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MINISTRY OF PLANNING AND INTERNATIONAL COOPERATION

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Date 6/11/2016

Dr. Jim Yong Kim
President of the World Bank Group
The World Bank
Washington D.C., USA

**Subject: Letter of Development Policy for the
Second Programmatic Energy and Water Sector Reforms Development Policy Loan**

Dear Dr. Kim,

Jordan, after a period of strong economic performance during the years 2000-2008, has suffered from two successive external shocks of significant importance; the global financial crisis of 2008 and the ensuing global recession, and regional turbulences that started in early 2011 with the onset of the Arab Spring events.

Conflicts in Syria and Iraq have led to a massive influx of refugees, putting enormous pressure on Jordan's limited and already stretched resources, and to disruptions in trade routes, less tourism and a hesitant investment outlook. At the same time, the near complete halt of gas flows from Egypt required imports of expensive fuel for electricity generation, contributing to large losses at the National Electric Power Company (NEPCO) and adding to the already high public debt. Economic performance remains well below potential (*with sluggish growth rates compared to an average of about 6 percent during the years 2000-2008*) and the hosting of Syrian refugees weighs on the economy and public finances.

Domestic revenues shrank from an average of 27 percent of GDP during 2000-2008 to an estimated 22 percent of GDP in 2015. Government expenditures increased to about 31 percent of GDP in 2014 (*although this started to decline to 29 percent by 2015*) to accommodate social demands through larger transfers and wage increases. This in addition to the government-guaranteed borrowing for NEPCO and the Water Authority of Jordan (WAJ) increased gross public debt to 93.4 percent of GDP by end-2015; the servicing of which exacerbates fiscal pressures.

Jordan has managed to stay resilient amidst a difficult external environment including the hosting of a large number of Syrian refugees. Macroeconomic stability has been maintained due to serious significant policy adjustment and reform measures undertaken by the Government of Jordan under the successfully completed IMF Stand-by-Arrangement (2012-2015).

In spite of continued spillover of regional conflicts, the Government is continuing with a major program of fiscal consolidation to preserve macroeconomic and fiscal stability and lower public debt while pursuing broad structural reforms to enhance the conditions for more inclusive growth. Our reform program is supported by a new IMF program Extended Fund Facility (EFF) for 2016-2019 approved in August 2016, which builds on the completed IMF Stand-by-Arrangement. The EFF aims at gradual fiscal consolidation to lower public debt to about 77 percent of GDP by 2021, while providing room for capital spending and preserving social spending. Key measures include revenue-enhancing reforms to the tax system, such as reforming the tax exemptions framework and broadening the tax base.

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MINISTRY OF PLANNING AND INTERNATIONAL COOPERATION

Ref No:

Date:

Moreover, structural reforms will be implemented in several areas to enhance competitiveness, job prospects, and foster equity, fairness, and good governance. Monetary and financial policies will remain focused on maintaining adequate reserves to anchor the exchange rate. Ensuring sustainability in the energy and water sectors is a core element of the Government's reform program and the IMF EFF.

The events in the region since 2011 have severely impacted the energy and water sectors. Critical natural gas supplies from Egypt, which fueled over 90 percent of power generation, were disrupted and eventually came to a complete halt and with majority of supplies continuing to halt. The interruptions of gas supply caused NEPCO to run deficits equivalent to 4-5 percent of GDP per year since 2011, and accumulating commercial loans and advances from the Ministry of Finance (MOF) of about JD 4.9 billion by 2015.

The Syrian refugee influx in particular is putting additional pressures on energy and water service delivery in Jordan. Six years into the crisis, the prospects for a prompt return of the millions of Syrian refugees to their home country are remote. Even in the unlikely event of a solution to the crisis, it will take more than a decade to rebuild Syria. While some Syrian refugees will return and others may attempt to relocate to third countries, the majority are expected to remain in the country for years to come.

For Jordan, the magnitude and longevity of the crisis will likely translate into mounting costs and ever-increasing challenges. Jordan continues to uphold its moral obligations, carrying more than its fair share of the response and providing a global public good on behalf of the region and the international community. Today, Jordan is hosting about 1.3 million Syrians have sought refuge within its borders, growing Jordan's population by almost 19 percent. More than 89 percent of the Syrians are currently residing in host communities, while the rest 11 percent reside within camps. The majority of refugees are concentrated in northern governorates and cities, mainly in Mafrq and Irbid. Funding shortfalls have contributed to increased pressure on national services and infrastructure, thereby affecting Jordan's resilience in addition to impacting Jordan's hard-earned development gains and the country's sustainable development path. This has also put further pressure on the economy and stretched social cohesion in Jordanians host communities.

Energy and water service delivery (*already under great strain before the crisis*) has been severely affected especially in the northern governorates. Jordan was already one of the world's most energy-insecure countries before the crisis, relying on imports for 97 percent of its energy needs. The rapid growth of the residential population is putting additional pressure on the sector, adding to long-standing structural challenges relating to supply security, financial sustainability and efficiency. Electricity consumption in the residential sector and water pumping grew by an average of 4.8 percent and 3.8 percent, respectively, between 2010 and 2015, significantly outpacing demand in the commercial (1.7 percent) and industrial (3.0 percent) sectors. In total, residential electricity consumption has grown by 26 percent since 2010. The rate of distribution losses has grown by a sixth from 12 percent in 2010 to 14 percent 2015, reflecting higher strain on the distribution networks. Electricity consumption in the northern governorates (*those mostly affected by the Syria crisis*) showed



MINISTRY OF PLANNING AND INTERNATIONAL COOPERATION

Ref No:

Date

an additional increase of 2.3 percent compared to other governorates in Jordan. From 2009 to 2014, Jordan has further seen a 33 percent increase in consumption of liquefied petroleum gas (LPG).

Jordan is already one of the most water scarce countries in the world, a situation aggravated dramatically by the influx of Syrian refugees. Before the refugee crisis, the severe water scarcity and the subsequent lack of capacity in combination with an aging infrastructure and inefficiencies in operation and maintenance resulted in a deficiency of water services for a growing population. Since the beginning of the Syrian refugee crisis, Jordan has seen a 21 percent increase in water demand across the country and a 40 percent increase in the north.

Due to insufficient water availability, the per capita daily consumption has decreased by 27 percent in the northern governorates since 2011. About 70 percent of the population (Jordanians and Syrian refugees) now suffer from inadequate water supply below the national standard of 100 liters per person per day. All in all, the annual direct short term cost of hosting Syrians on Water and Wastewater Sector is around JD 458.66 million, while other annual environmental and loss of opportunity costs are estimated at JD276.9 million.

Program Overview

The reform program supported by the DPL series is structured around two key policy areas (i) improving the financial viability of the electricity and water sectors; and (ii) increasing efficiency gains in the energy and water sectors. Key measures of the reform program 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. These policy areas are aligned with the Government's objectives, and support achievement of the medium term targets of the "Jordan 2025: A National Vision and Strategy" which seeks to achieve self-reliance and stability based on financial sustainability, enhanced productivity, increased competitiveness and the gradual removal of indiscriminate subsidies.

Reducing the fiscal burden of the electricity and water subsidies will also provide the Government with the fiscal 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. The reform program supported by the DPL series is aligned with the Jordan Compact, under which Jordan in cooperation with the international community sets a paradigm shift in dealing with the Syrian refugee crisis. The Jordan Response Plan 2016-2018 assesses budgetary needs of US\$8 billion for refugee and resilience response programs across impacted sectors including energy and water, sanitation and hygiene (WASH).

The second DPL will build on and sustain the substantial reforms supported by the First Programmatic Energy and Water Sector Reforms DPL that have taken place since 2015. These reforms are already showing results for Jordan, especially with regard to improved financial and operational performance of the electricity and water sectors. The reforms supported by DPL-II aim to lock-in the gains from these reforms and further strengthen the financial viability and increase efficiency in the



MINISTRY OF PLANNING AND INTERNATIONAL COOPERATION

Ref. No:

Date

electricity and water sectors in the increasingly challenging context resulting from the Syrian refugee crisis.

1. Improving the Financial Viability of the Electricity and Water Sectors

Achieving Electricity Tariff Cost Recovery

As a result of a series of electricity tariff increase between 2013 and 2015, the switch from oil to cheaper natural gas since mid-2015, the commissioning of the first large-scale renewable energy plants, and the sharp decline in international oil prices since mid-2014, full cost recovery of electricity tariffs was reached at the end of 2015 and sustained over the first half of 2016. This is a major achievement and marks the end of a five-year period during which NEPCO accumulated JD4.9 billion of commercial loans and advances from MOF. Cost recovery for the whole of 2015 reached 86 percent, up from 56 percent in 2014 and on track to reach the target of 100 percent in 2017. The Government is committed to locking-in its reform achievements through further tariff reforms with the aim to sustain cost recovery for NEPCO amid volatile energy import prices. To this end, the Government announced on 21 July 2016 that a mechanism for automatic adjustment of the electricity tariff will be adopted. **The Energy and Minerals Regulatory Commission (ERMC) has adopted on 5 October 2016 an electricity tariff adjustment mechanism to sustain cost recovery taking into account consumer affordability.**

While working to sustain cost recovery in the power sector, the Government is taking measures to manage and eventually repay NEPCO's accumulated debt. NEPCO's accumulated commercial loans and advances from MOF surged from JD193 million (1.1 percent of GDP) in 2010 to JD4.9 billion (18.8 percent of GDP) in 2015. The Government acknowledges that the financial viability of NEPCO needs to be restored in order to enable the company to maintain its assets and invest in the expansion of its transmission network. Therefore, **the Council of Ministers approved a multi-year Debt Management Plan for NEPCO for the period 2017-2023 on 2 November 2016.**

Under the Debt Management Plan, NEPCO will rely on domestic borrowing to refinance most of NEPCO's debt principal obligations in 2017-2023, while gradually reducing the stock of debt using the net profits guaranteed by the automatic adjustment of the electricity tariff according to changes in international oil prices. The Debt Management Plan aims to reduce the stock of fuel-related commercial debt by JD 84 million by 2017.

Enhancing Cost Recovery in the Water Sector

The recently adopted National Water Strategy 2016-2025 reconfirms the Government commitment to rationalize the price structure of water and wastewater services to ensure efficient use of water, while improving the use of commercial practices and reduce subsidies to the sector. The water sector puts a significant burden on the budget due to the combination of high cost of supplying water resulting from Jordan's extreme water scarcity and low revenues from the various water users, especially from agricultural and domestic water users who receive subsequently large water subsidies. The increase in electricity prices (aimed at putting NEPCO on a path of cost recovery) and the large influx of Syrian refugees have imposed an additional financial burden on the water sector,



MINISTRY OF PLANNING AND INTERNATIONAL COOPERATION

Ref. No:

Date:

underscoring the urgency to improve the financial viability of the sector. **The Ministry of Water and Irrigation has adopted the measures to increase water sector revenues to enhance operation and maintenance cost recovery in accordance with the Structural Benchmark Action Plan to Reduce Water losses dated August 2013 (2013-2021)** developed under the IMF SBA (2012-2015), which has been updated under the IMF EFF.

In accordance with the Structural Benchmark Program, the Government has since 2013 increased water prices for all water users, including increases in industrial groundwater charges (November 2013), water and wastewater tariffs (July 2014, and December 2015), charges for irrigation wells in the highlands (January 2016), wastewater connection fees (July 2014, originally planned for 2015) and treated wastewater reuse charge (January 2016). It has also signed management contracts to improve collection efficiencies in Madaba and Zarqa. As a result, the revenues of the three water companies and WAJ rose by JD 53 million (or 27 percent) between 2013 and 2015.

2. Increasing Efficiency Gains in the Energy and Water Sectors

In parallel with reforms aimed at restoring cost recovery, the Government is implementing measures to improve efficiency of supply and demand for energy and water. These measures will further improve operational and financial performance and lay the groundwork for achieving medium term efficiency gains to promote the long-term sustainability of these sectors.

Provision of cleaner fuel supply for power generation and scaling up development of domestic renewable energy resources and energy efficiency

Since the disruption of gas supplies from Egypt, the Government of Jordan has been making great efforts to diversify its fuel supply sources for power generation. The Government has completed the development of an LNG floating terminal at the port of Aqaba, which started operation in July 2015. With support from the World Bank, NEPCO has developed its institutional capacity to procure LNG and manage the gas supplies. As a result, since commissioning the terminal in July 2015, NEPCO has embarked upon diversification of natural gas supplies across medium-term LNG supply contracts and cargoes on the spot LNG market. More than 85 percent of power generation in Jordan is now fueled by natural gas, up from 7 percent in 2014 and already beyond the 70 percent target for 2017. The cleaner natural gas has replaced the more expensive and polluting diesel and heavy fuel oil. In order to further diversify its supply sources and reduce its exposure to price volatility, **NEPCO has adopted a strategy for diversification of fuel sources for power generation with increased reliance on cleaner energy sources on 1 September 2016.**

The Government also recognizes that the development of renewable energy is a key priority for diversification of its energy mix from domestic resources. The Renewable Energy and Energy Efficiency (REEE) Law was adopted in 2012, creating a regulatory and financial framework for renewable energy and energy efficiency and mandating the establishment of the Jordan Renewable Energy and Energy Efficiency Fund (JREEEF). A comprehensive regulatory and pricing framework has since been established by the Government, including indicative pricing schemes for various renewable technologies, a competitive and fair capacity procurement process, transparent grid



MINISTRY OF PLANNING AND INTERNATIONAL COOPERATION

Ref. No:

Date :

interconnection procedures, a technically sound grid code for renewable generators, and a workable operation protocol for project operators. Thanks to this regulatory and pricing framework Jordan has become a regional leader in private-sector owned renewable energy development and strives to become a regional hub for knowledge and service industries related to renewable energy.

The Ministry of Energy and Mineral Resources signed power purchasing agreements with private sector developers for over 900 MW of renewable energy projects and another 450 MW are in earlier stages of development. The share of MW renewable power in the generation mix increased to 4.7 percent as of May 2016, up from 0 percent in 2014, and the development of the various projects is on track to ensure that renewable energy makes up 10 percent of the power generation mix in 2017, as targeted in the Jordan 2025 National Vision and Strategy. The Government of Jordan also continues to improve the renewable energy regulatory framework. **On 29 September 2016, the Ministry of Energy and Mineral Resources has sent to Cabinet the "Instructions and Requirements for Proposal Preparation and Submission" regulations for the implementation of the direct proposals bylaws No. 50 of 2015, which streamline the investment procedures for renewable energy projects and were published in the Official Gazette on 16 October 2016.**

The Ministry of Energy and Mineral Resources has also established a Public Data Room within the Energy Information System (eis.memr.gov.jo) on 28 September 2016 for renewable energy development to improve transparency and increase investors and public confidence in the future renewable energy development in Jordan. Moreover, NEPCO is strengthening its institutional capacity in renewable energy operations. NEPCO has adopted standardized operating protocols for intermittent renewable energy to be integrated into agreements with new renewable power producers. In parallel, with support from other donors and IFIs, NEPCO is reinforcing the network in the central Jordan desert area, where most renewable projects are located, under the 'Green Corridor' project and is strengthening its institutional capacity for renewable energy operation and dispatch through capacity building programs and twinning arrangements.

Energy efficiency is a core pillar of the Government's reform program. The establishment of JREEEF in 2014 was a key step to raise awareness of potential energy savings among industry, commercial and household consumers, to provide technical and financial support to overcome existing investment barriers and to promote private investments for energy efficiency and renewable energy projects. The bylaws for JREEEF, adopted on 3 May 2015, were developed through extensive consultation with energy sector stakeholders and are designed to build the credibility of JREEEF by ensuring the effective and transparent management of the Fund. Since 2015, the Government and JREEEF have taken decisive steps to make the Fund fully operational. The board approved JREEEF's Strategic and Operational Plan for 2015 - 2018. **Since 1 August 2016, JREEEF has operationalized two of its Financing Programs to ensure better access to renewable energy and energy efficiency.**

The fund hired seven additional staff on 1 August 2016 reaching a total of 12 staff to manage its 7 programs that are aimed to promote energy efficiency and the use of renewable energy. These programs focus on schools, households, government buildings, worship places, SME's, innovation,



MINISTRY OF PLANNING AND INTERNATIONAL COOPERATION

Ref No.

Date

and awareness and capacity building. MOUs have been signed with a number of participating commercial banks and requests for proposals have been launched for several of the Fund's programs.

Development of Electricity Distribution Networks Loss Reduction Program

The Government's program to improve overall operational efficiency in the electricity sector includes reducing losses in the distribution networks. Distribution losses have increased from 12 percent to 14 percent between 2010 and 2015, in part due to the Syrian Refugee crisis. **To reduce losses in the electricity sector, EMRC and the distribution companies have agreed on a multi-year Network Loss Reduction Plan which includes specific yearly loss reduction targets for 2016 and 2017.** EMRC finalized bilateral performance agreements with the three private distribution companies (DISCOMs) as part of the biannual budget review exercise, with specific loss reduction targets for 2016 and 2017 agreed upon between the EMRC and each company. The targets will be reviewed in 2017 and new targets would be set for 2018 and 2019 under the next budget review exercise. A rolling two-year budget review exercise that provides loss reduction targets for the DISCOMs along with the related investment plan and action plan is expected to achieve loss minimization over the medium term.

Scaling Up Of Energy Efficiency and Renewable Energy in the Water Sector

The dismantling of electricity subsidies has had a significant impact on the financial viability of the water sector. Due to its water scarce environment and with water resources being located at considerable distance of population agglomerations, water needs to increasingly be distributed and pumped over often large distances and lifted to overcome altitude differences. As a result, about 14 percent of the electricity consumption in the country is currently used in the water sector, making the sector the largest user of electricity in the country. Hence, the Government recognizes that more efficient electricity consumption is essential to improve the operational and financial performance of the water sector. To generate energy savings in the water sector, the Cabinet of Ministers approved on 2 June 2015 an Energy Efficiency and Renewable Energy Policy for the water sector prepared by the Ministry of Water and Irrigation. **The Ministry of Water and Irrigation has piloted the use of performance-based operation for the implementation of energy efficiency and renewable energy measures.** Already renewable energy projects to support water sector electricity needs are underway.

Optimizing the Allocation of Water Resources

The per capita available renewable water resources are dropping steadily in the country due to population growth. In 2013, the surface water annual yield was about 362 million cubic meter (MCM), which is about 40 percent of the total water annual yield. As a result, Jordan still depends disproportionately on groundwater resources causing that resource to be over-exploited. The Government is developing policies to achieve a more efficient use of the existing surface water resources and increase reliance on treated wastewater. The Government is also implementing measures to use fresh water for the activities that generate the highest value and aims to reduce the volume of fresh water to the agricultural sector in the long-run by increasingly substituting fresh water with treated wastewater to supply farmers and industry. At the same time, the Government aims to



MINISTRY OF PLANNING AND INTERNATIONAL COOPERATION

Ref No:

Date :

increase the cost of groundwater as a tool to reduce over-pumping. This process was initiated with the increase of groundwater tariffs as per the Structural Benchmark Plan.

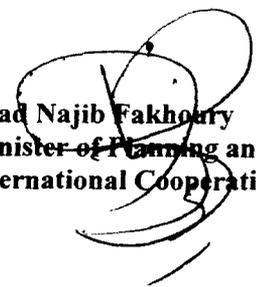
In 2015, the Ministry of Water and Irrigation approved a Surface Water Utilization policy that aims amongst others to use surface water resources more efficiently through a set of measures to increase water harvesting, land use measures and improvements in storm water management. Furthermore, **the Ministry of Water and Irrigation has adopted on 8 November 2015 the Water Substitution and Reuse Policy. The MOWI adopted the National Wastewater Treatment National Plan for Operation and Maintenance on 30 September 2015, which includes the use of performance-based operation of wastewater treatment plants.**

In conclusion, allow me to express my sincere gratitude to the World Bank for its tireless efforts and invaluable support. We would like to express again our strong commitment to the energy and water sectors reform programs outlined in this letter and whose execution in the difficult regional context will require significant mobilization of resources from our development partners, including the World Bank. For this purpose, the Government of Jordan requests the World Bank support for our programs, as a critical partner for Jordan's development agenda.

We therefore look forward to our continued collaboration in developing the energy and water sectors in Jordan. Additionally, we hope that DPL will be provided on maximum concessionality given the burdens Jordan is carrying and commitment to comprehensive reforms especially that Global Concessional Financing Facility is a great success for fair burden sharing, and came to existence based on a call made by Jordan, yet unfortunately came in five years late.

Please accept my high esteem and consideration.

Sincerely,


Imad Najib Fakhoury
Minister of Planning and
International Cooperation