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Lao People's Democratic Republic: 2001 Article IV Consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Staff Statement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Lao People's Democratic Republic

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2001 Article IV consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility with Lao People's Democratic Republic, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on **January 31, 2001,** with the officials of Lao People's Democratic Republic on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on April 6, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **April 23, 2001** updating information on recent developments.

- a Public Information Notice (PIN) and a Press Release summarizing the **views of the Executive Board as expressed during its April 23, 2001 discussion** of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Lao People's Democratic Republic.

The document(s) listed below have been or will be separately released.

Selected Issues and Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

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LAO PEOPLE'S DEMOCRATIC REPUBLIC

Staff Report for the 2001 Article IV Consultation and Request for A Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Prepared by the Asia and Pacific Department

Approved by Mario I. Blejer and Shigeo Kashiwagi

April 6, 2001

- Discussions for the Article IV consultation and the economic program were held in Vientiane during October 2000 and January 2001.
- The team, during some or all of the discussions, comprised Messrs. Winglee (Head), Cheunsomchit, Cook, Marciniak, Pani, and Soueid (all APD), Ms. Brunschwig (PDR), and Mr. Song (MAE). Mr. Blejer (APD) and Mr. Lathouly (OED) joined the concluding discussions. The missions were assisted by Mr. Sidgwick, resident representative, and worked closely with teams from the World Bank and Asian Development Bank.
- The missions met with Deputy Prime Minister and Minister of Finance Boun-Nhang Vorachith, Deputy Prime Minister Somsavat Lengsavad, Bank of the Lao P.D.R. Governor Soukanh Mahalath, other ministers and senior officials, and members of the donor community.
- In the attached letter dated March 26, 2001, the Government of the Lao P.D.R. requests a three-year arrangement under the Poverty Reduction and Growth Facility for the period January 2001–December 2003 (Attachment II). The government's program is described in the Memorandum on Economic and Financial Policies for 2001 (MEFP) (Attachment III), and the accompanying Interim Poverty Reduction Strategy Paper (I-PRSP) EBD/01/37).
- The authorities have agreed to the publication of the letter of intent, MEFP, I-PRSP, and joint staff assessment.
- The principal author of this report was Mr. Winglee with substantial inputs from Messrs. Cook and Marciniak.

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EXECUTIVE SUMMARY

Over the past 18 months, the Lao authorities have acted decisively to reduce inflation from triple- to single-digit levels. Monetary and fiscal policies were tightened along the lines recommended in the 1999 Article IV consultation. At the same time, distortions imposed during the high inflation period, especially limits on key prices and ad hoc trade and exchange controls, are being unwound.

With these positive results, the authorities have now requested a new three-year PRGF arrangement to solidify macroeconomic stabilization and restart structural reform, as part of their strategy, articulated in the Interim Poverty Reduction Strategy Paper, to reduce poverty through growth with equity.

Macroeconomic stabilization will be focused on raising budget revenue through administrative improvements and the introduction of a VAT in 2003, and on tightly controlling central bank credit. Stronger revenue performance together with improved public expenditure management, would allow for more socially-oriented expenditure while avoiding the need for domestic bank financing.

The structural measures will be aimed at strengthening the broad fiscal position and the banking system. State bank restructuring is a key economic reform goal to enable them to properly channel resources for productive investment and resolve their large stock of nonperforming loans. The restructuring framework is based on phased recapitalization linked to operational improvements. Bank specific plans are to be developed in consultation with the World Bank and Asian Development Bank (AsDB) by the first review of the PRGF arrangement. In the interim, state-owned commercial bank credit will be closely monitored to limit its growth and improve repayment performance, and international standard audits will be conducted. In support of strengthening public sector finances, public expenditure management reforms are envisaged, along with significant price actions on two large state enterprises to reduce the current and potential drain on fiscal resources.

The poor quality of economic statistics, especially for national accounts, external debt, public expenditure, and the balance of payments, has complicated analysis and policy formulation. In particular, poor expenditure data are a major constraint on developing a full poverty reduction program and improving governance.

The main risks to the program derive from Lao P.D.R.'s weak track record on macroeconomic stabilization policies. In particular, strengthening stabilization beyond the immediate measures will require reforming the state banks and improving the transparency of public sector finances, which previously have been difficult areas. The staff believes that the authorities' recognition of the cause and cost of the recent instability and pressures from regional integration will be a major impetus for progress. Nevertheless, close monitoring and substantial technical assistance will be needed to implement the program.

I. Background and Recent Developments

1. **Lao P.D.R. made good progress at economic reform through implementing its "New Economic Mechanism," supported by an ESAF arrangement, in the first half of the 1990s**. Growth rates averaged 7–8 percent and inflation averaged 11 percent while poverty was reduced (Box 1). However, from 1997 the reform momentum waned. Ambitious investment plans, particularly irrigation projects to achieve rice self-sufficiency, were pushed through despite domestic resource constraints and the Asian crisis. Recourse to central bank financing, given the high level of dollarization, caused inflation to skyrocket to triple digits and the kip to depreciate sharply.

2. **In concluding the 1999 Article IV consultation, Executive Directors expressed serious concern over the severe macroeconomic instability in 1998 and the first half of 1999**. They considered that key to resolving this instability were: containing central bank credit; strengthening revenue; and improving prioritization of public expenditures. Directors also stressed the critical need to revive structural reforms, especially to strengthen state-owned commercial banks (SOCBs) and banking supervision, address the problems of state-owned enterprises, and encourage private sector development. Directors regretted shortcomings in statistical data that hampered surveillance and complicated the formulation of an economic program.

3. **Recognizing the severe cost of high inflation, the authorities embarked on a strong stabilization program in mid 1999**. Over the subsequent 18 months, the authorities sustained this stabilization effort along the lines recommended by the Fund. With the success of this initial phase and with an emerging consensus for further reforms developing, the authorities have requested a new three-year PRGF arrangement with access of SDR 31.7 million (60 percent of quota). Disbursements under the schedule set out in Table 1 would increase Lao P.D.R.'s outstanding use of Fund resources from 62 percent of quota at end 2000, to 72 percent of quota at end 2004 (Table 2).

4. **With restrained credit and fiscal policies, macroeconomic performance has improved considerably since mid 1999.** Inflation fell sharply from 130 percent in mid 1999 to 9 percent in February 2001. Real GDP growth is estimated to have been about 5.7 percent in 2000, as stronger domestic demand appears to have offset the drop-off in FDI, but there is still considerable uncertainty with GDP estimates because of the poor quality of the data.[1]

[1] The authorities estimate real GDP growth in 1999 at 7.3 percent on account of the large increase in output from newly irrigated areas. Information from international agencies monitoring agricultural developments in Lao P.D.R. question the implied increase in rice production, and based on this, the Fund staff estimates that real GDP growth was about 5 percent in 1999.

Box 1. Lao P.D.R.: The Poverty Situation

Poverty Profile[1/]

Lao P.D.R. has made progress at reducing poverty in the last decade. It is still one of the poorest countries in the world with GDP per capita estimated at $252 per capita in 1998. About 39 percent of the population lived below the poverty line in 1997/98, down from 45 percent in 1992/93.[2/] High economic growth, 5.8 percent annual average—particularly in the industry sector, has been a key factor behind poverty reduction. However, the reduction was very disparate with the largest reductions in urban areas—especially Vientiane, where poverty was halved during 1992–98. Poverty incidence in 1997/98 was lower in urban areas (27 percent of poor) compared to 41 percent in rural areas. In addition, disparities across regions have been exacerbated, as the poverty gap between Vientiane (12 percent of poor) and other regions widened, especially with the Northern region (53 percent of poor) where large groups of ethnic minorities are located.

***Inequality* in Lao P.D.R. is low compared to most other Asian countries, as income levels are very low.** However, income inequality has increased, as shown by the Gini index of about 36 percent in 1997/98, up from 29 percent in 1992/93. Increased inequality provides evidence that the benefits of economic growth have not been sufficiently spread to the bulk of the population in poor rural areas.

The government in the I-PRSP identifies the main causes of poverty as: (i) a legacy of physical devastation during the Vietnam war, with unexploded ordinances still affecting half of the country's territory; (ii) weak public service delivery—especially in the health and education sectors; (iii) inadequate communication infrastructure; and (iv) shortcomings in governance. Poor road access to markets, low productivity and insufficient support services to farming, limited access to credit, and lack of a modern land framework are the main bottlenecks facing the rural poor.

Poverty Reduction Strategy

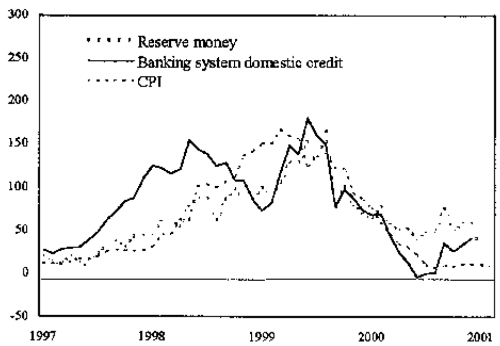
The overall thrust of the government's poverty reduction strategy is to promote sustainable growth with equity so as to graduate from the group of least developed countries by 2020. The strategy calls for implementing a wide reform agenda aimed at improving resource allocation in key sectors (e.g., financial and enterprise reforms) and fostering capacity-building and human resource development, while maintaining sound macroeconomic management. It emphasizes participation of the poor in the decision-making process, especially through a broad-based decentralization of public sector management.

[1/] Derived from the analysis of the Lao Expenditure and Consumption Surveys (LECS) conducted in 1992/1993 and 1997/98, which may not be fully comparable.
[2/] Headcount ratio showing the percentage of individuals in the population whose income (proxied by consumption-expenditure) fell below the poverty line. The poverty line has been derived as the weighted arithmetic average of food and nonfood poverty lines defined for the urban and rural areas.

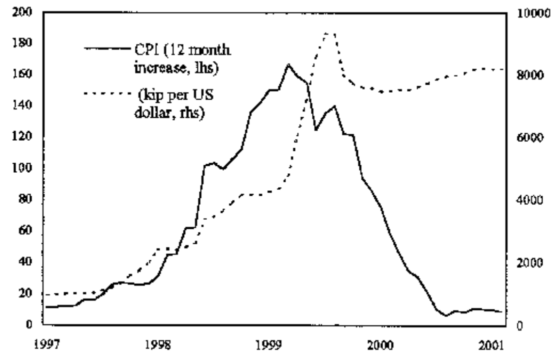
5. **Credit restraint has been central to the stabilization effort over the last 18 months**. Sharp limits on central bank financing, especially for irrigation projects, and the issue of central bank securities, were critical in reducing excess kip liquidity and bringing down inflation. Thus, Bank of Lao P.D.R. (BOL) domestic credit to the government and economy have been reined in sharply.[2]

[2] BOL credit to state-owned enterprises in 2000 increased solely because of onlending of a concessional foreign loan.

Monetary Developments, 1997–2001, (12-month percent change)

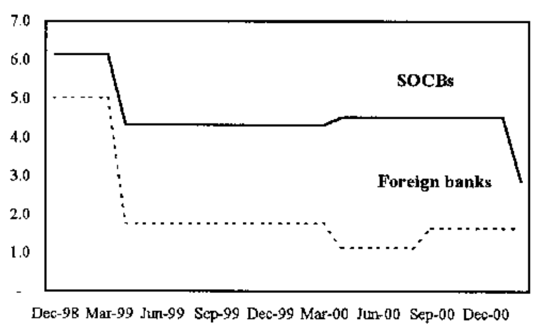


CPI and Exchange Rate, 1997–2001

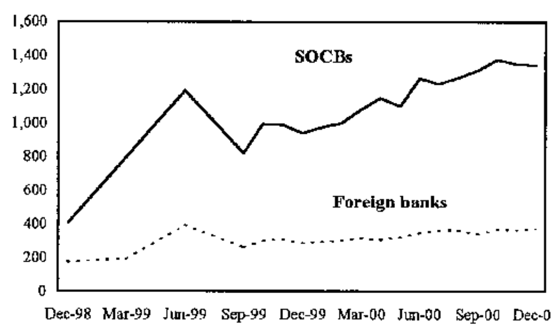


6. **Within this overall credit restraint, however, SOCB credit grew strongly putting further pressure on their portfolio quality.** After restraint in 1999, credit of SOCBs rose rapidly in 2000 (by 40 percent in U.S. dollar terms).[3] Interest rates were kept well above market levels to meet deposit mobilization goals and the rapid deposit growth, in turn, provided the opportunity to expand lending. However, part of the expanded lending might have been an attempt to improve book profits and regularize nonperforming loans when the underlying balance sheets remained weak. In February 2001, upon recognizing the greater risk to their portfolios, SOCBs reduced their rates closer to those of foreign banks.

Foreign Currency Deposit Rates, 1998–2001 (In percent)



Foreign Currency Deposits, 1998–2000 (In billions of kip)



7. **The 1999/2000 budget marked a return to more orderly fiscal management** (Table 4).[4] Revenue grew by more than 2 percent of GDP to 13 percent, as targeted. About half of this increase stemmed from better reporting of timber royalties, and the remainder mainly from strong efforts to improve tax administration, especially through developing

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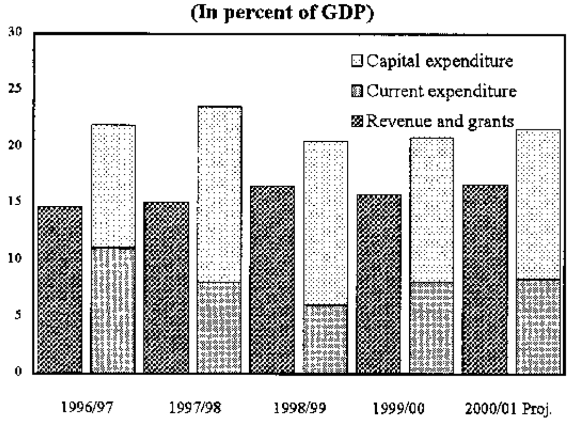
[3] About 75 percent of SOCB lending is in foreign currencies.

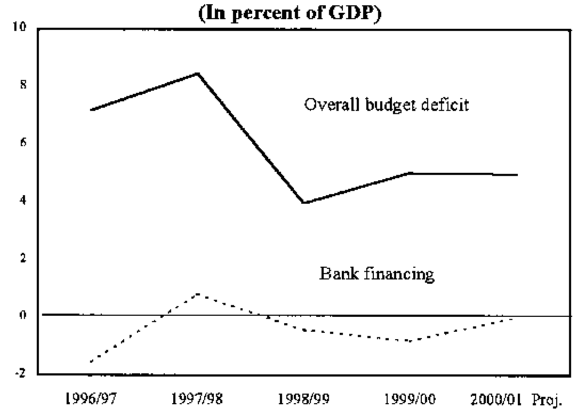
[4] The fiscal year runs October–September.

more effective procedures for the Large Taxpayer Unit, supported by FAD technical assistance. At the same time, scaling back construction projects sharply reduced capital spending in relation to GDP. This cut-back made more room for unwinding the very tight constraints on current spending, and enabled it to increase to 8 percent of GDP with additional spending in social areas, especially the payment of domestic arrears to social sector workers. Although the budget deficit increased from 4 percent to 5 percent of GDP, the disbursement of AsDB Financial Sector Program Loan II (US$11.5 million) in August 2000, enabled net banking system credit to the government to be reduced by ¾ percent of GDP. Central bank credit to the government was reduced by twice this amount.

Revenue and Expenditure, 1996/97–2000/01
(In percent of GDP)



Budget Deficit, 1996/97–2000/01
(In percent of GDP)



8. **While maintaining a flexible exchange rate system, prudent credit and fiscal policies have stabilized the rate since late 1999**. Although the rate subsequently depreciated by 9 percent against the U.S. dollar, it has remained stable against the baht (Figure 1) and the margin with the parallel market has generally remained at under 2 percent.[5] This recent stability of the kip vis-à-vis the baht has provided confidence in policies while avoiding a larger appreciation of the real effective exchange rate that could have come from tracking the dollar. Notwithstanding limited intervention for smoothing, gross international reserves increased from 2 months of prospective imports at end 1999 to 2.4 months at end 2000 (Table 3).

9. **With the return to stability, progress at structural reforms has restarted, but the agenda remains extensive**. The high nonperforming loans (NPLs) of SOCBs, where the rapid depreciation of the kip exacerbated the weaknesses of their management, are now

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[5] During mid 2000, as a result of the weakening of the baht against the U.S. dollar, the margin widened to about 4 percent with the dollar (but not the baht) for two months, as the banks gradually reset their rates, and resulted in a multiple currency practice.

starting to be addressed, and audits of the SOCBs were recently initiated. Large SOEs have made some price adjustments, especially for electricity, airfares, and petroleum, although much more needs to be done. Also, ad hoc trade and exchange restrictions, applied in an attempt to slow the depreciation of the kip, are now being relaxed.

10. **The 7th Party Congress, which took place in early March 2001, stressed the importance of economic development as the means for poverty reduction** and recognized the problems arising from attempting this through inflationary financing. In the subsequent session of the National Assembly, Deputy Prime Minister and Minister of Finance Boun-Nhang Vorachith and BOL Governor Soukanh Mahalath were promoted respectively to Prime Minister and Minister of Finance. With respect to the pace of policy implementation, the leadership continues to favor a carefully phased and market-based approach, to avoid major disruptions that could undermine the consensus for reform.

II. Medium-Term Outlook, Policy Framework, and the I-PRSP

11. **The policy discussions took place as the government was formulating its new five-year plan (2001–05), which will stress macroeconomic stabilization and poverty reduction through sustained growth with equity**. The authorities' general reform strategy seeks to adapt the experience of China and Vietnam to the Lao situation, recognizing that integration into the world and regional economies is key to achieving poverty reduction goals. In preparing the five-year plan, the authorities held extensive external discussions, conducted the Round-Table Meeting process to get inputs from donors and NGOs, and developed the Interim Poverty Reduction Strategy Paper (I-PRSP) out of these consultations.

12. **The proposed PRGF-supported program and the accompanying I-PRSP contain policy elements for sustaining macroeconomic stability and setting the stage for closely related structural policies for durable, higher growth (Box 2)**. With maintenance of macroeconomic stability, real growth is expected to reach 7 percent by 2003 (Table 6). The main impetus for growth is assumed to come from the Nam Theun 2 (NT2) hydroelectric project, which during the construction phase would contribute to about ¾ percent of GDP per year (Box 3).[6] Underlying growth would pick up moderately from a small base, in line with returning confidence in the business environment and sustained policy implementation. Inflation is expected to be reduced further to about 5 percent by 2003, with near-term inflation still significantly above trading partners, reflecting adjustments in some key prices and wages.

[6] As noted in Box 3, the World Bank is still considering its options for participation in this project. Given its enclave nature over the next 5 years, difficulties in proceeding with the project would reduce growth because of lower construction, but would not have a major impact on the overall balance of payments, the fiscal position, or the poverty strategy.

Box 2. Lao PDR: Main Elements of the PRGF-Supported Program, 2001–2003

Targets

- Raise real GDP growth to 7 percent by 2003, while reducing end of period inflation to 5 percent. To protect the external position, gross official reserves will be raised to 3 months of import coverage.

Macroeconomic policy

- ***Fiscal***: keep the overall deficit to an average of around 5 percent of GDP during 2001–2003, and protect medium-term sustainability by relying mainly on external concessional financing, and avoiding domestic bank financing.

- ***Monetary and credit***: tightly restrain credit by the central bank to government, banks, and enterprises, and restrict credit growth of the state-owned commercial banks (SOCBs) to 17 percent in 2001 to ensure low inflation and improve the loan quality of the insolvent banking system.

- ***Exchange system***: manage the exchange rate flexibility to allow for adjustment to real shocks. While keeping the margin between the bank and parallel markets to under 2 percent, adjust monetary policy to minimize exchange rate fluctuations. Continue to ease exchange system controls.

Structural agenda

- ***Fiscal reform***: continue to improve tax administration, focusing on large taxpayers in preparation for the introduction of a VAT in 2003. Improve public expenditure management, through improving the treasury system and fiscal reporting and accountability.

- ***Banking sector reform***: recapitalize the deeply insolvent SOCBs conditional on improvements in banks performance. Enhance governance, ensure the implementation of standard accounting framework, and loan classification and provisioning requirements. Improve the environment for SOCBs by phasing out directed lending, strengthening pressures for repayment, and developing bank supervision.

- ***Enterprise development***: focus on avoiding losses of key large state enterprises, initially through price adjustments, and issue the implementing regulations for the Foreign Investment Law.

- ***Trade reform***: liberalize exports as prior action, and liberalize imports in line with AFTA commitments with the removal of quantitative restrictions on a multilateral basis.

Box 3. Lao P.D.R.: Nam Theun 2 Hydroelectric Project[1/]

The Nam Theun 2 (NT2) hydroelectric project is a Build-Own-Operate-Transfer (BOOT) arrangement between the Government of Lao P.D.R. (GOL) and a private sector consortium (NTEC) consisting of Electricité de France, Italian-Thai Development, and EGCo (Thailand).

Nam Theun 2 is the largest of several potential hydroelectric projects designed to provide Thailand with 3,000 megawatts of energy by 2006 in accordance with a Memorandum of Understanding (MOU) signed between the respective governments. However, given the financial crisis in Thailand, supply levels have been revised down to provide 1,600 megawatts by end 2006, and the rest by 2008. Economic recovery and rising oil prices led to a tariff MOU being signed in August 2000 for the proposed NT2 project.

Project costs are estimated at US$1.0 billion (60 percent of GDP), to be financed through foreign direct investment comprising debt (70 percent) and equity (30 percent). The GOL will have a 25 percent equity stake in the project (US$75 million) which is expected to be financed through a combination of a grant from the partners, and concessional borrowing being explored with multilateral investment banks and bilateral donors. If required, any nonconcessional borrowing by the GOL would be determined in early 2002 as part of the final financing package. The government has requested the World Bank to support the project through an IBRD partial risk guarantee (US$100 million) and an IDA credit for the social and environmental aspects of the project. The government would provide a counter-guarantee for the IBRD guarantee; resulting in a government liability for this amount if public policy actions prevent the operation of the project.

The project will have significant macroeconomic impacts. Imports of capital goods and construction services in the construction phase (2002–06) will widen the current account deficit, to be largely financed by FDI. The construction phase of the project is likely to add about ½–1 percentage point of GDP to the growth rate. The project is expected to yield considerable export and fiscal revenues and the GOL is committed to investing these revenues in rural and human resource development programs for poverty alleviation.

The project also entails environmental and social impacts. Two independent panels have worked on these aspects—a government-appointed Panel of Social and Environmental Experts, and the Bank-appointed International Advisory Group. Both groups support Bank involvement. However, other groups have expressed concerns about its impact, especially on the environment, as well as on the Government's ability to meet its commitments.

Regarding Bank involvement in the project, the Bank program as articulated in its Country Assistance Strategy of March 1999, includes NT2 in the base case scenario. This would be triggered by a track record of improved performance in restoring and maintaining macroeconomic stability (as evidenced, for example, by agreement with the Fund on a PRGF-supported program). Additional Bank conditions have been set regarding environmental and social mitigation programs, key legal agreements, and the project financing plan. Bank management has not yet decided whether to proceed to appraisal of the project. With the signing of the MOU to provide power by end 2006 construction will need to commence by end 2002. To meet this schedule the Bank will need to decide on its approach by mid 2001 and, if appropriate, appraise the project in the first half of 2002.

[1/] Prepared by World Bank staff.

III. Macroeconomic Policies

13. **With the improving macroeconomic environment and confidence, real GDP growth is projected at about the same level as in 2000 (5.7 percent)**. Modest additional domestic investment from preparations for the NT2 project is likely to offset weaker external demand. Notwithstanding the significant state presence in the economy, it will be important for an increasing proportion of investment to come from the private sector. Inflation is expected to decline further, to under 8 percent by end 2001. With continued restrained policies, gross official reserves will be raised slightly to 2½ months of imports.

A. Monetary, Exchange Rate, and Exchange System Policies

14. **Monetary policy for 2001 has been set for continuing the gradual downward pressure on inflation**. The BOL recognizes that the high level of dollarization in the economy sharply limits the scope for central bank financing and will thus continue its policy of tightly controlling its net domestic assets. This policy is expected to limit reserve money growth to an underlying 7 percent during 2001.[7] Bank credit growth will be cut sharply to 17 percent in 2001, as SOCBs focus on strengthening their portfolios. The recent reduction in SOCB interest rates to market levels is expected to reduce inflows of deposits and constrain SOCB lending, which, together with the prohibition on lending to defaulting borrowers, should make their lending more prudent. However, given the weak state of market-based credit instruments, the authorities agreed to a ceiling on total SOCB credit as a performance criterion. The BOL will monitor individual SOCB credit growth and restrain it when the ceiling is threatened, and pressure banks to achieve a higher repayment rate. Over time, this ceiling could be removed depending on the effectiveness of actions by SOCBs to strengthen their internal controls and portfolios.

15. **The authorities consider that exchange rate stability played a crucial role in reducing inflation, both directly on prices and indirectly by restoring confidence in economic policymaking**. For this reason, while the exchange rate will be managed flexibly, the BOL would be prepared to tighten monetary policy if there was a sustained depreciation not attributable to real shocks (to be identified in conjunction with the staff), and to ensure that banks adjust their exchange rates to keep the margin with the parallel rate to under 2 percent. Development of an interbank market for foreign exchange is progressing slowly while the prerequisite greater confidence in the kip and domestic banks is built up.[8]

16. **The authorities have substantially eased ad hoc controls in the foreign exchange market**. While there are currently no identified restrictions on current payments and

[7] Reserve money at end 2001 will decline compared to end 2000, because of the netting of BOL positions in banks in January 2001 that resulted in a one-time 20 percent drop in reserve money.

[8]Reflecting their client base, the foreign banks do not have significant transactions in kip.

transfers, there has been the periodic use of informal foreign exchange rationing which is difficult to identify on an individual basis. Given the extensive use of foreign currencies, the staff considers the margin between the bank and parallel foreign exchange markets to be an indication of informal restrictions, which were temporarily evident in mid 2000. Under the program, this margin will be kept to less that 2 percent. While the BOL would work toward avoiding restrictions on current payments and transfers, the authorities could not commit to achieving Article VIII status by the end of the PRGF period because they were not sure that their macroeconomic policies would adjust fast enough to potential shocks. However, the authorities did not rule out making such a commitment as confidence develops in market-based stabilization policies.

B. Fiscal Policy and Reforms

17. **The authorities stressed that budgetary policies would continue to be framed to support macroeconomic stabilization and pro-poor expenditure**. This will be achieved by further revenue efforts, notably through improved tax administration, better management of nontax revenue sources, and the introduction of the value-added tax (VAT), tentatively scheduled for 2003. With the dedicated implementation of these measures, the authorities estimated that they could raise revenue by 2 percentage points over three years to 2002/03 to at least 15 percent of GDP (Box 4). Assuming that foreign financing continues to be in line with recent trends, a budget deficit remaining at about 5 percent of GDP would be consistent with the stabilization objectives, and the additional resources could be used for social expenditure.

18. **In 2000/01, the budget deficit is expected to remain about 5 percent, with no use of domestic bank financing**.[9] The official budget passed in September 2000 projects revenue to increase by 2 percentage points of GDP, through continued improvements in tax administration and reductions in exemptions. The staff cautioned that this revenue target would be very difficult to achieve by predominantly administrative measures, and that a 1 percentage point increase would be more realistic. While acknowledging that it was ambitious, the authorities argued that the target approved by the National Assembly was achievable, but would implement expenditures on the basis of the available revenue, to observe the overall domestic bank financing limit.

19. **The main revenue measures in the 2000/01 budget are the broadening of the tax base, reducing tax exemptions, and improving tax and customs administration**. These measures were implemented in late 2000 and are outlined in the attached MEFP

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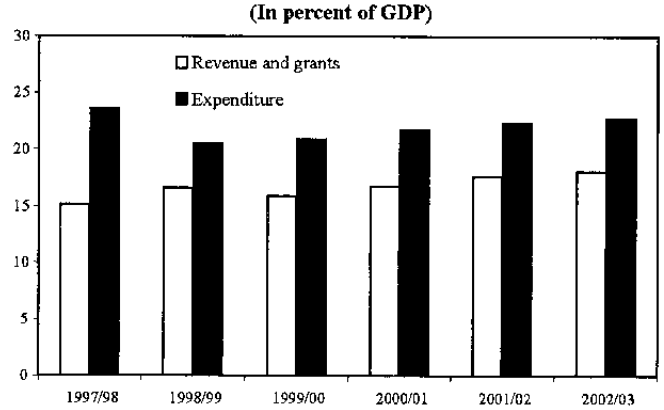
[9] Equivalent to 8 percent of GDP, using the authorities' official presentation presented in Table 3 of the Memorandum on Economic and Financial Policies (MEFP) (Attachment III), which treats grants as financing and amortization as expenditure. The budget also includes nonbank financing of about 1 percent of GDP, comprising equally state property sales and sales of government securities to nonbanks.

Box 4. Lao P.D.R.: Medium-Term Fiscal Framework

As outlined in the I-PRSP, over the medium term the budget will aim to provide additional finance for pro-poor expenditures while protecting fiscal sustainability. Enhancing revenue collections will be vital in meeting these goals. Following the tighter fiscal policy of the past two years, a budget deficit remaining at its current level of 5 percent of GDP through 2002/03 would be consistent with these goals, provided the projected external financing is available.

Lao PDR: Medium-Term Fiscal Famework

(In percent of GDP)



Under this framework, revenue would need to be raised from about 12.7 percent of GDP in 1999/00 to 15 percent by 2002/03. Increasing revenue collections by 0.5 percent of GDP in both 2001/02 and 2002/03 (over the projected 2000/01 outturn) can be accomplished through: fully implementing administration reforms, developing the system of large taxpayer units, strengthening the customs department, reducing tariff exemptions, and rationalizing the excise duty system. The experience with specialized attention to large taxpayers has shown that there is a substantial further revenue potential from more effective taxation of this source, if appropriately managed. The projections assume that the conversion of the current turnover tax into a VAT will raise revenue slightly, even after allowing for declining tariffs under the ASEAN Free Trade Area. However, VAT at 10 percent and few exemptions could lead to a larger revenue gain.

Enhanced revenue mobilization would permit a parallel increase in total spending with a redirection of resources to priority areas. Expenditure would therefore rise to 23 percent of GDP over the program period, from 21 percent in 1999/2000. Within this envelope, an appropriate balance of capital and current expenditures would need to be found. However, currently the basis for transparent spending decisions is constrained by the absence of information on spending by program, especially in health and education. It is clear that scope exists to reallocate spending by scaling back the public investment program to a level consistent with implementation capacity while increasing recurrent spending on vital social sector programs and civil service wages. It is expected that the Public Expenditure Review, being conducted jointly by government and the World Bank, AsDB and IMF, would identify issues critical for making these choices.

In 2000, the government launched its decentralization policy under which provinces become strategic units, to make decision-making and policy implementation more participatory. While moving ahead in a phased manner, the government recognizes that this will require capacity building at all levels and that there are significant risks from poor implementation.

The costs of state-owned commercial bank restructuring appear to be manageable within the fiscal framework. The results of forthcoming audits will determine the recapitalization requirement but preliminary estimates suggest that, because of the relatively small size of the banking sector, the capital deficiency is about 3 percent of GDP. This would imply annual interest costs of some 0.3 percent of GDP.

(paragraph 10). They include using current market exchange rates to assess taxes, increasing excise rates, extending large taxpayer units,[10] and reducing tax exemptions on imports financed by foreign investment. Revenue from timber royalties is projected to decline from 2 to 1 percent of GDP, reflecting less logging, but the transfer of these funds to the central budget was strengthened through the introduction of tracking and tight controls on revenues obtained in foreign currency.[11] Forestry sector policies, especially revenue aspects, will be reviewed by the end of the first year of the program, in consultation with the World Bank.

20. **A high priority for the government in the 2000/01 budget is rationalizing public expenditure**. The tight constraints on education and health expenditures during the stabilization period are being eased, and civil servants were given a flat wage increase equivalent to 20 percent of the average wage. To partly compensate for this increase (the first since 1996, that still leaves civil service wages at very low real levels), the size of the civil service would be reduced by 5 percent over two years, mainly by retirements and retrenchment of poorly qualified staff. Spending on materials and supplies was also increased significantly to allow for more maintenance, especially on roads. Significant payments of domestic arrears (included in other current expenditure) are also envisaged. In spite of recent corrective efforts, the Ministry of Finance noted that it could not prevent new arrears from being incurred, especially at lower levels of government.

21. **The 2000/01 budget started the government's initiative launched in early 2000 to decentralize government operations to promote more broad-based development**. In response to staff concerns about fiscal discipline, especially the incurrence of domestic arrears, and of the administrative ability and accountability systems to support this policy, the authorities stressed that they would apply this policy first to the most capable provincial administrations and quickly develop the appropriate guidelines while closely monitoring the overall fiscal position. Staff's concerns about meeting the high budget revenue target are supported by preliminary indicators for the first 5 months of 2000/01, which put revenues

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[10] Tax administration has improved greatly over the past two years as the authorities followed the large taxpayer unit (LTU) approach, especially self-assessments and audits. However, although the staff strongly recommended developing a single LTU in headquarters to conserve scarce resources, the authorities were committed to developing LTUs in 3–4 major provincial centers under a national policy, as part of their decentralization process, but would strengthen the control procedures.

[11] The World Bank has identified problems of illegal and under-reported logging, under valuation of timber, and substantial leakages in the transfer of these revenues to the budget as factors that reduce potential budget revenues. For 1999/2000, using indirect indicators, the staff could not account for more than half of timber revenue reaching the central budget accounts, and has imputed the missing amount as "timber-royalty financed expenditure," the main reason for the revisions to the fiscal accounts compared to the 1999 Article IV consultation. Under the program, these unauthorized expenditures would be sharply reduced.

lower than staff projections on account of initial administrative weaknesses in implementing decentralization. The staff have been urging the government to strengthen central control over revenue. Nevertheless, expenditures appear to be restrained, and during this period when revenues are seasonally low, net bank financing has been about ¼ percent of GDP.

22. **The government and the World Bank/AsDB/IMF have embarked on a joint public expenditure review (PER)**. The authorities are now trying to regularize the expenditure management system, especially with the move to decentralization, after the earlier economic crisis, and the need to meet skyrocketing nominal expenses, left the system in disarray. Although the three international institutions recognize the complexity of the problem, they consider the absence of data on social expenditures a major deficiency in monitoring the implementation of poverty reduction programs and their outcomes. Thus, the PER would, with strong participation from the relevant ministries, provide a basis for strengthening public expenditure management during the PRGF program period through sharpening the poverty focus of expenditures, and by improving budgeting, expenditure management, and fiscal transparency. FAD is providing technical assistance for public expenditure management, especially improving the information base on actual expenditures, essential for monitoring of poverty-related spending and avoiding domestic arrears. Drawing on the results of this technical assistance, the first review of the program will discuss progress in developing an action plan, and measures to improve public expenditure management which would be implemented in the context of the budget for 2001/02. A comprehensive action plan would be agreed by the end of the first program year and implemented under subsequent annual programs under the PRGF.

IV. Structural Policies

A. Banking Reforms

23. **The authorities have identified SOCB reform as a major structural goal during the PRGF program period**. The SOCBs account for about 70 percent of total assets of the banking system, while foreign bank branches (mainly Thai) have a 21 percent share, and the remainder is accounted for by joint-venture banks. Asset quality of the foreign bank branches appears to be relatively good. However, for the SOCBs, portfolio assessments estimate that NPLs were about 70 percent of total loans at end 1999, despite recapitalization in 1994. The authorities regard this as the main banking problem derived from fundamental deficiencies in SOCB management and operations. During 2000, the BOL worked with these banks to reduce their NPLs, as they established internal debt workout units, and held negotiations with defaulters. However, SOCBs also expanded credit rapidly, partly as a shortcut to higher profitability and lower NPL ratios.

24. **Based on discussions with the World Bank, AsDB, and Fund staff, the authorities adopted a comprehensive framework for bank restructuring that would guide the development of individual bank restructuring plans (see Box 5)**. In particular, steps are envisaged to improve the environment for commercial lending and to phase out policy lending through SOCBs. Recapitalization of banks would be phased and linked to

Box 5. Lao P.D.R.: Main Issues in the Reform of State Banks

The banking sector in Lao P.D.R. comprises three state-owned commercial banks (SOCBs) with 70 percent of banking system deposits, equivalent to 12 percent of GDP. In spite of recapitalization in 1994, an externally-funded consultant has estimated that **nonperforming loans (NPLs) were about 70 percent of total loans** in 1999. The need for reform is urgent, and the agreed framework provides for the following lines:

1. **Accounting framework, and loan classification and provisioning requirements**

- Effectively implement **loan classification and provision regulations**, and ensure that all off-balance sheet liabilities are fully accounted for. The SOCBs should also reinforce credit monitoring system by applying credit risk criteria developed by the AsDB consultants. The BOL should ensure that banks stop accruing interest on NPLs of 90 days or more overdue.

- Complete **external audits** for 1999 and 2000 at international accounting standards. Subsequent annual audits should be completed within 6 months of the end of the financial year.

2. **Operational restructuring of SOCBs**

- Improve **governance structure** of SOCBs by making boards and managements more accountable. For instance, establish business plans for operational improvements with annual (or more frequent) performance targets and goals, and with defined sanctions for management that consistently fails to meet these targets.

- Implement operational restructuring to improve better **risk control** and reinforce governance structure of board and management. Operational twinning with foreign partner should be considered.

3. **Resolution of NPLs and avoidance of new NPLs**

- Focus the NPL resolution on **debt workout units within the banks**, while recognizing that workouts with the largest debtors would require improvements in the policy environment. Avoid the rapid carve-out of NPLs. Develop loan workout procedures for each main type of NPL, distinguishing between policy lending and commercial lending.

- Ensure that both **directed lending** and support for SOE losses are phased out although the timing and modalities have not been specified.

4. **Phased and conditional recapitalization**

- Phase recapitalization, and make it **conditional on performance improvement**. Link phased recapitalization to implementation of the agreed business plan, which would include targets for debt workouts and operational and management improvements.

5. **Next Steps**

- Donor-**funded audits of the three SOCBs** have been initiated and will support the development of plans, although preliminary estimates and analysis indicate the nature and magnitude of the problems.

- Bank **specific restructuring plans** are to be formulated before the first review of the PRGF-supported program based on these principles. Technical assistance for this would be provided by the AsDB and World Bank in preparation for their joint financial sector loan.

improvements in operations, especially in lending and risk control practices, governance, and quality of management. Drawing on the recently initiated international standard audits, individual SOCB restructuring plans will be developed by the first review of the PRGF. Interim measures have also been put in place to avoid a further deterioration in the SOCBs' financial condition, including close monitoring of lending, and enhanced banking supervision, with more on-site inspections and active involvement of the BOL in debt negotiations.

B. Enterprise Policies

25. **The government recognizes that fulfilling its commitment to market-based reforms and international integration will require strengthening the enterprise sector, both state-owned and private**. Although reform in the enterprise area is an essential complement to banking reform, it is less well developed. The authorities intend to formulate comprehensive reform in the near future and will be requesting assistance from the World Bank and AsDB. The authorities' current goal for reform is that only 32 enterprises (including financial enterprises) will remain state-owned.

26. **Ahead of detailed plans for large state enterprises, the authorities' approach is to first focus on commercialization and immediate improvements in their financial operations**. Thus, utility enterprises have been adjusting their prices to achieve cost recovery. During 2000, domestic petroleum prices were adjusted to cover import costs. Domestic electricity prices are well below those in neighboring countries and they are subsidized by revenues from electricity exports. The appropriate level of prices for 2002 and beyond are to be based on a World Bank sponsored study; such adjustments could increase budget revenues by about ¾ percent of GDP per year and are incorporated in the fiscal projections for the 2001/02. For Lao Aviation, in light of the recent long-term lease of an additional aircraft and its past record of debt servicing difficulties (which have had to be assumed by the government), further significant fare adjustments are planned to achieve full cost recovery by the end of the first year of the PRGF program.

27. **To strengthen nonstate enterprises, considerable legal and institutional reforms are needed to improve the business environment**. Domestic enterprises, including former SOEs, now operate without direct state intervention, but their ownership structure needs to be clarified and bureaucratic impediments removed. For foreign-invested enterprises, implementing regulations for the 1994 Foreign Investment Law have recently been issued to make this relatively liberal law operational by setting out more transparent and faster procedures for investment approval, and allowing more investment projects to be approved at the local level.

C. Trade Reform

28. **Given the competitiveness of the region, the authorities believe that meeting their commitments under the ASEAN Free Trade Area (AFTA) will present both benefits and challenges in the coming years**. This reform will be very significant because ASEAN trade accounts for about 70 percent of Lao P.D.R.'s formal trade, and considerably

more if informal trade is included. Under the timetable submitted to AFTA, by the start of 2005, 95 percent of tariff items should be free of quantitative restrictions (QRs) (to be applied to a multilateral basis from mid 2001) and subject to AFTA tariff reductions, so that all AFTA tariffs will be 20 percent or less, with 87 percent of these items having tariffs of 0–5 percent.[12] In the meantime, the authorities have eased ad hoc trade restrictions, including eliminating the ban on imports of motor vehicles. Although the staff argued that with porous borders, trade controls are ineffective, encourage smuggling, and reduce revenue, the authorities responded that there was not sufficient political support for a faster removal of formal import barriers.

29. **The authorities are emphasizing development of the export sector to benefit from trade liberalization**. As private sector development is encouraged, they see a significant potential, especially in niche primary products. To this end, export licensing requirements on all exports (except mining and timber products) were eliminated, effective March 2001. The authorities are also seeking better access for their products to the European Union and Japan, and to the United States under normal trade relations, and have recently begun the process of accession to the WTO.

V. Other Issues

A. External Sector and Balance of Payments Outlook

30. **External financing requirements for 2001–03 are estimated at US$110 million**. (Tables 7 and 10). For 2001, the financing needs of the balance of payment and the budget (US$30 million) are expected to be fully covered by the first tranche of a joint Financial Sector Adjustment Credit from the World Bank and the AsDB (US$15 million), two disbursements under the PRGF (US$12 million) and committed support from other donors on concessional terms.

31. **In view of Lao P.D.R.'s limited debt-servicing capacity, external borrowing will need to be closely monitored by the newly established debt-monitoring unit.** The first year of the program does not allow for contracting or guaranteeing nonconcessional external debt by the public sector. A government-guaranteed loan from the Exim Bank of China, contracted in February 2001, for US$30 million for investment in the telecommunications sector, has a grant element of 24 percent, and will have a minor impact on debt sustainability.[13] Concerning NT2, no debt is expected to be contracted in 2001 and a detailed

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[12] Excluded items relate to unprocessed agricultural products, and those restricted for health, cultural, and safety reasons. The authorities also reserve the right to not extend multilateral removal of QRs to a few specified products, which are likely to be high-end luxury products.

[13] The loan from Exim Bank of China is not covered by the program, having been signed before the date of approval of the program. However, because ceilings on contracting and guaranteeing nonconcessional debt are defined relative to end 2000, the value of the ceiling (continued)

assessment will be made in a later review of the program. A preliminary assessment suggests that the impact on official debt service would be small, on the current assumption that the government's equity stake, US$75 million, will be financed on concessional terms. The partial-risk guarantee of US$100 million that would accompany IBRD participation would be limited to losses occurred as a result of government actions, that prevent the operation of the project. The government is currently negotiating with Russia and expects to reach an agreement on its outstanding ruble-denominated debt in 2001. The Lao authorities are still gathering detailed debt data before deciding whether to apply for debt relief under the HIPC Initiative. Preliminary staff estimates for end -2000 put the net present value (NPV) of debt at about 250 percent of exports of goods and services (Table 8), 160 percent after traditional debt-relief mechanisms, but a more comprehensive debt sustainability analysis is needed.

32. **Access of SDR 31.7 million, equivalent to 60 percent of Lao P.D.R.'s quota (with equally phased disbursements) under the three-year P.R.G.F. arrangement is proposed**. This level of access is within the standard levels for a second PRGF arrangement and the staff views such access as appropriate in light of: (i) the balance of payments need; (ii) the strength of the program; and (iii) the moderate level of outstanding use of Fund credit (62 percent of quota). With the implementation of the PRGF-supported program, Lao P.D.R. can be expected to meet fully prospective Fund obligations. With full disbursement under the PRGF-supported program, outstanding credit to the Fund would peak in 2003 at 74 percent of quota. The debt service due to the Fund would peak in 2001 at 1.8 percent of exports of goods and services, then decline to an average of 0.4 percent in 2006–09. Lao P.D.R. has maintained a good record of meeting its debt-service obligations to the Fund.

B. Statistical and Transparency Issues

33. **Statistical weaknesses remain a major constraint on surveillance and program design**. Estimates of GDP are hampered by the substantial subsistence and informal structure of the economy. In addition, official estimates and projections are only revised infrequently, slowing the incorporation of new information, especially when the external environment changes rapidly. Lack of reliable external debt data has been a major constraint in debt-sustainability analysis, but this is being remedied by a newly installed debt monitoring system. Balance of payments data are constrained by inadequate source data. The recently introduced customs data system will greatly improve trade statistics, but other areas are still lagging. Notwithstanding these weaknesses, the available information is generally sufficient to monitor program implementation, given the more open approach of the government to discussing and correcting the deficiencies.

34. **The most significant statistical deficiency for macroeconomic policy and the poverty reduction strategy is on fiscal expenditure**. Although data on basic expenditure

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excludes the Exim Bank loan. Concessionality in the program is defined as a debt with a grant element of 35 percent or more.

categories are available for the central government, little is available to the central government from provincial governments, which will have an increasing role in the execution of expenditure under the decentralization plan. Improving this information on a timely basis will be essential for improving the accountability of government and tracking social expenditure. A systematic program for improving public expenditure management will require significant technical assistance, especially in fiscal accounting and reporting of expenditures in general, and poverty-related expenditure in particular. While an important start, the recent publication of the budget for 2000/01 and the outturn for 1999/2000 is only an initial step towards fiscal transparency.

C. Program Monitoring, Implementation, and Coordination

35. **To monitor the implementation of the program, quantitative and structural performance criteria and benchmarks are specified in Tables 6 and 7 of the government's MEFP**. The first test date will be end-June 2001, and the first review of the program is scheduled for completion by end-October 2001. Monitoring for the program has made allowances for the poor state of data, but because of weak accounting systems, considerable cross-checking will be required.

36. **Although the program has streamlined conditionality, there are still a significant number of measures to ensure progress**. The eight prior actions for the program are important in setting a foundation for sustaining macroeconomic stability and reforms that will be supported by the PRGF arrangement. The structural performance criterion on the adjustment of electricity and airline tariffs is needed to reduce fiscal risks, by avoiding a drain on budget resources of about 1 percent of GDP. Moreover, Lao Aviation has a record of defaults on external payments because of low domestic fares. Although the World Bank and AsDB do not currently have lending programs that can incorporate this conditionality, they are expected to have them in place during the second year of the PRGF arrangement after which conditionality in this area would not be needed. In the meantime, the Fund staff will have the required information available from their technical work. The structural performance criterion and benchmark on banking reflect the importance of starting reforms in this area to overcome SOCB insolvency.

37. **Reflecting its least developed country status, Lao P.D.R. is in need of considerable technical assistance (TA) to implement economic reforms**. Despite this need, its record at implementing the TA has been patchy. In particular, some of the gains made during the early 1990s were lost in 1997–99, especially in the fiscal and banking areas. The authorities, however, recognize that further TA and its effective utilization will be needed to achieve its reform goals, especially in the tax administration and public expenditure management, bank supervision, and statistical areas.

38. **Under the safeguards assessments policy, the BOL is subject to a full Stage One safeguards assessment**. The BOL has not yet undergone an external audit, but as committed in paragraph 29 of the MEFP, the Lao Audit Office under the Prime Minister has started its audit of the BOL financial statements. This audit is to be conducted in accordance with

international standards and completed by July 2001. The Audit Office has received technical assistance from the AsDB, and under the safeguards policy, an assessment of the adequacy of the audit will be made after completion. Meanwhile, the staff is preparing a full Stage One assessment, which is expected to be completed by the time of the first program review.

39. **The World Bank, AsDB, and the Fund are closely coordinating their operations in support of the government's reform program**. The PRGF is consistent with the joint AsDB/World Bank financial sector operation, and the PER is being conducted jointly with the three IFIs, contributing to different areas where each has current or prospective operations. The World Bank is considering following the financial sector loan with a Poverty Reduction Support Credit (PRSC) at end 2002, which would further address the pro-poor orientation of public sector expenditure. The Bank is examining its potential role in NT2.

VI. Staff Appraisal

40. **The Lao authorities have made important strides in reestablishing macroeconomic stability after their inappropriate response to the Asian crisis precipitated domestic economic turmoil during the two years from late 1997**. Recognizing the severe costs of triple-digit inflation, starting in mid 1999, the authorities began tightening credit policy significantly, strengthening revenue efforts, and cutting back capital expenditure. As a result of these determined efforts, inflation has now been reduced to single-digit levels.

41. **The government's proposed PRGF-supported program and the I-PRSP are linked to the new five-year plan, which aims to strengthen macroeconomic stabilization and reduce poverty through economic growth with equity**. Structural reforms to support this growth are appropriately sequenced, with highest priority to policies that directly support macroeconomic stability, especially in the fiscal and banking areas. To promote equity, structural reforms will be supplemented with measures to promote rural development, health, and education, and to reduce the impediments to business.

42. **Lao P.D.R.'s medium-term prospects appear to be favorable, but implementation of the envisaged reforms is needed to ensure export expansion and effective use of natural resources for poverty reduction**. If the NT2 project does not go ahead, the growth outlook would be weaker, but the financial variables would not be greatly affected over the program horizon.

43. **Tight credit policy will be key to the continued reduction in inflation**. The BOL credit will need to be restrained to maintain exchange rate stability and reduce inflation. Although SOCB credit expanded excessively in 2000, risking a further increase in NPLs, measures are now in place to slow credit growth substantially. The exchange rate should continue to be managed flexibly, and the margin with the parallel market kept below 2 percent.

44. **The staff welcomes the prudent budgetary stance in 1999/2000 and 2000/01**. Revenue improvements through strengthening tax administration and reducing exemptions

were successful in 1999/2000. Although the government's revenue targets in 2000/01 are higher than those of the Fund staff, the government is committed to effective revenue mobilization and avoiding domestic bank financing, by adjusting spending in line with the available revenue, while protecting critical social spending. Stronger corrective measures are required to overcome the weakness in revenue collections observed during the early part of 2000/01 with the initial phase of decentralization.

45. **Beyond the current budget, significant fiscal reforms will be needed**. Continued efforts should be made to improve tax administration, especially for large taxpayers in preparation for the introduction of the VAT in 2003. Improving public expenditure management is key to effective fiscal discipline and poverty reduction, and should be coordinated with the ongoing process of fiscal decentralization. Measures to start this process should be implemented in the 2001/02 budget. Considerable technical assistance in fiscal operations will be necessary for the success of the program.

46. **Reform of state banks will be a critical complement for macroeconomic policies**. The staff supports the approach of phased recapitalization conditional on improvements in bank performance, governance, and resolution of NPLs, as well as reforms to the environment for lending and business. The staff recognizes that changing the lending culture will take time, but strong actions are needed to decisively start this process. Developing an appropriate reform plan by the first review will be crucial for the PRGF-supported program and early and thorough completion of the audits will be a major step toward achieving this.

47. **Improving competitiveness will be vital to successful integration and the necessary improvements in efficiency**. Appropriately, export liberalization is being sequenced first, followed by import liberalization, through an easing of ad hoc restrictions and implementing the AFTA schedule with the multilateral removal of QRs. Since ASEAN members account for the bulk of trade, full liberalization of QRs with relatively low tariffs by 2005 will be a major reform. In order for this policy to be successful, market access to industrial countries, especially the EU and Japan, and normal trade relations with the United States will be crucial.

48. **Policies to strengthen the enterprise sector, state and nonstate, will be essential to ensure the success of banking and trade reforms**. The most pressing SOE price adjustments have been included in the first year of the program to strengthen the finances of large state enterprises and protect fiscal resources. Issuing the long-delayed implementing regulations for the Foreign Investment Law is a much-needed improvement to the business environment. However, it will be important also to develop a more comprehensive enterprise reform strategy with the World Bank and AsDB, especially to develop the private sector, to complement the PRGF-supported program.

49. **Recent improvements in the compilation and provision of data are welcome but major improvements are still needed for monitoring financial developments and poverty reduction**. To maintain progress at stabilization, the authorities will have to continue their efforts to improve the quality and availability of key economic statistics.

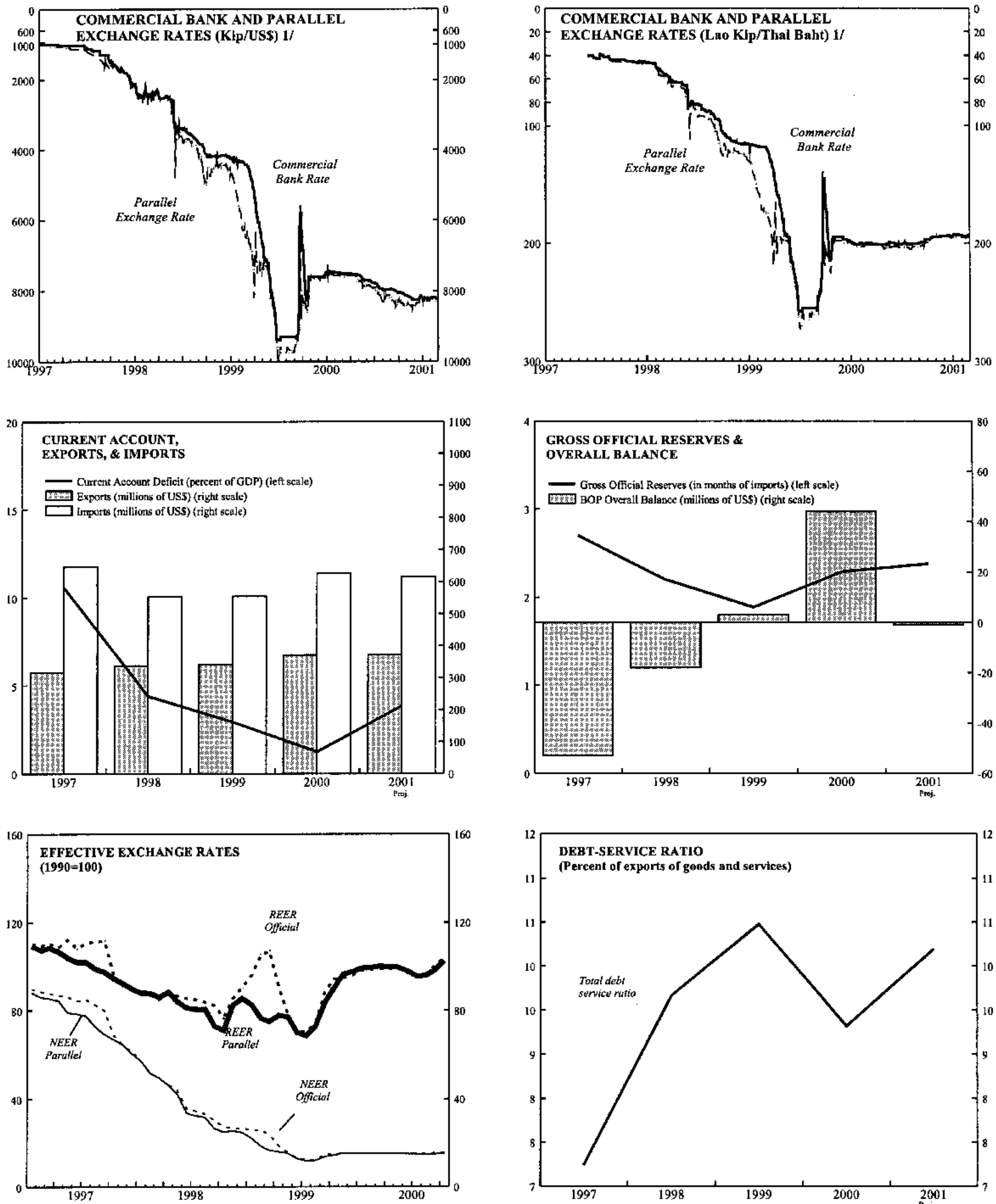
Although the publication of the state budget is a welcome start, much greater progress needs to be made in fiscal transparency and accountability within government, and to the public, by improving public expenditure data, especially on social expenditure. The audit of the BOL and further progress at providing additional information will be needed to complete Stage One of the Safeguard Assessment by September 2001.

50. **The proposed program has marked risks but these are manageable**. In particular, the program's reforms are phased and while the structural policies needed to achieve its final goals have not yet been fully defined, especially in the enterprise and public expenditure areas, they will be in the first year of the program. Although the authorities have agreed on the direction of reform, because of technical complexities, more time is needed to build ownership of the specific reform steps. The staff believes that the risk of moving ahead without these plans needs to be balanced with the advantage of building on the current momentum for macroeconomic stabilization and for restarting structural policy reform. Moreover, sufficient impetus to deepen reforms appears to be in place from the need to make economic integration successful and to meet the rising expectations of the population for development and poverty reduction.

51. **With this balancing of risks, and the recent track record of policies and prior actions, the staff considers the proposed policy package to be sufficiently comprehensive to strengthen the reform process and has reasonable assurances of successful implementation**. The staff therefore recommends approval of the authorities' request for a new three-year PRGF arrangement.

52. **It is proposed that the next Article IV consultation with Lao P.D.R. take place on the standard 12-month consultation cycle**.

Figure 1. Lao P.D.R.: Selected Economic Indicators, 1997-2001



Sources: Data provided by the Lao P.D.R. authorities; and Fund staff and Information Notice System (INS) estimates.

1/ Based on their average monthly respective buying rates.

Table 1. Lao PDR: Phasing of Disbursements Under the PRGF Arrangement

Date	Disbursement Millions of SDR	Disbursement Percent of Quota	Activity
37004	4.53	8.6	Board approves new three-year arrangement and endorses first-year program.
37072	n.a.	n.a.	Test date for performance criteria.
October 31, 2001	4.53	8.6	Board completes first review.
December 31, 2001	n.a.	n.a.	Test date for performance criteria.
April, 2002	4.53	8.6	Board completes second review and endorses second-year program.
June, 2002	n.a.	n.a.	Test date for performance criteria.
October, 2002	4.53	8.6	Board completes third review.
December, 2002	n.a.	n.a.	Test date for performance criteria.
April, 2003	4.53	8.6	Board completes fourth review and endorses third-year program.
June, 2003	n.a.	n.a.	Test date for performance criteria.
October, 2003	4.53	8.6	Board completes fifth review.
December, 2003	n.a.	n.a.	Test date for performance criteria.
April, 2004	4.52	8.6	Board completes sixth review.
Total	31.70	60.0	

Source: IMF, Treasurer's Department.

Table 2: Lao P.D.R.: Fund Position and Indicators of Fund Credit, 2000–09 1/

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
		Projections								
	(in millions of SDRs)									
Enhanced Structural Adjustment Facility (ESAF) and Poverty Reduction and Growth Facility (PRGF)										
Disbursements	0	9.1	9.1	9.1	4.5	0	0	0	0	0
Repayments	5.9	7.3	7.0	6.5	5.3	4.1	2.3	2.9	4.1	5.9
SAF/ESAF	5.9	7.3	7	6.5	5.3	4.1	1.8	0.6	0	0
PRGF	0	0	0	0	0	0	0.5	2.3	4.1	5.9
Total Fund credit outstanding, end of period										
Total	32.6	34.4	36.4	39.0	38.2	34.1	31.8	28.9	24.8	18.9
SAF/ESAF	32.6	25.3	18.3	11.8	6.5	2.4	0.6	0	0	0
PRGF	0	9.1	18.1	27.2	31.7	31.7	31.2	28.9	24.8	18.9
SDR charges and PRGF interest	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.5
	(in percent)									
Total Fund credit outstanding (in percent of quota, end of period)										
Total	61.6	65.0	68.8	73.7	72.2	64.5	60.1	54.7	46.9	35.7
SAF/ESAF	61.6	47.8	34.6	22.3	12.3	4.5	1.1	0.0	0.0	0.0
PRGF	0.0	17.1	34.3	51.4	59.9	59.9	59.0	54.7	46.9	35.7
Total Fund credit outstanding, end of period										
In percent of GDP	2.5	2.4	2.2	2.1	1.8	1.5	1.2	1.0	0.8	0.6
In percent of exports of goods and services	7.9	7.8	7.7	7.7	7.1	5.9	4.7	4.6	3.7	2.7
Total debt service due to the Fund										
Total obligations, including interest and charges (in millions of SDRs)	6.3	7.9	7.7	7.1	5.9	4.7	2.8	3.5	4.7	6.5
In percent of exports of goods and services	1.5	1.8	1.6	1.4	1.1	0.8	0.4	0.6	0.7	0.9
Memorandum items:										
Exchange rate (U.S.dollars per SDR)	1.32	1.31	1.31	1.31	1.31	1.31	1.31	1.31	1.31	1.31
Quota (in millions of SDRs)	52.9	52.9	52.9	52.9	52.9	52.9	52.9	52.9	52.9	52.9
GDP (in millions of U.S. dollars)	1,716	1,894	2,169	2,453	2,730	3,038	3,380	3,617	3,870	4,141
Exports of goods and services	544	578	620	666	702	753	884	833	882	936

Source: Data provided by the IMF Treasurer's Department; and Fund staff estimates and projections.

1/ Data may not add up due to rounding.

Table 3. Lao P.D.R.: Selected Economic and Financial Indicators, 1997–2001

Nominal GDP (1998): $1,286 million
Population (1998): 5.0 million
GDP per capita (1998): $257
Fund quota: SDR 52.9 million

	1997	1998	1999	Est. 2000	Proposed Program 2001
Nominal GDP (in billions of kip)	2,201	4,240	10,304	13,483	15,534
Real GDP growth (percent change)1/	7.0	4.0	7.3	5.7	5.7
Prices (percent change)					
Consumer prices					
(12-month rate; end-of-period)	26.6	141.9	86.7	10.6	8.0
(monthly percent change; end-of-period) 2/	-0.6	4.9	-1.1	-0.9	...
GDP deflator (annual average)	19.3	85.2	126.5	23.8	9.0
Government budget (percent of GDP) 3/					
Revenue	11.3	9.8	10.6	12.7	13.9
Grants	3.4	5.3	6.0	3.2	2.8
Expenditure	21.9	23.6	20.6	20.9	21.7
Current account balance (excluding grants)	0.2	1.7	4.4	4.6	5.5
Overall balance (including grants)	-7.2	-8.5	-4.0	-5.0	-5.0
Of which: Bank financing	-1.6	0.8	-0.4	-0.8	0.0
Money and credit (percent change; end-of-period)					
Broad money	65.8	113.3	78.4	45.7	20.0
Bank credit to the economy	110.8	86.3	74.2	41.3	17.8
Credit to SOEs	226.1	85.6	99.2	44.3	16.5
Credit to the private sector	83.4	86.6	63.6	39.7	18.5
Interest rates (in percent; end-of-period)					
On one-year deposits	19	23	24	24	...
On short-term loans	20-27	31-36	22-30	16-24	...
External trade					
Trade balance (US$ millions)	-331	-216	-191	-198	-231
Exports (percent change in US$ value)	-1.4	6.4	7.7	8.3	7.4
Imports (percent change in US$ value)	-6.0	-14.7	0.3	6.6	10.6
Balance of payments (percent of GDP)					
Current account balance (including official transfers)	-10.7	-4.4	-1.5	-1.6	-3.1
Overall balance (US$ millions)	-53.0	-18.0	3.0	44.0	-8.0
Gross official reserves (US$ millions)	136	112	106	140	152
(in months of prospective goods and service imports)	2.7	2.2	2.0	2.4	2.5
Net official reserves (US$ millions)	70	50	53	97	107
External debt (in percent)					
Ratio of debt-to-GDP 4/	60.9	95.2	89.4	73.4	72.0
Debt-service ratio 5/	7.3	9.7	10.4	9.2	9.7
Exchange rate					
Kip per U.S. dollar (end-of-period)					
Commercial bank rate	2,135	4,274	7,600	8,140	...
Parallel market rate	2,205	4,750	7,575	8,170	...
Real effective exchange rate (percent change, annual average)	4.5	-23.1	5.0	10.8	...

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates and projections.

1/ Staff estimate for 1999 real GDP growth is 5.0 percent; the lower estimate of Fund staff is due to their lower estimate of agricultural sector output, in line with observations of relevant international agencies.
2/ Moving average of latest 3 monthly observations.
3/ Fiscal data are on a fiscal year basis (October–September).
4/ Excludes debt in nonconvertible currencies; includes debt to the Fund (SAF and ESAF).
5/ As a ratio of exports of goods and services.

Table 4: Lao P.D.R.: General Government Operations, 1996/97–2000/01

	1996/97	1997/98	1998/99	Budget 1999/00	Est. 1999/00	Budget 2000/01	Proj. 2000/01
				(In billions of kip)			
Revenue and grants	298	567	1,461	2,160	2,018	2,614	2,471
Revenue	228	367	929	1,620	1,615	2,194	2,051
Tax	190	290	745	1,376	1,323	1,742	1,687
Of which							
Profit tax	23	33	80	170	172	316	301
Turnover tax	40	63	160	264	252	379	359
Excise tax	18	51	157	225	211	336	316
Import duties	47	50	99	173	138	192	192
Timber royalty receipts	32	37	89	270	288	115	115
Nontax	39	77	184	244	293	452	364
Grants	70	200	532	540	403	420	420
Expenditure	444	883	1,809	2,819	2,655	3,382	3,204
Current	224	304	539	1,052	1,031	1,417	1,239
Wages and salaries	92	117	181	348	348	417	417
Materials and supplies	57	63	132	137	197	342	342
Interest payments	16	39	59	133	103	175	175
Timber royalty financed expenditure		37	89	270	184	115	15
Other recurrent	27	49	78	164	199	368	290
Capital and onlending 1/	220	579	1,270	1,768	1,623	1,965	1,965
Current balance	4	63	390	568	584	776	812
Overall balance	-146	-317	-348	-659	-637	-769	-733
excluding grants	-216	-516	-879	-1,199	-1,040	-1,189	-1,153
Financing	146	317	348	659	637	769	733
Domestic financing	33	93	-52	7	-94	213	177
Bank financing 2/	-32	30	-39	0	-104	0	0
Nonbank financing	64	63	-13	7	10	213	177
Foreign financing (net)	114	223	400	652	731	556	556
Project loans	110	249	478	824	792	780	780
Program loans	12	0	0	0	96	0	0
Amortization	8	26	77	172	157	224	224
				(In percent of GDP)			
Revenue and grants	14.7	15.1	16.6	17.0	15.9	17.7	16.7
Revenue	11.3	9.8	10.6	12.8	12.7	14.9	13.9
Tax	9.3	7.8	8.5	10.8	10.4	11.8	11.4
Nontax	1.9	2.0	2.1	1.9	2.3	3.1	2.5
Grants	3.4	5.3	6.0	4.3	3.2	2.8	2.8
Expenditure	21.9	23.6	20.6	22.2	20.9	22.9	21.7
Current	11.1	8.1	6.1	8.3	8.1	9.6	8.4
Wages and salaries	4.5	3.1	2.1	2.7	2.7	2.8	2.8
Capital and onlending	10.8	15.5	14.4	13.9	12.8	13.3	13.3
Current balance, excluding grants	0.2	1.7	4.4	4.5	4.6	5.3	5.5
Overall balance	-7.2	-8.5	-4.0	-5.2	-5.0	-5.2	-5.0
excluding grants	-10.6	-13.8	-10.0	-9.5	-8.2	-8.1	-7.8
Financing	7.2	8.5	4.0	5.2	5.0	5.2	5.0
Domestic financing (net)	1.6	2.5	-0.6	0.1	-0.7	1.4	1.2
Bank	-1.6	0.8	-0.4	0.0	-0.8	0.0	0.0
Nonbank	3.2	1.7	-0.1	0.1	0.1	1.4	1.2
Foreign financing (net)	5.6	6.0	4.6	5.1	5.8	3.8	3.8
Memorandum item:							
Nominal GDP, fiscal year (in billions of kip)	2,029	3,745	8,788	12,691	12,691	14,755	14,755

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates.

1/ Compared to previously used fiscal data, the budget capital expenditures have been revised to exclude irrigation projects financed through bank credit to farmers and state enterprises, mainly in 1997/98.

2/ Bank financing excludes the valuation adjustments on the stock of government foreign currency deposits and credit in all years, as well as reclassification of printing costs by the BOL (KN 78 billion) in 1999/00.

Table 5. Lao PDR: Monetary Developments, 1997–2001 1/

	1998	1999	Mar. 2000	June 2000	Sept. 2000	Dec. 2000	Mar. 2001 Program 2/	June 2001 Program 2/	Sept. 2001 Program 2/	Dec. 2001 Program 2/
			(In billions of kip; end-of-period)							
Monetary survey										
Net foreign assets	498	1,266	1,352	1,470	1,477	1,526	1,382	1,379	1,361	1,465
Net domestic assets	368	278	408	578	634	725	981	1,097	1,228	1,235
Domestic credit	704	1,045	1,127	1,243	1,333	1,441	1,549	1,646	1,744	1,702
Net claims on government	-52	-272	-331	-328	-368	-420	-403	-386	-368	-491
Claims on the economy	756	1,317	1,458	1,571	1,701	1,861	1,951	2,032	2,112	2,192
Credit to state enterprises	224	445	502	579	627	643	677	701	725	748
Credit to private sector	533	872	956	993	1,074	1,218	1,275	1,331	1,387	1,444
Other items (net)	-337	-767	-719	-666	-699	-716	-568	-550	-517	-466
Broad money	866	1,545	1,758	2,048	2,111	2,251	2,363	2,476	2,588	2,701
Domestic currency (cash and deposits)	285	317	364	437	462	539	566	593	620	647
Foreign currency deposits	581	1,227	1,395	1,611	1,649	1,712	1,797	1,883	1,968	2,054
Bank of Lao P.D.R.										
Net foreign assets	216	405	389	515	758	799	796	794	775	880
Foreign assets	480	807	772	887	1,119	1,147	1,130	1,148	1,117	1,246
Foreign liabilities	-264	-401	-383	-372	-361	-347	-334	-355	-342	-366
Net domestic assets 3/	66	76	160	197	56	-33	-143	-130	-100	-194
Domestic credit	279	632	715	700	632	588	467	485	506	386
Net credit to government	14	-36	-52	-212	-269	-347	-337	-327	-315	-438
Credit to the economy	185	367	405	438	480	489	518	537	556	574
Credit to state enterprises	113	224	262	296	339	346	375	394	412	431
Credit to private sector	72	143	143	142	141	143	143	143	143	143
Credit to banks	80	302	362	475	421	446	286	276	266	250
BOL securities	-43	-142	-166	-167	-160	-159	-112	-98	-71	-26
Other items, net	-170	-415	-389	-337	-416	-461	-498	-517	-536	-554
Reserve money 3/	282	482	547	712	814	767	652	663	675	686
Memorandum items:										
Bank financing of the budget 4/	30	-39	-166	-76	-104	-46	-35	-18	0	-123
Of which: BOL financing of the budget 4/	53	46	-92	-168	-216	-73	-68	-58	-46	-123
			(In millions of U.S. dollars; end-of-period)							
Net foreign assets	117	167	179	188	183	186	169	168	166	179
Of which: BOL	50	53	51	66	94	97	97	97	95	107
Foreign currency credit to the economy	100	95	105	107	111	122	119	124	129	134
Foreign currency deposits	136	161	184	206	204	208	219	230	240	250
			(Annual percent change)							
Broad money	113.3	78.4	58.2	7.9	49.8	45.7	34.4	20.9	22.6	20.0
Credit to the economy	86.3	74.2	44.8	-3.8	35.2	41.3	33.8	29.3	24.2	17.8
Credit to state enterprises	85.6	99.2	70.4	11.2	58.0	44.3	34.9	21.1	15.6	16.5
Credit to the private sector	86.6	63.6	34.3	-10.9	24.7	39.7	33.3	34.1	29.2	18.5
Reserve money	87.7	71.0	59.1	40.9	75.2	59.1	19.3	-6.8	-17.1	-10.5
Money multiplier	3.1	3.2	3.2	2.9	2.6	2.9	3.6	3.7	3.8	3.9
Velocity (ratio)	7.0	7.4	...	...	...	6.8	...	...	...	6.4
Exchange rate, end-of-period (kip per U.S. dollar)	4,274	7,600	7,560	7,815	8,085	8,218	8,200	8,200	8,200	8,200

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates and projections.

1/ Compared to previously used monetary data, the reclassification of credit to farmers and state enterprises for irrigation projects as credit to the government has been discontinued, to be consistent with the sector of the debtors and in line with the authorities' presentation.

2/ For 2001, the increase in the net foreign assets assumes that the balance of payments gap is not filled. The filling of this gap would result in offsetting increases in foreign assets of the BOL and its foreign liabilities and government deposits.

3/ From January 2001 reserve money and NDA of the BOL have been reduced by KN 150 billion due to the netting of BOL deposits at banks and banks' deposits at BOL. The December 2001 level of NDA of the BOL includes the external disbursement of US$15 million (KN 123 billion). Excluding these two adjustments, the end-2001 stock would have been KN 64 billion, an increase of KN 97 billion from end-2000.

4/ Cumulative from the start of the fiscal year (which runs from October to September). Annual data are on a fiscal year basis. In 1999/2000 excludes the reclassification of the costs of printing money (KN 78 billion).

Table 6. Lao P.D.R.: Summary Macroeconomic Framework, 1998–2003

(In percent of GDP; unless indicated otherwise)

	1998	1999	2000	2001	2002	2003
Real GDP growth (percent change)	4.0	7.3	5.7	5.7	6.5	7.0
Inflation (percent change, annual average)	90.1	128.4	23.3	9.0	7.5	5.7
Merchandise exports (percent change)	6.4	7.7	8.3	7.4	8.6	9.0
Merchandise imports (percent change)	-14.7	0.3	6.6	10.6	23.8	10.6
(percent change excluding NT2)					10.0	8.4
Official gross reserves (in months of prospective goods and services imports, excluding NT2	2.2	2.0	2.4	2.5	2.7	3.0
Budget (fiscal year basis) 1/						
Revenue	9.8	10.6	12.7	13.9	14.5	15.0
Grants	5.3	6.0	3.2	2.8	3.1	3.1
Expenditure	23.6	20.6	20.9	21.7	22.4	22.8
Current	8.1	6.1	8.1	8.4	9.4	10.3
Capital and onlending	15.5	14.4	12.8	13.3	13.0	12.5
Current fiscal balance before grants	1.7	4.4	4.6	5.5	5.1	4.7
Overall fiscal balance after grants	-8.5	-4.0	-5.0	-5.0	-4.8	-4.7
Domestic financing	2.5	-0.6	-0.7	1.2	0.3	0.3
Foreign financing	6.0	4.6	5.8	3.8	4.4	4.4
Real GDP growth (percent change) 1/	4.5	6.5	6.1	5.7	6.3	7.0
Increase in GDP deflator (percent change) 1/	71.2	120.4	36.1	10.0	8.0	6.0
Savings and investment balance 2/						
National savings	12.7	16.4	14.6	14.8	15.5	15.6
Private	11.0	11.9	10.0	9.3	10.4	10.9
Government	1.7	4.5	4.6	5.5	5.1	4.7
Investment	22.8	22.7	20.4	21.6	28.6	29.5
Private	7.3	8.3	6.9	7.5	14.9	17.0
Of which: Hydropower	1.4	1.9	0.0	0.0	6.4	7.7
Other	5.9	6.4	6.9	7.5	8.5	9.3
Government 3/	15.5	14.4	13.5	14.1	13.7	12.5
Foreign savings	10.1	6.3	5.8	6.8	13.1	13.9
(excluding Hydropower)	8.7	4.4	5.8	6.8	6.0	5.5

Source: Data provided by the Lao P.D.R. authorities; and Fund staff estimates

1/ Fiscal year ending September.

2/ Estimates for private savings and investment are highly tentative as no official national accounts by expenditure have been compiled.

3/ Comprises government investment and selected public enterprise investment.

Table 7: Lao P.D.R. Balance of Payments, 1998-2005

	1998	1999	Est. 2000	Projections 2001	2002	2003	2004	2005
	(In millions of U.S. dollars; unless indicated otherwise)							
Current account	-56	-22	-28	-58	-214	-271	-281	-302
(excluding official transfers)	-130	-92	-98	-128	-284	-341	-351	-372
Merchandise trade balance	-216	-191	-198	-231	-351	-395	-411	-432
Exports, f.o.b.	337	363	393	422	458	500	529	574
(in percent change)	6.4	7.7	8.3	7.4	8.6	9.0	6.0	8.4
Imports, c.i.f.	553	554	591	653	809	895	940	1,007
(in percent change)	-14.7	0.3	6.6	10.6	23.8	10.6	5.1	7.0
Services (net)	71	98	105	108	72	64	77	80
Factor income (net)	-34	-28	-37	-37	-39	-46	-54	-59
Of which: interest payments 1/	-26	-19	-19	-19	-23	-23	-23	-22
Transfers (net)	123	99	101	102	104	105	107	109
Private	49	30	30	32	34	35	37	39
Official	74	70	71	70	70	70	70	70
Of which: technical assistance	17	14	16	...	...	...	...	...
Capital account	38	25	72	50	209	269	327	360
Long-term loans	86	62	96	83	114	98	100	105
Disbursements	98	91	120	110	139	128	134	141
Amortization	-12	-29	-24	-27	-25	-30	-35	-36
Foreign investment (incl. external loans)	56	79	30	28	188	253	269	286
Of which: hydropower investment 2/	18	27	17	-12	138	188	188	188
Net foreign assets of commercial banks (increase -)	-17	-47	25	-1	-30	-30	-10	-5
Errors and omissions	-86	-68	-79	-60	-63	-52	-32	-25
Overall balance	-18	3	44	-8	-5	-2	46	58
Financing	18	-3	-44	8	5	2	-46	-58
Central bank net foreign assets	18	-3	-44	-22	-35	-38	-46	-58
Assets (increase -)	23	6	-33	-12	-26	-30	-39	-52
Liabilities (reduction -)	-5	-9	-10	-10	-9	-8	-7	-5
Financing gap	0	0	0	30	40	40	0	0
Memorandum items:								
Current account (in percent of GDP)								
(excluding official transfers)	-10.1	-6.3	-5.7	-6.8	-13.1	-13.9	-12.9	-12.3
(including official transfers)	-4.4	-1.5	-1.6	-3.1	-9.9	-11.1	-10.3	-10.0
(including official transfers and excluding NT2)	-4.4	-1.5	-1.6	-3.1	-2.8	-2.7	-2.8	-3.2
(excluding official transfers and NT2)	-10.1	-6.3	-5.7	-6.8	-6.0	-5.5	-5.3	-5.5
Official gross reserves (in millions of U.S. dollars)	112	106	140	152	178	208	247	299
(in months of prospective goods and service imports, exc. NT2)	2.2	2.0	2.4	2.5	2.7	3.0	3.3	3.6
Debt service ratio (including Fund, in percent of goods and service exports) 1/	9.7	10.3	9.2	9.7	9.3	9.3	9.2	8.5

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates and projections.

1/ Includes debt service to official creditors and estimates for debt service to commercial creditors, but does not include obligations to the Russian Federation which are being clarified in the context of bilateral negotiations.

2/ The large hydroelectric project Nam Theun 2 (NT2) is valued at US$1.0 billion (approximately equivalent to 60 percent of GDP) to be implemented over 2002-06, and would be financed by foreign investment.

Table 8. Lao P.D.R.: Debt Stock and Debt Service 1998–2005 1/

	1998	Est. 1999	Projections 2000	2001	2002	2003	2004	2005
	(In millions of U.S. dollars)							
Total debt stock 2/	2,560.8	2,617.1	2,557.8	2,661.5	2,805.9	2,935.2	3,027.8	3,127.2
Bilateral	1,470.8	1,456.1	1,391.9	1,407.0	1,427.7	1,433.7	1,439.3	1,444.8
Of which:								
Russian Federation 3/	1,336.6	1,303.2	1,297.5	1,297.5	1,297.5	1,297.5	1,297.5	1,297.5
Multilateral	971.4	1,036.0	1,042.2	1,142.7	1,278.3	1,413.3	1,512.2	1,618.0
Of which:								
AsDB	500.0	540.4	541.5	...	...	...	...	...
IDA	363.1	380.7	393.6	...	...	...	...	...
IMF 4/	59.5	55.2	48.1	45.0	47.9	51.4	50.5	45.2
Commercial 5/	118.6	125.0	123.7	111.8	100.0	88.1	76.2	64.4
Total debt service 2/	45.1	52.8	50.1	56.1	57.4	61.6	64.7	64.1
Amortization	18.7	34.2	31.4	36.6	34.6	38.8	41.7	41.7
Bilateral	1.7	3.8	3.4	5.0	3.8	4.9	5.4	5.5
Of which:								
Russian Federation 3/	6.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Multilateral	11.2	18.5	16.1	19.8	18.9	22.0	24.5	24.3
Of which:	...	...						
IMF 4/	6.3	4.4	7.8	9.5	9.2	8.5	7.0	5.4
Commercial 5/	5.8	11.9	11.9	11.9	11.9	11.9	11.9	11.9
Interest payments	26.4	18.5	18.7	19.4	22.8	22.9	23.0	22.4
Bilateral	0.3	0.5	0.7	1.3	1.3	1.4	1.2	1.1
Of which:								
Russian Federation 3/	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Multilateral	8.4	7.9	9.0	10.1	14.6	15.6	16.9	17.6
Of which:								
IMF 4/	0.4	0.3	0.5	0.8	0.8	0.8	0.8	0.8
Commercial 5/	17.8	10.1	9.1	8.0	6.9	5.9	4.8	3.7
Memorandum items:								
New disbursements	98.0	90.9	119.7	140.3	179.0	168.0	134.4	141.1
Of which: Project financing	98.0	90.9	108.2	110.3	139.0	128.0	134.4	141.1
Ratios in percent of GDP								
Total debt service 6/	3.5	3.6	2.9	3.0	2.6	2.5	2.4	2.1
Total debt stock	199.2	178.1	149.1	140.5	129.4	119.7	110.9	103.0
excluding Russian Federation debt	95.2	89.4	73.4	72.0	69.6	66.8	63.4	60.2
Total debt stock (NPV)	97.8	87.4	73.1	68.9	63.5	58.7	54.4	50.5
Central government debt service in percent of revenues	7.8	6.3	4.7	4.6	5.0	4.6	4.3	4.0
Ratios in percent of exports of goods and services								
Total debt service 6/	9.7	10.4	9.2	9.7	9.3	9.3	9.2	8.5
Total debt stock 7/	548.7	514.9	505.3	489.8	483.4	472.4	456.9	442.2
Total debt stock (NPV) 7/	269.3	252.7	248.0	240.4	237.2	231.8	224.2	217.0

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates.

1/ Debt service is calculated on the basis of existing debt, and currently identified disbursements, including prospective disbursements from the Fund, the World Bank, the AsDB, the Exim Bank of China, and public debt contracted to finance NT2. It includes all public and publicly-guaranteed debt.

2/ Excluding private debtors.

3/ Debt under negotiation.

4/ Including the new arrangement.

5/ Publicly-guaranteed public enterprise debt.

6/ Excluding the debt service to the Russian Federation which is under negotiation.

7/ Three-year average of exports of goods and services.

Table 9. Lao P.D.R.: Indicators of External Vulnerability, 1998–2000

	1998	1999	Est. 2000
Financial indicators			
Broad money (M2: annual percentage change) 1/	113.3	78.4	45.7
Foreign currency deposits to broad money (in percent) 1/	67.1	79.5	76.0
Credit to other (nonstate) sectors (annual percentage change)	86.3	74.2	41.3
Foreign currency loans to credit to the economy (in percent)	57.0	55.0	54.0
External indicators			
Exports (annual percentage change, in U.S. dollars)	6.4	7.7	8.3
Imports (annual percentage change, in U.S. dollars)	-14.7	0.3	6.6
Current account balance (in percent of GDP, including official transfers)	-4.4	-1.5	-1.6
Capital account balance (in millions of U.S. dollars) 2/	38	25	72
Of which:			
Short-term capital (net) 3/	-17	-47	25
Gross foreign direct investment (inflows)	56	79	30
Medium- and long-term loans (net)	86	62	96
Errors and omissions	-86	-68	-79
Exchange rate (per U.S. dollar, period average) 4/	3,298	7,012	7,857
(annual percentage change)	163.5	112.6	12.1
Exchange rate (per U.S. dollar, end-of-period) 4/	4,274	7,600	8,218
(annual percentage change)	98.6	77.8	8.1
Real effective exchange rate (annual average, percentage change)	-23.1	5.0	10.8
Reserve indicators			
Gross official reserves, including gold (in millions of U.S. dollars)	112	106	140
(in weeks of next year's imports of goods and services)	2.2	2.0	2.4
Central bank short-term foreign liabilities (in millions of U.S. dollars)	62	53	42
Net official international reserves (in millions of U.S. dollars)	50	53	97
Gross official reserves to broad money (M2) (in percent)	55.4	52.2	51.0
Net foreign assets of commercial banks (in millions of U.S. dollars)	66	113	88
Debt indicators			
Total external debt (in millions of U.S. dollars) 5/ 6/	2,561	2,617	2,558
Total debt to exports of goods and services (in percent) 5/ 6/	548.7	514.9	505.3
Total debt-to-GDP ratio (in percent) 5/ 6/	199.2	178.1	149.1
Total debt service to exports of goods and services (in percent) 5/ 7/	9.7	10.4	9.2
Of which: External interest payments to exports of goods and services (in percent)	5.7	3.6	3.4
Total short-term external debt (in millions of U.S. dollars)	...	...	...

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates.

1/ Based on monetary survey.

2/ Excludes errors and omissions.

3/ Includes net external position of banking system and portfolio investment.

4/ Official mid-rate, which comprises the previous day's average interbank buying and selling rates.

5/ Excludes private sector debt.

6/ Including estimate of nonconvertible Russian debt under negotiation.

7/ Includes all public and publicly-guaranteed debt.

Table 10. Lao P.D.R.: External Financing Needs and Sources, 1998–2003

	1998	1999	Est. 2000	Proj. 2001	Proj. 2002	Proj. 2003
	(In millions of U.S. dollars)					
Gross financing needs	**125.8**	**119.8**	**163.2**	**177.4**	**344.5**	**409.6**
External current account deficit (excl. official transfers)	130.2	92.1	98.4	128.4	283.7	341.2
Debt amortization 1/	12.4	29.3	23.6	27.1	25.4	30.3
Medium- and long-term debt	12.4	29.3	23.6	27.1	25.4	30.3
Public sector	12.4	29.3	23.6	27.1	25.4	30.3
Corporate private sector	...	...	...	...	...	...
Short-term debt 2/	...	...	...	...	...	...
Gross reserve accumulation (- = increase) 3/	23.0	6.0	-33.4	-12.4	-26.2	-29.7
IMF repurchase and repayments	6.3	4.4	7.8	9.6	9.2	8.5
Financial Sources	**125.8**	**119.8**	**163.2**	**147.4**	**304.5**	**369.6**
Foreign direct investments (net)	55.8	79.0	29.6	28.3	188.2	253.1
Debt financing from private creditors	...	...	...	...	...	...
Financing from official creditors 4/	171.7	160.6	190.2	180.3	209.0	198.0
Other flows 5/	-101.7	-119.8	-56.7	-61.2	-92.7	-81.5
Financing gap 6/	**0.0**	**0.0**	**0.0**	**30.0**	**40.0**	**40.0**

Sources: Data provided by the Lao authorities; and Fund staff estimates.

1/ Excluding the IMF.
2/ Original maturity of less than one year. Includes all short-term outflows.
3/ Includes those transactions that are undertaken for the purpose of financing a balance of payments deficit or an increase in reserves.
4/ Includes both grants and loans.
5/ Includes all other net financial flows, and errors and omissions.
6/ Includes prospective IMF disbursements.

Table 11. Lao P.D.R.: Social and Demographic Indicators

	Latest Single Year			Same Region/Income Group	
	1970–75	1980–85	1993–98	East Asia and Pacific	Low-Income
Population					
Total population, mid-year (millions)	3.0	3.6	5.0	1,817.1	3,536.4
Growth rate (percent annual average)	2.2	2.3	2.2	1.0	1.4
Urban population (percent of population)	11.4	15.6	22.4	33.9	30.5
Total fertility rate (births per woman)	6.2	6.7	5.5	2.1	3.1
Poverty (percent of population)					
National headcount index	..	..	46.1	..	..
Urban headcount index	..	..	24.0	..	..
Rural headcount index	..	..	53.0	..	..
Income					
GNP per capita (US$)	..	..	320	990	520
Consumer price index (1995=100)	..	..	275	130	136
Social Indicators					
Public expenditure					
Health (percent of GDP)	..	..	1.2	1.7	1.3
Education (percent of GNP)	..	0.4	2.1	2.9	3.2
Net primary school enrollment rate *(percent of age group)*					
Total	..	70	73	99	86
Male	..	74	77	99	89
Female	..	66	69	99	82
Access to safe water (percent of population)					
Total	..	..	39	84	..
Urban	..	..	40	89	..
Rural	..	..	39	82	..
Immunization rate (percent under 12 months)					
Measles	..	6	67	93	80
DPT	..	4	60	93	82
Child malnutrition (percent under 5 years)	..	..	40	20	..
Life expectancy at birth (years)					
Total	40	46	54	69	63
Male	39	45	52	67	62
Female	42	48	55	71	64
Mortality					
Infant (per thousand live births)	145	122	96	35	68
Under 5 (per thousand live births)	218	200	170	43	92
Adult (15–59)					
Male (per 1,000 population)	610	531	376	188	235
Female (per 1,000 population)	510	439	320	145	208

Source: 2000 World Development Indicators CD-ROM, World Bank.

Lao P.D.R.—Fund Relations 1/
(As of February 28, 2001)

I. **Membership Status:** Joined 7/05/61; Article XIV

		SDR million	Percent Quota
II.	**General Resources Account:**	**SDR million**	**Percent Quota**
	Quota	52.90	100.0
	Fund holdings of currency	52.90	100.0

III.	**SDR Department:**	**SDR million**	**Percent Allocation**
	Net cumulative allocation	9.41	100.0
	Holdings	0.99	10.5

IV.	**Outstanding Purchases and Loans:**	**SDR million**	**Percent Quota**
	SAF arrangement	2.6	4.9
	ESAF arrangement	29.3	55.4

V. **Financial Arrangements:**

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR million)**	**Amount Drawn (SDR million)**
ESAF	6/04/93	5/07/97	35.19	35.19
SAF	9/18/89	9/17/92	20.51	20.51
Stand-by	8/04/80	8/12/81	14.00	14.00

VI. **Projected Obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	**Forthcoming**				
	01/31/01	**2001**	**2002**	**2003**	**2004**	**2005**
Principal	0.0	6.7	7.0	6.5	5.3	4.1
Charges/interest	0.0	0.5	0.5	0.4	0.4	0.4
Total	0.0	7.2	7.5	6.9	5.7	4.5

1/ Calculated using new quota accepted in March, 2001.

VII. Exchange Rate

In September 1995, the Lao P.D.R. adopted a managed floating exchange rate system, abolishing the official rate. From October 1997, commercial banks have been encouraged to follow the parallel market closely. On March 21, 2001 the commercial bank exchange rate was kip 8,290 (buying) and kip 8,340 (selling) per U.S. dollar.

VIII. Last Article IV Consultation Discussions

The last Article IV consultation discussions were held in Vientiane during August 9-25, 1999. The staff report (SM/99/271) was discussed by the Executive Board on November 22, 1999. The Lao P.D.R. maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

IX. Technical Assistance (since 1998)

Department	Purpose	Date
STA	- Assist in compilation of balance of payments data.	8/99
	- Review and assist in compilation of money and banking statistics.	2/99
MAE	- Assess banking sector soundness.	11/98
	Assist operation of market-based exchange system and interbank market.	2/98, 7/98
FAD	- Missions on tax policy and administration.	1/99, 2/00.
	- Expert on tax administration.	9/98-12/99, 1-3/00, 5-7/00, 9-11/00, 1-2/01
	- Expert on customs administration.	2-5/98, 10/98-1/99,5-6/00, 9-11/00, 1-3/01
	- Strengthen fiscal management (tax and customs administration reform).	2/98

X. Resident Representative

Mr. Eric Sidgwick assumed the post of resident representative in Vientiane on June 26, 2000.

Lao P.D.R.—Relations with the World Bank Group[1]

With the ultimate objective of reducing poverty in Lao P.D.R., the World Bank Group's operations assist the Government in achieving its overall goals of improving peoples' welfare and incomes, infrastructure development, and human resource development. Bank programs support the country's economic reform program, and the development of more efficient services across all key sectors of the economy. A Country Assistance Strategy (CAS) for FY2000 to FY2002, incorporating these broad objectives, was issued on March 30, 1999 and approved by the Board.

All projects are financed with IDA credits. As of February 28, 2001, 27 credits totaling about $576 million equivalent had been approved for Lao P.D.R.. The composition of this portfolio is as follows: adjustment support 21 percent; rural development 23 percent; transport 24 percent; energy 19 percent; telecommunications 5 percent; education and health 7 percent; and industry 2 percent. The Road Maintenance Project (US$ 25m equivalent) was approved on March 27, 2001 but is not yet effective.

Since 1977, the amount of IDA credits committed and disbursed has been as follows:

IDA: Commitments and Disbursements to the Lao P.D.R., 1977-2001
(In millions of U.S. dollars; as of February 28, 2001)

Fiscal Year (to June 30)	Committed	Disbursed	Repayments
1977-93	335.2	180.7	1.5
1994	48.4	45.1	0.6
1995	19.2	31.4	0.6
1996	60.7	28.6	0.6
1997	48.0	65.2	0.6
1998	34.7	26.5	1.3
1999	29.8	27.8	1.5
2000	0.0	18.1	3.0
2001 (February)	0.0	14.1	2.2
Total	576.0	437.5	11.9

Source: World Bank.

As agreed during the CAS consultations and as requested by the Government, the Bank intends to place increased emphasis on human resource development in its new credits in addition to its already broad role in basic infrastructure and productive sectors. The International Finance Corporation has also been providing support to the private sector, and

[1] Prepared by the World Bank, March 2001.

further investments are being developed. The World Bank Institute continues to provide training in support of capacity building initiatives. The Bank's analytical and advisory services and economic and sector work are currently focusing on improving the analysis and monitoring of poverty, and a joint public expenditure review is underway.

Note: The last Economic Report (*Lao P.D.R.: Country Economic Memorandum*, Report No. 12554-LA) was published on March 24, 1994. A report entitled the *Lao P.D.R.: Public Expenditure Review* was issued on February 28, 1997. The latest *Lao P.D.R. Country Assistance Strategy* was issued on March 30, 1999.

Lao P.D.R.—Relations with the Asian Development Bank[1]

The Asian Development Bank's (AsDB) has extended development assistance to Lao P.D.R. since 1970. In the 1970s and 1980s, AsDB assistance was focused mainly on economic growth projects involving infrastructure development in the transport and energy sectors. Financial sector development has also been assisted by AsDB since the latter part of the 1980s. Since the early 1990s, the emphasis of AsDB assistance to Lao P.D.R. has been broadened to include rural development, social development and environment. Furthermore, in the late 1990s, the AsDB assistance has shifted towards more social and rural development to address poverty.

AsDB's future operational strategic directions in Lao P.D.R. are: (i) increasing efficiency of development activities through continued structural reforms and enhanced governance related activities; (ii) the need for greater emphasis on rural development, especially the need to increase rural productivity and to reduce poverty in remote and rural areas; (iii) development of human capital through initiative in education and health sectors; (iv) sustainable natural resources management and environmental protection; (v) geographical and integrated planning focus of project interventions in order to build synergies between its own activities and increase developmental impact; and (vi) greater community participation in the selection and design of AsDB interventions.

AsDB's lending and technical assistance programs beginning in 2000 will increasingly focus on efforts to reduce poverty. The program of activities will include direct poverty intervention projects as well as pro-poor growth projects. AsDB will continue to promote subregional cooperation to enhance market opportunities for the landlocked economy of the Lao P.D.R..

Table 1. Lao P.D.R.: AsDB Commitments and Disbursements, 1997-2000

(In million of U.S. dollars)

	1997	1998	1999	2000
Commitments	103.0	20.0	57.6	60.5
Disbursements	87.0	66.0	46.8	51.0

Source: Data provided by the Asian Development Bank.

[1] Prepared by the Asian Development Bank.

Table 2. Lao P.D.R.: Asian Development Bank Program/Project Loan Disbursements, 1997-2001[1/]

(In millions of U.S. dollars)

	1997	1998	1999	2000	2001[2/]
Loans					
Nam Song Hydropower Development Project	1.9	-	-	-	-
Fourth Road Improvement Project	0.7	-	-	-	-
Southern Provincial Towns Water Supply Proj	1.2	-	-	-	-
Fifth Road Improvement Project	8.0	0.1	-	-	-
Rehabilitation and Upgrading Of Vientiane Water Supply Project	0.5	0.1	-	-	-
Nam Ngum-Luang Prabang Power Transmission Project	0.2	1.7	-	-	-
Theun-Hinboun Hydropower Project	35.8	0.5	-	-	-
Northern Provincial Towns Water Supply & Sanitation Project	8.1	2.8	0.1	-	-
Education Quality Improvement Project	3.1	5.2	1.8	-	-
Nam Leuk Hydropower Project	10.4	22.0	13.8	2.0	0.3
Second Financial Sector Program	-	-	-	11.3	-
Champassak Road Improvement Project	8.2	9.9	8.6	5.9	1.3
Sixth Road Improvement Project	2.4	3.7	3.9	3.1	2.0
Airports Improvements Project	2.6	4.7	2.7	1.2	0.2
Primary Health Care Project	0.9	0.9	0.8	0.7	-
Vientiane Integrated Urban Development Project	0.9	1.8	6.0	6.0	1.3
Industrial Tree Plantation Project	1.0	0.6	0.9	1.1	1.6
Postsecondary Education Rationalization Project	1.0	2.1	0.8	3.4	2.4
Xieng Khouang Road Improvement Project	-	6.0	3.6	8.2	9.0
Power Transmission & Distribution Project	-	0.6	0.7	0.7	7.0
Secondary Towns Urban Dev. Project	-	1.4	0.8	0.9	2.4
Community Managed Irrigation Sector Project	-	1.8	2.2	3.0	2.0
Greater Mekong Subregion:East West Corridor Project	-	-	-	1.6	2.8
Basic Education (Girls) Project	-	-	-	0.7	1.5
Shifting Cultivation Stabilization Pilot Project	-	-	-	0.8	1.4
Water Supply And Sanitation Sector Project	-	-	-	0.4	0.5
Primary Health Care Expansion	-	-	-	-	1.3
Decentralized Irrigation Development	-	-	-	-	0.1
Rural Access Roads	-	-	-	-	0.3
Total	87.0	66.0	46.8	51.0	37.4

Source: Data provided by the Asian Development Bank.

[1/] Based on actual or projected disbursements.
[2/] Planned

Lao P.D.R.—Medium-Term Balance of Payments

Lao P.D.R.'s external position is expected to improve over the medium term, assuming that the macroeconomic policies and structural reforms to improve competitiveness and attract foreign direct investment (FDI) are put in place as envisaged under the program. Exports and imports are expected to grow strongly, reflecting the construction of the Nam Theun 2 (NT2) Hydroelectric Project (see Box 3), which is to start in 2002, and the positive impact of regional integration. The external current account deficit is expected to increase to about 13 percent of GDP in 2002-05, and decline again when NT2 exports come on stream. Excluding imports of goods and services associated with the construction of NT2, the current account (excluding grants) is projected to decline from 6.8 percent of GDP in 2001 to 5.5 percent of GDP in 2003, and stabilize at this level until 2005. Gross official reserves are targeted to increase to 3 months of prospective imports of goods and services in 2003 and close to 4 months in 2005 (Table 7).

The improvement in the current account deficit (excluding NT2) is based on the following assumptions:

- **Exports** are assumed to grow by 8 percent on average in 2001-05, driven by a strong growth in the garment industry and other manufactures, as access to European, Japanese and U.S. markets improves. Growth in these sectors is projected to more than offset a possible decline in the wood exports resulting from preservation efforts. Exports of electricity from the new dam are projected to start in 2006, which would increase exports by 22 percent.

- **Imports** are projected to increase significantly in 2001-05, even excluding the effect of NT2, as a result of increasing regional integration, as AFTA commitments are implemented, and as customs procedures and transport links are improved.

Debt issues

According to data compiled by the Ministry of Finance, the debt stock is estimated at US$2.6 billion (Table 8).[1] The main bilateral creditor is the Russian Federation (US$1.3 billion), whose debt is currently under negotiations. With multilateral creditors accounting for almost half of the total, the net present value of this debt would amount to some US$1.3 billion (some 250 percent of three-year average exports of goods and services,160 percent after traditional debt relief mechanisms are applied). Also, the value of the commercial debt, mostly owed by state-owned enterprises, still needs to be confirmed.

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[1] As noted in the main text, the external debt management system was not in place at the time of preparation of this report so that these figures are estimates.

Over the medium term, the **ratio of debt service to exports of goods and services** (excluding the Russian Federation) is expected to decline from 9.7 percent in 2001 to 9.3 percent in 2003 and 8.5 percent in 2005. This assumes that the current account deficit is not financed by significant commercial borrowing. Thus debt sustainability indicators would improve in the period 2001-05, and thereafter with the increase in electricity exports from 2006: (i) the net present value of external debt (NPV) is projected to decline from 73 percent of GDP (248 percent of exports of goods and services) in 2000 to 50 percent of GDP (217 percent of exports of goods and services) in 2005; and the debt service is programmed to decline from 9.2 percent of exports of goods and services in 2000 to 8.5 percent in 2005.

Lao P.D.R.—Statistical Issues

The overall coverage and quality of economic statistics in Lao P.D.R. is subject to significant shortcomings and needs to be improved, possibly through additional technical assistance, to enable the production of timely and accurate data for policy analysis and program monitoring. Economic and financial data are published in periodic reports by the Bank of the Lao P.D.R. (BOL) and by the National Statistical Center (NSC). A page for the Lao P.D.R. was introduced in the April 1996 issue of *International Financial Statistics (IFS)*.

National Accounts

National accounts data are only available on an annual basis. These production-based estimates do not accurately reflect changes in the structure of the country's production and have recently displayed some implausible movements, particularly with regard to developments in the agricultural sector. The CPI acts as a proxy for the majority of sectoral deflators. Fund missions have been encouraging the authorities to address these weaknesses. The Swedish government and the World Bank have provided technical assistance on national income accounts, including compilation of expenditure-based GDP estimates that are now available on a preliminary basis (1997 base year).

Prices

The NSC reports a monthly CPI through the BOL with minimal lags. The latest CPI was introduced in January 2000 (rebased to December 1999) using data from the 1997/98 household consumption survey. It comprises nine product categories covering major urban centers, including Vientiane.

Government finance

Government finance statistics are very weak with scope to significantly improve their accuracy, coverage and transparency. The Budget Department produces monthly and quarterly revenue and expenditure summaries. Expenditure data by ministry and province allocation is available but not by program. In addition, data on bank and nonbank financing of the budget, including treasury bill operations, also need to be improved to provide consistency with the monetary accounts. Annual budget and outturn data is not produced to GFS standards complicating fiscal analysis. In early 2001 the authorities published annual tables for the 1999/00 outturn and 2000/01 budget.

Budget execution, reporting and cash management processes and system require significant upgrading. A FAD diagnostic mission will assess shortcomings and propose a remedial plan of action in the context of the 2001 Public Expenditure Review. Data quality and monitoring of external debt, especially state enterprises, is weak. A new debt monitoring unit has been recently established to remedy this with technical assistance from the World Bank. Greater decentralization in 2000/01 has further complicated the timely reporting of fiscal data from lower government levels as monitoring systems are weak and skilled staff limited. This continues to hamper the accurate reporting of such issues as timber related royalty payments to the central budget.

Owing to the lack of reliable data, no government finance data are presented in *IFS* country page or *Government Finance Statistics Yearbook.*

Monetary accounts

The Bank of the Lao PDR (BOL) regularly reports the BOL balance sheet (with a 2-week lag) and commercial bank balance sheet (with a 4-week lag). Although the authorities have made several improvements in compiling monetary statistics in recent years, the reporting by some banks, especially new branches of foreign banks, is still weak. A new chart of accounts for the Bank of the Lao P.D.R and commercial banks was introduced in October 1998. A Fund review of the new chart of accounts in February 1999 found them sufficiently detailed to meet internationally accepted standards for the compilation of monetary statistics. The review made suggestions to improvement and clarify the chart of accounts. Even though there has been a substantial improvement in the reporting of monetary statistics, there is a need to improve further the timeliness of monetary data reporting to STA.

Balance of payments

Data on foreign reserves (gross official and net international) are reported on a weekly basis and also derived from the monetary survey, at the prevailing kip per US dollar end-month exchange rate.

Balance of payments statistics need improvements in the frequency and the coverage of, the following areas: (1) customs trade data, (2) the commodity composition of external trade, (3) the recording of factor payments, (4) actual foreign direct investment flows, (5) the use of commercial bank data on foreign transfers and other transactions, and; (6) the reconciliation of fiscal and balance of payments data on external aid (loans and grants).

An STA mission in 1999 found that data coverage and valuation problems on traded goods arose from weaknesses of customs controls, due to staffing and computing constraints and delays in reporting from provincial customs points. A reorganization of the Customs department, including the introduction of new customs procedures, the Customs 2000 system and equipment, is being implemented (with FAD technical assistance) and has now started to produce more accurate and timely data since October 2000.

There is an acute need to improve the coordination and cooperation between the agencies involved in BOP compilation, viz., the Customs and External Financial Relations Departments of the Ministry of Finance, the Office for the Management of Foreign Investment, and the BOL, in order to produce accurate balance of payments updates on a regular basis.

Lao P.D.R.: Core Statistical Indicators

(As at March 30, 2001)

	Exchange rates	International reserves	Reserve/base money	Central bank balance sheet	Broad money	Interest Rates	Consumer price index	Exports/ imports	Current Account Balance	Overall government balance	GDP/GNP	External debt
Date of latest Observation	3/30/01	3/14/01	3/01	2/01	2/01	2/01	2/01	Q2/00	Q2/00	3/01	2000	Q2/00
Date received	3/30/01	3/19/01	3/29/01	3/29/01	3/29/01	3/5/01	3/5/01	1/18/01	1/18/01	3/21/01	5/00	1/18/01
Frequency of data	D	M [1/]	M	M	M	M	M	Q	Q	M [2/]	A	Q
Frequency of reporting	D	M [1/]	M	M	M	M	M	Q	Q	M [2/]	A	Q
Source of Data [3/]	A	A	A	A	A	A	A	A	A	B	C	A
Mode of reporting [4/]	E	E	E	E	E	C	E	C	C	C	C	C
Confidentiality [5/]	C	C	C	C	C	C	C	C	C	C	C	C
Frequency of Publication [5/]	O	O	O	O	O	O	O	O	O	O	O	O

[1/] International reserves are available on a bi-weekly basis.

[2/] Monthly budget revenue and expenditure reported with 3-week lag, but budget financing reported on an irregular basis.

[3/] Source A: Central Bank, B: Ministry of Finance, C: National Statistical Center.

[4/] Data are directly reported by the authorities via the resident representative's office (E –electronic , C- facsimile).

[5/] All data are eventually published in periodic reports by the BOL and the National Statistical Center. No explicit embargoes apply. These data (except fiscal data) have also been published in International Financial Statistics (IFS) since the April 1996 issue (C- unrestricted use, O – other irregular basis).

Lao P.D.R.—Report on the Technical Consultation Discussions

This note summarizes and assesses recent Fund-provided technical assistance to Lao P.D.R., and discusses the future directions. Over the past 10 years the government has provided Lao P.D.R. with considerable technical assistance. This has made an important improvement in the institutional capacity but there are still many areas of weaknesses.

Fiscal Affairs Department (FAD)

Past experience: FAD has provided technical assistance to Lao P.D.R. on tax policy and administration, tariff policy, and customs administration.

- Tax and tariff policy: In 1995, an FAD tax policy mission prepared an extensive tax reform agenda. A follow-up FAD technical assistance mission in 1997 advised on selected tax issues, including the VAT, taxation of small businesses, and excises. Another FAD mission in February 2000 updated the estimates of the revenue impact of ASEAN Free Trade Agreement (AFTA) and identified compensatory revenue measures, namely the transformation of the turnover tax to a VAT. The mission outlined the policy and administration measures needed to achieve this, proposed a reform of the excise duty system, and formulated measures for more effective taxation of small businesses.

- Tax and Customs Administration: Phase I of the UNDP/IMF/NORAD (TA Project Lao 96/005) Strengthening Fiscal Management, provided, over a 24-month period starting September 1997: a 24-month tax administration expert to provide assistance to modernize organization and procedures of tax administration; a 19-month Customs Operations and Procedures Expert; and a 10-month Customs Harmonized System and Valuation Expert.

Future needs: Under Phase II of the project (signed in October 1999), two experts are to be assigned over a two-year period for tax policy: (i) a VAT advisor for about six months (split into several visits during FY2001/2002) to develop VAT legislation, forms and procedures, and other preparatory work for VAT introduction; and (ii) a customs legislation advisor for a total of six months (two or three visits over a one-year period during FY2001/2002), to help revise the customs law and regulations to facilitate the adoption of conventions and agreements in the context of AFTA and WTO membership. The first visit of the customs legislation advisor is scheduled to begin in early 2001.

Assessment: Regarding tax policy advice, most of the recommendations were accepted and are being implemented by the authorities.

In tax administration, under Phases I and II, progress was made in taxpayer identification and development of the first tax administration computerized system, the introduction of a self-assessment tax system, and the development of comprehensive policies and procedures for conducting field audits and dealing with delinquent taxpayers. While initial progress in making the large taxpayer unit (LTU) operational has been slower than anticipated, the authorities have recently reiterated their intention to raise revenues through close administration of large taxpayers (by 2 percent of GDP in this budget for 2000/01), including through the extension of the new procedures and systems to the Vientiane Prefecture and the three other largest provincial tax offices.

The authorities have recently requested a 12-month extension for the tax advisor to further strengthen the audit program, assist in the implementation of new procedures for dealing with delinquent taxpayers, help operationalize the LTU concept, expand the tax administration computerized system, and extend its procedures and systems to other provincial tax offices. The tax advisor could also assist in the administrative preparations for introducing a VAT.

In customs administration, controls over the arrival of goods at border stations and their transfer to inland customs offices were strengthened, a cargo manifest system became operational, a new declaration form and simplified procedures for clearance of goods were introduced in all major ports. However, the main concern is the lack of properly trained counterparts to assist with customs modernization. Further work is needed for an advisor to develop the organization, procedures, computerization, and training for a total of eight months over an eighteen month period.

Although there has not been technical assistance from FAD on public expenditure management, the 1999 Tripartite Review under the UNDP-funded project and the proposal for the Public Expenditure Review, identified the need to improve budget preparation, execution, and treasury reporting. In particular, there is a clear necessity to improve the budget formulation process, including budget coverage, government borrowing, and government guarantee, and the budget execution process, especially expenditure control. Also, the treasury function, especially cash management, comprehensive fiscal reporting, as well as the reliable external audit system need to be either upgraded or established. A diagnostic FAD mission is planned for April 2001.

Legal Department (LEG)

Past experience: In August 1998 the Legal Department participated in a joint LEG/MAE mission to Lao on banking soundness, bank supervision and payments systems. The product of this mission was an aide-memoire entitled "Steps to Banking Soundness," completed and delivered to the authorities in November 1998.

Assessment: Following-up some of the recommendations of the mission, the authorities have enacted amendments to the Decree Law on Commercial Banks, the Bankruptcy Law, and the Secured Transactions Law. In addition, the Bank of Lao (BOL) has recruited a legal expert, increased staff in the Supervision and Examination Department, and organized training programs in bank supervision and accounting.

Future needs: The restructuring of Lao's banking sector will be a crucial component of the intended PRGF-supported program and the existence of a suitable legal framework to support such restructuring will be key. For example, the ability of banks to effectively recover their loans (or to foreclose on collateral) should not be hampered by legal obstacles, e.g., unclear laws, an inefficient court system, etc. Another area of concern which may need examination could be the state of the insolvency regime, as an effective insolvency regime can greatly enhance the chances of success in debt and bank restructuring.

Monetary and Exchange Affairs Department (MAE)

Past experience: In recent years, TA activity in the financial sector involved:

- The assignment of an advisor to the Bank of Lao (BOL) from June 1992 to June 1995 focused on improving the capacity of the central bank to compile and analyze monetary and balance of payments statistics; the design and implementation of auctions of government securities, and the setup of a discount window.

- MAE advisory missions focused in October/November 1995 on monetary management and interbank markets, and in March 1998 on foreign exchange market issues. The August 1998 mission dealt with bank restructuring, bank supervision, and payments issues.

Assessment: The August 1998 mission found that policy implementation in the monetary management area had been weak, and that some of the measures introduced after the 1995 TA had been reversed. Implementation of the March 1998 recommendations was also seen as partial. In 1998, there was no firm commitment from the authorities to following the recommendations on bank restructuring and re-establishing monetary control because of the Government's emphasis, at that time, on agricultural infrastructure to meet its plan for food self-sufficiency by the year 2000. However, in 2000, monetary control was reestablished after three years of very high inflation.

Future needs: The authorities see technical assistance as being important to reach the program objectives:

- Banking sector restructuring and resolution of nonperforming loans. A mission could be needed to support the development of an appropriate corrective strategy for the insolvent banks. This would be in coordination with the World Bank and the Asian Development Bank, which are currently developing financial sector reform loans.

- Reinforcing bank supervision. The effectiveness of bank supervision and the implementation of prudential regulations needs to be re-assessed in light of the recurrence of nonperforming loan problems in state banks. This assessment needs to be supported by an evaluation of the legal framework underpinning bank and corporate sector restructuring, in coordination with the Asian Development Bank which is active in this area.

- In the context of progressing towards acceptance of the obligations of the Article VIII, there would also be a need for technical advice from LEG for the identification of prevailing exchange restrictions.

Statistics Department (STA)

Past experience: Regarding balance of payments statistics, the most recent technical assistance mission to Lao, P.D.R. took place during August–September 1999, which was a follow-up on the January 1997 balance of payments mission. The latest mission addressed compilation issues, and strongly recommended a survey of enterprises to collect data on direct investment and private sector financial flows, as well an international transactions reporting system to supplement present data sources.

A 1999 money and banking statistics mission reviewed the charts of accounts for the BOL and the commercial banks, and the procedures for compiling monetary statistics.

Assessment: Regarding balance of payments data, although significant progress had been made by the Lao authorities in implementing several recommendations of the 1997 mission, substantial work remains to be done on improving the coverage and quality of data on imports, travel, transfers, direct investment, and other financial flows. However, it must be recognized that the openness of the economy, and the extensive use of foreign exchange present major problems in this area.

A review of the money and banking data sent to STA for publication in *IFS* indicates that most of the recommendations for improving the classification of accounts of the monetary authorities and deposit money banks have been implemented.

Future needs: A peripatetic balance of payments advisor could help implement the recommendations. Also short-term TA could be needed to bring the external debt monitoring system up to the standard needed to monitor this part of the PRGF program.

Lao People's Democratic Republic
Peace Independence Democracy Unity Prosperity
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March 26, 2001
Ref: 93/BOL

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, DC. 20431

Dear Mr. Köhler,

We have been authorized by the Government of the Lao People's Democratic Republic (Lao P.D.R.) to Inform you that the Government has adopted an economic and financial program for 2001-03 that is designed to promote economic growth with equity and strengthen macroeconomic stability. The attached Memorandum on Economic and Financial Policies (MEFP) describes the economic and financial program that the Government of the Lao P.D.R. intends to Implement during 2001. In support of our program, we are requesting a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in an amount equivalent to SDR 31.7 million (60 percent of quota) in seven equal semi-annual installments in accordance with the standard practice of the Fund In this regard.

The program provides for continued fiscal and monetary restraint and is centered on the implementation of revenue enhancement, restraining credit of the BOL, restructuring state-owned commercial banks, commercializing large enterprises, and developing the enterprise sector. These reforms are consistent with the Interim Poverty Reduction Strategy Paper (I-PRSP) that the Government has recently completed.

The Government believes that the policies and measures set forth in the attached MEFP are adequate to achieve the objectives of the program for 2001, and stands ready to take additional measures that may become necessary for this purpose. The Government will remain in close consultation with the Fund in accordance with the Fund's policies on such consultations, and will provide the Fund with such information as it requests on the progress made in policy implementation and the achievement of program objectives. In any event, the Government of the Lao P.D.R. will conduct with the Fund the first review of the arrangement by end-October 2001.

In view of facilitating the understanding of the on-going economic reform process, the Government does not object to the publication of this letter, the MEFP, the I-PRSP and the Joint-Staff Assessment in the network of information dissemination of the Fund.

Sincerely yours,

Boun-Nhang VORACHITH Deputy Prime Minister and Minister of Finance	Soukanh MAHALATH Governor Bank of the Lao P.D.R.

Attachment

Memorandum on Economic and Financial Policies of the Government of The Lao People's Democratic Republic for 2001

March 26, 2001

I. Introduction

1. The key economic objectives of the Government of the Lao People's Democratic Republic (Lao P.D.R.), outlined in the Five-Year Plan, 2001–05, are to raise the level of sustainable broad-based economic growth and per capita income, and make significant in-roads in reducing widespread poverty. This will be a major step toward our longer-term objective of graduating from least-developed country status by 2020. The Poverty Reduction and Growth Facility (PRGF)-supported program, covering the period 2001–03, is designed to establish stable macroeconomic conditions and undertake the structural reforms necessary for sustainable growth. Consistent with the broader poverty reduction objectives outlined in the government's accompanying Interim Poverty Reduction Strategy Paper (I-PRSP), dated March 20, 2001, this memorandum lays out the economic and financial policies that the government intends to pursue during the first year of the PRGF arrangement, covering calendar year 2001.

II. The Current Setting and Near-Term Outlook

2. Over the past 18 months, the government has made very substantial progress at stabilizing the economy and reducing high inflation. At the early stages of the Asian Crisis the government decided to invest in the construction and rehabilitation of irrigation schemes. Although these schemes made a major contribution to food self-sufficiency, especially in rice, the use of central bank financing led to an upsurge in inflation, which reached 167 percent (12-month basis) in early 1999. Since then, the tightening of macroeconomic policies has sharply reduced inflation, which fell to about 10 percent by end-2000. The exchange rate has also stabilized and has remained within a narrow range since late 1999. Real GDP growth in 2000 is estimated at 5.7 percent, supported by more stable domestic conditions and strong agricultural production (Table 1).[1] Central bank financing of the budget deficit was reduced in 1999/2000 as revenues were raised substantially (Table 2).[2] The growth in credit to the economy slowed from 74 percent in 1999 to 41 percent in 2000, as monetary policy was tightened and lending by nonstate banks slowed sharply. Import restraint and increases in exports appear to have contained the external current account

[1] The Lao P.D.R. authorities estimate real GDP growth at 7.3 percent in 1999, mainly due to very strong growth in agriculture. However, according to Fund staff, indicators point to 5 percent growth, with more modest agricultural output.

[2] According to the Lao P.D.R. classification of the budget, amortization is treated as expenditure and grants as financing. Under this definition, the deficit was 9½ percent of GDP in 1999/2000 (Table 3).

deficit (including official transfers) to 1.6 percent of GDP, while gross official reserves rose to about US$140 million (2½ months of imports), reflecting in part the disbursement of the second tranche of the Asian Development Bank (AsDB) Financial Sector Program Loan (US$11.5 million).

3. Notwithstanding these important achievements, we recognize that the macroeconomic situation remains fragile, with major policy challenges ahead. The government believes that high sustainable growth rates and lasting poverty reduction will require decisive efforts to sustain macroeconomic stability and address underlying structural weaknesses. For such policies to succeed, they must be backed by substantial external support to fill the financing gap that we expect to emerge during 2001–03 as the reforms are implemented.

III. Medium-Term Macroeconomic Framework

4. Our medium-term framework for poverty reduction is set within the goal for 2020, which we plan to achieve through: (i) continued implementation of the New Economic Mechanism (NEM); (ii) structural transformation and capacity building; and (iii) people-centered participatory development through the decentralization of government responsibilities. Under these policies, over the next three years, the government will maintain sound macroeconomic policies to further reduce inflation and sustain it at low levels, supported by strong actions to reform the state banking and enterprise sectors, develop the private sector, and attract foreign investment.

5. The program's macroeconomic framework for 2001–03 aims at raising GDP growth to 7 percent by 2003, reducing inflation to about 5 percent (end-period), and increasing import coverage of gross official reserves to 3 months (Table 1). To achieve the targeted growth rates, total investment will need to rise to 30 percent of GDP. Because of the need to raise current budget expenditure in key areas, public savings are projected to decline modestly. The external current account (including official transfers) deficit is expected to rise to about 11 percent of GDP (3 percent excluding Nam Theun 2).[3]

6. We will target our overall fiscal stance at protecting medium-term sustainability and generating more resources for poverty reduction. Underpinning this effort will be greater mobilization of revenue and prioritization of expenditures, and the decentralization of administrative responsibilities. Reflecting the greater orientation to poverty reduction, the budget deficit will remain at about 5 percent of GDP in 2000/01–2002/03 (IMF definition). These deficits will be largely financed by external concessional assistance to support investment and key structural reforms, and domestic bank financing will be avoided.

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[3] Nam Theun 2 (NT2) is a large hydroelectric project costing US$1.1 billion (approximately equivalent to 60 percent of GDP) to be built over 2002–06.

7. Monetary policy will remain prudent in order to achieve a sustained reduction in inflation. In particular, credit from the Bank of the Lao P.D.R. (BOL) to government, banks and enterprises will be tightly restrained. Banks' lending decisions will be guided by commercial lending criteria, and policy (and policy-induced) lending through the state-owned commercial banks (SOCBs) will be phased-out. Although the exchange rate will be managed flexibly to allow for adjustment to real shocks, monetary policy will be adjusted to minimize exchange rate fluctuations.

IV. Macroeconomic Policies for 2001

8. In September 2000, the National Assembly approved the Socio-Economic Plan for 2000/01 with targets of real growth in the range of 6–6½ percent and average inflation of 10–15 percent. The government acknowledges that the Fund staff currently projects, for calendar year 2001, real GDP growth to be about 5.7 percent in the face of the weakening external economy, and inflation to be reduced to about 8 percent by year-end in light of recent favorable performance. In addition, for 2001, the external current account deficit (including official transfers) is expected to increase to 3.1 percent of GDP, and gross official reserves are targeted to rise to US$152 million (2.5 months of imports). The key macroeconomic policies consistent with these targets are described below.

9. The government will continue fiscal discipline in the 2000/01 budget. The overall budget deficit is targeted to remain at 5 percent of GDP (IMF definition) to be financed largely through concessional external loans with no recourse to bank financing of the budget deficit (Table 2). As outlined in the Socio-Economic Plan for 2000/01, we aim to increase revenue collections substantially. Under the program, we are committed to raising revenue by at least 1 percent of GDP over the 1999/00 fiscal outturn to 14 percent of GDP. Total expenditure will rise by a smaller amount to 22 percent of GDP, with increased allocations for key recurrent spending and counterpart funds for donor-financed projects. We believe that the larger revenue increase in the 2000/01 budget passed in September 2000 is achievable with the strong implementation of the revenue measures. However, we acknowledge that attaining this target is subject to a degree of uncertainty. If revenue shortfalls occur from the budgeted amounts, we will take offsetting measures through expenditure adjustments, while protecting operations and maintenance, local counterpart funds, and key social spending.[4]

10. The revenue target for 2000/01 is ambitious but will be achieved through broadening the tax base, some increases in excise duties, and major improvements in tax and customs

[4] The Socio-Economic Plan for 2000/01 contains the fiscal presentation and GDP estimates of the Lao P.D.R. authorities approved by the National Assembly in September 2000 (Table 3). As part of the process of revision to the GDP deflator, the National Statistical Center (NSC), in consultation with other concerned ministries, has revised the nominal GDP for 2000 as shown in Tables 2 and 3.

administration. The key measures to increase revenues include; (i) using periodic adjustments to maintain the exchange rate for tax assessments within 5 percent of the current banks' exchange rate; (ii) increasing excise rates on beer, tobacco, soft drinks, and spirits; and (iii) narrowing tax exemptions for investment under the Foreign Investment Law through the issuing of the implementing regulations. In addition, the operation of the large taxpayer unit (LTU) will be enhanced through the use of improved on-site audits and strengthened procedures for delinquent taxpayers. In line with the decentralization policy, 3 to 4 parallel LTUs will be also set up in key provincial centers with appropriate control mechanisms. To strengthen further the tax base, we have decided to introduce a VAT in 2003, and have established the VAT Steering Committee to this end. Steps have also been taken to strengthen the transfer of royalties, especially on timber exports, to the central government accounts and thus reduce unidentified expenditures.

11. Overall expenditure will be restrained while ensuring increased funding for critical areas. Operations, maintenance, and local counterpart spending will be increased for key social services in support of poverty reduction, especially for primary education and basic health services, and for vital social and economic infrastructure (in particular for rural development). The wage bill will be increased by 20 percent to partially compensate for past inflation. The size of the civil service will be reduced by 5 percent by the end of 2001/02. Subsidies to state-owned enterprises (SOEs) will continue to be avoided.

12. The Public Expenditure Review (PER), to be conducted jointly by the World Bank, AsDB, and IMF in the first half of 2001 will review the poverty focus of expenditures, the balance between recurrent and capital expenditures, fiscal transparency, and the mechanisms for expenditure planning and management. In addition, we will closely monitor the implementation of the decentralization policy to determine its impact on the fiscal stance. An action plan to implement the agreed recommendations of the PER, especially to improve expenditure management and budget planning, will be developed during the first year of the program and be included more specifically in subsequent annual arrangements. Toward our goal of fiscal transparency, the budget for 2000/01, and its outturn for 1999/00 have been published.

13. Continuation of the firm monetary policy will be based on the strict control of central bank credit and prudent lending by commercial banks. Under this framework, the BOL will refrain from providing credit to the government, banks, and other sectors of the economy,[5] thus limiting the increase in the net domestic assets of the BOL to KN 97 billion (equivalent to 13 percent of reserve money at end-2000, excluding the counterpart for external assistance to fill the financing gap). This would also allow for some reduction in BOL securities outstanding, while achieving the target of net foreign assets of US$107 million; reserve

[5] Except onlending of specified external loans, and with a government guarantee.

money would be expected to increase by 7 percent in 2001 (Table 4).[6] Assuming a slight increase in the money multiplier, as excess reserves are drawn down, broad money could be expected to grow by 20 percent and credit to the economy to grow by 18 percent.

14. The BOL will supplement its control of the growth of its net domestic assets by restraining SOCB lending. Their lending will be closely monitored and they will refrain from extending new loans to defaulting borrowers. In light of recent commercial banks credit expansion we will also need to set temporary direct limits on the growth of credit by the three SOCBs under restructuring programs. Even with appropriate credit restraint, state bank credit growth will be about 30 percent by September 2001, considerably more than the 20 percent growth in the government's plan for 2000/01. However, by end 2001 SOCB credit growth will be reduced to 17 percent. If the fall in inflation continues, we will examine the scope to reduce nominal interest rates, while keeping them positive in real terms.

15. The BOL will continue to manage the exchange rate flexibly, permitting banks' exchange rates to adjust so as to maintain the margin with the parallel market rate at less than 2 percent and avoid multiple exchange rates. In the absence of real shocks, any significant widening of the margin with the parallel market or persistent weakness of the kip, would be an indication of the need to tighten monetary policy. In addition, we will continue to improve the functioning of the recently-introduced interbank foreign exchange market. We plan to create the conditions to enable the removal of the remaining exchange restrictions on current international transfers and payments by the end of the PRGF arrangement's period and pave the way for acceptance of the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement.

V. Structural Policies

16. Steady implementation of structural reforms will be needed to establish a sustainable high economic growth path necessary for reducing poverty. Structural reforms will be geared toward strengthening macroeconomic stability, reducing the drain on public resources from the state-owned banking and enterprise sectors, attracting private investment, and increasing financial transparency.

A. Banking Sector Reform

17. The reform strategy for the banking sector aims at fundamentally restructuring the deeply insolvent state banks to avoid the recurrence of large nonperforming loans (NPLs) and foster efficient financial intermediation. The government has adopted a reform approach designed to limit the potential fiscal costs of restructuring and avoid moral hazard. Central to

[6] See footnote 3 of Table 4 for an explanation of the increase in net domestic assets. Both this, and the increase in reserve money are adjusted for the netting of BOL deposits at banks and banks' deposits at BOL of KN 150 billion.

this approach are improving the performance and governance of banks in parallel with recapitalization, and phasing-out of directed lending through the SOCBs.

18. The restructuring plans for individual banks will be guided by the agreed main policy elements, developed in conjunction with the AsDB and World Bank (see Appendix I). The main elements are to:

- Foster meaningful operational improvements, especially better lending and risk control practices. These would require significant changes in the operations of management, and phased and conditional recapitalization based on objective criteria for performance improvements.

- Establish effective internal debt workout units in each of the SOCBs.

- Phase out policy lending through SOCBs and transfer such existing lending to a central unit under the Ministry of Finance or a specialized policy lending institution, not financed by deposits.

19. The fiscal costs of bank restructuring appear to be manageable. Based on a preliminary portfolio assessment at end-1999 that put NPLs of the three SOCBs at 70 percent of total loans, the capital deficiency is estimated at KN 400 billion, about 3 percent of GDP.

20. As a first step in strengthening the enforcement of banking supervision regulations and building on the AsDB-funded technical assistance, the loan classification requirements will be strictly applied, as specified in BOL Regulation 98. In addition, no new loans will be made to borrowers with loans in default, and the credit growth of the three SOCBs will be restrained. To set a baseline for financial restructuring, external audits using international standards were initiated for the three SOCBs for the 1999 and 2000 accounts in March 2001. Also, on-site and off-site supervision will be reinforced.

B. Enterprise Development

21. In tandem with banking reform, the government will develop a medium-term program for SOE reform and for private sector development. This program will aim at protecting macroeconomic stability and supporting bank restructuring through curtailing losses, and improving the efficiency and competitiveness of the enterprise sector. SOE reform will be needed to facilitate Lao P.D.R.'s progress in regional and global integration, especially in light of the substantial trade liberalization under the ASEAN Free Trade Area (AFTA) through 2008. The government's envisaged program will have two separate strands:

- The commercialization of the 24 nonfinancial SOEs declared by the government to be strategic, will be restarted. Initial emphasis will be on ensuring that their prices cover costs, including debt service. In order to sustain the commercialization of Electricité du Laos, agreement has been reached with the World Bank to keep increasing retail prices by 3–3½ percent per month through end-2001, and, in mid-2001, conduct a study on pricing policy to achieve fuller cost recovery starting in 2002, including its social impact. After adjustments in August and September, petroleum prices approximately cover costs, and will henceforth be adjusted more frequently to avoid losses by the Lao State Fuel Company. Domestic fares of Lao Aviation were increased by 20 percent in December 2000 and will be adjusted again in May 2001. Further fare adjustments will be made to ensure that by March 2002 Lao Aviation can achieve commercial viability and meet all its costs (defined according to international standards).

- The remaining nonstrategic enterprises will be divested. The government recognizes that the previous widespread leasing of enterprises has not led to the desired improvement in efficiency and will examine alternative ownership arrangements at both the central and local government levels.

22. A range of measures have also been adopted, or are being implemented, to promote the private sector by removing barriers to entry and leveling the playing field vis-à-vis the state sector. Implementing regulations for the 1994 Foreign Investment Law will soon be issued, consistent with its liberalizing spirit and narrowly interpreting the scope of tax exemptions and reductions. Further improvements in governance and transparency in public administration will include the prompt publication of rule-making documents, including implementation regulations and notices, clearer administration of property rights, and the removal of bureaucratic impediments for the establishment and operation of enterprises.

23. In support of these reforms, the government will work with the World Bank to develop an enterprise reform program by the end of the first year of the PRGF arrangement.

C. Other Structural Areas

24. The government is firmly committed to international integration as a means to strengthen competitiveness, develop the private sector, and improve living standards. On the trade front, significant improvements have already been made in simplifying customs procedures to expedite trade flows. In addition, the government:

- Has recently simplified the documentary requirements for exports of garments and made export licensing automatic for all products, except forestry and mining products, from March 2001. Automatic licensing for exports will apply to all companies registered under the Business Law.

- Will gradually liberalize imports in line with the anticipated increase in domestic production and exports, and its commitment to regional integration. In particular, the government will progressively liberalize imports according to commitments made under AFTA by transferring about 429 items each year for the next 4 years from the temporary exclusion list to the current inclusion list of 1,673 items which, are free of quantitative restrictions and subject to regional tariff reductions. By 2005 only 5 percent of total tariff lines will be subject to quantitative restrictions under the sensitive and general exception lists. These items mainly relate to unprocessed agricultural products, motor vehicles, alcoholic beverages, tobacco products, and items restricted for security and health reasons.

- Will endeavor to implement import licensing that may be applied to some items in the temporary exclusion list in a nonrestrictive manner.

- Will apply the removal of quantitative restrictions from items in the inclusion list on a multilateral basis from mid-2001, except for a few specified products.

- Will continue to seek entry into the WTO and improved access to major markets: Europe, Japan, United States (through normal trade relations status) and other countries.

25. Proper management of forestry resources is essential for sustainable development and preserving biodiversity, while also channeling more resources to the budget. In support of this approach, the government will develop a comprehensive forestry strategy with SIDA, the World Bank, FAO, and other donors during the first year of the PRGF arrangement.

VI. Statistical Issues and Policy Transparency

26. Steps are being taken to improve the quality and timeliness of data, and broaden publication and dissemination of statistics. Efforts will be made to strengthen the quality of data on the national accounts, balance of payments, in particular regarding trade and external debt, and government finance statistics. To better inform the public of the intentions and outcomes of economic policy and bolster investor confidence, the government has started to publish the annual state budget and outturns. Finally, the BOL will publish its audited financial statements and the monetary accounts by July 2001, and the National Statistical Center will start publishing a range of monthly indicators, including the consumer price index and its components.

VII. External Debt and Program Financing

27. With the policies described above and in the I-PRSP, the external current account deficit is projected to widen to an average of about US$67 million per year (3 percent of GDP), including official transfers and excluding NT2, during 2001–03. Lao P.D.R.'s capacity to secure external financing on appropriate terms will depend critically on maintaining macroeconomic stability and timely implementation of reforms. Currently, the external financing gap is projected to total about US$110 million during 2001–03, assuming prudent access to external commercial borrowing (see below). In addition to PRGF support of SDR31.7 million (60 percent of quota), this financing gap would be covered by program lending under the joint World Bank-AsDB Financial Sector Adjustment Credit, a World Bank forestry adaptable program loan and Poverty Reduction Support Credit, additional program lending from AsDB, and bilateral assistance on concessional terms.

28. In view of Lao P.D.R's limited debt-servicing capacity, external borrowing will be kept in check and closely monitored through the newly-established debt-monitoring unit to

ensure a sustainable debt burden. The government is currently negotiating with Russia and expects to reach an agreement on the terms of its outstanding transferable ruble debt in 2001. As regards the contracting or guaranteeing by the public sector (including by SOEs) of new nonconcessional debt, the government will observe the external debt ceilings specified in Table 6. It is expected that probably no more than one-third of the government's share of equity in NT2 (US$80 million total) will need to be financed, and concessional financing is being explored with multilateral investment banks. The government will not incur any arrears on external payments during the period of the PRGF-supported program.

VIII. PROGRAM MONITORING

29. The period for the first-year PRGF-supported program will cover calendar year 2001. Quantitative performance criteria and benchmarks are summarized in Table 6. The structural policy prior actions for approval of the PRGF arrangement, performance criteria, benchmarks, and subjects for the reviews are shown in Table 7. The first review under the PRGF arrangement will be completed by October 2001, and will assess implementation of budget for 2000/01, the main elements of the budget for 2001/02, especially revenue measures and improvements in the management and poverty focus of expenditures, and the elaboration of bank-specific restructuring plans. At that time, the quantitative performance criteria for end-December 2001 will also be set. The second review will be undertaken by end-April 2002 and will focus on the implementation of bank restructuring, the development of a SOE reform program, and the macroeconomically significant issues of forestry sector policies. Specific measurement and monitoring details, along with other program reporting requirements, are described in the attached Technical Memorandum on Program Monitoring.

30. In connection with the Fund's new safeguard assessments designed to protect its resources, the BOL is in the process of providing IMF's Treasurers Department with copies of financial statements for the past three years and other required information. The BOL has also initiated an external audit on international standards of its end-2000 accounts.

31. The government believes that the policies described above are adequate to achieve the objectives of the program and, on this basis, hereby requests approval of the arrangement under the PRGF. The government stands ready to take any additional steps that may be necessary and will consult the Fund on this matter in line with established Fund procedures.

Attachments

Table 1.	Summary Macroeconomic Framework, 1998–2003
Table 2.	General Government Operations, (IMF Presentation) 1998/99–2000/01
Table 3.	General Government Operations, (GOL Presentation) 1999/2000–2000/01
Table 4.	Monetary Developments, 1999–2001
Table 5.	State-Owned Commercial Banks, 1999–2001
Table 6.	Quantitative Performance Criteria and Benchmarks 1999–2001
Table 7.	Structural Policy Actions Under the First Annual PRGF-Supported Program
Appendix I.	Main Elements of State-Owned Commercial Bank Restructuring
Appendix II.	Technical Memorandum on Program Monitoring

Table 1. Lao P.D.R.: Summary Macroeconomic Framework 1998–2003

(In percent of GDP; unless indicated otherwise)

	1998	1999	2000	2001	2002	2003
Real GDP growth (percent change)	4.0	7.3	5.7	5.7	6.5	7.0
Inflation (percent change, annual average)	90.1	128.4	23.3	9.0	7.5	5.7
Merchandise exports (percent change)	6.4	7.7	8.3	7.4	8.6	9.0
Merchandise imports (percent change)	-14.7	0.3	6.6	10.6	23.8	10.6
(percent change, excluding NT2)					10.0	8.4
Official gross reserves (in months of prospective goods and services imports, excluding NT2)	2.2	2.0	2.4	2.5	2.7	3.0
Budget (fiscal year basis) 1/						
Revenue	9.8	10.6	12.7	13.9	14.5	15.0
Grants	5.3	6.0	3.2	2.8	3.1	3.1
Expenditure	23.6	20.6	20.9	21.7	22.4	22.8
Current	8.1	6.1	8.1	8.4	9.4	10.3
Capital and onlending	15.5	14.4	12.8	13.3	13.0	12.5
Current fiscal balance before grants	1.7	4.4	4.6	5.5	5.1	4.7
Overall fiscal balance after grants	-8.5	-4.0	-5.0	-5.0	-4.8	-4.7
Domestic financing	2.5	-0.6	-0.7	1.2	0.3	0.3
Foreign financing	6.0	4.6	5.8	3.8	4.4	4.4
Real GDP growth (percent change) 1/	4.5	6.5	6.1	5.7	6.3	7.0
Increase in GDP deflator (percent change) 1/	71.2	120.4	36.1	10.0	8.0	6.0
Savings and investment balance 2/						
National savings	12.7	16.4	14.6	14.8	15.5	15.6
Private	11.0	11.9	10.0	9.3	10.4	10.9
Government	1.7	4.5	4.6	5.5	5.1	4.7
Investment	22.8	22.7	20.4	21.6	28.6	29.5
Private	7.3	8.3	6.9	7.5	14.9	17.0
Of which: Hydropower	1.4	1.9	0.0	0.0	6.4	7.7
Other	5.9	6.4	6.9	7.5	8.5	9.3
Government 3/	15.5	14.4	13.5	14.1	13.7	12.5
Foreign savings	10.1	6.3	5.8	6.8	13.1	13.9
Excluding Hydropower	8.7	4.4	5.8	6.8	6.0	5.5

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates.

1/ Fiscal year ending September.

2/ Estimates for private savings and investment are highly tentative, as no firm national accounts have been established. In particular, private savings reflect unrecorded imports.

3/ Comprises government investment and selected public enterprise investment.

Table 2: Lao P.D.R. General Government Operations, IMF Presentation, 1998/99–2000/01

	1998/99	1999/00		2000/01	
		Budget	Est.	Budget	IMF
	(In billions of kip)				
Revenue and Grants	1,461	2,160	2,018	2,614	2,471
Revenue	929	1,620	1,615	2,194	2,051
Tax	745	1376	1,323	1,742	1,687
o/w: Profit tax	80	170	172	316	301
Turnover tax	160	264	252	379	359
Excise tax	157	225	211	336	316
Import duties	99	173	138	192	192
Timber royalty receipts	89	270	288	115	115
Nontax	184	244	293	452	364
Grants	532	540	403	420	420
Expenditure	1,809	2,819	2,655	3,382	3,204
Current	539	1,052	1,031	1,417	1,239
Wages and salaries	181	348	348	417	417
Materials and supplies	132	137	197	342	342
Interest payments	59	133	103	175	175
External	53	118	82	120	120
Domestic	5	15	21	55	55
Timber royalty-financed expenditure	89	270	184	115	15
Other recurrent	78	164	199	368	290
Capital and onlending 1/	1,270	1,768	1,623	1,965	1,965
Current balance	390	568	584	776	812
Overall balance	-348	-659	-637	-769	-733
excluding grants	-879	-1,199	-1,040	-1,189	-1,153
Financing	348	659	637	769	733
Domestic financing	-52	7	-94	213	177
Bank financing 2/	-39	0	-104	0	0
Nonbank financing	-13	7	10	213	177
Foreign financing (net)	400	652	731	556	556
	(In percent of GDP)				
Revenue and Grants	16.6	17.0	15.9	17.7	16.7
Revenue	10.6	12.8	12.7	14.9	13.9
Tax	8.5	10.8	10.4	11.8	11.4
Nontax	2.1	1.9	2.3	3.1	2.5
Grants	6.0	4.3	3.2	2.8	2.8
Expenditure	20.6	22.2	20.9	22.9	21.7
Current	6.1	8.3	8.1	9.6	8.4
Wages and salaries	2.1	2.7	2.7	2.8	
Capital and onlending	14.4	13.9	12.8	13.3	13.3
Current balance, excluding grants	4.4	4.5	4.6	5.3	5.5
Overall balance	-4.0	-5.2	-5.0	-5.2	-5.0
excluding grants	-10.0	-9.5	-8.2	-8.1	-7.8
Financing	4.0	5.2	5.0	5.2	5.0
Domestic financing (net)	-0.6	0.1	-0.7	1.4	1.2
Bank	-0.4	0.0	-0.8	0.0	0.0
Nonbank	-0.1	0.1	0.1	1.4	1.2
Foreign financing (net)	4.6	5.1	5.8	3.8	3.8
Project loans	5.4	6.5	6.2	5.3	5.3
Program loans	0.0	0.0	0.8	0.0	0.0
Amortization	-0.9	-1.4	-1.2	-1.5	-1.5
Memorandum items:					
Nominal GDP, fiscal year (in billions of kip)	8,788	12,691	12,691	14,755	14,755

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates.

1/ Compared to previously used fiscal data, budget capital expenditures have been revised to exclude irrigation projects financed through bank credit to farmers and state enterprises, mainly in 1997/98.

2/ Bank financing excludes the valuation adjustments on the stock of government foreign currency deposits and credit in all years as well as reclassification of printing costs by the BOL (KN 78bn) in 1999/00.

Table 3. Lao P.D.R.: General Government Operations, GOL Presentation, 1999/00–2000/01

	1999/00		2000/01		
	Budget	Est.	----------Budget----------		Proj.
			(In billions of kip)		
Total revenue	1,677	1,702	2,280	2,280	2,101
Revenue	1,368	1,299	1,732	1,732	1,677
Tax department	845	798	1,319	1,319	1,264
Customs department	241	206	285	285	285
Cadastre	12	7	13	13	13
Timber royalties	270	288	115	115	115
Nontax revenue	309	403	547	547	424
Debt service	117	157	80	80	80
Overflight fees	98	122	125	125	125
SOE profit	25	43	212	212	125
Public assets	55	72	119	119	83
Others	14	9	11	11	11
Expenditure	3,044	2,888	3,646	3,646	3,468
Current expenditure	1,194	1,157	1,641	1,641	1,463
Wages and salaries	351	351	422	422	422
Administrative costs	102	155	342	342	342
Timber royalty-financed expenditure 1/	270	184	115	115	15
Other	112	154	233	233	200
Debt service	359	314	529	529	484
External debt	290	239	344	344	344
Internal debt	69	75	185	185	140
Interest	15	21	55	55	55
Other	54	54	130	130	85
Capital expenditure	1,820	1,701	2,005	2,005	2,005
Foreign finance	1,364	1,195	1,200	1,200	1,200
Local finance	456	506	805	805	805
Projects	386	426	304	304	304
New construction	30	40	153	153	153
Investment debt	0	0	242	242	242
Other	40	40	106	106	106
Other expenditure	30	30	0	0	0
Balance	-1,366	-1,186	-1,367	-1,367	-1,367
Financing	1,366	1,186	1,367	1,367	1,367
Foreign finance	1,364	1,291	1,200	1,200	1,200
Domestic finance	2	-104	167	167	167
			(In percent of GDP)		
			Original GDP	Prel. Est.	
Revenue	13.2	13.4	13.6	15.4	14.2
Tax	10.8	10.2	10.3	11.7	11.4
Nontax	2.4	3.2	3.3	3.7	2.9
Expenditure	24.0	22.8	21.8	24.7	23.5
Current	9.4	9.1	9.8	11.1	9.9
Capital	14.3	13.4	12.0	13.6	13.6
Balance	-10.8	-9.3	-8.2	-9.3	-9.3
Memorandum items:					
Nominal GDP (in billions of kip)	12,691	12,691	16,757	14,755	14,755

Sources: Data provided by the Lao P.D.R authorities; and Fund staff estimates.

1/ Differs from the GOL presentation by the inclusion of timber royalty-financed expenditures.

Table 4. Lao PDR: Monetary Developments, 1999–2001 [1/]

	1999	2000 Mar.	2000 June	2000 Sept.	2000 Dec.	2001 Program Mar	2001 Program June	2001 Program Sept.	2001 Program Dec.
	(In billions of kip; end-of-period)								
Monetary survey									
Net foreign assets	1,266	1,352	1,470	1,477	1,526	1,382	1,379	1,361	1,465
Net domestic assets	278	408	578	634	725	981	1,097	1,228	1,235
Domestic credit	1,045	1,127	1,243	1,333	1,441	1,549	1,646	1,744	1,702
Net claims on government	-272	-331	-328	-368	-420	-403	-386	-368	-491
Claims on the economy	1,317	1,458	1,571	1,701	1,861	1,951	2,032	2,112	2,192
Credit to state enterprises	445	502	579	627	643	677	701	725	748
Credit to private sector	872	956	993	1,074	1,218	1,275	1,331	1,387	1,444
Other items (net)	-767	-719	-666	-699	-716	-568	-550	-517	-466
Broad money	1,545	1,758	2,048	2,111	2,251	2,363	2,476	2,588	2,701
Domestic currency (cash and deposits)	317	364	437	462	539	566	593	620	647
Foreign currency deposits	1,227	1,395	1,611	1,649	1,712	1,797	1,883	1,968	2,054
Bank of Lao P.D.R.									
Net foreign assets	405	389	515	758	799	796	794	775	880
Foreign assets	807	772	887	1,119	1,147	1,130	1,148	1,117	1,246
Foreign liabilities	-401	-383	-372	-361	-347	-334	-355	-342	-366
Net domestic assets 3/	76	160	197	56	-33	-143	-130	-100	-194
Domestic credit	632	715	700	632	588	467	485	506	386
Net credit to government	-36	-52	-212	-269	-347	-337	-327	-315	-438
Credit to the economy	367	405	438	480	489	518	537	556	574
Credit to state enterprises	224	262	296	339	346	375	394	412	431
Credit to private sector	143	143	142	141	143	143	143	143	143
Credit to banks	302	362	475	421	446	286	276	266	250
BoL securities	-142	-166	-167	-160	-159	-112	-98	-71	-26
Other items, net	-415	-389	-337	-416	-461	-498	-517	-536	-554
Reserve money 3/	482	547	712	814	767	652	663	675	686
Memorandum items:									
Bank financing of the budget 2/	-39	-166	-76	-104	-46	-35	-18	0	-123
Of which: BoL financing of the budget 2/	46	-92	-168	-216	-73	-68	-58	-46	-123
	(In millions of U.S. dollars; end-of-period)								
Net foreign assets	166.6	178.8	187.6	182.7	185.7	168.6	168.2	165.9	178.7
Of which: BoL	53.4	51.4	65.7	93.7	97.3	97.0	96.8	94.5	107.3
Foreign currency credit to the economy	95.4	104.8	107.4	111.2	122.1	119.0	123.9	128.8	133.7
Foreign currency deposits	161.5	184.5	205.6	204.0	208.3	219.2	229.6	240.0	250.5
	(Annual percent change)								
Broad money	78.4	58.2	7.9	49.8	45.7	34.4	20.9	22.6	20.0
Credit to the economy	74.2	44.8	-3.8	35.2	41.3	33.8	29.3	24.2	17.8
Credit to state enterprises	99.2	70.4	11.2	58.0	44.3	34.9	21.1	15.6	16.5
Credit to the private sector	63.6	34.3	-10.9	24.7	39.7	33.3	34.1	29.2	18.5
Reserve money	71.0	59.1	40.9	75.2	59.1	19.3	-6.8	-17.1	-10.5
Money multiplier	3.2	3.2	2.9	2.6	2.9	3.6	3.7	3.8	3.9
Velocity (ratio)	7.4	...	...	...	6.8	...	...	...	6.4
Exchange rate, end-of-period (kip per U.S. dollar)	7,600	7,560	7,815	8,085	8,218	8,200	8,200	8,200	8,200

Source: Data provided by the Lao authorities; and Fund staff estimates.

1/ Compared to previously used monetary data, the reclassification of credit to farmers and state enterprises for irrigation projects as credit to the government has been discontinued, to be consistent with the sector of the debtors and in line with the authorities' presentation.

2/ Cumulative from the start of the fiscal year (which runs from October to September). Annual data are on a fiscal year basis. In 1999/2000 excludes the reclassification of the costs of printing money (KN 78 billion).

3/ From January 2001 reserve money and NDA of the BOL have been reduced by KN 150 billion due to the netting of BOL deposits at banks and banks' deposits at BOL. The December 2001 level of NDA of the BOL includes the external disbursement of US$15 million (KN 123 billion). Excluding these two adjustments the end 2001 stock would have been KN 64 billion, an increase of KN 97 billion from end 2000.

Table 5. Lao PDR: State-Owned Commercial Banks, 1999–2001

	1999	2000				2001 Program			
	Dec.	Mar.	June	Sept.	Dec.	Mar.	June	Sept.	Dec.
	(In billions of kip; end-of-period)								
Net foreign assets	639	740	742	515	482	507	529	551	574
Foreign assets	769	864	918	695	674				
Foreign liabilities	131	124	176	180	193				
Net reserves 1/	30	35	45	190	102	143	184	225	272
Reserves	278	340	458	561	494	375	406	437	468
Credit from monetary authorities	249	305	413	371	392	232	222	212	196
Net credit to government	-203	-252	-107	-89	-66	-59	-52	-46	-46
Net credit in Kip	-150	-192	-33	-36	-13				
Net credit in foreign currency	-53	-59	-74	-53	-53				
Net domestic assets									
(excluding net credit to government)	682	802	892	1,023	1,189	1,227	1,265	1,302	1,340
Credit to the economy	556	640	689	775	884	921	959	996	1,034
Of which: Foreign currency	431	491	526	586	657				
Credit to state enterprises	197	213	235	242	253				
Credit to private sector	359	427	454	534	630				
Other items, net	126	163	203	247	306	306	306	306	306
Deposits	1,139	1,320	1,570	1,640	1,711	1,818	1,925	2,032	2,139
Deposits in Kip	197	239	305	329	372	429	486	542	599
Deposits in foreign currency	942	1,081	1,266	1,310	1,339	1,390	1,440	1,490	1,540
	(In millions of U.S. dollars; end-of-period)								
Net foreign assets	84	98	95	64	59	62	65	67	70
Foreign currency credit to the economy	57	65	67	73	80				
Month-on-month percentage change	2.0	5.3	0.2	2.2	2.0				
Foreign currency net credit to government	-7	-8	-10	-7	-6				
Foreign currency deposits	124	143	162	162	163	169	176	182	188
	(Annual percentage increase)								
Domestic credit	43	...	37	106	132	122	56	38	21
Credit to the economy	80	...	1	49	59	44	39	28	17
Of which: Foreign currency	...	...	2	53	53				
Deposits	91	...	14	59	50	38	23	24	25
Memorandum items:									
NFA coverage of FC deposits	68	68	59	39	36	37	37	37	37
Reserves-to-deposits ratio	0.24	0.26	0.29	0.34	0.29	0.29	0.29	0.29	0.29
Exchange rate, end-of-period									
(kip per U.S. dollar)	7,600	7,560	7,835	8,085	8,218	8,200	8,200	8,200	8,200

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates.

1/ Program for 2001 reflects the netting of BOL deposits at banks and banks' deposits at the BOL of KN 150 billion in January 2001.

Table 6. Lao P.D.R.: Quantitative Performance Criteria and Benchmarks, 1999–2001

	1999 Stock at end-Dec.	2000 March	2000 June	2000 Sept.	2000 Dec.	2001 Program March	2001 Program June 1/	2001 Program Sept.	2001 Program Dec.
	(In billions of kip)								
Net domestic assets of the Bank of Lao P.D.R. (BOL) 2/ 3/	76	160	197	56	-33	-143	-130	-100	-194
Net credit to the government from the banking system 3/	-272	-331	-328	-368	-420	-403	-386	-368	-491
Net domestic assets of the state-owned commercial banks (excluding net claims on government) 4/	682	802	892	1,023	1,189	1,227	1,265	1,302	1,340
	(In millions of U.S. dollars)								
Net official international reserves 3/ 7/	29	28	31	62	70	68	67	63	74
Contracting or guaranteeing of external debt by the public sector 5/									
- up to one-year maturity	...	...	...	...	...	0.0	0.0	0.0	0.0
- maturity of more than 1 year 5/	...	...	...	...	...	0.0	0.0	0.0	0.0
Of which: 1–5 years' maturity	...	...	...	...	...	0.0	0.0	0.0	0.0
Accumulation of external payments arrears 6/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:									
Nonproject budget support (cumulative flows from the beginning of the y	...	...	...	11.5	11.5	0.0	0.0	0.0	15.0
Program exchange rate (kip per dollar)	7,600	7,560	7,835	8,085	8,218	8,200	8,200	8,200	8,200
Foreign currency component of required reserves	24	23	35	31	27	29	30	32	33

Sources: Data provided by the Lao P.D.R.authorities. The full definition of terms is contained in the technical memorandum on program monitoring.

1/ Performance criteria. December 2001 values will be set as performance criteria at the time of the first review.

2/ Net domestic assets of the BOL are defined as reserve money minus net foreign assets (NFA) of the BOL, adjusted for the valuation changes arising from the difference between the program and actual exchange rates. The 2001 levels have been reduced from the end of December 2000 level to take account of the netting of KN 150 billion of banks reserves with BOL credit to banks.

3/ For purposes of verifying compliance with the program, the ceiling for net domestic assets of the BOL, net bank credit to the government will be adjusted upward (downward), while the floor on net official international reserves will be adjusted **downward (upward)** by any **shortfall (excess)** external nonproject budget support, and any **excess (shortfall)** in debt-service payments.

4/ Comprising Banque du Commerce Exterieur Lao, Lao May Bank and Lane Xang Bank. Net domestic assets of the SOCBs are defined as total deposits of these banks, less net foreign assets, net claims at the BOL, and net claims on government adjusted for the valuation changes arising from the difference between the program and actual exchange rate.

5/ Ceiling applies to debts contracted or guaranteed by the government, public enterprises, or the BOL on nonconcessional terms. Ceilings are flows from the start of the program. Excludes normal import-related credit, any borrowing associated with debt rescheduling, and the second loan from Exim Bank of China, for a maximum amount equivalent to US$ 30 million, contracted in February 2001. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274- (00/85), August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received.

6/ Continuous performance criterion.

7/ Net official international reserves are calculated as net international reserves on a BOP basis less foreign currency component of required reserves.

Table 7. Lao P.D.R.: Structural Policy Actions under the First Annual PRGF-Supported Program

Policy Action	Policy Monitoring
Banking reform	
Agree on the main elements of the restructuring of state-owned commercial banks (SOCBs) to be defined, in consultation with the AsDB and World Bank.	Prior action (Done, Appendix I.)
Initiate the external audits based on international standards of the three SOCBs for 1999 and 2000.	Prior action (Done.)
Formulate individual SOCB restructuring plans in support of comprehensive banking reform, consistent with the principles in the Memorandum on Economic and Financial Policies, and prepared with assistance from the AsDB and World Bank.	Structural performance criterion, September 2001
Strictly implement BOL Regulation 98, including on loan classification (Article 2.0-2.4) and cease making new loans to defaulting borrowers (Article 6.0); to be monitored by quarterly reporting of the 30 largest borrowers from SOCBs.	Structural benchmark, September 2001 and March 2002
Identify key targets in SOCB restructuring to be used as performance criteria for March 2002.	Subject of first review
SOE reform	
Continue to adjust petroleum prices to avoid losses of oil companies, and agree with the World Bank on a timetable for future adjustments of electricity tariffs.	Prior action (Done.)
Provide balance sheets and income statements for 1997, 1998 and 1999 for electricity, water, fuel, and airline companies.	Prior action (Done.)
Comply with agreed timetable for adjustment of electricity prices (MEFP paragraph 20) and adjust Lao Aviation fares to ensure cost recovery.	Structural performance criterion, March 2002
Review development of a program of SOE commercialization and privatization in consultation with the World Bank.	Subject of second review
Fiscal and public resource reforms	
Use current market exchange rates on tax assessments.	Prior action (Done.)
Publish summary tables for 2000/01 budget and outturn for 1999/00.	Prior action.
Implement tax reform measures, including: reduce exemptions, prepare for VAT, broaden the tax base, and strengthen the large taxpayer units.	Subject of first and second reviews
Review macroeconomically significant issues of forestry sector policies, mainly an assessment of related revenues and their transfer into the budget, in consultation with the World Bank.	Subject of second review
External sector measures	
Begin operation of external debt monitoring unit that records the contracting and disbursing of all public and publicly-guaranteed debt.	Prior action.
Introduce automatic licensing for exports, except forestry and mining products.	Prior action (Done.)
Issue regulation to apply the removal of quantitative restrictions on items liberalized under AFTA on a multilateral basis, except for a few specified products.	Structural benchmark, September 2001

Main Elements of State-Owned Commercial Bank Restructuring

The state-owned commercial banks need to be restructured in order to create robust banking institutions. The main elements for the restructuring program, which are drawn from technical work of the Asian Development Bank and the World Bank, are set out below:

- Restructuring will encompass more than recapitalization. Operational improvements (i.e., better risk control and monitoring of existing loans) are the objective. Such improvements will require significant changes in the operation of management, especially to eliminate the influence of the state on lending decisions, and may warrant major structural changes, including governance structure of boards and management. Therefore, a phased recapitalization linked to the restructuring efforts will be essential to adequately improve their operations. Performance improvements will be objectively monitored.

- Establishment of an efficient internal unit in each bank in charge of resolution/collection of nonperforming loans (NPLs) is required. Dealing with NPLs is a normal banking business, and such a unit will also improve evaluation of new loans.

- Vigorous collection of loans in default will be reinforced to ensure that borrowers have the incentive to repay and that a culture of non-repayment is not continued. Any design of a debt resolution mechanism should not let bankers assume they can easily dispose of NPLs.

- The handling of policy-lending operations should be changed and, preferably be conducted by Ministry of Finance, using transparent budget resources.

Implementation in the Context of the Enforcement Plan for Prudential Regulation

The Government's Enforcement Plan for Prudential Regulations (EPPR) aims to achieve a commercially-oriented banking system and to strengthen banking supervision.

The detailed operational design remains to be completed, i.e., there are as yet no clear and detailed specifications regarding actions. The above elements should guide the detailed operational design in implementing the EPPR.

However, some intended actions may need to be revisited. In particular:

- Recapitalization should not occur up-front but be phased and conditional to performance improvement;

- Identification of NPLs that would eventually be centrally worked out should be based on the nature of the borrower/loan rather than simply the size of the loan.

In addition, a set of qualitative and quantitative performance indicators for each SOCB needs to be carefully defined.

Interim measures

To prepare for the restructuring programs and to guard against further deterioration of the SOCB assets in the interim, a number of actions are warranted.

- The classification of loans should be implemented according to BOL regulation No.98, 1998.

- SOCBs will not be allowed to make new loans to borrowers with existing loans in default, and will be monitored quarterly for the largest 20 borrowers of BCEL and largest 5 borrowers of Lao May Bank and Lane Xang Bank, respectively, and additional sampling as required.

- In view of the 53 percent increase credit of the above three SOCBs in 2000 and the need to reduce their credit expansion to 17 percent in 2001, a direct limit on the total net domestic assets (excluding net claims on the BOL and net claims on government) of these banks will be applied.

- External audits based on international standards will be prepared for 1999 and 2000. These audits will provide banks a forward looking focus and be used to feed into the restructuring programs for the SOCBs. These audits will also serve to establish the base line against which performance improvement would be measured. The results will be shared with partners involved as early as possible.

GOVERNMENT OF THE LAO PEOPLE'S DEMOCRATIC REPUBLIC

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2001

TECHNICAL MEMORANDUM ON PROGRAM MONITORING

1. This **Technical Memorandum on Program Monitoring (TMPM)** defines the concepts used to determine observance of the quantitative and structural performance criteria and benchmarks specified in the **Memorandum of Economic and Financial Policies for 2001** (MEFP) of the Government of the Lao People's Democratic Republic (Lao P.D.R.) under the **Poverty Reduction and Growth Facility (PRGF)** arrangement (Sections I and II), and details the requirements for program monitoring and reporting (Section III).

2. Quarterly quantitative targets have been established for the following:

(i) ceiling on net domestic assets of the Bank of the Lao P.D.R. (NDABOL);

(ii) ceiling on net credit to the government from the banking system (NCG);

(iii) ceiling on net domestic assets of the state-owned commercial banks (NDASOCBs), excluding net claims on government;

(iv) floor on net official international reserves;

(v) ceilings on publicly-contracted or guaranteed nonconcessional external debt.

In addition, ceilings on the accumulation of external payments arrears will be applicable on a continuous basis.

3. Quantitative targets for the test date of end-June 2001 are performance criteria, and the disbursement associated with observance of end-June performance criteria will also be contingent on the completion of the first review. The targets for end-December 2001 are indicative and will be reviewed and set as performance criteria during the first review.

I. MONETARY AGGREGATES AND QUANTITATIVE TARGETS

A. Definitions[1]

4. **Net domestic assets of the Bank of Lao (NDABOL)** are defined as **reserve money (RM)** minus **net foreign assets of the BOL (NFABOL).**

[1] Variables with foreign currency components are to be valued according to Section I.B.

- **Reserve money** is defined as the sum of notes and coins issued by the BOL, excluding BOL holdings of currency, and deposits of commercial banks and the domestic nongovernmental sectors at the BOL. Reserve money excludes all BOL securities.

- **Net foreign assets of the BOL (NFABOL)** are defined as the **gross foreign assets of the BOL (GFABOL)** less **gross official foreign liabilities of the BOL (GOFLBOL)**. GFABOL include holdings of SDRs by the BOL, the Lao P.D.R.'s reserve position in the Fund, all foreign exchange holdings and foreign assets of the monetary authorities, including official holdings of monetary gold. Foreign exchange holdings of the monetary authorities include claims of the BOL and the Ministry of Finance (MOF) on nonresidents in the form of bank deposits and all foreign government securities, regardless of maturity. Foreign exchange assets of commercial banks held as collateral against BOL credits are not included as gross foreign assets of the BOL. GOFLBOL comprise foreign liabilities of the BOL with original maturity up to, and including, one year, and the use of Fund resources.

5. **Net credit to government from the banking system (NCG)** is defined as claims on the general government by the banking system less deposits of the general government with the banking system. Claims include bank loans and advances to the general government, as well as bank holdings of all government bonds and treasury bills, regardless of maturity, but exclude **government lending funds** as defined below.

- **Government lending funds (GLF)** of the BOL are defined as the sum of the kip value of long-term foreign liabilities of the BOL (i.e., with original maturities exceeding one year, except liabilities to the IMF) denominated in foreign currencies.

6. **Net domestic assets of the state-owned commercial banks (NDASOCB),** viz. Banque pour le Commerce Extérieur Lao (BCEL), Lane Xang Bank (LXB), and Lao May Bank (LMB), are defined as the sum of deposit liabilities less net foreign assets, net credit to government, and net claims on the BOL.

7. **Net official international reserves (NIRBOL),** for the purpose of program monitoring, are defined as "freely available" GFABOL minus GOFLBOL minus the foreign currency component of banks' required reserves at the BOL. Freely available reserves are defined in the IMF's *Data Template on International Reserves and Foreign Currency Liquidity: Operational Guidelines* and comprise of liquid or marketable foreign exchange assets readily available to the BOL (and exclude illiquid foreign assets especially those in nonconvertible currencies).

8. **Contracting or guaranteeing of nonconcessional external debt by the public sector** in the Lao P.D.R. is defined as having a **grant element** of less than 35 percent. **Ceilings on external debts** are calculated as commitments from the start of the program. They exclude concessional credits, use of Fund resources, normal trade-related credits, and any borrowing associated with debt rescheduling. During the program period, neither the

government, the BOL, nor any other agency acting on behalf of the government will contract or guarantee short-term external loans.

- **External debt**, as specified in point No.9 of the *Guidelines on Performance Criteria with Respect to Foreign Debt* (Decision No. 12274–(00/85), August 24, 2000), is defined as current (not contingent) liabilities which are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments discharge the principal and/or interest liabilities incurred under the contract. This definition includes all forms of debts, including loans, suppliers' credits (other than short-term trade credits) and financial leases. For the latter, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments that cover the operation, repair or maintenance of the property. This definition of debt also includes arrears, penalties, and judicially awarded damages arising from the failure to make payments under a contractual obligation that constitutes debt. Short-term external debt includes all short-term external debt obligations having an original maturity of up to one year, but excludes short-term trade credits. Debt falling within the limit would be valued in U.S. dollars at the exchange rate prevailing on the date that the contract or guarantee is entered into.

- **The public sector** is defined to include the Government of the Lao P.D.R., the Bank of the Lao P.D.R., state-owned enterprises, or any other agency acting on behalf of the government.

- **The grant element** of a debt is determined by comparing the net present value (NPV) of the financing costs and principal repayments with the nominal value of the debt. The NPV of financing costs and principal repayments will be calculated with a discount rate based on the OECD CIRRs for the currency of a debt in the table below, plus a margin. For debts with a repayment period of less than 15 years, the discount rate will be equal to the CIRR rate of the previous six months plus a margin of ¾ percent. For debts with maturities of 15 years or more, the discount rate will be equal to the average of the CIRRs for the previous ten years in Table 8 plus a margin that varies according to the maturity of the debt. The margins are 1 percent for debts of 15 to 19 years; 1.15 percent for debts of 20 to 29; and 1¼ percent for debts of 30 years or more.

9. **External payments arrears** are defined as the stock of external arrears on debts contracted or guaranteed by the government or the BOL, except on debts subject to rescheduling or debt forgiveness. For purposes of the program, external payments will be considered as arrears if they are not paid within 30 days of the date they are due. During the period of the program, neither the government nor the BOL will accumulate new external payments arrears. Overdue debt and debt-service obligations arising in respect of commercial obligations incurred directly, or guaranteed by, the government or the BOL, that are in

Lao P.D.R.: Average CIRRs (updated January 3, 2001)

	Six-month 2/15/-8/14/2000*	**Ten-year** 1/91-12/00 1/
	(In percent per year)	
Australian dollar	7.47	8.55
Austrian schiling 2/	n.a.	7.12
Belgian franc 2/	n.a.	7.69
Canadian dollar > 8.5 years	7.26	6.78
Danish krone	6.46	7.80
Deutsche mark 2/	n.a.	6.99
Finnish markkaa 2/	n.a.	8.17
French franc 2/	n.a.	7.44
Irish punt 2/	n.a.	7.94
Italian lira 2/	n.a.	8.98
Japanese yen	1.98	3.75
Korean won	10.18	11.57
Netherlands guilder >8.5 years 2/	n.a.	6.38
New Zealand dollar	8.08	8.33
Norwegian krone	7.51	7.94
Spanish peseta 2/	n.a.	9.47
Swedish krona	6.46	8.61
Swiss franc	5.24	5.67
U.K. pound	7.03	8.38
U.S. dollar > 8.5 years	7.54	7.35
Euro (ECU for ten-year average)	6.27	7.13
Memorandum item:		
SDR 3/	6.07	6.75

1/ Estimates based on actual CIRRs for 1/91 to 12/00.

2/ For the current 10-year averages, rates for Euro are used from 1/99.

3/ The 10-year SDR denominated CIRR rate was constructed based on the weighted average of the five 10-year CIRR averages for the underlying currencies.

For currencies not listed which are pegged to the U.S. dollar, the CIRR for the latter should be used; for all other currencies, as well as for units of account used by various multilateral institutions, the SDR CIRR should be used.

* The rates are calculated based on average CIRRs for the given currency for 2/15–8/14/2000.

dispute, will not be considered as external payment arrears for the purposes of program monitoring. As of December 31, 2000, there were no external payments arrears.

B. Valuation

10. In assessing observance of the program targets, valuation effects on the stock of gold holdings will be excluded, and gold holdings will be evaluated at the end-December 2000 gold price of US$272.65 per fine troy ounce. Similarly, the level of foreign currency assets and liabilities, excluding those denominated in SDRs, will be first converted into U.S. dollars at the test date midpoint market exchange rate. Only assets and liabilities identified as being in foreign currencies in the December 2000 balance sheets of the BOL and commercial banks would be subject to valuation adjustments.

11. For performance criteria and targets specified in kip, the U.S. dollar value of foreign currency assets and liabilities will be converted into kip at the midpoint program exchange rate of KN 8,200 = US$1. SDR assets and liabilities will be valued at a fixed midpoint program exchange rate of SDR1 = US$1.302. Non-U.S. dollar and non-SDR foreign assets and liabilities will be converted first into U.S. dollars using midpoint market exchange rates prevailing at end-period.

C. Program Adjusters

12. **The program (i) floor for NIRBOL** will be increased (decreased); and **(ii) ceilings for NDABOL and NCG** will be decreased (increased), by the amount of the excess (shortfall) in external nonproject budgetary support from the programmed amounts specified in Table 6 of the MEFP and the shortfall (excess) of external debt-service payments from programmed amounts.

II. Structural Performance Criteria and Benchmarks

13. **Defaulting borrowers** are defined as those borrowers from the banking system with loans classified by commercial banks as doubtful (grade D) and loss (grade E), as defined in BOL Regulation No. 98, 1998.

14. **Large borrowers** are defined to include, at each test date, the 20 largest borrowers from BCEL, the 5 largest borrowers from LMB, and the 5 largest borrowers from LXB.

15. The prior action to **"initiate" external audits of the SOCBs** (specified in Table 7 of the MEFP) will be satisfied by the government accepting the donor offer of assistance and the related conditions. The SOCBs in Table 7 and Appendix I are defined to be Banque pour le Commerce Extérieur Lao (BCEL), Lane Xang Bank (LXB), and Lao May Bank (LMB).

16. In paragraph 20 of the MEFP, the costs defined according to international standards include interest payments on debts but do not include rescheduled principal payments and payments on disputed debts.

III. Program Monitoring and Reporting Requirements

17. Data required to monitor performance under the program, including those related to performance criteria and benchmarks, will be provided to the IMF's Resident Representative by the 15th day of each month, unless otherwise indicated. The data to be reported are listed below and the respective reporting responsibilities between the BOL, the MOF, and the National Statistical Center (NSC) are indicated in parentheses.

Monetary data (BOL)

- The monthly monetary survey, the consolidated balance sheet of the commercial banks, and the individual balance sheets of the three SOCBs referred to in paragraph 15 above; to be provided within four weeks. Each of the three SOCBs will also report, at the same time as the balance sheet and within the same timeframe, all off-balance sheet obligations;

- The monthly balance sheet of the BOL; to be provided within two weeks;

- The monthly breakdown of NIRBOL in U.S. dollars (including the currency composition of foreign exchange holdings), GOFLBOL, and GLF and any transaction during the month that results in a future predetermined net drain on NIRBOC, excluding forward exchange, swap, and future contracts; and contingent obligations, such as foreign exchange guarantees to be provided within two weeks;

- Amount of bills offered by BOL in the central bank bills auction, amount sold to each bank, and the average yield in percent per month, to be provided within four weeks;

- A weekly report on loans, deposits, reserves at the BOL, and excess reserves of BCEL, LXB, and LMB; and the outstanding stock of BOL and Treasury securities, and the gross official reserve assets and liabilities of the BOL; both to be provided within one week;

- A quarterly report on the largest borrowers from the state-owned commercial banks (5 largest for LXB and LMB, and 20 largest for BCEL); to be provided within four weeks;

- Daily buying and selling exchange rates of the kip against the U.S. dollar and the Thai baht, including the official and parallel market exchange rates; to be provided daily (BOL).

Fiscal data (MOF)

- The quarterly consolidated accounts of the general government, including detailed data on tax, nontax and capital revenues, current and capital expenditures, net lending, and financing. Financing components should be separated into foreign sources (cash and project loans), domestic sources (bank and nonbank), and receipts from asset sales. All data to be provided within four weeks.

- The semi-annual receipts and expenditures of all nonbudgetary funds (as of March and September), including the Road Fund; to be provided within four weeks.

- The quarterly breakdown of new grants, loans, and government guarantees by main debtor; to be provided within four weeks.

- The quarterly outstanding stock of tax and nontax arrears, and any expenditure arrears, to be reported within four weeks.

External sector data (MOF)

- Quarterly outstanding stock of short-, medium-, and long-term external debt contracted or guaranteed by the government, state-owned enterprises, or the BOL, in U.S. dollars, by creditor; to be provided within four weeks;

- Monthly nonconcessional short-, medium-, and long-term external debt contracted or guaranteed by the government, state-owned enterprises, or the BOL, in U.S. dollars, by creditor; to be provided within three weeks;

- Monthly stock of external payments arrears; to be provided within three weeks (MOF);

- Monthly total export and total import values in U.S. dollars, along with available commodity breakdown; to be provided within four weeks (Customs, MOF).

Other data (NSC)

Overall monthly consumer price index and a detailed breakdown by major categories of goods and services included in the consumer basket; to be provided within two weeks.

Statement by the IMF Staff Representative
April 23, 2001

This statement provides information on development since the issuance of the staff report (EBS/01/53, 4/9/01). These developments do not change the thrust of the staff appraisal.

1. All the prior actions listed in EBS/01/53 have been completed (a full list of the prior actions for Board consideration of the PRGF arrangement is provided in Table 1). In particular:

- The audits for the SOCBs were initiated by the government's acceptance of the donor offer assistance and related conditions. The terms of reference have been finalized.
- The summary budget for the 1999/2000 outcome, budget for 2000/01, and performance in the first 6 months was published on April 5 in the local newspaper for the first time, and more detailed data will shortly be published in a booklet.

2. Preliminary information suggests that macroeconomic performance so far in 2001 has generally been in line with program expectations, except for fiscal performance, which has been slightly weaker. Inflation in March 2001 declined further to 8 percent (12-month basis) reflecting continued restrained policies. The exchange rate has remained reasonably stable with respect to the baht so far in 2001, although it has depreciated by 3 percent against the dollar. Through mid-March, credit of the state-owned commercial banks remained at about the end 2000 level, and thus should be broadly in line with the end March 2001 target.

3. Very preliminary budget data for the first half-year show revenue moderately lower than staff projections, while bank financing is over the program target but by a smaller amount. Recent revenue performance may have been affected by the ongoing decentralization effort. The authorities are now formulating measures, in consultation with the staff, to keep revenue on track, including some adjustments to excise rates and a further tightening of the administration of nontax revenue and large taxpayers. With these efforts, the staff considers that the program's fiscal targets will be achievable. Gross international reserves at end March were 2.1 months of imports, slightly below the program benchmark of 2.4 months, also reflecting mainly the weaker performance in budget revenue.

4. In addition to the prior actions, and in line with the program's framework, the authorities also have increased urban water prices by about 80 percent phased in between April and November 2001. Also, issuance of the implementing regulation for the Foreign Investment Law on March 23, 2001 is a significant step forward in making the investing environment more transparent and simplifying and speeding up the approval process.

- over -

Table 1. Lao P.D.R.: Completed Prior Actions for the First Annual PRGF-Supported Program

Policy action	Date completed
I. Banking reform	
Agree on the main elements of the restructuring of state-owned commercial banks (SOCBs) to be defined, in consultation with the AsDB and World Bank.	Nov. 1, 2000
Initiate the external audits based on international standards of the three SOCBs for 1999 and 2000.	Feb. 26, 2001
II. SOE reform	
Continue to adjust petroleum prices to avoid losses of oil companies, and agree with the World Bank on a timetable for future adjustments of electricity tariffs.	Nov. 30, 2000
Provide balance sheets and income statements for 1997, 1998 and 1999 for electricity, water, fuel, and airline companies.	Nov. 1, 2000
III. Fiscal reform	
Use current market exchange rates on tax assessments.	Oct. 15, 2000
Publish summary tables for 2000/01 budget and outturn for 1999/00.	Apr. 5, 2001
III. External sector measures	
Begin operation of external debt monitoring unit that records the contracting and disbursing of all public and publicly-guaranteed debt.	Apr. 12, 2001
Introduce automatic licensing for exports, except forestry and mining products.	Mar. 1, 2001

Public Information Notice (PIN) No. 01/40
FOR IMMEDIATE RELEASE
April 26, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with the Lao People's Democratic Republic

On April 23, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Lao People's Democratic Republic.[1]

Background

Lao P.D.R. made important progress at economic reform through implementing its "New Economic Mechanism" in the first half of the 1990s, supported by a program under the Enhanced Structural Adjustment Facility. Then, in 1997, an expansionary response to the Asian crisis was adopted. Ambitious investment plans, particularly irrigation projects to achieve rice self-sufficiency, were pushed through despite the regional crisis and without appropriate resource allocations. Recourse to central bank financing, given the high level of dollarization, caused inflation to skyrocket to triple digits and the kip to depreciate sharply.

Recognizing the severe cost of high inflation, the authorities embarked on a strong stabilization and sustained program from mid-1999. With restrained policies, economic conditions improved considerably. Under relative exchange rate stability, inflation fell sharply, from 87 percent at end-1999 to 9 percent in February 2001. Real GDP growth is estimated to have been about 5.7 percent in 2000, as stronger domestic demand from higher credit growth appears to have offset the drop-off in Foreign Direct Investment, but there is considerable uncertainty with GDP estimates because of the poor quality of the data.

Monetary policy played a key part of the stabilization effort. Sharp limits on central bank financing, especially on irrigation projects, and the issue of central bank securities, were critical in reducing the

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the April 23, 2001 Executive Board discussion based on the staff report.

excess kip liquidity. Thus, Bank of Lao P.D.R. (BOL) credit to the government and economy, which rose sharply in 1998 and early 1999, has since been flat, except for onlending of external project loans. Supplementing BOL credit restraint were efforts to make commercial banks operations more prudent. As a result of this caution, in 1999 commercial bank credit remained flat in U.S. dollar terms. However, in 2000, state-owned commercial banks (SOCBs), seeing a return to stability, SOCBs increased their lending rapidly, by 40 percent (in U.S. dollar terms), putting pressure on the underlying quality of their portfolios.

The 1999/2000 budget marked a return to more orderly fiscal management. Although there were attempts to restrain expenditures in 1998/99, the burden fell on social expenditures, and significant domestic arrears were incurred, including as unpaid wages to social sector workers. In the 1999/2000 budget, strong efforts were made to improve tax administration, and as a result, the ambitious target of raising revenue by nearly 2 percentage points to 13 percent of GDP was achieved. At the same time, scaling back the construction projects sharply reduced capital spending in relation to GDP, and made more room for unwinding the very tight constraints on current spending which increased to 8 percent of GDP. Additional external assistance enabled the budget deficit to be increased from 4 percent of GDP to 5 percent in 1999/2000, but with a reduction in net banking system credit to the government of about ½ percent of GDP, and credit from the central bank was reduced by more than twice this amount.

On the foreign exchange side, while maintaining a flexible exchange rate system, the strong policy actions have stabilized the rate since late-1999. Although the rate subsequently depreciated by 9 percent against the U.S. dollar, it has remained stable against the baht, and the margin with the parallel market has generally remained under 2 percent, and gross international reserves increased from 2 months of prospective imports at end-1999 to 2.4 months at end-2000.

Executive Board Assessment

Executive Directors commended the Lao authorities for their strong actions to stabilize the economy by tightening central bank credit and fiscal policy. These determined efforts succeeded in sharply reducing inflation from triple digits in 1999 to the current single digit range. Directors stressed the importance of building on this record to strengthen macroeconomic performance and more effectively meet the government's objectives of sustaining higher growth with equity. Extensive structural and appropriately sequenced reforms will also be essential, and should aim at promoting efficiency and private sector activity, while spreading the benefits of development more broadly, especially to rural areas.

Directors considered that further credit restraint by the central bank and the state-owned commercial banks is needed to sustain macroeconomic stability. This restrained credit policy is key for avoiding renewed inflationary pressures while maintaining a flexible and market-based exchange rate, which Directors consider to be appropriate.

Directors welcomed the framework for prudent fiscal policy. Central to this framework are strong revenue efforts, especially through more effective tax administration for large taxpayers, which will also pave the way for introduction of a value-added tax in 2003. A combination of revenue efforts and spending restraint will be needed to achieve the fiscal targets for the 2000/01 budget and, in this regard, Directors encouraged the authorities to adhere to their commitment of adjusting spending in line with available revenue. To enhance the poverty focus of the budget while maintaining fiscal discipline, they stressed that major improvements in public expenditure management will be needed, aimed at enhancing transparency and at directing expenditures more effectively for poverty reduction, especially in the context of ongoing decentralization. These efforts will require considerable technical assistance from the Fund and other multilateral institutions. Directors also observed that, in view of Lao P.D.R.'s limited debt-servicing capacity, external borrowing will need to be closely monitored in the period ahead. Several Directors encouraged the authorities to make further progress in their debt negotiations with key bilateral creditors.

Directors emphasized the need to move ahead decisively with reform of the state-owned commercial banks. They attached particular importance to developing and implementing bank specific restructuring plans based on phased recapitalization, which should be strictly conditional on improvements in bank performance and governance, as well as the resolution of nonperforming loans. Sustainable rehabilitation of the banking sector will equally depend on supporting measures to improve lending discipline, especially measures to phase out policy lending and develop banking supervision.

Directors agreed that reforms of the enterprise sector are essential to complement banking reforms. They welcomed the recent price adjustments that strengthened the financial performance of state-owned enterprises, but noted that additional adjustments will be needed to achieve cost recovery and will need to be followed by more comprehensive reforms. Regarding nonstate enterprises, the recent issuing of the implementation regulation for the Foreign Investment Law is an important start, but further progress will be required to create a transparent and fair business environment.

Directors supported the government's commitment to economic integration in order to boost its growth prospects. They recognized that, given the structure of Lao P.D.R.'s trade, liberalization under the ASEAN Free Trade Area will present both major benefits and challenges, and will need to be supported by measures to strengthen competitiveness.

While welcoming recent steps to strengthen the database, Directors expressed concern at the quality and availability of economic statistics for surveillance and for monitoring poverty reduction. They stressed, in particular, the importance of improving the quality of fiscal data as well as broadening its availability, within the government and to the public, to improve transparency.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Lao P.D.R.: Selected Economic Indicators, 1997–2001

	1997	1998	1999	Est. 2001	Proposed Program 2001
Output and prices		(Annual percentage change)			
Real GDP growth	7.0	4.0	7.3	5.7	5.7
CPI, end-of period	26.6	141.9	86.7	10.5	8.0
Government budget [2/]		(In percent of GDP)			
Total revenue	11.3	9.8	10.6	12.7	13.9
Grants	3.4	5.3	6.0	3.2	2.8
Total expenditure	21.9	23.6	20.6	20.9	21.7
Overall balance (including grants)	-7.2	-8.5	-4.0	-5.0	-5.0
Of which: Banking financing	-1.6	0.8	-0.4	-0.8	0.0
Money and credit		(Annual percentage change)			
Broad money	65.8	113.3	78.4	45.7	20.0
Credit to the economy	110.8	86.3	74.2	41.3	17.8
External sector					
Exports (percent change in U.S. dollar value)	-1.4	6.4	7.7	8.3	7.4
Imports (percent change in U.S. dollar value)	-6.0	-14.7	0.3	6.6	10.6
Current account balance (including official transfers, in percent of GDP)	-10.7	-4.4	-1.5	-1.6	-3.1
Gross official reserves (in millions of U.S. dollars)	136	112	106	140	152
(In months of prospective goods and service imports)	2.7	2.2	2.0	2.4	2.5
External debt					
Ratio of debt-to-GDP [3/]	60.9	95.2	89.4	73.4	72.0
Debt-service ratio (ratio of exports of goods and services)	7.3	9.7	10.4	9.2	9.7
Exchange rate (end-of-period)					
Commercial bank rate (kip per U.S. dollar)	2,135	4,274	7,600	8,140	...
Real effective exchange rate (percent change, annual average)	4.5	-23.1	5.0	10.8	...

Sources: Data provided by Lao. P.D.R. authorities; and Fund staff estimates and projections.

1/ Staff estimate for 1999 real GDP growth is 5.0 percent; the lower estimate of Fund staff is due to their lower estimate of agricultural sector output, in line with observations of relevant international agencies.

2/ Fiscal data are on a fiscal year basis (October–September).

3/ Excludes debt in nonconvertible currencies; includes debt to the Fund SAF and ESAF).

Press Release No. 01/18
FOR IMMEDIATE RELEASE
April 23, 2001

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves in Principle Three-Year, US$40 Million PRGF Loan for Lao P.D.R.

The Executive Board of the International Monetary Fund (IMF) today approved in principle[1] a three-year arrangement for Lao (People's Democratic Republic) under the Poverty Reduction and Growth Facility (PRGF)[2] for SDR 31.7 million (about US$40.2 million). The Board also approved in principle the release of a first loan under the PRGF arrangement in an amount equivalent to SDR 4.53 million (about US$5.7 million).

In commenting on the Executive Board's decision, the Deputy Managing Director, and Acting Chairman, Eduardo Aninat, made the following statement:

"The government's economic program and Interim Poverty Reduction Strategy Paper (I-PRSP) are aimed at strengthening macroeconomic stability and reducing poverty through growth with equity. Achieving these goals will require prudent monetary and fiscal policies as well as supporting actions to reform state-owned commercial banks (SOCBs), promote private sector activity, and improve public sector finances.

"The authorities will build on recent gains in macroeconomic stabilization through further credit restraint by the central bank and SOCBs, and a prudent fiscal stance. Further strengthening of revenue administration, paving the way for a value-added tax in 2003, and improving public

[1] A final decision by the IMF Executive Board is pending discussion of Lao P.D.R.'s interim Poverty Reduction Strategy Paper by the Executive Board of the World Bank. The World Bank board discussion is expected to take place on April 24, 2001.

[2] On November 22, 1999, the IMF's concessional facility for low-income countries, the Enhanced Structural Adjustment Facility (ESAF), was replaced by the Poverty Reduction and Growth Facility (PRGF), and its purposes were redefined. It was intended that PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a poverty reduction strategy paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. At this time for Lao P.D.R., pending the completion of a PRSP, a preliminary framework has been set out in an interim PRSP, and a participatory process is underway. It is understood that all policy undertakings in the interim PRSP beyond the first year are subject to reexamination and modification in line with the strategy that is to be elaborated in the PRSP. Once completed and broadly endorsed by the Executive Boards of the IMF and World Bank, the PRSP will provide the policy framework for future reviews under this PRGF arrangement. PRGF loans carry an annual interest rate of 0.5 percent, and are repayable over 10 years with a 5 ½ year grace period on principal payments.

expenditure management, especially in the context of ongoing decentralization, will be essential to maintain fiscal discipline and reduce poverty.

"SOCB reform will be achieved through the development and implementation of bank specific restructuring plans, based on phased and conditional recapitalization. These plans will be supported by measures to improve lending discipline, especially the phasing out of policy lending. Banking reform will be complemented with measures to improve the environment for private sector development and to strengthen the financial performance of state-owned enterprises, starting with an adjustment of their prices to cost recovery levels.

"The government's commitment to trade liberalization and regional integration under the ASEAN Free Trade Area provides an opportunity to accelerate growth, but ambitious reforms to the banking and enterprise sectors will be needed to meet the challenges of greater openness with improved competitiveness.

"The Interim Poverty Reduction Strategy Paper has been prepared in a broad participatory manner and meets the core requirements for developing a full PRSP by August 2002. Attention will have to be given to ensuring the quality of the poverty reduction strategy, identifying its links to the budget, improving data quality, and broadening the participatory process," Mr. Aninat said.

ANNEX

Program Summary

Under the PRGF-supported program, real GDP growth is projected to rise to 7 percent by 2003, while inflation would be reduced to 5 percent. In order to protect the external position, gross official reserves will be raised gradually to 3 months of import coverage. Sustained macroeconomic stability and higher growth with equity are to be the basis of the poverty reduction program. For 2001, macroeconomic performance is expected to be relatively favorable. Real GDP growth will remain at about 5.7 percent and inflation will fall to under 8 percent.

Credit by the central bank and SOCBs will be tightened to maintain the downward pressure on inflation. Credit growth of the latter will be sharply reduced to 17 percent in 2001, a target that will also support better loan quality. The exchange rate will be managed flexibly and the margin between the bank and parallel markets will be kept to under 2 percent. Exchange system controls would continue to be eased.

The overall budget deficit will be kept at about 5 percent of GDP during 2000/01–2000/03. The financing of the budget would rely mainly on external concessional financing, and avoid domestic bank financing. These goals will be supported by reforms to tax administration, focusing on large taxpayers in preparation for the introduction of a VAT in 2003, which would increase the revenue to GDP ratio by 2 percentage points. These additional resources would be available for social spending, including rural development. To more effectively meet these goals, public expenditure management would be reformed, through improving the treasury system and fiscal reporting and accountability.

The program provides for reform of the banking sector, to recapitalize the weak SOCBs conditional on improvements in their performance. The reform plan also aims to enhance governance, and ensure the implementation of a standard accounting framework and loan classification and provisioning requirements, supported by improvements to the environment for SOCBs, including phasing out directed lending and developing bank supervision.

Enterprise policies will have two main stands. For key large state enterprises, the government will initially focus on avoiding losses through price adjustments, while developing more comprehensive reforms during the first year of the program. In addition, it will also formulate measures to promote private sector development.

Trade reforms will be centered on implementing the commitments under the ASEAN Free Trade Area (AFTA), under which by the start of 2005, 95 percent of imports would be free of quantitative restrictions and for those from AFTA members would have tariffs at no more than 20 percent; 87 percent of these would have tariffs of 0–5 percent.

Lao P.D.R. became a member of the IMF on July 5, 1961. Its quota[3] is SDR 52.9 million (about US$67 million), and its outstanding use of IMF credit currently totals SDR 31.9 million (about US$40 million).

[3] A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

Lao P.D.R.: Selected Economic Indicators, 1997–2001

	1997	1998	1999	Est. 2000	Proposed Program 2001
		(Annual percentage change)			
Output and prices					
Real GDP growth 1/	6.9	4.0	7.3	5.7	5.7
CPI, end-of period	26.6	141.9	86.7	10.5	8.0
		(In percent of GDP)			
Government budget 2/					
Total revenue	11.3	9.8	10.6	12.7	13.9
Grants	3.4	5.3	6.0	3.2	2.8
Total expenditure	21.9	23.6	20.6	20.9	21.7
Overall balance (including grants)	-7.2	-8.5	-4.0	-5.0	-5.0
Of which: Bank financing	-1.6	0.8	-0.4	-0.8	0.0
		(Annual percentage change)			
Money and credit					
Broad money	65.8	113.3	78.4	45.7	20.0
Credit to the economy	110.8	86.3	74.2	41.3	17.8
External sector					
Exports (percent change in U.S. dollar value)	-1.4	6.4	7.7	8.3	7.4
Imports (percent change in U.S. dollar value)	-6.0	-14.7	0.3	6.6	10.6
Current account balance (including official transfers, in percent of GDP)	-10.7	-4.4	-1.5	-1.6	-3.1
Gross official reserves (in millions of U.S. dollars)	136	112	106	140	152
(In months of prospective goods and service imports)	2.7	2.2	2.0	2.4	2.5
External debt					
Ratio of debt-to-GDP 3/	60.9	95.2	89.4	73.4	72.0
Debt-service ratio (ratio of exports of goods and services)	7.3	9.7	10.4	9.2	9.7
Exchange rate (end-of-period)					
Commercial bank rate (kip per U.S. dollar)	2,135	4,274	7,600	8,140	...
Real effective exchange rate (percent change, annual average)	4.5	-23.1	5.0	10.8	...

Sources: Data provided by Lao P.D.R. authorities; and IMF staff estimates and projections.

1/ Staff estimate for 1999 real GDP growth is 5.0 percent; the lower estimate of Fund staff is due to their lower estimate of agricultural sector output, in line with observations of relevant international agencies.

2/ Fiscal data are on a fiscal year basis (October–September).

3/ Excludes debt in nonconvertible currencies; includes debt to the Fund (SAF and ESAF).

Statement by Dono Iskandar Djojosubroto, Executive Director and Madhav Prasad Bhatta, Advisor to Executive Director for the Lao People's Democratic Republic
April 23, 2001

We would like to thank staff for the well-written papers on the Article IV consultation on Lao and their recommendations for the approval of a three-year PRGF arrangement for Lao P.D.R. Our Lao authorities would also like to express their appreciation to the management and staff of the Fund for their continued support and policy advice. They broadly agree with the staff's comments and assessment of recent developments in Lao P.D.R as well as their policy recommendations.

Recent economic development and immediate macro-economic outlook

Over the past decade, Lao P.D.R has made good progress in economic reforms. The government has taken various measures to transform the country towards a more market-oriented economy under its New Economic Mechanism, which has the broad support of the international community, particularly the Bretton Woods institutions and the Asian Development Bank. In the first half of the 1990s, real GDP growth averaged 7-8 percent, per capita income increased significantly and inflation remained largely in single-digits.

However, the economy was adversely affected by the crisis that swept through a number of Asian countries in the second half of 1997. The most badly hit areas were the public finances and balance of payments. Government revenue declined significantly and capital inflow through private investment slowed substantially. Exports declined and the kip depreciated ten-fold against the US dollar and inflation reached three digits.

While agriculture remains the dominant sector of the economy, the other engines of growth now include manufacturing, construction and services. Meanwhile, significant foreign investment in hydropower has also increased with the better prospects for exporting energy to the neighboring countries.

The real sector of the economy particularly the agricultural sector performed well, especially during the early stages of the crisis, when global prices of rice and a number of other major crops remained high. For this reason, the agriculture sector continued to do well despite the crisis as the demand for some of the agricultural products increased markedly, especially from Thailand. Moreover, investments in public infrastructure in the rural sector paid off as they provided a strong impetus to growth in agriculture with many rural farmers being given increased direct access into the markets during this difficult period. Thus despite the negative spill-over effects of the Asian financial crisis, the real growth of the economy was maintained at reasonable levels due to favorable performance by the agriculture sector. However, the pre-crisis socio-economic development targets have yet to be achieved and the authorities continue to face many challenges in improving the economic conditions and welfare of the people of Lao P.D.R.

Since October 1999, the exchange rate has stabilized within the range of around 7,500 kip to 8,500 kip to a US dollar and remained stable relative to the Thai baht. Likewise, the inflation rate also declined sharply and has continued to fall to single digits in recent months.

Macro-economic Stabilization

The measures undertaken by the authorities which contributed to the macro-economic stabilization consisted of fiscal consolidation, for example, enhancement of revenue collection, curbing government overdraft from the central bank and cautious management of public expenditures. At the same time, increased use of open market operations such as the sale of central bank bills, treasury bills and high interest bearing certificates of deposit were used to absorb excess liquidity in the economy.

The government will continue its fiscal discipline and tight monetary policy stance over the medium term as spelled out in the MEFP. However, there is still the need to mobilize greater resources towards productive and priority social sectors amidst the tight fiscal condition. Therefore, the government has been striving to increase revenue through various measures including the strengthening of tax administration.

The main objective of monetary policy of the government for 2001 and in the medium term has been to further reduce the inflation rate to be in line with its major trading partners. Recognizing the fact that high level of dollarization in the Lao economy has limited the central bank's capacity to implement monetary policy, the central bank is now putting emphasis on strict control of its credit to the government and closely supervising the lending of commercial banks.

Structural reforms

Although there has been some setback in the reforms of the state-owned enterprises recently, a lot of progress has been made in the structural reforms of the state-owned commercial banks (SOCBs). The consolidation of seven SOCBs into three major banks were completed in early 1999 and the restructuring of these banks has been continuing with technical assistance from the AsDB since late1997.

The authorities recognize that those banks are still weak compared with international standards and thus the SOCBs reforms will be one of the major structural goals under the PRGF program with assistance from the World Bank and the AsDB. Similarly, the authorities are committed to undertake further reforms to introduce a market-based legal and institutional framework for the SOEs.

Interim Poverty Reduction Strategy Paper

Since Lao P.D.R remains one of the poorest countries in the world, poverty reduction is one of the key elements in the government's overall development strategy. The I-PRSP was prepared with wide participation by and consultation with the local private sector, NGOs and the international community. A more refined PRSP will be prepared to take account of comments and suggestions received as well as experiences gained with the I-PRSP and the joint staff assessment. The overall strategy of the government is to promote sustainable growth with equity so as to graduate from the group of least developed countries by the year 2020.

Trade Reform

As a member of ASEAN, the authorities are committed to meet their commitments under the ASEAN Free Trade Area (AFTA) by 2008. The licensing requirements for all exports (except for mining and timber products) have been revoked completely with effect from March 2001. The authorities have been coordinating with the European Union, Japan and the United States to seek better access for their products both under the general system of preference and under normal trade relations. Lao P.D.R is also in the process of seeking accession to the WTO.

Statistical Issues

Although there have been improvements in statistical data recently, the authorities recognize that there are still many areas that need further improvements to ensure the quality of data used for policy formulation and for dissemination to the general public information. Therefore, the Lao authorities would welcome receiving assistance from the donor community to provide suitable training to the local personnel and develop the necessary processes to enhance their capacity in this area.

Conclusion

Despite the numerous difficulties of the past three years, the Lao authorities have achieved significant results towards stabilizing the economy. The authorities do realize that there remains much to be done before the country can expect sustained economic growth over the medium term. They are therefore committed to implement the necessary measures under the PRGF.

The authorities hope that Executive Directors will consider the proposed program favorably to ensure strong and sustained economic development in Lao P.D.R, which would be necessary to support its efforts at reducing poverty in the country.