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March 28, 2005

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Dear Messrs Okazaki, Matsumoto, and Tanabe,

Thank you for your letter to Mr. Wolfensohn dated March 14, in which you express your views on the proposed Nam Theun 2 Hydroelectric Project (NT2). He has asked me to respond to your letter to let you know that we understand your concern that the people of Lao PDR benefit from development that is socially and environmentally sustainable. It is because we believe NT2 offers Lao PDR its best hope of generating additional revenues for poverty reduction and environmental conservation that we are presenting the project for consideration by our Board of Executive Directors on March 31. We also believe the project offers the opportunity to improve capacity within the country to manage revenues transparently and use its natural resources in a way that is socially and environmentally sustainable.

This is not to underestimate the risks the project entails, or the difficult context against which it is set. We are presenting NT2 to the Board following an extensive due diligence process, undertaken with full attention to the World Bank's operational policies and guidelines, and guided by the Decision Framework to which you refer. In the course of this due diligence process, arrangements and agreements were reached with the Government of Lao PDR and the Nam Theun 2 Power Company (NTPC), which should respond to your concerns:

1. ***There is a sound framework for managing NT2 revenues transparently and directing them towards priority poverty reduction and environmental conservation programs.*** As you note, the justification for World Bank support for NT2 hinges on the use of project revenues to benefit the poor. To this end, the Government has recently approved a Public Expenditure Management Strengthening Program (PEMSP) which lays out its reform and capacity building strategy for the five-year period from FY2005 to FY2009. The Bank believes that significant progress towards international benchmarks for public expenditure management can be made in this period. Government has recently publicly requested expressions of interest for two long term advisers to assist in the implementation of the PEMSP, and has also sent a letter to the World Bank indicating their desire to proceed with computerization of the expenditure management system using resources available under an International Development

Association (IDA) technical assistance credit. Other donors are also financing capacity building efforts to assist implementation of the PEMSP.

The Bank is encouraged by progress achieved under its Financial Management Adjustment Credit (FMAC), which has supported the design and early implementation of reforms in respect of public expenditure management, state-owned enterprises, and banking. In addition, progress is underway on the reform program laid out in the National Growth and Poverty Eradication Strategy (NGPES), which commits the Government to continued reforms in such areas as macroeconomic management, debt management, forestry management, improved delivery of public services and targeted poverty reduction. In part, as a result of policy changes reinforced by the NGPES, recent economic performance has been positive. Between 2001 and 2004, real GDP growth has averaged a robust 5.6 percent a year; inflation, especially non-food prices, has slowly begun to decline, helped by better aggregate fiscal control; and exports are performing strongly. The IMF's November 2004 Article IV Consultation reported robust medium-term prospects. Although the Poverty Reduction and Growth Facility will expire in April 2005, the Fund has agreed to continue surveillance on a semi-annual basis and to share its assessment of the macroeconomic situation and structural issues with the Bank.

As regards NT2 revenues more specifically, the Government has approved revenue and expenditure management arrangements, intended to provide further assurance that project revenues will be used to finance additional expenditures on poverty reduction and environmental management programs from the expected commercial operations date (COD) of 2009. Following these arrangements, NT2 revenues will be channeled through a dedicated Treasury account and will only be applied in financing programs that meet financial management, reporting and transparency standards. These arrangements are reflected in project legal agreements and will be subject to an annual consultative review, as well as on-going monitoring through the implementation of Public Expenditure Reviews and Tracking Surveys.

2. ***The project has been rigorously examined and prepared, with robust provisions to mitigate social and environmental risks.*** These aspects of the project have been the subject of intense due diligence, underpinned by an unprecedented level of analytical work, as acknowledged by many stakeholders and re-affirmed by expert panels, including the Panel of Environmental and Social Experts (POE) and the International Advisory Group (IAG). We have carefully considered the technical reviews commissioned by the International Rivers Network (IRN) and Environmental Defense (ED). While we understand the concerns they raise, we differ with the IRN-ED reviewers on the conclusions they draw; attached for your reference is a detailed response to the reviews, as well as material addressing the issues of project-related procurement and economic analysis. Having engaged the Government of Lao PDR and NTPC in intensive and systematic reviews of the baseline data and analytical work, the assumptions and methodologies underlying these, and the detail of the proposed mitigation measures, and having undertaken numerous visits to the project area to verify facts and consult local communities, World Bank staff are satisfied that the full extent of the project's impacts has been thoroughly understood and amply provided for.

Mitigation and compensation measures will include specific environmental management programs for species of special conservation significance, such as the Asian elephant and the white-winged duck; the protection of the NT2 watershed comprising forests nine times the size of the proposed reservoir and important ecological habitats; and proactive community development programs, designed through participatory local consultations, for the communities whose livelihoods would be affected by the project. Wherever possible, these programs rely on approaches familiar to Plateau and downstream communities, and where this is not possible, a range of viable alternative options has been proposed which would be implemented well in advance of the actual impacts, allowing time for piloting, assessing effectiveness, and retrofitting programs. These programs are supported by detailed implementation arrangements, including timelines, budgets, and monitoring and evaluation mechanisms. Uncertainties

and unforeseen impacts and outcomes have been provided for with contingency funds and recourse arrangements. Specific outcomes have been defined, including improved income targets for the affected communities.

I would note that such rigorous analysis and comprehensive risk mitigation and compensation are unprecedented in hydropower development in East Asia. These reflect the major lessons learned by the World Bank and the ADB from experience with previous hydropower projects in the region, including Pak Mun. Hence the thorough baseline work undertaken and the robust and proactive mitigation and compensation measures, to assist project-affected communities to prepare to cope with changes to their nutrition and livelihood ahead of time. In the case of NT2, there is also agreement that funding, implementing, and delivering these programs—an undertaking that would stretch the capacity and resources of the Government—would be the responsibility of NTPC, which is contractually bound to this under the terms of the Concession Agreement.

3. *Commitment to a continuous process for consulting local communities and international stakeholders is critical for international support and understanding for NT2.* As you note in your letter, the Decision Framework agreed with the Government of Lao PDR noted the need for broad-based support from the international donor community and civil society for its development strategy and NT2. This recognized that burden-sharing with other international donors was needed since reforms were more likely to be fully carried out if major donors are also deeply committed to the policy and institutional reform package while also supporting the implementation of NT2-related conditionality; and because NT2 required substantial external support through grants, export credits, financial transfers, and technical assistance from donors other than the Bank. As you may be aware, besides the World Bank and the ADB, the Agence Française de Développement (AFD), the European Investment Bank, the Nordic Investment Bank, and a number of credit export agencies are also considering support for the NT2.

It was also recognized that international civil society had a legitimate and strong interest in the project, and that the Government needed to develop a detailed program for systematic engagement with key international stakeholders. What we have seen as a result is an unprecedented level of openness and engagement from the Government of Lao PDR, which has pursued a series of actions to promote an informed discussion of the project:

- Proactive disclosure of project-related documents and background studies through websites, regular updates to interested parties, and public information centers in Lao PDR, Thailand, and elsewhere;
- Opening up the project site to visits by the press, civil society, parliamentarians, and others to talk with people there and, in some cases, observe ongoing local consultations.
- A series of international stakeholder workshops and follow-up meetings in Washington, Tokyo, Bangkok, Paris, and Vientiane to discuss all aspects of the project and Lao PDR's development framework.

We are encouraged by these measures taken to ensure that debate about NT2 has been informed, and that differing views have been taken into consideration. We respect the opinions that have been expressed regarding the project—your own, as well as those of other civil society organizations and those of the people who are most directly affected by the project.


Not all of these views can be reconciled; we recognize that dams are controversial. The third element of the Decision Framework was not intended to be measured by the number of signatures gathered for or against the project. This is especially true because from the outset, some groups were implacably opposed to this project and were sure to remain stridently opposed as long as the project involved a dam. As you know, we anticipated this in the Decision Framework. We have, however,

received positive feedback from many groups and individuals. Not all of them have chosen the sign-on letter approach to make their views known.

The intent of the third element of the Decision Framework was to ensure that civil society (not just non-government organizations interested in dams) had ample access to information and ample opportunity to express views and ask questions. That is why we have provided so much information on various websites, in different languages, and at numerous public meetings. It is why we have invested time in answering questions and writing responses, for a wide array of interested groups and individuals. This engagement has also provided the Government of Lao PDR and the developers with valuable input and ideas in preparing the project, resulting in qualitative improvements to the project design and increased openness and accountability in the process. I think that we have seen remarkable progress in this area; both the Government of Lao PDR and the developers have been forthright in their engagement with multiple external audiences, in a way and to an extent that has not happened before.

Ultimately, it is our Board, which represents the people and the interests of our member countries, who must evaluate whether we have satisfied this third element of the Decision Framework, and whether the process of engagement and disclosure has created a basis for proceeding. We are unequivocal in saying that it has.

Sincerely,



Ian C. Porter  
Country Director  
Lao PDR and Thailand  
East Asia and Pacific Region