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## THE LEGAL FOUNDATIONS OF PAYMENTS FOR ENVIRONMENTAL SERVICES IN THE LAO PDR

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# Abstract

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This report analyses the legal foundations for the design and implementation of PES schemes in the Lao PDR and provides recommendations to address potential legal barriers. Key challenges that may limit the supply effectiveness and efficiency of PES schemes in the Lao context include investment risks to buyers and sellers; liability risks to agents; potentially high transaction costs due to administrative requirements; and restrictions in the range of legally eligible ES supply actions. Drivers of these challenges include aspects of the land tenure system; land use restrictions (including access) that may limit the range of eligible supply actions; approval and registration requirements that may apply to some supply actions; requirements of business registration and the payment of taxes that may apply to ES sellers; feasibility of PES contracting and enforcement; and potential challenges in establishing an impartial, accessible and fair mechanism for grievance, conflict resolution and redress.

*Key words: business registration; land categories; land tenure; PES schemes; PES contracting*

## Recommendations

1. Explicitly exempt supply actions that produce ES performed under a PES scheme from land use registration.
2. Exempt supply actions performed under a PES scheme from the approval process regarding land use changes across land categories.
3. Explicitly remove land use restrictions for supply actions performed under a PES scheme on Agricultural Land that is allocated to individuals and villages or expand the range of land use options available on Agricultural Land, and ensure that the options are in accordance with current policies for poverty reduction and environmental protection.
4. Explicitly remove land use restrictions for supply actions performed under a PES scheme on Forestland that is allocated to individuals and villages or expand the range of land use options available on Forestland, and ensure that the options available are in accordance with current policies for poverty reduction and environmental protection.
5. Clarify which forest category at which level takes precedence in case of overlaps between forest categories at the macro level and the village level.
6. Extend the incentives provided for forest protection, forest regeneration and tree planting in Degraded Forestland and Barren Forestland to any supply actions performed on any land category under a PES scheme.
7. Explicitly include the ES produced under a PES scheme into the right to usufruct and allow for rights to ES to be sold independently of the use rights to land on which the supply actions were performed.
8. Support potential PES suppliers who are holders of Temporary Land Use Certificates to apply for Land Use Titles through awareness rising initiatives, a reduction of associated costs, and the removal of access barriers.
9. Specifically include ES in the laws that stipulate compensation for land requisition by the State for public purposes.
10. Specifically exempt supply actions performed under a PES scheme from the requirement of business registration or identify tax exemptions or other incentives to encourage PES.
11. Exempt cooperatives which are founded with the specific purpose to perform supply actions under a PES scheme from business registration fees and identify tax exemptions and other incentives.

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# 1. Introduction

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This Research Report analyses the legal foundation of Payments for Environmental Services (PES) schemes in the Lao People's Democratic Republic (Lao PDR). The insights gained through this analysis will be used in preparation for the design and implementation of PES scheme pilots in Lao PDR. This report not only furnishes the legal framework for the PES scheme pilots developed within the project but will inform the legal foundations of other PES schemes that may be developed and implemented in Lao PDR in the future.

This report presents an overview of the current legislation<sup>1</sup> relevant for designing and implementing PES schemes in Lao PDR, analyses potential legal barriers and provides a sequence of recommendations to remove or reduce them. The report does not discuss how the legislation may be interpreted, implemented and enforced at the different levels of the Government of Lao PDR (GoL).

Some of the laws stipulating land and forest management relevant to PES scheme design and implementation were under review while this report was written. Legal barriers identified in this report may be addressed in the revised laws.

This report draws on Research Report 1: Payments for Environmental Services: Concepts and Applications (Scheufele et al. 2013) and Research Report 3: Development of a 'virtual' PES scheme for the Nam Ngum River Basin (Scheufele et al. 2014). Research Report 1 provided the theoretical basis that underpins PES scheme design, while Research Report 3 demonstrated how a PES scheme could be designed and implemented step-by-step in the Lao context.

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<sup>1</sup> The analysis of the legislation is based on both official (if available) and unofficial English translations, which may not always accurately represent the wording or intent of the original Lao text.

## 2. Overview<sup>2</sup>

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The goal of a PES scheme is to provide incentives to sellers and buyers to engage in mutually advantageous trade so that the supply of Environmental Services (ES) can expand to match the growth in ES demand. To this effect, a PES scheme is defined as a mechanism that seeks to establish and sustain a financial<sup>3</sup> link between those with a demand for ES and those who are potential ES sellers<sup>4</sup>. This link is established through one or multiple agents interceding between prospective ES buyers and sellers to facilitate trade. Sellers are those who have legal control over the production of ES, whereas buyers are those who pay for their provision. PES scheme agents act as ‘brokers’ by performing tasks that involve costs of negotiating an exchange (so-called transaction costs). By specializing in these tasks they have the capacity to reduce otherwise prohibitively high transaction costs. As a result, trade in ES that would generally not be exchanged in conventional markets becomes mutually beneficial to buyers and sellers.

Transaction costs tend to be prohibitively high when the property rights to ES are poorly defined and defended. When ownership is poorly defined, uncertainties for both buyers and sellers cause transaction costs to rise. This can occur because the cause-effect relationship between supply actions (e.g. erosion control upstream) and produced ES (e.g. reduced reservoir sedimentation downstream) are difficult to estimate and hence costly to establish. There, buyers bear the risk of paying without getting the ES they wanted and sellers bear the risk of performing supply actions that may not produce the ES purchased by the buyers, and hence may not get paid. Similarly, uncertainties arise when rights to ES are poorly defended. This occurs when ES users who do not pay cannot be excluded. ‘Free-riding’ – benefiting from the ES without paying – then can predominate amongst users. For example, nobody can be precluded from enjoying the knowledge that a threatened species may be protected - even though some did not pay for the required conservation actions. As a consequence, the sellers

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<sup>2</sup> The overview includes material from Research Report 1: Payments for Environmental Services: Concepts and Applications (Scheufele et al. 2013).

<sup>3</sup> Including in-kind payments.

<sup>4</sup> Wunder (2005, p.5) defines a PES scheme as “... a voluntary transaction where a well-defined ES (or a land-use likely to secure that service) is being „bought“ by a (minimum one) ES buyer from a (minimum one) ES provider if and only if the ES provider secures ES provision (conditionality)”. Tacconi (2012, p.35) defines a PES scheme as “... a transparent system of additional provision of environmental services through conditional payments to voluntary suppliers”.

bear all the costs of producing the ES but they do not get any or only small revenue from sales.

A PES scheme aims to reduce transaction costs to make trading with otherwise non-marketed ES mutually beneficial to buyers and sellers – a ‘market’ for ES emerges. To this effect, a PES scheme can assist in adequately defining and defending ownership to ES by estimating the cause-effect relationships between supply actions (e.g. erosion control upstream) and produced ES (e.g. reduced reservoir sedimentation downstream). Such estimation may be conducted by a research organisation acting as a PES agent.

Since the property rights to most ES are only definable through cause-effect relationships between supply actions and produced ES, a seller has to have the property right (or use right) to the land used to perform the supply actions. More specifically, the seller has to have the right to perform the specific supply actions required for ES production. The range of legally approved supply actions may be restricted; some supply actions may require approval and registration.

The definition of property rights to ES can be strengthened by concluding contracts between sellers, buyers and their agents. Obligations and benefits to sellers and buyers (such as performing supply actions and making payments) need to be stipulated in PES contracts. Only enforceable contracts are effective in supporting the defence of property rights to ES. The underpinning legislation needs to enable sellers and buyers (or their agents) to claim restitution in case of contract non-compliance.

The retention period of the property rights (or use rights) to land determines the legal retention period of PES contracts and thus the legal retention period of a PES scheme. Temporary use rights and/or the risk of losing property rights (or use rights) through land requisition by the State for public purposes presents an investment risk to both the sellers and the buyers as well as a liability risk to the agents.

The land tenure also determines the contract type. Individuals or groups who hold property rights (or use rights) to land that is used to perform the supply actions may be directly contracted as sellers. Individuals without such property rights (or use rights) may be able to participate as subcontractors of the entity that holds the rights, notably the State at the national, provincial, district or community level. If the State holds the property rights, the State may be both seller and a buyers’ agent. For example, the State may act as a seller supplying ES within a National Protected Area and, at the same time, act as an agent



representing the general public if the funds required for the payments would be sourced through compulsory taxation.

Yet, contracting sellers and buyers (or their agents) and enforcing compliance is only effective in reducing free-riding if potential ‘free-riders’ become ES buyers. This may be achieved through negotiations (e.g. hydro-dam operators may recognize the benefits they would enjoy through reduced reservoir sedimentation and volunteer to become buyers). Otherwise, beneficiaries have to be ‘forced’ to become buyers and so circumvent the ‘free-riding’ problem. In that case, the State acts as a buyer on behalf of the beneficiaries (e.g. all taxpayers of a country become buyers of increased levels of biodiversity). The latter requires legislation that enables the use of taxes to make the PES payments, i.e. satisfying any regulatory requirements.

For a ‘market’ to emerge (and to enable PES contracting) it is not sufficient that the property rights to ES are defined and defended. They also need to be tradeable. Property rights are tradable if the legislation allows their transferal from a seller to a buyer in a voluntary exchange. Consequently, sellers must have the right to sell the ES produced on the land to which they hold the property rights (or use rights) and may be required to register the ES production as a business for a PES scheme to become operational.

The remainder of this report analyses the laws, regulations and mechanisms relevant to the design and implementation of a PES scheme. Section 3 investigates land tenure, in particular the land allocation process, land categories and land registration. Section 4 is concerned with exploring if ES sellers would be required to register as a business. The potential of associations and cooperatives to act as sellers is assessed in Section 5. Section 6 examines contract types and the enforceability of contracts and Section 7 explores mechanisms for grievance, conflict resolution and redress. Finally, Section 8 provides a conclusion and a summary of recommendations to remove or reduce potential legal barriers to PES design and implementation in the Lao PDR.

### 3. Land Tenure

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Land tenure in Lao PDR is defined through parallel and often overlapping formal legislation and legal mechanisms and informal or customary practices. The existence and the role of customary law have been increasingly recognized by GoL. The Legal Sector Master Plan of the GoL and the Customary Law Project (Ministry of Justice 2011) are examples of initiatives that aim to harmonise customary and formal legal systems and integrate customary legislation and legal practises into an overall legal framework. Consequently, both formal and customary legal systems form the legal foundations of PES schemes in the Lao PDR. PES scheme designs have to account for traditional land tenure systems based on customary laws and inheritance practises<sup>5</sup>, which may overlap with or may exist alongside the formal land tenure system and laws that govern transfer of an individual's assets.

All Lao PDR land is owned and managed by the State on behalf of the Lao people (*Constitution A.17; Land Law No. 04/NA 2003 A.3* (under review); *Property Law No. 04/PO 1990 A.4*). Yet, land use rights can be acquired by an individual or organisation through

- an allocation by the State;
- a transfer;
- an exchange; and
- a sale-purchase inheritance (*Land Law No. A.52; Ministerial Instructions No. 564/NLMA on Adjudications Pertaining to Land Use and Occupation for Land Registration and Titling 2007 1.2.3*).

All unallocated land is State Land managed by the State at the national, provincial or district level (*Decree No. 88/ PM on the Implementation of the Land Law 2008 A.3*). This implies that a PES scheme involving land allocated to individuals and organisations has to be based on land use rights rather than full ownership of land.

#### Land Allocation Process

Land allocation in the Lao PDR is legislated by the Land Law and conducted through the Land and Forest Allocation Policy. All land of the Lao PDR is divided into eight land

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<sup>5</sup> Customary land use rights and inheritance practises vary across ethnic groups.

categories (*Land Law A.11*). The GoL is responsible for category zoning and demarcation of boundaries for each land category (*Land Law A.12*). The categories most relevant to PES schemes involving small-scale land holders as sellers are

- Agricultural Land; and
- Forestland<sup>6</sup>.

The Land Allocation Process (LAP)<sup>7</sup> for the categories Agricultural Land and Forestland is documented in Figure 1. The Ministry of Agriculture and Forestry (MAF) is in charge of conducting the category zoning and demarcation of boundaries of these categories at the national level. Land areas that are larger than 50,000 hectares are managed at the national level, whereas smaller areas are allocated to the Provincial Agriculture and Forestry Offices (PAFO). The PAFO allocate land to the District Agriculture and Forestry Offices (DAFO), which allocate land to the villages (*Forestry Law No. 06/ NA 2007 A.79*, under review).

*The Prime Minister's Instruction No. 09/PB 2004* and the *Instruction No. 13/PM on Building Villages and Village Development Clusters 2007* require that “land use planning and allocation instructions be given to provinces in order to ensure the continuity and sustainability of village and village cluster development based on the Land Law and the Land and Forest Allocation Policy.” As a result there is an increased emphasis on Participatory Land Use Planning (PLUP), with standard procedures proposed<sup>8</sup>. At the local level, PLUP has also attempted to clarify the village boundaries.

At the local level, the allocated land is divided into categories specified within the village boundaries and specified in a Land and Forest Allocation Plan. Based on this plan, Forestland and Agricultural Land is then allocated to individual households and to the village as a whole. Forestland allocated to the village is managed as Collective Land<sup>9</sup> according to a Village Forest Management Agreement (VFMA).

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<sup>6</sup> The *Forestry Law* uses the term ‘Forestland’ and ‘Forestlands’ interchangeably.

<sup>7</sup> The Land allocation process has been under review for some time in response to the transition to market economy and changes in government policy.

<sup>8</sup> A Manual on Participatory Agriculture and Forest Land Use Planning at Village and Village Cluster Level was developed in 2009.

<sup>9</sup> Liu and Sigaty (2009) provide a comprehensive legal analysis of communal land and communal land title in the Lao PDR.

## LAND ALLOCATION AND LAND USE TITLE

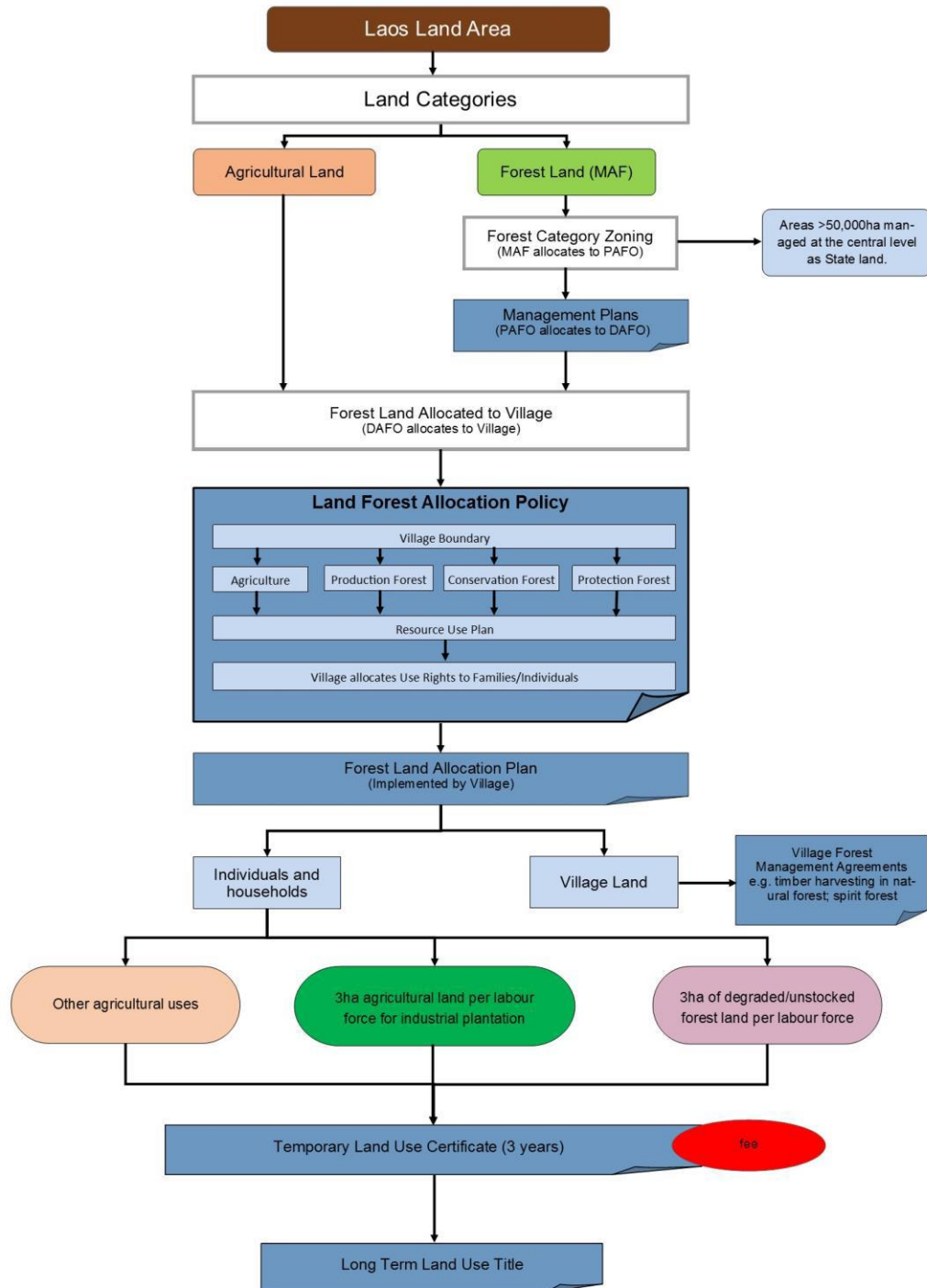


Figure 1: Land Allocation Process (Smith 2014)

\*Forest Land Allocated to Village refers to Forestland and Agricultural Land.

Collective Land is defined as “... all land parcels within the Lao PDR for which the State granted the right to collective use by villages, organisations and state organisations concerned, as specified in Article 59 of the Land Law” (*Decree on the Implementation of the Land Law A.3*).

The villagers’ rights and responsibilities regarding the management of the Collective Land are stipulated in the *Instruction No. 377/MAF on Customary Rights and the Use of Forest Resources (1995)*, *Instruction No. 0429/MAF on Rights and Duties on Forestry Resource Management at the Village Level (1992)*, *Regulation on Management of Village Forests No. 535/MAF (2001)* and *Order No. 54/MAF on Customary User Rights (1996)*. The PLUP manual discusses registration of collective and communal land and the formation of a Village Land and Forest Management Committee.

It may be legally infeasible to contract individual households to perform supply actions on Village Land. Instead, subcontracts between the Village Land and Forest Management Committee acting as the ES seller and the individual households acting as village contractors performing supply actions on Collective Land may be required.

The land categories determine the permitted land use types. Some land use types need to be formally registered even though these land use types are allowed within the respective land category. While most supply actions performed under a PES scheme are not expected to be affected by this regulation, some may if land holders receive a payment for their effort. For example, according to the *Regulation No. 196/ MAF on the Development and Promotion of Tree Planting (2000)*, supplementary reforestation, agroforestry or the planting of crop trees may require formal land use (plantation) registration if the landholders are paid to plant trees on more than 3 hectares and/or intend to harvest the trees for timber. Article 4 and 5 state that “... individuals and villages who plant trees with their own funds and labour on land for which they hold land use rights may not require approval.” If land use registration is required, transaction costs are expected to rise as in the case of Teak plantations; the transaction costs associated with the registration process of smallholder Teak plantations have been shown to be substantial and may act as a disincentive to registration and compliance with other regulations (Said forthcoming).

#### Recommendation 1:

Explicitly exempt supply actions that produce ES performed under a PES scheme from land use registration.

Land use changes across land categories are restricted and require prior approval (*Land Law A.14*). Whether the administrative authority of the district, province or the national level has the right to decide about a land category change depends on the size of the area of land involved (*Decree on the Implementation of the Land Law A.19*). It could have implications if, for example, a PES scheme took land out of agricultural production and converted it into Forestland. Land use restrictions and approval processes may limit the range of possible supply actions and thereby the supply effectiveness and efficiency of the PES scheme.

#### Recommendation 2:

Exempt supply actions performed under a PES scheme from the approval process regarding land use changes across land categories.

PES schemes may also involve land areas for which the Land and Forest Allocation Process has not yet been completed. Consequently, the land is State Land. In this case, households who may have the potential to perform supply actions do not hold formal land use rights despite being long term land users, possibly under customary law. The PLUP process is designed to recognise a variety of forms of evidence of long term land use and development for claims to formal land use rights. It would have to be assessed whether customary rules may be used as a foundation for a PES scheme. Alternatively, households may have to be subcontracted by the State, which would act as the ES seller.

## Agricultural Land

Agricultural Land is defined as land that is determined to be used for agriculture (*Land Law A.15*). Article 2 of the *Law 105/PO on Agriculture (1998)* defines Agriculture as follows: “Agriculture [refers to] cultivation, animal husbandry and fishery for consumption and [for producing] food for the public, raw materials to supply industrial processing factories, and commodities for domestic consumption and export”.

The State may allocate Agricultural Land as follows (*Land Law A.17*):

- up to 1 ha/ household labour force<sup>10</sup> for rice cultivation and farming;
- up to 3 ha/household labour force for industrial plantations, annual crops;

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<sup>10</sup> Interpreted as ‘per full-time family labour unit’ (e.g. when there are 5 full-time workers in the family the number of family labour units is 5).

- up to 3 ha/household labour force for fruit tree plantations; and,
- up to 15 ha/household labour force for using deforested land for growing grass and for grazing.

This implies that the quantity and range of possible supply actions that are legally permitted to be performed on Agricultural Land allocated to households may be restricted. Such restrictions may limit the supply effectiveness and efficiency of a PES scheme. Additionally, PES schemes will need to be carefully designed to take into account policies for poverty reduction and environmental protection to ensure that there are no unintended adverse consequences that result in the loss of productive agricultural land or an increase in the conversion of natural forest.

### Recommendation 3:

Explicitly remove land use restrictions for supply actions performed under a PES scheme on Agricultural Land that is allocated to individuals and villages or expand the range of land use options available on Agricultural Land, and ensure that the options are in accordance with current policies for poverty reduction and environmental protection.

## Forestland

The management of Forestland falls under the *Forestry Law*. Forestland is defined as all land that the State has determined to be Forestland (as defined by the *Forestry Law*) irrespective of whether or not it has forest cover (*Land Law A.19*).

The *Land Law A.23* and the *Forestry Law A.9* divide Forestland into

- Protection Forests;  
“Protection Forests are forests classified for the function of protecting water resources, river banks, road sides, preventing soil erosion, protecting soil quality, strategic areas for national defence, protection from natural disasters, environmental protection and so on.” (*Forestry Law A.10*)

Protection Forests are further divided into two subcategories:

- Total Protection Zones; and
- Controlled Use Zones (*Forestry Law A.23*).

- Conservation Forests<sup>11</sup>;

“Conservation Forests are forests classified for the purposes of conserving nature, preserving plant and animal species, forest ecosystems and other valuable sites of natural, historical, cultural, tourism, environmental, educational and scientific research experiments. Conservation Forest consists of National Conservation Forest areas and Conservation Forest areas at the Provincial, District and Village levels, which is described in the specific regulation”. (*Forestry Law A.11*)

Conservation Forests are divided into four subcategories:

- Total Protection Zones;
- Corridor Zones;
- Buffer Zones; and
- Controlled Use Zones (*Forestry Law A.24*).

- Production Forests

“Production Forests are natural forests and planted forests classified for the utilization purposes of areas for production, and wood and forest product businesses to satisfy the requirements of national socio-economic development and people’s living.” (*Forestry Law A.12*)

Village Use Forests as defined in Article 3 of the *Forestry Law* may be interpreted as ‘Production Forests’ at the village level: “Village use forests are the forest areas located within village areas and allocated to be under the village management, preservation and utilization according to the land and forest allocation plan.”

The forest categories and subcategories define their designated purposes and associated use restrictions as well as the area accessible to households and villages. The designated purposes and associated use restrictions for each category are listed in the *Forestry Law A.23-25*.

#### Recommendation 4:

Explicitly remove land use restrictions for supply actions performed under a PES scheme on Forestland that is allocated to individuals and villages or expand the range of land use options

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<sup>11</sup> In English translations of Lao legislation, a specific area of Conservation Forest (with a given name) is called a Protected Area. Yet, the Lao language does not differentiate between ‘Conservation Forest’ and ‘Protected Area’.



available on Forestland, and ensure that the options available are in accordance with current policies for poverty reduction and environmental protection.

Forestland is categorised at the macro level (national, provincial, and district level) and the village level. This two-tiered classification system has led to overlaps between forest categories at the macro level and the village level. Forestland within Provincial Conservation Forests or National Protection Forests may be classified as Village Use Forests<sup>12</sup>. Such overlaps may increase uncertainties about land use rights and the associated forest use restrictions.

#### Recommendation 5:

Clarify which forest category at which level takes precedence in case of overlaps between forest categories at the macro level and the village level.

Article 7 of the *Decree on the Implementation of the Land Law*, prohibits the granting of Land Use Rights (Land Title) or Land Utilisation Rights (Land Survey Certificate) for Protection Forests, Conservation Forests and Unexploited Forest Land. This implies that Land Titles cannot be issued for Village Protection Forests and Village Conservation Forests, which will remain the property of the State (Ministry of Agriculture and Forestry/National Land Management Authority 2010).

According to the *Land Law A.21*, the State may allocate three hectares per labour force of “unstocked land” and “degraded land” to individuals. These land types are not further defined in the *Land Law*. However, they are defined under the *Forestry Law A.3* as “degraded forests” and “degraded forestland”.

“Degraded forests are the forest areas that have been heavily damaged such as land without forest or barren forestland, which are allocated for tree replanting, agriculture- tree products, permanent animal husbandry areas or using land for other purposes in accordance with the socio-economic development plan” (*Forestry Law A.3*).

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<sup>12</sup> The Lao PDR recognizes the existence of four types of villages in relation to National Protected Areas (Sawathvong et al. 2000):

Type 1: Enclave villages (village areas located entirely inside NPAs).

Type 2: Straddle villages (village areas overlapping with NPAs).

Type 3: Adjacent villages (village areas distant from NPAs).

Type 4: External villages -villages distant away from NPAs, but their activities still impact on NPAs.

Classification of National and Provincial Conservation Forests or Protection Forests at village level can occur in line with the management planning of these forest areas on the ground. Village Use Forest may be allocated in the Controlled Use Zones of these two types of forests.

“Degraded Forestlands are the Forestland areas where forests have been heavily and continually damaged and degraded causing the loss of balance in organic matter, which may not be able to regenerate naturally or become a rich forest again. Typical species of plants and trees growing in this area are: Alang alang (*Imperata cylindrica*), May Tiou (*Cratoxylon* sp.), small bamboo, broom grass (*Thysanolaena maxima*) or other various species” *Forestry Law* A.3).

“Barren Forestlands are the forestland areas without trees caused by natural or human destruction” (*Forestry Law* A.3).

Article 5 of the *Forestry Law* encourages forest protection, forest regeneration and tree planting in Degraded Forestland and Barren Forestland through incentives including exemptions or reductions of taxes and duties according to the regulations.

#### Recommendation 6:

Extend the incentives provided for forest protection, forest regeneration and tree planting in Degraded Forestland and Barren Forestland to any supply actions performed on any land category under a PES scheme.

## Land Registration

The allocation of land is formalised through land registration (*Land Law*). Article 44 stipulates two ways to gain a land title through land registration: (1) systematic land registration (under the Land Allocation Process); and (2) land registration based on request (outside the Land Allocation Process).

A Land Use Title assigns the following rights:

- 1 right to protect the land<sup>13</sup>;
- 2 right to use the land<sup>14</sup>;
- 3 right to usufruct<sup>15</sup>;

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<sup>13</sup> “The right to protect land is the right assigned by the State to an individual or organisation to protect the land with a view to using it for a specific purpose” (*Land Law* A.54).

<sup>14</sup> “The right to use land is the right to use land for certain purposes in order to provide for the needs of the holder of land use rights, in accordance with the land allocation plan of the State” (*Land Law* A.55).

<sup>15</sup> “The right of usufruct from developed land is the right of the holder of land use rights to collect the usufruct or income from such land, such as from the lease [of land], or from the use [of land] as a share contribution or guarantee” (*Land Law* A.56). It appears that under Lao Law the right to usufruct does not include the right to use the land, which is treated as a separate right.

- 4 right to transfer the land use right<sup>16</sup>;
- 5 right relating to inheritance of the land use right<sup>17</sup>; and,
- 6 right to lease land (*Land Law A.53; A.54-56; Decree on the Implementation of the Land Law A.3; Ministerial Instructions No. 564/ NLMA on Adjudications Pertaining to Land Use and Occupation for Land Registration and Titling 1.2.4, 2007*).

A Land Use Title is the document considered to be the main evidence for claims to permanent land use rights (*Land Law A.49*), although other forms of evidence are also considered. Hence, a Land Title, in conjunction with a land contract, assigns the right to perform supply actions that are permitted within the respective land category. Whether the right to usufruct includes ES remains unclear<sup>18</sup> and hence, it is unclear if the right to ES can be sold independently of the use rights to land on which the supply actions are performed.

#### Recommendation 7:

Explicitly include the ES produced under a PES scheme into the right to usufruct and allow for rights to ES to be sold independently of the use rights to land on which the supply actions were performed.

In the past, a Land Use Title allocated to an individual or household under the Land Allocation Process was initially registered through a Temporary Land Use Certificate (TLUC) valid for three years. After three years, holders of a Temporary Land Use Certificate had the right to apply for a Land Use Title that assigns permanent land use rights (*Land Law A.3, A.18, A.22, A.48; Ministerial Instructions on Adjudications Pertaining to Land Use and Occupation for Land Registration and Titling 1.2.7*). Yet, landholders may not have applied for permanent land use rights after 3 years because it is (1) costly; (2) people may have assumed they have permanent rights; (3) they may have been unaware of the process; or, (4) they may not have had access to the process if systematic land allocation and land titling has not occurred in their area or if they were not able to access the government departments responsible for issuing permanent land use rights due to their geographical remoteness.

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<sup>16</sup> “The right to transfer land use rights is the right to give land use rights to other persons by sale, transfer or exchange” (*Land Law A.57*).

<sup>17</sup> “The right relating to inheritance of land use rights is the right to pass land use rights over developed land, in accordance with the laws, to one’s husband or wife, children, grandchildren, parents or close relatives upon the death of the holder of land use rights” (*Land Law A.58*).

<sup>18</sup> Article 10 of the *Law on Agriculture* stipulates that those who undertake agricultural activities have the right to own the products of their agricultural activities. If the definition of ‘products of agricultural activities’ includes ES remains unclear.

TLUCs are (theoretically) no longer issued. There are new processes in place, including the use of Land Development Certificates which are issued to demonstrate land development for permanent use has occurred and which support applications for more permanent land use rights.

#### Recommendation 8:

Support potential PES suppliers who are holders of Temporary Land Use Certificates to apply for Land Use Titles through awareness rising initiatives, a reduction of associated costs, and the removal of access barriers.

Communal Land Titles can be issued for parcels of Forestland designated by the LAP. These may include areas zoned as Village Sacred Land, Village Use Forests and Communal Grazing Lands, Communal Agricultural Land but not Village Protection Forests, Village Conservation Forests and Unexploited Forestland (*Decree on the Implementation of the Land Law A.7*). There are examples of the issuing of temporary communal land titles for growing bamboo which, if there are no disputes over the land use rights, can be converted to permanent land use rights under Article 22 of the *Land Law* and under the *Ministerial Instructions on Adjudications Pertaining to Land Use and Occupation for Land Registration and Titling*.

Other legal documents that may attest land use rights include land survey certificates (land certification outside the Land Allocation Process); Certifications of Land Ownership History; and Land Development Certificates (*Decree on the Implementation of the Land Law A.16*). The number of rural households holding land use rights attested by legally recognized documents varies greatly across the country. Other documents that are used to claim land use rights include a Declaration of Land Tax Payment and a Receipt of Land Tax Payment. These documents are, however, not legally considered evidence of registered land use rights. Some villages have records of ‘titles’ that pre-date the French occupation such as a Land Book established under the Royal Order (*Law No. 135 of 1958*). It is unclear if these titles are legally recognised and how widespread they are.

Land use rights can be revoked if the land use has not been exercised in accordance with the objectives of the land contract as allocated by the State (*Land Law A.62*) and can be terminated through land requisition by the State for public purposes (*Land Law A.63*). Laws for compensation exist but do not specifically include ES. They are also often not applied.

Recommendation 9:

Specifically include ES in the laws that stipulate compensation for land requisition by the State for public purposes.

In summary, land use rights may not be legally recognized, may be terminated through land requisition or may be revoked if supply actions are not in accordance with the land uses specified for the allocated land categories. This may present an investment risk to the sellers and the buyers of ES and consequently a liability risk to the PES agents. Yet, potential sellers may perceive PES participation as an additional element in proof of “ownership” of use rights such that a PES contract presents added security of a land title (Wang et al. 2012).

## 4. Business Registration

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Performing supply actions in exchange for a PES payment or selling produced ES under a PES scheme may require business registration.

The *Law No. 11/ NA on Enterprise (2005)* stipulates principles, rules and measures for establishing, operating and managing an enterprise in the Lao PDR, however it is not specific on which activities require business/enterprise registration. Article 2 defines an Enterprise as a “business organization of a person or juristic person that has its own name, assets, management system and office, and that is registered in compliance with this Law. An enterprise is also called a “Business unit”; business means an activity operating in one or all stages of an investment process starting from the stage of production to the provision of services, aiming to gain profits and utilize the benefits for the public interest”. Article 12 of the *Law on Enterprise* defines Enterprise Registration as “the State’s approval that a person or juristic person, whether foreign or domestic, has properly given notice of registration of the establishment of his/her enterprise in the Lao PDR”.

The *Forestry Law* provides some specifications under which circumstances business registration is required when utilising Forests, Forest Products and Forestland.

“A Forest is a precious natural resource of the nation and its specific ecology consists of biodiversity, water resources and forestland with various tree species growing naturally or planted in the protection forest zone, conservation forest areas and production forest areas.” (*Forestry Law A.2*)

“Forest products are all kinds of Non-Timber Forest Products (NTFP) growing naturally and they can include trunks, stems, vines, tubers, roots, buds, shoots, leaves, flowers, fruits, grains or seeds, bark, oil, resin, mushrooms, honey and so on. (*Forestry Law A.3*)

“Forestlands are all land plots with or without forest cover, which are determined by the state as forestlands.” (*Forestry Law A.3*)

Accordingly, the *Forestry Law* also differentiates between the utilization of Forests and Forest Products and the utilization of Forestland.

The *Forestry Law A.39* classifies the utilization of forests and forest products into four categories:

- utilization for village public benefits;

- utilization for households;
- customary utilization; and,
- utilization for business operations.

Utilisation for business operations is defined in Article 43 of the *Forestry Law* “... to use the forest for tourism, recreation sites, and logging and harvesting forest products for commercial purposes.”

The *Forestry Law A.45* specifies business operations in Forests to include:

- 1 production of tree and NTFP seedlings;
- 2 planting trees and NTFPs;
- 3 felling planted trees;
- 4 logging and harvesting of forest products;
- 5 processing of timber and forest products;
- 6 distribution of NTFP and forest products;
- 7 import and export of timber and forest products;
- 8 transportation of timber and forest products; and,
- 9 ecotourism.

The *Forestry Law A.45* further stipulates that individuals, households and organizations with the desire to operate businesses using forest and forest products must have approval from MAF and register the enterprise according to the *Law on Enterprise*.

The *Forestry Law A. 66* classifies the utilization of forestlands into three categories:

- utilization for public benefits;
- utilization for households; and,
- utilization for business operations.

“Utilization of forestland for public benefits is to use forestlands for tree planting to preserve the environment and landscape values, to create tourism sites and recreation sites with the permission from relevant authorized organizations.” (*Forestry Law A.67*)

“Utilization of Forestland for household is to use Degraded Forestland or Barren Forestland according to the households’ availability of labour and funds for forest regeneration, planting trees or NTFPs in the land area of not more than three hectares per labourer in the household.” (*Forestry Law A.68*)

“Utilization of Forestland for business operations in the Degraded Forestland where Forests cannot be naturally regenerated and Barren Forestland areas, which are so designated, and shall be operating in accordance with the Law on Enterprise and other related laws.” (*Forestry Law A.69*)

If the produced ES qualify as ‘harvested forest products’ and are sold under a PES scheme (commercial purpose), forest utilization may be classified as Utilization of Forests for Business Operations. In that case, ES sellers have to apply for approval from the Department of Forestry and require registration as a business with Ministry of Industry and Commerce according to the *Law on Enterprise (Forestry Law A.45)*.

If the supply actions rather than the produced ES are categorised, forest utilization may be classified as any of three categories. (1) Utilization for Public Benefits if the PES scheme produces public goods; (2) Utilization for Business Operations since the producers (the ES sellers) receive a payment; or, (3) Utilization for Households if households are contracted as ES sellers.

If the supply actions performed under a PES scheme fall under business utilization, for example, the planting of trees, ES sellers may have to apply for approval from the Department of Forestry and may require registration as a business with the Ministry of Industry and Commerce according to the *Law on Enterprise*.

If ES sellers have to register a business they will have to pay taxes. Operating as a business may result in Value Added Tax and Profit tax. Even if business registration is not required ES sellers are likely to have to pay income tax on any financial benefit they receive from the sale of ES. The sale of wood from forests is subject to a number of taxes, fees, royalties and duties which are an important source of government revenue.

Approval processes, business registration requirements and associated taxes and duties increase the transaction costs to potential sellers of ES.

Tax incentives and exemptions apply to some business sectors including activities relating to forestry, handicraft, agriculture and service sector (*Law No. 02/NA on Investment Promotion A.49, 2009*). A decree<sup>19</sup> on the sharing of benefits from the sale of forest products in production forest areas distributes revenue between the state and other entities and activities

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<sup>19</sup> Decree No. 001/PR (2012) pertaining to the Sharing of Revenue from Timber Harvested in the Production Forest Areas



such as forestry management, protection-conservation, and development activities, primarily the production forests, and the funds for the development of villages or the village groups bordered with the production forests. The benefit sharing decree could be extended to PES.

Article 49 of the *Law on Investment Promotion* further stipulates that the specific activities that fall under these sectors are determined based on, among other things, activities related to the eradication of poverty, improvement of living standard of the peoples, and the creation of job opportunities, all of which may be supported by PES schemes. Consequently, tax incentives and exemptions stipulated in the Law on Investment Promotion or other relevant legislation<sup>20</sup> may be applicable to performing supply actions in exchange for a PES payment or selling produced ES under a PES scheme.

#### Recommendation 10:

Specifically exempt supply actions performed under a PES scheme from the requirement of business registration or identify tax exemptions or other incentives to encourage PES.

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<sup>20</sup> For example Decree No. 01/PO on Land Tax (2007) which provides exemptions from the paying of land tax for registered plantations; Directive No. 0509/MF (2009) for the Calculation and Collection of Taxes on Timber and Non-timber Forest Products.

## 5. Associations and Cooperatives

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The GoL and specifically the Ministry of Agriculture and Forestry (MAF), have a strong focus on the development of farmer organizations, which are seen as important agents in MAF's medium to long term vision for the Agriculture and Forestry Sector Development. In 2008, a MAF Farmer Organization Working Group was established and subsequently the Agriculture Development Strategy 2011-2020 included a strong emphasis on the development of farmer organisations.

Through the formalisation of farmer organisations, such as cooperatives, it is anticipated that farmers will be able to:

- Increase their incomes;
- Connect more effectively to markets and increase their bargaining power;
- Maximise the benefits from commercial agriculture development and minimise risks;
- Produce and provide agriculture services to their members; and,
- Invest in collective processing tools.

Grower groups and cooperatives may act in various roles in the value chain for supplying goods and services, including ES. The most significant legislative reforms to enable these strategies are two new decrees which encourage farmers to organise themselves relatively independently of government: the *Decree No. 115/PM on Associations (2009)* and the *Decree No. 136/PM on Cooperatives (2010)*.

### Associations

*Under the Decree on Associations*, 'Association' refers to a non-profit civil organization set up on a voluntary basis and operating on a permanent basis to protect the rights and legitimate interest of the association, its members or communities.

Types of Associations (Art. 7) include:

- 1 Economic associations;
- 2 Professional, technical and creative associations;
- 3 Social welfare associations; and,

4 others.

These can be classified into different levels depending on their geographic scope (National, Provincial, District, Municipality, Village).

It might be possible to conclude PES contracts with associations representing seller groups if PES payments can be interpreted as wages paid to ES sellers performing supply actions.

## Cooperatives

The *Decree on Cooperatives* defines a ‘cooperative’ as a collective economic organization established by a group of small entrepreneurs such as farmers, manufacturers, traders, and others which voluntarily intend to form a cooperative aimed at cooperation on capital, experiences, technology in production, trade and service to succeed their own business as well as to ensure social welfare among the members and their families.

Article 3 identifies two types of cooperatives, being:

- 1 A cooperative of agricultural and forestry production, industrial processing and handicraft; and,
- 2 A cooperative of Services namely: trade, finance, transportation, tourism, construction, medical services and other services.

Other relevant laws and regulations include the *Law on Enterprise* through which cooperatives must be registered, thus creating a legal entity and the *Decree on Cooperatives* which makes general provisions with respect to membership, functions, duties, fees and dispersal of profits to members.

PES contracts could be concluded with cooperatives representing seller groups. Since cooperatives must be registered under the *Law on Enterprise* they are, however, likely to be subject to business registration fees. Yet, tax incentives/exemptions associated with group enterprises may exclude cooperatives from paying value added tax and profit tax.

### Recommendation 11:

Exempt cooperatives which are founded with the specific purpose to perform supply actions under a PES scheme from business registration fees and identify tax exemptions and other incentives.

## 6. Contracting

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### Contract Type

Prohibitively high transaction costs to engage in ES trade can be reduced through the use of contracts and agreements between sellers, buyers and/or their agents. An enforceable contract may reduce uncertainties associated with poorly defined and defended property rights to ES for the sellers and the buyers (and/or their agents). Article 1 of the *Contract Law 02/ NA (1990)* defines a contract as “... an agreement between organisations, between organisations and individuals, or between individuals, which [agreement] causes civil rights and obligations to arise, to be modified, or to be terminated.” Article 2 of the *Contract Law* stipulates that a contract can be established “... between the State or collective organisations; the State or collective organisations with other legal entities or individuals; and legal entities or individuals”.

This definition enables PES contracting between buyers and sellers (and/or their agents), where sellers are defined as those who have legal control over the production of ES, buyers as those who pay for their provision, and agents as those who establish and sustain a link between the buyers and the sellers. Individuals or groups who hold use rights to land on which the supply actions that produce the ES may be directly contracted as sellers. In cases where these use rights are held by the State individuals or groups may be able to participate as subcontractors of the State at the national, provincial, district or community level. To this effect, the *Contract Law* (Article 2) allows closing a contract between

- 1 sellers and buyers  
(perhaps between villagers reducing soil erosion on land for which they hold the land use rights and hydro-electricity power companies benefiting from reduced reservoir sedimentation),
- 2 sellers and an agent representing one or more buyers  
(perhaps between villagers patrolling on land for which they have the land use rights and a government department buying biodiversity conservation for the general public using taxes), and,
- 3 subcontractors and an agent acting as a seller  
(perhaps between villagers patrolling in a NPA for which the State holds the land title and a government department acting as a seller of biodiversity conservation).

The *Contract Law* differentiates between alternative contract types. A PES contract has to be suitable to either contract supply actions or ES delivery. The latter may be challenging since the supply actions may produce intangible ES that cannot be ‘handed over’ from the seller to the buyer. A suitable option may be a Service Contract. A Service Contract is defined as “an agreement between contracting parties whereby the service provider must serve, do, or create something according to the requirements of the service user who must pay for the services at the agreed upon price” (*Contract Law A.59*). The PES contracts have to be signed by each seller and buyer (and/ or their agent). Sellers may be organized in the form of a cooperative, in which case the legal representative of the cooperative has to sign the contract. Subcontracts might be required if the sellers are groups (e.g. an anti-poaching patrol team; village units). These subcontracts would have to be signed by all members of the group and may additionally have to be signed by the legal representative of the groups (e.g. village unit heads).

## Contract Performance

To ensure contract performance, satisfactory performance has to be rewarded but any breach of contract has to be penalised and the contracted parties have to be liable. Article 36 of the *Contract Law* defines a breach of contract as “... non-performance of contractual obligations, in whole or in part, or unreasonable performance of obligations by either contracting party, such as low quality performance of obligations, untimely performance, [or] performance not according to locations as specified by the contract. If either contracting party breaches a contract, that party must be liable to compensate [the other party] for damages which arise, except if the contract breach occurred as a result of an accident or force majeure such as lightning strikes, floods, earthquakes, etc.”. Article 31 stipulates penalties for breach of contract: “A penalty is a measure applied against those who do not perform their contracts or who have rendered incomplete performance or untimely performance. Penalties are to be applied according to specific regulations of relevant sectors or as agreed between the contracting parties agree in the case where that there are no specific regulations”.

Therefore, PES contracts have the potential to ensure that the payments made to the sellers are conditional on the performance of supply actions that are expected to yield ES or, if measurable, on ES production directly. Methods of dispute settlement related to non-performance of contractual obligations are specified in Article 34 of the *Contract Law*. A contract party has the right to lodge a claim with the courts for settlement of the dispute.

## 7. Conflict Resolution

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An impartial, accessible and fair mechanism for grievance, conflict resolution and redress (UN-REDD Programme 2013) is an integral part of a PES scheme and has to be accessible to all participants. Existing semi-formal and informal or customary mechanisms (Smith 2014) could be used for a PES scheme in the Lao context. Village mediation units (VMUs) are semi-formal mechanisms at the village level. The District Justice Offices (Department of Judicial Administration of the Ministry of Justice) supervise the VMUs and provide technical assistance, whereas the villages' Party Committees and village administrations oversee the establishment of VMUs (UNDP 2011). The VMUs usually include members of the Lao Front for National Construction, the Union of Army Veterans, the Lao Women Union, the Lao Revolutionary Youth Union, village elders or representatives of ethnic groups, and village security (UNDP 2011). The role of VMUs is to assist the village administration to improve justice, e.g. by settling disputes or conflicts on the basis of formal and informal or customary legislation and negotiation between the disputing parties (UNDP 2011). Informal mechanisms vary within and between ethnic groups and may include mediation by village heads or the village mediation committee. An overview of these mechanisms is provided by the publication 'Customary law and practice in Lao PDR' (Ministry of Justice 2011).

## 8. Conclusion

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This analysis has shown that the legal system in the Lao PDR challenges the design and implementation of PES schemes. The legal system is characterised by parallel and often overlapping formal legislation and informal or customary practises. Hence, both formal and customary legal systems form the legal foundation for PES schemes in the Lao PDR.

All land of the Lao PDR is owned and managed by the State on behalf of the Lao people. Yet, individuals or households and organisations can acquire land use rights. Land use rights include the right to use land and to usufruct. This indicates that holders of land use rights have the right to perform supply actions that produce ES. Whether the right to usufruct includes the right to sell the produced ES remains unclear. This represents an investment risk to the sellers and the buyers of ES and a liability risk to the PES agents. Clarifying this situation is a priority in the formation of the foundations of Lao PES schemes.

The range of legally approved ES supply actions may be restricted. This may limit the supply effectiveness and efficiency of PES schemes. Furthermore, performing some supply actions may require formal approval and registration. This increases the transaction costs borne by potential ES sellers and PES agents. Policy changes to ensure that transaction costs facing PES participants are low are recommended.

Additionally, land use rights may be terminated through land requisition, may be revoked if supply actions are not in accordance with the land uses specified for the allocated land categories or may not be legally recognized in the first place. The participants of the PES scheme - the sellers and the buyers of ES and the PES agents – bear the risk of being outcompeted by ‘boom crops’: The immediacy of short-term returns may trump the long-term values of ES so that land use changes associated with PES are reversed.

Furthermore, ES supply actions performed by households or legal entities representing seller groups may be classified as business operations and thus may require formal approval and business registration. Associated fees and taxes may be disincentives to PES participation. Policy changes that remove these disincentives are recommended.

Contracting ES services directly may be difficult since the ‘products’ are not tangible and cannot be ‘handed over’ to the buyer. Contracting supply actions, however, seem to be feasible by means of a Service Contract. A Service Contract may also allow contracting

households to perform supply actions (such as patrolling) on State Land such as National or Provincial Protected Areas. The *Contract Law* indicates that payment conditionality can be built into a PES contract; non-performance of contractual obligations can be punished; and contracting parties who breach the contract are liable for damages.

Supply actions performed on Village Land may require contracting villages as the sellers, rather than the individual households who perform them. This may present the risk of elite capture and inequities. Subcontracts between the village authority (such as a village head) and individual households to define the distribution of costs (tasks) and benefits of PES scheme participation across individual households may reduce this risk but increases the transaction costs of the scheme. Additionally, village heads are not elected by all village members - the process of village head appointments may be tied in with incentive structures. Consequently, households may not trust the reliability of such sub-contracts. Alternatively, sellers may be organised in the form of cooperatives. Their legal representatives may act as sellers on behalf of their members.

Finally, a mechanism for grievance, conflict resolution and redress accessible to and accepted by all participants is an integral part of a PES scheme. Existing semi-formal such as VMUs or customary mechanisms could be used in the Lao context. Which mechanism is best suited is expected to be context specific.



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