



The World Bank

LAO PDR ECONOMIC MONITOR



The World Bank Vientiane Office

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BACKGROUND

With an estimated per capita income of US\$390 in 2004 (see table 1), the Lao People's Democratic Republic (Lao PDR) is one of the poorest countries in East Asia. It is classified by the UN as a Least Developed Country (LDC). In 2004, 71 percent of its population lived on less than US\$2 a day, and 23 percent on less than US\$1 a day (see *East Asia Update*, World Bank, 2005). A significant decline in poverty has been achieved however during the last decade: using Lao PDR national poverty line (of approximately \$1.5 a day) the incidence of poverty has fallen from 46 percent in 1992/93 to around 33.5 percent in 2002/03. The social indicators have been improving too, but they remain among the worst in the region, and close to an average country in Sub-Saharan Africa.

Lao PDR has a population of around 5.8 million and a land area of 236,800 square km. It has significant natural resources like forestry, minerals and hydro-electric power. Agriculture is the major sector contributing 51 percent of GDP and employing 80 percent of the labor force; the industry accounts for 23% and services for 26%. Landlocked, Lao PDR is in the center of the Mekong region, bordered by Thailand, Vietnam, Southern China, Cambodia and Myanmar, with the first three neighbors growing rapidly.

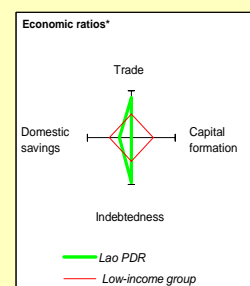
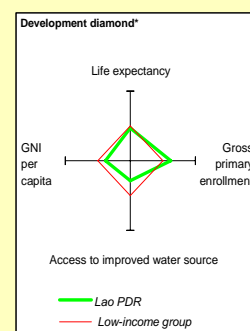
Lao PDR has grown strongly for more than a decade. In the 1990s, real GDP grew by an annual average rate of 6.3 percent - despite the sharp fall-off in growth during the regional crisis of 1997-1999 period. Exports grew at around 15 percent a year. Agriculture grew rapidly as did industry and services. Donors provided considerable financial and technical support; in 2003/04, donor-funded programs accounted for 5 percent of GDP, 29 percent of total public expenditure, and 63 percent of the capital budget.

Transition to market. The Government introduced the "New Economic Mechanism" (NEM) in 1986, to begin the transition from a centrally planned to a market-oriented economy. Gradually, price controls were removed, socialist cooperative farming abandoned as farmers were allowed to work on their plots and take ownerships, the exchange rate system was unified, government's monopoly on trade removed, the number of state-enterprises reduced, and establishment of private firms allowed. Reforms stalled during the regional crisis, as Lao struggled with serious macroeconomic problems. Successful stabilization began in 2000 and structural reforms revived in 2001.

Fighting poverty. In April, 2002, the Government of the Lao PDR finalized an Interim-Poverty Reduction Strategy. Using this and the five-year National Socio-economic Development Plan for 2001-05, the Government adopted a consultative process to prepare the National Poverty Eradication Program (NPEP). The NPEP was presented to the donors' Roundtable Meeting in September 2003, discussed by the National Assembly in October 2003, and subsequently upgraded to the National Growth and Poverty Eradication Strategy (NGPES) in early 2004. It articulates Lao's development framework for poverty reduction, specifies the targets and goals that the country values and indicates the policy reform and public expenditure programs that will be needed to achieve these goals.

Table 1. Lao PDR, EAP and Low Income Countries: Comparing Development Indicators

	Lao PDR	East Asia & Pacific	Low-income		
POVERTY and SOCIAL					
2004					
Population, mid-year (millions)	5.8	1,870	2,338		
GNI per capita (Atlas method, US\$)	390	1,280	510		
GNI (Atlas method, US\$ billions)	2.3	2,389	1,184		
Average annual growth, 1998-04					
Population (%)	2.7	0.9	1.8		
Labor force (%)	2.7	1.1	2.1		
Most recent estimate (latest year available, 1998-04)					
Poverty (% of population below national poverty line)	34		
Urban population (% of total population)	23	41	31		
Life expectancy at birth (years)	55	70	58		
Infant mortality (per 1,000 live births)	82	32	79		
Child malnutrition (% of children under 5)	40	15	44		
Access to an improved water source (% of population)	43	78	75		
Literacy (% of population age 15+)	53	90	61		
Gross primary enrollment (% of school-age population)	116	113	94		
Male	124	113	101		
Female	108	112	88		
KEY ECONOMIC RATIOS and LONG-TERM TRENDS					
	1984	1994	2003	2004	
GDP (US\$ billions)	1.8	1.5	2.1	2.5	
Gross capital formation/GDP	
Exports of goods and services/GDP	2.8	25.0	29.1	28.9	
Gross domestic savings/GDP	16.2	10.8	
Gross national savings/GDP	16.5	10.3	
Current account balance/GDP	-4.3	-6.0	-7.6	-13.2	
Interest payments/GDP	0.1	0.3	1.7	1.8	
Total debt/GDP	29.5	134.8	103.4	91.5	
Total debt service/exports	13.6	5.1	14.7	16.4	
Present value of debt/GDP	70.5	62.9	
Present value of debt/exports	240.5	215.9	
	1984-94	1994-04	2003	2004	2004-08
<i>(average annual growth)</i>					
GDP	5.1	6.1	5.8	6.4	7.2
GDP per capita	2.3	3.4	3.0	3.6	..
Exports of goods and services



Source: World Bank, World Development Indicators, 2005

ECONOMIC MONITOR – APRIL 2006 – Covers the last six months. The Lao Economic Monitor is issued in Lao and in English, twice a year (Spring and Autumn) by the World Bank in Lao PDR. It reports on recent economic performance (Part I), progress in the implementation of the Government's policy reform agenda (Part II), and donor activities in the relevant reform areas (Part III). This issue of the Monitor was prepared by Somneuk Davading, Cheanchom Thongjien, and Ekaterina Vostroknutova. It is based on inputs from Helle Buchhave, Morten Larsen, Alessandro Magnoli, Minh Van Nguyen, Francisco Quintana, and Renuka Vongviriyatham. It was produced under the overall supervision of Kazi M. Matin. We are grateful to the Government and the donors for providing information and other inputs, as well as for sharing their views with the team. We would like to thank Ruangrong Thongampai for formatting the Monitor. Our thanks also go to the staff in the Bank's resident mission in Vientiane who provided support to the Monitor.

THE WORLD BANK TEAM APPRECIATES FEEDBACK ON THE STRUCTURE AND CONTENT OF THE MONITOR.

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ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank	MOIC	Ministry of Information and Culture
AFD	Agence Française de Développement	MOFA	Ministry of Foreign Affairs
AFTA	ASEAN Free Trade Area	MOJ	Ministry of Justice
ASEAN	Association of Southeast Asian Nations	MOH	Ministry of Health
APB	Agriculture Promotion Bank	MOUR	Memoranda of Understanding
BCEL	Banque Pour Le Commerce Extérieur Lao	MPDF	Mekong Private Sector Development Facility
BOL	Bank of Lao PDR		
BPKP	Bolisat Phattana Khet Phoudoi	MTEF	Medium-Term Expenditure Framework
BPO	Business Promotion Office	NA	National Assembly
BTA	Bilateral Trade Agreement	NGPES	National Growth and Poverty Eradication Strategy
CEFT	Common Effective Preferential Tariff		
CFAA	Country Financial Accountability Assessment	NOSPA	National Organization for Studies of Politics and Administration
CPAR	Country Performance Assessment Review	NSEDP	National Socioeconomic Development Plan
CPI	Committee for Planning and Investment	NPEP	National Poverty Eradication Program
CPI	Consumer Price Index	NPL	Non-Performing Loan
DTIS	Diagnostic Trade and Integration Study	NPV	Net Present Value
EAP	East Asia & Pacific	NSC	National Statistical Center
ECC	External NPL Collection Committee	NTR	Normal Trade Relations
EDL	Electricité du Lao	PEM	Public Expenditure Management
EIB	European Investment Bank	PEMSP	Public Expenditure Management Strengthening Program
EU	European Union		
FDI	Foreign Direct Investment	PER	Public Expenditure Review
FINNIDA	Finland International Development Association	PIP	Public Investment Plans
		PM	Prime Minister
FMAC	Financial Management Adjustment Credit	PMO	Prime Minister's Office
FMCB	Financial Management Capacity Building Credit	PPIAF	Public Private Infrastructure Advisory Facility
FRP	Financial Recovery Plan	PRF	Poverty Reduction Fund
FY	Fiscal Year	PRGF	Poverty Reduction and Growth Facility
GDP	Gross Domestic Product	RMFC	Rural Micro Finance Committee
GOL	The Government of Lao PDR	SAMD	State Assets Management Department
GTZ	German Agency for Technical Cooperation	SCB	State-owned Commercial Bank
HIPC	Highly Indebted Poor Country	SIDA	Swedish International Development Association
IMF	International Monetary Fund		
IBA	International Banking Advisor	SME	Small and Medium Enterprise
ICA	Investment Climate Assessment	SNV	Netherlands Development Organization
JBIC	Japan Bank for International Cooperation	SOE	State-Owned Enterprise
JICA	Japan International Cooperation Agency	SPS	Sanitary and Phyto-Sanitary
LNCCI	Lao National Chamber of Commerce and Industry	STEA	Science, Technology and Environment Agency
LA	Lao Airlines	TA	Technical Assistance
LDC	Least-Developed Country	TOR	Terms of Reference
LTA	Lao Tourism Authority	UNDP	United Nations Development Programme
LTC	Lao Telecom Company	UNESCO	United Nations Educational, Scientific and Cultural Organization
LXB	Lane Xang Bank		
MAF	Ministry of Agriculture and Forestry	UNIDO	United Nations Industrial Development Organization
MCTPC	Ministry of Communication, Transport, Post and Construction		
		VAT	Value Added Tax
MDG	Millennium Development Goals	WASA	Water and Sanitation Authority
MIH	Ministry of Industry and Handicraft	WB	World Bank
MOC	Ministry of Commerce	WHO	World Health Organization
MOE	Ministry of Education	WTO	World Trade Organization
MOF	Ministry of Finance		

INTRODUCTION

Lao PDR economic performance has continued to improve during 2005 and 2006. Real GDP grew at 7.0 percent in 2005 and is expected to be slightly higher at 7.1 percent in 2006. This growth is in large part due to foreign investment inflows in mining and hydro-power and growing mineral exports; agriculture, manufacturing and services sectors are also expected to sustain growth at last year's rate. Average inflation dropped from 10.5 percent in 2004 to 7.2 percent in 2005 and is expected to decline further in 2006, as most of the rise in domestic retail oil price has already taken place.

Implementation of reforms in various areas has continued during the period under review, even if at a somewhat uneven pace. Important steps have been taken towards creating a better investment and business environment and a more open trade regime. The program of strengthening public expenditure management has gained momentum and SOE restructuring and actions to increase transparency in the SOE sector has continued even if slowly due to bureaucratic delays and weak capacity.

Implementation of the National Growth and Poverty-Eradication Strategy (NGPES) progressed further with the Government completing the first draft of the next National Socioeconomic Development Plan (NSED, 2006-10), the successor to the NGPES. This was done through a participatory process and the draft was presented to donors at a mini RTM in January 2006. A revised draft NSED was sent to the Party Congress in late March 2006 and the final version of the NSED is expected to go to the National Assembly in July 2006.

PART I – RECENT ECONOMIC DEVELOPMENTS

1.1 THE MACROECONOMIC SITUATION

BACKGROUND

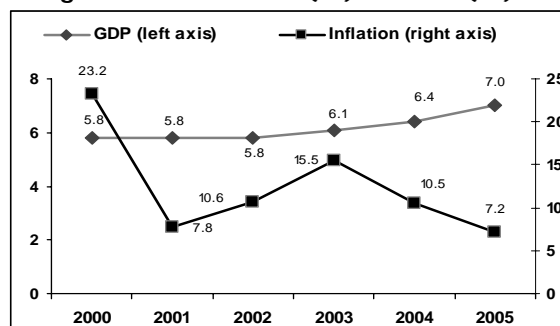
In the 1990s, Lao PDR grew at an annual average rate of 6.3 percent, and the incidence of poverty fell from 45 percent to 39 percent of the population in 1997-98 and to 33.5 percent in 2002-03. The crisis years of 1998 and 1999 saw inflation climb to an annual average of 110 percent and growth fall to 4 percent, but the resolution of the regional crisis and Lao's own policies stabilized the economy and resumed growth of around 6 percent.

The adoption of a stabilization program since 2000 and the implementation of a phased program of reforms since 2001 – in public expenditure management, banking, state-owned enterprises, forestry, trade and private sector – has contributed to this improvement. During 2000-03, inflation has averaged 15 percent and real GDP growth averaged around 5.6 percent annually.

The approval of Nam Theun 2 hydro-power project by the World Bank Board on March 31, 2005 and by the Asian Development Bank Board on April 4, 2005 means that various financing partners have committed a total of US\$ 1,450 million to Lao PDR to finance US\$1,250 million of project cost and US\$200 million of contingency. This investment is expected to occur between now and 2009. The resulting annual inflow is very large relative to the size of the Lao PDR economy, and will have significant growth effects during that period, even though most of this will comprise of imports.

Real GDP growth in Lao PDR rose to 7 percent in 2005, from 6.4 percent in 2004 (figure 1). All sectors grew rapidly – with industry growing the fastest even if from a relatively low base. The share of industry in GDP now exceeds 25%. The stimulus of large projects in mining and power sectors has more than offset the dampening effects of the expiry of the Multi-Fiber Agreement (MFA) quota system in end-2004, the high international oil prices in 2005 and 2006, and the slowdown in Thailand's growth in 2005.

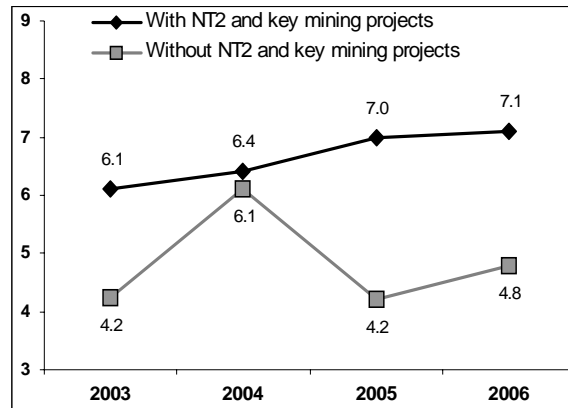
Figure 1. GDP Growth (%) and CPI (%)



Source: Lao authorities and IMF.

The Lao PDR economy is projected to grow at 7.1 percent this year; and is expected to grow steadily at 6-7 percent in the near future. A large part of this growth will come from increased foreign investment flows in hydropower and mining: without large projects and increased investment and exports in these sectors real growth would have been about one third lower (figure 2). Therefore, promoting growth in sectors other than mining and hydropower is increasingly important for ensuring stable and strong GDP growth in the long-run. The government's continued efforts in liberalizing trade and improving the investment climate are thus steps in the right direction.

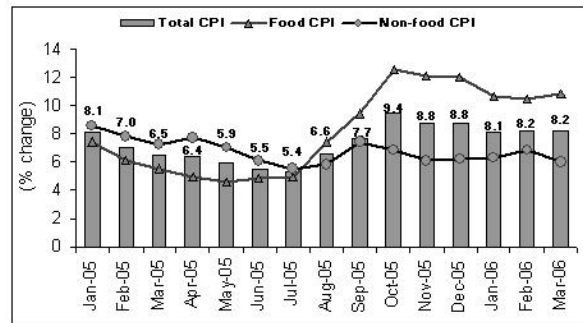
Figure 2. Growth (%) with and without major projects



Source: IMF staff estimates. Projection for 2006. Recent Article IV paper.

Macroeconomic conditions have remained broadly stable. Inflation has been brought down to single digits, with the period average inflation rate falling from 15.5 percent in 2003 to 10.5 percent in 2004 and 7.2 percent in 2005. Inflation did pick up in third quarter of 2005 as domestic oil prices rose due to jump in world prices and as rice prices rose due to floods. The cash budget deficit has been kept within the 4 percent (of GDP) target, despite slow revenue growth and salary increases. The kip exchange rate stayed within a very narrow band, and reserves were kept at level equivalent to three months of imports. The Bank of Lao PDR (BOL) maintained monetary stability. The balance of payments held up well in 2005, despite some adverse external shocks. A surge in mining exports offset the impact of higher oil prices. But the imports associated with NT2 and mining projects caused the external current account deficit to rise to 15 percent of GDP.

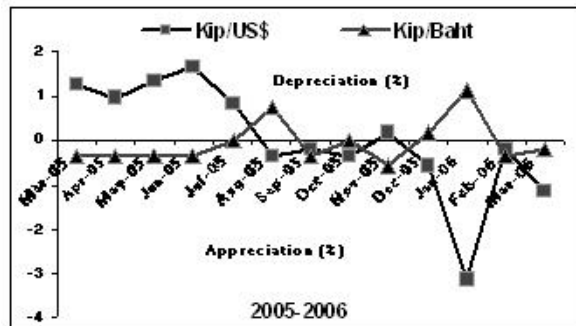
Figure 3. Food and Nonfood CPI (% change)



Source: Lao authorities (NSC) and WB staff calculations

Notwithstanding good macroeconomic performance, the budget remained under pressure due to weak revenue collection combined with a lack of realism in revenue projection. Significant increases in the wage bill, due to both rises in wage-rates and in provincial recruitments, added to the pressure. High public external debt remained a concern. The cash rationing that was used to control the budget deficit has resulted in non-wage recurrent expenditures being increasingly squeezed – building up arrears to Government suppliers.

Figure 4. Lao Exchange Rate



Source: Lao authorities (BOL) and WB staff calculations

Since Lao PDR is an oil importer, policy responses to the large world oil price increase in 2005 was an important component of macroeconomic policy. Retail prices of gasoline and diesel rose in Lao PDR by about 27 percent a year in nominal terms – the sum of landed

import price, several lump-sum charges and tax/duty rates. Recently, the Government removed the temporary exemptions to the prevailing tax/duty rates (these were introduced earlier in order to slowdown the pass-through from world prices), and by doing so saved more than \$7 million of potential revenue losses. The government also increased the fuel levy, revenues from which are earmarked for the road fund and used for road maintenance.

After a period of stability and a clamp down on lending to SOEs, the banking sector was able to reduce the growth of NPLs. However, credit growth at the SOCBs in 2005 was fast at about 35 percent, if only because of the large credits to the two mining projects. Substantial loan growth, coupled with a large withdrawal of deposits by NT2 operator, caused a tightening of the liquidity position in the two main SOCBs. However, additional loan disbursements for a cement project were wisely frozen while the sponsors searched for foreign equity partners.

Since 2000, with ADB, the World Bank and the IMF assistance the, Government embarked on an ambitious banking sector restructuring program with three broad objectives: restructuring the two SCBs; strengthening bank supervision; and improving the overall banking environment. The focuses are on the operational restructuring of two SCBs and increased transparency. Progress has been made in stabilizing the financial conditions of two SCBs. A management team was appointed for each SCB and started working in early 2003. New branch managers were also appointed, and audit committees and asset and liability management committees were established. Manuals on internal procedures on credit policies and internal organization have been designed with the help of the international advisers and adopted by the SCBs' boards. Each SCB has been assisted by two International Banking Advisers (IBAs) (later were cut down to one for each bank), whose role is to assist in strengthening the SCB's operations, especially in the credit review process. The introduction of the certification by IBAs for lending decision seems to have had positive impact on the quality of lending from 2003 onward. Independent International Accounting Standard (IAS) audits for two SCBs were completed for the period 2001-2003 and draft audits for 2004 are being finalized.

However the risk of further deterioration remains high given rapid expansion of credits by both SCBs in recent years. Pressure for non-commercial lending continues. NPL resolution is slow. The enforcement of newly approved operational policies and procedures, especially in the credit underwriting process by SCBs needs to be strengthened. Moreover the governance of SCBs needs to be strengthened further since the current compositions of the Board of Directors, without independent qualified directors, lack checks and balances. The MOF has not monitored progress of SCB restructuring and has not actively exercised its ownership role in appointing qualified directors to the SCBs' boards as stipulated in the Governance Agreements. The current regulatory framework does not provide the Lao banking sector with the level playing field. There is a general direction in the draft 6th National Socio Economic Development Plan to promote a level playing field competition, however restrictions on the activities of non-state banks and market segmentation remain in force. The proposed amendments to the Banking law aiming to promote level competition between state versus non-state banks and foreign versus domestic banks have not been enacted. Foreign banks are restricted from expanding their branch network and are required to deposit 25 percent of their capital with the BOL with no interest. The Presidential Decree Law 01 governing the management of foreign exchange and precious metals requires mining companies to hold bank accounts only with state banks. The SCBs are, accordingly, still protected from the competitive pressures from non-state banks that would motivate the SCBs to improve their efficiency.

Gradual progress was made in monitoring the performance of the remaining State-Owned Enterprises (SOEs) (while information is not up to date) and in preparing restructuring plans to

Table 2. Government revenues

	2003/0 4	est. 2004/0 5	Budget 2005/0 6
	<i>(billions of Kip)</i>		
Revenue & Grants	3,103	3,623	4,353
Revenue	2,821	3,200	3,868
Tax Revenue	2,328	2,654	3,254
Non-tax Revenue	493	546	614
Grants	283	423	485
	<i>(percent of GDP)</i>		
Revenue & Grants	12.1	12.4	13.1
Revenue	11.0	10.9	11.6
Tax Revenue	9.1	9.1	9.8
Non-tax Revenue	1.9	1.9	1.8
Grants	1.1	1.4	1.5

Source: Lao authorities (MoF) and IMF staff estimates. IMF budget proposal for 2005/06

return loss-makers to commercial viability. Implementation of many restructuring plans has lagged behind plans. Many SOEs do not yet have functioning Boards in place or competent directors; and few SOEs have regular annual audits. The capacity and authority of the Business Promotion Office (BPO) in the PMO and the State Asset Management Department (SAMD) in the MOF remain insufficient. Government recognizes that a combination of these factors limits the state's ability to manage risk and execute SOE reform policy. It has recently taken steps to bolster the capacity and authority of BPO and to accelerate implementation of plans. For the future, the priority is to implement the SOEs' restructuring plans. The draft NSEDP for 2006-10 indicates that the Government will, over the next five years, "complete the restructuring and reform of SOEs from the center to the provinces and the districts" and that "only a small number of key SOEs that are important for the national economy will be kept".

As reflected in the draft NSEDP 2006-10, the Government recognizes the key role of the private sector in growth and poverty reduction. For this reason, in the medium-term, the Government plans to: (a) give private sector equal rights and reduce entry restrictions for private firms to most of the sectors; (b) facilitate private sector development through a more favorable policy environment and level playing field and by streamlining registration and licensing procedures for new firms; (c) remove remaining biases in administrative procedures and regulations that favor SOEs over domestic or foreign private firms; (d) strengthen market institutions, including dispute resolution and contract enforcement; (e) facilitate the registration and licensing process for investors, and to equalize domestic and foreign investors; (f) improve land rights and the use of land as a collateral; and (g) to promote and increase exports and facilitate trade and regional integration.

In late 2005, the National Assembly approved the new Enterprise Law that creates a level playing field for private businesses, significantly simplifies regulations and procedures to start up a business, moves from licensing to registration as the main principle, envisages a transparent "negative list" of the sectors where entry of private business is conditional, and creates a one-stop-shop for business registration. Government prepared for the first semi-annual business forum by conducting central and provincial private sector focus groups. This process is intended to foster dialog between private sector and government and greater confidence amongst private sector businesses. Working group meetings have been conducted with the representatives of the private sector in three of the four sectors (tourism, manufacturing, service and trading) and discussions in energy and mining will be held starting from the next Forum. The first semi-annual business forum is scheduled for April, 2006. Lao PDR continues implementation of the AFTA agreement and the last tranches of products have been moved to the Inclusion List, as required by the accession process. They will be approved by the National Assembly Standing Committee later this year.

1.2 ELABORATION AND IMPLEMENTATION OF THE POVERTY REDUCTION STRATEGY

BACKGROUND

The Government (GOL) of the Lao Peoples' Democratic Republic (PDR) aims to achieve rapid economic growth in order to improve the living conditions of its poor, graduate from its status as a least-developed country (LDC) by 2020 and meet the Millennium Development Goals (MDGs). The development strategy to achieve these goals has been articulated in the National Socio-Economic Development Plan (NSEDP, 2001-05) and later in the National Growth and Poverty Eradication Strategy (NGPES). In November 2004 the latter was approved by IDA and IMF as the official Poverty Reduction Strategy Paper (PRSP) for Lao PDR.

The NGPES process was initially launched as a parallel to the national planning process and served as a basis for support by donors while introducing key PRSP principles to the national planning process, such as broad participation, poverty focus and result-orientation.

Over the past year efforts have been made in updating the PRSP/NGPES and integrating it into the 6th Five-Year National Socio Economic Development Plan (NSEDP). The NGPES costing and prioritization process aims to facilitate the inclusion of the NGPES into the next Five-Year National Socio Economic Development Plan (NSEDP 2001-05) and supports the Medium-Term Expenditure Framework (MTEF).

The first draft NSEDP. The Government shared the first draft of the 6th Five-Year National Socio Economic Development Plan (NSEDP) with the donors at the Round Table Meeting (RTM) in January 2006 where the donors commented on its content and process. The Government was

complimented by donors for being participatory and consultative, which represents a leap over the previous Plans. The donors also commented on how the draft Plan could be improved so that the donors could align their support with the NSEDP. A revised draft Plan was sent to the Party Congress in March 2006 and a final draft NSEDP will be presented for approval at the next National Assembly meeting in July 2006. Once final, the NSEDP, the successor NGPES for Lao PDR, the donors will have to consider aligning their programs more closely with it. The yearly updates of implementation (equivalent to PRSP Progress Reports) would be fully embedded in the national planning and development process.

The content of NGPES is well integrated into the draft NSEDP. The NGPES focus on Agriculture, Transport, Education and Health as key sectors for public expenditure is maintained in the NSEDP. Furthermore, the NSEDP incorporates some of the core principles of a successful poverty reduction strategy and process, by addressing participation, poverty focus and monitoring as follows:

- **Participation-** The elaboration of the NSEDP has been characterized by an extensive consultative process including a broad range of national stakeholders such as the private sector, mass organizations, village representatives, district and provincial governments, sectors (particular through the NGPES working group). While the draft NSEDP emphasizes the intention of general and broad participation in its implementation, it is expected that the final Plan would include a strategy for participation of various stakeholders in implementing and monitoring NSEDP, in addition to a strategy for dissemination of key Plan- related information to various stakeholders within and outside the Government.
- **Poverty focus** - It is one of the core strengths of the draft NSEDP that poverty reduction and shared growth objectives are within the framework of macro-fiscal stability and a more market-oriented economy. Other strengths are found in the recognition of the private sector as an increasingly important driving force in accelerating growth and reducing poverty; the emphasis on the rural sector as a driver for growth with wider poverty reduction and human development benefits and; a focus on social, gender and ethnic minority issues across the NSEDP. The draft NSEDP sets a realistic target of reducing poverty-incidence to 25 percent by 2010. It is also positive that the draft NSEDP makes extensive reference to the localized MDGs. However, reflecting this poverty focus in a more explicit and upfront way in respect of public spending in health, education, agriculture and infrastructure would strengthen the draft NSEDP considerably.
- **Monitoring and Evaluation** - The draft NSEDP includes a monitoring and evaluation matrix that aims to help measure the extent to which the strategy is effective in reducing poverty. Although the draft NSEDP and results matrix seem to contain a reasonable choice of indicators, both baselines and targets for those indicators are largely missing. More work in this area is revised draft would strengthen the credibility of the Monitoring and Evaluation Matrix and guide donor alignment with NSEDP. To the extent there are data-gaps for baselines, a statistical effort may be needed. At best such a system should build upon the existing systems for data collection and monitoring and M & E system should use a more select and small number of indicators that easy to monitor.

Specifics of Policy Actions. The revised draft is expected to articulate some of the specific policy-actions it is planning to take. The draft NSEDP at present provides broad directions for policies that the Government plans to implement to achieve its objectives. Building on that, the revised draft Plan is expected to provide a set of *specific policies* in several areas (e.g. PEM, PSD, and Trade), including some prioritization and sequencing of those policies.

Financing NSEDP. The financing requirement of US\$ 6.8 billion in the January draft was not realistic, given the available budget and donor funds in recent years and their reasonable growth. The donor discussions at the RTM highlighted the need for the NSEDP to reduce the size and say something about the priorities for public spending. The need to identify clearly the priority expenditure programs within key sectors aimed at poverty-reduction was highlighted. The earlier NGPES had identified priority expenditure programs in basic health, basic education and rural infrastructure. Also, the ministries of education, health, infrastructure and agriculture, completed a costing exercise led by the CPI and the MoF, the sectors will need to prioritize and/or sequence programs to meet the requirements of the national budget and available donor funding.

The next steps in the PRSP process are:

- Presentation and comments to the draft NSEDP at the Party Congress in March 2006.
- The GoL will co-host (April 4-6) the “Forum on National Plans and PRSPs in East Asia” for Cambodia, Indonesia, Mongolia, Timor-Leste, Vietnam and Lao PDR, where the experience of the NGPES and the NSEDP will be discussed. The Forum is organized jointly by the World Bank, the International Monetary Fund, the Asian Development Bank and the United Nations Development Programme and of course Lao PDR. Its objective is to integrate poverty reduction principles into domestic policy-making processes to help increase their effectiveness and reduce transaction costs. The Forum aims to enable an exchange of experiences in formulating and implementing plans and PRSPs, and to strengthen the consensus among governments and donors in the region regarding the critical attributes of: i) national plans that can function as effective poverty reduction strategies; ii) progress reports that efficiently monitor progress in translating these plans into results; and iii) donor support that is aligned with country priorities and with country-specific processes and timetables.
- Led by the CPI, the GoL will prepare a Conference Paper for the “Forum on National Plans and PRSPs in East Asia” suggesting how the following four PRSP principles can be optimally addressed in the national planning process: participation and transparency; poverty focus; results-orientation and; alignment of aid, cycles and reporting mechanisms. Showcasing the experience of Lao PDR in the PRSP process, the GoL will prepare several presentations to the forum of lessons learned.
- Complete Prioritization of sector programs, which are aligned with the new MTEF.
- Disseminate the revised NGPES costing results.
- Update the draft NSEDP based on comments received and distribution of a new draft NSEDP for comments.
- Another Mini-RTM on the NSEDP scheduled to take place before the National Assembly meeting in July 2006.
- Strengthen the monitoring and evaluation system in the draft NSEDP.

(For the NGPES measures taken in previous years please refer to the Annex–Box 1)

PART II – STRUCTURAL REFORMS

The implementation of the Government’s multi-year Public Expenditure Management Strengthening Program (PEMSP) gained considerable momentum, even if efforts to mobilize additional revenue made little progress. Progress with State-Owned Enterprise (SOE) restructuring remained slow, with relatively better progress in respect of the financial sustainability of the utilities SOEs. Restructuring of the state-owned commercial banks (SCBs), which had lagged for sometime in achieving the targets set in the ‘*Governance Agreements*’, made little progress in finalizing the revised *Governance Agreements* or in demonstrating a renewed commitment; there was however, considerable support for revising the financial-sector legislation and in drafting a Financial Institutions law that would, at a minimum, level the playing-field for state-owned and private banks. On the private sector and trade side, steps were taken to facilitate trade and a law adopted to liberalize registration of private enterprises to improve the investment climate.

2.1 PUBLIC EXPENDITURE POLICY AND MANAGEMENT

BACKGROUND

Since 2001, the government of Lao PDR revived its public expenditure reform, by reassessing its expenditure policies and its public expenditure management processes. The last PER, the CFAA and the CPAR were completed in 2002 & 2003 thereby raising issues and spurring actions, albeit slowly. These actions have made the legal framework for procurement a sound one, and other actions have improved transparency and accountability even if there is still a long way to go.

Public expenditure policy has also been improving, though with stagnating share of revenues in GDP and accumulation of arrears, the spending choices remain constrained. Nevertheless, there have been increases in expenditure on education and health in recent years and further efforts are underway to meet the country’s

poverty reduction objectives. Managing wage increases, and restraining growth in public employment to ensure sustainable growth in total wage bill is a pressing need. Phased payment of arrears, better balance between recurrent and capital expenditure and more efficient social sector spending remain important. Thus, more effective, accountable and transparent public expenditure management processes and improved public expenditure policies will be key in all future efforts of the Government of Lao PDR.

Building on the actions taken earlier by the Government as well as the technical assistance and advice provided by the World Bank, the IMF, the ADB, the UNDP and other bilateral donors the Government adopted a comprehensive, five-year Public Expenditure Management Strengthening Program (PEMSP) in early 2005. This Program focuses on the strengthening of management systems and the capacity of the Ministry of Finance and Provincial Finance Departments, through reform measures implemented annually – all of which are fully consistent with the Government’s “Policy Paper on Governance” and its “National Growth & Poverty Eradication Strategy”.

Public expenditure policy. In Lao PDR, total government expenditures as a share of GDP have been relatively flat, though the 2005/06 budget proposes an increase of 1 percentage point relative to 2004/05. A part of this rise comes from the proposed rise in current expenditure this year, both wage and non-wage. The budget clearly reduces the imbalance between capital and current expenditures, as it did in 2004/05, as a result of this rise. Spending on the wage bill have been growing quite rapidly (a bit more than 20 percent per annum in past few years), and this is only in part due to increases in wage-rates from very low levels. There is a considerable pressure in provinces to raise recruitment, and this limits the wage-rate increases that can be awarded to existing government employees, given limited resources.

Table 3. Government expenditures

		est.	est.	prop.
	2002/03	2003/04	2004/05	2005/06
	<i>(billions of Kip)</i>			
Total expenditures	4,017	3,967	4661	5670
Current Expenditure	1,527	1,890	2385	3039
O.W. Wages & Salaries	840	1076	1329	1650
Capital Expenditures and onlending	2,370	1,853	1900	2376
O.W. Domestically-Financed	1,026	799	580	667
Debt repayment/Contingency	120	224	377	255
	<i>(percent of total budget)</i>			
Total expenditures	100	100	100	100
Current Expenditure	38.0	47.6	51.2	53.6
O.W. Wages & Salaries	20.9	27.1	28.5	29.1
Capital Expenditures and onlending	59.0	46.7	40.8	41.9
O.W. Domestically-Financed	25.5	20.1	12.4	11.8
Debt repayment/Contingency	3.0	5.6	8.1	4.5
	<i>(percent of GDP)</i>			
Total expenditures	18.6	15.5	15.9	17.1
Current Expenditure	7.1	7.4	8.1	9.1
O.W. Wages & Salaries	3.9	4.2	4.5	5.0
Capital Expenditures and onlending	11.0	7.3	6.5	7.2
O.W. Domestically-Financed	4.8	3.1	2.0	2.0
Debt repayment/Contingency	0.6	0.9	1.3	0.8

Source: Lao authorities (MoF) and IMF staff estimates and proposal

Public Expenditure Management

In early 2005, GOL adopted – through the approval of the Ministry of Finance (MOF) & the Prime Minister Office (PMO) - a detailed 5-year Public Expenditure Management Strengthening Program (PEMSP) with targets and milestones. Implementation of reforms cited under PEMSP is expected to ensure that government revenues are spent accountably, transparently and effectively with significant growth and poverty-reduction impact. This would help better service delivery and reduce fiduciary risk. The PEMSP spans five components: A) Fiscal Planning and Budget Preparation; B) Budget Execution, Accounting and Financial Reporting; C) Local Government Financial Management; D) Financial Legislation and Regulatory Framework; E) Capacity-Building. It lays out the measures for each of key functions at the central and provincial levels, including a specific capacity building component focused on training, together with key performance indicators to monitor progress.

Following intensive inter-departmental discussions, as well as consultation with donors and other stakeholders, the annual implementation plan and the capacity building plan for the PEMSP were

approved by the PEMSP Steering Committee at its meeting on January 9, 2006. The plans translate the high-level PEMSP implementation schedule for FY2005/06 into specific program activities with outputs/milestones set for each of them. In addition, to ensure clear accountability, a lead department and collaborating departments are assigned to each activity. The plan also identifies existing technical assistance and indicates additional needs to help coordinate and mobilize donor support to PEMSP implementation.

The Government has made steady progress with PEMSP implementation. In addition to preparing the annual implementation and capacity building plan, the Government has appointed a long-term PEMSP Technical Adviser in the MOF; and has initiated discussions with a number of donors, including the EC, SIDA and the World Bank, regarding possible co-financing for a PEMSP multi-donor trust fund to support PEMSP-related technical assistance and capacity building. Progress in the areas of expenditure planning and budgeting, budget execution and reporting and province-level public expenditure management are set out in more detail below.

Expenditure planning and budgeting. The costing of the NGPES is a critical first step in the process to establish the interconnection between planning and budgeting. With close involvement from MOF and CPI, the central ministries responsible for the four priority sectors selected by the Government in its NGPES (Agriculture, Transport, Health and Education) have estimated their financial needs following a bottom-up approach. The results of this exercise have been disseminated and discussed, and will be integrated into the medium-term fiscal framework being prepared for the NSEDP 2006-10, to be presented at the National Assembly in July 2006.

The National Assembly approved the high level budget plan during its October 2005 session and finalized detailed budget breakdowns by administrative (organizational) classification by February 2006. The MOF has since conducted analysis to “map” the budget allocations by administrative classification to allocations by NGPES/NSEDP priority sector. This data was finalized and provided to the World Bank and other donors in March 2006, well ahead of the normal time for publication of the main budget and the Minister of Finance has approved the publication of this budget summary. As a first step in expanding the coverage of the Budget process, MOF also collected summary financial data on major statutory funds.

Budget execution and financial reporting. MOF approved the establishment of a new Government Financial Information System (GFIS) (Ministerial Decision 0607/MOF, March 10, 2005). More remarkably, the Government has also implemented the new GFIS in all central ministries and in 14 of 17 provinces in less than 12 months since then.

Using GFIS, data on accounts payable and treasury balances are now maintained at central level and in 14 out of 17 provinces using this system. The system is extremely new: the accuracy of data entry and coding is still being verified and strengthened; and both communication links and business processes need to be strengthened to ensure better reporting between provinces and the center using GFIS. However, international experience shows that new treasury/budget management information systems take time to become fully operational and that “running-in” problems are a necessary part of implementation. The Government’s GFIS has been examined in detail by two separate government financial information system experts and has been assessed favorably by both.

Simple cash plans have been prepared at central administration level, but are not prepared at province level at this stage and further work needs to be done under PEMSP to make the plans more realistic and effective. The new data on treasury balances available in GFIS will greatly help in this regard—ensuring that the plans are based on sound and up-to-date baselines.

Government has taken the opportunity of the Budget Circular (Ministerial Decision 2372/MOF, November 7, 2005) to clarify the division of responsibilities for budget execution between Treasury and Budget Departments. Expenditure approvals are now to a much greater extent left to the Treasury, with the Budget Department playing a more strategic monitoring role. Further work on this issue is ongoing under the PEMSP.

A Chart of Accounts (COA) Revision Committee has been established in MOF and an international consultant to assist the committee has been appointed and has started work. The consultant has prepared an inception report, and a process and work plan for finalizing and approving the new

COA and implementation strategy. International experience suggests that changes to COAs need dialogue and consultation with the users of government financial information.

Following the drafting of the National Procurement Manual, including Standard Bidding Documents (SBDs) with the assistance of international consultants under PRSO1, PrMO translated the documents into Lao, completed internal stakeholder consultation on the most important and commonly used SBDs and has shared them with key external partners for feedback to facilitate harmonization. PrMO also developed a procurement capacity building program which will be implemented with financing from the FMCBC; and initiated a baseline assessment and the development of a performance monitoring and evaluation system for procurement.

Support to procurement reforms is continuing under the existing IDF Grant “Improving the Efficiency of Public Procurement”. Progress was made on finalization of the standard procurement documents. A new IDF Grant “Strengthening implementation, monitoring and evaluation of the public procurement system” was signed and became effective, which will support the establishment of a mechanism to monitor the performance and outcomes of the procurement system, and creation of an e-procurement bulletin/website. Procurement reform is an integral part of PEMSP.

Provinces. To oversee the proposed revision of the Budget Law, the Government has established a Budget Law Revision Committee and has initiated discussions on options for revising and clarifying revenue and expenditure assignments and central-local fiscal transfers. The draft NSEDP states that the new Budget Law will “renovate and refine” central-local fiscal relations and an early draft of the revised Budget Law, shared with donors, addresses these issues. However, the early draft law requires further work and these issues remain under discussion.

The Nam Theun 2 Revenue Management Arrangement (NT2RMA) seeks to (a) ensure appropriate allocation of NT2 revenue into eligible expenditure programs, (b) track closely the movement of NT2 funds from project to treasury and to eligible program spending, (c) adopt transparent and verifiable reporting arrangements for expenditures financed by NT2 revenues and (d) monitor outcomes of these expenditure programs. It says that NT2 revenues will only be applied in financing programs that meet agreed eligibility criteria; NT2 revenues will be channeled through a segregated account to Treasury, and Government will withhold funds from expenditure programs that do not meet eligibility criteria; NT2 revenues will meet transparency standards and the auditor will be subject to a peer review; and eligible programs will be subject to regular PERs and PETS to assess outcome and impact and the findings will be fully disseminated.

Public Expenditure Reviews (PER). The last official Integrated Public Expenditure Review (PER) produced by the World Bank in collaboration with the Lao PDR authorities, the International Monetary Fund (IMF), and the Asian Development Bank (ADB), was carried out in 2002. The rationale for conducting a follow-up integrated PER in 2005 stems from the need to examine public expenditure trends between 2002 and 2005, and support the GOL to achieve its key development objectives by establishing sound, accountable and transparent financial management practices. This PER also fulfils the requirements of the Nam Theun 2 (NT2) revenue management arrangements. The PER process - expected to be completed by June 2006 - is helping in the costing of NGPES priority programs and provide input to the formulation of the 2006 state budget and the pilot 2006-2010 Medium-Term Expenditure Frameworks (MTEF), due to be presented to the National Assembly (NA) in July 2006.

The first Public Expenditure Tracking Survey (PETS), focusing on the education and health sector expenditures was initiated in September 2004. Rapid assessment reports were prepared in November (approved by Prime Minister’s Office in January 2005) and pilot testing was started in May 2005. A revised implementation schedule was approved by the PETS-committee, and training and the main field work are scheduled for early 2006. The main parameters for the survey and the sample design have been agreed as is the sample villages drawn from a subset of the villages visited for the LECS 2002/3. The National Statistical Center (NSC) is responsible for the PETS field work and data processing.

A dialogue is ongoing on public administration reform. There are two key issues: civil service pay and management and intergovernmental fiscal arrangements. At present, both these policy issues are overseen by the PMO with technical assistance coordinated by UNDP under the Governance and Public Administration Reform Program. During initial discussions, the PMO and

MOF indicated that the most useful role for the Bank to play is in ensuring adequate linkage between the broader public administration reforms and the public expenditure management reform agenda. Further work here will be carried out under the PER, including provincial financial management issues. Further work on provincial public expenditure management will also be pursued in the context of the Khammouane Province development work that has begun.

A revision of the Budget Law is ongoing. The revised Law can potentially help address many of the weaknesses in the Lao PDR budgetary system in terms of: (i) clarifying the roles and responsibilities of various actors involved in budget implementation; (ii) clarifying the assignment of expenditure and revenue between central and provinces; (iii) extending the budget preparation cycle to allow more time for dialogue between the MOF, CPI, the sector ministries and provinces; (iv) introducing a functional classification and program code structure into the budget format to allow for monitoring how the government money is being spent; (v) streamlining the budget execution process by strengthening the authority of the Treasury and clarifying its leading responsibility for budget execution; (vi) bring the budget preparation and implementation forward. Moreover, to oversee the proposed revision of the Budget Law, the government has established the Budget Law Revision Committee and has initiated discussions on options for revising and clarifying revenue and expenditure as well as central and local fiscal transfers.

(For the PEM reform measures taken in previous years please refer to the Annex–Box 2)

2.2 REFORM OF STATE-OWNED ENTERPRISES

BACKGROUND

The objective of the government's SOE reforms is to enhance transparency, reduce waste and increase efficiency in order to promote their commercial viability and reduce their burden on the budget and the SOCBs. Reforms implemented in the early 1990s reduced the SOE sector by closing down, leasing, merging and selling a large number of SOEs. The SOEs today are not only fewer in number, but more importantly, play a significantly smaller role in Lao's economy in terms of share in GDP and in share in total employment. Nevertheless, several large SOEs had generated a large share of the non-performing loans (NPLs) in the state-owned banking system in the second half of 1990s, which risked the stability of the banking sector and have to be ultimately funded by Government revenue.

The Government's SOE reform program, the current round initiated in 2001, had three objectives: (a) improving transparency and governance of state enterprise sector (b) restructuring the larger SOEs whose losses and accumulated debt to banks were undermining both the budget and the financial sector, and (c) rationalizing the regulatory and pricing environment for infrastructure SOEs through tariff policy reform.

Progress over the last four years has been uneven, but the Government has been successful in reining in the SOEs and in reducing the non-performing loans (NPLs) arising from the SOE sector – in fact a much larger share of NPLs over the last 3 years is due to the private sector not the SOEs. There was progress for 4 large SOEs as well as EdL, especially in 2003 and early 2004, was not only in preparing detailed time-bound restructuring plans, and developing consensus on actions, but also in Government taking many of the proposed actions to restructure (e.g. selling non-core assets, reducing employment, adjusting tariffs, restructuring old debt, setting up committees to continue the process and to do international standard audits on a regular basis) Even for all other SOEs, the Government carried out annual assessment of their financial performance and for chronic loss-maker, put them on a restructuring list. Nevertheless, the pace of progress during 2005 remained slow and uneven. And many SOEs are still able to take actions, on occasions, that are not consistent with the objective of commercial viability.

In 2004, a consensus was reached within the government on the SOEs to be restructured and a detailed time-bound action plans were developed and adopted by the Prime Minister's Office. At the heart of the plan is a time-bound restructuring plan of four large SOEs, two in infrastructure and two in manufacturing. In addition, the GOL selected another five SOEs for developing detailed restructuring action plans, and annual monitoring of performance of all SOEs. In late 2005, another group of four SOEs has been chosen for restructuring. The restructuring effort is led by the Business Promotion Office (BPO) within the Prime Minister's Office responsible for coordinating, implementing and monitoring the GOL's SOE Restructuring Plan, with support from the Ministry of Finance and parent ministries of respective SOEs.

Ongoing Restructuring of 4 large SOEs (Phase-1). Draft independent external audits of financial accounts for FY04 for the four Phase 1 SOEs: Lao Airlines (LA), Nam Papa Lao (NPNL),

Pharmaceutical Factory 3 (PH3), and Bolisat Pattana Khet Poudoi (BPKP) have been submitted to the Business Promotion Office (BPO) for review and comment on March 27, 2006 by the auditor (Ernst & Young), according to the agreed Audit Planning Memorandum submitted December 15, 2005. Once the final audit report is issued, discussions can proceed between BPO, SOEs and the MOF on the actions needed to address the findings in the audit report.

One of the phase-1 SOEs for restructuring, that was targeted for private participation but did not find many suitors in an environment of high oil prices, i.e. Lao Airlines, is now planning to obtain a credit from the Import-Export Bank of China. The credit terms are still under discussions, though it is expected that the Government of China will subsidize this to bring it down to concessional terms. This credit, in the amount of about US\$25 million will be used to buy two Chinese aircraft, and will be guaranteed by the Government of Lao PDR. Without a joint venture with a private airline – as had been decided by the Government earlier -- and consequently better airline management and financial practices, it is unlikely that Lao Airlines will be able to repay this credit, unassisted. Given the recent history of Lao Airlines, it is important for the Government to harden the budget constraint faced by large SOEs, if the SOE management's incentive for reform is to be sustained.

Development of Restructuring Plans for another 5 SOEs (Phase-2). These include the DAFI Group, the Agriculture Industry Development Import-Export State Enterprise, the Lao State Fuel Company, the Société Lao Import-Export, and the Road Bridge Construction Company No. 13. Development of the restructuring plans for these five SOEs is progressing with a TA from JBIC and is expected to be completed in next few months.

With support from the Japan Bank for International Cooperation (JBIC), the Prime Minister's Office (PMO) has started work on developing restructuring plans for the Phase-2 SOEs. The JBIC-financed consultants completed their fieldwork in January, 2006 and have produced a final report concerning each of the five SOEs. The report contains recommendations for the drafting of the restructuring plans for these enterprises under PRSO3. The Government will complete and approve these restructuring plans by September, 2006.

Restructuring of another 4 SOEs (Phase-3). In December, the BPO and MOF had a joint meeting to agree the four SOEs to be restructured. The following SOEs were selected: Lane Xang Phatthana (LXP), Lat Visahakit Sanong Vatthou Technique (LVSVT), Lat Visahakit Konchak Kasikam (LVKK) and Borisath Phalithaphanh Beton Lao (BPBL). The Prime Minister's Office approved these four enterprises for restructuring in December, 2005 and the process of development of restructuring plans has been initiated. The Restructuring Unit in the Business Promotion Office (BPO) has been appointed to oversee the preparation of restructuring plans.

SAMD Performance Monitoring and Assessment. SAMD submitted a report of all SOEs' performance for FY 2004 to the Ministry of Finance in January 2006. The report includes summary of annual financial data of all central and provincial SOEs and identifies the loss making and non-performing SOEs.

Tariff Policies for Infrastructure SOEs

BACKGROUND

The Government, cognizant of the need to reduce budgetary subsidies to these services and to tap into the private financing of investments, have been moving to more appropriate tariffs and prices for such services.

Most of infrastructure and services in Lao PDR -- electricity, water, and domestic air travel -- are provided by SOEs, though in telecommunications private providers have been delivering these services. There are many challenges to the financial sustainability of electricity and water utilities in Lao PDR. Tariffs have generally lagged inflation and remained below full cost-recovery levels, despite significant recent adjustments. Low and complex tariff structures have resulted in inefficient energy and water usage, and have reduced the resources available for further investment in these sectors. Major arrears have built up to the utilities, including arrears from the government budget. Against this, the utilities themselves have fallen behind on servicing of their debts to Government.

There has been a good deal of Government action in this respect over the last three years. These actions relate to: (1) actual changes in tariffs and in tariff structures, and (2) announcement of

guiding principles for setting of tariffs and for changes in those tariffs. In particular, tariffs were raised towards greater cost-recovery and policies and principles were announced that would guide future tariffs and tariff changes on water, telecommunications, power and airfares, through Prime Minister's Notices.

Water Tariffs

Background

In the second half of 2004, WASA conducted a comprehensive tariff review of 16 of the 18 NPSEs. This review set out to make recommendations for tariffs for the period 2005-2007 inclusive that set the NPSEs on the path to full cost recovery (WASA Annual Report 2004). The Government promulgated the Decree on Regulation of Urban Water Supply Operations in July 2005.

Since the last issue of Economic Monitor, WASA's tariff reviews for 2005-2007 were accepted and implemented by 8 of the Nam Papa State Enterprises (NPSEs – in Bolikhamxay, Savannakhet, Champasak, Sekong, Vientiane Capital City, Vientiane Province and Xieng Khouang). Two provinces (Luang Namtha and Luang Phrabang) are still reviewing the tariff proposals and the remaining 8 NPSEs require service and water supply system improvements before tariff reviews can take place.

The first 2 official private sector water supply concessions were awarded in 2005 to private operators in Feuang District Town and Tha Heua Neau Village, Vang Vieng District (both in Vientiane Province). The process of developing these private water supply operations has been supported by GRET (a French INGO). These water supply systems are expected to be operational in April 2006.

Electricity Tariffs

Background

Electricité du Laos (EdL) was particularly hard hit by the financial crisis and ensuing inflation of the late 1990's because of a currency mismatch: its revenues are largely in kip while the costs of debt servicing are mainly in US Dollars. A financial recovery plan was implemented during the subsequent years; the main features of this plan included conversion of government debt to equity and annual tariff adjustments of 25-50%. Consequently, EdL is now on a reasonably good footing and has been able to pay annual dividends to government in the order of 3-5 million US dollars since 2003.

The average domestic tariff rate is about 15% below the rate required for full cost recovery given existing costs. Residential and agricultural consumers are cross-subsidized by others. However, part of net returns of exports is covering the gap in full cost recovery.

On November 22, 2005, MIH, MOF and EDL signed the Action Plan for Financial Sustainability of Power Sector (Financial Action Plan). This plan is intended to address the major issues impeding EDL's financial sustainability, namely the need to increase tariffs to cost-recovery levels; and the need to eliminate the stock and avoid future additions to Government's payment arrears to EDL. The plan includes three main components:

- tariff adjustment, with tariffs being restructured and increased by an average of 1 percent per year in real terms until 2011 when cross-subsidy among customer categories should be minimized and full cost recovery achieved (based on the EDL tariff study – Electrowatt, 2004);
- settlement of accumulated arrears from Government to EDL, with agreement on a final arrears figure (as of October 31, 2005) by January 31, 2006, along with agreement on a settlement schedule over approximately two years. This may be financed, if needed, through EDL's debt service payments to Government which should go up effective January 2006 upon the expiry of a one time concession extended through a previous financial restructuring plan of EDL; and avoidance of future arrears by Government to EDL; and

- operational efficiency improvement by EDL, with overall system losses reduced from about 20 percent in 2004 to around 13 percent in 2011.

Government has made progress in the implementation of the Financial Action Plan. In September 2005 MOF approved a gradual settlement of arrears due from the central Government departments and agencies to EDL in the amount of almost US\$4 million, out of which almost US\$1 million was disbursed in 2005. Subsequently, on January 1, 2006, the first monthly tranche of the planned write-off of EDL's payments due to Government against the approved arrears was executed (in an amount of US\$ 69,000) in accordance with the Action Plan. On June 24, 2005, MIH issued Notice 302 (effective on July 1, 2005) for a tariff adjustment averaging 5.5 percent, in line with the decision made by the Prime Minister, and EDL implemented the initial tariff adjustment on August 1, 2005. On January 1, 2006 EDL implemented a further increase averaging 0.7 percent, in line with the agreed Action Plan. The adjustment for local inflation and exchange rate fluctuation, which is also a part of the agreed Action Plan, was implemented on April 1, 2006 (an increase by 1.05 % up to average tariff of 552 kip/kWh).

Table 4. Electricity tariff change for 2006

	2003	2004	2005	2006
	(in Kip)			
Residential consumers				
First Block (0-25 kWh/month)	99	113	115	133
Second Block (26-150 kWh/month)	231	265	265	276
Third Block (>150 kWh/month)	667	765	765	773
Non-residential consumers				
Agriculture	257	295	295	313
Government	616	706	706	703
Industry	555	636	636	634
Commercial	721	826	826	835
International organisations	1040	1066	1066	1077
Entertainment	955	1095	1095	1106
Medium Voltage				
Agriculture			251	266
Government			600	598
Industry			541	539
Commercial			702	709
Total average	25	514	543	552
Average tariff increase (weighted, %)		19.4	5.5	1.8

Source: Lao authorities (MIH/EDL)

Telecommunication Tariffs

Background

The current capacity of the telecommunications sector in Lao PDR is relatively small - estimated to be 90,000 fixed lines and 141,000 cellular lines – two-thirds of this capacity is in Vientiane. Transmission to Northern provinces is limited by mountainous geography. There are four authorized enterprises to provide fixed and mobile telecommunications in Lao PDR, with all four providing mobile phones but only three providing fixed lines. All of them have some government ownership. The enterprises are as follows: Lao Telecommunications Co Ltd (LTC, shareholding is GOL 51%, Shinawatra 49%); Enterprise des Telecommunications Lao (ETL, GOL 100%); Lao Asia Telecom (LAT, Ministry of Defense 100%); Millicom International Cellular SA (MLL, GOL 22%, Millicom 78%). The first three of them provide fixed line, mobile and other services, while the last one – only mobile and other services.

The entry of Millicom, the large shareholding by Shin Corp, the operations of PlaNet and the prevalence of Voice over Internet Protocol (VoIP) operators show that private investors are willing to invest in Lao PDR under the current policy regime. However, such investment is still primarily limited to activities in Vientiane and there is need to take stock of the situation with respect to tariffs and other policies.

The tariffs were revised upwards in early 2004 whereby fixed line rentals and local fixed line call rates were both increased, even as international fixed-line calling rates were lowered. The mobile rates reflect cost-recovery and thus are at competitive levels.

Telecommunication tariffs are closest to cost-recovery levels. Cellular or mobile phone tariffs are at full cost-recovery levels sufficient to support private investments. Fixed line tariffs have progressed, but international rates are still subsidized.

There have been no tariff changes in the last six months. The telecommunication sector remains relatively open with private entry and private operation, as joint-ventures with Government. Foreign investment especially in cellular continues. Nevertheless, the fact that many areas of Lao PDR do not have phone or telecommunication services means that further policy actions may be necessary to cover un-served areas -- where either new technology has to be used or private providers have to be supported because it is not sufficiently profitable.

(For the SOE reform measures taken in previous years please refer to the Annex–Box 3)

2.3 FINANCIAL SECTOR REFORM

BACKGROUND

The Lao banking sector remains rudimentary, shallow and predominantly state-owned. The sector remains small, with assets of less than US\$630 million and loans of US\$250 million in 2004. The three SCBs – Banque Commercial Extérieur du Laos (BCEL), Lao Development Bank (LDB) and Agricultural Promotion Bank (APB) – account for about 55 percent of the loan market. Three private domestic banks (two joint ventures and one with fully private ownership) account for about 31 percent; and six foreign bank branches for the remaining 14 percent. All three state commercial banks: BCEL, LDB, and APB are insolvent, having high levels of non-performing loans (NPLs) and weak profitability.

Since 2000, and with ADB, World Bank and IMF assistance, Government embarked on an ambitious banking sector reform program with three objectives: (a) restructuring the two SCBs, and reducing future NPLs and resulting contingent fiscal liabilities (b) enhancing transparency in the operation of SCBs and (c) strengthening central bank supervision. The objective of improving the overall banking environment for all banks was added more recently. The focus initially was mainly on the operational restructuring of SCBs and their increased transparency. SCBs were to be rewarded with gradual recapitalization only if they achieved the performance targets. The Bank Restructuring Implementation Committee (BRIC) was established within BOL to oversee program implementation and ensure that reforms are undertaken according to the agreed timetable. The implementation of the restructuring program has been slower than originally envisaged. It was not until early 2003 when key actions required under various programs took place and were enforced.

SCBs continue to be susceptible to pressure to extend non-commercial lending. Their capacity to evaluate credits, while being gradually improved, remains weak and the International Banking advisors (IBAs) are an important support in the transition. Proper governance structures, with checks and balances such as external board members, remain inadequate. And the Bank of Lao PDR (BOL) capacity to conduct supervision and enforce prudential regulations continues to be limited and will take time to improve.

SCB Restructuring and Improvement

In 2003, the framework was formalized with each SCB committing itself to the program under a separate "Governance Agreement" co-signed by the SCBs, Ministry of Finance and the BOL. In the meantime, the SCBs continued to extend noncommercial loans and make losses, with their asset quality deteriorating further in 2002.

Since 2003, a certain amount of progress was made in stabilizing the financial conditions of two SCBs. A new management team was appointed for each SCB and started working in early 2003. New branch managers were also appointed, and audit committees and asset and liability management committees were established. Operational policies and procedures (including credit policies) and internal organization have been designed with the help of the international advisers and adopted by the SCBs' boards. Each SCB has been assisted by an International Banking Adviser (IBA), whose role is to assist in strengthening the SCB's operations, especially in the credit review process. The introduction of certification by IBAs for lending decision seems to have had positive impact on the quality of new credits from 2003 onward. Independent International Financial Reporting Standard (IFRS) audits were completed for the period 2001-2003.

The government is in the process of revising Governance Agreements with the assistance of the ADB. These revised agreements will seek to streamline the management structure of the banks to make managers more accountable and are expected to put greater emphasis on concrete improvements in financial performance. The international advisers will be given expanded responsibility for monitoring performance against the operational and financial benchmarks. The revised Governance Agreements have not been finalized.

To strengthen the transparency of the SCBs, BOL finally submitted the draft 2004 independent IFRS audits for two SCBs (BCEL and LDB) to MOF in November 2005. Due to delay in procuring 2004 auditor for another SCBs (APB), the authorities decided to combine the procurement of audit services of APB for both 2004 and 2005.

The MOF approved in September 2005 the first tranche of recapitalization for BCEL and LDB in the amount of 129 billion Kip and 71 billion Kip, respectively. This is based on an agreement in August 2005 that MOF will conditionally recapitalize each SCB in four tranches of total 634 billion Kip from 2005 to 2008 mainly in form of bonds to compensate for losses from directed credits to state owned enterprises and credits guaranteed by MOF. The trigger for the first phased recapitalization was achieved by the signing of the Governance Agreement by each SCB. However subsequent tranches of recapitalization will be approved only if SCBs meet specified performance targets. The decision to proceed with each phase recapitalization will be made by the Bank Restructuring Implementation Committee (BRIC).

Banking Environment and Supervision

The current regulatory framework does not provide the Lao banking sector with the level playing field. There is a general direction in the draft 6th National Socio Economic Development Plan to promote a level playing field competition. Restrictions on the activities of non-state banks and market segmentation remain in force. The proposed amendments to the Banking law aiming to promote level competition between state versus non-state banks and foreign versus domestic banks have not been enacted. Foreign banks are restricted from expanding their branch network. The Presidential Decree Law 01 governing the management of foreign exchange and precious metals requires mining companies to hold bank accounts only with state banks. The SCBs are, accordingly, still protected from the competitive pressures from non-state banks that would motivate the SCBs to improve their efficiency.

In February 2005, the Prime Minister Office (PMO) submitted the amendments to Decree of the President on Commercial Banks, proposed by the Bank of Lao PDR (BOL), to the Standing Committees of the National Assembly. The proposed amendments aim to reduce barriers to entry and competition from non-state and non-resident banks, see Table 5. However with the proposed amendments, state banks will continue to get preferential treatment under the Part II of the Commercial Bank Decree and under the Presidential Decree Law No.01 governing the management of foreign exchange and precious metals. The latter requires businesses dealing with mining and exporting of natural resources to open deposit accounts only with state banks (Article 25 under Section VI Investment).

Table 5 Summary of amendments to Presidential Decree on Commercial Banks

	Min. req. registered capital	# yrs to bring capital	Capital reserve (% of registered capital)	Branch	Other req.
Presidential Decree on Commercial Banks No.02/PR					
A domestic bank 1/	3 mil. \$	3 yrs	25%	All country	No
A branch of a foreign bank	5 mil. \$	2 yrs 2/	25%	One branch in VTE	1 yr rep. office 3/
A state bank	no requirement 4/			All country	
Proposed amendments to Presidential Decree on Commercial Banks No.02/PR					
A domestic bank	10 mil. \$	90 days	max 25% 5/	All country	No
A foreign bank subsidiary	same as domestic bank			All country	1 yr rep. office 3/
A branch of a foreign bank	5 mil. \$	90 days	no requirement	5 mil.\$ per each branch	1 yr rep. office 3/
A state bank	same as a domestic bank for a new SCB			All country	No

Note: This needs to be verified.

1/ In practice, when Lao Viet Bank raised capital from 10 mil. USD to 15 mil. USD, the BOL didn't request LVB to surrender 25% of capital increase as capital reserve.

2/ The foreign investment law requires foreign investment to bring in capital within 2 years.

3/ BOL can propose to GOL to waive this requirement.

4/ SCB is treated differently under Part III of Presidential Decree on Commercial Bank No.02/PR.

Each SCB has a small paid up capital. Paid up capital as of 2004 for BCEL was 0.1 mil. USD and for LDB was 0.2 mil. USD.

5/ BOL will have discretion to reduce this requirement.

However the Standing Committees of the National Assembly declined to consider the proposed amendments until the BOL resubmits further amendments to the Decree of the President on Commercial Banks to make it consistent with the Enterprise Law, which was recently approved by National Assembly in October 2005. Based on the new Enterprise Law, commercial banks will have to be set up as a limited company or a public company. Beyond the technical amendments, the BOL plans to upgrade the Commercial Bank Decree to a Law and to cover all financial institutions including leasing companies which currently are governed by the Presidential Decree on Leasing.

As a result, the BOL sees the need for a comprehensive review of the Presidential Decree on Commercial Banks. Currently commercial banks are governed by Decree of the President on Commercial Banks 01/1997 and 02/2000 since the proposed amendments are not effective. The latter replaces some articles in the former but the former remains in force. The BOL established a working group to prepare a new Financial Institution Law. Timetable is tight since the BOL plans to submit the new Law to the National Assembly in September 2006. In addition, the team is expected to prepare draft amendments to the Presidential Decree Law No.01/OP. The aspects of the proposed amendments will not be limited to only promoting the level competition.

The revised Secured Transaction Law, approved by the National Assembly in May 2005, became effective in August 2005. The amendments expand and clarify eligible loan collateral. The revised law will be implemented following issuance of implementing regulations.

Rural and Micro-Finance

On June 22, 2005, the BOL issued the microfinance regulation No.10/BOL to implement the Rural and Microfinance Policy and Action Plan. The regulation provides an enabling environment to support the development of the microfinance industry and encourage establishment of microfinance institutions under diverse forms and types of ownership. A microfinance institution (MFI) can be established with registration only but cannot take deposits; it can take deposits from general public if it is granted licenses by the BOL. However uncertainty remains whether BOL will be required to revise the regulation to restrict foreign investment in the microfinance industry based on the guidance of a notice issued by the PMO in October 2005.

(For the reform measures taken in previous years please refer to the Annex–Box 4)

2.4 TRADE REFORM

BACKGROUND

Lao PDR has been integrating gradually into the world economy since 1989. The reform process accelerated after Lao PDR accession to the ASEAN and the joining of AFTA in July 1997. The highest current import tariff rate is 40 percent (compared to about 150 percent in 1995) and for most product groups it is below 20 percent. The current tariff schedule has six tariff rates: 5, 10, 15, 20, 30 and 40 percent, with non-weighted average MFN tariff of 11.3 percent. Non-tariff and quantitative import restrictions remain and in several sub-sectors are the primary binding restrictions. The country started to implement the AFTA Common Effective Preferential Tariff (CEPT) scheme in January 1998 and will complete the liberalization schedule by 2008 reducing its tariff on imports from ASEAN countries to 0-20 percent by 2005 and 0-5 percent by 2008; however, the legislative enactments for 2004 and 2005 for this purpose have been delayed. The Government has recently introduced one-stop services at customs border check-points to reduce bureaucratic procedures and provide better export and import services.

In November 2004, the USA granted Lao PDR normal trade relations (NTR), bringing into effect the US Bilateral Trade Agreement (USBTA) with Lao PDR signed sometime ago. This means that Lao exporters now have direct access to the US market, instead of being restricted by prohibitive US tariffs without the NTR. In the short-run, the Lao PDR industries that stand to benefit the most from increased market access are the garment and handicraft sub-sectors. The commitments under this agreement are closely related to the reforms that will be required for accession to the WTO.

Progress towards WTO accession. The government has received assistance to prepare the following checklist documents for WTO accession: ACC/4 (agricultural subsidies); ACC/8 (illustrative TBT/SPS measures); ACC/9 (TRIPS implementation); and ACC/5 (Services). In addition, as discussed below, the National Assembly has approved the new Customs Law, designed to implement the transaction value principle, as well as facilitate customs modernization more generally (WTO rules require all members to use the transaction value principle when assessing ad valorem customs duties).

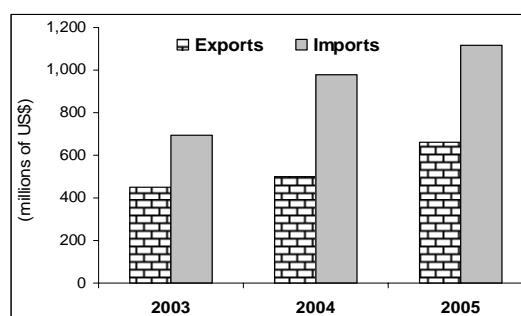
Progress towards AFTA implementation. A draft Resolution was submitted to the October 2005 session of the National Assembly, including a schedule of phased tariff reductions consistent with AFTA commitments, with all tariffs for items in the inclusion list reaching the 0-5 percent range by 2008. All remaining tariffs in the Temporary Exclusion List have been moved to the Inclusion List (the fourth installment took place in early 2004, and the fifth and last installment in early 2005). The fifth installment transfer to the IL has been approved in principle by the National Assembly but not been ratified yet by the Standing Committee which will convene in July, 2006.

Trade Developments

In 2005, as compared to 2004, *total* export earnings increased by more than 30 percent: from US\$500m to about US\$660m. At the same time, imports went up by 14 percent: from US\$977m to US\$1,116m (see figure 5). Machinery and equipment imports (major items of capital goods) grew from US\$310m to US\$354m accounted for by mining and hydropower foreign investments. Oil imports rose remarkably by 30 percent or from US\$124m to US\$161m due to higher world prices.

The sharp growth in total exports was driven largely by mining (gold and copper and other). Non-mineral-non-hydro exports overall remained unchanged compared to the previous year.

Figure 5. Lao Exports and Imports (US\$ m)



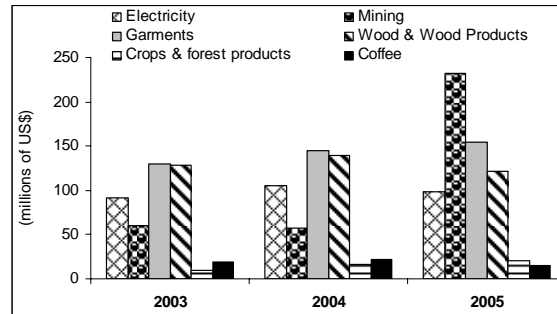
Source: Partner countries data (PCD) and IMF staff estimates

Strong exports. In 2005, mining export earnings increased by nearly 265 percent (or to US\$218m from US\$60m in 2004); exports of gold went up by 97 percent (US\$114m from US\$58m in 2004); Lao PDR started to export copper for the first time in 2005 in an amount of US\$100m. Exports of cash crops and forest products also grew fast, by 60 percent in the same year (or reached US\$24m) whereas electricity, garments and coffee remained at the previous year's levels and wood and wood products dropped by 13 percent (see figure 6).

Lao PDR export markets remain concentrated in ASEAN (Thailand & Vietnam) & China; exports to EU and US are picking up, though slowly.

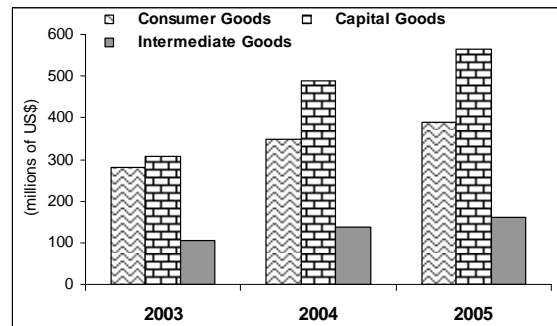
Composition of Lao imports. Imports are classified into three main product categories: investment, intermediate, and consumption goods. In 2005, as compared with 2004, Lao imports of capital goods increased by about 17 percent (from US\$496m to US\$580m), intermediate goods by 14 percent (from US\$132m to about US\$150m) whereas consumer goods by 10 percent (from US\$349m to about US\$385m (see figure 7). Lao PDR imported goods mainly from its traditional trade partners – neighboring countries, such as Thailand, China, Vietnam and others like Japan, Korea, Australia and EU.

Figure 6. Exports of Major Commodities (US\$ m)



Source: WB staff estimates based on GOL (BOL/MOC) and IMF/PCD data and inputs

Figure 7. Imports of major commodities (US\$ m)



Source: WB staff calculations based on GOL (BOL/MOC) and IMF/PCD data and inputs

(For the reform measures taken in previous years please refer to the Annex–Box 5)

2.5 PRIVATE SECTOR DEVELOPMENT

BACKGROUND

The Constitution of 1991 protects state, collective and private forms of ownership. During the 1990s an active program of legislation began to lay the foundation for the development of market based rules and institutions to support private sector development. The foreign investment legislation was passed in 1988 and a legal basis for land for use and transfer began to be established in 1992-93. Today, agricultural production and most of manufacturing production is in private hands and state-enterprises cover only around one percent of employment.

Nearly 97 percent of manufacturing units are small (less than 10 employees). Of the medium and large units, 35 per cent are privately owned by Lao citizens and 55 per cent were joint ventures with foreigners; the rest are owned by government (including provincial governments).

Foreign investments have been flowing into garments, wood processing, tourism, hydropower generation and more recently, mining. Between FY 2000/01 to FY 2001/02, foreign investment volume increased and approvals of investment increased tenfold (from US\$42m to US\$492m for the same period) and the actual investment went up by 23 percent (or from US\$75 m to US\$93m). In 2002/03, the approved FDI declined to US\$466m but the actual investment increased to US\$155m (or by 67 percent). The growth was largely due to mining, hydropower and service sectors. The main foreign investors are from Thailand, Malaysia, Singapore, Vietnam (ASEAN), China, Australia, South Korea, Taiwan, France, the Netherlands and United States.

The Ministry of Commerce issued PM Decree on Trade Competition that removed all restrictions on the movement of goods across provinces. This, if appropriately enforced should enhance market integration and ensure that all provinces have access to goods and services easily.

In the recent months, the Lao PDR Government has taken a number of measures to promote domestic and foreign private investments and generally improve the environment for doing business in the country.

Business environment. The National Assembly approved amendments to the 1994 Business Law, in the form of a new *Enterprise Law*, during the October 2005 legislative session. The new *Enterprise Law* creates a level playing field for private businesses, significantly simplifies regulations and procedures to start up a business, moves from discretionary licensing to more automatic registration as the main principle by having a “negative list” of sectors where entry of private business is conditional, and by creating a one-stop-shop for business registration.

Both the Enterprise Law and Domestic and Foreign Investment Laws (implementing decrees for which were issued at the end of 2005) include positive features. However, it should be noted that there are also some shortcomings and inconsistencies. For example, while Enterprise Law reduces the number of licenses and substitutes them with post-establishment registration, the Investment Laws require an investment license for domestic investors and keep a discretionary licensing regime for awarding them. While both sets of legislation envisage a one-stop-shop, the Enterprise Law and Investment Laws place them in different government agencies. The Investment Laws envisage a “positive list” of industries with restricted entry, instead of “negative list”. These inconsistencies are unfortunate and Government recognizes that they will need to be resolved through further review of the Investment Laws.

The Government has drafted a regulation to promote sustainable private investment in mining and this was adopted by the MIH in December 2005. It is intended to encourage sustainable development of private investment in mining, eliminating bottlenecks that impede development of this sector.

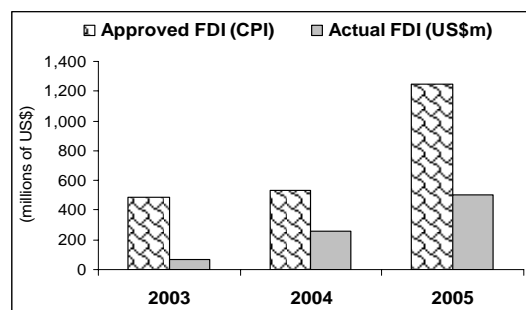
The Government has continued to foster dialogue between private sector and government generating increased confidence among private businesses. The first joint meeting between the government’s inter-ministerial committee and the private sector working group was held in January 2006 to discuss and agree on the key issues to be presented at the upcoming business forum. During the last six months, with support from MPDF, a number of working group meetings have been conducted with the representatives of the private sector from tourism, manufacturing, service and trading. The Lao Business Forum is scheduled to take place in April 2006.

FOREIGN DIRECT INVESTMENT (FDI)

There is growing interest from foreign investors, especially from the region, to invest in Lao PDR. While the recent rise in inflows of foreign investment is mainly in mining and hydropower, regional investors have expressed interest in investing in agriculture, agro-processing and other manufacturing. In agriculture and agro-processing, land-leases have been signed recently for producing pulp from eucalyptus, producing rubber, sugar and palm oil -- and they involve investors from India, Vietnam, Malaysia, and Thailand. There is also interest by Thai and Australian investors to come into cement-production and to buy into existing state-owned commercial banks. Such potential investments outside mining and hydro will bring in the much needed technology and management as well as capital, and will ensure that non-mineral-non-hydro exports can grow strongly over the medium-term to help Lao PDR achieve its Plan objectives.

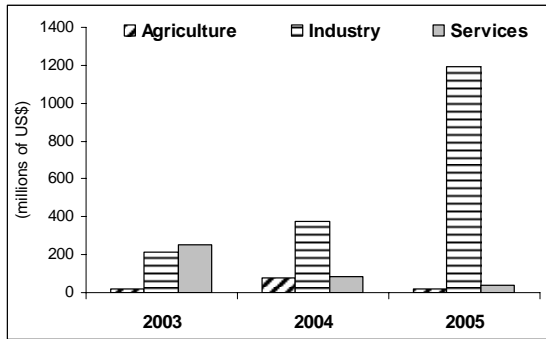
Inflows of FDI rose sharply in both 2004 and 2005. In 2005, actual FDI in the Lao PDR increased by more than 50 percent (or from US\$285m to about US\$450m). The rapid growth has been driven by large investments in the industry sector, especially hydropower NT2 project (about 83 percent of the total FDI in 2005). However, investments in the mining sector dropped by almost 80 percent (or from US\$215m to US\$43m) and FDI of services sector was down by half. FDI in agriculture is picking up the momentum as more foreign investors have showed their interests in this sector--during the past two years, GOL has approved a number of large projects worth more than US\$430m for plantations of rubber, eucalyptus, palm and sugarcanes and agro-processing industries and crop farming.

Figure 8. FDI in Lao PDR, US\$ m



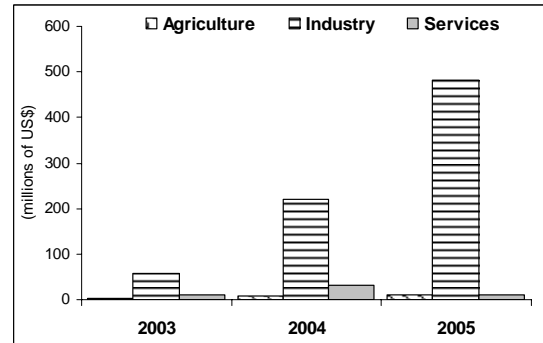
Source: Lao authorities (CPI) and WB staff estimates

Figure 9. Approved FDI by sector, US\$ m



Source: Lao authorities (CPI)

Figure 10. Actual FDI by sector, US\$ m



Source: WB staffs estimates

(For background on measures taken for private sector in previous years please refer to the Annex – Box 6)

PART III – DONOR ASSISTANCE TO THE REFORM AGENDA

Lao PDR has a high dependence on external support, some of which flow into considerable technical assistance. This Part examines the sort of technical assistance and other support that the donors are providing to the Government's policy reform agenda. This information has been provided by donors and has been collated and described by the Monitor.

3.1 PUBLIC SECTOR GOVERNANCE

ADB, Australia, the European Union (EU), France, Japan, New Zealand, SNV, Sweden, the Swiss Agency for Development and Co-operation (SDC), UNCDF (United Nations Capital Development Fund), and UNDP are the key donors providing support to various aspects of public sector governance. This covers public administration, including National Assembly, decentralization, public financial management, as well as legal and judicial reform.

ADB

- **Public Expenditure Planning for National Growth and Poverty Eradication Strategy** (\$0.7 million, 2005-2007). The TA provides capacity building and advisory services aimed at: (i) improved and effective allocation of public resources according to the Government's development and poverty reduction policy objectives; and (ii) improved quality of fiscal planning.

- **Enhancing Government Accounting Regulations and Procedures – Phase II** (\$0.62m, 2003-2006). The TA provides capacity building support to the Government for: (i) provision of reliable, timely, and relevant financial information by all ministries, agencies, and offices of government; and (ii) improved accountability of public financial resources at central and provincial governments.

- **Institutional Strengthening of the National Audit Office** (US\$0.7m, 2001-2005). The overall objective of the TA is to strengthen the state audit function in the Lao PDR by building the capacity of the National Audit Office staff. The TA specifically aims to assist the Government in upgrading NAO's capacity to effectively conduct audits on the basis of modern audit methodologies, systems, and procedures.

- **Capacity Building for Gender Mainstreaming in Agriculture** (US\$0.4m, 2005-2006). The TA aims to support the Government to (i) reduce poverty through gender mainstreaming in policies and programs to ensure equal benefits for men and women; and (ii) help build capacity of the National Commission on Advancement of Women.

Australia/AusAID

- **Asia Regional Cooperation for the Prevention of People Trafficking Project –ARCPPT** (A \$8.5 m for Lao PDR, Cambodia, Myanmar, Thailand, 2003-2006). Working with Department of Immigration, Ministry of Public Service to strengthen the criminal justice system capacity for successful prosecution of traffickers. The project is seeking to build up national structures and capacities as well as to improve coordination and cooperation across borders and regionally.

- **ASEAN-Australia Development Cooperation Program – AADCP** (A\$45 m, 2002-2008). **Regional Partnerships Scheme** component supports governance sector in areas of taxation, banking, enforcement of intellectual property rights and program and project design. **Program Stream** component has a governance focus in areas of standards and conformity assessment, customs capacity building, legal infrastructure for E-commerce, foreign direct investment data collection and reporting, private sector competitiveness, trade-related aspects of SPS.

UNDP and other Donors

- **Governance and Public Administration Reform - GPAR Central Phase II.** (Total US\$2.2m: UNDP-US\$0.92m and SDC-US\$1.35 2001-2006). During the first project had aimed at generating a high degree of understanding and commitment to the reform concept at senior political and bureaucratic levels of the government. Phase II focuses on strengthening the government's capacity to implement GPAR by supporting: (1) Strategic Management of the GPAR Program, (2) Capacity Development of the Cabinet of the Prime Minister's Office, (3) Priority Civil Service Reforms, (4) Implementation of the Decentralization Policy, (5) Targeted Central and Local Administrative Improvements, and (6) Priority GPAR Related Training.

- **The GPAR: Luang Prabang Pilot Phase II** (Total US\$3.098m: UNDP-US\$ 0.59 m; SIDA-US\$2.5 m, 2005-2009). The purpose is to assist the Luang Prabang authorities in the design and implementation of a better local governance system, in order to provide cost-effective services to the population. It supports the design and implementation of governance and public administration reforms related to the functioning of provincial departments so as to improve delivery of selected basic services for rural households and urban business.

- **The GPAR: Xieng Khouang Pilot** (Total US\$2.0m: SDC-US\$1.5, UNDP-US\$0.5m and SNV: advisory services and cost sharing agreement; 2005-2008). The project sets out to strengthen the operational capacities of selected government institutions at the provincial and district levels to contribute to poverty reduction and equitable economic growth. As such the project will pilot governance and public administration reforms with emphasis on more effective and participatory services in the agricultural sector and strengthen financial management and accountability. The project will facilitate institutional change to create an enabling environment especially for farmers and local entrepreneurs, notably by enhancing people's greater involvement and ownership.

- **The GPAR Saravane project - Saravane Governance, Public Administration Reform and Decentralised Service Delivery Project.** (Total US\$3 million; UNCDF US\$1.9, UNDP US\$0.5, EU US\$0.6, 2005-2009) GPAR Saravane will provide substantive support in six main areas: (i) inclusive and pro-poor planning and budgeting at local levels; (ii) effective and transparent implementation of local infrastructure and service delivery; (iii) financing and financial management of local public service delivery functions; (iv) organisational strengthening at provincial, district and sub-district levels; (v) human resource management and capacity development; and (vi) informing national policy-making on the basis of project experience in Saravane Province

- **The GPARLSP Khammouane Preparatory assistance project** (Total US\$ 1.13m: UNDP: US\$0.4m, SNV: -US\$0.15m and World Bank: US\$0.58m, 2005-2006). The project aims to provide a sound foundation through governance reform and preparatory studies, for a longer-term provincial programme that can strengthen livelihoods and facilitate rapid economic growth in Khammouane province. The project will focus on building an appropriate vision for growth and livelihood development, taking into account the opportunities from the construction of the Nam Theun 2 dam and route 12, while strengthening governance capacity to address this agenda for action. This will serve as basis for the main project which starts in 2007.

- **The GPAR: UNV project - UNV Support to Decentralized Governance for Poverty Alleviation** (UNV - US\$0.9m, 2003-2006). The project focuses on 3 pilot districts in Luang Prabang: Pak-Ou; Phonexay and Pakseng, and aims to train and support district and village level officials in their delivery of new tasks generated by the reform process. Additional GPAR pilots are being

developed in the provinces of Saravanh (joint project with UNCDF expected to start in late 2004), Xieng Khouang (funded by SDC) and Khammouane.

- ***The Sekong Ethnic People's Development (SEP-Dev) Project, Phase II*** (Total US\$2.33m, 2001-2006; NORAD 0.83m, UNDP 1.5m) – The project supports local ethnic communities in Kaleum and Dakcheung districts to play a part in reducing poverty through infrastructure activities and the introduction of agricultural alternatives to shifting cultivation practices. The project is furthermore supporting capacity development of various government agencies that implement project activities.

- ***Strengthening the National Assembly of Lao People's Democratic Republic*** (US\$1.5m: EU – US\$1.12m and UNDP - US\$0.41m, 2004-2007). UNDP has been a strong partner of the National Assembly for several years, with a series of projects that have helped strengthen the Assembly with regard to the legislative process and oversight function. This project takes a longer-term strategic look at the areas of assistance needed to help the National Assembly implement its constitutional mandate.

- ***Strengthening International Legal Instruments in Lao PDR, Phase II*** (US\$1.26m: Finland – US\$0.65m, EU – US\$0.39m and UNDP – US\$0.08m, 2005-2008). The project aims to strengthen the capacity of the Department of Treaties and Legal Affairs in the Ministry of Foreign Affairs in particular to enhance dissemination, enforcement and reporting mechanisms relating to international obligations of Lao PDR.

- ***Development of Lao PDR Legal Sector Reform Program*** (US\$0.47m: UNDP – US\$0.27m and SIDA - US\$0.20m, 2004-2006). This Preparatory Assistance (PA) project initiates a long-term program of support to the government for legal sector reform. It emphasizes the development of a long-term, strategic vision for legal sector reform, with improved coordination between government and development partners on such reforms.

- ***Enhancing Access to Justice*** (US\$0.22m: UNDP – US\$0.01m and DGTTF - US\$0.13m, 2004–2005). The government intends to make the Lao Bar Association (LBA); presently supervised by the Ministry of Justice, an independent institution. This project aims to assist the government in i) strengthening the Lao Bar Association to function eventually as a professional, independent institution; and (ii) creating an enabling environment for the implementation of a legal aid system in Laos. The LBA phase II project builds on achievements of the previous project. It focuses on three main areas, namely institutional capacity building, education and legal aid. As a result, the project will contribute to the following outcomes i) improved functioning of the LBA as a professional, self-regulatory organisation; ii) improved legal knowledge, skills and professionalism of members of the LBA; iii) improved awareness of the role and function of the LBA; iv) increase in the number of practicing lawyers and the LBA membership; and v) improved access to justice for the poor and vulnerable, particularly women and children.

- ***Information and Communications Technology (ICT) for Development – Digital Standardisation for Lao Information Exchange*** (UNDP: US\$.32m, 2003–2006). The project seeks to strengthen the capacities of the Lao government's Science, Technology, and Environment Agency (STEA) to establish and manage ICT standards for the country. The project consists of two components; 1) cooperation with UNDP's Asia-Pacific Development Information Programme (APDIP) sub-regional e-policy/e-strategy project; and 2) improving the utilization of the Lao language for electronic communication through the development of a standard Lao Character Set.

France

- ***Strengthening the capacities***: of ministries through NOSPA (Foreign Affairs, Justice, Office of Public Prosecutor), (US\$1.5m, 2003-2005). Its main activities include training of trainers, seminars, study tours, scholarships, French language training and support for equipments in order to enhance capacities of MoFA's and MoJ's training centers. The project is implemented through NOSPA.

Japan International Cooperation Agency (JICA)

- ***Legal and Judicial Development*** (US\$ 4million, JICA; Technical Cooperation Project 2003–2006). This project aims at developing human resources and the legal and judicial infrastructure with the Ministry of Justice, People's Supreme Court and Office of Public Prosecutor General. The project will support development of legal database, statute book, law

textbooks and dictionaries in civil and commercial laws, prosecutor's manual, and People's Supreme Court casebook.

- **Capacity Building in Public Investment Program Management** (US\$ 3million, JICA; Technical Cooperation Project 2004-2007). This project aims at improving overall management of domestic PIP (implemented by the Lao budget) in cooperation with the Committee for Planning and Investment (CPI). The main activities of the project are to support (1) planning, appraisal, monitoring, and evaluation of PIP, (2) providing workshops and training (3) training officials through the implementation of the actual project in selected provinces (OJT), (4) making a "PIP project guideline," "PIP program guideline," "PIP project manual," and "PIP program manual" and (5) establishing a coordination network among concerned organizations for PIP management.

New Zealand

- **English Language Training for Officials** (US\$0.284m, Ongoing). ELTO is a long standing project that is providing English language training to mid level officials. The project moved into a new phase at the beginning of 2003.

SIDA

- **Institutional capacity building for National Statistical Centre** – twinning cooperation between National Statistical Centre and Statistics Sweden finance by SIDA since 1992. A new and final phase was concluded in July for the period 2005-2008, amounting to about US\$3.2 million USD. The project objective is: to provide users with statistical information in accordance with the Strategic plan, following the defined quality concepts. The specific outputs are: 1) NSC has a regular statistical production program within its area of responsibility, 2) NSC has an efficient organisational structure and working methods to manage its regular statistical production, 3) NSC has sufficient professional capacity to produce statistics that meet the defined quality, 4) NSC has an efficient organisation in terms of financial management, 5) NSC is the main coordinator of the National Statistical system.

SNV Netherlands Development Organization

- SNV supports the UNDP project "Gender Empowerment for Poverty Reduction", building capacity for stronger policy practice. The project, to be started in 2006, has the medium term goal of building pro-poor and gender sensitive advocacy, planning and resource allocation skills within the Lao Government in support of decision making processes and policy formulations and planning forums. In addition, SNV supports the Gender Resource and Information Development Center (GRID) of LWU in their mandate to promote gender equality in the country.

3.2 REFORMS OF STATE OWNED ENTERPRISES AND FINANCIAL SECTOR

ADB

- **Banking Sector Reform Program** (US\$15m, 2002-2005). The objective of the program loan is to support the government (BOL, MOF) efforts to foster efficient intermediation of depositors' resources and ensure a sound banking sector capable of supporting private sector growth and extending rural outreach. The goals will be achieved through an improved operating environment for banking, the immediate application of commercial principles in SOCB operations, and increased diversity in forms of rural financing.

- **Strengthening Governance in Banks Program** (US\$4m, 2002-2005). The project intends to support the Government's to restructure and reform commercial banking, by engaging two resident international banking advisors (IBAs) for 3 years for each of the two state-owned commercial banks (SOCBs). An information technology (IT) upgrade will support these new governance structures by enabling improved financial reporting to management, shareholders, and the supervisory authority.

- **Strengthening Corporate Governance and Management of SOCBs II** (US\$0.9m, 2002-2006). The TA aims for a strengthened banking sector supported by a conducive legal environment and effective judicial processes. It assists the Government to strengthen shareholder oversight of bank restructuring, including (i) strategy development; (ii) human resource (HR) development; (iii) case by case NPL resolution; and (iv) the legal and judicial

framework to support NPL resolution, including establishing a commercial division of the court and strengthening the framework for commercial transactions.

- **Rural Finance Development – TA Cluster** (\$2.02 million, 2000-2005). The objectives are to (i) strengthen the capacity of BOL to support sustainable rural financial development, (ii) assist APB to build its capacity to expand the outreach on a sustainable basis, and (iii) introduce credit unions on a pilot basis. The TA cluster will include six subprojects each of which has to be sequenced to enhance its positive impact on the subsequent subprojects to better achieve the goal of the cluster. These are (i) building awareness and understanding of rural finance, (ii) diagnostic study of APB, (iii) establishment of pilot credit unions, (iv) building BOL's capacity for training in rural finance, (v) pilot tests of the best practices in rural finance, and (vi) institutional reforms of APB.

European Union (EU)

- **EuroTAL Bank Training Project** (Euro 3.37m: EU Euro3.0m, GOL Euro 0.37m 2003-2005). This project is the second part of the EC' Technical Assistance Programme for Transition to a Market Economy and involves capacity building for the staff of the Central and State-Owned Commercial Banks, supporting the SOCB's in the development and marketing of new banking products and enabling the Central Bank to set up a Management Information System for banking supervision. Ends December 2005.

France

- **Strengthening the Capacity Building and Training of the Ministry of Finance –** Departments of Customs and Accounting (0.6 M € - 2005-2008 and one advisor). The project aims at strengthening the capacities of the Ministry of Finance for improving its reform process (through seminars and study tours) and the on-going training of the civil servants, particularly at the Customs and Accounting Departments (training of trainers and creation of an on-going training center with in the Ministry of Finance).

IMF

- **Poverty Reduction and Growth Facility- PRGF expired. Two-mission surveillance now.**

Japan

- **Fiscal Policy and Financial Statistics Support** (Advisor and Training in Japan, US\$ 0.5m, JICA; 2005-2007). This technical cooperation provides an advisor to Fiscal Policy Department, MOF, and a series of counter-part training in Japan in order to improve financial statistics and fiscal policy of GoL.

- **Supporting the Development of Restructuring Plans for the Selected State-owned Enterprises** (US\$ 0.1m; JBIC; 2005-2006). This TA is intended to support the GoL in developing restructuring plans of the five selected SOEs (DAFI, DAI, LSFC, SLIE and CC13) and contribute to GOL's effort to achieve the policy reform agenda under PRSO 2.

SIDA

- **Strengthening Fiscal Management** (US\$3.20m, 2004-2006). The overall objective is to contribute to poverty alleviation by strengthening Lao PDR's ability to improve revenue collection. The project includes: tax policy and tax administration, human resource development, organization and management and ICT development.

World Bank

- **Poverty Reduction Support Operation - PRSO** (A one-year single tranche operation, about US\$8-10m per year, 2005-2007). The main objectives of this facility are to support NGPES/NSEDP implementation and provide additional contribution to the government budget. The first PRSC of US\$10m (US\$4.5m credit and US\$5.5m grants) to GOL was approved by the Board of the World Bank (on March 31, 2005) and the second PRSC/O is going to the WB Board in June 2006.

- **Financial Management Capacity Building Credit – FMCBC** (US\$8m, 2002-2008). The FMCBC aims to provide a comprehensive and strategic framework for the capacity building activities to improve the financial management in Laos and to provide a credit for specific technical assistance and training activities within such framework.

- **Financial Accountability** (IDF grant \$0.30m). This grant aims at improving Financial Accountability in SOEs and Private Enterprises. The project focuses on capacity building and introduction of international accounting and auditing standards and related training. The project also supports strengthening of LICPA and improvement of legal framework for accounting and auditing practices. Efforts are currently underway to translate international accounting standards into local language.

3.3 TRADE REFORM

ADB

- **Integrating the Poor in Regional Trade through Standard-Setting for Private Sector Development - Phase II** (US\$0.70 million, 2004-2005). The TA will work with Government to implement the national standardization framework with STEA and develop a consistent methodology and procedures on standards development across line ministries in coordination with private sector stakeholders.

Australia/AusAID

- **Support for the Role of Integrated Framework Facilitator.** *Initial 12-18 months.* Australia has been invited by the Lao Government to serve in the role of IF Facilitator to support World Bank-led IF process. Australian support for this role commenced through the participation of an expert consultant in the recent Diagnostic Trade Integration Study (DTIS) main mission to the Lao PDR (March 7-17). Australia will continue to work with the GOL's IF Secretariat and Focal Point, as well as with the IF core agencies, led by the World Bank and UNDP, in progressing the IF agenda in a positive direction over the coming few years.

- **Trade Analysis and Reform Project (A\$5m, 3 years and expected commencement - 2005).** Target countries: Laos, Cambodia, Thailand, Vietnam. Project interventions will focus on building analytical and research skills in order to strengthen capacity for trade policy analysis. The project has three components: 1) to improve understanding of the role of analysis in trade policy development and the capacity to incorporate analysis into the policy development cycle; 2) to strengthen the capacity of researchers in government agencies and the research community to deliver high trade policy relevant analysis; and 3) to deliver a high quality capacity building project in cost-effective and cooperative way.

- **Singapore-Australia Trilateral Cooperation Program (SATCP) (2004 -2007).** The program covers 8 countries in the ASEAN region. The selection of Laos as the first trilateral partner under the program reflects the commitment of both Australia and Singapore to providing quality technical assistance and capacity building for Laos officials, particularly in relation to important trade and WTO related matters and economic integration.

- **Sanitary and Phytosanitary Capacity Building Project - SPS CBP (A\$3.9m, 3 years (2004-06).** The program is for support of 8 ASEAN focal countries: Philippines, Indonesia, Malaysia, Thailand, Vietnam, Cambodia, Laos and Burma. The goal of the project is to enhance the capacity of the ASEAN focal countries to meet international SPS standards and the requirements of importing countries consistent with the WTO SPS Agreement. The three components focus on SPS-Trade linkages, Plant Health and Animal Health.

European Union (EU)

- **AsiaInvest - Export Challenge** (Euro 0.15m, 2004-2005). Under the regional AsiaInvest program for Asian and European business representative organizations, a project has been initiated to support the development of Lao trade promotion agencies and SMEs. The project aims at improving the access of Lao SMEs to European markets through strengthening the capacity of LNCCI and the Lao Trade Promotion Centre in the provision of market information and trade related advisory services to the private sector.

- **Multrap (Multilateral Trade Assistance Project) - Support for Lao PDR's accession to WTO** (US\$1.00 m, 2004-2006). The objective is to help the Lao government prepare for WTO accession, through capacity building. The project will help government officials understand better international trade, the role and requirements of WTO, revise legal and regulatory framework and develop university level courses on international trade for officials, lawyers, traders and students.

- **EC-Lao PDR Project on Standards, Quality and Conformity Assessment** (Euro 0,5 m, 2005-2006). The overall objective of the action is to enhance the capacity of Lao PDR to integrate into regional and international trade system. The project will support the national capacity in the area of setting standards, metrology, accreditation and conformity assessments.

- **EC-ASEAN Intellectual Property Rights Co-operation Programme ALA/96/25** (Euro 0,5 million 2005-2006 National Component Lao PDR) The objective of this programme is the development of a modern intellectual property system in Lao PDR. This includes technical assistance in the drafting of new legislation on Patents, Copyrights, and Industrial Design. Particular attention will be paid on TRIPS compliance, the judiciary and the enforcement.

- **AsiaInvest - Upgrading Lao companies of the wood-processing industry for better prospects on the European Market** (Euro 0,2m 2005-2007). The project aims at enhancing production and marketing skills of Lao companies of the wood-processing industry with regard to better prospects on the European and other foreign markets. Target groups are enterprises of this sector in the regions of Vientiane, Luang Prabang and Pakse and local trainers and consultants to be trained during the project.

International Trade Center--ITC (Funded by Switzerland (seco))

- **Support to Trade Promotion and Export Development in the Lao PDR** (US\$0.974m, 2004-2006). The main objective of this project is to build up the trade promotion and export development capacities of Government, trade support institutions and exporting enterprises in the Lao PDR, in close technical cooperation with Cambodia and Vietnam, so that in turn they could induce the expansion and diversification of exports. Areas of activities include: (1) Development of export strategies at the national and sectoral levels, (2) Establishment of an operational trade support network at the national level between Government, trade support institutions, product associations and exporting enterprises, led by strengthened trade promotion organizations, (3) Improvement of knowledge, strengthening of skills and development of capacities of training institutions to provide training in trade promotion and export development to exporting enterprises, (4) establishment of a trade information capacity at the national level servicing the specific needs of trade support institutions and exporting enterprises.

UNCTAD (funded by France)

- **TrainForTrade: Training and Capacity Building in the field of International Trade, FSP 2002-95** (US\$2.3m for Lao PDR and Cambodia, 2003-2007). The main project activities include: (1) training of trainers (ToT), (2) use of distance learning, and (3) cooperation between universities of LDCs. Operational changes will be undertaken in the economic sectors identified by decision-makers and authorities of the countries involved. The project is implemented by UNCTAD together with Ministry of Commerce.

UNDP and AusAID

- **Support for Lao PDR's Integration into the International Trading System** (US\$0.64m: AusAID – US\$0.59m and UNDP – US\$0.25m. 1999-2006). The main objectives of this project are to provide technical assistance to GOL in the areas of WTO accession, improvement of economic and trade policy formulation and integration. The project has two components: (1) support for Laos accession to the WTO, including preparation of Memorandum of Accession, establishment of a minister-level "National Steering Committee and its secretariat, identification of trade focal points in line ministries, and capacity building; (2) integration impact studies in the areas of laws and regulations, which should be changed to conform with WTO agreements, customs valuations, rules of origin, technical barriers to trade, quarantine, sanitary and phyto-sanitary measures and land transport policies.

UNDP

- **Enabling more effective Integration of Lao PDR into the ASEAN** (UNDP – US\$0.36m, 2004–2006). UNDP supports the ASEAN Department in the Ministry of Foreign Affairs in its role as Lao National ASEAN Secretariat including successfully carrying out its duties as Chair of the ASEAN for 2004-05. This includes hosting a successful ASEAN Summit facilitating the active involvement of GoL institutions in the Summit and other meetings in 2004-5. In addition, this Preparatory Assistance project is to support further integration of Lao PDR into ASEAN.

- **Strengthening capacity for National Human Development Reporting [NHDR]:** (UNDP-US\$778,050; June 2004-December 2007). The third NHDR is currently in production and explores "international trade and human development", analyzing the impacts of international trade on employment, production, poverty, income, consumption, the environment, gender and culture. A specific focus will be undertaken on the structure and composition of international trade and the impact of imports and exports on Lao human development and people's well being.

World Bank

- **Diagnostic Trade and Integration Study (DTIS)** to be completed in the context of the Integrated Framework (IF) exercise led by Australia. The main diagnostic trade and integration study (DTIS) mission took place during February-March and a follow up mission and workshops in July and November 2005. The DTIS consultation and action matrix formulation workshops were held jointly with GOL/MOC in Vientiane, Luang Prabang and Champasack in March 2006. The DTIS report will be completed by mid-2006, followed by the national validation workshop.

3.4 PRIVATE SECTOR, TOURISM DEVELOPMENT AND LAND REFORM

PRIVATE SECTOR DEVELOPMENT

ADB

- **Investment Climate and Productivity Study** (US\$0.15m, 2003-2006). The project conducts a study on business operating environment in the country based on sample survey of enterprises and identify effective ways to promote private investment and improve productivity. The goal of the TA is to help improve the environment for doing business and increasing productivity in the Lao PDR, thereby fostering private sector development. The TA will contribute to the country's northern region development strategy and implementation agreement on GMS cross-border movement or bilateral arrangements. It will also provide major inputs to ADB's private sector assessment.

- **Advisory Assistance on Small & Medium-Sized Enterprise and Private Sector Development** (TA: US\$0.67m, 2003-2005). The TA helps the Government develop an integrated institutional and capacity-building framework to establish the regulatory foundation for PSD and SME development.

- **Private Sector Development Program (\$0.7m, 2004-2005)**. The TA will formulate a prospective policy-based lending program to improve the business environment for private enterprises, and to achieve economic growth based on private sector development.

Germany (GTZ)

- **Human Resource Development for Market Economy (HRDME) Program** (Phase 1: USD 5.5 m, June 2004 – May 2007). Overall objective of the TA program is that Government and private sector jointly create the appropriate conditions for more dynamic economic development. It comprises three components with the following Lao partner organizations:

1. Market-economic framework conditions (CPI).
2. Integrated vocational education system related to economic and labor market development (MoE)
3. Promotion of SME development (MIH)

Japan

- **Lao-Japan Human Resource Cooperation Center (LJC) Project-Phase II** (US\$4m, JICA; 2005-2010). Cooperated with the National University of Laos (NUOL), this technical cooperation project is aiming at consistent supply of human resource for a market economy. Main courses and activities which LJC provides are (1) business management, (2) Japanese language, (3) information and cultural exchange between Laos and Japan, and (4) basic computer course.

- **Initiative to Promote Investment in Agro-industry Sector** (JBIC; 2005-2006). As a part of JBIC's follow-up activities to the Blue Book (see UNCTAD below), JBIC is planning investors' mission to Lao PDR from agro-industry, which is identified as a promising sector for future FDI. Contact mission from JBIC visited Lao PDR in February in order for fact finding before inviting investors.

MPDF (IFC/WBG)

- **Mekong Private Sector Development Facility** (MPDF). The main objective of the program is to support the development of private, locally owned, small and medium enterprises in Laos (also in Vietnam and Cambodia). MPDF has three main programs: (1) *Company Advisory Assistance* (help local SMEs improve operations, develop new markets, strengthen management, and develop sound business plans), (2) *Business Development Programs* (strengthen the capacity of local institutions providing essential business services to SMEs in the areas of financing, consulting, training, and information services), (3) *Business Enabling Environment* (conduct research and prepares analyses on specific issues facing local SMEs and on the environment in which they operate, working closely with relevant government authorities and institutions).

SNV - Netherlands Development Organization

- **Private Sector Development Program** In this program SNV aims at improving market access in order to create economic opportunities for the rural poor. The program consists of three service market combinations: 1) access to financial services, 2) value chain development (e.g. eco tourism, non timber forestry products and handicrafts) and 3) enabling environment for business development, including public – private dialogue and partnership and support to business membership organizations. Main clients are the SME Promotion and Development Office, Departments of Industry and Handicrafts, Chambers of Commerce and Industries, selected Business Associations, Lao Association of Travel Agents, the Lao Women Union and Credit Unions. Advisory services are concentrated in Luang Prabang, Khammouane, Savannakhet and Champasack provinces.

- **Non Timber Forest Products:** Advisory services in the field of non timber forest products (NTFPs) focus on developing best field practices for sustainable NTFP production and use, NTFP market development (including Marketing Information Systems), human resource development and supporting and institutionalizing networking and information exchange.

Switzerland (SDC)

- **The Promotion of Organic Farming and Marketing in Lao PDR** (US\$0.70m, 2003-2006). The project aims at promoting organic farming through creating enabling conditions for organic production, transfer of know-how to farmers, and facilitating access to domestic, regional and international markets.

- **Small-scale Agro-enterprise Development in Rural Uplands of Lao PDR** (Xieng Khuang and Luang Prabang) and Vietnam (US\$2.60m, 2003-2006).

Switzerland (seco)

- **Promotion of Cleaner Industrial Production in Lao PDR** (US\$ 0.72m, 2003-2007). The program aims to support the Government of Lao PDR in poverty eradication and environmental sustainability by improving the productivities and competitiveness of its growing industries, as well as its access to international and more local markets, through application of cleaner production techniques and technology.

- **Promoting Competition and Consumer Protection in the Mekong Region (Vietnam, Lao and Cambodia)** (USD 0.40m, 2004-2006). The Project aims at strengthening the competition culture in Vietnam, Laos and Cambodia, with a special focus on Vietnam. This will be achieved by enhancing the analysis capacity of research institutes; developing advocacy skills of the civil society; and improving training facility in the countries.

UNCTAD (funded by Japan (JBIC))

- Strengthening the investment climate: **Blue Book on Best Practices in Investment Promotion and Facilitation** (for Lao PDR and Cambodia, 2004-2006). The "Blue Book" for Lao PDR and Cambodia will contain concrete and measurable activities for the two governments in achieving best-practices in the following three broad areas: 1) Regulatory framework for investment; 2) Investment promotion strategy; 3) institutions.

UNDP –UNIDO

- **Promoting Private Sector Development through Strengthening of Lao Chambers of Commerce and Industry and Business Associations** (US\$2,33m, 2006-09) This project seeks to support the development of the private sector in Laos, in particular SMEs, by 1) optimising the use of research findings and recommendations in the areas of private sector development and business enabling environment; 2) strengthening the capacities of chambers of commerce and industry and business associations so that they can become independent, self-reliant and self-financing organizations providing effective and income generating services to the business community; 3) strengthening the capacities of chambers of commerce and industry and business associations to carry out advocacy on behalf of their members.

UNIDO

- **Lao UNIDO Integrated Program** (LAO IP/II: US\$5.6m, 2004-2008). The Integrated Program for Lao PDR (phase II) consists of the following key components:

- Industrial governance and enabling environment (\$0.9 m)
- Private Sector Development and SME promotion (\$0.9 m)
- Manufacturing productivity and environmental soundness (\$2.5 m)
- Market access, investment and trade facilitation (\$1.25 m)

World Bank

- **Investment Climate Assessment (Joint with ADB)**. The ICA is based on a survey of firms in six provinces and the capital, which was completed in October 2005. The firms were surveyed to identify the main constraints to doing business. The report will build on perception as well as on quantitative data about firms' productivity and costs of doing business. A workshop was held in Vientiane in September 2005 to discuss the preliminary results with the Government (led by DDFI/CPI). The final draft is due to come out in April 2006.

- **Assessment of Provincial Private Sector Environment (supported by EU)** takes stock of the current policy environment in 5 selected provinces for private sector development. The purpose of this assessment is to get a sense about the differences across provinces in the way existing Government policies with respect to starting a business and operating a business (investing, hiring/firing labor, importing/exporting, acquiring land etc) are practiced or implemented differently in different policies. This study is based on a review of existing rules, discussions with provincial government counterparts as well as a selected set of entrepreneurs in the provinces. Stories of around 10 successful Lao entrepreneurs are also documented to see how they have fared in an improving business environment. Also, comparisons of better performing provinces are available in the assessment. It is expected that fuller dissemination of findings in terms of small & large workshops, especially in provinces, are planned in mid-December 2005 onwards.

TOURISM

ADB

- **GMS: Mekong Tourism Development Project** (US\$10.9m, 2002-2007). The Project will promote the development of the tourism sector in the lower Mekong River basin. In Lao PDR, It will improve tourism-related infrastructure in provinces of Champasak, Khammouane, Louangnamtha, and Louangphabang, support pro-poor community-based tourism projects in the rural areas of the country, facilitating private sector participation in tourism marketing and promotion, establish mechanisms to increase subregional cooperation, and facilitate the movement of tourists across borders

Australia/AusAID

- **Child Wise: Preventing the Sexual Exploitation of Children in ASEAN Tourism Destinations through Community and Professional Education** (A\$0.6 m, 2005-06). The aim of this project is to establish Child Wise Tourism principles in the work of the National Tourism Administrations (NTAs) so that they work regionally in the prevention of child sex tourism. Participating countries include Thailand, Vietnam, Cambodia, the Philippines, Indonesia, Lao PDR, and Burma.

Japan (JBIC)

- **Luang Prabang Tourism Sector Development Project** (US\$0.6m, 2006). This study aims at sustainable tourism development in Luang Prabang, a major tourist destination in Lao PDR. It is expected that the study will reveal bottlenecks for sustainable tourism development, including conservation of heritage area, and prescribe how to address them.

NZAID

- **National Tourism Authority of Lao PDR – UNESCO Nam Ha Ecotourism Project**, Phase II (US\$0.338m, 2004-2007). Phase II of the Nam Ha project intends to assist Luang Namtha's provincial tourism and protected area managers become more effective stewards of their emerging ecotourism industry. It will also scale-up the core group of national professionals trained by the Nam Ha Project both in numbers and quality.

- **Village Assisted Mine Clearance in the Lao PDR** (US\$0.48m, Phase 1-2, 2004-2005). This project follows a pilot in Xieng Khouang province that established the merit of active village participation in UXO clearance in Lao. The project is scaling out the use of village-assisted clearance (VAC) in clearing both heritage sites and agricultural land and plans to demonstrate the merit of UXO clearance as an integral part of development planning and implementation. An operational partnership between MAG, UNESCO, CARE and the National Tourism Authority provides the means by which new agricultural, eco-tourism, and socio-economic development initiatives will be pursued.

SNV Netherlands Development Organization

- In the field of pro-poor sustainable tourism, a team of 11 advisors is delivering advice on policy, strategy, management and product development issues to a range of clients. At the national level, these include for instance the National Tourism Administration (NTA), the National University of Laos (NUoL), and the Lao Association of Travel Agents (LATA). At the provincial level provincial tourism offices are assisted and many other relevant governmental departments, also at district level. The ultimate aim is to promote tourism that benefits livelihoods improvements to the poor.

LAND

World Bank and AusAID

- **The Second Land Titling Project** (US\$23.92m: WB-US\$14.82m, AusAID-US\$6.84m and GOL-US\$2.27m, 2003-2008). The second phase of LTP aims at developing the land administration capacity to support the country's economic development and poverty reduction goals. The objectives of the project are to (i) improve the security of land tenure; (ii) develop transparent and efficient land administration institutions at the national and provincial levels; and (iii) improve the government's capacity to provide social and economic services through broader revenue base from property related fees and taxes.

Germany (GTZ)

- **Land Policy Development Project (LPDP)** (US\$1.75m, 2005-2008). The Lao-German LPDP aims at strengthening the policy and legal framework of land management and land tenure in Lao PDR. The overall objective is to increase land tenure security for individuals, groups and public administration. This project represents the German contribution to the Lao Land Titling Phase II (see above). Under the present first phase of the project a total of 15 land policy related studies will be conducted and the step-wise drafting of a national land policy document will be supported. HRD activities and pilot titling in rural areas are other components of the project.

3.5 SEMINARS AND STUDIES BY DONORS IN REFORM AREAS

3.5.1 List of key training workshops conducted and planned for 2005 and early 2006

Topic of training/seminars	Organized by	Date	Venue
<i>Governance</i>			
Workshop on "Regulatory Best Practice for Electrical and Electronic Sector" (Strengthening ASEAN Standard conformity and Assessment Systems)	AADCP Program/ AusAID	Mar 2005	VTE
Workshop on "Civil Law"	JICA and MOJ	Mar 2005	VTE/NOSPA
Training on "Credit Analysis"	JICA	Mar 2005	VTE
Training on "Management of state property" for MOF	French Embassy	Mar-Apr 2005	VTE
<i>Economic and sector Focus</i>			
Training workshop on "Macroeconomic Model"	JICA	Jan 2005	VTE
PIP (Public Investment Program) Seminar	JICA and CPI	Feb 3, 2005	VTE
Final Workshop on Macroeconomic Policy Support for Socioeconomic Development in Laos Phase 2 (MAPS 2)	JICA and CPI	Mar 2005	VTE
NGPES Prioritization and Costing Workshops II	GOL/UNDP/WB	Mar 2005	VTE
NGPES Prioritization and Costing Workshops III	GOL/UNDP/WB	Jan 2006	VTE
<i>Trade and Private Sector Development</i>			
Trade/DTIS: Action Matrix Formulation workshops	MOC/WB	Mar 2006	VTE, LPB, CPS
Training on "How to develop garment exports in a quota free world and prepare for after Jan 2005".	GOL/ITC	Jan 2005	VTE
International Trade Law: Market Access for Agricultural and Industrial Products and WTO Negotiations	GOL (MOFA) & AusAID/Singapore	Feb-Mar 2005	VTE
Export Competitiveness Workshops for Tourism, Manufacturing and Agricultural Sectors.	GOL/IF Mission/WB	Mar 2005	VTE
Training on Market Analysis " Trade Map and Product Map"	GOL/ITC	Mar 2005	VTE
Workshop on " support to trade promotion and export development in Lao PDR"	GOL/ITC	Apr 4, 2005	VTE
Seminar on "Export Market Research"	GOL/ITC	May 2005	VTE & CPS
Seminar on "Export Marketing"	GOL/ITC	Jun 2005	VTE & CPS
Seminar on" Export Marketing plan"	ITC/MOC	Sep. 2005	VTE

3.5.2 List of recently completed, ongoing/planned studies and surveys by donors on above reform areas

Topic/area of study	Conducted by	Start date	Completion date
Governance			
Human Development Report	UNDP	2004	2005
Country Governance Assessment	ADB	2004	2005
Economic and Sector Focus			
The Lao Economic Monitor (issued twice a year: Spring and Autumn)	WB	2003	Ongoing
Lao Poverty Assessment	NSC, ADB, SIDA and WB.	2005	May 2006
Public expenditure review (PER)—2005/2006 (A joint report by WB, GOL, IMF, ADB, EU, and SIDA)	WB with GOL and other donors	2005	Jun 2006
Public expenditure tracking survey (PETS)	WB	2005	Aug 2006
Study on Aid, Economic Growth, Inequality and Poverty Reduction	NERI/UNDP	2005	2006
Rural and Agriculture Sector Issues Paper	WB	2005	2006
Khammouanne Provincial Development Study	WB/UNDP/SNV	2006	2007
Supporting Local Development: An Assessment of Community-Based Mechanisms in Lao PDR (Social Protection paper)	WB	2006	Jun 2007
Public expenditure policy in primary education and health	EC Consultant	Jan 2005	Mar 2005
PEMSP: CB assessment and program design	EC Consultant	Feb 2005	May 2005
Study on the Tax and Administration Burden on Small and Medium Enterprises in Laos	EC	April 2006	May 2006
CEM: Realising the Development Potential of Lao PDR	WB	2003	Dec 2004
Trade and Private Sector Development			
Investment Climate Assessment (ICA)	ADB/WB/CPI	2004	Apr 2006
Diagnostic trade and integration study (DTIS)	GOL/IF agencies	Mar 2005	Mid-2006
Company registration and licensing in Lao PDR	MPDF/ERIT(MOC)	Jan 2006	May 2006
Microfinance training needs assessments	MPDF	Apr 2006	May 2006
Bamboo sector supply chain study	MPDF	Jan 2006	May 2006
TA support for developing the restructuring plans for the Selected State-owned Enterprises (SOEs)	JBIC	Oct 2005	Mar 2006
Initiative to Promote Investment in Agro-industry Sector	JBIC	Feb 2006	Sep 2006
Luang Prabang Tourism Sector Development study	JBIC	Mar 2006	Sep 2006
Mining sector study--Sector Plan for Sustainable Development of the Mining Sector in Lao PDR	GOL/Japan/WB	Beg-2006	End-2006
Reviews of the provincial policy and regulatory environment for PSD	EC Consultant	Jan 2005	Mar 2005
Enterprise survey	GTZ	Feb 2005	Apr 2005
National Export Strategy	ITC/MOC	Dec 2004	Jun 2005
Study on Trade Support Networks	ITC/MOC	Dec 2004	Jun 2005
Study on Trade Information Services	ITC/MOC	Dec 2004	Jun 2005
Study on HD for Trade	ITC/MOC	Dec 2004	Jun 2005
World Market survey	ITC/MOC	2005	Oct 2005
Assessment of Provincial Private Sector Environment	WB	2004	Dec 2005
National Human Development Report- Trade and Human Development in Lao PDR	UNDP	2004	2005
Private Sector Assessment	ADB	2004	2005

ANNEX BOXES ON ACTIONS TAKEN IN PREVIOUS YEARS

Box 1. GOL Actions to Implement the NGPES

Measures taken in 2003

- The National Poverty Eradication Plan (NPEP) is approved by the National Assembly in October. The Plan is based on the 5th National Socio-Economic Development Plan (NSEDP - 2001-05) and the Interim Poverty Reduction Strategy Paper (I-PRSP)

Measures taken in 2004

- The NPEP is reviewed and upgrade to National Strategy. The final document takes the name of National Growth and Poverty Eradication Strategy, approved by the National Assembly early in the year.
- The First Millennium Development Goals Report (MDG report) is submitted to the UN Secretary General in September 2004. The MDG report sets the goals to be met by the Government by 2015, ideally, through the implementation of the NGPES.
- The first NGPES workshop of October 2004 discussed the process of costing and prioritization, including methodology and type of data needed for costing.

Measures taken in 2005

- In March, the NGPES Working Group and the Ministry of Finance met to disseminate the preliminary findings of the costing exercise.
- In July 2005, CPI organized the NGPES Second Workshop 'From Costing to Prioritization and Sequencing', in which the preliminary results of the costing exercise are presented. Three of the key priority sectors undertook a revision of their priority program costing and CPI launched the NGPES Participatory Planning project in selected NGPES priority districts.
- With close involvement from MOF and CPI, four Ministries responsible in four priorities sectors (Agriculture, Transport, Health and Education) estimated their financial needs for NGPES using the bottom-up approach. The results of **NGPES costing exercise** have been discussed among agencies and are expected to be integrated into the medium-term fiscal framework of NSDEP (FY 2006-2010)

Box 2. GOL Actions to Improve Public Expenditure Management

Measures taken in 2002

- Decree No. 57/PM on the Management of Public Investment, issued on May 22, 2002. The decree requires that PIP submissions for new public projects in excess of 1 billion kip in the FY02/03 budget include estimates of associated recurrent costs during the operating period.
- FY 2000/01 outcome and FY 2001/02 budget published in April 2002 with classification by ministry, province, and services. The publication of the budget in the Official Gazette enhances budget transparency. However, the budget classification remains incomplete. The current budget nomenclature allows an economic classification and some functional accounts on an ad-hoc basis.
- The Government adopting the Accounting Implementing Regulations in July 2002 to implement Decree 20/PM on General Regulation of Public Accounting, to enhance financial accountability and transparency as well as internal financial control over revenues and expenditures to be maintained in each ministry, province, district and agency, and also provide financial statements of the Government for NA in each FY.

Measures taken in 2003

- Publication of the FY 2001/02 budget outturn and FY 2002/03 budget-plan in April 2003 in the Official Gazette, with classification by ministry, province, and sectors, a summary of which is provided in Table 3.
- The Procurement Monitoring Office (PMO) was established & became operational within the Ministry of Finance, to oversee the implementation of better procurement processes and to assist in related capacity building activities.
- New Procurement decree 03/PM issued in December 2003 and the Implementing Regulations approved by Prime Minister in June 2004 - they improved clarity of language and specified conditions for actions. They addressed the deficiencies identified in the Country Procurement Assessment.
- A methodology for estimating the recurrent costs has been developed for core construction projects in the PIP and was applied to actual PIP projects in the training of staff from CPC and MOF around middle of 2003.

Measures taken in 2004

- The new legislative and regulatory framework for procurement were announced (a Decree no. 03/PM dated January 9, 2004) and was followed by the issuance of Implementing Rules and Regulations on March 2004 to support the new Dec03 Procurement Decree.
- The new charter of PrMO was approved. It enhanced the authority of the Procurement Management Office (PrMO) to oversee procurement issues across government agencies.

Measures Taken in 2005

- In February 2005, the government adopted a comprehensive, five-year **Public Expenditure Management Strengthening Program or PEMSP** (FY 2005-FY 2009). This program aims to strengthen public expenditure management system and the capacity of the Ministry of Finance and Provincial Finance Departments.
- **The Government Financial Information System (GFIS)** was formally put into operation on March 2005 after several years of piloting. The system will improve the budget execution and accounting (MOF Ministerial Decision 0607 dated March 10, 2005). With the new system, data on accounts payable and treasury balances are now maintained at central level and 14 provinces. However, the accuracy of data entry and coding remains an issue; and both communication links and business processes need to be strengthened to ensure better reporting between provinces and the center using GFIS.
- The decree to set up the **Rural Electrification Fund (REF)** was promulgated on August 2005. The REF will enhance access to rural electrification.
- In order to raise the **Road Maintenance Fund (RMF)** revenue to more sustainable levels, the government approved increasing fuel levy for the RMF to 150 kips/litre on November 2005.
- **The Water supply Laws** was drafted and disseminated to donors and stakeholders at a workshop on October 2005.

Box 3. GOL Actions on SOE Reform

Measures taken in 2001

- The Business Promotion Office (BPO) - was established in the Office of Prime Minister to centralize the restructuring of SOEs, and a Minister was named to head the office;
- Governance of the largest loss-making state-owned enterprise, Bolisat Phatthana Khet Phoudoi (BPKP) was transferred from the Ministry of Defense to the Ministry of Finance, with BPO charged with the restructuring of BPKP;
- Management audits were undertaken in Lao Aviation and BPKP, leading to change in top management of Lao Aviation;
- Financial Recovery Plan (FRP) for EdL agreed with donors and its implementation was initiated;
- A new telecommunication law, passed in April 2001, laid the framework for telecom regulations, opening the sector to private participation, beginning November 2001.

Measures taken in 2002

- Decree No. 54/PM, May 2002, on Management of State-Invested Enterprises, and its Implementing regulations, Dec 2002, clarified the role and responsibilities of the Directors and managers of SOEs and their financial reporting requirements and provided guidance on capital investment in SOEs, procurement/transfer/replacement of assets, and the treatment of dividends, and; outlined sanctions for SOEs violating the regulations.
- Memoranda of Understanding (MOU) dated May 15, 2002 on the restructuring of BPKP, Lao Aviation, Nam Papa Lao, and Pharmaceutical Factory No. 3, setting out the broad parameters of the proposed restructuring, to be used as the basis for preparing detailed multi-year restructuring plans.
- Top management of BPKP and Pharmaceutical Factory No. 3 also changed to facilitate their restructuring.
- Letter of the Minister of Finance No. 618/MOF dated April 10, 2002 on new electricity tariff policy;
- White paper on water tariff policy; a draft 'Water Supply Authority (WASA) Charter' on Regulation of Water Supply Operations" is also under review. This is expected to give WASA the authority to function as the water supply sector regulator.

Measures taken in 2003

- Tariff increases for Lao Airlines, electricity, telecommunications, and water.

Measures taken in 2004

- Further increases in tariffs for water, electricity, telecommunications (especially fixed line) and aviation.
- Explicit Tariff Policies were adopted – PM Notices approving Ministry proposals – for telecommunications, water and aviation, though on the latter few details given the impending joint-venture of Lao Airlines.
- The Prime Minister's Notice No. 059/CPMO dated 15 January 2004 adopted the key elements of the detailed restructuring plans for four SOEs, including key principles of such restructuring. The subsequent four Implementing Guidelines/Instructions issued to all relevant agencies on April 29, 2004 by the Minister in the Prime Minister's office in charge of SOE restructuring set-out *detailed actions*, the institutional arrangements and agencies responsible for their implementation, transparent monitoring and evaluation procedures which include external audits and a specific timetable for 2004 and 2005.
- The State Asset Management Board (SAMB) in early 2004, completed its data-base development & the classification of all SOEs by performance. A system for collecting data & maintaining data-base for annual monitoring of SOE performance was established, based on the Implementing Regulations to the Decree on Management of State-Invested Enterprises, Decree No. 54/PM dated May 9, 2002.
- Memorandum of Understanding (MOU) for Restructuring adopted for five additional SOEs, namely, DAFI, Lao State Fuel Enterprise, Lao Export-Import Trading Company, Bridge-Road Construction Company No.

13 and Agro-industrial Development Company (DAI).

Measures taken in 2005

- The government procured external auditors to do international standard audits for 2004 financial accounts of four SOEs, i.e., Lao Airlines (LA), Nam Papa Lao (NPNL), Pharmaceutical Factory 3 (PH3), and Bolisat Pattana Khet Poudoi (BPKP). The audit planning memorandum was submitted on December 15, 2005.
- The decree on Regulation of Urban Water Supply Operations was promulgated on July 2005. The decree will provide WASA stronger legal authority to undertake regulatory activities and cover all urban water supply operators. The Regulatory Accounting Guidelines prepared by WASA which provide the principles of regulatory accounting shall be submitted for approval in 2006.
- The Action Plan for Financial Sustainability of Power Sector (or Financial Action Plan) was signed by the Ministry of Industry and Handicraft (MIH), MOF and Electricité du Laos (EDL) on November 2005. The plan includes (i) gradual increases in tariffs to full cost-recovery levels by 2011, (ii) settlement of accumulated arrears of government and rescheduling of EDL's debt to Government, (iii) avoidance of future arrears by the government and (iv) improve operational efficiency to reduce EDL losses.
- The MIH issued a Tariff adjustment notice effective in August 2005 allowing tariffs to rise annually about 1% (in real terms) throughout 2005-2010. Later in November 2005, MIH endorsed the "Action Plan for Sustainability of Power Sector" by empowering EDL to adjust tariff rates according to domestic inflation (20% weight) and exchange rate fluctuation (80% weight). EDL is currently in the process of calculating tariff adjustment indexation with inflation and exchange rate and expect to be completed within February 2006.
- The first 2 private operators' water supply concessions were awarded in Feuang District Town and the Heua Neau Village, Vang Vieng District.
- The Laos Airlines increased airfares and was able to generate a gross profit of US\$ 1.3 million in the first half of 2005 after terminate the Airbus contract on March 2005.
- In July 2005, MOF submitted the names of 14 SOEs to the Prime Minister's Office to approve their restructuring given the problems they are facing.

Box 4. GOL Actions in the Banking Sector

Measures taken in 2001

- Notice No. 90/BFSD dated March 19, 2001, requiring a commercial bank to make general provision from 0.5% to 1% of performing loans; Notice No. 209/BFSD dated June 15, 2001, reiterating that a commercial bank shall comply with Regulation No. 03/BOL, which set ceiling for lending at 60% of collateral value and for lending to a single borrower at 10% of the bank's capital, and a commercial bank shall comply with Regulation No. 98/BOL on loan classification, suspension of accrued interest income on a loan which becomes overdue for longer than 90 days, and restriction on new lending to a defaulted borrower;
- Instruction No. 176/BOL dated June 30, 2001, reiterating general reserve requirement and compliance with Regulation No. 98/BOL on loan classification; Notice No. 158/AMD dated July 3, 2001, which restricts SCBs to do policy lending and to focus on loan recovery;
- Instruction No. 195/BOL dated July 6, 2001 and letters to BCEL, LMB, LXB No. 263/BFSD dated August 6, 2001, which distinguish required provision on stock and flow (in accordance with Regulation No. 98/BOL)i, reiterate SCBs to stop accruing interest income on NPLs, require SCBs to submit to BFSD a report on directed lending.

Measures taken in 2002

- Instruction 01/BOL dated Jan. 10, 2002 on notional capital, credit to large customers, and level of NPLs;
- Instruction No. 03/BOL dated March 14, 2002, which restricts SCBs to grow their risk portfolio if flow NPL ratio exceeds 15% and reduce the branch approval limits. This regulation is aimed to stop further deterioration of SCBs' assets;
- Notice No. 15/CIMD dated April 24, 2002, which gives clarification of Instruction No. 03/BOL;
- Notice No. 566/MOF dated March 31, 2002 on autonomy of SCBs. The objective of this notice is to ensure that SCBs have full autonomy in operating their banks on a commercial basis;
- The Rural and Micro Finance Committee (RMFC) was established on Feb.15, 2002 under Bank of Lao PDR (BOL) to make assessment of the rural and micro-finance industry, formulate a policy statement, and develop an action plan for the implementation of a rural and micro-finance reform program;
- The External NPL Collection Committee (ECC) was established under BOL with the mandate to support debt restructuring on a voluntary basis by SCBs and debtors; Signed Memoranda of Understanding for Restructuring (MOUR) for each SCB dated March 31, 2002, stating the basic principles under which the restructuring will be conducted;

Measures taken in 2003

- Governance Agreement between Bank of the Lao PDR, Ministry of Finance, each SCB, its Board of Directors, and the management was signed in March 20, 2003. The Agreement is aimed to restructure and strengthen SCBs.

- New management team for each SCB was appointed in January 2003 and started working since end February 2003.
- Four international bank advisors (IBA) were recruited by BOL to assist in restructuring and strengthening SCBs. The first two IBAs have started working with SCBs since April 2003.
- Two SCBs, Lao May Bank and Lane Xang Bank, completed their merger into the “Lao Development Bank” (LDB) in April 2003.
- Letter No. 17 and 18/BFSD, dated February 26, 2003, Letter No. 053/BFSD, dated July 30, 2003, Letter No. 092/BFSD, dated October 23, 2003 and Letter No. 120 and 121/BFSD, dated December 5, 2003 instructing BCEL and LDB to limit their net new lending since their NPLs exceed 15%. Letter No.17 and 18/BFSD also requesting both SCBs to follow Instruction 01 and 03 closely since they exceeded the concentration limit without prior approval by BOL. These letters enforce SCBs to comply with the prudential regulation and restricted banking regime to avoid further deterioration in their portfolio.
- Notice No. 1760/PMO dated December 17, 2003 informing the MOF that the Prime Minister’s Office endorsed in principle the rural and microfinance policy and action plan in December 2003. This will serve as the building blocks for developing rural financial services for the poor.
- The MOF has issued “triangle” bonds to SCBs, which are designed to resolve NPLs of private contractors caused by government arrears. Series of bond of total about 210 billion kip were issued in 2003. Interest rates on these bonds seem below market rate.

Measures taken in 2004

- Regulation No. 6/BOL replacing Regulation No. 98/BOL on loan classification, issued in May 2004, to ensure that banks consistently review and classify loans, properly account for overdue interest, adequately set aside provisioning expenses, and properly classify restructured loans. Full implementation is targeted for 2005.
- Regulation No. 5/BOL issued in September 2003 replacing Regulation No. 178/BOL on foreign currency exposure. Although issued, the regulation has not been enforced. The objective of the regulation is to assure that banks maintain their foreign currency position within the prudential limits to avoid excessive risk.
- BFSD disseminated the approved policy statement and action plan in three provinces: Borikhamxay, Champasack, and Bokeo in October, November, and December.

Measures taken in 2005

- The draft amendment to the Decree Law on Commercial Banks has been submitted to the Standing Committees of the National Assembly in February. The objective of the amendment is to ensure level of playing field and lower the barriers to entry and expansion of non-state owned banks.
- The BOL has established Financial Intelligence Unit (FIU) and issued on August 30 a regulation on Customer Due Diligence (CDD). The regulation requires commercial banks to set up a compliance office to monitor suspicious transactions.
- The BOL submitted the draft Prime Minister’s Decree on Anti Money Laundering (AML) to the Prime Minister’s office.
- The amendment to the Secured Transaction Law was approved by the National Assembly in May 05 and has become effective since it was signed by the President in August 05. The type of secured transaction over movable assets has been expanded from the current three, to an unrestricted position. This should give banks more opportunities to use securities (i.e. trading stock, shares, debts and intellectual property) as collateral in stead of land and fixed assets. In addition, the amendment law no longer requires approval from the chiefs of the villages to certify the registration of securities as collateral but can register collateral with the MOF. It will facilitate project financing of large scale developments, private sectors and financial institution’s investment. In the event of a default, the revised provisions in respect of the realization of the security will not require the intervention of a court in the process if agreed in the credit contract and related government officials must facilitate the title transfer.
- The BOL issued on June 22, 2005 the microfinance regulation No.10/BOL to implement the Rural and Microfinance Policy and Action Plan. The regulation provides an enabling environment to support the development of the microfinance industry and encourage an establishment of microfinance institutions in diverse forms and types of ownership. A microfinance institution (MFI) can be established with a registration status but cannot take deposits. A MFI can take deposits from general public if it is granted licenses by the BOL.
- In September 2005, the MOF approved the first tranche of recapitalization for BCEL (129 Bil.Kip) and LDB (71 Bil. Kip). This is the first part of the four tranche that MOF committed to recapitalize (The total committed amount is 634 Billion Kip) between 2005-2008.
- The draft of the 6th NSEDP which was presented to the government in January 2006 proposes to relax regulatory framework of the Lao Banking sector in order to promote a level of playing field competition.
- The BOL set up a working group to prepare a new Financial Institution Law and amendment of Presidential Decree No.01/OP and plan to submit the draft law to the National Assembly in September 2006.

Box 5. GOL Actions towards Trade Promotion

Measures taken in 2003

- Coverage of import and export restrictions is significant¹. Notice 204 specifies that a license from the Minister of Commerce/provincial offices of MOC is needed to import the following: Petrol and gas; Cars and parts for assembling vehicles of any type other than tractors²; Cement; Steel; Jewelry; any of 17 foodstuffs that include all meats, eggs and poultry, animal feeds, sugar, canned foods, food coloring or seasoning, soft and alcoholic drinks (including beer) and animal medicines; seeds; Videos, movies, gambling machines, satellite TV receivers and telecommunications equipment; Sporting guns.
- in January 2003, of the 1291 items on Lao's Temporary Exclusion List (TEL) under AFTA, 436 items were transferred to Inclusion List (IL) of AFTA thereby putting 71 percent of all items and 45 percent of all dutiable imports by value in the Inclusion List³.
- On September 18, 2003 the Lao and US governments signed the first US-Lao Bilateral Trade Agreement (BTA) in Vientiane, which will go into effect after the US Congress enacts legislation authorizing normal trade relations (NTR) between the two countries.
- PM Decision No.14/PM of February 28, 2003 allowed the establishment of duty-free warehouses in Vientiane and Savannakhet (at Seno special economic zone) to facilitate the import processes.
- Supplementary Guiding Order No.530 of May 10, 2004, on business registration, has established sunset provision of two days for registration of local businesses in trade sector at one of the following three levels: central (MOC), provincial and district.
- Annex to the Supplementary Guiding Order No.530 (May 10, 2003) on business registration No. 538/MOC dated May 13, 2003 provides a division of business registration approval between different levels of government agencies: (1) MOC registers foreign companies (with registered capital from and over 200 thousands US\$), enterprises dealing with imports of vehicles and fuel and exports of wood and wood products, state enterprises and joint ventures established at central level: (2) provincial trade authorities provide registration to foreign investors (with registered capital below 200 thousands US\$), enterprises in agricultural, industrial and services sectors, trading firms, state enterprises and joint ventures established by local governments; (3) district offices can register and manage retail stores, shops and other small services.
- Decree No. 125/PM of July 24, 2003 on organisation and operations of Lao National Chamber of Commerce and Industry (LNCCI) (replacing the decree No.175/PM of 20 August 1998 on areas of responsibilities of LNCCI) redefines the role, functional responsibilities, organisational structure and financial matters of LNCCI. Under this, LNCCI is an independent organisation that represents the business communities and acts as a bridge linking public and private sectors and brings together continuing dialogue between the government agencies & business communities. On behalf of its members, LNCCI negotiates with GOL and foreign partners on trade, industrial and services issues and establishes its representative offices abroad. It issues the certificate of origin to exporters and approves the establishment of business groups in the country. LNCCI gets supports from its members (member fees), its own services (issuance of certificate, training and advisory services, trade exhibitions, etc.), the government as well as from individuals.

Measures taken in 2004

- Ministerial Guideline No.04/MOC of January 5, 2004 on *promoting commodity production*. It has defined the following goals for the next few years: (1) meet domestic demands and substitute imports (especially food, raw materials, construction materials and other consumer goods that have potential), (2) increase exports, especially to ASEAN and other neighbour countries (of agricultural and forestry products, and wood), (3) maintain market dynamics, by favouring demands and supplies to support economic growth. This guideline also provides some significant implementation measures: (1) create awareness among Lao people at all levels of the importance of the transition from a self-sufficient economy to market-oriented one, (2) improve existing regulations and procedures to encourage the production of commodities and facilitate domestic trade and exports, (3) increase roles and participation of business communities from all economic sectors in the commodity production process, (4) attract more FDI for commodity production and leverage the Lao economic potential, especially in the area of natural resources and human capital.
- In January 2004, 422 items were moved from TEL to IL bringing coverage of IL to 84% of import tariff lines.
- PM Decree No.15 of February 04, 2004 on trade competition, effective on August 1, 2004, has provided key principles to regulate monopolistic practices, and to promote fair competition and a level playing field for all players. The decree identified government agencies responsible for monitoring of competition, and defined roles & responsibilities to ensure free market & guarantee participation of various sectors.

Measures taken in 2005

- The new Customs Laws had been approved. These laws aim to implement the transaction value principle when assessing ad valorem custom duties and facilitate customs modernization as well as addressing WTO-related issues.

¹ Each year through Notices to implement the general Decree No.205 of the Prime Minister issued on 11 October 2001 on this issue. Notice 203 of February 2003 defines the lists of prohibited imports and exports and these appear to be relatively uncontroversial bans related to public safety and morals plus those related to logging & raw timber exports.

² Licensing of vehicles is now used only mainly as a registration device as importers can import as many as they want

³ Under AFTA, Lao PDR is committed to move all the items from its Temporary Exclusion List (TEL) to the Inclusion list (IL) by the beginning of 2005 and to reduce the CEPT rates on all IL items to between zero and 5 percent by the beginning of 2008.

- To facilitate AFTA commitments, a draft resolution including a schedule of tariff reductions and the plan to move the Temporary Exclusion lists to the Inclusion lists have been proposed to the National Assembly.

Box 6. GOL Actions to Improve Private Investment Climate

Measures taken in 2001

- GOL took steps towards improving transparency and simplifying the investment registration processes. A number of websites (inter alia: www.invest.laopdr.org, www.moc.gov.la) have been set up to provide basic information about the country's legal framework, business and investment related laws, sector and industry information and other services.
- Decree No.46/PM March, 2001 on the Implementation of the Law on the Promotion and Management of Foreign Investment provides basic guidelines for improving registration and speeding up approval processes for foreign investment. Based on this decree, total approval time for different types of projects has been reduced from 90-180 days to 45-60 days.
- On land, PM Decree 237/PM 2001 provides more clarity in the institutional setup and main functions and activities of the Department of National Land Use Planning and Development (DONLUPAD), which is responsible for the coordination of land-related policy⁴ and inter-agency consultations on appropriate institutional arrangements.

Measures taken in 2002

- Further to Decree No.46/PM, Decision of the Chairman of CIC, dated 27 February 2002, has decentralized approval of foreign investment projects, extension of foreign activities and establishment of branches of foreign companies in Lao PDR. It defines four size-classes of foreign investment based on value: (1) equal or less than US\$1m, (2) from above US\$1m to US\$5m, (3) from above US\$5m to US\$10m, (4) Above US\$10m. Approval of FDI equal or less than US\$1m can be done at the provincial level by all provinces. However, in large provinces, such as Vientiane Municipality, Savannakhet, Champasack and Luangprabang, the ceiling for provincial approval is US\$2m and less).

Measures taken in 2003

- PM Decree dated 23 April 2003, on roles and responsibilities of CIC at central and local levels. The decree provides local governments with new autonomy over investment and defines organisational structure, roles and responsibilities of CIC and other relevant line-ministries and agencies at central and local levels. It serves as a strategic guidance for CIC at all levels for decision-making process including approvals, promotion, management and monitoring of domestic and foreign investment. The effective implementation of the decree would contribute to the improvement of the investment environment in the country.
- Amendment of Lao constitution, especially with regard to chapter 2 on Social and Economic System. The new text states that GOL promotes every economic sector, including domestic and foreign investment, a modern industry, enterprises and services in order to accelerate economic growth of the country. The constitution further confirms the Government intention to guarantee interest in property and lawful capital of all investors.
- Publication of Quarterly Newsletter by DDFI. The government issued in July 2003 the first Quarterly Newsletter, to disseminate FDI information to investors and to promote foreign investment. The Newsletter provides recent updates on investment regulations (mainly on decentralized management and approval process at the central and provincial levels), tips for applications, investment incentives for various priority sectors and investment zones, and data on the cost of doing business in the country (business costs – land, office space, factory building, warehouse; and production costs – labor, utilities, i.e. electricity, water, fuel/gas, and telephone).
- PM established National Land Policy Committee (NLPC) on March 25, 2003, representing a number of line ministries/agencies involved in land administration and management, and providing an effective oversight mechanism to resolve policy issues as they arise and to facilitate the development of a comprehensive land policy framework. DONLUPAD is assigned as the secretariat of NLPC.

Measures taken in 2004

- PM Decree No. 42/PO of April 20, 2004 on Promotion and Development of Small and Medium Sized Enterprises, defines key policies and an action plan for SME promotion and development, including the establishment of SME Development Funds and supporting organizations (the SME Promotion and Development Committee and its permanent Office and Executive Committee). It also defines regulations, methods and measures needed to promote SMEs, the expansion of commodity production, and trade and

⁴ The Land Law 01/97/NA (April 12, 1997) repeals a number of previous laws (1979, 1989, 1992) and serves as the new basis for land administration and management in Lao PDR, defining institutional responsibilities for land administration and registration (especially for eight categories of land in Lao PDR: agricultural, forest, construction, industrial, communication, cultural, water-area land and land for national defence and peace-keeping), and (2) sets out the basic rights and obligations of the land user.

PM Decree 22/PM of 1999 is on implementation of the 1997 Land Law.

Presidential Decree on Land Tax (03/PDR of August 12, 2000) provides new guidelines for land tax collection and management, with detailed tax rates for each type of land and its location.

service activities. The policy gives priority to creating an enabling regulatory environment, enhancing competitiveness, expanding markets (domestic and international), improving access to financing and developing both entrepreneurship and an entrepreneurial culture in the country.

- The Domestic and Foreign Investment law was revised and the implementing decree for the Investment Laws will be drafted.

Measures Taken in 2005

- The revised Secured Transaction Law was approved on May 2005 and became effective on August 2005. The amendments expand and clarify eligible loan collateral.
- The business-government dialog with private sector has a good progress. CPI and MPDF signed a Memorandum of Understanding on collaboration on the Lao Business Forum. A responsible inter-ministerial committee was established by a Decision of CPI in mid-2005. The forum is conducted in two main stages. First, MPDF conducts working group meetings with the representatives of the private sector, to identify the main constraints and issues to be raised with the Government. This is followed by dialog between the private sector and the Government. CPI and MPDF are working together to prepare the topics for discussion, the forum agenda and a list of invitees, for the first Business Forum scheduled to take place on November 24.



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