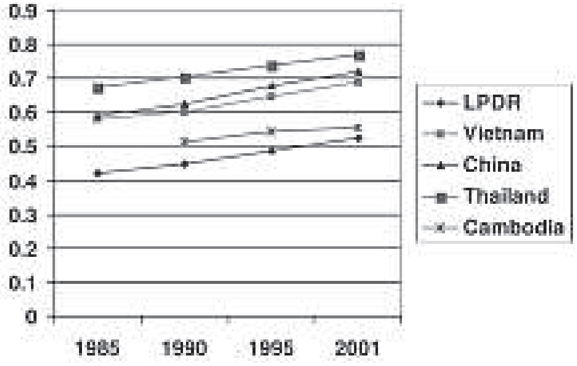
Lao People's Democratic Republic

Andrew Rosser*

1 Introduction
When the leaders of the Pathet Lao, a communist guerrilla force established in Laos in 1950, took power in that country in 1975, the economy was in ruins. Two decades of fighting between royalist and capitalist forces on one side, and communist forces on the other, had resulted in great loss of life and widespread destruction of livelihoods and property. With the Pathet Lao siding with the North Vietnamese communist forces against the Americans during the Vietnam War, Laos became a target of American military action. A massive bombing campaign conducted by the Americans between 1964 and 1973 aimed at cutting off the Ho Chi Minh Trail, a network of paths running through Laos and Vietnam, along which North Vietnamese soldiers and supplies passed, caused massive destruction and displaced almost one-quarter of the Lao population from their homes. At the same time, the end of the War in 1975 led to a massive flight of both capital and people. Vientiane, the capital, had developed a booming economy during the War based on the provision of services to US soldiers. With the end of the War, this activity – and the US aid that had supported it – came to an end. To escape poverty and in some cases persecution, many Lao fled overseas (Thalemann 1997: 89; Stuart-Fox 1986: 99; Economist Intelligence Unit 2004: 7).

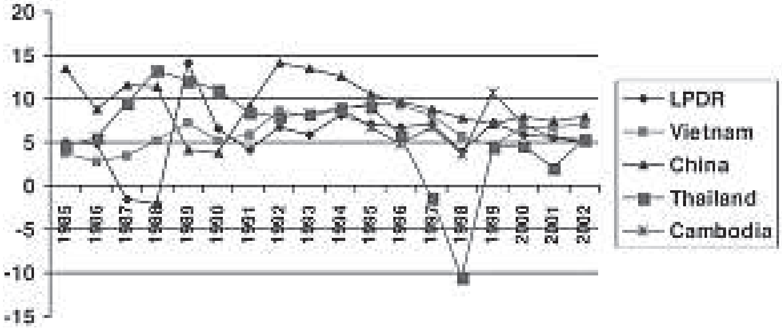
Over the next decade, Laos – or, more precisely, the Lao People's Democratic Republic (LPDR), as the country became known after 1975 – struggled to recover from this state. The communist victory in 1975 brought relative peace and political stability to the country. But peace and political stability did not translate into 'turnaround'. The first few years of communist rule were marked by economic stagnation rather than sustained economic growth. According to International Monetary Fund (IMF) estimates, the country's economy grew by 10 per cent in real terms in 1980 and by a further 6 per cent in 1981. But the country failed to sustain this level of economic growth, experiencing only modest economic growth in 1982 and a severe contraction in 1983 (Stuart-Fox 1986: 106). At the same time, living standards in the LPDR improved little during this period. In 1985, annual *per capita* income was estimated by the government to be US$135, placing the LPDR among the poorest of poor countries. Reflecting this, as well as the country's low health

Figure 1 **Human development in the LPDR and its neighbours**



Source UNDP (2003: 240–3).

Figure 2 **Real economic growth in the LPDR and its neighbours, 1985–2002**



Source World Bank, World Development Indicators CD-Rom.

and literacy standards (Zasloff 1991: 3–4), the country's human development index (HDI) stood at 0.422 in 1985, significantly lower than the HDIs of its neighbours, Vietnam, Thailand and China (Figure 1).

From the mid-1980s onwards, however, the LPDR began to make much more significant progress *vis-à-vis* turnaround. The economy contracted during 1987 and 1988 but bounced back strongly in 1989, growing by over 14 per cent that year. Between 1990 and 1997, the economy continued to grow strongly, achieving at least 6 per cent growth every year except 1992, when it achieved 4 per cent growth and 1993, when it achieved just less than 6 per cent growth (Figure 2). The onset of the Asian economic crisis in 1997–8 brought this period of rapid economic growth to an end. But although growth has been much more modest since 1998, it has still been strong compared with the first decade of communist rule and numerous other low-income countries. At the same time, the country experienced a marked improvement in human development during this period, with its HDI rising from 0.422 in 1985 to 0.525 in 2001. Finally, the country achieved these changes without experiencing severe violent conflict of the sort that had characterised its political history prior to the communist victory in 1975.

The purpose of this article is to explain the LPDR's changing fortunes *vis-à-vis* turnaround since 1975. In doing so, it focuses both on the agency of the country's political leaders and the structural context within which they have been located. It is argued that the country's poor performance on turnaround during the first decade and a half of communist rule reflected, on the one hand, poor economic management on the part of the political leadership and, on the other, various factors related to the country's location in the global political economy. While the decisive victory of the communists in 1975 facilitated the achievement of political stability, these factors worked against strong economic performance. The country's progress between the mid-1980s and 2004, it is argued, reflected changes both in the leadership's approach to economic policy making and in the global political economy as well as the government's continued ability to maintain political control.

I present this analysis in the next three sections. Section 2 examines the reasons for the LPDR's failure to achieve turnaround between 1975 and 1985, Section 3 examines the reasons for the country's progress towards turnaround between 1986 and 2004 and Section 4 presents the conclusions.

2 The political economy of failure to achieve turnaround, 1975–86

The victory of the Pathet Lao in 1975 in the war against US and royalist forces brought relative peace and political stability to Laos. The Pathet Lao's victory was decisive. The end of the war meant the withdrawal of US military forces from the region and an end to very substantial US financial support for the royalist government, in turn dramatically reducing the capacity of royalist elements to resist the communist takeover. At the same time, the Vietnamese government stationed tens of thousands of troops within the country to help the new government with security (Economist Intelligence Unit 2004: 12). Within this context, the leaders of the Pathet Lao were able to establish their political supremacy quickly. Within

Table 1 **Level of violent conflict, 1989–2002**

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Vietnam														
Thailand														
China														
Cambodia	War	Inter	Inter	Inter	Inter	Inter	Inter	Inter	Inter	Inter				
LPDR	Min	Min												
Burundi	Min	Min	Min	Min	Min	Min	Min	Min	Inter	War	Inter	War	War	War

Inter – Intermediate level of conflict; Min – Minor level of conflict; A blank space means little or no violent conflict during that year.
Source Uppsala Conflict Database.

months of entering Vientiane in August 1975, they had forced the abdication of King Savang Vatthana, declared the establishment of the LPDR, named Prince Souphanouvong (the so-called 'Red Prince') as President, and outlawed all political parties other than the Lao People's Revolutionary Party (LPRP), the political arm of the Pathet Lao. At the same time, they also incarcerated tens of thousands of political opponents and sent another 40,000 or so people to re-education camps (Economist Intelligence Unit 2004: 7; Evans 2004). Fearing persecution and lacking any capacity to resist the communist takeover, much of the Lao royal family fled overseas[1] along with thousands of their supporters. With the enemy largely gone and thousands of Vietnamese troops in the country to assist with security, the leadership of the Pathet Lao and LPRP had relatively little difficulty in maintaining relative peace and stability within much of the country.

It was only in those areas of the country populated by the Hmong ethnic group that the country's new leaders were to face continued armed resistance. The Hmong had supported the Americans and the royalist government during the war and continued to oppose the communists after 1975. The Hmong rebels were able to draw on resentment within the LPDR at the exclusion of highland Lao from political power – like the royalist government before it, the LPDR was dominated by lowland Lao. At the same time, they were able to draw recruits from Hmong refugee camps in Thailand and attract finance from Laotian exiles in the US and elsewhere. Although the Thai government did not officially support the Hmong rebels, they also gained assistance from elements within the Thai military stationed along the Lao border. But while this support enabled the Hmong rebels to maintain their insurgency against the communists following 1975, they lacked sufficient support to pose a serious threat to the LPRP, at least outside the highland areas that they inhabited. When they stepped up fighting in 1989–90, they were able to cut parts of the main road between the Plain of Jars and Vietnam and intercept truck convoys on Route 13 but inflict little other damage (Zasloff and Brown 1991: 152–3). With limited resources at their disposal compared with those of the government, they were to prove little more than a periodic irritant.

However, the achievement of relative peace and stability did not translate into sustained high levels of economic growth and human development – and hence 'turnaround' – during the first decade and a half of communist rule for several reasons.

One of these was that the country's new leaders had little experience or ability in economic management, reflecting the fact that they had spent much of the previous few decades fighting guerrilla warfare rather than running the country's economy. Any government would have had difficulty in promoting turnaround in the LPDR in the mid- to late-1970s, given the devastation caused by the War and the extreme poverty of the country. But the policy solutions chosen by the government simply made matters worse (Evans 1991: 97). The victory of the Pathet Lao was accompanied by a massive decline in the value of the kip and runaway inflation due to the withdrawal of US aid and the consequent collapse of the IMF-directed Foreign Exchange Operations Fund, which had hitherto supported the Lao currency. As Stuart-Fox (1986: 98) pointed out, the leadership's response to this situation was completely 'inappropriate'. Wage increases for government officials and large subsidies to state-owned firms generated a massive budget deficit and the printing of money to fund this deficit fuelled the inflationary spiral. Attempts to plug the budget deficit by raising revenue through the introduction of a progressive taxation system in the agricultural sector did little to raise government revenues and contributed to a fall in rice production as large numbers of peasant farmers found ways to evade the new tax charges and others cut rice production to reduce their tax liability (Stuart-Fox 1986: 99; Thalemann 1997: 89).

The leadership's over-zealous commitment to economic reconstruction along Stalinist lines, at least during the immediate postwar period, further contributed to the country's problems. The leadership had been heavily influenced by Stalinist economic ideas prior to coming to power, reflecting the dominance of these ideas within the global communist movement during this period. At the same time, the LPDR was dependent on the Soviet Union and Vietnam (the country's main donors during the late 1970s) for financial and military resources following the war, and Vietnam stationed thousands of soldiers in the country to help the LPRP maintain internal security – as well as the close personal ties between the Lao and Vietnamese leaderships which provided further impetus for Stalinist reform. The Soviet Union and Vietnam actively encouraged Stalinist reform in the LPDR and provided large numbers of economic advisers to the Lao government to assist with the reconstruction process. While it would be an exaggeration to describe the LPDR's relationship to the Soviet Union and Vietnam as one of total subordination of the former to the latter, it is nevertheless clear that the latter – and particularly Vietnam – exercised enormous influence over the former during the late 1970s (Gunn 1980; Brown and Zasloff 1978: 205–6). The result, as General Secretary Kaysone Phomvihan admitted in late 1979, was that the government pursued an overly centralised model of socialism. The defining feature of a Stalinist economy is direct government regulation of all major economic variables – investment, consumption, savings, exports, imports, etc. – according to a centrally formulated plan (Evans 1991: 84–5, 97). Accordingly, in its first year of power, the Lao leadership nationalised most of the LPDR's industrial and service sector firms (including the entire banking system) and initiated a programme of agricultural collectivisation (Bourdet 2000: 14).

These measures proved disastrous, both economically and politically. The nationalisation programme created a range of enterprises that operated more like government departments than commercial enterprises. Managers were required to follow directions from above rather than commercial imperatives, were given little control over production decisions or the flow of funds to and from their enterprises, and were required to focus on achieving specified physical targets rather than financial ones (Evans 1991: 84–5). By the late 1970s, most state-owned enterprises were being kept in business only because the government instructed state-owned banks to continue lending to them despite their inability to repay their loans. This, in turn, contributed to a blow-out in the government's budget deficit and high levels of inflation during this period. The government's attempts to collectivise agriculture proved equally disastrous. Farmers resisted attempts to impose collective control over their land, animals and equipment, resulting in lost production and fuelling support for anti-government resistance groups in the countryside (Stuart-Fox 1986: 98–100; Bourdet 2000: 14). While it is unlikely that the government would have fallen as a result of this resistance – its tenure was more or less guaranteed by the presence of Vietnamese troops – the resistance no doubt contributed, along with the continuing exodus of Lao across the border to Thailand, to undermine the legitimacy of the new government, particularly among the Lao peasantry, the class whose interests it purported to represent.

In any event, the economic and political problems caused by these policies, as well as a backing away from Stalinist economic policies in Vietnam, provoked a serious rethinking within the leadership about the government's economic strategy (Joiner 1988: 95). In the Seventh Resolution of the LPRP's Central Committee in 1979, the government acknowledged that it had made some serious errors in managing the economy and that a change of strategy was required. Most remarkably, it argued, as Stuart-Fox (1986: 100) has noted, that it needed 'to take account, in the current stage of the nation's economic development, of capitalist as well as socialist economic laws in order to promote economic growth'. In accordance with this view, the government introduced a series of economic policy reforms over the next few years, the most important of which were the suspension and then abolition of the collectivisation programme in favour of land distribution to family farming (Zasloff and Brown 1991: 147) and the introduction of a large package of policy reforms in 1979. This package included the lifting of restrictions on private participation in business activities; the bringing of government procurement and retail prices in line with local black market prices; the devaluation of the kip by 60 per cent against the US dollar; and changes to the system of agricultural taxation designed to create an incentive for farmers to increase production. Combined together these policy changes rehabilitated the role of individual entrepreneurship within the Lao economy and marked a shift in economic strategy towards what Kaysone labelled 'state capitalism' (Thalemann 1997: 91). While this shift in policy was undoubtedly significant – not least insofar as it paved the way for a more substantial programme of liberal economic reform in the 1980s – it has been argued that the leadership saw the reforms as 'temporary expedients until the conditions are ripe for the construction of a true socialist economy' (Bedlington 1980: 111).

The introduction of these reforms led to an improvement in the country's economic performance during the early to mid-1980s. Within a year or so of the introduction of the 1979 package of reforms, rice production had risen above the one million tonne mark for the first time; livestock and forestry production had increased; urban markets had been revived; and exports had increased, in part due to a sharp rise in hydroelectricity sales (Stuart-Fox 1986: 101–2). As noted above, the two years immediately following the 1979 reforms also witnessed a dramatic (if short-lived) spurt in economic growth. But the reforms introduced in 1979 failed to produce turnaround during this period, in large part because of continued government mismanagement of the economy. A particular problem in this respect was the government's inability to maintain control over the budget deficit, reflecting financial problems at state-owned banks stemming from so-called 'policy lending' to the state enterprise sector, burgeoning levels of foreign debt stemming from the country's dependence on foreign assistance, and a lack of political will on the part of the leadership to address either of these problems. Notwithstanding the changes wrought by the reforms of this period and the country's improved economic performance during the early to mid-1980s, compared with the first few years of communist rule, then, the country was still widely regarded as something of a basket case in the late 1980s (Zasloff 1991).

However, the LPDR's failure to achieve turnaround between 1975 and 1986 was not solely the result of poor economic management on the part of the country's leadership. It also reflected the country's location within the global political economy and the disadvantages that this brought. There were three disadvantages in particular. First, as an economy based largely on subsistence agriculture, the LPDR gained little from the commodity price booms of the mid- to late 1970s. The problem for the LPDR was not so much a lack of natural resource wealth – it is endowed with a wide range of natural resources including tin, lead, gold, iron ore, gypsum, gravel, salt, forests and an extensive river network (giving it great potential as a source of hydroelectrical power) (Economist Intelligence Unit 2004: 16) – as a lack of the basic transport and communications infrastructure required to successfully exploit this wealth. While other Southeast Asian countries received substantial windfalls from the oil, forestry and mineral price booms of the 1970s, therefore, the LPDR went without. In fact, insofar as the country experienced economic shocks during this period, they were entirely negative. Between 1975 and 1989, it experienced several droughts, all of which had a severe impact on its level of agricultural production (UNDP 1991: 76; Stuart-Fox 1986: 99).

Second, the country's alignment with the Soviet bloc meant that it did not receive many of the same economic opportunities as other Southeast Asian countries that were aligned with the USA during this period. Fear within the USA and other Western countries that communism would spread domino-like throughout Southeast Asia led to a series of initiatives by the US and other Western governments aimed at promoting successful capitalist development in many Southeast Asian countries. With the LPDR representing a domino that had already fallen, it did not benefit from these initiatives. Indeed, as noted above, the victory of the Pathet Lao was greeted with the withdrawal of US and other Western aid. It was also met with the introduction of an economic blockade by US-aligned Thailand, a move that contributed significantly to the economic instability that Laos experienced in the mid-1970s. The LPDR's receipt of aid and access to markets from the Soviet Union and Vietnam (Zasloff 1991: 16–19) partly compensated for the cessation of US and other Western assistance. But these states had fewer resources, smaller markets, and therefore much less capacity to support economic development in the LPDR than their Cold War opponents. At the same time, for ideological reasons, they actively encouraged the LPDR to pursue the Stalinist economic restructuring agenda that proved so disastrous during the early years of communist rule.

Third, the LPDR's alignment with the Soviet bloc contributed to a dramatic reduction in the country's human resources in the 1970s. As noted above, the victory of the Pathet Lao precipitated the exodus of thousands of people, many of whom sought to escape persecution for siding with royalist forces during the War. Among those fleeing were many members of the country's educated middle class who between them accounted for most of the country's technical and managerial expertise and much of its stock of private capital. Their exodus thus dramatically reduced the country's ability to administer the economy in a technically proficient manner and to mobilise domestic resources for investment. The country's alignment with the Soviet Union and Vietnam also added tension to its relationship with China, particularly as a result of the conflict in Cambodia, in turn limiting the potential for Chinese economic assistance.

Before moving on to the next section, it is necessary to make two further points about the role of foreign donors in the LPDR's development during this period. First, while the Soviet Union and Vietnam may have exerted greater influence over Laos' economic policies between the mid-1970s and 1986 than other donors, those Western donors that remained engaged with the country after 1975 did exert significant influence at key times. The World Bank, for instance, was instrumental in persuading the government to shift away from its Stalinist economic strategy towards a more conservative strategy in the late 1970s: as Stuart-Fox (1986: 100) has noted, the rethinking of economic policy within the leadership that led to the introduction of the 1979 package of reforms was provoked in part by the release of a critical World Bank report on the Lao economy in November 1978. Some bilateral donors, most notably Australia, also contributed to the process of market-oriented economic reform in the LPDR during this period through their technical assistance programmes (Zasloff 1991: 20; Cornford 1999).

Second, whatever the role of the Soviet Union and Vietnam in encouraging the Lao government to pursue its disastrous Stalinist economic restructuring strategy during the mid- to late 1970s, these countries were crucial in ensuring the survival of the government after 1975 and thereby preventing the country's disintegration. As Stuart-Fox (1986: 105) has pointed out, successive governments in Laos/LPDR have had difficulty in balancing their budgets since the early years of the French administration and have had to rely on fund transfers of one kind or another from foreign powers to cover budget deficits. The withdrawal of US and other Western aid in 1975 left a massive hole in the government's budget (Thalemann 1997: 89), one that probably would have made it impossible for the state to survive had it not been for new Soviet Union and Vietnamese aid. Certainly, the government would not have been able to fund capital expenditure during this period, given that this was funded largely out of its aid receipts (Lam 1997: 280). At the same time, the Soviet Union and Vietnam continued to support the Lao government financially and politically through the 1980s, despite its partial embrace of capitalism. Indeed, the Vietnamese government appears to have encouraged the Lao government's shift in economic strategy, given that it was undergoing a similar reappraisal of its economic policies at this time. The few Western donors that remained engaged in the LPDR after 1975 – Japan, Sweden and Australia, were the most important – also played a significant role in ensuring the government's survival through their aid programmes and thereby preventing the country's disintegration.

3 The political economy of progress towards turnaround, 1986–2004

Beginning in the mid-1980s, the LPDR finally began to make significant progress in turnaround. As noted above, the period between 1985 and 2004 was one of relatively strong economic growth, marked improvement in human development and a relative absence of violent conflict. It was also a period of significant reduction in poverty, with the proportion of people living below the poverty line falling from 46 per cent in 1992 to 33 per cent in 2003 (World

Table 2 **LPDR: foreign direct investment inflows by sector, 1988–99 (US$ millions pledged)**

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999*
Agriculture	–	–	0.4	9.8	15.7	16.9	6.8	5.1	1.9	6.3	7.9	62.0
Garments and textiles	–	–	9.3	6.6	13.2	13.6	12.3	13.1	2.7	2.6	5.0	0.9
Wood-based industry	–	22.0	2.8	34.5	6.8	22.4	0.6	12.0	2.1	2.5	–	
Other manufacturing	–	72.4	10.5	22.3	59.6	18.0	46.0	320.1	13.4	–	4.9	
Mining and petroleum	–	23	29.5	5.1	200.2	18.0	9.6	27.1	–	14.0	8.3	4.7
Trade	2	7	2.1	23.8	2.7	6.9	8.9	0.4	7.9	5.0	1.0	2.6
Hotels and tourism	–	–	7.0	95.8	6.6	4.8	279.3	0.3	211.7	0.5	1.8	–
Energy	–	–	0	1398.9	0	191.7	2146.0	498.4	231.8	–	–	–
Others	–	29	5.3	3.3	33.3	36.5	30.1	24.0	504.4	18.5	96.0	19.0

*First 10 months of 1999.
Source Freeman (2001a: 107).

Bank 2005: i). Although the LPDR was not classified as a 'miracle' economy in the World Bank's influential 1993 report on East Asia's economic success (World Bank 1993), its progress towards turnaround during this period – or more specifically between the mid-1980s and 1997 – was sufficiently impressive for the Assistant Director of the IMF's Asia and Pacific Department to suggest in 1997 that it had achieved 'take-off'. In contrast to many other transition economies, he argued, the LPDR (and the other Southeast Asian transition states, Vietnam and Cambodia) had been able to avoid a 'Soviet-style output collapse in their transition to a market-based system', achieve macroeconomic stability and sustain high levels of growth (Dodsworth 1997).

In explaining the country's progress towards turnaround during this period – and, in particular, its strong economic growth and improved human development – economists have emphasised the shift in economic policies that occurred at this time (Dodsworth 1997; Bourdet 2000; UNDP 2004). Beginning in 1986, the government introduced a wide-ranging programme of economic reforms that reduced state control over the economy and increased the role of market forces. Known as the 'New Economic Mechanism' (NEM), this programme involved three phases of reform. In the first phase – between 1986 and 1989 – it involved measures to liberalise prices and trade, encourage state-owned enterprises to operate more like commercial enterprises, promote the role of private enterprise in the economy, reform the taxation system, and liberalise the foreign investment regime (UNDP 1991: 76–9; UNDP 2004: 6–8; Economist Intelligence Unit 2004: 21).[2] In the second phase – between 1990 and 1991 – it focused on the introduction of monetary and fiscal reforms such as the imposition of restrictions on government and state-owned enterprise borrowing, the introduction of high-interest treasury certificates and bank deposits to absorb excess liquidity and promote savings, and attempts to rein in government spending. In the third phase – from 1991 onwards – the NEM focused on the introduction of structural economic reforms. The most important of these were a privatisation campaign aimed at selling off all state-owned enterprises except for those deemed strategic; measures to create a two-tier banking system in which the central bank and the commercial banks had well-defined and separate functions; the recapitalisation of the banking system; a revised foreign investment law that permitted 100 per cent foreign ownership of business ventures (UNDP 2004: 8–10; Economist Intelligence Unit 2004: 21).

Economists suggest that these reforms facilitated the process of turnaround and in particular, higher rates of economic growth and improved human development in two ways: by stabilising the economy and stimulating foreign investment. During the mid- to late 1980s, the LPDR experienced high levels of inflation, partly as a result of the government's continued reliance on bank finance and the printing of money to cover budget deficits and fund state-owned enterprises and partly because of the liberalisation of wages and prices in the first phase of the NEM. The monetary and fiscal reforms introduced in the second phase of the NEM and the taxation reforms introduced during the first phase served to address this situation by producing a sharp fall in the government's budget deficit. Between 1989 and 1993, the budget deficit fell from 12 per cent of gross domestic product (GDP) to 4 per cent (UNDP 2004: 8). At the same time, the liberalisation of the foreign investment regime led to a sharp increase in foreign direct investment (FDI), particularly from Thailand (Than and Tan 1997: 19). In large part this was because of a small number of large investments in the energy industry, although new investments in manufacturing, mining, and hotels and tourism also contributed to the increase (Table 2). Whereas FDI had stood at 0.7 per cent of GDP in 1991, it had risen to 5 per cent of GDP by 1994/5 (UNDP 2004: 5). Although it then fell sharply during the Asian crisis, mainly as a result of the contraction of the Thai economy caused by the crisis, it has recovered somewhat since, illustrating for some economists the merits of these and more recent reforms in this area (ADB 2004: 79, 81). The higher rates of economic growth generated by stabilisation and increased investment in turn contributed to improved human development. The improvement in human development does not appear to have stemmed from changes in government spending priorities – indeed, government spending on education and health fell dramatically in the early to mid-1990s (Bourdet 2000: 89). As such, it would seem that the improvement in human development was driven largely by increased material prosperity brought about by growth.

One cannot deny that the introduction of the NEM was crucial in promoting the LPDR's progress towards turnaround during this period. Yet to fully understand this progress, we also need to understand why the government adopted and implemented these policies. In this respect, economists' accounts are not especially helpful – as noted above, they have generally focused on the policy choices that contributed to progress towards turnaround rather than the dynamics shaping those choices. And insofar as they have tried to explain these choices, they have focused on the agency of the country's leadership. Bourdet (2000: 2), for instance, has suggested that the introduction of the NEM reflected a realisation on the part of LPDR's leaders that the state-centred economic policies that they had pursued since 1975 had failed. '[B]ad economic results between 1975 and 1986', he argues 'convinced the Lao leaders of the necessity of economic reforms'. Doubtless, the country's leaders changed their minds about the merits of the government's state-centred economic strategy prior to the mid-1980s. Yet this rethinking arguably reflected political as much as economic considerations.

As Zasloff and Brown (1991: 147) have pointed out, 'shifting external forces' over which the government had no control played a significant role in persuading the government to introduce the NEM. 'The arrival, in 1985, of Mikhail Gorbachev as prime mover in the USSR', they point out, 'led to prudent Soviet retrenchment in economic support of communist regimes abroad, as well as political restructuring and liberalisation at home'. This in turn forced the LPDR to seek greater economic assistance from countries outside the Soviet bloc. As Table 3 illustrates, the late 1980s saw a marked shift in the sources of official development assistance (ODA) to the LPDR, with Soviet bloc countries discontinuing their aid programmes and the World Bank and the Asian Development Bank, among the multilaterals, and Japan and Sweden, among the bilaterals, significantly increasing their respective aid programmes. The LPDR's aid dependence increased markedly between the mid-1980s and the early 2000s, rising from around 6 per cent to around 16 per cent of GDP (Lintner 2001: 51). Western governments were to use their newfound structural leverage over the Lao government to promote a shift away from state economic control and towards the development of a more market-based economic system (Cornford 1999; Zasloff 1991: 19–20).

At the same time, sensing that change was in the wind in Indochina, the Thai government switched boldly in 1988 from 'military confrontation at several disputed border points to free-wheeling commerce with its former Lao and Vietnamese antagonists' (Zasloff and Brown 1991: 147). This opened up greater opportunities for economic cooperation between the two countries. Within two years, the LPDR and Thailand had reached agreement that a new bridge should be constructed across the Mekong; that cooperation in areas such as trade, banking, cross-

Table 3 **LPDR: Sources of official development assistance (commitment basis, US$ millions)**

	Annual average		
	1981–5	**1990**	**1995**
Bilateral	102.5	54.1	174.4
CMEA/CEEC*	86.6	–	–
Japan	3.8	20.8	89.3
Sweden	8.5	15.6	13.3
Australia	2.6	3.5	26.1
Germany	0.2	5.0	18.2
France	0.2	3.4	11.9
Others	0.6	8.9	15.6
Multilateral†	22.1	78.0	151.9
ADB	5.1	17.9	89.4
IDA	4.3	15.0	19.2
UN	9.5	18.1	15.0
Others	3.2	27.0	28.3
Total assistance	**124.6**	**132.1**	**326.3**

*Council for Mutual Economic Assistance/Central and Eastern European Countries.
†Asian Development Bank, International Development Association of the World Bank and United Nations agencies.
Sources Lam (1997: 282) and OECD, *Geographical Distribution of Aid Flows to Developing Countries*, Statistical Database.

border taxation and agriculture should be deepened; and that money transfers between the two countries should be made in Thai baht rather than US dollars. At the same time, Thailand agreed, at the LPDR's request, to lift a 14-year ban on the export to Laos of 29 'strategic' goods (Gunn 1990: 85–6). Combined with the structural pressure for reform stemming from increased dependence on the West for aid and donors' encouragement of reform, the growing economic opportunities with Thailand left the Lao government with little choice but to move away from state control towards more open, market-based policies.

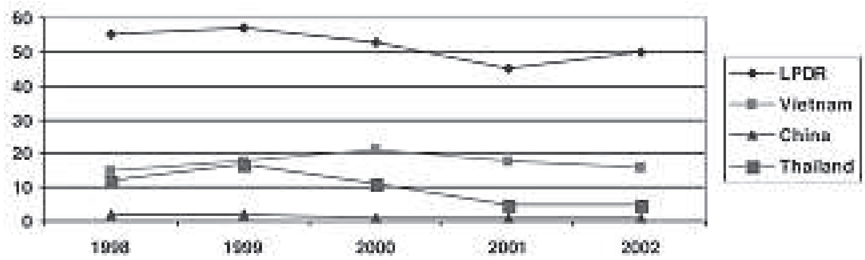
The process of reform was also facilitated by clever management of the politics surrounding reform. In contrast to their earlier attempts to promote Stalinist reconstruction in the late 1970s, the Lao leadership successfully structured the reforms in such a way as to minimise political opposition to reform. While the introduction of the NEM may have sparked a mini economic boom, and thereby contributed to an overall increase in the LPDR's economic welfare, it entailed potentially significant costs for a number of groups, particularly influential groups within the elite. The privatisation programme, for instance, posed a threat to the senior party and military officials who were in charge of state-owned enterprises insofar as it threatened to reduce their control over these enterprises. Greater fiscal rectitude and financial sector liberalisation also posed a threat to this group by potentially limiting their access to a key source of funding – state bank loans. State bureaucrats also stood to lose from greater fiscal rectitude insofar as it reduced the ability of the government to increase their wages in line with inflation, especially when inflationary pressures were high. Recognising these political constraints, the LPDR's leaders built into the reform process a series of strategic concessions to these groups. For instance, while the privatisation programme resulted in the sale of all but roughly 50 state-owned enterprises by the late 1990s, many of these enterprises were divested through leasing arrangements and management buy-outs, leaving ownership and control ultimately in the hands of state enterprise managers (Freeman 2003: 39–40). At the same time, the military was compensated for any potential losses it suffered as a result of the reform process by being granted new timber contracts and trading rights (Bourdet 2000: 2–3). Finally, the government continued 'policy lending' to state-owned enterprises and introduced wage rises for government officials at key points, despite the effect of these measures on the budget.

This unwillingness to allow the reform process to undermine support for the regime among elite groups became particularly apparent following the onset of the Asian crisis. As Freeman (2001b: 8) has pointed out, the Asian crisis strengthened the hand of those elements within the Lao government that had misgivings about the speed and depth of reform by illustrating the potential perils of integration into the global economy: 'It became almost accepted wisdom that, had it not been for delays in liberalising various elements of the economy (such as foreign exchange and the finance sector), the impact of the Asian crisis would have been much harder'. Underlying this view, as Stuart-Fox (2004: 26) has pointed out, was a fear that further economic shocks of the magnitude of the Asian crisis could open the way for radical political reform and, in particular, the overthrow of the LPRP's political monopoly. The result was a general slowing down of the reform process, a return to increased state control in some areas, and a greater unwillingness on the part of the government to maintain fiscal discipline. The economic cost of this was renewed macroeconomic instability: the late 1990s/early 2000s saw a return to relatively high rates of inflation (Lintner 2000; UNDP 2004; World Bank 2004b: 1). Yet, arguably, these economic costs have ensured the political sustainability of the reform process in the LPDR in the medium to long term by reducing potential opposition to this process from key groups within the elite.

On the security/conflict side, the LPDR's progress towards turnaround during this period was facilitated by two factors. The first of these, the successful management of the politics of reform and the implications of this for the country's political stability, has just been discussed. The second is the fact that the Hmong rebels remained weak and, if anything, became weaker during this period. The post-Cold War era saw a gradual thawing of relations between the USA and the LPDR. By late 2004, the two countries had increased cooperation in the areas of drug control, bomb disposal and the search for missing US servicemen and moved to improve economic relations by signing a bilateral trade accord and normalising trade relations, although the USA's refusal to increase aid remained a point of tension. With their erstwhile chief ally becoming more favourably disposed to the Lao government, the Hmong rebels have lost much of their external support. This in turn has reduced their capacity to oppose the government through armed resistance. Hmong rebels are suspected of being involved in a number of violent attacks on vehicles travelling in remote areas and may have been behind a series of bombings in Vientiane in 2000 (Economist Intelligence Unit 2004: 13; Thalemann 1997: 85; Stuart-Fox 2004: 32). But such actions are more an irritant to the communist leadership than a serious threat to its continued hold on power.

The role of donors in the LPDR's development during this period had several dimensions. First, as noted above, donors continued to underwrite the survival of the Lao state through the provision of financial assistance, although it was Western donors (and in particular multilateral donors) rather than ones from the former Soviet bloc that played the dominant role during this period in this respect. Second, as also noted above, donors were a key source of pressure for market-oriented reform. Their role in this respect extended beyond the introduction of reforms under the NEM to the management of the country's recovery from the Asian crisis. The Lao government has been a reluctant reformer, generally doing 'just enough to keep foreign donors engaged, and pumping in soft money, without really taking ownership of, or driving forward the economic reform and business liberalisation process' (Freeman 2004). As the Lao government began to back-track on reforms in the late 1990s, donors became increasingly critical of the government's economic management, with one donor representative even suggesting in early 2000 that there was 'a need for donors to meet separately among themselves and decide what measures to be taken and draw conclusions' (as quoted in Lintner 2000: 26). With the government's decision to seek the IMF's assistance in stabilising the economy in 2001, the pace of reform picked up again, although donors have continued to be concerned about the government's lack of fiscal discipline and the consequent high levels of inflation. Third, donors have continued to be an important source of finance for large infrastructure and energy projects, which are crucial to the country's exploitation of its natural resource wealth, as well as government investments

Figure 3 **Aid dependence in LPDR, aid *per capita* (US$)**



Source World Bank, World Development Indicators CD-Rom.

in health and education. As in the period prior to the introduction of the NEM, donors have continued to fund virtually all the government's capital expenditure. Finally, donors have been a source of pressure for political reform and better human rights practices, although arguably a rather ineffective one. When the Lao government jailed two European journalists and their American translator in 2003 for reporting from a conflict zone off-limits to foreigners, the Danish and Norwegian governments announced that they were withdrawing their aid programmes (Kazmin 2003). Yet actions such as this have done little to stop human rights abuses and political persecution in Laos, as countless reports on the country's political and human rights record attest (USCIRF 2003; Amnesty International 2004; US Department of State 2000; Evans 2004).

4 Conclusions

Between 1975 and the mid-1980s, the LPDR made little progress *vis-à-vis* turnaround. Although the victory of the Pathet Lao brought relative peace and stability to the country, this did not translate into sustained high rates of economic growth, improved levels of human development, and hence turnaround. Since the mid-1980s, however, the country has made much more significant progress in turnaround. Except for a brief downturn as a result of the Asian economic crisis, economic growth has been fairly strong while the country's HDI rating has improved considerably. At the same time, the government has been able to maintain relative peace and stability. An ongoing armed insurgency led by ethnic Hmong rebels has led to periodic violent episodes in recent years but has thus far been more of an irritant to the communist leadership than a serious threat to its power or to the political stability of the country. Despite this progress, however, Laos remains one of the poorest and least-developed countries in the world. As the World Bank (2004a: 3) has pointed out, the country faces a variety of serious development challenges: life expectancy is low, two-thirds of households have no electricity, half lack access to safe water, 40 per cent of children are underweight, and nearly one-third of children between 6 and 14 do not attend school. There are serious concerns about the quality of governance within the country as well, corruption being a particularly serious problem.

Whether the country will be able to overcome these challenges and make further progress regarding turnaround in the future will depend on three main factors. The first of these is the outcome of the political transition that will occur in the LPDR over the next few years. Currently, the leadership of the country is in the hands of a group of ageing men who fought in the revolutionary struggle and who, notwithstanding their adoption of the NEM, appear to feel uncomfortable about economic liberalisation. Most are 'reformers by necessity' rather than 'reformers by conviction'. It is likely that the next few years will see many of these figures pass from the scene, replaced by a new, better educated generation of political leaders. As Stuart-Fox (2004: 35) has noted, the impact that this transition will have on the nature of economic policy in Laos is hard to predict. While one might expect the new generation of leaders to be more favourably disposed towards market-based economic policies, they may be forced to share power for a period with remaining members of the old guard who will exercise influence from behind the scenes, as they have, for instance, in other Asian countries such as China and Singapore. The second factor is the extent to which neighbouring economies, particularly China, Thailand and Vietnam, grow strongly in the future. Since the mid-1980s, the LPDR has been pulled along by the economic success of its neighbours, particularly Thailand. If its neighbours grow strongly in the future, it will probably continue to benefit from their growth, particularly if this translates into the realisation of a few major investments in hydroelectricity and mining; if its neighbours do not grow strongly, the benefits of proximity will probably be less significant. Finally, the LPDR's prospects regarding turnaround are also likely to depend on future changes in donor policies concerning the distribution of aid. It is unlikely that the LPDR will again experience a large-scale withdrawal of foreign aid, as it did in the 1970s. Indeed, it may receive more aid in the future. The point is simply that, as a country dependent on aid from a few key donors (Figure 3), the LPDR's prospects remain tied up to some extent with donor decisions concerning aid distribution.

Notes

* I wish to thank Nick Freeman, Phil Keefer, Sarah Cliffe and officials at the World Bank's office in LPDR for comments on earlier drafts of this article. The usual caveat applies.

1. The King and his wife stayed behind, dying later in a Pathat Lao prison.
2. The most important such measures at this time included the elimination of the gap between official procurement prices and market prices, the introduction of a market-based exchange rate, the elimination of subsidies for agricultural inputs, the abolition of the forced procurement of rice by the government at below-market prices for in-kind payment of government salaries, the simplification of export and import taxes, the elimination of government monopoly trading practices in all areas except for a few strategic goods such as minerals and logs, the introduction of requirements for state-owned enterprises to pay market prices for capital and factor inputs and adopt new accounting and management practices, the granting of permission to state-owned enterprises to retain profits for reinvestment purposes, the granting of permission to private firms and farmers to purchase various imported products and borrow money from the country's banking system, the introduction of tax equalisation measures for public and private enterprises, and the formulation of a foreign investment code to encourage greater FDI (UNDP 1991: 76–9; UNDP 2004: 6–8; Economist Intelligence Unit 2004: 21).

References

ADB (2004) 'Lao People's Democratic Republic', *Asian Development Outlook*, Manila: Asian Development Bank

Amnesty International (2004) *Amnesty International Report 2004*, www.web.amnesty.org/report2004/index-eng (accessed November 2004)

Bedlington, S. (1980) 'Laos in 1980: The Portents are Ominous', *Asian Survey* 21.1: 102–11

Bourdet, Y. (2000) *The Economics of Transition in Laos: From Socialism to ASEAN Integration*, Cheltenham: Edward Elgar

Brown, M. and Zasloff, J. (1978) 'Dependency in Laos', *Current History*, December: 202–7, 228

Cornford, J. (1999) *Australian Aid, Development Advocacy and Governance in the Lao PDR: Mixed Messages and Emerging Possibilities*, Australian Mekong Resource Centre (AMRC) Working Paper No 1, James Cook University, June

Dodsworth, J. (1997) 'How Indochina's Economies Took Off', *Finance and Development* 34.1: 20

Economist Intelligence Unit (2004) *Country Profile 2004: Laos*, www.eiu.com (accessed November 2004)

Evans, G. (1991) 'Planning Problems in Peripheral Socialism: The Case of Laos', in Joseph J. Zasloff and Leonard Unger (eds), *Laos: Beyond the Revolution*, Basingstoke: Macmillan, Ch. 4

Evans, G. (2004) *Laos: Situation Analysis and Trend Assessment*, a Writenet report commissioned by the United Nations Commissioner for Refugees, www.unhcr.ch/cgi-bin/texis/vtx/rsd/rsddocview.pdf?CATEGORY=RSDCOI&id=40c723992 (accessed November 2004)

Freeman, N. (2004) 'Personal communication', 18 November

Freeman, N. (2003) 'Pragmatism in the Face of Adversity: Enterprise Reform in Laos', *Communist Studies and Transition Politics* 19.1: 35–48

Freeman, N. (2001a) 'The Rise and Fall of Foreign Direct Investment in Laos, 1988–2000', *Post-Communist Economies* 13.1: 101–19

Freeman, N. (2001b) 'The Challenges Posed by Globalization for Economic Liberalization in Two Asian Transitional Countries: Laos and Vietnam', *WIDER Discussion Paper* No 2001/40

Gunn, G. (1990) 'Laos in 1989: Quiet Revolution in the Marketplace', *Asian Survey* 30.1: 81–7

Gunn, G. (1980) 'Foreign Relations of the Lao People's Democratic Republic: The Ideological Imperative', *Asian Survey* 20.10: 990–1007

Joiner, C. (1988) 'Laos in 1987: New Economic Management Confronts the Bureaucracy', *Asian Survey* 28.1: 95–104

Kazmin, A. (2003) 'Laos Jailings Deepen Doubts of Aid Donors', *Financial Times*, 9 July: 1

Lam, N.V. (1997) 'External Assistance and Laos: Issues and Implications for Development Policy', in Mya Than and Joseph L.H. Tan (eds), *Laos' Dilemmas and Options: The Challenge of Economic Transition in the 1990s*, New York: St Martin's Press and Singapore: Institute of South East Asian Studies

Lintner, B. (2001) 'Gifts from Above', *Far Eastern Economic Review*, 30 August: 51

Lintner, B. (2000) 'Frustrated Reforms', *Far Eastern Economic Review*, 24 February: 26

Stuart-Fox, M. (2004) *Politics and Reform in the Lao People's Democratic Republic*, Political Economy of Development Working Paper No 1, The College of William and Mary, Williamsburg: Program on Civil Society and Governance

Stuart-Fox, M. (1986) *Laos: Politics, Economics and Society*, London: Frances Pinter (Publishers) and Boulder: Lynne Rienner Publishers Inc.

Thalemann, A. (1997) 'Laos: Between Battlefield and Marketplace', *Journal of Contemporary Asia* 27.1: 85–105

Than, M. and Tan, J. (1997) 'Introduction: Laos' Transitional Economy in the Context of Regional Economic Cooperation', in Mya Than and Joseph L.H. Tan (eds), *Laos' Dilemmas and Options: The Challenge of Economic Transition in the 1990s*, Singapore: Institute of Southeast Asian Studies (ISEAS): 1–22

UNDP (2004) *Economic Reforms in a Transition Country: The Recurring Experience of Laos*, Country Papers Series 6, International Policy Conference on Transition Economies, 31 May–1 June 2004, Hanoi, Vietnam

UNDP (2003) *Human Development Report 2003*, New York: Oxford University Press

UNDP (1991) 'The Economy of Laos: An Overview', in Joseph J. Zasloff and Leonard Unger (eds), *Laos: Beyond the Revolution*, Basingstoke: Macmillan, Ch. 3

USCIRF (United States Commission on International Religious Freedom) (2003) *Report on Laos*, February, www.uscirf.gov/reports/20Mar03/CPC-Laosfinal.pdf (accessed November 2004)

US Department of State (2000) *Country Reports on Human Rights Practices: Laos*, www.state.gov/g/drl/rls/hrrpt/2000/eap/728.htm (accessed November 2004)

World Bank (2005) *Country Assistance Strategy for the Lao People's Democratic Republic (Lao PDR)*, 10 March, Washington, DC: World Bank

World Bank (2004a) *Lao PDR Country Economic Memorandum: Realizing the Development Potential of Lao PDR: Summary/Overview*, 30 August, Washington, DC: World Bank

World Bank (2004b) *Lao PDR Economic Monitor*, May, Washington, DC: World Bank

World Bank (1993) *The East Asian Miracle: Economic Growth and Public Policy*, Oxford: Oxford University Press, for the World Bank

Zasloff, Joseph J. (1991) 'Political Constraints on Development in Laos', in Joseph J. Zasloff and Leonard Unger (eds) *Laos: Beyond the Revolution*, Basingstoke: Macmillan, Ch. 1

Zasloff, Joseph J., and MacAlister Brown (1991) 'Laos 1990: Socialism Postponed but Leadership Intact', *Southeast Asian Affairs 1991*, Singapore: Institute of Southeast Asian Studies: 141–58