

# Country Study for Japan's Official Development Assistance to the Lao People's Democratic Republic

March 1998

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The Committee on the Country Study for Japan's Official Development Assistance to the Lao People's Democratic Republic

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**This report is based on the findings of the Committee on the Country Study for Japan's Official Development Assistance to the Lao People's Democratic Republic. Opinions expressed in the report are those of the members of the Committee and do not necessarily reflect those of the Japan International Cooperation Agency and its affiliated organizations.**

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## Preface

This report compiles the findings of discussions by the Committee on the Country Study for Japan's Official Development Assistance to the Lao People's Democratic Republic, which was set up by JICA in August 1997, the committee's analysis of the present situation of the Lao economy and society, and its recommendations regarding Japanese aid to the Lao PDR.

In July 1997, one month before the committee was formed, the Lao PDR became a member of ASEAN, and coincidentally in the same month, the Thai currency was devalued, touching off an economic crisis in East Asia. The committee began its study at a time when Lao's externalities began to change in very significant ways.

Yet even if the Lao PDR had not been faced with this external turmoil coinciding with its insertion into the global network, from the start it was facing many obstacles to its development. Located in Indochina, it has a socialist government, the terrain is mountainous and landlocked, its domestic markets are isolated from each other, its human resources are not abundant, and the national economy itself is in the process of development. For a country whose industry is too immature to be internationally competitive while it constructs its national economy and whose transition to a market economy took place scarcely more than ten years ago, building up the Lao's place in the Asian economy is certain to be a very rocky road.

All committee members contributed ideas to flesh out a scenario for Lao's development reflecting the above situation that would both be realistic and take advantage of the country's specific strengths. The committee concluded that the necessary tasks for the Lao PDR were as follows; human resources development, increasing the nation's economic might to enable it to survive in the global economy. Rather than pursuing the path to prosperity through labor intensive and export-oriented industrialization, seeking affluence on an independent course in Southeast Asia. These tasks would be as time consuming as they were necessary.

Japan is the Lao's top bilateral donor and has given the Lao PDR relatively large-scale aid in comparison to the scale of the Lao economy. Lao's most precious and irreplaceable asset is its abundant nature, which it must protect while pursuing future economic growth, and Japan's cooperation via ODA should be designed to enable the Lao people living peacefully in the bosom of nature to avoid losing their national identity.

It is our sincere wish that this report, written by the committee's members and advisors and containing their perceptions of different aspects of the present situation and of the directions development should take, will deepen readers' knowledge of the Lao PDR and that the report's recommendations will contribute in some way, however small, to policy dialogue between the Lao government and Japan's development assistance policy decision makers and implementing organizations and to their formulation of ODA policy.

Finally, I wish to thank the committee members and advisors for taking time from their busy schedules to contribute to this report through valuable insights and research findings and the laborious process of putting these contributions into words. I wish also to express my appreciation to the staff of the Embassy of Japan in the Lao People's Democratic Republic, the

JICA local office, and Japanese experts on assignment in the Lao PDR for their assistance before and during the field study in December 1997, for the valuable information that only they could offer, and for their broad support during the discussion meetings that they arranged. And lastly, I wish to express my gratitude for their cooperation to the Ministry of Foreign Affairs' Economic Cooperation Bureau, the Institute for International Cooperation, Japan International Cooperation Agency, and the secretariat of this committee set up in the institute.

February 1998

Yonosuke Hara, Chairman  
Committee on the Country Study for Japan's  
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to the Lao People's Democratic Republic

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## Abbreviations

ADB	Asian Development Bank
ADS	Agricultural and Development Service
AFTA	ASEAN Free Trade Area
AICAF	Association for International Cooperation of Agriculture & Forestry
AIDS	Acquired Immuno-deficiency Syndrome
APDA	The Asian Population and Development Association
APB	Agricultural Promotion Bank
ARF	ASEAN Regional Forum
ASEAN	Association of Southeast Asian Nations
BOT	Build-operate-transfer
BPKP	Bolisat Phathana Khet Phoudoi
CATC	Civil Aviation Training Center
CEEP	Committee for Energy and Electric Power
CEPT	Common Effective Preferential Tariff
CIC	Committee for Investment and Cooperation
CP	Counterpart
DAC	Development Assistance Committee
DAFI	Development of Agriculture and Forestry Industry
DAFO	District Agriculture and Forestry Office
DCTPC	Department of Communication, Transport, Post and Construction
EDL	Electricité de Laos
EFA	Education for All
EIA	Environmental Impact Assessment
EU	European Union
FBIS-EAS	Foreign Broadcast Information Service
FIAT	Farmers' Irrigated Agricultural Training
FIMC	Foreign Investment Management Committee
FIR	Flight Information Region
F/S	Feasibility Study
GDP	Gross Domestic Product
GMS	Greater Mekong Subregion
GSP	Generalized Scheme of Preference
GTZ	Deutsche Gesellschaft für Technische
HIV	Human Immune Deficiency Virus
HRD	Human Resource Development
ICAO	International Civil Aviation Organization
ICOR	Incremental Capital Output Ratio
ICU	Intensive Care Unit
IDA	International Development Association
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund

<b>IPP</b>	<b>Independent Power Producers</b>
<b>ITU</b>	<b>International Telecommunication Union</b>
<b>IUCN</b>	<b>World Conservation Union</b>
<b>JICA</b>	<b>Japan International Cooperation Agency</b>
<b>JOCV</b>	<b>Japan Overseas Cooperation Volunteers</b>
<b>JVC</b>	<b>Japan International Volunteer Center</b>
<b>Lao-IRRI</b>	<b>Lao-International Rice Research Institute</b>
<b>LDC</b>	<b>Less Developed Countries</b>
<b>LLDC</b>	<b>Least Less Developed Countries</b>
<b>LSFP</b>	<b>Lao-Swedish Forestry Program</b>
<b>LWU</b>	<b>Lao Women's Union</b>
<b>MAF</b>	<b>Ministry of Agriculture and Forestry</b>
<b>MCTPC</b>	<b>Ministry of Communication, Transport, Post and Construction</b>
<b>MFA</b>	<b>Multi-Fiber Arrangement</b>
<b>MIH</b>	<b>Ministry of Industry and Handicrafts</b>
<b>NAWACOP</b>	<b>Nam Ngum Watershed Management and Conservation Project</b>
<b>NBCAs</b>	<b>National Biodiversity Conservation Areas</b>
<b>NEP</b>	<b>New Economic Policy</b>
<b>NEM</b>	<b>New Economic Mechanism</b>
<b>NGO</b>	<b>Non-Governmental Organization</b>
<b>ODA</b>	<b>Official Development Assistance</b>
<b>OECE</b>	<b>The Overseas Economic Cooperation Fund</b>
<b>PAFO</b>	<b>Provincial Agriculture and Forestry Office</b>
<b>PHC</b>	<b>Primary Health Care</b>
<b>PIP</b>	<b>Public Investment Program</b>
<b>PRA</b>	<b>Participatory Rural Appraisal</b>
<b>SFAs</b>	<b>Selected Forest Areas</b>
<b>Sida</b>	<b>Swedish International Cooperation Agency</b>
<b>SPC</b>	<b>State Planning Committee</b>
<b>SRTC</b>	<b>State River Transport Company</b>
<b>STENO</b>	<b>Science, Technology and Environmental Organization</b>
<b>TRIMs</b>	<b>Trade-Related Investment Measures</b>
<b>TRIPs</b>	<b>Trade-Related Aspects of Intellectual Property Rights</b>
<b>UNDCP</b>	<b>United Nations Drug Control Program</b>
<b>UNDP</b>	<b>United Nations Development Program</b>
<b>UNFPA</b>	<b>United Nations Population Fund</b>
<b>UNICEF</b>	<b>United Nations Children's Fund</b>
<b>UXOPLAO</b>	<b>the Lao National Unexploded Ordnance Program</b>
<b>WHO</b>	<b>World Health Organization</b>
<b>WID</b>	<b>Women in Development</b>
<b>WTO</b>	<b>World Trade Organization</b>





# Summary



## Summary

### I. Current state of development and development issues

The Lao PDR, a mountainous and landlocked country located in the center of the greater subregion bordering the Mekong River faces serious development challenges. For its' geographical conditions, the Lao population of less than 5 million has been thinly spread across the country. In addition to the conditions above, the fatigue caused by a series of military conflicts which continued until the establishment of the current Lao People's Democratic Republic in 1975, obstructed the nationwide penetration of the planned economy, which was in place from 1975 until the introduction of the New Economic Mechanism in 1986. The challenges for the international community, therefore, in providing assistance for the Lao PDR, will be to support Lao policies to integrate self-sufficient communities, which have been isolated in terms of economic trading or have not yet entirely involved in the monetary economy, into a single domestic market; to improve the efficiency of economic activities; and to ensure social equity.

Moreover, through its' accession to ASEAN and AFTA, the Lao PDR must proceed rapidly and simultaneously with integration of domestic markets, and the development of a market economy involving formidable issues such as globalization. It should also be noted that the vulnerability to the changes in economic circumstances of the neighboring countries, high-lighted by the recent Southeast Asian currency crisis.

With the Greater Mekong Subregion (GMS) plan and other moves underway toward international development involving Indochina, the Lao PDR must promote development that serves its own interests by making effective use of the growing international interest in the region, while also paying careful attention to the balance of cost and effectiveness for the country.

Rural development is the central issue in the Lao PDR. Ninety percent of the labor force is involved in agriculture, forestry and fishing, producing half of the country's GNP. Forestry accounts for 30% of Lao's annual foreign currency earnings, and forested land is also utilized for slash and burn agriculture. Because agriculture and forestry are linked to macroeconomic stability, and they support and employ a population growing at an annual average of around 3%, these sectors are closely related to improvement of income levels and poverty issues.

Rice cultivation in the Lao PDR depends on natural rainfall, utilizes little fertilizer or pesticides, and is frequently subject to drought and flood; this is hardly a situation permitting stable self-sufficiency in food production. Traditionally slash and burn agriculture was an environment-friendly production method. However, it is now becoming environmentally destructive as population pressures and migration to specific regions in recent years have shortened fallow periods. Another issue hampering rural development is the fragmented road system, which blocks the distribution of agricultural products and obstructs the penetration of education and social services into rural areas.

Delivery systems for health services are markedly undeveloped at all levels: national, provincial, district, and village level. The situation is particularly severe in rural villages and

remote areas. Infant mortality and maternal mortality rates are relatively high among neighboring countries; there are also disparities in these mortality rates between regions. The main causes of death are infectious disease, further complicated by malnutrition and a short supply of safe drinking water.

Despite the fact that women play an important role in economic activities, there are gender disparities particularly in rural area in terms of opportunities to attend school and pursue higher education. Women are expected to undertake heavy work, especially in agriculture. These elements also need to be addressed in improving living standards in rural villages.

Issues for human resources development (HRD) in the Lao PDR are the expansion of basic education and the development of highly-educated human resources. In basic education, the difficulty of school attendance for girls and ethnic minorities, as well as interregional disparities is significant. The Lao PDR faces both lack of educational "hardware" (school buildings, etc.) and the "software" issues of teacher training and textbook development. Since the 1990 World Declaration on Education for All, the government of the Lao PDR has adopted policies stressing basic education, increasing the budget allocation on education, while donor countries and international organizations are also increasing their assistance for basic education. As a result, school enrollment is improving, although further progress will hinge on serious commitment in the coming years to resolve educational disparities between men and women, between ethnic groups, and between regions.

The system and curricula of higher education and on vocational education influenced by socialism, do not meet the human resource need arise from the development of market economy and economic growth. Additionally, the changing economic environment in the Lao PDR is clearly increasing workers' study needs. In recent years the Lao PDR has been responding to these situations by integrating post-secondary institutions affiliated to the various ministries into the National University of Laos, supported by the Asian Development Bank. While future human resources are developed through education, early provision of appropriate know-how, operation and management training opportunities will also be vital for personnel currently involved in the development of a market economy, such as public servants in posts related to the economy and employees at financial institutions. Also, human resources in all administrative sectors are needed to be provided of appropriate training program on administration and coordination to facilitate the tasks related to the Lao's accession to ASEAN.

Full-fledged development of transportation infrastructure began in the late 1980s, driven primarily by foreign assistance, and a significant amount of capital has been allocated to this area under the government's Public Investment Plan. In the transportation sector, roads play the most important role in the movement of both freight and passengers in the Lao PDR. In the late 1990s, the development and rehabilitation of the national highway, the country's trunk road, are moving toward completion. The minimum necessary foundations have therefore been laid for economic development, although a single market will be difficult to achieve without the development of feeder roads and of operation and maintenance systems to prevent road deterioration.

In the communications sector, the backbone of a domestic communications network running from north to south has been completed and they have been digitalized. However, the number of phone lines per capita is still extremely low, and plans for the establishment of telephone exchanges have gone no further than the several major cities. In the future, efforts will be required to extend telephone services to other cities and rural areas. Access to international communications is also an issue. Private sector participation in both the domestic and international sectors is increasing.

Hydroelectric power generation accounts for the bulk of energy production in the Lao PDR, and electricity is a precious source of foreign exchange inflow. All oil is imported, and because of the underdevelopment of its power transmission grid, the Lao PDR also imports a limited amount of electricity from Thailand and Vietnam to areas unable to be serviced by domestic electricity supply. Many rural villages still do not have electricity. The Lao PDR has great hydropower potential, and this potential is currently attracting the interest of the private sector. At the same time, there are many issues which need to be considered: the electricity supply and demand forecasts for Indochina; the benefits the Lao PDR would derive from such development; government expenditure on hydropower development; the underdeveloped legal system; and the burden on the environment.

The Lao PDR imports most of the industrial products, that negatively affects the Lao's foreign exchange balance. Notable domestic manufacturing industries are food processing, wood processing and the garment industry; however, these industries are vulnerable to exogenous environment changes such as alternation and/or abolition of international agreements. Industry is not adequately being deepened because they have only a limited linkage with the domestic supply of raw materials and intermediate goods. Given conditions in the Lao PDR, it seems unlikely that the country will achieve adequate international competitiveness through labor-intensive and exported-oriented industrialization as in other ASEAN countries.

The most important environmental issues are forest degradation, resulting from slash and burn agriculture which extracts resources over a short cycle, and the problems this creates for irrigation water resources, land conservation, and the development of agriculture and industry. A succession of government ordinances on forests has been issued in the 1990s, with the National Forestry Law established in 1996. However, regulations and measures for enforcement are still being developed, for example, and water resources protection forests have only just begun to be established at district and village level. In 1993, the government formulated a plan for a major reduction in the number of households engaged in slash and burn agriculture by the year 2000. However, the plan fails to provide alternative agricultural production methods. In terms of future assistance, it is worthwhile to consider the results being achieved by a Sida (Swedish International Development Authority) forestry project in Luang Prabang, focusing on the development of rural villages and designed to provide alternatives to slash and burn agriculture.

There has been growing recognition in recent years of the importance of water catchment areas as it supports the hydroelectric power generation that has become a foreign exchange earner for the Lao PDR. There are also many environment-related issues that have not been coped or addressed, including regulation on land tenure and utilization to ensure environmen-

tal conservation, urban water quality and air pollution, waste issues in urban area, and the environmental impact assessments of large-scale development projects. In 1993, the Science, Technology and Environmental Organization (STENO) was formed to take charge of this area, and an Environment Action Plan was formulated. However, STENO's human resources are still insufficient at all levels. Additionally, legal systems and statistical data need to be expanded.

## **II. Orientation of Japanese assistance**

Since the fundamental issue of development in the Lao PDR is the integration of domestic market, Japan's assistance should focus on the development of the necessary conditions for building an efficient market economy system. One element of this is assistance in human resources development. Such assistance should include social development such as basic education, and the development of higher education, that improves knowledge and administrative capacities to deal with a market economy. The domestic market integration will also require support in transportation, communications, electricity, and other basic infrastructure areas.

In its accession to ASEAN, the Lao PDR has been given only a limited time to boost the capacities of the national economy enough to cope with the globalization. Such rapid economic transformations and developments are likely to expand currently minor interregional and income disparities. The priority therefore should be to satisfy basic human needs in order to raise the living standards of the whole population by supporting the development of agriculture and social services, and ensuring social equity.

Given the current situation in the Lao PDR, the suggested priority areas for assistance are as follows.

### **(1) Agriculture and rural development**

With the bulk of the country's population living in rural area and farming for a living, it is no overstatement to say that improving the state of agriculture and rural area will help combat poverty and reduce disparities. Priority issues in addressing the pressing task of increasing food production are cooperation with regard to small-scale irrigation development and users' association, as well as cooperation in varietal improvement toward the increased productivity of non-irrigated rice fields. To promote the dissemination of the new technology for the introduction of dry season crops, it will be vital to boost the number of personnel involved in the dissemination and to train them, to set up a fund for financing farmers, etc. Consideration should also be given to cooperation in experimental research related to commercial crops as a means of increasing income, assistance in resolving market access issues, and the development of feed resources in order to promote animal husbandry. In addition, developing small-scale industries such as silk weaving and agricultural product processing would enable rural villages to absorb the rapid increase of the labor force due to high population growth, and would promote the formation of an industrial structure suited to the Lao PDR; at the same time helping to avoid urban problems.

## **(2) Human resources development**

Human resources capacity building in both the public and private economic sectors is a vital challenge for the Lao PDR as the country moves toward a market economy rapidly expands contacts with other countries, and absorbs overseas assistance within the limited time frame of its development phase. Capacity building in the fiscal and monetary sectors will be particularly necessary in mobilizing needed development resources and ensuring their efficient distribution.

Expansion of basic education in rural and remote areas is an important task for the Lao PDR. On the one hand, the utilization rates for existing school buildings are comparatively low because of the low population density; on the other, schools are often not located within walking distance. To boost school enrollment rates, the problem of access will need to be resolved by building schools on the basis of appropriate school mapping. This should be combined with measures to encourage non-formal education, including efforts to promote literacy skills, as well as education traditionally conducted for local residents and ethnic minorities, making use of Japan's experience to date in the small-scale grant assistance.

To improve health and medical care services, efficient and effective operation and management systems will need to be developed over the long term for basic medical care, maternal and child health care, and preventive medicine. Consideration might be given to building village-level systems in tandem with village development. In such cases, however, attention should be given to the particular circumstances of the region involved, and to coordination with other donor countries and NGOs.

## **(3) Development of infrastructure and energy**

The development, maintenance and management of domestic distribution and communications networks in the Lao PDR will be of crucial importance in forming an integrated domestic market and social services delivery system. For transportation, cooperation could be considered to systematize statistics for the preparation of a comprehensive traffic masterplan and to strengthen the implementation mechanisms of government institutions. The masterplan should bear in mind the balance among the various subsectors and distribution trends. In addition, systems need to be created for the operation and maintenance of completed infrastructure projects. In general, new projects commencement should keep pace with the improvement of the Lao PDR operation and maintenance capacities.

The Lao PDR is expected to fulfill its function as a land-bridge in those international transportation and communications infrastructure development plans involving Indochina. When Japan assists projects along with those plans, Japan must take an approach that benefits the Lao economy, promoting domestic distribution, for example; and its approach should also be based on a development scale suited to the Lao's capital-bearing capacities.

Electricity is currently a precious source of foreign exchange for the Lao PDR. As the state economy will continue to need to use electricity as a source of funds for some time, development in this area needs to be conducted in harmony with environmental conservation. At the same time, there are still in lack of electricity in rural and remote areas, because of the underdevelopment of transmission grids. Consideration, therefore, could be given to coopera-

tion in rural electrification as one means of redressing interregional disparities. Considering that development in recent years is increasingly funded by the private sector, the central government's work on the establishment of legal systems in the electric power sector needs to be urgently enhanced.

#### **(4) Environmental conservation and environmental resource management**

Forest degradation is an important issue for the Lao PDR from an environmental conservation perspective, and resolution of this issue will be a vital element of the Lao's further economic development. The Lao PDR may not be currently in a position to develop a manufacturing industry that makes full use of leading science and technology; therefore, developing industries that utilize the country's forests would be one way the Lao PDR could pursue prosperity which is different from its neighbors. Japan should engage in ongoing cooperation in participatory forest management and reforestation through the collection and analysis of basic data, or in the form of projects, combining this with measures currently underway to control the use of slash and burn agriculture.

Water is also an important resource. Support needs to be given to the creation of river basin management plans with attention to land utilization and soil conservation. To put such an environmental management system into practice, the management systems of the STENO (Science, Technology and Environmental Organization) and other relevant government agencies, and at the same time a process to disseminate those systems to the local level should be strengthened. Even in assistance projects not directly targeting environmental issues, activities related to environmental conservation should be incorporated as part of the program, in order to increase environmental awareness and foster human resources.

### **III. Tasks and issues in implementing Japanese aid**

Considering the Lao's development, constraints have been attributed to the limited efficiency of development investment and restrictions on the scale and nature of projects imposed by personnel and fiscal shortages. Rather than the assistance which is implemented through central to regional government, the projects should be formulated in such a way that difficulties would be avoided. For example, experts in the development of a market economy could be fostered at the central government level, and at the same time, small-scale, regionally comprehensive development approaches could be implemented at the local level with agriculture as the core area, and combining other sectors such as health care and education.

It is imperative that Japan's overall assistance to the Lao PDR be coordinated to achieve the goals and priorities of "assistance for the formation of an integrated domestic market aimed at sustainable development, the transition to a market economy, and consolidation of BHN".

Raising standards of living in rural areas will address issues such as poverty, health and medical care, and education; thus, a multi-sector approach to cooperation in agriculture--addressing a number of areas simultaneously on a small scale, with cooperation efforts centering around the promotion of agriculture--would be highly effective. However, the content and objectives of cooperation in sectors other than agriculture will need to be rigorously selected,



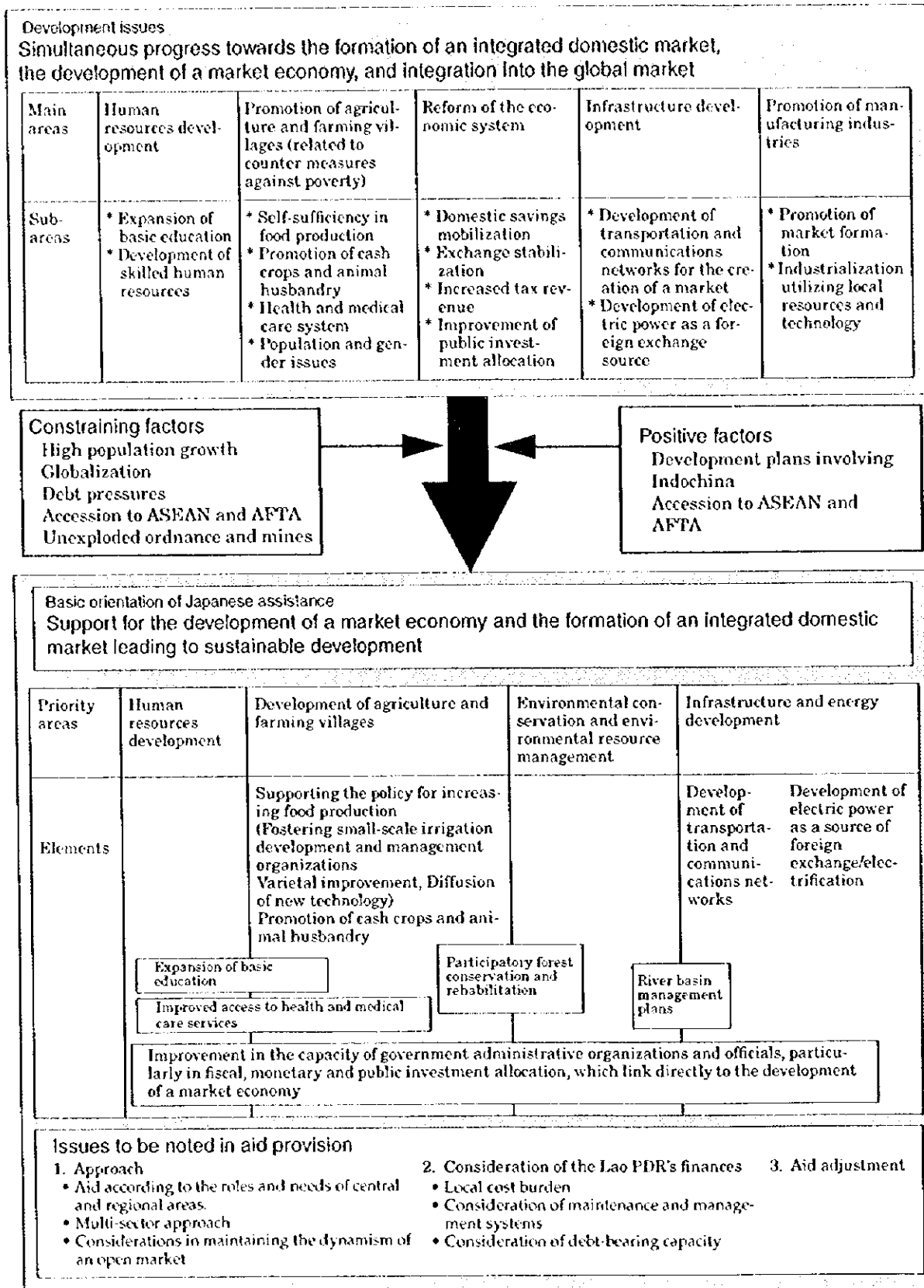
taking into consideration the priorities of the local residents and whether the aid donor is able to provide the appropriate resources.

Current expenditures make up a comparatively small portion of the government's annual expenditures, indicating the difficulty of securing fiscal resources for operation and maintenance. Japan should bear this fiscal constraint in mind when considering its assistance for systems and IIRD for the operation and maintenance of roads and other facilities provided. Because it is difficult to set aside an adequate budget for project operation, Japan will need to be flexible regarding local costs, keeping in mind the possibility of having to expand its commitments.

It would not be advisable for the country to finance the funds needed for development by simply increasing its foreign debt. Because the Lao PDR is unlikely to achieve in an early stage the necessary conditions for an alleviation of the burden of its debt repayment such as a rapid improvement in export competitiveness, markedly high investment productivity, and a low exchange risk burden for the Lao PDR, etc. Domestic savings must therefore be mobilized and the Lao's examination capacities strengthened to achieve efficient resource allocation. At the same time, when considering loan assistance, financing must be based on thorough assessments and highly concessional conditions.

It should also be borne in mind that the Lao PDR government still does not have sufficient human resources or institutional capacity to coordinate the multiple functions relating to the various development plans involving Indochina or the plans of the various donors and NGOs. Nor is the government able to make sufficient use of aid for the benefit of the country, with underdeveloped capacity to form development strategies and aid projects. In addition, institutions in charge of aid coordination need to be strengthened to prevent the concentration of projects in certain sectors and areas. As the top donor of bilateral assistance, Japan should take the lead in this area.

## Flowchart Illustrating the Provision of Aid to the Lao PDR and Priority Areas



# **I. Current State and Direction of Development**



# I. Current State and Direction of Development

## 1. Overview

### 1-1 The Lao PDR development

The Lao PDR is the only landlocked country in the Southeast Asian region, bordered by five countries: China, Viet Nam, Cambodia, Thailand and Myanmar. A total area of more than 236,800 square kilometers puts the country on virtually the same scale as Honshu, Japan. The Lao PDR, however, is only lightly populated, with fewer than five million people. Because of the primacy of the sea in world trade, the international community has paid little attention so far to this mountainous inland country.

However, with Viet Nam, for example, launching its *doi moi* policies in earnest to reform and open the national economy from the late 1980s, the continental Southeast Asian countries have begun to join the world trend toward economic globalization. Geography has positioned the Lao PDR as a land-bridge within this region and the development of the country carries great importance for the future of continental Southeast Asia as a whole. The Lao PDR development is likely to play a major role as well in ensuring that the benefits of development are shared by all areas bordering the Mekong River (an international river flowing the length of continental Southeast Asia) from its upper through to its lower reaches. The development of the Lao PDR will not benefit this country alone but also impact strongly on the entire Southeast Asian continent.

The Lao PDR is a mountainous country, 80% of which comprises mountains, hills and plateaus. Because of this topography, most of the human population is concentrated in the narrow but open river valley plains and basins nestled among the mountains. The former capital of the Kingdom of Lan Xang, Luang Prabang, an area located almost in the center of northern the Lao PDR with a long history of paddy cultivation, is a typical example of a basin surrounded by mountains which has been formed by the Mekong River and its tributaries.

The Mekong River has been the decisive factor in determining the country's topography. The plains opening out next to the river have been another site of human habitation, a representative example of which is the Vientiane Plain, where the modern capital, Vientiane, is located. The further south along the Mekong, the wider the plain areas become. The provinces of Khammouane and Savannakhet are the Lao's grain belt, consisting of plains formed by Mekong River tributaries and the surrounding hilly areas. The Champassak Plain in the southernmost part of the Lao PDR is also a fertile grain-producing region, with extensive rice farming.

The plateau areas, which are at a higher altitude than these plains, are used for the cultivation of commercial crops, taking advantage of natural conditions. A typical example is the Bolovens Plateau, which spreads out to the east of the Champassak Plain. This plateau was developed as plantation land during the period of French colonization, and produces coffee, tea and a variety of fruits.

On the plains and in the mountain basins, the majority of the population are ethnic Lao who speak various dialects. These are called the Lao-Loum (Lao lowlanders), who live on environmentally-friendly rain-fed agricultural production. In the mountains and hills dwell the

Hmong and the Yao peoples, whose livelihood is slash and burn agriculture which is again in harmony with the local environment. They are called the Lao-Soung (Lao highlanders). The Mon-Khmer peoples, such as the Kang, live between these two groups, as it were, and are known as the Lao-Theung (Lao hill peoples).

Viewed from the index of income per capita, the Lao PDR belongs among the countries with the lowest economic levels in the world. Beyond the lingering influence of the Lao's years as a socialist-style planned economy, the greater problem is the way in which topographical conditions have divided the country's various regions into independent trading areas, with the Lao PDR yet to become a single integrated domestic market. The economic development of the Lao PDR will hinge on overcoming this major problem and integrating the country into a single market.

At the same time, given that the Lao people have long lived in harmony with the bounty provided by the ecological conditions of their respective regions, drawing them into competition as part of a broader market economy in a short period of time will be far from easy. Moreover, this is not necessarily even the most desirable approach to development. Market integration will not automatically increase the efficiency of domestic economic activities, nor will it necessarily guarantee social equity among the population. A more appropriate development approach would be to work to protect the country's diverse ecosystem while the Lao people gradually become better able to respond to a market economy. The international community should support the Lao PDR realizing a mode of development which differs from that of other ASEAN countries. In this sense, Japan's mode of involvement in the Lao PDR development will also be a key issue.

## **1-2 Economic reform achievements and current constraints**

Since the New Economic Mechanism was introduced in 1986, the Lao economy has almost always achieved an economic growth rate in the 7% range. The major factor behind this smooth rise in the growth rate is that economic reform has allowed the private sector to take advantage of economic incentives. Direct investment has flowed in from neighboring countries, particularly Thailand, with economic activities flourishing in a number of manufacturing industry as well, including motorcycle assembly and sewing.

However, an analysis of the factors currently constraining development in the Lao PDR reveals the following.

Firstly, the various economic zones within the country have not been integrated because of the severe lack of infrastructure such as transport and communications. The Lao PDR is a topographically divided country, and many regions are still functioning as self-sufficient economies and have yet to be adequately incorporated into the market economy.

Secondly, in addition to the first condition, the Lao PDR domestic market remains small since the country is thinly populated despite its high population growth rate. Domestic commercial and market networks have yet to be fully developed, and the legal systems needed for the integration of the domestic market are also inadequate.

Thirdly, reflecting the country's high population growth rate, children make up a large proportion of the national population structure, and literacy rates among much of the population remain low. It would therefore be difficult to say that there is an adequate supply of

human resources to support market economy activities. Moreover, the multi-ethnicity of Lao society, which embraces many small ethnic groups, is also a factor hampering the integration of the domestic market.

### **1-3 Issues in economic development**

Given the above problems with which the Lao PDR is faced, the most fundamental issue for the Lao economy would not seem to be market economy transition but rather development aimed at transforming the domestic economy from self-sufficient economies and divided and isolated markets into a single nationwide integrated market economy. The centrally planned economy period did not last long, and even during that period, the entire domestic economy was not integrated under central planning. The Lao PDR could therefore be described superficially as a country making the transition to market economy, but in fact it is a less-developed country with a barely emerging market economy. Accordingly, it should be clearly recognized that while the economic incentives provided to the private sector through the economic reforms introduced since 1986 were once enough in themselves to realize high economic growth, this phase is already becoming a thing of the past.

For the Lao PDR to promote further development over the long term, it will be vital to develop transport and other physical infrastructure to link the divided and scattered rural communities, and also to improve the quality of human resources through the expansion of primary education and the development of the health and medical care system. Clear recognition is needed that in these fundamental points, the Lao PDR faces a more difficult development challenge than simply making the transition from a planned to a market economy.

The 1996-2000 Socio-Economic Development Plan created by the State Planning Committee aims to raise per capita income from 350 dollars per annum in 1995 to a 500 dollar level by the year 2000. This will apparently require annual average GDP growth of 8-8.5%. Target growth rates by sector are 5% for agriculture, 12% for industry and 10-11% for other services.

According to the above plan, realizing this growth will mean investment at around 25-30% of GDP. Of this, around 12% of GDP is supposed to be public investment. The plan puts the incremental capital output ratio (ICOR) at around four, which is not unrealistic given that the Lao PDR is still at the stage where public investment in areas such as infrastructure is still vitally needed. The problem is whether enough capital can be supplied to realize this much investment, given the scale of the domestic economy. According to the plan, most of the necessary investment capital will be covered in the form of aid and private investment from abroad.

Starting with the Lao's acceptance of structural adjustment financing in 1989, foreign aid has been on the increase, with around 80% of public investment currently realized through aid from foreign countries. Bearing in mind that foreign aid is determined according to the decision-making processes of donor countries and institutions, and that the international community is beginning to consider positioning the Lao PDR as a land-bridge on the Indochina peninsula, it is not overly unrealistic to envisage a certain amount of funds flowing in from outside sources.

However, the major question is whether or not much of the two billion dollars in private sector investment estimated in the plan really will flow in. This is where the effective mobilization of domestic savings is likely to become a fundamental issue. Looking at the figures for

1995-96, the ratio of private savings to GDP was 11%, the government savings ratio was around 2%, for a total of approximately 13% of GDP. Whether the rate of increase in private savings exceeds government savings could be a point of crucial importance for the future of the Lao economy. Accordingly, the issue of more basic importance for the Lao's development will be to enable domestic savings to be distributed more effectively to the production sector by improving capacities in the domestic banking sector to absorb deposits and provide credit.

Government fiscal revenues still stand at less than 15% of GDP. Given such problems as the major reduction of tariff revenues following the Lao's ratification of AFTA, the difficulty of levying taxes on foreign companies because of tax incentives set up to attract foreign direct investment, and the increase in expenditure resulting from the growing number of development projects, it is essential that the Lao PDR redress as soon as possible the current shortfall in tax revenue resulting from underdeveloped tax system and tax collection administration. This confronts the Lao PDR with the difficult task of expanding its tax base without relying on tariffs. However, without a dramatic reduction in fiscal spending, failure to secure fiscal revenue will cause major problems in the shape of a growing fiscal deficit and accelerated domestic inflation.

The current account deficit is yet another significant problem. Figures for 1995-96 indicate that this has reached around 15% of GDP. Caution is required to avoid further widening in the deficit by increasing domestic investment under conditions where the mobilization of domestic savings is not proceeding smoothly.

Since electricity and timber are Lao's only promising export industries, there is a major risk that depending too heavily on a swift inflow of foreign capital could make foreign debt management extremely difficult.

## **1-4 Development issues**

### **1-4-1 Economic system reform**

Creating an efficient market economy system will hinge on the following systemic improvements in operation of the macroeconomy.

Firstly, the tax base will have to be expanded and tax collection made more efficient, which will also help restrain growth of the fiscal deficit.

In the finance sector, a clearer separation must be made between the central bank and commercial bank systems, and the financial intermediary functions of the latter must be enhanced. A bond market needs to be developed, as one of the mechanisms to allow the central bank to effectively execute financial policies such as open market operations.

In its exchange policies, the Lao PDR faces the difficult task of how to balance exchange rate stability, virtually a condition for the inflow of foreign capital, and currency devaluation aimed at strengthening export competitiveness. What will probably be needed will be a combination of domestic money supply management and a floating exchange rate system which allows gradual devaluation. For the present, the Lao PDR urgently needs to establish an administrative system which will allow the effective implementation of foreign debt management.



## **1-4-2 Industrial development**

### **(1) Agriculture**

As around 90% of the population is engaged in agriculture, forestry and fishing, it is clear that agriculture, along with forestry and fishing, must be the foundation of Lao's economic development. Agricultural development will play a decisive role in macroeconomic stability and growth, employment expansion and responses to poverty, as well as in conservation of the natural environment. Because rice cultivation in the Lao PDR is dependent on rainfall, it is vulnerable to drought and flood, making it unable to achieve food self-sufficiency. Moreover, slash and burn agriculture, once an environmentally-sound livelihood, has now become environmentally destructive as population increases and migration and settlement have shortened fallow periods.

Given the above situation, an appropriate focus would seem to be the development of cash crops and animal husbandry, both of which will facilitate a stable food supply and earn foreign exchange. Moreover, the conservation of forest resources in slash and burn agriculture areas will also be crucial in stabilizing people's livelihoods. The most important means of achieving such agricultural development will be experimental agricultural research such as varietal improvements of crops which can be grown even in rain-fed paddies, as well as small-scale irrigation on plains and foothills. Long-term financing from the Agricultural Promotion Bank with the beneficiary bearing the burden will be important in the development of small-scale irrigation in particular.

### **(2) Manufacturing industry**

The industrialization strategy adopted by Thailand and other neighboring countries has been to substitute imports of labor-intensive products and to expand exports of semi-manufactured products through the active introduction of foreign private investment. This could hardly be judged an appropriate strategy for a country with the small population and limited domestic market such as the Lao PDR. In this case, an industrialization strategy utilizing local traditional resources and technology would be far more effective. An example of a promising industry under this strategy would be hand-weaving in rural villages, which included the development of domestic sericulture.

### **(3) Mining**

Large-scale development should probably be avoided given the high post-extraction transport costs and environmental pollution caused by mining, but Lao's various domestic mineral resources should be developed on an appropriate scale. Possible resources for development would include bauxite, lime, gemstones and gold.

### **(4) Forestry**

Forest products currently earn around 30% of Lao's foreign revenue. However, with population pressures making slash and burn agriculture non-regenerative, forest degradation is accelerating. The government of the Lao PDR has begun to address forest conservation, establishing, for example, the Forestry Law in 1996 and the Land Law in 1997. Vital forestry issues include creation of land utilization plans by local residents themselves, the rehabilitation and afforestation of wasteland and the establishment of protected areas on the basis of these plans,

as well as the establishment of forestry operations which take into consideration protection of the living environment.

## **(5) Tourism**

With the Lao's ecological conditions, it should be possible to promote eco-tourism in the country's diverse regions. Luang Prabang and the Khone Falls on the Mekong River in the south of the country would be potential areas for the development of international tourism.

### **1-4-3 Infrastructure**

The Lao's biggest development challenge is the formation of an integrated domestic market, and in this sense the development of infrastructure such as roads, transport and communications is obviously of crucial importance. Further development of the electricity sector will also be needed in relation to boosting the Lao's foreign currency earning capacity.

Because of the Lao's geographical position as a land-bridge in continental Southeast Asia, domestic infrastructure development should be consistent with a broader range of infrastructure development plans such as the Greater Mekong Subregion plan.

### **1-4-4 Environment**

Protection of the environment, and particularly of forests, will be extremely important in sustaining economic growth in the Lao PDR over the long term.

For the present, the development of forest resources and hydropower will have to be utilized as sources of foreign currency and government revenue. This will mean making effective use of forest resources--for example, logging at less than growth volume on the basis of a forest planning system and securing good buyers--as well as exercising the two options of improving the efficiency of existing power generation facilities and also developing new electric power. However, adequate consideration should be given to the environmental impact of logging, new electric power development and development of the manufacturing industry to prevent a situation where these cause the degradation and destruction of natural resources and threaten sustainable development rather than leading to improved living standards and sustained socioeconomic development. Therefore, an environmental impact assessment mechanism and technology guidelines will need to be developed, with capacities strengthened in terms of formulating regulations.

In developing international roads as well, care should be taken over zoning to ensure that the basis of local livelihoods is not destroyed, and the relevant regulations should be developed to prevent improved access from leading to the destruction of forests through, for example, the introduction of unsuitable tree species or commercial logging. Moreover, to improve the effectiveness of government regulations, the government's monitoring capacities need to be enhanced, as does its capacity to formulate by laws in regard to the actual operation of these regulations.

### **1-4-5 Human resources development**

The Lao PDR has the highest population growth rate in the Southeast Asian region, with the result that children comprise an extremely large proportion of the population structure. Given the country's population characteristics, primary education, health care and anti-pov-

erty measures are obviously crucial to the economic and social development of the Lao PDR. Moreover, special attention needs to be paid to women, who are excluded from decision-making in their households.

In addition, skilled human resources need to be developed in order to improve the capacity of the government and modern sectors (including, for example, banks) to function efficiently under a market economy system. Moreover, vocational training for staff involved in electrical engineering, electric appliance repair and hotel work, as well as in commercial areas, would have a significant economic effect.

### **1-5 The Asian network and the Lao PDR development**

The Lao's accession to ASEAN in July 1997 undoubtedly provided it with the chance to participate in the dynamic Asian economic network. The Lao PDR can now bring in capital from international markets, including private sector investment and aid, and it has become much easier to introduce foreign technology. Moreover, the Lao PDR can now participate in foreign markets.

It is particularly significant that the country's reinstatement as an official member of the international community has put the Lao PDR in a position to receive aid from the international community aimed at development of the Indochina peninsula as a whole. Of special importance is that the Lao PDR can now make active use of initiatives by the international community such as the Greater Mekong Subregion development plan, which seeks to position the Lao PDR, located in the middle of the Indochina peninsula, as an area of strategic importance as a land-bridge for east-west and north-south traffic within the region. More specifically, it is of major significance that it has become easier for the Lao PDR to gain capital and technical support from sources such as the Asian Development Bank to develop infrastructure such as National Highways 9 and 13 and other roads through the country.

However, at the same time, it is a fact that the Lao PDR has also found itself faced with numerous strong competitors. It should not be forgotten that with the formation of AFTA, the Lao PDR has been left with very little time before its full-fledged participation in global markets. The Lao PDR is faced with a major constraint of fostering the supply capacity of the domestic economy before 2008, when it must basically reduce all tariff rates on imported products down to 0-5%.

Another major problem for development in the Lao PDR is that in becoming part of the Asian network through market economy transition and economic liberalization at its borders, the country has become much more vulnerable to fluctuations in the economic circumstances of neighboring countries. One concrete manifestation of this is the way in which the recent currency crisis in Thailand reduced Lao exports to Thailand and rose prices of raw materials and other imports from Thailand soaring, impacting heavily on the domestic garment industry and others.

Participation in the Asian network will undoubtedly create major problems for the Lao PDR in a number of aspects, and the costs and benefits to the Lao PDR of its accession to ASEAN will be a particular focus of this report. Despite the extremely high short-term costs incurred, it is clear that the only effective development strategy for the Lao PDR will be to overcome these difficulties one by one, simultaneously deepening its participation in the Asian

network. The international community should also work to ensure that the Lao government continues to be clearly cognizant of this fact.

## **2. Current State of Socio-economic Development in the Lao PDR**

### **2-1 Politics and administration**

Contemporary history of the Lao PDR can be divided into three periods: the revolutionary period resulting in the Lao People's Revolutionary Party's seizure of power; the period when the Lao's push forward from what was virtually a natural economy to socialist transformation; and then the period when the Lao PDR adopted an open-door policy and a market economy, influenced by the perestroika initiated in the former Soviet Union from 1986. The third period comprises two stages. The first stage is during the time when the international socialist regime headed by the Soviet Union existed and the Lao PDR received a variety of support as a member of this regime. The latter stage is after the destruction of the Soviet Union and the dissolution of the socialist regime.

Domestically, in the first stage of the third period, Lao PDR pushed forward boldly with its open door policy and the New Economic Mechanism under the leadership of President Kaysone Phomvihane, who could well be described as the nation's father. The second stage saw the country entering a new phase altogether: for example, the collapse of the Soviet Union and better relations between the People's Republic of China and Viet Nam improved Lao's foreign relations; internally the death of President Kaysone Phomvihane brought a change in leadership; a constitution was enacted, laying the groundwork for constitutional government; and the Lao PDR became a member of ASEAN.

When a nation enters a new phase, this generally necessitates new systems, strategies, policies and mechanisms. However, in the case of the Lao PDR, the Lao People's Revolutionary Party (LPRP) has provided consistent leadership throughout the contemporary history of the Lao PDR. The adoption of single-party rule has meant there have been no political alternatives to the LPRP, nor have new leaders emerged. It enables the party leaders to alter policies, strategies and even systems to respond to the new phase. The problem lies with the party members through from senior officials to subordinates who have been placed in the various posts within the administrative structure and are therefore in charge of implementing such new systems and policies. For them, the open door and market economy transition policy is a major transformation totally outside their experience. It is vital that these officials reform their mindsets and acquire new skills. The LPRP is currently making an effort to educate its executive members, but to achieve efficient administration and also economic development over the long term, higher education and specialist education will have to be enhanced and new intellectual factors added to the party.

#### **(1) Nature of the Lao People's Revolutionary Party**

After 30 years of conflict, the Lao People's Democratic Republic was established on December 2, 1975 through a bloodless revolution. While the main agent of revolution was the Lao Patriotic Front (Nèo Lao Hak Sat), led by Prince Souphanouvong, this was guided from the wings by the LPRP.

##### **<Establishment of the Lao People's Revolutionary Party>**

The LPRP was founded on 22 March 1955 as a fusion of political forces drawn two different sources. One grew out of the Lao Issara (Free Laos) movement which followed the example

of Viet Nam and Cambodia in declaring independence after the surrender of the Japanese Army in August 1945. Having returned to Indochina as an Allied Power, France refused to recognize the independence of the Indochina countries, and the leaders and members of Lao Issara fled to Thailand. Pressured by anti-colonialist feeling after World War II, France recognized the Lao PDR as an independent state within the French Union in July 1949, and most Lao Issara members returned home. However, Prince Souphanouvong and some of the other leaders set off to Viet Nam to fight alongside the Viet Minh. Ho Chi Minh, who was looking to the Lao PDR for a strong resistance force in the war against France, actively supported this group, despite the fact that as members of the Indochinese Communist Party, another Lao group was already engaged in guerilla warfare in the east as part of the Viet Minh resistance. Many of the left-wing leaders of Lao Issara were members of the royal family or upper-class urbanites who had studied abroad and were well-known as intellectuals <sup>(1)</sup>. During the war with the United States as well, they took part in the negotiations with the Royal Lao Government in Vientiane as representatives of the Lao Patriotic Front. As a result, outsiders saw them as having greater status and influence within the Lao People's Revolutionary Party than was actually the case.

The second force was the group which had joined the Viet Minh in the war against France from the outset as Lao members of the Indochinese Communist Party. Kaysone Phomvihane and Nouhak Phoumsavanh formed the Eastern Laos Resistance Committee in August 1946, leading a guerilla struggle. With the exception of Kaysone, the leaders of this group had no academic background and many had been laborers and farmers, while the soldiers who took part were mostly from ethnic minorities. This group handled the military struggle and later formed the nucleus of the Lao People's Army.

#### <After the Geneva agreement>

Under the 1954 Geneva agreement which ended the war against France, the Lao Patriotic Front was granted the provinces of Sam Neua and Phong Saly in the north as regroupment areas and waited for integration into the Royal Lao Government. However, the Vietnam War prevented the two factions from integrating and invited U.S. intervention in Laos, plunging Laos into a state of civil war. The Lao Patriotic Front fought what was at times a political struggle and at times a military struggle for the first ten years, with the latter decade dominated by military struggle.

Intensification of the military conflict increased the influence of the Lao People's Revolutionary Party on the nature of the Lao Patriotic Front. Moreover, at the Second Party Congress in February 1972 toward the end of the Vietnam War, the party changed its name from the Lao People's Party to the Lao People's Revolutionary Party, making clear the party's revolutionary character.

#### <Lao People's Liberation Army>

The Lao People's Liberation Army (or Pathet Lao) was born in Sam Neua on 20 January 1949 under the command of Kaysone Phomvihane <sup>(2)</sup>. Between 1962 and 1970, the number of troops doubled to reach 48,000 <sup>(3)</sup>. There were also 21,000 LPRP members by the time of the

<sup>(1)</sup> Stuart-Fox, Martin (1996), *Buddhist Kingdom, Marxist State*, White Lotus, Bangkok, p.54.

<sup>(2)</sup> Gunn, Geoffrey C. (1998), *Political struggles in Laos (1930-1954)*, Editions Duang Kamol, Bangkok, p.259.

<sup>(3)</sup> Stuart-Fox, Martin (1986), *Laos, Politics, Economics and Society*, Francis Pinter, London, p.30.

Second Party Congress. Because there was little need for administrative officials in the liberated zones, most LPRP members took part in army activities, resulting in a high ratio of military personnel within the LPRP. Because of the location of the liberated zones in the Sam Neua and Phong Saly provinces, with operations based in the mountains, up until 1975 more than 60% of LPRP members were apparently from hill tribes. Most of the Pathet Lao were recruited from the Lao-Teung, the Lao-Song and the Tai hill tribes <sup>(4)</sup>.

Over the nine years of war against the French, followed by 20 years of civil war and the Vietnam War, the LPRP and the Pathet Lao engaged in joint operations with the Vietnam Communist Party and the Vietnamese forces and fought together against a common enemy. Protecting the Ho Chi Minh Trail, the main supply artery from North to South Viet Nam, from the U.S. army was the strategic role of the Pathet Lao. During the Vietnam War, Lao political parties and the military were under the strategic command of the Vietnam Communist Party and military, with both sides fighting together as comrades in arms. This was the origin of the "special relations" between the Lao People's Revolutionary Party, and in particular the Pathet Lao, and Viet Nam.

## **(2) The Socialist transformation experiment**

### **<Establishment of single-party rule>**

The decade between 1975 and 1985 was the period when the Lao People's Revolutionary Party cemented single-party rule. It began by holding a National People's Congress in December 1975, establishing a new government and the Supreme People's Assembly. Souphanouvong, leader of the Lao Patriotic Front, was appointed as the first President, while secretary-general of the Lao People's Revolutionary Party Kaysone Phomvihane was made Prime Minister. In March 1977, former King Savang Vatthana, who had been appointed supreme adviser to the President, was arrested and confined together with his family. The Lao Patriotic Front had continued to act on behalf of the LPRP as representative of the Lao revolutionary forces, but in February 1979 this role was brought to an end, with the emergence of a unified front organization called the Lao Front for National Construction. In April 1982, the Third LPRP Congress was held, attended by 228 members representing the 35,000 party members. The Congress elected Prime Minister Kaysone as secretary-general, also appointing 55 Central Committee members and alternates, seven Politburo members and nine Secretariat members. The Cabinet was reshuffled in September, with all state and government key posts occupied by senior LPRP officials. Of the 24 Cabinet members, only seven were not on the Central Committee. Not only party personnel but also government ministers, vice-ministers and members of the Supreme People's Assembly were appointed by the LPRP Secretariat <sup>(5)</sup>. Since then, in the Lao PDR, the LPRP and the government, which implements the LPRP's policies, have been fused together.

### **<Socialist transformation>**

Once the Lao People's Revolutionary Party had completed the backbone of its political regime, it immediately launched into socialist transformation toward the construction of a command economy. It first nationalized banks and companies, then established state stores and a

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<sup>(4)</sup> *ibid.*, p.130.

<sup>(5)</sup> Stuart-Fox, (1986), p.81.

state commercial network. In June 1978, when the Politburo decided to expand moves to establish agricultural cooperatives, the government established a central committee for the guidance of agricultural cooperatives. However, farmers were strongly resistant to being collectivized, and in July 1979, the government was forced to discontinue the collectivization movement. At that point, there were 2,800 agricultural cooperatives, embracing 25% of farming households<sup>(6)</sup>. With the exception of the city of Vientiane and around Savannakhet, there was still little class division among farmers in the villages, with few landlord-tenant relationships. As a result, the Lao PDR did not institute the land reforms that are normally conducted before the collectivization of agriculture in other socialist countries. In farming villages in other countries, land reforms turned landless farm workers and poor farmers into the small landholders they had aspired to be, creating supporters for the reform administration. This also tended to provide the engine for collectivization. Lao farmers not only had nothing at all over which to feel grateful to the new administration, they were angry at the government because of the agricultural tax introduced by the new administration in October 1976, and because they forced the purchase of their rice at 25 Kip per kilogram where it had fetched 200 Kip on the free market<sup>(7)</sup>. Farmers responded to collectivization by decreasing production, killing their livestock and selling surplus rice on the black market. What the new government perceived as a threat was farmers beginning a mass exodus to Thailand on the opposite bank of the Mekong River.

#### <Economic liberalization>

In 1976, 20,000 people fled to Thailand because of the worsening economic situation and their dislike for socialist transformation, which included sending people off to re-education centers. This swelled to 50,000 in 1978, mostly comprising farmers from the south<sup>(8)</sup>. After 1979, the Lao PDR discontinued collectivization and liberalized sales of farmers' surplus rice, also easing restrictions on the movement of people and goods and adopting a policy similar to the Soviet Union's New Economic Policy. The first Five-Year Plan (1981-85) lists as basic responsibilities (i) the expansion of agricultural production; (ii) the creation of key enterprises related to the economy and defence; and (iii) the establishment of the dominant position of the national economic sector. However, because of the shortfall in agricultural tax revenues, the country had to depend on foreign aid for the fiscal capital needed to create these key state enterprises.

#### <During the PRC-Viet Nam Conflict>

Between 1975 and 1985, the Lao PDR became involved in the Sino-Soviet confrontation which occurred toward the end of the Cold War, as well as the conflict between China and Viet Nam which arose as part of this. In July 1977, the Lao PDR concluded a 'Treaty of Friendship and Cooperation with Viet Nam, with both parties affirming "special relations" between them and pledging long-term cooperation and mutual assistance<sup>(9)</sup>. As a result of this treaty, Viet Nam stationed 50,000 troops in the Lao PDR to help maintain civil order and support national defense. Since the Lao PDR joined Viet Nam in siding with the Heng Samrin administration in Cambodia, not only antagonizing China but also damaging relations with Thailand and the other ASEAN countries, Japan, France and the United States, the Lao PDR ended up leaning

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<sup>(6)</sup> Stuart-Fox, (1996), p.117.

<sup>(7)</sup> *ibid.*, p.111.

<sup>(8)</sup> Stuart-Fox, (1986), *op.cit.*, pp.33-39.

<sup>(9)</sup> Institute of Developing Economies (1979), *Ajia doko nempo* 1978, p. 272.



internationally toward the former Soviet Union and the East European countries, as well as Viet Nam.

### (3) New Economic Mechanism (NEM)

The Lao PDR and Viet Nam were both critically influenced by the Gorbachev administration coming to power in the Soviet Union in March 1985 and the subsequent call for *perestroika*. Viet Nam started to stress *doi moi* (renovation) policies, while in the Lao PDR the emphasis was on *chintanakan mai* (new thinking) and economic reform. Over 1979 and 1980, the Lao PDR adopted policies such as discontinuing agricultural collectivization, relaxing market control policies and boosting wages for civil servants as well as prices for government-purchased agricultural produce. However, it then began to move back toward collectivization and the establishment of a command economy. There was growing concern within the party that allowing a market economy would lead to a revival of capitalism. Advice from the Soviet Union, Lao's largest donor, played a decisive role in the eventual dominance of the reform faction<sup>(10)</sup>.

#### 1) Economic reform

In November 1986, the Fourth LPRP Congress decided to introduce the New Economic Mechanism. This comprised five planks: (i) price determination and resource allocation would be left to the market; (ii) domestic and foreign trade would be liberalized, as well as the distribution of goods and capital; (iii) more autonomy would be given to companies and local authorities; (iv) command-based economic planning would be replaced by guidance-based planning; and (v) foreign investment would be actively introduced<sup>(11)</sup>.

##### <One product one price system>

The Lao's transition to the NEM began with a shift from a multiple price system to a one product one price system.

A June 1987 decree on price determination stated that the market would determine retail prices, while wholesale prices would be determined through agreement between buyers and sellers. Foreign currency exchange rates would be made uniform. Government agencies and local authorities would be forbidden to interfere in retail prices<sup>(12)</sup>. The government would set prices on 10 items, including electricity, water and fuel. In September 1987, the seven exchange rates were streamlined to four, with the commercial trading rate lowered from 95 to 350 Kip to the dollar. From mid-1988, the exchange rate was set at 400 Kip to the dollar, with adjustments subsequently made in line with free market fluctuations<sup>(13)</sup>. Price determination brought the price at which state commercial organizations purchased agricultural products closer to the market price, and at the same time, subsidies on fertilizer and other agricultural inputs were abolished. It was decided to leave the agricultural tax rate unchanged for three to five years from 1986, with payment

<sup>(10)</sup> Mikhail Gorbachev [translated by Kudo and Suzuki] (1996), *Gorbachofu Kaisoroku*, second volume, Shinchosha, pp. 532-533.

<sup>(11)</sup> Rigg, Jonathan, (1995), "Managing Dependency in a Reforming Economy: The Lao PDR", *Contemporary Southeast Asia*, Vol.17, No.2, p.151.

Chanthanavong Saignasith, (1997), "Lao Style New Economic Mechanism", in Mya Than & Joseph L.H. Tan eds., *Laos' Dilemmas and Options*, ISEAS, Singapore, p.25.

<sup>(12)</sup> *Ajia doko nempo* 1988, p. 278.

<sup>(13)</sup> Funck, Bernard, (1993), "Laos: Decentralization and Economic Control", in Ljunggren. Borje ed., *The Challenge of Reform in Indochina*, Harvard University, Boston, p.131.

accepted in cash or kind. In terms of rice harvests, 160 kg of unhulled rice was levied for paddies producing more than 3,501 kg, and 100 kg for paddies producing less than 2,500 kg<sup>(14)</sup>.

#### <Rethinking agricultural collectivization>

It is not clear when and in what form the government started to review agricultural collectivization in line with the NEM. However, review on a national scale was conducted from 1 June 1988 at the First National Congress of Farmers' Union and the following Sixth Plenum of the LPRP Central Committee. The government announced in regard to collectivization that there were 3,420 agricultural cooperatives in 1985, with 52% of farming households participating<sup>(15)</sup>, while in 1986 the total was 3,976, with a participation rate of 74%, indicating a rice paddy collectivization rate of 65%<sup>(16)</sup>. However, Politburo member Sali Vongkhamsao, Chair of the State Planning Committee, said at the National Congress of Farmers' Union in June 1988 that 62% of farming households had been collectivized, with a 55% rate of rice paddy collectivization<sup>(17)</sup>. This suggests that collectivization was probably brought to a halt in 1987, with the government beginning to rethink agricultural cooperatives.

The National Congress of Farmers' Union offered the following self-criticism. The LPRP and the government had hurried collectivization, forcing participation in agricultural cooperatives regardless of farmers' wishes, and making them work collectively. In addition to allocation being based on days worked, management had been poor, diminishing farmers' incentive to produce. As a result, the state had not been able to utilize the potential of farmers or their land<sup>(18)</sup>.

The resolutions of the Sixth Plenum of the LPRP Central Committee were not announced, but according to the newspaper *Pasason*, the right of land-ownership would be held by the state, but farm land and forests would be allocated to each village and thence consigned for use to individual farming households. This signaled a radical shift, giving farmers the right to long-term land use and to bequeath and transfer this land, in exchange for payment of a land tax and delivery of five to 8% of total production<sup>(19)</sup>. On 5 April 1989, the government issued a provisional decree on the management and use of farm land. The essence of the decree was to grant permanent land use rights to those farming that land. Farm land used by agricultural cooperatives and state farms would be divided among former cooperative members<sup>(20)</sup>. This marked the abandonment of agricultural collectivization.

#### <State enterprise reform>

Transition of state enterprises by adoption the New Economic Mechanism began early. In August 1986, the Cabinet decided that state enterprises would be converted into economically independent companies. In 1987, it was announced that 186 of the 377 state enterprises nationwide had made the shift to financial self-sufficiency. Vientiane Broad-

<sup>(14)</sup> *Ajia doko nempo* 1988, p. 278.

<sup>(15)</sup> *Ajia doko nempo* 1987, p. 252.

<sup>(16)</sup> *Ajia doko nempo* 1988, p. 275.

<sup>(17)</sup> *Ajia doko nempo* 1989, p. 276.

<sup>(18)</sup> *Ajia doko nempo* 1989, p. 270.

<sup>(19)</sup> *Pasason*, 26 August 1988.

<sup>(20)</sup> *Ajia doko nempo* 1990, p. 270.

casting noted on 6 March 1988 in a discussion program entitled "Toward a Steady and Comprehensive Shift of the Lowest-level Economic Units to Financial Self-sufficiency" that the lowest units had to display autonomy in four areas--fiscal aspects, raw material purchases and product sales, creation of business plans, and acting as corporate bodies--while upper-level organizations should not interfere in these activities <sup>(21)</sup>.

In addition to the reform of state enterprise management, the government also opened the door for a private economic sector and capitalist management, even adopting policies which used these to stimulate the economy. Under a 28 July 1989 decree on bank financing, banks became able to provide financing equally to all economic units, whether private or state. The establishment of private banks was also permitted. At the same time, the government gave the State Bank the power to determine Kip exchange rates. On 4 August 1989, a company registration decree was promulgated, allowing private companies to undertake the same economic activities as state enterprises and collective enterprises as long as they registered with the authorities and paid taxes. With the exception of a few commodities, state monopolies on imports and exports were also abolished. Under this decree, those Vientiane hotels which had been possessed by the state were returned to their original owners <sup>(22)</sup>.

The most important pillar of the New Economic Mechanism was the use of foreign capital. The Foreign Investment Law was promulgated on 29 July 1988. This law contained a number of incentive measures, guaranteeing non-nationalization, and allowing the establishment of 100% foreign-owned companies, the employment of foreigners and the remittance of profits <sup>(23)</sup>. On 4 September 1988, a garment manufacturing merger contract was signed first of all with a Thai company.

## 2) Political and diplomatic transitions

### <Shift to a constitutional state>

As of 1975, the Lao PDR had had no national assembly chosen through nationwide elections. The Supreme People's Assembly which had been in place was a provisional institution set up by the National People's Congress. If the Lao PDR was going to open itself up to the outside world, it urgently needed to draft a Constitution and establish a national assembly. Following on from local assembly elections in 1988, general elections were held on 26 March 1989. It would be difficult to describe these elections as free, with candidates chosen by the LPRP-guided Lao Front for National Construction, but it was a step away from a revolutionary state toward a constitutional one. Secretary-General Kay-sone stated that the formulation of a Constitution was the first priority of the Supreme People's Assembly.

### <Multi-directional diplomacy>

Perestroika in the Soviet Union brought about a turning point in the Lao's foreign policy. As relations between China and the Soviet Union improved, the Cambodia issue moved toward resolution, and China-Viet Nam relations also showed positive signs. During 1987, the Lao PDR virtually restored its relationship with China, and in June 1988,

<sup>(21)</sup> *Ajia doko nempo* 1989, p. 275.

<sup>(22)</sup> *Ajia doko nempo* 1990, pp. 270-271.

<sup>(23)</sup> In regard to the foreign investment law, see Reference 2, Toshikatsu Aoyama, (1995), *Raosu*, Chuokoron Shinsho, p. 227.

ambassadors from both countries submitted their credentials to the counterpart country's head of state. In December 1987, a military encounter occurred between the Lao PDR and Thailand in the Boten district of Xayaboury Province, but progress was subsequently made in improving relations, and in 1988 Thai Prime Minister Chatichai Choonhaven visited the Lao PDR. Cooperation with Thailand is an essential element in Lao's open-door policy. In addition to Thailand, the Lao PDR began rapprochement with the United States, Japan, France and West Germany, with Prime Minister Kaysone visiting Japan in November 1989 and France in December the same year. At the Soviet-Lao Cooperation Commission meeting in February 1989, the Soviet Union put forward the principle of cooperation in line with each side's capacity, and said that it was unable to guarantee in the next Five-Year Plan (1991-1995) the 250 million rubles in economic assistance received under the previous Five-Year Plan (1986-90). It also demanded that hard currency be used in trade settlements with the Lao PDR. This stance turned the Lao PDR toward economic cooperation with Japan and industrialized Western countries such as France.

#### (4) Economic development within intraregional cooperation

##### 1) Establishment of a constitutional system

###### <Enactment of the constitution>

While the Supreme People's Assembly constitutional enactment committee was working on the constitution, socialist administrations in East Europe were collapsing one after another. The Tiananmen incident occurred in China, but the single-party rule of the Chinese Communist Party was protected through military action. In March 1990 in Viet Nam, Politburo member Tran Xuan Bach, advocate of complete reform of the political regime in tandem with economic reform, was overthrown. In this international climate, eyes were on how the LPRP's status would be defined in the draft constitution--whether a multi-party system would be introduced or whether single-party rule would be maintained.

In the first draft, announced in May 1990, a clear reference to the Lao People's Democratic Republic as a people's democratic state led by the Lao People's Revolutionary Party (LPRP) drew criticism at home and abroad. An underground broadcast by the Lao People's Liberation Government, most members of which are ethnic Hmongs, called for the government to be brought down, accusing Kaysone of Stalinism<sup>(24)</sup>. On 8 October, Thongsouk Saisangkhi, former Deputy Minister of Science, Latsami Khamphoui, former Deputy Minister of Agriculture and Forestry, and four others were arrested for demanding introduction of a multi-party system. Lao students who had been sent to Czechoslovakia and Poland also held demonstrations in front of the Lao embassies in these countries, demanding a multi-party system, a free and democratic national assembly and the withdrawal of Viet Nam forces from the Lao PDR<sup>(25)</sup>. These voices were seized without effecting any change in the draft of Constitution.

The Fifth LPRP Congress was held at the end of March 1991. This Congress decided that while the Lao PDR would work toward socialism in the future, the immediate target was to establish a people's democracy, so party-led efforts toward complete political, eco-

<sup>(24)</sup> *Ajia doko nempo* 1991, p. 277.

<sup>(25)</sup> *Ajia doko nempo* 1991, p. 278.

conomic and social reform would be continued <sup>(26)</sup>. The LPRP's Rules and Regulations were revised at this Congress, with the Secretariat abolished and the post of LPRP Chairman established. Secretary-General Kaysone was elected as the first Chairman <sup>(27)</sup>. Abolition of the Secretariat focused daily LPRP administration in the hands of the Chairman and the Politburo, members of which have become younger, boosting Kaysone's power considerably.

<Government organs>

The first constitution of the Lao People's Democratic Republic was promulgated on 15 August 1991. Article 3 states that the rights of the multi-ethnic people to be the masters of the country are exercised and guaranteed through the functioning of the political system with the Lao People's Revolutionary Party as its nucleus. The People's National Assembly, which was the representative organ of the people, could formulate laws and elect and remove the President and Vice-President, Cabinet members, the President of the Supreme People's Court and the People's Public Prosecutor General <sup>(28)</sup>.

A major break with the past was local administration. Administration of provinces, special cities and districts had been in the hands of provincial, municipal and district people's councils. There were no provisions in the constitution at all for elections of provincial assemblies or provincial leaders. Provincial governors and city mayors were designated by the President, while deputy governors, deputy mayors and district chiefs were appointed by the Prime Minister. On 16 August 1991, the government issued a Cabinet decision on the centralization and unification of state finances, the budget and treasury management. This dissolved the budget spending management centers which had been run independently by the various government organs and local provinces and cities, bringing all spending under the central government's Ministry of Economy, Planning and Finance. Because the constitution in this way gave enormous powers to the National Assembly and the President and unified public finances, local governments lost power and the centralization of power and national unification gained momentum.

<Post-constitution political system>

Immediately after promulgation of the constitution, the Supreme People's Assembly elected LPRP President Kaysone as President of State and Politburo member Khamtai Siphandon as Prime Minister. Khamphuoi Keoboulapha, another member of the Politburo, was appointed as Deputy Prime Minister and Minister of Planning and Finance, with General Choummali Saignasong as Minister of National Defense. All major posts in the new government were held by members of the LPRP's Politburo, and most other ministers were members of the Central Committee. It seems as though the work of the abolished LPRP Secretariat had simply been transferred to the Cabinet. In November 1991, the Lao PDR and the United States agreed to establish diplomatic relations at ambassador level; and in July 1992 both countries appointed new ambassadors. The Lao PDR and Viet Nam both signed the Southeast Asian Treaty of Friendship and Cooperation in July 1992. Just as the Lao PDR was setting up a constitutional system at home and developing multi-directional diplomacy abroad, President Kaysone, orchestrator of the shift to the

<sup>(26)</sup> Political report at Party Congress. FBIS-EAS-91-071-S (April 12, 1991), p. 6.

<sup>(27)</sup> Revised Party Articles. *Ibid.*, p. 20.

<sup>(28)</sup> Toshikatsu Aoyama, *ibid.*, pp. 214, 239.

New Economic Mechanism, suddenly died. Prime Minister Khamtai Siphandon was appointed LPRP President, while Nouhak Phoumsavan, Chair of the Supreme People's Assembly and Politburo member, became President of State. After Kaysone's death, therefore, the two posts which he had held simultaneously--LPRP president and president of state--were divided among two party members.

On 20 December 1992, the first National Assembly elections were held based on the constitution. 99.33% of voters cast votes, with 85 members elected from among 154 candidates. In terms of ethnic background, 108 candidates were Lao Loum (lowland Lao), 29 Lao Theung (midland Lao) and 17 Lao Soung (highland Lao). Of those elected, 52 were Lao Loum, 16 Lao Theung and 17 Lao Soung, with Lao Soung candidates favored to the extent that all were elected<sup>(29)</sup>. These National Assembly elections and the subsequent Cabinet reshuffle were unique in terms of being guided by the Lao People's Revolutionary Party, but a constitutional system was at least set in place.

## 2) Accession to the Association of South-East Asian Nations (ASEAN)

### ① Sixth Party Congress

The Sixth LPRP Congress was held in March 1996 in Vientiane, attended by 381 party members representing all 78,000 party members (1.7% of the Lao's population). Secretary-General Do Muoi from the Vietnamese Communist Party, Wen Jibao, an alternate politburo of the Chinese Communist Party and Chea Sim and First Prime Minister Ranariddh from Cambodia attended as state guests.

The Congress chose 49 Central Committee members and nine Politburo members, among them Khamtai Siphandon, Chair of the Central Committee. President Nouhak Phoumsavan stepped down from the Politburo to become advisor to the Central Committee, effectively losing power, while the position of President of State became a mere title. At the National Assembly in April, Sisavat Keobounphan, a Politburo member ranked eighth within the LPRP, was elected as Vice-President to assist the aging President (who was born in 1914). Despite being the national figurehead and Supreme Commander of the Army, the President is in fact subordinate to the LPRP Chairman. Moreover, even after formulation of the constitution, the custom remains of holding a Plenum of the Central Committee to gain its approval on the establishment of laws, the economic plan for each fiscal year and the draft budget immediately before these are deliberated by the National Assembly. Economic policies and development strategies are determined by the Politburo and the Central Committee, approved by the National Assembly and implemented by the administration. All main state and government posts are held by party executives. At the Sixth LPRP Congress, party executives were expected to have a dual function--a specialist function in terms of administration, as well as involvement in Central Committee activities<sup>(30)</sup>.

These executives, who had been trained according to socialist ideology during the war period, have been faced with the need to acquire new knowledge and skills in line with the shift to a market economy. Of the 49 Central Committee members elected at the Sixth Party Congress, 76% had entered the party before the 1975 revolution--in other words, those who had fought in the revolution as soldiers, originating, moreover, from mountain

<sup>(29)</sup> *Ajia doko nempo* 1993, p. 239.

<sup>(30)</sup> FBIS-EAS-90-060 (March 27, 1996).

areas such as Phong Saly and Sam Neua, center of support for the Lao Patriotic Front. It is easy to imagine such men resisting sudden liberalization and open-door policies. This was also because the New Economic Mechanism had created overly large disparities in income between people in Vientiane and those in the mountains. This is why the new Central Committee is apparently conservative<sup>(31)</sup>.

Deputy Prime Minister Khamphoui Keoboualapha, who had pushed forward with the NEM under President Kaysone, lost his positions in the Politburo and Central Committee, while Minister of Communications, Transport, Posts and Construction Phao Bounnaphon and Chief Cabinet Secretary Khamsai Souphanouvong also lost their seats on the Central Committee. At the LPRP Congress, they were criticized as having transferred a number of state enterprises abruptly to other forms of ownership during the reform process, bringing about the loss of state assets<sup>(32)</sup>. With seven of the nine Politburo members military men, Khamtai Siphandon has a strong sway over party leadership, which is aiming for a market economy operated under state control<sup>(33)</sup>.

## ② Accession to ASEAN

The cohesiveness of leadership under the Khamtai administration has allowed the Lao PDR to move forward steadily if cautiously with reform and open-door policies. The political report of the LPRP Congress noted in regard to foreign relations that the objective was to develop: 1) the external environment for reform; 2) that economic cooperation with other countries would be expanded and foreign investment promoted; and 3) that the Lao PDR would develop the necessary conditions for cooperation with its neighbors and other Southeast Asian nations, then for accession to AFTA (ASEAN Free Trade Area) and the World Trade Organization (WTO) membership<sup>(34)</sup>. In July 1997, the Lao PDR joined ASEAN together with Myanmar, simultaneously submitting an application for accession to the WTO.

Ideologically, the Lao PDR is close to Viet Nam and China, retaining special relations with Viet Nam. However, in terms of economy, the Lao's ties with Thailand are vital, and there are many matters which should be coordinated between the two countries, such as freight charges and electricity rates. Through accession to ASEAN, the Lao PDR probably hopes to open the door to international specialization and development cooperation within the ASEAN region and to check the weight of Thailand in economic negotiations, as well as using ASEAN as a buffer between itself and the democratization demands and economic pressure placed by industrialized donor countries.

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<sup>(31)</sup> Bourdet, Yves, (1997), "Laos in 1996", Asian Survey, Vol.37, No.1, p.33.

<sup>(32)</sup> FBIS, *ibid.*, p.48.

<sup>(33)</sup> FBIS, *ibid.*, p.53.

<sup>(34)</sup> FBIS, *ibid.*, p.57.

## 2-2 Macroeconomy

### 2-2-1 Current state

#### (1) Economic reform

Despite efforts to institute a planned economy after the 1975 socialist revolution, by the late 1970s it was already being widely argued within the government that economic reform and liberalization were essential in supporting the important role which private activities should play in the economic development process. It was recognized that as a result of planned economy, (i) the production incentive of state enterprises and farmers had stagnated; (ii) mobilization of domestic savings had failed; and (iii) private enterprise development had been significantly impeded, throwing away growth and development opportunities<sup>(35)</sup>. To deal with these issues, the Lao PDR followed other transition economies in launching in one stroke the following economic reforms toward creation of the New Economic Mechanism, starting with the reorganization of certain state enterprises in 1985<sup>(36)</sup>:

- (i) Introduction of financial self-sufficiency in the operation of state and public enterprises
- (ii) Liberalization of agricultural produce prices (abolition of the government purchase price system for rice)
- (iii) Liberalization of retail prices (with the exception of public utility charges) and of foreign exchange rates (abolition of the multiple-rate system)
- (iv) Guarantee of free participation by private enterprises in production and distribution
- (v) Development of the monetary sector (separation of the Central Bank and commercial banks, introduction of the phased liberalization of deposit loan interest)
- (vi) Privatization of state and public enterprises (sale and lease)<sup>(37)</sup>
- (vii) Phased implementation of a plan for cutting the number of civil servants by 25%
- (viii) Development of various laws, particularly in economic areas (the Foreign Investment Law, etc.)
- (ix) Treasury asset management and centralization of budget (revenue and expenditure) execution (abolition of local government financial self-sufficiency)

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<sup>(35)</sup> The argument here is drawn from Kenji Domoto, *Raosu: Keizai kaihatsu no genjo to kokusai kyoryoku no hoko*, Shiga University, *Hikone ronshu*, No. 297, October 1995.

<sup>(36)</sup> The implementation of this series of reform measures was closely tied with the various structural adjustment financing packages the Lao PDR received from the IMF and the World Bank from 1989 onward and the various types of technical cooperation provided by the UNDP.

<sup>(37)</sup> Viewing inefficient state and public enterprises (the latter under provincial government jurisdiction) as worsening the fiscal deficit of the government sector, the government is pushing ahead with privatization through asset sales and leases. According to World Bank materials, the 600 state enterprises at the end of the 1980s had been reduced to 90 as at February 1997. Unlike China and Viet Nam, rationalization or privatization of state enterprises in the Lao PDR will not immediately provoke a major employment problem, which is why such dramatic privatization progress has been possible. At the same time, because the Lao PDR still has not developed the laws and implementation regulations for privatization, with technical problems such as the lack of uniformity in state-held asset evaluation methods and business report formats, the privatization process tends to lack transparency.



- (x) Liberalization of the foreign trade sector with the exception of mineral products and timber.

At the National Assembly in February 1993, the government also delineated the 'Socioeconomic Development Guidelines Toward the Year 2000' <sup>(38)</sup> \* <sup>(39)</sup> . The basic course of this plan was i) the expansion of production activities based on market principles, as well as ii) finding the way out from underdevelopment and developing a democratic system. It espoused a development strategy of electricity, manufacturing, transport and communications development, promotion of the development of rural villages <sup>(40)</sup> , active absorption of private sector foreign direct investment <sup>(41)</sup> , development of human resources, and maintaining a balance between economic development and environmental issues. The Lao PDR is currently implementing the 1996-2000 Socioeconomic Development Plan (below, the 2000 Plan), adopted at the Ninth Ordinary Session of the National Assembly in the third quarter of October 1996. Economic prospects related to this plan are discussed below.

## (2) Economic structure

The macroeconomy has remained generally stable since the Lao PDR launched economic reform in earnest in 1986. The real economic growth rate and inflation rate in particular maintained a generally stable course from 1989 when the World Bank and the International Monetary Fund (IMF) began structural adjustment financing up until the Thai currency crisis in the summer of 1997, with the economy developing steadily (Table I-1). Partially as a result of the various economic reform measures described above, economic stability over the last decade has also been underpinned in terms of production by the agricultural sector, which comprises around 60% of GDP. This remained relatively favorable despite drought and flood damage. Activation of the manufacturing industry also contributed <sup>(42)</sup> , particularly the garment industry, which has grown tremendously since 1988, while an expanding construction sector and service sector growth, including hotels and restaurants, played a significant part (Table I-2). The expansion of these production sectors has been paralleled by a trend toward greater foreign investment since the development of the Foreign Investment Law in 1988. As of December 1997, a total of around 5.9 billion dollars in foreign investment had been approved, around 47% of which is Thai capital; other main investors include the United States (26.6%), the Republic

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<sup>(38)</sup> "Speech by Mr. Khampoui Keoboulapha, Deputy Prime Minister, at the Annual Ordinary Session of the National Assembly, February 22, 1993, Vientiane"

<sup>(39)</sup> Four Five-Year Economic Development Plans have been implemented, including a provisional Three-Year Plan. For reasons of space, these are not considered here.

<sup>(40)</sup> Ethnic minority measures have been an important task since the revolution. Seeking to avoid a growing disparity between urban and rural areas, the government has made rural development a priority area, while emphasizing both at home and abroad a step-by-step approach to prevent sudden implementation of liberalization measures from impacting negatively on ethnic minorities.

<sup>(41)</sup> The Foreign Investment Law was announced in 1988 and revised in 1994. However, the government has been slow to develop the related domestic economic laws and regulations, while there continue to be strong doubts as to the government's administrative ability to implement these, as well as to the quality of road, telecommunications and other infrastructure services. As a result, where the Lao PDR's Foreign Investment Law was originally seen as containing preferential measures on a par with the Foreign Investment Laws of the ASEAN countries, it has in fact been unable to dispel the concerns of Japanese companies and other potential investors. That the implementation regulations for the 1994 revised Foreign Investment Law have yet to be officially announced is one manifestation of the problem.

<sup>(42)</sup> However, it is difficult to imagine that the garment industry and other such labor-intensive industries will have the major long-term effect in terms of raising income levels and absorbing employment as they have in other Southeast Asian countries. Compared to its neighbors, it would be extremely difficult for the Lao PDR from the perspective of labor force scale, or even the scale of the unskilled labor force, to strengthen and maintain international competitiveness in areas which use standardized production technology and which are generally considered as labor intensive.

of Korea (5.7%), Australia (5.1%) and Malaysia (4.9%). By sector, 66.1% of investment is in energy, 10.5% in manufacturing<sup>(43)</sup> and 20.7% in services (Table I-3).

Over the late 1980s and early 1990s, Lao's foreign trade has undergone a major transformation (Tables I-4 and I-5). With the tide of economic liberalization steadily expanding the domestic economy, the amount of trade has continued to grow, with the trade balance also improving amid a significant shift in the composition of import and export trade partners and commodities. Looking at Lao's main trade partners, in 1996 Viet Nam and Thailand alone accounted for 80% of total exports at 49.1 and 30.2% respectively. In terms of imports, Thailand alone accounts for 45.0%, followed by Japan (7.6%), Viet Nam (3.7%), China (3.4%) and Singapore (2.5%). In addition to such traditionally important foreign exchange sources as timber and electricity, there has also been tremendous growth in recent years in exports of motor-cycles (mainly for the Vietnamese market) and garments for the U.S. and French markets. Along with timber and electricity, these contributed significantly to export growth and improvement of the trade balance; in all cases, however, a major element has been the rapid increase in imports of machinery and raw materials from Thailand. The other noteworthy aspect of Lao imports, apart from machinery and raw materials is the size of the share of consumer goods such as foodstuffs and daily miscellaneous goods. At this point in time, the Lao PDR has not achieved food self-sufficiency, while the country's weak industrial production base has made it heavily dependent on imports from Thailand for daily miscellaneous goods.

### **(3) The 1996-2000 Socioeconomic Development Plan and economic prospects according to the IMF**

The Year 2000 Plan aims to raise the annual average economic growth rate to 8 to 8.5% by the year 2000, and to boost per capita GDP from the 1995 level of 350 dollars to 500 dollars within the same period (Table I-6). Bearing in mind the balanced distribution of benefits from economic development, the plan prioritizes eight areas: food production; forest and water resource conservation through the stabilization of slash and burn agriculture; expansion of commercial production activities; development of domestic infrastructure; development of farming villages; improvement of external economic relations; human resources development; and development of international infrastructure. Since the Lao PDR does not compile statistics for expenditure under national income accounting, this aborts discussion on how the government envisages that the goals of the Year 2000 Plan can be met in terms of macro investment and savings. However, a rough understanding of the Year 2000 Plan can be gained through a comparison with the Summary Macroeconomic Framework 1995-2004,<sup>(44)</sup> a report created independently by the IMF<sup>(45)</sup>.

According to the IMF scenario, by maintaining a domestic investment rate of 26 to 30.5% of GDP toward 2004, even with a somewhat low investment rate--a marginal capital-output ratio of 4--the Lao PDR should be able to achieve an annual economic growth rate of around 7% by 2000, maintaining an annual 6.5% even from 2001 onward (Table I-7). This scenario also suggests that a domestic investment rate of as much as 30% deriving from government investment and private domestic investment (excluding electricity) should be possible over the long

<sup>(43)</sup> Total of textiles and garments, wood processing and other manufacturing industries.

<sup>(44)</sup> IMF, (1997), *Lao People's Democratic Republic. Staff Report for the 1997*

<sup>(45)</sup> According to the Lao PDR State Planning Committee, the government intends revising the Year 2000 Plan once it has determined the effect of the Thai economic crisis on the national economy. As at February 1998, studies were underway on the situation in regard to public investment and foreign debt payments.

term through the mobilization of domestic savings, with the result that the ratio of investment in electricity development should continue to trend down below the 1996 peak. The degree of dependence on foreign savings should also drop rapidly from 2001 onwards as a result of greater domestic savings mobilization. Assuming that investment effectiveness will not change much, the critical factor in realizing the IMF scenario will be the mobilization of domestic savings to supplement large-scale domestic investment.

The government target of a macroeconomic growth rate of 8 to 8.5% by 2000 is an ambitious level higher than past performances, and also higher than the IMF forecasts. If the Lao PDR is to reach and maintain such high economic growth while reducing its dependence on foreign savings, it will have to work harder to mobilize domestic savings than would have been necessary under the IMF scenario, which postulates some unavoidable dependence on foreign savings up to 2000.

#### **(4) Impact of the Thai economic crisis**

The Thai economic crisis, surfacing with the sudden depreciation of the baht against the dollar in the summer of 1997, should be seen as impacting to some extent on the above-mentioned Year 2000 Plan and the IMF's economic forecast. Given the weight of the so-called "unorganized economy" in the Lao economy as a whole, even in the capital of Vientiane, it is extremely difficult to analyze accurately how much influence economic crises in neighboring countries will have, or through what routes this influence will be felt. However, for example, the Kip fell close to 100% against the dollar between the summer of 1997 and January 1998, when it stood at around 2300 Kip to the dollar. In terms of ordinary trade, the traditional loom weaving industry, which has gradually developed as part of tourism, has been impeded by the need to pay in dollars for importing Chinese looms. The sudden devaluation of the Thai baht has even affected the export performance of timber, formerly a major export commodity and dollar earner.

As was noted above, Lao's external relations are structured with a heavy dependence on Thailand in terms of both trade and investment. Moreover, while the Year 2000 Plan of the Lao PDR government and the IMF economic forecast depend overall on the expansion of domestic investment, we argue in the next section that the underlying assumption is that the current account balance, and particularly the trade balance, will remain stable. In other words, the longer the Thai currency and economic crisis drags on, the further Lao's growth rate forecasts and target growth rates will have to be revised downward.

However, the relationship between how soon the Thai economic crisis can be resolved and Lao's economic prospects will not be discussed below. The focus will instead be on the Lao's structural problems, and the need for medium- to long-term efforts to address these.

#### **(5) Investment-savings balance**

##### **1) Foreign aid and private foreign investment**

United Nations Development Programme (UNDP) materials on the aid the Lao PDR received between 1990 and 1996 and current account balance trends<sup>(46)</sup> show that the country received more than enough official development assistance (grant aid and loans) between

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<sup>(46)</sup> UNDP, *Report on Lao PDR Macroeconomic Performance, May, 1997*.

1990 and 1993 to cover the current account deficit, with the exception of aid. Since 1994, however, the current account deficit has greatly exceeded ODA and been supplemented by foreign capital (including direct investment) (Table I-8). The IMF forecast deals with this issue by postulating that private foreign investment will continue to cover part of the current account deficit up to 2004. According to the IMF, one condition of the Lao's international account stability is that the country continues to see an annual inflow of around 200 million dollars in foreign capital aside from the 80 to 90 million dollars received in grant aid. Policies which will ensure a stable inflow of foreign investment will therefore become even more essential. As the scale of the Lao PDR economy grows in years to come, and even more so as the Greater Mekong Subregion Plan moves into the implementation phase, the Lao PDR is likely to become increasingly dependent on private foreign capital and loans. However, given the fragility of the macroeconomy, private direct investment and other long-term rather than short-term capital will have to be introduced to maintain stable operation of the international account. An ongoing uncontrolled inflow of short-term capital could interfere with the smooth operation of the macroeconomy as a whole, as well as putting pressure on the country's debt-bearing capacity<sup>(47)</sup>.

## 2) Private savings

For the Lao PDR to mobilize domestic private savings over the medium to long term, it should first promote the monetization of the economy and maintain and stabilize the value of currency as means of absorbing economic activities such as self-sufficient agriculture which does not use money into more modern economic activity. Much of the economic surplus still remains inadequately absorbed into the financial system, stored away in the form of foreign currency (Thai baht and U.S. dollars) and precious metals. The monetary sector has to be modernized and channels need to be developed to expand investment and mobilize domestic savings.

According to the Central Bank's monetary survey (Table I-9), even in 1996, the total increase of Kip-denominated deposits and foreign-denominated deposits over the previous year was only the equivalent of 2.5% of GDP. On the other hand, this by no means approximates the value of the domestic savings rate, and in fact IMF and ADB simple cross-country estimates suggest a domestic savings rate of 8 to 10%. However, given Lao's history, and particularly the state of the nation barely 20 years ago around the time of the 1975 socialist revolution, it would not be easy for the time being to increase domestic savings unilaterally through bank deposits, even if local stores were expanded (Table I-10) and deposit interest raised, as well as developing banking sector systems, institutions and human resources. Sustained and stable economic growth and balanced profit distribution will be vital first steps if the government and the banking sector are to earn more trust from the Lao people.

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<sup>47)</sup> Of the foreign capital introduced, loans from the IMF go through the Central Bank; loans from the World Bank and bilateral aid go through the Ministry of Finance; and foreign private investment and grant assistance go through the Foreign Investment and Economic Cooperation Committee within the Prime Minister's Office. The State Planning Committee is supposedly in charge of macroeconomic management, but in fact handles no more than plan drafting, with no functions, for example, for policy coordination between the Central Bank and the Ministry of Finance. The Prime Minister's Office is thought to have the overall controlling function, and to function as the true policy decision-maker in regard to economic operation.

### 3) Government savings

Particularly since the structural adjustment programs of the World Bank and the IMF were launched in 1989, the Lao PDR has been implementing demand-restraining fiscal rationalization policies, and in addition to state enterprise rationalization, moves have also been made to expand the tax base and rationalize expenditure. However, the Lao PDR will be unable to avoid a major increase in expenditure, including a growing cost burden for locals for infrastructure development. This is particularly true of road construction undertaken with foreign aid, as well as outlays to cover maintenance, management and operation costs after construction. Taxation efforts, as well as efforts to rationalize expenditure, will have to be undertaken on a greater scale.

Looking at the current composition of annual revenue and expenditure (Table I-11), the Lao PDR still has room to strengthen tax revenues by expanding its tax base, and as such, like other developing countries, it will also need to increase direct taxes, such as income and property taxes. It is rather difficult to gauge the effect that AFTA participation will have on tax revenues--in other words, the policy effect of an international agreement whereby the Lao PDR, a country with generally poor administrative capacity, will in the near future lose the possibility of increasing import/export taxes on items previously easily taxable. The government should take into consideration that sudden tax increase before the economy as a whole shifts on to a growth path could generally stir domestic opposition. Considering the weak fiscal base and the fact that current expenditure makes up a smaller portion of fiscal spending than to capital expenditure compared with other Southeast Asian countries, special care and consideration will be needed for the present in regard to the local cost burden of aid projects (Table I-12).

### 4) Trends in the current account balance

In terms of expenditure, with the rationalization of state enterprises proceeding relatively smoothly, more work is needed on implementing more productive aid projects and further rationalizing expenditure, as well as public spending plan adjustment between the central and local governments. However, stimulating the economy as a whole and establishing the fiscal base of the central government are more urgent tasks, and as the adjustment of such plans will have to wait until local governments are ready to handle this, for the meantime it will be important that policy adjustment among the relevant central government ministries is conducted speedily and appropriately in regard to the implementation, management and operation of national-scale projects using aid capital in particular.

The economic crisis in neighboring Thailand since the summer of 1997 seems to be beginning to have a major impact on the Lao's external economic relations. The IMF and other international financial institutions are paying particular attention to current account balance movements at present. Looking at Table I-1 to briefly confirm recent current account trends, it is clear that the deficit has been on the increase since 1992. As was noted earlier, an optimistic scenario has the Lao PDR continuing to depend on foreign capital until around 2000, but at the same time, unless the country maintains a good export performance so that this heavy foreign dependence does not become excessive, the national economy will not be able to achieve stable growth. The smooth growth of exports in main areas such as timber and electricity, and also garments and motorcycles (for which the Lao PDR has to depend on importing raw materials) as well as stable current account movements, are vital

conditions for macroeconomic management. While domestic savings have still not been adequately mobilized, a combination of slowing exports and the sudden promotion of public infrastructure development could worsen the current account balance and cause severe inflation, while the surplus capital accumulated informally could flow out of the country, plunging management of the Lao economy into an extremely difficult situation. When the GMS plan is implemented, adequate consideration needs to be given to this weakness in Lao's macroeconomic structure. Even more so with the recent situation, in which economic crisis is very likely to constrain Thai import demand and investment in the Lao PDR, the country must avoid simply taking for granted any investment plans and economic prospects depending on external economies, while sounder fiscal and monetary management will also be required.

## 2-2-2 Macroeconomic sector challenges

### (1) Outline of the issues

As part of the economic liberalization process which was substantially launched in 1986, a variety of reforms were implemented in regard to the Lao's fiscal and monetary institutions, including the development of an economy-related legal system. Support was provided for these reforms in 1989 through the World Bank and IMF structural adjustment programs. The question at this point in time is whether the economy can be sufficiently reformed toward the economic growth rate of 8 to 8.5% which Lao's Year 2000 Plan envisages as being possible through mobilizing domestic savings to provide a relatively large amount of domestic investment. The Lao PDR in fact promulgated the Domestic Investment Law in 1995, putting the Decree of Prime Minister No.99 into force in October 1997 as the regulations to implement this law. One noteworthy point in terms of the basic objectives of this law is the promotion of joint business between private foreign capital and private Lao domestic capital by providing various incentives to domestic investors<sup>(48)</sup>. It is too early to evaluate the effect of this law or the regulation to implement it<sup>(49)</sup>, but in any case, it is clear that the Lao PDR is seeking to further expand private domestic investment while maintaining the importance of public investment. The issue is from where within the country the source of this investment expansion will be sought. The following section will examine fiscal policy, monetary policy and medium- to long-term exchange policy from the perspective of current account balance management.

### (2) Fiscal policy

The government has an enormous role to play in physical infrastructure, particularly roads, and given Lao's stage of economic development, government capital demand in this area for both aid projects and domestic projects will continue to be considerable. It should be borne in mind that a continued high level of public investment could have a negative effect on private investment capital procurement projects, causing so-called "crowding-out." The Ministry of Finance is still striving to rationalize expenditure and increase revenue, giving consideration to comprehensive prioritization of public investment projects in regard to the former and an increase in the number of items subject to commodity tax (currently only 15) in regard to the

<sup>(48)</sup> Even where new laws and related regulations are created, the lack of coordination among government sector organizations and the lack of understanding on the part of government personnel causes major enforcement problems in the Lao PDR, making it unlikely that laws and regulations alone will have any effect in increasing investment.

<sup>(49)</sup> The Lao PDR Chamber of Commerce and Industry has been placed in charge of implementation of this, and is currently working on joint venture promotion projects with technical cooperation from the IFC and the ADB. The first case to emerge from this support program framework is Siemens' fan manufacturing plant in Savannakhet.

latter. While not meeting the original target, a growth in revenues of 22% over the previous year is forecast for 1997. Looking ahead to lower tariff revenues as a result of AFTA participation <sup>(50)</sup>, the government is strengthening taxation efforts on currently taxed items and also considering expanding the taxation base further, introducing, for example, a value-added tax. There is, however, strong awareness even in the government of the lack of human resources skilled in taxation, and technical cooperation is already being implemented by the IMF and the UNDP in this area.

### **(3) Monetary policy**

Since around the time the Central Banking Law was promulgated in 1990 until the present, the Lao PDR has worked hard to rebuild its monetary system, but as was noted above, even in terms of deposits and the number of financial intermediary institutions, including foreign banks, it would be difficult to say that the Lao PDR has efficient paths of capital accumulation compared to its neighbors. In 1996, the Central Bank further liberalized interest (abolishing the ceiling on loan interest for state enterprises); consideration is also being given to (i) reorganization of the national commercial banks through ADB support; (ii) establishment of a Development Bank; and (iii) the fostering of an interbank market through the introduction of open market operations. Efforts are already being made to develop human resources, such as the establishment of a training center under a three-year European Union support program. Interest liberalization, or in other words, efforts to adjust real interest rates in a positive direction, will continue to be implemented and monitored as part of support from institutions such as the IMF, but structural issues such as securing human resources remain in terms of expanding the number of banks. Even if systemic hurdles were cleared, given that the degree of civilian confidence in banks and the government is to some extent linked to an improvement in savings rates from the balance on deposits through to the national income account, the possibility of mobilizing savings will hinge not only on monetary policy but also on the stability, continuity and transparency of economic policy as a whole.

### **(4) Exchange policy**

As seen above, while both the Lao PDR 2000 Plan and the IMF's economic forecast for 2004 place major expectations on the expansion of domestic investment and domestic savings mobilization, there are many elements in regard to these which remain unclear and which will take time to resolve. Of immediate importance are trends in the current account balance, and particularly the trade balance. As noted earlier, the Lao's current account balance is currently at a stage where an inflow of foreign investment has to be assumed because public assistance alone is not enough to bridge the gaps. A stable exchange rate is one important condition for foreign capital inflow, but with the repercussions of the Thai currency crisis, the Kip has dropped almost 100% against the dollar since August 1997. Moreover, the value of foreign currency reserves has not been published since September 1997, which implies a serious impact. Assuming that this situation will subside with the recovery of the Thai economy, Lao's economic growth over the next decade will hinge on the continued stability of the current account balance over the next five years. A stable inflow of foreign currency through electricity and other main exports would be valuable, while domestically it will be important to strengthen

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<sup>(50)</sup> The Lao PDR has until 2001 to reduce tariffs by 16 percent compared to 1996 levels, and is then expected to reduce these still further, which the government recognizes will make the situation all the more difficult in terms of income management.

efficient financial intermediary functions to encourage productive investment, as well as to continue currency management toward inflation restraint.

**Table I-1 Main Macroeconomic Indicators**

Land area:	236,800 km <sup>2</sup>									
Population:	4.8 million (1995)									
GDP:	US\$1,846 million (1996)									
Per capita GNP:	US\$374 (1995)									
	1989	1990	1991	1992	1993	1994	1995	1996 <sup>(iii)</sup>	1997 <sup>(iv)</sup>	
1. Real GDP growth rate (%) (1990 price basis)	14.3	6.7	4.0	7.0	5.9	8.1	7.0	6.8	7.5	
2. Consumer price increase (%)	59.5	35.7	13.4	9.9	6.3	6.8	25.7	7.3	8.0	
3. Public finance (ratio of GDP, %)										
Government revenue (excluding aid)	8.3	9.9	10.3	10.4	11.8	12.3	12.2	13.0	13.0	
Government expenditure	24.9	23.4	20.9	21.3	17.9	23.8	21.9	22.1	20.7	
Fiscal balance (excluding aid)	-16.6	-13.5	-10.6	-10.9	-6.1	-11.5	-9.7	-9.1	-7.7	
Fiscal balance (including aid)	-12.6	-10.7	-6.8	-6.7	-4.4	-5.2	-4.2	-5.6	-4.2	
4. Balance of international payments										
Exports (million dollars)	63	79	97	133	241	300	313	323	341	
Imports (million dollars)	211	202	228	266	432	564	589	690	719	
[Exports/imports] (%)	30.0	39.0	42.4	49.9	55.8	53.2	53.1	46.8	47.4	
Current account balance (excluding aid) (%) <sup>(i)</sup>	-18.5	-11.7	-11.3	-8.8	-10.9	-14.4	-13.0	-16.5	-15.4	
Current account balance (including aid) (%) <sup>(i)</sup>	-15.7	-9.0	-4.6	-3.5	-3.1	-6.3	-6.9	-12.1	-11.3	
Debt service ratio (against exports)	15.9	10.3	11.2	6.5	4.0	3.3	5.7	5.8	8.4	
Foreign reserves (million dollars)	59.7	64.8	57.2	85.5	150.9	158.2	191.1	285.0	349	
Number of possible import months	3.4	3.9	3.0	3.9	4.2	1.3	1.9	3.0	3.5	
5. Dollar exchange rate (Kip)	714	696	712	717	717	719	925	954	1021	
6. Foreign debt <sup>(iii)</sup> (million dollars)	238	309	338	414	492	579	675	803	960	

(i) Ratio of GDP (%)

(ii) Excluding debt to the former East European bloc (around \$1,382 million at the end of 1995)

(iii) Estimated value

(iv) Value forecast in May 1997

Source: IMF and World Bank survey teams



Table 1-2 Changes and Growth in GDP by Industry

A. Component ratio (%)		1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Agriculture, forestry and fishing	63.5	63.6	63.5	62.0	60.5	61.2	58.2	58.8	57.5	56.6	53.9	52.0	
Mining	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.3
Manufacturing	7.6	8.3	7.8	7.5	9.2	10.0	12.5	12.8	13.1	12.7	13.8	15.5	
Electricity and water	1.9	1.7	1.2	1.1	1.3	1.5	1.4	1.2	1.3	1.6	1.3	1.4	
Construction	2.3	3.0	2.1	2.4	2.7	2.9	2.8	2.8	3.1	3.2	3.4	3.4	
Commerce	6.5	6.8	6.9	6.4	7.3	6.9	7.4	7.4	8.3	8.1	8.2	8.5	
Transport and communications	4.5	5.1	6.6	6.7	6.4	5.2	5.1	5.1	5.0	4.7	5.2	5.6	
Finance	2.1	2.1	2.4	2.3	0.7	1.1	1.0	1.0	1.1	1.1	1.4	1.3	
Administrative services	7.8	7.4	7.5	7.6	7.0	5.9	5.1	4.6	4.4	3.7	3.3	3.1	
Other	3.7	1.8	1.9	3.7	4.8	5.1	6.5	6.2	6.1	7.9	9.3	8.9	
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
GDP (million Kip)	492,756	516,706	511,433	501,842	573,605	612,037	614,485	657,499	696,292	752,691	805,380	860,145	
B. Growth rate by sector (%)		1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Agriculture, forestry and fishing	-	5.1	-1.2	-4.2	9.9	8.7	-1.7	8.3	2.7	8.3	3.1	2.3	
Mining	-	23.0	-19.2	-12.7	19.5	-8.2	-7.9	13.0	36.5	30.4	3.7	37.2	
Manufacturing	-	14.3	-6.6	-6.3	39.5	15.5	29.7	9.4	7.7	7.0	17.4	19.2	
Electricity and water	-	-4.2	-32.8	-5.9	31.4	18.9	-1.9	-9.8	21.4	29.0	-8.8	15.0	
Construction	-	35.7	-32.0	15.3	24.0	18.7	-1.0	7.4	16.1	17.2	9.3	6.2	
Commerce	-	9.3	1.2	-9.7	28.9	1.9	10.0	7.0	18.5	7.9	9.4	9.8	
Transport and communications	-	18.5	27.7	0.1	7.4	-12.4	1.4	6.9	3.1	4.3	18.8	15.0	
Finance	-	4.9	13.9	-2.8	-66.0	73.3	-10.6	11.4	13.2	8.2	42.0	-0.9	
Administrative services	-	0.0	0.1	-0.1	2.8	-9.5	-10.5	-2.7	-0.2	-6.6	-4.5	0.0	
Other	-	-48.9	3.3	94.8	46.0	14.3	30.4	1.8	3.7	44.1	26.1	1.5	
GDP	-	4.9	-1.0	-1.9	14.3	6.7	4.0	7.0	5.9	8.1	7.0	6.8	

\* 1990 fixed price series

Source: Data search system, Economics and Development Resource Center, ADB

**Table I-3 Balance of Foreign Investment Received (approved base)**

	Investment amount (US\$1,000)	Component ratio (%)
<b>1. By sector</b>		
Energy	4,500,820	66.1
Hotels and tourism	605,468	8.9
Communications and transport	561,556	8.2
Manufacturing (excluding textiles and garments)	478,872	7.0
Timber processing	165,523	2.4
Mining	125,536	1.8
Banking and insurance	73,800	1.1
Textiles and garments	73,519	1.1
Agriculture	61,203	0.9
Commerce	61,011	0.9
Construction	59,986	0.9
Other services	41,120	0.6
Consultants	4,984	0.1
<b>Total</b>	<b>6,813,398</b>	<b>100.0</b>
<b>2. By investing country</b>		
Thailand	2,618,742	46.9
United States	1,483,383	26.6
Republic of Korea	318,021	5.7
Australia	283,139	5.1
Malaysia	275,595	4.9
France	269,688	4.8
Taiwan	70,802	1.3
China	55,986	1.0
Norway	54,000	1.0
United Kingdom	35,412	0.6
Hong Kong	27,766	0.5
Canada	17,814	0.3
Singapore	17,430	0.3
Russia	15,205	0.3
Japan	12,013	0.2
Other	27,969	0.5
<b>Total</b>	<b>5,582,965</b>	<b>100.0</b>

\* 1988-1997 aggregate

\* The different totals for the first and second categories are because the former includes the Lao PDR capital.

Source: the Lao PDR Foreign Investment Management Committee

**Table I-4 Trade Composition by Trading Partner**

**A. Exports (%)**

	1992	1993	1994	1995	1996
Thailand	43.0	31.1	25.7	26.8	30.2
Viet Nam	14.3	9.6	27.0	28.2	49.1
France	4.7	5.2	3.4	3.6	2.6
United Kingdom	0.1	0.0	0.3	0.3	2.1
United States	3.7	4.4	1.7	1.7	0.8
Russia	3.7	3.1	0.3	0.4	0.2
China	8.1	10.6	2.7	2.8	0.2
Germany	2.3	3.7	3.9	4.1	1.5
Taiwan	6.8	4.2	1.5	1.6	0.4
Japan	4.4	3.7	1.6	1.7	0.5
Finland	0.1	0.8	0.5	0.5	0.2
Netherlands	1.0	1.5	1.7	1.7	0.0
Italy	0.6	0.8	0.2	0.3	0.3
Republic of Korea	0.9	0.8	0.0	0.0	0.2
Belgium	0.2	0.2	0.4	0.4	0.6
Norway	0.1	0.0	0.2	0.2	0.6
Singapore	0.0	0.1	0.0	0.0	0.2
Other	6.0	20.2	28.9	25.7	10.3
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Total exports (million dollars)</b>	<b>162.7</b>	<b>240.5</b>	<b>300.4</b>	<b>311.2</b>	<b>320.7</b>

**B. Imports (%)**

	1992	1993	1994	1995	1996
Thailand	26.1	38.2	47.9	48.9	45.0
Japan	15.7	13.0	8.1	8.3	7.6
Viet Nam	4.1	4.6	4.0	4.1	3.7
Singapore	16.1	4.4	2.6	2.7	2.5
China	2.7	4.2	3.6	3.7	3.4
France	1.2	1.5	1.0	1.1	1.0
Taiwan	1.4	1.1	0.8	0.8	0.8
United States	1.1	1.0	0.2	0.3	0.2
Hong Kong	0.9	1.0	1.2	1.3	1.2
Russia	0.3	0.6	0.5	0.5	0.4
Cambodia	0.0	0.7	0.5	0.5	0.4
Republic of Korea	0.5	0.5	0.4	0.4	0.4
Australia	0.3	0.8	0.1	0.1	0.1
Denmark	0.2	0.1	0.1	0.1	0.1
Macao	0.5	0.1	0.1	0.1	0.1
Pakistan	0.2	0.2	0.1	0.1	0.1
Other	28.7	28.0	28.8	27.0	33.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Total imports (million dollars)</b>	<b>265.1</b>	<b>431.9</b>	<b>564.1</b>	<b>588.8</b>	<b>689.6</b>

Source: World Bank

**Table I-5 Trade Composition by Commodity**

**A. Exports (%)**

	1992	1993	1994	1995	1996
Wood products <sup>(i)</sup>	32.2	27.4	32.0	28.4	38.9
Coffee	1.8	1.7	1.0	6.8	7.8
Agricultural products	5.5	3.8	4.0	4.4	5.6
Manufactures <sup>(ii)</sup>	22.2	15.8	12.1	13.9	8.7
Garments	20.6	20.4	19.4	24.6	20.0
Motorcycles	0.0	15.0	15.4	5.7	3.9
Vehicle re-export	4.9	6.0	1.5	0.0	0.0
Electricity	12.8	8.1	8.3	7.7	9.3
Gold re-export	0.0	1.7	6.3	7.0	4.7
Oil-related fuel <sup>(iii)</sup>	0.0	0.0	0.1	0.1	0.1
Other	0.0	0.0	0.0	1.2	1.1
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
(= Total exports [million dollars])	132.6	240.5	300.4	311.2	320.7

**B. Imports (%)**

	1992	1993	1994	1995	1996
Machinery and equipment	5.2	5.3	5.7	7.4	10.3
Vehicles	6.3	6.4	4.4	6.1	10.4
Oil-related fuel <sup>(iv)</sup>	3.5	3.5	4.1	5.8	4.9
Construction machinery	11.3	11.3	12.0	13.4	14.7
Raw materials for garment and textile manufacturing	8.4	8.4	9.1	11.3	10.2
Parts for motorcycle assembly	6.3	6.3	6.1	2.3	1.7
	2.5	3.4	0.8	0.0	0.0
Gold and silver	3.0	3.0	8.3	5.0	2.7
Electricity	0.6	0.6	0.4	0.5	0.4
Consumer goods	53.0	52.0	49.0	48.2	44.7
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
(= Total imports [million dollars])	265.1	431.9	564.1	588.8	689.6

(i) In addition to timber, includes finished and semi-finished products such as furniture.

(ii) Excludes garments and wood products.

(iii) Fuel used by foreign freight companies to refuel within the Lao PDR.

(iv) Includes fuel used by domestic freight companies to refuel abroad.

Source: the World Bank

**Table I-6 Outline of 1996-2000 Socio-economic Development Plans (Macroeconomy)**

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(1) Per capita GDP:	To be raised from \$350 in 1995 to \$500 in 2000
(2) Annual average GDP growth rate during plan period:	8.0-8.5%
(3) Growth rates by sector:	Agriculture: 5% Industry: 12% Services: 10-11%
(4) Inflation rate:	Contained at 10% or less
(5) Government revenue:	Around an annual 16-16.5% of GDP by 2000
(6) Fiscal deficit:	Contained at an annual 10% or less of GDP
(7) Annual average export increase:	12.0%
(8) Annual average import increase:	10.5%
(9) Balance of trade:	Maintained at around an annual 12% of GDP
(10) Macro investment rate:	25-30% average (around 12% of which will be public investment) Total investment of \$3.8 billion (\$1.63 billion of which will be public investment)
(11) Foreign aid:	Double the 1991-1995; equivalent to 73% of public investment
(12) Foreign private investment:	A total of around \$2 billion will be necessary during the plan period

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Source: *1996-2000 Socio-economic Development Plans*, State Planning Committee, Vientiane, October 1996

**Table I-7 the Lao PDR Economic Prospects up to 2004 According to the IMF**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Real economic growth rate (% against previous year)	7.1	6.8	7.5	7.0	7.0	7.0	6.5	6.5	6.5	6.5
Inflation rate (% against previous year)	19.4	13.0	8.0	4.5	4.5	4.0	4.0	4.0	4.0	4.0
Exchange rate (Kip/US\$)	793	926	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Terms of trade (1991 = 100)	94.9	94.9	94.7	95.8	97.6	99.6	101.6	103.6	105.6	107.6
(The following are all percentages of GDP)										
Fiscal balance (excluding aid)	-4.2	-5.6	-4.2	-3.5	-2.4	-2.0	-2.1	-2.0	-1.8	-1.8
Investment-savings balance	13.0	16.5	15.5	14.4	12.4	11.1	7.9	7.1	6.4	5.3
National savings	13.0	14.0	14.5	14.5	16.8	17.2	19.5	20.2	20.5	21.1
Private	11.5	10.7	10.8	9.9	10.8	10.8	12.6	13.1	13.0	13.3
Government	1.5	3.3	3.7	4.6	6.0	6.4	6.9	7.1	7.5	7.8
Domestic investment	26.0	30.5	30.0	28.9	29.2	28.3	27.4	27.3	26.9	26.4
Private	15.7	19.5	19.7	18.5	18.9	18.0	17.1	17.2	16.8	16.3
Power generation	4.8	9.5	6.7	4.6	5.9	4.3	3.3	2.4	2.1	1.9
Other	10.9	10.0	13.0	13.9	13.0	13.7	13.8	14.8	14.7	14.4
Government	10.3	11.0	10.3	10.4	10.3	10.3	10.3	10.1	10.1	10.1

Source: IMF

**Table I-8 Current Account Balance and Trend of Foreign Capital Inflows**

	(million dollars)						
	1990	1991	1992	1993	1994	1995	1996
(1) Current account balance (including aid)	-78.1	-25.0	-41.1	-42.6	-96.6	-100.5	-235.0
(2) Current account balance (excluding aid)	-101.5	-110.5	-104.0	-146.1	-221.3	-200.0	-306.2
(3) Grant aid (= (1) - (2))	23.4	85.5	62.9	103.5	124.7	99.5	71.3
(4) Net foreign capital inflow	55.8	9.6	56.2	111.5	106.6	188.2	280.9
Long-term capital	49.8	35.1	62.1	69.5	55.7	82.9	123.4
Short-term capital	-	-33.5	-14.9	-35.8	7.5	10.2	-2.3
Direct investment	6.0	8.0	9.0	77.8	43.4	95.1	159.8
Reference:							
Official development assistance	175.0	132.6	134.0	181.3	188.7	197.4	212.2
Long-term loans	23.4	47.1	71.1	77.8	64.0	97.9	140.9
Grant aid	151.6	85.5	62.9	103.5	124.7	99.5	71.3
Amount of approved direct investment	58	1,586	328	355	2,598	615	1,293

Source: *Report on the Lao PDR Macroeconomic Performance*, UNDP, 15 May 1997

**Table 1-9 Monetary Survey**

(One billion Kip)

	1992	1993	1994	1995	1996
Foreign net assets	36.6	72.9	58.7	78.0	155.6
Foreign assets	60.8	108.2	113.7	176.5	266.3
Foreign debt	-24.2	-35.3	-55.0	-98.5	-110.7
Domestic net assets	39.8	52.9	107.3	115.3	89.3
Domestic assets	56.1	74.7	128.9	157.2	149.5
Of these, government net assets	0.6	-95.4	12.6	0.7	-43.1
Of these, state enterprises	17.8	18.3	17.4	27.7	36.9
Of these, private enterprises	37.7	65.9	98.8	128.9	155.7
Other	-16.3	-21.8	-21.6	-41.9	-60.2
Liquidity (= M2)					
Cash	22.8	33.2	38.6	42.0	43.0
Checking deposits	12.3	19.0	22.7	25.2	32.6
Savings deposits	9.7	30.4	45.6	44.4	70.2
Foreign currency deposits	31.7	43.2	59.0	81.6	99.2
Nominal GDP	844	951	1,109	1,395	1,710
[M2/nominal GDP] (%)	9.1	13.2	15.0	13.9	14.3
[(Savings deposits + foreign currency deposits)/nominal GDP] (%)	4.9	7.7	9.4	9.0	9.9

Source: *Annual Report* (various issues), Bank of the Lao PDR

**Table I-10 Lao's Banking System**

	<u>Location of main bank</u>	<u>Location of branches</u>					
<b>State commercial banks</b>							
Sethathilath Bank	Vientiane	Phone Hong	Paksane	Pakse			
Foreign Exchange Bank	Vientiane	Pakse	Savannaket				
Pharktai Bank	Champasak	Xekong	Saravane	Attapeu			
Nakhonluang Bank	Vientiane	-					
Aroun Mai Bank	Xieng Kuang	Sam Nuea					
Lao May Bank	Savannaket	Khammouanne					
Lane Xang Bank	Luangprabang	Sayabouly	Luang Namtha	Bokeo	Oudomxay	Phongsaly	
Agricultural Promotion Bank	Vientiane	Pakse	Savannaket	Luangprabang			
<b>Foreign banks (branches)</b>							
Bangkok Bank	Vientiane	-					
Siam Commercial Bank	Vientiane	-					
Krungthai Bank	Vientiane	-					
Thai Farmers Bank	Vientiane	-					
Thai Military Bank	Vientiane	-					
Ayudhya Bank	Vientiane	-					
Public Bank	Vientiane	-					
<b>Foreign banks (offices)</b>							
Standard Chartered Bank	Vientiane	-					
<b>Joint-venture banks</b>							
Vientiane Commercial Bank	Vientiane	-					
Joint Development Bank	Vientiane	-					

\* Foreign-affiliated banks may not have branches outside Vientiane.

Sources: *Annual Report 1996*, Bank of the Lao PDR



**Table I-11 Composition of Government Revenue and Expenditure**

(One billion Kip)

	1992/93	1993/94	1994/95	1995/96	1996/97*
Revenue	113.4	135.9	165.6	212.2	253.3
Tax revenue	86.1	106.8	134.8	175.8	212.7
Profit tax	8.6	11.5	17.3	20.7	28.3
Income tax	4.8	7.2	10.7	13.5	16.6
Agricultural land tax	1.2	2.2	1.6	2.1	3.2
Business license tax	0.1	0.1	0.2	0.1	0.2
Sales tax	14.3	19.9	27.6	33.9	40.3
Import tax	22.0	25.7	33.8	40.6	46.1
Export tax	3.1	8.1	4.9	6.0	6.0
Enterprise tax	4.4	5.1	5.5	15.5	26.0
Timber royalties	23.6	21.0	26.7	34.6	33.0
Other	4.0	6.0	6.5	8.8	13.0
Nontax revenue	27.3	29.1	30.8	36.4	40.6
Sale of state enterprises, etc.	4.7	3.0	3.0	5.2	7.0
Other	22.6	26.1	27.8	31.2	33.6
Overflight charges	8.4	7.2	7.9	9.8	11.0
Rental payments	4.9	4.6	5.0	3.8	3.8
Interest income	4.6	7.8	6.8	10.5	10.1
Other	4.7	6.5	8.1	7.1	8.7
Expenditure	170.5	258.9	293.7	361.6	464.0
Agriculture	15.7	24.3	28.5	28.3	35.0
Industry and energy	8.4	11.0	22.0	30.9	37.0
Transport and communications	33.1	77.4	70.0	85.7	101.9
Education	17.9	25.5	36.3	45.0	57.6
Health care	4.1	11.7	16.5	24.9	34.1
Other	91.3	109.0	120.4	146.8	198.4

\* Budget base

Source: World Bank references

**Table I-12 Government Local Cost-Bearing Capacity**

(%)

	Viet Nam	the Lao PDR	Cambodia	Thailand	Indonesia	Philippines	LDC average
	1991-95 average	1990-95 average	1991-95 average	1994	1994	1994	1995
(Ratio of GDP)							
Current expenditure	12.6	11.3	7.6	11.1	10.7	17.0	19.6
Capital expenditure	13.6	10.3	2.6	5.5	7.9	3.5	4.2
Total (= government expenditure)	26.2	21.6	10.2	16.6	18.6	20.5	23.8

Source: World Bank and other references