



Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 29-Jun-2019 | Report No: PIDC27365



BASIC INFORMATION

A. Basic Project Data

Country Nepal	Project ID P170248	Project Name Second Programmatic Energy Sector Development Policy Credit (P170248)	Parent Project ID (if any) P154693
Region SOUTH ASIA	Estimated Board Date Dec 30, 2019	Practice Area (Lead) Energy & Extractives	Financing Instrument Development Policy Financing
Borrower(s) Ministry of Finance	Implementing Agency Ministry of Energy, Water Resources and Irrigation		

Proposed Development Objective(s)

The Energy Sector Development Policy Credit (DPC) operation aims to support the government’s efforts to improve the financial viability and governance of the electricity sector. The programmatic DPC series has two pillars: (i) improving the financial viability of the electricity sector; and (ii) improving the governance of the electricity sector.

Financing (in US\$, Millions)

SUMMARY

Total Financing	100.00
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DETAILS

Total World Bank Group Financing	100.00
World Bank Lending	100.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

1. The Government of Nepal (GoN), the first elected government under the new constitution and federal structure, is committed to accelerating economic growth and achieving the middle-income status by 2030. Access to reliable, affordable, and sustainable electricity services is fundamental to Nepal's economic growth and competitiveness. While electricity connections – grid and off grid combined - are now available to 95% of the population,¹ the annual per capita electricity consumption in Nepal, at 190 kWh, remains low and represents 6% of the global average and

¹ Alisha Pinto and Han Kyul Yoo, 2019. “Nepal Beyond Connections: Energy Access Diagnostic Report Based on Multi-Tier Framework”. World Bank.



25% of the South Asian average. The economic loss from load shedding during 2008–2016 in Nepal was estimated to be as high as US\$1.6 billion per year.² Improved management of generation, reduced system losses, and increased electricity imports from India have helped eliminate the nationwide load shedding. Further structural reforms and investments are needed to ensure reliability, affordability and sustainability of electricity services.

2. Despite political instability and fragility that have characterized Nepal’s transition over the last two decades, poverty in Nepal has been on a declining trend. The proportion of Nepalese households living in poverty (as measured by the international extreme poverty line) fell from 46 percent in 1996 to 15 percent in 2011.³ Nepal has also had an impressive performance on shared prosperity. From 2003 to 2010, consumption growth of the bottom 40 percent was 7.5 percent compared to 4 percent on average across all households. With a higher poverty line of \$3.20 a day, the poverty rate is projected to decline to 42 percent in 2019, from 51 percent in 2010. The key drivers of improvement in the twin goals included an increase in the amount and number of households receiving remittances, an increase in labor income derived from wage and non-wage employment, and changes in the demographic structure with a lowering of the dependency ratio.
3. The proposed operation supports the World Bank's twin goals of poverty reduction and shared prosperity and is consistent with the World Bank's Mobilizing Finance for Development (MFD) approach and the Country Partnership Strategy for FY2019–2023. The DPC series complements the World Bank Group’s existing engagement in generation, transmission, distribution and off-grid, renewable-based solutions in the form of investment operations and technical assistance (TA). In addition, the operation has synergy with WBG’s engagement in social protection, environmental and social risk and impact management, and water resources management. It also complements with the activities by other development partners supporting various aspects of sector reforms.

C. Proposed Development Objective(s)

4. The Energy Sector Development Policy Credit (DPC) operation aims to support the government’s efforts to improve the financial viability and governance of the electricity sector. The programmatic DPC series has two pillars: (i) improving the financial viability of the electricity sector; and (ii) improving the governance of the electricity sector.
5. In line with the objectives, the key results expected under Pillar 1 are as follows: (a) average electricity tariff covers the full cost of electricity supply from a baseline of average electricity tariff 32 percent below the cost of electricity supply, (b) Nepal Electricity Authority’s (NEA’s) Profits before interest, tax, depreciation and amortization is at least NPR40 billion from a baseline of NPR 0.49 billion in FY2016, and (c) transmission and distribution losses are reduced to less than 18 percent from the baseline of 25.8 percent in FY2016. The key results expected under Pillar 2 are: (a) electricity traded and exchanged has increased by at least 20 percent from a baseline of 2,178 GWH, (b) Power Purchase Agreements (PPAs) are signed based on posted tariff and/or competitive bidding from a baseline where PPAs were signed based on negotiations, and (c) at least one project is informed by the Gender and Social Inclusion (GESI) guidelines from a baseline with no GESI guidelines.

D. Concept Description

6. The policy and institutional measures included in the proposed operation are consistent with the actions laid out in

² Timilsina Govinda, Prakash Raj Sapkota, and Jevgenjis Steinbuks, 2017. “How Much Has Nepal Lost in the Last Decade due to Load Shedding? An Economic Assessment Using a CGE Model.” Policy Research Working Paper WPS 8468, World Bank, Washington, DC.



GoN's power sector strategy and action plan. The proposed operation is the second in a programmatic series of three operations and is organized under two pillars: (a) improving the financial viability of the electricity sector and (b) improving the governance of the electricity sector. Under these pillars the credit supported the following specific prior actions:

- NEA publishes FY2020 tariff rates following ERC decision on its tariff application.
- NEA has restructured its financial arrangements with its subsidiary companies to meet expected return on equity as per its financial viability action plan.
- NEA has (i) implemented immediate priority institutional measures to reduce transmission and distribution losses; (ii) measured the transmission and distribution losses in the performance contracts with chiefs of regional and district offices and; (iii) through its Board of Directors, approved a loss reduction master plan.
- The Government of Nepal has submitted the Electricity Bill to the Parliament.
- The ERC has issued tariff-setting guidelines.
- The Cabinet has adopted a resolution on the sequence, timeline and milestones for the restructuring of NEA.
- NPTCL Board of Directors has approved its business plan and operating procedures.
- NEA Board of Directors has issued competitive bidding guidelines for electricity projects.
- (i) The Cabinet has adopted (a) improved forest clearance guidelines and (b) right of way guidelines; (ii) NEA has adopted the gender and social inclusion guidelines.

E. Poverty and Social Impacts and Environmental Aspects

7. The impact of tariff reforms supported in this operation on electricity affordability is likely to be small under the current electricity demand scenario. Electricity sector reform provides opportunities that otherwise would not exist to improve reliable access to electricity. These welfare gains are likely to significantly outweigh any adverse impact of tariff increase in the long run. A simulation analysis based on multi-tier household survey in 2017 was carried out for DPC 2 to assess the impact of tariff hike on electricity affordability. The analysis assumes that electricity prices would increase by 51% between fiscal 2018 and fiscal 2022 under a pessimistic projection for NEA's financial performance. In a suppressed demand scenario, the budget share of electricity would increase to 1.5 percent for the average population, and 2.2 percent for the poorest quintile in 2012.
8. GoN is committed to instituting mechanisms to mitigate the adverse impacts of the tariff reforms on the poor and improving access to electricity by all. The new regulatory agency's is required to ensure that mitigation mechanisms are in place to protect the poor and vulnerable in the short term. In the near term, mitigation mechanisms such as the strengthening of social assistance mechanisms and simplification of the current social assistance system, and tariff structures that differentiate according to consumption levels such as lifeline tariffs can be implemented. The tariff reforms proposed under the operation will also help to advance the dialogue on using existent delivery systems and create/adapt programs for the "economically" poor and on the development of the framework for the social registry, which will help the identification of "economically" poor households.
9. The proposed operation will prioritize actions to support positive environment, gender and climate impacts and mitigate potential adverse impacts. This operation will support the development and implementation of GESI guidelines and strengthening of the human and institutional capacity in the electricity sector. It will also support forest clearance guidelines and right of way guidelines to improve the environmental and social management of hydropower projects. The Ministry of Forest and Environment has prepared forest clearance guidelines which, once adopted, will ensure that the forest loss in the development of energy infrastructure is appropriately compensated in terms of quality and quantity. This guideline aims to minimize the potential negative impacts of infrastructure on



natural forests and to maximize the positive impacts of associated infrastructure. The forest clearance guidelines which includes standard norms for developers' cash payments is in the process of approval.

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APPROVAL

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