INTRODUCTION TO LOCAL SHARES

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Date: 23 January 2017
Venue: Gokharna Resort, Kathmandu, Nepal
All of us are victims of our history, our greed, lust, and as the economists say, “irrational exuberance.”

We are not the first:

“The stocks crashed and people all over the country lost all of their money. Suicides became a daily occurrence.

“The Clergy, Bishops and the Gentry lost their life savings; the whole country suffered a catastrophic loss of money and property”

The gullible mob . . . demanded vengeance”.

South Sea Bubble, London, 1720
Later, commentators observed that:

- The merchants and financiers were well aware of the issues, but
- The general public and political elite did not understand that there were risks as well as rewards involved in the schemes.

Of course it could happen here.

- Nothing has more potential for economic growth and prosperity in Nepal than hydropower
- Nothing is as politically charged
- Nothing is more temporary than local support
Could it Happen Here?

From a recent piece in the local press:

• “Today, everyone in the villages, on the streets and on social networks seems to be talking about local shares”
• “Today, the lure of quick, almost guaranteed profits with low risks is too tempting to pass up”
• “Some Initial Public Offerings in Nepal, have been oversubscribed by more than a hundred times”
• “The concept of local shares today is a far cry from how it all started when it was first born. And with each passing project, it continues to mutate and evolve”
• “Recently, a new set of interlocutors has entered the equation and their motive is questionable”
Take Away 1: It is not necessary for everyone in the market to be irrational to have a bubble. If just a proportion of market participants are over-optimistic, they can exert an upward pressure on share prices.

Take Away 2: Financial instability and uncertainty will always be exploited by political and financial predators.

- To remove uncertainty, it is imperative for the Government to develop and establish comprehensive and effective policies that will be applied to hydropower benefits, across the board.
- Our task is to support that process.
Pressing Local Share Issues

- **Distinction between small and large hydro projects**: should this be a one-size-fits-all approach?
- **Eligibility criteria**: Clear guidelines are required here as evidenced by recent protests.
- **Defining ‘local’ and ‘affected’ populations**: Because different classifications and categories of locals are used to determine the allocation of shares (and because several disputes over these classifications have arisen in the context of share allocations) it is important to formulate clear and consistent policies in order to prioritize share allocations to project-affected people in different project-affected areas.
Pressing Local Share Issues

• What is the right time to offer shares? Before, during or after Commercial Operations Date? These will affect participation and the reduction of risks. At or before COD limits risk which protects against local disputes if things go poorly, but the “equity” implies sharing of profits and risks.

• How should the shares be priced? At par value, or at a premium, or something in the middle? What should the criteria be for any one of these?

• Percentage of local shares: What percentage of the shares offered should be reserved for the local populations?
Pressing Local Share Issues

• **Handback:** What happens after shares have been transferred to the government at the end of the concession term?

• **Financial education and awareness:** What is the best way to provide the essential elements of project finance so that potential investors of all classes people understand the risks and rewards of equity investment?

• **Social inclusion:** Whatever system is developed must take active steps to ensure that all affected persons, whatever their gender, ethnic background have an opportunity to participate in the scheme.
Irrigation, Water, and Water Rights

- The Water Resources Act places the use of water for hydropower 4th, after drinking, irrigation, livestock, and fisheries.
- Hydropower development often interferes with formal and informal water rights. Today, the developer is required to compensate for hydrological damages just like any other kind of damage. But practically, it is very hard to do so.
- Is this a benefit payment or a compensation payment?
As the number of projects, both large and small, increase, conflicts arising from the competing interests of hydro development and the use of water for irrigation and other productive activities will also rise.

As the number of HPPs in the same basin increases, a frameworks for developing cumulative impact assessments will become even more important. Should they be mandatory?

Currently two large IPPs nearing Financial Close, UT 1 and Upper Karnali, have undertaken CIAs.
• Chronic failures in governance have brought us to where we are. Developers are increasingly required to fulfill governmental tasks.

• Local shares are here and not going away. While they may indeed bring rewards and secure local buy-in for a project they also carry significant risks, both to individual investors and to the government. Recent trends of protest and politicization indicate that awareness about benefit-sharing programs in Nepal is spreading rapidly via informal channels, and much information is inaccurate.

• Effective Communication is the key. On all levels.
Finally, the time has come for environmental issues to be considered within a larger discussion about water resources management and within the water, food, and energy nexus.

Special welcome to USAID’s PAANI Project and its Strategic Partners.

Also welcome to large WUSAs, including FECOFUN and NFIWUAN.
Thank You!
Addendum

Evolution of Benefit Sharing
And
The Royalty Payment Gap
In order to understand how benefit sharing has evolved to place us where we are today, we need to have understand two terms:

- **Compensation**
- **Benefits**

**Compensation**

- Since Roman times, the law has sought to compensate the dispossessed--those who have suffered damage or loss because the State was pursuing a public good. The goal of the law was compensate the injured and to make them whole.
- Compensation is a zero sum game. It rebalances the scales.
- This was always intended to be the obligation of the developer and compensation costs associated were intended to be recovered in the tariff (paid by the rate payer).
Benefits are more than Compensation

- Benefit sharing is more than making a person whole. It makes a person a beneficiary. Today, benefits include:
  - Royalties (all to the central government, a portion for the budget, and a portion to the affected regions and districts)
  - Employment and training
  - Investments for community development (roads, schools, hospitals, maybe even including rural electrification and irrigation/water related benefits)
  - Local Shares (Investment in project equity)
  - Environmental enhancement activities
**Royalty Definition:** What a developer pays to the government for the right to exploit a State-owned asset (in this case water). Nepal follows this traditional rule.

- The royalty payment goes to the government. How the government uses the money is a matter of policy.
- In many countries part of the royalty is paid to districts and communities as a benefit “over and above” the compensation for damage to families and property. The other part is used by the government as it sees fit.
- In Nepal, the royalty mechanism is neither well implemented nor understood. Even people in government complain about the “royalty black box.”
- Most local stakeholders have no idea how the royalty mechanism works.
Today there is a “Local Royalty Payment Gap”. The local royalty, the part intended for local benefit, is rarely seen. The “benefit package” has been expanded to cover that gap. Today, developers must go beyond compensation for damage caused and work with communities to maximize benefits that will produce “equitable outcomes”. This was always intended to be covered by the government and funded through the royalty payment. While it can be argued that the time has come to move beyond merely making those who are damaged “whole”, and while the developer may be able to recoup some of its costs through the tariff, it is inequitable for the government to place the burden of providing benefits on the rate base rather than the tax base.
Local Shares v. Royalties

- Local shares are a sub-category of benefits
- Shares go directly to individuals, not to local bodies charged to spend royalties allocated to them by the central authorities
- Shares operate in markets, and require little or no government intervention
- **Equities don’t always go up, but this not well understood**