
LAOS IN 2001

Political Introversion and Economic Respite

Yves Bourdet

For Laos, 2001 was a year of political introversion focused on the lengthy and intricate preparations for and the eventual holding of the Lao People's Revolutionary Party (LPRP) five-year congress. As in other communist countries with a one-party political system, the Party Congress in Laos constitutes the country's most important political event, especially since it settles internal political strife and sanctions the new distribution of power among individuals, factions, and provinces. Because of the close integration of it and the LPRP, the Party Congress also provides information on the longer-term economic strategy of the government.

The preparations for the Seventh Party Congress extended over several months, during which indications of internal strife flourished. Two factors in particular had an impact on the preparations for as well as the course and outcome of the Party Congress. First, a mysterious bombing campaign had hit the country during 2000. No arrests were ever made in connection with the blasts and the political motives of the perpetrators remained blurred, even if some unofficial sources related the campaign to strife between various factions within the LPRP. Second, the government was the target of much internal and external criticism for its inability to handle the affects of the Asian economic crisis. It was seen as having been ineffective at managing the economy and optimizing the returns in terms of growth and development of the huge foreign assistance—some 20% of gross domestic product (GDP)—received annually by the country.

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The Seventh Party Congress: Confessions without Concessions

The Seventh Party Congress opened in the Lao National Culture Hall in Vientiane in March 2001. There were 452 delegates on hand to represent the party's estimated 100,000 members, that is, less than 2% of the population. Representatives of the remaining members of the international communist brotherhood—Vietnam, China, Cuba, and North Korea—as well as from some neighboring countries were also on hand. The congress, which had been preceded by extensive and secretive discussions among the LPRP's top leadership, lasted only three days. It took place amid tight security measures, in place owing to ongoing concerns over the wave of mysterious bomb attacks that occurred during the preceding year.

Putting the Seventh Party Congress in historical perspective permits a better understanding of its main concern and outcome. The Fourth Party Congress in 1986 launched an ambitious program of market-oriented economic reforms called the New Economic Mechanism. The main factor behind its adoption was the admitted failure of the socialist line in raising the population's standard of living. The Fifth Party Congress in 1991 was aimed at consolidating economic reforms. The fear that control would be lost over those and subsequent reforms, along with worries about the possible political consequences of economic liberalization, dominated the Sixth Party Congress in 1996. This congress strengthened the power of the "reformers by necessity" at the expense of "reformers by conviction," as illustrated by the increased presence of the Lao People's Army in the top leadership, with seven out of nine members of the Politburo being or having been army personnel. The loss of control over macroeconomic development in the aftermath of the Asian financial crisis and revived political opposition inside, but above all outside, the country overshadowed the preparatory work for the Seventh Party Congress.

The LPRP's response to these new challenges revealed the preferences of its top leadership. The congress made cosmetic changes to the composition of both the Politburo and the Central Committee and introduced a new rule that limits the tenure of administrative posts to no more than two terms, all this in order to conciliate the younger generation. The congress also made fuzzy promises of market-friendly economic reforms and improved governance so as to appease the donor community, which finances 80% of Laos's development expenditures.

But after the long-lasting and complex campaign leading up to the Seventh Party Congress, the leadership changes it endorsed turned out to be a bit of an anticlimax. The old guard maintained its grip on power with State President Khamtay Siphandone, 77 and one of the few surviving members of the Indochinese Communist Party founded by Ho Chi Minh in the 1930s, retaining

the post of party chairman. The seven other members of the nine-member Politburo also stayed on (the ninth member, Vice-President Oudom Khatigna, died in December 2000). However, two more seats were added to the Politburo, expanding its total membership from nine to 11. The change was intended to give a younger look to the top leadership, not a sign of ideological renewal. Two of the three newcomers, Thongloun Sisoulith and Bouasone Bouphavanh, were educated in Vietnam and the former Soviet Union, and the third, Douangchai Phichit, was the military chief of staff. By the same token, the Central Committee was expanded from 49 to 53 seats (three of them women) to integrate younger party cadres. The average age of the Central Committee remains, however, rather high at 56. It includes all 16 provincial governors, probably to achieve better political monitoring of the provinces' activities now that they have been allotted greater financial and economic autonomy.

The government was reshuffled in late March to reflect the change in the party hierarchy endorsed by the Party Congress and the close interweaving between the LPRP and the state in Laos. The first change concerned the appointment of former finance minister and number six in the party hierarchy, Bounnyang Vorachit, to the post of prime minister in place of the aging General Sisavath Keobounphanh, who was considered responsible for the economic policy failure of the late 1990s. Bounnyang is a former army colonel with administrative background as governor of the province of Savannakhet and mayor of Vientiane. His choice seems to have been the result of a compromise between the military faction led by Khamtay and the more ideological wing led by former president and current party advisor Nouhak Phoumsavanh, 85 and the only remaining member of the first resistance government in 1950.¹ Other key moves were the appointment of Soukanh Mahalath, former central bank governor, to the post of finance minister; that of the new Politburo member General Duoangchay Phichit to the post of defense minister; and the designation of Foreign Affairs Minister Somsavat Lengsavat as deputy prime minister. Somsavat was not elected to the Politburo and his position in foreign policy issues is likely to be weakened by the election of Thongloun Sisoulith, former chairman of the National Assembly's Foreign Affairs Commission, to the Politburo (and now number nine in the party hierarchy) and his designation as deputy prime minister in charge of the State Planning Committee.

During the course of the Seventh Party Congress a kind of schizophrenic atmosphere prevailed in Vientiane, with the communist hammer and sickle flags everywhere across the city contrasting with the renunciation of commu-

1. "The Choice of the New Lao Premier Is a Sign of Pragmatism," *Nation* (Bangkok), April 1, 2001.

nist economics inside the Congress. In his political report to the delegates, Party Chairman Khamtay Siphandone referred explicitly to socialism and pointed out that the party still adheres to Marxist-Leninist principles. This, however, had no effect on the new five-year economic plan (2001–05) presented at the gathering. In his speech to the Congress, Khamtay confessed that domestic factors played a critical role in the macroeconomic and financial instability that hit the country in the late 1990s. Shortage of skilled personnel, an expansive monetary policy, and corruption among officials were the problems, he said. For the 2001–05 period, the government plans an average growth of at least 7%. The analysis of the development strategy needed to achieve this objective was rather vague, however. Emphasis is placed on the continuation of market-oriented reforms (without going into details), private sector development, human resource mobilization, improved road infrastructure, and the end of slash-and-burn practices in agriculture. This growth objective should be considered very optimistic for one main reason: the Lao economy is mostly an agricultural one (agriculture accounts for about half of GDP) and agriculture is dominated by subsistence farming, which by its very nature does not grow or grows very slowly.

The Congress advanced two other economic objectives. The first is to triple per capita income by 2020, while the second is to eradicate poverty by 2020 after having halved it by 2005.² Both objectives should also be regarded as unrealistic given the country's rapid population growth, some 2.8% per annum; at that rate, the population will double by 2025. In addition, the sector distribution of growth, concentrated in industry and services, makes the achievement of the second objective all the more unlikely. Poverty is mainly a rural phenomenon in Laos and raising growth and productivity in rural areas requires overcoming constraints such as low education, health, and nutrition standards, which can only be accomplished in the long term.

Respite from Economic Instability

The Lao economy continued its recovery in 2001 after the severe crisis that hit the country in 1997–99. Two factors contributed to the huge macroeconomic instability in the late 1990s and Laos's having been affected more severely than neighboring countries by the Asian crisis: an expansive monetary policy and the quasi-insolvency of the Lao state-owned commercial banks due to a large volume of nonperforming loans. The expansive mone-

2. According to a study undertaken by the World Bank, the Asian Development Bank, and the Lao government, some 39% of the Lao population live under the poverty line. For an analysis of the evolution and geography of poverty in Laos, see *Fighting Poverty through Human Resource Development, Rural Development and People's Participation*, Lao Government Report to the Seventh Round Table Meeting (Vientiane, November 2000), and Gun Alm Stenflo, *Poverty Profile of Lao PDR* (Vientiane: Statistics Sweden and Laostat 1999:2).

tary policy was triggered by the financing of an ambitious irrigation program and the money poured into it by the Lao central bank. Khamtay advocated the irrigation program aimed at achieving rice self-sufficiency in Laos.³ As for the banking system's quasi-collapse (that is, with no chance of recovery without recapitalization by the state), the problems there were owed to the permanence of soft budget constraints in the banking sector. Large volumes of loans had been granted on noneconomic (i.e., political) grounds to state-owned and military enterprises as well as individuals with close links to the LPRP.

To cope with these two factors, the Lao government, with the help of the international donor community and the International Monetary Fund (IMF) and the Asian Development Bank (ADB) in particular, put an end to the monetary financing of the budget deficit and recapitalized (and restructured) the state-owned commercial banks. Macroeconomic recovery in Laos over the past two years is the consequence of these two measures. However, by and large the underlying institutional and structural factors behind the financial and monetary instability are still in place. Both the Lao central bank (the Bank of the Lao PDR) and the state-owned commercial banks have only limited autonomy from the Lao government and indirectly the LPRP. Note that the negative impact of political considerations in the conduct of monetary policy and the loan policies of commercial banks is exacerbated by the lack of transparency in the Lao financial system and of business transactions in general. The latter is particularly true when it comes to military enterprises. As long as the underlying causes are not addressed in a more systemic way, the Lao recovery can be considered only a respite and macroeconomic instability may resurface at any time.

In 2001, inflation continued to decrease and was estimated at some 10% (to be compared with 27% and 134% in 2000 and 1999, respectively). Inflation in Laos was still higher than in its trading partners, which explains the further depreciation of the Lao currency, the kip, during 2001. Between end-2000 and end-2001, the kip depreciated by some 15% in relation to the U.S. dollar. Another illustration of the macroeconomic recovery is the improvement of the budgetary situation. Increased tax revenue brought down the budget deficit (excluding grants) from 10% of GDP in the fiscal year October-September 1998-99 to some 8% over the corresponding period in 2000-01. Foreign grants and concessional external loans finance the deficit.

3. Achieving rice sufficiency in Laos is problematic for two main reasons. First, Laos has no comparative advantage in rice production as compared to Thailand and Vietnam. Second, Laos has no integrated rice market with trade flowing with ease and rapidity between surplus and deficit areas, which is necessary to secure self-sufficiency within the country. On the rice sector in Laos, see Yves Bourdet, *Emerging Rice Market in Laos?* (Country Economic Report 2000:7, Swedish International Development Cooperation Agency).

Economic growth in Laos is largely de-linked from macroeconomic instability because of the predominant role of subsistence agriculture. Official statistics put GDP growth at 5.9% in 2000, and preliminary estimates for 2001 were of the same order of magnitude, about 6%. The impact on growth in Laos of the September 11 attacks and the coincident economic slowdown in industrial countries was likely to be negligible. More rapid growth was achieved in services and industry, some 8%. Official statistics in Laos tend to overestimate agricultural growth (see above) and underestimate the growth of industry and services by failing accurately to reflect the growth of informal activities, particularly in Vientiane and other large cities. An implication is that the growth differential between agriculture and industry and services is larger than in official statistics. This is supported by a comparison of the changes in poverty across space. Actually, poverty decreased much more rapidly in Vientiane Municipality, where industry and services are concentrated, than in the predominantly agricultural regions and provinces. Between the early and late 1990s, the proportion of people living in poverty decreased from 24% to 12% of the population in the municipality, whereas it only decreased from 58% to 53% in the Northern Region and from 40% to 35% in the Central Region. The worst situation is found in the northern provinces of Oudomxay and Hua Phan, where no less than three out of four inhabitants live in poverty.⁴

Broadening Vietnamization and a Hypnotic Donor Community

The Seventh Party Congress was preceded by internal strife within the LPRP, which, according to unofficial sources, was due to opposition to the old pro-Vietnamese guard on the part of an emerging younger faction leaning toward China. The outcome of the Party Congress provides only weak support to this hypothesis. The main proponent of the younger faction, Foreign Minister Somsavat Lengsawat, was not elected to the Politburo, but kept his position in the Central Committee and remained foreign minister. On the other hand, the newcomers in the Politburo have strong ties to Vietnam, where they have been educated. The past year has seen an expansion of Vietnam's role in Laos's affairs; from having been quasi-exclusively concerned with political and military issues, it now covers education, justice, media, trade unions, banking, trade, agriculture, transport infrastructure, and so forth. No similar broadening can be noticed in the aid from China, which certainly increased but has still been confined to economic and trade matters. The big and multi-

4. For an analysis of the determinants of disparities between the Lao provinces, see Yves Bourdet, *The Economics of Transition in Laos: From Socialism to ASEAN Integration* (Cheltenham and Northampton, England: Edward Elgar, 2000), chapter 7.

form intensification of Vietnamese assistance to Laos is all the more worth noting because Vietnam itself is a large recipient of foreign assistance, in particular from Western Europe and Australia. This is an illustrative example of international fungibility, when increased Western assistance to Vietnam frees domestic resources that can be used to expand Vietnam's influence in Laos.⁵

Another major dimension of Lao foreign policy concerns its relation with the donor community. The Bretton Woods institutions, the IMF and the World Bank, have resumed their assistance concomitantly with the improvement of the Lao government's macroeconomic stance. The IMF, for example, granted a new three-year loan worth US\$40 million in April 2001, some eight years after the last loan in 1993, and has provided the country with technical assistance. However, concern over macroeconomic policy has led the IMF to postpone the disbursement of the second tranche of the IMF loan. The ADB has also increased its involvement in Laos, launching an ambitious poverty alleviation program, with particular emphasis on primary education, private sector development, and the Northern Region provinces.⁶ The Lao government's promise of improved governance and transparency, for instance during the Seventh Round Table Meeting in Vientiane in late November 2000, contributed to this changing attitude of the multilateral donor community.

Notwithstanding, real signs of improved governance and transparency are scarce. Moreover, government policy toward the local media has tightened to prevent journalists from giving "false information about Laos to the world." Two events illustrated the limits of the government's promises and the lack of a truly independent legal system in Laos. The first event concerned two Australians who were detained for 10 months on allegations of stealing gemstones (worth US\$500,000) from the company for which they had worked, Gem Mining Lao (GML) PDR. The two denied the charges but were sentenced to seven years' imprisonment, together with fines and compensation payments of US\$1 million, after a slapdash trial. Diplomatic pressure from Australia (the fourth largest bilateral donor to Laos) enabled them to benefit from a presidential pardon and they could return to Australia in November 2001. Behind the judicial episode was a struggle over the control of the GML sapphire mine between members of the Lao government and the foreign formal owners, who had fled the country in 1999. The two Australians

5. Fungibility of foreign assistance refers to the possibility given a recipient country to shift resources out of the sector (or project) that receives aid to other sectors (or projects). The argument of fungibility suggests that in some cases foreign assistance does not finance projects it is ostensibly for, and which would have been carried out anyway, but other projects instead.

6. For more details, see ADB, *Country Strategy and Program (2002–2004): Lao People's Democratic Republic* (Manila: ADB, August 2001).

in fact were held as part of the Lao attempts to apprehend the foreign owners of the company.

The second event, which occurred on October 26, 2001, had a direct political character. It involved five European political activists (one of whom was a member of the European Parliament) who were arrested after demonstrating in front of the presidential palace in Vientiane for the establishment of multiparty democracy and respect for human rights. The demonstration marked the second anniversary of the disappearance of a group of Lao students, who had demonstrated for similar reasons at the same place in 1999. The president of the European Parliament, Nicole Fontaine, vigorously condemned the detention of the activists "as a breach of basic human rights and of Laos' cooperation agreement with the EU [European Union],"⁷ and the Foreign Affairs Committee of the European Parliament threatened to suspend the cooperation agreement and freeze all funds meant for Laos. Romano Prodi, the president of the European Commission, expressed similar concerns. After two weeks in jail, the five were convicted of "breaking Lao law, disturbing Lao political stability, and the peaceful life of the people"; sentenced to two years in jail; and eventually deported from Laos. Noteworthy is that both events have not affected the assistance to Laos from the countries concerned, which together account for the lion's share of development expenditures. During 2001, some EU countries not only renewed but also expanded their assistance to Laos.

Conclusion

The Seventh Party Congress of the LPRP fell short of expectations for those people hoping for the political system to open up and a new political elite to emerge in Laos. Only minor changes emanated from the Party Congress, and minor alterations occurred in the relations between Laos and neighboring countries. On the other hand, the macroeconomic situation continued to stabilize with the help of the international donor community, but little has been done to address the underlying structural and institutional determinants of macroeconomic and monetary instability. Growth has continued to be unbalanced, favoring urban areas where industry and services are concentrated. Only insignificant improvements in governance could be noticed, which means that the potential positive impact of the huge foreign assistance on economic growth and development has continued to be constrained by the poor quality of domestic state intervention and development policy.

7. "European Parliament Demands Release of MEP, Four Others in Laos," Agence France Presse, October 31, 2001.