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January 19, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Lao People's Democratic Republic - Staff Report for the 1987
Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1987 Article IV consultation with the Lao People's Democratic Republic, which has been tentatively scheduled for discussion on Wednesday, February 10, 1988. A draft decision appears on page 19.

Mr. Baumgartner (ext. 7307) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

Staff Report for the 1987 Article IV Consultation

Prepared by the Asian Department

(In consultation with the Exchange and Trade Relations,
Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by P. R. Narvekar and H. B. Junz

January 15, 1988

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I. Introduction

The 1987 Article IV consultation discussions with the Lao People's Democratic Republic were held in Vientiane during November 2-13, 1987. The Lao representatives included the Vice Minister of Finance, the Vice Presidents of the State Bank and the State Planning Committee, and senior officials of various ministries, the State Bank, and public enterprises. The staff team consisted of Messrs. Baumgartner (Head), De Wulf and Ordoobadi (all ASD), Ms. Di Tullio (IBRD), and Mrs. Ruch (secretary, ASD).

Laos continues to avail itself of the transitional arrangements under the provisions of Article XIV. It also imposes restrictions and multiple currency practices subject to approval under Article VIII, Sections 2(a) and 3. A description of the exchange system is contained in the accompanying paper on recent economic developments. Laos is eligible for access to the structural adjustment facility (SAF).

II. Background and Recent Developments

Laos is a landlocked, mountainous, and sparsely populated country with one of the lowest per capita incomes in the world. Subsistence agriculture and animal husbandry are the mainstay of the economy. Wood processing and the mining of tin and gypsum are the traditional non-agricultural activities, but, in recent years, the generation of hydro-electricity has assumed importance and has become a major source of export earnings. The difficult terrain and inadequate infrastructure have impeded both internal and external trade. Slash-and-burn cultivation, which is practiced in large parts of the country, has given rise to environmental concerns because of the destruction of forests and the erosion of soil.

Development has been hampered by a distorted incentive structure caused by rigid official prices, extensive controls on economic activity, and an overvalued exchange rate. The use of money has been limited by the prevalence of barter transactions between the state and farmers and the payment of most of the salaries of civil servants and state enterprise employees in the form of scrip usable only in government shops. Controls have led to the emergence of parallel markets for goods and foreign exchange, and high inflation has contributed to the circulation of foreign currency in border areas. The lack of expertise and adequate statistics have impeded the formulation and monitoring of economic policy.

Despite these obstacles to economic development, economic growth during 1984-86 was rapid. This reflected a low income base, favorable weather, the abundance of relatively fertile soil for rice cultivation,

the completion of a large hydroelectric project, and improvements in supply conditions. Real GDP is estimated to have increased at an annual average rate of 7 1/2 percent during 1984-86, with agricultural output growing by 8 percent and industrial production increasing by 11 percent per year. Growth suffered a setback in 1987, as drought affected both rice output and the production of electricity. Preliminary estimates suggest that rice output, which accounts for over 50 percent of total agricultural production, declined by some 18 percent in 1987; the shortfall was concentrated in late 1987 and the paddy harvest in early 1988 is also expected to be lower. Because of low water levels, the production of hydroelectricity fell in 1987 and is likely to remain below normal levels in early 1988. By contrast, logging activity was temporarily stimulated by the announcement of the introduction of a ban on log exports from January 1, 1988, while transport and commerce benefited from a liberalization of internal trade. In all, real GDP is estimated to have declined by about 3 percent in 1987.

Price developments were favorable in 1986-87, with estimated inflation ^{1/} in Vientiane slowing from 115 percent in 1985 (when official prices were adjusted about fourfold) to 35 percent in 1986 and 6 percent in 1987; price increases in other provinces are estimated to have been somewhat higher. The main reasons for the marked improvement in price performance were the freeing of domestic trade and the widening of import-export activities of the "Societes Mixtes" (joint ventures of private traders and various municipalities created to enhance foreign trade). These developments resulted in a substantial improvement in the supply of agricultural products in Vientiane, mainly rice shipped from surplus areas in the south, and of consumer goods, both imported and manufactured with imported inputs. Domestic credit, virtually all of which is to state enterprises, increased by 60 percent in 1986 and by close to 100 percent in the 12 months to June 1987, with currency and broad money growing even more rapidly (Table 1). However, there was also a substantial increase in the demand for money, reflecting the liberalization of domestic trade and increased use of cash in agricultural procurement.

The analysis of budgetary developments (consolidated central and provincial governments) is made difficult by a number of shortcomings in the fiscal accounts. First, the use of unrealistic exchange rates and official prices has introduced large distortions into the fiscal accounts. Second, while the Government has not borrowed from the State Bank, it has had indirect access to domestic bank credit through transfers of liquid funds from state enterprises, which account for about 80 percent of total budget revenues and have received large bank financing; as a result, both the budget deficit and financing are

^{1/} Based on an index constructed by the staff from data on official and free market prices of major items in Vientiane.

Table 1. Laos: Monetary Survey, 1984-87

	1984	1985	1986	1986	1987
	End of Year			June	
(In millions of kip)					
Foreign assets (net)	<u>41</u>	<u>287</u>	<u>236</u>	<u>222</u>	<u>228</u>
Domestic credit	<u>2,056</u>	<u>2,717</u>	<u>4,329</u>	<u>2,957</u>	<u>5,810</u>
Government (net)	<u>-109</u>	<u>-273</u>	<u>-484</u>	<u>-302</u>	<u>-604</u>
Private and cooperative sectors	<u>134</u>	<u>250</u>	<u>769</u>	<u>288</u>	<u>984</u>
State enterprises	<u>2,031</u>	<u>2,740</u>	<u>4,044</u>	<u>2,971</u>	<u>5,520</u>
Of which: commerce	<u>(530)</u>	<u>(725)</u>	<u>(1,999)</u>	<u>(803)</u>	<u>(3,015)</u>
Liquidity	<u>1,682</u>	<u>2,280</u>	<u>3,876</u>	<u>2,569</u>	<u>5,428</u>
Deposits of public enterprises	<u>1,075</u>	<u>1,411</u>	<u>2,307</u>	<u>1,599</u>	<u>2,997</u>
Deposits of private and cooperative sectors	<u>130</u>	<u>180</u>	<u>427</u>	<u>206</u>	<u>616</u>
Household savings <u>1/</u>	<u>37</u>	<u>54</u>	<u>95</u>	<u>69</u>	<u>104</u>
Currency in circulation <u>2/</u>	<u>450</u>	<u>635</u>	<u>1,047</u>	<u>695</u>	<u>1,711</u>
Other assets	<u>-333</u>	<u>-724</u>	<u>-689</u>	<u>-610</u>	<u>-610</u>
(Percentage growth over previous 12 months)					
Total credit	<u>23.1</u>	<u>32.1</u>	<u>59.3</u>	<u>36.0</u>	<u>96.5</u>
Private and cooperative sectors	<u>36.7</u>	<u>86.6</u>	<u>207.6</u>	<u>94.6</u>	<u>241.7</u>
State enterprises	<u>28.1</u>	<u>34.9</u>	<u>47.6</u>	<u>31.3</u>	<u>85.8</u>
Of which: commerce	<u>(12.3)</u>	<u>(36.8)</u>	<u>(175.7)</u>	<u>(38.4)</u>	<u>(275.5)</u>
Total liquidity	<u>-0.2</u>	<u>35.6</u>	<u>70.0</u>	<u>50.0</u>	<u>111.3</u>
Deposits plus household savings	<u>-9.4</u>	<u>32.8</u>	<u>71.8</u>	<u>55.9</u>	<u>98.4</u>
Currency	<u>40.6</u>	<u>41.1</u>	<u>64.9</u>	<u>36.0</u>	<u>146.2</u>
(In percent)					
Memorandum items:					
Cash/total liquidity	<u>26.8</u>	<u>27.9</u>	<u>27.0</u>	<u>27.5</u>	<u>31.5</u>
Liquidity/GDP	<u>6.5</u>	<u>5.4</u>	<u>6.2</u>	<u>4.1 <u>3/</u></u>	<u>8.4 <u>3/</u></u>

Source: Data provided by the Lao authorities.

1/ Includes foreign currency deposits.

2/ Excludes substantial amounts of U.S. dollars and Thai baht.

3/ Liquidity data for June over estimated GDP for the whole year.

understated. Third, most subsidies are borne by state enterprises, and changes in subsidies, therefore, mainly affect budget revenue (profit transfers from state enterprises) rather than expenditure; the total amount of subsidies cannot be fully ascertained.

Budgetary developments in 1986 indicate a decline in the deficit to 15 percent of GDP from 25 percent of GDP in 1985 (Table 2). ^{1/} Transfers from state enterprises almost doubled in 1986, mainly owing to price adjustments and some special factors. ^{2/} Large wage increases and increased expenditure on goods resulted in a 50 percent rise in current expenditure, while capital expenditure grew by only 15 percent. ^{3/} Preliminary estimates indicate a budget deficit of about 15 percent of GDP in 1987. As in earlier years, this deficit was entirely financed through foreign grants and concessional loans. Transfers from state enterprises are expected to grow by only 10 percent, in part owing to a decline in the price of electricity exports. ^{4/} At the same time, current expenditure has been curtailed through across-the-board cuts and is projected to increase by no more than 5 percent; capital expenditure is expected to continue to grow by 15 percent.

Laos' balance of payments has been characterized by large trade deficits with the nonconvertible zone and significantly smaller deficits (by about one half) vis-a-vis the convertible zone. The trade deficit with the nonconvertible zone rose steadily from \$89 million in 1984 to an estimated \$115 million in 1987 (Table 3). As long-term loans covered only about one-third of these deficits, Laos accumulated large negative balances under bilateral clearing accounts during this period. Despite the growing trade deficit, Laos registered sizable overall balance of payments surpluses with the convertible zone in 1985-86. However, a further large increase in the trade deficit, owing to the sharp drop in the price of electricity exports to Thailand, is estimated to have virtually eradicated this surplus in 1987. Gross external reserves amounted to \$33 million in September 1987, equivalent to five months of imports of good and services from the convertible zone but less than two months of total imports. Virtually all of the external debt is on

^{1/} Ratios to GDP need to be interpreted with caution because of the use of unrealistic prices and exchange rates in the compilation of national product.

^{2/} These were related to the audit of state enterprises prior to their inclusion in the New System of Economic Management; for details, see the accompanying paper on Recent Economic Developments.

^{3/} Most of the capital expenditure is foreign-financed and this portion is effectively recorded at current dollar prices.

^{4/} A five-year contract with Thailand that expired in 1986 was renegotiated in 1987.

Table 2. Laos: General Government Budget, 1984-87

	1984	1985	1986	1987	
				Budget	Est. 1/ Outcome
(In millions of kip)					
Revenue	4,947	10,299	18,503	22,157	20,108
Nontax revenue	3,278	8,902	16,748	19,387	18,138
Transfers from public enterprises	(2,962)	(7,761)	(14,940)	(18,213)	(16,498)
Tax revenue	1,669	1,397	1,755	2,270	1,970
Expenditure	8,384	20,806	27,615	31,290	30,075
Current expenditure	4,126	10,624	15,883	17,810	16,595
Capital expenditure	4,258	10,182	11,732	13,480	13,480
Overall deficit (-)	-3,437	-10,507	-9,112	-9,133	-9,967
Financing:					
External borrowing and grants	3,533	10,671	9,323	9,133	10,267
Change in domestic bank deposits (increase-)	-96	-164	-211	—	-300
(As percent of GDP)					
Revenue	19.1	24.5	29.4	34.1	31.0
Nontax revenue	(12.6)	(21.2)	(26.6)	(29.9)	(28.0)
Tax revenue	(6.4)	(3.3)	(2.8)	(3.5)	(3.0)
Expenditure	32.3	49.6	43.9	48.3	46.4
Current expenditure	(15.9)	(25.3)	(25.3)	(27.5)	(25.6)
Capital expenditure	(16.4)	(24.3)	(18.7)	(20.8)	(20.8)
Current surplus	3.2	-0.8	4.1	6.7	5.5
Overall deficit	-13.2	-25.0	-14.5	-14.1	-15.4

Source: Data provided by the Lao authorities.

1/ Based on the performance during the first nine months.

Table 3. Laos: Balance of Payments, 1984-87 ^{1/}

(In millions of U.S. dollars)

	1984	1985	1986	1987 Est.
Exports	43.8	53.6	55.0	50.9
Convertible area	30.0	34.6	39.4	32.0
Nonconvertible area	13.8	19.0	15.6	18.9
Imports	-161.9	-193.2	-185.7	-216.8
Convertible area	-59.3	-77.6	-78.4	-83.0
Nonconvertible	-102.6	-115.6	-107.3	-133.8
Trade balance	-118.1	-139.5	-130.7	-165.9
Convertible area	-29.3	-42.9	-39.0	-51.0
Nonconvertible area	-88.8	-96.6	-91.7	-114.9
Services and transfers (net)	35.1	45.8	40.8	36.7
Services (net)	-9.8	-7.2	6.6	3.2
Convertible area (net)	-4.8	-2.0	10.2	8.2
Receipts	(15.0)	(21.3)	(24.3)	(23.0)
Payments	(-19.8)	(-23.3)	(-14.2)	(-14.8)
Nonconvertible area (net)	-5.0	-5.2	-3.6	-5.0
Private transfers ^{2/}	2.8	3.5	3.7	4.0
Official transfers	42.1	49.6	30.5	29.5
Convertible area	26.7	45.4	26.0	25.0
Nonconvertible area	15.4	4.2	4.5	4.5
Current account	-82.9	-93.7	-89.9	-129.2
Convertible area	-4.5	3.9	0.9	-13.8
Nonconvertible area	-78.4	-97.6	-90.8	-115.4
Capital account	86.0	101.9	106.7	134.1
Convertible area	7.6	4.3	15.9	18.7
Long-term loans	2.0	1.0	12.3	15.2
Disbursements	(10.1)	(12.1)	(20.8)	(22.0)
Amortization	(-8.1)	(-11.1)	(-8.5)	(-6.8)
Private import financing	5.6	3.3	3.6	3.5
Nonconvertible area	78.4	97.6	90.8	115.4
Long-term loans	28.3	46.7	33.1	56.5
Disbursements	(30.2)	(50.0)	(34.9)	(58.3)
Amortization	(-1.9)	(-3.3)	(-1.8)	(-1.8)
Bilateral clearing arrangements ^{3/}	50.1	50.8	57.7	58.9
Errors and omissions	-9.1	10.4	-7.7	-4.6
Overall balance (convertible area)	-6.0	18.7	9.1	0.3
Change in net foreign assets ^{2/} (increase -)	6.0	-18.7	-9.1	-0.3
Assets	8.3	-14.8	-6.5	-1.2
Liabilities	-2.3	-3.9	-2.6	0.9
Of which:				
Use of Fund credit	(-5.4)	(-6.6)	(-2.2)	(--)

Sources: Staff estimates based on data provided by the Lao authorities.

^{1/} Data may not add up because of rounding.

^{2/} Convertible area.

^{3/} Calculated as residual of transactions with the nonconvertible area.

concessional terms and the debt service ratio stood at 13 percent in 1987. 1/

In September 1987, the seven different exchange rates, ranging from KN 10 per dollar to KN 380 per dollar were reduced to four within the same range. The result of this reform was that a larger share of transactions, including private transfers and part of exports and imports by state enterprises, now take place at more realistic exchange rates (KN 350-380 per dollar). 2/ However, this share is still small, no more than 15-20 percent of transactions with the convertible area, and the large majority of transactions take place at a rate of KN 95 per dollar. Between mid-1986 and mid-1987, the kip appreciated from KN 450 per dollar to KN 370 per dollar on the officially tolerated parallel market; the parallel market rate was KN 390 per dollar in October 1987. The representative rate with the Fund has remained at KN 10 per dollar despite repeated urging by the Fund to propose a more realistic rate. However, during the recent consultation discussions, the Laotian authorities indicated that a new rate would be proposed shortly (the change requires approval by the Council of Ministers). They also stated that the overdue obligations with respect to the valuation adjustment of the Fund's holdings of kip would be settled without further delay.

III. Report on the Discussions

In concluding the 1986 Article IV consultation, Executive Directors encouraged the authorities to reduce controls and liberalize the economic system. They also urged greater financial discipline on the part of state enterprises and tighter limits on the growth of credit, accompanied by an increase in interest rates. Furthermore, Directors expressed concern about the budget outlook and recommended a strengthening of budget revenues. Regarding the balance of payments, Directors were apprehensive about the prospects for exports and stressed the need

1/ Some countries in the convertible zone have recently converted, or are in the process of converting, their long-term loans into grants.

2/ The exchange rate of KN 10 per dollar has, for some time, only applied to local expenditure related to projects financed by multilateral lending institutions. (It has also been used for the conversion of foreign assets and liabilities for the purpose of the monetary survey.) The majority of transactions of state enterprises (surrender of foreign exchange to, and allocation from, the budget) takes place at a rate of KN 95 per dollar; this rate is also used for the budgetary accounting of foreign aid flows and government receipts and payment of services. Inward transfers are converted at a rate of KN 350 per dollar. The rates applying to other transactions are KN 370 (buying) and KN 380 (selling) per dollar (this includes foreign exchange retained by state enterprises and deposited with the Bank of Foreign Trade and foreign exchange bought from the bank).

for more remunerative export prices, a devaluation of the kip, and exchange rate determination on the basis of market forces and relative price movements. Directors also urged the authorities to eliminate the multiple currency practices.

Since the last Article IV consultation, the authorities have approved the Second Five-Year Plan (1986-90) and have introduced a number of important economic policy measures. These reforms comprise a liberalization of domestic trade; a fundamental reform of the price system; an increase in state enterprise autonomy through wider application of the New System of Economic Management (NSEM); and a major change of the fiscal system, in particular, state enterprise taxation. Furthermore, the authorities have indicated that a uniform market-related exchange rate will be applied to all transactions by state enterprises beginning from 1988. Against the background of these measures, the authorities have expressed interest in the structural adjustment facility (SAF). The discussions with the authorities focused on the recent reforms and on the additional measures needed to formulate a program that could be supported by use of Fund resources under the SAF.

1. Economic planning and investment program

The general objectives of the Second Five-Year Plan are to increase agricultural production, especially foodcrops; reduce slash-and-burn cultivation; increase manufacturing production for exports and import substitution; improve transport infrastructure; and raise the level of education. The projected annual average rate of growth of national income is 9 percent, with agricultural output expected to grow by somewhat less than 10 percent and industrial production increasing by 14 percent per year. Investment financed from domestic sources is to amount to KN 38 billion (at 1986 prices) of which KN 32 billion is to be financed by the Government. Foreign-financed investment is projected at \$465 million, or KN 44 billion (converted at KN 95 per dollar). The Plan implies a large increase in the public investment/GDP ratio from about 18 percent in 1986 to 25-30 percent in 1988-90. Transport (26 percent) is to receive the largest share of investment, followed by industry (21 percent), agriculture and forestry (19 percent), and social services (17 percent). In the area of transport, the focus is on the rehabilitation of the domestic road network and of road linkages with ports in Viet Nam. The investment strategy in agriculture maintains the aim of provincial food self-sufficiency, especially of rice. For this purpose, sizable funds have been allocated for irrigation projects in the Vientiane plain, a rice deficit area. In industry, the emphasis is on the upgrading of existing facilities to improve capacity utilization, which has been low (about 60 percent). The Plan also envisages the construction of a medium-sized hydroelectric facility, which is to produce mainly for exports.

With total production having grown by about 7 percent in 1986 and expected to decline by about 3 percent in 1987, the Plan's growth objective is unlikely to be reached. The staff team observed that agricultural production is likely to grow more slowly than envisaged, because rice self-sufficiency has been more or less achieved (per capita rice consumption is among the highest in the world) and export prospects are poor. The staff team welcomed the emphasis on increasing the utilization of existing industrial capacity, but questioned the projected rates of output growth, given the absence of large new projects. Foreign-financed investment was below target in 1986-87 and it appears that a significant shortfall in externally financed investment is likely to arise because of delays in implementing projects, in particular in irrigation, and difficulties in securing grants for the financing of social investment. Preliminary figures indicate that domestically-financed investment was broadly on track in 1986-87 (largely because of the utilization of the proceeds of sales of aid in kind). However, staff estimates suggest that budgetary savings, which amounted to some 4-5 percent of GDP in 1986-87, would have to double by 1990 to attain the level of government-financed investment specified by the Plan. This increase would have to come mainly from higher revenue, because current expenditure, especially for maintenance and operation, is already very low. Given the large increase in revenue needed, it is unlikely that domestically-financed investment will reach the ambitious Plan target.

The World Bank staff has recently reviewed the investment program and is in broad agreement with its orientation, notably the importance accorded to transportation. However, the Bank staff believes that the emphasis on new irrigation projects for rice cultivation is misplaced, because rice self-sufficiency has virtually been achieved and the envisaged improvements in transportation would facilitate the movement of rice from surplus to deficit areas. In the Bank staff's view, the irrigation program needs to be reviewed and priority given to the rehabilitation of existing irrigation facilities and operation and maintenance expenditure. The Bank staff is also concerned about the relatively small allocations for the development of cash crops and wood products; for on-farm improvements, which would increase returns on investment in irrigation already made; and for exploiting the export potential of the manufacturing and mining sectors.

2. Distribution and pricing policy

In early 1987, the domestic trading system was reorganized and liberalized. This involved the consolidation of trading companies and the elimination of fragmented responsibilities, which had given rise to trade barriers. Prior to this reform, trade was based on Plan volumes and official prices, and the interprovincial movement of goods was restricted. Now, trade rests on prices and volumes negotiated between trading organizations, and procurement from producers is conducted on the basis of freely negotiated prices. Agricultural output (including

rice) and other goods that are in excess of contracts with trading companies, can be sold freely by licensed traders (mainly cooperatives) throughout the country. Licenses will be issued against a fee; traders will have to pay taxes to maintain their licenses.

In mid-1987, the Government issued a decree that stipulated that all prices are to be market determined and that only one price should exist in a given market at a given time. Exceptions to this rule would be the prices of electricity, water, petroleum products, steel, machinery, vehicles, minerals, post and telecommunication charges, and air transport, which would continue to be set by the Government. Furthermore, a large subsidy is provided on rice sold to civil servants and employees of state enterprises in state shops, and a number of other goods sold in state shops are also subject to subsidization. However, the Government intends to phase out these subsidies, while compensating civil servants and employees of state enterprises through salary increases. The staff team emphasized that large subsidies and unrealistic exchange rates still impeded rational pricing, especially at the retail level. These factors also help explain why the price reform has had little discernible impact on the overall price level in 1987.

3. The New System of Economic Management (NSEM)

State enterprises have been under close government control and have had to transfer to the budget most of their earnings while receiving, in return, their working capital and investment funds from the budget. At the same time, they were given production targets, and prices, wages, and employment were determined by the Government. Beginning in 1983, the Government has given greater autonomy to an increasing number of enterprises, mainly allowing them to retain part of their profits and depreciation funds and to pay employees performance bonuses. Based on these initial steps, the Government has introduced a New System of Economic Management for state enterprises, which is to encompass all enterprises by the end of 1988. The NSEM provides them with greater autonomy in determining production, investment, prices, employment, and wages. Retained earnings are to be allocated to funds for bonus payments, general contingencies, fixed capital investment, and social expenditures. Access to government financing for investment expenditure will be limited to major projects. Other investment and working capital are to be financed from retained profits or through bank loans. The staff noted that the extent of enterprise autonomy still remained unclear and that many of the NSEM's provisions had yet to be put to practice.

4. Fiscal policy

The application of the NSEM to all state enterprises necessitated a fundamental reform of the tax system. Besides adapting the system to the financial autonomy of state enterprises, the main objectives of the reform are to introduce equal treatment of the public and private sectors and simplify the tax system. The new system is to be implemented in

1988, but further revisions would be introduced, as experience is gained. The centerpiece of the tax reform is the introduction of a profit tax, which replaces the budgetary transfers of liquid resources and a number of taxes on enterprises. The (proportional) rates of profit tax will range from 0-90 percent with a differentiation by sector, based on criteria such as profitability, the amount of current budgetary transfers, and the social desirability of the type of economic activity. Other important changes are a modification of the turnover tax for the services sector, and the introduction of a tax on logging (other production taxes remain unchanged). Wages and salaries will be subject to lower tax rates, and wages of civil servants and public enterprise employees will remain tax exempt. Import duties are to vary according to the type of goods and their scarcity premium in the domestic market. The new rates, ranging from 0-100 percent, are substantially lower than the present ones, but imports will be valued at market exchange rates instead of a rate of KN 10 per dollar and import duties will also be applied to imports from the nonconvertible zone. The existing schedule of export taxes is to be revised.

The staff team indicated its agreement with the objectives of the tax reform, but expressed reservations about some aspects of the proposed new system and presented suggestions for modifications. The differentiation in profit tax rates lacked economic justification and could lead to distortions, especially in an environment in which the liberalization of prices was likely to lead to changes in levels of profitability. A flat profit tax accompanied by a broad-based commodity tax and excise taxes would be superior. Second, given the presence of production and profit taxes, export taxes should be confined to absorbing windfall gains. Third, the envisaged system of import tariffs appears to be unnecessarily complex and a system with a few low rates would be preferable. Fourth, while the exemption of low incomes from income tax is acceptable, this does not justify exempting all civil servants and public sector employees (in particular, as the scrip system for salary payments is likely to be phased out). The authorities indicated that the suggestions on export taxes and exemptions from personal income tax would be incorporated immediately and that the other suggestions would be considered in a future review of the tax system.

At the time of the consultation discussions, the preparation of the 1988 budget had yet to be completed, pending a full assessment of the revenue implications of the proposed new tax system. However, the authorities provided the following broad outlines of expenditure and financing. Current expenditure is expected to increase substantially because of salary increases to offset the envisaged reduction of consumer subsidies. At the same time, efforts will be made to reduce the size of the civil service mainly through enforcing retirement regulations, encouraging early retirement, consolidating government agencies, and imposing tight limits on hiring. While the introduction of the NSEM would tend to reduce capital expenditure, the adoption of the new price system implies a large increase in costs. Capital

expenditure will be carefully scrutinized and some projects requiring substantial domestic financing may have to be cut or postponed. It is envisaged that the Government will continue to abstain from using bank credit to finance the budget deficit. The staff agreed with the need for tight control over expenditure in 1988, especially given the uncertainties arising from the tax reform and the expansion of the NSEM. Bank borrowing by the Government should be the last recourse and should only take place within a financial programming framework.

5. Monetary policy

In recent years, the role of monetary policy has been confined to accommodating the large credit demands of state enterprises. Credit plans established at the beginning of the year have been of little operational significance, as they have been exceeded by wide margins. Interest rates have played virtually no role in the allocation of credit, because of their low levels (the maximum rate on loans to state enterprises has been about 8 percent since July 1985). The authorities observed that a number of factors contributed to the acceleration in credit growth in 1986-87. First, the application of the NSEM to an increasing number of state enterprises resulted in larger credit demand, as enterprises lost part of their budgetary allocations. Second, the freeing of procurement prices led to an increase in credit to the Lao Trade Corporation and, third, the liberalization of domestic trade fueled credit demand by cooperatives. The authorities emphasized that greater restraint will be exercised with respect to credit to state enterprises and that credit demands would be scrutinized carefully. To strengthen the banking system, it is envisaged to split the State Bank into a central bank and a commercial bank.

The staff team noted that a number of structural factors related to trade and procurement had boosted the demand for money in 1987, reversing the decline observed in 1984-86. ^{1/} Furthermore, the decline in inflation itself and the progress toward liberalization are likely to have strengthened confidence in the domestic currency and increased the demand for money in 1987. The appreciation of the kip on the parallel foreign exchange market probably reflected the same factors. Although the effect of some of the structural factors could well continue into 1988, implying a further push toward monetization of the economy, a more cautious approach toward credit growth was now required. In this context, the staff team expressed particular concern about the effect of the NSEM on credit to state enterprises. It was of crucial importance that the State Bank tighten control over state enterprises' access to bank credit. Furthermore, monetary policy had to be based on an

^{1/} It appears that the adoption of the scrip system for payments of salaries to civil servants and the emphasis on barter for procurement led to substantial demonetization in 1984-86: liquidity as a percent of GDP declined from about 9 percent in 1983 to 5.5-6.5 percent in 1984-86.

appropriately designed financial program. Implementation of such a program would be facilitated by an interest rate policy that ensures positive real interest rates.

6. External policies

The principal issues in the area of external policy have been the use of unrealistic exchange rates, the absence of a rational system of foreign exchange surrender and allocation, and the restrictiveness of the exchange and trade system.

On the issue of the exchange rate, the authorities stated that, beginning from January 1, 1988, all foreign exchange transactions between state enterprises and the budget (i.e., foreign exchange surrender and allocations) would take place at a uniform market-related exchange rate. However, this rate might differ somewhat from the exchange rate applied by the Bank for Foreign Trade to other transactions (currently KN 370, buying, and KN 380, selling, per dollar). The staff team strongly urged the authorities to apply a unified exchange rate to all foreign exchange transactions (and also to the recording of foreign loans and grants in the budget). Based on an assessment of export profitability in some sectors, an exchange rate of around KN 370-380 per dollar appears to be realistic at present. However, exchange rate policy would have to be flexible, paying attention to developments in domestic costs, export profitability, and the overall balance of payments position.

The authorities did not envisage a substantial change in foreign exchange surrender and allocation practices. The surrender of foreign exchange by state enterprises and trading corporations to the budget (in part to discharge tax obligations) would be determined in a flexible manner and allocations would be based on the need for imported inputs. The staff team expressed the view that the authorities should adopt a system under which all foreign exchange transactions are channeled through the Bank for Foreign Trade. Exporters would be required to sell their foreign exchange earnings to the Bank for Foreign Trade, and all taxes should be paid in domestic currency. Access to foreign exchange should effectively be regulated through a liberal system of import licensing, replacing the current ad hoc retention or allocation of foreign exchange.

With respect to the trade regime, a recent Government decree reaffirmed the state monopoly on exports of "strategic goods," which represent the large majority of exports. ^{1/} Only the Lao Trade Corporation, provincial trading companies, and designated state enterprises can export these goods. Imports are also a state monopoly,

^{1/} Coffee, tobacco, cardamom, benzoin, stick lac, logs, processed wood, rattan, cattle, wild animals, minerals, and other "special" goods.

with the exception of imports made by the Societes Mixtes and authorized state enterprises. Furthermore, the Government has announced that exports of logs will be banned with effect from January 1, 1988 to prevent illicit exports, encourage domestic wood processing, and protect the resource base. The staff team expressed the view that the state monopoly on exports of strategic goods should be eased, because organizational difficulties have effectively reduced official exports of a number of forestry products. Furthermore, the ban on exports of logs should be reconsidered, because of the present limited capacity of the domestic industry to produce quality goods. To address the issues related to the forestry resource base and the environment in an appropriate manner, the Government would have to develop a comprehensive forestry policy.

Bilateral payments agreements are maintained with Bulgaria, Czechoslovakia, the German Democratic Republic, Mongolia, the U.S.S.R. and with four Fund members: Democratic Kampuchea, Hungary, Poland, and Viet Nam. The bilateral payments agreements with Fund members give rise to exchange restrictions subject to approval under Article VIII. In addition, the four different official exchange rates give rise to multiple currency practices, which are also subject to approval under Article VIII.

7. Balance of payments outlook

Based on the current stance of policies and a number of other factors, ^{1/} the staff has prepared a balance of payments scenario, covering the remainder of the Second Plan period, 1988-90. A striking feature of the balance of payments projections is the decline in exports to the convertible area caused by increasing domestic consumption of electricity and the proposed ban on exports of logs (Table 4). This decline in exports would lead to a sharp increase in the current account deficit with the convertible area and a sizable financing gap. At the same time, the current account deficit with the nonconvertible area would also continue to widen, giving rise to large negative balances under bilateral clearing accounts and an increase in debt from an estimated \$570 million in 1986 to about \$1,050 million in 1990. However, the Lao authorities do not envisage that this buildup of debt would give rise to debt service obligations in the medium term. They

^{1/} These factors included a supply side analysis of exports; some downward revision of projected inflows of foreign capital (and correspondingly lower imports) compared with the Plan figures; and the assumption that any shortfall in public savings (from the level implied in the Plan target for government financed investment) would be matched by lower investment. Non-aid imports (in dollar terms) are projected to grow by about 6 percent per year during 1988-90, broadly unchanged from the growth rate in 1985-87.

Table 4. Laos: Medium-Term Balance of Payments Scenario
1986-1990

(In millions of U.S. dollars)

	1986	1987	1988	1989	1990
Exports	55	51	44	46	51
Convertible area	39	32	22	21	22
Electricity	(30)	(14)	(14)	(12)	(12)
Wood and wood products	(6)	(15)	(4)	(4)	(5)
Other	(3)	(3)	(5)	(7)	(9)
Nonconvertible area	16	19	22	23	25
Imports	-186	-217	-236	-249	-266
Convertible area	-78	-83	-98	-103	-112
Nonconvertible area	-108	-134	-138	-146	-154
Services and transfers (net)	41	37	41	44	47
Current account	-90	-129	-151	-159	-168
Convertible area	1	-14	-35	-36	-39
Nonconvertible area	-91	-115	-116	-123	-129
Capital account (net)	107	134	147	152	162
Convertible area	16	19	30	29	33
Nonconvertible area	91	115	117	123	129
Long-term loans (net)	(33)	(57)	(55)	(57)	(59)
Bilateral clearing arrangements <u>1/</u>	(58)	(58)	(62)	(66)	(70)
Errors and omissions	-8	-5	--	--	--
Overall balance (convertible area)	9	--	-4	-7	-6
Memorandum items:					
External debt	740	884	1,030	1,183	1,345
Convertible area	(167)	(195)	(224)	(254)	(287)
Nonconvertible area	(573)	(689)	(806)	(929)	(1,058)
Debt service	15	13	12	12	9
Convertible zone	13	11	9	9	6
Interest	(2)	(2)	(2)	(2)	(2)
Amortization	(11)	(9)	(7)	(7)	(4)
Nonconvertible zone	2	2	3	3	3
Debt service ratio <u>2/</u>	15	13	12	12	9
Reserves	33	34	29	22	16
(In months of imports from convertible area)	(5)	(5)	(3.5)	(2.5)	(1.5)

Source: Staff estimates.

1/ Calculated as residual of transactions with the nonconvertible area.

2/ Ratio of debt service to exports of goods and services.

expect that, based on the experience during the preceding Five-Year Plan, the negative balances accumulated during the Second Five-Year Plan would be converted in 1991 into an interest free long-term loan with an extended grace period. It is also expected that, as in the past, a rescheduling would be arranged at the beginning of the next Plan period of other debt service obligations vis-a-vis the nonconvertible zone. (Repayment of debt accumulated under bilateral clearing accounts in the period up to 1986 is currently scheduled to begin in 1991 and, in the absence of a rescheduling, the debt service ratio would rise from 9 percent in 1990 to about 70 percent in 1991.) This external scenario underscores the need for rapid development of the export sector as well as continued large financing and debt relief from the nonconvertible zone.

IV. Staff Appraisal

In the course of 1986-87, Laos has introduced a number of important policy measures. These comprise the liberalization of many prices and the freeing of domestic trade, the provision of greater autonomy to state enterprises, the introduction of a new tax system, and a partial exchange reform. The staff very much welcomes these reforms. In all, they constitute substantial progress in moving toward a more liberal and market-oriented system. The emphasis now must be on fully implementing the reform measures and on complementing them in those areas in which further action is required.

In the field of fiscal policy, the proposed new tax system represents considerable progress, but some of its elements need further adaptation. In particular, the differentiated profit tax should be replaced by a flat tax, accompanied by a broad-based commodity tax and excise duties. The staff welcomes the indication that staff proposals concerning export taxes and the exemptions from personal income tax will be implemented and urges the authorities to adopt a simpler system of import duties than currently envisaged. The revenue implications of the new tax system are yet to be fully assessed. It is important that the authorities keep the tax system under review not only to make the improvements suggested above, but also to ensure a level of budgetary resources that permits sufficient expenditure for operation and maintenance as well as larger domestic financing of capital investment. The authorities should also seize the opportunity of the introduction of the new tax regime to eliminate the serious weaknesses in the fiscal accounts that have impeded analysis. This requires principally the adoption of realistic prices and exchange rates for all transactions and transparency with respect to subsidies and domestic bank borrowing.

The decision to include all state enterprises in the New System of Economic Management is a welcome step. However, for this system to succeed, a number of important issues must be resolved. One important issue is the status of detailed Plan production targets and the role and

process of economic planning, while another relates to the control of costs in a small, closed market dominated by a few large enterprises. There is also the need to improve managerial skills and accounting practices and to be prepared to rehabilitate or close loss-making enterprises. Moreover, the success of the NSEM depends crucially on a strengthening of control over state enterprises' access to bank credit. Following the opening of domestic trade to cooperatives and private persons, private sector activity in other areas should also be encouraged to increase production and enhance efficiency.

Durable control over inflation will require the commitment to a major change in the conduct of monetary policy, namely, to give the power to the monetary authority to effectively control credit and to use it. For this purpose, financial programming based on macroeconomic objectives and developments will also have to be introduced. To be sure, the important structural changes that have been taking place introduce a large element of uncertainty into financial programming and a flexible approach will be necessary. Nevertheless, a substantial reduction in credit expansion would now seem to be required to keep inflation under control. A resurgence of inflation would pose a serious threat to economic liberalization, for it would, no doubt, provoke pressure for the reintroduction of price controls. Financial programming would have to be supported by a more flexible interest rate policy aiming at positive real interest rates.

Despite the recent measures, further action is called for in the areas of pricing and exchange rate policy. Price reform will remain unfinished as long as the large subsidies that distort the incentive structure are maintained. Similarly, exchange rate reform will only be completed when a realistic, uniform rate is adopted for all foreign exchange transactions. This exchange rate would need to be adjusted flexibly in the light of developments in domestic costs, export profitability, and the overall balance of payments position. Present practices of foreign exchange retention and allocation are also in need of revision. A general surrender requirement should be introduced, accompanied by a system of free foreign exchange allocation based on import licensing. All foreign exchange transactions should be made through the banking system. Furthermore, the external trade regime should be liberalized and obstacles to foreign investment removed.

The balance of payments outlook indicates the urgent need for development of Laos' export potential. This requires a reorientation of the Plan toward the development of cash crops, wood products, and the manufacturing and mining sectors. Equally important, existing impediments on the supply side would have to be eliminated, and adequate export incentives established. The balance of payments outlook also underscores the need for continued large financing from the nonconvertible area as well as for debt relief to prevent a sharp increase in debt service in the medium term.

The reforms recently introduced point the economic system in a new and promising direction. The staff is in basic agreement with the economic strategy but, as discussed above, sees a need to supplement and improve it in several important areas through additional measures. These policy measures will be the main issues in further discussions with the authorities on a program supported by the use of Fund resources under the structural adjustment facility. Progress in the area of economic policy would have to be accompanied by substantial improvements in the coverage and quality of statistics. This will require the acceptance of a large amount of technical assistance to build up local expertise.

The staff does not recommend approval of the multiple currency practices and exchange restrictions subject to approval under Article VIII. The staff also urges the authorities to settle overdue kip obligations to the Fund resulting from maintenance of value adjustments and to cooperate with the Fund with respect to the establishment of a more realistic representative exchange rate with the Fund.

It is recommended that the next Article IV consultation with Laos be held under the bicyclic procedures (with the Article XIV consultation held on an annual basis). If SAF arrangements are approved in the meantime, the next Article IV consultation, however, would be held on the standard 12-month cycle.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to exchange measures of the Lao People's Democratic Republic subject to Article VIII, Sections 2(a) and 3, and in concluding the 1987 Article XIV consultation with the Lao People's Democratic Republic in the light of the 1987 Article IV consultation with the Lao People's Democratic Republic conducted under Decision No. 5392-(77/63), adopted April 29, 1977 as amended (Surveillance Over Exchange Rate Policies).
2. The Lao People's Democratic Republic continues to maintain restrictions on the making of payments and transfers for current international transactions in accordance with Article XIV, as described in SM/88/.., except for the multiple currency practices and the exchange restrictions arising from bilateral payments agreements with Fund members, which are subject to Fund approval under Article VIII, Sections 2(a) and
3. The Fund encourages the authorities of the Lao People's Democratic Republic to simplify the exchange system, and in particular to eliminate the multiple currency practices as well as the restrictive features of the bilateral payments arrangements with Fund members.

LAO PEOPLE'S DEMOCRATIC REPUBLIC

Basic Data—Economic Indicators

	1983	1984	1985	1986	1987 Est.	1988 Proj.
<u>Growth (percent change)</u>						
Real GDP	3	6	9	7	-3	5
<u>Inflation (staff estimates)</u>						
GDP deflator (percent change)	78	35	48	40	7	...
CPI (end of period, percent change) <u>1/</u>	62	27	115	35	6	...
Official	31	3	290	36	2	...
Free market	94	43	29	34	11	...
<u>Central government budget</u>						
Revenue (growth in percent)	27	42	108	80	9	...
Total expenditure (growth in percent)	22	25	148	33	9	...
Revenue (percent of GDP)	19	19	24	29	31	...
Expenditure (percent of GDP)	37	32	50	44	46	...
Current account (percent of GDP)	3	3	-1	4	5	...
Overall deficit (percent of GDP)	-18	-13	-25	-15	-15	...
Foreign borrowing (percent of GDP) <u>2/</u>	18	13	25	15	15	...
<u>Money and credit (end of year, percent change)</u>						
Domestic credit <u>3/</u>	20	23	32	59	70 <u>4/</u>	...
Total liquidity	38	—	36	70	80 <u>4/</u>	...
Of which: cash in circulation	36	41	41	65	130 <u>4/</u>	...
Interest rate (1 year deposit)	9.6	9.6	9.6	9.6	9.6	...
Liquidity as share of GDP	9.3	6.5	5.4	6.2	8.4 <u>5/</u>	...
<u>Balance of payments (\$ mn.)</u>						
Exports	41	44	54	55	51	44
Convertible zone	(28)	(30)	(35)	(39)	(32)	(22)
Nonconvertible zone	(13)	(14)	(19)	(16)	(19)	(22)
Imports	-149	-162	-193	-186	-217	-236
Convertible zone	(-76)	(-59)	(-78)	(-78)	(-83)	(-98)
Nonconvertible zone	(-73)	(-103)	(-116)	(-107)	(-134)	(-138)
Services (net) and transfers	13	35	46	41	37	41
Current account	-96	-83	-94	-90	-129	-151
Convertible zone	(-33)	(-5)	(4)	(1)	(-14)	(-35)
Nonconvertible zone	(-63)	(-78)	(-98)	(-91)	(-115)	(-116)
Long-term capital net	77	86	102	107	134	147
Convertible zone	(14)	(8)	(4)	(16)	(19)	(30)
Nonconvertible zone	(63)	(78)	(98)	(91)	(115)	(117)
Overall balance (convertible zone)	-12	-6	19	9	—	-5
Current account (percent of GDP)	-19	-11	-11	-14	-19	-19
<u>Reserves (end of year; \$ mn.)</u>						
Gross official reserves	19	11	26	33	34	29
(In weeks of imports)	(7)	(4)	(7)	(9)	(8)	(6)
(In weeks of imports from convertible area)	(13)	(10)	(17)	(21)	(21)	(14)

LAO PEOPLE'S DEMOCRATIC REPUBLIC

Basic Data—Economic Indicators (Concluded)

	1983	1984	1985	1986	1987 Est.	1988 Proj.
<u>External debt (end of year; \$ mn.)</u>						
Medium- and long-term nonmonetary	429	511	618	740	884	1,030
Convertible	121	126	135	167	195	224
Nonconvertible	308	385	483	573	689	806
Use of Fund credit	13.6	7.8	2.2	—	—	—
Debt service ratio 6/	13.3	22.2	22.4	14.8	13.0	12.0
<u>Use of Fund resources (mn. of SDRs)</u>						
Reserve tranche purchase	—	1.3 7/	—	—	—	—
Repurchases	—	4.7	6.4	1.9	—	—
Fund holdings of currency (percent of quota)	153.9	128.2	106.4	100.0	100.0	100.0
<u>Trust Fund</u>						
Trust Fund repayments	—	1.1	2.1	2.4	2.5	2.5
<u>Exchange rate 8/</u>						
Exchange rate regime		Pegged	to the U.S. dollar			
Present rates			KN 10=380/US\$1			
Present quota (SDR mn.)			29.3			

Social and Demographic Indicators

GDP per capita SDR 140 9/

<u>Area</u>		<u>Population (1986)</u>	<u>Density</u>
236.8 thousand sq. km.		3.7 million	16 per sq. km.
		Rate of growth	200 per sq. km of agricultural land
		2.9 percent	
<u>Population characteristics (1985)</u>			<u>Health and Nutrition (1985)</u>
Life expectancy at birth	45		Population per physician: 500
Infant mortality rate (per thousand)	151		Population per hospital bed: 37
Child death rate (aged 1-4 per thousand)	23		Per capita supply of:
			Calories (per day) 2,317
			Proteins (grams per day) 61
<u>Labor force (1985)</u>			<u>Education (1983)</u>
Participation rate (percent)	49		Primary enrollment rate
Male	53		(percent) 90
Female	45		Secondary enrollment rate
			(percent) 19
			Pupil-Teacher ratio 30

1/ Cost of living in Vientiane.

2/ All of it is concessional.

3/ Virtually all of it is to state enterprises.

4/ January-June, at annual rates.

5/ June data over estimate of 1987 GDP.

6/ Percentage ratio to current earnings.

7/ Reserve tranche purchase following the eighth quota increase.

7/ Reserve transfer purchase following the eighth quota increase.

8/ Effective exchange rate calculations are not reported here because of multiple and unrealistic official exchange rates.

9/ For the purpose of this calculation, GDP was converted at a rate of KN 95 per dollar.

Fund Relations with Lao People's Democratic Republic
(As of December 31, 1987)

I. Membership status

- (a) Date of membership: 1961
- (b) Status: Article XIV

A. Financial Relations

II. General Department

- (a) Quota: SDR 29.3 million
- (b) Total Fund holdings of kip: SDR 29.3 million
(100 percent of quota)
- (c) Fund credit: None
- (d) Reserve tranche position: Nil
- (e) Current operational budget: Not included
- (f) Lending to the Fund: None

III. Current stand-by or extended arrangement and special facilities

- (a) Current arrangement: None
- (b) Previous stand-by and extended arrangements during the last 10 years: Stand-by arrangement, June 1980-May 1981 for SDR 14 million, or 87.5 percent of quota. The amount was fully repurchased.
- (c) Special facilities during the past two years: None

IV. SDR Department

- (a) Net cumulative allocation: SDR 9.41 million
- (b) Holdings: Nil
- (c) Current designation plan: Not included

V. Administered accounts

- (a) Trust Fund loans
 - (i) Disbursed: SDR 12.7 million
 - (ii) Outstanding: SDR 4.43 million
- (b) SFF subsidy account: None

VI. Overdue obligations to the Fund:

Owing to communications and administrative problems, obligations of SDR 699,050 were overdue for more than one month on November 30, 1987. These obligations were cleared in December.

Overdue obligations with respect to the valuation adjustment of the Fund's holdings of Lao currency amount to KN 38 million.

B. Nonfinancial Relations

VII. Exchange rate

Laos has four official exchange rates, ranging from KN 10 per dollar to KN 375 per dollar (middle rate). The exchange rate of KN 10 per dollar applies only to local expenditure related to projects financed by multilateral development organizations; it is also used for the conversion of foreign assets and liabilities for the purpose of the monetary survey. Most transactions take place at rates of KN 95 or KN 370 (buying) and KN 380 (selling); inward remittances are converted at KN 350 per dollar. The representative rate established with the Fund continues to be KN 10 per dollar.

VIII. Last Article IV consultation discussions

The last Article IV consultation discussions were held in Vientiane during August 21-September 4, 1986. The Executive Board discussed the Staff Report (SM/86/280) on December 5, 1986. The decision was:

1. The Fund takes this decision relating to exchange measures of the Lao People's Democratic Republic subject to Article VIII, Sections 2 and 3, and in concluding the 1986 Article XIV consultation with the Lao People's Democratic Republic in the light of the 1986 Article IV consultation with the Lao People's Democratic Republic conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance Over Exchange Rate Policies).
2. The Fund notes that the Lao exchange system remains restrictive and involves multiple currency practices as described in SM/86/280 and SM/86/282. The Fund encourages the authorities of the Lao People's Democratic Republic to simplify the exchange system and, in particular, to terminate the multiple currency practices as well as the bilateral payments arrangements with Fund members.

IX. Technical assistance:

A member of the Bureau of Statistics went on a mission to Vientiane from March 28-April 11, 1985, and provided technical assistance in the field of balance of payments statistics. The IMF Institute conducted a seminar on Financial Analysis and Policy in Vientiane on June 12-25, 1987.

X. Resident Representative/Advisor: None

XI. Consultation cycle: Bicyclic procedure.

Laos: Relations with the World Bank Group

The World Bank supports the development priorities of the 1986-90 Plan. Provided existing bottlenecks in absorption can be reduced, IDA disbursements are expected to increase during the Plan period. All projects are financed with IDA credits. Current projects include various agricultural rehabilitation and development programs, the extension of a hydroelectric facility and a telecommunications project. A project for electrification of the southern provinces (amount: \$25.8 million) was approved by the Bank Board in June 1987 and a credit for a road rehabilitation project (amount: \$14.1 million) was signed in December 1987. Under discussion are an industrial credit project (amount: \$7 million) and the establishment of a National Polytechnic Institute (amount: \$3 million). Since 1978, the amount of IDA credits committed and disbursed has been as follows:

	<u>Amount Committed</u>	<u>Amount Disbursed</u>	<u>Repayments</u>
	<u>(In millions of U.S. dollars)</u>		
1978	8.2	0.1	--
1979	10.4	0.2	--
1980	13.4	5.3	--
1981	15.0	5.4	--
1982	--	3.1	--
1983	6.2	2.0	--
1984	--	10.0	--
1985	--	5.0	--
1986	3.9	7.0	--
1987 (end-Nov.)	<u>39.9</u> <u>1/</u>	<u>4.7</u>	--
Total	97.0	42.8	

Source: IBRD.

1/ Of this total, an amount of \$25.8 million is for a project approved by the Bank Board but not yet signed.

An economic mission, including a Fund staff member, visited Vientiane during November 16 to December 1 to prepare a Country Economic Memorandum (CEM). The last CEM, Report No. 6070-LA, was published on July 15, 1986.

Lao People's Democratic Republic--Statistical Issues

The statistical base of Laos is very weak. The problems lie in the collection and classification of data as well as in the consistency between different sets of data. Statistical information publicly available is limited to production trends, transport, commerce, education, and health. Laos does not report data for inclusion in Fund publications.

The Government has indicated its interest in receiving technical assistance to improve national income, price, and balance of payments statistics and to introduce the World Bank system of debt notification.

National Accounts

The National Accounts are compiled according to the Material Product System (MPS), which differs from the concept of GDP in that it excludes the value of nonmaterial services and depreciation. Data for the latter are estimated by the staff. The accounts are compiled at constant prices. The reliability and degree of detail of the accounts leave much to be desired. The GDP deflator is estimated by the staff on the basis of price series for consumer goods and construction materials in Vientiane.

Production

In agriculture, crop estimates are subject to wide margins of error. In industry, data cover only the output of major public enterprises located in the Vientiane plain. They exclude rice milling, the processing of agricultural products, and output of provincial industries.

Prices and wages

No price indices are currently published, although prices for a large number of items in the city of Vientiane are collected on a monthly basis. The staff uses those price series to establish a consumer price index by making assumptions on the consumption pattern of a middle-income household in Vientiane. Sub-indices are estimated for free market prices and official retail prices, as well as for the main categories of goods and services. Pending the official compilation of a CPI, the Government has been prepared to use the staff's methodology.

Information on salaries of civil servants and public enterprise employees is very limited.

Public sector

The breakdown of the consolidated budget between the central government and the provinces is not available. Budgetary accounts are drawn up using an overvalued exchange rate and fixed prices for investment expenditure. Furthermore, they do not reflect the large consumer subsidies granted by the Lao Food Corporation and debt service payments to the nonconvertible area. The accounts of public enterprises are not provided to the staff.

Money and banking

Balance sheets of the banking system are established on a monthly basis. The classification and degree of detail of the information need to be improved, particularly in view of the large size and variability of the item "other assets."

Balance of payments and debt

Laos does not compile balance of payments statistics. The staff has estimated balance of payments flows on the basis of information provided by the Foreign Trade Bank and various government agencies. Data are particularly deficient regarding the transactions with the nonconvertible area. Data on external debt is also inadequate; the staff has calculated external debt on the basis of estimated disbursement and amortization.

The Bureau of Statistics has offered technical assistance in the area of balance of payments. The authorities have expressed interest in such assistance and are requesting authorization from the Council of Ministers.

