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Lao People's Democratic Republic: 2004 Article IV Consultation—Staff Report; 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 2004 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 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on August 4, 2004, 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 November 17, 2004. 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 Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its November 29, 2004 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 documents listed below have been or will be separately released.

Joint Staff Advisory Note of the Poverty Reduction Strategy Paper
Poverty Reduction Strategy Paper
Selected Issues Paper and Statistical Annex

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.

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INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

Staff Report for the 2004 Article IV Consultation

Prepared by the Staff Representatives for the 2004 Consultation
with the Lao People's Democratic Republic

Approved by Daniel Citrin and Anthony Boote

November 17, 2004

- A mission visited Vientiane during July 21–August 4 to conduct discussions for the 2004 Article IV Consultation and continue discussions for the fourth review under the PRGF arrangement.

- The staff team comprised Messrs. Bingham (head), Hussain, and Miniane (all APD), Aiyar (PDR) and Maliszewski (FAD), and Ms. Del Rosario (Administrative Assistant, APD). Mr. Patrawimolpon (OED) joined the discussions. The team was assisted by the resident representative Mr. Beaugrand and coordinated closely with World Bank and AsDB staff.

- The team met with Deputy Prime Minister for Economic and Financial Affairs Bouasone Buophavanth, Minister of Finance Chansy Phosikham, Bank of the Lao P.D.R. Governor Phoumi Thipphavone, Vice President of the National Assembly Mme Pany Yathotou, other senior officials, and representatives of the private sector and civil society.

- The present PRGF arrangement (SDR 31.7 million) was approved in April 2001, and was extended by an additional year, through April 24, 2005, in September 2003 (Annex I). In concluding the Article IV consultations in August 2002, Directors welcomed the strengthening macroeconomic situation, but expressed concern about the slow progress on structural reforms, especially in the fiscal area. These views were reaffirmed at the time of the third review in September 2003. Discussions for the fourth PRGF review commenced in December 2003 and continued through October 2004.

- Staff reports on the PRGF arrangement have been published; the authorities have agreed to consider publication of this report and its background papers, but have not yet indicated their consent.

- Lao P.D.R.'s statistical base has significant limitations for surveillance purposes (Annex II). STA has provided technical assistance to address weaknesses in the key statistical systems and facilitate Lao P.D.R.'s participation in the General Data Dissemination System (GDDS).

- Lao P.D.R. continues to avail itself of transitional arrangements under Article XIV. Staff have conducted a review of exchange regulations to establish the remaining measures that would allow Lao P.D.R. to accept Article VIII. These measures are discussed in paragraph 38 of this report.

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EXECUTIVE SUMMARY

Lao P.D.R.'s recent macroeconomic performance has been relatively encouraging. Macroeconomic conditions are stable and economic growth has been robust. The latest data also suggest that poverty has continued to decline.

However, the pace of structural reform has remained slow, especially in the fiscal area. While some headway has been made in reforming the state banks and state-owned enterprises, progress in mobilizing revenues and strengthening expenditure management has been slow, due to capacity constraints and a difficulty advancing reforms in a decentralized fiscal structure.

The near-term outlook is favorable, but Lao P.D.R.'s high debt poses a risk to the medium-term outlook. Moving towards a sustainable debt burden will require accelerated progress on structural reform, especially with regard to revenue mobilization. Prudent debt management will also be critical. Maintaining sustainable growth will require further structural reform to encourage private sector development.

Policy discussions focused on macroeconomic policies and key structural reforms for sustaining macroeconomic stability and reducing poverty:

- ***Macroeconomic policies***. Discussions focused on establishing a sound framework for the 2004/05 budget, where there are concerns about a large increase in the wage bill, and maintaining tight control over credit expansion at the state banks.

- ***Fiscal reforms.*** The priority continues to be to advance structural reform to mobilize revenues and improve expenditure management. Progress in both areas depends on strengthening central control over fiscal management in the provinces. This may require a more comprehensive reform of inter-governmental relations.

- ***Banking reform***. Staff encouraged the authorities to maintain progress in restructuring the two state banks, as both banks remain vulnerable. Further progress is also needed in strengthening bank supervision and improving the overall banking environment, by encouraging greater competition in the banking system.

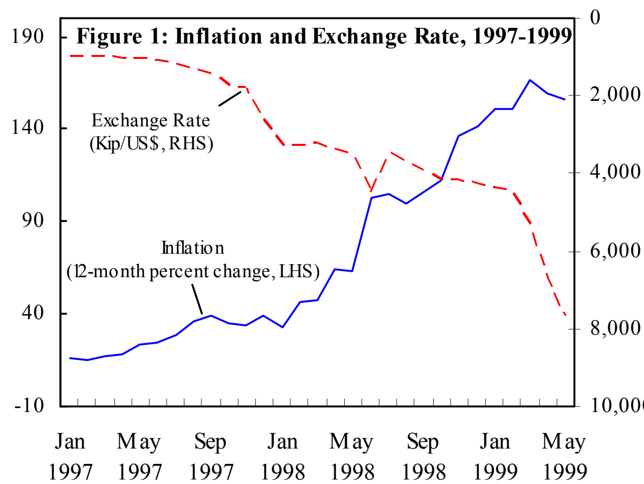
- ***Enterprise reform.*** Staff welcomed the recent progress in reforming state-owned enterprises, including steps taken to resolve the ongoing losses at Lao Airlines. Staff encouraged the authorities to complete ongoing restructuring plans at the major enterprises on schedule. Further efforts are also needed to promote private sector activity and improve the investment climate.

Completion of the fourth PRGF review has been delayed pending the resolution of a number of issues. These include clarification of the 2004/05 budget plan, the scope of tax incentives under new investment laws, and progress on revenue and state bank reforms. Staff are also seeking understandings on the external audit of the central bank's accounts. Further discussions on the fourth review are planned after the Article IV Consultation.

I. Background and Economic Setting

Background

1. **In early 2001, when the current PRGF arrangement was approved, Lao P.D.R. had just emerged from an acute period of macroeconomic instability**. Although the Asian crisis was a contributing factor, the domestic problems stemmed largely from a breakdown in fiscal management in 1997–98. The government, anxious to accelerate the pace of development, launched a series of large investments in irrigation aimed at achieving rice self-sufficiency. The investments, though well-intentioned, were unplanned and pushed through without adequate financing arrangements. The consequences were severe (Figure 1). Heavy borrowing from the central bank resulted in a rapid expansion of liquidity that caused a collapse of the kip and triple digit inflation.



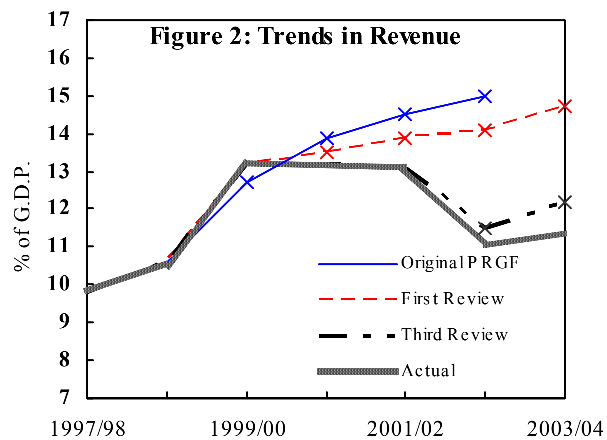
2. **The government launched a successful stabilization program in late 1999, but significant structural weaknesses remained**. Monetary and fiscal policies were tightened, along the lines recommended by Fund staff, and by early 2001 the kip had stabilized and inflation had been reduced to single digits. However, the fiscal position was fragile: budget revenues were low and over dependent on timber royalties, and recurrent spending, especially on social programs and civil service wages, was highly compressed. The state commercial banks (SCBs) were also insolvent, weighed down by high levels of nonperforming loans (almost 90 percent of the SCB loans were nonperforming). The latter arose mainly from noncommercial lending to state-owned enterprises (SOEs), although government arrears to private borrowers were also a contributory factor. The high level of non performing loans (NPLs) from SOEs[1] reflected a poor repayment culture, as well as operational weaknesses stemming (in part) from government interference in their pricing policies.

3. **The government requested the PRGF arrangement to help advance key reforms to consolidate the recovery from the economic crisis**. The primary objective was to strengthen public finances to sustain the stabilization effort and provide a solid platform to address Lao P.D.R.'s substantial development needs. Raising budget revenues and improving expenditure management were the main priority, but the program also focused on reforming SCBs and SOEs to strengthen the broader fiscal position. The program, which was closely coordinated with programs of the World Bank and Asian Development Bank (Annexes III

[1] SOEs accounted for about 80 percent of the SCBs' non performing loans.

and IV), formed part of a broader strategy, articulated most recently in the government's PRSP,[2] to raise Lao P.D.R. from the ranks of least-developed countries by 2020.

4. **Three years on, Lao P.D.R.'s macroeconomic performance has been relatively encouraging, but the pace of structural reform has been slow.** After a brief hiatus in 2002, macroeconomic stability has been restored and growth has been reasonably robust. The latest data also suggest that poverty has continued to decline (Box 1). Some headway has been made in reforming the SCBs and SOEs, although much remains to be done in both areas. However, progress in strengthening fiscal management has been slow and uneven, due to capacity constraints and a difficulty advancing reforms in a decentralized fiscal structure.[3] In particular, a progressive weakening of budget revenues since the start of the program has raised concerns about the sustainability of the fiscal outlook (Figure 2).[4] Also, expenditure management remains weak, undermining the capacity of the government to deliver effective social sector programs, and deficiencies in public debt management have persisted, hindering efforts to exert greater control over the contracting of public and publicly guaranteed debt.



5. **Discussions for the fourth review, which have been ongoing since December 2003, have focused mainly on reforms to strengthen the revenue base.** With revenues declining more sharply than expected in 2002/03,[5] the focus has been on reversing this decline and advancing key structural reforms to strengthen the revenue base over the medium-term. Time was needed to forge an appropriate consensus on the reform strategy, as some of the revenue reforms, particularly those related to reestablishing a national revenue administration strike at the heart of center-provincial relations. As discussed below, although the authorities have made progress over the last year, policy slippages in a few key areas have prevented the completion of the fourth review at this time.

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[2] The PRSP's official title is the *National Growth and Poverty Eradication Strategy (NGPES).*

[3] In 2001, the government launched a decentralization initiative to make provinces more self reliant. The original intent was to introduce new fiscal arrangements only on a pilot basis, but provinces were quick to assert control over revenues and expenditures, resulting in a fragmentation of fiscal control.

[4] The background papers discuss Lao P.D.R.'s revenue performance in greater detail.

[5] The fiscal year runs from October to September.

Box 1. Lao P.D.R.: Poverty Situation

Lao P.D.R. has made progress in reducing poverty during the last decade. Poverty (as measured by the percentage of population living below the poverty line) declined from 45 percent in 1992-93 to 39 percent in the late 1990s, and the latest survey suggests that it is now at 30 percent. High economic growth has been a key factor behind poverty reduction. In addition, the results on the composition of the consumption basket suggest a shift away from food items (especially own food consumption), which is consistent with a growing economy.

Nevertheless, Lao P.D.R. remains as one of the poorest countries in the world with GDP per capita estimated at around $369 for 2003. The majority of the population depends on subsistence agriculture. Moreover, there is considerable variation in poverty across regions and between rural and urban areas; the largest reductions were in urban areas, especially Vientiane, where poverty was more than halved. In particular, the poverty gap between Vientiane and other regions widened significantly, with the north of the country, where large groups of ethnic minorities are located, continuing to show the highest incidence of poverty.

Poverty in Lao P.D.R. is also linked to a number of socio-economic characteristics. Data from the latest survey shows a correlation between illiteracy and poverty. Households with illiterate heads are disproportionately poorer. Also, poor households tend to be larger than non-poor households and they tend to be concentrated in areas where infrastructure is less developed. There is also a link between limited access to health care facilities and poverty. The proportion of people with temporary health problems is higher for rural areas with limited access to healthcare facilities and transportation. This contributes to poverty by limiting their ability to work and disrupting income generating activities.

Income inequality in Lao P.D.R. is low compared to most other Asian countries. However, it has increased, as measured by the Gini coefficient, providing further evidence that the benefits of economic growth have not been sufficiently spread to the bulk of the population in poor rural areas.

The main causes of poverty include: (i) a legacy of physical devastation during the Vietnam war, with unexploded ordinances still affecting half of the country's territory; (ii) weak public service delivery, especially in the health and education sectors; (iii) inadequate communication infrastructure; and (iv) shortcomings in governance. Poor road access to markets, low productivity and insufficient support services to farming especially in upland areas, limited access to credit and weak marketing chains are the main bottlenecks facing the rural poor.

The government's strategic goal is to graduate from the group of least developed countries by 2020. The government's strategy to achieve this goal rests on three key pillars: (i) the development of a market oriented economy; (ii) building up the country's infrastructure; and (iii) improving social welfare through greater food security, extension of social services, and environmental conservation.

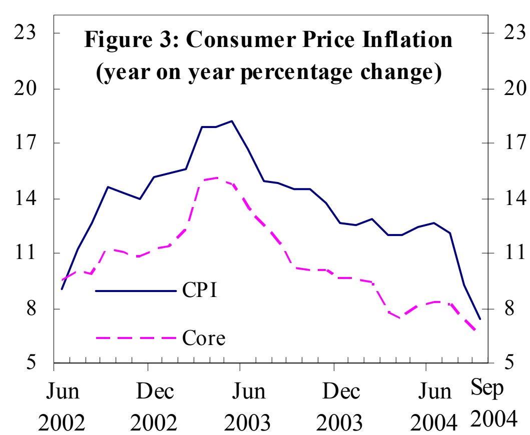
The government has finalized its National Growth and Poverty Eradication Strategy (NGPES), its equivalent of the PRSP. It provides a good framework on its strategy to reduce poverty and meet other developmental objectives. The joint staff assessment to this report is also being discussed at the Executive Board along with the staff report.

6. **Preparations for the Nam Theun 2 (NT2) hydroelectric project are entering into a critical phase.** This huge project has the potential to significantly boost Lao P.D.R.'s development provided that the resources it will generate are managed effectively. The deadline for finalizing the project is approaching, as the consortium of investors has until May 2005 to secure all the financing. The main outstanding issue concerns the financing of the government's equity stake in the project ($80–$100 million) and the provision of partial-risk guarantees to cover creditors against sovereign risk. The government has approached the World Bank and other agencies to assist with the remaining elements of the financing package. In addition to a satisfactory macroeconomic situation, this support is conditional on appropriate environmental and social safeguards, the establishment of effective revenue management mechanisms, and assurances relating to Lao P.D.R.'s external debt outlook.

Recent developments

7. **The economy has held up well in 2004** (Table 1). Although economic growth dipped in 2003 to 5¼ percent, half a percentage point lower than in 2002, the latest indicators suggest that activity has rebounded in 2004, with growth projected to rise to 6 percent of GDP. Agriculture and hydroelectricity output have recovered from a drought in 2003, and tourism has recovered from last year's SARs outbreak. Manufacturing activity has also been boosted by a pick-up in consumer demand, driven in part by buoyant informal sector activity.

8. **Inflation, which had surged into double digits in 2002, has been on a downward trend since mid 2003** (Figure 3). With the kip remaining stable, core inflation has fallen steadily over the last year to just over 6½ percent (12-month basis). Sharp increases in food (mainly rice), fuel and utility prices kept headline inflation relatively high for most of 2004, but with food prices starting to ease in recent months, headline inflation has also began to decline, falling to 7½ percent in September. Despite the recent increase in oil prices, headline inflation should stay in single digits for the remainder of the year, provided food prices remain subdued.



9. **The external position has improved, but Lao P.D.R.'s external debt remains high** (Table 2). Relatively brisk export growth, combined with buoyant donor and foreign direct investment inflows, is expected to lift external reserves to around $240 million by end 2004, sufficient to maintain reserve cover at around 4 months of imports. Public external debt has continued to rise over the last couple of years, mainly as a result of concessional borrowing from multilateral donors. Including Lao P.D.R.'s debt to Russia, the net present value (NPV) of public external debt stands at 220 percent of exports (Table 3).

10. **Monetary policy has generally been restrained over the past year** (Table 4). Net domestic assets of the Bank of Lao P.D.R. (BoL) have been broadly stable. Both reserve money and broad money have been growing relatively fast—broad money grew by 20 percent

in the year to September—but the recent decline in inflation suggests that this reflects mainly an increase in demand for kip, prompted by the recent stability of the exchange rate.[6] Tighter credit controls under the bank restructuring program kept state bank credit within the program path established for 2003/04 for much of the year. However, credit by the SCBs has expanded rapidly in the last quarter, raising concerns that the previously tight controls on credit allocations by the SCBs may be weakening, potentially undermining a key element of the monetary policy framework (Table 5).

11. **The preliminary fiscal outturn for 2003/04 indicates that the budget deficit declined to 3.9 percent of GDP, almost 2 percentage points lower than in 2002/03** (Table 6). The latest data suggest that revenues have performed relatively well, rising from 11.1 to 11.3 percent of GDP. Stronger administrative efforts, combined with the full year effects of last year's increase in petroleum taxes, raised tax revenues (excluding timber royalties) from 8.1 to 8.9 percent of GDP, despite the impact of tariff reforms related to the ASEAN Free Trade Arrangement (AFTA). However, these gains were partly offset by lower timber royalties and nontax revenues. Expenditures fell by 1.8 percent of GDP, due mainly to lower foreign financed capital expenditures, following the completion of a number of large projects. Domestic spending also contracted, as sharp cuts in the domestic capital budget, following tight controls over new projects, more than offset higher current spending.

12. **The authorities have implemented most of the original structural benchmarks for the fourth review, albeit some with delay** (Table 7)**.** The benchmarks related to onsite bank inspections (performance criterion), improving the budget classification, and transferring tax payers to the central large taxpayer unit were implemented on schedule. Implementing regulations for the presidential decree on tax incentives were issued, albeit with considerable delay.[7] However, progress has been slower in the core fiscal reforms related to the centralization of the customs and treasury departments. The amendments to the commercial bank law to permit foreign banks to operate nationwide have yet to be finalized.

13. **Completion of the fourth review has been delayed pending the resolution of a number of issues**. These include: (i) clarification of the 2004/05 budget plan approved by the National Assembly in mid October; (ii) confirmation that the scope of tax incentives provided under new investment laws conforms with understandings reached on the presidential decree on tax incentives; (iii) satisfactory progress in centralizing the customs administration; and (iv) corrective actions to contain credit expansion at the SCBs. Staff have also sought understandings on the external auditing of the BoL's accounts and to update the status of the rescheduling of Lao P.D.R.'s Russian debt. Discussions on these outstanding issues are still ongoing and a staff team plan to visit Vientiane after the conclusion of the Article IV Consultation to resume discussions on the fourth review.

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[6] However, dollarization is still high in Lao P.D.R., with foreign currency deposits remaining at around two-third of total deposits in the banking system.

[7] No tax incentives have yet been issued under Presidential Decree 01 (performance criterion).

II. Policy Discussions

14. **The Article IV Consultation, which comes on the heels of the authorities' PRSP, provided an opportunity to take a medium-term perspective on reform**. The joint staff advisory note (JSAN) for the PRSP has been separately circulated for consideration by the Executive Board (EBD/04/122). In line with the PRSP, discussions focused on fiscal reforms to solidify macroeconomic stability, expand the revenue envelope, and improve expenditure management, which are essential to the government's goal of achieving growth with equity. Complementary reforms in SCBs and SOEs were also addressed, as were potential sources of growth and steps to meet the competitive challenges of regional integration.

A. Fiscal Issues

15. **Policy discussions focused on advancing the process of fiscal reform**. The priority was to reach understandings on the 2004/05 budget framework and to review the government's medium-term plans for structural reform.

2004/05 budget

16. **The staff reached understandings on a sound budget framework for 2004/05 in August.** The authorities agreed to aim at raising revenue from 11.3 to 11.6 percent of GDP. The main tax measures included the reversal of the turnover tax reduction enacted in 2002/03, and a rationalization of excise duties. On the spending side, the staff encouraged the authorities to raise recurrent spending on health and education. Higher spending on the wage bill (0.4 percent of GDP), consistent with a mid-year increase in base salaries of 20 percent, was also justified, given that civil service wages have remained low. The overall budget framework was consistent with maintaining the budget deficit at around 4 percent of GDP, which could be fully financed through concessional loans.

17. **The staff have expressed reservations about the budget plan as approved by the National Assembly**. The plan's revenue target (12 percent of GDP) may be overambitious in the absence of additional revenue-raising measures and the proposed reallocation of domestic expenditures from capital to recurrent, in particular the large increase in the wage bill (1.3 percent of GDP) may not be sustainable. Staff also encouraged the authorities to ensure that world oil market prices were passed onto consumers without delay, as the budget could ill-afford a loss of petroleum revenue.[8] The authorities recognize that raising the wage bill would need to be conditional on achieving the revenue targets in the budget and realizing projected cost-savings in other areas of the budget. While staff are working with the authorities to clarify the budget measures proposed in the budget plan, a preliminary analysis indicates that the proposed increase in the wage bill may need to be phased in over a longer

[8] There is evidence that the recent price hike may not have been fully passed onto consumers.

time period.[9] The staff therefore welcome the authorities' intention to review the measures at the time of the mid-year budget in April, and to recalibrate them if necessary.

Medium-term fiscal reform strategy

18. **The key elements of the medium-term fiscal strategy are well defined in the PRSP**.[10] There is a broad consensus that revenue mobilization continues to be the main priority and that efforts in this area need to focus on strengthening tax and customs administration, which, inter alia, is essential for moving ahead with the VAT, the main tax policy reform (Box 2). On the expenditure side the priority is to strengthen the planning and execution of the government budget. Progress in both areas is dependent on strengthening central government control over revenue administration and treasury operations in the provinces. While progress can be made in the individual components, these reforms will require a more comprehensive reform of inter-governmental relations.

19. **The main challenge on the revenue administration front has been to re-centralize authority over the tax and customs administration.** The focus in 2003/04 had been on centralizing the customs department, starting with the seven main international check points. Some advances have been made in restoring central authority over the staff and revenues at the check points, but the reforms had encountered considerable resistance from provincial governors. Nevertheless, the authorities were committed to the reforms and indicated that the next steps were to: (i) place the provincial staff at the check points on the government's payroll; (ii) ensure all revenues were deposited directly into central government bank accounts; and (iii) pass a new customs law that would formalize central authority over the customs administration. Once the customs reforms became more deeply entrenched, the authorities would start the process of bringing the provincial large taxpayer units (LTUs) under central control. In the interim, work would proceed with improving the operations of the individual LTUs and strengthening the capacity of the tax department headquarters, with the assistance provided by the Swedish government (SIDA).

20. **Introduction of a VAT remains the main tax policy change in the medium-term.** The government intends to introduce this long-standing reform in January 2007. To this end, the government has submitted a proposal to the National Assembly to introduce a single rate VAT (10 percent). The staff welcomed this formal commitment to introducing a VAT and encouraged the authorities to finalize and publish their plans for the main parameters of the VAT and the detailed plan for its implementation. The authorities indicated that work on such a plan was underway with assistance from SIDA and regional partners. In this context, the staff also welcomed the reduction in the number of turnover tax rates (from three to two) in the 2004/05 budget, as this is an important step towards a single rate VAT.

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[9] These proposed measures include a 20 percent increase in base salaries, as well as a significant increase in pensions, benefits and allowances.

[10] A comprehensive list of structural reforms and implementation steps recommended by staff is presented in Table 8.

Box 2. Lao P.D.R.: Recent Revenue Developments and Outlook

The poor revenue performance since the start of the program in 2000/01 has been a major concern. Instead of rising by 2 percentage points, as originally envisaged under the program, the revenue-to-GDP ratio has declined significantly, falling to 11.1 percent of GDP by 2002/03, 2 percentage points below 1999/00. The original revenue gain had been based on the assumption that the VAT would be introduced in 2003 and that supporting administrative reforms would bolster revenue collections in the interim.

Although part of the decline reflected external factors, it has also reflected slow progress on revenue reforms (including policy reversals). A significant part of the revenue decline is attributable to a sharp drop in timber royalties, which fell by 1 percent of GDP following the imposition of an export ban on unprocessed logs. A rationalization of the finances of state banks and state-owned enterprises has also reduced taxes from the state sector (before recent reforms, state banks and SOEs continued to pay taxes despite running large underlying losses). However, a deterioration in tax and customs administration, following a decision in 2000 to decentralize fiscal management to the provinces, has been a major contributory factor. The revenue base has also been eroded by tax incentives, such as a reduction in turnover tax rates for domestic producers in 2002/03, and an extension of ad hoc exemptions on excises.

At the same time, it is now recognized that the original revenue objectives may have been too optimistic. Indeed, once account is taken of the large subsistence agriculture sector in Lao P.D.R., the overall revenue effort does not compare unfavorably with its neighbors in the region. The ratio of budget revenue to nonagricultural GDP (excluding revenue from natural resources) is comparable to that in Vietnam and significantly higher than in Cambodia. The challenge of overcoming acute capacity constraints may also have been underestimated, although this has been secondary to the challenge of forging a consensus on key policy reforms.

In light of these developments, the medium-term outlook for budget revenues has been revised downwards significantly relative to that presented at the time of the third review (Table). Staff now propose a medium-term revenue path that would raise the revenue-to-GDP-ratio by 1–1½ percent of GDP over the next three years. This path allows for a more realistic timetable for the introduction of the VAT and takes account of expected losses from the tariffs reduction under AFTA (estimated at 0.7 percent of GDP). It also recognizes that the decline in timber royalties is only partly recoverable and the reduction in taxes from state banks and enterprises will only be reversed once they have been placed on a sound financial footing.

Lao P.D.R.: Revenue Outlook, 2003/04–2007/08

	2003/04	2004/05	2005/06	2006/07	2007/08
	Program	Projections			
	(In percent of GDP)				
Projected revenues	11.3	11.6	11.9	12.3	12.8
Changes (cumulative impact)		0.3	0.6	0.9	1.4
Adjustment in excise rates		0.1	0.1	0.1	0.1
Improved compliance/monitoring		0.1	0.3	0.5	0.7
Turnover tax reversals		0.2	0.2	0.2	0.2
Hydrosector profit tax (THPC)		0.1	0.2	0.2	0.2
Hydrosector dividends (EDL)		0.1	0.1	0.1	0.1
VAT				0.3	0.5
AFTA		-0.2	-0.4	-0.5	-0.7
Oxiana		0.0	0.2	0.3	0.5
Other 1/		-0.1	-0.3	-0.3	-0.3
Memorandum item:					
Revenue outlook at 3rd Review	12.2	12.3	13.0	13.3	...

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

1/ Reflects the effect of GDP growing faster than the tax base due to the impact of the large Oxiana mining project.

21. **Limiting exemptions and other tax incentives is also important for broadening the tax base.** Staff welcomed the promulgation of regulations for the presidential decree on tax incentives, which were issued in August and struck an appropriate balance between promoting investment and protecting the revenue base. Staff welcomed in particular the provisions strengthening the Ministry of Finance's control over the administration of tax incentives. But the new regulatory framework has recently been superseded by new investment laws approved by the National Assembly in October. The staff have expressed concern that the new investment laws might broaden the scope of tax incentives and weaken the controls over their administration built into the presidential decree. While the staff still need to review the laws, the authorities have assured the staff that they are broadly consistent with understandings reached on the presidential decree.

22. **The mission discussed the authorities' agenda for public expenditure reform**. The main priority is to strengthen treasury controls, by bringing sub-treasuries in the provinces under the direct control of the central treasury. Over the longer term, this will require a comprehensive revision to the basic Treasury Law. The authorities agreed that it would be useful to launch this process by preparing a concept paper, with the assistance of FAD and the World Bank, to forge a consensus on the key reforms. In the interim, the authorities indicated that they would develop an integrated cash management plan to improve cooperation and information between the center and the six largest provinces. These reforms would be complemented by efforts to improve information, through the implementation of a revised chart of accounts and budget nomenclature based on international standards. Greater efforts are also needed to prevent and clear domestic budget arrears. The authorities noted that the September 2003 survey on arrears had been helpful in developing a strategy to reduce legitimate arrears and they intended to conduct another survey of arrears as of end-September 2004 to further this process.

23. **The authorities recognize that reforms to the broader decentralization framework are essential to strengthening fiscal management**. (The provinces are unlikely to cede control over revenues until such a framework is in place). The government is currently reviewing the regulatory framework for fiscal relations between the central government and the provinces, with a view to clarifying the assignment of revenue and expenditure responsibilities between the center and provinces and develop a robust mechanism for inter-governmental transfers. Staff recognize that the reform process is highly sensitive, and have offered technical assistance to explore different options in inter-governmental fiscal relations to help facilitate the ongoing dialogue in this area.

B. Monetary and Exchange Rate Policy

24. **The authorities confirmed that monetary policy would remain firmly geared towards reducing inflation**. They did not envisage a major shift in monetary operations in 2004/05. They would aim to keep the central bank's net domestic assets broadly unchanged over the year, a target that would be underpinned by a government commitment to avoid bank financing of the budget. After a period of retrenchment in bank loan portfolios, the authorities expected credit growth to rise to around 14½ percent in 2004/05, in line with

nominal GDP. They also saw merit in raising the level of gross international reserves further to around 4¼ months of imports, which would be broadly consistent with reserve money growing at around 12 percent over the year.

25. **Staff urged the authorities to maintain tight control over credit expansion at the SCBs**. This would be essential until the banks were placed on a sound commercial footing. Staff expressed concern about the rapid credit expansion in the SCBs in the last quarter of 2003/04, which caused the end-September indicative targets on the banks' net domestic assets to be breached by a significant margin. The authorities reaffirmed their commitment to prudent credit management at the SCBs, but noted that the recent credit expansion had reflected a one-off investment in the domestic cement industry, a high priority area for the government. Staff noted, however, that such a large exposure posed risks to both macroeconomic stability and the bank restructuring process,[11] and have encouraged the authorities to recalibrate the financing of this project to reduce the SCBs' exposure. The authorities are currently reviewing alternative financing options for the project in collaboration with the World Bank.

26. **The authorities regard exchange rate stability as key to maintaining macroeconomic stability**. Although the central bank's external reserves more than cover base money, the authorities recognize that they have neither the instruments nor sufficient control over the budget to credibly peg the exchange rate. Their interventions in the foreign exchange market would therefore be limited only to smoothing transitory fluctuations in the exchange rate. Sustained pressure on the exchange rate would have to be addressed by correcting the underlying policy slippages. They agreed with staff that exchange rate stability was best preserved through prudent fiscal management and effective control over the SCBs—a major source of credit expansion in the past—both of which were central to effective monetary control. The staff agreed with the authorities that recent trends in exports suggested that the exchange rate was not seriously misaligned.

C. External Debt Management

27. **Staff are clarifying the status of negotiations on the rescheduling of Lao P.D.R.'s external debt with Russia.** A preliminary agreement was signed in December 2003, which entailed an approximate NPV reduction of 20 percent on the face value of the outstanding debt ($387 million). Given the relatively limited degree of concessionality under this agreement, the authorities have approached the Russian government to secure more favorable terms (an initial payment was made in August, as a gesture of good faith). The Lao authorities are currently awaiting a response from Russia to their request.

28. **Staff urged the authorities to strengthen internal control over public debt management**. While the Ministry of Finance has made efforts to improve its monitoring and reporting of public external debt, significant weaknesses remain with regard to control over

[11] The exposure to this project violates prudential norms by a wide margin.

the contracting of external debt. While no new instances of contracting of nonconcessional public debt have been reported, there have been a number of instances of public debt being contracted without the Ministry of Finance's prior approval. These weaknesses in public debt management pose a significant risk to maintaining a sustainable debt burden.

D. Structural Reform

29. **Discussions on the structural reform agenda focused largely on efforts to improve public sector financial management**. SCB restructuring and SOE reform have been the two key elements of the reform program supported by the PRGF arrangement, as the finances of these state institutions need to be improved to protect the medium-term fiscal outlook.

Banking issues

30. **The authorities reaffirmed their commitment to creating a sound and competitive banking sector**. Progress is being made under the restructuring plans established for the two SCBs,[12] and the international banking advisers placed in both banks have helped strengthen the banks' operations and credit management practices. Steady progress is also being made in strengthening bank supervision, with the support from MFD.

31. **Staff noted that significant risks remained at the SCBs**. Both are still deeply insolvent and their underlying profitability is weak. Moreover, the risk of new nonperforming loans is high, as they are still vulnerable to pressures to extend credits on a non commercial basis. It was agreed that to mitigate these risks, the authorities should maintain close oversight over the banks' operations. The immediate priority was to finalize the external audit of the banks' 2003 accounts to help establish appropriate performance targets for the two SCBs in 2004/05. Regular on-site inspections of these SCBs would continue to be important, as would overall credit limits for the SCBs while they are in the process of restructuring. Staff also urged the authorities to introduce new regulations on credit limits and foreign exposure and establish a time table for bringing the SCBs into compliance with prudential regulations.

32. **Staff also discussed measures to improve the overall banking environment**. The immediate priority was to secure the passage of amendments to the banking laws to equalize the capital requirements for domestic and foreign banks and allow foreign banks to operate branches on a nationwide basis. Staff reviewed preparations for attracting private sector investors into the SCBs. The authorities noted that progress on this front would be difficult until the process of recapitalizing the SCBs was more advanced, and further progress had

[12] Banque pour le Commerce Exteriéur du Laos (BCEL) and Lao Development Bank (LDB).

been made in the ongoing reforms in the legal environment and private sector development, supported by the AsDB and the World Bank.[13]

Enterprise issues

33. **SOE reform has been an essential complement to the banking reform agenda**. Although the SOE sector is now relatively small, it accounts for a large share of credit and NPLs at the state banks. The reform program, supported by the World Bank, has focused on addressing the financial weaknesses of the largest and most indebted SOEs. The focus has been on tariff reform to commercialize the large utilities and on operational restructuring, including the sale of noncore assets.

34. **The authorities have made progress in SOE reform over the last year**.[14] Substantial adjustments have been made in the tariffs for the major utilities and the restructuring for the electric utility (EDL) is almost complete. Time-bound restructuring programs for three of the four other major enterprises have also been launched and are expected to be completed by end-2005. The authorities have also taken steps to address the losses of Lao Airlines, whose financial position had deteriorated sharply over the last year, partly as a result of leasing a new Airbus. The authorities have decided to ground the Airbus, to stem the losses from its operations, and are exploring options to contract the airplane to another airline. The authorities are also proceeding with the strategy agreed with the World Bank to secure a joint venture partner for the airline.

35. **The authorities have taken steps to improve the overall climate for private sector activity and stimulate investment.** A decree on competition was issued in February 2004, lifting barriers to trade and laying out a framework for dealing with uncompetitive practices, and a further decree was issued in June 2004, abolishing barriers to movements of goods within the country. In recent months, the authorities have also taken a series of initiatives designed to facilitate investment, including the finalization of a decree for setting up a one-stop window for the approval of new investment projects.

36. **The persistent deficiency of the Lao legal system is one of the major impediments to private sector development and increased foreign direct investment.** In order to address the shortcomings in the legal framework and strengthen the operation of the legal system, the authorities have launched several reform projects with assistance from the

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[13] The SCBs have a capital deficiency of around 3-4 percent of GDP. Staff have conservatively estimated that the bulk of the capital deficiency (2½-3 percent of GDP) will be covered by bank recapitalization bonds, with the remainder to be met by retained earnings as the banks return to profitability.

[14] The program focused on five large, indebted SOEs: the electricity utility (EDL), the Ministry of Defense conglomerate Phoudoi, the water utility (Nam Papa), the national airline (Lao Airlines), and a pharmaceutical factory.

AsDB and UNDP. These projects aim, inter alia, at simplifying the laws and regulations and increasing their dissemination, ensuring the consistency of the existing legal framework, expanding the body of commercial laws, and strengthening the operation of tribunals.

Trade and exchange system reforms

37. **The authorities recognize that reforms to the trade and exchange system are also key for developing the private sector.** To this end, quota restrictions on imports have been abolished, and import licensing is required for only four products: fuel, cement, steel, and vehicles.[15] The authorities are committed to continuing the process of tariff reform in line with their commitments under AFTA, are moving ahead with their application to the WTO, and have sought to advance the process of obtaining normal trade relations (NTR) with the USA. They are also working with international partners under the Integrated Framework (IF) scheme to integrate trade reform into their national growth and poverty reduction strategy.

38. **The authorities are committed to a liberal foreign exchange regime.** A joint LEG/MFD mission visited Vientiane in August 2004 to review the exchange system and facilitate acceptance by Lao P.D.R. of the obligations of Article VIII, sections 2,3 and 4. The mission recommended that Lao P.D.R. address a number of issues before accepting the obligations, including measures inconsistent with Article VIII, specifically: (i) the requirement to produce a tax payment certificate before certain payments and transfers for international transactions can be authorized;[16] and (ii) maintaining lists of persons to whom payments and transfers cannot be made.[17] Staff does not recommend approval of these exchange restrictions. The mission also suggested that the authorities amend the regulations in certain areas to clarify that the kip is convertible for *all* current international transactions. The authorities are reviewing the recommendations of the mission, with a view to expediting the process of accepting the obligations under Article VIII.

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[15] The authorities informed staff that an import-export balance requirement is still issued to provinces on an annual basis, but it serves only as an "indicative plan" and is nonbinding.

[16] In some instances, the tax certificate is required for taxes unrelated to the underlying transaction, which creates an exchange restriction.

[17] The latter exchange restriction is common to many countries. The mission noted that if the authorities wished to avail themselves of the Decision No. 144-(52/51) approval process, the authorities should notify the Fund of restrictions maintained solely for the preservation of security. It is possible some additional issues may arise from an ongoing review of Lao P.D.R.'s bilateral payments and trade agreements.

Other Issues

39. **The quality of macroeconomic statistics needs to be significantly improved.** Efforts have been made this year, with IMF technical assistance, to improve government finance and monetary and financial statistics. Moreover, the authorities have also identified steps needed to participate in the IMF's General Data Dissemination System (GDDS), and are continuing work on finalizing the metadata. This will also improve data coordination between the agencies in the government. Meanwhile, greater efforts are needed to improve the system of reporting and monitoring of all public debt, including SOE debt. Given significant weaknesses in the balance of payments statistics, it would be useful for the authorities to seek technical assistance in this area.

40. **A new issue has arisen regarding the Fund's safeguards policy**. The authorities have indicated that they are not in a position to implement an earlier agreement to undertake a joint audit of the BoL's 2003 accounts by the state auditor and an international audit firm. Staff have proposed a temporary compromise that involves commissioning a targeted external review of the BoL's external reserves and reserve money positions by an international audit firm, as a step towards a full-fledged joint external audit at a later stage. The authorities are currently reviewing their position with regard to this proposal.

III. Medium-term Outlook and Debt Sustainability

41. **The staff's medium term scenario envisages the economy growing at 6-6½ percent per annum** (Table 9).[18] Large foreign invested projects in the mining and hydroelectric power sectors are expected to be the main source of growth, complemented by smaller scale investments in agriculture, manufacturing and service sectors, as the benefits of increased regional integration take hold. Inflation is expected to ease to around 5 percent, provided monetary and fiscal policies remain under tight control. Strong export growth, mainly from a sharp increase in exports from the Oxiana mines, is expected to compensate for high oil prices.[19] The external current account deficit would widen to 10–11 percent of GDP, but this reflects primarily large capital imports associated with the NT2 project, that will be matched by increases in foreign direct investment. The underlying external position would remain manageable, with current account deficits declining to 3–4 percent of GDP,

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[18] The expansion of the Oxiana gold mine and the opening of a sister copper mine will contribute 1.4 percent to growth in 2005. The construction of the NT2 hydroelectric dam should raise growth by a further ½ percentage point in 2005-2006.

[19] The abolition of textile quotas under the Multi-Fiber Agreement in 2005 will lead to increased competition for Lao P.D.R. in the European market. However, this may be offset if Lao P.D.R. obtains increased tariff-free access to the EU under the new Generalized System of Preferences, and progress is made in normalizing trade relations with the USA.

and continuing to be financed mainly by concessional medium and long-term borrowings (Table 10).

42. **Even under a relatively optimistic base-line scenario, Lao P.D.R. faces risks from a high debt burden** (Tables 11a and 11b).[20] The NPV of public external debt is well in excess of the threshold for eligibility from debt relief under the enhanced initiative for Heavily Indebted Poor Countries (HIPC Initiative),[21] although the authorities have emphasized that they do not intend to seek HIPC assistance. In addition to the high debt stock ratios, the analysis suggests that due to weak revenue generation, servicing the debt may put pressure on the government budget over the next few years. Staff agree with the authorities that more concessional terms on the rescheduling of the Russian debt could ease this burden, but over the medium-and long-term, moving toward a more sustainable debt burden requires: (a) strong and sustained growth of real GDP and exports; (b) steady increases in government revenue relative to GDP; and (c) continued prudent debt management, with reduced levels of public sector borrowing and a high degree of concessionality on any new borrowing.

43. **The baseline scenario is clearly subject to a number of risks, in the absence of structural reform**. Foremost among these is the risk that slow progress in structural reforms to strengthen public finances undermines the government's ability to sustain a sound macroeconomic framework. As illustrated by the debt sustainability analysis, the pace of reform with regard to revenue mobilization will be especially critical to ensuring a sustainable fiscal position. Banking and SOE reform will also be important in this regard. Stringent external debt management is also essential, as the debt dynamics could quickly become unsustainable, if the discipline provided under the PRGF arrangement is eroded. Finally, achievement of the positive growth outlook hinges critically on structural reforms to encourage private sector development.

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[20] The staff has undertaken a comprehensive debt sustainability analysis in collaboration with the World Bank and the AsDB (see accompanying *Selected Issues*).

[21] Includes Lao P.D.R.'s debt to Russia, based on the terms of the agreement reached between the two governments in December 2003.

IV. Staff Appraisal

44. **Lao P.D.R.'s macroeconomic performance under the PRGF arrangement has been relatively encouraging**. The authorities have made considerable progress at ensuring macroeconomic stability, while sustaining relatively robust rates of economic growth. Recent data also suggest that poverty has continued to decline. Improved macroeconomic management has been central to this performance. However, underlying macroeconomic situation is fragile as progress in addressing the underlying structural weaknesses, especially in the revenue area, has been much slower than originally envisaged.

45. **The authorities' PRSP sets out a strategy to achieve rapid growth in the medium term to improve the living conditions of the poor**. As noted in the joint staff advisory note (JSAN), Lao P.D.R. has the potential to achieve a rapid pace of development provided that structural reforms are pursued in earnest. Slow progress in strengthening the public finances is a key risk which could undermine the government's ability to sustain macroeconomic stability. To mitigate this risk, the pace of reform with regard to revenue mobilization, and banking and state-owned enterprise reforms will need to be accelerated. This is especially critical in view of Lao P.D.R.'s high public debt burden.

46. **While the near-term macroeconomic outlook appears favorable, a number of risks have emerged**. Staff project high growth, modest inflation, and a manageable external position, but this is contingent on the government maintaining sound macroeconomic policies. Steps will need to be taken to address potential slippages in the 2004/05 budget. The possibility of an expansionary 2004/05 budget, combined with potential slippages in credit discipline at the state banks are important short term risks.

47. **A sound revenue strategy is key over the medium term.** The ongoing efforts to strengthen the central government's control and authority over provincial customs and tax administration will need to be accelerated, which would help reverse the revenue declines of the recent past and generate sufficient resources needed for poverty reduction. As part of the strategy, the decentralization policy pertaining to center-provincial revenue assignments would need to be clarified and streamlined. External technical assistance could be useful in moving this process forward.

48. **More specifically, staff welcome the restoration of the two-rate turnover tax and the government's commitment to introducing a single rate VAT in 2006/07**. To advance the process of the VAT, the authorities should soon finalize the plans for the main parameters of the VAT and its implementation. Care will also need to be taken to ensure that implementation of the new investment laws does not result in an erosion of the revenue base.

49. **Public expenditure management reform should be a high priority for the authorities.** Progress is needed in improving budget reporting, budget classification, and cash management, and greater efforts should be made in the prevention and clearance of budget arrears. A comprehensive treasury reform strategy should also be developed soon.

50. **Monetary policy should continue to be set in order to contain inflation.** A key element is a tight control over central bank's domestic assets. Improved credit appraisals by banks and prudent fiscal management are key to exchange rate stability, which in turn helps contain inflation. The current flexible exchange rate regime is appropriate.

51. **Although some progress has been made on state bank restructuring program, significant risks remain.** The financial position of the state banks remains precarious. Greater efforts are needed to improve the regulatory and supervisory environment, credit appraisals, recapitalize state banks, and strengthen bank competition. The state banks remain vulnerable to pressures to extend credits on a non commercial basis.

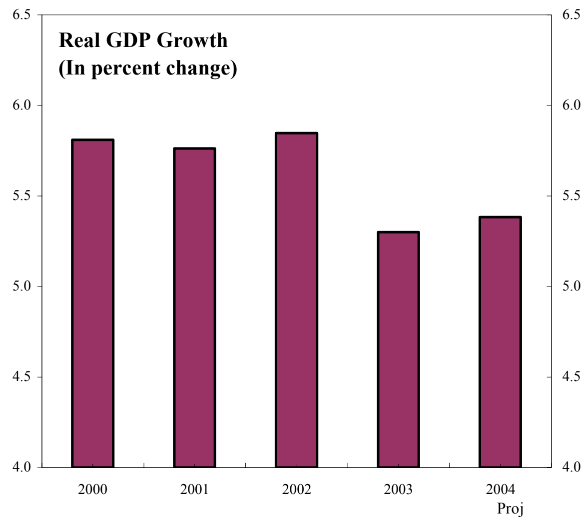
52. **Staff welcome the progress made in reforming the state owned enterprises.** While price adjustments have been continuing for some time, the sale of noncore assets should proceed in line with the restructuring plans of these enterprises. The government should also move rapidly with a comprehensive strategy to deal with the ongoing losses of Lao Airlines, especially from the leased Airbus. At the same time, the climate to promote private sector activity and investment should be further improved.

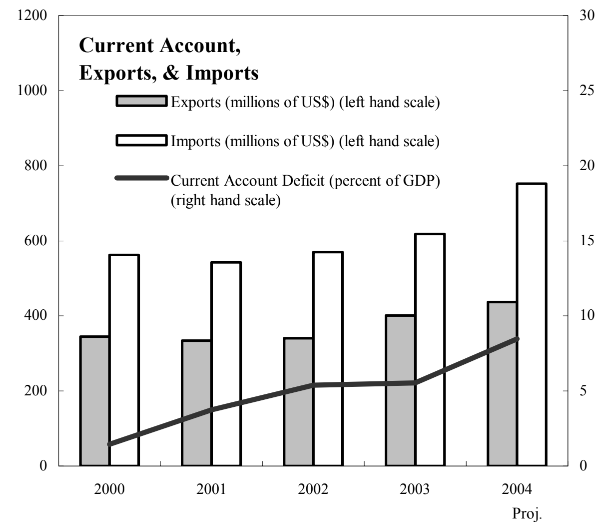
53. **Prudent public debt management is essential to mitigate the risks arising from Lao P.D.R.'s high debt burden.** Despite recent efforts to improve monitoring and reporting of public external debt, significant weaknesses remain regarding control over the contracting of external debt.

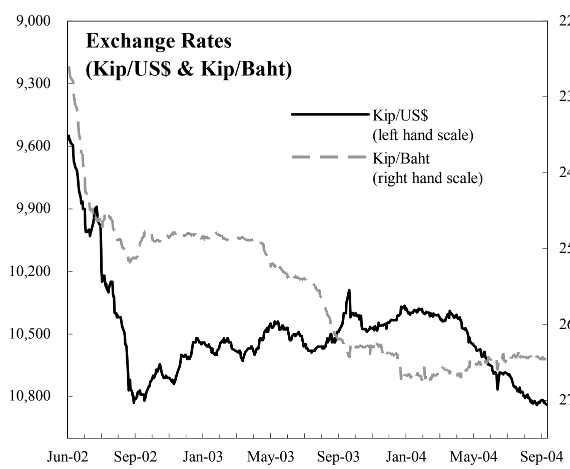
54. **Progress on safeguards is important to provide reassurance about the soundness of the central bank's accounts.** The staff encourages the authorities to commission a targeted external review of the BoL's external reserves and reserve money positions by an international audit firm as soon as possible, and as a step towards a full-fledged joint external audit of the BoL's accounts at a later stage.

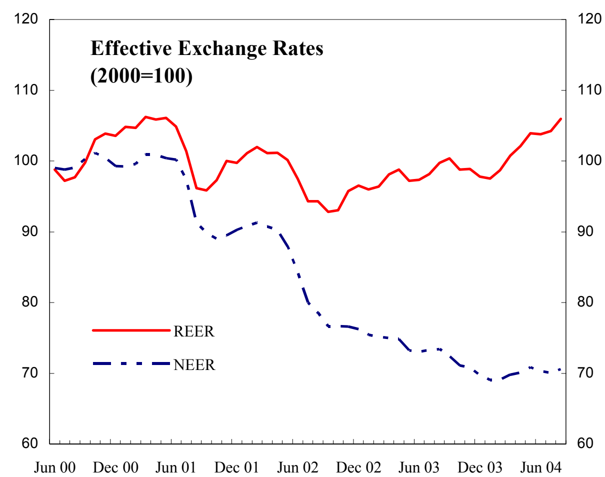
55. It is expected that the next Article IV consultation with Lao P.D.R. will be held in accordance with the provisions of the decision on consultation cycles approved by the Executive Board on July 15, 2002.

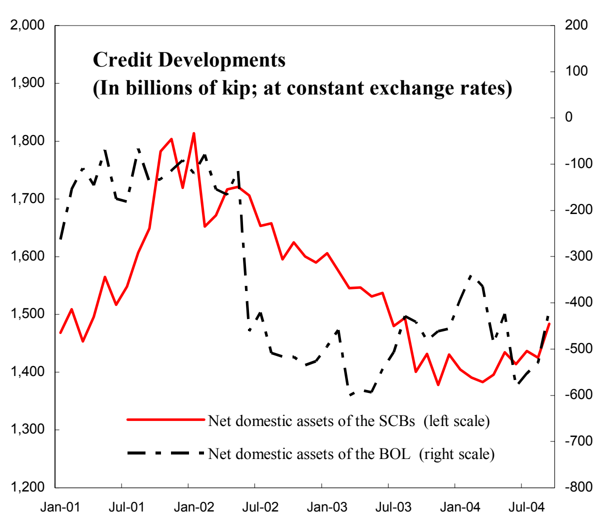
Chart. Lao P.D.R.: Selected Economic Indicators, 2000-2004

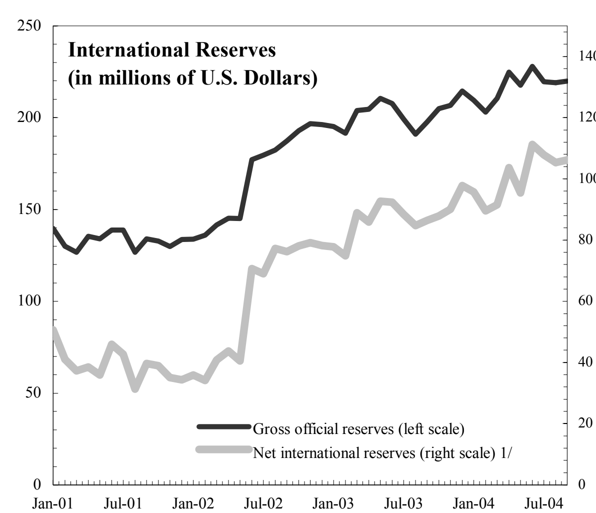












1/ Does not include the foreign currency component of reserve money.

Table 1: Lao P.D.R.: Selected Economic and Financial Indicators, 2001-2005

Nominal GDP (2002): $1,818 million
Population (2002): 5.53 million

GDP per capita (2002): $329
Fund quota: SDR 52.9 million

	2001	2002 Est.	2003 Est.	2004 Latest 1/	2004 Proj	2005 Proj
Real GDP growth (percentage change) 2/	5.8	5.8	5.3	...	6.0	7.0
Inflation (annual percent change)						
Period average	7.8	10.6	15.5	11.9	11.2	7.8
End of period	7.5	15.2	12.6	7.4	9.5	5.7
Government budget (in percent of GDP) 3/ 4/						
Revenue	13.2	13.1	11.1	...	11.3	11.6
Grants	3.1	1.3	2.1	...	1.9	1.9
Expenditure	20.7	18.4	19.0	...	17.2	17.7
Overall balance (including grants)	-4.4	-4.0	-5.8	...	-3.9	-4.1
Government debt	63.0	66.3	83.9		81.3	78.3
of which: bank restructuring bonds (excluding debt clearance bonds)	0.0	0.0	0.0	...	0.0	0.7
Money and Credit (annual percent change) 3/ 5/						
Reserve money	-19.3	19.4	23.7	...	28.7	11.7
Broad money	7.8	12.9	24.1	...	19.5	18.0
Bank credit to the economy	27.6	-5.2	5.4	...	6.6	14.4
Interest rates (end of period)						
On three-month deposits	16.0	17.0	10-15	7-9	...	...
On short term loans	12-18	12-20	22-25	16-18	...	...
Balance of payments (in millions of U.S. dollar)						
Exports	334	340	401	...	437	563
Imports	542	570	618	...	752	764
Current account balance (including official transfers)	-66	-98	-116		-204	-209
(in percent of GDP)	-3.7	-5.4	-5.5	...	-8.5	-7.9
Gross official reserves (in millions of U.S. dollars)	134	196	216	221	239	260
(in months of prospective goods and services imports)	2.6	3.5	3.2	3.1	3.9	4.2
Net international reserves (in millions of U.S. dollars)	152	152	172	183	203	215
External public debt 6/						
(in millions of U.S. dollar)	1,213	1,330	1,915	...	2,035	2,169
Net present value (in percent of exports)	...	233	218	...	213	187
External public debt service						
(in millions of U.S. dollars)	36	36	40	...	73	78
(in percent of exports)	7.2	7.1	7.2	...	11.9	10.3
(in percent of revenue, excluding grants)	19.0	18.1	13.8		19.7	24.2
Exchange rate						
Kip per dollar (end of period)						
Commercial bank rate	9,490	10,680	10,467	10,771 7/	...	...
Parallel market rate	9,560	10,760	10,470	10,784 7/	...	...
Nominal effective exchange rate 8/	95.7	83.3	73.1	70.1 9/		
Real effective exchange rate 8/	102.1	97.3	97.6	101.6 9/	...	...
Memorandum item:						
Nominal GDP (in billions of Kip) 2/	15,705	18,390	22,069	...	25,739	29,460

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

1/ Latest data are for September 2004 unless otherwise indicated.
2/ The government estimates real GDP and deflator growth in 2003 to be 5.8 percent and 15.8 percent respectively.
3/ Fiscal year basis (October to September).
4/ Numbers for 2004 are estimates and for 2005 are staff proposal.
5/ Money and credit data are evaluated at constant exchange rates.
6/ Russian debt for 2003-2005 is based on the agreement reached in December 2003 between the Lao P.D.R. and Russian governments. Prior to 2003 the Russian debt is excluded.
7/ Data as of November 10, 2004.
8/ Base Year 2000=100.
9/ Data as of July 2004.

Table 2. Lao P.D.R.: Balance of Payments, 2001–2008

	2001	2002	2003	2004	2005 3/	2006	2007	2008
				Projections				
	(In millions of U.S. dollars; unless otherwise indicated)							
Current account	-66	-98	-116	-204	-209	-304	-335	-367
Excluding official transfers	-129	-146	-178	-276	-284	-385	-420	-457
Merchandise trade balance	-209	-230	-217	-315	-201	-201	-238	-278
Exports, f.o.b.	334	340	401	437	563	663	683	705
Imports, c.i.f.	542	570	618	752	764	864	921	983
Services (net)	125	131	95	122	97	68	80	93
Income (net)	-67	-70	-81	-108	-208	-282	-295	-307
of which : interest payments 1/	-35	-29	-35	-47	-45	-44	-42	-115
of which : public debt	-11	-10	-12	-26	-27	-27	-28	-30
Transfers (net)	85	71	87	97	103	111	118	125
Private	22	23	24	25	27	30	32	35
Official	63	48	63	72	75	81	85	90
Capital account	65	153	135	212	215	332	373	402
Medium- and Long-Term Loans	66	127	89	72	185	324	338	342
Disbursements	105	165	136	139	256	406	418	427
Amortization	-39	-38	-47	-67	-71	-82	-80	-85
Foreign Direct Investment	24	60	69	186	105	86	88	90
of which : hydropower investment	0	0	0	0	27	61	61	61
Net foreign assets of commercial banks (increase -)	28	-7	-21	-38	-35	-35	-35	-25
Assets	21	-39	-15	-36	-35	-35	-35	-25
Liabilities	7	32	-6	-2	0	0	0	0
Other Private Flows and Errors and Omissions	-53	-27	-2	-9	-41	-43	-18	-5
Overall balance	-1	55	20	8	5	28	38	36
Financing	1	-55	-20	-8	-5	-28	-38	-36
Central bank net foreign assets	1	-55	-20	-30	-21	-28	-38	-36
Assets (increase -)	6	-62	-20	-23	-21	-28	-38	-36
Liabilities (reduction -)	-5	7	0	-7	0	0	0	0
Financing gap 2/	0	0	0	22	16	0	0	0
Coverage of financing gap	0	0	0	22	16	0	0	0
Memorandum items:								
Current account (percent of GDP; excluding official transfers)	-7.3	-8.0	-8.5	-11.5	-10.7	-13.3	-13.5	-13.5
Current account (percent of GDP; including official transfers)	-3.7	-5.4	-5.5	-8.5	-7.9	-10.5	-10.7	-10.9
Current account (percent of GDP; excluding NT2 and Oxiana)	...	...	-6.0	-3.1	-3.0	-3.3	-4.1	-4.2
Official gross reserves (in millions of U.S. dollars)	134	196	216	239	260	287	325	361
(in months of prospective goods and service imports, excl. NT2)	2.6	3.5	3.2	3.9	4.2	4.3	4.5	4.5
Nominal GDP at market prices (US$ million)	1,762	1,818	2,088	2,412	2,665	2,895	3,125	3,375

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

1/ Includes debt service to official creditors and estimates for debt service to commercial creditors.
2/ The financing gap in 2004 and 2005 are covered by disbursements under the PRGF program, and program loans from the World Bank and AsDB.
3/ Imports for NT2 start in late 2005, supported mainly by external financing.

Table 3: Lao P.D.R.: External Debt and Debt Service 2001–2008

	2001	2002	2003	2004	2005	2006	2007	2008
			Est.		Proj.			
				(In millions of U.S. dollars)				
Total debt stock (public and private)	1,458	1,614	2,171	2,265	2,456	2,762	2,932	3,202
Public debt	1,213	1,330	1,915	2,035	2,169	2,314	2,320	2,429
Bilateral official	68	64	497	512	519	521	523	522
of which: Russian Federation 1/	...	...	387	385	383	380	378	375
Multilateral	1,089	1,191	1,340	1,422	1,518	1,618	1,731	1,848
of which:								
AsDB	575	603	715	764	811	859	915	971
IDA	407	435	485	511	553	603	657	717
IMF	37	43	46	37	37	31	31	27
Commercial	56	75	78	102	132	175	66	59
Private debt	245	284	257	229	287	448	611	773
Total debt service	84	76	91	122	123	126	122	198
Amortization	49	47	56	75	77	82	80	85
Public debt	25	27	28	48	51	54	54	57
Bilateral official	4	4	2	6	8	10	11	11
of which: Russian Federation	0	0	0	2	2	3	3	3
Multilateral	20	23	26	29	29	29	33	37
of which : IMF	9	9	9	9	7	7	6	5
Commercial	1	0	0	12	14	15	10	10
Private debt	24	20	27	27	26	28	26	27
Interest payments	35	29	35	47	45	44	41	113
Public debt	11	10	12	26	27	27	27	28
Bilateral (official debt)	1	1	1	10	11	11	11	11
of which: Russian Federation 1/	0	0	0	9	9	9	9	9
Multilateral	9	9	11	12	13	14	15	16
of which : IMF	1	0	0	0	0	0	0	0
Commercial	1	0	0	3	3	2	2	2
Private debt	24	20	23	21	19	16	14	85
				(In percent of GDP)				
Total debt service	4.7	4.2	4.3	5.0	4.6	4.3	3.9	5.9
of which: public debt	2.0	2.0	1.9	3.0	2.9	2.8	2.6	2.5
Total debt stock	82.7	88.8	104.0	93.9	92.2	95.4	93.8	94.9
of which: public debt	68.9	73.2	91.7	84.4	81.4	79.9	74.2	72.0
				(In percent of exports of goods and services)				
NPV of public external debt	...	...	219	213	187	175	180	185
Total debt service	16.7	14.8	16.2	19.7	16.3	14.5	13.5	21.0
of which: public debt	7.2	7.1	7.2	11.9	10.3	9.4	9.2	9.4
Memorandum items:								
NPV of public external debt	...	...	1,223	1,313	1,408	1,511	1,624	1,741
GDP	1,762	1,818	2,088	2,412	2,665	2,895	3,125	3,375
Exports of goods and services	500	517	560	617	754	865	900	939
Three year average	502	512	525	565	610	745	840	901

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

1/ Based on the December 2003 agreement between Russian and Lao authorities.

Table 4. Lao P.D.R.: Monetary Survey, 2003–2005 1/

(In billions of kip, unless otherwise indicated)

	2003		2004				2005
	Sept		June		Sept		Sept
	Prog.	Est 2/	Staff 3/	Est	Staff 3/	Est	Proj
Bank of Lao (BoL)							
Net Foreign Assets	1,636	1,635	1,714	2,017	1,908	1,952	2,226
(In millions of US dollars)	151	154	162	190	180	184	210
Net Domestic Assets	-471	-441	-406	-581	-417	-416	-509
Government (net)	-391	-368	-374	-550	-362	-352	-468
Economy	756	732	732	717	710	709	690
Banks	185	139	140	134	132	138	132
BOL securities	-66	-96	-96	0	-47	0	-13
Other items (net)	-955	-849	-810	-882	-850	-910	-850
Reserve money	1,165	1,194	1,308	1,436	1,491	1,537	1,717
Currency in circulation	131	122	165	316	328	350	420
Bank reserves (Kip)	189	353	330	283	307	359	379
Bank reserves (Forex)	845	719	813	837	856	828	919
Monetary Survey							
Net foreign assets	2,437	2,601	2,826	3,287	3,191	3,060	3,763
(In millions of US dollars)	226	245	267	310	301	289	355
Net domestic assets	1,378	1,366	1,525	1,323	1,589	1,683	1,834
Government (net)	-205	-194	-131	-371	-81	-152	135
Budget	-344	-331	-341	-578	-327	-396	-433
Other	139	139	210	210	246	246	568
Credit to the economy	2,814	2,569	2,674	2,559	2,629	2,625	2,634
Other items (net)	-1,230	-1,009	-1,019	-866	-960	-790	-935
Broad Money	3,815	3,968	4,351	4,610	4,779	4,743	5,597
Currency outside banks	131	122	165	316	328	350	420
Kip deposits	957	1,209	1,296	1,363	1,417	1,428	1,710
Foreign currency deposits	2,727	2,637	2,890	2,931	3,034	2,964	3,467
			(Annual percentage change)				
Reserve money	20.7	23.4	5.7	16.0	24.9	28.7	11.7
Kip reserve money	22.6	81.9	13.8	37.7	33.8	49.3	12.5
Broad money	19.5	24.1	14.0	20.8	20.5	19.5	18.0
Credit to the economy 4/	15.6	5.4	14.8	9.4	6.8	6.6	14.4
Memorandum Items:							
Gross official reserves (in millions of U.S. Dollars)	193	198	203	228	219	220	256
Net international reserves (in millions of U.S. Dollars) 5/	73	86	85	111	99	106	123
Disbursement of Program Loans 6/	12	12	22	22	22	22	52
Issue of Debt Clearance/Bank Recapitalization Bonds 7/	139	139	210	210	246	246	568
Program Exchange Rate	10,800	10,600	10,600	10,600	10,600	10,600	10,600

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

1/ All figures evaluated at program exchange rate.
2/ The first column is evaluated at a program exchange rate of 10,800, while the second is evaluated at 10,600.
3/ Revised targets agreed with the authorities in December 2003 (for June 2004) and in July 2004 (for September 2004).
4/ Adjusted for the impact of Debt Clearance/Bank Recapitalization Bonds.
5/ Net Foreign Assets of BoL minus foreign currency component of reserve money.
6/ In millions of U.S. dollars, cumulative since March 2003.
7/ Cumulative since end-June 2003.

Table 5. Lao P.D.R.: Quantitative Performance Criteria and Indicative Targets, 2003-2004

	2003		2004						
	Sept.		Mar.			Jun.		Sept.	
	Program 1/	Est.	Program	Revised Program 2/	Est.	Staff 3/	Est.	Staff 3/	Est.
	(In billions of kip)								
1. Net domestic assets of the Bank of the Lao P.D.R. (BOL) 4/	-471	-459	-428	-324	-365	-406	-581	-417	-416
2. Net credit to the government from the banking system 4/ 5/	-205	-201	18	-49	-173	-131	-371	-81	-152
3. Net domestic assets of the state commercial banks 6/	1,643	1,426	1,553	1,465	1,383	1,503	1,414	1,419	1,484
4. Reserve money (kip) 7/	320	475	445	473	606	495	599	635	709
5. Budget revenue (excluding grants) 7/ 8/	2,430	2,336	1,218	1,127	1,194	1,916	1,970	2,817	2,817
	(In millions of U.S. dollars)								
6. Net official international reserves 4/ 9/	73	86	84	75	92	85	111	99	106
7. Publicly contracted or guaranteed nonconcessional external debt 10/ 11/	0	0	0	0	0	0	0	0	0
- up to one-year maturity	0	0	0	0	0	0	0	0	0
- maturity of more than 1 year	0	0	0	0	0	0	0	0	0
of which: 1–5 years' maturity	0	0	0	0	0	0	0	0	0
8. External payments arrears 10/	0	0	0	0	0	0	0	0	0
Memorandum items:									
Nonproject budget loans (in millions of U.S. dollars) 12/	12	12	12	12	12	22	22	22	22
Debt Clearance/Bank Recapitalization Bonds (in billions of kip) 13/	139	139	210	210	210	210	210	246	246
of which: state commercial banks	137	137	208	208	208	208	208	244	244
Foreign exchange component of reserve money (in millions of U.S. dollars)	78	68	75	74	79	79	79	81	78
Program exchange rate (kip per dollar)	10,800	10,800	10,800	10,600	10,600	10,600	10,600	10,600	10,600

Sources: Data provided by the Lao P.D.R. authorities. Definitions of terms are contained in the Technical Memorandum on Program Monitoring.

1/ Performance criteria.
2/ Revised program agreed with the authorities in December 2003 (for March 2004).
3/ Revised targets agreed with the authorities in December 2003 (for June 2004) and in July 2004 (for September 2004).
4/ The ceilings for net domestic assets of the BOL and net bank credit to the government will be adjusted upward (downward), and the floor of net official international reserves will be adjusted downward (upward) by any shortfall (excess) in nonproject budget loans.
5/ The ceilings for net credit to the government will be adjusted upward to the extent that issues of Debt Clearance/Bank Recapitalization Bonds exceed program assumptions.
6/ The state commercial banks include BCEL and LDB. Net domestic assets exclude net claims on government and BOL. The ceiling on net domestic assets of state commercial banks will be adjusted downward to the extent that issues of Debt Clearance/Bank Recapitalization Bonds exceed program assumptions.
7/ Indicative target.
8/ Cumulative from start of fiscal year (October to September).
9/ Excludes foreign currency component of reserve money.
10/ Continuous performance criterion.
11/ From March 2003 onwards. Excludes the three-year lease contracted by Lao Airlines on May 27, 2003 as well as debt contracted from the Asian Development Bank and the European Investment Bank to finance the government's equity portion of Nam Theun 2 hydroelectric project.
12/ Cumulative from end-September 2002.
13/ Cumulative issues from end-June 2003.

Table 6. Lao P.D.R.: General Government Operations 2001/02-2004/05

	2001/02	2002/03	2003/04		2004/05	
			Budget	Est.	Staff	Budget
			(in billion of kip)			
Revenue and grants	2,561	2,794	3,281	3,282	3,871	3,825
Revenue	2,324	2,341	2,816	2,817	3,316	3,431
Tax	1,875	1,924	2,404	2,379	2,792	2,872
of which: excluding timber royalties	1,513	1,706	2,254	2,198	2,586	2,722
Nontax	449	417	413	437	524	559
Grants	238	453	465	465	555	394
Expenditure	3,268	4,017	5,073	4,261	5,036	5,294
Current	1,483	1,647	2,245	2,082	2,568	2,683
Wage bill 1/	703	840	1,028	1,060	1,354	1,605
Wages and salaries 1/	547	668	839	872	1,164	1,118
Allowances and pensions /1	156	172	188	188	190	487
Other subsidies and transfers	109	169	138	138	200	202
Interest payments	138	123	289	249	333	306
of which: External	108	115	224	184	255	256
Other recurrent	533	514	790	634	681	570
Capital and onlending	1,785	2,370	2,828	2,179	2,468	2,611
Domestically financed	995	1,026	784	837	941	543
Externally financed	931	1,499	2,159	1,456	1,645	2,227
Onlending	-142	-156	-115	-114	-118	-159
Overall balance	-706	-1,222	-1,791	-980	-1,165	-1,469
Excluding grants	-944	-1,676	-2,256	-1,445	-1,721	-1,863
Bank restructuring bonds 2/	0	-139	0	-108	-282	-254
Financing	706	1,361	1,791	1,087	1,447	1,723
Domestic financing (net)	130	253	7	14	287	119
Bank financing	-234	230	2	42	282	109
of which: Bank restructuring bonds	0	-139	0	-108	-282	-254
Nonbank financing 3/	317	5	5	6	5	10
Discrepancy/Financing gap	47	18	0	-34	0	0
Foreign financing (net)	577	1,108	1,784	1,073	1,160	1,604
Disbursements	859	1,309	2,020	1,309	1,486	1,913
Amortization	-282	-201	-236	-236	-326	-309
			(in percent of GDP)			
Revenue and grants	14.5	13.2	13.4	13.2	13.6	13.4
Revenue	13.1	11.1	11.5	11.3	11.6	12.0
Tax	10.6	9.1	9.8	9.6	9.8	10.1
of which: excluding timber royalties	8.5	8.1	9.2	8.9	9.1	9.5
Nontax	2.5	2.0	1.7	1.8	1.8	2.0
Grants	1.3	2.1	1.9	1.9	1.9	1.4
Expenditure	18.4	19.0	20.7	17.2	17.7	18.6
Current	8.4	7.8	9.2	8.4	9.0	9.4
Wage bill 1/	4.0	4.0	4.2	4.3	4.7	5.6
Wages and salaries 1/	3.1	3.2	3.4	3.5	4.1	3.9
Allowances and pensions /1	0.9	0.8	0.8	0.8	0.7	1.7
Other subsidies and transfers	0.6	0.8	0.6	0.6	0.7	0.7
Interest payments	0.8	0.6	1.2	1.0	1.2	1.1
of which: External	0.6	0.5	0.9	0.7	0.9	0.9
Other recurrent	3.0	2.4	3.2	2.6	2.4	2.0
Capital and onlending	10.1	11.2	11.6	8.8	8.7	9.2
Domestically financed	5.6	4.9	3.2	3.4	3.3	1.9
Externally financed	5.3	7.1	8.8	5.9	5.8	7.8
Onlending	-0.8	-0.7	-0.5	-0.5	-0.4	-0.6
Overall balance	-4.0	-5.8	-7.3	-3.9	-4.1	-5.2
Excluding grants	-5.3	-7.9	-9.2	-5.8	-6.0	-6.5
Bank restructuring bonds 2/	0.0	-0.7	0.0	-0.4	-1.0	-0.9
Financing	4.0	6.4	7.3	4.4	5.1	6.0
Domestic financing (net) 3/	0.7	1.2	0.0	0.1	1.0	0.4
Foreign financing (net)	3.3	5.2	7.3	4.3	4.1	5.6
Memorandum items:						
GDP (in billions of kip)	17,719	21,150	24,460	24,821	28,530	28,530
Primary balance/GDP	-3.2	-5.2	-6.1	-2.9	-2.9	-4.1
Exchange rate	9,810	10,636	10,600	10,577	...	...

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

1/ Reflects staff provisional understanding of treatment of wages, salaries, and allowances and pensions in 2004/05 budget.
2/ In 2002/03 and 2003/04 the bonds were Debt Clearance Bonds issued to state banks to settle budget obligations to contractors with NPLs. In 2004/05 includes bank recapitalization bonds.
3/ In 2001/02 includes a transfer of $33 million from EDL to the government from the Theun-Hinboun Power Company refinancing.

Table 7. Lao P.D.R. : Structural Benchmarks under Third Annual Program

	Status
Continuous	
• No tax incentives under Presidential Decree 01 or any other legislation	✓
October-November 2003	
• Implement new expenditure classification in 2003/04 Budget. (October)	✓
• Complete on site inspections of two SCBs for end-September ’03 accounts.[1/] (November)	✓
• Transfer 20 large enterprises from provinces to central large tax payer unit. (November)	✓
• Issue implementing regulations for Presidential Decree 01 on tax incentives. (November)	✓
December 2003	
• Issue instructions to centralize national customs service and the national treasury.	×
January 2004	
• Submit amendments to the Decree Law on Commercial Banks to National Assembly Standing Committee.	In process

[1/] Performance criterion.

Table 8. Lao P.D.R.: Strategy for Structural Fiscal Reforms.

Priority Fiscal Reforms*

Establish national customs service

- establish pilot scheme in seven main international check points (2005)
- launch fully centralized customs service (2006)

Establish national tax administration

- establish central control over main provincial LTUs (2005)
- launch fully centralized tax administration (2006)

Establish integrated national treasury

- prepare concept paper for a revised legal framework for the treasury to establish central authority over provincial treasuries (2005)
- implement the revised legal framework (2006)
- develop integrated cash management system covering largest provincial treasuries (2005)
- implement integrated cash management covering all provincial treasuries (2006)

Introduce single rate VAT

- prepare implementation plan (2005)
- launch consultative process (2005)
- draft VAT law (2006)
- launch VAT (January 2007)

* A **comprehensive reform of inter-governmental relationships** (including revenue and expenditure assignments, and revenue sharing agreements) is crucial for the success of priority reforms.

Other Reforms

Tax policy

- *tax incentives*: strengthen control over granting tax incentives under the new investment law (2005)

Customs administration

- *customs law*: implement a new law clarifying the central authority over customs and consistent with WTO (2005)
- *automation*: stabilize the existing reporting system (2005)
- *organization*: implement a new HQ structure and regional offices in line with the centralization strategy (2005)

Tax administration

- *organization*: modernize the tax department HQ organization based on a functional model
- *operations of LTUs*: control compliance of non-filing and unlicensed taxpayers; establish and implement a risk-based compliance file selection system; improve information management system (2005)

Public Expenditure Management

- *budget reporting*: evaluate reporting standards for provinces (2005); improve reporting in priority sectors (2006)
- *automation*: introduce pilot accounting software to all ministries (2005) and provinces (2006)
- *banking arrangements*: prepare register of bank accounts (2005); close unauthorized/unnecessary accounts (2006)
- *expenditure arrears*: prepare census of arrears (2005); develop mechanisms to prevent new arrears (2006); clear the arrears (2007)
- *budget nomenclature and accounting*: introduce an economic budget classification for each administrative unit; harmonize accounting codes with the revised budget nomenclature (2007)
- *budget preparation*: bring the budget preparation cycle forward (2007)
- *improve external audit*: prepare and publish a full external audit of the budget by the State Audit Authority (2007)

Table 9: Lao P.D.R.: Summary Macroeconomic Framework, 2001-2008

	2001	2002	2003	2004	2005 1/	2006	2007	2008
		Est.	Est.			Proj.		
Nominal GDP (in billions of kip)	15,705	18,390	22,069	25,739	29,460	32,955	36,596	40,639
Real GDP (in billions of kip)	1,192	1,262	1,329	1,409	1,507	1,605	1,698	1,795
Real GDP growth (percent change)	5.8	5.8	5.3	6.0	7.0	6.5	5.8	5.8
Increase in GDP deflator (percent change)	8.6	10.6	14.0	10.0	7.0	5.0	5.0	5.0
Merchandise exports (percent change)	-3.2	2.1	17.8	9.0	28.8	17.8	3.0	3.2
Merchandise imports (percent change)	-3.6	5.1	8.4	21.7	1.6	13.1	6.6	6.7
Gross official reserves (in months of prospective goods and services imports, excl. NT2)	2.6	3.5	3.2	3.9	4.2	4.3	4.5	4.5
Budget (fiscal year basis) 2/			(In percent of GDP; unless otherwise noted)					
Revenue	13.2	13.1	11.1	11.3	11.6	11.9	12.3	12.8
Grants	3.1	1.3	2.1	1.9	1.9	1.9	1.9	1.9
Expenditure	20.7	18.4	19.0	17.2	17.7	17.7	18.0	18.4
Current	8.1	8.4	7.8	8.4	9.0	9.2	9.3	9.4
of which: interest on debt clearance bonds	0.0	0.0	0.0	0.2	0.2	0.2	0.3	0.3
Capital and onlending	12.6	10.1	11.2	8.8	8.7	8.5	8.7	9.0
Current fiscal balance before grants	5.1	4.7	3.3	3.0	2.6	2.7	3.0	3.4
Overall fiscal balance after grants 3/	-4.4	-4.0	-5.8	-3.9	-4.1	-3.9	-3.8	-3.7
Domestic financing	1.2	0.7	1.2	0.1	1.0	1.0	0.9	0.1
of which: debt clearance bonds	0.0	0.0	0.7	0.4	1.0	0.9	0.8	0.0
Foreign financing	3.1	3.3	5.2	4.3	4.1	3.8	3.7	3.6
Real GDP growth (percent change) 2/	5.8	5.8	5.4	5.8	6.7	6.6	5.9	5.8
Increase in GDP deflator (percent change) 2/	11.9	10.2	13.2	10.9	7.7	5.4	5.0	5.0
Savings and Investment balance 4/				(In percent of GDP)				
National savings	17.1	14.1	16.5	10.4	11.9	10.2	10.0	10.0
Private	8.9	8.0	11.0	5.6	7.3	5.5	5.1	4.7
Government	8.2	6.1	5.4	4.8	4.6	4.7	4.9	5.3
Investment	20.9	19.5	22.0	18.9	19.8	20.7	20.7	20.9
Private	7.4	8.6	10.1	10.1	11.1	12.2	12.0	11.9
Hydropower	0.0	0.0	0.0	0.0	1.0	2.1	1.9	1.8
Other	7.4	8.6	10.1	10.1	10.1	10.1	10.1	10.1
Government 5/	13.5	10.9	11.9	8.8	8.7	8.5	8.7	9.0
Foreign savings (excluding official transfers)	7.3	8.0	8.5	11.5	10.7	13.3	13.5	13.5
Foreign savings (including official transfers)	3.7	5.4	5.5	8.5	7.9	10.5	10.7	10.9

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

1/ It is expected that the construction of the large NT2 hydroelectric project will begin in late 2005.
2/ Fiscal year ending September; Fiscal numbers are based on staff estimates for 2004 and staff proposal for 2005-2008.
3/ The overall budget deficit for 2001/02 includes estimated expenditure arrears of KN 130 billion.
4/ Estimates for private savings and investment are highly tentative as no expenditure based national accounts have yet been established. In particular, private savings reflect unrecorded imports.
5/ Comprises government investment and selected enterprise investment.

Table 10. Lao P.D.R.: External Financing Needs and Sources, 2003–2008

(In millions of U.S. dollars)

	2003	2004	2005	2006	2007	2008
	Est.	Proj.				
Gross financing needs	254	374	268	242	285	306
External current account deficit (excl. official transfers)	178	276	170	129	164	182
Debt amortization 1/	47	67	71	82	80	85
Medium- and long-term debt	47	67	71	82	80	85
Public	19	39	44	54	54	57
Private	27	27	26	28	26	27
Short-term debt 2/	…	…	…	…	…	…
Gross reserve accumulation (- = increase)	-20	-23	-21	-28	-38	-36
IMF repurchase and repayments	9	8	6	3	3	4
Financial sources	254	352	253	242	285	306
Foreign direct investments	69	186	105	86	88	90
Financing from official creditors	199	211	247	298	314	328
Grants	63	72	75	81	85	90
Loans	136	139	172	217	229	238
Other flows 3/	-14	-45	-100	-143	-118	-112
Financing gap 4/	0	22	16	0	0	0

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

1/ Excluding the IMF.
2/ Original maturity of less than one year. Includes all short-term outflows.
3/ Includes all other net financial flows, and errors and omissions.
4/ Includes prospective IMF disbursements.

Table 11a. Lao P.D.R.: External Sustainability Analysis of Public and Publicly Guaranteed External Debt, 2003-2019

	2003	2004	2005	2006	2007	2008	2009	2010	2015	2019
a) Public debt stock										
1. NPV of debt to GDP	(In percent of GDP)									
Baseline	58.6	54.4	52.8	52.2	52.0	51.6	50.8	47.3	42.2	37.8
Without NT2	58.6	54.4	52.6	51.8	51.1	50.4	49.3	48.1	43.0	38.5
Alternative Macroeconomic Scenario 1/	58.6	54.4	52.8	52.2	52.0	51.8	51.5	47.9	44.2	40.9
2. NPV of debt to exports	(In percent of exports of goods and services)									
Baseline	...	212.7	186.7	174.6	180.4	185.5	188.2	156.3	158.5	145.9
Without NT2	...	212.7	185.8	172.1	176.3	180.0	181.4	181.3	179.9	161.8
Alternative Macroeconomic Scenario 1/	...	212.7	186.7	177.7	187.1	196.2	203.0	171.3	191.2	189.7
b) Public Debt Service										
1. Debt service to exports	(In percent of exports of goods and services)									
Baseline	7.2	11.9	10.3	9.5	9.3	9.5	10.0	8.5	9.6	9.3
Without NT2	7.2	11.9	10.3	9.4	9.2	9.3	9.8	9.8	10.6	10.1
Alternative Macroeconomic Scenario 1/	7.2	11.9	10.3	9.6	9.6	10.0	10.8	9.3	11.6	12.1
Memorandum items:	(In millions of dollars; unless indicated otherwise)									
NPV of public debt (Baseline)	1,223	1,313	1,408	1,511	1,624	1,741	1,857	1,958	2,570	3,142
Public debt service	...	73.4	77.7	82.0	83.6	89.0	98.7	106.1	155.4	200.0
Exports of goods and services	560	617	754	865	900	939	986	1,253	1,621	2,154
excluding NT2	560	617	754	865	900	939	986	1,043	1,399	1,920
Public sector borrowing (in percent of GDP)	6.5	7.3	6.9	6.9	6.8	6.5	6.1	5.5	5.5	4.9
Grant element of new public borrowing (in percent)	40.0	41.4	43.5	44.8	45.0	45.5	45.2	49.5	49.5	49.5

1/ Export growth is lower by 2 percent per annum from 2006. Real GDP growth falls to 5 percent by 2009 and stays at that level.

Table 11b. Lao P.D.R.: Fiscal Sustainability Analysis of Public Debt, 2003-2019 1/

	2003	2004	2005	2006	2007	2008	2009	2010	2015	2019
1. NPV of debt to GDP					(In percent of GDP)					
Baseline	58.9	54.7	53.2	53.1	52.7	52.0	50.6	47.4	39.5	34.3
Including SOE debt	62.0	57.7	56.3	56.3	56.3	55.9	54.7	51.7	45.0	40.2
Alternative macroeconomic scenario 2/	58.9	54.7	52.5	51.5	50.5	50.1	48.8	45.8	40.4	36.3
NPV debt to revenue excluding grants					(In percent of fiscal revenue)					
Baseline	533.6	482.3	457.7	445.6	429.3	407.3	392.2	366.6	284.7	236.9
Including SOE debt	561.2	508.9	484.3	473.1	458.3	438.0	424.2	400.0	324.4	277.6
Alternative macroeconomic scenario 2/	533.6	482.3	462.6	454.2	445.5	441.2	430.3	404.0	355.9	320.2
Debt service to revenue excluding grants										
Baseline	13.9	19.7	24.2	24.0	23.4	22.4	21.6	20.2	17.6	14.9
Including SOE debt	...	24.1	29.6	29.1	27.0	25.2	24.4	22.8	20.6	18.3
Alternative macroeconomic scenario 2/	13.9	19.7	24.8	25.2	25.4	25.2	24.6	23.0	22.4	20.4
Memorandum items:					(In percent of GDP; unless indicated otherwise)					
Debt service to revenue including grants	11.6	16.9	20.7	20.7	20.3	19.5	18.8	17.6	15.6	13.4
Primary balance	-5.3	-3.1	-2.9	-2.7	-2.6	-2.5	-2.3	-2.1	-2.2	-1.9
Baseline fiscal projection:										
Fiscal revenues excluding grants	11.0	11.3	11.6	11.9	12.3	12.8	12.9	12.9	13.9	14.5
Grants	2.1	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.8	1.7
Non-interest Expenditures	18.5	16.3	16.5	16.5	16.8	17.2	17.1	16.9	17.8	18.1
Non-interest Expenditures in millions USD	367.2	383.6	428.6	469.3	515.9	569.8	613.2	680.9	1065.4	1473.4
Alternative macroeconomic scenario fiscal projection:										
Fiscal revenues excluding grants	11.0	11.3	11.3	11.3	11.3	11.3	11.3	11.3	11.3	11.3
Grants	2.1	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.8
Non-interest Expenditures	18.5	16.3	16.2	16.0	15.9	15.8	15.6	15.4	15.4	15.1
Non-interest Expenditures in millions USD	367.2	383.6	421.3	453.4	487.3	522.8	557.7	617.8	878.5	1138.7

1/ Government debt, including domestic debt. Based on the Lao P.D.R. fiscal year (October-September).
2/ No reforms or administrative gains; revenues as a percentage of GDP stay at 2004 level.

Table 12: Lao P.D.R.: Millennium Development Goals Indicators, 1990-2015

	1990	1995	2001	2002	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 (%)	..	..	..	..	26.3 (1997)	[3.9]
Poverty gap at $1 a day (%)	..	..	..	..	6.3 (1997)	
Percentage share of income or consumption held by poorest 20%	..	7.6	..	..	7.5 (1997)	
Prevalence of child malnutrition (% of children under 5)	..	40	40	..	40 (2001)	
Population below minimum level of dietary energy consumption (%)	29.0	28.0	22.0	..	22.0 (2001)	[14.5]
2 Achieve universal primary education	2015 target = net enrollment to 100					
Net primary enrollment ratio (% of relevant age group)	61.4	70	82.8	..	82.8 (2001)	[100]
Percentage of cohort reaching grade 5 (%)	53.3	55.4	62.3	..	62.3 (2001)	[100]
Youth literacy rate (% ages 15-24)	70.1	74	78.6	79.3	80.0 (2003)	[100]
3 Promote gender equality	2005 target = education ratio to 100					
Ratio of girls to boys in primary and secondary education (%)	74.9	77.8	83.0	..	83.0 (2001)	[100]
Ratio of young literate females to males (% ages 15-24)	76.2	80.1	84.1	84.7	84.7 (2002)	[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	21	21	23 (2004)	
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	100 (2002)	[54.3]
Infant mortality rate (per 1,000 live births)	120	105	90	87	87 (2002)	
Immunization, measles (% of children under 12 months)	32	68	50	55	55 (2002)	
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 (2003)	[0.0]
Contraceptive prevalence rate (% of women ages 15-49)	..	25.1	..	..	32.2 (2000)	
Number of children orphaned by HIV/AIDS	..	..	280	..	280 (2000)	
Incidence of tuberculosis (per 100,000 people)	..	..	360	359	359 (2002)	[0.0]
Tuberculosis cases detected under DOTS (%)	..	24.0	38.0	43.3	43.3 (2002)	
7 Ensure environmental sustainability						
Forest area (% of total land area)	56.7	..	54.4	..	54.4 (2001)	
Nationally protected areas (% of total land area)	..	0.0	0.0	13.1	13.1 (2002)	
GDP per unit of energy use (PPP $ per kg oil equivalent)	..	..	..	..	..	
CO2 emissions (metric tons per capita)	0.1	0.1	0.1	..	0.1 (2001)	
Access to an improved water source (% of population)	..	..	37.0	..	37.0 (2001)	[74]
Access to improved sanitation (% of population)	..	..	30.0	..	30.0 (2001)	[60]
Access to secure tenure (% of population)	..	..	..	..	..	
8 Develop a Global Partnership for Development						
Youth unemployment rate (% of total labor force ages 15-24)	..	..	..	..	..	
Fixed line and mobile telephones (per 1,000 people)	1.6	3.9	15.2	21.2	21.2 (2002)	[Increase]
Personal computers (per 1,000 people)	..	1.1	3.0	3.3	3.3 (2002)	[Increase]
General indicators						
Population (millions)	4.1	4.7	5.4	5.5	5.5 (2002)	
Gross national income ($ billions)	0.8	1.7	1.6	1.7	1.7 (2002)	
GNI per capita ($)	200	370	300	310	310 (2002)	
Adult literacy rate (% of people ages 15 and over)	56.5	60.6	65.6	66.4	66.4 (2002)	
Total fertility rate (births per woman)	6	5.5	5	4.8	4.8 (2002)	
Life expectancy at birth (years)	49.7	51.8	53.7	54.5	54.5 (2002)	
Aid (% of GNI)	17.3	17.6	14.7	17.3	17.3 (2002)	
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	..	..	60.6 (1995)	

Source: World Development Indicators database, April 2004.

Table 13. Lao P.D.R.: Fund Position and Indicators of Fund Credit, 2003–2012

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	(In millions of SDRs)									
Enhanced Structural Adjustment Facility (ESAF) and Poverty Reduction and Growth Facility (PRGF)										
Disbursements PRGF	4.5	0.0	4.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments	6.5	5.3	4.1	2.2	1.9	2.7	3.6	4.0	4.1	3.2
ESAF/PRGF	6.5	5.3	4.1	2.2	1.9	2.7	3.6	4.0	4.1	3.2
SAF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Fund credit outstanding, end of period										
Total	29.9	24.6	25.0	22.8	20.9	18.1	14.5	10.5	6.4	3.3
ESAF/PRGF	29.9	24.6	25.0	22.8	20.9	18.1	14.5	10.5	6.4	3.3
SAF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	(In percent of quota)									
Total Fund credit outstanding, end of period										
ESAF/PRGF	56.5	46.5	47.3	43.1	39.4	34.3	27.4	19.9	12.2	6.2
Total Fund credit outstanding, end of period										
In percent of GDP	2.0	1.5	1.4	1.2	1.0	0.8	0.6	0.4	0.2	0.1
In percent of exports of goods and nonfactor services	7.5	5.9	4.9	3.9	3.4	2.8	2.2	1.2	0.7	0.4
Total debt service due to the Fund										
Total obligations, including interest and charges (in millions of SDRs)	6.7	5.4	4.3	2.4	2.1	2.9	3.7	4.1	4.1	3.2
In percent of exports of goods and nonfactor services	1.7	1.3	0.8	0.4	0.3	0.4	0.6	0.5	0.5	0.3
Memorandum items:										
Exchange rate (U.S. dollars per SDR)	1.40	1.47	1.47	1.47	1.47	1.47	1.47	1.47	1.47	1.47
Quota (in millions of SDRs)	52.9	52.9	52.9	52.9	52.9	52.9	52.9	52.9	52.9	52.9
GDP (in millions of U.S. dollars)	2,088	2,412	2,665	2,895	3,125	3,375	3,654	4,144	4,475	4,833
Exports of goods and services (in millions of U.S. dollars)	560	617	754	865	900	939	986	1,253	1,309	1,373

Sources: IMF Finance Department; and Fund staff estimates and projections.

Table 14. Lao P.D.R.: Phasing of Disbursements Under the PRGF Arrangement

Date	Disbursement 1/ Millions of SDR	Disbursement 1/ Percent of Quota	Conditions
April 25, 2001	4.53	8.6	Board approved new three-year arrangement and endorsed first-year program.
February 25, 2002	4.53	8.6	Board completed first review, based on quantitative performance criteria for June 2001.
August 26, 2002	4.53	8.6	Board completed second review, based on quantitative performance criteria for March 2002, and endorsed second-year program.
September 12, 2003	4.53	8.6	Board completed third review, based on quantitative performance criteria for September 2002. Board grants extension of program by one year.
April, 2005	4.53	8.6	Board completes fourth review, based on quantitative performance criteria for September 2003.
Total	22.65	42.85	

Sources: IMF, Finance Department; and staff projections.

1/ Since the fifth and sixth reviews are not expected to be completed, the last two disbursements of SDR 4.53 million and SDR 4.52 million respectively will not be made.

Lao P.D.R.—Fund Relations
(As of September 30, 2004)

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

II. **General Resources Account:**	**SDR million**	**Percent Quota**
Quota	52.90	100.0
Fund holdings of currency	52.90	100.0

III. **SDR Department:**	**SDR million**	**Percent Allocation**
Net cumulative allocation	9.41	100.0
Holdings	9.90	105.18

IV. **Outstanding Purchases and Loans:**	**SDR million**	**Percent Quota**
ESAF/PRGF arrangements	25.74	48.67

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				
	2004	**2005**	**2006**	**2007**	**2008**
Principal	1.17	4.11	2.21	1.95	2.72
Charges/interest	0.06	0.11	0.10	0.09	0.08
Total	1.24	4.22	2.31	2.03	2.79

VII. Implementation of HIPC Initiative

The Lao P.D.R. could be eligible for assistance under the HIPC Initiative. A loan-by-loan DSA has been undertaken with the newly available data on the recent mission. This, together with the outcome of the negotiations on the debt to the Russian Federation, will be needed to evaluate whether to seek HIPC relief.

VIII. **Safeguards Assessments**

Under the Fund's safeguards assessment policy, the Bank of the Lao P.D.R. (BoL) is subject to a full safeguards assessment with respect to the PRGF arrangement, which was approved on April 25, 2001. An off-site safeguards assessment of the BoL was completed on December 17, 2001. The assessment concluded that high risks may exist in the external audit mechanism, and financial reporting framework, internal audit mechanism, and system of internal controls and recommended an on-site assessment. The FIN on-site safeguards assessment mission took place in early December 2002. It noted that the BoL has taken initial steps to strengthen its safeguards framework with the creation of an internal audit department and the initiation of external audits. However, staff noted that significant vulnerabilities remain and the BoL must continue to strengthen its external audit, adopt a recognized financial reporting framework, and develop its internal audit function further.

To address the significant vulnerabilities, staff and the authorities had agreed that the BoL: (i) contract an audit firm with international experience and exposure to conduct joint audits with the state auditor for financial years ending December 2003 and 2004; (ii) adopt International Accounting Standards (IAS) as its financial reporting framework beginning with the financial year ending December 31, 2004; (iii) establish a formal monthly process of reconciling accounting data to program data reported to the Fund; and (iv) train internal audit staff to become proficient in conducting internal audits professionally.

The authorities have started the process of reconciling accounting data to program data and have recently completed the audit of BoL's 2002 accounts with assistance of an international audit firm. However, progress in the remaining areas listed above has been slow. The authorities have indicated that they are not in a position to implement an earlier agreement to undertake a joint audit of the BoL's 2003 accounts by the state auditor and an international audit firm. Staff have proposed a temporary compromise that involves commissioning a targeted external review of the BoL's external reserves and reserve money positions as of end-September 2003 by an international audit firm, as a step towards a full-fledged joint external audit at a later stage. The authorities are currently reviewing their position with regard to this proposal.

IX. **Exchange Rate**

In September 1995, the 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. On November 10, 2004 the commercial bank exchange rate was kip 10,752 (buying) and kip 10,816 (selling) per U.S. dollar.

X. Last Article IV Consultation Discussions

The last Article IV consultation discussions were held in Vientiane during April 24 – May 8, 2002. The staff report (IMF Country Report No. 02/221) was discussed by the Executive Board on August 26, 2002. Lao P.D.R. continues to avail itself of transitional arrangements under Article XIV. Staff have 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.

XI. Technical Assistance (since 1998)

Department		Purpose	Date
STA	-	Government finance statistics	4-5/04
	-	Money and banking statistics	4-5/04
	-	Multisector statistics/GDDS mission.	10/02
	-	Assist in compilation of balance of payments data.	8/99
	-	Review and assist in compilation of money and banking statistics.	2/99
FAD	-	Missions on tax policy and administration.	1/99, 2/00, 10-11/01, 3/02, 10/04
	-	Expert on tax administration.	9/98-12/99, 1-3/00, 5-7/00, 9-11/00, 1-2/01, 4-6/01, 3-4/03, 11/03, 4/04
	-	Expert on customs administration.	10/98-1/99, 5-6/00, 9-11/00, 1-3/01, 5-6/01, 3-4/03, 7-8/03, 11/03, 2/04, 4/04
	-	Mission on public expenditure management.	4-5/01, 10/02, 6-7/04, 10/04
MFD	-	Expert on banking supervision.	4-5/02, 7/02, 10-11/02, 1/03, 6-4/03, 7/03, 10-12/03, 1-2/04, 5-7/04, 9-11/04

XII. Resident Representative

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

Lao P.D.R.—Statistical Issues

The overall coverage, quality, and timeliness of macroeconomic statistics need to be significantly improved for effective monitoring of economic developments, policy formulation, and program compliance. In this regard, a multisector STA mission visited Vientiane during October 2002 in order to facilitate in the preparation of the General Data Dissemination System (GDDS) metadata. It provided key recommendations, including in areas where technical assistance and training would be needed. The mission recommended greater coordination between the various agencies responsible for compiling macroeconomic statistics, including through the formation of an inter-agency working group. In line with the recommendations of the multisector mission, a GDDS coordinator has recently been appointed. The authorities also need to finalize the GDDS metadata to formally endorse the strategy for statistical improvement. The multisector mission was followed up recently by two parallel STA missions 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 the Lao P.D.R. (BoL). Since 1996, the Lao P.D.R. has been included in the *International Financial Statistics (IFS)* publication.

National accounts

National accounts consist of annual estimates of GDP by activity at current and constant 1990 prices which broadly follow 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 quantity of production or quantity indicators collected by line ministries. The October 2002 multisector STA mission recommended to the authorities to establish a system for collecting data on current economic activities based on regular surveys and to 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 compile new series of GDP by activity and by expenditure at current and constant 2002 prices, which are expected to be completed in the near future. With SIDA support, the Lao Expenditure and Consumption Survey 2002-2003 (LECS 3) has just been finalized and released.

Prices

The NSC compiles a monthly CPI that is available on a timely basis. The latest CPI was introduced in January 2000 (with December 1999 as the reference period) using the results of the 1997/98 Lao Expenditure and Consumption Survey (LECS) for deriving a consumption basket. It comprises nine product categories covering major urban centers, including Vientiane. The NSC plans to revise the weights and review the sample of outlets and products on the basis of the LECS 3. The NSC is also working on the development of a producer price index (PPI) on a quarterly basis with SIDA's assistance.

Government finance

Government finance statistics are weak and there is scope to significantly improve their accuracy, coverage and transparency. The Budget Department produces monthly, quarterly, and annual revenue and expenditure statistics. Most data are currently 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 recently introduced 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. In July 2004, the authorities published in the *Official Gazette* the 2003/04 budget data by central government ministry and province and the 2002/03 outturn, which allows the identification of key spending categories. However, no government finance data are presented in *IFS* country page or the *Government Finance Statistics (GFS) Yearbook*.

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 are available by type of debt holder and instrument. Efforts are being made to further improve coverage, particularly relating to SOE debt.

The government finance statistics mission in 2004 provided recommendations to improve the quality of fiscal statistics and developed a roadmap for the eventual migration to *GFSM2001*.

Monetary statistics

The BoL regularly reports its balance sheet (with a two-week lag) and commercial bank balance sheet (with a four-week lag) to APD for program monitoring purposes, and to STA for publication in *IFS* with a lag of two to three months. In recent years, a number of STA missions have provided technical assistance in monetary statistics to BoL. The authorities have been implementing the recommendations made by these STA missions and making progress in compiling monetary statistics.

However, the latest monetary and financial statistics mission in April/May 2004 identified a number of problems in the compilation of monetary statistics and made 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 in 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 charts 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 any discrepancies in bank financing between monetary and government finance statistics.

Balance of payments

Data on foreign reserves are reported on a weekly basis, and also derived from the monetary survey at the prevailing kip per U.S. dollar end-month exchange rate.

Balance of payments statistics need significant improvements in the frequency and coverage 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) data quality and monitoring of external debt, especially of state owned enterprises. Since 2001, the MOF has adopted the Commonwealth Secretariat-Debt Recording and Management System (CS-DRMS) for processing and maintaining external debt data.

The introduction of new customs procedures, the Customs 2000 system and equipment, has been implemented (with FAD technical assistance) which started to produce 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 an acute need to improve the coordination between the agencies involved in BOP compilation, viz., the BoL, the NSC, the Customs and the External Financial Relations Departments of the MOF, the Department of International Cooperation of the Committee of Planning and Investment, and the commercial banks.

Lao P.D.R.: Core Statistical Indicators
(As at November 7, 2004)

	Exchange Rates	International Reserves	Reserve/Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Debt
Date of latest observation	10/28/04	09/04	09/04	09/04	09/04	08/04	09/04	Q2/04	Q2/04	06/04	2003	06/04
Date received	10/28/04	10/28/04	10/28/04	10/28/04	10/28/04	10/18/04	10/14/04	07/21/04	07/21/04	07/22/04	04/21/04	07/21/04
Frequency of data	D	M[1/]	M	M	M	M	M	Q	Q	M [2/]	A	Q
Frequency of reporting	D	M[1/]	M	M	M	M	M	Q	Q	M [2/]	A	Q
Source of Data [3/]	A	A	A	A	A	A	A	A	A	B	C	A/B
Mode of reporting [4/]	E	E	E	E	E	E	E	C	C	C	C	C
Confidentiality[5/]	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of Publication [5/]	O	O	O	O	O	O	O	O	O	O	O	O

1/ International reserves are available on a bi-weekly basis.
2/ Monthly budget revenue and expenditure reported with 3-week lag, but budget financing reported on an irregular basis.
3/ Source A: Central Bank, B: Ministry of Finance, C: National Statistical Center.
4/ Data are directly reported by the authorities via the resident representative's office (E - electronic , C - facsimile).
5/ All data are eventually published in periodic reports by the BOL and the National Statistical Center. No explicit embargoes apply. These data (except fiscal data) have also been published in *International Financial Statistics (IFS)* since the April 1996 issue (C - unrestricted use, O - other irregular basis).

Lao P.D.R.: Fund-Bank Relations Annex[22]

Partnership for Development

The Government (GOL) of the Lao Peoples' Democratic Republic (P.D.R.) aims to achieve rapid economic growth in order to improve the living conditions of its poor and graduate from its status as a least-developed country. The development strategy to achieve these goals has been articulated in the National Socioeconomic Development Plan (2001–05), the Interim Poverty Reduction Strategy Paper (I-PRSP) and the recently-prepared National Growth and Poverty Eradication Strategy (NGPES), approved by the National Assembly in October 2003. This strategy seeks to: (i) maintain macroeconomic stability by strengthening revenue and ensuring appropriate fiscal and monetary policies; (ii) deepen structural reforms in the following areas: public expenditure management, financial sector, state-owned enterprises (SOEs), private sector, trade, and development of the legal system; (iii) invest in the social sectors to expand access and improve social sector outcomes; (iv) invest in infrastructure such as roads, power, and water supply, and expand access to these services; (v) invest in rural development and natural resource management—including support for agricultural, mining, forestry and hydropower development; and (vi) strengthen capacity.

The World Bank Group—International Finance Corporation (IFC), Mekong Private Sector Development Facility (MPDF), World Bank Institute (WBI) and International Development Association (IDA)—provides technical and financial support to Lao P.D.R. in the implementation of this strategy. The Bank itself supports analytical work in the structural reform areas cited above, in poverty diagnostics, in key sectors and in capacity building for the public sector, in addition to concessional financial assistance of around US$30 million a year. As agreed during the recent Country Assistance Strategy (CAS) consultations and as requested by the GOL, the Bank intends to place increased emphasis on human resource development in its new credits, in addition to its existing role in basic infrastructure and agriculture. The WBI provides training in support of capacity building initiatives. The IFC, together with its MPDF, the private sector arm of the Group, promotes private sector development through technical assistance, strengthened dialogue between public and private sectors and direct financing of private-sector projects.

IMF-World Bank Collaboration in Specific Areas

The IMF takes the lead in advising the GOL on macroeconomic policy. This support covers tax, fiscal, monetary, interest rate and exchange rate policies, balance of payments and related statistical issues. In addition, some aspects of three structural policy areas that have an important bearing on macroeconomic performance (financial sector, revenue administration, public expenditure management, and trade policy) are also integral to the Fund's work

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[22] Prepared by the staff of the World Bank. Contact person: Mr. Alessandro Magnoli, Country Economist, Poverty Reduction and Economic Management Department, East Asia and Pacific Region, phone (202) 473–1653.

program. The Bank has taken the lead in supporting the GOL in growth strategies, poverty analysis and advice, poverty and social impact assessments, consultations for the poverty reduction strategy, SOE reform and restructuring, and legal/judicial development, in addition to natural resource management and sectoral reforms. The Bank in coordination with the Fund advises the GOL on structural areas of the financial sector, public expenditure management and trade policy as well as in supporting the GOL in the implementation of its poverty reduction strategy (NGPES). Both institutions also collaborate closely with the AsDB on financial sector reform and public expenditure management, and with the UN agencies in the trade policy and the NGPES.

The Bank also plans to initiate new work on capacity enhancement in the public sector as well as in transport, private sector development, education, and legal and judicial development. The GOL has indicated that while various types of capacity-building is ongoing on in different parts of the public sector, and the Bank projects have components that address this issue in the sectors, there is a need for greater focus, systematic effort and scaling up of capacity enhancement efforts. To address the situation, the Bank is preparing its CAS for the next four years with capacity enhancement as the defining theme, and WBI is closely working with the GOL and the National Organization for the Study of Policy and Administration (NOSPA) to concretely define both a capacity enhancing strategy and an agreed working plan. The GOL's recent governance report has emphasized its commitment to the rule of law and the need for implementing that in the country; the Bank plans to support this area.

Bank and Fund Policy Dialogue

Poverty Reduction Strategy. The Bank and the Fund, together with UNDP, have provided assistance to the GOL's process of formulating its medium-term poverty reduction strategy. In April, 2001, the GOL submitted an I-PRSP to the Boards of the World Bank and the IMF, and Progress Reports on the preparation of the full PRSP were submitted in August 2002 and September 2003. In May 2003, the GOL circulated the first draft of the full PRSP, which was initially called the *National Poverty Eradication Program* (NPEP). This was presented at the May 2003 mini Roundtable Meeting (RTM) of donors and NGOs for comments. In August 2003, GOL issued the final draft of the document, which was officially presented to the international community at the 8th Round Table Meeting (RTM) in September 2003 and approved by the National Assembly in October 2003. The NPEP was reviewed and upgraded to a national strategy in early 2004. The final text takes the name of *National Growth and Poverty Eradication Strategy* (NGPES), and is based on the five-year National Socio-Economic Development Plan for 2001–05 (NSEDP). In June 2004, the authorities submitted the full PRSP for consideration of the IDA and IMF staff and endorsement by the IDA and IMF Boards. The Bank and the Fund's Joint Staff Advisory Note (JSAN) of the strategy has been prepared in October 2004, and will be considered by the IDA and IMF Boards in November/December 2004.

Public Expenditure Management. In 2002, the Bank completed a Public Expenditure, Financial Management and Procurement Review (PER), jointly with the IMF, the AsDB and the GOL. Subsequently in late 2002, an FAD mission from the IMF completed a review of the treasury, budget reporting and accounting systems. These assessments provided a further basis for the GOL's reform program that has been supported by the IMF's PRGF and by the Bank's financial support in the form of the Financial Management Adjustment Credit (FMAC)[23], and the technical assistance provided by the Financial Management Capacity Building Credit (FMCBC), the IDF grants to improve public financial management, the efficiency of the procurement regime, and tariff-studies. In particular, the FMAC sought to enhance transparency, accountability and efficiency through the publication of the budget, improvements in procurement, greater balance between recurrent and capital expenditures and the development of a better chart of accounts for classifying expenditures. These actions complement several of the PRGF structural benchmarks in respect of treasury reforms, budget reporting and public accounting.

Given the current situation of public financial management, reforms are expected to continue for some time to make such management adequately transparent, accountable and efficient. The final NGPES incorporates not only the public investment and current expenditure plan that would be needed to achieve the goals set out in that strategy, but also reforms in public financial management that would be needed to effectively manage the rising revenues from natural resources and general taxes. Self-standing technical assistance projects may be provided by the Bank and the Fund in this area, if needed. Firm entrenchment of this reform process, along with clear, monitorable performance benchmarks, and an established track record will be necessary for the World Bank and other donors to continue expanding support to Lao P.D.R., including possible support for future projects to export power to neighbors, such as the Nam Theun 2 (NT2) power project.

The Bank has completed, jointly with the GOL, an examination of the likely sources of growth for Lao P.D.R., the institutional development that is necessary for better public financial management and the likely impact of both on poverty and human development. Work on intergovernmental fiscal relations is also planned. The Bank expects to support public financial management reforms over the medium term through a number of Poverty Reduction Support Credits (PRSCs). The PRSCs, adjustment credits supporting the implementation of the NGPES, will assist the GOL's reform efforts, inter alia, in the areas of public sector governance, social sectors, trade, and private sector development (PSD). The objective of the project is to develop and implement policies and structural reforms that are consistent with and supportive of the country's overall economic development strategy in a sequenced and phased manner. Timing will be synchronized with the budget cycle to the extent possible. Project concept review was scheduled for October 2004.

[23] This was a two-tranche adjustment operation of US$17 million, with the first tranche of US$7 million disbursed in January 2003. The second-tranche release was disbursed in May 2004.

Financial Sector Reforms. The World Bank and the IMF have worked closely with the AsDB to support the Bank of the Lao P.D.R.(BoL) in developing and implementing a multi-year banking reform program, with technical assistance provided by the AsDB. The Bank's FMAC supported restructuring of state-owned commercial banks (SCBs) and their move to a more commercial basis of operation, as well as the development of rural micro-finance institutions. Reflecting the Bank's view that SCBs must be put on a commercial footing, the conditionality under FMAC included detailed provisions on the restructuring of SCBs, including non performing loans (NPL) resolution process, proper and regular reporting by SCBs, as well as international audits so as to improve transparency and accountability. In addition, it supports the development of an appropriate policy framework for rural and micro finance institutions through a consultative process. The IMF is taking the lead in strengthening banking regulation and supervision, and complementing the Bank and AsDB work on SCB restructuring, by focusing on the financial aspects of restructuring and its fiscal implications.

The Bank recognizes, together with the IMF, that the restructuring of SCBs and the reform of regulation and supervision is not only important for the proper functioning of the financial sector, but also for fiscal and macro-stability in the Lao P.D.R., as NPLs and the losses from NPLs have impacted the budget adversely and could do so in the future. The FMAC, supported by the FMCBC, and the PRGF have sought to break this destabilizing cycle as a key step in the process of better management of public resources and fiscal stability. It is expected that this support will be needed over the medium-term which could be provided by PRSCs and the programs of the IMF and the AsDB.

Trade Policy. Trade policy was an integral part of both the Bank and IMF's earlier analytical work and programs. More recently, the WBI conducted several seminars on trade policy issues, and in April 2004, organized a face-to-face workshop on WTO accession and its potential for exports and poverty reduction, in a peer-learning mode, which was attended by more than a dozen senior Lao officials. The Bank completed the updating of earlier work on Lao P.D.R.'s trade regime and exports, and is leading a larger piece of diagnostic work on trade policy and export potential during June-October 2004; this is being done jointly with the GOL (led by the Ministry of Commerce) under the Integrated Framework program. Reforms in this area are also expected to be supported by the proposed PRSC.

The Bank's Key Roles in Policy Dialogue

Poverty and Social Impact Analysis. This work, supported by the Bank, is being mainstreamed into the various pieces of the Bank's analytical and advisory assistance (AAA) and so there will be no single piece of work designated as the PSIA. Instead, key prospective analytical work, agreed in consultation with the GOL, will not only diagnose the problems at hand and identify the technical solutions to the problems/constraints being analyzed, but go on to assess the ex ante poverty and social impact of those potential solutions and policies, before developing recommendations. Most of the AAA work is also being conducted in a consultative mode using some of the processes developed for the NGPES. The recently completed Country Economic Memorandum/Sources of Growth report, planned Poverty

Assessment and Public Expenditure Tracking work, and the planned Trade Policy Diagnostics will all be done in this mode; the IMF will provide relevant inputs for this work in the specific areas of its expertise (e.g., tax policy, exchange rate policy).

State-Owned Enterprises (SOEs). The SOEs have been large users of resources and certainly have been the main debtors to SCBs; they have also been major contributor to the problem of NPLs at SCBs. Accordingly, the FMAC supported the GOL's ongoing SOE reform program aimed at improving and institutionalizing the reporting and recording of annual performance of all SOEs, the restructuring of the nine large SOEs including, BPKP, Pharmaceutical Factory No. 3, Nam Papa Lao, Lao Airlines, DAFI, Electricité du Lao, and DAI SOEs, and appropriate pricing policy for public utility SOEs. The latter requires the development of tariff policies for water, telecommunications and aviation to ensure cost-recovery tariffs and transparent subsidies where applicable, so that the impact of pricing on the commercial viability of those SOEs are predictable and favorable.

For this purpose, the Bank has supported through technical assistance, the preparation of multi-year restructuring plans for five of the above-mentioned SOEs; the development of Memorandums of Understanding outlining the parameters of the restructuring for the next five SOEs; the implementation of the performance monitoring system for all 148 SOEs in Lao P.D.R. and detailed tariff studies in telecommunications and aviation. The SOE reform effort not only seeks to move SOEs towards greater efficiency and more commercially viable operations, but also expects to limit future contingent liabilities of SOEs that may undermine medium-term fiscal stability.

The Bank will support the implementation of the SOE's multi-year restructuring plans, the monitoring system as well as the utilities' tariff-policies beyond the second-tranche release of FMAC; this will be done through the PRSCs, the technical assistance grants and credits, and analytical work.

Private Sector Development. The Bank supports the development of the private sector, both economy-wide and in sectors. Over the next 12 months the World Bank Group (IDA, IFC, MPDF) will carry out extensive analysis in the PSD area to define a prioritized and feasible multi-year Action Plan with the objective of removing the constraints to private sector growth. Specific activities under this initiative include a joint ADB-WBG Investment Climate Survey of manufacturing and tourism firms in Lao P.D.R., provincial level reviews of the regulatory procedures and PSD promotion initiatives of local governments; a review of the key business laws, and coordination of the donor working group on macroeconomic and PSD issues. The IFC and MPDF are supporting the establishment of a regular business forum to institutionalize the private-public dialogue and the GOL's efforts to unify the domestic and foreign investment laws, in addition to continuing their efforts to develop private-sector projects for funding, and train SME managers and bankers. IDA has provided inputs to the private sector component of the NGPES. IDA's sector programs in education, health and transport are supporting the development of a policy framework supportive of private participation.

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 nested within and consistent with the overall NGPES/PRSP, Rural Development Program, and Agriculture Development Strategy. Through these, the GOL is, inter alia, seeking to (i) stabilize or increase forest cover and condition; (ii) ensure protection of water resources and critical infrastructure through forest conservation; and (iii) put forest resources to work directly for the reduction of rural poverty through partnerships with local communities.

The Nam Theun 2 Hydro-power Project. This project, involving the construction of a dam to generate power mainly for export to Thailand, constitutes an opportunity for Lao P.D.R. to: (i) combat widespread poverty in the country through additional revenues gained from electricity exports; (ii) help meet Thailand's energy needs and strengthen regional Mekong initiatives; (iii) promote sustainable development and the broader development agenda in Lao P.D.R.; and (iv) benefit from increased future opportunities to implement similar projects in the mining and electricity sectors, as Lao P.D.R. becomes better integrated into global developments and builds relationships with the international private sector. The GOL has requested World Bank Group's support for this project through an IBRD partial risk guarantee, an IDA environmental and social project and a MIGA guarantee.

A World Bank decision to support the proposed project is linked to: (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 proposed 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 proposed project.

World Bank Strategy and Lending Operations

Country Assistance Strategy (CAS). The last CAS was presented to the Bank's Board in April 1999 and the next one is proposed to be presented at the beginning of 2005; this timing is aimed at using the NGPES as the basis for the next CAS.

The overarching objective of the last CAS was poverty reduction, focusing on sustained growth to improve Lao P.D.R.'s' social indicators, and graduation from the rank of Least Developed Countries by the year 2020. The last CAS focused on supporting the stabilization of the economy, to be accomplished in close collaboration with the IMF. This consisted of a lending and non-lending program, with the former amounting to US$111 million of new commitments during July 1, 1999 to June 30, 2003. Since 2001, there has been a jump in the non-lending program for Lao P.D.R., given the special emphasis given to low income countries facing difficult conditions.

Non-Lending Program. The current sources of growth in the Lao P.D.R. economy haves been examined in a Country Economic Memorandum/Sources of Growth report, which was completed in May 2004 and will shortly be shared with the GOL.

The World Bank's Main Non-Lending Work
(recently completed and ongoing)

Area	Instrument
Poverty Reduction	Poverty Assessment Report (completed, 2002; new one ongoing, June 2004); Poverty-Environment Nexus Study Phase 1 (completed, 2002);
Growth Analysis	Sources of Growth - CEM (completed, May 2004)
Public Expenditure Management	PER, CFA, CPAR (completed, 2002); Public Expenditure Tracking in Health & Education (ongoing, November 2004); Intergovernmental Fiscal System Note (planned September 2004)
Private Sector Development & Trade Policy	Concept Note for AAA package on private sector development, including investment climate survey and provincial regulatory reviews. Integrated Framework work on trade diagnostics (planned to be completed by November 2004)
Capacity Enhancement & Public Sector Reform	Note on Capacity Enhancement for CAS (planned June 2004)

Lending Operations

As of September 7, 2004, IDA credits totaling US$723 million equivalent had been approved for Lao P.D.R. including support for adjustment operations, rural development, forestry, transport, energy, telecommunications, education, health, industry, and capacity building.

In the last three years, lending operations have focused on the above mentioned CAS objectives, with an average commitment of about US$37 million, while disbursements averaged US$34 million. The level and composition of the lending program for the next four years will be determined in the context of the forthcoming CAS, currently scheduled for early 2005.

IDA: Commitments and Disbursements to the Lao P.D.R., 1977–2004
(In millions of U.S. dollars; as of July 31, 2004)

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	48.0	65.2	0.6
1998	34.7	26.5	1.3
1999	29.8	27.8	1.5
2000	0.0	18.1	3.0
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	0.0	2.2	0.7
Total	722.9	573.9	32.3

Source: World Bank, 2004.

Lao P.D.R.—Relations with the Asian Development Bank[24]

The Asian Development Bank (AsDB) has extended development assistance to Lao P.D.R. since 1970. 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 financial sector development since the latter part of the 1980s. Since the early 1990s, the emphasis of AsDB assistance to Lao P.D.R. has been broadened to include rural development, social development and environment. Since the late 1990s, the AsDB has focused its activities on poverty reduction.

AsDB worked with the Government and other stakeholders to formulate its current Country Strategy and Program in 2001 to guide its operations in Lao P.D.R. for the next five-year period. The theme of AsDB's interventions in Lao P.D.R. will be poverty reduction by broadening community participation and opportunities. The core strategies for poverty reduction are: sustainable economic growth, inclusive social development, and good governance. The main strategic focus will be on four operational priorities including rural development and market linkages, human resource development, sustainable environmental management, financial and private sector development, and regional integration.

Lao P.D.R. is a key actor in the Greater Mekong Sub-Region (GMS) program as a land-link among the other 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 60 loans (including four loans for the financial/banking sector reforms) for a total of $1,085.4 million by end-December 2003, when 23 of these loans were still active. As of end-2003, technical assistance amounting to $95.76 million comprising 198 projects has been approved.

In 2004, two new loans had been approved by July, and one additional loan is envisaged to be approved, with the planned annual commitments of $37.7 million. Technical assistance of $1.45 million was approved during the first eight months of 2004.

Table 1. Lao P.D.R.: AsDB Commitments and Disbursements, 1999-2004
(In million of US dollars)

	1999	**2000**	**2001**	**2002**	**2003**	**2004** 1/
Commitments	57.6	60.5	65.0	86.9	46.0	37.7
Disbursements	46.8	51.0	44.7	45.6	54.7	61.8

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

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[24] Prepared by the Asian Development Bank.

Lao P.D.R.: Social Indicators

	Latest single year			Same region/income group	
	1970-75	1980-85	1995-2002	East Asia & Pacific	Low-income
POPULATION					
Total population, mid-year (millions)	3.0	3.6	5.5	1,838.5	2,494.6
Growth rate (% annual average for period)	2.2	2.4	2.4	1.0	1.9
Urban population (% of population)	11.1	13.8	20.2	38.2	30.6
Total fertility rate (births per woman)	6.5	6.5	4.8	2.1	3.5
POVERTY					
(% of population)					
National headcount index	..	..	38.6	..	..
Urban headcount index	..	..	26.9	..	..
Rural headcount index	..	..	41.0	..	..
INCOME					
GNI per capita (US$)	..	..	310	960	430
Consumer price index (1995=100)	..	..	938	135 1/	140
Food price index (1995=100)	..	..	..	..	..
INCOME/CONSUMPTION DISTRIBUTION					
Gini index	..	..	37.0	..	..
Lowest quintile (% of income or consumption)	..	..	7.6	..	..
Highest quintile (% of income or consumption)	..	..	45.0	..	..
SOCIAL INDICATORS					
Public expenditure					
Health (% of GDP)	..	..	1.7	1.9	1.1
Education (% of GDP)	..	0.4	3.2	3.2	3.1
Social security and welfare (% of GDP)	..	..	..	..	..
Net primary school enrollment rate					
(% of age group)					
Total	..	..	83	92	80
Male	..	..	86	92	85
Female	..	..	79	92	74
Access to an improved water source					
(% of population)					
Total	..	..	37	76	76
Urban	..	..	61	93	90
Rural	..	..	29	67	70
Immunization rate					
(% under 12 months)					
Measles	..	6	55	70	65
DPT	..	4	45	78	65
Child malnutrition (% under 5 years)	..	..	40	15	42
Life expectancy at birth					
(years)					
Total	42	47	55	69	59
Male	41	46	53	68	58
Female	44	49	56	71	60
Mortality					
Infant (per 1,000 live births)	145	135	87	32	79
Under 5 (per 1,000 live births)	218	200	100	42	121
Adult (15-59)					
Male (per 1,000 population)	610	531	355	184	310
Female (per 1,000 population)	510	439	299	129	259
Maternal (modeled, per 100,000 live births)	..	..	650	..	..
Births attended by skilled health staff (%)	..	..	19	80	..

Source: 2004 World Development Indicators CD-ROM, World Bank.

1/ Includes latest data in the range for 1994-2000.

Statement by Made Sukada, Alternate Executive Director for the Lao People's Democratic Republic and Pichit Patrawimolpon, Senior Advisor to Executive Director November 29, 2004

Introduction

On behalf of the Lao's authorities, we would like to express their appreciation to the staff, management and the Executive Board as well as to the donor community for their advice and continued support. The extensive consultation and discussions during the Fund mission have provided a comprehensive assessment and valuable suggestions to the authorities on Lao's economic development, including the implementation of the reform program. In this respect, the authorities would like to thank the mission team for the constructive dialogue as well as the well written and balanced Staff Report for the 2004 Article IV Consultation.

Continued implementation of the structural reform program coupled with sound macroeconomic policies, supported by financial and technical assistance from the Fund and other development partners, have contributed to macroeconomic stability and encouraging economic growth in the recent years. Inflationary pressures have subsided and poverty has continued to decline. Despite these positive developments, the authorities are aware that Lao's economy still faces major challenges. While significant progress has been made, structural weaknesses in a number of areas remain. In view of these challenges, the Lao authorities would like to reiterate their continued commitment to sound macroeconomic management and the reform agenda, consistent with the National Growth and Poverty Eradication Strategy (NGPES), the first full poverty reduction strategy prepared by the government. The NGPES has provided a broad strategic framework under which the Government's future growth and poverty eradication program will be developed and implemented in order to raise Lao P.D.R. from the rank of least-developed countries by 2020.

Recent Economic Developments

A combination of prudent macroeconomic policies and more favorable external developments contributed to Lao's favorable macroeconomic performance in the past few years. In 2004, the economy rebounded and growth is expected to reach 6 ½ percent of GDP, attributed mainly to agriculture and hydroelectricity output that have recovered from a drought in 2003. The tourism sector has also recovered from last year's SARs outbreak. In addition, manufacturing activity has also picked up in response to growth in consumer demand.

Inflation, which had surged into double digits in 2002, has been on a downward trend since mid-2003, reflecting continued prudent monetary policy. A temporary supply shock—mainly resulting in a sharp increase in basic food, fuel and utility prices—has caused headline inflation to be relatively high for most of 2004. However, as food inflation fell rapidly, headline inflation has declined to 7 percent in October 2004, and is expected to stay in single digits for the remainder of the year. With the kip remaining stable, core inflation has fallen significantly over the past year.

Lao's external position has continued to improve. Rapid export growth and continued buoyant donor and FDI inflows have allowed gross official reserves to increase steadily and are expected to reach US$ 240 million by end 2004, which is equivalent to around 4 months of imports. Nevertheless, with new contracts on concessional borrowings from multilateral donors, public external debt has continued to rise over the last couple of years.

On the structural reform front, the authorities have implemented most of the original structural benchmarks for the fourth review of the PRGF. The benchmarks related to onsite bank inspection, improving the budget classification, and transferring tax payers to the central large tax payer unit were implemented on schedule. However, some delays occurred in the finalization of implementing regulation for the presidential decree on tax incentives.

Fiscal Policy

Recognizing the importance of fiscal sustainability to macroeconomic stability, the authorities remain committed to pursue prudent fiscal policy and to continue the necessary fiscal reforms. However, the adjustment pace should also consider the favorable working environment between central and local government, given the prevailing capacity constraints and the need to ensure sustainability and irreversibility of the reforms.

As highlighted in the staff report, the preliminary fiscal outturn for 2003/04 indicates that the budget deficit declined to 3.9 percent of GDP, almost 2 percentage points lower than that in 2002/03. At the same time, revenue collections have also performed well, rising from 11.1 to 11.3 percent of GDP. As last year's increase in petroleum taxes take full effect combined with stronger administrative efforts, tax revenues (excluding timber royalties) increased from 8.1 to 8.9 percent of GDP. In order to further enhance the source of revenues, the authorities have submitted a proposal to the National Assembly to introduce a single rate value added tax (VAT).

The authorities broadly agree with staff that progress in revenue mobilization and strengthening of tax and custom administration will also depend on strengthening of central government control over revenue administration and treasury operations in the provinces. In this respect, the authorities are committed to undertake reform on inter-governmental relations. However, redefinition of central-local relations can only be undertaken on a step-by-step basis according to the capacity of local level officials to assume new responsibilities, and the ability of the Central Government to monitor compliance with national priorities. In this context, the government is committed to improve communication with people especially in the remote areas, clarify the responsibilities for each level of government, redeploy human resources from central to local level, improve capacity building at the local level, and improve the monitoring capacity of the central government.

Monetary and Exchange Rate Policy

The authorities will continue to gear monetary policy toward reducing inflation and creating a stable financial environment that are deemed essential to facilitate growth, private investment, and promote international trade. Monetary policy has generally been restrained over the past year. As illustrated in Table 4 in the staff report, growth of credit to the economy was slower than the target, largely contributed to by relatively tight credit controls under the state bank restructuring program during 2003/04. However, due to a one-off investment in a domestic strategic industry (cement), net domestic assets of the SCBs showed a temporary jump in 2004**.** The authorities are exploring ways to increase equity in this project and to diversify its sources of financing. Credit growth is expected to return to a moderate rate, in line with nominal GDP, over the medium-term.

On exchange rate policy, a managed floating exchange rate system has served Lao's authorities well. In this respect, the authorities' intervention in the foreign exchange market is aimed at smoothing transitory fluctuations in the exchange rate.

Structural Reforms

The authorities recognize that strengthening structural reform efforts in all sectors, particularly in the state commercial banks (SCBs), state owned enterprises (SOEs), and the trade sector, will be a key to promoting economic efficiency and competitiveness. This is crucial to sustaining economic growth which is required for poverty reduction.

On SCBs, the authorities are committed to continuing the banking sector reform program supported by the World Bank, the IMF, and the AsDB. The Lao authorities recognize that the reform is not only crucial to the proper functioning of the financial sector, but also to fiscal and macro stability. In this respect, the process of finalizing the external audit of the banks' 2003 accounts, which will be used to establish appropriate performance targets for BCEL (Banque pour le Commerce Exterieur du Laos) and LDB (Lao Development Bank) in 2004/05, is underway. The authorities agree with staff that on-site inspections and overall credit limits for the SCBs will remain and continue to provide critical operational benchmarks for these institutions. However, the time table for bringing the SCBs into compliance with these prudential regulations need to be set appropriately with due consideration to institutional capabilities. In this context, the authorities intend to proceed with the recapitalization of the SCBs during 2005. In addition the Bank of the Lao PDR will also issue regulation on loan concentration and foreign currency exposure.

For the non-financial state-owned enterprises*,* the authorities have made progress in restructuring the five large-indebted SOEs, namely the electricity utility (EDL), the Ministry of Defense conglomerate Phoudoi, the water utility (Nam Pa Pa), the national airline (Lao Airlines), and a pharmaceutical factory. Steps have also been taken to resolve and streamline operations of a number of key corporations, including to address the ongoing losses of Lao Airlines. With assistance from the World Bank, restructuring for the EDL is almost complete, and the programs for three other enterprises have also been initiated and are expected to be completed by end-2005. To promote private sector activity and improve the investment climate, the authorities intend to ensure that the new investment laws, as approved by the National Assembly in October 2004, are consistent with the earlier structure and levels of incentive provided under the presidential decree.

The authorities have also initiated several legal reform projects with assistance from the donor community. To foster the development of a more favorable environment conducive to private activities and investments, a number of reforms have been implemented to enhance competition and provide a more level playing field. In particular, quota restrictions on imports have been abolished and import licensing menu has been narrowed down to only four products, namely fuel, cement, steel, and vehicle. Furthermore, a decree on competition was also issued in February 2004, lifting barriers to trade and laying out a framework for dealing with uncompetitive practices, followed by another decree issued in June 2004, abolishing barriers to movements of goods within the country. The authorities are also committed to continuing the process of tariff reform in line with AFTA schedule, moving ahead with WTO application, and seeking to normalize trade relations (NTR) with the USA.

The authorities have made progress in improving the quality of macroeconomic statistics, with Fund technical assistance. Preparations are being undertaken to improve data coordination between the government agencies. On the safeguards issue, the authorities are reviewing staff's proposal for the commissioning of a targeted external review of the Bank of Lao's external reserves and reserve money positions by an international audit firm. Further discussion on this issue with the staff is expected to take place during the fourth PRGF review period, after this Article IV Consultation.

External Debt Management

The authorities recognize that the external debt level is high, but is nevertheless manageable. Accordingly, they are committed not to seek debt relief under enhanced HIPC Initiative. In this context, they will pursue policies aimed at raising economic growth in a sustainable manner and increasing gradually the government revenue ratio to GDP. In addition, the authorities plan to reduce the fiscal deficit over time and will make sure that new debts contracted carry a sufficiently high degree of concessionality, and will focus on strict enforcement of the Instruction on Centralization of the Management and Monitoring of External Debt at the Ministry of Finance.

Outlook

In the medium-term, the economy is expected to remain reasonably favorable, fostered by macroeconomic stability and continued progress in the structural reform program. The authorities agree with staff that FDI inflows, particularly in mining, and in the hydroelectric power sector are expected to be the main engine of growth. The current account deficit is expected to be fully financed by FDI and concessional borrowings. The authorities acknowledge that prudent fiscal and monetary policy is essential to sustaining the economic growth momentum. In addition, further acceleration of the structural reform program being undertaken by the authorities will gradually lessen the government's debt burden to a more sustainable level. The authorities are also aware that such an ambitious target to reduce the debt burden can only be achieved through a combination of revenue enhancing, expenditure streamlining, as well as private sector development measures. Strong and sustained economic growth will, in turn, provide a firm basis for continued poverty reduction over the period.

Conclusions

Considering the relatively dire conditions that the Lao's authorities had to start with, we believe that from the beginning of the PRGF program in 2001, Lao's economic and social development has come a long way. The authorities highly value the continued support from the international community, including the Fund. Despite considerable progress being achieved thus far, there are challenges ahead. The Lao's authorities look forward to the continuation of the close and effective cooperation, as in the past, with the Fund through further discussion on the fourth PRGF review. The authorities would like to thank staff, once again for their hard work and dedication, in seeking alternative ways to fulfill the requirements of the program, giving due consideration to the formidable constraints facing Lao PDR. On their part, the authorities will employ their utmost efforts in pursuit of development in order to fulfill both national targets, as well as international community' expectations.

With regards to AML-CFT, Lao PDR maintains restrictions on financial transactions and accounts are frozen if they involve individuals or organizations included in the list of terrorists maintained pursuant to (a) UN Secretary Council Resolution 1373 (September 28, 2001); and (b) the list of current terrorist organizations designated by the US Secretary of State.

The Authorities intend to authorize publication of the Staff Report for the 2004 Article IV consultation, Poverty Reduction Strategy Paper-Joint-Staff Advisory Note (EBS/03/127), Selected Issues and Statistical Appendix on the Fund's web site.

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IMF Executive Board Concludes 2004 Article IV Consultation with the Lao People's Democratic Republic

On November 29, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Lao People's Democratic Republic.[1]

Background

Since the last Article IV, Lao P.D.R.'s macroeconomic performance has been relatively encouraging. After a brief hiatus in 2002, macroeconomic stability has been restored and growth has been relatively robust. The latest data also show that poverty has continued to decline. However, while progress has been made in strengthening macroeconomic policies, advancing the agenda of structural reform has proved more challenging, especially with regard to mobilizing revenues and strengthening expenditure management, two key reform priorities under the PRGF arrangement.

The economy has performed relatively well in 2004, rebounding well from a number of shocks, including a drought and the regional impact of the Severe Acute Respiratory Syndrome (SARS) the previous year. Although economic growth dipped in 2003 to 5¼ percent, half a percentage point lower than in 2002, activity has rebounded in 2004, and growth is projected to rise to 6 percent, supported by a recovery in agriculture and hydroelectricity output, and a rebound in tourism. Inflation, which had surged into double digits in 2002, has been on a downward trend since mid-2003. With the kip remaining stable over the last 18 months, inflation has fallen to

[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.

7½ percent in September. The external position has also improved, with brisk export growth and continued donor assistance, leading to a further rise in external reserves. However, public external debt remains high.

The improvement in macroeconomic performance has been underpinned by steady implementation of macroeconomic policies for much of the past year. Monetary policy has been restrained over the past year, with the Bank of the Lao P.D.R. keeping its net domestic assets broadly stable. Preliminary data suggest that the budget performance also improved in 2003/04. Revenues rose from 11.1 to 11.3 percent of GDP, partly reversing the significant decline in revenues in 2002/03, and expenditures fell due to lower donor-financed capital expenditures. With the government keeping tight control over domestic spending, the overall deficit declined to 3.9 percent of GDP.

The priority over the past year has been to advance key structural reforms, especially with regard to strengthening the revenue base. To this end, the authorities have announced their intention to introduce a VAT in January 2007 and have started to reform the turnover tax—reducing the number of its rates from three to two—a key preparatory step. However progress in addressing the key administrative reforms, related to centralizing control over the tax and customs administration, has proved difficult as they touch directly on the issue of center-provincial relations. The authorities have also continued to make headway in reforming the state banks and state-owned enterprises, although much remains to be done in both areas to limit contingent liabilities to the budget.

Provided that sound macroeconomic policy implementation is sustained, macroeconomic performance is expected to remain favorable in 2005. Growth is projected to rise to 7 percent, driven by an expansion in mining exports, inflation should remain in single digits, and strong export growth would help Lao P.D.R. improve its external reserve position. However, two potential risks have emerged to this positive outlook: (i) the 2004/05 budget plan, approved by the National Assembly in October, proposes a large increase in the wage bill which may prove unsustainable, unless phased over a longer-time period; and (ii) state bank credit has expanded rapidly over the last quarter, potentially undermining a key element of recent monetary discipline.

The government's National Growth and Poverty Eradication Strategy sets out a medium-term strategy to achieve rapid growth in order to improve the living conditions of the poor. If strong progress is made in structural reform, Lao P.D.R. has the potential to achieve the government's medium-term objectives of raising growth to 6-6½ percent—and sharply reducing poverty—as a number of major projects, such as the Nam Theun 2 hydroelectric dam, are in the pipeline. Achievement of this outlook is predicated on further reform with regard to revenue mobilization, and banking and state-owned enterprise reforms, needed to address potential risks to fiscal sustainability, stemming from Lao P.D.R.'s high debt burden. Strengthening expenditure management will also be critical to maintaining progress in ensuring sustained improvements in social indicators consistent with the Millennium Development Goals.

The present PRGF arrangement for SDR 31.7 million, was approved in April 2001, and was extended by an additional year, through April 24, 2005, in September 2003. The third review was completed on September 12, 2003. Discussions of the fourth review, which have been ongoing since December 2003 will resume after the conclusion of the 2004 Article IV consultation.

Executive Board Assessment

Executive Directors commended Lao P.D.R.'s progress toward macroeconomic stability, with inflation declining and the external position strengthening, and welcomed the robust economic growth and reduction in poverty. While improved economic management has been central to this performance, Directors stressed that significant challenges remain. In particular, faster progress is needed in strengthening domestic revenue mobilization and public expenditure management, completing the restructuring of state-owned banks and enterprises, and promoting private sector activity and investment. In this context, Directors welcomed the completion of the National Growth and Poverty Eradication Strategy (NGPES), and called on the authorities to translate its objectives into concrete actions embedded in a robust policy framework. Given the country's limited capacity, these efforts will require continued support from the international community.

While Lao P.D.R's near-term outlook remains favorable, Directors expressed concern about the 2004/05 budget plan, approved by the National Assembly in October. They noted, in particular, that the revenue targets may not be achievable in the absence of additional revenue measures, and that the large increase in the wage bill will likely need to be phased in over a longer period of time. Directors also encouraged the authorities to ensure that increases in world oil prices are passed on to consumers, as the budget cannot afford a loss of revenue from reductions in petroleum taxes at this juncture.

Directors welcomed the authorities' intention to continue to gear monetary policy toward reducing inflation. Tight control over the Bank of the Lao P.D.R.'s net domestic assets, underpinned by a government commitment to avoid bank financing of the budget, should continue to be the principal anchor of monetary policy. This will need to be complemented by firm restraint of credit by the state banks, and, in this regard, Directors expressed concern about the recent expansion of credit to finance a government-sponsored project. Directors considered Lao P.D.R's flexible exchange rate system, with interventions limited to smoothing operations, to be appropriate. They welcomed the ongoing review of the exchange system, and encouraged the authorities to expedite the process of accepting the obligations under Article VIII.

Directors underscored that improving revenue mobilization will be critical to ensuring fiscal sustainability, given Lao P.D.R.'s substantial expenditure needs and high public debt. Key priorities in the period ahead are the strengthening of revenue administration, which will importantly depend on reforms to re-centralize authority over tax and customs administration, and the introduction of a value added tax in early 2007. Directors also encouraged the authorities to ensure that tax incentives provided under the new investment laws do not undermine efforts to broaden the tax base, and to reduce tax incentives over time.

Directors stressed the need to accelerate reforms of public expenditure management in order to strengthen the accountability and monitoring of public spending. They urged the authorities to develop a comprehensive treasury reform strategy that will bring treasury operations in the provinces under central government control. These reforms will require pressing ahead with the ongoing review of the decentralization framework, to clarify the assignment of revenue and expenditure responsibilities between the center and provinces, and develop a robust mechanism for intergovernmental transfers.

Directors urged the authorities to pursue vigorously the restructuring of state banks, whose financial position remain precarious, and to maintain close oversight over the banks' operations until the restructuring process is complete. Some Directors considered that private investor participation would facilitate the reform of state banks and improve their management and financial operations. Directors also encouraged the authorities to move ahead with measures to improve the overall banking environment, notably through legislation to strengthen competition in the banking sector.

Directors welcomed the recent progress on state-owned enterprise reforms and the ongoing utility price adjustments. They urged the authorities to proceed with the sale of noncore assets of the large and most indebted enterprises, and to finalize a comprehensive strategy to address the losses of Lao Airlines. To complement the reforms to the state sector, the overall climate for private sector activity and investment should also be improved, including by reforming the legal system.

Directors stressed that lowering Lao P.D.R.'s high external debt to a more sustainable level will require strong action on several fronts. In addition to efforts to mobilize domestic revenue and reduce borrowing relative to GDP, the authorities will need to maximize grant financing and maintain a high level of concessionality on new borrowing. Some Directors also called for limits on concessional borrowing. Directors also urged the authorities to improve the monitoring and reporting of public external debt, and to centralize control over the contracting of new debt. Directors noted that, despite Lao P.D.R.'s eligibility, the authorities have indicated that they do not intend to avail themselves of debt relief under the enhanced HIPC Initiative.

Directors regretted that the joint audit of the central bank's 2003 accounts by the state auditor and an international audit firm has not yet been undertaken. They urged the authorities to fully implement this key recommendation of the safeguards assessment as soon as possible. Most Directors supported the view that, in the interim, the authorities should ensure that, at minimum, adequate safeguards are put in place with respect to the reporting of the central bank's net international reserves and net domestic assets.

While efforts have been made to improve Lao P.D.R's statistics, Directors urged the authorities to continue to work, with IMF technical assistance, to address remaining weaknesses and to improve data dissemination.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The Staff Report for the year 2004 Article IV Consultation with Lao P.D.R. is also available.

Lao P.D.R.: Selected Economic and Financial Indicators, 2000-2003

Nominal GDP (2002): $1,818 million | GDP per capita (2002): $329
Population (2002): 5.53 million | Fund quota: SDR 52.9 million

	2000	2001	2002	2003
Output and Prices				
Real GDP growth (percentage change) 1/	5.8	5.8	5.8	5.3
Inflation (annual percent change)				
Period average	23.2	7.8	10.6	15.5
End of period	10.6	7.5	15.2	12.6
Government budget (in percent of GDP) 2/				
Revenue	13.2	13.2	13.1	11.1
Grants	3.7	3.1	1.3	2.1
Expenditure	21.5	20.7	18.4	19.0
Overall balance (including grants)	-4.6	-4.4	-4.0	-5.8
Government debt	65.3	63.0	66.3	83.9
Money and Credit (annual percent change) 2/ 3/				
Broad money	45.7	7.8	12.9	24.1
Bank credit to the economy	41.1	27.6	-5.2	5.4
Interest rates (on three-month deposits; end of period)	15.0	16.0	17.0	10-15
Interest rates (on short term loans; end of period)	16-24	12-18	12-20	22-25
External Sector				
Exports (in millions of U.S. dollars)	345	334	340	401
Imports (in millions of U.S. dollars)	562	542	570	618
Current account balance (including official transfers; in millions of U.S. dollars)	-25	-66	-98	-116
Gross official reserves (in millions of U.S. dollars)	127	134	196	216
(in months of prospective goods and services imports)	2.6	2.6	3.5	3.2
Net international reserves (in millions of U.S. dollars)	96	152	152	172
External public debt (in millions of U.S. dollars) 4/	1,179	1,213	1,330	1,915
External public debt service (in percent of exports)	5.8	7.2	7.1	7.2
Exchange rate				
Kip per dollar (end of period)				
Commercial bank rate	8,140	9,490	10,680	10,467
Parallel market rate	8,170	9,560	10,760	10,470
Real effective exchange rate 5/	100.0	102.1	97.3	97.6
Memorandum item:				
Nominal GDP (in billions of Kip) 1/	13,672	15,705	18,390	22,069

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

1/ The government estimates real GDP and deflator growth in 2003 to be 5/8 percent and 15.8 percent respectively.
2/ Fiscal year basis (October to September).
3/ Money and credit data are evaluated at constant exchange rates.
4/ Russian debt for 2003 is based on a preliminary agreement between the Lao P.D.R. and Russian governments. Prior to 2003 the Russian debt is excluded.
5/ Base Year 2000=100.