

## Position paper on private sector intervention for the ACP-EU Energy Facility

### 1. Introduction

"Since WSSD there has been a recognised need for a significant increase in funding for energy and poverty reduction in order to achieve the Millennium Development Goals. So far, provision of energy services to the poor has been able to attract only marginal private investment. Innovative and flexible funding mechanisms are urgently required to use the leverage effect of public resources and ODA and to attract more resources from the private sector, development banks and financial institutions. Public-private partnerships (PPPs) are a core instrument in the EUEI strategy, and the energy sector offers numerous possibilities for the EU and its developing country partners to work together in such partnerships with the private sector, financial institutions and civil society. However, greater efforts are needed at the political level to provide adequate, faster and more flexible resources and instruments, including the provision of seed capital<sup>1</sup>".

Investment needs in the energy sector are much higher than the financing capacity of ODA and developing countries. Therefore, the donors' community puts now a strong accent on the need for collaboration with the private sector in the energy area.

The energy sector involves commercial and social issues, with dominance of commercial elements: energy is transformed, distributed and sold. The sector generates important finance required for the implementation and maintenance of the investments, which could also procure profit and, thereby, attract private sector.

From its side, the Commission, with the support of the EU member States, intends to use the Energy Facility (EF) to leverage private finance by trying to increasingly involve the private sector in energy service provision and by supporting public-private partnerships and innovative mechanisms.

The objective of this note is to allow for a better understanding of the place and role for private sector companies in the Energy Facility and to provide them with some guidance regarding their participation to the programme.

### 2. The potential role of private sector in the access to energy in rural areas

In many ACP countries, the national electricity landscape is divided between 1°) large urban areas, which are serviced by a national public or private utility and a few independent power producers (IPP) and 2°) rural areas with a limited supply of electricity, many of them so far from interconnected national networks that their connection is unlikely in the short or medium term. In these regions, only decentralised solutions can provide energy services that are essential for people and economic development. Because of the distance to the networks and the population dispersion, investments costs per connection are relatively high. Local costs for producing electricity from fossil sources in small production units far from large urban centres are really important. Despite their high initial investments, solutions based on local sustainable energy are often more profitable from an economic point of view. In fact,

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<sup>1</sup> COM (2004) 711

considering the long deprecation period of equipments, high initial investments costs are compensated by the very significantly lower operation costs.

Many national companies facing financial problem have difficulties in coping with the maintenance of existing networks and their extension to the closest urban populations (the easiest and potentially most profitable clients). One cannot expect enough financial transfers from these urban clients to finance rural electrification. The involvement of the private sector, in particular local SMEs, and the bank sector, and a strong commitment from the authorities and local communities are probably the best way of attracting funds, technology and know-how as regards decentralised energy services supply. The question of the financial profitability of these systems, which is key for the private sector involvement, remains however uncertain.

Private sector is heavily involved in the biomass business, the largest source of energy used in many countries both in rural and urban areas. The economical importance of production, transformation and use of this energy source makes it an immense potential activity for private sector. However, an inappropriate legal framework hampers a frequently informal private sector intervention and leads to an inefficient use of resources.

### 3. Barriers for the private sector investments and actions

The understanding of the importance of the energy for economic development and the improvement of life conditions is recent, in particular regarding rural areas. The reflexion on the mechanisms that are most suitable to the rural electrification and to sustainable energy specificities has not yet lead to the set up of favourable legal framework and appropriate financial instruments.

Amongst the barriers for private sector involvement in the rural electrification notably with decentralized solutions; the following could be found in particular:

- The weakness of the institutional frameworks of the rural electrification, the absence of organisation and involvement of local actors (authorities, private sector and communities) as well as the absence of dialogues between these actors and the authorities in charge of policies and with international donors

The objective is to promote the elaboration, together with all the actors, the legal and institutional frameworks for the rural electrification, which establish the adequate role for the private sector and local actors.

- The absence of regulatory frameworks which promote investments, notably in terms of security and predictability and the absence of planning; in particular, due to their long period of depreciation and their important initial investments, decentralised electrification projects using sustainable sources need a stable framework of a long period and long visibility on income and exploitation conditions.

A sustainable contractual public-private relationships framework should be promoted such as concessions, as well as tariffs that are adapted to the needs of the population, or regulated purchase tariffs, which ensure the investor and its donors an adequate level of revenues predictability during the exploitation.

Administrative procedures must be simplified in order to not become a barrier to investments.

The equipments property and the respect of the contracts must be guaranteed.

- A competition sometimes distorted in order to promote fossil energy, due to favourable customs and fiscal conditions but not in favour of sustainable energy.

Unfair monopolies and customs and fiscal protection of traditional technologies must stop and the level of customs rights and equipments taxes linked to sustainable technologies must be reduced.

Electrification policies must take into account social and environmental benefits of renewable energy and integrate them in economic calculations.

- The lack of financial instruments suited to these projects specificities, which take into account the weakness of involved population incomes, the small size of individual projects and the long period in order to get investments back.

A variety of long term instruments should be put in place to finance the investments, composed of long term loans in foreign and local currency, up-front and interest rate subsidies, output based aid, and guarantees against interest rate fluctuations and political risks. The key for financing rural electrification rests in the appropriate combination of these instruments.

- Insufficient local competences of the authorities in charge of the sector, of the financial system and the private sector.

It is necessary to promote the transfer of technologies at international level throughout the use of joint ventures and to develop the technical capacities (local private sector), the political conceptions (decision-makers) and the management.

It is necessary to inform, create and support the local banking sector in the field of rural electrification.

It is also important to inform and raise the awareness of the public and all the actors in the sector about the economic and environmental issues related to the renewable energies.

The obstacles in front of biomass energy for heating and cooking are very similar:

- The weakness of the institutional framework for biomass, the absence of organisation and participation of the local actors (authorities, private sector and communities), the lack of communication between the relevant ministries in charge of the energy and the forests on these issues, as well as the absence of biomass in the national energy policies.

It is necessary to promote the elaboration of an appropriate legal and institutional framework for biomass energy, which takes into account the specificity of the context and the numerous steps in the biomass economic chain.

Must also be recognised the need to bring the biomass business into the legal space, as opposed to the current clandestinity, and the principal role of the private sector.

Improvement of economical and ecological efficiency requires providing support at all stages of the biomass chain.

## 4. Instruments of the Energy Facility addressing the private sector

### 4.1 Calls for Proposals

The instruments of the EF are focused on grants and do not include loans or long term guarantees. The principal instrument to identify projects that could benefit from grants is a Call for Proposals, open to all kinds of actors in the sector including private companies.

Through the projects selected in the framework of the Call for Proposals, the EF aims to support the interests and the intervention of private companies in the energy sector by means of:

- Actions that contribute to the framework of rural energy services (political, legal, macro-economic,...) and that promote capacity development of all actors involved (ref. document on the governance and capacity development) and
- Projects that envisage improving directly access to energy services in rural and peri-urban areas and energy efficiency through, for example, rural electrification, local development of biofuels or a better use of wood for energy purposes (ref. documents on rural electrification, biomass and biofuels).

The EF will in particular be seeking for projects that propose innovative and adapted solutions in relation to co-financing and that propose participation of local financial institutions. Moreover, the EF is looking for investment projects with private sector involvement which in addition also mobilize a critical mass of own resources and loans.

### 4.2 Cooperation with financial institutions

The EF will as well support projects identified by financial institutions in order to facilitate investments through a Pooling mechanism which will allow the blending of grants from the Facility and other donors, loans from European development banks and finance institutions, and private capital.

Against this background, the EF would finance innovative medium-sized projects which combine physical investments and the development of policy, legal framework and capacity, with a perspective of replicating these models.

### 4.3 Private sector participation in the first Call for Proposals of the EF

The private sector is a large contributor to the projects of the EF selected under the first Call for Proposals, with its support to 26 projects (out of 74 in total) as a project leader or as an important partner. In these projects, the function of the private companies includes providing technical assistance, performing studies, producing, distributing and selling electricity, etc. via different agreements, such as concessions.

All these projects provide in efficient manner important public benefits to the target groups and the State, which justifies the selection of these projects. Some of their components were even specifically designed for this purpose. Moreover, due to their lack of profitability, these projects would not have been feasible without a grant.

These 26 projects mobilise €74 million EF grants of out of a total projects budget of €153 million. Direct private sector investment (€14 million) amounts only around 9% of this total, slightly more than €10 million for the ACP private sector and less than €4 million for the EU private sector.

It is recognised that the EF will have to mobilise a larger share of private sector funds in the future.

#### ***4.4 Characteristics of EF grants***

##### Applicable rules

The rules applicable to EF grants (cf. Articles 6.1.1 and 6.2.10 of the PRAG<sup>2</sup>) foresee that a grant can not give rise to profits during the period of implementation of the project. Profit is defined as: "in the case of a grant for an action, a surplus of receipts over the costs incurred by the beneficiary when the request is made for final payment."

This rule covers both private investment projects and projects where private operators partially or completely implement the action, either as applicants or as partners.

As for other categories of actors, it is for sure possible for private operators to find other interest than direct profit when participating in an EF project. For example: penetration of new markets, corporate image building, knowledge and experience building, strengthening consumer relations...

Acting as a partner (in line with the Guidelines to the Call for Proposals), a private operator can only participate in an action in a non-profit making manner and can thus only be funded real costs<sup>3</sup>.

In general, profit-making sub-contracting of the implementation of a project can only be envisaged if this operator is contracted following a competitive procedure.

Moreover, the PRAG clearly specifies that a subcontractor can not at the same time be a partner nor an associate.

In all cases, an audit performed at the end of the project will determine *in fine* the amount of eligible real costs.

##### Investment projects with private sector involvement

In the case of investment projects, the award of a grant will be justified by real public project benefits, in terms of impact on development, poverty reduction and production of public goods. These projects would also have to avoid establishing monopolies and would have to deal in a steady manner with all questions related to the property of the investments, in line with the rules of the PRAG. Indeed, the PRAG establishes as a general rule that the investment belongs to the beneficiary of the grant (the applicant) or to the final beneficiaries, unless otherwise stipulated in the contract.

In order to ensure their compliance with these orientations, the projects will be evaluated on the basis of uniformly applied sound criteria. The projects will have to be prepared and formulated in a way that allows for a clear evaluation of key economic criteria, measurement

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2 Practical Guide to Contract Procedures for EC External Actions

[http://ec.europa.eu/europeaid/work/procedures/implementation/practical\\_guide/documents/2008new\\_prag\\_final\\_en.pdf](http://ec.europa.eu/europeaid/work/procedures/implementation/practical_guide/documents/2008new_prag_final_en.pdf)

<sup>3</sup> As is the case for NGOs, real costs may comprise activities realised by the partner outside of the project site if these activities are necessary and verifiable (For example: part-time support or supervision by a specialist in the headquarters of the consultancy firm).

of costs and benefits, and the identification of the public and private goods created. This implicates that investment projects will have to provide an economic and financial analysis that will reassure regarding their viability. This analysis will include the calculation of the net present value, their economic and financial internal rate of return... They will also provide a quantified analysis on their impact on society and on environment.