

**U.S. Position on AsDB's  
Proposed Loans  
Greater Mekong Subregion  
Nam Ngum 3 Hydropower Project for  
Lao People's Democratic Republic  
November 3, 2011**

The United States values its bilateral relationship with Lao People's Democratic Republic (Lao PDR) as one expected to broaden and strengthen in the future. The country's dynamic growth, driven by exploitation of its bountiful natural resources, has benefitted the Lao people and dramatically reduced poverty; however, significant development challenges remain. The country's institutional capacity remains weak in areas important to its medium-term development, including governance, public sector and financial management, private sector development, and natural resource management. Despite economic progress, Lao PDR's social indicators remain among the lowest in the region, and several of its Millennium Development Goals (MDG) targets are likely to be missed.

This project is the construction of a 220 m high dam and a 440 MW hydroelectric dam on the Nam Ngum River. The project seeks to export electricity to Thailand, with significant revenue flows to the Government of Laos over the concession period. It is a complex undertaking that will require careful orchestration of the different elements needed to bring it to fruition. Construction will be done under three separate - but interdependent - contracts in an environment where off-taker risk, transmission risk, project completion risk, hydrological risk and dam safety risk - all pose significant operational challenges.

The complexity of the financing plan is equally challenging. Internally, there is a great need for close cooperation between the South East Asia Department and the Private Sector Operations Department, as both sovereign and non-sovereign loans are necessary to finance different project participants. In addition, a Thai bank will be providing the necessary Baht financing, and plans call for syndicating as much as \$200 million through risk participation agreements with a group of commercial banks that the Asian Development Bank (AsDB) proposes to assemble. Subsequent to project approval, next year a second sovereign loan to Electricite du Lao will be needed to fund construction of a transmission line and substation necessary to enable this project to reach its full potential.

The United States supports the development of infrastructure projects in Asia, and notes that a cross-border power project like Nam Ngum 3 (NN3) is supportive of AsDB's Strategy 2020 goal for greater regional integration. However, if the Lao people are to benefit from this project, it is crucial to understand the social and environmental costs, and how the revenues it generates will be programmed to meet development objectives.

On environmental issues, the United States has reviewed carefully the environmental impact assessment for this operation and has concluded that the disclosure and content of the environmental impact assessment (EIA) are inadequate. The original EIA filed in January 2011 had significant gaps. It failed to provide complete and accurate terrestrial and aquatic baseline data, the absence of which is problematic in the context of measuring the changing biodiversity

due to the construction of the dam. A baseline survey will be undertaken as part of an associated Technical Assistance (TA) project. However, clearing works and other preconstruction activities are already underway at the site, so it will be difficult to characterize a later survey as a true baseline. There also continues to be insufficient assessment of potential environmental impacts of the project (both direct and cumulative), and there is insufficient discussion of potential mitigation measures. This is particularly worrisome in the area of flow rates and water quality, as there is no plan at the NN3 level, or inclusive of all the dams on the Nam Ngum, to manage flow rates and releases with the idea of managing overall river water quality. Ongoing AsDB assistance to the Nam Ngum River Basin Commission will help address this critical issue for river basin management. The United States also questions the timing of distributing the environmental offsets proposal, which will be incorporated into the biodiversity study published at the end of this year. It should have been available prior to the Board Meeting so countries could evaluate the individual efficacy and cumulative adequacy of proposed mitigation measures.

In addition, the treatment of the associated transmission line in the EIA is also inadequate. The third financing package, a \$100 - \$120 million sovereign loan will fund a 500 KV transmission line to the Thai border and related expansion of the Nabong substation in 2012, thus allowing additional time to complete the related EIA. However, this environmental plan should have been completed in time for the Board to consider the environmental effects of these associated facilities in their entirety, and prior to making decisions regarding the first two loans.

The United States appreciates that the AsDB issued an improved EIA in October 2011 that draws on past AsDB-funded assessments of the natural resource management issues in the Nam Ngum River Basin. However, important environmental concerns remain unresolved, and this revised EIA did not meet the advance disclosure requirements of the U.S. Pelosi Amendment. Therefore, the United States wishes to be recorded as abstaining on this operation.

On other safeguard concerns, AsDB staff have learned many lessons on resettlement issues from previous operations, notably the Nam Theun 2 (NT2) dam project, and these appear to have been incorporated in this operation. For example, an improved stakeholder consultation and grievance system has been placed locally; livelihood restoration programs will be implemented early in the project plan; and realistic targets have been established for affected peoples' capacity to assimilate new practices and livelihoods. However, the ability of the NN3 Power Company to manage a resettlement program on this scale is untested, and reliance on Laotian law for redress has proven inadequate in the past. Therefore, the United States calls for the communities to be fully resettled before the critical construction begins. In addition, the United States believes it is important that affected communities understand that the AsDB Accountability Mechanism is available to address concerns that may arise during implementation of the resettlement arrangements.

Regarding development impact, the (much larger) NT2 financing included rigorous fiduciary measures, such as: (a) audits of revenue inflows by the State Auditor that were made public; (b) special revenue-sharing arrangements that guaranteed funds flowed to health, education, rural infrastructure, and environment; and (c) special schemes designed to address village poverty eradication and fund small entrepreneurs in the poorest districts. Unfortunately, the same

rigorous commitments by the NN3 project sponsors are not evident for this project. NN3 revenue accounts will be a flow through account to the general government budget, and disclosure will be made through the Ministry of Finance budget execution report. However, at that point funds can no longer be tracked to ensure spending on development priorities.

Moreover, out of \$771 million of estimated revenue flows to the Lao PDR Government over the project's 17 year life, there is only a commitment to direct \$202 million to priority sectors focusing on poverty reduction and environmental management. The balance of project revenues will be subject to the 2006 budget law, which does not segregate project revenues into a dedicated treasury account or have defined allocation to eligible priority programs. In this context, it is important that project revenues be subjected to rigorous monitoring and accounting procedures with appropriate transparency to the Lao public. Moreover, management of the \$202 million of project dividends is particularly important. Despite current plans to delay decision-making, it is crucial that policies and procedures governing use of these funds are defined now to ensure application to priority eligible programs when revenues begin flowing in 2017.

Oversight by expert panels is an integral part of the action plan. The United States has serious concerns about inadequate preparations in this regard. The Independent Advisory Panel, financed by the AsDB, has yet to be constituted to assist the Government in evaluating the impacts on biodiversity and implement an effective offset program. The Nam Ngum River Basin Commission (NNRBC) has been created, and a Secretariat was established last year. This Commission is crucial to the development of an Integrated Water Resource Management Plan for the Nam Ngum. It is also charged with developing a comprehensive basin-wide Water Quality Monitoring Plan. However, the NNRBC today exists only in skeletal form. Finally, Nam Ngum will be one of the highest concrete-faced rockfill dams in the world. With dam failure potentially disastrous, AsDB is placing great reliance on the undertaking that a Dam Safety Review Panel will be established to independently review the dam's design, monitor its construction, and review safety precaution measures. An independent and professional dam safety panel should have been established earlier in this process, and the United States strongly urge this step be a condition for loan disbursement.

Finally on prior conditions and conditions for disbursement, the loan and project agreements submitted to the Board contain insufficient information on the timing of the action plan for project implementation. These agreements reference a timetable that is in the Concession Agreement, but which has not been submitted to the Board. Sections of the EIA, the Resettlement and Ethnic Minority Development Plan (REMDP), and the project administration manual (PAM) refer to the timetable, however in the event of dispute, the dates in the Concession Agreement are those which are actually enforceable. The Board should have been provided a schedule of required actions in the loan and project agreements so that members could evaluate whether the Bank has adequately managed these complex risks, and there are adequate incentives to ensure a smooth implementation process.

In closing, the United States commends the AsDB country and project teams for their diligence and dedication in developing the Nam Ngum 3 Project. Close engagement with the Government of Lao PDR, and the project sponsor, helped to enhance the quality of these operations. The Public Sector and Private Sector representatives working on this project are an excellent example

of what this Bank does well by cooperating and working closely with senior management and the Board. At the same time, however, the United States must express disappointment that NN3 failed to “raise the bar” for Lao PDR’s management of complex projects, and in many ways this effort fails to meet the standards achieved in NT2. The Lao authorities should renew their commitment to manage infrastructure development projects according to higher standards. In addition, the United States requests both Management and staff to continue efforts to strengthen the monitoring and oversight of this project and ensure that the envisioned development benefits flow to the intended beneficiaries.