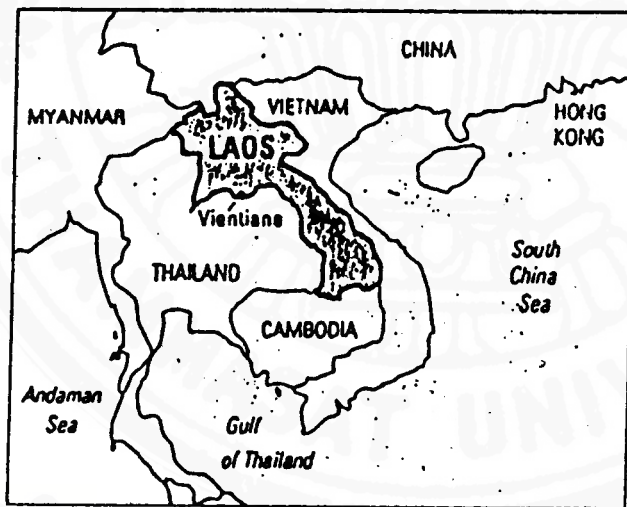


# **Economic Cooperation in Transition: Laos' Economic Development and Foreign Aid**

**Motoyoshi Suzuki\***

## **1. Introduction**

Laos has been the least well-known of the three Indochinese countries. As it is surrounded by the three strong countries of China, Vietnam and Thailand, and by two disorderly countries, Cambodia and Myanmar, world concern tends to shift to Laos' neighbouring countries rather than to Laos itself. However, this means good political stability in Laos. When we view this situation from a different angle, further development of Laos requires the same manner of development as the Indochinese countries. In particular, integrated development of Indochinese countries seems to depend on realization of peace in Cambodia. In the sense that peace in Cambodia is the precondition for future development in this region, Japan and Thailand should not be indifferent to the region's distress.



Source: *Tokyo Business Today*, Toyo Keizai Shinposha, Vol. 60,  
No. 10, October 1992

The objective of the paper is to delve into the relationship between Laos' economic conditions and foreign aid, and also into the role of economic cooperation, particularly with Thailand and Japan, in the economy in the

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transition period from a socialistic command economy to a market economy. In section 2, we will examine the main thrust of Laos' economic reform, called the "New Economic Mechanism", which is to introduce market mechanisms where demand and supply determine the product prices under minimum intervention from the government. In section 3, we will survey the profile of foreign aid in Laos and analyze the role of foreign aid in the economy. In section 4, the conditions of Russian aid will be revealed and the influence of its aid reduction on the Lao economy will be analysed. In section 5, Japan's aid in Laos will be reviewed. In the final section, the future prospects of economic cooperation concerning (1) improvement of Road 13, (2) construction of the Second Mekong Bridge, (3) Mekong River development and the Nam Theum II hydro project, (4) encouragement of foreign direct investment inflow into Laos, and (5) education creating development in the long term, will be detailed.

## **2. "New Economic Mechanism" on the Verge of Socialism's Collapse**

In Laos, a mere 4 million plus people are living on 237,000 km<sup>2</sup> of land, nearly equal in size to Japan's Honshu Island. Such sparse population density creates the impression that Laos is better-off than other Asian least less developing countries (LLDCs) such as Bangladesh or Nepal which actually have as much \$200 more per capita GDP as Laos.

The nation abolished its monarchy in December 1975 and established the Lao People's Democratic Republic. Although Laos made efforts to build a moderate socialist state through the nationalization and collectivization of industry, the situation of the trade deficit and budget deficit was not improved. As a result, the Lao government introduced the economic reform called "New Economic Mechanism" with the goals outlined below.

- 1) Introduction of the market mechanism.
- 2) Liberalization of internal and international trade.
- 3) Abolition of price control.
- 4) Privatization of state enterprises.
- 5) Reduction of the government budget deficit.
  - 5.1) Reform of the tax system including abolition of transfer, introduction of profit tax, etc.
  - 5.2) Discontinuation of subsidies for agricultural cooperatives, etc.
  - 5.3) Reduction in the number of public employees.
- 6) Monetary reform.
  - 6.1) Strict control of money supply and implementation of a high interest rate policy in order to control inflation.
  - 6.2) Stabilization of the foreign exchange rate.

Generally speaking, Laos' macro economic policy has been very successful as far as we can judge from the well-controlled inflation rate and more stabilized foreign exchange rate. However, it will take much more time for the New Economic Mechanism to influence rural areas beyond urban areas, because, first of all, Laos is an entirely agricultural country, where agricultural GDP accounts for roughly 60% of total production and where employees engaged in this primary industry form nearly 90% of the total labour force. Agriculture in this country used to be totally at the mercy of the weather.<sup>1</sup> Second, underdeveloped road infrastructure has divided Laos into regional areas, and this situation has caused deterioration of the administrative ability and stagnation of economic activity. In addition, it creates conditions which make it difficult to connect farmers with markets. Third, monetarization has not yet been spread over mountainous areas, where self-sufficiency and barter trade are the basic and principal economic activities of the people. We must investigate the role of foreign aid carefully after recognizing the present conditions of Laos which are continuing a vestige of socialism.

### 3. Foreign Aid in Laos

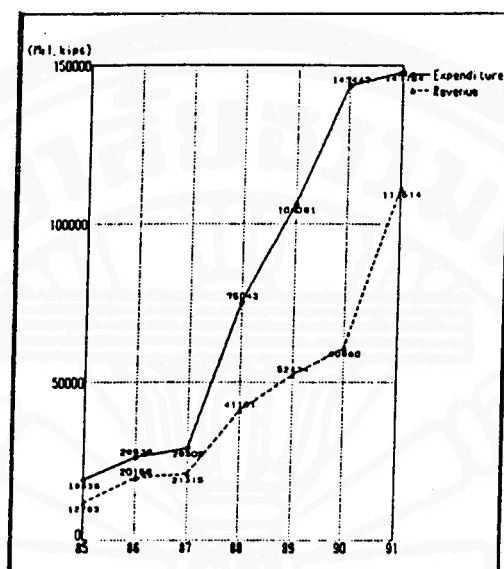
#### 3.1 Financial Deficit and Foreign Aid

In order to grasp the characteristics of foreign aid in Laos, we must delve into the financial situation of Laos' government. Laos has sustained a financial deficit since the nation's establishment in 1975. One of the main reasons is the increase of expenditure for wages/salaries to governmental officers and of capital expenditure. The expenditure for wages/salaries in 1990 increased by 3.2 times as much as that in 1988, and the expenditure for pensions increased more than 19 times in the same period.

The growth rates of capital expenditure such as education, construction of bridges, roads, and so on, were 250% in 1988 and 41% in 1989 compared with the previous year. Figure 1 illustrates the trend of financial deficit from 1985 to 1991. We can discover three characteristics from this figure. First, the expenditure exceeds the revenue every year. National budget has never attained its balance. Second, not only the scale of the expenditure but also the revenue has increased year by year. Third, the scale of financial deficit expanded after 1988. Figure 2 illustrates the method of financing the national budget. 52% is financed from revenue, 22% from grants, 20% from foreign loans and 6% from domestic borrowing. When we view the problem from a different angle, the government has made up for the deficit by means of two types of finance: foreign loans and domestic borrowing (Table 1). The percentage share of foreign loans within the financial deficit reached 92% in 1990 and 75% in 1991, respectively. Grant aid is calculated as part of revenue and grants items because it need not be returned. If it is deducted from this item, the Lao financial deficit

increases by 90%. Thus, Laos' economic scale is so small that foreign aid seems to play a vital role in its government budget.

**Figure 1**  
**Budget Deficit**



Source: International Monetary Fund, *Economic and Financial Trends in the Lao P.D.R. (Answers to I.M.F. Questionnaire)*, Vientiane, December 1991.

**Figure 2**  
**Method of Finance the National Budget (1991)**

Expenditure & Arrears (150,866 M. kip)	Revenue 52%
	Grants 22%
	Loans 20%
	Domestic financing 6%

Source: International Monetary Fund, *Economic and Financial Trends in the Lao P.D.R. (Answers to I.M.F. Questionnaire)*, Vientiane, December 1991.

**Table 1**  
**National Budget and Financing (1991)**

	(Million kip)
Revenue & Grants	111,514
Revenue	78,964
Grants	32,550
Expenditure	147,784
Current	81,956
Capital	65,828
Balance	-36,270
Arrears clearance	- 3,082
Overall balance	-39,352
Financing	39,352
Domestic borrowing	9,800
Foreign loans	29,552

Source: International Monetary Fund, *Economic and Financial Trends in the Lao P.D.R. (Answers to I.M.F. Questionnaire)*, Vientiane, December 1991.

### 3.2 Trade Deficit and Foreign Aid

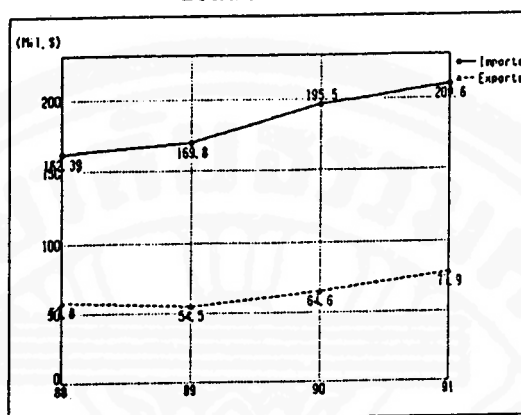
In 1991, Laos' exports totaled US\$ 65.5 million, while imports amounted to US\$ 209.6 million. The imports are at a level 3.2 times that of exports. Figure 3 illustrates the serious condition of the trade imbalance, which could provide the impression that it is beyond improvement. Laos' primary export products are only electricity, timber and coffee. We can not expect an increase of electricity exports, because its domestic demand is expanding by 10% annually and there is no concrete plan to construct a new hydro-power dam. In addition, it is very difficult to increase timber exports because of the need to protect forestry from serious deforestation. Even worse, coffee exports have shrunk rapidly as trade with Russia was reduced after the introduction of the hard currency settlement in 1990. Laos, on the other hand, must import a wide variety of products ranging from sundry goods like soap to industrial goods like cars and machinery.

Figure 4 illustrates how the trade deficit is financed. In 1991, 52.5% of the trade deficit is covered through "official transfer", that is, grant aid. 27.9% of the trade deficit is financed by "long term loans". 8% is made up by "services and private transfer". Private transfer is mainly remittance by refugees living in Thailand, USA etc. The remaining 11.4% is made up by "foreign direct investment". In short, the fact is that 80% of trade deficit is financed by foreign aid consisting of foreign grants and loans. Foreign aid plays a vital role to



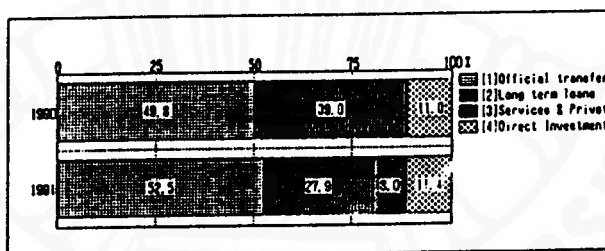
finance the trade deficit as well as the financial deficit. We explore the characteristics of foreign aid in the next section.

**Figure 3**  
**Trade Deficit**



Source: International Monetary Fund, *Economic and Financial Trends in the Lao P.D.R. (Answers to I.M.F. Questionnaire)*, Vientiane, December 1991.

**Figure 4**  
**Financing the Trade Deficit**



Source: International Monetary Fund, *Economic and Financial Trends in the Lao P.D.R. (Answers to I.M.F. Questionnaire)*, Vientiane, December 1991.

### 3.3 New Economic Mechanism and Foreign Aid

The first characteristic of foreign aid for Laos we must mention is that it increased rapidly after 1988 (Table 2). Laos started the economic reform called "New Economic Mechanism" in 1986 and tried to introduce the market mechanism. While aid from socialistic countries shrunk, Western aid has expanded to support the successful and smooth introduction of the market mechanism (Table 3). Foreign aid in 1988 amounted to the equivalent of US\$ 131.7 million, and exceeded that in 1987 by 2.24 times at US\$ 54.3 million. Second, the three sectors which disbursed the largest amount of foreign aid in 1990 were agriculture, forestry, and fisheries, economic management, and

natural resources and energy. In 1991, foreign aid totaled US\$ 177.343 million, and the three sectors which distributed the largest amount of foreign aid were transport and communication, economic management, and agriculture, forestry, and fisheries. Third, disbursement to the economic management sector was greatly increased under the structural adjustment facility by the IMF, Asian Development Bank and World Bank. Fourth, the share of foreign aid for the agriculture, forestry and fisheries sector decreased greatly from 39.5% in 1986 to 13.7% in 1991. This is due to poor performance of large-scale irrigation projects, most of which failed to operate.



**Table 2**  
**Foreign Aid to Laos**

Sector (1,000 US\$)	84	85	86	87	88	89	90	91	84	85	86	87	88	89	90	91
1. Economic management			30	248	15,007	30,763	32,883	36,439	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)
2. Development administration	2,300	5,117	5,383	9,396	14,521	1,454	1,836	11,527	6.8	12.6	12.2	17.3	11.0	0.9	1.1	6.5
3. Natural resources & Energy	5,793	5,254	8,545	3,301	21,202	22,827	32,571	13,898	17.0	12.9	19.4	6.1	16.1	14.1	18.7	7.8
4. Human resource development	1,197	2,418	2,122	2,757	3,833	24,614	22,600	7,952	3.5	5.9	4.8	5.1	2.9	15.2	13.0	4.5
5. Agriculture, Forestry, Fisheries	11,819	11,577	17,399	18,769	23,415	31,231	33,740	24,324	34.8	28.4	39.5	34.5	17.8	19.2	19.3	13.7
6. Area development			148	293	392	298	2,834	2,337	0.0	0.0	0.3	0.5	0.3	0.2	1.6	1.3
7. Industry	985	1,404	1,774	3,630	6,260	3,481	5,835	3,464	2.9	3.4	4.0	6.7	4.8	2.1	3.3	2.0
8. International & Domestic trade	53	16	45	21	3,104		268	105	0.2	0.0	0.1	0.0	2.4	0.0	0.2	0.1
9. Transport & Communication	3,258	6,881	5,603	7,092	26,418	30,098	28,062	64,529	9.6	16.9	12.7	13.1	20.1	18.6	16.1	36.4
10. Social Development	494	6	185	141	1,016	1,786	5,237	5,218	1.5	0.0	0.4	0.3	0.8	1.1	3.0	2.9
11. Health	4,245	7,132	1,870	2,825	4,929	3,008	5,404	6,336	12.5	17.5	4.2	5.2	3.7	1.9	3.1	3.6
12. Humanitarian Aid and Relief	3,840	949	953	5,865	11,659	12,687	3,244	1,214	11.3	2.3	2.2	10.8	8.8	7.8	1.9	0.7
Total	33,984	40,754	44,057	54,338	131,756	162,247	174,514	177,343	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

**Sources :** United Nation Development Programme, *Report on Development Cooperation. Lao People's Democratic Republic.* (Several issues) 1984, and 1985. United Nation development Programme, *Development Cooperation Lao People's Democratic Republic.* (Several issues) 1986, 1987, 1988, 1989, 1990 and 1991 Reports, Vientiane.



**Table 3**  
**Bilateral Aid to Laos (1982 ~ 91)**

Country (1,000 \$)	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
(1) Capitalist countries										
1. Australia	1782	1949	2291	1934	3607	5015.9	4742	6116	5207	6390
2. Austria	14					n.a.	148			
3. Belgium							17	100		
4. Canada					n.a.			21	n.a.	243
5. Finland									514	487
6. France			n.a.	22	n.a.	61	4160	1373	3299	6951
7. Germany	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	17978	8631	3390	13259
8. India	110	20	40	n.a.	50	53	2			
9. Indonesia						25	n.a.			
10. Italy				50	150	150	1250	1195	1055	561
11. Japan	2963	2998	3895	6950	13691	8977	14475	15845	6934	20871
12. Malaysia						20				
13. Netherlands	8096	2913	968	1806	999	141	n.a.	137	1281	436
14. Norway	50							3	13	579
15. New Zealand		12	11	16	33	10	6	6	17	13
16. Sweden	8400	7570	5049	5776	7477	10135	18082	10535	10733	14909
17. Switzerland		72		78	60	n.a.	112	2915	1840	1789
18. Thailand							6	47	303	214
19. U.K.			7	53	24			76	129	39
20. U.S.A.			2631	5	11	1904	2651	2300	823	1553
(Sub-total of aid value)	21415	15534	14892	16690	26102	26491	63626	49300	35538	68294
(Number of donor countries)	8	8	10	12	13	14	15	15	15	15

Country (1,000 \$)	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
(2) Socialist countries										
1. Bulgaria	161	n.a.	526	n.a.	n.a.	n.a.	n.a.			
2. China										209
3. Cuba	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.			10
4. Czech	400	400	491	n.a.	n.a.		3			
5. German Dem. Rep.	500		15	42	32	60		751	409	
6. Hungary	n.a.	n.a.	10	n.a.	n.a.	n.a.	n.a.	718	659	
7. Mongolia		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.		174	109
8. Russia	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	23021	26321	21143	1240
9. Vietnam	n.a.	n.a.						2400	939	
10. Yugoslavia					60					
(Sub - total)	1061	400	1042	42	92	60	23025	30190	23324	1568
(Number of donor countries)	7	7	7	7	8	6	6	4	5	4
(3) Grand-total of aid value	22476	15934	15934	16732	26194	26551	86651	79490	58862	69862
(4) Total num. of donor	15	15	17	19	21	20	21	19	20	19
(5) Capitalist Countries (%)	95.3	97.5	93.5	99.7	99.6	99.8	73.4	62	60.4	97.8
Socialist Countries (%)	4.7	2.5	6.5	0.3	0.4	0.2	26.6	38	39.6	2.2

**Sources :** United Nation Development Programme, *Report on Development Cooperation. Lao People's Democratic Republic. (Several issues) 1984, and 1985.* United Nation Development Programme, *Development Cooperation Lao People's Democratic Republic. (Several issues) 1986, 1987, 1988, 1989, 1990, and 1991 Report, Vientiane.*

#### 4. Russia's aid in Laos

##### 4.1 Present Situation of Russia's aid in Laos

Russia's aid to Laos was the dominant share after Laos' revolution in 1975. But Russia reduced its aid for Laos to nearly zero in 1992 because of Russia's tight financial situation. Despite Laos needing to repay its accumulated debts to Russia, it did not have enough capital to do so. In order to solve this accumulated debt problem, former acting President Poumy Vonvichit requested postponement of debt repayment until the year 2001 without interest as a rescheduled condition in the letter to Russian President Gorbachov dated on September 21, 1991. As the Russian government consented readily to this request, negotiations were held at the Ministry of Economy, Planning and Finance for about a week beginning January 22, 1992. As a consequence, the two countries agreed that Laos' debts from Russian loans were to be divided into two parts as shown in Table 4 below. It was confirmed that Laos' debts totaled 875 million roubles. Of the 875 million roubles, 800 million roubles are to be returned after the year 2001 with no interest and in kind. The remaining 75 million roubles with no interest have begun to be repaid in kind since 1991 (according to our interview with the Russian Embassy in Laos).

**Table 4**  
**Laos' Debts for Russian Loans**

(Million Roubles)	
Total	875
Repayment after 2001	800
Repayment after 1991	75

Source: Interview with Embassy of Russia in Laos.

In 1991, Laos paid a portion of its debts to Russia by various commodities, such as coffee, tin, timber, etc. which were equivalent to 5 million dollars.

The crucially important problem is how to fix a conversion rate between the Lao currency (kip) and the Russian currency (rouble). The conversion rate accepted in 1991 was 1 US\$ = 0.86 rouble (1 US\$ = about 710 kip). Although Laos had new negotiations to discuss the 1992 debt rescheduling in April 1992 with the Russian government delegation in Vientiane, they broke down because an agreement on the conversion rate which both sides were satisfied with could not be reached. In short, if they agree on a black market rate (which seems to reflect the true effective rate) as a conversion rate, Laos' debts from Russian loans will be reduced over 750 times.<sup>2</sup>

## 4.2 Actual Disbursed Value of Russian aid for Laos

According to our interview with Laos' Ministry of Economy, Planning and Finance, Russian aid for Laos from 1975 to 1991 totals \$ 1.45 billion according to agreements, but the actual disbursed value totals only \$ 760 million, of which half was the contract value. 62% of disbursed Russian aid was loans and the remaining 38% was grants (Table 5).

**Table 5**  
**Russian Aid for Laos in Terms of US Dollars**

(Thousand US\$)

	Contract base		Disbursement base	
	value	%	value	%
Total	1,450,514	100%	760,048	100%
Loans	1,044,910	72%	470,548	62%
Grants	405,600	28%	289,500	38%

Source: Interview with Laos' Economy, Planning and Finance

Main projects of Russian aid for Laos are shown as Table 6. Russia accepted the policy which gave priority to construction of infrastructure such as bridges, National Road No. 9, and a hospital as loan assistance projects. Although its dominant aid project before 1985 was thought to be military aid, the real situation is veiled in mystery. In my opinion, the remarkable grant projects were food aid and acceptance of Lao students and trainees. The former was timely aid which relaxed the rice shortage caused by a prolonged drought. The latter, we shall discuss in the final section.

**Table 6**  
**Main Russian Aid Projects for Laos**

Grants	Loans
1. Studying and training abroad	1. Construction of bridges
2. Construction of a circus pavilion	2. Construction of National Road No. 9
3. Construction of a satellite ground base	3. Construction of a hospital
4. Advanced political school	4. Agricultural Machinery and materials to Cooperative farms
5. Food assistance	5. Civil aircraft
6. Others	6. Military aid
	7. Others

Source: Interview with Embassy of Russia in Laos

### 4.3 Comparative Study of Russian Aid and Western Bilateral and Multilateral Aid

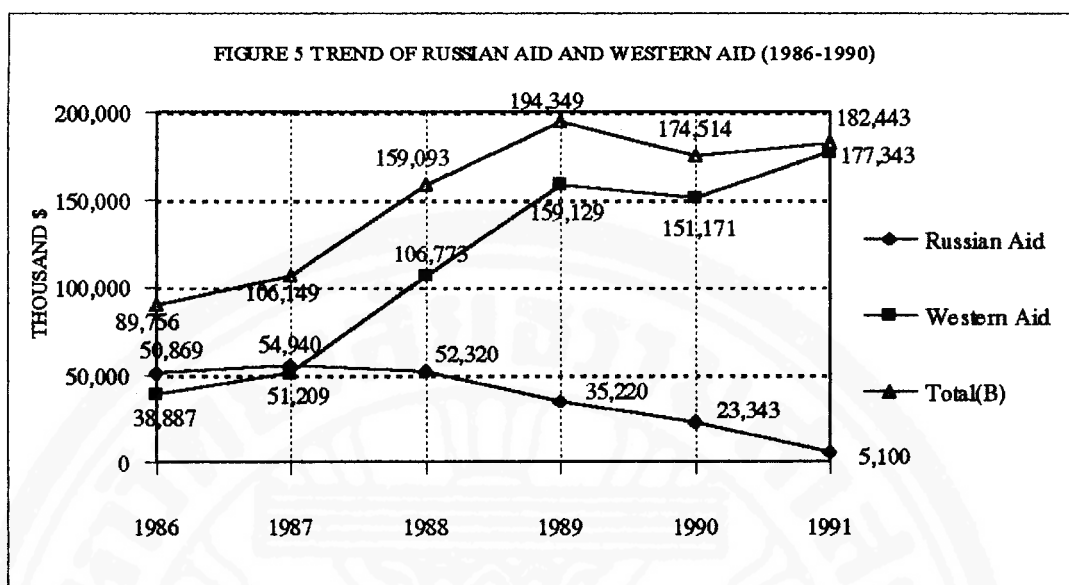
In order to compare Russian aid with Western aid, we must solve the problem of the conversion rate between the Russian rouble and the US dollar. According to the conversion rate of mutual agreement between Russia and Laos, we apply 1 US\$ = 0.76 roubles to the aid disbursed by Russia in 1986, and 1 US dollar = 1.75 rouble to that disbursed after 1987. This is shown in the second column of Table 7. Table 7 and Figure 5 show the declining trend of Russian aid to Laos. Although Russian aid comprised 57% of the total aid in Laos in 1986, it decreased to 3% in 1991 and nearly approaches zero at present. Western bilateral and multilateral aid, on the other hand, increased rapidly after 1988 in order to support the Lao economic reform called the New Economic Mechanism. Therefore, Laos has not been affected by Russian aid reduction from a quantitative point of view, because the increase of western aid compensates the reduction of Russian aid as shown in Figure 5.

**Table 7**  
**Trend of Russian Aid and Western Aid**

	(Thousand US\$)			
	Russian aid (Grants)	Western aid (Bilateral)	Total	% of Russian aid
1986	50,869 (3,800)	38,887 (26,102)	89,756	57%
1987	54,940 (4,400)	51,209 (26,491)	106,149	52%
1988	52,320 (1,500)	106,773 (63,626)	159,093	33%
1989	35,220 (1,700)	159,129 (49,300)	194,349	18%
1990	23,343 (2,200)	151,171 (47,814)	174,514	13%
1991	5,100 (800)	177,343 (69,862)	182,443	3%

Source: Interview with Embassy of Russia in Laos





Sources: Embassy of Russia in Laos. United Nation Development Programme, *Development Cooperation Lao People's Democratic Republic. (Several issues) 1986, 1987, 1988, 1989, 1990 and 1991 Reports, Vientiane.*

## 5. Japan's ODA in Laos

Japan's aid to Laos has been disbursed almost every year since 1966. This is in striking contrast to the other western aid donors which suspended their aid because of the establishment of the socialist nation in 1975.

As Laos is categorized as one of the LLDCs, the Japanese government has basically extended grant aid and technical cooperation to Laos. In FY 1991, Japan's aid totaled ¥ 3,642 million (US\$ 22.44 million), of which grant aid amounted to ¥ 2,964 million (US\$ 15.09 million) and technical cooperation amounted to ¥ 682 million (US\$ 7.35 million). See Table 8, 9 and 10. This amount is merely 2.7% of Japan's aid to Thailand. However, Japan's aid per capita in Laos is \$ 5.42 while that to Thailand is \$ 3.11. Therefore, Japan's aid is more outstanding and appreciated in Laos than in Thailand, because Japan's aid has a dominant share in Laos despite being a small amount. In the case of Laos, Japan's grant aid mainly concentrates on five sectors (1) construction and maintenance of infrastructure, (2) increase of food production (KR II), (3) small scale grant aid, (4) food aid and (5) debt relief assistance (Appendix 1). Concerning construction and the maintenance of infrastructure, the Japanese government carried out the Wattai airport runway extension project in 1969, the Vientiane water supply maintenance project in 1973, the Vientiane urban transportation improvement project in 1989, the project for improvement of the second telecommunication system in 1991, etc.

The Japanese government has introduced a new type of aid called small scale grant aid since 1989. This aims to support relatively small projects that are not suitable for the existing general grant aid. It enables Japan to meet the diversified needs of developing countries by providing its overseas diplomatic missions, which are familiar with socio-economic conditions of posted countries, with the means to respond promptly and appropriately to requests from local governments, research institutes, hospitals, NGOs and other organizations acting in developing countries.<sup>3</sup>

**Table 8**  
**Japan's Bilateral Disbursement in Laos**

(US\$ million)

Calendar year Up to	Grants		Total	Loans		Total
	Grant aid	Technical cooperation		Gross	Net	
1984	48.74	9.97	58.71	18.83	18.18	76.86
1985	7.99	0.17	8.16	0	-0.65	7.51
1986	4.87	1.85	6.72	0	-1.50	5.22
1987	14.80	0.45	15.25	0	-1.21	14.04
1988	11.96	1.78	13.74	0	-2.58	11.16
1989	18.29	2.94	21.22	0	-1.84	19.39
1990	15.48	3.63	19.11	0	-1.75	17.36
1991	15.09	7.35	22.44	0	-1.88	20.56
Total	137.22	28.14	165.35	18.83	6.77	172.12

Source: Japan's Ministry of Foreign Affairs, *Japan's ODA 1991, 2nd volume Countrywide Report, 1992*, in Japanese.

**Table 9**  
**Japan's Loan Aid**

(Hundred Million Yen)

Fiscal year (April - March)		
1974	Nam Ngum Hydro Power Station Construction Project	31.80
1976	Same as above	20.10
Total		51.90

Source: Japan's Ministry of Foreign Affairs, *Japan's ODA 1991, 2nd volume Countrywide Report, 1992*, in Japanese.

**Table 10**  
**Technical Cooperation**

(H.M. ¥ : hundred million yen)

Up to 1990	46.14 H. M. ¥
Acceptance of Trainees	392 person
Dispatch of Technical Experts	172 person
Dispatch of Investigation Delegation	479 person
Dispatch of Japan Overseas Cooperation Volunteers	255 person
Equipment Supply Program	9.30 H.M.¥
Project-type Technical Cooperation	3 cases
Development Studies	10 cases
1991	6.82 H.M.¥
Acceptance of Trainees	37 person
Dispatch of Technical Experts	10 person
Dispatch of Investigation Delegation	98 person
Dispatch of Japan Overseas Cooperation Volunteers	9 person
Equipment Supply Program	0.26 H.M.¥
Project-type Technical Cooperation	0 cases
Development Studies	4 cases
Grand Total	52.96 H.M.¥

Source: Japan's Ministry of Foreign Affairs, *Japan's ODA 1991, 2nd volume Country wise Report, 1992*, in Japanese.

## 6. Future Prospects of Economic Cooperation

It is necessary to make clear the predetermined conditions of Laos in order to project the future coordination of foreign aid.

Geographical features :

- 1) Land-locked topography creates export difficulty because it lacks a sea port.
- 2) A small population means small domestic demand where the secondary industry can not gain a scale of economy.

Industrial features :

- 3) Rain-fed agriculture.
- 4) Dominant primary industry in GDP and labour force
- 5) Secondary industry is still underdeveloped.
- 6) Poor infrastructure prevents national development.

#### **Educational features :**

- 7) Because of a sparse population, education in mountainous areas is relatively inefficient and costly to the government. Therefore, illiteracy is very high.
- 8) Scarce human resources are an indirect obstacle to improving governmental administrative works as well as to promoting private business activity.

#### **Financial and trade features :**

- 9) Financial deficit has expanded rapidly in recent years.
- 10) Trade deficit is so serious that trade balance can never be attained by present amount of primary export goods such as electricity, timber and coffee, while imported products are so numerous.

Given the above predetermined conditions in Laos, it would be efficient to follow a basic strategy for foreign aid as follows.

- 1) Improvement of infrastructure.
- 2) Encouragement of foreign direct investment in Laos to promote private economic activity.
- 3) Spread of education to enable sustainable and long term development.
- 4) Structural adjustment facility to stabilize macro economy.

Suggestions concerning (1), (2) and (3) above are as follows.

#### **6.1 Improvement of Road 13**

Highest priority should be given to improvement of Road 13 which connects the northern part of Laos with the southern part through Vientiane. As stated before, Laos must depend on foreign aid as a financial source to improve infrastructure. In fact, aid donors such as Australia, Sweden, UNDP, ASDB, etc. have been repairing some parts of Road 13 through bilateral or multilateral aid. Unfortunately, as grant aid is a very limited financial resource, it is not suitable for projects such as road construction which require huge capital. Therefore, it is necessary for donors to cooperate in concentrating larger parts of the total aid in Laos on the repair of Road 13.

Lack of a road network causes deterioration of the international competitiveness of Lao's export products. As Laos does not have any sea port, it must use ports in Vietnam or Bangkok Port in Thailand for exports. When Laos uses Da Nang in Vietnam, transportation requires 2 days from Vientiane by truck. Transport requires only 10 hours from Vientiane to Bangkok Port, but the cost is prohibitively expensive. According to a Cabinet decision dated August 13, 1991, the Thai government permitted the establishment of T.L. Enterprise (1991) Co., Ltd. which is a joint venture involving Thai and Lao

capital. Thus the monopoly of Express Transportation Organization (ETO) Co., Ltd. was terminated, and average freight rates were reduced 21.42%. However, rates are still high because of the oligopolistic market. Freight rates for one truck between Vientiane and Bangkok are nearly equal to ship rates between Bangkok and Kobe, Japan. If Road 13 is improved, Da-Nang port will become more attractive as an export port. This will affect the rigid freight rate between Vientiane and Bangkok.

## **6.2 Construction of the Second Mekong Bridge**

Australia is now constructing the Mekong Bridge between Tha Dua in Vientiane and Nong Khai in Thailand under grant aid available through 1994. This bridge has a politically symbolic importance in that it builds the connection between a socialist country, Laos, and a capitalist country, Thailand. If the Second Mekong Bridge is constructed between Savannakhet in Laos and Mukdahan in Thailand, we can expect a large economic impact on these regions. First, this bridge will necessarily encourage trade activities between Laos and Thailand. Second, transit trade between Thailand and Vietnam through Laos will be promoted. Third, this bridge will make some ports in Vietnam more attractive than Bangkok Port, and this will effect not only development in the southern part of Laos, but also in the north-eastern part of Thailand. Vietnamese ports will be used as a substitute for Bangkok ports because of advantages in location (the former is closer to Japan, Korea, Taiwan, etc. in Far East Asia).

## **6.3 Mekong River Development: Nam Theum II Hydro Project**

Domestic demand for electricity in Laos is increasing by 10% annually. Although demand in Thailand as well as Vietnam is increasing it is very difficult to expand domestic supply ability because of location problems such as domestic environmental problems, etc. Cambodian people dream of electrification of the villages.

From the topographical standpoint, Vietnam and Cambodian on the lower basin of the Mekong River form low plains and the Thai north-eastern region in the right bank catchment area forms the undulating Korat plateau. The southwest monsoon brings higher rainfall to the mountains of Laos than other parts of the basin, resulting in a large part of the Mekong River being fed from Laos's left bank catchment area.<sup>4</sup> This means that Laos has an advantage in location in developing the Mekong River.

Laos has inexhaustible water resources, but limited financial resources. World Bank estimates the total cost of this project at about US\$ 500 million. This cost includes the cost of transmission investments necessary to deliver power in Thailand. Following the BOT (Build Operation Transfer) method,



investment companies manage activities from construction of the project to actual operation, and receive a refund from operational revenue. The facilities will be transferred to the state after the investment fund is recovered. Investment risk will be decreased if private companies, international organizations and donor countries cooperate.

Construction of hydro power stations will bring positive results, such as electricity in the neighbourhood, flood control, irrigation in rain-fed fields, and spill-over effects to industrialization, as well as reinforcement of the close cooperation with the neighbouring countries which import electricity from Laos.

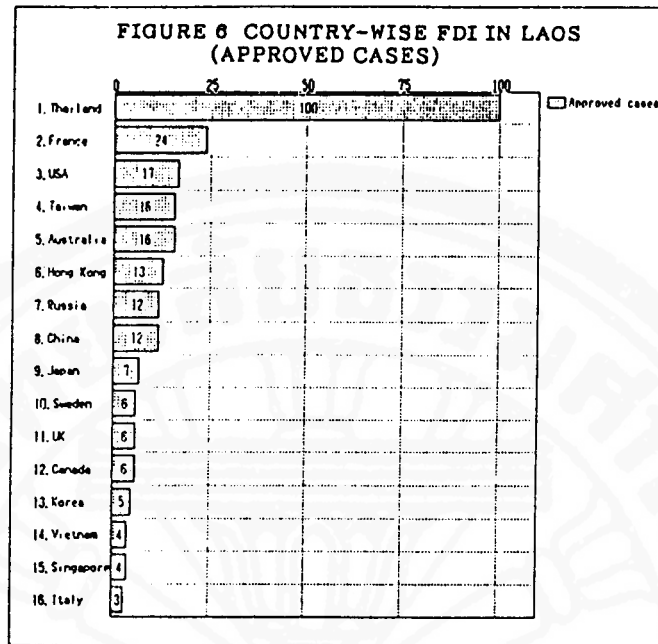
#### **6.4 Encouragement of Foreign Direct Investment Inflow into Laos**

The amount of foreign direct investment (FDI) approved for Laos from September 1988 to October 1992 reached \$ 449 million, in 257 separate investment projects. One hundred of these investment projects came from Thailand, a figure which is almost five times as large as the second biggest investor, France. But the second biggest investor in terms of amount is the USA (\$ 76,954,000, 17%), which has major investments in the mining/petroleum sector. Taiwan, which concentrates on the wood products sector, took the third place, while China, which invested mostly in the manufacturing/handicrafts sector, took fourth place. Surprisingly, Russian private FDI took fifth place, investing mainly in the agricultural sector, contrary to the trend of its aid reduction (Figures 6, 7, 8 and 9).

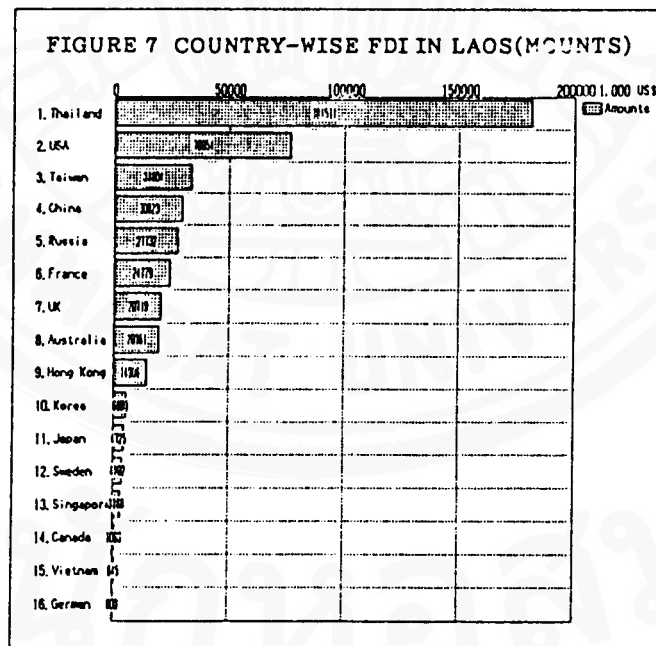
The most popular sector for investors is manufacturing/handicrafts (50 projects). Next place is garment and import/export with 45 instances. However, FDI for the hotel/ tourism sector has the largest monetary amount, followed by mining/petroleum, because investment for these sectors requires much more capital than that for light industries such as the garment industry.

Finally, we shall cover the characteristics of Thai FDI. Most investments into Laos come from medium to small-sized companies in Thailand. This category accounted for 100 separate investment cases worth US\$ 182 million (Figures 10 and 11). In terms of investment cases, Thai FDI contributed 57.1% for the wood product sector, 54% for the manufacturing/handicrafts sector, and 50% for the construction sector. In terms of investment amount, Thai investment occupied about 90% of the hotel/ tourism sector, and 56.3% of the banking/ insurance sector.

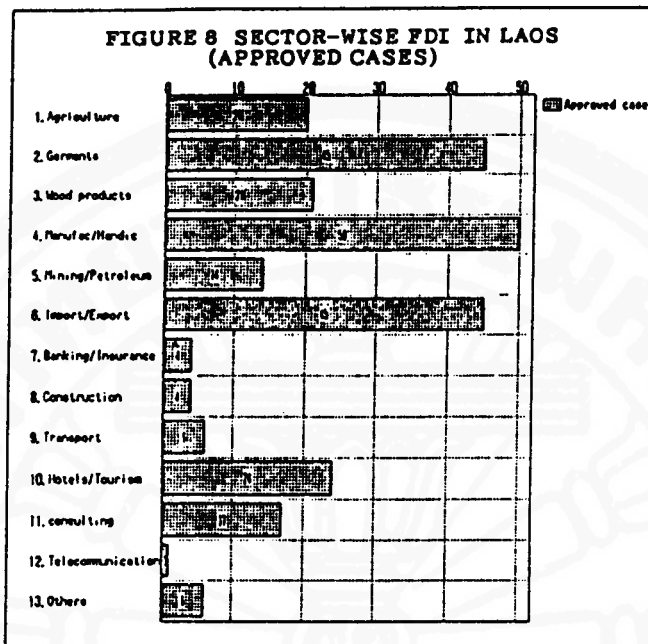
Thailand is a country geographically, culturally, and linguistically similar to Laos. That is to say, Thailand has a comparative advantage in investment in Laos. This means that Thailand has greater potential ability and a special position to encourage Lao economic development as compared with investors from other ASEAN and DC nations.



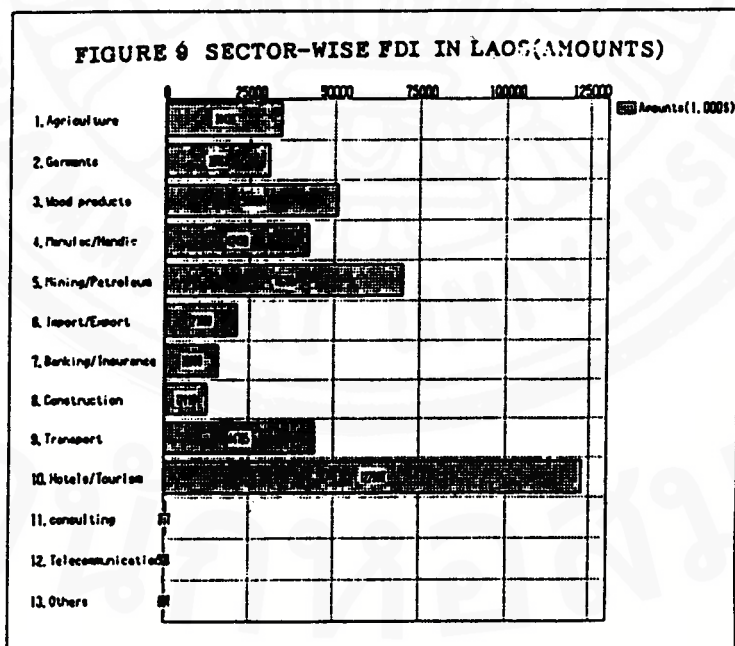
(Source) Laos' Ministry of External Economic Relations



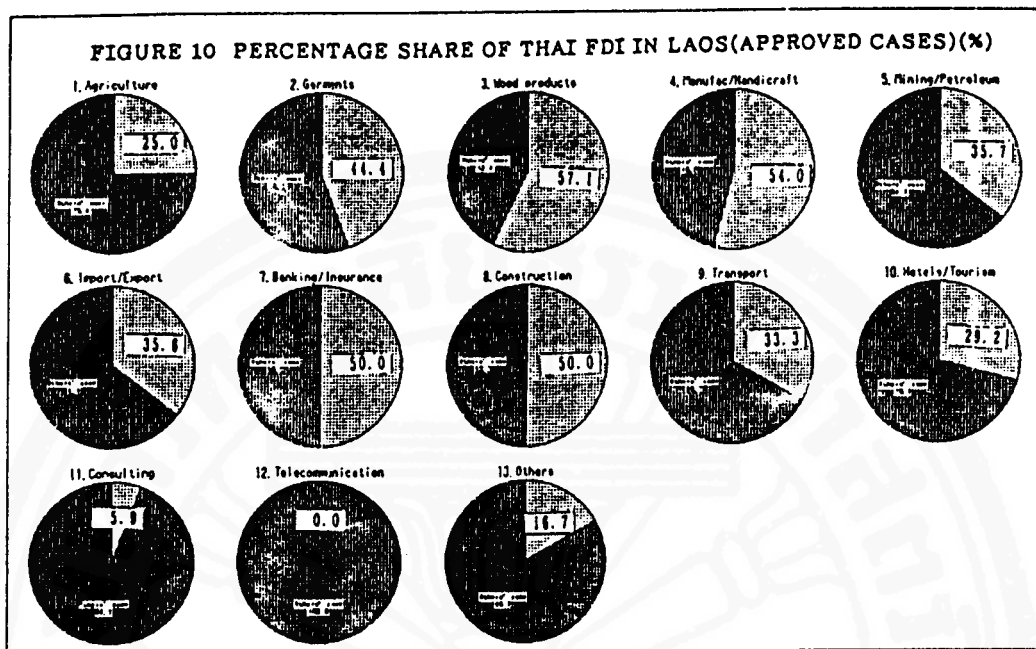
(Source) Same as FIGURE 6.



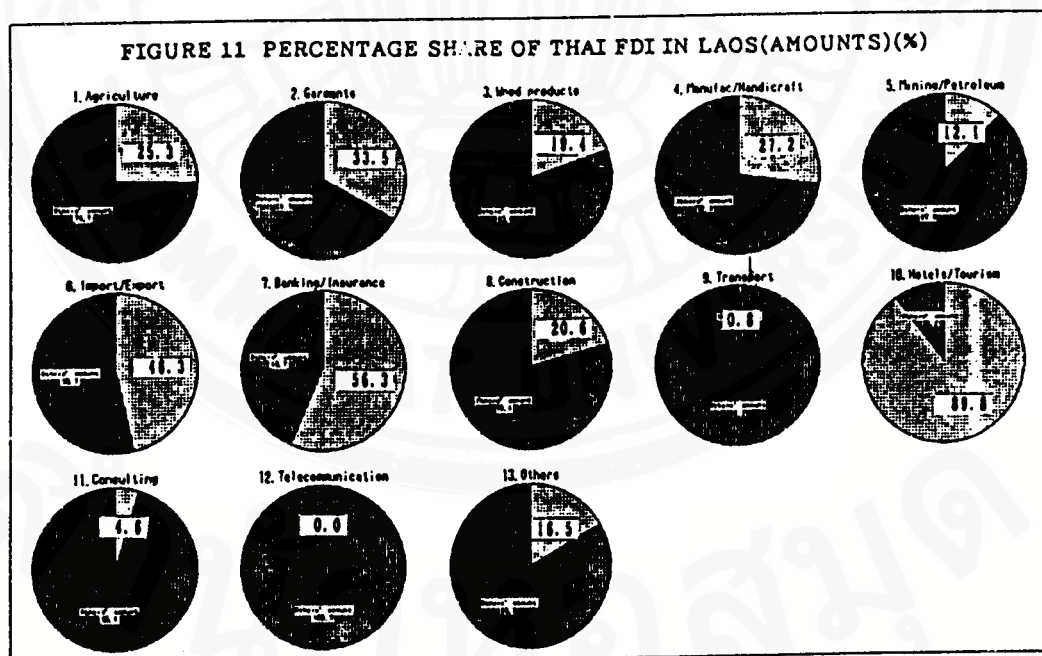
(Source) Same as FIGURE 6.



(Source) Same as FIGURE 6.



(Source) Same as FIGURE 6.



(Source) Same as FIGURE 6.

### 6.5 Education Creating Development in the Long Term

Investment for education will not bear fruit immediately, and it will be difficult for education to reach the people who are scattered throughout the mountainous areas. Nevertheless, education is necessary for Laos' development in the long term.

The main problems of education in Laos are as follows.

- 1) Inadequate quality of teachers.
- 2) Few textbooks written in the Lao language.
- 3) Shortage of experimental equipment in the schools.
- 4) Low wages of teachers.
- 5) Underemployment of students graduating from universities or vocational schools.
- 6) No acceptance of Lao students and trainees by Russia because of aid reduction.

Items 3) and 4) above stem from governmental financial problems. Concerning 1), there are many unqualified teachers in rural areas. Capable people will become teachers only if a higher wage is provided. This too stems from financial problems. One of the most serious problems is textbooks. As professors of certain subjects at Vientiane Teacher's College do not have textbooks written in the Lao language, they use notebooks which they made when they studied abroad in socialist countries. Therefore, lectures given to student are inconsistent, even within the same subject.

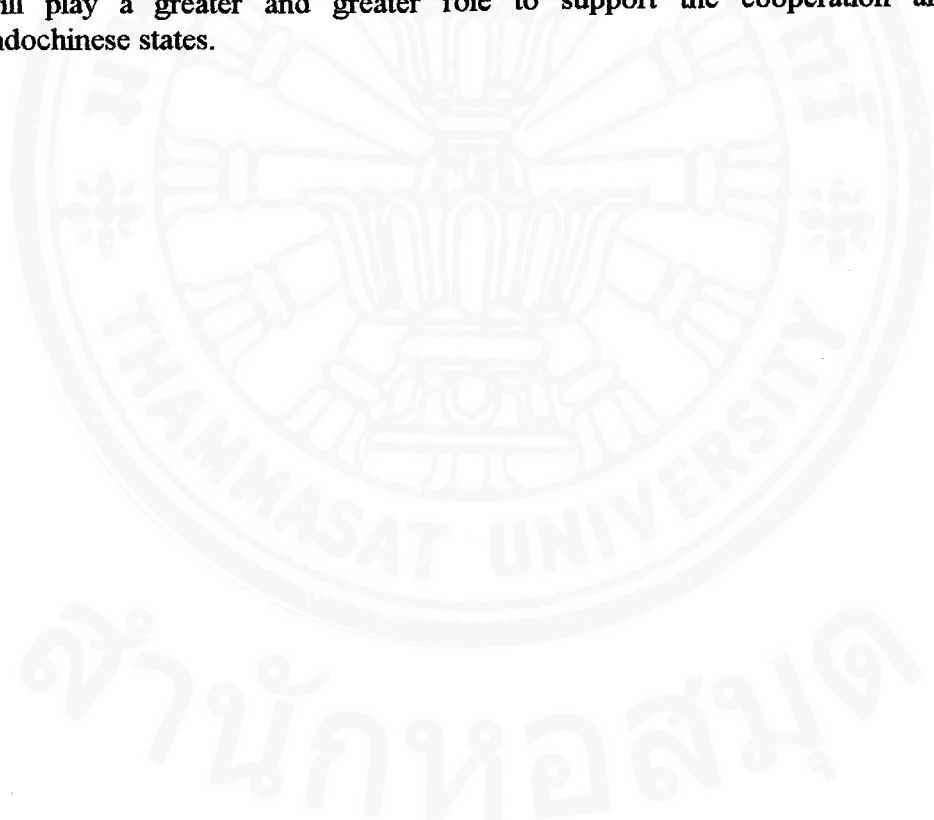
Some textbooks were created by foreign aid. United Nations Volunteers or Japan's Overseas Cooperation Volunteers play a vital role in making textbooks. This task must be taken over by Lao people themselves in the future. Such efforts will provide good incentive to national development.

Although Russia had accepted 2,000 to 4,000 students and trainees in the past, it presently accepts none because of its financial difficulties. This creates a big social problem, because it is impossible to have good access to a higher level of education in Laos. Australia accepted 45 students in 1992. France accepted about 10 students. Japan accepted 5 students and 37 trainees. However, this small number is far from bridging the gap left by the pullout of Russian aid.

As one aid to human resource development, Japan started the "Third-Country Training" under the Trainee Acceptance Programs. Trainees in the field of agriculture or nursery health care need not necessarily come to study in Japan. They can be accepted by a neighboring country of Laos, such as Thailand, which is geographically, culturally, and linguistically similar to Laos, while remaining under the auspices of Japan.



The year 1992 was a politically important year for Laos. In January, President Kaysone Phomvihane officially visited Thailand after accepting an invitation of the Thai King. Also, Prime Minister Kamthai Siphandone visited Thailand in order to solve practical matters in February. If we agree that Thailand is the most important partner for Laos among neighbouring countries, it is very gratifying that both Laos' President and Prime Minister paid official visits. Unfortunately, the world has also witnessed a very lamentable event. President Kaysone died on November 21. The Lao people grieved over the death of the founding hero of their nation. The chairman of the National Assembly, Nouthak Phoumsavanh, became the new Prime Minister.<sup>5</sup> Laos' new era is dawning under their close relationship with Thailand. Laos is the first country with which Thailand has provided foreign aid in its history. Thailand will play a greater and greater role to support the cooperation among Indochinese states.



## Notes

- <sup>1</sup> Motoyoshi Suzuki, "Laos, the Forgotten Shangri-La - Toward a Market Economy", *Tokyo Business Today*, Toyo Keizai Shinposha. Vol. 60, No. 10. October 1992. pp. 58-60.
- <sup>2</sup> According to "Rouble Rapid Depreciation", *Japan's Economic Paper*, March 3, 1993, p.9, the rouble has depreciated rapidly to 1 US\$ = 649 rouble at the Moscow Interbank Currency Exchange (MICE).
- <sup>3</sup> Japan's Ministry of Foreign Affairs, *Japan's ODA 1991*. p. 77.
- <sup>4</sup> United Nation Center for Regional Development (UNCRD), *Newsletter*, No. 11, October 1991.
- <sup>5</sup> Motoyoshi Suzuki, "Present Economic Cooperation and Future Prospect for Laos and Its Neighbouring Countries: Trade, Aid and FDI", Osamu Yamada, Chira Hongladarom and Mya Than, edited, *Vietnam, Laos and Cambodia: The Path to Economic Development*, The Sasakawa Peace Foundation, February 1993.

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- 2 Japan's Ministry of Foreign Affairs, *Japan's ODA 1991*.
- 3 \_\_\_\_\_, *Japan's ODA 1991, 2nd volume Countrywide Report*, 1992, in Japanese.
- 4 Lao Ministry of Economic, Planning, and Finance, *Basic Statistics about the Socio-Economic Development in the Lao P.D.R. for 15 Years*, 1990.
- 5 Motoyoshi Suzuki, Laos, "The Forgotten Shangri-La: Toward a Market Economy", *Tokyo Business Today*, Toyo Keizai Shinposha, Vol. 60, No. 10 October 1992.
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- 7 United Nation Development Programme, *Report on Development Cooperation. Lao People's Democratic Republic. (Several issues) 1981, 1982, 1983, 1984 and 1985, Vientiane.*
- 8 United Nation Development Programme, *Development Cooperation Lao People's Democratic Republic. (Several issues) 1986, 1987, 1988, and 1989 Reports, Vientiane.*

**Appendix 1**  
**Japan's Grant Aid**

(Hundred Million Yen)

1966	Nam Ngum River Development Fund	7.86
1968	Food Assistance (KR I)	1.80
1969	Extension of Wattay Airport Runway	2.50
	Food Assistance (KR I)	2.52
	Food Assistance (KR I)	1.80
1970	Extension of Wattay Airport Runway	1.80
	Construction of a Power Line between Vientiane and Tha Ngon	0.20
	Equipment for Communication Facilities between Vientiane and Nong Khai	0.32
1971	Construction of Taxiway at Wattay Airport	3.60
	Food Assistance (KR I)	3.08
	Equipment for Communication Facilities between Vientiane and Nong Khai	0.07
1972	Construction of Refugee Camp and Land Development	1.42
	Food Assistance (KR I)	1.54
1973	Rehabilitation of Water Supply System in Vientiane	1.50
	Construction of Refugee Camp, etc.	8.00
1974	Vehicles for Malaria Control Project	8.00
1975	Mimeographs for Primary and Junior High Schools in Vientiane	0.14
1976	Construction Machinery for Reconstruction of Road Network Project	3.00
1977	Same as 1976	5.00
1978	Vehicles for Improvement of Transportation Network Project	5.00
	Food Assistance (KR I) (through WEP)	1.20
	Dam Construction Materials	1.00
	Debt Relief Assistance	1.05
1979	Gymnastics Equipment	0.30
	Debt Relief Assistance	1.04
1980	Rehabilitation of Nam Ngum Hydro Power Station	5.50
	Debt Relief Assistance	1.04
1981	Musical Instruments	0.30
	Water Tower Construction in Vientiane	6.00
	Debt Relief Assistance	0.52
1982	Laboratory Equipment	0.30
	Rehabilitation of Water Supply System in Vientiane	6.00
	Debt Relief Assistance	1.40

(Hundred Million Yen)

1983	Pharmaceutical Development Center Construction Project (Phase I)	7.00
	Food Production Increase Assistance (KR II)	2.00
	Debt Relief Assistance	1.04
1984	Pharmaceutical Development Center Construction Project (Phase II)	10.45
	Food Assistance (KR I)	2.00
	Food Production Increase Assistance (KR II)	1.50
	Language Laboratory Equipment	0.26
	Debt Relief Assistance	1.82
1985	Food Production Increase Assistance (KR II)	4.00
	Debt Relief Assistance	2.57
	Project for the Rehabilitation of Substation in Vientiane Area (Phase I)	6.40
	Musical Instruments	0.22
	(Technical Cooperation)	(0.64)
1986	Project for the Rehabilitation of Substation in Vientiane Area (Phase II)	5.13
	Food Production Increase Assistance (KR II)	4.00
	Equipment for Science Education to the University of Dongdok	0.28
	Debt Relief Assistance	3.03
	Project for Tha Ngon Farm Rehabilitation and Rural Development (Phase I)	6.42
	(Technical Cooperation)	(0.84)
1987	Project for Tha Ngon Farm Rehabilitation and Rural Development (Phase II)	5.70
	Project for the Improvement of the Vientiane River Port	3.74
	Debt Relief Assistance	3.47
	Food Production Increase Assistance (KR II)	4.00
	(Technical Cooperation)	(0.51)
1988	Project for the Improvement of the Vientiane River Port	5.28
	Project for the Improving Public Transportation in Vientiane (Phase I)	4.25
	Food Assistance (KR I)	1.00
	Food Production Increase Assistance (KR II)	4.00
	Debt Relief Assistance	3.42
1989	(Technical Cooperation)	(2.55)
	Project to Repair Nam Ngum Dam Power Station (Phase I)	4.87
	Project for the Improving Public Transportation in Vientiane (Phase II)	5.82



(Hundred Million Yen)		
1989	Project to Improve Fire Fighting Equipment	2.50
	Food Assistance (KR I)	1.50
	Food Production Increase Assistance (KR II)	4.00
	Debt Relief Assistance	1.69
	Debt Relief Assistance	1.68
	Equipment and Vaccines to Help Expand and Strengthen the EPI and Polio Eradication Programme	0.72
	Equipment for Preserving Cultural Assets of the National Research Institute of Arts and Literature	0.20
	Small-Scale Grant Aid (3 Projects)	0.11
	(Technical Cooperation)	(3.75)
1990	Agricultural, Rural Development Project in the Suburbs of Vientiane (Phase I)	10.74
	Project to Repair Nam Ngum Dam Power Station (Phase II)	3.96
	Debt Relief Assistance	3.32
	Food Production Increase Assistance (KR II)	4.00
	Provision of Drug Control Equipment	0.05
	Equipment for National Library	0.21
	Small-Scale Grant Aid (4 projects)	0.13
	(Technical Cooperation)	(5.96)
1991	Project for Improvement of the Second Telecommunications System (Phase I)	9.25
	Agricultural, Rural Development Project in the Suburbs of Vientiane (Phase II)	6.88
	Food Production Increase Assistance (KR II)	4.00
	Food Assistance (KR I)	2.00
	Project for the Reconstruction of Lao National TV Station (Phase I)	3.41
	Debt Relief Assistance	2.88
	Debt Relief Assistance	1.62
	Provision of Equipment as a Follow-up for the Public Transportation Project	0.11
	Small-Scale Grant Aid (5 projects)	0.20
	(Technical Cooperation)	(N.A.)
	Total (Excluding Technical Cooperation)	262.65

Source : Embassy of Japan in Laos

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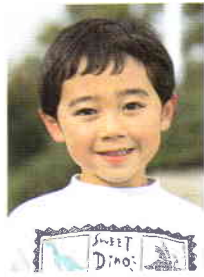
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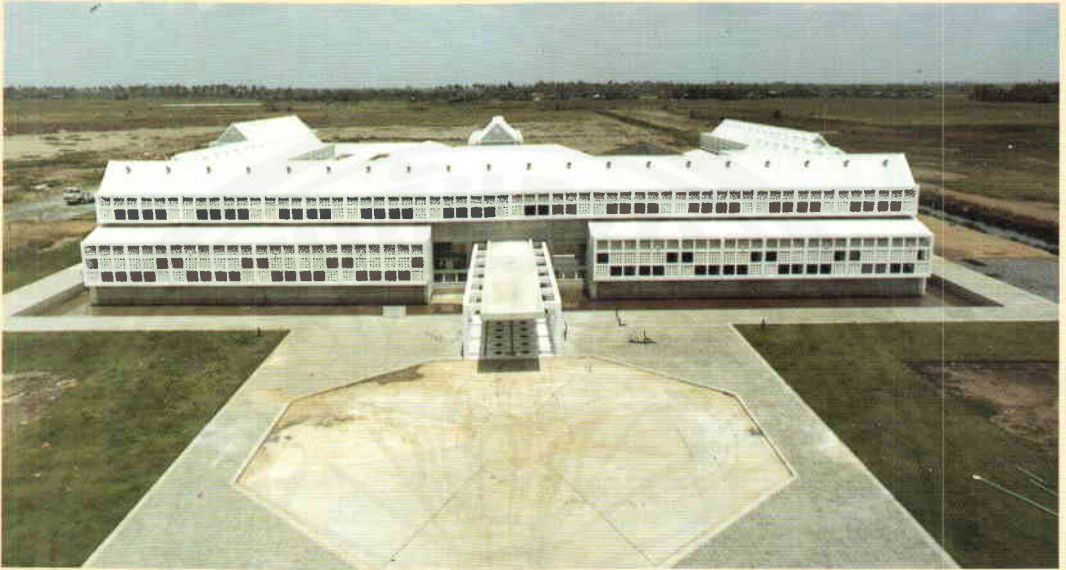


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