**FOR AGENDA**

SM/07/271

July 20, 2007

To: Members of the Executive Board

From: The Secretary

Subject: **Lao People's Democratic Republic—Staff Report for the 2007 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 2007 Article IV consultation with the Lao People's Democratic Republic, which is tentatively scheduled for discussion on **Friday, August 3, 2007**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of the Lao People's Democratic Republic indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. Valdivieso (ext. 34705) and Mr. Ishi (ext. 38034) in APD.

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

This document, together with a supplement providing an informational annex, will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. The supplement, which is not being distributed in hard copy, will also be available in the Institutional Repository; a link can be found in the daily list (http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm) for the issuance date shown above.

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LAO PEOPLE'S DEMOCRATIC REPUBLIC

# Staff Report for the 2007 Article IV Consultation

Prepared by the Staff Representatives for the 2007 Consultation
With the Lao People's Democratic Republic

Approved by Masahiko Takeda and Anthony Boote

July 19, 2007

- **The 2007 Article IV Consultation discussions were held in Vientiane during April 25–May 9, 2007.** The staff team comprised Messrs. Valdivieso (Head) and Ishi, Ms. Mitra (all APD), Mr. Zhan (PDR), Mr. McPherson (FAD), and Mr. Beaugrand (Resident Representative). Ms. Sucharitakul and Mr. Sitthilath (both OED) and Ms. Zekrya (World Bank, for Joint Debt Sustainability Analysis) also attended meetings.

- **The team met with** Finance Minister Chansy Phosikham, Bank of Lao P.D.R. Governor Phouphet Khamphounvong, Industry and Commerce Minister Nam Viyaket, Natonal Assembly Chairman of the Economy and Finance Committee Khamsing Sayakone, other senior government officials and representatives of the donor and business communities.

- **Response to Fund policy Advice:** The staff has been supportive of the authorities' policy priorities but their response to past Fund policy advice has been mixed (Appendix I). The last Article IV Consultation was concluded on March 8, 2006. Executive Directors' views can be found in http://www.imf.org/external/np/sec/pn/2006/pn0631.htm.

- **Exchange and trade regime.** Lao P.D.R. maintains restrictions for the preservation of national or international security notified pursuant to Decision No. 144-(52/51), and a restriction subject to Fund approval under Article VIII (tax payment certificates are required for some current account transactions). Staff does not recommend approval of the latter and has advised the authorities to eliminate it before accepting the obligations under Article VIII. They intend to consider its removal during the WTO accession process (Informational Annexes).

- **Statistics are very weak.** Significant improvements are required in the collection, compilation, and dissemination of data on the balance of payments, external debt, SOEs financial statements, provincial fiscal operations, national income accounts, and banking soundness indicators (Informational Annexes).

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## EXECUTIVE SUMMARY

**Lao P.D.R.'s economic performance continues to be strong, but progress on structural reform has been mixed**. Growth is robust and increasingly reliant on large export oriented mining and hydropower projects. Inflation has declined to historical lows, reserves have risen rapidly, and poverty has declined. Progress on reforms has been hampered by slow implementation of key reforms. The outlook is promising, but the outcome depends on the government's policy response to the emerging resource bonanza.

### Policy Challenges and Discussions

***Challenge: Sustaining macroeconomic stability***

- ***Fiscal policy.*** The authorities are committed to fiscal consolidation and debt sustainability over the medium term. However, the draft 2007/08 budget, approved almost two months after the mission ended, departs from the prudent stance of the last two years. Staff believes there is room for correction and is urging the authorities to act. Looking ahead, the announced medium-term policies (introduction of a VAT, and reform of the revenue and expenditure management and intergovernmental relations) should help achieve fiscal consolidation. Expenditure decisions need to be taken within a yet to be developed integrated fiscal framework that accounts for resource revenue volatility.

- ***Monetary policy:*** Pressures on monetary expansion from rising reserves are likely to continue, posing a risk to inflation. The authorities intend to keep money growth under control, counting on a further reduction in the domestic financing of the deficit. In addition, staff advised the Bank of Lao P.D.R. (BoL) not to relax prudential requirements to expand credit to the private sector, and to introduce a standing deposit facility (remunerated banks' deposits) to mop up liquidity, until other market-based instruments and the interbank market are developed.

- ***Exchange rate policy:*** The managed float regime has worked well and the nominal exchange rate level is in line with macroeconomic fundamentals. The authorities will allow market conditions to prevail despite concerns about volatility. They plan to develop the interbank foreign exchange market.

***Challenge: Managing resource revenues in support of growth and poverty reduction.*** There is an urgent need for expert advice to help develop a sound and transparent regime as an integral part of a medium-term fiscal framework.

***Challenge: Broadening the Sources of Growth***. There is a need for a renewed impetus on economic reform, especially to accelerate the restructuring of the state-owned banks and enterprises, and improving the investment climate. This together with sustained efforts to achieve greater trade integration should help raise and sustain broad-based growth.

## I. INTRODUCTION

1. **In recent years, Lao P.D.R. has recorded a strong economic performance, but progress on structural reform has been mixed**. Growth has been robust, inflation has declined markedly, international reserves have risen, and poverty has declined.[1] Of notice is the increasing role of the export-oriented large mining and hydropower projects (the resource sector), which have helped to strengthen public finances and the balance of payments. So far, the resource sector has not had visible adverse macroeconomic effects, mainly because resource-related foreign exchange inflows have been substantially offset by imports for large resource projects and net imports from the non-resource sector. However, some pressures are building up, particularly on monetary growth and exchange rate appreciation, as the resource sector's net inflows outpaced the net imports of the non-resource sector. It follows that the full economic impact of the newly emerging resource sector is yet to be seen, and it could become either a blessing or a curse depending on the government's policy response and reform effort.

## II. RECENT DEVELOPMENTS

2. **Macroeconomic performance remains strong.**

- Real GDP growth (7½ percent in 2006) continued to be robust, driven by the resource sector. Non-resource sector growth remains moderate (4½–5 percent), but there are signs of an incipient slowdown, including a slower growth of non-resource imports and a decline in credit to the private sector.

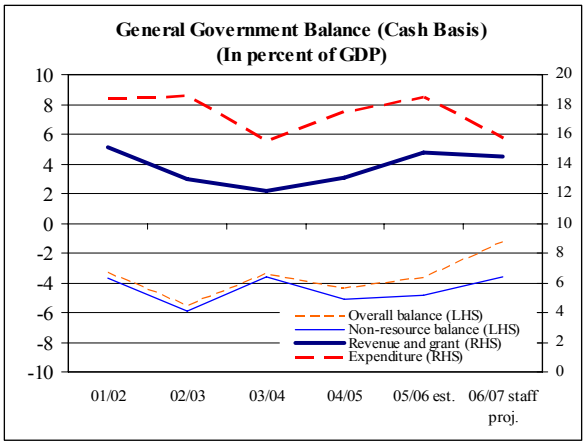
- Headline and core inflation declined to historical lows (3½ and 2 percent y-o-y in June 2007), reflecting favorable oil and food prices, and the appreciation of the kip.

- The current account deficit narrowed markedly in 2006. Strong resource exports and tourism receipts partially offset high imports led by petroleum products and construction materials. This, combined with high FDI and ODA inflows, resulted in a substantial surplus. These trends continued, and by end-June 2007 gross international reserves reached $460 million (4.6 months of non-resource imports and 62 percent of foreign currency liabilities, including deposits), reflecting partly sizable mining-related tax payments.

3. **Fiscal performance strengthened, contributing to lower demand pressures**.

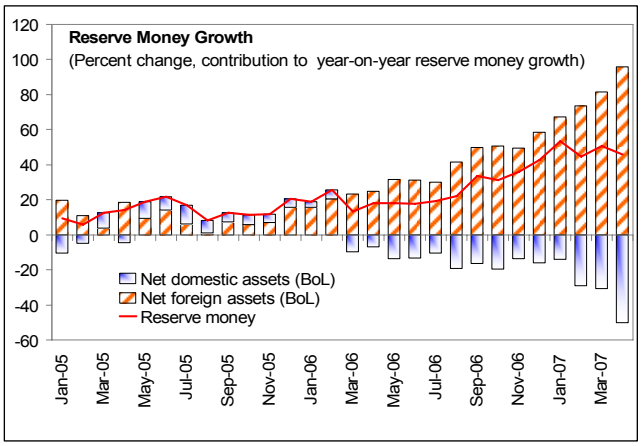
[1] Poverty indicators are presented in Appendix II.

- In 2005/06,[2] the overall cash deficit declined to 3¾ percent of GDP (4½ percent in 2004/05), while the non-resource deficit (overall balance minus resource revenues) remained at 5 percent of GDP. Strong revenues and contained domestic expenditure led to a decline in net domestic financing of about 1½ percent of GDP (equivalent to all resource revenues). Net external financing and grants increased allowing a corresponding rise in investment. Substantial domestic outlays were reportedly carried over to 2006/07, but there is no precise record.



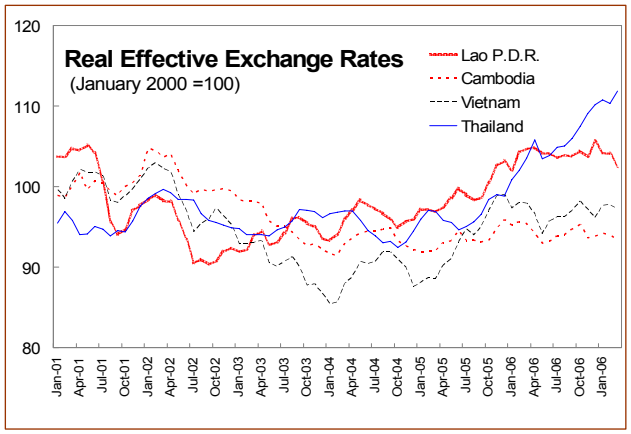

- In the first eight months of 2006/07, revenues continued to perform strongly, led by resources revenues. Domestic expenditures were in line with the yearly target. Altogether, there was an overall cash surplus and a low non-resource deficit. Net domestic financing continued to decline (equivalent to almost 90 percent of resource revenues). However, external financing and grants were significantly below the annual target.

4. **Monetary expansion has accelerated markedly and risks fueling inflation.** Reserve and broad money growth, which had reached 38 and 30 percent by end 2006, accelerated to 45 and 39 percent by end-May 2007. Monetary expansion has been driven by rapidly rising official international reserves. The improved fiscal position helped reduce the BoL net domestic assets (NDA). With credit to the private sector continuing to dwindle, the banking system net domestic assets also declined.




[2] The fiscal year ends on September 30.

5. **The real effective exchange rate has broadly stabilized after a sustained, albeit moderate appreciation**. The kip nominal exchange rate continued to appreciate against the U.S. dollar but it has depreciated against the Thai baht in 2006. This, combined with a lower inflation rate, contained real appreciation. These trends continued during the first part of 2007. So far, there has not been any visible impact on competitiveness (Box 1).




6. **Progress in key economic reforms has been mixed.**

- **Banking system**: A new commercial banking law became effective in April 2007, but implementing regulations are still under preparation with assistance from the International Finance Corporation. Meanwhile, a domestic private bank and a state-owned commercial bank (SOCB) for policy lending to the agricultural sector started operations, and a reputable international bank has taken a majority stake in a small private bank. Relevant indicators to assess the soundness of the banking system were not available.

- **State-owned commercial banks**. Management changes and prudent lending practices have lowered non-performing loans (NPLs) on new lending and reportedly improved profitability. However, the two major SOCBs still carry high NPLs (about 60 percent of loans) and the plan for their recapitalization has not proceeded as smoothly as anticipated.[3] The Asian Development Bank (ADB) is providing technical assistance.

- **State-owned Enterprises (SOEs).** The 12 largest SOEs undergoing restructuring are together generating profits. However, some of them still make losses, and several remain heavily indebted. They no longer receive direct subsidies, but there was a sizable onlending operation for the national airline company in 2006.

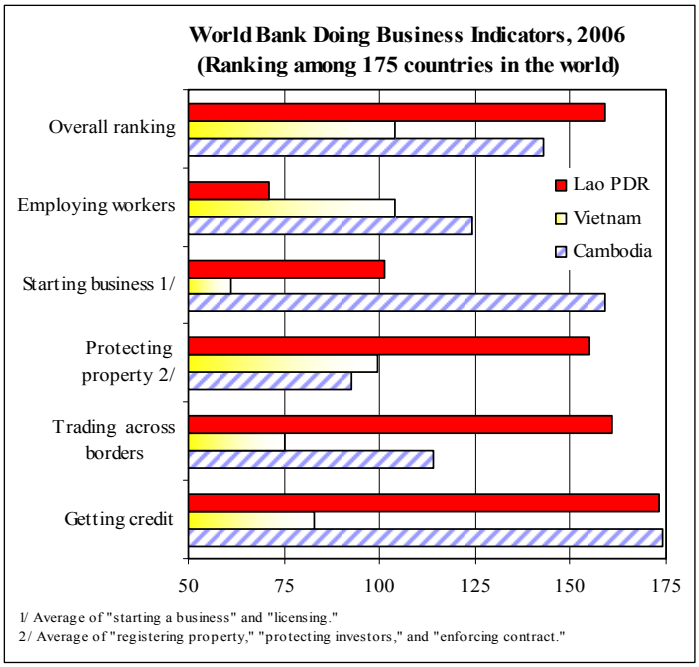
- **Management of public finances.** The 2006 state budget law envisages the centralization of tax, customs, and treasury administration and the reform of inter-governmental fiscal relations. Some changes in revenue assignments are expected to

[3] Half of the SOCBs' capital deficiency (estimated at 4 percent of GDP at end-2005) was to be covered by government recapitalization bonds and the rest by SOCBs' profits or strategic investors. So far, only a third of the bonds has been issued (a second tranche has been authorized but not issued yet). There is no active search for strategic partners.

be implemented in 2007/08,[4] but preparatory work on other components of the law, such as a new expenditure allocation norms, are still under discussion. The World Bank, ADB, and FAD are providing technical guidance. A detailed implementation plan for the introduction of the VAT in late 2008/09 is being crafted. FAD and other donors have provided extensive comments on draft regulations and implementation procedures. Several measures to strengthen public expenditure management have also been taken, including a new chart of accounts, developed with the assistance of the World Bank, which is expected to be fully in place by 2008/09.

7. **Several steps to facilitate trade and improve the investment climate have been taken, but the perception remains that the cost of doing business is high.**

- Tariffs on most imports from AFTA members are being reduced gradually and expected to be below 5 percent by 2008. Preparatory work to join WTO is also in progress.
- The 2005 Enterprise Law, which calls for a registration system (instead of licensing) and a one-stop shop for new business, is yet to be implemented. Similarly, the implementation strategy for the 2004 Policy Framework for Small and Medium Enterprise Development is still under preparation.




## III. Outlook

8. **The economic outlook is promising, but the outcome clearly depends on the government's policy response to the emerging resource bonanza.**

[4] Taxes accruing fully to the central government will now include import duties, turnover and excise taxes on imported goods, and mining taxes. Taxes accruing fully to local authorities will be limited to land and personal income tax. The turnover and excise taxes on domestic goods and the corporate income tax will be shared according to criteria yet to be decided.

- The direct macroeconomic impact of the resource sector is likely to be significant[5]. Staff estimate that the sector could: contribute 3 percentage points to annual GDP growth in the next 5 years and 1 percentage point thereafter; generate an annual average external surplus of 7 percent of GDP in the next five years; and, raise fiscal resource revenues up to about 3 percentage points of GDP in 2008, starting to decline gradually thereafter in line with proven mineral reserves depletion. Revenues from electricity companies will remain subdued (around ½ percent of GDP) over the next decade as their pre-tax profits remain low due to a heavy debt service burden.

- The outlook for the whole economy, however, will be ultimately determined by the supply response of the non-resource sector. Assuming the government adopts sound policies and accelerates reforms to shelter the non-resource sector from an adverse impact of the resource sector (a proactive policy response, see Box 2), staff projects that over the medium-term real GDP annual growth could be sustained at about 6½ percent (increasingly driven by non-resource sector growth), inflation kept below 5 percent, and international reserves strengthened to about 5 months of non-resource imports. Waiting to take policy action until the "resource curse" has set in (a reactive policy response) would eventually raise inflation, reduce investment incentives generally, and weaken international reserves.

9. **There are several risks to the outlook**. Upside risks include additional proven mineral reserves and mine development, and construction of more hydropower plants. Downside risks comprise adverse commodity price shocks, delays in construction of hydropower plants, and relaxation of the stabilization policy stance and significant delays in implementing economic and institutional reforms, particularly in the fiscal area.

10. **In addition, Debt Sustainability Analysis results continue to indicate a high risk of debt distress, although debt service remains manageable (Appendix III)**. The debt outlook is highly sensitive to changes in macroeconomic conditions which, in turn, will depend in part on the policy response. A proactive policy response would bring all debt indicators below the thresholds faster than a reactive policy response, increasing the resilience to shocks. However, under a reactive scenario, a combined shock could even create debt service problems. The debt outlook is also sensitive to the degree of concessionality of newly contracted debt, suggesting that future external financing of the deficit should continue to rely on grants and highly concessional borrowing.

## IV. Policy Discussions

11. Against this background, discussions focused on several policy challenges confronting the authorities, including (i) sustaining macroeconomic stability; (ii) ensuring an

[5] See accompanying Selected Issues Paper, Chapter I.

appropriate and transparent use of resource revenues; and (iii) accelerating banking and SOE reform and broadening the sources of growth.

## A. Sustaining macroeconomic stability

### *Fiscal policy*

12. **The expected fiscal outcome for 2006/07 should continue to help reduce demand pressures.** Staff projects the overall deficit could fall to 1¼ percent of GDP (about 2 percentage points of GDP below this year's target and the 2005/06 outcome), with the non-resource deficit at 3½ percent of GDP (1¼ percentage points lower than 2005/06). Continued high revenues and tight control of domestic expenditures would help reduce net domestic borrowing by about 1¼ percent of GDP (equivalent to about ½ of projected resource revenues). Foreign financed capital expenditure is likely to fall short of target, mainly reflecting optimistic expectations. The authorities agreed with the staff views, but found it prudent not to revise its revenue projections yet. Staff urged the authorities to minimize the outlays carried over into the next fiscal year and to monitor carefully unpaid obligations.

13. **Staff discussed the broad outline of the budget framework for 2007/08 and encouraged the authorities to pursue further consolidation.**

- Staff projects revenues will continue strong, mainly driven by resource revenues. Staff suggested that (i) current expenditures be programmed cautiously (especially wages) aiming to reduce net domestic financing further to help confront a potential revenue impact of commodity price volatility; and (ii) efforts be made to shore up non-resource revenues ahead of the introduction of the VAT, including by avoiding ad hoc exemptions and closely monitoring exemptions under the investment law; reviewing outdated terms of leasing and concession contracts on state property; expediting the process of centralizing administration; and bringing the large taxpayers units in the provinces and the main regional customs offices under central government control. With foreign financed capital expenditures declining further in line with an expected reduction in foreign assistance, the overall deficit could be reduced by about ¾ percent of GDP in 2007/08, with a more gradual reduction in the non-resource deficit.

- The authorities agreed that a stepped-up effort to strengthen tax and customs administration would be required, and indicated they were enhancing their monitoring of exemptions. They noted, however, that centralization is a politically sensitive issue and can only be done gradually. Discussions made it clear that the authorities were trying to find a balance between raising expenditure to attend to long overdue demands (including public wages) and setting aside some of the resource revenues. There is a contingency reserve fund created under the new budget law that could be used for this purpose, but details on its operation were under discussion.

14. **The 2007/08 budget was approved by the National Assembly in early July 2007, two months after the mission ended.** A preliminary assessment indicates that the underlying fiscal policy stance is more expansionary than anticipated. Non-resource revenues are broadly in line with staff projections, but resource revenues are somewhat higher owing mainly to price differences. Current (mostly wages and subsidies) and domestically financed expenditures will increase sharply, appropriating virtually all revenues available. Net domestic financing is expected to decline by the equivalent of about 15 percent of resource revenues. The approved budget, if fully implemented, will exacerbate the country's risk of debt distress. Pending access to more detailed expenditure information, staff believes that lower but better targeted and prioritized subsidies and transfers could make the budget outcome consistent with the authorities' medium term fiscal objectives.

2007/08 Preliminary Budget Plan
(In percent of GDP)

| | 2005/06 | 2006/07 | | 2007/08 | | |
|---|---|---|---|---|---|---|
| | Staff. est. | Budget | Staff est. | Budget prel. 1/ | Staff proj. reactive | Staff proj. proactive |
| Revenue | 12.7 | 12.4 | 13.2 | 13.4 | 13.2 | 13.4 |
| *Of which: resource revenues* | 1.2 | 2.1 | 2.3 | 2.9 | 2.6 | 2.6 |
| Grants | 2.1 | 1.8 | 1.3 | 1.3 | 1.0 | 1.1 |
| Expenditure | 18.5 | 17.8 | 15.7 | 17.5 | 16.3 | 15.1 |
| *Of which: domestically financed expenditure* | 12.6 | 11.5 | 11.3 | 12.2 | 12.4 | 11.1 |
| Current | 9.3 | 9.5 | 9.5 | 9.9 | 10.3 | 9.2 |
| Capital and onlending | 7.5 | 7.4 | 5.2 | 6.4 | 5.1 | 5.0 |
| *Of which: domestically financed* | 1.2 | 1.4 | 1.4 | 1.6 | 1.7 | 1.5 |
| *Of which: foreign financed* | 5.8 | 6.4 | 4.4 | 5.3 | 3.9 | 4.0 |
| Others including contingencies and discrepancies | 1.6 | 1.0 | 1.0 | 1.2 | 0.9 | 0.9 |
| Overall balance | -3.7 | -3.7 | -1.3 | -2.7 | -2.1 | -0.6 |
| Non resource balance | -4.9 | -5.7 | -3.6 | -5.6 | -4.7 | -3.2 |
| Domestic financing | -1.3 | -0.1 | -1.3 | -0.4 | 0.0 | -1.6 |
| Foreign financing | 5.0 | 3.7 | 2.5 | 3.1 | 2.1 | 2.2 |

1/ The National Assembly has approved the gross domestic borrowing based on the aggregate parameters, but the final fiscal numbers are still under discussion.

15. **In discussing the medium term fiscal strategy, the authorities reiterated their commitment to fiscal consolidation and debt sustainability.** Discussions covered the following areas:

- ***Non-resource revenue mobilization.*** The authorities are committed to centralize tax and customs administration and start implementing a VAT in 2008/09. It is important that the VAT be designed to be revenue-enhancing to help offset a possible, albeit moderate, reduction in trade taxes under trade agreements. Staff also suggested to eliminate the discretionary tax relief, align corporate tax rates with those of neighboring countries, and simplify the personal, excise, and land tax structure. The 2007/08 budget includes a general commitment to review the tax system, but only mentions specifically the review of land and property taxes and fees.

- ***Reform on inter-governmental fiscal relations.*** Progress in this area has been encouraging. On current plans, developed with World Bank and other donors' assistance, all shared revenues will be pooled and put under central administration management and distributed to provinces with a simple sharing rule. Expenditure assignments have not been finalized yet, but the authorities have been advised to ensure assignments are clear and to adopt a transfer system based on objective criteria. Staff recommended to calculate the expenditure bonus given to provinces that exceed revenue collection targets on the basis of non-resource revenues only, and eventually to abolish it.

- ***Strengthen a public expenditure management system.*** The authorities have made significant progress towards the introduction of a new chart of accounts. However, there is a need for setting a time-bound plan for the establishment of the national treasury and the introduction of a single treasury account.

- ***Developing an integrated medium-term fiscal framework.*** The authorities agree that expenditure decisions need to be made in a multiyear context. Such a framework should account not only for the volatile nature and uncertainties associated with resource revenues, but should align expenditures to the priorities of the National Socio-economic Development Plan (NSEDP). It is important that future budgets include this type of framework.

***Monetary and exchange rate policy***

16. **Staff shares the authorities' concern about the inflationary risk posed by the ongoing rapid monetary expansion.**

- The authorities plan to reduce monetary expansion through a targeted reduction in BoL's NDA (led by a further reduction in the net domestic financing of the deficit) and keeping tight limits on SOCBs' credit expansion. Staff suggested that, in addition, a standing deposit facility (remunerated banks' deposits) be introduced to help mop up liquidity. At the same time, they are facing demands to increase credit to the private sector, by lowering policy interest rates, raising SOCBs' lending ceilings, and relaxing prudential regulations. Those arguing in favor point to the need to support private sector growth, the benign inflation, and the low NPLs of the SOCBs' new lending. Staff recommended against such measures, because the SOCBs' overall financial condition is still very weak, and the banks' low loans-to-deposits ratio reflects mainly difficulties in realizing collaterals and complex bankruptcy procedures.

- Staff also supported the authorities' interest in broadening their tools to manage liquidity, and developing the interbank market to allow policy rates to play a more fundamental role. To this end, staff suggested that the BoL should (i) enhance its

liquidity forecasting framework by incorporating explicitly detailed fiscal operations; (ii) start developing market-based instruments for managing liquidity using treasury bills; (iii) start discussions with the MoF on a new financial arrangement to share the net cost of monetary operations.

17. **The authorities believe the exchange rate should reflect market conditions.**

- The current managed float framework has appropriately helped smooth exchange rate movements and strengthen the reserve position, and is also consistent with external stability. The official exchange rate is determined on the basis of the market outcome for the preceding day and the current nominal exchange rate level is deemed to be in line with economic fundamentals.

- The authorities have not received complaints about loss of competitiveness owing to the continued nominal appreciation. However, they expressed concerns about potentially large exchange rate adjustments given their increasing exposure to commodity price volatility.

- The authorities agreed that upward pressures on the kip are likely to continue, but had no intention to intervene. Most private foreign exchange transactions are channeled through one of the major SOCBs, and the BoL sets reference rates based on the market clearing rate of the previous day. The authorities are, however, committed to develop a well functioning interbank foreign exchange market and will take steps to build up the BoL's intervention capacity for smoothing purposes.

### B. Ensuring an Appropriate and Transparent Use of Resource Revenues

18. **The current fiscal regimes for the resource sector have several sound features, but some improvements are needed to align them to best international practices.**[6]

- Staff stressed the importance of developing a transparent and standardized fiscal regime across concessions. A predictable framework that ensures a level playing field is key to attract investor interest. Most existing concessions have been negotiated on a case-by-case basis without full disclosure of fiscal terms, complicating fiscal administration and giving rise to governance concerns. The authorities broadly agreed with staff but noted they had limited technical capacity to change the system. While a comprehensive framework is developed, staff suggested to adhere to the IMF's Guidelines on Resource Revenue Management and participate in the Extractive Industries Transparency Initiative.

[6] See accompanying Selected Issues Paper, Chapter II.

- Staff also suggested that the authorities take a fresh look at the pros and cons of taking equity stakes in resource projects. Direct participation could become costly given the financial risks associated to resource sector activities, and give rise to a conflict of interest between the government's dual role as regulator and as shareholder. Staff noted that taxation can be designed to generate equivalent and more predictable revenues than dividends, and depending on the design, they could even collect revenues before the activities start generating profits. The authorities noted that the decisions to acquire equity stakes had been done mainly at the request of their investment partners, and should not be read as the government's general policy. They agreed to continue the dialog and seek expert assistance.

- Regarding the utilization of resource revenues, the authorities are considering ways to set aside for future use some of the resource revenues. The use of a reserve fund could be considered provided that (i) the size of the contributions and the conditions for the withdrawals from a fund be decided within an integrated medium-term fiscal framework; (ii) all expenditures are on-budget; and, (iii) there are clear operating rules for the fund that ensure transparency, good governance, and proper accountability.

### C. Accelerating Banking and SOE Reform and Broadening the Sources of Growth

19. **A sound and competitive banking system is key to support long-term growth**. Full implementation of the new banking legislation should intensify competition by leveling the playing field and facilitating new entry. It is therefore important that relevant implementing regulations be in place, that the system be in good health, and the supervisory and regulatory framework be effective and strictly enforced.

- **Bank soundness**: There is a need to assess the soundness of the banking system. Efforts to develop standard soundness indicators should be expedited, and preparatory work for an eventual Financial Sector Assessment Program (FSAP) initiated. However, limited information available indicates that the restructuring of the two major SOCBs.(that share about 55 percent of the market) needs to be accelerated. These banks still carry sizable NPLs, have negative capital, and are heavily exposed to foreign exchange risk. The authorities expect to conclude their restructuring by 2010. In their view SOCBs are making gradual but firm progress, as evidenced by their very low NPLs and rising profitability of new lending operations.

- **Regulation and supervision:** Prudential requirements are broadly in line with the Basel I guidelines, but some regulations lack clear definitions and important regulatory concepts. There is also a need to improve enforcement and avoid forbearance, particularly for SOCBs. Most commercial banks are not complying with foreign currency exposure limits. The anti-money laundering decree was approved in March 2006, but full implementation is constrained by the lack of an operational

financial intelligence unit. BoL officials indicated that the system health was generally satisfactory, except for a very small bank which was experiencing some problems, and that they were currently working on strengthening the regulations.

20. **Further progress in SOE reform is essential to strengthen the banking sector**. Staff recognizes the importance of having turned around the combined financial outcome of the largest SOEs under restructuring. The authorities and the staff agreed that closer attention should be paid to those enterprises that still have a relatively weak financial situation or are highly leveraged. While noting that reliance on subsidies has virtually stopped and requests for sovereign guarantees have become less common, staff advised that any future budgetary support be limited and conditional on a viable business plan.

21. **Promoting broad-based growth will require significant improvements in the investment climate and expanded regional and global market opportunities.**

- **Investment climate**: The NSEDP clearly identifies the need for improving the legal and regulatory framework to help promote private sector initiative and attract FDI. The strategy, the approval of the enterprise law, and some of the steps taken (such as accelerating investment approval and maintaining an active dialog with the private sector) are in the right direction. However, it is clear that more needs to be done to reduce the cost of doing business, enhance transparency, and combat corruption.

- **Trade integration**: Staff encouraged the government to continue WTO accession efforts. It will also be important to start acting on the trade reform areas identified in the Diagnostic Trade Integration Study, such as simplifying lengthy procedures for starting business and acquiring business property, eliminating redundant trade licensing, and streamlining the customs clearance process.

## V. STAFF APPRAISAL

22. **Lao P.D.R.'s recent economic performance and progress in reducing poverty have been impressive, but the economic reform record is mixed.** Favorable export commodity prices and a rapidly growing resource sector have boosted growth and strengthened the balance of payments. The resource bonanza has induced an appreciation of the kip, which together with a prudent fiscal policy has helped contain demand pressures and lower inflation to historical lows. There has been some progress in banking and SOE reform and some steps taken to improve the investment climate. But there have also been significant delays in implementing key strategies and laws which would have advanced economic reform further.

23. **The economic outlook is promising,** but it will require that the authorities take measures to maintain stability and accelerate the reform effort before the "resource curse" sets in. Such a proactive policy response would also help mitigate the various risks to the outlook, including that of debt distress.

24. **Staff support the authorities' commitment to fiscal consolidation and debt sustainability over the medium term.** However, the 2007/08 budget, if fully implemented, would be inconsistent with the government's medium-term objectives. Staff believes there is room to contain expenditures and would strongly encourage the authorities to identify appropriate measures to return to the recent path of fiscal prudence. Looking ahead, a timely introduction of the VAT and a review of the tax system, coupled with stepped-up efforts to improve revenue administration, expenditure management, and intergovernmental fiscal relations, should help pave the way for fiscal consolidation. Expenditure decisions need to be taken within an integrated medium-term fiscal framework that makes explicit a deficit reduction path and takes into account the volatility and uncertainties of projected resource revenues. Given that Lao P.D.R. continues to face a risk of debt distress, it will be essential that, in addition to firmly pursuing fiscal consolidation, future external financing should continue to rely on grants and concessional loans.

25. **Expert advice is urgently required to develop a sound and transparent resource management framework.** To maximize resource rents, the authorities should weigh the benefits of direct and effective resource taxation versus equity participation. It would also be advisable to save some of the resource revenues until an integrated fiscal framework is available.

26. **The ongoing rapid monetary expansion warrants a tight control of BoL NDA and bank credit to the private sector**. The BoL's liquidity management toolkit needs to be upgraded. An early introduction of a standing deposit facility could usefully precede the introduction of open market operations using treasury bills. Steps should also be taken to develop the interbank money market and mechanisms to avoid quasi-fiscal costs of managing liquidity.

27. **The current exchange rate policy has served Lao P.D.R. well and the nominal exchange rate is in line with macroeconomic fundamentals.** Staff welcomes the authorities' intention to let the kip reflect market conditions and shares their concern about the risk of large exchange rate fluctuations. Building the BoL's capacity to smooth fluctuations, developing a well-functioning foreign exchange market, and strengthening reserves further should help manage such risks. However, this should not be taken as a substitute for pursuing sound policies and deepening reform to reduce external vulnerabilities.

28. **There has been some progress in banking and SOE reform but a renewed impetus is required.** Besides ensuring full banking law implementation and strictly enforcing a strengthened regulatory framework, the recapitalization of SOCBs needs to be expedited, including by involving strategic investors. Deepening SOE restructuring will also help strengthen the banking sector. Extension of public guarantees on SOEs' borrowing should be conditional on demonstrable viable business plans.

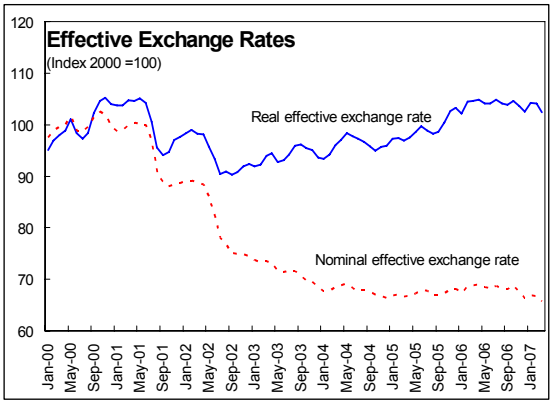
29. **Enhancing trade integration and improving the investment climate will help raise and sustain broad-based growth**. In particular, the preparations to join WTO should be sustained. However, reaping the full benefits of trade integration will require more efforts to reduce the high cost of doing business and improve the business climate more generally.

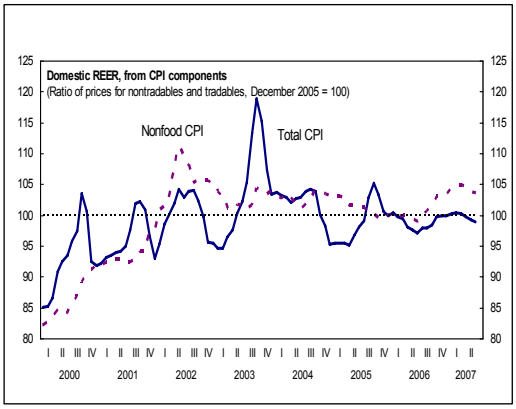
30. **The macroeconomic and financial data needs to be improved to support policy decision making and effective surveillance.** Priority should be assigned to improving the compilation of the balance of payments, broadening the coverage of external debt, and preparing and disseminating bank soundness indicators. Closer interagency cooperation would be advisable.

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

**Box 1. Competitiveness**

**Real effective exchange rate (REER) developments in recent years have not affected competitiveness significantly.** Following a long upward trend, the trade-weighted REER remained broadly stable in 2006. The relative price of nontradables and tradables (domestic REER) has also fluctuated within a narrow range in recent years. Against this backdrop, non-resource exports have grown on average by 8 percent per year since 2001. During the same period, garment exports, the most important non-resource exports, have maintained their market share in EU countries, a key destination.




**The impact of the real appreciation on exports has been mitigated by several factors.** First, the bulk of Lao P.D.R.'s exports are commodities which are not too sensitive to exchange rate fluctuations because of their low domestic cost components. Second**,** there is a high degree of dollarization. Finally, garments exports have managed to maintain its market share because of EU preferential treatment.

**On the cost side, the non-resource sector has benefited from low labor costs but confronts a high cost of doing business and poor governance**.

- Average wages are flexible and the lowest in the region.

| Annual salary in US$ (2006) | |
|---|---|
| Factory worker | |
| Malaysia | 3,910 |
| Philippines | 3,721 |
| Thailand | 3,686 |
| China | 2,795 |
| Indonesia | 2,793 |
| India | 2,728 |
| Vietnam | 1,109 |
| Lao P.D.R. | 700-750 |

Sources: Nikkei Asia and Nikkei Research and staff estimates.

- Lao P.D.R. ranks very low in the World Bank's 2006 *doing business indicators* (No. 159 among 175 countries), trailing regional countries in almost all subcategories. In particular, starting up a business takes more than three times the regional average, while securing property rights takes twice. Lao P.D.R. ranks equally poorly in the Heritage Foundation's Index of Economic Freedom (No. 140 among 157 countries). Furthermore, Lao P.D.R.'s ranking in the Corruption Perception Index by the Transparency International deteriorated to No. 111 in 2006 from No. 77 in 2005.

## Box 2. Alternative Policy-Response Scenarios

**Proactive policy response.** The government smoothes spending and saves a large portion of resource revenues for future use, while pursuing fiscal consolidation of the non-resource budget. It also continues to make efforts to mobilize non-resource revenues to compensate a loss in mineral revenues following the depletion of proven reserves, and optimizes the generation of resource revenues. Prudent fiscal policy stance, together with an enhanced BoL capacity to conduct monetary policy, help contain the monetary impact of rising resource external surpluses. Inflationary pressures are subdued and the real exchange rate appreciates only moderately. The prevailing macroeconomic stability, coupled with improvements in the investment climate, including banking and SOE reform, as envisaged in the NSEDP, raises private investment contributing to higher non-resource exports and output growth. As a result, GDP annual growth stabilizes at around 6½ percent while inflation stays below 5 percent.

Key Macroeconomic Assumptions: Proactive Scenario

| | 2002–06 average | 2007–12 average | 2013–27 average |
|---|---|---|---|
| Real GDP growth (percent) | 6.6 | 7.2 | 6.4 |
| Inflation (percent) | 10.1 | 4.4 | 4.5 |
| Exports growth (percent) | 20.6 | 10.6 | 11.2 |
| Revenue (percent GDP) | 11.8 | 13.4 | 13.7 |
| Primary deficit (percent GDP) | 2.6 | -0.1 | 1.3 |
| Grant element of new borrowing | ... | 41.1 | 43.7 |

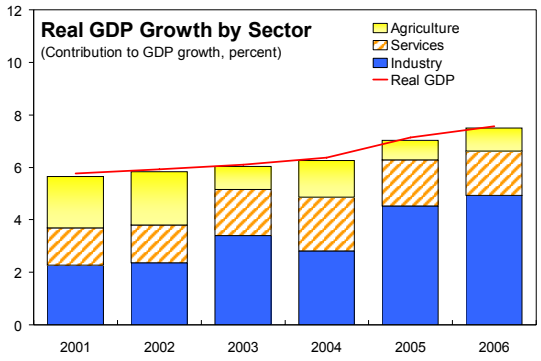
**Reactive policy response.** The government spends all revenues attending to urgent domestic expenditures, keeping its net position with the banking system unchanged. The BoL takes time in developing monetary management tools and inflationary pressures emerge, exacerbating the appreciation of the exchange rate and adversely affecting the competitiveness of non-resource exports. Efforts to enhance the business environment advance only gradually and SOCBs and SOEs continue fragile posing a fiscal risk. GDP growth initially increase to nearly 8 percent, buoyed by higher consumption stimulated by government expenditures. Soon thereafter, however, non-resource exports start to weaken, and the BoL loosens monetary policy in an attempt to counter declining activity and maintain consumption. The government continues to borrow externally, while avoiding recourse to domestic financing. After an initial rapid growth, real GDP decelerates to 4-5 percent.

Key Macroeconomic Assumptions: Reactive Scenario

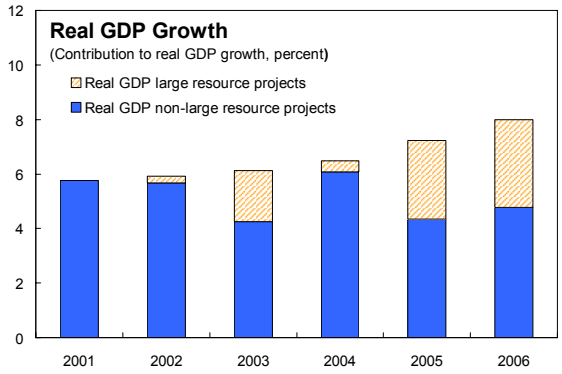
| | 2002–06 average | 2007–12 average | 2013–27 average |
|---|---|---|---|
| Real GDP growth (percent) | 6.6 | 6.3 | 4.5 |
| Inflation (percent) | 10.1 | 7.3 | 9.0 |
| Exports growth (percent) | 20.6 | 8.7 | 7.6 |
| Revenue (percent GDP) | 11.8 | 12.6 | 9.9 |
| Primary deficit (percent GDP) | 2.6 | 0.9 | 2.8 |
| Grant element of new borrowing | ... | 41.1 | 42.3 |

# Figure 1: Lao P.D.R: Real Sector Developments

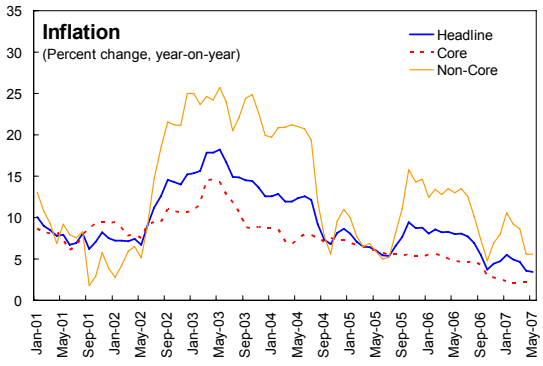
***Growth has been robust...***



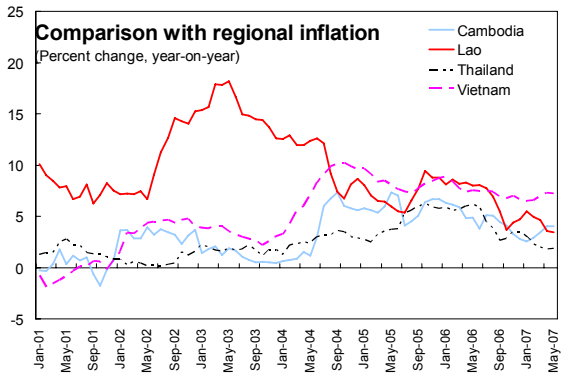

***... largely driven by the resource sector.***



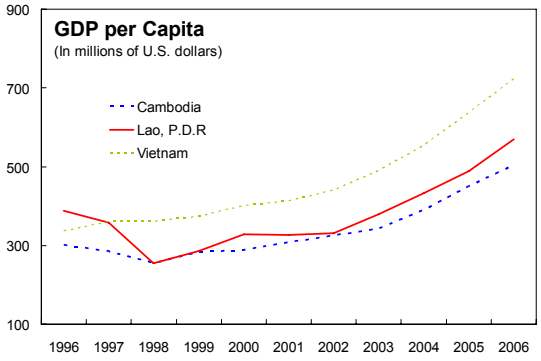

***Inflation has declined...***



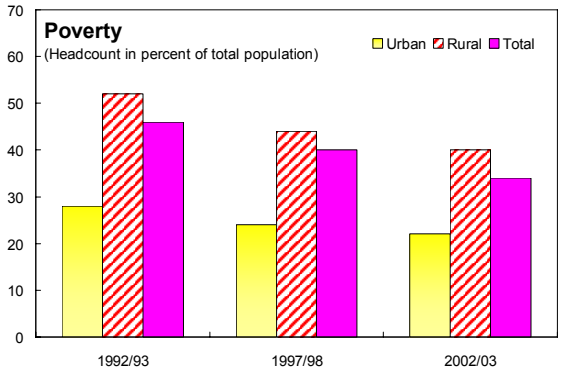

***... but remains higher than Thailand.***




***GDP per capita has been rising...***



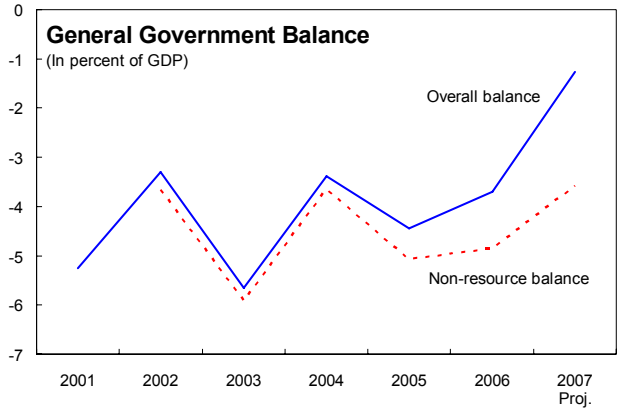

***... and the overall poverty declined, although rural poverty remains high.***



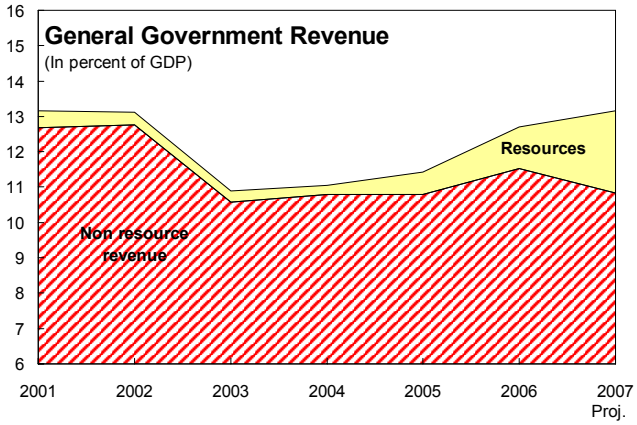

*Sources: Lao P.D.R. authorities' and Fund staff estimates.*

# Figure 2: Lao P.D.R: Fiscal and Monetary Developments

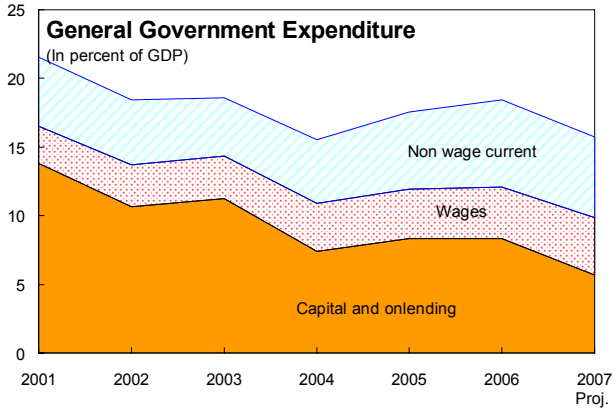
***Fiscal deficit has declined...***



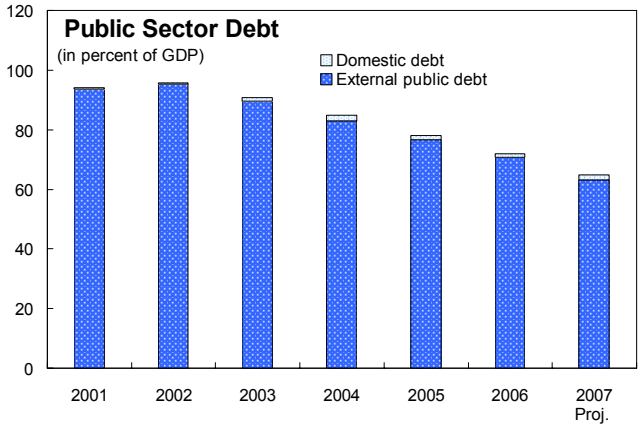

***... owing to rising resource revenues...***



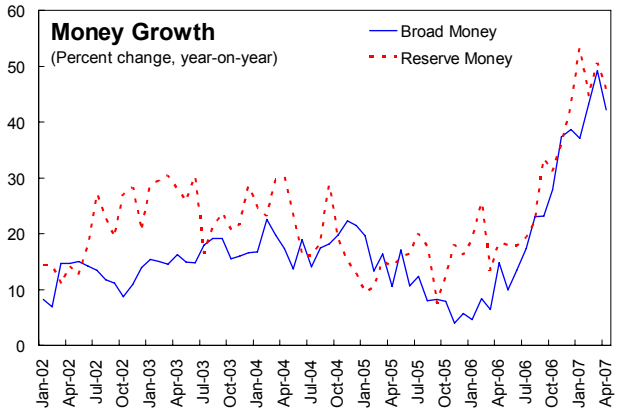

***... and contained expenditure.***



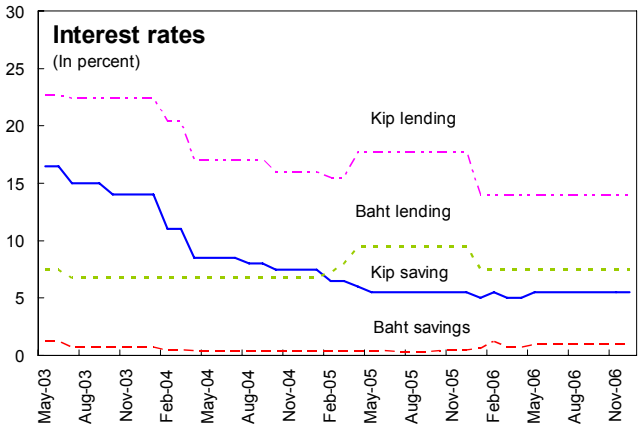

***Public sector debt is on a declining trend.***




***Money growth has accelerated,***



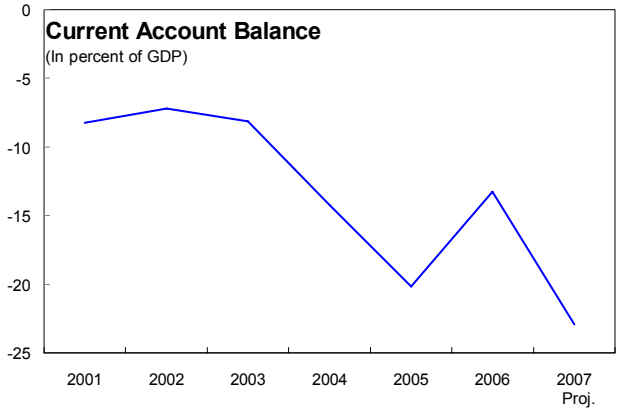

***... while interest rates have remained stable.***



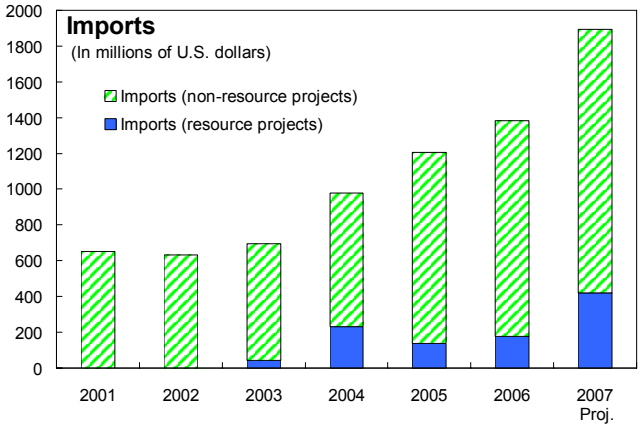

*Sources: Lao P.D.R. authorities' and Fund staff estimates.*

# Figure 3: Lao P.D.R: External Sector Developments

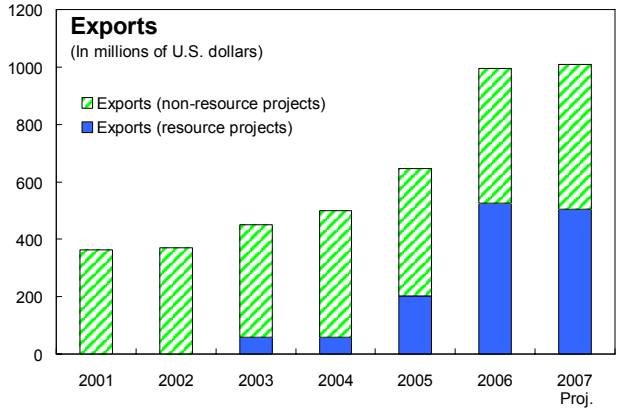
***The current account deficit remains sizeable ...***



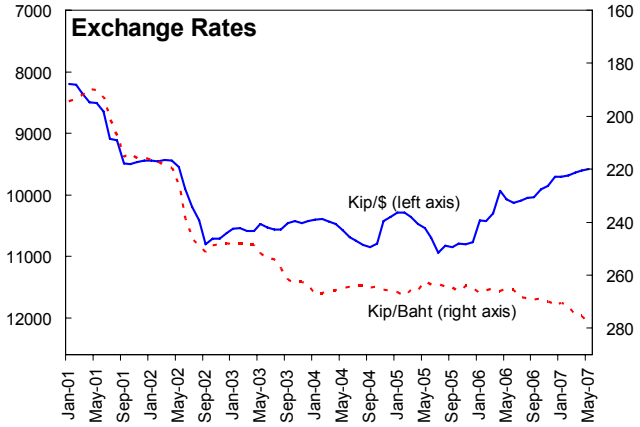

***... due to a large increase in imports, mainly from the resource sector.***



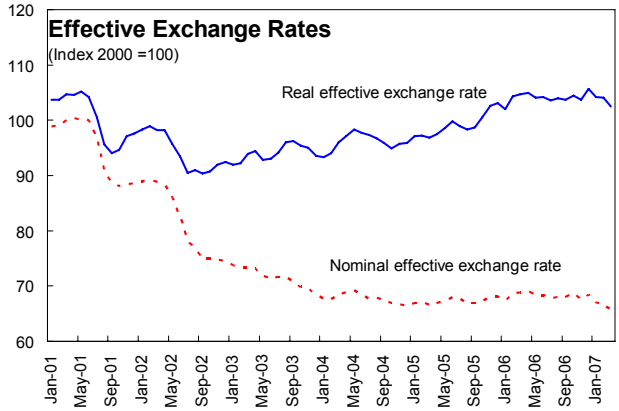

***Exports have also grown strongly.***



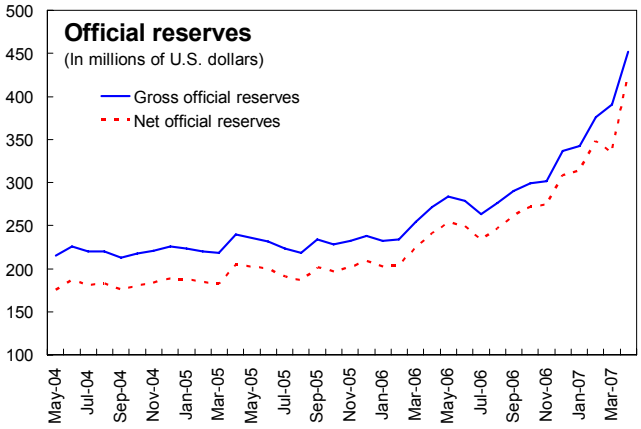

***The Kip has appreciated against the U.S. dollar, but depreciated against the Thai baht...***




***... but the real exchange rate has stabilized after months of appreciation.***




***Official reserves have risen strongly.***




*Sources: Lao P.D.R. authorities' and Fund staff estimates.*

Table 1. Lao P.D.R.: Selected Economic and Financial Indicators, 2003-2007

Nominal GDP (2006 est.): $3,437 million
Population (2006 est.): 6.0 million
GDP per capita (2006 est.): $ 572.8

| | 2003 | 2004 | 2005 | 2006 Staff est. | 2007 Staff proj. |
|---|---|---|---|---|---|
| GDP and prices (percentage change) | | | | | |
| Real GDP growth | 6.1 | 6.4 | 7.1 | 7.6 | 7.1 |
| CPI (annual average) | 15.5 | 10.5 | 7.2 | 6.8 | 4.0 |
| Public finances (in percent of GDP) 1/ | | | | | |
| Revenue | 10.9 | 11.0 | 11.4 | 12.7 | 13.2 |
| Grants | 2.1 | 1.1 | 1.7 | 2.1 | 1.3 |
| Expenditure | 18.6 | 15.5 | 17.5 | 18.5 | 15.7 |
| Overall balance (including grants) | -5.6 | -3.4 | -4.4 | -3.7 | -1.3 |
| Domestic financing | 0.4 | -0.2 | 0.2 | -1.3 | -1.3 |
| External financing | 5.1 | 3.6 | 4.2 | 5.0 | 2.5 |
| Money and Credit (annual percent change) 2/ | | | | | |
| Reserve money | 28.5 | 12.9 | 17.6 | 38.2 | 20.4 |
| Broad money | 15.5 | 21.5 | 7.7 | 30.1 | 24.8 |
| Bank credit to the economy 3/ | 1.3 | 12.6 | 26.8 | 4.2 | 16.0 |
| Interest rates (end of period) | | | | | |
| On three-month kip deposits | 14.0 | 7.5 | 5.5 | 5.5 | ... |
| On short-term kip loans | 22.4 | 16.0 | 17.8 | 14.0 | ... |
| Balance of payments | | | | | |
| Exports (percent change) | 21.6 | 11.0 | 29.4 | 54.1 | 1.3 |
| Imports (percent change) | 9.6 | 40.9 | 23.4 | 14.8 | 37.0 |
| Trade Balance (in percent of GDP) | -11.3 | -19.0 | -19.4 | -11.3 | -22.1 |
| Current account balance (in percent of GDP) | -8.1 | -14.3 | -20.2 | -13.3 | -22.9 |
| Gross official reserves (in millions of U.S. dollars) | 214 | 226 | 238 | 336 | 437 |
| (In months of prospective goods and services imports) 4/ | 3.2 | 3.0 | 2.8 | 3.6 | 4.3 |
| (In percent of short-term debt) | 305.1 | 277.2 | 180.9 | 225.4 | 334.5 |
| External public debt and debt services | | | | | |
| External public debt (in percent of GDP) | 89.1 | 83.2 | 77.1 | 69.0 | 63.0 |
| Net present value of debt (in percent of exports) | 204.6 | 198.9 | 168.9 | 134.5 | 140.4 |
| External public debt services (in percent of exports) | 6.7 | 7.5 | 7.7 | 4.0 | 6.1 |
| Exchange rate | | | | | |
| Official exchange rate (kip per dollar; end of period) | 10,434 | 10,357 | 10,767 | 9,655 | ... |
| Nominal effective exchange rate (2000=100) | 71.6 | 67.7 | 67.3 | 68.6 | ... |
| Real effective exchange rate (2000=100) | 94.1 | 96.1 | 99.1 | 104.5 | ... |
| **Memorandum item:** | | | | | |
| Nominal GDP (calendar year; in billions of kip) | 22,597 | 26,539 | 30,705 | 34,581 | 38,569 |

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

1/ Fiscal year basis (October to September).
2/ Money and credit data are evaluated at current exchange rates.
3/ Excluding debt write-offs.
4/ Excludes imports associated with large resource projects.

Table 2. Lao P.D.R.: Balance of Payments, 2003–08

| | 2003 | 2004 | 2005 | 2006 Est. | 2007 Staff proj. | 2008 Staff projections | |
|---|---|---|---|---|---|---|---|
| | | | | | | Proactive | Reactive |
| | (In millions of U.S. dollars, unless specified otherwise) | | | | | | |
| **Current Account** | -175 | -358 | -582 | -456 | -918 | -950 | -965 |
| Excluding official transfers | -237 | -417 | -639 | -567 | -998 | -1027 | -1033 |
| Merchandise trade balance | -244 | -478 | -559 | -388 | -887 | -915 | -934 |
| Exports, f.o.b. | 450 | 500 | 646 | 996 | 1009 | 1198 | 1182 |
| Mining and hydro exports | 147 | 149 | 310 | 632 | 612 | 765 | 765 |
| of which: mining projects | 60 | 58 | 203 | 525 | 505 | 661 | 661 |
| hydropower projects | 87 | 91 | 107 | 107 | 107 | 104 | 104 |
| Other exports | 303 | 351 | 337 | 364 | 397 | 434 | 418 |
| Imports, c.i.f. | 694 | 977 | 1206 | 1384 | 1896 | 2113 | 2116 |
| of which: mining projects | 45 | 232 | 139 | 176 | 420 | 472 | 472 |
| hydropower projects | 0 | 0 | 215 | 271 | 445 | 507 | 507 |
| Services (net) | 95 | 132 | 161 | 171 | 196 | 216 | 219 |
| *of which tourism* | 84 | 119 | 150 | 160 | 185 | 205 | 208 |
| Income (net) | -113 | -98 | -269 | -409 | -371 | -398 | -398 |
| Interest payments | -38 | -54 | -106 | -94 | -117 | -120 | -120 |
| *of which public* | -15 | -27 | -31 | -24 | -34 | -36 | -36 |
| of which: mining projects | 0 | -6 | -11 | -10 | -7 | -5 | -5 |
| hydropower projects | 0 | 0 | -45 | -43 | -61 | -72 | -72 |
| Dividends and profit repatriation | -78 | -56 | -179 | -344 | -289 | -318 | -318 |
| of which: mining projects | -34 | -7 | -36 | -201 | -146 | -164 | -164 |
| hydropower projects | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other | 3 | 12 | 16 | 29 | 35 | 40 | 40 |
| Transfers (net) | 86 | 85 | 85 | 170 | 144 | 147 | 147 |
| Private | 24 | 26 | 28 | 59 | 64 | 69 | 79 |
| Official | 62 | 60 | 57 | 111 | 80 | 78 | 68 |
| **Capital Account** | 197 | 376 | 599 | 556 | 1022 | 1014 | 1006 |
| Public sector | 118 | 118 | 115 | 164 | 152 | 120 | 120 |
| Disbursements | 146 | 147 | 156 | 195 | 202 | 187 | 187 |
| Amortization | -28 | -29 | -41 | -31 | -50 | -67 | -67 |
| Banking sector (net) | -21 | -39 | 22 | -93 | -50 | -81 | -40 |
| Private sector | 100 | 297 | 462 | 485 | 920 | 975 | 926 |
| Foreign direct investment (net) 1/ | 42 | 234 | 349 | 319 | 842 | 895 | 855 |
| of which: mining projects | 30 | 198 | 44 | -48 | 180 | 184 | 184 |
| hydropower projects | 0 | 0 | 265 | 325 | 557 | 621 | 621 |
| Other private flows and errors and omissions | 58 | 63 | 113 | 166 | 78 | 80 | 71 |
| **Overall Balance** | 22 | 19 | 17 | 99 | 104 | 64 | 41 |
| **Financing** | -22 | -19 | -17 | -99 | -104 | -64 | -41 |
| Central bank net foreign assets | -22 | -19 | -17 | -99 | -104 | -64 | -41 |
| Assets (increase -) | -18 | -12 | -11 | -98 | -100 | -60 | -37 |
| Liabilities (reduction -) | -4 | -6 | -6 | -1 | -3 | -4 | -4 |
| **Memorandum Items:** | | | | | | | |
| Current account (percent of GDP) | -8.1 | -14.3 | -20.2 | -13.3 | -22.9 | -21.1 | -20.8 |
| (excluding official transfers) | -11.0 | -16.6 | -22.1 | -16.5 | -24.9 | -22.8 | -22.2 |
| Resource current account (percent of GDP) | 3.2 | -3.8 | -4.7 | -2.0 | -11.7 | -10.1 | -9.8 |
| Non-resource current account (percent of GDP) | -11.3 | -10.5 | -15.4 | -11.3 | -11.2 | -10.9 | -11.0 |
| Resource balance of payments (percent of GDP) | 4.6 | 4.1 | 5.9 | 6.0 | 6.7 | 7.7 | 7.5 |
| Non-resource balance of payments (percent of GDP) | -3.5 | -3.3 | -5.4 | -3.1 | -4.1 | -6.3 | -6.6 |
| Official gross reserves (in millions of USD) | 214 | 226 | 238 | 336 | 437 | 497 | 473 |
| (in months of imports, excl. large projects ) | 3.2 | 3.0 | 2.8 | 3.6 | 4.3 | 4.5 | 4.3 |
| Nominal GDP at market prices (in millions of USD) | 2,149 | 2,508 | 2,887 | 3,437 | 4,008 | 4,509 | 4,646 |

Sources: Data provided by the Lao P.D.R. authorities; and Fund staff estimates and projections.
1/ Including repayment of private debt.

Table 3. Lao P.D.R.: General Government Operations, 2002/03–07/08

| | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 | | 2007/08 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Staff est. | | | | Budget | Staff proj. | Budget preliminary | Staff proj. Reactive | Staff proj. Proactive |
| | (In percent of GDP) | | | | | | | | |
| **Revenue and grants** | 13.0 | 12.1 | 13.1 | 14.8 | 14.2 | 14.5 | 14.8 | 14.2 | 14.5 |
| Revenue | 10.9 | 11.0 | 11.4 | 12.7 | 12.4 | 13.2 | 13.4 | 13.2 | 13.4 |
| Tax | 8.9 | 9.1 | 9.4 | 10.8 | 10.8 | 11.5 | 11.8 | 11.6 | 11.8 |
| *Of which: Non-renewable resources1/* | 0.1 | 0.1 | 0.3 | 0.9 | 1.8 | 2.1 | 2.6 | 2.4 | 2.4 |
| *Of which: Renewable resource 1/* | 0.2 | 0.1 | 0.3 | 0.3 | 0.3 | 0.2 | 0.3 | 0.2 | 0.2 |
| *Of which: Non resource revenue* | 8.6 | 8.9 | 8.8 | 9.7 | 8.7 | 9.2 | 9.0 | 9.0 | 9.2 |
| Nontax | 1.9 | 1.9 | 2.0 | 1.9 | 1.6 | 1.7 | 1.6 | 1.6 | 1.6 |
| Grants | 2.1 | 1.1 | 1.7 | 2.1 | 1.8 | 1.3 | 1.3 | 1.0 | 1.1 |
| **Expenditure** | 18.6 | 15.5 | 17.5 | 18.5 | 17.8 | 15.7 | 17.5 | 16.3 | 15.1 |
| *Total domestically-financed expenditure* | 11.6 | 11.0 | 12.4 | 12.6 | 11.5 | 11.3 | 12.2 | 12.4 | 11.1 |
| Current | 7.1 | 7.2 | 8.5 | 9.3 | 9.5 | 9.5 | 9.9 | 10.3 | 9.2 |
| Wages, salaries and benefits | 3.1 | 3.5 | 3.6 | 3.8 | 4.1 | 4.2 | 4.5 | 4.6 | 4.0 |
| Transfers | 1.6 | 1.2 | 1.7 | 2.0 | 2.3 | 2.3 | 2.4 | 2.4 | 2.2 |
| Interest payments | 0.6 | 0.9 | 1.1 | 0.8 | 1.0 | 0.7 | 0.8 | 0.7 | 0.7 |
| Other recurrent | 1.8 | 1.5 | 2.1 | 2.7 | 2.1 | 2.3 | 2.1 | 2.5 | 2.3 |
| Capital and onlending | 11.0 | 6.4 | 7.6 | 7.5 | 7.4 | 5.2 | 6.4 | 5.1 | 5.0 |
| Domestically financed | 4.8 | 2.3 | 1.6 | 1.2 | 1.4 | 1.4 | 1.6 | 1.7 | 1.5 |
| Externally financed | 7.0 | 4.6 | 5.2 | 5.8 | 6.4 | 4.4 | 5.3 | 3.9 | 4.0 |
| Onlending (net) 2/ | -0.7 | -0.5 | 0.9 | 0.5 | -0.4 | -0.6 | -0.4 | -0.5 | -0.5 |
| Others and contingencies 3/ | 0.6 | 0.9 | 1.2 | 1.0 | 1.0 | 1.0 | 1.2 | 0.9 | 0.9 |
| Discrepancy including unidentified expenditu | -0.1 | 1.0 | 0.3 | 0.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Overall balance** | -5.6 | -3.4 | -4.4 | -3.7 | -3.7 | -1.3 | -2.7 | -2.1 | -0.6 |
| **Non-resource current balance 4/** | 5.0 | 3.8 | 2.8 | 3.3 | 1.6 | 1.6 | 0.9 | 0.4 | 1.7 |
| **Non-resource balance 4/** | -5.9 | -3.6 | -5.1 | -4.9 | -5.7 | -3.6 | -5.6 | -4.7 | -3.2 |
| **Financing** | 5.6 | 3.4 | 4.4 | 3.7 | 3.7 | 1.3 | 2.7 | 2.1 | 0.6 |
| Domestic financing (net) 5/ | 0.4 | -0.2 | 0.2 | -1.3 | -0.1 | -1.3 | -0.4 | 0.0 | -1.6 |
| Foreign financing (net) | 5.1 | 3.6 | 4.2 | 5.0 | 3.7 | 2.5 | 3.1 | 2.1 | 2.2 |
| Disbursements | 6.1 | 4.5 | 5.2 | 5.9 | 4.8 | 3.8 | 4.1 | 3.5 | 3.6 |
| Amortization | -0.9 | -0.9 | -1.0 | -0.9 | -1.1 | -1.2 | -0.9 | -1.4 | -1.4 |
| | (In percent of non-resource GDP) | | | | | | | | |
| Non resource tax and nontax revenue | 10.7 | 11.0 | 11.3 | 12.4 | ... | 11.9 | ... | 11.9 | 12.1 |
| Total domestically-financed expenditure | 11.8 | 11.2 | 12.9 | 13.5 | ... | 12.4 | ... | 13.9 | 12.4 |
| Non-resource current balance | 5.1 | 3.9 | 2.9 | 3.5 | ... | 1.8 | ... | 0.4 | 1.9 |
| Non-resource balance | -6.0 | -3.7 | -5.3 | -5.2 | ... | -3.9 | ... | -5.3 | -3.6 |
| **Memorandum items:** | | | | | | | | | |
| GDP (in billions of kip) | 21,548 | 25,553 | 29,663 | 33,612 | 37,926 | 37,572 | 43,288 | 42,714 | 42,154 |
| Growth rate (percent) | 21.6 | 18.6 | 16.1 | 13.3 | 14.5 | 11.8 | 14.1 | 13.7 | 12.2 |
| Exchange rate (kip per US dollar) | 10,576 | 10,560 | 10,571 | 10,310 | ... | 9,666 | ... | 9,543 | 9,615 |
| Wages and salaries (in percent of non-resour | 29.3 | 32.6 | 32.1 | 31.8 | ... | 37.5 | ... | 43 | 36.0 |
| Total aid (in millions of US dollars) | 167 | 136 | 188 | 234 | 259 | 197 | 233 | 203 | 203 |
| Project aid | 142 | 111 | 174 | 202 | 250 | 170 | 228 | 174 | 174 |
| Program aid | 25 | 25 | 14 | 32 | 9 | 27 | 5 | 29 | 29 |
| Resource revenue saving ratio (percent) 6/ | -142.0 | 89.0 | -33.8 | 109.6 | 3.5 | 54.5 | 14.8 | 0.0 | 58.7 |

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

1/ Non-renewable resource: royalties and taxes from mining; renewable resource: those from hydro-power.
2/ Includes the government NT2 equity purchase.
3/ Includes payments on liabilities carried in from the previous budget years and arrears clearance.
4/ Current and overall balance net of resource revenues.
5/ Excludes bank restructuring bonds.
6/ (Negative) domestic financing divided by resource revenue.

Table 4. Lao P.D.R.: Monetary Survey 2003–07 1/
(In billions of kip, unless otherwise indicated)

| | 2003 | 2004 | 2005 | 2006 | | | | 2007 | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Dec. | Dec. | Dec. | Mar. | Jun. | Sept. | Dec. | Mar. | Apr. | May |
| **Bank of Lao** | | | | | | | | | | |
| Net Foreign Assets | 1,835 | 2,031 | 2,211 | 2,406 | 2,644 | 2,856 | 3,273 | 3,938 | 4,505 | 4,620 |
| (In millions of U.S. dollars) | 173 | 192 | 209 | 227 | 249 | 269 | 309 | 372 | 425 | 436 |
| Net Domestic Assets | -456 | -475 | -403 | -523 | -674 | -650 | -691 | -1,102 | -1,599 | -1,654 |
| Government (net) | -379 | -456 | -423 | -423 | -579 | -457 | -342 | -724 | -1,207 | -1,242 |
| Economy | 685 | 738 | 348 | 325 | 296 | 270 | 269 | 257 | 258 | 259 |
| Banks | 138 | 131 | 222 | 140 | 177 | 147 | 144 | 160 | 165 | 163 |
| BoL securities | -46 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other items (net) | -854 | -889 | -550 | -565 | -567 | -610 | -763 | -795 | -814 | -833 |
| Reserve money | 1,379 | 1,556 | 1,808 | 1,883 | 1,970 | 2,206 | 2,581 | 2,836 | 2,906 | 2,966 |
| Currency in circulation | 262 | 511 | 805 | 855 | 782 | 849 | 1,231 | 1,389 | 1,345 | 1,369 |
| Bank reserves (kip) | 319 | 213 | 217 | 237 | 317 | 430 | 421 | 384 | 454 | 468 |
| Bank reserves (foreign currency) | 798 | 832 | 787 | 791 | 871 | 927 | 930 | 1,063 | 1,107 | 1,129 |
| **Monetary Survey** | | | | | | | | | | |
| Net foreign assets | 2,773 | 3,381 | 3,329 | 3,566 | 3,629 | 4,153 | 5,380 | 6,438 | 7,267 | 7,253 |
| (In millions of U.S. dollars) | 262 | 319 | 314 | 336 | 342 | 392 | 508 | 607 | 686 | 684 |
| Net domestic assets 2/ | 1,400 | 1,688 | 2,027 | 2,093 | 2,159 | 2,168 | 2,048 | 2,004 | 1,067 | 1,078 |
| Government (net) | -136 | -215 | -179 | -174 | -338 | -343 | -167 | -413 | -962 | -1,019 |
| Budget | -346 | -462 | -426 | -549 | -784 | -790 | -614 | -860 | -1,410 | -1,466 |
| Other | 210 | 246 | 246 | 375 | 446 | 447 | 447 | 447 | 447 | 447 |
| Credit to the economy | 2,480 | 2,705 | 2,836 | 2,932 | 3,139 | 3,100 | 2,795 | 2,596 | 2,622 | 2,683 |
| Excluding debt write-offs | 2,112 | 2,337 | 2,468 | 2,564 | 2,771 | 2,732 | 2,795 | 2,596 | 2,622 | 2,683 |
| Other items (net) | -944 | -802 | -630 | -665 | -642 | -589 | -579 | -179 | -592 | -587 |
| Broad Money | 4,173 | 5,068 | 5,356 | 5,659 | 5,788 | 6,321 | 7,429 | 8,442 | 8,334 | 8,331 |
| Currency outside banks | 262 | 511 | 805 | 855 | 782 | 849 | 1,231 | 1,389 | 1,345 | 1,369 |
| Kip deposits 3/ | 1,244 | 1,435 | 1,453 | 1,450 | 1,490 | 1,549 | 1,712 | 1,870 | 1,868 | 1,887 |
| Foreign currency deposits | 2,667 | 3,122 | 3,099 | 3,354 | 3,516 | 3,923 | 4,486 | 5,183 | 5,121 | 5,075 |
| | | | | (Percent change at constant exchange rates) | | | | | | |
| Reserve money | 28.5 | 12.8 | 16.2 | 13.3 | 17.9 | 33.5 | 42.8 | 50.6 | 45.7 | 47.1 |
| Kip reserve money | 92.2 | 24.6 | 41.1 | 30.7 | 30.6 | 46.2 | 61.7 | 62.3 | 58.7 | 67.2 |
| Broad money | 16.6 | 21.5 | 5.7 | 6.4 | 13.5 | 23.1 | 38.7 | 49.2 | 42.1 | 43.5 |
| Kip broad money | 37.8 | 29.2 | 16.0 | 9.1 | 11.7 | 15.9 | 30.4 | 41.4 | 38.4 | 46.9 |
| Credit to the economy excluding debt write-offs 2/ | 2.7 | 12.6 | 5.7 | 2.6 | 20.1 | 5.8 | 13.2 | 1.2 | -4.0 | -1.2 |
| | | | | (Percent change at current exchange rates) | | | | | | |
| Reserve money | 28.5 | 12.9 | 17.6 | 13.1 | 15.4 | 29.9 | 38.2 | 47.7 | 44.2 | 45.3 |
| Broad money | 15.5 | 21.5 | 7.7 | 5.8 | 9.5 | 17.2 | 30.1 | 43.1 | 38.5 | 39.3 |
| Credit to the economy excluding debt write-offs 2/ | 1.3 | 12.6 | 26.8 | 17.4 | 13.8 | -1.7 | 4.2 | -3.2 | -5.8 | -3.9 |
| **Memorandum items:** | | | | | | | | | | |
| Credit to the economy (in percent of GDP) | 11.0 | 10.2 | 9.2 | 8.5 | 9.1 | 9.0 | 8.1 | 6.7 | 6.8 | 6.9 |

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

1/ All figures evaluated at constant exchange rate, unless otherwise indicated.

2/ Adjusted for the impact of debt write-offs and Debt Clearance/Bank Recapitalization Bonds.

Table 5. Lao P.D.R.: Summary Macroeconomic Framework (Proactive Scenario), 2005–12

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|
| | | Staff est. | | | Staff proj. | | | |
| Output and prices (percent change, unless otherwise indicated) | | | | | | | | |
| Real GDP | 7.1 | 7.6 | 7.1 | 7.6 | 8.2 | 7.6 | 6.2 | 6.4 |
| (excluding resources) | 4.3 | 4.8 | 5.1 | 5.0 | 5.1 | 5.3 | 5.4 | 5.7 |
| GDP per capita (in millions of US dollars) | 489 | 570 | 653 | 721 | 798 | 880 | 958 | 1,045 |
| CPI (annual average) | 7.2 | 6.8 | 4.0 | 4.5 | 4.5 | 4.5 | 4.5 | 4.5 |
| Savings and investment balance (in percent of GDP) 1/ | | | | | | | | |
| Gross fixed investment | 32.6 | 32.5 | 42.1 | 41.0 | 35.7 | 30.3 | 24.7 | 21.5 |
| Private | 26.1 | 25.7 | 36.5 | 35.6 | 30.6 | 25.6 | 19.9 | 16.6 |
| Government | 6.5 | 6.8 | 5.6 | 5.4 | 5.0 | 4.7 | 4.8 | 4.9 |
| Gross national savings | 11.7 | 18.7 | 18.3 | 19.3 | 19.5 | 19.8 | 19.9 | 20.1 |
| Foreign savings (including official transfers) | 20.9 | 13.8 | 23.8 | 21.7 | 16.2 | 10.5 | 4.8 | 1.4 |
| Public finances (in percent of GDP) 2/ | | | | | | | | |
| Revenue | 11.4 | 12.7 | 13.2 | 13.4 | 13.4 | 13.3 | 13.4 | 13.5 |
| Grants | 1.7 | 2.1 | 1.3 | 1.1 | 1.0 | 0.9 | 0.9 | 0.8 |
| Expenditure | 17.5 | 18.5 | 15.7 | 15.1 | 14.9 | 14.5 | 14.6 | 14.8 |
| Of which: current | 8.5 | 9.3 | 9.5 | 9.2 | 9.0 | 8.9 | 9.1 | 9.3 |
| capital and onlending | 7.6 | 7.5 | 5.2 | 5.0 | 4.7 | 4.4 | 4.5 | 4.6 |
| Overall balance | -4.4 | -3.7 | -1.3 | -0.6 | -0.5 | -0.3 | -0.3 | -0.5 |
| Non-resource balance | -5.1 | -4.9 | -3.6 | -3.2 | -3.0 | -2.6 | -2.4 | -2.3 |
| Domestic financing | 0.2 | -1.3 | -1.3 | -1.6 | -1.2 | -1.1 | -1.1 | -0.9 |
| Foreign financing | 4.2 | 5.0 | 2.5 | 2.2 | 1.7 | 1.4 | 1.4 | 1.4 |
| Balance of payments (in millions of US dollars; unless otherwise indicated) | | | | | | | | |
| Current account balance | -582 | -456 | -918 | -950 | -800 | -584 | -295 | -98 |
| In percent of GDP | -20.2 | -13.3 | -22.9 | -21.1 | -15.7 | -10.2 | -4.6 | -1.4 |
| Exports | 646 | 996 | 1,009 | 1,198 | 1,276 | 1,538 | 1,639 | 1,813 |
| Of which: resources | 310 | 632 | 612 | 765 | 802 | 1,016 | 1,064 | 1,170 |
| Imports | 1,206 | 1,384 | 1,896 | 2,113 | 2,185 | 2,215 | 2,193 | 2,215 |
| Of which: resources | 355 | 447 | 865 | 979 | 952 | 864 | 681 | 549 |
| Services and income (net) | -108 | -238 | -175 | -182 | -49 | -76 | 79 | 113 |
| Transfers | 85 | 170 | 144 | 147 | 158 | 170 | 179 | 190 |
| Capital account balance | 599 | 556 | 1,022 | 1,014 | 869 | 664 | 391 | 205 |
| Of which: private | 484 | 391 | 870 | 894 | 765 | 567 | 280 | 78 |
| Trade (in percent of GDP) | | | | | | | | |
| Exports | 22.4 | 29.0 | 25.2 | 26.6 | 25.1 | 26.9 | 25.8 | 25.7 |
| Imports | 41.8 | 40.3 | 47.3 | 46.9 | 42.9 | 38.8 | 34.6 | 31.4 |
| External public debt and debt services | | | | | | | | |
| External public debt (in percent of GDP) | 77.1 | 69.0 | 63.0 | 58.6 | 54.0 | 49.8 | 46.6 | 43.7 |
| Net present value of debt (in percent of exports) | 168.9 | 134.5 | 140.4 | 127.2 | 124.5 | 110.1 | 107.6 | 102.4 |
| External public debt services (in percent of exports) | 7.7 | 4.0 | 6.1 | 6.5 | 6.6 | 5.8 | 5.6 | 5.3 |
| Gross official reserves | | | | | | | | |
| In millions of US dollars | 238 | 336 | 437 | 497 | 561 | 635 | 726 | 830 |
| In months of imports 3/ | 2.8 | 3.6 | 4.3 | 4.5 | 4.7 | 4.7 | 4.9 | 5.2 |
| **Memorandum items:** | | | | | | | | |
| Nominal GDP (in billions of kip) | 30,705 | 34,581 | 38,569 | 43,349 | 48,920 | 54,962 | 60,985 | 67,805 |

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

1/ Estimates for total investment are from National Statistical Center; and other indicators are estimated using data for public finances and balance of payments.
2/ Fiscal year basis (October to September).
3/ Excludes imports associated with large resource projects.

Table 6. Lao P.D.R.: Summary Macroeconomic Framework (Reactive Scenario), 2005–12

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|
| | | Staff est. | | | Staff proj. | | | |
| Output and prices (percent change, unless otherwise indicated) | | | | | | | | |
| Real GDP | 7.1 | 7.6 | 7.1 | 7.9 | 7.5 | 6.4 | 4.6 | 4.2 |
| (excluding resources) | 4.3 | 4.8 | 5.1 | 5.3 | 4.4 | 3.9 | 3.5 | 3.0 |
| GDP per capita (in millions of US dollars) | 489 | 570 | 653 | 743 | 843 | 892 | 936 | 985 |
| CPI (annual average) | 7.2 | 6.8 | 4.0 | 6.2 | 7.3 | 8.5 | 9.0 | 9.0 |
| Savings and investment balance (in percent of GDP) 1/ | | | | | | | | |
| Gross fixed investment | 32.6 | 32.5 | 42.1 | 37.9 | 32.3 | 26.1 | 20.8 | 16.7 |
| Private | 26.1 | 25.7 | 36.5 | 32.4 | 27.7 | 21.9 | 16.8 | 12.8 |
| Government | 6.5 | 6.8 | 5.6 | 5.4 | 4.6 | 4.2 | 4.0 | 3.9 |
| Gross national savings | 11.7 | 18.7 | 18.3 | 16.3 | 16.4 | 15.1 | 14.9 | 13.8 |
| Foreign savings (including official transfers) | 20.9 | 13.8 | 23.8 | 21.5 | 15.9 | 11.0 | 5.9 | 2.9 |
| Public finances (in percent of GDP) 2/ | | | | | | | | |
| Revenue | 11.4 | 12.7 | 13.2 | 13.2 | 12.6 | 12.3 | 12.2 | 11.9 |
| Grants | 1.7 | 2.1 | 1.3 | 1.0 | 0.9 | 0.9 | 0.9 | 0.9 |
| Expenditure | 17.5 | 18.5 | 15.7 | 16.3 | 15.2 | 14.6 | 14.4 | 14.1 |
| Of which: current | 8.5 | 9.3 | 9.5 | 10.3 | 10.1 | 10.1 | 9.9 | 9.9 |
| capital and onlending | 7.6 | 7.5 | 5.2 | 5.1 | 4.3 | 3.9 | 3.8 | 3.6 |
| Overall balance | -4.4 | -3.7 | -1.3 | -2.1 | -1.6 | -1.4 | -1.3 | -1.3 |
| Non-resource balance | -5.1 | -4.9 | -3.6 | -4.7 | -4.0 | -3.6 | -3.5 | -3.3 |
| Domestic financing | 0.2 | -1.3 | -1.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Foreign financing | 4.2 | 5.0 | 2.5 | 2.1 | 1.6 | 1.4 | 1.3 | 1.3 |
| Balance of payments (in millions of US dollars; unless otherwise indicated) | | | | | | | | |
| Current account balance | -582 | -456 | -918 | -965 | -828 | -628 | -363 | -192 |
| In percent of GDP | -20.2 | -13.3 | -22.9 | -20.8 | -15.4 | -10.8 | -5.8 | -2.9 |
| Exports | 646 | 996 | 1,009 | 1,182 | 1,233 | 1,460 | 1,522 | 1,641 |
| Of which: resources | 310 | 632 | 612 | 765 | 802 | 1,016 | 1,064 | 1,170 |
| Imports | 1,206 | 1,384 | 1,896 | 2,116 | 2,175 | 2,172 | 2,100 | 2,071 |
| Of which: resources | 355 | 447 | 865 | 979 | 952 | 864 | 681 | 549 |
| Services and income (net) | -108 | -238 | -175 | -178 | -43 | -86 | 51 | 63 |
| Transfers | 85 | 170 | 144 | 147 | 158 | 170 | 164 | 175 |
| Capital account balance | 599 | 556 | 1,022 | 1,006 | 840 | 582 | 315 | 149 |
| Of which: private | 484 | 396 | 870 | 886 | 736 | 485 | 211 | 37 |
| Trade (in percent of GDP) | | | | | | | | |
| Exports | 22.4 | 29.0 | 25.2 | 25.4 | 22.9 | 25.2 | 24.6 | 24.7 |
| Imports | 41.8 | 40.3 | 47.3 | 45.5 | 40.5 | 37.5 | 33.9 | 31.2 |
| External public debt and debt services | | | | | | | | |
| External public debt (in percent of GDP) | 77.1 | 69.0 | 63.0 | 56.9 | 51.1 | 49.1 | 47.7 | 46.4 |
| Net present value of debt (in percent of exports) | 169 | 135 | 140 | 128 | 127 | 115 | 116 | 114 |
| External public debt services (in percent of exports) | 7.7 | 4.0 | 6.1 | 6.5 | 6.7 | 6.0 | 6.1 | 5.9 |
| Gross official reserves | | | | | | | | |
| In millions of US dollars | 238 | 336 | 437 | 473 | 480 | 429 | 376 | 329 |
| In months of imports 3/ | 2.8 | 3.6 | 4.3 | 4.3 | 4.1 | 3.4 | 2.8 | 2.3 |
| **Memorandum items:** | | | | | | | | |
| Nominal GDP (in billions of kip) | 30,705 | 34,581 | 38,569 | 44,096 | 51,101 | 58,994 | 67,258 | 77,077 |

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

1/ Estimates for total investment are from National Statistical Center; and other indicators are estimated using data for public finances and balance of payments.
2/ Fiscal year basis (October to September).
3/ Excludes imports associated with large resource projects.

## APPENDIX I: THE AUTHORITIES' RESPONSE TO RECENT FUND POLICY ADVICE

| Advice from the 2005 Article IV Consultation | Actions Taken |
|---|---|
| **Maintaining macroeconomic stability** | |
| Ensure a sound budget framework for 2005/06 | Fiscal performance improved in 2005/06 with increased revenue and contained expenditure. However, higher wage growth, reflecting a wage hike, squeezed domestically-financed capital expenditure. |
| Make the expansion in civil service employment conditional on strengthened revenue mobilization | Employment growth has been contained. |
| Continue to gear monetary policy toward reducing inflation | BoL's net domestic assets have declined, partially offsetting the impact of reserves accumulation on rapidly rising monetary aggregates. |
| Reduce the exposure of state-owned commercial banks to a government-sponsored project | State-owned commercial banks have reduced exposure to the project. |
| **Public finance issues** | |
| Introduce VAT | VAT law was approved in 2006, and it is scheduled for introduction in late 2008. |
| Establish a strong tax and customs administration | The government plans to centralize tax and customs administration. |
| Establish a strong national treasury | A new Treasury decree was drafted with the aim of establishing a national treasury. |
| Review center-province relations | Budget law was approved in 2006, and its operational details, including revenue and expenditure responsibilities, are under preparation. |
| Maximize grant financing and concessional borrowing | The government intends to borrow commercially for a hydro project. |
| **Structural issues** | |
| Expedite the restructuring of the state-owned commercial banks | Little progress. Only the first tranche of the recapitalization bonds has been issued, and there is no active search for strategic partners. |
| Strengthen the trade and investment climate | Some progress in trade liberalization but limited progress in improving the investment climate. |
| Improve the quality of economic statistics | Some progress, but signified improvements required. |

# APPENDIX II. POVERTY INDICATORS

Table 1. Lao P.D.R.: Millennium Development Goals Indicators, 1990-2015

| | 1990 | 1995 | 1997 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | Latest Data | 2015 Target |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **1 Eradicate extreme poverty and hunger** | | | | 2015 target = halve 1990 $1 a day poverty and malnutrition rates | | | | | | | |
| Population below $1 a day (%) | 53.0 | .. | 38.4 | 31.3 | 28.1 | 25.8 | .. | .. | .. | 25.8 (2003) | [26.5] |
| Poverty gap at $1 a day (%) | .. | .. | 6.3 | .. | 6.1 | .. | .. | .. | .. | 6.1 (2002) | |
| Percentage share of income or consumption held by poorest 20% | .. | 7.6 | 7.6 | .. | 8.1 | .. | .. | .. | .. | 8.1 (2002) | |
| Prevalence of child malnutrition (% of children under 5) | .. | 40 | .. | 40 | .. | .. | .. | .. | .. | 40 (2001) | |
| Population below minimum level of dietary energy consumption (%) | 29.0 | 28.0 | 28.0 | 22.0 | .. | 22.0 | .. | .. | .. | 22.0 (2003) | [14.5] |
| **2 Achieve universal primary education** | | | | | 2015 target = net enrollment to 100 | | | | | | |
| Net primary enrollment ratio (% of relevant age group) | 61.4 | 70.0 | 80.2 | 81.4 | 82.8 | 85.0 | 84.4 | .. | .. | 84.4 (2004) | [100] |
| Percentage of cohort reaching grade 5 (%) | 53.3 | 55.4 | 54.3 | 62.3 | 64.1 | 62.6 | .. | .. | .. | 62.6 (2003) | [100] |
| Youth literacy rate (% ages 15-24) | 70.1 | 74.0 | .. | 78.6 | 79.3 | 80.0 | 78.5 | .. | .. | 78.5 (2004) | [100] |
| **3 Promote gender equality** | | | | | 2005 target = education ratio to 100 | | | | | | |
| Ratio of girls to boys in primary and secondary education (%) | 75.3 | 77.8 | 81.1 | 82.0 | .. | 83.1 | .. | .. | .. | 83.1 (2003) | [100] |
| Ratio of young literate females to males (% ages 15-24) | 76.2 | 80.1 | .. | 90.4 | .. | .. | 90.0 | .. | .. | 90.0 (2004) | [100] |
| Share of women employed in the nonagricultural sector (%) | 42.1 | .. | .. | .. | .. | .. | .. | .. | .. | 42.1 (1990) | |
| Proportion of seats held by women in national parliament (%) | 6 | 9 | 9 | 21 | 21 | 23 | 23 | 23 | 23 | 23 (2006) | |
| **4 Reduce child mortality** | | | | 2015 target = reduce 1990 under 5 mortality by two-thirds | | | | | | | |
| Under 5 mortality rate (per 1,000) | 163 | 134 | .. | 105 | 100 | 91 | 83 | .. | .. | 83 (2004) | [54.3] |
| Infant mortality rate (per 1,000 live births) | 120 | 105 | .. | 90 | 87 | 82 | 65 | .. | .. | 65 (2004) | |
| Immunization, measles (% of children under 12 months) | 32 | 68 | 67 | 50 | 55 | 42 | 36 | .. | .. | 36 (2004) | |
| **5 Improve maternal health** | | | | 2015 target = reduce 1990 maternal mortality by three-fourths | | | | | | | |
| Maternal mortality ratio (modeled estimate, per 100,000 live births) | 650 | 650 | .. | 650 | .. | .. | .. | .. | .. | 650 (2001) | [162.5] |
| Births attended by skilled health staff (% of total) | .. | .. | .. | 19.4 | .. | .. | .. | .. | .. | 19.4 (2001) | |
| **6 Combat HIV/AIDS, malaria and other diseases** | | | | 2015 target = halt, and begin to reverse, AIDS, etc. | | | | | | | |
| Prevalence rate of HIV, females (% ages 15-24) | .. | .. | .. | 0.1 | .. | 0.1 | .. | .. | .. | 0.1 (2003) | [0.0] |
| Contraceptive prevalence rate (% of women ages 15-49) | .. | 25.1 | .. | .. | .. | .. | .. | .. | .. | 32.0 (2000) | |
| Number of children orphaned by HIV/AIDS | .. | .. | .. | 280 | .. | .. | .. | .. | .. | 280 (2001) | |
| Incidence of tuberculosis (per 100,000 people) | .. | .. | 166.7 | 161.8 | .. | 157.2 | .. | .. | .. | 157.2 (2003) | [0.0] |
| Tuberculosis cases detected under DOTS (%) | .. | 24.0 | 33.5 | 40.1 | 46.3 | 46.7 | 55.3 | .. | .. | 55.3 (2004) | |
| **7 Ensure environmental sustainability** | | | | | | | | | | | |
| Forest area (% of total land area) | 56.7 | .. | .. | 54.4 | .. | .. | 69.9 | .. | .. | 69.9 (2004) | |
| Nationally protected areas (% of total land area) | .. | .. | .. | 16.0 | 16.0 | 16.0 | 16.0 | 16.0 | .. | 16.0 (2003) | |
| GDP per unit of energy use (PPP $ per kg oil equivalent) | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | |
| CO2 emissions (metric tons per capita) | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | .. | .. | .. | 0.2 (2001) | |
| Access to an improved water source (% of population) | .. | .. | .. | 37.0 | .. | 43.0 | 51.0 | .. | .. | 51.0 (2004) | [74] |
| Access to improved sanitation (% of population) | .. | .. | .. | 30.0 | .. | 24.0 | 30.0 | .. | .. | 30.0 (2004) | [60] |
| Access to secure tenure (% of population) | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | |
| **8 Develop a Global Partnership for Development** | | | | | | | | | | | |
| Youth unemployment rate (% of total labor force ages 15-24) | .. | 5.0 | .. | .. | .. | .. | .. | .. | .. | 5.0 (1995) | |
| Fixed line and mobile telephones (per 1,000 people) | 1.6 | 3.9 | 6.1 | 15.2 | 21.2 | 32.0 | 48.2 | .. | .. | 48.2 (2004) | [Increase] |
| Personal computers (per 1,000 people) | .. | 1.1 | 1.6 | 3.0 | 3.3 | 3.5 | 3.8 | .. | .. | 3.8 (2004) | [Increase] |
| **General indicators** | | | | | | | | | | | |
| Population (millions) | 4.1 | 4.7 | 4.9 | 5.4 | 5.5 | 5.7 | 5.8 | 5.9 | .. | 5.9 (2005) | |
| Gross national income ($ billions)1/ | 0.8 | 1.7 | 1.9 | 1.7 | 1.8 | 2.1 | 2.5 | 2.7 | .. | 2.7 (2005) | |
| GNI per capita ($) | 200 | 370 | 380 | 315 | 318 | 372 | 431 | 440 | .. | 440 (2005) | |
| Adult literacy rate (% of people ages 15 and over) | 56.5 | 60.6 | .. | 68.7 | 66.4 | .. | 68.7 | .. | .. | 68.7 (2004) | |
| Total fertility rate (births per woman) | 6 | 5.5 | 5.3 | 5.0 | 4.8 | 4.7 | 4.6 | .. | .. | 4.6 (2004) | |
| Life expectancy at birth (years) | 49.7 | 51.8 | 52.5 | 53.7 | 54.5 | 54.7 | 55.3 | .. | .. | 55.3 (2004) | |
| Aid (% of GNI) | 17.3 | 17.6 | .. | 14.5 | 15.9 | 14.7 | 11.3 | .. | .. | 11.3 (2004) | |
| External debt (% of GNI) | 204.3 | 123.2 | .. | 150 | 165.2 | .. | .. | .. | .. | 165.2 (2002) | |
| Investment (% of GDP) | 13.5 | 26.0 | .. | 22.1 | .. | .. | .. | .. | .. | 22.1 (2001) | |
| Trade (% of GDP) | 35.8 | 60.6 | 65.2 | 61.6 | 62.3 | 57.4 | 57.4 | 58.9 | | 58.9 (2005) | |

*Sources: Millenium Development Goal Indicators (http://mdgs.un.org/unsd/mdg), World Development Indicators database and World Bank, 2005.*

1/ Fund staff estimates.

Table 2. Lao P.D.R.: Regional Comparison of Selected Indicators 1/

| | Lao P.D.R. | Cambodia | China | Thailand | Vietnam | East Asia & Pacific | Low-income | Sub-Saharan Africa |
|---|---|---|---|---|---|---|---|---|
| POPULATION | | | | | | | | |
| Total population, mid-year (millions) | 5.9 | 14.1 | 1,304.5 | 64.2 | 83.0 | 1,885.3 | 2,353.0 | 741.4 |
| Growth rate (% annual average for period) | 2.3 | 2.0 | 0.6 | 0.8 | 1.0 | 0.8 | 1.8 | 2.1 |
| Urban population (% of population) | 20.6 | 19.7 | 40.4 | 32.3 | 26.4 | 41.5 | 30.0 | 35.2 |
| Total fertility rate (births per woman) | 4.6 | 4.0 | 1.8 | 1.9 | 1.8 | 2.0 | 3.7 | 5.3 |
| POVERTY | | | | | | | | |
| *(% of population)* | | | | | | | | |
| National headcount index | 33.5 | 35.9 | 4.6 | .. | 28.9 | .. | .. | .. |
| Urban headcount index | 19.7 | 40.1 | 2.0 | .. | 35.6 | .. | .. | .. |
| Rural headcount index | 37.6 | 13.9 | 4.6 | .. | 6.6 | .. | .. | .. |
| $ 1 a day headcount index | 26 | 19 | 12 | 2 | 11 | 11 | .. | 46 |
| $ 2 a day headcount index | 73 | 65 | 36 | 24 | 55 | 37 | .. | 77 |
| Human Development index | 0.55 | 0.58 | 0.77 | 0.78 | 0.71 | 0.76 | 0.56 | 0.47 |
| INCOME | | | | | | | | |
| GNI per capita (US$) | 440 | 380 | 1,740 | 2,750 | 620 | 1,627 | 580 | 745 |
| Consumer price index (2000=100) | 138 | 114 | 107 | 112 | 124 | .. | .. | .. |
| INCOME/CONSUMPTION DISTRIBUTION | | | | | | | | |
| Gini index | 35 | 40 | 45 | 42 | 37 | .. | .. | .. |
| Lowest quintile (% of income or consumption) | 8.1 | 6.9 | 4.7 | 6.3 | 7.5 | .. | .. | .. |
| Highest quintile (% of income or consumption) | 43.3 | 47.6 | 50.0 | 49.0 | 45.4 | .. | .. | .. |
| SOCIAL INDICATORS | | | | | | | | |
| Public expenditure | | | | | | | | |
| Health (% of GDP) | 1.2 | 2.1 | 2.0 | 2.0 | 1.5 | 1.9 | 1.5 | 2.6 |
| Education (% of GDP) | 2.3 | 2.0 | 2.2 | 4.2 | 1.8 | 3.2 | 3.2 | 3.3 |
| Adult literacy | | | | | | | | |
| *(% of people aged 15 and above)* | | | | | | | | |
| Total | 69 | 74 | 91 | 93 | 90 | 91 | 62 | 65 |
| Male | 77 | 85 | 95 | 95 | 94 | 95 | 73 | 71 |
| Female | 61 | 64 | 87 | 91 | 87 | 87 | 50 | 58 |
| Net primary school enrollment rate | | | | | | | | |
| *(% of age group)* | | | | | | | | |
| Total | 84 | 98 | 95 | 86 | 94 | 93 | 80 | ... |
| Male | 87 | 100 | 97 | 87 | 98 | 93 | 83 | ... |
| Female | 82 | 96 | 94 | 85 | 92 | 94 | 77 | ... |
| Access to an improved water source | | | | | | | | |
| *(% of population)* | | | | | | | | |
| Total | 51 | 41 | 77 | 99 | 85 | 79 | 75 | 58 |
| Urban | 79 | 64 | 93 | 98 | 99 | 92 | 89 | 82 |
| Rural | 43 | 35 | 67 | 100 | 80 | 70 | 70 | 46 |
| Access to improved sanitation | | | | | | | | |
| *(% of population)* | | | | | | | | |
| Total | 30 | 17 | 44 | 99 | 61 | 51 | 38 | 36 |
| Urban | 67 | 53 | 69 | 98 | 92 | 72 | 61 | 55 |
| Rural | 20 | 8 | 28 | 99 | 50 | 36 | 28 | 26 |
| Immunization rate | | | | | | | | |
| *(% 12-23 months)* | | | | | | | | |
| Measles | 36 | 80 | 84 | 96 | 97 | 82 | 65 | 64 |
| DPT | 45 | 85 | 91 | 98 | 96 | 86 | 67 | 64 |
| Prevalence of undernourishment (% of population) | 22 | 33 | 12 | 21 | 17 | 12 | 25 | 32 |
| Child malnutrition (% under 5 years) | | | | | | | | |
| Height for age | 42 | 45 | 14 | 13 | 37 | 22 | 41 | 39 |
| Weight for age | 40 | 45 | 10 | 19 | 28 | 15 | 39 | 29 |
| Life expectancy at birth (years) | | | | | | | | |
| Total | 55 | 57 | 71 | 71 | 70 | 70 | 59 | 46 |
| Male | 54 | 53 | 70 | 67 | 68 | 68 | 58 | 46 |
| Female | 57 | 60 | 73 | 75 | 73 | 72 | 60 | 47 |
| Mortality | | | | | | | | |
| Infant (per 1,000 live births) | 65 | 97 | 26 | 18 | 17 | 29 | 79 | 100 |
| Under 5 (per 1,000 live births) | 83 | 141 | 31 | 21 | 23 | 37 | 121 | 168 |
| Adult (15-59) | | | | | | | | |
| Male (per 1,000 population) | 355 | 373 | ... | 245 | 203 | 179 | 319 | 519 |
| Female (per 1,000 population) | 299 | 264 | ... | 150 | 139 | 122 | 268 | 461 |
| Maternal (modeled, per 100,000 live births) | 650 | 450 | 56 | 44 | 130 | 116 | 689 | 917 |
| Births attended by skilled health staff (% of total) | 19 | 32 | 96 | 99 | 90 | 86 | 41 | 42 |

Source: World Bank (2006) and UNDP (2006).

1/ Latest year available.

INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL RELATIONS DEPARTMENT

**APPENDIX III**

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# IMF Concludes 2007 Article IV Consultation with the Lao People's Democratic Republic

On August 3, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Lao People's Democratic Republic.[7]

## Background

Macroeconomic performance remains strong. Real GDP growth increased to 7½ percent in 2006, driven by the resource sector such as a sizable expansion of mineral production and the construction of the Nam Theun 2 (NT2) hydro-electric dam. The non-resource sector continued to grow moderately. Inflation has fallen below 4 percent in recent months, due to favorable oil and food prices and the lagged impact of the exchange rate appreciation. The current account deficit narrowed, reflecting buoyant resource exports and rising tourism receipts, and together with higher FDI and ODA inflows, resulted in an increase in the balance of payments. By end-June 2007, gross international reserves increased to about $460 million, 4.6 months of non resource imports. The rapid accumulation of international reserves led to an acceleration

[7] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the August 3, 2007 Executive Board discussion based on the staff report.

in the growth of monetary aggregates. By end–May 2007 reserve and broad money growth accelerated to 45 and 39 percent respectively.

Fiscal policy in 2005/06[8] and the first eight months of 2006/07 contributed to lower demand pressures. Higher-than-anticipated resource revenues, coupled with non-resource revenues gains from the full implementation of tax changes in 2005 helped to reduce the deficit and lower net domestic borrowing. Bank credit to the private sector has also fallen in recent months.

Progress in economic reform has been mixed and the cost of doing business remains high. Restructuring of state-owned banks (SOCBs) and enterprises (SOEs) is proceeding, but SOCBs are far from being solvent and some SOEs are still making losses or are heavily indebted. Several laws for reforming the budget system (such as tax and customs administration and intergovernmental relations), introducing a VAT, and improving the investment climate (including the 2005 Enterprise Law and 2006 Commercial Bank Law) have been approved, but there is considerable delay in finalizing the respective implementing regulations. AFTA agreement is being pursued, and work to gain WTO accession is ongoing.

The economic outlook is promising, but much depends on the way in which the government handles the natural resource bonanza. Were the government to adopt sound policies and accelerate reforms in anticipation of an adverse impact of the resource sector, growth would remain strong at around 6½ percent in the medium term, and inflation would stay below 5 percent. On the contrary, the outlook would be less benign if the government does not take timely policy actions, with lower growth and higher inflation. There are several risks to the outlook. Upside risks include additional proven mineral reserves, new investment in the mining sector, and construction of more hydropower plants. Downside risks comprise adverse commodity price shocks, delays in construction of hydropower plants, and slow process in important economic reform.

**Executive Board Assessment**

[8] The fiscal year ends on September 30.

## Lao P.D.R.: Selected Economic and Financial Indicators, 2003–07

Nominal GDP (2006 est.): $3,437 million
Population (2006 est.): 6.0 million
GDP per capita (2006 est.): $ 572.8

| | 2003 | 2004 | 2005 | 2006 Staff est. | 2007 Staff proj. |
|---|---|---|---|---|---|
| GDP and prices (percentage change) | | | | | |
| Real GDP growth | 6.1 | 6.4 | 7.1 | 7.6 | 7.1 |
| CPI (annual average) | 15.5 | 10.5 | 7.2 | 6.8 | 4.0 |
| Public finances (in percent of GDP) 1/ | | | | | |
| Revenue | 10.9 | 11.0 | 11.4 | 12.7 | 13.2 |
| Grants | 2.1 | 1.1 | 1.7 | 2.1 | 1.3 |
| Expenditure | 18.6 | 15.5 | 17.5 | 18.5 | 15.7 |
| Overall balance (including grants) | -5.6 | -3.4 | -4.4 | -3.7 | -1.3 |
| Domestic financing | 0.4 | -0.2 | 0.2 | -1.3 | -1.3 |
| External financing | 5.1 | 3.6 | 4.2 | 5.0 | 2.5 |
| Money and Credit (annual percent change) 2/ | | | | | |
| Reserve money | 28.5 | 12.9 | 17.6 | 38.2 | 20.4 |
| Broad money | 15.5 | 21.5 | 7.7 | 30.1 | 24.8 |
| Bank credit to the economy 3/ | 1.3 | 12.6 | 26.8 | 4.2 | 16.0 |
| Interest rates (end of period) | | | | | |
| On three-month kip deposits | 14.0 | 7.5 | 5.5 | 5.5 | ... |
| On short-term kip loans | 22.4 | 16.0 | 17.8 | 14.0 | ... |
| Balance of payments | | | | | |
| Exports (percent change) | 21.6 | 11.0 | 29.4 | 54.1 | 1.3 |
| Imports (percent change) | 9.6 | 40.9 | 23.4 | 14.8 | 37.0 |
| Trade Balance (in percent of GDP) | -11.3 | -19.0 | -19.4 | -11.3 | -22.1 |
| Current account balance (in percent of GDP) | -8.1 | -14.3 | -20.2 | -13.3 | -22.9 |
| Gross official reserves (in millions of U.S. dollars) | 214 | 226 | 238 | 336 | 437 |
| (In months of prospective goods and services imports) 4/ | 3.2 | 3.0 | 2.8 | 3.6 | 4.3 |
| (In percent of short-term debt) | 305.1 | 277.2 | 180.9 | 225.4 | 334.5 |
| External public debt and debt services | | | | | |
| External public debt (in percent of GDP) | 89.1 | 83.2 | 77.1 | 69.0 | 63.0 |
| Net present value of debt (in percent of exports) | 204.6 | 198.9 | 168.9 | 134.5 | 140.4 |
| External public debt services (in percent of exports) | 6.7 | 7.5 | 7.7 | 4.0 | 6.1 |
| Exchange rate | | | | | |
| Official exchange rate (kip per dollar; end of period) | 10,434 | 10,357 | 10,767 | 9,655 | ... |
| Nominal effective exchange rate (2000=100) | 71.6 | 67.7 | 67.3 | 68.6 | ... |
| Real effective exchange rate (2000=100) | 94.1 | 96.1 | 99.1 | 104.5 | ... |
| **Memorandum item:** | | | | | |
| Nominal GDP (calendar year; in billions of kip) | 22,597 | 26,539 | 30,705 | 34,581 | 38,569 |

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

1/ Fiscal year basis (October to September).
2/ Money and credit data are evaluated at current exchange rates.
3/ Excluding debt write-offs.
4/ Excludes imports associated with large resource projects.