



POLICY BRIEF: THE ENERGY SECTOR PRIVATIZATION PLAN

September 2004

Issue Background

Nearly half of Mongolia's public debt is energy sector related. Much of this concessionary debt will be coming due within the next couple of year, representing a major drag on the Mongolian economy as a whole and the energy sector companies in particular. The only way sector companies have maintained acceptable debt/equity ratios is by arbitrarily revaluing assets. Book values now have little relationship with the real market value of those assets. Real equity investment is needed. Since the government cannot afford this investment, privatization has to take place. But privatization has to take place in a form acceptable to strategic investors in a transparent manner.

Current investor interest in the Mongolian energy sector is low because of the high level of perceived investor risk, as compared to other countries. By following a well thought out plan, reduction in investor risk can be achieved. But before serious privatization can take place, a number of steps have to be taken. Following are EPRC's recommendations for input into the new government's approach to sector privatization.

Recommendations

1. Pass a Concession Law as an alternative to 100% asset sales to reduce investor risk
2. Conform the Energy Law to international best practices
3. Revise other business related laws to reduce investor country risk
4. Continue efforts to make the ERA independent and more effective as a regulator
5. Set tariffs on a cost plus profit basis to attract private equity and debt financing
6. Resolve the energy sector internal receivables and payables issues
7. Assure accounting practices conform with the standards issued by the Board of the International Accounting Standards Committee (IASC) and International Financial Reporting Standards (IFRS)
8. Require energy sector companies to divest themselves of non-core businesses such as animal herds and holiday resorts
9. Privatize one company through a concession arrangement, bringing in international investment bankers to assist in the process of a transparent international tender to reduce the risk of failure
10. Consider privatization of transmission companies, the National Dispatch Center, and the Fuel and Energy Authority
11. Mandate independent power plant (IPP) development for all new generation projects to eliminate investor fear of government competition
12. Consider unsolicited proposals for difficult to privatize assets.

Potential benefits

Provided that macroeconomic policies focus on continued reduction of country risk to reduce country risk premium demanded by foreign investors, Mongolia can benefit from:

1. Attracting private foreign and domestic investment to close the gap between capital investment requirements required in the energy sector and the ability of the government to finance these requirements
2. Improved performance (quality of service delivery, coverage, and efficiency) of energy sector companies by attracting international best practices management
3. Improved financial position of sector energy companies loaded with debt which, given a realistic valuation of assets, is currently bleak
4. Prevent the energy sector from being a major contributor to country debt and high level of country risk.

Sources

EPRC's "Policy Brief: Public debt, the energy sector and private investment" Ulaanbaatar: September 2004.

EPRC's PowerPoint presentation on "Privatization: The investor's point of view." Ulaanbaatar: April 2004.

"Methods of Privatization: A summary." EPRC paper. Ulaanbaatar: September 2004.