FOR AGENDA

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July 15, 2002

To: Members of the Executive Board

From: The Secretary

Subject: **Lao People's Democratic Republic—Selected Issues**

This paper provides background information to the staff report on the 2002 Article IV consultation discussions with the Lao People's Democratic Republic, the second review under the Poverty Reduction and Growth Facility, and the Lao People's Democratic Republic's request for a waiver of performance criteria (EBS/02/129, 7/15/02), which is tentatively scheduled for discussion on **Monday, July 29, 2002**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of the Lao People's Democratic Republic indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. Winglee (ext. 35693) and Mr. Q. Hussain (ext. 37334) in APD.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the Asian Development Bank, the Food and Agriculture Organization, and the United Nations Development Programme, following its consideration by the Executive Board.

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INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

Selected Issues

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Approved by the Asia and Pacific Department

July 12, 2002

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GLOSSARY OF ABBREVIATIONS

APB	Agricultural Promotion Bank
AsDB	Asian Development Bank
BCEL	Banque pour le Commerce Extérieur du Laos
BOL	Bank of the Lao P.D.R.
BRC	Bank Restructuring Committee
CAR	Capital adequacy ratio
CPC	Committee for Planning and Cooperation
CPI	Consumer price index
DAFI	Development of Agro-Forestry Industry Group
EDL	Electricité du Laos
FMAC	Financial Management Adjustment Credit (World Bank)
FSPL3	Financial Sector Program Loan III (AsDB)
GDP	Gross Domestic Product
HIPC	Highly Indebted Poor Country
IAS	International accounting standards
Lao P.D.R.	Lao People's Democratic Republic
LMB	Lao May Bank
LXB	Lane Xang Bank
MCPCT	Ministry of Communication, Post, Construction and Transport
MOF	Ministry of Finance
MOJ	Ministry of Justice
Nam Papa	Lao Water Supply Enterprise
NAO	National Audit Office
NPLs	Nonperforming loans
NPEP	National Poverty Eradication Program
NPV	Net present value
NT2	Nam Theun 2
PEM	Public expenditure management
PER	Public Expenditure Review
PF3	Pharmaceutical Factory No. 3
Phoudoi	Bolisat Phathana Khet Phoudoi (BPKP) Highland Development Enterprise
PIP	Public Investment Plan
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
RBPs	Restructuring and Business Plans
SCBs	State commercial banks
SDR	Special Drawing Rights
SME	Small and Medium Enterprises
SOEs	State-owned enterprises
SUR	Soviet Union rubles
THPC	Theun Hinboun Power Company

I. THE REFORM OF STATE-OWNED BANKS AND ENTERPRISES[1]

A. Introduction

1. **Persistent inefficiencies in the operations of state-owned commercial banks (SCBs) and enterprises (SOEs) have constrained the growth potential of the economy.** Recurring high levels of nonperforming loans (NPLs) of SCBs have been caused by internal factors, including continued weak credit risk management, lack of skilled and experienced credit personnel, and poor credit culture; and external ones, including the absence of financial discipline among both state and private borrowers, outside interference in lending decisions, and an inadequate regulatory, legal, and judicial framework. Enduring reform of SCBs and SOEs will require that these problems are corrected, and that SCBs and SOEs are put on a commercial footing, including through increased private sector participation. Only with such reforms will effective financial intermediation promote the growth of an efficient enterprise sector.

B. The Endemic Problem

State-owned commercial banks

2. **The Lao financial system is dominated by the three SCBs, which together account for almost three quarters of total gross assets of the banking system.**[2] BCEL alone accounts for about half of total deposits and 40 percent of total loans. There are branches of several foreign banks which are permitted to operate only in Vientiane. The weak banking environment has so far limited foreign bank activities to mainly trade finance, and thus they are not well integrated into the local economy. There is also a joint venture bank (Lao-Viet Bank), with two branches outside the capital, and a small domestically-owned private bank.

3. **For over a decade and a half, the SCBs have failed to fundamentally improve their performance, despite recapitalization in 1994.** Following the break-up of the monobank system in 1988, the commercial banking system grew from 2 to 17 in the decade to mid-1998, including 7 SCBs, accounting for two-thirds of total assets. In the early-1990s, under the weight of "inherited" bad loans from the monobank system and continued state interference in the commercial banking system, all the SCBs became deeply insolvent. In 1994, the government recapitalized all SCBs through a cash injection of KN 4 billion and the issuance of KN 14 billion in treasury bonds (amounting to about 35 percent of all outstanding

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[1] Prepared by Eric Sidgwick.

[2] Banque pour le Commerce Extérieur du Laos (BCEL), Lane Xang Bank (LXB), and Lao May Bank (LMB). The Agricultural Promotion Bank (APB), which accepts deposits but acts more as a development bank and is used for policy lending to the agricultural and rural sectors, accounts for only about 5 percent of total assets. APB is not covered by the Commercial Banking Law, and is not required to comply with BOL prudential regulations.

loans), eliminating NPLs originating from the monobank period, and in principle bringing the banks to a capital adequacy ratio (CAR) of 8 percent.[3] At that time, SOEs accounted for about 80 percent of the total NPL portfolio, while cooperatives and the private sector accounted for the remaining 4 percent and 16 percent, respectively.[4]

4. **The recapitalization was not accompanied by operational restructuring or a reduction in outside interference**. As could have been anticipated, without operational restructuring, the up-front recapitalization of the SCBs in 1994 improved balance sheets only temporarily. As a result of a political shift in 1996 to more interventionist polices, bad loans grew rapidly, especially to SOEs such as Phoudoi and DAFI, and others under the influence of provincial governments. In 1998, the 7 SCBs were merged into the current three, but operational restructuring proved impossible in the face of the massive exchange rate depreciation of the kip stemming from the Asia crisis and inappropriate domestic policies. As a result, balance sheets worsened further (especially for BCEL, which accounted for the bulk of foreign exchange transactions).

5. **The accumulation of bad loans has continued, even after the economic crisis**. BOL estimates indicate that by end-1999, less than 5 years after an initial round of recapitalization, the total amount of NPLs for all the 3 SCBs had risen to about 3 percent of GDP. State-related NPLs accounted for over 70 percent of total NPLs, of which 55 percent from SOEs and a further 11 percent from other policy loans. In the two years to end-2001, the ratio of newly approved or flow NPLs of the SCBs ranged from 23 percent for BCEL, 30 percent for LXB, and around 70 percent for LMB. Notwithstanding such poor lending, until recently all three SCBs paid taxes and declared dividends, resulting in further capital erosion.[5] [6]

6. **The vast majority of NPLs was concentrated in the construction and manufacturing sectors**. In addition to loans to large SOEs, another major source of NPLs is contractors for government projects who borrowed funds (often with the support of

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[3] The Treasury bonds exchanged for the bad loans were long-term securities, ranging from 1 to 10 years, issued by the government at an average interest rate of 15-18 percent. The bonds are redeemable up to 2004. The bonds plus the cash injection amounted to 1.6 percent of GDP.

[4] The Bank of the Lao P.D.R., Asian Development Bank, and World Bank, "The Banking and Financial Sector of Lao PDR: Financial Sector Note" (May 2002).

[5] Until early 2002, the SCBs were not appropriately implementing the Bank of Lao P.D.R. Prudential Regulations (BOL Regulation 98), for loan classification and provisioning. The above NPL rates are based on those standards, and while not up to international best practice, they capture the essential elements. International standard external audits of the SCBs' 2001 accounts are expected to be completed by end-2002.

[6] In addition to the losses from high levels of NPLs and large negative foreign exchange positions, indications are that off-balance sheet liabilities, though not yet fully identified, are likely to be significant.

provincial governments) to implement these projects but were not paid by the government. These arrears, mainly at the provincial level, are complex to clear because of the need to ascertain both that the project was included in the budget, and that the appropriate work was done. Reflecting poor banking practices, about 75 percent of loans were made in foreign currencies often to borrowers who did not have a foreign exchange income source, including to finance imports and for government construction projects.

State-owned enterprises

7. **Over time, the relative size of SOEs in production and employment has declined significantly**. Before 1990, the state enterprise sector accounted for virtually all of the modern industrial sector, and employed an estimated 16,000 workers (about 10 percent of the non-agricultural labor force). Three quarters of the SOEs were engaged in manufacturing, and the others in construction, electricity, and mining. The largest were centrally managed, while the rest were run by local authorities. Beginning in the late 1980s, recognizing the very weak performance of SOEs, the government began granting them more managerial autonomy, reforming the larger ones, and privatizing the smaller ones. In the early 1990s, the emphasis toward privatization shifted to include more of the larger SOEs, and a more articulate plan was announced whereby all but a handful of strategic enterprises were to be privatized within a three-year period. Though the process took longer than anticipated, by 1997, out of the 640 SOEs in 1989, only 93 remained as fully state-owned, of which 32 were deemed "strategic".[7] As a result, the SOE sector now constitutes less than 1 percent of total employment and contributes only about 15 percent to industrial production.[8]

8. **But SOEs have generally been a cause of high NPLs in the SCBs**. The persistent recurrence of NPLs is largely attributable to directed lending to the SOEs, the absence of repayment culture, due partly to interference on pricing, and protracted weaknesses in the operations of SOEs. Out of the total stock of NPLs at end-1999, almost half are owed by two of the SOEs (Phoudoi, accounting alone for 40 percent of NPLs; and DAFI, accounting for another 5 percent). In the case of these two enterprises there has been a lack of will to repay their bank debt, given that both Phoudoi and DAFI had a sufficiently high cash flow from lucrative logging ventures.

9. **Partial and infrequent adjustments of utilities' tariffs during high inflation periods have also weakened the financial position of SOEs**. In the case of EDL, the lack of transparency in its accounts from the losses on sales to domestic customers has made it difficult to track the returns from its large investments in the export of hydroelectric power, in relation to meeting its debt service obligations (mainly to the government from onlending of

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[7] Aside from the SCBs, of which there were eight at the time, these comprised mostly the utility companies and the three Ministry of Defense holding companies primarily engaged in logging, including Phoudoi operating in the central region and now transferred to the MOF, DAFI (in the southern area), and the Northern Agro-Forestry Development Company (in the northern region).

[8] See World Bank, *Financial Management Adjustment Credit (FMAC) Report*; Report No: P7526-LA (May 28, 2002); p.11.

concessional loans) and transfers to the government. Low domestic fares have also caused financial difficulties for Lao Aviation, including defaults on loans. In the past couple of years, increases in foreign travelers (who pay much higher fares), landing fees, cutbacks in operating expenses, and modest domestic fare increases have enabled it to avoid further defaults. However, much higher domestic fares and improved management are needed to improve the quality of its service and replace aging and unreliable aircraft. The water company (Nam Papa) faces a similar situation with its tariffs, and will need more revenue for maintenance of its newly upgraded supply system, additional investment, and future debt service.

C. The Road Map of Reforms

10. **The government's plans to accelerate development and reduce poverty over the next two decades will require fundamental and sustained reforms in the banking and enterprise sectors**. The government's reform program in this area, supported by the Asian Development Bank (AsDB), the World Bank, the IMF, and several bilateral donors, aims at financial restructuring to settle nonperforming assets, including through asset sales; and accelerated operational restructuring to improve the performance of state-owned commercial enterprises, including through proper credit risk management to stem the flow of new NPLs, foreign management expertise and joint ventures, price and tariff adjustments, sharply reduced state intervention, and private sector competition. The government has committed to privatize or liquidate persistently loss-making SOEs. The estimated direct costs to the government of banking reform through the issuance of treasury bonds currently stand at around 3½ percent of GDP, to which another 1-2 percent of GDP could be added to meet the costs of SOE reforms.[9]

State-owned commercial banks

11. The government's multi-year reform program includes phased financial and operational restructuring and the development of a market-based commercial banking system. The phased approach recognizes that even with an end to noncommercial policy and connected lending, and changes in management, weaknesses in the enterprise sector and the credit environment preclude a rapid turnaround to profitability. Because it would be difficult to attract fit and proper private investment in the SCBs in the near term, the program also includes expanding the role for private banks over the medium term. The reform program comprises the following three main tracks: (a) immediate improvements in operations; (b) phased restructuring and conditional recapitalization (2002 through 2005); and (c) gradual enhancement of the banking environment.[10]

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[9] World Bank estimate.

[10] The task of preparing the necessary policy reforms has been entrusted to the Working Committee for Financial Sector Development, comprising representatives of the MOF, BOL, MOJ, and CPC, while a Bank Restructuring Committee (BRC) within BOL has elaborated, with AsDB and World Bank assistance, individual Bank Restructuring and Business Plans (RBPs). In addition, shareholder oversight of SCB restructuring will be exercised by a new Banking Department in the MOF. APB is subject to a separate reform strategy within AsDB's Financial Sector Program Loan 3 (FSPL3), currently being prepared.

(a) Immediate operational improvements

12. **Measures already taken to avoid any further deterioration in the SCBs' balance sheets include**: a commitment to avoid any new non-commercial lending on behalf of the state;[11] individual credit ceilings for each SCB (consistent with the overall ceiling on net domestic assets of the SCBs included in the PRGF arrangement); prohibition of any lending if flow NPLs exceed 15 percent of total loans and any lending to defaulting borrowers; prior authorization from headquarters for branch loans above a specified amount; suspension and reversal of any interest accrued on NPLs and the prohibition on the distribution of dividends;[12]and strict loan classification and provisioning.[13]

13. **Not all of the above immediate measures have been fully complied with by the SCBs, and some are slow in having an effect**. There has been some further weakening of SCB balance sheets, particularly because of excessive lending in foreign exchange and from lending decisions in the large provincial branches. However, the more frequent and closer monitoring of SCB operations by the BOL has enabled the problems to be identified more rapidly. In particular, the BOL has intensified its monitoring of SCBs, including more frequent on-site inspections of the largest branches outside the capital to prevent further irregular lending and to ensure overall compliance with appropriate loan standards.

(b) Medium-term operational restructuring

14. **Because of the failure of previous recapitalizations, the RBPs include phased recapitalization conditional on the SCBs' achieving performance improvements** over a four-year period (2002–2005). The RBPs are designed to balance between proper incentives for performance improvements, in the form of payment of non-transferable recapitalization bonds,[14] and phased implementation of banking regulations, and the credible threat of sanctions, in the form of non-payment of recapitalization bonds, changes to management, and potential closure.

15. **The RBPs include bi-annual performance targets and indicative benchmarks for the whole period**; targets for 2003 will be set in late 2002 and indicative benchmarks for

[11] Under the World Bank's FMAC, non-commercial loans are defined as those that are: i) unsecured by the borrowers' ability to generate sufficient cash flow for repayment; ii) priced at below market interest rates; or iii) approved outside established credit appraisal procedures.

[12] Loan-loss provisions have now been made fully tax deductible.

[13]SCBs have recently restated their 2001 accounts to reflect the full amount of provisioning required for their post-2000 NPLs.

[14] The government securities would be made transferable over time, in line with the improvement in performance and the macroeconomic situation.

subsequent years would be specified more precisely every year.[15] Key elements of the RBPs include: i) operational restructuring through annual performance targets on indicators to strengthen management performance and instill better governance, including through the placement of external bank advisors in the SCBs and strengthening credit risk management to sharply limit new NPLs; ii) streamlining of branch and staff structures (supported by an appropriate social safety net for retrenched staff); iii) upgrading information technology to strengthen headquarters control and supervision; and iv) financial restructuring to resolve pre-2000 NPLs, including through treasury bond injections, and clearance of government arrears to contractors. The external advisors would have a mandatory role in reviewing all large loans in the credit review committees of the SCB's and would be in a position to object to those loans not made on commercial criteria. In the event the SCBs do not meet their performance targets, the record of overriding the advisor's objections would provide additional justification for upgrading the external advisors to co-managers.

16. **The RBPs for BCEL** aim to recover old NPLs, sharply limit new NPLs, arrest and gradually reduce the negative foreign exchange position, improve product pricing, and regain tight control over operational costs. In addition, to help solve the problem of the large stock of off-balance sheet liabilities, all such items would be individually screened for legitimacy before being accepted onto the BCEL's balance sheet. At the same time, BCEL would selectively hire/rehire new staff and management on a case-by-case basis.

17. **The two smaller SCBs, LMB and LXB, will be consolidated into a new bank.** Given the high level of old and new NPLs of LMB, all credit decisions would be removed from the former LMB branches, and the surviving branches would only mobilize deposits and perform appropriately remunerated services on behalf of the government. The assets and liabilities of LXB would be consolidated with deposits and fully-documented performing assets of LMB. The new bank would be issued with treasury securities to cover the excess of LMB's deposits over its performing loans in the amount of KN 137 billion (about US$15 million). It would also be given the task of collecting LMB's NPLs, and any collections would be retained to help strengthen its financial position. A merger would not imply much overlapping operations, given the distinct geographical distribution of both banks and would maintain banking services throughout the country, including on behalf of the government.[16] The strategic focus of the new bank would be geared toward SME and trade-related finance, retail deposit-taking, and government securities' trading. As in the case of BCEL, the new bank would also hire/rehire new staff on a case-by-case basis.

(c) Strengthening mechanisms to resolve NPLs

18. **Under the FMAC, the government is committed to resolve KN 100 billion in NPLs of at least 10 accounts by end-March 2003**. This would be supported by the AsDB

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[15] There would be three distinct phases in FSPL 3 for adopting concrete measures and assessing performance: October 1, 2002–June 30, 2003 (Phase I); July 1, 2003–December 31, 2003 (Phase II); and January 1, 2004–December 31, 2006 (Phase III).

[16] Outside of Vientiane, LXB operates mostly in the north, while LMB operates mostly in the south.

under FSPL3 with a collection strategy for the largest NPL accounts through either a fast-track voluntary debt resolution process or enforcement through the formal judicial system.[17] With regard to the latter, the ability of SCBs to deal with defaulting borrowers would be enhanced through: i) setting up of a commercial division in the court system to rule on cases involving creditor/debtor disputes over loan and security contracts; ii) stronger enforcement of judicial decisions; iii) amendments to legislation on land security and other forms of collateral; iv) standardization of loan and security documentation; and v) the establishment of a computerized registry of securitized transactions.

(d) Specific improvements to the banking environment

19. **In support of operational and financial restructuring, the reform program includes strengthening banking supervision**, especially in on- and off-site inspections to monitor bank developments in a timely manner, and gradually raise prudential regulations and standards to international best practice in line with progress in bank restructuring. Well targeted reforms to the legal and judicial system will also be required, particularly in the areas of bankruptcy, secured transactions, property, and land laws; establishment of a commercial court system; and strengthening enforcement. Finally, recognizing the potential of competition to advance the restructuring process, the government recently agreed to the opening of a new branch of the joint venture Lao-Viet Bank, and is considering allowing foreign banks to operate outside Vientiane in 2003. This would not only provide a potential stimulus to regional economic activity outside the capital, but also facilitate the take-over of surplus SCB branches.

Enterprises

20. **The government is pursuing SOE reform to strengthen competitiveness and complement banking reform**. The government recognizes that a well-functioning, financially-sustainable enterprise sector is required to improve the delivery of services, especially to the poor, create productive employment, and support the development of the economy. More specifically, the government's SOE reform program, supported by the World Bank under the FMAC, aims to initially address the financial weaknesses of some of the largest strategic SOEs, including the most indebted through phased tariff increases, operational restructuring, asset sales, and improved oversight, to help avoid the accumulation of new NPLs (see Box 1). In that connection, the government has taken measures requiring SOE performance to be reported regularly to the MOF, and the accounts be audited and published; limiting the creation to new SOEs to essential services which cannot be provided by the private sector or the budget; and prohibiting non-commercial policy lending to SOEs and all lending to SOEs with outstanding NPLs or without an agreed restructuring plan. Recognizing that a few SOEs have contributed disproportionately to NPLs in the banking system, the government has agreed Memoranda of Understanding (MoU) to initiate the restructuring process for Phoudoi, Lao Aviation, Nam Papa, and Pharmaceutical Factory No.3. These MoUs define the contribution of the enterprise, the Prime Minister's Office—

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[17] A Steering Committee for NPL Resolution has been established in each bank, and an External NPL Collection Committee has been set up in the BOL, to facilitate and coordinate NPL collections.

Box 1. Large State-Owned Enterprises Targeted for Restructuring

Lao Aviation

Lao Aviation is fully-owned by the Government and is the only airline operating in the country. The airline is burdened with debt, fares are below cost-recovery levels, and both the quality of service and safety record are poor. The Ministry of Transportation signed an MOU with Air France Consulting, a subsidiary of Air France, on April 23, 2002 to develop a business plan for the airline. The key points of the business plan are to: 1) increase the average air fare to a level of overall profitability (from 8 cents/km/seat to 20 cents/km/seat in 3 steps between May 2002 and January 2003 after 3 increases in 2001); 2) expand service routes to Europe by linking to Air France flights; 3) enhance the image of the airline through purchases of new aircraft; and 4) set up a new joint venture between the Lao P.D.R. government (40 percent) and private firms (60 percent) in order to facilitate an estimated working capital requirement of $6 million and aircraft acquisition.

Bolisat Phattana Khet Phoudoi (BPKP or Phoudoi)

BPKP, a 58 company conglomerate until recently controlled and operated by the military, is responsible for the largest amount of NPLs in the banking system (40 percent of the pre-2000 stock of NPLs). A phased restructuring process has been initiated. Phase 1 was completed in December 2001 when the ownership was transferred to the Ministry of Finance. Phase 2, which is expected to be completed by mid-2002, will involve separating the financial accounts for each of the 58 constituent companies (travel, hotels, construction, logging, etc.), based on ongoing audits. Finally, in Phase 3 (beginning in 2003), business portfolio restructuring will be initiated to: 1) consolidate the total number of companies to 9 (including through the sale of noncore assets to settle NPLs of the SCBs); 2) reduce significantly the number of staff; and 3) improve oversight management mechanisms.

Nam Papa Lao

Implement in July 2002 a restructuring plan for the Vientiane water company. The key points of the restructuring plan are to: 1) increase the water tariffs from an average of KN 550/m^3 to KN 750 /m^3 by July 2002 (after increasing tariffs from KN 195/ m^3 in 2000) but further increases are needed to reach full cost recovery and allow for new investment; 2) reduce significantly the number of employees; 3) reorganize to improve efficiency within the organization; and 4) decentralize units within Vientiane in order to provide better customer service.

Pharmaceutical Factory No. 3 (PF3)

Implementation of a restructuring plan has begun, and is expected to be completed by December 2002. The key tasks of the plan are to: 1) reorganize the enterprise to create a more market-oriented organization; 2) reduce costs through staff reduction; and 3) improve the product portfolio through new products with higher margins. The key concern for PF3 is obtaining adequate capital to replace necessary fully depreciated assets while continuing restructuring. An option for this is seeking a joint-venture partner.

Source: Based on information provided by the World Bank.

the lead agency for SOE reform—and the MOF with respect to the preparation of time-bound restructuring plans for each enterprise and the initial stages of their implementation.

21. **Tariff reforms will help commercialize the operations of the airline and large utilities**. Given the current weak regulatory framework, the government does not consider that privatization of strategic enterprises, including the large utilities, is appropriate at this time. However, the government recognizes the need to commercialize SOE operations starting with pricing adjustments. Three tariff increases were implemented over the last year for Lao Aviation, and the government is considering further phased increases to bring tariffs to cost-recovery levels in the first quarter of 2003. With regard to the water utility, Nam Papa, the principle of achieving full cost-recovery has been accepted and tariffs should reach cost-recovery levels in 2003. For electricity, average increases of 2.3 percent a month in EDL's tariffs began in May and are scheduled to continue for a 36 month period to bring the average tariff level to KN 665/Kwh. Following the proposal of the tariff study, the schedule will move towards a marginal cost structure, while keeping a lifeline tariff to protect low-income consumers.

Large loss-making SOEs will be restructured. In addition to overdue tariff increases, Lao Aviation is being restructured under a management contract with Air France Consulting. This is expected to soon lead to the formation of a joint venture to obtain additional capital for upgrading the company's fleet. The large conglomerates, Phoudoi and DAFI, will be restructured through identifying the financial status of the constituent companies, and reducing the number of companies and staff levels by sales of the non core assets. The extent of this downsizing will be determined in the course of the review of their operations. Such asset sales would greatly help reduce the burden of NPLs on BCEL's balance sheet. Pharmaceutical Factory No. 3 will be converted to a joint venture with a foreign partner, also after an initial restructuring phase. DAFI and four other loss-making SOEs will need to develop and start implementing time-bound restructuring plans.

23. **Greater private sector development will be promoted**. The government recognizes that only a predominantly private sector-led economy can be competitive under regional integration. However, the government is focusing first on developing the environment for new investment while phasing in private sector participation and investment in existing SOEs, as in the case of the banking, energy, and communications sectors. Reflecting this strategy, the government has recently agreed new joint venture arrangements with Corama of France for Lao Tobacco in December 2001 and with Carlsberg Asia for Lao Brewery in January 2002, and others are being encouraged. The government has also simplified the environment for attracting investment by issuing the implementing regulations for the Foreign Investment Law, and streamlining approval arrangements by sector and size of investment. In that connection, domestic and foreign investors provided opportunities to raise concerns about complex and duplicative procedures, and the lack of a "level playing field" and additional measures are being considered to simplify the establishment and operating environment for domestic and foreign enterprises and strengthen the credit environment and creditor rights. Finally, further gradual reductions in nontariff barriers to imports, which are easily avoided in practice, will also be required to reduce the administrative burdens on private business.

D. Conclusions

24. **Persistent inefficiencies in the operations of both the SCBs and the large SOEs have restrained the country's growth potential**. Aside from the constraints of poor banking skills and management, an inadequate legal system, and the absence of a proper credit culture––all of which are to be expected in a transition economy–sustained operational restructuring has proved elusive because of persistent interference through policy and connected lending on noncommercial terms. Drawing lessons from past experience, the government has adopted a dual-track process for reforming the SCBs and large-debtor SOEs. The first track emphasizes immediate and sustained performance-based improvements in the operations of SCBs over a 4 year period to resolve past state-related NPLs, limit the incurrence of new NPLs, and foster a market-based commercial banking system. A second parallel track is designed to lead to lasting operational restructuring of the large SOEs, including those with the highest levels of NPLs in the SCBs, to help contain the generation of new NPLs, and improve the efficiency of SOEs and the quality of the services they provide. Looking ahead, a more market-based approach to banking and enterprise reform would attract much needed private capital, and help economize scarce public sector resources and generate significant efficiency gains for the economy as a whole.

II. Developments in Public Expenditure[18]

A. Introduction

1. **Improving public expenditure management is essential for maintaining macroeconomic stability, ensuring public sector accountability, and supporting transparent expenditure decisions**. In the past, weaknesses in expenditure planning, control, and information have undermined fiscal performance and have not provided the information needed to track spending in relation to the government's announced goals, which would be needed under the National Poverty Eradication Plan (NPEP). This chapter has two main objectives: a) to outline the recent and prospective improvements in public expenditure management; b) to briefly discuss the recent developments in expenditure by focusing on sectoral composition.

B. Expenditure Management Reform

2. **As indicated in the recent Public Expenditure Review (PER), the Lao budget system has many weaknesses for modern fiscal management**. Improved budget information and planning is needed to ensure that fiscal outcomes are as close as possible to the government's objectives. Proper cash management, reporting, auditing and control mechanisms are necessary for fiscal control.

Budget planning

3. **Two key issues have emerged in budget planning**; i) the need for realistic revenue projections for making expenditure plans, both for the current budget, and the medium term; and ii) the need for the budget process to be consistent with a strategic plan, especially on the balance between current and capital expenditure.

i) Overly optimistic revenue projections, when unfulfilled have led to a combination of excessive bank financing of the budget, expenditure arrears (often leading to nonperforming loans), and ad hoc expenditure cutbacks that have often fallen hardest on the politically weakest sector of the government, especially social sector workers in rural areas. Thus, having a budget process that generates achievable revenue targets is critical for developing a systematic expenditure management system.

ii) Achieving a better balance between capital and current expenditure was also identified as critical. Traditionally capital expenditure has constituted a large share of the budget, mainly attributed to both the large infrastructure needs, as well as the availability of donor financing. The choice and management of these investments is being strengthened with a more systematic approach to the Public Investment Program (PIP), including the tracking of donor-funded investment expenditures. Nevertheless, the rapid increase in investment has been straining the availability of current expenditure, including for road maintenance and staffing and supplies for schools and medical facilities. Under a recently passed Decree (No.58/PM

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[18] Prepared by Qaizar Hussain.

dated May 22, 2002) on Management of Public Investment, the project selection will follow a two-stage process[19], with projects to be evaluated against clearly established guidelines in the first stage, while the second stage will involve the projects' overall assessment against the availability of budgetary resources, including estimates of large projects' recurrent costs covering the entire span of the operating period.

Budget information systems

4. **Improved information on the function of budget expenditures is critical for analyzing the budget in relation to the provision of needed services**. Work has already started on accounting and computer systems, and related regulations and procedures (under an AsDB financial project). Revisions to the accounting regulations were issued at end-June 2002, and the new computer and accounting systems have been installed in four line ministries, two other organizations, and two provincial administrations.

5. **In parallel to this, budget information is also being improved**. In the past, provinces did not report to the central government expenditure with classifications similar to line ministries (as first approximation of a functional classification). This changed in the 2001/02 budget report which sets out the full ministry/sector classification (see Section C). This will be extended in the 2002/03 budget with a pilot project to identify expenditures by type of administrative unit for the education and health sectors (e.g., administration, primary and secondary schools) for a number of districts in the main provinces.

Treasury and cash management

6. **In line with previous Fund recommendations, the government is improving management of bank accounts across provinces and line ministries**. The Treasury Department has started the process of requiring an inventory of accounts at all levels of the government whereby unauthorized ministry bank accounts are to be closed. By the end of 2001/02, the government also aims to improve regulations applicable to the treasury offices in line ministries to monitor cash transactions. Over time, the Treasury Department should expand its offices in all line ministries and develop a single network of treasury accounts. The improvement in treasury management network should also enable the proper reconciliation between revenue, expenditure, and financing.

Commitment controls and transparency

7. **In order to better control expenditure commitments, the Budget Department's review of expenditures was introduced in October 2001 on quarterly wage and provincial level recurrent expenditures and individual investment projects**. This was aimed at ensuring that, ex ante, spending authorizations are only for budgeted programs, and that there are sufficient funds for this spending, in case of revenue shortfalls. Recognizing that a modern fiscal system must, over time, give more weight to ex post monitoring, the National Audit Office (NAO), with AsDB technical assistance, has been strengthening its capacity for

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[19] See World Bank, *Financial Management and Adjustment Credit (FMAC) Report*; Report No: P7526-LA (May 28, 2002).

conducting audits of line ministries, provinces, and individual projects. The government is also taking steps to further improve the capacity of the NAO. In addition, the government should improve internal audit and accounting procedures. In order to further increase transparency, the government plans to continue the publication of the budget documents with a shorter lag, and improve oversight and reporting of government financial transactions especially those that are now off budget.

C. Expenditure Composition

8. **As noted above, analyses of budget developments in the past have been constrained by the lack of functional classification of expenditures**. This changed with the publication of the 2001/02[20] *Official Gazette* in March 2002, which now includes expenditure data by ministry/sector for the 2000/01 outcome and the 2001/02 budget. The 2001/02 budget envisages an increase in total expenditure to 21.9 percent of GDP from 21.3 percent of GDP in 2000/01.[21] Within that, the share of capital expenditure in total expenditure fell slightly from 63 percent in 2000/01 to 61 percent in the 2001/02 budget (from 14.1 percent of GDP to 13.8 percent of GDP). Reflecting the objective of increasing the relative share of current expenditure, it rose from 8.4 percent of GDP to 8.8 percent of GDP. This was partly used to increase base civil wages (by 25 percent) beginning 2002, aimed at partly correcting real wage levels for high inflation in the past years. In the 2001/02 budget, the government allocated expenditure for the clearance of both current and capital arrears (3 percent of GDP), and stated its intention to clear these arrears by about half during 2001/02 and the remainder during 2002/03.[22] Fiscal data for the first eight months of 2001/02 shows that the government, in light of weak revenue performance, is implementing cuts in both capital and current expenditure, particularly domestically financed capital expenditure, to meet the deficit target.

9. **As regards current expenditure, the snapshot sectoral distribution shows a relatively large share of current expenditure to defense, education and finance**. In contrast, most other sectors, especially the health sector, constitute a small proportion of current expenditure. Both interest payments and current arrears constitute the main components of expenditure incurred by the Finance Ministry. Over the two years, although the 2001/02 budgetary allocations to education and health (10.8 percent and 6.1 percent of total expenditure) are significantly higher as compared to the 2000/01 outturn (7.9 percent and

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[20] The fiscal year runs October through September.

[21] Including the repayment of lending for the amount of KN 160 billion in 2000/01 and KN 108 billion in the 2001/02 budget (see attached Statistical Appendix Table 7). However, the analysis in this chapter follows the Government of Lao P.D.R. (GOL) definition of expenditure which treats repayments of lending as revenue. As a result, there is no difference in the ratio of current expenditure, but capital expenditure according to the GOL definition is higher by about 1.1 percent of GDP for 2000/01 and 0.7 percent of GDP for the 2001/02 budget.

[22] See the *Presentation in the 8th Ordinary Session of the Congress of the National Assembly, 4th Legislature*, September 24, 2001.

4.0 percent), their shares in current expenditure have fallen.[23] These sectors also received lower budgetary allocations for salaries and allowances as a proportion of total salaries and allowances than the previous year's outturn. On a positive note, the defense expenditure allocation for current expenditures remained at about 20 percent, and the share of defense salaries and allowances in total salaries and allowances remained at about 37 percent in both years. The current expenditure allocation to the Prime Minister's Office rose significantly, although it fell slightly for the Interior Ministry.

10. **The snapshot sectoral distribution for capital expenditure** shows that the Ministry of Communication, Post, Construction and Transport (MCPCT) has the largest allocation of capital expenditure, given its large focus on infrastructure, followed by agriculture and provincial offices in Vientiane. In terms of sectoral patterns spanning the 2000/01 outturn and the 2001/02 budget, the authorities' focus on capital expenditure still remains high while showing an increasing pattern for several key sectors including education and health, which are typically related to donor funding. On the other hand, total allocations to agriculture, industry and handicrafts, and MCPCT in the 2001/02 budget have fallen relative to the previous year's outcome. This could be related to the lumpiness of capital expenditures devoted to these sectors over the two periods. In addition, the share of labor and social welfare in capital spending rose.

11. **Following the recent decentralization policies of the government, the provinces are receiving an increasingly greater share of total expenditure allocations**. The 2001/02 budget has an allocation of 47 percent; higher than the 2000/01 outturn of 42 percent. As a result of decentralization, the provinces are receiving higher expenditure allocations in several sectors, particularly provincial offices in Vientiane, and MCPCT. In addition, education and health also have higher provincial budgetary allocations (particularly capital expenditure) as compared to their actual spending in 2000/01. Other expenditure categories had little or no change over the year, except for agriculture which fell significantly (likely related to lumpiness of large projects).

12. **Provincial data also show that almost all provinces are targeted to have budget deficits in 2001/02; even more provinces than in the previous year's outturn** (see Tables II.4 and II.5). Only Savannakhet and the Vientiane Municipality show large surpluses in both periods. We also note a significant degree of variability in domestically financed capital expenditure, between 2000/01 and that planned for 2001/02. In particular, twelve of the fourteen deficit provinces in 2000/01 had an increase in domestically financed capital expenditure allocations in the 2001/02 budget than actually spent in the previous year, while only three provinces (Savannakhet, Sayabouri, and Attapeu) were granted lower allocations.

D. Final Remarks

13. **The aim of the government is to increase transparency and accountability, and provide wider and more focused choices in the ongoing NPEP and PRSP, through the availability of detailed fiscal data**. Moreover, expenditure management reform has gained

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[23] Although this sectoral information spanning the two recent years is valuable, it is not sufficient to make observations regarding policy trends.

additional focus in light of the recent decentralization and weak revenue performance. A closer examination of public expenditure in this chapter suggests that although the government has recently taken a number of initiatives in this direction, much remains to be done in the medium term in order to establish a system for expenditure tracking and introduce transparency in expenditure management.

14. **Further improvements in the ongoing budget reporting of the upcoming 2002/03 budget, and in subsequent budgets**, are expected to help provide greater transparency to the public, the business community, and the international agencies, as well as to strengthen the accountability of the government.

Table II.1. Lao P.D.R.: Total Expenditure by Sector 1/

	2000/01Actual			2001/02 Budget		
	Total	Central Ministry	Provinces	Total	Central Ministry	Provinces
			(In billions of kip)			
Agriculture and forestry	589.0	79.7	509.3	419.0	81.5	337.4
Industry and handicrafts	116.0	49.2	66.8	68.2	15.5	52.7
MCPCT	810.0	652.2	157.7	634.9	276.2	358.6
Commerce and tourism	8.5	3.4	5.1	14.0	3.5	10.5
Finance	352.0	301.5	50.5	456.7	414.1	42.6
CPC	13.8	3.6	10.2	54.2	8.3	45.9
Education	261.0	109.2	151.8	402.5	199.0	203.6
Health	131.4	26.2	105.2	225.7	86.3	139.4
Information and culture	40.4	26.4	14.0	101.7	58.1	43.5
Labor and social welfare	117.1	82.2	34.9	144.7	101.1	43.6
Justice	7.2	3.2	4.0	11.8	5.1	6.8
Foreign affairs	71.2	71.2	0.0	75.4	75.4	0.0
Defense	278.0	278.0	0.0	323.5	323.5	0.0
Interior	100.6	100.6	0.0	125.1	125.1	0.0
Prime Minister's Office	137.0	137.0	0.0	145.9	145.9	0.0
National Assembly	2.0	0.0	2.0	2.4	0.0	2.4
Provincial offices in Vientiane	263.0	0.0	263.0	466.6	0.0	466.6
Other	3.0	0.2	2.8	49.6	45.0	4.6
Total expenditure	3301.1	1923.8	1377.3	3721.7	1963.6	1758.1
			(In percent of total expenditure)			
Agriculture and forestry	17.8	2.4	15.4	11.3	2.2	9.1
Industry and handicrafts	3.5	1.5	2.0	1.8	0.4	1.4
MCPCT	24.5	19.8	4.8	17.1	7.4	9.6
Commerce and tourism	0.3	0.1	0.2	0.4	0.1	0.3
Finance	10.7	9.1	1.5	12.3	11.1	1.1
CPC	0.4	0.1	0.3	1.5	0.2	1.2
Education	7.9	3.3	4.6	10.8	5.3	5.5
Health	4.0	0.8	3.2	6.1	2.3	3.7
Information and culture	1.2	0.8	0.4	2.7	1.6	1.2
Labor and social welfare	3.5	2.5	1.1	3.9	2.7	1.2
Justice	0.2	0.1	0.1	0.3	0.1	0.2
Foreign affairs	2.2	2.2	0.0	2.0	2.0	0.0
Defense	8.4	8.4	0.0	8.7	8.7	0.0
Interior	3.0	3.0	0.0	3.4	3.4	0.0
Prime Minister's Office	4.2	4.2	0.0	3.9	3.9	0.0
National Assembly	0.1	0.0	0.1	0.1	0.0	0.1
Provincial offices in Vientiane	8.0	0.0	8.0	12.5	0.0	12.5
Other	0.1	0.0	0.1	1.5	1.4	0.1
Total expenditure	100.0	58.3	41.7	100.0	52.8	47.2

Source: *Official Gazette*; Ministry of Finance, Lao P.D.R., 2002.

1/ This table excludes amortization which is classified as part of expenditure in the GOL definition of fiscal accounts. In addition, this table does not include net lending (negative capital return), for the amount of KN 160 billion for 2000/01 and KN 108 billion for the 2001/02 budget, since it is in GOL format of fiscal accounts.

Table II.2. Lao P.D. R.: Current Expenditure by Sector 1/

	2000/01Actual			2001/02 Budget		
	Total	Central Ministry	Provinces	Total	Central Ministry	Provinces
			(In billions of kip)			
Agriculture and forestry	22.1	5.2	16.9	24.5	5.4	19.1
Industry and handicrafts	3.2	1.0	2.2	3.8	1.1	2.7
MCPCT	18.6	13.1	5.5	17.1	10.7	6.5
Commerce and tourism	5.4	1.9	3.4	6.1	1.8	4.3
Finance	335.3	295.0	40.4	362.2	331.3	30.9
CPC	5.9	1.0	4.9	5.0	1.4	3.6
Education	159.3	30.5	128.9	171.7	37.4	134.3
Health	47.8	15.2	32.6	48.3	11.8	36.5
Information and culture	13.9	7.4	6.5	14.7	7.3	7.4
Labor and social welfare	41.5	9.8	31.7	44.6	9.5	35.1
Justice	5.7	2.2	3.5	7.9	1.9	6.1
Foreign affairs	70.7	70.7	0.0	73.9	73.9	0.0
Defense	251.1	251.1	0.0	295.3	295.3	0.0
Interior	90.6	90.6	0.0	105.1	105.1	0.0
Prime Minister's Office	75.0	75.0	0.0	103.3	103.3	0.0
National Assembly	2.0	0.0	2.0	1.4	0.0	1.4
Provincial offices in Vientiane	79.8	0.0	79.8	117.4	0.0	117.4
Other	1.5	-0.8	2.3	46.4	43.4	3.0
Total current expenditure	1229.4	868.9	360.5	1448.7	1040.5	408.2
			(In percent of total current expenditures)			
Agriculture and forestry	1.8	0.4	1.4	1.7	0.4	1.3
Industry and handicrafts	0.3	0.1	0.2	0.3	0.1	0.2
MCPCT	1.5	1.1	0.4	1.2	0.7	0.4
Commerce and tourism	0.4	0.2	0.3	0.4	0.1	0.3
Finance	27.3	24.0	3.3	25.0	22.9	2.1
CPC	0.5	0.1	0.4	0.3	0.1	0.2
Education	13.0	2.5	10.5	11.8	2.6	9.3
Health	3.9	1.2	2.7	3.3	0.8	2.5
Information and culture	1.1	0.6	0.5	1.0	0.5	0.5
Labor and social welfare	3.4	0.8	2.6	3.1	0.7	2.4
Justice	0.5	0.2	0.3	0.5	0.1	0.4
Foreign Affairs	5.7	5.7	0.0	5.1	5.1	0.0
Defense	20.4	20.4	0.0	20.4	20.4	0.0
Interior	7.4	7.4	0.0	7.3	7.3	0.0
Prime Minister's Office	6.1	6.1	0.0	7.1	7.1	0.0
National Assembly	0.2	0.0	0.2	0.3	0.0	0.3
Provincial offices in Vientiane	6.5	0.0	6.5	8.1	0.0	8.1
Other	0.1	-0.1	0.2	3.2	3.0	0.2
Total current expenditure	100.0	70.7	29.3	100.0	71.8	28.2

Source: *Official Gazette* ; Ministry of Finance, Lao P.D.R., 2002.

Table II.3. Lao P.D. R.: Capital Expenditure by Sector 1/

	2000/01Actual			2001/02 Budget		
	Total	Central Ministry	Provinces	Total	Central Ministry	Provinces
			(In billions of kip)			
Agriculture and forestry	566.9	74.5	492.4	394.5	76.1	318.4
Industry and handicrafts	112.8	48.2	64.6	64.4	14.4	50.0
MCPCT	791.4	639.1	152.3	617.7	265.6	352.2
Commerce and tourism	3.2	1.5	1.7	7.9	1.7	6.2
Finance	16.7	6.5	10.2	94.5	82.8	11.7
CPC	7.8	2.5	5.3	49.2	6.9	42.3
Education	101.6	78.7	22.9	230.9	161.6	69.3
Health	83.6	11.0	72.6	177.3	74.5	102.8
Information and culture	26.6	19.0	7.5	87.0	50.8	36.2
Labor and social welfare	75.6	72.4	3.2	100.1	91.6	8.5
Justice	1.5	1.0	0.5	3.9	3.2	0.7
Foreign affairs	0.5	0.5	0.0	1.5	1.5	0.0
Defense	26.9	26.9	0.0	28.2	28.2	0.0
Interior	10.0	10.0	0.0	20.0	20.0	0.0
Prime Minister's Office	62.0	62.0	0.0	42.6	42.6	0.0
National Assembly	0.0	0.0	0.0	0.9	0.0	0.9
Provincial offices in Vientiane	183.2	0.0	183.2	349.2	0.0	349.2
Other	1.5	1.0	0.5	3.1	1.6	1.5
Total capital expenditure	2071.7	1054.9	1016.8	2273.0	923.1	1349.9
			(In percent of total capital expenditures)			
Agriculture and forestry	27.4	3.6	23.8	17.4	3.3	14.0
Industry and handicrafts	5.4	2.3	3.1	2.8	0.6	2.2
MCPCT	38.2	30.8	7.3	27.2	11.7	15.5
Commerce and tourism	0.2	0.1	0.1	0.3	0.1	0.3
Finance	0.8	0.3	0.5	4.2	3.6	0.5
CPC	0.4	0.1	0.3	2.2	0.3	1.9
Education	4.9	3.8	1.1	10.2	7.1	3.0
Health	4.0	0.5	3.5	7.8	3.3	4.5
Information and culture	1.3	0.9	0.4	3.8	2.2	1.6
Labor and social welfare	3.7	3.5	0.2	4.4	4.0	0.4
Justice	0.1	0.0	0.0	0.2	0.1	0.0
Foreign affairs	0.0	0.0	0.0	0.1	0.1	0.0
Defense	1.3	1.3	0.0	1.2	1.2	0.0
Interior	0.5	0.5	0.0	0.9	0.9	0.0
Prime Minister's Office	3.0	3.0	0.0	1.9	1.9	0.0
National Assembly	0.0	0.0	0.0	0.0	0.0	0.0
Provincial offices in Vientiane	8.8	0.0	8.8	15.4	0.0	15.4
Other	0.1	0.0	0.0	0.1	0.1	0.1
Total capital expenditure	100.0	50.9	49.1	100.0	40.6	59.4

Source: *Official Gazette* ; Ministry of Finance, Lao P.D.R., 2002.

1/ This table does not include net lending (negative capital return), for the amount of KN 160 billion for 2000/01 and KN 108 billion for the 2001/02 budget, since it is in GOL format of fiscal accounts.

Table II.4. Lao P.D.R.: General Government Operations, 2000/2001 1/

	Total	Ministries	Provinces 3/	VTEM	PSL	LNT	ODS	BK	SYBL	LPB	HP	XK	VTE	BLKS	KM	SVNK	SLV	CPS	SK	ATP	XSB
(In billions of kip)																					
Total revenue	2,167	989	1,179	399	6	31	11	26	24	9	63	15	35	47	99	261	27	101	7	14	4
Total expenditure 2/	3,301	1,924	1,377	200	88	37	65	57	109	70	71	82	85	40	69	128	79	111	28	38	21
Capital expenditure	2,072	1,054	1,018	158	78	26	51	48	88	47	53	64	62	27	46	82	65	59	19	29	15
Local finance	872	216	656	110	22	22	27	24	54	29	21	28	47	20	36	82	20	51	19	28	14
Foreign finance	1,200	838	362	47	56	4	24	24	34	18	32	36	15	7	10	-	45	8	0	0	1
Surplus / Deficit	-1,134	-936	-198	199	-83	-7	-54	-31	-85	-62	-8	-67	-49	7	30	133	-52	-10	-21	-24	-17
Foreign financing	1,200	838	362	47	56	4	24	24	34	18	32	36	15	7	10	-	45	8	0	0	1
Domestic financing	-66	97	-164	-246	27	2	30	7	51	44	-24	31	35	-15	-40	-133	7	1	21	24	16
(In percent of GDP)																					
Total revenue	14.7	6.7	8.0	2.7	0.0	0.2	0.1	0.2	0.2	0.1	0.4	0.1	0.2	0.3	0.7	1.8	0.2	0.7	0.0	0.1	0.0
Total expenditure 2/	22.4	13.1	9.4	1.4	0.6	0.3	0.4	0.4	0.7	0.5	0.5	0.6	0.6	0.3	0.5	0.9	0.5	0.8	0.2	0.3	0.1
Capital expenditure	14.1	7.2	6.9	1.1	0.5	0.2	0.3	0.3	0.6	0.3	0.4	0.4	0.4	0.2	0.3	0.6	0.4	0.4	0.1	0.2	0.1
Local finance	5.9	1.5	4.5	0.7	0.1	0.2	0.2	0.2	0.4	0.2	0.1	0.2	0.3	0.1	0.2	0.6	0.1	0.3	0.1	0.2	0.1
Foreign finance	8.2	5.7	2.5	0.3	0.4	0.0	0.2	0.2	0.2	0.1	0.2	0.2	0.1	0.0	0.1	-	0.3	0.1	0.0	0.0	0.0
Surplus / Deficit	-7.7	-6.4	-1.3	1.4	-0.6	0.0	-0.4	-0.2	-0.6	-0.4	-0.1	-0.5	-0.3	0.0	0.2	0.9	-0.4	-0.1	-0.1	-0.2	-0.1
Foreign financing	8.2	5.7	2.5	0.3	0.4	0.0	0.2	0.2	0.2	0.1	0.2	0.2	0.1	0.0	0.1	-	0.3	0.1	0.0	0.0	0.0
Domestic financing	-0.5	0.7	-1.1	-1.7	0.2	0.0	0.2	0.0	0.3	0.3	-0.2	0.2	0.2	-0.1	-0.3	-0.9	0.0	0.0	0.1	0.2	0.1
Memorandum item:																					
GDP (in billions of kip)	14,721																				

Source: Ministry of Finance, Lao P.D.R.

1/ Grants are included below the line.
2/ Figures for expenditure in this table exclude amortization which is classified as part of expenditure in the GOL definition.
3/ VTEM: Vientiane Municipality, PSL: Phonsaly, LNT: Laung Nam Tha, ODS: Oudomxay, BK: Bokeo
SYBL: Sayabouri, LPB: Luang Phrabang, HP: Houaphan, XK: Xieng Khouang, VTE: Vientiane Province
BLKS: Bolikhamxay, KM: Khammouane, SVNK: Savannekhet, SLV: Saravane
CPS: Champassak, SK: Sekong, APT: Attapeu, XSB: Saysomboun Special

Table II.5. Lao P.D.R.: General Government Operations, 2001/2002 Plan 1/

	Total	inistries	Provinces 3/	VTEM	PSL	LNT	ODS	BK	SYBL	LPB	HP	XK	VTE	BLKS	KM	SVNK	SLV	CPS	SK	ATP	XSB
(In billions of kip)																					
Total revenue	2,595	1,299	1,296	495	6	37	10	28	26	10	35	17	36	55	91	264	39	124	8	12	3
Total expenditure 2/	3,722	1,963	1,759	200	119	48	87	69	110	161	115	82	91	59	111	164	55	184	37	38	29
Capital expenditure	2,273	921	1,352	160	106	35	70	55	83	129	93	61	65	44	86	109	39	140	27	27	23
Local finance	1,017	236	781	130	35	35	33	30	43	40	45	36	50	25	42	78	36	55	23	27	19
Foreign finance	1,256	686	570	30	71	-	37	25	40	89	48	25	15	19	44	31	3	85	4	0	4
Surplus / Deficit	-1,127	-665	-462	295	-113	-11	-76	-41	-83	-150	-81	-65	-55	-4	-21	100	-16	-60	-29	-26	-26
Foreign financing	1,256	686	570	30	71	-	37	25	40	89	48	25	15	19	44	31	3	85	4	0	4
Domestic financing	-129	-21	-108	-325	41	11	40	16	44	61	32	39	40	-15	-24	-130	13	-25	25	26	22
(In percent of GDP)																					
Total revenue	15.7	7.9	7.9	3.0	0.0	0.2	0.1	0.2	0.2	0.1	0.2	0.1	0.2	0.3	0.6	1.6	0.2	0.8	0.0	0.1	0.0
Total expenditure 2/	22.5	11.9	10.7	1.2	0.7	0.3	0.5	0.4	0.7	1.0	0.7	0.5	0.6	0.4	0.7	1.0	0.3	1.1	0.2	0.2	0.2
Capital expenditure	13.8	5.6	8.2	1.0	0.6	0.2	0.4	0.3	0.5	0.8	0.6	0.4	0.4	0.3	0.5	0.7	0.2	0.8	0.2	0.2	0.1
Local finance	6.2	1.4	4.7	0.8	0.2	0.2	0.2	0.2	0.3	0.2	0.3	0.2	0.3	0.2	0.3	0.5	0.2	0.3	0.1	0.2	0.1
Foreign finance	7.6	4.2	3.5	0.2	0.4	-	0.2	0.2	0.2	0.5	0.3	0.2	0.1	0.1	0.3	0.2	0.0	0.5	0.0	0.0	0.0
Surplus / Deficit	-6.8	-4.0	-2.8	1.8	-0.7	-0.1	-0.5	-0.2	-0.5	-0.9	-0.5	-0.4	-0.3	0.0	-0.1	0.6	-0.1	-0.4	-0.2	-0.2	-0.2
Foreign financing	7.6	4.2	3.5	0.2	0.4	-	0.2	0.2	0.2	0.5	0.3	0.2	0.1	0.1	0.3	0.2	0.0	0.5	0.0	0.0	0.0
Domestic financing	-0.8	-0.1	-0.7	-2.0	0.3	0.1	0.2	0.1	0.3	0.4	0.2	0.2	0.2	-0.1	-0.1	-0.8	0.1	-0.2	0.1	0.2	0.1
Memorandum item:																					
GDP (in billions of kip)	16510																				

Source: Ministry of Finance, Lao P.D.R.

1/ Grants are included below the line.
2/ Figures for expenditure in this table exclude amortization which is classified as part of expenditure in the GOL definition.
3/ VTEM: Vientiane Municipality, PSL: Phonsaly, LNT: Laung Nam Tha, ODS: Oudomxay, BK: Bokeo
SYBL: Sayabouri, LPB: Luang Phrabang, HP: Houaphan, XK: Xieng Khouang, VTE: Vientiane Province
BLKS: Bolikhamxay, KM: Khammouane, SVNK: Savannekhet, SLV: Saravane
CPS: Champassak, SK: Sekong, APT: Attapeu, XSB: Saysomboun Special

III. Financial Aspects of the Hydroelectric Power Sector[1]

1. **The importance of the hydroelectric power sector for the economy is significant and is expected to increase**. The main purpose of this brief chapter is to summarize the financial information on the sector, rather than provides an overview of developments.

2. **Currently, the hydroelectric power sector contributes to 20 percent of exports of goods and services**. Net foreign exchange earnings for the economy (some 3 percent of GDP) represent mostly payments to the public sector (estimated at 20 percent of fiscal revenue), including dividends to the public electricity company EDL (Electricité du Laos), the public participant in all existing projects. Government revenue consist of royalties as well as transfers from EDL, after payment of debt service and cross subsidies for domestic electricity consumption. The construction of Nam Theun 2 (NT2) is envisaged to start in 2004, and production to come on stream in 2008, which would increase exports by 200 percent. Income generation from this project for the government would be relatively small initially, but would increase substantially after 15 years, as a result of sharp increases in the royalty and tax rates.

Structure of the sector

3. **The government has adopted a policy of using external debt to finance EDL's ownership of the smaller plants that supply domestic power and private/public partnerships for the larger export plants**. Most production comes from the two dams built in the period 1994-99, Theun Hinboun Power Company (THPC) and Huay Ho, financed in partnership with private investors (Table III.1) on the basis of export contracts to Thailand. EDL holds a 20 percent share in the Huay Ho project and a 60 percent share in THPC, a limited liability company. The government borrowed, mostly in concessional terms from the AsDB, the World Bank, the Nordic Fund, OPEC, and Japan, to finance EDL's participation in hydroelectric projects, and onlent to the public enterprise. Government project preparation, financed through grants, also accounted for some of the public equity participation. Only one public loan was contracted in commercial terms, for US$10 million, which was borrowed for Huay Ho, initially from the Korean partner Daewoo. A Belgium investor, Tractebel, is in the process of purchasing all private shares in Huay Ho and refinancing the loan to EDL.

4. **THPC refinanced its outstanding commercial borrowing (US$93 million) in 2002**, which was replaced by a new loan of US$144 million, mainly from a consortium of Thai banks. The resulting reduction in equity may free up some US$33 million additional resources for EDL, most of which could be transferred to the government. The increase in private debt service resulting from this operation is estimated at about US$5 million per year over 2003-06.

[1] Prepared by Sonia Brunschwig.

Debt service

5. **Private borrowing financed most of the construction cost of the large export projects**. The ratio of private debt service to total electricity exports of goods and services is estimated at about 40 percent (Table III.2). The private debt service amounts to about 80 percent of hydroelectric exports, net of payments to the government, EDL, and local contractors. This ratio is projected to peak at 98 percent in 2005, but to decline rapidly thereafter as a result of rising exports and lower outstanding debt.

Balance of payments impact

6. **Table III.3 shows a preliminary attempt to separately account for the hydroelectric power sector in the balance of payments**. Hydrolectric exports are clearly identified, while imports, foreign investments, and private debt service are estimated from project-specific information on dam construction cost and financing. The overall balance is calculated to equal the net foreign assets distributed as royalties to the government, dividends to EDL, and payments to local contractors. It is assumed that foreign exchange earned by foreign investors, net of imports, debt service, and payments to the government, EDL and local contractors, are repatriated. The current account is shown to improve by US$50 million in 2000, with higher export and lower import resulting from the completion of Huay Ho and Nam Leuk, but to turn into deficit starting in 2004 with the initiation of NT2 construction. Movements in the capital account reflect the higher financing needs in 1999 and beyond 2004. The stability of the overall balance and net foreign exchange receipts, at about 3 percent of GDP, is consistent with a slight increase in profit repatriation, which is calculated residually.

7. **The government is aware of the risks associated with the weight of the hydroelectric sectors in exports**. To mitigate these risks, it has developed the following strategy: (i) medium- and long-term agreements with Thailand, the main destination for electricity, which define both the quantity and the price of future purchases; (ii) a debt structure which matches the currency composition of exports; and (iii) explicit limitation of public liabilities. Moreover, to maximize the benefits of these investments in terms of growth and poverty reduction, enterprise and fiscal transparency and accountability are being upgraded.

Table III.1. Lao P.D.R.: Hydroelectric Power Projects

	Theun Hinboun		Huay Ho	Nam Leuk	Xeset -1	Nam Ngum 1	NT2
	initial financing	after refinancing					Proj.
			(In million of U.S. dollars)				
Construction/refinancing dates	1994-98	2002	1994-99	1996-99	1970's	1970's	2004-08
Project cost	234	199	225	108	16.6	90.5	1,070
Financing							
Equity	110	55	50	108	17	91	321
Public (EDL) 1/	66	33	10	108	17	91	80
Of which: debt-financed	58	...	10	82	17	91	32
Private	44	22	40	0	0	0	241
Norway Hydropower AB	22	11					
MDX Lao Company Limited (Thai)	22	11					
Loxley (Thai) 2/			30				
Daewoo (Korea) 2/			10				
Private debt	124	144	175	0	0	0	749
Projected annual production	65.1 3/	65.1 3/	24.9 3/	3.4 3/	3.3 3/	14.8 3/	212.3 4/
In GWH	1,660	1,660	621	230	90	190	3,000
Government revenue	3.3 3/	3.3 3/	1.2 3/	0.2 3/	0.2 3/	0.7 3/	11.0 4/
Revenue to EDL 5/	27.1 3/	27.1 3/	0.0 3/	3.2 3/	3.1 3/	14.1 3/	14.1 4/
			(In percent)				
Equity (in percent of total cost)	47	28	22	100	100	100	30
Public (in percent of equity)	60	60	20	100	100	100	25
Private (in percent of equity)	40	40	80	0	0	0	75
Private debt (in percent of total cost)	53	72	78	0	0	0	70

Sources: Data provided by EDL; and Fund staff estimates.

1/ The public shareholder in NT2 has not yet been determined.
2/ To be purchased by Tractebel (Belgium) in 2002.
3/ Estimate for 2002.
4/ Projections for 2008.
5/ Gross income before debt service.

Table III.2. Lao P.D.R: Hydroelectric Power Sector Private Debt Service, 1999-2006

	1999	2000	2001	2002	2003	2004	2005	2006
	(In millions of U.S. dollars)							
Private sector debt service								
Theun Hinboun 1/	22.5	21.8	20.2	13.6	25.4	24.5	22.3	22.5
Huay Ho	16.0	28.6	27.4	26.3	25.1	23.9	22.8	21.6
Total	38.5	50.4	47.6	39.9	50.5	48.4	45.0	44.1
	(In percent)							
Ratio of private sector debt to exports								
To total hydroelectric exports	42.5	44.9	41.7	35.7	43.3	42.7	40.8	39.5
To hydroelectric exports net of domestic payments	90.5	89.3	82.9	74.9	81.1	89.7	98.3	95.9
	(In millions of U.S. dollars)							
Memorandum items:								
Total hydroelectric exports	90.5	112.2	114.2	111.5	116.6	113.2	110.2	111.6
Hydroelectric exports net of domestic payments	42.5	56.4	57.4	53.2	62.3	54.0	45.8	46.0
Private debt outstanding	291.7	268.2	244.7	224.4	196.9	244.5	386.7	527.6
Theun Hinboun 1/	116.7	104.9	93.0	84.4	68.6	52.9	38.3	22.3
Huay Ho	175.0	163.3	151.7	140.0	128.3	116.7	105.0	93.3
NT2	0.0	0.0	0.0	0.0	0.0	74.9	243.4	412.0

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

1/ After refinancing in 2002.

Table III.3. Lao P.D.R.: Balance of Payments by Sector, 1999-2006

(In millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005	2006
				Projections				
			Hydroelectric power sector					
Current account	29.9	79.3	80.3	78.6	81.7	-20.4	-150.0	-147.5
Merchandise trade balance	68.5	112.2	114.2	111.5	116.6	38.3	-58.3	-57.0
Exports, f.o.b.	90.5	112.2	114.2	111.5	116.6	113.2	110.2	111.6
Imports, c.i.f.	22.0	0.0	0.0	0.0	0.0	74.9	168.5	168.5
Services net	-8.0	0.0	0.0	0.0	0.0	-26.8	-60.2	-60.2
Income (net)	-30.6	-32.9	-33.9	-32.9	-34.8	-32.0	-31.6	-30.3
Profit repatriation (- outflow)	-4.1	-6.0	-9.8	-13.4	-11.8	-10.9	-12.8	-13.9
Interest payment 1/	-26.6	-26.9	-24.1	-19.5	-23.1	-21.1	-18.7	-16.4
Capital account	18.1	-23.5	-23.5	-20.3	-27.4	79.7	214.5	213.0
Amortization	11.9	23.5	23.5	20.3	27.4	27.3	26.3	27.7
Foreign investment (foreign equity and debt)	30.0	0.0	0.0	0.0	0.0	99.0	222.7	222.7
EDL equity financing	0.0	0.0	0.0	0.0	0.0	8.0	18.1	18.1
Overall balance	48.0	55.8	56.8	58.3	54.3	59.3	64.4	65.6
(In percent of GDP)	3.3	3.2	3.2	3.3	2.8	2.9	2.9	2.7
Net foreign assets (increase -) 2/	-48.0	-55.8	-56.8	-58.3	-54.3	-59.2	-64.5	-65.6
Taxes and royalties (paid by foreign shareholders)	1.5	2.2	2.3	2.3	2.4	8.5	8.9	9.0
Return EDL	37.7	41.9	44.8	46.4	42.2	35.9	34.1	35.1
Royalty paid by EDL	3.0	3.4	3.4	3.3	3.4	3.2	3.1	3.1
Local contracts	5.8	8.3	6.3	6.3	6.3	11.7	18.3	18.3
			Non-hydroelectric power sector					
Current account	-89.5	-103.2	-141.5	-136.4	-134.0	-128.6	-136.8	-147.2
Excluding official transfers	-159.2	-224.3	-202.7	-191.2	-204.0	-210.7	-224.9	-235.3
Merchandise trade balance	-280.7	-330.7	-331.8	-323.4	-343.5	-364.7	-384.1	-403.8
Exports, f.o.b.	251.6	238.8	235.6	260.0	287.1	312.0	334.2	358.9
(in percent change)	-9.0	-5.1	-1.3	10.3	10.4	8.7	7.1	7.4
Imports, c.i.f.	532.3	569.4	567.4	583.3	630.6	676.7	718.4	762.6
(in percent change)	11.5	7.0	-0.4	2.8	8.1	7.3	6.2	6.2
Services (net)	106.2	125.6	141.3	146.7	159.4	174.3	183.0	194.4
(in percent change)	5.6	18.3	12.5	3.8	8.6	9.4	5.0	6.2
Factor income (net)	-14.3	-40.0	-34.0	-37.3	-44.1	-46.1	-50.9	-54.8
Of which: interest payments 1/	-8.4	-10.4	-11.0	-14.2	-18.4	-19.4	-20.1	-20.6
Transfers (net)	99.3	141.9	83.0	77.6	94.2	107.8	115.3	117.0
Capital account	44.4	91.3	83.1	82.9	90.7	96.6	93.4	104.1
Long-term loans	76.8	86.1	97.7	86.3	89.0	88.5	85.1	85.6
Disbursements	94.2	98.3	113.5	105.9	115.9	117.9	118.0	120.6
Amortization	-17.5	-12.2	-15.8	-19.6	-27.0	-29.4	-33.0	-35.0
Foreign investment	51.6	31.3	33.2	41.0	60.0	69.0	79.4	85.7
Net foreign assets of commercial banks (increase -) 2/	-47.2	24.6	34.0	-4.5	-22.0	-20.0	-20.0	-20.0
Errors and omissions	-36.8	-50.7	-81.8	-39.9	-36.3	-40.9	-51.0	-47.3
Overall balance	-45.1	-11.9	-58.4	-53.5	-43.3	-32.0	-43.3	-43.1
Financing	45.1	11.9	58.4	53.5	43.3	32.0	43.4	43.1
Central bank net foreign assets 2/	45.1	11.9	58.4	33.1	8.3	12.0	43.4	43.1
Financing gap	0.0	0.0	0.0	20.3	35.0	20.0	0.0	0.0
Memorandum items:								
Current account (in percent of GDP, incl. official transfers)	-6.1	-5.9	-8.1	-7.7	-7.0	-6.2	-6.1	-6.1
Current account (in percent of GDP, excl. official transfers)	-10.8	-12.9	-11.6	-10.7	-10.7	-10.2	-10.0	-9.8

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

1/ Debt service due by EDL is classified in the non hydroelectric power sector.

2/ Assuming that all foreign assets accumulated in the hydrolectric power sector are deposited at the central bank.

IV. External Debt Structure and Debt Service Profile [1]

A. External Debt in Convertible Currency[2]

1. The available information shows that Lao P.D.R. has a relatively high total external debt stock and debt-service burden. As of end-2001, the total external debt stock in convertible currency is estimated at US$1.5 billion (75 percent of GDP), and the total debt service at 15.5 percent of exports of goods and services (Tables IV.1 and IV.3). This level of debt service is partly due to commercial borrowings by private investors in the hydroelectric power sector, whose external liabilities are secured by long-term export contracts.[3]

External public debt in convertible currency

2. The external public debt amounts to US$1.2 billion in nominal terms (69 percent of GDP) (Tables IV.1 and IV.3). In NPV terms, the public debt represents 137 percent of total exports (three-year average). The public debt service absorbed 6.7 percent of all exports in 2001, which is relatively manageable. Since a large share of hydroelectric export receipts are earmarked for use by private investors in this sector, a more meaningful assessment of the government's debt servicing capacity is the ratio of public debt service to exports, excluding the hydroelectric sector,[4] which was 7.5 percent in 2001.

3. Multilateral creditors account for 83 percent of the public debt in NPV terms, and industrial country creditors for another 6 percent. Among the multilateral creditors, the AsDB and the World Bank are by far the most important lenders, while Japan is the second most important bilateral creditor after the Russian Federation. Commercial loans, contracted in the late 1990s, account for about 8 percent of the total NPV of convertible currency debt. Lao P.D.R.'s debt is highly concessional, with an average grant element of 42 percent, of which 46 percent for multilateral creditors and 35 percent for bilateral and commercial creditors.

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[1] Prepared by Sonia Brunschwig.

[2] The external debt to the Russian Federation is excluded from this section because the stock and terms of this debt are subject to high degree of uncertainty and are object of ongoing negotiations. For the other creditors, the staff did not have access to the loan documents; therefore, this analysis is based on loan by loan information provided by the authorities for the public debt, and information on project costs for the private debt.

[3] For details on the hydroelectric power sector investment and financing, see Chapter III.

[4] Nonhydroelectric exports plus receipts from the hydroelectric sector net of private debt service, profit repatriation and imports for project construction.

4. Multilateral creditors financed mostly development projects, with only 15 percent lending as general budget support (Table IV.2). By order of importance, road construction, investment in the hydroelectric power sector, and agriculture were the sectors which received the largest share of multilateral loans. Lending by industrial countries was concentrated in the hydroelectric power sector.

Debt sustainability analysis

5. The public debt service burden relative to exports and fiscal revenue is expected to increase in the short term (Table IV.3 and IV.4). The ratio of public debt service to total exports, including hydroelectric exports, is expected to increase from 6.7 percent in 2001 to 7.5 percent in 2002 and 8.7 percent in 2003, as a result of higher debt service to commercial creditors.[5] The debt service to multilateral creditors will also contribute marginally to the higher debt service.

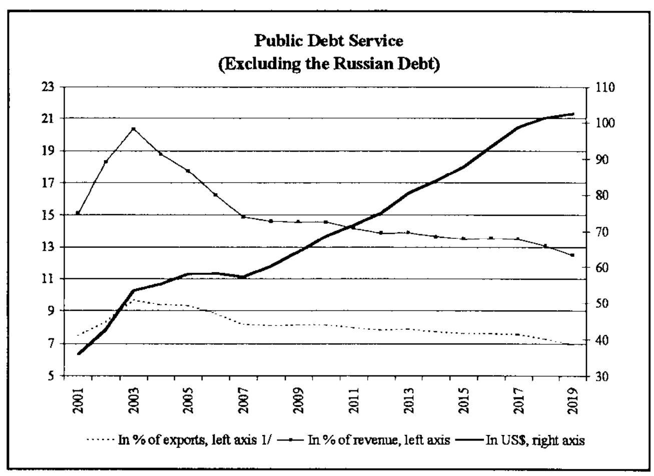
6. The debt sustainability analysis (DSA) is based on the assumption of a prudent borrowing strategy and strong revenue efforts, as well as conservative growth projections. Specifically,

- The Nam Theun 2 (NT2) hydroelectric project is excluded from the scenarios (in terms of the effect on exports and fiscal revenues) because this project has not yet been finally confirmed.

- Exports, excluding NT2 electricity exports, are conservatively assumed to grow by about 6 percent a year, in line with the GDP.

- The ratio of government revenue to GDP is assumed to improve over time from 13 percent in 2002 to 16 percent in 2010.

- New borrowing will be limited to concessional loans, with an average grant element of about 50 percent. The value of new disbursements is projected to decline from 6 percent of GDP in 2003 to less than 4 percent of GDP over the next 15 years.



7. Under these assumptions, the public debt service would decline progressively from

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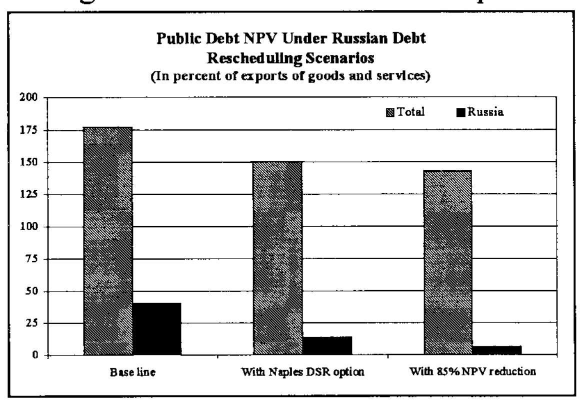
[5] It would peak at 9.7 percent of non-hydroelectric exports plus domestic payments by the hydroelectric power sector in 2003.

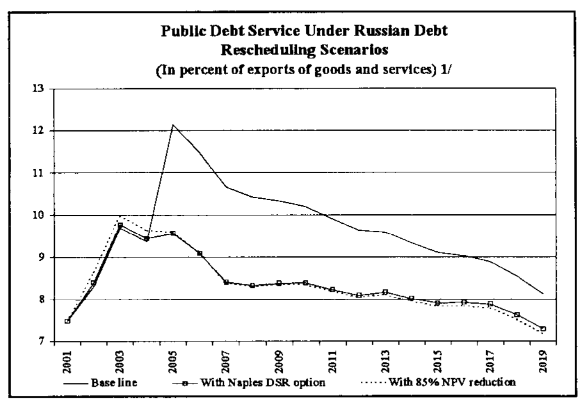
8.7 percent of exports in 2003 to 6.7 percent in 2019, and from 20.3 percent of fiscal revenue in 2003 to 12.5 percent in 2019, as a result of revenue efforts. The NPV would also decline from 137 percent of exports in 2001 to 88 percent in 2019.

B. Debt to the Russian Federation

8. In addition to the debt in convertible currency, Lao P.D.R. owes to the Russian Federation a debt mostly denominated in rubles (estimated at SUR 772 million) and a small amount in U.S. dollar (US$ 0.4 million) (Tables IV.3 and IV.4).[6] These loans arose mainly from the large Soviet net exports to Lao P.D.R. and project assistance.

9. The government of Lao P.D.R. and the Russian Federation are currently negotiating bilaterally the value and the terms of the rescheduling of the Russian debt. This chapter examines three alternative scenarios: (i) the baseline with an upfront discount of 70 percent in nominal terms; (ii) a stock-of-debt operation under the debt-service-reduction (DSR) option with Naples terms (outside of the Paris Club); and (iii) rescheduling with an 85 percent NPV reduction.





10. Under the baseline scenario, the U.S. dollar equivalent is calculated on the basis of the conversion at the exchange rate of SUR 0.6 per dollar, and the stock of arrears and the value of future obligations for the ruble-denominated debt are reduced by 70 percent.[7] Repayments over 20 years, starting in 2005 are assumed, as well as a zero interest rate. Thus, the value of the Russian debt would amount to US$386 million and the annual debt service to the Russian Federation, US$17.5 million, would be equivalent to 2 percent of exports in 2005-2015. Including the ruble-

[6] The value and terms of the debt to the Russian Federation are only preliminary indications and need to be verified.

[7] This exchange rate, the official U.S.S.R. Gosbank ruble exchange rate, and the upfront discount of 70 percent in nominal terms, is consistent with the Memorandum of Understanding of September 1997 on Russia's participation as a creditor in the Paris Club.

denominated debt, total public debt would amount to 91 percent of GDP and 177 percent of exports of goods and services (three year average), above the cutoff point under the HIPC initiative.

11. Rescheduling under Naples terms would reduce the NPV ratio from 177 percent to 150 percent, the HIPC initiative cut-off point. In addition, debt service to the Russian Federation would be contained at 0.3 percent of exports of goods and services, 2 percentage point below the baseline scenario in 2005-09 and would thus be manageable. Rescheduling with an 85 percent NPV reduction would reduce the debt stock further to 143 percent of exports, but would initially result in a slight increase in the debt service.

C. Public External Debt Management

12. Important progress has been made regarding the management of existing debt. The data base now includes all loans contracted by the government, as of end- 2001, with the details on the terms of each loan. Debt service obligations are routinely reconciled with the creditors, so as to ensure realistic budget appropriation and timely payments. Information on disbursements is also compared with creditors' data. The hardware and software system (the Commonwealth Secretariat Debt Recording and Monitoring System or CS-DRMS) is being used to monitor debt and will be used to develop a comprehensive debt strategy with technical assistance from the Fund. Also, the authorities are committed to extend debt monitoring to all public debt, including the external debt contracted by public enterprises or guaranteed by the government. The authority to approve any new borrowing is vested in the Prime Minister.

Table IV.1. Lao P.D.R.: External Debt Stock by Creditor, End-2001

(In millions of U.S. dollars; unless specified otherwise)

	Baseline Scenario			Grant element
	Nominal	NPV	% of Total	
Total external public debt in convertible currency	1,213.5	709.1	100.0	41.6
Multilateral Creditors	1,089.3	588.2	82.9	46.0
Asian Development Bank	575.0	306.9	43.3	46.6
IDA	406.6	210.1	29.6	48.3
IFAD	20.0	10.2	1.4	48.8
IMF	37.4	32.3	4.6	13.5
Nordic Development Fund	33.5	16.0	2.3	52.2
OPEC	14.5	11.4	1.6	21.6
EU	2.3	1.3	0.2	44.5
Bilateral and Commercial Creditors	124.3	120.9	17.1	2.7
Paris Club	43.3	40.5	5.7	6.4
France	0.4	0.4	0.1	3.0
Germany	6.9	6.0	0.8	13.8
Japan	35.9	34.1	4.8	5.0
Non-Paris Club	24.6	20.8	2.9	15.6
China	21.5	17.7	2.5	17.8
Czech Republic	0.1	0.1	0.0	0.0
Hungary	0.3	0.3	0.0	0.0
Slovakia	0.1	0.1	0.0	0.0
Vietnam	2.6	2.6	0.4	0.0
Commercial creditors	56.4	59.6	8.4	-5.8
Private external debt stock 1/	244.7	244.7		
Total public and private debt in convertible currency	1,458.2	953.8		
Memorandum items:				
Public debt in percent of GDP	69.2	40.5		
Total debt in percent of GDP 1/	83.2	54.4		
NPV of public debt (in percent of exports) 2/	...	137.0		
NPV of public debt (in percent of exports) 2/ 3/	...	152.3		
Russian debt stock (before debt relief)				
(in millions of SUR) 4/	771.7	...		
Russian debt (in U.S. dollars) 5/	386.2	209.0	...	45.9
Public debt (in percent of GDP, including Russia) 5/	91.3	52.4		
Total debt (in percent of GDP, including Russia) 5/	105.2	66.3		

Sources: Data provided by the Ministry of Finance; and Fund staff estimates.

1/ NPV estimated with insufficient details about the terms of the private debt.
2/ Three-year average exports.
3/ Nonhydroelectric exports plus net receipts from the hydroelectric sector.
4/ Preliminary estimate subject to verification.
5/ Under baseline scenario assumptions.

Table IV.2. Lao P.D.R.: Composition of External Public Debt, 2001 1/

	Multilateral	Bilateral	Total
		(In percent of total loans)	
Agriculture	20.2	1.8	22.0
Road	16.5	0.9	17.4
Education	3.7	0.0	3.7
Health	2.8	0.0	2.8
Hydropower	10.1	3.7	13.8
Power transmission	2.8	0.0	2.8
Water	4.6	0.0	4.6
Forestry	3.7	0.0	3.7
Electrification	5.5	0.0	5.5
Financial sector	2.8	0.0	2.8
Other sector	8.3	0.0	8.3
Program	12.8	0.0	12.8
Total	93.6	6.4	100.0
		(In percent of total debt)	
Agriculture	12.3	0.2	12.5
Road	26.7	0.0	26.7
Education	2.3	0.0	2.3
Health	1.1	0.0	1.1
Hydropower	13.7	3.2	16.9
Power transmission	3.2	0.0	3.2
Water	2.8	0.0	2.8
Forestry	1.7	0.0	1.7
Electrification	7.0	0.0	7.0
Financial sector	4.2	0.0	4.2
Other sector	6.7	0.0	6.7
Program	14.9	0.0	14.9
Total	96.6	3.4	100.0

Sources: Data provided by the Ministry of Finance; and Fund staff estimates.

1/ Includes only multilateral and Paris Club creditors, excluding the Russian Federation.

Table IV.3. Lao P.D.R.: External Debt Indicators, 2001-19 1/

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2019
	actual	budget							Projections							
							(In million of U.S. dollars)									
Nominal public and private debt stock																
in convertible currency	1,458	1,527	1,564	1,676	1,880	2,083	2,290	2,435	2,418	2,392	2,365	2,336	2,305	2,271	2,247	2,266
Private sector external debt stock	245	224	197	245	387	528	670	751	671	583	495	408	320	232	157	4
Nominal public debt stock	1,600	1,689	1,754	1,818	1,862	1,907	1,953	2,000	2,046	2,090	2,133	2,175	2,214	2,250	2,284	2,385
Nominal public debt stock on existing debt	1,600	1,568	1,533	1,496	1,443	1,391	1,340	1,289	1,238	1,184	1,131	1,077	1,022	967	911	674
Multilateral	1,089	1,068	1,045	1,021	997	973	948	921	893	862	831	800	767	732	695	534
Official Bilateral	454	451	446	442	421	400	378	356	334	313	292	270	251	232	213	137
Of which: Paris Club	429	426	423	421	402	383	363	343	324	304	285	266	247	228	210	134
Of which: Russian Federation 2/	386	386	386	386	369	351	334	316	299	281	264	246	229	211	194	124
Commercial	56	49	41	33	26	18	14	12	11	9	8	6	5	3	3	3
Stock of new borrowing	0	121	221	321	419	516	614	711	808	906	1,003	1,098	1,192	1,283	1,373	1,711
NPV of total public debt	918	976	1,014	1,052	1,073	1,095	1,120	1,146	1,172	1,197	1,222	1,247	1,270	1,292	1,311	1,363
NPV of existing public debt	918	917	914	910	890	870	852	834	814	792	769	745	719	692	664	524
Multilateral	588	588	586	584	581	579	575	569	563	554	544	534	521	507	490	401
Official Bilateral	270	277	284	292	283	273	262	251	240	229	217	205	194	183	171	120
Of which: Paris Club	250	256	264	273	265	257	249	240	230	221	211	201	191	180	168	117
Of which: Russian Federation 2/	209	219	229	240	234	227	221	214	206	198	190	182	172	163	153	107
Commercial	60	51	43	35	27	19	15	13	11	9	8	6	5	3	3	3
NPV of new borrowing	0	59	100	142	182	224	267	312	358	405	454	502	551	599	647	838
							(In percent of exports of goods and services, excluding NT2)									
NPV of public debt 3/ 4/	137.0	139.2	136.9	133.0	129.3	126.9	125.0	122.6	120.1	117.4	114.6	111.8	108.8	105.6	102.3	87.6
Of which: multilateral	113.6	119.1	119.8	118.8	117.7	117.5	117.2	115.9	114.5	112.7	110.8	108.7	106.2	103.4	100.4	86.4
NPV of public debt, incl. Russian debt 3/	177.4	179.5	176.9	172.3	165.4	160.2	155.7	150.7	145.7	140.7	135.8	130.8	125.8	120.8	115.8	95.0
Public debt service 4/	6.7	7.5	8.7	8.5	8.5	8.1	7.5	7.5	7.6	7.6	7.5	7.4	7.5	7.4	7.3	6.7
Of which: multilateral	5.4	5.4	6.0	6.1	6.4	6.2	6.2	6.6	6.7	6.9	6.9	6.9	7.1	7.1	7.2	6.6
Public debt service, incl. Russian debt	6.7	7.5	8.7	8.5	11.1	10.6	9.8	9.7	9.6	9.6	9.4	9.2	9.1	9.0	8.8	7.9
Public debt service ratio to exports,																
excluding hydroelectric exports 4/ 5/	7.5	8.3	9.7	9.4	9.3	8.8	8.2	8.1	8.1	8.1	8.0	7.8	7.9	7.7	7.6	6.9
but including Russian debt 5/	7.5	8.3	9.7	9.4	12.1	11.5	10.7	10.4	10.3	10.2	9.9	9.6	9.6	9.3	9.1	8.1
Public and private debt service 4/	15.5	14.6	16.9	16.0	15.2	14.3	12.8	30.3	31.0	27.9	24.9	22.2	20.1	18.3	15.8	8.3
incl. Russian debt	15.5	14.6	16.9	16.0	17.7	16.7	15.1	32.5	33.1	29.9	26.8	24.0	21.7	19.9	17.2	9.5
								(In percent)								
NPV of public debt-to-GDP ratio 4/	40.5	42.5	41.2	39.2	37.4	36.0	35.2	34.4	33.6	32.8	32.0	31.2	30.3	29.4	28.5	24.4
Ratio of public and private debt to GDP 4/	83.2	85.7	82.1	80.9	83.8	86.5	89.6	89.9	84.3	78.6	73.3	68.4	63.6	59.1	55.2	44.1
Public debt service to fiscal revenue 4/ 6/	15.1	18.3	20.3	18.8	17.8	16.3	14.9	14.6	14.6	14.6	14.2	13.9	13.8	13.7	13.5	12.5
Including the Russian debt	15.1	18.3	20.3	18.8	23.1	21.1	19.4	18.9	18.6	18.3	17.7	17.1	16.8	16.5	16.2	14.6
Grant element in total debt 4/	42.6	41.5	40.4	39.2	38.3	37.4	36.4	35.3	34.2	33.1	32.0	30.8	29.6	28.4	27.1	22.2
Grant element in new borrowing 4/	...	50.9	54.7	55.8	56.4	56.5	56.4	56.1	55.7	55.3	54.8	54.3	53.8	53.3	52.9	51.0

Sources: Data provided by the Ministry of Finance; and Fund staff estimates, and projections.

1/ Under the assumptions of the baseline scenario.
2/ Preliminary estimate subject to verification.
3/ Based on a three-year average of exports on the previous year.
4/ Excluding the Russian debt.
5/ Nonhydroelectric exports plus net receipts from the hydroelectric sector.
6/ Revenues are defined as general government revenues, excluding grants.

Table IV.4. Lao P.D.R.: Debt Service on External Debt, 2001-19 1/

(In millions of U.S. dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2019
	actual	budget							Projections							
Public external debt on existing debt																
Principal payments	25.0	28.5	35.1	36.0	53.1	52.7	50.8	50.7	51.7	53.3	53.5	53.9	54.9	55.2	55.5	60.4
Multilateral	20.1	21.2	23.2	24.1	24.3	23.5	25.0	27.3	28.3	30.3	30.9	31.3	33.4	34.7	36.6	41.4
AsDB	5.0	5.2	6.7	7.7	9.2	10.8	12.2	14.0	14.5	15.3	16.0	16.8	18.1	18.7	20.1	23.2
World Bank	3.6	5.5	6.3	6.9	7.3	7.9	8.6	9.7	10.2	11.4	11.8	12.9	13.7	14.2	14.7	16.1
IMF 2/	9.2	8.9	8.1	6.6	5.2	2.8	1.9	1.1	1.1	1.1	0.6	0.0	0.0	0.0	0.0	0.0
OPEC	1.7	1.1	1.7	2.1	1.7	1.2	1.2	1.2	1.2	1.2	1.2	0.2	0.2	0.1	0.0	0.0
IFAD	0.4	0.4	0.2	0.3	0.3	0.3	0.4	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.7
NDF	0.0	0.1	0.1	0.3	0.5	0.5	0.6	0.7	0.7	0.7	0.7	0.8	0.8	1.0	1.1	1.3
EEC	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Bilateral	3.7	3.2	4.2	4.2	21.1	21.5	21.8	21.8	21.8	21.5	21.1	21.1	20.0	18.9	18.9	18.9
Paris Club	3.7	3.2	3.0	2.1	19.0	19.3	19.7	19.7	19.7	19.3	18.9	18.9	18.9	18.9	18.9	18.9
Japan	2.4	1.9	1.9	1.3	0.7	1.1	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Germany	1.2	1.0	0.9	0.7	0.7	0.7	0.7	0.7	0.7	0.4	0.0	0.0	0.0	0.0	0.0	0.0
France	0.2	0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Russia 3/	0.0	0.0	0.0	0.0	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5
Non-Paris Club	0.0	0.0	1.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	1.0	0.0	0.0	0.0
China	0.0	0.0	1.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	1.0	0.0	0.0	0.0
Commercial	1.3	4.1	7.7	7.7	7.7	7.7	4.0	1.5	1.5	1.5	1.5	1.5	1.5	1.5	0.0	0.0
Interest payments	11.0	14.2	13.7	12.9	12.0	11.1	10.3	9.8	9.3	8.8	8.3	7.8	7.4	6.9	6.5	5.0
Multilateral	9.0	9.6	9.3	9.1	8.9	8.7	8.5	8.3	8.0	7.8	7.5	7.2	7.0	6.6	6.3	4.9
AsDB	4.3	5.7	5.6	5.5	5.5	5.4	5.2	5.1	5.0	4.8	4.7	4.5	4.3	4.2	4.0	3.1
World Bank	2.9	3.0	3.0	2.9	2.9	2.8	2.8	2.7	2.6	2.5	2.5	2.4	2.3	2.2	2.0	1.6
IMF 2/	0.7	0.4	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
OPEC	0.7	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IFAD	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
NDF	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
EEC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral	1.3	1.5	1.1	1.0	0.9	0.8	0.7	0.6	0.5	0.4	0.3	0.3	0.2	0.2	0.2	0.1
Paris Club	0.9	0.9	0.5	0.4	0.4	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.1
Japan	0.4	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.1
Germany	0.4	0.4	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
France	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Russia 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-Paris Club	0.5	0.6	0.6	0.5	0.5	0.4	0.4	0.3	0.2	0.2	0.1	0.1	0.0	0.0	0.0	0.0
China	0.5	0.6	0.6	0.5	0.5	0.4	0.4	0.3	0.2	0.2	0.1	0.1	0.0	0.0	0.0	0.0
Commercial	0.7	3.1	3.4	2.8	2.2	1.6	1.1	0.9	0.8	0.6	0.5	0.3	0.2	0.1	0.0	0.0
Debt service on new borrowing	0.0	0.0	4.6	6.5	10.6	12.1	13.6	17.3	20.9	24.1	27.4	30.8	35.1	39.2	43.3	54.6
Principal	0.0	0.0	0.0	0.0	2.5	2.5	2.5	4.8	7.1	9.1	11.2	13.6	16.9	20.2	23.5	32.2
Interest	0.0	0.0	4.6	6.5	8.1	9.6	11.1	12.5	13.8	15.0	16.1	17.2	18.1	19.0	19.8	22.4
Total public debt service	36.0	42.7	53.4	55.4	75.7	75.9	74.8	77.7	81.8	86.2	89.2	92.6	97.3	101.3	105.4	120.0
Principal	25.0	28.5	35.1	36.0	55.6	55.2	53.4	55.5	58.7	62.4	64.8	67.6	71.8	75.4	79.0	92.6
Interest	11.0	14.2	18.4	19.4	20.1	20.7	21.4	22.3	23.1	23.8	24.5	25.0	25.5	25.9	26.3	27.5
Total public debt service in convertible currency	36.0	42.7	53.4	55.4	58.2	58.4	57.3	60.2	64.3	68.7	71.7	75.1	79.8	83.8	87.9	102.5
Private debt service	47.6	39.9	50.5	48.4	45.0	44.1	40.0	183.0	199.2	182.3	165.6	149.0	134.7	123.5	101.2	23.7
Public and private debt service in convertible currency	83.6	82.6	103.9	103.8	103.2	102.5	97.3	243.3	263.5	251.0	237.4	224.1	214.5	207.3	189.1	126.2

Sources: Data provided by the Ministry of Finance; and Fund staff estimates, and projections.

1/ Under the assumptions of the baseline scenario.
2/ Excludes debt service on future disbursements.
3/ Preliminary estimate subject to verification.