

Lao People's Democratic Republic

Economic Assessment

The first half of 2004 saw GDP growth at an estimated annual rate of 6.5%, driven by mining (gold and zinc), manufacturing, construction, tourism, and electricity production. Agriculture's performance was moderate, with growth of 3.5%, due to a reduction in dry-season rice production caused by irrigation problems (Figure 2.7). Higher production was recorded for most other crops, especially export-oriented cash crops such as maize, sugarcane, and tea. Within the services sector, tourist arrivals rose by 30% in the first 5 months of 2004, more than offsetting the downturn in 2003 caused by the regional SARS outbreak and local security concerns.

Reflecting effective restraints on credit expansion by the monetary authorities, inflation has been contained to some degree since October 2003, and declined to an average of 12% for the first 8 months of 2004, from an average of 15.5% in 2003. Credit expanded by just 3.6% in June 2004 from a year earlier, while the M2 money supply grew by 21.7%. The higher price of imported oil has resulted in price increases for some consumer items and for construction materials, and could exert further upward pressure on inflation over the rest of this year.

Preliminary estimates indicate that revenue collection through August 2004 reached 89% of the target for the fiscal year (October–September), an improvement from a year earlier. Gains in revenue collection reflect a series of measures undertaken by the Government, including enhanced onsite tax inspection of firms, provincial customs reform, and improvement in tax administration.

The trade deficit narrowed to 1.0% of GDP in the first quarter from 4.3% in the same period in 2003, reflecting increases in exports of gold, cash crops, and garments. Building on recent successes

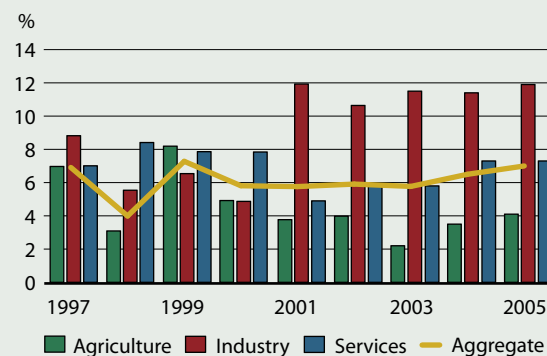
and interest in industry (particularly mining), FDI inflows have been trending up in recent years.

Policy Developments

Steady progress has been made on the restructuring of state-owned commercial banks, addressing challenges associated with their low capital base, and a high burden of NPLs. The Government has issued instructions on the capital requirements of these banks for supervisory purposes, and a forthcoming decree for commercial banks generally is expected to help establish an improved environment for foreign private commercial banks operating in the country.

Momentum has also picked up on restructuring the four largest SOEs—Lao Airlines, Bolisat Phattana Khet Phoudoi (a rural developer), Pharmaceutical Factory No. 3, and Nam Papa Lao (a water utility). The Government outlined the key principles of SOE reforms early in 2004 and followed up with four implementation guidelines to put the SOE restructuring plans into effect and

Figure 2.7 GDP Growth by Sector, Lao People's Democratic Republic, 1997–2005



Sources: Government of the Lao PDR; staff estimates.

**Table 2.7 Selected Economic Indicators,
Lao People's Democratic Republic, 2004–2005, %**

Item	2004		2005	
	<i>ADO 2004 Update</i>	<i>ADO 2004 Update</i>	<i>ADO 2004 Update</i>	<i>ADO 2004 Update</i>
GDP growth	6.0	6.5	6.2	7.0
Inflation (CPI)	12.0	12.4	10.0	10.0
Current account/GDP	-2.2	-2.0	-1.9	-1.6

Source: Staff estimates.

to monitor progress in 2004–2005. Restructuring is also proceeding at Electricité du Laos.

In moves to encourage the private sector, in April the Government issued a decree on the promotion and development of SMEs. The decree defined overall policies on private sector development and authorized the establishment of an SME promotion and development fund. The policy aims to create an enabling regulatory environment, enhance competitiveness, expand access to domestic and international markets, improve access to finance, and encourage entrepreneurship. A separate decree was issued to implement an earlier decision to provide tax incentives for priority private investment, and the Government is in the process of reviewing the 1994 Investment Law. In addition, a commercial court division is being established in provincial courts.

Trade issues also have received attention from the Government. Under the Common Effective Preferential Tariff (CEPT) scheme of the ASEAN Free Trade Area (AFTA), all import items currently listed in the Temporary Exclusion List will be moved to the Inclusion List by 2005, and the CEPT rates on the items in the Inclusion List will be phased down to 5% or less by 2008. In accordance with AFTA commitments, tariff rates were reduced and a number of items shifted from the Temporary Exclusion List to the Inclusion List in January 2004. The Government issued instructions in April to integrate seven major customs checkpoints under central administration, paving the way for a streamlined customs administration. On the multilateral front, the first working party session for the country's accession to WTO is planned for end-October, in Geneva.

Reducing poverty remains a major challenge—the latest estimate is that the incidence of poverty declined from 38.6% in 1997 to a still-high level of around 32% in 2003. A National Growth and Poverty Eradication Strategy approved by the National Assembly in October 2003 was subsequently finalized by the Government in April as the Poverty Reduction Strategy Paper. The aim is to reduce poverty through economic growth and an increased focus on the poorest districts, with agriculture, education, health, and transportation proposed as priority sectors for action. The Government selected 47 of the poorest districts for priority investment.

A related challenge is to develop the capacity of the labor force to improve the country's competitive position in attracting investment and trade and to reduce underemployment. The population growth rate increased to 2.8% in 2003, implying a broad-based population pyramid and rapid growth of the labor force. Most of the population is engaged in rural subsistence farming, where seasonal underemployment is pervasive.

Outlook for 2004–2005

GDP growth of 6.5% is forecast for all of 2004, revised up from 6.0% in *ADO 2004*. There are signs that stronger growth has continued, supported by the same drivers as in the first half of the year. The Government's continued efforts to simplify administrative procedures for investment will help improve the environment for private sector-led growth. It also is possible that the US may grant Normal Trade Relations status, in which case exports to the US could increase significantly.

If global oil prices stabilize later in the year, then continued monetary discipline, combined with new revenue-raising measures, should keep inflation in check. On these grounds, stronger GDP growth of 7.0% is projected for 2005, up from 6.2% in *ADO 2004*. Given the mostly concessional nature of the country's external debt and with strong export growth forecast, future debt service flows should remain at a manageable level.