



Supporting REDD Implementation in Laos
Through the Design of a REDD-compliant Benefit Distribution System

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1 BACKGROUND

Lao PDR (Laos) is climate change-vulnerable, because of its high dependence on natural resources, and its low adaptive capacity as a developing country. On the other hand, Laos has a large forest area (especially per capita), and relatively high per capita emissions (including from fuel wood). While globally deforestation and forest degradation account for ca. 20% of greenhouse gas emissions, in Laos it is 72%.

The main drivers for deforestation and forest degradation are (i) encroachment / conversion into tree or agriculture crop plantations (e.g. rubber), (ii) commercial logging (according to unofficial estimates ca. 900,000m³ per year, with >50% illegal), (iii) hydropower dams ("salvage logging", which then triggers illegal logging above the high-water demarcation line), (iv) mining (ca. 120 companies hold ca. 200 mining concession, and (v) shifting cultivation (especially in the north of Laos). The Department of Forest Inspection (DoFI) was established in March 2008 to improve forest law enforcement.

Both the Forestry Strategy 2020 and the National Action Plan & Strategy on GHG Emission Mitigation include the ambitious long-term target of increasing national forest cover from currently ca. 40 to 70%.

Laos was selected in July '08 (of) to be included in the Readiness Fund under World Bank's REDD-FCPF (Forest Carbon Partnership Facility), as one of 13 countries in total (Laos is not a UN-REDD country).

In August 2010 Laos prepared a draft Readiness Preparation Proposal (R-PP), with \$ 3m foreseen for a 3-year implementation phase; and is working National Strategy and Action Plan on CC (NSAP) and Second National Communication (SNC) to UNFCCC (the latter would include a new and improved GHG inventory, a programme for mitigation & adaptation measures, and climate change scenarios for Laos).

The REDD approach (Reducing Emissions from Deforestation and Forest Degradation in developing countries) is still a moving target: the rules have not been fixed yet. But what is already clear is that the extent to which Laos will be able to attract international investment and REDD payments will depend to a considerable extent on its ability to put in place a system that rewards forest managers who are changing behavior to reduce deforestation and degradation. In other words, they need to establish a benefit distribution system (BDS) that is transparent and efficient, and is seen to reward those actually providing the emissions reduction service, such as local forest managers and communities.

For the success of REDD the importance of ensuring that financial benefits also reach the local forest stewards, i.e. the rural communities and local administrations, who are changing behavior to reduce deforestation and degradation cannot be overstated.

The objective of this study is to develop some initial recommendations about the specific legal and administrative reforms that will be required in order for Laos to position itself to fully benefit from REDD.

It will, thus, assess key areas of policy, legislation and institutional arrangements in terms of their suitability in the context of a future REDD BDS implementation in Laos.

2 LEGAL AND INSTIUTIONAL FRAMEWORKS RELEVANT TO ESTABLISHING A REDD+ BENEFIT SHARING MECHANISM IN LAOS¹

2.1 Overview and Analysis of Primary Legislation

The following is an overview and analysis of the primary legislation² in the Lao PDR that are directly relevant to the establishment of a REDD+ benefit sharing mechanism in the country. While the Prime Ministerial Decrees that established the special State Funds analyzed in this report are subsidiary regulations, their importance in the legal analysis is such that they are discussed in the following section below. The legal analysis in this section is, by necessity, limited in scope and does not cover all issues relevant to the establishment and operation of a REDD+ system of forestland and forest resources management in the country.

Law and Governance in the Lao PDR (an often changing landscape)

It should be understood by the reader that the legal and regulatory frameworks in the country are continuously developing and changing, and that some of the information contained in the report may become out of date in the near future. For example, the National Assembly is currently working on a new Environmental Protection Law, which will likely be enacted later this year. In addition, a new Investment Law was enacted late in 2009 that might be relevant to the establishment of REDD+ benefit sharing arrangements in the country, but a translation of this legal document could not be secured for the purpose of this report. Another directly relevant example involves the State Budget Law, which refers to a Committee of Planning Investment, rather than the relatively new Ministry of Planning and investment. While the exact future of law and governance structures in the Lao PDR that will be relevant to REDD+ cannot be predicted, change is certain.

Constitution (2003)

The Constitution provides the basis upon which all other laws and regulations can exist in the country. It provides for foreign direct investment and promotes the use of modern management technologies (Article 15), lays out the basis for both State and private property ownership (Article 16), guarantees the protection of land property rights (rights to use, transfer and inherit) in Article 17, and also creates a duty in all citizens and organizations in the country to protect the environment and natural resources of the country (Article 19).

¹ In support of this section of the report, a legal matrix that provides easy access to REDD+ benefit sharing relevant provisions in existing legislation in the country is included in an annex to the report. This annex can be used on its own as a quick reference guide for the stakeholders involved in the decision making process for establishment of REDD+ benefit sharing mechanisms in the Lao PDR.

² The term legislation is being used narrowly in this analysis: legislation = laws passed by the legislative branch of government, which in the case of the Lao PDR are laws enacted by the National Assembly.

State Assets Law (2002)

The State Assets Law defines the different types and outlines the management responsibilities for assets of the State such as forest-lands and the trees occurring naturally on them (as opposed to plantation forests, where the trees are owned by the plantation developers). This law is critical and should form the basis of any REDD+ legal analysis in the Lao PDR. since this piece of legislation goes directly to the heart of the question, “who owns the carbon?”

According to this law, State assets are owned by the national community and centrally controlled, though access, use and management of these assets may be granted to organizations and individuals (Article 3). State assets with natural features such as forestlands are classified in the law as “Public Assets” (Article 4), and while these assets must be used for the good of the public and are still owned and held in trust by the State, they can be granted to individuals and organizations through a lease or concession (Article 13).

Article 13 in this law is of particular importance for the creation of REDD+ benefit sharing arrangements in the future, as it provides room for designing creative approaches while using the already existing legal framework in the country, such as the creation of carbon forestry concessions, whereby local groups could be granted access, use and management rights over an area in order to gain a particular set of defined incentive benefits in exchange for sustainably managing the area granted over an extended period of time. Article 13 is essentially the basis mechanism by which the SUFORD village production forest concessions are authorized (Sustainable Forestry and Rural Development project supported by Government of Finland and World Bank) and is also the foundation of support for the recent eco-tourism conservation concessions that are now being authorized in the country (Nam Lik, Bokeo Gibbon Project, etc.).

State Budget Law (2006)

The State Budget Law provides the legal framework for the management and expenditure of all State revenues, which are to be centrally controlled by the National Treasury. All State revenues are to remain in the overall State budget system, though special State funds may be established with proper authorization (Article 6). According to this law, special State funds can be created with the authorization of the government for specific purposes as outlined through regulation (Article 3). The Environment Protection Fund (EPF), Poverty Reduction Fund (PRF) and Forest and Forest Resources Development Fund would be considered as such funds. A specific REDD+ benefit-sharing fund could be established, either by modifying and creating specific finance windows in an already existing fund, or as a newly created fund. To encourage governance efficiency and utilize already existing capacity within the Government of Laos PDR (GoL) where it exists, this report places emphasis on the option that an already existing fund should be modified and used for REDD+ benefit sharing purposes.

In addition to outlining the rules for the management and expenditure of various State revenues, the law also outlines the roles and responsibilities of the Bank of Lao (Article 30), the Ministry of Finance (Article 74), and the Ministry of Planning and Investment (Article 74), which until relatively recently existed in accordance with the provisions of this law as the Committee for Planning and Investment under the Prime Ministers Office (Article 29).

Forestry Law (2008)

The Forestry Law provides the overall framework for the classification of forestlands and forest resource management in the Lao PDR. As such, it is one of the most important pieces of legislation in terms of analyzing how to implement REDD+ benefit sharing arrangements in the country.

While natural forest and forestlands are considered as property of the State (with the possibility of various access and use rights granted to individuals and organizations), trees that are planted in designated areas are considered the property of those that planted them (Article 4). This provision is important in terms of answering the question of who owns the carbon sequestered by forests, and how benefits resulting from carbon credit sales should be distributed, depending on how broadly such a provision might be interpreted by the GoL.

The Forestry Law promotes the concept that local people should be involved in the sustainable management of forest resources in the country, and they should be able to benefit from such involvement (Article 6). Building upon this idea, the Law mandates that regulations should be implemented to create incentives that encourage households and individuals to be involved in the regeneration of forests and forestlands (Article 34). These provisions could form the basis and justification for creating a performance based REDD+ benefit sharing system in the country. Additional support for creating such a system exists in the mechanism for allocating production and non-production forestlands to villages, thus allowing them to legally access, use, manage and benefit from these areas (Articles 3 & 82). The Law also allows the Government to grant forestlands to households, individuals and organizations as a lease or concession, which could create additional opportunities for the development of REDD+ performance based benefit-sharing arrangements in the country if properly utilized (Article 85).

In addition to the above, the Forestry Law provides the legal basis for the Forest and Forest Resource Development Fund (Articles 37 & 38). Unfortunately the Law states that use of these funds are limited to activities relating to the conservation, rehabilitation and management of forests and forest lands, and it does not appear that it can be used as a mechanism to provide non-forest management related poverty alleviation or other benefits to local communities or individuals that might be involved in the sustainable management of forest resources in the country. Depending on how broadly the language in the Forestry Law is interpreted by the GoL, this might limit the use of the Forest and Forest Resource Development Fund as a REDD+ benefit sharing mechanism.

The Forestry Law also outlines the authority of the Department of Forestry and its line agencies at the provincial, district and village levels (Articles 26, 57, 104-108). The Law also makes note of the responsibilities of the National Land Management Authority in relation to forestlands in the country (Article 58).

Environmental Protection Law (1999)

The Environmental Protection Law lays out important provisions for the protection and restoration of the natural environment in the country. The Law also provides the basis for the establishment of the Environmental Protection Fund in Laos (Articles 30-32). Finally, the Environment Law outlines the roles and responsibilities of the Science, Technology and Environment Agency, which has now been renamed the Water Resources and Environment Authority to more accurately reflect its areas of authority and focus in the country.

Land Law (2003)

The Land Law outlines the overall regime for the classification, use, management and protection of land resources in the Lao PDR. The law states that all land in the country is technically owned by the State, various rights can be granted, including the right of access, use, usufruct, transfer, inheritance and alienation (Article 3). The type of rights granted depends on the legal entity involved and the type of land involved.

Similar to the Forest Law, the Land Law defines forestland (Article 19). Individuals and families may only be granted long term use rights to degraded forestlands, while other areas of forestlands, such

as production forest areas or forestland areas for tourism, may be granted through a lease or concession from the government (Article 21).

In addition, the Law includes provisions that outline the authority of the National Land Management Authority and the Ministry of Agriculture and Forestry (Articles 10, 20 & 78).

Contract Law (1990)

The Contract Law defines the parameters of contractual arrangements in the country, which is important since REDD+ arrangements could not occur without contractual agreements being recognized in the Lao PDR; REDD+ is ultimately a contractual agreement between parties, where payment for a particular specialized service is being made (Article 1).

The Law lists the possible parties to a contract, including the State, individuals, legal entities and collective organizations (Article 2). Collective organizations could be broadly defined or interpreted to include a community group or organization. Contracts under the Law may be between multiple parties, such as an international organization, the State, and a community group or organization (Article 4). This ability to have multiple parties to a contract could be very important in the REDD+ context in Laos.

GoL Authority to Grant Awards Supports REDD+ Performance Based Benefit Sharing

There is a peculiar legislative tradition in the Lao PDR where very similar language provisions can be found in a number of REDD+ relevant and other laws, the Environment Protection Law (Article 43), the National Heritage Law (Article 70), the State Assets Law (Article 26), the Land Law (Article 83), the Wildlife Law (Article 66) and most important the new Forestry Law (Article 121).

The provisions all state that individuals and organizations that do a good job of managing State lands and natural resources in compliance with the law shall be granted awards and other benefits from the GoL for their efforts in compliance with rules and regulations. These provisions could form an important basis of REDD+ “performance based” benefit sharing arrangements in the country.

2.2 Analysis of the Prime Ministerial Decrees that have been enacted for the Establishment of the (three) existing State Funds

The following analysis is based solely on the black and white in the legal text within the Prime Ministerial Decrees that were enacted to establish the three funds examined in this report, with the goal of attempting to determine whether they match up with what would be needed legally for a REDD+ fund in the Lao PDR in the future (basically, does the language contained in these legal instruments meet what are generally agreed upon as minimum requirements for such mechanisms by the international community under future REDD+ protocols; things like transparency, civil society involvement, relevance to management issues in the sector, etc.).

2.2.1 Forest & Forest Resources Development Fund (FFRDF)

The primary strength of the Prime Ministerial Decree that establishes the FFRDF is that it is focused on the development of forestry sector and forest resources in the country (highly relevant to REDD+, as it is primarily concerned with forest sector governance issues). In addition to this, the fund management council includes representatives from institutions not directly linked to the forestry sector (Director General from the Environment Department within WREA, Director General of Department of State Assets within the Ministry of Finance, and the Director General for Planning and Land Development within the Prime Minister's Office). There are also important provisions relating to annual and special audits of the funds, and reports being made available for review to those entities that contribute to the fund and other concerned organizations as required, which indicates a certain level of transparency in the operation of the fund.

Some of the apparent weaknesses within the Prime Ministerial Decree include the fact that the fund is situated at a relatively low level within the Ministry of Agriculture and Forestry, and individuals representing this Ministry dominate the fund's management council. There is also no stipulation for civil society or other non-government representation on the fund's management council, which would most likely be required of any REDD+ benefit sharing fund mechanism that is created. Finally, by definition, sources of funding for the fund are somewhat limited, and can only be utilized for rather narrow purposes within the forestry sector. There seems little room that the fund could actually be used for benefit sharing purposes to local communities with the Prime Minister's decree that established it as currently written; in fact there is no mention that the fund can be used for community development or poverty reduction purposes. As such, it is quite likely that those responsible for managing this fund have little direct experience with supporting community development activities through the use of the fund.

2.2.2 Environmental Protection Fund (EPF)

The Prime Ministerial Decree of the Environmental Protection Fund's obvious strength is that it deals generally with natural resources and environmental protection issues in the country, and can also be concerned with social development and governance capacity building issues that are linked to broader natural resources management issues in the country. In addition, the fund is situated quite high in the government hierarchy, with the board of directors of the fund being led by the Deputy Prime Minister. The decree also outlines very broad membership on the fund's Board of Directors from various concerned line ministries, the private sector, mass organizations and members from civil society organizations. Finally, the decree has very strong provisions relating to the transparency of its operations, requiring the development of five-year strategic plans, annual plans, quarterly and annual financial reports, and operational manuals. The Decree also allows some flexibility in the operation of the fund, in that newly created specialized financial windows can be added to its operations, and there is very little limitation on the sources of financial resources that can be fed into the fund.

One of the weaknesses of the Decree is that it blocks the creation of any other funds dealing with environmental or natural resources related issues. This provision essentially mandates that any REDD+ fund that is established, which is inevitably linked to natural resources management issues, be embedded within the EPF through the use of its provisions allowing for the creation of specialized financial windows. Another weakness of the fund is its rather odd limitation that "resources of the EPF shall only be used to finance regular and recurrent expenses of ministries, departments, agencies, and any other public or private entities receiving financial support from the EPF. Such a provision would appear to limit funds in the EPF from being used to support REDD+ community development activities in the sphere of performance based payments.

2.2.3 Poverty Reduction Fund (PRF)

As with the EPF, a real strength of the PRF being that the Administrative Board is led by a non-ministerial representative (deputy Prime Minister), and that Civil Society representatives are not only included as members, but that a Civil Society Member is appointed as second vice Chair to the operation of the fund.

One of the weaknesses of the PRF in terms of what is needed for a REDD+ fund is the fact that there is no representation on the board from any of the government institutions or ministries primarily concerned with natural resources management or environmental protection in the country. Likewise, there is no focus within the fund found in the Prime Ministerial Decree establishing it, and therefore likely to be little actual experience, with issues relating to natural resources management in the country. There are also limited provisions in the Prime Ministerial Decree establishing the fund relating to reporting requirements of the fund, whether financial or otherwise.

2.3 Options for the Development of a Benefit Sharing System, and Regulatory Instruments

The drafting and enactment of new legislation, or amendment of already existing legislation, is not recommended at this point in time in order to create a REDD+ benefit sharing mechanism in Laos. Development of REDD+ benefit sharing mechanisms can be handled through the creative, well-coordinated and properly harmonized drafting and enactment of subsidiary rules, regulations, guidelines, manuals, contracts and overarching policy documents. In addition, the option is presented below that, in the interest of governance efficiency and utilization of existing capacity, that a previously created special State fund be modified to incorporate various REDD+ funding streams.

In order to fully understand the possible options that are presented for the development of a REDD+ benefit sharing fund mechanism in the country, some relevant background information should first be presented and its relevance explained.

2.3.1 National and International References

The recently released Annual Review of REDD+ in Lao PDR (2009) provides the following information regarding the GoL's position on supporting a nested phased approach and preferences for financing (Section 8.2: *Position of Lao PDR*):

“With respect to scale, Lao PDR supports the nested approach in which the overall aim is to implement REDD+ at a national level. However, having a subnational approach nested within a national framework is the most realistic option as it takes into account the national circumstances and capacities of the country, which differ by region, and supports project related REDD activities, as well as national level strategies, programmes and action plans. Having a sub-national approach also means that REDD+ demonstration activities can start very quickly, and have the option of access to the voluntary carbon market. The nested approach also supports the 3 phased implementation of REDD+ where the timeframe for implementing readiness (phase 1), demonstration activities (Phase 2), and full implementation (phase 3), will differ significantly depending on the region in Lao PDR.

For implementation, Lao PDR supports the 3-phased approach. Phase 1 begins with the development of national strategies, action plans, policies and measures, and has a specific focus on capacity building. Phase 2 would follow with implementation of national policies and measures, and national

strategies or action plans and, as appropriate, sub-national strategies that could further involve capacity building, technology transfer and results-based demonstration activities. Phase 3 would include results-based actions that are fully monitored, reported and verified. The timeframe for implementation of such activities should depend on national circumstances, capacities and capabilities.

Financing REDD+ is an essential feature and will be strongly related to the overall outcome and success of REDD+ in Lao PDR – flexibility is the most important element for financing REDD+ in Lao PDR. At this stage, Lao PDR prefers to build readiness for REDD+ with bilateral relationships with donors, given the extensive capacity building, which is required within the readiness phase. As a participating country within the Forest Carbon Partnership Facility (FCPF), Lao PDR also supports multilateral approaches for financing. In the hope to keep financing flexible, particularly within the UNFCCC, Lao PDR supports the hybrid approach to financing which means financing REDD can come from both funds and market based approaches. Lao PDR is also interested in opportunities within the voluntary market to support sustainable project based approaches to REDD+.”

The text from the following section of this document is also relevant (Section 8.3: *Outlook 2010, An Experts View*):

“With regard to financing REDD projects through carbon markets...a new possibility may emerge. The US, together with e.g. Colombia, is pushing strongly to keep sub-national approaches inside the REDD text and intends to allow sub-national REDD offsets for its domestic cap and trade system from a range of developing countries for a time window of 8 to 15 years (up to 2017, possible extension to 2025 max). Countries eligible for selling emission reductions from projects or district/province-based approaches to the US cap and trade system are those with little present capacity for national approaches and that contribute very little to global GHG and land use change emissions (LDC such as Laos would be in, Brazil, Indonesia, China, India are out).”

The outtakes provided above link to analysis from other reports relevant to the Lao context. For example, from the “Legal Frameworks for REDD” IUCN report (Page 64 of Chapter 3 on Benefit Sharing):

“National governments eventually should be able to centrally manage accounting and crediting mechanisms for their forest carbon emissions, as national-level carbon reporting will be critical in assessing international progress towards combating climate change. Given some countries’ short-term national capacity difficulties, however, an interim hybrid framework may offer a compromise between sub-national and national accounting and crediting systems. Under this option, existing national and sub-national capacity may be leveraged simultaneously in countries via nationally aggregated project baselines and monitoring, allowing for a dual-track system of national and project-based crediting and reporting on forest carbon emissions sequestered. Financial and in-kind public funding during this interim period could provide for the development of necessary laws and law enforcement capabilities, as well as legal and public financial management institutions, for equitable benefit sharing. From a legal perspective, a main goal of such work would be to develop integrated regulatory safeguards to monitor and ensure national monitoring, accounting and reporting correspond with credit or fund in-flows and benefit out-flows to sub-national-level recipients.”

Also from IUCN, the “Benefit Distribution System Experiences” report states (Section 3.2: p. 29 & 30):

“A combination of project-based funding utilizing private sector involvement directly and a national fund for other REDD - PLUS activities has been discussed as the most promising REDD mechanism internationally. This is sometimes referred to as the nested approach.

Project-based funding: The private sector is directly involved in REDD – PLUS projects on the ground, which generates credits.

REDD - PLUS fund within the government administration: A national fund that is established within existing structures of the state administration, with representatives from various national stakeholder groups on the board.”³

2.3.2 Options for the Development of a REDD+ Fund

Taking into account the background information above, It is suggested as an option that a legal enabling document is drafted and enacted in the near future that will create a special State fund for the purpose of pooling and distributing monies being made available from the international community for REDD+ support activities, including donor funds that are earmarked for the implementation of the REDD+ Strategic Plan that is scheduled to be drafted and approved this year. The fund can then be modified as necessary over time in conjunction with the nested phased approach that the GoL has decided is the best way forward in the Lao context.

In addition to financial resources contributed by donors in support of REDD+ activities, a portion of the revenues generated from the various sub-national private sector/voluntary carbon market or future cap & trade related sub-national projects could also be fed directly into the fund in order to ensure that monies generated from these projects go directly back to the local communities that are associated with the forest resources where the carbon credits were generated. These revenues, while located within the same REDD+ State fund as the financial resources contributed by various donors, could be placed into a specially created financial window that is designed specifically to handle such revenues and earmark their use to supporting the communities associated with the forest resources as already mentioned.

The key to this option is that it will combine various financial resources into one fund in order to ensure the performance-based linkages actually exist. In addition, the more money that can be placed into the same fund, the easier it will be to manage and monitor successfully, and the greater likelihood of there being actual performance based payments that reach local communities in the country. Why should the GoL seriously consider taking such an approach? Because in the Lao context, the forest resources that will be generating carbon credits will most likely be claimed or classified as State property by the GoL that are being held in trust for the entire country.

The two following scenarios help to illustrate how this option might work and be justified in the Lao context:

Example 1: SUFORD Project FSC certified commercial production forest areas are likely contenders for generating carbon credits. Do the villages actually own these forest resources? No, definitely not. Under the regulatory framework that was created to support this project approach to forest resource

³ The analysis here does not include the “REDD-Plus fund outside the State Administration,” as the authors of this study felt that this option was not appropriate in the Lao context. Similarly, the “Regular Budgets” approach is not presented as this could be handled within the establishment of a REDD+ fund in the Lao PDR, as long as there is a mechanism within the fund utilized/modified/built upon that channels a certain percentage of available money to cover REDD+ related administrative costs that are shouldered by various GoL agencies.

management in the country, it is clear that the villagers can get a portion of the proceeds from the commercial timber sales, but the production forest lands and the natural forest on those lands belong to the GoL, even though they are within village administrative boundaries. The same is true for non-commercial production, conservation, and protection forest areas within village administrative boundaries. The villagers may have access, use, and management rights (they create their own rules and regulations), the forest resources are still owned de-facto by the GoL. The forest resources include the carbon in the trees, so the carbon credits would most likely be considered as property of the GoL.

With this being the case, the option is being presented that a percentage of the proceeds from carbon credit sales go directly into the REDD+ special State fund, specially earmarked in a specific financial window within the fund for the benefit of the village or Koumban (cluster of around three to five villages) from which the carbon originated (basically utilizing the financial model that the Poverty Reduction Fund already uses, which is based on the needs and desires of the community in question), thus avoiding being lost forever in the National Treasury after the Ministry of Finance (MoF) takes possession, which, in accordance with the State Budget Law, is where the proceeds from carbon credit sales would otherwise be transferred.

Example 2: After the NLMA (district level land management offices) rezone village forest areas in cooperation with members from the Department of Forestry (DoF, including the Provincial / District Agriculture and Forestry Offices, PAFO and DAFO) in accordance with the Land Law, Forestry Law and the new Participatory Agriculture and Forest Land Use Planning Manual, and proper follow up village forest management extension services are provided, it is quite likely that non-commercial village production forest areas, village protection forest areas, and village conservation forest areas could generate carbon credits.⁴ Again, under the option being presented, a portion of the proceeds from carbon credit sales should go directly into the REDD+ fund, specially earmarked for the benefit of the villages/Koumbans from which the carbon originated.

Note on Allocation of Carbon Credit Sale Proceeds

For examples 1 & 2 above, it is suggested that an actual portion of the carbon credits be allocated to villages/Koumbans, with 100% of the proceeds from those carbon credits sold going directly into the REDD+ fund. Each time carbon credits are sold from the area in question, the agreed upon portion of carbon credits allocated to the villages/Koumbans are apportioned in the sale along with any other parties (portion belonging to the carbon credit project developer/financier, portion belonging to GoL, etc.). This will avoid scenarios where carbon marketing contracts between the financier and the GoL are written in such a way that, for example, proceed from the first 100,000 carbon credits sold go to the financier, proceeds from the next 200,000 carbon credits sold go to the GoL, and the last 50,000 sold go to the community, which may never see any proceeds since those final carbon credits are the most speculative (the carbon stocks may never reach the estimated amounts reflected in the project contract documents). This arrangement also limits the risk that proceeds may end up being much lower than anticipated for some reason, as has been the case with the share of proceeds to communities in relation to commercial timber auctions conducted through the SUFORD project.

⁴ The carbon credit sales in examples 1 and 2 should most likely be associated with Koumbans, or groupings of Koumbans linked to the carbon credits generated, due to the fact that members of villages with poor forest resources have a tendency to go into other village forest areas to extract the resources they cant find closer to home.

2.3.3 Options for the Development of a Legal Enabling Document for a REDD+ Special State Fund

In terms of creating a REDD+ Special State Fund with the options for phased development and operation presented in the section above, The GoL can decide to either create an entirely new fund, or it can adopt the option of modifying an already existing State Fund in order to maximize governance efficiency and to ensure the utilization of already existing knowledge and capacity that exists in the country. This would entail modifying one of the Prime Ministerial Decrees that established an already existing fund in order to incorporate the various REDD+ funds into its operation, or drafting and enacting a new Prime Ministerial Decree in order to create an entirely new fund.

One of the problems with creation of a new fund is that Article 17(4) of the Prime Ministerial Decree establishing the Environmental Protection Fund already expressly prohibits the creation of any new funds that deal with environmental protection or natural resources management issues in the country. It would appear that this provision would inherently block the creation of a standalone REDD+ fund as a possible option in the Lao context.

Regardless of the option ultimately chosen by the GoL, there are certain boilerplate provisions that should be incorporated into a Prime Ministerial Decree in order to ensure that the fund mechanism ultimately chosen will meet minimum standards and protocols of the international community that is ultimately supporting such a fund. The following are general examples of what these boilerplate provisions should contain.

- 1) **Organizational Makeup:** The fund management should have participation from all relevant government institutional organizations, private sector representatives, donors, civil society and local government.
- 2) **Transparency:** Financial data and planning documentation should be readily available for public review.
- 3) **Use of funds:** REDD+ Fund resources should be able to be used for natural resources management and conservation activities in the forestry sector, governance capacity building and also community development/poverty reduction activities.

2.4 Overview of Institutional Authorities Relevant to REDD+ Revenue Sharing Arrangements (other than State Funds)

The following chart provides an overview of the GoL institutions and authorities, other than the three State funds discussed in Sections 2.3 and 3.

National Steering Committee for Climate Change (NSCCC)

Established in July 2008. Chaired by the Deputy Prime Minister, with Vice-chairs from MAF, WREA and MPI. Secretariat hosted at the Department of Environment (DoE).
7 Technical Working Groups, including one on “Agriculture, Forestry and Land Use”.

National Climate Change Office (NCCO)

Established in October 2008. Hosted by WREA / Department of Environment.
Relevant Units are for (i) Policy and Coordination (e.g. National CC Strategy and Action Plan, (NSAP), (ii) Vulnerability and Adaptation (National Action Plan for Adaptation, NAPA May 2009), and (iii) Mitigation and CDM units.

REDD Task Force

This specialized task force’s secretariat is in the Department of Forestry. It meets regularly, with strong membership and participation from the University, international organizations, and the private sector.

National Environment Committee (NEC)

Established in 2002. The main responsibilities of NEC are to coordinate and provide advice to GoL and its agencies regarding environmental management, strategies, regulations and plans. The NEC consists of management level officials from 14 key agencies, and is chaired by the Vice Prime Minister, with the WREA President and the MAF Minister acting as Deputy Chairpersons. The Secretariat is housed in WREA. (Source: STEA-WB Environment Report 2005)

National Land Management Agency (NLMA)

The NLMA, located under the Prime Minister's office, is the lead Government entity responsible for the drafting of policies, strategic plans and legislation in relation to land management and development in the country. The NLMA is essentially responsible for taking the lead role in land classification or zoning and land use planning activities mandated by the Land Law in coordination with other government entities from the local to the central level. NLMA is also primarily responsible for managing construction land throughout the country, including issuing regulations on the management, protection, development and use of this land.

Sub-National Entities

At the sub-national level, provincial land authorities, district land authorities and village land units are to be established throughout the country. The provincial authority is in charge of registration and issuing titles or land survey certificates, district in charge of conducting surveys, zoning of village land and putting together necessary documentation for registration, and village units in charge of gathering data/evidence for land files and assisting with conflict resolution at the grassroots level.

Ministry of Agriculture and Forestry (MAF)

Primary responsibility over management of forest, agricultural and water lands, including drafting and enforcement of legislation and regulations related to these lands. Primarily responsible, in coordination with other sector entities, for categorizing different agriculture and forest land types at national, provincial, district and village levels.

Key Departments or Divisional Entities Within MAF

Department of Forestry: Responsible for managing forest lands and forest resources in the country in coordination with other line ministries, including National Protected Areas.

Department of Forest Inspection (DoFI): Responsible for investigating and bringing for prosecution possible violations of law relating to the use and management of forest resources in the country, including issues relating to National Biodiversity Conservation Areas and wildlife trade.

National Agriculture and Forestry Research Institute (NAFRI): Responsible for carrying out scientific research on issues relating to agriculture and forestry resource use in the country.

National Agriculture and Forestry Extension Service (NAFES): Responsible for handling extension services in relation to agricultural and forestry issues throughout the country.

Sub-National Entities

Provincial & District Agriculture and Forestry Offices (*PAFO & DAFO*): Oversight over Village Forest Management Units for planning and management of local forest resources. Also responsible for forest-land allocation of degraded forest lands, in coordination with NLMA at provincial and district level, to both individuals and organizations.

National Protected Areas: NPAs are generally staffed and managed by the relevant PAFOs/DAFOs. The most common arrangement is for the NPA Head to be assigned from the PAFO, and his core staff drawn from a mix of PAFO and DAFO staff.

Ministry of Information and Culture

Responsible for managing the cultural land throughout the country, such as National Heritage sites, including issuing regulations on the management, protection, development and use of this land.

Ministry of Industry and Commerce

Responsible for managing industrial land throughout the country, including issuing regulations on the management, protection, development and use of this land. This Ministry is also responsible for monitoring and regulating wood processing enterprises in the country.

With regards to forest resources in the country, the Ministry of Industry and Commerce is responsible for timber sales related to pre-planned and scheduled harvests of timber in the country. Since this ministry is responsible for timber sales in the country, it would be reasonable to assume that it would be responsible for carbon credit sales as well, though this is not entirely certain and there is no clarity in the Law on this point.

Ministry of Planning and Investment (MPI)

Responsible for reviewing large scale planning and investment projects, including those that involve land resources such as various types of concession agreements. Responsible for entering into and enforcing Project Development agreements (PDA), which should include provisions for feasibility studies and ESIA's.

Ministry of National Defense and Ministry of Public Security

Responsible for managing the national defense and security land throughout the country throughout the country, including issuing regulations on the management, protection, development and use of this land.

Water Resources and Environment Agency (WREA)

Formerly the Science, Technology and Environment Agency (STEA), which was established under the Prime Minister Office in 1993, includes the Department of Environment (DoE) and the Environmental Research Institute (ERI). WREA is the principal Government agency for formulating and guiding environmental policy in the country. These two departments are the national focal points for environmental management, including the development of strategies, policies, regulations, programs and projects, implementing Government responsibilities in environmental impact assessment, environment monitoring, and research and training activities. WREA responsible for ensuring that the Law on Environmental Protection is complied with, including being responsible for ensuring provisions within the law relating to Environmental and Social Impact Assessments (ESIAs) are properly prepared and complied with. This would include projects that impact on land resources such as various types of concessions (hydropower, plantation, mining).

Local Administration (province, district, village)

The Local Administration Law spells out very broad mandates for the various levels of local administration, without providing much in the way of detail on what exactly the various levels do in relation to one another, except that the province supervises the district, and the district supervises the village. The three levels do have administrative decision-making and regulatory authority where it has not been superseded by or conflicts with other rules and regulations. In addition, it should be pointed out that the village is the basic level for revenue (tax) collection, and that the village chief is responsible for conflict resolution among the people within the village. More detail tends to exist in legislation on the various line ministries and ministry-equivalent organizations, which have local offices or representatives at the provincial, district and sometimes village level.

Note: *Emergence of Koumban or Village Clusters as a Unit for Local Governance Interaction*

The Koumban is a cluster of between 5 and 10 villages, with each District made up of between 5 and 10 clusters. As part of the GoL strategy for decentralisation, efforts are being made to strengthen service delivery at the Koumban level. Although the Koumban is not a fully established administrative layer in the currently recognized Government structure (the Local Administration Law does not make mention of this administrative level or its arrangement), coordination of certain development activities in some areas of the country is carried out through a committee that represents key ministries - agriculture, health, and education - and the security services. The head of these Koumban committee is appointed by the Party and reports to the District Governor.

3 COSTS, RETAINED REVENUES FOR ADMINISTRATION, AND PAYMENT STRUCTURE OF A REDD+ BDS FOR LAO PDR

3.1 Potential REDD+ revenue flows to Lao PDR

Parties to the UNFCCC have yet to decide what might actually qualify as an emission reduction under REDD+; and the necessary assessments of changes to carbon stocks are hampered by the unavailability of quality data.

Based on the various assumptions made (carbon pricing, avoided deforestation / emission reductions), the existing calculations for potential national REDD income vary too widely (and wildly) to be useful at this stage.

3.2 Defining and calculating the costs of REDD+: international experiences

In general, existing literature on costs related to REDD identifies three types of costs: opportunity costs, transaction costs and implementation costs.

Opportunity costs constitute the largest cost component. In the context of REDD, they can be defined as the net income per hectare per year or the net present value (NPV) that is sacrificed as a result of not logging or not converting land to other productive uses (Olsen and Bishop 2009). Opportunity costs are, of course, different in different parts of the country.

Implementation costs are the second largest cost component. They consist of expenses for planning and implementing activities under a REDD project, such as forest management, patrolling, law enforcement, alternative livelihood programmes, capacity building, education and awareness, etc. They are influenced by economies of scale; that is, the larger the REDD project area, the smaller the implementation cost per unit (e.g. ton CO₂e).

Transaction costs refer to the costs that enable the monitoring, reporting, verification and certification of the emission reductions, which include the costs of negotiations for financing and contracts between buyers, sellers and verifiers (Minang et al. 2009).

IUCN estimate of REDD implementation and transaction costs

IUCN has adopted US\$ 1/ton CO₂e as a rough global estimate of implementation and transaction costs (Olsen and Bishop, 2009, p.3). The estimate is based on the aggregation of sub-sets of implementation and transaction costs from a range of studies:

Antinori and Sathaye's (2007) estimate of transaction costs of US\$ 0.38/ton CO₂e,

Nepstad et al.'s (2007) implementation cost estimate of US\$ 0.51/ton CO₂e), and

Grieg-Gran's (2006) highest administrative cost estimate of US\$ 0.04/ton CO₂e.

Following the example from Vietnam (Cam Duc Phat, 2010, pp. 106-107), a fourth element of costs – the REDD+ rent – is also included in the REDD+ costs. The rationale is that REDD+ payments should not only cover the costs but also generate some incentive for the stakeholders, particularly the local community, for avoiding deforestation and forest degradation.

REDD+ Rent

In economic terms, “REDD rent” is similar to the concept of producer surplus – the difference between what a producer is paid for a good or service and what it costs them to supply it.

Not all REDD+ costs can be expressed in purely monetary terms. Some will be felt as the loss of non-monetary benefits or of non-marketed goods and services. The opportunity costs of avoided deforestation are not limited to a reduction in income. They may also be felt as losses of un-marketed goods and services (such as traditional healthcare products, wild meat or emergency foods) or through a decline in social wellbeing or other indicators (such as a decline in nutritional standards). Along similar lines, the cash returns to different land and resource uses are not the only factors motivating forest degrading activities – and therefore monetary payments are unlikely, by themselves, to add up to a sufficient incentive package to persuade people not to deforest.

For this reason, there is broad consensus that local payment mechanisms to compensate REDD+ opportunity costs must usually consider the provision of both cash and non-cash benefits, which will balance the monetary and non-monetary losses that forest land and resource users incur. These BDSs must, in addition to covering costs, provide positive incentives for avoiding deforestation and forest degradation.

3.3 Review of approaches for allocating and retaining conservation payments in Lao PDR

Currently there are three major national State Funds related to forest resource management in Laos: the Poverty Reduction Fund (PRF), the Environmental Protection Fund (EPF) and the Forestry and Forest Resource Development Fund (FRDF).

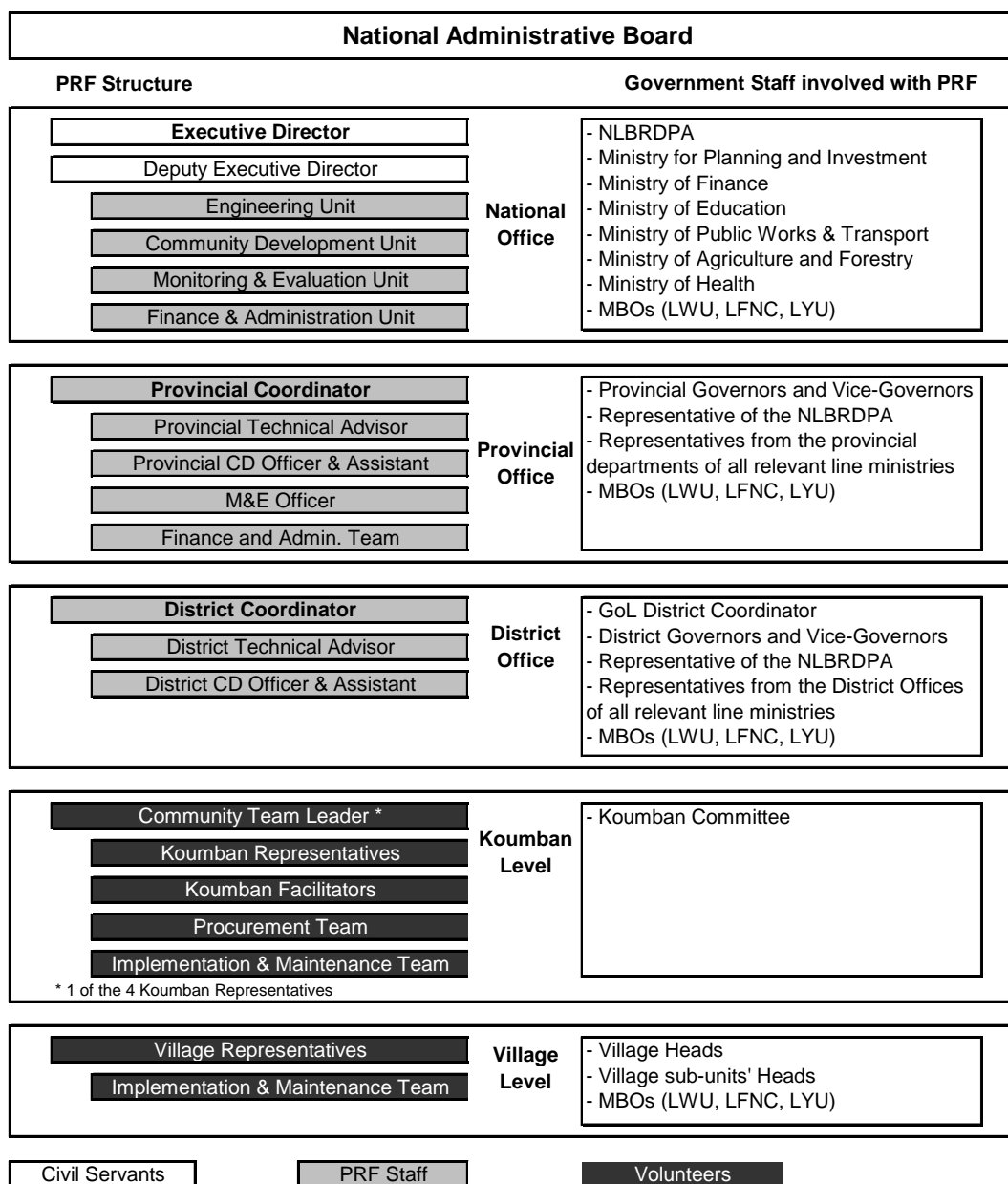
3.3.1 The Poverty Reduction Fund

The Poverty Reduction Fund (PRF) is a financially autonomous organization, legally set up by the Decree No 31 / PM dated 31st May 2002 and operated in accordance with Decree No 222 / PM dated 29th September 2006. The main objectives of the PRF are to finance small-scale infrastructure and services and to strengthen local capacity in respect to village development.

Currently the main funding sources are from the World Bank (the International Development Association, IDA), and Swiss Development Cooperation (SDC), plus some revenue from e.g. the sale of PRF products such as T-Shirts).

PRF now works in all 17 provinces, in 47 districts out of the total 72 districts that have been officially classified as “poor”. The organizational structure of PRF reaches from the national down to the village levels.

Figure 1: Organizational structure of the Poverty Reduction Fund
(Source: PRF Finance and Administrative Manual)



At the national level, PRF decision making and governance is carried out by the National Administrative Board. The PRF National Office facilitates fund management for funded projects and is the secretariat to the Administrative Board. The provincial PRF team consists of a group of around 5 technical experts and two support staff working under a provincial coordinator. At the district level, there are three technical staff members and a district coordinator. At Koumban level, there are a

community team leader, Koumban facilitators, a Koumban implementation and maintenance team, a Koumban procurement team, and Koumban representatives. At the village level, there are village representatives working with the Village Implementation and Maintenance Team (number of team members depending on the number of sub-projects in a village). Staff of PRF at the national (except for the executive director and his deputy who are civil servants), provincial and district levels are on the pay-role of PRF. At Koumban and village levels work is undertaken on a voluntary basis.

Funded activities focus mainly on road access, agriculture, public health (e.g. wells), education (school buildings), and income generation. Activity planning under PRF starts at village level where villagers meet to agree on priorities. Normally each village can propose around three “sub-projects”. After that, there is a meeting at the Koumban level where priorities for the whole Koumban are prepared and submitted to the district level, where all submissions by Koumbans in the district are reviewed. Results of the review are presented at a meeting, and decisions made whether a proposed activity will be funded or not. Usually, there are not more than three sub-projects funded each year per Koumban, with the funds not exceeding US\$30,000 per sub-project per annum.

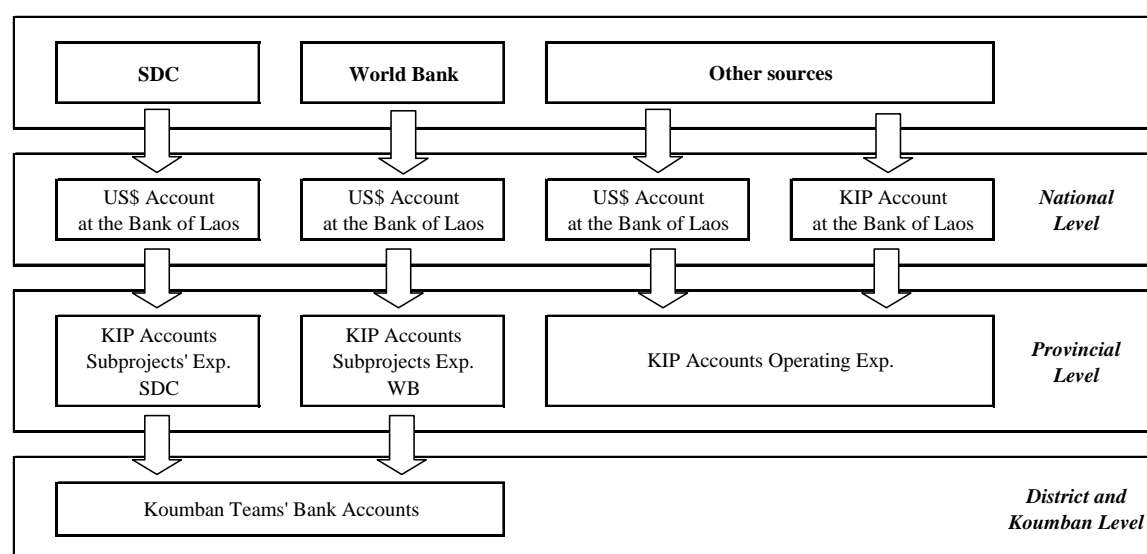
All the planning, management and fund allocation activities follow detailed manuals / guidelines prepared at the national level to meet the requirements of the donors:

- The *Manual of operations* provides detailed guidance on all operational aspects at all levels.
- The *Finance and administration manual* describes financial and accounting policies and procedures, budget preparation, delegation of authority to project staff, disbursement procedures, internal controls, etc.
- The *Social and environmental guideline* stipulates policies and procedures to avoid or minimize adverse environmental and social impacts of sub-projects and to ensure that they meet the World Bank’ safeguards policies.

At central level, PRF has three separate bank accounts in US\$ for IDA and SDC and other sources, and one additional account in KIP for other sources (**Error! Not a valid bookmark self-reference.**). At the provincial level, all funds are converted into KIP and held in separate accounts: accounts for operational costs and development activities, and accounts for subprojects. Bank accounts are set up at the Koumban level but not at the village level.

The current separate bank accounts for the World Bank and for SDC are supposed to be a temporary arrangement until an agreement is reached that all funds can be pooled into one single Special Account.

Figure 2: The Poverty Reduction Fund’s bank account system
(Source: PRF Finance and Administrative Manual)

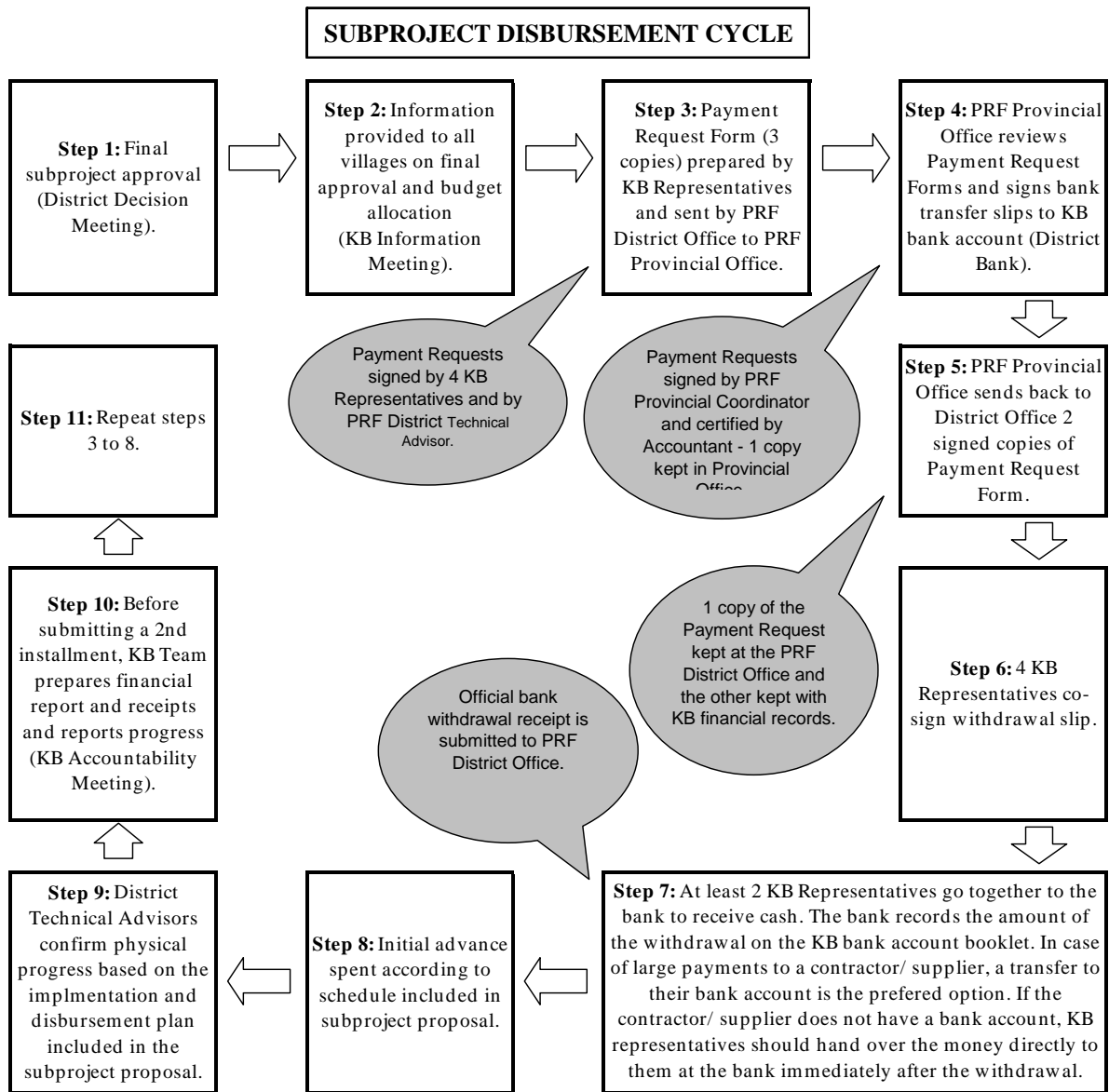


For approved activities, which have become sub-projects, the fund will go from the national level to the sub-projects through bank transfer (Figure 3). A maximum of 40% of the total sub-project fund can be made in the initial transfer. Subsequent transfers are only made after the Koumban Team has reported progress and a PRF technical advisor certified physical progress. The Koumban representatives are responsible for paying sub-project expenses. In case of large amounts, funds can be disbursed directly from the provincial account.

The donors require that the cost of delivering the funds is kept to a minimum so that most of the funds have a direct impact on poverty at the community level. At least 75% of PRF’s total budget must be used for subproject financing and capacity building, i.e. no more than 25% of the budget can be used for fund management. In addition, 3% of the sub-project budgets can be used to cover Koumban Team management costs (i.e. travel and meetings) and 2% for the sub-project technical supervision.

So far, the actual costs of management/ supervision are around 20% (excluding those at the sub-project level).

Figure 3: Fund disbursement for PRF sub-project activities



3.3.2 The Environmental Protection Fund

Similar to PRF the Environmental Protection Fund (EPF) is an autonomous organization set up by the Government of Laos (Prime Ministerial Decree No 146, dated 6 June 2005). EPF aims to strengthen environmental protection, sustainable natural resource management, biodiversity conservation and community development in Lao PDR.

The EPF's organization consists of two bodies at national level (with no branches at sub-national level):

- Board of Directors: chaired by the Deputy Prime Minister, with members such as ministers of MOF and WREA, and representatives mass organizations, chamber of commerce, research institutes or civil society organisations.
- Executive Office: headed by an executive director, with four units, including a Window Management Unit (WMU) for the Special Financing Windows (SFW).

The main sources of funding are the Asian Development Bank (ADB) through the Environment and Social Program Loan (US\$ 5.7 million), and the World Bank (WB), providing US\$ 4 million through the Lao Environmental and Social Project (LEnS) (EPF Five Years Strategic Plan, 2007).

Funding from EPF is provided through grants in five Special Financing Windows (SFW). Two SFW are financed by the World Bank and the other three by ADB:

Table 1: EPF's Special Financing Windows Budget in 2009/2010
(Source: EPF Five Years Strategic Plan, 2007)

Special Financing Windows	Date of establishment	Donor
1. Policy Implementation and Capacity Enhancement (PICE)	2005	WB
2. Community Biodiversity Investment (CBI)	2005	
3. Pollution Control	2006/07	ADB
4. Waste Water Management	2006/07	
5. Sustainable Land Management	2007/08	

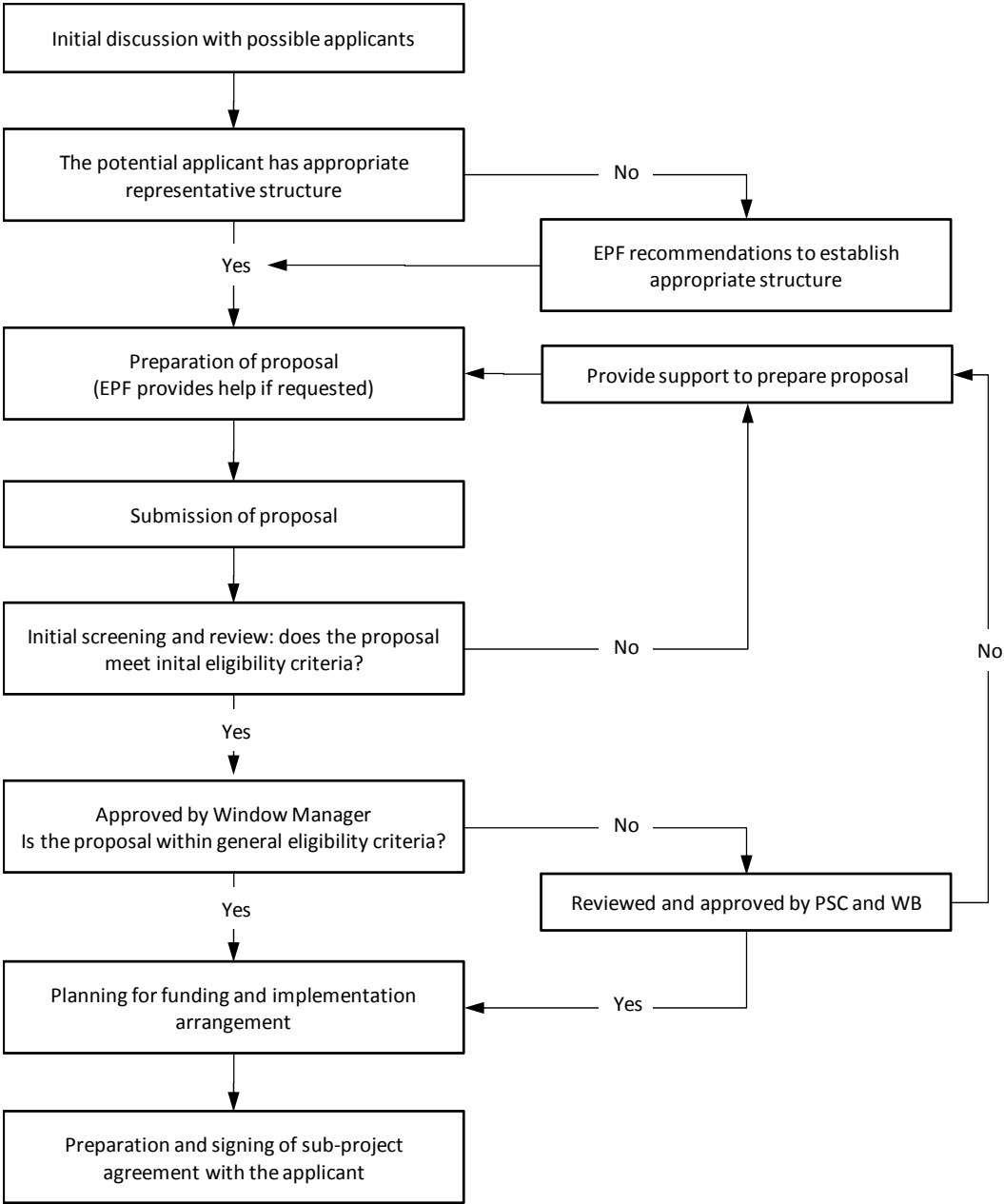
Both agencies and individuals are eligible to receive EPF funding, provided that their proposed activities are in line with the direction set out by the decree and the SFW's regulations.

Figure 4 depicts the funding application process for activities under the Community and Biodiversity Investment Window. Small grant applications are submitted to the provincial facilitator for initial review. EPF may provide help to the applicant to revise the proposal for resubmission. For grants above 10,000 US\$, the proposal must be endorsed by the LEnS Project Steering Committee (PSC).

Once the proposal is approved, the applicant signs a sub-project agreement. The implementing organization needs to have a separate account for the sub-project (multiple sub-projects under one implementing agency can jointly use one account but need separate bookkeeping). Funding for the sub-project will come directly from the Designated Account. The formal representative for the sub-project must assign a person in charge of managing all financial matters and an accountant to prepare monthly financial statements.

EPF administration is financed by the interests from an initial ADB Endowment Fund.

Figure 4: Fund application for activities under CBI window
 (Source: EPF Guidelines on preparation of proposals for Community and Biodiversity Investment Financing Window)



3.3.3 The Forestry and Forest Resource Development Fund

The Forestry and Forest Resource Development Fund (FRDF) was set up in 2005, following the Prime Minister's Decree No 38/PM dated 21 February 2005, as a body under the Ministry of Agriculture and Forestry (MAF). FRDF aims "to generate and aggregate financial resources from national and international agencies to be used for implementation of forest development activities, especially, management of Protected Forest Areas and National Biodiversity Conservation Forests, plantation establishment, maintenance and regeneration of degraded forests and forest lands, watersheds, environmental protection, wildlife conservation, dissemination of and training in forest development policies, forestry laws, forest management techniques and other policies related to forest and forest resources management" (Article 2 of Decree 38/PM).

The Board of Directors (BOD) is chaired by MAF's Deputy Minister, with members from relevant MAF departments, Ministry of Finance (MOF), Office of the Prime Minister, and the Department of Environment, Science and Technology. A "Secretary Committee" supports the BOD and undertakes day-to-day fund management.

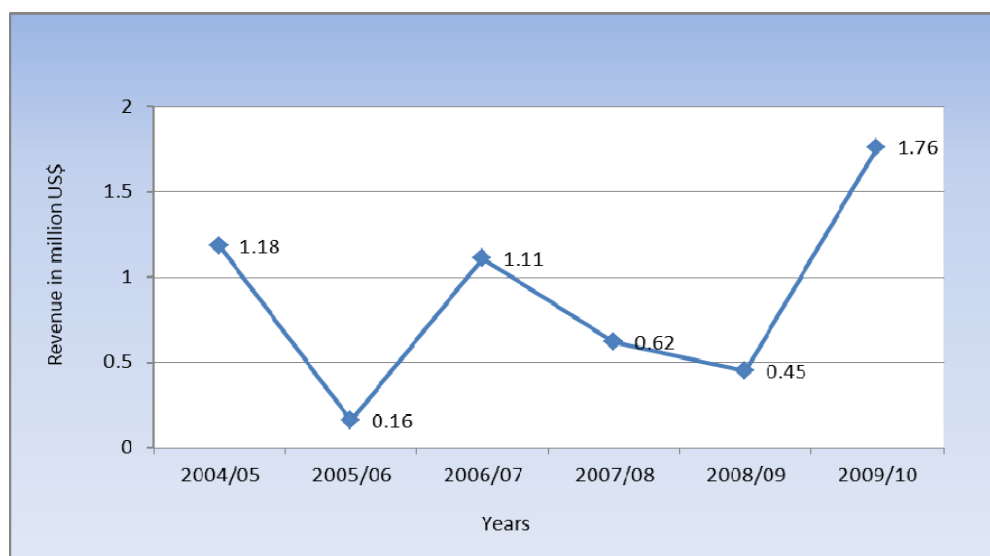
Funding sources for FRDF are supposed to be:

- royalties and fees for forest land and forest resources
- fees for timber and NTFPs harvested from plantations
- fees for forest, forest land and forest resource inventories
- contributions from national and international organisations including non-profit organisations
- the additional revenue from competitive log sales
- interest on bank deposit.

Nevertheless, so far only fees collected from timber and NTFP harvests contribute to the fund! Funding has been highly volatile ever since the date of its establishment.

Figure 5: FRDF Budget over time

(Source: Kyophilavong, P.: Sustainable National Protected Area Management (SuNPAM), 2010)



FRDF finances forest management activities such as forest inventories, plantations, regeneration, harvesting (?!), processing, protection and stabilization of shifting cultivation. Eligible have so far only been state agencies at the national (NAFRI and departments under MAF) and provincial (PAFO / DAFO) levels. So far, funding has been approved for 13 programs with a total budget of 15 billion Kip or ca. 1.76 million USD - Table 2. This represents only 44% of the total budget requested (34 billion Kip).

Table 2: Budget by programs under Forest Resource Development Fund in 2009/2010
(Source: Kyophilavong, 2010)

	Proposed budget		Approved budget	
	Million Kip	% over total	Million Kip	% over total
Agriculture and forestry land use planning at district level	2,000	5.7%	1,300	8.7%
Monitoring and evaluation of agriculture and forestry land uses	600	1.7%	500	3.3%
Eradicating shifting cultivation and providing permanent jobs for people living in in three forest types	2,000	5.7%	1,600	10.7%
Management of production and plantation forests	2,000	5.7%	500	3.3%
Forest inventory and planning	10,000	28.6%	2,900	19.3%
Forest and forest resources regeneration for economic and environmental purposes	500	1.4%	2,000	13.3%
Biodiversity conservation, forest conservation and wildlife protection	7,000	20.0%	3,000	20.0%
Dissemination of forest policy, law and regulation	800	2.3%	500	3.3%
Management of forest and forest development fund at national level	100	0.3%	900	6.0%
Forest and forest resource inspection and protection	300	0.9%	1,000	6.7%
The NTFP management and preservation	50	0.1%	350	2.3%
Forestry research project	0	0.0%	0	0.0%
Projects which replace projects associated with credits and loan	0	0.0%	0	0.0%
The project for monitoring and evaluation of forest and forest resource management	5	0.0%	450	3.0%
	25,355		15,000	

First, the applicant organization prepares an expenditure plan, based on Fund guidelines. In general, the proposed activity has to come under the list of programs identified by FRDF. FRDF reviews the activities and budgets, feasibility and priority of submitted projects and submits them to the Fund Committee for approval. Approved projects and budgets are sent to Ministry of Finance (MOF), who will inform the concerned provinces when the funds are available. MOF transfers the budget directly to the recipient organisations.

Costs for administration of the FRDF are borne by the state budget, i.e. not taken from the FRDF. For the year 2009/10, 900 million Kip has been approved for the administration of the fund at national and provincial level, which is around 6% the amount of the budget approved for projects.

4. CONCLUSIONS AND RECOMMENDATIONS

4.1 Recommendations for REDD+ Fund Development

Taking into account the background information and deliberations above, it is suggested that a **legal** enabling document is drafted and enacted in the near future that will create a **REDD+ Special State Fund** for the purpose of **pooling and distributing** monies being made available from the international community for REDD+ activities, including **donor funds** that are earmarked for the implementation of the REDD+ Strategic Plan that is scheduled to be drafted and approved later this year. The fund can then be **modified as necessary** over time in conjunction with the nested (local\province\national) and phased approach that the GoL has already decided is the best way forward in the Lao context.

In addition to financial resources contributed by donors in support of REDD+ activities, a portion of the revenues generated from the various sub-national **private sector/voluntary carbon market** or future cap & trade related sub-national projects could also be fed directly into the fund in order to ensure that monies generated from these projects go directly back to the **local communities** that are associated with the forest resources where the carbon credits were generated. These revenues, while located within the same REDD+ State fund as the financial resources contributed by various donors, could be placed into a specially created financial window that is designed specifically to handle such revenues and earmark their use to supporting the communities associated with the forest resources as already mentioned.

The key to this option is that it will **combine various financial resources into one fund** and to ensure the performance-based linkages actually exist. In addition, the more money that can be placed into the same fund, the easier it will be to manage and monitor, and the greater the likelihood of performance based payments that reach local communities.

In the Lao context, the forest resources that will be generating carbon credits will most likely be claimed or classified as **State property** by the GoL that are being held in trust for the entire country. The two following scenarios help to illustrate how this option might work:

Example 1: SUFORD Project FSC-certified commercial **production forest** areas are likely contenders for generating carbon credits. Do the villages actually own these forest resources? No, definitely not. Under the regulatory framework that was created to support this project approach to forest resource management the villagers *can* get a (relatively small, if any) portion of the proceeds from the commercial timber sales, but the production forest lands and the natural forest on those

lands belong to the GoL, even though they are within village administrative boundaries. The same is true for non-commercial production, conservation, and protection forest areas within village administrative boundaries. The villagers may have access, use, and management rights (they create their own rules and regulations), the forest resources are still owned de-facto by the GoL. The forest resources include the carbon in the trees, so the carbon credits would most likely be considered as property of the GoL.

With this being the case, the option is being presented that **a percentage** of the proceeds from carbon credit sales go directly into the REDD+ special State fund, specially **earmarked in a specific financial window within the fund for the benefit of the village or Koumban from which the carbon originated** (basically utilizing the financial model that the Poverty Reduction Fund already uses, which is based on the needs and desires of the community in question), thus avoiding being “lost” in the National Treasury after the MoF takes possession, which, in accordance with the State Budget Law, is where the proceeds from carbon credit sales would otherwise be transferred.

Example 2: After the NLMA (district level land management offices) rezone village forest areas in cooperation with DoF in accordance with the Land Law, Forestry Law and the new Participatory Agriculture and Forest Land Use Planning Manual, and follow up village forest management extension services are provided, it is likely that **non-commercial village production forest areas, village protection forest areas, and village conservation forest areas** could generate carbon credits.⁵ Again, under the option being presented, a portion of the proceeds from carbon credit sales should go directly into the REDD+ fund, **specially earmarked** for the benefit of the villages/Koumbans from which the carbon originated.

Note on Allocation of Carbon Credit Sale Proceeds

It is suggested that, with 100% of carbon credits sold going directly into the REDD+ fund, an agreed upon portion of the proceeds be allocated to villages/Koumbans. Each time carbon credits are sold from the area in question, the portion of carbon credits allocated to the villages/Koumbans are apportioned in the sale along with any other parties (portion belonging to the carbon credit project developer/financier, to GoL, etc.). This will avoid carbon marketing contracts between the financier and the GoL written in such a way that, for example, proceeds from the first 100,000 carbon credits sold go to the financier, proceeds from the next 200,000 carbon credits sold go to the GoL, and the last 50,000 sold go to the community, which may never see any proceeds since those final carbon credits are the most speculative (the carbon stocks may never reach the estimated amounts reflected in the project contract documents). This arrangement also limits the risk that proceeds may end up being lower than anticipated, as has been the case with the share of proceeds to communities in relation to commercial timber auctions conducted through the SUFORD project.

⁵ The carbon credit sales in examples 1 and 2 should most likely be associated with Koumbans, or groupings of Koumbans linked to the carbon credits generated, due to the fact that members of villages with poor forest resources have a tendency to go into other village forest areas to extract the resources they cannot find closer to home.

4.2 Developing a REDD+ Special State Fund Legal Enabling Document

In terms of creating a REDD+ Special State Fund with the options for phased development and operation presented above, the GoL can decide to **either create an entirely new fund, or modify an already existing State Fund** (i.e. FFRDF, EPF, or PRF) in order to maximize governance efficiency and to ensure the utilization of already existing knowledge and capacity that exists in the country. This would entail modifying one of the Prime Ministerial Decrees that established an already existing fund in order to incorporate the various REDD+ funds into its operation, or drafting and enacting a new Prime Ministerial Decree in order to create an entirely new fund.

Regardless of the option ultimately chosen by the GoL, there are certain **provisions** that should be incorporated into a Prime Ministerial Decree in order to ensure that the fund mechanism ultimately chosen will meet minimum standards and protocols of the international community that is ultimately supporting such a fund. The following are general examples of what these boilerplate provisions should contain:

- 1) **Organizational makeup:** The fund management should have **participation** from all relevant government institutional organizations, private sector representatives, donors, civil society and local government.
- 2) **Transparency:** Financial data and planning documentation should be readily available for public review.
- 3) **Use of funds:** REDD+ Fund resources should be able to be used for natural resources **management and conservation** activities in the forestry sector, governance **capacity building** and also community development/**poverty reduction** activities.

4.3 Recommendations for Revenue Retention and Payment Structure

The review of existing experiences with payment mechanisms in Laos provide useful insights for future REDD+ payments.

4.3.1 Revenue Retention

The first issue is where the funds for administering the REDD+ funds and payment system should come from: the REDD+ revenue or the Lao government budget? In one instance, the administrative costs are covered by the State budget (Forest Resources Development Fund, FRDF) while in other cases the costs are paid by donor funds (Environmental Protection Fund, EPF; and Poverty Reduction Fund, PRF).

In the former case, it is obviously attractive for international investors to know that the Lao government is willing to pay for the administrative costs of the payment system and, thus, a higher portion of the REDD+ revenue can directly reach the ultimate beneficiaries. Nevertheless, it is more realistic to expect **costs to be borne by REDD+ revenues**.

The second issue, then, is how much of REDD+ funds should be retained to pay for administration costs. The PRF has used around 20% of the total fund for administration, which is lower than the 25% permissible by the World Bank. In Vietnam, the Five Million Hectare Reforestation Program (5MHRP)

set a flat rate for management costs at 10% of the total budget; of which 0.7% is for national level, 1.3% for provincial level and 8% for the project developers⁶. The PES Pilot payment scheme set a rate of 19% of the total revenue to be used to cover administration costs (10% at the provincial and 9% at the district level). In Latin America, the National Programme for Hydrological Environmental Services in Mexico and the National Fund for Forest Financing in Costa Rica have a ceiling of 4% and 7%, respectively. In Indonesia, levels are specified by law, and allow between 10% and 50% of the total to be retained by government; of which 40% is remitted to central, 20% to provincial and 20% to district governments (Cao Duc Phat 2010). Nevertheless, fixed percentages risk leading to a situation where some entities cannot cover their costs, and may encourage inappropriate expenditures by others. It is, therefore, advisable that the rate be based on **real costs**.

A third issue is the incentive for the government to take part in REDD+ payment system. As discussed earlier, there are different elements to be considered: **implementation costs**, **transaction costs**, **opportunity costs**, and a certain level of **rent**.

Finally, as REDD+ fund allocation is contingent on **performance**, that is on achieving the specified emissions reductions targets that a given level of government administration is mandated to deliver, any method for calculating retention levels should also be **flexible** enough to cope with changes in costs over time. Normally, costs of introducing and setting up REDD+ programs will be higher than the subsequent costs of running the system once it is established.

4.3.2 Payment Structure

Capacity to manage the fund: The existing experiences with the three Lao funds discussed earlier show that complex procedures for fund management have been developed to meet the requirements of donors like ADB and WB (PRF and EPF). Over the years, human resources have been developed for fund management. Only PRF appears to have developed a comprehensive structure down to village level. EPF has sub-ordinate offices at the provincial level and FRDF will start offices at this level from late 2010 onward. In addition, experiences so far have only been with managing project grants and little if at all have been with distribution of money to different stakeholders, as should be the case with REDD+ revenue distribution.

Cash or non-cash payment: Cash payments are desirable from the point of view of the ultimate beneficiaries. However, given the lack of experience with cash payment so far, it is advisable to start with non-cash payments while developing the necessary framework for both beneficiaries and staff involved in the REDD+ revenue distribution for cash payments.

Stakeholder participation: so far, in the management of the three existing funds, the decision-making involvement of *non-state* actors (NSAs, i.e. civil society and the private sector) has been minimal. For REDD+ revenue distribution, however, the active involvement of NSAs in the fund management and payment system is pre-requisite to ensure transparency, equity and accountability. The REDD+ payment system will have to take this into account.

Management level: given the in-country experience discussed earlier, it is desirable to work at the national and provincial at the beginning. At the same time, capacity at the district level should be built so that, in the long run, payments can be managed at the district level.

⁶ Decision 100/2007/QĐ-TTg of the Prime Minister of Vietnam, dated 6 July 2007

Fund management agency: although the goals of all three existing funds are relevant to REDD+, PRF would seem to have the most adequate set up to manage REDD+ revenues. It has established management structures from the national down to village levels, and developed procedures to meet the strict requirements from international donors. Nevertheless, even the PRF is not yet ready to take over the specific requirements of REDD+ fund management.

Beneficiaries: which types of resource users should receive REDD funds? For Lao PDR where most of forests are still legally owned by the **State**, the important issue is how local communities can benefit from future REDD+ revenues. In the short run, **local communities** can be contracted to protect the forest resources and thus be paid for the labor and time they invest. At the same time, however, it will be necessary to accelerate the forest land allocation to local communities to ensure they will benefit from REDD+ in the long run.

R-coefficients: to determine the appropriate distribution of REDD+ benefits, taking into account the **variations in conditions and costs related to achieving emission reductions in different sites**. Such coefficients can be used for distribution of REDD+ revenues to provinces, then to districts and finally to local beneficiaries. These tentatively termed “R-coefficients” need to reflect actual contributions to emissions reductions and performances by different levels (and still need to be developed; Cao Duc Phat 2010).

Timing of payment: timing and frequency of REDD+ fund disbursement from international sources to Lao PDR and then to ultimate beneficiaries. If REDD+ payments were only to be made *ex post* or “on delivery” of carbon emissions reductions, it would be hard or even impossible for many groups to invest their very limited resources into REDD. The delay in payment would have significant impacts on the ability of different stakeholders to implement REDD+ projects (ICF International 2009, cited by Cao Duc Phat 2010). It is, thus, preferable to establish **ex-ante payment** at the out-set of a REDD+ project to at least cover some initial costs of establishment, **in combination with ex-post** performance-related payments. This would increase the likelihood for participation by especially the poor as there is less risk involved. Nevertheless, the issue how to acquire the funds needed for upfront payments still needs to be discussed and resolved.