

SUMMARY OF LAO PDR GOVERNANCE ASSESSMENT

Lao PDR has a number of geographical disadvantages that help explain its weak socioeconomic position: it is landlocked, mountainous, and thinly populated, with people tending to live in small, isolated villages. (This section is based on ADB 1999e.)

Basic Parameters of Governance

Historical Background

The 14th century kingdom of Lan Xang broke up into three separate kingdoms in the late 18th century, and some 100 years later France took control and combined them under the rule of the royal house of Luang Prabang. With the exception of a brief period of Japanese control in World War II, French colonial rule continued until 1954. The Lao People's Party, later the Lao People's Revolutionary Party (LPRP), linked with the Pathet Lao resistance movement, was established in 1955 under the leadership of Kaysone Phomvihane. In the 1960s the Lao PDR, under the United States (US)-supported government of Prince Souvanna Phouma, was subjected to heavy bombing as the US sought to hinder the passage of North Vietnamese soldiers and supplies along the Ho Chi Minh Trail (this section draws on Savada 1974).

The Lao PDR was proclaimed in 1975. Prince Souphanouvong was named president, but the real power lay with Kaysone Phomvihane, secretary-gen-

eral of the LPRP. At this time, much of the country was in ruins after 20 years of political struggle, civil war, and bombing. Foreign assistance was minimal, Thailand imposed an economic blockage from 1975 to 1976, and many skilled administrators and professionals emigrated. The first two years of LPRP rule also involved harsh policies of "accelerated socialization." As many as 40,000 people were sent to re-education camps and anywhere from 30,000 to 160,000 were imprisoned for "political crimes." The former king, Savang Vatthana, had initially been assigned the position of supreme adviser to the president, but in 1977 he was banished to a remote area of the country. Prince Souvanna Phouma was allowed to live quietly in Vientiane until his death in January 1984.

Attempts to collectivize agriculture encountered strong opposition and production stagnated. The LPRP took the first steps toward market-oriented reform in 1979 by easing restrictions on private trade and encouraging joint ventures between the state and the private sector. It reduced agricultural taxes and increased government procurement prices for most crops; however, it made no move to dismantle central planning.

More far-reaching reforms began in 1986 with the introduction of the New Economic Mechanism (NEM). The Government abandoned the collectivization of agriculture, eased many restrictions on private sector activity, and gave state enterprises more decisionmaking power. Privatization began in 1988 and accelerated until slowing down after 1993.

By 1989 most political prisoners had been released and the camps closed. The Sixth Party Congress in 1996 confirmed that economic reforms would continue, but that the state would retain overall control over the economy. In late 1997 a younger and better educated National Assembly was elected, with the military well represented. In 1998 General Khamtai was elected president and appointed General Sisavat Keobounphan as prime minister. This strong alliance promised political stability and the continuation of economic reform, although the LPRP remained opposed to political reform along multiparty lines (Economist Intelligence Unit 1999). Table 4 summarizes Lao PDR's recent history in relation to governance.

The population is ethnically diverse. Some 68 ethnic groups can be roughly categorized into three major groupings: the Lao Loum, who constitute about 65 percent of the population; the Lao Theung, who make up about 25 percent of the population; and the Lao Soung, who constitute about 10 percent of the population. The Lao Loum are politically dominant, and historical tensions with minority groups persist. One of the most alienated groups is the Hmong, some of whom received US military training and opposed the communists before 1975. There are also a small number of ethnic Vietnamese and Chinese.

The Lao People's Revolutionary Party

The LPRP has around 65,000 members and is the country's only political party. It is governed by a central committee and headed by the nine-member Politburo. The Politburo formulates policy making in virtually every aspect of public life. The highest authority is the Party Congress, a gathering of party cadres that meets to ratify decisions already taken by the party leadership. Next in the party hierarchy is the Central Committee, some 59 party elite who fill key political positions and lead the party between congresses, which are held every five years.

The LPRP has shown itself to be remarkably resilient. Transitions of power have tended to be smooth, the new generation of leaders has proven more open to reform, and the Politburo now has some ethnic diversity. Organized opposition to the LPRP

Table 4. Recent Events Bearing on Governance, Lao PDR

1986	Economic reforms are launched under the New Economic Mechanism.
1988	Government approves a liberal foreign investment law.
1989	With the support of multilateral financial institutions, the Government launches a macroeconomic stabilization program.
1991	The Government announces plans to privatize a number of large state enterprises.
1992	The president and founding member of the LPRP, Kaysone Phomviharn, dies. The prime minister, Nouhak Phomsavan, is elected president, and Kaysone's deputy, General Khamtai Siphandon, becomes prime minister.
1993	The International Monetary Fund approves a three-year enhanced structural adjustment facility.
1994	A revised law on foreign investment is passed, permitting 100 percent foreign-owned ventures.
1996	A new body, the Committee for Management of Investments and International Economic Relations, is established to oversee the approval of foreign investment.
1996	The Sixth Party Congress is held. The party confirms that reforms will continue, although state control over the economy is to be maintained. The military dominates the new Politburo line-up.
1997	The Lao PDR joins ASEAN.
1997	National Assembly elections are held. The military is well represented.
1997	The Government stresses that the development of hydroelectric power is part of its economic strategy, and that light industry, notably, garments and agroprocessing, is also important.
1998	The Government emphasizes the need to reduce its economic dependence on Thailand following the Asian financial crisis.
1998	President Nouhak Phomsavan retires and is replaced by General Khamtai. General Sisavat, who is linked to General Khamtai by the marriage of their children, becomes prime minister.

is weak. A number of small guerrilla groups exist, bandits launch occasional attacks, and a few dissident groups are based in the United States and Eastern Europe. The media are entirely state controlled.

The party is currently facing a dilemma. It wants to maintain power and control, but also recognizes the need for economic reform. However, fostering market-oriented reforms and enhancing the private sector will lead to greater openness of the economy

and society and threatens to undermine the party's power.

The LPRP is due to convene for its Seventh Congress in 2001, and National Assembly elections are scheduled for December 2002. Those running for election began maneuvering in 2000, which may result in important decisions being delayed.

The 1991 Constitution

The Supreme People's Assembly adopted the constitution in 1991 (Savada 1974), declaring the country to be a people's democratic state. Although the Assembly had been charged with drafting a constitution in 1975, it gave the task a low priority. However, international development agencies were reluctant to invest in the Lao PDR in the absence of fixed, knowable law.

Following Politburo approval in 1990, a draft constitution was made public. Despite calling for discussions of the draft, first among party and government officials and then among the public, the LPRP viewed disagreement with the party line unfavorably, and reiterated that a multiparty system would not be forthcoming. However, a group of some 40 government officials and intellectuals, organized in the unofficial Social Democratic Club, began criticizing the one-party system in earnest. Criticism of the draft document gathered strength in the succeeding months. Laotian students in Paris, Prague, and Warsaw joined in the call for free elections. Criticism broadened as a group of young, educated party cadres—many educated in France and Canada—targeted veteran party leaders. These groups charged that the new policies of the old guard were fostering corruption and increased social and economic inequality. In October 1990 the Government finally cracked down on these calls for democratic reforms, arresting and imprisoning several protesters. Thus, even though the constitution purports to guarantee freedom of speech and petition and pays lip service to the desirability of public discussion, the ruling party has demonstrated that it will not tolerate challenges to its exclusive exercise of power.

While the 1991 constitution contains elements of an earlier revolutionary orthodoxy, it is clearly influenced by the economic and political liberalization within the Lao PDR and the dramatic changes in

the socialist world. Even though it states that while the LPRP should be responsible for setting broad policy guidelines and the Government should manage day-to-day administration, in reality the two are almost indistinguishable. The constitution emphasizes that the economy is market oriented and that all forms of economic ownership are permitted. It specifies the functions and powers of the various organs of government and defines the rights and duties of citizens. It has little to say about the limitations on government. In foreign policy, the Lao PDR follows the principles of peaceful coexistence.

The constitution legally establishes a set of authorities that resemble the traditional differentiation between executive, legislative, and judicial branches of government. The delineation does not imitate any particular model (neither Vietnamese, nor Russian, nor French), but it pays respect to the idea of basic responsibilities lodged in designated institutions.

The constitution eliminated elected people's councils at the provincial and district levels, but left governors, mayors, and district and village chiefs free to "administer their regions and localities without any assistance from popularly elected bodies." It gives no clear guidance on provincial and district responsibilities except to specify that the leaders at each echelon must ensure implementation of the constitution and the law and must carry out decisions taken by a higher level. The leading role of the party within the administration of the nation overall is illustrated by the fact that Politburo members hold a number of state offices, for example, prime minister, deputy prime ministers, chair of the National Assembly, and minister of defense.

The term "multi-ethnic Lao people" is used frequently in the constitution, a clear rhetorical attempt to promote unity within an ethnically diverse society. The constitution proclaims that the state will respect the "principle of equality among ethnic tribes," which have the right to promote "their fine customs and culture," and that it is committed to upgrading the "socioeconomy of all ethnic groups." The dominant role played by the LPRP, however, is scarcely mentioned, and the constitution is almost silent about the party's functions and powers. It notes that the National Assembly and all other state organizations "function in accordance with the principle of democratic centralism." It also calls upon mass

organizations, such as the Lao Front for National Construction, the Federation of Trade Unions, the People's Revolutionary Youth Union, and the Federation of Women's Unions, to "unite and mobilize the people." Regarding religion, the state "respects and protects all lawful activities of the Buddhists and of other religious followers."

The objective of economic policy is to transform the "natural economy into a goods economy." Private property appears to be assured. The state is authorized to undertake such tasks as managing the economy; providing education; expanding public health; and caring for war veterans, the aging, and the sick. The constitution admonishes that "all organizations and citizens must protect the environment," and sets forth a cluster of rights, including freedom of religion, speech, press, and assembly, although no safeguards exist to protect the rights to freedom of opinion and expression, peaceful assembly and association, and independence of the judiciary. Women and men are proclaimed equal, and all citizens can vote at age 18. In return, citizens are obliged to respect the laws, pay taxes, and defend the country (which includes military service).

Even though the constitution has not changed the imbedded patterns of the Laotian political system or threatened the party's dominant role, it has the potential to protect human rights and respect for the law, by the rulers as well as the ruled. The crumbling of communist regimes elsewhere, accompanied by widespread pro-democracy movements, suggest that the Lao PDR will not be immune to growing demands for a more dependable rule of law.

The Public Sector

Structure of Government

The central Government consists of 16 ministries and equivalent organizations, down from 23 following PAR in the 1990s. The president is head of state and of the armed forces, and is elected by the National Assembly for a five-year term. The Council of Ministers is the highest executive body and includes the prime minister and three deputy prime ministers. There is also a vice-president. None of the key political and government leaders are women; however, there are four women members of the Central Party

Committee, two women vice-ministers, and one woman governor.

In 1998, the Lao PDR completed a leadership transition that had been under way since 1996. According to diplomatic observers and political analysts, after intense debate the LPRP leadership gave priority to enhancing the party's ability to deal with the economy because of the adverse effects of the 1997 Asian financial crisis. In 2001, Finance Minister Bounnyang Vorachit became Prime Minister, following Sisavat Keobounphanh, who had served as prime minister for the previous three years. President Khamtay Siphandone continues as the chief of the ruling Lao People's Revolutionary Party and the top official in the Government. Defence Minister Choummaly Sayasone became Vice-President, replacing Oudom Khattigna, who died in December. The top eight leaders of the politbureau kept their positions.

Since a border conflict with Thailand in 1987, the Lao PDR has been at peace with its neighbors. However, the Lao People's Army still maintains a regular armed force of 29,100 and a local militia of around 100,000. In addition, the military remains politically powerful: only two of the nine-member Politburo have no military background. While the military is regarded as politically conservative, it has exploited the nexus between its powerful position and the opportunities provided by economic reform. At the heart of the military's commercial empire is the Import-Export Company, whose diverse activities include agriculture and forestry, construction, light industry, trade, and tourism. Yet for most soldiers, army life is austere. Pay is low, and uniforms and equipment are in short supply. Consequently, most young Laotian men serve only the minimum term after being drafted.

From 1975 until the early 1990s, the Lao PDR relied heavily on Vietnamese and Soviet military aid. Once the internal security threat from resistance groups had been reduced and relations with the country's neighbors had improved in the late 1980s and early 1990s, the leadership was able to reduce the defense budget, and as of mid-1994, the Lao PDR had the smallest defense budget in Southeast Asia.

When assessing Lao politics, it is important to distinguish between the formal political structure and the informal networks through which much

of the decision making takes place. Nepotism and patronage are endemic within the party and the bureaucratic system. The lack of transparency makes it extremely difficult for outside observers to fully understand the political decision-making structures.

The National Assembly

The Lao PDR is, at best, at the very beginning of democracy. At present, the public participates in only two elections, namely, those for the National Assembly and village heads. However, the party controls elections and determines the outcomes by preselecting the candidates.

The National Assembly, the country's supreme legislative body, is elected every five years. The constitution does not specify the number of members in the National Assembly, but the 1997 elections placed 99 members in this body (21 of them women). The National Assembly's powers include electing and approving the holders of a number of high-level positions, amending the constitution, determining taxes, approving the state budget, ratifying treaties, and endorsing or abrogating laws. These powers may prove to be limited, however, by a provision in the constitution that the National Assembly will generally meet only twice a year. Between sessions the Standing Committee of the National Assembly, consisting of the president, the vice-president, and an unspecified number of other members, prepares for future sessions and oversees the activities of the administrative and judicial organizations.

The state has administrative units at the national, provincial, district, and village levels, yet there has been little real devolution of power. Most members of the Government are members of the LPRP, and those who stand for election to the National Assembly must be approved by the party-controlled Lao Front for National Reconstruction, which comprises such organizations as trade unions, peasant associations, and religious and business groups. At the National Assembly election in December 1997 only four nonparty candidates were selected to stand, and only one gained a seat.

External Relations

Relations between the Lao PDR and Viet Nam remain close. The two countries face similar challenges and have signed various bilateral agreements. In ad-

dition, the number of officials going to Viet Nam for training is rising. The Lao PDR became increasingly reliant on Thailand for trade and investment during the 1990s, but their common border and the presence of Hmong refugees in Thailand continue to cause friction. Relations with the PRC have improved as relations with Viet Nam have shifted to a less exclusive footing, and cross-border trade (some of it illegal) is thriving.

The Lao PDR joined ASEAN in 1997, and a bond has been created between the newer, less developed members (Cambodia, Lao PDR, Myanmar, and Viet Nam). Myanmar and the Lao PDR have cordial relations following the signing of the Treaty on the Demarcation of Boundaries in 1994. Relations with Cambodia are uncomplicated, apart from occasional friction along the border resulting from illegal logging. The Lao PDR's membership in ASEAN has aided the search for new export markets and sources of aid, and international relations have improved. Despite its economic problems, the Lao PDR has continued to take steps to meet tariff reduction targets by 2008 to comply with ASEAN Free Trade Area commitments.

The Lao PDR has been working with the US in the areas of drug control, bomb and mine disposal, and the search for US servicemen missing in action, and has been praised for its help. However, the US has flagged human rights concerns as the reason for the delay in awarding the Lao PDR normal trade relations status.

In 1998 the first session of the EU-Lao PDR Joint Commission gave priority to rural development, primary education, legal reform, health, and human resources. The EU is an important market for the country's textiles and garments, and the Lao PDR was awarded the EU's General System of Preferences trade privileges. However, the EU is also concerned about human rights.

Before the regional economic crisis, inflows of foreign direct investment (FDI) were increasing modestly. Between 1988 and mid-1996 nearly \$6 billion of FDI was approved, although only around 30 percent of this has actually been disbursed. Thailand accounted for 41 percent of approved investment, with US investors (largely overseas Laotians) a distant second, followed by the Republic of Korea, France, and Australia. Approved FDI plummeted to \$142.4 million in 1997 and did not recover in 1998.

International donor agencies play a major role in public investment, covering roughly 19 percent of GDP (ADB 1999f, appendixes 1 and 3). During 1995–1997 ADB was the largest donor, followed by Japan, the World Bank, Germany, Australia, Sweden, and France.

The Ministry of Foreign Affairs has taken on an increasingly important role. Currently it is reviewing all international agreements that the Government has signed, with a view to improving compliance. In addition, the ministry's Economic Unit is becoming an important provider of economic advice to senior policymakers.

The Civil Service

The civil service has about 82,300 employees (few of them women), up 18 percent from 1995, along with roughly the same number of other workers paid by the Government but not part of the civil service, including the military. This is equivalent to 1.7 civil servants per 100 people, which is less than in most other governments in the region (Schiavo-Campo 1998). Civil service wages amount to 4 percent of GDP, which is also less than the average of 4.5 percent for other countries in the region (ADB 1997, p. 27; UNDP 1999a). However, the apparent size and cost of the civil service is deceptive. There is no master list of employees, and no systematic procedure for removing former employees from payrolls, thus there are ghost workers (World Bank 1997, pp. 171–84). Furthermore, many teachers are former revolutionaries with few qualifications who do little teaching. This group amounts to an estimated 6,000–7,000 people. In addition, 89 percent of civil servants work in provincial governments, leaving many central ministries without enough staff to carry out critical functions. Inflation has eroded the value of wages to the point that they are well below the minimum needed for food and basic necessities. As a result, many civil servants lack the motivation to perform their jobs effectively. This problem is exacerbated by low skill levels, recruitment and promotion based on factors other than merit, and frequent marginalization of many talented staff through transfers and assignment to low priority tasks.

In 1991 the Government established the National School of Administration and Management to train civil

servants. It also created the Department of Public Administration in 1992, which is responsible for guidelines and policy issues regarding the organization of government at the central and local levels. Decrees addressing the basic rules that guide civil service management were approved in 1993.

Capacity constraints exist at the individual, institutional, and organizational levels of the civil service because of low educational levels, poor incentives, and inappropriate personnel and recruitment policies. At the individual level they are most severe at the local level. The major constraints include lack of English language, office management, and management and planning skills. At the institutional level, job descriptions are missing and there is no clarification of roles and responsibilities. Bureaucrats are still only familiar with a top-down environment, and therefore tend not to make decisions or bring problems to their superiors' attention. Exchanges of information are limited. At the organizational level, the concept of delegation of authority has not filtered through the public administration machinery. Initiative is not rewarded, and there are no grievance mechanisms if officials are punished for mistakes; as a result, officials pass even minor decisions upward rather than take any risks.

Recruitment procedures for civil servants differ significantly among ministries. National recruitment plans or schemes do not exist, while the brightest students prefer to work in the private sector or for international organizations. Promotion tends to be based on seniority, clan ties, and political patronage.

A major structural problem is that public administration is still based on a bottom-up reporting system with no institutionalized channels for interministerial communication. In addition, a strong party structure whose organization parallels the government administrative structure significantly influences processes within the public administration. This leads to a lack of coordination and a duplication of efforts, and underlies the party's nontransparent influence on PAR and policy making.

Public Financial Management

Under a system for budgetary allocation implemented in 1991, all revenues collected by provincial and local authorities are integrated into the national budget, and all expenditures are linked to a national budget expenditure plan (for details on public ex-

penditure management see World Bank 1997, pp. 99–113). The objective is to ensure that local expenditures are consistent with national planned expenditures. In practice, however, implementation has proceeded slowly and the provinces continue to hold extensive fiscal powers. Subsequent changes included the adoption in 1992 of the Public Accounting Plan; the establishment of the Treasury in 1992; the breakup of the Ministry of Economy, Planning, and Finance in 1993; the adoption of a budget law in 1994; and the formation of the State Planning Committee in 1996.

The Lao PDR is a member of the International Monetary Fund (IMF), which in 1998 laid down an international code for public financial management (IMF 1998). The code covers four broad requirements: clarity of roles and responsibilities; public availability of information; open budget preparation, execution, and reporting; and independent assurances of integrity. The Government has made some progress in moving toward these requirements.

As concerns role clarity, the constitution requires the National Assembly to approve both the budget and the development plan, but contrary to the code, the National Assembly does not receive detailed information on the budget. There is also no indication that the National Assembly approves or reviews extrabudgetary spending, quasi-fiscal activities, or government equity holdings.

The Lao PDR generally does not comply with the code's requirement for public availability of information. While a budget document was released to the public for the first time in 1997 for fiscal year (FY) 1997/98, it did not cover extrabudgetary activities, contingent liabilities, tax exemptions, quasi-fiscal activities, original and revised estimates for the preceding two years, and fiscal reporting practices as required by the code. Nevertheless, this was a promising step toward compliance, although no such publication was released for FY 1998/99.

The FY 1997/98 budget did not conform to the code's requirement for open budget preparation, including public disclosure of economic forecasting assumptions, fiscal risks, overall budget balance, and accounting standards.

As concerns independent assurances of integrity, government accounts are incomplete, inconsistent, and

difficult to comprehend, and there is no independent audit authority (World Bank 1997, pp. 99–113). ADB is providing technical assistance to help set up a National Audit Office; however, it will be under the Office of the Prime Minister, and thus not in compliance with the minimum standard of independence.

On the revenue side, the Government has introduced a number of fiscal reforms intended to reduce the budget deficit and inflation. A key aim has been to shift the revenue base away from a dependence on transfers from state enterprises toward income, property, excise, and trade taxes. In 1989 the Government streamlined the corporate and export tax systems, broadened personal income tax, and began to tax certain resources. In 1991 it sought to centralize control over the budget by consolidating central and provincial budgets and establishing the Treasury. Export taxes were eliminated in 1994, in 1995 import tariffs were restructured, and in 1996 a new tax law was passed. The efforts to diversify revenue sources resulted in a fairly steady rise in revenue as a percentage of GDP.

IMF's code also calls for the administrative application of tax laws to be subject to procedural safeguards. Here the situation has recently improved with assistance from a UNDP/IMF project (IMF/UNDP 1999). Various reforms have reportedly improved the filing rate from 30 to 80 percent and increased collections significantly. Customs procedures have also improved, although customs revenues have not, probably because of low valuations of imported goods, smuggling, and the tariff reductions required by ASEAN.

Largely because of problems on the revenue side, the fiscal deficit has gradually worsened since the late 1980s, and reached 14.8 percent of GDP in 1998, excluding grants. For the first time, part of this deficit was not covered by foreign assistance and had to be financed by the Central Bank.

Selected Line Ministries and Departments

The Ministry of Agriculture and Forestry has overall responsibility for this subsector (for more details see MAF 1999; Winrock International 1998). Provincial and district agriculture and forestry service offices and rural development committees also help translate policies into spending allocations.

Roughly two thirds of the 6,000 staff are in the districts and provinces. While they report to the ministry, provincial governors control their field budgets.

The Department of Electricity under the Ministry of Industry and Handicrafts handles electric power development (for more details on this and other ministries see UNDP 1996). The Lao PDR has only developed 2 percent of possible hydropower sites along the Mekong tributaries. Significant work needs to be done in deciding how to move forward.

The focus of the Ministry of Communication, Transport, Post, and Construction is roads. Donor funding covered some 80 percent of capital expenditure and 50 percent of improvements and emergency repairs. Local funding is inadequate, leading to project delays, poor maintenance, and payment arrears to contractors. Despite a reorganization, management practices are still weak and the division of roles between central and provincial authorities is unclear.

Reform of the financial sector began in 1988 when the state bank devolved its commercial banking functions, adopted a supervisory central banking role, and rationalized its extensive branches. The banking system now consists of seven state-owned commercial banks, two private banks, and seven foreign bank branches (restricted to Vientiane and all but one Thai-owned). In 1993 the Government established the Bank for Agricultural Promotion to improve the flow of credit to the agriculture sector. The reach of the banking sector is limited: most assets and deposits are concentrated in Vientiane. Even though the 1990 Central Bank Law gave the Central Bank formal autonomy over monetary and exchange rate policy, the bank works under strict political control. Some indirect monetary instruments exist and Treasury-bill auctions have been held since 1994, but a stock market remains a distant prospect.

Lending to state-owned firms is more common than lending to the nonstate sector, and there is a bias toward short-term loans. This has led to a thriving informal capital market, including private money-lenders and revolving credit circles. Much bank lending is government directed rather than market led. The Central Bank's capacity to regulate the banking sector remains a cause for concern. A 1997 government-commissioned audit reported that nonperforming loans made the state-owned banks insolvent.

The poor quality of the education system is a serious constraint to the Lao PDR's development prospects. The country suffers from a shortage of schools and textbooks, poorly qualified teachers, and low enrollment and completion levels. The Government showed its commitment to education by increasing education expenditures from 1.3 to 2.9 percent of gross national product during 1987/88–1995/96. However, most of this growth came from the donor-funded investment budget, hence priorities may be influenced by donor preferences rather than objective analysis. Recent reforms have sought to centralize responsibilities for education at the Ministry of Education. The ministry now manages and controls the entire education budget, and determines standards and curricula. While the central level is responsible for higher and upper secondary education, the provincial level takes care of lower secondary education and district education offices are responsible for primary, adult, and nonformal education.

Health standards are low compared with similar-income countries in the region. Underlying these poor standards is a poorly maintained public health system that is inaccessible to much of the population. Many poor people rely on the private pharmacies that have sprung up in recent years for treatment, but their personnel are often inadequately trained. A positive sign is that government health expenditure increased from 0.7 to 1.7 percent of GDP from 1990 to 1996/97. However, expenditures are concentrated in a few provinces and this concentration is increasing (World Bank 1997, p. 63).

Subnational Government

The Lao PDR is divided into 16 provinces, 112 districts, and more than 11,000 villages. Provinces, districts, and some villages are run by party committees. The chief representatives of the Government are provincial governors and district and village chiefs. Villages also have traditional leaders. As at the national level, the leadership structure is overwhelmingly male.

The Government has initiated important reforms in the area of central-local government relationships. For example, by a decree on the re-centralization of public finances all revenues and expenditures have to pass through the national budget, and only the Ministry of Finance can organize and ensure

revenue collection. A positive feature of this system is that provincial governments can keep 30 percent of any revenues they collect above their agreed annual targets, which gives them an incentive to perform well. Only some 15 percent of total expenditure is allocated directly to subnational governments, although central ministries spend much of the remainder at the provincial level (World Bank 1997, p. 110).

Previous efforts to decentralize the Government's economic functions have not worked effectively because of a lack of capacity at the provincial level and weak central institutions. The lack of accountability of subnational authorities and of an effective and transparent system of fiscal decentralization have affected the transfer of tax revenues to the center, which may further undermine the central Government's authority. Local empowerment is also hindered by unaccountable provincial governments and the lack of institutionalized mechanisms for beneficiary participation.

The economic gap between Vientiane and the rest of the country has widened since the reforms began, as most FDI has gone to the capital and its environs. In addition, central control over the regions has always been weak, largely because of poor communications and transport links between the provinces.

Legal and Judicial System

Legal and judicial reforms began in 1989. A draft criminal code established procedures for criminal cases, set up a court system, and established a law school. In addition, the functions of the Supreme People's Court were separated from those of the office of the public prosecutor general. However, only the Ministry of Justice routinely publishes its decrees and those of other ministries it deems important. This leads to confusion in the application of unpublished decrees and arbitrary enforcement.

Although the implementation of judicial reforms has proceeded slowly and reportedly has not yet improved the administration of justice significantly, the new legal framework offers the possibility of moving away from the arbitrary use of power toward the rule of law. Theoretically, the Government provides legal counsel to the accused, although in practice, the accused must defend themselves without outside legal counsel. Professional personnel trained at the Institute of Law and Administration are becoming more widespread.

Legal reforms have been motivated in part by the desire to attract private investment, and enforcement is reportedly more predictable and transparent for foreign than for domestic business people.

Public-Private Interface

The number of SOEs has been reduced from more than 800 in the early 1990s to about 90; however, the privatization program has reportedly lost momentum. Thirty-two SOEs are currently excluded from the privatization process and will remain under state control for "strategic" reasons.

The Sixth Party Congress in 1998 emphasized that different forms of economic ownership were permitted, but stressed boosting the efficiency of state enterprises. Its report emphasized that foreign investment should be accepted only in areas the Government regarded as priorities. While debates about the relative roles of the state and the private sector will continue, even the most conservative among the Lao PDR's leaders acknowledge that the market has a role to play in economic development.

Currently, the private sector consists mainly of small family trading and food-related businesses. There are an estimated 146,000 small and medium private firms, with net growth of some 13,000 new businesses per year. However, according to many entrepreneurs, the Government still views the emerging private sector, especially indigenous entrepreneurs, with suspicion, because of its fear that a thriving private sector may gradually undermine both the LPRP's authority and the Government's ability to control the economy.

In 1994 the Government passed a revised law on foreign investment that allowed 100 percent foreign-owned ventures. Investment is encouraged in a range of sectors, including manufacturing and energy. Since 1996 the Committee for Management of Investments and International Economic Relations has overseen foreign investment.

In 1987 the Government abandoned the state monopoly on foreign trade in several commodities. Quotas have gradually been removed and the tariff structure rationalized. Quantitative restrictions remain only for imports of vehicles and exports of timber. The Lao PDR has already benefited from a number of preferential trade agreements and has signaled its desire to join the World Trade Organization.

Accountability Institutions

A key governance constraint is corruption at all levels: “The politically powerful avoid paying tax, accept ‘commissions’ for facilitating projects or awarding contracts, and pocket pay-offs for reducing charges, duties or taxes for family and friends” (Stuart-Fox 1997, p. 207). Donor-funded procurements are rigged to include funds for cars for personal use and ministers try to commandeer cars provided to support donor projects for their personal use. This sets an example for lower-level officials, who supplement their low salaries through similar behavior.

New opportunities for corruption opened up as economic reforms started to take hold in the 1980s. For example, giving provinces the right to trade directly with neighboring countries has opened the way for trade-related graft, the opening up to foreign investment has introduced opportunities to collect money to facilitate required authorizations, and the enhanced political and economic role given to the army has provided new opportunities for smuggling. Corruption also spread to personnel management, leading to the rapid promotion of those close to powerful leaders (Stuart-Fox 1997). This behavior reduces government revenues, misallocates expenditures, reduces foreign investment, and erodes public trust. Many people believe that corruption has become so pervasive that it is now the main impediment to reform (Evens 1998). Officials fear that their own actions will be discovered, and are uncertain what their status would be in a setting with less corruption. Widespread corruption also helps to explain resistance to the liberalization and deregulation of the business environment and the implementation of a liberal foreign investment regime.

The current Government has taken many actions to address the problem, including setting up an Anti-Corruption Commission in 1993, placing new controls on illegal logging, and publicly condemning lavish consumption (*Khaosan Pathet Lao*, news bulletin cited in Stuart-Fox 1997).

The institutional framework needed to address these problems is gradually evolving, but is far from complete. The Ministry of Finance’s Department of Financial Inspection only inspects the accounts of government organizations where financial problems are known to have occurred. This limited role is reportedly due to the lack of staff and expertise. A Na-

tional Auditing Office has been set up with assistance from UNDP and ADB, with 20 specialists experienced in Lao PDR public financial management.

Civil Society

Currently the Lao PDR has only a few indigenous organizations that might be viewed as the beginnings of a civil society independent from the Government. The Government does not encourage local NGOs because it sees them as a potential threat to its monopoly of power. Thus the Government is denying itself the opportunity to learn from and work through them. Nevertheless, some Laotian NGOs are emerging, for example, Champa works on health issues and Padek Lao works on community-based agricultural issues.

Some international NGOs are present. These disbursed an estimated \$12.5 million in 1997, focusing on area development and health (UNDP 1999b, p. 38). Foreign NGOs have reportedly developed further than indigenous ones because the Government finds them easier to control.

The private business sector is small and has little influence on policy making. There are no business associations operating independently of the LPRP; however, some 15–20 associations are formally linked to line ministries and are effective in lobbying. The Chamber of Commerce is gradually developing but still depends on party guidance. The party’s mass organizations have extensive networks at the village level and some accomplishments to point to, for example, the Lao Federation of Trade Unions has promoted the rights of textile workers and HIV/AIDS prevention as a right of all workers.

On international citizens’ rights, according to a Freedom House (2000) survey, the Lao PDR’s rankings are comparable to those of most other countries in the region. For example, on a scale of 1 (free) to 7 (unfree), the Lao PDR scores 7 for political rights and 6 for civil liberties.

The Media

Information and communication have been tightly controlled since French colonial times. During the years of revolutionary struggle, the LPRP relied

heavily on radio broadcasts to a largely illiterate, mountain-dwelling audience. Press operations oriented to the Mekong Valley towns were conducted secretly. Given this heritage of party control, the operation of the mass media as a tightly controlled party monopoly without private participation is not surprising.

In 1994 the official media consisted of a daily newspaper in Lao; a news service issuing bulletins in Lao, English, and French; and a radio service and four television stations broadcasting in Lao and various tribal languages. Other media are aimed at particular audiences. Some are published regularly, such as the journal *Sangkhom Thoulakit*, which targets readers interested in Vientiane business and society. Others published by various mass organizations tend to appear intermittently.

Given the proximity of Thai radio and television, Thailand remains both an open window to a different economic system and provides a perspective on the news. Furthermore, outside information has proven to be too pervasive for the authorities to eradicate it using surveillance or jamming.

A Freedom House (1999) press freedom survey, where a score of 1 was most free and 100 least free, scored the Lao PDR as 66. The Government controls all radio, television, and newspaper and reacts harshly to expressions of political dissent. Content is therefore severely restricted. Satellite dishes are legal on payment of a fee to the Government.

Present Reform Prospects

The National Assembly

Some positive changes have taken place: members now discuss and vote on draft laws and do not enact all those submitted; an electronic voting system allows secret ballots; microphones permit members to speak from their seats, thereby promoting more debate; and a Department of Citizens' Complaints and Petitions has been established.

Nevertheless, much more work is needed to make the National Assembly a truly effective legislative body. Agenda setting needs to be more systematic

and validated through nationwide public consultation; legislative drafting and floor deliberation processes need to be streamlined; legal draftspersons should be better trained and legislative committees should be given more technical skills; session proceedings should be documented; and new laws, regulations, and session proceedings should be disseminated more widely and systematically. The National Assembly is proceeding to address these and other improvements with support from a UNDP project (Reyes 1999).

Public Administration Reform

The need for PAR has increased as the market-oriented economy has continued to develop and new challenges have emerged. The aim of the PAR program approved in 1997 is to develop an effective, efficient, and low-cost civil service. Steps include restructuring ministries, refining their mandates, balancing decentralized and central control, strengthening personnel management, reviewing salary and career structures, introducing more results-oriented and merit-based systems, and providing training. UNDP has been providing assistance.

While the reform effort has the correct focus and high-level political leadership, tangible results have been elusive. The civil service has not only grown, but real salaries have plummeted, recruitment and promotion continue to be based on factors other than merit, and many talented staff continue to be marginalized.

Salaries at all levels are inadequate to cover basic subsistence needs, although the most senior officials may get benefits such as housing and transport. Other countries in a similar situation have shown that incentive experiments can begin to address the problem in areas where effort and results are easy to measure and are responsive to incentives. The Lao PDR has initiated some experiments of this type. For example, an unexploded ordinance project paid field workers bonus pay to compensate them for the risks they were taking (however, the payments were stopped when other staff complained of unfairness). Donor-funded projects may provide other types of incentives, including training, overseas travel, and the use of vehicles and computers.

Yet even if incentives were to improve, many other steps would be needed to improve performance levels: recruitment and promotion would have to be merit based, delegation would have to be expanded, and transfers would have to consider the impact on task performance. Steps have been taken in some of these areas; however, recent experience has been that work on reforms such as these proceeds, usually with donor support, until meeting a political constraint. It then stops until a consensus emerges among the senior leadership, which takes time. Even when agreement has been reached, work proceeds slowly because of capacity constraints. In many cases, the capacity constraint is artificially created by replacing effective technocrats with inexperienced ones and/or by disrupting the ministry concerned by undertaking restructuring. Until these conditions change, significant progress is doubtful.

Public Financial Management Reform

The leadership is seeking to draw lessons from the Asian crisis as it pursues a program of liberalization and deregulation, for example, the crisis illustrated the dangers of economic integration with Thailand. The belief that gradual reforms will continue is supported by the severe economic situation, which includes high inflation. Only greater exchange rate stability will reduce imported inflation, and for the time being this looks unlikely. Thus the Government is likely to take seriously the policy recommendations made by IMF in 1999 to tighten monetary controls. However, the prospects for institutional and structural reforms recommended by IMF are less good. For example, the achievement of revenue collection targets is unlikely without overall progress in improved tax administration, which includes treating all taxpayers equally without “special arrangements” for some. Political will is also needed to put an end to giving politically favored importers advantageous import quotas. Sustained implementation of such institutional reforms over the next few years is unlikely for a number of reasons, including the need

for consensus among the senior leadership and manipulation by vested interests.

Even when the Government is determined to move on a specific issue, capacity for market-oriented development management, including indicative planning, policy formulation, and coordination, is limited. Until conditions change, significant progress is doubtful.

Line Ministries and Departments: Sectoral Reform

The introduction of market mechanisms under the NEM and the 1992 reorganization of the Ministry of Agriculture and Forestry has led to some improvements in output, but increases in the output of staple food crops are barely keeping pace with population growth. Institutional reasons for the slower than hoped for progress include difficulties in implementing the NEM; the lack of overall consensus about the NEM's ultimate goals, resources and incentives, performance measurement standards, political support, and transparent communications; and weak links between the ministry and subnational and higher levels (Winrock International 1998, vol. 4, p. 24). One of the main prerequisites for addressing these problems is reaching consensus on policy directions. While some progress has been made, more is needed, which will be challenging given the overall fiscal, political, and administrative constraints.

Continued ADB support of the Department of Electricity in the Ministry of Industry and Handicrafts and of *Électricité du Lao* has resulted in major tariff reforms for the electricity subsector and enhanced institutional capacity to plan and implement projects. However, the following actions are still needed: increasing domestic tariffs in line with the economic cost of production, continuing support for private sector participation in the energy sector, reviewing foreign investment proposals in a transparent manner, analyzing hydropower development projects to ensure that they do not degrade natural resources or cause unnecessary population displacement, and improving coopera-

tion and coordination between pertinent institutions and local populations. Carrying out these tasks will require considerable expertise and technical skills and suitable incentives and work processes. Implementation is unlikely except in a few donor-funded activities.

A number of key concerns related to the transport sector include planning and managing road maintenance; privatizing road construction, maintenance, and transport operations; and improving financial control, project monitoring, and coordination within the ministry and with other ministries, and technical and managerial skills at the Ministry of Communication, Transport, Post, and Construction.

The financial sector has been strengthened in recent years. Under the Financial Sector Program Loan a two-tier banking system was established, the base for a market-oriented financial system was created, the functions of the Bank of the Lao PDR were strengthened, and new monetary instruments were introduced; however, capacity constraints are still severe. Outstanding issues include improving human capital, focusing on institution building for the foreign exchange and interbank markets, enhancing bank supervision and management and rule enforcement, and strengthening the autonomy and commercial orientation of the state-owned commercial banks and the supervisory function of the Bank of the Lao PDR. While many of these concerns are being addressed, further assistance will be needed.

Sustainable improvement in the education subsector is critical to create the basis for long-term growth and development. Long-term underfunding and inadequate management of educational services has resulted in weak performance, particularly in rural areas. Major concerns include the limited access to education, the lack of a supportive learning environment, low internal efficiency, inadequate educational management capacity, and the lack of qualified staff and coordination between different departments of the Ministry of Education. To improve access to and the relevance and quality of education, the

ministry's coordination, planning, monitoring, and policy formation capacities need strengthening.

Concerns in the health subsector center around increasing health expenditures in an environment of constrained resources and the optimal allocation of such expenditures. For example, most government funds are allocated to curative services rather than to more cost-effective preventative care and basic clinical services. The challenges in addressing these constraints are the same as in other sectors.

Subnational Government Reform

Although the present policy framework is basically suitable for fostering decentralization, several impediments persist, including the lack of coordination at the decision-making level; the centralization of the early 1990s, which led to dominance by the center in policy making and budget allocation; the absence of transparent conflict resolution channels; the long time lag between the detection of a policy problem at the local or district level and policy action; and the hindrances to efficient service delivery created by numerous bureaucratic layers and line ministries' tendency to override local priorities. Another key constraint is the lack of clarification of the roles and responsibilities of civil servants, including governors. In many situations the division of labor depends not on job descriptions, but on the power wielded by particular individuals.

Although the constitution established the basic institutional arrangements with respect to local government, much has to be done before a balance between decentralized operational management and central control can be achieved. Local self-government is virtually nonexistent. With regard to rural development, top-down approaches still dominate the reform process, so no adequate foundation for participatory development exists. Furthermore, neither the provinces nor districts have any financial autonomy. Even though the authorities see decentralization as a way to promote responsible behavior and a more output-oriented management

style, they also recognize that delegation of powers and decentralized management can only be implemented when control and accountability mechanisms are in place. In this regard, the National Audit Office has the potential to become a key institution of efficient public sector management.

Legal and Judicial System Reform

Some heartening legal and judicial improvements have taken place, including the evolution of an identifiable system of legislation, the publicizing of laws and decrees, the expansion of legal training, the completion of a bench book for judges, and the development of a private bar. However, the vast majority of new laws are not yet being enforced.

The legal system's overall capacity remains weak and faces many of the same systemic problems as the civil service. These problems cannot be addressed with donor-funded projects alone, but require political commitment and financial support. As a result, businesses will continue to be hampered by ambiguous rules, opaque enforcement procedures, and opportunities for administrative intervention and discretionary actions. Laws tend to be enforced in ways that benefit vested interests.

Public-Private Interface Reforms

The Government has made significant progress in relation to privatizing SOEs and attracting FDI. The private sector's response to the economic liberalization has been promising, and it now dominates transport, manufacturing, and distribution. However, the Government is concerned that FDI may create dependencies within the domestic economy, because of domestic entrepreneurs' lack of business experience. This problem is aggravated by the inability of most domestic businesses to mobilize venture capital or to raise sufficient equity for starting their own new projects or for joint ventures.⁴

⁴ Most information in this section was provided by J. Tomecko of the Lao-German Small Enterprise Development Project.

Private businesses face numerous constraints, including a lack of business skills and management capability; the weakness of the domestic financial sector, and hence the lack of credit; the excessive bureaucratic red tape, especially for exporters; the impediments to long-term private investment because of the time taken to approve FDI and the lack of guarantees in regard to extensions; the lack of a transparent system of property rights; the deficiencies in the legal and regulatory framework; and the insufficient infrastructure.

The Chamber of Commerce may gradually develop into an institution that can effectively represent the interests of private business; however, it is still relatively weak because of poor leadership and persisting political constraints. As the private sector lacks an effective organization that represents its interests, it has only negligible influence on policy making. Another important bottleneck to building capacity to foster private sector development is the Government's unwillingness to facilitate the creation of domestic NGOs or private voluntary organizations.

Reform of Accountability Institutions

Even if the National Audit Office reports to the National Assembly as planned, the close ties between the National Assembly and the prime minister will limit the office's independence from the executive. Accountability is only likely to improve if further steps are taken on such fronts as strengthening freedom of information, public grievance procedures, and investigating agencies; distinguishing petty procedural irregularities from substantive misconduct; enabling immediate prosecution and removal of corrupt officers; and drawing up a charter of ethics and a civil service code. However, as many of these initiatives would conflict with the principles of democratic centralism, progress will be slow.

Civil Society and Media Reform

Indigenous NGOs will continue to develop on a small scale, and international NGOs will continue to do useful work in disadvantaged areas. No major

increase in scope is likely. The media are likely to become slightly more open in response to pressure from citizens, businesses, and donors.

Conclusion

Improving the overall governance structure in the Lao PDR requires resolute and sustainable improvement of the ability to formulate, implement, and enforce market-oriented policies and development projects. The best way to achieve this is through a leverage-point approach that addresses key governance constraints related to the core institutions of govern-

ment and line ministries, subnational governance issues, the public-private interface, legal and regulatory reform, and civil society.

As the absorptive capacity of the Lao PDR has been constrained by weak institutional capacity and shortages of skilled personnel, and moreover resources available for external assistance are becoming scarcer, a narrower focus of ADB operations seems to be inevitable. Besides focusing projects more on the financial and education sectors and selected leverage points, a geographical focus of ADB operations appears to be a reasonable approach to increasing its developmental impact.