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The Financial Institutions of the
Royal Kingdom of Laos

This paper reflects the personal
opinion of the author and must not
be interpreted as representing the
opinion of the Board of Governors.

LAOS

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Introduction

The Economic Setting

Laos is the least developed country in Southeast Asia with a 1969 per capita GNP of only about \$70. Not having been a really independent economic unit during the French colonial period, the Laotians have had little opportunity to develop a viable economy. Economic progress has also been retarded by political instability and an intermittent war with the Communist-inspired Pathet Lao and the North Vietnamese forces. The necessity of maintaining a costly and extensive military effort has been the chief obstacle to the achievement of financial stability. Operating a wartime economy, the Government in mid-1969 had control of only about 60 per cent of the country's total land area.

Laos achieved its political independence on October 22, 1953, and late in 1954 terminated the economic and customs union with France which had been established four years earlier. Since independence Laos has had a constitutional monarchy with a parliamentary form of government.

The King of Laos serves as both the spiritual and temporal leader of the country. He is the Head of State, the Commander-in-Chief of the Army, and the supreme religious authority. He resides in Luang Prabang which is the royal capital of the country, having been the ancient seat of the royal family. The administrative capital, and the largest city in Laos with a population of about 140,000, is Vientiane, which is situated on the north bank of the Mekong River.

The executive branch of the Government consists of a 12-member Council of Ministers headed by a Prime Minister, while the legislative branch consists of a 59-member National Assembly which is elected approximately every five years. The country is divided into 16 provinces, each one being governed by a Provincial Chief who is assisted by an elected Provincial Council.^{1/}

Laos is approximately the size of the state of Colorado, having 91,000 square miles, and it has an elongated shape which runs northwest to southeast. The bulk of the land consists of rugged jungle terrain. Only 5 per cent of the land area is cultivated,

^{1/} For additional details, see "Section II. Political" of Area Handbook for Laos, Foreign Area Studies, The American University (Department of the Army Pamphlet No. 550-58), Washington, D. C., June 1967, pp. 153-208.

while 4 per cent is used as pasture. An additional 3 per cent is arable, but the remaining 88 per cent consists mainly of forests and is considered to be unsuitable for cultivation.

In early 1969, Laos had a population of about 2.9 million consisting of many diverse ethnic groups. The Lao are the most prominent and constitute about 40 to 50 per cent of the population. Next in importance are the mountain Mon-Khmer^{1/} who account for 30 to 35 per cent of the population. This group includes many ethnic groups. The Tribal Tai account for 15 to 20 per cent of the population, and they live in the mountain valleys as well as the northern and central plateaus. The Meo, who are Chinese in origin, account for another 5 per cent of the population. During the 1960's, population increased at an estimated annual rate of 2.4 per cent.

Approximately 90 per cent of the people live in small self-contained villages. Of the total labor force of about 1.3 million in early 1969, 87 per cent were engaged in agriculture, 12 per cent in manufacturing and services, and 1 per cent in work for the Government. The literacy rate is quite low, being only about 12 to 15 per cent.

Most Laotians are basically subsistence farmers, although some crops are grown for export and there are coffee plantations. Only a very small proportion of the villagers have specialized occupations and even handicraft is generally a secondary occupation. The more important agricultural products are rice, corn, cotton and tobacco, while other minor crops include peanuts, spices, tea, pimento and manioc. Laos is close to self-sufficiency in rice, the major food problem actually being one of obtaining an improved distribution of food products. In recent years, however, the country has had an annual foodgrain deficit of about 60,000 to 80,000 tons.

Laos has a small livestock and fishery industry. Although landlocked, the Laotians have access to a long stretch of the Mekong River which is a major source of fish. Forestry is also important and exports of teakwood constitute one of the country's major export products. Over half of the country is covered by forests, but improved transportation facilities are needed in order to exploit the forestry resources.

The secondary industry in Laos consists primarily of saw mills, rice mills, cement production, various cottage industries, and light manufacturing, such as production of soft drinks, cigarettes,

^{1/} Also known as the Phoutheng ("mountain people"), Lao Theng ("mountain Lao") or Kha.

ice, ice cream and industrial alcohol. Of these products, only the cigarettes are exported. Except for the cottage industries, most of these firms are located in Vientiane.

Laos also has a tin mining industry located at Phong Tiou where the facilities have recently been modernized. Tin constitutes one of the country's more important export products. Laos has other valuable mineral products, such as iron ore and coal, but again the country lacks a suitable transportation network to bring these products out of the hinterland.

Private investment in Laos has been relatively limited and has been confined mainly to tin mining, banking, and foreign trading activities. Much of the foreign investment has been French, and this has been primarily in tin mining and coffee plantations. Most of the domestic capital generated in the 1960's has been used to finance foreign trade activities.

Laos' transportation facilities are relatively underdeveloped. Although the country has about 7,700 miles of highways, only about 500 miles are paved. Laos does not have a railway, but it does have approximately 200 airfields, including 24 of major status. However, only 3 of these have a permanent landing surface. The Mekong River is a major transportation artery, however, certain parts of the river are not navigable. The five major river ports on the Mekong are Vientiane, Luang Prabang, Savannakhet, Pakse, and Thakhet.

International trade is important for Laos, but mainly on the import side. As indicated in Table 1, recorded exports have been only \$2 million in recent years, whereas imports have ranged from \$25 million to \$43 million. The result has been a very large import surplus which has been financed mainly by foreign aid.

Laos imports a wide variety of goods, some of the more important being vegetables, petroleum products, rice, transportation equipment, machinery and textiles. Although large amounts of gold are imported, much of this is reexported. Being landlocked, the bulk of Laos' imports tend to flow through Thailand.

Laos' main exports are tin ore, timber and unroasted coffee. Other less important exports include cardamon, benzoin, leather, and hides. Undeclared exports of opium are believed to be significant, but the value of these exports is not known. Some estimates have set the worth of these exports to the producers at \$2 million.

Table 1. Changes in Selected Economic Indicators

	1960	1961	1962	1963	1964	1965	1966	1967	1968
1. Mid-year Population (1,000's)	2,330	2,390	2,450	2,510	2,570	2,635	2,698	2,763	2,825
Change	+ 2.4%	+ 2.6%	+ 2.5%	+ 2.4%	+ 2.4%	+ 2.5%	+ 2.4%	+ 2.4%	+ 2.2%
2. Central Government: ^{1/}									
Expenditures (Mill. of Kip)	1,184	3,369	3,719	4,282	6,080	10,315	14,390	15,310	16,055P
Revenue (Mill. of Kip)	702	489	583	848	1,602	4,735	4,721	6,391	7,278P
Deficit (Mill. of Kip)	- 482	-2,880	-3,136	-3,434	-4,478	-5,581	-9,669	-8,919	-8,777P
3. Claims on Government: ^{2/}									
Change	+ 445	-	8	+2,894	+4,345	+5,226	+3,137	+5,116	+ 126
4. Claims on Private Sector: ^{3/}									
Change	135	145	146	236	621	1,139	940	1,040	n.a.
5. Money Stock:									
Currency (Mill. of Kip)	2,564	2,482	4,232	5,858	6,701	8,113	9,624	10,260	n.a.
Demand Dpts., Private Sector (Mill. of Kip)	251	225	682	1,628	1,099	953	1,118	1,000	n.a.
Total (Mill. of Kip)	2,815	2,707	4,914	7,486	7,801	9,066	10,742	11,260	n.a.
Change	..	4%	82%	52%	4%	16%	18%	5%	747 (Sept)
6. Cost of Living ^{4/} (1959=100)	142	115	148	365	551	596	654	713	5%
Change	..	19%	29%	147%	51%	8%	10%	9%	n.a.
7. External Trade:									
Exports (Mill. of US\$)	1	1	1	1	1	1	1	2	4
Imports (Mill. of US\$)	13	17	24	29	25	33	43	42	n.a.
Balance (Mill. of US\$)	- 12	- 16	- 23	- 28	- 24	- 32	- 41	- 38	n.a.
8. Gold Imports (Metric tons)	17.0	26.8	20.5	7.0	11.3	36.3	53.0	72.2	33.0P
9. Gross Exchange Holdings of National Bank (Mill. of US\$) ^{5/}	27.0	21.6	22.3	10.8	7.0	6.6	6.7	5.7	n.a.

SOURCES: ^{1/} Statistical Report, U. S. AID, Laos; ^{2/} Monthly Bulletin of Statistics, United Nations; ^{3/} Bulletin de Statistiques du Laos; ^{4/} Service de la Statistique du Laos. Data for 1968, for example, cover fiscal year 1967-68. Data for 1960 cover only the fiscal year ends June 30. Data for 1968, for example, cover fiscal year 1967-68. Data for 1960 cover only the fiscal year ends June 30. Data for 1968, for example, cover fiscal year 1967-68. Data for 1960 cover only the fiscal year ends June 30.

^{1/} Fiscal year ends and do not include the military budget.
^{2/} Civil budget and do not include the military budget.
^{3/} Outstanding year-end advances from the National Bank of Laos to the Government.
^{4/} Outstanding year-end loans and advances from commercial banks to the private sector.
^{5/} Cost of living index is for middle-class families in Vientiane during the month of December.
 End of year. Includes IMF gold tranche.

Official GNP data are not available for Laos, but because of the political, military and economic problems of the country, economic growth has been slow. Rough estimates place Laos' GNP in 1968 at about \$200 million and per capita GNP at \$70.^{1/}

As indicated by the data on prices in Table 1, Laos has experienced rapid rates of inflation during certain periods and the maintenance of price stability has been a serious problem. Because of the underdeveloped nature of the economy, the basic measures needed to achieve price stability are relatively simple. Primarily because of the military burden it has had to assume, government expenditures have been quite large. However, domestic sources of revenue have not been adequate to finance these expenditures in a non-inflationary manner. In recent years, less than half of the expenditures have been financed from domestic revenues, one of the most important being the customs duties on gold imports which have accounted for approximately 40 per cent of domestic revenues. During certain periods, the Government has had to rely heavily on central bank financing which has expanded the money stock greatly (see Table 1, especially 1962 and 1963) and has been highly inflationary.

Inflationary pressures have been reduced at times through the provision of substantial amounts of foreign aid. This has taken the form of budget support, project aid, military assistance, and contributions of convertible currencies to the Foreign Exchange Operations Fund (FEOF).^{2/}

The United States has been the major foreign aid donor to Laos. In the fiscal year ending June 30, 1968, U. S. economic aid to Laos totaled \$58 million and consisted of approximately two-thirds project aid and one-third non-project aid. Other foreign aid donors include France, Japan, the United Kingdom and Australia. These countries in recent years have accounted for about 30 per cent of the annual contributions to the Foreign Exchange Operations Fund, total contributions in 1968 being \$19 million.

In January of 1964 a major stabilization program was launched which was successful in reducing the annual rate of inflation during 1965-68 to approximately 10 per cent. The operations of FEOF have also been successful in maintaining the exchange rate for the kip in

^{1/} The Colombo Plan for Cooperative Economic Development in South and Southeast Asia, Fifteenth Annual Report of the Consultative Committee, Rangoon, November-December 1967, p. 217.

^{2/} The FEOF is basically a fund of convertible foreign exchange provided on a grant basis to Laos by five donor countries, which has been used by the authorities since January of 1964 to stabilize the exchange rate in the official free market and to reduce inflationary pressures by providing the foreign exchange resources to meet the demand for imports. Some of the kip counterpart funds generated by the FEOF contributions have been used by the Government to reduce its indebtedness to the National Bank of Laos.

the official free market at approximately K.500 to the U. S. dollar. If the foreign contributions to FEOF are not sufficient to meet the actual demand for imports in the free market, the only other practical way to maintain stability is to increase the domestic revenues of the Government, or to reduce government expenditures, or both. Thus there is a very close relation in Laos between the size of the government's budget deficit and the availability of foreign exchange resources to relieve demand pressures.

Although currency is used extensively in the cities and some village market places, barter is still a very important means of exchange in the Laotian economy. Money substitutes, such as pieces of gold and silver, as well as tea and opium, are also used in the rural areas.

Prior to independence, the unit of currency was the piaster, its value being tied to that of the French franc. Piaster bank notes were issued for many years by the quasi-private Bank of Indo-China, but in 1949 the French assumed direct control of the currency issue. Through 1954 the issue was handled by the Joint Currency Board for Cambodia, Laos and Vietnam (Institut d'Emission des Etats du Cambodge, du Laos et du Vietnam), but in January 1955 the new National Bank of Laos assumed responsibility for the issue of the currency, and the name of the unit of currency was changed from piaster to kip.^{1/}

There have been several devaluations of the piaster/kip in the postwar period. In 1953 the piaster was devalued to K.35 to the U. S. dollar. This was the rate of exchange assigned the kip on January 1, 1955, when it first came into use. Later in October of 1958 the kip was devalued further to K.80 to the U. S. dollar, and on January 1, 1964, to K.240 to the dollar,^{2/} these devaluations being necessitated by the substantial increase in prices over the years. (See Table 1.) By mid-1969 the rate of K.240 to the dollar still applied to foreign aid commodities, government imports, specified invisibles, and to a certain proportion of the proceeds of certain exports.^{3/} All other transactions were made in the official free market at rates of roughly K.500 to the dollar. Because of these various restrictions,

^{1/} Earlier the piaster was subdivided into 100 "centimes" and later into 100 "at," but with the depreciation of the kip in the 1960's, the smallest currency unit has become 1 kip.

^{2/} The rate in the free foreign exchange market in January of 1964, however, was about K.480 to the dollar.

^{3/} For additional details on the Laotian exchange system, see Twentieth Annual Report on Exchange Restrictions, International Monetary Fund, Washington, D. C., 1969, and earlier issues.

the kip in mid-1969 was not completely convertible on current account at the rate of K.240 to the dollar; however, there were no restrictions on capital or other transactions through the official free market.

The Financial Institutions in Brief

Laos has only a small number of financial institutions. In addition to the commercial banks and the central bank, there is the Development Bank of Laos, the Agricultural Development Organization, the Small Industry Loan Fund, the insurance companies and the private moneylenders. These institutions are listed in Table 2, the date in parentheses indicating the year in which the institution first began to operate.

Table 2. Laotian Financial Institutions

<u>Banks:</u>	<u>Private:</u>	Bank of Indo-China (1953) Bank of Tokyo (1956) Bank of Laoviang (1956) Commercial Development Bank of Laos (1957)
	<u>Government:</u>	National Bank of Laos (1955) Development Bank of Laos (1956)
<u>Other Financial Institutions:</u>	<u>Private:</u>	Insurance companies Private moneylenders
	<u>Government:</u>	Agricultural Development Organization (1965) Small Industry Loan Fund (1967)

These institutions are discussed in more detail later.

Table 3 provides data on the interest rates paid and charged by the major financial institutions in Laos. Except for the private moneylenders, the rates charged are relatively low in relation to going market rates of interest. Deposit rates are quite low and hence generally unattractive to savers.

Table 3. Interest Rates of Selected Laotian Financial Institutions
(In per cent per annum; December 1967)

<u>Institution</u>	<u>Credits</u>	<u>Deposits</u>
1. Private commercial banks	8.5-15.0	3.0-12.0 (3-mo. to 12-mo.)
2. National Bank of Laos	7.0	--
3. Development Bank of Laos	5.0-10.0	3.0- 6.0 (15-day to 6-mo.)
4. Small Industry Loan Fund	11.0	--
5. Agricultural Development Organization	3.0-12.0	--
6. Private moneylenders	24.0-43.0	

NOTE: Data are taken from text material on the individual institution.

Certain other financial institutions which are found in most other Southeast Asian countries, either do not exist in Laos, or their operations are relatively modest. In mid-1969, for example, Laos did not have any rural credit cooperatives. The only significant cooperative at that time was a salt cooperative near Muong Tourakom, and this was a production and marketing cooperative, rather than a credit cooperative.

Similarly, Laos does not have any pawnshops or a government pension fund. The lack of pawnshops appears to be due to the generally underdeveloped state of the economy and the fact that some private moneylenders perform functions similar to those of a pawnbroker. Prior to 1960 the Government did maintain a special fund^{1/} to finance the payment of government pensions, but since 1960 all pension payments made to former government employees have been paid out of general revenues.

Like other Southeast Asian countries, however, Laos does have some small, informal, mutual lending societies. Known locally as a huai, these groups are formed by people either to raise money to help friends, or by persons interested in earning interest on their idle cash. The basic idea is for the savers to make monthly cash contributions to the group, the borrowers repaying both principal and interest.

^{1/} Loans were also extended to government employees by the management of the pension fund at rates of 12 per cent per annum.

Laos does not have either an open money, or capital, market. Although there was some direct interbank lending during 1959-61, there has generally been none since then, and Laos has never had an interbank call loan market.

The lack of appropriate medium- or long-term credit institutions has not, however, prevented the financing of some construction activities.^{1/} Such financing has generally been on a direct personal basis, and both the scale and volume of such activities have generally been small.

Commercial Banks

A commercial bank first began to operate in Laos in 1953, most banking needs having been met previously by the banks in present-day Vietnam and other neighboring areas. By mid-1969 Laos had four commercial banks, all with their headquarters in Vientiane. The bulk of the bank activity in recent years has consisted of short-term credits extended to finance commodity imports. Other types of credits and investments have been relatively small.

Establishment, Objectives and Organization

Commercial banking began in Laos on December 10, 1953, when the Bank of Indo-China (Banque de l'Indochine) established a branch in Vientiane. The Paris-based Bank, originally established in 1875, had provided banking facilities to Laos earlier in the pre-war period through its branches in Saigon, Hanoi and Haiphong. Several years later, when an increase in foreign aid permitted an increase in imports, three more commercial banks were established and began to operate in Laos. These were the Bank of Laoviang and a branch of the Bank of Tokyo, both of which began to operate in 1956. In 1957 the Commercial

^{1/} The following would be a typical example of how construction is financed in Laos without the assistance of banks or any other organized financial institution: (1) the various construction groups (carpenters, lumbermen, cement firms, etc) reach agreement with the owner of a piece of land for construction of a building; (2) the building is constructed and part of the property is turned over to the landowner to compensate him for the land; (3) the rest of the property is then sold directly for cash to the original landowner or someone willing to invest in the property; (4) the property owner then rents the property at an adequate price and for a sufficiently long period to at least recoup his investment.

Development Bank of Laos^{1/} was also established. In mid-1969 these four banks were still in operation, although a fifth commercial bank did operate briefly in 1963-65,^{2/} and a sixth bank was reportedly operating in Vientiane in 1966.^{3/}

Of the four banks, two are foreign, one is clearly indigenous, and one is nominally indigenous. The Bank of Indo-China and the Bank of Tokyo are French and Japanese branch banks, respectively, while the Bank of Laovieng is basically owned by Laotians. The Commercial Development Bank of Laos is partially owned by Laotians, and it has the nominal status of a local bank, however, the bulk of the Bank's capital has actually been provided by Thai investors.

In mid-1969 only one of the four commercial banks had any branches. This was the Bank of Laovieng, which had a branch in Savannakhet and agencies in Luang Prabang and Pakse. The Bank of Indo-China had a branch in Pakse from December of 1956 through mid-1963, but it was closed down mainly because it was not profitable.

The two local banks are stock companies and are organized along corporate lines,^{4/} with the stockholders electing the board of directors. The two foreign banks are under the control of a manager, who is responsible to the head office. Bank organization is relatively simple and generally includes separate departments for Accounts, Cash, and Foreign Operations (especially import financing). The size of the staff of the four banks early in 1968 ranged from about 42 for the Bank of Tokyo to about 80 for the Bank of Indo-China. The Bank of Laovieng's branch in Savannakhet had only six persons.

Sources of Funds and Deposit Rates

The commercial banks' main sources of funds are their deposits, commissions (particularly from foreign exchange transactions), and, to a lesser extent, their retained earnings and capital. The National Bank of Laos has also been a source of funds at times, but during 1964-67

1/ Originally the Bank was known as the Lao Commercial Bank, but in 1961 the Bank was reorganized and its name was changed.

2/ This was the Bank of Laos which opened in 1963 and closed down in February 1965. The Bank discontinued operations mainly because of a change in the country's political leadership which was not favorable to the main sponsor of the Bank.

3/ This is the Lao-Thai Bank, dominated by Thai capital but with some participation by local Chinese. See Area Handbook for Laos, op. cit., p. 274.

4/ Local banks are required by law to be a limited company, i.e., a société anonyme.

when a stringent stabilization program was in operation, the National Bank generally reduced its credit accommodation to the commercial banks. The foreign banks have generally not relied on their head offices for any funds, and only limited use has been made of overseas credit lines. Similarly, there has been very little in the way of interbank lending activity, although the Bank of Tokyo did extend some credits to the Bank of Laoviang during 1959-61.

All of the banks, except the Bank of Indo-China, are required to have an authorized capital of at least K.30 million and a paid-up capital of at least K.15 million.^{1/} The Bank of Indo-China is exempted, however, since its establishment pre-dated the original Commercial Banking Act of March 10, 1956.^{2/} At the end of 1967 the Commercial Development Bank of Laos and the Bank of Tokyo each had a paid-up capital of K.15 million, while the Bank of Laoviang had a paid-up capital of K.30 million.

As indicated earlier, the banks' deposits are their main source of funds. Bank practices regarding the types of deposits accepted and the interest rates paid on deposits, vary substantially as indicated in Table 4. The four main types of deposits are demand, time, savings (involving the use of a passbook), and notice.^{3/} Interest is not paid on demand deposits.

The bulk of the deposits--other than demand deposits--are time deposits. The amount of savings deposits held by the banks is not very large, and two of the banks do not generally maintain savings deposits. The volume of notice deposits is also relatively small. In mid-1968, term deposits (time, savings and notice) were only 7 per cent of total deposits. (See Table 5.) However, sight deposits denominated in foreign currencies have been fairly large since 1965 and in mid-1968 accounted for 27 per cent of total deposits.

The banking habit is still not highly developed in Laos, and the number of bank depositors is a relatively small proportion of the total population. Most people prefer to hold any liquid savings personally, generally in the form of bank notes, gold or silver.

Check clearing is handled by the National Bank of Laos, for the four commercial banks. There is only one clearing a day which takes place at 3:00 p.m.

^{1/} Article 9, Royal Ordinance No. 279 of November 9, 1960, which is a revision of the March 10, 1956, Ordinance.

^{2/} Established as law by Presidential Decree No. 66.

^{3/} Notice deposits are basically short-term time deposits where a certain minimum period of notification is required of the depositor before any withdrawal of funds.

Table 4. Rate of Interest Paid on Commercial Bank Deposits
(Data as of the end of 1967; in per cent per annum)

	<u>Time Deposits</u>	<u>Savings Deposits</u>
1. Bank of Laoviang	3.5% (3-mo.)	<u>1/</u>
	6.0% ^{2/} (6-mo.)	
	7.0% ^{2/} (9-mo.)	
2. Commercial Development Bank of Laos	4.0% (6-mo.)	3.0% ^{3/}
	10.0% (1-yr.)	
3. Bank of Indo-China	^{4/}	<u>4/</u>
	3.0% (6-mo.)	<u>5/</u>
4. Bank of Tokyo	3.5% (1-yr.)	

NOTE: Time period in parentheses indicates the minimum deposit maturity.

1/ On the date indicated, the Bank did not have any savings or notice deposits.

2/ At times the particular rate is negotiated.

3/ On the date indicated, the Bank did not have any notice deposits.

4/ The Bank generally accepts only demand deposits.

5/ Savings deposits are accepted, but no interest is paid on the deposits. The rate on 7-day notice deposits (only 1-day notice is required) was 3.0 per cent for the date indicated.

The Nature of Lending Activities and Credit Terms

The bulk of the commercial bank lending in Laos tends to be for the financing of imports. Hence, most credits are short-term, often carrying a three-month maturity. Relatively few credits carry a maturity of more than six months to a year. Extensive use is made of letters of credit, with most credits being extended to domestic borrowers by means of overdraft facilities. Credits are also occasionally provided by means of advances and unsecured (clean) loans.

Domestic credit needs are relatively modest and include the financing of rice mills and saw mills. Only a small amount of real estate and working capital credits are extended. Export financing is also quite small because of the relatively low volume of goods exported by Laos. Bank holdings of securities are very small because of the absence of government securities and a developed capital market. None of the banks extends either agricultural credits or medium-term equipment loans to industry.

Table 5. Assets and Liabilities of the Commercial Banks
(In millions of kip; end of year)

	1960	1961	1962	1963	1964	1965	1966	1967	June 1967	June 1968
<u>Assets</u>										
Cash in Till	30	28	32	97	72	79	108	137	105	90
Reserves in the National Bank and Treasury	115	29	410	927	249	301	386	436	624	483
Foreign Exchange Assets	77	221	103	262	371	359	408	636	707	868
Credit to Private Sector:										
Loans and Advances	135	145	146	236	621	1,139	940	1,040	875	989
Investments	20	30	43	24	14	15	15	12	12	19
Deposits of FEOF Balances with the National Bank and Treasury	--	--	--	--	839	1,888	2,175	1,755	705	892
Other	146	122	155	143	148	223	805	208	425	126
TOTAL	523	575	889	1,689	2,314	4,004	4,836	4,224	3,454	3,467
<u>Liabilities</u>										
Sight Deposits:										
in Kip	234	189	558	1,355	609	620	710	761	843	795
in Foreign Exchange	31	65	21	2	44	208	305	277	305	316
Term Deposits	12	40	44	57	45	58	52	90	60	79
FEOF Deposits	--	--	--	--	839	1,888	2,174	1,755	705	892
Advances from the National Bank	10	28	17	18	43	29	16	27	9	42
Devaluation Account	--	--	--	--	520	520	520	520	520	520
Other	180	198	179	172	140	604	978	705	929	534
Capital and Reserves	56	55	70	85	74	77	81	89	83	89
TOTAL	523	575	889	1,689	2,314	4,004	4,836	4,224	3,454	3,467

SOURCES: Annual Reports of the National Bank of Laos and Statistical Report, U. S. AID, Laos.

The major import products financed by the commercial banks include petroleum, textiles, vehicles, construction materials, light machinery, and a wide variety of consumer products. Oil imports are particularly important for several of the banks, and virtually all of the imports of gold are arranged by the Bank of Indo-China.

As indicated earlier, the customs duties on the gold imports (which totaled about 33 metric tons in 1968) are a very important source of revenue for the Government. The Bank of Indo-China also earns a substantial sum from the fees it collects for the services it provides in connection with the gold trade. It purchases the gold in Europe (often in Switzerland) and arranges for the gold to be imported by plane to Vientiane via Bangkok. Once the gold arrives (often in the form of one kilogram bars), the Manager of the Bank takes delivery of the gold and while still at the airport, takes it to a customs shed where it is subsequently delivered to the Laotian gold traders.^{1/} Much of the gold then moves eventually, in one form or another, legally and illegally, to South Vietnam, Thailand, and other Asian countries.

In addition to their earnings from interest charges, the banks also have substantial earnings from the commissions charged on foreign exchange transactions, remittances and letter-of-credit openings. In addition, the banks extract fees for guarantying the payment by their clients of customs duties.

Some of the banks utilize the services of a comprador. Both of the foreign banks have compradors, and one local bank had a comprador for a limited period.

Most of the banks require their borrowers to provide some type of collateral before extending a credit. In the case of imports, the merchandise involved generally serves as collateral for the loan, while in other cases the bank may require the borrower to assign land, buildings, foreign exchange, cash deposits, or some other type of property, as collateral. Sometimes co-signers are required for a loan, but borrowers are seldom required to supply the bank with statements of their financial position. In opening letters of credit, the banks in early 1968 were requiring a cash margin of 15 to 35 per cent from their clients, with 25 per cent being rather common.

The interest rates charged on loans in December of 1967 generally ranged from 8.5 to 15 per cent per annum, excluding commissions and surcharges. For the two foreign banks, their lending rates averaged about 9 to 10 per cent. For the other banks, rates of 12 to 15 per cent tended to prevail.

^{1/} For a more detailed description of the Laotian gold trade, see the Far Eastern Economic Review, Hong Kong, August 25, 1966, pp. 365-67, and Fortune, New York, September 1, 1968, pp. 51-3.

Volume of Bank Activity

Commercial bank loans and advances have generally not constituted a very large proportion of commercial bank assets in Laos. In mid-1968, for example, the volume of loans and advances outstanding was equal to only 29 per cent of total commercial bank assets. The other major assets consisted of deposits of FEOF balances, foreign exchange assets, and legal reserves. (See Table 5.)

Loans and advances outstanding rose rapidly in 1963-65, increasing from K.146 million to K.1,139 million. Since then the volume has generally stabilized and in mid-1968 was K.989 million.

The volume of commercial bank investments has generally been very small. In mid-1968, for example, it was K.19 million, or only 1 per cent of total commercial bank assets. After reaching a peak of K.43 million at the end of 1962, investments generally declined through 1967. By mid-1968 the volume had increased slightly, but it was still less than half the peak level reached in 1962.

Government Supervision and Publications

The commercial banks in Laos are regulated in accordance with banking legislation enacted in 1956 and 1960.^{1/} Although the banks are required to submit periodic financial reports to the central bank, the banks are apparently not examined on their premises by central bank examiners on a regular basis. The two local banks have an external audit of their books, but the two foreign banks have only an internal audit. The banks are also subject to a substantial number of financial restraints as detailed in the general banking law and various banking regulations, but not all of these regulations are always strictly enforced.

Since 1963 the commercial banks have been required to maintain minimum legal reserves of at least 50 per cent against their total deposit liabilities.^{2/} Up to half of this reserve can be held in the Treasury. This is advantageous for the banks since the Treasury has generally paid interest of from 0.5 to 1.0 per cent per annum on these funds, while the central bank has not paid any interest on the banks' legal reserves. Banks holding less than the minimum reserves are subject

^{1/} The basic law is Royal Ordinance No. 176 of July 11, 1955, which was implemented by Presidential Decree No. 66/PC of March 10, 1956, and subsequently amended by Royal Ordinance No. 279 of November 9, 1960.

^{2/} Private demand deposits denominated in foreign currency, however, are not subject to the reserve requirement.

to a penalty fee equal to 1 per cent of the amount of the reserve deficiency. Banks finding themselves short of legal reserves often make up the deficiency by liquidating some of their foreign exchange assets.

The banks have also been subject to legal ceilings on both their loan and deposit rates. Originally the maximum loan rate was 15 per cent,^{1/} but by the end of 1967 the limit had been reduced to 11 per cent (the basic discount rate plus 4 percentage points). The legal maximum deposit rate at the end of 1967 was also 11 per cent.

Laotian banks are also subject to a minimum capital-to-risk-assets ratio of 10 per cent.^{2/} More specifically, the total amount of paid-in capital, reserves and undistributed profits should equal at least 10 per cent of the bank's total assets less deposits with the central bank and with other banks located outside of the country.

Bank regulations limit the total amount of loans by a bank to any one borrower to no more than 15 per cent of the bank's paid-up capital and reserves, and individual bank mortgage credits are limited to no more than 60 per cent of the value of the property financed. Bank regulations also prohibit the banks from purchasing forward foreign exchange, and as a consequence, Laos does not have a forward foreign exchange market.

Each commercial bank is required to submit monthly balance sheets, and annual profit and loss statements, to the central bank. Periodic reports must also be submitted to the Committee on the Foreign Exchange Fund. None of the commercial banks, however, publishes an annual report dealing with their operations in Laos. The head offices of the two foreign banks, however, publish annual reports dealing with their global operations, but without any breakdown of their activity in Laos.

Prior to the appearance of severe inflationary conditions in Laos, the bankers were organized into a bankers' association. However, as the inflation intensified, interbank competition increased, and the agreements arranged by the association were not always respected. Partly as a result of this, the association tended to become defunct during most of the 1960's.

^{1/} Article 30, Royal Ordinance No. 176 of July 11, 1955.

^{2/} Article 10, Royal Ordinance No. 279 of November 9, 1960.

Conclusions

The commercial banks in Laos have made only a moderate contribution to the country's economic development. In recent years most of the banks' credits have been limited to financing commodity imports and there has been relatively little financing of local industry, agriculture, real estate, or property development. Banking facilities are utilized by only a small portion of the population, and the banks have not experienced very much growth in their deposits, particularly when the deposits are measured in real terms.

A frequent complaint of the bankers is that they suffer from a shortage of funds. One of the main reasons for this is the unattractiveness of the rate of return on deposits. The interest rates are relatively low compared to alternative uses, and two of the banks do not even offer savings deposit facilities. A third bank that does accept savings deposits does not pay any interest on them. Consequently, it is not surprising that there has been a shortage of loanable funds, which in turn has held down the rate of growth of the banking institutions. Other factors, such as political and military instability, as well as low productivity, in general, have also inhibited the growth of the banking institutions.

Since 1965 there has been little or no growth in bank loans. In this sense, the banking system has not been very dynamic. However, in view of the need to restrain inflationary pressures, particularly in view of the government's deficit financing, a high rate of bank credit expansion would have added substantially to the inflationary pressure and thus further aggravated Laos' economic problems.

The banks also suffer from certain other special problems. Some of the banks have a relatively high proportion of doubtful loans. These are a threat to both the banks' profitability and solvency. The banks are also subject to a substantial tax burden^{1/} since the tax rates in 1967 were still based on a predevaluation exchange rate for the kip of K.35 to the U. S. dollar. In addition, there is a shortage of large denomination bank notes (e.g., K.1,000 notes, worth about US\$2.00), with the result that much time and expense is devoted to counting the many K.100 (US 20 cents) and K.200 (US 40 cents) notes. (In Laos, currency also accounts for about 90 per cent of the money stock.) On the other hand, the banks benefit from the fact that certain bank regulations are not strictly enforced by the authorities.

^{1/} There is a 30 per cent business tax and a 5 per cent office tax.

National Bank of Laos

The National Bank of Laos is the country's central bank and sole currency authority. The Bank has a broad range of central bank powers and functions, and it is wholly-owned by the Government. Established in 1955 as a completely new institution, the Bank has its headquarters in Vientiane and one agency in Pakse. In recent years the Bank has had an influential, although not necessarily decisive, voice in financial policy decisions.

Establishment, Objectives and Organization

During the early 1950's, Laos was a member of the Indochinese Monetary Union and the note issue function was handled by the Joint Currency Board for Cambodia, Laos and Vietnam.^{1/} With the dissolution of these arrangements at the time that Laos was granted its independence, an ordinance was passed in December of 1954^{2/} which provided for the establishment of a central bank in Laos to be known as the National Bank of Laos.

On January 1, 1955, the National Bank of Laos assumed responsibility for the note issue function, and in July of 1955 its basic statutes were approved^{3/} according to the full range of central bank powers and functions.

The Bank's basic statute charges it with four obligations or objectives. These are to contribute: (1) to the proper functioning of the country's monetary and banking system; (2) to the maintenance of monetary stability; (3) to the maintenance of a stable rate of exchange; and (4) to the development and proper utilization of the country's resources, as well as to an adequate distribution of credit among the different sectors of the national economy. In connection with the last objective, the Bank has the responsibility to assist, when appropriate, in the development of certain financial institutions, and the Bank's statutes permit it to provide equity financing of up to 25 per cent of the new financial institution's capital.

Basic control of the Bank is exercised by an eight-man General Council consisting of the Governor of the Bank (who serves as President of the Council), the Deputy Governor^{4/} (who serves as Vice-President), three government members and three private members. The three government

^{1/} Known in French as the Institut d'Emission des Etats du Cambodge, du Laos et du Vietnam.

^{2/} Royal Ordinance No. 414 of December 25, 1954, providing for the establishment of the National Bank of Laos.

^{3/} Royal Ordinance No. 176 of July 11, 1955, later amended by R. O. No. 279/77-CR of October 15, 1956, and R.O. No. 245 of October 4, 1960.

^{4/} During most, if not all of the 1960's, the post of Deputy Governor has been vacant.

members consist of representatives from the Ministry of Finance, the Ministry of Commerce and Industry, and the Inspector-General of the Kingdom. The three private members, representing economic and social interests, are chosen by the Minister of Finance from names presented by each of the interprovincial chambers of commerce and industry in Laos. The three private members represent, respectively, industrial and commercial interests, agricultural interests, and animal husbandry. All members of the Council, except for the Governor, Deputy Governor, and Inspector-General, are designated for a period of four years.

The Bank's statutes require the General Council to meet at least once a month. Many important matters, such as the commercial bank interest rate that can be charged on loans or paid on deposits, are decided by the Council. When differences of viewpoint have occurred in the past, the Ministry of Finance view has tended to prevail.

The Bank's chief executive officer is the Governor who is appointed by Royal decree on the basis of a Cabinet decision. The Deputy Governor is also selected by the Cabinet and he exercises those functions delegated to him by the Governor. In actual practice, the second-ranking officer in recent years has been the Secretary-General who is the head of one of the Bank's main departments. Other officers of the Bank include the Directors of the Bank's six departments^{1/} and the Controller General who is in charge of the Department of Inspection and General Control. The Controller General is permanently charged in the name and for the account of the Governor to exercise complete supervision of the operations of the Bank.

The Bank does not maintain any regular branches, but in August of 1966 it opened its first agency in Paksé. This unit does not extend any credits or private check-clearing facilities, but it does collect payments from businessmen who have transactions with Vientiane, particularly import and foreign exchange transactions.

At the end of 1967 the Bank^{*} had 173 employees, of which 152 were located at the Bank's headquarters in Vientiane.^{2/}

Basic Functions and Authorized Capital

The National Bank performs a fairly broad range of functions of the type normally assigned to a central bank. These include issuing and retiring the currency,^{3/} serving as fiscal agent for the Government,

^{1/} Department of: (1) the General Secretary; (2) Research and Statistics; (3) Control and Inspection; (4) Foreign Services; (5) Central Fund; (6) General Accounts; and (7) the Vientiane Branch. The last Department is not so much a "branch" of the National Bank as it is an accounting office for the Bank's Vientiane operations.

^{2/} Compte Rendu des Operations: Exercice 1967, Banque Nationale du Laos, Vientiane, 1968, p. 40.

^{3/} Bank notes are issued in various denominations up to K.1,000, however, the 1,000-kip bank note has a tendency to disappear from circulation.

controlling credit conditions, supervising the commercial banks, and controlling foreign exchange operations.^{1/} The Bank is also authorized to buy and sell gold and foreign exchange, to engage in foreign exchange transactions with the public, and to engage in banking transactions with the private sector.

The Bank's actual transactions with the non-bank public, however, are quite small. In recent years they have been limited mainly to advances extended to private contractors doing construction work under a government contract. The advances from the National Bank permit the contractor to receive payment for work performed where there is a delay in Treasury payments, and these transactions of the Bank have given rise to a small amount of deposit liabilities due to the non-bank sector.^{2/} Except for the above, the Bank does not basically engage in commercial banking operations.

Other Bank functions include the maintenance of the country's international reserves and the promotion of new financial institutions. In this regard, the Bank has not only provided part of the equity capital of the Development Bank of Laos (formerly Crédit National Lao), but has also purchased shares in at least 10 different government enterprises.^{3/} Although the Bank has the authority to conduct open market operations involving the purchase and sale of securities in the private market, it had not done so through mid-1969. Similarly, the Bank has not utilized its powers to establish a system of guarantees or insurance covering bank credits.

The National Bank's authorized capital is K.100 million. When it first began to operate in January of 1955, its basic capital ("Fonds de Dotation") of K.66.7 million was supplied in the form of a loan from the Government. The Bank has used part of its annual profits through the years to repay this loan and to build up its own capital and reserves. At the end of 1967 the Bank's capital was K.100 million,^{4/} and its Statutory Reserve was K.150 million. Changes in these and other items are indicated in Table 6.

1/ Regulation of foreign exchange operations is on the basis of legislation passed by the Government and directives issued by the Ministry of Finance.

2/ The Bank also has some deposit liabilities owing to the members of its staff and other government employees.

3/ See Compte Rendu des Operations: Exercice 1967, op. cit., p. 40.

4/ This includes the earlier capital ("Fonds de Dotation") provided by the Government as well as some reserves from the former Institut d'Emission des Etats Associés.

Table 6. National Bank of Laos' Balance Sheet
(In millions of kip; end of period)

	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967
<u>Assets</u>												
Foreign Exchange	1,576	1,337	2,052	1,873	2,218	1,085	1,944	1,052	1,795	1,676	1,710	1,399
Advances to the Govt. ^{1/}	425	732	488	468	913	905	3,799	8,144	13,370	16,507	21,623	21,749
Subscriptions to International Financial	--	--	--	--	--	72	72	72	72	72	130	130
Institutions												
Investments	148	110	62	22	35	24	87	107	133	138	143	143
Advances & Rediscounts	--	--	--	--	17	58	38	56	99	96	117	149
Fixed Assets	43	35	44	51	48	52	53	79	114	138	150	178
Other	485	390	384	427	401	516	498	71	1,561	1,116	1,415	1,165
Total Assets	2,677	2,604	3,030	2,846	3,632	3,512	6,491	9,581	17,144	19,743	25,288	24,913
<u>Liabilities</u>												
Note Issue	1,519	1,554	1,570	1,816	2,594	2,510	4,289	5,990	6,798	8,559	10,104	10,840
RLG Treasury & Foreign Aid Deposits	416	255	450	318	191	222	614	876	1,678	1,951	1,630	1,228
Commercial Bank & Private Deposits	152	60	138	67	141	84	463	1,011	1,390	2,857	3,541	4,119
FEOP Deposits	--	--	--	--	--	--	--	--	2,533	2,229	5,946	4,858
Deposits of International Financial Institutions	--	--	--	--	--	72	72	101	122	122	185	190
Liabilities in Foreign Exchange	13	13	141	29	44	13	178	621	516	206	193	74
Capital & Reserves	34	116	160	160	176	189	220	220	234	239	248	250
Other	493	606	571	456	486	422	655	762	3,873	3,580	3,441	3,354
Total Liabilities	2,677	2,604	3,030	2,846	3,632	3,512	6,491	9,581	17,144	19,743	25,288	24,913

NOTE: Foreign exchange assets are converted at a rate of K.80 per U. S. dollar up to December 1963 and K.240 per U. S. dollar beginning January 1964.

SOURCE: Comptes Rendu des Operations, Banque Nationale du Laos.

^{1/} Excludes the Government's debt to the National Bank pending the liquidation of the Indo-Chinese Treasury.

At the time that the National Bank was established, it assumed a certain portion of the assets and liabilities of the Joint Currency Board for Cambodia, Laos and Vietnam pending the liquidation of the Board.^{1/} However, since the three countries have not been able to reach a final agreement on the distribution of the Board's assets and liabilities, the National Bank continues to have a claim on the Government of Laos arising from the Board's claims on the Laotian Government. The Bank reportedly receives from the Government payments of interest but not principal on the government's obligations arising from these claims, as well as from the liquidation of the old Indo-China Treasury.^{2/} The National Bank at the end of 1967 still had a provisional liability of about K.600 million for bank notes issued by the old Joint Currency Board. (See Table 6.)

Use of Monetary and Credit Instruments

Of the various credit instruments at its disposal, the Bank has mainly utilized as its major weapon changes in the minimum legal reserve requirement. While not exactly a credit instrument, the Bank has also simply not provided any credit accommodation to the commercial banks since 1964. The Bank has made little or no use of penalty discount rates, commercial bank loan ceilings, and flexible interest rate policies.

In 1956, when the Commercial Banking Act was enacted, the banks were required to maintain a legal reserve of at least 15 per cent against their demand deposit liabilities. This was later increased in 1963 to 25 per cent and with the introduction of a stabilization program late in 1963, the minimum was increased to 50 per cent for all deposit liabilities. This is probably one of the highest basic reserve requirements in the world, if not the highest. The high requirement reduces sharply the multiple credit expansion that can occur under a fractional reserve system, the ratio of expansion already being quite low due to the high drain of reserves into currency in Laos.

The legal reserves consist only of deposits in the National Bank or the treasury, vault cash not being eligible. Up to one-half of the reserves can be held at the treasury, the commercial bank receiving interest of about 1 per cent per annum on the reserves at the treasury but none on the reserves at the National Bank.

^{1/} These were provisionally divided as follows: Laos, 3.5 per cent; Vietnam, 85.4 per cent; and Cambodia, 11.1 per cent.

^{2/} Area Handbook for Laos (edited by Wendell Blanchard), Human Relations Area Files, American University, Washington, D. C., 1958, p. 457.

Because of the Government's stabilization program, the National Bank has not extended any credit to the commercial banks since January of 1964 with one exception; this is for credits provided through the Agricultural Development Organization (ADO). Under ADO's program, the National Bank assists the importer's bank by financing up to half of the cost of the imports at rates of 3 to 4 per cent per annum. Repayments are then made by the importer to his bank over a period of 3 to 5 years.

Changes in the National Bank's discount rate have been small and infrequent. Prior to 1964 the rate was 8 per cent, but in January of 1964 it was lowered to 7 per cent where it remained through at least mid-1969. Since 1955 the discount rate for government accommodation has been 1 per cent per annum.

The commercial banks and the Development Bank are also subject to certain interest rate ceilings established by the General Council. In the mid-1950's the maximum rate for bank loans was fixed at the basic discount rate plus 4 percentage points. Consequently, since January of 1964 the maximum interest rate that banks can charge on their loans has been 11 per cent, i.e., the discount rate of 7 per cent plus 4 percentage points. Interest paid on bank deposits is also subject to the same interest rate ceiling, which has been 11 per cent since January of 1964.

Although the National Bank's credit policies have been helpful in restraining inflationary pressures, the key aspect in recent years in maintaining relative price and exchange rate stability has been the use of a Foreign Exchange Operations Fund (FEOF), coupled with appropriate budget policies. FEOF is basically a fund of foreign exchange which is used by the authorities to stabilize the exchange rate in the official free market through relatively liberal licensing of a substantial number of imported commodities. The Fund is financed mainly by the United States, France, the United Kingdom, Japan and Australia.

Since the mid-1950's the main source of inflationary pressure has been the government's budget deficits, financed mainly by central bank credits. (See Table 1.) Since its establishment in 1964, the primary function of FEOF has been to offset the expansionary impact of these deficits. The local currency counterpart generated by the donor-country contributions of foreign exchange to FEOF, is used in part to finance the budget deficits, substituting for central bank credit.^{1/} The expansionary impact from the government's deficit spending is largely offset, or neutralized, by the high volume of imported commodities,

^{1/} From a technical point of view, counterpart funds are not "loaned" to the Government. Instead, the National Bank uses the funds to provide the Government with a "cash facility." If the latter were called a loan, the Government would have to pay interest.

financed by the donor-country contributions of foreign exchange to FEOF, and by U. S. budget support through project and non-project assistance. In 1968 total contributions to FEOF were about \$19 million and U. S. economic aid to Laos in the year ending in mid-1968 was \$58 million.

The volume of contributions to FEOF is an important factor influencing the size of the budget deficit. If the amount of contributions in a particular year were to decline, the authorities would have to reduce the size of the budget deficit if they were to continue to avoid inflationary pressures.

Supervisory Powers and Publications

In addition to its monetary and credit powers, the General Council of the National Bank also has the power to approve or disapprove the establishment of new banks, bank mergers, and changes in bank capitalization or location. In addition, the Bank has a Department of Control and Inspection which has the authority to examine the commercial banks at least once each year. The banks are also required to submit quarterly and annual financial data to the National Bank.

The National Bank's main publication is its annual report,^{1/} although this has not always appeared regularly. For example, the 1966 Compte Rendu covered the period 1963-66. The Bank's statutes (Article 82) also require it to publish at least quarterly in the official journal a statement on the Bank's financial situation. The Bank has met this requirement by issuing a monthly balance sheet.

Restrictions on Operations

During 1955-61 the Bank was subject to several important statutory restraints in its operations, but in recent years these have been largely replaced by an economic stabilization program adopted and operated under the close supervision of the International Monetary Fund. The earlier restraints related mainly to a limit on central bank advances to the Government, and a gold and foreign exchange cover requirement against the issue of currency.

Article 43 of the National Bank's statutes states that the total amount of loans extended by the Bank to the Treasury cannot exceed 25 per cent of the government's revenue during the preceding year, or 50 per cent over a maximum period of five years. However, during a

^{1/} This is published in French. See Compte Rendu des Operations: Exercice 1967, Banque Nationale du Laos, Vientiane, 1968, and earlier issues.

financial crisis in 1962, the limit was exceeded and the authorities suspended Article 43. The provision continued to remain suspended through at least mid-1969. But since the implementation of the 1964 stabilization program, this IMF-supervised program has placed limits on the size of the government's budget deficit, and hence the amount of deficit financing that has to be provided by the National Bank.

The National Bank's statutes (Article 29) also provide that the Bank must maintain a gold and foreign exchange fund equal in value to at least 30 per cent of the bank notes in circulation and the Bank's current account liabilities to various creditors. This provision was in force through early 1962, but between January and March of 1962 the foreign exchange cover fell from 74 per cent to 5 per cent,^{1/} largely as a result of the withdrawal of the United States' aid and rampant inflation. Consequently, the authorities also suspended Article 29 in early 1962 and it continued to remain suspended through at least mid-1969.

The Bank is also subject to certain restrictions^{2/} in its credit operations with banking establishments and individuals. The Bank can provide credit only against certain types of paper, which do not exceed certain maturities (generally 365 days), and in certain cases, only up to 50 per cent of the value of the collateral provided. For loans to individuals, the proportion of credit provided in relation to the value of the collateral is not permitted to exceed 33-1/3 per cent for crops, 50 per cent for real estate, 60 per cent for bills of exchange, 90 per cent for material other than coins made of gold and silver, and 100 per cent of the current price for merchandise. As mentioned earlier, the National Bank cannot legally subscribe to more than 25 per cent of the stock of a financial institution.

The Bank's financial operations are subject to supervision by two different authorities. One authority is the Controller General, who is permanently charged in the name of the Governor, to exercise a complete supervision of the operations of the Bank.^{3/} The other authority is the Commission of Supervision which consists of two auditors or examiners (censeurs) named by the head of the Government on the basis of proposals from the Ministry of Finance. The Commission maintains a broad surveillance over all of the operations of the Bank, attends meetings of the General Council, and presents a report to the Government at the beginning of each year on the controls that it introduced in the previous year.

^{1/} Area Handbook for Laos, Foreign Area Studies, The American University, Washington, D. C., June 1967, p. 273.

^{2/} These are detailed in Articles 50 through 66, Royal Ordinance No. 176 of July 11, 1955.

^{3/} See Article 22, Royal Ordinance No. 176 of July 11, 1955.

Conclusions

Although the National Bank during the first 15 years of its operation was not able to maintain monetary and exchange rate stability, this was largely due to developments beyond its own control. The political and military problems of the country produced large budget deficits which could not possibly have been offset by a financial squeeze of the private sector. In addition to these problems, the Ministry of Finance played a predominant role in central bank policy, making it extremely difficult, if not impossible, for the Bank to pursue truly independent and effective anti-inflationary policies. Since 1964, however, with the assistance of the IMF and certain donor countries, a greater degree of stability has been achieved.

It is interesting to note that the two key restraints on the central bank's operations, which would have helped to preserve economic stability, viz., the limit on credit to the Government and the gold and foreign exchange cover requirement, were both suspended in 1962. Because of the political and military problems that the country faced at the time, there probably was no other realistic alternative. If nothing else, however, the suspension of these two key provisions served the purpose of notifying all interested parties of the extreme seriousness of the economic situation.

Although it is unlikely that discount policy could have played a very important role in maintaining monetary stability, the Bank's use of the discount rate as a monetary instrument has been overly rigid. During most of the 1960's the discount rate was changed only once, and that was a modest reduction from 8 per cent to 7 per cent. During those periods in the past when commercial bank credit expanded excessively, the Bank could have introduced a penalty discount rate.

Lastly, the National Bank is somewhat unusual among central banks in that it holds equity shares in almost a dozen of the country's major business enterprises, including a cement company, a hotel and an airline. This is not a very appropriate activity for a central bank. As the opportunity arises, it would probably be prudent for the National Bank to transfer these shares to the Development Bank or some other appropriate entity.

Development Bank of Laos

The present-day Development Bank of Laos was first established by the Laotian Government in 1956 as Crédit National Lao (CNL) to help finance economic development. In 1967, CNL was superseded by the Development Bank of Laos (DBL) which in October of 1967 was owned 83 per cent by the National Government and 17 per cent by the National Bank of Laos. DBL extends mainly long-term credits to public utilities and industries, and also holds a substantial amount of equities in quasi-public companies.

Establishment, Purpose and Organization

In 1956 the Government of Laos established a special financial institution known as Crédit National Lao to provide credit to both public and private enterprises. Created by an order in council^{1/} and incorporated on October 8, 1956, the institution's basic statute was amended in December of 1956 and completely redrafted in 1961.^{2/} In 1967, the Crédit National Lao was superseded by the Development Bank of Laos (DBL) following the approval of a new statute^{3/} for the institution. On August 1, 1967, the institution formally changed its name from Crédit National Lao to the Development Bank of Laos.^{4/}

The basic purpose of the Bank, as stated in its 1967 law, is to offer its financial and technical assistance to those projects which promote the economic and social development of Laos. Its framework of operations is broad and provides for the extension of credits to agriculture, industry, commerce, and all types of businesses contributing to the country's general economic development.

The Bank is under the direction of a 10-man Administrative Council with the Minister of Finance serving ex officio as President of the Council and the Governor of the National Bank as Vice-President. The other eight members include representatives from the Departments of Finance, Rural Development, National Economy, and Cooperation and Planning, as well as two representatives from those organizations contributing to the capital of the Bank, and two from certain local economic

^{1/} No. 267/65 of October 8, 1956.

^{2/} No. 61/8 of August 24, 1961.

^{3/} Law No. 67/1 of April 7, 1967, promulgated by Royal Ordinance No. 212 of July 10, 1967.

^{4/} In French, Banque de Developpement du Laos.

and social organizations.^{1/} The Director-General of the Bank serves as rapporteur for the Council and the State Financial Controller has a consultative voice in the Council. All except the ex officio members of the Council are appointed, or removed, by Presidential decree.

The Bank's chief executive officer is the Director-General. He is nominated by the Administrative Council and, with the approval of the Cabinet, is appointed by means of a Royal Ordinance. The other three officers of the Bank are the Secretary-General, the State Financial Controller, and the Director of Financial Operations. The Secretary-General assists the Director-General, handling administrative matters and economic studies. The State Financial Controller maintains a surveillance of the Bank's financial operations for the Government, while the Director of Financial Operations, who is selected by the Minister of Finance, has the responsibility to see that all financial operations are executed in accordance with existing statutes and regulations.

At the end of 1967 the Bank was not formally organized into different departments. However, operations tended to be carried out through three basic groupings: (1) planning, research and studies; (2) financial operations; and (3) financial control. The Bank does not maintain any branches or agencies and at the end of 1967 had about 35 employees.

Sources of Funds and Deposit Rates

In recent years, the main sources of funds for the Bank have been the increases in its basic capital, advances from the French Caisse Centrale de Cooperation Economique,^{2/} loans from the Government, rediscounts at the National Bank and retained earnings. As indicated in Table 7, the two largest sources late in 1967 were the paid-in capital of K.240 million^{3/} and an advance of K.139 million from the Caisse Centrale. Except for its foreign borrowings and a small amount of deposits, most of the Bank's resources are obtained from government sources.

^{1/} At the end of 1967 the Council included the first six members described above plus the Secretary-General of the National Bank, the Vice-President of the National Chamber of Commerce and Agriculture, and the President of the Inter-provincial Chamber of Commerce and Agriculture of Luang Prabang.

^{2/} The Central Fund for Economic Cooperation is one of the vehicles used by the French Government to extend financial assistance to certain foreign countries.

^{3/} The Development Bank's official balance sheet shows only "Authorized Capital" on the liability side, however, paid-in capital can be calculated by deducting "Capital to be Received," which is shown on the asset side, from "Authorized Capital."

Table 7. Assets and Liabilities of the Development Bank of Laos
(In millions of Kip; end of year)

	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967^{1/}</u>
<u>Assets</u>							
Funds in National Treasury and Banks	15	35	2	4	13	20	25
Short-term Credits	--	2	24	56	60	58	69
Medium- & Long-term Credits	28	40	67	117	220	201	207
Shares in Quasi-Public Companies	22	43	50	71	102	102	102
Capital to be Received	--	--	--	--	195	190	120
Other	<u>3</u>	<u>5</u>	<u>8</u>	<u>33</u>	<u>26</u>	<u>65</u>	<u>75</u>
Total	68	125	151	281	616	636	598
<u>Liabilities</u>							
Deposits	--	--	--	--	--	--	4
Short-term Debt due NBL	--	--	--	23	14	26	5
Short-term Liabilities to Special Fund	--	--	--	--	--	--	9
Advances from CFE ^{2/}	5	3	21	82	177	172	139
Loans from the State ^{3/}	--	--	--	40	40	35	32
Construction Guarantees	--	--	--	--	--	3	3
Other Liabilities	--	1	2	1	5	8	1
Authorized Capital: State	59	90	90	90	270	270	270
NBL	19	30	30	30	90	90	90
Reserves	2	2	8	9	14	20	30
Fiscal Year Profits	<u>1</u>	<u>--</u>	<u>--</u>	<u>6</u>	<u>6</u>	<u>11</u>	<u>14</u>
Total	68	126	151	281	616	636	598

SOURCES: Credit National Lao Etablissement Public: 1965, Credit National Lao, Vientiane, 1966;
and balance sheets of the Credit National Lao.

^{1/} October 31, 1967.

^{2/} Central Fund for Economic Cooperation (Caisse Centrale de Cooperation Economique).

^{3/} This is a 2.5 per cent, 10-year credit, with annual repayments of K.4.0 million through 1974.

Since the Bank first began to operate in October of 1956 as the Crédit National Lao, its basic capitalization has been increased several times. In 1958 the Bank's statutes were revised so as to provide for a capital of K.40 million, of which K.30 million was contributed by the Government and K.10 million by the National Bank of Laos. As indicated in Table 7, the authorized capital was increased in 1962 from K.60 million to K.120 million, and in 1965 it was increased again to K.360 million. On October 31, 1967, the Bank had a paid-in capital of K.240, of which K.200 million had been subscribed by the Government and K.40 million by the National Bank.

Deposits have only recently become a source of funds for the Bank. The statutes of Crédit National Lao did not permit it to accept deposits, however, the 1967 statutes of the Development Bank of Laos allow the Bank to accept deposits. These consist basically of demand, savings and term deposits.

A passbook system is used for savings accounts and in December of 1967 the Bank was paying 3.5 per cent per annum on savings deposits. Three types of term deposits were also offered at that time, depositors being issued an avis de depots. Deposits requiring 15 days notice paid 3.0 per cent, 90-day term deposits paid 4.0 per cent, and 180-day deposits paid 6.0 per cent. The Director-General also had the power to increase or decrease these rates by one percentage point. The minimum amount accepted for savings deposits was K.1,000 (maximum was K.100,000), but for term deposits, there were no minimum requirements.

Nature of Lending and Investing Activities

In recent years, most of the Bank's credits have been extended to utilities and industry, with a relatively small part granted to agriculture. The Bank has also purchased a substantial number of shares in certain quasi-public companies, and extended some loans to municipal governments.

In October of 1967, a high proportion of the Bank's credits outstanding were extended to public utilities. Of K.259 million in short- and long-term credits, K.147 million was extended to electric power companies, K.38 million to water companies, K.25 million to cement companies, and K.14 million to other industries. Agriculture loans accounted for only K.17 million and other miscellaneous credits totaled K.35 million. Holdings of shares in quasi-public companies totaled K.102 million and consisted primarily of the Nong Sun Mining Company, the Khammouane Cement Company, the National Hotel, and the Laotian Royal Airline.^{1/} (See Table 7.) The Bank did not hold any government securities.

1/ For additional details, see "National Credit Bank of Laos," Development Banks in Asia, Japan Development Bank, Tokyo, 1966, p. 79.

Designed originally to extend medium- and long-term credits, the institution's statutes were revised in 1951 so as to permit the extension of short-term credits with a maturity of one year or less. As indicated in Table 7, short-term credits grew rapidly in 1963-64, and in 1957 were equal to one-fourth of the Bank's total loans.

The Bank draws a distinction between medium-term and long-term credits. The former have maturities ranging from one to five years, while the latter have maturities of five years or more. In 1967, the bulk of these credits had long-term rather than medium-term maturities.

Contrary to some reports,^{1/} the Bank through the end of 1967 had not yet extended any credits to rural cooperatives or to the housing sector of the economy. It does, however, have the power to extend credits of this type.

All individual credits in excess of K.10 million need the approval of the Administrative Council. For smaller amounts, the decision can be made by the Bank's special committees for agriculture, industry, properties, or commerce.

In addition to its lending and investment activities, the Bank also provides technical assistance to some borrowers. The Bank's guarantee activities have been very limited and through 1967 consisted of only one credit guarantee provided for a government electric utility company.

Credit Terms

Borrowers from the Bank are required to meet several conditions. If the loan is for the purchase of machinery, the title to the machinery must remain with the Bank until the loan has been repaid. In addition, most borrowers are required to provide collateral, such as real estate, and unless the title to the real estate is properly registered, the borrower must also obtain two co-signers for the loan. The amount of collateral provided is generally twice the amount of the loan. The Bank does not require that its clients borrow any fixed minimum amount.

The amount of financing provided by the Bank tends to vary with the maturity of the loan. For medium- and long-term loans, the Bank was lending up to 70 per cent of the total cost of the investment in 1967.

^{1/} See, for example, "Basic Data on the Economy of Laos," Overseas Business Reports, U. S. Department of Commerce, Washington, D. C., 1964, p. 6.

For short-term credits, however, the maximum amount was 40 per cent. This was substantially less than the 60 per cent maximum for short-term credits which had been in effect in 1966.

Although the Bank's statutes do not specify any maximum maturity on long-term credits, all credits have been for 15 years or less, and in recent years, the self-imposed maximum has been 10 years. Short-term credits, as indicated earlier, are for one-year or less.

In December of 1967 the Bank was charging an interest rate of 10 per cent,^{1/} plus 1 to 3 per cent commission, on its short-term credits. For medium- and long-term credits extended to the private sector, the rate was 5 per cent plus 1 to 3 per cent commission, while credits to the public sector were a flat 5 per cent.

Volume of Loans and Investments

As indicated in Table 7, the volume of loans outstanding generally increased through 1965, but in 1966 and 1967 it declined to slightly lower levels. Medium- and long-term credits have been consistently larger than the short-term credits by a ratio of about three to one. Thus in October of 1967 the Bank had outstanding K.207 million in medium- and long-term credits and K.69 million in short-term credits.

Only a small part of these credits were extended to the agricultural sector or for commercial purposes.^{2/} The bulk reflected long-term credits to public utilities and various industries.

The Bank's investment in quasi-public companies rose steadily during the early 1960's (see Table 7), but during 1965-67 the holdings remained unchanged at K.101.5 million. In 1967 the Bank held shares in a total of seven^{3/} quasi-public companies.

Government Supervision and Publications

The Development Bank of Laos is subject to only a few basic restraints in its financial operations. Like the commercial banks, the Development Bank must also hold a minimum legal reserve of 50 per

^{1/} The 10 per cent rate had been in effect since 1962.

^{2/} For additional details, see Crédit National Lao Etablissement Public: 1965, Crédit National Lao, Vientiane, 1966, pp. 8-9.

^{3/} For a list of the companies, see "National Credit Bank of Laos," Development Banks in Asia, op. cit., p. 79.

cent against its deposit liabilities, and loans to individual borrowers cannot exceed 49 per cent of the borrower's assets. In addition, the interest rate charged by the Bank late in 1967 could not legally exceed 11 per cent, i.e., the central bank's basic discount rate of 7 per cent plus 4 percentage points.

The Bank is under continual financial surveillance of the full-time representative of the Ministry of Finance, viz., the State Financial Controller. In addition, the Bank has two Account Commissioners (Commissaires aux Comptes), one representing the National Bank of Laos and the other the Ministry of Finance, to check the books, cash flow, and loan and securities portfolio of the Bank about two or three times each year.

Late in 1967 the Bank's main publications consisted of monthly balance sheets and profit and loss statements. The Bank expects to eventually publish annual reports on its operations, but the only publication of this type through 1967 was a brief booklet on the operations of the Crédit National Lao during 1961-65.^{1/}

Conclusions

The Development Bank of Laos, and its predecessor, Crédit National Lao, have made a substantial contribution in financing the public and quasi-public sectors of the economy. This financing has not been confined to loans, but has also included a substantial amount of equity financing. Although the absolute amount of financing is not large compared to other countries, the amounts are significant in relation to the size of the Laotian economy.

One of the institution's main problems, however, has been a lack of funds in recent years which has caused a slight decline in the volume of loans outstanding. CNL did not have any deposits until 1967 when the Bank was established, and the advances from the French Central Fund for Economic Cooperation declined in 1966-67 after reaching a peak in 1965. Central bank financing decreased in 1967 and the Government's capital contributions have also been paid in at a relatively slow pace.

One of the main reasons for establishing the new Development Bank was to provide potential donors, such as the Asian Development Bank or the U. S. foreign aid agency, with a suitable organization to receive the funds. Another reason was to obtain more resources by having the new Bank accept deposits.

^{1/} See Crédit National Lao Etablissement Public: 1965, op. cit.

It is unlikely, however, that even if the Bank had more funds it would be able to utilize them effectively. The Bank lacks a sufficient number of skilled and technically trained employees to conduct feasibility studies and to properly assess loan applications. The Bank's statutes are somewhat rigid, and the number and the degree of formalities required of potential borrowers have probably been a hindrance to an expanded volume of business. In addition, Laos has suffered from an uncertain political and security situation which has hindered the execution of normal financial operations.

Although some of the Bank's initial capital was reportedly invested in poorly prepared projects, the Bank's accounts do show a steadily rising amount of profit. Between 1961 and 1966 net profits increased from K.0.3 million to K.11.1 million. Data are not available, however, on loan delinquencies or defaults, hence it is not possible to assess the quality of the loan portfolio.

While the Bank has played a useful role to date, its main problem in the future will be raising new financial resources and training its staff. To encourage a more rapid growth in deposits, consideration could be given to a general upward revision of the Bank's deposit rates in order to make them more attractive to potential savers. Loan rates, which are now probably below market levels, would also have to be adjusted upward accordingly to more realistic levels.

Small Industry Loan Fund

The Small Industry Loan Fund (SILF) was established in 1967 as a joint effort by Laos and the United States to provide medium-term loans to small, private industrial ventures. The Fund is also authorized to guarantee credits, provide advisory assistance, and conduct feasibility studies. The SILF is funded by U. S. foreign aid grants and counterpart funds, and operates as a unit within the Development Bank of Laos. Credits are extended only to private enterprises.

Establishment, Purpose and Organization

As the result of a Project Agreement signed by the representatives of Laos and the United States of America^{1/} on March 10, 1967, the Small Industry Loan Fund^{2/} was established to encourage the growth of

^{1/} The Agreement is between the General Commission for the Plan, represented by the Ministry of Finance, and the United States Agency for International Development, represented by the Director of the American foreign aid program in Laos.

^{2/} The formal name of the Fund is the Special Fund for the Development of Small Private Industries.

selected small industrial establishments in Laos. For ease of administration and other reasons, the Fund was established within the Development Bank of Laos. Separate accounts, however, are maintained on the Fund's operations. The Fund began to operate actively in August of 1967 with its first disbursement of funds.

The Fund's basic goal is to encourage the creation of private productive enterprises and the expansion of existing ones. This objective is to be achieved primarily by extending medium-term loans to businessmen in such fields as forestry, wood products, metal working and textiles. The Project Agreement provides that credits be limited to enterprises that are essentially private in character and that do not have any government equity financing.

In achieving its basic objectives, the Fund is also authorized to provide advisory and technical assistance, to supply funds for training, and to provide experts to evaluate the feasibility of proposed loan projects. Full details on the scope of the Fund's operations are spelled out in the Project Agreement.

The Fund is basically operated and organized on a joint basis between Laos and the United States. The top controlling group is the six-man Management Committee which consists of the President^{1/} or Vice-President of the Development Bank of Laos, the Director of the U. S. foreign aid mission, the Commissioner of Plan, the Director of Industry, a representative of the National Chamber of Commerce and Industry, and the Director-General of the Development Bank of Laos. For loans totaling \$20,000 or less, final approval can be granted by the lower-level Technical Committee. This five-man Committee is headed by the Director-General of the Development Bank of Laos and the Small Industry Representative of the United States' aid mission.

The working staff of the Fund consists of selected employees from the Development Bank of Laos. The Fund does not maintain any branches or agencies.

Sources of Funds

During at least the first two years of its operation, all of the funds for the operation of the Small Industry Loan Fund (SILF) were supplied by the U. S. Government. Dollar obligations have been met through use of United States' foreign aid funds, and local currency has been provided from the U. S. AID Trust Fund, fed either by the

^{1/} The Laotian Finance Minister serves ex officio as President of the Development Bank.

Counterpart Special Account or the U. S.-owned local currency account. No interest is earned by the United States on its holdings of counterpart in the central bank.

The Fund's original capital, as specified in the March 1967 Project Agreement, was \$529,000 (K.127 million). Additional funds have been supplied to the SILF through annual U. S. foreign aid appropriations.

Once a specific loan agreement is signed, funds are transferred to the special account for the SILF in the Development Bank. The funds are disbursed in tranches by the U. S. aid mission in Laos when needed for use in the loan project.

Nature of Activities and Credit Terms

The Small Industry Loan Fund's basic operation consists of providing medium-term loan capital, primarily for export-oriented industries and import-saving industries. The Fund is also authorized to furnish commercial credit guarantees (although through early 1969 it had not yet entered into this type of activity) and to conduct feasibility studies.

The Fund's first three loans were to the logging industry, primarily to finance the purchase of heavy logging equipment for timber extraction. The Fund also expects to finance veneer and plywood manufacturing, and the purchase of heavy equipment for mechanized farming. Other potential projects include tire recapping, textile manufacturing, lumber seasoning and treatment, furniture manufacture, well drilling, and pump installation.

Borrowers are required to meet certain conditions. They must contribute funds equal to at least 30 per cent of the cost of a project (fixed capital and working capital) and provide collateral equal to 100 per cent of the loan value. The potential borrower's company must also be registered with the Government and the project must receive governmental approval if it involves the creation of a new industry or a major expansion of an existing industry. If the project involves the procurement of foreign goods, at least 70 per cent of these must be obtained from U. S. sources.

The maximum term permissible for all loans and guarantees granted by the Fund is five years. The Fund's first loan (for heavy timber extracting equipment) had a term of five years including a one-year grace period. Most credits have so far carried an interest rate of 11 per cent per annum (the legal maximum) plus 1 to 3 percentage points

commission, the latter depending on the amount of time which elapses between the loan contract and the first disbursement of funds. For loan guarantees, the Fund charges a rate of 3 per cent per annum.

As of July 1, 1968, the Fund had authorized \$380,000 in loans and had disbursed \$238,000 (K.57 million). At that time the Fund did not hold any securities, its main assets consisting of its loan portfolio.

Fund Reserves and Government Supervision

Since the Fund does not conduct a deposit business, it is not subject to minimum legal reserve requirements. However, the Project Agreement does provide that 40 per cent of all repayments of loan principal must be credited to the Fund's Reserve Account and the Revolving Fund Account. The remaining 60 per cent must be repaid to the U. S. foreign aid mission. In addition, 5/12's of the repayments of interest and commission are to be credited to the Fund's Reserve Account and the Revolving Fund Account.

The only limitation on the volume of operations of the Fund is the amount of funds at its disposal. It is, however, prohibited from financing certain activities such as the purchase of land. Foreign procurement of goods are to be limited to those countries which are members of the Asian Development Bank and the International Bank for Reconstruction and Development. In addition, no loan disbursements can be made without the approval of the Director of the U. S. foreign aid mission.

The Fund is audited at least once a year by the USAID/Laos Controller, and by an auditor from the Lao Finance Department. Borrowers from the Fund are also subject to annual audits by the representatives of the Fund.

The staff of the Fund is required to prepare quarterly reports on each approved loan and to transmit a copy to the Controller of the U. S. foreign aid mission. The Fund, however, does not publish an annual report, or any other periodic reports.

Comments

The Fund's operations during its first two years have been relatively modest. This has been due not so much to a lack of funds as to a shortage of skilled personnel to conduct careful loan appraisals. Consequently, it is still too early to ascertain whether the Fund will be successful in achieving its basic objectives.

Agricultural Development Organization

The Agricultural Development Organization (ADO) is a joint entity created by the governments of Laos and the United States to help increase agricultural productivity by means of its distribution and credit activities. Established in 1965, the Organization hopes to expand the production of paddy and thereby reduce the heavy dependence on rice imports. Short-term and medium-term credits are extended by ADO to Laotian farmers to finance materials, equipment, and work animals.

Establishment, Purpose and Organization

In a move to stimulate and promote agricultural development, the governments of Laos and the United States jointly established in October of 1965 the Agricultural Development Organization which also began to operate in the same month. Details regarding the framework of operations for the Organization are spelled out in an agreement^{1/} between the two governments and in a presidential decree.^{2/} The joint agreement can be terminated by either side upon 60 days notice.

The basic purpose of the Organization is to stimulate and promote agricultural development, particularly the production of rice. Since Laos is partly dependent on the importation of rice, ADO has been given the power and authority to establish projects for increasing the production, purchase and distribution of rice in order to reduce this dependence on imports. In actual practice, ADO's main function has been to make available to farmers the assets of ADO (fertilizers, insecticides, etc.) on either a cash or credit basis, and to finance the purchase of buffaloes and water pumps.

^{1/} Accord No. 5065.

^{2/} Decree No. 605 signed October 4, 1965.

The top operating officials of ADO are the two National Co-Directors. Both of these, as well as the other officers of ADO, are determined on an ex officio basis. The Laotian Co-Director is the Directorate of Agriculture, while the U. S. Co-Director is the Chief of the Agricultural Division of the U. S. foreign aid mission. Directly responsible to the Co-Directors is the Administrative Officer of ADO's headquarters.

ADO's operations late in 1967 were carried out through six provincial offices. These are located in Vientiane, Paksé, Luang Prabang, Savannakhet, Sayaboury and Thakhet. The Provincial Co-Directors are the Provincial Agricultural Chief of the Royal Lao Government and the U. S. AID agricultural adviser. Subordinate to the Director is a field agent for each province.

Periodic meetings of the officers of ADO are held at the Directorate of Agriculture, but most of the full-time headquarters staff is located in the Development Bank of Laos' building. In 1967 ADO had approximately 150 employees.

Sources of Funds

The organization's main sources of funds consist of annual U. S. budget appropriations for agricultural development and local currency counterpart. ADO does not have any basic capital and began its operations on the basis of budget appropriations. All of the funds for the organization's operations through at least mid-1969 were supplied by the United States.

From the basic funds indicated above, ADO obtains goods which are sold for local currency. These proceeds are placed in a revolving fund which can be used to finance ADO's various operations. ADO maintains funds both in the central bank and in the Development Bank of Laos.

Nature of Activities and Credit Terms

ADO's main activities have so far consisted of selling fertilizer, insecticides, seeds, tools, and machinery to farmers lacking access to commercial suppliers, and of extending credits at relatively low interest rates when necessary to finance these sales. The organization has also engaged in some price support operations for newly produced agricultural surpluses not absorbed through purchases by the private sector.

The major commodities supplied on a credit basis have been buffaloes, water pumps, fertilizer and insecticides. Hand tools are sold for cash, while repayment for fertilizer is in paddy--one kilogram of paddy for one kilogram of fertilizer.

Potential borrowers are required to file a loan application and to sign a contract for the purchase of the item to be financed. For purchases of pumps, a minimum cash downpayment of 40 per cent is required, but for buffaloes there is no downpayment. Borrowers are generally required to provide some type of collateral.

Interest rates and maturities vary, depending on the item financed. For buffaloes, the rate is 3 per cent per annum and the repayment period is three years. For small water pumps, it is 1 per cent per month interest, with the principal due six months after the date of sale. Fertilizer, seeds, and insecticides are sold on a cash basis, or with repayment in paddy (kilo for kilo) at the end of the harvest period, or on credit with rates of interest ranging from 3 to 10 per cent with repayment in four to six months.

Volume of Activity

Through November of 1967 the organization had extended 585 buffalo loans valued at about K.15 million, and had financed the purchase of 97 water pumps valued at K.7 million. With a 40 per cent cash downpayment on the pump loans, total credits granted for pumps were about K.4 million. Credit sales of fertilizer and insecticides during the year ending mid-1968 were about K.50 million.

Government Supervision

The Agricultural Development Organization is subject to relatively few financial restraints, the main limitation on the volume of its operations being the amount of budgeted funds approved annually by the U. S. Congress. Unlike the Small Industry Loan Fund, it does not maintain a reserve fund. As of December 1967, there were no limitations on the amount of credit that ADO could extend to any one borrower, although some consideration was being given at the time to establishing such a limit.

The organization's accounts are audited by the Controller of the U. S. foreign aid mission. Although ADO does not issue any publications, monthly reports are sent to the Director of the Directorate of Agriculture and to the Director of the U. S. foreign aid mission.

Comments

It is still too early to know whether ADO will be successful in achieving its basic objectives. It has had administrative problems, including a shortage of skilled personnel and some problems of communication and authority in the chain of command. The data available on ADO's debt collection experience are also too skimpy to indicate whether there will be problems in this area. However, its activities represent some modest, but basically sound, steps in the direction of improving agricultural productivity, which is essential if the country is to expand its rate of economic growth.

Insurance Companies

Laos has only a limited number of insurance companies which are mainly engaged in providing general insurance, often on a reinsurance basis. The industry is not an important source of funds, the total volume of assets being relatively small. There is relatively little information available on the insurance companies and no regularly published source of data.

Number and Nationality of Insurance Companies

At the end of 1967 Laos had six insurance companies of which two were indigenous^{1/} and four were foreign.^{2/} All of the companies were located in Vientiane except Chanhsoth Assurance which was in Savannakhet. Of the four foreign companies, three were French and the fourth (Compagnie Générale de Commerce Lao) was representing American insurance underwriters. At the time, Laos did not have any insurance agencies operated by the Government.

Types of Insurance

Most of the insurance provided in Laos is general insurance, with only a small amount of life insurance being sold. Automobile insurance is by far the most important and reportedly accounts for about 90 per cent of the insurance underwriting. Fire insurance is also provided,

1/ Société Franco-Lao Elephant and Chanhsoth Assurance.

2/ Denis Frères (representing La Société Générale d'Assurances), Le Secours, La Preservatrice, and Compagnie Générale de Commerce Lao (serving as an agent for American International Underwriters).

as well as a small amount of insurance on imported commodities. Most of the insurance on imported commodities is placed outside of the country.

Specific data are not available, but a substantial portion of the policies are reinsured by companies outside of Laos. Some insurance is also handled by subbrokers for insurance companies in Thailand and elsewhere.

Premium Income and Insurance Assets

Official data are not available on the volume of insurance business transacted annually in Laos, however, the amounts appear to be relatively small. One French company in 1966, for example, received about US\$14,000 in premiums.

The insurance companies hold a relatively small amount of assets, partly because a substantial portion of their policies are reinsured overseas. Consequently, the insurance companies are not an important source of capital funds for any part of the economy.

Government Supervision

The insurance companies are controlled by the Government in accordance with a 1958 law.^{1/} Under the law, the companies are required to register with Le Directeur de l'Enregistrement Chargé du Contrôle des Compagnies d'Assurances, and to deposit K.400,000 with the Government. In general, however, the companies are not very closely regulated.

Comments

As indicated earlier, the insurance companies in Laos are not a significant source of capital funds for the economy. It also appears unlikely that this situation will change substantially in the next five to ten years.

^{1/} Ordonnance Loi sur les Assurances et Entreprises Annaloques, No. 133 of May 23, 1958.

Private Moneylenders

Very little information is available on private moneylending activities in Laos. There are no published data on this subject and, in addition, both the borrower and lender are reluctant to discuss the matter since the interest rates involved exceed the legal interest rate ceiling.^{1/}

A relatively high proportion of the moneylenders are Chinese, the others tending to be Vietnamese, Indian, or Laotian.^{2/} Many of the moneylenders are merchants who perform a dual role. They not only provide the farmer with essential pre-harvest operating supplies, but also purchase his output after it is harvested. Thus they employ money or their goods on a credit basis, repayment being made at harvest time in kind, usually in the form of rice or other agricultural output. Because the price of rice is relatively lower at harvest time, the moneylender-middleman is generally able to make a substantial profit by selling the rice later at a higher price. On the other hand, the borrower does not have this flexibility since his needs for funds or supplies prior to harvest are usually urgent, and the loan repayment generally has to be made at harvest time.

The credits extended are used for several purposes. These include supplies, such as seeds and fertilizer for use during the planting season, cash to pay for hired labor or work animals, and food to sustain the farmer and his family until harvest time.

Although moneylending activities are carried out in both urban and rural areas, the bulk of the operations are in the rural areas. Data indicate that about 90 per cent of Laos' labor force is engaged in agricultural activities.

The rate of interest charged by moneylenders tends to vary, depending upon the rate of domestic inflation and other factors. During the late 1960's, when the rate of inflation had abated somewhat, money rates were reported to be lower than during earlier periods. In recent years the rate has generally ranged between 2 per cent and 4 per cent per month, and in early 1969 the rate in Vientiane reportedly ranged between 25 and 40 per cent per annum.

Despite the level of these rates, the Laotian farmer continues to borrow from the private moneylender. This is not only because of the absence of alternative sources of credit, but also because the farmer

^{1/} In mid-1969 this ceiling was 11 per cent per annum.

^{2/} Area Handbook for Laos (ed. by Wendell Blanchard), Human Relations Area Files, American University, Washington, D. C., March 1958, p. 459.

knows the moneylender as a person and is familiar with his way of doing business. The high rates also influence the channeling of savings. Various reports indicate that relatively few persons are interested in placing their funds in savings or time deposit accounts in commercial banks (which in December of 1967 yielded only 3 to 10 per cent per annum), and prefer instead to make personal loans to relatives, acquaintances and others at more remunerative rates.

Conclusions

The Laotian economy is only at the beginning stages of development and this is true also for the monetary and financial system. Outside of the larger cities and towns, a pre-money economy virtually prevails. With the exception of the commercial banks, central bank and development banks, the country has no major financial institutions. There is no money market or capital market, and the bulk of the commercial bank credit is extended to finance commodity imports.

Even if the Laotians were to be successful in markedly improving their system of financial institutions, rapid economic growth would probably not take place because of many other major problems plaguing the economy. Stated very briefly, these problems include: (1) a labor force which is low on skills, including entrepreneurship, and is not wage-oriented; (2) both a low level of productivity in general and low productivity gains; (3) the lack of a good infrastructure; (4) certain natural problems such as inhospitable terrain, the country's landlocked condition, and a major river not completely navigable; (5) Communist aggression and subversion; (6) political instability; (7) a low rate of domestic saving; and (8) a limited domestic market.

Contribution of the Financial Institutions to Economic Development

The commercial banks have made only a moderate contribution to the country's economic development. Most of their credits have been extended to finance commodity imports, and few, if any, loans have been extended to finance the agricultural, construction or consumer sectors. There has been relatively little growth in commercial bank loans since 1965, and during the 1960's bank assets, measured in real terms, have not increased very rapidly.

Although the credits and investments made by the Development Bank are small compared to other countries, they have made a substantial contribution in certain fields in Laos. The contributions made so far by the Small Industry Loan Fund and the Agricultural Development Organization

have been modest, both of these institutions still being relatively new. No real contribution to the country's economic development has been made by the insurance companies, the pre-1960 government pension fund, or the mutual lending societies.

In 1968 the total assets of Laos' financial institutions were equal to approximately 30 per cent of the country's GNP. This ratio is quite low compared to those for the more developed countries, and it has probably not changed much since 1964. This is partly because there has been relatively little growth in the volume of bank credits since an economic stabilization program was launched in 1964.

The inadequacy of certain existing financial institutions has not been the main obstacle preventing economic development in Laos. The main obstacles have been the many problems and impediments listed earlier. Hence, while creating new, or improving the existing, financial institutions would help promote economic growth, such measures will not guarantee successful economic development because of the many other problems which must be overcome.

Laos clearly has a need for improved agricultural credit facilities, the main present institution being the private moneylenders. This could initially take the form of efficient and soundly managed agriculture credit cooperatives. The main problem will be to obtain suitable personnel to operate these cooperatives--persons who will follow sound financial policies both with regard to attracting funds and in providing credits. In this connection, the Asian Development Bank sent a technical assistance mission to Laos late in 1968 to prepare an integrated agricultural development program for the Vientiane Plain, including suggestions for improving agricultural credit facilities.

As the economy develops, there will also be a need for such financial institutions as credit unions, savings and loan associations, finance companies, and pawnshops. However, some institutions, such as a stock exchange, are not likely to be feasible for many years. Concomitant with the establishment of these new institutions will be the need for the Government to pass appropriate legislation to protect both the investors in these institutions and their customers.

Given the proper training and policies, more could also be done by the existing institutions. The Development Bank of Laos, for example, lacks the trained staff to properly appraise projects. Until this defect is remedied, it cannot effectively utilize increased funds that it might obtain from domestic or external sources. One indication of the weakness of the developmental institutions in Laos is the fact that the central bank has had to purchase equity investments in almost a dozen of the country's major firms. Also, the economic soundness of some of the early investments of the Crédit National Lao has been questioned in some quarters.

Except for some of the credits and investments made by the Development Bank of Laos and the central bank, the bulk of the credits extended have been influenced mainly by market factors. This has tended to hold down any misallocation of resources with the result that most of the funds have been used efficiently. At Laos' present stage of economic development, this means primarily to finance imports, since the scope for investment in economically productive activities is limited. However, this pattern is likely to be altered later as the economy develops.

The Role of Interest Rates in Mobilizing Savings and Allocating Resources

National income data are not available on aggregate savings in Laos, but the time and savings deposits data of the commercial banks indicate that savings in this form have been relatively small and have not grown very rapidly in recent years. The interest rate policies pursued by the authorities have not been very forward-looking and they have not helped to increase bank deposits. The rates paid on time and savings deposits are subject to legal ceilings which have been set at unrealistically low levels. As a result, the deposits are not attractive to actual or potential savers.

The commercial banks have frequently complained that they suffer from a shortage of funds. More funds could be mobilized if there were an upward adjustment of both loan and deposit rates to a more realistic level. Bank profit margins would, of course, have to be maintained at adequate levels. Because of the substantially reduced rate of inflation since 1964, major changes in the interest rate structure would presumably not need to be made very often following the basic upward revision of the rates.

Neither the structure of the interest rates nor the official interest rate policies have played a very important role in allocating funds to alternative uses. Although different interest rates have been in force for different types of deposits and credits, there is little evidence to indicate that the differentiation of the rates, per se, has had any substantial impact on the allocation of funds. The actual differences in the credit rates have not been very large and most of the deposit rates have been too low to be attractive.

Some Policy Lessons

One of the lessons which emerges from the Laotian experience is that more than just financial resources are needed if a financial institution is to operate successfully. A case in point is the Development Bank of Laos. Funds are available from external sources, but these are not likely to be utilized until an adequate staff is recruited and trained to employ the funds efficiently. Similarly, one of the main problems of the Small Industry Loan Fund is not so much the lack of funds as the lack of skilled personnel to carry out a successful operation.

Another lesson is that unless savers are offered an attractive return on their funds, it will be difficult--if not impossible--to mobilize a substantial volume of domestic savings. As indicated earlier, this problem can be overcome through a general restructuring of both deposit rates and loan rates.

Finally, the economic developments in Laos since independence illustrate very clearly the inseparability of the internal and external sectors of the economy, and the need for official policies to promote equilibrium in both sectors in order to achieve general economic stability. Excessive domestic monetary expansion has had a direct impact in the past on the balance of payments and the exchange rate system, while an overvalued exchange rate has had disturbing effects on the domestic economy. With the assistance of relatively large injections of foreign aid in recent years, Laos has experienced only a moderate rate of inflation since 1964. The complete withdrawal of foreign aid would necessitate major and basic readjustments in the economy, however, such a development appears unlikely, although there could be some reduction in the future in the volume of foreign aid.

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