PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

July 7, 2015
Report No.: 97919

Operation Name	First Programmatic Energy and Water Sector Reforms DPL
Region	MIDDLE EAST AND NORTH AFRICA
Country	Jordan
Sector	General energy sector (65%);General water, sanitation and flood protection sector (35%)
Operation ID	P154299
Lending Instrument	Development Policy Lending
Borrower(s)	HASHEMITE KINGDOM OF JORDAN
Implementing Agency	Ministry of Planning and International Cooperation (MoPIC), Amman, Jordan Tel: +962-6-4644466, Email: Mop@mop.gov.jo
Date PID Prepared	July 7, 2015
Estimated Date of Appraisal	July 15, 2015
Estimated Date of Board Approval	September 15, 2015
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Country and Sector Background

1. The proposed operation in the amount of US$ 250 million - the first in a programmatic series of two Development Policy Loans (DPLs) - aims to support fiscal and policy reform programs undertaken by the Government of Jordan (the Government) in the energy and water sectors. The policy program supported by the DPL is necessary for improving the fiscal position of the Government and laying the groundwork for the implementation of short and medium term efficiency gains to promote the long term sustainability of these sectors. The programmatic DPL series will also address key sector issues and mitigate risks identified by the Jordan Systematic Country Diagnostic, under preparation, and will promote economic growth, fiscal balance and private sector development.

2. Two successive external shocks—the global recession and the regional turmoil that followed the Arab Spring—have exacerbated Jordan’s long-term structural vulnerabilities. Following the global financial downturn of 2008, growth decelerated sharply. Turmoil throughout the region further undermined Jordan’s outlook, which led to (i) slower growth and lower fiscal revenues, and (ii) initially, increased public spending to partly accommodate social pressures. This has resulted in an accumulation of a large public debt whose servicing exacerbates fiscal pressures. In particular, interruptions in the Egyptian natural gas supply, which in 2009 fueled about 90 percent of Jordan’s power generation, forced the country to increasingly rely on more expensive and less efficient diesel and heavy fuel oil during a time of high oil prices. The Government’s initial decision not to pass-through the higher fuel costs to final consumers resulted in a significant increase in the National Electricity Power Company’s (NEPCO) operating losses. As a result, NEPCO has been running deficits equivalent to around 4-5 percent of GDP per year since 2011 and accumulated total operating losses of about US$ 6.44 billion, for which debt servicing has been directly covered by the budget. As a result, gross public debt has risen rapidly and is estimated to have reached around 90 percent of GDP at the end of 2014. Further budgetary losses equivalent to 1 percent of GDP were added in 2012 by the water sector. The increased dependence on high cost technologies to make water available and high energy intensity of the sector has resulted in a sharp increase in the costs of providing water, with the subsequent result that the sector was not able to cover its basic operation and maintenance costs.

3. The Government consequently has embarked on a major program aimed at strengthening its macroeconomic framework. Policy adjustments within the framework of the IMF Standby Arrangement (SBA)[1] and the Bank's Programmatic Development Policy Loan[2] have already achieved a significant reconfiguration of fiscal policies, improvements in the business climate, and a broadening of the revenue base. The unsustainably high cost of energy subsidies has led the Government to embark on a major subsidy reform program supported by the IMF SBA which in November 2012 completely eliminated subsidies on petroleum products (except for Liquefied Petroleum Gas (LPG) cylinders mainly used for household cooking). The Government is also implementing a five year electricity tariff adjustment plan that aims at enabling NEPCO to reach full cost recovery by 2017. In order to promote energy security, the Government is also seeking to diversify its energy sources through scaling up renewable energy and developing a Liquefied Natural Gas (LNG) terminal in Aqaba which will become operational in July 2015. In addition, the Government is implementing a Structural Benchmark Plan which aims to achieve operation and maintenance cost recovery in the water sector by 2020 through a combination of revenue increases and cost reductions.

4. While the IMF-supported program has addressed fiscal pressures caused by the energy and water sectors, it is critical for Jordan to implement broader policy and structural reforms to sustain economic growth, despite the temporary relief arising from the fall of oil prices. The economy in Jordan is expected to grow at about 3 percent annually, which will increase electricity and water demand at average annual rates of 6 and 5 percent respectively. This high rate of growth puts further stress on public resource, especially if the underlying fundamental stress factors in these sectors are not addressed and systems are not optimized. To that end, key elements of the Government efforts focus on the restoration of the financial viability of sector utilities, in particular NEPCO - the backbone of the electricity sector - and on improving the operational performance of the energy and water sectors through efficiency gains. Government seeks to reduce the cost of electricity and water supplies, which would yield significant savings in system operations and therefore reduce the fiscal burden on Jordan's public resources. The overall objective of the DPL is to improve the financial viability and increase efficiency gains in the energy and water sectors in Jordan. The policy program supported by the DPL will be structured around two pillars based on: (i) improving the financial viability of the electricity and water sectors; and (ii) increasing efficiency gains in the energy and water sectors. The first pillar will support the Government's plan to set the electricity and water sectors on a path of sustainable cost recovery and its efforts to restore NEPCO's creditworthiness by addressing its accumulated debt. The second pillar will support Government's programs that strengthen efficiency gains in the supply and demand sides of the energy and water sectors through deeper diversification to more economic fuel supply resources and power generation mix, scaling up of energy efficiency programs in both sectors, and a more efficient utilization of water resources.

5. These policy areas supported by the DPL are aligned with the objectives, and support achievement of the medium term targets of the recently approved "Jordan 2025: A National Vision and Strategy". The Jordan 2025 Vision seeks to achieve self-reliance and stability based on financial sustainability, enhanced productivity, increased competitiveness and the gradual removal of indiscriminate subsidies. . The implementation of the DPL policy program and achievement of its results could yield significant increase in revenues and cost savings in the total amount of up to JD1.7 billion in the electricity sector over the DPL period (2015-2017). That will reduce the fiscal burden of electricity subsidies on the Government's budget and will provide the Government with larger fiscal space to invest in pro-poor programs and in more inclusive economic activities to

[1] The IMF SBA was approved by the IMF board in August 2, 2012 in the amount of SDR 1,364 million (about $2 billion) and is expected to close in August 2015

[2] The Jordan Second Development Policy Loan (US$ 250 million) was approved by the Board on April 1, 2014 and is expected to close on October 1, 2015.

improve the standard of living of the population in Jordan. The DPL program of fuel switching and renewable energy development will also produce over the period of the DPL significant environmental benefits by reducing energy-related emissions in the amount as much of 23.5 $mtCO_2$.

II. Operation Objectives

6. The program development objective of the DPL is to improve the financial viability and increase efficiency gains in the energy and water sectors in Jordan. Lessons learned from energy and water sector reforms show that improving the operational efficiency in parallel with increasing sector revenues is essential to achieving sector sustainability, as users are reluctant to pay higher prices if services deteriorate. The DPL policy program will be structured under two main pillars: *Pillar A: improving the financial viability of the electricity and water sectors; and Pillar B: increasing efficiency gains in the energy and water sectors*. The first pillar will support Government's plans to set the electricity and water sector on a path of sustainable cost recovery, including efforts to restore the creditworthiness and financial standing of NEPCO. The second pillar will support Government's programs that aim to increase efficiency gains both in the supply and demand for energy and water including diversification into more economic fuel supply resources and power generation mix, scale up of energy efficiency programs, and a more efficient use of water resources.

III. Rationale for Bank Involvement

7. The overarching strategic objective of the World Bank's Jordan Country Partnership Strategy for 2012-2015 is laying a foundation for inclusive growth. Given recent changes in the regional context, the CPS Progress Report (dated June 23, 2014) focused on the need for Jordan to adapt to evolving circumstances. The Bank's support focuses on mitigating the immediate impact of the regional crisis while at the same time supporting long term development objectives and structural reforms, which this DPL operation targets. In addition, the proposed DPL contributes to Pillar I of the original CPS ("strengthening fiscal management and increasing accountability") as it aims to increase efficiency of public expenditures and revenue generation therefore generating stronger economic growth in the medium term.

8. Policies supported by the proposed DPL will contribute to the twin goals of reducing poverty and promoting shared prosperity. Reducing the fiscal burden of electricity and water subsidies would allow the Government to achieve greater fiscal sustainability and therefore provide the Government with the space to invest in pro-poor programs and more inclusive and productive economic and social sectors to improve the standard of living of the population in Jordan.

IV. Tentative Financing

Source:	($m.)
Borrower	0
International Bank for Reconstruction and Development (IBRD)	250
Borrower/Recipient	
Others (specify)	
Total	**250**

V. Institutional and Implementation Arrangements

9. The overall responsibility for monitoring implementation of the DPL program rests with the Ministry of Planning and International Cooperation (MoPIC). MoPIC will be responsible for coordinating, and reporting to the Bank on, progress of implementing the Development Policy Loan (DPL) programs with the Government authorities responsible for the program implementation including the Ministry of Energy and Mineral Resources (MoEMR), the National Electric Power Company (NEPCO), and the Energy and Minerals Regulatory Commission (EMRC), Ministry of

Water and Irrigation (MoWI) and the Cabinet of Ministers. Throughout implementation, the World Bank multi-sector team will undertake intensive supervision missions and provide technical assistance and policy advice to support implementation and monitoring the DPL supported program.

VI. Risks and Risk Mitigation

10. **The overall risk** rating **is assessed to be substantial.** Continued performance by the Government on its reform agenda in the energy and water sectors and the achievement of the proposed program's outcomes are subject to geopolitical and macroeconomic risks as well as financial sustainability risks related to the water and electricity sectors: More specifically:

a. **Political and Governance risk is substantial:** The volatility of the region and Jordan's high degree of integration with its neighbors remain a substantial risk to operations. The recent escalation of violence in neighboring countries with the rise of ISIS and Jordan's direct involvement in the anti-ISIS coalition have compounded geopolitical and security risks to the country. Mitigation is stemming from actions taken by the government at the national and international level to preserve Jordan's integrity/stability. The protracted nature of the conflict in Syria will likely continue to have significant repercussions on the country. These have been mitigated by grant support, particularly from GCC countries, to help Jordan mitigate the impact of Syrian refugee influx. The most significant risk is linked to political support for the proposed policy reforms, especially tariff reforms. The Government has however been able to mitigate these risks through reducing the impact of tariff reform on large groups of residential users by using the current electricity and water tariff structures that allow for cross-subsidies between different groups of consumers.

b. **Sector Strategy and Policies risk is substantial:**

- ***Energy.*** The major risk in the energy sector is linked to the fluctuation of oil price. In order to reduce the impact of increasing fuel cost on NEPCO's financial position and the subsequent fiscal burden, the Government has removed subsidies for fuel products (except LPG), and has been implementing an electricity tariff increase plan, according to which the electricity selling price to customers was increased by 15 percent twice. The recent sharp fall of oil price has positively revised the forecasts for full cost recovery in the electricity sector, and the decision for the 2015 electricity tariff increase has been to implement an increase of 7.5 percent instead of 15 percent. To mitigate this major risk, the Government is taking several measures to sustain the electricity subsidy reform program assessed. In addition, the Government is diversifying its energy sources to mitigate security of supply vulnerability and reduce electricity production costs to reduce the size of required electricity tariff increases.

  Water: The major water sector risks are associated with the political sensitivities linked to implementing water tariff increases, as the dismantling of energy subsidies will put upward pressure on the cost of water provision (due to the high energy intensity of water production in Jordan). Increases in water and wastewater tariffs, groundwater charges and irrigation fees are likely to have a positive impact on cost recovery while providing incentives to water conservation. To mitigate the risks associated with tariff increases the Government needs to continue communicating to the public and raising awareness about the sustainable provision of water focusing on the value of water and the need for water conservation. Although the reduction of water subsidies is politically sensitive, households are according to opinion polls more willing to consider reduction in water subsidies, as a result of previous awareness campaigns.

a. **Stakeholder risk is substantial**: The policy actions are made up of those actions aimed to improve the financial viability of the sector through increases in the electricity and water tariffs that will increase the cost of the service for consumers. The Government is however mitigating impact of electricity prices on the poor and vulnerable by limiting price increases to household consumption above 600 KWh. The water tariff restructuring in 2011 has also left the sector with a tariff structure that allows for the price impact to be mostly felt by residential users who use large quantities of water, or non-residential users. Nonetheless, during the implementation of the DPL, the potential poverty impact of electricity and water tariff adjustments supported by the DPL will be closely monitored to consider, if needed, with the Government, mitigating any possible adverse impacts on the poor and vulnerable consumers if such impact arises. In that case, the recent progress to develop a unified national registry will enable the Government to set up a more targeted cash transfer program that could help if necessary during the DPL implementation to ease any effect of tariff increases on poor households.

VII. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

11. . The policy actions are made up of those actions aimed to improve the financial viability of the sector through increases in the electricity and water tariffs that will increase the cost of the service for consumers, and hence may have an impact on the poor and vulnerable. The Government is however mitigating impact of electricity prices on the poor and vulnerable by limiting price increases to household consumption above 600 KWh. The water tariff restructuring in 2011 has left the sector with a tariff structure that allows for the price impact to be mostly felt by residential users who use large quantities of water, and non-residential users. Nevertheless, during the implementation of the DPL, the potential poverty impact of electricity and water tariff adjustments supported by the DPL will be closely monitored with the Government to mitigate if needed, any possible adverse impacts on the poor and vulnerable consumers that could arise. The recent progress by the Government to develop a unified national registry will enable the Government to set up a more targeted cash transfer program that could help if necessary during the DPL implementation to ease any effect of tariff increases on poor households.

Environment Aspects

12. The implementation of the policy actions supported by the proposed DPL is not likely to have significant impact on environment, forests, and natural resources. The tariff reform programs supported under the first pillar that aim to improve the financial viability of the electricity and water sectors, could also help in curb the growth in energy and water demand resulting in less environmental degradation. Similarly, efficiency gains programs under the second promoting growth in renewable energy and energy efficiency development and deeper utilization of natural gas in power generation instead of the more polluting fuel oil and diesel will noticeably improve air quality by reducing energy-related emission by as much as 23.5 mtCO2, thus improving air pollution and reducing the related impacts on human health..

13. Negative environmental impacts from the DPL-supported reforms may result from identified priorities for investments in infrastructure. Jordan, however has adopted in 2005 an Environmental Impact Assessment (EIA) regulation (regulation 37/2005) to regulate the EIA process, in terms of scope of application, substantive requirements and procedures of approval. To the extent that the construction of any infrastructure related policy actions will be subject to the existing EIA regulation, which has been assessed as robust. Any significant negative environmental effect is likely therefore to be avoided or mitigated.

VIII. Contact point

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