November 2007
IMF Country Report No. 07/360

Lao People's Democratic Republic: 2007 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Lao People's Democratic Republic

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2007 Article IV consultation with the Lao People's Democratic Republic, the following documents have been released and are included in this package:

- The staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 9, 2007 with the officials of the Lao People's Democratic Republic on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 19, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement on the joint World Bank/IMF debt sustainability analysis.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its August 3, 2007 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for the Lao People's Democratic Republic.

The document listed below has been or will be separately released.

Selected Issues Paper and Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

Staff Report for the 2007 Article IV Consultation

Prepared by the Staff Representatives for the 2007 Consultation
with the Lao People's Democratic Republic

Approved by Masahiko Takeda and Anthony Boote

July 19, 2007

- **The 2007 Article IV Consultation discussions were held in Vientiane during April 25–May 9, 2007.** The staff team comprised Messrs. Valdivieso (Head) and Ishi, Ms. Mitra (all APD), Mr. Zhan (PDR), Mr. McPherson (FAD), and Mr. Beaugrand (Resident Representative). Ms. Sucharitakul and Mr. Sitthilath (both OED) and Ms. Zekrya (World Bank, for Joint Debt Sustainability Analysis) also attended meetings.

- **The team met with:** Finance Minister Chansy Phosikham, Bank of Lao P.D.R. Governor Phouphet Khamphounvong, Industry and Commerce Minister Nam Viyaket, Natonal Assembly Chairman of the Economy and Finance Committee Khamsing Sayakone, other senior government officials and representatives of the donor and business communities.

- **Response to Fund policy advice:** The staff has been supportive of the authorities' policy priorities but their response to past Fund policy advice has been mixed (Appendix I). The last Article IV Consultation was concluded on March 8, 2006. Executive Directors' views can be found in http://www.imf.org/external/np/sec/pn/2006/pn0631.htm.

- **Exchange and trade regime:** Lao P.D.R. maintains restrictions for the preservation of national or international security notified pursuant to Decision No. 144-(52/51), and a restriction subject to Fund approval under Article VIII (tax payment certificates are required for some current account transactions). Staff does not recommend approval of the latter and have advised the authorities to eliminate it before accepting the obligations under Article VIII. They intend to consider its removal during the WTO accession process (Informational Annexes).

- **Statistics are very weak:** Significant improvements are required in the collection, compilation, and dissemination of data on the balance of payments, external debt, SOEs financial statements, provincial fiscal operations, national income accounts, and banking soundness indicators (Informational Annexes).

Contents Page

EXECUTIVE SUMMARY

Lao P.D.R.'s economic performance continues to be strong, but progress on structural reform has been mixed. Growth is robust and increasingly reliant on large export oriented mining and hydropower projects. Inflation has declined to historical lows, reserves have risen rapidly, and poverty has declined. Progress on reforms has been hampered by slow implementation of key reforms. The outlook is promising, but the outcome depends on the government's policy response to the emerging resource bonanza.

Policy Challenges and Discussions

Challenge: Sustaining macroeconomic stability

- ***Fiscal policy.*** The authorities are committed to fiscal consolidation and debt sustainability over the medium term. However, the draft 2007/08 budget, approved almost two months after the mission ended, departs from the prudent stance of the last two years. Staff believes there is room for correction and is urging the authorities to act. Looking ahead, the announced medium-term policies (introduction of a VAT, and reform of the revenue and expenditure management and intergovernmental relations) should help achieve fiscal consolidation. Expenditure decisions need to be taken within a yet-to-be developed integrated fiscal framework that accounts for resource revenue volatility.

- ***Monetary policy.*** Pressures on monetary expansion from rising reserves are likely to continue, posing a risk to inflation. The authorities intend to keep money growth under control, counting on a further reduction in the domestic financing of the deficit. In addition, staff advised the Bank of Lao P.D.R. (BoL) not to relax prudential requirements to expand credit to the private sector, and to introduce a standing deposit facility (remunerated banks' deposits) to mop up liquidity, until other market-based instruments and the interbank market are developed.

- ***Exchange rate policy.*** The managed float regime has worked well and the nominal exchange rate level is in line with macroeconomic fundamentals. The authorities will allow market conditions to prevail despite concerns about volatility. They plan to develop the interbank foreign exchange market.

Challenge: Managing resource revenues in support of growth and poverty reduction. There is an urgent need for expert advice to help develop a sound and transparent regime as an integral part of a medium-term fiscal framework.

Challenge: Broadening the Sources of Growth. There is a need for a renewed impetus on economic reform, especially to accelerate the restructuring of the state-owned banks and enterprises, and improving the investment climate. This together with sustained efforts to achieve greater trade integration should help raise and sustain broad-based growth.

I. Introduction

1. **In recent years, Lao P.D.R. has recorded a strong economic performance, but progress on structural reform has been mixed.** Growth has been robust, inflation has declined markedly, international reserves have risen, and poverty has declined.[1] Of notice is the increasing role of the export-oriented large mining and hydropower projects (the resource sector), which have helped to strengthen public finances and the balance of payments. So far, the resource sector has not had visible adverse macroeconomic effects, mainly because resource-related foreign exchange inflows have been substantially offset by imports for large resource projects and net imports from the non-resource sector. However, some pressures are building up, particularly on monetary growth and exchange rate appreciation, as the resource sector's net inflows outpaced the net imports of the non-resource sector. It follows that the full economic impact of the newly emerging resource sector is yet to be seen, and it could become either a blessing or a curse depending on the government's policy response and reform effort.

II. Recent Developments

2. **Macroeconomic performance remains strong.**

- Real GDP growth (7½ percent in 2006) continued to be robust, driven by the resource sector. Non-resource sector growth remains moderate (4½–5 percent), but there are signs of an incipient slowdown, including a slower growth of non-resource imports and a decline in credit to the private sector.

- Headline and core inflation declined to historical lows (3½ and 2 percent y-o-y in June 2007), reflecting favorable oil and food prices, and the appreciation of the kip.

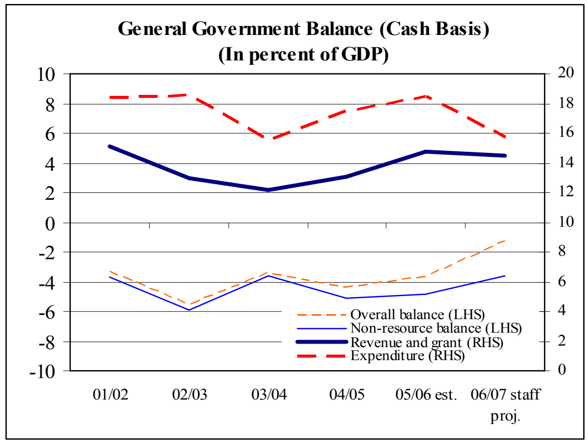
- The current account deficit narrowed markedly in 2006. Strong resource exports and tourism receipts partially offset high imports led by petroleum products and construction materials. This, combined with high foreign direct investment (FDI) and official development assistance (ODA) inflows, resulted in a substantial surplus. These trends continued, and by end-June 2007 gross international reserves reached $460 million (4.6 months of non-resource imports and 62 percent of foreign currency liabilities, including deposits), reflecting partly sizable mining-related tax payments.

3. **Fiscal performance strengthened, contributing to lower demand pressures.**

---

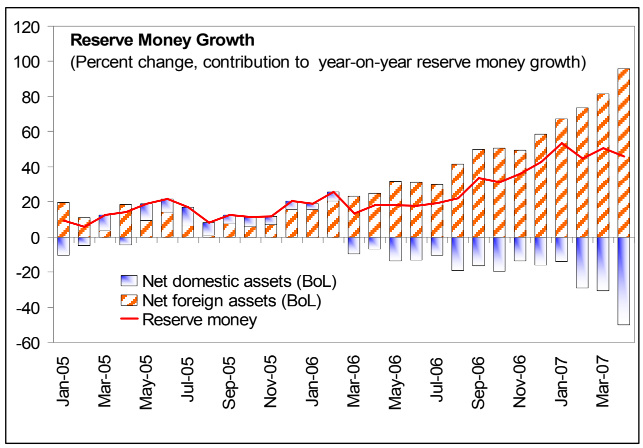
[1] Poverty indicators are presented in Appendix II.

- In 2005/06,[2] the overall cash deficit declined to 3¾ percent of GDP (4½ percent in 2004/05), while the non-resource deficit (overall balance minus resource revenues) remained at 5 percent of GDP. Strong revenues and contained domestic expenditure led to a decline in net domestic financing of about 1½ percent of GDP (equivalent to all resource revenues). Net external financing and grants increased allowing a corresponding rise in investment. Substantial domestic outlays were reportedly carried over to 2006/07, but there is no precise record.



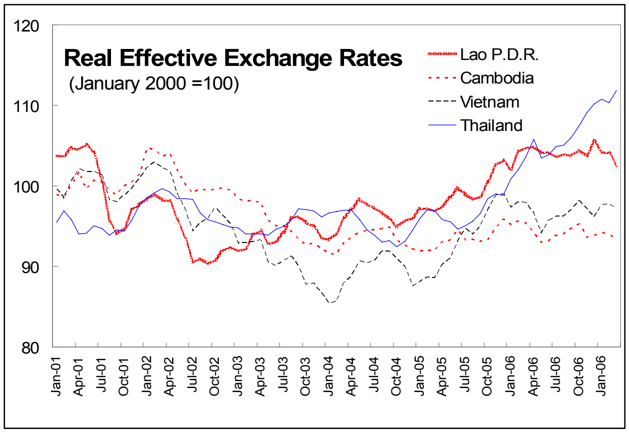
- In the first eight months of 2006/07, revenues continued to perform strongly, led by resources revenues. Domestic expenditures were in line with the yearly target. Altogether, there was an overall cash surplus and a low non-resource deficit. Net domestic financing continued to decline (equivalent to almost 90 percent of resource revenues). However, external financing and grants were significantly below the annual target.

4. **Monetary expansion has accelerated markedly and risks fueling inflation.** Reserve and broad money growth, which had reached 38 and 30 percent by end-2006, accelerated to 45 and 39 percent by end-May 2007. Monetary expansion has been driven by rapidly rising official international reserves. The improved fiscal position helped reduce the BoL net domestic assets (NDA). With credit to the private sector continuing to dwindle, the banking system net domestic assets also declined.



[2] The fiscal year ends on September 30.

5. **The real effective exchange rate has broadly stabilized after a sustained, albeit moderate appreciation.** The kip nominal exchange rate continued to appreciate against the U.S. dollar but it has depreciated against the Thai baht in 2006. This, combined with a lower inflation rate, contained real appreciation. These trends continued during the first part of 2007. So far, there has not been any visible impact on competitiveness (Box 1).



6. **Progress in key economic reforms has been mixed.**

- **Banking system.** A new commercial banking law became effective in April 2007, but implementing regulations are still under preparation with assistance from the International Finance Corporation. Meanwhile, a domestic private bank and a state-owned commercial bank (SOCB) for policy lending to the agricultural sector started operations, and a reputable international bank has taken a majority stake in a small private bank. Relevant indicators to assess the soundness of the banking system were not available.

- **State-owned commercial banks.** Management changes and prudent lending practices have lowered non-performing loans (NPLs) on new lending and reportedly improved profitability. However, the two major SOCBs still carry high NPLs (about 60 percent of loans) and the plan for their recapitalization has not proceeded as smoothly as anticipated.[3] The Asian Development Bank (AsDB) is providing technical assistance.

- **State-owned Enterprises** (SOEs). The 12 largest SOEs undergoing restructuring are together generating profits. However, some of them still make losses, and several remain heavily indebted. They no longer receive direct subsidies, but there was a sizable onlending operation for the national airline company in 2006.

- **Management of public finances.** The 2006 state budget law envisages the centralization of tax, customs, and treasury administration and the reform of inter-governmental fiscal relations. Some changes in revenue assignments are expected to

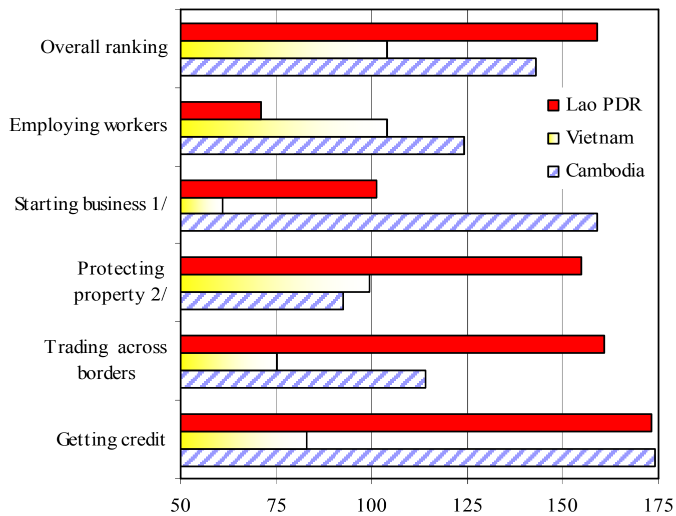
---

[3] Half of the SOCBs' capital deficiency (estimated at 4 percent of GDP at end-2005) was to be covered by government recapitalization bonds and the rest by SOCBs' profits or strategic investors. So far, only a third of the bonds has been issued (a second tranche has been authorized, but not issued yet). There is no active search for strategic partners.

be implemented in 2007/08,[4] but preparatory work on other components of the law, such as a new expenditure allocation norm, are still under discussion. The World Bank, AsDB, and Fiscal Affairs Department (FAD) are providing technical guidance. A detailed implementation plan for the introduction of the VAT in late 2008/09 is being crafted. FAD and other donors have provided extensive comments on draft regulations and implementation procedures. Several measures to strengthen public expenditure management have also been taken, including a new chart of accounts, developed with the assistance of the World Bank, which is expected to be fully in place by 2008/09.

7. **Several steps to facilitate trade and improve the investment climate have been taken, but the perception remains that the cost of doing business is high.**

World Bank Doing Business Indicators, 2006
(Ranking among 175 countries in the world)



1/ Average of "starting a business" and "licensing."
2/ Average of "registering property," "protecting investors," and "enforcing contract."

- Tariffs on most imports from AFTA members are being reduced gradually and expected to be below 5 percent by 2008. Preparatory work to join WTO is also in progress.

- The 2005 Enterprise Law, which calls for a registration system (instead of licensing) and a one-stop shop for new businesses, is yet to be implemented. Similarly, the implementation strategy for the 2004 Policy Framework for Small- and Medium-Enterprise Development is still under preparation.

III. Outlook

8. **The economic outlook is promising, but the outcome clearly depends on the government's policy response to the emerging resource bonanza.**

[4] Taxes accruing fully to the central government will now include import duties, turnover and excise taxes on imported goods, and mining taxes. Taxes accruing fully to local authorities will be limited to land and personal income tax. The turnover and excise taxes on domestic goods and the corporate income tax will be shared according to criteria yet to be decided.

- The direct macroeconomic impact of the resource sector is likely to be significant.[5] Staff estimates that the sector could: contribute 3 percentage points to annual GDP growth in the next five years and 1 percentage point thereafter; generate an annual average external surplus of 7 percent of GDP in the next five years; and, raise fiscal resource revenues up to about 3 percentage points of GDP in 2008, starting to decline gradually thereafter in line with proven mineral reserves depletion. Revenues from electricity companies will remain subdued (around ½ percent of GDP) over the next decade as their pre-tax profits remain low due to a heavy debt service burden.

- The outlook for the whole economy, however, will be ultimately determined by the supply response of the non-resource sector. Assuming the government adopts sound policies and accelerates reforms to shelter the non-resource sector from an adverse impact of the resource sector (a proactive policy response, see Box 2), staff projects that over the medium-term real GDP annual growth could be sustained at about 6½ percent (increasingly driven by non-resource sector growth), inflation kept below 5 percent, and international reserves strengthened to about five months of non-resource imports. Waiting to take policy action until the "resource curse" has set in (a reactive policy response) would eventually raise inflation, reduce investment incentives generally, and weaken international reserves.

9. **There are several risks to the outlook.** Upside risks include additional proven mineral reserves and mine development, and construction of more hydropower plants. Downside risks comprise adverse commodity price shocks, delays in construction of hydropower plants, and relaxation of the stabilization policy stance and significant delays in implementing economic and institutional reforms, particularly in the fiscal area.

10. **In addition, Debt Sustainability Analysis results continue to indicate a high risk of debt distress, although debt service remains manageable** (Appendix III). The debt outlook is highly sensitive to changes in macroeconomic conditions which, in turn, will depend in part on the policy response. A proactive policy response would bring all debt indicators below the thresholds faster than a reactive policy response, increasing the resilience to shocks. However, under a reactive scenario, a combined shock could even create debt service problems. The debt outlook is also sensitive to the degree of concessionality of newly contracted debt, suggesting that future external financing of the deficit should continue to rely on grants and highly concessional borrowing.

IV. Policy Discussions

11. Against this background, discussions focused on several policy challenges confronting the authorities, including (i) sustaining macroeconomic stability; (ii) ensuring an

[5] See accompanying Selected Issues Paper, Chapter I.

appropriate and transparent use of resource revenues; and (iii) accelerating banking and SOE reform and broadening the sources of growth.

A. Sustaining Macroeconomic Stability

Fiscal policy

12. **The expected fiscal outcome for 2006/07 should continue to help reduce demand pressures.** Staff projects the overall deficit could fall to 1¼ percent of GDP (about 2 percentage points of GDP below this year's target and the 2005/06 outcome), with the non-resource deficit at 3½ percent of GDP (1¼ percentage points lower than 2005/06). Continued high revenues and tight control of domestic expenditures would help reduce net domestic borrowing by about 1¼ percent of GDP (equivalent to about one-half of projected resource revenues). Foreign financed capital expenditure is likely to fall short of target, mainly reflecting optimistic expectations. The authorities agreed with the staff views, but found it prudent not to revise its revenue projections yet. Staff urged the authorities to minimize the outlays carried over into the next fiscal year and to monitor carefully unpaid obligations.

13. **Staff discussed the broad outline of the budget framework for 2007/08 and encouraged the authorities to pursue further consolidation.**

- Staff projects revenues will continue strong, mainly driven by resource revenues. Staff suggested that (i) current expenditures be programmed cautiously (especially wages) aiming to reduce net domestic financing further to help confront a potential revenue impact of commodity price volatility; and (ii) efforts be made to shore up non-resource revenues ahead of the introduction of the VAT, including by avoiding ad hoc exemptions and closely monitoring exemptions under the investment law; reviewing outdated terms of leasing and concession contracts on state property; expediting the process of centralizing administration; and bringing the large taxpayer units in the provinces and the main regional customs offices under central government control. With foreign financed capital expenditures declining further in line with an expected reduction in foreign assistance, the overall deficit could be reduced by about ¾ percent of GDP in 2007/08, with a more gradual reduction in the non-resource deficit.

- The authorities agreed that a stepped-up effort to strengthen tax and customs administration would be required, and indicated they were enhancing their monitoring of exemptions. They noted, however, that centralization is a politically sensitive issue and can only be done gradually. Discussions made it clear that the authorities were trying to find a balance between raising expenditure to attend to long overdue demands (including public wages) and setting aside some of the resource revenues. There is a contingency reserve fund created under the new budget law that could be used for this purpose, but details on its operation were under discussion.

14. **The 2007/08 budget was approved by the National Assembly in early July 2007, two months after the mission ended.** A preliminary assessment indicates that the underlying fiscal policy stance is more expansionary than anticipated. Non-resource revenues are broadly in line with staff projections, but resource revenues are somewhat higher owing mainly to price differences. Current (mostly wages and subsidies) and domestically financed expenditures will increase sharply, appropriating virtually all revenues available. Net domestic financing is expected to decline by the equivalent of about 15 percent of resource revenues. The approved budget, if fully implemented, will exacerbate the country's risk of debt distress. Pending access to more detailed expenditure information, staff believes that lower but better targeted and prioritized subsidies and transfers could make the budget outcome consistent with the authorities' medium term fiscal objectives.

2007/08 Preliminary Budget Plan
(In percent of GDP)

	2005/06	2006/07		2007/08		
	Staff. est.	Budget	Staff est.	Budget prel. 1/	Staff proj. reactive	Staff proj. proactive
Revenue	12.7	12.4	13.2	13.4	13.2	13.4
Of which: resource revenues	1.2	2.1	2.3	2.9	2.6	2.6
Grants	2.1	1.8	1.3	1.3	1.0	1.1
Expenditure	18.5	17.8	15.7	17.5	16.3	15.1
Of which: domestically financed expenditure	12.6	11.5	11.3	12.2	12.4	11.1
Current	9.3	9.5	9.5	9.9	10.3	9.2
Capital and onlending	7.5	7.4	5.2	6.4	5.1	5.0
Of which: domestically financed	1.2	1.4	1.4	1.6	1.7	1.5
Of which: foreign financed	5.8	6.4	4.4	5.3	3.9	4.0
Others including contingencies and discrepancies	1.6	1.0	1.0	1.2	0.9	0.9
Overall balance	-3.7	-3.7	-1.3	-2.7	-2.1	-0.6
Non resource balance	-4.9	-5.7	-3.6	-5.6	-4.7	-3.2
Domestic financing	-1.3	-0.1	-1.3	-0.4	0.0	-1.6
Foreign financing	5.0	3.7	2.5	3.1	2.1	2.2

1/ The National Assembly has approved the gross domestic borrowing based on the aggregate parameters, but the final fiscal numbers are still under discussion.

15. **In discussing the medium term fiscal strategy, the authorities reiterated their commitment to fiscal consolidation and debt sustainability.** Discussions covered the following areas:

- **Non-resource revenue mobilization.** The authorities are committed to centralize tax and customs administration and start implementing a VAT in 2008/09. It is important that the VAT be designed to be revenue-enhancing to help offset a possible, albeit moderate, reduction in trade taxes under trade agreements. Staff also suggested to eliminate the discretionary tax relief, align corporate tax rates with those of neighboring countries, and simplify the personal, excise, and land tax structure. The 2007/08 budget includes a general commitment to review the tax system, but only mentions specifically the review of land and property taxes and fees.

- **Reform on inter-governmental fiscal relations.** Progress in this area has been encouraging. On current plans, developed with World Bank and other donors' assistance, all shared revenues will be pooled and put under central administration management and distributed to provinces with a simple sharing rule. Expenditure assignments have not been finalized yet, but the authorities have been advised to ensure assignments are clear and to adopt a transfer system based on objective criteria. Staff recommended to calculate the expenditure bonus given to provinces that exceed revenue collection targets on the basis of non-resource revenues only, and eventually to abolish it.

- **Strengthen a public expenditure management system.** The authorities have made significant progress towards the introduction of a new chart of accounts. However, there is a need for setting a time-bound plan for the establishment of the national treasury and the introduction of a single treasury account.

- **Developing an integrated medium-term fiscal framework.** The authorities agree that expenditure decisions need to be made in a multiyear context. Such a framework should account not only for the volatile nature and uncertainties associated with resource revenues, but should align expenditures to the priorities of the National Socio-economic Development Plan (NSEDP). It is important that future budgets include this type of framework.

Monetary and exchange rate policy

16. **Staff shares the authorities' concern about the inflationary risk posed by the ongoing rapid monetary expansion.**

- The authorities plan to reduce monetary expansion through a targeted reduction in BoL's NDA (led by a further reduction in the net domestic financing of the deficit) and keeping tight limits on SOCBs' credit expansion. Staff suggested that, in addition, a standing deposit facility (remunerated banks' deposits) be introduced to help mop up liquidity. At the same time, they are facing demands to increase credit to the private sector by lowering policy interest rates, raising SOCBs' lending ceilings, and relaxing prudential regulations. Those arguing in favor point to the need to support private sector growth, the benign inflation, and the low NPLs of the SOCBs' new lending. Staff recommended against such measures, because the SOCBs' overall financial condition is still very weak, and the banks' low loans-to-deposits ratio reflects mainly difficulties in realizing collaterals and complex bankruptcy procedures.

- Staff also supported the authorities' interest in broadening their tools to manage liquidity, and developing the interbank market to allow policy rates to play a more fundamental role. To this end, staff suggested that the BoL should (i) enhance its liquidity forecasting framework by incorporating explicitly detailed fiscal operations; (ii) start developing market-based instruments for managing liquidity using treasury bills; (iii) start discussions with the ministry of finance on a new financial arrangement to share the net cost of monetary operations.

17. **The authorities believe the exchange rate should reflect market conditions.**

- The current managed float framework has appropriately helped smooth exchange rate movements and strengthen the reserve position, and is also consistent with external stability. The official exchange rate is determined on the basis of the market outcome for the preceding day and the current nominal exchange rate level is deemed to be in line with economic fundamentals.

- The authorities have not received complaints about loss of competitiveness owing to the continued nominal appreciation. However, they expressed concerns about potentially large exchange rate adjustments given their increasing exposure to commodity price volatility.

- The authorities agreed that upward pressures on the kip are likely to continue, but had no intention to intervene. Most private foreign exchange transactions are channeled through one of the major SOCBs, and the BoL sets reference rates based on the market clearing rate of the previous day. The authorities are, however, committed to develop a well functioning interbank foreign exchange market and will take steps to build up the BoL's intervention capacity for smoothing purposes.

B. Ensuring an Appropriate and Transparent Use of Resource Revenues

18. **The current fiscal regimes for the resource sector have several sound features, but some improvements are needed to align them to best international practices.**[6]

- Staff stressed the importance of developing a transparent and standardized fiscal regime across concessions. A predictable framework that ensures a level playing field is key to attract investor interest. Most existing concessions have been negotiated on a case-by-case basis without full disclosure of fiscal terms, complicating fiscal administration and giving rise to governance concerns. The authorities broadly agreed with staff, but noted they had limited technical capacity to change the system. While a comprehensive framework is developed, staff suggested to adhere to the IMF's Guidelines on Resource Revenue Management and participate in the Extractive Industries Transparency Initiative.

---

[6] See accompanying Selected Issues Paper, Chapter II.

- Staff also suggested that the authorities take a fresh look at the pros and cons of taking equity stakes in resource projects. Direct participation could become costly given the financial risks associated to resource sector activities, and give rise to a conflict of interest between the government's dual role as regulator and as shareholder. Staff noted that taxation can be designed to generate equivalent and more predictable revenues than dividends, and depending on the design, they could even collect revenues before the activities start generating profits. The authorities noted that the decisions to acquire equity stakes had been done mainly at the request of their investment partners, and should not be read as the government's general policy. They agreed to continue the dialog and seek expert assistance.

- Regarding the utilization of resource revenues, the authorities are considering ways to set aside for future use some of the resource revenues. The use of a reserve fund could be considered provided that (i) the size of the contributions and the conditions for the withdrawals from a fund be decided within an integrated medium-term fiscal framework; (ii) all expenditures are on-budget; and, (iii) there are clear operating rules for the fund that ensure transparency, good governance, and proper accountability.

C. Accelerating Banking and SOE Reform and Broadening the Sources of Growth

19. **A sound and competitive banking system is key to support long-term growth.** Full implementation of the new banking legislation should intensify competition by leveling the playing field and facilitating new entry. It is therefore important that relevant implementing regulations be in place, that the system be in good health, and the supervisory and regulatory framework be effective and strictly enforced.

- **Bank soundness.** There is a need to assess the soundness of the banking system. Efforts to develop standard soundness indicators should be expedited, and preparatory work for an eventual Financial Sector Assessment Program (FSAP) initiated. However, limited information available indicates that the restructuring of the two major SOCBs.(that share about 55 percent of the market) needs to be accelerated. These banks still carry sizable NPLs, have negative capital, and are heavily exposed to foreign exchange risk. The authorities expect to conclude their restructuring by 2010. In their view SOCBs are making gradual but firm progress, as evidenced by their very low NPLs and rising profitability of new lending operations.

- **Regulation and supervision.** Prudential requirements are broadly in line with the Basel I guidelines, but some regulations lack clear definitions and important regulatory concepts. There is also a need to improve enforcement and avoid forbearance, particularly for SOCBs. Most commercial banks are not complying with foreign currency exposure limits. The anti-money laundering decree was approved in March 2006, but full implementation is constrained by the lack of an operational financial intelligence unit. BoL officials indicated that the system health was generally satisfactory, except for a very small bank which was experiencing some problems, and that they were currently working on strengthening the regulations.

20. **Further progress in SOE reform is essential to strengthen the banking sector.** Staff recognizes the importance of having turned around the combined financial outcome of the largest SOEs under restructuring. The authorities and the staff agreed that closer attention should be paid to those enterprises that still have a relatively weak financial situation or are highly leveraged. While noting that reliance on subsidies has virtually stopped and requests for sovereign guarantees have become less common, staff advised that any future budgetary support be limited and conditional on a viable business plan.

21. **Promoting broad-based growth will require significant improvements in the investment climate and expanded regional and global market opportunities.**

- **Investment climate.** The NSEDP clearly identifies the need for improving the legal and regulatory framework to help promote private sector initiative and attract FDI. The strategy, the approval of the enterprise law, and some of the steps taken (such as accelerating investment approval and maintaining an active dialog with the private sector) are in the right direction. However, it is clear that more needs to be done to reduce the cost of doing business, enhance transparency, and combat corruption.

- **Trade integration.** Staff encouraged the government to continue WTO accession efforts. It will also be important to start acting on the trade reform areas identified in the Diagnostic Trade Integration Study, such as simplifying lengthy procedures for starting business and acquiring business property, eliminating redundant trade licensing, and streamlining the customs clearance process.

V. Staff Appraisal

22. **Lao P.D.R.'s recent economic performance and progress in reducing poverty have been impressive, but the economic reform record is mixed.** Favorable export commodity prices and a rapidly growing resource sector have boosted growth and strengthened the balance of payments. The resource bonanza has induced an appreciation of the kip, which together with a prudent fiscal policy has helped contain demand pressures and lower inflation to historical lows. There has been some progress in banking and SOE reform and some steps taken to improve the investment climate. But there have also been significant delays in implementing key strategies and laws which would have advanced economic reform further.

23. **The economic outlook is promising**, but it will require that the authorities take measures to maintain stability and accelerate the reform effort before the "resource curse" sets in. Such a proactive policy response would also help mitigate the various risks to the outlook, including that of debt distress.

24. **Staff supports the authorities' commitment to fiscal consolidation and debt sustainability over the medium term.** However, the 2007/08 budget, if fully implemented, would be inconsistent with the government's medium-term objectives. Staff believes there is room to contain expenditures and would strongly encourage the authorities to identify appropriate measures to return to the recent path of fiscal prudence. Looking ahead, a timely introduction of the VAT and a review of the tax system, coupled with stepped-up efforts to improve revenue administration, expenditure management, and intergovernmental fiscal relations, should help pave the way for fiscal consolidation. Expenditure decisions need to be taken within an integrated medium-term fiscal framework that makes explicit a deficit reduction path and takes into account the volatility and uncertainties of projected resource revenues. Given that Lao P.D.R. continues to face a risk of debt distress, it will be essential that, in addition to firmly pursuing fiscal consolidation, future external financing should continue to rely on grants and concessional loans.

25. **Expert advice is urgently required to develop a sound and transparent resource management framework.** To maximize resource rents, the authorities should weigh the benefits of direct and effective resource taxation versus equity participation. It would also be advisable to save some of the resource revenues until an integrated fiscal framework is available.

26. **The ongoing rapid monetary expansion warrants a tight control of BoL NDA and bank credit to the private sector.** The BoL's liquidity management tool kit needs to be upgraded. An early introduction of a standing deposit facility could usefully precede the introduction of open market operations using treasury bills. Steps should also be taken to develop the interbank money market and mechanisms to avoid quasi-fiscal costs of managing liquidity.

27. **The current exchange rate policy has served Lao P.D.R. well and the nominal exchange rate is in line with macroeconomic fundamentals.** Staff welcomes the authorities' intention to let the kip reflect market conditions and share their concern about the risk of large exchange rate fluctuations. Building the BoL's capacity to smooth fluctuations, developing a well-functioning foreign exchange market, and strengthening reserves further should help manage such risks. However, this should not be taken as a substitute for pursuing sound policies and deepening reform to reduce external vulnerabilities.

28. **There has been some progress in banking and SOE reform but a renewed impetus is required.** Besides ensuring full banking law implementation and strictly enforcing a strengthened regulatory framework, the recapitalization of SOCBs needs to be expedited, including by involving strategic investors. Deepening SOE restructuring will also help strengthen the banking sector. Extension of public guarantees on SOEs' borrowing should be conditional on demonstrable and viable business plans.

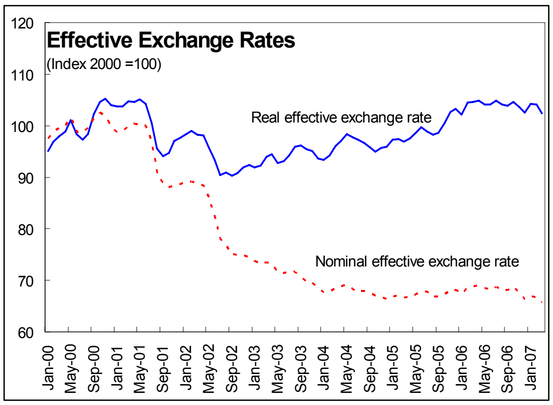
29. **Enhancing trade integration and improving the investment climate will help raise and sustain broad-based growth.** In particular, the preparations to join WTO should be sustained. However, reaping the full benefits of trade integration will require more efforts to reduce the high cost of doing business and improve the business climate more generally.

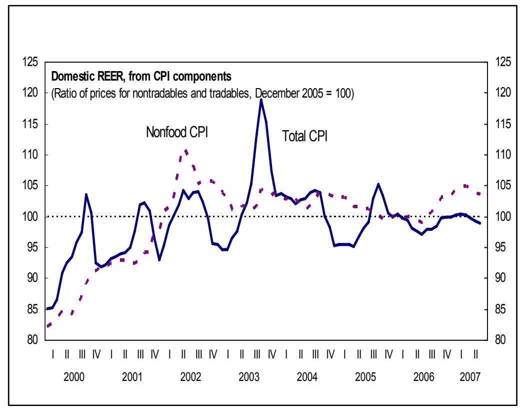
30. **The macroeconomic and financial data need to be improved to support policy decision making and effective surveillance.** Priority should be assigned to improving the compilation of the balance of payments, broadening the coverage of external debt, and preparing and disseminating bank soundness indicators. Closer interagency cooperation would be advisable.

31. **It is recommended that the next Article IV consultation with Lao P.D.R. take place on the standard 12-month cycle.**

Box 1. Competitiveness

Real effective exchange rate (REER) developments in recent years have not affected competitiveness significantly. Following a long upward trend, the trade-weighted REER remained broadly stable in 2006. The relative price of nontradables and tradables (domestic REER) has also fluctuated within a narrow range in recent years. Against this backdrop, non-resource exports have grown on average by 8 percent per year since 2001. During the same period, garment exports, the most important non-resource exports, have maintained their market share in EU countries, a key destination.





The impact of the real appreciation on exports has been mitigated by several factors. First, the bulk of Lao P.D.R.'s exports are commodities that are not too sensitive to exchange rate fluctuations because of their low domestic cost components. Second, there is a high degree of dollarization. Finally, garments exports have managed to maintain its market share because of EU preferential treatment.

On the cost side, the non-resource sector has benefited from low labor costs but confronts a high cost of doing business and poor governance.

- Average wages are flexible and the lowest in the region.
- Lao P.D.R. ranks very low in the World Bank's 2006 *doing business indicators* (No. 159 among 175 countries), trailing regional countries in almost all subcategories. In particular, starting up a business takes more than three times the regional average, while securing property rights takes twice. Lao P.D.R. ranks equally poorly in the Heritage Foundation's Index of Economic Freedom (No. 140 among 157 countries). Furthermore, Lao P.D.R.'s ranking in the Corruption Perception Index by the Transparency International deteriorated to No. 111 in 2006 from No. 77 in 2005.

Annual salary in US$ (2006)	
Factory worker	
Malaysia	3,910
Philippines	3,721
Thailand	3,686
China	2,795
Indonesia	2,793
India	2,728
Vietnam	1,109
Lao P.D.R.	700-750

Sources: Nikkei Asia and Nikkei Research and staff estimates.

Box 2. Alternative Policy-Response Scenarios

Proactive policy response. The government smoothes spending and saves a large portion of resource revenues for future use, while pursuing fiscal consolidation of the non-resource budget. It also continues to make efforts to mobilize non-resource revenues to compensate a loss in mineral revenues following the depletion of proven reserves, and optimizes the generation of resource revenues. Prudent fiscal policy stance, together with an enhanced BoL capacity to conduct monetary policy, help contain the monetary impact of rising resource external surpluses. Inflationary pressures are subdued and the real exchange rate appreciates only moderately. The prevailing macroeconomic stability, coupled with improvements in the investment climate, including banking and SOE reform, as envisaged in the NSEDP, raises private investment contributing to higher non-resource exports and output growth. As a result, GDP annual growth stabilizes at around 6½ percent while inflation stays below 5 percent.

Key Macroeconomic Assumptions: Proactive Scenario

	2002–06 Average	2007–12 Average	2013–27 Average
Real GDP growth (percent)	6.6	7.2	6.4
Inflation (percent)	10.1	4.4	4.5
Exports growth (percent)	20.6	10.6	11.2
Revenue (percent GDP)	11.8	13.4	13.7
Primary deficit (percent GDP)	2.6	-0.1	1.3
Grant element of new borrowing	...	41.1	43.7

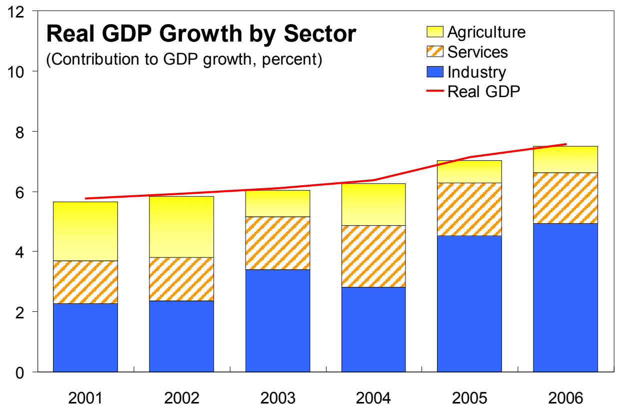
Reactive policy response. The government spends all revenues attending to urgent domestic expenditures, keeping its net position with the banking system unchanged. The BoL takes time in developing monetary management tools and inflationary pressures emerge, exacerbating the appreciation of the exchange rate and adversely affecting the competitiveness of non-resource exports. Efforts to enhance the business environment advance only gradually and SOCBs and SOEs continue fragile posing a fiscal risk. GDP growth initially increase to nearly 8 percent, buoyed by higher consumption stimulated by government expenditures. Soon thereafter, however, non-resource exports start to weaken, and the BoL loosens monetary policy in an attempt to counter declining activity and maintain consumption. The government continues to borrow externally, while avoiding recourse to domestic financing. After an initial rapid growth, real GDP decelerates to 4–5 percent.

Key Macroeconomic Assumptions: Reactive Scenario

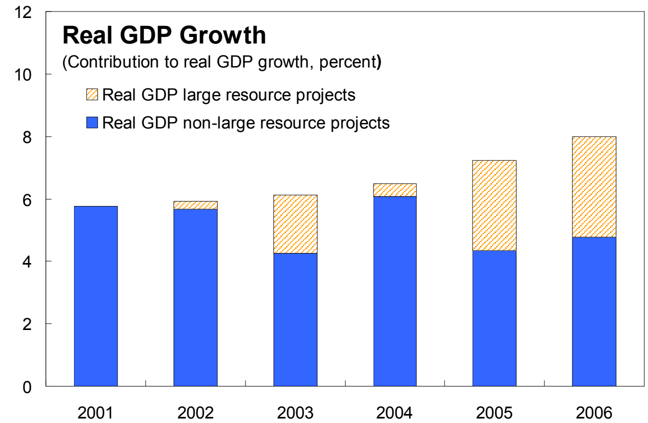
	2002–06 Average	2007–12 Average	2013–27 Average
Real GDP growth (percent)	6.6	6.3	4.5
Inflation (percent)	10.1	7.3	9.0
Exports growth (percent)	20.6	8.7	7.6
Revenue (percent GDP)	11.8	12.6	9.9
Primary deficit (percent GDP)	2.6	0.9	2.8
Grant element of new borrowing	...	41.1	42.3

Figure 1. Lao P.D.R.: Real Sector Developments

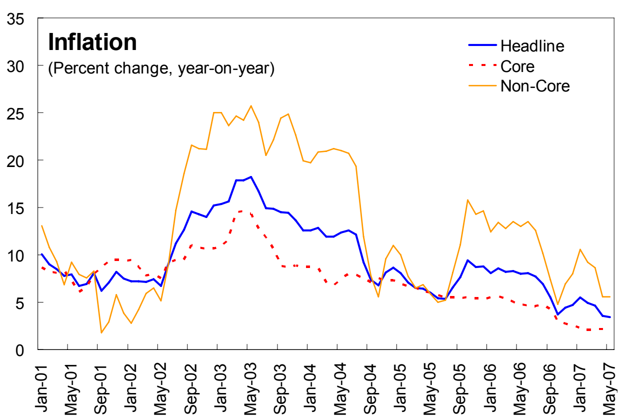
Growth has been robust...



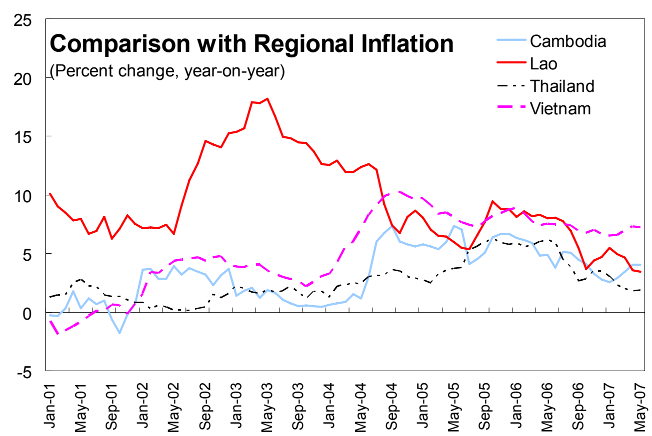
... largely driven by the resource sector.



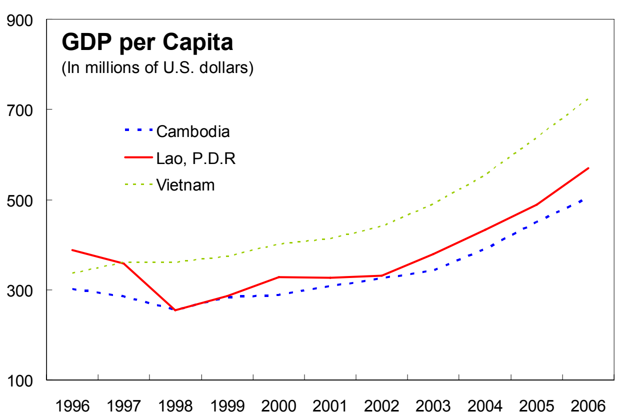
Inflation has declined...



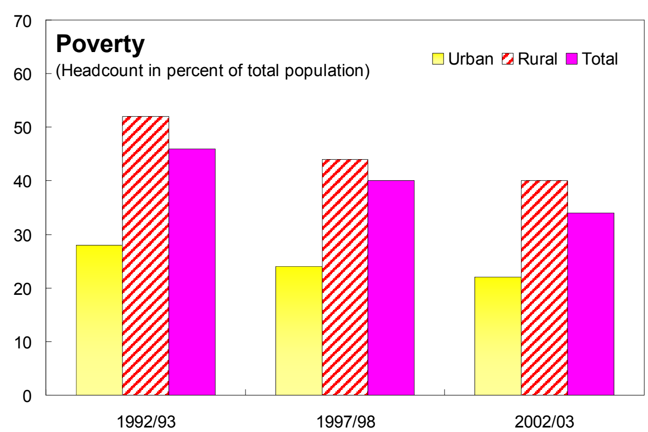
... but remains higher than Thailand.



GDP per capita has been rising...



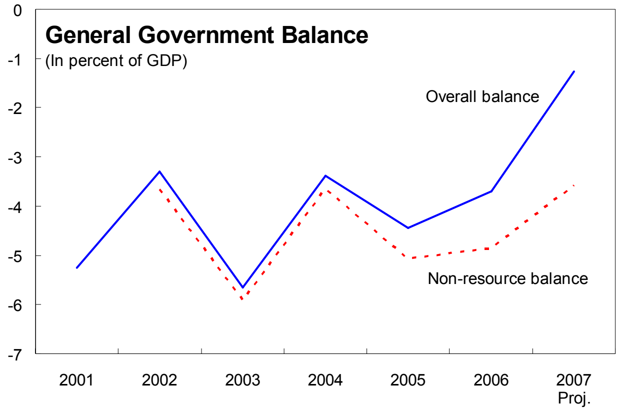
... and the overall poverty declined, although rural poverty remains high.



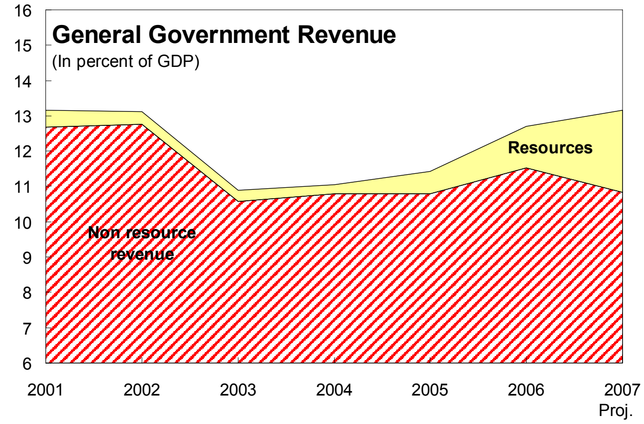
Sources: Lao P.D.R. authorities; and Fund staff estimates.

Figure 2. Lao P.D.R.: Fiscal and Monetary Developments

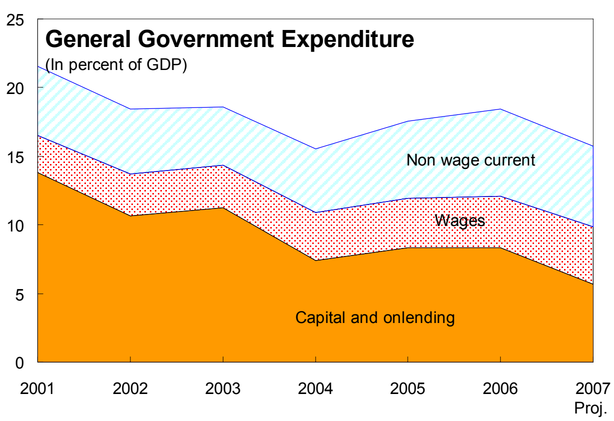
Fiscal deficit has declined...



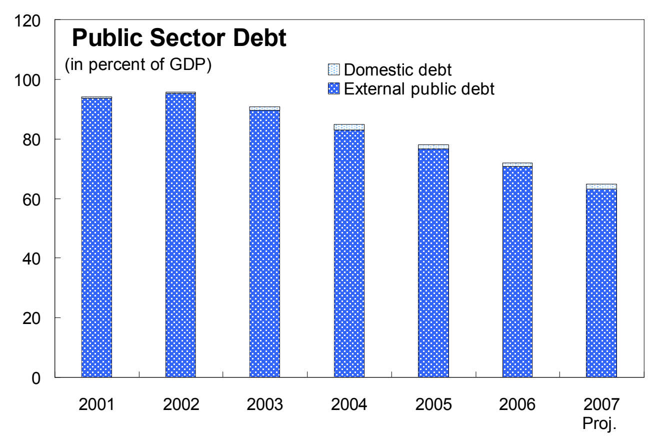
... owing to rising resource revenues...



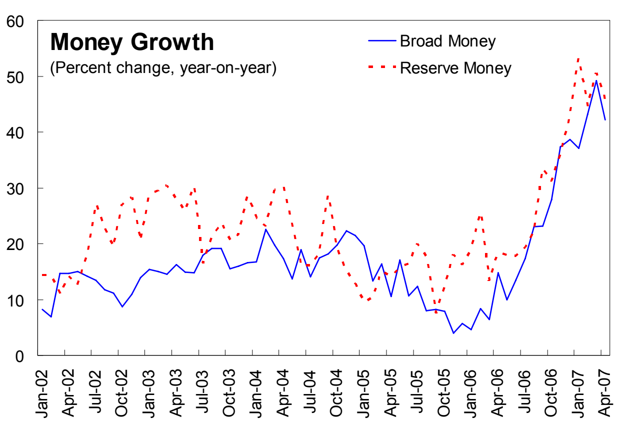
... and contained expenditure.



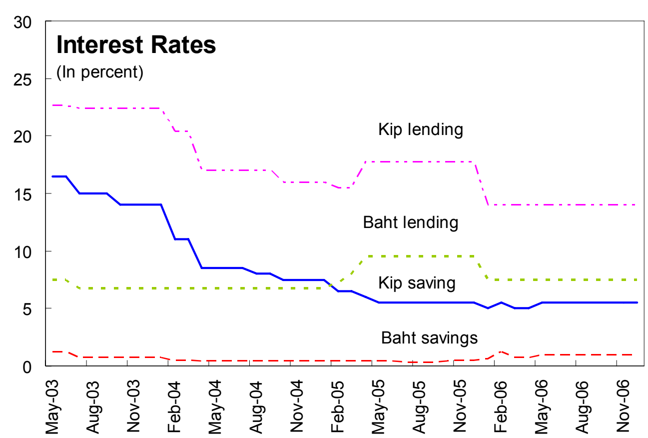
Public sector debt is on a declining trend.



Money growth has accelerated,



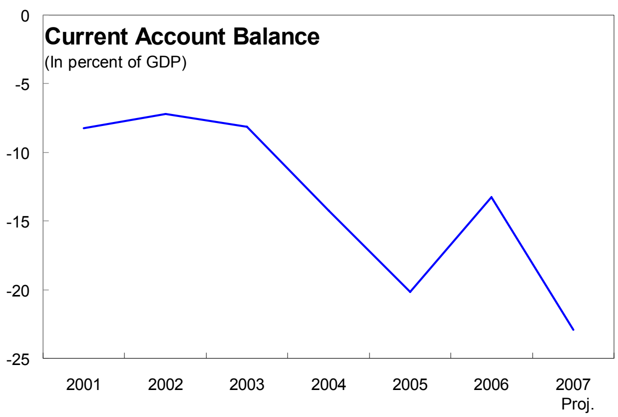
... while interest rates have remained stable.



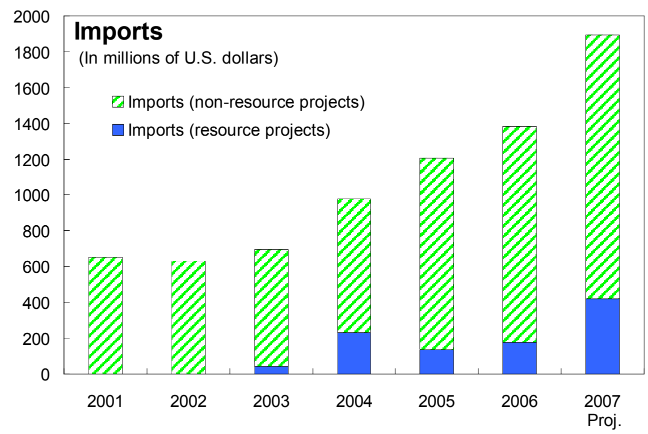
Sources: Lao P.D.R. authorities; and Fund staff estimates.

Figure 3. Lao P.D.R.: External Sector Developments

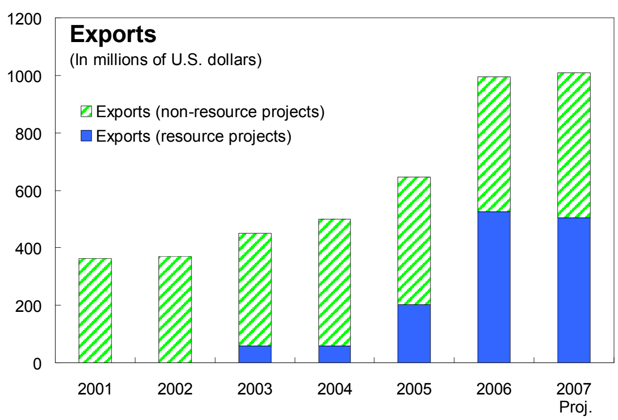
The current account deficit remains sizeable ...



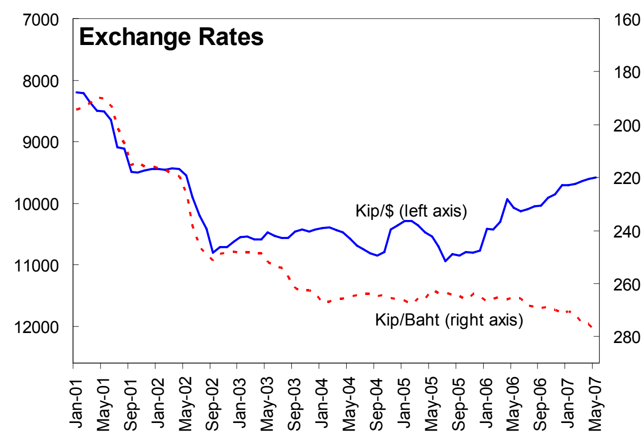
... due to a large increase in imports, mainly from the resource sector.



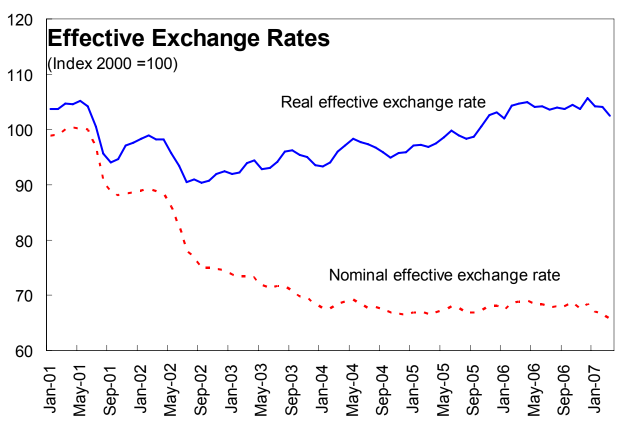
Exports have also grown strongly.



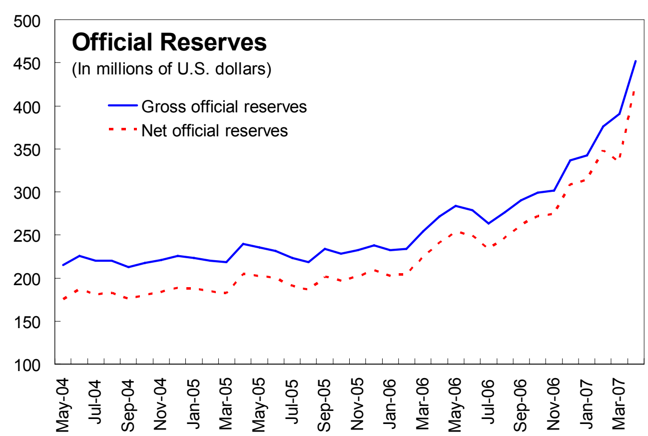
The Kip has appreciated against the U.S. dollar, but depreciated against the Thai baht...



... but the real exchange rate has stabilized after months of appreciation.



Official reserves have risen strongly.



Sources: Lao P.D.R. authorities; and Fund staff estimates.

Table 1. Lao P.D.R.: Selected Economic and Financial Indicators, 2003–07

Nominal GDP (2006 est.): $3,437 million
Population (2006 est.): 6.0 million
GDP per capita (2006 est.): $ 572.8

	2003	2004	2005	2006 Staff est.	2007 Staff proj.
GDP and prices (percentage change)					
Real GDP growth	6.1	6.4	7.1	7.6	7.1
CPI (annual average)	15.5	10.5	7.2	6.8	4.0
Public finances (in percent of GDP) 1/					
Revenue	10.9	11.0	11.4	12.7	13.2
Grants	2.1	1.1	1.7	2.1	1.3
Expenditure	18.6	15.5	17.5	18.5	15.7
Overall balance (including grants)	-5.6	-3.4	-4.4	-3.7	-1.3
Domestic financing	0.4	-0.2	0.2	-1.3	-1.3
External financing	5.1	3.6	4.2	5.0	2.5
Money and credit (annual percent change) 2/					
Reserve money	28.5	12.9	17.6	38.2	20.4
Broad money	15.5	21.5	7.7	30.1	24.8
Bank credit to the economy 3/	1.3	12.6	26.8	4.2	16.0
Interest rates (end-of-period)					
On three-month kip deposits	14.0	7.5	5.5	5.5	...
On short-term kip loans	22.4	16.0	17.8	14.0	...
Balance of payments					
Exports (percent change)	21.6	11.0	29.4	54.1	1.3
Imports (percent change)	9.6	40.9	23.4	14.8	37.0
Trade balance (in percent of GDP)	-11.3	-19.0	-19.4	-11.3	-22.1
Current account balance (in percent of GDP)	-8.1	-14.3	-20.2	-13.3	-22.9
Gross official reserves (in millions of U.S. dollars)	214	226	238	336	437
(In months of prospective goods and services imports) 4/	3.2	3.0	2.8	3.6	4.3
(In percent of short-term debt)	305.1	277.2	180.9	225.4	334.5
External public debt and debt services					
External public debt (in percent of GDP)	89.1	83.2	77.1	69.0	63.0
Net present value of debt (in percent of exports)	204.6	198.9	168.9	134.5	140.4
External public debt services (in percent of exports)	6.7	7.5	7.7	4.0	6.1
Exchange rate					
Official exchange rate (kip per dollar; end-of-period)	10,434	10,357	10,767	9,655	...
Nominal effective exchange rate (2000=100)	71.6	67.7	67.3	68.6	...
Real effective exchange rate (2000=100)	94.1	96.1	99.1	104.5	...
Memorandum item:					
Nominal GDP (calendar year; in billions of kip)	22,597	26,539	30,705	34,581	38,569

Sources: Data provided by the Lao P.D.R. authorities, and Fund staff estimates and projections.

1/ Fiscal year basis (October to September).
2/ Money and credit data are evaluated at current exchange rates.
3/ Excluding debt write-offs.
4/ Excludes imports associated with large resource projects.

Table 2. Lao P.D.R.: Balance of Payments, 2003–08

	2003	2004	2005	2006	2007	2008	
				Est.	Staff proj.	Staff projections	
						Proactive	Reactive
	(In millions of U.S. dollars, unless specified otherwise)						
Current Account	-175	-358	-582	-456	-918	-950	-965
Excluding official transfers	-237	-417	-639	-567	-998	-1,027	-1,033
Merchandise trade balance	-244	-478	-559	-388	-887	-915	-934
Exports, f.o.b.	450	500	646	996	1,009	1,198	1,182
Mining and hydro exports	147	149	310	632	612	765	765
Of which: mining projects	60	58	203	525	505	661	661
hydropower projects	87	91	107	107	107	104	104
Other exports	303	351	337	364	397	434	418
Imports, c.i.f.	694	977	1,206	1,384	1,896	2,113	2,116
Of which: mining projects	45	232	139	176	420	472	472
hydropower projects	0	0	215	271	445	507	507
Services (net)	95	132	161	171	196	216	219
Of which: tourism	84	119	150	160	185	205	208
Income (net)	-113	-98	-269	-409	-371	-398	-398
Interest payments	-38	-54	-106	-94	-117	-120	-120
Of which: public	-15	-27	-31	-24	-34	-36	-36
Of which: mining projects	0	-6	-11	-10	-7	-5	-5
hydropower projects	0	0	-45	-43	-61	-72	-72
Dividends and profit repatriation	-78	-56	-179	-344	-289	-318	-318
Of which: mining projects	-34	-7	-36	-201	-146	-164	-164
hydropower projects	0	0	0	0	0	0	0
Other	3	12	16	29	35	40	40
Transfers (net)	86	85	85	170	144	147	147
Private	24	26	28	59	64	69	79
Official	62	60	57	111	80	78	68
Capital Account	197	376	599	556	1,022	1,014	1,006
Public sector	118	118	115	164	152	120	120
Disbursements	146	147	156	195	202	187	187
Amortization	-28	-29	-41	-31	-50	-67	-67
Banking sector (net)	-21	-39	22	-93	-50	-81	-40
Private sector	100	297	462	485	920	975	926
Foreign direct investment (net) 1/	42	234	349	319	842	895	855
Of which: mining projects	30	198	44	-48	180	184	184
hydropower projects	0	0	265	325	557	621	621
Other private flows and errors and omissions	58	63	113	166	78	80	71
Overall balance	22	19	17	99	104	64	41
Financing	-22	-19	-17	-99	-104	-64	-41
Central bank net foreign assets	-22	-19	-17	-99	-104	-64	-41
Assets (increase -)	-18	-12	-11	-98	-100	-60	-37
Liabilities (reduction -)	-4	-6	-6	-1	-3	-4	-4
Memorandum items:							
Current account (percent of GDP)	-8.1	-14.3	-20.2	-13.3	-22.9	-21.1	-20.8
(excluding official transfers)	-11.0	-16.6	-22.1	-16.5	-24.9	-22.8	-22.2
Resource current account (percent of GDP)	3.2	-3.8	-4.7	-2.0	-11.7	-10.1	-9.8
Non-resource current account (percent of GDP)	-11.3	-10.5	-15.4	-11.3	-11.2	-10.9	-11.0
Resource balance of payments (percent of GDP)	4.6	4.1	5.9	6.0	6.7	7.7	7.5
Non-resource balance of payments (percent of GDP)	-3.5	-3.3	-5.4	-3.1	-4.1	-6.3	-6.6
Official gross reserves (in millions of USD)	214	226	238	336	437	497	473
(In months of imports, excluding large projects)	3.2	3.0	2.8	3.6	4.3	4.5	4.3
Nominal GDP at market prices (in millions of USD)	2,149	2,508	2,887	3,437	4,008	4,509	4,646

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates and projections.
1/ Including repayment of private debt.

Table 3. Lao P.D.R.: General Government Operations, 2002/03–2007/08

	2002/03	2003/04	2004/05	2005/06	2006/07		2007/08		
	Staff est.				Budget	Staff proj.	Budget	Staff proj.	
							preliminary	Reactive	Proactive
	(In percent of GDP)								
Revenue and grants	13.0	12.1	13.1	14.8	14.2	14.5	14.8	14.2	14.5
Revenue	10.9	11.0	11.4	12.7	12.4	13.2	13.4	13.2	13.4
Tax	8.9	9.1	9.4	10.8	10.8	11.5	11.8	11.6	11.8
Of which: Non-renewable resources1/	0.1	0.1	0.3	0.9	1.8	2.1	2.6	2.4	2.4
Of which: Renewable resource 1/	0.2	0.1	0.3	0.3	0.3	0.2	0.3	0.2	0.2
Of which: Non resource revenue	8.6	8.9	8.8	9.7	8.7	9.2	9.0	9.0	9.2
Nontax	1.9	1.9	2.0	1.9	1.6	1.7	1.6	1.6	1.6
Grants	2.1	1.1	1.7	2.1	1.8	1.3	1.3	1.0	1.1
Expenditure	18.6	15.5	17.5	18.5	17.8	15.7	17.5	16.3	15.1
Total domestically-financed expenditure	11.6	11.0	12.4	12.6	11.5	11.3	12.2	12.4	11.1
Current	7.1	7.2	8.5	9.3	9.5	9.5	9.9	10.3	9.2
Wages, salaries, and benefits	3.1	3.5	3.6	3.8	4.1	4.2	4.5	4.6	4.0
Transfers	1.6	1.2	1.7	2.0	2.3	2.3	2.4	2.4	2.2
Interest payments	0.6	0.9	1.1	0.8	1.0	0.7	0.8	0.7	0.7
Other recurrent	1.8	1.5	2.1	2.7	2.1	2.3	2.1	2.5	2.3
Capital and onlending	11.0	6.4	7.6	7.5	7.4	5.2	6.4	5.1	5.0
Domestically financed	4.8	2.3	1.6	1.2	1.4	1.4	1.6	1.7	1.5
Externally financed	7.0	4.6	5.2	5.8	6.4	4.4	5.3	3.9	4.0
Onlending (net) 2/	-0.7	-0.5	0.9	0.5	-0.4	-0.6	-0.4	-0.5	-0.5
Others and contingencies 3/	0.6	0.9	1.2	1.0	1.0	1.0	1.2	0.9	0.9
Discrepancy including unidentified expenditure	-0.1	1.0	0.3	0.6	0.0	0.0	0.0	0.0	0.0
Overall balance	-5.6	-3.4	-4.4	-3.7	-3.7	-1.3	-2.7	-2.1	-0.6
Non-resource current balance 4/	5.0	3.8	2.8	3.3	1.6	1.6	0.9	0.4	1.7
Non-resource balance 4/	-5.9	-3.6	-5.1	-4.9	-5.7	-3.6	-5.6	-4.7	-3.2
Financing	5.6	3.4	4.4	3.7	3.7	1.3	2.7	2.1	0.6
Domestic financing (net) 5/	0.4	-0.2	0.2	-1.3	-0.1	-1.3	-0.4	0.0	-1.6
Foreign financing (net)	5.1	3.6	4.2	5.0	3.7	2.5	3.1	2.1	2.2
Disbursements	6.1	4.5	5.2	5.9	4.8	3.8	4.1	3.5	3.6
Amortization	-0.9	-0.9	-1.0	-0.9	-1.1	-1.2	-0.9	-1.4	-1.4
	(In percent of non-resource GDP)								
Non-resource tax and nontax revenue	10.7	11.0	11.3	12.4	...	11.9	...	11.9	12.1
Total domestically-financed expenditure	11.8	11.2	12.9	13.5	...	12.4	...	13.9	12.4
Non-resource current balance	5.1	3.9	2.9	3.5	...	1.8	...	0.4	1.9
Non-resource balance	-6.0	-3.7	-5.3	-5.2	...	-3.9	...	-5.3	-3.6
Memorandum items:									
GDP (in billions of kip)	21,548	25,553	29,663	33,612	37,926	37,572	43,288	42,714	42,154
Growth rate (percent)	21.6	18.6	16.1	13.3	14.5	11.8	14.1	13.7	12.2
Exchange rate (kip per US dollar)	10,576	10,560	10,571	10,310	...	9,666	...	9,543	9,615
Wages and salaries (in percent of non-resource revenue	29.3	32.6	32.1	31.8	...	37.5	...	43	36.0
Total aid (in millions of US dollars)	167	136	188	234	259	197	233	203	203
Project aid	142	111	174	202	250	170	228	174	174
Program aid	25	25	14	32	9	27	5	29	29
Resource revenue saving ratio (percent) 6/	-142.0	89.0	-33.8	109.6	3.5	54.5	14.8	0.0	58.7

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates and projections.

1/ Non-renewable resource: royalties and taxes from mining; renewable resource: those from hydro-power.
2/ Includes the government NT2 equity purchase.
3/ Includes payments on liabilities carried in from the previous budget years and arrears clearance.
4/ Current and overall balance net of resource revenues.
5/ Excludes bank restructuring bonds.
6/ (Negative) domestic financing divided by resource revenue.

Table 4. Lao P.D.R.: Monetary Survey, 2003–07 1/

(In billions of kip, unless otherwise indicated)

	2003	2004	2005	2006				2007		
	Dec.	Dec.	Dec.	Mar.	Jun.	Sept.	Dec.	Mar.	Apr.	May
Bank of Lao P.D.R.										
Net foreign assets	1,835	2,031	2,211	2,406	2,644	2,856	3,273	3,938	4,505	4,620
(In millions of U.S. dollars)	173	192	209	227	249	269	309	372	425	436
Net domestic assets	-456	-475	-403	-523	-674	-650	-691	-1,102	-1,599	-1,654
Government (net)	-379	-456	-423	-423	-579	-457	-342	-724	-1,207	-1,242
Economy	685	738	348	325	296	270	269	257	258	259
Banks	138	131	222	140	177	147	144	160	165	163
BoL securities	-46	0	0	0	0	0	0	0	0	0
Other items (net)	-854	-889	-550	-565	-567	-610	-763	-795	-814	-833
Reserve money	1,379	1,556	1,808	1,883	1,970	2,206	2,581	2,836	2,906	2,966
Currency in circulation	262	511	805	855	782	849	1,231	1,389	1,345	1,369
Bank reserves (kip)	319	213	217	237	317	430	421	384	454	468
Bank reserves (foreign currency)	798	832	787	791	871	927	930	1,063	1,107	1,129
Monetary survey										
Net foreign assets	2,773	3,381	3,329	3,566	3,629	4,153	5,380	6,438	7,267	7,253
(In millions of U.S. dollars)	262	319	314	336	342	392	508	607	686	684
Net domestic assets 2/	1,400	1,688	2,027	2,093	2,159	2,168	2,048	2,004	1,067	1,078
Government (net)	-136	-215	-179	-174	-338	-343	-167	-413	-962	-1,019
Budget	-346	-462	-426	-549	-784	-790	-614	-860	-1,410	-1,466
Other	210	246	246	375	446	447	447	447	447	447
Credit to the economy	2,480	2,705	2,836	2,932	3,139	3,100	2,795	2,596	2,622	2,683
Excluding debt write-offs	2,112	2,337	2,468	2,564	2,771	2,732	2,795	2,596	2,622	2,683
Other items (net)	-944	-802	-630	-665	-642	-589	-579	-179	-592	-587
Broad money	4,173	5,068	5,356	5,659	5,788	6,321	7,429	8,442	8,334	8,331
Currency outside banks	262	511	805	855	782	849	1,231	1,389	1,345	1,369
Kip deposits	1,244	1,435	1,453	1,450	1,490	1,549	1,712	1,870	1,868	1,887
Foreign currency deposits	2,667	3,122	3,099	3,354	3,516	3,923	4,486	5,183	5,121	5,075
	(Percent change at constant exchange rates)									
Reserve money	28.5	12.8	16.2	13.3	17.9	33.5	42.8	50.6	45.7	47.1
Kip reserve money	92.2	24.6	41.1	30.7	30.6	46.2	61.7	62.3	58.7	67.2
Broad money	16.6	21.5	5.7	6.4	13.5	23.1	38.7	49.2	42.1	43.5
Kip broad money	37.8	29.2	16.0	9.1	11.7	15.9	30.4	41.4	38.4	46.9
Credit to the economy excluding debt write-offs 2/	2.7	12.6	5.7	2.6	20.1	5.8	13.2	1.2	-4.0	-1.2
	(Percent change at current exchange rates)									
Reserve money	28.5	12.9	17.6	13.1	15.4	29.9	38.2	47.7	44.2	45.3
Broad money	15.5	21.5	7.7	5.8	9.5	17.2	30.1	43.1	38.5	39.3
Credit to the economy excluding debt write-offs 2/	1.3	12.6	26.8	17.4	13.8	-1.7	4.2	-3.2	-5.8	-3.9
Memorandum items:										
Credit to the economy (In percent of GDP)	11.0	10.2	9.2	8.5	9.1	9.0	8.1	6.7	6.8	6.9

Sources: Data provided by the Lao P.D.R authorities; Fund staff estimates and projections.

1/ All figures evaluated at constant exchange rate, unless otherwise indicated.

2/ Adjusted for the impact of debt write-offs and Debt Clearance/Bank Recapitalization Bonds.

Table 5. Lao P.D.R.: Summary Macroeconomic Framework (Proactive Scenario), 2005–12

	2005	2006	2007	2008	2009	2010	2011	2012
	Staff est.		Staff proj.					
Output and prices (percent change, unless otherwise indicated)								
Real GDP	7.1	7.6	7.1	7.6	8.2	7.6	6.2	6.4
(Excluding resources)	4.3	4.8	5.1	5.0	5.1	5.3	5.4	5.7
GDP per capita (in millions of US dollars)	489	570	653	721	798	880	958	1,045
CPI (annual average)	7.2	6.8	4.0	4.5	4.5	4.5	4.5	4.5
Savings and investment balance (in percent of GDP) 1/								
Gross fixed investment	32.6	32.5	42.1	41.0	35.7	30.3	24.7	21.5
Private	26.1	25.7	36.5	35.6	30.6	25.6	19.9	16.6
Government	6.5	6.8	5.6	5.4	5.0	4.7	4.8	4.9
Gross national savings	11.7	18.7	18.3	19.3	19.5	19.8	19.9	20.1
Foreign savings (including official transfers)	20.9	13.8	23.8	21.7	16.2	10.5	4.8	1.4
Public finances (in percent of GDP) 2/								
Revenue	11.4	12.7	13.2	13.4	13.4	13.3	13.4	13.5
Grants	1.7	2.1	1.3	1.1	1.0	0.9	0.9	0.8
Expenditure	17.5	18.5	15.7	15.1	14.9	14.5	14.6	14.8
Of which: current	8.5	9.3	9.5	9.2	9.0	8.9	9.1	9.3
capital and onlending	7.6	7.5	5.2	5.0	4.7	4.4	4.5	4.6
Overall balance	-4.4	-3.7	-1.3	-0.6	-0.5	-0.3	-0.3	-0.5
Non-resource balance	-5.1	-4.9	-3.6	-3.2	-3.0	-2.6	-2.4	-2.3
Domestic financing	0.2	-1.3	-1.3	-1.6	-1.2	-1.1	-1.1	-0.9
Foreign financing	4.2	5.0	2.5	2.2	1.7	1.4	1.4	1.4
Balance of payments (in millions of U.S. dollars; unless otherwise indicated)								
Current account balance	-582	-456	-918	-950	-800	-584	-295	-98
In percent of GDP	-20.2	-13.3	-22.9	-21.1	-15.7	-10.2	-4.6	-1.4
Exports	646	996	1,009	1,198	1,276	1,538	1,639	1,813
Of which: resources	310	632	612	765	802	1,016	1,064	1,170
Imports	1,206	1,384	1,896	2,113	2,185	2,215	2,193	2,215
Of which: resources	355	447	865	979	952	864	681	549
Services and income (net)	-108	-238	-175	-182	-49	-76	79	113
Transfers	85	170	144	147	158	170	179	190
Capital account balance	599	556	1,022	1,014	869	664	391	205
Of which: private	484	391	870	894	765	567	280	78
Trade (in percent of GDP)								
Exports	22.4	29.0	25.2	26.6	25.1	26.9	25.8	25.7
Imports	41.8	40.3	47.3	46.9	42.9	38.8	34.6	31.4
External public debt and debt services								
External public debt (in percent of GDP)	77.1	69.0	63.0	58.6	54.0	49.8	46.6	43.7
Net present value of debt (in percent of exports)	168.9	134.5	140.4	127.2	124.5	110.1	107.6	102.4
External public debt services (in percent of exports)	7.7	4.0	6.1	6.5	6.6	5.8	5.6	5.3
Gross official reserves								
In millions of US dollars	238	336	437	497	561	635	726	830
In months of imports 3/	2.8	3.6	4.3	4.5	4.7	4.7	4.9	5.2
Memorandum items:								
Nominal GDP (in billions of kip)	30,705	34,581	38,569	43,349	48,920	54,962	60,985	67,805

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates and projections.

1/ Estimates for total investment are from National Statistical Center; and other indicators are estimated using data for public finances and balance of payments.
2/ Fiscal year basis (October to September).
3/ Excludes imports associated with large resource projects.

Table 6. Lao P.D.R.: Summary Macroeconomic Framework (Reactive Scenario), 2005–12

	2005	2006	2007	2008	2009	2010	2011	2012
		Staff est.			Staff proj.			
Output and prices (percent change, unless otherwise indicated)								
Real GDP	7.1	7.6	7.1	7.9	7.5	6.4	4.6	4.2
(Excluding resources)	4.3	4.8	5.1	5.3	4.4	3.9	3.5	3.0
GDP per capita (in millions of US dollars)	489	570	653	743	843	892	936	985
CPI (annual average)	7.2	6.8	4.0	6.2	7.3	8.5	9.0	9.0
Savings and investment balance (in percent of GDP) 1/								
Gross fixed investment	32.6	32.5	42.1	37.9	32.3	26.1	20.8	16.7
Private	26.1	25.7	36.5	32.4	27.7	21.9	16.8	12.8
Government	6.5	6.8	5.6	5.4	4.6	4.2	4.0	3.9
Gross national savings	11.7	18.7	18.3	16.3	16.4	15.1	14.9	13.8
Foreign savings (including official transfers)	20.9	13.8	23.8	21.5	15.9	11.0	5.9	2.9
Public finances (in percent of GDP) 2/								
Revenue	11.4	12.7	13.2	13.2	12.6	12.3	12.2	11.9
Grants	1.7	2.1	1.3	1.0	0.9	0.9	0.9	0.9
Expenditure	17.5	18.5	15.7	16.3	15.2	14.6	14.4	14.1
Of which: current	8.5	9.3	9.5	10.3	10.1	10.1	9.9	9.9
capital and onlending	7.6	7.5	5.2	5.1	4.3	3.9	3.8	3.6
Overall balance	-4.4	-3.7	-1.3	-2.1	-1.6	-1.4	-1.3	-1.3
Non-resource balance	-5.1	-4.9	-3.6	-4.7	-4.0	-3.6	-3.5	-3.3
Domestic financing	0.2	-1.3	-1.3	0.0	0.0	0.0	0.0	0.0
Foreign financing	4.2	5.0	2.5	2.1	1.6	1.4	1.3	1.3
Balance of payments (in millions of US dollars; unless otherwise indicated)								
Current account balance	-582	-456	-918	-965	-828	-628	-363	-192
In percent of GDP	-20.2	-13.3	-22.9	-20.8	-15.4	-10.8	-5.8	-2.9
Exports	646	996	1,009	1,182	1,233	1,460	1,522	1,641
Of which: resources	310	632	612	765	802	1,016	1,064	1,170
Imports	1,206	1,384	1,896	2,116	2,175	2,172	2,100	2,071
Of which: resources	355	447	865	979	952	864	681	549
Services and income (net)	-108	-238	-175	-178	-43	-86	51	63
Transfers	85	170	144	147	158	170	164	175
Capital account balance	599	556	1,022	1,006	840	582	315	149
Of which: private	484	396	870	886	736	485	211	37
Trade (in percent of GDP)								
Exports	22.4	29.0	25.2	25.4	22.9	25.2	24.6	24.7
Imports	41.8	40.3	47.3	45.5	40.5	37.5	33.9	31.2
External public debt and debt services								
External public debt (in percent of GDP)	77.1	69.0	63.0	56.9	51.1	49.1	47.7	46.4
Net present value of debt (in percent of exports)	169	135	140	128	127	115	116	114
External public debt services (in percent of exports)	7.7	4.0	6.1	6.5	6.7	6.0	6.1	5.9
Gross official reserves								
In millions of US dollars	238	336	437	473	480	429	376	329
In months of imports 3/	2.8	3.6	4.3	4.3	4.1	3.4	2.8	2.3
Memorandum items:								
Nominal GDP (in billions of kip)	30,705	34,581	38,569	44,096	51,101	58,994	67,258	77,077

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates and projections.

1/ Estimates for total investment are from National Statistical Center; and other indicators are estimated using data for public finances and balance of payments.
2/ Fiscal year basis (October to September).
3/ Excludes imports associated with large resource projects.

APPENDIX I: THE AUTHORITIES' RESPONSE TO RECENT FUND POLICY ADVICE

Advice from the 2005 Article IV Consultation	Actions Taken
Maintaining macroeconomic stability	
Ensure a sound budget framework for 2005/06.	Fiscal performance improved in 2005/06 with increased revenue and contained expenditure. However, higher wage growth, reflecting a wage hike, squeezed domestically-financed capital expenditure.
Make the expansion in civil service employment conditional on strengthened revenue mobilization.	Employment growth has been contained.
Continue to gear monetary policy toward reducing inflation.	BoL's net domestic assets have declined, partially offsetting the impact of reserves accumulation on rapidly rising monetary aggregates.
Reduce the exposure of state-owned commercial banks to a government-sponsored project.	State-owned commercial banks have reduced exposure to the project.
Public finance issues	
Introduce VAT.	VAT law was approved in 2006, and it is scheduled for introduction in late 2008.
Establish a strong tax and customs administration.	The government plans to centralize tax and customs administration.
Establish a strong national treasury.	A new Treasury decree was drafted with the aim of establishing a national treasury.
Review center-province relations.	Budget law was approved in 2006, and its operational details, including revenue and expenditure responsibilities, are under preparation.
Maximize grant financing and concessional borrowing.	The government intends to borrow commercially for a hydro project.
Structural issues	
Expedite the restructuring of the state-owned commercial banks.	Little progress. Only the first tranche of the recapitalization bonds has been issued, and there is no active search for strategic partners.
Strengthen the trade and investment climate.	Some progress in trade liberalization, but limited progress in improving the investment climate.
Improve the quality of economic statistics.	Some progress, but signified improvements required.

APPENDIX II. POVERTY INDICATORS

Table 1. Lao P.D.R.: Millennium Development Goals Indicators, 1990-2015

	1990	1995	1997	2001	2002	2003	2004	2005	2006	Latest Data	2015 **Target**
1 Eradicate extreme poverty and hunger				2015 target = halve 1990 $1 a day poverty and malnutrition rates							
Population below $1 a day (%)	53.0	..	38.4	31.3	28.1	25.8	..	..	..	25.8 (2003)	[26.5]
Poverty gap at $1 a day (%)	..	..	6.3	..	6.1	..	..	..	..	6.1 (2002)	
Percentage share of income or consumption held by poorest 20%	..	7.6	7.6	..	8.1	..	..	..	..	8.1 (2002)	
Prevalence of child malnutrition (% of children under 5)	..	40	..	40	..	..	..	..	..	40 (2001)	
Population below minimum level of dietary energy consumption (%)	29.0	28.0	28.0	22.0	..	22.0	..	..	..	22.0 (2003)	[14.5]
2 Achieve universal primary education				2015 target = net enrollment to 100							
Net primary enrollment ratio (% of relevant age group)	61.4	70.0	80.2	81.4	82.8	85.0	84.4	..	..	84.4 (2004)	[100]
Percentage of cohort reaching grade 5 (%)	53.3	55.4	54.3	62.3	64.1	62.6	..	..	..	62.6 (2003)	[100]
Youth literacy rate (% ages 15-24)	70.1	74.0	..	78.6	79.3	80.0	78.5	..	..	78.5 (2004)	[100]
3 Promote gender equality				2005 target = education ratio to 100							
Ratio of girls to boys in primary and secondary education (%)	75.3	77.8	81.1	82.0	..	83.1	..	..	..	83.1 (2003)	[100]
Ratio of young literate females to males (% ages 15-24)	76.2	80.1	..	90.4	..	..	90.0	..	..	90.0 (2004)	[100]
Share of women employed in the nonagricultural sector (%)	42.1	..	..	..	..	..	..	..	..	42.1 (1990)	
Proportion of seats held by women in national parliament (%)	6	9	9	21	21	23	23	23	23	23 (2006)	
4 Reduce child mortality				2015 target = reduce 1990 under 5 mortality by two-thirds							
Under 5 mortality rate (per 1,000)	163	134	..	105	100	91	83	..	..	83 (2004)	[54.3]
Infant mortality rate (per 1,000 live births)	120	105	..	90	87	82	65	..	..	65 (2004)	
Immunization, measles (% of children under 12 months)	32	68	67	50	55	42	36	..	..	36 (2004)	
5 Improve maternal health				2015 target = reduce 1990 maternal mortality by three-fourths							
Maternal mortality ratio (modeled estimate, per 100,000 live births)	650	650	..	650	..	..	..	..	..	650 (2001)	[162.5]
Births attended by skilled health staff (% of total)	..	..	..	19.4	..	..	..	..	..	19.4 (2001)	
6 Combat HIV/AIDS, malaria and other diseases				2015 target = halt, and begin to reverse, AIDS, etc.							
Prevalence rate of HIV, females (% ages 15-24)	..	..	..	0.1	..	0.1	..	..	..	0.1 (2003)	[0.0]
Contraceptive prevalence rate (% of women ages 15-49)	..	25.1	..	..	..	..	..	..	..	32.0 (2000)	
Number of children orphaned by HIV/AIDS	..	..	..	280	..	..	..	..	..	280 (2001)	
Incidence of tuberculosis (per 100,000 people)	..	..	166.7	161.8	..	157.2	..	..	..	157.2 (2003)	[0.0]
Tuberculosis cases detected under DOTS (%)	..	24.0	33.5	40.1	46.3	46.7	55.3	..	..	55.3 (2004)	
7 Ensure environmental sustainability											
Forest area (% of total land area)	56.7	..	..	54.4	..	..	69.9	..	..	69.9 (2004)	
Nationally protected areas (% of total land area)	..	..	..	16.0	16.0	16.0	16.0	16.0	..	16.0 (2003)	
GDP per unit of energy use (PPP $ per kg oil equivalent)	..	..	..	..	..	..	..	..	..	..	
CO2 emissions (metric tons per capita)	0.1	0.1	0.1	0.2	0.2	0.2	..	..	..	0.2 (2001)	
Access to an improved water source (% of population)	..	..	..	37.0	..	43.0	51.0	..	..	51.0 (2004)	[74]
Access to improved sanitation (% of population)	..	..	..	30.0	..	24.0	30.0	..	..	30.0 (2004)	[60]
Access to secure tenure (% of population)	..	..	..	..	..	..	..	..	..	..	
8 Develop a Global Partnership for Development											
Youth unemployment rate (% of total labor force ages 15-24)	..	5.0	..	..	..	..	..	..	..	5.0 (1995)	
Fixed line and mobile telephones (per 1,000 people)	1.6	3.9	6.1	15.2	21.2	32.0	48.2	..	..	48.2 (2004)	[Increase]
Personal computers (per 1,000 people)	..	1.1	1.6	3.0	3.3	3.5	3.8	..	..	3.8 (2004)	[Increase]
General indicators											
Population (millions)	4.1	4.7	4.9	5.4	5.5	5.7	5.8	5.9	..	5.9 (2005)	
Gross national income ($ billions)1/	0.8	1.7	1.9	1.7	1.8	2.1	2.5	2.7	..	2.7 (2005)	
GNI per capita ($)	200	370	380	315	318	372	431	440	..	440 (2005)	
Adult literacy rate (% of people ages 15 and over)	56.5	60.6	..	68.7	66.4	..	68.7	..	..	68.7 (2004)	
Total fertility rate (births per woman)	6	5.5	5.3	5.0	4.8	4.7	4.6	..	..	4.6 (2004)	
Life expectancy at birth (years)	49.7	51.8	52.5	53.7	54.5	54.7	55.3	..	..	55.3 (2004)	
Aid (% of GNI)	17.3	17.6	..	14.5	15.9	14.7	11.3	..	..	11.3 (2004)	
External debt (% of GNI)	204.3	123.2	..	150	165.2	..	..	..	..	165.2 (2002)	
Investment (% of GDP)	13.5	26.0	..	22.1	..	..	..	..	..	22.1 (2001)	
Trade (% of GDP)	35.8	60.6	65.2	61.6	62.3	57.4	57.4	58.9		58.9 (2005)	

Sources: Millenium Development Goal Indicators (http://mdgs.un.org/unsd/mdg), World Development Indicators database and World Bank, 2005.

1/ Fund staff estimates.

Table 2. Lao P.D.R.: Regional Comparison of Selected Indicators 1/

	Lao P.D.R.	Cambodia	China	Thailand	Vietnam	East Asia & Pacific	Low-income	Sub-Saharan Africa
POPULATION								
Total population, mid-year (millions)	5.9	14.1	1,304.5	64.2	83.0	1,885.3	2,353.0	741.4
Growth rate (% annual average for period)	2.3	2.0	0.6	0.8	1.0	0.8	1.8	2.1
Urban population (% of population)	20.6	19.7	40.4	32.3	26.4	41.5	30.0	35.2
Total fertility rate (births per woman)	4.6	4.0	1.8	1.9	1.8	2.0	3.7	5.3
POVERTY								
(% of population)								
National headcount index	33.5	35.9	4.6	..	28.9	..	..	..
Urban headcount index	19.7	40.1	2.0	..	35.6	..	..	..
Rural headcount index	37.6	13.9	4.6	..	6.6	..	..	..
$ 1 a day headcount index	26	19	12	2	11	11	..	46
$ 2 a day headcount index	73	65	36	24	55	37	..	77
Human Development index	0.55	0.58	0.77	0.78	0.71	0.76	0.56	0.47
INCOME								
GNI per capita (US$)	440	380	1,740	2,750	620	1,627	580	745
Consumer price index (2000=100)	138	114	107	112	124	..	..	..
INCOME/CONSUMPTION DISTRIBUTION								
Gini index	35	40	45	42	37	..	..	..
Lowest quintile (% of income or consumption)	8.1	6.9	4.7	6.3	7.5	..	..	..
Highest quintile (% of income or consumption)	43.3	47.6	50.0	49.0	45.4	..	..	..
SOCIAL INDICATORS								
Public expenditure								
Health (% of GDP)	1.2	2.1	2.0	2.0	1.5	1.9	1.5	2.6
Education (% of GDP)	2.3	2.0	2.2	4.2	1.8	3.2	3.2	3.3
Adult literacy								
(% of people aged 15 and above)								
Total	69	74	91	93	90	91	62	65
Male	77	85	95	95	94	95	73	71
Female	61	64	87	91	87	87	50	58
Net primary school enrollment rate								
(% of age group)								
Total	84	98	95	86	94	93	80	...
Male	87	100	97	87	98	93	83	...
Female	82	96	94	85	92	94	77	...
Access to an improved water source								
(% of population)								
Total	51	41	77	99	85	79	75	58
Urban	79	64	93	98	99	92	89	82
Rural	43	35	67	100	80	70	70	46
Access to improved sanitation								
(% of population)								
Total	30	17	44	99	61	51	38	36
Urban	67	53	69	98	92	72	61	55
Rural	20	8	28	99	50	36	28	26
Immunization rate								
(% 12-23 months)								
Measles	36	80	84	96	97	82	65	64
DPT	45	85	91	98	96	86	67	64
Prevalence of undernourishment (% of population)	22	33	12	21	17	12	25	32
Child malnutrition (% under 5 years)								
Height for age	42	45	14	13	37	22	41	39
Weight for age	40	45	10	19	28	15	39	29
Life expectancy at birth (years)								
Total	55	57	71	71	70	70	59	46
Male	54	53	70	67	68	68	58	46
Female	57	60	73	75	73	72	60	47
Mortality								
Infant (per 1,000 live births)	65	97	26	18	17	29	79	100
Under 5 (per 1,000 live births)	83	141	31	21	23	37	121	168
Adult (15-59)								
Male (per 1,000 population)	355	373	...	245	203	179	319	519
Female (per 1,000 population)	299	264	...	150	139	122	268	461
Maternal (modeled, per 100,000 live births)	650	450	56	44	130	116	689	917
Births attended by skilled health staff (% of total)	19	32	96	99	90	86	41	42

Source: World Bank (2006) and UNDP (2006).

1/ Latest year available.

INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

Staff Report for the 2007 Article IV Consultation—Informational Annexes

Prepared by the Asia and Pacific Department
(In Consultation with Other Departments)

July 19, 2007

Contents | Page

ANNEX I. LAO P.D.R.: FUND RELATIONS

(AS OF MAY 31, 2007)

I. **Membership Status:** Joined 7/05/61; Article XIV

II.	**General Resources Account:**	**SDR million**	**Percent Quota**
	Quota	52.90	100.00
	Fund holdings of currency	52.90	100.00

III.	**SDR Department:**	**SDR million**	**Percent Allocation**
	Net cumulative allocation	9.41	100.00
	Holdings	9.78	103.97

IV.	**Outstanding Purchases and Loans:**	**SDR million**	**Percent Quota**
	ESAF/PRGF arrangements	17.21	32.54

V. **Latest Financial Arrangements:**

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR million)**	**Amount Drawn (SDR million)**
PRGF	4/25/01	4/24/05	31.70	18.12
PRGF	6/04/93	5/07/97	35.19	35.19
SAF	9/18/89	9/17/92	20.51	20.51

VI. **Projected Obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2007	**2008**	**2009**	**2010**	**2011**
Principal	0.91	2.72	3.62	3.62	3.17
Charges/interest	0.09	0.07	0.06	0.04	0.02
Total	0.99	2.79	3.68	3.66	3.19

VII. **Implementation of HIPC Initiative**

Lao P.D.R. is eligible for assistance under the HIPC Initiative. However, to date the authorities have indicated that they do not want to avail themselves of this facility.

VIII. Safeguards Assessments

A safeguards assessment of the Bank of Lao P.D.R. (BoL) was completed in April 2003 with respect to the PRGF arrangement approved in 2001. The main findings, recommendations, and progress thereon, were reported in Country Report No. 03/308 and Country Report No. 05/8. Progress on safeguards recommendations has been slow. The authorities indicated that they were not in a position to implement an earlier agreement to undertake a joint-audit of the BoL's 2003 and 2004 accounts by the state auditor and an international audit firm. These audits have subsequently been completed by the state auditor, but the joint-audit issue remains unresolved.

IX. Exchange Rate

In September 1995, Lao P.D.R. adopted a managed floating exchange rate system. From October 1997, commercial banks have been encouraged to follow the parallel market closely. From October 27, 2003, the commercial bank exchange rate is calculated by the BoL as the weighted average of the previous day's commercial banks' and interbank market rates. The BoL provides this reference rate to the commercial banks, who then set their own rates, keeping them close to the parallel market rates. The foreign currency and precious metal decree (No.02/BoL, August 29, 2003) is under review.

X. Exchange and Payments System

Lao P.D.R. no longer maintains restrictions on the making of payments and transfers for current international transactions under the transitional arrangements of Article XIV, Section 2, but maintains restrictions imposed for the preservation of national or international security, which have been notified pursuant to Decision No. 144-(52/51), and a restriction subject to Fund approval under Article VIII (tax payment certificates are required for some transactions). A joint LEG/MFD mission in August 2004 conducted a review of the exchange system to establish the remaining measures that would facilitate Lao P.D.R.'s acceptance of the obligations under Article VIII, including the elimination of an exchange restriction on the making of payments and transfers for current international transactions. During the 2007 Article IV consultation, the authorities informed staff that they would consider the elimination of the exchange restriction during the WTO accession process (expected to take place by 2010 under the current government plan).

XI. Last Article IV Consultation Discussions

The last Article IV consultation discussions were held in Vientiane during November 7–18, 2005. The staff report (Country Report No. 06/399) was discussed by the Executive Board on March 8 2006 and was published on November 7, 2006.

XII. Resident Representative

Mr. Philippe Beaugrand assumed the post of resident representative in Vientiane on January 28, 2004.

XIII. Technical Assistance (since 2004)

Department	Purpose	Date
STA	- Government finance statistics.	April–May 2004
	- Money and banking statistics.	April–May 2004
	- National accounts statistics.	November–December 2006
FAD	- Missions on tax policy and administration.	October 2004
	- Expert on tax administration.	March–April 2004, November 2004
	- Expert on customs administration.	January 2004, June 2004, February 2005, May 2005, March–April 2006, October–November 2006
	- Mission on public expenditure management.	June–July 2004, October 2004
	- Expert on public expenditure management.	November 2004, March–April 2005
	- Expert on customs law and regulations.	March–June 2007
LEG	- Desk review of the draft Anti-Money Laundering Decree and Regulation on Collecting Information and Reporting on Money Laundering and Terrorism Financing.	October 2005
MFD	- Expert on banking supervision.	January–February, May–July, September–October 2004; January–March, April–June , September–December 2005
	- Mission on Central Bank audit.	May 2005
	- Expert on foreign exchange regulations.	July–August 2004
	- Mission of Article VIII (jointly with LEG).	August 2004

ANNEX II. LAO P.D.R.: RELATIONS WITH THE WORLD BANK GROUP[1]

IMF-Bank Collaboration

The IMF takes the lead in advising the government of Lao P.D.R. (GOL) on macroeconomic policy. The support covers tax, fiscal, monetary, and exchange rate policies, and economic statistical issues. The Bank takes the lead in supporting the GOL in formulating a growth and poverty reduction strategy and implementing structural reform, such as in public finance management, SOE restructuring, private sector development, trade, legal and judicial development, and natural resource management. The Bank and IMF have coordinated their work on some structural areas that have important implications on macroeconomic performance, for example, in areas of the financial sector, public expenditure management, trade policy, and poverty reduction strategy.

IMF and Bank Joint Role in Policy Dialogue

Poverty Reduction Strategy. The Bank and the IMF, together with the UNDP, have provided assistance to the GOL's process of formulating its medium-term poverty reduction strategy. In 2003, the GOL prepared the first full Poverty Reduction Strategy Paper, called the *National Growth and Poverty Eradication Strategy* (NGPES). The Bank and the IMF's Joint Staff Advisory Note (JSAN) of the strategy was presented before IDA and IMF Boards in November 2004. In 2006, the government prepared the Sixth National Socioeconomic Development Plan (NSEDP) 2006–2010 with a strong poverty focus and wide consultations with the Bank, donors and the IMF, key domestic stakeholders in Vientiane and provinces, and presented it to the development partners in November 2006 at the 9th Round Table Meeting with donors.

The Bank is supporting the implementation of NGPES and NESDP through the Poverty Reduction Support Operations (PRSOs). The focus of PRSOs includes public finance management reform, social and infrastructure sectors, regional integration. and private sector development. PRSO-1 ($10 million) was approved in March 2005), followed by PRSO-2 ($8 million) in April 2006, and PRSO-3 ($10 million) in June 2007. The next cycle of PRSO is under discussion and is expected to go to the Bank Board early next year.

Public Expenditure Management. The Bank has provided extensive technical assistance in developing and implementing the government's multi-year Public Expenditure Management Strengthening Program (PEMSP). The Bank completed a Public Expenditure Review in early 2007, jointly with the IMF, other donors, and GOL and a Public Expenditure Tracking

---

[1] Prepared by the staff of the World Bank. Contact person: Ms. Ekaterina Vostroknutova, Economist, Poverty Reduction and Economic Management Department, East Asia and Pacific Region, email: evostroknutova@worldbank.org.

Survey (PETS) for education and health sectors in mid-2007. The Bank is also assisting GOL in the preparation and implementation of the GFS compatible Chart of Accounts, the new Budget Law, especially to improve intergovernmental fiscal relations.

Financial Sector Reforms. The Bank and the IMF have worked closely to support the government in developing and implementing a banking reform program. The Bank has supported restructuring of state-owned commercial banks (SOCBs), and drafting of banking sector legislation.

Trade Policy. The Bank led preparation of the Diagnostic Trade Integration Study (DTIS), jointly with the GOL, and other Integrated Framework donors. A Multi-Donor Trust Fund (to be administered by the Bank) is currently being set up to support the action matrix in the DTIS, and a Trade Facilitation Project is being designed in close collaboration with the IMF to support customs modernization through implementation of ASYCUDA system.

The Bank's Key Roles in Policy Dialogue

State-Owned Enterprises (SOEs). The SOEs have been a debtor to SOCBs and one of the sources of their NPL problems. The Bank has supported the GOL's SOE reform and restructuring program, aimed at improving transparency by institutionalizing the reporting and recording of annual performance of all SOEs and international standard audits of large SOEs, at restructuring the largest SOEs to reduce losses or raise profits, and reforming the pricing policy for public utility SOEs in water, power, and telecoms.

Private Sector Development. The Bank supports the development of the private sector, both economy-wide and in the sectors. Main activities include a joint ADB-Bank Investment Climate Assessment of manufacturing and tourism firms, a review of the regulatory procedures and private sector promotion initiatives of local governments, a review of the key business laws, and coordination of the donor working group on macroeconomic and private sector development issues. In addition the Bank conducts policy dialogue to improve the climate for private investment, both domestic and foreign.

Forestry Development. The GOL is involved in a continuing process of reforming its forestry sector and improving the implementation of forestry programs and projects. The Bank is trying to ensure that the GOL's objectives and strategy for forestry are consistent with the NGPES, Rural Development Program, and Agriculture Development Strategy.

The Nam Theun 2 Hydro-power Project. The Bank has supported the project through an IDA partial risk guarantee, an IDA grant for environmental and social mitigation, and a MIGA guarantee, all done in March 2005. The World Bank decision to support the project was based on a "decision framework" with the following three pillars: (i) Lao P.D.R. establishing and implementing a viable development policy framework, characterized by concrete performance, and national programs for poverty reduction and social and environmental protection; (ii) the technical, financial, economic and implementation aspects of the project, as well as the design and implementation of safeguards policies, being sound; and (iii) wider understanding and broader support from the international donor community and global and local civil society for Lao P.D.R.'s development framework and the project. The Bank is supporting and monitoring the implementation of the NT2 project, and its progress remains good; it is expected to be operational in early 2010.

Bank Strategy and Lending Operations

Country Assistance Strategy (CAS). The full CAS was presented to the Bank's Board in March 2005, and the CAS update (and extension through 2011) was submitted to the Board in June, 2007. The CAS selectively targets key NGPES priorities, including: (i) sustaining growth through linking to and capitalizing on regional opportunities and better natural resource management; (ii) improving social outcomes through strengthening financial management and service delivery capacity; (iii) strengthening management capacities, partnerships, and monitoring for NGPES implementation; and (iv) implementing the NT2 program as a model for supporting sustainable growth, improving social outcomes, and building key development capacities. The CAS consists of a lending and non-lending program, with a notional amount of about US$128 million in new commitments (credits and grants) between July 1, 2005 to June 30, 2008 (subject to the IDA Performance Based Allocation system).

Lending Operations

As of March 15, 2007, a total amount of US$835.88 million equivalent of IDA credits and grants had been approved. This included support for adjustment operations, rural development, forestry, transport, energy, telecommunications, education, health, industry, capacity building, and risk guarantees. In the last three years, IDA support has focused on the CAS objectives, with an average disbursement of US$32 million.

IDA: Commitments and Disbursements to Lao P.D.R., 1977–2006

(In millions of U.S. dollars; as of March 15, 2007)

Fiscal Year (to June 30)	Committed	Disbursed	Repayments*
1977–93	335.2	180.7	1.5
1994	48.4	45.1	0.6
1995	19.2	31.4	0.6
1996	60.7	28.6	0.6
1997	48	65.2	0.6
1998	34.7	26.5	1.3
1999	29.8	27.8	1.5
2000	0	18.1	3
2001	41.7	29.9	3.6
2002	44.8	30.5	4.9
2003	24.7	41.2	6.1
2004	35.7	46.7	7.3
2005	76	36	8.4
2006	37.0	36.3	8.7
Total	835.9	644.0	48.7

* Note: repayments include principal repayments and do not include commitment or service charges.

The World Bank's Main Non-Lending Work

(Recently completed and ongoing)

Completed FY05–FY06	Ongoing and Proposed for FY07–FY11
Regional Integration/Private Sector Development	
PRSP – JSAN Financial Sector Note Economic Monitors (2 issues each year) CEM - Sources of Growth Investment Climate Assessment Diagnostic Trade Integration Study Integrated PER (with CFAA, CPAR)	Economic Monitors (2 issues each year) Financial Sector Assessment Investment Climate Follow-up Integrated PER ICT Strategy Investment Climate Assessment 2
Natural Resources Management, Environment and Rural Development	
Environment Monitor Rural Sector Strategy Khammouane Provincial Development Study Poverty Environment Nexus Study	Upland Livelihood Typology Flagship on Natural Resources Management Environment Monitor Land Allocation, Planning, and Management Forestry Sector Strategy Note Water Sector Review
Public Sector and Financial Management	
IDF-Efficiency in Public Procurement Peer Review of State Audit Organization Contract Value Norms Study	NT2 Revenue Management Intergovernmental Fiscal Relations and Decentralization Public Expenditure Tracking Survey Strengthening Anti-Corruption Measures Assessment of Government Strategic Plan for Governance
Service Delivery and Vulnerability	
Poverty Assessment Decentralization Study IDF-Ethnic Minorities' Concerns in PRSP IDF-Monitoring and Evaluation in Education Public Expenditure Tracking Survey	Teachers' Study Review of Poverty Reduction Fund Public Expenditure Tracking Survey Civil Service Reform Study Health Sector Financing Strategy Education for All Assessment Social Monitor (Youth Opportunities)
Other/Infrastructure	
Mining Sector Review	Rural Water and Sanitation Strategy Cross-Border Cooperation in Sustainable Hydropower Development

ANNEX III. LAO P.D.R.: RELATIONS WITH THE ASIAN DEVELOPMENT BANK[2]

The Asian Development Bank (AsDB) has extended development assistance to Lao P.D.R. since 1968. In the 1970s and 1980s, AsDB assistance was focused mainly on economic growth projects involving infrastructure development in the transport and energy sectors, as well as agriculture. AsDB has been active in the development of the financial sector since the latter part of the 1980s, and broadened its assistance to Lao P.D.R. to include rural development, social development and environment in the 1990s. AsDB has focused its activities on poverty reduction since the late 1990s.

AsDB's new Country Strategy and Program (CSP) for Lao P.D.R. for 2007–11 is anchored in and closely aligned to the Lao P.D.R.'s 6th National Socioeconomic Development Plan, 2006–10 (NESDP). A results-based strategy, the CSP focuses on promoting sustainable pro-poor sustainable growth, strengthening governance, developing government's capacity, improving social inclusiveness and gender, enhancing regional cooperation and integration, managing the environment, and supporting private sector (including banking) developments. These strategic focuses are shaped by the country's specific requirements and capabilities after extensive stakeholder consultations. The CSP is designed to achieve high impact and sustainable development results and to contribute to the government's Millennium Development Goals and sector-specific commitments as set out in NSEDP, with specific goals, targets, and progress indicators for AsDB interventions.

Lao P.D.R. is a key actor in the Greater Mekong Sub-Region (GMS) program as a land-link among the other GMS member countries. The AsDB will aim to explore various options to maximize the benefits to Lao P.D.R. from sub-regional cooperation. To enhance the development impact of projects and ensure their close monitoring, AsDB's interventions will focus primarily on the poor northern region provinces and along the East-West economic corridor, which links Thailand to Savannakhet and Vietnam.

Since 1970, the AsDB has approved 71 loan and grant financed projects for a total of $1.18 billion—of which 28 projects were currently active—and 224 technical assistance projects for a total of $113.0 million (as of end-December 2006).

In 2006, six new loans and grants were approved (comprising two for agriculture, two for education, and two for rural finance, of which one loan each in education rural finance were programs to support sector reforms). In addition, eight technical assistance projects amounting to $4.7 million were approved.

---

[2] Prepared by the Asian Development Bank.

Table 1. Lao P.D.R.: AsDB Commitments and Disbursements, 2000–06
(In millions of U.S. dollars)

	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007** 1/
Commitments	65	43.2	34.9	54.8	87.0	60.8	56.0
Disbursements	44.7	48.6	54.7	48.5	78.7	78.5	78.7

Source: Data provided by the Asian Development Bank.
1/ Planned figures.

ANNEX IV. LAO P.D.R.: STATISTICAL ISSUES

The macroeconomic and financial data needs to be improved to support policy decision making and effective surveillance. In this regard, a multisector STA mission visited Vientiane during October 2002 to facilitate the preparation of the General Data Dissemination System (GDDS) metadata. It recommended greater coordination between the various agencies responsible for compiling macroeconomic statistics, including the formation of an inter-agency working group. While a GDDS coordinator has been appointed, the authorities have yet to finalize the GDDS metadata and a strategy for statistical improvement. Two STA missions took place in April/May 2004 in the areas of government finance statistics and monetary and financial statistics. Economic and financial data are published in periodic reports by the National Statistical Center (NSC) and the Bank of Lao P.D.R. (BoL). An expert on national accounts provided assistance in late 2006.

National accounts

National accounts consist of annual estimates of GDP by activity at current and constant 1990 prices, broadly following the *System of National Accounts 1968 (1968 SNA)*. The lack of regular surveys to collect comprehensive data on current economic activities and the use of inadequate compilation methods raise questions about the coverage and reliability of the GDP estimates. The estimates rely heavily on data on production or volume indicators collected by line ministries. The October 2002 multisector STA mission recommended that the authorities establish a system for collecting data on current economic activities based on regular surveys and implement compilation methods in accordance with the *System of National Accounts 1993 (1993 SNA)*. The Swedish International Development Agency (SIDA) is providing technical assistance to the NSC to improve the national income accounts. With SIDA support, the Lao Expenditure and Consumption Survey 2002–03 (LECS 3) has been finalized and released. An STA regional advisor visited Vientiane in November/December 2006 as part of APD staff visit to update the assessment of the quality of national accounts statistics. The advisor assessed that there had been progress in improving the quality of source data, including implementing annual enterprise and household surveys, but weaknesses remained in estimates for deflators, constant price estimates, and expenditures.

Prices

The NSC compiles a monthly CPI that is available on a timely basis. The latest CPI was introduced in January 2006 (with December 2005 as the reference period), using the results of the 2002/03 Lao Expenditure and Consumption Survey (LECS) for deriving a consumption basket. Similar to earlier CPI series, the consumption baskets only include goods and services purchased in the market, and own consumption is not reflected in the basket weight. The NSC is planning to introduce a producer price index (PPI) in 2007.

Government finance

Government finance statistics are weak and there is scope to significantly improve their accuracy, coverage, timeliness, and transparency. The Budget Department produces monthly, quarterly, and annual revenue and expenditure statistics. Most data are recorded on a cash basis. Expenditure data by economic type are compiled by central government and the provinces. Data on bank and nonbank financing of the budget, including treasury bill operations, need to be made consistent with the monetary accounts. The social security fund and off-budget activities are not included in fiscal data. Annual budget and outturn data are not disseminated according to an international standard, which complicates fiscal analysis. A government finance statistics mission in 2004 recommended improving the quality of fiscal statistics and developed a roadmap for eventual migration to *GFSM2001*. No data are being reported for publication in the *Government Finance Statistics Yearbook* or *International Financial Statistics*.

Budget planning, execution, reporting, and cash management require significant upgrading, as noted by the October 2002 FAD mission on public expenditure management. Moreover, greater decentralization in 2000/01 further complicated the timely reporting of fiscal data from lower government levels, as monitoring systems are weak and skilled staff limited. This continues to hamper the accurate reporting of various items to the central budget, such as timber-related royalty payments.

Central government debt data are compiled by two departments of the MOF; external debt by the External Financial Relations Department and domestic debt by the Budget Department. Debt data are comprehensive and available by type of debt holder and instrument. Efforts are being made to further improve coverage, particularly relating to SOE debt.

Monetary statistics

The latest monetary and financial statistics mission in April/May 2004 identified a number of problems in the compilation of monetary statistics and made further recommendations for (i) improvement in the sectorization of various institutional units (e.g., nonfinancial public enterprises) and uniform treatment of sectors on both asset and liability sides of the commercial bank balance sheet; (ii) valuation of financial assets and liabilities (e.g., valuing monetary gold at market prices); (iii) classification of financial instruments (e.g., classifying loan loss provisions as other liabilities and valuation adjustments as part of shares and other equity); (iv) improvement in the chart of accounts for BoL and commercial banks, including preparation of a “Manual of the Chart of Accounts”; (v) improvements in the coverage and identification of IMF accounts; (vi) reconciliation of differences between the accounting data (from the Accounting Department of the BoL) with monetary data sent to APD and STA (compiled by the Economic Research Department using source data from the Operations Department of the BoL); and (vii) on investigation of discrepancies in bank financing between monetary and government finance statistics. Many of the recommendations of the mission have yet to be implemented, including those to rectify the inconsistent sectorization of units on the asset and liability sides of the commercial bank balance sheet.

Balance of payments

Data on foreign reserves are reported weekly and derived from the monetary survey at the prevailing kip per U.S. dollar end-month exchange rate. Balance of payments statistics need significant frequency and coverage improvements in the following areas: (i) customs trade data; (ii) the commodity composition of external trade; (iii) services and income; (iv) actual foreign direct investment flows; (v) separation of current and capital transfers as well as coverage of some type of grants, especially from international nongovernment organizations; (vi) the reconciliation of fiscal and balance of payments data on external loans and grants; and (vii) monitoring of external debt, especially of state owned enterprises. In 2001, the ministry of finance adopted the Commonwealth Secretariat-Debt Recording and Management System (CS-DRMS) for processing and maintaining external debt data.

New customs procedures (the Customs 2000 system) and equipment permitted (with FAD technical assistance) production of more accurate trade data in October 2000. However, for a range of technical reasons, the customs department has not yet produced these data on a regular basis. Fund missions have emphasized that this problem needs to be urgently addressed. In order to produce accurate balance of payments updates on a regular basis, there is a need to improve the coordination between the agencies involved in BOP compilation, for example., the BoL, the NSC, the Customs and the External Financial Relations Departments of the Ministry of Finance, the Department of International Cooperation of the Committee of Planning and Investment, and the commercial banks. The Japanese government is providing technical assistance to address some of these issues.

Lao P. D. R.: Table of Common Indicators Required for Surveillance
(as of July 2, 2007)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	07/02/07	07/02/07	D	D	O
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	April 2007	06/06/07	M	M	O
Reserve/Base Money	April 2007	06/06/07	M	Q	O
Broad Money	April 2007	06/06/07	M	Q	O
Central Bank Balance Sheet	April 2007	06/06/07	M	Q	O
Consolidated Balance Sheet of the Banking System	April 2007	06/06/07	M	Q	O
Interest Rates[2]	April 2007	06/15/07	M	M	O
Consumer Price Index	May 2007	06/06/07	M	M	O
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	March 2007	04/25/07	M	M	O
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	March 2007	04/25/07	M	M	O
Stocks of Central Government and Central Government-Guaranteed Debt[5, 7]	Sept 2006	12/1/06	A	A	O
External Current Account Balance	Q4 2005	05/03/06	Q	Q	O
Exports and Imports of Goods and Services	Q4 2005	05/03/06	Q	Q	O
GDP/GNP	2004	6/24/05	A	A	O
Gross External Debt[7]	Dec 2006	05/08/05	A	A	O

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA)
[7] Data often reported with a delay of 2 months.

INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

LAO PEOPLE'S DEMOCRATIC REPUBLIC

Joint World Bank/IMF Debt Sustainability Analysis

Prepared by the staff of the International Monetary Fund and
the International Development Association

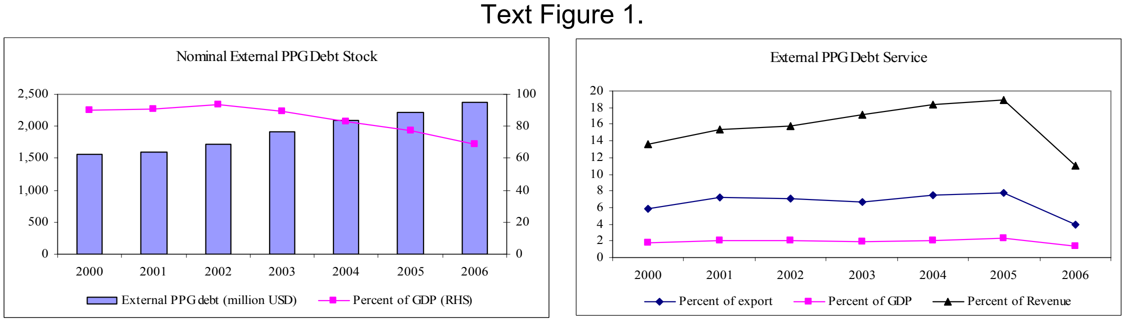
July 19, 2007

1. The debt sustainability analysis (DSA) conducted during the 2007 Article IV consultation discussions indicates that Lao P.D.R. continues to face a high risk of debt distress.[1] The current DSA points to an improved outlook compared to the previous DSA. The stock indicators are expected to decline faster and the debt service burden is projected to be lower in terms of exports. Moreover, debt service ratios remain relatively low. However, despite these improvements, the debt stock indicators remain well-above the policy-based indicative thresholds and could increase further depending on future macroeconomic performance and the concessionality of external financing.

A. Background

2. **Lao P.D.R.'s external public and publicly guaranteed debt (PPG) ratios have declined in recent years** (Text Figure 1). While nominal debt stocks have increased, strong growth has led the nominal debt-to-GDP ratio to steadily decline since 2002. All debt service indicators reversed their upward trends in 2006, reflecting continued strong GDP and export growth helped by high commodity prices.

Text Figure 1.



[1] The last DSA for Lao P.D.R. was prepared in the context of the 2005 Article IV Consultation.

3. **Despite these positive developments, Lao P.D.R.'s external public debt stock remains at an elevated level.** The total external public debt stock amounted to US$2.4 billion (70 percent of GDP) at end-2006, with a net present value of US$1.7 billion. At these levels, Lao P.D.R.'s debt stock indicators are significantly above the policy-based indicative thresholds for countries with similar CPIA rating (Text Table 1).[2] However, debt service ratios remain below the indicative thresholds due to a high degree of concessionality.

Text Table 1. Lao P.D.R.: External Public Debt Indicators

	Indicative thresholds	End-2006
NPV of debt in percent of:		
GDP	30	48
Exports	100	135
Revenue	200	377
Debt services in percent of:		
Exports	15	4
Revenues	25	11

4. **About 75 percent of Lao P.D.R.'s external public debt are concessional loans from multilateral creditors, primarily the AsDB and IDA** (Text Table 2).[3,4] Debt to bilateral and commercial creditors amounted to approximately US$633 million. Traditional bilateral creditors include Russia and Japan. In recent years, neighboring countries, including China, Vietnam, and Thailand, are becoming increasingly active, although information is limited regarding their lending activities. Since the signing of the rescheduling agreement with Russia in 2003, Lao P.D.R. has not accumulated any external debt payment arrears.[5]

Text Table 2: Summary of Public External Debt

	In millions of U.S. dollar	Percent share
Total External Debt	**2,371**	100.0
Total Multilateral	**1,738**	**73.3**
AsDB	938	39.6
IDA	617	26.0
NDF	50	2.1
EIB	46	2.0
IFAD	45	1.9
IMF	26	1.1
OPEC	16	0.7
Total Bilateral	**633**	**26.7**
Russia	382	16.1
China	100	4.2
Japan	76	3.2
Thailand	28	1.2
Sweden (SIDA)	15	0.6
France	10	0.4
Korea	9	0.4
Vietnam	7	0.3
Germany	4	0.2
Singapore	4	0.2
Norway (NORAD)	0.1	0.0

[2] The low-income country debt sustainability framework (LIC DSF) provides indicative levels (thresholds) of debt burdens beyond which a country's risk of debt distress reaches levels that are considered unacceptable. See IDA/R2004-0253, "Operational Framework for Debt Sustainability Assessments in Low-Income Countries—Further Considerations." The LIC DSF recognizes that better policies and institutions allow countries to manage higher levels of debt, and thus the threshold levels are policy dependent. Lao P.D.R.'s policies and institutions, as measured by the World Bank's Country Policy and Institutional Assessment (CPIA), place it as a "weak performer." The relevant indicative thresholds for this category are indicated in Text Table 1 above.

[3] Except for two loans for the NT2 project from AsDB and EIB for which near-market terms apply.

[4] The assessment in this annex is based on available information and any debt that has not been identified by the authorities would further increase the risk of debt distress. For example, some sources indicate higher domestic debt due to unaccounted quasi-fiscal liabilities; more research is needed to quantify this component of domestic debt.

[5] This excludes the non-payment of an amount due in May 2007, which the Russian authorities consider to be in arrears, while the Lao P.D R. authorities have informed the staff that they had communicated in June 2007 to the Russian authorities their desire to renegotiate the rescheduling agreement. Debt to Russia was rescheduled on a

(continued…)

5. **The size of domestic public debt is negligible.** At the end of 2005/06, the stock of domestic public debt stood at around Kip 560 billion (1¾ percent of GDP).

B. Debt Sustainability Outlook

6. **The medium- to long-term debt sustainability of Lao P.D.R. depends on the government's choice of policies to deal with potentially adverse effects of the resource bonanza.** The proactive scenario (baseline) assumes that policies are put in place in anticipation of adverse effects on the non-resource sector (such as greater appreciation of the real exchange rate–see Box 1).[6] To examine the implications of an alternative policy response, staff have developed a reactive scenario, where policies are undertaken as the adverse effects materialize (Box 2). Under each scenario, standard stress tests are carried out to check the resilience of the debt outlook in the event of external shocks.

Box 1. Macroeconomic Assumptions 2007–27

The assumptions in the baseline scenario are consistent with a proactive policy response to the recent increase in natural resource revenue. In particular, the government is assumed to save a large portion of resource revenue for future use, while pursuing fiscal consolidation of the non-resource budget. Moreover, improvements to the investment climate envisioned in the National Socio-economic Development Plan (NSEDP) are assumed to be realized.

Real GDP growth is projected to accelerate in the early years fueled by high investment demand in the resource sector, later stabilizing at around 6.5 percent increasingly supported by non-resource sector growth.

Text Table 3. Lao P.D.R. Key Macroeconomic Assumptions
(Proactive scenario)

	2002-06 average	2007-12 average	2013-27 average
Real GDP growth (percent)	6.6	7.2	6.4
Inflation (percent)	10.1	4.4	4.5
Exports growth (percent)	20.6	10.6	11.2
Revenue (percent GDP)	11.8	13.4	13.7
Primary deficit (percent GDP)	2.6	-0.1	1.3
Grant element of new borrowing	...	41.1	43.7

Inflation is projected to remain around the recent levels (4.5 percent) as the BoL's enhanced set of market-based tools for conducting monetary policy helps to contain the monetary impact of external surpluses from natural resources.

The real exchange rate is expected to appreciate due to the resource sector boom, but only moderately.

Export growth is volatile in the early years reflecting the mining output profile, commodity price changes, and the timing of the start of operations of the NT2 dam project. In the medium term, nominal export growth stabilizes at around 11 percent, increasingly driven by non-resource exports.

Import growth is projected to increase sharply in 2007–08 due to the dam construction projects, then to decline thereafter, stabilizing around 11 percent after 2012.

The **non-interest current account deficit** is projected to stabilize at around 1 percent of GDP from 2008 onward as construction-related imports decrease and electricity and non-resource exports increase. **FDI** is assumed to decline from an average of 13.9 percent of GDP in 2007–11 to 1.9 percent of GDP after 2012 as earlier levels were related to dam construction and mining projects that should be completed by that time.

Fiscal revenues are expected to increase from 12.7 percent of GDP in 2006 to around 13.5 percent of GDP in the long term, while **total expenditures** are assumed to remain roughly constant as a percent of GDP. As a consequence, the **primary fiscal deficit** is assumed to decrease from 3.7 percent of GDP in 2006 to around 1 percent after 2012.

External financing is assumed to be on highly concessional terms, with a grant element over 40 percent.

---

bilateral basis in December 2003, with a 70 percent up-front debt stock reduction and a rescheduling of maturities.

[6] This also requires the authorities carry out its reform commitment under the NSEDP and continue the fiscal consolidation effort in the medium term.

Box 2. Reactive Policy Response (Alternative) Scenario

To examine the implications of a different policy response to the boom in natural resource revenues, the staff have also considered a reactive policy scenario characterized by higher expenditures and slower progress in structural reforms.

Under the reactive policy scenario the government spends all resource revenues, leading to a sharp increase in government expenditures. As a result, its net position with the banking system would remain unchanged. The BoL would take time in developing monetary management tools and inflationary pressures would emerge, exacerbating the appreciation of the exchange rate and adversely affecting the competitiveness of non-resource exports.

Efforts to enhance the business environment are projected to advance only gradually in this scenario, and SOCBs and SOEs continue to pose a fiscal risk and burden to the budget. GDP growth is projected to initially increase to nearly 8 percent, buoyed by higher consumption stimulated by government expenditures. Soon thereafter, however, non-resource exports would start to weaken, which could lead the BoL to loosen monetary policy in an attempt to counter declining activity and maintain consumption. The government is assumed to continue to borrow externally, while avoiding recourse to domestic financing. After an initial rapid growth, real GDP is projected to decelerate to 4–5 percent. Key assumptions of the reactive scenario are summarized in Text Table 4 below.

Text Table 4. Lao P.D.R. Key Macroeconomic Assumptions
(Reactive scenario)

	2002-06 average	2007-12 average	2013-27 average
Real GDP growth (percent)	6.6	6.3	4.5
Inflation (percent)	10.1	7.3	9.0
Exports growth (percent)	20.6	8.7	7.6
Revenue (percent GDP)	11.8	12.6	9.9
Primary deficit (percent GDP)	2.6	0.9	2.8
Grant element of new borrowing	...	41.1	42.3

C. Outlook for External Public and Publicly Guaranteed Debt

Proactive scenario (baseline)

7. **The results of this DSA suggest Lao P.D.R. is still at a high risk of debt distress even with the proactive policy response assumed in the baseline scenario** (Figure 1). However, the debt outlook is expected to improve in the projection period.

- **In the near term, debt stock indicators will remain at elevated levels, but they are projected to steadily decline to below the relevant indicative thresholds within the projection period.** Lao P.D.R. had a high NPV debt-to-GDP ratio of 48 percent at end-2006, which, under the proactive scenario, is projected to decline substantially over time to reach below 20 percent by 2027, crossing the 30 percent indicative threshold by 2014 (Table 1). The NPV of debt-to-exports ratio is projected to decline from 135 percent to below 60 percent toward the end of the projection period.

- **The debt service ratios are expected to remain well below the thresholds.** As a percent of exports or revenue, debt service during the entire projection period is expected to be at comfortable levels.

8. **The standard stress tests indicate that the Lao P.D.R.'s external debt outlook is fairly resilient to exogenous shocks under the baseline scenario** (Figure 1 and Table 2). Except for the simulations based on historical averages, all stress tests lead to higher, but stabilizing ratios below the relevant thresholds. Under the historical trend simulation, the NPV of debt-to-GDP ratio and NPV of debt-to-export ratio would deteriorate to stay above the thresholds throughout the projection period, mainly because the historical averages incorporated little impact from the recent rapid development of mining and hydropower sectors, which are expected to improve Lao P.D.R.'s growth and export performance as well as its balance of payments and fiscal balance substantially in the medium term and beyond. Similarly, the debt service to exports ratio would worsen, although remaining below the thresholds.[7]

Reactive scenario (alternative)

9. **The risk of debt distress—already high in the proactive scenario—would deteriorate further under the reactive scenario** (Figure 1 and Table 3). Although the debt stock indicators based on GDP and exports are still expected to decline over time, they would approach the relevant thresholds only toward the end of the projection period. The debt service burden in terms of exports, despite at a low level, would be higher than that under the proactive scenario. Finally, under the reactive scenario, the NPV of debt-to-revenue ratio would remain at an unsustainable level and the debt service burden in terms of government revenue would rise in early years, but stabilize at a higher level of around 20 percent toward the end of the projection period.

10. **The standard stress tests under the reactive scenario further highlight the significant risk of debt distress in the event of exogenous shocks.** All stress tests under reactive scenarios will lead the debt stock indicators to be well above the sustainability thresholds. The outlook on the fiscal side is more precarious as the NPV of debt-to-revenue ratio could rise to more than twice the threshold level. The stress tests will also cause the debt service indicators to rise significantly with the debt service to revenue ratio exceeding sustainable threshold (Figure 1 and Table 4).

---

[7] Due to the sharp declines in copper price already incorporated in the proactive and reactive scenarios, further temporary shocks to commodity prices will only worsen the external debt indicators modestly. For example, if both the copper and gold prices took the 10-year historical average between 2008–12, the NPV of debt-to-exports ratio would increase by 6 percentage points from the baseline.

Text Table 5: Summary of Debt Sustainability Indicators under Alternative Scenarios
(In percent)

		Proactive (Baseline)			Reactive (Alternative)		
	2007	2017	2027	Average 2007-27	2017	2027	Average 2007-27
NPV of debt-to-GDP	45	25	19	27	31	30	33
NPV of debt-to-exports	140	79	58	86	102	98	107
NPV of debt-to-revenue	338	192	125	203	313	319	306
Debt service-to-exports	6	5	4	5	7	6	6
Debt service-to-revenue	15	12	8	12	21	20	19

D. Outlook for Total Public and Publicly Guaranteed Debt

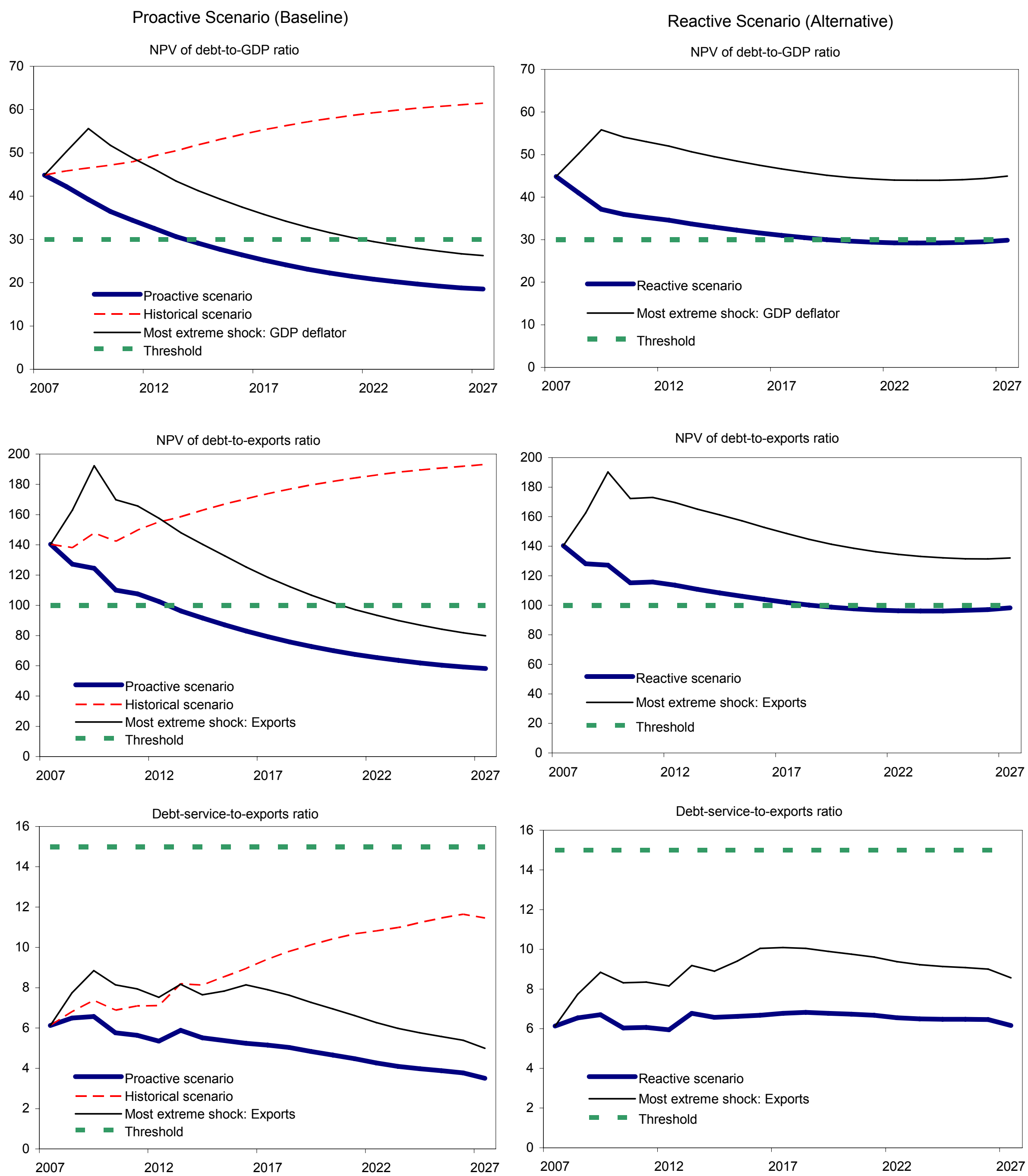
11. **Because the majority of public debt is to external creditors, the public debt trajectory will closely follow the external debt** (Figure 2 and Table 5). Under the proactive scenario (Baseline), both the NPV of public debt-to-GDP and debt-to-revenue ratios (51 percent and 345 percent, respectively, at the end of 2005/06) are envisaged to fall steadily to 20 percent of GDP and around 120 percent of GDP, respectively, by 2026/27. The debt service to revenue ratio—which is currently relatively low due to high concessionality—is projected to decline to less than 7 percent by 2026/27.

12. **The public debt outlook will be less benign under the reactive (alternative) scenario** (Tables 7 and 8). The NPV of public debt-to-GDP ratio is projected to decline only moderately through the projection period. The debt service to revenue ratio could even rise in the middle of the 2010s, if the government fails to increase revenues.

III. Conclusion

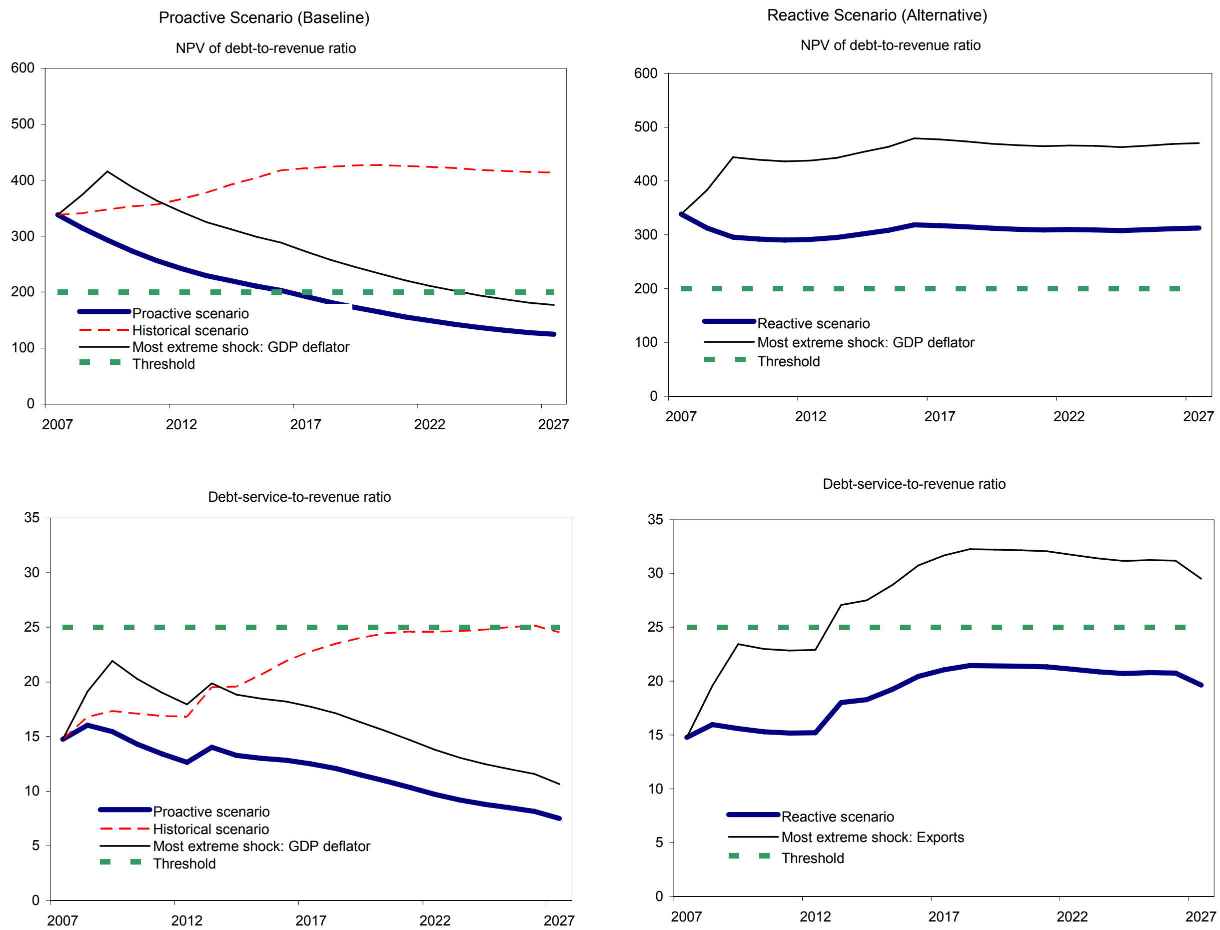
13. **Although Lao P.D.R.'s debt ratios continue to improve, the overall debt burden remains elevated and the risk of debt distress is high.** While the debt service ratios are expected to remain below the thresholds, suggesting low risk of a liquidity crisis in the short term, Lao P.D.R.'s debt-stock indicators are expected to remain significantly above their thresholds for a number of years. To mitigate these risks, sound macroeconomic policies need to be put in place and a renewed impetus given to the economic reform effort to raise the growth and export performance of the non-resource sector. The current high risk of debt distress also calls for an extremely prudent approach for future external borrowing. In particular, Lao P.D.R. should continue to rely on grants or highly concessional resources for its development needs.

Figure 1. Lao PDR: Indicators of Public and Publicly Guaranteed External Debt
Under Alternative Scenarios, 2007-2027



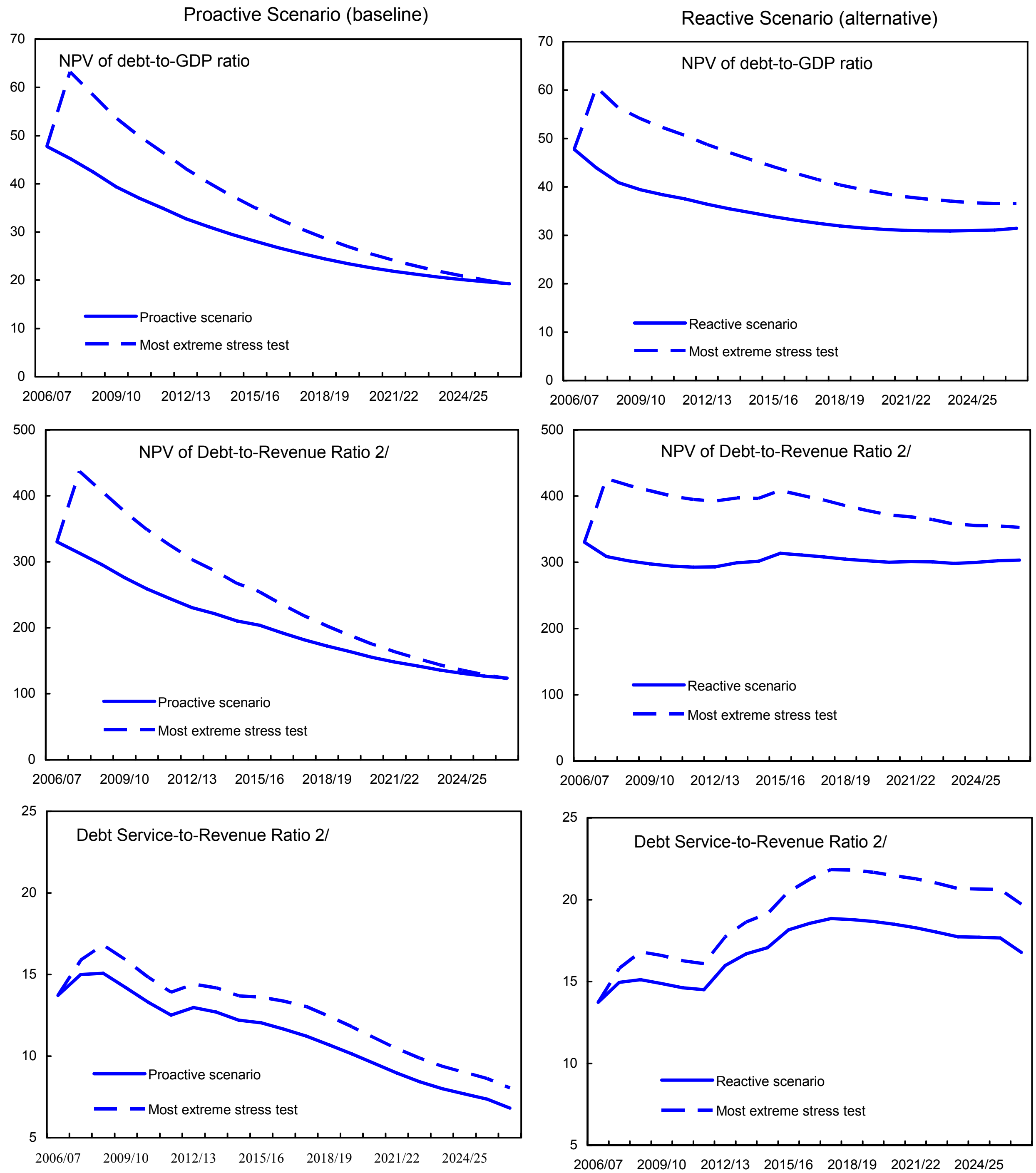
Source: Staff projections and simulations.

Figure 1. Lao PDR: Indicators of Public and Publicly Guaranteed External Debt
Under Alternative Scenarios, 2007-2027 (Continued)



Source: Staff projections and simulations.

Figure 2. Lao PDR: Indicators of Public and Publicly Guaranteed Debt, 2006/07-2026/27
(In percent)



Source: Staff projections and simulations.
1/ Most extreme stress test is "one time 30 percent real depreciation in 2007/08" a test that yields highest ratio in 2016/17.
2/ Revenue including grants.

Table 1. Lao P.D.R.: External Debt Sustainability Framework, Proactive Scenario (Baseline), 2007-2027 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2004	2005	2006			2007	2008	2009	2010	2011	2012	2007-12 Average	2017	2027	2013-27 Average
External debt (nominal) 1/	**83.2**	**77.1**	**69.0**			**63.0**	**58.6**	**54.0**	**49.8**	**46.6**	**43.7**		**34.8**	**28.4**	
of which: public and publicly guaranteed (PPG)	83.2	77.1	69.0			63.0	58.6	54.0	49.8	46.6	43.7		34.8	28.4	
Change in external debt	-5.9	-6.1	-8.1			-6.0	-4.3	-4.6	-4.2	-3.2	-2.9		-1.2	-0.3	
Identified net debt-creating flows	-7.8	-2.8	-8.3			-2.3	-3.0	-3.3	-3.1	-2.4	-3.2		-2.6	-2.2	
Non-interest current account deficit	**13.4**	**19.3**	**12.7**	**9.4**	**5.0**	**22.2**	**20.4**	**15.1**	**9.6**	**4.1**	**0.9**		**0.8**	**1.0**	0.9
Deficit in balance of goods and services	13.8	13.8	6.3			17.2	15.5	13.2	7.3	4.2	1.2		1.2	1.2	
Exports	27.4	30.1	36.0			32.0	33.2	31.5	33.1	32.0	31.8		31.8	31.8	
Imports	41.2	43.9	42.3			49.2	48.7	44.7	40.4	36.2	33.0		33.0	33.0	
Net current transfers (negative = inflow)	-3.4	-2.9	-4.9	-5.6	2.3	-3.6	-3.3	-3.1	-3.0	-2.8	-2.7		-2.7	-2.7	-2.7
of which: official	-2.4	-2.0	-3.2			-2.0	-1.7	-1.6	-1.6	-1.5	-1.4		-1.4	-1.4	
Other current account flows (negative = net inflow)	3.0	8.4	11.4			8.5	8.1	5.0	5.3	2.8	2.4		2.3	2.5	
Net FDI (negative = inflow)	**-9.3**	**-12.1**	**-9.3**	**-6.2**	**4.1**	**-21.0**	**-19.8**	**-14.8**	**-9.6**	**-4.2**	**-1.9**		**-1.9**	**-1.9**	-1.9
Endogenous debt dynamics 2/	**-11.9**	**-10.0**	**-11.8**			**-3.5**	**-3.6**	**-3.6**	**-3.1**	**-2.2**	**-2.2**		**-1.5**	**-1.2**	
Contribution from nominal interest rate	0.9	0.9	0.5			0.7	0.7	0.6	0.6	0.5	0.5		0.6	0.4	
Contribution from real GDP growth	-4.9	-5.2	-4.9			-4.2	-4.3	-4.3	-3.7	-2.8	-2.7		-2.1	-1.6	
Contribution from price and exchange rate changes	-7.9	-5.8	-7.4			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**1.9**	**-3.3**	**0.3**			**-3.7**	**-1.3**	**-1.3**	**-1.2**	**-0.8**	**0.3**		**1.4**	**1.9**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt 4/	...	...	48.4			44.9	42.2	39.2	36.5	34.5	32.6		25.2	18.5	
In percent of exports	...	...	134.5			140.4	127.2	124.5	110.1	107.6	102.4		79.2	58.2	
NPV of PPG external debt	**...**	**...**	**48.4**			**44.9**	**42.2**	**39.2**	**36.5**	**34.5**	**32.6**		**25.2**	**18.5**	
In percent of exports	**...**	**...**	**134.5**			**140.4**	**127.2**	**124.5**	**110.1**	**107.6**	**102.4**		**79.2**	**58.2**	
In percent of government revenues	**...**	**...**	**377.1**			**338.0**	**314.0**	**293.1**	**273.2**	**256.1**	**242.0**		**192.0**	**124.7**	
Debt service-to-exports ratio (in percent)	**7.5**	**7.7**	**4.0**			**6.1**	**6.5**	**6.6**	**5.8**	**5.6**	**5.3**		**5.2**	**3.5**	
PPG debt service-to-exports ratio (in percent)	**7.5**	**7.7**	**4.0**			**6.1**	**6.5**	**6.6**	**5.8**	**5.6**	**5.3**		**5.2**	**3.5**	
PPG debt service-to-revenue ratio (in percent)	**18.4**	**18.8**	**11.1**			**14.8**	**16.0**	**15.5**	**14.3**	**13.4**	**12.6**		**12.5**	**7.5**	
Total gross financing need (millions of U.S. dollars)	153.0	274.7	168.2			126.4	121.6	120.0	110.1	106.5	47.2		56.8	46.7	
Non-interest current account deficit that stabilizes debt ratio	19.3	25.4	20.8			28.2	24.7	19.7	13.9	7.3	3.8		2.0	1.3	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.4	7.1	7.6	6.3	1.0	7.1	7.6	8.2	7.6	6.2	6.4	7.2	6.4	6.4	6.4
GDP deflator in US dollar terms (change in percent)	9.7	7.5	10.7	0.9	13.3	8.8	4.5	4.3	4.4	4.5	4.5	5.2	4.5	4.5	4.5
Effective interest rate (percent) 5/	1.2	1.2	0.8	0.8	0.2	1.2	1.2	1.2	1.2	1.2	1.1	1.2	1.9	1.7	1.7
Growth of exports of G&S (US dollar terms, in percent)	14.9	26.5	42.3	12.0	14.0	3.6	16.8	7.1	18.3	7.2	10.5	10.6	11.2	11.2	11.2
Growth of imports of G&S (US dollar terms, in percent)	38.4	22.7	14.7	7.8	17.6	35.7	11.3	3.5	1.6	-0.6	1.4	8.8	11.2	11.2	11.2
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	37.1	40.0	42.5	42.3	42.3	42.3	41.1	43.9	43.5	43.7
Grant-equivalent financing (in percent of GDP) 7/	...	...	...			2.0	1.8	1.6	1.4	1.4	1.4		1.6	1.5	1.5
Grant-equivalent financing (in percent of external financing) 7/	...	...	...			38.6	41.5	44.1	44.0	43.9	43.9		45.3	44.9	45.1
Memorandum item:															
Nominal GDP (millions of US dollars)	2,508	2,887	3,437			4,008	4,509	5,088	5,716	6,343	7,052		11,982	34,592	

Source: Staff simulations.

1/ comprehensive data on private sector external debt are not available.

2/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that NPV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the NPV of new debt).

Table 2. Lao P.D.R.: Proactive Scenario (Baseline), Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2007-27
(In percent)

	Projections							
	2007	2008	2009	2010	2011	2012	**2017**	2027
NPV of debt-to-GDP ratio								
Baseline	45	42	39	36	34	33	**25**	19
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	45	46	46	47	48	49	**55**	61
A2. New public sector loans on less favorable terms in 2008-27 2/	45	43	41	39	38	36	**32**	28
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	45	43	41	38	36	34	**26**	19
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	45	45	46	43	41	38	**29**	20
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	45	50	56	52	49	46	**36**	26
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	45	53	56	52	49	46	**34**	21
B5. Combination of B1-B4 using one-half standard deviation shocks	45	49	54	51	48	45	**34**	24
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	45	59	55	51	48	46	**35**	26
NPV of debt-to-exports ratio								
Baseline	140	127	125	110	108	102	**79**	58
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	140	138	148	142	150	155	**174**	193
A2. New public sector loans on less favorable terms in 2007-26 2/	140	130	130	118	117	114	**100**	89
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	140	127	125	110	108	102	**79**	58
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	140	163	192	170	166	157	**118**	80
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	140	127	125	110	108	102	**79**	58
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	140	159	179	158	154	146	**107**	66
B5. Combination of B1-B4 using one-half standard deviation shocks	140	147	154	136	133	126	**96**	68
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	140	127	125	110	108	102	**79**	58
NPV of debt-to-revenue ratio								
Baseline	338	314	293	273	256	242	**192**	125
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	338	341	348	353	356	366	**421**	414
A2. New public sector loans on less favorable terms in 2007-26 2/	338	322	307	292	279	269	**242**	190
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	338	321	308	287	269	254	**202**	131
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	338	338	348	324	303	286	**221**	131
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	338	374	416	388	363	343	**272**	177
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	338	392	421	392	367	345	**258**	140
B5. Combination of B1-B4 using one-half standard deviation shocks	338	367	407	379	355	335	**262**	163
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	338	440	411	383	359	339	**269**	175
Debt service-to-exports ratio								
Baseline	6	6	7	6	6	5	**5**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	6	7	7	7	7	7	**9**	11
A2. New public sector loans on less favorable terms in 2008-27 2/	6	6	7	6	6	6	**6**	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	6	6	7	6	6	5	**5**	4
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	6	8	9	8	8	8	**8**	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	6	6	7	6	6	5	**5**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	6	6	7	7	7	6	**7**	4
B5. Combination of B1-B4 using one-half standard deviation shocks	6	7	8	7	7	6	**6**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	6	6	7	6	6	5	**5**	4
Debt service-to-revenue ratio								
Baseline	15	16	15	14	13	13	**12**	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	15	17	17	17	17	17	**23**	25
A2. New public sector loans on less favorable terms in 2008-27 2/	15	16	15	15	14	13	**15**	12
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	15	16	16	15	14	13	**13**	8
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	15	16	16	16	15	14	**15**	8
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	15	19	22	20	19	18	**18**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	15	16	17	17	16	15	**18**	9
B5. Combination of B1-B4 using one-half standard deviation shocks	15	18	20	19	18	17	**17**	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	15	22	22	20	19	18	**18**	11
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	40	40	40	40	40	40	**40**	40

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3. Lao P.D.R.: External Debt Sustainability Framework, Reactive Scenario (Alternative), 2007-2027 1/
(In percent of GDP, unless otherwise indicated)

	Projections									
	2007	2008	2009	2010	2011	2012	2007-12 Average	2017	2027	2013-27 Average
External debt (nominal) 1/	**63.0**	**56.9**	**51.1**	**49.1**	**47.7**	**46.4**		**42.1**	**44.8**	
o/w public and publicly guaranteed (PPG)	63.0	56.9	51.1	49.1	47.7	46.4		42.1	44.8	
Change in external debt	-6.0	-6.1	-5.8	-2.1	-1.4	-1.3		-0.5	0.8	
Identified net debt-creating flows	-2.3	-1.9	-1.7	-0.3	0.5	-0.7		-0.6	-0.8	
Non-interest current account deficit	**22.2**	**20.1**	**14.8**	**10.2**	**5.3**	**2.4**		**2.1**	**2.2**	2.2
Deficit in balance of goods and services	17.2	15.4	13.0	7.9	5.1	2.4		2.4	2.4	
Exports	32.0	32.0	29.2	31.2	30.4	30.4		30.4	30.4	
Imports	49.2	47.3	42.2	39.1	35.5	32.8		32.8	32.8	
Net current transfers (negative = inflow)	-3.6	-3.2	-2.9	-2.9	-2.6	-2.6		-2.6	-2.6	-2.6
o/w official	-2.0	-1.5	-1.2	-1.0	-1.0	-1.0		-1.0	-1.0	
Other current account flows (negative = net inflow)	8.5	7.9	4.7	5.3	2.8	2.6		2.3	2.4	
Net FDI (negative = inflow)	**-21.0**	**-18.4**	**-13.4**	**-8.1**	**-3.2**	**-1.7**		**-1.7**	**-1.7**	-1.7
Endogenous debt dynamics 2/	**-3.5**	**-3.6**	**-3.1**	**-2.5**	**-1.6**	**-1.4**		**-1.0**	**-1.2**	
Contribution from nominal interest rate	0.7	0.7	0.6	0.6	0.5	0.5		0.8	0.7	
Contribution from real GDP growth	-4.2	-4.3	-3.7	-3.0	-2.1	-1.9		-1.7	-1.9	
Contribution from price and exchange rate changes	…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**-3.7**	**-4.2**	**-4.0**	**-1.8**	**-1.9**	**-0.6**		**0.1**	**1.6**	
o/w exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt 4/	44.9	41.0	37.1	36.0	35.3	34.6		31.0	29.9	
In percent of exports	140.4	128.1	127.2	115.2	115.9	113.7		102.0	98.3	
NPV of PPG external debt	**44.9**	**41.0**	**37.1**	**36.0**	**35.3**	**34.6**		**31.0**	**29.9**	
In percent of exports	**140.4**	**128.1**	**127.2**	**115.2**	**115.9**	**113.7**		**102.0**	**98.3**	
In percent of government revenues	**338.4**	**312.6**	**295.5**	**292.2**	**290.1**	**291.3**		**317.1**	**312.8**	
Debt service-to-exports ratio (in percent)	**6.1**	**6.5**	**6.7**	**6.0**	**6.1**	**5.9**		**6.8**	**6.2**	
PPG debt service-to-exports ratio (in percent)	**6.1**	**6.5**	**6.7**	**6.0**	**6.1**	**5.9**		**6.8**	**6.2**	
PPG debt service-to-revenue ratio (in percent)	**14.8**	**16.0**	**15.6**	**15.3**	**15.2**	**15.2**		**21.1**	**19.6**	
Total gross financing need (millions of U.S. dollars)	126.4	177.1	178.3	233.6	244.2	164.2		234.6	467.8	
Non-interest current account deficit that stabilizes debt ratio	28.2	26.2	20.6	12.3	6.7	3.7		2.6	1.3	
Key macroeconomic assumptions										
Real GDP growth (in percent)	7.1	7.9	7.5	6.4	4.6	4.2	6.3	4.4	4.8	4.5
GDP deflator in US dollar terms (change in percent)	8.8	7.5	7.6	1.4	2.2	2.9	5.1	3.0	3.0	3.0
Effective interest rate (percent) 5/	1.2	1.2	1.2	1.2	1.2	1.1	1.2	1.9	1.7	1.8
Growth of exports of G&S (US dollar terms, in percent)	3.6	15.9	5.6	15.4	4.2	7.1	8.7	7.5	7.9	7.6
Growth of imports of G&S (US dollar terms, in percent)	35.7	11.5	3.1	0.0	-2.9	-0.9	7.8	7.5	7.9	7.6
Grant element of new public sector borrowing (in percent)	37.1	40.0	42.5	42.3	42.3	42.3	41.1	42.3	42.3	42.3
Grant-equivalent financing (in percent of GDP) 6/	3.1	2.6	2.4	2.2	2.2	2.3		2.5	3.0	2.6
Grant-equivalent financing (in percent of external financing) 6/	49.6	52.2	55.6	56.1	55.6	55.2		53.2	49.8	52.2
Memorandum item:										
Nominal GDP (millions of US dollars)	4008.4	4646.1	5372.0	5798.3	6198.9	6647.7		9501.0	20010.8	

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that NPV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the NPV of new debt).

Table 4. Lao P.D.R. : Reactive Scenario (Alternative), Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2007-27
(In percent)

	Projections							
	2007	2008	2009	2010	2011	2012	**2017**	2027
NPV of debt-to-GDP ratio								
Baseline	45	41	37	36	35	35	**31**	30
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	45	45	45	45	44	45	**47**	54
A2. New public sector loans on less favorable terms in 2008-27 2/	45	42	39	38	38	38	**39**	45
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	45	42	39	38	37	36	**32**	31
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	45	44	44	42	41	40	**35**	32
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	45	50	56	54	53	52	**47**	45
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	45	51	52	51	50	48	**41**	34
B5. Combination of B1-B4 using one-half standard deviation shocks	45	49	54	52	51	50	**44**	41
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	45	57	52	50	49	48	**43**	41
NPV of debt-to-exports ratio								
Baseline	140	128	127	115	116	114	**102**	98
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	140	141	155	143	145	147	**155**	177
A2. New public sector loans on less favorable terms in 2007-26 2/	140	131	133	123	126	127	**127**	149
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	140	128	127	115	116	114	**102**	98
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	140	163	190	172	173	170	**149**	132
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	140	128	127	115	116	114	**102**	98
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	140	159	180	162	163	159	**136**	111
B5. Combination of B1-B4 using one-half standard deviation shocks	140	146	152	137	138	135	**120**	112
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	140	128	127	115	116	114	**102**	98
NPV of debt-to-revenue ratio								
Baseline	338	313	295	292	290	291	**317**	313
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	338	344	359	362	363	376	**482**	565
A2. New public sector loans on less favorable terms in 2007-26 2/	338	320	310	312	316	324	**396**	474
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	338	320	309	306	304	305	**332**	327
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	338	335	347	343	340	341	**362**	330
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	338	383	444	439	436	438	**477**	470
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	338	387	417	412	408	409	**423**	353
B5. Combination of B1-B4 using one-half standard deviation shocks	338	376	428	423	420	421	**453**	431
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	338	434	410	405	402	404	**440**	434
Debt service-to-exports ratio								
Baseline	6	7	7	6	6	6	**7**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	6	7	8	7	7	7	**9**	10
A2. New public sector loans on less favorable terms in 2008-27 2/	6	7	7	6	6	6	**8**	9
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	6	7	7	6	6	6	**7**	6
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	6	8	9	8	8	8	**10**	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	6	7	7	6	6	6	**7**	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	6	7	7	7	7	7	**9**	7
B5. Combination of B1-B4 using one-half standard deviation shocks	6	7	8	7	7	7	**8**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	6	7	7	6	6	6	**7**	6
Debt service-to-revenue ratio								
Baseline	15	16	16	15	15	15	**21**	20
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008-27 1/	15	17	18	18	18	18	**28**	33
A2. New public sector loans on less favorable terms in 2008-27 2/	15	16	16	16	16	16	**24**	29
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2008-09	15	16	16	16	16	16	**22**	21
B2. Export value growth at historical average minus one standard deviation in 2008-09 3/	15	16	16	17	16	16	**25**	21
B3. US dollar GDP deflator at historical average minus one standard deviation in 2008-09	15	20	23	23	23	23	**32**	30
B4. Net non-debt creating flows at historical average minus one standard deviation in 2008-09 4/	15	16	17	18	18	18	**29**	24
B5. Combination of B1-B4 using one-half standard deviation shocks	15	19	21	21	21	21	**30**	27
B6. One-time 30 percent nominal depreciation relative to the baseline in 2008 5/	15	22	22	21	21	21	**29**	27
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	40	40	40	40	40	40	**40**	40

Source: Staff projections and simulations.
1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 5. Lao P.D.R.: Public Sector Debt Sustainability Framework, Proactive Scenario (Baseline), 2003/04-2026/27
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 5/	Standard Deviation 5/	Projections									
	2003/04	2004/05	2005/06			2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2006/07-11/12 average	2016/17	2026/27	2013/14-26/27 average
Public sector debt 1/	88.2	80.9	74.1			66.7	62.2	57.7	53.0	49.5	46.3		36.6	29.4	
of which: foreign-currency denominated	86.2	79.3	72.7			64.9	60.3	55.6	51.2	47.8	44.8		35.7	29.1	
Change in public sector debt	-6.9	-7.3	-6.8			-7.4	-4.5	-4.5	-4.6	-3.6	-3.1		-1.4	-0.3	
Identified debt-creating flows	-8.5	-7.8	-11.3			-9.1	-6.6	-6.5	-6.1	-5.1	-4.5		-1.9	-0.8	
Primary deficit	2.5	3.4	2.9	3.3	1.1	0.5	-0.1	-0.2	-0.4	-0.3	-0.1	-0.1	1.3	1.8	1.3
Revenue and grants	12.1	13.1	14.8			14.5	14.5	14.4	14.3	14.3	14.3		13.9	15.6	
of which: grants	1.1	1.7	2.1			1.3	1.1	1.0	0.9	0.9	0.8		0.8	0.8	
Primary (noninterest) expenditure	14.6	16.5	17.6			15.0	14.3	14.1	13.9	14.0	14.2		15.2	17.4	
Automatic debt dynamics	-11.0	-11.2	-14.2			-9.6	-6.5	-6.3	-5.7	-4.8	-4.4		-3.2	-2.6	
Contribution from interest rate/growth differential	-7.2	-7.1	-6.9			-5.4	-5.1	-5.0	-4.5	-3.6	-3.3		-2.4	-2.0	
of which: contribution from average real interest rate	-1.6	-1.4	-1.3			-0.4	-0.4	-0.4	-0.4	-0.4	-0.4		-0.1	-0.2	
of which: contribution from real GDP growth	-5.6	-5.7	-5.6			-5.0	-4.6	-4.6	-4.2	-3.2	-3.0		-2.3	-1.8	
Contribution from real exchange rate depreciation	-3.8	-4.1	-7.2			-4.2	-1.4	-1.3	-1.2	-1.1	-1.1		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	1.6	0.5	4.5			1.7	2.2	2.0	1.5	1.5	1.4		0.5	0.5	
NPV of public sector debt	...	...	50.8			47.7	45.3	42.4	39.4	37.0	34.9		26.7	19.3	
of which: foreign-currency denominated	...	...	49.5			46.0	43.4	40.3	37.5	35.3	33.4		25.9	19.0	
of which: external	...	...	49.5			46.0	43.4	40.3	37.5	35.3	33.4		25.9	19.0	
NPV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	5.2	7.1	6.0			3.2	2.9	2.7	2.3	2.2	2.3		3.3	3.0	
NPV of public sector debt-to-revenue ratio (in percent) 3/	...	...	344.3			330.0	313.0	295.7	276.2	259.1	244.3		192.4	123.5	
of which: external	...	...	335.3			318.1	300.0	281.1	263.1	247.3	233.8		186.0	121.5	
Debt service-to-revenue ratio (in percent) 3/ 4/	14.9	15.8	11.9			13.7	15.0	15.1	14.2	13.3	12.5		11.6	6.8	
Primary deficit that stabilizes the debt-to-GDP ratio	9.4	10.7	9.7			7.9	4.3	4.3	4.3	3.3	3.0		2.7	2.1	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.3	6.9	7.5	6.5	0.7	7.2	7.5	8.1	7.8	6.5	6.3	7.2	6.4	6.4	6.4
Average nominal interest rate on forex debt (in percent)	1.0	1.2	1.0	0.9	0.2	0.9	1.0	1.1	1.1	1.0	1.0	1.0	1.5	1.3	1.4
Average real interest rate on domestic currency debt (in percent)	4.6	1.6	1.4	8.9	18.5	7.4	5.0	5.0	3.9	3.8	3.7	4.8	3.7	3.7	3.7
Real exchange rate depreciation (in percent, + indicates depreciation)	-4.3	-5.1	-10.0	-5.6	7.1	-6.2	-2.4	-2.3	-2.3	-2.4	-2.4	-3.0	0.0	0.0	0.0
Inflation rate (GDP deflator, in percent)	11.6	8.5	5.4	10.1	3.4	4.2	4.4	4.3	4.4	4.5	4.5	4.4	4.5	4.5	4.5
Growth of real primary spending (deflated by GDP deflator, in percent)	-14.0	20.5	15.1	4.1	15.2	-8.9	2.8	6.6	5.7	7.3	8.2	3.6	7.7	7.6	7.9
Grant element of new external borrowing (in percent)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...

Sources: Lao P.D.R. authorities; and Fund staff estimates and projections.

1/ Gorss general government debt.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues including grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages are for 2001/02-2005/06.

Table 6. Lao P.D.R.: Proactive Scenario (Baseline), Sensitivity Analysis for Key Indicators of Public Debt 2006/07-2026/27
(In percent)

	Projections							
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2016/17	2026/27
NPV of Debt-to-GDP Ratio								
Proactive scenario	48	45	42	39	37	35	27	19
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	48	48	47	46	45	44	38	30
A2. Primary balance is unchanged from 2006	48	46	43	40	38	37	27	15
A3. Permanently lower GDP growth 1/	48	45	43	40	37	35	28	21
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	48	46	44	41	39	37	29	23
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	48	48	47	43	41	39	29	20
B3. Combination of B1-B2 using one half standard deviation shocks	48	48	48	44	41	39	30	20
B4. One-time 30 percent real depreciation in 2007	48	63	58	54	50	46	33	19
B5. 10 percent of GDP increase in other debt-creating flows in 2007	48	51	47	44	41	39	29	20
NPV of Debt-to-Revenue Ratio 2/								
Proactive scenario	330	313	296	276	259	244	192	123
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	330	328	326	321	314	307	275	194
A2. Primary balance is unchanged from 2006	330	315	301	284	269	256	195	97
A3. Permanently lower GDP growth 1/	330	313	297	278	261	247	198	136
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	330	318	308	290	273	260	212	145
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	330	330	327	305	286	269	210	130
B3. Combination of B1-B2 using one half standard deviation shocks	330	331	332	309	290	273	213	131
B4. One-time 30 percent real depreciation in 2007	330	437	407	376	349	325	235	123
B5. 10 percent of GDP increase in other debt-creating flows in 2007	330	350	329	307	288	271	211	130
Debt Service-to-Revenue Ratio 2/								
Proactive scenario	14	15	15	14	13	13	12	7
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	14	15	17	16	16	15	15	10
A2. Primary balance is unchanged from 2006	14	15	15	15	14	13	12	6
A3. Permanently lower GDP growth 1/	14	15	15	14	13	13	12	7
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	14	15	16	15	14	13	12	8
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	14	15	17	16	14	13	13	7
B3. Combination of B1-B2 using one half standard deviation shocks	14	15	17	16	14	13	13	7
B4. One-time 30 percent real depreciation in 2007	14	16	17	16	15	14	13	8
B5. 10 percent of GDP increase in other debt-creating flows in 2007	14	15	19	15	14	13	13	7

Sources: Lao P.D.R. authorities; and Fund staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period (20).
2/ Revenues are defined inclusive of grants.

Table 7. Lao P.D.R.: Public Sector Debt Sustainability Framework, Reactive Scenario (Alternative), 2006/07-2026/27
(In percent of GDP, unless otherwise indicated)

	Projections									
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2006/07-11/12 average	2016/17	2026/27	2013/14-26/27 average
Public sector debt 1/	66.7	60.9	54.5	51.7	49.9	48.4		43.5	45.7	
of which: foreign-currency denominated	64.9	59.1	52.5	50.0	48.4	47.1		42.8	45.5	
Change in public sector debt	-7.8	-5.7	-6.4	-2.8	-1.8	-1.5		-0.6	0.8	
Identified debt-creating flows	-9.2	-7.0	-5.6	-2.7	-2.2	-2.1		-1.0	0.1	
Primary deficit	0.5	1.3	0.9	0.7	0.7	0.8	0.8	1.4	2.8	1.8
Revenue and grants	14.5	14.2	13.5	13.2	13.1	12.8		10.7	10.4	
of which: grants	1.3	1.0	0.9	0.9	0.9	0.9		0.9	0.9	
Primary (noninterest) expenditure	15.0	15.5	14.5	14.0	13.8	13.6		12.0	13.2	
Automatic debt dynamics	-9.7	-8.3	-6.5	-3.4	-2.9	-2.8		-2.4	-2.7	
Contribution from interest rate/growth differential	-5.5	-5.2	-4.7	-3.8	-2.9	-2.5		-2.0	-2.3	
of which: contribution from average real interest rate	-0.4	-0.5	-0.4	-0.4	-0.4	-0.4		-0.2	-0.3	
of which: contribution from real GDP growth	-5.0	-4.8	-4.3	-3.4	-2.5	-2.1		-1.9	-2.1	
Contribution from real exchange rate depreciation	-4.2	-3.1	-1.8	0.4	0.0	-0.3		...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	1.4	1.3	-0.9	-0.1	0.4	0.6		0.5	0.7	
NPV of public sector debt	47.7	43.9	40.9	39.4	38.4	37.5		33.2	31.4	
of which: foreign-currency denominated	46.0	42.1	38.9	37.7	36.9	36.2		32.5	31.3	
of which: external	46.0	42.1	38.9	37.7	36.9	36.2		32.5	31.3	
NPV of contingent liabilities (not included in public sector debt)	...	...	...	...	...	...		...	...	
Gross financing need 2/	3.5	4.3	3.8	3.4	3.2	3.1		3.6	4.6	
NPV of public sector debt-to-revenue ratio (in percent) 3/	330.0	308.9	302.3	297.8	294.1	292.9		310.9	303.3	
of which: external	318.1	295.9	287.3	284.6	282.4	282.4		304.6	301.7	
Debt service-to-revenue ratio (in percent) 3/ 4/	13.7	15.0	15.1	14.9	14.6	14.5		18.6	16.8	
Primary deficit that stabilizes the debt-to-GDP ratio	8.3	7.0	7.4	3.5	2.5	2.2		1.9	2.1	
Key macroeconomic and fiscal assumptions										
Real GDP growth (in percent)	7.2	7.7	7.6	6.7	5.0	4.3	6.4	4.4	4.9	4.5
Average nominal interest rate on forex debt (in percent)	0.9	1.0	1.0	1.1	1.1	1.1	1.0	1.6	1.4	1.5
Average real interest rate on domestic currency debt (in percent)	5.0	3.8	2.0	0.1	-0.4	-1.2	1.6	-1.5	-1.5	-1.5
Real exchange rate depreciation (in percent, + indicates depreciation)	-6.2	-5.2	-3.3	0.8	0.0	-0.7	-2.4	6.9	6.9	6.9
Inflation rate (GDP deflator, in percent)	4.2	5.6	7.4	8.3	8.9	9.8	7.4	10.0	10.0	10.0
Growth of real primary spending (deflated by GDP deflator, in percent)	-1.1	11.6	0.4	3.0	3.4	2.8	3.3	3.9	7.1	4.1
Grant element of new external borrowing (in percent)	...	...	...	...	...	...	...	...	...	...

Sources: Lao P.D.R. authorities; and Fund staff estimates and projections.
1/ Gorss general government debt.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues including grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

Table 8. Lao P.D.R.: Reactive Scenario (Alternative), Sensitivity Analysis for Key Indicators of Public Debt 2006-2026

	Projections							
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2016/17	2026/27
NPV of Debt-to-GDP Ratio								
Baseline	48	44	41	39	38	38	33	31
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	48	45	43	43	42	41	36	30
A2. Primary balance is unchanged from 2006	48	44	40	39	38	37	31	23
A3. Permanently lower GDP growth 1/	48	44	41	40	39	38	34	33
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	48	45	43	41	40	40	36	35
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	48	45	44	42	41	40	35	33
B3. Combination of B1-B2 using one half standard deviation shocks	48	46	44	43	41	40	35	33
B4. One-time 30 percent real depreciation in 2007	48	61	56	54	52	51	43	37
B5. 10 percent of GDP increase in other debt-creating flows in 2007	48	49	46	44	43	42	37	33
NPV of Debt-to-Revenue Ratio 2/								
Baseline	330	309	302	298	294	293	311	303
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	330	317	319	321	320	320	340	297
A2. Primary balance is unchanged from 2006	330	306	298	293	288	286	290	221
A3. Permanently lower GDP growth 1/	330	309	303	299	296	296	319	322
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	330	315	314	311	309	309	335	335
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	330	319	324	318	314	313	331	315
B3. Combination of B1-B2 using one half standard deviation shocks	330	320	326	320	316	315	332	315
B4. One-time 30 percent real depreciation in 2007	330	426	416	408	400	395	401	353
B5. 10 percent of GDP increase in other debt-creating flows in 2007	330	347	337	332	328	326	344	322
Debt Service-to-Revenue Ratio 2/								
Baseline	14	15	15	15	15	15	19	17
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	14	15	16	16	16	15	19	16
A2. Primary balance is unchanged from 2006	14	15	15	15	14	14	18	13
A3. Permanently lower GDP growth 1/	14	15	15	15	15	15	19	18
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	14	15	16	16	15	15	20	18
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	14	15	16	16	15	15	20	18
B3. Combination of B1-B2 using one half standard deviation shocks	14	15	16	16	15	15	20	18
B4. One-time 30 percent real depreciation in 2007	14	16	17	17	16	16	21	20
B5. 10 percent of GDP increase in other debt-creating flows in 2007	14	15	19	16	15	15	21	18

Sources: Lao P.D.R. authorities; and Fund staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period (20).
2/ Revenues are defined inclusive of grants.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 07/106
FOR IMMEDIATE RELEASE
August 23, 2007

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2007 Article IV Consultation with the Lao People's Democratic Republic

On August 3, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Lao People's Democratic Republic.[1]

Background

Macroeconomic performance remains strong. Real GDP growth increased to 7½ percent in 2006, driven by the resource sector such as a sizable expansion of mineral production and the construction of the Nam Theun 2 (NT2) hydro-electric dam. The non-resource sector continued to grow moderately. Inflation has fallen below 4 percent in recent months, due to favorable oil and food prices and the lagged impact of the exchange rate appreciation. The current account deficit narrowed, reflecting buoyant resource exports and rising tourism receipts, and together with higher foreign direct investment and official development assistance inflows, resulted in an increase in the balance of payments. By end-June 2007, gross international reserves increased to about US$460 million, 4.6 months of non-resource imports. The rapid accumulation of international reserves led to an acceleration in the growth of monetary aggregates. By end–May 2007, reserve and broad money growth accelerated to 45 and 39 percent, respectively.

---

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Fiscal policy in 2005/06[2] and the first eight months of 2006/07 contributed to lower demand pressures. Higher-than-anticipated resource revenues, coupled with non-resource revenues gains from the full implementation of tax changes in 2005 helped to reduce the deficit and lower net domestic borrowing. Bank credit to the private sector has also fallen in recent months.

Progress in economic reform has been mixed and the cost of doing business remains high. Restructuring of state-owned banks (SOCBs) and enterprises (SOEs) is proceeding, but SOCBs are far from being solvent and some SOEs are still making losses or are heavily indebted. Several laws for reforming the budget system (such as tax and customs administration and intergovernmental relations), introducing a VAT, and improving the investment climate (including the 2005 Enterprise Law and 2006 Commercial Bank Law) have been approved, but there is considerable delay in finalizing the respective implementing regulations. ASEAN Free Trade Area (AFTA) agreement is being pursued, and work to gain World Trade Organization (WTO) accession is ongoing.

The economic outlook is promising, but much depends on the way in which the government handles the natural resource bonanza. Were the government to adopt sound policies and accelerate reforms in anticipation of an adverse impact of the resource sector, growth would remain strong at around 6½ percent in the medium term, and inflation would stay below 5 percent. On the contrary, the outlook would be less benign if the government does not take timely policy actions, with lower growth and higher inflation. There are several risks to the outlook. Upside risks include additional proven mineral reserves, new investment in the mining sector, and construction of more hydropower plants. Downside risks comprise adverse commodity price shocks, delays in construction of hydropower plants, and slow process in important economic reform.

Executive Board Assessment

Executive Directors welcomed Lao P.D.R.'s recent record of robust growth, low inflation, and strengthened external position, which reflects a rapidly growing mining and hydropower resource sector as well as a favorable external environment. Poverty has been reduced significantly. Directors were encouraged by Lao P.D.R.'s strong fiscal performance, by the progress achieved in banking and state-owned enterprise (SOE) reform, and by the steps taken to improve the investment climate.

Directors concurred that the economic outlook for Lao P.D.R. is promising. They considered that the implementation of policies to sustain macroeconomic stability and accelerate the pace of reform will be key to realizing the full benefits of the resource sector, by supporting a strong

[2] The fiscal year ends on September 30.

supply response in the non-resource sector. This will be needed to help Lao P.D.R. mitigate the risks associated with the increased reliance on the natural resource sector and to help reduce exposure to debt distress.

Directors welcomed the authorities' commitment to fiscal consolidation and debt sustainability over the medium term, but expressed concern that full implementation of the recently approved 2007/08 budget will be a move away from the realization of the government's medium-term fiscal objectives. Accordingly, they encouraged the authorities to identify additional measures that would maintain fiscal prudence. Directors underscored the importance of a timely introduction of a VAT and a review of the tax system, coupled with stepped-up efforts to improve revenue and expenditure administration, and reform intergovernmental fiscal relations. In order to support the alignment of expenditures with national priorities, Directors called on the authorities to put in place an integrated medium-term fiscal framework that takes into account the uncertainties of resource revenues. Future external financing should continue to rely on grants and concessional loans.

Directors stressed that the development of a sound and transparent resource management framework, with appropriate expert assistance, will be key to ensuring a level playing field and attracting investor interest. In this regard, the net benefits of taking an equity stake in future resource projects should be closely evaluated, given the associated financial risks and the potential conflict of interest with government's dual role as regulator and shareholder. Directors also encouraged the authorities to participate in the Extractive Industries Transparency Initiative.

Directors underscored the need for maintaining a tight control of Bank of Lao P.D.R.'s (BoL) net domestic assets and bank credit to the private sector. They agreed the BoL's liquidity management instruments should be upgraded, and supported the introduction of a standing deposit facility until instruments using treasury bills are in place. Steps should also be taken to develop the interbank money market and mechanisms to avoid the quasi-fiscal costs of managing liquidity.

Directors considered that the Lao P.D.R.'s exchange rate policy is appropriate, and that the exchange rate appears to be in line with macroeconomic fundamentals. They shared the authorities' concern about the risk of large exchange rate fluctuations. To help manage such risk, Directors encouraged the authorities to strengthen international reserves further, to build up the BoL's capacity to smooth fluctuations, and to take steps to develop a well-functioning foreign exchange market.

Directors urged the authorities to accelerate banking and SOE reform, including by fully implementing the banking law, strictly enforcing prudential regulations, and strengthening bank supervision. Directors encouraged the authorities to expedite the recapitalization of the state-owned commercial banks, including by involving strategic investors. They noted that deepening

SOE restructuring would help strengthen the banking sector. With the reduced reliance of SOEs on the budget, the extension of public guarantees on SOEs' borrowing should henceforth be conditioned on the viability of business plans.

Directors welcomed the authorities' plans to enhance trade integration and improve the investment climate. The authorities' efforts to gain WTO accession should be sustained. Directors considered that more decisive steps to reduce the high cost of doing business will help Lao P.D.R. to reap the full benefits of trade integration.

Directors observed that improving the Lao P.D.R.'s macroeconomic and financial data will support more effective surveillance and enhance decision-making, and encouraged the authorities to focus, in particular, on data on the balance of payments, government finances, and external debt, and on bank soundness indicators.

Lao P.D.R.: Selected Economic and Financial Indicators, 2003–07

Nominal GDP (2006 est.): $3,437 million
Population (2006 est.): 6.0 million
GDP per capita (2006 est.): $ 572.8

	2003	2004	2005	2006 Staff est.	2007 Staff proj.
GDP and prices (percentage change)					
Real GDP growth	6.1	6.4	7.1	7.6	7.1
CPI (annual average)	15.5	10.5	7.2	6.8	4.0
Public finances (in percent of GDP) 1/					
Revenue	10.9	11.0	11.4	12.7	13.2
Grants	2.1	1.1	1.7	2.1	1.3
Expenditure	18.6	15.5	17.5	18.5	15.7
Overall balance (including grants)	-5.6	-3.4	-4.4	-3.7	-1.3
Domestic financing	0.4	-0.2	0.2	-1.3	-1.3
External financing	5.1	3.6	4.2	5.0	2.5
Money and Credit (annual percent change) 2/					
Reserve money	28.5	12.9	17.6	38.2	20.4
Broad money	15.5	21.5	7.7	30.1	24.8
Bank credit to the economy 3/	1.3	12.6	26.8	4.2	16.0
Interest rates (end of period)					
On three-month kip deposits	14.0	7.5	5.5	5.5	...
On short-term kip loans	22.4	16.0	17.8	14.0	...
Balance of payments					
Exports (percent change)	21.6	11.0	29.4	54.1	1.3
Imports (percent change)	9.6	40.9	23.4	14.8	37.0
Trade Balance (in percent of GDP)	-11.3	-19.0	-19.4	-11.3	-22.1
Current account balance (in percent of GDP)	-8.1	-14.3	-20.2	-13.3	-22.9
Gross official reserves (in millions of U.S. dollars)	214	226	238	336	437
(In months of prospective goods and services imports) 4/	3.2	3.0	2.8	3.6	4.3
(In percent of short-term debt)	305.1	277.2	180.9	225.4	334.5
External public debt and debt services					
External public debt (in percent of GDP)	89.1	83.2	77.1	69.0	63.0
Net present value of debt (in percent of exports)	204.6	198.9	168.9	134.5	140.4
External public debt services (in percent of exports)	6.7	7.5	7.7	4.0	6.1
Exchange rate					
Official exchange rate (kip per dollar; end of period)	10,434	10,357	10,767	9,655	...
Nominal effective exchange rate (2000=100)	71.6	67.7	67.3	68.6	...
Real effective exchange rate (2000=100)	94.1	96.1	99.1	104.5	...
Memorandum item:					
Nominal GDP (calendar year; in billions of kip)	22,597	26,539	30,705	34,581	38,569

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.
1/ Fiscal year basis (October to September).
2/ Money and credit data are evaluated at current exchange rates.
3/ Excluding debt write-offs.
4/ Excludes imports associated with large resource projects.

Statement by Chantavarn Sucharitakul, Alternate Executive Director for Lao P.D.R.
August 3, 2007

Introduction

My authorities are most grateful to the staff for the productive discussions and the high-quality papers which cover impending and structural, longer-term issues. There is broad consensus between the staff and the authorities on most aspects of diagnosis of and policy recommendations for the Laotian economy.

The economic and social performance of Lao P.D.R. during the last decade has been outstanding, supported by prudent policy management and anchored by a focused and ambitious forward looking strategy. Nevertheless, Lao P.D.R. remains a poor country and continues to be highly vulnerable to weather-related and external shocks. Moreover, a low tax revenue-to-GDP ratio has impeded the government's ability to finance crucial development expenditure. To address these challenges, my authorities are determined to pursue the necessary adjustments and promote a more rapid diversification of the economy which they hope will ensure a more sustainable level of growth to meet the MDGs. To meet these objectives, the government strategy has included fiscal consolidation, efforts to improve the business climate and the continued opening up of the economy in order to avail themselves of the benefits from globalization.

Recent Economic Developments and Outlook

As in the previous year, real GDP growth in 2005/06 was robust. The estimated 8.1 percent growth was attributable mainly to the mining and hydropower sectors and the supportive regional economic environment. This positive growth momentum has been sustained into the first half of 2006/07 and economic developments have been largely favorable on the back of stronger external demand, strong growth in construction activity, and a renewed domestic and foreign investment. Meanwhile, inflation remains well-contained, averaging 4.25 percent for the six months of 2007, while the exchange rate continues to be broadly stable against the U.S. dollar during the past four years. During 2006, the kip appreciated by 10.4 percent against the U.S. dollar.

The macro-economic outlook for **2006/07** remains buoyant, reflecting the continuation of strong growth in the mining and hydropower sectors. Real GDP growth is expected to increase to about 7.5–8.0 percent and the CPI inflation is expected to decline to 4 percent by end-2007. The current account deficit (including official transfers) is expected to be about

3.0 percent of GDP, due to stronger net exports. Gross official international reserves are expected to reach five months of import coverage.

The authorities fully recognize that strong and sustained growth is key to reducing poverty and achieving the MDGs. They have, therefore, continued to implement sound macroeconomic policies and structural reforms to achieve these goals. They are committed to promoting private sector-led growth by fostering a conducive business climate and strengthening the financial environment. Particular attention will also be given to reducing the cost of doing business, monitoring the soundness of the banking sector, and developing microfinance institutions.

Fiscal Policy

My authorities believe that fiscal consolidation is the cornerstone of their development strategy. They have adopted an integral approach to strengthen revenue collection, enhance the quality of public expenditures, and improve debt management. In terms of tax policy, the government undertook in 2005 their most comprehensive reform of the last decade, which has begun to reap dividends. During the fiscal year of 2005/06, the tax and non-tax revenue outturn was 108.7 percent of the planned target. However, the outturn of the government revenue including grants was only 93.9 percent of the planned target due to some slippages of the revenue from project grants. It is estimated that the fiscal performance in 2006/07 will be more favorable than the previous fiscal year.

The authorities are determined to further reduce the budget deficit over the medium term, through a combination of measures to improve revenue performance and tighter expenditures controls.

Specifically, with the recently approved budget and VAT law, the government will continue to strengthen tax administration by (i) reinforcing the central tax department; (ii) reorganizing the tax and customs departments on a functional basis; and (iii) integrating large provincial customs offices into the national administration. Preparations for the introduction of a VAT have begun and will be accelerated in 2007/08, including through continued improvements in administrative systems. The implementation of VAT is scheduled to be in late 2008 or early 2009.

In addition, the authorities plan to streamline the tax policy and broaden the taxpayer base by limiting ad hoc tax exemptions and rate reductions, and fighting tax evasion. In doing so, the authorities hope to raise additional revenue to place future budget outcomes on a sustainable path. They will further restrain expenditure where they can, to compensate for budget slippages from project grants. They also intend to step up the clearance of the budget arrears, especially the arrears on capital expenditures.

The authorities acknowledge the challenges of managing the resource sector and appreciate the staff assessment of the various scenario analyses of proactive and reactive policy responses. In this respect, they would carefully examine these scenario analyses as an important input into developing their fiscal framework going forward.

Monetary and Exchange Rate Policy

The BoL has been successful in implementing its monetary policies with the view to maintaining a low and stable inflation rate, and in managing the floating exchange rate regime.

Monetary developments were well above the planned target in 2006. M2 increased by 30 percent, above the targeted 18 percent. This is mainly due to the short-term increase of net foreign assets of 53.3 percent. In this connection, the BoL has been monitoring closely the monetary expansion in the first and second quarters of 2007 and stand ready to tighten monetary policy, with available monetary tools, should inflationary pressures emerge. In order to maintain the current low inflation rate, the monetary stance of the BoL will continue to remain firm. Tight control over the BoL's net domestic assets will continue to be the main anchor of its monetary policy. Going forward, BoL intends to develop market-based instruments for managing liquidity by using both domestic securities and sale of foreign exchange.

At present, the authorities feel comfortable with the competitiveness of the exchange rate and the level of reserves. Intervention in the foreign exchange market has been aimed at smoothing transitory fluctuations in the exchange rate, and maintaining an adequate level of reserves.

Financial Sector

My authorities concur with the staff that a well-developed financial sector plays a pivotal role in promoting efficiency and stimulating productivity. In December 2006, the National Assembly adopted the commercial bank law, which was promulgated by the President of the Lao P.D.R. in January 2007. This is testimony to the priority the government attaches to the importance of financial sector reform.

The performance of commercial banks has improved. All banks have low NPL ratios. The income statement of the two state-owned commercial banks (Banque Pour le Commerce Exterieur Lao and Lao Development Bank), which have been restructured under the Asian Development Bank's Banking Sector Reform Program Loan, have registered some profits since 2004 and 2005, respectively. The Agriculture Promotion Bank (APB), which is the third state-owned bank, is now being restructured under the Rural Finance Sector

Development Program Loan of Asian Development Bank, drawing lessons from the restructuring of the earlier two state-owned commercial banks.

While the taking over of NPLs has helped improve the balance sheets of banks, my authorities note that the health of the banking sector remains fragile. They intend to work closely with the International Financial Institution (IFIs) to ensure a forceful implementation of its recommendations aimed at addressing weaknesses in banks' management and supervision.

Investment Climate and Regional Integration

The authorities are committed to reforming the economic system to support the integration of its economy with the rest of the world. To this end, the National Assembly adopted two main laws to support trade and investment in the country, namely, the new enterprise law in 2005, and the new foreign investment law in 2004 to facilitate trade and foreign investment into Lao P.D.R..

Following the enactments of these two laws, the approval of foreign investment in Lao P.D.R. in 2006 rose to around US$2.6 billion from US$1.2 billion in 2005. The registration of new enterprises in the Ministry of Industry and commerce during 2006 was about 115 units compared to 97 units in 2005. Foreign participation in the Lao P.D.R. economy has largely been in the mining and hydropower sectors, which accounts for more than two-thirds of the total value of foreign direct investment in the country.

Import and export procedures have also been further simplified. All goods can be freely imported by making declarations at the customs point, except for four product groups subject to control goods (fuel, vehicles, cement, steel bars), and those restricted for health and security reasons. In addition to the requirements related to the accession of the World Trade Organization (WTO), the government will continue to liberalize their trade regime based on their commitments to the ASEAN Free Trade Agreement (AFTA).

My authorities are cognizant that all reforms aimed at reviving the economic activity and attracting investors must be complemented with a strengthening of the business environment. In this connection, the authorities launched the Second Lao Business Forum on March 15, 2007 to discuss progress in resolving issues facing the private sector and government plans to improve the business environment.

Statistics

The authorities will continue to make efforts to improve the collection and compilation of data on the balance of payments, external debts, SOEs financial statements, and provincial fiscal operations. In addition, the authorities will work towards enhancing the accuracy of the national accounts based on the SNA 1993 framework which the authorities have started since 1999.

Conclusion

My authorities highly value the continued support from the international community, including the Fund and the World Bank. Despite the numerous difficulties of the past, my authorities have achieved significant economic success, not least of which is stabilizing the economy. Nevertheless, they recognize that much remains to be done before the country can achieve its medium-term poverty reduction goals. My authorities are fully committed to continuing prudent macroeconomic policies, liberalization of the economy and improvements in the business climate.

I am pleased to inform the Board that the authorities consent to the publication of the staff report for the 2007 Article IV consultation, and the accompanying documents, with the **necessary deletion of market-sensitive** information.