

FOR
AGENDA

SM/82/218

CONTAINS CONFIDENTIAL
INFORMATION

November 18, 1982

To: Members of the Executive Board
From: The Secretary
Subject: Lao People's Democratic Republic - Recent Economic Developments

This paper provides background information to the staff report on the 1982 Article IV consultation discussions with the Lao People's Democratic Republic, which was circulated as SM/82/214 on November 12, 1982.

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INTERNATIONAL MONETARY FUND
LAO PEOPLE'S DEMOCRATIC REPUBLIC

Recent Economic Developments

Prepared by W.G.L. Evers (ASD), R. Pownall (ETR),
T. Rommel (ASD), and F. Palanza (ASD)

Approved by the Asian and Exchange and Trade Relations Departments

November 17, 1982

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LAOS

Basic Data

<u>Population (1981)</u>	3.3 million			
<u>Population growth rate</u>	2.0 per cent per annum			
	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u> <u>Proj.</u>
<u>Output</u>				
Economic growth (per cent change)	10	10	5	1
GNP value (in billions of kip)	2.5	5.2	7.4	13.8
Rice ('000 tons)	520	625	666	636
Timber ('000 cu. m.)	131	140	147	150
<u>Prices</u>				
COL in Vientiane (change in per cent)	3	100	55	100
GDP deflator (change in per cent)	8	90	35	85
Parallel market exchange rate; kip per U.S. dollar (average for the year)	15	21	38	70-80
<u>Monetary survey (per cent change)</u>				
Credit to the public sector	45	150	24	-- 1/
Credit to the private sector	33	700	63	2 1/
Domestic liquidity	18	164	4	17 1/
<u>Budget (per cent change from previous year)</u>				
Current revenue	154	179	32	178
Current expenditure	3	161	--	120
Capital expenditure	28	209	24	247
<u>Official exports (US\$ mn.)</u>	<u>19.4</u>	<u>13.5</u>	<u>19.4</u>	<u>47.8</u>
To the convertible area	19.4	13.5	14.0	29.9
To the nonconvertible area	--	--	5.4	17.9
<u>Official imports (US\$ mn.)</u>	<u>70.3</u>	<u>92.3</u>	<u>90.2</u>	<u>120.9</u>
From the convertible area	20.3	42.0	36.2	35.9
From the nonconvertible area	4.1	4.7	13.8	35.0
Aid-financed imports	45.9	45.6	40.2	50.0
<u>Commodity composition of official exports to the convertible area (US\$ mn.)</u>				
Hydroelectric power	6.1	5.3	7.9	22.5
Timber	8.5	6.1	5.1	5.9
Coffee	4.1	1.1	--	1.2
Tin	0.2	0.5	0.4	--
Other goods	0.5	0.5	0.6	0.3

LAOS

Basic Data (concluded)

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u> <u>Proj.</u>
<u>Commodity composition of official imports</u>				
<u>from the convertible area (US\$ mn.)</u>	<u>20.3</u>	<u>42.0</u>	<u>36.2</u>	<u>35.9</u>
Foodgrains and other foodstuffs	1.3	10.7	2.0	1.6
Petroleum products	8.8	12.9	12.9	12.0
Equipment and raw materials	1.8	11.1	) 21.3	) 22.3
Other goods	8.4	7.3))
<u>External reserves (US\$ mn.)</u>				
Gross (end of period)	26.1	14.0	13.5	12.4
In months of imports	4.5	1.8	1.8	1.2
Net (end of period)	14.2	3.1	-1.5	-1.6
<u>External debt (US\$ mn.)</u>				
Outstanding (end of period)	215	266	312	395
To international institutions	29	39	47	56
To bilateral donors	183	224	262	336
Socialist countries	(...)	(153)	(192)	(265)
Non-socialist countries	(...)	(71)	(71)	(71)
Suppliers' credits	3	3	3	3
Servicing	3.3	2.5	3.8	2.5
As a per cent of exports of goods and services	15	15	13	5
<u>Selected ratios, expressed as a per cent of GDP</u>				
Total budgetary expenditure	25.4	34.2	26.4	39.7
Current revenue minus current expenditure	-5.0	-5.4	-0.5	3.6
Total budgetary deficit	14.7	19.8	13.1	19.7
Official exports of goods ^{2/}	3.1	2.6	2.6	12.1 ^{3/}
Official imports of goods ^{2/}	11.2	17.8	12.2	30.7 ^{3/}
Current account deficit ^{2/}	11.5	19.8	12.4	23.9 ^{3/}
External debt ^{2/}	34.4	51.2	42.2	100.2 ^{3/}
External debt servicing	0.6	0.6	0.5	0.9

1/ For January 1-June 30 period.

2/ Computed by converting nominal GDP into U.S. dollars at the official rate of exchange.

3/ Changes from 1981 are in part due to a sharp decline in the U.S. dollar value of GNP.

I. Introduction and Summary

In early 1980, the authorities adopted a comprehensive economic program aimed at a high rate of growth, greater domestic resource mobilization and a progressive improvement in the balance of payments. The main policies adopted under the program were the removal of controls on internal and external trade, the adoption of flexible pricing policies, including the introduction of negotiated procurement prices for paddy, and a substantial devaluation of the kip. These policies, which were accompanied by an enlargement of foreign exchange allocations for imports, led to considerable progress in 1980 and 1981 with regard to production and the fiscal position; however, the balance of payments situation remained weak and there have been rapid increases in domestic prices.

Agricultural output increased significantly. paddy production rose by 20 per cent in 1980 and another 7 per cent in 1981, and production of root crops rose by 17 per cent in 1980 and another 21 per cent in 1981. While the large output gains were mostly attributable to successful reclamation of land through resettlement of displaced population, the new production-oriented policies were probably an important contributing factor. The domestic rice availability per capita increased by 21 per cent between 1979 and 1981; at the same time, rice imports, which represented 17 per cent of domestic production in 1979, could be halted by 1981. Mainly as a result of the expansion in agricultural output, GDP rose by 10 per cent in both 1979 and 1980 and by 5 per cent in 1981.

The budgetary performance also greatly improved. Domestic budgetary revenue benefited from the improved profitability of public enterprise, and rose from 10.7 per cent of GDP in 1979 to 13.4 per cent in 1981. Budgetary expenditure was tightly controlled and there was a shift toward more outlays for development; capital outlays increased from 9.7 per cent of GDP in 1979 to 12.5 per cent in 1981. The excess of current expenditure over domestic revenue, which amounted to about 5 per cent of GDP in both 1979 and 1980, was nearly eliminated in 1981.

Notwithstanding a rise in domestic production, a higher level of imports, and the liberalization of domestic and border trade, the rate of inflation was high in both 1980 and 1981. More than two thirds of the increase in the domestic price level in 1980 was attributable to adjustments in administered prices, but excessive liquidity was also an important contributing factor. In 1981, official prices were not adjusted, but a prolonged border closure and the substantial depreciation of the kip in the parallel exchange market, with its attendant effects on domestic free market prices, represented considerable inflationary elements. The growing differential between official and free market prices led to adjustments in agricultural procurement prices in January 1982. In addition, the preferential exchange rate was moved from K 30 to K 35 per U.S. dollar and made applicable to all official import and export transactions that had previously benefited from the official rate of K 10 per U.S. dollar. The effects of the change in the exchange rate system and of the higher procurement prices were, with the exception of

rice, fully incorporated in official retail prices. In part also because of interruptions in road transportation, the rise in prices in the Vientiane area during 1982 is expected to exceed that of 1981.

The current account of the balance of payments fell from US\$103 million in 1980 to US\$92 million in 1981, mainly because of the temporary closure of the border with Thailand and reductions in imports of food-grains. Since October 1981, there has been a sharp increase in receipts from exports of electricity to Thailand, but exports of timber and some other exportable goods have continued to stagnate. This, together with a sharp increase in imports, has led to a widening of the current account deficit to US\$60 million during the first half of 1982. At the end of June 1982, gross foreign exchange amounted to US\$12.5 million or about one month of imports.

Real GDP growth is projected to level off to about 1 per cent in 1982. As a result of unusually dry weather during the summer months, agricultural production may decline slightly, but, following a slowdown in 1981, industrial production is expected to accelerate somewhat due to greater availability of imported raw materials and spare parts. Reflecting mainly substantially higher profits by public enterprises and continued expenditure restraint, the budget performance is expected to improve further in 1982.

II. Production

1. Changes in real and nominal GDP 1/

Real GDP rose significantly during the 1979-81 period, as a consequence of increases in agricultural production due to an expansion in acreage under cultivation, favorable weather, and the adoption of more production-oriented policies. After rising by 10 per cent in both 1979 and 1980, real GDP increased by an estimated 5 per cent in 1981 (Table 1). In that year, agricultural and forestry production rose by 7 per cent, but, as a result of the Lao-Thai border closure from February to April, production declined in the other sectors of the economy. Real GDP growth is estimated at about 1 per cent in 1982, agricultural output is likely

1/ National accounts data are available only in real terms and only for 1980. Production figures for later years are available for the agricultural and forestry sectors, which represent about 70 per cent of GDP. Changes in real value-added of other sectors of the economy, including construction and services, must be estimated. Both administered and free market prices have been taken into account in estimating nominal GDP and the GDP deflator. In line with the UN-SNA conventions, the value of agricultural production that is consumed on the farm is computed at the free market price. To the extent that free markets are relatively narrow and sensitive also to noneconomic factors, free market prices can be quite volatile, which may have implications for the interpretation of the GDP deflator.

to be sluggish, reflecting the impact of the drought that occurred during the second quarter, but production in the other sectors is expected to increase by about 10 per cent.

Table 1. Laos: Gross Domestic Product, 1979-82

	1979	1980	1981	1982 Estimate
GDP value (in billions of kip)	2.5	5.2	7.4	13.8
GDP per cent change in real terms	10	10	5	1
GDP deflator (change in per cent)	8	90	35	85

Source: Based on data provided by the Lao authorities.

Between 1978 and 1981, nominal GDP increased by an estimated 250 per cent, of which about 27 per cent was in real terms. The high rate of inflation resulted from substantial adjustments in official prices, as well as from sharp increases in free market prices; the latter reflected the continued depreciation of the kip in the parallel exchange market and frequent border closures during that period. In 1982, nominal GDP is projected to increase by about 90 per cent as a consequence of further large adjustments in official prices and salaries as well as accelerating inflation in the nonofficial markets.

2. Agricultural production

Most agricultural products recorded a sharp increase in output between 1977 and 1981. Production of paddy rose by 57 per cent, vegetables by 42 per cent, cotton by 108 per cent, coffee by 79 per cent, tobacco by 286 per cent, and soybeans and root crops by about 100 per cent (Table 2). Total cultivated area increased by about 45 per cent, which reflected government programs for the reclamation of abandoned land as well as higher official prices for agricultural products. The increase in the production of paddy resulted mainly from increased acreage during the 1977-79 period and from higher yields thereafter. About 60 per cent of the area under paddy cultivation is located in the lowland areas, much of it subject to flooding, and about 35 per cent is in the upland areas, where paddy is largely grown under a slash and burn system.

Table 2. Laos: Area, Yield, and Production of Major Agricultural Crops, 1977-82

	1977	1978	1979	1980	1981	1982 Estimate
Area ('000 hectares)						
Paddy	570.0	590.0	690.0	724.0	738.0	740.0
Vegetables	3.9	4.4	5.3	5.3	5.4	5.8
Maize	29.7	27.0	23.0	28.3	30.9	31.6
Cotton	3.7	5.0	6.9	7.0	7.1	7.4
Coffee	4.5	4.8	5.4	6.5	7.7	7.7
Tobacco	1.3	3.0	3.4	4.0	4.4	4.9
Root crops	5.6	5.7	8.6	9.1	11.0	...
Soybeans	3.1	4.3	4.4	4.8	5.6	...
Tea (hectares)	62.0	66.0	73.0	82.0	83.0	...
Yield (ton/hectare)						
Paddy	1.2	1.2	1.2	1.4	1.5	1.4
Vegetables	7.9	8.1	8.0	8.0	8.1	7.8
Maize	1.2	1.0	0.9	1.0	1.1	1.1
Cotton	0.7	0.6	0.7	0.7	0.7	0.7
Coffee	0.6	0.6	0.6	0.7	0.7	0.7
Tobacco	0.5	0.6	0.6	0.6	0.6	0.6
Root crops	8.7	8.9	8.0	8.8	8.8	...
Soybeans	0.6	0.7	0.7	0.7	0.7	...
Tea	0.4	0.4	0.4	0.3	0.3	...
Production ('000 tons)						
Paddy	707.0	724.0	867.0	1,042.0	1,110.0	1,060.0
Vegetables	30.8	35.4	42.7	42.6	43.6	45.1
Maize	31.4	45.4	27.6	28.3	32.8	33.5
Cotton	2.4	3.7	4.8	4.9	5.0	5.3
Coffee	2.8	3.0	3.5	4.4	5.0	5.2
Tobacco	0.7	1.8	2.1	2.4	2.7	3.1
Root crops	48.7	50.6	68.6	80.3	97.1	105.0
Soybeans	1.9	2.9	3.3	3.3	3.9	...
Tea (tons)	24.7	27.0	30.3	29.0	29.7	...

Sources: Data provided by the Lao authorities.

Only 5 per cent of the total paddy area is irrigated. Inclement weather may cause year-to-year fluctuations in paddy output of up to 15 per cent, but in most years, flood losses in the lowlands are partially offset by higher rainfall and production in the upland rice areas. Conversely, drought and low production in the uplands may coincide with a favorable, flood-free season in the lowlands. Most of the cultivated area permits only one crop a year. The area under rice cultivation accounts for about 90 per cent of the total cultivated area.

In 1981, paddy production increased by about 7 per cent to a record high of 1.11 million tons; the average yield rose by 7 per cent and cultivated area by 2 per cent. Per capita rice production increased further in 1981 to an estimated 160 kg. a year, compared with 132 kg. in 1979 and 153 kg. in 1980 (Table 3).^{1/} These figures suggest that, while Laos has not yet reached full food self-sufficiency, there has been rapid progress in narrowing the food deficit. The production of vegetables and root crops--which constitute with rice the mainstay of the local diet--rose by 2 per cent and 21 per cent, respectively, due to both increases in acreage and a higher yield. The production of other agricultural crops, such as maize, cotton, coffee, and tobacco, increased by percentages ranging from 2, in the case of cotton, to 16, in the case of maize. The increase in agricultural output was broadly in line with the 1981 production plan.

The 1982 production plan had forecast a 2.5 per cent increase in paddy production, to 1.2 million tons. This increase was projected to result mainly from a 2 per cent increase in average yield; only a marginal expansion in acreage was anticipated. The production of other crops was to increase by percentages ranging from 4 for coffee and vegetables to 15 for tobacco. In order to facilitate the attainment of these objectives, the authorities raised the procurement price of paddy and a number of other agricultural products in early 1982. They also substantially increased the flow of consumer goods to the countryside. Based on the production performance during the first eight months of 1982, only the production target for paddy may fall short of the plan target, due to insufficient rains during the second quarter of the year, which led to an estimated 10 per cent decline in the wet season crop. The current official estimate of paddy production in 1982 is 1.06 million tons, 5 per cent less than in 1981. Per capita rice availability is expected to decline to 150 kg. a year, after three years of continued increases.

3. Forestry production

Production of timber, which had increased by about 32 per cent between 1978 and 1980, increased by only 5 per cent in 1981 to 147,000 cubic meters (Table 4). This represented a shortfall of 9,000 cubic meters from the 1981 Plan, due to shortages of fuel and spare parts, difficulties

^{1/} By comparison, the FAO-suggested norm of foodgrain intake is about 180 kg. In Thailand, where there are many additional kinds of food available, per capita rice consumption is 155 kg.

Table 3. Laos: Production, Availability, and Distribution of Rice, 1979-82

(1 thousands of tons, unless otherwise indicated)

	1979	1980	1981	1982
Production of paddy	867	1,042	1,110	1,060
Production of rice (net) <u>1/</u>	468	563	599	572
Population (millions)	3.56	3.67	3.75	3.82
Per capita production (kg.)	<u>132</u>	<u>153</u>	<u>160</u>	<u>150</u>
Imports of rice	80	46	--	5
Total availability	548	609	599	577
Per capita availability (kg.)	<u>154</u>	<u>166</u>	<u>160</u>	<u>151</u>
Official rice procurement	100	124	92	99
Purchases	8	42	51	52
Agricultural tax	12	36	41	42
Imports	80	46	--	5
Official rice distribution	100	124	92	99
Civil servants	80	55	46	45
Other <u>2/</u>	20	69	46	54

Source: Based on data provided by the Lao authorities.

1/ Paddy production, minus 10 per cent for seed requirements and animal feed, converted into rice at a rate of 0.6.

2/ Including movements in stocks.

in reaching more remote areas of exploitation, and low procurement prices. The 1982 Plan calls for a production of 150,000 cubic meters, a target that appears within reach based on the performance during the first half of 1982.

Table 4. Laos: Forestry Production, 1978-82

	1978	1979	1980	1981	1982 Estimate
Timber ('000 cu. m.)	106	131	140	147	150
Secondary products					
Sticklac (tons)	140	132	...	...	...
Benzoin (tons)	80	81			
Cardamom (tons)	...	...	28	42	...

Source: Data provided by the Lao authorities.

Laos' forest resources used to be viewed as an economic asset that required only efficient exploitation to provide a large increase in export earnings. The lack of a national forestry inventory and insufficient knowledge of the more remote regions helped perpetuate belief in the substantial contribution forestry could make to export earnings and the economy. It has recently become apparent that, at no more than 3 million hectares, the accessible forestry area is much less than once thought. In 1981, the authorities therefore suspended the permission granted to provincial authorities and the private sector to engage in timber exploitation and trading, and transferred the exploitation of the country's timber resources to eight regional state companies, set up with foreign assistance. By 1982, three companies, each with an allotment of 50,000 hectares, were fully operational. Based on new official guidelines on exploitation and reafforestation, the potential timber yield is about 2.5 cubic meters per hectare but the actual yield appears to be substantially less. Provincial authorities may obtain rights to cut and export timber in order to pay for essential imports. Effective April 1981, the State Trading Company (STC) was granted the monopoly of timber exports and, in mid-1981, the authorities declared a ban on the export of newly cut logs in order to promote domestic processing of timber. In view of the limited domestic processing capabilities, the ban has been enforced rather flexibly so far.

No reliable information is available on the production of other forestry products, such as benzoin, sticklac, and cardamom. While some of these products are still officially procured, it appears that the Government has now accepted that these products are largely handled outside

official channels and exported by the private sector and provincial authorities. The private export of benzoin from northern Laos is estimated at between 10 and 30 tons a year.

4. Industrial production

The industrial sector is relatively small, providing employment to probably fewer than 10,000 persons and contributing about 5 per cent of GDP. In addition to electricity and mining, the sector comprises two distinct kinds of industries, i.e., small factories that supply inputs to the domestic economy or process domestic raw materials and a group of larger factories, established before the mid-1970s, that produce mainly consumer goods, such as beer, soft drinks, tobacco, textiles, detergents, and wood products.

At present, there are hydroelectric facilities with a capacity of 113 megawatt (mw); the capacity of the Nam Ngum hydroelectric plant is 110 mw. In 1979, generation of hydroelectric power increased by nearly 300 per cent, as a result of the addition of two new generators at the Nam Ngum dam. In 1981, production declined by 10 per cent, as a consequence of a low water level and reconditioning work on the first two units. All four units are expected to become operational again in the course of 1982, which will permit an increase in gross generation of electricity. Domestic consumption of electricity is relatively small, amounting to only 9 per cent of generation; the bulk of generated electricity is exported to Thailand and constitutes the most important source of foreign exchange for Laos.

Tin production has been falling steadily since 1977, from about 700 tons to less than 250 tons in 1981, because of a decline in the ore content of several veins and difficulties related to repairing or maintaining equipment dating back to the 1940s. With the assistance of the USSR, new tin veins have been identified and new investments have been undertaken; it is expected that, by 1984, tin production will resume an upward trend. The other mining operation in Laos concerns gypsum. Mining began in 1980 and in that year 30,000 tons were produced, chiefly for sale to Viet Nam. In 1981, production rose to 40,000 tons, compared with a plan target of 80,000 tons. The plan target was kept unchanged for 1982.

Production in the larger factories was hampered during the early months of 1981 when the closure of the Lao-Thai border prevented the importation of raw materials. When the border reopened, production picked up briskly and for the year as a whole most of these factories recorded increases in output--starting from a low base in most cases. The production of cigarettes rose by 3.5 per cent, zinc products by 50.0 per cent, and beer and soft drinks by 55.0 per cent. The increased allocation of foreign exchange to industrial companies in 1982 may permit a rise in production of about 10 per cent.

III. Price Developments and Official Procurement and Distribution

The Lao economy consists of a public sector where prices are determined administratively and a private sector where prices are determined by market forces. Prices that are determined administratively include prices paid for the procurement of agricultural and forestry products by the STC, the state procurement agency, prices at which industrial state enterprises purchase their inputs and sell their production, and prices at which public sector employees obtain rations of selected commodities.

In both 1981 and 1982, overall price developments have been characterized by high rates of inflation, particularly in the Vientiane area. An important source of inflationary pressures in Laos is the inadequate transport system which makes it difficult to supply the food-deficit areas of the north (including Vientiane) with surpluses of the south. With the attainment of food self-sufficiency and the corresponding reductions in imports of foodgrains through Vientiane, the deficit areas have become more dependent on the surpluses of the south and thereby more prone to supply interruptions. Other causes of inflation have been the closure of the border with Thailand during a five-month period in 1981 and a sharp depreciation of the kip in the parallel market. In January 1982, the Government increased a number of official procurement and retail prices. At the same time, the preferential exchange rate was moved from K 30 to K 35 per U.S. dollar and made applicable to all exchange transactions, including all official imports and exports that had previously benefited from the official rate of K 10 per U.S. dollar. The cost-of-living in the Vientiane area in 1982 is estimated to reach about 100 per cent, from about 55 per cent in 1981.

1. Developments in administered prices

In the course of 1981, the authorities doubled the price the SCL is allowed to offer to farmers for their paddy, from an average of K 1 to K 2 per kilo (Table 5). The higher price and a larger supply of essential consumer goods permitted an increase in official rice procurement from 42,000 tons in 1980 to 51,000 tons in 1981. Another increase in the official price for paddy, from K 2 to K 3 per kilo of paddy, took place in early 1982. Based on half-yearly data, it is expected that the STC will be able to increase its domestic rice procurement to 52,000 tons in 1981 or about 7.5 per cent of total domestic output. The authorities increased the procurement price of coffee from K 7.8 to K 16 per kilo during 1981 and to K 28 per kilo in January 1982. As in the case of paddy, these increases aimed at providing stronger production incentives and at enabling the STC to acquire larger amounts of coffee for export. The official procurement price of timber, which had remained unchanged since 1978, was raised in the course of the latter half of 1981. Another, more substantial increase took place in early 1982. While the official procurement price of timber is presently three to five times higher than in 1978, it is still too low to provide adequate incentives to the timber cutters. Official procurement prices for other products, such as sticklac,

benzoin, and cardamom, have not been increased, despite substantially higher prices in the private market. In some areas, cardamom is privately marketed at a price of K 150 per kilo, compared with an official price of K 20 per kilo.

Table 5. Laos: Selected Official Procurement Prices, 1978-82

	1978	1979	1980	1981		1982
		December		June	December	June
Paddy (kg.)	0.2-0.3	0.8-1.2	0.8-1.2	0.8-1.2	2.0 (national average)	3.0 (national average)
Maize (kg.)	0.3	1.0	1.0	1.0	1.0	1.0
Coffee (kg.)	2.5	7.8	7.8	16.0	16.0	28.0
Timber (cu. m.)						
Hard wood	500	500	500	500	845-1,055	2,000-2,500
Soft wood	400	400	400	400	400-700	1,000-1,400
Cardamom (kg.)	5.0	20.0	20.0	20.0	20.0	20.0
Sticklac (kg.)	4.0	16.0	16.0	16.0	16.0	16.0
Benzoin (kg.)	...	56.0	56.0	56.0	56.0	56.0

Source: Data provided by the Lao authorities.

Effective January 1982, prices at which industrial public enterprises sell their production were substantially increased. Prices were raised from K 3 to K 6 to K 9 per pack for cigarettes; from K 6 to K 20 per bottle for beer; from K 1 to K 6 per bottle for cola drinks; from K 0.02 to K 0.04 per unit for electricity; and from K 20 to K 44 per kilo for detergents. These increases reflected higher costs including higher agricultural procurement prices, the effect of the application of the K 35 per U.S. dollar rate of exchange to all official imports, and higher depreciation allowances. In some cases, such as beer and cigarettes, the rise in prices also reflected the elimination of subsidies or an increase in profit margins.

Public sector employees benefit from rations of a number of basic commodities at subsidized prices. As part of the price adjustments of early 1980, the number of these commodities had been reduced to 11, and

a plan was established to periodically review their prices in order to keep the cost of subsidies under control. However, during the remainder of 1980 and in 1981, the prices were not changed, and by early 1982, substantially subsidies had developed. Therefore, in January 1982, the authorities reduced the number of rationed commodities to four (rice, sugar, fabrics, and detergent). At the same time, prices were increased so as to cover costs of production, except in the case of rice where the subsidy is now substantial (Table 6).

Table 6. Laos: Rice Subsidy, 1979-82

(In kip)

	1979	1980	1981	1982
Cost per kg.	1.8	3.0	3.8	6.6
Procurement price of rice	0.5	1.7	2.5	4.3
Transportation and milling	1.0	1.0	1.0	2.0
Other distribution costs	0.3	0.3	0.3	0.3
Distribution price per kg.	0.45	3.0	3.0	3.0
Subsidy per kg.	1.35	--	0.8	3.6
Total subsidy (in millions)	135	--	80	360

Source: Based on data provided by the Lao authorities.

Public sector salaries are closely linked to the price level of rations. By deleting seven products from the ration system and increasing the sales price of three out of the remaining four products in early 1982, the cost-of-living of public sector employees is estimated to have increased by about 60 per cent. Accordingly, salaries of civil servants, which had not been changed in 1981, were increased, on average, by 60 per cent in the course of the first half of 1982. Salaries of other public sector employees were, however, not adjusted. As shown in Table 7, the cost-of-living for public sector employees living in Vientiane may have increased by as much as 135 per cent between the first quarter of 1980 and the first quarter of 1982.^{1/} This would mean that public sector employees, although in varying degrees, have suffered a loss in real income since early 1980. Higher real incomes were probably experienced in the agricultural sector and in private trade.

^{1/} Information on free market prices are available only for Vientiane.

Table 7. Laos: Cost-of-Living Indices, 1980-82
(January 1980 = 100; monthly average)

	Cost of Living Index for Public Sector Employees	Index of Official Sales Price of Rice	Cost of Living Index for Other Income Earners <u>1/</u>	Index of Free Market Sales Price of Rice <u>1/</u>	Parallel Market Exchange Rate
1980 Mar.	109	100	118	113	100
June	129	100	173	165	160
Sept.	135	100	216	213	147
Dec.	123	100	167	150	160
1981 Mar.	141	100	197	150	187
June	160	100	288	275	267
Sept.	185	100	323	275	267
Dec.	185	100	323	275	400
1982 Mar.	256	100	408	350	400
June	362	100	696	625	500

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

1/ Based on free market prices in Vientiane only.

2. Developments in free market prices

A large number of products, including domestic agricultural and industrial products and imports which are not subject to a state monopoly, can be traded on the free market. Nonofficial imports consist mostly of non-food consumer goods that have been paid for by foreign exchange obtained on the parallel foreign exchange market. The supply of foreign exchange in the parallel market originates mostly from the foreign community in Laos and from nonofficial exports. Another source of foreign exchange consists of payments received by the private sector from foreign timber buyers for transportation and handling of logs purchased from the STC. Free market prices in the Vientiane area tend to be influenced by movements in the exchange rate on the parallel market, which, in turn, tend to respond to psychological factors in addition to demand and supply conditions. The supply of foreign exchange in the parallel market during the first six months of 1982 appears to have been affected by a drastic drop in official timber exports, which reduced the amount of private receipts for transportation and handling of logs.

Inflationary pressures increased during the first half of 1981. Demand increased due to record payments of paddy by the STC in late 1980-early 1981 and precautionary buying in response to the border closure in February 1981. In April, the border trading points were reopened, but free market prices failed to stabilize as the kip began depreciating on the parallel exchange market. Between end-March and end-June, it had depreciated by close to 45 per cent, probably because of the authorities' decision to reorganize foreign trade and to require private traders to obtain official licenses. During the third and fourth quarters of the year, free market prices were relatively stable; the parallel market rate of exchange stabilized and the reopening of the border permitted imports of consumer goods (Chart 1). In December 1981-January 1982, the exchange rate on the parallel market depreciated by 50 per cent just before the sharp increase in official prices. Influenced by these two developments, free market prices increased by 26 per cent during the first quarter of 1982. They increased by another 71 per cent during the second quarter of 1982, as prices of major foodstuffs rose substantially, due to adverse weather conditions and difficulties in transportation. Other factors were a further depreciation of the kip on the parallel market and the increase in civil service salaries. In August, when it appeared that rain patterns were returning to normal, fears of a major crop loss diminished, and food prices in the free market started to stabilize.

3. Official procurement and distribution

Control of the distribution system to regulate supplies and prices of major commodities is one of the Government's main concerns. Under current policies, the STC is in charge of all official procurement and distribution, including official exports and imports. However, electricity exports do not fall under its purview. The STC procures from state enterprises at official, administered prices and from the private sector mostly at negotiated prices. It distributes imported and domestically procured products at cost plus a markup of 15 per cent for transportation, other expenses, and profit. Only commodities available to public sector employees under the rationing system may be distributed at prices below cost; these prices are determined administratively and may remain unchanged often for a long period of time. Official distribution of rice to civil servants declined sharply in 1980 when the authorities restricted the number of beneficiaries per family of civil servants. In 1981, a further reduction was achieved by excluding nonworking spouses. The official distribution of other consumer goods has, however, been increasing.

IV. Medium-Term Development Strategy

In November 1980, the Council of Ministers issued a decree that outlined the basic orientation of economic and social development for 1981-85, under the First Five-Year Plan. Following the 1976-80 transition period, the basic economic objective for the 1981-85 period is to create a socialist economy with developed agriculture, forestry, and industry sectors

able to satisfy the growing needs of the population. Quantitative targets have been established as an indication of relative priorities and of the direction in which the economy is to be developed; these targets, however, are not intended to serve as a quantitative guideline for decision-making. Annual planning will remain flexible and guided by pragmatism, in particular with regard to availability of domestic and external resources, and the absorptive capacity of the country.

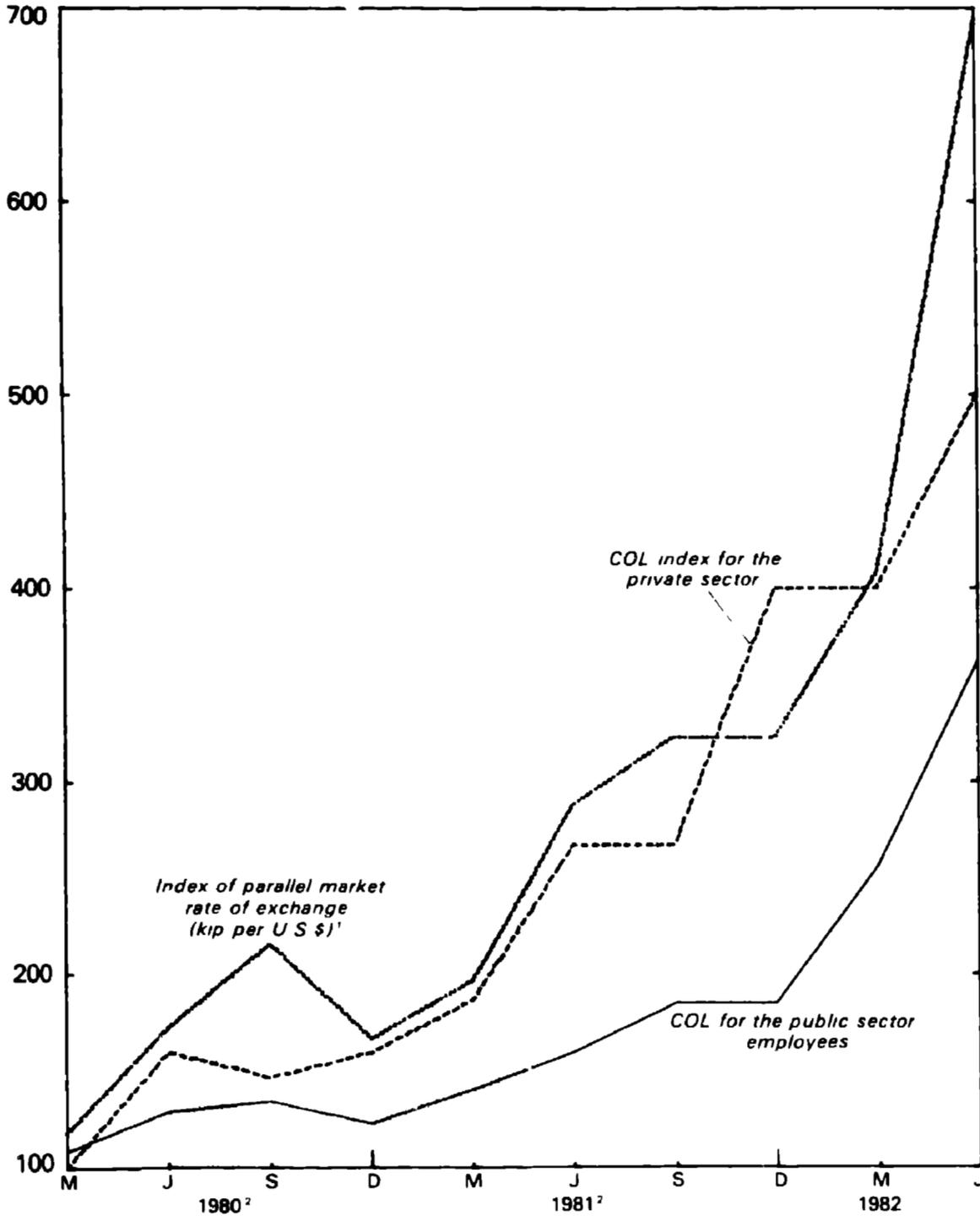
The objectives of the First Five-Year Plan are improvements in the transportation system, self-sufficiency in rice--which would require a level of paddy production of up to 1.4 million tons--development of other agricultural crops, and improvement in the country's export potential. Recognizing the vital role of transport and communications, the Plan envisages allocating up to 40 per cent of investments to this sector, compared with 26 per cent to agriculture, forestry, and irrigation, 20 per cent to industry, and 14 per cent to other sectors, including social services. The major priority within the transport sector is the construction of Route 9 and the rehabilitation of Route 13. Route 9 will connect southern Laos to the port of Danang in Viet Nam, and reduce the country's dependence on Bangkok as its main seaport. Route 13 runs north-south and connects Laos' major cities. The Plan also envisages establishing a public company that would be in charge of internal transportation and that would manage the public sector's means of transportation. The country's vast timber resources will be exploited, but in an orderly and planned fashion by strictly prohibiting unlicensed felling and requiring the regional state enterprises in charge of forestry exploitation to grow trees in areas that have been logged. Finally, the Plan aims at rehabilitating the country's industrial base in order to absorb and process the rising agricultural and forestry production; with the exception of a cement factory, no new industrial enterprises of any size will be established.

In pursuing these aims, the authorities face a number of constraints. Laos suffers from a severe shortage of manpower at both the technical and managerial levels. The capacity of the country to absorb foreign assistance is limited, due not only to manpower limitations and lack of expertise, but also to cumbersome administrative procedures and lack of coordination among ministries involved. Domestic savings fall short of domestic investments by a wide margin and, in many instances, implementation of foreign-financed investments slowed because of lack of counterpart funds. To cope with these constraints, the authorities intend to avoid excessive reliance on administrative procedures, and to let the private sector play a larger role in production, trading, and investment. They also intend to increase domestic resource mobilization by improving the efficiency of public enterprises, the elimination of subsidies, and a more efficient tax collection.

Improving the country's export performance is a major objective of the Five-Year Plan. It calls for developing exports of timber, coffee, tin, gypsum, electricity, and handicraft items. For the first four products, the authorities are relying on assistance from foreign countries.

CHART 1
LAOS
PRICE AND PARALLEL MARKET EXCHANGE RATE
DEVELOPMENTS, 1980 I-1982 II

(January 1980=100)



Source: Staff calculations based on data provided by the Laos authorities
1Between January 1980 and December 1981 the exchange rate used in official transactions remained unchanged at K10=US\$1. In January 1982 it was modified to K35=US\$1
2Shaded area represents border closures between Laos and Thailand

Sweden and a number of CMEA countries are assisting with the creation of the eight regional forestry companies; the USSR and East Germany have expressed interest in rehabilitating and developing coffee plantations. The USSR is also providing assistance in exploiting newly discovered tin veins and Viet Nam is providing assistance in the exploitation of gypsum mines. Recently, Laos obtained financing from the World Bank Group and the OPEC Fund for the installation of a fifth generator to the Nam Ngum dam, which will increase total electricity generating capacity at the dam from 110 megawatt to 150 megawatt. The new generator is expected to become operational in 1984. Export receipts from electricity will also increase as a result of the new agreement signed in 1981 between Laos and Thailand. Under this agreement, the export price for electricity was increased by 200 per cent in 1981 and annual increases of 9 per cent per annum will apply to subsequent years.

V. Public Finance

1. Structure of the Lao public sector

The public sector consists of the Central Government, 13 provincial administrations, and a number of public enterprises which are either under the supervision of specific ministries or of a provincial authority. The budget is prepared in combination with the annual production plan and reflects the activities of both the Central Government and the provinces. State enterprises maintain their own accounts, but their operations affect budget revenue (through transfers of operating surpluses and turnover taxes) and budget expenditure (100 per cent of their investment capital and 50 per cent of their working capital is financed by the central budget; the remaining 50 per cent of working capital is financed by the central bank). Foreign commodity and project assistance that enters into the budget is valued at contract or world market prices.

2. Overall fiscal performance, 1979-82

After a slackening of budgetary discipline following the 1975 war, measures were adopted in 1979 and 1980 to strengthen public finance. They included stricter enforcement of the tax code, expenditure controls, the adjustment of official prices to cost levels, and tighter supervision of the financial activities of public enterprises. These measures, combined with a growing economic activity, resulted in a considerable improvement in fiscal performance. The share of budgetary revenue in GDP rose from 11 per cent in 1979 to an estimated 20 per cent in 1982 as transfers from public enterprises, which account for approximately 70 per cent of total revenue, increased considerably (Table 8). The ratio of expenditure to GDP also rose from 25 per cent in 1979 to an estimated 40 per cent in 1982, reflecting chiefly an expansion of development outlays. From 10 per cent in 1979, development expenditure is estimated to rise to about 23 per cent of GDP in 1982.

Table 8. Laos: Fiscal Performance in Relation to GDP, 1979-82

(In per cent of GDP)

	1979	1980	1981	1982 <u>1/</u>
Revenue	10.7	14.4	13.2	20.0
Of which: transfers from public enterprises	7.4	10.9	9.5	16.3
taxes on the private sector	1.9	1.9	2.7	3.0
Expenditure	25.4	34.2	26.1	39.7
Current	15.7	19.8	13.7	16.4
Capital	9.7	14.4	12.4	23.3
Deficit (-)	14.7	19.8	12.9	19.7
Domestic financing	0.5	-0.1	--	--
External financing	14.2	19.9	12.9	19.7

Source: Staff estimates.

1/ Based on the revised 1982 budget.

In spite of its considerable expansion, revenue remained significantly lower than expenditure, resulting in large budget deficits. In 1980, the deficit increased to 20 per cent of GDP, from 15 per cent in 1979. It declined to 13 per cent in 1981, but is expected to reach 20 per cent again in 1982. Although the deficit has been financed entirely by foreign assistance in recent years, the share of foreign assistance in total expenditures has gradually declined. From 56 per cent of total budgetary expenditure in 1979, it fell to less than 50 per cent for the revised budget for 1982. Furthermore, domestic revenue is expected to exceed current expenditures for the first time in 1982. The excess is estimated at about 4 per cent of GDP.

3. The 1981 budget

a. Revenue

Domestic revenue had expanded by 179 per cent in 1980, largely as a consequence of adjustments in official prices; transfers from public enterprises had tripled and tax receipts from the private sector had doubled. The 1981 budget incorporated a further expansion of revenue by 28 per cent, mostly on account of a 25 per cent rise in transfers from

public enterprises (Table 9). Tax collection from the private sector was to increase through stricter enforcement, a modification of the agricultural tax, and a change in the definition of business income to take into account the previous year's inflation. Tax receipts from the private sector were estimated to grow by 61 per cent, or to 16 per cent of total revenue.

Actual results for 1981 indicate that revenue rose by 32 per cent to K 989 million. This occurred in spite of a slowdown in economic activity during the first half of 1981, due to the three-month closure of the border with Thailand. The border closure resulted in lower-than-projected receipts from taxes on international trade. These taxes amounted to K 109 million compared with a budgeted level of K 164 million (Table 10). It also resulted in a lower than expected level of production in state enterprises, which caused revenue from the turnover tax on state enterprises to amount to K 119 million, compared with a budgeted amount of K 133 million. However, operating surpluses and other transfers of public enterprises rose by 35 per cent and exceeded budget estimates by 14 per cent.^{1/} This reflected in part higher profits recorded by the State Electricity Company (Electricite du Laos) as a result of the tripling in the price of electricity sold to Thailand, and in part transfer of excess working capital to the budget by certain public enterprises, the STC in particular. Depreciation allowances transferred to the budget by public enterprises also exceeded the budgeted level as new equipment became operational; these allowances rose to K 100 million, from K 53 million in 1980. Revenue from the turnover tax on the private sector also exceeded the budget estimate, reflecting increased economic activity as well as better collection of tax arrears.

b. Expenditure

Expenditure in 1981 was originally budgeted to grow by 23 per cent; 44 per cent of total expenditure was planned to be financed by domestic resources. Current expenditure was to increase by 10 per cent, primarily to meet the higher costs of imported materials and supplies and, to a lesser extent, the higher level of interest payments on foreign indebtedness. The size of the civil service was to decline by about 25 per cent. Capital expenditure was to expand by 41 per cent, most of this increase was to take place in the industry and communication sectors (Table 11).

^{1/} While revenue from the turnover tax on public enterprises fell short of the 1981 budget forecast, these enterprises transferred larger operating surpluses than the budget forecast. This discrepancy reflects methods of calculation. The turnover tax is levied on goods valued at a certain price at the beginning of the fiscal year; this valuation does not change in case of price increases in the course of the year. In 1981, profits by the State Electricity Company were affected in this way by the increase in electricity prices.

Table 9. Laos: Budget, 1979-82

(In millions of kip)

	1979		1980		1981		1982	
					Budget	Results	Budget	Preliminary 1/ estimates
Revenue	268.0	748.2	961.4	989.2	1,190.0	2,755.0	1,190.0	2,755.0
Transfers from public enterprises	184.2	567.8	710.4	713.3	876.3	2,255.0	876.3	2,255.0
Taxes on the private sector	48.4	98.3	158.2	200.1	251.7	415.0	251.7	415.0
Other revenue	35.4	82.1	92.8	75.8	62.0	85.0	62.0	85.0
Expenditure	636.0	1,776.9	2,181.4	1,955.8	2,152.0	5,475.0	2,152.0	5,475.0
Current expenditure	393.9	1,028.0	1,127.1	1,028.3	1,053.6	2,259.0	1,053.6	2,259.0
Of which: wages and salaries								
Capital expenditure	242.1	748.9	1,054.3	927.5	1,098.4	3,216.0	1,098.4	3,216.0
Of which: communications and public works	(...)	(282.8)	(442.9)	(373.0)	(440.0)	(1,237.2)	(440.0)	(1,237.2)
agriculture and forestry	(74.3)	(178.8)	(233.3)	(282.8)	(307.3)	(955.5)	(307.3)	(955.5)
industry, mining, and commerce	(...)	(43.4)	(153.1)	(148.9)	(174.3)	(573.0)	(174.3)	(573.0)
Budget deficit	-368.0	-1,028.7	-1,220.0	-966.5	-962.0	-2,720.0	-962.0	-2,720.0
Budget financing	368.0	1,028.7	1,220.0	966.5	962.0	2,720.0	962.0	2,720.0
Internal (recourse to the BNL)	13.6	-4.0						
External	354.5	1,032.7	1,220.0	966.5	962.0	2,720.0	962.0	2,720.0
Project aid	(...)	(...)	(660.0)	(...)	(...)	(2,275.0)	(...)	(2,275.0)
Commodity aid	(...)	(...)	(400.0)	(...)	(...)	(445.0)	(...)	(445.0)
Other	(...)	(...)	(160.0)	(...)	(...)	(-)	(...)	(-)

Source: Ministry of Finance.

1/ Does not include the January 1982 devaluation of the kip and the salary increase.

Table 10. Laos: Budgetary Revenue, 1980-82

(In millions of kip)

	1980	1981		1982	
		Budget	Preliminary estimates	Budget	Preliminary estimates
Fiscal receipts	<u>300.3</u>	<u>418.2</u>	<u>395.6</u>	<u>503.8</u>	<u>775.0</u>
Tax on industrial and commercial profits	15.4	28.4	30.8	35.0	60.0
Tax on wages and salaries	1.3	1.5	1.0	3.0	2.0
Agricultural tax	31.0	57.2	55.4	81.0	117.0
Other	0.1	0.8	...	...	1.0
Turnover tax	90.5	155.3	195.1	256.0	383.0
of which: public enterprises	(81.0)	(132.7)	(119.3)	(166.0)	(223.3)
Business licenses	6.6	11.2	4.4	5.0	7.0
Tax on foreign trade	155.4	163.8	108.9	123.8	205.0
Import duties	(...)	(104.7)	(83.9)	(89.2)	(142.5)
Of which: public enterprises	[...]	[71.0]	[54.9]	[56.0]	[83.5]
Export duties	(...)	(59.1)	(25.0)	(34.6)	(62.5)
Of which: public enterprises	[...]	[56.3]	[21.3]	[30.1]	[53.2]
Nonfiscal receipts	<u>447.9</u>	<u>543.2</u>	<u>593.6</u>	<u>686.2</u>	<u>1,980.0</u>
Operating surpluses of public enterprises	312.4	367.2	420.4	474.4	1,595.0
Depreciation allowances paid by public enterprises	53.4	83.2	100.0	150.0	300.0
Other	<u>82.1</u>	<u>92.8</u>	<u>73.2</u>	<u>61.8</u>	<u>85.0</u>
Total	<u>748.2</u>	<u>961.4</u>	<u>989.2</u>	<u>1,190.0</u>	<u>2,755.0</u>

Source: Ministry of Finance.

Table 11. Laos: Economic Classification of Budgetary Expenditure, 1979-82

(In millions of kip)

	1979	1980	1981		1982	
			Budget	Preliminary estimates	Budget	Preliminary estimates
Current expenditure	<u>393.9</u>	<u>1,028.0</u>	<u>1,127.1</u>	<u>1,028.3</u>	<u>1,053.6</u>	<u>2,259.0</u>
Wages and salaries	<u>113.9</u>	<u>269.6</u>	<u>198.0</u>	<u>200.0</u> ^{1/}	<u>200.0</u> ^{1/}	<u>280.0</u> ^{1/}
Materials and supplies	95.5	667.8	816.7	725.0	765.0	1,798.0
Subsidies to public enterprises)))	--	--	--	--
Scholarships)	165.3	55.9	61.5	56.1	58.0	82.0
Pensions )	)	2.4	3.0	2.6	3.0	3.0
Other subsidies and transfers )	)	9.7	10.7	--	--	--
Debt service	19.2	22.6	37.2	44.6	27.6	96.0
Capital expenditure	<u>242.1</u>	<u>748.9</u>	<u>1,054.3</u>	<u>927.5</u>	<u>1,098.4</u>	<u>3,216.0</u>
Education	<u>3.8</u>	<u>23.5</u>	<u>64.7</u>	<u>20.7</u>	<u>30.0</u>	<u>77.0</u>
Health	2.2	112.4	134.5	66.5	84.0	253.5
Agriculture )	)	)	186.2)))
Forestry)	74.3	) 178.8	47.2	) 282.8	307.3	955.5
Industry, mining, energy	24.5	43.4	153.1	148.9 ^{2/}	174.3 ^{2/}	573.0 ^{2/}
Transportation and communications	113.1	282.8		) 373.0	440.0	1,237.2
Trade and cooperatives )	)	)	442.9)))
Public works)	24.2	108.0)))
Other	<u>--</u>	<u>--</u>	<u>25.8</u>	<u>35.6</u>	<u>62.8</u>	<u>119.8</u>
Total	636.0	1,776.9	2,181.4	1,955.8	2,152.0	5,475.0

Source: Ministry of Finance.

^{1/} Estimated.

^{2/} Includes also STC.

Actual expenditure in 1981 increased by only 10 per cent to K 1,956 million, falling 10 per cent short of the original budget. Current expenditure remained at its 1980 level of K 1,028 million, while capital outlays increased by 23.8 per cent to K 928 million. Most of the shortfall in current expenditure was due to lower-than-expected outlays for material and supplies. Expenditure on wages and salaries fell as budgeted to K 200 million. Capital outlays rose by K 178.6 million compared to 1980, but were still K 127 million smaller than originally budgeted. Capital outlays in the agriculture and forestry sectors exceeded budgeted levels, but investment in industry, communication, and trade fell short of the targeted amounts.

The factor which caused capital expenditure to fall short of the budgeted level was a lower-than-expected level of foreign assistance, combined with the authorities' commitment to avoid bank financing of budgetary deficits. Actual disbursement of foreign assistance amounted to only K 966.5 million, K 253.5 million less than budgeted; this was attributable to delays in disbursements related to the border closure, internal transportation and security problems, and to a reduction in commodity assistance provided by CMEA countries.

4. The 1982 budget

According to the original 1982 budget, revenue was projected at K 1,190 million, K 201 million or 20 per cent higher than in 1981. Transfers from public enterprises were to increase from K 713 million to K 876 million on account of a higher level of economic activity, higher official prices, and the full year impact of the tripling of the export price of electricity. Tax receipts from the private sector were to increase from K 200 million to K 252 million, reflecting an expansion in private sector activities. Expenditure was budgeted to grow moderately in 1982. Current expenditure was budgeted to rise by only 2.5 per cent to K 1,054 million, by keeping public sector employment unchanged and permitting only a small increase in purchases of materials and supplies. Capital outlays were planned to grow by 18 per cent to K 1,098 million. The budget deficit was expected to decline from K 966.5 million in 1981 to K 962.0 million. As in previous years, it was to be financed entirely from foreign sources.

The outturn of the 1982 budget will be strongly affected by two major reforms introduced in the first part of the year. First, official prices were increased sharply following the depreciation of the kip and the introduction of higher procurement prices in the agricultural sector. Second, to compensate for higher official consumer prices, public sector salaries were increased by 50 to 70 per cent during the January-June period. The depreciation of the kip affected the valuation of foreign aid, the value of which more than tripled, and the cost of government imports. As a consequence of these developments, the revised budget estimates for 1982 differ considerably from the original budget.

According to revised budget estimates, revenue is presently projected to reach K 2,755 million, an increase of 180 per cent over 1981, reflecting primarily a sharp increase in transfers from public enterprises. Their operating surpluses are estimated to increase by 280 per cent from the 1981 level, as unchanged profit margins are applied to much higher prices. Furthermore, the State Electricity Company will be able to raise its transfer to the budget to as much as K 685 million due to the tripling of the export price of electricity and the conversion of its foreign exchange receipts at a depreciated rate. Depreciation allowances paid by public enterprises are projected to triple from the 1981 level, as all imported equipment is being revalued to reflect the depreciated rate of exchange.

Transfers from state enterprises will be adversely affected, however, by a sharp increase in the cost of rice subsidization which the STC covers with profits made on trading other products. Since the 1980 price reform, when the rice subsidy was reduced to nil, the official sales price of rice has not been allowed to keep pace with rising costs. The recent increases in the negotiated procurement price of paddy and higher transportation costs have led to an estimated quadrupling in the total rice subsidy between 1981 and 1982, to an estimated 2.6 per cent of GDP and 13.1 per cent of budgetary revenue.

Further liberalization of private sector activities is projected to have a significant impact on tax revenue. An important development in this context is the permission recently granted to the private sector to sign contracts with the Government and supply construction materials. Tax revenue from the private sector is projected to rise to K 415 million, more than double the 1981 amount, about 72 per cent of the total will be obtained from taxes on trade and industry (i.e., licenses, turnover tax, and the taxes on profit). The agricultural tax, valued at the new official procurement price, is estimated to yield K 117 million, or more than twice the 1981 amount. Import duties are expected to increase by 70 per cent from their 1981 level, with custom duties still being assessed at the rate of K 10 per U.S. dollar, this increase reflects a higher level of imports compared with the depressed level of 1981.

Budgetary expenditure is estimated to increase by 180 per cent over its 1981 level, in real terms, however, expenditure will be approximately the same as in 1981. Current expenditure is projected to increase by 120 per cent, reflecting the higher level of domestic costs and prices, an increase in debt servicing as a result of the depreciation of the kip, and a 50 to 70 per cent increase in civil service pay. This salary increase became effective in January 1982 for some branches of the public sector and was extended to the remaining branches during the April-June period. The salary increase is expected to be partly offset, however, by a further reduction in public sector employment. Salary payments are estimated to amount to K 280 million, only 40 per cent more than in 1981. At that level, they represent only 12 per cent of current expenditure. Capital expenditure is expected to reach K 3,216.0 million, a 250 per cent increase over 1981; a real decline in

foreign budgetary assistance will be largely offset by a rise in public earnings. About 30 per cent of capital outlays is to be allocated to agriculture and forestry, 18 per cent to industry and energy, and 38 per cent to transportation, communications, and public works.

The overall budget deficit is expected to amount to K 2,720 million in 1982, wholly financed from foreign sources. Although it represents a sharp increase from 1981, it does not indicate a move toward expansionary policies. To a large extent the increase is attributable to the valuation of aid receipts and the corresponding expenditure items at an exchange rate at K 35 instead of K 10 per U.S. dollar. In terms of GDP, the budget deficit is expected to increase to 20 per cent, from 13 per cent in 1981.

5. Reforms in the public enterprise sector

In the course of the last three years, the authorities have introduced measures which, combined with a more flexible pricing policy, aimed at improving the financial performance and increasing the productivity of the public enterprises. These measures included greater autonomy in investment and production decisions, increased accountability and stricter financial discipline. Public enterprises are now required to maintain balanced budgets as well as a small reserve to counterbalance temporary deficits. In January 1982, additional reforms were introduced. Sales prices of public enterprises were increased, and managers were required to determine the number of employees on the basis of the amount of work to be performed. The integration of the cost of excess labor in total production costs was no longer permitted. Furthermore, on a trial basis, three enterprises (i.e., those producing plywood, tobacco, and beer) were granted larger autonomy and permitted to retain wider profit margins. More specifically, these enterprises have been authorized to negotiate directly with foreign customers and suppliers, as well as with other national firms. They have been allowed to retain 40 per cent of their planned profits versus the 10 to 20 per cent share allocated to the other firms. Half of the retained profits are directed to investment, 25 per cent to the security fund, and 25 per cent to bonuses for the workers. In view of the small size of the investment fund, the latter can only be used, at present, for purposes such as improvement in working conditions. Although the retention of higher profits will initially mean lower transfers to the Government, the greater incentives could result in larger production and, ultimately, increased revenue for the Government. This new management and profit system will be extended to other public enterprises, if the experiment proves successful.

VI. Money and Credit

Two institutions make up the Lao monetary system: the Banque Nationale du Laos (BNL), or the central bank, which issues domestic currency, extends credit in kip for domestic use, and keeps the accounts of the Central Government and the provincial authorities; and the Banque pour le Commerce Exterieur Lao (BCEL), a subsidiary of the BNL, which is responsible for Laos' international transactions. It is the holder of international reserves and maintains the accounts related to commercial agreements with foreign countries, as well as the accounts of foreigners working in Laos.

1. Policies and developments

Credit policy is largely determined by the state enterprises' annual production plans and the level of official prices; in the recent past, credit policy has also been influenced by the authorities' desire to expand the role of the private sector in economic activity. To this effect, 52 new branches of the BNL were established in rural areas between 1979 and 1982.

Total credit increased by 25.1 per cent in 1981 (Table 12). Although substantially less than in 1980, when domestic credit requirements rose sharply as a result of large price increases and special import programs,

Table 12. Laos. Monetary Survey, 1979-82

(In millions of kip; end of period)

	<u>1979</u>	<u>1980</u>	<u>1981</u>		<u>1982</u>
	<u>December</u>		<u>June</u>	<u>December</u>	<u>June</u>
Assets					
Net fore'gn assets <u>1/</u>	-243	-446	-478	-524	-367
Domestic credit	451	899	1,098	1,125	1,130
Government (net)	59	55	15	18	7
Public enterprises	288	812	1,040	1,055	1,070
Private sector	4	32	43	52	53
Other items (net)	183	315	282	194	164
Liabilities					
Total liquidity	291	768	902	795	927
Currency in circulation	100	157	165	169	231
Public enterprises deposits	169	519	656	551	610
Private sector deposits	18	82	71	65	77
Saving deposits	4	10	10	10	9

Source: Data provided by the Lao authorities.

1/ Excludes balances under bilateral payment arrangements.

the increase in 1981 was still relatively large. The main factor contributing to the increase in credit outstanding was a 40 per cent increase in credit to the STC, mainly on account of increased procurement of paddy at higher prices. The share of credit to the STC in total credit outstanding to public enterprises rose from 69 per cent at end-1980 to 75 per cent at end-1981 (Table 13). Credit to other public enterprises increased during the first half of the year and declined thereafter; the increase for the year as a whole was relatively small. Domestic industrial production, which had been relatively buoyant in the early part of the year, weakened as the impact of the border closure started being felt throughout the economy, furthermore, the increase in the price of electricity and the improvement in the liquidity position of the State Electricity Company resulted in a net repayment of credit by that company to the banking system.

Credit to the private sector expanded by K 20 million in 1981, rising from K 32 million to K 52 million. In spite of this expansion, it accounted for only 4 per cent of total credit outstanding at the end of 1981. The increase in private sector credit reflected the Government's decision to rely more on the private sector to distribute consumer goods to the countryside. It reflected to a lesser extent the provision of bank credit to finance the rehabilitation and expansion of small family enterprises that can provide services to the public sector, such as transportation and repairing.

Domestic liquidity increased by only 3.5 per cent in 1981; it had increased at an annual rate of about 35 per cent during the first half of 1981, but declined during the second half. The main factor behind this pattern was a build up, followed by a decline, in deposits of state enterprises. The increase in domestic liquidity in 1981 was substantially less than the estimated growth rate of 40 per cent in nominal GDP. Factors that may account for this difference include (1) the stability of prices in the public sector where most of the liquidity is held, and (2) indications that the relatively large circulation of foreign currency in the private sector has been increasing further.

During the first half of 1982, total domestic credit remained more or less unchanged as a decline in net credit to the Government was affected by a rise of K 15 million in credit to public enterprises. Despite the substantial increases in official prices that became effective in early 1982, the increase in total domestic credit was relatively modest, mainly because a further reduction of excess inventories by public enterprises at considerably higher prices reduced the need for credit. Credit to the STC rose by only 3.4 per cent during the first half of 1982. Credit to the private sector remained more or less stationary during the first half of 1982, notwithstanding a continued expansion in private sector activity. The slowdown was caused mainly by the private sector's inability to repay past credit, as a result of which the banks have begun requiring additional information and the submission of a work plan for all new credit applications. This new requirement led to a reduction in credit applications and may have resulted in increased nonbank borrowing from Thailand. Domestic liquidity expanded at

Table 13. Laos: Consolidated Balance Sheet of the BNL and BCEL, 1979-82
(In millions of kip; end of period)

	1979 December	1980	1981 June	1981 Dec.	1982 June
Assets					
Foreign assets	270	192	140	139	292
Domestic credit	417	1,034	1,273	1,297	1,313
Government	125	190	190	190	190
Private sector	4	32	43	52	53
Public enterprises	288	812	1,040	1,055	1,070
Of which: SCL	(157)	(564)	(655)	(788)	(815)
Other assets (net)	183	315	282	194	164
Total	870	1,541	1,695	1,630	1,769
Liabilities					
Foreign liabilities	499	619	614	653	649 1/
Short-term	8	22	24	23	44
Letters of credit	56	123	64	66	70
Long-term	9	97	97	97	97
International organizations	33	374	426	464	435
Other	2	3	3	3	3
Foreign currency deposits	14	19	4	10	10
Demand deposits	253	736	902	788	870
Government	66	135	175	172	183
Private sector	18	82	71	65	77
Public enterprises	169	519	656	551	610
Savings deposits	4	10	10	10	9
Currency in circulation	100	157	165	169	231
Total	870	1,541	1,695	1,630	1,769

Source: Data provided by the Lao authorities.

1/ Not all foreign liabilities have been recorded at the new exchange rate of K 35 per U.S. dollar.

an annual rate of 17 per cent during the first half of 1982. Currency in circulation increased significantly, because of the rise in civil service salaries that became effective during the first half of 1982.

2. Interest rates

The structure and level of interest rates have not been changed since June 1979, and real rates of interest have been negative by a substantial margin (Table 14). In combination with noneconomic considerations, this situation has kept domestic savings deposits at a low level that has remained unchanged since end-1980. The demand for bank credit originates mostly from the public enterprises; credit is allocated to that sector on the basis of annual production plans rather than on the basis of the cost of credit and the financial return on investment. Therefore, the rate of interest has probably little impact on the demand for credit and credit outstanding. Although the demand for bank credit by the private sector is certainly more cost-sensitive, a preference for confidentiality and limited investment possibilities are probably still the most important determinants of private sector demand for credit.

In conjunction with recent moves toward a price structure that reflects production costs and relative scarcities, the authorities have also initiated a study on interest rate policy. The results of this study could lead to a change in the structure and level of interest rates during the course of 1983

Table 14. Laos. Interest Rates, 1979-82

(In per cent)

	Until June 1979	Since June 1979
Deposit rates		
Saving deposits	1.2	3.6
Time deposits		
1 year	3.6	7.2
6 months	3.6	4.0
3 months	3.6	5.0
Lending rates		
For agriculture, industry, and transportation		
Short-term	6.0	4.8
Long-term	3.0	3.0
For trade		
Private	...	12.0
Public	12.0	7.2

Source. Data provided by the Lao authorities.

VII. Balance of Payments

1. Background and overall developments

Balance of payments developments have been marked by a deteriorating current account and, although considerable external assistance in the form of both grants and loans has been made available to Laos, overall balance of payments deficits were incurred in both 1980 and 1981. External assistance from the nonconvertible area has assumed growing importance, as have trade relations with that area in general.

The major factor underlying the current account deficits, which, on average, were equivalent to some 15 per cent of GDP in the 1979-81 period, has been the structural weakness of the export sector. This has resulted mainly from insufficient price and other incentives in the production of traditional export commodities as well as policies aimed at giving the state a monopoly over certain exports, through the creation of the SCL. Other important factors have been a poor transportation system and frequent closures of the border between Laos and Thailand. In the recent past, attempts have been made to improve export performance, the kip was devalued in early 1980 and again in early 1982, producer prices for exportable commodities, timber and coffee in particular, were increased, and private sector economic activities were liberalized. The impact of the poor export performance has been compounded by Laos' substantial import needs. Although the country's reliance on food imports, especially of rice, has diminished over the past two or three years, the development effort has necessitated heavy reliance on imports of raw materials, capital equipment and petroleum.

In 1980, the overall balance of payments weakened considerably and registered a deficit of US\$11 million, compared with a surplus of US\$6.6 million in 1979 (Table 15). This was largely attributable to a decline in official exports to the convertible area and a sharp rise in import payments; external assistance remained largely unchanged. The overall deficit was financed by a reduction in reserves.

In 1981, the overall balance of payments position showed some improvement, recording a deficit of US\$5.8 million. Official export earnings revived by about 44 per cent to their 1979 level of US\$19 million, while official import payments remained more or less the same at about US\$90 million. The improvement in exports was exclusively due to higher revenues from sales of electricity to Thailand (electricity prices had been tripled on October 1) and increased exports to socialist countries under the bilateral clearing arrangements. Exports of traditional commodities continued to stagnate, partly as a result of the closure of the trading points along the Lao-Thai border from February to April 1981. Imports were affected by the general scarcity of foreign exchange, following the enlarged overall deficit in 1980, and the border closure with Thailand. Nonaid imports from the convertible area were reduced from US\$42 million in 1980 to US\$36 million, reflecting mostly a decline in imports of food. As a result, the current account deficit was contained to US\$92 million, equivalent to 12 per cent of GDP, compared with US\$103 million, or 20 per cent of GDP, in 1980.

Table 15. Laos: Balance of Payments, 1979-82

(In millions of U.S. dollars)

	1979	1980	1981	1982 Jan.-June	1982 Plan
Merchandise trade	-50.9	-78.8	-70.8	-51.6	-73.1
Exports (f.o.b.)	19.4	13.5	19.4	18.0	47.8
To the convertible area	19.4	13.5	14.0	11.8	29.9
To the nonconvertible area <u>1/</u>	...	...	5.4	6.2	17.9
Imports (c.i.f.)	-70.3	-92.3	-90.2	-69.6	-130.9
Non-aid imports from convertible area	-20.3	-42.0	-36.2	-21.3	-35.9
Imports from nonconvertible area <u>1/</u>	-4.1	-4.7	-13.8	-18.3	-35.0
Imports under aid programs <u>2/</u>	-45.9	-45.6	-40.2	-30.0	-50.0
Services (net)	-21.2	-24.2	-20.8	-8.3	-21.1
Receipts	7.4	7.5	14.5	9.0	16.0
Payments	-28.6	-31.7	-35.3	-17.3	-37.1
Interest	-2.1	-1.8	-2.0	-1.3	-2.1
Technical assistance	-25.0	-27.9	-28.0	-15.0	-30.0
Other	-1.5	-2.0	-5.3	-1.0	-5.0
Current account balance	<u>-72.1</u>	<u>-103.0</u>	<u>-91.6</u>	<u>-59.9</u>	<u>-94.2</u>
Capital and transfers (net)	80.7	83.8	86.9	56.2	95.7
Import aid	50.0	50.3	58.6	52.1	77.1
Commodity aid	(...)	(15.3)	(...)	(...)	(...)
Project aid	(...)	(35.0)	(...)	(...)	(...)
Technical assistance	25.0	27.9	28.0	15.0	30.0
Amortization	-1.9	-1.3	-2.4	-0.9	-1.4
Trust Fund	5.0	4.3	0.1	--	--
SDR allocation	2.6	2.6	2.6	--	--
Short-term capital and errors and omissions	<u>-2.0</u>	<u>8.2</u>	<u>-1.1</u>	<u>3.5</u>	<u>--</u>
Overall balance	<u>6.6</u>	<u>-11.0</u>	<u>-5.8</u>	<u>-0.2</u>	<u>1.5</u>
Change in reserves (increase -)	-6.6	11.0	5.8	0.2	-1.5
Assets (increase -)	-4.6	12.0	0.5	1.1	...
Liabilities (decrease -)	-2.0	-1.0	5.3	-0.9	...

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

1/ Under clearing agreements.

2/ Includes both the convertible and the nonconvertible areas.

The balance of payments prospects for 1982 point to a small overall surplus. In the first six months of the year, the overall balance of payments was almost in equilibrium. With the increase in electricity prices now having their full effect, official exports to the convertible area reached nearly US\$12 million in the January-June period. Exports to the nonconvertible area were also quite buoyant and reached more than US\$6 million. This improved performance has permitted a sharp rise in nonaid imports from the convertible area; there have also been increases in aid-financed imports and imports under the clearing arrangements. For the year as a whole, both export receipts and import payments are anticipated to be markedly higher than in 1981. A significant widening of the current account deficit to an estimated US\$96 million, or 24 per cent of GDP, is projected for 1982. But with external assistance projected to rise to US\$96 million, a small balance of payments surplus of US\$2 million may be registered.

Laos' balance of payments records only international transactions of the official state sector. In 1979, the private sector and provincial authorities were permitted to import and export; the substantial improvement in the domestic availability of numerous imports suggest that this private trade has expanded very rapidly since then. In April 1981, the STC was given a monopoly over the exporting of six essential products and the importing of a specific list of commodities, including rice, sugar, building materials, spare parts, and equipment. All other products may be freely traded by the private sector and the provincial authorities. There are no reliable data on the transactions that are conducted outside the official state sector.

2. The current account

a. Export

The most noteworthy feature of Laos' export sector in recent years has been the disappointing growth in official, traditional exports, such as wood and wood products, tin, and coffee, that are directed to the convertible area. While to some extent this has been the result of weakening international prices, a more important cause has been failure to provide adequate incentives to local producers combined with the authorities' desire to ensure that all exports are undertaken by the STC which, however, is lacking technical and managerial expertise. Forestry products other than timber have been particularly affected by these policies, with official exports virtually disappearing by 1981. More generally, transportation and distribution problems as well as frequent border closures have also been important factors. In addition, a growing share of exports which had been traditionally sold for cash in convertible currencies are now being directed to CMEA countries under the annually negotiated bilateral clearing arrangements.

A recognition by the Lao authorities of the need for a dynamic export sector has prompted some recent measures designed to stimulate products for exports. Effective January 1982, official exports and imports

were valued at a rate of K 35 per US\$1, compared with a rate of K 10 prior to that date, producer prices for timber and coffee have been raised significantly over the past two years--although a substantial gap remains between these prices and world market prices--and local authorities have been permitted to negotiate procurement prices of exportable products with private producers.

Exports to the convertible area declined by about 30 per cent in 1980, due largely to a sharp fall in coffee and timber exports (Table 16). This was in part a result of the closure of the border with Thailand for two months in mid-1980 and to the opening of only one border point near Vientiane thereafter. Export receipts from the convertible area remained depressed in 1981 at about their 1980 level. Timber exports declined further, and there were virtually no cash export sales of coffee; however, the overall value of exports was sustained by increased revenue from the sale of electricity to Thailand. The fall in coffee exports to the convertible area was due to a sharp rise in shipments to socialist countries under the bilateral clearing arrangements, the decline in timber exports resulted from difficulties with traders in Thailand, particularly over appropriate prices, and from the Government's rescinding previous rights of the private sector and provincial authorities to exploit and export timber. The export price of electricity was tripled effective October 1, 1981, bringing export receipts from electricity from US\$5.3 million in 1980 to US\$7.9 million in 1981. Total export receipts were buoyed by sales of traditional commodities to socialist countries at prices generally comparable to world market prices.^{1/}

Data on exports for the first six months of 1982 follow the pattern established in 1981. With the exception of electricity, there have been virtually no merchandise exports to the convertible area except for a small quantity of timber. The poor performance of timber exports was attributable to a reluctance on the part of the STC to sell timber against low prices. Currently, negotiated prices for sawn Lao logs in Thailand are about two thirds of world market prices for comparable hard woods. Out of total exports of US\$11.8 million, electricity exports amounted to US\$10.2 million. With petroleum imports now amounting to about US\$17 million a year, the sharp increase in earnings from electricity exports has resulted in a substantial improvement in Laos' energy balance. While in 1980, this balance recorded a deficit estimated at US\$7.6 million, a surplus of about US\$6 million is projected for 1982. Exports to the nonconvertible area increased sharply, reaching US\$6.2 million and increasing total official exports to some US\$18 million.

^{1/} Beginning in 1981, the valuation of trade flows between Laos and the CMEA countries has been made on the basis of a three-year moving average of world market prices of the commodities being traded.

Table 16. Laos: Composition of Official Exports, 1979-82

(In millions of U.S. dollars)

	1979	1980	1981	1982 Jan.-June	1982 Proj.
Exports to the convertible area	19.4	13.5	14.0	11.8	29.9
Timber	8.5	6.1	5.1	1.6	5.9
Tin	0.2	0.5	0.4	--	--
Coffee	4.1	1.1	--	--	1.2
Forestry products	0.2	0.2	--	--	0.1
Hydroelectric power	6.1	5.3	7.9	10.2	22.5
Other exports	0.3	0.3	0.6	--	0.2
Exports to the non-convertible area <u>1/</u>	...	..	5.4	6.2	17.9
Total official exports	19.4	13.5	19.4	18.0	47.8

Source: Data provided by the Lao authorities.

1/ Under clearing arrangements.

Prospects for the remainder of 1982 appear, on the whole, more favorable. Substantial timber stocks have accumulated following legislation introduced in 1981 banning the sales of unprocessed timber, and the authorities have recently signed contracts for exporting part of these stocks. Receipts from electricity sales will remain buoyant, and sales of coffee are also expected to show some revival. For the year as a whole, exports to the convertible area are projected at about US\$30 million, and to the nonconvertible area at about US\$18 million.

The evolution of exports since 1980 illustrates the growing importance of the CMEA group of countries in the pattern of Laos' trading arrangements. Until 1980, bilateral trade agreements with these countries allowed wide imbalances, and virtually all Lao exports were directed to the convertible area, such imbalances (excluding project-related imports and technical assistance) were financed through long-term credit. However, starting in 1981, merchandise trade with most CMEA countries has been subject to more stringent arrangements. In 1981, Laos entered into five-year bilateral clearing arrangements with certain CMEA members, which are implemented through annual protocols. Under these five-year agreements, there are annual limits on the deficits which Laos can incur in its transactions with these countries and these deficits are to be settled

through trade transactions within six months starting at the end of the year during which they developed. However, it is possible that any remaining imbalances be converted into long-term loans (30 years, at an interest rate of 2 per cent per annum). The deficit Laos incurred vis-a-vis CMEA countries amounted to the equivalent of US\$8.4 million in 1981. It appears that this deficit will widen substantially in 1982, possibly to the equivalent of some US\$27 million.

b. Imports

With virtually no domestic manufacturing capacity, Laos is heavily dependent on imports of capital goods and consumer commodities. Prior to 1981, imports of foodstuffs were necessary to supplement domestic rice production; rice imports have, however, been eliminated due to more successful harvests. Mos. of Laos' imports have been financed through foreign grants and loans, especially machinery and equipment related to projects. Certain commodity imports, such as petroleum, cereals, and sugar were provided by the CMEA countries as commodity aid until 1981. Since then, these imports have taken place under the clearing arrangements. Some countries from the convertible area have also provided commodity assistance, mostly in the form of grants. Nonaid imports from the convertible area have mainly comprised certain foodstuffs, raw materials, petroleum and, increasingly, consumer goods for distribution as incentives to farmers.

The decline in total official imports in 1981 was entirely attributable to the fall in nonaid imports from the convertible area, from US\$42 million in 1980 to US\$36 million (Table 17). Payments for capital equipment and raw materials remained largely unchanged but payments for foodstuffs declined sharply. In addition to the more abundant rice harvests of 1980 and 1981, this decline reflected a return to normal levels following the decision in 1980 to increase imports of certain foodstuffs to barter against locally produced paddy. Imports from the nonconvertible area under clearing arrangements grew sharply, from US\$5 million in 1980 to US\$14 million. By contrast, imports financed under aid programs, at US\$40 million, were slightly lower than in 1980, implying some further reduction in real terms. This decline resulted from the absence of any new loan commitments from the convertible area and the full utilization of existing loan agreements. Disbursements for projects from multilateral agencies were also sharply reduced, reflecting domestic obstacles to the implementation of certain projects and the closure of the border between Laos and Thailand.

In the first half of 1982, total official imports rose sharply to attain approximately US\$70 million. Nonaid imports from the convertible area amounted to US\$21 million, and imports from the nonconvertible area under clearing arrangements to over US\$18 million. Aid-financed imports rose to an estimated US\$30 million, due to an intensification of the implementation of three main projects. a project to construct a university center; the continuation of work on Route No. 9, and a cooperative project with Hungary in the agricultural sector. For the year as a whole,

Table 17. Laos: Composition of Official Imports, 1979-82

(In millions of U.S. dollars)

	1979	1980	1981	1982 Jan.-June	1982 Proj.
Non-aid imports from the convertible area	<u>20.3</u>	<u>42.0</u>	<u>36.2</u>	<u>21.3</u>	<u>35.9</u>
Rice and other foodstuffs	1.3	10.7	2.0	0.4	1.6
Petroleum products	8.8	12.9	12.9	7.5	12.0
Machinery and raw materials	1.8	11.1)		7.8)	
Other imports	8.4	7.3)	21.3	5.6)	22.3
Imports from the non-convertible area 1/ Of which: credit financed	<u>4.1</u> (<u>4.1</u>)	<u>4.7</u> (<u>4.7</u>)	<u>13.8</u> (<u>8.4</u>)	<u>18.3</u> (<u>22.1</u>)	<u>35.0</u> (<u>27.1</u>)
Imports under aid programs 2/	<u>45.9</u>	<u>45.6</u>	<u>40.2</u>	<u>30.0</u>	<u>50.0</u>
Convertible area	...	8.0	...	...	...
Nonconvertible area	...	37.6	...	...	...
Total official imports	<u>70.3</u>	<u>92.3</u>	<u>90.2</u>	<u>69.6</u>	<u>120.9</u>

Source: Data provided by the Lao authorities.

1/ Includes imports financed by credit under clearing agreements with CMEA countries.

2/ Partially estimated data.

it is anticipated that total official imports will reach US\$121 million. There are likely to be further increases in imports from the convertible area and substantial imports from the nonconvertible area; the latter are projected to attain around US\$35 million and are estimated to include US\$5 million for petroleum products. In addition, it is expected that aid-financed imports will exceed their 1981 level.

c. Services

Net service payments in 1981 amounted to about US\$21 million, slightly down from the US\$24 million recorded in 1980. Underlying this marginal improvement was a sharp rise in service receipts from US\$7.5 million to US\$14.5 million. The major sources of foreign exchange earnings in the service sector have been sales of foreign currency to the BCEL by embassies and tourists, interest earnings on official foreign exchange reserves, communications and transportation earnings, and overflight fees. The rise in receipts in 1981 resulted mainly from an improvement in the collection from state enterprises and ministries, and from an increase in expenditure by diplomatic missions and foreign visitors. Overflight fees at some US\$3.5 million were little changed from the previous year. On the expenditure side, the major item is payments for foreign technical assistance, estimated at about US\$28 million in 1981. Other important items are interest payments on external debt and government expenditure abroad, the latter has been rising steadily. Over the first six months of 1982 the rising trend in service receipts has continued, but the net position for the year as a whole is not anticipated to show much change from 1981.

3. The capital account

The persistence of large current account imbalances has necessitated continued reliance on external assistance.^{1/} Since 1976, loans from the nonconvertible area have been the most important source of external assistance. Typically, these loans carry very long maturities with generous grace periods and low rates of interest. In addition to commodity and project loans, the nonconvertible area has also provided technical assistance and financing for trade imbalances under the clearing agreements. With the prospect of the imbalance under these agreements widening in 1982 and beyond, this form of financing is likely to assume growing importance, while commodity assistance is rapidly being phased out.

In recent years, bilateral loans from the convertible area have been only modest. There were no new commitments from these bilateral creditors in both 1980 and 1981, and most loans, which were contracted prior to 1976, have now been fully utilized; disbursements in 1980 amounted to only US\$0.6 million, and there were no disbursements in 1981 and 1982. Grants from the convertible area have, however, been substantial, amounting to US\$23 million in 1981, and are expected to be of the same

^{1/} Due to data limitations it is not possible to provide a clear distinction between loans and grants in the balance of payments.

order in 1982. The main donors have been Sweden, the Netherlands, and Japan, as well as the UNDP. New loan commitments by multilateral agencies and OPEC have also been significant, amounting to US\$19 million in 1980 and US\$23 million in 1981. Disbursements amounted to US\$6.4 million in 1981, and a similar amount is expected to be disbursed in 1982. Laos also benefited from disbursements under the Trust Fund.

4. International reserves

Gross international reserves declined from US\$26 million at the end of 1979 to US\$14 million at the end of 1980, equivalent to about three-and-a-half months of nonaid imports and less than two months of total official imports (Table 18). The gross reserve position changed little in 1981, and amounted to US\$13.5 million by year-end. There was a further small decline in the first six months of 1982 to US\$12.5 million, equivalent to less than two months of nonaid imports and about one month of total official imports. The liabilities in convertible currencies of the banking system consist only of liabilities to the Fund. They declined in 1980 due to net repurchases. However, net purchases from the Fund in 1981 increased external liabilities to the equivalent of US\$15 million at year-end, they have remained approximately constant since that date.

5. External debt

At the end of 1981, external public and publicly guaranteed debt amounted to an estimated US\$312 million, including two Trust Fund Loans totaling US\$15.8 million (Table 19). Of this amount, US\$192 million represented indebtedness to the nonconvertible area. In general, loans from this area bear either zero or very low rates of interest, have long maturity periods of up to 40 years, and grace periods of up to 10 years. Indebtedness to the convertible area, including the Trust Fund loans, amounted to some US\$120 million, of which US\$71 million was provided by bilateral sources and the bulk of the remainder from multilateral institutions, particularly the Asian Development Bank and IDA. There were no new bilateral loan commitments from the convertible area in 1981 and no further disbursements, as outstanding commitments had been fully utilized. There were three new commitments from multilateral institutions, US\$15 million from the IDA, US\$4.3 million from the AsDB and US\$4 million from the OPEC fund. Disbursements from multilateral sources amounted to US\$6.4 million in 1981 and have amounted to US\$3 million so far in 1982.

The maturity structure and relatively low interest rates on loans contracted in recent years, especially since 1976, have resulted in relatively low debt service payments even in relation to the poor performance of exports. Debt service payments in 1981 amounted to only US\$4.4 million, equivalent to about 13 per cent of exports of goods and services, and are expected to fall slightly to about US\$3.5 million in 1982, equivalent to 5 per cent of export earnings (Table 20). This decline in dollar terms is principally due to the recent strength of the U.S. dollar as many of the loans are denominated in other currencies.

Table 18. Laos: International Reserves, 1979-82

(In millions of U.S. dollars; end of period)

	1979	1980	1981				1982	
	December	December	March	June	Sept.	Dec.	March	June
Gold	0.70	0.82	0.88	0.88	0.88	0.88	0.88	0.88
Foreign exchange	24.31	13.21	9.81	10.57	10.16	12.09	13.63	11.21
SDRs	1.05	0.01	--	0.92	0.32	0.56	0.35	0.35
IMF reserve position	--	--	--	--	--	--	--	--
Gross reserves	26.06	14.04	10.69	12.37	11.36	13.53	14.86	12.44
External liquid liabilities <u>1/</u>	11.85	10.97	9.58	11.39	14.77	15.02	14.36	14.09
Net official reserves	14.21	3.07	1.11	0.98	-3.4	-1.49	0.50	-1.65

Sources: Data provided by Lao authorities; and IMF, International Financial Statistics.

1/ The banking system has no external liabilities in convertible currencies other than the use of IMF credit.

Table 19. Laos: External Public Debt, 1981-82

(In millions of U.S. dollars)

	Outstanding at Dec. 31, 1981		1981		1982	
	Com- mitted	Dis- bursed	Disburse- ments	New commit- ments	January Disburse- ments	June Commit- ments
Suppliers' credits	<u>3.0</u>	<u>3.0</u>	--	--	--	--
Multilateral loans	<u>104.3</u>	<u>31.3</u>	<u>6.4</u>	<u>23.3</u>	<u>3.1</u>	--
AsDB	<u>35.8</u>	<u>12.1</u>	<u>0.8</u>	<u>4.3</u>	<u>1.7</u>	--
EEC	2.7	0.6	0.4	--	--	--
IFAD	6.1	0.2	0.1	--	--	--
IDA	47.0	11.5	5.1	15.0	1.0	...
OPEC	12.7	6.9	--	4.0	0.4	--
Bilateral loans						
Convertible area	<u>70.5</u>	<u>70.5</u>	--	--	--	--
France	<u>10.1</u>	<u>10.1</u>	--	--	--	--
Germany	35.8	35.8	--	--	--	--
Indonesia	1.0	1.0	--	--	--	--
Japan	23.6	23.6	--	--	--	--
Nonconvertible area	<u>...</u>	<u>191.8</u>	<u>39.1</u>	<u>...</u>	<u>30.7</u>	<u>...</u>
Trust Fund	<u>15.8</u>	<u>15.8</u>	<u>0.1</u>	--	--	--
Total	193.6 <u>1/</u>	312.4	45.6	23.3 <u>1/</u>	33.8	-- <u>1/</u>

Source: Data provided by the Lao authorities.

1/ Excluding nonconvertible area.

Table 20. Laos: External Debt Service, 1979-82

(In millions of U.S. dollars)

	1979	1980	1981	1982
Debt service	3.98	3.07	4.40	3.45
Principal	(1.90)	(1.26)	(2.45)	(1.40)
Interest	(2.08)	(1.81)	(1.95)	(2.05)
Suppliers' credits	0.35	--	0.63	--
Principal	(0.26)	(--)	(0.19)	(--)
Interest	(0.09)	(--)	(0.44)	(--)
Multilateral loans	1.10	1.03	1.24	1.60
Principal	(0.21)	(0.25)	(0.25)	(0.41)
Interest <u>1/</u>	(0.89)	(0.78)	(0.99)	(1.19)
Bilateral loans				
Convertible area	2.53	2.04	2.47	1.85
Principal	(1.43)	(1.01)	(1.95)	(0.99)
Interest	(1.10)	(1.03)	(0.52)	(0.86)
Nonconvertible area	...	...	0.06	--
Principal	(...)	(...)	(0.06)	(--)
Interest	(...)	(...)	(...)	(--)
<u>Memorandum item:</u>				
Debt service payments as per cent of exports of goods and services	14.9	14.6	12.9	5.4

Source: Data provided by the Lao authorities.

1/ Including Fund charges.

6. The exchange and payments system

The currency of the Lao People's Democratic Republic is the kip (K). In early January 1980, the official exchange rate was devalued from K 4 to K 10 per U.S. dollar. Over the course of the past several years, a parallel market in foreign exchange has developed. This has resulted from the general restrictiveness of the exchange and payments system and the low level of official reserves. This market has been supplied by the growing numbers of expatriates in Laos receiving salaries in foreign currencies, unofficial border trade with Thailand, and local payments made in foreign currency by foreign buyers of official exports. The exchange rate in the parallel market has depreciated steadily, and by mid-1981 stood at about K 40 per U.S. dollar, compared with an average of about K 22 per U.S. dollar in 1980. In order to attract foreign exchange from the parallel market into official channels, a periodically determined exchange premium giving rise to a preferential rate was introduced in December 1979 for transactions with tourists and embassies and for inward remittances. This preferential rate was K 30 per U.S. dollar on June 1, 1981.

Throughout the second half of 1981 and in early 1982, the exchange rate on the parallel market continued to weaken. In response to this widening differential, the preferential exchange rate was depreciated from K 30 to K 35 per U.S. dollar in early 1982, and this new rate was made applicable to all official transactions, including official imports and exports that had previously been transacted at the official rate of K 10 per U.S. dollar. The official rate is now used only for customs valuation purposes.

Since the beginning of 1982, the exchange rate in the parallel market has declined sharply and reached K 105 per U.S. dollar by August. Factors that have contributed to this development include a decline in private receipts for services to Thai timber traders, following the slowdown of official timber exports, and a recent decision by official shops to accept only foreign currency in payment for imported consumer goods.

In general, Laos' trade and payments system remains highly restrictive.^{1/} Restrictions are in effect on current transfers and payments for services. Laos has bilateral payments arrangements with the USSR, Bulgaria, Czechoslovakia, the German Democratic Republic, and with two Fund members, Viet Nam and Hungary. Imports by the private sector may be undertaken provided that importers possess foreign exchange of their own. Payments may be made through Lao banks who will arrange the necessary letters of credit. However, only a limited number of private sector importers are permitted to hold foreign exchange accounts with the banking system.

^{1/} A detailed description of the system is contained in the IMF's Annual Report on Exchange Arrangements and Exchange Restrictions for 1982.

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