Structural Adjustment in Lao PDR

In many transition economies, sweeping economic reforms were preceded or accompanied by major political changes. But in the Lao People's Democratic Republic (PDR), the government carried out a Bank-supported structural adjustment program without effecting significant political reform. This led to both opportunities and obstacles. Committed to economic adjustment, the government quickly initiated sweeping macroeconomic reforms that soon stabilized the economy, leading to resumed economic growth and a strong supply response. But the pace of reforms slowed when the government tried to translate policies into administrative actions. Here it faced a political system with no tradition of transparency, challenges posed by vested interests at the national and provincial levels, and poor coordination among the ministries affected by the reforms.

Background

In 1985, after ten years of pursuing economic development along socialist lines of central planning and state control, the Lao PDR faced an economy in decline. The situation was worsened by the cessation of aid from the former Soviet Union on which the country's investment program depended.

During 1980-84, manufacturing fell by 50 percent, growth in other sectors stagnated, and exports declined to only 30 percent of imports. With the large trade deficit, external debt doubled. By 1985, the debt/service ratio had risen to 22 percent, seriously undermining the government's ability to meet its service payments. Increasingly, the pattern of growth tended to revolve around barter trade and subsistence activities. Without a strong formal sector, the government faced mounting difficulties mobilizing domestic resources to finance the budget. In 1986, the government embarked on an ambitious program to transform the country's command economy to one based on open, competitive market forces.

The reforms, known as the New Economic Mechanism (NEM), aimed at liberalizing trade and foreign investment, strengthening the private sector, and improving macroeconomic management. Two World Bank/IDA credits, the $40 million structural adjustment credit (SAC I) (approved in 1989) and SAC II (also for $40 million, approved in 1991), supported NEM, with parallel support provided by an arrangement under the IMF Structural Adjustment Facility and the Asian Development Bank.

Program goals and implementation

The government began the NEM before approval of SAC I, focusing on macroeconomic stabilization. The program liberalized most prices; eliminated consumer subsidies; unified the multiple exchange rates, bringing the rate on par with that of the market; extended autonomy to most state-owned enterprises (SOEs), while eliminating their subsidies and other privileges; and authorized private sector activities in formerly restricted sectors. The reforms also sought to strengthen the financial sector by separating central and commercial banking activities. The state bank was turned into the central bank, while its branches were converted into six autonomous commercial banks. Finally, the reforms attempted to restore fiscal balance by increasing revenues and reorienting expenditure priorities. The program introduced a major tax reform, ushering in several new taxes, and reduced the civil service by 19 percent between 1988 and 1990.

While SAC I was designed principally to address macroeconomic reforms, SAC II focused on consolidating the achievements from the first phase and creating the institutional and legal underpinnings of a market economy. It was designed to strengthen fiscal management through budgetary and financial reforms, privatizing nonstrategic...