

# PROJECT INFORMATION DOCUMENT (PID)

## APPRAISAL STAGE

Report No.: AB2843

<b>Project Name</b>	LB-EMERGENCY POWER SECTOR REFORM CAPACITY REINFORCEMENT PROJECT
<b>Region</b>	Middle East and North Africa
<b>Sector</b>	Energy (100%)
<b>Project ID</b>	P104774
<b>Borrower(s) [Grant]</b>	Government of Lebanon
<b>Implementing Agency</b>	Council for Development and Reconstruction (CDR)
<b>Environment Category</b>	<input type="checkbox"/> A <input type="checkbox"/> B <input checked="" type="checkbox"/> C <input type="checkbox"/> FI <input type="checkbox"/> TBD (to be determined)
<b>Date PID Prepared</b>	January 24, 2007
<b>Estimated Date of Appraisal Authorization</b>	January 8, 2007
<b>Estimated Date of Management Approval</b>	February 28, 2007

### I. Key development issues and rationale for Bank involvement

#### *Key development issues*

The hostilities in the summer of 2006 resulted in serious human and physical infrastructure losses in Lebanon. The direct damage has been estimated by the World Bank at about US\$2.4 billion with a further \$700-\$800 million of indirect damage.<sup>1</sup> The cost of the hostilities as well as the social impact on the lives and livelihoods of the families affected signify a severe blow to Lebanon's long-term prospects for recovery. Economy-wide losses from foregone output are estimated at US\$2.3 billion in 2006 alone; and the projected growth in real GDP of 6 percent in 2006 has contracted by nearly the same magnitude. Jobs have been lost, government revenues have reduced and as a result government expenditures have increased by approximately US\$690 million.<sup>2</sup>

It is against this grim public finance context that reform of the power sector is urgently needed. With the unexpected increase in public expenditure, the required government subsidies to the power sector – which were already unsustainably high before the hostilities – put a tremendous burden on the government's finances and threaten to undermine Lebanon's ability to raise donor funds for the much needed reconstruction of its economy and social fabric. Simply stated, Lebanon is unlikely to be able to secure the much needed donor support and financing unless it addresses the severe performance problems, inefficiencies and poor governance of the power sector.

#### *Key Sector Issues*

Lebanon's electricity sector is suffering from years of overall poor governance, weak institutional, management and technical capacity, a serious lack of investment in operation and maintenance as well as in new infrastructure, all leading to poor quality of service and consumer confidence in the utility, high

<sup>1</sup> Lebanon: Economic and Social Impact Assessment: From Recovery to Sustainable Growth; The World Bank, November 2006.

<sup>2</sup> Same as above.

cost of electricity, inadequate cost-recovery and considerable dependence on budgetary subsidies estimated by the Ministry of Finance to be close to US\$ 1 billion in 2006.

Although the hostilities caused limited physical harm to the overall electricity infrastructure; the indirect impact on loss of revenue (primarily due to a drop in supply capacity, interruptions in collections, and the destruction of some service perimeters) and increased cost for Electricite du Liban (EdL) (primarily due to damage to the production fuel supply chain, particularly the storage facilities) was substantial. This is severely aggravating the needs for government subsidies at a time when budgetary resources are particularly strained by the reconstruction effort in other sectors which suffered more extensive damage.

### ***The proposed reform program***

In 2002, an Electricity Law (Law 462) was passed which lays out the restructuring of EdL. The Law calls for: the creation of a regulatory authority; unbundling of parts or the entire sector; corporatization of the new entities; and ultimately privatization of up to 40% of the shares. The transmission segment would remain under public ownership, but could be under private management. Since the Law was enacted, several attempts have been made to advance its implementation; but there has been no change to the structure of EdL as of yet. It will be challenging but all the more urgent to implement this strategy successfully in Lebanon today and under the current subsidy requirement. Political commitment to implement the reforms will be paramount.

In an effort to progress on the reform of the sector, the Council of Ministers (in July 2006) endorsed a reform package proposed by the MOEW that includes immediate reforms and initiatives for improving sector performance. The reform program has as ultimate objective to turn the sector around through private sector participation. While there is recognition that full privatization is difficult in today's environment of high fuel prices and large subsidies, several steps have been proposed to commence the turnaround of the sector, including restructuring and corporatization and continued outsourcing to the private sector of key functions of running the utility given the lack of staff and their imminent departures to retirement.

### ***Rationale for Bank involvement***

The Bank and Lebanon have a long-standing relationship in the energy sector, both in investment support and sector reform. There have been several projects, but with mixed results on the policy and reform front. Since the end of the hostilities last summer, the Bank has been working closely with the government at all levels and across several ministries to lay out the reform program for the sector, which will also be the basis for which Lebanon seeks substantial donor support to its economy following the devastation from the hostilities. Most of the emphasis has been placed at the short-term measures to essentially initiate the reform process and builds on the endorsed measures back in July 2006.

The rationale for Bank involvement is therefore the extensive experience that the Bank brings in terms of implementing sector reform in difficult settings, which help lay sound foundations for sustainable reform over the longer term. Bank involvement in the power sector is also expected to send a strong signal to other donors to support the effort and to leverage additional resources for technical assistance as well as physical investment, and facilitate donor coordination, through the Bank's unique convening power.

In addition, the Bank's long-standing engagement with Lebanon in the energy sector as well as in the Middle East and North Africa region as a whole will facilitate the flow of international and regional experience and best practices based on its considerable work in rehabilitating and improving energy systems, in strengthening institutional capacity and supporting effective sector reform places it in a strategic position to help Lebanon rebuild and reform its power sector in an effective and sustainable manner.

## **II. Proposed objectives**

The objective of the proposed project is to accelerate the implementation of reforms and restructuring of EdL by enhancing the capacity in the Ministry of Energy and Water (MEOW), the Electricity utility (EdL) and a multi-Ministry Higher Level Committee (HLC) overseeing the reform process and in particular the restructuring of EdL, both in the short and the longer term. The capacity enhancement is expected to come from three distinct but closely related advisory service components (see description below).

## **III. Preliminary Description**

The proposed operation will contribute to the cost of three advisory service components, which will complement the service contracts already in place and technical assistance and investment support provided by other donors. The Bank supported components are heavily featured in the Government's reform program and will help assure that the reform program can move from plan to reality by injecting much needed capacity to implement the reforms. The components are the following:

***Advisory Service Component 1: Strengthening the Capacity of the Ministry of Energy and Water (MEOW) to Implement Power Sector Policy Reform.*** The objectives of the assistance proposed under this component are to (i) provide policy advice to MOEW in strategic areas; (ii) complete key on-going projects; and (iii) assist in the establishment of the regulatory agency. The duration of this component is expected to last for 2 years. The services covered include (i) Policy advice on key sector strategic issues (national energy strategy, sector least cost plan, tariff study, fuel sourcing strategy) (ii) Complete on-going projects (proposals for supply of LNG, contract to reduce the financial gap in distribution, review of proposals to attract IPPs) and (iii) Establishment of the Regulatory Agency (review of previous studies, assist in the recruitment of key staff and allocation of budget to the Agency). Support to the MOEW will also include a short-term component that will support the immediate hiring of a strategic advisor to the MOEW given the particular lack of capacity in the Ministry at present.

***Advisory Service Component 2: Support to Government of Lebanon in the Restructuring of EdL.*** The objective of the services proposed under this component is to assist the Government in the restructuring of EdL, including corporatization of the proposed structure of generation, transmission and distribution under a holding company. The assistance is expected to last for 18 months, with several intermediate milestones. The main tasks envisaged under this component are to (i) advise on the Government's proposed structure of the new EdL and restructuring strategy, (ii) provide support for the corporatization of the companies to be created, (iii) design for each company a detailed organization chart, governance scheme, set of job descriptions and staff mapping, internal procedures and help prepare their initial business plan, and (iv) develop an asset register and propose level of capitalization of the new companies and shareholding structure.

***Advisory Service Component 3: Support to EdL to Improvement of the Operational and Financial Performance and Implementation of the Restructuring.*** The objectives of the assistance proposed under this component are to (i) help EdL improve its performance with a focus on technical and procurement, commercial and financial aspects during the interim period between the beginning of the project and the moment the restructuring is implemented, and (ii) to assist the restructuring of EdL. The assistance is expected to last for eighteen months, or until EdL is corporatized and restructured. The tasks covered under this component will address, in addition, (i) generation efficiency and procurement, (ii) T&D reliability and efficiency and commercial, (iii) financial issues and accounting.

The proposed advisory services will run in parallel to other donor supported activities as well as other emergency and priority needs in the sector. The overall technical assistance and investment program in the sector, which are closely inter-related, is presented below:

### **Short-Term**

<b>Immediate Needs</b>	<b>Cost</b>	<b>Donors</b>
Build capacity in MOEW, EDL and Government to design and implement reforms/achieve sector improvement.	US\$8 million	World Bank Trust Fund US\$ 5 million Additional US\$3 million to be financed by Gov or AFD (tbc).

### **Medium-Term**

<b>Needs</b>	<b>Cost</b>	<b>Donors/Private Sector</b>
Complete 220 kV.	Already underway.	Secured.
Complete Ksara substation for 400 kV.	Already underway.	Secured.
Establish national control center.	Already underway.	Secured.
Installation of CMM/remote metering.	US\$200 million.	TBD.
Priority investments in transmission and distribution.	US\$250 million.	TBD; Arab Fund using what remains from US\$112 million facility.
LNG facility and gas pipeline infrastructure .	US\$200 million. US\$200 million.	TBD.
New generation capacity.	US\$300 million.	TBD.
Upgrading of Management Information System & other institutional services.	US\$35 million.	TBD.
Outsourcing contracts.	US\$185 million.	TBD.

*TBD: to be determined*

## **IV. Safeguard Policies that might apply**

As a technical assistance project financing consulting service contracts, the proposed operation is not expected to have any significant environmental or social impact.

<b>Safeguard Policies Triggered by the Project</b>	<b>Yes</b>	<b>No</b>	<b>TBD</b>
Environmental Assessment (OP/BP 4.01)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Natural Habitats (OP/BP 4.04)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Pest Management (OP 4.09)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Physical Cultural Resources (OP/BP 4.11)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Involuntary Resettlement (OP/BP 4.12)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Indigenous Peoples (OP/BP 4.10)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Forests (OP/BP 4.36)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Safety of Dams (OP/BP 4.37)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Projects in Disputed Areas (OP/BP 7.60)*	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Projects on International Waterways (OP/BP 7.50)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	
Piloting the Use of Borrower Systems to Address Environmental and Social Issues in Bank-Supported Projects (OP/BP 4.00)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	

## **V. Proposed preparation schedule and tentative financing**

Given the urgency of the situation and the significant dialogue already held with the government on the TA needs and in particular the need for capacity reinforcement, this project should be ready for

\* By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas

implementation by early 2007. The project is expected to be implemented over a two-year period from March 15, 2007 to March 15, 2009.

During the appraisal mission, the cost estimates have been finalized and the cofinancing requirements and arrangements finalized.

Source:	(\$m.)
Recipient	3.0
IBRD Grant	5.0
<b>Total</b>	<b>US\$8.0</b>

## **VI. Partnership arrangements**

The proposed project was developed in close coordination with a number of donors active in the power sector in Lebanon. All parties are ready to consider supporting the reform of the power sector, including if needed the capacity reinforcement component. Support to the medium and longer term reforms, including the need for physical investments in transmission, distribution and generation as well as natural gas infrastructure is also included in the Lebanon CAS spell out; thus ensuring the continuity of Bank support beyond the emergency phase.

## **VII. Implementation**

The project will be implemented over a period of two years, using existing Government structures where possible. The institutional and implementation arrangements will be as follows:

The three assignments will be overseen by a Higher Level Committee (HLC) under the chairmanship of the Prime Minister and comprising the Ministers of Energy, and Finance, CDR, HCP spell out and EdL. The implementing agency will be the CDR, which will also sign the contracts. The consultants will report directly to the beneficiaries of the grant, namely the MOEW, EdL and the High Commission for Privatization (HCP) as the administrative arm of the HLC. The HLC will assign the administrative reporting and day to day work with the consultants to the HCP. The selection and evaluation committee for the consulting assignments will be headed by the CDR and comprise representatives from the HLC.

## **VIII. Sustainability**

Political will and support is paramount. The need for political commitment at the highest level can't be stressed enough when embarking on power sector reform. Significant awareness-raising also need to accompany the reforms and facilitate buy-in to cooperate with international experts.

## **IX. Lessons Learned from Past Operations in the Country/Sector**

It needs to be noted that the Bank's past experience in implementing sector reform projects in Lebanon is not fully satisfactory. Reforms are slow to be designed and endorsed due to political fragmentation of the country and interference in the day to day operations of EdL. However, the momentum for reform is very high in Lebanon at the moment given the heavy burden the sector plays on the government budget and the need for the deteriorated government means to fund other priority reconstruction and on-going efforts. Therefore, the plan agreed among the key decision-makers is worth supporting and the most important first ingredient is to ensure sufficient capacity to implement what has been endorsed and work out the details of how to solicit private sector participation to the sector, including executing all the necessary preparatory work.

More generally, the Bank's experience in implementing projects in post-conflict countries, most recently in Iraq, has highlighted the importance of a synergy-focused, flexible and very concrete project design to allow for adaptation to changing circumstances in a context of very wide participation of the donor community. In line with this, the project design has been kept concrete, building on numerous existing measures that had already emerged from earlier work in the sector, while targeting areas that seem to best complement or leverage donors' contributions, in this case by concentrating its efforts to a technical assistance that focuses on sector human capacity and reform. Laying the ground for sector reform will also lead to increased opportunities for donors to provide complementing financing support to this longer-term initiative.

Over the years, the Bank has also captured global lessons on power sector reform. The main lessons learned that are relevant for Lebanon are (i) in cash short sectors, it is vital to have strong, centralized cash management in place before unbundling to ensure money will flow back to fuel procurement and O&M or subsidies may increase, (ii) unbundling should be done carefully and the number of unbundled entities should be as few as possible, (iii) the time period between unbundling and privatization should be limited as longer periods give rise to games without offsetting efficiency gains, (iv) learn how to reform as the processes gets underway – be ready to make adjustments in midstream, and (v) ensure there is sufficient in-house capacity to design and manage the reform process.

## **X. Contact point**

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