

EXECUTIVE SUMMARY

This report by the Operations Evaluation Department (OED) evaluates 20 years (1986–2005) of Asian Development Bank (ADB) support to agriculture and natural resources (ANR) development in the Lao People's Democratic Republic (Lao PDR). During this period, ADB financed the following ANR projects: 2 programs (totaling \$50 million), 7 investment projects (\$84 million), 32 technical assistance (TA) grants of \$12.4 million, 11 project preparatory TAs (\$6.7 million), and 14 regional TAs (\$10.5 million) with coverage that included the Lao PDR. During 1986–2004, ANR accounted for 13% of ADB lending to the Lao PDR, 22% of total TA, and 27% of total project preparatory TA provided by ADB to the country.

Following the Lao PDR's pronouncement of its New Economic Mechanism (NEM) in 1986 for the transition of the country to a market-based economy, ADB responded to the NEM's unprecedented reform initiatives with policy-based lending. This lending modality followed a broad-based approach aimed at reducing market distortions with measures to liberalize trade, rationalize pricing practices, restructure taxation systems, and separate commercial and central banking functions, among others. After the NEM, ADB support for investment projects began in 1993. These investments and associated TAs comprised several subsectors covering development efforts targeted at agribusiness, commercialization of smallholder agriculture, irrigation, livestock, river basins, watersheds, upland agriculture, and tree plantations.

Individual projects have been relevant to the country's development challenges and ANR issues. However, the composition of ADB sector assistance in ANR (in terms of objective, scope, type, and location) has been diffused. For ANR, the ADB country strategies have been less effective. The country strategies for ANR sector assistance are rated as **partly satisfactory**. They are broad, and have not provided guidance for focused sector assistance. The current pipeline of ADB sector assistance in ANR includes investments in river basin and watershed management, livestock development, tree plantations, and initiatives to stabilize shifting cultivation. This represents a project-driven approach of providing assistance. The current Country Strategy and Program (CSP) does not have a framework for prioritizing ANR sector assistance. Clear links have not been established to optimize development synergies among projects and TAs. Investment projects in ANR have been localized interventions, without significant coordination to address common constraints facing subsistence agriculture, and to overcome the impediments confronting commercialization of agriculture. Over the last two decades, the ADB country strategies have emphasized the importance of the transition of the ANR sector to a market-based economy, crop diversification, commercialization, and increased role of the private sector. However, ADB-financed investment projects have generally emphasized improvements of rural infrastructure, facilities, and capacity development related to factors of production without adequate attention to finding solutions to binding constraints facing crop diversification, market orientation, and value addition. Agriculture has remained largely rice based and subsistence in nature, but there is an increasing trend towards commercialization and diversified cropping.

The CSP emphasizes the role of the private sector for ANR development, recognizing that improved performance and marketing are critical to improving rural livelihoods. Nonetheless, there has not been a clear distinction between (i) addressing the needs of subsistence farmers and their immediate concerns for household food security; and (ii) options for commercialization of agriculture, and the extent to which such options were also meant for the predominantly subsistence farmers who have encountered genuine obstacles to becoming commercial farmers. Although ADB has paid attention to the poor mountainous Northern Region through the Northern Regional Development Strategy (2004), and emphasized economic

integration of the region with neighboring economies, the dichotomy between subsistence farmers and those who can produce for the market has not been clearly dealt with.

The Operations Evaluation Mission (OEM) rates the overall performance of the ANR sector assistance as **partly successful** using OED guidelines (and based on a four-category scale of highly successful, successful, partly successful, or unsuccessful). ADB's policy-based lending was partly successful. TA operations (16 TAs) supporting policy-based lending and reform generated mixed results: unsuccessful (2), partly successful (6), successful (6), and highly successful (2). The performance of investment projects has been equally mixed. Among six projects assessed by the OEM, one was unsuccessful, three were found doubtful to succeed, and two were likely to succeed. There is room for improvement if midcourse actions are taken to improve development results and make ongoing projects successful. Among six other TAs sampled by the OEM, two were rated successful, and the rest were not rated because they had just commenced. Among a sample of seven regional TAs, the OEM rated one as partly successful, three as successful, two as likely to succeed, and one was unrated (it had just commenced).

Policy-based operations have been relevant to the country's policy and priorities for the transition to a market-based economy. Individual projects and TAs were relevant to the Government's development priorities and ANR issues. However, clear links were not established to address overriding constraints facing ANR sector development, and to overcome impediments confronting the commercialization of agriculture. Individual operations had their own merits and relevance to specific ANR development issues, but their combined objectives and scope lacked focus, and their targets were dispersed over many aspects. Sequencing of separate operations was not fully consistent, and several projects and TAs were not coordinated. Overall, ADB sector assistance in ANR has been **partly relevant** (based on a four-category scale of highly relevant, relevant, partly relevant, or irrelevant) to the ANR strategies and the ANR sector performance of the Lao PDR.

Policy-based lending has been less effective. Many of the individual policy measures represented a case of outputs being delivered rather than outcomes achieved. Major impediments to doing business in ANR persisted. Investment projects have been less effective to effective. ADB, through TA operations, helped the Government develop its Strategic Vision for the Agriculture Sector (1999). The development of this strategy had a high level of government ownership. Various elements of this policy direction were subsequently taken up further by the Government, and incorporated into the current National Growth and Poverty Eradication Strategy. Some undesirable effects also occurred: Loan 1295-LAO jeopardized the financial health of the Agricultural Promotion Bank and undermined the development of rural finance. TA operations yielded mixed results. The contribution of ADB-financed projects to ANR sector performance has been limited. On balance, the OEM rates the performance of the ANR sector assistance as **less effective** (based on a four-category scale of highly effective, effective, less effective, and ineffective).

Policy-based lending has been less efficient. It underestimated the efforts required to effect policy changes. Requirements for institutional preparedness for change, management of change, and the time needed to generate outcomes in the context of the Lao political economy were underestimated. Achievements of outcomes were moderate. Investments in irrigation were less efficient with heavy costs, low returns, negligible crop diversification, and continuing market constraints. ADB-financed investments in tree plantations generated economic losses. The efficiency of TA operations was generally affected by inadequate counterpart arrangements, poor absorptive capacity, and lack of institutional analysis. TAs intended for capacity development often resulted in capacity substitution. Although some capacity development has

occurred, the overall ANR sector assistance is assessed as **less efficient** (based on a four-category scale of highly efficient, efficient, less efficient, or inefficient).

The policy reform measures achieved have been sustained, with no overt reversals in the formal policy direction. However, policy implementation has been affected by an environment characterized by regulatory uncertainty, unpredictability, lack of transparency and accountability, and other governance issues including corruption. Central and local government jurisdictions and decentralization measures have also influenced the reform process and implementation. TA operations often produced recommendations that could not be implemented because of deficient analysis of the implications of recommended actions concerning requirements for resources, institutional arrangements, and organizational development and management. The sustainability of investment projects is generally assessed as less likely due to (i) shortfalls in operation and maintenance, (ii) inadequate arrangements (human, financial, institutional and other resources) to sustain outcomes, and (iii) marketing constraints confronting farmers and agribusinesses. The investment climate remains poor and presents a formidable challenge to doing business in the country.

Overall sector performance has been encouraging, but with constraints on market orientation and commercialization. In constant terms, the size of the gross domestic product (GDP) of the ANR sector slightly more than doubled between 1986 and 2004, accounting for about half of the total GDP in 2004. Agricultural growth rates averaged 4.7% per annum up to 2000, then declined slightly to 2–4% per annum. Agriculture has remained largely rice based, subsistence, and extensive in nature, without major structural transformation over the last two decades. Rice production underwent tremendous changes over the last 20 years, and the Lao PDR has become self-sufficient in rice since 1999. However, ADB-financed investments in irrigated agriculture contributed only a fraction of the country's increased crop production. There is still household food insecurity in parts of the country, particularly in the Northern Region.

ADB's policy-based operations were partly responsible for policy change in the country. This supported reform initiatives in ANR soon after the NEM. Major contributions included policy changes that helped the State to (i) exit from agricultural production, (ii) end the state order procurement, (iii) promote state divestment of state-owned enterprises, (iv) liberalize input/output prices, and (v) prevent investments in inefficient large irrigation schemes. Policy reforms resulted in a legislative framework for ANR to promote investment and development. While significant challenges remain in many areas, the improved policy environment and greater incentives for private individuals have contributed to growth in agriculture. ADB, development partners, and the Government contributed to the modest growth of the ANR sector through two decades of engagement, and progressive policy and institutional reforms towards a market-based economy. Policy-based measures can impact upon the formal structure of the operating context and policy environment of the sector, but this in itself can generate only limited ANR outcomes (in terms of incomes, employment and poverty reduction) unless private sector resources can be attracted and mobilized to invest in the sector. The policy reforms were relevant and necessary for the formal transition of ANR to a market-based system, but these policy measures were not sufficient. Promoting greater private sector involvement requires that the enabling environment for ANR investment be made attractive. This point has not yet been reached in the Lao PDR. Making the business and investment climate attractive is part of an unfinished agenda. Overall, the sustainability of the ANR sector assistance is assessed as **less likely** (based on a four-category scale of most likely, likely, less likely, or unlikely).

The aggregate contribution of ADB-financed investment projects to the ANR sector performance has so far been limited, with relatively small investments dispersed over many locations and types of interventions (total approved loans of \$84 million over the last 12 years).

Clusters of projects and TAs with similar development themes and focus (such as commercialization, irrigation, livestock, river basin, upland agriculture, and watershed) do not generally interact. Coordination among staff of ADB and implementing agencies of projects and TAs needs to be strengthened. Greater efforts are required to interface ANR sector operations to develop workable and replicable development approaches through information sharing and collaborative efforts within ADB's own portfolio. Further synergies should be attained by collaborating closely with the Government and development partners.

ADB's portfolio management and project administration of ANR sector assistance need strengthening in several areas. The OEM rates the historical performance of ADB in managing its ANR assistance as **partly satisfactory**. Review missions were not conducted on a regular basis, and appropriate expertise in ANR was not always available. Systemic problems affect project administration in ADB. However, more could and should have been done by the concerned department to mitigate these ADB-wide limitations. There was a mismatch between available resources and the requirements of the ANR portfolio. Review missions were typically of short duration, and did not visit project sites in rural areas extensively. Many of these project sites are in remote locations and difficult to reach. On the ground, observations are needed to help resolve implementation difficulties and ensure that the projects are benefiting people as intended. Staff movements, frequent changes of assigned staff, and a lack of technical expertise have created client perceptions that ADB's engagement has been characterized by discontinuity, distance, slow response, and deficiency in sector and country knowledge. The composition and spread of the ANR portfolio make it difficult for ADB to service the client satisfactorily. Options for delegating more project administration to the Lao Resident Mission (LRM) need to be explored. As of 31 December 2004, only 2 (8.7%) of a total of 23 active ADB loans were delegated to LRM, compared with an average of 30.6% ADB-wide and 23.8% in the Mekong Region. The OEM discussed these issues with staff of the Mekong Department, who confirmed that steps were being taken to address these issues.

The relevance of the sector assistance to the country's development policies and strategies is important, but this relevance alone will not make ADB an effective institution to deliver and monitor its assistance. Greater selectivity in engagement is required, recognizing that ADB's staff resources, capacity, and expertise limit its ability to effectively service its clients in all ANR subsectors. Reliance on external consultants and outsourced expertise is not synonymous with having an in-house institutional capacity to make a strategic impact and achieve development results in the ANR sector in the Lao PDR.

A number of actions will be required for ADB (in consultation with the Government) to improve the performance of its sector assistance. In light of the evaluation findings, the following are recommendations for ADB and government considerations.

- (i) **During the CSP process, the Government and ADB should jointly reassess ADB's future involvement in the ANR sector.** Recognizing that ANR is an important sector in the Lao economy and OED's assessment that ADB has only partly succeeded in achieving development results in this sector, the question should be asked whether continued involvement in the sector is an optimal use of scarce Asian Development Fund resources. Continued support to the ANR sector needs to be based on an evaluation of the performance of the country assistance program and the current priorities of the Government. In terms of future support to ANR sector development, a better approach may be to address some of the broader economic and policy issues that adversely affect the performance of the ANR sector, including through Greater Mekong Subregion

programs such as the initiation of cross-border trade facilitation and investment in the context of regional cooperation.

- (ii) **If the joint government/ADB assessment concludes that ADB has a role to play in the ANR sector, prepare a suitable strategy that results in a higher probability of achieving development results.** Such a strategy should consider the following elements: ADB activities in the ANR sector should be more selective and focused in terms of composition and spread, and should take into account government priorities, the division of roles and responsibilities among development partners, past performance of ADB operations, identified lessons, and ADB's comparative advantage and skills mix requirements. ADB should discontinue the project-by-project approach of defining relevance and priorities for the ANR sector, because this approach has led to diffused ANR sector assistance. This should result in a more strategic and results-oriented framework for prioritizing development assistance in the ANR sector. This should be based on an assessment of key challenges, binding constraints, and opportunities facing the ANR sector, including overriding considerations that have significant bearing on the sector's performance (e.g., the investment climate, governance, corruption, markets, and opportunities for economic integration and regional cooperation). The future approach should include using existing aid coordination channels more effectively to (a) share experience and knowledge, (b) find solutions to binding constraints facing the ANR sector, and (c) develop replicable approaches that can provide greater benefits countrywide.
- (iii) **Within the next 12 months, ADB should assess its in-house capacity to service clients in the ANR sector in the Lao PDR, and determine the extent to which it can offer expertise and knowledge with respect to the country's development strategies and priorities.** If ADB does not have the requisite in-house expertise, there is a significant risk that its operations will not lead to the anticipated development results.
- (iv) **Within 12 months, ADB should improve its project administration capabilities and commit resources to match the current ANR portfolio.** Adequate resources should be made available to support project administration in the ANR sector. ADB should conduct review missions more regularly for ANR projects, ensuring that missions are of appropriate frequency and duration, particularly for complex ANR projects. If resources are not available, the scope of ADB's ANR activities should be scaled back accordingly. Delegation of responsibilities and provision of resources to LRM for project administration should also be considered.
- (v) **Within 12 months, ADB and the Government will review the performance of ongoing projects such that mid-course actions can be taken to improve the probability of achieving development results.** This review will take into account the findings of the case studies presented in this report. In particular, the review should (a) examine options to increase the economic efficiency of irrigation projects; (b) assess the development costs of community-managed irrigation schemes, reexamine the heavy reliance on contractors, and promote greater community engagement and self-reliance to find more cost-effective ways of delivering assistance; (c) assess the existing policy and procedures for irrigation management transfer and the rules for irrigation service fee; (d) examine options to use the Smallholder Development Project more

strategically to address commercial impediments and improve the marketing of agricultural crops of other ADB-financed ANR projects; and (e) analyze the piloting experience of ongoing projects and TAs, and develop a strategy to increase synergies among them.

- (vi) **ADB should strengthen ex-ante project economic analysis of ANR projects in the Lao PDR to recognize realistic assumptions and risks.** This will avoid unrealistic assumptions as encountered, for example, with past irrigation projects, and reduce the risk of ADB financing projects that are not viable.

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