

Report on USAID and US Embassy/Baghdad Iraq Distribution Reform Workshop

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1. Introduction

A workshop for the Ministry of Electricity of Iraq (Ministry) was held on March 8, 2012, focusing on reform of the electricity distribution sector. The venue was the Ministry of Electricity and included speakers provided by USAID and the Ministry itself. This workshop followed on to an earlier workshop on general power sector reform held in May of 2011; the distribution reform workshop was intended originally to be delivered on August 1, 2011, but due to an unexpected government announced holiday, followed by the resignation of the Minister of Electricity, the workshop was postponed until the March 2012 timeframe.

The workshop was well attended, with about 30 representatives from the Ministry of Electricity and distribution directorates participating. Due to security considerations, the workshop was scheduled to last only two hours; however, due to the lively discussion among the participants, the workshop lasted almost three hours. The final agenda is included in the attached Annex.¹ Unfortunately, the Minister of Electricity had to excuse himself from attendance due to an unexpected scheduling conflict; the Ministry staff noted that they would prepare a written report on the workshop to share with the Minister.²

This brief report is intended to summarize the key discussion points that were raised, to offer some observations on the current thinking of possible reforms (e.g., through comparing the prior workshop from May of last year with the March workshop) as well as to provide recommendations for the consideration of USAID and the US Embassy in Baghdad.

¹ A list of participants, although collected, has not yet been provided by the Ministry.

² The Ministry representatives agreed to share this report with the US Embassy, but as of the date of writing this report, it has not been provided.

2. Workshop Observations

It is interesting to note that the thinking on reform has advanced considerably since the first workshop in May 2011. At that time, there was very limited understanding of the various reform steps and terminology. For instance, concepts such as single buyer, or the basics of regulatory were difficult for the participants to absorb. There was also a strong bias towards addressing reform by first and foremost, bringing more generation on line.

Based on this second workshop, it is evident that the thinking on reform has advanced, although there remains a long way to go. Distribution is now recognized as being a vital component of any reform program, at least on par with addressing generation supply problems. This is a major step forward. There is now a recognition that reform of distribution needs to go in hand with other sector reform steps. It is also positive that the Ministry requested a follow-on workshop to focus on organization of the wholesale side of the electricity sector, and specifically, how to form a single buyer.

During the discussion, the bias towards technology-based solutions for the problems seen in the sector was apparent. For instance, in his presentation, the Director General of Distribution noted the large number of projects underway in distribution, such as a new ABB distribution control center, and that the Ministry was planning to spend about \$3 billion on new distribution projects (e.g., new substations, cabling, transformers) in the next three years, and that these projects would help to improve distribution operations as well as reduce losses. Given the apparent lack of managerial control that exists throughout the distribution sector, it is a concern as to whether the Ministry will be able to implement such projects effectively and whether they will achieve their intended benefits.

There was considerable discussion on the difficulties of distribution, and especially the breakdown of payment discipline throughout the sector. Some of the attendees noted that prior to 2003, the customer base was disciplined, would pay in full and would also respond to curtailment requests. Now, the average customer refuses to pay, the ability to enforce disconnection in the event of non-payment is very difficult (and dangerous for the utility staff involved), and the judicial system is not a practical recourse (again, due to the possibility for reprisals against utility personnel not to mention the effectiveness of the judicial system itself). It was noted that this dynamic is typical, using diagrams from both of the USAID sponsored presentations that show the negative dynamic of a sector in decline, as well as the ways in which reforms can help break this cycle. This seemed to resonate with the participants.

The thinking has also evolved towards the use of the private sector either through management contract, concession or franchise. The Ministry noted that it is considering outsourcing the bill delivery and collection function to local diesel generator operators, believing that these operators have the tenacity to collect, something now lacking among the utility personnel. This raises a whole host of issues and is arguably not a sound way forward, but at least it indicates an openness towards considering other ways of organizing and managing the distribution sector, especially the revenue collection process. This is also seen in the interest the participants had in specific reform examples presented, such as the Bhiwandi franchise.

It is also clear from the discussion that the consideration of regulation is at a very early stage. Regulation was not discussed, nor were some critical difficulties, such as current tariff levels in

comparison with the full cost of service.³ The Ministry would benefit from more support on regulatory concepts so long as such concepts were realistic and practical in light of the difficulties seen in the Iraqi power sector. Regional examples could be helpful, especially Jordan and a more sophisticated regulatory regime, such as that found in Oman.

During the workshop, a general consensus to move in the direction of a single buyer model for the wholesale electricity market became evident. This is positive and realistic, given the present organization and crisis conditions found within the electricity sector. It also seems that there is a move towards a reform model that will not be a single centralized approach (e.g., no single nationwide distribution utility reform model), but that it will be a 'mixed' model, using certain approaches, such as provincial based distribution utilities, along with various and differing localized reform approaches (e.g., private sector participation options may be individually tailored and differ substantially throughout the country).

Corporatization also remains a challenge. Although the importance of corporatization was stressed by the USAID side of the workshop, it is not clear whether the concepts of corporatization (and what constitutes a corporatized entity) as well as the benefits that corporatization can provide have been internalized by the participants.

Finally, the time required for the reform program was also discussed. There is recognition that reform is not a 'quick fix', but will take time, and require 'course corrections' throughout (as, for instance, unintended consequences are revealed). The experience in other countries, such as Jordan and Egypt, were discussed, as were reform programs in more advanced countries (UK, Turkey) to demonstrate the amount of time required for a reform program to be designed, implemented and modified as the situation evolves.

³ An example cited was that Turkish imports are costing \$0.08 per kWh without fuel, and Iranian imports are at \$0.10 per kWh all in. This compares with a tariff of about \$0.015 per kWh for the average residential consumer.

3. Recommendations

Based on the results of the workshop, a series of recommendations are offered for USAID and the US Embassy's consideration.

1. *A workshop on a single buyer model is recommended as the third workshop to be offered.* The workshop participants and key members of the Ministry recommended that a workshop be offered on how to create a single buyer organization for the wholesale electricity. It seems that the concept is to combine the single buyer function as part of the transmission and central dispatch organization. Given that there appears to be a growing consensus to move in this direction, which is positive, it would be very useful if the US government were able to offer such support. Further, any such workshop should maximize the amount of time available for discussion.
2. *More exposure of the Ministry to other countries in the region is advisable.* The Ministry would benefit from engagement and exposure to the reform history, regulation and current institutional arrangements in other countries in the region. Jordan, in particular, would be valuable. Further, Oman is recommended given that it migrated from a state-owned vertically integrated system, to an unbundled system, with a quasi-independent regulator, buttressed by strong corporate governance. Oman has also been able to attract significant IPP investment and now relies near-entirely on the private sector for incremental generation needs for both electricity and desalinated water. It also has a highly transparent approach to the handling of subsidies given the below cost tariffs that remain in place, an approach the Ministry may find applicable.
3. *The draft electricity law should be reviewed and recrafted; support is needed.* The electricity law draft under consideration appears to be the same draft as reviewed one year ago. It is poorly crafted and in the author's opinion, not at all suitable for the needs of the Iraqi power system. The draft borders on unworkable and is in need of substantial rework. Some expert involvement either provided by the US government or multilateral development bank is recommended. Passage of the current draft would do little to advance the reform agenda, or provide any sort of assurance to the private sector. It would only be a matter of time before it a new law would need to be introduced to replace this current draft.
4. *The need for corporatization in the sector is vital and effort should focus on providing further explanation of what corporatization means in the Iraqi context and the benefits it can achieve.* This may be a subject for an additional workshop, or at least a white paper that can be shared with Iraqi counterparts. Regional corporatization examples would be useful to provide.
5. *There is also a need for support to better understand the models of private sector participation and how they might apply to Iraq.* The Ministry seems quite interested in the use of the private sector, but there is an incomplete understanding of the various models and their application. As a result, there have been the 'on-again/off-again' efforts to attract independent power producers, or the recent discussion regarding the use of diesel generator operators to handle revenue collection. The risk of a misstep is high. In this regard, it is suggested that members of the Ministry attend a venue in the Middle East, such as an

upcoming public private partnership workshop, to gain more experience and understanding on engagement of the private sector.

6. *An additional distribution reform workshop, perhaps later this year, is recommended.* The second workshop solicited excellent discussion among the participants, but was truncated due to the time permitted given security considerations. An opportunity for a follow-up workshop, with time for discussion of several key questions (i.e., those posed in Dr. Eisendrath's presentation) is recommended. If resources can be mobilized, a workshop outside of Iraq, perhaps coinciding with a study tour, would be ideal, allowing substantial time to discuss the subject matter and in sufficient detail.

This second workshop was a useful contributor to the ongoing dialogue on power sector reform. It was interesting to see a much more informed discussion about key reform concepts than what was witnessed in the first workshop, and that there seems to be a consensus emerging around some of the reform steps, such as towards a single buyer and some form of private sector engagement. Importantly, the workshop also demonstrated recognition among the participants that reform cannot be achieved through focusing on one subsector, such as generation, but must be comprehensive and include distribution reform as well. There is still a long way to go to develop a coherent 'road map' for power sector reform, but at least the direction being taken by the Ministry of Electricity appears positive.

Annex: Final Workshop Agenda

ELECTRICITY REFORM WORKSHOP #2 – DISTRIBUTION REFORM

Hosted by the Ministry of Electricity of Iraq

March 8, 2012

Facilitators: Allen Eisendrath, USAID; Dean White, Tetra Tech

10:00 Welcoming Remarks

- Karim Aftan - Minister of Electricity
- Ambassador Peter W. Bodde - Assistant Chief of Mission for Assistance Transition
- Alex Dickie - USAID Mission Director

10:15 Presentation of Iraq's Distribution System

The MOE will provide information on the current status and performance of the distribution sector. The distribution sector's business model will be described within the framework of the larger electricity system.

- Nafea Abdul Sada, Director General of Distribution, Ministry of Electricity

10.30 Presentation of Regional Examples of Distribution Reform: Corporatization and Commercialization, Regional Decentralization, and Private Participation

This session will include presentation and discussion of regional examples of reforming the Distribution Directorates, including corporatization and commercialization, regional decentralization, and private participation. Regional business models for generation supply to distribution businesses, for new customer relationships, and for new personnel policies will be summarized. Several reform case examples will be provided.

- Dean White, Tetra Tech

11:00 Presentation of MOE Distribution Reform Views and Efforts

The MOE will review its distribution reform objectives and current ideas about a potential model for Iraqi distribution reform.

- Amer Rajab, Directorate of Studies and Planning, Ministry of Electricity

11.15 Presentation and Discussion of the Requirements and Decisions to be made to enable the Implementation of Distribution Reform in Iraq

- Allen Eisendrath, USAID

11:30 Facilitated Discussion: What is the Right Distribution Reform Model for Iraq – A facilitated discussion of options for an Iraqi distribution reform model. Pros and cons of various options such as management contracts and concessions, and regional decentralization will be identified. Further questions and analysis needed to develop an Iraqi model will be outlined.

- Dr. Kosay Sattar – Director General of Studies and Planning, Ministry of Electricity
- Nafea Abdul Sada, Directorate of Distribution, Ministry of Electricity
- Allen Eisendrath
- Dean White, Tetra Tech

12:00 Day Concludes