Arun III Hydroelectric Project In Nepal: Another World Bank Debacle?

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Despite growing evidence of the unsoundness of the Arun III dam, the World Bank seems determined to approve this massive hydroelectric project to be constructed in a remote pristine valley in western Nepal. The costly Arun III could undermine Nepal's economy, dissipate local indigenous populations and cause irreversible destruction to one of the last remaining intact forests in the Himalayas. Although local Nepali hydro experts have been promoting a series of viable alternatives, and donor governments are raising serious questions about the project, the Bank is worried if it backs down on Arun III it will lose credibility as a financing partner for large scale infrastructure projects.

It's a five day walk from the nearest road to get to the proposed site of the Arun III dam in the Arun river valley. A planned 74.4 mile long access road to be constructed through the valley and the influx of up to 10,000 construction workers and their families will jeopardize the lives and cultures of 450,000 indigenous people and threaten over 100 species of endangered and rare flora and fauna. The Arun III project is the first in a series of three dams to be built in the valley and yet there has been no cumulative environmental impact assessment for the entire scheme. The World Bank is slated to lend $175 million for the project; other major donors include the Asian Development Bank ($127.6 million), Japanese Overseas Economic Cooperation Fund ($163.3 million) and Germany's KFW $124.4).

On October 24th, the Arun Concerned Group, a coalition of Nepali NGOs filed the first claim against the World Bank in the newly created Inspection Panel, an independent appeals mechanism set up to investigate claims from people directly affected by Bank projects. The Arun Concerned Group (ACG) claim charges that the Bank violated its policies and procedures during the preparation of the Arun III hydroelectric project. The ACG believes that there are alternatives to the project that are less expensive, less environmentally and socially damaging, and that would have the advantage of building domestic industrial capacity and developing hydropower more evenly throughout Nepal. While Arun III will be largely dependent on international contractors, a range of small to medium dams could be planned, built and run by domestic companies the NGOs said in the claim. ACG questions the prudence of building the $1 billion project which costs almost one and half times the annual national budget of Nepal. The claim against the Bank submits that the Bank violated its policies on economic evaluation of projects, and other policies such as energy, information disclosure, environment, and indigenous people during the preparation of Arun III.

"It's no exaggeration to say that Nepal's economic future is at stake" warned Gopal Siwakoti a lawyer with the Arun Concerned Group "Nepal is a poor country and this megaproject is completely inappropriate for it. But the World Bank is ignoring viable alternatives that will meet our energy needs at a lower cost".

The Inspection Panel made a preliminary study of the claim and in December 1994 recommended to the World Bank Board of Executive Directors that there be a full scale investigation of the policy violations. The panel noted several policy violations and cited the "absence of a close examination of alternatives [to Arun] " and concluded "There is reason to believe that if a less restrictive assessment, including a wider ranger of hydro resources, could be undertaken it would result in expanding the number of economically and environmentally acceptable options".

Local hydro experts such as Alliance for Energy have been promoting alternatives to Arun III for over a year. Alliance for Energy has put forward to the Bank and the Nepali government a concrete set of alternative proposals which include small and medium scale dam projects of up to 100 MW which could be developed in a number of river basins spread evenly throughout Nepal and could easily met the growing demand for electricity. These projects could be developed and built in less time than Arun III, and have the advantage of providing

electricity to rural communities. According to the Alliance, the alternatives would be less damaging environmentally because the proposed sites are already near existing roads. "It is highly risky for a weak economy such as Nepal to put all funding into one costly project" said Bikash Pandey, an engineer with Alliance for Energy.

The U.S. Government has also questioned the wisdom and economics of the project in a recent draft report released by U.S. AID on October 31, 1994. The study contradicted the Bank's analyses of Arun III and concluded that Arun was not the lowest cost solution to the problem of Nepal's future power generation and that at this juncture Arun III would be a risky investment for Nepal. The study raised a series of questions about the Bank's economic analysis and risk assessment and stated "The thrust of all our results is that a prudent planner would postpone the construction of Arun by several years while developing credible responses to these as yet unanswered questions". The study was requested by Jan Piercy, the U.S. Executive Director to the World Bank who will be one of 24 Executive Directors to vote on project approval.

Concerns about the high cost of the project are even a growing controversy inside the Bank. The issue is reported to have polarized the entire the South Asia Country Department which includes Nepal, Bhutan and Bangladesh. Martin Karcher, a World Bank division Chief in that Department quit his job over his strongly held belief that the project would put Nepal at unnecessary economic risk. In a September 9, 1994 interview with Environmental Defense Fund (EDF), Karcher revealed the high cost of the project could prevent important future investments in Nepal in social sectors such as health, education and nutrition. Karcher stated that Bank management gave him little support in attempting to develop a targeted poverty alleviation program in Nepal, while focussing intensively on Arun. "My feeling was that the project was not being handled in an objective and even handed manner" said Karcher in the EDF interview, "Since senior management seemed committed to the project, a serious and open debate was no longer possible, and even common sense questions were being dismissed. All the available energy went into building the case in favor of the project, rather then examining alternatives". The World Bank's responded to Karcher's interview by claiming that Karcher's views were outdated and that the Bank had since revised its economic analysis for Arun III. However, Karcher has stuck to his original charges "The project is not in conformity with the Bank's poverty alleviation strategy for Nepal" said Karcher "Its an unbalanced use of Bank funds with an overemphasis on energy which will crowd out investments in the social sector and other high priorities such as rural infrastructure and agriculture".

In 1993, the World Bank was forced to withdraw from the Sardar Sarovar (Narmada) dam in India after years of intense international and Indian public pressure. The withdrawal was widely viewed as a major victory for environmental and human rights activists. But the Bank wants to be sure the Narmada withdrawal did not set a precedent for major infrastructure projects and is using Arun III as the battle ground. Joe Wood, Vice President for South Asia has made several public statements to the effect that the Bank's credibility as a funding partner for large-scale and controversial infrastructure projects is at stake, and if the Bank backs down on Arun it will become more difficult in the future for Bank management to bring large scale projects before the Board of Executive Directors for approval. "If we don't do it, the signal we'd send out is that the Bank can no longer support infrastructure projects like this" said Wood, in a recent interview with the Wall Street Journal "That would take away what the Bank can do for small counties like Nepal, which have no other source of financing to turn to". But the credibility of the Arun project in the eyes of key bilateral co-funders such as the Japanese and German governments is a more immediate problem for the Bank.

The Japanese government's Overseas Economic Cooperation Fund (OECF), one of the bilateral funders of the Arun III project was also stung by international criticism for its co-financing role in the discredited Sardar Sarovar dam and is now indecisive on Arun III. The Government of Japan jolted Bank confidence in July 1994 by informing Bank officials that it was not ready to publicly commit itself to co-financing Arun, until it did its own independent assessment of the project. This caused the World Bank to postpone the July 26th board approval date, which has not been rescheduled.

In August 1994, in a highly unusual move, the Japanese government sent two separate delegations to Nepal to conduct assessments and meet with Nepali officials and NGOs. One team was from the Overseas Economic Cooperation Fund and the second team included Bureau Directors from the Ministries of Finance, Foreign Affairs and International Trade and Industry. The participation of such high level Japanese officials in this type of investigation is

unprecedented. The Bank has been working aggressively behind the scenes to convince the Japanese to fund the project, which has not yet made a commitment.
Controversy over the project has also been growing in Germany, particularly since the release of a report from the German Federal Audit Office in December 1994 which criticized KfW's appraisal. The report questioned the economic viability and risk assessment of Arun III stating "The economic viability of the project which is based on a considerable domestic electricity tariff increase and an intended export of energy to India, is insufficiently secured in various regards, in our view."
NGOs have accused the World Bank of pressuring the Nepali government to approve the Arun III project at a politically volatile time in Nepal and at a time when open public debates about the project were only beginning. Last July, Prime Minister Korirala resigned and disbanded the parliament. Even though there was only a "caretaker" government in place, Bank management was continuing with project preparation. On October 18, 1994, the chief opposition Communist party leader in Nepal, Madhav Kumar Nepal, wrote to Lewis Preston on October 18th, expressing his concern over the perceived attempt to approve Arun III before a permanent government was in place. "Formal and meaningful discussion about the proposed project with the availability of basic project documents and information in advance has not yet taken place in Parliament" he wrote, and added that "Arun III must be reviewed by the new government in light of the ongoing controversies before Nepal makes any commitment to such projects".
National elections inside Nepal took place in November 1994 and UML Communist party won the most seats in parliament and has formed the new Communist government. This has impacted on the debate around Arun III inside the country. On December 30th, an all day parliament session was devoted to Arun in which critical questions were raised about the cost of the project and the location of the access road. The new Minister for Industry and Water Resources, Hari Prasad Pandey, has also indicated he would consider alternatives designs to Arun III. In fact, a Nepali government delegation lead by Minster Pandey came to Washington in early 1995 attempting to re-negotiate certain aspects of the Arun III loan agreement in order to lower project costs, but the World Bank refused to allow any changes in the project. Despite the ongoing debate, the World Bank reportedly gave the Nepali government a January 8th deadline to make up its mind on Arun. The deadline was widely publicized inside Nepal. The Arun Concerned Group was angered by the pressure and in a January 5th letter to Lewis Preston said "the January 8th deadline is considered [an] undue intervention by the Bank in the internal affairs of Nepal in the decision making process on Arun III".
In the same letter the Nepalese NGOs responded to what seemed to be attempts by Bank management to interfere with the Inspection Panel Process. Vice President for South Asia, D. Joseph Wood, had made a statement to the World Bank Executive Directors which misrepresented the panels' preliminary report and recommendations, including the panel's view on project alternatives. The Arun Concerned Group charged "We are alarmed with attempts by Bank management to undermine the mandate of the inspection panel and the inspection process. We are particularly concerned with the fact that the management is attempting to misrepresent and misinterpret the preliminary findings of the panel..." Despite Bank management's interference, the Board of Executive Directors approved the inspection panel investigation on February 2nd which will look at violations of the Bank's environment, resettlement, and indigenous people's policies. The Inspection Panel reportedly felt it was not in their mandate to investigate alternatives to Arun III, although they clearly indicated they believed alternatives had not been adequately investigated and that the World Bank and the Government of Nepal should further look at alternatives. Regardless of this, Nepali NGOs believe that the issue of alternatives is fundamental to any investigation of Arun III, and if conducted comprehensively, the Inspection Panel investigation will undoubtedly raise further questions about the need for alternatives.
Out of all the recent developments around Arun III, one of the most critical for the Bank will be its actions vis-a-vis the inspection panel claim. The inspection panel was set up by Executive Directors in the wake of the Narmada controversy to act as an independent mechanism to investigates complaints about Bank management's violations of policy and procedures. NGOs, donor governments and legislators are all monitoring the development of this untested public accountability mechanism. If the Bank approves the Arun III project before the panel investigates the extensive Arun III complaint, or if Bank management

continues its attempt to interfere in the claim process, it could undermine the effectiveness and integrity of the panel and the credibility of the Bank's stated commitment to public accountability.