

**Lao PDR**  
**World Bank Mission**  
**AIDE MEMOIRE**  
April 1, 2002

**Introduction**

A World Bank mission on the proposed Nam Theun 2 project and related issues led by Mr. Ian Porter, Country Director, and comprising of Messrs. J. Shivakumar, Peter Stephens, Christopher Chamberlin, Kazi Mahhub-Al Matin, Linda Schneider and Enrique Crousillat, visited Vientiane on April 1, 2002. The mission held discussions with H.E. Mr. Thongloun Sisoulith, Deputy Prime Minister and President of the Committee for Planning and Cooperation, H.E. Mr. Soukanh Mahalath, Minister of Finance, H.E. Madame Khempheng Pholsena, Vice President of the Committee for Planning and Cooperation, H.E. Mr. Phanethong Phommahasay, Ambassador of the Lao PDR to the United States of America, and other government officials on the project as well as the developers.

The purpose of the mission was to take stock of the progress since the August 2001 mission and review next steps jointly. The mission wishes to thank the Government of the Lao PDR for the excellent arrangements made for its visit and for the frank and cordial manner in which the discussions have been conducted.

**Recap of August 2001 Aide Memoire**

It is recalled that the framework for the further processing of the proposed project was set out in the Aide Memoire of the August 2001 mission led by the Country Director, Mr. Ian Porter (see Attachment 1). Key messages of the August 2001 mission as stated in the Aide Memoire are the following:

1. The World Bank is prepared to consider its support to the proposed Nam Theun 2 project only if it is strongly embedded in a development framework, characterized by concrete performance, that aims at poverty reduction and environmental protection;
2. Bank support would, of course, be contingent on the proper design and establishment of implementation capacity relating to safeguard policies, an area where significant progress has been achieved; and
3. It would be important to develop greater understanding and wider support for the project among the international donor community and global and local civil society.

**Review of progress on recommendations of the August 2001 Aide Memoire**

Significant progress has been made on the recommendations. The mission wishes to express its appreciation of the efforts taken by Government and the developer in this regard and the support extended to over twenty Bank missions during the past eight months. The mission also wishes to report that the Bank convened a two-day meeting of managers and staff working on Lao PDR to exchange information and consider the way forward, and that the meeting reaffirmed the approach outlined by the Bank in August 2001. The following sections present mission

comments and recommendations regarding specific areas and issues covered by the August Aide Memoire, beginning with the Development Framework.

## **A. Progress on Development Framework**

- Macro and Sectoral Reform: Improvement in macroeconomic and sectoral areas is essential. As indicated in the August 2001 Aide Memoire, the poverty reduction and environmental benefits of the NT2 project cannot be realized without such improvements because progress on reforms in these areas has lagged behind in recent years. The progress made and the present mission's comments on each of these areas is laid out below.

Area: The record of performance under the IMF's PRGF.

Progress: After some setbacks, the IMF Board completed the review of the PRGF in February 2002.

Mission comments: Government must continue to make satisfactory progress under the PRGF, meet its targets in a timely manner, and ensure that there are not setbacks.

Area: The development of a full PRSP to underpin poverty reduction and progress in meeting program targets.

Progress: Work, led by Government, is ongoing on the National Poverty Reduction Strategy/PRSP. The Bank, the IMF, the UNDP, the ADB and other donors are associated with this work.

Mission comments: The PRSP is a critical document that would underpin Government's efforts to improve governance and human development indicators. The PRSP is expected to be completed and presented to the Bank's and IMF's Boards by the end of 2002. The Bank expects to support the PRSP through a series of PRSCs from FY 2004 onwards. The Bank urges Government to place high priority on the completion of a high-quality PRSP and the development of a pipeline of PRSCs and offers its full support for this effort. The mission was pleased to note that the National Poverty Reduction Strategy (PRSP) is likely to be considered by the National Assembly in September 2002.

Area: Improvements in fiscal discipline, transparency and overall public expenditure management, and the restructuring of state-owned enterprises (SOE) and state-owned commercial banks (SOCB).

Progress: Government has begun to embark on measures to address these issues. This is part of the Government's financial management adjustment program.

Mission comments: The performance on this program which the Bank expects to be able to support through an adjustment credit which focuses on the near term and a Capacity Building Project which focuses on the longer term is critical. In particular:

- Measures to avoid deterioration of the SOCBs' portfolio and to address the SOCBs' financial and operational weaknesses.
- Measures (structural) to ensure that the financial sector supports growth
- Measures to properly balance recurrent and capital spending
- Measures to improve Budget accounting, control and transparency
- Measures to strengthen oversight of SOEs
- Measures to restructure SOEs

Area: Visible progress in dealing with illegal logging and protecting bio-diversity in conservation areas and securing results from village forestry initiatives.

Progress: A logging monitoring mission has just completed its field visit and reports satisfactory progress in the areas it was able to see; however, access to the Northern Extension area was not provided. Village forestry initiatives are being undertaken by Government.

Mission comments: The logging mission recommendations need to be implemented. Protection of the Northern Extension is a critical issue and protection measures as well as monitoring developments in this area have to be facilitated by Government. The mission noted the response of H.E. Mr. Thongloun Sisoulith that the question of access to the Northern Extension area will be looked into. On village forestry, the performance in the coming year and the maintenance of the reform momentum, aided by the FMAC and the Forestry Management Capacity Building Project, is critical.

Area: Improvements in EdL's financial performance through tariff reform, restructuring, efficiency improvements, and a better sectoral framework.

Progress: While Government has before them a set of implementable measures to address these issues, progress has been very disappointing -- particularly on adjusting electricity tariffs.

Mission comments: These issues have been under discussion with the Bank for a long time in the context of the Southern Province Rural Electrification (SPRE), which is currently part of the Bank's ongoing portfolio and a problem project. They are also critical to the broader financial management program. The mission is pleased to note that Government proposes to announce its decisions on electricity tariff level and structure and implementation timetable within the next week. The mission emphasized in the meeting that the conditions set out in the SPRE and the FMAC are critical, and so is the serious consideration of sector reform.

Area: Improvements in the performance of the Bank-supported project portfolio in the Lao PDR.

Progress: There have been some improvements in the portfolio but one project relating to EdL mentioned above is still a problem project.

Mission comments: This project needs to be taken out of problem status by implementing tariff revision and EdL restructuring measures immediately. The overall performance of Bank supported projects in Lao PDR also needs to be further enhanced.

- Poverty Directed Funding Mechanism for NT2 Revenues: Another important issue raised in the August Aide Memoire relates to the design and implementation of a funding mechanism to demonstrate that the NT2 project would also directly support the poor. Such a mechanism may initially be funded by an IDA credit and could subsequently be used to channel a portion of NT2 revenues into direct support for the poor.

Progress: An IDA Poverty Reduction Fund Project, to address this need, is now at an advanced stage of preparation. Progress to date has been rapid and encouraging.

Mission comments: Many more steps and decisions will be required on the part of the Government and the Bank in order to clear the way for appraisal of the project by end April and Board presentation in June 2002.

## **B. Improving Project Standards**

- Bank Due Diligence: There is a need for the Bank to carry out due diligence on the financial, economic, technical and legal aspects of the private sector investment project with the cooperation of the developers and Government.

Progress: Efforts to meet due diligence is in progress and the Bank appreciates the cooperation that has been extended by the Government and the developer.

Mission comments: The unfinished agenda is substantial and due diligence work will continue as developments on the project, such as the signing of the PPA and CA, arrangements for procurement and financing, responses on procurement bids, etc. unfold.

- Safeguards Documentation: While it was recognized in August that the progress, with regard to safeguard policies, made by the Government and the developers was commendable, the EAMP needs to be improved further. The August Aide Memoire noted that a clearer assignment of responsibilities between the developer and Government is needed regarding management of safeguard issues; arrangements for the management of the Northern Extension must be further developed and explained; fishery and livelihood issues relating to Xe Bang Fei need to be expanded upon; preparation of an IPDP is needed, deeper treatment should be given to explaining the public consultation process and its effectiveness, and riparian issues need further treatment.

Progress: The Bank has discussed safeguard issues and its views on the EAMP, RAP and Resettlement IPDP with the developer and Government. Detailed written comments will be delivered shortly. A consultant has been engaged by the GOL and NTEC to prepare a revised Watershed operational plan, including IPDP and RAP components. A Bank team has been assigned to advise the GOL and NTEC on the preparation of the documentation.

Mission comments: The developers and Government need to review the Bank's comments and implement them in the documentation and obtain Bank confirmation that the required documentation meets Bank standards. The Bank will review the draft Watershed documentation once it is submitted.

## **C. Mobilizing International Support**

- Mobilization of International Support: In addition to securing broad support among international donor agencies and the Bank's own shareholders, the August mission pointed to the need to explore the scope for direct financial support for the project -- particularly from MIGA, ADB and bilaterals. An effective communications approach covering donors, the international private sector, civil society (both local and global), and the media is required to ensure transparency and make readily available accurate information regarding the project.

Progress: Work is in progress.

Mission comments: An action plan that sets out the unfinished agenda on mobilizing external assistance and promoting an international consensus on the proposed project

needs to be developed. The implementation of this plan should then be closely monitored.

The international community is watching closely the progress registered by Government in implementing comprehensive policy and institutional reforms that would create the development framework within which NT2 can succeed. Unless the international financial community gains comfort from the Government's leadership of this program and its delivery on the reform measures, international support for the project would be difficult to mobilize. It is therefore important that all the reform measures, along with performance milestones, are made public by government and indeed put on its website. And that the actual progress registered on the ground be updated periodically.

It is timely for Government to approach ADB and MIGA for support to the proposed project and also tap financial support from bilateral donors to help finance the Government's equity contribution to the project.

## **Next Steps**

The World Bank has concluded that the experience and progress over the last six months confirms the rationale of the approach laid out in the August 2001 Aide Memoire. Progress overall is encouraging, but significant issues and steps remain. To facilitate further efforts, the Bank is prepared to send further missions in support of the Government and the developer in the coming months to address the agenda and work program that lies ahead.

### **A. With regard to the development framework:**

- The Bank will continue to work closely with the Government and the IMF on the PRGF.
- A PRSP mission will visit Laos in the week of April 8 to review with the Government and other stakeholders the progress made on the National Poverty Reduction Strategy and next steps.
- The Bank is currently reviewing with EdL and the Government the program on the energy sector and the issue of EdL tariff increase and financial restructuring, and will seek agreement on the immediate implementation of tariff reform in the context of the mid-term review of the SPRE project.
- On receiving confirmation from Government on tariff measures for EdL, the Bank will submit the proposed Financial Management Adjustment Credit to its senior management for approval to appraise. If senior management so authorizes, the Bank expects to appraise the Credit in May and thereafter proceed to negotiations and Board approval.
- The Bank will continue to work with the Government on the proposed Financial Management Capacity Building Project and the Poverty Reduction Fund Project with a view to appraise and negotiate these projects in April/May.
- The Bank will continue to work with the Government on the Forestry Management Program.
- The Bank will continue to support the Government to monitor and improve the status of the Lao PDR project portfolio.

**B.** With respect to the **proposed NT2 project**, the Bank is prepared to gear up activities related to due diligence on the project, the preparation of NTSEP, and the review of compliance with Bank safeguard policies.

**C.** With respect to **mobilization of international support**, the Bank is prepared to assist the Government through technical assistance for the preparation of a detailed communications plan for implementation by the Government.

In conclusion:

Provided there is satisfactory performance with respect to the Government's policy and institutional agenda for the Financial Management Adjustment Credit, and completion of project preparation, appraisal and negotiations, the Bank expects, by the middle of calendar year 2002, to submit for approval by its Board, the Financial Management Adjustment Credit, the Financial Management Capacity Building Credit, and the Poverty Reduction Fund Credit.

Regarding Government's overall development framework, it is important that all the reform measures, along with clear and monitorable performance benchmarks, as agreed with the Bank, are made public by Government and actual progress registered on the ground be made public from time to time. Provided there is satisfactory performance against such benchmarks, in each of the areas of Government's development framework, and once sufficient and satisfactory progress has been made on NT2-specific issues and on the mobilization of international support, the Bank would be in a position to ask its senior management for authorization to appraise the proposed NT2 project. However, the mission reiterated that, as indicated in the August 2001 Aide Memoire, the Bank support would be assured only when the Bank's Board approves the proposed project.