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## Lao People's Democratic Republic

Last year's economic outcomes—solid growth and moderate inflation—are likely to be repeated this year and next. Foreign direct investment has doubled in the past 2 years. However, rising domestic demand, stimulated by credit expansion, is putting pressure on foreign reserves. Concerns over the management of land and other natural resources are still to be addressed.

### Economic performance

Growth in 2012 benefited from developments in agriculture, construction, hydropower, mining, and services. GDP increased by 7.9%, slightly above the average rate over the past 10 years (Figure 3.25.1).

The industry sector grew by an estimated 14% to remain a major driver of GDP. Mining production was boosted by the start of the Ban Houayxai gold and silver mine and the expansion of existing minerals projects. Copper output from the two largest producers, which together generate more than 90% of total production, rose by 8% to 149,500 tons, with gold production climbing by 61% to 206,240 ounces, and silver production up by 15% to 616,680 ounces.

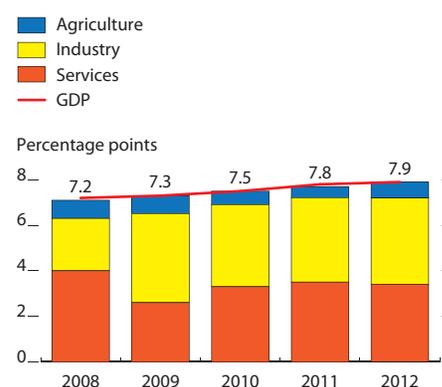
Hydropower output jumped by 29% to 13.8 billion kilowatt hours. The country's biggest hydropower project, Nam Theun 2, raised production close to full capacity. Ample water in reservoirs enabled other plants to operate at higher capacity. New hydropower projects commissioned in 2012 increased national output by more than 650 megawatts. About 70% of all hydropower generated is exported, mainly to Thailand.

Major construction projects under way last year included the \$3.7 billion Hongsa lignite thermal power project, seven new hydropower projects, and expanded facilities in the capital, Vientiane, to handle a major international meeting and the Association of Southeast Asian Nations (ASEAN) University Games toward the end of 2012. Cement production rose by an estimated 42.4% in 2012, reflecting buoyant construction. However, the garment industry suffered from weaker external demand and shortages of skilled labor. Garment exports fell by 25% to \$173 million (Figure 3.25.2).

In agriculture, higher production of rice, cassava, maize, poultry, and livestock lifted the sector's output by 2.5%.

The service sector expanded by 8%, underpinned by a 22% boost in tourist arrivals to 3.3 million supporting hotels, restaurants, and transportation (Figure 3.25.3); growth in wholesale and retail trade; and the deepening of financial services. The increase in tourist arrivals from Asian countries outpaced declines from Europe and the US.

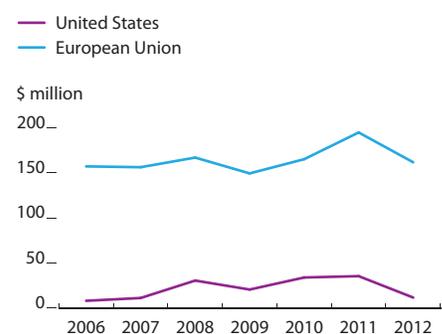
3.25.1 Supply-side contributions to growth



Sources: Lao Statistics Bureau; Asian Development Outlook database.

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3.25.2 Exports of garments and footwear to the European Union and United States



Notes: Import data from US OTEXA and Eurostat. Data from Eurostat were converted to US dollars using the euro/dollar average exchange rate for the year.

Sources: Office of Textiles and Apparel. <http://otexa.ita.doc.gov>; Eurostat. <http://epp.eurostat.ec.europa.eu> (both accessed 14 March 2013).

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Decelerating food and fuel prices brought down inflation to 2.9% year on year in July, at which point inflation started to edge up again (Figure 3.25.4). The year-average inflation rate of 4.3% was 3 percentage points below that of 2011.

While growth in M2 money supply remained strong at 31%, and in credit at 36.2%, credit expansion moderated from the very high rates of previous years (Figure 3.25.5). The central bank reduced its direct lending for infrastructure and slowed the registration of new commercial banks to dampen growth in credit. Foreign exchange policy focused on keeping the Lao kip broadly stable against the US dollar and the Thai baht. The kip appreciated by 0.3% against the dollar and by 2.4% against the baht in 2012. Dollarization declined to about 44% of M2, maintaining a gradual downtrend.

Fiscal accounts benefited from buoyant revenue from mining and hydropower, coupled with rising income from a value-added tax introduced in 2010 and external grants. The fiscal deficit, including grants and excluding off-budget spending, narrowed to 1.5% of GDP in FY2012 (ended 30 September 2012).

Growing credit and domestic demand propelled merchandise imports up by an estimated 17% to \$5.4 billion in 2012. Exports rose by a relatively sedate 9% to \$3.4 billion, resulting in a trade deficit of \$2.1 billion. Receipts from tourism rose, but so did payments abroad of interest and income by resource-based companies, so that the current account deficit widened to an estimated 22.6% of GDP. Foreign direct investment increased to \$1.4 billion last year, doubling since 2010. However gross international reserves of \$708 million provided cover for just 1.6 months of goods and services imports.

Structural reforms in 2012 included improvements to trade and investment regulations instituted to satisfy commitments made to join the World Trade Organization (completed in early 2013) and the ASEAN Economic Community at the end of 2015. The government established the State Accumulation Fund to finance its responses to future natural disasters, economic downturns, and revenue shortfalls when global mineral prices slide. Fund resources are to come from additional mining revenue and any budget savings.

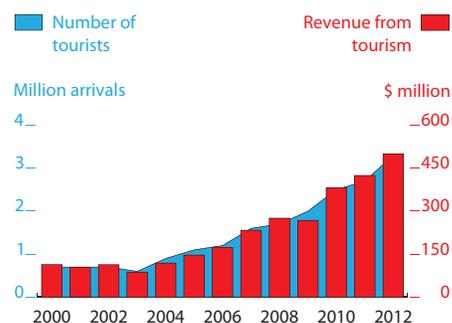
The International Monetary Fund and the World Bank analyzed debt sustainability in the Lao People's Democratic Republic (PDR) and consequently reclassified its risk of debt distress to moderate from high. The country's stock of external public and publicly guaranteed debt was, at \$3.7 billion in 2011, equivalent to 44.4% of GDP, showing a decline from 50.3% in 2010 because of economic growth and the appreciation of the kip against the US dollar. However, the share of non-concessional debt has expanded over recent years.

## Economic prospects

The outlook is for further solid growth during the forecast period, just below the 8% growth target in the government's Seventh National Socioeconomic Development Plan, 2011–2015 (Figure 3.25.6).

Substantial investment flowing into hydropower and mining, coupled with the construction of hotels, offices, and housing, will drive GDP

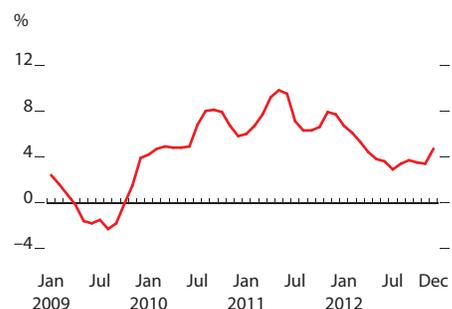
### 3.25.3 Tourism



Source: National Tourism Administration.

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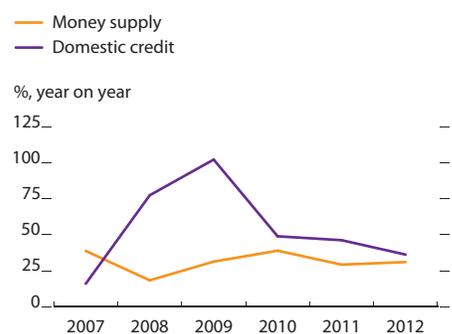
### 3.25.4 Monthly inflation



Source: CEIC Data Company (accessed 15 March 2013).

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### 3.25.5 Monetary indicators



Note: Available data for 2012 is from January to November only.

Source: Bank of Lao PDR.

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growth. In addition to the large Hongsa lignite power plant, which is about 40% completed, work has started on the \$3.5 billion Xayaburi dam and hydropower project, scheduled for commissioning in 2018 with capacity to generate 1.3 gigawatts of electricity. Five smaller hydropower projects are under development. Some new commercial-residential projects in the capital involve investments of several hundred million dollars, largely funded by foreign investment.

The hydropower plants brought on line last year will contribute to an expected 12% increase in power generation in 2013. Gold and silver production is expected to increase, but copper output is likely to be little changed. The mining and processing of potash for fertilizer is an expanding industry, with one project starting last year and another scheduled to produce fertilizer this year. Coal production is expected to rise.

Agriculture, which employs more than 60% of the workforce, is expected to grow at a slightly faster pace in 2013.

Tourist arrivals are projected to rise by 5%–10% in 2013. Other service industries likely to maintain good growth include financial services, wholesale and retailing, and transport and communications. Manufacturing industries will benefit from the government's promotion of food and beverage processing, cement production, and garments, which aims to reduce imports of these products.

Fiscal policy may be more expansionary in FY2013, given that the target for the fiscal deficit is 3.1% of GDP, taking grants into account. The government is raising salaries for the civil service, police, and military by 165% in steps over 3 fiscal years, starting in FY2013.

Monetary policy could tighten during the forecast period if the strong growth in the money supply and credit over several years is considered to undermine banking system stability, contribute to the problem of low international currency reserves, or pose other macroeconomic risks. The government targets holding growth in the money supply below 30% in 2013, and the central bank aims to keep the kip broadly stable against the dollar and the baht.

Inflation is projected to edge up to 5.5% on average in 2013 in light of buoyant domestic demand and higher salaries for government employees (Figure 3.25.7). Prices for meat and cooked food picked up early this year.

Rising imports of consumer and capital goods will maintain pressure on the external position. Merchandise imports are forecast to increase by 15% this year and exports by 14%, widening the trade gap to \$2.4 billion. The current account deficit will continue to exceed 20% of GDP (Figure 3.25.8).

Poverty incidence has likely declined from 27% in 2008, the last official survey. Projected economic growth and government social programs should further reduce poverty, but additional efforts are needed in remote regions, where high concentrations of poverty persist. Moreover, rates of child malnutrition are still high, as 41% of children under 5 years of age suffer chronic malnutrition. The country will be challenged to meet some Millennium Development Goals by 2015, including improvements in maternal mortality and access to safe drinking water and basic sanitation.

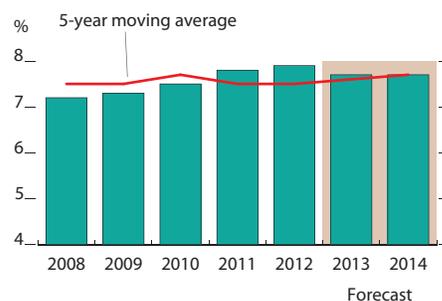
Risks to economic prospects come from increasingly volatile weather patterns, which can have severe impacts on agriculture. Viet Nam's

### 3.25.1 Selected economic indicators (%)

	2013	2014
GDP growth	7.7	7.7
Inflation	5.5	5.0
Current account balance (share of GDP)	-21.5	-23.6

Source: ADB estimates.

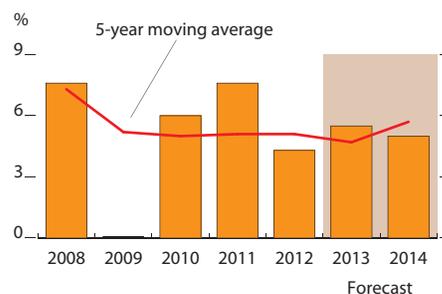
### 3.25.6 GDP growth



Source: Asian Development Outlook database.

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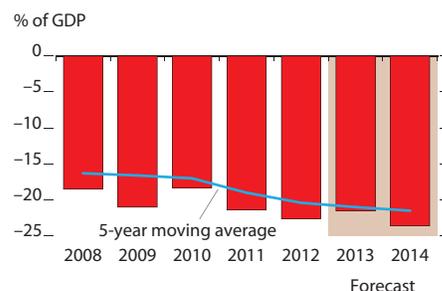
### 3.25.7 Inflation



Source: Asian Development Outlook database.

[Click here for figure data](#)

### 3.25.8 Current account balance



Source: Asian Development Outlook database.

[Click here for figure data](#)

economic slowdown poses risks because Vietnamese companies are major investors in the Lao PDR.

## Policy challenge—managing land and other natural resources

The government has granted land concessions over a significant area in the past decade to encourage investment. During this period the country has attracted investment into agriculture; tree plantations; commercial, residential, and tourism property development; hydropower; and mining.

Investors, mostly from abroad, were awarded 1.1 million hectares of land from 2000 to 2009, according to a report prepared last year for the government (Figure 3.25.9). This area, which excludes land concessions for logging, mineral exploration, contract farming, and hydropower, is about 5% of the country's total land area, more than is dedicated to wet season rice, the main crop. Most foreign investors holding land concessions are from the People's Republic of China, Thailand, and Viet Nam.

While the report found that land concessions have contributed to economic growth and government revenue, it noted weaknesses in the management of concessions and the governance of land and natural resources.

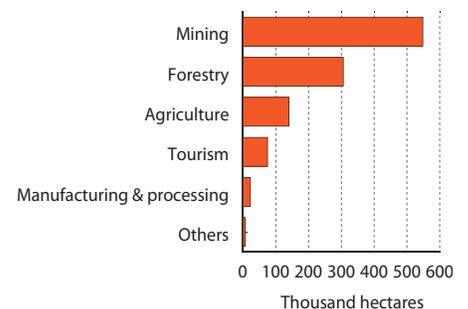
Much of the investment in agriculture is directed to lowland areas that are accessible to towns and cities, with little going to poorer remote areas. Land concessions for agriculture and forestry are dedicated to a handful of mostly exotic crops, such as rubber and eucalyptus, endangering biodiversity and local food security. The narrow range of crops makes only a limited contribution to the goal of diversifying exports. Tracts of farmland on urban fringes are being converted for housing, manufacturing, and other property developments.

In some cases, local populations have lost access to the land and forests upon which they depended for subsistence. Inadequate compensation for land and the resettlement of displaced people in areas where they struggle to earn a livelihood have become major concerns for affected communities.

The land-concession system could be improved by better monitoring the allocation and development of land and by ensuring that displaced people receive fair compensation and resettlement in areas that enable them to maintain their livelihoods. Further, strengthening the land title system would provide people in rural areas with legally protected access to land for their livelihoods and enable the enforcement of existing land titles.

It would be helpful to establish a system for settling disputes over land, which would shorten the time taken and lift the burden on the courts.

3.25.9 Area allocated for investment, 2000–2009



Note: Excludes logging concessions, contract farming, hydropower projects, and mining exploration.

Sources: Ministry of Natural Resources and Environment Natural Resource; Environment Information Center.

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