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ANNEX

**MID-TERM REVIEW DOCUMENT**

**2009**

**LAO PDR**

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## ACRONYMS

ADB	Asian Development Bank
AHIF	Avian and Human Influenza Facility (a World Bank trust fund)
AFD	Agence Française de Développement
AFTA	ASEAN Free Trade Area
ASEAN	Association of South East Asian Nations
AusAid	Australian Agency for International Development
CfP	Call for Proposals
CBO	Community-Based Organisation
CSP	Country Strategy Paper
DP	Development Partner
DTIS	Diagnostic Trade Integration Unit
EBA	Everything But Arms
EC	European Commission
EIF	Enhanced Integrated Framework (see IF)
FLEGT	Forest Law Enforcement Governance and Trade
FTA	Free Trade Agreement
GBS	General Budget Support
GFATM	Global Fund to Fight AIDS, Tuberculosis and Malaria
GTZ	Gesellschaft für Technische Zusammenarbeit (German Technical Cooperation)
GoL	Government of Lao PDR
INGO	International Non-Governmental Organisation
IF	Integrated Framework (for Trade-Related Assistance to LDCs)
LDC	Least Developed Country
MIP	Multiannual Indicative Programme

MRC	Mekong River Commission
MTR	Mid-Term Review
NDS	National Development Strategy
NGPES	National Growth and Poverty Eradication Strategy
NGO	Non-Government Organisation
NNGO	National Non-Governmental Organisation
NRM	Natural Resource Management
NSA	Non-State Actor
NSEDP	National Socio-Economic Development Plan
NUDP	Northern Uplands Development Programme
PEMSP	Public Expenditure Management Strengthening Programme
PFMSP	Public Finance Management Strengthening Programme
PRSO	Poverty Reduction Support Operation
RTIM	Round Table for Implementation Monitoring
SDC	Swiss Agency for Development and Cooperation
SELNA	Support for an Efficient Lao National Assembly
SME	Small and Medium-sized Enterprise
SPS	Sanitary and Phyto-Sanitary (issues)
SWG	Sector Working Group
TDF	Trade Development Facility
UXO	Unexploded Ordnance
WB	World Bank
WTO	World Trade Organisation
WREA	Water Resources and Environment Administration

## 1. EXECUTIVE SUMMARY

The 2007-2013 CSP for Laos concentrates on one focal area and three non-focal areas, as described below. In line with the principles of EU development policy the number of cooperation areas was reduced compared with the previous CSP while the financial envelope and flexibility in allocation has been increased.

An evaluation of EU cooperation in Laos carried out in 2008 confirmed the relevance of the strategy and performance of the programme on the basis of the existing CSP. The EU has played a prominent role with its general budget support operation (Poverty Reduction Support Operation — PRSO) in the focal area under the MIP 2007-10. Furthermore, improved coordination and the establishment of joint programmes with other donors complement and support the implementation of reforms agreed under the PRSO, thus reflecting the aid effectiveness agenda formulated by the Government of Laos (GoL) and development partners on the basis of the Vientiane Declaration on Aid Effectiveness. The economic crisis unfolding after 2008 and the impact of the many changes taking place in rural Laos may widen inequality and exacerbate poverty and food shortages in remote areas. Furthermore, environmental degradation may also impact on rural populations. The government's achievement of the Millennium Development Goals (MDG) by 2015 and the target of leaving Least Developed Country status by 2020 could be in jeopardy.

The MTR confirmed that the existing CSP, with its thematic scope and mix of instruments, provides an adequate and flexible platform to address most of the issues related to the GoL's development policy agenda as well as new EU priorities. The MIP 2011-2013 fully reflects these considerations and will retain the same focal and non-focal areas (building on achievements and lessons learned during the MIP 2007-10).

The **focal area** under the MIP 2011-13 will continue to *support the pro-poor objectives and policies of the GoL's reform agenda* defined in the context of the Poverty Reduction Support Operation (PRSO), which the EU started to support in 2007. The PRSO articulates a GoL policy reform programme within a sound macro-economic framework with strengthened public revenue and expenditure management.

The **first non-focal area** will continue to be *sustainable development in the uplands and policy dialogue on relocation*. The Northern Uplands Development Programme (NUDP) established jointly with the EU Member States Germany and France and with Switzerland under the MIP 2007-10 provides a platform for a coherent area-based, multi-sector approach. In view of the persistent development problems caused by high UXO contamination in Laos, and acknowledging the proactive political role played by the country in formulating and ratifying the Oslo Convention on Cluster Munitions, support for UXO clearance is added as a new bilateral activity under this thematic area in the MIP 2011-13, with a coherent linkage to the NUDP.

The **second non-focal area** will be *good governance and human rights*. Activities will be defined by the Working Group on Institution Building and Administrative Reform, Governance and Human Rights. While the MIP 2007-10 had a focus on legal reform and institutional strengthening, activities under this MIP will also aim to deepen and strengthen human rights dialogue between the EU and Laos.

The **third non-focal area** will be *trade and economic development*. Building on the joint approach between the World Bank, the EU and AusAid with the Trade Development Facility

(TDF), the EU will continue to support trade, preferably through a joint programme-based approach led by the Ministry of Industry and Commerce.

A total EU grant of €36 million is proposed for the period covered by the MIP for 2011-13. The indicative breakdown of this amount is as follows:

	<b>Share</b>	<b>€million</b> <i>(t.b.c.)</i>
<b>Focal area: Support for the GoL's reform agenda</b>	<b>50-55 %</b>	<b>18-20</b>
<b>Non focal areas</b>	<b>45-50 %</b>	<b>16-18</b>
1. Sustainable development in the uplands and policy dialogue on relocation, UXO clearance	25-30%	9-11
2. Good governance and human rights	5-10%	2-4
3. Trade and economic development	5-10%	2-4
<b>TOTAL</b>	<b>100 %</b>	<b>36</b>

## **2. ANALYSIS OF POLICY FRAMEWORK AND COUNTRY STRATEGY**

### **2.1. Existing Country Strategy 2007-13 and Indicative Programme 2007-10**

The CSP 2007-13 has the overall objective of supporting the Government's poverty reduction strategy through a shift towards general budget support and increased use of country systems on the basis of the country's own medium-term socio-economic development planning. It places great emphasis on concentration of activities, country ownership, and coordination with EU Member states and other donors. Structural reforms, policy dialogue and aid effectiveness in line with the Paris Declaration on Aid Effectiveness and the EU Consensus on Development are at the centre of this strategy. It concentrates on one focal area and three non-focal areas of development aid. The focal area is support for the Government's National Poverty Reduction Strategy, as expressed in the National Socio-Economic Development Plan (NSEDP), a rolling plan updated at five-year intervals (6th Plan 2006-2010; 7th Plan 2011-15). The three non-focal areas are: i) support for sustainable development in the uplands and policy dialogue on relocation, ii) good governance and human rights, and iii) trade and economic development.

The centrepiece of the MIP 2007-10 is a general budget support operation (PRSO) linked to NSEDP goals and targets, jointly monitored with other development partners. In this approach, the EU supports local policy making and planning mechanisms and uses local systems for their implementation. At the same time, the EU maintains a strong independent monitoring framework (see Annexes 4 and 6) and provides technical support and capacity building for improved public finance management, social service delivery, and trade and SME policy.

Activities in the three non-focal areas also have a coherent linkage with the NSEDP: i) the Northern Uplands Development Programme (NUDP) contributes to poverty reduction, particularly in rural areas, and offers a hub for the EU's dialogue with the GoL on the issue of village relocation and human rights issues for specific ethnic groups; ii) EU-supported activities in the area of good governance and human rights are coherently linked to issues of institutional reform, while public service and public finance management is addressed and monitored under the focal area; iii) EU support for trade and economic development is implemented through a joint programme with other development partners aimed at fostering economic growth, strengthening the tax base, improving public services for the business sector and furthering tax and customs reforms.

## **2.2. The Country Strategy in the light of political and socio-economic changes**

**The political situation** — Historically, Laos has been subject to the political and economic influence of neighbouring countries, particularly China, Vietnam and Thailand, and the relationship with these neighbours still determines much of the present-day economic and political agenda, also influencing trade and economic cooperation and development aid relations with the European Union. Relations with the US, for years blighted by the US/Vietnam war, have improved and the US has lifted the last embargoes on trade.

Since the formulation of the present CSP, the government (GoL) has become more open to dialogue with development partners regarding human rights issues, and the ratification in September 2009 of the International Covenant on Civil and Political Rights is encouraging. However, it still remains very cautious on regional political matters and also certain domestic policy matters, including questions regarding Hmong repatriation from Thailand and migrant refugees. At the same time, the National Assembly is becoming more assertive on domestic issues and is increasingly exercising its power as a political institution within the constitutional context. Under the 2011-13 MIP, the EU can take advantage of governance reforms and the new openness by linking its Working Group on Governance and Human Rights more closely to its development cooperation activities.

In 2009 the GoL approved a new decree creating a legal framework allowing the formation and registration of national civil society organisations, and drafted a decree with legal and policy provisions for INGOs. These two decrees mark a significant change in GoL policy and are expected to facilitate the formation and operation of NSAs and their relations with donors, which may be reflected in EU development cooperation under thematic budget lines. The Public Administration and Civil Service Authority has been leading governance reforms with the creation of new agencies (WREA), new laws and regulations, and improved service delivery at provincial level, as well as strengthening central-provincial relations in preparation for the creation of local councils in 2011.

Another significant event was the signing and ratification by the GoL of the Oslo Convention on Cluster Munitions. This is particularly important for a country which, per capita, is the most heavily bombed in the world, and carries a legacy from the US/Vietnam war of 80 million UXOs. The GoL has integrated UXO clearance within the 7<sup>th</sup> NSEDP, and is seeking additional support from donors.

**The economic situation** — The economic liberalisation policy of the GoL over the past 10 years has translated into an average annual real growth rate of 6%. In 2008, this rate was 8%,

just before the global financial crisis unfolded. Average per capita income rose from US\$456 in 2005 to about US\$ 859 by 2008<sup>1</sup>, but this has been accompanied by growing inequality between urban and rural areas. At present, subsistence agriculture, dominated by rice, accounts for about 40% of GDP and provides 80% of total employment. Agriculture is likely to remain the economic backbone for the majority of the population over the intermediate term.

However, as a result of major infrastructure projects such as hydropower, mining, and agro-industries, including controversial plantation agriculture, a major transformation is taking place in the rural areas. The impact of this process, along with rampant unregulated logging and GoL policy to convert natural resources (including land) to capital, to end slash-and-burn shifting agriculture, to relocate remote villages, and to eradicate poppy growing, is changing the face of rural Laos and impacting on livelihoods at an unprecedented pace. Despite steady economic growth there is increasing inequality between urban and rural areas, and the nutritional status of the majority of the rural population has not improved in recent years. Food insecurity still affects a large part of the population, particularly in the uplands.

The largely agrarian economy and lack of exposure to global financial markets helped spare the country from the brunt of the 2008 banking crisis. However, there is mounting evidence that the economic crisis has had an impact, with forecast growth rates significantly lower after 2008 (see Annex 9 for a detailed analysis). This has hit GoL budget projections, and will materialise in a widening budget deficit, making it more difficult to meet the targets in the NSEDP.

Trade remains primarily commodity-based, but manufacturing, agro-business and services are expanding as the country modernises and tourism expands. Laos signed the Association of Southeast Asian Nations (ASEAN) Charter in 2008 and is also progressing in its negotiations for accession to the WTO. Trade and economic development at country level must be increasingly seen in the context of regional and international integration. Due to its level of economic development, Laos is not covered by the negotiating mandate for an EU-ASEAN FTA, but does benefit from the EU Everything But Arms initiative. Garment products account for 85% of total exports to the EU. Exports of other products such as coffee, rice, handicraft, or processed fruit are increasing gradually.

Despite recent achievements in improving the investment climate in the country, significant constraints to doing business remain and greater coordinated effort by different sectoral agencies is needed to promote investment in non-resource sectors. The initial findings of the latest Investment Climate Assessment (ICA 2009) show that the top five binding constraints for private sector in Laos are taxation, followed by access to finance, inadequate skilled labour force, electricity, and access to land.

SME activities accumulate to 95% of total business operations in Laos. Dominant business sectors are light manufacturing (food and wood processing, garment, light construction material) and tourism. FDI constitutes 14 % of GDP in 2008. Foreign investment in natural resources accounted for more than 80 % of the total FDI during the past few years although investment in non-resource sectors has also increased steadily, particularly private investment in the banking sector. The Lao Chamber of Commerce and Industry has expanded services to its members but its capacity is still low and mainly limited to the capital, Vientiane. A public-

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<sup>1</sup> World Bank estimate 2009.

private sector dialogue has been facilitated by the Lao Business Forum. The forum organises two meetings a year to address the concerns of three private sector working groups on Services and Trade, Mining, and Tourism.

**Social situation** — The UNDP HDI gives Laos a ranking of 131 out of 179<sup>2</sup>. The government's goal of graduating from the UN list of least developed countries by 2020, so far considered not unrealistic, might be hampered by the impact of the global financial crisis. Despite some significant improvements in the last decade, most social indicators are below the average for both low-income and East Asian countries. Laos is at great risk of failing to meet the MDGs. In the health sector, overall mortality and morbidity still remain very high, especially among the rural population. Maternal mortality is an issue of special concern. In the education sector, universal primary education is still far from being secured. Public spending on both health and education is below the regional average, and the health sector in particular appears to be critically under-funded. The ratio of recurrent to non-recurrent expenditure is low in both sectors, giving the government insufficient leverage for improvements in much-needed human resources for both sectors.

Supported by development partners, the GoL is formulating an MDG roadmap for inclusion in the 7<sup>th</sup> NSEDP (2011-15), which will likely be presented to the National Assembly and Party Congress in 2010. A key step will be the preparation of a health financing strategy. For the education sector, a comprehensive framework with pro-poor priorities was approved in 2009.

**Environment, disaster risk reduction, climate change and energy** — The Mekong region, in itself a very disaster-prone area, has been described as particularly vulnerable to global climate change and related hazards, and Laos is always at risk of floods, flash floods and soil erosion. Ecological sustainability is jeopardised by some of the land use changes taking place, and there is strong evidence of degradation, loss of biodiversity and pollution. Unregulated water use and excessive use of herbicides and pesticides threaten safe water access in rural areas, particularly during the dry period. The Mekong floods in 2008 and particularly the flash floods in the northern and southern uplands (in 2008 and 2009) demonstrated the country's vulnerability under changed weather patterns and deforestation, as well as its high exposure to hazard threats. Extended drought periods aggravate the situation and add to food insecurity. At the same time, the country still has a large area of tropical forest, which, if managed sensibly, can play an important role in climate regulation and biodiversity conservation.

The GoL recognises the importance of a more protective strategy for natural resources management to guard against disaster risks, and has enacted a series of laws and decrees to this end. It is also preparing a Strategic National Action plan for Disaster Risk Management. However, there is limited implementation and enforcement capacity, and unsustainable NRM practices continue to cause significant environmental damage. Given Laos's increasing exposure to hazard and climate change risks, disaster risk reduction measures, including climate change adaptation and resilience plans, will need to be integrated systematically within programmes across sectors.

### **2.3. Relevance of new EU policy initiatives and commitments**

Given the geographic conditions of Laos (predominantly mountainous and forested) and its mainly agrarian economy, EU policy commitments in areas such as disaster risk reduction,

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<sup>2</sup> Reference year: 2008.

climate change, tropical forests, and food security are highly relevant. The CSP provides a coherent linkage particularly with the focal area of support for socio-economic reforms and the non-focal area of sustainable development in the uplands and policy dialogue on relocation. Laos is also increasingly involved in regional cooperation (ASEAN, Greater Mekong Sub-Region, cross-border water management and MRC), which provides a hub for EU regional cooperation instruments from which Laos could benefit.

The Government has prepared a Drug Control Master Plan for the period 2009-2013 to combat the production, distribution and trafficking of drugs. While poppy eradication campaigns have been successful in the past, the GoL recognises the risk of resurgence in the production and use of drugs, sparked by increased production and trafficking in neighbouring countries and volatile prices for other cash crops, and is seeking support to provide economically viable alternatives to communities previously producing opium. For the EU, this offers an important entry point for its rural development and food security activities, particularly in the northern uplands, offering alternative livelihoods to replace the opium cultivation previously concentrated in this area, but potentially also for the use of thematic budget lines like the Instrument for Stability.

The EU's envisaged response to climate change in the run-up to Copenhagen foresaw a role for developing countries in limiting the growth of their emissions by 25-30% by 2020. Laos has a significant regional role to play in view of its hydropower prospects. To the extent that it might be possible to tap the Climate Facility, the new agency WREA could be a partner. The main linkage in the CSP is with the non-focal area for sustainable development in the uplands and policy dialogue on relocation.

The adoption of 'due diligence regulation' by the EU, the progress with Voluntary Partnership Agreements elsewhere, and increased efforts by the European Commission and certain EU Member States to help countries in Asia tackle unregulated logging could raise the profile of the EU Action Plan for Forest Law Enforcement Governance and Trade (FLEGT) in Laos. The country still has some of the largest tracts of forest in the region, but all of these are under serious threat. FLEGT can be addressed under the rural development and trade cooperation areas.

The Food Facility as an EU response to soaring food prices in developing countries is relevant in view of the persistent food insecurity in the poorest districts of the country. However, as a one-off exercise, it may raise expectations that cannot be followed through in the longer term without future reflection at the level of the country support strategy.

With a rather small population and low population density, migration, whether inward or outward, is not so much a quantitative problem for Laos, but there are political aspects of migration owing to the country's recent history, which the EU can address in its human rights dialogue and using thematic instruments. This also applies to human trafficking, mainly related to regional drug production and trafficking. The non-focal areas of governance and uplands rural development provide a policy linkage within the CSP. Given particular sensitivities between Thailand and Laos on the issue of illegal labour migration and the status of certain ethnic groups like the Hmong, close cooperation is necessary between the Delegations in Laos and Thailand, at the level of political dialogue but also in terms of aid coordination.

The international aid effectiveness agenda, based on the Paris Declaration and the Accra Agenda, the European Consensus on Development, and the EU Code of Conduct on Division

of Labour in Development Policy, is already reflected in the Commission's cooperation with Laos, but still needs to be taken further. The government has established a country-level framework for donor coordination in the form of the Vientiane Declaration on Aid Effectiveness, with emerging country ownership over the coordination process. The EU has significant responsibilities under this process. It provides technical assistance to improve the capacity of the government to lead and manage the aid effectiveness process.

#### **2.4. Results, performance and lessons learnt**

All activities implemented under the MIP 2007-10 in the different areas of support are based on logical frameworks with specific targets, and indicators are regularly monitored. The results achieved with the MIP are at this stage considered satisfactory, although quantitative result indicators could not be measured in all areas, particularly where activities have recently started. At this stage of CSP implementation, the main qualitative outcomes of EU's cooperation are at the institutional level, in the form of legal and regulatory reforms. Under the overall objective of facilitating the attainment of the Government of Laos' national development policy objectives, EU cooperation activities have contributed mainly to macro-economic stability, economic reforms (e.g. trade liberalization and the transition from a centralized, planned economy), and improved public finance management (e.g. improved fiscal transparency and discipline). With regard to the social sectors and progress towards the MDG, the EU managed to establish a good policy dialogue and support relevant line ministries in improving their sector planning and budgeting capacities. Support activities in the area of governance and human rights helped GoL in aligning with international law standards and incorporating them into national legislation, complementary to ongoing economic reforms. Capacities of staff in relevant line ministries and agencies were strengthened, under the MIP 2007-10 mainly at central level. The National Assembly was strengthened inter alia in its oversight and control functions over the executive. Ongoing project activities in rural development and support coming from thematic budget lines provided assistance and support for the establishment of sustainable rural livelihoods (e.g. by facilitating the shift from swidden cultivation to animal husbandry) and the fight against food insecurity as a persisting development issue in Laos. A systematic overview of results achieved but also of risk mitigation measures under the MIP 2007-10 is contained in Annex 4. The Government's capacity to manage the initiated reforms, and the expected commitment to social development and poverty reduction, with clear quantitative progress indicators, along with the related EU contributions, need to be closely monitored during implementation of the MIP 2011-13.

An evaluation of European Commission development cooperation with Laos was carried out in 2008-09, offering the Commission the following main conclusions for ongoing cooperation:

- *“The Commission should continue to provide budget support with strong emphasis on improving public sector financial management. It should continue to strengthen institutions capable of monitoring the budgetary process. In its ongoing support, the Commission already targets institutions capable of monitoring the budgetary process and ensures that budget resources are aligned with pro-poor policies, in combining the budget support operation with specific measures for PFM and for sector management and planning capacity building in health and education.*”

- *The EC should change the way it approaches the issue of social sector development in Laos to place the sources and uses of resources, specifically financial flows (including out-of-pocket payments), in the foreground.* Ongoing Commission budget support tackles social sector development and its financial sustainability. For both sectors a variable tranche is promoting an increase of government recurrent allocations. In the health sector, the PRSO includes the promotion and expansion of health security schemes as well as support for a proper health financing strategy. In the education sector, the Commission supported the formulation and adoption of a new sector framework with pro-poor priorities in early 2009.
- *The increasing willingness of the Government of Laos to engage in dialogue has created opportunities to improve the implementation of relocation so as to minimise its negative poverty impacts. The Commission should follow a two-pronged strategy regarding relocation, combining political dialogue and development cooperation, to ensure that human rights issues are not sidelined.* The Northern Uplands Development Programme will be a key element in collecting direct and indirect information on (forced) relocations, as well as on the way the GoL addresses issues of human rights in the context of relocation. The informal working group between Government of Laos and European Commission on Governance and Human Rights is used as a platform for the political dialogue on relocation.
- *In its assistance related to trade and enterprise development, the Commission should take greater account of low competitiveness, failure to add value, and human resource development.* The current bilateral trade and economic cooperation has so far contributed to simplifying business start-up procedures and access to finance for the private sector. The ongoing trade programme helps simplify import-export procedures and facilitates trade. With limited resources, it can only contribute to developing human resources in specific sectors like the garment industry, agribusiness, and wood production.
- *In consultation with its partners, especially the EU Member States, the Commission should define what coordination role it wishes to play in Laos vis à vis the Member States as well as other donors.* On behalf of all EU donors, the Commission was a key participant in the process leading up to the adoption of the Country Action Plan on Aid Effectiveness. Good progress has already been made in increased EU co-ordination and harmonisation for aid-effectiveness under the MIP 2007-10. Work continues on the implementation of the EU Division of Labour through an established EU Development Cooperation Meeting format. “

For its aid programming and implementation under the new MIP 2011-13, the Commission has taken the following lessons from the country evaluation and from Results-Oriented Monitoring (ROM) missions at programme and project level:

- While the PRSO has so far triggered regulatory reforms in several areas and encouraged macro-economic stability, progress in the social sectors, particularly regarding budget allocations, is yet to be seen (see Annex 6). However, including the social sectors in the PRSO matrix and linking progress to a results-based disbursement scheme and its continuous review have resulted in an intensive dialogue with government. The main conclusion for the MIP 2011-13 is that policy dialogue and

support to reform in the social sectors needs to be intensified within the context of the present support strategy to the NSEDP on the basis of a performance-oriented dialogue until the end of the present CSP, when general policy lessons can be drawn.

- Trade and economic development support is closely linked to the PRSO agenda. A joint Trade Development Facility has been set up by the European Commission, Australia and WB to support the GoL in implementing the DTIS under the Integrated Framework. It is increasingly seen by the Government as a vehicle for policy review and dialogue with development partners in a context of intense preparations for WTO accession. There is potential for strengthening this partnership and expanding the programme to extend support to private sector development, in particular for SME development.
- Support for governance also complements the PRSO reform agenda, particularly with regard to public finance management reforms and civil service reforms. The EU is one of the main donors in the governance sector, and its role will increase still further after Sweden phases out its activities in the sector at the end of 2009. While there is generally limited financial absorptive capacity in this sector, activities can be continued and possibly be extended.
- Based on lessons learned from previous cooperation, the MIP 2007-10 initiated a shift from a previously scattered project-based approach in agriculture towards a joint programme-based approach with a geographic focus on the northern uplands, which provides the vehicle for the EU's dialogue on rural development and village relocation, in addition to the existing human rights dialogue. This shift is embedded in a wider dialogue between the government and several development partners active in agriculture and rural development. The mid-term review also pointed to parallel policies in the implementation of EU activities in agriculture and food security as a result of different budget lines. As food security constitutes the most important sector supported by thematic budget activities, closer alignment with the EU country strategy for agriculture and rural development will be sought for the future. The global economic crisis starting in 2008 will most likely translate into a resurgence of subsistence agriculture and a greater risk of food insecurity.

## 2.5. Quality improvements in EU country assistance

**Coherence** — The main aim is to support the government's poverty reduction strategy with emphasis on improving basic social services, in line with government priorities set out in the NSEDP. The three non-focal sectors complement this objective.

**Concentration** — EU aid to Laos has moved away from fragmented projects in different sectors and now concentrates on one single focal sector and three complementary non-focal sectors. Reflecting the EU aid effectiveness agenda, activities are aligned with other donors as well as with the government's development strategy.

**Coordination and division of labour** — Activities are aligned with other donors where possible, as well as with the government's development strategy. EU programmes under the CSP 2007-13 support country ownership and reinforce the use of country systems. Programme formulation for the MIP 2011-13 will be part of an EU roadmap for closer coordination and enhanced aid effectiveness in Laos. In practical terms, the EU has moved towards joint programmes in all sectors covered by the CSP.

## 2.6. Conclusion

The CSP remains relevant overall in the light of the EU's policy towards Laos, the economic and political situation in the country, and implementation to date. The MIP 2011–2013 will take forward programme activities started under the previous MIP, which has so far shown a satisfactory implementation history and results. The recent developments highlighted above can be adequately addressed within the framework of the existing CSP.

The shift from the previous to the present CSP has significantly improved the quality and delivery of EU development support to Laos. The overall setup of the CSP offers the EU a platform for dialogue and cooperation where reforms, targets and milestones can be negotiated at macro-level on the basis of the country's own national development planning. To the extent possible, the EU already uses country systems for implementing activities. The EU has engaged in joint planning, monitoring and financing mechanisms with other development partners, using country systems and direct budget support where appropriate and possible.

The impact of the global economic crisis on government revenues as well as on social sectors and rural areas may seriously threaten the achievement of the MDGs by 2015. Consequently, it is important that the EC maintain and even strengthen its policy dialogue with government on the macro economy and public finances. There is scope for the EU to enhance its support to social sector reforms and to engage in supporting pro-poor policies of the NSEDP.

As the risk of increased food insecurity must be expected over the coming years, the EU should continue its support using thematic instruments while seeking closer linkage with its agriculture and rural development activities, as well as improved integration of disaster risk reduction and climate change adaptation approaches. In this context, support could also be considered for remote upland communities previously dependent on opium.

Recognition should be given to the GoL initiative on banning cluster munitions. EU support for UXO clearance should be significantly increased given its importance for poverty reduction and agricultural productivity, and should be incorporated in the policy dialogue.

Given the opportunities that exist for better natural resource management and the implications this will have for the environment, climate change and energy, the EU should consider how to assist this using the Climate Facility and FLEGT, and consider the potential role of regional organisations in tackling these issues.

## 3. MIP 2011-2013

### 3.1. MIP summary

The MIP 2011-13 will support the GoL in the areas defined in the CSP 2007-13 by continuing the activities started under the MIP 2007-10, most of which are joint activities with other development partners and increasingly using government systems. The **focal area** under the MIP 2011-13 will continue to *support the pro-poor priorities and policies of the GoL's reform agenda*, defined in the context of the Poverty Reduction Support Operation (PRSO), which the EU started to support in 2007. The PRSO articulates a GoL policy reform programme within a sound macro-economic framework with strengthened public revenue and

expenditure management. It is designed to assist the government to manage the expected increased revenues from hydropower and mineral exports. The programme is structured around two components aligned with the National Development Strategy (NDS):

- (i) Sustaining growth through improvement of the investment climate, facilitation of trade and management of natural resources;
- (ii) Protecting the poor and improving social outcomes through better public financial management systems and service delivery.

The EU supports the NDS goals by providing the GoL with financial and technical support for implementing key policy reforms on the basis of an agreed matrix, monitored through a joint review mechanism with the government and the other PRSO partners, the World Bank and AusAid. Within this joint approach, and supported by the other partners, the EU has established a close linkage under the MIP 2007-10 with progress in the social sectors, monitored on the basis of an agreed set of indicators. The focus on social sectors will be continued under the MIP 2011-13. Moreover, experience with the MIP 2007-10 has confirmed the importance of complementing financial support with support to capacity development and sector dialogue in order to build up and strengthen policy making and result-oriented management capacities. The combination of financial support and institutional strengthening will be continued and expanded under this MIP.

The **first non-focal area** will continue to be *sustainable development in the uplands and policy dialogue on relocation*. The Northern Uplands Development Programme (NUDP), established jointly with EU Member States Germany and France and with Switzerland under the MIP 2007-10, provides a platform for a coherent area-based multi-sector approach. The programme focuses on the upland regions in the north of Laos, where subsistence farmers with different ethnic backgrounds have often been the target of relocation efforts by the government, aiming to eliminate ‘slash and burn’ agricultural practices, eradicate opium poppy cultivation and bring people closer to government services and markets. These objectives have not always been achieved, and experience shows that relocated villages are at considerable risk of being worse off than they were before moving. The preparatory phase for the NUDP took several years in order to establish a coherent inter-sector dialogue between government agencies and among different development partners. This shows that the difficult political dialogue on relocation is best addressed within a wider programme, in which the EU can play a prominent role. Against the background of persisting food insecurity in Laos, and the significant support for food security from thematic budget lines, the EU will seek a more coherent linkage between uplands rural development and food security activities under this MIP.

Following the ratification of the Oslo Convention on Cluster Munitions by Laos in 2008, and acknowledging the fact that Laos is one of the countries most affected by unexploded cluster bombs worldwide, the EU sees a strong need to support the country in clearing unexploded ordnance, which severely affects rural populations and limits the availability of arable land, particularly in the upland areas in the north and south of Laos. The EU sees a strong thematic linkage with its non-focal area for sustainable development in the uplands and policy dialogue on relocation, and immediate benefits from the coordination of UXO clearance activities with other activities for agriculture and rural development with the same geographic coverage. However, given the specific nature of the required works and services, UXO clearance will most likely have to be addressed as a stand-alone activity under the thematic umbrella of uplands rural development.

The **second non-focal area** will be *good governance and human rights*. Activities will be defined by the Working Group on Institution Building and Administrative Reform, Governance and Human Rights. While the MIP 2007-10 focused on legal reform and institutional strengthening, activities under this MIP will also aim to deepen and strengthen the human rights dialogue between the EU and Laos. Support could be considered in response to the GoL decree to legalise and register civil society organisations.

The **third non-focal area** will be *trade and economic development*. Building on the joint approach between the World Bank, EU and AusAid for a Trade Development Facility (TDF), the EU will continue to support trade, preferably through a joint programme-based approach led by the Ministry of Industry and Commerce. Through the sector working group, the EU will also advocate a stronger linkage between the policy dialogues on trade-related assistance and on SME development.

### 3.2. Budget

A total EU grant of €36 million is proposed for the period covered by the MIP for 2011-13. The indicative breakdown of this amount is as follows:

	Share	€ million (t.b.c.)
<b>Focal area: Support for the GoL's reform agenda</b>	<b>50-55 %</b>	<b>18-20</b>
<b>Non focal areas</b>	<b>45-50 %</b>	<b>16-18</b>
1. Sustainable development in the uplands and policy dialogue on relocation, UXO clearance	25-30%	9-11
2. Good governance and human rights	5-10%	2-4
3. Trade and economic development	5-10%	2-4
<b>TOTAL</b>	<b>100 %</b>	<b>36</b>

### 3.3. Focal area: Support for the GoL's reform agenda

#### Strategic context/justification

In the past four years, the policy agenda of the GoL has shifted decisively towards targeting poverty reduction within a strategic, long-term development framework, on the basis of the sixth five-year NSEDP. It integrates plans drawn up earlier, including the 2003 Growth and Poverty Eradication Strategy (NGPES). In 2009, the government undertook a mid-term review of the sixth NSEDP and started formulating the seventh five-year plan for 2011 to 2015. This plan, coinciding with the 2015 MDG milestone, will be the framework that the EU will support through this MIP.

In implementing the MIP 2007-10, EU support for the Government's poverty reduction policy as part of a wider reform agenda has taken the form of budget support in the context of the PRSO, in combination with specific support for public finance management reforms and

technical assistance for capacity building to improve sector planning and monitoring in health and education. This mix of policies and instruments has led to concrete results and reforms (see Annexes 4 and 6) and is generally considered to have been successful. Building on achievements and lessons learned, the EU will continue under the MIP 2011-13 to provide financial and technical support to the pro-poor priorities of the NSEDP, through continued budget support if that remains feasible... An enhanced focus on (pro-poor) social service delivery will be reflected in the policy dialogue and technical and financial support for the health and education sectors under the new MIP.

### **General objective**

The overall objective is to support poverty reduction policies. To achieve this objective, the specific purpose of this focal area is to support key government economic and social reforms set out in the NSEDP with the aim of improving the business environment, trade conditions, the management of public finances, and social sectors.

### **Results**

Expected results of the programme include positive effects from the introduction of key reforms in the context of a medium-term development strategy, including sustainable growth, efficient management of public sector resources and increased social service delivery, contributing to reducing poverty in line with the country's MDG goals.

### **Activities**

Specific activities will be determined by the government's reform agenda and the relevant sector-specific agendas. Annual policy actions will be outlined in an agreed programme/performance framework closely aligned with the 2011-15 NSEDP. Policy dialogue, policy matrix and performance assessment framework will seek to build on the achievements of the previous years, deepening structural reforms in public financial management, and extend reforms in two broad categories:

- (i) Investment climate, competitiveness, and business development;
- (ii) Public finance management and improving service delivery (which will be given increased attention).

### **Implementation**

Implementation will build on the experience gained through supporting the NSEDP in the framework of the PRSO process and the existing policy dialogue, particularly in the areas of public finance, private sector development, trade, health, and education. This has already strengthened the EU's position and brought into the dialogue a focus on the pro-poor impact of the PRSO. Future EU support, whether delivered in the form of budget support or otherwise, will continue emphasising increased access for the poor to social services, fostering government policy implementation capacities and strengthening pro-poor service delivery mechanisms.

### *Risks and conditions*

There are five risks for continued budget support in Laos:

- (i) Lack of GoL commitment to some of the reforms; continuing ambiguity regarding accountability between institutions.
- (ii) Diversion of funds away from poverty reduction priorities, particularly due to fiscal stress resulting from the global financial crisis.

- (iii) Severe capacity constraints and skills shortages in the civil service, making the policy dialogue with development partners more difficult.
- (iv) Provincial autonomy without adequate supervision and accountability mechanisms, hampering implementation of national policies and equitable distribution of resources.
- (v) Potential deterioration in the macroeconomic situation in the wake of the global financial crisis, which may lead to a sharp increase in contingent liabilities in the state-owned financial sector and arrears owed to utility companies and private contractors.

Based on the first experiences with PRSO, these risks seem to be mitigable (see Annexes 4 and 6) and the GoL has shown a strong reform will and commitment.

Public Financial Management risks are closely monitored by the Delegation. PFM risks are still considered high although ongoing reforms triggered under the PRSO framework and the technical assistance of the PFMSP have contributed to improving PFM risk mitigation. The preparation and the efforts for implementing the revised budget law with all its implications for enhancing the controls of revenues collection and budget execution as well as the changes on central-local transfers gives concrete evidence. In line with the 2009 EC Guidelines for General Budget Support, the audit of national accounts was left to the responsibility of the partner country. Recognizing however the weaknesses of the existing system, a project to strengthen the institutional and staff capacities of the State Audit Office is under preparation and will be aligned with the PRSO and PFMSP framework matrices. Respecting the institutional independence of the State Audit Office, it will be pursued separately from the PFMSP.

### **Indicators**

The Ministry of Planning and Investment (MPI) is leading the preparation of an action plan to strengthen the monitoring and evaluation framework (M&E) for the NSEDP. However, this framework is not yet strong enough to be fully incorporated within the PRSO. Nevertheless, the present parallel monitoring systems for the NSEDP and PRSO share the majority of outcome indicators, and their sector focus conforms to the EU's approach of monitoring the results of reforms and poverty reduction. The PRSO policy matrix includes end-of-series outcomes expected under each sub-component of the PRSO programme . An assessment under the Public Expenditure and Financial Accountability (PEFA) performance measurement framework is being undertaken to develop the baseline for indicators against which progress can be evaluated for the PFM component.

The EU introduced a performance-based approach in the ongoing second budget support operation, linked to supporting and accelerating progress in the health and education sectors as measured by specific indicators. Based on positive first experiences, this approach will be continued and wherever possible enhanced under the MIP 2011-13. There will be a gender-disaggregated analysis of outcomes.

### **Financial envelope**

*€18-20 million [to be confirmed]*

### **3.4. Additional action 1: Support for sustainable development in the uplands and policy dialogue on relocation**

#### **Strategic context/justification**

This action is being taken within the context of the government's broad rural development policy of 'stabilising' settlement. The policy incorporates land allocation directives, eradication of slash-and-burn agriculture and elimination of poppy cultivation, an increase in agricultural productivity, and attempts to bring people closer to services such as education, health care, and water and sanitation.

The government has in the past faced two major constraints in implementing its strategy: firstly, the cost of preparing sites for relocation has far exceeded the government's means; secondly, suitable unoccupied land has been lacking in the quantities required. As a result, access to agricultural land, forests and government services has in several cases been inadequate to meet the needs of the relocated communities. Studies have demonstrated that food security, health and the traditional culture of ethnic minority groups can suffer seriously as a result. The allocation of land concessions to private investors has also had a significant impact in farmers losing their land or being relocated, and has negatively affected conservation areas and forests, biodiversity, and income from non-timber forest products. Furthermore, the economic crisis may aggravate rural poverty as a result of the return of migrants, and may make it difficult for farmers to find viable alternatives in former opium-growing areas.

Social, economic and environmental benefits can be gained from better management of development in the uplands. Allocating more resources will allow specific participatory assessments of localised and adapted options for sustainable development. This approach could significantly ease the difficult process of deciding whether villages should move or not and, when they do, improve the outcomes of the transition.

Following a long preparatory process, the GoL has embraced the idea of joint programme-based approaches to rural development in the northern and southern upland regions. While the programme for the south is implemented by the ADB and IFAD, the GoL has invited the European Commission, AFD, SDC and GTZ to join forces for a programme-based approach for the north. The GoL's long-term vision is to bring both programmes together under a common development framework. For the EU, the focus on the north is of specific strategic importance, as the northern uplands have been affected by major village relocation campaigns in the past. The joint Northern Uplands Development Programme (NUDP) was formulated in 2009 and will be co-financed by the EU in its initial phase, with funds from the MIP 2007-10. Following an assessment, this support might be continued under the MIP 2011-13. At the same time, the GoL has acknowledged UXO contamination as a major hindrance to increased agricultural productivity and rural development, and has played a leading international role in bringing about a ban on cluster bombs. The GoL has invited development partners to support its efforts for a major UXO clearance campaign in the coming years. The EU identifies involvement in UXO clearance as a key element in its support for sustainable development in the uplands, and will address this issue as a separate programme under the non-focal support area for uplands rural development. If possible, it will establish a close linkage with the NUDP.

## Objectives

The overall objective of EU support for this non-focal area is to contribute to rural poverty reduction and to achieve sustainable development in the uplands. Specifically, the actions to promote uplands rural development seek to secure, improve and sustain the livelihoods of the rural poor in these areas, to create a constructive dialogue on current policy reform, and to establish a programme-based approach based on GoL priorities, policies and implementation systems. The actions relating to UXO clearance seek to increase the availability of safe land and to reduce the number of UXO accidents related to farming and land cultivation.

## Results

- (i) Introduction of participatory and decentralised planning in villages in priority districts using pro-poor methods;
- (ii) Improved social infrastructure and rural livelihoods in highland villages with good potential for economic and environmental sustainability *in situ*;
- (iii) Improved health and livelihoods in recently relocated or consolidated villages;
- (iv) Improved planning, use and management of land, including protection and sustainable use of natural resources;
- (v) Participatory preparation of new locations for voluntary village relocation, where remaining *in situ* is not a viable option;
- (vi) Better and more conducive economic environment for the poorest farmers;
- (vii) Enhanced ability of poor households to negotiate market issues, to defend their rights and to organise themselves;
- (viii) Improved capacity of GoL staff at provincial, district, *kumban* and village level in needs assessments, planning, and services delivery;
- (ix) More safe arable land available to farmers, reduced risk of accidents due to UXO, specifically in rural farming areas.

## Activities

Activities under the NUDP are decided by the GoL and the EU in coordination with the other development partners involved in the programme, on the basis of the joint programme framework formulated in 2009.

UXO activities will be determined in line with the National UXO Strategy, which is currently being updated, and with the main recommendations of the International Conference on UXO due to take place in Laos in 2010. They should encompass de-mining activities, capacity building for Lao personnel and institutions, and specific care for mine-affected people and locations.

## Implementation

The NUDP is scheduled to start in 2010 for a period of four years and can, subject to a positive assessment by the EU, be continued using funds from this MIP. The EU will place particular emphasis on respect for the rights of the ethnic groups living in the uplands regions of Laos, with a particular focus on the status of women in the rural context.

The NUDP will initially be implemented in nine districts of three Northern provinces, where lessons will be learned and fed into a programme based-approach for the agricultural sector in all Lao uplands. The Ministry of Agriculture and Forestry (MAF) will implement the programme, which will be financed by the EU, France, Switzerland and Germany. Synergies and close coordination, as well as later integration, with other initiatives and programmes will be sought.

In addition, the EU will seek increased synergy and complementarities between the NUDP and other EU-funded projects, particularly on food security. Under this MIP, UXO-related actions will be given due attention and will seek to maximise the results obtained under EU-funded rural development and food security projects. The appropriate implementation mode for UXO activities will be defined in close consultation with the GoL and other development partners.

### **Risks and conditions**

Major risks are associated with the poor outcome of past efforts by the government to stabilise the location of villages and to make their agricultural practices sedentary. These activities have often resulted in a decline in the food security and health status of relocated villagers.

In the past the government has been reluctant to discuss its rural development policy and in particular the issue of ‘stabilisation’. However, this is progressively changing, and the GoL is showing more openness on the subject. Donor and NGO approaches to this issue differ widely. Many international NGOs would prefer to support efforts to bring development services to remote villages rather than bring the villages to the services. The administrative environment needed for INGOs, NNGOs and CBOs to operate in an adequate and timely manner is not yet in place, although significant regulatory changes were made in 2009. As a mitigation strategy, the EU needs to remain involved in civil society issues through support from thematic budget lines to foster the dialogue between the GoL and civil society.

The increasing effects of climate change pose a significant risk to rural communities, particularly in relation to food security, infrastructure, protection against natural disasters, and health. Appropriate adaptation, mitigation and risk management measures will need to be incorporated into programmes wherever relevant.

### **Indicators**

Indicators for the NUDP and a joint monitoring framework will be developed by MAF, in close coordination with the development partners and covering all the programme components. Indicators will relate to the objectives and expected results as specified above, and could include e.g. regional economic growth and exports, establishment of free market zones, establishment of kumban (cluster of villages) -level planning mechanisms, registration of land titles and established settlement procedures for dispute, transparent and participatory relocation decisions, mitigation processes for economic and social consequences of relocation.

Indicators for UXO clearance will be developed with future implementation partners and could include: quantities of removed ordnance, size of cleared areas (including arable land), existence of qualified clearance teams, number of accidents, type of support for UXO victims.

### **Financial envelope**

€9 – 11 million (to be confirmed), of which indicatively €3 million for UXO clearance.

### **3.5. Additional action 2: Governance — rule of law and human rights**

#### **Strategic context/justification**

Support for good governance is a core priority for EU development cooperation. While the rule of law and the strengthening of human rights are important development goals in themselves, good governance has an important cross-cutting dimension as it will help implement reforms leading to desired results in other sectors as well.

In the context of cooperation with Laos, good governance was introduced with the CSP 2007-13 as a non-focal area of cooperation. Concrete areas of cooperation under the MIP 2007-10 resulted from the policy dialogue in the informal Working Group on Institution Building and Administrative Reform, Governance and Human Rights, which was established in 2005 and has met regularly since then. Under the MIP 2007-10, activities focused on aligning local legislation with existing international law, ensuring its better understanding by the National Assembly, judiciary and administration, and institutional strengthening of the National Assembly as a working parliament, in addition to an existing project to support decentralisation efforts at province level. Activities were implemented under joint management with UNDP, the leading development partner in the sector. Tangible results of European Commission support include increased awareness among Lao lawmakers and legal experts of existing international law and law standards, and some progress in the discussion on the ratification of international law, including the International Criminal Court. The Lao National Assembly has recently exercised its power to scrutinise government decisions. By 2009, a reduced master plan for the legal sector outlining the most crucial legal reforms and a roadmap for 2020 was formulated and should provide a basis for future EU cooperation in the sector. Under the MIP 2011-13, the EU will continue to support good governance mainly on the basis of existing activities and established cooperation mechanisms. However, while the focus of the MIP 2007-10 has been on capacity building and strengthening of government institutions, the new MIP should provide an additional impetus to the strengthening of human rights dialogue and the fostering of a civil society culture on the basis of new government regulations introduced in 2009. Consultations with CSOs and side-activities (such as seminars, workshops and study tours) linked to the Working Group on Governance and Human Rights can also be envisaged.

#### **Objectives**

The general objective for this area under the MIP 2007-10 is to support the GoL in its activities in the fields of governance, rule of law and human rights. Specifically, EU support aims to i) support the development of a civil society culture and local NSA activities in development cooperation based on new regulatory frameworks introduced in 2009, and ii) assist the GoL to develop a coherent, credible and predictable legal, financial and administrative framework for all its citizens and to promote and protect all human rights, including the specific rights of women and children,

#### **Results**

- (i) The human, institutional, legal and organisational capacity of the GoL to address key justice, rule of law and human rights issues will be enhanced.
- (ii) Laos will effectively comply with the international treaties to which it is a signatory.
- (iii) The Laos parliament is empowered and effectively represents and defends Lao citizens.
- (iv) Lao civil society is empowered and contributes to the development of the country.
- (v) The human rights dialogue between the EU and Laos is strengthened.

## **Activities**

Activities will be based on the possible areas of cooperation identified in consultation with the government and with other DPs, civil society and the informal European Commission-Laos working group on Institution Building and Administrative Reform, Governance and Human Rights.

## **Implementation**

Building on the experience under the MIP 2007-10, the EU will seek close coordination with other development partners in this sector, specifically with a view to continuing existing cooperation mechanisms and support activities.

## **Risks and conditions**

The government has to be fully committed to and accountable for the reform process over the long term, especially as wide-ranging reforms will be necessary. The active involvement of the targeted institutions is crucial for the success of the programmes. Coordination between and commitment of the different donors has to be assured.

## **Indicators**

For the objective of developing a coherent, credible and predictable legal, financial and administrative framework for all Lao citizens and the promotion and protection of all human rights, the following indicators may be used:

- Improved participation in the legislative process;
- Parliamentary inquiries and fact-finding missions becoming routine;
- Increased public understanding of the role and function of the National Assembly;
- Staff of MoFA and other line ministries particularly Ministry of Justice (MoJ) and students have received training;
- Up-to-date equipment and information sources are available and used in relevant libraries;
- Legislation passed/reviewed in the field of human rights/good governance;
- Ratification of international treaties, number and type of international treaties and conventions signed by GoL specifically related to Human Rights and good governance;
- Frequency and level of participation in international/regional meetings dealing with good governance/human rights.

For the objective of the development of a civil society culture and increased local NSA activities in development cooperation, the following indicators may be used:

- number of Human Rights oriented civil society organizations obtaining their registration
- number of meetings/discussions between authorities and civil society groups on Human Rights and governance topics
- frequency and level of CSOs' participation to consultation with GoL on Human Rights

## **Financial envelope**

€2 - 4 million (to be confirmed)

### **3.6. Additional action 3: Trade**

#### **Strategic context/justification**

Trade generally has a high priority in EU development cooperation, recognising the role trade can play in generating pro-poor growth. The Government of Laos emphasises the importance of trade and private-sector development for sustainable economic growth in its NSEDP. The EU will continue to play an active role in this area by building on the ongoing policy dialogues under the PRSO and the activities of the previous MIP, particularly to support WTO accession and SME development.

On the basis of the MIP 2007-2010, a multi-donor trust fund for a Trade Development Facility (TDF) co-financed by the EU and Australia and administered by the World Bank was set up in August 2008 to support implementation of the Integrated Framework's DTIS Action Matrix and the establishment of a National Integrated Framework Governance Structure for coordinating trade-related assistance. The TDF has made satisfactory progress during its start-up period and has the potential to achieve its objectives.

Assistance provided through the TDF and the SME Development Programme is consistent with and complementary to the PRSO policy dialogue on trade and private sector development (PSD), in addressing Laos' priority in the AFTA and WTO commitments. The TDF provides direct technical assistance to support the reforms as specified in the PRSO policy matrix related to trade facilitation. In addition, the SME Development Programme is supporting the simplification of business registration, licensing and investment procedures. TDF and SME Development Programme interventions supporting SPS/TBT regulatory frameworks, capacity of the public/private sector and business intermediate will further improve Lao business environment and competitiveness.

#### **Objectives**

To build on the achievements under the MIP 2007-10 to further enhance the capacity of the GoL and the private sector to improve integration within regional and international trade systems, leading to economic growth and in turn contributing to poverty reduction.

#### **Results**

The action will build on the MIP 2007-2010 and further strengthen the capacity of the private sector, particularly SMEs, to participate in a globalised economy.

Specific results will be:

- (i) Reduced poverty and sustained growth through enhanced trade performance and private sector expansion as a consequence of the reduction of trade barriers and the creation of an enabling business environment linked to the PRSO policy matrix. Laos participating effectively and becoming more integrated in regional and international trade systems;
- (ii) Greater capacity for trade policy formulation and implementation, including customs and border measures, trade facilitation, and 'behind-the-border' regulatory issues;

- (iii) Improved knowledge of Lao officials and improved legal and regulatory framework (in particular on customs and SPS issues) and administrative capacity to ensure compliance with WTO requirements;
- (iv) Improved trade facilitation, leading to increased import/export flows and control over transit flows;
- (v) Stronger expertise on the part of Lao officials on subjects and issues covered under comprehensive FTAs;
- (vi) Strengthened capacity of the Lao private sector, in particular SMEs, to optimise global trade opportunities.

### **Activities**

The EU will continue supporting the implementation of the current DTIS Action Matrix, covering the areas of trade facilitation, customs, SPS, and technical barriers to trade. Details of additional activities will be agreed upon and further defined when the DTIS is reviewed in 2010. From the lessons learnt, the TDF can be a main resource of capacity building and technical assistance to support the achievement of PRSO-related policy reforms. Strategic linkages between TDF and PRSO can be further developed and expanded.

### **Implementation**

Building on the foundations of the TDF, the EU will continue to support trade through this joint programme-based approach. Further analysis of national capacity is needed to assess whether a national system can be used by the future programme, taking into account the efficiency and fiduciary risks in order to move forward on the aid effectiveness agenda. The EU will also advocate a stronger linkage between the policy dialogues on trade-related assistance and on SME development through a sub-sector working group. Possible support for SME development might form part of the programme activities. The private sector will be consulted during preparation and will be involved as much as possible during implementation, including through support for government/private sector dialogue. This will also entail reflection on economic opportunities for women.

### **Risks and conditions**

Lao trade has not been severely affected by the 2008 global economic crisis. Preliminary data suggest that exports in 2009 declined by 5-10 per cent compared to the same period of 2008, mainly due to copper price variations. Trade is expected to pick up again in the coming years thanks to a rebound in commodity prices and a quantitative increase in mineral, electricity and agricultural production. However, the crisis confirms the need to accelerate the ongoing trade reforms to improve the environment for private investment and trade. This has been recognised by the Lao government.

The remaining risk related to TDF is the difficulty in coordinating technical assistance activities in trade and private sector development due to the fact that Laos has still two separate government structures implementing separate technical assistance programmes (IF and SME). Donor coordination is challenging for IF implementations as there are many on-going and pipeline projects assisting the implementation of the DTIS, including planned EIF Tier 1 activities.<sup>3</sup> The limited absorption capacity and a rapid increase in the implementing

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<sup>3</sup> EIF Tier 1 is a financing arrangement of the enhanced Integrated Framework (IF) aimed specifically at strengthening country-level capacities for trade policy mainstreaming, diagnostic studies, coordination of activities, etc.

agencies' workload might have a negative impact on the quality of outcomes and the entire process of aid coordination.

The government is well aware of this challenge. Hence it has established the Trade and Private Sector Development Subgroup (TPSDSG) under the Round Table Process to serve as a forum for coordinating trade and private sector development initiatives. Synergy among different programmes is further ensured through the consultation and information sharing among donors led by the IF National Implementation Unit. The EU will continue supporting the government to manage trade related assistance and assure that TDF is synergised with new programmes of other developing partners. TDF has earmarked 11% of the total funds for strengthening the IF National Implementation Unit. Regular communication between EU Delegation and related services in both DG AIDCO and DG TRADE will be maintained.

### **Indicators**

The indicators identified in the MIP 2007-2010 remained unchanged:

- (i) reduction in the cost and time needed for customs clearance;
- (ii) increase in the value of official trade;
- (iii) increase in customs revenue;
- (iv) increase in the number of business operators registered;
- (v) increase in the quality of inputs provided by the Ministry of Commerce in the WTO accession process/AFTA.

### **Financial envelope**

€2 - 4 million (to be confirmed).

### **3.7. Complementarity with regional and thematic budget lines**

In terms of regional cooperation, Laos has so far benefited from the 'Asia Programmes' to only a modest extent. The Mekong River Commission (MRC), as a regional organisation based in Laos, has potential as a partner for the EU in the areas of natural resources management and climate change.

Activities financed from several thematic budget lines will continue to complement the bilateral cooperation activities under this MIP. Of particular relevance for Laos are:

- Health. EU support - mainly through the Global Fund to Fight AIDS, Tuberculosis and Malaria (GFATM) and the Avian and Human Influenza Facility (AHI) contributions and other regional and thematic budget lines - include the prevention and control of communicable and non-communicable diseases in Laos and the implementation of international health treaties to which Laos is a party.
- Food Security. As food insecurity is persistent in many rural areas, and since the EU has been successful in establishing partnerships with several NGOs on the basis of thematic budget line funding, this has become a financially significant complementary measure to bilateral activities in agriculture and rural development. With funds so far coming exclusively from thematic budget lines, the EU has become one of the most important donors in this field.
- Non-State Actors / Local Authorities. Cooperation with non-state actors with funding from relevant thematic budget lines has significantly increased under the present CSP and has further potential. Reforms to the regulatory framework in Laos are expected to

make the establishment of new partnerships easier. Project proposals often focus on food security, rural development and the provision of basic social services in remote areas, thus representing important complementary actions to the EU's bilateral cooperation.

- Democracy and Human Rights. While relevant thematic budget lines have not yet developed their full potential in Laos, the revised regulatory framework, particularly for local associations, might offer more opportunities in the future. The refocusing of the 'governance' non-focal area under the MIP 2011-13 might offer opportunities to use the instrument more strategically.
- Thematic programmes for Natural Resources Management (e.g. FLEGT) and Climate Change are of high relevance for Laos and dovetail with bilateral activities under the MIP 2011-13 in several areas, e.g. agriculture, trade, governance.

These thematic activities are complementary to the strategic objectives pursued under this MIP and form an important part of the policy dialogue with Laos, with financial resources provided in addition to the MIP.

**ANNEX 1A: LAO PDR AT A GLANCE - MACRO-ECONOMIC INDICATORS**

source	Basic data	2005	2006	2007	2008	2009e	2010e	2011f
A	1. Population (in million) annual change in %	5,9	6,0	6,1	6,3	6,4	6,5	6,6
B	2. Nominal GDP (in billion \$US)	2,8	3,6	4,3	5,4	5,8	n/a	n/a
A	3. Real GDP (annual change un %)	7,1	8,1	7,9	7,2	4,4	4,7	n/a
	4. Gross fixed capital formation (in % of GDP)							
	<b>International transactions</b>							
F	5. Exports of goods and services (in % of GDP)	27.8	30.2	31.4	30.9	n/a	n/a	n/a
F	6. Trade balance (in % of GDP)	-23	-13.6	-19.6	-22.4			
A	7. Current account balance (in % of GDP)	-17,2	-10,5	-18,0	-15,6	-11,7	-6,5	-10,7
B	8. Net inflows of foreign direct investment (in % of gross fixed capital formation)	n/a	2,7	1,7	8,8	7,5	4,6	7,5
B	9. External debt (in % of GDP)	n/a	97,1	104,5	96,6	97,8	n/a	n/a
B	10. Service of external debt (in % of exports of goods) and non-factor services	n/a	5,7	12,5	10,3	11,1	19,5	17,4
B	11. Forex reserves US\$ m ( <i>in months of imports of goods and non-factor service</i> )	n/a	336	531	636	536	n/a	n/a

	<b>Government</b>							
B	12. Revenues (in % of GDP)	n/a	14,4	15,4	15,5	14,8	12,6	n/a
B	of which: grants (in % of GDP)	n/a	n/a	1,7	1,3	1,6	1,6	n/a
B	13. Expenditure (in % of GDP)	n/a	18,4	18,3	17	22,3	20	20,2
B	of which: capital expenditure (in % of GDP)	n/a	8,4	8,3	7,1	8,7	7,9	8,0
B	14a. Deficit (in % of GDP) including grants	-3,8	-3,1	-1,8	-6,8	-4,5	-3,5	-3,3
B	15. <i>Public Debt</i> (in % of GDP)	63,1	59,1	53,1	54,5	55,7	54,8	53,4
	<b>Other</b>							
A	16. Consumer price inflation (annual average change in %)	7,2	6,8	4,5	7,6	0,2	2,6	4,0
E	17. Interest rate (for money, annual rate in %) [ <i>lending in local currency</i> ]	21.1	19	17.5	17.64	n/a	n/a	n/a
B	18. Exchange rate (annual average of kip per 1 US\$)	n/a	10,061	9,563	8,607	8,478	n/a	n/a
D	19. Unemployment (in % of labour force, ILO definition)	1.36	n/a	n/a	n/a	n/a	n/a	n/a
	20. Employment in agriculture (in % of total employment)							

Sources : A: International Monetary Fund; B: World Bank; c The Economist; D: Lao Population Census 2005; E: Annual Reports (2006-2008), Bank of Laos <http://www.bol.gov.la> , F:DG Trade, Laos-EU Bilateral Trade and Trade with the World (2005-2009).

e: estimate ; f: forecast

**ANNEX 1B: LAO PDR AT A GLANCE - INDICATORS DERIVED FROM MDGs**

Key indicators	1990b	2006	2007	2008	2010e	2015t
1. Proportion of population below 1\$/day in PPP (%)	46	n/a	n/a	n/a	n/a	24
2. Prevalence of underweight children (under five years of age %)	n/a	37	n/a	n/a	n/a	22
3. Under 5 child mortality (rate deaths per 1000 live births)	170 (1995)	98 (2005)	n/a	n/a	n/a	80
4. HIV prevalence rate of women aged 15-49 (commercial service women)	0,9 (in 2001)	n/a	2 (2004)	n/a	n/a	<5
5. Proportion of births attended by skilled health personnel	14,0 (in 1994)	23 (2005)	n/a	n/a	n/a	50
6. Proportion of 1 year old children immunised against measles (%)	68 (in 1995)	69 (2005)	n/a	n/a	n/a	90
7. Net enrolment ratio in primary education (%)	58 (in 1991)	84 (2005)	n/a	n/a	n/a	98
8. Ratio of girls to boys in primary education	77 (in 1991)	97,9	n/a	n/a	n/a	100
9. Primary school completion rate (proportion of pupils starting grade 1 and completing grade 5 - %)	48 (1991)	62 (2005)	n/a	n/a	n/a	95
10. Proportion of population with using an improved water source (%)	28	n/a	74	n/a	n/a	80
11. Telephone land lines per 100 inhabitants	0.2	1.6 (2005)	2	n/a	n/a	n/a
12. Formal cost required for business start up	n/a	n/a	n/a	n/a	n/a	n/a
13. Time required for business start up (days)	n/a	163	103	103	n/a	n/a
14. GDP per person employed, annual % growth – [World Bank]	4	4 (2007)	n/a	n/a	n/a	n/a
15. Access of rural population to an all season road	n/a	n/a	n/a	n/a	n/a	n/a
16. Household electrification rate (%)	n/a	n/a	n/a	n/a	n/a	80

1990b= baseline for MDGs ; 2010e= intermediate target / estimate ; 2015t= MDG target

Source: MDG 2008 report for Lao PDR, unless specified otherwise

## ANNEX 2: SUMMARY TABLES MIP 2007-10 AND 2011-13

**Table 1: Comparison of MIP 2007-10 and MIP 2011-13 Allocations**

Cooperation Areas	Allocations			
	MIP 2007-10		MIP 2011-13	
	€ m	%	€ m	%
<b>Focal Area: Support for GoL reform agenda</b>	<b>19.2</b>	<b>58</b>	<b>20</b>	<b>56</b>
<b>Non-Focal Areas:</b>	<b>13.8</b>	<b>42</b>	<b>16</b>	<b>44</b>
<i>1 - Sustainable development in the uplands / relocation</i>	8	24.2	11	31
<i>2 - Governance and Human Rights</i>	1.6	4.8	2	6
<i>3 - Trade and Economic Cooperation</i>	4.2	12.7	3	8
<b>Total</b>	<b>33</b>	<b>100</b>	<b>36</b>	<b>100</b>

**Table 2: MIP 2007-10 Implementation**

	Amount € m	Start	End
<b>Focal Area: Support for GoL reform agenda</b>	<b>19.2</b>		
<i>Poverty Reduction Support Operation - PRSO 3</i>	3.2	2007	2011
<i>Poverty Reduction Support Operation - PRSO 4-7</i>	13	2009	2012
<i>PFMSP - Public Finance Management Strengthening Programme</i>	3	2008	2012
<b>Non-Focal Areas:</b>	<b>13.8</b>		
<i>1 - Sustainable development in the Uplands / relocation</i>	8		
<i>Northern Uplands Development Programme (NUDP)</i>	8	2010	2013
<i>2 - Governance and Human Rights</i>	1.6		

<i>International Law Project Phase III</i>	0.5	2009	2012
<i>Support to an Efficient Lao National Assembly - SELNA</i>	1.1	2009	2012
<i>3 - Trade and Economic Cooperation</i>	4.2		
<i>Trade Development Facility – TDF</i>	4.2	2008	2011
<b>Total</b>	<b>33</b>		

**ANNEX 3: DONOR MATRIX – DISBURSEMENTS IN 2007**

in US dollars million	Education	Health	Population policies	Water Supply and Sanitation	Government and Civil Society	Other social infrastructures and services	Transport and storage	Communication	Energy	Banking and financial system	Business and other services	Agriculture, Forestry and fishing	Industry, mineral resources and mining construction	Trade and tourism	Multi-sector/cross-cutting	Commodity aid and General Programme Assistance	Action related to debt	Emergency assistance and reconstruction	Administrative Costs of Donors	Support to NGOs	Refugees in donor countries	Unallocated/unspecified	Total by donor	
<b>All Present</b>	<b>11,1</b>	<b>5,9</b>	<b>0,1</b>	<b>3,4</b>	<b>14,4</b>	<b>4,3</b>	<b>9,5</b>	<b>2,8</b>	<b>0,1</b>	<b>0,1</b>	<b>2,6</b>	<b>32,2</b>	<b>2,1</b>	<b>0,6</b>	<b>15,0</b>	<b>1,6</b>	<b>0,3</b>	<b>2,0</b>	<b>1,3</b>	<b>0,2</b>	<b>0,0</b>	<b>1,8</b>	<b>111,4</b>	
Belgium	1,1	1,1		0,1	0,5	0,2	0,2					0,2			1,1									4,5
Denmark															-0,3									-0,3
EC	2,4	0,2		0,3	1,0							2,2	0,6		0,7	0,6		0,8				0,0		8,9
Finland	0,3				0,1	0,3			0,1			2,4			0,6									3,7
France	3,7		0,1	2,4	0,8	1,9						21,1			3,1		0,3	0,0	0,7	0,2		1,3		35,7
Germany	1,6	0,2		0,4	1,5	0,4	2,9	2,8			2,5	2,4		0,6	6,3	0,9		1,2			0,0			23,8
Ireland				0,2	1,5							0,5												2,2
Luxembourg	0,7	4,2			2,7	0,4				0,1		0,8			1,5				0,6			0,4		11,3
Netherlands											0,1													0,1
Sweden	1,2	0,3	0,0		4,5	1,2	6,4			0,0		2,8	1,5		2,0							0,1		19,9
United Kingdom					1,7																			1,7
<b>Major non-EU donors</b>	<b>6,9</b>	<b>10,6</b>	<b>0,9</b>	<b>6,3</b>	<b>18,2</b>	<b>2,7</b>	<b>28,0</b>	<b>0,7</b>	<b>1,9</b>	<b>1,2</b>	<b>5,7</b>	<b>8,7</b>	<b>1,4</b>	<b>1,4</b>	<b>8,2</b>	<b>9,6</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>2,5</b>	<b>0,0</b>	<b>1,3</b>		<b>116,4</b>
Australia	1,3	3,0			4,2		0,0				5,7	1,3		0,8	3,9									20,3
Canada		0,5			0,0			0,3							0,3									1,1

China

0.0

in US dollars million	Education	Health	Population policies	Water Supply and Sanitation	Government and Civil Society	Other social infrastructures and services	Transport and storage	Communication	Energy	Banking and financial system	Business and other services	Agriculture, Forestry and fishing	Industry, mineral resources and mining construction	Trade and tourism	Multi-sector/cross-cutting	Commodity aid and General Programme Assistance	Action related to debt	Emergency assistance and reconstruction	Administrative Costs of Donors	Support to NGOs	Refugees in donor countries	Unallocated/unspecified	Total by donor
India																							0.0
Japan	4.4	7.0	0.8	5.7	10.6	2.6	28.0	0.4	1.3	1.2		4.2	1.4	0.5	2.3	9.6				2.0		1.2	83.1
New Zealand	0.3				0.5							0.6			0.1					0.5			2.0
Norway	0.8		0.1	0.6	0.5	0.1			0.5			0.2			0.1							0.1	2.9
South Korea																							0.0
Switzerland					1.5							2.5	0.0	0.1	1.4								5.6
Thailand																							0.0
United States		0.1	0.0		0.8	0.1			0.1				0.0		0.2								1.4
Vietnam																							0.0
Other																							0.0
<b>International Organisations</b>	<b>0,4</b>	<b>9,1</b>	<b>5,4</b>	<b>0,3</b>	<b>3,5</b>	<b>0,4</b>	<b>0,3</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>0,8</b>	<b>0,6</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>0,0</b>	<b>20,8</b>
FAO																							0.0
Global Fund		8.5	3.1																				11.6
Others																							0.0
UNAIDS			0.2																				0.2
UNDCP																							0.0
UNDP		0.1	0.2		3.3		0.3								0.5	0.6							4.9
UNESCO																							0.0
UNEPA			1.4																				1.4
UNICEF	0.4	0.5	0.4	0.3	0.2	0.4									0.4								2.6

UNIDO

0.0

in US dollars million		Education	Health	Population policies	Water Supply and Sanitation	Government and Civil Society	Other social infrastructures and services	Transport and storage	Communication	Energy	Banking and financial system	Business and other services	Agriculture, Forestry and fishing	Industry, mineral resources and mining construction	Trade and tourism	Multi-sector/cross-cutting	Commodity aid and General Programme Assistance	Action related to debt	Emergency assistance and reconstruction	Administrative Costs of Donors	Support to NGOs	Refugees in donor countries	Unallocated/unspecified	Total by donor
MEP																								0.0
WHO																								0.0
Financial Institutions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ADB																								0.0
IMF																								0.0
IBIC																								0.0
OPEC																								0.0
W/B																								0.0
Others																								0.0
Total by sector	18.4	25.6	6.3	10.0	36.2	7.4	37.8	3.5	1.9	1.3	8.3	41.0	3.5	2.0	24.0	11.8	0.3	2.0	1.3	2.7	0.0	3.0	248.6	
%FC	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.0	0.0	0.1	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.9

Ministry of Planning, Department of International Cooperation, data non available. Data extracted from OECD website.

Net ODA Receipts (USD million)					GNI/CAP (d)	Population	Current GNI	ODA/GNI
2003	2004	2005	2006	2007	2007	2007	2007	2007
					<i>USD</i>	<i>million</i>	<i>USD million</i>	<i>per cent</i>
301	270	296	364	396	580	5,86	3 637	10,90

**ANNEX 4: CSP 2007-13 LOGICAL FRAMEWORK MATRIX**

*(italic: comments on risk mitigation, achievement of results, and data on indicators under MIP 2007-10)*

<b>Overarching Objective:</b> <b>Support to the Achievement of the MDGs and Poverty Reduction in Lao PDR</b>	
<b>Focal Area: Support to the Government of Lao PDR's Reform Agenda</b>	
<b>MIP 2007-10</b>	<b>MIP 2011-13</b>
<b>General Objective:</b> to facilitate attainment of the Government's national development policy objectives	<b>General Objective:</b> to support poverty reduction policies underpinned in the NSEDP through a series of key government economic and social reforms
<b>Risks</b>	
<ul style="list-style-type: none"> <li>• Failing GoL commitment to reforms, resulting in poor policy performance and unclear accountability between institutions;</li> </ul> <p><i>GOL overall commitment to the PRSO reforms has been high during the last two years; progress has been faster in certain areas receiving complementary specific technical assistance. Institutional framework created by MOF for coordination has been critical to maintain reform impetus and to increase accountability.</i></p> <ul style="list-style-type: none"> <li>• Standard fiduciary risks in general budget support operations</li> </ul> <p><i>Revision of Budget Law completed between 2007 and 2009. Institutional framework strengthenedBudget transparency decreased in the latest official gazette where details on military expenses are not available anymore for the first time.</i></p>	<ul style="list-style-type: none"> <li>• Government's uneven commitment to some of the reforms;</li> <li>• High fiduciary risks resulting in diversion of funds away from poverty reduction priorities;</li> <li>• Severe capacity constraints and skills shortage in the civil service;</li> <li>• Provincial autonomy without adequate monitoring and accountability mechanisms;</li> <li>• Potential deterioration of the macroeconomic situation in the wake of the global financial crisis;</li> </ul>

**Results:**

- **Strengthening public financial management** systems for revenue collection as well as allocating, executing and monitoring public expenditure, at both national and provincial levels. This includes strengthening revenue collection, financial discipline and restructuring of State-owned banks and enterprises, as well as a reform of public utilities such as electricity and water.

*Public financial management has been improving during the implementation of PRSO. Revenue collection and financial discipline have particularly received attention as evidenced by the stable fiscal situation until 2008. The GOL has brought state-owned utilities into cost recovery levels and regular tariff levels increases have been decided. State-owned banks (SOB) have been regularly audited by independent and international companies. Two SoB have met operational and financial targets and were eligible to be recapitalised by the Ministry of Finance in 2006 and 2007.*

- Increasing the impact of public spending in terms of poverty reduction by **aligning budget resources with pro-poor National Development Strategy goals**. Public expenditure will be redirected to basic services that improve human development outcomes.

*GOL commitment to rise funding to the social sectors is confirmed by the data on budget allocation since 2005 showing steady increase. However deeper sectoral reforms are needed to ensure an efficient allocation of resources and a translation into better service delivery.*

- **Promoting sustained growth** through a stronger private sector, a greater volume of trade and sustainable management of natural resources. This involves improving the business environment, making progress on implementing AFTA commitments and managing forests and rivers more sustainably.

*Oversight of the State-Owned Enterprises strengthened and new Enterprise Law adopted between 2007 and 2009 as important steps in continuing the shift from a planned to a market economy.*

- Efficient management of public sector resources
- Creation of conditions to increase social service delivery with a view of reducing poverty in line with the country's MDG goals
- Introduction of key reforms in the context of a medium-term development strategy in the public sphere to sustain growth

## Indicators

- PEFA indicators

*(PEFA assessment ongoing currently and final results are expected tentatively in May 2010)*

- PI-1 Aggregate expenditure out-turn compared to original approved budget
- PI-24 Quality and timeliness of in-year budget reports
- PI-6 Comprehensiveness of information included in budget documentation
- PI-8 Transparency of Inter-Governmental Fiscal Relations
- PI-10 Public Access to key fiscal information
- PI-16 Predictability in the availability of funds for commitment of expenditures
- PI-26 Scope, nature and follow-up of external audit

*Although assessment PEFA indicators is not available yet, substantial progress has been made in the overall public financial management reform program (PFM). Key PFM reforms implemented to-date by the government include: (i) establishing a centralized control over all provincial and ministerial spending accounts, representing about 80 percent of total budgetary resources; (ii) revising of the budget classification system to be consistent with the IMF GFS statistics, and implementing it for FY2008/09 budget (iii) publishing -- with expanding coverage and improved timeliness -- the annual budget and outturn reports; (iv) mandating minimum spending on health and education sectors by provincial governments from FY2008/09; and (v) improving the legislative framework governing public financial management and external audit.*

- Increase in percentage of expenditure on the health and education sectors: for health from 5.5% to 7.5% of the budget by 2007, and for education from 11% in 2005 to 13% by 2007;

*The percentage of the budget allocated to Education between FY 2003/04 and FY 2006/07 increased to 14.5% while there has been a decline in health to 2.8%. The*

- Headcount poverty in Lao PDR (international \$1.25 poverty line 27.6% and national poverty line 37,4% in 2007/08)

Additional specific indicators to monitor reform progress and related effects on poverty reduction will be selected and agreed with the government at programme formulation amongst the following sources and according to the areas of reform. Some examples of indicators that could be included are listed below:

- GoL monitoring and evaluation framework for the NSEDP (under preparation final version will be presented to Development Partners in November 2010)
  - Literacy rate of 15-24 year-olds, women and men (84 in 2005)
  - Proportion of births attended by skilled health personnel (23 in 2005)
- Indicators of PRSO policy matrix (will be aligned as much as possible to NSEDP indicators and will be selected at programme formulation tentatively planned for 2011)
  - Number of businesses registered with tax authority
  - % share of credit to private sector
  - Recurrent education expenditure
  - Primary school enrolments
  - Recurrent health expenditure
  - % of population enrolled in health security schemes schemes
- PEFA indicators to measure progress in Public Finance Management reforms *(PEFA assessment ongoing currently and final results are expected tentatively in May 2010)*
  - PI-1 Aggregate expenditure out-turn compared to original approved budget
  - PI-24 Quality and timeliness of in-year budget reports
  - PI-6 Comprehensiveness of information included in budget

*latter is due almost entirely to the decline of donor-financed infrastructure.*

*If donor spending is excluded from the calculation, spending as percent of total spending grew in education (from 9.2 to 11.9 percent) and health (from 3 to 3.2 percent)*

- % of total primary school enrolments accounted for by 47 priority districts

*School enrolments in the 47 priority districts have increased from 28.4% in 2006 to 30.4% in 2008.*

- Improved textbook/student ratios: from 1:5 in FY 2004/05 to 1:1 in FY 2006/07 in grades 1 and 2;

*This indicator has not been measured within the PRSO. PROS4-7 measures the average student/textbook ration in 47 priority districts. In 2006/7 the percentage was 4.7 and the target is to see a decrease by 2011.*

- Halving the delays in payment of teachers' salaries: from 20% of teachers' salaries with over two months' delay in 2004 to less than 10% with any delay in 2007.

*Government improved the timeliness of payment of salaries to teachers and health workers during PRSO-3 from the benchmarks established in PRSO2 (in the case of teachers, a stock of salaries outstanding more than 1 month of 6 percent of one month's payroll). The last report mentioned by the WB in the PRSO3 document (Q4 of FY05/06) showed no deviation from the trend of improving timelines of payments in comparison to the benchmark. The report for Q1 of FY06/07 shows that the salary payment timelines have improved as the salary arrears were reduced from 8% in Q2 2005/6 to 2.9% in Q1 2006/7.*

- Pilot community school grants programmes implemented: from zero in 2004 to 500 grants in 300 villages in FY 2006/07.

documentation

- PI-8 Transparency of Inter-Governmental Fiscal Relations
- PI-10 Public Access to key fiscal information
- PI-16 Predictability in the availability of funds for commitment of expenditures
- PI-26 Scope, nature and follow-up of external audit

*This indicator has not been measured within the PRSO process due to the postponement of the establishment of the school block grants by the Government until the strategy and the legislative framework are in place. The PRSO is supporting preparation of those steps. Some community school grants have been set up within donor funded projects although the exact number is not known.*

- Increase in percentage of health expenditure going to district hospitals and health centres: from 22% in 2003 to 45% by 2007.

*This indicator has not been measured within the PRSO process and no data is available.*

*In the current system health spending in Lao PDR is predominantly the responsibility of provinces which reduces the ability of the central authorities to implement national programs. Thus national consolidated data on this indicator is currently very difficult to obtain. Measures are being taken to improve availability of this type of data and the ongoing preparation of the health financing strategy as well as the work on the budget norms should help.*

- Number of health personnel in 47 priority districts

*The Government has maintained a steady increase of the number of health personnel available in the 47 priority districts in its efforts to improve health services in the priority districts. The indicator has increased from 1644 in 2006 to 1998 in 2009.*

- Private sector development and improvement of the investment climate - Number of days to start-up a business

*This indicator has decreased from 183 in 2006 to 145 in 2009 showing an improvement in the legislative framework supported by PRSO reforms.*

- Trade facilitation (see under non-focal area below for more details)- Number of documents to export and import

<p><i>This indicator has decreased from 12.16 in 2006 to 9.10 in 2009 reflecting government efforts to reduce trade barriers under the PRSO.</i></p>	
<p><b>Additional Action 1: Support to sustainable development in the Uplands and policy dialogue on relocation</b></p>	
<p><b>MIP 2007-10</b></p>	<p><b>MIP 2011-13</b></p>
<p><b>General Objective:</b> to contribute to poverty reduction, food security and environmental and cultural sustainability through support to sustainable development in the uplands and dialogue on reform of current policy</p>	<p><b>General Objective:</b> to contribute to rural poverty reduction and to achieve sustainable development in the Uplands</p>
	<p><b>Specific Objective 1:</b> to secure, improve and sustain livelihoods of the rural poor in these areas, to create a constructive dialogue on current policy reform, and to establish a programme-based approach based on GoL priorities, policies and implementation systems</p>
	<p><b>Specific Objective 2:</b> to increase the availability of safe land and to reduce the number of UXO accidents related to farming and land cultivation</p>
<p><b>Risks:</b></p>	
<ul style="list-style-type: none"> <li>• International perception of GoL village relocation policy might hamper donor community support;</li> </ul> <p><i>GoL has been recently more open to discuss issues of relocation and seems to take into account international advice. The NUDP will offer a platform for a more coordinated and systematic approach.</i></p> <ul style="list-style-type: none"> <li>• GoL reluctance to discuss rural development policy and ‘stabilisation’ with development partners;</li> </ul>	<ul style="list-style-type: none"> <li>• International perception of GoL village relocation policy might hamper donor community support;</li> <li>• GoL reluctance to discuss rural development policy and ‘stabilisation’ with development partners;</li> <li>• Differing perceptions and approaches between donors and NGOs on delivery of services to rural communities;</li> </ul>

<p><i>This is increasingly addressed at GoL level; the initial programme document of the NUDP includes references to these issues. The EC and other NUDP partners share a common understanding and pragmatic approach.</i></p> <ul style="list-style-type: none"> <li>• Differing perceptions and approaches between donors and NGOs on delivery of services to rural communities;</li> </ul> <p><i>EC established practice prevents development support to recently relocated villages so as to avoid "validating" uncoordinated GoL policy. Issues of relocation are constantly addressed through the prism of poverty and poverty reduction.</i></p>	<ul style="list-style-type: none"> <li>• Administrative environment for INGOs, NNGO and CBOs to operate in an adequate and timely manner not yet established, although significant regulatory changes have taken place in 2009;</li> </ul>
<p><b>Results</b></p>	
<ul style="list-style-type: none"> <li>• Introduction of participatory planning in villages in priority districts;</li> <li>• Improved social infrastructure and rural livelihoods in highland villages with good potential for economic and environmental sustainability <i>in situ</i>;</li> <li>• Improved health and livelihoods in recently relocated or consolidated villages;</li> <li>• Improved planning and preparation of new locations for village relocation where remaining <i>in situ</i> is not a viable proposition and villagers are willing to move.</li> </ul> <p><i>Despite delays in the programming of the NUDP, several achievements can be noted :i) a diagnostic study and a feasibility study have been conducted; ii) extensive joint work amongst DPS and between DPs and GoL to prepare the project document has taken place; iii) a clear commitment from DPs to the NUDP is now shown; iv) there is an increased understanding and cooperation amongst DPs, v) the NUDP is taken as a model by GoL; vi) GoL seems to be willing to review its policy on land concession. As shown by the indicators adopted by the GoL in the NUDP (draft) programme document, there is a clearer will to discuss</i></p>	<ul style="list-style-type: none"> <li>• Introduction of participatory and decentralised planning in villages in priority districts using pro-poor methods</li> <li>• Improved social infrastructure and rural livelihoods in highland villages with good potential for economic and environmental sustainability <i>in situ</i></li> <li>• Improved health and livelihoods in recently relocated or consolidated villages</li> <li>• Participatory preparation of new locations for village voluntary relocation, where remaining <i>in situ</i> is not a viable option</li> <li>• Improved planning, use and management of land, including protection and sustainable use of natural resources</li> <li>• Better and more conducive economic environment for the poorest farmers</li> </ul>

<p><i>and address so far sensitive issues.</i></p>	<ul style="list-style-type: none"> <li>• Enhance position of poor households to negotiate market issues, to defend their rights and to organise themselves</li> <li>• Improved capacity of GoL staff at provincial, district, kumban and village level in needs assessments, planning and services delivery</li> <li>• More safe arable land available to farmers. Risk of accidents related to UXO reduced specifically in rural farming areas</li> </ul>
<p><b>Indicators</b></p>	
<ul style="list-style-type: none"> <li>• food security, measured in terms of number of months of rice sufficiency for each village;</li> <li>• food production, measured in terms of increases in rice, other cereal, vegetable and livestock production and labour input per hectare cultivated or per tonne of rice production, broken down by gender;</li> <li>• alternative livelihoods, measured in terms of introduction of and increases in non-traditional and cash crops, wage labour, non-agricultural businesses and income-earning ventures;</li> <li>• health status, measured in terms of numbers of protected water supplies installed, increases in malaria prevention practices, recorded mortality and morbidity rates;</li> <li>• service delivery indicators, including numbers of visits by extension staff, vaccinations administered, numbers and proportions of children in school, and literacy rates;</li> <li>• cross-cutting indicators, such as environmental impact assessment reports, gender impact reports and cultural impact reports.</li> <li>• specific indicators in accordance with the EC and World Bank policies on Indigenous Peoples</li> </ul> <p><i>(a comprehensive monitoring framework including the specified indicators will be developed under the Northern Uplands Development Programme to start in 2010)</i></p>	<ul style="list-style-type: none"> <li>• (joint monitoring framework for NUDP to be developed by MAF)</li> <li>• (Indicators for UXO clearance to be developed with future implementation partners, e.g. quantities of removed ordnance, size of cleared areas, existence of qualified clearance teams, number of accidents, type of support to UXO victims)</li> </ul>

<b>Additional Action 2: Governance – Rule of Law and Human Rights</b>	
<b>MIP 2007-10</b>	<b>MIP 2011-13</b>
<b>General Objective:</b> to support the Government in its activities in the fields of governance, rule of law and human rights	<b>General Objective:</b> to support the Government in its activities in the fields of governance, rule of law and human rights
<b>Specific Objective:</b> to assist the Government of Lao PDR to develop a coherent, credible and predictable legal, financial and administrative framework for all citizens and to promote and protect all human rights	<b>Specific Objective 1:</b> to assist the Government of Lao PDR to develop a coherent, credible and predictable legal, financial and administrative framework for all its citizens and to promote and protect all human rights
	<b>Specific Objective 2:</b> to support the development of a civil society culture and local NSA activities in development cooperation based on new regulatory frameworks introduced in 2009.
<b>Risks:</b>	
<ul style="list-style-type: none"> <li>• Uncoordinated donor support;</li> <li>• Lack of GoL commitment to reforms;</li> </ul>	<ul style="list-style-type: none"> <li>• Uncoordinated donor support;</li> <li>• Lack of GoL commitment to reforms;</li> </ul>
<b>Results</b>	
<ul style="list-style-type: none"> <li>• The capacity of the GoL to address key justice, rule of law and other human rights issues will be enhanced</li> <li>• Lao officials have increased knowledge on International Law including Human Rights, International Humanitarian Law, International Private Law and anti-corruption legislation</li> </ul>	<ul style="list-style-type: none"> <li>• The human, institutional, legal and organisational capacity of the Government of Lao PDR to address key justice, rule of law and other human rights issues will be enhanced</li> <li>• Lao PDR is effectively compliant with the International Treaties to which it is a signatory</li> <li>• Lao PDR Parliament is empowered and effectively represents and defends Lao citizens</li> <li>• Lao Civil Society is empowered and contributes to the development of the</li> </ul>

	<p>country</p> <ul style="list-style-type: none"> <li>The Human Rights Dialogue between the EC and Lao PDR is strengthened</li> </ul>
<b>Indicators</b>	
<ul style="list-style-type: none"> <li>Reform of the legal system: adoption and ratification of laws and treaties <i>Lao PDR is now party to almost 100 multilateral treaties, over 100 ASEAN treaties and regional treaties and over 300 bilateral treaties.</i></li> <li>Capacity of Lao officials: judicial knowledge and instrumental skills <i>Several trainings and workshops have been organized targeting government officials, judges and law students; a yearly Law Forum has been organized; an Official Gazette officially notifying the treaties binding on the Lao PDR as a State Party has been published.</i></li> </ul>	<ul style="list-style-type: none"> <li>Improved participation in the legislative process ;</li> <li>Parliamentary inquiries and fact finding missions become routine;</li> <li>Increased public understanding of the role and function of the National Assembly;</li> <li>Number of MoFA and other line ministries and students who received training;</li> <li>Equipment available and used in the libraries;</li> </ul>
<b>Additional Action 3: Trade</b>	
<b>MIP 2007-10</b>	<b>MIP 2011-13</b>
<b>General Objective:</b> to provide trade-related assistance to Lao PDR to enhance its capacity to integrate into regional and international trade systems, leading to economic growth and in turn to reduction of poverty	<b>General Objective:</b> to enhance Lao PDR's capacity to integrate with regional and international trade systems, leading to economic growth and in turn to reduction of poverty
<b>Risks:</b>	
<ul style="list-style-type: none"> <li>Uncoordinated donor support;</li> </ul> <p><i>The Integrated Framework (IF) process has considerably fostered donor coordination. EC TRA activities are coordinated with other donors as part of the on-going IF exercise. The TDF is well supported by all stakeholders and any future contributing partners will be encouraged to participate through this structure.</i></p>	<ul style="list-style-type: none"> <li>Uncoordinated donor support;</li> <li>Lack of GoL commitment to reforms;</li> <li>Lack of GoL capacity (staff and resources);</li> </ul>

- Lack of GoL commitment to reforms;

*The Government has shown strong commitment to complete the accession process into the WTO. Trade and private sectors have been included as priority areas in the current NSEDP and it is foreseen that an even stronger emphasis will be made on these sectors in the upcoming 7<sup>th</sup> Plan. Following on the recommendations made in the Diagnostic Trade Integration Study, the GoL has furthermore shown its strong commitment and leadership to implement Aid for Trade activities while following a Sector Wide Approach. In Lao PDR, this is done under the National Integrated Framework Government Structure (NIFGS) (reflecting the WTO IF concept). This lengthy process involved not only the adaptation of the GoL internal structure to incorporate the IF and Trade Development Facility (TDF) structure, but also helped in the establishment of a Sub-working Group on Trade and Private Sector Development to enhance the overall coordination mechanisms and strengthen linkages between the two inter-related sectors*

- Lack of GoL capacity (staff and resources);

*The current relatively low capacity of the Government of Lao PDR to manage TRA was one of the 'raison d'etre' of the TDF, i.e. its specific objective is to support the establishment of the NIFGS through a National Implementation Unit (NIU) (capacity building is one of the main components of the TDF). It is expected that with these structures fully operational the implementation of activities as set out in the IF Action matrix will accelerate and with that, the absorption capacity of the GoL to receive and manage additional 'Aid for Trade' funds will increase. A pre-requisite is the channeling of further future TRTA funds through existing government systems and structures, such as the TDF. A recent result-oriented monitoring report of the TDF showed that there is a very high potential for the TDF to achieve its targeted objectives. TDF has set up systematic knowledge transfer to ensure capacity building within the government to take over the overall management of future TRTA to Laos.*

**Results**

- Reduction of poverty, thanks to enhanced trade performance  
*(no data available, due to insufficient poverty data).*

- Reduced poverty and sustained growth through enhanced trade performance and private sector expansion as results of the reduction of trade barriers and the creation of an enabling business environment as being supported currently under the PRSO
- Lao PDR will participate effectively and become more integrated in regional

- Lao PDR will participate effectively and become more integrated in regional and international trade systems

*Export share to GDP has increased steadily, from an average of 24.6 % of the year 2004-2007 to 30% in 2008. The share is relatively low compared to other countries in the region.*

- Greater capacity for trade policy formulation and implementation, including customs and border measures and trade facilitation and “behind-the-border” regulatory issues

*Reforms of customs and trade facilitation are ongoing.*

- Improved knowledge on the part of Lao officials of the legal and regulatory framework (in particular of customs and SPS issues) and administrative capacity to ensure compliance with WTO requirements

*Since 2002, Lao PDR has adopted and amended 20 laws and 35 decrees/regulations in relation to WTO requirements. In 2009, three SPS related laws were passed. Currently, 18 Laws and decrees are pending.*

- Improved trade facilitation leading to increased import/export flows and control over transit flows;

*Reforms of customs and trade facilitation are ongoing.*

- Revised legal and regulatory framework with better implementation and enforcement;

*Refer to WTO-related legal reforms on SPS, TBT, TF (customs and non-customs clearance) and investment. Implementation and enforcement of these laws is at an early stage. These will become prominent in post-WTO accession after 2011.*

- Stronger negotiating skills on the part of Lao officials;

and international trade systems

- Greater capacity for trade policy formulation and implementation, including customs and border measures and trade facilitation and “behind-the-border” regulatory issues
- Improved knowledge of Lao officials and legal and regulatory framework (in particular of customs and SPS issues) and administrative capacity to ensure compliance with WTO requirements
- Improved trade facilitation leading to increased import/export flows and control over transit flows
- Stronger expertise on the part of Lao officials on subjects and issues covered under comprehensive FTAs, and better understanding of the interests/priorities/consequences /impact of negotiating future FTAs
- Capacity of Lao private sector in particular small and medium enterprise is strengthened to optimise global trade opportunity

*The Lao Business Forum is a main public-private dialogue/consultations platform to ensure the interests of private sector are covered when GoL negotiates trade agreements.*

- Stronger expertise on the part of Lao officials on subjects and issues covered under comprehensive FTAs, and better understanding of the interests/priorities/consequences /impact of negotiating future FTAs.

*(awaiting data from the TDF RFM)*

### **Indicators**

- reduction in the cost and time needed for customs clearance;

*The World Bank's Doing Business report has verified the progress of PRSO's Indicators on "Reduce trade barriers and proceed with implementation of international and regional agreements - Streamlined cross-border procedure" as follows:*

*- Number of days to export and import was reduced from 66, 78 in 2006 to 50, 50 in 2008 with the target of 32, 33 in 2011*

*.- Number of documents to export and import was reduced from 12, 16 in 2006 to 9, 10 in 2008 with the target of 7, 8 in 2011.*

- 2. increase in the value of official trade;

*Total trade value of 2007 was \$ 3,100 million and 2008, \$ 3,750 million.*

- 3. increase in customs revenue;

*WB estimates that customs automation may contribute to the increase of Customs revenue collection on non-petroleum. Figure will be available when the*

- reduction in the cost and time needed for import-export including customs clearance and other related procedures/documents;
- increase in the value of official trade;
- increase in customs revenue;
- Increased number of business operators registered.
- increase in the quality of inputs provided by the Ministry of Commerce in the WTO accession process/AFTA.

*automation is completed by 2012.*

- 4. increase in the number of business operators requesting a licence;

*The data of the Tax Department showed that the Number of businesses registered with tax authority was 47,320 units in 2008 increased from 32,763 in 2007.*

- 5. increase in the quality of inputs provided by the Ministry of Commerce in the WTO accession process/AFTA.

*WTO accession is ongoing. MOC is taking a leading role in the accession process.*

## **ANNEX 5: DESCRIPTION OF THE MTR DOCUMENT DRAFTING PROCESS**

### **Background on consultations:**

Consultations for the Mid Term Review of the country strategy for Lao PDR took place between January and October 2009. A kick-off event was held on 29<sup>th</sup> January 2009 in Vientiane with Government of Laos (GoL), Donors, and Civil Society in order to explain the MTR process and for feedback on new issues and lessons learnt from earlier cooperation. GoL officials were drawn principally from the policy planning and operational departments of the key line ministries, the Department of International Cooperation (DIC) in the Ministry of Planning and Investment, and from the Ministry of Foreign Affairs (MOFA). The donors group comprised all the main bilateral donors (including EU MS) and international organisations active in Laos.

Since civil society is not well developed in Laos and limited to either Mass Organisations or international NGOs (INGOs), the choice of participants was limited. Representatives from 17 organisations participated in the consultations, including 8 INGOs. In addition representatives of the National Assembly were invited.

These consultation meetings were held back-to-back with a presentation of the 2008-09 Country Evaluation of the EUs development cooperation with Laos, which allowed participants to better understand the context in which the MTR was taking place and offered lessons learnt from earlier cooperation. In each meeting the MTR process was presented by RELEX and AIDCO desks, and chaired by the Delegation. The MTR questionnaire was handed out in the civil society meeting to encourage feedback.

Specifically for the EU MS, the MTR process was further explained and discussed at a HOM's meeting held on Friday January 30<sup>th</sup> at which Austria, Belgium, France, Germany, UK, Luxembourg, Sweden, and EU Delegation participated.

The MTR process was also part of the agenda for the Working Group on Trade and Cooperation and the Joint Committee meeting between Laos and the European Commission on 9 March 2009. The final draft MTR document prepared by the Delegation was then again presented to EU Member States resident in Laos on 28 September and to Civil Society representatives on 12 October for their feedback. The comments received throughout the process have been incorporated into the draft document and are summarised as follows:

### **Consultation with Government:**

The meeting on 29 January was co-chaired by the Deputy Director of DIC. DIC noted the importance of improved coordination between Development Partners and the Government and hoped the EU would continue taking an active role in this. DIC considered the MTR process a good participatory initiative and confirmed they would like to maintain the focal sectors. Line ministries were requested to send in written comments to DIC and the EU Delegation. MOFA asked for further elaboration on donor coordination and the EU Code of Conduct and how this might be related to the MTR process. MOFA Director for Europe expressed the view that no major adjustments in the EU's strategy were needed, but noted the new difficult economic situation and hoped that despite this the EU would be able to maintain or increase the country allocation.

In addition, the MTR dialogue with Government was taken further in the Working Group on Cooperation held on the 9<sup>th</sup> March prior to the Joint Committee meeting the same day, and has been reported on in the agreed minutes. Both parties appreciated the concentration on a limited number of cooperation areas and the move towards programmes under the MIP 2007-10, which has strengthened the relationship between Laos and the EU beyond individual projects to a wider and comprehensive partnership based on policy dialogue. This is seen as an avenue to be taken further

### **Consultation with Donors:**

17 donor representatives participated in the meeting on 29 January and made the following key suggestions:

- i) the 2008-09 economic crisis will also affect Laos, and the implications need to be taken into account in the review;
- ii) while recognising the valuable support of EU to PRSO, economic reform and trade, coordination specifically between the areas of Trade and Small and Medium-size Enterprise development should be strengthened;
- iii) closer ties could be developed between EU and other donors in regional cooperation;
- iv) acknowledgment of improved coordination between the Commission and EUMS, such as the monthly cooperation meetings, the EU Delegation's role in the Vientiane Declaration(VD)/Country Action Plan (CAP) and in the Uplands Rural Development Sub-Working Group;
- v) the EU should pursue and deepen its interests in the field of human rights and is perceived as a development partner which "does not only have the competence, but also the courage" to discuss sensitive issues with the Government ;
- vi) the EU will have wider influence if it maintains a mix of instruments in Laos and does not focus exclusively on budget support;
- vii) the Commission has an important role to support NGOs and could lobby GoL to register local NSAs;
- viii) the EU could assist in developing a stronger link between donor strategies and national plans to eradicate drug production and trans-national criminal activities (aligning with GoL's sectoral plans, in this case the Drug Control Master Plan), and strengthening their oversight in HIV/Malaria Global Fund and giving more attention to the legal framework of women's access to the justice system.

In a meeting with EU Development Councillors and Member State agencies (AFD, DED, GTZ, SIDA) on 28 September, the draft MTR document was presented and shared, and participants were invited to submit comments. However, no comments were received ahead of the formal consultation process with MS ahead of the DCI Committee Meeting.

### **Consultation with Civil Society:**

The key points made in the discussion on 29 January were:

- i) Representatives of the National Assembly emphasized the role of civil society and non-state actors for development;
- ii) The specific difficulties of NGOs in Laos, operating under a rather undefined national regulatory framework and with many small and scattered projects and many cross-cutting issues to deal with needs to be recognised. Support to expanding the space for civil society should be an element in the modification of the CSP as well as a wider definition of civil society to embrace rural groups. The EU should lobby for improvements in the new INGO Decree proposed by GOL;
- iii) There is need for longer-term funding to NSA's to encourage programme-based planning also on their side, moving away from short-term funding for relatively small projects;
- iv) Where the EU provides budget support, there should be a role for NSAs to challenge and hold the Government accountable; Civil society should be able to play a watchdog role but in Laos they are not yet given the necessary freedom of expression;
- v) Laos has signed the ASEAN-charter, which makes provisions for establishing Human Rights mechanism (AICHR) in the partner countries and promoting democratic reform – this should be recognised by the EU;
- vi) In a volatile economic environment dominated by the neighbouring countries, particularly China, the Commission should use its leverage to promote responsible development by the new donors and to use its leverage (such as EC support in trade and economy) to counter the lack of transparency in business practices in Laos, especially those involving foreign purchases of land and natural resources;
- viii) The signing of the Oslo Convention on Cluster Munitions removes conditions expressed by some donors on UXO clearance and victim assistance – the EU should provide assistance on a larger scale now ,

These issues raised at the beginning of the MTR process were reviewed again, together with an outline of the draft MTR document in a meeting with selected NGO partners on 12 October in which three national and 18 international organisations were represented. Participants confirmed the strategic approach chosen by the EU for MIP 2011-13 but raised three important points with implications beyond the scope of the country programme:

- With an increasing move towards coordinated programmes and sector-wide approaches, how can the contributions of NGOs be integrated? Financing instruments for NGOs have usually a limited thematic and geographic focus, and project durations are usually short. This does not allow for significant contributions to sector dialogue and sector programmes.
- The competitive selection process in Calls for Proposals makes it difficult for NGOs to enter into a longer-term policy dialogue and joint programming with the EU. It is unclear for many NGOs to which extent their activities are part of the country strategy and how they can actively contribute to this strategy.
- The hurdles for local organisations in participating in competitive Calls for Proposals of the EU are perceived as very high in a country like Laos. There is a language barrier, and the EU should think about publishing Calls also in Lao. More generally, the EU should think about funding windows specifically for small local NGOs.

## ANNEX 6: BUDGET SUPPORT IN LAO PDR

General budget support is the selected aid modality to implement the focal area of the EU Strategy Paper 2007-2013 for Lao PDR and of the 2007-2010 Multi-Annual Indicative Programme (MIP), namely "Support to the Government of Lao PDR's reform agenda". Within that framework the EU started providing general budget support to the Government of Lao PDR by supporting the implementation of the Third Poverty Reduction Support Operation (PRSO-3) with a single fixed tranche. A second budget support operation for four years (PRSO 4-7) was approved by the end of 2008. The EU introduced in this programme performance indicators as a basis of disbursement of an annual variable tranche for PRSO-5, 6 and 7.

### 1. The PRSO mechanism in Lao PDR

The Government of the Lao People's Democratic Republic (GoL) has been receiving support for the implementation of its Development Strategy through the PRSO since 2004. This programme emerged in Lao PDR with the aim to ensure that Government would undertake key reforms to ensure the Nam Theun 2 (NT2) hydroelectricity project revenues are used to support the Government's priority poverty reduction programmes. The purpose of the programme is to introduce key reforms in the public sphere to sustain growth, ensure efficient management of public sector resources and create the conditions to increase social service delivery with a view of reducing poverty.

PRSO is the only general and non-targeted budget support currently operational in the country that has been useful in promoting key public sector reforms and inter-sectoral dialogue. PRSOs are annualised operations within the framework of a multiyear programme. The PRSO annual policy matrix contains the list of actions to be achieved for each priority area jointly agreed by the Government and PRSO co-financiers: World Bank (WB), Australia, Japan (funds not committed yet) and EC.

**Table 1 - Snapshot of donor financial support to the PRSO (in million EUR)**

	PRSO3	PRSO4	PRSO5	PRSO6	PRSO7
<b>World Bank</b>	7.5 (disbursed)	7.5 (disbursed)	13.6 (approved)		
<b>Japan</b>	3.3 (disbursed)				
<b>EC</b>	3 (disbursed)	3 (approved)	3 (committed)	3 (committed)	3 (committed)
<b>Australia</b>	NA	1.5 (disbursed)	1.5 (committed)	1.5 (committed)	1.5 (committed)

During implementation of the PRSO, the main focus of attention concerning the policy matrix is at 'activity' level: an annual progress review of the implementation of prior policy actions so called "triggers" precedes and determines individual disbursement decisions by each contributing donor. The policy matrix however also contains a set of expected 'reform programme outcomes' and indicators (with baselines and targets) aimed at monitoring the progress made towards achieving the outcomes at the end of the series which the PRSO is intended to support.

**PRSO1 to 3** was the first programmatic series of support which ran for three years (from 2004 to 2007) with the focus in three areas: i) **Public resource management** (strengthening public expenditure management, the banking sector, improving the performance of state-owned enterprises and promoting the financial sustainability of utilities); ii) **Public expenditure policies** (aligning spending with pro-poor NGPES priorities, and monitoring this expenditure); and iii) **Sustainable growth** (strengthening private sector development, accelerating regional and global integration, and improving resource management).

**PRSO4 to 7** started in July 2007 (and is expected to end in 2011) as a second series of four years. It is currently half-way in its implementation: PRSO-4 was completed in April 2008 and PRSO-5 implementation finished end of April 2009. Aligned with the Sixth 2006-2010 National Socio-Economic Development Plan (NSEDP), PRSO 4-7 focuses on two components: i) Investment climate, competitiveness and business development and ii) Public finance and improving service delivery (health and education).

The main achievements of the Lao Government during the implementation of PRSO-4 included:

- (i) Maintaining macroeconomic stability in a context of rising oil and food prices and achieving a strong economic growth of 7% in 2008 by attracting important foreign direct investments in the hydropower and mining sectors. This resulted in increased revenue collection and external reserves.
- (ii) Improving the business climate: reforms undertaken included the simplification of the business registration by approving a clear negative list of a limited number of activities requiring the registration with the relevant line ministry.
- (iii) Progressing in the implementation of the 2007 Budget Law by strengthening the inter-governmental fiscal relations and strengthening the central control over revenues which represents an important improvement of the Public Finance Management reform.

## **2. EU participation in the PRSO**

The first support for a one year programme was approved by the EU in September 2007. It included a EUR 3 million tranche disbursed in 2008 against satisfactory progress in implementing PRSO-3 reforms and the fulfilment of the three general conditions: progress in implementing the NSEDP, progress in strengthening the PFM and macroeconomic stability. PRSO-3 progress and conditions were assessed jointly by the EC and other PRSO donors during an appraisal mission.

The full and fast completion of the eleven triggers (or key policy actions) and twenty five policy actions under PRSO 3 (included in the agreed PRSO matrix) and the request of the Government to continue with a new PRSO series demonstrated the increasing commitment of the Government to implement difficult structural reforms in a broad range of areas such as the approval of a revised budget law, a new chart of accounts, regular monitoring of State Owned Banks and State Owned Enterprises through audits and the diminution of the arrears in the payment of salaries to teachers and health workers. The success of this PRSO can be attributed to government's ownership in the reform and the frequent inter-ministerial coordination meetings within the PRSO team and its secretariat.

Encouraged by those achievements, the EU approved in 2008 EUR 13 million of four-year support to the PRSO 4-7 including 12 million for transfers to the Lao Treasury upon fulfilment of the conditions, additional capacity development support to strengthening the capacities of Government

to move towards comprehensive sector strategies for a total amount of EUR 0,8 million and EUR 0,2 million for monitoring and evaluation.

In addition to the fixed tranche, related to the conditions mentioned above, this support introduced the results based approach through a variable tranche in order to increase the focus in the social sectors. The disbursement of a variable tranche of EUR 1 million per year during three years of the programme is subject to the achievement of the agreed targets of the indicators that measure progress in health and education. A set of six indicators in the social sectors was agreed with the Government: three in the education and three in the health sector as presented in the table 2 below.

**Table 2 – Performance indicators of EC's Second General Budget Support**

	Indicators	Baseline	Target by March 2009 (end of PRSO 5)	Target by March 2010 (end of PRSO 6)	Target by March 2011 (end of PRSO 7)
<b>EDUCATION SECTOR (Weight 0.5)</b>					
1	MOE adopts and implements an Education Sector Development Framework	Formulation and development of ESDF draft to be completed by November 2008	MOE adopts Education Sector Development Framework	MOE implements the Education Sector Development Framework	MOE implements Education Sector Development Framework
2	Recurrent education budget as % of total budget (domestic, allocation)	14.1% in FY 2007/08	Education share in FY 2008/09 at least equal to the baseline	Education share in FY 2009/10 increases from the previous year in line with ESDF targets	Education share in FY 2010/11 increases from the previous year in line with ESDF targets
3	Share of total primary enrolment in the poorest 47 districts	28.4% share for academic year 2006/07 (2007/08 figure to be confirmed by MOE for the baseline)	Share at least equal to the baseline for academic year 2008/09	Share in academic year 2009/10 increases from the previous year in line with ESDF targets	Share in academic year 2010/11 increases from previous year in line with ESDF targets
<b>HEALTH SECTOR (Weight 0.5)</b>					
4	Government adopts and implements a Health Financing Strategy			Government Adopts a Health Financing Strategy	MoH initiates implementation of the approved Health Financing Strategy based on agreed plan

	Indicators	Baseline	Target by March 2009 (end of PRSO 5)	Target by March 2010 (end of PRSO 6)	Target by March 2011 (end of PRSO 7)
5	Recurrent health budget as % of total budget (domestic, allocation)	3.9% in FY 2007/08	Share in FY 2008/09 at least equal to the baseline	Share in FY 2009/10 increases from the previous year not less than percentage increase in overall Government recurrent budget allocation	Share in FY 2010/11 increases from previous year in line with HFS targets
6	Number of health personnel in 47 priority districts	1644 in 2007	Number in 2008 at least equal to the baseline	Number in 2009 increases from previous year	Number in 2010 increases from previous year in line with HFS targets

The agreed performance indicators aim to encourage: i) pro-poor sector public financial management and resource alignment, ii) pro-poor health and education access strategies and iii) poverty focused sector development strategies and partnerships. The successful achievement of the yearly targets for each indicator will allow the EU to disburse a variable tranche of EUR 1 million.

Intense discussions were held around the variable tranche indicators in health and education during the joint PRSO-5 appraisal mission in April 2009. Their preliminary assessment indicated that two of the targets on budget allocations are not met. More up-dated data is being consolidated by the government to finalise the assessment and the forecast for the disbursement of the second tranche is being postponed to 2010.

The preliminary results of the first assessment of the performance indicators revealed a lack of full understanding by the GOL of the EU's results-oriented approach, despite intensified communication efforts by the Delegation. This indicates that the dialogue needs to be even more intensive and sector-specific and cannot be covered from within the PRSO framework only.

### 3. The evolution of the GBS eligibility criteria

A brief review of the progress regarding the three eligibility criteria for EU budget support is presented below.

#### 3.1 Macroeconomic stability

The Lao economy has been stable and has been benefiting from a strong macroeconomic performance. Growth has been high (7,5 percent of GDP growth in 2007) and boosted mainly by the rapid expansion of the mining and hydropower sectors thanks to the attraction of important foreign direct investments but also by the dynamism of the tourism sector. This resulted in increased revenue collection and external reserves. Maintaining macroeconomic stability in a context of rising oil and food prices during 2008 was a challenge.

In the context of global economic slowdown, macroeconomic monitoring intensified during the first half of 2009 throughout the PRSO general budget support review mission. As the Lao government started experiencing the effects of the global economic crisis with a decrease in revenue collection, it was urgent for the PRSO co-financiers (World Bank, Japan, Australia and EC) to discuss the measures the government is taking to ensure macroeconomic stability. Government commitments

towards macroeconomic stability are summarised in the PRSO-5 letter of development of July 2009 as follows:

- i) maintain the budget deficit at 4.5 percent of GDP in FY2008/09 and phase out any further quasi-fiscal activities by end 2009,
- ii) maintaining fiscal sustainability of our expenditure programme and thus formulating the FY2009/10 budget towards targeting the total deficit of not more than 4.5 percent of GDP (in Lao PDR Government's classification) with no additional off budget activities,
- iii) tightening monetary policy and significantly slowing the growth of bank credit in 2009 to a level consistent with macroeconomic stability
- iv) coordinating fiscal and monetary policy to maintain macroeconomic stability and sustainability (including by establishing a task force), and
- v) ensuring that budget allocations to social sectors are adequate for meeting the Government's sectoral policy objectives.

### *3.2 PFM reform*

Complementary to the general budget support, the EU is supporting the Public Finance Management reform with EUR 3 million managed by the World Bank in a multi donor trust fund that also receives funds from Australia, Sweden and Switzerland. The Government has been implementing a PFM reform programme since November 2005. Two critical components of this programme are: the capacity building activities and the reforms in the central-local relationship. This complementary action is critical to ensure one of the three eligibility criteria for EU's General Budget Support is fulfilled.

Lao PDR has made satisfactory progress in the implementation of the Public Finance Management reform in the last couple of years. The main achievement in 2008 consisted in the increased control over revenues by the central authorities by strengthening the central treasury, effectively centralising tax and customs functions and development of a new revenue sharing formula. In addition, inter-ministerial work has been intense to implement the revised chart of accounts and the new budget nomenclature with focus on piloting it in the education sector. Efforts are also being made to improve the accounting, treasury, customs and debt information systems.

### *3.3 Progress in implementing a national development strategy*

Finally, the implementation of a well defined national development strategy, i.e. the 2006-2010 National Socio-Economic Development Plan (NSED) has been satisfactory, on the basis of the 2008 and 2009 reports on the Round Table Implementation Meeting (RTIM). The report reviews the third year of implementation of the NSED and highlights the progress achieved by the Government in implementing Government policies and sector programmes.

The NSED implementation has supported the achievement of five MDGs targets. However, maternal mortality and child malnutrition remain high, according to the draft MDG report used for the preparation of the report. Despite the increase in the GDP per capita, the resources to the education, but particularly, to the health sector remain insufficient. The government reasserts the importance of these two sectors and the efforts to prepare the Education Sector Development Framework are a good indication of the commitment.

## ANNEX 7: OVERVIEW OF TRADE

### Lao PDR's trade with the world and the EU

TRADE FLOWS	€million			
	2005	2006	2007	2008
<b>Lao PDR-World</b>				
Exports	557	908	944	1,110
Imports	1,022	1,316	1,532	1,916
Balance	-465	-408	-588	-806
<b>Lao PDR- EU</b>				
Exports	110	95	118	124
Imports	42	31	61	71
Balance	68	64	57	53

Source: DG TRADE, 22 September 2009

<http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/statistics/>

### Main destinations for Lao PDR's exports in 2008

Destinations	Value (€million)	Share (%)
Thailand	386.7	35
Vietnam	146.7	13.3
EU 27	122.5	11.1
China	95.5	8.6
South Korea	49.6	4.5
Others	303	27.4
<b>World</b>	<b>1,104</b>	<b>100 0</b>

Source: DG TRADE, 22 September 2009

## ANNEX 8: COUNTRY ENVIRONMENT PROFILE<sup>4</sup>

### 1. Summary

Environmental issues are at the centre of the welfare of over 80% of the population in Lao PDR. For many rural communities, current negative environmental trends directly threaten their livelihoods and welfare. And Lao PDR has signed Multilateral Environmental Agreements. The following issues are identified as serious environmental concerns and pose a threat to biodiversity, enhancing in turn the vulnerability of rural poor:

- Illegal logging and deforestation;
- Loss of watershed function in logged upland areas;
- Land degradation and loss of habitats through unsustainable agricultural practices;
- Unsustainable extraction of wildlife and other Non-Timber Forest Products (NTFP) either for food or for sale;
- Illegal trade in wildlife and protected species;
- Socio-environmental impacts of large-scale hydropower, mining, and commercial agriculture, particularly large scale plantations; Increased urban and industrial pollution, in turn posing public health threats.

Despite the existence of legislative and other administrative frameworks that aim to govern the exploitation of natural resources and environmental management, weaknesses remain in regulatory and enforcement capacity to support the control of natural resources exploitation. The Water Resources and Environment Administration (WREA) was created in 2007. It is made of six departments and functions under the auspices of the Prime Minister's Office. In general, there is a lack of coordination on environmental conservation and management issues at central government level coupled with very weak enforcement of existing environmental laws: at least six major Plans, Regulations or Actions are in force at present.

WREA has updated and or is reviewing most of the environmental regulations. For example, the old decree on environmental impact assessment has been updated and approved on 16<sup>th</sup> February 2010 (Decree PM 112). Consequently the 2000 regulation on environmental assessment in Lao PDR is being revised. Both the water and water resource law of 1996 and the environmental protection law of 1999 are also under revision. The mining law of 1997 has been replaced by the new minerals law of 2009 and the regulations on environmental protection in mining dated 2004 is being updated to bring it in line with the new minerals law. In addition, the electricity law of 1997 which concerns power generation and transmission has been revised and was approved in 2008. There are proposals underway for the preparation of pollution control regulation and watershed management. Two laws which remain to be modernised are the land law dated 1997 (so important for land use in view of the commercialisation of agriculture) and regulations on the management of the national biodiversity conservation areas. In the case of the latter, there are proposals to update this for it to become a Prime Minister's decree. In addition to these, the forestry law of 1996 has also been amended in 2007. Details of these amendments are available under relevant Government websites.

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<sup>4</sup> Sources: *Country Environmental Profile Lao PDR*, AGRIFOR Consult, June 2005. ; *Environmental evaluation for the Northern Uplands Core Coherent Programme*, Transtec, 2009, Contribution to the Feasibility and Design Study; *Lao PDR National Socio-Economic Development Plan (2006-2010)*, Committee for Planning and Investment.; *Hydro Nepal*, issue # 4,

## 2. State of the environment

Lao PDR occupies a land area of 231,000 km<sup>2</sup> within the geographically distinct Mekong Basin. It shares riparian interests with China, Myanmar, Thailand, Cambodia and Vietnam. The country lies mainly on the eastern (left) bank of the Mekong, with a small area in the north-west on the right bank. The population, which is mostly rural, is estimated at around 6.3 million in 2008.<sup>5</sup>

The small population and relatively difficult access to natural resources (due to the largely mountainous terrain and poor infrastructures) has resulted in relatively modest resources extraction until the late 1990's. However, whilst natural resource utilisation was in the past almost exclusively an essentially locally-based subsistence activity, this has changed dramatically in recent years, with the development of large-scale organised depletions on natural resources, with insufficient regard to the core issue of their environmental sustainability. Although the legislative framework on which environmental management should be based exists, the effective management of natural resources utilisation and pollution control is complicated by a number of challenges:

- Lack of capacity and resources;
- Dilution of responsibilities amongst various GoL agencies,
- Weak, diluted, and sometimes contradictory enforcement and compliance with the rules and environmental standards;
- Lack of clear standards, targets and compliance levels that hamper environmental protection;
- Weak human resources capacity at local levels
- Extension of cultivated areas without prior assessment of impact on the environment, and generally lack of sound land planning and utilisation mechanisms.

The National Growth and Poverty Eradication Strategy (NGPES) adopted in 2003 states clearly: "The socio-economic development of the country must be balanced between economic growth, socio-cultural development and environmental preservation. These are the three pillars of the Lao PDR's development policy." However, IUCN, WCS and WWF<sup>6</sup> published jointly in 2007 a very alarming "Consuming the Future – The real status of biodiversity in Lao PDR" where unregulated access to natural resources and insatiable demand were pointed as the main cause of environment degradation.

### Forestry

Lao PDR is fairly well endowed with valuable, productive and ecologically unique forest in comparison with its neighbouring countries. Eighty percent of the population relies heavily on the forest for timber and non-timber products for food, fuel, medicines, income sources and spiritual protection. The forest cover has decreased from 47% to only 34% in the past fifteen years, despite an official ban on the removal of timber. The main causes of deforestation are forest clearing for agricultural purposes and large-scale illegal (and legal) logging. Forest change, including decreases in stocking and size of trees, loss of wildlife and plant habitats, is also a serious problem. Recognising that forest resources were depleting at an alarming rate, the Government of Lao PDR

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<sup>5</sup> Lao National Census, 2005

<sup>6</sup> International Union for the Conservation of Nature (IUCN), Wildlife Conservation Society (WCS) and World Wildlife Fund (WWF)

has set development targets for 2005, 2010 and 2020. These targets included stabilising shifting cultivation by 2005 and phasing it out completely by 2010. Tree plantations for commodity production are to be strongly promoted, and acceleration of classification, delineation and management of forests for protection, conservation and production was also called for.

Significant areas of upland are being converted to commercial plantations, often rubber, under the Government policy of converting land to capital. Land is awarded by the provincial authorities as long lease concessions to private companies (mostly Chinese and Vietnamese). The companies prefer forested concessions as these give an instant revenue from logging. In any event there is serious loss of biodiversity, NTFP, and negative social consequences for the communities affected who may become transformed from peasant farmers to plantation labourers. The most common complaint to the National assembly in the last sitting concerned land concessions.

### **Biodiversity and Protected Areas**

The natural biodiversity remains extremely high throughout the country. A total of 319 of the animal species recorded for Lao PDR are of national or global conservation significance, specifically 67 percent of large mammals, 53 percent of bats, 6 percent of insectivores, 14 percent of rodents, 22 percent of birds, 25 percent of reptiles and 2 percent of amphibians. The real pressure on biodiversity in Lao PDR arises from illegal trading of plants and wildlife and loss of habitat. Effective control of the present illegal trading pathways and their replacement by officially endorsed and correctly managed domestic pathways is necessary. In addition, Foreign Direct Investment, in the form of contract farming or concessions, affects the agro-ecology systems by imposing mono cropping in the landscape. Monoculture reduces agro-biodiversity as well as ecological diversity. The uniformity of the vegetation increases the risk for pest and disease outbreaks. Furthermore, monoculture on sloping lands enhances soil erosion and degradation.

Since 1993, 20 National Protected Areas (NPAs) and two protected corridors have been created, covering about 23% of the country surface area according to the World Bank. These include Provincial PAs, District PAs, Protected Watershed Areas and Provincial Conservation Forests. The joint IUCN-WCS-WWF paper though, shows that even PAs see a decline in biodiversity.

### **Vulnerability to disasters**

Floods and droughts are major natural disasters. Flood flows in the Mekong have relatively low variability compared to most Asian rivers of comparable size. There are exceptional floods such as that of August 2008. Flood peaks tend to occur in August in the upper Mekong and September in the lower basin. Possibly linked to climate change, the size and seasonality of the floods are becoming increasingly unpredictable. The main cause of flood flows is prolonged heavy rain on saturated soils. The four major flood-prone areas are the Vientiane Plain, Khammoune Province (Thakhek town), Savannakhet Province and Champasak Province (Pakxe town). With increasing populations living close to main rivers, the risks to life and property from flooding are increasing. To some extent this may be mitigated by the development of new water control infrastructure in the power and irrigation sectors, but this itself brings additional problems – for example the consequential loss of an essential component (fish) in the diet. Droughts tend to occur in the northern region.

## **Agriculture**

Agriculture is a crucial economic sector in Lao PDR where about 80% of the population is concerned. Major impacts on natural resources and the environment arise from agricultural practices, particularly in the highland areas where the environment, if richer in many ways, is also more fragile. These areas are characterised by unfertile soils that are particularly difficult to access. Communities living in these areas have been practicing shifting cultivation and swidden agriculture (slash and burn) in order to increase soil fertility and sustain minimum agricultural outputs. These practices are sustainable only when sufficient time (fallow period) is allowed for regeneration in the areas which are not exploited anymore. Increasing population pressure in the highlands has forced established swidden farmers to migrate to steeper terrain and to increase the intensity of cultivation. This has resulted in deforestation, land degradation and loss of habitats. Other impacts from agricultural activities come from the use of chemicals (pesticides, fertilisers, weed control, etc). Although these are relatively little used, there are increasingly becoming a problem both in terms of human health and damage to the environment, because of improper handling and the use of banned chemicals. A recent phenomenon which is having far reaching social and environmental effects is the rapid rise in large scale commercial plantation agriculture, which sometimes takes place with the primary objective of a windfall gain from the sale of the cleared timber.

## **Land degradation**

Excessive land clearance on sloping ground due to deforestation and large-scale hydropower development has increased soil erosion and sediment transport in some tributaries of the Mekong. Deposit of sediments in lowland areas increases the threat of localised flash flooding and consequently damages lowland agricultural activities and river fisheries. The recent development of mining activities for gold and toxic metals such as copper and zinc has resulted in huge quantities of potentially toxic wastes being inappropriately disposed of. This has brought a high risk of toxic leachate draining to ground and surface waters and contaminating soils, including in Vientiane. Excessive irrigation in the dry season and irrigation with poor drainage can, in combination with certain soil and water conditions, cause salinity problems. Salt can accumulate in the subsoil and at the surface and cause immediate damage to agriculture and fish production and productivity, as well as long-term soil deterioration.

## **Water resources and water pollution**

The Mekong river runs the length of Laos and represents a vital ecosystem to the country in terms of water resources, fisheries and transport systems, not to mention the potential for hydro-power and irrigation. Oversight for management and development of the river basin is vested in the Mekong River Commission (MRC). The MRC is faced with many development challenges such as mainstream dams, flooding and flood management, river water quality and pollution, conservation of fish stocks and biodiversity. To put this resource in context, the entire basin contributes 2.5% of global fish catch worth billions of dollars per annum and provides a livelihood for millions of people.

The total renewable supply of fresh water in the country is estimated at 54,000 m<sup>3</sup> per person per year, compared with an estimated per capita demand of 228 m<sup>3</sup>/year. Most of the water

consumption occurs in the agricultural sector. Water availability is not a limiting factor of development in Lao PDR.

Only 60% of urban populations receive a direct domestic water supply. Water for domestic use (but not for drinking) is commonly obtained from shallow wells or surface streams. Only about 51% of rural households have direct access to good-quality water supplies, but in fact only about half of these systems actually function, due to poorly selected technologies and a lack of spare parts to maintain them. Inadequate hygiene and sanitation results in contamination of good-quality water and leads to significant morbidity and mortality from water-borne and water-related bacterial, viral and parasitic infections. Monitoring of the incidence of these diseases is poor, and this sector is in urgent need of support and improvement. In rural areas, sanitation is generally non-existent. Rural sanitation schemes suffer from poor planning, unreliable water supplies, and socially inappropriate design and location.

Although water quality in the Mekong basin is generally satisfactory, increasing pressures on surface water quality are developing due to agricultural activities (pollution by livestock waste, inappropriate use of chemicals), and increasing contamination from garbage and other anthropogenic wastes. Water contamination with arsenic and other chemicals is a rising concern in Lao PDR.

### **Urban environment**

With its large and rapidly expanding population (+ 700,000 inhabitants), Vientiane is the only large urban conglomeration in Lao PDR. Large numbers of workers have moved into the town in recent years, and the slow progress of road reconstruction has failed to prevent localised traffic congestion at peak traffic periods. The most prominent environmental issues are the lack of appropriate sewerage and waste disposal systems and traffic issues such as noise and air quality. The former is under review and upgrading, whilst the latter is not yet so severe that it represents an environmental problem although a bypass road on the Mekong River is currently under construction in the capital city. No detailed data on air quality are available.

### **Energy and mine production**

Lao PDR has a great potential for hydropower development. Actual implementation has been sporadic and hampered by well-founded environmental and social concerns. The theoretical potential in Lao PDR is estimated at about 26 000 MW while the current exploitation rate is of 3%. The electricity sector is the third largest export earner for the country Laos has 10 operating hydropower plants with installed capacity of about 678 MW. Another 9 projects have been granted concession agreements or are under construction (including NT2) and a further 17 projects have development agreements approved. The remaining 42 have signed MOUs. If all 78 projects go ahead they will have an installed capacity of 23,000 MW. The Hongsa Lignite-Fired Power Project which would present some serious environmental issues is currently on hold pending availability of funding.

Hydropower, although widely promoted as an “environmentally friendly” form of power generation, has had severe socio-environmental impacts in Lao PDR especially with regard to fisheries (disturbance of natural occurrence of fish in the Mekong River), fragmentation of habitats, methane emissions and pre-emptive logging. Hydropower activities also alienate farmers from

production area and increase pressure on land. Often it wipes out fertile land fit for paddy rice cultivation. Flooding of the reservoir changes the ecology of the area and affects biodiversity while it also provides income to the country and work and income to the rural people. The reservoir also provides a potential for irrigation to agricultural lands and for village water supply.

There exist tin, copper and gold mining activities, and massive bauxite potential on the Boloven Plateau, as well as coal extraction to a lesser extent, all with potential adverse effects on agriculture and more generally on environment, if mitigation measures are not implemented and standards followed: open pit exploitation leads to erosion and siltation, loss of vegetation, habitat and biodiversity. The ongoing and likely increase in ore processing waste can pollute soil, rivers, ground water as well as air with hazardous chemicals. Health and livelihoods hazard for populations located downstream from the mining activity exist.

## Annex 9: Impact of the Global Financial Crisis on Lao PDR

Until 2008, the economic liberalisation policy of the GoL over the past 10 years had translated into a stable macroeconomy with a controlled fiscal deficit, low inflation, increasing international reserves and average annual real growth rate of 6%. In 2008, this rate was at 7.9%, just before the global financial crisis unfolded. Average per capita income has risen from US\$ 594 in 2006 to about US\$ 859 by 2008<sup>7</sup>. The nature of the economy – largely agrarian - and lack of exposure to global financial markets helped spare the country from the worst brunt of the 2008 banking crisis.

However, there is mounting evidence that the economic crisis has had an impact on Foreign Direct Investments in Laos which was expected to fall by 30% in 2009. This has repercussions on forecasted growth rates which are expected to drop from 7% in 2008 to around 5% this year (WB estimates). However, Laos appears to be the only country in the Southeast Asia region with positive growth, and the projected growth rate is among the highest worldwide at the moment. Commodity export prices – particularly for copper – have dropped sharply immediately after the crisis unfolded, and although prices have recovered there is still a high element of volatility. This has hit GOL revenue collection and will materialise in a widening budget deficit (estimated at about US\$ 383 million in FY 2008/09) making it more difficult to meet the targets foreseen in the NSEDP.

There is concern that the social sectors may see a drop in their budget allocations making it more difficult to achieve the MDGs. For the time being, the GOL has not cut expenditures for FY2008/09 but decided to increase the fiscal deficit. In the future some prioritisation of expenditures might have to be considered, as announced to development partners by the Ministry of Planning and Investment in a briefing in September 2009. However, health and education will remain to be priority sectors according to the GOL. Within the current formulation of its new 7<sup>th</sup> NSEDP, the crisis is bringing more emphasis on some priorities: focus on a diversification of the economy through the development of the non-resource sector, diversification of agricultural production and also better exploitation of the high price potential of "green agriculture", and better access to markets for producers by forming producer associations.

To mitigate the effects of the economic slowdown, there has also been an expansionary monetary policy with rapid and very high credit growth (reaching 85% in June 2009), including some off-budget activities. This has raised concerns on the sustainability of the financial sector with the risk of non-performing loans. However, the Government has ensured development partners in the briefing meeting of September 2009 that the credit growth will be controlled and that more timely information will be provided on the financial sector situation.

Although limited data is available, according to the WB the socio-economic impacts of the crisis are likely to be:

- higher unemployment particularly among the workers in Thailand representing 10% of active population, and to a lower extent in the domestic manufacturing sector (which employs only 2% of the active population);
- lower earnings particularly in the rural areas where 25% of the poor have reported cash wage reductions and 12% of households do not have access to land for cultivation;
- lower foreign remittances, particularly important from Lao migrants in Thailand;

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<sup>7</sup> World Bank estimates

- possible social sector spending cuts, particularly in investments, and a continuation of reliance on patient/parents contributions to finance operational costs in health and education, posing a risk of even lower utilization of health and education services as household incomes decrease;
- in a context of limited social protection systems in the country, household coping strategies could include: sale of livestock, increased child labour or sex work, and (re-) migration to rural areas increasing pressure on land use and natural resources.

ANNEX 10: MAP OF LAO PDR

