



The World Bank

LAO PDR ECONOMIC MONITOR



The World Bank Vientiane Office

NOVEMBER 2004

BACKGROUND

With an estimated per capita income of US\$320 in 2003 (see table 1), the Lao People's Democratic Republic (Lao PDR) is one of the poorest countries in the East Asia region. It is classified by the UN as a Least Developed Country (LDC). Today, nearly 73 percent of its population live on less than US\$2 a day, and 25 percent live on less than US\$1 a day (see *East Asia Update*, Nov 2004). Using Lao PDR national poverty line (of approximately \$1.5 a day) the incidence of poverty has fallen from 46 percent in 1992/93 (first household survey) to around 32 percent in 2002/03 (preliminary results of latest survey) – a significant decline in poverty by most standards. The social indicators have improved too, but they remain among the worst in the region, and close to the average for Sub-Saharan Africa.

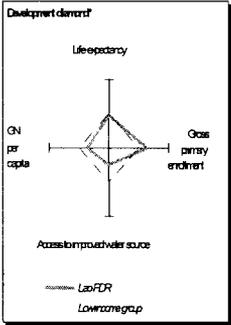
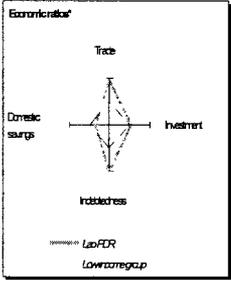
Lao PDR has a population of around 5.7 million and a land area of 236,800 square km. It has significant natural resources like forestry, minerals and hydro-electric power. Agriculture is the major sector contributing 51 percent of GDP and employing 80 percent of the labor force; the industrial and service sectors account for the rest (23% for industry and 26% for services). Landlocked, Lao PDR is in the center of the Mekong region, bordered by Thailand, Vietnam, Southern China, Cambodia and Myanmar, with the first three growing rapidly.

Lao PDR has grown strongly and reduced poverty significantly 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 – and exports grew at around 15 percent a year. Agriculture grew rapidly as did industry and services. Donors provided considerable financial and technical support; in 2002/03, donor-funded programs accounted for 7 percent of GDP, 39 percent of total public expenditure, and 61 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, farmers were allowed to work on their plots, the exchange rate system was unified, government's monopoly on trade removed, the number of state-enterprises reduced, and 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 in early 2004 to the National Growth and Poverty Eradication Strategy (NGPES). 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 those goals.

Table 1. Lao PDR, EAP and Lao-income World: Comparing Development Indicators

	Lao PDR	East Asia & Pacific		Low Income	
		1998	1998		
POVERTY and SOCIAL					
2003					
Population, mid-year (millions)	57	1,055	2,310		Development cluster 
GN per capita (Abstract US\$)	30	1,000	400		
GN (Abstract US\$ billions)	18	2,011	1,028		
Average annual growth 1999-03					
Population (%)	23	10	19		Economic cluster 
Labor force (%)	23	11	23		
Most recent estimate (latest year available, 1997-03)					
Poverty (% of population below national poverty line)	39	-	-		
Urban population (% of total population)	21	40	30		
Life expectancy at birth (years)	55	69	58		
Mat mortality per 1,000 live births	87	32	82		
Child malnutrition (% of children under 5)	40	15	44		
Accession to power source (% of population)	37	76	75		
Literacy (% of population age 15+)	34	10	39		
Gross primary enrollment (% of total population)	115	111	92		
Male	123	112	99		
Female	108	111	85		
KEY ECONOMIC RATIOS and LONG TERM TRENDS					
GDP (US\$ billions)	1998	1998	2002	2003	
Current account/GDP	13	18	20		
Exports of goods and services/GDP	215	-	-		
Current account/GDP	-78	-	-		
Interest payments/GDP	03	06	06		
Total debt/GDP	1485	1457	1388		
Total debt service/exports	84	-	-		
Present value of debt/GDP	-	-	782		
Present value of debt/exports	-	-	-		
(Average annual growth)					
GDP	48	61	50	50	
GDP per capita	20	36	26	26	
Exports of goods and services	-	-	-	-	

Source: World Bank, Economic Indicators of Development, 2004

ECONOMIC MONITOR – NOVEMBER 2004 – Covers the last six months. The Lao PDR Economic Monitor (the 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). The Monitor is prepared by Somneuk Davading (Economist) and Alessandro Magnoli (Country Economist), under the overall supervision of Kazi M. Matin (Lead Economist, South East Asia). We would like to thank Renuka Vongviriyatham and Amanda Carlier for their inputs and to Khun Ruangrong Thongampai for formatting the Monitor. We are also grateful to the Government and the donors for providing information and other inputs, as well as for sharing their views with the team. 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.

TABLE OF CONTENTS

INTRODUCTION	1
PART I – RECENT ECONOMIC DEVELOPMENTS	1
1.1 THE MACROECONOMIC SITUATION	1
PART II – STRUCTURAL REFORMS	6
2.1 PUBLIC EXPENDITURE POLICY AND MANAGEMENT	6
2.2 REFORM OF STATE-OWNED ENTERPRISES	8
2.3 FINANCIAL SECTOR REFORM	11
2.4 TRADE REFORM	13
2.5 PRIVATE SECTOR DEVELOPMENT	17
PART III – DONOR ASSISTANCE TO THE REFORM AGENDA	19
3.1 PUBLIC SECTOR GOVERNANCE	19
3.2 REFORM OF STATE OWNED ENTERPRISES	21
3.3 FINANCIAL SECTOR REFORM	21
3.4 TRADE REFORM	22
3.5 PRIVATE SECTOR,	23

Figures

Figure 1. GDP Growth (%) and CPI (%)	2
Figure 2. Food and Non-food CPI (%), 2003-04	3
Figure 3. Decomposition of Non-Food CPI	3
Figure 5. Lao exchange rate, 2003-04	5
Figure 6. Lao Exports and Imports (US\$ m)	15
Figure 7. Exports of Major Commodities (US\$ m)	16
Figure 8. Imports of major commodities	16
Figure 9. Quarterly imports of major commodities, 2003-04 (share in total, %)	16
Figure 10. FDI in Lao PDR (US\$ m)	18
Figure 11. FDI by sector, 2003/04	18
Figure 12. Approved FDI by country (US\$ m)	19

Tables

Table 1. Lao PDR, EAP and Lao-income World: Comparing Development Indicators	2
Table 2. Government Revenue	5
Table 3. Government expenditures	7
Table 4. Government expenditure for four key factors	7
Table 5. Water tariff changes in Vientiane, 2004	10
Table 6. Electricity tariff changes, 2004	10
Table 7. Changes in AFTA – Categories	15

Annexes

Box 1. GOL Actions to Improve Public Expenditure Management	27
Box 2. GOL Actions on SOE Reform	27
Box 3. GOL Actions in the Banking Sector	28
Box 4. GOL Actions towards Trade Promotion	29
Box 5. GOL Actions to Improve Private Investment Climate	30

ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank	MOIC	Ministry of Information and Culture
AFTA	ASEAN Free Trade Area	MOFA	Ministry of Foreign Affairs
ASEAN	Association of Southeast Asian Nations	MOJ	Ministry of Justice
APB	Agriculture Promotion Bank	MOH	Ministry of Health
BCEL	Banque Pour Le Commerce Extérieur Lao	MOUR	Memoranda of Understanding
BOL	Bank of Lao PDR	NA	National Assembly
BOP	Balance of Payment	NPL	Non-Performing Loan
BPKP	Bolisat Phattana Khet Phoudoi	NPV	Net Present Value
BPO	Business Promotion Office	PM	Prime Minister
CEFT	Common Effective Preferential Tariff	NSC	National Statistical Center
CIC	Committee for Investment and	PEM	Public Expenditure Management
COCI	Cooperation	PER	Public Expenditure Review
CPC	Committee of Culture and Information	PIP	Public Investment Plans
DDFI	Committee for Planning and Cooperation	PMO	Prime Minister's Office
DOL	Department of Domestic and Foreign	PPIAF	Public Private Infrastructure Advisory Facility
	Investment Management	PRF	Poverty Reduction Fund
DONLUPAD	Department of Land Use Planning and	PRGF	Poverty Reduction and Growth Facility
	Administration	RMFC	Rural Micro Finance Committee
CPI	Consumer Price Index	SAMD	State Assets Management Department
EAP	East Asia & Pacific	SCB	State-owned Commercial Bank
ECC	External NPL Collection Committee	SIDA	Swedish International Development
EDL	Electricité du Lao		Association
EU	European Union	SOE	State-Owned Enterprise
FDI	Foreign Direct Investment	STEA	Science, Technology and Environment
FINNIDA	Finland International Development		Agency
	Association	TOR	Terms of Reference
FMAC	Financial Management Adjustment Credit	UNDP	United Nations Development Programme
FMCB	Financial Management Capacity Building	WASA	Water and Sanitation Authority
	Credit	WB	World Bank
FRP	Financial Recovery Plan	WTO	World Trade Organization
FY	Fiscal Year		
GDP	Gross Domestic Product		
GOL	The Government of Lao PDR		
GTZ	German Agency for Technical Cooperation		
HIPC	Highly Indebted Poor Country		
IMF	International Monetary Fund		
JICA	Japan International Cooperation Agency		
LDB	Lao Development Bank		
LMB	Lao Mai Bank		
LNCCI	Lao National Chamber of Commerce and		
	Industry		
LTA	Lao Tourism Authority		
LTC	Lao Telecom Company		
LXB	Lane Xang Bank		
MAF	Ministry of Agriculture and Forestry		
MCTPC	Ministry of Communication, Transport,		
	Post and Construction		
MDG	Millennium Development Goals		
MIH	Ministry of Industry and Handicraft		
MOAF	Ministry of Agriculture and Forestry		
MOC	Ministry of Commerce		
MOE	Ministry of Education		
MOF	Ministry of Finance		

INTRODUCTION

In 2004, economic performance has improved further: real GDP growth is expected to strengthen to 6 percent and headline inflation, to fall to just below 10 percent. Core inflation has been in single digits throughout this year, after spiking in the middle of last year. The current account deficit is likely to widen to around 8 percent of GDP in 2004 as a result of higher world prices of oil and higher investment imports, but projected inflows of foreign assistance and of are adequate to finance it. Agriculture has recovered as indeed has tourism, the latter from the downturn last year due to SARS. Private investment is enjoying a revival, especially due to foreign investment in mining and hydro-power. Exports are growing robustly. Poverty continues to decline.

Regionally and internationally, the prospect and potential of Lao PDR is being increasingly recognized. For the first the country is hosting the 10th ASEAN Summit (November 29-30, 2004) in Vientiane, which is attended by ASEAN member-states and dialogue countries, namely China, Japan, Republic of Korea, India, Australia and New Zealand. The World Trade Organization (WTO) completed the first Working Party meeting in Geneva in October on the Lao's accession to the WTO and the US Congress approved in late November Normal Trade Relations (NTR) for the country thereby expanding its access to the US market.

Domestically, reforms have continued during the period under review, even if at a somewhat uneven pace. Various measures have been implemented in respect revenue-collection, public expenditure management, state-enterprises, banking, trade and private sector development.

In addition, the National Growth and Poverty-Eradication Strategy (NGPES) is being implemented, though at a slower pace than was planned. The Government completed a workshop in October, with participation from sector ministries and provinces, to discuss methodology and process for costing the proposed public spending programs in the Strategy. The next steps are to complete an initial costing, compare the resulting resource-needs for achieving the NGPES-goals with the current size of available financing, discuss with donors the availability of additional resources, and finally prioritise the public spending interventions. The resulting prioritized medium-term public expenditure program will be an input into the next National Socioeconomic Development Plan (NSED, 2006-10), which is expected to be merged with the NGPES process and document¹.

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-enterprises, forestry, trade and private sector has contributed to this improvement. During the 2000-03 period, inflation has averaged 15 percent and GDP growth averaged around 5.6 percent annually. The 2002/03 revenue shortfall and the pick-up in inflation in the first half of 2003 has been addressed by the Government.

Growth remains strong and buoyant. In 2004, real GDP growth is estimated to be 6.0 percent as a result of higher private and public investment, a recovery in tourism, and robust export performance (fuelled by growth in China, Vietnam and Thailand as well as faster world trade growth³, including EU) .

¹ The Government announced, at the September donors' Roundtable Meeting (RTM), that it will merge the NGPES with the next NESDB, and have a single process and document for the Government's growth and poverty-reduction strategy.

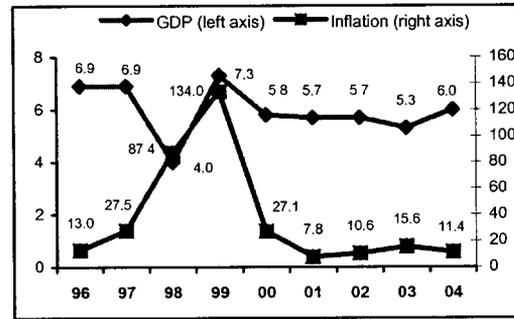
² After a year's delay, all seventeen specific reform actions for the release of the Financial Management Adjustment Credit (FMAC) second tranche have been completed.

³ Despite the sharp rise in oil prices, the volume of world trade is likely to grow by 8.5% in real terms by the end of 2004, a significant improvement over 2003, according to the WTO's latest International Trade Statistics report. For more information: http://www.wto.org/english/news_e/pres04_e/pr386_e.htm

Rising oil prices may dampen this momentum.

Higher oil prices are estimated to raise Lao's import bill by 3 percent of GDP and raise domestic petroleum prices; inflation is likely to be higher and thus prices nearly sharp rise in world oil prices is likely to have a net negative effect on the Lao economy. As Lao PDR is an oil importer, it might suffer an income loss and hence cut aggregate domestic demand; structural rigidities could exacerbate adjustment costs in the form of temporarily higher unemployment of labor and other resources. Inflation might rise; the extent and duration of the rise will depend on whether labor market rigidities and macroeconomic conditions will lead to a price-nominal wage spiral. The real exchange might slightly depreciate.

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



Source: Lao authorities and WB staff estimates.
* CPI 2004 is an average of the first nine months only.

In 2005, though world growth and regional growth is projected to slow relative to 2004 (it will be still higher than in 2003), GDP growth in Lao PDR is likely to exceed that of 2004, due to a projected jump in foreign investments in mining and hydro-power, continued strong export performance from mining, and stable agricultural, manufacturing and tourism growth.

Agricultural growth has been stronger in 2004 at around 3 percent. Earlier this year, the bird flu outbreak inflicted losses on the poultry farmers: nearly 150,000 poultry birds were lost, for 3.8 billion Kip (GOL estimate). According to a Ministry of Finance compensation proposal, farmers could receive 20 percent for poultry that died, and 30 percent for poultry lost to government culling. The Ministry of Finance proposal also suggests banks could extend loan terms for poultry farmers unable to meet repayment terms. Inefficiencies in the rice supply chain, and weaknesses in the rural financial sector (farmers are unable to obtain credit), caused problems with irrigation systems and difficulties in obtaining fertilizer. As a consequence, dry-season rice cultivation occurred on only 75 percent of the targeted area; thus the harvest output figure is expected to be below target. In some areas farmers have switched to producing non-rice crops during the dry season, such as corn, beans and egg-plants, for which production costs are lower. In April - May 2004, Lao PDR received sufficient rain for wet-season rice planting to begin in most provinces. To develop the rubber sector, the Chinese government pledged aid worth Rmb30m (US\$3.6m). Laos currently produces little rubber, but demand for the commodity in China is high, and Chinese firms are increasing their investment in the rubber sector in Oudomxay and Phongsaly provinces.

Industry is growing fast too. In 2004, the industrial sector has surged at an estimated rate of 10 percent. Investments and exports from mining and hydro-power projects have contributed to this performance. Mining is enjoying rising foreign investment, following the success of the Sapon mine, an Australian-company backed project, and inflow on this account has been high in 2004 and is expected to continue. On the manufacturing side there are concerns that the phasing out of the Multi-Fibre Arrangement (MFA) by end-2004 under the Agreement on Textiles and Clothing⁵ will undermine garment exports. This impact is hopefully going to be partly ameliorated by the US Government granting of normal trade relations (NTR) status; the Congress has just approved the NTR and it is expected to be signed by the President soon. Construction activity is benefiting by the rising number of infrastructure development projects, particularly road, bridge, and power generation building.

Services are recovering. In 2004, service sector growth has improved (at about 7.6 percent) after the 2003 slow performance. In the first quarter of 2004, according to figures issued by the Lao National Tourism Authority (NTA), foreign tourist arrivals reached 200,650, representing a year-on-year rise of 9.3 percent; while fewer European tourists visited Lao PDR, arrivals of regional tourists (mainly China, Singapore and Vietnam) rose by 13 percent. The NTA is projecting that, in

⁴ Laos has until 2008 to lower tariffs to below 5%, and reductions are taking place each year.

⁵ From 2005 onwards garment exporters in WTO member countries will no longer be subject to export quotas.

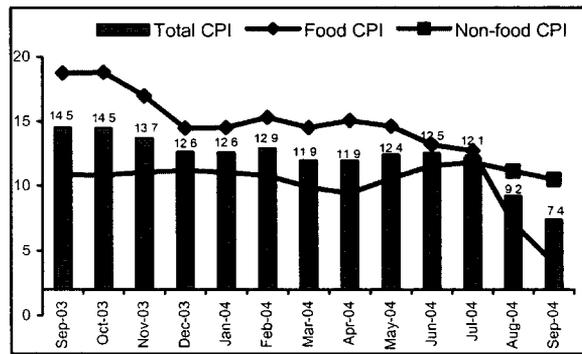
⁶ From 2005 onwards garment exporters in WTO member countries will no longer be subject to export quotas.

2004, around 747,000 foreign tourists will visit Laos, earning foreign exchange of around US\$105m. Yet, the tourism industry is not fully achieving its potential because of the effects of the 2003-04 outbreak of bird flu and Severe Acute Respiratory Syndrome (SARS), and heightened security concerns (a number of travel advisories by Western governments warned visitors of potential political instability). In other areas of the service industry, the outlook is mixed. The telecom services continues to grow as telephone penetration rates rise. Demand for trade-related services is increasing as merchandise export growth strengthens, but growth in financial services remains slow because of the continued weakness of the banking sector.

Inflation has been declining for most of this year. In the last six months of 2004, year-on-year headline consumer price inflation has decreased from about 12 percent in the first quarter of 2004 to a single-digit level in the third quarter of the year (i.e. 7.4 percent in September, see figure 2). This is notwithstanding the rise in petroleum prices. Food prices have fallen the most since the beginning of 2004, especially in the last two months. Non-food CPI has fallen much less, in part because of rising petroleum prices (diesel & petrol prices rose by 4-5.5% in June)

Decomposing inflation. The CPI is composed by nine components, of which six are the most relevant, together accounting for 86.2 percent of the total CPI. These are: 1) food (which constitutes the 46.2 percent of CPI); (the rest are part of the non-food CPI) 2) transport and telecommunications (17.9); 3) household goods (8.1); 4) beverage and tobacco (6.4), 5) housing (3.8); and 6) medical care (3.8).

Figure 2. Food and Non-food CPI (%), 2003-04



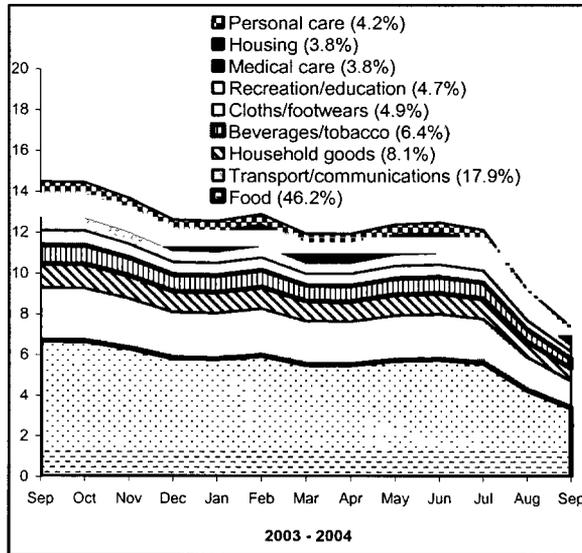
Source: Lao authorities and WB staff estimates

- The twelve-month CPI for food averaged 15 percent, and peaked at 18.8 percent in October 2003. Rice prices were on the rise, because of strong demand from Thailand. After a sharp decline in the Fall of 2003, month-to-month food CPI resumed growth, in early 2004 – it did not resume falling until May and then fell most sharply in August and September 2004.

- The non-food CPI dipped in April 2004, rose for the next few months until July and then fell over the next few months as figure 2 shows. The behavior of some of its components are as follows:

- *Transport & telecommunications (17.9).* The CPI for transport & telecommunications, after peaking at 18-19 percent in March-May04 due to higher oil prices, decreased in April to about 6 percent showing that month-to-month changes are declining.

Figure 3. Decomposition of Non-Food CPI (% change)



Source: Lao authorities and WB staff estimates

- *Household goods (8.1).* Household goods prices have gradually declined to about 6 percent after peaking in early 2003.

- *Beverage and tobacco (6.4)*. The prices of beverages and tobacco increased from about 1 percent in January 2003 to 11 percent in February 2004, as a result of higher GOL taxes. However, in March and April 2004 prices have been declining (to 9.9 percent in April 2004).
- *Housing (3.8)*. The prices of housing also decreased during the rainy season (to 20 percent in April 2004) after peaking to 85-90 percent during the last dry season (November-April 2003). However, in terms of percentage changes, month-to-month CPI has been rising, from an average of 1.5 percent throughout 2003 to 2.5 percent in April 2004.
- *Medical care (3.8)*. Costs are rising: while it is possible that SARS and the avian flu played a role, medical care prices in Lao PDR are on the rise – and will keep rising while the health care system gets upgraded. Health services in Laos are getting rapidly upgraded from very rudimentary to fairly sophisticated. The availability in Thailand of a wide variety of medical services has been a major driver in this race to modernize. The costs of some of the new machines and lab facilities are many times greater than what was previously available in Laos. In terms of percentage changes, the medical care CPI is growing, with some seasonality in the month-to-month numbers (last April it increased, in November and in December it rose again, to peak in March 04). From February to April 2004 the month-to-month growth rate more than doubled – from 1.2 to 2.5.

Nominal exchange rate has been stable over this period. In 2004 the Kip has fluctuated slightly against the US Dollar and the Thai Baht (between plus and minus one percent, except a 1.5 percent depreciation against the US Dollar in August), but overall remained stable. Indeed, in the first nine months of 2004, the Kip has depreciated 2 percent against the US Dollar and was largely stable against the Thai Baht.

The real exchange rate remained relatively stable in 2004, and foreign-exchange reserves rose to about \$220 million, covering more than 4 months of imports.

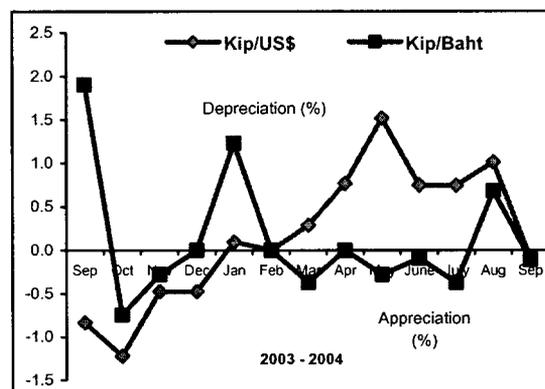
Fiscal position remains fragile. Public spending on wages and on non-wage recurrent spending, especially on social sectors, are compressed. Revenue is down by nearly 1.5% of GDP relative to 2001/02 levels, largely due to lower timber and non-tax revenues. The state-owned commercial banks (SCBs) are still weighed down by a significant share of non-performing loans, in part due to provincial arrears to borrowers.

Revenue performance has improved slightly this year. Nevertheless, the revenue-collection situation remains below potential. After falling sharply in 2002/03, the share of total government revenue in GDP rose modestly from 11% in 2002/03 to 11.2% in 2003/04. The actual increase is much larger for tax-revenues excluding timber royalties – they rose from 8.1% to 8.9%, due in part to higher rate of petroleum taxes and to part to better collection effort from the provinces.

To raise revenue-collection towards its potential, the government has taken some limited actions. The center has initiated steps to establish greater control over the seven main international checkpoints, with other to follow later. The key steps included enhanced supervision of the checkpoints by visiting headquarter teams, transfer of authority over the staff at the checkpoints to the Customs Department, and the deposit of revenues into central government accounts.

The new implementing regulations for Presidential Decree 01 on tax incentives provides greater control by the center over the granting of exemptions. While the new Investment Law also permits tax holidays and import duty exemptions for investors, new implementing regulations are expected to provide more specifics as to how such allowance will be applied in practice.

Figure 5. Lao exchange rate, 2003-04



Source: Lao authorities and WB staff estimates

Table 2. Government Revenue

	2002/03	2003/04
		est.
	(billion Kip)	
Revenue & Grants	2,789	3,267
Tax and non-tax revenue	2,336	2,775
Tax Revenue	1,919	2,325
Non-tax Revenue	417	450
Grants	453	493
Other (asset sales, amort.)		
	(percent of GDP)	
Revenue & Grants	13.2	13.2
Tax and non-tax revenue	11.0	11.2
Tax Revenue	9.1	9.4
Non-tax Revenue	2.0	1.8
Grants	2.1	2.0
Other (asset sales, amort.)		

Source: Lao authorities and IMF

⁷ To address the revenue shortfall, in May 2003, the authorities implemented new revenue and expenditure measures. In particular, petroleum taxes raised by 17 percent (effectively doubling the tax rate – this is expected to bring in additional revenue of 0.6 percent of GDP annually). However, while complying with the ceiling on bank credit to the government (see below), significant budget arrears were accumulated, on top of the stock of arrears that existed before. About two-thirds of these arrears is planned to be cleared by the end of 2003/04, mainly by the issuance of debt clearance bonds. This will also settle Government's obligations to the contractors who in turn had overdue obligations to the SCBs, thereby supporting bank restructuring.

Nevertheless, more vigorous reform efforts are needed. Weak technical capacity of the revenue administration, a highly decentralized revenue administration, in which provinces have weak incentives to collect and remit revenue to the national budget, especially surplus-revenue government's desire to promote investment by providing tax-exemptions, are factors that undermine the realization of the full revenue potential of Lao PDR.

Monetary policy is still cautious. In 2004, cautious bank lending practices by BOL continued in an effort to stem increases in non-performing loans (NPLs). Additionally, the BOL has used indirect monetary instruments, such as the issuing of bonds. In 2004, broad money (M2) growth is expected to drop to below 20% year on year in 2004-05, from 20.1% in 2003. The central bank will probably continue to use indirect monetary instruments, such as the issuing of bonds, rather sporadically. The attractiveness to domestic investors of coupon rates offered with bond sales is unlikely to improve, given the high rate of inflation that has reduced real interest rates. Commercial bank deposit rates rose sharply from 6% in November 2003 to 13% in the following two months before dropping back to around 8% in March. Deposit rates, however, are still far below lending rates, which remain around 27%.

PART II – STRUCTURAL REFORMS

The Government of Lao PDR revived implementation of structural reforms in 2001, to improve the management of public expenditures and state-enterprises (SOEs), enhance transparency of state-owned banks (SCBs), and achieve better natural resource management, especially forestry management. The key objectives of the reform process were reducing waste and enhancing efficiency, as well as increasing the transparency and accountability of public resource use. If future increases in revenue from mining and hydro-power are to be used for improving social outcomes instead of financing losses of SCBs and SOEs, financial improvements in banks and state-enterprises were key to better use of all public resources. In addition, the Government was continuing its reforms in the areas of trade and in private sector development, aimed at completing the transition to a market-economy, that Lao PDR had initiated more than a decade ago.

This part of the Monitor records the actions taken in these areas during the last six months of 2004 (see the Boxes in the Annex for the actions that were taken in 2001-2003).

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. With the share of revenues in GDP stagnating, and arrears accumulating, the spending choices are becoming more difficult and more critical, if the country's poverty reduction objectives are met. Phased payment of arrears is needed, as indeed, a better balance between recurrent and capital expenditure. Social spending needs to be made more efficient and certainly protected. More effective public expenditure management processes will be useful to ensure that the decisions are taken through accountable and transparent processes, and the allocations reach their destinations.

Public expenditure policy. In order to reduce the imbalance between capital and current expenditures, the Lao government increased current expenditures by 2 percent in 2003/04 as share of the total spending and by 0.6 percent as share of GDP. The share of salaries and wages went up slightly by 1 percent, from 17 percent to 18 percent. The capital spending dropped by 5 percent, from 59 percent to 54 percent in the same period. As percentage of GDP it declined from 11.2 percent to 10.6 percent.

According to budget publications in May 2004, in sectoral terms the share of spending going to agriculture in 2002/03 was more than 11 percent of total spending, higher than before, while health and education received 15.7 percent (see Table 4).

The plan was to reduce agricultures share in total spending in 2003/04 to 8 percent and raise education by 1 percentage point; infrastructure and health were to receive similar shares. This implied that these four sectors together received a lower share than in 2002/03. Early indications are that actual spending confirms that plan. But we will not know for sure until the publication of the budget out-turn in April 2005.

Table 3. Government expenditures

	2002/03	2003/04
		est.
	(billion Kip)	
Total expenditures	4,029	4,864
Current Expenditure	1,659	2,081
O.W. Wages & Salaries	671	871
Capital Expenditures	2,370	2,633
O.W. Domestically-Financed	1,026	551
Unallocated		150
	(percent of total budget)	
Total expenditures	100	100
Current Expenditure	41	43
O.W. Wages & Salaries	17	18
Capital Expenditures	59	54
O.W. Domestically-Financed	25	11

	2002/03	2003/04
	(percent of GDP)	
Total expenditures	19.1	19.6
Current Expenditure	7.8	8.4
O.W. Wages & Salaries	3.2	3.5
Capital Expenditures	11.2	10.6
O.W. Domestically-Financed	4.9	2.2

Source: Lao authorities and IMF

Table 4 Government expenditure for four key factors

	act.	plan
	2002/03	2003/04
Overall Public Spending	100.0	100.0
Central	55.3	67.3
Provincial	44.7	32.7
Agriculture	11.5	7.9
Central	16.7	39.9
Provincial	83.3	60.1
Recurrent	4.5	5.7
Capital	94.6	93.1
Infrastructure (MCTPC)	22.3	22.6
Central	50.6	62.5
Provincial	49.4	37.5
Recurrent	0.7	0.6
Capital	98.2	98.4
Education	9.9	10.5
Central	44.0	50.8
Provincial	56.0	49.2
Recurrent	28.5	26.4
Capital	61.0	64.9
Health	5.8	5.2
Central	32.0	44.7
Provincial	68.0	55.3
Recurrent	17.8	18.4
Capital	79.6	79.2
Total Four Sectors	49.6	46.3

Source: Official Gazette 2004, MoF

Public Expenditure Management

The Government has been implementing its existing program and developing a more comprehensive *Public Expenditure Management Strengthening Program (PEMSP)*.

Several actions were taken during the period under review. This included implementation of the new chart of accounts, classifying by administrative units, updated the register of bank accounts, and completed a survey of arrears. The Treasury has agreed to a IMF Treasury Advisor and has hired a national consultant to help with treasury reform implementation. For earlier measures taken please refer to the Annex – Box 1.

2.2 REFORM OF STATE-OWNED ENTERPRISES

BACKGROUND

Recent Trends. 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 number of SOEs today are fewer, but more importantly, they play a significantly smaller role in Lao's economy in terms of its share in GDP and in its 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 banking sector and ultimately needs to be funded by Government revenue.

The Government's recent SOE reform program initiated in 2001 has three thrusts: (a) improving transparency and governance of state enterprises, (b) restructuring those enterprises which have caused losses to the state and banks, and (c) rationalizing the regulatory and pricing environment for infrastructure SOEs, through tariff reform. Progress over the last three years has been uneven. Good progress was made in late 2003 and early 2004 in preparing SOEs restructuring plans to return key loss-makers to commercial viability, in monitoring the performance of all SOEs and identifying those for liquidation/sale or restructuring. Subsequent progress in implementing these plans has been limited. The Government now needs to move the SOE reform program beyond plans into actions on the ground.

Actions Taken for SOE Reform in 2004 (April-September)

After making significant progress in stemming losses and in developing detailed restructuring plans by early 2004, the actual implementation of SOE restructuring has slowed. The challenge is now to build on that progress, and donors support for continuation of SOE reforms is helpful. The World Bank places high priority on supporting the Government to implement the agreed SOE reform program. The progress so far has been limited and are described briefly below:

Ongoing Restructuring of 4 large SOEs. Following approvals of the detailed time-bound restructuring plans (December 2003) for Lao Airlines, BPKP, Pharmaceutical Factory No. 3, and Nam Papa Lao, the ad option of those plans through Prime Ministers decision and the subsequent Implementing Guidelines/Instructions issued by BPD to all relevant agencies (April 29, 2004), GOL has set up the "restructuring committees" in each of the four SOEs to oversee the implementation of restructuring plans.

- **Lao Airlines.** The government is seeking a joint venture partner for Lao Airlines and wants to complete this process as soon as possible in order to minimize the continuing accumulation of losses. Discussions are underway with a regional airline.
- **BPKP.** The revaluation of assets and liabilities of non-core businesses has been completed and assets of one of the non-core activities, i.e. sea transport business with two vessels have been leased out to firms in Vietnam. Other non-core assets like hotels are being negotiated for sale: one hotel in Nakai negotiated for sale to NT2 project, which wants to turn it into an office and the other two hotels in Paksan and Thakhek are under negotiations for sale with private investors. The tourism centre is reported to have been separated from BPKP and is running as a separate state-owned entity.

Two core businesses, such as wood processing and construction continue to operate as before with little progress in implementing the agreed operational and financial restructuring. The financial performance of the wood processing operation is reported to have improved, largely as a result of increased logging quota from GOL this year. The

construction business is finding it difficult to compete successfully for larger contracts, and its continued viability remains in question. However independent audits expected in the coming months will provide a clearer picture.

- **Nam Papa Lao.** The company has started to implement the restructuring plan. Its performance has improved in part due to tariff increases in March and July 2004. Asset revaluation has been completed. Efforts at operational cost reduction in respect of material purchases, production and accounts receivables management are continuing. Financial restructuring with debt-equity conversion is expected to take place in late 2004.
- **Pharmaceutical Factory 3.** The revaluation of assets and accounting audit (2003) have been completed. But there is little progress on other measures: setting-up strict internal and credit control mechanisms, financial restructuring for debt servicing of existing loans and so on.

Development of Restructuring Plans for another 5 SOEs. A high level "restructuring committee" chaired by Minister of PMO in charge of SOE has been set up, based on PM Decision No.49/PMO of September 28, 2004 to oversee the restructuring work of these five SOEs (DAFI, Lao State Fuel Enterprise, Lao Export-Import Trading Company, Bridge-Road Construction Company No. 13 and Agro-industrial Development Company). The committee's vice-chairmen and members include vice-ministers of MOF, MOC, MCTPC and MOH. BPO is the secretariat of the committee. A working group for each of these SOEs has also been appointed and collection of detailed financial and operational information is in progress. It is likely that some of these enterprises will need external support to complete restructuring plans.

Tariff & Pricing Policies for Infrastructure

BACKGROUND

Most of the infrastructure services in Lao PDR -- electricity, water, telecommunications and aviation -- 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) articulating guiding principles for setting of tariffs and for changes in those tariffs. In particular, tariffs have been raised towards greater cost-recovery and policies and principles that would guide future tariffs and tariff changes have been adopted in respect of water, telecommunications and aviation, through Prime Minister's Notices approving the proposals made by MCTPC.

Having improved the cost-recovery of infrastructure pricing over the previous two years, the challenge for the Government is to continue adjusting prices in line with changes in cost i.e. to implement the explicit pricing policy and principles adopted by the respective ministries. Except for the freeze in respect of electricity price increases, other prices have been kept in line. Actions are being taken to assess whether further price increases are needed in electricity to maintain financial stability.

Water. In July 2004, GOL raised water tariffs for Vientiane Capital for second time in the year (phase 2 for July-December, 2004). Between July and December, tariffs for households and government officials have increased by an average of 23%, and tariffs for the second group i.e. commercial/industrial users while tariffs for embassies and foreign residences have been kept unchanged (see Table 5).

Table 5. Water tariff changes in Vientiane, 2004

Water users	Consumption Vol.(m3)	Before Mar-04	Mar-Jun 2004	Jul-Dec 2004	Percent change (%)
			(Kip/m3)		
Group I. Households, government offices	0 - 5	219	285	350	23
	6 - 30	292	412	526	28
	> 30	<u>336</u>	<u>546</u>	<u>706</u>	<u>29</u>
	<i>Average</i>	282	414	527	27
Group II. Commercial & industrial	0 - 10	691	899	1,210	35
	11 - 50	869	1,303	1,720	32
	>50	<u>953</u>	<u>1,811</u>	<u>2,364</u>	<u>31</u>
	<i>Average</i>	838	1,338	1,765	32
Group III. Embassies, foreign residential	0 - 10	6,184	5,260	5,260	0
	11 - 50	7,668	5,620	5,620	0
	> 50	<u>7,668</u>	<u>6,180</u>	<u>6,180</u>	<u>0</u>
	<i>Average</i>	7,173	5,687	5,687	0

Source: Lao authorities (BPO, WASA & NAM PAPA Vientiane)

Electricity. In the first half of 2004, the electricity tariffs continued to be increased by 2.3% per month for all categories of users, except for embassies and international organizations - whose tariffs are fixed in USD (see Table 5 below). However, since June 2004 the electricity tariff has been frozen, in the light of the burden of higher oil prices on consumers and producers of Lao PDR.

Table 6. Electricity tariff changes, 2004

User categories	Minimum charge	Monthly increase	Kip/month	
			Apr	May
1. Residential	650			
1-50 kw/month	-	2.3%	108	110
51-150 kw/month	-	2.3%	253	259
>150 kw/month	-	2.3%	731	747
2. Embassies, intern. organizations	4,500	Fixed	9.9 cent	9.9 cent
3. Commercial and services	4,500	2.3%	790	808
4. Entertainment	4,500	2.3%	1046	1070
5. Government offices	4,500	2.3%	675	690
6. Irrigation	4,500	2.3%	282	288
7. Industrial, handicrafts, agriculture	4,500	2.3%	607	621

Source: Electricité du Lao (EDL)

Telecommunications. This sector remains relatively open with private entry and private operation. The tariffs remain unchanged since the last increase in early 2004, but they are at levels that are profitable for private sector operation and expansion as well as for state-owned entities to not require a subsidy from the Government. Foreign investment is also coming into this sector for the provision of various services. The number of phone lines, especially cellular, continues to grow (see Box for more information on the sector).

The Lao Telecom Sector

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 - with two-thirds of this capacity 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 four providing mobile phones and only three providing fixed lines. All of them have some government ownership. The enterprises are as follows:

- (i). Lao Telecommunications Co Ltd (LTC) providing fixed line, mobile and other services; (shareholding: GOL 51% Shinawatra 49%)
- (ii). Enterprise des Telecommunications Lao (ETL) providing fixed line, mobile and other services (GOL 100%)
- (iii). Lao Asia Telecom (LAT) providing fixed line, mobile and other services; (Ministry of Defense 100%)
- (iv). Millicom International Cellular SA (MLL) providing only mobile and other services
- (v). (GOL 22% ; Millicom 78%)

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 sector investment is available and 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 thus there is need to assess the situation.

Aviation. The tariffs for Lao Airlines remained grossly below cost-recovery levels for many routes and many services, despite several revisions in the past. However, while Lao Airlines actively seeks a joint-venture partner, no changes in tariffs have been taken place.

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

2.3 FINANCIAL SECTOR REFORM

BACKGROUND

The Lao banking system is the financial sector. It is small in absolute terms, with total system assets of approximately US\$400 million, which is less than 25% of Gross Domestic Product (GDP). In the first phase of reforms in the late 1990s, Lao moved away from its mono-bank system, separating central banking from commercial banking and permitting joint-venture and foreign banks to operate in the country. In the mid-1990s, state-owned commercial banks (SCBs) had to be restructured and rehabilitated.

However, the SCBs accumulated significant non-performing loans since then. Thus restructuring those banks, improving regulation and supervision, supporting micro-rural finance and opening up the banking system have become key pieces of the current round of banking reforms initiated in 2001. The challenge is to get SCBs to run on more commercial principles, improving their lending decisions and enhancing their risk management practices. BCEL is the largest SCB. Two smaller SCBs were merged into a new SCB called the Lao Development Bank (LDB). Various changes in regulations were issued in 2001 and 2002 (see Box in the Annex). Today, the banking system comprises of three state-owned banks, including the Agriculture Promotion Bank (APB), a policy bank, three joint-venture banks, six branches of foreign banks, and one representative office. There are no domestic private banks.

Beyond the priorities of stopping losses in SCBs, resolving NPLs in SCBs and restructuring their operations on commercial lines, key next steps include developing a holistic medium term financial sector blueprint, with a ten-year vision, including a delineation of the role of private sector in the financial sector. Strengthening the legal framework and judicial capacity to enforce contracts on a fair and timely basis through a specialized commercial court is also being discussed as are improved accounting standards and practices, and building capacity of staff in central and commercial banks all part of its this round of reforms.

The Government of Lao PDR has continued its financial sector reform effort in terms of strengthening of supervision and regulation, the restructuring of state commercial banks (SCBs), and the implementation of rural-micro finance policy, strategy and action plan.

SCB Restructuring. The two state owned commercial banks (SCBs) started, in second quarter of 2004, to implement their permanent credit policies, approved by their Boards of Directors. The Banks and Financial Institutions Supervision Department (BFSD) in the Bank of Lao PDR (BOL), confirmed the SCBs' actions by issuing a notice number 172/BFSD in July 2004 withdrawing the instruction 01 and 03 that imposed restrictions on SCBs' credit activities⁸. The termination of the instruction 01, which set a notional capital for each SCB, means that SCB, whose capital is severely negative, does not have capital to operate. Nevertheless, the Bank Restructuring Committee (BRC) has advised SCBs to follow their permanent credit policies as stipulated in the Governance Agreement.

Independent international standard audits of SCBs' 2003 performance is nearing completion; available evidence suggest that while the share of NPLs in loans have been falling, including in 2003, they need to be brought down further. Special efforts will have to be made to minimize provincial payment arrears to private contractors, to improve closer and more effective BOL supervision of SCBs, to make better use of the International Banking Advisors and avoid non-commercial reasons for making loans and to strengthen measures to build capacity of SCBs.

Prudential Regulations. The BOL issued a new regulation on loan classification in May 2004. The full implementation of the new regulation is expected in 2005. Objectives of the new regulation are to ensure that banks consistently review and grade loans, properly account for unpaid interest in the profit and loss statement, adequately set aside provision expenses, and properly classify restructured loans. The BOL also issued a new regulation on the foreign currency exposure by commercial banks in September 2003. This regulation attempts to assure that banks maintain their

⁸ Key restrictions are in the area of a lending limit to a single or grouped borrower, a limit to a foreign currency exposure, a branch lending limit, and a lending restriction if SCB's NPLs exceed 15 percent.

foreign currency position within the prudential limits to avoid excessive risk, promote a maximum availability of foreign currencies at competitive rates, and allow banks to conduct business in a profitable but prudent manner. A bank unable to comply with the regulation are required to submit is the BOL a plan to reduce their foreign currency exposure within a certain timeframe. This regulation has not been enforced, awaiting the BOL to issue an instruction on the required reports and the calculation of banks' foreign currency exposure. In parallel, the BOL is reviewing a new regulation on lending limit to single or group borrowers and considering a new level of a notional capital for each SCB to allow highly insolvent banks to operate. This regulation aims to reduce credit concentration risk of banks by establishing an absolute limit on lending to single or group borrowers.

Law on Commercial Banks. The amendment to the Presidential Decree on Commercial Bank was endorsed by the Ministry of Justice (MOJ) and approved by the Cabinet. The Prime Minister's Office (PMO) will submit the amendment to the Legal Commission and the Economic Commissions of the Standing Committees of the National Assembly for their endorsement. The objective of the amendment is to lower the barriers to entry and expansion of non-state owned banks. However such objective cannot be met if a foreign bank is not allowed to open an additional branch and the language in the latest draft as of June 2004 is unclear. The latest draft also maintains a high level of the unremunerated capital reserve but the BOL will consider paying the appropriate interest for the unremunerated capital. The amendment recognizes the difference between a subsidiary, a branch, and a representative office of a foreign bank.

Rural and Micro-finance. Due to limited budget, the Rural and Microfinance Committee (RMFC) has become less active and the BFSD of the BOL has carried on actions as planned in the microfinance policy. BFSD disseminated the approved policy statement and action plan in two provinces, Borikhamxay and Champasack. Practitioners and key authorities in the provinces including the department chiefs, and district governors participated in the dissemination workshops. Further dissemination of the microfinance policy is planned for two provinces, Bokeo and Oudomxay in October and November. The draft legal and regulatory framework is being finalized. BFSD anticipates to issue the microfinance regulation by year end. Three pilot saving and credit unions were established and have been in operations, under the supervision of BFSD. Restructuring program for Agricultural Promotion Bank (APB) is awaited approval by the Ministry of Finance.

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. The objective of the regulation is to assure that banks maintain their foreign currency position within the prudential limits to avoid excessive risk and is expected to be enforced in 2005.
- Regulation No.3/BOL on lending limit to single and group borrowers is being reviewed. This will establish an absolute limit on lending to single and group borrowers and remove BOL and BFSD from approval of large loans in excess of the prudential limit.
- The draft amendment to the Decree Law on Commercial Banks was approved by BOL, the Ministry of Justice (MOJ), and the Cabinet. The objective of the amendment is to lower the barriers to entry and expansion of non-state owned banks. This is expected to be submitted to the National Assembly Standing Committee soon.
- BFSD disseminated the approved rural micro finance policy statement and action plan in two provinces, Borikhamxay and Champasack. Further dissemination of the microfinance policy is planned for two provinces, Bokeo and Oudomxay in October and November 2004.

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

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 is below 20 percent. The current tariff schedule has six tariff-rates: 5, 10, 15, 20, 30 and 40 percent, with un-weighted average tariff of slightly above 10 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. The Government has recently introduced one-stop services at customs border check-points to reduce bureaucratic procedures and provide better export and import services. Lao PDR signed a bilateral trade agreement with U.S.A. in 2003 and has recently applied for the WTO accession; the first working party meeting was held recently.

Increasing Openness. Lao PDR is increasing its openness to foreign trade and investment. The recent approval of Normal Trade Relations (NTR) by the US Congress, based on the Lao-US bilateral trade agreement (BTA) signed in 2003, means that exports from Lao PDR will have access to the largest market at the most-favored nation (MFN) tariffs, as soon as Lao PDR ratifies the BTA and US President signs the omnibus trade bill. Commitments under the ASEAN free trade agreement (AFTA), and now under the US BTA puts the country firmly on the track to integrating continuously with the region and the world. Foreign and domestic investors can invest and produce in Lao PDR knowing that they will have access to world markets and technology.

Under the US BTA, Lao PDR is committed to, among other things, removing non-tariff import restrictions on controlled products as also on potentially controllable products, allowing 100 percent market access in a dozen service sectors (such access already available in telecom and tourism), increasing transparency in all trade and procurement issues, protecting intellectual property and ensuring that the customs valuation that is used is based on the transactions value of the product.

AFTA. Similarly, under the AFTA agreement, it is committed to transferring 98 percent of the tariff-lines in to the Inclusion List (IL) and then reducing tariffs on IL products to 0-20% by 2005 and to 0-5% by 2008 i.e. reach the common external preference tariff (CEPT). This AFTA process has been ongoing in Lao PDR since 1997. On January 2004 another 432 tariff lines were added to the IL making IL coverage 84 percent of tariff lines. So far tariff-rates have been reduced to 0-20% on nearly two-thirds of the items in the IL (see Box...). Thus the average tariff for ASEAN imports is now 2 percent lower than the MFN tariff rate which is slightly more than 10 percent; however, the product-specific tariff preferences are significantly larger, ranging between 20 and 40 percent. By 2008 the average tariff-preference for ASEAN imports is expected to exceed 6 percent if Lao's MFN tariffs remain unchanged.

The challenge for the Government of Lao PDR, especially the Ministry of Commerce (MOC) and the Customs, is to get individuals and enterprises to make use of AFTA preferential tariffs. The *Certificate of Origin* Division of the Foreign Trade Department of the MOC keeps records on the usage of form D (necessary to obtain AFTA tariff rate)¹⁰ by both exporters and importers and they show that their usage rate has not exceeded 0.1 percent of AFTA imports. The problem of low-usage of AFTA preferences relative to what is available is not unique however, although it appears to be more extreme in Lao PDR. At the same time given this country's dependence on ASEAN countries for its imports and exports – which is much in excess of any other country of ASEAN – facilitating the use of form D and thus greater use of AFTA tariff-preferences, should be adopted as an important trade-promotion campaign by MOC and Customs, with annual reporting of its actual use.

¹⁰ The non-usage of the CEPT scheme seems to be due to the procedures that would be necessary to prove ASEAN origin (see item 4 in the list above). To demonstrate that a product conforms to the ASEAN rules of origin, the exporter must obtain 4 copies of a certificate—"Form D"—from the Ministry of Commerce in the exporting country. This certificate specifies the Ministry of Commerce's estimate of the proportion of ASEAN value added. One copy is kept by the Ministry of Commerce in the exporting country and a second is kept by the exporter. The other two copies are given to the importer, who keeps one and surrenders the other to the Customs Office in the importing country at the time when the goods clear customs and the duty exemptions are claimed.

Simplifying domestic processes for trade. The Government of Lao PDR has taken several other measures to promote trade and exports, including termination of levies on goods being transported, simplification of trade procedures.

- *PM Order No.12/PM of June 10, 2004 on termination of all kind of the informal inspection and collection of fees on goods and services during its transportation within the country.* The main objective of this measure is to promote domestic trade, exchange of goods and services between provinces, urban and rural areas by abolishing all informal inspections, collection of fees and penalties of goods and services by government officials along all domestic transport routes. Consequently, this would provide a more freely movement of goods and services within the country and help reduce transport costs, delivery time and other expenses involved.
- *PM Order No.24/PM of September 22, 2004 on trade facilitation (exports, imports and movements of goods and services within the country),* all relevant ministries and local authorities have been ordered to revise, amend and simplify all trade related regulations, export and import licensing procedures and implement one-stop services at each border checkpoint that currently exists. The order has also identified the government agencies the responsible for implementation and monitoring and their respective roles that are the DPM in charge of economic affairs has been assigned to oversee the implementation of this order.
- *PMO Notice 1691/PMO of October 7, 2004 provides simplified steps for export and import licensing arrangements, including free movements of goods and services within the country.* To export, the companies need to present only an invoice and a packing list to the officials at the border checkpoint (one-stop service). For the government-controlled products, a letter of request should be attached. For imports, each year importers need to prepare and present month or an annual import plan to the Trade Department in their provinces with a copy to the trade officials at the border checkpoint. After that, for each consignment of imports the relevant importer presents only an invoice and a packing list to the trade officials at the border check point for record and the imported amounts will be deducted each time from the six-month or annual plan. For importing strategic goods (controlled by GOL), importers still need an approval from MOC and other relevant ministries.

In addition, the Government of Lao PDR have been continuing its other initiatives for integration. The country received in July 2004, the first preliminary mission (a joint group from six multilateral agencies – the World Bank, IMF, UNDP, ITC, WTO and UNCTAD) to Lao PDR to build mutual understanding, create awareness of the Integrated Framework Initiative¹¹ (IF) and prepare ground work for the Diagnostic Trade and Integration Study (DTIS) for developing and promoting exports. On October 28, 2004, the Commerce Minister Soulivong Daravong led the Lao delegation to the WTO First Working Party (WP) on "Accession of Lao to WTO". The discussions went very well, with participants seeking more information on the country. Lao PDR is expected to prepare its first offers of market access for its next meeting scheduled for mid-2005.

IMPLEMENTATION OF AFTA TRADE REFORM

Lao PDR continues to implement its plans for further integration into ASEAN and AFTA. It has made progress in liberalizing trade in terms of gradually moving an increasing number of tariff lines to the Inclusion List under CEPT. The table shows the changes in number of tariff lines under each CEPT category over time. As can be seen, in 1997 when Lao PDR joined AFTA, the Inclusion List only covered 533 tariff lines, but by January 2004 it included 2,967 out of 3,551 tariff lines (or almost 84 percent of total tariff lines).

¹¹ The Integrated Framework (IF) is an initiative or program proposed to assist least-developed countries to mainstream trade priorities into their national development plans and poverty reduction strategies and to assist in the coordinated delivery of trade-related technical assistance. While trade can be a catalyst for economic growth, unless trade policy is appropriately factored into the national planning framework, the gains from trade cannot be fully materialized. In Lao PDR, main IF work is expected to start in 2005.

Table 7 Changes in AFTA – Categories

Category	Number of tariff lines					
	1997	2001	2002	2003	2004	2005
General Exception List	102	74	74	74	74	74
Sensitive List	96	88	88	78	75	75
Temporary Exclusion List	2,820	1,716	1,291	864	435	-
Inclusion List	533	1,673	2,098	2,535	2,967	3,402
Total	3,551	3,551	3,551	3,551	3,551	3,551

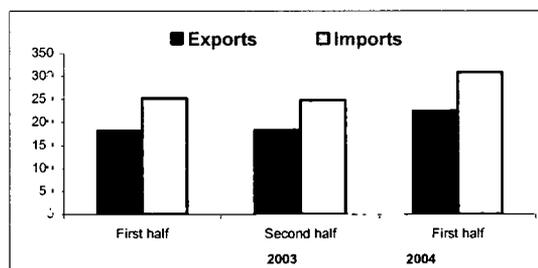
Source: Lao authorities and WB staff calculations

- (a) **Sensitive List (SL).** This category consists of 75 tariff lines (mainly unprocessed and processed agricultural products). Lao PDR has until 2015 to include these tariff lines in the Inclusion List (IL), but may consider doing it earlier. The ASEAN-6 accelerated their transfer of SL items to the IL from 2010 to 2003, which opened up some commercial opportunities. Currently, Lao PDR maintains 25 tariff lines on livestock (mainly meat of bovine animals, swine, poultry, etc.) in the SL and the tariff rates are at 30% level. To promote exports of agricultural products and get lower import duty rates from the neighboring countries, Lao PDR need to reassess this issue and make use of the opportunities. However, the sanitary and phyto-sanitary aspects would have to be carefully considered in this context.
- (b) **Inclusion List (IL).** This is category that is eligible for preferential tariffs if meet the following 4 conditions: (i) the item or tariff line must also be on the IL of the importing country (ii) the item or tariff line must also be on the IL of the exporting country (iii) if the importing country's CEPT rate for the item is 20 per cent, or less, the exporting country's CEPT rate for the same item must also be 20 per cent, or less; (iv) the importer must be able to demonstrate "origin" to the satisfaction of the Customs Department that the ASEAN content of the good, defined in terms of the share of value added originating in ASEAN countries, is at least 40 percent. In 2004, more than 90% of 2,967 tariff lines in the IL have tariff rates at 0-10% and 65% have tariff rates in the targeted band of 0-5%. Lao PDR is committed to have 98% of its tariff lines in the band 0-5% for ASEAN imports by 2008.
- (c) **General Exception List (GEL).** There are 74 tariff lines included were which 15 refer to beer, spirits, wine and other alcoholic beverages, and 13 refer to motor vehicles. The rationale for including these items in this category is unclear.

Trade Developments

In the first six months of 2004, as compared with the same period of 2003, Lao exports increased by 22 percent, or from US\$182m to about US\$225m and, at the same time, imports also went up by about 23 percent, or from US\$252m to about US\$309m (see figure 6). The growth in exports was driven mainly by garments, electricity, mining and coffee whereas the imports by machineries and equipment and raw materials for the garment industry.

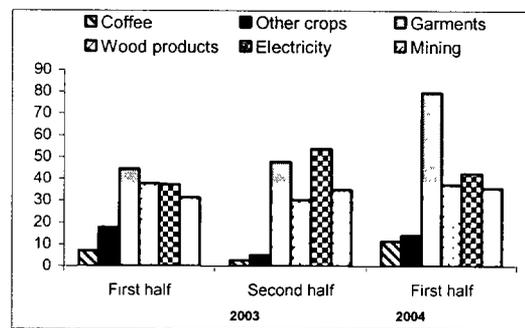
Figure 6. Lao Exports and Imports (US\$ m)



Source: The Lao authorities and WB staff estimates

Strong exports. In the first half of 2004, as compared with the same period last year, exports of electricity and mining products increased by about 14 percent (or reached US\$43m and US\$36m respectively) and surprisingly garments jumped by nearly 80 percent (or increased to US\$80m), see figure 7. Exports of agricultural products grew only at around 3 percent (or about US\$26m). Lao export markets are concentrated in a few countries ASEAN (Thailand, Vietnam), China, Japan, Australia, Korea and the EU.

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

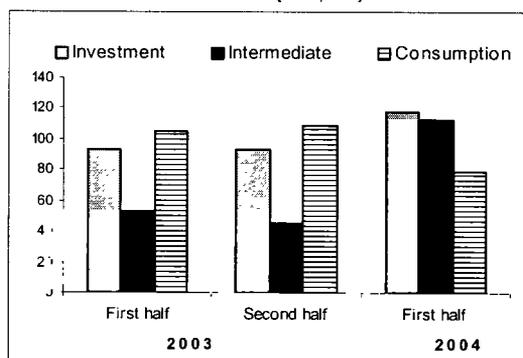


Source: The Lao authorities and WB staff estimates

Composition of Lao imports¹³. In the first two quarters of 2004, as compared with the same period in 2003, Lao imports of investment goods increased by about 26 (or from about US\$95m to US\$120m) and the intermediate went up more than double (from a bit more than US\$50m to nearly US\$120m) whereas the consume imports dropped by nearly 26 percent (from US\$106m to about US\$80m, see figure 8).

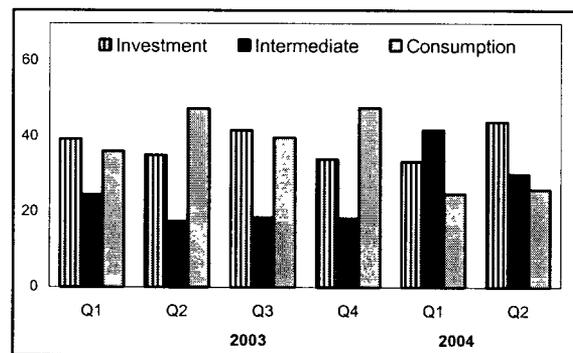
Figure 8. Imports of major commodities.

2003-04 (US\$ m)



Source: The Lao authorities and WB staff estimates

Figure 9. Quarterly imports of major commodities, 2003-04 (share in total, %)



Source: The Lao authorities and WB staff estimates

Investment and intermediate imports are rising. In early 2004, investment and intermediate goods (especially machineries, equipment and raw materials for construction, mining and garment industries) accounted for about 75 percent of the total imports. The share of investment imports increased significantly from 35 percent in 2003 (Q2) to 44 percent in 2004 (Q2). The intermediate peaked at 44 percent in Q1 of 2004 whereas the consumption remained at around 25 percent over the first two quarters of 2004, see figure 9.

In the first two quarters of 2004, 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.

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

¹³ Imports are classified into three main product categories: investment, intermediate, and consumption goods.

¹⁴ The data from the World Bank World Tables (WBWT) are identical to those in the IMF IFS CD ROM for the years for which both give data, but the data in the latest IFS CD-ROM only go back to the March quarter of 1994, whereas those in the WBWT go back to 1984. For 1999, which is the last year given by the WBWT and IFS-CD ROM, both report exports of goods of \$338.2 million. According to the latest estimates of the Lao monetary authorities, which are used in Table 3 and 3, exports of goods in 1999 were \$342.1 million. Since this discrepancy is only 1 percent, it is trivially small compared to the other discrepancies in measuring export performance.

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 all agricultural production and most of manufacturing production is in private hands; the industrial sector accounts for 5 percent of employment and state-enterprises cover only around one percent.

Nearly 97 percent of manufacturing units are small (less than 10 employees). Of the medium and large units, 35 per cent were privately owned by Lao citizens and 55 per cent were joint ventures with foreigners; the rest were 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 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 Government has been making efforts to improve the investment climate in Lao PDR and catch up with its neighboring countries in attracting foreign direct investment (FDI). In recent months, it has taken a number of measures to promote both domestic and foreign private investments and improve environments for doing business in the country.

The measures taken include:

- Domestic and Foreign Investment Laws have been recently revised by GOL and adopted by the National Assembly (NA) in October 2004. The new investment laws provide equal tax incentives and a level playing field for both local and foreign investors. The new domestic investment law gives local investors a better and fairer deal compared to the old one while they will receive incentives and other treatments the same as foreign investors. Overall, the new laws would increase transparency and simplify the investment management process and improve the investment climate in the Lao PDR if it is effectively implemented.
- PM Decision No.43/PM dated August 27, 2004 on the new procedure for registration and approvals of FDI in Lao PDR through the one-stop service. The main purpose of this measure is to create a favorable business environment and promote FDI in the country by harmonizing and simplifying registration and licensing procedures, accelerating approval process and increasing transparency. The paper classified FDI into three categories: (1) trade and consulting services, (2) investments that do not need construction of basic structures or premises, and (3) investments that need construction of basic structures or premises. In addition, the decision identified the government agencies and defined their role and responsibilities for monitoring and implementation of the measure at the central and provincial levels.

There has also been a number of other activities aimed at enhancing the public and private sector dialogue and at disseminating information on options for private sector development. In August 2004, the Lao government successfully hosted the foreign investor forum, with good participation from the government officials, foreign and domestic investors and donor community. At this forum, the Deputy PM announced new regulations to help facilitate FDI. This was the second forum held in the last few years. In June 2004, with funding from the Japanese Brain Trust Program, Ministry of Industry and Handicraft together with World Bank Institute (WBI) hosted a seminar on development of Small and Medium Enterprises in Vientiane. The essence of the seminar was to share regional experiences on the development strategy of SMEs. Cross-country lessons and experiences were drawn from Indonesia, Vietnam and Thailand. Approximately 80 participants from the GOL, private sector and international community attended the seminar.

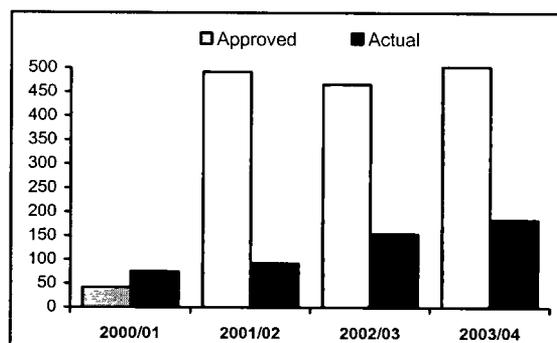
Investment Climate Survey in Lao PDR. ADB and the World Bank are working with the government to conduct a Survey of the Investment Climate. This survey will involve interviewing dozens of medium to large scale firms in the manufacturing and tourism sectors in several provinces through-out Lao. These interviews will provide an effective voice to the private sector to help shape the policy environment, by listening to entrepreneur views about the business environment and constraints to more rapid growth. This information will then be used help create a better business environment. For further information on the Investment Climate surveys please see at, inter alia: <http://iresearch.worldbank.org/ics/jsp/index.jsp>

Other pieces of analysis. These are also being undertaken to assess what more can be done to improve the policy environment. The ADB is also completing an analysis of the existing business laws, policies and procedures and that report will provide some guidance on changes needed in national policies and procedures. The World Bank Group (WBG) is also meeting with provincial governments to better understand the regulatory procedures and bottlenecks at the provincial level that businesses are struggling with. While improvements in the national policy environment is essential, provinces need to be equally supportive if the national regime is to promote investments in the provinces. Based on this review the WB hopes to work with these local authorities to streamline their procedures and build the capacity of the local authorities to support private sector development.

FOREIGN DIRECT INVESTMENT (FDI)

Overall, the actual FDI in the Lao PDR has increased remarkably over the last few years (a growth of more than 30 percent per year in average over the last three FY, 2000/01-2003/04), see figure 10. In 2003/04, as compared to 2002/03, the actual investment is estimated to increase by almost 20 percent (or from US\$150m to about US\$180m) while the approved FDI rose by about 8 percent (or from US\$466m to US\$503m, respectively). Investments in mining, hydropower and services are seen to be the main drivers for the FDI growth.

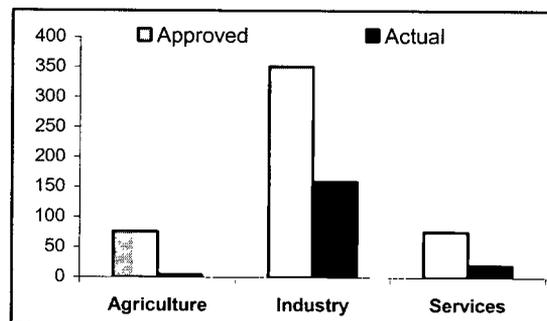
Figure 10. FDI in Lao PDR (US\$ m)



Source: Lao authorities and WB staff estimates
* Estimates for the actual, 2003/04.

FDI by Sector. In 2003/04, approved investments in the industrial sector (mining, handicrafts, wood processing) accounted for almost 70 percent of the total approvals (or US\$350m) whereas agriculture and services made up around 25 percent (or US\$76m) by each, see figure 11. In respect to the actual investments, the industrial sector (mainly mining) was estimated for about 86 percent of the total (or about US\$150m, of which mining was US\$130m or 87 percent), agriculture was around 3 percent and services - 11 percent. Traditionally, most of FDI in Lao PDR concentrated in natural resources (Hydropower, mining) and somewhat in services, very little in the agricultural sector.

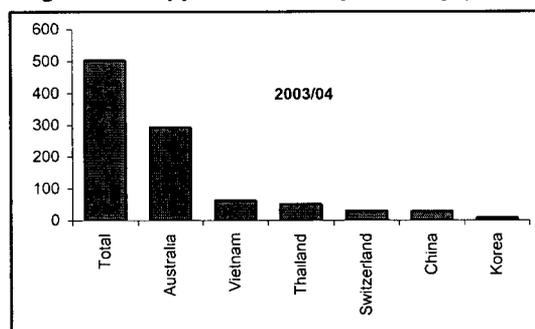
Figure 11. FDI by sector, 2003/04
(US\$ m)



Source: Lao authorities and WB staff estimates
* Estimates for the actual

FDI by Country. In 2003/04, the key countries/investors in the approvals have been mainly Australia (US\$293m), Vietnam (US\$63m), Thailand (US\$51m), Switzerland (US\$30m), China (US\$28m) and other countries (see figure 12). Although data of the actual investments by country were not available yet while this paper is being published, main investors in 2003/04 were expected to be Australia, China, Malaysia, Thailand, Vietnam, ANIEs and a few other EU member countries.

Figure 12. Approved FDI by country (US\$ m)



Source: Lao authorities

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

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

UNDP, European Union (EU), Japan, France, Sweden and the ADB are the 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.

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.

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 UNV project - UNV Support to Decentralised 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, 2001-2004). The project aims to strengthen the capacity of the Department of Treaties and Legal Affairs in the Ministry of Foreign Affairs is 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 NOSP (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 NOSP.

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.

3.2 REFORM OF STATE OWNED ENTERPRISES

World Bank (US\$0.30m)

- **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 FINANCIAL SECTOR REFORM

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.

- **Rural Finance Development Program** (US\$8.5 m, 2004). The program has four components: creating an enabling policy framework for public and private provision of rural and microfinance, creating a sound prudential regulatory and supervisory environment, transforming and restructuring the Agriculture Promotion Bank (APB) into a financially self-sustainable, market-oriented rural finance institution; creating a supportive non-prudential regulatory environment for rural and microfinance.

- **Rural Finance Development Technical Assistance** (US\$1.5m, 2004). The project loan has three components: building Bank of Lao's supervision capacity of MFIs; supporting APB to complete the risk management, accounting, and MIS components of its restructuring plan; and upgrading the ICT system of the APB.

- **Institutional Strengthening for Rural Finance** (US\$0.70m, 2004). The TA aims to coordinate and integrate rural and microfinance policy reforms and strategy implementation, carry through the policy lending phase-out plan and performance based recapitalization of APB, develop a simplified mechanism, policies and procedures for residual on-budget policy lending and assist APB to build capacity in its human resources management.

- **Catalyzing Microfinance for the Poor** (US\$1.98m, 2004). The project intends to create a Microfinance Fund to make matching grants for seed capital, equipment and capacity building in new MFIs. It will also disseminate microfinance best practice through workshops and training, and prepare TOR for a study to create a national level MFI.

European Union (EU)

EuroTAL Bank Training Project (Euro3.47m, 2003-2004). This project is the second part of the EC's support to Lao PDR and involves capacity building for the staff of the Central and State Owned Commercial Banks, supporting the SOCB's in the marketing of and developing new banking products and enabling the Central Bank to set up a Management Information System for banking supervision.

IMF

Poverty Reduction and Growth Facility- PRGF (US\$25m, 2001-2004). The PRGF is the IMF's concessional facility for low-income countries and has completed three reviews in Lao PDR since it started in 2001.

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, organisation and management and ICT development.

World Bank (US\$26.45m)

- **Financial Management Adjustment Credit – FMAC** (US\$17m, 2002-2004) has been completed and closed.
- **Financial Management Capacity Building Credit – FMCBC** (US\$9.45m, 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.

3.4 TRADE REFORM

ADB

- **Integrating the Poor in Regional Trade through Standard-Setting for Private Sector Development** - Phase II (US\$0.70 million). 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.
- **Marketing Support for the Organic Produce of Ethnic Minorities** (US\$0.60m). The TA project is designed to enhance income generating opportunities for vulnerable ethnic minorities through marketing supports for their produce. It aims to establish handicraft trade groups and develop linkages with fair trade markets, identify alternative markets for agro-forestry products through improving processing facilities, organic farming promotion and certification, and development of contract farming arrangements.

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 the WTO accession, especially on 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.

International Trade Center (ITC)

- **Support to Trade Promotion and Export Development** (US\$0.6m, 2004-2006). The TA project aims to develop national export development strategy focusing on key sectors such as garment, handicraft, coffee, medicinal herbals, wood products, rice, and fruits and vegetables. Some capacity building will also be provided to policy making bodies, supporting institutions and 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.

- **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 2004-5. 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.

World Bank

- Regional workshops and seminars on trade and poverty, to assess the impact of both China's WTO accession and regional trade integration including ASEAN.
- Study on Lao foreign trade policies, to be completed in the context of the Integrated Framework (IF) exercise.

3.5 PRIVATE SECTOR,

PRIVATE SECTOR DEVELOPMENT

ADB

- **Smallholder Development Project** (US\$12.0m, 2002). The project is designed to promote agricultural commercialization and agri-business through extension and training, and by improving access of enterprises to information and markets. The project covers the provinces of Savannakhet, Champasack and Vientiane.
- **Improving the Climate for Investment and Productivity Research** (US\$0.15m, 2004). The project will conduct 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.

- **Small & Medium Enterprise and Private Sector Development Project** (TA: US\$0.79m, 2004). The purpose is to assist the Government to develop institutional and regulatory framework for private sector development. Among others, the TA includes support for implementation of SME decree, for facilitating access to finance, streamlining investment procedure.

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:

- *Component 1:* Market-economic framework conditions (Committee for Planning and Investment - CPI). This component focuses on supporting public-private sector (investor) dialogue and follow-up action, economic performance monitoring and analysis, training of civil servants in market economy, related publications, conferences and public relations for economic reforms.
- *Component 2:* Integrated vocational education system related to economic and labor market development (Ministry of Education). The component continues efforts and reform issues from the former VETSA and BAFIS projects in creating an integrated vocational education and training system geared at labor market demand and economic development. This comprises occupational standards and curricula development, private public partnership in dual-cooperative VET, training for teachers, trainers and school managers etc.
- *Component 3:* Promotion of SME development (Ministry of Industry & Handicraft - MIH/SPEDPO). The promulgation of the SME Promotion Decree No. 42 has defined the institutional framework and focus of corresponding GOL efforts in consultation and cooperation with private sector representatives. The component will support the establishment and capacity building of the respective institutions and bodies to operationalise and subsequently implement an effective action plan.

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

SNV's private sector development program (2004). The project consists of three components including financial services and access to financial services, sub-sector intervention with focus on non-timber forestry products and ecotourism.

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** (Xieng 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** (US\$1m for phase I, 2001-2003; the phase II is under preparation). The Integrated Program for Lao PDR aims at alleviating the country's persistent trade deficit by strengthening productive capacities in the manufacturing sector. Phase one conducted sub-sectoral studies and produced medium-term strategy and action plans for industrial development in Lao PDR¹⁵.

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

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.

¹⁵ Recently produced reports are: *Composition and Evolution of Lao PDR's External Trade*; *Report on Food Processing Sector in Lao PDR: Product Innovation in the Food Processing and Packaging Sector in Lao PDR*; *Construction Materials Industry in Lao PDR: Product Innovation in the Construction Materials Industry in Lao PDR*; *Strategy for Development of the Wood Processing Industry*; *Artisan Craft Development*; *The Textile and Garment Industry in Lao PDR*; *Prospects for Further Integration of Lao PDR's Manufacturing Sector into ASEAN*; *Technical Report on the Industrial Land Development Program*; *Technology Needs Assessment in Lao PDR*; *International Experience of Promotion of SMEs: Small and Medium-sized Enterprise Development Framework*; and, *Proposal for Promotional Tools for Promotion of Foreign Direct Investment*..

LAND

World Bank and AusAID (US\$47.66m)

- **The First Land Titling Project** (US\$29m: WB-US\$20m, AusAID-US\$6m and GOL-US\$3, 1997-2003). The project fostered land-lifting and the development of more efficient land markets to strengthen social and economic development.

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.

ANNEX BOXES ON ACTIONS TAKEN IN PREVIOUS YEARS

Box 1. 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 (PrMO) 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 2. 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 BKPK 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 3. 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); 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;

- Two SCBs, Lao Mai Bank and Lane Xang Bank, were merged into the "Lao Development Bank" (LDB) and has been operating as such since the end of 2002.

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.
- International bank advisors (IBA) were recruited by BOL to assist in restructuring and strengthening SCBs. IBAs have been working with SCBs since April 2003.
- Regulation No. 6/BOL replacing Regulation No. 98/BOL on loan classification and Regulation No. 5/BOL replacing Regulation No. 178/BOL on foreign currency exposure. Regulation No.3/BOL on lending limits is amended. The amendment improves and strengthens existing prudential regulations, which are currently ambiguous. BOL are reviewing the drafts, which may be implemented in 2004.
- 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 caused by government arrears. 120 billion kip was issued in July 2003 with one-year tenure and 11% semi-annual coupon. The second lot of 120 billion kip was issued in September 2003 with two-year term and 11% semi-annual coupon.
- The draft amendment of the Decree Law on Commercial Banks was approved by BOL and is being reviewed by Ministry of Justice in early 2004.

Box 4. GOL Actions towards Trade Promotion

Measures taken in 2003

- Coverage of import and export restrictions are significant¹⁶. 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 tractors¹⁷; Cement; Steel; Jewellery; 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 ¹⁸.
- 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, 2003, 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

¹⁶ 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 to be relatively uncontroversial bans related to public safety and morals plus those related to logging & raw timber exports.

¹⁷ Licensing of vehicles is now used only mainly as a registration device as importers can import as many as they want

¹⁸ 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.

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.

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 5. 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 policy¹⁹ and inter-agency consultations on appropriate institutional arrangements.

¹⁹ 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.

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.
- 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.



THE WORLD BANK OFFICE, VIENTIANE

Patou Xay, Nehru Road
Vientiane, Lao PDR.
Tel: (856-21) 414209, 450010-11
Fax: (856-21) 414210
www.worldbank.org/laos



THE WORLD BANK

1818 H Street, N.W.
Washington, D.C. 20433
U.S.A.
TEL: (202) 473-1653
Fax: (202) 522-1560/1557
www.worldbank.org