

## Draft TC ABSTRACT

### I. Basic project data

▪ Country/Region:	Honduras/CID
▪ TC Name:	Institutional strengthening for energy sector stakeholders
▪ TC Number:	HO-T1184
▪ Team Leader/Members:	Carlos Jácome (ENE/CHO) Team Leader; Carlos Trujillo (INE/ ENE); Nancy Jesurum (INE/ ENE); Jorge Mercado (ENE/ DRP); Kamchan Kang (INE/ ENE); Edwin Malagón (INE/ ENE); Liliana Lopez (INE/ENE); Alejandro Quijada (CID/CHO); Ana Paz (CID/CHO); under the supervisión of Alejandro Melandri, Chief (INE/ENE) and Rep. Ian Walker (CID/CHO).
▪ Indicate if: Operational Support, Client Support, or Research & Dissemination.	Operational Support
▪ If Operational Support TC, give number and name of Operation Supported by the TC:	HO-L1070
▪ Reference to Request: (IDB docs #)	38900786
▪ Date of TC Abstract:	1 <sup>st</sup> of July 2014
▪ Beneficiary (countries or entities which are the recipient of the technical assistance):	Honduras Government, under the coordination of Secretary of Energy, Natural Resources and Environment - SERNA and Governmental General Coordination Secretary
▪ Executing Agency and contact name	Inter-American Development Bank (IDB), through Energy Division (INE/ENE).
▪ IDB Funding Requested:	US\$450.000
▪ Local counterpart funding, if any:	N/A
▪ Disbursement period (which includes execution period):	24 months
▪ Required start date:	September 2013.
▪ Types of consultants (firm or individual consultants):	Firm and Individual Consultants
▪ Prepared by Unit:	Energy Division (INE/ENE)
▪ Unit of Disbursement Responsibility:	
▪ Included in Country Strategy (y/n);	Yes
▪ TC included in CPD (y/n):	Yes
▪ GCI-9 Sector Priority:	The TC is consistent with the following priorities: (b) Infrastructure for competitiveness and social welfare; (c) Institution for growth and social welfare focused on fiscal efficiency and sustainability; and (d) Competitive regional and global international integration. It also stipulates a preferential support to least developed countries. Small and vulnerable countries.

## II. Objective and Justification

### General Objective

- 2.1 The purpose of the Technical Cooperation (TC) is to support the Government of Honduras (GoH) in its energy sector reform process, aimed at reducing the fiscal impact of the financial problems of the energy sector. The objective is expected to be achieved through technical assistance that will provide tools for an adequate decision making process and support to the local institutions of the energy sector.

### Justification

- 2.2 The energy sector shows structural problems, evidenced with greater intensity in the electricity sector due to: (i) irrational allocation of subsidies on the demand side of the power sector; ii) unbalanced tariff system; iii) high energy costs due to high dependency of fossil fuels; iv) high level of losses; and v) weak institutions operating regulation, control and planning.
- 2.3 At the end of 2013 the fiscal impact of the power sector financial situation of the country represented 1.18% of GDP, while the fiscal debt of the country was 6% of the GDP. The magnitude of the direct negative impact of the power sector explains the interest of the International Monetary Fund (IMF) to see advances in the power sector reform agenda.
- 2.4 Below is a summary of the main sources of losses in the power sector:
- ✓ Direct Subsidy in residential customers with electricity consumption <150 kWh/month: 1,100 million Lempiras, equivalent to 0.3% of GDP;
  - ✓ Crossed subsidy created by the unbalanced tariff system: L. 2,500 million, 0.68% of GDP;
  - ✓ Debts of the State-owned power utility to Independent Power Producers: L. 4,000 million, equivalent to 1% of GDP;
  - ✓ Incentives for renewable generation: L. 80 million
  - ✓ Non-technical losses (18% of total production): L. 4.307 million, 1.16% of GDP.
- 2.5 Based on the strong impact of the power sector in the fiscal situation of the country, since December 2013 the GOH has adopted a series of legal measures to improve the financial situation of the Electricity Sector. The most relevant measures are summarized below, including the first two listed, that resulted from the enactment of the Law Planning Act for Public Finance, approved in December 2013.
- 2.6 **Financial sustainability**
- a. Targeting direct subsidy by reducing the threshold for residential consumers from 150 kWh/month to 75 kWh/month. This reduces the amount of total subsidy from L. 1,100 million/year to 400 million/year;
  - b. Sales Tax application to residential customers consuming more than 750 kWh/month. This represent a total tax increase of L. 160 million/year;
  - c. Revision of long term purchase power agreements – PPA from thermal private utilities, generating annual savings of up to L. 846 million/year.
  - d. Sales growth in the Regional Electricity Market, accounting to L. 40 million/year.
  - e. Actions for non-technical electricity loss reductions, representing collection increase of L. 184 millions.

### **Operational and Regulatory Reforms**

- 2.7 In addition to the outlined fiscal measures the GoH has: (i) approved the Power Industry Law; and (ii) launched Public Private Partnerships (PPP) in the different subsectors to enhance efficiency in generation; distribution; public lighting; transmission; and operation. Distribution and transmission PPPs have an additional target of reducing technical and non-technical energy losses valued in 31% in 2013. The new law was approved by Congress in January 2014 and published by the Executive Branch in May 22<sup>nd</sup>. This new law contains several improvements to the former law, particularly by providing the legal framework to enable the participation of the private sector in the different business components of the energy industry chain. It also creates the power regulatory commission, as well as a social development fund for rural electrification.
- 2.8 The products of this proposed TC will contribute to preparation of the “Support Program for Structural Reforms in the Power Sector” - HO-L1070. Execution of this Operation is conditioned to signature of Agreement of the IMF with the GoH. The experience of providing effective technical assistance to energy decision makers in Honduras guarantees that this TC will be instrumental in the GoH’s efforts to reduce the fiscal impact of the power sector financial crisis, the main objectives of the power sector reform. A good illustration of effective TC support from IDB to the government is the revision of thermal generation PPAs as a result high level technical reports.

### **III. Description of activities and outputs**

- 3.1 ***Component I: Support for establishment of the entity responsible for the power sector policy making.*** The new Power Industry Law considers the creation of a Subsecretary of Energy responsible for public policies to provide guidance for the development of the power sector, and to monitor adopted public policies. For this purpose the TC will finance: an assessment and recommendations of an organization for the Secretary; technical support and capacity building for preparing power sector policies; and hiring local qualified staff.
- 3.2 ***Component II: Support for the establishment of the power sector regulator.*** The new legal framework creates a new power sector regulator. The main challenge faced by this new body would be preparing regulations for implementing the law and for the new tariff scheme. The component will finance consultancies to provide support to these tasks and to evaluate the organization requirements and definition of an institutional action plan.
- 3.3 ***Component III: Execution of high fiscal impact assessments.*** The component will finance studies to focus on some specific assessments, and/or support the preparation of regulation to effectively implement the actions envisaged in the new legislation with high impact on fiscal improvement, such as subsidies, tariffs, review of PPAs, tenders for purchasing electricity, fiscal risk assessments for PPPs. The most recent legislation affecting the energy sector include: a) Planning Act for Public Finance; b) New Power Industry Law; c) Promotion of Biofuel Production; d) PPPs for energy sector. In order to strengthen the decision making process of government authorities it is mandatory to develop.
- 3.4 ***Component IV. Communication and dissemination.*** This component will provide support for preparation of a communication strategy, implementation of tariffs adjustment, planning for introducing renewable energy in the energy matrix and energy savings. It will support

development of technical workshop(s), aimed at sharing experiences from relevant stakeholders in Latin America in order to be familiar with, learn, inform and improve the decision making process of the above mentioned components.

**IV. Budget**

<b>Activity/Component</b>	<b>Description</b>	<b>IDB/Fund Funding (US\$)</b>	<b>Counterpart Funding (US\$)</b>	<b>Total Funding (US\$)</b>
Component I		150,000	0	150,000
Component II		150,000	0	150,000
Component III		75,000	0	75,000
Component IV		75,000	0	75,000
<b>TOTAL</b>		<b>450.000</b>	<b>0</b>	<b>450.000</b>

**V. Executing agency and execution structure**

5.1 The TC will be executed by the Energy Division of IDB.

**VI. Project Risks and issues**

6.1 The main risks in the execution of this TC are: (i) inadequate implementation capacity of the suggested changes inside the government; (ii) difficulties in coordinating with different institutions involved, and (iii) political willingness to promote changes.

**VII. Environmental and Social Classification**

7.1 It is expected that during this phase of the project there will not be environmental and social risks associated with the implementation of the TC.