



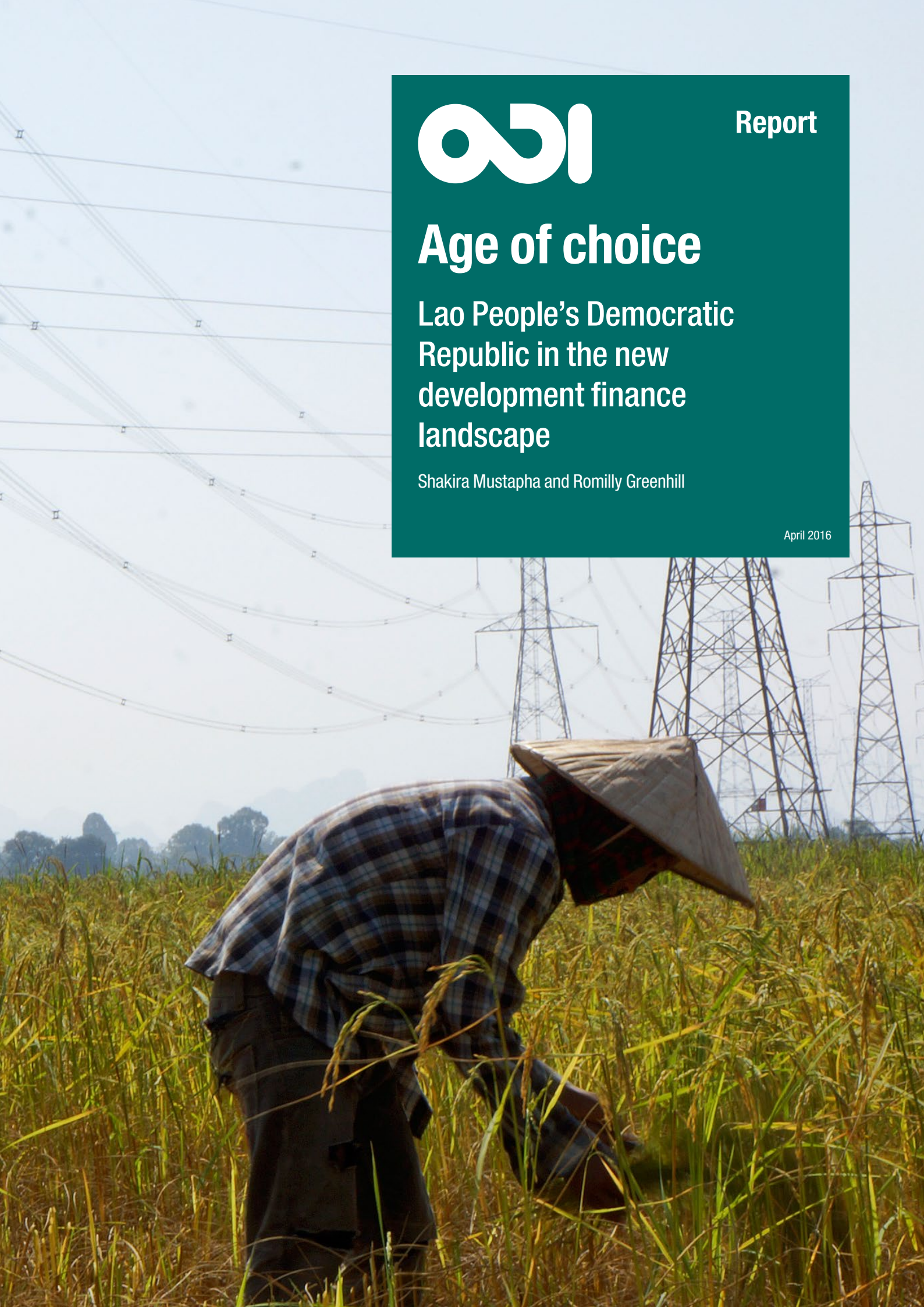
Report

Age of choice

Lao People's Democratic Republic in the new development finance landscape

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Cover photo: Reuters/Aubrey Belford, 2013. A farmer works in a paddy field under the power lines near Nam Theun 2 dam in Khammouane province October 28, 2013. The government is staking much of its future on large-scale infrastructure projects, including multi-billion dollar road and high-speed rail links intended to turn Laos into a crossroads of China, Thailand and Vietnam.

Key messages

- **ODA remains buoyant, despite Lao PDR's transition to LMIC status**, but there has been a shift from grants to loans.
- **Development finance beyond ODA increased between 2002 and 2013**, from \$21 million to \$433 million, and from 11% to 48% of total external development finance.
- **Chinese assistance has grown rapidly.** By 2012, China was as large a donor as Japan, the biggest DAC donor.
- **Concessionalism is the main priority for the government**, but it has also accessed non-concessional finance for projects with high economic returns.

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Abstract

This report considers the experience of the Lao People's Democratic Republic in accessing and managing development finance beyond ODA: external finance flows that are available, or potentially available, for governments to fund national development strategies, but which are not counted as ODA. Overall 'beyond ODA flows' increased significantly between 2002 and 2013, from \$21 million (11% of total external development finance) to \$433 million (48%). China accounts for a very large share of beyond ODA flows: 86% of total external development finance on average over the period 2011-2013. Lao PDR has also issued sovereign bonds, accounting for 8% of beyond ODA flows over the same period. Philanthropic assistance, multilateral climate finance and support from other non-DAC donors appear to be very small. ODA flows have also continued to grow, despite Lao PDR's graduation to LMIC status, but the share of loans is increasing.

The government has expressed a clear priority for concessional financing, and has an appropriate policy of channelling resources into particular sectors depending on the level of concessionality. However, an emphasis on maintaining good relationships with near neighbours can mean Lao PDR accepts more expensive financing for some projects. Ownership, alignment and the volume of finance are also priorities.

Recommendations for Lao PDR include developing clear strategies on debt, climate finance, and development finance. These strategies should set out clear criteria for prioritising between sources of finance, particularly in the context of rising debt levels. A clear definition of public private partnerships should be agreed and disseminated. Finally, Lao PDR should recognise that ODA remains important, and continue its efforts to improve the effectiveness of aid.

Acronyms and abbreviations

ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
CPIA	Country Policy and Institutional Assessment
DAC	Development Assistance Committee (OECD)
FDI	foreign direct investment
FY	fiscal year
GNI	gross national income
HL RTM	High Level Round Table
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
INGO	international non-governmental organisation
LDCs	least developed countries
LIBOR	London Interbank Offered Rate
LIC	low-income country
LMIC	lower-middle-income country
Lao PDR	Lao People's Democratic Republic
LPRP	Lao People's Revolutionary Party
MDB	multilateral development bank
MDG	Millennium Development Goal
MAF	Ministry of Agriculture and Forestry
MoF	Ministry of Finance
MoFA	Ministry of Foreign Affairs
MoNRE	Ministry of Natural Resources and Environment
MPI	Ministry of Planning and Investment
NEDA	Neighbouring Countries Economic Development Cooperation Agency (Thailand)
NSEDP	National Socio-Economic Development Plan
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
OECD-DAC	OECD Development Assistance Committee
OOF	other official flows
PPPs	public-private partnerships
RTIM	Round Table Implementation Meeting
RTP	Round Table Process
SWG	Sector Working Group
TICA	Thailand International Cooperation Agency

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1 Introduction

1.1 Background

Development finance has been changing rapidly over the past 15 years and traditional official development assistance (ODA) from members of the Organisation for Economic Co-operation and Development's Development Assistance Committee (OECD-DAC) is becoming less important for recipient countries. This trend has been driven by factors of both supply and demand, as follows.

In terms of supply, the development finance landscape underwent what Severino and Ray (2009) have described as a 'triple revolution' in actors, goals and tools. There are many new providers of development finance, including non-DAC donors (e.g. India and China) and philanthropic foundations (such as the Gates Foundation). New goals include those related to climate change adaptation and mitigation, which have led to the creation of vertical funds to address such global and national challenges. Finally, complex new finance instruments have been developed to foster the involvement of the private sector, such as public-private partnerships (PPPs). Another main factor is that fiscal austerity in OECD countries has been putting pressure on aid budgets.

On the demand side: first, the number of low-income countries (LICs) has been shrinking over the past 10 years. Graduation to the status of lower-middle-income country (LMIC) has clear implications for financing. Ever more countries will be excluded from eligibility for concessional financing from the multilateral development banks (MDBs) absent changes in graduation policies by those institutions. In addition, several bilateral development agencies review their funding strategy for an aid-recipient country once that country has reached middle-income status, and may either move from providing grants to loans or phase out their assistance completely.

Second, several countries in sub-Saharan Africa have obtained access to international sovereign bonds in the past 10 years, including countries that benefited from debt relief. While there are advantages to this form of finance, in terms of the flexible use of funds, volumes and diversification/risk mitigation, international sovereign bonds are far more expensive than concessional and non-concessional loans offered by OECD-DAC member countries or the MDBs. Governments do not borrow

extensively from harder MDB facilities despite the low-interest environment in international markets.

This study is one of a set of case studies examining the challenges and opportunities facing governments in managing development finance within this new context. It builds on and expands the framework developed in Greenhill et al. (2013), within which (Phase 1) the cases of Cambodia, Ethiopia, Fiji, Papua New Guinea, Vanuatu and Zambia were analysed. Schmaljohann and Prizzon (2015) summarise the key findings for those countries.

Taking stock of these first case studies, in 2015 a second phase of the project was carried out, with studies in Kenya, Uganda, Viet Nam as well as Lao People's Democratic Republic (PDR). The focus of the project is on external finance flows that are available, or potentially available, to governments to fund national development strategies. We also specifically focus on flows beyond ODA. ODA has been comprehensively studied, but there are few studies and only limited evidence on the negotiation, access and management of beyond ODA flows. We therefore include flows that meet the following criteria:

- cross-border, so excludes domestic bond markets and taxation
- spent with a public or philanthropic motive, so excludes foreign direct investment (FDI) and remittances
- not managed via traditional bilateral and multilateral aid systems, so excludes ODA grants and concessional loans originating from OECD-DAC donors (but not multilateral public climate finance when subject to project- or programme-level competition)
- potentially under the direct influence of, or control by, the recipient-country government and is, in principle, accounted for in government budgets.

These 'development finance flows beyond ODA' are counted independently from the level of concessionality, and potentially have an impact on government budgets (such as contingent liabilities or PPPs). For example, this would be the case for issuances of sovereign bonds in international financial markets, but not for FDI and personal remittances.¹

¹ The volumes and terms of these flows can be indirectly influenced, for example via tax incentives or changes to macroeconomic investment conditions; the same would apply to export credits, which are primarily aimed at the private sector. We do not apply a balance of payments approach, i.e. a review all cross-border flows.

Applying these criteria, the ‘beyond ODA’ flows examined in this case study are:

- bilateral and multilateral ODA (from OECD-DAC donors)
- other official flows (OOFs)² from DAC/multilateral development institutions, i.e. official transfers that fail to meet the ODA concessionality criteria and/or do not have a development focus
- flows from non-DAC donors, both ODA and OOF equivalent (including China, India, Viet Nam etc.)
- assistance from philanthropic foundations
- climate finance (multilateral)
- international sovereign bonds issuances
- PPPs.

PPPs are an instrument, and not a source, but they provide a concrete example of how governments, aid agencies and the private sector can work together.

We define *providers* of development finance beyond ODA as:

- non-DAC donors such as China, India, Viet Nam etc.
- OECD-DAC donors and MDBs when providing funding that is not sufficiently concessional or developmental to be classified as ODA, such as non-concessional loans
- philanthropists
- multilateral climate funds. We include multilateral (not bilateral) climate finance, since funding and delivery mechanisms for these are based on competitive processes rather than bilateral negotiations.

To the best of our knowledge, there is no existing case study on how financing choices are made at the level of the ministry of finance, in particular with reference to cross-border/external flows. There is very limited information on flows from development finance institutions and via PPP instruments, including their impact on debt sustainability and whether they are considered and managed differently from ODA. This series of studies aims to fill this gap.

1.2 Methodology and research questions

The methodology for the case studies is adapted from Fraser and Whitfield (2008) and Ostrom et al. (2001), using the Institutional Analysis and Development (IAD) framework. The key insight from Fraser and Whitfield (2008), in contrast with much of the literature on the political economy of aid, is seeing the engagement between recipient-country governments and donors as one of negotiation, since it is assumed that their objectives may diverge. Fraser and Whitfield also focus on the importance of both the economic and political contexts in shaping country and donor negotiations, and thereby negotiation outcomes.

Drawing on the IAD framework, we also emphasise the importance of negotiation arenas. Rather than taking these as a given, however, we ask whether governments seek to engage with different providers of development finance in the same fora. This includes, but is not limited to, arenas related to in-country aid coordination, such as sectoral or technical working groups, or regular high-level donor–government meetings. These fora often involve donors and governments in discussion of sectoral strategies, project identification, policy dialogue and conditionalities.

The next section of this report (Section 2) focuses on the Government of Lao People’s Democratic Republic (Government of Laos) and its capital for negotiation with various providers of development finance. The section highlights the main elements of the economic, political, governance and aid-management systems that influence negotiations.

Drawing on this theoretical framework, we seek to answer four main research questions for the case of Lao PDR:

- **Volume of flows** (Section 3): Does the country receive external development finance beyond ODA and has the volume increased since the early 2000s?
- **Arenas for the negotiation of development finance** (Section 4): In which fora does the Government of Laos seek to engage with providers of development finance beyond ODA, and what strategies does it employ to negotiate with them? How do these differ from the fora and strategies in which the Government of Laos engages with ODA donors?
- **Priorities and characteristics of development finance** (Section 5): What are the Government of Laos’s priorities for the type of development finance it receives and how do these change across ministries and sectors?
- **Outcomes** (Section 6): To what extent is the Government of Laos achieving its objectives in negotiating with the providers of development finance? How has the existence of development finance flows beyond ODA helped or hindered the country in achieving its objectives?

We use ‘government’ to refer to central agencies, such as ministries of finance or national planning (or their equivalents), and line agencies. We assume that these will have different sets of priorities and types of engagement with different actors. We did not manage to interview local/provincial governments, which may also have different priorities from central government.

This analysis does not reflect civil society priorities, which may well differ from those of government.

2 Other Official Flows are defined by the OECD as ‘Transactions by the official sector with countries on the List of Aid Recipients which do not meet the conditions for eligibility as Official Development Assistance or Official Aid, either because they are not primarily aimed at development, or because they have a Grant Element of less than 25 per cent.’

Lao PDR has experienced several of the supply-side and demand-side changes outlined in Section 1.1, making it an excellent case study choice. It has become less dependent on ODA since the early 2000s, with the ODA/GNI ratio falling from 15.8% in 2003 to 4.7% in 2012, largely as a result of GNI growth (World Bank 2015). Lao (PDR) achieved LMIC status in 2011 and has been receiving less in grants from multilateral donors, such as the Asian Development Bank (ADB) and the World Bank, since 2012.³ Bilateral grant donors such as Sweden have been exiting the country, or shifting from grants to concessional loans. Moreover, the Government of Laos aspires to graduate from Least Developed Countries (LDC) status by 2020, which will affect its external financing mix.

Lao PDR's external sources of development finance have also diversified in recent years. Located in the centre of Indochina, the Government of Laos maintains good diplomatic relations with its neighbours, particularly

China, Thailand, and Viet Nam, all of which provide some form of development finance to Lao PDR. Chinese aid in particular has increased dramatically since 2009; in 2012 it was comparable to the volume received from Japan, the largest DAC donor (Khennavong, 2014). The Government of Laos has also issued four tranches of international sovereign bonds on the Thai market since 2013. The first three were unrated, but the most recent one had a BBB+ rating from Thailand-based TRIS Rating. In addition, the Government of Laos is in the process of developing its PPP framework as a new way of procuring public infrastructure and services, to speed up the investment programme and improve the performance of public infrastructure (Government of Laos, 2013).

Research in Vientiane took place between 10 and 21 August 2015. This included semi-structured interviews with 36 key informants. See Annex 4 for a list of interviewees.

3 As a result of improved debt sustainability indicators, effective 1 January 2011, Lao PDR also gained access to the Asian Development Fund (ADF) on a 50% grant and 50% loan basis. However, all of the ADF allocation for 2013-2014 was in the form of loans because ADB classified Lao PDR as being at low risk of debt distress in 2011 and 2012 (ADB, 2012). Similarly, as the World Bank classifies it as an International Development Association (IDA) country, Lao PDR only receives IDA loans and no grants (as of 1 January 2015).

2 Influence of country context

Several elements of the political, economic, governance and aid-management context are likely to have shaped the negotiating capital of the Government of Laos in relation to ODA and beyond ODA providers.

Lao PDR has a one-party government, and shares similar political and economic traits with China and Viet Nam.⁴ Importantly, despite the tense diplomatic relationship between its two larger neighbours, Lao PDR has successfully maintained strong economic and diplomatic relations with both countries since the early 1990s.⁵ Both China and Viet Nam are among Lao PDR's top trading partners and sources of FDI. This political orientation and the close connection between Lao PDR and its neighbours heavily influence its negotiating position in relation to these and other donors. Like Viet Nam and China, Lao PDR has made the transition from a centrally planned economy towards a more market economy, a trend which started with the adoption of the New Economic Mechanism in 1986.

Lao PDR's geographical location also impacts on its negotiating power quite significantly. Although it is a small country (with a population of 6.6 million in 2013), it is located in the centre of Indochina and shares a border with five countries: Cambodia, China, Myanmar, Thailand and Viet Nam. It is also at the heart of the Mekong Region. Given this geographical location, the 'security and prosperity of Lao PDR' is widely perceived as a precondition for the 'security and prosperity of the Mekong Region' as well as ASEAN as a whole.⁶ Lao PDR's location also makes it a part of three important

Greater Mekong Subregion transport and economic corridors. Together with Cambodia, Myanmar and Viet Nam, Lao PDR belongs to the group of four countries (the so-called CLMV group) within ASEAN facing the largest development challenges. This has led more-developed ASEAN countries to grant them special attention in regard to trade, finance and the development of human resources (Phraxayavong, 2009). Lao PDR also benefits from ASEAN support through the Initiative for Asian Integration.

Lao PDR became an LMIC in 2011 and has consistently demonstrated high and sustained GDP growth, with average annual growth of over 7% over the past decade –among the highest and least volatile in the region. Macroeconomic policies have remained generally sound, with the fiscal deficit declining between 2009 and 2012 due to steadily growing resource revenues.⁷ Structural reforms have also accelerated in the context of commitments under the ASEAN Economic Community and the prospect of World Trade Organization (WTO) accession, with Lao PDR becoming a member of the WTO on 2 February 2013. Going forward, Lao PDR is expected to meet the criteria for LDC graduation by 2020, thus financing is likely to shift from concessional to more market-based terms. Under the IDA pipeline, there is expected to be a shift towards International Bank for Reconstruction and Development (IBRD) terms, with half of disbursements expected to be financed under these terms within the next few years, while within a decade all World Bank is expected to shift to IBRD terms (IMF, 2015).

4 The Lao People's Revolutionary Party (LPRP) came to power in 1975 as a Marxist-Leninist regime modelled on that of Viet Nam, and with support from Viet Nam.

5 Between the late 1970s and mid-1980s, China withdrew its aid as a result of Lao PDR's support for the Vietnamese invasion of Cambodia (Stuart-Fox, 2006). As the war in Cambodia drew down, Lao PDR and China normalised their relations in 1989, following the October visit to China by H.E. Kaysone Phomvihane, Secretary General of the LPRP and President of the Council of Ministers (Thayer, 2013). During this visit both sides signed four cooperative agreements: on consulate and cultural cooperation, a temporary agreement on border issues, and visa exception.

6 The Association of Southeast Asian Nations (ASEAN) is a political and economic organisation of 10 South-East Asian countries. Its aims include accelerating economic growth, social progress and sociocultural evolution among its members, protection of regional peace and stability, and opportunities for member countries to resolve differences peacefully.

7 General government net lending/borrowing declined from –4.1% of GDP in 2009 to –0.5% in 2012 (IMF World Economic Outlook, 2015). The fiscal balanced deteriorated in 2013 to –5.6% due to a large increase in civil service compensation and capital spending. However, the Government of Laos started to tighten fiscal policy in 2014.

The pace of social progress, however, has not matched that of economic progress. This is reflected in Lao PDR's mixed progress towards the Millennium Development Goals (MDGs). On the one hand, Lao PDR has significantly reduced its national poverty rate,⁸ and is well on its way to reducing child mortality, reaching targets under combating HIV/AIDS, malaria and other diseases, and meeting water supply and sanitation targets in urban areas. On the other hand, under-nutrition in Lao PDR continues to be a major issue: 44% of children [under five] are affected by stunting (Government of Laos and UN, 2013). MDGs relating to maternal mortality and gender disparity in education are also off track.

Lao PDR's governance performance has also been mixed. Government of Laos has made visible efforts to build modern public sector institutions, with the quality of Lao policies and institutions (as measured by the Country Policy and Institutional Assessment (CPIA) ratings) improving significantly between 2005 and 2012. The ranking in 2012 was at 3.1, up from 2.5 in 2005, and put Lao PDR just below the LMIC average of 3.2. The ranking on economic management in 2012 was also in line with the LMIC average, at 3.7, although it declined to 3.3 in 2013 and 2014. However, Lao PDR scores relatively poorly on Transparency International's Corruption Perceptions Index, being ranked at 160 out of 176 countries.

Lao PDR's ranking for ease of doing business has improved slightly in recent years, now standing at 134 out of 189 countries (2015), but it remains behind its regional competitors such as Viet Nam (90) and Cambodia (127). Nevertheless, Lao PDR has successfully attracted resource-related FDI flows (hydropower and mining sector) over the years, with the ratio of FDI to GDP increasing between 2003 and 2012.⁹ Government tax revenue as a share of GDP has also steadily increased, from 9% to 15% between 2003 and 2012. Lao PDR's tax revenue effort compared well with the LIC average at about 15.5% of GDP in 2012, but underperformed when viewed against the regional¹⁰ and world averages of 17% and 19%, respectively (IMF, 2015). Migrant workers' remittances, on the other hand, have contributed even less to development finance, estimated at below 1.5% of GDP between 2002 and 2013, although this may be due to under-reporting. The official figures put Lao PDR significantly below both the LIC and LMIC average of 4%-5% between 2003 and 2013.

Partly as a result of strong economic growth, Lao PDR's ODA from DAC bilateral and multilateral donors

as a share of GNI has fallen rapidly in recent years, from 12% in 2003 to 4% in 2013, and its contribution to development budget has declined (although is still significant). Donors have been instrumental in funding Government of Laos' capital expenditure, accounting for 76% of the annual capital budget between 2006/07 and 2009/10 (JICA and ICT Net, 2012). The seventh five-year National Socio-Economic Development Plan (NSED, 2011-2015) also estimated that 24%-26% of the \$15 billion required was funded through ODA grants and loans (Government of Laos, 2011).¹¹ The eighth NSED (2016-2020) estimates that ODA will account for a smaller share of the total investment, at 12%-16% of the total \$27 billion investment required (Douangdy, 2015). However, because the total amount of finance required for the NSED has increased, absolute amounts of ODA required annually will actually increase.

ODA from traditional donors is composed mostly of grants, with the share of loans in ODA falling from a high of 27% in 2002 to a low of 4% in 2012 (see Table 1). This trend has recently reversed, increasing to 11% in 2013, partly due to improved debt sustainability indicators at the time. Since 2013, Lao PDR has only received credits, and not grants, from ADB, while the World Bank adopted a similar policy in January 2015. Grants have also declined from several DAC donors, such as Australia, Germany and the EU institutions since 2011/12 and France between 2007 and 2010. Sweden has exited the country altogether (GoS, 2008). Notably, these traditional bilateral donors do not appear to have substituted grants with loans. Japan and the Republic of Korea are the only two bilateral DAC providers of ODA loans. While Japan's development assistance to Lao PDR is mostly in the form of grants (90% of its annual portfolio between 2003 and 2013), the Republic of Korea's

Table 1: Trends in ODA loans and grants since 2002

	2002	2012	2013
Total ODA	172	465	463
Total grants	126	445	413
Total concessional loans	46	20	49
Share of loans	27%	4%	11%

Source: see Annex 1

Notes: ODA figures are net of climate change financing from multilateral climate funds (which are ODA eligible)

8 The proportion of people living below the poverty line reduced by more than 40% over the period 1992/93 to 2007/08 (Government of Laos and UN, 2013).

9 FDI net inflows to GDP increased from 1% in 2003 to 3.1% in 2012 (World Bank, 2015).

10 Regional comparators include Brunei, Cambodia, Indonesia, Malaysia, Myanmar, Philippines, Singapore, Thailand, Timor-Leste and Viet Nam.

11 Between FY 2010/11 and September FY 2013/14 (i.e. three and a half years), Lao PDR mobilised \$2.02 billion of ODA, equivalent to 64.6% of the plan target (MPI, 2015a).

portfolio has been split evenly between grants and loans since 2008, increasing from \$2.1 million in 2008 to \$14 million in 2013 (surpassing Japan's total ODA in 2011).

The Government of Laos decided not to participate in the Heavily Indebted Poor Countries (HIPC) initiative despite having high levels of debt in the early 2000s.¹² Its view was that the transaction costs of the HIPC procedure, and possibly the resulting reduced access to new loans, would outweigh the gains from debt relief in the medium term (IMF, 2005). Until 2012, debt levels were classified as high risk by the World Bank and IMF, with the risk upgraded to moderate in 2012 as a result of improvements in policy performance. However, debt levels have continued to rise since then, with stock of PPG external debt growing from \$4.5 billion in 2012 to about \$5.1 billion by end 2013, mainly due to borrowing from Thailand and China. The share of non-concessional external debt is also rising, albeit from a low base (IMF 2015). Lao PDR remains on the cusp of returning to a high-risk rating, which can be expected to influence both the Government of Laos' strong prioritisation of grants over loans and its negotiating position in relation to its major donors. It also means that agreeing a formal debt strategy is of particular importance, an issue discussed further in later sections.

Climate considerations are likely to be relevant for Lao PDR's future development. Over 80% of Lao PDR's population depend on natural resources for their livelihoods, with the economy relying heavily on the country's natural resource base (forests, agricultural land, water and hydropower potential, and mineral resources

– copper and gold).¹³ The country is still highly susceptible to the impacts of climate change. Of a sample of 183 countries in 2013, Lao PDR was assessed as the 45th most vulnerable country to the negative effects of climate change and the 60th least ready country, according to the Notre Dame Global Adaptation Index (ND-GAIN matrix).

Responsibility for management of development finance flows, including ODA and beyond ODA flows, is shared between a number of ministries. The Ministry of Finance (MoF) is responsible for negotiating loans (concessional and commercial) and for debt management, as well as for managing grants from the ADB and World Bank. The Ministry of Planning and Investment (MPI) takes the lead on resource mobilisation, managing grants from most donors (with the exception of international financial institutions), and the Round Table Process for aid coordination. Finally, the Ministry of Foreign Affairs (MoFA) also has a role in grant mobilisation through managing relationships with other countries. It also manages grants through international non-governmental organisations (INGOs). For some non-DAC donors, bilateral cooperation commissions play an important role in mobilising development assistance from these countries. These Joint-Cooperation Commissions tend to be under the MoFA, with the exception of the China and Viet Nam Commissions, which are permanent divisions of the MPI. Priorities for aid effectiveness are articulated through the 2006 Vientiane Declaration on Aid Effectiveness, Lao PDR's localised version of the Paris Declaration on Aid Effectiveness, which is currently being revised.

12 At the end of 2003, Lao PDR's stock of public and publicly guaranteed (PPG) external debt was \$1.2 billion, equivalent to 59% of GDP, 218% of exports and 534% of government revenues (IMF, 2005).

13 A high proportion of the proceeds from natural resource-based exports accrue directly to Government of Laos. Over the eight years preceding 2011, total government revenue increased from 11% of GDP to over 19% of GDP, due almost entirely to revenues derived from mining and hydropower (via royalties, taxes and dividends).

3 Development finance in Lao PDR

This section reviews the evolution of development finance beyond ODA to Lao PDR since 2002. As outlined in Section 1, beyond ODA sources include international sovereign bonds, bilateral non-DAC donors and OOFs, philanthropic assistance, multilateral climate finance, and other private flows such as PPPs. Total development finance includes ODA plus these other flows.

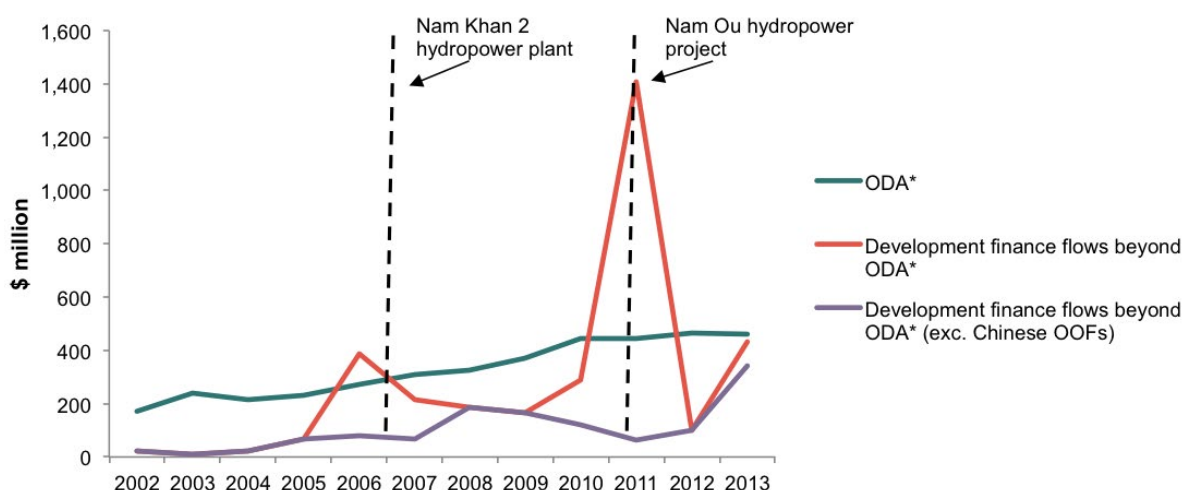
3.1 Overview

Between 2002 and 2013, development finance flows beyond ODA increased from \$21 million (11% of total development finance as defined here) to \$433 million (48% of total development finance). As shown in Figure 1, these

beyond ODA flows to Lao PDR appear to be quite volatile (compared with ODA, which steadily increased over this period). At the same time, they have been quite significant in size, even surpassing ODA in 2006 and 2011 as a result of the large OOF-like flows (commitments) from China for two hydropower projects: a China Exim Bank loan for Nam Khan 2 hydropower plant of \$308.5 million and China Development Bank loan of \$1 billion for the Nam Ou hydropower project.

Excluding these OOF-like flows from China, the beyond ODA flows appear less volatile, undergoing three distinct phases between 2003 and 2013 (as shown in Figure 1). The first was from 2003 to 2008, and was characterised by a steady increase in these flows, driven largely by an

Figure 1: Comparison of ODA and beyond ODA flows, 2002-2013



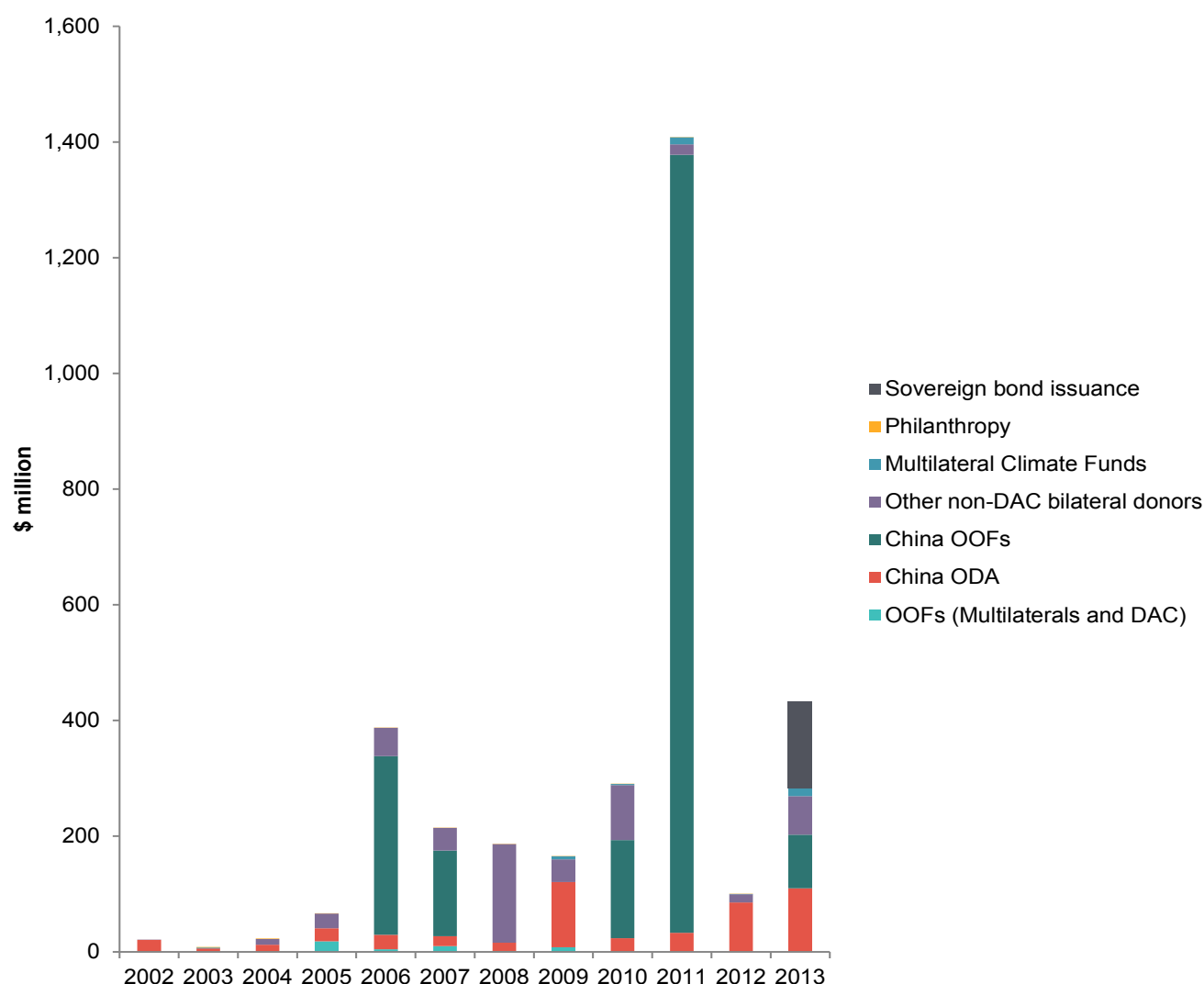
Source: AidData; Climate Funds Update Database; Foundation Center Database; Government of Laos (2010); Khennavong (2014); OECD aid statistics; Strange et al. (to be published); Tierney et al. (2011)

Notes: ODA includes: ODA in the form of grants and concessional loans from DAC donors and multilateral organisations net of multilateral climate funds disbursements. Flows beyond ODA include: aid from non-DAC bilateral donors, multilateral climate funds, OOFs (multilaterals), philanthropic assistance and sovereign bonds. All flows are in disbursements with the exception of multilateral climate funds and flows from China and India that are commitments.

increase in aid from non-traditional donors (Thailand and China). The second phase involved a sharp reduction in the volume of these flows between 2008 and 2011, and can be attributed to the sharp decline in aid from non-traditional donors (specifically Thailand). The third phase followed Lao PDR's graduation to LMIC status in 2011, and was characterised by a dramatic resurgence beyond ODA flows over the following two years. Much of this resurgence can be explained by flows from non-DAC bilateral donors (China, Thailand and India), and most recently by Lao PDR's first issuance of (unrated) international sovereign bonds in 2013, accounting for

52% and 44% of total beyond ODA flows (excluding China's OOFs) in 2013, respectively (see Figure 2). These aggregate trends and 2013 estimates, however, should be treated with caution given that data for China and India are based on commitments rather than disbursements, while the value of disbursements from Viet Nam is likely to be underestimated. It is interesting to note that Lao PDR's beyond ODA flows appear to be much more volatile and 'lumpy' than ODA flows, and reliant on two large sources (sovereign bonds and China's OOFs) that can vary substantially from year to year.

Figure 2: Beyond ODA flows to Lao PDR, 2002-2013



Source: Climate Funds Update Database; Foundation Center Database; Government of Laos (2010); Khennavong (2014); OECD aid statistics; Strange et al. (forthcoming); Tierney et al. (2011)

Notes: The international sovereign bond issuances in 2014 (\$170 million) and 2015 (\$355 million) are not included in the above figures.

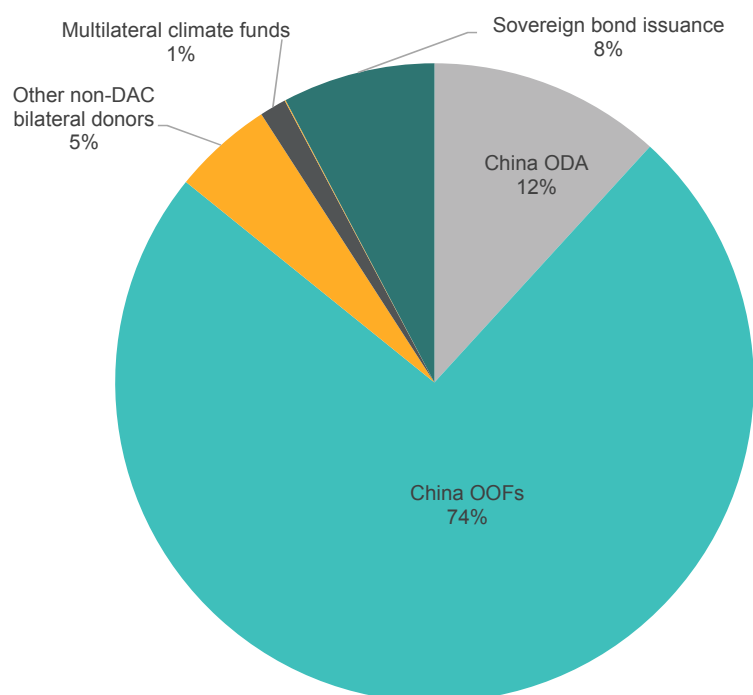
At the same time, it is quite clear that, like other country case studies in this project, flows from non-DAC bilateral donors were the main drivers of the increase in beyond ODA flows, with those from China being among the largest (Schmaljohann and Prizzon, 2015).¹⁴ The ODA-like flows from these non-traditional bilateral donors (including China) provided on average 17% of the total beyond ODA flows between 2011 and 2013 (12% from China and 5% from other non-DAC donors). OOF-like flows from China accounted for 74% of the beyond ODA total between 2011 and 2013 (Figure 3). The relative importance of these flows declined in 2013 with Lao PDR's first issuance of international sovereign bonds. The contribution of multilateral climate investment funds, on the other hand, hovered at around 0%-3% throughout the period, while philanthropy's contribution also appears to have been quite negligible (at an average of 0.08% between 2011 and 2013), a finding that is common to several other case studies. Based on available data, the ADB was the only multilateral donor providing OOFs to the Government of Laos in 2010 and 2011 (\$0.15 million and \$0.08 million for the Nam Theun 2 hydropower project), while France provided \$42 million in OOFs between 2005 and 2009 (Tierney et al., 2011).

3.2 ODA-equivalent flows from non-DAC donors

The Government of Laos has successfully attracted development finance from a diverse set of development partners, both DAC and non-DAC. The major bilateral non-DAC donors active in Lao PDR since the early 2000s include China, Thailand, India and Viet Nam. Other smaller non-DAC donors (as shown in Table 2) include Hungary, Kuwait, Turkey, United Arab Emirates, Russia and Israel- providing \$4.9 million in ODA-like flows between 2002 and 2013 (OECD statistics, 2015). As shown in Figure 3, ODA-like flows from all non-DAC bilateral donors accounted for 17% of development finance flows beyond ODA between 2011 and 2013 (China: 12%; other non-DAC bilateral donors: 5%).

Like in many other case studies, Chinese assistance (grants and concessional loans) has been one of the main factors contributing to the rise in development finance beyond ODA, accounting for more than 50% of non-DAC bilateral aid (ODA-like) in most years, with the exception of 2005-2008 and 2010 (Figure 4).

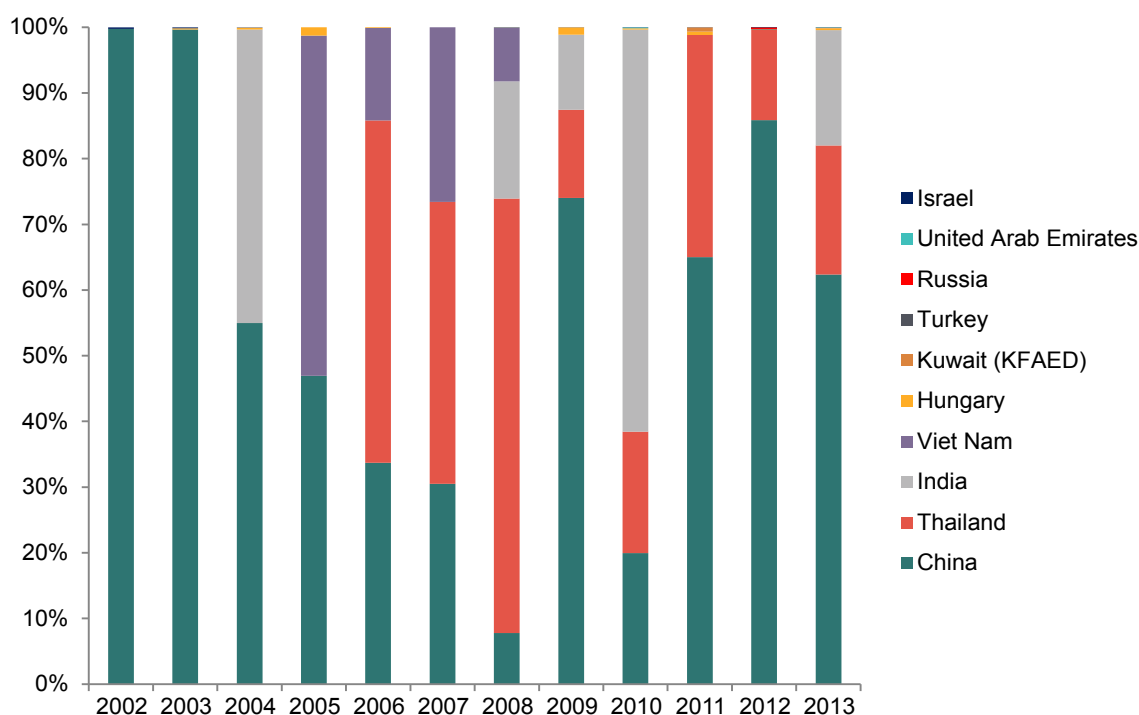
Figure 3: Shares of development finance to Lao PDR beyond ODA, 2011-2013



Source: AidData; Climate Funds Update Database; Foundation Center Database; Government of Laos (2010); Khennavong (2014); OECD aid

¹⁴ Please note the change in definition between earlier case studies and this case study. Unlike the definition of flows beyond ODA in this case study, the previous category 'non-traditional development assistance' included vertical health funds but not international sovereign bonds.

Figure 4: Comparison of ODA-like flows from non-DAC bilateral donors



Source: AidData; Government of Laos (2010); Khennavong (2014); OECD statistics (2015)

Note: Figures for China and India are commitments/approvals; figures for other donors are disbursements.

China

Though Chinese official assistance to Lao PDR goes back to the 1960s, Chinese aid was intermittent, partly as a result of Lao PDR's close relationship with Viet Nam (Phraxayavong, 2009). After the normalisation of relations between China and Lao PDR in the early 1990s, due to the winding down of the war in Cambodia, relations between

the two sides rapidly developed following several high-level visits. The two sides established the principle of promoting 'long-term stability, good-neighborliness and friendliness, mutual trust, all round co-operation' (Embassy of China, 2015). However, it is only over the past 4-5 years that China has emerged as one of Lao PDR's top three sources of development finance. As shown in Figure 5, Chinese aid (commitments) to Lao PDR has dramatically increased since 2009, and in 2012 it was comparable to the volume of aid received from Japan, the largest DAC donor (Khennavong, 2014). The estimates for China provided in this section are based on commitments, which are multi-year commitments rather than the single-year commitments reported by traditional donors to DAC.

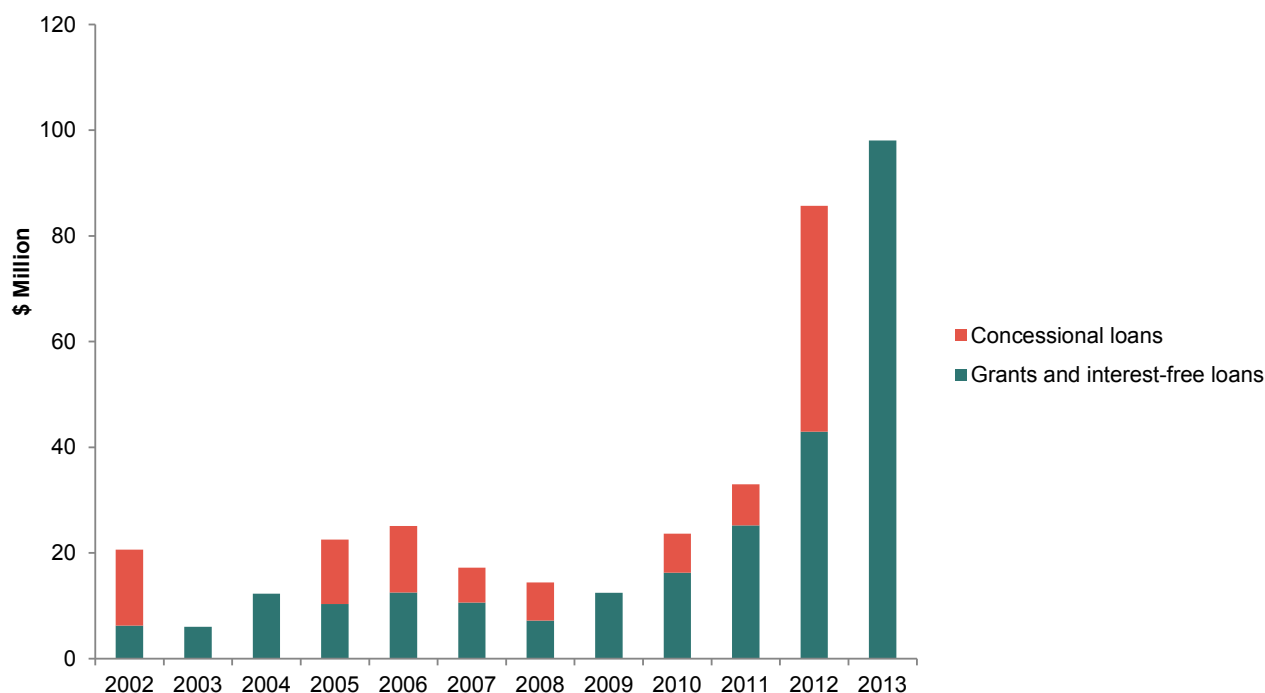
China provides three types of ODA-like finance to Lao PDR: grants, interest-free loans and concessional loans (yuan, low interest). The interest rates on Chinese loans range between 2% and 3%. Grants and interest-free loans amounted to \$260 million between 2002 and 2013 and were used for at least 44 projects in a wide variety of sectors (health, education, human resource development, agriculture and, even, equipment for the population census, i.e. cars and computers). China provided concessional loans of \$110 million for 11 projects between 2002 and 2012. Concessional loans are mostly used in the infrastructure sector (roads, bridges and irrigation).

Table 2: Total amount of ODA-like flows by non-DAC bilateral donor, 2002-2013

Donor	Total 2002-2013 (\$ million)
China	482.98
Thailand	293.48
India	163.83
Viet Nam	65.43
Hungary	3.49
Kuwait (KFAED)	0.41
Turkey	0.39
Russia	0.23
United Arab Emirates	0.23
Israel	0.1

Source: AidData; Government of Laos (2010); Khennavong (2014); OECD statistics (2015)

Figure 5: Comparison of China's grants and interest-free loans, and concessional loans, 2002-2013



Source: AidData; Khennavong (2014)

Note: Figures for Chinese grants and concessional loans are commitments.

Based on available data and interviews, annual grants have not been large, about \$6-16 million between 2002 and 2010. More recently, grants amounted to \$25 million and \$42 million in 2011 and 2012, respectively (Khennavong, 2014). In 2011, Chinese and Lao PDR officials agreed to cooperate more closely on poverty alleviation, economic development, increased trade and agricultural training on the grounds that enhancing good-neighbourly friendship and reciprocal cooperation is conducive to both countries' economic and social development, as well as to regional peace and stability (Embassy of China, 2011).

Thailand

Of the four bilateral non-DAC donors investigated in this report, only Thailand has established its own bilateral cooperation programme and cooperation agencies – the Thailand International Cooperation Agency (TICA) and the Neighbouring Countries Economic Development Cooperation Agency (NEDA) – with Lao PDR as the largest recipient of Thai ODA.¹⁵ Between 2006 and 2013, the Government of Thailand provided \$293 million in ODA-like flows to the Government of Laos (32% of all

ODA-like flows from non-DAC bilateral donors over the period).

Since 1994, Thailand's assistance has focused on the same four sectors: education, agriculture, public health, and natural resources and environment. Some ministries in Thailand also give scholarships,¹⁶ which may not be included in these estimates. Flows have not been only in one direction, however: in 2011, the Government of Laos presented 1.5 million baht (\$0.05 million) to the Government of Thailand as a gesture of solidarity with the victims of recent flooding (IBP, 2015).

TICA has a three-year work plan with the Government of Laos, which includes a total of 90 scholarships. It also currently has 24 projects: 14 in education, three in public health, two in agriculture, and five in natural resources and environment. In addition, it offers 20 training courses per year in Thailand.

Of the 12 NEDA projects completed in Lao PDR, 10 were based on the 'mixed assistance' model (30% grant and 70% loan, with an interest rate of 1.5%). The remaining two projects – the building of a road from Chiang Rai to Khunming (the R3A) (1,385 million baht) and improvements to the sewage pipeline in Vientiane (95 million baht) – were fully funded by loans. When providing

15 Based on statistics on Thailand's official development assistance, 2010-2014, on the TICA website (see <http://www.tica.thaigov.net/main/en/other/3568>).

16 This assistance amounted to 3,926 million baht between 2005 and 2014.

financial assistance, NEDA assesses the revenue potentials of the proposed project: for example, if the project does not generate an income, the funding will usually be approved on the basis of the 30:70 mixed assistance model. However, if the project generates a revenue, it will usually be fully funded through a loan with an interest rate of 2.5%.

In terms of ongoing projects, four projects have been started since 2000. Two involve the construction of roads, one the construction of a railway and one the improvement of a water system. There are two projects in the pipeline, valued at roughly 3,000 million baht, comprising a road project and an electricity project. The organisations that NEDA mostly engages with in Lao PDR are the Department of Roads, the Department of Housing and Urban Planning and the Ministry of Public Works and Transport, as well as Electricite du Lao and the MoF.

India

India has enjoyed longstanding, friendly and mutually supportive relations with Lao PDR. This relationship is partly based upon historical ties. For example, Lao PDR admires 'the historic role played by India in Indochina towards promoting national liberation movements, the independence of colonized countries and the safeguarding of the newly acquired freedom' (Embassy of India, 2015). On account of this, Lao PDR has been supportive of major issues of regional and international concern to India, such as the latter's claim for permanent membership of the UN Security Council.

In general, the Government of India does not provide grants to the Government of Laos (except for a small project to renovate the Vat Phou or Wat Phou Hindu temple over an eight-year period, valued at \$4 million). Instead, a number of projects have been supported through Indian lines of credit, which have totalled \$160 million since 2004 (roughly 17% of non-DAC ODA-like flows over the same period). Some of the recent projects are listed in Annex 2. All lines of credit are negotiated by the India Exim Bank, whose conditions depend on the income level of the recipient country. As an LMIC, Lao PDR receives concessional loans at an interest rate of LIBOR + 0.5% per annum, a maturity of eight years, a two-year grace period and a grant element of 34.4% (GoI, 2010).

India also provides assistance for capacity-building and human resource development, sending 25 students every year for undergraduate and postgraduate studies on full scholarships. Additionally, it offers more than 100 short-term training programmes for civil servants in any field in India through the Indian Technical and Economic Cooperation Programme, depending on requests made by the recipient country. This programme has been expanding over time, but currently there are no plans to extend it further.

The Government of Laos also benefits from the ASEAN-India Fund. Examples include the Lao-India Entrepreneurship Development Centre, which was set up in 2004, and the Lao India Centre for English Language Training, which was set up in 2007 under the ASEAN-India Cooperation framework.

In terms of future assistance, there are ongoing discussions for India to do more in the agriculture sector, IT and human resource development. However, nothing has been concretised to date.

Viet Nam

Viet Nam's history of assistance to Lao PDR dates back to the 1930s and 1940s, when the Government of Viet Nam helped the LPRP to establish the first teacher training college in the northern Lao, 'Xam Neua'. This was a form of exchange within the 'brotherhood of Indochinese' countries that had fought against the French, the United States and the Royal Lao Government (Faming, 2009). After 1975, when the LPRP took control of the government, assistance from Viet Nam became formalised in a 1977 Treaty of Friendship and Cooperation. The treaty remains in place, although Lao PDR's foreign policy horizon has broadened to include South-East Asian regional powers.

Statistics regarding Lao PDR-Vietnamese economic cooperation are rarely released to the public, partly because Viet Nam itself is an LMIC and aid recipient. According to one report, Viet Nam provided assistance for 31 projects, which cost a total of \$8.75 million and were to be implemented from 1995 to 2001 (Phraxayavong, 2009). In FY 2005/06, Viet Nam's total ODA-like disbursements to Lao PDR amounted to \$24.86 million, making it the second largest bilateral donor at that time (Government of Laos, n.d.). Subsequently, Vietnamese aid to Lao PDR declined by roughly 40%, amounting to \$15.1 million for FY 2008/09 (Government of Laos, 2010). However, this figure only represents ODA-like flows from Viet Nam's central government, and is likely to be an underestimate since it excludes concessional loans and/or grants provided and/or negotiated at the provincial level within Viet Nam or within Lao PDR.

Disbursements in 2005/06 were concentrated in the transport, education and human resources development, and development of administration sectors. Education has been a major focus of Vietnamese assistance for many decades, comprising more than 50% of Viet Nam's grants to Lao PDR (Government of Laos, 2010). Viet Nam has provided support for a number of cooperative and exchange programmes that send civil servants, experts and children of Lao PDR leaders and veterans to study in primary, secondary and technical schools and universities in Viet Nam (Faming, 2009). In 2003, Viet Nam was offering 550 scholarships to Lao students annually (Phraxayavong, 2009).

3.3 OOFs from China

It has been suggested that non-traditional donors such as China have been giving loans to the Government of Laos which could probably be classified as OOFs. While details for these types of flows are generally not publicly available, a list of nine projects for which the Government of China provided OOF-like flows to the Government of Laos (hydropower and infrastructure projects, such as stadiums and airports) is provided in Annex 3 (Strange et al., forthcoming). Between 2011 and 2013, these OOF-like flows from China accounted for roughly 74% of the total beyond ODA flows. The China Development Bank and China Exim Bank were the main providers, accounting for 70% and 17% of the total Chinese OOF-like flows between 2006 and 2013, respectively. This is unlikely to be a comprehensive list. According to one interviewee, China provided \$4.19 billion in buyers' credit loans (which are likely to be OOF-like) for 51 projects (mainly hydropower projects) between 2005 and 2014.

Another OOF-like project with China in the pipeline is the construction of a \$7.2 billion¹⁷ high-speed railway megaproject connecting Vientiane to Yunnan province. In October 2012, the Government of China agreed to finance the railway, however the deal is still being negotiated and so is not included in the estimates of non-DAC OOF-like flows in Section 3.1. The Government of Laos' rationale for this project is that it would allow Lao PDR to overcome its geographical constraints, transforming the land-locked nation into a land- and sea-linked nation. Under the original envisaged arrangement, the Government of Laos would provide \$840 million in initial financing, with \$1.26 billion coming from China (AidData website¹⁸). The balance of just under \$5 billion would be borrowed from the China Exim Bank by a joint venture company established to build and operate the rail link between Kunming and Vientiane. The venture would eventually be transferred to Laotian ownership. Several traditional development partners, such as the ADB and the World Bank, have expressed concerns that the amount of borrowing required for this project would place Lao PDR's debt trajectory in severe distress (IMF, 2013).

3.4 OOFs from DAC donors and multilaterals

Both the available data and interviews suggest that traditional donors are generally not providing OOFs to the Government of Laos, with the exception of France and the ADB. Between 2005 and 2009, OOFs of \$42 million from

France accounted for 4% of the total beyond ODA flows over the same period (Tierney et al., 2011). ADB disbursed loans of \$0.23 million on near-market terms for the Nam Theun 2 hydropower project in 2010 and 2011 (IMF, 2007). These loans were used to finance the Government of Laos's shareholding in the project.

Lao PDR also has occasional allocations from ADB's ordinary capital resources (OCR), subject to the project meeting the prerequisites for accessing OCR and the availability of OCR. One such project in the 2015-2017 indicative pipeline is the National Backbone Transmission Line Project (ADB, 2014). ADB's graduation policy and the Asian Development Fund grant framework indicate that exceptions to restrictions for public or public-guaranteed OCR borrowing may be considered for high-revenue projects that are able to fully service their foreign debt from their net foreign exchange earnings (ADB, 2013).

3.5 International sovereign bonds

The Government of Laos has issued several tranches of Thai baht bullet bonds since 2013, with issuances accounting for 35% of beyond ODA flows in 2013. Over time the amounts have increased, maturity lengthened and the interest rates risen, suggesting a positive yield curve.

The first issuance comprised \$50 million (1.5 billion baht) of bonds, issued on the Thai market in May 2013 at a fixed interest rate of 4.76% per annum and a maturity of three years. There were then two issuances totalling \$100 million (3 billion baht) in December 2013, and a \$170 million (4.5 billion baht) of bonds was issued in October 2014. The Bond Series 2 had a fixed interest rate of 5.20% per annum and a tenor of five years, while the Bonds Series 3 had a fixed interest rate of 5.50% per annum and a tenor of seven years. These first three bond series were unrated, but they were guaranteed by the Government of Thailand.

Notably, the Government of Laos' fourth bond series (senior unsecured bonds), issued in 2015 with a 10-year maturity and totalling \$355 million (12 billion baht), had a BBB+ rating from Thailand-based TRIS Rating. The rating is said to reflect the country's strong growth rate, the abundance of natural resources, the increasing government revenue from the hydropower sector, and the Government of Laos' commitment to modernise the economy and alleviate poverty (TRIS Rating, 2015). On the other hand, the ratings are constrained by moderately high public external debts, the government revenue exposure to volatile global prices of commodities, a limited data reporting

17 Interviews with government officials suggest that the total project cost has been revised downwards,

18 <http://china.aiddata.org/projects/33726>

19 While only one Thai bank (TMB Bank) acted as the arranger for the bond sales, five Thai banks (Kasikornbank, Krung Thai Bank, Bank of Ayudhya (Krungsri), Thanachart Bank and TMB) came on board as underwriters for the latest sovereign bond,

system for the public sector, and the nation's small but emerging financial and capital markets.

Ultimately, these issuances have largely been seen as successful, with a good response from investors and banks.¹⁹ The increased interest shown by Thai banks is reported to be the result of the mutually dependent relationship between them and the energy companies operating in Lao PDR.

The Government of Laos is open to issuing bonds on other foreign markets, but noted that at present the risk premium for these markets is still too high. Money raised from the first bond issuance in 2013 was used to finance the sudden increase in the budget deficit that had resulted from an increase in the public sector wage bill,²⁰ which would have been difficult to finance through donor loans. Subsequent issuances were said to be used to finance hydropower projects, specifically government equity share in joint ventures. Given that Lao PDR has an estimated 20 GW of technically viable hydropower capacity, but only a fraction of this capacity has been developed and is producing power for domestic consumption and for export,²¹ it is possible that the Government of Laos is going to continue to explore capital market instruments to finance investment in this expensive but highly profitable area.

3.6 Climate finance

The Lao PDR has been recognised as vulnerable to climate change impacts due to its particularly high dependence on climate-sensitive natural resources and its low capacity to adapt to the effects of climate change. Some of Lao PDR's major forms of natural resource utilisation, such as rain-fed rice cultivation and hydropower generation, are very vulnerable to the negative effects of climate change. The Government of Laos itself recognises that there is a great need for investment and innovations to improve readiness and a great urgency for action. However, while the Government of Laos has a National Strategy on Climate Change, it currently lacks a clear definition of climate finance as well as a climate finance strategy.

As noted in Section 1, multilateral climate finance is defined as 'beyond ODA' in our methodology because it is not managed via traditional bilateral and multilateral aid

systems. However, the terms are often 'ODA equivalent' (i.e. grants and concessional loans), and it is often counted as part of ODA budgets.²²

The Government of Laos mobilised grant financing of \$35 million (in approvals) from multilateral climate investment funds for 11 projects between 2003 and 2013 (accounting for 1% of beyond ODA flows).²³ These multilateral funds are partly financed via bilateral ODA (and are excluded from ODA in Figure 1 to avoid double counting). Overall, multilateral climate finance has expanded since 2009 (see Annex 1), having approved \$5.6 million to Lao PDR in 2009 and \$13.3 million in 2013. To date, the largest single grant (\$13.3 million) was received by the Ministry of Agriculture and Forestry (MAF) in 2013 from the Forest Investment Programme, for scaling-up Participatory Sustainable Forest Management. Despite this upward trend, the volume of external support for climate change is still marginal relative to the estimated resource requirements of Lao PDR's National Strategy on Climate Change over the next 10 years: \$1.5 billion for mitigation and \$900 million for adaptation.²⁴ This is a trend that is matched in almost all other case studies carried out for this project, suggesting that it may be driven more by supply-side than demand-side factors.

The Government of Laos is preparing to access the Green Climate Fund.²⁵ The Ministry of Natural Resources and Environment (MoNRE) is the focal point of the Green Climate Fund, although it has yet to identify national implementing entities. The United Nations Development Programme (UNDP) is currently helping the Government of Laos to enhance its readiness to prepare potential project proposals. It was widely noted that the Government of Laos has historically lacked the technical capacity to meet the rigorous requirements and procedures associated with accessing multilateral climate funds, and thus has been dependent on financial and technical support from multilateral and bilateral development partners to access any form of international climate finance (Roehrl and Tirpak, 2014). An additional challenge in regard to mobilising climate finance strategically relates to the fact that MoNRE (created in 2011) is a relatively new ministry. Although MoNRE is the technical lead ministry for climate change matters in Lao PDR, the division of responsibilities between MoNRE and MAF remains unclear.

20 The Government of Laos implemented a rapid, across-the-board increase in civil service salaries and benefits in 2013 as part of a stated plan to increase the compensation of public employees over three years. As a result, the public sector wage bill rose to 50% of revenue, well above the LIC average (IMF, 2013).

21 By 2011, 2,570 MW of this capacity had been developed and was operational, producing power for domestic consumption and for export. A further 2,623 MW of capacity, involving 12 power plants, is in various stages of construction. By 2020, it is expected that Lao PDR will have total generating capacity of about 8.1 GW to serve both domestic and export markets (TRIS rating, 2015).

22 In this paper, we have netted out multilateral climate funds from our ODA figures as presented in Annex 1 and in the text.

23 Between 2003 and 2013, Cambodia and Viet Nam mobilised \$105 million (3% of total beyond ODA flows) and \$133 million (2% of beyond ODA flows), respectively, from multilateral climate funds.

24 Based on interview with Government of Laos official.

25 The Green Climate Fund currently has large commitments at the global level (more than \$10 billion committed at the time of writing).

3.7 Philanthropic and NGO assistance

There is very little information on philanthropic assistance provided to Lao PDR. In total, US grant-makers provided \$4.7 million to 23 recipients through 56 grants between 2003 and 2013. This type of assistance accounted for less than 0.5% of development finance beyond ODA between 2005 and 2013. Philanthropic assistance was highest in 2003 and 2004, averaging around \$1 million per year (12% and 4% of beyond ODA finance, respectively), then declined significantly over the next two years to \$0.2 million in 2006 (0.06% of beyond ODA finance). There was then a slight recovery, with assistance increasing to approximately \$0.7 million in 2007 and fluctuating between \$0.1 million and \$0.4 million during the subsequent years (Foundation Center, 2015). Interviews suggested that the potential for philanthropy in Lao PDR may be limited as the country's population is small and transaction costs are high. Having said that, the very limited volume of philanthropic assistance is in line with the findings from other similar case studies under this project (see Schmaljohann and Prizzon, 2016), implying that the issue may be more on the supply side than on anything specific to Lao PDR.

The two largest US grant-makers in Lao PDR have been the Rockefeller Foundation and the McKnight Foundation, which provided \$2.3 million and \$1.3 million, respectively, between 2003 and 2014. The Bill and Melinda Gates Foundation does not appear to have any projects in Lao PDR, although it does in Viet Nam. Based on interviews and available data, foundations do not appear to work directly with central government ministries. The one exception is the Rockefeller Foundation, which provided grants to MAF, the Ministry of Health and the Ministry of Information and Culture, although of small amounts. For example, a grant of \$462,500 was given in 2007 to the Department of Hygiene and Prevention to strengthen national and sub-regional capacity in disease surveillance and response through the Mekong Basin Disease Surveillance Network.²⁶ The Rockefeller Foundation appears to have provided no grants since 2011, whereas the McKnight Foundation remains active, most recently providing a \$0.1 million grant to HELVETAS Swiss Intercooperation in 2014.

Box 1 provides details of support provided by INGOs. This support is not included in the project analysis because it largely overlaps with bilateral ODA and usually lies

beyond government control. The Government of Laos increasingly sees INGOs as important development partners, who have successfully improved the livelihood of Lao people, especially in remote areas. Nevertheless, INGOs in the Lao context are much more under the control of the Government of Laos than is the case elsewhere, and the legal and regulatory environment for NGOs remains challenging.

3.8 Public–private partnerships

The Government of Laos sees the potential for stronger private sector involvement, particularly through PPPs, as an opportunity to develop a comprehensive and modern infrastructure system, as envisaged in the NSEDP (Government of Laos, 2011). At present, there are few examples of PPPs (as defined in the draft PPP decree²⁷) in Lao PDR, given the lack of a formalised institutional framework and no clear definition of a PPP. In light of this, it is not surprising that there is considerable disagreement among government officials and donors regarding whether the Government of Laos has entered into any PPPs. Instead, there is greater agreement on the fact that the Government of Laos has engaged in several projects with PPP characteristics, especially in the energy sector. The most notable example is the Nam Theun 2 hydroelectric dam.²⁸ In general, most of these hydropower projects have been launched on a directly negotiated basis and almost exclusively with international firms (Government of Laos, 2013). The projects that actually reach financial closure typically originate from unsolicited proposals, and thus do not currently fully comply with the definition of a PPP in the draft PPP decree (which defines a PPP project as one procured through a competitive tendering process or competitive conditions).

The new focus on PPP places more emphasis on the structuring of projects and on the introduction of competitive procurement in order to obtain better performance (measured in value for money). It also identifies that PPPs can be set up to fund infrastructure and services that cannot be charged to the user; in this case, the government itself buys the service. This widens the scope to set up PPPs in other sectors, such as social services, government estate, etc.

26 Similar grants appear to have been given to the Governments of Cambodia, Thailand and Viet Nam (see http://www.topfoundationgrants.com/grant_display.php?id=18972).

27 The draft PPP decree defines a PPP as having six essential characteristics: 1. A contractual arrangement between a Project Executing Agency and a private body; 2. Concerning the delivery of a public service or infrastructure for which the Project Executing Agency remains accountable; 3. Where the required service or infrastructure is specified as an output; 4. Where significant risks are transferred to the private firm, making its private investment and financial returns linked to its performance; 5. Procured through a competitive tendering process or competitive conditions; and 6. Often wholly or partly financed by the private sector (Government of Laos, 2014).

28 The build-own-operate-transfer structure developed for the project has allowed the Government of Laos to undertake the project without incurring the financial risk of fully funding the entire project.

Box 1: Assistance to Lao PDR from INGOs

INGOs operate in all sectors and all provinces in Lao PDR, but they tend to be most active in poverty reduction, health care, education, disaster relief and clearance of unexploded ordnance. As stipulated in Decree No. 75 (the ODA decree) (Government of Laos, 2009), the Ministry of Foreign Affairs (MoFA) takes the lead in ‘the development of strategy, plan, program, and cooperation projects with International Non-government organizations’. All INGOs must obtain a permit to operate from the Department of International Organizations, MoFA.

One of the requirements for project approval is that the proposed project should be in line with the Government of Laos’ development strategy. A more contentious key requirement for project approval is that the project should be based on a budget allocation of not less than 70% for project activities and 30% for administration purposes (Government of Laos, 2015). Interviewees noted that this was a difficult requirement for INGOs involved in capacity-building to meet. The implementation of the project cannot commence without the signing of a memorandum of understanding (MOU). Interviewees also noted that it is more difficult to operate in Lao PDR than in other countries as MOUs can take between six months and a year to be signed. INGOs are also required to submit an evaluation report on their operations to MoFA on a regular basis, and at least once a year. Prior to 2015, INGOs were not required to report on their financial activities; however, this may change with the new Guidelines for the Implementation of the Prime Minister’s Decree on International Non-Government Organisations (Government of Laos, 2015), which require INGOs to provide more details in terms of outcomes and financial activity.

INGOs operating in Lao PDR are financed by a variety of sources, including ODA, individual contributions and foundations. According to MoFA, both the number of INGOs and amount of funding channelled through INGOs have increased, with there currently being 172 INGOs in Lao PDR. Estimates from MPI suggest that in FY 2011/12, development partners channelled approximately 5% (or \$23 million) of development assistance through non-profit associations and/or INGOs as implementing agencies (MPI, n.d). Notably, this figure only captures funds disbursed from the 33 development partners that report regularly to the Government of Laos, therefore it does not provide a comprehensive picture of the NGO (local and international) sector in Lao PDR. In FY 2011/12, a number of INGOs (such as Oxfam, Friends International and Plan Finland) also contributed to the implementation of targeted interventions by making individual contributions amounting to \$4.7 million to various development partners (MPI, n.d). Separate estimates by the INGO Network suggest that these figures are likely to be underestimates, with the total funding channelled through INGOs standing at at least \$82 million in 2013, including funds from donors and INGO’s own contributions (INGO Network, 2013).

It was noted that several INGOs have actively sought to diversify their funding sources beyond ODA. There are also a few examples of INGOs partnering with the private sector and considering Development Impact Bonds.

A taskforce called the PPP Unit has been established within the Department of Investment Promotion in the MPI (composed of staff seconded from other divisions of the ministry) to facilitate PPP initiatives. The taskforce is currently working to develop an enabling environment for PPPs (including the policy and regulatory framework), to set up pilot projects²⁹ and to build up the capacity of government staff in both the MPI and other agencies. The PPP Unit has developed and disclosed an initial conceptual framework for the development of PPPs, which sets out a road map for PPP reforms in 2014-2016.

ADB, in particular, has been very much involved in the development of Lao’s PDR’s PPP framework, through its Governance and Capacity Development in Public Sector Management Program, which commenced in mid-2013. The initiative focused on three main areas: (i) institutional capacity-building, (ii) policy and legislation framework development, and (iii) demonstration of model/pilot projects in social sectors, namely education and healthcare.

29 The Government of Laos is currently in the early stages of developing two pilot PPPs in the health and education sectors: construction of a university hospital and a school dormitory.

4 Arenas of negotiation

This section describes the main arenas in which the Government of Laos seeks to engage with different providers of development assistance. The focus is on arenas related to in-country aid coordination (e.g. regular high-level development partner–government meetings and sector working groups), as these are often key fora in which development partners and government engage in discussing sectoral strategies, project identification, policy dialogue and conditionalities. We also review the extent to which providers of development finance beyond ODA (notably non-DAC donors, INGOs and philanthropic organisations) participate in these arenas, or whether they negotiate with government separately, and what impact this has.

One important set of arenas in which the Government of Laos interacts with its development partners is that related to the Round Table Process (RTP), which dates back to 1983. The RTP serves as the primary platform for in-depth dialogue between the Government of Laos and development partners on key development issues. It has evolved over the years to become a dynamic process held in-country, rather than just a one-off meeting every three years. The Government of Laos is now leading the management of the RTP, with support from the UNDP as co-chair. Over the years the structure, purpose and participants in this process have also changed to become broader, more ambitious and more inclusive.

The RTP comprises three components:

- **High Level Round Table Meetings (HL RTMs):** Held every three years, these meetings review plans, strategies and programmes of the Government of Laos and development partners in accordance with the National Development Strategy and Aid Effectiveness Agenda. In the future, the HL RTM will be held every five years in line with the NSEDP. Originally, this process was intended to serve a pledging function, but it has since shifted to supporting policy discussions between the Government of Laos and its donors on development challenges. However, according to the interviewees consulted for this study, it is still widely perceived as a platform for knowledge-sharing, with a pledging function, and that greater clarity is required on the overall objective and purpose of the RTP in general. Participants include Government of Laos representatives, donors (about 26 bilaterals) and INGOs (5 and the INGO Network) and, in recent years, non-profit associations (5) and private sector actors (5 and

the national and sometimes international Chambers of Commerce).

- **Round Table Implementation Meetings (RTIMs):** Held annually, these meetings review achievements and recommend further actions for development strategies, policy reforms and programmes. Their purpose is to discuss and build consensus around some of the opportunities and challenges that have occurred over the past year and the upcoming priorities. Round Table provincial consultations are also held, in a different province every year, to inform the RTIMs.
- **Sector Working Groups (SWGs):** Created in 2005, SWGs are responsible for formulating and implementing sector strategies, and for aid coordination and effectiveness in their particular sector. Lao PDR currently has 10 SWGs, which bring together representatives from government (line ministries, as chairs of SWGs, based on their sectoral expertise), development partners (as co-chairs, based on their substantive contributions – co-chairs can be rotated as needed), civil society organisations, the private sector and other related stakeholders. Although SWGs are supposed to feed into the round table meetings, according to most interviewees this link is generally weak. Moreover, the SWGs are not all the same, varying in dynamism and effectiveness (SIDA, 2008). The Health and Agriculture SWGs were identified as among the best organised, which was attributed to the strength of their respective government chairs. There are also some sub-SWGs, including Environment and Climate Change and Forest Management. However, there are challenges (e.g. lack of resources, political sensitivities) that prevent discussion in some sectors that generate financing (e.g. hydropower) and of some issues that cause the lack of effectiveness of that financing (e.g. corruption).

Although ambassadors from non-traditional donor countries, such as China, Thailand, India and Viet Nam, attend the HL RTMs, and even some provincial-level meetings and SWGs, interviewees suggested they are observers rather than active participants. Non-traditional development partners also have never co-chaired any SWGs. While traditional donors generally expressed a desire for these donors to participate in a more meaningful way, no clear consensus emerged from government interviewees on this issue.

It was suggested that the lack of participation of non-traditional development partners can be explained by the fact that they still perceive themselves as developing countries (which in some cases are ODA recipients themselves), and hence believe that they are fundamentally different from the traditional developed country partners. A similar rationale was proposed to explain the reluctance of non-traditional donors to report to the Aid Management Platform.³⁰ (Thailand is an exception, which may be explained by the fact that it is the only non-traditional donor active in Lao PDR to have dedicated cooperation agencies: TICA and NEDA.) Another plausible explanation for the non-traditional donors' mostly passive approach to the RTP is that the relationships between Lao PDR and some of these countries are highly political and so discussions often go well beyond aid, covering a wide range of issues that are perhaps best suited to bilateral talks. In addition, the RTP emphasises policy dialogue and so has involved discussions on political and human rights issues, which in turn may explain non-traditional donors' reluctance to engage in these fora given their policy of non-interference (MPI, 2015b).

For three of the four top non-traditional donors active in Lao PDR (China, Viet Nam, and Thailand) there is a Joint Cooperation Commission. These bilateral commissions discuss a wide range of issues, including development assistance. It is interesting to note that the Lao–China Commission and the Lao–Viet Nam Commission are permanent divisions of the MPI organisational structure (although they report directly to the Deputy Prime Minister), whereas the Joint Commissions for other major non-traditional development partners (including Thailand) fall under the MoFA. No clear rationale has been given for this difference.

Although the negotiation process for Chinese aid is separate from that for traditional donors, there are some similarities between the two. For example, like for traditional donors, most of the project selection work for Chinese grants is done by line ministries, and grants are signed by the MPI. In addition, all loan negotiations are centralised in the External Finance Department and signed by the MoF irrespective of the identity of the donor and the terms: sovereign DAC, sovereign non-DAC, non-sovereign, concessional or commercial. Aggregate annual funding commitments for grants and interest-free loans are declared during high-level visits.

However, unlike for traditional donors, projects with interest-bearing concessional-loan funding tend to originate with Chinese companies, or at least are developed by interaction with Chinese companies (some of which attend sub-SWGs). Both the LPRP and line ministries have regular contact with interested Chinese companies, when discussions over loans are initiated. Chinese companies inform ministries and the Party about Chinese loan financing schemes (under the China Exim Bank), and the resulting availability of cheap finance, and consult on candidate projects. Once projects are identified, line ministries then notify the MoF, which is responsible for preparing all formal documents for clearance by the LDRP. The cleared documents are then forwarded to the Government of China through the Chinese Embassy in Lao PDR. After that, if the request by the Government of Laos for funding is approved by the Chinese government, an inter-government framework agreement for the loan is prepared. Based on the literature, this process is not unique to Lao PDR, with Cambodia also having a similar negotiation process for Chinese loans, although the role of Cambodian politicians is not highlighted (Sato et al., 2011; Khennavong, 2014).

A distinguishing feature of Chinese aid is that informal contact between Chinese officials and Lao ministers is common, while such contact is much less likely between ministers and traditional donors in Lao PDR (Khennavong, 2014). It is unclear to what extent the bilateral cooperation arrangements between Lao and other non-traditional donor are shaped by informal contact, with there being established formal procedures. For example, the Annual Consultation on Technical Cooperation Meeting between Thailand's TICA and Lao PDR's Department of Asia, Pacific and Africa, MoFA, provides a mechanism to discuss and follow up technical cooperation programmes and activities agreed by both sides, as well as to examine Lao PDR's new proposals. Traditional donors in Lao PDR have high-level dialogues with Lao ministers, but tend to have more regular contact with government officials. Meetings with ministers usually require formal written requests, which have to be approved by the LPRP. Furthermore, while the Government of Laos undertakes overseas missions (referred to as sensitisation missions) with the help of UNDP to the countries of traditional donors in preparation for an HL-RTM, this does not occur with non-traditional donors, at least not through the RTP.

30 As Lao PDR's ODA management, planning and coordination systems face growth in the volume and complexity of assistance being received, the Government of Laos has sought to establish, with the help of UNDP, an internet-based ODA database. The objectives of this database are not only to track regular development projects and to function as both a planning and monitoring tool for future development initiatives, but also to contribute to the realisation of the Vientiane Declaration's objectives (MPI, 2010). While the system is fully owned, managed and maintained by the Department of International Cooperation of the MPI, the information inputted into the database is provided by development partners, hence the quality of information available is dependent on development partners.

Beyond non-traditional bilateral donors, the Government of Laos has also recently taken steps to include local NGOs, INGOs and private sector representatives in the RTP. Non-profit associations have been invited to the Governance SWG, while private sector representatives have been invited to the Trade and Private Sector Development SWG and the Natural Resources and Environment SWG. Based on interviews, involvement of the private sector is motivated by the Government of Laos'

recognition of the growing importance of private finance, as well as the need to diversify sources of development finance. Although not officially registered with MoFA, the previous chairperson of the voluntary INGO network³¹ was invited to take part in the 2014 RTIM dialogue and had frequent contact with MoFA to discuss issues of mutual interest. However, a recent government report on the RTP described the involvement of non-profit associations as 'too little/too late' (MPI, 2015b).

31 The majority of the INGOs in the Lao PDR, including the major ones, are members of this voluntary INGO Network. Established in 2005, the Network currently has 75-80 members. It is estimated that roughly 50 INGOs exist outside this network, such as INGOs with single projects or programmes or East Asian INGOs. The primary focus of the INGO Network is to facilitate liaison and information sharing among INGOs and other development partners as well as with the Government of Laos .

5 Government priorities

This section reflects on the Government of Laos' priorities for the terms and conditions of development finance – specifically the qualitative aspects the Government of Laos seeks to achieve in negotiating with the providers of development finance. The main reference points for Government of Laos' financing strategy are Decree No. 75, 'Decree on the Management and Utilization of Official Development Assistance' (the ODA decree) (Government of Laos, 2009), and the National Socio-Economic Development Plan (NSED, 2011-2015) (Government of Laos, 2011). The former sets the principles for effective mobilisation and management of ODA grants and concessional loans³² and also the priority sectors for ODA. It does not cover less concessional external financing, a point which we return to in the conclusions. The latter³³ provides the Government of Laos with the framework for both economic and social advancement for the country. Its two essential elements include the achievement of the MDGs by 2015 and the realisation of graduating from LDC status by 2020. The NSED not only provides an overarching development strategy, but also contains a financing plan that outlines the orientation of investment expenditure by source of financing. Section 6 looks at the results of these arrangements.

5.1 Financial priorities for development finance

The 2009 ODA decree explicitly states that the Government of Laos considers that ODA in the form of **grant assistance is the top priority** (Government of Laos, 2009). This priority was also articulated strongly by government interviewees. Several interviewees noted that the Government of Laos does not reject any financing offers in the form of grants. It is possible that the emphasis placed on grants is due to Lao PDR's relatively high debt levels and huge development needs, although this did not emerge clearly from the interviews.

The Government of Laos' ODA decree also states that grants should be used for projects in the fields of 'socio-economy, science and technology, and the environment' (Government of Laos, 2009). Grant assistance and concessional loans, the latter with a maximum interest

rate of 3% and long-term maturity, will be used 'for the construction and upgrading of socio-economic infrastructure and commodity good production, as in the NSED' (Government of Laos, 2009; IMF, 2015). While this is not explicitly stated in the ODA decree, interviewees indicated that it is intended that commercial borrowing will only be used to finance projects that can generate returns and can therefore repay their costs, notably hydropower projects. Interviewees appeared to be well aware of, and to actively support and utilise, these informal guidelines. Nevertheless, the guidelines are not binding, with authorities stating they could be modified should financing needs and financial conditions change. For example, the Chinese high-speed railway, an infrastructure project, may be financed on OOF-like terms, which has been justified by the high expected economic returns. As noted below, cases were also cited in which the Government of Laos had prioritised project financing from near-neighbours over that from traditional donors, irrespective of the financial terms, which also suggests that the priority placed on concessionality has to be balanced with other political considerations and the desire to reduce conditionality, in the context of limited civil society oversight.

The Government of Laos is aware that the supply of grants and concessional loans is limited and that as the country graduates from LDC status over the longer term, grant financing is likely to decline relative to loans from bilateral creditors and commercial sources. Given the country's large financing needs, this expectation prompted another priority for government: **diversify the external sources of development finance**. The Government of Laos' decision to issue baht bonds on the Thai market in 2013 was partly motivated by this priority. The seventh NSED also explicitly stated that the Government of Laos would 'look for financial assistance from large donors such as Japan, and new donors like Kuwait and India, and additionally seek assistance from other donor countries' (Government of Laos, 2011: 230).

The other priority that emerged from government documentation, although less strongly from the interviews, was around the **volume of development finance**. The Government of Laos does not have a target for ODA as a

32 Referred to as 'soft loans' in the ODA decree.

33 This is nested within the Long Term Strategy of Socio-Economic Development to the year 2020, which is the overall guidance for development policy in Lao PDR. This strategy is supported by the 10-year Socio Economic Development Strategy 2001-2010 and the rolling five-year NSED.

share of GDP, but the seventh five-year NSEDP included a financing plan that estimated the total investment required to implement it (\$15 billion). ODA was expected to fund 24%-26% of this investment, or \$650- 700 million annually. Between 2011 and 2013, the Government of Laos mobilised \$450 million annually, and at least \$91 million was received annually from non-DAC donors. While the volume of development finance mobilised has grown significantly, there remains a considerable financing gap to get to the \$700 million target. As noted above, absolute ODA requirements for the eighth NSEDP are even higher. The emphasis that the Government of Laos puts in mobilising additional finance is therefore understandable (MPI, 2015a).

The NSEDP's aim has been to ensure annual economic growth of 8% during 2011-2015, which has required significant levels of investment, hence the priority put on mobilising finance. It was reported that traditional donors such as the World Bank and ADB had limited funding available, despite high levels of demand from the Government of Laos, particularly for hydropower projects. This may explain the Government of Laos' exploration of alternative funding sources.

A mixed picture emerged of the degree of prioritisation that the Government of Laos places on maintaining debt sustainability. Lao PDR's draft decree on debt management has been under development since 2011, but has not yet been approved. There is currently no agreed public document outlining Lao PDR's policies on debt sustainability. Possibly as a result, interviewees gave conflicting reports of the debt indicators targeted by the Government of Laos, including whether debt service/revenue ratios or debt stock/GDP ratios were considered the most significant. There appears to be no publicly announced threshold for the debt/GDP ratio, although a recent IMF Article IV report explicitly states two key thresholds. The first is a limit on new external commercial borrowing, to no more than 25% of government revenue. The second is a restriction on borrowing for infrastructure and social development purposes, which only allows financing on concessional terms, with interest rates below 3% and with long-term maturity (IMF, 2015).

5.2 Non-financial priorities for development finance

The interviews provided a less clear picture of the non-financial priorities for development finance. This is possibly because the Government of Laos generally has a policy of saying 'yes' (at least initially) to all grants and concessional loans, and perhaps does not wish to make any strong statements of priorities around the 'terms of conditions' of finance that could alienate any donor.

However, Lao PDR does have the Vientiane Declaration on Partnership for Effective Development Cooperation 2016-2025, which is its localised development effectiveness framework. This Declaration comprises the five key principles derived from the Paris Declaration (which were embodied in the previous Vientiane Declaration for Aid Effectiveness) and complemented by Busan commitments to form eight principles of: ownership; alignment; harmonisation and simplification; inclusive partnerships for development results; transparency, predictability and mutual accountability; domestic resource mobilisation; South-South cooperation, triangular cooperation and knowledge sharing; and business as a partner in development. Most governmental officials interviewed highlighted **ownership** and **alignment to national priorities** as the key principles. In fact, these are explicitly mentioned in Article 5 of the ODA decree (Government of Laos, 2009). Nonetheless, the ODA decree also states that the Government of Laos has the right to consider and approve grant projects that are not in the NSEDP as proposed by the MoFA, based on consultation with the MPI and the MoF (Government of Laos, 2009: 3).

Another common response from both government and non-government interviewees was that the Government of Laos aims to reduce **policy conditionality**. The seventh NSEDP (2011-2015) explicitly stated that when seeking to raise funds (loans and grants) from domestic and foreign sources to finance infrastructure, the Government of Laos should give particular attention 'to sources that do not have too many commitments and conditions'. A few interviewees also emphasised the need for **flexibility**. The rigidity of earmarking in the unexploded ordnance sector was highlighted twice in separate interviews, though it was emphasised that this is an issue in other sectors as well.

Although only explicitly stated in one interview, but alluded to in others, the importance of **balancing political interests and remaining on favourable terms with its neighbours** also appear to be key priorities of the Government of Laos as it navigates the increasingly complex development finance landscape. This is important given the diplomatic tensions that exist among some of its largest providers of development finance (China, Japan and Viet Nam). Lao PDR's political orientation and particular relations with both China and Viet Nam make maintaining these relationships particularly important.

In general, the Government of Laos did not appear to be overly concerned about the **tying** of aid to goods and services provided by the donor country, although interviewees observed that it could potentially be problematic under certain circumstances. Tied aid was not a cause for concern when the foreign equipment is of high quality compared with alternative inputs. However, it was felt that it could be a problem, specifically in the hydropower sector, if equally effective but cheaper

alternatives are available locally. This is because more expensive inputs increase project costs, which then pushes up electricity costs and makes electricity tariffs unaffordable. Interviewees did not raise concerns about Chinese grants being paid directly to Chinese companies, with the MoF only informed after the event, although this apparent lack of concern may also be due to a desire not to criticise an important donor. One interviewee noted that there had been some preliminary discussions concerning increasing local content in projects financed by Chinese loans, but nothing definitive had been decided to date.

The speed of negotiation and delivery of external finance, which emerged as a priority for some other case studies, did not appear to be a priority for the Government of Laos. The lack of emphasis placed on speed may be attributed to the fact that the Government of Laos is generally satisfied with the disbursement rates for donor financing, which were 93% and 84% in 2011/12 and 2012/2013, respectively (MPI, n.d.).³⁴ However, the Government of Laos recognises that disbursement capacities do vary among development partners and sectors, but it is unclear of the reasons for this.³⁵

³⁴ Disbursement rates are only calculated for the traditional donors.

³⁵ A preliminary analysis of this issue suggested that large projects (above \$5 million) tend to have higher disbursement rates because contracts for projects with larger outcomes can be easier to manage. For other projects (except in the \$0.5-1 million range), the disbursement capacity may not directly relate to size. The report infers that a number of activities and project outputs could cause problems for disbursement. For smaller projects with multi-sector involvement, it is harder for policy-makers to plan and follow up on key progress (MPI, n.d.).

6 Negotiation outcomes

The analysis of the economic, political and governance contexts in Section 2 highlighted that the Government of Laos has some leverage when negotiating with donors. This is largely because of its good economic performance, abundant natural resources, geostrategic importance, political history and vulnerability to climate change and its proactive approach to diversifying sources of external finance and balancing different political interests. These factors have strengthened the negotiating capital of the Government of Laos, which has managed to achieve most of its priorities for the terms and conditions for development finance identified in Section 5. The Government of Laos does not express different priorities and/or preferences for traditional ODA donors and other providers of development finance, so the following considerations apply to both categories.

As noted in Section 2, Lao PDR has historically been successful in securing a large proportion of its financing in the form of grants. However, this has already started to change, with grants falling slightly (from \$445 million to \$413 million) between 2012 and 2013, while loans increased (from \$20 million to \$49 million). This trend is likely to continue over the next decade as Lao PDR's income levels continue to increase. As noted, the two main multilaterals in Lao PDR, the World Bank and the ADB, have already stopped providing grants and moved to concessional loans. There is also likely to be a move to less-concessional forms of financing from the multilaterals. For example, as of FY 2021/22, half of disbursements from the World Bank are expected to be financed under IDA terms and half under IBRD terms. Some traditional grant providers, such as Sweden, have already phased out their support from Lao PDR, while other bilaterals reported that they are considering increasing the share of loans in Lao's financing mix. This changing mix of development finance could mean changes to the way Lao negotiates with providers, with rising debt levels meaning that the current approach of accepting all forms of finance may no longer be appropriate. It is also possible that the shift towards greater loan financing will mean that the Government of Laos has to de-prioritise the social/MDG sectors in its budgetary allocations, although there was no evidence to suggest that it has occurred to date.

The Government of Laos has been much more successful in diversifying its sources of external finance, both by issuing international sovereign bonds and by increasing the number of DAC and non-DAC donors that provide support. Kuwait provided \$0.41 million in

ODA-like disbursements between 2011 and 2013, while recent Article IV reports emphasise the rise in government borrowing from non-DAC bilateral donors, such as China, India and Thailand (IMF, 2013; 2015). The Government of Laos has also succeeded in avoiding becoming dependent on any one donor. There are some concerns, however, that this may change as China's influence in Lao PDR continues to increase, especially with the forthcoming entry of the Asian Infrastructure Investment Bank. Government officials may therefore be motivated to welcome Western donors as well as other regional donors to avoid excessive dependence on China.

The Government of Laos has also been successful in mobilising development finance, both ODA and beyond ODA, in order to fund the NSEDP. As mentioned in the previous section, the seventh NSEDP (2011-2015) estimated that \$650–\$700 million was needed annually in ODA funds. Although a funding gap remains, ODA more than doubled in nominal terms between 2002 and 2013, from \$172 million to \$463 million (see Annex 1), while the overall volume of external finance more than quadrupled, from \$192 million in 2002 to \$896 million in 2013. While this is now provided on harder terms, there is no doubt that the aggregate volume of resources is increasing steadily.

The Government of Laos has been particularly skilful in mobilising commercial financing for revenue-generating projects. This is particularly evident in the hydropower sector, which has rapidly developed in the Lao PDR since 2005, with the Government of Laos being able to bring 20 projects to completion between 2005 and 2015. A critical factor underlying this success is the Government of Laos' ready access to large sums of international debt financing on commercial terms (2014: \$2 billion; \$1 billion annually) (DFDL, 2015). This is important since concessional loans from traditional bilaterals and multilaterals are limited in this sector. For example, the World Bank and ADB only contribute a small share of project costs, covering mainly the social and environmental impact assessments. Technical assistance from these partners, however, has been instrumental in enabling the Government of Laos to develop a solid legal system for this sector, covering environment and safety, project approvals and security.

However, Lao PDR's rising debt levels may constrain the country's ability to continue to borrow to finance the NSEDP, and the lack of a clear policy on debt may also cause concern among some financiers. Perception of risk and policy uncertainty will itself lead to lower credit

ratings and higher borrowing costs. It has already been reported that China has restricted lending due to concerns on debt, although it is not clear how this matches with China's approach to the new high-speed railway. Several donor interviewees raised concerns about rising debt levels. One interviewee reported that concerns about public debt levels was informing the Government of Laos' focus on the private sector as a financing source, in which risks are shared.

The Government of Laos appears to have been broadly successful in ensuring that ODA and other sources of development finance are aligned with government priorities. This is partly because of how aid programmes are negotiated, with several donors such as the Republic of Korea, Thailand and India stating that their aid programmes in Lao PDR are demand driven, with their respective governments responding to the demands of the Government of Laos. The RTP itself provides a mechanism to channel donors' support towards the Government of Laos' priorities as identified in the NSEDP. In fact, the Government of Laos' decision to get development partners more involved in formulating the eighth NSEDP may be a strategy to further increase ownership. To our knowledge, no project has been declined because it does not meet Government of Laos' priorities, but this may be because the NSEDP is sufficiently broad to allow this condition to be met. Alignment with country systems has, however, been more limited, largely due to perceived weaknesses in those systems and lack of budget

transparency on the part of the Government of Laos. In 2010, only 41% of aid utilised country systems, compared with 31% in 2007 (OECD, 2012).

Interviewees also suggested that Lao PDR's prioritisation of political interests has led to the favouring of non-DAC donors, particularly from within the region, at the expense of traditional aid providers. Interviewees from two different sectors provided examples of cases in which the Government of Laos chose non-DAC donors over DAC ones for two particular projects, with financial considerations not being the deciding factor. In both cases, in accordance with the Government of Laos' policy of accepting all offers of support, the Government of Laos unofficially agreed for the traditional donor to finance the project, but subsequently altered its decision. It was reported that these decisions were made because the chosen donor already had a track record in the relevant project area and/or the project was part of a package of planned projects, although it was also reported that political considerations, including relationships with near-neighbours, were important factors.³⁶

On a less positive note, Lao PDR lacks an explicit climate finance strategy. Furthermore, the current amount of external support that has been secured is very small relative to the resource requirements for the National Strategy on Climate Change. It is estimated that \$1.5 billion will be required for mitigation and \$900 million for adaptation over the next 10 years.

³⁶ One study found that on projects to be financed by Chinese loans, an informal agreement had often already been made by LPRP members prior to any government officials providing advice (Khennavong, 2014).

7 Conclusions

The main messages, trends and recommendations emerging from the case study of Lao PDR are listed below. As Lao PDR is the thirteenth country to be studied under this project, key findings and comparisons from other case studies have been included where relevant.

Lao PDR's experience of managing beyond ODA flows is likely to be quite heavily influenced by its geographical position in the Mekong Region and on the Mekong River (with potential for hydropower generation), its political system and its links with both Viet Nam and China. These are likely to have influenced both the mix of beyond ODA flows, which are heavily skewed towards China, and its negotiating position with DAC and non-DAC donors.

Beyond ODA flows have increased significantly in Lao PDR over the past decade, both in absolute and relative terms. Beyond ODA flows only amounted to \$21 million, or 11% of total development finance (as defined here), in 2002. By 2013, such flows stood at \$433 million, or 48% of total development finance. Lao PDR is relatively unusual among our case study countries in having such a high share of beyond ODA flows: only Cambodia has more.³⁷

This increase is overwhelmingly accounted for by Chinese support (ODA and OOF-like), as a result of Lao PDR's close political and geographical relationship with China. Again, Lao PDR has an unusually high share of beyond ODA flows accounted for by Chinese support: more than 80% on average over the period 2010-2012. Only Cambodia and Ghana had a higher proportion over the same period, although several other countries also have high levels (including Ethiopia, Senegal and Zambia). However, Lao PDR has also received significant funds from the \$150 million sovereign bond issuance in 2013.

Philanthropic assistance, multilateral climate funds and support from other non-DAC donors appear to be very small, although information remains limited. This finding is in line with that emerging from our other case studies, suggesting that these are unlikely to provide additional sources of finance in the near future. In the case of philanthropic assistance, this may be because funding tends to be channelled through other actors, such as global funds and NGOs, so that once it reaches the country it is no longer 'tagged' as philanthropic assistance. In the case of climate finance, limited capacity has been identified as a constraint to accessing funds such as the Adaptation Fund,

which often have quite complex requirements. In this respect, Lao PDR is once again consistent with other case study countries such as Fiji, Timor Leste and Vanuatu.

ODA flows have also continued to grow over the past decade, more than doubling in nominal terms between 2002 and 2013, from \$172 million to \$449 million, despite Lao PDR's graduation to LMIC status. This finding is again consistent with other case studies carried out, with a doubling or more of ODA between 2003 and 2012 occurring in Cambodia, Ethiopia, Kenya, Viet Nam and others. This suggests that Lao PDR and its donors should continue to focus on ensuring that ODA flows are spent effectively to support the country's development priorities, in addition to exploring other financing sources.

In terms of priorities, concessionality appears to be a clear and consistent government priority (with a preference for grants, then concessional loans, then non-concessional loans). The Government of Laos also has a clear policy of channelling financing sources to sectors depending on their level of concessionality, with (broadly) grants channelled to social sectors, concessional loans to infrastructure and non-concessional loans to hydropower. However, the Government of Laos appears to place significant importance on maintaining good political relationships with near neighbours. This priority can, on occasion, lead it to accept more expensive financing from priority donors. The volume of development finance and the need for support to be nationally owned and aligned with government priorities also came across strongly in interviews. The Government of Laos has very significant financing needs in the hydropower sector in particular, and even the MDBs do not have sufficient resources to fill the financing gap.

Given Lao PDR's strategy on channelling resources to sectors based on their level of concessionality, it is conceivable that a shift from grants to loans may result in reduced allocations to the social sectors. Although no evidence has been provided to support this hypothesis to date, the Government of Laos and donors should ensure that social sectors are supported within the changing financing mix.

The Government of Laos also appears to have a policy of accepting all grants. This may have been an appropriate strategy in an era of highly concessional financing (albeit

³⁷ Note that comparative data analysis was only carried out for the nine African and Asian countries in our case study selection: Cambodia, Ethiopia, Ghana, Kenya, Lao PDR, Senegal, Uganda, Viet Nam and Zambia. The Pacific Island cases (Fiji, Papua New Guinea, Timor Leste and Vanuatu) were considered separately given their diverse geographical position.

with some macroeconomic implications). However, it is likely to become more of a challenge for the Government of Laos given that support is increasingly moving towards less-concessional finance. There is a risk that Government of Laos's approach to welcome all offers of finance may lead to an unsustainable debt burden. This is particularly concerning given that the Government of Laos appears to lack a clear strategy on debt, and the draft decree on debt developed in 2011 appears not to be publicly available. Interviewees differed on the key targets for debt sustainability and the process for ensuring that they are met. High-profile political projects, such as the Chinese high-speed railway, may put further pressure on debt levels.

Some evidence emerged of the Government of Laos prioritising support from non-DAC donors for political reasons, despite the possibility that DAC donors may be able to offer better terms and conditions. There may be a risk that traditional donors will become less attractive partners in the context of a shift towards less-concessional financing. At present such donors are welcomed, given their better financing terms, but this may change in the future. Lao PDR does not yet seem to be using the presence of non-DAC donors to strengthen its negotiating positions in relation to DAC donors, something which other case study countries appear to be doing more successfully.

Non-DAC donors are involved in Government of Laos' aid coordination process, known as the Round Table Process, but mainly as observers. There does not appear to be a strong push from the Government of Laos for them to be more heavily involved. This may be because the Government of Laos is content to negotiate separately with this group of donors, or because the RTP largely involves policy dialogue and discussion on conditionalities, which non-DAC donors generally do not engage in. This finding is again consistent with other case study countries. With the exception of Zambia, it was found that non-DAC donors either do not participate in aid coordination fora at all, or attended only as observers, as in Lao PDR.

Lao PDR appears to lack a clear strategy for climate finance and seems to have difficulty in accessing climate finance. A priority for the Government of Laos will be to articulate a clear strategy on climate finance, agree a definition of climate finance, clarify the division of labour between MoNRE and MAF, and take steps to access funds that will provide additional climate finance. However, as noted above, other case study countries have also struggled to access climate finance, and so there may be limits to the level of funding that Lao PDR can access even once a clearer strategy has been developed. At the international level, a priority should be to ensure that the existing climate funds make accessing funding easier, especially for capacity-constrained governments such as the Government of Laos.

Recommendations

Based on the case study findings, the following recommendations emerge:

1. Lao PDR should agree and publish a clear strategy on debt. The strategy should include publicly announced targets on key debt measures, such as the ratio of external debt to GDP and the ratio of external debt service to government revenue. Other case study countries considered for this project have such agreed debt ratios. Lao PDR is already on the cusp of becoming a high debt risk, according to World Bank and IMF Debt Sustainability Analysis (IMF, 2015), and continues to take on new borrowings, including on non-concessional terms. A debt strategy should also consider contingent liabilities, such as those accompanying some PPP projects. A clear strategy on debt would help the Government of Laos to prioritise and manage borrowing.
2. Lao PDR's approach of accepting all sources of finance may have been appropriate in an era in which grants were the dominant financing instrument. However, Lao PDR is already receiving a larger proportion of its development finance in the form of loans, and this trend is likely to continue given the country's rising income levels. It may be time for Lao PDR to set out clearer criteria under which finance will be accepted, and to prioritise more clearly between financing sources. This will help to ensure there is a more efficient allocation of development finance to priority areas in the context of a potential borrowing threshold.
3. Lao PDR's policy of channelling financing into sectors according to the rate of return is an appropriate one, and appears to have wide understanding and support among government officials. It would be helpful for the country to set down this policy more clearly and to develop a publicly available financing strategy, as is the case in Kenya, Uganda and Viet Nam. Lao PDR's ODA decree does this to a certain extent, but it does not include non-concessional financing or beyond ODA flows. A strategy that considers all sources of external development finance would be helpful. Lao PDR also needs to ensure that its policy of channelling grants into the social sectors does not lead to a reduction in support for such sectors as grant financing declines.
4. Lao PDR should consider reviewing the institutional arrangements for managing external development finance. At present, different flows are considered by different ministries, with grants from DAC donors and multilaterals being managed by MPI, loans by the MoF, and grants from INGOs and some non-DAC donors by MoFA. This fragmented set of arrangements may undermine the ability of the Government of Laos to

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- consider all sources of external development finance in a coordinated way, and to develop and implement a financing strategy that applies across all of them.
5. While recognising the benefits of exploring beyond-ODA flows, including new mechanisms such as PPPs, Lao should also recognise that ODA volumes remain significant and growing. As such, efforts to improve the effectiveness of ODA, on the part of both donors and government, remain important. It is also important to recognise that ODA has a specific role — in the social sectors, in capacity development and so on — that beyond ODA flows are unlikely to cover. A future resource mobilisation strategy must emphasise the complementarity of the different flows in moving towards LDC graduation and the MDGs.
 6. Lao PDR should clarify its policy and definitions regarding PPPs, and ensure there is common understanding among officials and other stakeholders on these issues. At present, lack of clarity may be undermining the effective exploration of the potential for PPPs.
 7. The Government of Laos should develop a clear strategy on, and an agreed definition of, climate finance. To date, the country has only accessed a very small amount of climate financing. While this has also been the case for other case study countries, Lao PDR's reasonably high level of vulnerability to climate change suggests that climate finance should be an important funding source.

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Annexes

Annex 1: Mapping external finance flows

\$ Millions	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
ODA*	172	238	214	231	272	310	326	370	445	444	465	463
ODA DAC donors	124	176	167	156	203	237	225	260	286	267	290	282
Grants	122	171	157	151	182	213	211	222	252	242	280	266
Concessional Loans	2	5	11	5	21	24	14	38	34	25	10	15
ODA multilateral donors	48	62	46	76	69	73	102	110	161	177	175	181
Grants	4	7	9	41	43	46	84	95	128	155	165	147
Concessional loans	44	55	37	35	26	27	17	16	33	23	10	34
Development finance flows beyond ODA*	21	8	23	67	388	215	187	166	290	1,409	100	433
OOF				18	5	10	1	8	0.15	0.08		
Bilateral DAC OOFs (AidData)				18	5	10	1	8				
Multilateral OOFs									0.15	0.08		
Non-DAC bilateral donors**	21	6	22	48	383	204	185	152	288	1,396	100	269
China ODA	21	6	12	23	25	17	14	112	24	33	86	110
China OOFs					309	148			170	1,345		93
Other non-DAC bilateral donors			10	25	49	39	171	39	95	18	14	67
Multilateral climate funds (approvals)		1						6	2	12	1	13
Philanthropy		0.99	1.05	0.30	0.22	0.70	0.12	0.24	0.17	0.38	0.11	0.39
Sovereign bond issuance												150
Total external finance	192	247	237	298	660	525	513	536	736	1,853	565	896

Sources: AidData; Climate Funds Update Database; Foundation Centre Database; Government of Laos ; Khemnavong (2014); OECD aid statistics.

Notes: *ODA figures are net of climate change financing from multilateral climate funds (which are ODA eligible);

**Non-DAC bilateral donors for 2013 only includes concessional loans from India and China's grants commitments announced in September 2013. Blank cells denote no data.

Annex 2: Projects supported through Indian lines of credit in Lao PDR

Year	Project	Tenor (years)	Amount of credit (\$ million)	Amount available for utilisation (\$ million)
2004	115 kV transmission line from Ban-Na in Champassak to Attapeu	N/A	10	–
2008	(i) Paksong S/S-Jiangxai 115 kV, double-circuit transmission line project, (ii) Nam Song 7.5 MW hydropower project and (iii) equipment for rural electrification phase 2 project	Up to 20 years	33	–
2009	Development of irrigation projects in Chamassack Province	Up to 20 years	17.34	–
2010*	(i) 230 kV double-circuit transmission line from Nabon to Thabok and substations and (ii) Nam Boun 2 hydropower project (15 MW) in Lao PDR	Up to 20 years	72.55	35.25
2013	Construction of storage dams and development of irrigation systems in four major provinces of Lao PDR	Up to 10 years	30.94	27.85

Source: Exim Bank's Operative Lines of Credit as on 6 August 2015

Note: *In 2013, this project was substituted by the extension of Thabok and Nabong substations to Thasala Nam Gnung Laksao 115 KV transmission line and substations, for a total amount of \$35.25 dollars.

Annex 3: China's OOF-like projects in Lao PDR

Year	Project	Amount (\$ million)
2006	China Exim Bank loan for construction of Nam Khan 2 and 3 hydropower plants*	308.5**
2007	China Development Bank loan for construction of sports stadium	90
2007	China Exim Bank loan for rebuilding Luang Prabang Airport	57.8
2010	Loan for construction of Mekong Bridge	50
2010	Chinese Yunnan Construction Co. provides preferential loan for a Lao Airlines hangar and maintenance training centre project	16.7
2010	Norinco, state-owned company, provides loan for construction of Nam Theun 2 irrigation system	103
2011	China Development Bank loan for and CWE investment in construction of Nam Ngiep hydropower plant	345
2011	China Development Bank loan for construction of Nam Ou hydropower project phase 2 (Nam Ou 1, 3, 4, 7)	1,000
2013	Chinese Government to give loans for the expansion of the Dongmarkkhai water supply project	92.8

Source: AidData

Notes: All projects included in this table have either been completed or are currently being implemented. Therefore, the \$7.2 billion railway that China agreed to finance in October 2012 is not included because it is classified as a pipeline/pledge.

*The memorandum of understanding was signed in 2006, but construction of the plant began on 26 November 2011 (AidData);

** Only includes the loan given for the construction of the Nam Khan 2 hydropower plant (from the China Exim Bank, at an interest rate of 2% per year and duration of 20 years). Details of the loan for the Nam Khan 3 power plant are unknown.

Annex 4: List of interviewees

Name	Organisation
Dr Kikeo Chanthaboury	Vice-Minister, Ministry of Planning and Investment
Ms Sisomboun Ounavong	Director General, Department of International Cooperation (DIC), Ministry of Planning and Investment
Mr Vichit Sindavong	Assistant Minister, Lao–China Cooperation Commission, Ministry of Planning and Investment
Dr Phanthanousone (Pepe) Khennavong	National Technical Advisor, Round Table Process in Lao PDR, Department of International Cooperation, Ministry of Planning and Investment
Ms Thavichanh Thiengethpongsa	Deputy Director General, Investment Promotion Department, Ministry of Planning and Investment
Mr Rithikone Phoummasack	Deputy Director General, External Finance Department, Ministry of Finance
Ms Bouanguen Ounnalath	Acting Director General, Fiscal Policy Department, Ministry of Finance
Dr Bounleua Sinxayvoravong	Director General, Budget Department, Ministry of Finance
Ms Phavanh Nuanthasing	Director General, Department of International Organizations, Ministry of Foreign Affairs
Mr Chanthaphone Phanvisouk	Director, Department of Cooperation and Investment, Ministry of Public Works and Transport
Mr Phetsamone Viraphanth	Deputy Director General, Department of Cooperation and Investment, Ministry of Public Works and Transport
Mr Xaypaseuth Phomsoupha	Director General, Department of Energy Business, Ministry of Energy and Mines
Ms Dara Phrakonekham	Deputy Director General, Department of Finance, Ministry of Education
Representative	Division of International Cooperation, Ministry of Health
Mr Syamphone Sengchandala	Director of Legislation and Coordination Division, Department of Disaster Management and Climate Change, Ministry of Natural Resources and Environment
Mr Phouvong Luangxaysana	Director General, Department of Disaster Management and Climate Change, Ministry of Natural Resources and Environment
Mr Bounpone Sisoulath	Member of the National Assembly of Lao PDR and Vice-Chairman of the Economic Planning and Finance Committee
Mr Shunsuke Bando	Senior Country Specialist, ADB
Ms Sally Burningham	Country Manager, World Bank
Mr Evgenij Najdov (Geno)	Country Senior Economist, World Bank
Ms Viengsamay Srithirath	Country Officer, World Bank
Mr Jonathan Dunn	Regional Resident Representative for Laos and Viet Nam, IMF
Ms Nga Kim Ha	Senior Economics Officer, IMF
Ms Vonglatda Omany	Economist, IMF
Ms Vimaly Savannarideth	Economic Analyst, IMF
Ms Azusa Kubota	Deputy Resident Representative, UNDP
Ms Makimoto Saeda	Senior Representative, JICA
Mr Andreas Zurbrugg	Deputy Head of Mission, Australian Embassy, Lao PDR
Mr Ernst Hustaedt	Country Director, GIZ
Ms Kim Minyoung	Aid Effectiveness Specialist, KOICA
Mr Subir Dutta	First Secretary, Embassy of India
Ms Putriga Ampaipan	Minister Counsellor, Royal Thai Embassy
Ms Julia Graham	Country Director, SNV, Lao PDR

(continued)

Name	Organisation
Mr Glenn Bond	Country Director, CARE International, Lao PDR
Mr Khammouane Siphonesay	Civil society actor
Mr Houmphanh Rattavong	President, Lao Biodiversity Association (LBA)



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Cover photo: Reuters/Aubrey Belford, 2013. A farmer works in a paddy field under the power lines near Nam Theun 2 dam in Khammouane province October 28, 2013. The government is staking much of its future on large-scale infrastructure projects, including multi-billion dollar road and high-speed rail links intended to turn

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