

Lao People's Democratic Republic

Resource-based industries, manufacturing, and services generated robust growth in 2011, and are expected to drive similar growth rates during the forecast period. Inflation, after speeding up last year, is projected to moderate. The country signed agreements that bring it closer to joining the World Trade Organization. However, generating well-paying jobs remains a major challenge.

Economic performance

Despite severe flooding that damaged agriculture in 2011, the economy grew by 7.8% (Figure 3.25.1), mainly owing to expansion of hydropower, manufacturing, mining, and services.

Typhoons in the second half of the year brought floods that took down rice output by 11% to about 2.9 million tons. Production of corn, beans, and vegetables also fell, although sugarcane, fisheries, and poultry performed better than in 2010. Output of timber declined as the government curbed illegal logging and restricted logging quotas. Agriculture as a whole, which accounts for just under one third of GDP, was virtually flat in 2011.

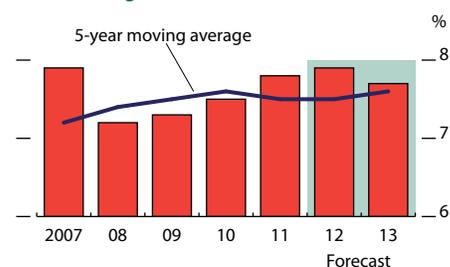
By contrast, industry expanded by 15.6%. Production of copper from the country's two biggest mines—Phu Bia and Sepon—rose by about 5% to 139,000 tons. Silver production also gained, by about 6% to 538,000 ounces, though output of gold fell by about 22% to 128,000 ounces.

Hydropower output rose by 18.5% in 2011, spurred by new plants coming online, including the 615 megawatt Nam Ngum 2 in April 2011, and by heavy rainfall during parts of the year. Most of the electricity generated is exported to Thailand. Investment in mining and power plants contributed to growth: several mines, including the Ban Houayxai gold and silver mine as well as eight hydropower plants and a lignite power plant were being built. Other construction focused on housing, commercial buildings, and hotels in Vientiane, Luang Prabang, and Savannakhet. Construction overall increased by about 6% in 2011.

Garment manufacturing benefited from the European Union's relaxation, from January 2011, of rules of origin for imports of garments from certain developing countries, including the Lao People's Democratic Republic (the Lao PDR) (Figure 3.25.2). Garment exports to the European Union and United States, the two main markets, rose by about 17% to \$225.6 million.

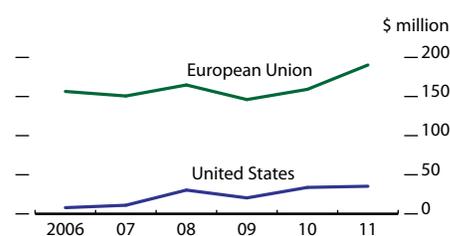
The services sector grew by 7.9% last year. Tourist arrivals went up by 9% to 2.7 million (Figure 3.25.3), supporting the hotels and restaurants as well as transport subsectors. The rollout of third-generation

3.25.1 GDP growth



Source: Asian Development Outlook database.

3.25.2 Garment exports to the European Union and United States



Notes: Using import data from US OTEXA and Eurostat. Data from Eurostat were converted to US dollars using €/s average exchange rate for the year.

Sources: Office of Textiles and Apparel. <http://otexa.ita.doc.gov> (accessed 20 March 2012); Eurostat. <http://epp.eurostat.ec.europa.eu> (accessed 21 March 2012).

mobile telephone and Internet services contributed to growth of telecommunications and banking continued to expand.

Inflation peaked at 9.8% in May (Figure 3.25.4) and averaged 7.6% for the year (up from 6.0% in 2010). Rising global oil prices drove up domestic fuel costs and the disruption to supplies of food during the floods pushed up prices of food. Higher inflation in neighboring countries that supply consumer goods—the People’s Republic of China (PRC), Thailand, and Viet Nam—added to pressure on prices.

Growth in credit moderated from very high rates in recent years to a still high 34.2% in December 2011 (Figure 3.25.5). The deceleration stemmed from reduced direct lending by the central bank for infrastructure projects and steps the bank took to curb lending for real estate speculation. A shortage of longer-term bank deposits constrained commercial bank lending to the private sector.

The central bank also maintained its policy of keeping the kip broadly stable against the US dollar and Thai baht. During 2011 the kip appreciated by 2.7% against the US dollar and by 1.6% against the baht. Dollarization has gradually declined from 79% in 1999 to about 45% last year.

Strong flows of revenue to the government from mining and hydropower, coupled with reduced off-budget spending, brought down the overall fiscal deficit to about 2.0% of GDP in FY2011 (ended 30 September 2011) from 5% the previous year. A value-added tax introduced in 2010 supported growth in total revenue, which is estimated to have reached the equivalent of 19.4% of GDP (including grants). Government spending is estimated at 21.4%.

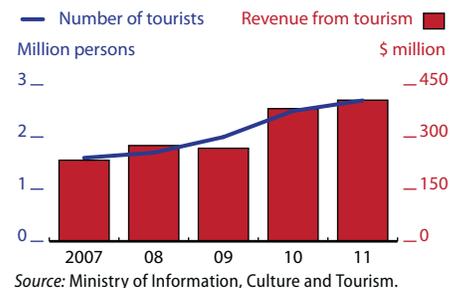
Merchandise exports, mainly minerals, hydropower, garments, and wood products, rose by an estimated 24.0% to \$2.7 billion in 2011. Imports increased by 19.4% to \$4.3 billion, bolstered by purchases of capital equipment for the resource industries and two Airbus aircraft for Lao Airlines. After dividend and profit repatriation and interest payments by resource-based companies, the current account deficit was estimated at 15.9% of GDP.

Accounting for foreign direct investment and other capital flows, gross international reserves fell to \$679 million in 2011, sufficient for about 2.5 months of nonresource imports.

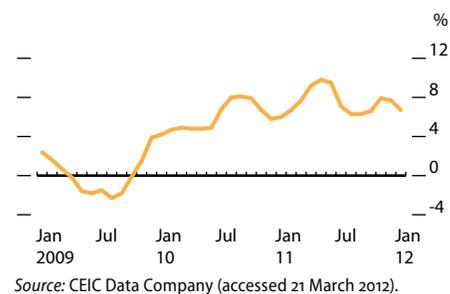
The Lao PDR has moved closer to joining the World Trade Organization, after reaching bilateral agreements with major trading partners. (It has sought membership in that body since 1997 to foster trade and investment.) Under the market access agreement signed last year with Australia, for example, the government agreed to an average ceiling on import tariffs of about 25%, and as low as 5% on some goods. It committed to allow market access for suppliers of a range of services and to allow majority foreign ownership of joint ventures.

In another market-opening development, the government sold stakes of about 30% in two state-owned companies—power company EDL-Generation Co. and Banque Pour Le Commerce Extérieur Lao—through initial public share offerings, and listed the shares on the new Laos Securities Exchange last year. Further such listings are planned.

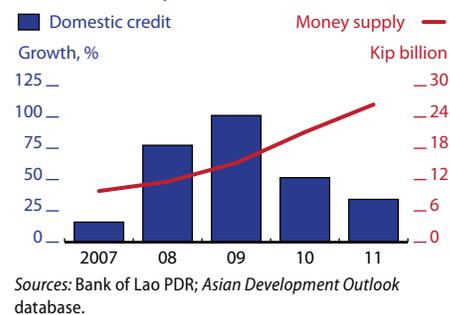
3.25.3 Tourism indicators



3.25.4 Inflation



3.25.5 Monetary indicators



3.25.1 Selected economic indicators (%)

	2012	2013
GDP growth	7.9	7.7
Inflation	6.7	6.0
Current account balance (share of GDP)	-21.0	-22.0

Source: ADB estimates.

Economic prospects

Growth looks likely to continue in 2012–2013 at similar rates to last year. Construction is gathering momentum on the \$3.7 billion Hongsa lignite thermal power plant (1,878 megawatts) and associated coal mine. Work will get under way this year on Nam Ngum 3 (440 megawatts), joining eight other hydro plants under construction. Expansion of Theun Hiboun (280 megawatts) is due to be completed in July 2012.

The Ban Houayxai mine is scheduled to start production in the first half of 2012, at a full-year rate of 100,000 ounces of gold and 700,000 ounces of silver, and the Phu Kham copper–gold project, one of the biggest in the country, is being expanded. A potash mine and processing plant costing \$94 million is expected to be completed this year and a company from Viet Nam has started work on a larger potash project (costing \$450 million) to be completed by 2015. Most fertilizer from these potash plants will be exported.

In the capital Vientiane, the government is investing more than \$180 million on building facilities for the 2012 Asia–Europe meeting of senior officials from 50 countries to be held in November 2012. The PRC is providing loans for conference facilities and airport expansion.

Tourism will get a lift from international promotion of 2012 as Visit Laos Year and from the ASEAN University Games to be held in December 2012. Lao Airlines has launched flights between Vientiane and Singapore after acquiring the Airbus planes in late 2011.

Rice production is expected to recover from last year's flood-suppressed level. Agricultural production is expected to increase by 2–3% in 2012, depending on the weather. The government is repairing irrigation systems damaged by the floods and building new irrigation systems to support dry-season crops.

Fiscal policy is more expansionary in FY2012, and the fiscal deficit is projected to widen to 4.6% of GDP. The government has budgeted to increase spending considerably, in part to repair the flood-damaged infrastructure. The central bank is targeting 25% growth in M2 money supply and aims to curtail expansion of credit to 28% (such targets have been missed in recent years, though).

Inflation is forecast to moderate to average 6.7% this year and 6.0% in 2013. Lower global food prices and a better domestic harvest will ease the pressures on food, which has a large share in the consumer price index. There will be some upward impact on prices from an increase of about 18% in administered electricity tariffs in the first half of 2012.

Sluggish global economic growth is expected to weigh on prices of copper, holding back merchandise export growth to about 19.0% in 2012. Imports of capital equipment needed for new mining and power projects will underpin an increase of about 17.0% in merchandise imports. The current account deficit is forecast to widen to 21.0% of GDP.

External public debt rose to an estimated \$3.7 billion dollars in 2011, although as a ratio to GDP it fell to about 47%. An external-debt sustainability analysis by the International Monetary Fund in 2011 found that the country still faces a high risk of debt distress, and that the projected rate of debt accumulation could increase in the next few years, reflecting borrowings mainly from the PRC.

3.9.1 Policy challenge—generating more jobs

Poverty incidence declined from 46% of the population in 1993 to a still high 27% in 2008. Consequently, major development goals are to sustain growth of income and employment, and better distribute income and wealth.

Central to these tasks is raising productivity and incomes in agriculture, which employs about three-fifths of the workforce. Rural areas are home to the majority of the poor. As improved productivity reduces the number of workers in agriculture, however, industry and services must grow if the surplus workers are to find jobs.

Investment in recent years has focused on mining and hydropower. They have indeed driven much of the growth, but, being capital intensive, have not generated enough jobs to take in all the workers leaving agriculture.

Industries that could create many well-paid jobs include:

Agribusiness. Processing crops like rice, corn, and natural rubber adds value and is labor intensive. As links strengthen between the Lao PDR and its neighbors Cambodia, the PRC, Myanmar, Thailand, and Viet Nam, market access for agribusiness production will expand.

Tourism. This group of countries also offers a cluster of tourism destinations that could be developed and promoted to achieve faster growth. Services associated with tourism, such as hotels, have a strong employment response to growth in output.

Services. It is efficient to cluster development of services in towns and cities to capture economies of scale and agglomeration. Moves in this direction require the government to address issues including inadequate urban planning and provision of water and sewerage systems.

More broadly, development of these and other industries depends on bringing down the high cost of finance, expanding education and skills training, building transport infrastructure, and addressing weaknesses in governance.