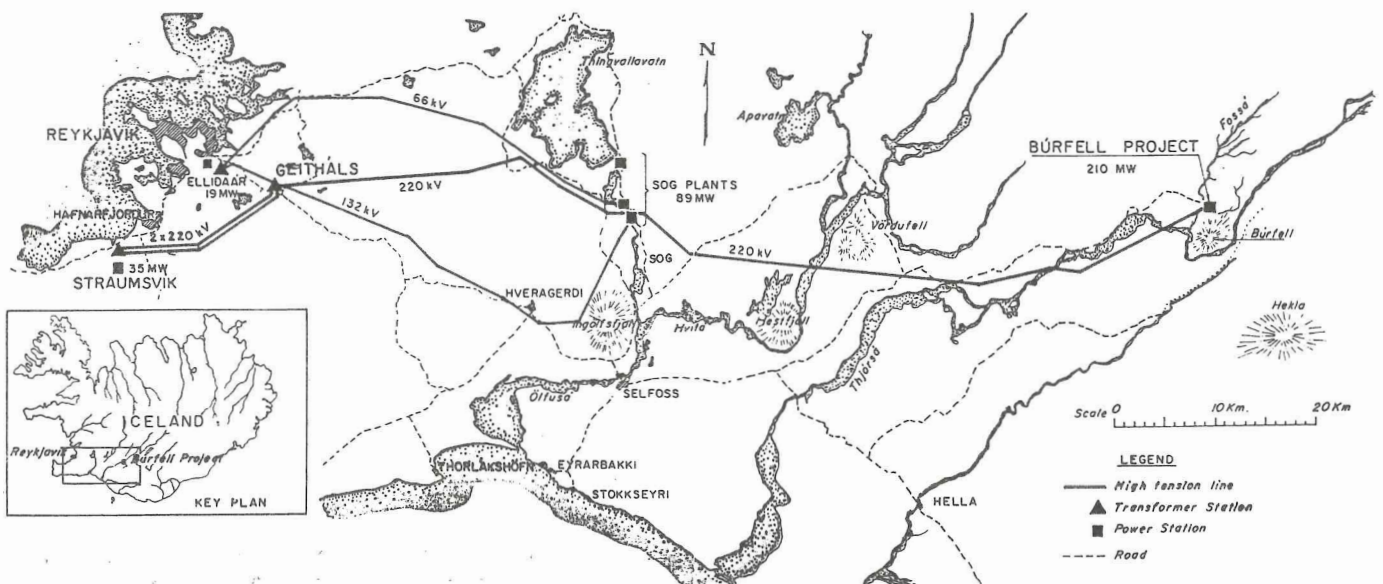


Aerial view of the Búrfell power station (top).

The Landsvirkjun power system after completion of the Búrfell power project (below).





The World Bank's strategy in the electric power sector

By Elias Davidsson

The article first describes and analyses the context in which the National Power Company was established and its legal structure. It then analyses the World Bank's role in promoting the establishment of institutions such as Landsvirkjun, monitoring their operations and finances, promoting their fast growth and steering their development.

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Although some of the documents referred to in this article are a bit dated, the World Bank has not — as far as is known — changed its goals and methods in the electric power sector within the last decade. Thus, the following analysis may be considered both timely and relevant.

The National Power Company of Iceland (Landsvirkjun) was established on July 1, 1965 by a partnership agreement between the Government of Iceland and the City Council of Reykjavik (capital of Iceland) pursuant to Law No 59 of May 20, 1965. The concern was jointly owned by these parties, each owning half of the company, until 1982. At that time the northern town of Akureyri joined in, acquiring from the city of Reykjavik 6 per cent of the shares.

The principal objectives of Landsvirkjun are to construct and operate electric power plants and main transmission facilities and to sell electric power wholesale for public and industrial consumption.

We will first describe and analyse the context in which the company was established and its legal structure. We will then analyse the World Bank's role in promoting the establishment of institutions such as Landsvirkjun, monitoring their operations and finances, promoting their fast growth and steering their development.

Landsvirkjun's establishment and constitution

On May 3, 1965, members of the Icelandic parliament (Althing) received a copy of a Government Bill, concerning the establishment of a National Power Company, Landsvirkjun. As on other occasions, when the local power elite was pushing legislation related to foreign policy, its political arm (Government) took care to limit the debate about the proposed legislation in time and space. The legislature was granted just one day to prepare for the debate about the Bill, and a week's time before a vote was taken.

We will review the articles of the Bill that have affected the political role Landsvirkjun has assumed, leaving aside those of a more technical nature.

Constitution

Article 1 establishes that Landsvirkjun

be jointly owned by the Government and the City of Reykjavik, in equal parts. Neither party is entitled to leave this joint-venture without the other's consent.

Article 8 refers to the nomination of Board members and fixes their terms at six years. Both articles together have succeeded in immunizing the company against occasional changes in the government's and city council's political composition. Thus, the founders of Landsvirkjun — and those who formulated these articles — ensured until today that the Board of Landsvirkjun remained under the leadership of, and majority rule of, individuals favourable to the basic philosophy underlying Landsvirkjun's role and foreign relationships.

Financial independence

Article 11 describes the procedures that Landsvirkjun has to follow in fixing electricity rates: After consulting with the Central Economic Institute, the Company's Board is free to set prices, so that a "normal return on fixed capital in operations will be assured". The new company's revenue should also ensure an unspecified level of self-financing capabilities, allowing Landsvirkjun to expand power load capacity and "meet demand" independently of government policy.

Article 12 establishes that Landsvirkjun is allowed to raise local and foreign loans for its own needs. It is not required to consult its owners before negotiating new loans with foreign banks, as is the normal practice of other public enterprises in Iceland. In accordance with this article, Landsvirkjun has repeatedly issued bonds for sale in the European and American money markets.

Fiscal privileges

Article 13 exempts Landsvirkjun from paying import duties, estimated at 20—30 per cent of the cost of power plants and related equipment.

Article 16 exempts Landsvirkjun

from paying income tax, community tax and other taxes.

Government guarantee

Article 15 permits the Government to guarantee loans that Landsvirkjun may raise, up to the amount of 28 M USD or the equivalent in other currencies. This article has been amended a few times since, to keep up with the financing targets of Landsvirkjun.

Burfell power plant

Pursuant to *article 6*, Landsvirkjun was allowed to construct a hydro-electric power plant of a total capacity of 210 MW (megawatt) at Burfell on the Thjórsá River. Landsvirkjun is also allowed to set up thermal power stations — for backup purposes — when and where it sees fit.

The above articles were not readily accepted by all Althing members, although a consensus existed about two main points: The desirability of establishing a National Power Company and the choice of Búrfell as the most economic site for a hydro-electric power plant.

The proposed Law was opposed on two levels: On a more general level it related to foreign investment policy; on a more specific level, the unique privileges granted to the company were considered unjustified.

It must be noted that the creation of the National Power Company and the proposed power plant at Búrfell were directly related to the plans of attracting foreign investment, especially power-intensive industry. At the time of the Bill's debate, extensive discussions had already taken place with Alusuisse concerning the establishment of an aluminium smelter (which has been operating since 1969) and with the World Bank, concerning loans for the Búrfell Power Project.

Although discussions with Alusuisse were then reaching their final stages, no formal decision was taken concerning

the smelter at the time of the Bill's enactment.

Some legislators considered it inappropriate to grant a permission for a 210 MW power plant, that could more than feed a 60 kt/year aluminium smelter, while negotiations with Alusuisse were still pending. By enacting this permission, it was argued, the negotiating leverage of Iceland vis-a-vis Alusuisse would be reduced. It was furthermore claimed, that it would strengthen the negotiating posture, if Iceland could credibly demonstrate its ability and readiness to expand power generation capacity (for local use) without recourse to a foreign bulk customer. Thus, a permission for a 70 MW power plant would have sufficed at the time.

Others claimed that by granting Landsvirkjun a whole array of fiscal privileges (articles 13 and 16), the authors of the Bill attempted to reduce operating costs — with the sole aim of making electricity prices for a potential foreign investor more attractive. The general public — representing a captive market of Landsvirkjun — would thus subsidize indirectly the power company's import duties and taxes. One parliamentary representative raised the question why electric power *retailers* were not granted similar fiscal privileges.

The tariff philosophy (article 11) was also criticized by some legislators. As the legislature was denied the control of Landsvirkjun's investment policies, concern was raised that a process of unchecked asset accumulation could ensue.

Some also considered inappropriate to hand the ultimate control of the electricity sector to a Board on which the City of Reykjavik would have power of veto. This was apprehended because the development strategy for the electrical power sector was closely related to the policy on foreign investment. The question whether Iceland (240 000 inhabitants!) should allow foreign investment has been a hot political issue in the

country for over 50 years.

In the next two sections, we will analyse the role of the World Bank in establishing, monitoring and steering Landsvirkjun.

The World Bank's role in creating appropriate conditions for foreign investment in Iceland

The role of the World Bank in promoting a development scheme favorable to transnational companies has been analyzed by several writers¹⁻³. This being the case, no attempt will be made here to add evidence that is widely known. Instead we will give specific information about means used by the World Bank group to pursue its goals in the electric power sector.

In this section we will analyze the World Bank's role in *establishing institutional bases* apt to carry out the Bank's ultimate aims "from within" a country, a method that has sometimes been called the "Trojan horse" method. The establishment of the National Power Company in Iceland (Landsvirkjun) may be considered a typical case.

Did the World Bank formulate the Landsvirkjun Act of parliament?

No firm evidence exists that allows to answer this question with an unqualified yes. Having said so there are nevertheless a series of indications that strongly support the claim that the Bank was actively involved in formulating the law, or at least its most significant provisions. These indications will be reviewed here one by one:

1. A report of the Industrial Development Committee to the Icelandic Government (1964-11-14), describes the World Bank's attitude to the integrated power-station/aluminium-smelter project. Regarding the power company yet to be established, the Bank is quoted to have said "that it would like in a future discussion to study in detail the organization and financial structure of the Company".

2. According to the World Bank's report "Operations Evaluation Report: Electric Power" (hereafter called the WB Report)⁴ the Bank has regularly used its "leverage" to impose upon its borrowers conditions ("covenants") of an institutional character.

In the conclusions of this report the authors state:

"Effective project execution is important and it is not irrelevant to the role of the Bank insofar as most of the companies studied were either created or considerably reorganized within the period, *with the Bank contributing to a greater or lesser extent to the formulation of their basic constitutions.*" (italics by ED) (p 66)

The report describes several methods the Bank uses to impose specific policies on borrowers in this sector. Some of these methods will be described later.

3. The Act of Landsvirkjun has provisions that "insulate" the Power Company from what the Bank calls "political interference", a label that carries itself political connotations! This "insulation" was achieved by the provisions of articles 1, 8, 11 and 12 of the Act, described in the last chapter.

These provisions reflect faithfully the Bank's philosophy (WB report p 6, p 10. See also example later in this article).

4. The World Bank has acknowledged the Landsvirkjun Act by covenants in all Loan Agreements made between itself and Landsvirkjun. In these agreements, special covenants restrict the legislative power of the Icelandic Parliament⁵. Should Iceland's parliament nevertheless decide to exert its rights of legislation and amend the Law of Landsvirkjun so as to make Landsvirkjun for instance more accountable to the legislature and to the general public, the World Bank would be entitled — at its own discretion — to define such amend-

ments as a default on the Loan Agreement. If this should occur, the Bank,

"... at its option, may... declare the principal of the Loan and of all the Bonds then outstanding to be due and payable immediately together with the interest and other charges thereon."⁶

Whether such infringement upon the sovereignty of a country's legislature is consistent with current trends in international law, is open to question. It is noteworthy that this fact was never brought to the attention of the Althing. Whether the World Bank ever referred to these clauses in its dealings with Iceland to obtain its will, is not known and may never become known.

The World Bank's invisible hand and Landsvirkjun

What quality has the relationship between the World Bank and Landsvirkjun taken? To what extent is Landsvirkjun's autonomy real? How does the World Bank exercise its control over Landsvirkjun?

We will proceed by looking at the Búrfell Loan Agreement — a publicly available document⁷ — made between Landsvirkjun and the Bank in 1966, and offer comments on those provisions that demonstrate the Bank's influence on, or control of Landsvirkjun's organization, constitution and operating procedures (as distinct from the Bank's influence on or control of the execution of the Búrfell Power Project, for which the Bank has loaned funds).

Article 5.01

Landsvirkjun's consultants and contractors must be "acceptable to, and to an extent and upon terms and conditions satisfactory to, the Bank".

Implications

This covenant (condition) can be interpreted in several ways. The Bank would maintain that such a covenant does en-

sure the qualifications and financial strength of consultants and contractors. In addition to this legitimate concern of the Bank it is plausible to ascribe to the Bank the aim of ensuring the selection of firms and individuals which share the Bank's economic philosophy (support of MNCs etc).

The above assumption is quite legitimate, if one considers the general ideological framework under which World Bank personnel operate⁹, plus the fact that the Bank has often made loans conditional on hiring specific individuals (WB Report, Table 4, 5).

Article 5.02 (c)

Landsvirkjun "shall enable the Bank's representatives to inspect", not only the project for which loans are disbursed, but also "the goods, and all other plants, works, properties and equipment (of Landsvirkjun), and to examine any relevant records and documents."

Article 5.02 (d)

Landsvirkjun "shall furnish to the Bank all such information as the Bank shall reasonably request concerning" not only "the expenditures of the proceeds of the Loan, the Búrfell Project" and related matters, but also "the administration, operations and financial condition (of Landsvirkjun), its relations with ISAL (the subsidiary of Alusuisse in Iceland) and the exercise of Landsvirkjun's and ISAL's respective rights, and the carrying out of their respective obligations, under the Power Contract and any other agreement related thereto."

Implications

This covenant permits the World Bank to monitor and control the entire information base of Landsvirkjun, financial, legal, administrative and operational.

These rights are denied to the members of the Althing and to Iceland's taxpayers.

Article 5.03 (b)

Landsvirkjun "shall inform the Bank of any condition which interferes with, or threatens to interfere with, the accomplishment of the purposes of the Loan, the maintainance of the service thereof, or the performance by Landsvirkjun of its obligations under this Loan Agreement, the Power Contract, the Purchase Agreements and the External Bonds".

Article 5.09 (b)

"The Bank and Landsvirkjun shall exchange views as to any arbitral or judicial proceeding contemplated or undertaken pursuant to the Power Contract . . . Landsvirkjun shall promptly advise the Bank of any such proceeding contemplated or undertaken and shall give the Bank such information as the Bank shall reasonably request . . ."

Implications

While covenants 5.02 (c) and (d) call for a passive relationship towards the Bank, covenants 5.03 (b) and 5.09 (b) require Landsvirkjun to actively supply the Bank with legal and economic intelligence pertaining to domestic matters (such as government policies, plans and strategies to increase Iceland's revenues from electricity sales to Alusuisse subsidiary, etc . . .).

Article 5.08

Landsvirkjun "shall at all times take all steps necessary to maintain its existence and right to carry on operations?" It shall "except as the Bank shall otherwise agree, take all steps necessary to acquire, maintain and renew all rights, powers, privileges and franchises

which are necessary or useful for (. . .) the conduct of its business?"

Implications

It seems obvious that the World Bank wanted hereby to ensure the cooperation of Landsvirkjun in warding off any laws or regulations that might affect the company's constitution, prerogatives and "particular relationships."

There is evidence (WB Report p 10), that the Bank is ready to assume the defense of its borrowers in eventual conflicts with their legitimate owners.

Articles 6.01 and 6.02

If "any provision of the Landsvirkjun Act or the Regulations (pertaining to Landsvirkjun — ED) shall have been amended, suspended, abrogated or repealed so as to affect adversely the financial condition or operations of Landsvirkjun or the performance by Landsvirkjun of its obligations under the Loan Agreement, (. . .) the Bank, at its option, may declare the principal of the Loan and of all the Bonds then outstanding to be due and payable immediately." (see also note 8).

Implications

This covenant, mentioned previously, restricts effectively the exercise of democratic control by the Icelandic people over the main producer of electric energy in the country. It must be borne in mind that the terms "affect adversely" used in this covenant, may have a wide range of applications: It may not only infer a deterioration of finances but refer to any decision that would affect the administrative obligations of Landsvirkjun towards the World Bank, such as those dealing with the role of Landsvirkjun as intelligence officer in behalf of the Bank.

There are some people who believe that stringent control of power companies by the World Bank is beneficial

insofar as it ensures the completion of projects on time and within budget. This is not always the case, as the internal WB report readily admits (p 75):

"Considerable cost overruns occurred in many of the projects reviewed in Colombia and Mexico (projects funded by the Bank), and in particular by experience of Calima for which the cost overrun was so great that, in combination with other factors of lesser importance, it raises some doubt now as to whether the project was the most economical means of meeting system load growth."

The above analysis focused on administrative, institutional and constitutional covenants, that ensure the Bank's control of Landsvirkjun. Financial covenant will be reviewed later, in relation to the central aims of the Bank, as an agency for steering a particular form of (state) capitalist accumulation.

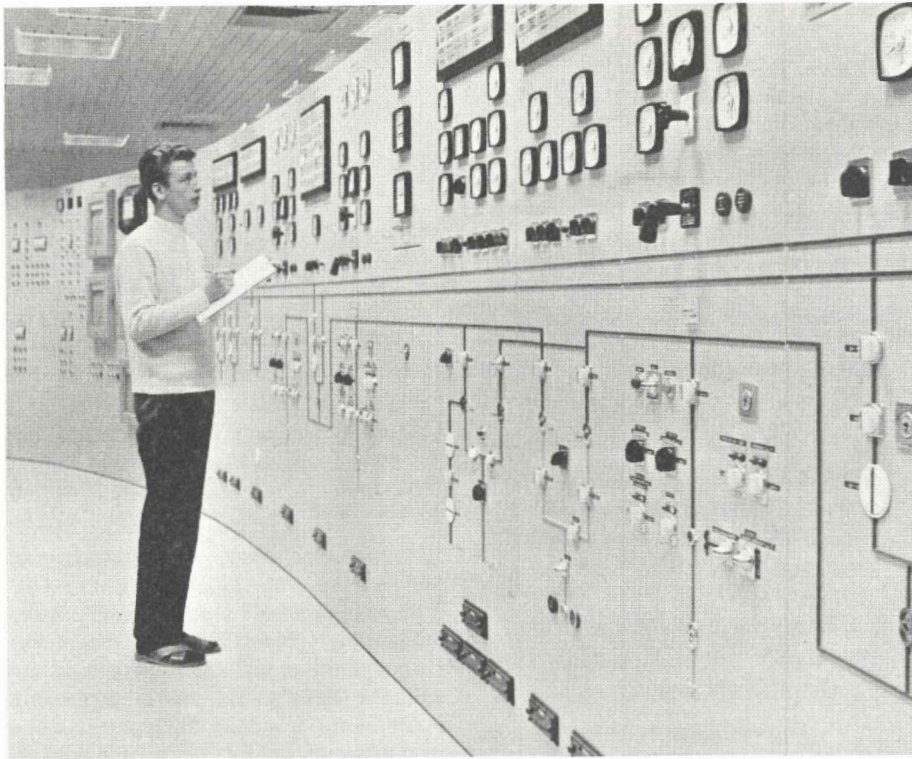
Means and ends according to the World Bank's own report

The main aims of the Bank in attaching conditions (covenants) to loan agreements are summarized by the Bank's officials in the following terms:

"Many of the Bank's financial and institutional objectives in connection with its loans have been expressed in the form of covenants in the Loan Agreements or supplementary letters attached to the Loan Agreements. The conditions set were generally designed to assure sound financial management and development and sound organization and operations in the company and/or the country's power sector as a whole." (p 41).

There are basically three classes of covenants: Financial, managerial and institutional:

- Financial covenants attempt to insure



The control room at the Búrfell power station.

a minimal self-financing ratio and limit the incurrence of long-term debt.

- Managerial covenants include obligations of the borrowing company to consult with the Bank on issues such as contracting, consulting, accounting, bidding, hiring of executives and the like.
- Institutional covenants attempt to ensure or increase the autonomy of the borrowing company toward its owners (Government, City . . .) or induce a specific sectoral development in a whole region or country.

Let us quote a few extracts from the Bank's report, that describe in more detail the means and the ends of the Bank's involvement in its member countries' electric power sector:

To be able to obtain World Bank financing, borrowers had to bow to the Bank's conditions or be turned down:

"A loan for a second stage at Jurong (Singapore — PUB) was seriously considered in 1970 but finally turned down because of PUB's failure to take action on the appointment of a General Manager?" (p 18)

It should not be assumed that this type of condition (covenant) is unique to this case:

"Covenants regarding Bank approval of appointments to senior positions in (public) utilities, have

been quite frequent features of Bank loans." (p 6)

Another important type of institutional covenant is one dealing with a utility's autonomy (meaning insulation from public policy):

"EEEB is an autonomous entity responsible for all phases of public electricity supply in the city of Bogota, the capital of Colombia, (. . .) The autonomy of the entity and its independence from other city services were assured by decrees issued in 1959 as a precondition for Bank lending. Although owned by the municipality of Bogota, appointments to the Board are made in such a way as to prevent the city council from obtaining a majority of the seats; *this arrangement, agreed with the Bank, has been designed to insulate the entity from intrusion of politics.*" (italics by ED) (p 23)

Once a public utility is established in accordance with World Bank's directives, the relationship with that utility,

" . . . has often been maintained by further loans in support of further expansion. There are a number of companies with which the Bank has been associated more or less continuously since the early 1950s or even earlier, such as CFE in Mexico, KESC in Pakistan,

Chidral in Colombia, ENDESA in Chile and CEMIG in Brazil (. . .) Interruptions in the Bank's series of loans to such companies, where they have occurred, have generally resulted from delays by the company, or more often, the Government authorities, in taking certain steps upon which the Bank insisted." (p 4)

When the Bank's client-utilities have difficulties with their legitimate owners, the Bank stands on the side of their clients:

"The Bank has been a strong proponent of the company's interests in negotiations with the Government (of Argentina), for instance, securing lower taxes on equipment purchased by SEGBA, special Government contributions in 1966 to its working capital, Government support for renegotiation of the labor contract in 1968?" (p 10)

An operational aim of the World Bank in the electric power sector is to initiate and sustain a rapid expansion of electrical generation capacity, so that "all demand in the existing service area" would be met (p 4). Since demand must be met *at all times*, then public utilities will have to dispose of excess capacity, a situation sought after by the power-intensive industry (smelters and process industries).

The Bank admits readily that its methods lead to a rapid expansion of its clients' generation capacity:

"Through studies, advice, loan conditions and lending itself, it has sought to bring about changes in the sector's institutional structure or in Government policies toward the industry, which would enable the power sector to expand more quickly and at a lower unit cost than would otherwise be the case." (italics by ED) (p 7)

The results have demonstrated that the Bank's expansionary aims were fulfilled:

"Sales by borrowing companies have grown faster than customers, indicating an average annual increase of 4 per cent in kW/h consumption per customer." (p 37)

Although many methods are used by the Bank to stimulate its "clients" expansion, one method is used more widely and more regularly than others:

"Tariff covenants have probably been in practice the most important: They have generally been *phrased in such a way* as to require that the borrowing utility earn a surplus sufficient to finance part of its own further investment requirements (. . .) or to yield a certain rate of return on total net fixed assets in operation, sometimes revalued to allow for inflation." (italics by ED) (p 6)

As most electricity sales to bulk users (power-intensive industry) are made under long-term agreements, the only way for a utility to reach the prescribed level of return "on total net fixed assets (revalued)" is to increase electricity tariffs to the general public.

As utilities earn a surplus, they invest in new facilities, thus increasing their capacity (fixed assets). As World Bank covenants require them to yield a rate of return on the value of fixed assets, the borrowing utilities are forced to increase their earnings. This can best be done by pushing up electricity consumption and/or increasing the price to the captive population.

Concluding remarks

We have now expanded on the means and ends of the World Bank in the elec-

tric power sector. these should be related to one of the Bank's major purposes, namely:

"to promote private foreign investment by means of guarantees or participation in loans and other investment made by private investors."⁹

This primary purpose was reaffirmed in another Bank's publication dated 1969, in slightly different terms:

" . . . as the records of the Bretton Woods deliberations indicate, the emphasis from the beginning was not so much on what the Bank could lend out of its paid-in capital as on the concept of the Bank as a safe brige over which private capital could move into the international field."¹⁰

To provide "private capital" (in this context a euphemism for transnational corporations) a receptive investment and operating "climate" in the Bank's less developed member countries, the Bank carries out specific policies in each sector. The Bank's operational strategy in *electric power* may be broadly defined as follows:

- Subvert effective public control over electrical power utilities.
- Build-up an oversupply of installed generation capacity.
- Use captive markets (local populations) to subsidize international competition between power utilities, for the benefit of power-intensive industries operating internationally.

Notes:

¹ Teresa Hayter, *Aid as Imperialism*, Penguin books, 1971.

² Bruce Nilsson, "The World Bank - A

Political Institution", *Pacific Research and World Empire Telegram*, San Francisco, Sept—Oct 1971.

³ Amon J Nsekele: "The World Bank and the New International Economic Order", *Development Dialogue*, Uppsala (Sweden), 1977:1.

⁴ International Bank for Reconstruction and Development. (The World Bank): *Operations Evaluation Report — Electric Power*, 1972-03-10, Report Z—17 (restricted). Although this report deals in a general way with the Bank's strategies in the electric power sector, it analyzes in more detail the operations of and its relationship with ten electricity companies in Third World countries, namely: CFE (Mexico), VRA (Ghana), SEGBA (Argentina), CELPA (Ethiopia), FURNAS (Brazil), NEB (Malaysia), PUB (Singapore), EEEB (Colombia), EPM (Colombia), CVC/CHIDRAL (Colombia).

⁵ *Loan Agreement*. (Burfell Power Project) between International Bank for Reconstruction and Development (the World Bank) and Landsvirkjun, Loan No 466—0 for 18 M USD.

⁶ idem, Article 8.01.

⁷ Contrary to general belief, Loan Agreements between the World Bank and its borrowers all over the world, are freely available from the Bank's stationary stores in Washington, DC.

⁸ Article IX.10 in the Suppliers Credit Agreement between Landsvirkjun (Borrower) and Manufacturers Hanover Trust Company and ExImBank (Lenders), dated 1974-04-05, reads:

"(If) the Borrower shall have defaulted under any other agreement involving the advance of credit to the Borrower, if such default gives to the holder of the obligation the right to accelerate the indebtedness . . . then either lender . . . may make immediately due and payable . . . (a) the entire principal indebtedness owing to it then outstanding . . . and (b) accrued interest to the date of payment!"

⁹ International Bank for Reconstruction and Development (The World Bank), *Articles of Agreement*, Washington 1976, Article I.

¹⁰ *The World Bank, IDA and IFC Policies and Operations*, The World Bank (IBRD), Washington, DC, June 1969. ■