
Country Report

Laos

June 2009

The Economist Intelligence Unit
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The Economist Intelligence Unit

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Laos

June 2009

Summary

- Outlook for 2009-10** There is little prospect of the ruling Lao People's Revolutionary Party (LPRP) will face a serious threat to its authority in 2009-10. As the risk of high inflation has receded, the main challenge for the LPRP is to address popular unrest stemming from the economic slowdown and a rise in job losses. No major change in the LPRP's ideology or policies is likely in the forecast period. The government will continue to pursue economic reforms, and will remain keen to attract foreign investment. Although efforts to join the World Trade Organisation may provide impetus for reform, overall progress will be slow. Economic growth will slow to an average of 4% a year in 2009-10, down from 7.5% a year in 2007-08, but there are downside risks to this forecast. Consumer price inflation will fall to 2.6% in 2009, from an estimated 8.6% in 2008. The current account will remain in deficit, owing to the deficit on the merchandise trade account and to the repatriation of profits and dividends by foreign mining firms.
- The political scene** The prime minister, Bouasone Bouphavanh, has passed a decree that will permit the formation of local non-governmental organisations from November in a further relaxation of restrictions on civil society. However, the government has announced plans for a communications surveillance centre to monitor telephone calls and e-mail messages. Eventually, the government aims to establish monitoring stations in three different locations in the country at an estimated cost of US\$20m-30m.
- Economic policy** In May Bouasone called for foreign economic assistance amid the global downturn. A value-added tax (VAT), introduced on January 1st 2009, was officially withdrawn in March following pressure from the private sector. In April the cabinet approved plans to merge existing laws on the promotion of domestic and foreign investment. A single process for all investors should assist in the country's efforts to attract foreign investment.
- The domestic economy** The government has lowered its forecast for real GDP growth in fiscal year 2008/09 (October-September) to 6-7%. Laos experienced deflation in April, with prices down by 0.2% year on year. Thailand is expected to resume work on two hydropower plants in Laos, the 525-mw Nam Theun I and the 1,300-mw Nam Ou plants, where construction was suspended earlier this year.
- Foreign trade and payments** Thai imports from Laos have continued to contract on a year-on-year basis, falling by 26.2% to US\$139.9m in the first four months of 2009.
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Basic data

Land area	236,800 sq km
Population	5.76m (2006, IMF data)
Main towns	Population of the province in which a main town is situated (2005 population census):
	Vientiane (capital) 698,318
	Vientiane (province) 388,895
	Savannakhet 825,902
	Champasak 607,370
	Luang Prabang 407,039
Climate	Tropical; rainy season, May-October; dry season, November-April
Weather in Vientiane (2006, 531 ft above sea level)	Hottest month, March, 33.4°C; coldest month, January, 17.5°C; wettest month, July, 440 mm rainfall; driest months, November, December and January, 0 mm rainfall
Language	Lao and others
Measures	Metric system; local measures include:
	1 va = 5 sok = 10 khup = 2 metres
	1 rai = 4 ngane = 1,600 sq metres
	1 kang = 10 hoi = 1.2 kg
Currency	Kip (K). Average exchange rate in 2007: K9,594:US\$1. Exchange rate on April 11th 2008: K8,722:US\$1
Time	Seven hours ahead of GMT
Fiscal year	October 1st-September 30th
Public holidays	January 1st (New Year); January 6th (Pathet Lao Day); January 20th (Army Day); January 26th (Chinese New Year); March 8th (International Women's Day); March 22nd (Day of the People's Party); April 13th-15th (Pi Mai Lao, or Lao New Year); May 1st (Labour Day); May 9th (Buddha Day); June 1st (Children's Day); July 7th (Khao Pansa); August 13th (Lao Issara); October 4th (Bouk Ok Pansa); October 12th (Day of Liberation); December 2nd (National Day)

Political structure

Official name	Lao People's Democratic Republic	
Form of state	One-party rule	
The executive	The Council of Ministers is the highest executive body; the vice-chairmen of the council (deputy prime ministers) oversee the work of ministers; all members of the council are appointed by the chairman of the Council of Ministers (the prime minister)	
Head of state	The president, Choummaly Sayasone	
National legislature	A unicameral National Assembly, which was expanded to 115 seats following the 2006 election	
National elections	The last National Assembly election took place in April 2006; the next is due in 2011	
National government	The Lao People's Revolutionary Party (LPRP) dominates the government and bureaucracy	
Main political organisations	Lao Front for National Reconstruction (LFNR), an umbrella organisation, the main component of which is the LPRP	
Main members of Council of Ministers	Prime minister	Bouasone Bouphavanh
	Deputy prime ministers	Somsavat Lengsavad Thongloun Sisoulith Asang Laoly Douangchay Phichith
Key ministers	Agriculture & forestry	Sitaheng Rasaphone
	Defence	Douangchay Phichith
	Education	Somkot Mangnormek
	Energy & mining	Soulivong Daravong
	Finance	Somdy Douangdy
	Foreign affairs	Thongloun Sisoulith
	Industry & commerce	Nam Viyaketh
	Information & culture	Mounkeo Oraboun
	Justice	Chaleuan Yiapaohou
	Labour & social welfare	Onechanh Thammavong
	National post & telecommunications	Khamlouat Sidlakone
	Planning & investment	Sinlavong Khoutphaythoune
	Public health	Ponmek Dalalay
	Public works & transport	Sommat Pholsena
	Security	Thongbanh Sengaphone
	Water resources & environment	Khampheng Pholsena
Central bank governor	Phouphet Khamphoungvong	

Economic structure

Annual indicators

	2004 ^a	2005 ^a	2006 ^a	2007 ^a	2008 ^b
GDP at market prices (K bn)	26,590	30,594	35,407	39,284	45,623
GDP (US\$ bn)	2.5	2.9	3.5	4.1	5.2
Real GDP growth (%)	6.9	7.3	8.3	7.5	7.5
Consumer price inflation (av; %)	10.5	7.2	6.8	4.5	8.6
Population (m)	5.8	5.9	6.0	6.1	6.2 ^a
Exports of goods fob (US\$ m)	341	475	810	922	1,161
Imports of goods cif (US\$ m)	614	854	1,045	1,067	1,387
Current-account balance (US\$ m)	-189	-193	50	107	-52
Foreign-exchange reserves excl gold (US\$ m)	223	234	328	533	796
Exchange rate (av) K:US\$	10,585	10,655	10,160	9,603	8,743

^a Actual. ^b Economist Intelligence Unit estimates.

Origins of gross domestic product 2006	% of total
Agriculture & forestry	42.8
Industry (incl construction)	32.0
Services	25.3

Principal exports 2006 ^a	% of total	Principal imports 2006 ^a	% of total
Copper & gold	52.8	Capital goods	52.6
Timber	15.9	Other	25.8
Garments	13.3	Petroleum	14.5
Electricity	10.8	Materials for garment manufacturing	7.1

Main destinations of exports 2008	% of total	Main origins of imports 2008	% of total
Thailand	49.0	Thailand	68.6
Vietnam	18.6	China	11.3
China	12.1	Vietnam	4.7
South Korea	6.3	South Korea	2.5
UK	3.3	Japan	2.5

^a IMF estimates

Quarterly indicators

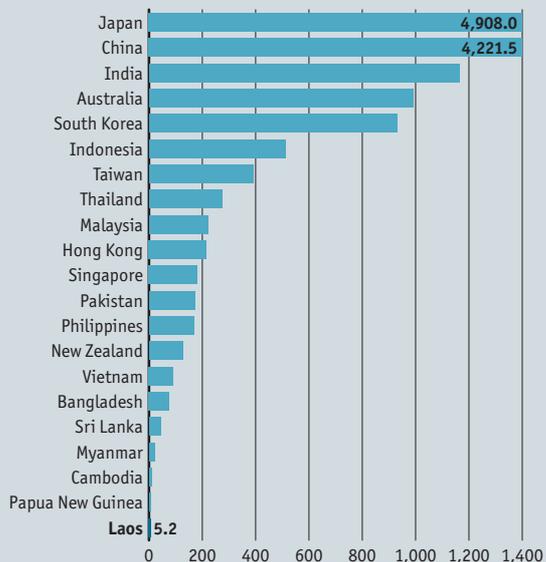
	2006		2007				2008	
	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr
Prices								
Consumer prices (2000=100)	177.6	176.3	177.3	180.0	184.3	186.5	189.3	197.6
Consumer prices (% change, year on year)	6.7	4.3	5.0	3.4	3.8	5.8	6.8	9.8
Financial indicators								
Exchange rate K:US\$ (av)	10,116	9,888	9,689	9,617	9,589	9,518	9,062	8,731
Exchange rate K:US\$ (end-period)	10,073	9,745	9,643	9,601	9,623	9,346	8,746	8,711
Bank rate (end-period; %)	20.00	20.00	14.67	12.00	12.00	12.00	8.00	8.00
Deposit rate (av; %)	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
Lending rate (av; %)	30.00	30.00	30.00	30.00	30.00	24.00	24.00	24.00
Treasury bill rate (av; %)	17.89	19.56	19.31	18.42	18.90	18.72	18.72	n/a
M1 (end-period; K bn)	1,501.5	1,998.3	2,244.2	2,258.3	2,542.2	3,064.7	3,214.3	n/a
M1 (% change, year on year)	26.3	28.2	34.7	35.2	69.3	53.4	43.2	n/a
M2 (end-period; K bn)	6,100.7	7,046.1	7,960.0	8,143.6	8,866.9	9,774.2	11,180.2	n/a
M2 (% change, year on year)	17.3	26.7	37.2	37.9	45.3	38.7	37.3	n/a
Sectoral trends								
Rice production (annual totals; '000 tonnes) ^a	(2,664)		(2,870)				n/a	n/a
Foreign trade (US\$ m)								
Exports fob	204.9	247.1	257.0	184.2	242.4	237.9	258.2	251.7
Imports cif	-259.4	-287.9	-263.3	-264.9	-278.1	-260.6	-261.1	-359.9
Trade balance	-54.5	-40.8	-6.3	-80.7	-35.7	-22.7	-2.9	-108.2
Foreign reserves (US\$ m)								
Reserves excl gold (end-period)	287.9	328.4	389.4	456.8	485.0	532.6	685.1	n/a

^a The figure for 2007 is an estimate.

Sources: UN Food and Agriculture Organisation; IMF, *International Financial Statistics*.

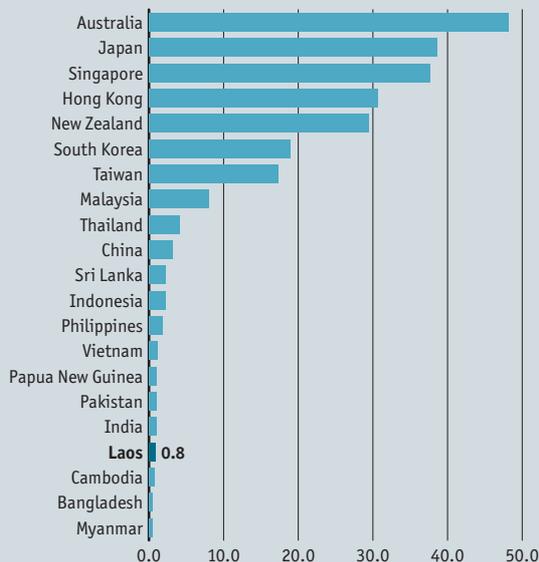
Comparative economic indicators, 2008

Gross domestic product
(US\$ bn; market exchange rates)



Sources: Economist Intelligence Unit estimates; national sources.

Gross domestic product per head
(US\$ '000; market exchange rates)



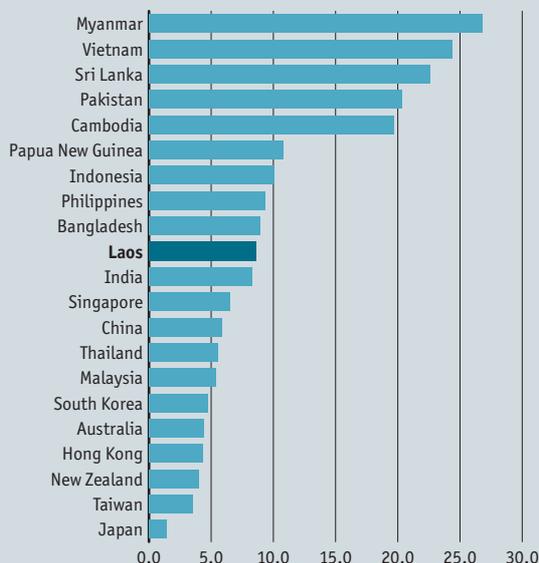
Sources: Economist Intelligence Unit estimates; national sources.

Gross domestic product
(% change, year on year)



Sources: Economist Intelligence Unit estimates; national sources.

Consumer prices
(% change, year on year)



Sources: Economist Intelligence Unit estimates; national sources.

Outlook for 2009-10

Political outlook

Domestic politics There is little prospect that the ruling Lao People's Revolutionary Party (LPRP) will face a serious challenge to its authority in 2009-10. Accelerating inflation (especially in prices of staple food items and fuel) failed to provoke serious protest in 2008. Despite reports of rice shortages in remote areas, the fact that the majority of the Lao people are self-sufficient rice farmers ensured that the government did not face problems on the scale seen in other rice-reliant countries in Asia. Now that the risk of high inflation has receded, the main challenge facing the LPRP is addressing popular unrest stemming from the economic slowdown and a rise in job losses. The LPRP has maintained its firm grip on power and has exerted tight control over Lao society even as the economy has continued its rapid development and the country has opened up to foreign technology and ideas. Services and facilities will continue to be modernised, and the population (particularly in urban areas) is increasingly starting to enjoy many of the choices offered by globalisation. On balance, the Economist Intelligence Unit believes that this growing prosperity, combined with the relatively low level of education and a strong state security apparatus, means that political dissent is unlikely to be voiced publicly in the short term. However, the potential for social instability stemming from job losses should not be underestimated.

Moves towards a multiparty political system are unlikely for the time being, but the prime minister, Bouasone Bouphavanh, has been frank on several issues. The public seems to welcome his reforms, although they pose a challenge to entrenched elites within sections of the government and the military. Bouasone has halted grants of land concessions to foreign investors (although there are reports that new concessions have been approved despite the moratorium). The government has also cracked down on illegal mining and logging operations in response to the concerns expressed by rural communities. However, as with other reforms designed to curb cronyism and leakage in revenue collection, Bouasone is unlikely to find enough allies to confront the powerful entrenched interests involved in these activities. Following the approval by the National Assembly (the legislature) in July 2008 of a law permitting private ownership of media outlets, the government has passed a law permitting the formation of civil society organisations. These two laws should provide the legal framework for Lao citizens to organise in groups independent of party control. However, the existence of an extensive security apparatus and the lack of independent courts will deter overt criticism of the status quo.

Despite continued ethnic tensions, the authorities have maintained stability and there have been no recent reports of attacks by insurgents on government or civilian targets. Nevertheless, the administration will continue to struggle to project an image of stability in Laos to foreign governments until the Hmong issue is resolved, amid persistent allegations of harsh treatment of this ethnic minority. The Southeast Asian Games in December in the capital, Vientiane, will give the government scope to raise Laos's profile in the region.

International relations Laos will push ahead with its policy of regional and international integration in 2009-10, while maintaining close ties with the ruling communist parties in neighbouring China and Vietnam. Its policy on international affairs is firmly based on non-interference and peaceful co-operation, as demonstrated in its dealings with Myanmar in the aftermath of the devastation caused there by Cyclone Nargis. The Lao leadership places great emphasis on regional prosperity, and will support efforts by China and other countries to improve trade arrangements with the Association of South-East Asian Nations (ASEAN), of which Laos is a member. Co-operation between Vietnam and Laos will improve, and Laos will benefit from aid (including training for its military and civil service) in return for giving Vietnam access to natural resources.

The government will remain careful not to become entangled in contentious international issues that could threaten its attempts to attract investment and aid. Relations with Thailand will continue to be tested as Lao Hmong refugees are repatriated from a camp there—a process that could cause both Laos and Thailand further diplomatic embarrassment. Lao-US relations will remain prickly, given US pressure over the Lao government's human rights record.

Economic policy outlook

Policy trends The main priority for the government is to reduce the impact of the global downturn on the domestic economy. Although Laos is less integrated into the global economy than any country in South-east Asia except Myanmar, it has benefited from increasing trade and investment flows in recent years. In May Bouasone said that the government had revised down its growth forecast for fiscal year 2008/09 (October-September) by 1-2 percentage points to 6-7%. Laos will certainly suffer as a result of economic contractions in neighbouring countries, such as Thailand, where real GDP is expected to shrink by 4.5% in 2009. Slower economic growth in China and Vietnam will also have an adverse impact on the Lao economy during the forecast period, as will lower world agricultural and mineral prices, which will depress rural incomes and export earnings. So far, the government has responded to the downturn in a piecemeal manner, promising to press on with pro-market reforms in an attempt to attract foreign investment. In truth, the government does not possess the fiscal resources for a large stimulus package and it will depend on the largesse of foreign donors to finance any measures to prop up domestic demand. However, foreign investment has continued to flow into Laos. Chinese and Vietnamese state-owned companies have channelled funds into the mining sector. Meanwhile, Thai investors are expected to resume work on hydropower projects that were postponed earlier this year.

The government is expected to make progress on reforming Laos's foreign trade regime in the next few years, with the primary objective of achieving membership of the World Trade Organisation (WTO) by the end of 2009. A Lao delegation to the WTO's headquarters in Geneva, Switzerland, in July 2008 stated the case for the country's accession to the organisation. The minister of industry and commerce, Nam Viyaketh, told the WTO accession working party

that his country had made progress on improving laws related to trading standards, intellectual property, customs and enterprises, to bring regulations into line with WTO requirements. However, Nam recently refused to put a date on Laos's accession to the WTO.

Fiscal policy The government will push ahead with efforts to improve its fiscal performance. Owing to the solid performance of the mining and energy sectors in the first half of fiscal year 2007/08, the finance minister, Somdy Douangdy, has said that the government achieved its collection target in that year. However, the 2008/09 collection target of K8.3trn (around US\$980m) will be more difficult to achieve following a sharp fall in world mineral prices. On the London Metal Exchange the price of copper—Laos's most important mineral export—fell from a high of US\$8,700/tonne in April 2008 to less than US\$3,300/tonne in January. Although the price of copper has since rallied to US\$4,400/tonne, the government has conceded that revenue will fall about K740bn (US\$87m) below target. The suspension on March 1st of a value-added tax (VAT)—only two months after its introduction—will also weigh down on tax revenue. The introduction of VAT was needed in order to limit the impact of falling customs revenue as Laos fulfils its tariff-reduction obligations as a participant in the ASEAN Free-Trade Area (AFTA). The government will continue to run budget deficits in the forecast period. On the expenditure side, the government has made progress in strengthening its management of public expenditure. However, it increased public-sector salaries in 2008/09, in a move that could damage its recently earned reputation for prudence. Nevertheless, assuming that the government does not falter in its management of the economy, we forecast that the budget deficit (including grants) will average 3.2% of GDP in the forecast period.

Monetary policy The main challenge facing the Bank of the Lao People's Democratic Republic (the central bank) remains that of reining in money supply growth as part of the overall effort to contain inflation. Monetary expansion has been driven by rising international reserves. However, the rate of reserves accumulation is likely to slow in 2009-10, owing to a fall in inflows of private investment, as well as to the continuation at around the present level of the repatriation of profits and dividends from foreign-invested mines. The rate of growth in narrow money (M1), which stood at 42% year on year in April 2008, will therefore continue to slow in 2009. There will be steady improvements in the competitiveness of the banking system, following gradual reforms (such as the lowering of entry barriers) initiated by the central bank, and, in addition, non-performing loans held by state-owned commercial banks have been falling.

Economic forecast

International assumptions

International assumptions summary

(% unless otherwise indicated)

	2007	2008	2009	2010
Real GDP growth				
World	5.0	3.0	-1.8	2.1
OECD	2.7	0.9	-4.0	0.4
EU27	2.9	0.9	-4.4	-0.5

International assumptions summary

(% unless otherwise indicated)

	2007	2008	2009	2010
Exchange rates				
¥:US\$	117.8	103.4	96.3	94.8
US\$:€	1.369	1.470	1.328	1.385
SDR:US\$	0.651	0.629	0.664	0.648
Financial indicators				
€ 3-month interbank rate	4.27	4.65	1.40	1.43
US\$ 3-month Libor	5.30	2.91	1.05	1.04
Commodity prices				
Oil (Brent; US\$/b)	72.7	97.7	47.5	53.3
Gold (US\$/troy oz)	696.7	870.2	895.8	827.5
Food, feedstuffs & beverages (% change in US\$ terms)	30.9	29.5	-22.4	3.1
Industrial raw materials (% change in US\$ terms)	11.2	-5.1	-40.0	14.3

Note. Regional GDP growth rates weighted using purchasing power parity exchange rates.

Recent data suggest that the worst of the recent global economic freefall may be coming to an end. Nevertheless, the Economist Intelligence Unit maintains its cautious view of global economic prospects in the forecast period, with the global economy at purchasing power parity (PPP) forecast to contract by 1.8% in 2009 and to expand by just 2.1% in 2010. We have made a slight upward revision to our forecast for international oil prices (dated Brent Blend), to US\$47.5/barrel in 2009 and US\$53.5/b in 2010. A return of investor risk appetite and renewed flows of investment into commodities, including oil, have propelled oil prices higher.

Economic growth

As a result of the global recession, Laos's economic growth will slow in the forecast period. In 2009 real GDP growth will fall to 3%, the slowest rate since the early 1990s, before recovering to 5% in 2010. At present, economic growth is being driven by an expansion in industry, the output of which has been rising at double-digit year-on-year rates. The main engines of industrial growth are construction and mining. The construction sector will be supported by the increasing number of infrastructure development projects, particularly road- and bridge-building schemes, and also hydropower projects (for example, construction of the US\$1.2bn Nam Theun II hydroelectric project began in late 2005 and is on schedule to be completed by 2010). Continued expansion will depend on financing from international donors, but Thai investors are expected to resume work on the Nam Theun I and Nam Ou projects which were suspended in the first quarter of 2009 owing to financing concerns linked to the global credit crunch. The fall in world mineral prices will lead to a downturn in investment in the mining sector, which has experienced strong growth in recent years as a result of an expansion of gold and copper mining. Chinese state-owned companies are replacing Australian firms as the main investors in the mining sector.

The manufacturing sector will remain weak. The garment industry faces intense competition from China and Vietnam, while an appreciation in Laos's currency, the kip, has made the country's exports less competitive in overseas markets. Production of building materials, such as cement, limestone and electrical

cables, will be adversely affected by the slowdown in the construction of infrastructure and housing. Agricultural growth will remain weak and faces downside risks from falling prices for agricultural commodities. The outlook for services is mixed and the tourism industry will struggle to grow in the global economic downturn.

Inflation Inflation will slow to 2.6% in 2009, down from an estimated average of 8.6% in 2008, owing to a sharp decline in global prices for food and fuel. In April 2009 Laos experienced deflation for the first time since records began in the mid-1990s, with consumer prices falling by 0.2% year on year. Lower inflows of foreign investment will result in a slower rate of growth in the money supply. Inflation will edge up to 5.5% in 2010.

Exchange rates Although it has depreciated in recent months, falling to around K8,520:US\$1 in early June from K8,450:US\$1 at end-2008, the kip remains strong against the US dollar, having appreciated from K9,346:US\$1 at end-2007. Owing to the importance of Thailand as a trading partner, the Lao authorities have generally been keen to prevent dramatic shifts in the kip's value against the Thai baht. However, the kip has gained ground against the baht recently, in line with that currency's depreciation against the US dollar. The kip will be subject to downward pressure in the next year or so as a consequence of Laos's large budget deficit and the continued deficit on the current account. The authorities will welcome a steady depreciation of the currency as a means of propping up exports.

External sector Exports will contract in 2009-10, owing to slower economic growth in the country's main export markets as well as low global prices for energy and minerals. Although exports of electricity to Thailand will emerge as a major source of revenue in the next two years or so as new hydropower projects come on stream, the outlook for total exports in 2009-10 is poor, as the economy of Thailand, Laos's main export market, is forecast to shrink by 4.5% in 2009 and grow by only 1.9% in 2010. Mineral exports also hold potential, but global prices for copper are expected to decline by 43% in 2009. Gold will fare better, with global prices edging up by 2.9% this year, but that will not be enough to prevent a contraction in exports. Growth in garment exports will be modest, owing to the poor competitiveness of the industry and labour shortages, as well as weakening demand in end markets in the US and Europe.

The merchandise trade deficit widened to an estimated US\$222m in 2008 as imports rose by an estimated 30%, primarily owing to increased purchases from abroad of construction materials and machinery for new mining and hydro-power projects. Lower tariff barriers in line with AFTA commitments, combined with the poor competitiveness of local products, have also led to strong growth in imports of consumer goods. In 2009 imports will contract as a result of a fall in prices, as well as weakening demand for shipments of construction materials and other capital goods. As a result, the merchandise trade deficit will narrow to an estimated US\$204m. The surplus on the services account will continue to rise in line with growth in the tourism industry, but this will only partly balance the merchandise trade deficit. The surplus on the current transfers

account will also continue to be offset by the income deficit, with the latter widening from US\$50m in 2007 to US\$205m in 2010 owing to the remittance of profits from foreign-invested mining projects.

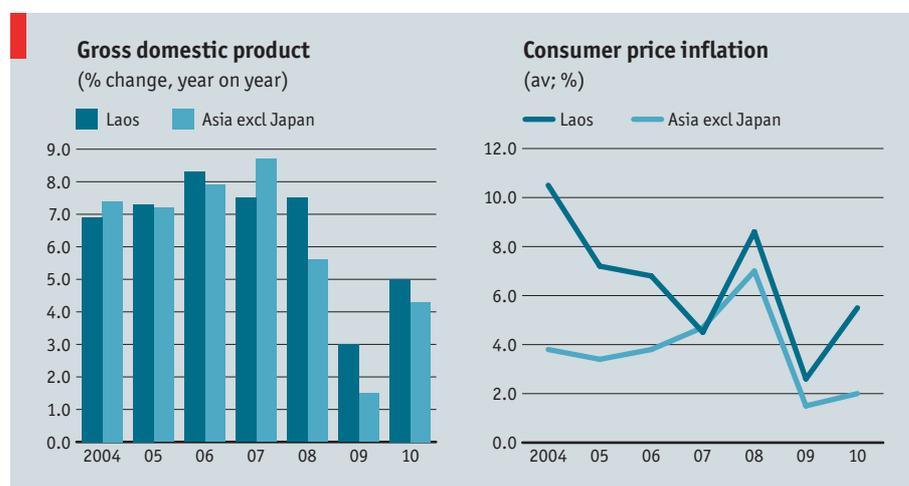
As a result of these trends the current account is estimated to have moved from a surplus equivalent to 2.6% of GDP in 2007 (based on IMF data) to a deficit of 1% of GDP in 2008. The current-account deficit will narrow to 0.4% of GDP in 2009 (owing to the narrowing of the merchandise trade gap), before widening to 1.3% of GDP in 2010. Although private investment inflows are likely to fall, transfers from official donors will continue, and foreign reserves have been built up in recent years. As a result, the country's ability to meet its external financing requirement is not an immediate concern.

Forecast summary

(% unless otherwise indicated)

	2007 ^a	2008 ^b	2009 ^c	2010 ^c
Real GDP growth	7.5	7.5	3.0	5.0
Gross agricultural production growth	3.2 ^b	3.0	3.0	3.2
Consumer price inflation (av)	4.5	8.6	2.6	5.5
Lending interest rate	28.5	29.0	29.0	29.0
Central government balance (% of GDP)	-2.8 ^b	-2.8	-3.3	-3.1
Exports of goods fob (US\$ bn)	0.9	1.2	1.1	1.1
Imports of goods fob (US\$ bn)	-1.1	-1.4	-1.3	-1.4
Current-account balance (US\$ bn)	0.1	-0.1	0.0	-0.1
Current-account balance (% of GDP)	2.6	-1.0	-0.4	-1.3
Exchange rate K:US\$ (av)	9,603	8,743	8,557	8,853
Exchange rate K:¥100 (av)	8,154	8,458	8,890	9,344
Exchange rate K:€ (year-end)	13,648	11,786	11,729	12,669
Exchange rate K:SDR (year-end)	14,916	12,750	13,164	14,062

^a Actual. ^b Economist Intelligence Unit estimates. ^c Economist Intelligence Unit forecasts.



The political scene

The government relaxes restrictions on civil society

The ruling Lao People's Revolutionary Party (LPRP) continues to cautiously relax restrictions on civil society as the country develops a middle class with time to devote to social causes. From November local non-governmental organisations (NGOs) will be permitted in Laos, following a new prime ministerial decree. According to the decree, which was approved in late April, a group of two or more people may apply to form an NGO. Applicants must obtain permission from the "government sectors concerned", before submitting an application to the Public Administration and Civil Service Authority if in the capital, Vientiane, or to the provincial authority if based in one of the country's 16 provinces. The government's decision to relax the controls on civil society follows many years of lobbying by international agencies, particularly the UN.

Preparations continue for the Southeast Asian Games

At the same time, the party is making efforts to ensure that it retains control over potentially dangerous opposition. The government has announced plans for a communications surveillance centre, which it hopes will be ready in time to improve security for the Southeast Asian Games, which are to be held in Vientiane in December. Equipment to monitor telecommunications usage, such as telephone calls and emails, and to locate the source of unauthorised transmissions, will be imported this year. Eventually the government aims to establish monitoring stations in three different locations in the country at an estimated cost of US\$20m-30m. The director of the government's telecoms and Internet department, Syyang Chertoi, has conceded that this represents a big investment for Laos. Part of the funding will come from fees that have recently been imposed on telecoms operators.

The LPRP has invested much political capital in the games. Given the party's politically dominant position and the minimal gains to be had from hosting a successful event, Laos's decision to host the tournament may represent something of a risk. The games will focus the region's media on a reclusive government that usually attempts to avoid attention, and any discussion of its political structure and human rights record. If any embarrassing incident was to occur, that attention might become global. Laos has no experience in organising international games and is relying heavily on foreign assistance to do so.

The preparations for the games have been controversial. In 2008 a deputy prime minister, Somsavath Lengsavad, appeared to withdraw his public support for a Chinese "Super City" development on the That Luang marsh in Vientiane amid pressure from low-ranking party members. The concession had been granted to a Chinese company in return for the construction of the major facilities for the games. Building work was briefly halted on the main stadium, but the sporting facilities are now approaching completion. The fate of the That Luang project remains uncertain. Meanwhile, a Vietnamese company has been granted logging and land concessions as payment for building the athletes' village.

Although games-related construction work and advertising contracts have provided a much-needed stimulus to the economy, it remains unclear whether the games will attract an audience in Laos, where there is no tradition of

travelling to watch sporting events. In addition the choice of events has caused resentment among a number of participating nations, who perceive the influence of Laos's neighbours, Thailand and Vietnam, on the games as potentially unfair.

Democracy index: Laos

The Economist Intelligence Unit's 2008 Democracy index ranks Laos 157th out of 167 countries, putting it among countries that are considered to be authoritarian. This designation includes a number of states in the region, such as China, Vietnam, Myanmar and North Korea. The ruling Lao People's Revolutionary Party (LPRP) is the only legal political party. Political power resides with the party's 11-member politburo and 55-member central committee. Elections are held to the National Assembly (the legislature) every five years, but only those whose candidacy has first been approved by a mass organisation of pro-LPRP groups, the Lao Front for National Reconstruction, are eligible to stand. Constitutional amendments passed in 2003 give the legislature the right to dismiss the prime minister and members of the government. However, the legislature remains subservient to the party.

The legislature's powers have increased

The National Assembly's powers have increased since the early 1990s, and its role is now one of overseeing the government. The previous system of rule by party fiat has been replaced by a system of debating and passing legislation through the National Assembly. However, the legislature remains dominated by the LPRP. A total of 175 candidates were selected to stand for the 115 seats available in the expanded legislature in the election in April 2006. Only two non-party candidates were elected. Policy formulation remains a convoluted process, compromised by vested interests and widespread corruption. The judiciary is in no sense independent from the LPRP.

The party will survive the global recession

Amid the global recession, the party may face increased opposition owing to slower economic growth, rising job losses and falling agricultural and mineral prices. However, Laos's economy is not expected to be as severely affected by the downturn as other economies in the region. There is little organised opposition to the LPRP, except among groups of foreign exiles and isolated ethnic minorities, such as the Hmong. Continued inflows of overseas development assistance will also limit any political fallout from the economic downturn.

Democracy index

	Overall score	Overall rank	Electoral process	Government functioning	Political participation	Political culture	Civil liberties	Regime type
Laos	2.10	157	0.00	3.21	1.11	5.00	1.18	Authoritarian

Note. Overall and component scores are on a scale of 0 to 10; overall rank is out of 167 countries.

Note on methodology

There is no consensus on how to measure democracy, and definitions of democracy are contested. Having free and fair competitive elections, and satisfying related aspects of political freedom, is the sine qua non of all definitions. However, our index is based on the view that measures of democracy that reflect the state of *political freedom* and *civil liberties* are not "thick" enough: they do not encompass sufficiently some crucial features that determine the quality and substance of democracy. Thus, our index also includes measures of *political participation*, *political culture* and *functioning of government*, which are, at best, marginalised by other measures.

Our index of democracy covers 167 countries and territories. The index, on a 0 to 10 scale, is based on the ratings for 60 indicators grouped in five categories: *electoral process and pluralism*; *civil liberties*; *functioning of government*; *political participation*; and *political culture*. The five categories are interrelated and form a coherent conceptual whole. Each category has a rating on a 0 to 10 scale, and the overall index of democracy is the simple average of the five category indices.

The category indices are based on the sum of the indicator scores in the category, converted to a 0 to 10 scale. Adjustments to the category scores are made if countries fall short in the following critical areas for democracy:

- whether national elections are free and fair;
- the security of voters;

- the influence of foreign powers on government; and
- the capability of the civil service to implement policies.

The index values are used to place countries within one of four types of regimes:

- full democracies—scores of 8 to 10;
- flawed democracies—score of 6 to 7.9;
- hybrid regimes—scores of 4 to 5.9;
- authoritarian regimes—scores below 4.

The full methodology for the index and related discussion can be found at www.eiu.com/DemocracyIndex2008.

China and Vietnam pour in investment

The government remains politically aligned to its two communist-ruled neighbours, China and Vietnam, and it continues to receive large sums of investment from those countries. Laos expects to be a primary beneficiary of a US\$10bn investment fund and a US\$15bn credit line announced by China as a stimulus to “needy” countries in the Association of South-East Asian Nations (ASEAN). China has also promised an additional US\$39.7m “special aid” package for Cambodia, Laos and Myanmar, the poorest members of the group. Vietnam is consciously targeting economic expansion into both Laos and Cambodia. Its influence in Laos is expected to increase in the next few years as mining and electricity projects receive approval. Vietnam was the biggest investor in Laos in fiscal year 2007/08 (October-September), channelling about US\$1bn into 32 projects. Ties remain close between the communist parties of both countries, and Vietnam recently showed further solidarity by eliminating import tariffs on various Lao agricultural goods, notably rice and tobacco.

Relations with Thailand are overshadowed by refugees

Relations with Thailand, which supplies the majority of Laos’s imports and is also a major investor and cultural influence, remain cordial, despite the political instability that has occurred in Thailand in the past two years or so. Thai investment in hydropower projects is crucial to Lao economic planning, and the government hopes that existing electricity export agreements can be renegotiated to raise the low tariffs that Thailand managed to secure in previous years. The president, Choummaly Sayasone, paid a mainly ceremonial visit in May to the Thai capital, Bangkok, at the invitation of the Thai monarch, King Bhumibol Adulyadej. In that month Laos and Thailand also signed various co-operation agreements, including deals on electricity trade.

However, the relationship remains overshadowed by the 5,000 or so Lao Hmong refugees (or “illegal migrants”, according to Laos) who are still in Thailand. At a meeting in May Thailand promised to return all the Hmong detained at the Huay Nam Khao camp in Petchaboun province in northern Thailand before the end of 2009. After a meeting, the Lao government said that the two sides had agreed that all Hmong in that camp, plus the 158 people held at a detention camp in Thailand’s Nong Khai province, were illegal migrants. This followed an April announcement by the Thai foreign minister, Kasit Piromya, that his government regarded the 158 Hmong in Nong Khai as “asylum seekers” and would facilitate their resettlement in third countries. Since December 2005 more than 2,800 of the refugees have returned to Laos. Around 450 Hmong returned in late March, while another 300 were repatriated at the end of April. Those interviewed by Lao state media spoke of poor conditions in the Huay Nam Khao camp and said that they had been tricked into going to

Thailand by traffickers, who had promised passage to the US for a fee of Bt3,000 (US\$95) per person.

The case of a British woman, Samantha Orobator, who was imprisoned in Laos for alleged heroin smuggling, but became pregnant after her detention began, led has to the first Lao ministerial visit to the UK in many years. In May the foreign ministers of the two countries signed a prisoner transfer agreement that would permit Miss Orobator to be deported to the UK if she were convicted. She was found guilty of trafficking on June 3rd and was sentenced to life imprisonment. She is now awaiting deportation to the UK. The incident has proved to be embarrassing for the Lao authorities, with international media attention focusing on its opaque judicial system and poor prison conditions.

Economic policy

The government calls for economic assistance

The government of Laos continues to look to international donors for support in minimising the effects of the global economic crisis. In May the prime minister, Bouasone Bouphavanh, travelled to Japan where he called for support from the government and private investors. Stressing the importance of sustainable development, Bouasone said that Laos was committed to helping to combat climate change and to expanding the country's forests if it could obtain assistance from other nations. He also said that although Laos had not been as severely affected by the global financial crisis as many other countries, the domestic economy was vulnerable to slower world growth and lower global commodity prices. Mineral exports fell by 13% in the first quarter of 2009. Bouasone also stressed the political stability that has been brought by the communist regime, as well as recent efforts to improve the investment environment.

Despite the prevailing global economic gloom, Laos continues to encourage foreign investment. In April the cabinet approved plans to merge existing laws on the promotion of domestic and foreign investment. At present, proposals for foreign investment are dealt with differently and separately from domestic proposals; a single process for all investors should assist in the country's efforts to attract foreign investment and to gain accession to the World Trade Organisation. In this respect the government is also focusing on improving the regulations that govern tax, trade and foreign exchange. In late May the government approved a draft decree on import procedures in order to streamline and standardise imports in line with international trading obligations. A similar decree on export procedures is under preparation, as is a national export strategy, which will promote priority sectors, such as electricity, mining, tourism, garments and handicrafts. However, despite the decrees, overall progress remains slow. The foreign minister, Thongloun Sisoulith, recently complained that the various government departments responsible for economic integration policies have yet to come up with plans for joining regional and global organisations.

The authorities' approach to dealing with the economic crisis remains piecemeal, with a number of officials still convinced that the country's isolation means that it will not be affected by the downturn. The Ministry of Finance has

recommended that plans for ambitious state projects be reconsidered, urging the postponement or cancellation of several proposed schemes in order to focus available funds on the construction of roads and the repair of irrigation systems that were damaged by flooding in 2008. The construction industry has applauded the large amounts that have been dedicated to basic infrastructure projects, saying that this has enabled many companies to survive the economic slowdown. The finance ministry is also looking to improve the collection of fees that are charged for government services, including licences, certificates and other official documents, transport, immigration and broadcasting rights. The cabinet has approved in principle budget allocation for priority projects and debt payment in fiscal year 2009/10 (October-September). The budget will be submitted to the National Assembly (the legislature) by October.

The government is planning to cut leakage within provincial administrations by setting up a national treasury. A law on the matter will be presented to the next session of the National Assembly in June, but the proposal could face strong opposition from vested interests within the legislature. The ruling Lao People's Revolutionary Party (LPRP) depends on provincial fixers around the country to maintain its image of national unity, and any attempt to reduce the financial independence of rural powerbrokers will not be welcomed. The law will seek to control both revenue and expenditure in every province by requiring all transactions to be conducted through official banking channels.

A value-added tax (VAT), introduced at the beginning of 2009, was officially withdrawn in March owing to the financial crisis and following pressure from the private sector. The government has announced that VAT will be reintroduced in 2010. Although opposition to the new tax is expected from retailers and other groups, notably in the tourism industry, it is unlikely that the government will again postpone VAT implementation and risk upsetting agreements with the donors and international financial institutions that have long pressed for tax reform.

The government hopes to raise more than US\$72m by selling foreign-currency denominated bonds that are guaranteed by royalties from operational hydro-power projects. The funds will be partly used to develop future electricity projects, and the five- or ten-year bonds may prove popular with local investors looking for reliable returns on cash generated in the last few years of market growth. The scheme is backed by the Asian Development Bank (ADB) as part of the Association of South-East Asian Nations' (ASEAN) +3 Asian Bond Markets Initiative and, according to the finance ministry, foreign commercial banks (including HSBC and Standard Chartered of the UK, Siam Commercial Bank of Thailand and the Thai Military Bank) are interested in managing the sale. The move will mark Laos's first venture into the international debt markets. Two different schemes for the bond issue are under consideration, but both will probably feature a US dollar swap and will be guaranteed by the Export-Import Bank of Thailand. If the bonds are well received, more auctions may be expected in the future, based on mining royalties.

Work is also ongoing on the national stock exchange, which is scheduled to open by October 2010. Laos's major state-owned bank, Banque pour le Commerce Extérieur Lao (BCEL), has said that it will list on the exchange and

that it will aim to use the funds generated to expand operations across the country. BCEL reported profits of US\$21m in 2008. The bank also plans to establish a stockbroking arm to service the new bourse. The government will continue to own a majority shareholding in all state enterprises listed on the exchange.

The domestic economy

The government lowers its growth forecasts

The Lao government has lowered its forecast for economic growth in fiscal year 2008/09 (October-September) by 1-2 percentage points to 6-7% owing to falling merchandise exports and lower income from mining and tourism. Although the Asian Development Bank (ADB) is less bullish, forecasting growth of 5.5% in 2009, this is still the bank's highest growth forecast for a South-east Asian country. Meanwhile, a government think-tank, the National Economic Research Institute, has forecast growth of 7%. The government expects agriculture to expand by 3%, industry by 13.4% and services by 7.2%. It has also predicted that the inflation rate will remain in single digits, while government revenue collection will reach 15% of GDP and expenditure 20% of GDP. According to the Ministry of Planning and Investment, in the first half of 2008/09 merchandise exports fell by 5.6% year on year to US\$533m. Merchandise imports also fell, by 8%, to US\$554m, leaving a trade deficit of about US\$39m. The ministry estimated that total foreign direct investment in the country reached US\$2.8bn, with another US\$800m coming from domestic sources.

The ADB has said that it will help the government achieve its 2008/09 revenue targets after the bank projected a 10% shortfall in expected government revenue owing to the global financial crisis. The government expects revenue to fall about K740bn (US\$87m) below its target of K8.3trn (US\$980m) due to lower prices for its main exports, such as agricultural commodities and minerals. Delays in building new hydropower projects have also affected revenue. The ADB will provide about US\$5m in grants to a programme aimed at supporting small and medium-sized enterprises if the government is able to meet certain expenditure conditions. The ADB has pre-existing plans to provide grants worth US\$85m to Laos in 2009. Meanwhile, the EU has said that it will provide additional funding of about US\$14m over three years for the specific purpose of countering the effects of the global recession. The funds will be provided in addition to already arranged grants worth US\$50m. The EU ambassador to Laos, David Lipman, has expressed concern that the economic downturn will increase hunger among poor people.

Unemployment and currency appreciation are concerns

Rising unemployment is a concern for the government, but so far its efforts to address the problem have been weak, focused on organising job fairs, labour market surveys and short-term training courses. Skilled labour remains in short supply in Laos, with educational standards falling below those across most of South-east Asia. Given that nearly one-half the Lao population of 6.5m people are aged under 16, long-term training and employment opportunities are real concerns.

Since May 1st the Ministry of Labour and Social Welfare has been enforcing a new minimum wage that was announced by the government. Including all

allowances, the monthly minimum wage for unskilled workers working 208 hours per month is K569,000 (US\$67). The government's decision to raise the minimum wage followed public pressure from the Lao Federation of Trade Unions, which accused employers of using the financial crisis as an excuse to postpone paying workers their legal wages. The federation also insists that the new minimum wage fails to match the rising cost of living in Laos.

Lao exporters remain concerned by the strength of the kip, which has appreciated by more than 10% against the US dollar and by 15% against the Thai baht in the past year. In response, the Bank of the Lao People's Democratic Republic (the central bank) is targeting a trading band that would restrict the kip to a movement of 5% against a basket of major foreign currencies. The bank says that its international reserves are sufficient to cover five months of imports and that it is confident of maintaining the value of the kip within the prescribed trading band. The bank has also guaranteed that it will not interfere in market mechanisms to determine exchange rates. Currency controls have been relaxed in recent years, and people are now able to use kip to buy foreign currencies with few restrictions. The kip has actually weakened slightly against the dollar since the beginning of 2009, but is stable at around K8,500:US\$1.

The construction industry is enjoying a return to strong profits due to lower prices for building material and fuel products. After renegotiating contracts in the second half of 2008 when costs were high, companies are now enjoying a windfall as prices return to 2007 levels while contracts remain at the higher rates. State infrastructure projects, such as the facilities for the Southeast Asian Games, as well as transport and irrigation projects, are supporting demand for construction services. Private investment in hotels and houses or apartments for rent is also buoyant. According to a member of a Lao construction group, Phimmaha Panyanouvong, road and bridge construction companies are making the most significant profits but the whole sector is thriving, mainly owing to lower fuel prices. In the capital, Vientiane, petrol topped K12,000 (US\$1.4) per litre in June 2008, but by April 2009 it had fallen by more than 40% to below K7,000/litre. In the same period the price of steel dropped from around K11m (US\$1,300) per tonne to about K6m/tonne. Prices for cement have remained at around K750,000/tonne. Average construction prices in the country stand at US\$100-300/sq m.

Laos records deflation, despite rising food prices

Year-on-year deflation occurred in April, despite the seasonal price rises that are expected in the lunar New Year festival in mid-April. According to the national statistics office, the consumer price index rose by 0.8% month on month, but fell by 0.2% year on year. Inflation reached a peak of 10.3% in May last year, but fell to 1.6% in February and 0.7% in March. Local economists attribute the deflation—the first period of falling prices recorded in Laos since the 1975 revolution—to an oversupply of beer. Beer consumption is high in Laos, with the state brewery, the Lao Brewery Company, widely seen as the most successful and best-run company in the country. Alcohol sales peak in the New Year period, traditionally tempting traders to charge higher prices. However, the advent of competition and expansion in the beer market seems to have ended the practice. Perhaps more significantly, fuel prices were 11% lower than they were in the year-earlier period.

Food prices rose over the holiday, showing a year-on-year increase of 3.4%. Hot weather and water shortages at the end of the dry season (which traditionally runs from November to April) led to vegetable prices rising by as much as one-third in March. Normal seasonal trends were exacerbated by problems with the irrigation network, a legacy of damage caused by the 2008 floods. Many farmers have shifted production to crops which require less water, such as sweetcorn and potatoes. A member of the National Economic Research Institute, Leeber Leebuapao, has welcomed the increase in vegetable prices as a stimulus for agricultural production, but has also warned that purchasing power has begun to drop across the country.

Several state banks have lowered interest rates, which generally range from 9% to 16%, depending on the repayment terms and customer credit rating. The 1-percentage-point reduction is an attempt to stimulate investment and reduce bank losses on savings accounts. Meanwhile, expansion of the deregulated banking sector continues. A new Lao-French bank is set to open by the end of the year, the result of a joint-venture between BCEL and the BRED Banque Populaire Group, also known as COFIBRED. The bank intends to open branches in Vientiane, Luang Prabang, Savannakhet and Pak Se, and is looking to attract investment from Europe and Asia.

The north experiences a shortage of rice

A plague of rats and mice in the north of the country has led to serious food shortages in many villages, with the UN World Food Programme estimating that 85,000-140,000 people are food insecure as a result. The rodents have attacked rice, maize and other cash crops, with farmers reporting losses of 50-100% of their potential harvest. The plague is thought to be associated with the flowering of local bamboo species, an event that occurs only once every 30-40 years.

The Ministry of Industry and Commerce has proposed state stockpiling of rice in a bid to buy up excess crops and stabilise prices. The ministry has called on the central bank to provide K50bn to fund the project and to set the price of rice bought from the farmers. Proposals for a consortium of private traders to buy 400,000 tonnes of unsold rice from farmers in southern provinces last year have yet to be implemented, perhaps because farmers are holding out for prices that are significantly higher than the market rate. Low prices caused by falling demand persuaded many farmers to not bother with dry-season cropping this year. In addition, the lack of a certification system for Lao rice makes exporting difficult for traders.

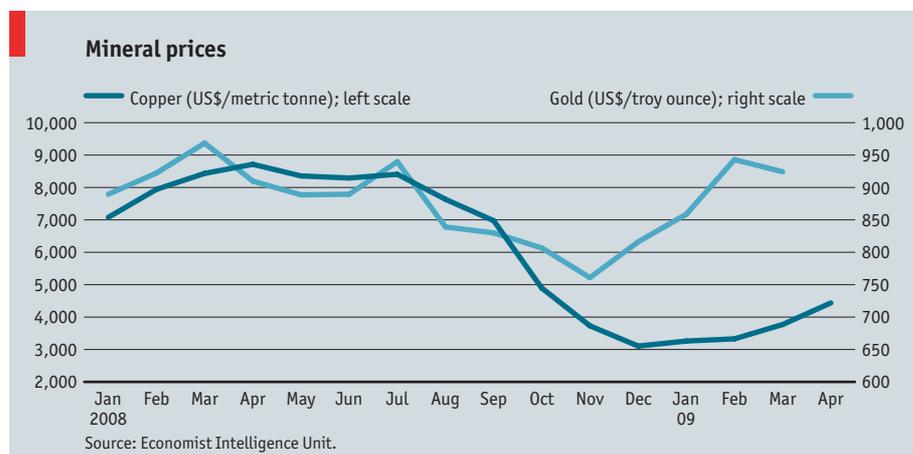
Illegal exports of timber continue, with the Ministry of Agriculture and Forestry struggling to keep up with smugglers. Given that civil-service salaries are low, enforcement remains weak, although the authorities have been able to bring cases to court. A regional shortage of unprocessed timber has led to a rise in timber prices, increasing the attraction of wood smuggling. Official logging quotas allow for only 150,000 cubic metres of timber a year to be felled for construction purposes nationwide. In Vietnam it has been reported that a local company, Hoang Anh Gia Lai, has secured a quota for 300,000 cubic metres of wood (worth US\$15m) from Laos over a three-year period, plus a large land

concession for rubber plantations, in return for developing the athletes' village for the Southeast Asian Games, which are to be held in Laos in December.

Development of mineral reserves continues

According to a survey published in May by the Ministry of Energy and Mining, large mineral reserves remain to be exploited in Laos. The figures are based on primary surveys of about 65% of Laos's 236,800 sq km of territory, but the ministry concedes that does not have the resources to conduct more comprehensive surveys and that not all private investors are providing accurate and detailed information. The survey lists 17m tonnes of gold ore, which could be processed into 143 tonnes of gold, 182m tonnes of copper ore that could produce 2.9m tonnes of the metal, and 0.8m tonnes of lead-zinc ore that could be refined into 0.2m tonnes of metal. It also details 1.6m tonnes of tin ore, 125m tonnes of aluminium ore, 14m tonnes of iron ore, 128m tonnes of gypsum, 399m tonnes of potash, 374m tonnes of coal and 44m tonnes of limestone.

Currently 132 mines are operational in Laos, the largest of which is the Sepon gold and copper mine in Savannakhet province. In 2008 the mine was valued at US\$2.2bn-2.4bn, but its value fell to US\$520m-560m this year owing to the global collapse of commodity prices. The sale of the mine by an Australian company, OZ Minerals, to a Chinese state-owned company, Minmetals, is expected to be approved by OZ shareholders in June. Meanwhile, the Australian parent company of Laos's Phu Bia Mining, PanAust, looks set to sell 20% of its stock to a Chinese investment group, Guangdong Rising Assets Management. Phu Bia has said that the sale will not affect the mine's management structure or the Lao government's shareholding. The sale is required to pay off debt and to fund expansion at the Phu Kham copper-gold mine and to develop the Ban Houayxai gold-silver project. Phu Bia is confident about the medium- to long-term outlook for copper prices, given that demand is expected to grow, particularly in China. The company aims to produce 65,000 tonnes of copper, 70,000 oz of gold and 500,000 oz of silver this year.



Local officials are trying to allay fears that a planned US\$4bn bauxite project on the Bolovens Plateau in southern Laos will strip topsoil from large swathes of the country's major coffee-growing area. Champassak province's planning and investment department director, Nalongsak Xattakhoun, told national media in May that the proposed mine would not encroach on coffee plantations and

that the projected aluminium processing plant would be built 100 km away from the bauxite quarry—far enough to ensure that coffee plantations would not suffer from the associated pollution. However, coffee producers remain concerned. A member of the Lao Coffee Association, Viengkham Sisanguan, has complained that discussions about the impact of the project say something different, leaving producers confused. The plateau produces 20-25 tonnes of coffee per year, generating about US\$33m in exports.

Vietnamese lobbying for mining concessions in Laos is proving successful, with three project agreements signed in recent months. In April, Hoang Phat Forestry and Minerals was awarded a concession to explore and exploit copper ore in the northern province of Luang Namtha. The three-year contract provides for an initial investment of US\$3m for a one-year exploration period and two-year mining period, which may be extended after further negotiations. In early May a second Vietnamese company, Esaco, signed a US\$7m agreement, which gave the firm copper exploration rights over 396 sq km in the southern province of Attapeu. Another Vietnamese miner, Cavico, has teamed up with two Lao partners to explore for copper in Vientiane province. Cavico is providing 78% of the US\$30m investment, with the exploration phase estimated to cost US\$4m, according to Vietnamese state media.

Electricity generation falls temporarily

Electricity generation dropped by almost 9% year on year in the first six months of 2008/09, owing to a water shortage at hydropower plants. The shortage stems from low rainfall in the south of the country and the construction of the Nam Theun II project in central Laos, which has reduced flow to the Theun Hinboun dam further downstream. However, electricity exports should still reach above US\$1bn for the year and the sector continues to grow steadily. Thailand is expected to resume construction work on two hydropower plants in Laos, the 525-mw Nam Theun I and the 1,300-mw Nam Ou, both of which were suspended earlier this year due to spiralling construction costs. Laos has agreed to provide Thailand with 7,000 mw of electricity by 2015.

An extension to the Theun Hinboun project, currently the largest hydropower plant in Laos, is under way at a cost of US\$720m. The extension will dam a tributary of the Nam Theun River (known as the Hinboun further along its course) and increase generating capacity from 220 mw to 500 mw, of which 440 mw will be exported to Thailand. Over 700 households are being relocated by the Theun Hinboun Power Company, 60% of which is owned by the Lao government, with Norway's Statkraft and Thailand's GMS Lao each holding 20%. The extension scheme, formerly known as the Nam Theun 3 project, will compensate for the reduced water flows to the existing dam caused by Nam Theun 2. It should be ready for operation by July 2012.

South Korean investment in Laos continues to grow and is spreading across various sectors. A formal agreement to "strengthen co-operation" in mining, electricity and renewable energy was signed at ministerial level in May. South Korea is seeking access to mineral resources and has offered technical assistance in inspection and development of mining projects. Laos has requested South Korean financing for the construction of electricity transmission lines from southern Laos to the Thai border. The lack of connections between hydropower

plants and the national grid and export markets is presently hindering Laos's attempts to extract full benefit from the proposed battery of hydropower facilities.

Utilities are reformed

Fees for the use of frequency spectrums by telecommunications operators have been introduced for the first time by the new telecoms regulator, the National Authority of Posts and Telecommunications. Fees are low by international standards, ranging from K200,000-400,000 (US\$24-48) per kilohertz per year, but are proving unpopular with operators in what has become a competitive sector. The Lao Telecommunications Company and the Enterprise de Telecommunications Laos (ETL) are state-owned and are the biggest operators in the sector. They will each face total fees of about K8bn (US\$940,000) this year. ETL has threatened to refuse to pay the fee, complaining that it was not informed of the new fees last year and so was unable to budget for them. Any telecoms operator that holds a frequency licence but fails to make use of it within a year will be fined 120% of the fee. This regulation may spell the end in the Lao market for Sky Telecom of the US, which received a licence more than two years ago, but has yet to open for business.

Vientiane's water supplier, Nam Papa Lao, is one of the state utilities that is considering listing on the future stockmarket. The company's director, Daophet Bouapha, has said that although listing would allow the enterprise to raise private sector financing, a public listing would also require a complete overhaul of its business. The utility does not have the necessary resources for expanding and maintaining water-supply facilities (currently only 80% of Vientiane residents receive piped water). Daophet acknowledged that in order to successfully list on the market, it would need to raise water rates to make its business profitable. Water prices are regulated by the state, while leakage and non-payment of bills by government agencies continue to render the water utility one of the worst performing state enterprises. In May Nam Papa was permitted to introduce a new sliding scale of water charges depending on the amount of water used. This is to be uniformly applied to all customers. (In the past government agencies were charged lower rates than average customers, while businesses and foreigners faced inflated rates.) It is estimated that the new tariff, which begins at K500 per cubic metre and rises to K5,000, will mean an average price increase of 20%.

The global downturn affects the tourism industry

Laos's national airline, Lao Airlines, has been forced to reduce the frequency of both international and domestic flights owing to falling numbers of passengers. The airline blames the global financial crisis, political turmoil in Thailand, the regional travel hub, as well as the spread of swine flu for the downturn. In 2008 the airline carried more than 360,000 passengers, up by 7% from 2007. The Lao Association of Travel Agents estimates that advance bookings have dropped by 10% so far this year and will fall by the same amount again. Operators are being encouraged to lower prices in an attempt to attract more low-season visitors and local tourists. However, many operators do not agree with the plan, pointing to high occupancy rates in higher-standard hotels. The rates for top-end hotel rooms in Laos are 30-40% percent higher than for comparable accommodation in Thailand, but rates are 20-30% lower than in

Vietnam. The Lao National Tourism Administration had originally forecast 1.9m tourist arrivals for 2008/09 and 2m for 2009/10, despite the financial downturn. A small local tourism market has grown from a base of virtually nothing in the past decade as purchasing power has risen and the concept of leisure time has spread. Lower fuel prices have also encouraged domestic travel this year.

Construction of a new road between the provinces of Savannakhet and Khammouane is well under way and is expected to be completed by April 2010, two months later than planned. The US\$9.3m road will reduce the travel distance between the cities of Thakhek and Savannakhet by 40 km and will increase trade opportunities for villages along the Mekong valley. Laos's first railway service is struggling to attract passengers and changes are planned. The train runs across the Mekong bridge outside Vientiane to the Thai town of Nong Khai, where passengers mostly disembark to obtain a ticket for the onward journey to the Thai capital, Bangkok, on board a different train. Given that fewer than 2,000 people used the train in April, its first month of service, the Lao Railway Authority has asked its Thai counterpart to provide a direct train service between Vientiane and Bangkok. This would require a one-stop immigration and customs service between the two countries, demanding a practical level of bureaucratic co-operation that has so far proved to be elusive. Tickets for the Vientiane-Bangkok rail route cost US\$10-32 per passenger.

The government aims to upgrade three airports in the north of the country to enable them to receive the ATR-72 turboprop aeroplanes used by Lao Airlines for international and major domestic routes. Improvements to existing airports in Xieng Khouang and Bokeo should be completed in about a year's time, but in Houaphan province a new facility is required, and this is expected to take two years.

Foreign trade and payments

Laos remains heavily dependent on Thailand as a market for its exports and as a source of imports. Recent data on trade with Thailand published by the Bank of Thailand (BOT, the Thai central bank) show that bilateral trade has been growing at a rapid pace. Thai imports from Laos rose by 30.3% in 2008, to US\$612.6m, compared with a fall of 8.9% in 2007. However, Thai imports from Laos have been contracting on a year-on-year basis since October 2008, and in February 2009 shipments dropped to US\$33m, the lowest level recorded since May 2007. In the first four months of 2009 Thai imports from Laos fell by 26.2% year on year to US\$139.9m. The balance of bilateral trade remains in Thailand's favour, with Thai exports to Laos worth US\$1.8bn in 2008, a rise of 35.5%. In January-April Thai exports to Laos fell by 12.3% to US\$515.6m. (The BOT's trade data series do not appear to be consistent with the series published by the IMF, in that the latter may undervalue Laos's overall import bill.) In 2008 Laos benefited from strong demand in Thailand for minerals and timber, while the development of infrastructure projects in Laos pushed up demand for imports of construction materials and equipment. The trade figures so far this year have heightened concerns that Laos will not escape the impact of the global economic downturn.