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Paramaribo, April 28, 2016

Mr. Luis Alberto Moreno
President
Inter-American Development Bank
1300 New York Ave, N.W.
Washington, D.C. 20577

Our Reference: LaF. No. 282/16/Min

Enclosure(s) : --

Subject : **Support to the Institutional and Operational Strengthening of the Energy Sector III**

Dear President Moreno,

The purpose of the present letter is to reaffirm the commitment of the Government of the Republic of Suriname to strengthen the energy sector as part of its political commitment to the economic development of the country.

The Government of Suriname, in close collaboration with the Inter-American Development Bank (IDB), has been implementing the "Support to the Institutional and Operational Strengthening of the Energy Sector Program" (the Program), a series of three Policy Based Programmatic operations establishing a reform agenda that has been covered between 2012 and 2016.

The main objective of the Program is to support Suriname's efforts towards a more efficient, transparent and sustainable power sector through the implementation of the following technical components:

- a. Development of a Sustainable Power Sector Framework.
- b. Strengthen Sector Corporate Capabilities.

A description of the current macroeconomic context in Suriname is presented below, followed by a brief summary of the actions taken in the context of the Program in order to meet its objectives.

A. Macroeconomic context

Suriname's economy is highly concentrated on the extractive industries—specifically gold, oil, and bauxite—which play a key role in driving growth, employment and government revenue. On average during the last decade, these sectors accounted for about 30% of GDP, 90% of total exports and 25% of government revenue. The Surinamese economy grew at a relatively high average yearly rate (3.8%) for most of the past decade with macroeconomic stability, marked by an average fiscal deficit of 0.8% of GDP with an average external current account surplus of 1.2% of GDP. However, Suriname is currently facing challenging conditions, caused largely by the sharp decline in the international prices of its commodity exports. The sustained drop in the prices of gold and oil has weakened the external and fiscal positions, with the fiscal deficit deteriorating to around 8.8% of GDP and the external current account balance falling to a deficit of 15.8% of GDP in 2015, while net international reserves fell by 47% to around US\$330 million in 2015. These developments, combined with the closure of the alumina refinery in late-2015, have pushed the economy into a recession.

Lower revenue from the mineral sector weakened the fiscal position and subsequently increased the debt stock. The increase in the fiscal deficit in 2015 was due to a 3.2% of GDP fall in revenue, while expenditure contracted by 2.4% of GDP. Government outlays on subsidies and transfers were about 7% of GDP in 2015, with transfers to the power utility company comprising the bulk of this share. The worsened fiscal position and the decline in nominal GDP as measured in U.S. dollars increased Suriname's total debt stock, by 14% to 43% of GDP at the end of 2015. Though the debt ratio is low in comparison to countries in the Latin America and Caribbean region, the increase points to a clear need for further macroeconomic adjustment.

The Government of Suriname designed its stabilization and reform plan and began implementing it in August 2015, presented it to the International Monetary Fund in early-2016, and reached a staff-level agreement on a 24-month Stand-By Arrangement (SBA) in March 2016 in the amount of around US\$478 million. The SBA will help smooth the impact of the fall in commodity prices and provide a bridge to 2017 when new productive capacities in the oil and mining sectors are expected to be fully operational. The strong adjustment effort and the improved balance of payments outlook are projected to fully correct current unsustainable fiscal and balance of payments positions and encourage a return of confidence and investment by Suriname's private sector.

The government program will also strengthen the resilience of the fiscal, monetary, and exchange rate policy framework to limit the impact of future external shocks through institutional and operational reforms, which will be supported by technical assistance. Further structural reforms target an improvement in the private sector environment and competitiveness.

B. Reforms associated with the support to the institutional and operational strengthening of the energy sector.

The government has prioritized the establishment of a Sustainable Energy Framework for Suriname (SEFS). Supported by the IDB through a series of Policy-Based Programmatic (PBP) loans, the

government has shaped and defined the SEFS since 2012, with the objective of organizing the energy sector to obtain improvements in financial sustainability and improved service provision. Given the key role that the electricity company EBS plays in the sector, the program addresses specific corporate capabilities that will need to be strengthened to improve corporate governance, transparency and accountability required of a growing utility operating to international standards.

The PBP loan approach was envisioned as a set of three individual lending operations that would support and move in parallel with the energy reform process. This instrument provides the necessary flexibility to respond to technical and regulatory developments alongside the efforts undertaken by the Government of Suriname. The program has developed operations that, although independently delivered, are technically interlinked, with connected and coherent institutional and policy goals to be met in 2012, 2013, and 2016 respectively.

The first operation (2848/OC-SU, US\$15 million), approved and disbursed in 2012 had the following objectives: (i) support the government in commencing the process of policy and legislation formulation by drafting policy documents and the establishment of basic regulatory norms and institutional structure for the sector; (ii) create a dedicated office within the Ministry of Natural Resources (MNH), as a focal point for sector dialogue and coordination of the reform process; (iii) prepare an expansion strategy to improve supply efficiency by EBS; and (iv) strengthen EBS's corporate governance through the development of a corporate assessment to identify upgrade requirements and areas of improvement.

The second operation (3062/OC-SU, US\$10 million), approved and disbursed in 2013, sought to start the implementation of certain regulations and management practices that would: (i) reduce Operations & Maintenance costs of the system; (ii) review the current tariff schedule; (iii) draft a model contract for the purchase of electricity from third party generators; (iv) assess the potential of low-carbon energy technologies; (v) improve access to sustainable and quality energy; and (v) foster an increase of the electricity coverage in Suriname. As a way of advancing the development of the legal and institutional framework to incorporate all the above themes, the government opted for the establishment of an Energy Desk. While this provided a good focal point for coordinating the preparatory work, the legal and institutional structure essential to establish a regulatory and planning agency required more form and definition.

This third operation is the last in the PBP series, and seeks to strengthen previous interventions, consolidating the sector reform by deepening and broadening its implementation. While the specific goals are defined in the Policy Matrix, the key interventions can be summarized as follows: (i) approval of a sector policy with an accompanying legal and institutional framework; (ii) a revised electricity tariff that reflects price-setting principles; and (iii) improvements in EBS's corporate capacity and governance.

The program has built upon experience gained in its initial stages, as well as from other initiatives in the region, to address reliability of electricity provision, in the context of limited technical, institutional and financial resources to deliver the required energy service. Additionally, the program has used the lessons learned from previous PBPs to guide the design of this operation. In particular, attention has been paid to efforts that support the revision of the tariff schedule so that it reflects price-setting principles and also to the definition of a stand-alone Energy Entity, which is central to the execution of the proposed new legal framework. Furthermore, given the expected increase in

energy demand over the next years, and the key position that EBS will continue to play in the sector, this operation has taken into account and complements other IDB interventions in Suriname that help to strengthen the utility's corporate and operational capacities.

a. Development of a Sustainable Power Sector Framework.

The program will support the evolution of an energy policy, institutional, legal and regulatory framework for the energy sector in Suriname.

Regulatory and Legal Framework. This sub-component will contribute to a more effective power sector by supporting: (i) the approval of a Power Sector Policy for Suriname that establishes the basic principles for the sustainable growth of the energy sector, consistent with its new legal and institutional structure; and (ii) the presentation to Parliament of the draft Electricity Act that will regulate the organization and functioning of the electricity sector. The Electricity Act aims to address the shortcoming of the sector by: (a) defining the institutional framework and responsibilities of all energy sector entities, (b) determining the role and responsibilities of an energy authority, (c) creating rules and guidelines detailing the changes in roles and responsibilities, (d) defining what represents an acceptable level of energy security, and (e) delineating clear boundaries for the energy authority to ensure independence on the one hand, and sufficient stakeholder input on the other.

Implementation of Sector Institutions. The program, through this sub-component, supports the development of instruments, mechanisms and necessary organizational arrangements to enable a commercially-based operation and clear social, economic and financial incentives to achieve efficiency. The program has set up the following policy conditions for this sub-component: (i) draft legislation that creates the Energy Authority of Suriname (EAS) presented to Parliament for its approval. This policy condition has changed from the previous operation (3062/OC-SU) to reflect a change in view by the government that the EAS should be defined by law as opposed to the set-up of an entity that only requires ministerial approval, and that its role be more central and authoritative regarding sector planning and regulation. The trade-off improves the institutional and legal infrastructure to ensure a clear single entity responsible for oversight of the sector. Having the definition, structure and responsibilities of the EAS in a legal Act ensures a greater level of coherence in function between the agencies and avoids duplication or overlap of mission and activities.

The EAS will be responsible for the formulation and implementation of an Electricity Sector Plan and will facilitate communication and cooperation among energy sector entities. In summary, while the set-up of the Energy Desk was timely, cost-effective and supported the preparation of drafts and coordination of stakeholder inputs to the draft legislation as per the first two PBP operations, the scope of the newly envisioned EAS is substantially broader than what was originally anticipated. It rightly forms an integral component of the new structures proposed by the draft Electricity Act and provides a more coherent and decisive place within Suriname's energy sector; (ii) price setting principles are reflected in a new tariff schedule. EBS has started the implementation of the first stage of a tariff adjustment program which is scheduled for a timeframe of one year. The adjustment will be completed along three stages, after which it is expected that EBS will no longer require government subsidies. The first stage came into effect on October, 2015 and entailed a tariff increase for all groups of consumers,

including residential, commercial and industrial. In the case of residential customers, the average price of electricity increased from 0.17 SRD/kWh to 0.35 SRD/kWh, a relative increase above 100%. In order to protect the most vulnerable consumers, EBS established a special tariff for small households using up to 150 kWh per month, with a tariff of SRD0.15 plus a flat rate of SRD10.85. The remaining two other tariff adjustment stages are programmed for 2016.

Preparation of an Expansion Strategy to Improve Supply Efficiency. This sub-component seeks to improve the economic and technical efficiency of EBS's electricity purchases. More specifically, the program will support: (i) the use of EBS's new Power Purchase Agreement contract model, as required also by the new Electricity Act; (ii) the implementation of environmental and social sustainability principles throughout the project cycle (from planning to execution); and (iii) the completion of at least one feasibility study for the implementation of renewable energy technologies to increase energy access.

b. Strengthen Sector Corporate Capabilities.

Following up on the actions taken during the first and second PBP operations, Component III aims to support efforts to strengthen EBS's corporate governance, transparency and accountability. The program will support technical and corporate governance improvements to enable the company to strengthen its strategic decision-making capacity and operate to international standards. The sub-components reflecting this support include: (i) the execution of the EBS's Strategic Business Plan; (ii) the implementation of technical recommendations from a corporate assessment that include improvements in monitoring the transmission and distribution of electricity; and (iii) the implementation of initiatives to improve corporate governance transparency and accountability to ensure organizational agility, resilience and accountability as recommended in a corporate assessment.

Conclusion

As stated above, the Government of Suriname reaffirms its commitment to move forward with the reforms proposed by the Program. Therefore, through this communication, the Ministry of Finance, on behalf of the Government of the Republic of Suriname, requests the Inter-American Development Bank's financing for up to US\$70 million to be disbursed in 2016 to Support the Institutional and Operational Strengthening of the Energy Sector.

We look forward to continue successfully working with the Bank to attain the objectives of this Program.

Mr. President, I avail myself of this opportunity to renew the assurances of my high esteem and cooperation.

Yours sincerely,



G. Hoefdraad

Minister of Finance of Suriname