

## Internal Report - final

### China and its Influence on the Swiss Development Cooperation in the Mekong Region

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#### Focus China

The mandate commissioned by SDC to prepare an overview of the influence of neighbouring countries, in particular China, on the development of the Lao PDR has been addressed in the short paper "Analysis of Investments of China and other Neighbouring Countries and their Influence on the Development Context in Laos" (Sommer, 2010).

The present, more in-depth second step of the same study will emphasize on the Chinese influence in particular as this is seen as *the* major factor of change in the country and the Mekong region.

#### Self-confident, Power conscious, Proactive

"Adopt a low profile and never take the lead" advised Deng Xiaoping when he was leading the country. Within less than a decade, China has transformed its foreign policy attitude from a reticent, reactive and ideology-driven observer on most international arenas towards that of a self-confident, proactive and increasingly power conscious driver of change. Gone are the days in which Chinese delegations in multilateral events found it difficult to articulate their points due to lack of delegate authority, inadequate comprehension of complex global issues or language constraints.

In terms of economic scale, China is today the second largest economy next to the US and may soon graduate to become the biggest market place in the world (Belfast Telegraph, 16 Feb. 2010). More, it sits already on the

biggest foreign currency reserves worldwide with over 2 trillion US\$. This wealth translates into an active wave of discrete asset purchases around the globe today, which provides the foundation for future more broad-based economic stability beyond trade in consumer goods and mass commodities. Economically, China seeks a balanced relationship with the US as both countries are dependent on one another.

#### Chinas Role and Policy Priorities in the Global Arena

China could be seen as a smart winner of globalisation. The country has been lifting hundreds of millions of its citizens out of material poverty. Accelerate economic growth has also been used intelligently to internationalise relations, penetrate foreign markets and participate in the multilateral system. The country has benefited from an emerging shift of the global balance of powers since 1989, the economic progress in many G77 countries such as Brazil, South Africa, Mexico, India, Indonesia, Thailand or Korea and the progressive decline of western hegemony due to demographic developments and market shifts.

In recent years, China's economic relations with developing countries have been expanding rapidly. China drives forward a **new foreign policy** of active networking and enhanced bilateral relations to broaden its influence much beyond its multilateral engagement. President Hu Jintao declared the principles of Chinese foreign policy in late 2009 including "the joint and harmonious development of the world, shared

responsibilities with all states and vigorous involvement in world affairs” (McCauley, 2009). This policy has several distinct features which are most relevant for future development cooperation:

- Promotion of stability and peace (the world shall perceive China as a non-threatening but influential partner)
- Enhancing the export markets (Chinese manufacturing industries and service sectors are increasingly competitive)
- Energy security (economic and demographic growth require secured and sustainable energy supply systems)
- Access to the natural resource base abroad (by FDI and Government cooperation) to feed domestic markets
- Strengthen and reorient the historic relationships to 3<sup>rd</sup> world developing countries from aid provider to trade partner, investor, technology supplier, provider of credits and ODA as well as a political friend (principle of political non-interference).

China has massively beefed up the participation in international bodies since the turn of the century to make itself heard and co-shape reforms. It is today an increasingly active member in the UN (Security Council; vocal spokesperson for the South; supporter of the MDGs; provider of peacekeeping forces for UN operations in Africa). China continues to represent with its size and power the over 130 nations regrouped in the G77 (although other emerging economies increasingly take their own stance) and it sits in the G20 as a major barometer for the voice of many poorer nations but with greatest future human and market potentials.

### **China as a Global Aid Provider**

Throughout decolonisation and during the cold war period, China has always been a discrete but politically targeted aid provider to communist and other nations to expand its socialist influence. Support however often remained at limited scale and exhausted in often non-productive prestige projects such as the erection of stadiums, monuments or

cultural halls. China did however not undertake such massive capacity building programmes comparable to those of the former USSR or East European Socialist countries. The Chinese approach to aid was seen as driven by ideological and geo-political self interest and less by seeking to strengthen capacities of other nations.

Today, China recognizes the shared responsibilities to support poorer countries beyond self interest. The **Chinese aid approach** during past years is a more sophisticated mix of different instruments, including bilateral and multilateral development assistance, foreign direct investment from public and private sources, the establishment of special economic zones in neighbouring countries, science and technology exchange and proactive diplomacy. Engagements are often characterized by several of these instruments in a package deal, the role and scale of each component being hidden behind broad “friendship cooperation agreements” published in diplomatic rhetoric.

The approaches employed by China abroad are often criticised as being intransparent and outside the established good practice standards of the international donor community (DAC), as being self-centred and promoting undue advantage to Chinese private investors, as overloading already weak administrative services of poor recipient countries, as adding to the debt burden of poor nations and, most of all, as being ignorant to good governance, democratic systems and a rights based approach. The impact of a superpower with opaque and repressive governance standards on aid dependent countries is feared to undermine efforts towards transparency and rule of law. The case of Cambodia: substantial aid from the US is now increasingly matched with Chinese assistance with no strings attached. As a consequence, the government is closing the space for alternative voices and independent institutions, western donors fear to lose their influence and increasingly hesitate to voice their concerns (Walker and Cook, 2010).

The flip side: Chinese aid is increasingly recognised as a major driver of change in some parts of the world, in particular Africa and South East Asia. Positive attributes include the growth stimulating effects, a level-headed approach in which recipients are considered equal partners rather than “underdeveloped and backward” by a country that has only recently graduated itself from poverty, bringing technology leaps even to marginal areas, enhancing south-south cooperation, emphasizing the human resource and capacity development and unleashing local market dynamics through hard work and role model projects.

Since 2001, China is also member of the WTO. In OECD/DAC, China maintains an observer position, together with India. Since 2008, China has more actively engaged in the China-DAC Study Group (OECD, 2009). Also the fact that China is a signatory to the Paris Declaration on aid effectiveness is a stark commitment towards more direct engagement with the western development community. This bears the potential that diverging Chinese development paradigms may be put under more public scrutiny and eventually new hybrid forms of development approaches could emerge from such a debate.

### **China’s Influence in South East Asia and the Mekong Region**

As for any country in the world, its immediate neighbourhood is of particular political relevance and economic importance in terms of cultural-linguistic affinities, social cross-border relations, trade and labour exchange, but also territorial claims and sharing of regional public issues.

China, by its sheer size and scale of market, may appear as an unstoppably dominant actor in the region. However, countries like India, Japan, but also Vietnam, Thailand and Korea are other significant powers which eventually contribute to a fragile regional power balance.

China’s declared foreign policy goal no. 1 is to contribute to regional stability and peace through cooperative forms of inter-state

relations. Hence market forces and multiple initiatives in the economic, scientific, cultural or sports domain are as important as the nurturing of brotherly relations to the communist parties in other countries. Aggressive power politics tending to interfere in neighbouring states’ internal affairs could not be observed for longer periods. Yet, the new website opened by the Vietnam government in late 2009 (Vietnam border correction website) in which over 20 disputed border areas are unilaterally “defined and mapped” is just one expression of many on-going territorial disputes in the region still simmering under the surface.

Some of the special features of China’s influence in the Mekong region include:

- Political stability with peer-support from the Chinese Communist Party to CPs in neighbouring countries in “good brotherhood spirit”;
- Pursuance though of obvious geo-strategic interests to secure access to the Indian ocean through multiple activities in Myanmar and the Andaman Sea, partly to the great concern of India;
- Active participation in regional bodies (ASEAN+3, Asian Free Trade Agreement negotiations, UNESCAP);
- China joined ADB in 1986 and was its 2<sup>nd</sup> most important client in 2008. High-level (PM Wen Jiabao) policy dialogue in the GMS Summit Platform 2008 to promote sustainable economic growth in the region.
- In 2005, PRC contributed \$30 million to the Asian Development Fund (ADF) and established the PRC Regional Cooperation and Poverty Reduction Fund, becoming the first developing member country to set up such a fund with an international development agency. In 2008, the PRC contributed \$35 million to the ADF.
- China however remains just a “dialogue partner” on more sensitive subjects such as international rivers (Mekong River Commission) or sanction politics over Myanmar and North Korea.
- Shared borders with Myanmar, Laos and Vietnam with strong cross-border

economic and social relations due to improved transport and communication infrastructure promoted and co-financed by China;

- Chinese border Provinces such as Yunnan and Guangzhi engage more directly across the borders into Laos and Myanmar than the Chinese central government which operates more on a Government-to-Government framework agreement level;
- Opening development gap between China and the Mekong countries which (except Vietnam) have not experienced such dramatic economic growth and transformation in recent years.

China's influence in the Mekong region is multi-faceted. While trade promotion and FDI in neighbouring countries to the PRC are the dominant and official factors to "drive forward the sustainable economic development and integration in the Mekong region", there are numerous flanking measures coming along with this such as a flourishing industry for land concessions, the establishment of behind-the-border development plans, easing of cross-border regulations to allow freer flow of goods, capital (China Exim-Bank) and labour, good neighbourly development assistance on regional issues such as drug substitution, research collaboration on subjects of commercial interest, the donations of Provincial administrative offices or cultural halls, the lease or purchase of large chunks of land reserves for undisclosed purposes or the negotiation of privileged investment conditions in special zones along the border.

Regarding the latter, China operates with an approach that was earlier employed by western countries within China itself (Tjanjin, Shenzhen, Macau and many harbour areas), the "**Special Economic Zones**" (SEZ). Such zones were established under special concessionary arrangements and are today erected by Chinese investors in the Mekong neighbouring countries. They do provide for investment, employment and propelling local markets, but they also tend to circumvent existing industrial, labour and environmental laws and regulations, provide for rapid and unscrupulous profit making by few influential

investors and in some cases, even the territorial sovereignty of the land under lease is being threatened.

### China's Influence on the Lao PDR

The case of "Golden Boten City" in Northern Laos is exemplary in this regard. In 2004, the investment company Fu-Khing has been granted lease of 4000 acres of land over 30 years for a lumpsum of U\$ 7.5 m to build a number of hotel-casinos, golf course, entertainment industry, staff dormitories and apartments for service providers (Nyiri, 2009). Along with it came Chinese security personnel, building contractors and business operators. The place today is linked to Chinese telecom and internet provider systems, has Chinese time (one hour ahead of Laos) and it even introduced special vehicle number plates. The provincial authorities in Luang Namtha in



Fig. 1: Chinese Security in Boten SEZ

which the SEZ is located expressed serious concern over the way in which this investment is evolving. While only minimal benefits accrue for the local population through the provision of agricultural goods and small services, the place is said to have attracted all forms of shady business around drugs, arms trading, prostitution, human trafficking and trading wildlife. Trafficking is considered to be economically more attractive than all other forms of illegal businesses cumulated (Feingold, 2000). Drug shipments along the Mekong in the Golden Triangle in Bokeo Province see a new boost with violent incidents between militias from across the border and Lao and Chinese security forces. A new 4-star, 698-room hotel and casino complex is being completed for over 300 m \$

by the Kings Romans Group Co Ltd in Tonpheung District in Bokeo Province (Asia Times online, 7 April 2009). Growing crime rates, the eroding sovereignty over these SEZ and emerging resentments against the Chinese are of concern to the authorities who consider temporary closure to recapture control over the basic functions in this SEZ (personal communication to SDC, March 2010).

China, in its own best interest, has extended assistance to the Lao government to **substitute opium cultivation** aligned to other international initiatives across the Mekong region. In Luang Namtha however, this poppy substitution program is said to have been a rather covered up operation which had resulted in accelerate extraction of timber, exploration of mineral deposits and land suitable for rubber investments, even in the trafficking of women according to knowledgeable local sources.

In general however, **living standards** of the people along the Lao-Chinese border in Luang Namtha Province are relatively better than for most of the population interior (UNDP, 2006). Better housing, higher participation in education, more secure drinking water systems and the possession of assets (vehicles, agricultural tools, animals, durable goods), although this is true mostly for the villages well connected. The proximity of the border provides for high demand for agricultural produce on Chinese markets, traders even penetrate the Province in search for wood and timber, organic vegetables, fish, clean poultry, pork, medical herbs and other good in high demand. In protection from over-exploitation of the fragile resource base, some

villages have meanwhile resorted to strict penalties for unsustainable fishing, and the Provincial authorities have declared a temporary freeze on land concessions for rubber plantations due to the lack of an enforceable FDI policy and regulatory framework and foreseeable labour shortages when plantations turn productive.

The **Northern Plan** (Shi, 2009), a development strategy prepared by the Yunnan Authorities, foresees the investment of billions of \$ over the next 10 years along the northern border to Laos and within Laos to improve infrastructure (roads, transport, energy), propel sustainable and advanced technology driven economic development in selected key “backbone” industries (mining, agroindustry), pave the way for large scale tourism and reduce poverty in these Provinces. The plan proposes the establishment of further SEZ, but it also includes investments into health and education. Although the implementation of the plan considers diverse funding including international donors, first investments have already been initiated by expanding and modernising airports in Luang Prabang, Udomxai and Luang Namtha (completed), simplifying the cross border trade formalities in Luang Namtha and fielding identification missions into northern Laos to explore mineral deposits and hydropower potentials.

“Laos is simply too small for China to take a more direct political influence. In terms of a natural resource base and a transit country to Thailand and other ASEAN countries however, Laos is important for China” (Schuhbeck and Goldnick, 2010). The **German Technical Cooperation GTZ**, through its Rural Development Program in Mountainous Areas in the Luang Namtha Province of the Lao PDR, is addressing the FDI dynamics by seeking direct engagement with investors, a.o. to introduce more sustainable approaches along the entire value chain in the rubber sector. Innovations such as the capacity strengthening of the Administration as a regulator, land use planning, model contracts considering a fair profit sharing between investor and villagers or the promotion of sector-specific China-Lao research



Fig. 2: Fishing Regulations Nalae District

collaboration appear to be effective ways to engage with Chinese developers to help mitigate on negative social or environmental impacts



Fig. 3: Sino-Lao Research Centre Muong Sing

China’s aid flows to the Lao PDR however go **well beyond the northern border provinces** and include prestige buildings in the capital Vientiane such as the Lao National Cultural Hall, the Central Avenue Lane Xang, the Victory Arch Patuxay, the Sino-Lao Friendship Hospital in Luang Prabang and many other investments (Mekong Press). Chinese investments in south Laos are best understood in the chapter on mining below. Even on the 5000 KIP note of the Lao currency, the Vang Vieng based Chinese cement factory is captured. From 1988 to 2000, Chinese aid to Laos totalled only 2% of all ODA to the country (Mekong Press). Since then, Chinese assistance was beefed up massively through public and private investments. Reliable figures are difficult to obtain and remain partly undisclosed. Competition with Japan as key donor to Laos is increasingly visible. While JICA invested in a Hospital facility in Vientiane, China responded the following year with a new hospital in Luang Prabang, likewise with the establishment of foreign language centres. “China is Laos’ most reliable elderly brother” (Mekong Press). Since 2005 the Government of China offers 55 scholarships for Lao nationals every year at the Yunnan University and has increased this number ever since.

The most **striking changes** today are taking place in the agriculture sector in Laos. An estimated 400’000 has of land have already been leased under long-term **concessions** to foreign rubber investors mainly from China, but also Vietnam mostly in southern Laos, to Japan, Korea, Thailand and Australia. The

Yunnan Natural Rubber Industrial Co. alone operates some 133’000 has today and foreign advisors in Vientiane are talking of “a mess in granting concessions”. While the government has acknowledged that land conflicts are rising as plantations encroach village fields and nearby forests, taking away traditional livelihoods with often no compensation, they have declared an indefinite moratorium on large concessions for mining and agriculture in May 2008.



Fig. 4: Rubber Plantation Nalae District

Soon thereafter however, the give away of land went on with some Provincial and District Governors exercising their powers to grant further concessions in a rather indiscriminate manner, claiming that plantations would reduce poverty and provide income to villagers and ethnic minorities. In most cases, such praised opportunities end up in cheap labour for international entrepreneurs.

Laos is still considered one of the countries with highest **biodiversity concentration and forest cover**. In 2007, a total of 14.9 m ha or about 63 % of total land area was under different forms of forest cover (6.6 m ha protection forest; 4.7 m ha conservation forest and 3.6 m ha production forests). The deforestation rate is counted at 78’000 ha/y. By 2005, a total loss of forests of 1’172’000 ha or 6.8% has been computed since 1990 (Rainforests, 2005). In 2005, there were 224’000 ha of forest plantations in the country (Lao PDR Department of Forests, 2007).

In terms of **water resources**, Laos is contributing up to 35% to the Mekong river waters. Increasingly frequent droughts and occasional years of severe flooding are cause for concern. Citizens as well as Governments

in the Mekong region are blaming the Chinese for having modified the river flow patterns by the erection of dams upstream. The Mekong River Commission (MRC) however claimed in 2004 that there is little evidence from the last 45 years of data of any systematic changes in the hydrological regime of the Mekong. The upstream dams are rather the likely cause for positive change in dry season flow. The barrages block the wet season flow to fill the reservoirs, but in the dry season water stored in the reservoirs is released gradually to produce electrical power and water for irrigation. This increases the discharge in the dry season. Concerns of downstream countries however persist, all the more since China wants to construct even more reservoirs to cope with future water shortages affecting millions in south-west China (Financial Times, 31 March 2010).

The third resource dependent sector is **mining**. Numerous deposits of lignite, gold, copper, iron ores, bauxite and other minerals have been identified and are currently in the process of exploitation. As of 2008, 181 mining concessions had been awarded to 118 companies. At that time, the two biggest foreign investors were the Sepone copper and gold mines in Savannakhet, and the Phou Bia gold mines in Vientiane province, both Australian investors. The latest even bigger project is a bauxite and aluminium mining investment in southern Laos, a 2,000 million-dollar undertaking by Chinese companies (Baccam, 2008). So far the mining concessions granted to international investors cover an estimated area of 330'000 ha. The link below [http://cfdt52x.googlepages.com/South\\_Laos\\_Mineral\\_2007.pdf](http://cfdt52x.googlepages.com/South_Laos_Mineral_2007.pdf) provides an already somewhat outdated spatial impression of the magnitude of coverage of these concessions for southern Laos.

The total area leased under different forms of concessions over the past 10 years amounts to an estimated 2-3 m ha (GTZ, 2009).

#### Some Key Features of China in the Lao PDR

- China was minor investor before 2000 (ODA share only 2%), today no.2 in FDI
- Data on foreign workers in Laos are unreliable. The Asian Migration Centre reported in 2002 an estimated 80'000 Chinese migrant workers in Laos;
- Massive recent investments in rubber, mining and other land intensive activities with an estimated total area coverage by all foreign concessionaries of near to 25% of the Lao territory to date (of which 1/3 China's share)
- China and other foreign investors promote development of up to 78 new hydropower schemes in Laos for energy exports to feed growing regional demand
- Deforestation rate in Laos is 78'000 ha/year, mainly linked to land conversion due to agribusiness and mining concessions
- Multiple Chinese capital investments in basic infrastructures (roads, bridges, airports, administrative buildings, hospitals, stadiums) and in Special Economic Zones e.g. in Boten and Tonpheung have been realized in recent years
- The "Northern Plan" designed by the Yunnan Province to develop northern Laos is targeting by 2020 a.o.: more than 6000 km of new roads, 13'700 MW installed energy capacity, 150'000 ha new rubber and 100'000 jatropa and other biofuel plantations, 200'000 ha of paddy (Shi, 2009)

The above figures indicate that the natural resource sector in the Lao PDR has come under accelerate pressure since the turn of the century. Although some of these resources are renewable, the country is rapidly losing its natural capital and does in most cases not yield adequate returns for it. If not met with a deliberate policy to slow down extraction and diversify the economy towards less resource intensive investments, the gold rush will soon dry up with nothing in its place.

By late 2009, foreign companies from 37 countries are investing in Laos based on 1255 investment permits granted since 1988 over a total value of 11 bn \$ of which 35% in hydropower, 25% in mining and agriculture, 12% in service sector and the rest on other sectors (Al Jazeera, Sept. 2009). See also: Sommer, 2010.

In the past, the Lao PDR depended heavily on economic aid from countries like Japan, Sweden, France, Germany and Australia as well as that of the Worldbank, IMF, ADB and

the UN-System. A certain donor fatigue has set in as the Lao government resists the demand to fundamentally reform the country's legal, financial and political systems. China, on the other hand, provides aid to Laos without calling for major reforms that would weaken the Communist Party's control over the political and economic life.

Today, the fraternal **political feelings** towards China are still less than those with Vietnam. This is in the process of change however with the ageing of society and the "soft power" of China's extended formation of Lao cadres to manage transition from a command to a "socialist market economy" model (Jamestown, 2005). In March 2008 and again on 15<sup>th</sup> September 2009, China and the Lao PDR signed a comprehensive cooperation and friendship agreement covering economic development, technology exchange, energy and e-governance.



**Fig. 5: 2004 Sino-Lao Friendship Agreement**

**Some Key Lessons from the Analysis**

1. The global shift of power to the favour of Asia and China in particular is also reflected in a shift of the aid architecture. What grew over decades to become the OECD-rooted development paradigm promoting democratic values, governance and a rights based approach is being challenged by a powerful natural resource development, infrastructure and trade related development ideology. In order to develop the Swiss cooperation approach further, a sound understanding of these dynamics is required.
2. Stigmatizing the little known Chinese approaches to development by drawing on ugly and detrimental, but often specific cases of uncontrolled investments does create a skewed picture. Many murky

strategies of these investors are borrowed from earlier capitalist models and have roots in the profit maximising logic of neoliberal concepts so much praised during the recent globalization hype. To put one school of thinking against the other may not yield the desired influence on the Chinese way of doing business, constructive engagement and progressive refinement of it may well have.

3. While attention to CSR and environmental safeguards are often minimal, economic impacts of Chinese investments are not rarely striking and more competitive. An issue of scale is involved when comparing the relatively modest poverty reduction progress in countries with predominantly OECD-aid and the scale, speed and cost at which China has been lifting its own poor out of material deprivation. I conclude that OECD can learn from these experiences and should adapt its own concepts.
4. The mechanisms for Mekong regional cooperation and integration are officially recognized and increasingly utilized bodies by China. If Switzerland is seeking to influence the regional development agenda, it may have to play a more active role in these bodies to complement the bilateral and multilateral engagements already in place.
5. The Lao PDR can enormously benefit from increased exchange with its neighbours and in particular China, while it is most vulnerable today due to weak governance systems, regulatory frameworks and enforcement mechanisms. The Swiss cooperation programme is addressing the key sectors in which the country is facing major challenges and has most stakes. An acceleration of reforms however is needed to keep pace with the rapid economic transformation. For the Lao authorities to be able to cope, enhanced efforts and alliances among the international support community are required.

## Recommendations for SDC

The following recommendations entail that the China factor in development is best addressed at several levels simultaneously:

### Global Level

- Learn more systematically about China's poverty reduction approach and the multi-instrument ODA practice;
- Engage in the China-DAC Study Group and link up with SDC's Africa and SEA-Programmes; China to participate in DAC peer review missions?
- Continue to support China's participation in multilateral institutions and donor fora (beyond DAC, e.g. in the CGIAR etc.)
- Support like-minded efforts (e.g. from Norway) to encourage China's joining the extractive industries transparency initiative and other global bodies of relevance to Swiss cooperation;
- Maintain targeted bilateral cooperation in niche areas of mutual interest (Sino-Swiss Management training; biotechnology; water etc.)

### Regional Level

- Monitor China's Mekong policy systematically through the Swiss network of SDC offices, Embassies and possibly private sector contacts;
- Study more in-depth the nature of China's engagement in ASEAN, ADB, AFTAs, ESCAP, MRC etc. to develop a competent basis for decision making on SDC's regional engagement;
- Advocate socially and environmentally responsible investment standards and

safeguard mechanisms through the Swiss participation in the ADB (both Governor seat and co-funded projects, e.g. in Laos);

- Participate actively in the GMS high level and ministerial level platform (condition: programmatic engagement SDC);
- Explore direct collaboration with China as a partner in the context of GMS (e.g. PPP human resource development programme);
- Consider ways to include the China climate change policy and key actors in the planned ASEAN Asia Social Forestry Network engagement of SDC's Global Programme.

### Laos Level

- Learn from GTZ while designing the Northern Upland Development Project partnership;
- Strengthen government capacities to negotiate cooperative agreements with China in those Provinces where SDC is involved;
- Invite China participation to sector policy and strategy discussions with SDC partners where opportune;
- Explore innovative ways for more direct engagement with Chinese partners e.g. on science and technology cooperation, commissioning of studies to Chinese researchers or consultants, study tours;
- Reorient SDC's strategic vector in NRM: adapt smallholder livelihood security approach to include mitigation measures by selectively engaging with FDI where applicable.

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## Figures

Courtesy M. Sommer (2010)