



The World Bank

LAO PDR ECONOMIC MONITOR



The World Bank Vientiane Office

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BACKGROUND

With an estimated per capita income of US\$390 in 2004 (see table 1), the Lao People's Democratic Republic (Lao PDR) is one of the poorest countries in East Asia. It is classified by the UN as a Least Developed Country (LDC). In 2004, 71 percent of its population lived on less than US\$2 a day, and 23 percent on less than US\$1 a day (see *East Asia Update*, World Bank, 2005). A significant decline in poverty has been achieved however during the last decade: using Lao PDR national poverty line (of approximately \$1.5 a day) the incidence of poverty has fallen from 46 percent in 1992/93 to around 33 percent in 2002/03. The social indicators have been improving too, but they remain among the worst in the region, and close to an average country in Sub-Saharan Africa.

Lao PDR has a population of around 5.8 million and a land area of 236,800 square km. It has significant natural resources like forestry, minerals and hydro-electric power. Agriculture is the major sector contributing 51 percent of GDP and employing 80 percent of the labor force; the industry accounts for 23% and services for 26%. Landlocked, Lao PDR is in the center of the Mekong region, bordered by Thailand, Vietnam, Southern China, Cambodia and Myanmar, with the first three neighbors growing rapidly.

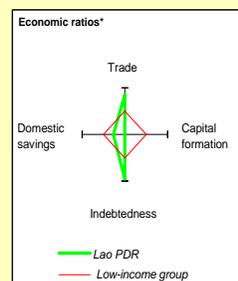
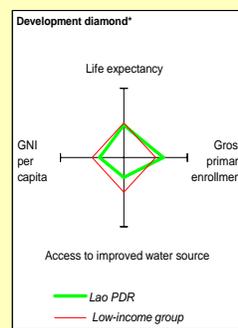
Lao PDR has grown strongly for more than a decade. In the 1990s, real GDP grew by an annual average rate of 6.3 percent - despite the sharp fall-off in growth during the regional crisis of 1997-1999 period. Exports grew at around 15 percent a year. Agriculture grew rapidly as did industry and services. Donors provided considerable financial and technical support; in 2003/04, donor-funded programs accounted for 5 percent of GDP, 29 percent of total public expenditure, and 63 percent of the capital budget.

Transition to market. The Government introduced the "New Economic Mechanism" (NEM) in 1986, to begin the transition from a centrally planned to a market-oriented economy. Gradually, price controls were removed, socialist cooperative farming abandoned as farmers were allowed to work on their plots and take ownerships, the exchange rate system was unified, government's monopoly on trade removed, the number of state-enterprises reduced, and establishment of private firms allowed. Reforms stalled during the regional crisis, as Lao struggled with serious macroeconomic problems. Successful stabilization began in 2000 and structural reforms revived in 2001.

Fighting poverty. In April, 2002, the Government of the Lao PDR finalized an Interim-Poverty Reduction Strategy. Using this and the five-year National Socio-economic Development Plan for 2001-05, the Government adopted a consultative process to prepare the National Poverty Eradication Program (NPEP). The NPEP was presented to the donors' Roundtable Meeting in September 2003, discussed by the National Assembly in October 2003, and subsequently upgraded to the National Growth and Poverty Eradication Strategy (NGPES) in early 2004. It articulates Lao's development framework for poverty reduction, specifies the targets and goals that the country values and indicates the policy reform and public expenditure programs that will be needed to achieve these goals.

Table 1. Lao PDR, EAP and Low Income Countries: Comparing Development Indicators

POVERTY and SOCIAL	Lao PDR	East Asia & Pacific	Low-income		
2004					
Population, mid-year (millions)	5.8	1,870	2,338		
GNI per capita (Atlas method, US\$)	390	1,280	510		
GNI (Atlas method, US\$ billions)	2.3	2,389	1,184		
Average annual growth, 1998-04					
Population (%)	2.7	0.9	1.8		
Labor force (%)	2.7	1.1	2.1		
Most recent estimate (latest year available, 1998-04)					
Poverty (% of population below national poverty line)	34		
Urban population (% of total population)	23	41	31		
Life expectancy at birth (years)	55	70	58		
Infant mortality (per 1,000 live births)	82	32	79		
Child malnutrition (% of children under 5)	40	15	44		
Access to an improved water source (% of population)	43	78	75		
Literacy (% of population age 15+)	53	90	61		
Gross primary enrollment (% of school-age population)	116	113	94		
Male	124	113	101		
Female	108	112	88		
KEY ECONOMIC RATIOS and LONG-TERM TRENDS					
	1984	1994	2003	2004	
GDP (US\$ billions)	1.8	1.5	2.1	2.5	
Gross capital formation/GDP	
Exports of goods and services/GDP	2.8	25.0	29.1	28.9	
Gross domestic savings/GDP	16.2	10.8	
Gross national savings/GDP	16.5	10.3	
Current account balance/GDP	-4.3	-6.0	-7.6	-13.2	
Interest payments/GDP	0.1	0.3	1.7	1.8	
Total debt/GDP	29.5	134.8	103.4	91.5	
Total debt service/exports	13.6	5.1	14.7	16.4	
Present value of debt/GDP	70.5	62.9	
Present value of debt/exports	240.5	215.9	
	1984-94	1994-04	2003	2004	2004-08
(average annual growth)					
GDP	5.1	6.1	5.8	6.4	7.2
GDP per capita	2.3	3.4	3.0	3.6	..
Exports of goods and services



Source: World Bank, World Development Indicators, 2005

ECONOMIC MONITOR – OCTOBER 2005 – Covers the last six months. The Lao Economic Monitor is issued in Lao and in English, twice a year (Spring and Autumn) by the World Bank in Lao PDR. It reports on recent economic performance (Part I), progress in the implementation of the Government's policy reform agenda (Part II), and donor activities in the relevant reform areas (Part III). This issue of the Monitor was prepared by Ekaterina Vostroknutova and Somneuk Davading. It is based on inputs from Helle Buchhave, Morten Larsen, Alessandro Magnoli, Minh Van Nguyen, Tanatat Puttasuwan, Francisco Quintana and Renuka Vongviriyatham, and produced under the overall supervision of Kazi M. Matin. We are grateful to the Government and the donors for providing information and other inputs, as well as for sharing their views with the team. We would like to thank Ruangrong Thongampai for formatting the Monitor. Our thanks also go to the staff in Bank's resident mission who provided support to the Monitor.

THE WORLD BANK TEAM APPRECIATES FEEDBACK ON THE STRUCTURE AND CONTENT OF THE MONITOR.

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ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank	MOIC	Ministry of Information and Culture
AFD	Agence Française de Développement	MOFA	Ministry of Foreign Affairs
AFTA	ASEAN Free Trade Area	MOJ	Ministry of Justice
ASEAN	Association of Southeast Asian Nations	MOH	Ministry of Health
APB	Agriculture Promotion Bank	MOUR	Memoranda of Understanding
BCEL	Banque Pour Le Commerce Extérieur Lao	MPDF	Mekong Private Sector Development Facility
BOL	Bank of Lao PDR		
BPKP	Bolisat Phattana Khet Phoudoi	MTEF	Medium-Term Expenditure Framework
BPO	Business Promotion Office	NA	National Assembly
BTA	Bilateral Trade Agreement	NGPES	National Growth and Poverty Eradication Strategy
CEFT	Common Effective Preferential Tariff	NOSPA	National Organization for Studies of Politics and Administration
CFAA	Country Financial Accountability Assessment	NSEDP	National Socioeconomic Development Plan
CPAR	Country Performance Assessment Review	NPEP	National Poverty Eradication Program
CPI	Committee for Planning and Investment	NPL	Non-Performing Loan
CPI	Consumer Price Index	NPV	Net Present Value
DTIS	Diagnostic Trade and Integration Study	NSC	National Statistical Center
EAP	East Asia & Pacific	NTR	Normal Trade Relations
ECC	External NPL Collection Committee	PEM	Public Expenditure Management
EDL	Electricité du Lao	PEMSP	Public Expenditure Management Strengthening Program
EIB	European Investment Bank	PER	Public Expenditure Review
EU	European Union	PIP	Public Investment Plans
FDI	Foreign Direct Investment	PM	Prime Minister
FINNIDA	Finland International Development Association	PMO	Prime Minister's Office
FMAC	Financial Management Adjustment Credit	PPIAF	Public Private Infrastructure Advisory Facility
FMCB	Financial Management Capacity Building Credit	PRF	Poverty Reduction Fund
FRP	Financial Recovery Plan	PRGF	Poverty Reduction and Growth Facility
FY	Fiscal Year	RMFC	Rural Micro Finance Committee
GDP	Gross Domestic Product	SAMD	State Assets Management Department
GOL	The Government of Lao PDR	SCB	State-owned Commercial Bank
GTZ	German Agency for Technical Cooperation	SIDA	Swedish International Development Association
HIPC	Highly Indebted Poor Country	SME	Small and Medium Enterprise
IMF	International Monetary Fund	SNV	Netherlands Development Organization
IBA	International Banking Advisor	SOE	State-Owned Enterprise
ICA	Investment Climate Assessment	SPS	Sanitary and Phyto-Sanitary
JBIC	Japan Bank for International Cooperation	STEA	Science, Technology and Environment Agency
JICA	Japan International Cooperation Agency	TA	Technical Assistance
LNCCI	Lao National Chamber of Commerce and Industry	TOR	Terms of Reference
LA	Lao Airlines	UNDP	United Nations Development Programme
LDC	Least-Developed Country	UNESCO	United Nations Educational, Scientific and Cultural Organization
LTA	Lao Tourism Authority	UNIDO	United Nations Industrial Development Organization
LTC	Lao Telecom Company	VAT	Value Added Tax
LXB	Lane Xang Bank	WASA	Water and Sanitation Authority
MAF	Ministry of Agriculture and Forestry	WB	World Bank
MCTPC	Ministry of Communication, Transport, Post and Construction	WHO	World Health Organization
MDG	Millennium Development Goals	WTO	World Trade Organization
MIH	Ministry of Industry and Handicraft		
MOC	Ministry of Commerce		
MOE	Ministry of Education		
MOF	Ministry of Finance		

INTRODUCTION

Economic performance of Lao PDR has continued to improve during 2004 and 2005. Real GDP grew by a little over 6 percent in 2004 and is expected to increase by more than 7 percent in 2005. This growth is in large part due to rising foreign investment inflows in mining and hydro-power and growing mineral exports; agriculture, manufacturing and services also sustained last year's growth. Average inflation was slightly more than 10 percent in 2004 and is likely to stay in single digits in 2005.

Reforms across various areas continued during the period under review, even if at a somewhat uneven pace. Important steps have been taken towards a better investment and business environment and more open trade regime, and the program of strengthening of public expenditure management and revenue mobilization is also continuing. Unfortunately, SOE restructuring has been slow due to bureaucratic delays and weak capacity of the implementing agencies.

Implementation of the National Growth and Poverty-Eradication Strategy (NGPES) kept gaining momentum. The Government is working on the costing of the proposed public spending programs in four key sectors. The next key steps are to compare the resource-needs for achieving the NGPES-goals with the current size of available financing, and budgetary resources, discuss availability of additional resources with the donors, and finally prioritize public spending interventions and the implied changes in sector allocations. The resulting prioritized medium-term public expenditure program will be an input into the next National Socioeconomic Development Plan (NSDP, 2006-10), the successor to the NGPES, to be presented to the Party Congress in late March 2006 and to the National Assembly in late April 2006.

PART I – RECENT ECONOMIC DEVELOPMENTS

1.1 THE MACROECONOMIC SITUATION

BACKGROUND

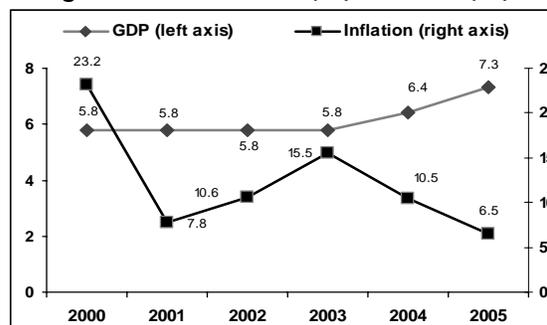
In the 1990s, Lao PDR grew at an annual average rate of 6.3 percent, and the incidence of poverty fell from 45 percent to 39 percent of the population in 1997-98 and to 29 percent in 2002-03. The crisis years of 1998 and 1999 saw inflation climb to an annual average of 110 percent and growth fall to 4 percent, but the resolution of the regional crisis and Lao's own policies stabilized the economy and resumed growth of around 6 percent.

The adoption of a stabilization program since 2000 and the implementation of a phased program of reforms since 2001 – in public expenditure management, banking, state-owned enterprises, forestry, trade and private sector – has contributed to this improvement. During 2000-03, inflation has averaged 15 percent and GDP growth averaged around 5.6 percent annually.

The approval of Nam Theun 2 hydro-power project by the World Bank Board on March 31, 2005 and by the Asian Development Bank Board on April 4, 2005 means that various financing partners have committed a total of US\$ 1,450 million to Lao PDR to finance US\$1,250 million of project cost and US\$200 million of contingency. This investment is expected to occur between now and 2009. The resulting annual inflow is very large relative to the size of the Lao PDR economy, and will have significant growth effects during that period, even though most of this will comprise of imports.

The Lao economy is projected to grow at 7.3 percent in 2005 and to continue growing steadily at 7 percent in 2006. However, a large part of this growth comes from increased foreign investment flows in hydropower and mining: without increased investment and exports through large projects, real growth would have been about 4.2 percent in 2003, 6 percent in 2004 and projected at 4.8 percent in 2005 and 2006 (see figure 2). Therefore, promoting growth in sectors other than mining and hydropower is increasingly important for ensuring stable and rapid growth in the long-run.

Figure 1. GDP Growth (%) and CPI (%)



Source: Lao authorities and IMF. CPI 2005: average of first 9 mths.

Real growth in Lao PDR reached 6.4 percent in 2004, up from 5.8 in 2003. Agriculture recovered from 2003, growing at above 3 percent in 2004 and 2005 (projected), in comparison to 1.8 in 2003; this increase came mainly from recovery in crops after the drought. Manufacturing picked up on the back of strong domestic demand. Private investment and exports in other sections performed better too. Rapid growth in the neighboring countries and increasing foreign investment and trade provide a base for keeping this performance in the future.

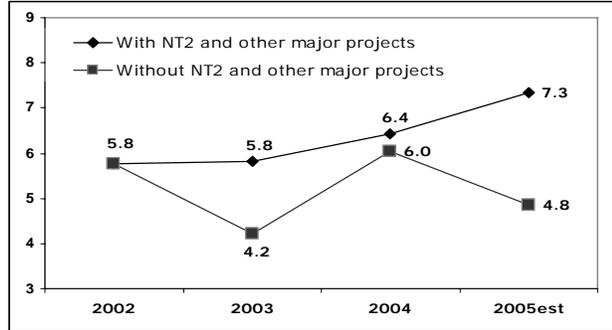
The macroeconomic situation remains stable. Inflation continues to decline, having fallen from 15.5 percent in 2003 to 10.5 percent in 2004 and is now projected to fall to 5.9 percent in 2005. End-of-period inflation rates were halved, from 12.4 percent in May 2004 to only 6 percent in May 2005. This was made possible by the fiscal adjustment in 2003/04 and by steady revenue collection levels above 11 percent of GDP. The kip has also remained stable, with the nominal exchange rate of 10,613 kip per dollar in 2004, only a slight depreciation from the previous year's exchange rate of 10,572 kip per dollar. The reserves have remained above 3 months of imports and are not projected to fall in the near future. With higher foreign investment and exports, the external sector will remain buoyant into 2006.

Nevertheless, continued vigilance will be needed to sustain macroeconomic stability, especially on three fronts:

First, the pressures to increase wages of public servants need to be managed in a fiscally sustainable manner. Wages are being increased gradually, albeit from very low levels. The total wage bill is expected to rise from 4.3 percent of GDP in 2003/04 to a projected 4.5 percent in 2004/05. Thus reaching a target of 12 percent of GDP in revenue collection is important for fiscal sustainability.

Second, revenue collection needs to be strengthened to compensate for a decline in forestry royalties, non-tax revenues and a potential decline in revenues from lower tariffs related to AFTA. This will require implementation of reforms to strengthen tax collection and the adoption of new revenue measures. In particular, the government should work on centralizing custom duties collection,

Figure 2. Growth (%) with and without major projects



Source: IMF and WB staff estimations and projections

Figure 3. Food and Nonfood CPI (% change)

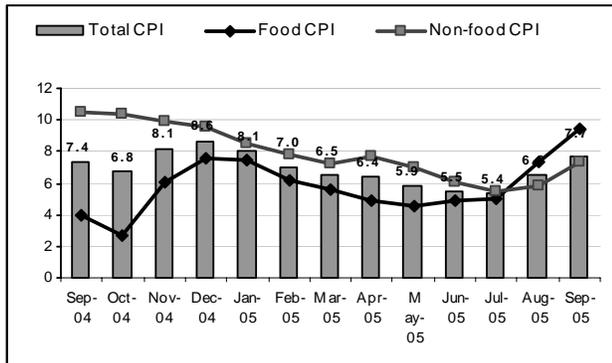


Figure 4. Decomposition of Nonfood CPI (% change)

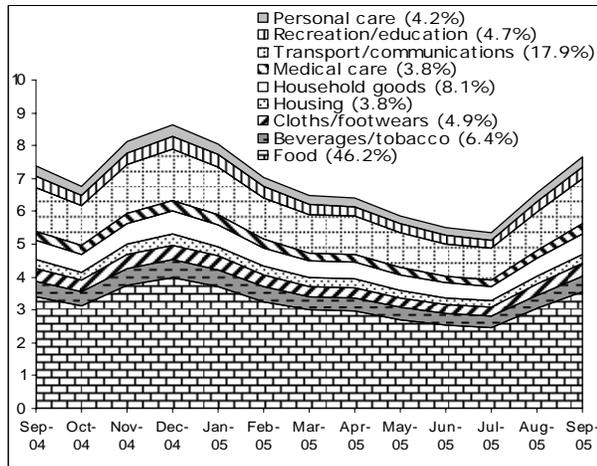
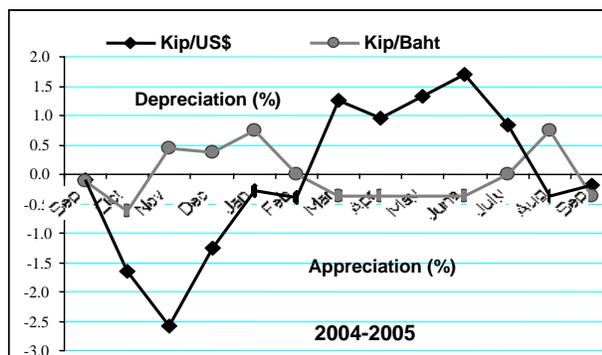


Figure 5. Lao Exchange Rate, 2004-05



Source: Lao authorities and WB staff calculations

improving management of provincial large tax-payer units, improving finance ministry monitoring of provincial revenue collection and better control of granting of tax exemptions. As part of the revenue side reform, the government has recently submitted to the National Assembly a major reform agenda that includes the introduction of a single rate VAT in 2006/07. The steps to improve revenue collection are also important to ensure fiscal sustainability of debt-servicing over the medium-term.

Third, the commercial banks remain vulnerable to pressures to extend credit on a non-commercial basis and at a rapid pace; this has to be managed carefully as failure to do so will generate inflationary pressures as well as build up contingent liabilities.

Table 2. Government revenues

		est.	est.
	2002/03	2003/04	2004/05
	<i>(billions of Kip)</i>		
Revenue & Grants	2,794	3,103	3,740
Revenue	2,341	2,821	3,230
Tax Revenue	1,924	2,328	2,678
Non-tax Revenue	417	493	551
Grants	453	283	511
	<i>(percent of GDP)</i>		
Revenue & Grants	13.16	12.38	12.95
Revenue	11.02	11.26	11.18
Tax Revenue	9.06	9.29	9.27
Non-tax Revenue	1.96	1.97	1.91
Grants	2.13	1.13	1.77

Source: Lao authorities and IMF staff estimates

1.2 IMPLEMENTATION OF NGPES

BACKGROUND

The Government of the Lao Peoples' Democratic Republic (GoL) aims to achieve rapid economic growth in order to reduce poverty, graduate from the status of a least-developed country (LDC) by 2020 and meet the Millennium Development Goals (MDGs). The development strategy to achieve these goals has been articulated in the National Socio-Economic Development Plan (NSEDP 2001-05) and later in the National Growth and Poverty Eradication Strategy (NGPES).

Since October 2004, the Committee for Planning and Investment (CPI) is working along with the Ministry of Finance (MOF) to guide the four key sectors (Agriculture, Transport, Health and Education) in preparing the implementation of the NGPES through a process of costing sector yearly economic and budget plans.

This NGPES costing and prioritization process aims to facilitate the inclusion of the NGPES into the next Five-Year National Socio Economic Development Plan (NSEDP) and supports the Mid-Term Expenditure Framework (MTEF). The process includes three main working processes: costing of the NGPES sector programs, further prioritization of NGPES sector programs, and identification of capacity enhancement needs for the implementation of the priority programs.

Each of the main processes of the NGPES starts with a workshop for government officials. As such, the first NGPES workshop in October 2004, kick-started the NGPES program costing techniques, and the second NGPES workshop held in July 2005 discussed the need and technical aspects of program prioritization and sequencing.

The costing of NGPES. Four line ministries (Agriculture, Transport, Health and Education) have been selected as the "key priority sectors" for NGPES costing exercise and results will be inputs into the next NSEDP. The costing estimates distinguish among the following three aspects of public expenditures: i) projected capital and recurrent costs of proposed public interventions; ii) distribution between central and provincial governments; iii) sources of financing budget or external. The costing is being carried out by the Departments of Planning of the main ministries, with the technical support funded by SIDA, WHO, UNDP and the World Bank. UNESCO funded the costing of the Education for All Plan, which has provided key information to the process.

The preliminary results of the NGPES costing have uncovered significant difficulties of the GOL in planning and implementing its budget. For example, according to these preliminary estimates from ministries, the expected yearly spending needs for the four priority sectors amount to nearly US\$ 500 million. On average, each sector would need to more than double their current level of financial allocations in to complete the implement the sectors' planned programs. Thus, if the NGPES were to be implemented without further prioritization, the total Government expenditure in 2004 (US\$ 441 million) would not cover annual spending proposed by these four ministries. Hence, the need for prioritization of the spending needs at the stage of budget planning is evident.

The results of the NGPES costing exercise have also drawn attention to several other issues: an imbalance of recurrent and capital costs in most of the sectors (74 percent of capital expenditure in health, 80 percent in transport and 90 percent in agriculture); this is a bias in spending pattern of Lao PDR that was highlighted in the last PER - high dependency on foreign budget financing; lack of alternatives to user-fees in the poorest districts (health), and an imbalance between expenditure in transport in comparison to all other sectors.

The iterative process by which line Ministries and MOF agree on sectoral allocations is underway. The sectors will have to downsize their requirements so that the aggregate number is consistent with the national budget and maximum available donor funding. These sectors will need to engage in the program prioritization and sequencing process. Several iterations will be needed after the first costing plan, in order to: put forward prioritized NGPES programs and to arrive at a realistic, prioritized medium-term expenditure program. The final MTEF, after being agreed upon among all participants (NSED), will be approved by GOL and incorporated into the 6th National Socio-Economic Development Plan.

The Next steps in NGPES costing process are:

- Prioritization of sector programs, which are aligned with the new MTEF, to be included in the NSED.
- External financing needs included in the costing projections of the line-ministries, and discussed with donors to assess the feasibility of the financial requests.
- As the NGPES costing process is attracting more financing from donors in several fields, the need for coordination becomes more evident. To date, UNDP has allocated financing to support integration of NGPES and the 6th NSED and development of a Monitoring and Evaluation System which can track information on the progress of the implementation of the integrated NGPES/NSED. ADB will be supporting CPI in integrating the Northern Strategy into the NGPES/NSED and MOF in the preparation of the MTEF during the next two fiscal years, strengthening the ministries budgeting and planning skills. The World Bank, working with UNDP and ADB, will support the planning and budgeting process in the line ministries and CPI as well as integrating the work in NSED.
- The third NGPES workshop scheduled for end of 2005 will wrap up the results of the past year's costing and prioritization working process of the key sector ministries, CPI and MOF. It will evaluate the process and identify further capacity enhancement needs to institutionalize costing and prioritization in the planning process. Finally, the workshop will discuss the future process of identifying capacity enhancement needs for the implementation of the programs included in the NGPES/6th NSED.

For NGPES implementation measures taken in previous years please refer to the Annex – Box 1.

PART II – STRUCTURAL REFORMS

2.1 PUBLIC EXPENDITURE POLICY AND MANAGEMENT

BACKGROUND

Since 2001, the government of Lao PDR revived its public expenditure reform, by reassessing its expenditure policies and its public expenditure management processes. The last PER, the CFAA and the CPAR were completed in 2002 & 2003 thereby raising issues and spurring actions, albeit slowly. These actions have made the legal framework for procurement a sound one, and other actions have improved transparency and accountability even if there is still a long way to go.

Public expenditure policy has also been improving, though with stagnating share of revenues in GDP and accumulation of arrears, the spending choices remain constrained. Nevertheless, there have been increases in expenditure on education and health in recent years and further efforts are underway to meet the country's poverty reduction objectives. Managing wage increases, and restraining growth in public employment to ensure sustainable growth in total wage bill is a pressing need. Phased payment of arrears, better balance between recurrent and capital expenditure and more efficient social sector spending remain important. Thus, more effective, accountable and transparent public expenditure management processes and improved public expenditure policies will be key in all future efforts of the Government of Lao PDR.

Building on the actions taken earlier by the Government as well as the technical assistance and advice provided by the World Bank, the IMF, the ADB, the UNDP and other bilateral donors the Government adopted a comprehensive, five-year Public Expenditure Management Strengthening Program (PEMSP) in early 2005. This Program focuses on the strengthening of management systems and the capacity of the Ministry of Finance and Provincial Finance Departments, through reform measures implemented annually – all of which are fully consistent with the Government's "Policy Paper on Governance" and its "National Growth & Poverty Eradication Strategy".

Public expenditure policy. In Lao PDR, total expenditures have been relatively flat as a share of GDP. In real per capita terms, spending on service delivery in health and education falls short of the levels seen in the mid-1990's. In order to reduce the imbalance between capital and current expenditures, the Lao government continued to increase current expenditures, see table 3. The share of current expenditures has increased in 2004/05 by almost 2 percent of the total expenditures. This change was equivalent to 0.8 percent of GDP. However, wages and salaries have grown in nominal terms, as well as percent of GDP, between FY04 and FY05 (estimated). Since table 2 shows that at the same time revenue collection as percent of GDP has slightly declined, special vigilance is needed to keep wage bill increases in line with growth in revenue collections.

Table 3. Government expenditures

	2002/03	2003/04e	estimate 2004/05
	<i>(billions of Kip)</i>		
Total expenditures	<u>4,017</u>	<u>3,967</u>	<u>4846</u>
Current Expenditure	1,527	1,890	2,391
O.W. Wages & Salaries	840	1,076	1,294
Capital Expenditures and onlending	2,370	1,853	2,350
O.W. Domestically-Financed	1,026	799	837
Debt repayment/Contingency	120	224	105
	<i>(percent of total budget)</i>		
Total expenditures	<u>100</u>	<u>100</u>	<u>100</u>
Current Expenditure	38.0	47.6	49.3
O.W. Wages & Salaries	20.9	27.1	26.7
Capital Expenditures and onlending	59.0	46.7	48.5
O.W. Domestically-Financed	25.5	20.1	17.3
Debt repayment/Contingency	3.0	5.6	2.2
	<i>(percent of GDP)</i>		
Total expenditures	<u>18.9</u>	<u>15.8</u>	<u>16.8</u>
Current Expenditure	7.2	7.5	8.3
O.W. Wages & Salaries	4.0	4.3	4.5
Capital Expenditures and onlending	11.2	7.4	8.1
O.W. Domestically-Financed	4.8	3.2	2.9
Debt repayment/Contingency	0.6	0.9	0.4

Source: Lao authorities and IMF staff estimates

Public Expenditure Management

In addition to the development and adoption of the comprehensive multi-year reform program in public expenditure management, Lao PDR continued to take actions: the Government updated the registers of accounts, the MOF approved the charter of the Procurement Monitoring Office and developed the draft procurement manual; and further steps were taken to review the treasury rules and procedures.

The on-going exercise to revise the 1994 Budget Law is expected to help address many of the weaknesses in the Lao PDR budgetary system in terms of: (i) clarifying the roles and responsibilities of various actors involved in budget implementation; (ii) clarifying the assignment of expenditure and revenue between the central and provincial levels; (iii) extending the budget preparation cycle to allow more time for dialogue between the MOF, CPI, the sector ministries and provinces; (iv) introducing a functional classification and program code structure into the budget format to allow for monitoring how the government money is being spent; (v) streamlining the budget execution process by strengthening the authority of the Treasury and clarifying its leading responsibility for budget execution (vi) bring the budget preparation and implementation forward.

Public Expenditure Management Strengthening Program. With internal coordination and implementation arrangements in place; the MOF has started preparing a first annual implementation plan of the PEMSP. It is expected that the annual implementation plan will be ready by early November and a meeting with the donors is scheduled to take place in mid-November to present the implementation plan and to discuss coordination of donor supports of the plan. A contract is to be signed shortly with the PEMSP Technical Advisor. It is envisaged that the advisor will start working in November.

Public Expenditure Reviews (PER). The last official PER produced by the World Bank in collaboration with the Lao PDR authorities, the International Monetary Fund (IMF), and the Asian Development Bank (ADB), was carried out in 2002. That PER was an integrated product including a Country Financial Accountability Assessment (CFAA) and focused on: (i) the macroeconomic framework and resources; (ii) budget planning, execution and control; (iii) poverty; and (iv) sectoral analysis of public spending (in education, health, energy, forestry, agriculture and transportation).

The rationale for conducting a follow-up PER stems from the need to examine public expenditure trends between 2002 and 2005, and support the GOL to achieve its key development objectives by establishing sound, accountable and transparent financial management practices. This PER also fulfils the requirements of the Nam Theun 2 (NT2) revenue management arrangements. The PER process will help in the costing of NGPES priority programs and provide input to the formulation of the 2006 state budget and the pilot 2006-2010 Medium-Term Expenditure Frameworks (MTEF), due to be presented to the National Assembly (NA) in September 2006. The preliminary drafts will be available in Lao and English in November 2005, January, February and April 2006; workshops will be held in February and July 2006.

This participatory PER is managed jointly by the GOL and World Bank. The Asian Development Bank (ADB) and the International Monetary Fund (IMF) will also collaborate in selected sections, and the PER will be published as a joint product (WB, GOL, ADB and IMF). The Japanese International Cooperation Agency (JICA), the European Union (EU), the Agence Française de Développement (AFD), and the European Investment Bank (EIB) have also been invited to participate. The Concept Note and the sectoral studies' terms of reference were circulated, discussed and agreed between these institutions and the main development partners, as the team welcomed donors' offers on direct participation and/or co-financing of the proposed work. As the PER will be built up from a series of thematic and sectoral studies, there will be extensive interaction between Government teams and international experts.

For earlier PEM reform measures taken in previous years please refer to the Annex – Box 2.

2.2 REFORM OF STATE-OWNED ENTERPRISES

BACKGROUND

The objective of the government's SOE reforms is to enhance transparency, reduce waste and increase efficiency in order to promote their commercial viability and reduce their budgetary burden. Reforms implemented in the early 1990s reduced the SOE sector by closing down, leasing, merging and selling a large number of SOEs. The SOEs today are fewer, but more importantly, they play a significantly smaller role in Lao's economy in terms of share in GDP and in share in total employment. Nevertheless, several large SOEs have been generating a large share of the non-performing loans (NPLs) in the state-owned banking system, which risks the stability of the banking sector and is ultimately funded by Government revenue.

The Government's SOE reform program, the current round of which was initiated in 2001, has three thrusts: (a) improving transparency and governance of state enterprise sector (b) restructuring larger SOEs which are losing money and accumulating debt to banks, and (c) rationalizing the regulatory and pricing environment for infrastructure SOEs through tariff policy reform. Progress over the last three years has been uneven. Good progress was made in late 2003 and early 2004 in preparing detailed time-bound restructuring plans for 4 large SOEs (2 in infrastructure) to restore their commercial viability and in monitoring the annual performance of the SOE sector. Subsequent progress in implementing these plans has been slow.

The Government now needs to move on implementing restructuring actions for the 4 large SOEs, on developing restructuring plans, in doing actual restructuring in the other 5 large SOEs, and in taking actions on more than 30 smaller SOEs identified as losing money in recent performance assessments.

SOE Reform Actions in the second half of 2005

2004, a consensus was reached within the government on the SOEs to be restructured and a detailed time-bound action plans were developed and adopted by the Prime Minister's Office. At the heart of the plan is a time-bound restructuring plan of four large SOEs, two in infrastructure and two in manufacturing. In addition, the GOL selected another five SOEs for developing detailed restructuring action plans, and annual monitoring of performance of all SOEs. The restructuring effort is led by the Business Promotion Office (BPO) within the Prime Minister's Office responsible for coordinating, implementing and monitoring the GOL's SOE Restructuring Plan, with support from the Ministry of Finance and parent ministries of respective SOEs.

Ongoing Restructuring of 4 large SOEs. Since March 2005, progress on restructuring actions of the four large SOEs has been uneven. Good progress was made on stemming the loss-making operations of two SOEs. However, it has taken a long time to commence external financial audits based on International Auditing Standards (IAS). The audits will now commence in all four SOEs at the end of October 2005, and completed by mid-January 2006.

Except in Lao Airlines, little progress was made in carrying out other restructuring actions in the other three SOEs (BPKP, NPNL, and PF3) since March 2005, such as improve corporate governance, convert government loans into public investments, and re-evaluate assets. The GOL has indicated that these actions are pending the completion of the external financial audits.

Lao Airlines (LA). Operational costs declined since the termination of the Airbus contract in March 2005, and LA was able to generate a gross profit (before tax and depreciation) of US\$1.3 million in the first half of 2005. However, the LA Restructuring Committee has terminated the international advisors who were advising on the operational restructuring.

The joint venture negotiation with Vietnam Airlines has come to a halt, given the disagreement on: (1) the number of years the Vietnam joint venture partner prefers to carry net loss forward, 10 years as opposed to the 2 years offered by LA; (2) the new investment amount of US\$ 6 million is seen as inadequate by the Lao PDR's authorities, and an increased amount has not been agreed; and (3) the Vietnamese government would like the GOL to guarantee the loans in excess of the US\$6 million investment, but the GOL has yet to agree.

Development of Restructuring Plans for another 5 SOEs

These include the DAFI Group, the Agriculture Industry Development Import-Export State Enterprise, the Lao State Fuel Company, the Société Lao Import-Export, and the Road Bridge Construction Company No. 13. Since the guidelines and memorandum of understanding on development of restructuring plans for these five SOEs were issued by the Prime Minister's Office in April 2004, no progress has been recorded. In early 2005, JBIC has indicated its intention to provide technical assistance to support the development of the restructuring plans; but their technical assistance proposal has not yet been approved by the authorities.

Selection of another 14 loss-making SOEs to be restructured

In July 2005, the Ministry of Finance submitted the names of these 14 SOEs to the Prime Minister's Office who plans to establish a joint committee comprising BPO, SAMD, parent ministries, and the 14 SOEs to develop an implementation plan and supervise the restructuring actions. The joint committee will be established before December 2005.

Tariff Policies for Infrastructure SOEs

BACKGROUND

Most of infrastructure and services in Lao PDR -- electricity, water, telecommunications and domestic air travel -- are provided by SOEs, though increasingly, more private providers are entering into these services. The Government, cognizant of the need to reduce budgetary subsidies to these services and to tap into the private financing of investments, have been moving to more appropriate tariffs and prices for such services. There has been a good deal of Government action in this respect over the last three years. These actions relate to: (1) actual changes in tariffs and in tariff structures, and (2) announcement of guiding principles for setting of tariffs and for changes in those tariffs. In particular, tariffs were raised towards greater cost-recovery and policies and principles were announced that would guide future tariffs and tariff changes on water, telecommunications, power and airfares, through Prime Minister's Notices.

Actual tariffs and the policies guiding tariff changes in infrastructure have come a long way. Tariffs on electricity, telecommunications, water and air travel continued to increase to reach cost-recovery levels.

Water Tariffs

Background

Following the water tariff increases from 195 Kip/m³ in 2000 to 650 Kip/m³ in July 2002, water tariffs for Vientiane Capital were raised for the second time between July and December 2004. Especially with respect to two categories of users that were subsidized. Water tariffs for households & government offices were raised by 27 percent on average and for commercial & industrial users by 32 percent on average – those for foreign embassies were left unchanged. This has helped to improve the commercial viability of urban water SOEs and reduced the extent of subsidy received by users in Vientiane.

Since the last issue of Economic Monitor, the water tariffs in Vientiane have not changed. In provinces, the fee varies depending on the policy of the local authorities. In some provinces, water tariffs have been deregulated. There are some indications that private sector has started to be involved in water supply services.

Electricity Tariffs

Background

Electricité du Laos (EdL) was particularly hard hit by the financial crisis and ensuing inflation of the late 1990's because of a currency mismatch: its revenues are largely in kip while costs are mainly in US Dollars. A financial recovery plan was implemented during the subsequent years; the main features of this plan included conversion of government debt to equity and tariff adjustments of 2.3% per month. Consequently, EdL is now on a reasonably good footing and was able to pay annual dividends to government in the order of 3-5 million in 2003 and 2004.

The average domestic tariff rate is 17% below the rate required for full cost recovery given existing costs. Residential and agricultural consumers are cross-subsidized by others. However, part of net returns of exports is covering the gap in full cost recovery.

In September 2005, EDL's Power Sector Action Plan was approved by the Deputy Prime Minister. The plan includes three components: i) tariff adjustments in real terms; ii) settlement of

accumulated arrears of government and rescheduling of EDL's debts to Government; and iii) avoidance of future arrears by Government. The Ministry of Finance and the Ministry of Industry and Handicrafts are working to ensure that there is no slippage in implementation of the action plan for financial sustainability of EDL. The Ministry of Finance has paid almost USD\$1 million to EDL and approved a phased write-off of an additional US\$4 million of arrears.

Telecommunication Tariffs

Background

The current capacity of the telecommunications sector in Lao PDR is relatively small - estimated to be 90,000 fixed lines and 141,000 cellular lines – two-thirds of this capacity is in Vientiane. Transmission to Northern provinces is limited by mountainous geography. There are four authorized enterprises to provide fixed and mobile telecommunications in Lao PDR, with all four providing mobile phones but only three providing fixed lines. All of them have some government ownership. The enterprises are as follows: Lao Telecommunications Co Ltd (LTC, shareholding is GOL 51%, Shinawatra 49%); Enterprise des Telecommunications Lao (ETL, GOL 100%); Lao Asia Telecom (LAT, Ministry of Defense 100%); Millicom International Cellular SA (MLL, GOL 22%, Millicom 78%). The first three of them provide fixed line, mobile and other services, while the last one – only mobile and other services.

The entry of Millicom, the large shareholding by Shin Corp, the operations of PlaNet and the prevalence of Voice over Internet Protocol (VoIP) operators show that private investors are willing to invest in Lao PDR under the current policy regime. However, such investment is still primarily limited to activities in Vientiane and there is need to take stock of the situation with respect to tariffs and other policies.

The tariffs were revised upwards in early 2004 whereby fixed line rentals and local fixed line call rates were both increased, even as international fixed-line calling rates were lowered. The mobile rates reflect cost-recovery and thus are at competitive levels.

There have been no tariff changes in the last six months. The telecommunication sector remains relatively open with private entry and private operation, as joint-ventures with Government. Foreign investment especially in cellular continues. Nevertheless, the fact that many areas of Lao PDR do not have phone or telecommunication services means that further policy actions may be necessary to cover unserved areas and to reduce costs in order to expand access.

Air Tariffs

Background

Since 2002, Lao Airlines has been adjusting its air travel tariffs on a quarterly basis to cope with seasonal patterns of the tourist market in the country and in the region. Air fares were raised first in June 2002, and then by more than 50% in September 2002. The tariffs for most routes remained unchanged in 2003, due to a sharp decline in overall sales (given the large shift from air travel to road transport). The air tariff for international flights has not changed recently. However, the company has reduced air tariffs within the country, on average by 20 percent, in May 15, 2003.

Recently, routes have been rationalized and domestic air tariffs adjusted according to market demands, seasonal flows of travelers, and competition from other transport services (road and water transport, see Table 4). In 2004 and 2005, the Airfares were raised in October on all nine routes shown below compared to May 2005. Compared to a few years ago, the recent changes in air tariffs and flight routes have improved the financial standing of the Lao Airlines.

Table 4. Recent changes in air tariffs

Flight - One-way	15-May-2003	1-Apr-2004	01-Oct-2004	1-Apr-2005	1-May-2005	31-Oct-2005
	<i>(in thousands Kip)</i>					
VTE-Luangprabang	320	350	370	390	400	420
VTE-Xiengkhuang	285	315	360	380	390	410
VTE-Houaphanh	350	380	430	450	460	480
VTE-Phongsaly	450	480	500	520	530	550
VTE-Xayaboury	290	320	350	370	380	400
VTE-Bokeo	408	438	460	480	490	510
VTE-Oudomxay	382	412	430	450	460	480
VTE-Luangnamtha	395	425	450	470	480	500
VTE-Pakse	420	420	450	470	480	500
Average	367	393	422	442	452	472
Average change (%)		7	7	5	2	4

Source: Lao Airlines

For earlier SOE reform measures taken in previous years please refer to the Annex – Box 3.

2.3 FINANCIAL SECTOR REFORM

BACKGROUND

The Lao PDR has a small banking system with system-wide assets of less than US\$500 million, equivalent to around 20 percent of GDP. The system is dominated by two state-owned commercial banks (SCBs) which hold over 50 percent and 70 percent of the banking system's total assets and deposits, respectively. Private domestic banks are weak and foreign banks have a small market share, due in part to existing barriers to entry and expansion by non-state financial institutions. Banque pour le Commerce Extérieur Lao (BCEL) has a dominant position, accounting for approximately half of total deposits and loans in the system. The Lao Development Bank (LDB), resulting from the merger of two smaller SCBs - Lao May Bank and Lane Xang Bank in 2002 – is smaller. Both BCEL and LDB are insolvent, having high levels of non-performing loans (NPLs) and weak profitability. There is also a state-owned policy bank, the Agricultural Promotion Bank (APB) that lends mainly to rural areas, that has recently been brought into the folds of the bank restructuring program.

SCB Restructuring and Improvement

Financial conditions of state commercial banks (SCBs) remain fragile. Balance sheets of both SCBs and NPLs remains. While the ongoing international audit for 2004 is likely to confirm that the rates of SCBs capital deterioration have slowed down and risk portfolios have stabilized. Tighter controls on new lending and the introduction of certification by the IBAs contributed to improved quality of new credit since 2003. However, after lifting the restricted lending regime in 2004, loan portfolios of SCBs have grown rapidly, the pressure on SCBs to make non-commercial transactions continues and thus greater vigilance in new lending is required.

The governance of SCBs remains weak. Currently, SCBs' Boards do not have independent directors and thus the banks operate under strong directive of the chairmen. The MOF needs to monitor closely the progress of SCB restructuring, seat on SCB boards.

The authorities are in the process of revising the Governance Agreements among the relevant SCB, BOL and MOF expected to be finalized and signed by December 2005. The objectives of the revision are to simplify the agreements, to increase the involvement by MOF in the bank restructuring program, to have a restricted lending regime if SCBs' NPLs exceed 15%, and a revised recapitalization plan for SCBs with revised performance targets. The decision to proceed with the recapitalization of each tranche will be made by the Bank Restructuring Committee, which will apply both quantitative assessment of performance targets and qualitative assessment. The first tranche of about 200 billion kip is likely to be issued by the MOF before the end of the year.

Prudential Supervision and Regulation

The current supervisory regime of SCBs have to be strengthened further. Collection and analysis of information on commercial banks is weak. There is a good deal of forbearance as well as technical capacity.

On August 30, the BOL has issued a regulation on Customer Due Diligence (CDD). The Financial Intelligence Unit (FIU) has been established under the BOL and the FIU starts to require commercial banks to set up a compliance office to monitor suspicious transactions. The BOL organized a workshop in September to explain commercial banks on how to implement the CDD regulation and to establish the compliance office. In addition, the BOL already submitted the draft Prime Minister's Decree on Anti Money Laundering (AML) to the Prime Minister's Office. The Prime Minister's Office will submit the draft Decree to the Cabinet for its approval. Originally the AML and Combating the Terrorist Finance (CTF) were going to be covered in the same Decree but the GOL decided to issue two separate laws: one for AML and another for CTF. Lastly, the authorities are considering adding provisions in the Criminal Law to cover terrorist financing and money laundering.

The Decree of the President on Commercial Banks has been submitted to the Standing Committees of the national Assembly by the Prime Minister Office in February 2005. The proposed amendments aim to ensure a level playing field between state and non state banks and reduction of barriers to entry and competition from non-state banks.

Another legal impediment to level playing field for non-state financial institutions is the restriction in the Presidential Decree Law No. 01/OP dated August 9, 2002 "Governing the Management of Foreign Exchange and Precious Metals", that restricts companies exploiting natural resources, to open deposit accounts with state owned banks only.

The potential for better contract enforcement has been increased by the approval of the Secured Transaction Law in August 2005. The amendments bring it in line with international best practice on several counts. The types of secured transaction over movable assets has been expanded. This should give banks more opportunities to use securities as collateral, in addition to land and fixed assets i.e. trading stock, shares, debts and intellectual property. The approval from the chiefs of the villages is no longer required to certify registration of securities as collateral, but the collateral can be registered with the MOF. It will facilitate project financing of large scale developments as well as serve the private sector and financial institutions in the Lao PDR. In the event of default, intervention of the court will no longer be required, if agreed in the credit contract and if related government officials facilitate the title transfer. The Ministry of Justice is expected to issue the implementing regulation soon.

Rural and Micro-Finance

On June 22, 2005, the BOL issued the microfinance regulation No.10/BOL to implement the Rural and Microfinance Policy and Action Plan. The regulation provides an enabling environment to support the development of the microfinance industry and encourage establishment of microfinance institutions under diverse forms and types of ownership. A microfinance institution (MFI) can be established with registration only but cannot take deposits; it can take deposits from general public if it is granted licenses by the BOL. The "fit and proper criteria" should be developed and BOL's capacity to evaluate applicants for licensed microfinance institutions (MFIs) should be strengthened to ensure that only qualified MFIs with strong management team are granted license to mobilize deposits from general public only, otherwise there is high risk that deposits will be lost.

For the reform measures taken in previous years please refer to the Annex – Box 4.

2.4 TRADE REFORM

BACKGROUND

Lao PDR has been integrating gradually into the world economy since 1989. The reform process accelerated after Lao PDR accession to the ASEAN and the joining of AFTA in July 1997. The highest current import tariff rate is 40 percent (compared to about 150 percent in 1995) and for most product groups it is below 20 percent. The current tariff schedule has six tariff rates: 5, 10, 15, 20, 30 and 40 percent, with non-weighted average MFN tariff of 11.3 percent. Non-tariff and quantitative import restrictions remain and in several sub-sectors are the primary binding restrictions. The country started to implement the AFTA Common Effective Preferential Tariff (CEPT) scheme in January 1998 and will complete the liberalization schedule by 2008 reducing its tariff on imports from ASEAN countries to 0-20 percent by 2005 and 0-5 percent by 2008; however, the legislative enactments for 2004 and 2005 for this purpose have been delayed. The Government has recently introduced one-stop services at customs border check-points to reduce bureaucratic procedures and provide better export and import services.

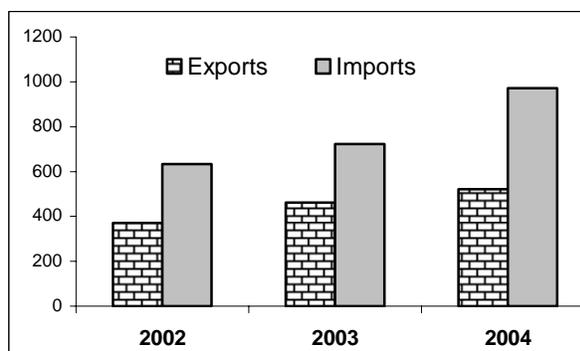
In November 2004, the USA granted Lao PDR normal trade relations (NTR), bringing into effect the US Bilateral Trade Agreement (USBTA) with Lao PDR signed sometime ago. This means that Lao exporters now have direct access to the US market, instead of being restricted by prohibitive US tariffs without the NTR. In the short-run, the Lao PDR industries that stand to benefit the most from increased market access are the garment and handicraft sub-sectors. The commitments under this agreement are closely related to the reforms that will be required for accession to the WTO.

Trade Developments

In 2004, as compared to 2003, Lao exports increased by 13 percent: from US\$462m to about US\$521m. At the same time, imports went up by 34 percent: from US\$723m to US\$972m (see figure 6). The growth in exports was driven mainly by garments, electricity, mining and coffee whereas the growth in imports -- by machineries and equipment for investments in mining and other large projects, as well as materials for the garment industry.

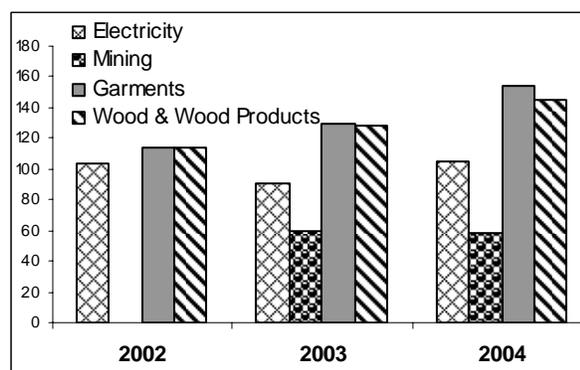
Strong exports. In 2004, exports of electricity, garments, wood and wood products, coffee and other cash crops grew markedly (see figure 7). Exports of electricity increased by about 15 percent (from US\$91m to US\$105m), garments by 19 percent (from US\$130 to US\$155m), wood products by 13 percent (from US\$128m to US\$145m) and coffee by 18 percent (from US\$19m to US\$22m). At the same time, exports of mining products (gold) declined slightly by 4 percent (from US\$60m to US\$58m). The markets for Lao exports are concentrated in ASEAN countries and the EU: Thailand, Vietnam, China, Australia, Japan, Korea and the EU. Lao exports to US are expected to grow in the coming years.

Figure 6. Lao Exports and Imports (US\$ m)



Source: Partner countries data and IMF staff estimates

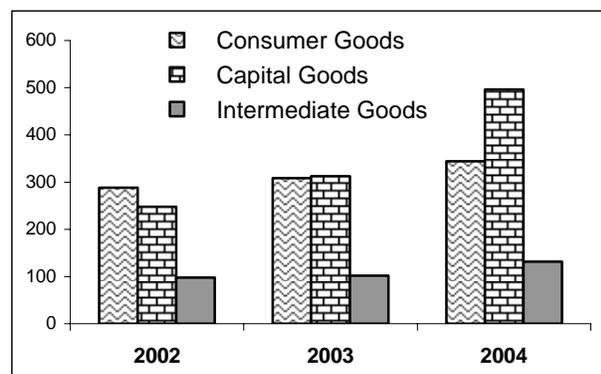
Figure 7. Exports of Major Commodities (US\$ m)



Source: Lao authorities and WB staff estimates

Composition of Lao imports. Imports are classified into three main product categories: investment, intermediate, and consumption goods. In 2004, as compared with 2003, Lao imports of investment goods increased drastically by about 59 percent (from US\$312m to US\$496m). Imports of intermediate goods went up by 29 percent (from US\$102m to about US\$132m) whereas imports of consumer goods grew by 11 percent (from US\$309m to about US\$344m (see figure 8). Lao PDR imported goods mainly from its traditional trade partners – neighboring countries, such as Thailand, China, Vietnam and others like Japan, Korea, Australia and EU.

Figure 8. Imports of major commodities (US\$ m)



Source: Lao authorities and WB staff estimates

Lao PDR was continuing to open its trade sector. Implementation of tariff reductions under AFTA and the FTA will ensure this in future. The WTO accession preparations have been ongoing in the GoL, led by the MOC. The Action Plan for WTO accession is being prepared to be submitted to the National Assembly in March 2006. It includes a legislative plan to modify the check lists on agricultural products, SPS measures and standards, and services. A standards law is being drafted in collaboration with STIA and UNIDO.

Coping with Oil Price Increase

BACKGROUND

Lao PDR is an importer of oil products. There are 11 companies that import regular and premium gasoline and diesel, with further distribution inside the country. Two of these companies are SOEs. There thus seems to be competition on upstream market, while downstream retail prices are fixed by a decree of the Ministry of Commerce and do not differ within provinces. The price differences among provinces are mostly due to transport costs.

Before 2002, there was a specific lump-sum tax for each liter of gasoline (kip/liter), collected in the form of custom duty and a turnover tax. Starting in 2003, the government introduced the prevailing rates for custom duty, turnover tax, and an excise tax (in percent of price per liter). In addition to these, a road fund levy in the amount of 100 kip per liter is collected. Current fixed taxes and duties are shown in table 5.

Retail price of gasoline and diesel has been rising at about 27 percent a year in nominal terms in 2004 and 2005 (see Table 8). As a result of the tax structure, the retail price of diesel is on average 15 percent *lower* than that of regular gasoline. This is a result of government's policy to keep the price of diesel low, to lower cost of transport and production. While the government does not directly subsidize retail prices, it does regulate them by exemption from the tax rates set by the 2003 decree. Using this mechanism, the GoL slows down the pass-through increases in retail prices that result from the world oil price growth.

Retail prices are a combination of import price, plus several lump-sum charges and tax/duty rates. Temporary exemptions to

Table 5. Prevailing taxes and duties set in 2003

	Import Duty, %	Import Excise Tax, %	Turnover tax, %	Road fund fee, kip/liter
Premium	20%	23%	5%	100
Regular	15%	24%	5%	100
Diesel	5%	12%	5%	100

Source: Lao authorities

Table 6. Amendments to prevailing rates, 2003-05

	Regular gasoline, import duty	Diesel, excise tax
19-Aug-04	5%	12%
06-Oct-04	10%	0%
18-Dec-04	10%	3%
31-Aug-05	13%	6%

Source: Lao authorities

the prevailing tax/duty rates are introduced by a special administrative order by the government (MOC). These temporary exemptions only apply to excise tax on diesel and import duty on regular gasoline. The history of reductions in these duties that amount to temporary exemption is outlined in Table 6.

Even in the absence of direct subsidization, regulating retail prices through reductions in taxes on oil imports leads to a reduction in budget revenues (compare Tables 5 and 6). An estimate of the likely revenue losses in 2004 due to adjustment in the prevailing tax rates on regular gasoline and diesel was about \$3m. Assuming that the current policy will continue (table 6), estimated likely reduction in revenues in 2005 could be around \$7.8m (or approximately 1% of GoL revenues projected for 2005).

Potential revenue losses of this size would be harmful to the already tight budget. Table 8 shows that the GoL has been gradually phasing out these exemptions, having realized that high oil price trend will continue in the medium term. With such policy in place, revenue losses would also be gradually reduced, since the GoL indicated its intention to bring the tax rates to that set in 2003 over the next two years.

Table 7. Imports of petroleum products

Fuel	(Jan-Jun)	
	2004	2005
	<i>(mln litres)</i>	
Gasoline premium	1.4	0.76
Gasoline regular	120.8	67.75
Diesel	222.9	128.66
Kerosene (jet fuel)	11.9	5.28
Cooking gas	4.9	2.52
Lubricants	3.47	2.17
	<i>(US\$ mln)</i>	
Gasoline premium	0.51	0.29
Gasoline regular	37.19	25.8
Diesel	71.15	52.44
Kerosene (jet fuel)	3.77	2.17
Cooking gas	1.02	0.63
Lubricants	3.26	1.96
Total	116.11	83.3

Source: Lao authorities (MOC)

Table 8. Average retail prices, 2002-2005

	Diesel	Gasoline	Gasoline
		Regular	Premium
	<i>(in US cents/liter)</i>		
2002	30	-	36
2003	30	36	42
2004 (Nov)	44	54	61
2005 (Aug)	56	70	74

Source: Lao authorities (MOC)

For the reform measures taken in previous years please refer to the Annex – Box 5.

2.5 PRIVATE SECTOR DEVELOPMENT

BACKGROUND

The Constitution of 1991 protects state, collective and private forms of ownership. During the 1990s an active program of legislation began to lay the foundation for the development of market based rules and institutions to support private sector development. The foreign investment legislation was passed in 1988 and a legal basis for land for use and transfer began to be established in 1992-93. Today, agricultural production and most of manufacturing production is in private hands and state-enterprises cover only around one percent of employment.

Nearly 97 percent of manufacturing units are small (less than 10 employees). Of the medium and large units, 35 per cent are privately owned by Lao citizens and 55 per cent were joint ventures with foreigners; the rest are owned by government (including provincial governments).

Foreign investments have been flowing into garments, wood processing, tourism, hydropower generation and more recently, mining. Between FY 2000/01 to FY 2001/02, foreign investment volume increased and approvals of investment increased tenfold (from US\$42m to US\$492m for the same period) and the actual investment went up by 23 percent (or from US\$75 m to US\$93m). In 2002/03, the approved FDI declined to US\$466m but the actual investment increased to US\$155m (or by 67 percent). The growth was largely due to mining, hydropower and service sectors. The main foreign investors are from Thailand, Malaysia, Singapore, Vietnam (ASEAN), China, Australia, South Korea, Taiwan, France, the Netherlands and United States.

The Ministry of Commerce issued PM Decree on Trade Competition that removed all restrictions on the movement of goods across provinces. This, if appropriately enforced should enhance market integration and ensure that all provinces have access to goods and services easily.

In the recent months, the Government of Lao PDR, has taken a number of measures to promote both domestic and foreign private investments and generally improve the environment for doing business.

The draft new Enterprise Law was approved by the Government and submitted to the National Assembly to be considered during the October 2005 legislative session. This law is viewed as a key legislative step toward a better business environment. Mekong Project Development Facility (MPDF), a part of the World Bank Group, has been supporting the GoL during the drafting process, and will continue working along with the GoL to make the implementation of the Enterprise Law successful.

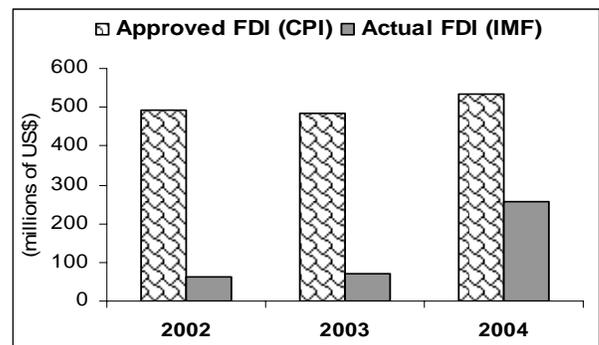
Domestic and Foreign Investment Laws were revised last year. An implementing decree for the Investment Laws is now being drafted. There is apparently a contradiction between the new Enterprise Law and the implementing decrees of the Investment Laws: the Enterprise law creates a one-stop process for licensing, while the Investment law requires the obtaining of an investment license from CPI. The Government acknowledges this problem and is working to solve it.

Good progress has also been made in business-government dialog on private sector issues. A Memorandum of Understanding has been signed between CPI and the MPDF on collaboration on the Lao Business Forum. A responsible inter-ministerial committee was established by a Decision of CPI in mid-2005. The forum is conducted in two main stages. First, MPDF conducts working group meetings with the representatives of the private sector, to identify the main constraints and issues to be raised with the Government. This is followed by dialog between the private sector and the Government. CPI and MPDF are working together to prepare the topics for discussion, the forum agenda and a list of invitees, for the first Business Forum scheduled to take place on November 24.

FOREIGN DIRECT INVESTMENT (FDI)

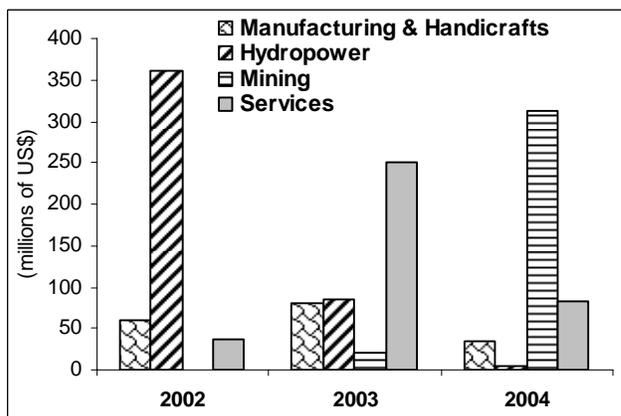
Actual FDI in the Lao PDR has been steadily increasing over the last years. Due to investments in mining, hydropower and services, there has been a significant jump in 2004 in comparison to the previous year. Traditionally, most of FDI in Lao PDR is concentrated in natural resources (hydropower, mining) and somewhat in tourist services, but relatively little in the agricultural sector. This trend has continued into 2004.

Figure 9. FDI in Lao PDR, US\$ m



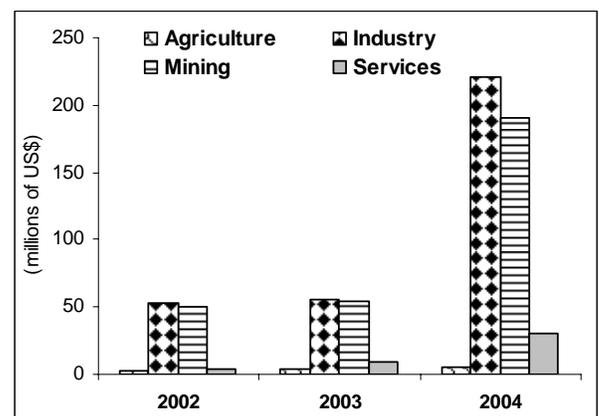
Source: Lao authorities (CPI) and IMF estimates

Figure 10. Approved FDI by sector, US\$ m



Source: Lao authorities (CPI)

Figure 11. Actual FDI by sector, US\$ m



Source: IMF and WB staffs estimates

For background on measures taken in previous years please refer to the Annex – Box 6.

PART III – DONOR ASSISTANCE TO THE REFORM AGENDA

Lao PDR has a high dependence on external support, some of which flow into considerable technical assistance. This Part examines the sort of technical assistance and other support that the donors are providing to the Government's policy reform agenda. This information has been provided by donors and has been collated and described by the Monitor.

3.1 PUBLIC SECTOR GOVERNANCE

ADB, Australia, the European Union (EU), France, Japan, New Zealand, SNV, Sweden, the Swiss Agency for Development and Co-operation (SDC), UNCDF (United Nations Capital Development Fund), and UNDP are the key donors providing support to various aspects of public sector governance. This covers public administration, including National Assembly, decentralization, public financial management, as well as legal and judicial reform.

ADB

- **Public Expenditure Planning for National Growth and Poverty Eradication Strategy** (\$0.7 million, 2005-2007). The TA provides capacity building and advisory services aimed at: (i) improved and effective allocation of public resources according to the Government's development and poverty reduction policy objectives; and (ii) improved quality of fiscal planning.

- **Enhancing Government Accounting Regulations and Procedures – Phase II** (\$0.62m, 2003-2006). The TA provides capacity building support to the Government for: (i) provision of reliable, timely, and relevant financial information by all ministries, agencies, and offices of government; and (ii) improved accountability of public financial resources at central and provincial governments.

- **Institutional Strengthening of the National Audit Office** (US\$0.7m, 2001-2005). The overall objective of the TA is to strengthen the state audit function in the Lao PDR by building the capacity of the National Audit Office staff. The TA specifically aims to assist the Government in upgrading NAO's capacity to effectively conduct audits on the basis of modern audit methodologies, systems, and procedures.

- **Capacity Building for Gender Mainstreaming in Agriculture** (US\$0.4m, 2005-2006). The TA aims to support the Government to (i) reduce poverty through gender mainstreaming in policies and programs to ensure equal benefits for men and women; and (ii) help build capacity of the National Commission on Advancement of Women.

Australia/AusAID

- **Asia Regional Cooperation for the Prevention of People Trafficking Project –ARCPPT** (A\$8.5 m for Lao PDR, Cambodia, Myanmar, Thailand, 2003-2006). Working with Department of Immigration, Ministry of Public Service to strengthen the criminal justice system capacity for successful prosecution of traffickers. The project is seeking to build up national structures and capacities as well as to improve coordination and cooperation across borders and regionally.

- **ASEAN-Australia Development Cooperation Program – AADCP** (A\$45 m, 2002-2008). **Regional Partnerships Scheme** component supports governance sector in areas of taxation, banking, enforcement of intellectual property rights and program and project design. **Program Stream** component has a governance focus in areas of standards and conformity assessment, customs capacity building, legal infrastructure for E-commerce, foreign direct investment data collection and reporting, private sector competitiveness, trade-related aspects of SPS.

UNDP and other Donors

- **Governance and Public Administration Reform** - GPAR Central Phase II. (Total US\$1.97m: UNDP-US\$0.54m and SDC-US\$1.35 2001-2006). During the first phase, the project had aimed at generating a high degree of understanding and commitment to the reform concept at senior political and bureaucratic levels of the government. Phase II focuses on

strengthening the government's capacity to implement GPAR by supporting: (1) Strategic Management of the GPAR Program, (2) Capacity Development of the Cabinet of the Prime Minister's Office, (3) Priority Civil Service Reforms, (4) Implementation of the Decentralization Policy, (5) Targeted Central and Local Administrative Improvements, and (6) Priority GPAR Related Training.

- **The GPAR: Luang Prabang Provincial Pilot** (Total US\$0.998m: UNDP-US\$0.12 m; SIDA-US\$1.1 m, 2002-2005). The purpose is to assist the Luang Prabang authorities in the design and implementation of a better local governance system, in order to provide cost-effective services to the population. This includes Strengthening Organisational Development and Human Resources Management, Improving Financial Management, Developing a Model Office Environment, Assessing Service Delivery.

- **The GPAR: Xieng Khouang Pilot** (Total US\$2.0m: SDC-US\$1.5, UNDP-US\$0.5m and SNV: advisory services; 2005-2008). The project sets out to strengthen the operational capacities of selected government institutions at the provincial and district levels to contribute to poverty reduction and equitable economic growth. As such the project will pilot governance and public administration reforms with emphasis on more effective and participatory services in the agricultural sector and strengthen financial management and accountability. The project will facilitate institutional change to create an enabling environment especially for farmers and local entrepreneurs, notably by enhancing people's greater involvement and ownership.

- **The GPAR Saravane project - Saravane Governance, Public Administration Reform and Decentralised Service Delivery Project.** (Total US\$3 million; UNCDF US\$1.9, UNDP US\$0.5, EU US\$0.6, 2005-2009) GPAR Saravane will provide substantive support in six main areas: (i) inclusive and pro-poor planning and budgeting at local levels; (ii) effective and transparent implementation of local infrastructure and service delivery; (iii) financing and financial management of local public service delivery functions; (iv) organisational strengthening at provincial, district and sub-district levels; (v) human resource management and capacity development; and (vi) informing national policy-making on the basis of project experience in Saravane Province

- **The GPAR: UNV project - UNV Support to Decentralized Governance for Poverty Alleviation** (UNV - US\$0.9m, 2003-2006). The project focuses on 3 pilot districts in Luang Prabang: Pak-Ou; Phonexay and Pakseng, and aims to train and support district and village level officials in their delivery of new tasks generated by the reform process. Additional GPAR pilots are being developed in the provinces of Saravanh (joint project with UNCDF expected to start in late 2004), Xieng Khouang (funded by SDC) and Khammouane.

- **Strengthening the National Assembly of Lao People's Democratic Republic** (US\$1.5m: EU – US\$1.12m and UNDP - US\$0.41m, 2004-2007). UNDP has been a strong partner of the National Assembly for several years, with a series of projects that have helped strengthen the Assembly with regard to the legislative process and oversight function. This project takes a longer-term strategic look at the areas of assistance needed to help the National Assembly implement its constitutional mandate.

- **Strengthening International Legal Instruments in Lao PDR** (US\$.70m: Finland – US\$0.62m and UNDP – US\$0.08m, 2005-2008). The project aims to strengthen the capacity of the Department of Treaties and Legal Affairs in the Ministry of Foreign Affairs in particular to enhance dissemination, enforcement and reporting mechanisms relating to international obligations of Lao PDR.

- **Development of Lao PDR Legal Sector Reform Program** (US\$0.47m: UNDP – US\$0.27m and SIDA - US\$0.20m, 2004). This Preparatory Assistance (PA) project initiates a long-term program of support to the government for legal sector reform. It emphasizes the development of a long-term, strategic vision for legal sector reform, with improved coordination between government and development partners on such reforms.

- **Enhancing Access to Justice** (US\$0.22m: UNDP – US\$0.01m and DGTTF - US\$0.13m, 2004-2005). The government intends to make the Lao Bar Association (LBA); presently supervised by the Ministry of Justice, an independent institution. This project aims to assist the government in i) strengthening the Lao Bar Association to function eventually as a professional,

independent institution; and (ii) creating an enabling environment for the implementation of a legal aid system in Laos.

- **Information and Communications Technology (ICT) for Development – Digital Standardisation for Lao Information Exchange** (UNDP: US\$.29m, 2003–2005). The project seeks to strengthen the capacities of the Lao government's Science, Technology, and Environment Agency (STEA) to establish and manage ICT standards for the country. The project consists of two components; 1) cooperation with UNDP's Asia-Pacific Development Information Programme (APDIP) sub-regional e-policy/e-strategy project; and 2) improving the utilization of the Lao language for electronic communication through the development of a standard Lao Character Set.

France

- **Strengthening the capacities**: of ministries through NOSPA (Foreign Affairs, Justice, Office of Public Prosecutor), (US\$1.5m, 2003-2005). Its main activities include training of trainers, seminars, study tours, scholarships, French language training and support for equipments in order to enhance capacities of MoFA's and MoJ's training centers. The project is implemented through NOSPA.

Japan International Cooperation Agency (JICA)

- **Legal and Judicial Development** (US\$ 4million, JICA – TCP 2003–2006). This project aims at developing human resources and the legal and judicial infrastructure with the Ministry of Justice, People's Supreme Court and Office of Public Prosecutor General. The project will support development of legal database, statute book, law textbooks and dictionaries in civil and commercial laws, prosecutor's manual, and People's Supreme Court casebook.

- **Capacity Building in Public Investment Program Management** (US\$ 3million, JICA – TCP 2004 - 2007). This project aims at improving overall management of domestic PIP (implemented by the Laotian budget) in cooperation with the Committee for Planning and Investment (CPI). The main activities of the project are to support (1) planning, appraisal, monitoring, and evaluation of PIP, (2) providing workshops and training (3) training officials through the implementation of the actual project in selected provinces (OJT), and (4) establishing the organization-based coordination network in PIP management.

- **Macroeconomic Policy support for Socio-Economic Development**. Phase 2 –MAPS 2 (US\$ 1.2million, JICA – TCP 2003 - 2005). MAPS 2 intends to enhance the capability of the Lao Government to formulate the proper macroeconomic policies based on the appropriate process of research and data analysis. In collaboration with National Economic Research Institute(NERI), CPI, this project organizes four working groups among the ministries concerned focuses on following four key issues; (1) Agriculture and Rural Development, (2)Promotion of SMEs, (3)Improvement of Financial Sector, (4) Integration into Regional Economy.

New Zealand

- **English Language Training for Officials** (US\$0.284m, Ongoing). ELTO is a long standing project that is providing English language training to mid level officials. The project moved into a new phase at the beginning of 2003.

SIDA

- **Institutional capacity building for National Statistical Centre** – twinning cooperation between National Statistical Centre and Statistics Sweden finance by SIDA since 1992. A new and final phase was concluded in July for the period 2005-2008, amounting to about US\$3.2 million USD. The project objective is: to provide users with statistical information in accordance with the Strategic plan, following the defined quality concepts. The specific outputs are: 1) NSC has a regular statistical production program within its area of responsibility, 2) NSC has an efficient organisational structure and working methods to manage its regular statistical production, 3) NSC has sufficient professional capacity to produce statistics that meet the defined quality, 4) NSC has an efficient organisation in terms of financial management, 5) NSC is the main coordinator of the National Statistical system.

3.2 REFORMS OF STATE OWNED ENTERPRISES AND FINANCIAL SECTOR

ADB

- **Banking Sector Reform Program** (US\$15m, 2002-2005). The objective of the program loan is to support the government (BOL, MOF) efforts to foster efficient intermediation of depositors' resources and ensure a sound banking sector capable of supporting private sector growth and extending rural outreach. The goals will be achieved through an improved operating environment for banking, the immediate application of commercial principles in SOCB operations, and increased diversity in forms of rural financing.

- **Strengthening Governance in Banks Program** (US\$4m, 2002-2005). The project intends to support the Government's to restructure and reform commercial banking, by engaging two resident international banking advisors (IBAs) for 3 years for each of the two state-owned commercial banks (SOCBs). An information technology (IT) upgrade will support these new governance structures by enabling improved financial reporting to management, shareholders, and the supervisory authority.

- **Strengthening Corporate Governance and Management of SOCBs II** (US\$0.9m, 2002-2006). The TA aims for a strengthened banking sector supported by a conducive legal environment and effective judicial processes. It assists the Government to strengthen shareholder oversight of bank restructuring, including (i) strategy development; (ii) human resource (HR) development; (iii) case by case NPL resolution; and (iv) the legal and judicial framework to support NPL resolution, including establishing a commercial division of the court and strengthening the framework for commercial transactions.

- **Rural Finance Development – TA Cluster** (\$2.02 million, 2000-2005). The objectives are to (i) strengthen the capacity of BOL to support sustainable rural financial development, (ii) assist APB to build its capacity to expand the outreach on a sustainable basis, and (iii) introduce credit unions on a pilot basis. The TA cluster will include six subprojects each of which has to be sequenced to enhance its positive impact on the subsequent subprojects to better achieve the goal of the cluster. These are (i) building awareness and understanding of rural finance, (ii) diagnostic study of APB, (iii) establishment of pilot credit unions, (iv) building BOL's capacity for training in rural finance, (v) pilot tests of the best practices in rural finance, and (vi) institutional reforms of APB.

European Union (EU)

- **EuroTAL Bank Training Project** (Euro 3.37m: EU Euro3.0m, GOL Euro 0.37m 2003-2005). This project is the second part of the EC' Technical Assistance Programme for Transition to a Market Economy and involves capacity building for the staff of the Central and State-Owned Commercial Banks, supporting the SOCB's in the development and marketing of new banking products and enabling the Central Bank to set up a Management Information System for banking supervision. Ends December 2005.

France

- Strengthening the Capacity Building and Training of the Ministry of Finance – Departments of Customs and Accounting (0.6 M € - 2005-2008 and one advisor). The project aims at strengthening the capacities of the Ministry of Finance for improving its reform process (through seminars and study tours) and the on-going training of the civil servants, particularly at the Customs and Accounting Departments (training of trainers and creation of an on-going training center with in the Ministry of Finance).

IMF

- **Poverty Reduction and Growth Facility- PRGF expired. Two-mission surveillance now.**

SIDA

- **Strengthening Fiscal Management** (US\$3.20m, 2004-2006). The overall objective is to contribute to poverty alleviation by strengthening Lao PDR's ability to improve revenue

collection. The project includes: tax policy and tax administration, human resource development, organization and management and ICT development.

World Bank

- **Poverty Reduction Support Operation - PRSO** (A one-year single tranche operation, about US\$8-10m per year, 2005-2007). The main objectives of this facility are to support NGPES implementation and provide additional contribution to the government budget. The first PRSO of US\$10m (US\$4.5m credit and US\$5.5m grants) to GOL was approved by the Board of the World Bank (on March 31, 2005) and the first PRSO is expected to go to the Board early next year (2006).

- **Financial Management Capacity Building Credit – FMCBC** (US\$8m, 2002-2008). The FMCBC aims to provide a comprehensive and strategic framework for the capacity building activities to improve the financial management in Laos and to provide a credit for specific technical assistance and training activities within such framework.

- **Financial Accountability** (IDF grant \$0.30m). This grant aims at improving Financial Accountability in SOEs and Private Enterprises. The project focuses on capacity building and introduction of international accounting and auditing standards and related training. The project also supports strengthening of LICPA and improvement of legal framework for accounting and auditing practices. Efforts are currently underway to translate international accounting standards into local language.

3.3 TRADE REFORM

ADB

- **Integrating the Poor in Regional Trade through Standard-Setting for Private Sector Development - Phase II** (US\$0.70 million, 2004-2005). The TA will work with Government to implement the national standardization framework with STEA and develop a consistent methodology and procedures on standards development across line ministries in coordination with private sector stakeholders.

Australia/AusAID

- **Support for the Role of Integrated Framework Facilitator. Initial 12-18 months.** Australia has been invited by the Lao Government to serve in the role of IF Facilitator to support World Bank-led IF process. Australian support for this role commenced through the participation of an expert consultant in the recent Diagnostic Trade Integration Study (DTIS) main mission to the Lao PDR (March 7-17). Australia will continue to work with the GOL's IF Secretariat and Focal Point, as well as with the IF core agencies, led by the World Bank and UNDP, in progressing the IF agenda in a positive direction over the coming few years.

- **Trade Analysis and Reform Project (A\$5m, 3 years and expected commencement - 2005).** Target countries: Laos, Cambodia, Thailand, Vietnam. Project interventions will focus on building analytical and research skills in order to strengthen capacity for trade policy analysis. The project has three components: 1) to improve understanding of the role of analysis in trade policy development and the capacity to incorporate analysis into the policy development cycle; 2) to strengthen the capacity of researchers in government agencies and the research community to deliver high trade policy relevant analysis; and 3) to deliver a high quality capacity building project in cost-effective and cooperative way.

- **Singapore-Australia Trilateral Cooperation Program (SATCP) (2004 -2007).** The program covers 8 countries in the ASEAN region. The selection of Laos as the first trilateral partner under the program reflects the commitment of both Australia and Singapore to providing quality technical assistance and capacity building for Laos officials, particularly in relation to important trade and WTO related matters and economic integration.

- **Sanitary and Phytosanitary Capacity Building Project - SPS CBP (A\$3.9m, 3 years (2004-06).** The program is for support of 8 ASEAN focal countries: Philippines, Indonesia, Malaysia, Thailand, Vietnam, Cambodia, Laos and Burma. The goal of the project is to enhance the capacity of the ASEAN focal countries to meet international SPS standards and the

requirements of importing countries consistent with the WTO SPS Agreement. The three components focus on SPS-Trade linkages, Plant Health and Animal Health.

European Union (EU)

- ***AsiaInvest - Export Challenge*** (Euro 0.15m, 2004-2005). Under the regional AsiaInvest program for Asian and European business representative organizations, a project has been initiated to support the development of Lao trade promotion agencies and SMEs. The project aims at improving the access of Lao SMEs to European markets through strengthening the capacity of LNCCI and the Lao Trade Promotion Centre in the provision of market information and trade related advisory services to the private sector.

- ***Multrap (Multilateral Trade Assistance Project) - Support for Lao PDR's accession to WTO*** (US\$1.00 m, 2004-2006). The objective is to help the Lao government prepare for WTO accession, through capacity building. The project will help government officials understand better international trade, the role and requirements of WTO, revise legal and regulatory framework and develop university level courses on international trade for officials, lawyers, traders and students.

- ***EC-Lao PDR Project on Standards, Quality and Conformity Assessment*** (Euro 0,5 m, 2005-2006). The overall objective of the action is to enhance the capacity of Lao PDR to integrate into regional and international trade system. The project will support the national capacity in the area of setting standards, metrology, accreditation and conformity assessments.

- ***EC-ASEAN Intellectual Property Rights Co-operation Programme ALA/96/25*** (Euro 0,5 million 2005-2006 National Component Lao PDR) The objective of this programme is the development of a modern intellectual property system in Lao PDR. This includes technical assistance in the drafting of new legislation on Patents, Copyrights, and Industrial Design. Particular attention will be paid on TRIPS compliance, the judiciary and the enforcement.

- ***AsiaInvest - Upgrading Lao companies of the wood-processing industry for better prospects on the European Market*** (Euro 0,2m 2005-2007). The project aims at enhancing production and marketing skills of Lao companies of the wood-processing industry with regard to better prospects on the European and other foreign markets. Target groups are enterprises of this sector in the regions of Vientiane, Luang Prabang and Pakse and local trainers and consultants to be trained during the project.

International Trade Center (ITC)

- ***Support to Trade Promotion and Export Development in the Lao PDR*** (US\$0.974m, 2004-2006). The main objective of this project is to build up the trade promotion and export development capacities of Government, trade support institutions and exporting enterprises in the Lao PDR, in close technical cooperation with Cambodia and Vietnam, so that in turn they could induce the expansion and diversification of exports. Areas of activities include: (1) Development of export strategies at the national and sectoral levels, (2) Establishment of an operational trade support network at the national level between Government, trade support institutions, product associations and exporting enterprises, led by strengthened trade promotion organizations, (3) Improvement of knowledge, strengthening of skills and development of capacities of training institutions to provide training in trade promotion and export development to exporting enterprises, (4) establishment of a trade information capacity at the national level servicing the specific needs of trade support institutions and exporting enterprises.

UNCTAD (funded by France)

- ***TrainForTrade: Training and Capacity Building in the field of International Trade, FSP 2002-95*** (US\$2.3m for Lao PDR and Cambodia, 2003-2007). The main project activities include: (1) training of trainers (ToT), (2) use of distance learning, and (3) cooperation between universities of LDCs. Operational changes will be undertaken in the economic sectors identified by decision-makers and authorities of the countries involved. The project is implemented by UNCTAD together with Ministry of Commerce.

UNDP and AusAID

- ***Support for Lao PDR's Integration into the International Trading System*** (US\$0.64m: AusAID – US\$0.59m and UNDP – US\$0.05m. 1999-2004). The main objectives of the this

project are to provide technical assistance to GOL in the areas of WTO accession, improvement of economic and trade policy formulation and integration. The project has two components: (1) support for Laos accession to the WTO, including preparation of Memorandum of Accession, establishment of a minister-level "National Steering Committee and its secretariat, identification of trade focal points in line ministries, and capacity building; (2) integration impact studies in the areas of laws and regulations, which should be changed to conform with WTO agreements, customs valuations, rules of origin, technical barriers to trade, quarantine, sanitary and phyto-sanitary measures and land transport policies.

UNDP

- **Enabling more effective Integration of Lao PDR into the ASEAN** (UNDP – US\$0.36m, 2004–2005). UNDP is starting a one-year Preparatory Assistance project to support the ASEAN Department in the Ministry of Foreign Affairs in its role as Lao National ASEAN Secretariat including successfully carrying out its duties as Chair of the ASEAN for 2004-05. This includes hosting a successful ASEAN Summit facilitating the active involvement of GoL institutions in the Summit and other meetings in 2004-5. In addition, this Preparatory Assistance project is to support further integration of Lao PDR into ASEAN.

- **Strengthening capacity for National Human Development Reporting [NHDR]**: (UNDP-US\$778,050; June 2004-December 2007). The third NHDR is currently in production and explores "international trade and human development", analyzing the impacts of international trade on employment, production, poverty, income, consumption, the environment, gender and culture. A specific focus will be undertaken on the structure and composition of international trade and the impact of imports and exports on Lao human development and people's well being.

World Bank

- **Diagnostic Trade and Integration Study** (DTIS) to be completed in the context of the Integrated Framework (IF) exercise led by Australia. The main diagnostic trade and integration study (DTIS) mission took place during February-March and a follow up mission and workshops in July 2005. The DTIS report will be completed by the end of 2005.

3.4 PRIVATE SECTOR, TOURISM DEVELOPMENT AND LAND REFORM

PRIVATE SECTOR DEVELOPMENT

ADB

- **Investment Climate and Productivity Study** (US\$0.15m, 2003-2006). The project conducts a study on business operating environment in the country based on sample survey of enterprises and identify effective ways to promote private investment and improve productivity. The goal of the TA is to help improve the environment for doing business and increasing productivity in the Lao PDR, thereby fostering private sector development. The TA will contribute to the country's northern region development strategy and implementation agreement on GMS cross-border movement or bilateral arrangements. It will also provide major inputs to ADB's private sector assessment.

- **Advisory Assistance on Small & Medium-Sized Enterprise and Private Sector Development** (TA: US\$0.67m, 2003-2005). The TA helps the Government develop an integrated institutional and capacity-building framework to establish the regulatory foundation for PSD and SME development.

- **Private Sector Development Program (\$0.7m, 2004-2005)**. The TA will formulate a prospective policy-based lending program to improve the business environment for private enterprises, and to achieve economic growth based on private sector development.

Germany (GTZ)

- **Human Resource Development for Market Economy** (HRDME) Program (Phase 1: USD 5.5 m, June 2004 – May 2007). Overall objective of the TA program is that Government and

private sector jointly create the appropriate conditions for more dynamic economic development. It comprises three components with the following Lao partner organizations:

1. Market-economic framework conditions (CPI).
2. Integrated vocational education system related to economic and labor market development (MoE)
3. Promotion of SME development (MIH)

JICA

- **Macro Economic Study Project** (MAPS)-Phase II (US\$1m, 2003-2005). The research project aims at strengthening the capacity of the Lao government agencies in policy formulation and conducting of research through establishing of data center.

- **Lao-Japan Human Resource Center Development Project** (US\$5m, 2000-2005). This is a Technical Cooperation Project aiming at consistent supply of human resource for a market economy.

MPDF (IFC/WBG)

- **Mekong Private Sector Development Facility** (MPDF). The main objective of the program is to support the development of private, locally owned, small and medium enterprises in Laos (also in Vietnam and Cambodia). MPDF has three main programs: (1) *Company Advisory Assistance* (help local SMEs improve operations, develop new markets, strengthen management, and develop sound business plans), (2) *Business Development Programs* (strengthen the capacity of local institutions providing essential business services to SMEs in the areas of financing, consulting, training, and information services), (3) *Business Enabling Environment* (conduct research and prepares analyses on specific issues facing local SMEs and on the environment in which they operate, working closely with relevant government authorities and institutions).

SNV - Netherlands Development Organization

- **Private Sector Development Program** In this program SNV aims at improving market access in order to create economic opportunities for the rural poor. The program consists of three service market combinations: 1) access to financial services, 2) value chain development (e.g. eco tourism, non timber forestry products and handicrafts) and 3) enabling environment for business development, including public – private dialogue and partnership and support to business membership organizations. Main clients are the SME Promotion and Development Office, Departments of Industry and Handicrafts, Chambers of Commerce and Industries, selected Business Associations, the Lao Women Union and Credit Unions. Advisory services are concentrated in Luang Prabang, Khammouane, Savannakhet and Champasack provinces.

- **Non Timber Forest Products:** Advisory services in the field of non timber forest products (NTFPs) focus on developing best field practices for sustainable NTFP production and use, NTFP market development (including Marketing Information Systems), human resource development and supporting and institutionalizing networking and information exchange.

Switzerland (SDC)

- **The Promotion of Organic Farming and Marketing in Lao PDR** (US\$0.70m, 2003-2006). The project aims at promoting organic farming through creating enabling conditions for organic production, transfer of know-how to farmers, and facilitating access to domestic, regional and international markets.

- **Small-scale Agro-enterprise Development in Rural Uplands of Lao PDR** (Xiang Khuang and Luang Prabang) and Vietnam (US\$2.60m, 2003-2006).

UNCTAD (funded by Japan)

- Strengthening the investment climate: **Blue Book on Best Practices in Investment Promotion and Facilitation** (for Lao PDR and Cambodia, 2004). The "Blue Book" for Lao PDR and Cambodia will contain concrete and measurable activities for the two governments in

achieving best-practices in the following three broad areas: 1) Regulatory framework for investment; 2) Investment promotion strategy; 3) institutions.

UNIDO

- **Lao UNIDO Integrated Program** (LAO IP/II: US\$5.6m, 2004-2008). The Integrated Program for Lao PDR (phase II) consists of the following key components:

- Industrial governance and enabling environment (\$0.9 m)
- Private Sector Development and SME promotion (\$0.9 m)
- Manufacturing productivity and environmental soundness (\$2.5 m)
- Market access, investment and trade facilitation (\$1.25 m)

World Bank

- **Investment Climate Assessment (Joint with ADB)**. The ICA is based on a survey of firms in five provinces and the capital, which was completed in October 2005. The firms were surveyed to identify the main constraints to doing business. The report will build on perception as well as on quantitative data about firms' productivity and costs of doing business. A workshop was held in Vientiane in September 2005 to discuss the preliminary results with the Government (led by DDFI/CPI). The final draft is due to come out in March 2006.

- **Assessment of Provincial Private Sector Environment (supported by EU)** takes stock of the current policy environment in 5 selected provinces for private sector development. The purpose of this assessment is to get a sense about the differences across provinces in the way existing Government policies with respect to starting a business and operating a business (investing, hiring/firing labor, importing/exporting, acquiring land etc) are practiced or implemented differently in different policies. This study is based on a review of existing rules, discussions with provincial government counterparts as well as a selected set of entrepreneurs in the provinces. Stories of around 10 successful Lao entrepreneurs are also documented to see how they have fared in an improving business environment. Also, comparisons of better performing provinces are available in the assessment. It is expected that fuller dissemination of findings in terms of small & large workshops, especially in provinces, are planned in mid-December onwards.

TOURISM

ADB

- **GMS: Mekong Tourism Development Project** (US\$10.9m, 2002-2007). The Project will promote the development of the tourism sector in the lower Mekong River basin. In Lao PDR, It will improve tourism-related infrastructure in provinces of Champasak, Khammouane, Louangnamtha, and Louangphabang, support pro-poor community-based tourism projects in the rural areas of the country, facilitating private sector participation in tourism marketing and promotion, establish mechanisms to increase subregional cooperation, and facilitate the movement of tourists across borders

Australia/AusAID

- **Child Wise: Preventing the Sexual Exploitation of Children in ASEAN Tourism Destinations through Community and Professional Education** (A\$0.6 m, 2005-06). The aim of this project is to establish Child Wise Tourism principles in the work of the National Tourism Administrations (NTAs) so that they work regionally in the prevention of child sex tourism. Participating countries include Thailand, Vietnam, Cambodia, the Philippines, Indonesia, Lao PDR, and Burma.

NZAID

- **National Tourism Authority of Lao PDR – UNESCO Nam Ha Ecotourism Project**, Phase II (US\$0.338m, 2004-2007). Phase II of the Nam Ha project intends to assist Luang Namtha's provincial tourism and protected area managers become more effective stewards of their emerging ecotourism industry. It will also scale-up the core group of national professionals trained by the Nam Ha Project both in numbers and quality.

- ***Village Assisted Mine Clearance in the Lao PDR*** (US\$0.48m, Phase 1-2, 2004-2005). This project follows a pilot in Xieng Khouang province that established the merit of active village participation in UXO clearance in Lao. The project is scaling out the use of village-assisted clearance (VAC) in clearing both heritage sites and agricultural land and plans to demonstrate the merit of UXO clearance as an integral part of development planning and implementation. An operational partnership between MAG, UNESCO, CARE and the National Tourism Authority provides the means by which new agricultural, eco-tourism, and socio-economic development initiatives will be pursued.

LAND

World Bank and AusAID

- ***The Second Land Titling Project*** (US\$23.92m: WB-US\$14.82m, AusAID-US\$6.84m and GOL-US\$2.27m, 2003-2008). The second phase of LTP aims at developing the land administration capacity to support the country's economic development and poverty reduction goals. The objectives of the project are to (i) improve the security of land tenure; (ii) develop transparent and efficient land administration institutions at the national and provincial levels; and (iii) improve the government's capacity to provide social and economic services through broader revenue base from property related fees and taxes.

3.5 SEMINARS AND STUDIES BY DONORS IN REFORM AREAS

3.5.1 List of key training workshops conducted and planned for 2005 and early 2006

Topic of training/seminars	Organized by	Date	Venue
<i>Governance</i>			
Workshop on "Regulatory Best Practice for Electrical and Electronic Sector" (Strengthening ASEAN Standard conformity and Assessment Systems)	AADCP Program/ AusAID	Mar 2005	VTE
Workshop on "Civil Law"	JICA and MOJ	Mar 2005	VTE/NOSPA
Training on "Credit Analysis"	JICA	Mar 2005	VTE
Training on "Management of state property" for MOF	French Embassy	Mar-Apr 2005	VTE
<i>Economic and sector Focus</i>			
Training workshop on "Macroeconomic Model"	JICA	Jan 2005	VTE
PIP (Public Investment Program) Seminar	JICA and CPI	Feb 3, 2005	VTE
Final Workshop on Macroeconomic Policy Support for Socioeconomic Development in Laos Phase 2 (MAPS 2)	JICA and CPI	Mar 2005	VTE
NGPES Prioritization and Costing Workshops II	GOL/UNDP/WB	Mar 2005	VTE
NGPES Prioritization and Costing Workshops III	GOL/UNDP/WB	Jan 2006	VTE
<i>Trade and Private Sector Development</i>			
Export Competitiveness Workshops for Tourism, Manufacturing and Agricultural Sectors.	GOL/IF Mission/WB	Mar 2005	VTE
Training on "How to develop garment exports in a quota free world and prepare for after Jan 2005".	GOL/ITC	Jan 2005	VTE
Training on Market Analysis " Trade Map and Product Map"	GOL/ITC	Mar 2005	VTE
International Trade Law: Market Access for Agricultural and Industrial Products and WTO Negotiations	GOL (MOFA) & AusAID/Singapore	Feb-Mar 2005	VTE
Workshop on " support to trade promotion and export development in Lao PDR"	GOL/ITC	April 4, 2005	VTE
Seminar on "Export Market Research"	GOL/ITC	May 2005	VTE & CPS
Seminar on "Export Marketing"	GOL/ITC	Jun 2005	VTE & CPS

3.5.2 List of recently completed, ongoing/planned studies and surveys by donors on above reform areas

Topic/area of study	Conducted by	Start date	Completion date
<i>Governance</i>			
Human Development Report	UNDP	2004	2005
Country Governance Assessment	ADB	2004	2005
<i>Economic and Sector Focus</i>			
CEM: Realising the Development Potential of Lao PDR	WB	2003	Dec 2004
Public expenditure tracking survey (PETS)	WB	2004	2005
Public expenditure review (PER)	WB	2005	2006
Public expenditure policy in primary education and health in Lao PDR	EC Consultant	Jan 2005	Mar 2005
Capacity building assessment and program design for PEMSP	EC Consultant	Feb 2005	May 2005
<i>Trade and Private Sector Development</i>			
Investment Climate Assessment (ICA)	ADB/WB/CPI	2004	2006
National Export Strategy	ITC/MOC	Dec 2004	Jun 2005
Study on Trade Support Networks	ITC/MOC	Dec 2004	Jun 2005
Study on Trade Information Services	ITC/MOC	Dec 2004	Jun 2005
Study on HD for Trade	ITC/MOC	Dec 2004	Jun 2005
Reviews of the provincial policy and regulatory environment for PSD	EC Consultant	Jan 2005	Mar 2005
Enterprise survey	GTZ	Feb 2005	Apr 2005
Diagnostic trade and integration studies (DTIS)	GOL/IF agencies	Mar 2005	End 2005
Private Sector Assessment	ADB	2004	2005
Assessment of Provincial Private Sector Environment	WB	2004	December 2005

ANNEX BOXES ON ACTIONS TAKEN IN PREVIOUS YEARS

Box 1. GOL Actions to Implement the NGPES

Measures taken in 2003

- The National Poverty Eradication Plan (NPEP) is approved by the National Assembly in October. The Plan is based on the 5th National Socio-Economic Development Plan (NSED - 2001-05) and the Interim Poverty Reduction Strategy Paper (I-PRSP)

Measures taken in 2004

- CPI and representatives from the four priority line ministries visited the provincial authorities around the country to disseminate the draft NGPES and take stock of the provincial priorities.
- The NPEP is reviewed and upgrade to National Strategy. The final document takes the name of National Growth and Poverty Eradication Strategy, approved by the National Assembly early in the year.
- The First Millennium Development Goals Report (MDG report) is submitted to the UN Secretary General in September 2004. The MDG report sets the goals to be met by the Government by 2015, ideally, through the implementation of the NGPES.
- The first NGPES workshop of October 2004 discussed the process of costing and prioritization, including the methodology and type of data needed for a first cut of costs and the process of iteration that will follow in order to relate the total sector cost with the sector allocations (from budget & donors) and with the sector goals in NGPES.

Measures taken in 2005 (From January to April)

- In March, the NGPES Working Group and the Ministry of Finance meet to disseminate the preliminary findings of the costing exercise.

Box 2. GOL Actions to Improve Public Expenditure Management

Measures taken in 2002

- Decree No. 57/PM on the Management of Public Investment, issued on May 22, 2002. The decree requires that PIP submissions for new public projects in excess of 1 billion kip in the FY02/03 budget include estimates of associated recurrent costs during the operating period. The rationale is that it will help Lao PDR correct the imbalance between investment and recurrent expenditures in the budget, which at present is heavily skewed towards the former, by clearly identifying recurrent cost requirements.
- FY 2000/01 outcome and FY 2001/02 budget published in April 2002 with classification by ministry, province, and services. The publication of the budget in the Official Gazette enhances budget transparency. However, the budget classification remains incomplete. The current budget nomenclature allows an economic classification and some functional accounts on an ad-hoc basis. The budget classification system needs to be revised to allow for the identification of administrative units and level of government (central, provincial, district) classification, and to be harmonized with the accounting nomenclature.
- The Government adopting the Accounting Regulations in July 2002 to implement Decree 20/PM on General Regulation of Public Accounting, to enhance financial accountability and transparency as well as internal financial control over revenues and expenditures. The regulations cover basic features of internal control that must be established and maintained in each ministry, province, district and agency, and also provide financial statements of the Government which are to be submitted to the National Assembly at the end of each FY.

Measures taken in 2003

- Increases in transparency was maintained for the second year by the publication of the FY 2001/02 budget outturn and FY 2002/03 budget-plan in April 2003 in the Official Gazette, with classification by ministry, province, and sectors, a summary of which is provided in Table 3.
- The Procurement Monitoring Office (PMO) was established within the Ministry of Finance, to oversee the implementation of better procurement processes and to assist in related capacity building activities. The office is operational in its new premises. In addition, the office is revising the implementing regulations, which is expected to be completed by the end of the year.
- New Procurement decree 03/PM issued in December 2003 and the Implementing Regulations approved by Prime Minister in June 2004 - they have improved clarity of language and specified conditions for actions.
- A methodology for estimating the recurrent costs has been developed for core construction projects in the PIP and was applied to actual PIP projects in the training of staff from CPC and MOF around middle of 2003. Of the 149 new construction-related projects in excess of 1 billion kip, (90 percent of new projects are construction-related), recurrent costs were estimated for 96 of them.

Box 3. GOL Actions on SOE Reform

Measures taken in 2001

- The Business Promotion Office (BPO) - was established in the Office of Prime Minister to centralize the restructuring of SOEs, and a Minister was named to head the office;
- Governance of the largest loss-making state-owned enterprise, Bolisat Phatthana Khet Phoudoi (BPKP) was transferred from the Ministry of Defense to the Ministry of Finance, with BPO charged with the restructuring of BPKP;
- Management audits were undertaken in Lao Aviation and BPKP, leading to change in top management of Lao Aviation;
- Financial Recovery Plan (FRP) for EdL agreed with donors and its implementation was initiated;
- A new telecommunication law, passed in April 2001, laid the framework for telecom regulations, opening the sector to private participation, beginning November 2001.

Measures taken in 2002

- Decree No. 54/PM, May 2002, on Management of State-Invested Enterprises, and its Implementing regulations, Dec 2002, clarified the role and responsibilities of the Directors and managers of SOEs and their financial reporting requirements and provided guidance on capital investment in SOEs, procurement/transfer/replacement of assets, and the treatment of dividends, and; outlined sanctions for SOEs violating the regulations.
- Memoranda of Understanding (MOU) dated May 15, 2002 on the restructuring of BPKP, Lao Aviation, Nam Papa Lao, and Pharmaceutical Factory No. 3, setting out the broad parameters of the proposed restructuring, to be used as the basis for preparing detailed multi-year restructuring plans.
- Top management of BPKP and Pharmaceutical Factory No. 3 also changed to facilitate SOE restructuring.
- Letter of the Minister of Finance No. 618/MOF dated April 10, 2002 on new electricity tariff policy;
- White paper on water tariff policy; a draft 'Water Supply Authority (WASA) Charter' on Regulation of Water Supply Operations" is also under review. This is expected to give WASA the authority to function as the water supply sector regulator.

Measures taken in 2003

- Tariff increases in tariffs for Lao Airlines, electricity, telecommunications, water.

Measures taken in early 2004

- Further increases in tariffs for water, electricity, telecommunications and aviation.
- Explicit Tariff Policies were adopted – PM Notices approving Ministry proposals – for telecommunications, water and aviation, though on the latter few details given the impending joint-venture of Lao Airlines.
- The Prime Minister's Notice No. 059/CPMO dated 15 January 2004 adopted the key elements of the restructuring plans for four SOEs, including key principles of such restructuring. The subsequent four Implementing Guidelines/Instructions issued to all relevant agencies on April 29, 2004 by the Minister in the Prime Minister's office in charge of SOE restructuring set-out detailed actions, the institutional arrangements and agencies responsible for their implementation, transparent monitoring and evaluation procedures which include external audits and a specific timetable for 2004 and 2005 for their implementation.
- The State Asset Management Board (SAMB) has, in early 2004, completed its development of the data-base and the classification of all SOEs by performance. A system for collecting data and maintaining the data-base for annual monitoring of SOE performance has been established, based on the Implementing Regulations to the Decree on Management of State-Invested Enterprises, Decree No. 54/PM dated May 9, 2002.
- Memorandum of Understanding (MOU) for Restructuring have been adopted for five additional SOEs, namely, DAFI, Lao State Fuel Enterprise, Lao Export-Import Trading Company, Bridge-Road Construction Company No. 13 and Agro-industrial Development Company (DAI).

Box 4. GOL Actions in the Banking Sector

Measures taken in 2001

- Notice No. 90/BFSD dated March 19, 2001, requiring a commercial bank to make general provision from 0.5% to 1% of performing loans; Notice No. 209/BFSD dated June 15, 2001, reiterating that a commercial bank shall comply with Regulation No. 03/BOL, which set ceiling for lending at 60% of collateral value and for lending to a single borrower at 10% of the bank's capital, and a commercial bank shall comply with Regulation No. 98/BOL on loan classification, suspension of accrued interest income on a loan which becomes overdue for longer than 90 days, and restriction on new lending to a defaulted borrower;
- Instruction No. 176/BOL dated June 30, 2001, reiterating general reserve requirement and compliance with

Regulation No. 98/BOL on loan classification;

- Notice No. 158/AMD dated July 3, 2001, which restricts SCBs to make a policy lending (for an infrastructure project, promotion of export and import substitute, and rice plantation) and focus on loan recovery;
- Instruction No. 195/BOL dated July 6, 2001 and letters to BCEL, LMB, LXB No. 263/BFSD dated August 6, 2001, which distinguish required provision on stock (subject to regulatory forbearance) and flow (in accordance with Regulation No. 98/BOL)i, reiterate SCBs to stop accruing interest income on NPLs, require SCBs to submit to BFSD a report on directed lending.

Measures taken in 2002

- Instruction 01/BOL dated Jan. 10, 2002 on notional capital, credit to large customers, and level of NPLs;
- Instruction No. 03/BOL dated March 14, 2002, which restricts SCBs to grow their risk portfolio if flow NPL ratio exceeds 15% and reduce the branch approval limits. This regulation is aimed to stop further deterioration of SCBs' assets;
- Notice No. 15/CIMD dated April 24, 2002, which gives clarification of Instruction No. 03/BOL;
- Notice No. 566/MOF dated March 31, 2002 on autonomy of SCBs. The objective of this notice is to ensure that SCBs have full autonomy in operating their banks on a commercial basis;
- The Rural and Micro Finance Committee (RMFC) was established on Feb.15, 2002 under Bank of Lao PDR (BOL) to make assessment of the rural and micro-finance industry, formulate a policy statement, and develop an action plan for the implementation of a rural and micro-finance reform program;
- The External NPL Collection Committee (ECC) was established under BOL with the mandate to support debt restructuring on a voluntary basis by SCBs and debtors; Signed Memoranda of Understanding for Restructuring (MOUR) for each SCB dated March 31, 2002, stating the basic principles under which the restructuring will be conducted;

Measures taken in 2003

- Governance Agreement between Bank of the Lao PDR, Ministry of Finance, each SCB, its Board of Directors, and the management was signed in March 20, 2003. The Agreement is aimed to restructure and strengthen SCBs.
- New management team for each SCB was appointed in January 2003 and started working since end February 2003.
- Four international bank advisors (IBA) were recruited by BOL to assist in restructuring and strengthening SCBs. The first two IBAs have started working with SCBs since April 2003.
- Two SCBs, Lao May Bank and Lane Xang Bank, completed their merger into the "Lao Development Bank" (LDB) in April 2003.
- Letter No. 17 and 18/BFSD, dated February 26, 2003, Letter No. 053/BFSD, dated July 30, 2003, Letter No. 092/BFSD, dated October 23, 2003 and Letter No. 120 and 121/BFSD, dated December 5, 2003 instructing BCEL and LDB to limit their net new lending since their NPLs exceed 15%. Letter No.17 and 18/BFSD also requesting both SCBs to follow Instruction 01 and 03 closely since they exceeded the concentration limit without prior approval by BOL. These letters enforce SCBs to comply with the prudential regulation and restricted banking regime to avoid further deterioration in their portfolio.
- Notice No. 1760/PMO dated December 17, 2003 informing the MOF that the Prime Minister's Office endorsed in principle the rural and microfinance policy and action plan in December 2003. This will serve as the building blocks for developing rural financial services for the poor.
- The MOF has issued "triangle" bonds to SCBs, which are designed to resolve NPLs of private contractors caused by government arrears. Series of bond of total about 210 billion kip were issued in 2003. Interest rates on these bonds seem below market rate.

Measures taken in 2004

- Regulation No. 6/BOL replacing Regulation No. 98/BOL on loan classification, issued in May 2004, to ensure that banks consistently review and classify loans, properly account for overdue interest, adequately set aside provisioning expenses, and properly classify restructured loans. Full implementation is targeted for 2005.
- Regulation No. 5/BOL issued in September 2003 replacing Regulation No. 178/BOL on foreign currency exposure. Although issued, the regulation has not been enforced. The objective of the regulation is to assure that banks maintain their foreign currency position within the prudential limits to avoid excessive risk.
- BFSD disseminated the approved policy statement and action plan in three provinces: Borikhamxay, Champasack, and Bokeo in October, November, and December.

Measures taken in 2005

- The draft amendment to the Decree Law on Commercial Banks has been submitted to the Standing Committees of the National Assembly in February. The objective of the amendment is to ensure level of playing field and lower the barriers to entry and expansion of non-state owned banks.
- The BOL has established Financial Intelligence Unit (FIU) and issued on August 30 a regulation on Customer Due Diligence (CDD). The regulation requires commercial banks to set up a compliance office to

monitor suspicious transactions.

- The amendment to the Secured Transaction Law was approved by the National Assembly in May 05 and has become effective since it was signed by the President in August 05. The type of secured transaction over movable assets has been expanded from the current three, to an unrestricted position. The amendment no longer requires approval from the chiefs of the villages to certify the registration of securities as collateral but can register collateral with the MOF. In the event of a default, the revised provisions in respect of the realization of the security will not require the intervention of a court in the process if agreed in the credit contract and related government officials must facilitate the title transfer.
- The BOL issued on June 22, 2005 the microfinance regulation No.10/BOL to implement the Rural and Microfinance Policy and Action Plan. The regulation provides an enabling environment to support the development of the microfinance industry and encourage an establishment of microfinance institutions in diverse forms and types of ownership. A microfinance institution (MFI) can be established with a registration status but cannot take deposits. A MFI can take deposits from general public if it is granted licenses by the BOL.

Box 5. GOL Actions towards Trade Promotion

Measures taken in 2003

- Coverage of import and export restrictions is significant¹. Notice 204 specifies that a license from the Minister of Commerce/provincial offices of MOC is needed to import the following: Petrol and gas; Cars and parts for assembling vehicles of any type other than tractors²; Cement; Steel; Jewelry; any of 17 foodstuffs that include all meats, eggs and poultry, animal feeds, sugar, canned foods, food coloring or seasoning, soft and alcoholic drinks (including beer) and animal medicines; seeds; Videos, movies, gambling machines, satellite TV receivers and telecommunications equipment; Sporting guns.
- in January 2003, of the 1291 items on Lao's Temporary Exclusion List (TEL), 436 items were transferred to Inclusion List (IL) of AFTA thereby putting 71 percent of all items and 45 percent of all dutiable imports by value in the Inclusion List ³.
- On September 18, 2003 the Lao and US governments signed the first US-Lao Bilateral Trade Agreement (BTA) in Vientiane, which will go into effect after the US Congress enacts legislation authorising normal trade relations (NTR) between the two countries.
- PM Decision No.14/PM of February 28, 2003 allowed the establishment of duty-free warehouses in Vientiane and Savannakhet (at Seno special economic zone) to facilitate the import processes.
- Supplementary Guiding Order No.530 of May 10, 2004, on business registration, has established sunset provision of two days for registration of local businesses in trade sector at one of the following three levels: central (MOC), provincial and district. However, the application must include: (1) an application form, (2) personal biography, (3) a statement of criminal records No.3, a copy of ID card and three pieces of 3x4 photo, (4) financial statement, (5) charter-by-law approved by trade agency (for entity as company only). Thus the application requirements remain quite time-consuming in terms of other formalities.
- Annex to the Supplementary Guiding Order No.530 (May 10, 2003) on business registration No. 538/MOC dated May 13, 2003 provides a division of business registration approval between different levels of government agencies: (1) MOC registers foreign companies (with registered capital from and over 200 thousands US\$), enterprises dealing with imports of vehicles and fuel and exports of wood and wood products, state enterprises and joint ventures established at central level: (2) provincial trade authorities provide registration to foreign investors (with registered capital below 200 thousands US\$), enterprises in agricultural, industrial and services sectors, trading firms, state enterprises and joint ventures established by local governments; (3) district offices can register and manage retail stores, shops and other small services.
- Decree No. 125/PM of July 24, 2003 on organisation and operations of Lao National Chamber of Commerce and Industry (LNCCI) (replacing the decree No.175/PM of 20 August 1998 on areas of responsibilities of LNCCI) redefines the role, functional responsibilities, organisational structure and financial matters of LNCCI. LNCCI is an independent organisation that represents the business communities and acts as a bridge linking between the public and private sectors and brings together continuing dialogues between the government agencies and business communities. On behalf of its members, LNCCI negotiates with GOL and foreign partners on trade, industrial and services issues and establishes its representative offices abroad. It issues the certificate of origin to exporters and approves the establishment of business groups in the country. Being financially independent, LNCCI gets supports from its members (member fees), its own services (issuance of certificate, training and advisory services, trade exhibitions, etc.), the government as well as from individuals and local and international organisations.

¹ Each year through Notices to implement the general Decree No.205 of the Prime Minister issued on 11 October 2001 on this issue. Notice 203 of February 2003 defines the lists of prohibited imports and exports and these appear be relatively uncontroversial bans related to public safety and morals plus those related to logging & raw timber exports.

² Licensing of vehicles is now used only mainly as a registration device as importers can import as many as they want

³ Under AFTA, Lao PDR is committed to move all the items from its Temporary Exclusion List (TEL) to the Inclusion list (IL) by the beginning of 2005 and to reduce the CEPT rates on all IL items to between zero and 5 percent by the beginning of 2008.

Measures taken in early 2004

- Ministerial Guideline No.04/MOC of January 5, 2004 on promoting commodity production. It has defined the following goals for the next few years: (1) meet domestic demands and substitute imports (especially food, raw materials, construction materials and other consumer goods that have potential), (2) increase exports, especially to ASEAN and other neighbour countries (of agricultural and forestry products, and wood), (3) maintain market dynamics, by favouring demands and supplies to support economic growth. This guideline also provides some significant implementation measures: (1) create awareness among Lao people at all levels of the importance of the transition from a self-sufficient economy to market-oriented one, (2) improve existing regulations and procedures to encourage the production of commodities and facilitate domestic trade and exports, (3) increase roles and participation of business communities from all economic sectors in the commodity production process, (4) attract more FDI for commodity production and leverage the Lao economic potential, especially in the area of natural resources and human capital.
- In January 2004, 422 items were moved from TEL to IL bringing coverage of IL to 84 percent of import tariff lines.
- PM Decree No.15 of February 04, 2004 on trade competition. It will be effective on August 1, 2004, and has provided key principles to regulate monopolistic practices, and to promote fair competition and a level playing field for all players. The decree has identified the government agencies responsible for the monitoring of competition, and defined roles and responsibilities to ensure free market and guarantee the participation of various sectors of the economy.

Box 6. GOL Actions to Improve Private Investment Climate

Measures taken in 2001

- GOL took steps towards improving transparency and simplifying the investment registration processes. A number of websites (inter alia: www.invest.laopdr.org, www.moc.gov.la) have been set up to provide basic information about the country's legal framework, business and investment related laws, sector and industry information and other services.
- Decree No.46/PM March, 2001 on the Implementation of the Law on the Promotion and Management of Foreign Investment provides basic guidelines for improving registration and speeding up approval processes for foreign investment. Based on this decree, total approval time for different types of projects has been reduced from 90-180 days to 45-60 days.
- On land, PM Decree 237/PM 2001 provides more clarity in the institutional setup and main functions and activities of the Department of National Land Use Planning and Development (DONLUPAD), which is responsible for the coordination of land-related policy⁴ and inter-agency consultations on appropriate institutional arrangements.

Measures taken in 2002

- Further to Decree No.46/PM, Decision of the Chairman of CIC, dated 27 February 2002, has decentralized approval of foreign investment projects, extension of foreign activities and establishment of branches of foreign companies in Lao PDR. It defines four size-classes of foreign investment based on value: (1) equal or less than US\$1m, (2) from above US\$1m to US\$5m, (3) from above US\$5m to US\$10m, (4) Above US\$10m. Approval of FDI equal or less than US\$1m can be done at the provincial level by all provinces. However, in large provinces, such as Vientiane Municipality, Savannakhet, Champasack and Luangprabang, the ceiling for provincial approval is US\$2m and less).

Measures taken in 2003

- PM Decree dated 23 April 2003, on roles and responsibilities of CIC at central and local levels. The decree provides local governments with new autonomy over investment and defines organisational structure, roles and responsibilities of CIC and other relevant line-ministries and agencies at central and local levels. It serves as a strategic guidance for CIC at all levels for decision-making process including approvals, promotion, management and monitoring of domestic and foreign investment. The effective implementation of the decree would contribute to the improvement of the investment environment in the country.
- Amendment of Lao constitution, especially with regard to chapter 2 on Social and Economic System. The new text states that GOL promotes every economic sector, including domestic and foreign investment, a modern industry, enterprises and services in order to accelerate economic growth of the country. The constitution further confirms the Government intention to guarantee interest in property and lawful capital of all investors.

⁴ The Land Law 01/97/NA (April 12, 1997) repeals a number of previous laws (1979, 1989, 1992) and serves as the new basis for land administration and management in Lao PDR, defining institutional responsibilities for land administration and registration (especially for eight categories of land in Lao PDR: agricultural, forest, construction, industrial, communication, cultural, water-area land and land for national defence and peace-keeping), and (2) sets out the basic rights and obligations of the land user.

PM Decree 22/PM of 1999 is on implementation of the 1997 Land Law.

Presidential Decree on Land Tax (03/PDR of August 12, 2000) provides new guidelines for land tax collection and management, with detailed tax rates for each type of land and its location.

- Publication of Quarterly Newsletter by DDFI. The government issued in July 2003 the first Quarterly Newsletter, to disseminate FDI information to investors and to promote foreign investment. The Newsletter provides recent updates on investment regulations (mainly on decentralized management and approval process at the central and provincial levels), tips for applications, investment incentives for various priority sectors and investment zones, and data on the cost of doing business in the country (business costs – land, office space, factory building, warehouse; and production costs – labor, utilities, i.e. electricity, water, fuel/gas, and telephone).
- PM established National Land Policy Committee (NLPC) on March 25, 2003, representing a number of line ministries/agencies involved in land administration and management, and providing an effective oversight mechanism to resolve policy issues as they arise and to facilitate the development of a comprehensive land policy framework. DONLUPAD is assigned as the secretariat of NLPC.

Measures taken in early 2004

- PM Decree No. 42/PO of April 20, 2004 on Promotion and Development of Small and Medium Sized Enterprises, defines key policies and an action plan for SME promotion and development, including the establishment of SME Development Funds and supporting organizations (the SME Promotion and Development Committee and its permanent Office and Executive Committee). It also defines regulations, methods and measures needed to promote SMEs, the expansion of commodity production, and trade and service activities. The policy gives priority to creating an enabling regulatory environment, enhancing competitiveness, expanding markets (domestic and international), improving access to financing and developing both entrepreneurship and an entrepreneurial culture in the country.



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