

# Country Report 9

## Lao PDR Country Report

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# LAO PDR

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## **Economic development of Lao PDR**

In 1986, the Lao government approved a comprehensive reform program called the New Economic Mechanism (NEM) to pave the way for a shift from a centralized economy to a market-oriented economy. Specifically, the development efforts aimed to transition from a command economy to a market economy; from a subsistence-based and isolated rural economy to a production and service economy; and from a relatively closed economy to an open economy. Since the introduction of economic reform under the NEM, considerable progress has been made in macroeconomic stabilization and structural adjustment. After the Asian financial crisis, annual GDP growth averaged about 7%.

Lao PDR is well endowed with natural resources. It has untapped reserves of agricultural arable land, large forest, hydropower potential, and mineral resources that, when efficiently exploited, could contribute substantially to economic development. However, the country also faces serious disadvantages. Its land-locked position, rugged terrain, low population density, and widely dispersed settlements generate high transportation and communication costs and render broad, equitable improvements in social and economic infrastructure expensive.

In the longer term, Lao PDR has many advantages to grow further. It shares borders and many common interests with neighboring countries and has opportunities to participate in the sub-regional, regional and global economic network, forming the real potential forces for economic growth and stability in the future.

The National Growth and Poverty Eradication Strategy (NGPES) emphasizes commercial production and promotion of export-oriented sectors while improving market linkages and facilitating trade. Trade revenues have increased but trade still contributes only a small amount to the Lao GDP. This shows that in many respects, the openness of the country's economy is still inadequate.

In 1992, Lao PDR joined the agreement on sub-regional economic cooperation among Greater Mekong Subregion (GMS) countries. In this respect, the Lao PDR

government requested ADB to help coordinate the efforts of international donors, as well as promote private sector participation in the development of priority sub-regional projects, particularly in the transport and energy sectors. Of particular significance is that Lao PDR is now able to involve itself in the GMS development plan.

In 1997, the Lao PDR became a full member of ASEAN. Becoming a fully responsible member of the region's main organizations (ASEAN and AFTA) is one of the Lao PDR's most important foreign policy objectives. Currently, Lao PDR is preparing to join the WTO soon.

### **Potentials and opportunities for the Lao PDR's economic integration**

Domestic context: There has been political and social stability since the foundation of Lao PDR, and this situation will be sustained. The production capacities and abilities of many industries have increased substantially, and the economic structure has changed significantly. Enterprises and the national economy have adapted better to the international market and the competitiveness of Lao products has improved steadily. The economic structure has changed progressively, and the Party's priority has been implemented methodically in priority projects. The market economy structure has been adjusted and progressively improved. The country has been recognized in the region and globally as having a dynamic economy within a stable political situation and is a safe destination for investment and tourism.

Socio-political stability is an important foundation and an essential precondition for socio-economic development, which is an advantage that the Lao PDR enjoys now. The full membership of the Lao PDR in the regional and global political, economic, and monetary organizations will boost the dynamism of the economy and accelerate the country's development.

Location: Lao PDR is located in the center of the Indochina Peninsula. It is the so-called land-linked country or land-bridge among GMS countries. Hence, the Lao PDR's great potential for the integration is its strategic location, which can be an important overland transit point for trade in the Mekong region and between South-East Asia and the Chinese and East Asian economies.

Natural resources: Lao PDR possesses relatively huge potentials in untapped natural resources. It could become a supplier of commodities to promote economic development in its neighbors, particularly in the fields of hydro and bio-energy production, forestry, agriculture, and mining.

Opportunities: Lao PDR could benefit from the opening up of and integration with the ASEAN market. Some of the preferences it enjoys are the tariff reductions

under the Common Effective Preferential Tariff Scheme (CEPT) and the ASEAN Integrated System of Preferences (AISP) offered by the six original ASEAN members.

### **Major challenges and problems on the integration**

There are at least three challenges to Lao PDR's integration. First, domestic economic regions are not unified, mainly due to the lack of infrastructure in transportation and communication, and to the underdevelopment of the nationwide market economy. Lao PDR is a nation that is topographically segmented, and many regions are still characterized by a subsistence economy that is not adequately incorporated into a market economy. Its domestic commerce-and-market network has not been adequately formed, and institutions are not sufficient for the unification of its domestic market.

Second, Laos is a sparsely populated nation, although the population is growing rapidly. As a result, labor is not abundant. Because the level of wages is not significantly lower than that of neighboring countries, it is a crucial fact that any strategy based on the use of abundant labor is challenging for Lao PDR, at least for the coming decade. In addition, since the literacy rate of the population remains low, human resources are not sufficiently available to uphold the activity of a market economy.

Third, the participation in the AFTA has remarkably shortened the remaining preparation time of its integration into the global market. Lao PDR's is facing an extremely difficult constraint upon its ability to develop several industries at the competitive international and regional levels by the year 2008, because it has been, in principle, required to reduce its tariffs to the 0-5% range for all imported commodities. Beyond AFTA, Lao PDR needs to reform its domestic economic policies and institutions to make such more compatible to the ASEAN-China FTA and ASEAN-Japan Economic Partnership Agreements, mainly by identifying the industries and commodities that have high potential for international competitiveness.

### **The role of ERIA**

From the Lao PDR country team's perspective, some policy recommendations for the country's development strategy are: (1) building and strengthening market institution (particularly the financial, real estate, stock, labor, and technology markets); (2) developing infrastructure, particularly to link the country to other economic corridors; (3) setting up SME development strategies to enhance competitiveness; (4) support nature-based industry with environment-friendly and economically efficient

approaches; (5) backing the agro-forestry and mining processing industry; (6) developing human resource, in particular by supporting vocational school development for skilled labor and strengthening R&D.

To deepen the economic integration in East Asia, the AEC initiative should be supported with the future goal of an EAC. In addition, a practical approach should be established by country group and by region. Issues such as production and trade networks, investment promotion, tourism, labor market and labor migration should be addressed from a regional perspective.

To narrow development gaps in the region, ERIA is expected to contribute to the following issues: (1) Fair trade and competition policy; (2) Development strategies for private sectors in CLMV; (3) Early harvest programs for CLMV in FTAs; (4) Human resource development program for CLMV; (5) education for skilled labor and R&D promotion; and (6) technical assistance for CLMV by training the trainers, and adopting the “learning by doing,” and “doing by learning” approaches.