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MEMORANDUM

TO: Clay Lowery, Deputy Assistant Secretary for International Debt and Development Policy Analysis, U.S. Department of Treasury

William E. Schuerch, Deputy Assistant Secretary for Multilateral Development Banks and Specialized Development Institutions, U.S. Department of Treasury

FROM: Barbara Turner, Acting Assistant Administrator, Bureau for Policy and Program Coordination, U.S. Agency for International Development BTurner

SUBJECT: USAID Recommendation for U.S. Vote on the Inter-American Development Bank (IDB) Camisea Energy Project (Peru)

RECOMMENDATION

USAID recommends that the U.S. Government **should not support** on the IDB Camisea Energy project to be presented to the Board of Executive Directors on July 30, 2003.

Despite the significant economic benefits that could accrue from the project to the Peruvian economy, USAID believes the U.S. should not support the project as it poses **significant environmental and social concerns that to date have not been sufficiently addressed.**

RATIONALE

Camisea Natural Gas Pipeline project is Peru's largest private investment project, involving $1.8 billion in the first phase. The project is projected to add as much as $1.0 billion to Peru's GDP for many years. The project will attract substantial foreign direct investment. Construction has already added some 8,000 jobs to the Peruvian economy, and thousands more direct and indirect jobs are anticipated. The revenue associated with this project is critical to the Peruvian government's ability to provide services and assistance.

However, several areas of concern have been raised in the course of USAID's Environmental Title XIII Pelosi analysis. They include the effect of the pipeline, marine terminal and loading platform on Paracas Bay and Block 88 concerns such as ethnic and resource use mapping and environmental/social monitoring. The Government of Peru (GOP) is enthusiastic about the project, but shares many of the same concerns. The GOP, LAC/W and the Mission believe that a partnership with international financial institutions (IFI) will help to ensure that the potentially negative environmental and social impact of the project are mitigated.

Addressing the many of the issues that USAID's Environmental review identified would be ill-served through purely private funding. There is a real risk that the GOP will pursue solely private funding if IFI funds are denied. A partnership between the GOP and IFIs will provide a strong counterbalance to purely business concerns and ensure an equitable balance between the overwhelming employment and development needs of the country and long term commitment to management of the ecosystem and protection of human rights.

As part of the U.S. Agency for International Development's (USAID) due diligence under the International Financial Institutions Act (Title XIII/Pelosi Amendment), EGAT Bureau has reviewed the Camisea Natural Gas Project which is scheduled for Inter-American Development Bank (IDB) Board vote on or about July 30, 2003. USAID's detailed review of the project consists of an 18 day site visit to Peru visiting a substantial portion of the project and meeting with civil society, affected communities, Government of Peru (GoP) Officials, local and international NGOs and project sponsors.

Following the site visit, EGAT has been involved in a number of meetings in Washington with local and international NGOs, project sponsors, IDB staff, Treasury, State, EPA, Ex-Im Bank and to a lesser extent GoP. Although EGAT recognizes the importance of this project to the GoP, there are substantial Title XIII environmental and social issues on which neither the IDB nor the sponsors appear to have made substantial progress in addressing. Most siginificant among them is the lack of appropriate site selection analysis and subsequent EIAs for the fractionation plant and marine terminal associated with the project.

With respect to the EIAs, USAID's responsibility under the Pelosi Amendment requires us to recommend that the Secretary of Treasury instruct the U.S. Executive Director (USED) to not vote in favor of the proposed Camisea Natural Gas Project. The basis for this recommendation is that the site selection analysis and subsequent EIAs for the fractionation plant and marine terminal associated with the project are insufficient and do not meet the test of being completed and made publically available 120 days before the vote [section 1307 (a)(1)] (Attached please see the analysis completed by Paul DesRosiers, Bureau Environment Officer for EGAT).

A number of other environment and social issues were also found in our analysis. They include:

- Lack of knowledge of indigenous peoples land/natural resource use around well platform sites within the Nahua-Kugapokori Indigenous Reserve and associated direct and indirect impacts of the project activity.

- Lack of appropriate measures to control migration of colonists into the Nahua-Kugapokori Indigenous Reserve.

- Lack of biodiversity baseline data and inadequate biodiversity monitoring given the unavoidable and irreversible losses of primary and secondary tropical forests and montane cloud forests along the pipeline ROW.

- Inadequate erosion control and revegetation plan along the pipeline in sensitive ecosystems resulting in severe erosion, potable water contamination, increased sediment deposition in waterways and loss of topsoil.

- Lack of adequate revenue management and development/planning capacity within the regional government to handle large revenue flows from royalties.

- Lack of adequate mechanisms for interactions between affected communities and project sponsors.

- Lack of adequate GoP capacity to effectively monitor and enforce components of the project.

Specific reasons for our findings on the fractionation plant and marine terminal portion include:

- The site alternative selection analysis was not conducted according to standard EIA practices. A thorough description of alternatives in an EIA process facilitates their side-by-side comparison in terms of their technical, social, environmental and economic risks and benefits. The site alternative selection process in this case was based on engineering and economic factors not taking into account environmental and social risks and benefits.

- The EIAs associated with the proposed site are clearly deficient and lack comprehensive analysis concerning potential adverse impacts (direct, indirect and cumulative) of construction and operation activities on resident and migratory birds, marine species, including sea turtles, fish, mammals and the benthos.

- The lack of baseline information and comprehensive analysis of direct, indirect and cumulative impacts of the proposed activity makes it impossible to determine what mitigation measures to recommend and to what extent impacts can be mitigated.

- Deficient environmental monitoring plan to identify project impacts during construction or operation phases.

- The lack of an adequate spill response plan and deficiency in not including all petroleum products that will be associated with the facility.