

Lao PDR

Lao PDR macroeconomic performance remains strong, while the impact of resource sectors growth is becoming stronger. Real GDP growth speeded up to 7.6 percent in 2006, up from 7.1 percent in 2005. While manufacturing and other non-resource sectors continued to grow moderately, economic growth is increasingly driven by the resource sector, especially by expansion in copper extraction and construction of the large hydropower projects. Growth is expected to remain high at above 7 percent in the coming years. On a year-to-year basis, inflation fell below 4 percent in recent months, due to favorable oil and food prices and the lagged impact of exchange rate appreciation. Average inflation is expected to drop from 6.8 percent in 2006 to about 4 percent this year. The current account deficit narrowed, reflecting buoyant resource exports and rising tourism. Higher foreign direct investment and official development assistance further added to an improvement in the balance of payments. By end-June 2007, gross international reserves increased to about US\$460 million, equivalent to 4.6 months of non-resource imports. As a result, reserve and broad money growth accelerated to 45 and 39 percent respectively, by end-May 2007. This rapid growth of monetary aggregates may put upward pressure on inflation.

Fiscal performance strengthened, resulting in lower deficit and net domestic borrowing. Fiscal revenues grew, driven by higher than anticipated resource revenues, as well as by non-resource revenues, which were boosted by lagged impact of 2005 tax law implementation. Domestic expenditures remained on track. This resulted in an overall cash surplus and a low non-resource deficit. In 2005/06 the overall budget deficit declined to 3.7 percent of GDP compared to 4.4 percent in 2004/05 and is expected to drop to 1.3 percent in 2006/07. Strong revenue and contained domestic expenditure led to a decline in net domestic borrowing.

According to the recent DSA, Lao PDR is at high risk of debt distress, although the debt burden has declined and debt service remains manageable. The external public debt as percentage of GDP remains high, but the trend is declining. In 2006, it decreased to 69 percent of GDP compared to 77 percent in 2005 and is projected to decline further in 2007 to about 63 percent of GDP.

The economic reform agenda has progressed, but lagged somewhat on implementation. Several laws for reforming the budget system (such as the Budget Law on centralization of the Treasury, tax and customs administration and intergovernmental relations) have been approved, but implementation measures have been delayed due to administrative adjustments at the MOF. The implementation of the Enterprise Law continued, although progress has been slower than envisaged earlier. The Law on Commercial Banks, as well as the Revised Presidential Decree Law on Management of Foreign Exchange and Precious Metals have been approved by the Government. In general, there has been a delay in finalizing the respective implementing decrees and regulations as compared to previously agreed timelines.

Public financial management reform continued. A new Budget Law was signed by the President in February 2007, and the Prime Minister issued a Decree on restructuring of the Ministry of Finance to allow more effective implementation of the Budget Law. The new law aims to transform the intergovernmental fiscal transfer mechanism and also mandates more extensive reporting of budget information to the National Assembly. The Public Expenditures Management Strengthening Program (PEMSP) program document and work plan for FY2006/7, which is the umbrella public finance management reform program, was adopted in February 2007. Progress with implementation of PEMSP remained on-track. Implementation of the new Budget Law and the PEMSP will require significant technical capacity and sustained political support for this on-going reforms.

Progress on trade and private sector development has been strong, although more attention was needed to the inter-agency coordination. The government continued its work on WTO accession: after preparation of the initial offer for goods, the MOIC has drafted the initial offer for services. With respect to implementing AFTA commitments, in February 2007 the National Assembly's Standing Committee ratified the last (fifth) installment of the Inclusion List and the actual applied tariff (MFN rates) will be reduced to 0-5 percent by 2008. Export and import related procedures are being simplified, in particular significant progress has been made to prepare implementing regulations to simplify business start-up procedures including preparation of the Negative List, abolition of factory establishment license and reduction in number of days required to approve operating license for manufacturing sector.

Reform of SOEs and state-owned commercial banks has also continued. According to SOEs performance monitoring and assessment reports by MOF, SOE performance has been improving and the number of loss-making SOEs is on a steady decline. The government has made the independent audits of the major loss-making SOEs according to international standards a regular exercise, and is planning to streamline the results of these audits into the future restructuring programs. The Lao banking sector is opening up with the entry of ANZ Bank and IFC into a joint venture with a local private bank. The new banking law will provide a level playing field for all banks and ensure competitive entry into the sector. The Government is working on its Financial Sector and SOE Reform Strategies.