



## Case Study

### Comparing investments in the Lao Tea Sector:

Concessions, contracts, and outcomes for  
smallholder farmers

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Thiphavong Boupha

January 2023



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# ABBREVIATIONS

|       |   |
|-------|---|
| ASDPS | Association to Support the Development of Peasant Societies |
| CF    | Contract Farming  |
| COPE  | Community Organization, Participation & Empowerment Program |
| DAFO  | District Agriculture and Forestry Office                    |
| DICO  | District Industry and Commerce Office                       |
| DOA   | Department of Agriculture                                   |
| FOTPG | Farmer Organic Tea Production Group                         |
| GI    | Geographical Indication                                     |
| LFP   | Lao Farmers' Products                                       |
| LURAS | Lao Upland Rural Advisory Services                          |
| MAF   | Ministry of Agriculture and Forestry                        |
| MoIC  | Ministry of Industry and Commerce                           |
| MRLG  | Mekong Region Land Governance                               |
| NGO   | Non-governmental organisation                               |
| PAFO  | Provincial Agriculture and Forestry Office                  |
| PFO   | Provincial Finance Office                                   |
| PICO  | Provincial Industry and Commerce Office                     |
| PONRE | Provincial Office of Natural Resources and Environment      |
| PPI   | Provincial Planning and Investment Office                   |
| SDC   | Swiss Agency for Development and Cooperation                |
| TABI  | The Agro-Biodiversity Initiative                            |

# EXECUTIVE SUMMARY

The tea sector in Lao PDR (hereafter Laos) has high potential to generate income for smallholder farmers and to reduce poverty in the country's remote uplands. While Laos benefits from highly suitable growing conditions and desirable varieties – as well as close proximity to a vast market in China – the sector faces many challenges to achieve its full potential. Key issues include controversial forms of investment such as exclusive trade concessions and informal contracting where smallholder farmers gain a modest share of profits compared to a larger share enjoyed by downstream actors.

To better understand the benefits and drawbacks of prevailing forms of investment in the Lao tea sector and the range of issues and challenges that emerge, three in-depth case studies were conducted on tea investments in different areas of the country. The research compares different investment models, roles and obligations of parties involved, production arrangements and their outcomes. The aim is to provide recommendations to inform policies that may better support more transparent and mutually beneficial investments for both producers and companies. Some tea investments include out-grower or contract farming (CF) schemes. These have emerged as a key component in the Lao agricultural sector since the early 2000s, mostly for export-oriented commodities produced on a large scale. Although many different CF models exist throughout the country, they are often based on informal ad hoc agreements between traders and smallholder farmers, and vary significantly across different products, including tea. The present study is based on comprehensive desk research supplemented by 30 stakeholder interviews to validate the findings. The study was conducted from November 2021 to January 2022 and focused on tea investments in key production areas in the north and south of the country that are among the most developed in the Lao tea sector and represent diverse models. The three provinces (and specific locations) selected were Phongsaly and Xieng Khouang (Phouasan) in the north; and Champassak (Paksong) in the south.

Although tea is not considered to be as culturally embedded in Laos as it is in neighbouring countries, it is widely consumed domestically.

Wild and ancient tea varieties in Laos are of high quality and there is strong demand in China for Lao-produced Pu'er tea (a fermented tea), particularly during spring picks. This demand has attracted many Chinese investors and traders to the Lao tea sector. The structure and development of the Lao tea sector varies by location and can involve a variety of actors and relationships. The case studies presented here show that, in characterising these structures and the relationships between actors, it is useful to consider the following questions:

- *Is there a trade concession involved?*

In the main production areas of Laos, local governments have often granted investors the rights to purchase tea from communities in a given area. These trade concessions (as distinct from land concessions that denote acquisition of land rights) generally grant investors exclusive purchasing rights, although enforcement of such agreements varies. In exchange, investors may commit to providing support to help develop the local tea sector such as by supplying tea producers with agricultural inputs or building tea processing facilities. However, the trade concession structure creates monopsonies where producers are unable to choose who they sell to and prices are fixed by buyers. Instead of supporting the growth of the tea sector, exclusive trade concessions may often limit value chain development by stifling competition.

- *Is there an out-grower or contract farming scheme?*

In some cases, investors enter into a formal contract agreement with government agencies (whether an exclusive trade concession or otherwise) which stipulates a CF arrangement between tea investors and individual producers or producer groups. The CF scheme is typically based on 2+3 contracts – a model where the investor supplies farmers with inputs, technical expertise, and access to markets, while farmers provide land and labour. There are several variations on CF in the Lao tea sector but in terms of labour, farmers are typically responsible for land preparation, planting of seedlings, farm

management and picking of fresh leaves. In terms of inputs, investors may provide tea seedlings and production or processing technologies. They may also buy fresh tea leaves for processing and/or marketing tea products.

- *To what degree is the local tea sector value chain and market-based?*

Questions regarding value chains and market-based investments are interconnected with the above two questions. Forms of investment in the Lao tea sector vary significantly based on the development of local value chains and the extent to which the investment is market-based and subject to open competition. Tea producers may benefit from competition between traders that enables transparent pricing, more effective marketing of finished tea products or links to profitable export markets, among other factors. The development of integrated tea value chains depends on market-based relationships between producers, traders and processors/buyers. These relationships may be supported by formal or informal agreements between producers and traders, and between investors and local governments.

Key challenges for improving the benefits to smallholder producers surround the enabling conditions for engaging in higher value-added processing, and for domestic firms to be able to export to China independently.

- *Are other non-market actors involved in the value chain?*

The structure of local tea value chains may also be influenced by other actors such as non-governmental organisations (NGOs), development projects or tea producer groups. In some cases, these non-market actors seek to support producers by facilitating access to export markets or otherwise supporting market-based growth of the local tea sector. Tea producer groups or cooperatives – sometimes with the backing of NGOs and other actors – may negotiate on behalf of individual producers to strengthen their position in dealing with investors.

This study explores the development, advantages and disadvantages of the above structures and relationships through the three case studies of tea in Phongsaly, Phousan and Paksong. Findings from the three cases are summarised below.



A smallholder tea plantation in Phongsaly province (Photo by Fabio Lamanna / Dreamstime.com)



## Summary of the Phongsaly, Phoustan and Paksong cases

|   | Phongsaly   | Phoustan  | Paksong   |
|---|---|---|---|
| Tea variety                               | Ancient tea plus newly cultivated local varieties, and lower-quality varieties from Yunnan.   | Wild tea plus a newly cultivated local variety.   | Ancient tea plus a newly cultivated variety.  |
| Forms of investment                       | Tea factory investors signed trade concession agreements with the district government, and later 2+3 subcontracts with tea producer groups.                 | Concessions granted by provincial government proved ineffective. Traders made informal agreements with producers and processors.  | Local government provides extension support in collaboration with producer groups and development projects. Traders and producer groups have informal agreements.                 |
| Role of tea investor in contract          | Provides marketing, tea seedlings, additional price premium, and other social contributions to tea producer groups.   | No enforcement from tea investors. Anecdotal evidence that traders informally provide capital/ equipment/ processing techniques to local producers.                                       | Provides marketing only.  |
| Role of smallholder producers in contract | Within the allocated zones, farmers exclusively supply fresh tea leaves to the granted tea investor at an agreed price.                                     | Farmers supply processed tea to traders based on informal trade agreements.   | Farmers supply processed tea to traders based on (reportedly informal) advanced orders and price agreements.  |
| Role of local government                  | District government signs contracts with investors in coordination with PICO/ PAFO/ PONRE/ PFO, etc.  | Provincial governor signs agreements with PPI, PICO and PAFO but with little clarity as to roles and responsibilities.  | Tea agreements are subject to formal investment procedures but local government involvement in informal trader–producer contracts is minimal.                                     |
| Role of non-market actors                 | Tea development projects play a key role in improving 2+3 CF, from preparation of contracts to liaising with parties and indirectly monitoring obligations. | A mixture of support from development projects on improvement of local capacity and market linkages but no role in concession area. Top-down government intervention at the early stages. | A mixture of support from development projects on improvement of production, processing capacity and market linkages for producer groups, but emphasising market-led value chain. |

Based on these findings, the research suggests the following policy recommendations for improving investments in the tea sector in Laos:

- Granting exclusive purchase rights to a single investor is rarely beneficial for farmers and has

failed to support value chain development in most cases. Although investors provide annual revenues for local governments via concession fees, this approach stifles competition and often results in lower prices for producers. Such trade concessions can attract investors

at the early stages. However, when the local tea sector is immature, concessions should be phased out towards smallholder-inclusive models thereafter.

- Government agencies need a full understanding of local contexts and the specific issues caused by trade concessions and the implications for all parties involved. This requires a clear technical feasibility study in consultation with all stakeholders before the concession agreement is signed.
- The process of drafting and signing a contract must be streamlined, and comprehensive content and clear mechanisms for effective enforcement must be ensured. When disputes arise, local governments should play a facilitating role in enforcing the contract and solve issues in a timely manner. An independent grievance mechanism could help to address contract disputes fairly and effectively.
- Contracts between local governments and tea investors witnessed by provincial and district offices can underpin 2+3 CF schemes. All aspects should be transparent and accepted by all parties. Subcontracts signed between the tea factory and tea producer groups should be agreed upon by all members and contents should be regularly discussed among the parties and monitored by local government.
- Contracts should include clauses on minimum price, payment methods and selling times, management of side-selling during high demand, quality of production and picking, and provision of inputs and technologies from tea investors. Written contracts should be encouraged and all members of the scheme should receive a copy of the contract.
- Market-led tea value chain development with less direct government intervention should be emphasised. Without stable and transparent market linkages, 2+3 CF and other advance purchase agreements will not be successful.
- Improvements to value chains should focus on the collective ability of producers to meet quality standards and traceability systems and to engage in higher value-added processes in the value chain. Improvements should also support the ability to export processed tea directly as these opportunities are predominantly only available to downstream actors in the current context.

- The Lao tea sector is gradually evolving and continues to have strong potential to contribute to poverty reduction in remote uplands where some locations also have better growing conditions for high-quality tea varieties than for other crops.
- Smallholder farmers and producer groups could be better supported with production and processing technology to increase the benefits to the domestic industry.
- Support could also be provided to meet export standards and make links to higher-value markets through fairer contracting and purchase agreements. Current barriers for Lao producers to export independently to China need to be addressed by removing requirements to be under contract with a Chinese company.
- Local investors meanwhile also need support to engage other international markets beyond China. Technical and marketing advisory services are needed to reinforce the effectiveness and efficiency of tea value chains.



**Natural drying is the first step in the processing of fresh tea leaves, here in the Meung Tea Producers Cooperative in Bokeo province (Photo: Arnaud Vontobel, Gret)**

# 1. INTRODUCTION

## Background

Over the past two decades, the Lao tea sector has evolved rapidly and shows great potential to support local income generation and reduce poverty. There is also the potential for other socioeconomic benefits and the promotion of environmentally sustainable production in the uplands. At the same time, the sector faces many issues surrounding controversial forms of domestic and foreign investment. These include trade concessions and informal contracting where smallholder farmers accrue only a modest share of profits compared to a larger share enjoyed by downstream actors. This research aims to understand these dynamics to help inform policies that can support both smallholder farmers and the wider development and growth of the Lao tea sector. This research gathers lessons and perspectives on investment arrangements in the tea sector by examining the nature of contract arrangements as well as the rights, obligations and division of responsibilities among key parties, namely tea investors, producers, producer groups and local government agencies.

The Lao tea sector has evolved from initial top-down trade concession arrangements to include contract farming (CF) and more market-based arrangements with smallholder tea farmers. In some cases, external actors such as NGOs or development projects have supported these initiatives. In Laos, CF has emerged as a key commercial agricultural production model since the early 2000s (Cole and Soukhathammavong, 2021) and is common for commodity crops, including cassava, coffee, tea, sugarcane, banana, maize and rubber. Although forms of CF observed in Laos vary significantly, informal ad hoc agreements between traders and farmers are widespread. The rapid expansion and changing nature of agro-investments in Laos create challenges for the regulation of CF and for ensuring fair outcomes for farmers and investors. Avoiding negative social or environmental consequences from rapid commodity crop transitions is also a challenge. To address these challenges, there is a need for effective policy responses that are informed by an understanding of the different forms of agro-investment, how they compare and what the implications are for smallholder farmers and investors.

## Rationale, research questions and methods

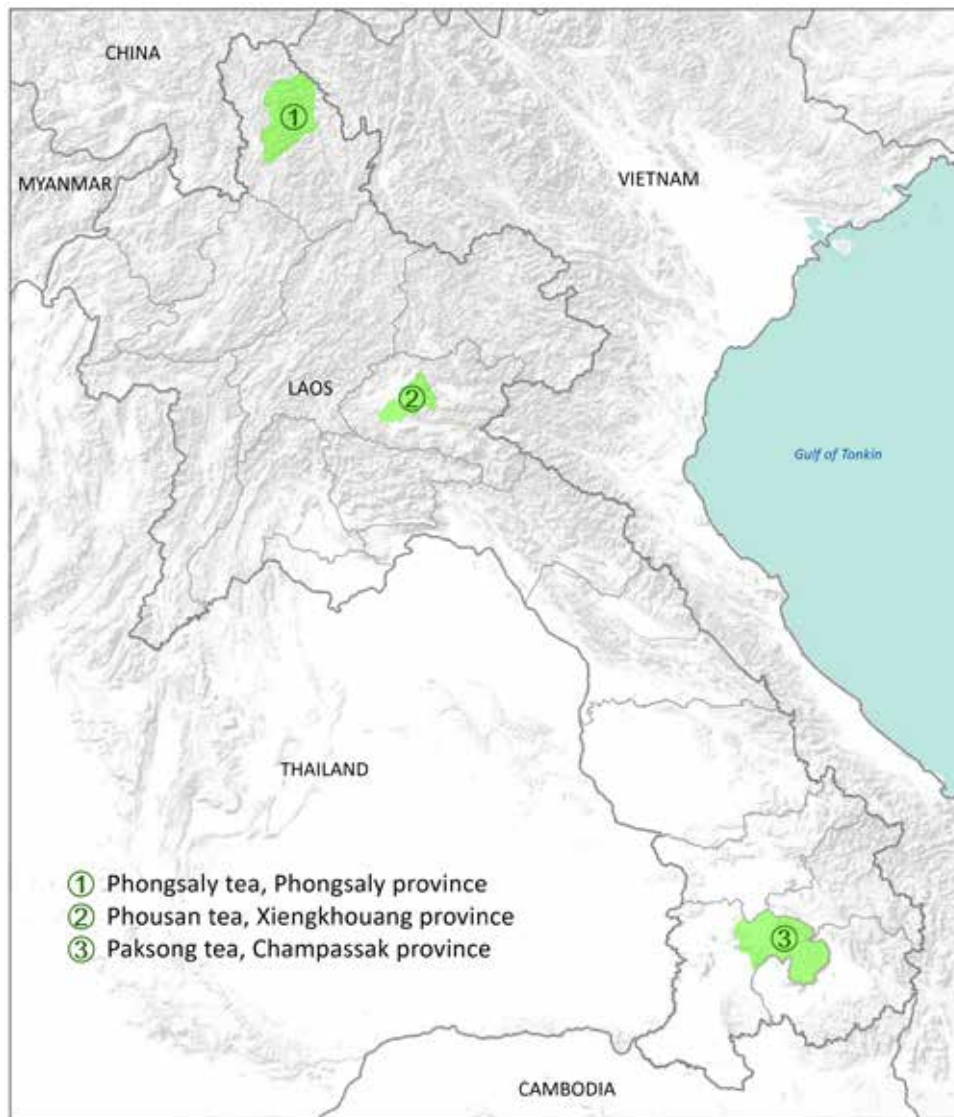
The rationale for the present study is to understand the dominant forms of investment seen in the Lao tea sector. These have evolved in a unique way due to the emergent nature of cross-border purchasing, processing and supply arrangements largely for the Chinese market. As such, tea investments have featured varying combinations of exclusive purchase agreements and CF, with the latter being a key area of current agricultural policy interest in Laos. Part of the purpose of the study is therefore to inform the development of sub-legislation that supports the formalisation and regulation of agro-investments – particularly CF – to protect the rights of both smallholder farmers and investors.

The research compares a representative range of investments in the Lao tea sector by analysing three case studies from Phongsaly province; Xieng Khouang province (Phousan tea); and Champassak province (Paksong tea, see figure 1). The research questions that inform the study are as follows:

1. What types of investment arrangements exist in the tea sector in Laos, and in what socioeconomic contexts?
2. How were these models established and what were the challenges in setting them up?
3. What are the contents of tea concession and CF contracts in Laos in terms of rights and obligations of the contract parties? How do these compare across the different models?
4. How are roles and responsibilities divided among contract parties, namely tea investors, producers, producer groups and local government agencies?
5. What are the positive and negative outcomes of CF in the tea sector for farmers and investors? How do these compare between fully market-driven CF models and those with different levels of support from government agencies, development projects and NGOs?

Research methods included a literature review of existing studies and reports and qualitative interviews with key actors who have been involved in the selected cases. The literature review included documents on the selected

Figure 1. Map of research locations



Map: Chanthavone Phomphakdy.

cases and official tea production and trade data from the Ministry of Agriculture and Forestry (MAF) and the Ministry of Industry and Commerce (MoIC). The author validated the desk research findings via primary interviews. A total of 30 interviews were conducted remotely with producers, producer groups, tea associations, factories/processors, local and foreign tea investors, local government offices (Provincial Planning and Investment Office (PPI), Provincial/District Agriculture and Forestry Office (PAFO/DAFO), Provincial Industry and Commerce Office (PICO)) and representatives from tea sector development projects. An anonymised list of interviewees is included in the annex.

Limitations included access to information on concessions and contracts as some trade concessions granted by local governments are not publicly available, and most contracts for tea production are informal and not accessible. Reasons for limited accessibility may include lack of transparency of investment arrangements in general or a reluctance to share sensitive information that could affect the reputation or business of the parties involved.

## 2. OVERVIEW OF LAO TEA SECTOR

### From trade concessions to market-based arrangements

The value of a tea is determined by taste, colour, aroma and appearance, all of which depend on the type of tea tree, ecology, altitude, the season in which it was picked, processing quality, storage and distribution. Teas from Laos<sup>1</sup> are of good quality and can fetch high prices, particularly when produced at high elevation and in suitable agro-ecological conditions. Tea cultivation in Laos typically follows three main production systems:

- » (1) wild tea collected from forests
- » (2) ancient tea collected from coppiced stumps<sup>2</sup> or cultivated in gardens over hundreds of years
- » (3) recent tea varieties from modern, intensive plantations

In Phongsaly district of Phongsaly Province, commercial tea production has intensified since the late 1990s following the approval of an investment in a Chinese tea factory (Phoufa). This factory was established to process an ancient tea variety in the Korman area but lower-quality Yunnanese tea was introduced at the same time. The establishment of the Phoufa factory could be considered the start of trade concessions for tea in Laos.

Lao tea has also gained a higher profile due to the increasing popularity of the Pu'er tea sector in the neighbouring Chinese province of Yunnan. In addition, some Lao teas have acquired a reputation for their high quality and natural characteristics.

Unlike seasonal cash crops, tea is a long-term perennial tree crop that takes at least three years from planting to the first harvest, with tea from older trees typically more highly valued. Significant investment is required to prepare

plantation land. In addition, both management and harvesting are labour intensive. The labour- and capital-intensive nature of tea plantations disincentivises traders and buyers from acquiring plantation concessions of their own and making long-term investments in production. This is a key motivation for the types of investment seen in the sector, which are geared towards securing supply arrangements from local communities of smallholder producers.

High-quality tea resources are typically wild or ancient teas and these account for two of the above three main production systems in Laos. Where these resources already exist, investors often approach local governments to sign agreements or seek approval for exclusive rights to collect tea leaves from smallholder producers. This basic trade concession has been particularly common in immature markets where there are few demand-side competitors and value chains are not yet established or stable. These are the conditions which allowed early-adopter investors to secure exclusive purchase agreements with local governments.

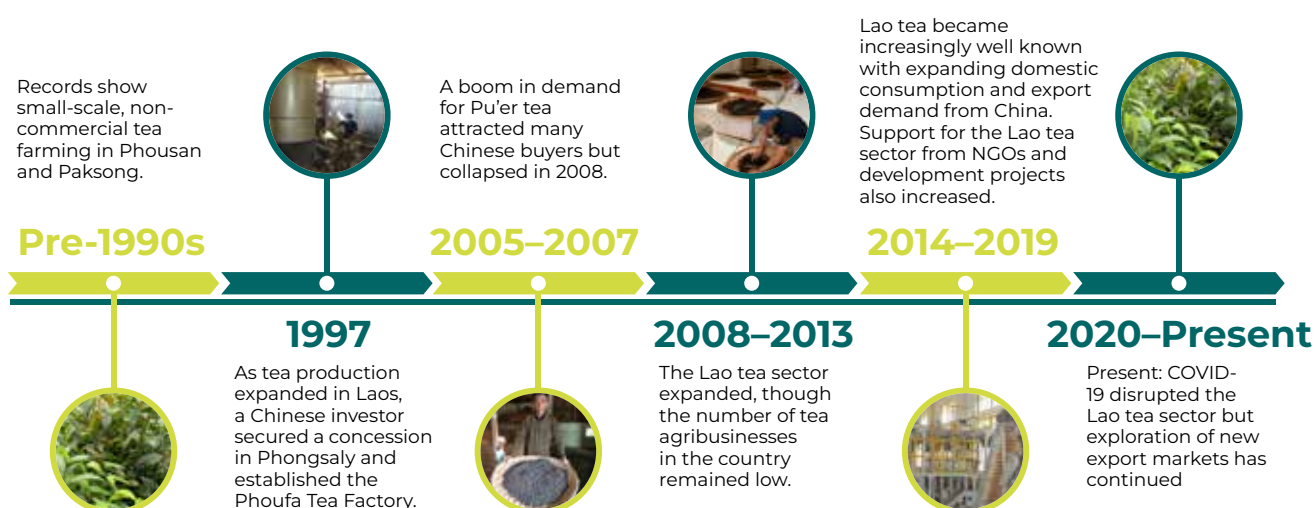
When offering such rights to investors, a common stipulation of local governments is that investors should introduce improved production technologies, provide tea seedlings and/or guarantee farmers a minimum price for their tea according to the picking season. These requirements are intended to stimulate value chain development and contribute to local economic growth in return for exclusive purchase rights. More recently, granting trade concessions may include a commitment to a 2+3 CF scheme between investors and farmers where farmers provide land and labour, and investors provide inputs, technical knowhow and access to markets.

A brief timeline of the evolution of the Lao tea sector is described in Figure 2.

1 There are two main varieties of tea cultivated in Laos today: *Camellia sinensis*, var. *assamica* and *Camellia sinensis* var. *sinensis*.

2 Coppicing is a cultivation technique in which trees are cut back to produce new growth.

**Figure 2. Evolution of the Lao tea sector**



## Trade volume and production areas

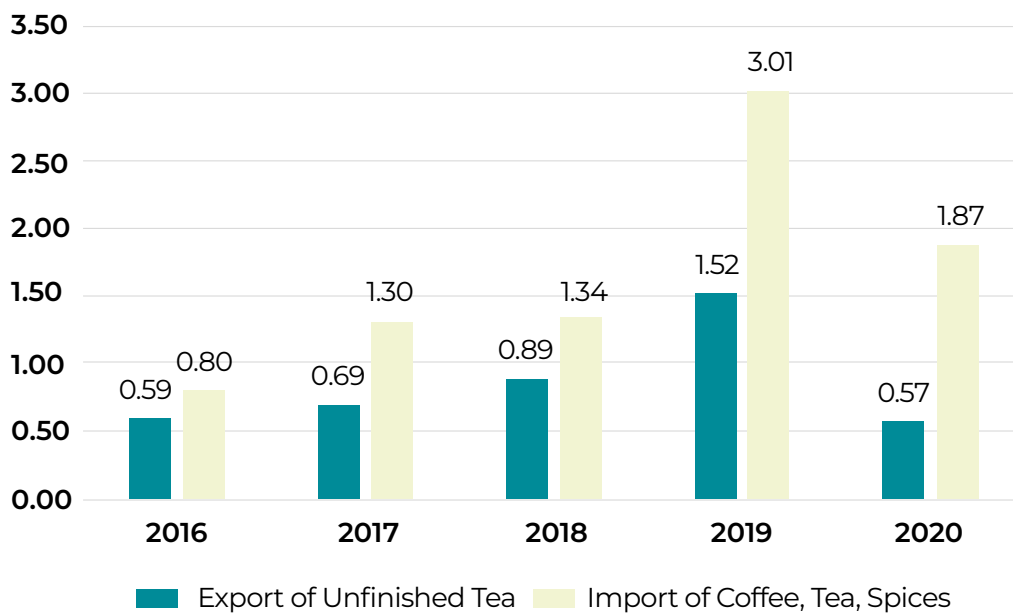
As of 2020, the northern provinces of Phongsaly and Luang Prabang accounted for the majority of Lao tea production, together representing three quarters of the total 7,720 ha of land cultivated for tea (see Table 1). Xieng Khouang province accounted for just under 8% (604 ha) and Champassak province just under 6% (458 ha). Despite the good quality of varieties and growing conditions in Laos, the country imports more tea than it exports. However, trade overall slowed dramatically during COVID-19. As shown in Figure 3, official exports of tea from Laos totalled around US\$1.52 million in 2019 and decreased to US\$570,000 in 2020,

but such figures are often unreliable. Limited availability of recent trade data is indicative of a key challenge to more effective tea sector planning as data sources remain unclear and inconsistent. Data for combined imports of coffee, tea and spices to Laos are available and show a total of US\$3.01 million in 2019 and US\$1.87 million in 2020. In the last five years, the main official importers of Lao tea were Thailand (68%), China (16%), Germany (9%) and France (4%) (MoIC, 2021). It should be noted that most tea exported to China is through informal cross-border trade and is not recorded. This means that official statistics do not represent the total value of Lao tea sold in China, which is likely to be far more than other export markets.

**Table 1: Tea planting area in Laos by province, 2011–2020 (ha)**

|               | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  |
|---------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Phongsaly     | 2,460 | 2,585 | 2,655 | 3,230 | 3,235 | 2,810 | 2,370 | 2,405 | 2,410 | 2,504 |
| Luangnamtha   | ND    | ND    | ND    | ND    | ND    | ND    | 30    | 350   | 350   | 350   |
| Oudomxay      | 225   | 305   | 215   | 385   | 445   | 60    | 60    | 135   | 135   | 431   |
| Luang Prabang | 430   | 125   | 695   | 710   | 785   | 785   | 785   | 785   | 785   | 3,213 |
| Houaphan      | 135   | 30    | 45    | 65    | 80    | 110   | 160   | 160   | 160   | 160   |
| Xieng Khouang | ND    | ND    | ND    | 120   | 135   | 290   | 290   | 290   | 290   | 604   |
| Champasack    | 285   | 285   | 285   | 460   | 460   | 460   | 460   | 460   | 460   | 458   |
| Total         | 3,535 | 3,330 | 3,895 | 4,970 | 5,140 | 4,515 | 4,155 | 4,585 | 4,590 | 7,720 |

Figure 3. Tea imports and exports in Laos, 2016–2020 (US\$m)



Source: Department of Agriculture (DOA), MAF, 2021; DoIm&Ex, MoIC, 2021<sup>3</sup>

## Value chain actors

A value chain is a vertical coordination of actors involved in the processes needed to carry a product from the input stage, through stages of production and on to a final market (UNIDO, 2009). A tea value chain begins with the distribution of agricultural inputs at production areas and technical extension on tea tree cultivation, leaf picking methods, delivery to factories, processing, grading, storage, packing, transport, distribution, marketing and final delivery to consumers.

In Laos, tea value chains vary depending on the location of production areas and the destination market. However, the actors along the tea value chain typically include producers and/or producer groups, processors (tea factories), traders, wholesalers, retailers, exporters and importers. Supporting actors are those who do not handle the tea but provide support or enabling services. These actors include government agencies (such as MAF, MoIC, Ministry of Planning and Investment and the Ministry of Natural Resources and Environment); service providers (such as for machinery, credit, loans or marketing); and quality and standard accreditation entities (including domestic certification through the Intellectual Property Department, MoIC, and international accreditation from Organic Agriculture Certification Thailand).

In recent years, NGOs and development projects have also paid increased attention to the potential contribution of tea value chains to poverty reduction and income generation in upland communities where wild and ancient tea resources exist. Some projects have provided technical and marketing support for tea value chains, especially in the northern provinces of Laos. Specific organisations and locations for these initiatives include: Comité de Coopération avec le Laos in Yot Ou (Phongsaly) and Sing districts (Luang Namtha); CARE in Khua district (Phongsaly); Helvetas Community Organization, Participation & Empowerment Program (COPE) in Phongsaly; Lao Upland Rural Advisory Services (LURAS) in Oudomxay and Xieng Khouang; BioTrade in Phongsaly and Bokeo; the Soum Son Seun Jai project in Oudomxay and Xayaburi; and Mekong Tea in Bokeo and Xayaburi.

Although there are few official records for most tea exports from Laos, from personal communication with traders it is estimated that around 80% of Lao tea is sold in Yunnan as Mao Cha (partially processed tea), red tea and green tea. Chinese consumers will continue to play a critical role in driving the Lao tea sector despite emerging demand from other export markets, including in Europe. Lessons from the development of tea value chains in Laos to date show that the sector depends on cultivating high-quality, niche tea products that can generate increased income

<sup>3</sup> Import figures are not disaggregated for coffee, tea and spices.

for smallholder farmers and a high return for tea investors. This entails promoting more efficient tea value chains through sustainable and profitable tea resource management and production systems. It also requires supporting farmers with better information on markets, quality standards and practices such as appropriate post-harvest handling, processing and packaging.

## Types of contractual arrangements

The structure of the Lao tea sector varies by area, and relationships between investors, farmers, government and other actors range from exclusive trade concessions to more market-based value chains. In some cases, these relationships represent a CF arrangement. Some of the key structures and relationships between actors in the tea sector are as follows:

### *(1) Concession agreements*

Where wild or ancient tea resources are available, top-down land and trade concessions are common. Investors often sign agreements with local governments to promote the

development of a plantation or to establish a processing factory. Land concessions for factory and production demonstration sites are also included in such agreements. These investments are normally approved by the district or provincial governor through the Investment Promotion Committee, depending on the size of the concession. These agreements may include a 2+3 CF scheme – but more often constitute monopsony arrangements – and give investors exclusive rights to buy tea from producers in specified villages, usually at a minimum set price for tea harvested during the rainy season and at market prices during the dry season. Farmers may also gain additional income through certifications that allow access to high-end markets.

In concession areas, investors may also sign an agreement with producers or producer groups to purchase freshly collected tea leaves. Investors and farmers may enter into a land lease agreement in which investors secure a lease for an area of land and farmers provide wage labour. This is sometimes referred to as a 1+4 model and is distinct from CF as farmers



Fermented tea from 400-year-old tea trees in Phongsaly province (Photo by Phouvieng Phongsas, Dreamstime.com)



only provide labour (one element) and investors provide inputs, production techniques, access to markets and land (four elements). Investors pay landholders a fee for a fixed period and manage all aspects of production, including post-harvest handling, processing and marketing.

Information on concession agreements – including results of technical feasibility studies – is not normally available to the public and consultation with tea farmers rarely takes place. Tea farmers in many areas feel they have little say regarding the terms or enforcement of the agreements. On the other hand, in some cases, farmers feel these agreements reduce their exposure to risk, particularly where tea markets are immature.

In terms of tea resources, concession arrangements often follow one or more of the following patterns: (i) wild tea resources are on community-held land which all farmers can harvest and sell to the tea investor; (ii) farmers expand tea plantations on their land or inside the community's production forest area with support from local authorities; or (iii) investors manage all production and processing for a given concession area, with farmers providing labour (i.e. 1+4 leasing).

### *(2) Contract farming*

In many areas, the Lao tea sector has moved towards the 2+3 CF model, where tea farmers provide labour and land while investors provide capital, technology and market access. Tea farmers are then involved in land preparation, planting of tea seedlings, farm management and picking of fresh tea leaves. The technology provided by investors includes processing facilities or technical advice as well as agricultural inputs like seeds, tea seedlings and fertiliser. As for market access, investors buy fresh leaves for processing and market the tea products domestically or abroad. Agreements for tea CF also nearly always include commitments from investors to support improved production techniques, although contracts are rarely enforced.

The Government of Lao PDR has promoted the 2+3 CF model with the stated goal of helping villagers maintain access to land and secure more reliable income while also improving access to technology and agricultural productivity (Manorom et al., 2011; Wright, 2009)

### *(3) Advance purchase agreements*

The tea sector in some areas may also feature purchase agreements where farmers manage the entire production process and traders only purchase the tea through either formal or informal agreements. Although an advance purchase agreement is made, this is not considered to be a form of CF as the investor commits only to purchasing tea from producers. Farmers manage their own land, labour, inputs and techniques on a plantation, while the traders or investors only provide access to markets. However, this structure often includes more buyers and therefore allows for more market competition.

At the same time, advance purchase agreements can be functionally similar to trade concessions as local governments grant purchase rights to either the harvested fresh tea leaves or processed tea from specific villages. Investors may also subcontract fresh tea leaf collection to producer groups or village authorities. In many cases, such purchase agreements are informal or verbal, or involve simple written records signed by a tea trader or the head of tea producer group and are not witnessed by any local authorities.

### *(4) Tea development projects and non-market actors*

In an effort to develop the Lao tea sector, NGOs, development organisations and other non-market actors have provided support for farmers and local value chains through tea development projects, producer groups and other programmes. Development projects have supported the arrangement of contracts between local governments and tea investors as well as subcontracts between investors and tea producer groups. Support from external actors can lead to the development of more market-based local value chains for tea. However, questions may arise over the sustainability of the model when projects or other forms of support reach completion.

**Table 2: Overall strengths and weaknesses of trade concessions and CF in the Lao tea sector**

|          | Strengths  | Weaknesses   |
|----------|--|--|
| Investor | <ul style="list-style-type: none"> <li>• Improved assurance of quantity and quality of fresh tea leaf supply compared to the open market</li> <li>• Access to land to develop tea gardens and processing factories</li> <li>• Not directly responsible for tea production</li> <li>• Ability to fix purchase and collection schedules according to demand</li> <li>• Supported by actors such as producer groups and development projects</li> </ul>   | <ul style="list-style-type: none"> <li>• Price and demand fluctuation in end markets</li> <li>• Low quality fresh tea leaves in some cases</li> <li>• Weak export market links – particularly restrictions on exports by Lao commercial entities</li> <li>• Possibility of constricting changes in local regulations</li> <li>• Problems accessing capital</li> <li>• Limited local awareness of CF processes, contract terms, conditions, obligations and dispute resolution mechanisms</li> <li>• Side-selling to other buyers when demand is high during the spring pick</li> <li>• Limited government support for investors fulfilling obligations under tea CF</li> </ul>                   |
| Farmer   | <ul style="list-style-type: none"> <li>• Access to stable markets, seedlings, credit, technical extension services, infrastructure and social benefits</li> <li>• Opportunity to negotiate a minimum price for rainy season harvest while still selling at market price for dry season harvest, leading to increased income</li> <li>• Premium price for niche products and through certifications</li> <li>• Membership of production groups can help overcome individual constraints on production and marketing capacity</li> </ul> | <ul style="list-style-type: none"> <li>• Production and processing without sufficient technical support from investors</li> <li>• Possibility of lower prices due to lack of market information and limited negotiating power</li> <li>• Possibility of long-term cyclical debt to investors</li> <li>• Lack of understanding of government oversight on CF</li> <li>• Preference for verbal or informal agreements with traders</li> <li>• Lack of clarity in dispute resolution mechanisms</li> <li>• Some CF or concession agreements prevent collective organisation of producers – such as for processing purposes – therefore retaining higher value-added stages for investors</li> </ul> |

## 3. CASE STUDIES

### 3.1. PHONGSALY TEA

#### Background and establishment of Phongsaly tea

In Laos, tea was first cultivated in the northern region of the country and many wild and ancient tea varieties still grow in the northern provinces today. Phongsaly tea in particular is highly regarded by buyers and consumers in the Chinese provinces of Yunnan and Guangxi. During the late 1990s, the Government of Lao PDR and other actors heavily promoted tea cultivation as a replacement crop for opium and as a means of reducing and sedentarising upland swidden practices under land reform policies aimed at poverty eradication. Commercial tea investments gained a foothold in 1997 when a Chinese investor (the founders of the Phoufa Tea Factory) signed a concession agreement with the district government for the collection of high-quality fresh tea leaves from the Korman area of Phongsaly district. The investor also agreed to develop tea plantations and to establish a tea processing factory. The Korman area is well known for its 400-year-old tea trees and consists of seven villages with some 79 ha of ancient tea and 175 ha of modern tea gardens. However, the Phoufa factory investors found that the quantities of ancient tea leaves and seeds from the area were too limited, and the company became increasingly reliant on a lower-quality Yunnanese tea variety. The investor supported the expanded cultivation of Yunnanese tea by supplying seedlings as part of their agreement with the local government. The impact of this intensified cultivation on product quality and marketing potential was not effectively assessed by local government. The concession agreement for the Phoufa Tea Factory therefore did not distinguish different types of tea.

In the mid-2000s, the Phongsaly district government granted tea trade concession agreements to two other factories: Phongsaly Green Tea, backed by a local investor, and Lao Syuen Classic Tea, backed by a Malaysian investor. With the aim of developing the sector, the government formally opened up the Korman zone for the collection of high-quality ancient teas and the competition for these teas intensified, particularly during the spring picks.

Phoufa Tea Factory expressed disappointment as they were unable to collect as much fresh tea from the Korman area as they felt they had the right to under their contract with local government. They complained that local officials did not enforce or protect their tea investment under the concession contract (Boupha et al., 2010). All three factories introduced a form of the 2+3 scheme by providing farmers with inputs (typically financial support to expand seedlings and planted areas, sometimes by ha per year), extension expertise (production and processing techniques) and market access (in most cases, marketing is the main form of support provided) in exchange for exclusive purchase rights under the tea zoning concession agreements.

Over the last ten years, increased tea production and a resulting oversupply in the rainy season has seen the Phongsaly district government try to approve more tea factories and processing units, with continued allocation of collection rights to investors through concessions. In 2020, Phongsaly district had a total of 1,570 ha under cultivation for tea with an annual fresh leaf production of 3,409 tons, accounting for about 64% of total tea production in the province. The Phoufa factory area is the most developed with around 409 ha under cultivation. A key challenge in the Phongsaly case continues to be the peaks and troughs in demand from the Chinese market for ancient teas in the dry season and fresh leaves during the rainy season. The rainy season is often a period of oversupply, pointing to the need to identify other marketing channels, and/or enable Lao producers and processors to export to China autonomously.

Tea investors pledged to introduce new production techniques in contracts with the local government. However, evidence appears to show minimal activity on the part of tea factories in this regard. This is mainly due to either limited technical knowledge (typically among local investors) or concerns that the government will not enforce contractual guarantees to the tea harvest. This is typically a concern among Chinese investors and evidenced by the Phoufa case. Some investors are afraid that the local government may open up or sign away a portion of their concession zones to others, or that farmers may also side-sell tea outside of the contract when there is high market demand. The

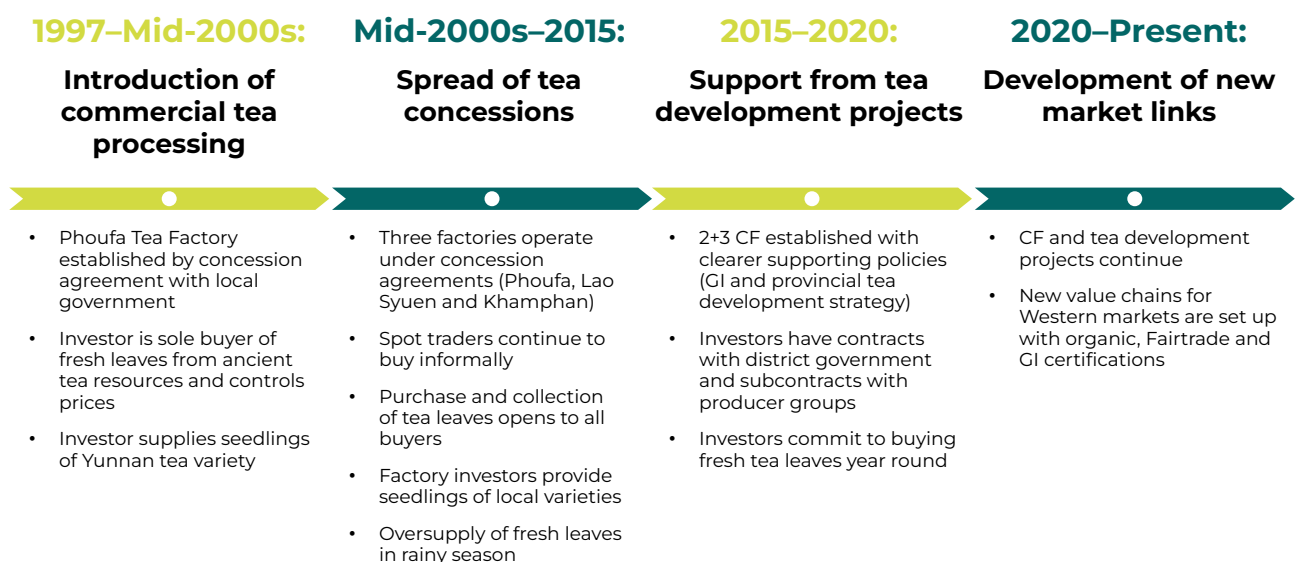
impacts of these perceived risks on investment mean that tea productivity in Phongsaly is much lower than it could be, particularly compared to the intensive production system in neighbouring Yunnan (though recognising the generally lower-quality varieties involved). Moreover, tea processing equipment and facilities in Phongsaly are not as modernised as those in Yunnan, partly because of capital constraints and limited processing technologies. Long-term trust relations and the introduction of more advanced processing capacities are critical for effective tea value chain development.

Since 2014, the COPE project and later the BioTrade project have collaborated with the local government in Phongsaly to support tea value chain development by improving production and marketing linkages. Tea farmers have formed stronger producer groups, and tea factories have received support to build links to export markets for rainy season tea. Farmers have committed to producing high-quality tea leaves and to end side-selling during the dry season. Tea factories have committed to buying more tea leaves in the wet season, specifically with farm gate cash payments (it was previously common for buyers to issue a written I-owe-you when short of cash, which caused problems for farmers). The system of 2+3 CF has been scaled up and refined, with clearer contract content and roles and responsibilities for each party involved. Contracts often aim to increase the rainy season harvest by securing a higher price for farmers.

The growth of the tea sector in the province is supported by the Phongsaly Provincial Tea Development Strategy. The strategy was prepared and endorsed in 2018 by investors, producer groups, development projects and many provincial and district offices (the Provincial Governor's Office, Provincial Finance Office (PFO), Provincial Office of Natural Resources and Environment (PONRE), Provincial Science and Technology Office, PAFO, PICO and other relevant provincial and district offices). This strategy sets the direction for tea sector development in Phongsaly, including outlining support for tea investors. However, it includes no detailed information about tea CF as this was not prioritised. The establishment of a Phongsaly Tea Association was proposed during the preparation of the strategy, which was officially initiated in late 2020 as a precondition for seeking Geographical Indication (GI) approval under the remit of the Intellectual Property Department of MoIC. These efforts and the process for GI status were heavily supported by international organisations and, like other project-supported activities in the sector, questions of sustainability emerge once project support comes to an end.

The Phongsaly district government is now aiming to push tea investors to buy more tea in the rainy season. The government continues to apply both a zoning approach and the use of 2+3 CF schemes but now requires that investors submit a proposal with a preliminary feasibility study. District authorities may recommend that a trade concession be allocated for a specific village if the

**Figure 4. Summary of the evolution of the tea sector in Phongsaly**



investor does not have their own target villages. This allocation is usually done by the One Stop Service Unit, a division under the District Planning and Investment Office. When the feasibility study report is complete, a multisectoral meeting will be held to go through the contents of the investment proposal and the report. All related provincial offices will join the consultation session. For this process, Chinese investors must also present a letter from the local Chinese authorities in the Xishuangbanna or Pu'er government certifying their financial and technical capacities. This is intended to ensure that the investors can bring advanced expertise and facilities without constraining their financial investment. The Phongsaly district authorities and the investor can then sign a specific contract for the promotion of a tea plantation and establishment of a tea processing factory.

Following this process, tea investors and producers also sign subcontracts for the collection of fresh

tea leaves in each village within the concession. These subcontracts are supported by district government offices (DICO and DAFO) and development projects. The process starts with the preparation of a draft of the contract, followed by a meeting with all households in the target village to explain the contract objectives and contents. Village authorities and lead local producer groups play an important role in this process. Tea projects, village heads or producer group committees must then clearly explain the contract in Lao or a local language. When the contents are clear to the tea producers, a contract is signed by the tea factory and the head of the producer group, witnessed by village authorities and DICO. A list of signatures from all the household heads indicating their agreement is also needed during this process.

A detailed outline of the contents of both types of contracts (investor–government and investor–producer) for tea CF in Phongsaly is shown below in Table 3:

**Table 3: Contents of investor–government and investor–producer contracts in Phongsaly**

| Government–investor contract contents  | Investor–producer group contract contents   |
|--|---|
| <ul style="list-style-type: none"> <li>• Goal and objectives of contract</li> <li>• Definitions of terms</li> <li>• Contract model and division of income</li> <li>• Contract period and investment capital</li> <li>• Responsibilities of investor and tea farmers</li> <li>• Implementation measures</li> <li>• Coordination and obligations of provincial and district parties involved</li> <li>• Tea plantation scheme <sup>4</sup></li> <li>• Minimum price setup</li> <li>• Taxes and financial obligation of investor</li> <li>• Worker and personnel management</li> <li>• Scope of obligations</li> <li>• Dispute resolution mechanism</li> <li>• Termination of contract</li> <li>• Cooperation of parties involved</li> <li>• Environmental protection and management</li> <li>• Reporting and addressing issues</li> <li>• Transferring and authorisation</li> <li>• Contract effectiveness/duration</li> </ul> | <ul style="list-style-type: none"> <li>• Objectives</li> <li>• Specification of which tea farmers are to be supported by the investor</li> <li>• Responsibilities of tea producer group members</li> <li>• Responsibilities of tea producer group committee</li> <li>• Prohibitions for tea producer group members</li> <li>• Responsibilities of tea factory</li> <li>• Payment</li> <li>• Prohibitions and debt service for tea factory</li> <li>• Minimum price</li> <li>• Fresh tea leaf collection quantity and quality requirements</li> <li>• Dispute resolution mechanism</li> <li>• Contract effectiveness/duration</li> </ul> |

Source: Phongsaly PAFO, 2015.

<sup>4</sup> Managed by the company. Contracts between investors and the government often include a demonstration area where techniques can be shared with surrounding tea producers.

## Roles of actors involved in tea investments in Phongsaly

The Phongsaly case shows that the CF model can result in more stable arrangements than a monopsony concession for both investors and tea farmers in target villages through the improvement of production and processing capacity. In recent years, support from the COPE project has improved the structure and functioning of CF with tea producer groups in Phongsaly. The project facilitated the preparation of contracts with more detailed technical content and liaised with each party involved to organise meetings and facilitate the enforcement of contracts, especially subcontracts between tea investors and tea producer groups.<sup>5</sup>

Contracts between the district government and tea investors mention the responsibilities of the investor, tea farmers and provincial and district government offices. Although these contracts do not specify the role of each government office involved, overall monitoring and facilitation are the responsibility of PICO, PAFO, PFO, PONRE and district authorities. The contracts are witnessed by the Provincial Court under the Provincial Justice Office. The agreements also outline the role of village authorities, including their responsibility to: (a) guide tea farmers to enforce the sub-agreement between the investor and the village; (b) coordinate with the investor to address and solve problems; and (c) regularly report activities to the District Government Office. The key roles and responsibilities of each party are summarised in Table 4.



400-year-old tea trees in the Phunoy ethnic village of Ban Komaen in Phongsaly province, which according to some tea experts has some of the oldest tea trees in the world. The tea from this area benefits from the protection of a geographical indication. (Photo by Phouvieng Phongsy, Dreamstime.com)

<sup>5</sup> Note: Different projects have sought to provide such support, and COPE was able to facilitate the contract implementation alongside the BioTrade project (also under Helvetas) which has been supporting tea factories to link to other markets.

**Table 4: Specific roles of each party involved in tea investments in Phongsaly**

| Investor  | Tea farmers  | Provincial government   | District government  |
|---|--|---|--|
| <ul style="list-style-type: none"> <li>• Adherence to investment promotion and other related laws and decrees</li> <li>• Provision of technical support on tea production and processing</li> <li>• Social development contributions such as repairing of roads and schools in target villages</li> <li>• Free provision of tea seedlings for 3.3 ha/year<sup>6</sup></li> <li>• Collection of all fresh tea from target villages based on market price with cash payment</li> <li>• If breached, a fine of 50% of guaranteed price will be imposed</li> <li>• Building of tea processing factory with modern equipment and facilities</li> </ul> | <ul style="list-style-type: none"> <li>• Land preparation, planting and farm management</li> <li>• Adherence to technical guidance from investor</li> <li>• Prohibition from selling tea garden land</li> <li>• Prohibition from using chemical inputs</li> <li>• Sale of fresh tea leaves exclusively to the investor</li> <li>• If breached, a fine based on market price will be imposed</li> </ul> | <ul style="list-style-type: none"> <li>• PICO plays a key role in coordination, promotion, monitoring, evaluation and reporting</li> <li>• PAFO is responsible for guiding production, planting and farm management, and for allocating land with minimum negative impacts</li> <li>• PFO is responsible for tax and fee collection and may propose tax-free import of equipment based on investor's proposal before submission to PICO</li> <li>• PONRE monitors environmental impact and land issues for factories</li> </ul> | <ul style="list-style-type: none"> <li>• Has a contract with the investor, witnesses contracts between investors and farmers</li> <li>• Disseminates information to farmers on adhering to contracts and enforcement in the event of contract breach</li> <li>• Liaises with PAFO and PONRE to allocate land to farmers to increase plantation area</li> <li>• Supports dispute resolution and refers issues to PICO</li> <li>• Works with investors to set up subcontracts with tea farmers</li> <li>• Reports on the implementation of the agreement to Provincial Government Office / PICO</li> </ul> |

## Lessons learned

The Phongsaly case demonstrates the evolution of tea investments from trade concessions at the outset to increasing focus on collective representation of farmers in producer groups. It also shows models that incorporate contracts between local governments and investors who then subcontract producers. This evolution has tracked the growth of the sector where more investors have become involved, ultimately discouraging monopsonies and price suppression. This improves the viability of investments and supply–demand management within the value chain. Where markets are immature, it is important for local governments to have a proper understanding

of how trade concession agreements affect the development of the tea sector in terms of stifling competition and restricting growth. Before granting a concession contract, authorities should consider three elements: the types of wild and ancient tea resources available at the location; the production technology and marketing risks; and growth potential of the intended investment. By considering these three elements, local authorities can take a more strategic approach to the development of the local tea sector to reflect the business profile of the tea investors.

Today, the Phongsaly district government is promoting zoning for fresh leaf collection in parallel with a policy on open trading of high-quality tea from the Korman area. This has encouraged more

<sup>6</sup> The provision of thousands of seedlings imposes quite demanding requirements on investors, and also increases the risk of losing the investment if farmers do not sell back to them once the trees are mature.

investors to come to the district and could allow the scaling up of tea CF in the whole district as the market matures.

The process of contract establishment has also been streamlined, with improved local awareness on roles and obligations. In Phongsaly, contracts between the district governor and tea factories, witnessed by provincial offices, are a key pillar of tea investments. These underpin the subcontracts between tea factories and producer groups, the contents of which should be regularly discussed, including quality requirements for fresh tea leaves, minimum price and the need for timely cash payment. The government should continue to emphasise and enforce specific contract terms, including the obligations of tea factories to pay cash at the time of sale, with a 10% fine in cases of delays. There should also be enforcement of commitments by farmers not to sell tea outside of their contracts, with the possibility of a fine in cases of violation.

Tea farmers could better fulfil their obligations and secure more benefits from tea CF agreements through stronger group formation. Producer groups allow farmers to share issues regarding tea production technologies and market information and to enhance their negotiating power with tea investors. Groups also help to coordinate more closely with local government. Tea producer groups can also receive extra income from price premiums for both organic and Fairtrade certificates, incentivising them to adhere to contract obligations and conditions. At the same time, tea factories can benefit from stronger collective engagement with producer groups. For example, standardisation of quality and quantities can reduce risks from production and transaction costs for fresh leaf collection. It was also considered that monitoring and reporting by local government was improved through the existence of producer groups. In the evolution of the tea sector in Phongsaly, local government staff have built their capacity and the profile of Phongsaly tea has been raised in other export markets in addition to China.

Development projects have played an important role in the support of 2+3 tea CF arrangements in Phongsaly, from establishing producer groups and supporting marketing for tea factories, to facilitating contract preparation and implementation. Where producer groups are supported by projects to receive local and international organic and Fairtrade certifications, it is common for tea factories to have close

working relationships with the tea producers they buy from, as both see increased income through these certifications. Projects have provided support to establish links to high-end markets for rainy season tea, which in turn has helped reduce the oversupply of rainy season tea in producing villages. Again, extra income from premium prices in these cases goes to producer groups. However, a clear roadmap is needed for capacity building of local stakeholders to implement main contracts and subcontracts and to develop the tea value chain. This needs to include support for producer groups to develop internal control systems, quality standards, traceability systems, business networking and communication with international export markets.

## 3.2. PHOUSAN TEA

### Background and establishment of Phousan tea

The quality of teas from Xieng Khouang province – particularly Phousan tea – is very well known among Chinese tea traders. It is considered truly wild, natural and free from chemicals compared to teas from input intensive tea production systems in China. The tea resources for the sites considered in this study – Phousan Ngai (Oo'an area) and Phousan Noi (Yotpieng area) – include both wild and newly cultivated teas.

The establishment of tea investments in Phousan highlights the impacts of the lack of transparency in trade concession agreements, and the need for consultation with farmers when establishing contracts. In Phousan, an informal 2+3 tea CF model started around 2005 when two groups – the NGO Association to Support the Development of Peasant Societies (ASDPS) and organic and fairtrade group Lao Farmers' Products (LFP) – provided opportunities for several Oo'an farmers to learn tea production and processing techniques from Paksong, where the tea sector was more developed at that time. LFP then bought processed tea from Oo'an farmers who joined the tea producer group without formal contracts. When the tea was marketed via local and Chinese traders, several big Chinese investors showed interest in Phousan tea and submitted proposals for a trade concession. By 2021, a total of eight tea investors (mostly Chinese) had been granted land and trade concessions in Oo'an areas. The contracts aimed to secure exclusive collection of fresh tea leaves for the investors, and also linked some



investors to local tourism opportunities. These investors include GSM, Jingxing, Champakham and Phousan Ancient Tea Company.

As mentioned by LURAS (2021), these concessions fixed the prices paid to farmers for fresh tea leaves and Mao Cha, causing significant dissatisfaction amongst tea farmers. Producers complained that the company did not provide technical support or other benefits under the concession agreement, but more importantly, they also said that Champakham, for example, had bought only a small portion of the tea they produced. This may relate to the marked seasonal fluctuations in the value of tea based on market demand in China, with a strong preference for Chinese buyers to purchase the limited spring pick rather than the much larger quantity of tea that is harvested in the rainy season. With the company unwilling to buy as much as farmers could produce and the concession restricting sales to other buyers, pressure from tea farmers eventually led to revocation of the concession agreement. The local government called for a meeting to insist on adherence to the contract otherwise it would be voided. The concession was eventually terminated and replaced by an agreement with a new investor in 2018 (Phousan Xiengkhuang Ancient Tea Development Company).

Concession agreements are often not publicly available and cannot be openly scrutinised. However, it is widely thought that the agreements have not been effectively enforced and are not considered successful. Provincial and district government offices do not show the same understanding of the rights and obligations of parties under the concession agreements. As such, different parties may not adhere to certain parts of their contracts. Land and trade concessions approved by the provincial governor did not reflect consultation with tea farmers. Investors did not implement their contract obligations to provide inputs, offer technical support, construct tea processing factories and buy tea from producers. In turn, farmers did not sell to the concession-approved companies.

In recent years, many farmers have built close links with Chinese traders who sometimes provide financial and technical support in setting up tea processing factories/units. Since 2018, Phousan tea producers and groups have regularly been able to pick and sell their tea through both the dry and rainy seasons. This situation results from a market-led value chain approach in the context of an inefficient concession, and is uncommon in other production zones of northern Lao PDR.



A tea farmer picking tea leaves from her garden in Phongsaly province (Photo: Alberto Buzzola/LightRocket via Getty Images)

Some associations and projects have left the Oo'an area following the provincial governor's approval of concessions to Chinese investors. Under these concessions, investors will collect wild tea resources, promote tea plantation through a 2+3 CF model and establish tea processing factories. De Ligne (2015) reports that Phousan tea was originally supported for organic certification and promoted by Oxfam Solidarity Belgium but the project stopped after a concession made to Chinese companies stipulated that they had an exclusive right to purchase all Phousan tea. Other projects were also of the opinion that there should not be land and trade concessions, particularly where this has caused disagreement with smallholder tea producers. With the revocation of the concession agreement, an influx of new buyers drove up demand and prices, triggering widespread conversion to tea gardens which raised a new set of concerns around sustainability and management of resources and forests.

Yotpieng, in contrast, is located in another area of Phousan and has not been included in the concession scheme. Supporting actors (including projects such as ASDPS, LURAS and The Agro-Biodiversity Initiative) have worked with communities to apply a tea value chain development approach, and have made significant progress in supporting production improvements and domestic market linkages. However, no formal tea CF or purchase agreement has been signed between traders and producer groups in Yotpieng, despite significant assistance and the high level of interest that local traders have shown in fresh and processed teas from the area. This may be due to a combination of differential access to highly valued wild tea resources and local preferences regarding engagement in collective producer groups.

Though production data may be unreliable, Xieng Khouang PAFO reports a total of more than 300,000 large wild and ancient tea trees in four main tea production villages in Phousan, including Oo'an, Ta, Yotpieng and Phoon. DOA (2021) statistics reported that the area planted for tea production in Phousan in 2020 was about 604 ha and annual production was about 977 tons. If the figures are correct, a total of about 200 tons of dry tea could be produced from the area. Only about 20% of processed tea is

consumed through local markets and there is high potential for more efficient market-led tea value chain development in Phousan.

Between 2019 and 2022, the price for Phousan spring picks has been stable – the farm gate price for fresh leaves typically ranged from 25,000 to 50,000 kip (US\$2.27–US\$4.55) per kg, with some wild teas selling for up to 100,000–120,000 kip (US\$9.09–US\$10.91) per kg if certified for quality by a tea master. During the three months of spring pick, farmers could either sell fresh leaves at these prices or process them into Mao Cha and sell dry tea to local or Chinese traders at about 200,000–250,000 kip (US\$18.18–US\$22.73) per kg in Phousan Ngai or about 120,000–150,000 kip (US\$10.91–US\$13.64) per kg in Phousan Noi.<sup>7</sup> However, deforestation and destruction of wild tea trees has emerged as a problem in Phousan Ngai and closer monitoring of wild tea resources by local governments is necessary – a responsibility that was not included in previous contracts.

## Roles of actors involved in tea investments in Phousan

In the past, concession agreements granted to tea investors were not transparent and did not include detailed roles and responsibilities for parties involved. Agreements only described the economic conditions and potential for tea investors. One such example could be the concession agreement granted by the provincial governor to Champakham<sup>8</sup> in Xieng Khuang in 2014 which gave the investor exclusive rights to tea produced in the main Phousan tea producing villages. Although the company set up a factory and began processing, their business has not been actively operating in compliance with the proposal that was submitted.

At the time of writing, some farmers are also acting as processors and have set up small processing units in Phousan. Local and Chinese investors are operating processing factories in Oo'an village where tea is plentiful and of good quality. In 2021, a total of 11 tea processing factories and units were operating in Oo'an village. The number continues to rise and household processing has also become increasingly common. In all cases, the processing is overseen by Chinese tea experts.

<sup>7</sup> Exchange rates in December 2021 (US\$1 = 11,000 kip).

<sup>8</sup> The company was also granted a similar land and trade concession agreement in Xaysathan in Xayaburi province, with the same contract contents and implementation approach.

Based on the agreement currently granted to Phousan Xiengkhuang Ancient Tea Development Company, local farmer-processors can buy fresh leaves from other farmers in the village and process them into dry tea but are not allowed to work with other, non-registered Chinese traders. Despite this, local processors always have strong links to Chinese traders (non-registered intermediaries) who provide processing equipment, invest in processing locations and purchase fresh leaves in cash. It is not clear what the profit-sharing arrangement is between the local processors and Chinese intermediary traders. However, the local processors receive an agreed commission per kg of dry tea processed. Within such informal trade relationships, local processors manage all fresh leaf collection, processing and export documentation required from DAFO and DICO and receive about 5,000 kip per kg of dry tea. The local processors are not able to export processed tea independently, however, which is restricted to Chinese commercial entities only.

Other local smallholder producers process tea based on market demand. These local processors have relationships with different Chinese traders who purchase tea on a spot market basis. The producers process *Mao Cha* during spring pick without contracts and with no obligation to sell to particular traders. They also have capacity to process green tea which they sell in the local market during the rainy season. An informal, hand-written *Mao Cha* collection contract between one local intermediary and a

tea producer group in Phousan stipulated that *“the trader agrees to buy 3 tons of processed Mao Cha at 150,000 kip/kg for wild and ancient tea, and at 120,000 kip/kg for new cultivated tea between March 11th and May 30th. The next steps will be further discussed. However, the trader agrees to buy processed tea year round with a deposit of 10 million kip as a guarantee”*. The contract was signed by the local trader and head of the tea producer group with four other group members as witnesses. All members in the group had joined the contract discussion and agreed to the deal.

By November 2021, the trader had collected two 3.5-ton batches of tea at the agreed price, but another 6.5 tons of processed tea had not been collected. According to the producer group, the trader was still in contact but had to wait for a signal from the end-market buyer in China that demand was increasing before he could buy more. The interruption was likely because of the COVID-19 pandemic, preventing Chinese experts from assessing the spring pick prior to purchase. The tea producer group could not resolve the issue under the contract and had difficulties selling their tea as the local market in Xieng Khouang is very small, despite project support for storage until sales could be secured. Tea producers were reportedly unable to turn to local government for support as the contract was not properly signed and witnessed by a third party.

**Table 5: Main contents of concession agreements for tea in Phousan**

| Component                    | Description   |
|------------------------------|---|
| Activity                     | Concession for wild tea where the investor commits to promoting the tea plantation, establishing a tea processing factory and selling tea within domestic and export markets. Investors are also committed to supporting producers in a 2+3 CF arrangement.   |
| Investment period            | 30 years  |
| Main obligations of investor | <ul style="list-style-type: none"> <li>• Declare at least 20% of registered capital within 60 days after the date of approval</li> <li>• Adhere to a technical feasibility study report (#4)</li> <li>• Contribute 80 million kip per year for local social development (#6)</li> <li>• Provide an investor deposit of US\$30,000 within 60 days after the date of approval. The company can get the deposit back only after implementing the agreed conditions endorsed by relevant provincial government offices. If conditions of the agreement are not met, the deposit will be confiscated by government (#8)</li> <li>• Adhere to relevant fees, tax regulations and other policies.</li> </ul> |

## Lessons learned

In response to booming demand, Phousan teas have attracted many investors, particularly from China. The wild tea resources in Phousan provide strong potential for further growth of the tea sector in this area. Earlier support from non-market actors such as ASDPS/LFP, LURAS and The Agro-Biodiversity Initiative encouraged farmers with the potential income opportunities from existing wild tea already available in Phousan. Despite the initial influence of development project support, these non-market actors have encouraged value chain development through market-led approaches. Some tea farmers have adopted improved production and processing technologies, leading to more diversified tea products being produced in line with market demand.

However, due to limited understanding of the local government on how to develop the tea sector in Phousan, many trade concessions for tea investors approved by the provincial government have failed. Earlier concession approvals showed minimal involvement from local government, with unclear roles and obligations. Critically, the concession agreements lacked consultation with tea farmers as a core party in any smallholder-based model. In addition, comprehensive technical feasibility studies were not conducted prior to the approval of the tea concessions. This was clear from several angles:

- » (i) There were no assessments of investor profiles and understanding of their tea business proposals was limited.
- » (ii) Land for establishing demonstration and tea processing facilities was not studied well prior to granting the concession and suitable land could not be found for some factories.
- » (iii) Contracts did not include dispute resolution mechanisms for addressing instances in which investors did not fulfil their obligations.

In contrast to the weak performance of trade concessions, market-led tea value chains in Phousan have developed rapidly and continue to show strong growth potential and opportunities for smallholder producers to benefit. The downsides of rapid value chain development have been soaring competition and instances of conflict over ownership of tea resources and access to suitable land for tea production. It is important to note a key distinction between wild

tea and tea gardens – wild tea is a limited resource of high value at risk of overextraction, and tea gardens are a rapidly expanding monoculture cash crop. Based on the differential access to wild teas and land for tea gardens, flexibility is needed in the types of assistance provided by projects and local government agencies, as well as in the content of investment agreements or contracts. As reported by LURAS (2021), overinvestment in processing led to a land rush for tea gardens and caused damage to wild tea resources. Closer coordination among relevant government agencies is needed to ensure these impacts are addressed. A key challenge with such rapid development in a limited production area is efficient resource management. If this is not improved, the risks to long-term sustainable development of the tea sector in Phousan are high.

## 3.3. PAKSONG TEA

### Background and establishment of Paksong tea

Due to its agro-ecological advantages, Paksong in the Bolaven plateau region of Champasak province is considered one of the main ancient tea areas in Lao PDR with a history of over one hundred years of cultivation. Tea is the second most prevalent crop in Paksong after coffee. However, during the 1990s, tea production in Paksong decreased at around the same rate as coffee production expanded (De Ligne, 2015).

Paksong's tea sector benefits from its location on the Bolaven plateau with ancient tea resources and an optimal agro-ecological environment to produce good quality tea. Tea farmers have been supported to improve tea production and processing and have received international certifications. Farmers have developed awareness and experience on how to produce collectively to high standards for export markets in Europe, which has also incentivised tea traders and investors to work with smallholder producers.

In the late 2000s, Paksong tea was supported by ASDPS/LFP and linked to European markets. However, market demand dropped after tests of one shipment of certified organic tea to Germany in 2009 identified chemical compounds above the maximum residue level. Today there is a diverse range of tea garden models in Paksong, including smallholder producers, producer groups and large tea agribusinesses such as those of Dao Coffee, Sinouk Coffee and Three Six Manor.

By 2020, Paksong as a whole had a total of 458 ha under cultivation for tea with an annual production capacity of about 200 tons of dry tea. A total of 87 villages cultivate tea and have been involved in initiatives to achieve GI certification, although follow-up marketing support has been limited.

The Paksong Farmer Organic Tea Production Group (FOTPG) has 136 members cultivating 107 ha of tea, spread over 10 villages in Paksong district (De Ligne, 2015). Most of the members are smallholder farmers who own less than 1 ha of ancient and new cultivated teas, including plots where tea plants are grown in combination with coffee and other plants. Overall, the tea gardens were reportedly not well managed as there was not enough demand. The members delivered tea to a small processing unit which was established in 2013 with support from ASDPS and Oxfam Solidarity Belgium and owned by the producer group.

In recent years, the Lao Three Six Manor Trade Export-Import SOLE Co., Ltd (Three Six Manor) has invested in the tea sector in Paksong through establishing a plantation, purchasing fresh tea from a tea producer group covering many local smallholder plantations, and processing and marketing the tea products. The company hires about 50 local labourers during peak production periods. The company also purchases fresh tea leaves from other smallholder producers outside of the formal purchase contract.

There are reports of other informal processed tea purchase contracts between spot traders and smallholder tea producers or groups who manage their own tea gardens, process the tea and supply finished teas to intermediaries.

In 2020, Paksong tea was issued with an official GI certificate via the international accreditation body with the support of donor-funded projects and the Paksong Tea Promotion Association was established. Although the GI process requires clear networking and traceability between tea investors and producers, the enforcement of such regulations and requirements has not yet been verified as the GI for tea is new for the tea sector in Paksong. To date, the GI scheme involves a total of just over 54 ha owned by 106 tea producers and processors in 87 villages.

## Roles of actors involved in tea investments in Paksong

During the early 2010s, producers in Paksong started delivering fresh leaves to a tea processing unit to be processed for FOTPG. Twice a year, LFP would order processed tea to be packed and marketed in Vientiane and then exported. However, demand from LFP was very low and the production capacity of Paksong FOTPG resulted in excess supply.

Other supporting actors and organisations are also involved in promoting Paksong tea, including the GI-affiliated Paksong Tea Promotion Association. Lao GI, Lao Organic and Made in Lao PDR brands are registered under the Intellectual Property Department of MoIC, although results from these efforts are limited to date. The role of ASDPS is now mainly to support tea farmer groups, with a focus on sustainable production in collaboration with PAFO/DAFO.

Other traders operating and trading Paksong tea include Dao Coffee, Sinouk Coffee, LFP, Lao Tea Mountain, Kinnari, Rakkasan Tea, Amazon, Curious Tea, Epizy and E-tu Tea Bolaven Plateau Group.



**A woman is steaming tea leaves in a home factory in the Bolaven plateau in Paksong. (Photo by Tuayai, Dreamstime.com)**

In general, tea farmers are involved in three types of value chain in Paksong:

- » (i) Tea farmers cultivate tea, collect the leaves, process and sell independently. They manage the whole process without any contracts and sell primarily through wholesale or retail in local spot markets.
- » (ii) Tea farmers supply processed tea under informal advance purchase agreements to traders who distribute tea through different outlets to both domestic and export markets, again with no formal contracts reported.
- » (iii) Farmers produce and supply fresh tea leaves for processors who operate factories, again with no formal contracts between the tea factories and farmers.

Interviews with tea producers in Paksong indicated that tea is less prevalent and less important economically than other crops, particularly coffee and cassava. However, farmers still preserve some tea gardens as they are ancient varieties and can be an additional source of income for smallholder farmers.

PAFO/DAFO normally work in close collaboration with tea producer groups and development projects in Paksong, and also promote organic production of coffee, tea and vegetables through the provision of technical extension. Tea traders consult PICO/DICO when they have queries about accessing funds for small and medium-sized enterprises, marketing or applying for the government's One District One Product program. As per the normal investment process, PPI/DPI is also involved in the application and approval process for tea investments.



**Green tea as the end product after processing in Meung Tea Producers Cooperative in Bokeo province**  
(Photo: Arnaud Vontobel, Gret)

## Lessons learned

The development of Paksong tea stands apart from the other cases as there is no concession system and it is based entirely on a market-led value chain approach. Market access and information is relatively free and transparent in Paksong, with no reports of trade concessions in which a single tea investor controls the market for an area.

Unlike northern provinces, where tea value chains mostly rely on the Chinese market, the Paksong tea sector has built market linkages with Europe and the United States, highlighting niche products through certification initiatives. Paksong farmers produce diversified varieties. A range of traders and investors are currently operating in Paksong, often with a combination of tea, coffee and other crops.

Lessons learned from other sectors and support from development projects have played a key role in providing technical facilitation to local government and preventing the monopsony concessions seen in other provinces. Above all, the experiences of the coffee sector have been especially valuable for tea sector actors in Paksong, with comparatively open competition and lack of exclusionary trade concessions encouraging many buyers and business actors to invest.

While demand for niche, high-end products is normally limited, some key tea agribusinesses have been able to set up market linkages. These groups have faced concerns in terms of both the oversupply of tea in Paksong and the question of how producer groups or farmers can cover the cost of international certifications. Other tea producing provinces could share lessons from certification efforts. Experience with a COPE project in Phongsaly shows that both producer groups and tea investors need technical and financial support at the early stages of applying for certification. The project set a clear schedule for tapering off financial support after the first year of accreditation, with reductions to 75%, 50% and 25% financial support in years 3, 4 and 5 respectively. This strategic drawdown of funding can help producer groups to build commercial self-sufficiency to be sustainable beyond the life of the project. At the same time, local government facilitation of production agreements between tea investors and producers could underpin value chain development in the absence of project support. However, the impact of this could be limited if such agreements remain informal.

## 4. CONCLUSIONS

### Strengths and weaknesses of the different approaches

The Lao tea sector has significant potential to support smallholder livelihoods in remote uplands where conditions are often better suited to tea than many other crops. Wild and ancient tea resources of high quality also offer opportunities for developing the tea sector. The possibility that income from tea may reduce poverty in these areas is also of interest to local governments and development projects. However, as this study has shown, achieving the full potential of the sector depends on supporting market-led value chain development, collective engagement of smallholders through producer groups, and opportunities for Lao producers to engage in both higher value-added processing and exports. Supporting these outcomes while also encouraging the productive and profitable engagement of investors to foster the overall growth of the sector requires carefully targeted policies that benefit companies, traders, processors and producers.

The pattern of granting exclusive rights to a single investor through trade concessions has proven unsuccessful in both the Phongsaly and Phousan cases. Although such concession arrangements generate revenues for investors and local governments, the contract parties rarely fully

implement the agreement or fulfil obligations. These exclusive purchase arrangements only function where markets and the sector as a whole are immature, by opening the door for early adopter investors in settings where there are no functional market linkages. Beyond this nascent stage, they soon constrain market competition and prevent farmers from receiving true market prices. There are obvious motivations to maintain this among some investors, but farmers and the wider value chain stand to benefit when they are free to choose who they sell to.

At the same time, while there are major opportunities for the Lao tea sector to expand, there are also significant risks if resources are not carefully managed. A key distinction is between wild teas and tea gardens – wild tea is a limited resource of high value at risk of overextraction; tea gardens are an expanding monoculture cash crop driving rapid changes in land use in locations such as Phousan. In addition to management of resources, producers need an enabling policy environment and extension support to meet product standards and export conditions for high-end markets. This would require stable market linkages with exporters as well as the ability for producers to export in their own right, including to China. Advantages and disadvantages of the three cases are summarised in Table 6.



Grading young tea leaves in Ban Cha Phou, Phongsaly province. (Photo by Tessa Bunney, In Pictures Ltd./Corbis via Getty Images)

**Table 6: Summary of advantages and disadvantages of the three investment case studies**

|               | Phongsaly  | Phouan  | Paksong   |
|---------------|--|---|---|
| Advantages    | <ul style="list-style-type: none"> <li>Local government supports tea sector development based on the evolution of the market</li> <li>Close coordination among local government offices to establish contracts</li> <li>Strong support from tea development projects through value chain approaches</li> <li>Producers get additional income from premium prices through certifications (organic, Fairtrade and GI), incentivising them to fulfil contract obligations</li> <li>Good lessons learned from 2+3 CF model for other crops, such as sugarcane and rubber</li> </ul>            | <ul style="list-style-type: none"> <li>Local government gains annual revenues from concession fees</li> <li>Local government opens opportunities for producer groups and local processors to operate tea businesses in parallel with concession agreements</li> <li>Potential for further development of processing groups, tea enterprises, joint ventures etc.</li> </ul>   | <ul style="list-style-type: none"> <li>Local government facilitates market-led tea development approaches but does not directly intervene</li> <li>Multiple forms of investment including land lease and informal purchase agreements led by large tea investors, producer groups and tea associations</li> <li>External support enhances producer groups' capacity and access to high-end markets</li> <li>Good lessons learned for market-led development from the coffee sector</li> </ul> |
| Disadvantages | <ul style="list-style-type: none"> <li>Trade concessions prevented market competition and depressed prices</li> <li>A long time was needed to alter the model by building local government capacity to facilitate 2+3 CF with concession arrangements</li> <li>Unclear sustainability of 2+3 CF schemes without project support; investors and farmers may be less efficient in fulfilling 2+3 CF obligations without stronger government monitoring</li> <li>High reliance on Chinese markets increases risks for both investors and farmers, particularly during rainy season</li> </ul> | <ul style="list-style-type: none"> <li>Concession with exclusive rights granted to a tea investor without local consultations proved problematic</li> <li>Market-led approaches, while leading to beneficial outcomes for the sector overall, have increased competitive pressures over resources and land</li> <li>Close monitoring, facilitation and regulation is needed by multiple government offices, particularly on resource management</li> <li>Producers face high risks without stable market linkages to absorb all supply</li> </ul> | <ul style="list-style-type: none"> <li>Local government may have a reduced role in developing the tea sector</li> <li>Smallholders have gained experience in producing quality tea for high-end markets, but continue to depend to some extent on external support</li> <li>Strong market promotion is needed to link farmers to stable markets, prevent oversupply and discourage replacement of tea by other crops</li> </ul>   |



## Policy recommendations

Based on the above findings, this research suggests the following policy options for improving investments in the Lao tea sector.

Contracts and agreements:

- Trade concessions are only appropriate at the early stages of market development, beyond which they constrain competition and provide poor outcomes for farmers. Such concessions should be discouraged in general but where they exist could have a phased conversion towards more smallholder-inclusive models, including CF.
  - Agreements between district governments and tea investors – and between the investors and producer groups that supply them – should be witnessed by provincial authorities. Agreements should be transparent, publicly accessible, accepted by all parties, and regularly consulted and updated if necessary.
  - Local governments need a full understanding of the issues caused by trade concessions in the tea sector. Clear technical feasibility studies are required in consultation with all stakeholders.
  - Risks for smallholders can be reduced with an appropriate process of free, prior and informed consent as well as requirements for technical support to help them overcome production risks.
  - As with all forms of contract or investment agreement, concerned stakeholders need a clear breakdown of their roles, responsibilities and obligations. All agreement conditions should be appropriately monitored and enforced by local authorities.
  - Market demand and price information need to be more clearly communicated across the value chain as lack of information constrains the ability of farmers and local processors to adapt to changes. This is particularly risky for indebted farmers who may be compelled to sell their production regardless of downstream market conditions.
  - An accessible, independent dispute resolution mechanism can help contract parties to raise concerns about contract conditions and ensure redress in instances of wrongdoing. Issues include minimum pricing, payments, sale period, side-selling, production and picking quality, and provision of inputs by tea investors.
- Wild and ancient tea resources are at risk of overextraction while planting of commercial varieties can lead to rapid expansion of monocultures. A multisectoral approach is needed to find the balance, and efficient management of resources could be specified in contracts.

Tea value chain development:

- Emphasis should be placed on market-led tea value chain development with minimal local government intervention. At the same time, external support is needed to manage the expansion of production, and access export opportunities for high-value markets.
- A market-led approach requires a clear roadmap for how external actors plan to help develop the tea value chain. Support from service providers in the early stages is crucial for producers and traders in terms of trade facilitation, technical extension to achieve product standards, certification and traceability systems.
- Support for value chain development from non-market actors should recognise and plan for the sustainability of the model once project or policy supports cease. Any initiative should build in an approach to ensure farmers and processors are able to respond to competitive pressures.
- Ensuring farmers profit more from engaging in tea value chains is a priority. This can only happen by increasing the value-addition undertaken by Lao producers within Laos so that communities capture more of the gains currently extracted by downstream actors.
- Lao commercial entities still face major barriers to independently export to China. This presents an obstacle to the development and autonomy of Lao-owned and operated tea production and processing. Bilateral agreements which require exports to be under contract with a Chinese company should be revised to support domestic producers and exporters.

# ANNEX

## List of stakeholder interviews

| Stakeholder type | Location   | Position and organisation                          |
|------------------|------------|--|
| Government       | Phongsaly  | Head of Phongsaly PFO/ Former Deputy Head of PPI   |
| Government       | Phongsaly  | Deputy Head of Phongsaly PAFO                      |
| Government       | Phongsaly  | Head of Agriculture Division Phongsaly PAFO        |
| Trader           | Phongsaly  | Tea producer and processor                         |
| Project          | Phongsaly  | COPE project staff                                 |
| Farmer           | Phongsaly  | Head of producer group – Phayasy                   |
| Farmer           | Phongsaly  | Head of producer group – Khounsoukluang            |
| Project          | Phongsaly  | COPE project manager                               |
| Farmer           | Phongsaly  | Tea producers in Sailom village                    |
| Trader           | Phongsaly  | Phayasy tea factory                                |
| Trader           | Phongsaly  | Phayasy tea factory                                |
| Government       | Phongsaly  | Extension staff, Phongsaly PAFO                    |
| Government       | Phongsaly  | Deputy Head of Phongsaly PICO                      |
| Government       | Bounneua   | Head of Bounneua DAFO                              |
| Government       | Bounneua   | Agricultural Staff, Bouneua DAFO                   |
| Farmer           | Phousan    | Tea producer and processor                         |
| Farmer           | Phousan    | Tea producer                                       |
| Project          | Phousan    | LURAS project staff                                |
| Government       | Phousan    | Head of Peak DAFO                                  |
| Farmer           | Phousan    | Tea producer and processor                         |
| Farmer           | Phousan    | Head of tea producer group - Yotpieng              |
| Government       | Champasack | Head of provincial governor's office               |
| Government       | Champasack | Deputy Head of Champasack PICO                     |
| Trader           | Champasack | Manager of 36 Manor Company                        |
| Trader           | Champasack | Paksong Tea Promotion Association Committee        |
| Trader           | Vientiane  | Thirty Six Manor Company Staff                     |
| Trader           | Vientiane  | Former Deputy Manager of Lao Farmers Product       |
| Government       | Vientiane  | Deputy Head of Standard Division, DOA              |
| Government       | Vientiane  | GI Technician, Department of Intellectual Property |
| Project          | Vientiane  | Helvetas project manager                           |

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Most tea in Laos is produced by smallholder farmers, who benefit from highly suitable growing conditions and strong demand for sought-after varieties from the vast Chinese market. However, the sector faces many challenges to achieve its full potential. A key barrier in the northern provinces has been the tendency towards monopsony trade concessions, in which the production of a whole district can be under exclusive control of one buyer. Such arrangements were initially beneficial to catalyse investment in an immature market, but have ultimately stifled competition and held back value chain development. Although contract farming has improved the livelihood benefits for tea growers in some locations, there are still challenges to ensure clear definitions, rights and obligations among the parties. Moreover, the limited processing that takes place in Laos, and the inability of domestic enterprises to export in their own right, mean that smallholders gain a modest share of profits compared to downstream actors. This study compares different investment models and their outcomes for farmers and investors in the Lao tea sector. The comparison of trade concessions and contract farming offers valuable policy insights for governing more responsible agricultural investments in Laos.

The **Mekong Region Land Governance Project** (MRLG) and its alliance members work together to protect the tenure rights of smallholder farmers in the Mekong Region and has been operating in Cambodia, Laos, Myanmar and Vietnam since April 2014.

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