



LAO PDR:  
GOVERNANCE ISSUES  
IN AGRICULTURE AND  
NATURAL RESOURCES

A Case Study from the 2005 Sector Assistance Program  
Evaluation for the Agriculture and Natural Resources  
Sector in the Lao People's Democratic Republic

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# Abbreviations

ADB	Asian Development Bank
ANR	agriculture and natural resources
Lao PDR	Lao People's Democratic Republic
LPRP	Lao People's Revolutionary Party
NEM	New Economic Mechanism
NTFP	nontimber forest product
SOE	state-owned enterprise

## NOTE

In this report, "\$" refers to US dollars.

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# I. Background

1. The Asian Development Bank (ADB) defines governance as the manner in which power is exercised in the management of a country's economic and social resources for development.<sup>1</sup> The pillars of the ADB's policy on governance are presented in Table 1. The concept of governance is concerned with the management of the development process, involving both the public and private sectors. It covers the functioning and capability of the public sector, including the rules and institutions that create the framework for the conduct of both public and private business, and regulatory frameworks. There is an extensive literature on governance in the Lao People's Democratic Republic (Lao PDR), and this case study highlights a few key issues which affect the agriculture and natural resources (ANR) sector's performance.

**Table 1: Pillars of the ADB Governance Policy**

Pillars of Governance	Key Dimensions	Specific Action Areas
1. Accountability means making public officials answerable for their behavior, actions, and decisions and being responsive to the entity from which they derive authority	<ul style="list-style-type: none"> <li>Establishing criteria to measure performance of public officials</li> <li>Institutionalizing mechanisms to ensure that standards are met</li> </ul>	<ul style="list-style-type: none"> <li>Public sector management</li> <li>Public enterprise management</li> <li>Public financial management</li> <li>Civil service reform</li> </ul>
2. Participation refers to enhancing people's access to and influence over policy and decision making	<ul style="list-style-type: none"> <li>Undertaking development for and by the people</li> </ul>	<ul style="list-style-type: none"> <li>Participation of beneficiaries and affected groups</li> <li>Government-private sector interface</li> <li>Decentralization of public and service delivery functions (empowerment of local governments)</li> <li>Cooperation with nongovernment organizations</li> </ul>
3. Predictability refers to the fair and consistent application of laws, regulations, and policies to regulate society	<ul style="list-style-type: none"> <li>Establishing and sustaining appropriate legal and institutional arrangements</li> <li>Observing and upholding the rule of law</li> <li>Maintaining consistency of public policies</li> </ul>	<ul style="list-style-type: none"> <li>Law and development</li> <li>Legal frameworks for private sector development</li> </ul>
4. Transparency refers to the availability and accessibility of information to the public and the clarity of rules and regulations	<ul style="list-style-type: none"> <li>Ensuring access to accurate and timely information about the economy and government policies</li> </ul>	<ul style="list-style-type: none"> <li>Disclosure of information</li> </ul>

Source: Summarized from ADB. 1995. *Governance: Sound Development Management*. Manila.

<sup>1</sup> ADB. 1995. *Governance: Sound Development Management*. Manila.

2. The Lao PDR was proclaimed in 1975, ending the rule of the Royal Lao Government of the Kingdom of Lao (1946–1975). Much of the country was in ruins after 20 years of political struggle and the effects of the Indochina war (1964–1973). The communist government sought development through agriculture. Attempts at collectivization of agriculture, designed to gain state control over agricultural production, encountered strong opposition. Agricultural production stagnated. In 1979, the Lao People’s Revolutionary Party (LPRP) took its first steps towards market-oriented reform by easing restrictions on private trade and encouraging joint ventures between the State and the private sector. An interim 3-year economic development plan began in 1979. The Government reduced agricultural taxes and increased state procurement prices for most crops, but it retained central planning. In 1981, the first 5-year development plan began. More far-reaching reforms began with the introduction of the New Economic Mechanism (NEM) in 1986, coinciding with the commencement of the second 5-year development plan. The NEM recognized the dominant role of agriculture and sought to address shortcomings in the sector through reform measures to move toward a market economy. The Government abandoned the collectivization of agriculture, eased restrictions on private sector activities, and allowed state enterprises to have more decision-making authority.

3. The adoption of the 1991 Constitution of the Lao PDR marked an important milestone, laying the foundation for the country to create an effective legal system on which to establish the rule of law. The Constitution defines the country as a people's democratic state, with the LPRP as the nucleus of the country’s political system. With around 65,000 members, the LPRP is the only political party in the country. It is governed by a Central Committee and headed by an 11-member Politburo. The members of the Politburo are elected from and by the Central Committee. The Politburo dominates policy making within the LPRP and is the single most influential body within the Lao PDR. Major policy is set at the LPRP Congress, which is held every 5 years, and at meetings of the Central Committee in the interim.

4. The political economy of the Lao PDR exhibits certain features that may be regarded as constituting weak governance. These include an overly bureaucratic, politicized, and underperforming civil service; a weak judicial system and poor legislative oversight; and the lack of empowerment of civil society.<sup>2</sup> There is some nepotism and patronage within the political and bureaucratic systems.<sup>3</sup> With inadequate transparency and accountability, observers (including aid agencies) find it difficult to understand the decision-making processes and structures. The Governance Research Indicator Country Snapshot (2005) of the World Bank rated the Lao PDR below all countries in the region except Myanmar on measures covering the rule of law, regulatory quality, control of corruption, and government effectiveness.<sup>4</sup>

5. The Government has taken several steps to increase the efficiency of public services by (i) introducing guidelines on public administration reform in 1998, (ii) establishing the central committee for government organization improvement under the Prime Minister and provincial committees (1998–2000), (iii) establishing the State Audit Organization (1998), (iv) issuing a Prime Ministerial order on anticorruption (1999), (v) restructuring central agencies and ministries (1999–2000), (vi) issuing a Prime Ministerial decree on decentralization (2000), (vii) transferring personnel management functions from the LPRP (organizational committee) to the Prime Minister’s Office (Public Administration Department) in 2001, (viii) reviewing and increasing civil servants’ salaries (2000–2002), and (ix) developing and

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<sup>2</sup> There are four nonstate mass organizations: the Lao Women's Union, Lao People’s Revolutionary Youth Union, Lao Front for National Construction, and the Lao Federation of Trade Unions. The Government does not officially encourage the establishment of local nongovernment organizations. Except for the Lao Red Cross, there are few indigenous organizations that may be considered as emerging organizations operating independently of the Government. Two examples are Champa, which is active on health issues, and Padek Lao on agriculture.

<sup>3</sup> Articles 36 and 37 of the Civil Service Decree prohibit nepotism. Article 32 seeks to stop conflicts of interest in relation to involvement of government employees in private businesses. Neither of these Articles has been elaborated with procedures of mutual rights and obligations.

<sup>4</sup> World Bank. 2005. *Governance Research Indicator Country Snapshot, 1996–2004*. Washington DC. Available: <http://info.worldbank.org/governance/kkz2004/>.

implementing a new performance evaluation system for civil servants (2000–2002). However, even with these measures, the structure and capability of public service needs further strengthening to realize the country's potential.

6. Priority areas for governance reform were identified and described by the Government in 2003. For the first time, the Government drafted a policy paper on governance issues and discussed it with funding agencies at a governance roundtable meeting in 2003.<sup>5</sup> This represents an important milestone towards governance reform, emphasizing public service improvement, people's participation, the rule of law, and sound financial management. In November 2004, a follow-up governance roundtable was held, and the Government reported on progress during the first 18 months of implementation, further prioritized governance policy reform areas, and highlighted resources required.

7. Strengthening the legal framework has continued. Regulatory frameworks for public finance were introduced with assistance from ADB including (i) decrees on the public investment program and official development assistance management, and (ii) government accounting regulations and procedures. Nevertheless, weak governance and capacity, particularly at the local level, continue to be serious constraints to the country's development and poverty reduction efforts. Further progress in establishing a regulatory framework for improved governance includes (i) amendments to the Constitution, strengthening the public administration mechanism and structure; (ii) adoption of the revised National Assembly Law, the Government Law, the Local Administration Law, and the Law on Enforcement of Court Sentences; and (iii) revisions to the Land Law, Civil and Criminal Law, the Law on the People's Court, and the Law on People's Judiciary Authority. The Prime Minister issued the Civil Service Act in May 2003 to improve civil service management by introducing recruitment exams, job descriptions, assignment criteria, performance evaluations, and a reward system. ADB has supported development of commercial courts.

8. The Government developed a program to strengthen public expenditure management with assistance from ADB and the World Bank. The program was designed to improve consistency, efficiency, transparency, and accountability in public expenditure management, including expenditure planning and budgeting, budget execution, accounting, and reporting at both the central and provincial levels. ADB has provided technical assistance to the Government to strengthen its accounting regulations and procedures, and the institutional capacity of the State Audit Organization. In 2004, the Lao PDR adopted laws on enforcement of court decisions and the National Assembly's monitoring and inspection function.

9. Major governance concerns in the ANR sector include (i) corruption and its consequences, (ii) deficiencies and inconsistencies in the legislative framework and its implementation to manage common property natural resources on a sustainable basis, (iii) inadequately supervised and largely unaccountable state-owned enterprises (SOEs), and (iv) a number of policies that appear to be biased against the interests of the rural poor (including ethnic minorities). The importance of good governance in ANR to the country's economic development is well recognized by the Government and aid agencies including ADB. The Government recognizes that governance is a vital link between economic growth and poverty reduction and that environmental sustainability is a prerequisite for continued sustained economic growth and poverty reduction.

10. A key governance constraint in the Lao PDR is corruption at all levels. New opportunities for corruption emerged as economic reforms started to take hold in the 1980s.<sup>6</sup> Since 1993, the

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<sup>5</sup> Lao PDR: Public Service Reform, People's Participation, Rule of Law and Sound Financial Management - Background Paper on Governance, Priority Areas for Governance Reform: Roundtable Process. Vientiane, March 2003.

<sup>6</sup> Clay Wescott in Jack Rabin, ed. *Encyclopedia of Public Administration and Public Policy*. New York: Marcel Dekker, Inc., in press (Online). Available: <http://www.dekker.com/sdek/132499623-95569352/issues~db=enc~content=t713172970>.

Government has taken many actions to address corruption by adopting an anticorruption decree in 1999; issuing new directives at the LPRP Congress in 2002; publicly condemning lavish consumption; and strengthening the State Audit Organization, State Inspection Authority, and Inspection Department of the Ministry of Finance. Box 1 presents a chronology of major anticorruption initiatives. In April–May 2005, the National Assembly deliberated on and adopted laws on anticorruption measures, commercial arbitration, and amendments to laws on taxation and customs.

#### Box 1: Chronology of Anticorruption Initiatives in Lao PDR

- 1986** Corruption was recognized for the first time at the 4th Party Congress. The system of central planning was blamed for the deficiencies in the management of state affairs.
- 1993** The Prime Minister issued a decree designating the role of Party Control Committees to fight corruption at the central, provincial, and local levels, as well as in the ministries, prosecutor's offices, and courts. The decree stipulated that all citizens have the right to sue and provide information to battle corruption. A Central Task Force on Corruption was formed.
- 1996** Prime Ministerial Decree No. 8 details the relevance of eradicating corruption; the State Inspection Committee was created, tasked to serve as the internal control within the Government. However, the committee was dissolved after a year and was replaced by the Party Control Committee.
- The United Nations Development Programme (UNDP) funded the first study on audit and inspection in the country, which led to the formation of the State Audit organization in 1998 with technical assistance (TA 2987-LAO) from ADB.
- 1998** At the time of the financial crisis, Prime Ministerial instruction No. 16/PM was issued to prevent mismanagement and misuse of government resources, including resources obtained from official development assistance. This instruction also attempted to cease widespread unofficial use of government vehicles. The State Audit Organization was established under PM Decree No. 174/PM.
- 1999** Prime Ministerial Decree No. 192/PM established detailed regulations of the budget law and how to economically use the state budget. The Anticorruption Decree (No. 193/PM) was issued to suppress the growing incidence of petty and grand corruption in the government. It defined corruption as the endemic abuse by some groups and individuals, who intentionally misuse their position, power, and authority to steal public assets, accept illegal fees or bribes; and disobey rules, regulations, and laws in order to benefit themselves, their families and relatives, their cronies, and partners (article 2).
- 2001** The State Inspection Authority (SIA) was established as the new anticorruption body reporting directly to the Prime Minister.
- 2003** The first Round Table Meeting on Governance was organized by the Government and the United Nations Development Programme. Aid agencies were requested to provide assistance in the area of accountability, transparency, and integrity. Lao PDR became a signatory of the United Nations convention against corruption.
- 2005** April–May 2005, the National Assembly deliberated on and adopted laws on anticorruption measures.

#### Sources:

Keuleers, Patrick. 2002. *Case Study Lao PDR Corruption in the Lao PDR: Underlying Causes and Key Issues for Consideration*. Bangkok: UNDP.

UNDP. 2004. *Combating Fraud and Corruption for the Transparency and Effectiveness of the Public Management in Lao PDR*. Paper presented at the Training and Experience Sharing Seminar on "Public Ethics and Accountability". 20-22 September 2004 Hanoi, Viet Nam.

ADB. 2005. *Lao PDR: Country Strategy and Program Update (2006–2008)*. Manila.

11. Factors contributing to corruption in the civil service include (i) inconsistent understanding among government staff of government policies and their responsibilities, (ii) incomplete legal

framework, (iii) unclear decentralization systems and inadequate job descriptions,<sup>7</sup> (iv) limited capacity in public administration at the central and local levels, and (v) inadequate organizational systems.<sup>8</sup> Despite past wage increases, government salaries are still generally below the minimum needed for food and basic necessities.<sup>9</sup> Low salaries effectively mean that government employees must have other jobs, family businesses, or other sources of income to survive. The current salary-scale is a major impediment to curbing abuse of public positions for private gain.

12. The relevance of governance to the ANR sector can be illustrated as follows: (i) agricultural growth directly benefits the majority of the poor; this growth (including in foreign direct investment) in ANR depends on the transparency and predictability in the implementation of investment laws, the trade regime, and taxation; (ii) farmers, agribusiness enterprises, and investors must have confidence in relation to their land tenure to ensure security of property rights; (iii) agricultural growth also depends on protecting water, soil, and forest resources through controlling the commercial and population-driven loss of forest, and on the Government's capacity to monitor and regulate, and to impose penalties for illegal acts; and (iv) changes required to increase the agricultural growth rate depend partly on governance and how well domestic organizations function.

## II. Resource Allocation

13. Since fiscal year (FY) 2001, with the implementation of fiscal stabilization initiatives launched in late 1999, the Government has made some progress in shifting the structure of spending towards priorities laid out in its development and poverty reduction strategies. However, the scope for reallocation of resources has been constrained by slow recovery of revenues and, consequently, modest growth in the budget base. Allocations to agriculture fell sharply from 19% of total public expenditures in FY2001 to 9% in FY2004, as the Government cut back on large irrigation schemes (Table 2). About one half of domestically financed expenditures were allocated to public administration, security and justice, with the share of these rising slightly in recent years, partly driven by increases in personnel costs. Across all sectors, there has been a marked shift from capital to recurrent spending, with recurrent spending increasing from 53% of domestically financed expenditures in FY2001 to 65% in the FY2004 budget. However, operating and maintenance expenditures are still under-funded across all sectors, including ANR, and cost-recovery schemes finance key inputs.

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<sup>7</sup> New administrative and financial arrangements were introduced in 2000–2001 with the government decentralization measures, which devolved financial management to the provinces and districts. These changes worsened weaknesses in revenue management, budget formulation and execution, and expenditure management. Reportedly, provincial authorities failed to remit taxes and duties collected locally to the national treasury as required under the law.

<sup>8</sup> Lao PDR. *Implementation of Priority Areas of Governance Reforms, Progress Report, Governance Round Table Meeting*. Vientiane, November 2004.

<sup>9</sup> In January 2005, the government salary scale was categorized into 5 grades, each with 15 steps. The lowest salary grade and step was KN202,500 (\$19/month) and the highest KN631,500 (\$59).

**Table 2: Percentage of Public Expenditures in the Lao PDR  
(Excluding Debt Service)**

Sector	Total Expenditure				Excluding External Capital			
	Actual 2000/01	Actual 2001/02	Actual 2002/03	Budget 2003/04	Actual 2000/01	Actual 2001/02	Actual 2002/03	Budget 2003/04
<b>Public</b>	32	40	34	29	47	47	49	54
<b>Administration</b>								
<b>Economic Sectors,</b> of which	50	35	41	38	34	31	31	25
Agriculture	19	13	13	9	23	15	14	6
Transport and Communications	26	19	25	26	8	12	13	16
<b>Social Sectors, of</b> which	18	25	24	24	18	22	17	19
Education	9	13	11	12	10	12	10	11
Health	4	6	6	6	4	4	3	3
<b>Other/Reserve</b>	0	0	1	9	0	0	2	2

Source: Ministry of Finance, Budget Books.

### III. Business and Investment Climate

14. When the overall business and legal climates remain poor, it is unlikely that there will be large inflows of foreign capital, technology, and market information links to the ANR sector. For example, the 2005 Index of Economic Freedom ranked the Lao PDR 150th among 155 countries, with a weighted score of 4.33 (1 indicates best, 5 worst). Individual scores were as follows: trade policy (4), fiscal burden (3), property rights (5), regulation (5), informal market (5), government intervention (3), monetary policy (4), foreign investment (4), banking and finance (5), and wages and prices (4).<sup>10</sup> A snapshot of the business environment (2004) in the Lao PDR does not provide encouraging perceptions, reflecting major predictability and transparency issues in doing business in the country.<sup>11</sup>

15. The Lao PDR is perceived to be an unsafe place to invest by many companies that might otherwise invest in Lao agribusiness. Impediments include (i) risk imposed by the uncertain legal environment; (ii) difficulties with contract enforcement; (iii) transaction costs for business registrations, export licenses and other administrative processes; (iv) weak, sometimes contradictory, and often opaque regulatory and legal framework, which imposes extra burdens; and (v) market-restraining practices, nontariff barriers, and border irregularities. While the legal framework for the operation of commercial businesses has been developed, uncertainty persists.

16. Several factors hinder lending by banks and discourage foreign investors: (i) lack of translation and dissemination of legislation, (ii) limits on judicial capacity, (iii) incomplete repeal of legislation that is technically no longer in force, (iv) overlap between laws and between decrees, (v) uncertainty of title registration procedures, (vi) incomplete land titling and associated transaction costs, and (vii) time-consuming legal processes in relation to contract enforcement and debt recovery. All of these factors undermine the business environment in general, including the ANR sector.

<sup>10</sup> Available: <http://www.heritage.org/research/features/index/country.cfm?id=Laos>.

<sup>11</sup> World Bank. 2004. Doing Business, Snapshot of Business Environment, Lao PDR. 2004.

Available: <http://www.doingbusiness.org/ExploreEconomies/BusinessClimateSnapshot.aspx?economyid=107>.

## IV. Corruption and Its Consequences

17. The issue of corruption in the ANR sector is important, because it is both inequitable and it affects economic efficiency. Lao society is characterized by social control systems, inspired by tolerance, compassion, respect for authority and seniority, loyalty to kinships, and avoidance of confrontation. Some of these factors, combined with the country's political and economic history, contribute to the difficulties experienced in addressing corruption. Some of the new opportunities for corruption (which opened up as economic reforms started to take hold in the 1980s and afterwards) have included, for example, the following: (i) giving provinces the right to trade directly with neighboring countries has opened the way for trade-related graft; (ii) the opening up to foreign investment has introduced opportunities to collect money to facilitate required authorizations; and (iii) the enhanced political and economic role given to the army has provided new opportunities for smuggling.<sup>12</sup> Appointment or promotion on factors unrelated to merit and motivation can be a major disincentive for all government staff to perform effectively. Allegations of corruption in the ANR sector are not uncommon, and these may have also affected the ADB-financed Industrial Tree Plantation Project (Box 2).

### Box 2: Industrial Tree Plantation Project (Loan 1295-LAO)—Allegations of Corrupt Practices

The Project Completion Report (PCR) of this project was included as part of a sample of PCRs subjected to an in-depth review by the Operations Evaluation Department. The project was rated unsuccessful.

- Targeted and subsidized credit in the form of government-directed “policy” lending led to abuse and inefficiency. The interest rate to sub-borrowers was kept at 7% per annum in nominal terms in the local currency, while the inflation rates were subsequently higher than the interest rate.
- There were alleged cases of corrupt practices such as collusion between credit officers of the Agriculture Promotion Bank (APB) and clients to facilitate clients obtaining credit, and alleged ghost borrowers.
- There were serious allegations of misuse of credit funds, inflated development costs, and overdisbursements of loan funds. Credit amounts authorized by APB for individuals and, particularly, for enterprises were excessive. It was likely that credit funds were used not solely for the purpose of establishing tree plantations. An APB survey found major discrepancies between actual planted areas and the areas for which subloans were authorized.
- There was external interference, as APB acted as an agent of the Government to deliver directed credit. This allegedly included lending by APB to individuals endorsed by people of political influence.
- Thousands of farmers and individuals were misled into expecting unattainable gains, leaving the majority of farmers with onerous debts and with no prospect of repaying their loans. Business plans of individual sub-borrowers were developed based on unrealistic assumptions of expected yields, prices, and sub-borrowers' debt repayment capacity. The project counted on the prospect of markets developing rather than on actual markets. The approach as it evolved during project implementation was too risky for a public sector investment.

Sources:

- (i) ADB. 2005. *Project Completion Report on the Industrial Tree Plantation Project in the Lao People's Democratic Republic*. Manila.
- (ii) Interviews and observations by the Operations Evaluation Mission.

18. Recent work by the United Nations Development Programme suggests that corruption in the Lao PDR has now reached a level where it can no longer be ignored or tolerated by society, and that it may be the single biggest impediment to ongoing reform.<sup>13</sup> Articles have appeared in official media saying that corruption is a “chronic problem” and may be “undermining the revolution.”<sup>14</sup> This helps to

<sup>12</sup> ADB. 2001. *Key Governance Issues in Cambodia, Lao PDR, Thailand, and Viet Nam*. Manila.

<sup>13</sup> Keuleers, Patrick. 2002. *Case Study Lao PDR Corruption in the Lao PDR: Underlying Causes and Key Issues for Consideration*. Bangkok: UNDP.

<sup>14</sup> For example, in the ‘*Vientiane Times*’ (18-21 July 2003), cited in *Politics and Reform in the Lao People's Democratic Republic*; Martin Stuart-Fox, *Political Economy of Development Working Paper No.1 Program on Civil Society and Governance*, The College of William & Mary, 2004.

explain resistance to liberalization and deregulation of the business environment. Many opportunities for rent-seeking can be curtailed if not eliminated with increased efforts to fight corruption. Corrupt behavior reduces government revenues, misallocates expenditures, reduces foreign investment, and erodes public trust.

19. Rent-seeking behavior on the part of officials helps to explain many of the features of ANR transactions and activities in the Lao PDR. For example, the border trade with Thailand is driven by the market's ability to pay for primary produce. However, much of the border trade is conducted informally and illegally, largely in response to customs officials' demands for illicit payments. While



Tree plantation in poor condition

this is hard to document systematically, an example encountered by the ADB-financed Smallholder Development Project in early 2005 indicated that traders exporting castor beans to Thailand had to pay customs officials.<sup>15</sup> The added cost, unpredictability, and lack of transparency adversely affect the country's competitive advantage in export markets. Arbitrary imposition of informal levies on livestock exports encourages illegal activities and noncompliance with quarantine regulations. Numerous regulations (about which there is little understanding by officials and traders) governing the interprovincial movement of livestock, rice, fruits, and vegetables provide opportunities for domestic rent-seeking. The overall consequence of corrupt behavior exploiting the ambiguous and often inconsistent regulatory framework keeps ANR activity small-scale, informal, and low in value addition. More generally, the weakness of the tax and customs administrations, and corruption, are perceived to be among the main reasons for poor revenue generation. This has direct consequences on the rural poor, as services that might have been provided by the State cannot be made available (or are of inferior quality) because of a lack of funding.

## V. Need to Protect Common Property Resources

20. The policy, legal, and regulatory framework for sustainable environmental management has improved with passage of the Law on Water and Water Resources (1996), Forestry Law (1996), Land Law (1997), Agriculture Law (1998), and Environmental Protection Law (1999). Major gaps remain, however, between the formulation and implementation of legal instruments, and between the establishment and enforcement of rules and regulations. Inadequate transparency and poor accountability compromise the ability to monitor the environment. The lack of transparency is evident in the case of logging, where breaches of the law have not been dealt with or have gone unnoticed (Box 3).

<sup>15</sup> Allegedly, traders paid B6/kg to customs officials at the border, while the crop price at the farm gate was only B4/kg.

### Box 3: Governance Issues in Forestry

In general, legislation and regulations governing forestry are complex, incomplete, inconsistent, and difficult to interpret and apply. This creates a lack of transparency and predictability that permits various forms of inefficiency and inequity and severely compromises the performance of the forestry sector. Work under way for the possible creation of a plantation authority for the Lao PDR identified 26 specific pieces of legislation, decrees, and regulations that cover plantation operations with a list of articles that have to be complied with in plantation operations.

Logging is based on a complex system of quotas and permissions. The public allocation of logging rights has managed to guarantee neither long-term sustainability nor optimal economic return for the country or the local community. The system suffers from a lack of clear procedures, poor accountability, poor predictability, lack of transparency, and short-sighted views. It suffers from undue interventions by politicians and vested interests. Decisions on logging quotas are not based on sustainable forest management principles but rather on the need to supply wood industries with raw material and the Government with budget revenues. Four main factors contribute to this situation.

First, the regulatory framework is not geared to supporting effective forest management and utilization; criteria for land/forest designation are not published, and the official production forest is not mapped. Production forest designation is largely administrative, and not technical or economic. The arbitrary production forest designation distorts and is a serious constraint to planning and policy making.

Second, some entities issuing logging permits do not have the authority to do so. Logging approval obtained from local or central government authorities is often granted in violation of the law. In addition, unauthorized logging—carried out with or without the knowledge of the authorities—is illegal. Weaknesses in the enforcement of laws and regulations mean that illegal logging is not punished in the courts.

Third, the inadequate field demarcation and definition of protected areas compromises the system of national biodiversity conservation areas (which are extensive).

Fourth, the pressure exerted by companies for logging permits combines with the opportunities for corruption that the confusing legal and administrative arrangements permit. Allocation of production forest resources to firms is unsystematic, uncompetitive, and nontransparent; nor is it related to the annual allowable cut. Allocations are based on *ad hoc* short-term administrative criteria rather than on long-term sustainable forest management principles. Procedures for quota setting and granting are not clear, criteria not disclosed to the public, and guidelines are not available. Company proposals should be submitted through the provincial agriculture and forestry offices or the provincial governors to the Department of Finance and/or the Ministry of Agriculture and Forestry for review. There are allegations of companies circumventing this process.

Poor governance in the forestry subsector directly affects government finances. Logging royalties from forestry as a share of government revenues decreased from 20% in the mid-1990s to 6% of tax revenues and 5% of all revenues in 2000. In the 5 years to 2000, only 50% of royalties on logs was paid (representing a cumulative loss of some \$114 million in 1994/95–1998/99). Due to low recovery rates and log price trends, the government royalty from logging has been declining since 1990. The royalty system is based on an administrative pricing system that does not adequately respond to market trends. Wood processing is dominated by SOEs of various types and there is significant overcapacity.

#### Sources:

- (i) Lao PDR Production Forestry Policy: Status and Issues for Dialogue. A Joint Report (June 2001) by the World Bank, Swedish Bilateral Assistance (SIDA), and Ministry of Foreign Affairs of the Government of Finland.
- (ii) SIDA. 2004. *Lao PDR Country Analysis*. Embassy of Sweden, Vientiane.
- (iii) Keuleers, Patrick. 2002. *Case Study Lao PDR Corruption in the Lao PDR: Underlying Causes and Key Issues for Consideration*. Bangkok: UNDP.
- (iv) ADB. 2005. *TA 4419–LAO: Forest Plantations Sector Project, Model for the Proposed Lao Plantation Authority, (Draft) 2005*.

21. Law enforcement is a continuing challenge to protect common property in ANR. Experience suggests that it is difficult for the Science, Technology and Environmental Agency (STEA) to ensure that laws and regulations are followed at the provincial and district levels. Whereas technical and

administrative competence at STEA has improved (via externally funded projects), little has been done to enhance competence and capabilities at the provincial and district levels. This situation adversely affects the poorest, whose livelihoods typically depend on common property resources to a disproportionate extent.

22. Since poorly defined property rights often result in market failures in the development and use of these resources, a robust institutional framework is required (particularly in the context of securing informal property rights and good management of common resources) if private sector development and markets



Harvesting fuelwood from a tree plantation (*Eucalyptus camaldulensis*)

are to work for the poor. In the Lao PDR, the institutional framework is weak and largely ineffective. For example, for nontimber forest products (NTFP),<sup>16</sup> the Government's ability to enforce regulations on illegal exports appears weak. Increased commercialization (mainly with the People's Republic of China, Viet Nam and Thailand) of rare NTFPs is a threat to biodiversity, bringing several rare species to the edge of extinction. The importance of these products to rural livelihoods should not be overlooked. In 2001 a rural family consumed about \$280 equivalent per year of NTFPs.<sup>17</sup> Thus, the 800,000 rural families (about 4 million people) may use or consume NTFPs worth more than \$200 million annually, equivalent to 40% of the average rural family income. Experience from other countries indicates that the Government alone cannot ensure sustainable management of natural resources. Rural residents, civil society, and the autonomous research community, although weak in the Lao PDR, can play an important and necessary role in monitoring the actions of the Government and the private sector.<sup>18</sup>

## VI. Role of State-Owned Enterprises in Logging, Livestock, and Marketing

23. The political economy of the Lao PDR and its impacts on ANR may be illustrated through the operations of SOEs, mainly but not exclusively involved in logging. Until recently, three SOEs under the jurisdiction of the Ministry of Defense dominated the forestry sector (footnote 17).<sup>19</sup> At the heart of the military's commercial domain is the Import-Export Company, whose diverse activities include agriculture and forestry, construction, light industry, trade, and tourism (footnote 12). The forestry SOEs enjoyed preferential treatment in the allocation of logging, processing, export quotas, and logging contracts as well as exemptions from paying royalties (footnote 17). Over time, these SOEs

<sup>16</sup> NTFPs include food (such as game, bamboo shoots, fruits, honey, and plants), fibers (*khem* grass used to produce brooms, and paper mulberry), medicinal products, resins and oleoresins, bamboo poles, rattan, fuelwood, fish, and frogs.

<sup>17</sup> World Bank, Swedish Bilateral Assistance (SIDA), and the Ministry of Foreign Affairs of the Government of Finland. *Lao PDR Production Forestry Policy: Status and Issues for Dialogue A Joint Report* (June 2001).

<sup>18</sup> SIDA. 2004. *Lao PDR Country Analysis*. Embassy of Sweden, Vientiane.

<sup>19</sup> The three SOEs are the Agricultural Development Services Group, Bolisat Phathana Khet Phoudoi Group, and Development Agriculture Forestry Industry Group.

grew increasingly independent and nontransparent, and their operations were rarely disclosed by the Government.

24. The administrative distribution of timber quotas has now been replaced by more competitive procedures for allocating production forest resources. While the virtual monopoly exercised by certain enterprises has been abolished, the new system lacks transparency—with new and hard-to-identify enterprises (state dominated, if not 100% owned) taking over from the previous SOEs. Consequently, logging remains an obscure issue of national concern because of its effects on the environment, and because it is prone to corruption. A public debate on these issues has not yet taken place. As the 2001 forestry policy review concluded, “...the privileged position enjoyed by SOEs is a serious obstacle to improved performance and reform. In view of both strong demand from other enterprises, domestic and foreign, for Lao timber, and poor revenue and forest management performance, there is little justification for the continued reliance on SOEs”.

25. SOEs have also been inefficiently involved in livestock and agricultural activities. Following the Asian financial crisis, and as an attempt to control part of the food commodity markets, the Government reinstated the State Enterprise and Food Crop Promotion (SEFCP). SEFCP fixed prices (sometimes at lower than production costs) for certain commodities (rough rice, milled rice, and meat). Consequently, wholesale markets for rice and meat became less competitive. In some provinces, the SEFCP mechanism exerted a virtual monopoly over markets for food commodities, and private traders were not permitted to trade beyond provincial borders without authorization. There are lengthy procedures (accompanied by rent-seeking opportunities) for private enterprises to obtain licenses and permits to trade food commodities. For example, in Khammuane Province, any business trading in livestock and livestock products requires nine different documents to operate legally.<sup>20</sup>



Women hauling nontimber forest products



Hardwood logs waiting for transportation

<sup>20</sup> ILRI. 2002. *Review of the Livestock Sector in the Lao PDR*. Prepared for the Asian Development Bank. Manila.

## VII. Political Economy of Uplands and Lowlands

26. Another aspect of governance that affects ANR performance in the Lao PDR is policy regarding upland areas and ethnic minorities. Although the term “*multiethnic Lao people*” is employed frequently in the 1991 Constitution (in an attempt to emphasize unity within an ethnically diverse society), conditions in lowland and upland areas of the country are different. Lowland perspectives dominate the political economy. The past decade has seen growing concern over poverty incidence gaps between the lowlands and uplands, which are populated by ethnic minorities, as economic development and poverty reduction have largely been confined to the lowlands. Poverty incidence data (2002/2003) by region indicate that the central and northern mountainous regions are the poorest. A concerted attempt has been made to change the livelihood basis of upland areas; the swidden farming system practiced in the uplands has long been viewed as detrimental to the country by the Government. Phasing out shifting cultivation has been part of the prioritized development agenda of the Government. The Seventh Party Congress (2001) set targets endorsed by the National Assembly to stabilize pioneering shifting cultivation by 2005, with elimination of all shifting cultivation by 2010.<sup>21</sup>

27. For many years, the Lao PDR was an important producer and supplier of illicit opiates to the world. Opium poppy has been part of the farming system based on shifting cultivation concentrated in the Northern Region. For highlanders, opium cultivation provided cash income, and options were often scarce. Opium poppy cultivation is both a source of income to growers and a source of poverty in the Northern Region. Households consume up to 60% of their opium production for traditional, medicinal, and other purposes. The Seventh Party Congress (2001) resolved to eliminate opium production by 2005. Consequently, efforts to eliminate opium poppy cultivation intensified. Many poor farmers have given up opium poppy cultivation. The United Nations Office on Drugs and Crime survey (2005)<sup>22</sup> reported that among those who had given up opium poppy cultivation, 50% did so because of law enforcement. However, permanent elimination of opium poppy cultivation will require sustainable alternative livelihoods among poor farmers.



Shifting cultivation in Huaphanh



Planting food crops in a slash-and-burn system

<sup>21</sup> Pioneering shifting cultivation involves undisturbed (primary/secondary) forest being felled for cultivation.

<sup>22</sup> UNODC. 2005. *Laos Opium Survey*. Vienna.

28. The Government views shifting cultivation as unsustainable and intends to stabilize it by making agriculture more sedentary. Its strategy to stabilize shifting cultivation is to (i) promote sedentary agriculture on sloping lands through crop diversification, (ii) develop market access to communities through road development and market information delivery, (iii) promote land use zoning based on land capability and slope, (iv) promote rural savings and credit provision, and (v) implement land use planning and land allocation.<sup>23</sup> One reason for increased hardship in the uplands in recent years is misconceived or poorly implemented policies. Two interlinked policies have been detrimental to the livelihoods of the people in the uplands—land allocation policy and the policy to stabilize shifting cultivation. Many upland dwellers consider the land allocation policy to be a major factor behind growing hardship.<sup>24</sup> The core issue, however, is the way land is allocated rather than the land allocation itself; too little land has been allocated for shifting cultivation, which means shortened rotation periods. This, in turn, results in falling soil fertility and lower productivity. Interpretations of policies in practice have often been inconsistent. Existing policies suggest that fallows of more than 3 years can be considered as degraded forest instead of a stage within a cycle of rotational agriculture. As lands unutilized (perceived to be abandoned) for more than 3 years can be reclassified as regeneration forest, farmers face increased pressure not to let their land rest and regenerate for more than 3 years. To compensate for reduced self-sufficiency in rice and other crops, upland households are forced to overexploit wild forest resources, both for their own consumption and as a source of cash income.

29. The Government has used a focal site approach to curb shifting cultivation in targeted remote poor areas. This approach aims to stabilize shifting cultivation by improving access to social services, developing market-oriented economic activities, and integrating regions into the national economy. The focal site approach was ostensibly used as an instrument for enhanced service delivery and for poverty reduction in remote areas but has often been perceived in practice and criticized by observers in some cases as resembling relocation and resettlement. Some observers claim that relocation programs in some cases led to human suffering and increased mortality because of poor sanitary conditions, inadequate resettlement facilities, and sickness, such as malaria and water-borne diseases.<sup>25</sup> ■



Weaving, an alternative to shifting cultivation

<sup>23</sup> MAF. 1999. *The Government's Strategic Vision for the Agricultural Sector*. Ministry of Agriculture and Forestry. Vientiane.

<sup>24</sup> ADB. 2001. *Participatory Poverty Assessment: Lao People's Democratic Republic*. Manila.

<sup>25</sup> Romagny, Laurent. 2005. *Resettlement: An Alternative for Upland Development?* A paper in Bouahom, B., A. Glendinning, S. Nilsson, M. Victor (Editors). *Poverty Reduction and Shifting Cultivation Stabilization in the Uplands of the Lao PDR: Technologies, Approaches and Methods for Improving Upland Livelihoods*. Proceedings of a workshop held in Luangprabang, January 27–30, 2004. National Agriculture and Forestry Research Institute. Vientiane.p. 117–127.