UPDATE ON THE
LAO PDR: NAM THEUN 2 (NT2)
HYDROELECTRIC PROJECT

March 28, 2006
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<th>ABBREVIATIONS AND ACRONYMS</th>
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UPDATE ON THE LAO PDR: NAM THEUN 2 (NT2)
HYDROELECTRIC PROJECT

CONTENTS

I. Background and Summary Assessment of Progress ......................................................... 1
   A. Background ......................................................................................................................... 1
   B. Summary Assessment of Progress ...................................................................................... 2

II. Country Development Framework ................................................................................... 4
    A. Macroeconomic Situation and Structural Reform .............................................................. 4
    B. National Socioeconomic Development Plan and Poverty Reduction Strategy ............. 4
    C. Donor Coordination and Emerging Issues ........................................................................ 5

III. NT2 Project Implementation ............................................................................................ 6
    A. Progress of Construction Activity ................................................................................... 6
    B. Environmental and Social Activities ............................................................................. 7
    C. Complementary Investment Projects ............................................................................. 12
    D. Project Revenue Management ....................................................................................... 14
    E. Consultations, Disclosure and Stakeholder Engagement ................................................ 16
    F. Supervision, Independent Oversight and Reporting ......................................................... 17

Annex 1. NT2 Final Project Financing Plan (June 2005) ......................................................... A1
Annex 3. Update from ADB on the Theun-Hinboun Project ................................................... A24

Map. IBRD 34163R
UPDATE ON THE LAO PDR: NAM THEUN 2 HYDROELECTRIC PROJECT

I. BACKGROUND AND SUMMARY ASSESSMENT OF PROGRESS

A. BACKGROUND

1. The management of the World Bank (WB) and the management of the Asian Development Bank (ADB) have prepared this report together, in accordance with their agreement to keep their respective Boards informed about implementation of the Lao PDR Nam Theun 2 Hydroelectric (NT2) project through joint reporting on an annual basis, supplemented by semi-annual updates. In June 2005, an interim Update Report on implementation progress was issued to the Boards of both Banks. This present Update is the first annual progress report, and presents project status and key developments since project approval. It reflects the findings and assessment of a recent joint management mission of the International Financial Institutions (IFIs) concerned with the project.2

2. The Government of Lao PDR (GOL) agreed to an implementation framework, set out in the Government Letter of Implementation Policy (GLIP, 2005), to guide project implementation. The GLIP was built on the Decision Framework that guided work during preparation.3 It asserts GOL’s commitment to: (i) continue to build a viable development policy framework and programs for poverty reduction and for social development and environmental protection, using the National Growth and Poverty Eradication Strategy (NGPES) and the National Socio Economic Development Plan (NSEDP) as drivers; (ii) focus on effective implementation of the technical, financial and economic aspects of the project, as well as of the environmental and social safeguard activities; and (iii) further strengthen support from the international donor community and from global and local civil society for poverty reduction programs and associated development plans, and facilitate donor and civil society involvement during implementation of the NT2 project itself.

3. This Update provides an assessment, following the broad framework of the GLIP, of progress regarding the country development framework and key aspects of NT2 project implementation and partnerships. The GLIP focuses on five areas in particular: (i) revenue management; (ii) environmental and social performance outcomes; (iii) consultation and participation; (iv) monitoring and evaluation; and (v) activities complementary to the NT2 project. The Update pays special attention to progress in these areas and makes note of emerging issues. It is best read in conjunction with the final project financing plan and the GLIP, circulated

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1 Approved by the WB’s Board on March 31, 2005 and by the ADB’s Board on April 4, 2005.
2 ADB, Nordic Investment Bank, European Investment Bank, COFACE, Agence Française du Développement (AfD) and the International Development Association (IDA) participated in the mission, which took place February 20-24, 2006.
3 The “Decision Framework for NT2” called for: (i) establishing and implementing a viable development policy framework and program for poverty reduction and for environmental protection; (ii) ensuring that the technical, financial, implementation, and economic aspects of the proposed project, as well as the design and implementation of safeguards policies, are sound; and (iii) obtaining broad understanding and support from the international donor community and global and local civil society for Lao PDR’s poverty reduction program and the proposed project.
to the respective Boards at the time of project approval, and attached here as Annexes 1 and 2 to facilitate quick reference. Annex 3 provides updated information supplied by ADB regarding the Theun-Hinboun Hydropower Project. This Update will be disclosed to the public, as were the June 2005 interim Update report and the standard documents circulated to the Board in March 2005.

B. SUMMARY ASSESSMENT OF PROGRESS

4. Overall, given the complexity of the project, implementation of NT2 is progressing satisfactorily, with construction activities well under way, and is doing so within the context of an improving development framework. However, the Government and the Nam Theun 2 Power Company Limited (NTPC) need to move quickly to address some delays in the social and environmental programs to ensure that any negative impacts the project’s construction may have on the people or environment are mitigated and managed well. The economics of the NT2 project, itself a subject of some controversy in the past, are now unassailable, given recent trends in energy prices. The development framework, in which the project is sited, is improving; and macroeconomic stability is being maintained while progress is being made on implementing the national poverty reduction strategy and reforms to strengthen public financial management systems. The GOL has implemented key parts of its development framework over the past year. The next five-year NSEDP is nearing completion, and given its appropriate emphasis on participation, reform, growth and poverty-reduction, will be the successor to the NGPES. Reforms are being implemented gradually and are proceeding on a satisfactory basis in most areas. Nevertheless, reform progress in a few areas such as commercial bank restructuring is slower than expected, with the ADB’s Banking Sector Reform Program loan 2nd tranche release delayed as a result. The next WB Poverty Reduction Support Operation (PRSO2) has been negotiated and is scheduled for Board presentation this fiscal year. The ADB, AfD, European Union (EU) and Swedish International Development Authority (SIDA) are providing technical assistance (TA) to support the public financial management reform program as well as trade and private sector development. These efforts are laying the stepping stones to successfully managing the project revenue stream from 2009 onwards, although tough implementation challenges lie ahead. A series of complementary investment projects supported by the two Banks are in place or in an advanced stage of preparation to address environmental and social capacity building issues and improve livelihoods in the NT2 project area.

5. The physical implementation of the NT2 project has begun well. Impressive construction activities are ongoing at the dam site and the river diversion took place in early March 2006. Construction has begun on the coffer dam and dam abutments are being excavated. The headrace channel and tunnel, the power house and the downstream water works, including the regulating dam and pond and downstream channel, are all under construction. The overall construction quality is good. Given the complexity of obstacles facing implementation, particularly capacity constraints and the severe rainy season in 2005, this is a creditable achievement. The progress of physical construction is indeed impressive, dispelling fears of unexpected cost escalations. This augurs well for completing construction within cost and beginning reservoir impoundment by the target date of June 2008, with commencement of commercial operations in December 2009.
6. While physical construction work has gained strong momentum, there are delays in resettlement activities and shortcomings in remedying environmental impacts, which can be ascribed in part but not entirely to the heavy rains of the past season. GOL and NTPC need to improve the implementation of environmental and social activities and compliance with environmental standards through improved coordination, staff training and skills building, and better synchronization between the construction and safeguard schedules, so as to bring resettlement programs in line with the advance of civil works. The problems encountered in building capacity in the key GOL institutions dealing with environmental and social safeguards are also formidable, and pose a substantial risk, as anticipated during project preparation. Supplemental action on the part of the NTPC has been agreed upon to address these issues. On the positive side, the performance of the GOL’s Watershed Management and Protection Authority (WMPA), which is a key entity for conservation of the protected area, has been impressive. The challenge here is to maintain the momentum in this young organization. Overall, managing project impacts in a timely manner and consistent with agreed environmental and social plans – taking into account the potential for disruption created by heavy rainy seasons – poses serious but manageable risks to achieving the conditions required for impoundment of the reservoir by the target date.

7. Initiatives to further local consultations and to involve a broad range of stakeholders in project development also require continued attention. These consultations are an essential part of project transparency and will be important to maintain throughout the implementation period. Such consultations will ensure prompt feedback and effective functioning of the complaint resolution system, while also assisting project implementation staff by providing valuable inputs into overcoming potential problems, particularly in regard to synchronizing construction and social and environmental activities, and managing social issues such as resettlement, salvage logging in the reservoir area, and handling of downstream impacts. The consultations also need to be better linked to the strong monitoring and evaluation framework supported under the project.

8. In summary, the project has commenced well, but work still needs to be done to more effectively manage risks and mitigate impacts in the area of environmental and social safeguards, and synchronize these actions with construction momentum. This will require more effective measures to build capacity, strengthen implementation, improve coordination within GOL and NTPC, and streamline coordination and communications between them. With good progress in tunneling work and significant reduction in geological risks, the project is unlikely to face delays or cost escalation, provided the implementation agencies accelerate implementation of resettlement and mitigation of environmental impacts, and ensure that construction and safeguards measures progress in tandem.

9. The progress relating to the development framework and NT2 project implementation is described in more detail in the sections that follow.
II. COUNTRY DEVELOPMENT FRAMEWORK

A. MACROECONOMIC SITUATION AND STRUCTURAL REFORM

10. Lao PDR has maintained relatively stable macroeconomic conditions and robust economic growth. Monetary and fiscal discipline has been maintained and the momentum on structural reforms, in respect of trade, private sector and public financial management, has been sustained. Strong economic growth and relatively low inflation continue to reduce poverty in both rural and urban areas and improve social outcomes.

11. Growth was 7 percent in 2005, compared to 6.5 percent in 2004, as a result of large investments in mining and hydropower and rising gold and copper exports. This rate of growth is expected to continue in 2007. Tourism and non-agricultural exports continued to perform well in part because of the fast growth in neighboring economies, while agriculture continued its recovery from its low point during the drought of 2003.

12. Inflation reached 9 percent in 2005, although it would have been lower were it not for the large rise in world oil prices and in rice prices. The GOL judiciously kept tight control over the budget deficit despite rising wage bills and slower revenue growth, but this generated arrears and reduced non-wage recurrent expenditures. Also, large credit growth in state-owned commercial banks, sometimes breaching single-borrower limits, created new macro risks in the face of falling liquidity in the banking system. Clearly, additional Government actions are needed to mobilize more revenue, to control new recruitments and increases in wages, as well as to freeze further loans to over-exposed borrowers. This is critical, given the high debt-stock, and the high debt-service burden as a share of revenue, even if as a share of exports debt service is manageable.

13. Implementation of structural reforms has continued, even if slowly in certain areas. Actions to open up trade and private investment continue to be taken. The state-owned enterprise sector is borrowing less from banks and receiving fewer subsidies from the GOL, and large state enterprises are undergoing restructuring and price adjustments. But the restructuring of state-owned commercial banks is not going well; there is an urgent need to adhere to the “Governance Agreements,” to make better use of the International Banking Advisors and to seek private strategic partners for some state-owned banks. To improve banking services in the country, there is also a need to “level the playing field” for all state-owned and private banks. Public financial management reform is proceeding satisfactorily, with greater acknowledgement by the GOL of the centrality of reforms in center-local fiscal relations.

B. NATIONAL SOCIOECONOMIC DEVELOPMENT PLAN AND POVERTY REDUCTION STRATEGY

14. Lao PDR has been formulating the 6th NSEDP over the last 12 months using a consultative and participatory process for the first time. Donors have provided comments on the draft that was circulated in January 2006, and the GOL and donors expect the 6th NSEDP to be

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4 Following the expiry of the Poverty Reduction and Growth Facility in April 2005, IMF surveillance has been conducted through two missions a year, one of which results in an Article IV Consultation report and the other, an Assessment Letter.
the successor to the NGPES that was completed in 2004. This draft 6th Plan appropriately emphasizes the objective of poverty reduction and of the Millennium Development Goals (MDGs), as well as directions for policies and public investments necessary to achieve them. The draft Plan is scheduled to be discussed at the Party Congress in April 2006.

15. **The links between the objectives of the NGPES and the public expenditure programs in the Plan are being strengthened.** The Committee for Planning and Investment has conducted a series of workshops with sector ministries and donors on the proposed expenditure interventions submitted by ministries in four priority sectors – agriculture, transport, health and education – to develop a consensus on the five-year sectoral allocations, as well on expenditure priorities within these sectors. The final outcome of this process is expected to be incorporated in the 6th Plan, identifying the priority public expenditure programs for poverty reduction, as well as the priority sector-policies that may accompany them. The January 2006 draft Plan requires more work to reflect these aspects adequately and the GOL has assured all stakeholders that this is being done.

16. **The broad directions and goals for reforms in the private sector, trade, banking, state-enterprises and public financial management are also laid out in the draft Plan, or NSEDP,** which is expected to guide reform actions over the next five years. However, in the January 2006 draft of the Plan, the identification of specific actions under each of the reform areas is insufficient. Nevertheless, it is expected that the final Plan will draw on the findings and recommendations of the ongoing analytical work in trade, investment climate, and public expenditure areas to address this gap.

### C. DONOR COORDINATION AND EMERGING ISSUES

17. **Donors are providing financial support for implementation of policy reforms.** The WB takes the lead in the PRSO, the Public Expenditure Review (PER) and the Public Expenditure Management Strengthening Program (PEMSP) work, jointly with other Official Development Assistance (ODA) partners, while the International Monetary Fund (IMF) advises the GOL on macroeconomic management. The WB’s PRSO has been proceeding satisfactorily in all areas except banking, where progress in reforms has been slower than expected. The 2nd tranche of the ADB’s Banking Sector Reform Program loan has also been delayed as a result. The ADB continues to support the GOL in strengthening its accounting and auditing capability, and lately its fiscal planning and budgeting; the principal output of the latter will be a Medium-term Expenditure Planning Framework which will be pilot-tested in certain sectors/line ministries. In addition, ADB is currently formulating a Private/Small and Medium Enterprise Sector Development Program which aims to improve the regulatory environment by addressing various issues including: (i) business registration and licensing system; (ii) trade and investment procedures; and (iii) development of the legal framework for alternative forms of financing for small and medium enterprises. AfD, EU and SIDA ,along with the World Bank are providing TA to support implementation of PEMSP while AfD and EU are supplying Technical Advisors on trade and private sector development. The European Commission (EC) is planning to provide a

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5 The NGPES was the culmination of a long process of formulation using a consultative process for the first time. The Government started preparing an explicit poverty reduction strategy in April 2001, when it prepared an interim strategy. A Governance report was prepared in 2003 and an MDG report was completed in early 2004. The first full poverty reduction strategy, the NGPES, was completed in 2004 and discussed at the National Assembly and at the donor Roundtable.
long-term expert to support the PEMSP, with a focus on strengthening the Treasury Department of the Ministry of Finance (MOF). The United Nations Development Program (UNDP) is supporting the GOL in civil service reform at the provincial level.

18. **GOL needs to address several issues in order to maintain the pace of reform.** There must be greater consistency among NGPES, NSEDP, and Millennium Development Goal (MDG) initiatives and NT2 revenue management, bearing in mind that NT2 revenues will represent less than five percent of Government revenues when they begin to flow. There is a pressing need to synchronize and maximize synergy of donor support to capacity building for public financial management (including those under PEMSP and PRSO) with the other three major governance reform programs of the GOL: (i) civil service reform; (ii) people’s participation; and (iii) the rule of law, being supported by a number of donors and ODA partners (e.g., EC, UNDP). In response, the WB has initiated work on a comprehensive approach to capacity building in Lao PDR to coordinate the various initiatives currently being taken in an *ad hoc* manner. The adequacy of grant TA for PEMSP implementation is another critical issue, given the GOL’s reluctance to use credits. Although some grant TAs have been made available by ADB (to support fiscal planning and the budget preparation component of the PEMSP), and on a smaller scale by UNDP (through the Governance and Public Administration Reform Program) and SIDA to fund operating expenses and provincial consultation workshops, much larger and more systematic TA is needed to implement this ambitious and multi-year PEMSP adopted by GOL. The GOL has expressed its desire to pool donor funding into a multi-donor trust fund (MDTF). Other countries’ experience has shown that a flexible MDTF can be set up to allow one or two donors to contribute in the first year and others to join subsequently; SIDA and EC have expressed interest in participating in such an MDTF. The GOL has been urged to pursue this offer.

19. **The process for budget law revision that is underway provides an excellent opportunity to address key issues involving the public expenditure system** -- in particular, PEMSP implementation and NT2 revenue management. Hence, dialogue and provision of TA on the revision of the budget law will need to be intensified in the coming months. A needs assessment for capacity building should be expedited; additional staff in relevant areas, and training of existing staff, is much needed. A donor coordination matrix would be useful to all donors and development partners to plan their possible support.

### III. NT2 PROJECT IMPLEMENTATION

#### A. PROGRESS OF CONSTRUCTION ACTIVITY

20. **Project construction activities are off to a good start despite a very severe rainy season in 2005.** Five subcontracts – three for civil works and two for electromechanical systems – were signed and the Head Construction Contract (HCC) came into force on 15 May 2005. Following financial close in mid-June, the HCC began main construction activities. These started at the onset of a very severe rainy season, which in 2005 was significantly wetter than the long term average. This led to some delays as access roads were submerged for long periods, and floods interrupted work at the dam site and the power house. Initial management issues in the tunneling

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6 Rainfall was 75 to 100 percent above the long-term average at several of the meteorological stations in the project area.
contract caused slow excavation progress, but active intervention by the top management of the tunneling contractor resolved these issues, and progress is now satisfactory. The Nam Theun River was diverted in early March, enabling construction of the dam; impoundment of the reservoir is planned for June 2008 and NT2 commercial operations are scheduled to start in December 2009. Overall construction quality is good and progress is about 12 percent compared with a target of about 15 percent. Currently, activities are ongoing at: (i) the dam site (river diverted, construction has started on the coffer dam, dam abutments are being excavated), (ii) headrace channel and intake works (impressive progress has been achieved in excavation of the headrace channel and tunnel, and excavation and concreting work is on schedule); (iii) underground works (headrace tunnel, surge shaft, high pressure tunnel and drainage tunnel); (iv) power house; and (v) downstream water works (regulating dam and pond, downstream channel). At present, the site work force numbers about 4,600 – of which 80 percent are Lao nationals. This number will peak at more than 5,200 by mid-2006. With progress in tunneling work and significant reduction in geological risks (given that no major geological surprises have been encountered in the underground work completed to date), the project is unlikely to face delays or cost escalation – however, it is absolutely essential that the implementing agencies accelerate implementation of resettlement and mitigation of environmental impacts, and ensure that construction and safeguards measures progress in tandem.

B. ENVIRONMENTAL AND SOCIAL ACTIVITIES

21. The environmental and social work program is under implementation with variable rates of progress for key elements. The watershed and downstream activities, the regional health program, and curbs on camp followers illustrate a promising start on implementation of the environmental and social program. Construction-related environmental impacts – dust, waste management, spoil disposal and erosion control – have been identified and are being progressively addressed. The Nakai and project land resettlement programs and salvage logging are behind the schedule planned at project financial closing, for a variety of reasons, and this situation needs to be remedied through a number of measures (including quick finalization of program design and more rapid implementation). The inadequate synchronization between construction and environment/social schedules has also affected the overall pace of implementation and requires immediate attention from NTPC. Further, the slow mobilization of capacity and expertise in NTPC and GOL (except for WMPA), and inadequate rigor in internal due diligence procedures of NTPC are giving rise to new implementation challenges (e.g., forest clearance for the dam site access road).

22. Key issues in the different geographical, functional and cross-cutting areas of the project, and the proposed actions to remedy them, are summarized below.

(a) Plateau

23. The social program has commenced, but Nakai resettlement activities are behind schedule. NTPC and GOL have made some progress in all components of the Social Program. The Nakai Community Forestry Program, one of the key livelihood activities for the Nakai resettlers, and the Public Health Program, covering all project areas, have made a good start, with teams fully mobilized, working programs developed and implementation commenced. The GOL and NTPC have also thus far succeeded in curbing camp followers and in-migration to the project areas. However, the plateau resettlement program that will relocate nearly 6,200 people is
around four to six months behind schedule due to: (i) unusually heavy rains during the recent wet season; (ii) longer-than-anticipated time needed earlier to build up the required capacity within NTPC and GOL to complete consultations, design and procurement processes; and (iii) the need to find an alternative site (in Khamkerd District) to relocate two villages due to water quality issues (outside the control of NTPC, resulting from a gold mining operation outside of the project area) at the previously selected sites. These delays make synchronization between the construction and resettlement schedules even more critical. Even though there is still time to catch up on the schedule, given the possibility of unforeseen problems, NTPC has recognized that these resettlement delays must be immediately addressed to ensure that the people affected by construction have timely access to the new sites and livelihoods provided through the project. NTPC has therefore been taking actions to improve timing and sequencing links between infrastructure construction and livelihood development. Following additional studies, NTPC and GOL have revised their schedule, and are now implementing an accelerated resettlement and livelihoods program, and improving their capacity.

24. **Coffer dam closing will affect the majority of the villages to be relocated.** Existing villages’ productive land has been regularly flooded in the past, causing loss of livelihood; the villages themselves also have experienced occasional flooding (recently in 1996 and 2005). The delay in implementation of the resettlement program has increased the risk of additional flooding impact on some villages because closure of the coffer dam is expected to take place before the start of the 2006 wet season. It is anticipated that the next three rainy seasons are likely to result in an impact on a majority of the villages to be resettled along Nam Theun. To mitigate this impact, and to help the people cope with crop loss from the 2005 floods, NTPC is developing an assistance package that will provide the affected households with rice and sources of protein. For those villagers participating in the development of their new resettlement sites, arrangements are being made for provisional housing, water supply, nurseries, schools, and access to new plots, as well as continued use of existing livelihood sites during the transition period. Mitigation measures to address more severe flooding impacts, regardless of cause, are also being put in place, including radio equipment, boats for villagers and speed boats for NTPC (for transportation and wet season evacuation).

25. **Salvage logging will commence on a limited basis this year, and then be scaled up in 2007 and 2008.** An estimated (high end) 700,000 m$^3$ of wood, including commercially valuable timber, is available on the Nakai Plateau. The GOL has already included this volume of timber in its annual average allowable cut, and has also publicly announced that logging in other parts of the country will be curtailed during the Nakai Plateau salvage logging period. Preparatory work for salvage logging operations commenced in June 2005, with an estimation of the total volume and value of timber and NTFPs (Non-Timber Forest Products) to be extracted, and an outline of an operational plan.

26. **GOL produced a number of planning documents for the salvage operations, including a Code of Practice and a draft Strategic Plan.** The content of these documents is generally encouraging, and the key issues currently being addressed include: (i) selection of the most suitable road to evacuate the felled timber to markets in Thakhek and Lak Sao, and its environmental and social implications; (ii) ensuring that the conservation integrity of the National Protected Area (NPA) is not compromised; (iii) ensuring that priority is given to Nakai Plateau residents to collect NTFPs; and (iv) ensuring that the workforce and worker camps adhere to the same standards as those being followed by NTPC. On the first two issues, the
construction of a new temporary access track at the southeastern end of the reservoir and connecting to Route 12 (via the escarpment) is being proposed. An environmental impact assessment for this road construction and a social impact scoping study for the logging are ongoing, and GOL has agreed to put in place the necessary environmental safeguards including the establishment of gates/checkpoints operated by the WMPA to limit access to the NPA, decommissioning the road down the escarpment to Route 12 after completion of logging operations, and requiring logging contractors to implement a zero tolerance policy on wildlife consumption. In regard to the last two issues, details are being worked out, but GOL acknowledges the need for local communities to take a prominent role in collection of minor forest products, and a set of technical guidelines for contractors is being discussed. In addition, the GOL has agreed to undertake both internal and external monitoring, and discussions are ongoing to finalize the arrangements.

27. The elephant management program has commenced. NTPC has contracted the Wildlife Conservation Society, and work is currently progressing after some initial delays. Results of the elephant population assessment, which will form the basis for the management program, are expected by the middle of the calendar year. Progress on contracting consultants for the rest of the wildlife program, including the Phase 2 elephant work, is being given priority. NTPC is expecting both terrestrial and aquatic wildlife survey programs to begin shortly, and anticipates developing a plan to consolidate its efforts in relation to the wildlife trade by mid-year.

(b) Project Lands

28. Project land\textsuperscript{7} compensation is advancing at a rapid pace. CARE, an international non-governmental organization (NGO), has been contracted by NTPC for livelihood planning and implementation for all project lands. While project lands have been handed over in most cases, detailed resettlement planning (particularly in the Gnommalat District area) is behind schedule for land required for project construction areas. Lack of expertise and of experienced persons dealing with detailed resettlement planning are issues being addressed by NTPC. Work on the compensation and resettlement program in the Nakai District town of Oudomsouk is the most advanced, with an updated plan prepared. In the meantime, other lands, including lands for the downstream channel, have been handed over to the HCC. Provisional compensation has been paid to families whose income is affected pending detailed resettlement planning, which is being expedited, that would enable full compensation payment and implementation of livelihood restoration programs. Several households have been relocated temporarily to good quality housing with water supply, electricity and transfer assistance until their final sites are ready for occupancy. The IFIs have indicated their concern with over-reliance on provisional compensation, as affected households may use compensation funds for immediate needs rather than for longer-term investments, and/or may become dependent on such assistance. NTPC has agreed on the need to minimize the use of provisional compensation and instead follow the initially agreed detailed planning procedures.

29. Implementation of the livelihood program for those affected by the channel downstream of the power house in Gnommalat District requires priority attention. NTPC is acquiring large areas of paddy land for the downstream channel in the Gnommalat Plain. While civil works are speeding ahead and many parcels of paddy land have been acquired (using

\textsuperscript{7} Project lands are defined as all land required for project facilities other than the reservoir and resettlement sites (i.e., lands required for the dam structure, powerhouse, channels, transmission lines, roads and other ancillary works).
provisional compensation), the final compensation and livelihood restoration program is significantly lagging behind in development and implementation, although it is at an advanced stage of preparation. NTPC, GOL and CARE are working together to accelerate this program, but the urgency of this issue needs to be fully appreciated by NTPC and GOL and carefully monitored by the IFIs.

(c) Downstream

30. The design of the downstream livelihoods restoration program is on track. NTPC, with assistance from a consulting firm, is currently finalizing the design of the program aimed at proactively addressing potential impacts that will be caused in the downstream Xe Bang Fai and Nam Theun rivers by closing of the dam and the start of commercial operations. This program will detail the opportunities that need to be pursued to ensure that the livelihoods of people living along the two rivers are not negatively impacted, building on the approach described in the Social Development Plan. A detailed study of potential downstream impacts has been undertaken and a detailed resettlement and livelihood restoration program, as envisaged in the Social Development Plan, will be ready for discussions with the IFIs in May 2006. The current design proposes three main components: (i) preventing flooding along tributary streams to the Xe Bang Fai River, through the construction of polders; (ii) securing potable water quality through construction of drinking water wells; and (iii) supporting income generation and food security through financial and technical assistance to village-level producer groups, for livestock, small-scale irrigation, fishing, rice and vegetable production and handicrafts. The program is expected to be implemented jointly by NTPC and GOL working closely with relevant GOL institutions at the national, provincial and district levels. The study team has concluded that large-scale irrigation development may not be feasible, although there may be scope for limited expansion of irrigated area in Gnommalat District using flows from the downstream channel.

(d) Watershed

31. Initial progress of the WMPA has been impressive. The WMPA has filled most of the current local staff positions and has all three long-term, full-time TA consultants on board. For the remaining nine positions to be filled, suitable candidates have been identified for all but two. With the additions in personnel, field activities have intensified considerably, including continued scaling-up of patrolling activities and the launching of land use planning and village development programs\(^8\) through pilots within the watershed. The implementation of these programs has demonstrated the team's ability to work at a high standard, both in participatory tasks and planning with local communities, and in involving and building the capacity of local government staff. Given the complexity of integrated conservation and development programs, the WMPA is inevitably faced with various technical and strategic questions, e.g., over the control of access to and economic activity within the watershed, and how resources are integrated and divided among their core programs.

32. At the same time, the WMPA remains a very young organization and still has considerable work to do in establishing its own internal systems and institutions. Accounting and procurement systems, human resources policies, data management and decision-making systems have yet to be firmly established. The recent creation of the WMPA also means that it

\(^8\) The ethnic groups displaced from the Watershed through past resettlement have been included by the WMPA in the planning process, and GOL has requested additional grant funds to support implementation activities. Efforts are under way to help realize such support.
still receives only limited recognition and understanding from other government bodies. Ensuring a clear understanding of its mandate will be key to obtaining appropriate cooperation on a range of issues. The WMPA requires supportive action from various local authorities, such as the local police and judiciary in prosecuting poachers, and the Nakai District authorities in providing salaries to district health and education workers within the watershed in a timely fashion. It also needs cooperation from external authorities, in accordance with the provisions of its founding decree, to ensure it is consulted about activities that could impact on the watershed. These particularly relate to the activities of the military and its role in protecting the international border; the development of mining in Khamkerd District; access to the area by outsiders; the role of districts in granting licenses for NTFP harvesting; permissions for research within the watershed; and ensuring effective safeguards against unauthorized bio-prospecting.

(e) Cross-cutting Environmental Issues

33. **NTPC needs to strengthen its due diligence efforts.** NTPC, working with its Head Contractor, is taking steps to improve its tracking of environmental documentation such that, rather than just recording the list of plans received, issuance and approval of plans can be synchronized with the schedule of construction activities. Regular, proactive and issue-focused environmental reporting from NTPC in general, and having the necessary baseline information in place, will streamline the task of external monitoring, allowing issues to be identified and therefore addressed more rapidly and efficiently. NTPC is also reviewing its practice of authorizing engineering works to ensure that environmental and social clearances are available at the time of engineering design approval, and NTPC together with the Head Contractor will examine whether existing incentives for environmental performance within construction contracts are adequate. Appropriate specifications for the construction of the new section of Route 8b across the Special Conservation Area known as the “Thousand Islands” would be discussed among NTPC, WMPA, and the IFIs before work commences on this stretch.

34. **Dust, waste management and erosion control have emerged as priority environmental problems at different construction sites.** The following are being addressed: (i) Dust levels along the roads in the project have become a concern, although progress has been made in a number of critical locations through completion of the Gnommalat bypass, increased watering and installation of speed bumps in Ban Sop Hia. NTPC should continue to identify sensitive sites for dust control and explore options for temporary improvements and accelerating the timetable to seal upgraded roads in critical locations; (ii) responding to the IFI missions and Lenders’ Engineer (LE) findings, the NTPC and HCC are upgrading waste disposal facilities and negotiating arrangements for disposal of used oil; and (iii) erosion and sedimentation measures require further attention by all parties ahead of the wet season, especially given the scale of new earthworks and spoil being generated in the construction of the downstream channel. Revised re-vegetation and spoil disposal plans due within the next few weeks from the HCC should form the basis for addressing these issues.

35. **Vegetation clearance along new roads is also of concern.** Construction of new roads to the dam site and Route 8b bypass are in progress, with substantial vegetation clearance needed in critical mountainous areas found to have steep slopes and loose soil. The IFIs will coordinate with GOL and NTPC to advise them on how the clearance for the new roads can be minimized while meeting the technical requirements for safety and stability of the roads. Forest clearance along the dam site road in the protected area corridor has illustrated the importance of timely completion and approval of environmental documentation. The lack of specific information
related to the vegetation clearance in the Site Specific Environmental Mitigation Plan for these roads has made it difficult for NTPC's Environmental Management Office (EMO) to be aware of the issue and proactively take appropriate actions. The Head Contractor and NTPC have been advised to take urgent actions to address these issues and ensure that re-vegetation is undertaken. The Head Contractor must also continue to exercise diligence in ensuring that unsafe burning practices in areas cleared for road construction are stopped.

(f) Organization, Staffing and Capacity

36. Implementing organizational and staffing changes in a timely manner is a prerequisite to building capacity. Performance in this area has been mixed. NTPC capacity needs further strengthening and the GOL’s Resettlement Management Unit (RMU) needs restructuring and stronger measures for its mobilization. While the NTPC has followed its staffing plan and most of the planned staff are in place, the lack of staff with adequate experience in hydropower-related resettlement is a weakness. In order to address this issue, NTPC is now reinforcing its team by recruiting a well experienced resettlement specialist. Internal coordination and communication also seem to be a concern. Most of GOL’s RMU staff remain on temporary assignment and the RMU lacks qualified technical staff to be fully functional. Recognizing this, GOL is streamlining RMU functions to make it a coordinating body, transferring implementation responsibilities to the District Resettlement Working Groups and focusing capacity-building efforts at the District level. Activity of the GOL’s Environmental Management Unit (EMU), strengthened by the recruitment of full-time staff, is expected to intensify now that TA has been mobilized and detailed implementation arrangements are being developed.

37. The Head Contractor has responded promptly to concerns raised by the external monitors, the LE and the Panel of (Environmental and Social) Experts (POE) in terms of increasing environmental staff capacity. In particular, the Head Contractor has now divided the previous responsibilities of the Environment, Health and Safety Manager, and engaged an experienced environmental manager, who is due to start work shortly. It is expected that the reorganization and strengthening of the Head Contractor’s Environmental Unit should provide for a more proactive approach to recurrent issues such as dust control, re-vegetation and sedimentation control, including testing a range of management options where appropriate.

38. NTSEP (Nam Theun 2 Social and Environment Project) procurement problems are being addressed. At the time of appraisal and negotiations of the project, commonly used country parameters for threshold amounts and procurement methods were adopted for the NTSEP. However, in the first six months of implementation, NTPC and WB recognized that this was constraining the use of the IDA grant provided through the NTSEP. Following discussions involving the World Bank’s procurement and fiduciary staff, and a further assessment of NTPC’s capacity, it was agreed to increase the thresholds and provide greater flexibility in the use of procurement methods. The Project Agreement between IDA and NTPC will be amended to reflect these refinements.

C. Complementary Investment Projects

39. The Environment and Social Program, a USD 15 million loan, approved by the ADB’s Board on 6 December 2001, has supported the policy reform agenda of the GOL for improved environmental management and social safeguards in the energy and transport sectors. The Environment and Social Program covers five closely linked priority areas for policy action: (i)
strengthening national policy and the regulatory framework for environmental management and social safeguards, (ii) enhancing policy implementation measures and capacity in the provinces and by sector, (iii) improving compliance and enforcement, (iv) promoting river basin management as a multi-sectoral and integrated planning framework for energy and transport development, and (v) establishing sustainable financing mechanisms, including an environment fund. Under the aegis of the Program, the GOL has issued in 2005 a Decree, Implementing Regulations and Technical Guidelines on Compensation and Resettlement, and a Decree establishing the Environmental Protection Fund (EPF), and has issued Third Party Monitoring Guidelines. Preparation of the Decrees on Resettlement and the EPF involved close cooperation between ADB and World Bank; the EPF will be operationalized under the World Bank's Lao Environment and Social (LEnS) Project.

40. The IDA LEnS Project is a complementary activity to the NT2 project to strengthen environmental and social policy and capacity. The project, a USD 4 million IDA grant, was approved by the WB’s Board on June 30, 2005, and is expected to become effective in mid-April 2006, following delays in recruiting certain key staff. The project seeks to strengthen institutions and instruments for assessment, monitoring and compliance for environmental and social sustainability and broadening the constituency for environmental change; invest in on-the-ground environmental improvement activities identified in the NGPES, with emphasis on biodiversity conservation and livelihoods enhancement; and operationalize the EPF (that was established with ADB support) to become a permanent entity that is eligible to use NT2 revenues for priority environmental protection activities in the country. Specifically, LEnS will: (i) apply the lessons learned during preparation of the NT2 project to other development projects, with special emphasis on hydropower development; (ii) address cumulative impacts of river basin development in the Nam Theun/Nam Kading Basin; (iii) strengthen the institutions responsible for implementing the recently-enacted Resettlement Decree (see paragraph 39); and (iv) support specific actions aimed at strengthening the management of selected protected areas in the country.

41. The IDA Rural Electrification Program (REP) will increase rural household access to electricity and improve the sustainability of power programs. The development program, scheduled for presentation to the Board shortly, is to be implemented over a six-year period in two phases and would provide access to electricity to some 106,000 rural households (GOL’s connection target for 2006-2010 is about 280,000 households, to achieve a 70 percent household electrification ratio by 2010); assist Electricité du Laos (EdL) to achieve financial sustainability; promote development of the legal, regulatory and institutional framework; encourage other participants in sector development; provide a sound planning basis for electrification; and increase the efficiency of electricity delivery and consumption. The specific objectives of phase one of the REP (REP I), an Adaptable Program Loan, are to: (i) increase access to electricity of rural households in villages of targeted provinces (about 42,000 rural households in seven southern provinces – including Bolikhamxay, Khammouane and Savannakhet, which together cover the NT2 project area – are targeted for grid extension and 10,000 rural households in 17 provinces are targeted for off-grid electrification); and (ii) improve the power sector's financial performance (through implementation of tariff reform and minimization of cross-subsidies); reduce EdL's system losses; and develop budgetary procedures, planning and implementation capacity within EdL for Demand Side Management and energy efficiency, a sector financing strategy, rural electrification master planning capacity, and necessary legal, regulatory and institutional arrangements. For the global environmental objective, REP I would bring about two
key outcomes: (i) substantial adoption of renewable energy in GOL’s program and (ii) increased efficiency of energy delivery by EdL and consumption by EdL customers, leading to increased exports of hydropower to, and reduced imports of thermal power from Thailand, with eventual greenhouse gas emission reductions, as thermal power plants would be operated for marginal production in Thailand over the project period. Proposed support for REP I would be through an IDA Grant of USD 10 million, a Global Environment Facility Grant of USD 3.75 million and co-financing of USD 10 million by the Norwegian Agency for Development Cooperation.

42. A proposed IDA Khammouane Rural Livelihoods project would broaden the positive benefits of NT2 across the whole province. It would do so by: (i) strengthening capacity of farmers and of local institutions; (ii) providing critical production and infrastructure assets for improved productivity; and (iii) supporting market integration. The proposed project concept is based on a series of studies that will serve as analytical inputs to a provincial development report and strategy, under the leadership of the Office of the Governor, and which will assess the current status of the province, identify priority needs, and better coordinate actual and future development assistance. The provincial strategy should also provide a basis for overall monitoring of service delivery and indicators of improved livelihoods at the local level. The Khammouane Development Report and Strategy are expected to be completed by September 2006. The follow-on Rural Livelihoods project is expected to be ready for WB appraisal by March 2007. In parallel, the WB funded a preliminary feasibility assessment of large-scale irrigation schemes utilizing discharge from NT2 flows. This study concluded that such schemes are unlikely to be viable given the poor performance of existing irrigation schemes and the high financial and environmental costs of irrigation development. There remains continued interest within the Province in new large-scale irrigation schemes and other large-scale water management infrastructure, however, and this issue needs to be addressed.

D. PROJECT REVENUE MANAGEMENT

43. NT2 revenues will, through revenue management arrangements, provide additional resources to support eligible programs, which reflect GOL’s development priorities. These programs are laid out in the NGPES and are expected to be updated in its successor, the

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9 These studies are part of an ongoing capacity building TA under the Governance and Public Administration Reform Program (GPAR) with support from Stichting Nederlandse Vrijwilligers (SNV) of the Netherlands, UNDP and the World Bank. In Khammouane province, GPAR explicitly links capacity building at the provincial, district and village levels with strengthening of mechanisms for public service planning and accountability, in support of improved rural livelihoods and broader economic growth led by the private sector. GPAR is also intended to better link future investments to the planned mitigation support implemented by NTPC and ongoing projects supported by ADB, CARE, Japan, Liechtenstein, Wildlife Conservation Society, and the World Bank.

10 Under NT2 revenue management arrangements, expenditure on priority sectors must show evidence of additionality (i.e., such expenditures must be additional to “normal” government expenditures in these sectors). The number and scope of eligible programs is expected to gradually expand as financial and program management capacity is strengthened. The indicative eligible programs, identified on the basis of GOL’s priorities as of March 2005, include: basic education; basic health care; rural roads (including the Road Maintenance Fund); local development initiatives identified through a participatory planning process (including the Poverty Reduction Fund); and environmental protection initiatives (e.g., through Lao Environment Fund).

11 Costing of the NGPES has already begun, and is a critical first step in the process to establish the interconnection between planning and budgeting within the existing system of public administration and financial management. So far, this process has been successfully formulated in a series of participatory workshops. However, prioritization of the NGPES programs, following the costing exercise, will provide the basis for identifying the targeted programs.
NSEDP. The draft NSEDP recognizes that “sound, accountable and transparent financial management is an integral part of the Government efforts to increase efficiency of public management and resource allocation.” For the NT2 project to ultimately be successful in meeting its poverty reduction objective, and to help ensure that the NT2 revenues to GOL are used transparently and effectively in support of GOL’s poverty reduction and development objectives, it is essential that momentum be maintained in the GOL’s reform efforts – particularly the implementation of the PEMSP over the next few years (before NT2 revenues begin to flow in late 2009). The WB and ADB, together with other ODA partners, are supporting this effort through analytical and advisory services, and a series of WB-supported PRSOs.

44. Implementation of PEMSP and NT2 revenue management arrangements have progressed reasonably well, despite some slippages in the early months. In particular, the management arrangements for implementing the PEMSP are operational and execution of the first annual (October 2005-September 2006) PEMSP implementation plan is underway; the key instruments for monitoring, benchmarking and transparency have been initiated and the process of defining the priority areas and thus eligible expenditure programs is underway in the NSEDP, scheduled for completion shortly.

45. The main focus of implementation is on PEMSP to ensure better management of all public spending of Lao PDR, including spending of NT2 revenues. The rationale for this is that revenue from the NT2 project, by itself, is unlikely to exceed five percent of total government revenues, and better management of all expenditures is essential to ensure “additionality” of NT2 revenues. The key elements relating to ongoing implementation are as follows:

- **PEMSP.** The GOL established, in August 2005, the Steering Committee for PEMSP, headed by the Vice Minister of Finance, as well as the Technical Working Committee, headed by the Deputy Director of the Fiscal Policy Department in the Ministry of Finance (MOF). Following intensive inter-departmental discussions, and consultation with donors and other stakeholders, the first annual (October 2005-September 2006) PEMSP implementation plan and the capacity building plan for PEMSP were approved by the Steering Committee at its meeting on January 9, 2006. The plan transforms the PEMSP targets for FY2005-2006 into specific program activities with outputs/milestones identified and lead department and collaborating departments assigned to each of these activities. The plan also provides information on existing TA and additional TA needs so as to help mobilize donor funding to support PEMSP implementation. The expatriate Technical Advisor for PEMSP (financed by the ongoing World Bank Financial Management Capacity Building Credit) started work in mid-November 2005, and the Capacity Building Advisor is expected to be on board shortly. ADB is providing a TA grant in support of the Fiscal Planning and Budgeting component of the PEMSP, in particular the pilot implementation of the medium-term expenditure and budgeting frameworks for the period FY2006-2008. The Government is upgrading its existing information system, and developing a modified Chart of Accounts, so as to track more details of public spending. Based on the above, the progress on the PEMSP implementation is considered to be satisfactory.

- **Poverty Reduction Support Operations (PRSO).** A sequence of three PRSOs provides financial support to implementation of key reforms, including PEMSP actions. These operations are tied to the budget cycle of the Government, comprising three one-year operations, and they are on track. The PRSO1 has been disbursed. The second operation (PRSO2) has been negotiated and is scheduled for Board presentation later this fiscal year.
• **Monitoring of Public Expenditures.** The *Public Expenditure Review* (PER) is on track for completion by end-June 2006, and the completion of the *Public Expenditure Tracking Survey* (PETS) has been slightly delayed to August 2006. The State Audit Organization’s (SAO) annual audit of public spending is on track and preparation of the first Peer Review of the SAO has proceeded well. There is agreement at the technical level, on the terms of reference, for the Peer Reviews, as well as GOL’s choice of the New Zealand Auditor General as the International Organization of Supreme Audit Institutions (INTOSAI) Peer Reviewer. ADB’s ongoing TA to the SAO will provide support to the institution when the first Peer Review takes place in 2006. However, the completion of the Peer Review will take longer, going beyond June 2006.

• **Eligible Expenditure Programs.** To finalize eligible programs, priority areas for poverty reduction have to be defined, the budget format and the Chart of Accounts must be modified so that these programs can be clearly identified and tracked, and the provinces can be held accountable for spending under these programs and timely reporting of such expenditures. The formulation of the NSEDP is on track and is expected to finalize the areas for eligible expenditure sectors/programs by June 2006. The preparation of the Chart of Accounts is in process and its revision and approval is a trigger for the PRS03 operation due next year. The revision of the budget law is expected to, among other things, elaborate and clarify center province/local fiscal relations; this is important because a large share of eligible expenditures is likely to be spent by the provinces and districts. A preliminary draft law is circulating for comments and is expected to be enacted in the latter part of this calendar year, though details of center-province relations will take longer to be fully worked out.

**E. CONSULTATIONS, DISCLOSURE AND STAKEHOLDER ENGAGEMENT**

46. **Consultations with local communities continue in all project areas under the various planning and implementation activities.** Communities on the Nakai Plateau participate in regular consultations, in some areas on a daily basis, on preparation of the resettlement and livelihood program. Consultations have recently included discussions on alternative resettlement sites for villages that had originally chosen to relocate to Nam Pan in Khamkerd District, the preparation of the accelerated resettlement program, and preparation of mitigation measures for additional flooding impacts as a result of the closing of the coffer dam. Communities and households affected by project lands, for instance in the Gnommalat area, also participate in ongoing consultations and participatory preparation and implementation processes for the project land compensation and livelihood restoration program. Leaflets explaining compensation rights and grievance procedures have been distributed to potentially affected villagers. Thus far, the grievance mechanism appears to be working satisfactorily. A few complaints have been received, and are reported to have been resolved to the satisfaction of the complainants.

47. **Some communities in the downstream areas have already been consulted in the ongoing preparation of the downstream livelihoods restoration program.** More intensive consultations will be undertaken as site specific activities are designed, based on the needs and priorities of affected communities. Communities in the watershed are continuing to be involved in biodiversity conservation and community development activities that are outlined in the Social and Environment Management Framework and First Operational Plan (SEMFOP) and are currently being implemented by the WMPA. These activities will be gradually expanded as
lessons are learned and the WMPA is fully staffed. The expert who conducted the independent review of consultations during project preparation has been contracted by the WB to conduct site-based assessments of the consultation process. In addition, the consultant will also review the grievance mechanism and will share the findings with GOL; if any strengthening of the process is required, it will be discussed, agreed and then implemented by the GOL.

48. The project continues to attract international attention. The project area has been visited by media, students, scholars, civil society, parliamentarians, donor agencies and other stakeholder groups. GOL and NTPC have facilitated these visits nearly on a weekly basis over the past nine months and allowed unhindered access to different project sites. GOL, NTPC and the IFIs have been proactively sharing information with the public through regular media releases, and also responding to queries from the media and civil society. The IFIs are currently reviewing a request from GOL to further strengthen its communications and consultations capacity building so that it can continue to build upon the good progress made during the project preparation period in increasing the transparency, accountability, and openness around the NT2 project.

49. Disclosure of key documents continues to take place. The practice of disclosing important project documents is being continued by GOL and NTPC. NTPC disclosed the semi-annual progress report in January 2006. The disclosure of the Project Implementation Plan (PIP) by NTPC has been deferred to accommodate the integration of some specific sub-plans, and this is expected take place shortly. Certain operating plans like the Annual Implementation Plans, Monthly Reports and some technical reports will not be disclosed, since these are detailed operational documents, written for the purpose of guiding the work of a large number of technical staff and managers working on the project and often are subject to revision in response to evolving circumstances. The GOL annual report for the watershed and revenue management will be disclosed when ready. The joint International Advisory Group (IAG) and POE report of August 2005 has been disclosed and the March 2006 reports of the IAG and POE are also documents that will be disclosed. The reports of the Independent Monitoring Agencies (IMAs) will also be disclosed when they become available. Appropriate disclosure of technical documents, like the Salvage Logging Plan, Community Forestry Plan, and Detailed Resettlement Village Plans, will be undertaken.

50. Annual Stakeholder Forum is planned for mid-May 2006. GOL has confirmed that it will host the first Forum in coordination with NTPC and the IFI partners. The Forum will be open to members of the public, and will be an opportunity for interested stakeholders to hear updates on the project, share lessons learned and engage with GOL, developers, and IFIs on a range of project-specific issues including project implementation, construction progress, environmental management, resettlement measures and livelihood restoration, social development and gender activities and revenue management. The ADB and WB also regularly keep the donor community in Vientiane briefed on the progress of the project through the Round Table Process co-chaired by the GOL and UNDP, specifically through the Infrastructure and Macro-economic Working Groups.

F. SUPERVISION, INDEPENDENT OVERSIGHT AND REPORTING

51. Given the complexity and risks associated with this important project, strong supervision and oversight arrangements involving a large number of entities have been put in
place and are now being streamlined taking into account the experience of the first months of implementation. Feedback from clients and oversight groups during the initial NT2 supervision activities indicates the need for a more harmonized and targeted approach among the parties engaged in supervision and oversight of implementation progress. The supervision arrangements agreed at the project launch workshop in June 2005 have therefore been reviewed and revised as follows: (i) the LE will visit four times per year, the Dam Safety Review Panel (DSRP) will visit once per year (overlapping with the LE), the Government of Lao Engineer (GOLE) will visit four times per year (timed to coincide, where possible, with key construction events and the visits of the LE and the DSRP); (ii) the IMAs, as envisaged under the Concession Agreement (CA), will oversee the respective performance of the three government implementing bodies (EMU, RMU and WMPA) on an annual basis; (iii) the IAG and POE will each visit once per year but POE may visit more often at the request of GOL; (iv) the IFIs will make use of reports from the DSRP, GOLE, IAG, IMA, LE and POE to monitor and assess project progress, and will continue dialogue with NTPC and GOL; (v) NTPC will debrief the IFIs (Vientiane and Bangkok-based teams of the ADB, AfD and WB) on its monthly progress reports, and the teams will visit the project site, on an as needed basis, for troubleshooting and problem solving, and will continue to assist GOL in capacity building; (vi) the IFI teams will brief the different headquarters teams on implementation progress and emerging issues in need of special attention; (vii) formal IFI supervision missions will be undertaken twice a year; and (viii) the IFI management mission will visit Lao PDR once a year, if possible overlapping with one of the two IFI supervision missions.

52. Recognizing the challenge of supervising the NT2 project, the WB and the ADB have strengthened their field presence in Vientiane and Bangkok. Experts have been hired or relocated to provide continuous oversight and support to the project. There has been increased delegation to field-based staff, and the World Bank Country Manager based in Vientiane has been empowered to coordinate the activities of the different Bank units working on NT2 at the country level as well as the day-to-day communication with the Government and NTPC. Management arrangements at Bangkok and Washington have been streamlined to support this process and to discharge the fiduciary and oversight responsibilities more effectively.

53. NTPC and GOL have responded favorably to the findings and recommendations of the past IFI supervision missions. Since the financial close in June 2005, several site visits by the field-based staff and three joint IFI supervision missions have taken place. Key issues raised by IFI staff include the need for: better synchronization between construction, resettlement and environmental impact mitigation; preparation of downstream impact mitigation plans; finding alternative resettlement sites for two villages as a result of unsuitability of the originally-selected site (Nam Pan); additional measures for flood warning and protection for the villages on the Nakai Plateau to be relocated next year, who may be affected by potential incremental flooding during the 2006 rainy season (May-August) due to construction of the coffer dam; and improved attention to environmental issues such as dust control and proper disposal of waste oil.

54. The independent oversight and reporting system is being put in place. The POE, reporting to GOL, advises on environmental and social issues and the IAG advises the WB’s President and senior management on implementation of the project, covering revenue management arrangements as well as environmental and social aspects. The POE has its full complement of three members, while appointment of additional members for the IAG (with expertise in public financial management, consultation and participation) is currently in progress.
The appointment of staff for the field-based IMA reporting to GOL has been delayed, but this has not affected the quality of monitoring as the POE and LE have provided detailed assessments and evaluation of the initial phase of activities. However, the updating or completion of baselines is urgently needed. The recruitment of the IMA for the EMU is in progress. The WMPA’s IMA, consisting of an international and a national expert, is now in place, and will review the first year performance and second year work plan between May and August of 2006. Recruitment of the IMA for the RMU has been delayed in order to refine the terms of reference to ensure full coordination between internal and external monitoring and to maintain a full and transparent database. The IFIs, NTPC and GOL have now agreed on the overall NT2 monitoring framework for resettlement, under which internal and independent monitoring will complement each other. NTPC and GOL have agreed to immediately start work on the design and establishment of the internal monitoring system and recruitment of this IMA.

55. **GOL, NTPC and the IFIs are responding to guidance from the IAG and POE.** The IAG and POE have visited the project twice since full-scale implementation was started – once in August 2005 and again in January/February 2006. The IAG and POE have provided recommendations on ways to strengthen and improve project supervision coordination between the activities of the GOL, NTPC and the IFIs. The IAG has recommended that greater emphasis be given to capacity building for the GOL, especially at the local level. The IAG and POE both commended the progress being achieved in the WMPA and expressed concern about the issue of inadequate synchronization of construction with environmental and resettlement activities. In addition to recommendations on issues identified by staff supervision missions, the POE has also made recommendations on mitigating the impacts of salvage logging and on improving WMPA’s enforcement capacity by providing police and judicial support in prosecution of offenders caught in the NPAs. The use of satellite imagery to strengthen oversight and supervision activities is also being explored, based on the recommendation of the POE. Although the POE is normally expected to visit once a year, the GOL and NTPC have requested more frequent visits; the next visit is scheduled for August 2006. The IAG and POE are also both scheduled to make a visit during January 2007.

56. **The planned progress reports have been issued.** NTPC issues monthly progress reports for internal use by the implementing and monitoring entities, with semi-annual reports made available to the public. The first semi-annual public progress report was released in January 2006 and is available on the NTPC website (under the section entitled Documentation: Monitoring and Reporting). In parallel, the GOL will also produce two semi-annual reports (watershed management and revenue management) that are expected shortly and will also be made public. The LE has been providing quarterly progress reports (covering all aspects of project implementation, for internal use by the implementing and monitoring entities) since July 2005, following each of its visits. The GOLE has also issued progress reports after each of its quarterly visits. The IAG and POE issue and publicly disclose reports following their respective visits.
## NT2 FINAL PROJECT FINANCING PLAN (JUNE 2005)

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ADB  Asian Development Bank  
AFD  Agence Française de Développement  
EIB  European Investment Bank  
GOL  Government of Lao PDR  
IDA  International Development Association  
MIGA  Multilateral Investment Guarantee Agency  
NIB  Nordic Investment Bank  
THB  Thai Baht
ANNEX 2

GOVERNMENT LETTER OF IMPLEMENTATION POLICY

Lao People's Democratic Republic
Peace Independence Democracy Unity Prosperity

Committee for Planning and Investment

No: 198/CPI
Date: 7 March 2005

To: Mr. James D. Wolfensohn
President
The World Bank
1818 H Street
Washington, DC 20433
United States of America

Subject: Nam Theun 2 Hydroelectric Project: Implementation Policy Framework

Dear Mr. Wolfensohn,

1. The Nam Theun 2 Hydropower Project is an important milestone in the development history of Lao PDR. The project has been strongly endorsed by our National Assembly. It symbolizes the hopes and aspirations of the people of our country.

2. The contribution of the project to poverty reduction and improvement of the country's human development indicators is sizeable and the project will also make a significant contribution to our country's other development goals. The preparation of the project has been an enormous learning exercise in terms of building capacity to plan and manage complex multi-sector programs, foster stakeholder participation and strengthen donor coordination. The project will serve as a model for natural resources conservation, trans-boundary cooperation in the Mekong region, and international private-public partnerships. In addition, the project has helped focus attention on building capacity for improving public financial systems, targeting revenues to poverty reduction programs, and strengthening environmental and social safeguard management. The lessons learned will help the preparation of future projects and will be applied whenever opportunities arise to improve existing projects.
3. The main purpose of my writing to you is to reiterate the government’s determination to build upon the gains already achieved through our cooperation and to sustain them by adopting an Implementation Policy Framework for the project.

4. In this regard, I invite your attention to the earlier Decision Framework, which we mutually adopted to guide the preparation of the project. You may recall that this framework is founded on three pillars: (i) implementing a development policy framework characterized by concrete performance that aims at poverty reduction and environmental protection; (ii) ensuring that the technical, financial and economic aspects of the project and the design and implementation of safeguard policies are of a standard acceptable to the donor community; and (iii) obtaining broad support from international donors and civil society for the country’s development strategy and the Nam Theun 2 project itself.

5. In order to achieve the full benefits of the project, the government proposes an Implementation Policy Framework that will build further on these pillars and asserts its commitment to:

   - continue to build a viable development policy framework and programs for poverty reduction and for social development and environmental protection, using the National Growth and Poverty Eradication Strategy and the Social and Economic Development Plans as drivers;
   - focus on effective implementation of the technical, financial and economic aspects of the project, as well as of the environmental and social safeguards activities; and
   - further strengthen support from the international donor community and global and local civil society for poverty reduction programs and associated development plans, and facilitate their involvement during the implementation of Nam Theun 2 project itself.

6. As the centerpiece of our development framework, I wish to reiterate the government’s strong commitment to our National Growth and Poverty Eradication Strategy (NGPES). We have set ourselves the goal of reducing poverty by half by 2015 and achieving the other Millennium Development Goals in our country.

7. We recognize the critical role of macroeconomic stability in this effort and value the advisory role of the multilateral institutions. The continued support of the donor community for the NGPES and the Social and Economic Development Plans is imperative for the achievement of our growth and poverty reduction objectives. We look forward to a series of projects in support of our efforts and will also work closely with all donors to restructure the current portfolio as needed to align it better with the NGPES.

8. In this context, I wish to express my appreciation for World Bank support to the first Poverty Reduction Support Credit that is being prepared in parallel with the Nam Theun 2 project and ADB’s comprehensive program of strengthening the State Audit Organization for enhancing the independent audit capacity of the Lao PDR’s supreme audit institution. We would like to draw attention to the Letter of Development Policy sent by my colleague, the Finance Minister, to the World Bank wherein the government’s plans relating to the strengthening of the
development framework are set out. I do not wish to cover the same ground again in this letter but will deal with five critical project-related issues.

9. The important issues I would like to focus in this letter are (i) revenue management, (ii) ensuring adequate environmental and social performance and outcomes, (iii) consultation and participation, (iv) monitoring and evaluation, and (v) activities complementary to the Nam Theun 2 Project.

**Revenue Management**

10. Improvements in public financial management, especially the effectiveness of public expenditures, will be essential if Lao PDR is to achieve its ambitious development and poverty reduction objectives. In this context, the government has recently approved a Public Expenditure Management Strengthening Program (PEMSP), which aims to improve policy consistency, efficiency, transparency and accountability in public expenditure management by strengthening institutional systems and making progress towards appropriate international financial management standards. The PEMSP encompasses improvements in expenditure planning and budgeting, budget execution, accounting and reporting at both the central and provincial levels in the period to end of FY2009. Implementation of the PEMSP will require technical support from long-term and short-term advisors, as well as extensive training for financial management personnel. The government is seeking the support of external partners for technical assistance and training under PEMSP, complementing on-going projects financed by the World Bank and the Asian Development Bank. The PEMSP will provide a framework for coordinating such external assistance. In order to make an early start on PEMSP implementation, we will draw monies from the ongoing Financial Management Capacity Building Credit of the World Bank to fund program technical assistance requirements until the Ministry of Finance secures grant financing.

11. The revenue management arrangements described in an attachment to this letter describe the arrangements the government will adopt to utilize revenues derived from the Nam Theun 2 project. These arrangements will complement and support implementation of the Public Expenditure Management Strengthening Program. The government is committed to ensuring that all Nam Theun 2 revenues, net of the costs of the NT2 shareholding and overseeing the implementation of the NT2 project, are used to finance incremental spending on eligible poverty reduction and environmental protection programs, reflecting the priorities identified in the NGPES and its successors. Nam Theun 2 revenues will be channeled through a dedicated “NT2 Revenue Account” and released to the Central Treasury Account for the purposes of budget execution. Nam Theun 2 revenues will be used to finance: the repayment of debt incurred by the Government for the purpose of acquiring equity in NTPC; expenditures related to the exercise of its rights and the performance of its obligations under the Concession Agreement and the Project Documents; and eligible poverty reduction and environmental management programs that meet required financial management, financial reporting and performance monitoring standards.

12. Publication of estimates and allocations of Nam Theun 2 revenues to eligible programs in the annual budget, as well as quarterly budget execution reports, annual financial statements, summaries of inspection reports and audit reports, will ensure high standards of transparency in resource allocation. A program of public expenditure reviews and public expenditure tracking
surveys, undertaken in collaboration with the World Bank, the Asian Development Bank and other development partners, will monitor progress in the development of financial management systems and the impact of eligible programs' spending at the field level. An annual report will be prepared on the implementation of the Nam Theun 2 revenue management arrangements and serve as the basis for consultations with external partners.

13. In order to manage the Government’s shareholdings in the NTPC project efficiently and transparently, we have established a special purpose company, the Lao Holding State Enterprise (LHSE). While LHSE may play an important role in the future of development of other independent power producers in Lao PDR, its primary function in the medium-term will be to support implementation of the NT2 project. In this context, LHSE’s operating budget, financed from NT2 related income, will cover only costs directly related to its obligations as an NTPC shareholder, NT2 project oversight and implementation costs. The Government of Lao PDR will also ensure that LHSE’s shareholding in NTPC is fully protected from any risks associated with LHSE’s broader development activities.

**Ensuring Environmental and Social Performance and Outcomes**

14. We have worked closely with the World Bank, the Asian Development Bank and other partners to ensure that the decision making process, detailed project design, and implementation program have adopted measures to adequately manage potential environmental and social impacts and risks. The Nam Theun 2 project has been prepared to adhere to the environmental and social policies of Lao PDR, the World Bank, the Asian Development Bank and other partners.

15. We fully subscribe to the vision developed for addressing environmental and social aspects of the project through the Environmental Assessment and Management Plan (EAMP), Social Development Plan (SDP) and the Social and Environmental Management Framework and First Operational Plan (SEMFOP). We will spare no effort, in cooperating with our project partners, the Nam Theun 2 Project Company (NTPC), to anticipate, monitor and effectively mitigate environmental and social impacts and risks, on the plateau and in the watershed and downstream areas of the project. We commit to ensuring the integrity of the project’s watershed (Nakai Nam Theun National Protected Area and its two corridors) and will strictly promote and abide by the guiding principles for its medium-to-long-term development set forth in the SEMFOP. Specifically, we will ensure that there is no commercial development (including roads, logging, mining and other resource extractive activities) in the Nakai Nam Theun National Protected Area and the two corridors which together comprise the NT2 watershed, and that all land use within the watershed is fully consistent with the community-based forest and land use planning and management (FLUPAM) process described in the SEMFOP.

16. We will also monitor and regulate in-migration into the watershed and reservoir areas, resolve the legacy of resettlement of affected ethnic groups in the watershed, and ensure adequate management of cumulative impacts downstream of the Theun Hinboun dam. We have addressed the above-referenced resettlement issues in a letter directed to the World Bank by my colleague, the Minister of Agriculture and Forests in November 2004. As for the impacts downstream of the Theun Hinboun, we intend taking a long-term, strategic and integrated approach to the management of the Nam Theun/Nam Kading river basin, to address and mitigate
cumulative impacts caused by different development projects, including the suite of planned hydropower and other development projects. This will serve as a pilot for river basin management that will be extended over time to other basins within Lao PDR. We will be seeking donor support to implement such an initiative, including the establishment of an appropriate institutional structure.

17. The government will ensure that capable and qualified staff are assigned to work on a permanent basis in the Watershed Management and Protection Authority, the Resettlement Management Unit and the Environmental Management Unit, to achieve the outcomes specified in the EAMP, SDP, SEMFOP and Project Implementation Plan, in partnership with NTPC. As indicated in these documents, we have designed, in collaboration with the World Bank, the Asian Development Bank and other partners, detailed mechanisms for grievance resolution, as stated in the SDP, and arrangements for continued consultations with project-affected persons throughout implementation. We will mobilize the resources and accord the priority needed to successfully implement these arrangements.

Consultation and Participation

18. We will build on the lessons learned from the local consultations in the preparatory phase of the Nam Theun 2 project. In this context, may I reiterate that the government will conduct direct consultations with communities and individuals in the project area during the implementation and operation phase to seek their views on a diversity of issues, covering impacts, mitigation measures and outcomes of the project. These consultations and the associated disclosure of information will be used to make adjustments to project design and to refine mitigation and monitoring programs.

19. Let me also stress the government’s continued strong commitment to seeking support for the project from the international donor community and from civil society. We value their involvement in our poverty reduction programs and development plans and will continue to facilitate their access to information and participation in discussions on the project in the future. We will support the use of the Government-led and UNDP-supported Roundtable Mechanism for monitoring the NGPES and progress on the Nam Theun 2 project. We will convene periodic meetings of co-financiers for review of: (i) the physical progress in implementation of project investments, (ii) results of monitoring and evaluation of social and environmental impacts and outcomes, (iii) measures taken to address unforeseen events, and (iv) other dimensions of the project. The government has definite plans to further improve its capacity in the area of public communications and media relations in respect of the project and will continuously update its website.

Monitoring and Evaluation

20. To support effective implementation of the Nam Theun 2 project, we will implement the project monitoring and evaluation (M&E) framework, described in an attachment to this letter, comprised of five complementary components:

- supervision and systematic monitoring of physical implementation of the hydropower project, including the environmental and social safeguard programs;
• monitoring of conditions and outcomes on the Nakai plateau (reservoir and resettlement areas) and in the downstream and watershed areas as defined in the EAMP, SDP and SEMFOP;
• monitoring of revenue management arrangements;
• maintaining a Panel of Environment and Social Experts to advise the government on implementation of the project; and
• maintaining a Dam Safety Review Panel.

21. We welcome the fact that these efforts will be complemented by several other M&E measures financed by the NTPC and the financing partners:

• systematic monitoring of the technical and safeguards components of the project and its impacts by one or more professional firms on behalf of the private and public sector financial institutions;
• regular supervision by staff of the World Bank, the Asian Development Bank and other development partners; and
• visits from the International Advisory Group that advises the senior management of the World Bank.

22. Let me also assure you that the government will continue to ensure that staff of the financial institutions involved in the project and their advisors and consultants will have full access to the project area and to information about the project and its numerous activities throughout the implementation period.

Activities Complementary to the Nam Theun 2 Project

23. The Government’s commitment to conservation goals, to better managing the environmental and social aspects of development programs, and to improving rural livelihoods goes well beyond the scope of the Nam Theun 2 project. We recognize the importance of strengthening our policies and institutional capacity in these areas and will be taking several measures in this regard during the project implementation period. We are working with the Asian Development Bank on the establishment of a Lao Environment and Conservation Fund by June 2005. We will use this Fund to apply part of Nam Theun 2 revenues to support priority environmental protection and conservation programs. In the intervening period, we will ensure that the fund follows financial management and reporting practices that are consistent with the Government’s public expenditure management system. We are also seeking support from the World Bank, for two other projects. The first is a nation-wide Environmental and Social (LEnS) Project, addressing the need to mainstream environmental and social safeguards in infrastructure development, strengthen biodiversity conservation in Central Lao, and increase the public’s knowledge of and support for environmental management. The second is the Rural Livelihoods Project, for the vicinity of the Nam Theun 2 project, that would address resource management and rural development challenges at the community level. Both will place strong emphasis on broader and longer-term capacity building.

24. We will also work on plans for the further development of the Lao power sector, including measures to promote energy conservation. We will continue our cooperation with other
riparian countries directly and through the Mekong River Commission to optimize decisions on water resources management and hydropower development, taking into account trans-boundary benefits and costs, including environmental and social aspects. In addition, we will work with the World Bank, the Asian Development Bank and other partners to improve the governance and management of hydropower planning and development within Lao PDR. Through the LEnS Project and other instruments we will seek support to improve our capacity to conduct and apply the findings of environmental assessments, resettlement action plans, ethnic minority development plans and other related instruments in the hydropower sector.

25. In closing, let me reiterate that the government is fully committed to the implementation of the Nam Theun 2 project so as to meet Lao PDR’s development aspirations and international standards on project procurement, technical aspects and safeguards. We will not hesitate to mobilize technical expertise to achieve this end, both by strengthening our own professional cadres, and by tapping the capacity of consultants and non-government organizations with the required experience and demonstrated record of commitment, where needed to address our own capacity constraints. We will extend our full cooperation to the donor community by working in partnership, as we have in the past.

26. Please be assured of the government’s deep appreciation of the role of the World Bank and the Asian Development Bank and other donors in mobilizing financial resources and support for the Nam Theun 2 project. Because of their interest in the project, we are copying this letter to the other co-financiers. Also, an identical letter has been addressed to the President of the ADB.

With best regards.

Yours Sincerely,

Dr. Thongloune Sisoulith
Deputy Prime Minister
Government of Lao PDR

Attachments:
1. Nam Theun 2 Revenue Management Arrangements
2. Nam Theun 2 Environmental and Social Issues
3. Nam Theun 2 Monitoring and Evaluation Arrangements
Technical Annex to GLIP
NT2 Revenue Management Arrangements

1. The NT2 revenue management arrangements seek to ensure that NT2 revenues are applied transparently and efficiently in financing of poverty reduction and environmental conservation programs reflecting the Government of Lao PDR's policy priorities as laid out in the National Growth and Poverty Reduction Strategy and its successors. These revenue management arrangements complement the broader Public Expenditure Management Strengthening Program. The NT2 revenue management arrangements will be applied for the duration of the Concession Agreement or as mutually agreed between the Government and the NT2 GOL equity financiers. The NT2 revenue management arrangements described below comprise four pillars: the first pillar addresses the allocation of NT2 revenues; the second pillar addresses the flow of funds; the third addresses mechanisms for reporting on the application of NT2 revenues; and the fourth addresses mechanisms for monitoring and consultation with NT2 GOL equity financiers.

First Pillar: Allocation of NT2 Revenues

1.1 Allocation of NT2 revenues

Allocations of NT2 revenues\(^1\) will be determined through the Government's expenditure planning and budget process, as part of the allocation of overall public resources. The repayment of debt incurred by the Government for the purpose of acquiring equity in NTPC, and any associated charges, and expenditures related to the exercise of its rights and the performance of its obligations under the Concession Agreement and the Project Documents, shall be financed from NT2 revenues. All remaining NT2 revenues will be allocated to eligible programs.

The Government will prepare a list of eligible programs that may benefit from NT2 revenues. The selection of eligible programs will be consistent with the criteria identified in 1.3 below. Indicative eligible programs have been identified to reflect the Government's current priorities, as laid out in the NGPES, in order to focus attention of capacity building efforts in the period before NT2 project commissioning. This list will be adjusted as the Government prepares successors to the NGPES: some eligible programs may be dropped others that meet the selection criteria may be included. The number and scope of eligible programs is expected to gradually expand as financial and program management capacity is strengthened. NGPES successors will identify the NT2 eligible programs and include indicative allocations to these programs. A revised list of indicative

\(^1\) NT2 revenues are defined in the Development Grant Agreement, to include: resource usage charges and taxes payable by NTPC; part of the payments under Article 19.1 of the Concession Agreement; taxes and dividends payable by the Lao Holding State Enterprise relating to its equity holding in NTPC.
programs, indicating their objectives and key performance indicators, will be prepared by the start of FY2008 or the start of fiscal year before the year in which project is to be commissioned, whichever is earlier.

1.3. Criteria for the selection of eligible programs

The selection of eligible programs to be financed with NT2 revenues will be based on the following criteria:

a) Programs identified as priorities in the Government’s National Growth and Poverty Eradication Strategy, and its successors;

b) A significant and verifiable poverty reduction impact, providing public goods, services and infrastructure used by the poor in rural areas, including public services which aim to promote economic growth by increasing productivity and incomes of the poor; and/or

c) A significant and verifiable conservation or environmental impact; and, additionally,

d) clearly defined objectives, performance indicators and systems in place for monitoring performance in terms of the volume and quality of services provided;

e) established mechanisms for program performance evaluation, involving key stakeholders at or close to the field level;

f) programs will be clearly distinguished in the Government’s budget and chart of accounts (through a detailed administrative / organizational or program classification) at all levels of administration, with institutional responsibility for program management clearly assigned;

g) Administrative and financial management arrangements in place that would allow them to meet financial reporting requirements (see 3.1 to 3.3), and have demonstrated compliance with these financial reporting requirements;

h) Programs will have benefited from budgeted expenditures prior to selection and have a continuing recurrent financing requirement over the medium to long-term, and with a medium-term financing plan. In some cases, the Government may introduce new medium to long-term programs, reflecting policy initiatives launched under NGPES successors.
1.4. Identification of indicative eligible programs on basis of current NGPES.

Indicative eligible programs have been identified on the basis of the Government's current policy priorities. These indicative eligible programs will benefit from capacity building initiatives to strengthen program and financial management capacity in the responsible agencies. The list of indicative eligible programs will be subject to change as successors to the NGPES are prepared. The indicative eligible programs are:

a) basic education;
b) basic health care;
c) rural roads, including the Road Maintenance Fund;
d) local development initiatives identified through a participatory planning process, including the Poverty Reduction Fund;
e) environmental protection initiatives (the Government is in the process of establishing an Environment Fund).

1.5 Additionality of expenditures financed with NT2 revenues.

NT2 revenues will provide additional resources to support eligible programs and will not substitute for financing from other sources. Additionality of budgeted and actual expenditures for eligible programs will be verified against base expenditures. Base expenditures are the expenditures on eligible programs financed from general revenues (i.e., excluding externally financed projects and NT2 revenues). Base expenditures will be determined as, whichever is greater: a) budgeted expenditures in the previous year expressed in real terms for the comparator year; b) the average expenditures in the three previous years, again expressed in real terms for the comparator year and c) eligible programs' percent share of budgeted and actual total expenditures, excluding expenditures related to debt servicing, in the previous year. The basis for determining additionality of NT2 financed expenditures will be reviewed three years after project commissioning, thereafter as deemed necessary, and agreed with NT2 GOL equity financiers, in order to ensure policy consistency and efficiency in the application of NT2 Revenues.

1.6 Allocation of proceeds under Section 19.1 of the Concession Agreement

Proceeds to Government of Lao PDR under section 19.1 of the Concession Agreement that are NT2 revenues, will be allocated to a) financing of eligible programs in the fiscal year in which such proceeds are made available or in subsequent years; and b) capital projects consistent with the objectives of the eligible programs.

1.7 Documentation of NT2 allocations of funds

Allocations of NT2 revenues to eligible programs will be identified in an annex to MTEF documents and state budget. This annex will present detailed estimates of NT2 revenues, the corresponding allocations to each of the eligible programs, the expenditures financed from general revenues to each of these programs and demonstration of additionality in these allocations. A MTEF and budget documents identifying allocations to eligible programs will be prepared and
published in FY2008. Thereafter, budget documents identifying allocations to eligible programs will be prepared and published annually, and the MTEF will be published as updated.

Second Pillar: Flow of Funds

2.1. Treasury NT2 revenues will be deposited in a dedicated "NT2 Revenue Account", held and managed by Treasury.

NT2 revenues will be deposited in a dedicated Treasury account held at the Bank of the Lao PDR ("NT2 Revenue Account"). This account will be managed by Treasury as one of the Government's treasury accounts. The Tax and State Property Departments will administer revenue payments according to applicable legislation. NT2 revenues payable by NTPC will be paid directly by NTPC to the NT2 Revenue Account. NT2 revenues payable by the Lao Holding State Enterprise (LHSE), will be paid through an onshore escrow account opened by the LHSE directly to the NT2 Revenue Account.

2.2 Transfer of NT2 revenues from the "NT2 Revenue Account" to the Central Treasury account.

Treasury will transfer funds from the "NT2 Revenue Account" to the Central Treasury Account on a monthly basis, for the purpose of budget execution. Transfers of funds from the "NT2 Revenue Account" will be authorized by the Budget Department on the basis of apportionments for each of the eligible programs, reflecting budget allocations and budget execution, apportionments for the repayment of debt incurred by the Government for the purpose of acquiring equity in NTPC, and expenditures related to the Government's exercise of its rights and the performance of its obligations under the Concession Agreement and the Project Documents. Funds transferred to the Central Treasury Account will be disbursed following procedures foreseen under applicable legislation.

2.3 Annual financial statement of "NT2 Revenue Account"

The Ministry of Finance will prepare an annual statement of balances, receipts and transfers for the "NT2 Revenue Account", starting from the fiscal year in which the Government of Lao PDR first receives revenues from the NT2 project.

2.4 Withholding of funds in the NT2 revenue in the "NT2 Revenue Account"

In exceptional circumstances, the Minister of Finance will withhold NT2 revenues in the "NT2 Revenue Account", corresponding to all or part of the allocations and related apportionments of eligible programs where the Ministry of Finance considers that one or more of the following applies:

a) the application of funds is no longer justified or appropriate;
b) the agencies responsible for eligible programs have not complied with financial reporting, inspection and audit requirements on a timely basis;
c) there has been a serious financial control failure by an agency, as demonstrated by audit, inspection reports or information received from monitoring program implementation;
d) budget execution has slowed significantly and the Ministry
2.5 Reallocation of NT2 revenues during budget execution

The Ministry of Finance may reallocate NT2 revenues between eligible programs during the fiscal year in order to ensure efficient budget execution. The Ministry of Finance may reallocate allocations and apportionments withheld as described in 2.4 above. Reallocations of funds will be authorized following procedures laid out in applicable legislation and will be reflected in published quarterly budget execution reports.

2.6 Application of “NT2 Revenue Account” balances

Any end-of-fiscal year balances of the “NT2 Revenue Account” will be retained in the account and applied in apportionments for eligible programs in the following fiscal year as described in 2.4 and 2.5 above, ensuring that the application of revenues is consistent with additionality requirements in 1.5 above. This may include funds retained to meet commitments carried forward for eligible programs. It is not intended that there should be an accumulating balance on this account. However, balances resulting from the payments of NT2 revenues under Section 19.1 of the Concession Agreement (see 1.6 above) be retained in the account for the purposes of levelizing expenditures on eligible programs.

**Third Pillar: Reporting**

3.1 Budget and accounting registers for eligible programs

The published statutory chart of accounts and budget nomenclature will clearly identify all eligible programs (following a detailed administrative/organizational or program classification) so that the application of NT2 revenues can be tracked (see criteria in 2.2). A revised chart of accounts will be implemented for eligible programs in the preparation of the FY2008 budget.

3.2 Reporting on budget execution for eligible programs

The Ministry of Finance will prepare and publish, from FY2008: quarterly budget execution reports, providing summary information on expenditures for each eligible program, within sixty days of end of period; and end-of-year financial statements covering each of the priority programs within the time frame specified in legislation. The financial reports and financial statements for priority programs should be prepared on both a cash and a modified-cash (including reporting commitments) in accordance with international public sector accounting standards.

3.3 Reporting on internal control in

The Ministry of Finance’s Inspection Department and other relevant Departments will undertake an annual program of internal audits of
eligible programs

eligible programs and from FY2008 publish a summary report outlining the financial management, control weaknesses and irregularities identified, cases of non-compliance in the proper use for funds for eligible purposes, recommendations made to address these concerns and the management actions taken by the responsible agencies.

3.4 Audit of "NT2 Revenue Account" and eligible programs

The State Audit Organization will conduct and publish, each year starting with financial statements for FY2008: an audit opinion on the statement of receipts and transfers of the "NT2 Revenue Account"; and an audit opinion on the financial statements of eligible programs and compliance with the Government’s financial management and procurement procedures, and that funds have been applied for the purpose of the eligible program. In addition to audit opinions, the auditors will provide a summary of audit findings and the management response highlighting the principal weaknesses and irregularities identified by the auditor and corrective action to be taken to strengthen management systems.

3.5 Audit standards

Audits will be conducted in accordance with international public sector accounting standards issued by IFAC for financial audits and INTOSAI standards for performance audits. As part of its capacity building efforts the State Audit Organization will commission a peer review by an INTOSAI member to advise on progress towards meeting applicable standards. Steps will be taken to implement peer reviewer’s recommendations. Peer reviews will be conducted: in FY2006; in the fiscal year in which the Government of Lao PDR first receives revenues from the NT2 project; and every three years thereafter.

3.6 Annual report on implementation of NT2 revenue management

The Ministry of Finance will publish an annual report within six months of the end of each fiscal year in which it will confirm that NT2 revenues have been allocated to priority programs, consistent with the fund criteria, and that these programs have complied with reporting and Government financial management requirements. The report will also detail corrective measures have been taken to ensure that eligible programs meet allocation and reporting requirements. The report will also include summary information on the performance of eligible programs in relation to their objectives and performance indicators.

Fourth Pillar: Monitoring and Consultation

4.1 Implementation of Public Expenditure Review and Public Expenditure

The PER and PETS will be an on-going process, implemented through a collaborative approach between the Ministry of Finance and NT2 GOL equity financiers. In consultation with the Government, other development partners may be requested to support the PER and PETS. Public expenditure reviews and expenditure tracking surveys will be
Tracking Surveys

undertaken every two years starting in 2006, in order to assess (i) progress in implementation of the NT2 revenue and expenditure management arrangements; (ii) progress in strengthening public expenditure management systems, assessed PEMSP performance indicators; (iii) the efficiency and effectiveness of spending; and, after commissioning, (iv) the impact of NT2 financed eligible program expenditures and the effectiveness of expenditure management and control arrangements. The Government will ensure access to the data, personnel and documentation needed to assess progress in implementing the revenue and expenditure management arrangements, the financial control environment and the performance of programs financed with NT2 revenues. The PER and PETS reports will be published, following standard disclosure procedures.

4.2 Review of status prior to project commissioning

Prior to project commissioning, the Government and NT2 GOL equity financiers will consult annually on progress in implementing the NT2 revenue management arrangements. At least six months prior to the Commercial Operations Date, the Government, in collaboration with the NT2 GOL equity financiers, will assess progress in setting up revenue management arrangements and prepare a report covering the issues addressed in the annual report described in 3.6 above. This review will be informed by analysis of the results of audit peer review process and recommendations (3.5) and PERs and PETs (4.1).

4.3 Annual consultations with NT2 GOL equity financiers

After project commissioning, annual consultations between Government of Lao PDR and NT2 GOL equity financiers will review progress in implementation of NT2 revenue management arrangements and the impact of NT2 financed expenditures. These consultations will be informed by the annual report (see 3.6), financial and inspection reports (see 3.2 and 3.3) and audit reports (3.4), as well a summary report on the audit peer review process and recommendations (3.5) and PERs and PETs (4.1). In the context of these consultations, NT2 GOL equity financiers may advise on strengthening implementation arrangements.
The Government’s Role in Implementation of Environmental and Social Programs and Activities of the Project

1. The Nam Theun 2 project has been designed to ensure full consistency with the environmental and social policies of Lao PDR, the World Bank, the Asian Development Bank and other financing parties. The three safeguards documents -- the Environmental Assessment and Management Plan (EAMP), the Social Development Plan (SDP) and the Social and Environmental Management Framework and First Operational Plan (SEMFOP) -- lay out principles, technical guidelines, procedures and programs which the GOL is fully committed to supporting in the course of project implementation. The Concession Agreement signed with Nam Theun 2 Power Company (NTPC) specifies the obligations of the Government and NTPC to implement the provisions contained in the three documents. The NTPC’s Project Implementation Plan and Annual Implementation Plans (AIP) will further detail the modalities, timelines and budgets.

2. The GOL recognizes its dual role in the project:

(i) *As a party to the Concession Agreement*, the Government will perform the functions stipulated therein, including those involving functions such as land titling, licensing and enforcement of all regulations applicable to any aspect of the project; and

(ii) *As a shareholder of NTPC*. The Government-owned Lao State Holding Enterprise (LSHE) holds 25 percent equity in NTPC. NTPC is responsible to ensure the achievement of the project’s objectives and that its programs and activities are implemented in accordance with the principles, technical standards and procedures embodied in the Concession Agreement, and the safeguards documents, and elaborated in NTPC’s Project Implementation Plan (PIP) and the AIPs.

Joint Responsibilities

3. As a party to the Concession Agreement, the Government will ensure that adequate facilities and resources are available in a timely manner to support project implementation. This includes qualified staff in sufficient numbers, assigned or recruited to work in the Resettlement Management Unit (RMU), the Environmental Management Unit (EMU), and the Watershed Management and Protection Authority (WMPA). To this end, the Concession Agreement sets out the respective obligations of both the Government and NTPC, as summarized below:

1. LSHE, jointly with the other shareholders of NTPC, will implement, the social and environmental programs on the plateau and in the downstream areas.

2. NTPC will contractually obligate the Head Construction Contractor, civil contractors and sub-contractors to implement environmental and social mitigation measures under its guidance.
3. NTPC will also assist the Government’s RMU and the EMU in carrying out those activities of the SDP and the EAMP which have been attributed to government agencies, on the basis of arrangements that will be reviewed at the time of preparation of each AIP and as needed in the course of the year.

4. In the case of the programs on the Nakai Plateau and the downstream areas, it is envisaged that the role of government agencies will gradually increase as project implementation proceeds and the agencies' capacity is strengthened.

5. In the case of the NT2 Watershed, the Government, through the Watershed Management Authority (WMPA), will have sole responsibility for implementing SEMFOP, and will seek assistance from NTPC for project management (procurement and financial management) expertise.

6. WMPA will work in close coordination with sectoral agencies, and provincial and district authorities.

7. NTPC will provide the financing for SEMFOP implementation and will carry out procurement and financial management activities on behalf of WMPA.

4. As indicated in the documents, the Government, in collaboration with the World Bank, the Asian Development Bank and other financing parties of the NT2 Project, has designed arrangements for continued consultation with and participation of project-affected persons throughout the course of project implementation. The Government has also developed detailed mechanisms for grievance resolution in anticipation that a project of the scale and complexity of NT2 may give rise to unforeseen impacts and disputes which will need to be channeled and resolved in a timely and fair manner. The grievance mechanisms currently foreseen in the SDP and the EAMP (including the HCC-EMMP) will be carefully observed in the course of the first year of implementation. The Government proposes to explicitly review the effectiveness of these grievance mechanisms with the Social and Environmental Panel of Experts (POE) by June 30, 2006, and adjust them, as needed, thereafter.

**Exclusive Responsibilities**

5. With respect to areas where the Government has exclusive responsibilities — such as land titling, licensing and enforcement of regulations — we commit similarly to ensuring timely and competent performance in support of the project. To this end, a number of ministries, agencies and provincial administrations will play an important role in implementation of the project. These include: (a) the Ministry of Agriculture and Forestry and agencies under it, including Department of Fisheries, Agriculture, Forestry and Forest Resources Conservation; (b) the Ministry of Industry and Handicrafts, and agencies under it, including the Bureau of Secretariat for the Lao National Committee on Energy and Electricity of Laos; (c) the Science, Technology and Environment Agency, and the Department of Environment under it; (d) the Ministry of Finance; (e) the Ministry of Labour and Social and Welfare; and (f) the Administrations of Khammouane, Bolikamxay and Savannakhet Provinces.

6. To ensure effective coordination in project implementation, the Government has established a steering committee, integrated by the above-referenced ministries, agencies and local authorities, supported by a full-time secretariat. The Government has assessed the strengths and weaknesses of the key implementing agencies, with special focus on the RMU, EMU,
WMPA LHSE, and accordingly GOL has developed an institutional strengthening program where needed. This program will be implemented over a period of three years and paid for by the Project, as provided for in the Concession Agreement. The program will include a menu of capacity building options and will be undertaken by staffing up on critical skills, conducting in-house training, and/or bringing in external assistance (such as consultants or NGOs). Government agencies are in contact with operational NGOs to assist in these capacity building efforts and in some cases work has already begun. The Government intends to widen the involvement of these operational NGOs in project activities, eventually leading up to their possible involvement in other projects.

7. The Government also highlights the following specific activities, complementary to the NT2 project, where it has sovereign authority:

(i) **Controlling migration and land use on the Nakai Plateau**: The Government, through the Khammouane Provincial Governor, will control and regulate in-migration into the plateau and more specifically the reservoir area, ensuring that (a) the updated census undertaken in 2003 is accepted as the basis for identifying those who will need to be relocated and are thus eligible for compensation measures defined in the CA; (b) maintaining the reservoir area, once the area is cleared and before the reservoir filling operations are complete, will be absolutely ensured; and (c) once resettlement villages and the reservoir is formed, these areas and the resources therein will be for the exclusive use of resettlers. In addition, the Government, through the relevant district authorities, will revise and update urban development plans to take into account the likely influx of population arising out of construction activities. Plans will be updated for Gnommalath and Oudumsouk Towns by May 1, 2006; and thereafter for any others, as identified in the Annual Work Plans or as otherwise agreed to in the course of project implementation.

(ii) **Legacy of past resettlement of ethnic groups in the Watershed.** As confirmed by the Minister of Agriculture and Forestry in his letter of November 2004 to the World Bank, the Government will address pending issues of past resettlement in the Watershed. It proposes to: (a) by March 30, 2006, identify and consult with the ethnic groups, who were previously displaced from the Watershed through past resettlement; and (b) by December 30, 2006, develop appropriate plans as needed to resolve pending issues, including the option for households to return to their previous ancestral and cultural territory; and to benefit from the SEMFOP program. The Government also commits to not resettle any other inhabitants from the Watershed area.

(iii) **Management of cumulative impacts in Nam Theun/Nam Kading (NTNK) River Basin.** In keeping with the decision of the Government’s Water Resources Coordination Committee, relevant agencies are collectively pursing the task of establishing a national approach for the integrated management of the country’s river basins, including the main tributaries of the Mekong. Developing and implementing such an approach, in line with international practices, is resource-intensive and will take many years. With assistance from the Asian Development Bank and the Agence Française de Développement, the Government is already preparing such a plan for the Nam Ngum River. Similarly, the Government proposes to take a long-term, strategic and integrated approach to the management of the NTK Basin, to address and mitigate cumulative impacts caused by
different development projects, including the suite of planned hydropower and mining projects. Specifically, the Government will seek support from IDA through the proposed Lao Environment and Social Project for this initiative. The Government envisages that: (i) the scope of work to design such an integrated approach would be agreed by December 31, 2005; (ii) an institutional framework for river basin management of the NTNK Basin will be designed by June 30, 2007; and (iii) a specific agreement with the Thin Hinboun Power Company on the management of the cumulative impacts downstream of the Theun Hinboun dam would be reached by December 31, 2007.

8. In addition to the above, the Government sees in the NT2 Project a model for testing guidelines and approaches that, with suitable adaptation, could be applied more broadly in the country. In the medium term, the benefits from such an approach would lead to the strengthening of our capacity to manage large infrastructure projects, biodiversity conservation, management of social and environmental safeguards of development programs, and improvement of rural livelihoods, as mentioned in this letter.
Technical Annex to GLIP
NT2 Monitoring and Evaluation Arrangements

1. The NT2 project is large and complex, encompassing three distinct geographic areas within the overall project area: the Nakai Nam Theun National Protected Area and two corridors linking it to other NPAs (the NT2 Watershed), the Nakai Plateau, and the downstream areas of the Nam Theun and Xe Bang Fai rivers. The monitoring and evaluation (M&E) arrangements for the project seek to ensure that information on physical progress and the impacts and outcomes expected from the project are adequate in scope and detail, accurate, timely and relevant to the needs of the Government of Lao PDR (GOL), project sponsors, financial institutions and other stakeholders involved in the project, so as to ensure that effective arrangements are in place for regular oversight, monitoring and evaluation of project implementation.

2. The purpose of this annex is to describe the Government’s obligations and commitments with regard to the M&E framework that have been agreed between the GOL, the Nam Theun 2 Power Company (NTPC) and the international financial institutions acting as lenders and/or guarantors to the project.

3. Under the project agreements, the GOL has the sole responsibility for management and protection of the NT2 watershed, as described in the SEMFOP document, and shares responsibility for some of the resettlement activities on the Nakai Plateau and for some of the social and environmental impacts in the downstream areas with NTPC. It also has a national responsibility to ensure that the terms of the Concession Agreement between it and NTPC are honored in full and that there are no material impacts on its citizens, the environment or the economy in the project area that are caused by the project and left unmitigated. Finally, the GOL is concerned to maintain a high degree of interest and involvement of the international financial and development institutions and civil society in progress on the NT2 project and, more generally, in the development of Lao PDR.

4. Accordingly, the GOL acknowledges the following responsibilities which fall to it under the M&E framework and intends to take the following actions to meet these responsibilities:

   a. Ensure the accurate collection and analysis of data and information by government bodies involved in project implementation. These bodies include the Environment Management Unit (EMU), the Resettlement Management Unit (RMU) and the Watershed Management and Protection Authority (WMPA) under the respective authority of the Science, Technology and Environment Agency (STEA), the Resettlement Committee (RC) of the Khammouane Provincial Government and the Ministry of Agriculture and Forestry (MAF). To do so, the GOL will ensure that these implementing bodies are staffed with qualified professionals and that the scope and frequency of the data to be collected and the reporting formats for each of these bodies will be agreed with the lenders prior to project effectiveness. GOL will also grant external M&E bodies full access to the project sites and other affected areas.
b. **Ensure the prompt dissemination of that information in the form of periodic progress reports of agreed scope, detail and format** to the independent monitoring agencies (IMAs) which are charged with monitoring and evaluating the performance of these bodies, expert advisors to the Government, including the Government's Engineer (GOLE), the Dam Safety Review Panel (DSRP), the Panel of Experts (POE), and to the Government bodies involved in direct project oversight: the Lao National Committee on Energy (LNCE) and the National Steering Committee on NT2 Implementation (SC).

c. **Ensure the prompt dissemination of all information on project progress, in the form of periodic progress reports of agreed scope, detail and format, to the participating financial institutions and their advisor, the Lenders' Technical Advisor (LTA).** The LTA will receive information on project progress directly from NTPC and from all government implementing agencies through the Secretariat of the LNCE as these reports become available. These reports would cover physical progress, environmental and social aspects of the project, revenue management arrangements and progress under the public expenditure management strengthening program (PEMSP), whether produced by project implementing agencies or by the expert advisory bodies and the IMAs. The scope, frequency and reporting formats for each of these bodies will be agreed with the lenders prior to project effectiveness. The information from Government agencies to the LTA will be for the use of the IFIs and bilateral agencies and will not be made available to the private lenders. We understand that adequate provisions will be put in place by the LTA to ensure the confidentiality of this information and would expect that a suitable confidentiality undertaking would be entered into for this purpose with the Government. Reporting on revenue management issues will be directed to the IFIs and interested bilateral agencies only.

d. **Facilitate the timely work of the expert bodies established to advise the Government (these include the DSRP, GOLE, and POE), as well as the IMAs, being financed by NTPC under the CA, to monitor and evaluate the performance of government implementing agencies (EMU, RMU and WMPA).** To do so, we will ensure that the expert bodies and the IMAs remain in place, legally empowered, with adequate resources and full access to the information necessary and to the project area so that they can carry out their respective responsibilities during the project period. They will receive copies of periodic reports in their areas of responsibility electronically and as soon as they are published.

e. **Facilitate periodic supervision by the individual financial institutions participating in the project and their advisors, in particular the LTA and the International Advisory Group (IAG), providing them full information from Government and non-government sources, and enabling them access to the full project area.** The Government will continue to provide full support to the supervision activities of the IFIs, the private financial institutions and their advisors. It understands that the lenders will seek to coordinate their supervision activities so as to minimize the number of requests for information or site visits and to utilize information available to project implementing agencies where available.
Facilitate the work of the international financial institutions to assist the GOL to lay the foundations for robust NT2 revenue management arrangements through periodic supervision missions by their staff and advisors, and the carrying out of periodic public expenditure reviews and public expenditure tracking surveys, as set forth in the technical annex on revenue management.

Coordinate the Government's involvement in and oversight of the project to ensure efficient coordination of all governmental agencies involved in the NT2 project, prompt action on the part of these agencies to meet the government's commitments under the project agreements, and act as liaison to the financial institutions participating in the project, as well as local, regional and international stakeholders. To carry out these functions, the Government has established two bodies to oversee implementation of the NT2 project. The Lao National Committee on Energy (LNCE) is responsible for ensuring that NTPC and the Government meet their respective responsibilities under the CA. Through its secretariat, it will coordinate Government oversight of implementation of the NT2 project, receive reports from project implementation entities and expert advisory bodies and disseminate information to lenders and, through its website, to the public. The Chairman of the LNCE is the Deputy Prime Minister. The Lao Holding State Enterprise has been established as a new state-owned enterprise, wholly owned by the Ministry of Finance, to hold the Government's shares in NTPC. It will build a specialist staff with the necessary technical skills sufficient to act as shareholder. The Government has a third entity, which is the National Steering Committee on NT2 Implementation. It brings together all concerned government departments involved in the NT2 project to ensure smooth, cross-ministerial cooperation and coordination between agencies of the central government and the provincial and local governments involved in the project. The Secretariat of the LNCE will assume the responsibility to coordinate the inputs of all concerned government agencies and to follow up to ensure that the Committee's decisions are implemented efficiently.

Join with the participating financial institutions in annual consultations to review progress on technical, environmental, social and other project-related matters, including the public expenditure management strengthening program and NT2 revenue management arrangements, as well as an in-depth review of all aspects of the project six months prior to the commercial operations date (COD). The Government intends to entrust this responsibility to the LNCE which will act as the Government's international representative on the project. The Government plans to take the lead in calling for and chairing an annual consultative review of project progress, bringing together the GOL, NTPC and the participating financial institutions, with the support of the IFIs involved in the project.

Inform interested stakeholders, including civil society, about project developments through the UNDP Round Table Process, or alternative mechanisms, and an updated Lao Government project website and other measures. The LNCE will represent the Government in the UNDP Round Table Process, which brings together development organizations beyond the scope of the NT2 project. Finally, it plans to maintain a periodic dialogue with civil society
on the project. The LNCE will update its current project website to post periodic reports on project progress, including the reports of the expert advisory bodies (DSRP, GOLE and POE) and the IMAs.

5. The GOL expects to be able to continue to draw freely on the advice and support of the participating financial institutions, and in particular the support of the IFIs, to build its institutional capacity for the purposes described above, to ensure that the progress reports are complete, objective and timely, and to maintain a constructive dialogue with all project stakeholders and civil society.
UPDATE FROM ADB ON THE THEUN-HINBOUN PROJECT

Background

1. A public-private partnership, the Theun-Hinboun Power Company (THPC) Limited, was formed in 1993 to plan, finance, construct, own, and operate the Theun-Hinboun Hydropower Project (the Project). It started operations on schedule in March 1998. The Project is a trans-basin hydropower scheme diverting the Nam Theun by means of a dam consisting of a combination of radial gates, flap gate, and a weir. The flow is diverted through an underground tunnel to a 210-megawatt surface powerhouse and is discharged to the Nam Hai, a tributary of the Nam Hinboun. An 86-kilometer transmission line to the border at Thakhek allows the export of power to the Electricity Generating Authority of Thailand (EGAT).

2. As a result of significant cost savings in main civil works, mechanical works, and electrical equipment, the Project was completed at a cost of $240 million, 11% below the appraisal estimate of $270 million. The Asian Development Bank (ADB) approved a loan of $60 million from the Asian Development Fund (ADF) for the Lao People's Democratic Republic (Lao PDR) to implement the first joint-venture hydropower project with foreign investors. Electricité du Laos (EdL), the state-owned power utility, contributed 60% of the share capital, and two foreign investors, MDX Lao Public Company Limited and Nordic Hydropower AB, 20% each. Assisting the transition to a market economy by supporting such private sector participation, ADB acted as the lead coordination agency for the Government’s negotiations with the foreign investors and provided legal and financial advice in the form of a technical assistance grant.

3. THPC and EGAT signed a power purchase agreement (PPA) in 1996 for a guaranteed off take of 95% of THPC's power generation, which has ranged between 1,358 and 1,521 gigawatt-hours (GWh) per annum in the last five years; sales to EGAT were about 97% of declared availability. It is expected that the power plant will generate on average 275 GWh per annum less when Nam Theun 2 starts impounding its reservoir in June 2008. The PPA between THPC and EGAT is based on the take-or-pay principle, has a term of 25 years from the start of commercial operation, and contains an option for renegotiating the tariff after 10 years. The tariff in the first year of operation was $0.0484 per kilowatt-hour, and increased by a fixed rate of 1% per annum after 1999. The payment is determined half in US dollars and half in Baht at a fixed exchange rate of $1.00 = B25.35. THPC later refinanced its commercial loans aligning the currency profiles of the debt payments with those of the revenues.

4. The Project has achieved its intended purpose. It is currently one of the largest foreign exchange sources in the Lao PDR. THPC’s sales revenues increased from $42 million in 1998 to a high $57 million in 2005, and are expected to be maintained at about $55 million in the future. THPC’s financial performance is very good. THPC has a healthy profit and maintains a comfortable debt-servicing capacity. The Project generated a net income of $88 million from 2003 to 2005. THPC’s dividend payments in the same period amounted to $78 million, of which $47 million went to EdL. In addition THPC paid about $2.8 million in royalties to the Government in 2005. In 2004 THPC started paying taxes. The profit tax payment for 2004 was about $3.4 million and about $2.9 million for 2005. Revenue sharing arrangements among the
shareholders of THPC is as per the joint venture agreement, i.e. 60% for EdL on behalf of the GOL and remaining 40% equally shared between the Thai and Nordic investors.

5. The feasibility study included an environmental impact assessment that was completed in May 1993, but due to the lack of baseline data on environmental and social impacts, the extent of these impacts was not properly understood; this resulted in some design weaknesses. The Project was funded and constructed before ADB had fully developed its policies on environmental and social issues, and the lack of baseline information was dealt with by postponing the study of impacts to post-construction period. Physical relocation of persons was not anticipated, as the communities living in the project area mostly consisted of shifting cultivators. Therefore, the Project did not have a resettlement plan to systematically address income restoration and other social impacts. However, the EIA did propose several community programs in the project area. During implementation and initial operation, it became apparent that the environmental and social impacts were more extensive than anticipated and various parties, including international non-government organizations, raised their concern such as (i) The number of villages affected by the Project increased from 21 to 57; (ii) Loss of dry season riverbank gardens, which were an important source of food and income; (iii) Loss of access to traditional fishing and fish breeding areas, which are an important protein source for villagers; (iv) Erosion along sections of the Nam Hinboun, which caused loss of land and access to clean water supplies; (v) Loss of income by villagers due to delays by the company in taking action to solve the problems caused by the project.

Agreed action plan to mitigate the social and environmental impact

6. To remedy the environmental and social problems, a 10-year mitigation and compensation program (MCP) was agreed upon in June 2000, and a new Environmental Management Division (EMD) was formed within THPC in 2001 to implement it. The MCP is comprehensive and ambitious, and tries to adopt best practices in terms of participation. The EMD addresses the issues raised in the MCP, which provided that approximately 3,000 families in 57 villages had been impacted by the Project. One of the first actions by EMD was the development of a management strategy in the form of a logical framework (Logframe) to implement activities to mitigate identified project impacts. A significant number of Logframe activities have been initiated and showing relatively good progress. THPC reports quarterly on the implementation of the Logframe on the following activities which are considered most critical:

- **Community assessment and organization.** Village development committees (VDCs) have been established and trained in 48 villages and sample socioeconomic baseline surveys are being carried out as per the targets in the logical framework, adopting a livelihood framework to monitor and assess the impact. The process is on-going for the remaining 9 villages. To date all villages have been visited and VDCs and/or village working groups are being established to follow through with the assessment work.

- **Social mitigation implementation.** Savings and credit programmes have been established in 57 villages. Twenty-seven livestock groups have also been established.

- **Water supply.** A total of 106 dug and tube wells have been completed as well as four gravity fed systems and several water pumps for gardens, and culverts.
• **Health and sanitation.** Village health volunteers have been trained, and basic medicine kits, mosquito nets, and revolving medicine funds have been provided completed in 27 villages. The process is also on-going for the remaining 30 villages. VDCs and/or village working groups are

• **Savings and credit funds.** Villages, 3,013 accounts are operating with a total Kip value of 2,200 billion of which 1,400 billion has been lent to group members.

• **Gardens.** House gardens have been established in eight villages with participatory land use planning, terracing where appropriate, and planting fruit trees and vegetables.

• **Other activities.** Other livelihood enhancement activities carried out in several villages include silkworm rearing and weaving and training for livestock management. Some essential supplies have been provided to several schools. THPC runs a school and a health center adjacent to the power plants that are open to the public in the area.

7. THPC released a fisheries study in late 2004. In addition THPC has conducted several erosion and erosion/sedimentation studies for the Nam Hai and Nam Hinboun downstream of the regulating pond. THPC has informed that claims for land loss due to bank erosion are paid in full. The process in assessing the claims and compensation is through direct consultation with the Project Affected People (PAP). The land is accurately measured at the fair market value and compensated accordingly. If it is an agricultural land, the replacement land is secured before compensation is made to ensure that the head of the family do not spend the compensation money on something else and leave the family with no land. In some cases, replacement land is levelled and graded before the PAP takes over. The agreement on compensation is signed with individual PAP and witnessed by the village chief.

8. One of the provisions of the Logframe was that an independent review should be undertaken from time to time. THPC decided to undertake this review at the end of 2004 with the overall objective being to examine the effectiveness of THPC’s mitigation and compensation activities; and in particular, to examine the strategy and actual implementation of Logframe activities as well as the operations of EMD, and to make, where appropriate, recommendations to improve EMD’s performance with such matters. The preparation of the ToR and the selection of consultants were done in cooperation with International Rivers Network. The following is a summary of the 28 main findings and recommendations made by the Team.

• In general, the Social Impact Compensation Strategy is well conceived, the implementation of activities is largely successful, and the community development aspect of the Project rate very well when compared to other projects in Lao PDR undertaking similar tasks in Lao PDR. More follow up and fine-tuning is required in the field.

• EMD management is efficient and effective; staff were praised for their dedication. The consultants recommended that the management style of EMD should continue more or less in its present form. The consultants however, recommended that staffing levels be slowly increased and their mandate extended given the complex nature of many social mitigation activities and the simple socio-economic status of many AP within impacted villages. THPC is recruiting additional staff as and when needed. For example, a fisheries specialist was recruited recently to implement fisheries activities. While the more progressive farmers have successfully adopted many activities, the consultants recommended closer supervision of the poorer members of the village. There was a real
concern that the poorest sectors of the impacted communities and those relying on aquatic resources for their livelihoods and diets, may not be adequately covered by the activities to date.

- The consultants recommended that the villages in the lower Nam Kading area should be brought into the main framework of EMD activities. Throughout 2005, additional staff were recruited to handle multiple activities in lower Nam Kading and other project impact areas. With increased staffing, EMD was now in a better position to selectively target the need of these villages.

- Erosion of riverbanks continues to be an issue in the Nam Hai and Nam Hinboun. The consultants recommended automatic stage recorder in the Nam Hai to assist in the determination in the erosion processes, and the subsequent turbidity of the water. The consultants also recommended that additional studies be carried out to establish whether erosion is increasing, decreasing or stabilizing. THPC has started improving the monitoring program to ensure proper assessment of the situation on the ground. This would enable them to better evaluate where actions are required. THPC has been taking remedial actions when there are imminent or potential erosion problems.

9. THPC found the independent review process to be quite constructive. They are planning to undertake a similar review in the near future. It is envisaged that the Logframe would be revised taking into account any future activities.