

**PHARE / POLISH MINISTRY OF INDUSTRY AND TRADE**

**ERG ENERGY RESTRUCTURING GROUP**

**DECEMBER 1992 TO March 1995**

**AN EVALUATION**

**FINAL REPORT**

PREPARED BY

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## 1. PREFACE

Within the sector restructuring programmes in the former socialist economies, the "Energy Restructuring Group" in Poland is a unique project in at least four aspects:

- *First of all, it is a truly international effort* - pooling resources from four donor organisations. The group was born out of negotiations between the Government and ESMAP (the World Bank/ UNDP/ Bilateral Donors' programme for energy development) who persuaded the PHARE programme, USAID, and the UK Know How Fund to provide funding for several experts united under the ERG-umbrella. The consultants were drawn from five nationalities: Polish, US, UK, Belgian and Danish.
- *Secondly, due to its size and the length of its lifetime.* It involves 13 international and 13 Polish consultants; a total budget of at least 6 MECU; and after beginning in December 1992 it will end in March 1996 after 3 1/2 years of existence.
- *Thirdly, due to its special "twinning" arrangement: each international consultant works with a Polish consultant who is specialized within his area of expertise.*
- *The ERG is a cross-sectoral group established to provide advisory services for the implementation of a strategy for energy sector restructuring.* Therefore, interesting lessons can be drawn both with regard to the design of a strategy for restructuring, and with regard to the organisation of technical assistance for the implementation phase of a strategy.

The project documents signed with the PHARE programme foresaw that evaluations of the project would be made. This evaluation is financed by the PHARE programme and ordered by Mrs. Mechtild May, project responsible officer at the PHARE programme in Bruxelles. Since the ERG acts as a group, the whole project is evaluated, not just the PHARE financed parts. Thus, the "project" which is evaluated refers to the totality of contracts which cover the costs of the ERG consultants and the cost of ERG operation; that is, the relevant, ERG-related contracts provided by PHARE funding (PESAP-PL9103, FIESTA-PL9213, ERG'93-PL9315, SERP'94-PL9405), USAID and the UK-Know How Fund.

The TOR dated October 11 are attached as annex VIII. During a meeting with Mrs. May on November 8 it was agreed that (i) all four main tasks of the ERG be analyzed: the advisory tasks, the co-ordinating tasks, training tasks and the programming and implementation (PMU) tasks; and (ii) that the performance of the ERG proper be the main focus of the evaluation rather than the whole energy programme financed by PHARE in Poland.

The original ambition of the evaluator was to write a report of 20 to 30 pages including annexes; based on his firm belief that evaluation reports longer than that are not read. Alas, the report has crept up to 80 pages severely stretching the patience of the reader. But the ERG as an experiment deserved to get an in-depth performance review. It turned out that many different factors influenced its results and these factors had to be properly accounted for and analysed to avoid

accusations of unwarranted, unsubstantiated conclusions. The ERG story is a fascinating piece of economic, political and social history, of problems in transition economies, of approaches to project management, of strategy design and of organisation. It is therefore the evaluator's hope that the reader will feel rewarded after all, once the last page has been turned.

The evaluation of the ERG is structured into four chapters: one which analyzes the quality of project design, one which looks at the efficiency of implementation, one which list the project results, and one which outlines the external constraints which influenced results. The scope and the sub-issues of these four topics are detailed in Annex I "Evaluation Methodology".

A final chapter summarises the findings and presents the conclusions and lessons learned which are of general interest for experts involved in energy sector restructuring projects.

Understanding of background and environmental context are essential for a proper evaluation of project performance. This type of information is provided in annexes II to V called: the mandate of the ERG - the energy policy letter, socio-economic context, present and past institutional set-up for policy formulation and energy supply, history of the ERG.

Result evaluation in "restructuring & strategic planning" projects poses one difficulty: in addition to tangible products, such as plans and strategies for reorganisation; there are non-tangible products in the form of change of minds in the receiving institutions. It can be argued that the "process" aspect of restructuring projects is more important than the final plans themselves: a "perfect" plan can be shelved by a change of minister who needs to prove that the predecessor was wrong. What will not be affected by political changes are the insights that company and ministry staff have gained while they worked on the plan. This know-how will remain and continue to be applied in daily work thereby shaping the course of events as long the staff remains in positions of influence. Therefore, the evaluation of results attempts to look not only at the tangible outputs, but also to verify the quality of the "process aspects".

The evaluation is based on an evaluation of written material produced by ERG during its lifetime and on interviews and observations made during two visits in Poland, one from 12-16 December 1994, the other from 8-21 January 1995. The draft report was submitted the beginning of March and gave rise to detailed written reactions. They were discussed and additional information received at meetings with ERG team members in Warsaw on April 20 and 21. Before the last visit, a few exchanges of opinions had taken place with some team members at the margin of the PennWell conference on power restructuring March 29-30. The list of interviewed persons is found in annex VI and of the written material in annex VII.

The mission would like to express its thanks to the Polish authorities and to the ERG team members for the excellent cooperation which was provided before and during the three visits - by preparing a programme of visits and collecting relevant materials - and for the very detailed written comments to the first draft which lead to the elimination of factual errors. Deficiencies and misunderstandings must be blamed fully on the evaluator not to want of information.

## 2. PROJECT DESIGN

*"The original ERG mission was an outgrowth of the Energy Policy Letter which, while containing laudable objectives, was not reduced to an actionable plan. For example, it set specific timing objectives for raising energy prices to world market levels, but did not say a word about managing the stresses that could be created in the process. In short, the Policy Letter and all the ESMAP work that supported it emphasized the physical end-point characteristics of the restructured energy sector without ever defining the range of adjustments that had to take place, their cost, and how they might be managed".*  
Memorandum, ERG-USAID Team, October 1, 1993

### 2.1 The Strategic Quality of Project Design

#### (a) Scope of work on energy sector restructuring

Contrary to PHARE-financed energy sector restructuring projects in other countries, the ERG was not responsible for the definition of the strategy for sector restructuring. Prior to the arrival of the team, the strategy had been defined by ESMAP with the help of a number of consultant reports prepared during 1990 and become official Government policy with the signature in August 1991 of the energy policy letter addressed to the World Bank<sup>1</sup>. The ERG's role was to be the lead technical consultant for defining the practical approaches to implement the strategy in practice. For ERG's possibilities to achieve results it was therefore essential that the strategy was coherent and implementable.

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<sup>1</sup> See the beginning of annex V "A short history of the ERG" for details, and annex II "Energy Policy Letter" for a summary of its content. ESMAP's strategy was published in a five volume report in January 1993. The ESMAP-report based interpretation of the ERG's role is questioned by the three relevant ERG managers - Mr. Sonck, the project manager, Mr. Filipczak, the "twin" manager and Mr. Nowakowski, the PAO. They point out that neither the PHARE financial memorandum of March 1992 nor the TOR of November 1992 make any reference to ESMAP or to the "Energy Policy Letter". The interpretation is maintained by the evaluator for three reasons. First of all, as illustrated by the introductory quote, the USAID and UKKHF funded experts referred to the Policy Letter in their work; and no internal discussion documents were shown to suggest that an alternative interpretation was developed in response to the October 1993 memorandum. Secondly, the ESMAP January 1993 report is a document approved by the Government prior to publication. Thirdly, at the time of the creation of the ERG, the ESMAP strategy was the only developed concept for energy sector restructuring in Poland.

The issues of "coherence" and "implementability" are partly linked:

- To be implementable, a strategy should preferably be coherent. If it is not, it is either not implementable at all, or calls for adjustments to be made during implementation. Adjusting requires (i) that management of ERG is able to identify crucial voids in the strategy and (ii) is able to react upon these by elaborating and presenting policy proposals to fill the gaps. This is part of the thought leadership role which ERG has to play, an issue to which we shall return in chapter 3 "Efficiency of implementation".
- A strategy can be coherent, but not implementable if either (i) it is not sufficiently adapted to local conditions, or (ii) local political conditions do not allow an otherwise perfectly defensible strategy to be implemented. (The local constraints are discussed in chapter 5)

The preparatory work done by ESMAP - despite of the flaws identified in this report - was a great intellectual achievement. It was a pioneering effort, being the first integrated reform proposal on energy sector restructuring in Eastern Europe. It looked at sector restructuring issues in a broad, comprehensive and well integrated way. As such, it is a superb piece of reference work for Polish discussions on energy restructuring providing the discussions with a solid foundation. Any alternative proposal faces the challenge of presenting an equally coherent framework for the restructuring of Polish energy industry.

However, ESMAP's interpretation of its preparatory work went beyond the "reference framework" level. ESMAP considered its output to be a "blueprint" for sector reform, where it was necessary only to fill out details in order to get it implemented. It was no longer an input for Polish discussions on sector reform, it was already the output of the discussions and accepted as such by the policy letter. The question therefore is, whether ESMAP's work lived up to this high level of ambition? In order to qualify as a blueprint for energy sector restructuring the proposed strategy:

- \* First of all, must be comprehensive providing a coherent analysis of and recommendations for: (i) the policy formulating framework; (ii) the regulatory framework; (iii) the organisational framework for energy supply; (iv) the energy policy instruments (see figure 1 overleaf, reproduced from a PHARE report on Latvia).
- \* Secondly, the strategy must identify the right issues to be addressed in sector restructuring and propose adequate solutions that have a realistic chance of being implemented.
- \* Thirdly, the objectives and rationale of the strategy must be properly communicated to the involved parties to ensure a maximum degree of consensus and minimize resistance during implementation.
- \* Fourthly, the strategy must define appropriate institutional arrangements for the implementation of the plan for restructuring.
- \* Fifthly, the strategy must have a plan for implementation with realistic time schedules and an outline of its critical path showing which elements are particularly dependent

upon others.

The first two issues concern the development of a high-quality, integrated and credible strategic plan for energy sector restructuring, the other three the proper approach to strategy implementation. The next five sections will look at each issue in turn.

(b) Comprehensiveness and coherence of coverage

Looking at the content of the policy letter (see Annex II) one notices:

- that the programme for restructuring (and, thus, for the ERG) was rather comprehensive in the field of energy sector regulation and in energy supply; in the latter, only the oil industry was excluded from the TOR;
- that little of substance could be found regarding definition of energy policy; only the inclusion of an energy saving expert on the team opened up for the possibility of some work being in the area.
- that no work was foreseen to assist with the modernization of the policy formulating framework.

The energy policy letter defines a "competition policy", rather than an "energy policy"<sup>2</sup>. In the context of widely differing interests and opinions in the Polish energy community on sector reform, the *lack of a framework of reference on the energy policy objectives of reform* is a handicap for the ERG's work on legislation and on commercialization:

- The preparation of the draft energy law was complicated by an absence of consensus in the Polish energy community about the content of the law. The discussions on issues take place in a policy void, which undermines the quality of the discussion<sup>3</sup>.
- Frequently, in internal ERG memos one finds quotes such as "commercialization and privatisation are not objectives in themselves, they are only means to reach wider goals". One senses that the wider policy goals of restructuring have not been sufficiently well

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<sup>2</sup> In the sense that privatisation was supposed to raise the level of investment and to lower costs, privatisation and energy policy objectives went hand in hand.

<sup>3</sup> The Government (cabinet?) decided to prepare an energy policy document for submission to Parliament jointly with the presentation of the draft energy law for discussion in Parliament.



communicated to the energy community.

The *non-inclusion of work on the restructuring of the Energy Ministries* is a logical flaw of the strategy. Under the previous regime, the Hard Coal / Power & Lignite / District Heating Boards played a dominant role in energy policy formulation as mixed enterprise managers/subsector policy makers; therefore, historically, the ministerial structure for policy making was weak<sup>4</sup>. With the break-up of the boards, the traditional structure for the formulation of policy making was broken up as well. This void has to be filled by a proper strengthening of the ministerial structure for policy making.

Apart from making the strategy incomplete, the flaw has practical consequences for the ERG's work on the draft energy law, in particular, the articles dealing with the structure, operation and responsibilities of the Energy Regulatory Agency. In the absence of a clearly defined structure and objectives for the work of the Department of Energy including the practical division of work and of responsibilities between the DOE and the ERA, the discussion on the establishment of the ERA is a bit abstract. The uncertainty about whether or not the DOE will be in a position to properly formulate and to control the energy policy of the country (lack of understanding of tools), reinforces the "natural" tendency of the ministry to defend its turf against the new institution, the ERA.

(c) Identification of issues and appropriateness of proposed solutions

The question of *whether the strategy proposed by ESMAP provided the correct solutions for the Polish energy sector* is very difficult to answer. It is a question both of appropriate tactics for restructuring as well as of appropriate adjustments of concepts to Polish reality.

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<sup>4</sup> See Annex IV "Present and historical structure for policy making and for energy supply"

The work done by ESMAP was a pioneering effort to define a strategy for the restructuring of a socialist energy sector to a market driven energy sector and it is hotly debated what the correct strategy for transition is: *whether gradualism or a radical break with the past is the appropriate approach to restructuring?* The argument for gradualism is that it takes time to change the mentality of sector staff and that the supporting framework of legal and regulatory traditions is not yet in place. The argument for a radical break with the past is that gradualism risks to perpetuate the thinking of the past and to delay reform, whereas a radically new structure forces staff to break with ingrown habits and to change institutional behavior<sup>5</sup>.

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<sup>5</sup> To quote Jack Welch, chairman of General Electric on company reengineering: "When you reform be radical. If your change isn't big enough, the bureaucracy can beat you". George Yarrow from Oxford university argued in a paper presented at a conference in Warsaw that English-style power structures are the future in the EU; and that Poland by going boldly for such a structure will be able to leapfrog Western European countries. He envisages that these one day might come to Poland to learn about how Poland organised its sector. The snag is that leap-frogging can be attempted too early if it is based on insufficiently developed concepts. Work teams, for example, are the present rage of the most advanced industries in the world. But when Volvo as the first manufacturer in the world build a car assembly line 15 years ago built on teams, the plant failed miserably making losses ending in closure ten years later.

There are no generally applicable paradigms for energy sector organisation. It is probably not possible to identify two countries in the world with an identical institutional structure for energy supply. Each institutional structure evolved in response to the specifics of the national situation. Since no paradigms exist consultants have a tendency to fall into the trap of using national institutions as role models for the countries they work in. *The question therefore is, whether the ESMAP consultants adjusted their recommendations to the specific needs of Polish society?* This question is easier to answer: the reform for power sector restructuring proposed by Coopers & Lybrands who worked as consultants for ESMAP was a carbon copy of the English model (the country of origin of the consultants) with a grouping of power companies to provide competition (only the number was higher), a power pool with compensation payments for differences compared to directly contracted power supplies by the distribution companies, independent regulator, etc. etc. The similarities are too striking to avoid the impression that the consultants took the easy way out! While elements in the English model, e.g. the independent regulator make good sense under Polish conditions, an English type power pool makes not <sup>6</sup>.

(d) Communication of strategy and programme of action

Energy sector restructuring has much in common with "reengineering" in modern industries - it is complex, demands rethinking across the organisation and involves a breakdown of vested interests, not the least of middle management. In order to motivate an organisation to support a radical change programme it is essential that substantial efforts are made to communicate the needs and the rationale for the new structure.

It is a rather common experience of energy sector restructuring projects in former socialist countries that the final recommendations are understood and supported by the national experts who participated in the preparatory studies, but that few officials outside this narrow circle are able to understand them. This reflects that project design normally does not include a sufficiently long period for communication of results once the final strategy report is finished.

ESMAP thought that it had paid proper attention to the communication aspect. The preface of the January 1993 "Poland Energy Sector Restructuring Program. Volume 1: Main Report" mentions that "the restructuring study was completed in late 1990 and presented in two ministerial meetings"; that "the results of the study and its implementation phase were also discussed in a seminar that included the management of the energy enterprises, the Ministry of Industry and Trade, the Bank of Poland and Ministry of Finance, the Privatization Plenipotentiary's office, unions, Polish experts, consultants, and the World Bank and ESMAP. Because the study was undertaken jointly with the relevant Polish authorities, a sense of collective ownership of the work emerged that proved highly productive in the implementation phase". The policy letter (see the quote at the start of Annex II) put it even more strongly. It claimed:

- that the *consultations* during the preparation of the studies, and the two days

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<sup>6</sup> Any first year student of economics knows that you do not get competitive pricing under oligopolistic industry structures; and mathematically talented post graduate students with exposure to game theory can prove that such structures will lead to collusive behavior. Yet the English power pool operated under the principle that price behavior would mirror "perfect competition" behavior. It did not, and the English power pool has during the last nine months had price caps imposed upon it.

- seminar/review by sector representatives created a broad consensus for the strategy that there was broad *agreement at the technical level* on the details of the sectoral action plans

However, already shortly after project start, it became painfully clear that there was no broad consensus in the Polish energy community on neither the general scope of reform, nor on its technical details. What ESMAP saw as a consultative process of project preparation was seen differently by Polish ministry and sector enterprise staff: they attended a one/two days seminar where the presentations were held in English, where the written material which was handed out was in English (which few understood); where the subjects were complicated and often not immediately understandable; and that at the end of the seminar it was concluded that there was broad agreement behind the proposed reformed structure.

The one group which wholeheartedly supported the proposed reforms was centered around Prof. Popczyk, who became the chairman of the PSE, the Polish power transmission company and the lead agent for power sector reform. In the MoIT, in the early days of ERG existence, Mr. K. Adamczyk, Director of Energy Management Department and - later - Deputy Minister, and Mr. S. Okrasa were reform leaders (both left around the middle of 1993). Most of the other staff were against the reforms both due to sheer conservatism but also because they felt marginalised during strategy preparation (the minister talked directly to the consultants) and now felt a chance to get back into a position of influence.

(e) Organisation structure for project implementation

In the concept foreseen by ESMAP, the ERG played the triple role of (i) technical advisor to the MoIT and MPPC<sup>7</sup> on the details of the policy reforms, (ii) technical advisor to the enterprises on enterprise restructuring and (iii) of a policy think tank, providing guidance to the overall process and not just the details of it.

The triple role poses an organisational challenge because it cannot be reconciled easily with the group concept: the first and third functions basically call for ERG advisors to be placed in the ministries (project manager, energy saving, legal, regulatory, energy planning in the MoIT and district heating in the MPC) the second function basically calls for ERG experts to be placed in the companies to work as advisors for the managing directors (natural gas in the PGNiG, power in the Polish Power Grid Company and coal in the Hard Coal Agency). But breaking up the group could have implied some loss of synergy in e.g. the work on the energy law and would have left the cross-sectoral experts in training, corporate planning and privatisation without a natural basis. In addition, the companies (and their managers) have agendas of their own to pursue which are not necessarily in the interest of the country, whereas the ERG sector experts must look at national interests only.

ESMAP opted to keep the group intact and to propose a rather heavy structure of supporting

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<sup>7</sup> At the donor's meeting in 1992, it was decided that ERG should be advisory body for all involved ministries as well as Parliament. In addition, ERG cooperated with Ministry of Finance, Ministry of Privatization, Ministry of Environment Protection and the Anti-Monopoly Office.

groups to provide linkages with the ministerial and the company institutions (for details see Annex V "History of ERG"):

- \* Since the ERG was to serve "everybody" it was placed outside all institutions as an independent group, a kind of "quango" ("quasi non governmental institution")<sup>8</sup>.
- \* Each foreign experts had a so-called *twin*, a Polish consultant in his field of expertise attached to him, to provide insights on Polish reality and to ensure a proper transfer of know-how and continuity after project closure.
- \* Being placed on the outside, the ERG needed formal linkages to the sector institutions. These linkages were to be provided by two groups of Polish experts (each subdivided into hard coal, power & lignite, oil & gas, district heating) established with the specific objective of collaborating with the ERG:
  - One group, the so-called "*counterparts*" composed of 18 persons from ministries and enterprises had a basically "passive" function: the responsibility of the group was to supply information required by the ERG, thus providing the ERG with what could be called a backward linkage to the institutions.
  - The other, the so-called "*coordinating groups*" composed of 45 senior officials from the energy enterprises and policy institutions, were to be responsible for the implementation of the reforms. Thus, they had an "active" follow-up function providing, what could be called a forward linkage to the institutions.

In addition, ESMAP expected to be a "fourth group" with a role in the restructuring process. The role was not well-defined in the January 1993 ESMAP report on "Energy Sector Restructuring in Poland" which stated "ESMAP will support the work of the ERG through (a) the proposed activities to be carried out under the ESMAP programme, and (b) the active involvement in ERG activities". What the latter implied was unclear. But according to the main report's organisation chart, the ERG through the PAO was supposed to report both directly to the Director General of the MoIT and indirectly through ESMAP.

Any organisation expert looking at the organisation chart in ESMAP's report would have predicted that the proposed structure would not work: the structure was heavy with many groups, reporting structures and unclear lines of responsibility. The proposed structure was based on the premise that the preparatory work of ESMAP was a genuine blueprint for reform. In addition, in order for this structure to function, two assumptions were critical: that there was general consensus behind the reform programme, and that the Minister was willing and able to actively monitor and support the work of the ERG.

Due to the absence of general consensus, the "quango" form of organising the ERG became a serious handicap for its work:

- Being placed outside the ministries, the ERG did not have direct and automatic access to the flow of information generated in the ministry, and officials in the ministries could prevent the ERG team from getting regular access to the (deputy)minister.

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<sup>8</sup> The ERG letter head says "Ministry of Industry and Trade, ERG".

- Being placed outside the companies, the ERG experts did not have direct and automatic access to the flow of information generated in the companies. Also, as they were not part of the restructuring teams set up within the companies, they did not take part in the internal discussions on restructuring.

In the absence of broad support for their work, the ERG was crucially dependent on active support from reform minded ministers who were interested in using the ERG as an instrument to step up the pace of reform against a foot dragging bureaucracy. Unfortunately, ministers changed frequently and became less and less reform minded as the political winds moved against reforms in general.

The *"twin" concept* proved to be valuable as an efficient instrument for the transfer of know-how from the foreign experts to their Polish counterparts, and as a facilitator of contacts and promoter of understanding between the ERG and the Polish sector companies and institutions.

The *counterpart groups* were a misconception:

- (i) The passive nature of the function did not provide staff with much motivation.
- (ii) The ERG as a consultant works with specific staff on specific issues and needs to get specific information from such staff. To access this staff through a counterpart group is too artificial to be practical. This role was taken over by the subsectoral twins who had sufficient contacts in each subsector to get the necessary information.
- (iii) In addition to the issue specific type of information, the ERG needs more general information, e.g. on business plans. Clearance from top management was needed to get access to this type of information and the counterpart group was not in a position to grant this. Instead, this information was obtained through requests from the PAO to top management.

Thus, in practice, the counterpart groups proved to be a hindrance to (censorship) rather than a facilitator of information. After a very short initial period of use, they soon became superfluous and withered away never to be missed by ERG staff.

The *four subsector coordinating groups* never became operational. Those who were established lived only for a short time, as neither the MoIT nor the Ministry of Construction were willing to finance the operational costs of "their" coordinating groups<sup>9</sup>. The ERG suffered from this. If the groups had functioned, the ERG twin experts could have become members of the groups (the expatriate district heating expert was nominated deputy chairman of the short lived DH group) thereby providing the ERG with an important communication channel.

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<sup>9</sup> A small *"District Heating Coordination Committee"* was established by Minister of Physical Planning and Construction in April 1992 for cooperation with ERG. In March 1993 a new 15 member *"Coordination Committee (District Heating Task Force Committee)"* chaired by Mr. Stanislaw Mankowski, Professor in Warsaw Technical University was nominated. The *Electricity Restructuring and Coordinating Group* was replaced on May 1993 by an *Electricity Restructuring and Implementation Group* chaired by Voice Minister Morawski.

The delay in the start-up of the ERG was an important reason for the non-functioning of the coordinating groups. During 1992, the MoIT set-up *working groups for the implementation of the reforms*. These started their work before the creation of the ERG and in many ways had usurped the leadership function originally foreseen for the ERG - in particular, the PSE - and had no interest in ceding influence to the ERG. The PSE under its chairman, Prof. Popczyk, a strong reform oriented personality, had become the lead organisation for power sector restructuring. The *State Hard Coal Agency (PAWK)* functioned as coal sector restructuring advisor to the Government. The PGNiG was responsible for its own restructuring.

Thus, when the ERG started to operate, the proposed structure for project implementation was outdated by events and the ERG had to fight an uphill fight to establish its proper presence. In the meantime, ERG's competence was largely reduced to:

- study various Government proposals
- discuss various options
- express opinions and concerns
- propose solutions based on international experience
- promote the knowledge of market economy

ESMAP's wish to maintain a position of influence in the restructuring process is psychologically understandable: ESMAP prepared the strategy and created the ERG. In addition, the World Bank as a major lender of finance for the energy sector has an active interest in creating a favourable framework for investments. Unfortunately, ESMAP's strategy for maintaining influence was ill conceived. Instead of creating a monitoring and advisory role for itself, ESMAP wanted a leadership role. Formally it could be justified with reference to the policy letter (a commitment to the Bank), but it was naive. It created an untenable situation of dual management between ESMAP's lead consultant and the project manager of the ERG. ESMAP was bound to lose the inevitable fight for influence. The ERG was too large as a group to be pushed around, and the ERG manager was permanently present in the field, whereas ESMAP staff flew in for short visits. After playing an important role during the first few months of ERG's operation, ESMAP was effectively squeezed out of the project. While this solved the dual management problem, it created another handicap for the ERG: the ERG lost the means of influence provided by the financial muscle of the World Bank and the stimulus of qualified outside monitoring as well as the access to the strategic thinking and the world wide experience of the World Bank in energy sector restructuring.

Looking at the project experience it can be concluded that the "dinosaur-quango" structure for the ERG is not the right structure for the provision of advisory services for strategy implementation.

The experience of the coal experts proves that an alternative more decentralised ERG structure would have produced better results. The coal expert and his twin did not stay with the group in Warsaw but moved to Katowice and got office space within the headquarters of the Hard Coal Agency. The experts remained independent from the agency - being well aware of the fact that the agency had an agenda of its own from which it had to keep a distance - but had a visible presence within the organisation. The coal experts managed to provide advice to the agency, to the individual companies supervised by the agency, to the MoIT and to participate constructively in ERG discussions on a number of key strategy and policy issues.

(f) Time schedules and critical path outlines

A final requirement for a strategy to be classified as a blueprint is (i) that it contains well defined and realistic time schedules and (ii) that a "critical path" is outlined - showing which elements need to be in place first and what complementary reforms have to be implemented in other sectors.

*The time schedule for the restructuring programme proposed by the Policy letter was very optimistic!* It expected the majority of the reform programme to be implemented by the end of 1992. The Policy letter recognised that the expectation was optimistic but concluded that the overall time table was feasible: difficulties with workers councils and the stretching of the existing legal and institutional capabilities to its limits would only have the effect that some sectors came to evolve more rapidly than others. Yet, when the ERG started up with one year's delay at the end of 1992 hardly any of the reforms had been implemented.

The time schedule underestimated the time it takes to get from general framework definitions to carving out the details of reforms - in terms of primary and secondary legislation, enterprise restructuring, etc. In addition, delays arose from opposition to reforms provided by officials and by politicians who became more cautious (1992 saw a strengthening of a public mood against reform in general; see Annex III on "Socioeconomic Background"). Finally, the workers' councils proved to be a tenacious obstacle to enterprise restructuring. According to Polish law, the "workers' council" perform a powerful "supervisory board" function in state enterprises as long as they have not been corporatised (or commercialised as this process erroneously is called in Poland). The Policy letter wrongly assumed that agreement in restructuring by the *workers' councils* was needed only in cases involving liquidation of state enterprises (see quote in Annex II). But since decisions on commercialization need agreement by the workers' councils, they try to blackmail the MoIT into agreeing to generous terms for workers' ownership of shares. Workers' councils oppose divestments or downsizing prior to commercialization because workers who are laid off do not have rights to the company shares which are distributed to workers upon commercialisation (see Annex III).<sup>10</sup>

*The strategy of ESMAP was insufficiently supported by "critical path" analysis.* There was an almost complete absence of emphasis on supportive policies: e.g. how to introduce social compensation to low income households for energy prices increases; how to introduce social programmes for labour redundancies in the mining sector.

There was one exception: ESMAP was aware that an early adoption of the energy law was needed in order to get the reforms moving beyond the critical stage and pushed for adoption by

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<sup>10</sup> The workers' councils are an anomaly from the past structure. However, as long as a company is not corporatised they are intact, and since the labour movement in Poland was the primary responsible for the overthrow of communist Government the political influence of labour unions was and is strong.



the so-called "fast track process". Unfortunately the fall of the Government in May 1993 prevented this (see Annex V). That was very bad luck, and has hurt the ERG ever since. If the energy law had been adopted in the middle of 1993, the ERG would not have to spend considerable time on defending law drafts against continuous attempts at revisions and could have moved ahead with work on secondary laws.

(g) Conclusion: the role and mandate of the ERG

The conclusion of the above is that the ESMAP strategy did not represent a genuine blueprint for reform. Therefore, the role of the ERG is not limited to "designing appropriate structures and instruments for strategy implementation", it involves also work on "strategy formulation" in addition to the inevitable work on "strategy adjustment" <sup>11</sup>.

In the eyes of the managers of the ERG, the ERG is a "high level policy advisory unit to the Polish Government in the energy sector". The question which then has to be raised is "policy advice on what?" The ERG managers refer to the objectives listed in the Financial Memorandum of March 1992 as the appropriate guidelines for the evaluation of the ERG's work<sup>12</sup>. These objectives, however, are too general to qualify as operational objectives - they are relevant for "any" early 1992 strategy project working broadly on energy sector restructuring in former socialist economies.

In the interpretation of the evaluator, the ERG is to be considered the elite unit for policy advice in Poland on energy sector reform. Its role is to provide advice of operational value on energy sector restructuring to the management of the energy supply companies and to relevant ministries, in particular, the MOIT and MPPC within the scope of the strategy prepared by ESMAP. In doing this, the ERG will not be held accountable for its compliance with the content of the

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<sup>11</sup> A strategist knows that the important consideration in strategy formulation and implementation is not to get everything right from the start (in that case too much time is wasted and there is a risk that one gets never started) but to move in the right direction. Errors are corrected along the way and appropriate adjustments made. For this, however, monitoring systems for result evaluation and strategy updating must be put in place.

<sup>12</sup> The stated objectives are: to reorganize the sector in order to put it on commercial footing; to make the sector more responsive to the needs of a developing market; to improve efficiency of energy production and use, taking into account the optimal use of domestic resources; to improve the environmental impact of the sector; to improve policy making leading to the necessary institutional and legal adjustments; to prepare and implement market related tariff structures; to improve programming of operations and investment in the sector; to prepare and to implement an energy conservation strategy; to improve management of existing companies.

strategy; but be judged, inter alia, for its ability to provide advice of equal coherence and equal scope as ESMAP.

## 2.2 Logical Framework of the Project<sup>13</sup>

The technical proposals prepared by the PHARE contractor, the IBF, to win the contract - both the 1992 proposal as well as the proposal for the extension of the project<sup>14</sup> in the fall of 1994 - were weak:

- The proposals contain no precise definition and separation of objectives, output/deliverables, activities and inputs; these are all lumped together under the description of TORs for individual consultants
- There is no specified work programme nor any timetables
- No performance criteria are given. They are according to the prodoc to be defined in the initial stages of the preparation of a work programme.

Obviously, if a technical proposal is made without "performance criteria", it is because the proposers are unsure about how performance shall be measured. Hence, one can not expect that these will be formulated after project start; and in fact, this never happened.

The weakness of the last technical proposal prepared by the IBF can be explained easily. The IBF has the technical capacity to do a better job. But as there was no competition, the IBF was sure to get the job and the preparation of the proposal was a mere formality. The result, however, has two practical consequences:

- \* It is impossible for an evaluator to use the technical proposal as an input (terms of reference) to evaluate project performance.
- \* Since neither outputs nor activities are defined in the prodoc, performance control by the PHARE project officer has to be done by a careful review of workplans and action plans; a process which is very time consuming.

The TOR prepared by PHARE for the project extension from September 1994 to March 1996 covered the following:

- 1) Legislation: work on secondary legislation and advise for the establishment of the ERA
- 2) Companies: monitoring of the privatisation process, development of business relations with international finance institutions and foreign investors
- 3) Institutional: reorganisation of the MOIT and the setting up of coordinating mechanisms with relevant sector institutions

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<sup>13</sup> The total logical framework for the project comprises the ESMAP strategy report and the PHARE / USAID / UKKHF contracts. Here, we concentrate on the IBF contracts only.

<sup>14</sup> Formally, the new contract was awarded after a call for tender. For obvious reasons no other tenderer bid for the contract.

#### 4) Long term energy policy strategy

What is missing in the project TOR is the absence of any technical assistance in enterprise reorganisation.

The IBF's technical proposal hardly refers to the important topics of institutional/organisational development (topics one and three in the project TOR). The "description of tasks" (a mixture of objectives, outputs, inputs) only include work on the Energy Regulatory Agency in the task description of the legal expert<sup>15</sup>. There is no reference at all to work on the reorganisation of the MOIT in the task descriptions. It is only mentioned under "methodology" that it is important that the Energy Department be strengthened<sup>16</sup>.

When a task asked for by the TOR is not listed in the task descriptions of the contractor one should not expect that this task is taken up during the implementation of the project! In fact, by the end of March, several months after the extension of the project, still no work seems to have been done on the future organisation structure of the Department of Energy.

Short-term experts play no role in the technical proposals. During 1992 to 1994, the PHARE-financed part of the ERG team was provided in the form of long term experts all of them working full time except for the training expert who worked half-time. In the technical proposal for the September 1994 to March 1996 project period, the long term experts have been increased to six full time and two half-time (training plus finance). The project budget allocates 12 m.m. for short term experts; but they have no independent status. The budget is to be used during the August 1995 to March 1996 period to call on the foreign legal, natural gas, district heating and energy saving experts (whose long-term contracts expire in July 1995) for short term missions.

The fact that almost all the work of the PHARE financed foreign consultants was done in situ in Poland is very positive. It pays due regard to the importance of the "process" aspect of restructuring work.

In the case of the legal expert, the adopted "long-term plus short term contract" procedure makes good sense - the September 1995 to July 1996 period calls for full time attention of the legal expert due to the fine tuning of the energy law draft and the preparation of secondary legislation.

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<sup>15</sup> task "h) to assist in the setting up of the structure, the internal organisation and training sessions for 1) The Energy Regulatory Agency and 2) the Energy Conservation Agency".

<sup>16</sup> "Point 1.2.3 Transfer of Know-How: According to our experience, one of the priorities is to set up an operative Energy Department within the MOIT and to appoint and to train well-skilled staff of the ministries".

For the work of the natural gas, district heating and energy savings experts, the alternative solution of giving them half-time long term contracts covering the total period from September 1994 to March 1996 would have been a more rational solution <sup>17</sup>.

The absence of short term expertise in the project is a conscious decision by project management: it is of the opinion that short term experts are not sufficiently useful as a lot of time and effort are lost in getting them acquainted with Polish reality. Two observations must be made:

- First of all, the absence of short term experts reflects the lack of depth in the ERG's work on ministerial and company reorganisation. If the ERG had decided to go into that area, short term specialist expertise would have been necessary to supplement the expertise of the long-term staff.
- Not having a budget to draw on for short term specialist expertise for specific assignments, the ERG has to draw up special TA projects for donor funding to cover needs for specialist expertise that are encountered. This topic is taken up again in section 3.4 on the PMU function.

The inclusion of the experts in energy policy and in finance is an interesting adjustment to the project.

But, on the whole, a good opportunity for mid-term reflection was lost due to the "let's get it over with" approach to the preparation of the technical proposal. ERG-management should have started the assessment report exercise in the summer of 1994 prior to the preparation of the technical proposal instead of waiting till December 1994. Likewise, it was a mistake by PHARE-Bruxelles not to carry out the ERG-evaluation before passing a decision on the extension of the project. The evaluation could have provided the quality control and thought stimulus which remained dormant in the absence of competition.

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<sup>17</sup> None of the USAID and UK-KfW funded foreign experts was employed full-time in the project, a fact, which does not seem to have prevented them from participating fully in the most important policy discussions and to provide adequate transfer of know-how to their "twins"

### 3. EFFICIENCY OF IMPLEMENTATION

*"Until ERA has been formally established, it would be advisable to allow its staff identified to work on regulation to operate in a separate section within the MoIT to assist in the preparation of the regulatory framework they will ultimately be required to administer".* ESMAP, Energy Sector Restructuring Program. Volume 1: Main Report

#### 3.1 Efficiency of Project Management

##### (a) Selection and replacement of team members

This section tries to provide answers to five questions: (i) was the staff of good quality?; (ii) was the team proposed by the IBF actually fielded?; (iii) when team members were replaced, where they replaced by experts of the same quality?; (iv) how was the work of the project affected by changes in team members?; (v) did the team have the appropriate balance between the young and talented and the older and experienced?

The ERG has two strengths: (i) the average quality of staff is high <sup>18</sup>, and (ii) it is a truly international team. The latter is a great advantage in energy sector restructuring. It provides the client with exposure to a broad range of institutional experience and ensures that proposals by individual experts that are too "nationally" coloured are questioned by others.

The *foreign expert team* proposed during contract negotiations by the PHARE, USAID and UK-KHF contract holders, was fielded without exception. During the lifetime of the project, most of the foreign experts of the PHARE team had to be replaced for various reasons:

- Mr. Groosen, the first project manager resigned in May 1993 and was replaced by Mr. Fernand Sonck.
- The part time arrangement for the original foreign legal expert Mr. Kaj Worsaa did not work out, he resigned and was replaced by a full time foreign legal expert, Mrs. Anita Rønne.
- The first energy saving expert Mr. Finn Lauritsen was replaced by Mr. Per Stockholm in November 1993.
- The training expert. Mr. Borsu was not an expert in that field, and never developed a proper concept for the training programme. He was relieved from his duties at the end of 1994. His replacement started in January 1995.
- In October 1994, in connection with the extension of PHARE's project commitment for

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<sup>18</sup> See annex V "History of ERG" for details on the background of team members

an additional 1 1/2 years, two additional foreign experts joined the team - one in energy planning, Mr. Nackaert, and one in project finance, Mr. Scokaert, the latter on a half time basis.

- Mr. Scokaert left the project in March 1995 and was replaced by Dr. Frank Braun.

Concerning the stability of UK-KHF and USAID financed staff, the following can be said:

- The American privatisation expert hardly ever showed up. There was not enough work to do on privatisation <sup>19</sup>.
- The British regulatory expert Ms. Rosie Miller represented the most liberal free market oriented positions in the group during discussions on restructuring and regulatory frameworks. As long as Mr. Brierly from ESMAP still collaborated with the ERG, she had an ally who supported her views. But when he and ESMAP withdrew from the project, she felt increasingly isolated in the group and left the team in December 1993. A replacement was not nominated. Some of the financial savings were used by the UK-KHF to finance the extension of the regulatory "twin" contract until June 1995. In addition, Coopers & Lybrand provided a follow-up six weeks regulatory expert mission by Mrs. Rachel starting January 1995 to work on the regulatory structure and style of the ERA. Given the lack of progress in the adoption of the energy law, the interruption was justifiable.

All experts who left were replaced by experts of equivalent quality.

The work of the ERG was little affected by the change of foreign staff. The exception is the replacement of the financial expert. The task of the financial expert is not an easy one. Many institutions are available to provide expert advice on matters of project finance (the EBRD, the World Bank, foreign commercial and investment banks) or to prepare feasible studies to identify bankable projects (add the bilateral programmes). It is not easy to carve out a niche under these circumstances. The departure of the first financial expert makes the work of his replacement still more difficult: he has hardly anything to build on and needs to make the same round of visits to institutions which his predecessors has made already, asking the same questions. This will irritate

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<sup>19</sup> As late as March 1995 not a single energy enterprise has been privatised yet. The Law on the Privatisation of the State Owned Enterprises, one of the three laws of the Commercialization Programme of State Owned Enterprises, which was to supersede the Law on the Privatisation of the SOEs enacted in 1990 with later amendments has not yet been agreed upon although it had been expected to be approved in 1994..

the contact partners.

Ideally, the team of *Polish twins* should be put together on the basis of two considerations. First of all, it should have good professional qualifications. Secondly, the "twin idea" (know-how transfer) and the "restructuring focus of the project" (need for innovative thinking) call for an appropriate balance to be found between the "young and talented" (to provide innovative thinking and for getting maximum long term benefit from the know-how transfer) and the "old and experienced" (established network of contacts and prestige vis-a-vis decision takers).

The first team of nine twins was chosen on the basis of a call for tender. One of the twins came from the MOIT, the others from a variety of institutions. The professional qualifications were very convincing, but the team was tilted towards "experience": three were in the twenties, the other nine in the 40s, 50s and 60s. Two of the members were well-known sector personalities: Mr. Cherubin, is "Mr. district heating" in Poland, a strong personality widely respected by the district heating community; Mr. Duda in many ways held a similar position in the power sector. While such a recruitment has obvious advantages it has also its risks<sup>20</sup>.

The stability of the team is high. The original legal expert was replaced in 1993 by Mr. Muszynski (a strong replacement), otherwise the team in April 1995 is the same.

In connection with the extension of the project, the team was supposed to be expanded with four twins - for energy savings, training, finance, energy planning. This time, the team was not chosen on the basis of a separate tender for twins, but included directly in the technical proposal as part of the team. In the end:

- The finance position was not filled by the proposed candidate, the "privatisation twin" was used instead. This was a good decision. He is young and talented, but had not enough to do in privatisation as such. To merge the privatisation and finance functions made good sense. In addition, it is particularly fortunate to have an experienced twin to provide continuity and contacts in a situation where the original financial expert quickly left the team.
- The proposed candidate for energy savings was never recruited; his replacement Mr. Parczewski comes from the Polish Academy of Science
- The other two twins both come from the MOIT, a choice which can be interpreted as an effort to provide training to MOIT staff.

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<sup>20</sup> The advantages in terms of decision taking influence are obvious. In addition, due to the split up of the district heating sector into 500 enterprises it is an advantage for a minister to have one person he can make "accountable" for the reform process in the sector. The risk of the time of recruitment of such personalities is that one cannot know beforehand (i) whether they will be able to adjust their thinking (they are asked to reform a system they have helped to build up and therefore in many ways will identify themselves with) and (ii) whether they will be able to work as team members, be able to listen and cooperate instead of going "solo".



All three new twins are in the 40s, which reinforces the "experience" bias of recruitment. The resulting 9:3 composition of old:young is regrettable. But otherwise, the project must be complimented for its ability to recruit a strong and stable "twin" team.

In June 1995, the foreign natural gas, district heating, energy saving and legal experts change status to ad hoc short term experts; and the contracts of the USAID and UK-KHF funded "twins" are ending, a situation which is taken up under recommendations.

(b) Administrative efficiency and logistics

The project manager, Mr. Sonck established an efficient office administration. The secretary services and logistics are well functioning. The book keeping and accounting system is well organised.

A curious failure is in budgeting: the PHARE budget line for travel in Poland covers only expenses born by Polish staff, not by international staff (apparently due to a decision by the MoIT). Therefore, the international staff travels very little inside the country on official missions.

(c) Reporting

The quarterly progress reports prepared for the PHARE programme are too lengthy and too repetitive (maybe reflecting that not much was happening in the project) to serve their purpose: to inform overburdened PHARE officials adequately about project progress and factors which influenced results. Some sections of the reports show the drawbacks of word processing technology: you grab the previous text and add/delete a few words and a new report is ready. The introductions written by the managers are too anonymous to give a proper indication of what results were achieved and what kept progress from being realised.

However, the lengthiness of the quarterly progress reports is caused by the dual "PMU-Quarterly Report" and "Technical Assistance Quarterly Progress Reports" nature of the reports. The team followed the format proposed by PHARE in the January 12, 1993 note to all PHARE-Energy PIU on "Quarterly Activity Reports".

(d) Work as a team

A major achievement of the project manager is to keep a team spirit intact in a potentially quarrelsome team:

- (i) while the international composition of the team is ideal for constructive discussions, it can also lead to tension due to differences in "national ideologies" for how things are approached;
- (ii) highly talented and ambitious professionals were put in a situation where their talents were sub-employed which created a fertile ground for deep frustrations (they were felt) and could have degenerated into cynicism (mainly kept under control);

- (iii) the Polish twins were of good quality from the start and learned quickly from their counterparts; thus, their position changed from assistants to equal partners, a development which could have given tensions as they increasingly asserted themselves. Indeed, some tensions did arise at times e.g. when the foreign consultants felt left out of internal sector debates in which the Polish twins participated.

But these were minor incidences. In general, there was and is mutual professional respect in the team.

The cross-sectoral and multinational synergistic potential of the team is exploited in internal discussions and in internal position memos; and in common work on individual enterprise issues. The major area of team work has been in the drafting of the energy law. But also in the performance of the management consulting function examples of productive collaboration abound. The district heating experts, coal experts, power experts, corporate planning experts and privatisation experts analyzed the privatisation options for a CHP plant owned by a mine; the gas and corporate planning experts had a fruitful collaboration in the evaluation of business plans for individual divisions of PGNiG; the power & lignite experts worked together with the corporate planning experts in the evaluation of business plans for individual power companies; and the district heating experts used the corporate planning experts to draw up a detailed TOR for a project to train managers in the district heating sector.

(e) Management style

Faced with a hostile environment at project start, *the style of the ERG became low-key, adaptive and reactive*. The ERG accommodates rather than takes an offensive position to get reforms moved forward. The reactive, inoffensive style was probably necessary at project start. With the very limited active political support provided by MoIT ministers to the group it is not likely that a more assertive style could have produced results - unless the donor community had been willing to put pressure on the MoIT to show more active interest in getting results out of the expensive investment in the ERG.

The reactive style, however, has resulted in a certain loss of direction: work has become piecemeal and there is a lack of feeling of forward movement towards a clearly defined goal. The reactive style can, for example, be witnessed in the passive attitude towards public sector reform where ERG management refers to other initiatives in this area to justify its passivity. (see section 3.2.3.a).

Since the ERG has managed to gain respect and establish good work relationships it should become more assertive during its last year of operation and demonstrate the intellectual/conceptual leadership which is commensurate with its size and talent.

*The project is managed not like a "project" - with clearly specified objectives, milestones and time tables - rather it is run like a "Government department" which responds to ad hoc requests for information and for analysis.* There is no sense of urgency in the project - that the project will finish soon and that before closure it is necessary to leave specified achievements behind. The Polish counterpart management team knows that much work remains to be done when the project finishes in March 1996. From this, the MoIT staff seems to draw the conclusion that PHARE will

respond to the unfinished nature of the business either by prolonging the project a second time, or by initiating a new project.

ERG management believes that it is not productive to set timetables for result achievement, because the achievement of results within the estimated time is subject to political factors beyond the control of the ERG. Therefore, management believes it should be complimented for its unwillingness to set deadlines and milestones as a demonstration of (i) its realism and (ii) its emphasis on producing "reform strategies not to be shelved but to be implemented". This reaction, however, misses the point of timetables for project work: to check if a project is on track in result achievement; and if not, to make appropriate adjustments either in the results to be achieved or in the approach for achieving the results. Milestones are set to ensure reflection! No professional manager in a private company would abstain from setting timetables for the achievement of a formulated strategy because of the uncertainties and the unpredictability of the market place!

(f) Working relationship with the client organisations

By mid-1994 the ERG had overcome the initially hostile attitude of the local energy community. There is now general respect for the work of the ERG and active interest in its assistance.

The assistance of the MoIT to gain access to company information is no longer needed. In particular, a close collaboration has been established between the PGNiG and the ERG in company restructuring. In recognition of the value of ERG's work, the manager of PGNiG signed a cooperation agreement in November 1994, giving the ERG full access to any wanted information without first passing through the MoIT. It is sad that it took two years to get that far; in the meantime, the gains of the companies from ERG assistance have been below their potential<sup>21</sup>.

While there is a good working relationship between individual MoIT/MPPC and ERG staff, very few meetings take place between the manager of the ERG and deputy minister Gabrys - about 7 meetings per year of less than one hour.

In his letter of September 3, 1994, Minister Gabrys proposed to "establish task forces staffed by employees of both ERG and Department of Energy and Solid Fuels (DESF)" in the following areas:

- upgrading the energy policy according to decisions of strategy
- preparing a preliminary concept of financing energy sector development with money from energy companies, domestic and international sources
- preparing a programme of establishing ERA
- preparing secondary legislation
- training programmes for ministerial staff

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<sup>21</sup> None of the companies in the power sector have so far submitted any of their business plans to the ERG for comments or for information.

(g) Work productivity

Productivity of work has two components: (i) efficiency in carrying out assigned tasks and (ii) effectiveness in terms of final result achievement. Whereas the effectiveness of work was affected by external constraints (and, to a lesser degree, by management style), the efficiency of the group has been high. The written output of the ERG is voluminous and of good quality, and company/ministry requests for information and for analysis are speedily complied with.

### **3.2 Efficiency in the Performance of Advisory Tasks**

#### **3.2.1 Provision of technical advice to MoIT and MPC on policies for restructuring**

(a) Assistance in the drafting of the energy law

The first draft energy law was prepared by a team of Polish experts led by the former Minister of Industry, Mr. Tadeusz Syrczyk. In principle, the ERG's role is to provide detailed comments on the drafts which are prepared; to draw up detailed lists of secondary laws which have to be prepared; and to provide detailed comments on the drafts for secondary legislation. In practice, the ERG ends up writing most of the texts; the ERG deletes, drafts, amends and advises MoIT on the reaction towards other ministries and institutions. Particularly detailed work was done on the February 1993 and July 1993 drafts; in the spring of 1994 detailed meetings were held with Minister Czerwinski and other staff of the ministry<sup>22</sup>.

Following a request of MPPC, the two district heating experts on the ERG team prepared a Heat Supply Act late 1993 / early 1994. The MPPC was of the opinion that the first drafts of Energy Law concerned mainly power and gas subsectors and that heat supply problems were regulated insufficiently. The draft Heat Supply Act after corrections following discussions with MPPC was transmitted to the district heating sector for comments. After a public discussion arranged by MPPC the accepted draft was officially sent to the Minister of Industry and Trade. As a result of this action, a meeting of MPPC and MoIT management was arranged and it was agreed that principal regulations concerning heat supply should be included in the draft Energy Law. The proposal to connect these two acts was prepared by the ERG district heating advisors and after discussion presented by MoIT and MPPC as a common draft for interministerial co-ordination<sup>23</sup>.

The work on energy legislation is a time consuming task for the ERG (i) due to the way the

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<sup>22</sup> ESMAP provided comments to the February 1993 version and submitted its proposal for an Energy Law in October 1993, which, however, was rejected by the Polish authorities.

<sup>23</sup> The district heating experts consider the integration of the district heating subsector in the energy law a major achievement of their effort. According to the district heating experts, at the beginning of their work some ERG members presented the opinion that only the MoIT was a client for ERG and were against contacts with MPPC.

consultative process is organised in Poland (whenever a new draft is prepared it recircles for new comments among related organisations), (ii) due to the reactive position of the ERG in the preparation of the drafts and (iii) due to the frequent attempts by other institutions to change basic objectives and principles of the law (see quotes in chapter 5 "Constraints"). Literally hundreds of comments have been received during the preparation of the various drafts, and the ERG and the MoIT have to react to these.

The work on the draft laws is a truly collaborative effort by practically all ERG members. Their internal discussions provide a first class forum for clarifying issues and developing clear thinking on the principles of sector regulation in Poland. The ERG is presently the only institution in Poland which has a clear understanding of the objectives and principles for energy legislation in a market economy. The quality of ERG's papers and oral presentations on the subject is superb.

A detailed and well-argued paper on the requirements of the Energy law for secondary legislation was presented by the ERG and discussed with the relevant outside sector experts at a meeting in December 1994. This paper is a solid framework and guideline for the further work on secondary legislation.

Unfortunately, the process aspect of the work (the most efficient means of communication) was neglected by the ERG. The key outsiders working on the draft law do not participate in the internal discussions of the ERG, they are only presented with the final outcome of the discussions in the form of written ERG comments and explanations at work group meetings<sup>24</sup>. The fact that the draft law is so little understood by Polish experts demonstrates that the ERG paid too little attention to the process aspect of law preparation.

(b) Policy advice on the structure for the four subsectors

The advisory services provided by the ERG to the MoIT and to the MPC on the future structure and regulation of enterprises in the four subsectors were of great value for three reasons:

- \* Firstly, the ERG's presence enabled ministers to get neutral advice thereby counterbalancing political lobbying of narrow sector interests. Without the ERG, the ministers would have had to rely completely on the recommendations of the companies for their own restructuring; the ministerial staff is too weak to provide a qualified opposition to company proposals.
- \* Secondly, its work as management consultant to the companies enables the ERG to look behind the scene. The meetings with the companies revealed the lack of coordinated government policy and many bottlenecks that are obstacles for the commercialized companies to act according to market rules. ERG experts due to their constant presence

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<sup>24</sup> During the fall of 1993, the Polish legal expert participated in daily working meetings in MoT together with a lawyer from PSE. Furthermore, he spent a full week together with the person from the MoT responsible for the law project and the PSE lawyer outside Warsaw in order to assist in the preparatory legislation work.

and good relations with the field enterprises had a better understanding of those problems than any other group of experts.

\* Thirdly, due to the broad experience and analytical quality of the group.

The power & lignite experts presented a number of important discussion papers on contractual relationships in the power sector, e.g. between power stations and lignite mines. The coal experts had a very important role in the preparation of the stage 2 and stage 3 plans for the restructuring of the coal mining sector.

The natural gas experts were less involved in this type of work, as there is only one company in the gas sector.

The first energy saving expert provided inputs to the discussions leading to the creation of the Polish Energy Saving Agency.

Since the district heating subsector is very heterogenous and a local affair, the specific contributions of the district heating experts for sector restructuring are difficult to evaluate because they are "spread". However, in the important field of pricing and tariffs, the district heating experts have provided concrete proposals for tariff formulas; they are frequently consulted by the Polish Chamber of District Heating Companies; and they provide active support towards the creation of the six heating regional training centres for district heating. The draft energy law foresees a decentralised structure for the regulation of the district heating sector - the responsibility is entrusted to the voivods. In principle, this could lead to the creation of up to 50 local regulatory agencies, depending on the number of regions that finally will be set up; presently it looks as if somewhere between 8 and 15 will be established. The district heating experts have the priority task to develop consistent concepts for the organisation of the regulation including appeals possibilities.

### 3.2.2 Advise to company management on enterprise restructuring and corporate planning

The work of the ERG in this field is its primary success story: it is thanks to the consistently high quality of its management consultant services provided by the experts in natural gas, power & lignite, coal, corporate planning and privatisation experts that the ERG was able to overcome the original hostility of the enterprises against its existence.

Many district heating companies have been corporatized; but as long as there is a unitary national pricing regime and metering insufficiently developed, none of the district heating companies can be said to be commercialized. Typically, corporatization has not been followed up by internal reorganisation; and therefore, assistance of the ERG in this matter has not been asked for. However, the district heating experts have been involved in cases involving privatisation of industrial CHP and cogeneration plants.

The laudatory comments on company restructuring must be subject to one qualifying remark: the ERG did not work on the internal reorganisation of the companies assisted by the ERG; its assistance was mainly "limited" to assistance in the preparation of business plans. This is a pity:

whatever concepts are conceived for sector restructuring, they are implemented through reforms that take place at the micro level; and internal reorganisation is a precondition.

### 3.2.3 Thought leadership

#### (a) Development of concepts for institution building

The development of concepts for overall strategy and policy in energy sector restructuring is a key obligation of the ERG: from the start there were "institutional holes" in the plan for restructuring which had to be filled and as time passes, concepts have to be adjusted in the light of political realities.

The ERG has the size (amounting to 50% of the energy sector staff in the MoIT and MPC), the experience and the analytical-intellectual capacity to come up with important contributions in strategy. Yet, although the ERG demonstrated genuine thought leadership in its proposals for energy legislation, power and coal sector restructuring and in the preparation of the energy policy paper, it has not made use of its potential to develop a coherent vision for the future institutional structure in Poland. The most important omission is the lack of work on defining future structures for the DOE and the ERA and the detailing of the practical division of labor between the two.

For a successful introduction of the ERA concept it is absolutely essential that the ERA is properly staffed from the very start. The energy industry is used to do more or less as it pleases, and managers are convinced they will be able to control the regulator - a phenomenon referred to as "regulatory capture". The ERG, however, has not developed any concepts for *how the staffing of the ERA could be properly prepared before the ERA is set up* officially. ESMAP, as can be seen from the quotation at the start of this chapter, had given some thought to the matter - although the recommendation to build up a core staff for ERA around a group of staff in the MoIT does not reflect sufficient in-depth thinking. MoIT staff has neither the expertise nor the status to do the job. The recommendation, however, is accepted by the MoIT which intends to transfer about eight of its staff to ERA. That would be a prescription for failure!

In order to live up to its name, the ERG has the responsibility to present a plan for the development of a "least cost" institutional structure for efficient policy making in Poland. First of all, it is clear that the DOE as it is now cannot perform the policy making role satisfactorily and secondly, it is listed in the TOR for the prolongation of the project. Yet, work on the reorganisation of the energy department is not included in the lists of tasks of any of the individual ERG members, a mistake of the technical proposal for prolongation which was followed in practice: as late as March 1996, the ERG had not taken any initiative to develop a concept for the future policy making structure.

The ERG team put forward three justifications for its passive attitude in this area:

- \* *The future energy structure is still unclear.* The proper structure for the Energy Division/Department depends on the scope of competencies of the Minister after achievement of reforms. The structure of new organs, mainly ERA depends on the scope of the competencies of those organs as an output of the legal frame which in the end is

adopted. The concept of establishing ERA was strongly opposed by Ministry of Finance, and till the fall of 1994 there was no certainty that the concept would be finally accepted. The MoIT must make decisions on such issues as the scope of autonomy and the structure of ERA, its role in regulating prices and the style of regulation; these decisions have not been taken yet.

- \* *We have to await decisions on public sector reform in general.* The Government has established a special task force for the modernisation of the economic ministries led by a former Minister of Industry and Trade <sup>25</sup>. Other PHARE-programmes are already active in the modernisation of public administration such as the OMEGA programmes for the restructuring of the Public Administration.
- \* *Other technical assistance projects have been committed to this work.* Negotiations on a project for the organisational structure for energy policy making have been held with the Dutch ECN centre <sup>26</sup>. Negotiations have been held with ESMAP since early 1994 for a (Dutch funded) technical assistance project for the establishment of the ERA and the preparation of secondary legislation <sup>27</sup>. The ERG waited for the start of these activities.

All three arguments illustrate the passive, reactive attitude of the ERG in sector reform which has been pointed out already under section 3.1.c.

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<sup>25</sup> The Government issued policy guidelines on "The Basic Goals of Public Administration" in April 1993. A special "Office for the Public Administration Reform" has been established within the Council of Minister's Office.

<sup>26</sup> A grant for this purpose was committed by the Dutch Government in 1994. Final edition of the TOR has been suspended following the order of Minister Gabrys, due to the above mentioned Government plans of ministerial reorganisation.

<sup>27</sup> Negotiations started early 1994 and suspended by the World Bank late 1994 - due to the delays in the adoption of the Energy Law. Discussions are expected to resume with a visit by an ESMAP expert to Warsaw in May 1995.



In response to the first argument, it must be pointed out that a proper strategist not only reacts to events, he also actively seeks to shape the future, including the external environment. The ERG, as the elite policy advisory institution cannot wait for others to take decisions before it reacts. It has to seek to influence decisions by coming up with high-quality proposals to policy makers before their decisions are taken.

The second argument overlooks that the ERG is the lead institution for sector restructuring. The ERG is the best placed and best informed group to provide a "blueprint" for the reform of the energy administration. No other institution has the broad in-depth knowledge of energy sector problems which the ERG has; and what demands these problems pose for sector coordination and intervention. If the ERG believes in its elite role it should come up with constructive inputs to the reform work of the task force on the grounds, that otherwise second best reforms will be proposed and adopted. In order to avoid "turf" conflicts and step on sensitive toes, the ERG proposals should not be publicised but submitted with due regards of confidentiality to pertinent reform officials.

The third argument illustrates, inter alia, the absence of milestones and timetables for ERG outputs: although the organisation structures for the ERA and the Department of Energy are priority issues, the ERG waits passively for others to start the work. Above all, the argument does not pay attention to the interconnectedness of the future structures for the ERA and the Energy Department. The work is entrusted to two different projects being managed by two different organisations. The ERG, of course, will impose conditions of coordination upon the two and by supervising the work of both be able to intervene constructively if problems occur. Yet, the work of the two projects will be more productive if the ERG defines a general overall concept for the two institutions to serve as a common framework for the two projects to work under before they start their work. The ERG should prepare proposals for a practical operational division of work between the two institutions and for how an efficient "minimalist" staffing policy can be implemented taking into account available resources in other existing institutions.

#### (b) Communication

A tool of influence which is insufficiently used by the ERG is the arrangement of seminars. ERG members have been invited to give speeches at inter-ministerial seminars, at seminars for communes and to e.g. members of the labour union in energy supply companies to explain the necessity of restructuring. ERG staff have held informal informative meetings with relevant members of the Polish Parliament. But on the whole, too few seminars are given by ERG members in Poland - ERG staff may have given as many lectures on reform issues at international conferences as they have in Poland<sup>28</sup>.

The need for active ERG involvement in seminars is illustrated by the work on the drafts of the new energy law. There are few public debates in Poland on the energy law. And although a rather large number of sector experts have been involved in providing comments to the various energy

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<sup>28</sup> The exceptions are Mr. Cherubin and Mr. Szablewski who are frequent attendants at Polish seminars. Mr. Cherubin also lectures at the technical university of Warsaw on regulatory and organisational issues in district heating.

law drafts, it is evident from ERG comments to the IEA report on Poland (see quotes in the next chapter) that the rationale of the scheme is insufficiently understood by the Polish sector specialists who work on primary and secondary drafts.

### 3.3 Efficiency in the Provision of Training

The ERG project provides training in three ways: (i) through the transfer of know-how from the foreign experts to the "twins", (ii) through training seminars on various topics (e.g. management issues) arranged by ERG staff for client organisations (project target group) and (iii) through the "formal" training activities for Polish energy institutions arranged by the training expert under the budget assigned for this purpose in the project.

The first two means of training were efficiently performed. The twin concept proved its value in practice and the seminars arranged by the different experts covered priority topics. The formal training of the Polish energy institutions, however, received too little attention in the project. The foreign training expert was employed on a part time basis. He did not have convincing qualifications for the job and never managed to develop a proper concept for training. A twin was not assigned before November 1994.

A training programme for MoIT staff is properly prepared through a four step procedure. First of all, the future role for the DOE and its organisational structure is specified. Then, the skills requirements for the fulfillment of the future functions are defined. Next, existing skills gaps are identified by a comparison of skills requirements with the qualification profiles of DOE staff. Finally, this gap identification is used to draw up a targeted training programme for staff. Since the ERG never did any work on the first part of this exercise, the training expert was forced to draw up his training programmes in a vacuum and on an ad hoc basis. The most valuable activity was a two weeks training course organised during September-November 1994 by the Privatization Centre for staff from the Energy Department of the MoIT on legal, financial, and strategic issues in enterprise restructuring.

Lacking a vision for what is to be achieved, the 1995 training programme prepared in November 1994 by the Polish twin is very simple<sup>29</sup>. It foresees a few English language courses for DOE staff, a few seminars on regulatory topics in Warsaw and abroad, trips to Bruxelles to introduce MoIT staff to DG 17 and other EU institutions of relevance, trips to Paris to get acquainted with the IEA. The management of the ERG team has turned to "improving the Polish energy administration's understanding of the EU", "improving the knowledge in Poland of EU energy policies" (something which hardly exists in practice!!), "preparing the Polish administration for the future entry of Poland into the EU", "explaining the implications of the European Energy Charter/Treaty for Polish energy and restructuring policy" as the guiding words for ERG's training effort. While each of these are praiseworthy objectives as such, they look like slogans, detracting from the real issue: the job is to assist Poland in developing an efficient administrative structure capable of fulfilling the requirements of a market economy in an efficient manner. If they do so, the EU requirements are fulfilled "automatically".

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<sup>29</sup> It is, however, in full agreement with the TOR for training activities defined for the prolongation of the PHARE-financed part of the ERG project: know-how transfer to the MoIT especially with regard to EU decision taking process and EU legislation.

The replacement for the training expert started his work at the end of January and presented a first position paper on March 2. Being a first introductory attempt, the paper is unclear and the consultant failed to observe that very basic technical training needs for DOE staff are not covered in the programme prepared by the Polish twin (which he endorsed): e.g. financial and economic project analysis<sup>30</sup>. What is praiseworthy though, is his idea to work for the establishment of a training fund and his attention to put emphasis on the implementation of a training programme for Supervisory Boards.

In January 1995, the DOE is as weak as it was when the project started; and unless the approach is changed it will be equally weak when the project is finished. In view of the great importance of the work on the draft energy law and the substantial procedural and coordination problems that have been experienced, it is not comprehensible that the MoIT energy law expert was not given intensive English courses at an early stage of the project lifetime to enable him to participate constructively in internal ERG discussions on the subject.

However, while the formal training effort has produced modest results, the informal training of company managers through ERG discussion papers and through discussions with ERG staff is valuable.

In addition, the ERG prepared several project proposals for training projects. Three PHARE projects were launched: the 250,000 ECU "Management Assistance Training" project, the 150,000 ECU "Training in the Hard Coal Sector" project, and the 64,000 ECU "Training of Supervisory/Management Staff" project. The corporate planning and district heating experts prepared very good TORs for a training programme for management of district heating companies for Danish funding and to be carried out by regional district heating training centres. The first three project documents were not read by the evaluator.

### **3.4 Efficiency in the Exercise of the PMU Function**

The sectoral programmes financed by PHARE are prepared by so-called Project Management Units (PMU) who draw up project proposals, prepare and carry out calls for tender and monitor project progress. The relevant sector ministry nominates a Programme Authorising Officer (PAO) who has the primary responsibility to ensure the link of the foreign experts with other departments/sections of the ministry. Generally, the PAO is the director of the PMU, while the technical work of staffing and running the PMU is given to a consulting firm.

In Poland, the Bureau of the Government Plenipotentiary on European Integration (headed by Minister Saryusz-Wolski) of the Office of the Council of Ministers is the overall responsible for the programming of PHARE-assistance. The ERG acts as the PHARE programme's PMU for the energy sector. Mr. Nowakowski is responsible PAO and Mr. Filipczak, the twin project manager,

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<sup>30</sup> One should take note though that the task description of the new financial expert includes "training of Polish experts in the identification and analysis of the investment needs in the energy sub-sector."

plays the lead role in the technical work. Proposals and TORs are prepared under his final responsibility by experts outside and inside the ERG team.

In theory, the ERG is ideal for the PMU-Energy function: it works in all sub-sectors (except oil) and can thus identify and formulate priority projects. In practice, the core function of the ERG - the provision of management and policy advice - will overshadow the PMU function: the success of the ERG will primarily be judged by its restructuring performance .

*A first criteria for a proper execution of the tasks is in the quality of tendering: preparation of TOR, realistic estimates of budgets, selection of consultants.* This part of the work seems to be well done. The TOR seen by the evaluator were detailed and professionally done, the EU firms on the short list were qualified.

*A second criteria for a proper execution of the PIU task is the quality and the scope of the annual programmes presented to PHARE for adoption under its annual country budget.* The list of projects prepared or executed by the ERG is attached as annex VIII. Out of the 19 projects with a total budget of 7.1 MECU <sup>31</sup>:

- seven projects (nos. 1,2,3,4,5,8,11) totalling 4 MECU cover the cost of the PHARE financed part of the ERG operation;
- three projects "no. 16 Energy Policy Guidelines", "no. 17 PHARE Co-Investment Data Bank" and "no. 18 "Energy Law Implementation" totalling 1.1 MECU cover activities directly related to ERG work, partly overlapping and partly expanding its TOR;
- three projects (nos. 6,7,19) totalling 1.3 MECU were in the coal sector <sup>32</sup>; two projects (nos. 9,10) totalling 0.7 MECU were in energy savings; two projects amounting to 0.2 MECU were in district heating; and two projects (nos. 12, 14) totalling 0.5 MECU were in energy/environment.

As far as the scope and the number of projects is concerned, the ERG was a failure:

- \* Only nine projects totalling 2.2 MECU are "outside" the ERG framework (which however, in itself covered all subsectors, except oil)
- \* The 1994 programme was prepared on an improvised basis by the PHARE desk officer in Bruxelles, as the ERG did not draw up a proper programme in time for the deadline.
- \* In 1994 only 2.2 MECU out of the PHARE programme's 200 MECU allocated for Poland

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<sup>31</sup> Another budget list prepared by the ERG for the evaluator showed totalled commitments of 9 MECU 3 MECU from PHARE 91 PESAP, 1.3 MECU from PHARE 92 FIESTA, 3 MECU from PHARE 93 ERP, 2.2 MECU from PHARE 94. Presumably, the PHARE 94 funds have not yet been "filled up" with project proposals.

<sup>32</sup> Two of the projects were prepared by an ERG staff member whose firm afterwards won the contract. One of the contracts was below the 50,000 ECU limit and thus awarded without tendering; the other 150,000 ECU contract was awarded after tendering. Such practices must give rise to lifted eyebrows. However, the amounts were small, the activities were high priority and the firm has outstanding qualifications in that area. In cases where all these three criteria are fulfilled, one must be pragmatic.

are dedicated to the energy sector. This share is probably the lowest of any PHARE-TACIS assisted country

- \* A project proposal for funding under the "strategic transport links" fund of the EU had to be rejected as it was not justified by a genuine need: there was sufficient capacity in the existing telecommunication links for power between Berlin and Warsaw.

The investment level is surprising in view of the quality of the team. However, the team is not used for brainstorming on project preparation. While the foreign consultants (with their twins) were busy preparing programmes and project proposals for a number of bilateral and multilateral aid programmes, they worked little on preparing proposals for PHARE funding.

The ERG provided two explanations for the performance:

- \* "The low ratio of PHARE funds devoted to energy is due to the focus on direct advisory support in this stage of reforms in stead of spectacular study-funding. Phare funding should be mainly concentrated on studies which are of immediate use for decision making process and not just to produce shelved reports" . In other words, *it was not possible for the ERG to identify high value projects.*
- \* "Financing of sectoral programmes depends on Government priorities as fixed by the Bureau of the Plenipotentiary. Within the structure, the ministry has limited influence upon the financing of sectoral programmes. During the allocation of funds coming from PHARE 94, the energy sector was absent from the list of Governmental priorities. Only thanks to the ERG and its smooth co-operation with Brussels it was possible to obtain funds not only for 1994, but also for 1993 and 1992. The energy sector has been supported as part of other programmes: SERP'94, ERP'93, FIESTA'92. In 1991 only the energy sector was supported directly under PESAP." In other words, *the low project level was due to priorities fixed by higher ranking decision takers who could not be influenced by the ERG.*

If the ERG by preparing a well-argued and long list of high-priority energy projects to the Bureau could have influenced the Bureau to increase the PHARE-allocation given to the energy sector, the ERG can be criticized. However, the ERG insists that this would not have made a difference and that the criteria for decision taking in the Bureau are not very transparent. Whatever the reason, the lack of project ideas gives rise to concern as to whether Poland will be able to generate sufficient and qualified investment proposals for the new and potentially large cofinancing scheme of PHARE. In this regard it is encouraging that the ERG has prepared a document "A contribution of the energy sector to the PHARE Indicative Programme 1995-1999 for Poland" which foresees a substantially expanded level of activities.

*A third criteria for a proper execution of the PIU function is a high level of information services to foreign and national consultants looking for information on project opportunities. Providing good information encourages consultants to take contact with the PIU. This widens the knowledge of the PIU of consultants in the field and widens the range of choice for the short lists. In addition, project ideas can be generated through these visits. Unfortunately, also in the field of information the ERG failed - foreign consultants complain that they cannot get any information at the ERG but have to go to Bruxelles to get information on what is being prepared in Warsaw. However, the low information level is linked to the low number of projects - when there is little*

of interest to tell consultants, the information level becomes low!

*A fourth criteria for a proper execution of the PMU function is transparency in project preparation and in tendering.* Transparency is important for two reasons: it promotes a fertile ground for the generation of ideas which improves the quality of the programme and it reduces the risks for and unjustified accusations of kick-backs in the awarding of contracts. Corruption in government bureaucracy is a potential problem in Poland and the ERG must provide a good example for how these risks can be reduced through proper procedures<sup>33</sup>. The ERG failed in this respect - the transparency of project preparation and of tendering is low: the 1995-99 indicative programme was prepared by a narrow circle of ERG staff, the foreign experts on the team do not seem to have an idea of what's going on and the PHARE desk officer from Bruxelles (the only foreigner present) experienced during a day long tender evaluation frequent and long interruptions due to conversations in Polish among the other participants who knew that she was not able to understand the language.

To draw a conclusion: (i), it seems justified to conclude that it is better in the future to entrust the PMU function to a small unit for whom the performance of this function is **the** success criteria and not a secondary side activity; (ii) the ERG scores well on technical competence in project preparation and tendering; (iii) the low score on project identification depends on the role of the Bureau; (iv) the low score for information services is related to the low activity level, which also to some degree can explain the low transparency of project preparation.

### **3.5 Coordination of Work on Energy Sector Restructuring in Poland**

#### **(a) Coordination of international assistance**

Having staff of nationalities from some of the major donors on its team, being promoted and assisted by the World Bank at the early stages of its birth, having a broad sector expertise represented on the team, working across the field in the Polish energy sector and having Polish staff with very broad contacts puts the ERG in a unique position to act as a neutral coordinator / provider of ideas and forum for exchanges of opinion in Warsaw. There is no other institution in Poland capable of providing an equally impartial and objective overview of the situation to donors. The donor community, therefore, has a strong interest in developing contacts with the ERG in order to use the ERG for brainstormings on project identification and for information on the status of reforms.

Yet, in spite of its strength and genuine donor interest in seeing the ERG take up a lead consultative role, the ERG took few initiatives maybe reflecting a lack of self-confidence during its first year of difficult existence. Things started to change at the end of 1994, when the ERG became active with a series of information seminars. The ERG arranged a general information meeting on ERG work for donor's in December 1994 which was very well received; and the

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<sup>33</sup> Transparency is part procedure, part psychology. The evaluator admits that it is as difficult for him to define transparency as to define good art: "I can recognise it when I see it, but I cannot define it".

general reaction of non-ERG participants during the meeting was "why didn't we have such a meeting already a long time ago"? It is being followed during the winter and spring of 1995 with information seminars on a number of specialised topics.

But whereas the ERG as a team did little to promote coordination among donors before December 1994, the experts took important individual initiatives (which is a pragmatic way of fulfilling this function). The Danish district heating and energy saving experts were asked by the Danish Energy Agency to assist in the drawing up and the coordination of the 1994/95 programme of Danish funded assistance to the Polish energy sector. In addition, they held meetings with Norwegian Institute for Energy Efficiency and with Swedish NUTEK for the definition of fundable energy saving projects. The coal experts assisted in the project definition of the US-TDA study "Feasibility study on the proposed modernization of three coal mining companies in Poland", the UK-KHF study "Feasibility study on the proposed modernization of three coal mining companies in Poland" and the World Bank Sector Adjustment Loan. The natural gas and power experts took similar initiatives.

(b) Coordination of work with new Polish sector institutions

The *Energy Efficiency Foundation* and the *National Energy Conservation Agency, NECA*, with its associated *Regional Energy Conservation Agencies* are natural cooperation partners for the ERG. The ERG has limited contact with the first institution. NECA is the main contact and cooperation partner for the energy saving experts. The first energy saving expert assisted in getting the NECA established and in securing 200,000 ECU from PHARE to finance projects during its first two years of operation. His successor continued the close collaboration with NECA, inter alia, acting as facilitator for the securing of a 70,000 ECU grant by the Danish Aid Programme for Eastern Europe for the operation of the agency.

(c) Coordination with the EC Energy Centres in Poland

The THERMIE programme of DG 17 has three energy centres in Poland: the EC Energy Centre Warsaw, the EC Regional Coal Centre Katowice and the EC Regional Renewable Energy Centre Elbjag.

The Elbjag centre is not yet fully operational, and its field of interest is rather far from the ERG's area of work.

The coal experts have very good contacts with the Katowice coal centre and have collaborated and actively participated in some of the initiatives undertaken by the centre.

There is no collaboration between the Warsaw Centre and the ERG, although the centre manager has tried to get the ERG interested in his assistance - he is just seen as yet another consultant looking for work and money. However, the Warsaw centre could be used for information purposes and for project identification.



## 4. RESULTS

*"Performance control: There is no defined product that ERG effort can be measured by. Since neither commercialization nor privatization are ultimate goals but rather some measures leading to strong and efficient economy, the number of commercialized or privatized enterprises cannot be taken to measure ERG success either. Engagement of ERG experts in a broad discussion, direct exchange of points of views with large representation of the industrial management produces no material paper reports. It is however a very important factor of pursuing the mental change of the new generation of the Poles and their understanding of a market economy and getting them ready for market behavior. This role of ERG cannot be overstated."* (Marek Grzybowski, August 31, 1993 on ERG Mission)

### 4.1 ERG as Policy Advisor on Restructuring

#### (a) Provision of continuity and promotion of consensus

During times of frequently changing ministers some of whom, in addition, were inexperienced, the ERG provided continuity of effort and of approach - without its presence the work on the energy law would have gone off the track.

On the one hand, the ERG's presence enabled ministers to get neutral advice thereby counterbalancing political lobbying of narrow sector interests. Without the ERG, the ministers would have had to rely completely on the recommendations of the companies for their own restructuring. On the other hand, this position also helped the companies. The meetings as management consultant with the companies revealed the lack of coordinated government policy and many bottlenecks that are obstacles for the commercialized companies to act according to market rules. The ERG managed to draw Government's attention (via MoIT) to existing bottlenecks and to the need of working out national solutions.

The neutral position of the ERG and the quality of its arguments furthermore served to bring about a certain harmonization of views among sector staff. At the start, sector staff had widely diverging and strongly argued views; the intervention of ERG helped to narrow down the differences.

#### (b) Draft energy law and Energy Policy Paper

The ERG's coal mining experts were able to provide comments on the drafts of the new *Geology and Mining Law*. The law regulates the ownership and the right to explore and extract natural resources. The law was passed by the Sejm in February 1994 and effective from October.

The *draft Energy Law* sets out the principles for the regulation of supply and use of fuels. There is general agreement among experts that the November 1994 draft is a good quality law and that the

ERG was instrumental in getting it to the present stage of development.

Minister Gabrys announced his intention to introduce the draft law to Parliament in February. But since previous timetables for the discussion of the law in Parliament have not been kept, neutral observers have a "wait and see if it really happens" attitude.

(c) Energy Policy Paper

The energy law when presented in Parliament is accompanied by an energy policy paper. The first draft written by experts outside the ERG was rejected; and Mr. Duda, the power & lignite twin was asked by the minister to prepare a new draft which was accepted<sup>34</sup>.

(d) Power sector restructuring

The ERG experts, Messrs. Duda and Alridge can be credited for (i) pointing out a number of weaknesses in the original concepts for the restructuring of the power sector; (ii) for providing well-analyzed proposals for contractual relationships in the power industry, e.g. between lignite mines and power companies; and (iii) for drawing attention to the risks of the overly dominant position of the PSE in restructuring and in operating the future system - the PSE is using its position as the lead agency for power restructuring to define a longer range of responsibilities for power sector planning and investments for itself than is rational. The critics on the weaknesses of the "English" model were not always welcomed by the chairman of the PSE, who accused Mr. Alridge of old-fashioned thinking. However, the critiques were sound and must have made a mark on the work of the PSE in restructuring - the PSE has defined what can be called a Polish model for power purchase contracting that looks more realistic than the Coopers & Lybrand proposal; less than 30% of total supply will be traded through the power pool, the rest will be covered by PPAs won through competitive tenders.

(e) Coal sector restructuring

The ERG coal experts have managed to play an important advisory role in the restructuring of the coal sector. They provided insightful comments on the stage II restructuring plan, and prepared their own proposal for stage III for the minister, competing with the plan made by the Hard Coal

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<sup>34</sup> The paper has good qualities but would have benefited from a critical review of ERG team members before it was submitted to the Government. In particular the parts on energy efficiency deserve to be polished up, inter alia, by making benchmarking comparisons with e.g. Germany on specific consumption figures in a number of sectors: heating of residential housing in GJ/m<sup>2</sup>/year, efficiency of coal and lignite fired coal plants, energy consumption in energy intensive industries such as cement, steel, glass, fertiliser. The delay in the presentation of the energy law presents a good occasion for an updating of the paper, also because the work of the ERG energy planning experts presumably has produced some new and relevant statistics in the meantime.

Agency.

(f) Energy savings

The first ERG energy saving expert assisted in the promotion of the *National Energy Conservation Agency, NECA*. He collaborated during the preparatory stages with the later chairman of the agency providing inputs to the development of the original proposal for the creation of the agency. Next, he drew up a proposal to secure 200,000 ECU of PHARE funds to cover operational costs of the agency and got it accepted by PHARE.

(g) District heating reforms

The district heating experts contributed to a change of thinking about the heat tariff and pricing system. Now both the ministries and the district heating enterprises are firmly in favour of two-part tariffs. In addition, district heating enterprises are now changing their contracts taking over responsibility for technical conditions. Also, the district heating enterprises have accepted that the distribution centres should be operated by them and that measurement should be done at that level.

#### **4.2 ERG as Management Consultant on Company Restructuring**

The management consultant role is together with ERG's work on the energy law the area where ERG provided its most valuable contributions. The assistance provided in management training in strategy, business planning and company restructuring (including detailed comments on business plans prepared by managers) by the gas-, corporate planning-, coal- and power experts was of first class quality. The top management of PGNiG, for example, realized through comments provided by the ERG experts on the business plans produced by division managers that some of these were unable to operate these centers on a decentralized for-profit-only basis.

#### **4.3 Training**

(a) Strengthening of the MoIT

In connection with the prolongation of the PHARE contract in September 1994, a training twin was included and a staff member from the MoIT was seconded to the ERG on a half time basis for this function. As a trainee supported by a proper foreign expert, the twin can develop "personnel policy" skills which can be useful to the MoIT/DOE afterwards.

(b) Training of company managers

The participative "process" of ERG's work in the field of management consulting provides valuable training to company managers.

(c) Training of national consultants

Through the know-how transfer obtained from the twin concept - and from the learning by doing as such - Poland has build up a strong national consultant expertise in areas as diverse as natural gas, district heating, power, legal and regulatory matters, etc. The work of the consultants will continue to provide benefits to Polish society for many years to come.

**4.4 Donor coordination**

The expatriate staff of ERG assisted their national donor organisations with information and with the preparation of project proposals for funding. The district heating and energy saving experts prepared the 1994/95 energy assistance programme of the Danish Energy Agency and assisted Norwegian and Swedish funding organisations in the identification of fundable projects; the coal experts prepared projects for UK- USAID and World Bank funding.

## 5. CONSTRAINTS WHICH INFLUENCED RESULTS

*"Down with the ERG. Foreign consultants shall not decide on the future of Polish power and mining industry"* Text of a banner carried by lignite miners during a strike and protest demonstration in April/May 1994 against the proposed reforms for power sector restructuring (which, incidentally, were not supported by the ERG)

### (a) Weak ministry

When the counterpart is weak, the result of restructuring work is modest. *For historical reasons, the ministry had been weakly staffed* - the most important policy and planning functions were performed by the Hard Coal/Power & Lignite/District Heating Boards, and thus, the best training was given there. The DOE is small having some 40 staff. The most dynamic staff has left the ministry due to low public sector salaries and the low prestige of ministerial work since 1989. The age composition is skewed - no staff in the 20s, a few in the 30s, the rest in the 40s, 50s (largest number) and 60s. It is therefore difficult to design training programmes and career development planning for such an institution. Getting new qualified staff is difficult - it is hard to attract talented staff due to low public sector salaries and the low prestige of public sector work in Poland.

The original idea of recruiting staff on national Government salaries had to be dropped: The salaries were too low to attract the high calibre staff needed to assist in the restructuring of the sector. By going for quality, the Polish staff had to be attracted from the outside or from high calibre "internal" staff which was on the way out; and which certainly had no intention to return to the ministry. Therefore, the training of the twins will not benefit the ministry directly; indirectly it may be by providing the MoIT with good consulting staff to draw on when the ERG project stops. But basically, because of the structural problems, the aim to strengthen the ministry has been dropped. Implicitly, it has been concluded that the ministry is too weak and the age structure too skewed to build up a meaningful reform programme. Thus, the 1995 training programme has character of a "general information cum tourist visits" programme.

### (b) Absence of clear policy commitments to reform in the energy sector

The productivity of the ERG's work would have been substantially higher if its work had been supported by a genuine political commitment by the Government to energy sector restructuring. This was not forthcoming for a number of reasons: (i) In a Ministry of "Industry and Energy", industry issues will always take precedence over energy issues in the minister's attention. (ii) The MoIT's ability to provide genuine leadership and direction to the reform process was weakened by a frequent change of ministers. The ERG had to deal with four different ministers since project start and during the first months the MoIT was not headed by a minister, but by a "minister in charge"! The present deputy minister Mr. Gabrys will be the first minister to have held office for a whole year! (iii) Parliament does not show a great interest in the energy sector; there seems to be little pressure to present the draft energy law for adoption. There is no "energy crisis" - energy continues to be provided, the economy is based on domestic coal, there is substantial surplus capacity in the power industry, and reforms would increase the number of unemployed.

The IEA 1994 Survey of the Polish Energy Sector claims with full justice that the continuous postponing of the submittance of the draft Energy Law to Parliament creates the impression of "losing momentum". In its comments to Deputy Minister Gabrys on the IEA report, the ERG complained in November 1994 that

- \* "It received draft ordinances that were inconsistent with the stated policy of moving towards a market based system and only regulate the market where companies hold a monopoly position... "
- \* "Whenever ERG gets the impression that it has received the final version of the energy law like in May when the *final settlement meeting among ministries* was held or in September when ERG was informed that the draft had been *submitted to and put on the agenda of the Economic Council of Ministers* a new amended version is presented. Every second month has its own version. Since May there is the 25th June draft, the August 30 draft and the 5th October draft".
- \* "Unfortunately the amendments are moving away from the original concept and ideas behind the new system of regulation: (i) In previous versions, the justification for a new Energy Law contained the word "competition" in many different variants and places. In the last version, "competition" cannot be found at all. (ii) The independence of the regulator - the Energy Regulatory Agency has gradually become more and more weak. First the financial independence was deleted, then the board management of the regulator and the qualified grounds for dismissal were deleted; and yes - the President can be removed at any time. Also the powers of ERA has been redrafted in a way which water out the independence of this body. (iii) Furthermore, the abandonment of artificially fixed prices was weakened by adding that energy prices have to be in conformity with the annual State budget. At the same time it was inserted that the price control system of the Ministry of Finance has to continue for some more years (end 1998). (iv) Finally, it has been introduced that energy enterprises cannot be declared bankrupt".

In spite of these criticisms - shared by important donors and finance institutions such as the EBRD and the World Bank - the minister did not ask for an immediate meeting with the manager of the ERG and key sector staff involved in the preparation of the energy law. It illustrates the weakness of the minister's advisory staff in the ministry that such a meeting was not arranged.

The last draft version dates from November 1994, when it was approved by *Economic Committee, KERM*, under the Council of Ministers<sup>35</sup>. It has been discussed by the Parliamentary Commission. But already a meeting a month later to define the programme of work for the preparation of secondary laws, it was evident that the ERG has to fight against attempts by sector experts who are involved in the preparation of the secondary law drafts to revise the scope and liberalizing intent of the November 1994 law draft. In addition, there continue to be differences of opinion within the ERG openly expressed at the meeting.

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<sup>35</sup> It now has to be reviewed by the legal commission at the Council of Ministers before it is submitted for approval by the Council of Ministers.

In the light of this experience one may speculate whether the ERG would have been more effective in gaining ministerial support, if the ERG had been attached directly to the MoIT as an advisory group within the premises of the ministry. It is likely, that this would have made a positive difference; although, on the other hand, this might have made the management consulting function more difficult.

(c) Popular reaction against reforms in Poland

The start of the ERG coincided with a growing popular political reaction against the pace of change in Poland (see Annex II "Socioeconomic Background" for details). Politicians felt that in order to survive they had to keep a low profile on far-reaching restructuring. The energy sector was obviously affected by this.

(d) Absence of well-developed procedures and traditions for concertation

Being a young democracy, Poland does not have the necessary well-developed procedures for "consultation cum consensus building" and for solving technical and political differences between ministries - e.g. at the level of the pertinent ministers who dictate the TOR to their relevant staff once they have reached agreement. The ERG observed in its comments on the IEA report, dated November 9 that "there is a weak coordination and plan for performing this job (drafting of the energy law) or common knowledge of the overall system that is to be developed. The task of preparing a draft is designated to one body which, however, does not represent various interests, nor is there an outline for the content. The draft is then distributed for comments among all interested parties, which, however, do not have common terms of reference or understanding of the whole programme or intent of the new regulations system".

Under communist rule, appropriate coordination was provided by the dual power structure, where formal legal structures were supplemented by and dominated by the power structure of the communist party and the nomenklatura system. Informal basis of power and political directives of the communist party and its power structures often had a larger importance for the bureaucratic institutions than their formal legal foundations. As a result, the formal organisational structures were not always logically coherent. But the unclear formal division of tasks and of authority was overshadowed by the parallel power structure. At this stage of the reform process in Poland, the coordinating and guiding role of the communist party (its Central Committee) has been eliminated; whereas the existing bureaucratic structures are being reformed rather than being replaced by a completely new system. In the Council of Ministers three government committees have been created to coordinate all major Government actions in their areas: the economic committee KERM, the social committee KSPRM and the security committee. At lower levels, however, cross-ministerial committees are hardly found.

Therefore, under the present procedures for consultations, "everything" in Poland has to be solved first at the ground level. Changes that are introduced in a draft have to go around to all interested ministries and companies for comments, after which adjustments are made calling for new consultations and comments, etc. There is no structure where, for example, policy papers can be discussed at high Government level to establish the main principles after which experts can fill out details. Discussions always start at the lower level, a fact which multiplies the consultative

process.

(e) Lack of political interest in energy savings

Both energy saving experts had a hard time and a twin was first provided in November 1994. Domestically produced coal is the dominant fuel in the Polish economy, and where economists see the advantages of energy savings in terms of increased industrial efficiency and cost effective pollution control, politicians tend to see displaced Polish mining workers only.

Environmental consciousness is still too low in Poland to be an effective driving force for energy savings - Poland is one of the most polluted countries in the world, and bad habits change slowly.

(f) Delays in the adoption of adequate pricing policies

The absence of "full cost" prices makes privatisation, restructuring and market oriented planning difficult. Natural gas prices cover operating costs but the revenues are not sufficient to generate funds for replacement of capital and for investments.

Price reform in Poland has been delayed for social reasons and for turf reasons - the Ministry of Finance is used to fix energy prices. This made sense in the socialist economy when the level of prices also influenced the level of state budget allocations to companies. But although the objective reasons for its involvement has disappeared, the Ministry of Finance is not happy about losing its influence over pricing<sup>36</sup>. An additional obstacle to more market oriented pricing is the absence of legislation to permit subsidies to be paid to individual households; presently subsidies are paid to cooperatives and companies only.

(g) Turf battles between the MoIT and the Ministry of Privatisation

The restructuring process of the Polish Oil and gas Company has been delayed due to disagreement about which ministry, the MoIT or the Ministry of Privatisation would control PGNiG, once it is transformed into a joint stock company. To add the PGNiG on the list of companies with strategic role for the national economy, an amendment to the existing legislation is needed; it would create the basis for the reorganisation and the direct commercialisation of the PGNiG under the MoIT responsibility.

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<sup>36</sup> The Ministry of Finance has two good reasons to keep a watchful eye on energy prices. (i) Fear of inflationary consequences in the short term (ii) If high energy prices impose a social burden on an important part of the population, the ministry has to find financial sources for compensating social programmes.



## 6. CONCLUSIONS AND RECOMMENDATIONS

### 6.1 Conclusions

The ERG achieved important results. In a time of frequently changing ministers and loss of commitment to reforms the ERG provided continuity and attempted to keep the reform work on track. It provided independent advice to the MoIT which counterbalanced the influence of lobbying. In the drafting of the energy law, it fought against attempts to water out the reform intentions of the law. In the power sector, the ERG provided insightful comments pointing out weaknesses in the original concept for power sector restructuring, thereby contributing to make the structure more realistic. To the PGNiG and to the coal mines the ERG provided valuable management training and assistance in the preparation of business plans. Assistance by the ERG made top management of PGNiG aware of the incapacity of some division managers to lead independent business units. In coal sector restructuring the ERG commented on the stage I and II plans and prepared an independent stage III plan for the MoIT. In energy savings, the ERG was a key actor in getting the Polish Energy Conservation Agency off to a good operational start. In district heating, the ERG helped to introduce modern concepts for the setting and the approval of tariffs.

But compared to the financial resources of almost 4 MECU (an estimated 2.8 MECU from PHARE and 1 MECU from USAID and UKKHF) which by April 1995 have been put into the project and the high talent of the ERG team, the results are modest. In part, the low result achievement can be ascribed to failures in the strategy proposed by ESMAP, some of it can be ascribed to the low-keyed reactive management style of the ERG, but the most important reason for the low result achievement must be ascribed to external circumstances: to political constraints posed by Polish society - during its first year of operation, the attitude of the energy supply companies and the MoIT was hostile rather than cooperative and political problems continue to pose problems for ERG work.

The last year of ERG's existence from May 1995 to March 1996 provides the ERG with a great opportunity to increase result achievement: (i) it now enjoys respect and acceptance in the Polish energy community; (ii) the recent change in Government should provide a more reform friendly political environment; (iii) ESMAP is likely to take up its cooperation with the ERG with a project to assist in the establishment of the ERA; and (iv) a new PHARE financed project reinforces the work of the ERG in the area of secondary legislation. However, the benefits of the favourable environment will only be reaped if a number of management changes are made by the involved parties and work on the priority issues is intensified. These are outlined below in the recommendations section.

But the ERG also stands at a cross road whose implications have to be properly dealt with by ERG management and by the donors. First of all, the assignment of the foreign legal, energy saving, gas and district heating experts ends ultimo July; the UK funding with respect to the Polish regulatory expert is only guaranteed to end June; the coal team's funding ends in December and the USAID funded support at the end of May/June. Secondly, the "quango"-concept of the ERG as a semi-independent institution being placed outside its client organisations is increasingly becoming outdated. The ERG is a typical example of an institution which is set up

to solve a specific short term problem (uncertain and inadequate institutional framework) and which then develops ambitions to gain a longer term status. In this process, the original structure becomes irrational. The work on the energy law has provided the main rationale for the group-structure. It makes up the rallying point which connects the work of the individual experts. But as the work on energy legislation is nearing its completion (or in the case of secondary legislation its specialist phase) the reasons for keeping the group intact become weaker:

- It made sense for the energy saving expert to be part of the group as long as the institutional responsibility for energy savings in Poland was undecided. But with the creation of NECA, the energy saving expert and his twin belong there.
- In the future, the DOE will most likely be a small policy formulating group. For this, the energy planning role of the DOE should be strengthened as much as possible. Although the work of the energy planning expert implies contacts with a wide group of institutions (e.g. national statistical office, academy of science) outside the MoIT, the energy planning expert and his twin belong inside the MoIT to prepare the future structure.
- The restructuring unit in the PGNiG is the most important cooperation partner for the ERG natural gas experts; and although the interests of PGNiG management and the Government in the restructuring of the company may not fully coincide, it would be more rational for the natural gas experts to be inside the PGNiG.
- Due to the very heterogenous and decentralised nature of the district heating sector, it is particularly important that the minister of the MPPC has well-qualified expertise nearby to support him; therefore, the district heating experts should be located inside the MPPC.

## 6.2 Recommendations

### 6.2.1 Recommendations to ERG management

#### (a) **Take measures to promote an early adoption of the Energy Law**

*Pass message that early adoption of the law is better than perfection*

In strategy formulation and implementation it is more important to move into the right direction soon than to do everything right from the start. This is particularly true in the energy law area. Energy companies around the world operate under different legal frameworks, and the operational results even under substantially different organisational and regulatory systems do not differ in a systematic way. The continuous postponement of the adoption in the energy law, however, is hurting the Polish economy because of its negative impact on investments and on the pace of company restructuring.

The message that insistence on further changes in the draft is hurting the economy should be stated clearly by the ERG and preferably by a joint statement of the MoIT and the MPCC or by the Council of Ministers. Suggestions for non-essential changes should be systematically ignored; only comments providing genuine improvements should lead to text changes.

### *Recommend to MoIT improved procedures for the drafting of energy legislation*

The awkward experience of the drafting of the energy law shows that the present procedures used in the preparation of drafts and in the consultative process need to be rationalized.

The first reform which needs to be done is to introduce some basic rules for draft preparation. When the ministry asks an outside institution to prepare a draft for secondary legislation the request should be accompanied by a short description of objectives and background and guidelines for draft preparation including an outline chapter and indication of "maximum" size.

Secondly, the apparently "watertight walls" between the ministry's preparation of drafts and the ERG's contribution in terms of comments need to be broken down. The division made sense at project start: in order to gain acceptance of law proposals, these must be understood by the national institutions; and the best way to understand a law is to assist in its preparation. If the ERG had collaborated "upfront" from the beginning, the ministry staff would have been marginalised in the process. However, since we have now passed the 20th version or so, the educative role "of learning to swim by being thrown into the water" should be more than covered and the draw back of the loss in terms of "not learning by working alongside ERG staff" has become rather apparent. In order to improve the productivity of the process, the MoIT should order its (lonely) legal staff (an engineer) to work in close collaboration and consultation with the two legal experts of the ERG. The latter, for example, should be consulted in the drafting of requests to institutions for assistance in secondary legislation.

Thirdly, the excessive hearing procedures used by the MoIT during the drafting of legislation need to be rationalized. Once the interested parties have expressed their views on a draft law the MoIT can take these *political views* into account when it prepares the next drafts. While the MoIT for *quality control* reasons may send the new drafts to outside experts for *technical comments* it is not necessary that "every" institution is asked to provide new comments. Any chairman knows that there comes a time when further discussions no longer promote consensus but provoke further divisions and problems! This has been the problem of the energy law!

Fourthly, the recommendation made above concerning the disregard to non-essential draft changes calls for an authority to determine what is essential. A possibility would be for the MoIT and the MPPC to nominate a chairman and a secretariat (staffed by the ERG legal and regulatory consultants) to lead the work and to decide on what changes should be incorporated subject to regular reporting to them and their approval.

### *Creation of a shadow energy legislation group.*

There is a need to create a larger constituency in favour of the adoption of the law and to promote a better understanding of the basic principles of the law among relevant Polish sector staff. During its work on secondary legislation, the ERG should work closely with a "shadow legislation group" consisting of the energy law expert in the MoIT, and the relevant experts on energy law drafting in the PSE and the PGNiG and the relevant legal official in the Council of Ministers. ERG should provide this group with copies of internal discussion memos and encourage them to participate in ERG brain storming sessions on the legal framework. The educative process will facilitate further drafting work on the law and after adoption improve the

understanding of its application in practice.

#### *Rules for participation of ERG staff in working group sessions on energy legislation*

The foreign experts have performed prominently in working group discussions on the energy law and the elaboration of secondary legislation. They have done it well. But law preparation - in particular work on primary legislation - touches sensitive national nerves which foreign consultants can easily overlook<sup>37</sup>. Therefore, the Polish twin should chair the official working group sessions when outsiders are present; the foreign experts should provide back-stopping but otherwise keep a low profile.

Within the group there are differences of opinion concerning the details of the energy law. While differences of opinion provide for constructive internal discussions, group members must present a common front during official discussion meetings with outsiders - otherwise the consensus reaching process gets further complicated. If differences of opinion prevail, ERG management should decide on which position is to be the official ERG position.

#### *Revision of the Energy Policy Guidelines*

The energy policy guidelines which accompany the presentation of the draft energy law in Parliament should be updated (see previous comments in chapter III).

#### **(b) Preparation of a diagnosis for the status of sector reform**

While management consultancy assistance to the companies continues to be of importance, it is necessary for the ERG during its last year of existence to shift more attention to the formulation of wider strategies and to guide national policy. The ERG should prepare a diagnosis of the status of energy sector restructuring during the spring of 1995, analyzing the achievements since 1992, the obstacles to reform, the likely structure to evolve during the next three years and provide a prioritized list of policy reforms which should be implemented including a realistic time schedule.

The assessment reports prepared by the individual experts and their twins during December 1994/January 1995 are a good basis for the diagnosis. Based on the reports, ERG management should write a first draft diagnosis and have this draft discussed at a one or two days brain storming session with the ERG team. After this, management should write a draft final report and circulate the draft for comments before a final half-day brain storming session is held to provide inputs to the final edition of the report.

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<sup>37</sup> A committed professional consultant will after a short while begin to identify 100% with the problems of the country he/she is asked to address. This leads to very enthusiastic participation in group discussions.

**(d) Preparation of a proposal for the future structures of the DOE and the ERA**

*Reach early agreement with ESMAP on the ERA project*

An early agreement with ESMAP on the initiation of the ERA project is recommendable for three reasons: (i) to ensure a proper and timely start up of the ERA; (ii) to give the ERA access to the world wide experience of the World Bank in this area; (iii) to provide the ERG with a qualified sparring partner to monitor and critical review ERG approaches.

Both parties should show flexibility during negotiations. ESMAP must recognise that the ERG is the lead agent for energy sector restructuring in Poland, while the ERG must recognise that it is not a Government institution but a mere group of consultants and that its authority vis-a-vis the World Bank is correspondingly lower.

The ERG has prepared a *proposal for a new PHARE funded project to assist in the drafting of secondary legislation*. It has to be reassessed whether this project is still relevant if the ESMAP project gets started; and if so, what relevant changes should be introduced to the project TOR.

In addition, an early decision has to be reached concerning the prolongation of *the contract of the regulatory twin*. In view of the fact that work on secondary legislation and on the structure of the ERA is reaching a critical stage, it is strongly recommended to extend his contract. The only relevant question is whether the twin should remain within the ERG team funded by the UK-KHF or be assigned to the ESMAP project funded either by UK-KHF or by ESMAP.

*Define an appropriate organisation structure for policy making*

The work of the forthcoming ESMAP project on the organisation structure of the ERA should be accompanied by similar work on the organisation structure for the energy department. There are wishes to create a "super-ministry of economy" which includes, inter alia, energy. If the ministerial structure is going to be changed anyhow, ERG has as good a chance as ever to influence developments provided that it succeeds to come up with a convincing blueprint for a small energy policy department with supporting "agency"-structures attached to it.

The MoIT's project with the Dutch ECN centre on defining an appropriate structure for energy policy will presumably be restarted in the summer of 1995. But it seems unlikely, that the ECN can produce results early enough to influence the ongoing work concerning the creation of a super-ministry of economy; and possibly, relevant OMEGA activities. Therefore, the ERG has to start up work to provide a general framework concept, the ECN can then fill out the details.

The project manager, the training expert and the energy planning expert should be the key staff for this task.

*Definition of an operational division of work between the DOE and the ERA*

Before the ESMAP and ECN projects become operational the ERG should develop well detailed descriptions of the division of labour between the two organisations and of the sub-delegations of tasks to other institutions having expertise in the particular area.

This activity is needed in order to ensure an appropriate a priori umbrella and coordination framework for the work of the two projects. But an important side benefit of the detailed task descriptions / practical division of work for the two institutions is to make it easier for politicians and sector experts to understand how the future regulatory and legal system will function in practice, thereby, hopefully, promoting consensus around the draft energy law.

The project manager, the training expert, the regulatory twin and the energy planning expert should be the key staff for this task.

#### *Preparation of a strategy for the staffing of the ERA*

In parallel with the above task, the ERG team should define a practical preparatory approach to the staffing of ERA.

ERA's work calls for two types of qualifications: (i) *technical qualifications* in the form of legal expertise, expertise in regulatory economics and technical engineering expertise in energy; and (ii) *in-depth knowledge about how the energy industry operates*. With this in mind, ideally, staffing of ERA should be built up around one or two staff from the MOIT (engineering expertise), recent graduates from university for the legal and regulatory expertise, one well respected staff member from the PGNiG and one from a power company. Finally, two or three staff members should be recruited among the Polish twins. To achieve the latter will be difficult: ERG's proposal to finance ERA operations through contributions levied on the energy supply industry was rejected; instead, the ERA will be financed under the state budget and subject to state salary policy. This will make it difficult to attract staff from the "twins" and qualified "insiders" from the energy supply companies unless a concept is found to recruit some highly qualified staff on a consultant contract for the build up phase - the first two years of operation. By then, some of the "junior" staff should have received sufficient training to fill the role of the staff which leave. ERG during 1995 has to provide proposals on these issues. If it does not, the ERA will be staffed in an improvised manner to the detriment of the quality of regulation.

#### **(e) Internal reorganisation of companies**

The time is ripe for the ERG team to go a step deeper in the management assistance to companies and to *advise on the internal reorganisation of the companies*. A couple of district heating companies interested in the cooperation should be selected as well as some distribution companies in the power sector. Detailed assistance to the PGNiG in this area has to await the decision to break it up, but a few preliminary organisation charts and job descriptions could probably be drawn up. Although only a few companies will be touched directly by this activity, the demonstration effect should stimulate similar initiatives in other companies.

This assistance in company reorganisation should be accompanied by the provision of *technical assistance in benchmarking*. Proper competition outside power generation is not foreseeable in

the near energy future in Poland and benchmarking provides a second best solution to direct competition - indirect competition. Thus, benchmarking is an excellent tool to promote productivity growth and management change during the transitional period. In addition, it will provide Polish companies with "state of the art" management practices. The benchmarking exercise is a powerful tool to promote organisational changes in the deeper layers of the organisation because it identifies the "hot spots" and the direct comparison shows how better results can be achieved in practice. Other energy companies are already cooperating in this area - British Gas, Gasunie and DONG, for example use each other for benchmarking, and it should be possible to encourage EU firms to provide Polish firms with benchmarking figures. The ERG could draw up a PHARE project for this purpose.

**(f) Preparation of a phasing out strategy for ERG**

During 1995 the ERG should gradually start to transfer some of its staff to the relevant client institutions.

**(g) Preparation of a Strategy for Future PHARE financing**

The management of ERG has prepared an interesting proposal for future PHARE financing in the energy sector in its "1995-99 PHARE indicative energy programme" covering technical assistance as well as investment cofinancing. The proposed investment emphasis in the paper is on the co-financing of infrastructure investments e.g. in natural gas storage. Investments in energy savings receive a very small allocation. It is argued that energy savings receive priority attention in projects financed by grants from bilateral donors. The approach may be pertinent. However, the objective of the European Energy Charter is to promote private sector investments. It can be argued that it should be possible to finance investments in natural gas infrastructure through commercial partners. Therefore, the PHARE strategy should be formulated also with reference to its degree of congruence with the goals of the energy charter and the role of private sector investments.

The paper deserves to be discussed in an ERG brain storming session on PHARE financing. After this, a revised version should be discussed at a "donors providing assistance to Poland in the energy sector" meeting to receive critical comments and observations. After this, a final draft could be sent to PHARE/Bruxelles and the EU delegation in Poland as the ERG position on this matter <sup>38</sup>.

**(h) Institutionalising a "seminar series" on energy sector restructuring**

During 1995 ERG should organize three types of seminars:

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<sup>38</sup> Minister Gabrys in his comments to the draft report asked the evaluator to provide suggestions for a future PHARE energy programme. The evaluator, however, does not know enough about investment priorities in the Polish energy sector to provide an expert opinion on this matter. The procedure proposed above should give more qualified results.

- \* A monthly "ERG-seminar" series where different topics on energy sector restructuring are taken up by ERG staff, by prominent members of the Polish energy community or foreign specialists who happen to be in Poland. Participation at these seminars should be open to both Polish specialists and relevant donor representatives.
- \* Seminars at the universities to students and staff of law, economics, political science, business and energy-engineering with topics on regulatory economics, energy legislation and enterprise restructuring.
- \* A closed seminar/meeting series every fourth month with members of the donor community on "status quo of sector reforms and priorities for donor funded projects"

**(i) Contract extensions**

Presently, the financial twin position in the IBF's PHARE contract is filled by the privatisation twin Mr. Kurczewski. When his USAID financed contract expires, the IBF should take over his financing under the PHARE contract. Mr. Kurczewski is one of the few young twins and will provide the financial expert with the continuity which is badly needed for his function.

**6.2.2 Recommendations to the MoIT**

**(a) Improve the minister's exposure to ERG expertise**

The quality of ERG staff is unmatched by the staff in the MoIT. By not making use of regular and informal contacts with ERG staff, the deputy minister of energy deprives himself of a free and high quality source of policy inspiration. The ERG manager, Mr. Sonck has a distinguished career as Director of the Belgium Energy Department and has many years of experience as government representative at high level energy policy meetings in Bruxelles. It is a pity that Deputy Minister Mr. Gabrys does not take advantage of the presence of Mr. Sonck to use him as "sparring partner" for informal exchanges of views and ideas. This wasted opportunity does not pay tribute to the quality of his advisors in the ministry! It is strongly recommended to the deputy minister that he during the remaining lifetime of the project invites the ERG manager alone or accompanied by selected staff members to regular discussion lunches (once a month). It is not necessary that these lunches have a specific project related agenda, they should be informal.

Deputy minister Mr. Gabrys should be encouraged by his advisors to use the ERG as a "policy think tank" preparing position papers as "independent consultants" to stimulate public debate without in any way committing him politically. Ideas for such papers could for example be generated spontaneously during discussion lunches.

**6.2.3 Recommendations to PHARE concerning energy sector restructuring assistance in Poland**



(a) Assistance to the MoIT

The PHARE programme must make it clear to the MoIT (i) that the ERG in March 1996 will have outlived its useful role and will not be prolonged by PHARE; (ii) that a follow-up project of institutional assistance to the MoIT will, first of all, be very small, secondly be located within the ministry, thirdly, be comprised of short term specialist expertise rather than long term generalists and fourthly be dependent on the adoption of a plan for substantial organisational reform in the MoIT/Energy Department.

There are three reasons for this recommendation.

Firstly, the definition of a final date for activities is necessary in order to step-up the productivity of the project during its last year of existence. ERG management and the MoIT have to be motivated to show more sense of urgency concerning the work of the project.

Secondly, even under the best of circumstances, external assistance can never achieve more than a modest contribution to sector reforms. The major impetus has to come internally from the country itself. Under unfavourable circumstances, donor assistance may even block for national reforms because donor finance underwrites inefficiencies by keeping non-viable institutional structures afloat through subsidies. The objective of PHARE assistance is to strengthen the Polish institutions, not to undermine restructuring by making it possible to postpone administrative/institutional reforms because the existence of PHARE financed teams makes it possible to fill "institutional voids". The ERG has filled a "policy formulation capacity" void in the Polish energy administration; a further continuation of PHARE financing towards this activity risks to delay necessary adjustments in the Polish administration by removing the urgency of reform.

Thirdly, partly related to the "quango" nature of the ERG (see 6.3) ministry staff is increasingly transferred to the ERG as part time or seconded staff. It has to be shown that consultant contracts for public sector staff are a temporary happening only.

(b) Transfer of the PMU function to an independent "specialised" unit

At the latest in March 1996, and preferably already starting January 1, 1996 to provide overlapping, the PMU function should be put up for tender as a small specialised unit for this task only.

At that stage of the Polish reform process, it is likely that technical assistance has to be provided in the form of ad hoc specialist technical expertise rather than by long term experts. The unit should be provided with a budget to finance high priority demands for short term specialists in a flexible manner.

#### **6.2.4 Recommendations to USAID**

The contract of the American tender winner for USAID' work in Poland in that sector runs out in end-February 1995. This comes at an unfortunate time. Work has started on the important subject

of secondary legislation. As Polish staff from the sector institutions work on the drafts for the ordinances, one will witness many attempts at changing the spirit and the content of the draft primary law through the draft secondary laws. It is important at this crucial stage that John Alridge, the power & lignite expert, as well as his twins and the twins for corporate planning and privatisation stay on the job. Mr. Alridge has been one of the star performers of the team combining in-depth personal knowledge of the power industry as previous manager with solid analytical and presentational skills. More than any other staff on the team, he has managed to provide insightful comments on the drafts and to correct mistakes. Having operated as power company manager under the overregulated US-regulatory machinery he is on the look-out for attempts to introduce unnecessary bureaucratic regulatory burdens on the industry. The Polish twins have managed to gain the respect of the energy industry and are able to influence what's going on, Mr. Duda, the twin of Mr. Alridge, for example, has written the Government's energy policy paper which accompanies the introduction of the draft energy law in Parliament. In order to ensure continuity of effort during the secondary legislation phase, USAID should attempt to seek the renewal of the contracts of Messrs. Alridge, Grybowski and Duda until the end of 1995.

If USAID is approached to finance technical assistance in benchmarking, it should react positively.

#### 6.2.5 Recommendations to UK-KHF

If the regulatory twin is not taken on by the ESMAP project, UK-KHF should extend his present contract until December 1995. If UK-KHF is approached to finance technical assistance in benchmarking, it should react positively.

### 6.3 General Lessons for PHARE / TACIS

#### (a) Communication of strategy

The history of the ERG confirms the general lesson of projects for the *formulation of strategies for restructuring*: the finalisation and presentation of a strategy must be followed up by a proper phase of information with a series of seminars to wider audiences.

#### (b) Organisation structures for strategy implementation

The genuine novelty of the ERG concept is the "quango-dinosaur" structure for *advisory assistance during strategy implementation*: a large cross-sectoral group of experts that are placed as an "independent" advisory institution serving both the ministries as well as the sector companies. Three general lessons can be drawn from the experience:

- \* Whereas it makes good sense to use "large" outside teams *during strategy formulation* (good ideas for restructuring are often generated by outsiders who look at structures and procedures with fresh, unbiased eyes), it does not make sense to place advisory teams *during the implementation phase* on the outside as advisors. Implementation is the work and responsibility of inside teams, and advisors should work directly alongside these internal teams. Much valuable time and effort is lost in confidence building when ministry staff and company staff look at advisors as outsiders, and not as "house consultants".
- \* *Having a large team of experts providing advisory services on implementation to company management and to ministries under a common project framework* makes good sense. It generates synergies between consultants and deepens the understanding of the process for restructuring because the team can look behind the scenes in the ministry as well as in the companies and provide neutral advice to both.
- \* *Placing a technical assistance team outside the pertinent sector ministry undermines the institutional strengthening potential of technical assistance.* Since the ERG experts do not work alongside staff of the ministry, ministry staff is not trained by direct involvement in ERG work. One has tried to compensate for this by transferring staff from the ministry and to the ERG (on a full time and on a part time basis) as "twins". Whereas originally, the twins had been drawn from a number of different institutions, lately, they have been drawn mainly from the MoIT. This is a solution which should be used only in exceptional cases and only for short periods. There is a clear danger (amply proven by international experience with technical assistance projects to public institutions) that such a situation - if it becomes "institutionalised" - leads to projects being generated and implemented to satisfy the personal interests of the public officials that get contracts under the project rather than to satisfy objective needs of the country. Thus, the "twin" concept should be used to train national consultants. For public officials it should be used only in very exceptional cases where there is an interest in building up a specific expertise in the institution - for example the regulatory twin. Otherwise training should take place by attaching advisors/consultants to staff in a ministry.

The recommendation which can be drawn from this is that technical assistance projects for the implementation phase of energy sector restructuring efforts should preferably be built up around a nucleus of experts placed in a ministry with subsectoral experts placed in the relevant energy supply companies. The work load of the latter should be split on an 80/20 basis between assistance to company management and assistance to the ministry on specific subjects of general interest.

(c) The "twin" concept

In spite of what is said under (b) above concerning the use of twins seconded from the public sector, the *concept of twins* has proven its worth in practice. It is a useful tool to achieve a maximum of know-how transfer and improves the productivity of EU experts by providing them with instant and constant access to local (inside) information. In addition, it ensures that local consultants are actively involved in the advanced projects that are carried out inside their country and "learn by doing". PHARE and TACIS should consider on a trial basis to issue some calls for tenders with the twin concept being a precondition for the winning of a technical assistance contract. If successful, this could become a more generalized feature of PHARE & TACIS contracts. However, particularly in restructuring projects, the tenders should include the condition that the average age of the twin-consultants may not exceed 40 years.

(d) Quality conditions for technical proposals

PHARE and TACIS should reject technical proposals which are not based on a clear statement of operational objectives, outputs/deliverables, inputs and work plans with time schedules and milestones. If a winning proposal for a call for tender does not contain such clearly stated workplans, the winning consultant should be asked to revise his technical proposal and submit the revised version for approval by TACIS/PHARE before the contract is signed.

(e) Guidelines to increase transparency in tenders for PHARE/TACIS projects

Even if the preparation and implementation of tenders is subdelegated to local PMUs, PHARE/TACIS should insist on the presence of well prepared foreign experts in the tender meetings.

Meetings should be conducted exclusively in English or in French if the latter is relevant.

(f) Evaluations before contract extensions

If PHARE/TACIS receives a request to extend the lifetime of a project substantially, and the likelihood of effective competition for the tender is purely theoretical, PHARE/TACIS should insist that a project evaluation is made by an outside consultant before a decision is taken.

## ANNEX I: METHODOLOGY

The evaluation looks at four themes, which are subdivided into a number of issues:

### 1) Quality of project design

- a) What was the **strategic quality** of the project?
  - were the correct issues addressed by the project?
  - were external constraints properly taken into account?
  - were proper solutions offered?
  - was the strategy compatible with national economic goals?
  - was the institutional structure for project organisation appropriate?
- b) Was the **logical framework of the project** formally coherent?
  - consistency between objectives, outputs, activities and inputs

### 2) Efficiency of implementation

- a) Did the Polish counterparts fulfill their obligations?
  - provision of office facilities
  - provision of counterpart teams
  - reform commitment of policy makers
- b) Was the ERG properly managed?
  - was project planning adequate?
  - were logistics and administration properly organised?
  - was proper information produced and reported?
  - did the project have proper monitoring and self-evaluation?
  - did management provide efficient responses to problems?
  - did the ERG work as a group?
- c) Did the funding organisations provide proper backup and show adequate flexibility?

### 3) Result achievement

- a) Quantitative results:
  - strategy reports
  - issue papers
  - comments on proposals, business plans and policy issues
  - legal texts
  - PIU-related functions and programme preparation
- b) Reforms achieved where ERG intervention played a substantive role

- c) Institutional strengthening through training and through "process"
  - counterparts
  - ministry level
  - enterprise level
  
- 4) What **external constraints** influenced result achievement?
  - a) Macro-economic, political and social changes in the country
  - b) Psychological factors
  - c) Institutional factors:
    - lack of democratic traditions
    - position of counterpart institutions
    - lack of proper coordinating mechanisms
  - d) Lack of established paradigms for transitional reforms

## ANNEX II: ERG MISSION - THE ENERGY POLICY LETTER, JUNE 17, 1991

*"With the help of the Bank/ESMAP, we recently completed comprehensive studies of hard coal restructuring, power, lignite, and district heating restructuring, and gas restructuring. Detailed consultations at all levels took place over the period July 1990 to June 1991, including a two day review by the Government, the Bank and representatives of all the sectoral agencies and enterprises concerned in April of this year. As a result of this process, there is broad consensus that the Government strategy outlined in this letter is an efficient way to translate the intentions of Poland's privatization and anti-monopoly laws into reality in the energy sector. There is also broad agreement at the technical level on the details of the sectoral action plans. Nonetheless, much of what is proposed will be at the frontiers of Poland's present legal framework and institutional capability. And in cases where restructuring involves liquidation of existing state enterprises, progress depends on negotiations with the workers' councils. For these reasons the Government anticipates that, while the overall timetable for energy restructuring is feasible, progress in some sectors may well be more rapid than in others".* Development Policy Letter

In this letter addressed to the World Bank, the Polish Government committed itself to "launch a special programme for restructuring, privatization and regulatory reform in the energy sector". The letter stated that "the Government has two overriding objectives in the energy sector: to improve economic efficiency in the supply and use of energy, and to mobilize additional domestic and foreign private capital for investment". The proposed strategy had three main elements:

- *price reforms*: the gradual elimination of price distortions to reach economic pricing
- *changes in the structure, governance and ownership of the energy supply industry* by (i) restructure and demonopolize the sector, (ii) decontrol the potentially competitive segments of the industry and regulate the core natural monopoly networks to promote competitive behavior in these sectors, (iii) convert the restructured state owned enterprises into joint stock or limited liability companies, (iv) privatism the energy supply industry, starting with divested non-core ancillary activities and once the sector structure and regulatory regime were stabilized, to privatize the remaining core companies by selling shares and/or by encouraging joint-ventures with foreign partners
- *steps to improve environmental performance*

The programme and time schedules were ambitious:

- \* In pricing, the strategy was first to raise official prices to households to parity with official prices to industry. This was already achieved mid-1991 with electricity and gas prices; heat prices paid by households would achieve parity with industrial heat prices by the end of 1993. In a second step, to begin end 1992, all electricity, gas and heat prices were to be shifted from direct price control to indirect supervision. A second phase of price adjustment to full economic cost would then take place within this framework. Industrial gas prices were to be raised to parity with corresponding average prices in Western Europe by end 1992.
- \* By end 1992 suitable regulatory bodies for electricity, gas and district heating were to be

in operation and functioning according to consistent principles

- \* An "*English*" style regulatory system was to be put in place with a "sequence of phasing as follows: a. guaranteed third party access to networks at regulated transportation ("wheeling") charges, b. third party (i.e. independent producer) access to standby energy supplies at regulated prices, c. competitive bidding to supply new capacity; and d. competitive bidding for daily or hourly output ("dispatch"). We anticipated that competitive bidding will be phased in more rapidly in the electricity sector than in the gas or district heating sectors. However, we expect to reach *the final stage of competitive bidding for electricity dispatch* only after the restructuring and commercialization of the electricity sector is largely complete, that is, after end 1992."
  
- \* In the *hard coal* sector the Government was to put 10 mines in the initial closure programme, and group the remaining 60 mines in 10-15 independent commercial companies. Each portfolio was to include some mines that are clearly viable and some that appear marginal. By end 1992, all of the present mining enterprises would have completed the majority of legal steps towards their establishment in 10-15 companies. The question of mining rights (licenses) and sharing of resource rents (via taxes, royalties, etc.) were to be resolved prior to the formation of the new commercial mining companies.
  
- \* The *lignite* mines were to be grouped together with their mine-mouth power stations under the same management. Prior to forming the companies, the Government would a. set resource rent taxes on lignite mining, b. issue mining licenses to existing operators, c. issue generation licenses to lignite fired power stations. By end 1992 the majority of steps would have been completed.
  
- \* The power industry was to be restructured with the *joint stock electricity transmission and dispatch company (PSENN)* as the future centerpiece:
  - the PSENN was to be given obligation to provide transmission services to third parties (e.g. independent power producers) at non-discriminatory rates
  - electricity purchase contracts were to be prepared between PSENN and the generation companies
  - sales contracts were to be prepared between PSENN and the distribution companies
  - all transmission lines were to be transferred from the distribution companies to PSENN ownership; also all pumped storage power stations
  
- \* The *16 hard coal fired power plants* were to be grouped into four-to-five independent commercial companies. The merger process was to be partly market based - the generators submitted agreed merger proposals - partly Government guided, as the government issued a set of merger criteria. The Anti-Monopoly Office could subsequently allow further mergers or selling of individual generators.
  
- \* The *CHP plants* were to be grouped into about nine independent companies.



- \* The 33 *distribution companies* were to be regrouped into about half that number using the voluntary merger route.
- \* In *district heating* the gminas had until end 1991 to decide on regional groupings for the ownership of heat networks and on the type of ownership (municipal or commercial). Traditionally, while the heat transmission/distribution networks were controlled by local district heating enterprises; the CHP stations and large heat only plants belonged to the national power sector. The possibility was left open to transfer some of the large heat only boilers to companies that would combine heat production and distribution. This was to be the solution in smaller towns where there was little prospect of competition between heat producers to supply the local network. The regulator was to be vigorously pro-active, pro-competition. Regulation could be done either by local regulators having access to a national heat advisory unit that supplied "yardstick" data; or by a national regulatory office with regional branches.
- \* In *gas* by end-1992, the Government was to internally restructure PGNG into divisions while still holding PGNG as a single state-owned enterprise, and to have a list of ancillary activities to be separately divested. Then each division was to be converted into independent commercial companies comprising: one or two upstream companies, one gas transmission company, approximately six gas distribution companies (replicating the present gas distribution divisions).

### **ANNEX III: SOCIO-ECONOMIC BACKGROUND**

Poland's real GDP dropped by 11.5% between 1989 and 1990. The "economic chock therapy" in 1990, the Balcerowicz plan named for Leszek Balcerowicz, Poland's first post-communist finance minister, was a classical IMF style stabilization programme. The government decontrolled nearly all prices on January 1st that year, slashed subsidies to industries and households and tightened monetary policy to bring down inflation. Margaret Thatcher was a highly admired role model as a politician and reformer, and British consultants played important roles in work on commercialization, privatisation and regulatory reforms.

Economic growth started to pick up again in 1992 and in 1993 the Polish economy experienced the highest growth rate in Europe growing at 4%, a growth rate which was maintained in 1994. The macroeconomic reforms, however, did not affect all parts of the economy in the same way. While they created new opportunities for small private businesses, they made life very difficult for large state enterprises. The economy split into two: a fast growing private sector and an ailing state industry. Society was divided between two categories of Poles: those who had benefitted from reforms, and those who had suffered. Unemployment kept rising and reached more than 16% in 1994.

Ordinary workers in state industry, once favoured, suddenly found themselves at the bottom of the heap. Miners, for example, had been considered the vanguard of the working class in Poland's coal-based, communist economy. They were paid better wages than other workers, flattered with praise, parades and special holidays. After the reforms, in contrast, they found themselves at the bottom of the scale, both in incomes and in social status. They resented the drop in living conditions, and in particular, the drop in the relative economic position more than others. Silesian hard coal miners launched strikes in December 1992 and in April 1994, the lignite miners went on strike protesting against the forced model of power sector reform leading to the establishment of three holding companies merging lignite mines with lignite fired power plants. The latter brought down the then Minister of Energy. Although the wage level in 1994 of the coal miners was twice the national average, they knew that their position was threatened by financial losses in coal mining and by the perspectives for mine closures and rationalization in the mines that survived.

The Government was weak. One of communism's legacies to Poland was an extreme form of proportional representation which resulted in a large number of parties gaining seats in Parliament. No party had a majority and the coalitions that were formed proved to be unstable. The years since the economic chock therapy took hold saw five governments and as many finance ministers.

The division of the nation into winners and losers could not help but influence politics. Both right and left began to use populist, anti-capitalist slogans to attract discontented state enterprise employees. Successive Governments had to respond to these slogans in some way. Since the Governments were weak and could easily be toppled by demonstrations, most chose to do so by avoiding awkward decisions. Reforms of the coal and steel industry were postponed and hard decisions about the closure, privatisation or methods of continuing management of state companies were not made.

Although the central government was able to begin monetary reforms and to open up opportunities for private enterprise, it did not prove an effective reformer of state companies. The problems in following up on the macroeconomic reform by micro-economic reforms were substantially underestimated by both Polish and foreign experts. The determination for reform which was demonstrated by the economic shock therapy and the speed of its implementation had impressed "everybody" and had led to exaggerated expectations with regard to the speed of the privatization process. The slow down in the reform effort can be ascribed to three factors: technical problems in reaching agreement on the appropriate approach to privatisation, practical problems in reaching agreements with the workers' councils and national politics:

- \* The *first privatisation efforts* in 1991 of the privatisation ministry involved the flotation of a handful of large state firms on Poland's nascent stock market. But although the stock flotation was prepared with extensive and expensive advice from Western management and accounting firms, the privatisation did not save the companies from poor management or structural problems. Also, the complexity of using share sales (evaluation, preparation and promotion) seemed to outweigh the advantages.

As the method proved too slow, the Government aided by Western advisors began work on a programme of mass privatisation by other means. The programme would create 15 large holding companies, each run by experienced western fund managers. Every Pole would be given a voucher, which could be invested in one of the holding companies. These in turn could use the vouchers to buy shares in 600 hard-to-privatise large state companies<sup>39</sup>. Despite initial enthusiasm the programme languished for year in the privatisation ministry and in Parliament.

In 1995, it seems that 430 medium sized companies will be privatized by handing them over to 15 funds. The fund managers will be paid according to the rise in the asset value of the companies in their portfolios, and will be encouraged to raise additional cash from banks and the stock market.

However, a new plan is to convert all of Poland's remaining SOEs into joint stock firms under the control of a new government agency. That could in theory hasten their privatisation by breaking the power of their workers' councils and laying the legal framework for acquisition by outside investors.

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<sup>39</sup> The approach was supposed to provide an answer to the problem how to unload hundreds of firms at once without giving them away to small shareholders who can neither invest new money nor guide their managers.

- \* The important *influence of the workers' council in the management of the state enterprise* poses a difficult obstacle to reform efforts. Workers control the firm and have the power to fire the managing director. Once a company is corporatized into a joint stock or limited liability company, the workers' council is eliminated - it does not have a role under company/ commercial law. But since a decision for corporatization (or "commercialization" as it is called in Poland and by the ERG<sup>40</sup>) demands the agreement of the workers' council, the workers were in a position to extract pay-offs in the form of getting a percentage of shares free, and another percentage at a discount.

Negotiation between the government and all trade union federations ended up with the formulation of the treaty between the government and trade unions concerning also the way to privatisation. The treaty was presented to the Parliament in the form of six drafts of new parliamentary acts. The Act on Privatisation of State Enterprises gives the employees the right to appoint a third of the members of the Supervisory Board of the Company and to buy up to 20% of the shares in the company with a special 50% discount on the price offered to other entities on the first day of sale.

- \* *Poles in September 1993 voted to slow down reform* providing the Democratic Left Alliance, SLD (politicians mainly drawn from the former communist party) and the Polish Peasant Party, PSL (already represented in parliament under communist rule) with a majority in the Parliament. The two parties promised "reforms without extremism". The outcome of the election demonstrated the Polish electorate's concern with the economic and social uncertainty brought about by the speed of the initial reform process (and the weakness of the enterprises, the legacy of communist rule).

As a result, the privatisation process until 1995 has been largely "spontaneous". Of Poland's 8,400 SOEs in 1990, about 2,500 have been privatized by liquidation, worker/ management buy-out, often by selling or leasing the assets to employees, and joint venture<sup>41</sup>. A mere 200 have been sold to strategic investors or through the stock market.

At the beginning of 1995 the state still owns 60% of Polish industry and plans to hold to firms considered strategic such as those in power and natural gas industry. Restructuring of the energy industry continues to be low on the list of priorities (and attention) in the Council of Ministers and in Parliament. There is no immediate urge for reforms - heat, gas and electricity continues to

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<sup>40</sup> Somehow misleadingly, the term "commercialization" is used in Poland to categorize the transformation of a state company into state owned joint stock company. While it is true, that corporatization subjects a company to commercial law, commercialization means to introduce strictly commercial criteria and principles in company management. A state enterprise can be commercialized without being corporatized and a state company can be corporatized without being commercialized if political interference remains strong!

<sup>41</sup> They could be conducted by local authorities and were much less affected by the vagaries of Polish politics.

be provided, and due to the existence of surplus capacity, there is not immediate need for investments.

The *reaction against reforms* was accompanied by a *reaction against foreign consultants* in some parts of Polish society, companies and ministries. Poles are very proud people and with the heavy legacy of foreign domination during much of Polish history it is not surprising that a certain xenophobia can be witnessed during times of stress. Accusations were raised against the "Mariott Brigade" of foreign consultants for being too removed from Polish reality, for drawing conclusions and recommendations too fast which were not sufficiently well suited to Polish conditions and for being very expensive. Much criticism was justified. Although Western consultants had superior know-how in modern techniques of management and of accounting; for obvious reasons, they had no prior experience in transforming socialist economies into market economies. Therefore, for them as well as for Polish decision takers and consultants a substantial learning process took place and mistakes were made. Often Polish institutions did not feel that they were getting value for (donor financed) money from foreign consultants. At time it was an objective reaction, at other times it reflected nationalistic chauvinism and arrogance.

The ERG at project start in 1992 both suffered under the reaction against reforms as well as under the reaction against the "Mariott brigade". This severely affected the efficiency of the ERG. Much effort had to be invested in confidence building and in eliminating suspicions and misunderstandings by Polish officials in ministries and sector companies.

In the absence of a Parliamentary majority to bring about change the only serious opposition to the Government headed by Prime Minister Mr. Waldemar Pawlak (from P.S.L., the Polish Peasant Party) came from President Mr. Lech Walesa. The President brought down the Government in February 1995. A new Government was formed (with many ministers remaining) headed by Prime Minister Mr. Jozef Oleksy (from the S.L.D.).

## **ANNEX IV: PAST AND PRESENT ORGANISATIONAL STRUCTURE FOR ENERGY POLICY AND SUPPLY**

### **(a) Former Regime**

Previously, the Ministry of Mining and Power was charged with national energy policy design and implementation, except for the oil industry (refineries) which was dealt with by the Ministry of Chemical and Light Industry. Control over the energy sector was exercised by four powerful state organizations, i.e. the Hard Coal Board, the Power and Lignite Board (WEWB), the Board of District Heating and the Polish Oil and Gas Company who functioned as state managers and planners of the industry. Energy conservation fell within the competence of the Ministry of Material Resources and Fuel Management. In the latter Ministry the Main Inspectorate of Energy Management was responsible for policies concerning energy conservation.

In 1987, the Ministry of Industry was established taking over the functions of four ministries which were liquidated: the Ministry of Mining and Energy, the Ministry of Material and Fuel Management, the Ministry of Machinery, industry and Steel, and the Ministry of Chemical and Light Industry. After taking over also the responsibilities of the liquidated Ministry of Domestic Trade and Services, the Ministry changed name to Ministry of Industry and Trade.

### **(b) Reformed structure for energy policy making since 1990**

In 1990, by resolution of Parliament, the Boards were liquidated.

The Department of Energy within the MpIT employs a staff of about 40, in addition another 20-30 staff in the ministry are involved in issues related to energy (e.g. legal backstopping functions in law preparation) Between November 1991 and July 1992, the MoIT was not headed by a minister, but by a so-called "manager of the Industry". The DOE reports to a Deputy Minister who has the political responsibility and is headed by a Director of the Department of Energy who is technically responsible for the work of the department. The six offices were:

Foreign Relations;  
Energy Policy and Energy Balances;  
Energy Sector Restructuring;  
Informatics and Statistics;  
Energy Investments and Technology;  
Energy Industry Machinery.

In July 1993 the DOE was split into a "Department of Energy and Solid Fuels" and "Department of Liquid and Gaseous Fuels" divided between two Directors. Since October 1, 1994 there is once more only one Energy Department, divided into seven offices:

- 1) Energy Policy Group
- 2) Mining and Geology Group
- 3) Investment and Supervision Group
- 4) Gas and Liquid Fuels Group

- 5) Informatics and Statistics Group (Jacek Nowakowski)
- 6) Energy Devices Group
- 7) Foreign Relations Group

The Polish Government decided in 1991 to subordinate the district heating subsector to the Ministry of Physical Planning and Construction . In April 1993, the ministry formed its Department of Urbanization and Communal Services with responsibility for overall supervision of all communal services, including district heating.

The World Bank/ESMAP report had proposed to separate the dual roles of the Government as *owner* and *ultimate regulator* by letting the Ministry of Finance hold all shares held by the Government. In this way, the Ministry of Finance's primary objective would be maximising the returns from these shareholdings, while the objective of the MoIT would be concerned with the wider economic development of the sector. A special act made the MoIT state supervisor for all enterprises of economy infrastructure listed by special ordinance of the Council of Ministers. The MoIT was authorised to perform ownership transformation in the power sector and supervise the enterprises transformed into companies. The authority for the transformation of the PGNiG is still a subject of discussion between the MoIT and the Ministry of Privatisation. Thus, while the State Treasury (Ministry of Finance) is the shareholder of the all state owned joint stock companies in the energy sector, the MoIT acts as the State Treasury over the power companies.

The Ministry of Privatization acts as primary advisor to the Ministry of Finance (and local Governments where gminas were shareholders) on matters relating the sale of shares drawing up a programme for share sales of a company at its inception and subsequently advising the Ministry of Finance on detailed disposal tactics.

The Ministry of Environmental Protection and Natural Resources acts as ultimate regulatory authority in matters concerning the environment and functions as the economic regulator of natural resource development.

(c) Reforms of the structure for energy supply

District Heating

As a consequence of local government reform in Poland, approximately 2,500 municipalities have arisen. This number is excessive - too many municipalities are too small to provide the fundamental services for the local society efficiently.

In the heating sector, the ownership transformation was complicated. Individual elements forming a technological entirety are managed and owned by various economic and legal entities. The district heating system with its boilers, transmission and distribution systems can be owned by a municipality or a voivodship, the large CHP plants by the state, in addition, individual heating sources can be managed by various entities. In 1993, the then 50 district heating enterprises, many of which ran several non-integrated networks, were broken up into 473

companies in charge of one DH network each. These companies represent a variety of ownership forms - some are communal budgetary units, some are joint stock companies owned by the municipalities served by them, some are owned by cooperatives, a few are private; a large number (31%) are still based on the old state enterprise law.

Another element which unfavourably affects the economic standing of the heating enterprises is the application of uniform, nation-wide official prices for heating and warm water in housing developments. In order to counteract the growth in subsidies from the central budget, the Minister of Finance, since the fourth quarter of 1991, limited the liberty with which heating prices are set by introducing maximum growth indices for heating prices per quarter, and sometimes even more often. In the majority of cities, these prices are lower than the costs of supplying heat and the stipulated fee schedules to be used by the heating companies. The differences between official prices and fee schedules are covered by state-government budgetary subsidies for cooperative housing units and by municipal budgets for communal buildings. On average these subsidies constituted 70% of the mean fee schedules in 1991 and 30% in 1993.

Only since 1990 has the regulation requiring the installment of heat meters and hot water meters in new and buildings undergoing modernization been in force.

### Organisation of Coal Sector

Poland has seventy operational coal mines; all of these mines are in State ownership, reporting to the Ministry of Industry and Trade (MoIT). In the economic transformation which followed the change of political system it was decided to allow all the mines to operate autonomously in terms of production and marketing decisions. This experiment failed; the bulk of the mines were unable to operate commercially under the conditions then obtaining. Only six mines showed a profit under the Polish accounting system for 1992.

The Hard Coal Board. was transformed into a joint stock company, renamed the Hard Coal Agency (PAWK) and charged with overseeing the industry on behalf of its owner, the Government, advising local and central authorities on coal issues including restructuring and providing services to the operating units.

Between March and July 1993 the sector organisation was changed again in an attempt to promote viable operation. The Government formed the potentially viable mines into seven commercially oriented companies of joint stock type with all shares owned by the Ministry of Industry on behalf of the State. The structure was designed by PAWK, supported by various consultancy studies, and approved by the coal specialists in ERG.

The mines seen as hopelessly nonviable - the four companies in Lower Silesia and three mines in Upper Silesia - have been kept in direct Government control and their closure announced.

### Power

Till 1990 all enterprises in the power sector in Poland were state owned except some number of



small hydropower stations that were owned by private persons according to the resolution of Council of Ministers from 1981. In 1990, the Parliament liquidated the Power and Lignite Board and made all the power companies independent technically and economically. In order to secure the market as well as to prepare the development programme for the Polish Power System - the Polish Power Grid Company (PSE) including the National Dispatching Centre, was called up as a joint stock company fully owned by State Treasury to take up the lead role for restructuring. The commercialized company should operate in accordance with the commercial code and had no longer the organizational structure imposed by the law for State owned enterprises. It was assumed that in the case of PSE the State should remain decisive influence not only of the regulatory activity but also by state ownership of vast majority of the company shares. This means that State Treasury should have minimum 51% of the shares of PPGC.

According to the law all 32 electricity generation and 33 electricity distribution companies, formerly managed by the Power and Lignite Board, got their economic independence and could go for privatization themselves based on existing law.

The Minister of Industry and Trade in spring 1993 called up a group of specialists for implementation of restructuring policy within the power sector, adopted by the government in 1992. The program covered such activities as:

- transferring of ownership of the transmission grid from distribution companies to PPGC
- incorporation of the pumped-storage hydropower plants into PPGC
- creating holding companies for integration of lignite mines and associated power plants
- creating 2 to 4 generation companies grouping coal power stations
- accepting detailed principles of electricity market.

Privatisation was slow. However in January 1995, Energoprojekt, a company with a staff of about 200 became the first company to be privatized in the power sector. In the same month, the MoIT announced plans to offer stakes of up to 49 percent in its 18 power plants to raise money for their technological upgrade. The power complex in Konin, central Poland is supposed to be the first to undergo privatisation. Next group of power plants - Patnov and Kanin (lignite power plants) plus Adamov (oil).

The PSE in January 1995 was convinced that the decentralized structure of 19 CHP plants and 15 power plants provided Poland with a better chance to introduce genuine competition than England had. The PSE operated with three types of contracts with power producers (PPAs):

- (a) Long term PPAs of 15-20 years, having one goal - to ensure financing of power projects.
- (b) Medium term PPAs of 4 years being similar to English contracts after 1990 and having one goal - to secure stability of supply on the fuel market
- (c) Short term or spot market contracts covering about 20% of total supplies

Competitive negotiations were started to for long term contracts. The PSE expected 39 offers to be submitted; but would this year only sign long term PPAs with some 3-4 companies. This would make it possible to maintain competition the next year, when again 3-4 long term PPAs would be awarded.

## Gas

Whereas the restructuring programme outlined in the policy letter continues to be valid official policy, in January 1995, the Polish Oil and gas Company (PGNiG) continues to be one of the last remaining fully integrated monopoly hydrocarbon enterprises in Europe. It is responsible for the complete natural gas chain from exploration through development and production to transmission, storage and distribution to industrial and residential customers as well as for upstream oil activities. It includes some 23 affiliates operating with their own budgets: two geophysical entities; four oil and gas exploration/drilling entities; three oil and gas entities; six regional units operating regional transmission and distribution networks supplying gas and providing services to gas users, residential and industrial; three construction units; three ancillary units; and one designing and engineering office.

## ANNEX V: A SHORT HISTORY OF THE ERG

### Origin

The World Bank had been approached early on by the new democratic Government to provide technical assistance in the process of restructuring the Polish economy. In late 1989 the Polish Government requested the World Bank and ESMAP to undertake a full-scale restructuring study of the energy sector. The restructuring study covering the natural gas, electricity and lignite, coal mining and district heating subsectors, was completed in late 1990 and presented in two ministerial meetings. Through conditions attached to the Bank's SAL I (Structural Adjustment Loan) and the Bank's Energy Resource Development Loan, the Bank was able to exert considerable positive influence on the reform process in Poland. A follow-up on the restructuring study was undertaken by ESMAP, together with World Bank Operations and Polish experts, to turn the recommendations into a blueprint that could be more easily implemented. The follow up actions focused on three areas to promote implementation:

- A 17 pages "letter of sector development policy" addressed to the World Bank was drafted by ESMAP experts and signed by the Polish Government in August 1991. In the letter, the Government pledged to implement a detailed programme for restructuring, privatization and regulatory reform in the energy sector. It was expected that the reformed structure would be largely in place and be in operational by the end of 1992. The outlined programme followed the recommendations of the restructuring study undertaken by ESMAP.
- It was realized that significant resources would be needed to carry out the restructuring process and that it was important to engage international specialists with relevant experience. The director of the Energy Management Department in the MoIT proposed to seek World Bank funds to finance a group of experts to be located in his Department. But the Government and the World Bank were unable to reach agreement on the terms. Instead, the Ministry of Industry and Trade and ESMAP actively encouraged the donor community to support the reform programme by providing funding to various experts, and to do so under a common "hat" to ensure proper coordination. The PHARE programme, USAID and the UK Know How Fund were approached by the Polish Government with request to share in the cost of an international/local team, which was baptized the "Energy Restructuring Group". The mandate of the ERG was to provide technical assistance to the implementation of the restructuring programme prepared with ESMAP assistance. Agreement was reached on the funding and makeup of the ERG in December 1991. But for various reasons, the group was not established before end of November 1992; when according to the time table of the policy letter most of the restructuring was to have taken place already.
- After August 1991, ESMAP continued work continued on ensuring that the recommendations for the various subsectors were consistent and operational. The result - based on the work completed in 1990 - was published in January 1993 in the form of a five volume study "Poland: Energy Sector Restructuring Programme". ERG experts were involved in providing comments on the draft of the last volume - on district heating

The work of the ERG was scheduled by ESMAP to last 18 months with possibilities of extension should work on restructuring take longer. The process was designed by ESMAP with the intent that the Polish specialists by then would be competent to take over the tasks of the foreign specialists in the ERG with a minimum of involvement of the latter. To achieve this aim, each international expert was to be assisted by a Polish "twin" recruited locally and paid by the respective donor agency.

The ERG was to consist of eight international specialists with their twins as follows:

- PHARE was to finance the ERG manager, the oil & gas expert, the district heating expert and the legal expert
- USAID was to finance the lignite & electricity expert, the privatisation expert and the corporate planning expert
- UK Know How Fund was to finance the coal expert, and the regulatory expert

In addition, PHARE financed one energy conservation expert on a full time basis and a management training expert on a half time basis. None of them had a twin assigned to them.

#### Original composition of the team

The PHARE tender was won by a consortium led by a British firm. But during contract negotiations with PHARE, the winning consortium withdrew and the contract was awarded to the second rated bidder, a consortium led by IBF, a small organisation owned by the Belgian state to sell consultants drawn from public Belgian institutions, and including the Danish Energy Agency and the Danish consulting firms Carl Bro and Elsamprojekt. IBF provided the task manager (Mr. Groosen a former manager from the Belgian power sector) and the training specialist (Mr. Jean-Marie Borsu , IBF staff), Carl Bro the district heating specialist (Mr. Mogens Larsen) and the energy saving expert (Mr. Finn Lauritsen), DEA seconded the head of its own legal department (Mr. Kaj Worsaa) to assist the project on a half time expert as legal expert and Elsamprojekt the gas expert (Mr. Jørn Christophersen, a former consultant from the Danish gas distribution companies Naturgas Sydand Naturgas Midt/Nord). Apart from the legal expert, who worked half time and was expected to spend one week per month in Warsaw and one week per month working from his office in Copenhagen, the PHARE experts worked full time on the project being stationed in Poland.

The USAID tender was won by RCG/Hagler, Bailly, Inc. The corporate planning expert, Mr. Jim Wilson worked part time on the project, spending approximately half of his project time in Poland, the other time working from his office in the USA. The power and lignite sector expert, Mr. John Alridge (a former manager in a US power utility) worked full time, spending most of his time in Warsaw interrupted by working stays in the USA. Mr. Bob Blick, the privatisation expert never got to play a significant role - as no privatisation took place there was not much work for him to do, and he seldomly showed up in Warsaw.

The UK Know How Fund awarded only part time contracts for the UK experts and for the regulatory twin, whereas the coal twin received a full time contract. Coopers & Lybrand, the consultant used by ESMAP to design the regulatory framework for the power sector in the Polish

sector studies provided the regulatory expert, Ms. Rosie Miller (legal expert from Coopers & Lybrand). The coal mining expert contract was awarded to International Economic and Energy Consultants who provided Mr. Peter Moore (a former manager in a major British coal company).

In December 1992, ads were placed in Polish newspapers for the recruitment of Polish twins. Originally, the intention had been to pay Polish Government salaries to the twins; but it turned out that it was impossible to attract the high-calibre national staff which were needed to fulfill the important role they were expected to play. Once the salary offers were raised to attractive levels, the project succeeded in recruiting staff of very high quality drawn from the MoIT and from the sector companies: Mr. Wieslaw Filipczak, the twin project manager was a senior official in the MoIT, Mr. Witold Cherubin was the leading figure ("grand old man") in the Polish district heating sector, Mr. Andrzej Piwowarski, the gas twin had long international consulting experience in the gas and energy industry as former World Bank and UNIDO staff, Mr. Jan Piekorz the coal twin was director for restructuring in the Hard Coal Agency, Mr. Miroslaw Duda the power & lignite twin is a doctor of physics with a long experience as energy researcher, Mr. Marek Grybowski the corporate planning twin had long experience in the export-import business, Mr. Andrej Szablewski the regulatory twin was a young economist who worked half time in the Polish Anti Monopoly Office, while Mr. Piotr Kurczewski the privatization twin was a young economist specialized in business. The legal twin was Mr. J. Porejki.

The ERG succeeded in recruiting a first class team of secretaries; all university graduates with excellent English-Polish language skills and knowledge of computer software programmes.

The basic foundation of the ERG was solid: the team of international as well of the Polish experts was both talented and experienced. To recruit a Polish team based on merits only was an important achievement - nepotism is strong in Poland <sup>42</sup>.

#### Original Structure foreseen for ERG's Work

According to the ESMAP scheme ERG was supposed to work within the following structure:

- \* Work on energy restructuring was the responsibility of the *Ministry of Industry and Trade (MoIT)*, the *Ministry of Physical Planning and Construction* was involved in district heating.

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<sup>42</sup> There was one exception to the merit principle. Early 1993, the ERG was forced to take on an extra staff, officially to act as "coordinator of office work". The function once the secretarial services had become well organized became superfluous and a constant source of friction. She was dismissed from the team end December 1994.

- \* An *Interministerial Committee* was to ensure coordination of activities in issues crossing Ministerial boundaries.
- \* To carry out the rehabilitation and restructuring proposals, a *coordinating group in each subsector headed by higher management* was established:
  - The *Power Coordinating Group*, a body of industry executives and higher level technical staff, chaired by the President of the Power Grid Company
  - The *Hard Coal Coordinating Group*
  - The *Oil & Gas Coordinating Group*
  - The *District Heating Coordinating Group*
- \* To assist MoIT and the ERG, a *Counterpart Group* was established staffed by seconders from the energy industries. The group was:
  - to assist *the ERG* in the collection and understanding of data, gaining access to industry executives as appropriate and offering comment on the implementation options.
  - to assist *the MoIT* by identifying important matters for consideration and by ensuring that consequential actions which involved the coordinating groups and other parts of Government were solved in a timely manner.
- \* *ESMAP* was to support the work of the group through a number of activities proposed to be carried out under the ESMAP programme, and by active involvement in ERG activities.
- \* Finally, within the MoIT a so-called *project authorizing officer* was nominated to act as liaison officer between the ministry and the ERG, and to be the ERG's point of reference in the ministry for the establishment of contacts and for resolving issues and problems that arose and needed action by the Ministry.

#### Objectives defined for ERG work

The general objective of the ERG was (i) to advise the MoIT on implementation options and choices made; and (ii) to assist in carrying out the implementation process. ESMAP expected the main requirements to be assistance with:

- preparation of a draft Energy Law
- preparation of draft secondary legislation to be promulgated after the Energy Law was enacted
- formation of new companies in each of the sub-sectors, their corporatization and commercialization
- privatization of ancillary activities and later of the core companies
- establishment of satisfactory contractual arrangements between the various entities involved in energy supply

When seen within the above structure, it can be concluded that ERG had a dual role as technical advisor to Polish authorities and institutions and as a provider of thought leadership to move the restructuring process forward.

In addition, the PHARE used to ERG as its energy PIU (programme implementing unit), that is, as the local PHARE institution with responsibility to identify project opportunities, to define the TOR for new PHARE financed projects, to carry out the tendering for new projects, and to monitor project progress during implementation.

### Start-up of activities until August 1993

The first nine months of ERG's existence were a deeply frustrating experience for the team members. The operation of the team was hindered by a number of pressures and obstacles.

First of all, much constructive effort was "wasted" on practical issues. To acquire proper offices facilities was an uphill fight against Polish bureaucracy. As late as April 1993, the offices were not fully equipped. The temporary installations, hardware as well as software did not work properly, only few staff members had gotten their PCs through the Polish custom office, photocopies of documents (an essential part of data collection) had to be done in outside agencies. Communication was a problem as few Polish staff, e.g. in the MoIT spoke English.

Secondly, the ERG was met by deep suspicion by the MoIT and by direct opposition by the sector companies and institutions who flatly refused to cooperate in providing needed information:

- The MoIT was in its "interregnum period" not having a minister since November 1992. The two directors in charge, Mr. Okrasa and Mr. Adamczyk were reform minded in principle, but also cautious, careful not to come out with clear policy statements and guidelines. In part, this was a reaction against the overoptimistic speed and scope of the restructuring which the ERG was supposed to promote.
- The so-called "coordinating groups" had been established since spring 1993 and been directly responsible for the restructuring processes. The PSE was in charge of power sector restructuring, the Hard Coal Agency in charge of the restructuring of the coal sector, the PGNiG in charge of its own restructuring. None of these institutions looked with positive eyes at the ERG; rather than supportive, the work of the ERG was viewed as potential interference in the functions carried out by the agencies.

The practical implication was that "none" of the Polish institutions seemed genuinely interested in making use of the ERG team's expertise and advice. In addition, the authorities insisted that the ERG staff needed security clearance from Polish intelligence to get access to documents, and getting "cleared" took time. The "project authorizing officer" had a busy time during this period to ask organisations like PGNiG and PSE to provide documents to the ERG. The different subsector specialists were not, except for power and lignite (due to the complexity of the restructuring design for power, he was often asked for advice) and to some extent district heating (due to the personal prestige of Mr. Cherubin) directly involved in the restructuring work prepared on the Polish side.

Thirdly, the ERG team suffered from problems of "internal management authority" due to the double leadership exercised on the one hand by the PHARE financed project manager, Mr. Goosen, and on the other hand, by ESMAP staff. Mr. Christopher Brierly, who had drafted the Polish Government's energy policy letter to the World Bank, was assigned by ESMAP to lead the

activities of ERG on a half-time basis. Mr. Luis Gutierrez was task manager for ESAMP activities in Poland in general and was the editor of ESMAP's five volume study on the Polish energy sector. Already the upstart showed the potential for conflict - PHARE resented that ESMAP had called the kick-off meeting without informing PHARE officials on beforehand. Yet, in the very beginning, the arrangement worked out well, as a sort of division of labour was established. Mr. Goossens concentrated on solving the practical and logistical issues of the ERG and had a "wait and see, let's first get to understand the issues" attitude to the reform work of the ERG. Since the objective of ERG was to assist in the implementation of the regulatory-institutional structures recommended by the ESMAP study, Mr. Brierly was able to provide genuine thought leadership to guide the activities of the group. He pressured hard to achieve results in crucial areas such as legislation and had a particularly good cooperation with the regulatory expert. Both were in favour of the English model for power sector restructuring and regulation. Within a few months, however, the involvement of Mr. Brierly was more and more seen as a duplication of the functions of the ERG team leader. Mr. Brierly interfered in concrete actions, negotiated directly with the MoIT and other institutions and continued to push for a more liberal regime and at a faster pace than most team members thought was realistic.

By June/July 1993, Mr. Brierly's involvement in the project stopped. Mr. Gutierrez continued to come once in while; but ESMAP's influence on the ERG was definitely broken. An ESMAP proposal in the spring of 1994 to assist in the elaboration of the secondary legislation and the establishment of the regulatory agency was rejected by the ERG<sup>43</sup> which had several amendments to the proposal. The ERG management feared that ESMAP involvement would once again lead to problems of dual management. But whereas there had been genuine problems with ESMAP's collaboration, the loss of ESMAP / World Bank involvement led to some loss of directional leadership and to some loss of clout. The World Bank due to its international prestige as a thought leadership institution and due to its financial "muscle" (expressed in loan conditions) had possibilities to provide pressure for reform which the ERG as a consultant did not have. In addition, the World Bank can transfer lessons learned from restructuring projects around the world. In September 1994 the World Bank informed the ERG that it had been decided not to start the project until the proposed Energy Law had been adopted by Parliament.

The strategy of the ERG (and Mr. Brierly) had been to get the energy law presented to Parliament as a fast track decree system. However, a no-confidence vote was cast on 28 May by the Polish Parliament, and the President subsequently dissolved the Parliament. The energy law therefore had to proceed through the normal Parliamentary process, and Parliamentary work could not start until after the election in September 1993. As a consequence, the team knew that the energy law could not be passed until late 1994.

By August 1993, the ERG was in a deep crisis. The staff felt underutilised and insufficiently challenged in the work and was demoralized:

- The manager Mr. Goossens resigned on May 1 due to health reasons, the energy saving expert, Mr. Lauritsen left in August for family reasons, and the regulatory expert, Ms.

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<sup>43</sup> ESMAP had received Dutch bilateral finance for a project to assist in the establishment of the ERA.



- Miller left in December because she felt isolated within the group. There is no doubt that the frustrating work situation was a contributing factor for the resignation of all three.
- The USAID team wrote a memorandum on the mission of the ERG; whether it was correctly formulated, and whether the position of the ERG as advisor to the MoIT was the correct one. The group argued that the ERG should not be limited to the contacts with MoIT only. The progress of energy restructuring and reforming had to be coordinated with the reformatory efforts throughout the whole national economy. A platform for ERG cooperation with the Ministers Council should be established.

The legal expert Mr. Worsaa left the team as well. It had become clear that his part time assignment in the ERG project was incompatible with an efficient fulfillment of his functions in the DEA; and that a full time legal expert was needed in Warsaw. Mr. Igor Muszynski, a young talented lawyer from an English-American law firm joined the team as new legal expert in August 1993.

#### Autumn 1993 to summer 1994 - the period of stabilization and confidence building

Mr. Ferdinand Sonck, Director General of the Administration of Energy in the Belgium Ministry of Economic Affairs, was nominated as the new manager of ERG; Coopers & Lybrand postponed the replacement of the regulatory expert until conditions for work on regulation had become more favourable (the Polish twin continued to be financed); Mrs. Anita Rønne (assistant professor in energy law at the University of Copenhagen) began work as legal expert and Per Stockholm from the DEA as energy saving specialist from November 1993.

The office facilities were now well established, the staff had received security clearance, working relationships with the MoIT and the sector enterprises improved considerably. Established personal contracts and working routines facilitated access to information. The style of the ERG was very reactive - the ERG responded to requests for comments and information which came from sector enterprises, from the MoIT and from the Ministry of Construction. But hardly any proactive action was taken. Although the ERG provided consulting advice of high quality, little tangible progress was achieved, and the quarterly progress reports came to look very repetitive. The work on the energy law, a cornerstone of ERG activity proceeded frustratingly slowly. It seemed to be inevitable that every time work on the law progressed by two steps a reaction came bringing the work at least one step backwards again.

ERG experts assisted the donor community in identifying technical assistance, demonstration and strategy projects in the energy sector.

At the less tangible level, the ERG produced work of value by providing consistent high quality advice to the enterprises and to the ministry. Through comments on the business plans of its divisions, the PGNiG realised that several of its managers were not capable of performing in an "independent market" environment; and slowly the attitude towards the ERG changed from outright rejection to one of positive interest.

The political situation continued to pose problems.

### The period since summer 1994 - a fully operational ERG

The 18 months period foreseen in the original contract was over. But PHARE extended the lifetime of its part of the project to March 1996. A new 2 MECU contract was given to IBF (after a formal tender) providing 93 m.m. of EU experts and 136 m.m. of Polish experts. Two new specialist subjects were taken on board by the PHARE project: an energy planning and strategy expert, Mr. Jos Nackaerts from the Belgian EC Representation and Mr. Pierre Scokaert, a Belgian financial specialist, who in March was replaced by Mr. Braun. It was correctly believed that the ERG needed to strengthen its assistance in the area of energy strategy and in the area of financing energy sector investments. The training expert Mr. Borsu was replaced by a new expert. Mrs. Elzbieta Kwiatkowska and Mr. P. Zawadzki from the MoIT were taken on the team as "twins" for training and for energy planning, and Mr. Zygmunt Parczewski from the Polish Academy of Science was assigned as twin in energy savings. Since the "privatisation twin" was underutilised he was transferred as twin to the financial expert.

Working relationships with the MoIT and the sector enterprises had now become so good, that the functions of the "project authorizing officer" Mr. Jacek Nowakowski which related to problem solving and information facilitating became almost superfluous. A cooperation agreement was signed between the ERG and the PGNiG providing the ERG with full access to information without prior consultation with the MoIT.

In spite of this, the potential of the ERG is still underutilized. Vice Minister H. Gabrys from the MoIT, for example, seldomly meets experts from the group.

### Coal Team

The coal team set up its office within the premises of the Polish Hard Coal Agency in Katowice. The choice of Katowice meant being away from the rest of the ERG team and far away from the Ministry of Industry and Trade (MoIT). This had the disadvantage of reduced daily interaction with the other team members, and some inconvenience in fulfilling the advisory function to the ministry. But it signalled the team's commitment to work with the industry directly in its restructuring.

Setting up the office within the Hard Coal Agency increased the visibility of the team - the staff of the agency could see them meet for work daily, and knew that some work was being done. Before joining the ERG team, Mr. Jan Pierkorz was a director of the Coal Agency responsible for restructuring. But despite of this interaction with staff of the Coal Agency was rather limited. The agency had an agenda of its own in coal sector restructuring. Before the process started the agency was managing the coal industry; whereas it now had to change to an advisory role. Its number of staff was reduced from 450 in 1992 to about 200 in 1994 working in three areas: (i) as advisors to the ministry in restructuring; (ii) providing staff as members of the supervisory boards of the coal companies (all chairmen come from the agency), (iii) as consultants to the coal industry. To some degree the agency saw the ERG as a competitor in its advisory role, and since the ERG was asked by the MoIT to comment on proposals made by the agency, there were limits to the scope for cooperation.

The coal team worked on three fronts:

- as an advisor to individual mines on plans for restructuring and development of business plans (in collaboration with the corporate planning advisors and the privatisation advisors)
- as an advisor to the MoIT on the plans for Phases II and III of the restructuring programmes
- as an advisor to PHARE and other donors on the identification and preparation of new project proposals

## **ANNEX VI: LIST OF INTERVIEWED PERSONS**

### Ministry of Industry and Trade

Mr. Gabrys, Deputy Minister

Mr. Andrzej Pierzak, Director, Department of Energy and Solid Fuels

Mr. Jacek Nowakowski, Project Authorising Officer

### Ministry of Physical Planning and Construction

Mr. Ryzicki, Deputy Director of Urban Department

### ERG-team

Mr. Fernand Sonck, Project Manager

Mr. Wieslaw Filpczak, "twin" project manager

Mr. Mirosław Duda, power industry advisor

Mr. Peter Moore, coal specialist

Mr. Jan Piekorz, coal specialist

Mr. Jørn Christophersen, gas advisor

Mr. Andrzej Piwowarski, gas advisor

Mr. Kaj Worsaa, legal specialist

Mrs. Anita Rønne, legal specialist

Mr. Igor Muszynski, legal consultant

Mr. Finn Lauritsen, energy saving specialist

Mr. Per Stockholm, energy saving specialist

Mr. Witold Cherubin, district heating specialist

Mr. Mogens Larsen, district heating specialist

Mr. Andrej Szablewski, regulatory expert

Mr. Jos Nackaets, energy strategy expert

Mr. Marek Grybowski, corporate planning expert

Mr. Piotr Kurczewski, privatisation expert

Mrs. Elzbieta Kwiatkowska, training specialist

Mr. Jean Borsu, training specialist

### Polish Power Transmission and Dispatching Company

Prof. Jan Popczyk, President

### Polish Oil and Gas Company

Mr. Andrzej Schoeneich, Director for Restructuring

### Polish Chamber of District Heating Companies

Mr. Stefan Sikora, Director

### National Energy Conservation Agency

Mr. Krzysztof H. Zmijewski, President

### PHARE - Programme, Bruxelles

Mrs. Mechtild May, Programme Official, PHARE Operations

EU Delegation, Warsaw

Mr. Klaus Schmidt, counsellor

Mr. Radek Czapski, programme officer

EC Energy Centre Warsaw

Mr. Witold Pawlowski, Director

EC Energy Centre Katowice

Mr. Allan Stretton, Director

Mr. Andrzej Krol, Deputy Director

World Bank Office, Poland

Mr. Christian Duvigneau, World Bank Representative

USAID, Warsaw

Ms. Maria Jakubowicz

UK Know How Fund, Warsaw

Mr. Dominique Meiklejohn

## **ANNEX VII: LIST OF CONSULTED WRITTEN MATERIAL**

### PHARE Project Documents:

- Financial Memorandum, Project Number 9103 Sectorial Support Programme in Energy Sector, Polish Energy Sector Assistance Support Programme (PESAP)
- Financing Memorandum, PL 9213, Facility for implementation of effective sectoral and technical assistance in the Energy Sector (FIESTA- Energy)
- TOR, Assignment of a group of high level experts to the Ministry of Energy Trade, Poland for assistance in the restructuring of the energy sector
- Services Contract 94-0548, Energy Restructuring Group at MOIT
- Financing Proposal, Poland Energy Programme, 1994

### Background Documents:

- ESMAP, Poland Energy Sector Restructuring Programme, Volumes 1-5, 1993
- IEA, 1994 Survey of the Polish Energy Sector
- The Netherlands - Poland Task Force on Integrated Energy and Environmental Planning, Vol 1: "Institutional Organisation of the Energy Administration in EC Countries and in Poland", ECN-c-93-031 Report.
- Strategy for Poland, report to parliament by Vice Minister of Finance & Vice Prime Minister
- The Economist, A Survey of Poland, April 16th 1994
- Jens Henrik Haahr, Reformer af den offentlige forvaltning i Østeuropa: Eksemplet Polen, Samfundsøkonomen, vol.3, 1995
- Issues and Opportunities of Energy Restructuring in Poland, A View from the World Bank, 1st Silesian International Conference on Coal Bed Methane Utilization, October 1994

### Ministerial and other outside" documents"

- Minister Gabrys, Tasks on Energy Sector Restructuring to be executed jointly by the Department of Energy and Solid Fuels (DESF), MOIT and ERG
- Scopes and principles of cooperation between the ERG and Polish Oil and Gas Company

### Documents prepared by the ERG

- First draft of the national orientation document for the energy sector in Poland, PHARE Indicative Programme for 1995-1999
- Country Operational Programme, Poland
- Quarterly Activity Reports, Volumes 1-8
- Complete set of the December 1994/January 1995 Assessment Reports prepared by team members
- ERG memorandum December 7, 1993 "National Energy Policy Guidelines"
- Complete set of the different draft energy laws, and ERG comments
- Paper listing the need for preparation of secondary legislation, december 1994
- Moore & Piekorz:
  - Quarterly Review September - November 1994
  - Report to Know-How Fund on Activities January 1993-June 1994 with Workplan for Extension to December 1995
  - International assistance to coal sector as at November 1994

- Complete set of USAID-financed ERG team's 1993 and 1994 reports and working papers
- ERG Remarks on 1994 Survey of the Polish Energy Sector by the IEA, including letter addressed to Minister Gabrys on November 9, 1994
- Nackaerts/Zawadzki,
  - Elements for a possible financing system of the Energy Information Centre (EIC)
  - Energy Statistics in Poland, October 1994
  - Organizational elements for long term energy planning
- Finn Lauritsen, National Energy Preservation Agency, 2.3.1993
- ERG Training, Work Programme, March 1995
- Kwiatkowska, Information on training for the MOIT staff within the PESAP programme
- Larsen/Cherubin/Grybrowski/Wilson: TOR for management training in Polish district heating sector, Invitation to tender
- Larsen, Background paper on energy sector in Poland prepared for Danish parliamentary delegation
- Christophersen/Grybrowski, Business planning in gas ancillaries
- Christophersen / Piwowarski, Assessment of the economic situation of PGNiG, June 93
- Christophersen / Piwowarski, Manuscript for the presentation of PGNiG ancillaries about business planning
- Christophersen / Piwowarski, Letter to MoIT concerning restructuring of PGNiG, May 1994
- Stockholm, Memo concerning status for the National Energy Conservation Agency, Nov. 18, 1994
- Stockholm/Parczewski, Preparation of Secondary legislation, Dec. 12, 1994
- Rønne/Stockholm, Energy Policy paper, Internal Memo, 31.5.1994
- Stockholm / Rønne, List of contents for the outlining of an energy policy, Internal memo, Dec. 2, 1993
- Larsen/Cherubin, Draft Heat Supply Law, 1993
- Larsen / Cherubin, Principles for Pricing