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LAO PEOPLE'S DEMOCRATIC REPUBLIC

FIRST DRAFT OF THE NATIONAL PROGRAMME OF ACTION
(Summary)

I. INTRODUCTION

1. The Lao PDR is a small landlocked country in the South East of Asia. The agriculture and forestry sector is the backbone of the Lao economy. In 1999, it accounted for more than 50 per cent of GDP and employed 90 per cent of the work force. The industrial sector (including mining, manufacturing and hydropower generation) contributed more than 20 per cent to GDP. Despite its abundant natural resources and efforts made by the Government with economic reform during the last decade, the Lao PDR remains poor. According to the recent Lao Expenditure and Consumption Survey (1997-98), about 39% of Lao population still live below the established poverty line. Educational and health standards are lower than in most developing countries. A severe shortage of trained personnel, inadequate physical and socio-economic infrastructure, budget and trade deficits, external debt burden and aid-dependency are major problems facing the Lao PDR. Nevertheless, the Lao PDR has the advantage of enjoying socio-political stability.

II. THE LAO PDR'S ECONOMY DURING THE 1990s

Performance in the 1990s: Economic and social aspects

2. The Lao PDR's economic growth in the 1990's has been constant and continuous, at an average growth rate of 6.1 % for the period 1996-2000. However, since 1996, the country's economic and financial situation, in terms of prices and exchange rate stability, deteriorated due mainly to poor macroeconomic management of the market-oriented economy by the State and the lack of coordination among macroeconomic management agencies.

3. The Lao PDR has implemented the Programme of Action for the 1990s through its 1993-2000 socio-economic development plan, which can be divided into two phases (1993-1995 and 1996-2000). The first phase, which in fact started from 1991, coincided with the implementation period of the New Economic Mechanism (NEM), introduced in 1986. The NEM initiated a programme of economic reform with the goal of stabilizing the economy and increasing growth by shifting from a centrally planned economy to a market-oriented economy. This programme focused on; macro-economic stability and fiscal adjustment, enhancing the private sector activities, reorganization of the public, privatization of state-owned enterprises, deregulation of banking sector and prices, and foreign investment promotion among others. The public finance system has undergone restructuring since 1988. The general budget was unified in 1992. The tax system has undergone substantial innovation. The expenditure control system has been centralized and discipline in expenditure was enhanced. The National Assembly adopted the New Tax Law on 14 October 1995 and further minor adjustments were made to the tax system in 1998. Within the context of its socio-economic development plan for the decade, the Lao government has also set up 8 national priority programmes, which were adopted by the National Assembly in 1994. These were: food production, commercial production, stabilization of shifting cultivation and resettlement of shifting cultivators; rural development; human resources development; improved foreign economic relations; infrastructure development; and services development covering tourism, trade, banking and finance.

4. During the first half of the 1990s, the reform produced early economic benefit to the country: inflation was quickly brought down to single digit level from 10% in 1992 to 6.3% in 1993; the exchange rate became stable for four years (1991-1994), at around Kip 720-730 to the US \$; and there was a build-up in foreign exchange reserves equivalent to two months of imports, as a result of improved export performance and the inflow of external resources in the form of ODA and FDI. The average annual growth of GDP was between 6-7% in real terms. This commendable growth was accompanied by relative stability of domestic prices and currency. However, during the second phase (1996-2000), the country started to face a deteriorating economic and monetary situation, which was further, aggravated by the Asian economic crisis. Inflation rate reached 150.8 % in January 1999, and there was an unprecedented devaluation in the national currency and the exchange rate increased considerably, reaching Kip 9'700 for one US Dollar in August 1999. Inflation was brought down from 121% in October 1999 to 21.39% in June 2000. Prices and the exchange rate are now stable at Kip 7'500 to 1 US Dollar.

5. Virtually, all agricultural production is in private hands, a large share of which is produced at near subsistence levels, particularly in remote provinces where market access is severely inhibited by lack of transport infrastructure. In 1998-1999, rice production reached 2.1 million tons of paddy, thereby achieving the level of self-sufficiency. Other food crops, such as maize, beans, oleaginous crops, fruit trees, as well as livestock and fishery, are expanding in several regions. Likewise, the output of non-rice crops such as coffee, sugar cane and tobacco are also expanding. In 1990, the industrial sector accounted for around 16.6 % of GDP (having increased from 11.2 % in 1988). Under the 1986 economic reform, there was substantial domestic as well as foreign investment in industrial activities, namely in the field of power generation, mining, and small and medium scale processing industries. The dominant area for investment in the sector is hydropower generation. Processing and small scale industry of various types (e.g. cement plant, wood processing plants, furniture processing plants, construction material, garment, rice mills, biological fertilizer plant, etc.) have developed rapidly in the main urban areas of different regions. On the whole, the economic contribution of the industrial sector increased to nearly 22 % of GDP in 1999.

6. In the field of transport services, construction in recent years of new roads, especially rural roads, has facilitated the expansion of the wholesale and retail distribution network to the rural areas. In the financial services, the Lao banking system has been restructured. A programme to bring the state-owned Commercial Banks to international standards have been underway for several years. In the tourism sector, improvement has been made in, *inter alia*; natural and cultural tourism sites and tourism routes linked between provinces, and regulations on issuance of tourist visas.

7. With regard to foreign trade, the country's traditional exports include agricultural commodities, logs and sawn timber, wood and wood products, livestock and hydro-electricity. Since 1999, however, cash crops, particularly coffee, have become important export products. In the industrial sector, foreign investment in the 1990s has helped the expansion of export-oriented manufactured products such as garments. The Lao PDR's major trading partners are Thailand and Vietnam. In 1997, Thailand absorbed about 22% of Lao exports and contributed to 51.9% of imports. Vietnam is the largest market for Lao exports, taking up 47.1% of all exports in 1998. Despite efforts made to develop and diversify its exports, the Lao PDR still has a deficit in its trade balance. Main items of imports are composed of consumption goods such as fuel, gas,

electrical appliances, investment goods such as machinery and equipment, and intermediate goods, especially raw materials for its garment industry. From 1994 to 1998, the average annual deficit was about US\$ 290 million.

Factors that enhanced the Lao PDR's development in the 1990s

8. The country has enjoyed peace and socio-political stability during the last decades. With regard to economic infrastructure, a substantial share of public investment has been directed to improving the physical economic infrastructure such as the communication network. This has contributed to gradual reduction of the isolation of rural areas and expansion of the domestic market. As for domestic policy reforms, the government has shown its commitment to the reform programme, the NEM. One significant task of the economic reform was the promotion of the private sector activities, starting with the privatization of state-owned enterprises (SOE). Between 1989 and 1997, more than 130 SOEs have been privatized. To encourage private sector participation in the development of the country's economic infrastructure, the government has adopted a number of laws and regulations with the aim of protecting the rights and interests of individuals and private persons.

Factors that constrained the Lao PDR's development in the 1990s

9. The major bottleneck in the Lao economy is the limited development of human resources. The absence of qualified managers is being felt both in the private and public sector. The State budget constraint led to difficulties in planning and financing human resources development over the long term. In the Public Investment Programme (PIP) 1991–1995, 14 per cent of the fund was planned for social programmes (education, public health and social welfare), but actual realization was 10 per cent. For the 1996–2000 period, this percentage increased to 24 per cent. With regard to economic infrastructure, project construction suffered the following problems: frequent delay; construction technique not complying with required norms or standard; weak road utilization, management, maintenance and repair; lack of supervision of the works by the relevant authority. Like in most LDCs, domestic financing capacity is still small in the Lao PDR, compared to foreign-sourced finances. In order to increase revenue, and given that taxation constitutes the main revenue generator, the government has taken measures to improve the domestic tax system. Nevertheless, belated and uneven implementation of these measures has not yet given the expected results.

10. Low productivity in agriculture, particularly rice production, does not derive from population pressure or lack of land, but from the reliance of farmers or rural population on archaic technique of production and the dependence on climatic conditions. On the other hand, the country's industrialization has firmly and continuously progressed during the 1990s. Nevertheless, industrial development has not yet been sufficiently linked to the domestic agricultural-forestry raw materials. Guidelines and policies for agro-industrial research, experimentation and promotion have not yet induced firm production growth and the development of production models has not received appropriate attention. In the area of foreign trade, the main problems and constraints include: dependency on low value-added agricultural exports; the predominance of smuggling

activities and informal border trade; lack of competitiveness and quality disadvantage of the products in foreign markets; and lack of sales promotion capacity and of subsidies for export.

11. **Vulnerability to shocks.** Since its economy is still heavily dependent on agriculture, the performance of which was virtually at the mercy of nature, Lao PDR is vulnerable to natural disasters. For example, serious drought in 1991 and 1993 resulted in a drop in rice production. In 1995 and 1996, the country was heavily affected by serious flooding, which caused a great loss in terms of cultivated crops (207,740 tons of paddy valued at more than 30.6 billion kip), basic infrastructure (damage to 65 irrigation schemes valued at 722.5 million kip, damage to road infrastructure valued at 1.5 billion kip, schools, hospitals, pagodas and electrical systems), as well as people property (houses, fruit trees, industrial plantations). Overall, the country's level of disaster preparedness and prevention is weak: weak infrastructure for water storage and diminished capacity to control water during flooding or conserve on seasonal rains in years of drought. The country is also vulnerable to economic and financial shocks. Macroeconomic imbalances, resulting in currency fluctuation and a rapid rise in the inflation rate after 1995, and the Asian financial crisis, have caused the deterioration of the country's economic situation, for which an appropriate solution cannot yet be found.

External opportunities and challenges

12. **Official Development Assistance (ODA).** Between 1991-1995, the country received external assistance, both bilateral and multilateral, in the form of grants and loans, totaling about US \$ 1.1 billion (4% of GDP in 1993-94). External assistance pledges for 1997-2000 was totaling about US \$ 1.2 billion, of which US \$ 640 million was in the form of grants and US \$ 560 million in the form of loans. All this assistance has been used for development purposes, particularly for the reconstruction and rehabilitation of infrastructure development: 23% for the transport sector, 15% for Agro-Forestry and Fishery sector, and 17% for social needs and human resource development. In the PIP, for 1991-95 and for 1996 -2000, 80% was projected to be funded by foreign source. That illustrates the country's degree of aid-dependency. External assistance contributed significantly to the country's economic growth in the 1990, but the lack of efficiency in the management of public expenditure had led to no small wastage of funds. Therefore, the institutional modality to assume the task of planning, coordination, implementation and monitoring of external development assistance needs to be improved and reinforced.

13. **External debt burden.** The Bank of the Lao PDR estimated the total official external debt at US\$ 1.2 billion at the end of 1995, of which amount debt to western donor countries, the World Bank, the Asian Development Bank and the IMF accounted for US\$ 678 million (55% of total debt). With recent loans from International Financial Institutions, the total debt must be even higher. But the country is not being considered as an HIPC.

14. **Foreign Investment.** The government has backed a policy of encouraging foreign investment by adopting the Law on Foreign Investment in 1988, then the Law on the Promotion and Management of Foreign Investment in 1994. Under the 1994 Law, all sectors of the economy are open to investment, and various incentives are provided. Areas where foreign investment are encouraged include energy, production and processing of agriculture and forestry products, export - oriented industries using local raw materials and import substituting industries. Foreign

investors can invest in the country either in a joint venture with domestic investors (in which case the foreign component must be at least 30% of the value of the project) or as a wholly-owned foreign enterprise. In fact, foreign investment is concentrated in the hydropower sector. But inflow of investment into other manufacturing and hotels and tourism has recorded a marked increase. Besides, from 1997 on, the trend of investment has been declining in value and in the number of projects as a result of the regional financial crisis. Nevertheless, the drive to attract foreign investment has been quite successful; by 1998, there were more than 700 foreign investment projects to a total value of about US \$ 7 billion.

15. **The Regional Cooperation Dimension.** Expansion of external economic cooperation is of national interest for the country. In recent years, it has widened its participation in regional and sub-regional fora. The most important achievement in this field has been its full membership of ASEAN and ASEAN Free Trade Area (AFTA) in July 1997. As a member of ASEAN, the country will further integrate itself into the regional economy and will benefit from the larger market. The old ASEAN Members will also be a source of assistance in terms of financing, technical assistance and providing skills training. The Lao PDR's active involvement at a sub-region level, such as the Mekong River Commission, the Comprehensive Forum for the Development of Indochina (CFDI), the ASEAN–Mekong Basin Development Cooperation, acted as a catalyst for major investments in the field of energy, transport and communication and in the building of East–West corridors. But the country membership of ASEAN raises also other issues in the global context, such as its accession to the World Trade Organization (WTO). The accession to WTO entails, not only a positive impact, but also a negative short-term impact that may stall the development of the country in certain sectors vulnerable to foreign competition.

III. PROGRAMME OF ACTION FOR THE LAO PDR: 2001-2010

16. Actually, Lao PDR has only the General Outlines of the Economic Development Strategy until the year 2020 that aims at getting the country out of underdevelopment, by continuing to implement the government priority programmes. The Strategy is to be carried out in the following phases:

- Up to the year 2000: Paving a firm base and position to progress towards the 21st Century;
- 2001-2010: Establishing an economic base for ensuring stable growth;
- 2011-2020: Developing the Economic and Social sectors so as to be able to get the country out of the state of underdevelopment.

17. Sectoral targets and figures have to be readjusted and updated together with the 2001-2005 Socio-Economic Development Plan. This important part will be elaborated accordingly.