efficiency and competitiveness of all enterprises, eliminating the financial and administrative burden on the Government, promoting the country's modernization through new investments, technology, and efficient management, and redeploying scarce public resources. To that end, the Privatization Unit has brought six public companies--valued at US$84 million--to the point of sale this year, including the National Edible Oil Company, Guyana Stock Feeds, Guyana Co-Operative Insurance Service, Guyana National Printers, Guyana Stores Limited, and the National Bank of Industry and Commerce. In addition to these, GUYSUCO is currently managed by the private sector, and the Government intends to privatize LINMINE and the Guyana Electricity Corporation (GEC).

The Electricity Sector Programme

Despite some recent improvements, the electricity sector, key to Guyana's economic recovery, continues to face periodic power shortages and significant unmet demand. Several operational and financial factors have contributed to the poor performance of the GEC, the state electric utility. The GEC has not generated internal capital for investments, and has required government funds to meet its basic rehabilitation needs, and to cover operating costs. In order to finance the expansion and rehabilitation required to meet the current shortfall and to cope with the surging demand resulting from economic growth, we have determined that it will be necessary to expand and diversify the available sources of finance through a joint venture with the private sector.

In pursuit of the modernization of the electricity sector, the Government has decided to privatize the electric utility through a capitalization programme for the creation of a new GEC in partnership with the private sector. On the basis of a recent Cabinet decision, a public-private capitalization (joint venture) scheme for the new GEC has been structured under which management and 40 percent ownership of the GEC would be offered competitively to a strategic private investor to be responsible for management, 20 percent would be sold to Guyanese private investors, with the Government retaining the remaining 40 percent.

As mentioned earlier, the Government would like to promote a pivotal role

for the private sector in the rehabilitation and expansion of physical infrastructure. In order to achieve the objectives of the privatization programme, in particular, the elimination of the financial and administrative burden on the Government, and the redeployment of scarce public resources, the Government does not intend to increase its 40 percent ownership share in the new GEC. All public enterprises will be excluded from acquiring shares through the initial public offering of 20 percent to be allocated to Guyanese private investors in the new GEC or subsequent placements of any unsubscribed shares.

In support of the privatization of the GEC, the Government will provide the selected strategic investor with both a management and a regulatory contract specifying the rights and obligations of the investor and the Government; and a regulatory, legal and institutional framework with certainty on rights and obligations, tariff increases, a monopoly license, procedures for dispute resolution and other matters to provide comfort regarding a rate of return mechanism designed to provide shareholders with a floating rate of return commensurate with the business, inflation and sovereign risks undertaken.

We are fully aware that the success of this scheme rests on the existence of an investment climate along with a legal, regulatory and environmental framework that promotes the participation of potential private investors while at the same time preventing monopolistic abuses, protecting the rights and interests of consumers, and assuring a reliable and safe supply of electric power. To that end, the Government is committed to the implementation of the required measures to provide this framework in a timely manner.

In particular, the Government will timely submit to Parliament all the required modifications to the legal and regulatory framework to enable the new GEC to operate as an independent autonomous enterprise with the same legal requirements of private firms, and as such, subject to the same private standard commercial, tax and labor laws and commercial accounting procedures. The new GEC will enjoy an arm's length relationship with the Government in terms of policy and operating procedures, and with its suppliers.

One important component of the reform programme is the introduction of a comprehensive framework for environmental management of electricity sector operations. The enactment of the Environmental Protection Agency Act earlier in the year, which provides the legal framework for environmental management and protection of the country's natural resources, constitutes our first achievement in this regard. The reform programme will support the structuring and implementation of an environmental regulatory framework for electricity sector operations. Due to the dynamic nature of the process, specific details in this regard, in particular the treatment of pre existing environmental liabilities, will be defined with the selected strategic investor during the negotiation stages.

The privatization of the GEC will improve the company's technical and operational performance while at the same time having a private partner finance the rehabilitation and expansion required to cope with the surging demand resulting from a growing economy. This joint venture would

represent the single most important privatization initiative the current administration has promoted to date. The significance of this initiative can be measured not only in terms of the private investment resources that would be secured for upgrading of the system and the improved management capabilities, but also on the basis of the improved prospects for the country to achieve its full growth potential.

Final Considerations

The Government would like to emphasize its commitment to maintain the macroeconomic policies and reforms already implemented to date. A macroeconomic framework with no price and interest rate controls, a free and open foreign exchange market and prudent fiscal and monetary policies consistent with the agreements with the International Monetary Fund will be prevalent throughout the execution of the Electricity Sector Programme.

Finally, I would like to take this opportunity to express our gratitude to the IDB for its continued technical support during the preparation of this reform programme. We remain fully committed to the timely implementation of the sector loan and the parallel technical cooperation project.

Bharrat Jagdeo
Senior Minister of Finance

GUYANA

ELECTRICITY SECTOR PROGRAM
(GY-0048)

POLICY CONDITIONS

Set forth below is a list of conditions which are to be fulfilled by the Borrower to the Bank's satisfaction prior to the presentation of the loan to the Board and the release of the first, second and third tranches, respectively:

I. CONDITIONS TO BE FULFILLED PRIOR TO BOARD PRESENTATION AND FIRST TRANCHE

A. Public-private joint venture for the Guyana Electricity Corporation (GEC)

1. Offering memorandum including details of technical, financial, legal and environmental aspects of the transaction and bidding terms and conditions issued and made available to pre-qualified investors.

2. Strategy for offering of the shares to Guyanese private investors (20 percent) included in the offering memorandum.

3. Receipt of bids from pre-qualified investors *

B. Sectoral policy, legal and regulatory framework

1. Enabling legislation consistent with public-private joint venture for new GEC, including the separation of policy, regulatory and operational functions specified in the offering memorandum.

2. Criteria for detailed regulatory contract including licensing, tariff setting, specification of performance standards, review of capital investment plan, and proposed mechanism for settlement of disputes incorporated in offering memorandum.

3. Basic structural form of regulation, including organizational design and funding mechanism, and any required modifications to enabling legislation specified in the offering memorandum.

4. Basic proposed environmental regulations and criteria for Environmental Impact Assessment for the electricity sector specified in offering memorandum.

5. Key recommendations in environmental action plan for the GEC including implementation costs and responsibility incorporated in the

*/ *This condition is to be fulfilled prior to the disbursement of the first tranche.*

offering memorandum.

C. General framework

1. Maintenance of a macroeconomic policy framework and financing plan consistent with the objectives of the program.

2. Satisfactory progress in implementing the overall reform program as set out in the Policy Letter.

II. CONDITIONS TO BE FULFILLED PRIOR TO SECOND TRANCHE

A. Public-private joint venture for the Guyana Electricity Corporation (GEC)

1. Winning bidder selected, contract awarded and financial closing underway.

2. Implementation plan for the sale of 20 percent of the shares of the new GEC to Guyanese private investors agreed.

B. Sectoral policy, legal and regulatory framework

1. New legislation consistent with the public-private joint venture enacted and taken effect.

2. License and/or detailed regulatory contract signed and ratified by Parliament.

3. Enabling regulatory legislation enacted and taken effect, and program to consolidate functions of regulatory agency under implementation.

4. Basic environmental regulations included in license and/or regulatory contract.

C. General framework

1. Maintenance of a macroeconomic policy framework and financing plan consistent with the objectives of the program.

2. Satisfactory progress in implementing the overall reform program as set out in the Policy Letter.

III. CONDITIONS TO BE FULFILLED PRIOR TO THIRD TRANCHE

A. Public-private joint venture for the Guyana Electricity Corporation (GEC)

1. Satisfactory transfer of management responsibilities and operations to selected strategic private sector partner.

2. Compliance with implementation plan objectives and timetable for the offering of 20 percent equity participation in the new GEC to

Guyanese private investors.

B. Sectoral policy, legal and regulatory framework

1. Satisfactory compliance with license and/or detailed regulatory contract conditions.

2. Regulatory agency to administer detailed contractual obligations operational for the electricity sector.

3. Environmental regulatory framework (EPA) operational for the electricity sector.

C. General framework

1. Maintenance of a macroeconomic policy framework and financing plan consistent with the objectives of the program.

2. Satisfactory progress in implementing the overall reform program as set out in the Policy Letter.

A

GUYANA: ELECTRICITY SECTOR PROGRAM (GY-0048)
ACTION PLAN **

POLICY CONDITIONS	RESPONSIBLE	MEANS OF VERIFICATION	OUTPU
TO BOARD PRESENTATION AND FIRST TRANCHE			
lic-private joint venture for the Guyana Electricity Corporation (GEC)			
ering memorandum including details of technical, financial, legal and environmental aspects of the nsaction and bidding terms and conditions issued and made available to pre-qualified investors.	GOG/GEC	Offering memorandum approved by Cabinet and submitted to pre-qualified bidders	Offering memorandu submitted
ategy for offering of the shares to Guyanese private investors (20%)included in the offering morandum.	GOG/GEC	Cabinet approval of strategy	Strategy for IPO of shares
ceipt of bids from pre-qualified investors *	GOG	Minutes of bid opening	Bid proposals r
toral policy, legal and regulatory framework			
posed enabling legislation consistent with public-private joint venture for new GEC, including the aration of policy, regulatory and operational functions specified in the offering memorandum.	GOG/GEC	Cabinet approval of offering memorandum	Draft legisla
teria for detailed regulatory contract including licensing, tariff setting, specification of performance ndards, review of capital investment plan, and proposed mechanism for settlement of disputes orporated in offering memorandum.	GOG/GEC	Cabinet approval of offering memorandum	Criteria for reg contract
sic structural form of regulation, including organizational design and funding mechanism, and any uired modifications to enabling legislation specified in the offering memorandum.	GOG/GEC/PUC	Cabinet approval of offering memorandum	Basic regulat framework for th
sic proposed environmental regulations and criteria for Environmental Impact Assessment for the ctricity sector specified in offering memorandum.	EPA	Basic regulations and criteria for EIA approved	Basic regulations criteria in off memorandu
y recommendations in environmental action plan for the GEC including implementation costs and ponsibility incorporated in the offering memorandum.	GOG/GEC	Action plan approved by Cabinet	Action plan incl offering memora
neral framework			
intenance of a macroeconomic policy framework and financing plan consistent with the objectives the program.	GOG	Satisfactory compliance with IMF agreement	Adequate ger framework

condition is to be fulfilled prior to the disbursement of the first tranche.

GUYANA: ELECTRICITY SECTOR PROGRAM (GY-0048)
ACTION PLAN **

POLICY CONDITIONS	RESPONSIBLE	MEANS OF VERIFICATION	OUTPUT
sfactory progress in implementing the overall reform program as set out in the Policy Letter.	GOG	Satisfactory compliance with Policy Letter	Adequate ger framework
TO SECOND TRANCHE			
lic-private joint venture for the Guyana Electricity Corporation (GEC)			
nning bidder selected, contract awarded and financial closing underway.	GOG	Copy of signed contract	Strategic investor
plementation plan for the sale of 20% of the shares of the new GEC to Guyanese private investors eed.	GOG	Cabinet approval of plan with objectives and timetable	Implementation
toral policy, legal and regulatory framework			
v legislation consistent with the public-private joint venture enacted and taken effect.	GOG	New Electricity Act, New GEC Act, New Energy Policy Paper and any other legal modifications	New legal fram
ense and/or detailed regulatory contract signed and ratified by Parliament.	GOG	Copy of signed contract and Parliamentary record	Regulatory cor
abling regulatory legislation enacted and taken effect, and program to consolidate functions of ulatory agency under implementation.	GOG/PUC	New legislation	New legislation i
ic environmental regulations included in license and/or regulatory contract.	GOG/EPA	Regulatory contract	Basic environm regulations
neral framework			
intenance of a macroeconomic policy framework and financing plan consistent with the objectives he program.	GOG	Satisfactory compliance with IMF agreement	Adequate ger framework
sfactory progress in implementing the overall reform program as set out in the Policy Letter.	GOG	Satisfactory compliance with Policy Letter	Adequate ger framework

A

GUYANA: ELECTRICITY SECTOR PROGRAM (GY-0048)
ACTION PLAN **

POLICY CONDITIONS	RESPONSIBLE	MEANS OF VERIFICATION	OUTPU
TO THIRD TRANCHE			
lic-private joint venture for the Guyana Electricity Corporation (GEC)			
sfactory transfer of management responsibilities and operations to selected strategic private sector tner.	GOG	Articles of incorporation, bylaws. Contracts for joint venture, regulation and management, and shareholders' agreement ratified	New GEC oper
npliance with implementation plan objectives and timetable for offering of 20% equity participation he new GEC to Guyanese private investors.	GOG	Evidence of compliance with objectives and timetable agreed in implementation plan.	Objectives and ti fulfilled
toral policy, legal and regulatory framework			
isfactory compliance with license and/or detailed regulatory contract conditions.	GOG/PUC	Progress report	Regulatory str operationa
gulatory agency to administer detailed contractual obligations operational for the electricity sector.	PUC	Progress report	Regulatory ag operationa
vironmental regulatory framework (EPA) operational for the electricity sector.	EPA	Progress report	EPA operatio
neral framework			
intenance of a macroeconomic policy framework and financing plan consistent with the objectives he program.	GOG	Satisfactory compliance with IMF agreement	Adequate ger framework
isfactory progress in implementing the overall reform program as set out in the Policy Letter.	GOG	Satisfactory compliance with Policy Letter	Adequate ger framework

ese policy conditions correspond to the policy matrix conditions presented in Annex III-1.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK
MULTILATERAL INVESTMENT FUND
NOT FOR PUBLIC USE

GUYANA

TECHNICAL COOPERATION FOR THE IMPLEMENTATION OF THE ELECTRICITY SECTOR PROGRAM

(TC-95-07-33)

DONORS MEMORANDUM

This document was prepared by the project team consisting of: Cristobal Silva (COF/CGY), Maria Claudia Perazza (RE3/EN3), Miguel Coronado (LEG/OPR), Rafael de Gracia, Rosa Sosa, and Roberto Manrique (RE3/FI3), team leader.

I. COUNTRY ELIGIBILITY

1.1 The Donors Committee declared Guyana eligible for all modalities of MIF financing on November 2, 1995.

II. PROJECT DESCRIPTION

A. Objective

2.1 The objective of the proposed project is to assist the Government of Guyana (GOG) in the implementation of a comprehensive reform of the electricity sector, supported by an associated IDB sector loan (GY-0048). The reform program supported by the loan includes three main components. First, the implementation of the specific transaction for the capitalization/joint venture for the Guyana Electricity Corporation (GEC). Second, the implementation of policy, legal and regulatory reforms and the introduction of an environmental regulatory framework for sector operations, promoting an enabling environment consistent with the join-venture. Third, maintaining a satisfactory macroeconomic and policy framework. The proposed MIF Technical Cooperation would support the Government of Guyana on the implementation of the first and second components.

B. Activities

2.2 Specifically, MIF technical assistance will be provided in the following areas: (i) legal advisory services required prior to financial closing, and for the preparation of regulations consistent with the proposed joint venture; (ii) design and implementation of a program to consolidate the regulatory framework; (iii) development of the implementation plan for the initial public offering (IPO) for the 20 percent shares to be allocated to Guyanese private investors in the new GEC; (iv) establishment of an environmental institutional and regulatory framework applicable to sector operations; and (v) a review of related financial sector legislation and procedures to facilitate the public placement of shares of the new GEC.

1. Legal advisory services in support of the transaction and the reforms to the regulatory and legal framework

2.3 At present, several laws and statutes impact the power sector and contain clauses that are not consistent with sound regulatory development and the elements of the proposed joint venture transaction. This transaction will require continuous legal advisory support during bid preparation and until financial closing to ensure both parties' interests are protected. To that end, this component will finance legal advisory services in support of the preparation of the necessary legislation and for the competitive selection of a strategic investor for the new GEC, and all other sectoral reforms. These services to be financed under several contracts will include, but not be limited to, the preparation of the management, and regulatory contracts, shareholders' agreement and other

documents required prior to financial closing; the preparation of legislation and regulations consistent with the proposed joint venture; and support in the drafting of articles of incorporation and bylaws for the new GEC. Additional activities will include advise on tax related issues, treatment of potential environmental liabilities, employment related issues, license agreement, and the IPO proposed below.

2. <u>Design and implementation of a program to consolidate the framework for power sector regulation</u>

2.4 Because the new GEC will function as a monopoly within a sector that underpins Guyana's aggregate economic development, regulation will be required to prevent monopolistic abuses, protect the rights and interests of consumers, and assure a reliable and safe supply of electric power. An analysis of the recent history and current status of power sector regulation in Guyana reveals the existence of broad weaknesses in the regulatory framework relative to the majority of regulatory systems: weak legal foundation, ineffectiveness of the Public Utilities Commission (PUC), and lack of autonomy of the regulatory agency. In order to address these weaknesses the proposed project will finance the recruitment of consultants to design and implement a program to strengthen the PUC, with emphasis on staff "on-the-job training".

3. <u>Development of implementation plan for the IPO for the 20 percent shares to be allocated to Guyanese private investors in the new GEC</u>

2.5 An important element of the approach selected by the GOG for the joint venture/capitalization of the GEC is the offering of 20 percent of the shares of the new GEC to the Guyanese public and business community. Public enterprises will be excluded from acquiring these shares. This MIF project will finance the development of an implementation plan for the initial public offering (IPO) for these shares as well as any required complementary technical support in case some of these shares are undersubscribed (related to activity 5).

4. <u>Establishment of an environmental institutional and regulatory framework applicable to sector operations</u>

2.6 A framework for environmental management of electricity sector operations is critical for an orderly structuring of the proposed joint venture. However, since the recently established Environmental Protection Agency (EPA) will not be fully operational prior to the GEC capitalization and given that clear rules for all aspects related to the GEC will be sought from potential strategic investors and the Guyanese private sector, a basic structure for an environmental regulatory framework for the electricity sector needs to be in place. This project will finance activities required to establish an environmental institutional and regulatory framework for sector operations based on the principle of self regulation. To this end, the proposed project will also finance activities to support the EPA to become operational for the sector and to

provide technical support to the GOG during the negotiation with the strategic investor on pre-existing environmental liabilities.

5. Review of existing financial sector legislation, regulation and procedures to facilitate the placement of shares of the new GEC.

2.7 The expected disbursement of shares to the Guyanese public and business community will contribute to a wider ownership base in the GEC, enhancing prospects for the development of a capital market in Guyana. Some initial efforts, in particular, the IPO of shares for the Guyana Stores Limited transaction in 1995 have proven to work effectively. However, the size of transactions to date has been small relative to the proposed IPO of 20 percent shares in the new GEC to the Guyanese public (see Activity 3). In order to facilitate the public placement of shares of the new GEC in the market, a review of the related financial sector legislation, regulation and procedures will be undertaken. This will enable the GOG to devise and implement measures to standardize procedures for registering ownership, time periods for settlement of trades, and any other changes required to enable Guyanese shares to be traded in other countries, and for other countries' shares to be traded in Guyana.

C. Cost and Financing

2.8 The proposed project is estimated to have a total cost of US$1.1 million. MIF financing would amount to US$990,000, and the remaining US$110,000 would be financed by local counterpart. The project would be financed on a non-reimbursable basis from the Window 1 Facility of the MIF. The estimated budget is presented in the table below.

TENTATIVE PROJECT BUDGET (US$)			
ACTIVITY	**MIF**	**LOCAL COUNTERPART**	**TOTAL**
1. Legal advisory services	375,000	0	375,000
2. Regulatory framework	175,000	0	175,000
3. Implementation of IPO	190,000	0	190,000
4. Environmental framework	100,000	0	100,000
5. Financial sector	75,000	0	75,000
Subtotal	915,000	0	915,000
6. Logistical support	0	100,000	100,000
7. Contingencies	75,000	10,000	85,000
TOTAL COST	990,000	110,000	1,100,000

D. Special Conditions for Disbursement

2.9 Prior to the first disbursement of resources, the GOG will have submitted to pre-qualified bidders an offering memorandum, detailing

the technical, financial, legal, and environmental aspects of the transaction.

2.10 The Bank will give its no objection to all proposed consultancy services to be procured in accordance with Bank's standards for competitive bidding as well as to terms of reference for all activities financed with the proposed project.

E. Organization and Execution

1. Executing Agency

2.11 The same executing agency of the Electricity Sector Program (GY-0048), the Ministry of Finance, will be responsible for the execution of the MIF Technical Cooperation Project.

2. Procurement of Goods and Services

2.12 Goods and services will be procured following the Bank's standards for competitive bidding, and in accordance with MIF procurement procedures.

3. Execution Period

2.13 The execution period for the project will be two years. This period is consistent with the disbursement period for the associated sector reform program (GY-0048).

F. Reporting and Monitoring

2.14 Supervision of the proposed project will be carried out through in-country reviews on a semester basis. Continued technical support will be provided by Bank technical staff. The overall supervision will be the responsibility of the Project Team with assistance from the Bank's Country Office.

G. Environmental Considerations

2.15 The Environmental Management Committee classified this along with the Electricity Sector Program (GY-0048) as Category III operations on September 7, 1995. An Environmental Report detailing the recommendations applicable to the proposed project and the associated sector loan was approved by the EMC on October 22, 1996. The proposed project includes a component to support the introduction of an environmental institutional and regulatory framework.

III. COMPLIANCE WITH PROJECT ELIGIBILITY CRITERIA

3.1 The proposed MIF project is fully consistent with the general purpose of the MIF which is to increase private investment and expand private sector activity, and is compatible with the criteria for financing

under the Technical Cooperation Facility, Article III, Section 2 of the MIF Agreement. This section establishes that, under the Technical Cooperation Facility, grants shall be provided for technical cooperation, as appropriate, to governments to finance the development of national country plans for comprehensive reform of the policy and legal environment for investment, in conjunction with, and complementary to, Bank country programs, and advisory services to implement these plans, which may involve advice on reforming investment laws, as well as advice on implementing those laws, and regulatory agencies.

3.2 The project is expected to be financed through a grant based on the following criteria: (i) Guyana was declared eligible for all modalities of financing under the MIF by the Donors Committee in November 1995; (ii) the compliance of Guyana with eligibility criteria for obtaining grant resources at the country level (Article 3, Section 5b of the MIF Agreement) is presented in chapter III, paragraphs 3.1 and 3.2 of the Country Eligibility Memorandum (MIF/GN-38); and (iii) the proposed project is expected to have a catalytic impact on private investment as required by Article 3, Section 5 (a) of the MIF Agreement.

3.3 The MIF is financing similar reforms aimed at attracting private sector investment for energy projects in Bolivia, Colombia, Costa Rica, El Salvador, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay and Uruguay; projects for the Dominican Republic and Guatemala are in the final preparation stages.

IV. CONSISTENCY WITH THE BANK'S COUNTRY PROGRAM

4.1 The project is fully consistent with the Bank's country program. The Bank lending program places increased emphasis on supporting GOG policy in health, education, electricity, and agriculture. The main objectives in these areas include debt alleviation, human resource development, infrastructure enhancement, and improvement of natural resource management. In all these sectors, the weakness of the public sector is the primary cause of poor project execution and needs to be addressed. The Bank also intends to reduce poverty indirectly through its social sector lending and directly, through further support for a community driven social investment fund.

4.2 The proposed project will support the implementation of comprehensive reforms in the electricity sector, in fulfillment of the goal in that area. Improvements in the electricity sector will unleash the potential for economic growth and promote a more active economy and private sector participation. The project will also indirectly contribute to the other objectives in the Bank strategy by reducing the need for public investment resources in the sector, increasing the availability of resources for improvements in other priority sectors.

MIF GUYANA
TECHNICAL COOPERATION FOR THE IMPLEMENTATION OF THE ELECTRICITY SECTOR REFORM PROGRAM
PROJECT SUMMARY AND EXPECTED RESULTS

GENERAL OBJECTIVE

The main objective of the proposed project is to assist the GOG in the implementation of a comprehensive reform of the electricity sector, supported by an associated IDB sector loan (GY-0048).

SPECIFIC OBJECTIVES

The project will support the GOG in all legal advisory services required prior to financial closing, and for the preparation of regulations consistent with the proposed joint venture; in designing and implementing a program to consolidate the regulatory framework, in developing a implementation plan for offering 20 percent of shares in the new GEC to Guyanese private investors. It will also support the establishment of an environmental institutional and regulatory framework applicable to sector operations, and facilitate the public placement of shares of the new GEC.

Components	**Activities**	**Expected results**
Legal advisory services	• Advice on drafting of management contract • Preparation of legislation • Draft license agreement • Prepare articles of incorporation • Advice on tax and employment related issues, IPO implementation • Prepare shareholders' agreement	• Management contract • New legislation • License agreement • Articles of incorporation • Joint venture contract signed • Shareholders' agreement
Regulatory framework	• Preparation of regulatory contract • Design and implement program for regulatory agency	• Regulatory contract • Regulatory agency operational
Implementation plan for initial public offering	• Design of implementation plan for IPO of 20 percent of shares in the new GEC to Guyanese private investors. • Provide technical support in case of share undersubscription	• Plan for offering of 20 percent of shares in the new GEC to Guyanese private investors. • Strategy to manage undersubscribed shares.
Environmental framework	• Establish environmental institutional and regulatory framework for the sector. • Design and implement program for EPA. • Provide technical support during negotiations	• Environmental regulations and procedures for sector operations. • EPA operational for electricity sector operations
Financial sector	• Review related financial sector legislation, regulation and standardized procedures to promote the modernization of the capital market in Guyana.	• Financial sector legislation, regulation and standardized procedures.

PROPOSED RESOLUTION

GUYANA. LOAN ___/SF-GY TO THE COOPERATIVE REPUBLIC OF GUYANA
Electricity Sector Program

The Board of Executive Directors

RESOLVES:

1. That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Cooperative Republic of Guyana, as Borrower, for the purpose of granting it a financing to cooperate in the execution of the Electricity Sector Program. Such financing will be for the amount of up to US$45,000,000, or its equivalent in other currencies, except that of the Cooperative Republic of Guyana, which are part of the Fund for Special Operations of the Bank, and it will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.