Statement by Jan Piercy  
Date of Meeting: April 20, 1999

Laos: Country Assistance Strategy

1. The U.S. welcomes the opportunity to discuss the Country Assistance Strategy for Laos. I would like to begin by commending staff for the extensive consultations undertaken to produce this document. The boxes on corruption, social effects of the Asian crisis, and gender profile are quite useful. We welcome the emphasis on donor coordination, especially strengthened collaboration with the IMF; if the Bank moves forward with banking sector work, we would expect close collaboration with the ADB to build on their experience with state bank restructuring.

With that said, we understand that the corruption situation in Laos is quite bleak and would appreciate more information on the Bank's good governance agenda. We infer from the document (paragraph 55) that an initial draft of the CAS that focused more directly on governance was diluted after consultation with the authorities (i.e., "The Government argued for a more balanced presentation of the political and governance context...") Could staff elaborate on this issue?

2. Although Laos has been struck by the Asian crisis, its current problems derive not from contagion but from weak economic management, an insolvent financial sector, and lack of political will. In this context, staff's decision to cancel the 2nd tranche of SAC III was appropriate, and the U.S. supports the low-case scenario as outlined. We also support the proposed analytical work in public expenditure management, poverty, and forestry. Reinvigorated focus should be placed on improving existing portfolio quality. The Bank has an important role to play in improving public sector management, especially in raising the efficiency of public expenditure decisions, increasing transparency of budgets and prioritizing development objectives. In this regard, we would appreciate staff's comment on whether PER work done to date has identified the benefits of reducing unproductive spending; have the factors
underlying unproductive spending (low civil service capacity; inadequate checks and balances in budgetary processes) been fully identified and acknowledged?

3. Given poor macroeconomic performance, weak public expenditure management, and lack of leadership at high levels, we do not view Laos as a good candidate for the Comprehensive Development Framework pilot program. Given what we understand will be increased efforts at the provincial level, we would welcome further information on the good lessons learned to date as referenced in paragraph 49.

4. The poverty situation in Laos is staggering. In addition to public spending issues, issues of efficiency of service delivery and gender gaps in the education sector require serious attention. The government's agreement with UNICEF to meet social sector goals in paragraph 48 is ambitious, and we urge the authorities to protect social sector spending in future fiscal corrections.

5. The forestry subsector is plagued by weak regulatory and enforcement schemes which inhibit sustainable development. We are particularly concerned by the fact that the Ministry of Defense controls one of the logging companies, and would appreciate a better understanding of whether revenues from the company are adequately accounted for in defense budgets.

6. We would appreciate staff's comments on the extensive reliance on the APL instrument in the lending program. Although this Chair has noted several positive elements of the APL framework (e.g., the ability to make a long-term commitment to a sector and set out a road map for medium-term policy changes), we have also raised several concerns (e.g., the requirement for three Directors to request Board evaluation of out-year tranches). We would like to have staff's assurances that the APLs proposed for this lending program -- in forestry, road maintenance, and education -- will be brought to the Board under Regular Procedure.

7. If Laos makes it into the base case -- and here we seek staff's assurances that a formal agreement on an IMF ESAF is a prerequisite -- there are two major strategic investments foreseen in the CAS that bear special mention. The first is the Nam Theun II dam. This project has more than passing resemblance to the ill-fated Arun Dam in Nepal -- it has the potential to yield major benefits, but also carries serious risks. There is now a limited window for the vetting of long-standing concerns. Specifically: 1) an improved, more realistic EIA reflecting the revised design and consequent increased water diversion; 2) more information on the integrity of the consultation process (in the indicated absence of local NGOs); and 3) clear integration of capacity building efforts to effectively manage this project (nb, Attachment 2 indicates that other donors will need to foster these initiatives). More fundamentally, serious economic analysis needs to be given, post-Asia crisis, to whether the original projections for Thai power demand are still valid. If the project's ERR/FRR has fallen, smaller hydroelectric investments could now make more sense.

8. Lastly, there is the issue of the proposed Financial Sector Adjustment Credit. The strategic rewards from investing in this sector are huge. However, solving the problems outlined in the CAS would be a tremendous challenge for even the most solidly popular and reform-
minded of governments -- hardly what we see in Laos today. If the authorities can develop a pro-reform consensus underpinned by a strong track record of ESAF implementation, then we will be likely to support the proposed FSAL. Unfortunately, we are concerned that the government will grudgingly be driven to make policy commitments to the Fund in order to unlock vital budgetary and BOP support from the IMF and the proposed FSAL, but will lack the real political will to make the program stick. Accordingly, although we see signature of an ESAF as the primary trigger for moving to the base case, we expect management to allow the authorities to prove their intentions before moving the FSAL to approval.

Thank you.