

*COUNTRY  
ECONOMIC  
REVIEW*

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*Lao People's Democratic Republic*

*August 2001*

## CURRENCY EQUIVALENTS

(as of 31 July 2001)

Currency Unit	=	Kip (KN)
KN 1.00	=	\$0.000110
\$1.00	=	KN9,120

## ABBREVIATIONS

ADB	–	Asian Development Bank
ASEAN	–	Association of Southeast Asian Nations
BOL	–	Bank of Lao PDR
CPI	–	consumer price index
FDI	–	foreign direct investment
GDP	–	gross domestic product
ha	–	hectare
IMF	–	International Monetary Fund
Lao PDR	–	Lao People's Democratic Republic
LECS	–	Lao expenditure and consumption surveys
NPL	–	Non-performing loan
SOE	–	state-owned enterprise

## NOTES

- (i) The fiscal year (FY) of the Government ends on 30 September 2001. FY before a calendar year denotes the year in which the fiscal year ends. For example, FY2001 begins on 1 October 2000 and ends on 30 September 2001.
- (ii) In this report, "\$" refers to US dollars.



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## EXECUTIVE SUMMARY

The gross domestic product (GDP) has continued to grow after a slowdown in 1998. The real GDP growth rate was 7.3 percent in 1999 and 5.9 percent in 2000. Growth in the agriculture sector has been healthy at 8.2 percent in 1999 and 5.1 percent in 2000, and growth is balanced among the sectors. Agriculture led the recovery in 1999, and industry and energy production (largely for export) were major contributors to growth in 1999 and especially in 2000.

During the regional financial crisis, Government spending was overly expansionary and too heavily focused on capital spending. Capital spending increased from around 50 percent of total Government expenditures to around 75 percent, as inflation eroded the value of recurrent expenditure, particularly government salaries. The Government is taking steps to restore the balance between capital and recurrent spending; capital spending now accounts for about 65 percent of total Government expenditures. The Government is implementing an ambitious decentralization that will give local governments (provinces and districts) more authority in spending and collecting revenues.

Development agencies make a major contribution to the Government's revenues in the form of concessionary loans and grants. The Government is increasing both tax and nontax revenues in response to the significant decrease during the regional financial crisis. The Government is planning to introduce a value-added tax in 2003 as part of comprehensive tax reform. Currently taxes fall mostly on imports and the tax system is not very transparent or efficient.

After several years of moderately high inflation (in the 10 to 20 percent range), prices increased sharply in 1998 and 1999. Inflation was estimated to be 87 percent in 1998 and 134 percent in 1999. This increase in prices has several causes. First, the devaluation of the Thai baht put downward pressure on the Lao kip. The Bank of Lao (BOL) made no attempt to sterilize aid assistance, which led to an increase in the domestic money supply. In addition, BOL started monetarizing the budget deficit, in particular Government investments in irrigation. This effectively led to a real decline in recurrent expenditures and salaries. In 2000, inflation moderated to 27 percent and will likely be below 10 percent in 2001. BOL has committed to not financing the Government deficit in the future. The International Monetary Fund recently approved a poverty reduction and growth facility for the country; this is a testament to the country's efforts at economic reform.

The sharp increase in inflation led to a corresponding rapid devaluation of the kip against the US dollar and the Thai baht. Stability has since returned to the exchange rate, and the kip has appreciated from the lows reached against the dollar in August 1999. As a result of the instability, dollarization (the holding of foreign currency for domestic transactions) has increased. Both the dollar and the baht circulate widely, and dominate in commercial transactions and bank deposits.

Exports have grown steadily since 1998 and the balance of payments, although in deficit, is improving. Key exports include timber and forestry products, electricity, and textiles. The amount of unregistered exports of timber and rice is significant. External financing has been the major source of funding for the balance of payment deficit, although foreign direct investment (especially in the hydroelectric sector) has played an important role as well. This trend is expected to continue as new hydroelectric investments enter the country. Tourism is also playing an important role in the balance of payments. In 2000, more than 720,000 tourists

entered the country compared with 375,000 in 1996. Foreign reserves have increased to an estimated \$140 million in 2000, enough to provide 2.4 months of import coverage.

The financial sector is in need of reform. The proportion of nonperforming loans is quite high. Interest rates are capped and do not respond to market conditions. This severely limits the financial sector's ability to serve as a financial intermediary and provide investment funds for development.

External conditions permitting, the country should be able to grow by 6 to 7 percent in the next two years. Although this will have a positive effect on poverty, this effect is likely to be dampened by an increase in income inequality. Growth is expected to be balanced among the principal sectors.

The Government is committed to increasing (i) targeting of public expenditures to the poor and (ii) social spending. Further investment in infrastructure should also increase the access of the poor to markets. Revenue, as a percentage of GDP, is expected to increase as the Government strengthens the tax system. Saving rates are expected to increase as faith is restored in the domestic economy and the financial sector is strengthened. Foreign domestic investment will also enter the country to support the hydroelectric sector.

Inflation is expected to be moderate as the Government seeks to increase its revenue from taxes and other fiscal sources. BOL has committed to not finance future budget deficits by printing money. The high level of dollarization and the weak financial sector limit the options available to BOL in terms of monetary policy. Government expenditures are expected to increase as the balance between recurrent and capital spending is restored; tax revenues are also expected to increase.

A large part of the country's population lives outside of the market economy and, as a result, the positive effects of growth were largely felt in urban areas and in lowlands. Poverty decreased from 45 percent in 1992/93 to 39 percent in 1997/98; income inequality increased.

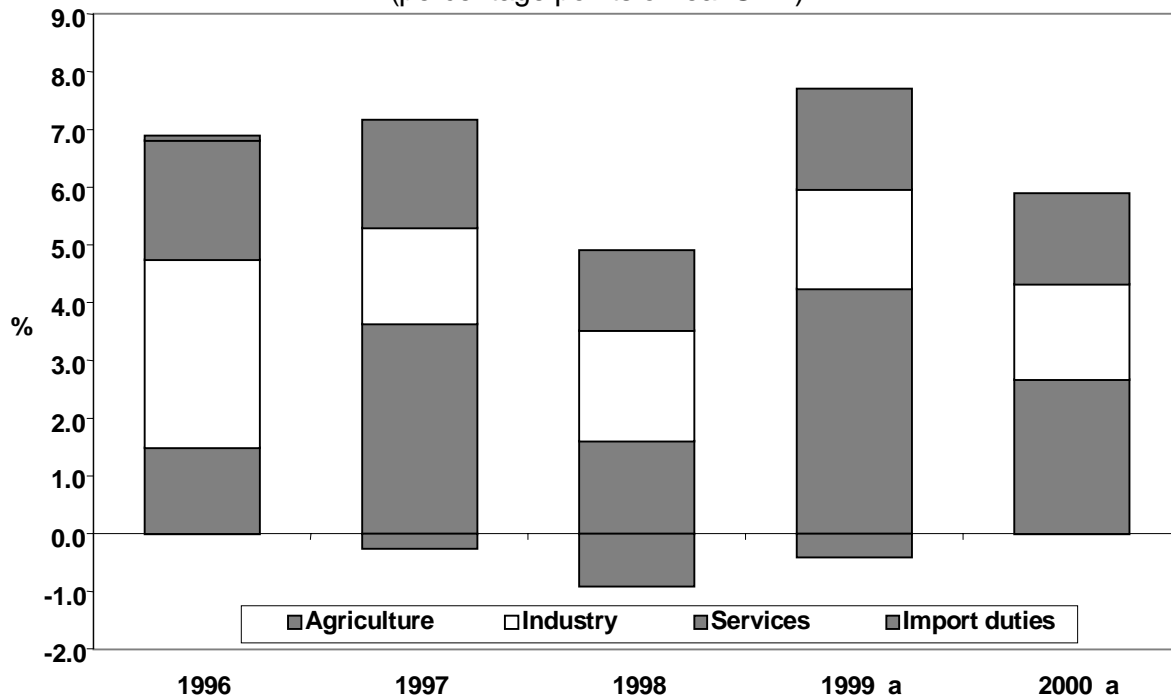
## I. RECENT ECONOMIC DEVELOPMENTS

### A. Growth, Employment, Saving, and Investment

#### 1. Aggregate Growth

1. From 1992 until 1997, the gross domestic product (GDP) of the Lao People's Democratic Republic (Lao PDR) grew at an average rate of 7.0 percent. In 1998, GDP growth slowed to 4.0 percent only to increase to 7.3 percent in 1999 and 5.9 percent in 2000 (Table 1). The slowdown in economic growth was less dramatic than in many other Association of Southeast Asian Nations (ASEAN) countries and was largely caused by a reduction in foreign investment and construction spending. Agriculture led the recovery in 1999, although manufacturing and electricity production were also major catalysts for recovery in 1999 and 2000 (Figure 1). The country is growing from a low economic base. Population growth at around 2 percent per annum reduces the beneficial effect of economic growth on per capita income growth. The Lao Expenditure and Consumption Surveys (LECS) data show that between 1992/93 and 1997/98, per capita consumption grew at an annualized rate of 5.8 percent (Table 2).

**Figure 1: Sectoral Contribution to Real**  
(percentage points of real GDP)



<sup>a</sup> Preliminary estimates.

Source: National Statistical Centre.

2. The regional financial crisis affected the country negatively, reducing GDP growth, Government revenues, and officially measured imports and exports. It contributed to the sharp increase in inflation as the Thai baht lost value (the Thai baht is a major component of the Lao money supply), and the Government monetarized debt in an attempt to maintain investment

spending with reduced revenues. The ability of lowland farmers to export to Thailand and the relative isolation of the poor population limited the effects of crisis on the welfare of the poor.

**Table 1: Gross Domestic Product by Economic Activity  
Growth Rates**  
(constant 1990 prices, percent)

<b>Economic Activity</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999<sup>a</sup></b>	<b>2000<sup>a</sup></b>
<b>Agriculture</b>	2.8	7.0	3.1	8.2	5.1
Crops	2.9	14.0	6.4	13.5	8.0
Livestock and Fishery	2.8	2.4	2.5	2.3	2.0
Forestry	2.0	(4.9)	(9.8)	2.3	0.0
<b>Industry</b>	17.3	8.1	9.2	7.9	7.5
Mining and Quarrying	61.2	28.5	13.8	33.5	10.0
Manufacturing	18.1	9.3	9.6	7.1	8.0
Construction	12.3	5.0	(14.1)	(1.2)	0.0
Electricity and Water	15.0	(1.9)	62.7	21.6	12.0
<b>Service</b>	8.5	7.5	5.5	6.9	6.2
Transport, Post, and Telecommunication	10.1	10.3	6.5	9.7	8.0
Wholesale and Retail Trade	11.2	10.8	9.8	7.2	8.0
Bank, Insurance and Real Estate	(2.7)	9.0	2.0	3.0	3.0
Ownership of Dwellings	6.2	2.5	2.5	2.5	2.5
Public Wage Bill	0.4	1.1	4.2	6.7	3.0
Nonprofit Institutions	7.9	(1.2)	(20.3)	(10.0)	0.0
Hotels and Restaurants	21.3	9.6	8.0	15.0	8.0
Other Services	11.8	3.2	2.0	12.4	0.0
Import Duties	2.9	(10.5)	(45.1)	(37.7)	0.0
<b>Gross Domestic Product</b>	6.9	6.9	4.0	7.3	5.9
<b>Memorandum Item:</b>					
Gross Domestic Product (KN million) <sup>b</sup>	893,256	955,009	993,194	1,065,817	1,128,629

<sup>a</sup> Preliminary estimates.

<sup>b</sup> At constant 1990 prices.

Source: National Statistical Centre.

3. In 2000, GDP per capita was estimated to be \$330, making the Lao PDR one of the poorest countries in the Asia and Pacific Region. The United Nations Development Programme's human development index tells a similar story: In 2000, the Lao PDR was ranked 140 out of 174 and, in human development terms, is the poorest country in ASEAN.

4. National account statistics do not measure economic growth by province or region although the LECS consumption data does provide some insight into regional growth rates (Table 2). Between 1992/93 and 1997/98, consumption growth increased the fastest in Vientiane municipality at 10.8 percent. In other regions of the country, the growth rate was slower, between 4.4 and 4.9 percent.



5. Consumption growth was generally higher in urban areas than in rural areas, with the exception of Vientiane municipality. In all regions outside of Vientiane, the gap between urban and rural consumption increased, contributing to the overall increase in inequality.

**Table 2: Growth in Consumption By Region**  
(percent)

Region	Aggregate	Urban	Rural
Vientiane	10.8	10.7	12.7
North	4.9	6.7	5.0
Central	4.7	6.9	4.5
South	4.4	5.2	5.0
Lao PDR	5.8	9.0	5.4

Lao PDR = Lao People's Democratic Republic.

Source: National Statistical Centre.

## 2. Sectoral Growth

6. The economy of the Lao PDR is largely resource based and depends heavily on a sustainable environment to generate future growth. Agriculture is the largest sector, accounting for 52 percent of GDP (Appendix, Table A2). This proportion was stable from 1996 to 2000 (Table 3). About 85 percent of the employed population works in agriculture.<sup>1</sup> This situation is common in low-income countries: 15 percent of the workforce produces about 50 percent of GDP. In part this reflects the fact that a large part of the rural economy is not monetarized and not properly counted in the national accounts. However, it also indicates an imbalance in labor productivity. Future economic growth will have to build on improving productivity in the agriculture sector, and the migration of the labor force to more productive subsectors of the economy.

**Table 3: Sector Contribution to Growth**  
(percent of gross domestic product)

Sector	1996	1997	1998	1999 <sup>a</sup>	2000 <sup>a</sup>
Agriculture	52.2	52.2	51.8	52.2	51.8
Industry	20.6	20.8	21.9	22.0	22.3
Services	24.8	25.0	25.3	25.2	25.3
Import Duties	2.4	2.0	1.1	0.6	0.6
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

<sup>a</sup> Preliminary estimates.

Source: National Statistical Centre.

7. Crops have been a leading contributor to economic growth in the past four years. From 1997 to 2000, the crops subsector (which accounted for 27 to 29 percent of GDP) has grown faster than the aggregate economy. Rice yields have increased steadily from 2.6 tons/hectare

<sup>1</sup> State Planning Committee. 1997. *Results from the Population Census 1995*. Vientiane.

(ha) in 1996 to an estimated 3.2 tons/ha in 2000 (Table 4). While the yield of all three categories of rice has increased, most of the increase in rice yield is due to a large increase in area under irrigation, from 18,000 ha in 1996 to 110,000 ha in 2000 (Appendix, tables A3.1 and A3.2). A decomposition of rice production shows that around 45 percent of the increase in rice production is due to an increase in land under irrigation. Evidence from qualitative surveys suggest that informal exports increased substantially as Lao farmers increasingly took advantage of the higher relative prices for rice in Thailand.<sup>2</sup>

**Table 4: Yield of Agricultural Crops**  
(tons/hectare)

<b>Crops</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000<sup>a</sup></b>
<b>Cereals</b>					
Rice	2.6	2.8	2.9	2.9	3.2
Season Rice	3.0	3.1	3.1	3.2	3.3
Irrigated Rice	4.0	4.2	4.0	4.1	4.2
Upland Rice	1.5	1.6	1.6	1.6	1.6
Maize	2.1	2.1	2.4	2.4	2.4
<b>Manufacturing Products</b>					
Sugarcane	25.6	25.7	31.7	36.7	36.7
Tobacco	3.6	3.7	3.9	5.4	5.3
Peanut	1.3	0.9	1.0	1.0	1.0
Cotton	0.7	1.0	1.0	1.0	1.0

<sup>a</sup> Preliminary estimates.

Source: National Statistical Centre, State Planning and Committee.

8. **Agricultural Diversification.** Based on evidence of land planted to different crops, the relative share of different categories of crops seems to have remained stable.<sup>3</sup> The share of land allocated to rice and other cereals has dropped slightly, while the area of land dedicated to vegetable, beans, and cash crops has increased slightly. Of particular interest is coffee, whose production increased from 10,000 tons to 17,500 tons, with the area under cultivation approximately doubling in five years.

9. After a period of rapid growth in the late 1980s and the first half of the 1990s, livestock production generally declined after 1996. The number of pigs dropped from 1,772,000 to 1,101,000 from 1996 to 2000, with similar, albeit smaller, declines in the number of buffalo and cattle.

10. **The Industry Sector.** In recent years, manufacturing has played an increasingly important role in the economy, growing from 15.4 percent of GDP in 1996 to 16.8 percent in

<sup>2</sup> Asian Development Bank. 1999. The Social Impact of the Financial Crisis in Lao People's Democratic Republic. Manila.

<sup>3</sup> The existing data does not measure double cropping on agricultural land (i.e., the planting of two crops on the same plot of land, either in succession or at the same time).

2000. Although specific data on the contribution of textiles in this subsector is not available, textiles are considered to be one of the driving forces. Textile exports grew from \$64 million in 1996 to \$77 million in 2000; presumably local consumers bought more domestically produced textiles as their income increased.

11. **The Energy Sector.** The energy sector, particularly the generation of electricity from the country's hydro resources is playing an increasingly important role in the economy. Investment in the hydroelectric sector has been a major source of investment in the economy and the export of energy has been one of the country's major exports in recent years (Table 5).

**Table 5: Lao PDR Energy Generation and Consumption**

Items	1986	1990	1995	1996	1997	1998
Energy (GWh)	867	844	1,085	1,332	1,355	2,598
Consumption (GWh)						
Total	812	801	1,013	1,158	1,224	2,087
Domestic	128	194	337	366	410	587
Export	684	607	676	792	710	1,500
Import	—	22	77	84	104	128

— = not available, GWh = gigawatt per hour, Lao PDR = Lao People's Democratic Republic.

Source: Lao PDR Power Sector Study, Asian Development Bank Technical Assistance 3374, December 2000.

12. Traditionally, the Lao PDR has exported the bulk of the energy generated. Even in 1976, the first year with statistics, the country exported about 75 percent of the electricity generated. This ratio has been more or less steady over the past 25 years. Since the introduction of the New Economic Mechanism in 1986, domestic energy consumption has increased more than fourfold due to growing demand for electricity by households and industry.

13. **The Service Sector.** The output of the service sector has also increased. Tourism has expanded from 1.7 percent of the economy in 1996 to 2.4 percent in 2000. Tourism is also an important source of foreign exchange and with proper investment in the future, it will continue to be an important source of economic growth, employment, and foreign exchange. The biggest subsector in the service sector continues to be wholesale and retail trade, which continued to grow from 1996 to 2000. In 2000, commercial trade accounted for 9.6 percent of GDP. Little specific data is available on this subsector, but it appears to be mostly dominated by informal trade.

### 3. Employment and Wages

14. Little data is available on the composition of the country's labor force. To date, no large-scale labor force survey or household living standards surveys have been undertaken. The 1995 census showed that approximately 85 percent of the employed population work in the agriculture sector (Table 6); the 1997/98 LECS shows that 84 percent of households are farm households; 97 percent of farm households own the land that they cultivate and 5 percent also farm rented land.

**Table 6: 1995 Census Results By Economic Activities**

<b>Economic Activity</b>	<b>Total</b>	<b>Women</b>	<b>Men</b>
	<b>Percent of Labor Force</b>		
Legislators, Senior Officials	0.4	0.1	0.8
Professionals	1.2	0.8	1.7
Technical	2.9	2.1	3.7
Clerks	0.2	0.3	0.2
Service Workers	4.0	4.4	3.5
Agriculture and Fishery	85.5	89.5	81.2
Crafts and Related	2.6	2.0	3.2
Operators and Assemblers	1.0	0.1	2.0
Elementary Occupations	1.2	0.6	1.8
Others	1.0	0.2	1.9
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Total Workforce	2,166,501	1,121,230	1,045,271

Source: National Statistical Center. 2000 . Basic Statistics of Lao PDR. Vientiane.

15. Little quantitative data is currently available on wages and salaries. Government salaries appear to be well below the market level and salary increases are largely given as administrative rewards rather than as adjustments to market conditions. During the most recent bout of high inflation (1998 to 1999), public salaries were only adjusted once and in real terms fell dramatically. Evidence from qualitative surveys during this period show that salaries in state-owned enterprises (SOEs) and the private sector are substantially above those in the Government, and that these salaries increased substantially faster than those in the public sector. The salary scale in the Government is quite flat, with the salary of top officials about twice that of the low paid individuals. A top government official might earn only one tenth of the salary paid for a similar position in a private enterprise (footnote 2).

#### **4. Savings and Investment**

16. To maintain a high growth rate, the Lao PDR must have adequate levels of savings and investment. Although foreign savings, in the form of concessionary lending and foreign direct investment (FDI) currently provide a large share of investment, future growth will increasingly need to rely on domestic sources of savings.

17. National accounts do not provide estimates of the savings and investment rates, but the International Monetary Fund (IMF) has estimates that are consistent with growth (presented in Appendix, Table A1). Estimates of the savings rates from 1993 to 1998 are around 13 percent annually.<sup>4</sup> The share of Government savings increased sharply in 1999 as the Government took steps to restrain spending after the 1998 increase in inflation.

18. Investment has been significantly greater than domestic savings, with a savings-investment gap estimated to be around 10 percent of GDP in 1998, and dropping to around 6

<sup>4</sup> Bank of Lao PDR. 2000. Banking and Financial Sector of Lao PDR. Vientiane.

percent in 2000. This was caused by a reduction in foreign investment in the hydropower subsector. Government investment also decreased mildly as a percent of GDP.

19. Due to the high levels of inflation and the administratively set interest rates in banks, households and businesses probably avoid the formal financial system whenever possible. These estimates are only likely to capture part of private savings. Households in the Lao PDR often use physical assets as investments, such as gold, jewelry, livestock, and rice. Harnessing some of these savings will help to ensure that the country is able to meet its growth targets.

## **B. Fiscal Developments**

20. In the 2000 fiscal year, the Lao PDR was able to increase its revenue collection from 10.6 to 14.0 percent of GDP. In the same fiscal year, current expenditures increased from 4.9 to 7.8 percent of GDP (Table 7). This improved revenue mobilization is part of the Government's commitment to increase its spending on priority areas and to increase recurrent spending. The Government is committed to responsible spending and is currently keeping expenditures to a realistic level given the revenues collected. The central bank, the Bank of Lao (BOL) has agreed not to finance Government deficits in the future.

21. Low current spending is a concern, as is the focus of the Government budget on capital expenditures. As a result of the sharp increase in inflation in 1998 and 1999, much of the fiscal adjustment was done through a real reduction of the salaries of public workers and of real recurrent expenditure in order to maintain the existing level of capital expenditure. In particular, the Government relied on BOL financing to cover the budget deficit, which was largely created by increased investments in irrigation.<sup>5</sup>

### **1. Revenue Developments**

22. In fiscal year (FY) 2000, tax revenues accounted for around 10.6 of GDP, which represents a small improvement over tax collection in the previous years, particularly in FY1998 and FY1999, which were affected by the regional crisis. Nontax revenues are playing an increasing large role in total Government revenues. Part of this increase is due to the devaluation of the kip increasing the value of exports from SOEs, especially electricity. Royalties from timber sales are also included as nontax revenues.

23. The three principal taxes (the turnover tax, excise tax, and foreign trade tax) account for 47 percent of Government revenues and have been relatively stable as a percentage of total Government revenues. The turnover tax is similar to a sales tax and is collected from importers and producers, with rates from 5 to 10 percent. Excise taxes are similar and are levied primarily on "luxury" consumption goods (vehicles, alcohol, tobacco, consumer appliances) and on fuel, with rates ranging from 5 to 104 percent. Import duties are charged on the value of imported goods, with rates ranging from 5 to 40 percent.

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<sup>5</sup> National Steering Committee of the Roundtable Process. 2000. Report of the Policy Dialogue Meeting on the Macro-Economic Policy and Reform Framework. Government of Lao PDR. Vientiane.

Table 7: Government Finance

Item	FY1997	FY1998	FY1999	FY2000 <sup>a</sup>	FY2001 Budget
	<b>KN billion</b>				
<b>Total Revenue</b>	228	367	929	1,780	2,279
Tax Revenue	190	290	745	1,345	1,719
Nontax Revenue	39	77	184	435	560
<b>Total Expenditure</b>	412	487	1,700	2,778	3,531
Current Expenditure	192	268	430	995	1,495
Capital and Onlending	220	219	1,270	1,783	2,037
<b>Current Balance<sup>b</sup></b>	36	99	499	785	784
<b>Overall Fiscal Balance<sup>c</sup></b>	<b>(184)</b>	<b>(120)</b>	<b>(770)</b>	<b>(998)</b>	<b>(1,252)</b>
Grants	70	200	486	475	541
<b>Overall Fiscal Balance<sup>d</sup></b>	<b>(114)</b>	<b>80</b>	<b>(285)</b>	<b>(523)</b>	<b>(711)</b>
<b>Total Financing</b>	<b>114</b>	<b>(80)</b>	<b>285</b>	<b>523</b>	<b>711</b>
Domestic Financing	0	(8)	(143)	7	213
Foreign Financing	114	(72)	428	516	498 <sup>e</sup>
	<b>As Percent of GDP</b>				
<b>Total Revenue</b>	11.0	9.8	10.6	14.0	15.2
Tax Revenue	9.1	7.8	8.5	10.6	11.5
Nontax Revenue	1.9	2.1	2.1	3.4	3.7
<b>Total Expenditure</b>	19.8	13.0	19.3	21.9	23.5
Current Expenditure	9.2	7.2	4.9	7.8	10.0
Capital and Onlending	10.6	5.9	14.4	14.1	13.6
<b>Current Balance<sup>c</sup></b>	1.7	2.7	5.7	6.2	5.2
<b>Overall Fiscal Balance<sup>d</sup></b>	(8.8)	(3.2)	(8.8)	(7.9)	(8.4)
Grants	3.4	5.4	5.5	3.7	3.6
<b>Overall Fiscal Balance<sup>e</sup></b>	(5.5)	2.1	(3.2)	(4.1)	(4.7)
<b>Total Financing</b>	5.5	(2.1)	3.2	4.1	4.7
Domestic Financing	0.0	(0.2)	(1.6)	0.1	1.4
Foreign Financing	5.5	(1.9)	4.9	4.1	3.3
<b>Memorandum item:</b>					
Nominal GDP, In KN billion <sup>f</sup>	2,082.0	3,730.3	8,788.0	12,687.9	14,996.5

GDP = gross domestic product.

Note: The fiscal year (FY) ends on 30 September. For example, FY 1997 refers to the year beginning on 1 October 1996 and ending on 30 September 1997.

<sup>a</sup> Preliminary actual

<sup>b</sup> On commitment basis, excluding grants.

<sup>c</sup> On cash basis, excluding grants.

<sup>d</sup> On cash basis, including grants.

<sup>e</sup> Residual.

<sup>f</sup> Adjusted for fiscal year

Source: Ministry of Finance.

24. The Lao PDR has an income tax and a profit tax, which together contribute 15 percent of Government revenues. The profit tax has a general rate of 35 percent but lower rates are available to foreign investors and investors in certain zones of the country. Income tax is progressive with rates ranging from 5 to 40 percent. Interest income is not taxed and rental income is taxed in a special regime. The Lao PDR also has a property tax on durable assets such bicycles, motorcycles, televisions, and other goods. This tax is collected at the local (village) level and shared between the village and the district.

25. Although the tax system is, on paper, quite progressive with its focus on luxury consumer goods, the myriad rates is likely to create distortion in the economy and encourage tax evasion. The Government is in the process of developing a value-added tax (VAT), presumably to replace the turnover tax, scheduled for 2003. The turnover tax and the excise tax are primarily collected on imported goods, making them essentially proxy trade taxes. This also creates distortions and is likely to complicate the Lao PDR's entrance to the ASEAN Free Trade Area and to the World Trade Organization.

26. Central to increasing tax revenues is tax reform that simplifies procedures, reduces distortions, and discourages evasion. This includes the introduction of the VAT, consolidation of excise and import tax rates, adjusting rates, and substantial reform of the income tax. In addition to reforming and simplifying the tax system, greater effort is needed to improve tax administration. The Government should focus on better enforcing tax codes. Key steps include strengthening the already existing Large Taxpayer Unit, reducing loopholes and arbitrary exemptions, and providing greater transparency in tax collection. Related to this is the need to better define the responsibility of tax collection. Currently taxes are collected at the national, provincial, district, and local levels. During the transition to greater decentralization, many local officials are unclear as to what revenues should be transferred to a higher authority and what revenues should remain under local control.

## **2. Expenditure Developments**

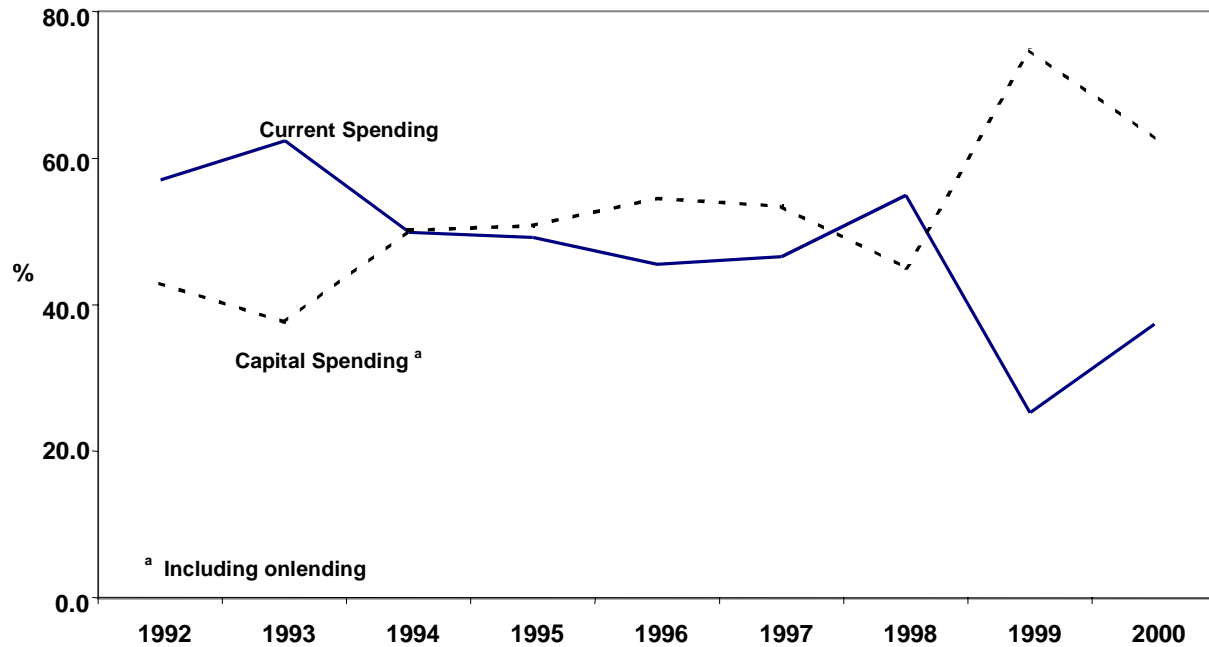
27. For most of the decade of the 1990s, capital and current expenditure were approximately equal, with each accounting for approximately 10 to 11 percent of GDP. However in FY1998, capital spending as a proportion of total Government expenditures increased dramatically pushing current expenditures to historically low levels (Figure 2). In FY1999, capital expenditure accounted for 75 percent of total expenditures, dropping to an estimated 64 percent in FY2000.

28. As a result of the ongoing decentralization process, a great deal of uncertainty surrounds how expenditure is allocated to the different sectors. Until FY1998, the Government was able to monitor the allocation of resources to different sectors. Previously, line ministries (for example, education) directly requested funding from the national budget and allocated these resources among the provinces. Currently, line ministries receive an allocation for their central level activities but the bulk of resources are channelled directly to the provinces, which are responsible for allocating resources among the sectors following national guidelines. Spending on key social and economic sectors is difficult to monitor. The Government is in the process of estimating sector expenditure as part of the public expenditure review process, conducted with the support of the Asian Development Bank (ADB), IMF, and World Bank.

29. Salaries, which have traditionally accounted for between 20 and 25 percent of total expenditures have dropped in the past two fiscal years to around 10 to 12 percent of total

Government expenditures. Spending on materials and supplies have dropped even more dramatically in the same period.

**Figure 2: Current and Capital Spending**  
(percent of total spending)



Sources: Bank of Lao People's Democratic Republic; International Monetary Fund Article IV Consultations, April 2001.

30. Currently, spending is weighted too heavily to investment, with the Government committing insufficient resources to recurrent spending. The Government is not spending a sufficient amount to ensure the operation and maintenance of its existing investments. At the same time, additional loans from ADB and the World Bank will require a counterpart contribution, which will put upward pressure on the capital budget. The Government will need to increase revenues to ensure that it is able to maintain and operate Government services and invest in additional infrastructure, which the country needs to meet its development goals. If the trend is not reversed, the reduction of current spending will have serious consequences. Lower recurrent spending reduces the funds available for the maintenance of capital investment, which will lower the quality of these investments.

## C. Monetary Development and Prices

### 1. Monetary Developments

31. From a peak of 113.3 percent growth in 1997, broad money growth dropped to 78.3 percent in 1999 and to 45.8 percent in 2000 (Table 8). Traced from the liabilities side, the slowdown in broad money growth during the previous years was due to the deceleration in growth of foreign currency deposits. Year-on-year growth of foreign currency deposits decreased from 131.6 percent in 1997 to 111.3 percent in 1999, and down to 39.6 percent in 2000; cash and deposits reflected mixed trends during the same period. These trends reflect



the relatively high dollarization rate<sup>6</sup> of the Lao PDR, reflecting in part the effects of various measures undertaken to liberalize the economy in the late 1980s. By 2000, the amount of foreign currency deposits accounted for more than three fourths of the total stock of broad money.

**Table 8: Monetary Survey**

Item	1996	1997	1998	1999	2000
	KN billion				
<b>Net Foreign Assets</b>	<b>156</b>	<b>250</b>	<b>498</b>	<b>1,266</b>	<b>1,527</b>
<b>Net Domestic Assets</b>	<b>89</b>	<b>156</b>	<b>368</b>	<b>278</b>	<b>724</b>
Domestic Credit	149	362	705	1,045	1,440
Claims on Government Sector (net)	(43)	(44)	(52)	(272)	(420)
Claims on Nongovernment Sector	193	406	756	1,317	1,860
Claims on State Enterprises	37	120	224	445	606
Claims on Private Sector	156	286	533	872	1,253
Other Items (net)	(60)	(207)	(337)	(767)	(715)
<b>Total Liquidity (M2)</b>	<b>245</b>	<b>406</b>	<b>866</b>	<b>1,544</b>	<b>2,252</b>
Cash and Deposits	146	176	285	317	539
Foreign Currency Deposits	99	230	581	1,227	1,712
	<b>Annual percentage change</b>				
<b>Net Foreign Assets</b>		<b>61.0</b>	<b>98.9</b>	<b>154.1</b>	<b>20.6</b>
Foreign Liabilities		79.0	12.4	98.7	97.0
<b>Net Domestic Assets</b>		<b>74.1</b>	<b>136.4</b>	<b>-24.4</b>	<b>160.6</b>
Domestic Credit		142.3	94.5	48.3	37.8
Claims on Government Sector (net)		1.4	18.5	424.7	54.4
Claims on Nongovernment Sector		110.8	86.3	74.1	41.2
Claims on State Enterprises		226.1	85.6	99.1	36.3
Claims on Private Sector		83.4	86.6	63.7	43.7
Other Items (net)		243.6	62.9	127.7	-6.7
<b>Total Liquidity (M2)</b>		<b>65.8</b>	<b>113.3</b>	<b>78.3</b>	<b>45.8</b>
Cash and Deposits		21.0	61.8	11.2	70.2
Foreign Currency Deposits		131.6	152.8	111.3	39.6
<b>Memorandum items:</b>					
Reserve Money, In Billion Kip		150.1	281.7	481.8	767.0
Money multiplier <sup>a</sup>		2.70	3.073	3.205	2.936

<sup>a</sup> Broad money divided by reserve money.

Source: Bank of Lao People's Democratic Republic.

32. The ratio of broad money to GDP (a measure of the country's financial deepening) dropped to 16.7 percent in 2000 from 18.5 percent in 1997. Excluding foreign currency deposits, broad money as a percentage of GDP dropped to 4 percent in 2000 from 8 percent in 1999.

<sup>6</sup> Defined as the ratio of foreign currency deposits to total stock of broad money. In the case of the Lao PDR, the Thai baht plays an especially important role.

When compared with Viet Nam (40.3 percent), this ratio appears to be extremely low, suggesting weak mobilization of domestic funds in the Lao PDR.

33. Traced from the asset side, the growth in broad money was mainly driven by the rise in credit extended by the monetary system to the public and private sectors. However, since 1998, growth of domestic credit has been slowing. Year-on-year growth of domestic credit dropped from 94.5 percent in 1998 to 48.3 percent in 1999, and down to 37.8 percent in 2000. BOL stopped financing the Government's deficit. This measure was complemented by the increased use of BOL bills and treasury bills (T-bills) to siphon off excess liquidity in the system.

34. In 2000, domestic credit rose by 37.8 percent, following the increase in credit to the public sector (at 54.4 percent) and private sector (at 43.7 percent). In particular, commercial banks' total credit grew by 44 percent in 2000 from 1999, about 63 percent of which was in foreign currency. In terms of relative share to total credit of commercial banks, the private sector continued to be the primary borrower, availing KN1.1 trillion or 78 percent of total credit. Meanwhile, broad money growth was accompanied by the improvement in the monetary system's net foreign assets, one of the components of net domestic assets, as increased foreign capital inflows strengthened the monetary system's foreign exchange reserves.

35. The domestic use of foreign currency, known as "dollarization" (regardless of the currency used) is an important issue in the Lao PDR. Currently foreign currency deposits account for between 70 and 80 percent of total deposits. Estimates suggest that as much as 80 percent of value of cash circulated is held in foreign currency, predominantly the Thai baht, but also the US dollar and the Vietnamese dong. In addition to serving as a means of exchange, foreign currency is an important store of value and increasingly as a unit of accounting. In addition, many Lao citizens store their wealth in "hard" assets such as cattle and gold.

## **2. Interest Rates**

36. Historically interest rates have been set administratively and been inflexible, which has serious consequences in a traditionally inflationary economy such as the Lao PDR's. From 1996 to 2000, inflation ranged from a low of 13 percent to a high of 134 percent, yet interest rates for saving accounts have been fixed in the range of 6 to 22 percent and were in fact lower in 2000 than in 1996, despite the fact that the inflation was twice as high in 2000.

37. In addition to bank saving accounts, the Government sells T-bills. Starting in March 1994, T-bills were auctioned twice a month and secondary trading was allowed (although it was quite rare). In October 1997, the Treasury set a ceiling rate of 20 percent of T-bills and not surprisingly, the auctions were suspended in April 1998 as inflation far exceeded the ceiling rate and demand dried up. In 1999, the Treasury issued T-bills with a fixed rate of 30 percent.

## **3. Prices**

38. The Lao PDR has had several bouts with inflation in the past decade. In 1989, inflation rose to 59.7 percent only to drop to 13.4 percent in 1991. From 1991 until 1997, inflation as measured by the consumer price index (CPI) was below 20 percent. Although the level of inflation was high compared with rates reported in other Southeast Asian countries and probably has some harmful effect on economic growth, inflation was not a serious problem in the Lao PDR until 1998 (Table 9).

39. Inflation rates, as measured by the CPI, increased dramatically in 1998 and 1999. In 1998, inflation increased to 87.4 percent, a more than four-fold increase from the previous year. In 1999, inflation peaked at a record 134.0 percent. In 2000, the inflation rate dropped significantly to 27.0 percent. For the first quarter of 2001, inflation has significantly moderated to 9.2 percent (on an annualized basis). Lao authorities expect the annual inflation rate to remain below 10 percent.

**Table 9: Inflation Rate**

<b>Items</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
	<b>Inflation Rate<sup>a, b</sup></b>				
<b>All Items</b>	<b>13.0</b>	<b>19.3</b>	<b>87.4</b>	<b>134.0</b>	<b>27.0</b>
January	27.0	11.4	31.3	150.8	75.9
February	29.1	12.0	44.6	150.5	58.9
March	25.0	12.4	45.6	167.1	45.5
April	19.7	12.3	62.4	159.2	35.0
May	13.8	16.2	62.8	155.4	31.0
June	13.3	15.9	101.6	124.7	21.4
July	11.4	19.6	103.8	135.7	10.6
August	4.6	25.7	99.5	140.2	6.6
September	2.9	27.7	106.3	122.6	9.6
October	5.7	26.9	112.5	121.1	8.3
November	7.0	25.1	136.3	94.3	11.0
December	7.3	26.6	142.0	86.7	10.4

<sup>a</sup> The 1996 inflation rate series is based on the Bank of Lao PDR index with December 1987 as the base year. In 1997, the series from the National Statistical Centre replaced the BOL series as the official index.

<sup>b</sup> Inflation for the last 12 months.

Source: National Statistical Centre.

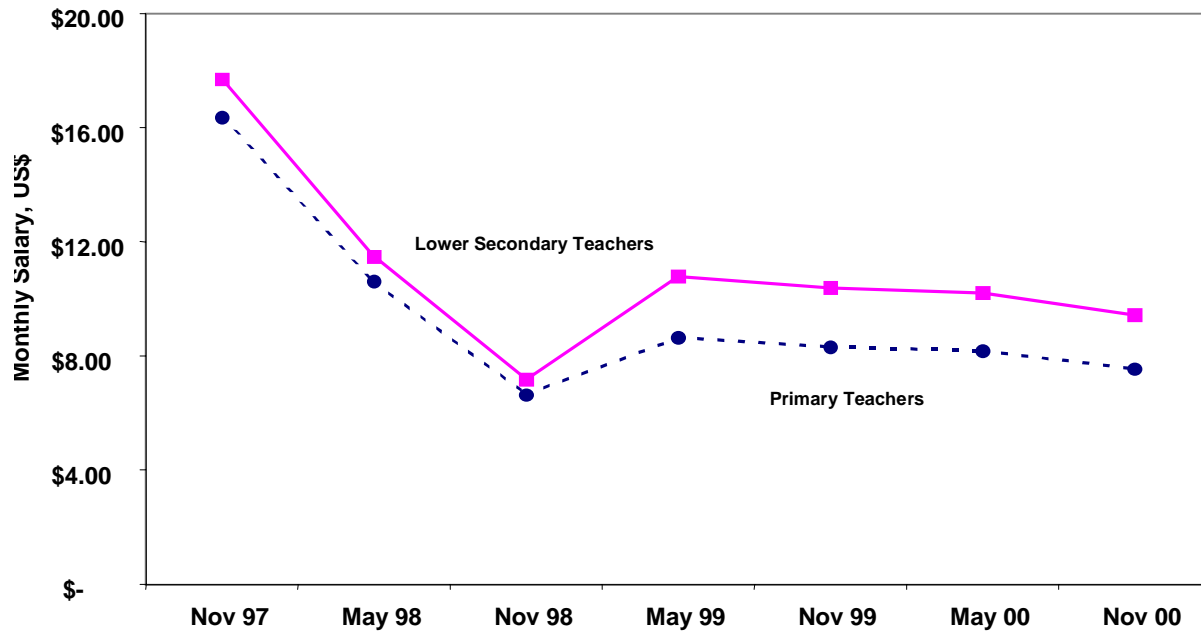
40. Given the high level of dollarization, the price level is very sensitive to the money supply. The devaluation of the Thai baht in 1997 led to almost automatic devaluation of the Lao kip, which increased the value of dollars circulating in the economy and the value of dollars received by the country as concessionary loans and grants. Instead of taking action to reduce the inflationary effect of the devaluation, BOL started monetarizing capital spending by the Government. This spending was primarily for investment in lowland irrigation schemes. The extensive use of foreign currency, the already built-in inflation expectations, and the lack of depth of the financial system guaranteed that the increase in the monetary stock was rapidly transmitted into an increase in prices and a depreciation of the exchange rate. These two facts led to a vicious circle of ever-increasing inflation leading to devaluation of the kip to further increase the monetary supply from the inflow of foreign capital.

41. BOL probably only has a limited ability to fight inflation given the small size of the financial sector and the lack of bonds that are held by the public. Adjusting the reserve requirement in commercial banks is one option open to BOL, and there is some room for open market operations. While reducing inflation can be painful, it is clear from the Lao PDR's

experience that having high levels of inflation can be extremely costly as well in terms of a loss of faith in the domestic currency and economy.

42. Inflation is essentially a tax on the population that holds currency. As such, it can have serious distributional consequences. The burden of inflation usually fall most heavily on the poor, as wealthier households are able to protect themselves through financial instruments and foreign exchange. Due to the lack of household surveys, little quantitative evidence is available on the winners and losers of the recent bout of inflation. However, qualitative studies have been completed on the effect of inflation. In the case of Lao PDR, the biggest losers were formal sector workers with fixed salaries. This group largely consisted of government workers, including civil servants, teachers, and health workers. Essentially, inflation led to a direct cut of the salary of public sector workers. Private sector workers were largely compensated by increases in salary. Lowland agricultural producers largely subsist in the baht-based economy. Highland farmers, who are overwhelming poor are generally not well-integrated into the market economy, and hence were probably not affected directly by inflation.

**Figure 3: Monthly Wages of Teachers**  
(\\$)



Source: Ministry of Education.

43. The fact that inflation seemed to have little direct effect on the poor does not mean that it had no effect on their welfare. Figure 3 presents an example of the effects of inflation on one vulnerable group: school teachers. In 1998, teachers' salaries dropped precipitously to less than half of their original value. In 1999, salaries were increased in nominal terms, but in real terms salaries remained well below their initial levels.<sup>7</sup> The significant decline in real income of social sector workers has a particularly severe effect on these providers in rural areas, who are not able to fall back on household contributions or a second job, like as their urban counterparts. Anecdotal evidence suggests that many teachers did in fact stop working in rural areas.

<sup>7</sup> Data provided by the Department of Planning and Cooperation, Ministry of Education.

Likewise, the cost of many essential imported goods, such as medication, increased with potentially negative effects on the well-being of the population.

44. The measurement of inflation in the Lao PDR is still being developed. Until 1997, BOL calculated the CPI based on prices in Vientiane municipality. In 1996, the National Statistical Centre introduced a CPI covering five provinces and 130 items. In 1999, the National Statistical Centre updated the CPI and adopted a new consumer basket. The number of items covered increased to 197, and the index was expanded to cover price movements in three more provinces.

#### **4. Exchange Rates**

45. The slowdown in broad money growth and the consequent deceleration of inflation contributed partly to the slowdown in the rate of depreciation of the kip relative to the dollar. The Banque pour le Commerce Extérieur Lao (midpoint) rate shows that the average annual depreciation rate of the kip to the dollar slowed from 161.7 percent in 1998 to 115.6 percent in 1999, and down to 10.4 percent in 2000.

46. The initiative to keep the margin between the parallel and bank rates to less than 2 percent was evident in 2000. On average, the gap between the parallel and bank rate of the kip relative to the dollar narrowed from 8.5 percent in 1999 to 2.2 percent in 2000. The impact of the initiative was even more pronounced in the case of the kip relative to the baht. On average, the gap between the parallel and bank rates of kip relative to baht was trimmed from 8.5 percent in 1999 to 1.0 percent in 2000.

#### **D. External Trade and Balance of Payments**

47. Although the Lao PDR is a large country in area, much of the country's economic activity is confined to the Mekong River corridor, and to a much less extent along the borders with the People's Republic of China and Viet Nam. Official statistics show that the sum of imports and exports equal about 50 to 60 percent of GDP. This is relatively low compared with other countries in the region; which ranged from 85 to 125 percent in Thailand, 70 to 100 percent for Cambodia, and 90 to 100 percent for Viet Nam. However, informal trading is generally believed to be significant as large amounts of timber and rice are exported, and unrecorded consumer goods are imported. Thus the Lao economy is probably more open than official statistics suggest.

48. The Lao PDR has typically maintained a large trade deficit (Table 10), estimated at around 12 percent of GDP in 2000. The current account deficit, which was between 16 and 17 percent of GDP in 1996 and 1997, has narrowed substantially to around 6 percent of GDP. Part of this gain has been due to a narrowing of the trade deficit and part to a substantial increase in net services; the Lao PDR's export of services improved largely because of the strong increase in tourism.

##### **1. Exports**

49. The total value of exports has grown steadily in the past five years, increasing from \$321 million in 1996 to an estimated \$393 million in 2000. The major factor contributing to exports is the export of electricity, which increased from \$30 million in 1996 to \$112 million in 2000 (Appendix, Table A5).

**Table 10: Balance of Payments**  
(\$ million)

Item	1996	1997	1998	1999	2000 <sup>a</sup>
<b>Current Account</b>					
Trade Balance	(368)	(331)	(216)	(191)	(198)
Exports (FOB)	321	317	337	363	393
Imports (CIF)	(690)	(648)	(553)	(554)	(591)
Services (net)	25	28	71	98	105
Factor Income (net)	(7)	(22)	(34)	(28)	(37)
Transfers, net	125	140	123	99	101
of which: official transfers	82	98	74	70	71
Current Account Balance, including official transfers	(226)	(185)	(56)	(22)	(29)
excluding official transfers	(307)	(283)	(130)	(92)	(100)
<b>Capital Account</b>	295	155	38	25	73
Medium- and Long-Term Loans	139	161	86	62	96
Disbursements	155	179	98	91	120
Amortization	(16)	(18)	(12)	(29)	(24)
Foreign Investments <sup>b</sup>	176	104	56	79	30
of which: hydropower investment	—	60	18	27	17
Commercial Banks Net Foreign Assets	(7)	15	(17)	(47)	25
Errors and Omissions	(13)	(124)	(87)	(69)	(78)
<b>Overall Balance</b>	69	(30)	(18)	3	44
<b>Financing</b>	(69)	30	18	(3)	(44)
Change in Central Bank Net Foreign Assets					
Assets	(74)	31	23	6	(33)
Liabilities	5	(1)	(5)	(9)	(11)
	<b>annual percentage change</b>				
Exports (FOB)	2.6	(1.4)	6.4	7.7	8.3
Imports (CIF)	17.1	(6.0)	(14.7)	0.3	6.6
Foreign Investments	85.1	(40.9) <sup>1</sup>	(46.2)	41.1	(62.0)
	<b>annual percentage change</b>				
Exports (FOB)	17.2	18.1	26.2	25.0	22.9
Imports (CIF)	37.0	37.1	43.0	38.2	34.4
Current Account Balance <sup>c</sup>	(16.5)	(16.2)	(10.1)	(6.3)	(5.8)
<b>Memorandum Item:</b>					
End-year Gross Official Reserves (\$million)	170	111	113	106	140
(in months of CIF imports)	3.0	2.1	2.4	2.3	2.4

CIF = cost, insurance, and freight; FOB = free on board.

<sup>a</sup> Preliminary estimates.

<sup>b</sup> Include external loans.

<sup>c</sup> Excludes official transfers.

— Data not available

Sources: Bank of Lao PDR; International Monetary Fund Article IV Consultations (April 2001).

50. The second largest export has been wood products, primarily in raw form as logs and timber. The current rate of forest clearing is not sustainable, and the timber industry will either have to adopt sustainable forestry practices or timber will not be available for logging. The garment industry also increased its exports to \$77 million in 2000, although the value-added contribution of this sector is quite small. In 2000, imports for the garment sector were estimated to be around \$67 million.

51. 1997 is the last year for which detailed information is available on the direction of trade by destination of export and source of imports. The Government is currently working to reestablish its trade statistics.

## **2. Imports**

52. Imports to the Lao PDR have been gradually declining, from \$690 million in 1996 to \$591 million in 2000. Part of this decline is likely due to a decline in FDI in hydropower, which is largely used for the purchase of imported capital goods. This is reflected in the large reductions of machinery, equipment and construction equipment between 1996 and 2000. The share of fuel in the total import bill rose in response to an increase in the cost of petroleum products and also to the increasing number of motorized vehicles in the country.

## **3. Nontrade Current Account**

53. In recent years, the net export of services has made a major contribution to the Lao PDR's balance of payments, increasing from 1.3 percent of GDP in 1996 to 6.1 percent in 2000. Although no data is available for 2000, based on the estimates from 1999, most of this increase appears to be due to the expenditure of foreign tourists in the Lao PDR.

54. The country formally opened to tourism in 1990, but tourists only started entering the country en masse in the mid-1990's. In 1990, for example, 6,920 tourists entered the country compared with 420,000 in 1996 and more than 720,000 in 2000 (Table 11). In each year since 1995, tourism has grown compared with the previous years. In 1999 and 2000, the number of new entries grew by 100,000 per year. The average length of stay has also increased from 4.3 days in 1995 to 5.5 days in 2000.

55. The tourism sector still has the potential to grow, considering the number of tourists visiting Cambodia, Thailand, and Viet Nam. Future increases will depend on the building of appropriate infrastructure and the country's ability to preserve its environment, which is one of the main attractions for many foreign visitors.

56. The Lao PDR receives official transfers (largely bilateral aid) that make a significant contribution to the balance of payments. In recent years, the share of official transfers has hovered around 4 to 4.5 percent of GDP. Most of these transfers do not enter the Government balance sheet.

**Table 11: Tourists, By Country of Origin**

Item	1996	1997	1998	1999	2000 <sup>a</sup>
<b>Asia and Pacific</b>	<b>374,930</b>	<b>403,781</b>	<b>421,196</b>	<b>510,703</b>	<b>583,688</b>
Thailand	227,634	261,826	273,095	356,105	415,124
Viet Nam	65,545	79,659	78,216	71,748	68,132
Other ASEAN	7,501	12,497	13,743	18,442	26,906
China, People's Rep. of	16,707	17,661	15,802	20,269	22,067
Japan	6,672	9,194	12,936	14,860	18,989
Australia	6,121	7,876	9,579	10,789	12,637
Other Asia and Pacific	44,750	15,068	17,825	18,490	19,833
<b>Europe</b>	<b>30,582</b>	<b>38,583</b>	<b>52,076</b>	<b>68,565</b>	<b>89,405</b>
<b>North America</b>	<b>14,102</b>	<b>18,213</b>	<b>25,326</b>	<b>31,762</b>	<b>42,315</b>
<b>Rest of the World</b>	<b>624</b>	<b>2,623</b>	<b>1,602</b>	<b>3,231</b>	<b>8,297</b>
<b>Total</b>	<b>420,238</b>	<b>463,200</b>	<b>500,200</b>	<b>614,261</b>	<b>723,705</b>

ASEAN = Association of Southeast Asian Nations.

<sup>a</sup> Preliminary estimates.

Source: National Statistical Centre. 2000. Basic Statistics of the Lao PDR. Vientiane.

#### **4. The Capital Account**

57. The Lao PDR receives substantial capital inflows, largely in the form of concessionary loans from international organizations, such as ADB, IMF, and the World Bank. The drop-off in concessionary lending in 1998 and 1999 was significant in response to concerns about the macroeconomic management of the country due to the high inflation levels. These concerns have largely eased. Concessionary lending currently accounts for around 3 percent of GDP.

58. The valuation of the Lao PDR's debt stock depends on the treatment of debt that the country contracted with the Union of Soviet Socialist Republics, which is now held by the Russian Federation. At face value, this debt is worth \$1.3 billion and accounts for more than half of the total debt stock. This debt is no longer being serviced and the Government is in the process of negotiating the final status of this debt with the Russian Federation.

59. The Lao PDR also has about \$1.3 billion in convertible debt. This debt is largely with the multilateral organizations (primarily ADB and the World Bank), although the country has more than \$200 million in debt with commercial sources and bilateral lenders. Although the total amount of this debt is almost as large as GDP, debt service is manageable as a percent of total exports. In recent years, debt services have accounted for around 10 percent of total exports of goods and services. Prudent management of the debt and increased exports will ensure that the Lao PDR is able to sustain its debt service.



**Table 12: External Debt and Debt Service**  
(\$ million)

Item	1996	1997	1998	1999	2000 <sup>a</sup>
<b>Total Debt Stock</b>	<b>2,177.6</b>	<b>2,322.0</b>	<b>2,560.8</b>	<b>2,617.1</b>	<b>2,557.8</b>
Convertible	827.3	978.5	1,224.2	1,313.9	1,260.3
Bilateral	70.9	90.0	134.2	152.9	94.4
Multilateral	756.4	888.5	971.4	1,036.0	1,042.2
Commercial	-	-	118.6	125.0	123.7
Nonconvertible	1,350.3	1,343.5	1,336.6	1,303.2	1,297.5
<b>Total Debt Service</b>	<b>15.5</b>	<b>30.0</b>	<b>45.2</b>	<b>52.7</b>	<b>50.2</b>
Convertible	15.5	30.0	45.2	52.7	50.2
Bilateral	5.1	14.0	2.0	4.3	4.1
Multilateral	10.4	16.0	19.6	26.4	25.1
Commercial	0.0	0.0	23.6	22.0	21.0
Nonconvertible	0.0	0.0	0.0	0.0	0.0
<b>Percentage of Exports of Goods and Services</b>					
<b>Total Debt Service</b>	4.5	8.7	11.1	11.4	10.1
Convertible	4.5	8.7	11.1	11.4	10.1
Nonconvertible	0.0	0.0	0.0	0.0	0.0
<b>Percent of GDP</b>					
<b>Total Debt</b>	116.8	132.9	199.1	180.5	148.8
Convertible	44.4	56.0	95.2	90.6	73.3
Nonconvertible	72.5	76.9	103.9	89.9	75.5

<sup>a</sup> Preliminary estimate.

Sources: Bank of Lao PDR, International Monetary Fund, Asian Development Bank estimates.

60. In addition to loans from international organizations, FDI has been a major source of support for the country's balance of payments. In 1988, the Lao PDR passed a law on foreign investment that allowed foreign participation in all sectors of the economy and established specific incentives for foreign investors. In 1999, FDI was \$79 million, compared with a \$22 million current account deficit (including official transfers). From 1995 to 1997, FDI in the energy sector accounted for more than half of all private FDI. However, in 1998 and 1999, the share decreased as a percentage of total FDI. In 1999, investments in the energy sector accounted for \$27 million.

61. From 1996 to 2000, the country approved 263 projects for more than \$1.6 billion (Table 13). The total amount of actual FDI received in this period was substantially less, although part of this represents commitments for future investments, particularly in the hydroelectric sector.

62. FDI will be increasingly important as the amortization payment of the official debt increases and trade expands as a result of the country's greater integration in ASEAN. Of particular importance is the Nam Theun 2 hydroelectric project. The project, being built by the Government and a consortium of foreign investors, is expected to cost around \$1 billion over five years; this represents 60 percent of annual GDP. Construction is likely to contribute significantly GDP growth and will also lead to an increase in imports, which will be offset by corresponding capital flows. BOL will have to take steps to sterilize this inflow of capital. Much of the capital inflow will be used to finance the import of capital equipment and thus will have little effect on money supply. However the wages of workers on the project will largely be paid in kip

and this could have a major inflationary effect, particularly considering the high level of dollarization in the country.

**Table 13: Approved Foreign Investments By Country of Origin**

Source	1996	1997	1998	1999	2000 <sup>a</sup>
	Value in \$ million				
Thailand	761.5	9.5	65.6	2.4	2.0
United States	6.7	0.9	1.2	0.9	—
Taipei, China	0.5	0.3	1.3	0.3	—
France	1.0	1.0	2.3	1.1	1.9
China, People's Republic of	3.2	3.5	6.5	24.4	3.5
Malaysia	211.2	73.2	3.0	2.5	3.0
United Kingdom	17.9	0.2	0.3	0.7	—
Australia	0.0	5.6	1.5	1.5	0.2
South Korea	276.8	6.9	6.6	0.8	2.9
Singapore	10.0	2.2	0.4	0.3	0.4
Japan	2.8	4.3	2.0	—	2.1
Germany	0.0	0.1	0.4	—	0.2
Canada	0.0	0.2	0.7	—	—
Others	1.1	5.8	30.7	81.5	8.4
<b>Total Value of Licensed Investments<sup>b</sup></b>	<b>1,292.7</b>	<b>113.7</b>	<b>122.5</b>	<b>116.4</b>	<b>24.6</b>

— = not available.

<sup>a</sup> Data for the first nine months.

<sup>b</sup> Excludes the proposed capital contributions of domestic Lao investors as well as some energy-related investors.

Source: Bank of Lao PDR

## II. SHORT- AND MEDIUM-TERM ECONOMIC PROSPECTS AND POLICY ISSUES

### A. Policy Issues

63. The Lao PDR is well on the way to recovery after the economic instability caused by heavy government borrowing from BOL and the slowdown in investment and economic activity associated with the regional financial crisis. In early 2001, the Government entered into a poverty reduction and growth facility agreement with IMF, reflecting the country's renewed economic stability. The Lao PDR is highly integrated in the Greater Mekong Subregion, especially with Thailand, and is vulnerable to economic slowdowns in the subregion. The economy is highly dollarized and shocks in foreign currencies (especially the Thai baht) can have serious effects on the Lao economy.

64. The Lao PDR plans to graduate from its classification as one of the least developed countries by 2020. This will require substantial effort by the Government and significant economic growth and reform. This paper discusses several recurrent themes that need to be addressed for the country to have sustainable economic growth and to reduce poverty significantly. These include

- (i) maintaining macroeconomic stability, with low and predictable inflation and exchange rates;
- (ii) ensuring that government spending is balanced between capital and recurrent expenditures;
- (iii) strengthening government revenue mobilization to ensure that sufficient resources are available for counterpart funding of concessionary loans, and to maintain and staff existing investments; and
- (iv) reforming and deepening the financial sector to ensure an adequate flow of funds for investment to the private sector and to microfinance operations.

65. These themes are all interlinked and center on providing a stable environment for growth and better defining the role of the state and the private sector.

### **1. Financial Sector Reform**

66. The financial sector currently consists of four state-owned banks accounting for approximately 70 percent of total assets in the banking system and a variety of foreign and joint venture banks, accounting for the remaining 30 percent. Deposits are about evenly split between individuals and firms. Foreign banks are restricted to Vientiane; local banks have a strong regional focus.

67. Currently the depth of the financial sector is quite low. The ratio of broad money (M2) as a percentage of GDP, a common indicator of financial sector depth, is around 18 percent, which is one of the lowest in the world. In addition, approximately 80 percent of broad money is in the form of foreign currency deposits. Based on regression estimates, the Lao PDR will need to increase the proportion of broad money to approximately 50 percent to reach its stated target of graduating from the category of least developed country.<sup>8</sup> A larger and more robust financial sector will be able to better mobilize domestic savings and permit the economy to grow. It will also strengthen the ability of BOL to maintain macroeconomic stability by strengthening its monetary tools.

68. The financial sector needs to reform its lending practices. Currently most credit is directed towards SOEs. The ratio of nonperforming loans (NPL) is thought to be quite high, although it varies considerably. BOL estimated NPLs in 2000 to be 20 to 25 percent of total loans, while a review of the financial sector estimated the range at 50 to 70 percent of total loans.<sup>9</sup> Banks do not have adequate provisions to cover this risk. Credit will have to be targeted to firms on the basis of their ability to repay the loan (which depends on the lender making economically sound investments) and lending interest rates will have to become more flexible to allow adjustments for risk. A formal system of sharing information on bad credit risk is also an important prerequisite in strengthening the financial sector.

### **2. Public Expenditure, Governance, and Decentralization**

69. The Lao PDR is gradually introducing decentralization as a tool to reduce poverty. Provinces will be increasing responsible for the design of local strategies and setting the framework for development in their jurisdiction, while districts will have greater responsibility for

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<sup>8</sup> Following the estimates and statistics presented in BOL. 2000. Banking and Financial Sector of Lao PDR. Vientiane.

<sup>9</sup> BOL. 2000. *Financial Sector Note*, June. This study was financed by ADB and the World Bank.

planning and budgeting. Although decentralization creates new opportunities for provinces and districts to respond to develop their own solution to local issues, it can also lead to new risks.

70. Decentralization should involve the transfer of responsibility along with the transfer of resources necessary to ensure that these responsibilities can be met. The central Government also needs to clarify local governments' right to control certain tax revenues that are collected locally. At the same time, local governments need to provide the central Government with information to ensure that they are meeting their obligations. Without an understanding of government responsibilities at all levels, decentralization can seriously affect public finances and reduce the possibility of good governance.

71. Currently the Government does not have data on spending by sector (i.e., health, education, roads, etc.). This is largely because spending has largely been decentralized and the central Government does not receive systematic information from local authorities on spending by sector. This complicates the Government's ability to set priorities and meet its long-term economic and social goals.

72. As mentioned, the Government will have to take steps to increase the amount of money received and to improve the quality of the tax system. This is necessary to ensure that the Government is able to implement the pro-poor policies that it has committed itself to. Additionally, however, raising revenue is essential to ensure that the Lao PDR can provide necessary counterpart financing for future concessionary debt.

### **3. State-Owned Enterprises**

73. Related to problems in the financial sector, is the need to reform SOEs. SOEs are by far the largest borrowers from the banking system and are largely responsible for the high level of NPLs. A myriad of SOEs are operating in the country, at both the national and local levels. Some like Electricité du Lao, the electricity producer, and Lao Aviation are major companies with substantial operations all over the countries, while others are small companies with a very local focus.

74. SOEs can also create other distortions in the economy. Some are able to pay reduced taxes by taking advantage of their political connections. SOEs often serve as informal licensing agencies by restricting trade and charging fees to private sector firms that attempt to enter the market.

75. Increasing transparency is key to reforming the SOEs. This requires the codification of their rights and limitations of SOEs in the markets where they operate. Establishing and using sound accounting and auditing practices also play an important role in guaranteeing transparency.

### **B. Short- and Medium-Term Prospects**

76. In 1986, the Lao PDR introduced new economic measures to stimulate economic growth and improve living standards. Despite several bouts with high inflation, GDP has grown substantially and the country is now well-integrated in the subregion. Poverty has declined although it appears that the nonpoor have been the biggest beneficiaries of recent economic growth.

**Table 14: Short-Term Projections**

Item	1998	1999 <sup>a</sup>	2000 <sup>a</sup>	2001 <sup>b</sup>	2002 <sup>b</sup>
<b>A. Income and Growth</b>					
1. GDP Per Capita (dollars, current)	262.5	284.2	330.5	343.7	374.2
2. GDP Growth (% in constant prices)	4.0	7.3	5.9	6.0	6.5
Agriculture	3.1	8.2	5.1	5.3	5.9
Industry	9.2	7.9	7.5	7.5	7.8
Services	5.5	6.9	6.2	6.1	6.5
<b>B. Saving and Investment</b>					
1. Gross Domestic Investment	24.9	22.7	20.5	21.0	22.1
2. Gross Domestic Saving	14.8	16.4	14.7	15.8	17.5
<b>C. Money and Inflation</b>					
1. Consumer Prices (annual average)	87.4	134.0	27.0	9.0	7.5
2. Broad Money (M2) <sup>c</sup>	113.3	78.3	45.8	20.0	20.0
<b>D. Government Finance<sup>d</sup></b>					
1. Total Revenue <sup>e</sup>	9.8	10.6	14.0	15.2	14.5
2. Total Expenditure and Net Lending	13.0	19.3	21.9	23.5	22.5
3. Overall Surplus/Deficit (-) <sup>e</sup>	(3.2)	(8.8)	(7.9)	(8.4)	(8.0)
<b>E. Balance of Payments</b>					
1. Merchandise Trade Balance (% of GDP)	(16.8)	(13.2)	(11.5)	(12.2)	(16.4)
2. Current Account Balance (% of GDP) <sup>f</sup>	(10.1)	(6.3)	(5.8)	(5.2)	(4.6)
3. Export (\$) Growth (annual percent change)	6.4	7.7	8.3	7.4	8.6
4. Import (\$) Growth (annual percent change)	(14.7)	0.3	6.6	10.6	23.8
<b>F. External Payments Indicators</b>					
1. Gross International Reserves, in months of imports	2.4	2.3	2.4	2.4	1.9
2. External Debt Service (% of exports of goods)	11.1	11.4	10.1	13.3	12.5
3. External Debt (% of GDP)	199.1	180.5	148.8	134.9	126.9
<b>G. Memorandum Items</b>					
GDP (current prices, billion <i>local currency</i> )	4,240	10,304	13,483	15,501.2	17,666.4
GDP (current prices, million <i>US dollars</i> )	1,286	1,450	1,718	1,890	2,133
Exchange Rate (local currency per dollar, average official rate)	3,296	7,108	7,846	8,200.0	8,282.0
Population (million)	4.9	5.1	5.2	5.5	5.7

GDP = gross domestic product.

<sup>a</sup> Preliminary estimates by the Lao PDR authorities.

<sup>b</sup> Projections.

<sup>c</sup> Includes foreign currency deposits

<sup>d</sup> Figures are on a fiscal year basis where fiscal year ends 30 September.

<sup>e</sup> Excluding grants.

<sup>f</sup> Excluding official transfers.

Sources: National Statistical Centre, Bank of Lao PDR, State Planning Committee, International Monetary Fund, Asian Development Bank estimates.

77. Economic growth remains a prerequisite for poverty reduction and is crucial if the Lao PDR is to increase funding for social services, and construct and maintain basic infrastructure, as it has committed to in a number of policy statements. The population of the Lao PDR is estimated to be growing at a rate of 2 to 2.5 percent per annum, which will put a heavy burden on the economy to grow.

78. In the short term, the Lao PDR appears to have largely recovered from the negative effects of the regional financial crisis and the subsequent inflationary bout. Growth in 2000

appears to have been around 5.9 percent (Table 14). This is below the growth rate in 1999; all sectors reported reduced growth.

79. In 2001 and 2002, growth is expected to pick up slightly, led primarily by industry. Although agriculture is generally lagging the other sectors (as is expected in developing countries), it is still expected to grow at respectable rates. This is essential to reduce poverty, as the overwhelming majority of the poor live in rural areas. Due to the lack of extensive data, estimates for the Lao PDR are not based on econometric estimates but are designed to be internally consistent. These figures are based on estimates developed by ADB, IMF, and the Lao Government.

80. Tourism will continue to play an important role in economic growth. This will require additional and well-targeted investment that ensures environmental sustainability and at the same time increases the accessibility of the country. The trade deficit is expected to widen substantially due to increased foreign investment in the hydroelectric sector. This will be financed by FDI and loans from ADB and the World Bank. To avoid inflation, BOL will have to take steps to sterilize the inflow of foreign capital, which is expected to be substantial. Given the lack of instruments available to BOL, this may prove to be a substantial challenge.

81. The country's economy will continue to be vulnerable to external shocks, especially from its neighbors. Economic relations with Thailand are key, as Thailand is a major source of investment and tourism, and is a key destination for exports. The Thai baht circulates widely in the Lao PDR and shocks to the baht could lead to shocks to the domestic money supply. In particular, further weakness in the baht will weaken the kip and may lead to increased inflation.

82. The Lao PDR will need to continue to diversify its export markets. One particularly attractive export is electricity; currently the Lao PDR is focusing largely on Thailand. However both Cambodia and Viet Nam are also potential purchasers of electricity. Estimates suggest in some parts of these countries, electricity purchased from the Lao PDR would be cheaper than relying on electricity generated from fossil fuels.

83. Although the Lao PDR's total debt is large as a percentage of GDP, it appears to be manageable as a percentage of exports. The Government will need to reach a favorable settlement with the Russian Federation on the final disposition of nonconvertible currency debt. It will also have to monitor new debt carefully to ensure that total debt is maintained at a reasonable level. Increasing exports should be a priority so that the country can continue to service its debt. New loans will play an important role in the country's long-term development by financing critical infrastructure.

84. In the long term, the Government is expecting growth to increase to 7.0 percent in 2003, which seems realistic given the country's historical performance and successful adjustment. The Lao PDR will have to continue to reform and open its economy and continue investment in infrastructure and human capital.

85. Inflation has largely been controlled and is expected to remain under 10 percent in both 2001 and 2002, with a definite downward trend. In the long run, the Lao PDR will have to restore faith in the kip and reduce the role of foreign currency in the money supply. This will give BOL more flexibility to carry out monetary policy and also reduce the risk of inflation. At the same time, restoring confidence in the kip will require clear evidence of monetary and price stability.

86. Government expenditure is expected to stay relatively stable at 20 to 22 percent of GDP. The Lao PDR is committed to restoring the balance between capital and current expenditure (historically around 50 percent for each) and to substantially increase spending on health and education as a percentage of the Government's budget. Salaries of government workers (both in administration and the social sectors) must also be increased to ensure that sufficient staff are available.

87. The Government is committed to increasing revenues, as a percentage of GDP, to between 14 and 15 percent in 2002, from around 10 percent in 1998. The overall deficit will remain large although external assistance agencies are expected to provide significant resources both in the form of grants and concessionary loans. For the Lao PDR to continue to receive such substantial inflows, it will need to continue to show its commitment to reform, sound economic management, and improving the living standards of the poor. Otherwise, assistance agencies will focus their efforts on other low-income countries.

### III. POVERTY REDUCTION

#### A. Trends in Poverty and Inequality

88. Transmitting the benefits of economic growth to the poor is essential to reduce poverty and raise the welfare of the most vulnerable. While poverty reduction requires economic growth, international evidence shows that growth alone is not sufficient to reduce poverty substantially.

89. Evidence from the 1992/93 and 1997/98 LECS shows that the poverty incidence (the percentage of the population with consumption below the poverty line) dropped from 45.0 percent to 38.6 percent.<sup>10</sup> The largest decline was in Vientiane municipality, although incidence of poverty was down in all regions. This happened at a time when GDP growth averaged by 7.0 percent. In a similar period, the incidence of poverty in Viet Nam dropped from 58 percent to 37 percent, albeit with an economic growth rate of 9.0 percent.

90. During the same period inequality increased in the Lao PDR, with the Gini indicator increasing from a relatively equitable 28.6 to 35.7. This is still quite equitable compared with many other countries in the region; for example, Thailand has a Gini indicator around 50, indicating a substantial gap between wealthier and poorer households. As economic growth increases, the poor in the Lao PDR face the risk of falling into a poverty trap. Households with human capital are in the best positions to take advantage of the opportunities generated by economic growth. Those without human capital may find themselves increasingly falling behind wealthier households, lacking the resources to invest in human capital for the future.

91. While past economic growth in the country has benefited the poor, the biggest gainers have been the nonpoor. Kakwani and Pernia estimate the elasticity between economic growth and poverty reduction is approximately 0.7, meaning that on average, a 1 percent increase in consumption growth will only reduce poverty by 0.7 percent. In the case of the Lao PDR, economic growth does not contribute substantially to poverty reduction and the positive effect is largely offset by increases in inequality. This is low compared with growth-poverty elasticities in other countries in the region, such as Thailand.

92. As in most countries, the poor are located predominately in rural areas. The topography and the low population density of the Lao PDR make many rural areas especially isolated and

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<sup>10</sup> Kakwani and Pernia. 2000. "What is Pro-poor Growth?". Asian Development Review, Vol. 18. Manila.

reduce the opportunities that the poor have to escape poverty. In terms of the percentage of the population living in poverty, the northern region is the poorest in the country. Not surprisingly, Vientiane municipality and the central region have the lowest incidence of poverty (Table 15).<sup>11</sup>

**Table 15: Percentage of the Population Living in Poverty, 1992/93 and 1997/98**

Region	1992/93			1997/98		
	Urban	Rural	Total	Urban	Rural	Total
Vientiane	22.5	30.1	24.4	16.7	4.5	12.2
Northern	48.9	60.4	58.4	43.3	53.5	52.5
Central	37.4	39.9	29.5	27.7	35.9	34.9
Southern	27.6	49.6	38.4	35.8	38.7	38.4
Lao PDR	33.1	48.7	45.0	26.9	41.0	38.6

Source: Kakwani et al. 2001. Poverty in Lao PDR. Manila.

93. Not only does Vientiane have the lowest incidence of poverty in the country, it also saw the largest decline in poverty between the two LECSs. Poverty in the Lao PDR is largely a problem located outside of the major cities. Although poverty has declined in all regions of the country, this decline has been slow.

## **B. Public Policies and the Poor**

94. Given the low level of automatic transmission of economic growth to poverty reduction, the Government and assistance agencies should take additional steps to reduce poverty. Investing in rural infrastructure will help the benefits of growth reach the poor due to the opening of markets and increasing economic activities. At the same time, concrete investments to improve agricultural productivity (such as increasing agricultural extension and applied agricultural research) will also directly benefit the poor, who largely depend on agriculture as their main source of income.

95. The high population growth rate not only lowers the economic potential of the country, it also places additional burdens on the country. Women are placed at risk from additional births (the total fertility rate in the Lao PDR is around six children per woman) and a growing population can burden the education and health system. The high dependency rate (nonworking household members compared with working household members) also dilutes the household's income and contributes to poverty. However the high population rate is not only a cause of poverty, it is also an effect of poverty. Part of the motivation for households to have a large number of children is the fear of infant and child mortality (reducing the number of surviving children) and to provide security in the parents' old age.

96. Investing in the human capital of the poor will also allow the poor to integrate better into the economy. Although, the agriculture sector has played an important role in economic growth in the past decade, the overwhelming historical evidence shows that the sector will decrease as

<sup>11</sup> The northern region is a geographic and not political grouping. It consists of the provinces of Phongsali, Louang Namtha, Oudomxai, Bokeo, Louang Phrabang, Houaphanh, and Sayaburi. The central region consists of the provinces of Vientiane, Xieng Khouang, Borikhamxai, Khammouan, Savannakhet, and the Xaisomboun Special Region. The southern region consists of the province of Saravane, Sekong, Champassak, and Attapeu. The Municipality of Vientiane is normally treated as a separate region.



a proportion of the economy and agricultural growth rates will fall below those of the rest of the economy. Education is essential for the population to take advantage of the growing opportunities in the economy. Investing in towns and small cities will also increase the opportunities of the rural population by increasing the market and by serving as a destination for migration.

97. The Government is formulating its 5<sup>th</sup> five year socioeconomic development plan for 2001 to 2005 as part of its long-term framework to reduce poverty. The Government is to seek to promote balanced economic growth in both the urban and rural areas. Recognizing that a large percentage of the population of the Lao PDR depend on the natural environment for their well-being, the Government also emphasizes sustainable natural resource management. The Government has also prepared an interim poverty reduction strategy paper to refine its poverty reduction strategy.

98. Given the lack of data, measuring the effect of government spending on the welfare of the poor is difficult. A study of the health and education needs of ethnic minorities in the Lao PDR,<sup>12</sup> showed that education spending disproportionately benefits urban students. Estimates are that a university student receives a subsidy that is 20 times larger than the subsidy for a primary student. Likewise the increase in government capital expenditures probably tends to be biased towards wealthier households. The Government is committed to reduce this imbalance in its new socioeconomic development plan with its increased focus on recurrent spending and social spending.

99. Since the poor are largely out of the cash economy, they do not suffer the direct effects of taxation (which mostly falls on imported goods) but are likely to suffer from the fact that tax policy restricts trade. They also suffer from internal barriers to trade, in the form of taxes on domestic commerce and local monopolies that reduce the commercialization of goods.

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<sup>12</sup> Research Triangle Institute. 2000. Health and Education of Ethnic Minorities in the Greater Mekong Sub-Region: Lao PDR Country Report. North Carolina.

**APPENDIX**

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## STATISTICAL APPENDIX

Table A.1: Key Economic Indicators

Item	1995	1996	1997	1998	1999 <sup>a</sup>	2000 <sup>a</sup>
<b>A. Income and Growth</b>						
1. GDP Per Capita (dollars, current)	377.0	396.5	364.0	262.5	284.2	330.5
2. GDP Growth (% in constant prices)	7.0	6.9	6.9	4.0	7.3 <sup>b</sup>	5.9
Agriculture	3.1	2.8	7.0	3.1	8.2	5.1
Industry	13.1	17.3	8.1	9.2	7.9	7.5
Services	10.2	8.5	7.5	5.5	6.9	6.2
<b>B. Saving and Investment (current market prices)</b>						
				(percent of GDP)		
1. Gross Domestic Investment	24.5	28.9	26.2	24.9	22.7	20.5
2. Gross Domestic Saving	11.5	12.4	10.0	14.8	16.4	14.7
<b>C. Money and Inflation</b>						
				(annual percent change)		
1. Consumer Prices (annual average, December 1995=100) <sup>c</sup>	19.4	13.0	19.3	87.4	134.0	27.0
2. Broad Money (M2) <sup>d</sup>	16.4	26.7	65.8	113.3	78.3	45.8
Private sector credits (level)				459.0	872.0	1,218.0
Credit to the private sector				76.5	90.0	39.7
<b>D. Government Finance<sup>e</sup></b>						
				(percent of GDP)		
1. Total Revenue <sup>f</sup>	12.2	13.2	11.0	9.8	10.6	14.0
2. Total Expenditure and Net Lending	21.9	22.1	19.8	13.0	19.3	21.9
3. Overall Surplus/Deficit (-) <sup>f</sup>	-9.7	(8.9)	(8.8)	(3.2)	(8.8)	(7.9)
<b>E. Balance of Payments</b>						
1. Merchandise Trade Balance (% of GDP)	-15.4	(19.8)	(18.9)	(16.8)	(13.2)	(11.5)
2. Current Account Balance (% of GDP) <sup>g</sup>	-13.0	(16.5)	(16.2)	(10.1)	(6.3)	(5.8)
3. Export (\$) Growth (annual percent change)	4.1	2.6	(1.4)	6.4	7.7	8.3
4. Import (\$) Growth (annual percent change)	4.4	17.1	(6.0)	(14.7)	0.3	6.6
<b>F. External Payments Indicators</b>						
1. International Reserves (billion dollars, end of period) <sup>1</sup>	92.5	166.6	135.5	112.0	106.0	140.0
1. Gross International Reserves, in months of imports	1.9	3.0	2.1	2.4	2.3	2.4
2. Total External Debt Service (% of exports of goods)	5.7	4.5	8.7	11.1	11.4	10.1
3. Total External Debt (% of GDP)		116.8	132.9	199.1	180.5	148.8
<b>Memorandum Items:</b>						
GDP (current prices, KN billion)	1,430.4	1,726	2,201	4,240	10,304	13,483
GDP (current prices, \$ million)	1746	1,864	1,747	1,286	1,450	1,718
Exchange Rate (KN per \$, average official rate)	819.0	926	1,260	3,296	7,108	7,846
Population (million)	4.6	4.7	4.8	4.9	5.1	5.2

GDP= gross domestic product.

<sup>a</sup> Preliminary estimates by the Lao PDR authorities.

<sup>b</sup> The Lao PDR authorities estimate real GDP at 7.3 percent in 1999, mainly due to significant growth in agriculture. However, the staff estimates real GDP to have grown by 5.2 percent in 1999 following the more modest growth in agriculture.

<sup>c</sup> The 1996 inflation rate is based on the Bank of Lao consumer price index series with December 1987 as the base year.

<sup>d</sup> Includes foreign currency deposits.

<sup>e</sup> Figures are on a fiscal year basis where fiscal year ends 30 September.

<sup>f</sup> Excluding grants.

<sup>g</sup> Excluding official transfers.

Sources: National Statistical Centre, Bank of Lao PDR, State Planning Committee, International Monetary Fund, Asian Development Bank estimates.

**Table A.2.1: Gross Domestic Product by Economic Activity**  
(constant 1990 prices, percent)

Economic Activity	1996	1997	1998	1999 <sup>a</sup>	2000 <sup>a</sup>
	<b>KN million</b>				
<b>Agriculture</b>	466,206	498,683	514,071	556,199	584,639
Crops	222,393	253,419	269,712	306,119	330,609
Livestock and Fishery	183,941	188,325	192,972	197,498	201,448
Forestry	59,871	56,939	51,387	52,582	52,582
<b>Industry</b>	183,997	198,848	217,079	234,161	251,783
Mining and Quarrying	2,774	3,566	4,057	5,416	5,958
Manufacturing	137,265	150,027	164,455	176,086	190,173
Construction	31,105	32,646	28,054	27,711	27,711
Electricity and Water	12,852	12,609	20,513	24,948	27,942
<b>Service</b>	221,615	238,296	251,504	268,890	285,641
Transport, Post, and Telecommunication	48,011	52,935	56,390	61,844	66,792
Wholesale and Retail Trade	76,773	85,061	93,397	100,144	108,156
Bank, Insurance, and Real Estate	11,701	12,751	13,006	13,397	13,799
Ownership of Dwellings	30,141	30,887	31,659	32,451	33,262
Public Wage Bill	27,743	28,040	29,217	31,186	32,122
Nonprofit Institutions	10,659	10,535	8,401	7,561	7,561
Hotels and Restaurants	15,092	16,543	17,859	20,537	22,180
Other Services	1,496	1,544	1,575	1,770	1,770
Import Duties	21,439	19,183	10,540	6,567	6,567
<b>GDP (at market prices)</b>	893,256	955,009	993,194	1,065,817	1,128,629
	<b>As percent of GDP</b>				
<b>Agriculture</b>	52.2	52.2	51.8	52.2	51.8
Crops	24.9	26.5	27.2	28.7	29.3
Livestock and Fishery	20.6	19.7	19.4	18.5	17.8
Forestry	6.7	6.0	5.2	4.9	4.7
<b>Industry</b>	20.6	20.8	21.9	22.0	22.3
Mining and Quarrying	0.3	0.4	0.4	0.5	0.5
Manufacturing	15.4	15.7	16.6	16.5	16.8
Construction	3.5	3.4	2.8	2.6	2.5
Electricity and Water	1.4	1.3	2.1	2.3	2.5
<b>Service</b>	24.8	25.0	25.3	25.2	25.3
Transport, Post, and Telecommunication	5.4	5.5	5.7	5.8	5.9
Wholesale and Retail Trade	8.6	8.9	9.4	9.4	9.6
Bank, Insurance, and Real Estate	1.3	1.3	1.3	1.3	1.2
Ownership of Dwellings	3.4	3.2	3.2	3.0	2.9
Public Wage Bill	3.1	2.9	2.9	2.9	2.8
Nonprofit Institutions	1.2	1.1	0.8	0.7	0.7
Hotels and Restaurants	1.7	1.7	1.8	1.9	2.0
Other Services	0.2	0.2	0.2	0.2	0.2
Import Duties	2.4	2.0	1.1	0.6	0.6
<b>GDP (at market prices)</b>	100.0	100.0	100.0	100.0	100.0

GDP=gross domestic product.

<sup>a</sup> Preliminary estimates.

Source: National Statistical Centre.

**Table A.2.2: Gross Domestic Product by Economic Activity**  
(current prices)

Economic Activity	1996	1997	1998	1999 <sup>a</sup>	2000 <sup>a</sup>
	KN million				
<b>Agriculture</b>	891,066	1,138,578	2,226,881	5,507,539	7,129,930
Crops	425,064	578,600	1,168,353	3,031,219	4,221,837
Livestock and Fishery	351,569	429,978	835,927	1,955,648	2,481,499
Forestry	114,433	130,001	222,601	520,671	426,595
<b>Industry</b>	351,676	454,005	940,353	2,320,684	3,079,054
Mining and Quarrying	5,303	8,143	17,573	53,625	77,447
Manufacturing	262,357	342,537	712,394	1,744,051	2,318,303
Construction	59,451	74,536	121,526	276,089	304,766
Electricity and Water	24,565	28,789	88,861	246,919	378,539
<b>Service</b>	441,970	564,327	1,011,465	2,400,711	3,189,584
Transport, Post, and Telecommunication	91,764	120,859	244,272	590,882	773,960
Wholesale and Retail Trade	146,738	194,208	404,581	991,701	1,288,506
Bank, Insurance, and Real Estate	22,363	29,114	7,169	57,478	96,083
Ownership of Dwellings	57,608	70,521	137,144	321,333	406,230
Public Wage Bill	78,500	94,757	122,934	194,593	264,694
Nonprofit Institutions	13,293	13,572	11,180	10,999	12,271
Hotels and Restaurants	28,845	37,770	77,361	215,079	317,702
Other Services	2,859	3,526	6,824	18,646	30,137
Import Duties	40,976	43,797	61,504	74,990	84,000
<b>GDP (at market prices)</b>	<b>1,725,689</b>	<b>2,200,707</b>	<b>4,240,203</b>	<b>10,303,924</b>	<b>13,482,568</b>

GDP=gross domestic product.

<sup>a</sup> Preliminary estimates.

Source: National Statistical Centre.

**Table A.3.1: Agricultural Crop Production**  
(Thousand Tons)

<b>Crops</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000<sup>a</sup></b>
<b>Cereals</b>	<b>1,582.3</b>	<b>1,832.0</b>	<b>1,992.3</b>	<b>2,270.7</b>	<b>2,305.5</b>
<b>Rice</b>	<b>1,413.2</b>	<b>1,660.0</b>	<b>1,774.6</b>	<b>2,094.0</b>	<b>2,230.0</b>
Season Rice	1,075.7	1,303.5	1,349.0	1,502.0	1,635.0
Irrigated Rice	71.5	113.5	212.1	354.0	465.0
Upland Rice	266.0	243.0	213.5	238.0	130.0
Maize	76.6	78.0	109.9	96.1	23.6
Starchy Roots	92.5	94.0	107.9	80.6	51.9
<b>Manufacturing Products</b>	<b>146.3</b>	<b>158.2</b>	<b>241.6</b>	<b>239.4</b>	<b>246.9</b>
Sugarcane	87.1	95.0	170.2	173.6	173.6
Tobacco	26.0	28.0	25.6	23.4	39.8
Peanut	11.9	12.0	15.0	13.0	7.0
Cotton	6.8	7.0	7.5	4.3	4.7
Others <sup>b</sup>	14.5	16.2	23.3	25.1	21.8
<b>TOTAL</b>	<b>1,728.6</b>	<b>1,990.2</b>	<b>2,233.9</b>	<b>2,510.1</b>	<b>2,552.4</b>

<sup>a</sup> Preliminary estimates

<sup>b</sup> Includes mungbeans, soybeans, coffee, and tea.

Source: National Statistical Centre. 2000. Basic Statistics of Lao PDR, Vientiane.

**Table A.3.2: Agricultural Crops**  
Harvested Plant Area ('000 hectares)

<b>Crops</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000<sup>a</sup></b>
<b>Cereals</b>	<b>605.7</b>	<b>656.9</b>	<b>685.6</b>	<b>771.9</b>	<b>708.0</b>
<b>Rice</b>	<b>553.7</b>	<b>599.5</b>	<b>617.5</b>	<b>718.1</b>	<b>690.0</b>
Season Rice	363.1	421.1	430.2	477.5	500.0
Irrigated Rice	18.0	27.3	53.1	87.0	110.0
Upland Rice	172.6	151.1	134.2	153.6	80.0
Maize	37.4	38.0	46.4	40.7	10.0
Starchy Roots	14.6	19.4	21.7	13.1	8.0
<b>Manufacturing Products</b>	<b>57.9</b>	<b>61.2</b>	<b>71.6</b>	<b>78.0</b>	<b>71.6</b>
Coffee	23.1	23.3	28.6	42.3	42.3
Peanut	9.4	14.0	14.9	12.9	7.0
Tobacco	7.2	7.5	6.6	4.3	7.5
Cotton	9.1	7.2	7.2	4.4	4.7
Sugarcane	3.4	3.7	5.4	4.7	4.7
Others <sup>b</sup>	5.7	5.5	8.9	9.4	5.4
<b>TOTAL</b>	<b>663.6</b>	<b>718.1</b>	<b>757.2</b>	<b>849.9</b>	<b>779.6</b>

<sup>a</sup> Preliminary estimates.

<sup>b</sup> Includes mungbeans, soybeans, tea.

Source: National Statistical Centre. 2000. Basic Statistics of Lao PDR, Vientiane.

**Table A.4: Average Market Exchange Rate**

<b>Month</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
<b>kip/dollar</b>					
January	941.4	993.0	2,478.2	5,184.5	7,591.5
February	941.7	1,030.8	2,501.7	5,856.5	7,608.5
March	938.2	1,043.7	2,474.5	7,005.0	7,627.0
April	941.1	1,464.0	2,585.5	7,140.9	7,654.5
May	944.1	1,135.0	2,777.5	7,406.3	7,823.5
June	946.2	1,131.9	3,744.0	8,870.0	7,921.5
July	945.5	1,254.0	3,777.0	9,736.0	8,125.5
August	947.1	1,417.6	3,981.0	9,755.0	8,262.5
September	956.7	1,571.5	4,552.5	8,559.0	8,366.5
October	965.4	1,674.5	4,668.5	8,321.5	8,416.0
November	971.9	1,803.5	4,447.5	7,700.0	8,486.5
December	980.7	2,064.5	4,586.0	7,686.1	8,356.0
<b>Average</b>	<b>951.6</b>	<b>1,382.0</b>	<b>3,547.8</b>	<b>7,768.4</b>	<b>8,020.0</b>
<b>kip/baht</b>					
January	37.3	39.3	47.3	142.4	203.5
February	37.5	39.9	48.4	160.1	203.5
March	37.5	40.4	59.0	190.5	202.9
April	37.5	41.1	67.5	198.1	203.4
May	37.6	43.6	66.5	201.1	204.5
June	37.6	44.0	91.8	242.5	204.1
July	37.6	47.0	92.9	265.5	204.7
August	37.7	46.9	92.9	260.5	204.3
September	38.2	46.1	92.9	220.0	202.1
October	38.3	45.7	92.9	213.3	196.6
November	38.4	46.4	92.9	199.5	195.4
December	38.6	47.1	92.9	201.7	195.0
<b>Average</b>	<b>37.8</b>	<b>44.0</b>	<b>78.1</b>	<b>207.9</b>	<b>201.7</b>

Source: National Statistical Centre.



**Table A.5: Composition of Merchandise Exports and Imports**  
(\$ million)

Item	1996	1997	1998	1999	2000 <sup>a</sup>
<b>Exports</b>					
Wood Products	125	90	112	106	120
Logs	34	17	11	—	69
Timber	79	67	87	—	41
Other	12	6	14 <sup>b</sup>	—	10
Coffee	25	19	48	15	15
Agriculture and Forest Products	18	18	8	8	13
Manufactures	28	15	10	28	11
Garments	64	91	70	72	77
Motorcycles	13	17	18	38	41
Electricity	30	21	66	91	112
Car Reexports	0	0	0	0	0
Gold Reexports	15	42	0	0	0
Fuel Purchases by Foreign Carriers	0	1	0	1	1
Others	4	4	4	4	4
<b>Total Merchandise Exports (FOB)</b>	<b>321</b>	<b>317</b>	<b>337</b>	<b>363</b>	<b>393</b>
<b>Imports</b>					
Consumption Goods	308	268	234	253	226
Investment Goods	277	227	227	185	153
Machinery and Equipment	71	52	44	21	9
Vehicles	72	54	39	36	14
Fuel	33	38	62	37	79
Construction and Electrical Equipment	101	83	81	91	51
Materials for Garment Industry	70	74	67	67	67
Motorcycle Parts for Assembly	12	25	17	37	43
Cars for Reexport <sup>c</sup>	0	0	0	0	0
Gold and Silver	19	50	1	2	0
Electricity	3	3	6	8	9
Fuel Purchased Abroad by Lao Carriers	1	1	2	2	2
Unrecorded Imports <sup>d</sup>	—	—	—	—	91
<b>Total Merchandise Imports (CIF)</b>	<b>690</b>	<b>648</b>	<b>553</b>	<b>554</b>	<b>591</b>

— Not available.

FOB = free on board, CIF = cost, insurance, and freight.

<sup>a</sup> Preliminary estimates.

<sup>b</sup> Estimate.

<sup>c</sup> Includes gold for reexports.

<sup>d</sup> Estimate included for unrecorded imports in 2000 due to weaknesses in customs data.

Sources: Bank of Lao PDR; International Monetary Fund Article IV Consultations Report, April 2001.

**Table A.6: Outstanding External Debt and Debt Service Payments<sup>a</sup>**  
(\$ million)

Item	1996	1997	1998	1999	2000 <sup>b</sup>
<b>Total Debt Stock</b>					
<b>(including Russian Federation debt)</b>	<b>2,177.6</b>	<b>2,322.0</b>	<b>2,560.8</b>	<b>2,617.1</b>	<b>2,557.8</b>
<b>(excluding Russian Federation debt)</b>	<b>827.3</b>	<b>978.5</b>	<b>1,224.2</b>	<b>1,313.9</b>	<b>1,260.3</b>
<b>Bilateral Creditors</b>	1,421.2	1,433.5	1,470.8	1,456.1	1,391.9
of which:					
Russian Federation <sup>c</sup>	1,350.3	1,343.5	1,336.6	1,303.2	1,297.5
<b>Multilateral creditors</b>	756.4	888.5	971.4	1,036.0	1,042.2
of which:					
ADB	342.7	429.8	500.0	540.4	541.5
IDA	307.1	347.6	363.1	378.2	393.6
IMF <sup>d</sup>	67.5	67.4	59.5	55.2	48.1
<b>Commercial creditors<sup>e</sup></b>			118.6	125.0	123.7
<b>Total Debt Service</b>	<b>15.5</b>	<b>30.3</b>	<b>45.1</b>	<b>52.7</b>	<b>50.1</b>
<b>Amortization</b>	9.6	11.3	18.7	34.2	31.4
<b>Bilateral</b>	4.4	2.1	1.7	3.8	3.4
of which:					
Russian Federation <sup>c</sup>	6.7	6.7	6.7	0.0	0.0
<b>Multilateral</b>	5.2	9.2	11.2	18.5	16.1
of which:					
ADB	1.1	1.9	1.6	7.1	7.1
IDA	0.4	1.5	2.1	5.0	5.0
IMF <sup>d</sup>	3.0	4.8	6.3	0.4	7.8
<b>Commercial creditors<sup>e</sup></b>			5.8	11.9	11.9
<b>Interest Payments</b>	5.9	19.0	26.4	18.5	18.7
<b>Bilateral</b>	0.7	11.9	0.3	0.5	0.7
of which:					
Russian Federation <sup>c</sup>	0.0	0.0	0.0	0.0	0.0
<b>Multilateral</b>	5.2	6.8	8.4	7.9	9.0
of which:					
ADB	2.1	3.2	4.0	4.1	4.1
IDA	2.3	2.7	3.4	3.0	3.0
IMF <sup>d</sup>	0.6	0.4	0.4	0.3	0.5
<b>Commercial creditors<sup>e</sup></b>			17.8	10.1	9.1

ADB = Asian Development Bank, IDA = International Development Association, IMF = International Monetary Fund.

<sup>a</sup> Debt is calculated on the basis of existing debt. It includes all public and publicly-guaranteed debt.

<sup>b</sup> Preliminary estimate.

<sup>c</sup> Debt under negotiation.

<sup>d</sup> Includes the new arrangement.

<sup>e</sup> Publicly-guaranteed public enterprise debt.

Sources: Bank of Lao PDR, International Monetary Fund Article IV Consultations, April 2001.