
LAOS IN 2000

The Economics of Political Immobilism

Yves Bourdet

Laos is often called a “forgotten land” because the country is seldom mentioned in the world press. In 2000, however, Laos divested itself of this cliché with a wave of mysterious bombings in the capital Vientiane and elsewhere in the country. No one has been arrested and the motives of the perpetrators of the bomb attacks, which have injured more than 40 people, remain something of a puzzle. Whatever the reasons behind the bombing campaign, the political situation in Laos has become unstable. Internal strife within the Lao People’s Revolutionary Party (the Pathet Lao, LPRP), the only officially accepted party since the communist takeover in December 1975, and growing opposition inside and outside the country to the party’s monopoly on political power make political developments in Laos all the more difficult to foresee. Economically, after three years of huge macroeconomic instability Laos saw some recovery in 2000, but the country remains fragile and highly dependent on foreign assistance. It is therefore not surprising that one may have noticed much greater involvement of both the donor community and neighboring countries, in particular Vietnam, in the internal affairs of the country over the year.

Boiling Cauldron behind Apparent Political Inertia?

The current balance of power among the different groups and individuals within the LPRP goes back to the changes that took place during the Sixth Party Congress in March 1996. That Congress strengthened the power of the

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party faction opposed to instituting comprehensive and rapid reforms; it constituted a clear setback for the advocates of economic reforms. Political developments in Laos since then have cemented the results of the Sixth Party Congress, accompanied by a gradual reinforcement of the power of the military network composed of former and current members of the Lao People's Army. The increased domination of this network over political life is not that surprising; the absence of political competition and the weakness of the civil society make it the only organized, well-structured, and officially accepted political network outside the LPRP.

Nonetheless, the incapacity shown by the government in how it handled the impact of the regional economic downturn and through its demonstrated macroeconomic mismanagement has led to serious questioning of the legitimacy of the leadership anointed by the Sixth Party Congress. The criticisms have been directed toward the old guard, which gained political legitimacy during the "liberation war" of more than two and a half decades ago. As a result, the LPRP is experiencing internal strife from a native version of the struggle between the Ancients and the Moderns, pitting the advocates of political immobilism against those calling for the infusion of young blood into the top leadership. According to a widely quoted article in the *Far Eastern Economic Review*, strife within the party reflects three (partly) overlapping conflicts, between older and younger members, between pro-Vietnamese and pro-Chinese factions, and between Southern and Northern provinces. The same article connects the bombing campaign to this intra-party struggle, but without any evidence. This interpretation is questioned by Grant Evans, a Laos expert, who regards the strife within the party as a struggle for the division of spoils and the bombings "as simply anarchic, perpetrated by people who are fed up with the system."¹

The main representatives of the immobilist group include such individuals as General Khamtay Siphandon, number one in the party hierarchy and state president; the prime minister General Sisavath Keobounphan; and Defense Minister Lieutenant-General Choummaly Sayasone. Opposing them is a group whose main proponent is Foreign Minister Somsavat Lengsawat. As yet, the advocates of political immobilism constitute the majority in the party hierarchy, but a campaign for power has been launched by the advocates of limited renewal ahead of the Seventh Party Congress, scheduled for March 2001. The coming Party Congress will clarify things within the party hierarchy and provide a better indication of the balance of power between different groups and individuals. But the congress is unlikely to produce movement on any political reforms that would threaten the communist regime's grip on

1. "Behind the Bombings," *Far Eastern Economic Review*, July 27, 2000; and Grant Evans, "Demoralisation but No Revolt in Laos," *The Nation* (Bangkok), August 16, 2000.

power. That said, evidence of internal strife in the LPRP could be seen in the defection of Khamsay Souphanouvong, the minister in charge of state enterprises and former finance minister, who was given political asylum in New Zealand in November 2000.

Radical political changes are being advocated by the Laotian opposition abroad, however, which is spread out over different groups and continents, ranging from Hmong exiles in the U.S. to royalists in France and the transnational United Lao National Resistance for Democracy. Attempts to unify the various anti-government forces took place in 2000 under the auspices of Prince Soulivong Savang, the pretender to the throne, who lives in exile in France. The main objective of this loosely organized alliance is to institute a multiparty political system in Laos. Another objective of the prince and some of his allies is the restoration of the monarchy. Some Western politicians, mostly conservatives in the U.S., have shown sympathy for Prince Soulivong's campaign. Furthermore, an anti-government force of some 60 people coming from Thailand attacked a border checkpoint in the southern province of Champasak in July and hoisted a royalist flag. Seven attackers were killed in the ensuing clash with government troops. The exiled royal family denied complicity in the raid. Such events only reinforce the sense that the Laotian opposition abroad will need some form of internal opposition to interact with if it is to have a real chance of destabilizing the current regime.

Recovering from Macroeconomic Turmoil and De-Linked Growth

Internal strife in the LPRP contributed to crippling the government's ability to make rapid and clear macroeconomic responses to the economic turbulence created in the wake of the Asian financial crisis. Not surprisingly, the Laotian government's poor, opaque, and slow decision making made the impact of the regional economic downturn on the macroeconomic situation in Laos considerably worse than it could have been. An expansive fiscal policy and an accommodating monetary one lay behind the considerable deterioration of the country's macroeconomic situation in the late 1990s. Inflation reached 91% in 1998 and 128% in 1999, and the Laotian currency, the kip, lost no less than 90% of its value (with respect to the US\$) between 1997 and late 1999. The quasi-insolvency of the state-owned domestic banks, which held a volume of non-performing loans (in particular to state-owned enter-

prises) corresponding to some 60% of total loans in 1999, also contributed to the steep depreciation and flight out of the kip.²

Since late 1999, though, the macroeconomic situation has improved with the government having regained some control over its fiscal policy and instituted a tighter monetary one. The main factors behind the improvement of fiscal policy are larger tax revenues and a contraction of public expenditures. It is worth noting that the decrease in expenditures concerns principally the social sectors, which can be expected to have a negative impact on longer-term growth. The central bank has improved its control of the money supply, having instituted severe restrictions on the credit policy of state-owned commercial banks and increased sales of high-interest treasury bills to absorb excess liquidity. The main outcome of this improved macroeconomic stance has been a significant decrease in the budget deficit. This also means that there is less need for monetary financing of the deficit, and thus should eventually lower the inflation rate. The fiscal deficit decreased from some 13% of the gross domestic product (GDP) in 1997–98 to 8.5% in 1999–2000 (the figures refer to the fiscal year October–September). Inflation has decreased steadily since late 1999. In 2000, it amounted to some 15% on an annual basis. However, inflation remains higher than it is in the countries that are Laos's trading partners, which may eventually result in a further depreciation of the kip.

Economic growth in Laos is largely de-linked from macroeconomic imbalances (inflation and exchange rate instability) because of the dominant position of the subsistence agricultural sector in the economy. After all, weather conditions matter more than stabilization policy for agricultural output. Long-term GDP growth in Laos ranges between 6% and 7%; the average growth rate for industry and services was above this range and below it for agriculture. It is known that official statistics overestimate agricultural production and growth, which means that actual GDP is lower than 6%–7%. Macroeconomic mismanagement and instability produced by the regional economic problems brought down the growth rates of industry and services but left the rate of agricultural growth relatively unchanged. Part of the reduction in the growth rates of industry and services could be ascribed to the sharp drop in foreign direct investments. On the other hand, relatively favorable weather conditions in 1999 had contributed to boosting agricultural production by some 8% as compared to 1998, with the largest increase coming in rice production. In 2000, though, agricultural performance again worsened, this time as a result of serious floods in the central and southern provinces in

2. For an analysis of macroeconomic instability in relation to the transition process, see Yves Bourdet, *The Economics of Transition in Laos: From Socialism to ASEAN Integration* (Cheltenham and Northampton, England: Edward Elgar, 2000).

September and October. The floods affected some 10% of the Laotian population at a critical time in the rice-growing season. Growth in industry and services did recover somewhat in 2000, however, with foreign investments gradually coming back.

The spatial distribution of growth is a critical factor in the development of regional economic disparities that can exacerbate social, ethnic, and political tensions. National income in Laos is unevenly distributed among the provinces and different types of households. Economic reforms introduced in the 1990s contributed to a widening of income disparities across provinces and resulted in a rapid increase of real incomes in urban areas and the provinces of Vientiane Municipality, Champasack, and Xaboury.³ For example, the average income per capita in Vientiane Municipality was twice that of Laos as a whole in 1997–98, while it had been only 1.5 times higher in 1992–93. The worsening of the economic situation in the late 1990s mostly affected the urban population, in particular state employees, who were most dependent on imported goods and whose real incomes dropped dramatically with hyperinflation and the huge fall in the value of the kip. On the other hand, there are indications that the kip's depreciation has boosted exports of agricultural products to Thailand and improved living conditions in districts with road access to that country and the Mekong River.⁴ All this suggests that the income disparities between urban and rural areas might have decreased somewhat over the past two to three years, but at much lower levels in terms of per capita incomes as measured in foreign currency.

International Sponsoring

The political immobilism and poor macroeconomic policy contributed to a clear deterioration of the economic and social situation in Laos in the late 1990s. Strife within the LPRP created a kind of leadership vacuum, which was rapidly filled by powerful neighboring countries—in order of influence, Vietnam and China. After the army, the main support for the current Laotian political leadership now comes from such neighbors, though the importance of foreign aid makes the donor community a critical factor in the support of the political leadership as well.

Vietnam's role in Laos has expanded tremendously in military, economic, and political areas in recent years. The Laotian government sought Vietnamese intervention to face an escalation of the Hmong rebellion in the northeastern province of Xiang Khouang. Vietnamese troops were involved

3. See Yves Bourdet, "Laos: An Episode of Yo-Yo Economics," *Southeast Asian Affairs 2000* (Singapore: Institute of Southeast Asian Studies, 2000), pp. 157–59.

4. See e.g., James R. Chamberlain, *The Social Impact of the Economic Crisis in the Lao PDR* (Manila: Asian Development Bank, May 1999).

in the operation, though the Laotian government denied this. Vietnam's economic ties with Laos also have increased notably over the past few years. This can be seen in the deeper cooperation between border provinces; a stepping up of cross-border and barter trade; Vietnamese investment in such strategic sectors as construction, transport infrastructure, forestry, and agro-processing; joint-venture agreements in the banking sector; financial and auditing assistance; and the outflow of Vietnamese workers to Laos (some 10,000 in 1999). Last, but not least, political and ideological solidarity has been on the increase. For example, Vietnam constructed a pharaonic mausoleum in honor of former president Kaysone Phomvihane just outside Vientiane, while ideological training of Laotian officials has been organized by the Ho Chi Minh National Politics Institute in Hanoi. Plenty of other examples of Vietnamese-Laotian solidarity can be found almost daily on the front page of the semi-official *Vientiane Times*.

The increase in China's influence, which has been more modest and often limited to economic matters, seems to be part of that country's natural economic expansion toward Southeast Asia. But China also wants to use economic cooperation to balance the influence of Vietnam and achieve political goals, not least since Laos has become a member of ASEAN. China donated \$7.2 million to build a grandiose Laotian cultural center in Vientiane and provided Laos with interest-free loans to help stabilize the kip. Also, Chinese construction firms have been engaged in infrastructure projects in northern Laos. And to make the Chinese brotherhood more complete, President Jiang Zemin paid the first-ever visit of a Chinese head of state to Laos in mid-November 2000, during which he promised still more economic aid to the country.

As for the influence of the donor community, it is not that imposing but is real nonetheless because of the economic importance of foreign aid. Official development assistance (ODA) increased during the 1990s and now represents 17%–20% of GDP. Part of the increase can be ascribed to the depreciation of the domestic currency, given the level of aid in foreign currency. Note, however, that the structure of ODA has changed, with grants accounting for a smaller share and loans for a larger one. This change has implications for the future development of external debt. ODA finances some 80% of public investments, which is a considerable share. The highest degrees of aid dependency (the foreign aid share of investment expenditures) are found in transport and communications (more than 90%) and public health and social welfare (some 80%). Together, these sectors account for some 80% of the total development assistance to Laos. The main foreign donors are Japan, Australia, Germany, Sweden, France, and the European Union (EU). The donor community has from time to time expressed concerns over human rights abuses and the Laotian government's secrecy. Yet, the donors have

been reluctant to make full use of their economic influence to promote transparency and aid efficiency—that is, good governance—and wean Laos away from its mentality of aid dependence. Both the meeting between the donor countries and the Laotian authorities in November and the ASEAN-EU ministerial meeting in Vientiane in December confirmed this contention.

As noted above, the Seventh Party Congress is to be held in Vientiane in March 2001. It is likely to modify slightly the balance of power among individuals, factions, and provinces within the top leadership of the LPRP. But the congress is unlikely to reform the political system as such and empower Laos's policy makers with the legitimacy and instruments that would permit them to regain control over longer-term development strategy. Longer-term prospects for Laos are therefore gloomy and the country will most likely continue to be dependent on foreign aid, especially from interested neighboring countries.