

LAO PDR – EUROPEAN COMMUNITY

STRATEGY PAPER

FOR THE PERIOD 2007-2013

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Acronyms and Abbreviations

ACMECS	Ayeyawady-Chao Praya-Mekong Economic Cooperation Strategy
ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
ARF	ASEAN Regional Forum
ASEAN	Association of South-East Asian Nations
ASEM	Asia-Europe Meeting
ATS	Amphetamine-Type Stimulants
CDB	The Convention on Biological Diversity
CEPT	Common Effective Preferential Tariff
CPI	Committee for Planning and Investment
DIC	Department of International Cooperation
DIPECHO	Disaster Preparedness European Commission Humanitarian Office
EBA	Everything-But-Arms
ECHO	European Commission Humanitarian Office
EIB	European Investment Bank
FAO	Food and Agriculture Organization
FLEGT	Forest Law Enforcement Governance and Trade
FORCOM	Forest Management and Community Support Project
GDP	Gross Domestic Product
GFIS	Government Financial Information System
GFS	Government Finance Statistics
GFTAM	Global Fund for Tuberculosis, AIDS and Malaria
GoL	Government of Lao PDR
GSP	Generalised System of Preferences
HDI	Human Development Index
ICC	International Criminal Court
ICCPR	International Covenant on Civil and Political Rights
ICESCR	International Covenant on Economic, Social and Cultural Rights
JHA	Justice and Home Affairs
LPRP	Lao People's Revolutionary Party
LRRD	Link Relief to Rehabilitation and Development
MAF	Ministry of Agriculture and Forestry

MCTPC	Ministry of Communication, Transport and Post and Construction
MDGs	Millennium Development Goals
MRC	Mekong River Commission
NEC	National Environment Committee
NEM	New Economic Mechanism
NGPES	National Growth and Poverty Eradication Strategy
NGO	Non-Governmental Organisation
NPEP	National Poverty Eradication Programme
NSEDP	National Socio-Economic Development Plans
NT II	Nam Theun II
ODA	Official Development Assistance
OPEC	Organization of the Petroleum Exporting Countries
PEFA	Public Expenditure and Financial Accountability (Assessment)
PEMSP	Public Expenditure Management Strengthening Programme
PER	Public Expenditure Review
PRONAM	Provincial Natural Resources Management
PRSO	Poverty Reduction Support Operation
PRSP	Poverty Reduction Strategy Paper
PSIA	Poverty Social Impact Assessment
SCB	State Commercial Bank
SIDA	Swedish International Development Cooperation Agency
SME	Small and Medium-sized Enterprise
SOE	State-Owned Enterprise
SPS	Sanitary and Phytosanitary (Measures)
SWAP	Sector-Wide Approach
TRA	Trade-Related Assistance
TREATI	Trans-Regional EU-ASEAN Trade Initiative
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFPA	United Nations Population Fund
UNICEF	United Nations Children's Fund
UNIDO	United Nations Industrial Development Organization
UXO	Unexploded Ordnance

EXECUTIVE SUMMARY

The Lao PDR-EC Country Strategy in Lao PDR for the period 2007-2013 will be geared to the development policy of the European Commission (see Annex 6). The 'added value' of EC assistance will be maximised through concentration of activities, promotion of ownership by government and co-ordination with Member States and other donors. To achieve these goals budget support will be introduced and traditional stand-alone project development will be phased out.

Lao PDR has been successful in maintaining **rates of economic growth of 5-8% per annum** in recent years. This performance is, however, unlikely to continue without further reforms in government policy. The major development challenges in Lao PDR at present are:

- (a) to ensure that government revenues continue to grow and are directed towards poverty reduction;
- (b) to continue to attract foreign investment and encourage the local private sector by further market liberalisation;
- (c) to diversify export products and markets; and
- (d) to broaden the narrow base of economic growth, which currently is centred on relatively few sectors and towns.

The EC's financial contribution should concentrate on a strictly limited number of initiatives in order to prevent assistance being spread too thinly. Thus, structural reforms, policy dialogue and aid effectiveness, in line with the Paris Declaration of March 2005, are placed at the centre of the strategy. The Government has produced its own version of the Paris Declaration on Aid Effectiveness which most donors signed at the triennial Round Table Meeting on 28-29th November 2006. The SP is fully aligned with the National Development Strategy of the Government of Lao PDR ensuring consistent support for the Government's efforts to attain the Millennium Development Goals.

The focal area of the EC Country Strategy for the period 2007-2013 will be **support for the Government's reform agenda under the National Development Strategy**. This will receive 58% of the budgeted allocation.

The non-focal actions comprise three sectors:

- a. **Support for sustainable development in the uplands and policy dialogue on relocation.** (24% of the budgeted allocation)
- b. **Governance and human rights.** (5% of the budgeted allocation)
- c. **Support for trade and economic cooperation.** (13% of the budgeted allocation)

Further assistance will be provided under thematic and Asia-wide budget lines. Humanitarian aid will be delivered if required and ECHO's natural disasters preparedness and mitigation programme, DIPECHO, will continue. The cross-cutting issues of environmental protection and sustainable development, good governance, HIV/AIDS and a gender-sensitive approach will be mainstreamed into all cooperation activities. Activities carried out in the field of higher education will be financed within the context of the regional programming for Asia

1. POLITICAL, ECONOMIC, SOCIAL AND ENVIRONMENTAL SITUATION

Lao PDR is a low-income country with a population of 5.8 million people and an average income of 456 USD per capita in 2005. It ranks the lowest of the South-East Asian and Pacific countries in terms of the UN Human Development Index (131st out of 177 countries in 2005). **The population of the country is very diverse**, with 49 different ethnic groups, and poverty reduction remains the main challenge particularly in rural and inaccessible, mountainous areas where ethnic minorities are concentrated. Lao PDR is highly dependent on development aid, with **ODA funds making up more than half of the state budget**.

1.1 Political situation

Lao PDR has remained a stable one-party state since 1975, when the Lao People's Revolutionary Party (LPRP) became the only legal political party. The Lao People's Revolutionary Party continues to be the pre-eminent political institution. The political system is headed by the State President and the Politburo.¹ Members of the Politburo are elected by the Central Committee of the Party (currently 55 members) at the Party Congress. Six out of the 11 members of the Politburo elected in 2006 are current or former members of the army. The Politburo also includes the President of the National Assembly.

The National Assembly elects the President, appoints the Prime Minister on the basis of the recommendation of the President as well as cabinet members on proposal of the prime minister.

The most recent national elections for membership of the National Assembly took place on 30 April 2006. Normally candidates have to be Party members in order to stand for election, but some candidates are independent. The legislature normally enjoys a term of five years but elections were brought forward to immediately follow the 8th Party Congress of March 2006 –

The political ideology is officially Marxist-Leninist and civil servants still attend refresher courses in the subject. Public statements by the Party inevitably refer to a socialist economic system. However, since the introduction of the New Economic Mechanism in 1986, the country has been gradually moving towards a more liberal market economy. Attempts are currently being made to incorporate a stronger role for the private sector into the 6th National Socio-Economic Development Plan. Nevertheless, tensions sometimes exist between Party pronouncements and government policy development.

The Government adopted a Governance Reform Programme in 2003. Activities are organised according to four objectives: public-service reform, people's participation, the rule of law and sound financial management. Attempts are being made to improve the workings of the civil service, to formalise and regulate relations between central and local government, to improve public financial management and to strengthen participation and encourage local empowerment, but progress is perceived to be slow.

¹ The Party leader serves also as the President of the country. At the National Party Congress of March 2006, the post of Party President was transformed into the post of Party Secretary General. On this occasion, Mr Choummaly Sayasone succeeded Mr Khamtay Siphandone and became Party Secretary General and State President.

Respect for human rights is still well below international standards. The Lao legal system functions poorly and consequently the judicial system, prison conditions, freedom of association and media freedom remain issues of concern for the donor community.

In recent years the situation has, however, started to improve in a number of fields.

Although local non-governmental organisations are still not permitted, there is an increasing number of trade and professional organisations, who are now allowed to register. The number of community service groups has grown and the mass organisations of the Party such as the Lao Women's Union have also started to play a more proactive role. International NGOs have been present in Lao PDR for many years, and many of these work with local community-based organisations. The National Assembly plays a more active oversight role, and corruption cases have been reported in the media. Freedom of religion has significantly improved.

Party elections have led to substantial changes in the Central Committee and the Government itself with a new generation of politicians emerging. At the latest elections for the National Assembly 175 candidates stood for election of 115 seats. Dialogue on human rights is more common and Ministers raise the topic themselves. Laos has ratified both the International Covenant on Economic, Social and Cultural Rights (CESCR) and the International Covenant on Civil and Political Rights (CCPR). The same applies for the National Convention on the Elimination of All Forms of Racial Discrimination (CERD).

Work is now being undertaken (including in EC funded projects) to ensure that all national policies and laws are in line with these conventions.

GoL's increased readiness to discuss human rights issues has also led to the creation of the EC/GoL Informal Working Group on "cooperation in the areas of institution building and administrative reform, governance and human rights"..

Ethnic minorities inhabit the more remote areas of the country and as a result of this isolation tend to be excluded from political power. At the same time, government strategies designed to eliminate slash-and-burn agriculture and opium poppy cultivation and to bring remote communities closer to government services have had a disproportionately negative impact on ethnic minorities. The Government faces a real dilemma here, as leaving people in remote areas where they may have greater access to land and natural resources often leaves them isolated from services, markets and politics.

In recent years, the foreign policy of Lao PDR has been geared towards regional integration. The country has also taken a more active stance in international fora and as described above has recently signed a number of human rights conventions.² Lao PDR has been a member of ASEAN since July 1997 and hosted an ASEAN summit in 2004 and a Regional Forum in 2005. The country is also actively engaged in the Greater Mekong Sub-Region initiative.

Vietnam remains Lao PDR's "political reference point", but China has increased its political influence and now has at least equal importance in "cooperation terms". The commitment to international engagement and regional integration will bring with it a series of political challenges. In order to attract foreign investment and abide by the rules of

² The GoL is also seriously considering ratification of the Rome Statute of the International Criminal Court (ICC).

future WTO membership there will have to be a relaxation of controls over business registration, trade and investment. Lao PDR will be expected to integrate its obligations under international law into domestic legislation and there will be pressure to improve the rule of law and for more concerted implementation of laws already on the statute books. It thus seems that the role and performance of government may come under more scrutiny from Lao PDR's regional and international partners than its own population, as education levels remain low and civil society develops only slowly.

1.2 Economic situation

The economic reforms that began in 1986 with the New Economic Mechanism (NEM) have gradually shifted the economy from socialist central planning towards greater market-orientation. Ongoing economic reforms aim to **further liberalise the economy, to create an enabling environment for the private sector and to stimulate trade and investment.**

Early reforms under the NEM included price liberalisation and exchange-rate unification, the removal of the Government's monopoly on trade and the expansion of foreign and inter-provincial trade. Private farms were encouraged instead of collectives and private firms were allowed to trade.

Structural reforms continued into the 1990s with limited restructuring of the banking sector and other State-Owned Enterprises (SOEs). The Asian economic crisis of 1997-1998 was a severe blow to the Laotian economy. Growth fell, inflation rose and monetary and fiscal management broke down. By 2001, however, stability had been restored and inflation was back under control. In the period since then there has been some acceleration in the rate of reforms, while the stabilisation programme has remained firm. Attempts are currently being made to strengthen public expenditure management, improve banking and the provision of rural financial services, continue the reform of SOEs, and continue improvements in forestry, trade and the promotion of the private sector.

In general, on the economic front, the **situation has improved in Laos particularly since late 2005.** Real GDP growth rates averaged 5.7% during the years 2001-2004 and rose to 7% in 2005. Over the past two years however, growth rates have increased to 7-8%. Inflation remains in single digits and dropped remarkably in the last months of 2006 to 5.5% in September and 3.7% in October.

The economy remains highly reliant, although to a decreasing extent, on the agricultural sector. It is a source of income for nearly 80% of the population despite the fact that its share of GDP declined from 61% in 1990 to 49% in 2003. The industrial sector increased its share of GDP from 14% to 26% in the same period thanks mainly to development of the textiles and garment industry. With the ending of the Multi-Fibre Agreement, Lao PDR lost some of the advantages it has enjoyed and future growth in this sector is uncertain. Growth is thus mainly fuelled by heavy investment in a few large mining and hydro-electricity projects, as well as tourism.

Electricity generation has recently attracted substantial foreign investments in the **Nam Theun II (NT II)** dam, which was officially opened in November 2005 following the approval of a PRSC loan by the World Bank in March 2005. NT II will begin generating electricity revenues in 2009, and is expected to become the largest single contributor to the state budget. The project has cost some 1.2 billion USD and has been financed through

loans and equity participation. The Nam Theun II Power Company Ltd is owned by a consortium of four equity holders: Electricité de France (35%), the Government of Lao PDR (25%), the Electricity Generating Authority of Thailand (25%), and Ital-Thai plc (15%). The European Investment Bank (EIB) has lent USD 55 million to the Government of Lao PDR to help finance its equity contribution.

Although the budget deficit was reduced to 3.9% in 2004, public external debt reached 84% of GDP in that year and remains a cause for concern. The expected net inflows from NT II will contribute towards improving the external balance, but fiscal reforms and monetary discipline are central to ensuring continued macroeconomic stability.

Progress in improving government revenue collection has been slow. This is largely due to human capacity constraints and the highly decentralised nature of revenue administration, whereby provinces collect a substantial proportion of government revenues but only remit a fraction of this to central government. The Government is taking measures to address the situation. It is restoring control over seven international border crossings, increasing control over major provincial large taxpayers units and increasing control over the granting of tax exemptions to investors. **Thus, for the first time in recent history, revenue collection has improved reaching 12.4% of GDP in 2006 well ahead of prognosis and the Government's own plans.**

The key challenge to Lao PDR's economy however still remains the **need to make further progress on structural reforms in the area of fiscal management**. Domestic revenue mobilisation needs to be further strengthened, public expenditure management improved, the restructuring of state-owned banks and enterprises should be completed and private sector activity and investment further promoted. The imbalance between recurrent and capital expenditures also needs to be redressed. To this end, Lao PDR intends to introduce VAT in early 2007 to strengthen revenues and compensate for the loss incurred by the reduction of import tariffs in accordance with its AFTA commitments (estimated at 0.7% of GDP). Reforms are also under way to re-centralise authority over tax and customs administration.

Many of these structural reforms are being deepened under the umbrella of the Poverty Reduction Support Operation (PRSO), a reform programme of the Government supported by an IDA grant from the World Bank.

1.3 Trade structure

Although Lao PDR is not currently a WTO member, it is seeking to become one, and lodged an application for WTO membership in 1997. The first Working Party meeting was held in 2004 and the second such meeting is expected to be held in 2006. Accession negotiations with WTO members are ongoing and domestic legislation is being reformed to conform to WTO regulations and requirements. The trade regime of the country is characterised by an import tax system that promotes imports of materials and equipment for investment while protecting domestic production and limiting imports of luxury products. Import quotas and import bans are in force.

Garments, wood products, minerals, timber and electricity are major export products, accounting for some 71% of total exports. The country's terms of trade are therefore vulnerable to fluctuations in world commodity prices. **Export diversification is necessary and formulation of the first national export strategy is under way.** The abolition of

WTO textile quotas at the end of 2004 affected world prices for garments and garment prices quoted to Lao firms have fallen by some 20-30%. While it is too early to judge the long-term impact of the elimination of quotas, Lao garment exports in the first half of 2005 were down 10% on the same period in 2004. Exports of electricity are expected to increase significantly once the Nam Theun II dam comes into operation as scheduled in 2008. Current account deficits have steadily increased from 3.7% of GDP in 2001 to 8.5% of GDP in 2004. Export-to-GDP ratios remain limited at around 23%.

The main export destinations of Lao PDR are the EU, Thailand and Vietnam, which together absorb some 64% of Lao exports (with 28.3% for the EU alone). Bilateral trade flows with the US are expected to grow following the normalisation of trade relations with the US in 2004. This will allow import duties on Lao products to the US to be reduced from 40-90% to 5-20%. The EU is the second trading partner of Lao PDR, but its first export destination. Lao PDR has enjoyed trade surpluses with the EU in recent years. **Garments account for some 86% of exports to the EU.** Lao PDR benefits from the Everything-But-Arms (EBA) scheme of the EU GSP and its exports, except for arms and ammunition, enjoy duty-free and quota-free access to the EU market.³ Exports of certain textile products have benefited since 1997 from the derogation from the GSP rules of origin which have been extended to 2008.

Lao PDR has engaged in regional and bilateral arrangements that are expected to assist its integration into regional and international markets. Lao PDR has participated in the ASEAN Free Trade Area (AFTA) since 1997 and, under the Common Effective Preferential Tariff (CEPT), import duties applicable to imports from AFTA members are to be reduced to 0-5% by 2008 and abolished by 2015. In the context of ASEAN, Lao PDR also participates in free trade area negotiations with Japan, China, India, Australia and New Zealand. Through ASEAN integration, Lao PDR cooperates in the areas of Trade Facilitation, Intellectual Property, Standards and Conformity, and Transportation and Communication. Lao PDR is also participating actively in a new regional initiative entitled ACMECS.⁴ It also takes part in the Trans-Regional EU-ASEAN Trade Initiative (TREATI), which is a forum for dialogue and regulatory cooperation to improve the EU-ASEAN trade and investment relationship and support the process of ASEAN economic integration. ASEAN and the European Commission are also exploring closer economic cooperation, including the feasibility of an EU-ASEAN Free Trade Agreement, through the work of a “Vision Group” on economic partnership.

In September 2006, the Government officially adopted the Diagnostic Trade Integration Study and Action Matrix which articulate key policy actions to be taken by the Government to increase export competitiveness and promote trade and investment in the country. The EC has participated as a leading donor in the Diagnostic Trade Integration Study and has contributed to the design of a multi-donor trust fund for supporting trade-related initiatives. The EC has been heavily involved in the Integrated Framework process that aims to link trade policy to wider development policy.

³ However, bananas, sugar and rice are subject to a transitional period and import duties on these products are being gradually phased out in January 2006, July 2009, and September 2009 respectively.

⁴ Ayeeyawady-Chao Praya-Mekong Economic Cooperation Strategy. The five ACMECS countries are Thailand, Cambodia, Lao PDR, Burma/Myanmar and Vietnam.

1.4 Social developments

Lao PDR belongs to the Least Developed Countries, ranked 131st out of 177 countries on the UN Human Development Index (2005), with GDP per capita of 456 USD. The authorities are committed to targeting the Millennium Development Goals and big strides have been made in improving performance against many of the key indicators. However, the development status of Lao PDR remains low and there is still much to be done. Although the incidence of poverty has fallen significantly in recent years (from 45% of the population in 1992 to 30% in 2003), life expectancy at birth is still only 55 years. About 60% of the population is under 20 years old.

Child mortality rates have slowly improved but remain relatively high. The mortality rate of the under-five age group (deaths per 1 000 live births) fell from 170 in 1990 to 91 in 2003. The proportion of one-year old children immunised against measles increased from 50% in 2001 to 55% in 2002, but had been as high as 62% in 1996. Mortality rates are much higher in rural areas, particularly in the most remote districts, than in urban areas. Most children's deaths are caused by communicable diseases, in particular malaria, acute respiratory infections, diarrhoea and epidemics such as dengue fever, measles or meningitis. Malnutrition is also a significant, yet rarely acknowledged problem in Lao PDR.⁵ The prevalence of underweight children under five years of age remained unchanged at 40% between 2000 and 2001.

The country has made remarkable progress in reducing the number of **women dying in childbirth**. The maternal mortality rate fell from 750 to 530 deaths per 100 000 live births between 1990 and 2000. Nevertheless, there are doubts whether this rate of progress can be sustained given the current low levels of investment in the health sector. The fertility rate dropped from 7.1 births per woman of reproductive age in 1995 to 4.9 in 2000. Although this represents a dramatic reduction the rate remains among the highest in the region and there are significant differences between urban areas (2.8 births per woman) and rural areas (5.4 births).

HIV prevalence remains **low, but the poor knowledge of methods of preventing** sexually-transmitted HIV and the low levels of use of condoms indicate a high risk of an increase in infection rates. Death rates from malaria fell from 9 per 100 000 in 1990 to 3.5 in 2002. This was associated with an increase in the use of insecticide-impregnated bed nets from 25% of the at-risk population in 1999 to 60% in 2002.

Net enrolment in primary schools rose from 58% of primary school-age children in 1991 to 83% in 2002. Although gender gaps have been reduced, they remain significant, with the number of girls per 100 boys in primary education rising from 77 in 1991 to 84 in 2002. Over the same period, indices for lower secondary education improved from 66% to 74%, for upper secondary from 56 to 68 and for tertiary from 49 to 58 per cent.

The most marked improvements can be seen in the indices for **access to safe water and sanitation**. The proportion of the population with sustainable access to an improved water source rose from 28% in 1990 to 58% in 2000.

⁵ Estimates suggest that over 40% of children in the country suffer from some form of insufficient nutrition.

At 11% of the state budget, **education spending in Lao PDR is among the lowest in the region. Nearly two thirds of all investment expenditure in this sector comes from development aid, mainly concentrated on primary education.** Donor coordination in this sector started in 2002, and in the next National Development Plan for Education (2005-2010) a sector development programme initiated by SIDA will be formalised. The World Bank is now funding a capacity-building programme at the Ministry of Education and other donors such as the ADB are also involved in funding this sector. A SWAP is programmed to start in 2008.

The Lao PDR health sector suffers from endemic problems of low state spending (5.5% of state expenditure in 2005) and lack of competent manpower. **Basic healthcare remains inaccessible to a large proportion of the rural population,** especially ethnic minorities and women. In the next five years, the impact of the Global Fund for Tuberculosis, AIDS and Malaria (GFTAM) will be substantial. Some 455 million USD have been approved for Lao PDR, of which 27 million have been disbursed so far.

Income inequality is high and economic growth has benefited the lowland population more than the ethnic minorities in the uplands. A substantial reduction in opium cultivation⁶ has also removed an important source of income in certain remote regions. As a result, poverty in Lao PDR is heavily concentrated in the upland areas, which are inhabited largely by ethnic minority communities. Gender gaps among the ethnic minority communities in these areas are also substantially higher than in lowland communities and the ethnic Lao majority. Finally, the high level of fiscal autonomy of provinces has prevented central government from re-distributing resources from the better-off provinces to the poorest.

Rural development is still critical to poverty reduction in Lao PDR. However, unexploded ordnance (UXO) contamination remains a very serious problem (2004 estimates refer to more than 87 000 square kilometres, that is 37% of the land area, at risk from UXO, with about 12 500 square kilometres considered at high risk). This puts a significant burden on public health and limits development potential in large areas of the country, especially in rural Lao PDR.

1.5 Environment

Environmental issues are at the centre of the welfare of over 80% of the population of Lao PDR, as negative environmental trends such as illegal logging and deforestation, land degradation, illegal trade in wildlife and protected species, socio-environmental impacts of large scale hydropower systems, and increased urban and industrial pollution directly threaten their livelihoods and welfare.

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 depredations on natural resources with insufficient regard to the core issue of their environmental sustainability.

Environmental priorities include the need to establish sustainable systems of natural resources management (principally forests, water resources and agricultural land). There

⁶ Officially from 26 387 ha in 1998 to 3 556 in 2004. At the beginning of 2006, the GoL officially declared Lao PDR opium-free.

are concerns related particularly to illegal logging and deforestation (the forest cover has declined from around 47% of the total national area in 1990 to near 34% now), the illegal wildlife trade, and the impacts of shifting cultivation and swidden agriculture.

Despite the existence of legislative and other administrative frameworks that aim to govern the exploitation of natural resources and environmental protection, weaknesses remain in regulatory and enforcement capacity.

2. COUNTRY POLICY AGENDA

In October 2003, the National Assembly mandated the Government to implement an ambitious development plan which, in its draft version, was known as the National Poverty Eradication Programme (NPEP). This was finalised in January 2004 and renamed the **National Growth and Poverty Eradication Strategy (NGPES)**. It was regarded as a working Poverty Reduction Strategy Paper (PRSP) by the IMF and the World Bank.

The NGPES was divided into three components:

- Maintenance of macro-economic stability and sound management of public finances;
- Improved social and economic service provision (in agriculture, education, health and infrastructure); and
- Creation of an enabling environment for the private sector.

Proposed actions include the following:

- (a) Maintaining macroeconomic stability
 - Increasing government revenue;
 - Limiting the size of government debt by establishing control over expenditure;
 - Controlling inflation;
- (b) Improving social and economic service provision
 - Increasing government expenditure in the education and health sectors;
 - Investing in infrastructure such as roads, power, and water supply, and expanding access to these services;
 - Upgrading agricultural extension services;
- (c) Creating an enabling environment for growth and development
 - Streamlining business regulation and licensing;
 - Reforming the tax code;
 - Pushing forward structural reforms in the financial sector, state-owned enterprises (SOEs), land-use planning and management and trade;
 - Improving governance and the rule of law;
 - Promoting greater regional integration (including active participation in ASEAN the Greater Mekong Sub-region, implementing both the “Growth Triangle” plan involving Lao PDR, Cambodia and Vietnam and the “Emerald Triangle” to promote tourism in those three countries).

Rural development policy revolves around improving service delivery in 47 priority districts. Activities may follow sectoral lines such as expanding school places or upgrading

health facilities or they may be area-based: for example, ten districts now have development plans that were formulated with the participation of local populations.

In support of rural development policy a process of village consolidation is under way to move all villages into village clusters (*khets*) of viable size. This might involve several villages with a common ethnic origin or the merging of groups of different ethnicity into a single khet. The policy of village consolidation is most controversial where minorities are moved from upland areas to khets in the lowland or valleys.

Studies have rarely been able to provide an overview of the extent of village relocation in Lao PDR. However, the few localised studies that do exist provide compelling evidence of a mass movement of people. Estimates indicate that 30-50% of villages in the districts have moved within the last 20 years and that this process is still continuing, although the current rate of movement is difficult to judge. The process of relocation has been subject to two main economic constraints: the cost of preparing the new sites has far exceeded the Government's means and not enough suitable unoccupied land has been available. Thus, in several cases, access to agricultural land, forests and government services has been inadequate to cope with the needs of the relocated communities. This has resulted in many villages being less well off after moving than they had been before.

In exploring alternatives to the current relocation policy, the Government has presented its Plan of Action for Poverty Eradication in Focal Development Areas as a possible way forward. At the Round Table meeting at the end of November 2006 the Government officially invited donor interest in supporting Focal Area Development. Meanwhile, the EC Delegation has joined the World Bank in conducting a Poverty and Social Impact Assessment so as to be better informed about the nature and impact of current government poverty eradication efforts.

The Party Congress sets the guidelines for development activities. The five-yearly National Socio-Economic Development Plans (NSED) translate these guidelines into specific objectives, identify priorities by sector and outline programmes to achieve the objectives. The NGPES was published in parallel with the 5th National Socio-Economic Development Plan 2001-2005. At the November Round Table meeting the Government presented its Sixth Five-Year National Socio Economic Development Plan (NSED) 2006-2010. The NSED is an important plan for the government as it presents a single strategy document that integrates other plans that were created earlier including the (2003) National Growth and Poverty Eradication Strategy (NGPES). Overall, it has been positively received by the donor community. It successfully addresses poverty reduction, recognizes the role of the private sector and encourages the reallocation of government financial resources towards education, health and infrastructure. There are however certain limitations to the NSED (no least as regards mechanisms for monitoring), and many challenges lie ahead if the country is to fulfill its goals of achieving the MDGs by 2015 and exit the LDCs' status by 2020.

Work is on-going to implement the Enterprise law which was promulgated in 2005. A Prime Minister's Order has provided for the implementation of a 'One Stop Shop' for enterprise registration as well the setting up of provincial offices to facilitate business registration. A review is on-going to ensure that all laws and regulations are consistent with the Enterprise law.

To-date however, progress in implementing reforms has been uneven, largely as a result of the tensions described above, as well as ongoing human resource constraints in the civil service. While government debt and international balances remain under control for the present, risks exist. Current government projections of future donor financial assistance appear over-optimistic. Revenues remain very low (around 11% of GDP), and are rising only slowly. Reform of SOEs and state-owned banks is also slow. The SOEs may be expected to continue to be a drain on bank funds and the main source of bad credit, thus continuing to deprive deserving private businesses of credit.

Long-term sustainability of current rates of growth and the efficient use of the anticipated revenues from new hydro-electricity and mining projects will depend on the Government's willingness to continue with reforms in the management of public finance and the creation of an enabling environment for the private sector.

The pace of reform will in part be determined by the need to build capacity at lower levels starting from the fundamentals of public administration and financial management. However, the Government has shown its will to undertake an ambitious reform agenda under the World Bank-financed Poverty Reduction Support Operation (PRSO). If these reforms are duly carried out, Lao PDR may look forward to a further rapid decline in poverty levels.

3. OVERVIEW OF PAST AND ONGOING EC COOPERATION, COORDINATION AND COHERENCE

3.1 Overview of past and ongoing EC cooperation

EC assistance to Lao PDR started during the early 1990s when the main priorities were rural development, urban development and support for refugees returning from Thailand. The CSP 2002-2006 expanded the scope of cooperation to social sectors (education and health) and trade, while maintaining the focus on rural development as the main area of support. Governance was identified as a cross-cutting issue.

For 2002–2004, the EC committed **€14 million**, with **€5 million** allocated for rural development, **€6 million** for the education sector, and the remainder for trade and governance respectively. In 2005–2006 a further **€4 million** was allocated to strengthen the Lao small and medium-sized enterprise (SME) sector (**€3 million**) and to promote good governance (**€1 million**) in the field of legal reform, notably the adoption and enforcement of international legislation, support for the decentralisation process and freedom of expression. The overall amount of EC development aid to Lao PDR in 1993 - 2006 was approximately **€100 million**.

Overall, the ongoing projects have a value of **€57 million**, with rural development and food security projects making up some two thirds of the EC project portfolio. NGO-implemented projects in food security and rural development, health, UXO clearance and basic education account for approximately 20% of ongoing projects. In addition, there are 14 Asia-wide projects with components affecting Lao PDR under implementation, as well as 10 projects under horizontal/thematic budget lines, bringing the volume of the existing

portfolio for Lao PDR to ~~€61~~ **million**. Moreover, €3 million has been allocated for Lao PDR and Cambodia for a direct aid regional food security programme, and a further €2 million for a call for proposals also divided between Lao PDR and Cambodia. ECHO and DIPECHO have funded 14 projects worth €2.8 million in 2002-04 and 6 projects worth €1.9 million in 2005. New ECHO funding in Lao PDR for 2006 amounts to €2.1 million.

Since 2004 Lao PDR has benefited from EC financing in the field of higher education. Activities carried out in this field will be financed within the context of the regional programming for Asia.

The main lesson learned from past EC cooperation is that although the great majority of projects have been successful and have had a positive impact on the direct beneficiaries, their long-term structural impact on the country's economic and social development has been limited. Moreover, a large number of relatively small projects represents a disproportionately heavy administrative burden both on the Delegation and on the Government. In light of this, the following general lessons can be drawn from the past EC assistance to Lao PDR:

- Limited EC aid has, in the past, been dispersed over too many small projects in various sectors. Using a more limited range of aid instruments and focusing on policy dialogue in fewer sectors would enhance the effectiveness of EC aid;
- The EC should strive to make a strategically significant contribution to policy dialogue in areas where it can demonstrate added value. In the long term, strategic policy reform yields more sustainable benefits at structural level than direct project support;
- The recurrent funds available in the state budget are currently not sufficient to match the capital investments made by donors. This can be best addressed by budget support;
- The EC should take a lead on aid harmonisation, coordination and alignment as stated in the European Consensus on Development (15 December 2005) and demonstrate this commitment by moving towards sector-wide operations and budget support;
- Actions under the Financial and Administrative Framework Agreement between the European Community and the United Nations, implemented by specialised UN agencies, clearly have a positive impact in increasing policy dialogue. A similar approach can be applied in relation to cooperation with the World Bank;
- Difficulties in establishing a policy dialogue with the Government for a variety of reasons such as a lack of human resources means that dialogue needs to **be firmly anchored to a concrete set of reforms**. This is precisely the case with the World Bank-financed PRSO programme: it comprises a clear and monitorable reform framework which is directly linked to the National Development Strategy;
- Finally, an important lesson learned from past development cooperation in Lao PDR is that village relocation can undermine the sustainability of development impacts of rural development. Most rural development projects have had to deal with the implications of relocation either explicitly or implicitly. Many villages in the target areas of rural development projects have recently been relocated or consolidated into "focal development areas". To ignore relocation would therefore be to ignore a major factor determining the livelihoods and welfare of rural people.

The need to move towards policy dialogue and budgetary support instruments will require adjustments in the staffing profile of the Delegation, while bearing in mind that the existing projects (under NIP 2005-06) will also extend beyond 2006. In particular, local capacities for policy analysis and public financial management issues are being strengthened, and external expertise has also been used through short-term contracts.

3.2 Programmes of EU Member States and other donors

The key aspects of development assistance programmes in Lao PDR are anchored to the National Development Strategy and the Government's reform agenda. Reform of Public Finance Management (PFM) is one important area where several donors – most notably the WB, the ADB, the IMF, the JICA, the UNDP, SIDA and the EC – are involved. So far technical assistance in this area has been provided by the JICA (fiscal policy), SIDA (tax issues), France (customs and accounting), the WB (capacity building and fiscal policy), the UNDP (customs and PFM reforms at local government levels), the IMF (macro-economy) and the EC (capacity building, budget process and fiscal policy).

In November 2005, the Government launched a Public Expenditure Management Strengthening Programme (PEMSP), and is currently setting up a multi-donor trust fund to support its implementation. This is a fully government-owned programme and it is expected that the PEMSP will bring most of the donor-funded technical assistance under a single strategic reform framework in the PFM area. Another important instance of cooperation is the Public Expenditure Review (PER), which in 2005-06 has been a joint effort between the World Bank, the ADB, the IMF and the EC.

In overall terms the main bilateral donor to Lao PDR is **Japan**, providing an average of 100 million USD in assistance annually, which represents almost half of total bilateral assistance. Most of this support takes the form of grants to finance infrastructure (energy, transport). **China** is increasing its economic links with Lao PDR, becoming a major source of both FDI and a new market for Lao products. It is also involved in major infrastructure projects including roads and dams, accounting for some 15% of total ODA received by Lao PDR. **Australia's** cooperation (about 8% of total ODA) focuses on education but is also present in other development sectors. The **World Bank, the ADB, the IMF and the United Nations** all have a significant presence. The ADB in particular plays a major role in financing infrastructure, and is by far the largest Financial Institution active in Lao PDR. The UNDP and other UN agencies have diverse assistance portfolios. Among **EU Member States**, the top donors are **France, Germany and Sweden. Belgium and Luxembourg** also have bilateral development programmes. Commission and EU Member State funding accounts for some 25% of total assistance (loans and grants) to Lao PDR. EU Member States are strong in the sectors of education and rural development (including UXO clearance). **The US** is supporting programmes in poppy eradication, UXO clearance and food aid/food security. **Thailand** intends to become a more important donor to Lao PDR in the future. The **European Investment Bank** is contributing USD 55 million to the Nam Theun II dam also financed by the World Bank, France (Electricité de France) and others.

The EC and the Member States regularly meet to discuss and exchange information. The European Consensus on Development of 15 December 2005 reaffirmed the Commission's leading role in harmonisation and coordination, stating that the Commission will play an active role in implementation of the Paris Declaration on Aid Effectiveness and will be one

of the driving forces to promote delivery of the commitments made by the EU in Paris on ownership, alignment, harmonisation, results and accountability.

The GoL has produced its own version of the Paris Declaration, which most donors signed at the triennial Round Table Meeting on 28-29th November 2006. A new Task Force with representatives from the government and the donor community will be set up to produce an Action Plan by May 2007 to implement the Declaration. The EC is an actor in this process and has recommended that a high-level donor-government aid effectiveness group should draft the Action Plan. This plan would contain dated indicators to measure progress thus truly committing donors and government alike to working closer together.

The Round Table process has so far been the main aid coordination mechanism between donors and the GoL and is aiming at mobilising aid resources to finance development plans. In between these meetings, there are local Round Table meetings attended only by the GoL and donor representatives resident in Vientiane. In 2004, the UNDP launched a new donor coordination mechanism, consisting of eight sectoral/thematic Donor Working Groups (DWGs) with quarterly meetings and one overall yearly meeting.

3.3 Policy mix and coherence

The EC-Lao PDR Cooperation Agreement sets out the framework for EC-Lao PDR cooperation while ensuring coherence between all Community policies. External aspects of the EU's own policy and cross-cutting issues (gender, ethnic minorities, environment and good governance) are systematically factored into EC activities at both country and regional level. As natural resource exploitation becomes an increasingly important driving force in the economy, the issue of environmental protection takes on high importance. While the new draft Five-Year Plan does integrate environmental protection into economic and development planning across most sectors, concerns remain about the enforcement of policies at local level. The weak institutional capacity of local government is a major obstacle to enforcing the existing legislative and regulatory framework. The EC will thus seek to address cross-cutting issues in the context of governance reforms.

Public Financial Management reforms can help to promote good governance in improving access to information and scrutiny of public financial data. Making these data more understandable and accessible to communities, citizens and the National Assembly helps improve financial transparency and accountability. Ultimately, the national budget can be gradually transformed into a tool of public policy with clear linkages to the country's Poverty Reduction Strategy.

In terms of Justice and Home Affairs (JLS) issues, the main issue of concern is the increase of human trafficking especially in women and children, as well as illegal migration and migrant smuggling, particularly towards Thailand. Security issues (including terrorism and drugs) are dealt with under the ASEAN (ARF) and ASEM dialogue processes.

Since trade-related assistance is an important part of the SP, developments in trade policy will be closely monitored, in particular those concerning WTO negotiations and recommendations from the high-level "Vision Group". The EC will also ensure that EC support to Lao PDR is coherent with action taken at regional level in the context of the 1980 EC-ASEAN Cooperation Agreement and the 2003 Communication on a "New Partnership with South-East Asia".

4. THE EC RESPONSE STRATEGY FOR THE PERIOD 2007-2013

4.1 General approach, objectives and principles

EC development cooperation in Lao PDR for the period 2007-2013 will be based on a response strategy that is fully aligned with the Government's National Development Strategy. **Poverty reduction and helping the country achieve the MDGs will continue to be the overarching objective of development cooperation** between the EC and Lao PDR. At the same time, support is shifting away from targeted project aid towards a more holistic approach which pays more attention to strengthening the Government's own governance and economic reforms as well as facilitating its integration into the regional and global political economy. The strategy aims to **improve and strengthen the business environment** as a precondition for sustainable growth and development. Increased attention to **trade/investment sector** support is also planned. The EC would thus add value by taking account of its comparative advantage in linking trade, aid and development. In strengthening the country's own governance and financial management systems, the EC strategy aims to ensure that the National Development Strategy translates itself into concrete resource flows to priority sectors and areas and results in tangible progress towards the attainment of the MDGs.

In line with the above, EC cooperation in Lao PDR is phasing out specific support for the following:

- The health sector (high concentration of donors, little added value from our contribution). However, we will continue to support health projects through our contribution to the Global Fund;⁷
- Bilateral rural development projects (high concentration of donors, difficult coordination, no SWAP yet established). However, we will continue to support the promotion of alternative development options for the most vulnerable in rural areas. Additional funding for rural development could come through thematic programmes such as NGO Co-financing, the Food Security thematic programme and support for export diversification;
- Bilateral private-sector development projects (government and donor intentions are moving in the direction of creating an enabling environment for the private sector rather than focusing on projects).

4.2 EC strategic cooperation priorities (2007 – 2013)

Despite the country's success in achieving economic growth rates of 5-8% per annum in recent years, this rate of progress is unlikely to be sustained without further reforms. Lao PDR is confronted by four major development challenges:

⁷ €40 million will be available in 2005-09, for Lao PDR among other countries. In 2003-05, the Global Fund made specific grants to Lao PDR of the order of €23 million and a further €15 million is expected to be committed in 2006, subject to positive performance in ongoing project implementation. The EC's share is around 6% of the total.

- (a) ensuring that government revenues are directed towards reducing poverty, especially in terms of increased expenditure on agriculture and rural development, education, health and infrastructure;
- (b) continuing to attract foreign investment and to encourage local private sector development by further market liberalisation;
- (c) diversifying export production and export markets to reduce the risk of external shocks to the economy;
- (d) broadening the base for growth and development and therefore doing more to reduce poverty.

Four key reforms are essential for the continued development of the Lao economy: (a) the creation and consolidation of **macro-economic stability** through sound fiscal and monetary policy together with improved public finance management to ensure good use of revenues expected from energy and mining. This is so as to direct additional resources to strengthen government service provision in the key development sectors of agriculture and rural development, education, health and infrastructure; (b) the introduction of **reforms to liberalise the economy** with a view to creating an enabling environment for the private sector through improved infrastructure and human resources, a coherent legal and regulatory framework and reduced waste in SOEs, in particular the commercial banks; (c) **the diversification of the economy** and the promotion of non-traditional exports especially within the SE Asian region; and (d) the generation of **development opportunities** for the poor so that economic growth results in poverty reduction.

4.2.1 Sector of concentration: support for the Government of Lao PDR's reform agenda

Based on the above analysis, the focal area of action will be **support for the Government's reform agenda under the National Development Strategy**. The preferred approach would be through the Poverty Reduction Support Operation (PRSO – see also Annex 7). This a reform programme of the Government supported by an IDA grant from the World Bank. The PRSO offers a results-oriented budget support instrument that supports a **policy reform programme delivered in a three-year series**. In its early phase the PRSO aims to ensure that public resources, including those emanating from the NT II project, are increasingly available and effectively used to meet Lao PDR development objectives as outlined in the National Development Strategy. **The PRSO has a set of objectives which are fully in line with EC development goals**, has strong government ownership, offers opportunities for donor coordination and participation in policy dialogue with government, will make disbursements based on outcomes/results and would offer great added value for EC cooperation.

The first Poverty Reduction Support Operation (PRSO) series covers three areas of reform: (a) strengthening public financial management (including strengthening the banking sector, improving the performance of state-owned enterprises and improving the financial sustainability of utilities); (b) aligning budget resources with pro-poor national development goals and monitoring this spending against the established priorities; (c) promoting sustained growth (including private sector development, accelerating regional and global integration, and improving resource management). It is expected that the current

PRSO series, which expires in March 2008, will be followed by a further three-year series for the period 2008-11. It is anticipated that this series will have a broader scope.

The EC has been involved in PRSO policy dialogue since late 2004. Over 2006, the EC prepared the ground for its expected future participation in the PRSO. A Diagnostic Study on Public Financial Management was completed early in 2006 in conjunction with the Public Expenditure Review (PER) led by the World Bank. This marked the beginning of serious negotiations with WB about EC participation in the PRSO process under the 2007-2013 SP. The EC also participated in the Public Expenditure Management Strengthening Programme (PEMSP) with implementation due to take place early in 2007.

EC involvement in the preparation of the PRSO-2 programme has taken place through the Public Expenditure Review (PER) and through various preparatory studies. The PER provides an assessment of the Government's reform performance, serving as a basis for yearly PRSO negotiations and the 2005-06 version was a joint exercise between the EC, the WB, the IMF, the ADB and the Government. In addition to a broad public expenditure agenda and fiscal sustainability framework, it incorporates many cross-cutting issues, such as public expenditure analysis from the perspective of women, ethnic minorities and the environment. Gender and ethnic minority concerns are the subject of a separate study to assess the distribution of government expenditures from a gender and ethnic minority perspective (Poverty and Social Impact Assessment). These studies related to the allocation of public expenditure will be used as the basis of recommendations for the possible redirection of future government financial resource flows. The PER ensures regular, quick and practical feedback on results and outcomes in a format which is immediately operational for policy dialogue and can be directly linked to the PEMSP reforms. In addition, it has been agreed that the Public Expenditure and Financial Accountability (PEFA) framework will be used as a key tool for monitoring PFM reform performance.

As a result of policy dialogue with the Government and the World Bank on PRSO and the PER as well as the National Development Plan, the current policy reform agenda in Lao PDR largely reflects EC priorities. **Joining as a full financial partner in the PRSO will ensure a key role for the EC in the establishment and implementation of reform in Lao PDR, and will enhance the EC's profile as one of the country's most prominent and influential development partners.** It will help the EC to ensure a broadening of the PRSO to strengthen the agenda for social sector reform, in order to better reflect the ambitions of the National Development Strategy. The EC will attach particular importance to monitoring social sector indicators.

Conditions that have to be met for EC support to take place relate to a solid national development strategy, viable medium-term macroeconomic framework, a positive trend as regards transparency, accountability and efficiency in Public Finance Management (PFM) and a reform programme supported, but not necessarily financed by the Bretton Woods Institutions (World Bank and IMF) (see also the European Commission *Guide to programming and implementation of budget support for third countries*). If conditions for budget support are met, the **PRSO could be established as a framework for effective policy dialogue and aid harmonisation and coordination involving the whole donor community.** In particular, the participation of Member States in reform-related policy dialogue would be encouraged and facilitated. At the moment, the JBIC and Japan are exploring the areas and means of their possible support for the PRSO, and other donors such as SIDA, France, the UNDP, the ADB and the IMF are closely involved in Public Financial Management reforms in general and in the process of PRSO policy dialogue.

Strong, credible, and influential involvement in the PRSO by the EC and other EU donors will increase EC and EU visibility in Lao PDR.

58% of the overall country allocation is indicatively allocated to supporting the reform agenda.

4.3 Additional actions

A credible involvement in policy dialogue enhances EC visibility. All additional actions are linked to policy dialogue in their key aspects.

4.3.1 Support for sustainable development in the uplands and policy dialogue on relocation

EC involvement in this sector is motivated by the importance of preventing an escalation in poverty levels of the most vulnerable populations. A majority of these are ethnic minorities. They inhabit remote, mountainous areas. Gender gaps in these communities are also substantially higher than in lowland areas.

The Government recognises these challenges in the National Growth and Poverty Reduction Strategy for Lao, and also more recently in the draft National Socio-Economic Development Plan. Strategies proposed to address the issues of poverty and gender inequality in these communities revolve around the prioritisation of 47 districts for poverty reduction programmes. Amongst these, 10 districts now have development plans prepared with the participation of local stakeholders. The Government's policy is to target development programmes in these areas and to provide finance for poverty reduction funds.

These actions take place within the context of the Government's broad rural development policy of "stabilisation" of settlement. This broad policy incorporates land allocation directives, the eradication of slash-and-burn agriculture and elimination of poppy cultivation and the attempt to bring people closer to services such as education, health care and water and sanitation.

The Government has faced two major constraints in implementing its strategy: firstly, the cost of preparing sites for relocation has far exceeded the Government's means; secondly, there has been a lack of availability of suitable unoccupied land in the quantity required.

Thus in several cases the access to agricultural land, forests and government services has been inadequate for the needs of the relocated communities. Studies have demonstrated that food security, health and the traditional culture of ethnic minority groups can suffer serious negative impacts as a result.

There are social, economic and environmental benefits to be gained from better management of development in the uplands. The allocation of a larger amount of resources will allow the participatory assessment on a case-by-case basis of options for sustainable development.

This approach could significantly ease the difficult process of deciding whether villages should move or not and, where they do, improve the outcomes of the transition.

The Government has recently shown a willingness to enter into dialogue with the EC and other donors on the matter. The Vientiane Delegation has taken the lead in this initiative and has indicated that the EC is willing to allocate funds if the following principles are agreed upon:

- The choice of development option should fit within a long-term vision of sustainable development which is based on the results of sound research;
- The choice of development option should be based on participatory assessment of the current situation, possible alternative courses of action, and the social, economic and environmental viability of those alternatives;
- Villages that have potential for development where they are should be encouraged to exploit it;
- Any relocation should be voluntary and based on a participatory approach that respects cultural and sociological considerations;
- Where relocation is the preferred option, sites should be developed in advance of occupation with the participation of those who are to move, should be adequate for their needs and should be subject to safeguards against negative environmental impacts;
- A follow-up programme of capacity building involving training in agricultural techniques, sanitation, primary health care, income-earning opportunities and village governance should be provided

Most major donors are supporting this EC-led initiative. They have proposed that the dialogue with the Government begins with a discussion of development priorities for government, an examination of existing information on development options and the nature, extent and effects of relocation as one of those options in the broader context of sustainable rural development. If agreement is reached in principle, the dialogue will go on to take place at three levels: central government, provincial government and district administration.

If this dialogue makes concrete progress, the EC would provide substantial assistance to ensure that development at village level is appropriate given the local situation and that any relocation agreed with GoL is undertaken according to the principles outlined above.

Progress in dialogue on development policy for remote communities will have a positive impact on gender equality and environmental conservation. Indeed, the EC is funding a pre-identification study of the impact of current government policy on gender and ethnic minorities. Current efforts to understand more about gender relations in ethnic minority communities may lead to policies to address inequality and increase opportunities for women's development. Further, any work with ethnic minorities on agriculture will have to address slash-and-burn cultivation techniques. Any successful relocation of communities has to be linked to the promotion of sedentary agriculture and this has the potential to stop or reduce the destruction of forests.

24% of the overall country allocation is indicatively allocated to this initiative.

4.3.2 Governance and human rights

Governance and human rights are an area of key importance for the democratic development of Lao PDR. Under the SP, governance will be treated as a non-focal area as well as an area that cross-cuts all other EC-funded activities. The Government of Lao PDR accords high importance to activities in governance and recognises the linkages between improvements in governance and poverty reduction. Over the past decade the GoL has embarked on wide-ranging public administration reforms, designed to create an effective, efficient, accountable and low-cost public administration, together with the requisite institutional and legal framework. However, much remains to be done. For example the **legal sector is in its infancy**, with only 69 practicing lawyers in the country, mainly based in the capital. Access to the legal system is costly. At every level: courts, the bar, police, etc., a basic understanding of justice and human rights issues is lacking as well as the necessary equipment and infrastructure.

The Government's priorities under its National Development Strategy in the governance field are: (1) public-service reforms, (2) people's participation, (3) the rule of law, and (4) sound financial management. Currently the Government is working on two major documents relating to governance. The first is the **Legal Sector Master Plan** for 2006 to 2020 which will provide the framework for development of the whole legal sector. The second is a Governance Reform Roadmap which will highlight the key priority initiatives to be implemented over the coming three years 2006-08. The Roadmap is intended to facilitate monitoring and reporting on governance reform.

All cooperation activities in the governance and human rights sectors will be linked to policy dialogue with the Government. The GoL holds Governance Round Table meetings with the donor community twice a year to discuss developments and outline needs. The GoL is showing an increasing willingness to engage with the donor community on governance and human rights/basic freedoms issues, and on strengthening the democratic institutions such as the National Assembly. The EC will continue to play a role in this field in the framework of the EC/GoL Informal Working Group on "Cooperation in the areas of institution building and administrative reform, governance and human rights". Governance issues will also cross-cut other areas of activity. The PRSO could for example provide a forum for effective dialogue on governance issues, particularly those related to public financial management.

5% of the total budget should be allocated to this sector.

4.3.3 Trade and economic cooperation

Supporting the GoL's trade policy can make an important contribution to sustainable development of the country. Enhanced market access and an improved trading environment alone, however, are not sufficient to realise the benefits. The country must generate the capacity of government, infrastructure and human resources to be able to benefit from the opportunities offered. The GoL acknowledges that trade development is an important element of poverty eradication. Private sector development has received special attention in the NGPES.

Lao PDR's external trade is facing special challenges after the end of the Multifibre Agreement in 2004, with the accession to the WTO of most of its neighbours, and with the

rapid development of a network of preferential trade agreements in the Asian region. Ahead of Lao PDR's own accession to the WTO, and in view of the likely spread of FTAs, a regulatory framework has to be put in place and Laotian industry has to be equipped to take advantage of the new opportunities and respond to challenges, including increased competition. **The GoL requires increased capacity for trade policy formulation and implementation**, including regulatory issues in sectors like SPS and trade facilitation. In order to increase FDI and domestic investment, a level playing-field for all actors needs to be assured and the business environment has to be improved. Financial sector reform, especially in commercial banking, needs to be pursued; excessive regulation of enterprises and customs red tape has to be reduced; and the reform of SOEs needs to continue.

The EC will provide **Trade-Related Assistance (TRA)** to the GoL in the context of the Integrated Framework, a multi-donor initiative aimed at assisting Lao PDR to expand its participation in the global economy, thereby enhancing its economic growth and poverty reduction strategy. In particular, the EC will provide technical assistance and capacity building to the GoL to assist Lao PDR in its preparation for WTO membership and the continued development of FTAs, and to respond to other challenges faced by Lao PDR with its integration into the multilateral trading system and the global economy. The EC intervention is likely to pay particular attention to issues related to trade facilitation and SPS and will take into consideration cross-cutting issues such as environment and gender. Within the ASEAN framework and under the TREATI initiative, the EC will continue to support additional operations/activities such as training and expert dialogue on subjects including standards, SPS, wood-based products, investment and trade facilitation.

13% of the total budget should be allocated to this sector.

4.4 Cross-cutting issues

While cross-cutting issues are addressed specifically in various thematic/horizontal budget lines, these issues will also be mainstreamed into policy dialogue and other forms of ongoing cooperation.

Environment. A Country Environmental Profile has been completed (see Summary in Annex 4). The EC is committed to addressing environmental policy and sustainable natural resource management in the context of the PRSO negotiations. Policy dialogue on relocation will also directly address environmental concerns, with special reference to unsustainable agricultural practices (e.g. slash-and-burn agriculture) and to land issues. As the Government has completed a National Environmental Action Plan, the EC is keen to ensure that measures relating to the environment under the PRSO take full account of this. The EC strategy will pay special attention to: (a) strengthening the institutional and administrative capacity to manage the environment effectively through the PRSO, (b) including environmental checks in the design of the EC-supported programme on village relocation, and (c) using the opportunities offered both by the Asia-wide programme and ASEAN as much as possible.

Gender and ethnic minorities. According to the UNDP Human Development report 2005, the gender development index in Lao PDR is ranked at 102 out of 177 countries. Among the five selected indicators in the report women only score better than men for life expectancy. The latest draft of the NSEDP (January 2006) outlines a vision and strategy to

promote gender equality. The four overall objectives are to (i) support poor women's economic activities, (ii) improve their access to basic services such as education and health, (iii) involve women in local decision making, and (iv) generally increase their involvement and take their needs into account when developing policies and plans. A National Strategy for the Advancement of Women is in the final stages of drafting and a set of Guidelines for a National Gender Action Plan are being developed. The NSEDP also contains a specific gender strategy for different sectors of activity, e.g. agriculture and education.

The policy dialogue on relocation is directly related to ethnic minorities. Poverty in Lao is heavily concentrated in upland areas inhabited largely by ethnic minority communities. As in the case of the environment, issues related to gender and ethnic minorities will be mainstreamed in the design of all EC-supported programmes. In the particular case of this SP, ethnic minority issues will be addressed in two ways. Firstly through the PRSO, the EC will use the findings of a Poverty Social Impact Assessment (PSIA) led by the World Bank. The analysis of the impact of public expenditure on women and ethnic minorities will be used to inform policy aimed at ensuring fair participation for all in the development process. Activities under the policy dialogue on relocation will disproportionately benefit ethnic minorities as they constitute the majority of resettled communities.

Good governance and institution building. In addition to the specific activities carried out as a result of our dialogue with the GoL on governance, components of institutional strengthening and capacity building will be systematically included in the design of all EC-supported activities. It is also recognised that an improved regulatory and enforcement capacity relates directly to environmental protection, and hence environmental issues need to be mainstreamed into governance activities.

HIV/AIDS. HIV prevalence remains low but there are risks that infection rates may increase (see above, section 1.4). Opportunities to address this and other diseases will therefore be considered in all areas of the strategy and in particular in the framework of the health indicators in the focal sector.

4.5 Risks affecting the strategy

With regard to the risks that may jeopardise the implementation of the Strategy Paper, the following aspects will be closely monitored for each activity:

- Backtracking by the Government in relation to the reform agenda. This risk can be monitored through the 55 priority actions contained in the PRSO, linked to policy dialogue;
- Fiduciary risks related to budget support. These risks are mitigated by the ongoing capacity-building support in the field of public financial management and financial auditing and a clear action plan by the GoL to improve the transparency of its financial management (the PEMSP programme);
- Political risks and sensitivities related to relocation. These risks will be addressed through a concerted dialogue with the GoL and other stakeholders, to identify the EC assistance through consensus building;
- Health pandemics (SARS, avian influenza). This risk is mitigated by the existing and planned early-warning systems.

5. ACTIVITIES UNDER OTHER EC BUDGETARY INSTRUMENTS

5.1 Humanitarian aid

ECHO has for many years provided support to the most vulnerable ethnic minorities particularly where they have been subject to government policy on banning shifting cultivation, eradicating opium poppy cultivation and village relocation and consolidation. As the EC attempts to link relief to rehabilitation and development (LRRD) some of its programmes are being taken over as longer-term development programmes, including the EC's Food Security programme. This process of phasing out ECHO activities in Lao PDR is planned to be completed by 2006. ECHO will, however, continue to monitor the humanitarian situation in Lao PDR and will intervene if required.

DIPECHO (ECHO's natural disaster preparedness and mitigation programme), on the other hand, will continue to build the capacity of local communities and their institutions to better prepare for, and mitigate, natural disasters. DIPECHO is considered one of the primary vehicles for facilitating the linking of relief, rehabilitation and development (LRRD) in a sustainable and effective manner, and will provide a bridge for the coherent transfer of strategies to better equipped, longer-term Commission funding instruments (among other things, the Food Security thematic programme) in Lao PDR.

5.2 Regional cooperation

In terms of regional cooperation, Lao PDR has been only a modest beneficiary of the "Asia Programmes". The reasons range from the difficulty of accessing information (these programmes are widely disseminated through the internet, a medium still out of reach for many, including in government circles) to a lack of capacity and potential partners in Lao PDR.

In October 2004 Lao PDR signed the Memorandum of Understanding on Cooperation against trafficking in Persons in the Greater Mekong Sub-Region with five other Governments, namely Cambodia, Thailand, Vietnam, China and Myanmar. Trilateral cooperation with Thailand and Singapore in particular is planned in this and other areas.

5.3 Fight against drugs

In its efforts to implement the UN Resolution of 1998, the Government of Lao PDR has prepared a strategy together with UNODC to achieve the goal of eradicating opium completely by 2006. Substantial progress has been made in reducing poppy cultivation and Lao PDR declared itself "opium free" in February 2006. However, and like other countries in the region, there has been a sharp increase in abuse of amphetamine-type stimulants (ATS), particularly methamphetamine, in the last few years. Ways to support actions in this field should therefore be seriously considered.

5.4 Mine action

Lao PDR is, per capita, the most heavily-bombed nation in the world. Unexploded ordnance (UXO), rather than anti-personnel mines *per se*, represents a threat to the physical safety, livelihoods and food security of people in 25% of all villages in the country. UXO

clearance remains a priority as the litter of unexploded bombs denies access to agricultural land, deters the planting of crops and grazing of livestock and limits commercial and social life. Continued funding of UXO clearance in Lao PDR should therefore be favourably considered under Thematic Programmes (see also under 5.3) such as Investing in People, Environment and Sustainable Management of Natural Resources, Non State Actors and Local Authorities in Development or Food Security. Possibilities of Regional Cooperation should also be considered. Alternatives to the traditional calls for proposals include the provision of funding for a contribution to the established UNDP-sponsored UXO/Lao trust fund (but only if Lao PDR signs the Ottawa Convention on land mines).

5.5 Thematic programmes

In the context of the cooperation with Lao PDR, alongside the measures envisaged under this SP, the Commission intends to pursue thematic activities particularly in the following areas:

- Food Security. Given the problems in achieving food security in certain local communities, a continuation of the activities funded under this thematic programme would be justified. Indeed, the provision of a significant amount of funding would increase the prospects of success in defining and implementing a sound policy for the development of remote villages in conjunction with the Government, thus completing the bridge from relief to long term development. The EC will continue to play an active role in the Working Group on Nutrition and Food Security;
- Non-State Actors Development. Financing of European NGOs (national NGOs do not exist in Lao PDR) under the ““NGO Co-financing”” facility has risen in the last few years and it is expected that an increasing number of proposals covering Lao PDR will be presented in the future;
- Democracy and Human Rights. Activities funded under the additional “Governance and Human Rights” action will be supplemented by activities funded under this thematic programme.

These thematic activities are complementary to the strategic objectives pursued by the Commission under the SP and form part of the policy dialogue with Lao PDR. These activities are meant to be carried out, inter alia, by the actors from civil society through calls for proposals. The financing of these thematic activities as well as regional cooperation and instruments used to support the fight against drugs and mine action will be additional to financial resources provided under MIPs.

ANNEX 1: Lao PDR at a glance

Land area 236 800 sq km	Population 5.8 million (year 2003)	Population density 24 people per sq km
GDP per capita: 456 USD (2005)		
Population of main town (Vientiane): 600 000 (2003)		
Annual population growth (% per year): 1980-2002: 2.6% 2002-2015: 2.1% (estimate)		
Population living in rural areas: 80% (2004)		
Human Development Index (HDI): 133 (2005)		
Life expectancy at birth: 54.5 years (2003)		

Political and economic situation

Lao PDR belongs to the Least Developed Countries of the world, with a Human Development Index ranking of 133rd out of 177 countries (2005). Some 80% of the population depends on subsistence agriculture, with some 32% of the people living under the poverty line (the figure in 1997/98 was 45%). The country remains a one-party state ruled by the Lao People's Revolutionary Party (LPRP) since 1975. Lao PDR began opening itself to international influence only in the late 1980s and early 1990s – in economic terms, as well as politically and in social aspects through tourism. The country is now preparing itself for WTO accession, having joined ASEAN in 1997. Lao PDR is also liberalising its economy to attract FDI particularly in the natural resource extraction industries, which form the mainstay of the economy together with the garment industry. While economic growth has remained at some 6% in the past few years and structural change is rapid in the urban areas, the benefits of this growth have not yet brought a significant development impact to the rural areas. Economic reforms have not been accompanied with political change, although some relaxation in the political atmosphere has been observed and the GoL has indicated its willingness to engage with international development partners.

Economic summary

Indicator	2000	2003	2005
Real GDP growth (%)	5.8	5.3	7.0
GDP USD billion (p.p.p.)	8.3	10.3	12.1
GDP per capita (USD)	329	368	456
Inflation, annual % change	23.2	15.5	5.9
Current account balance (% GDP)	-10.5	-7.6	-16.4

Source: International Monetary Fund

Selected social indicators

Indicator	2000	2001	2002	2003
Adult literacy rate over 15 years (%)	75.6	-	77.4	-
Primary school enrolment (%)	77	80	80	83
Secondary school enrolment (%)	65	66	68	68
Life expectancy at birth (years)	53	53.7	54.5	54.5
Underweight children <5 (%)	40	40	-	-
<5 mortality rate (per 1 000 live births)	106.9	87	100	91
Maternal mortality rate (per 100 000 live births)	530	650	-	-
Children <2 years fully immunised (%)	42	-	-	50
Infants <1 years fully immunised (%)	-	50	55	-
Births supervised by trained personnel (%)	17.4	-	-	-
Households with access to safe water (%)	56	-	58	-

Source: Millennium Development Goals, Progress Report Lao PDR 2004

ANNEX 2: Map of Lao PDR

(insert PDF file)

ANNEX 3: Overview of past and present EC cooperation (1993-2006)

SECTOR	1993-1999 (€ million)	2000-2006 (€ million)	Total (€ million)
Banking and Financial Services	4.8	0.0	4.8
Business and Other Services	0.0	3.7	3.7
Commodity Aid and General Programme Assistance	1.8	4.5	6.3
Education	0.3	6.6	6.9
Emergency Assistance	0.6	0.1	0.7
Government and Civil Society	1.9	6.1	8.0
Health	10.8	3.4	14.2
Other Social Infrastructure and Services	0.3	0.0	0.3
Population Policies/ Programmes and Reproductive Health	1.2	0.8	2.0
Rural Development ⁸	35.7	17.6	53.3
GRAND TOTAL	57.4	42.8	100.2

⁸ In the area of rural development, two projects of a total value of €21.6 million extend over both reporting periods. Hence, there has in fact been no significant decline in support for rural development in the latter period.

ANNEX 4: Country Environmental Profile⁹

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. The following issues are identified as serious environmental concerns:

- Illegal logging and deforestation;
- Loss of watershed function in logged upland areas;
- Land degradation and loss of habitats through unsustainable agricultural practices;
- Illegal trade in wildlife and protected species;
- Socio-environmental impacts of large-scale hydropower systems;
- Increased urban and industrial pollution.

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. There is a lack of coordination on environmental conservation and management at central government level coupled with very weak enforcement of existing environmental laws.

2. State of the environment

Lao PDR occupies a land area of 231 000 km² 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 5.7 million (ADB, data for 2003).

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 now. 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 depredations 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 seems adequate, the effective management of natural resources utilisation and pollution control is complicated by a number of challenges:

- Lack of capacity and finance of the national environmental agency (Science, Technology and Environment Agency, STEA) to enable it to effectively implement environmental legislation;
- Weak enforcement and compliance with the rules and environmental standards;
- Lack of clear standards, targets and compliance levels that hamper environmental compliance.

⁹ Based on the Country Environmental Profile Lao PDR, AGRIFOR Consult, June 2005.

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, food, fuel, medicines 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 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 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.

Biodiversity and Protected Areas

The natural biodiversity remains extremely high throughout the country. A total of 319 of the 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. Effective control of the present illegal trading pathways and their replacement by officially endorsed and correctly managed domestic pathways is necessary.

National Protected Areas (also known as National Biodiversity Conservation Areas) are relatively new in Lao PDR. Currently there are 20 of them, which correspond to Category IV in the IUCN Protected Areas classification. In addition, there are many smaller areas that have been designated as Protected Areas (PAs). These include Provincial PAs, District PAs, Protected Watershed Areas and Provincial Conservation Forests. None have protection under national legislation, and even Provincial PAs have somewhat uncertain local legislative protection.

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. Thus when exceptional floods do occur, they are not very much larger than the normal average flood. Flood peaks occur in August in the upper Mekong and September in the lower basin. 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 the most important economic sector. Major impacts on natural resources and the environment arise from agricultural practices in the highland areas. 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 pesticides and fertilisers. Although these are very little used, there are problems with improper handling and the use of banned pesticides.

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.

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 total renewable supply of fresh water in the country is estimated at 54 000 m³ per person per year, compared with an estimated per capita demand of 228 m³/year. Most of the water consumption occurs in the agricultural sector. Water availability is not a limiting factor in development.

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 chemical fertilisers and pesticides), and increasing contamination from garbage and other anthropogenic wastes. Water contamination with arsenic is a rising concern in Lao PDR.

Urban environment

With its large and rapidly expanding population, 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 is in progress, whilst the latter is not yet so severe that it represents an environmental problem. No detailed data on air quality are available.

Energy production

Lao PDR has great potential for the development of hydropower. Actual implementation has been sporadic and hampered by well-founded environmental and social concerns. Nine large-scale plants, with an output capacity of 624 MW, were in operation in 2003. The theoretical potential in Lao PDR is estimated at about 18 000 MW, indicating a current exploitation rate of 3.5%. 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.

3. Environmental policy, legislative and institutional framework

3.1. Environmental policies and legislation

The basic legal framework is laid down in the Environmental Protection Law of 1999, which was approved by an implementation decree in 2002. The law includes provisions for EIA for projects and activities that might have an impact on the environment, and regulations for all enterprises to control pollution and comply with environmental quality standards. Environmental management and compliance is governed by a number of sectoral laws and decrees. Major regulations are detailed below:¹⁰

Title	Year	Purpose
Environmental Protection Law	1999	Includes measures for the protection, mitigation and restoration of the environment, as well as guidelines for environmental management and monitoring.
Forestry Law	1996	Lays down the general framework for management of all forest-related resources, including all plants, wildlife and watercourses, and governs allocation of the use of forest land and forest resources. The Department of Forestry, Ministry of Agriculture and Forestry, has overall responsibility. Forests are grouped into the following five categories: Protection, Conservation, Production, Regeneration, and Degraded, each with their specific management policy.
Water and Water Resources Law	1996	To ensure sustainable use of water. Water use is categorised into small, medium and large-scale use. The legislation prescribes the rights and permit procedures for the different categories of water use. The development of large-scale user projects requires the preparation of an EIA. The Water Law is administered by the Water Resources Coordination Committee under the Prime Minister’s Office.
Land Law	1996	Provides the legal basis for land use and land ownership. In principle the State owns all land but long-term occupancy and utilisation rights for individuals are recognised.
Mining Law	1997	No information available.
Agriculture Law	1998	No information available.

¹⁰ Information taken from Country Environmental Profile – Laos, Japan International Cooperation Agency, 1999.

General Law for Conservation of Fauna and Flora/National Protected Areas Regulations	1993/2001	The conservation of areas for biodiversity purposes has its legal basis in the Prime Minister's (PM) Decree of 1993 aimed at fulfilling the Lao PDR obligations under the Convention on Biological Diversity. Through this Decree 20 National Biodiversity Conservation Areas (NBCAs) have been established. The National Protected Areas Regulations make provision for the creation of National Parks.
Industrial Waste Discharge Regulation	1994	Regulates emissions from industries and sets emission standards for various types of factories, including sugar mills, textile and garment factories and pulp and paper mills.

Major concerns over the current legislative framework are the lack of enforcement and compliance. Some of the problems may be attributable to lack of finance, training, staffing and equipment within the government sector. Far-reaching political and administrative efforts are needed to improve law enforcement in the environmental sector.

3.2. Environmental institutional framework

The cross-sectoral nature of environment and natural resources issues requires the involvement of various ministries and agencies. The Science, Technology and Environment Agency (STEA) is the main executing agency under the Prime Minister's Office, which has overall responsibility for environmental affairs. The STEA undertakes macro-level environmental management and planning, leaving line ministries responsible for their own environmental management. In effect this reduces the mandate of the STEA to such an extent that it has little or no control over the environmental practice of line ministries. The STEA is also in charge of reviewing Environmental Impact Assessment (EIA). The Agency is under-resourced and its staff capacities are weak.

Other key agencies/ministries involved in environmental matters are:

- The National Environment Committee (NEC), which intends to facilitate the ongoing development of an environmental policy framework for Lao PDR. The NEC was created by Presidential decree in 2002. The role of the committee is to coordinate the development of environmental management and monitoring plans by sectoral agencies, advise the Government on management, protection and inspection of the environment, propose views regarding strategy, regulation and guidelines related to the environment, and research mitigation methods for problem solving in the environment sector;
- The Ministry of Agriculture and Forestry (MAF) and more specifically the Department of Forestry and Environment. The MAF looks at deforestation, land degradation and water pollution issues. In addition it has administrative responsibility for management of the protected areas;
- The Ministry of Communication, Transport and Post and Construction (MCTPC), which is in charge of providing potable water to urban centres;
- The Ministry of Industry and Handicrafts, which has overall responsibility for hydropower development and mining activities.

Agencies with secondary environmental responsibility include the Leading Committee for Rural Development and the Department of Land-Use Planning and Development, both of whom report to the Prime Minister's Office. Coordination committees exist for the water, transport, industry, agriculture and forestry ministries. The effectiveness of all coordination committees is hindered by a lack of enforcement of the rule of law relating to environmental practice.

To ensure effective management of environmental issues the Environmental Protection Law stipulates that Environmental Management and Monitoring Units (EMMUs) are to be set up to support sector agencies in their activities. EMMUs have not been established in the MAF and those that have been established are largely ineffective.

International agreements on the environment. Lao PDR ratified the Convention on Biological Diversity (CDB) in 1992, and the Convention on International Trade in Endangered species (CITES) in 2004. In addition, Lao PDR participates in the United Nations Framework Convention on Climate Change (1992), the Vienna Convention on the Protection of the Ozone Layer (1985), the Convention for the Protection of World Cultural and Natural Heritage (1972), the Convention on International Trade in Endangered Species of Flora and Fauna (CITES, 1973) and the Convention on Wetlands of International Importance especially as Waterfowl Habitat (RAMSAR, 1971).

4. European Commission and other international development assistance

The EU is one of the most active donors of development, humanitarian and trade assistance to Lao PDR. There are 25 ongoing EC projects amounting to a total of €61 million. Rural development makes up two thirds of the EC project portfolio. The “Forestry Conservation and Rural Development Project” in Phongsaly has made a great impact upon environment issues through protection of forest resources. The EU also recognises the importance of aquatic resources and has implemented a wetlands protection project in the Siphandone Wetlands. These bilateral initiatives are supplemented by a number of projects funded under the EC’s horizontal programmes Asia Pro-Eco/Asia Urbs that aim to promote sustainable urban environment in Vientiane and Luang Prabang, assess the potential and the feasibility for renewable energy and foster the adoption of policies, technologies, and practices that promote cleaner, more resource-efficient solutions to environmental problems.

Among EU international initiatives being implemented in Lao PDR, there are the Forest Law Enforcement Governance and Trade (FLEGT) and the Biodiversity Action Plan.

Other donors particularly active in the field of environmental protection are:

- Japan, through the Forest Management and Community Support Project (FORCOM) and substantial support for the Ministry of Agriculture and Forestry during the preparation of the Forestry Strategy to the Year 2020;
- The Asian Development Bank, with the Forest Plantation for Livelihood Improvement Project (formally tree plantation for livelihood improvement project). This project provides support to smallholder farmers wishing to establish fast growing forest plantations in support of growing markets for pulpwood and other forest industry raw material requirements;
- The World Bank (WB), with the Sustainable Forestry Rural Development Project (SUFORD), aims to develop protocols and best practices in low-intensity sustainable logging of community-managed natural forest and equitable distribution of income from harvested products. Another contribution from the World Bank is the creation of the Environmental Protection Fund as an umbrella fund for the implementation of project initiatives identified and proposed by the Government. In July 2005, the WB approved a loan of USD 4 million for the Lao Environmental and Social Project. This project will help the Government and other key stakeholders to improve Lao’s ability to manage environmental protection;

- The UNDP is carrying out a Governance Programme in the STEA aimed at introducing clean and accountable governance. The second initiative is a joint UNDP/MRC Environmental Governance project which aims to strengthen the capacity of the National Mekong Committee;
- The Swedish International Development Cooperation Agency (Sida) is implementing projects in the field of natural resources/rural development/environment. National Agriculture and Forestry Research Institute (NAFRI) is receiving support to develop improved methods for sustainable, pro-poor management of natural resources in the Northern provinces. A project for implementation of the Lao Forestry Strategy to the year 2020 is being supported by Sida. Another significant project, Strengthening Environment Management through cooperation with the STEA, aims to strengthen the mandate and authority of the STEA through institutional strengthening and capacity building, including support to the National Environmental Committee (NEC). The project is placing importance on environmental and social impact assessments, environmental awareness education, environmental strategy formulation, and training. IUCN is receiving support for implementation of its five-year plan. A project to support the poor upland farmers in the Northern provinces is under preparation by MAF for Sida support;
- The IUCN programme of activities in Lao PDR is currently concerned with the sustainable use of Non-Timber Forest Products, the management of forest and wetland ecosystems, the implementation of the Convention on Biological Diversity (CBD), participatory protected area management and EIA of planned infrastructure projects. The IUCN works with a range of donors and continues to provide an important environmental monitoring service to Lao PDR.

ANNEX 5: Overview of trade

Lao PDR's trade with the world and the EU

TRADE FLOWS		€million				
		2000	2001	2002	2003	2004
Lao PDR-World						
Exports		420	415	405	400	440
Imports		745	800	768	740	849
Balance		-325	-385	-363	-340	-409
Lao PDR-EU						
Exports		111	123	122	111	124
Imports		49	35	41	42	73
Balance		62	88	81	69	51

Source: IMF

Main destinations for Lao PDR's exports in 2004

Destinations	Value (€million)	Share (%)
EU	124	28.3
Thailand	84	19
Vietnam	72	16.5
China	10	2.3
Japan	6	1.3
Others	144	32.6
World	440	100

Source: IMF

ANNEX 6: EU/EC cooperation objectives

1. The EU Treaty objectives for external cooperation

In accordance with Article 177 of the Treaty establishing the European Community,¹¹ Community policy in development cooperation must foster:

- Sustainable economic and social development of developing countries;
- Smooth and gradual integration of developing countries into the world economy;
- The campaign against poverty in developing countries.

The Community's development policy must contribute to the **general objective** of developing and consolidating democracy and the rule of law, and encouraging respect for human rights and fundamental freedoms. Development cooperation is a multidimensional process covering broad-based equitable growth, capacity and institution building, private sector development, social services, environment, good governance and human rights.

On the basis of article 179 of the same Treaty, a new Development Cooperation Instrument (DCI) was adopted in December 2006. Lao PDR is eligible to participate in cooperation programmes financed under the DCI [European Parliament and Council Regulation (EC) No.1905 of 18 December 2006 establishing a financial instrument for development cooperation.

2. Objectives of the EU as laid down in other applicable documents

Commission Communication COM(2001) 469 "Europe and Asia: A Strategic Framework for enhanced partnerships" set out the following six objectives: (i) contribute to peace and security in the region and globally, through a broadening of our engagement with the region; (ii) further strengthen our mutual trade and investment flows with the region; (iii) promote the development of the less prosperous countries of the region, addressing the root causes of poverty; (iv) contribute to the protection of human rights and to the spreading of democracy, good governance and the rule of law; (v) build global partnerships and alliances with Asian countries, in appropriate international fora, to help address both the challenges and the opportunities offered by globalisation and to strengthen our joint efforts on global environmental and security issues; and (vi) help strengthen the awareness of Europe in Asia (and vice versa).

On 9 July 2003, the European Commission adopted a Communication on a new partnership with South East Asia (COM (2003) 399/4) setting out a comprehensive strategy for future EU relations with the region. Its main objective is to promote good governance, regional trade and poverty reduction, thus strengthening the EU's presence in Asia. The "New Partnership" communication proposes revitalising the EU's relations with ASEAN and the countries of South East Asia, and identifies a number of strategic priorities.

In 2001, the Council adopted guidelines for "*strengthening operational coordination between the Community, represented by the Commission, and the Member States in the field of external assistance*", which made far-reaching commitments in relation to most areas of aid delivery and in terms of coherence, coordination, and complementarity. Subsequently, the Council agreed in Barcelona in March 2002 to take concrete steps in the

¹¹ <http://europa.eu.int/abc/obj/treaties/en/entoc05.htm>

area of coordination of policies and harmonisation of procedures before 2004. The General Affairs and External Relations Council at its meeting on 22/23 November 2004 endorsed further recommendations for EU harmonisation and coordination in advance of the Paris High-Level Forum on Aid Effectiveness on 2 March 2005. The Community and the Member States are committed to striving towards increased aid effectiveness, supporting fully the agenda set down in the Paris Declaration.

A Cooperation Agreement¹² between the European Community and the Lao People's Democratic Republic was signed on 29 April 1997. Its major objectives are to step up EC-Lao PDR development cooperation and to enhance and diversify economic and trade relations through the reciprocal application of Most-Favoured-Nation treatment. The agreement also covers science and technology issues, intellectual property rights, clearance of mines, human resources development, energy, regional cooperation and drug abuse control. A Joint Committee comprising members of the GoL and the EC has been established in order to ensure the smooth operation and effective implementation of the agreement.

The Protocol for the accession of Lao PDR to the EC-ASEAN Agreement of 1980 was signed on 28 July 2000. Participation in the agreement allows parties to be involved in EC-ASEAN cooperation activities. Both sides are working on a number of projects designed to enhance trade and investment between the two regions and to promote mutual understanding. These include sectoral programmes dealing with standards, energy, environment, business links and education. In addition, in 2004 Lao PDR joined the Asia-Europe Meeting (ASEM), which is an informal process of dialogue and cooperation bringing together the EU Member States and the European Commission with ten Asian countries.¹³

3. The Development Policy Statement

On 20 December 2005, the Presidents of the European Commission, the European Parliament and the EU Council signed the first joint Development Policy Statement (DPS). This "European consensus" will provide the Union with a common vision of values, objectives, principles and means for development. The revised statement is intended to take account of changes both within the EU and internationally since the first statement on the European Community's development policy was adopted by the Council and Commission in November 2000. The new joint statement is structured in two parts, which set out:

- In the first part, "the EU vision of development", the objectives, principles and methods by which the EU at Community and Member State levels implement their development policies; the eradication of poverty in the context of sustainable development, including pursuit of the MDGs, remains the overarching objective. The fundamental principles are ownership by partner countries, political dialogue, participation of civil society, gender equality and improved response to "difficult partnerships" and fragile states. The importance of increased financial resources and aid effectiveness is stressed, especially the commitments under the Rome (2003)

¹² [http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:21997A1205\(01\):EN:HTML](http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:21997A1205(01):EN:HTML)

¹³ Brunei, China, Indonesia, Japan, South Korea, Malaysia, the Philippines, Singapore, Thailand and Vietnam. The ASEM 5 process will also include three ASEAN countries that are new members of ASEM (Cambodia, Lao PDR, Burma/Myanmar).

and Paris (2005) Declarations. Furthermore, the EU states its commitment to policy coherence in the sense that the objectives of development cooperation must be taken into account in all the policies that it implements which affect developing countries.

- The second part, “the European Community’s development policy”, gives guidance for implementation at Community level. This part clarifies the EC’s role and added value and how the objectives, principles, values, policy coherence for development and commitments defined in the common vision will be made operational at Community level. The European Commission should play an important role in facilitating coordination and harmonisation, especially as a driving force for the implementation of the Paris Declaration on aid effectiveness.

ANNEX 7: Budget support in Lao PDR

1. Mechanism of budget support under the PRSO

The Poverty Reduction Support Operation (PRSO) is a three-year budget support instrument of the World Bank. The current PRSO series (PRSO-1-2-3) will expire in March 2007, and the need for another three-year programme will be negotiated on the basis of an assessment of the end-of-series indicators.

From the standpoint of the EC, the PRSO is not a classical mechanism of budget support. EC funds are expected to be channelled directly to the Treasury. Successful completion of the Government's own plans, the key elements of which are identified as PRSO "expected actions", will enable donors to release funds, while the completion of a series of "triggers" (those "expected actions" considered most critical by the GoL and the PRSO co-financiers) will help donors to decide to begin preparations for the next PRSO.

2. Outline of the PRSO

The PRSO policy matrix is made up of three components: public expenditure management, public expenditure policies and sustainable growth, with a number of sub-components in each. Each component is composed of a number of essential policy actions (or "triggers") and other "expected actions". Currently there are 37 priority actions out of which 11 have been agreed as triggers for PRSO-3, offering a rigorous framework for measuring reform progress (the number of expected actions and triggers is subject to policy dialogue). Until now, the overall reform performance has been satisfactory, which demonstrates strong ownership of the Government over the policy matrix. However, it should be noted that one "trigger" relating to the reform of the banking sector was judged to be "off track" under PRSO-2.

The Government, the EC and the World Bank have agreed that the Public Expenditure and Financial Accountability (PEFA) framework will be used as a key monitoring mechanism for reform performance in the PFM area. Under the next multi-year programme document, the PEMSP reform outcomes will be linked directly to the PEFA framework in order to facilitate performance monitoring.

In its current form, the PRSO is highly focused on PFM (Public Finance Management) issues, particularly on reducing the fiscal liabilities of State-Owned Enterprises and State-Owned Commercial Banks, and on improving revenue mobilisation and the functioning of the budgetary system. This is appropriate in order to ensure that the large NT II revenues will be channelled towards the pro-poor priority sectors (health, education, rural development and infrastructure), and to build proper control systems for public finances prior to the inflow of the new funds. The PRSO will target social sectors in aiming to ensure that a growing proportion of the state budget is allocated to health and education. The budgetary process needs to be strengthened in order to demonstrate that the NT II revenues are **additional** to other investments in the priority sectors. Over the long run the scheme is expected to gradually deepen its policy reform agenda in the social sectors, trade, private sector development and natural resource management. The current "triggers" under PRSO-3 are:

Triggers for PRSO-3

Trigger 1: MOF approves an updated PEMSP based on 2005/06 PER analysis and demonstrates ongoing progress with implementation and capacity building
Trigger 2: MOF prepares FY2006-07 budget with (i) administrative classification; (ii) priority expenditure sectors/programmes; and (iii) summary data on statutory funds, publishing a summary within the first quarter of the fiscal year
Trigger 3: MOF drafts and issues for consultation an appropriately revised Budget Law, Treasury Decree and other implementing regulations and guidelines
Trigger 4: MOF approves revised GFS-compatible chart of accounts, budget nomenclature and implementation strategy, following consultations with key stakeholders
Trigger 5: MOF (i) approves a reporting format for quarterly consolidated budget execution reports; (ii) develops a tool for extracting the necessary data from the GFIS; and (iii) pilots quarterly consolidated budget execution reports
Trigger 6: Bank Restructuring Implementation Committee (BRIC) submits to MOF a quarterly evaluation of BCEL and LDB performance against operational and financial targets and MOF and BOL take corrective actions for targets off track
Trigger 7: BPO carries out quarterly monitoring and evaluation and submits to PMO a semi-annual evaluation of progress against approved restructuring plans for SOEs; and PMO takes corrective action for SOEs off track
Trigger 8: Government and <i>Electricité du Laos</i> implement succeeding phases of the power sector action plan
Trigger 9: Government improves the timeliness of payment of salaries to teachers and health workers
Trigger 10: Government makes progress with new Enterprise Law implementation
Trigger 11: Government prepares a Forest Industry Restructuring Plan to rationalise industrial capacity and resource supply

3. Risks involved with budget support

Important concerns remain regarding the risks related to the weak public financial management system in Lao PDR. To analyse these fully, a Diagnostic Study on the state of the PFM system was completed in May 2006. (Preliminary findings of the study are attached to the MIP.)

In Lao PDR, no IMF programme currently exists due to issues related to independent external auditing of the state bank. The GoL has indicated that auditing is to be done by the State Audit Office, in accordance with international auditing standards, and the ADB is providing capacity building in this area. The IMF continues to work in the country through the Enhanced Surveillance mechanism, conducts standard Article 4 consultations yearly and issues six-monthly reviews. It also participates in the Public Expenditure Review. The IMF is ready to provide a letter of confidence in support of EC participation in the PRSO, if necessary.

4. Donor involvement in the PRSO and PFM reform

(a) Joint analytical work

In the PFM area, there is an ongoing effort by key donors to conduct joint analytical work, resulting in technical and policy recommendations to the GoL. The ongoing Public Expenditure Review (PER) is the best example of this, being a joint effort between the WB, the ADB, the IMF and the EC. Japan, Sweden and France participate regularly in the donor consultation meetings on the PRSO and PER.

(b) Technical Assistance

To mobilise Technical Assistance for the Public Expenditure Management Strengthening Programme (PEMSP), the Ministry of Finance is currently setting up a Multi-Donor Trust Fund. This fund is expected to be operational by end-2006 and it is expected to be administered by the World Bank, with a view to providing pool-funding for TA. In the next MIP, a minimum of 5-7% of the funds will be earmarked for TA (to be delivered probably through the Trust Fund). In mid-2006, EC also plans to use the Framework Contract facility for financing a long-term TA mission in preparation for budget support and in support of the PEMSP.

(c) Coordination mechanism

It is not entirely clear to what extent the PRSO lends itself to be used as an operational aid harmonisation/policy dialogue instrument as such, given that the PRSO negotiations are mostly dominated by the Ministry of Finance (whereas the Ministry of Foreign Affairs remains in charge of donor coordination). Another option may be to mainstream the policy dialogue on PRSO reforms into the wider policy dialogue on reforms in the PFM and economic sectors, in the context of the Donor Working Group on Macro-Economy. In December 2005, the EC Delegation in Vientiane organised a four-day seminar and workshop event on budget support. This event involved a high-level Budget Support Seminar and a technical workshop attended by some 50 participants from government and the donor community.

A key coordination mechanism for all reforms in the PFM area is the Public Expenditure Management Strengthening Programme (PEMSP), which is a programme under the umbrella of the NGPES, officially launched in November 2005. It has been agreed that **the PEMSP reform outcomes will be linked directly to the PEFA framework** in order to facilitate performance monitoring.

ANNEX 8: Donor matrix (disbursements in 2003)

Donor /Sector	Transport	Energy	Rural Development	Economic Management	Social Development	Health	Agriculture, Forestry & Irrigation	Education	Development Administration	Other	TOTAL USD MILLION	TOTAL %
ADB	15.56	8.9	6.06	1	10.68	3.99	1.56	3	1.54		52.29	
World Bank	16.72	7.34	7.73	7.12		1.37	1.23		2.11		43.62	
IMF					11.4						11.4	
OPEC	1.03		1.46				0.9				3.39	
JBIC	23.92										23.92	
Others		10.21	2.6				1.73				14.54	
Financial Institutions	57.23	26.45	17.85	8.12	22.08	5.36	5.42	3	3.65		149.16	36%
UNDP		0.003	0.41	0.93	3.23	0.35	0.003	0.31	0.45	0.84	6.526	
UNICEF					0.6	2.06		2.98			5.64	
UNESCO					0.059	0.047		0.119			0.225	
WFP			1.92					0.9		1.2	4.02	
WHO						1.33					1.33	
FAO		0.04					0.63				0.67	
UNIDO								1.23	0.49	0.44	2.16	
UNFPA					0.17	0.8		0.17			1.14	
UNDCP	2.36		2.38		0.09				0.03		4.86	
Others					1.09		0.47	0.04	0.06	1.69	3.35	
UN Agencies	2.36	0.043	4.71	0.93	4.149	4.587	11.943	5.749	1.03	2.48	29.921	7%
EC			5.8	0.36		1.56	1.32	0.24		0.36	9.64	
France		1.8	2.2		2.37	0.31	2.42	3.47			12.57	
Germany					0.3		0.63	0.67	0.63	8.11	10.34	
Sweden	6.78						2.92	3.46		5.4	18.56	
Belgium					0.5	0.65	0.095	0.13			1.375	
Luxembourg			1.08		1.16	0.7		1			4.023	
Denmark			0.85	0.083	1.36		0.2	1.28		0.3	3.99	
EC + MS	1.66	1.8	6.78	0.083	6.7	4.02	5.185	7.86	1.79	9.76	52.098	15%
Japan	27.98	13.35			4.93	3.07	6.6	5.56	38.38	3.55	103.42	25%
China	3.04	22.31			0.52	2.44		0.62		0.3	29.23	
Australia		0.06	0.54	0.64	2.91	2.88	0.5	7.15	2.55		17.23	
Vietnam	0.33			0.13	1.67	0.43	2.67	3.66		1.73	10.62	
USA	2.46		0.35		5.45						8.26	
India		3.33									3.33	
S Korea					0.1		0.16	0.75			1.01	
Switzerland							0.88				0.88	
Thailand	0.23						0.035	0.48		0.03	0.775	
New Zealand	0.19							0.26	0.11	0.11	0.67	
Finland										0.29	0.29	

Norway						0.06					0.06	
Non-EU bilateral	34.23	39.05	0.89	0.77	15.58	8.88	10.845	18.48	41.04	6.01	175.78	42%
Bilateral total	35.89	40.85	7.67	0.853	22.28	12.9	16.03	26.34	42.83	15.77	227.87	
OVERALL TOTAL	95.48	67.343	30.23	9.903	48.509	22.847	33.393	35.089	47.51	18.25	406.95	100%

ANNEX 9: Concept paper for establishing policy dialogue between donors and government on village consolidation

1. Typology of relocation

Village relocation is a part of Lao history. People have traditionally moved their villages either as part of a pattern of shifting cultivation or in the search for better economic prospects. In addition, there have been occasional external shocks that have caused significant displacements of populations. These have included the Lao-Siamese war of the 19th century as well as the Indochinese War and post-war reconstruction.

However, the relocation of villages that principally concerns this paper is that associated with Government of Lao relocation policy. This has taken place in the period since Independence in 1975 and particularly since the launching of the New Economic Mechanism in 1986.

Two key development objectives underpin relocation policy. They are preserving natural resources and integrating remote areas into the market economy.

The elimination of slash-and-burn agriculture is seen as key to arresting the rapid decline in forest cover. It is the ethnic minorities in remote locations who commonly practice this method of farming. The most remote and poorest regions might also cultivate opium poppy. A further policy objective has been to make government services accessible to everyone. Given the expense of bringing good-quality services to remote and scattered communities, government has preferred instead to bring the communities to the services.

Attempts to reduce slash-and-burn agriculture, eradicate poppy cultivation and bring people closer to services have led to the creation of “focal zones” for development. These zones are created along the routes of new roads and in lowland areas suitable for sedentary rice cultivation. Thus a significant feature of resettlement through government policy is the movement of people from upland areas to the lowlands and valleys. Another important element is that movement is typically the result of negotiations between government and community. These negotiations can extend for more than a year if the community is reluctant to move. Displacements are often accepted or even requested by villagers because of the difficulty of sustaining their livelihoods in their original locations.

Relocation policy is not consistently implemented across all provinces and districts. Development potential, the availability of lowland land, the extent of upland food shortages, the number of villages involved, the provincial government’s means and officials’ commitment to the policy all vary from one province or district to another.

2. Extent of relocation

Each district assesses its capacity to develop alternative economic activities with which to sustain its population as slash-and-burn agriculture is eliminated. Districts that calculate they cannot support all of their populations are expected to arrange the movement of the excess population to other districts. In some cases up to 50% of a district’s upland villages may be expected to relocate.

Studies have rarely been able to provide an overview of the extent of village relocation in Lao PDR. However, the several localised studies that do exist provide compelling evidence

of a great movement of people. Estimates indicate that 30-50% of villages in studied districts have moved within the last 20 years and that this process is still continuing, although the current rate is difficult to judge.

3. The effects of resettlement

The process of resettlement has been subject to two main economic constraints: the cost of preparing the resettlement sites, which has far exceeded the Government's means, and the lack of availability of suitable unoccupied land. Thus in several cases the access to agricultural land, forests and government services has been inadequate for the needs of the relocated communities. This has resulted in many villages being less well off after moving than they had been before. Studies have highlighted the following key issues:

Health. Villagers' health is often the first casualty of relocation. Some villages have recorded high death rates in the first year after moving. Epidemics of malaria, dysentery and measles are common. Infant mortality too has been seen to remain stubbornly high several years after migration. On the positive side, improved practices of boiling drinking water and using mosquito nets have been observed.

Food and agriculture. Conversion from traditional slash-and-burn techniques to sedentary paddy cultivation usually results in an initial fall in rice production and an increase in the food gap between harvests. Problems appear particularly acute in the north, where available paddy land is in short supply and serious problems of low fertility exist. The shortage of forests in the lowlands limits villagers' ability to hunt and gather alternative foods. Furthermore, particularly in the early years after relocation, resettlement in the north has not been successful in eliminating swidden practices as communities resort to their old practices to compensate for low rice yields.

Alternative economic activities. These may include labouring for a wage, handicraft production, cash cropping and horticulture. Proximity to towns and markets can have a positive effect here. However, evidence suggests that revenue is limited and that acquiring knowledge of markets is a necessary pre-condition for generating alternative sources of income through trade.

Culture. One notable impact of relocation is "cultural rupture" – the abrupt parting from traditional beliefs and ways of doing things. Young people tend to be more adaptable than the old and adopt change more readily. Cultural rupture is therefore most pronounced between generations. Population movement can result in changes in language, dress, housing, agriculture, diet, beliefs and other behavioural traits. Although there are benefits associated with cultural assimilation (such as the ability to communicate in a common language with people of other ethnic backgrounds) and access to services and markets associated with relocation, it is equally clear that cultural heritage is put at risk.

In addition to the issues discussed above village relocation may also result in an increase in human trafficking as a result of people seeking off-farm work, increased risk of conflict due to competition for limited land and resources and sometimes the concentration in one village of groups with differing ethnicity and increased drug and alcohol consumption.

4. The case for donor assistance

Village relocation is a difficult issue for donors. It has a bad image and is often associated with forced movement of ethnic minorities against their will to places where they are worse off than before.

However, it also needs to be recognised that both spontaneous migration and the policy of relocation are proceeding whether or not donors provide support. The Government has requested assistance and has indicated its willingness to enter into dialogue with donors on the matter. In addition, given the sheer scale of village relocation, most rural development projects have to deal with the issue of resettled villages.

There are social, economic and environmental benefits to be gained from better management of the programme. The application of a larger amount of resources to planning and implementing village relocation could significantly ease the difficult process of transition and offset the threats to health and food production whilst allowing the communities to benefit from the advantages that relocation can offer. At the same time the case for some villages and some parts of villages to remain where they are can be examined and supported in a complementary way.

5. Proposed approach

Rationale

Relocation occurs as a result of the implementation of policy designed to achieve the objectives of eliminating slash-and-burn agricultural practices, eradicating opium poppy cultivation and bringing people closer to services and markets. Where successful the policy results in the preservation of natural resources, particularly forests, the eradication of an illegal activity and an increase in the welfare of the relocated communities. However, these objectives have not always been achieved and there are many cases in which relocated people have become worse off than they were before moving and in many cases agencies like ECHO and the WFP have been obliged to intervene to address humanitarian needs. In order for Lao PDR to achieve the NGPES long-term objective of eradicating poverty by 2020 and moving out of the category of Least Developed Countries the issues of both poverty in relocated villages and development for villages *in situ* need to be addressed.

Principles

Donors believe that a good village reconsolidation policy should respect the following principles:

- Relocation should be voluntary and based on a participatory approach that respects cultural and sociological considerations;
- Villages with development potential where they are should be encouraged to exploit it;
- Resettlement sites should be developed in advance of occupation and be adequate for the needs of those moved;
- Relocation should fit within a long-term vision of development.

Methodology

Donors propose that the dialogue with the GoL should begin with a discussion of priorities for government and an examination of existing information on the nature, extent and effects of relocation. If agreement is reached in principle, dialogue will go on to take place at three levels. It will begin with Central Government with a view to agreeing on a strategy

for relocation and a partnership role for donors. At provincial level, discussions with the Provincial Governor and his staff will focus on the identification of villages given priority for moving, planning of the relocation and planning for those that can remain. At district level, discussions will be held with local authorities and implementing agencies to agree on the details of relocation. Implementation of any action will be based on these discussions and will embrace consultations and planning with villagers.

Donors also propose the creation of a joint “task force” to lead a consultative process with a view to making a better contribution to the issues of development and village relocation. Indicatively, the task force should consist of representatives of: the DIC, the CPI, Governors of provinces with large resettlement programmes, the Ministry of Agriculture, the Ministry of Education and Country Representatives of participating donors. The task force will be responsible for shaping a policy on resettlement, determining the extent of available resources and drawing up a programme for implementation. It will be necessary to recognise the limited nature of resources in comparison with the scale of the problem and that some slowdown in the rate of relocation will be necessary to allow for improved planning. Implementation agencies may be government offices, NGOs or other players.

ANNEX 10: Consultations with Member States and other stakeholders

The first draft of the Strategy Paper was presented to the four Member States resident in Vientiane (S, DE, FR and PO) in June 2005. The Member States gave their comments in a meeting at the EC Delegation and these were taken into account in the text.

A second draft was sent to the Member States in October 2005. Comments from Sweden were received focusing on relocation and aid effectiveness and these were taken account of in the text. A later draft of the text (April 2006) was discussed with Member States in Thailand and Vietnam accredited to Lao PDR.

A summary of the main approach of the Strategy Paper was presented to the broader Donor Working Group in December 2005. No reactions were received.

The draft SP was sent to the Government of Lao PDR in December 2005. Some comments were integrated into the text at a meeting held at the Vientiane Delegation.