

**THE POLITICAL ECONOMY OF TRANSITION IN LAOS:
FROM PERIPHERAL SOCIALISM
TO THE MARGINS OF GLOBAL CAPITAL**

A Dissertation

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by

Bounlonh J. Soukamneuth

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Bounlonh J. Soukamneuth, Ph.D.

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Remarkably, in the view of some observers, a poor and relatively weak government in Laos survives as a one-party state, even as it transforms the country's political economy in response to declining communist fortunes in the early 1990s and the onslaught of economic globalization. How has the Lao government managed the socialist transformation and capitalist incorporation, while maintaining some semblance of external sovereignty and internal legitimacy? Through the broad lens of political economy and sociology, my research addresses this question, in exploring three areas of Lao state capacity: (1) political structure, (2) public administration, and (3) fiscal management.

I rely on several sources: a set of observations during my time on research assignment in Laos (May 2004-April 2005); an examination of governance-related, donor-funded development projects; an exhaustive survey of government laws, regulations, and documents since the reform period; and a review of literature on the political economy of development, market transition, and globalization. To assess different points of view on contemporary Laos, I conducted open-ended interviews with selected Lao officials, townspeople, expatriates, international consultants, and members of the diplomatic and donor communities.

From my research, evidence suggests that the Lao government actively promotes political, administrative, and economic centralization over regionally dispersed and fiscally independent provinces. In the transition process, a strong central

government capable of regulating and enforcing economic governance has gradually eroded traditional autonomy of Lao provincial authority. The recent history reveals a party apparatus pragmatically adjusting to economic constraints, while consolidating its power base, unifying the country, and exerting its centralizing influence on an ideologically indifferent countryside.

Laos is not an isolated case. For many developing countries struggling to build a unitary state and a national economic space of private exchange, centralized control over regionally autonomous regions constitutes one of the major governance challenges of nationally guided development. Contrary to the general global trend of public decentralization in the transition process, Laos provides a stark contrast, offering a valuable insight into the important role of governments in structuring economic relations.

BIOGRAPHICAL SKETCH

Bounlonh J. Soukamneuth was born in Vientiane, Laos, grew up in Providence, Rhode Island, and has called Ithaca home since 1992. After graduating from Cornell with a degree in Electrical Engineering (in 1996), he returned briefly to work in information systems in Manhattan, where he interned in 1994-95. Unsatisfied with this career move, he quickly left to apply his academic training in communities that could benefit from his technical expertise.

In 1997, he joined the Peace Corps as a starry-eyed, young immigrant American living out his American Dream (imagined or otherwise) and wanting to give something back to his adopted country. Two years later, he returned to the U.S. more introspective about charity and with a greater appreciation of the limits to aid. In 2000, he came back to Cornell for graduate studies in international planning and development. Having prolonged his graduate studies at Cornell beyond his initial expectations, Bounlonh looks forward to the near future when he will continue with his international development work, with more skills and resources to contribute to sensible change in an integrating world of unequal development.

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My advisors, William W. Goldsmith, Philip D. McMichael, and Iwan J. Azis, provided helpful feedback throughout the evolution of this dissertation. From Iwan, I learned the quantitative methods and macroeconomics that grounded my study of political economy. Phil's broad insights on globalization and markets have greatly expanded my understanding of development. To Bill, my worst critic, best editor, academic mentor, colleague and friend, I owe a debt of gratitude for his patience and unending professional support of my wide-ranging academic interests and evolving scholarship.

To my friends and family, I owe more than words can express. In such a fanatical world, the love and affection of such good people provide an easy impetus to roll out of bed and work hard for one's causes.

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Chapter I

LAOS AND THE SEARCH FOR THE END OF HISTORY

The end of the Cold War and the accelerated pace of global integration have dramatically altered the dynamics of the international system of states. According to John Lewis Gaddis, a prominent cold war historian, the collapse of the Soviet communist sphere discredited dictatorships and inaugurated the globalization of democracy.¹ In one famously optimistic account, Francis Fukuyama proclaims the “end of history,” in which liberal democracies constitute the highest form of social organization, embodied in the universal, homogeneous state.² According to this reasoning, a Leninist party-state like the Lao People’s Democratic Republic (Lao PDR or Laos) remains “mired in history” for not upholding the liberal ideals of democracy. Although this “end of history” thesis has been severely criticized in academic circles, the belief in a liberal democracy as a normative vision and universal trend has broad-based appeal, cutting across the ideological spectrum. Moreover, the apparent decline of the socialist state raises questions about the viability of alternatives to liberal democracies.

On the fate of Marxism, the *Economist* wryly notes, “As a system of government, communism is dead or dying. As a system of ideas, its future looks secure.”³ Even so, this observation fails to appreciate the adaptive capacity of non-

¹ John Lewis Gaddis, *The Cold War: A New History* (New York: Penguin, 2006).

² Francis Fukuyama, “The End of History?” *The National Interest* (1989). presents a compelling argument of the inevitable marriage between economic liberalism and democracy. See also his Francis Fukuyama, *The End of History and the Last Man* (New York: Free Press, 1992), especially Chapter 1. In essence Fukuyama identifies capitalism with democracy. “The ideology of victorious industrial capitalism defined democracy almost completely in agreeable *economic* terms, as liberty of contract.” See Daniel Bell, “Is There a Ruling Class in America? The Power Elite Reconsidered,” in *The End of Ideology: On the Exhaustion of Political Ideas in the Fifties* (Cambridge, MA: Harvard UP, 2001), 67.

³ *Economist*, “Marxism after Marx,” *Economist* (2003).

European forms of Marxist-Leninism. Ignoring the glaring exceptions of China, Vietnam, North Korea, Laos, and Cuba, one scholar notes, “while the end of communism is a matter of fact, the transition to democracy and free markets remains a work in progress.”⁴

In the Lao PDR, the market transition has not produced the communist decline experienced in the former communist states of Eastern Europe. Underscoring this astonishing communist complacency, the weak government in Laos earlier relied almost completely on the former Soviet Union for military aid, financial assistance, and ideological support, all of which disappeared by 1989. Since then, the party-state has pragmatically embraced market liberalization, all the while restructuring its public administration, plugging its financial gap, and regulating political demands upon the state. What accounts for Laos’ divergent socialist trajectory? To what extent does the Lao experience provide clues to the ways in which other developing countries integrate into the world economy?

In addressing these broad questions, my dissertation examines the political and economic restructuring of the Lao government since the early 1990s. This introductory chapter begins by laying out my research inquiry and hypotheses about the nature of the market transition in Laos. Following a brief overview of contemporary Laos, I present some theoretical perspectives on global economic integration and post-socialism. The fourth section justifies my method of inquiry, a regime-centered organizational perspective on the processes of political and economic change. The concluding section outlines the chapters to follow.

⁴ Michael Mandelbaum, ed., *Post-Communism: Four Perspectives* (New York: Council of Foreign Relations, 1996) 4. On the fate of Marxism, the *Economist* writes, “As a system of government, communism is dead or dying. As a system of ideas, its future looks secure.” *Economist*, “Marxism after Marx.”

The Collapse of Communism and Expectations of Democracy

By the late 1980s, the international movement of communism pulled back in full retreat. The idealism and sense of historical inevitability that animated much of the socialist movement gave way to the harsh reality of economic privation, in stark contrast to the wealth creation of market capitalism. In the name of reform, communist governments the world over began to promote free enterprise and private property. Instead of strengthening the leading role of the communist party, however, economic reforms in the second world hastened regime change. In 1989, the Berlin Wall came tumbling down, symbolizing the opening of the Iron Curtain. Demand for change resonated strongly in many parts of the communist world. In Poland, the Solidarity trade union forced multi-party elections that resulted in a coalition government. In China, tens of thousands of university students gathered in Tiananmen Square to protest government corruption and to demand democratic elections. Although brutally crushed, the student takeover of Tiananmen called into question the legitimacy of a communist dictatorship in China and elsewhere. Tellingly, the communist leader of the Lao PDR, Kaysone Phomvihane, celebrated these repressions by making the first post-Tiananmen state visit to Beijing, where he re-affirmed his government's solidarity with its Asian brethren.

Back in Laos, the communist leaders worked diligently to crush dissent. An editorial in the Lao communist newspaper decried 1989 as “a nightmare year for socialism,”⁵ and party operatives moved swiftly to limit the democratic contagion. In an initial burst of *glasnost*, or political opening, the Social Democratic Club, a group of about 40 Lao intellectuals and party members, vocally criticized the government in early 1990. In an open letter of resignation to the party, Thongsouk Saisangkhi, a vice-

⁵ As quoted in Soren Ivarsson, Thommy Svensson, and Stein Tonnesson, *The Quest for Balance Is a Changing Laos: A Political Analysis, Nias Report Series, No. 25* (Copenhagen: Nordic Institute of Asian Studies, 1995).

minister in the government, described the Lao PDR as a “communist monarchy” and a “dynasty of the Politburo.” He called for “a multiparty system in order to bring democracy, freedom and prosperity to the people.”⁶ Instead of provoking a thoughtful process of change, the political opening helped Kaysone identify and purge democratic sympathizers within the party. Thongsouk and two other leading members of the Social Democratic Club were jailed and later tried on charges of libel and defamation “against the country.”⁷

Rumblings of democratic dissent soon faded in Laos.⁸ In this sparsely populated and geographically dispersed land, the Lao People’s Revolutionary Party (henceforth LPRP or party) retains a strong grip on power. The 5th Party Congress in 1991 promulgated the regime’s first constitution and re-confirmed the party’s leading role in society. As the country moves toward the Chinese model of market-based authoritarianism, economic reforms occur under the aegis of the party.

Today, the authoritarian regime survives politically and remains unchallenged. In its commentary on recent party elections for the National Assembly, the *Economist* captures the following scene in Laos:

Up swept both cars of the presidential motorcade, bringing Khamtay Siphandone to choose between the various party functionaries running for office. As Mr. Khamtay cast his ballot, a journalist asked him what would change as a result of this uplifting spectacle. “There will be no change,” the president explained, since last year’s party congress had already undertaken all

⁶ As quoted in Grant Evans, *A Short History of Laos: The Land in Between, Short History of Asia Series* (Chiang Mai, Thailand: Silkworm Books, 2002) 200.

⁷ Thongouk, Latsami Khamphoui (vice-minister of Economics and Planning), and Pheng Sakchittaphong (from the Ministry of Justice) were eventually tried in 1992 and sentenced to 14 years in a re-education camp in Houaphan Province. *Ibid.* 200-1.

⁸ In October 1999, about fifty students and teachers at the National University of Laos organized a peaceful protest outside the Presidential Palace in central Vientiane. The protesters called for a multi-party system, elections for a new National Assembly, respect for human rights, and the release of political prisoners. The government quickly silenced these dissenting voices. All the protesters were sent to prison. To this day, five organizers of the protest remain in detention and without recourse to due process before the law or the possibility of a trial.

the necessary measures to update and reinvigorate the revolution.... As the hammer-and-sickle flags draped over the polling booths attested, Laos remains a resolute and unabashed communist dictatorship.⁹

The large-scale uprising that engulfed most of the communist bloc in the period 1989-91 lacked a Lao counterpart. Among the small intelligentsia in Laos today, democratic change remains a distant possibility.

This democratic silence is even more striking in light of recent transformations in Southeast Asia. Boasting the longest running democracy in the region, the Philippines has embraced political pluralism since the “people power” revolution of 1986 forced Ferdinand Marcos and his cronies into exile. In 1988, student demonstrations in Burma culminated in multiparty elections two years later, when the National League for Democracy, under the leadership of Aung San Suu Kyi, appeared poised for victory. Elsewhere, democratic breakthroughs followed the forceful retreat of the military in Thailand (1992) and the collapse of Suharto’s New Order in Indonesia (1998). The 1990s also inaugurated a period of democratic consolidation in Cambodia.¹⁰

Against this wave of democracy, the communists in Laos face little opposition to one-party rule. Remarkably, in the view of some observers, a poor and relatively weak government in the Lao PDR survives as a one-party state,¹¹ even as it transforms the country’s political economy in response to declining communist fortunes in the early 1990s and the onslaught of economic globalization. Motivating my research is a desire to unpack this conundrum— in the hopes that an analysis of the Lao state might broaden our understanding about the changing nature of peripheral states, their general

⁹ The Economist, "Elections in Laos: Not Exactly a Cliff-Hanger," *The Economist*, Mar 2-8 2002, 41.

¹⁰ For a general overview of Southeast Asian history, see Norman G. Owen, ed., *The Emergence of Modern Southeast Asia: A New History* (Honolulu: Univ. of Hawai'i Press, 2005).

¹¹ Ivarsson, Svensson, and Tonnesson, *The Quest for Balance*.

relationship to development, and the pre-conditions of capitalist development. Several questions guide this inquiry. What accounts for the government's stability in the face of major upheavals in the communist and capitalist worlds? How has the Lao government managed the socialist transformation and capitalist incorporation, while maintaining some semblance of external sovereignty and internal legitimacy?

An early, but well-regarded, analysis of the socialist transformation in Laos quickly dismisses, out of hand, any immediate prospect for political pluralism.¹² Another, by one long time observer, notes, "The economic liberalization of the late 1980s did little to weaken the Party's hold on power, not even after the collapse of the Soviet Union."¹³ The party-state continues to monopolize political power, while overseeing a more market-oriented economy. Still, these developments leave several questions unanswered.

In what ways have macro-historical changes engendered by the collapse of the Soviet empire created space for meaningful democratic transformations in one of the last communist holdouts? How have changing economic and regional dynamics affected domestic political change in Laos? Have changes in the international system fostered or inhibited democratic developments in the country? What are the determinants for a successful socialist transformation in Laos? To this end, do democratic institutions matter?

In tackling these questions, my dissertation will outline the general characteristics of Laos' emerging political economy¹⁴ and the role of international

¹² Martin Stuart-fox, "Prospects for Democracy in Laos," *Asian Studies Review* 17, no. 2 (1993). Ivarsson, Svensson, and Tonnesson, *The Quest for Balance*, come to a similar conclusion.

¹³ Martin Stuart-fox, *Buddhist Kingdom, Marxist State: The Making of Modern Laos* (Bangkok: White Lotus, 1996) 151. He goes on to argue, "Greater economic freedom led to some relaxation of the more arbitrary aspects of the Party's social control." But his pessimism about democratization remains firm.

¹⁴ In general, political economy as an idea implies the relationship between politics and economics. As a field of study, it entails an investigation into the systematic links between politics and economics in society. From classical economics, political economy simply means the study of how society materially reproduces itself. Prior to the twentieth century, the study of economics in various and sundry forms

actors in shaping the contours of the evolving Lao state. While documenting socio-economic change in the country, I also explore the relationship between the development of a market economy and the ways in which it necessitates a reorganization of political interests and creates space for considering alternative forms of political organizations.

For many Lao nationalists, the establishment of Lao PDR in 1975 marked the first time in modern history that Laos became truly independent. For others, its relative backwardness and dependence upon the communist sphere for political guidance and financial support have ensured a continuity of external meddling in the country's political economy. In popular myth, the communist government in Laos survives only

was always considered political economy, and no sharp distinction was made between the two. With the development of more abstract analyses of economics, especially with the marginalist revolution in economics early in the 20th century, the politics was formally dropped from critical inquiry of economic behavior.

A modern interpretation of political economy starts with the assumption that the economy is politically and socially embedded in society and structured by power relations. See R. Andrew Sayer, *Radical Political Economy: A Critique* (Oxford: Blackwell, 1995). The classic definition of political economy comes, however, from Karl Polanyi, who distinguishes between the study of formal and substantive economics. The former refers to the study of economic decision making under conditions of scarcity (a choice of sufficiency of means in relations to ends). See Karl Polanyi, "The Economy as Instituted Process," in *The Sociology of Economic Life*, ed. Mark Granovetter and Richard Swedberg (Boulder, CO: Westview Press, 1992). Analyses of these choices under scarce resources (i.e. price-making markets) make up the academic field normally considered economics. The formal, abstract deductive approach focuses on prices as a manifestation of relative scarcity, under conditions of supply and demand. Formal economics "offers a total description of the economy as determined by choices induced by an insufficiency of means" (Ibid. 32). On the other hand, substantive economics, or political economy, involves an analysis into the working of the economy, which requires investigating its social structure. As academic inquiry, political economy requires an empirical analysis into the instituted processes of an economy. For Polanyi, political economy presupposes the human economy, which "is embedded and enmeshed in institutions, economic and noneconomic. The inclusion of the noneconomic in society is vital. For religion or government may be as important for the structure and functioning of the economy as monetary institutions or the availability of tools and machines themselves that lighten the toil of labor" (Ibid. 34). Political economy thus suggests "the shifting place occupied by the economy in society" and "the manner in which the economic process is instituted at different times and places" (Ibid.). By instituted process, he means the institutionalization of rules and modes of conduct that govern economic behavior.

For a good summary of the competing currents of political economy, see Frank Stilwell, *Political Economy: The Contest of Economic Ideas* (Oxford: Oxford UP, 2002).

as a satellite of the Socialist Republic of Vietnam¹⁵ — and increasingly of the People’s Republic of China. By extension, the Lao PDR’s political fortunes depend, first and foremost, on the fate of its socialist sponsors. Repeating a familiar historical pattern, the argument runs, Laos exists for the political convenience of stronger states.¹⁶

No doubt partly accurate for all Lao regimes in the modern era, this assessment fails to take into consideration the ways in which the Lao PDR successfully transitioned to a form of market capitalism without the need for a deeper political realignment. As in Vietnam and Cambodia, internal dynamics provided the initial impetus for reforms in Laos.¹⁷ The collapse worldwide of state communism forced the Lao state to embrace economic restructuring, in accommodating market capitalism. This market opening (*perestroika*) has transpired in the absence of a political one (*glasnost*). That is, communism survives in Laos because the regime has opted not to deregulate authority. In trying to understand how and why perestroika can succeed in the absence of glasnost, this dissertation examines the ways in which the market transition has unfolded under the guidance of the communist party in Laos.

Political and economic modernization elsewhere in East Asia provides a window onto the possible socialist trajectory in Laos. In the book *Governing the Markets*, Robert Wade analyzes the success of one of the East Asian success stories.

¹⁵ In one revealing analysis, Hans Luther argues that Laos’ political liberation from France and the U.S. has not resulted in national self-determination, but rather has reproduced a new and more structural form of dependency. Hans Ulrich Luther, *Socialism in a Subsistence Economy: The Laotian Way: An Analysis of Development Patterns in Laos after 1975* (Bangkok: Chulalongkorn University Social Research Institute, 1983) 28-9. In his analysis of economic development in Laos under socialism, Luther fails to provide convincing evidence to back up his argument of Laos’ structural dependency.

¹⁶ As some historians suggest, “The political history of Laos since 1945 has been dominated by the efforts of various Lao and foreign groups to construct a political entity named “Laos” where none existed before.” See David Joel Steinberg, ed., *In Search of Southeast Asia: A Modern History*, Rev. ed. (Honolulu: University of Hawaii Press, 1987) 383.

¹⁷ Changes have come about as a consequence of peasant alienation and other internal discontent over the part-state symbiosis. Borje Ljunggren, *Market Economies under Communist Regimes: Reform in Vietnam, Laos and Cambodia, Development Discussion Paper No. 394* (Cambridge, MA: Harvard Institute for Interational Development, 1991).

Through the 1960s, the political system of this country maintained, in the words of Wade, “a virtual monopoly on power in a single party or institution for a long period of time.” This state exhibited both authoritarian and corporatist tendencies “with very limited scope for popular preferences in the selection of rulers,” as well as “tight restrictions on interest groups.” Not only was the regime militarized, but the entire society as well. The military enjoyed “veto-power over the selection of the top most political leaders.” Civil society had a weak presence, and

indeed, even today the state shows resemblance to a Leninist party-state. It lacks the element of class struggle, and it explicitly sanctions private property and markets; but it shares with Leninist states a need to limit commitment to existing groups, a sense of urgency to develop, a comprehensive prospective on the development problem, and a tutelary notion of government.

The 1970s witnessed a “softening of the authoritarian qualities of the regime.” As Wade argues, “What is striking... is how this softening comes—long after the regime was well formalized and institutionalized... long after the period of economic breakthrough, long after living standards began to rise for everyone.” Throughout, “the government has continued to be preoccupied with the legitimacy question, with insuring its survival in power.”¹⁸ Although referring to Taiwan, Wade’s observations may, in fact, describe a general path of modernization promoted by the regime in Laos and other East Asian government’s pursuing the developmentalist model of economic development.

Questioning the sustainability of China’s economic boom under a communist dictatorship, a reporter recently asked Chinese President Hu Jintao, on the occasion of his first visit to the United States: *Would limiting political freedom cause social unrest that could undermine economic growth?* Dismissing the links between democracy

¹⁸ Robert Wade, *Governing the Market: Theory and the Role of Government in East Asian Industrialization* (Princeton, NJ: Princeton UP, 1991) 253-4.

and economic development, the communist leader responded that China was committed to democracy but that, nonetheless, “China’s political system suits its economic development.”¹⁹ Insofar as the regime in Laos replicates the economic successes of its East Asian neighbors, the developmentalist path of modernization also legitimizes its one-party dictatorship.

My observations suggest that the development of a market economy in Laos, as well as the inevitable reorganization of political interests it engenders, continues to enhance the political structure of the Leninist party-state, rather than de-stabilize it. Further, the reorganization of political interests says less about the relative strength of the regime or the institutional failings of socialism, per se, and more about the ways in which the Lao party-state successfully controls access to political power and economic wealth, while adroitly navigating the geo-political—and increasingly geo-economic—landscape of Southeast Asia.

Socio-economic Underdevelopment in Laos

Laos merits study. (See Appendix A1 for map of Laos.) The threads of “post” socialism, internationalization, and globalization converge in a forgotten country once at the periphery of state socialism but now at the margins of global capital. By most standards of modernity, Laos captures the definition of a poor country.²⁰ The United Nations Human Development Index rates it as one of the most wretched places on earth. Out of 177 countries, Laos ranks near the bottom of many socio-economic indicators. Normalized for cross-country comparison, gross domestic product (GDP) per capita in Laos roughly equals US\$ 1,759, far removed from the wealthiest country, Luxembourg (at US\$ 62, 298). The average Lao person can expect to live 54 years,

¹⁹ Associated Press, "Hu Caps U.S. Tour with Yale Visit." *Associated Press*, available at <http://www.cnn.com/2006/POLITICS/04/21/hu.visit.ap/index.html>, Friday, April 21, 2006.

²⁰ For detailed macroeconomic data on Laos, see Appendix A2.

two-thirds as long as people in the West. In educational enrollment, Laos falls in the bottom quartile of countries. Together, these figures combine to give Laos an overall human development ranking of 133, below all its Southeast Asia neighbors, except newly formed Papua New Guinea.²¹

The predominance of the agricultural sector helps explain this low level of development in the Lao socio-economy. Of the 5.5 million Lao, around three-quarters live in the rural area, following the natural rhythms of life and engaging mostly in the natural economy.²² In the past few decades, the agricultural sector has accounted for over half of all economic output in the country. In recent years, an expanding industrial sector has taken a larger portion of economic output, rising from 19.3% in 1995 to over 25% in 2003. The manufacturing subsector, particularly the expanding garment industry, accounts for over three-fourths of all industrial output. All the while, the private sector has yet to take root in Laos. Military conglomerates, state-owned enterprises, and other party-affiliated businesses dominate many areas of the expanding economy.

With services contributing steadily to a quarter of the economy in the past decade, industrial gains have come at the expense of agriculture. On the labor side however, the agricultural sector continues to employ over four-fifths of the population.

²¹ Most recent data were collected in 2003. United Nations Development Programme, *Human Development Report 2005, International Cooperation at a Crossroads: Aid, Trade and Security in an Unequal World* (Oxford: Oxford UP, 2005).

²² The natural economy characterizes the primitive, pre-capitalist mode of production, in which peasants live off the land, produce the bulk of their basic subsistence needs, and occasionally engage in barter trade. In Western scholarship, this rural economy is often wrongly described as a “subsistence economy,” which implies a lack of surplus. In reality, rural villages produce a variety of surplus value. For example, wealth is accumulated in the form of non-consumable heirloom wealth, or stored in livestock, especially buffaloes, for the purchase of heirlooms or dowry payments. Personal communications with James Chamberlain, February 2005. Anthropologists have long observed that “a significant proportion of what is produced in primitive economies is exchanged, although the nature of exchange is different from that in a capitalist market.” Rules of reciprocity to strengthen group solidarity govern the natural economy, which expresses no uniform economic logic. See Grant Evans, *Lao Peasants under Socialism and Post-Socialism* (New Haven, CT: Yale UP, 1995) 11.

In trade, the country runs a perennial current account deficit, mitigated by foreign direct investment, bilateral grants, and concessionary loans from the international financial institutions (e.g., IMF, World Bank, and Asian Development Bank). These external funds nourish the country's insatiable appetite for consumption goods, which devour over half of all imports. Meanwhile, exports, dominated by natural resource extraction, barely pay for 70% of all imports. Garments, timber, and electricity together account for almost three-quarters of all exports by value.

These economic conditions reflect a Lao people straddling the margins of modernity. The government estimates that 31% of Lao people live in poverty, down from 46% in 1993.²³

In the process of reforming its economy, in response to globalization and economic change, the Lao government has recently integrated into the regional

²³ The government boasts that poverty has reduced substantially in the country and floats the number of 31% around the development community in Vientiane. In the late 1990s, household surveys put the poverty level at 39%. The poverty line in Laos denotes the food benchmark of money required to satisfy the nutritional requirements of all household members. The minimum poverty threshold corresponds to about 2000 calories per person per day. See Nanak Kakwani et al., "Poverty in Lao PDR During the 1990s," ed. National Statistics Center (Committee for Planning and Cooperation, Lao PDR, 2002). A recent qualitative assessment of poverty in Laos discovers that poverty in Laos is new poverty. See Asian Development Bank, *Participatory Poverty Assessment: Lao People's Democratic Republic* (Manila, Philippines: ADB, 2001). Authored by anthropologist James Chamberlain, this important research explores the cultural construction of poverty, which is not an endemic condition to Lao people. When left to fend for themselves in the natural economy, Lao peoples of all ethnic stripes do not go hungry. Thus, poverty does not equate with hunger in Laos. In fact, linguistically the word "poverty" (in reference to economic circumstances) does not exist for any of the 47 ethnic groups in the country.

Abundant natural resources have long sustained traditional livelihoods throughout the countryside. Only with their incorporation into a modernizing state have Lao villagers recently experienced poverty. This "new poverty," argues Chamberlain, derives from failed government land use policies and other development initiatives that deprive villagers of their livelihoods. For example, focal sites, (resettlement), land tenure, and other development schemes continue to deprive ethnic minority villages of their traditional means of livelihood. Programs to eliminate shifting cultivation (but only pioneering—not rotational—cultivation indigenous to the Hmong peoples, who have been, since their alliance with the CIA during the Indochinese conflict, the center of the resistance movement against communist rule in Laos) serve to control a suspicious countryside known for resistance to communist rule. According to the participatory poverty assessment, poverty for many villagers refers to individual conditions of depravity associated with misfortune or suffering precipitated by external forces. Asian Development Bank, *Ppa, Lao PDR* 31. Privately, development professionals concede that poverty may have actually increased in Laos, due in no small measure from poorly administered land use policies and resettlement schemes.

grouping, ASEAN (Association of Southeast Asian Nations). As the country opens up to the world, its membership in ASEAN and incorporation into the world market present as many opportunities and possibilities as challenges and threats. Rich in land and natural resources, but lacking in technical skills and finance capital, Laos could conceivably become a key node in the development of mainland Southeast Asia.²⁴ As a sign of changes, major transport arteries through Laos will soon link the country to all of mainland Southeast Asia.

Nonetheless, the country remains at a cross-road. Surrounded by powerful neighbors in a dynamic and fast growing region, it is either well-positioned to benefit from economic integration, or regrettably isolated and potentially overwhelmed by more powerful economic actors. The economic necessity of trade, the small size of its economy, the dependence on limited markets, and vulnerability to natural disasters will invariably condition the country's degree of openness. Yet, the social and economic repercussions of Laos' internationalization have received a minimum of attention in the academic literature.

The Lao state is situated uncomfortably at the heart of mainland Southeast Asia. Throughout most of the modern era, the country has remained politically and economically exposed to regional and international forces. As Peter Katzenstein notes, small states like Laos are, on the whole, more vulnerable politically, economically and militarily than larger ones.²⁵ For this forgotten country, sovereignty has had, in the past, little meaning. Yet, the global process of reterritorialization presents the current

²⁴ Jonathan Rigg, "Land-Locked Laos: Dilemmas of Development at the Edge of the World," in *Land-Locked States of Africa and Asia*, ed. Dick Hodder, Sarah J. Lloyd, and Keith McLachlan (London: Frank Cass, 1998), 171.

²⁵ Peter J. Katzenstein, *Small States in World Markets: Industrial Policy in Europe* (Ithaca, NY: Cornell UP, 1985) 80. In his analysis of democratic corporatism, he focuses primarily on small states of Western Europe and also notes that they are more open economically than larger states.

regime in Laos with opportunities to transform this historical legacy. According to Jonathan Riggs,

The linking of Laos, Cambodia, Vietnam, Thailand, Myanmar and China's Yunnan province, with Laos as 'keystone' of this so-called 'Golden Quadrangle' or 'Economic Rectangle', is an attempt to minimize the dependency that is part and parcel of being a poor, largely powerless, and land-locked state... At the same time, the Lao leadership are hoping that by integrating more fully into the regional economy, their country will be in a better position to benefit from the economic growth and prosperity of countries and regions like Thailand and southern China.²⁶

For two hundred years, Laos as a political entity has been considered a satellite of— as well as a buffer for— more powerful neighbors.²⁷ In fact, its existence as a nation state owes more to the historic interests of its more powerful neighbors than to any systematic scheme of self-determination on its own part.²⁸ Some scholars have gone so far as to call Laos a non-state and view it as a modern construct because of its “comparatively thin, short-lived history as a unified nation.”²⁹

In the most recent past, its landlocked position and unfortunate propinquity to the Vietnam quagmire resulted in countless unnecessary deaths and lasting ecological damage from the heaviest bombing in the history of warfare at the time.³⁰ During the

²⁶ Rigg, "Land-Locked Laos: Dilemmas of Development at the Edge of the World," 170.

²⁷ For a good, concise history of Laos' turbulent past, see W. Randall Ireson and Carol J. Ireson, "Laos: Marxism in a Subsistence Rural Economy," *Bulletin of Concerned Asian Scholars* 21, no. 2 (1989). A more substantial and academic reading of Lao history can be found in Martin Stuart-fox, *A History of Laos* (Cambridge, U.K.: Cambridge UP, 1997). See also Evans, *A Short History of Laos: The Land in Between*.

²⁸ According to Grant Evans, *Laos: Culture and Society* (Bangkok: Silkworm, 1999) 21, “the modern state of Laos only exists because of French colonial occupation. Without this it is almost certain that at least the lowland areas of Laos would have become part of the Thai state, while the upland areas such as Houaphan (which only became part of French Laos in the 1930s anyway) would probably have been absorbed by Vietnam.”

²⁹ Randi Jerndal and Jonathan Rigg, "Making Space in Laos: Constructing a National Identity in a "Forgotten" Country," *Political Geography* 17, no. 7 (1998): 813.

³⁰ Although the country took a neutral stance officially, more bombs were dropped in Laos during the Vietnam struggle than in all of World War II. According to Titus Peachey, "Figures and Cost Comparisons on U.S. Air War over Laos" Memo (Lao PDR: Mennonite Central Committee May 1994), for the period 1964-1973, the American military dropped over 2 million tons of bombs over Indochina

war, the Royal Lao Government survived off the goodwill of its American benefactor, which abruptly ended with the Pathet Lao communist victory in 1975. Thereafter, the Lao PDR has relied heavily on its communist brethren for financial, ideological and military support. With the collapse of Soviet communism, Western donors have taken over the supporting role for a country marred by the legacy of Vietnam, during an otherwise uninterrupted history of dependency. Nonetheless, the country's dependent position cannot be assumed. The strength and durability of the current regime needs to be explained.

Global Integration and Post-socialism

This research delves into the relationship between socio-economic internationalization and the Lao state's management, control, and regulation of these same changes. I situate this work within the larger debates on global transformations, specifically the academic literatures on globalization, post-socialist transition, and economic internationalization, most of which, as explained in the following section, prove inadequate to describe the processes unfolding in Laos.

Dialectics of Globalization

The trend towards democracy coincides with the modern era of capitalism, marking a new phase in capitalist expansion and domination, a period otherwise known as late-capitalism or popularized as *globalization*. While some academics

(33 percent more than on Germany during World War II, according to Keuleeers et al. 230). Using detailed accounting of bombing missions, tonnages, and costs (from the U.S. Congressional Record, Senate, May 14, 1975, pp.14264-66), Peachey calculates that over the nine-year period, bombing missions (including fighter-bombers and B-52s over Laos) totaled 580,344 (costing \$6.9 billion, with an average per day cost of \$2,190,124). These figures do not include pilots' salaries. As a cost comparison, an unexploded ordnance training and clearance project in Xieng Khouang province totals \$1 million per year and equals the cost of sustaining the air war for 12 hours, by conservative estimates. Moreover, the ordnance clearing project would need to continue (at the same spending rate) for an additional 6,894 years to match the amount spent on the air campaign. It is a tragedy out of all human proportions that a small and relatively backwards country would become a pawn in the geopolitical chess game waged by the superpowers in their ideological struggle for supremacy in Southeast Asia.

herald the apparent victory of liberal democratic principles, others are more sobered by the dominance and exploitation of rich countries in the capitalist world system.

Without a doubt, the literature on globalization is vast. The popular and academic discourses on globalization are unlikely ever to produce agreement on its meaning, provenance, significance, or implications.³¹ Categorized as *hyperglobalizers*, many of the early writers on globalization over-emphasize or prematurely celebrates the decline of state power, a victim or accomplice to the logic of global capital.³² At the other extreme of the globalization debate, *skeptics* counter that hyperglobalizers oversimplify the role of nation states and ignore the dynamic process of legitimation in which states redefine their existence.³³ In between the two extremes,

³¹ In a recent overview of the debates, Guillén provides, nonetheless, a useful way to start thinking about the content of these discourses. Instead of a monolithic concept of globalization, he suggests the notion of globality as “a network of relationships that creates mutual awareness.” Mauro F. Guillen, “Is Globalization Civilizing, Destructive or Feeble? A Critique of Five Key Debates in the Social Science Literature,” *Annual Review of Sociology* 27 (2001): 244. With this definition, Guillén extends upon Anthony Giddens, *The Consequences of Modernity* (Stanford, CA: Stanford UP, 1990) 64. for whom globalization implies “the intensification of worldwide social relations which link distant localities in such a way that local happenings are shaped by events occurring many miles away and vice versa.”

To make sense of the various and sundry forms of globalization, I follow the work of David Held et al., *Global Transformations: Politics, Economics and Culture* (Stanford, CA: Stanford UP, 1999), who outline three broad schools of thought on this vibrant debate: the hyperglobalizers, the skeptics, and the transformationalists.

³² From this perspective, the full rationalization of a disembedded world economy takes shape, demanding new rules of global governance in a supposed borderless world. In this sense, markets amount to a de-nationalizing movement in which state management of national economies becomes reactionary, forcing governments to accept a global agenda (or project) of economic management. For the roots of this school, see Kenichi Ohmae, *The Borderless World: Power and Strategy in the Interlinked Economy* (New York, NY: Harper Business, 1990). and Kenichi Ohmae, *The End of the Nation State: The Rise of Regional Economies* (New York: The Free Press, 1995).

³³ While capital may diminish the significance of states in some areas of economic management, the skeptics remind us that a loss of sovereignty for some might imply a gain for others. Paul Hirst and Grahame Thompson hold to the centrality of states because of the growing significance of the rule of law and regulation of the global economy, on the one hand, and the political implications of physical territory and, concomitantly, control of interior population on the other. For Hirst and Grahame, states remain key actors in the legitimacy of moves to transfer power or sanction new power centers that either undermine or transcend traditional bounds of state authority. They view states not as sovereign subjects to the logic of capital, but as enablers of capital. Hence, “Sovereignty is alienable and divisible, but states acquire new roles even as they cede power.” Paul Q. Hirst and Grahame Thompson, *Globalization in Question: The International Economy and the Possibilities of Governance* (Cambridge, MA: Blackwell Publishers, 1996) 276-7.

transformationlists criticize both for reducing all facets of socio-cultural and political life to economics and promoting a normative vision on a defiant reality. This more nuanced school of thought views globalization dialectically as a contingent historical process, full of contradictions and in search of meaningful synthesis.³⁴ The dialectics of globalization captures the fundamental transformation of the state and its relations to the economy and society.

Economic Internationalization

This dialectical process of global change and development remains for the most part uneven and contradictory, while lacking a coherent logic and intentional design.³⁵ The complex nature of global processes invites more research, especially to address the global-local nexus in ways that “clarify the economic, political, cultural, and aesthetic dimensions of globalization and how they interact with each other.”³⁶

Laos is a good place to begin. While the dialectical approach, broadly conceived, presents globalization as a conflictive and highly indeterminate process, it fails to

³⁴ Giddens, *The Consequences of Modernity* 175, 64. describes globalization as “a process of uneven development that fragments as it coordinates...The outcome is not necessarily, or even usually, a generalised set of changes acting in a uniform direction, but consists in mutually opposed tendencies.” See also the work of Held et al., *Global Transformations: Politics, Economics and Culture.*; the collection of essays in David A. Smith, Dorothy J. Solinger, and Steven Topik, eds., *States and Sovereignty in the Global Economy* (New York: Routledge, 1999). Instead of their demise, we witness the decentering of nation states, which constitute one of many emerging sources of authority. In the process, states become intertwined in broader networks and constellation of power. Thus, in the current era of globalization, more fruitful insights on the dynamics of the international system of states come from interpreting the transformation of state sovereignty, rather than debating the merits of its strength. See Manuel Castells, *The Rise of the Network Society* (Cambridge, MA: Blackwell Publishers, 1996) 303. The transformation reveals many contradictions. While powerless to the logic of capital, states are also enablers of capital expansion.

³⁵ Giddens describes globalization as “a process of uneven development that fragments as it coordinates...The outcome is not necessarily, or even usually, a generalised set of changes acting in a uniform direction, but consists in mutually opposed tendencies.” Giddens, *The Consequences of Modernity*.

³⁶ Guillen, "Is Globalization Civilizing, Destructive or Feeble?" 255. Guillen suggests the need to “bridge the micro-macro gap, i.e. that move across levels of analysis from the world-system to the nation-state, the industry, sector, community, organization, and group.” In his view, many of the disagreements in the literature stem from “the various levels of analysis at which different researchers operate.”

capture adequately the process of social change in an economically marginal place like Laos. A close examination will reveal, for example, the role of human agency, special interests, and local resistance in shaping the content and meaning of these global processes.

At a lower level of analysis, the international political economy literature is instructive of how countries continue to integrate into the world economy. According to Jeffrey Garrett and Peter Lange, the literature on the domestic politics of internationalization has implicitly relied on a model of “economic pluralism,” in which the content of policies is “a function of political conflict shaped by preferences of different actors, weighted by their market power and their propensity for collective action.”³⁷ In the seminal article “Internationalization, Institutions, and Political Change,” Jeff Frieden and Ronald Rogowski, aided by various trade models of economic pluralism, assert that transactions costs, to varying degrees, affect all states, where changes in relative prices impose opportunity costs of economic closure.³⁸ This neoliberal model of economic internationalization posits that external, or exogenous, easing of trade restrictions leads to increased demands for liberalization from relatively competitive economic actors, with concomitant demands for protection from uncompetitive ones. According to some analysts, this model of “exogenous easing” also applies to transforming socialist countries as well.³⁹

³⁷ Geoffrey Garrett and Peter Lange, “Internationalization, Institutions, and Political Change,” in *Internationalization and Domestic Politics*, ed. Robert O. Keohane and Helen V. Milner (New York: Cambridge UP, 1996), 49.

³⁸ Jeff Frieden and Ronald Rogowski, “The Impact of the International Economy of the National Policies: An Overview,” in *Internationalization and Domestic Politics*, ed. Robert O. Keohane and Helen V. Milner (Cambridge; New York: Cambridge University Press, 1996).

³⁹ See for example, Susan Shirk, “Internationalization and China's Economic Reforms,” in *Internationalization and Domestic Politics*, ed. Robert O. Keohane and Helen V. Milner (New York: Cambridge UP, 1996).

In line with this approach and applied to a socialist state, David Zweig, in *Internationalizing China : Domestic Interests and Global Linkages*, presents a model of “segmented deregulation,” in which governments like China favor policies of selected liberalization, favoring some localities, sectors, or organizations over others.⁴⁰ From his extensive research, Zweig discovers that the country’s transformation has followed a neomercantilist route, and not deeper integration and internationalization, which economic liberals continue to promote and celebrate. However, as the country further internationalizes, his model of segmented deregulation predicts a move from neomercantilism to neoliberalism. On the whole, Zweig’s model of segmented deregulation superficially looks suspiciously like the neoliberal variant promoted by Frieden and Rogowski, who posit that exogenous easing of international exchanges would create a competitive environment in domestic politics that pushes for more economic liberalization.

There are several reasons to believe that the experience of Laos’ economic transition differs markedly from predictions of these various neoliberal models. First, the low level of both development and marketization cautions against economic generalities in a country where upwards of 80 percent of the population remains at subsistence level. Second, Laos’ political, economic, and physical isolation effectively limits the scope for autonomous action that these models, anyhow, assume away. Given the country’s historic dependency on more powerful neighbors, socio-economic and political inclusion into the capitalist world system will, in all likelihood, be predicated on exogenous forces. Third, a symbiosis of state, party, and army seems to play a role in the political system.⁴¹ Such an institutional arrangement appears to have

⁴⁰ David Zweig, *Internationalizing China: Domestic Interests and Global Linkages*, *Cornell Studies in Political Economy* (Ithaca: Cornell UP, 2002).

⁴¹ Ivarsson, Svensson, and Tonnesson, *The Quest for Balance* 16.

a mediating effect on policies of economic liberalization. Fourth, there is enduring strength of a clan patronage system, which has characterized Lao politics and government since the country's independence from France in 1954.⁴² In the Lao form of clientelism, political power and prestige derive more from family politics and personal connections than from unbending adherence to ideology. But how have greater socio-economic openness transformed these relations? Research exploring these issues in Laos is currently lacking. Finally, restrictions on free, political expression in the country thwart internal pressure for continued change along the lines of most macroeconomic models. Associations normally linked with civil society hardly exist in Laos.

In countering the neoliberal school, Matthew Evangelista, in "Stalin's Revenge: Institutional Barriers to Internationalization in the Soviet Union," puts forward a version of internationalization that more plausibly captures the dynamics of the Lao case. His model emphasizes the mediating role of institutions in obstructing, channeling, and regulating market openness, to the point of distorting the logic of exogenous easing.⁴³ In his analysis of internationalization in the former Soviet Union, Evangelista argues that Soviet institutions, such as the State Planning Commission (Gosplan), shaped the ways in which domestic economic actors viewed their preferences. He discovers that Soviet authorities, through the central planning system, limited the impact of internationalization through direct instruments of policy or simply the inefficient running of the domestic economy. Even in post-Soviet Russia, the legacy of the Stalinist economic system continues to frustrate efforts to liberalize the economy in predictable, neoliberal ways. Evangelista points to the important role

⁴² Martin Stuart-fox, "Politics and Patronage in Laos," *Indochina Issues* 70 (1986): 3.

⁴³ Matthew Evangelista, "Stalin's Revenge: Institutional Barriers to Internationalization in the Soviet Union," in *Internationalization and Domestic Politics*, ed. Robert O. Keohane and Helen V. Milner (New York: Cambridge UP, 1996).

of pre-existing institutions in shaping the domestic politics and impacts of internationalization. He writes,

Not only actors' strategies and behaviour but their very goals are influenced by the institutional context. Institutions shape actors' perceptions of their interests, and, therefore, their behaviour, sometimes even after the demise of the institutions themselves.⁴⁴

Building upon the study of organizations and institutions, the literature on postsocialism offers keen insights into the functioning of bureaucracies and also helps to explain political and economic trajectories of transitioning societies.

Socialist Transformations

The academic literature on postsocialism advances competing theories on the eventual embrace of capitalism in the former Soviet block, in light of the institutional failings of communism. Much of this literature posits the eventual weakening and demise of the communist, one-party state.⁴⁵ In an edited volume by Andrew Walder, for example, the essays examine the ways in which departures from the practices of central planning (by altering control over property and opportunity) have brought about political change.⁴⁶ As Walder observes, “*all* communist regimes have departed in some way from the defining features of central planning in an effort to compensate for shortcomings in the performance of these institutions.”⁴⁷ While many observers

⁴⁴ Ibid., 185.

⁴⁵ See for example, Gil Eyal, Ivâan Szelâenyi, and Eleanor R. Townsley, *Making Capitalism without Capitalists: Class Formation and Elite Struggles in Post-Communist Central Europe* (London; New York: Verso, 1998).; David Charles Stark and Lâaszlâo Bruszt, *Postsocialist Pathways: Transforming Politics and Property in East Central Europe* (New York: Cambridge UP, 1998).; Zweig, *Internationalizing China*. ; and Shirk, "China's Economic Reforms."

⁴⁶ Andrew G. Walder, *The Waning of the Communist State: Economic Origins of Political Decline in China and Hungary* (Berkeley: University of California Press, 1995). Emphasis original.

⁴⁷ Andrew G. Walder, "The Quiet Revolution from Within: Economic Reform as a Source of Political Decline," in *The Waning of the Communist State: Economic Origins of Political Decline in China and Hungary*, ed. Andrew G. Walder (Berkeley: University of California Press, 1995), 3.

concede that economic reforms lead to political changes, few agree about how.⁴⁸ The collection of essays analyze how departures from central planning reallocate resources and redirect opportunities, while ushering in a process of political change. The authors claim that changes in economic institutions bring about a steady political decline of state power, irrespective of the success of economic policies.⁴⁹ Departures from central planning “set in motion a chain of consequences, usually unintended, and if the departures are extensive enough, they eventually alter political institutions and relationships to the point where Communist party rule can no longer be sustained.”⁵⁰ I challenge his conclusions— on grounds similar to those used against the neoliberal school above— but agree with his methods for the Laos case.

In making these claims, Walder advances two ways in which to gauge the decline of socialist states: (a) a weakening of the bureaucratic state apparatus in promoting social mobility of party members, and (b) a decay of surveillance capabilities of the state to monitor and sanction political behavior. He focuses exclusively on the former factor but, nonetheless, gives no way to measure— and hence to falsify— the extent and scope of regime decline. Furthermore, the thesis provides no clue to the interactions between the two factors and, by ignoring the role of the military to mediate any push away from socialist norms, says little about how the strength of one can obviate or circumscribe that of the other. For example, what if the state over-compensates the decline of the party-state bureaucracy (a) with an increase in its surveillance power (b)? What combination actually leads to a decline of the communist state? Walder provides no plausible threshold of state decline.

⁴⁸ Ibid., 4.

⁴⁹ Ibid., 2.

⁵⁰ Ibid., 3.

Yet, even with the weakness of his argument, Walder provides a useful approach to the study of market transitions in former communist states. In using an organizational approach, he moves away from the prevalent concerns on state-society relations common in much of the transition literature.⁵¹ For example, in *Making Capitalism without Capitalists: the New Ruling Elites in Eastern Europe*, Gil Eyal, Iván Szelényi, and Eleanor Townsley describe how the working class became demobilized in the postcommunist transition.⁵² In the communist period, interclass struggle played a minimum role in historical changes. Rather, rank determined power and privilege, and political capital mattered more than economic wealth. In the subsequent transition period when these socialist regimes collapsed, the socialist working class had lost all significance and lacked the capacity for collective action.⁵³ The socialist system prevalent in Eastern Europe contained a dual stratification system in which rank took precedence over class. Thus, intraclass instead of interclass conflict over the making of a new dominant class characterized the transition period for the Eastern European countries in their study. In the immediate decade after the transition, the working class failed to pursue any collective goals for a noncapitalist alternative.⁵⁴ According to Eyal et al., struggles to make classes continue to shape, in significant ways, postcommunist Eastern Europe.

The title of their book, *Making Capitalism without Capitalists*, nicely captures the main findings of their work. In postcommunist Eastern Europe, a domestic,

⁵¹ See for example, the transition debates in

⁵² Eyal, Szelényi, and Townsley, *Making Capitalism without Capitalists: Class Formation and Elite Struggles in Post-Communist Central Europe*.

⁵³ See Gil Eyal, Iván Szelényi, and Eleanor R. Townsley, "The Utopia of Postsocialist Theory and the Ironic View of History in Neoclassical Sociology," *Review Symposium* (2001), which nicely summarizes their book *Making Capitalism without Capitalist*, while making a strong rebuttal to Burawoy's book review.

⁵⁴ *Ibid.*: 2-3. In their ethnographic accounts, the authors document "the demobilization of the working class: the loss of solidarity, the failure of collective organization, and the absence of an attractive alternative."

propertied bourgeoisie has developed slowly. In this environment, the intelligentsia matured into what Eyal et al. call a “cultural bourgeoisie,” the vanguard of the capitalist transformation. Extending upon Bourdieu’s work on symbolic capital, the authors argue that cultural capital, as opposed to property or political capital, constitutes the main source of power and privilege in the emerging social system of Eastern Europe.

Elsewhere, in *Postsocialist Pathways: Transforming Politics and Property in East Central Europe*, David Stark and László Bruszt chart the different paths from socialism shaped by the strategic interaction of (1) hardliners and reformers and (2) ruling elites and the opposition.⁵⁵ The diversity of actually-existing socialism accounts for the plurality of emergent capitalism. The authors suggest that, most prominently, postsocialist transformations have created property holders, while extending political rights to the property-less.⁵⁶ They use path dependency to explain why different privatizations strategies in four Eastern European countries (Germany, the Czech Republic, Poland, and Hungary) produced different transitions out of state socialism. That is, “a diversity of origins gives rise to a plurality of capitalisms.”⁵⁷ In this sense, path dependency simply implies past dependency, where origins matter. Diversity

⁵⁵ Stark and Bruszt, *Postsocialist Pathways*.

⁵⁶ See David Charles Stark and László Bruszt, "One Way or Multiple Paths: For a Comparative Sociology of East European Capitalism," *Review Symposium* (2001), in which the authors respond to criticism of their book from Michael Burawoy, "Neoclassical Sociology: From the End of Communism to the End of Classes," *Review Symposium* (2001).

⁵⁷ Burawoy, "Neoclassical Sociology," 7. Here, Burawoy provides a strong critique of Stark et al.’s use of path dependency and questions the appropriateness of their critical juncture (late 1980’s and early 1990’s) to explain differences in postsocialist pathways. He writes, “there may be path dependency, but where does the path begin, which crystallizing event determines which future, how many such events might there be? It is far from obvious that the most significant divergence of historical paths begins when the party state is replaced by the formal trappings of liberal democracy” (7). He later points to the need to incorporate the mediating, and decisive, effects of the capitalist world system: “Russia and Hungary may diverge in remarkable ways, but that divergence is as much a product of their differential insertion into what is a singular world capitalist system as it is of their communist origins. Or better, it is a product of the way global capitalism combines with antecedent forms of production as these undergo market transition” (12).

within Central Europe has its roots in recent patterns of extrication from communism. Nonetheless, these analyses focus on state-society relations, which may have relevance in Eastern Europe but remain inadequate to describe the processes of change in Laos.

If changes within political institutions themselves play a major role in shaping the post-socialist transition, then a focus on state-society relations may fail to capture the dynamics of places like Laos. As Walder suggests “large systemic changes can occur without the agency of citizens, whether organized or not.”⁵⁸

Methods of Inquiry

Through extensive field work in Laos, my research examined the process of market liberalization and regional integration in Laos’ socialist transformation. This research involved a mixture of observation, literature review, and qualitative interviews methods. I rely on observations during my time on research assignment in Laos (May 2004-April 2005); an examination of governance-related, donor-funded development initiatives; an exhaustive survey of government laws, regulations, and documents since the reform period; and a review of literature on the political economy of development, market transition, and globalization.

Regime-centered Organizational Perspective

The research documents the different ways in which Laos’ internationalization has transformed the country’s socio-economic infrastructure, domestic politics, and capacity for reforms. Through the broad lens of political economy and sociology, the inquiry focuses on three areas of Lao state capacity: (1) political structure of the Lao People’s Revolutionary Party (LPRP); (2) public administration as revealed in the Governance and Public Administration Reform (GPAP) program, and (3) fiscal

⁵⁸ Walder, "The Quiet Revolution from Within: Economic Reform as a Source of Political Decline," 17.

management under the Ministry of Finance (MoF). In choosing these areas, I draw on the insights of Theda Skocpol, who suggests, “Basic questions about a state’s territorial integrity, financial means, and staffing may be the place to start in any investigation of its capacities to realize goals.”⁵⁹

An exploration of the structure and political culture of the party-state (presented in Chapter II) provides a window onto the territorial integrity of the country, sovereignty, the party’s basis for legitimate rule, and the inevitable re-organization of political interests engendered by economic liberalization. The study of the public administration (Chapter III) examines the organization and management of government ministries in their restructuring for market liberalization. Reforms at the MoF (Chapter IV) have specific relevance to the state’s role in extraction, redistribution, and financial infrastructure for accumulation, particularly with the abrupt withdrawal of Soviet aid in 1989.

For each Lao government institution, I pay particular attention to the transformation of state capacity, the government’s freedom of action, and ability to determine its own destiny. During the extended transition period, what accounts for the state’s ability to realize its capacities in key areas of political authority (LPRP), governance (GPAR), and extraction (MoF)? The state, of course, is more than just the sum of its organizations. To be sure, the state is not reducible to either a system of decision making or a monopoly on violence. Nor is the state simply an arrangement of authority or policies backed by force. Nonetheless, the focus on these three state institutions, subsumed under the study of political sociology, provide a meaningful way to gauge relative state capacity and the strength of governments as containers of socio-economic processes.

⁵⁹ Theda Skocpol, "Bringing the State Back In: Strategies of Analysis in Current Research," in *Bringing the State Back In*, ed. Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol (Cambridge, U.K.: Cambridge University Press, 1985), 17.

I take this organizational approach in the belief that social changes can result predominantly within institutions themselves, and not only or even primarily through struggles that redefine state-society relations. There are several reasons why this methodological approach makes sense in the Lao case. First, the country lacks any elaborate civil society. Public organizations are inseparable from the state, which persists in frustrating public outlets for free political expression. Second, a ruling party anchored in Marxist-Leninist theory continues to govern Laos. Economic liberalization has yet to lead to a political one. Third, a clan patronage system, blurring the lines between party, state and army, continues to characterize the political system. Thus, my more organizational and regime-centered focus will better capture and explain the country's transition than would a study concerned with state-society relations. As Walder notes,

Communist regimes have owed their existence to the discipline and cohesion of the party apparatus and to that apparatus's ability to avert organized political opposition. If we can uncover the process that weaken the discipline and cohesion of the party-state apparatus, we shall have illuminated one of the main causes of decline of communist rule, and perhaps also have helped to explain the rise of citizen resistance and changes in state-society relations.⁶⁰

Whereas state-society approaches see societal actors and their capacity for collective action as keys to explaining the dynamics of postsocialist transitions, a regime-centered method gives primacy to political institutions as themselves the motor force of change.

From an organizational perspective, I can better appreciate "the changing interests, orientations, and capacities of party-state officials"⁶¹ and how they negotiate the changing organizational environment wrought by globalization. An analysis of the

⁶⁰ Walder, "The Quiet Revolution from Within: Economic Reform as a Source of Political Decline," 5.

⁶¹ *Ibid.*, 16.

emerging character of these powerful government institutions can provide insights into their contribution to the political stability of the current regime. I reason that relations of clan patronage, linked to the enduring Leninist party structure, continue to provide coherence and stability to a relatively poor and weak government struggling to forge a sense of national unity. It is the shape and form of these relations that I wanted to examine. How has the country's marketization entrenched economic and political elites? In what ways have the country's economic liberalization and strategies of *dependent* incorporation into the world economy served to cement domestic coalitions of rule? How are these coalitions expressed through the workings of the three institutions under investigation? What are the changing patterns of authority in these institutions, in relation to either its respective line ministries or international organizations? Under what conditions have old patterns reproduced themselves despite the introduction of new practices? In what ways does the clan patronage system continue to take shape? Concomitantly, what is the evolving relationship among the party, state, and army?

Because these organizations have continued to evolve since the country's market liberalization in the early 1990's, questions of bureaucratic commitment have specific relevance to each organization's ability to realize public aims. What attitudes and symbols are commanding the loyalties of the staff? What precedents and institutional norms are being established? What alliances are being made within and across these government institutions?

Following Walder's approach, for each organization, I analyze "changes in the relationship of higher to lower levels of government, in the relations between superior and subordinate within the party and government, and the interests and orientations of officials within the party-state apparatus, especially in its lower reaches."⁶² For this

⁶² Ibid., 4.

task, the pathbreaking work of Philip Selznick provides important insights into organizational dynamics⁶³ and has shaped the content of my methodology. From his classic study of the Tennessee Valley Authority, he advances the thesis that

All formal organizations are molded by forces tangential to their rationally ordered structures and stated goals.... [T]he organization may be significantly viewed as an adaptive social structure, facing problems which arise because it exists as an organization in an institutional environment, independently of the special (economic, military, political) goals which called it into being.⁶⁴

Drawing on Selznick's methods, the organizational approach led me to:

- analyze the policies of these organizations in administering their programs and operational objectives;
- search for the underlying implications of official doctrines promulgated by each organization;
- observe the interaction of these agencies with other organizations in their area of operation; and
- explore patterns of cooperation with international donors, which fund the operation of practically every state agency in this highly aid-dependent country.

Throughout my investigation, I paid particular attention to political actors at the vanguard of the country's economic integration and the ways in which they responded to the opportunities and challenges presented by the country's openness.

Ethnography

While using a variety of quantitative methods to measure state capacity and restructuring, I also relied on qualitative methods, specifically Michael Patton's phenomenological approach to research, which "focuses on descriptions of what people experience and how it is that they experience what they experience."⁶⁵

⁶³ Philip Selznick, *TVA and the Grass Roots; a Study in the Sociology of Formal Organization* (New York: Harper & Row, 1966).

⁶⁴ *Ibid.* 251.

⁶⁵ Patton, Michael Quinn. *Qualitative Evaluation and Research Methods*. 2nd ed. London: Sage, 1990.

Ethnography played important part in this study of state restructuring. As Michael Burawoy suggests, there exists a need “to understand how the global, whether through supranational institutions, transnational connections, or postnational discourse, has mediated effects on what has come to be called the “local.”⁶⁶ For these purposes, he advocates the use of ethnographic research. In *Uncertain Transition : Ethnographies of Change in the Postsocialist World*, he and Katherine Verdery bring together a diverse range of social scientists who use ethnography in studying the local content of postsocialist transitions.⁶⁷ These ethnographic accounts reveal the “complex relations of socialist and postsocialist life worlds, emphasizing unintended consequences and the way the past enters the present, not as legacy but as novel adaptation.”⁶⁸

Influenced by this approach, my ethnographic research comprised interviews, meetings, discussions, dialogues, and debates with over 100 private citizens, government officials, business people, and development professionals in Laos. To assess different points of view on economic liberalization in Laos, I conducted open-ended interviews with the following people: (i) high-level government officials from all three agencies, to understand the country’s overall goals and objectives for regional integration and market liberalization; (ii) mid-level government bureaucrats to understand their motivations, perceptions, and interpretations of government policies; and (iii) donor representatives to scrutinize their organization’s policies vis-à-vis development objectives and their role in assisting the country’s internationalization and marketization.⁶⁹ More informally, I surveyed the opinions of selected

⁶⁶ Burawoy, "Neoclassical Sociology," 12.

⁶⁷ Michael Burawoy and Katherine Verdery, *Uncertain Transition: Ethnographies of Change in the Postsocialist World* (Lanham: Rowman & Littlefield Publishers, 1999).

⁶⁸ Ibid. 4.

⁶⁹ To minimize errors inherent in this form of institutional ethnography, I follow the advice of Selznick, *TVA and the Grass Roots* 249-50, who writes,

If the use of personal interviews, gossip channels, working papers, and participation opens the way for error, it remains, however, the only way in which this type of sociological research can

townspeople, expatriates, international consultants, and members of the diplomatic and development communities. I considered their views on a variety of topics relating to contemporary Laos, such as the socialist transformation, the economy, socio-economic development, the reform process, foreign aid, and the future outlook for the country.

Data Collection

I used a comprehensive, multi-level approach to data collection and apply both qualitative and quantitative techniques to strengthen the quality of information gathered and to ensure reliability across data sets. In addition to the organizational analysis and ethnographic data, the research also relies on an exhaustive examination of development reports and government documents. Data sources include the National Statistics Center, the organizations under investigation, as well as the information centers of the multilateral organizations such as the United Nations Development Programme, International Monetary Fund, Asian Development Bank, and the World Bank.

Organization of Dissertation

Examining the political, administrative, and fiscal restructuring of the Lao state, the following three chapters present the findings of my dissertation research, which broadly point to government centralization since the reform period. Chapter II analyzes the political and territorial re-organization of the country since the collapse of state communism elsewhere. In relation to the population at large, the communist party in Laos appears small; yet its strong party apparatus pervades all organizations of government and oversees many areas of society. Although the public administrative

be carried on. A careful investigator can minimize error by such means as checking the consistency of statements against the documentary record, appraising the consistency of information supplied to him, and avoiding reliance on any single source. On the other hand, he will not restrict his data to that which is publicly acknowledged.

remains weak, as Chapter III documents, the party retains a strong grip on the machinery of government. Fiscal reforms emphasize the need for strong national controls over tax management, revenue collection, and customs administration; and Chapter IV investigates how the Lao government controls public expenditures, while expanding the tax base in an overall push to mitigate fiscal crises. Here, I also use a model of decision making to simulate the pros and cons of various policies of fiscal restructuring. In confronting the challenges of market reforms, the Lao party-state's struggle for modernization equates with a bureaucratic centralization and rationalization of the apparatus of government. A running theme of these three chapters, centralization follows a familiar pattern of restructuring experienced in other peripheral states. The concluding chapter summarizes the findings of the dissertation while contrasting two diametrically opposed views of market developments.

Contrary to the liberal tradition in the West, the development of markets is not anathema to central government control and regulation. In fact, for many developing countries struggling to create a unitary state and a national economic space of private exchange, centralized control over regionally autonomous regions constitutes one of the major governance challenges of nationally guided development. Small developing countries struggling to create the rudiments of a market society, on the whole, will require more central government control and oversight of the development process than is currently advised by the international development community.

Chapter II

THE ANATOMY OF PERIPHERAL SOCIALISM IN THE LAO PEOPLE'S DEMOCRATIC REPUBLIC

Today, the socialist programs envisioned by Marx and Engels and realized by Lenin and Stalin no longer provide a viable alternative to capitalist development. To many observers, the end of communism is a matter of fact. Only five communist states exist in the world today: China, Vietnam, North Korea, Cuba, and Laos. While their commitment to the economic program of socialism remains suspect, their adherence to its political structure signifies the enduring legacy of Marxist-Leninism.⁷⁰ One-party rule, modeled on the political organization of the former Soviet Union, continues to characterize these last communist holdouts, the remnants of a fading political system and its bankrupt economic program. Where communist states in Eastern European attempted *perestroika* with *glasnost* to their own demise, these remaining regimes pragmatically embraced the former and astutely resisted the political suicide of the latter.

⁷⁰ Throughout, I use “communism” and “socialism” interchangeably, although the social engineering of Marxist-Leninism more accurately refers to the latter. While the idea of communism dates back to at least Plato’s *Republic*, socialism has a relatively recent history. In his history of socialism, Emile Durkheim claims that the term was first coined in England in 1835. See Emile Durkheim, *Socialism and Saint-Simon (Le Socialisme)* (Yellow Springs, OH: Antioch Press, 1958) 65. As the founder of socialism, Henri de Saint-Simon makes a clear distinction between socialism and communism. Socialism implies a program to regulate economic life from some central organizing body. State socialism gives the broadest of rights to the government, which directs economic life for the maximum production of industrial output. In contrast, communism assumes a state of economic abundance and thus repudiates all private property and, hence, economic inequality and the redistributive role of government. The state has no larger task than the management of things. Economic functions have a peripheral position in communist societies, while socialist ones place a central role on economic production. See Durkheim, *Socialism*, who presents the socialist ideas and philosophy of Henri de Saint-Simon. More generally, the socialist project entails the nationalization of economic functions and state ownership of the means of production, while communism constitutes the highest stage of development, in which property, social classes, and the state no longer exist.

With a population of 5.5 million people, the Lao PDR is the smallest of these remaining states and its leaders possibly the least ideologically committed. This regime is also the newest and poorest, by far. Nominally still communist, the Lao party-state maintains a monopoly of political expression within its borders, while successfully managing the transition to a form of market capitalism. The political structure and socialist system that developed in the Lao PDR diverges from classical socialism in several important respects, relegating this party-state to the status of “peripheral socialism.”⁷¹ By examining the nature of these differences, this chapter hopes to provide important clues to the nature of the reform process (as examined in subsequent chapters) and why the trajectory of the Lao PDR continues to diverge from the experience of the former Soviet block in Eastern Europe.

Before delving into the structure and political culture of communist Laos, this anatomy of peripheral socialism begins with an overview of the Marxist legacy that gave rise to the classical system of socialist production and central planning. Based on the European experience, many accounts of the system’s failures wrongly point to the inability of communist institutions to reform under the dominating presence of the

⁷¹ The term “peripheral socialism” comes from E.V.K. Fitzgerald, “The Problem of Balance in the Peripheral Socialist Economy: A Conceptual Note,” *World Development* 13, no. 1 (1985). Although Fitzgerald’s analysis of the transition to socialism for poor agrarian countries is dated, the term “peripheral socialism” encapsulates some of the characteristics of, as well as the challenges and dilemmas facing, the Lao PDR. The socialist economies of newly independent states after World War II diverged in many ways from the classical system of Eastern Europe, which embarked on the socialist experiment from a much higher level of development. The “peripheral socialist economy” refers to poor countries limited by a large agrarian sector dominating a shallow economic base. Peripheral socialist economies depend heavily on international markets and foreign exchange for development. This “accumulation bias” manifests itself in budgetary allocations which tend to favor investment in agricultural products and natural resource exploitation for export, rather than domestic consumption and public welfare expenditures. (An “accumulation bias” refers to the tendency of socialist policies to favor public investment over personal consumption.) More generally, peripheral socialism denotes socialism in the third world that has yet to consolidate the core features of the classical system. Conversely, they constitute peripheral states under a communist regime. The term “peripheral” emphasizes the preponderance of the export sector in the economic development (and subordinate position in the international division of labor) of these newly independent countries. Like small states in general, peripheral socialist states are unavoidably linked to and materially dependent on the world economy.

vanguard party. This Euro-centric bias, thus, limits the analytical value of much of the transition literature in explaining socialist transformations elsewhere. The rest of the chapter then examines the contours of the Lao party-state, focusing on political restructuring since market reforms. The second section provides background on the brief phase of socialist planning. In analyzing reforms to the state apparatus at central and local levels, the third section focuses on the organization of the Lao People's Revolutionary Party, as well as the political administration of the country. Evidence reveals a process of political consolidation taking place in the Lao state— as manifested within the party and the territorial organization of the country. For modernizing states, these political developments fit a familiar pattern; and a body of literature on peripheral state power, presented in the final section, helps to shed light on developments in Laos.

Communism in Asia and the Limits of the European Experience

Revolutionary Socialism and the End of History

Karl Marx championed a socialism that envisioned a world free of capitalist exploitation and inequality. In his writing, he offers a clear vision of a humane world, which requires "replacing the domination of circumstances and chance over individuals by the domination of individuals over chance and circumstances."⁷² In Marx's vision of dialectical history, communism, as the higher form of social organization, overcomes the inner contradictions of capitalism and progresses to the end of human history.⁷³ Supposedly, the birth of communism resolves the tendency towards crises in capitalist development. Marx was incensed by the contradictions of

⁷² Quoted in Amartya Kumar Sen, "Development: Which Way Now?" *Economic Journal* 93 (1983), 15.

⁷³ According to his materialist conception of history, human progress culminates in the end of history, with the transition from capitalism to communism. As prophesized in the *Manifesto of the Communist Party*, this utopia would contain "an association in which the free development of each will be the condition for the free development of all." Karl Marx and Friedrich Engels, "Manifesto of the Communist Party," in *The Marx-Engels Reader*, ed. Robert C. Tucker (New York: Norton, 1978), 491.

wealth and productive capacity, on the one hand, and their resultant impoverishment and waste, on the other. Although he marveled at technological and productive advances of capitalist industrialization, he reserved the brunt of his invective at the waste and social inequality of the same wealth-generating system. For Marx, private property creates the basis for exploitation, alienation, unfreedom, and untold human misery. Those who owned the means of production exploited those who were forced, on pain of starvation, to sell their seemingly “free” labor as a commodity for wage subsistence.⁷⁴

Marxism articulates a political philosophy of redistribution and a revolutionary program for gaining power. Its program of government, however, subverted the very ideals of democracy that Marx so vigorously championed. The theoretical splendor of Marxism degenerated into the practical horrors of Leninism and the mass terror of Stalinism. Regrettably, socialist revolutions and their transformation of property relations, when and where they occurred, did little to remove the substance of exploitation and only succeeded in changing its nature. One ruling class replaced another, while exploitation and domination continued in new forms. The conquest of power in the name of Marxist utopias relied on un-Marxist means of workers’ exploitation. Would-be state builders in the name of Marx the world over have used undemocratic means to achieve the impossible democratic end-state, a workers’ utopia under public ownership of the means of production. From the gulags of Stalinist Russia, the Cultural Revolution and the great leap backward in Maoist China, to the

⁷⁴ In the elegance of this compelling theory, as Bell summarizes, “exploitation was an economic phenomenon that arose out of the system of private property which allowed the capitalist to “extract” surplus value from the worker through the exchange process; once private property was socialized, the “surplus” would belong to the people, and the material basis for exploitation, a product of a specific stage of history, would disappear.” Daniel Bell, "Two Roads from Marx: The Themes of Alienation and Exploitation and Workers' Control in Socialist Thought," in *The End of Ideology: On the Exhaustion of Political Ideas in the Fifties* (Cambridge, MA: Harvard UP, 2001), 357.

killing fields of the Khmer Rouge in Cambodia, more people have arguably died in the name of socialism than for any other cause in human history.⁷⁵

Contradicting Marx and Engel's materialist conception of history, revolutionary socialism emerged not in mature capitalism, as they predicted, but in underdeveloped, economically backward and illiberal societies wrought by inequalities ripe for social upheavals.⁷⁶ Real socialism emerged not through crisis tendencies of capitalism but rather as a reaction to capitalist imperialism.⁷⁷ And the same is true of Lao communism.

⁷⁵ This assertion denies the whole history of capitalist development and its coincidence with nation state building in the West, which was marked by incessant warfare throughout the modern era. In gleeful validation of the market order, *The Economist*, "Marxism after Marx," Dec 28-Jan 3 2002-3, disdainfully notes, "Communism had tyrannized and impoverished its subjects, and slaughtered them in the tens of millions. For decades past, in the Soviet Union and its satellite countries, any allusion to the avowed aims of communist doctrine— equality, freedom from exploitation, true justice—had provoked only bitter laughter." In almost apologetic terms, Zygmunt Bauman, *Socialism: The Active Utopia* (New York: Holmes & Meier Publishers, 1976) 90, gives food for thought,

What, in fact, took place in the Soviet Union was a modernising revolution, complete with industrialisation and urbanisation, nation-building, construction of a modern state towering over vast domains of public life, ruled by a narrow minority, with the masses engaged in their habitual everyday routine and rarely transcending the confines of commonsense. This modernising revolution, however, achieved at tremendous cost, took place before the eyes of a world already appalled by the consequences of its own past industrialist intoxication, and unlikely to take delight in the sight of a few more factory chimneys and a denser crowd at the factory gates. The same world could be bewildered and terrified when shown its own past cruelty at the same time as it prided itself on its compassion for human suffering, its observance of the inviolable rights of the individual and its advances on the road to personal freedom.

Nonetheless, in Stalinist Russia, as many as 20 million disappeared from the gulag, according to Tariq Ali, *The Stalinist Legacy: Its Impact on Twentieth-Century World Politics* (New York: Penguin Books, 1984). In a utopian campaign to ruralize Cambodia, the Kmer Rouge were directly responsible for the deaths of over two million people, a quarter of population.

⁷⁶ In later writings, Marx qualified his materialist conception of history. A socialist revolution in Russia was possible, but only as an adjunct to the much anticipated upheavals in the industrial, Western Europe.

⁷⁷ Countries which eventually developed a socialist system exhibited these key characteristics on the eve of revolutionary change: a poor and underdeveloped economy; a small industrial base; salience of economic inequality; suppressed political liberties; dependency on other states; and social upheavals. See Janos Kornai, *The Socialist System: The Political Economy of Communism* (Princeton, N.J.: Princeton UP, 1992) 23.

Social Syncretism and the Classical System

In a remarkable essay entitled “Theses on the Syncretic Society,” Felip Garcia Casals aptly calls the empirical departures from classical Marxism “syncretic societies” or “premature socialism,” which combine and reconcile the impossible task of socialist construction in underdeveloped regions still in search of capitalist industrialization.⁷⁸ The international collision of underdevelopment and imperialism provided the backdrop to the emergence of premature socialism, offering a path to industrialization via Leninist revolutions.⁷⁹

All social revolutions have instigated a process of centralization.⁸⁰ The initial revolutionary period involves a substantial redistribution of property and income, as well as waves of nationalization and socialization of the country’s wealth.⁸¹ At the vanguard of this social revolution, the party-state directs the top-down transformation, merging political and administrative functions of the previous, repressive regime. Captured in the idea of bureaucratic collectivism, the second world aspired for “a

⁷⁸ Felipe Garcia Casals, "Theses on the Syncretic Society," *Theory and Society* 9, no. 2 (1980). Elsewhere, Bauman, *Socialism* 9, calls state socialism “the abortive adventure into equality.”

⁷⁹ Casals, "Syncretic Society," 233-4. In Casals’ scenario, there have been three historical responses to imperialism:

1. resignation and the reproduction of underdevelopment;
2. opposition to imperialism through imitation (Reactionary reforms and defensive imperialist conquests); or
3. Leninist revolutions: negation of imperialism and capitalism (the abolition of the private ownership of the means of production).

Industrialization may have taken one of two routes, through imperialist wars or Leninist revolutions. Casals argues, “At the beginning of [the twentieth] century, there was an economic convergence between national capitalism and foreign imperialism largely independent of political relationships. Under those circumstances, the Leninist strategy, seeking essentially to unite the anti-imperialist revolution with the anti-capitalist revolution, was a perfectly logical, if not the only, alternative to the perpetuation of underdevelopment. History has subsequently proven the foundations of this strategy to be sound. It has promoted the lasting elimination of external imperialist domination and of internal capitalist domination; it has promoted an accelerated industrialization; but it has not promoted the effective transition to a socialist organization of society.”

⁸⁰ Theda Skocpol, *States and Social Revolutions: A Comparative Analysis of France, Russia, and China* (New York: Cambridge UP, 1979). Social revolutions imply a fundamental change in the social and political structures of society.

⁸¹ Kornai, *Socialist System* 27.

state-directed society which has sought to fuse all realms into a single monolith and to impose a common direction, from economics to politics to culture, through a single institution, the Party.”⁸²

The high phase of communism, sometimes called classical socialism, describes a political structure and social system modeled on the Soviet Union under Stalin and China under Mao Zedong.⁸³ Scholars offer many interpretations of the socialist state,⁸⁴ but its defining feature is the communist party. Every five years or so, a party congress elects a Central Committee, as well as the inner circle of party leaders for the political bureau, or politburo. In most cases, absolute power resides with a general secretary, who dominates political life of the party. The governing elite oversees a vast machinery that penetrates all aspects of socio-economic life. The party apparatus becomes inseparable from the bureaucracy, where administrative affairs of government reflect the political interests of the party. In time, the bureaucratic apparatus houses the power elite, promoting social mobility of party members. Keeping members in line, the principle of “democratic centralism” governs decision making and ostensibly promotes consensus-building in party deliberations. In practice,

⁸² Daniel Bell, *The Cultural Contradictions of Capitalism* (New York: Basic Books, 1996) 14.

⁸³ For a positivist analysis of “actually existing” socialism—based primarily on the experience of Eastern Europe—see Kornai, *Socialist System*.

⁸⁴ In the academic literature, “actually existing,” “real,” and “positive” socialism all refer to the same state project of enforced industrialization under the guidance of a vanguard communist party. Joseph Alois Schumpeter, *Capitalism, Socialism, and Democracy*, 3d ed. (New York: Harper, 1950) 167, provides the most succinct definition of positive socialism and its structure in practice: “an institutional pattern in which the control over the means of production itself is vested in a central authority... in which, as a matter of principle, the economic affairs of society belong to the public and not the private sphere.” For a normative interpretation of the possibilities of socialism, see Bauman, *Socialism*, who views socialism as the counter-cultural and alternative program to capitalism. For him, socialism presents an alternative social reality, as an “intrinsic criticism of the present, inseparable from its future-orientation, which defies all attempts to describe socialism in terms of a specific social programme given once and for all.” Bauman, *Socialism* 50-1. The socialist utopia aims to redress inequality, poverty, and inequities. Bauman pejoratively calls the social programs in existential socialism “the abortive venture into equality” Bauman, *Socialism* 9. See also Robert W. Cox, ““Real Socialism” in Historical Perspective,” *Socialist Register* (1991): 170, who defines socialism “as an historical experience arose from a particular crisis of world order. It aspired to be at the same time a system of political rule and of production. The organization of production lies at the heart of socialist politics.”

the principle effectively discourages dissent and ensures that all party cells faithfully obey party directives dictated by the leadership.

A “siege mentality” besets the governing apparatus, which hides behind an “Iron Curtain” of international isolation and domestic terror.⁸⁵ The socialist state projects the illusion of perpetual war, so as to justify the police state.⁸⁶ Hence, the socialist command economy maintains a constant war footing, mobilizing the masses for the struggle against capitalist imperialism and demanding a collective sacrifice of personal savings in the name of rapid industrialization.⁸⁷

Enforcing the state’s monopoly on violence, an elaborate police apparatus monitors political expression of the ideologically suspect and other subversive elements in society. In practice, socialism equates with totalitarianism, while its bureaucracy systematically acts above the law.⁸⁸ While progressive in its revolutionary transformation of society, premature socialism nonetheless exhibits feudal-like characteristics in its regression to authoritarian rule.⁸⁹ Social syncretism attempts the

⁸⁵ In a remarkable speech entitled “The Sinews of Peace,” delivered on March 5, 1946 at Westminster College in Fulton, Missouri, Winston Churchill inaugurated the Cold War by warning against the shadow of communism lurking behind a metaphoric “Iron Curtain” in Central and Eastern Europe. Although a call to arms against complacency in the aftermath of American victory, the speech also made a compelling case for a strong United Nations to enforce peace. The safety of Europe required a “special relationship” between the U.S. and the U.K., as well as the establishment of a durable world organization. Churchill inveighed, “We must make sure that [the United Nations’] work is fruitful, that it is a reality and not a sham, that it is a force for action, and not merely a frothing of words, that it is a true temple of peace in which the shields of many nations can some day be hung up, and not merely a cockpit in a Tower of Babel.” Winston S. Churchill, “The Sinews of Peace,” in *Winston S. Churchill: His Complete Speeches 1897-1963*, ed. Robert Rhodes James (London: Chelsea House, 1964).

⁸⁶ Robert Skidelsky, *The Road from Serfdom: The Economic and Political Consequences of the End of Communism* (New York: Allen Lane, 1996) 102.

⁸⁷ The socialist command economy was not a technical solution to the problems of inadequate savings and investment, but rather “a device for maximizing and perpetuating the power of the state.” The command economy did not produce a totalitarian dictatorship; instead totalitarian control required the command economy. *Ibid.* 103.

⁸⁸ Kornai, *Socialist System* 41-7.

⁸⁹ Casal writes, “the State... assumes a charismatic and repressive legitimacy; it adds to the economic constraint a non-economic one aims to determine the productive tasks, and a price for labor power inferior to its real value. To this end it prohibits the producers from using any regular means of defense. All of these are profound traits of a specifically feudal character. Given the actual underdevelopment of

impossible task of capitalist industrialization, while denying market relations and negating the very freedom that absolute democracy and communism have always envisioned.

Communism amounts to government by decree with the overall objective of economic development and social security. By nature authoritarian, socialist regimes cultivate a well-defined ruling elite directing, if not altogether benefiting from, economy and society. The party controls the state and manages the economy, which exists to fulfill a central plan, rather than to satisfy market demand.⁹⁰ Once consolidated, classical socialism achieves the centralization of administrative and economic decision making, characterized by information hoarding, dominance of hierarchical dependence, and vertical control over horizontal authority.⁹¹ Bureaucratic allocation, instead of market signals, determines the economic parameters of industrial output in state-owned enterprises. A hallmark of socialist production, state-owned enterprises exhibit “soft budget” constraints unburdened by the incentives of profit-making.⁹² As a result, chronic shortages of resources plague the entire system. In contrast to the capitalist economy, marked by demand-constraints, socialist production runs into perennial supply constraints, which account for its low level of efficiency.⁹³

this society, its historical origin, and the specific potential of the coercive model of feudalism, the uncontrollable propensity toward this model confers to the political state power... of premature socialism its preponderant character.” Casals, "Syncretic Society," 239-40.

⁹⁰ Skidelsky, *Road from Serfdom* 96.

⁹¹ Kornai, *Socialist System* 363.

⁹² State-owned enterprises under “soft budget” constraints “are likely to over-expand, thus generating excessive demands for particular investment goods that in turn create chronic shortages. The result of shortages is that the production process continues, but by the mechanism of “substitutions.” If a firm does not find a raw material or spare part it will continue production by substituting it with the next available material or part. This inevitably will affect the quality of production. Although in areas of extensive growth, production in heavy industries, textiles, etc., may not be affected devastatingly, if production is in high technology it will.” See Ivan Szelenyi and Balazs Szelenyi, "Why Socialism Failed: Towards a Theory of System Breakdown - Causes of Disintegration of East European State Socialism," *Theory and Society* 23 (1994): 223.

⁹³ To the extent that the socialist economy relies upon a monetary system, the currency is non-convertible with the capitalist world system. At the same time, perennial current account deficits rely

In summary, social syncretism constitutes the historical manifestation of the socialist revolutionary project implanted upon underdeveloped regions. The system expresses the contradictions of socialism and underdevelopment: a communist utopia predicated upon abundance but uncomfortably confronted by an overwhelming privation and economic misery calling for the very capitalist development its ideology repudiates.⁹⁴ Reconciling these contradictions, the state ascends the commanding heights of the economy in a political reversion to feudalism, thus revealing the moral bankruptcy of the socialist enterprise and discrediting the Marxist law of history. Historical materialism and dialectical history were turned on their heads, while repression of liberty justified, in some tragic sense, the end state of democracy.⁹⁵

Market Reforms and Post-socialism

A communist country describes a polity organized around a Leninist party-state, in which the organs of government and public administration appear inseparable from the organization of the ruling party and politburo. Leninist revolutions produce premature socialism in poor countries. The attempt to build socialism in backwards societies demands a stage of economic development and industrialization. The result is

upon loans financed from the capitalist first world. Most countries of the socialist world belonged to the Council of Mutual Economic Assistance (CMEA), which served to integrate their economies.

⁹⁴ Socialism in practice has meant the transformation of the mode of production from dependent capitalism to a social syncretism of incompatible parts: the premature elimination of private property and the negation of economics, on the one hand, and the search for capitalist industrialization rooted in capitalist exchange relations and private appropriation of the means of production, on the other.

⁹⁵ In a cruel twist of history, the construction of a socialist alternative destroyed the collective exploitation of individual bourgeois, only to inaugurate the unlimited exercise of collective brutality. The alienation of the capitalist production process was replaced by the iron cage of the socialist allocative system. The inequalities of capitalist economics were overwhelmed by the iniquities of a socialist bureaucratic apparatus. The hidden hand of the market was exchanged for the forceful fist of the planned economy. The private ownership of the means of production was merely surpassed by state ownership of mass terror. The capitalist creation of unequal wealth was enthusiastically cast aside for the collective redistribution of equal penury. Marxists confidently predicted that the administration of people under capitalism would make way for the socialist administration of things. Instead, the central allocation of things demanded the general domination of people. The bourgeois hegemony of a democratic myth was exchanged for an iron curtain concealing a bankrupt ideology. The irony was inescapable: a quixotic belief that ends justified the means without considering that the means might destroy any hope of ever reaching the ends.

a syncretic system, unstable and transitory to the core.⁹⁶ Premature socialism systematically tampers and deliberately interferes with economic production and exchange for political purposes, thus creating disincentives to produce.⁹⁷ Even the initial success of anti-capitalist industrialization portends a deeper and eventual crisis of premature socialism.

Expanding on the transitory nature of state socialism, the literature on post-socialism emphasizes the institutional failings of communism, which constitutes a closed system capable of sustaining itself only in the medium term. As long as the one-party monopoly remains in place, it is argued, economic restructuring and reforms to socialist production appear seemingly impossible.⁹⁸ Once the process of reform begins in a socialist country, the political and ideological hold of the party begins to erode.⁹⁹ Much of the literature posits the eventual weakening and demise of the

⁹⁶ This syncretic society has the functional role of ensuring the capitalist industrialization under socialist planning. In the process, ownership of the means of production appears in limbo, lacking a well-defined status. In place of private property, premature socialism fails to create the rudimentary foundations for the social means of production. Without a firm status of the means of production, this social system can only be transitory. It is a passing society. As Casals reasons:

the role of this syncretism is to ensure the simultaneous functioning and malfunctioning of the capitalist economic mechanisms needed for industrialization. The alternative which this regime offers to the absence of the private ownership of the means of production is another absence: that of the social ownership of these same means. In turn the state maintains the monopoly of control (not the ownership) of these means. This results in a vacuum of ownership, expressing in an absurd fashion the eminently transitional nature of this society. Casals, "Syncretic Society," 235-6.

⁹⁷ Ibid.: 248.

⁹⁸ Kornai argues,

the system is incapable of stepping away from its own shadow. No partial alteration of the system can produce a lasting breakthrough. For that a change of system is required... Stalinist classical socialism is repressive and inefficient, but it constitutes a coherent system. When it starts reforming itself, that coherence slackens and its internal contradictions strengthen. In spite of generating a whole series of favorable changes, reform is doomed to fail: the socialist system is unable to renew itself internally so as to prove viable in the long run. So the time for really revolutionary changes does come in the end, eliminating the socialist system and leading society toward a capitalist market economy. Kornai, *Socialist System* xxv.

⁹⁹ In János Kornai's analysis of socialism, "The socialist system is not capable of renewal that could free it of its dysfunctional features while retaining the sole rule of the Communist party and the dominance of the state sector." Ibid. 377.

communist, one-party state.¹⁰⁰ Capturing the theme of post-socialism, Victor Nee and Peng Lian assert,

The dilemma confronting the few remaining communist rulers is that to survive in a world of competing states, they are compelled to initiate and sustain market reform. Yet the spread of markets erodes commitment to the party and paves the way for regime change.¹⁰¹

In one conventional view, the deregulation of political, economic, and social life results in the loss of monopolistic control of state violence and leads, concomitantly, to regime change.¹⁰²

These deterministic assessments dismiss, out of hand, the flexibility of Asian communism. As the argument runs, system collapse seems inevitable and unavoidable with market reforms; deeper economic transformations demand political reforms. This line of reasoning follows a circular logic. As a closed economic and political system, socialism has no capacity for reform or renewal; a lack of incentives towards private economic actors prevents the creation of economic rationality. According to these theorists, for countries defying this logic, e.g. China, their successful transformation to embrace a form of market economy effectively relegates them to the realm of capitalism, where they can contribute to no larger understanding of the communist program of government. This tautology is less than revealing. At worst, the analysis falls victim to what political scientists call “selecting on the dependent variable,” or in economic parlance “selection bias.”

¹⁰⁰ See for example, Eyal, Szelâenyi, and Townsley, *Making Capitalism without Capitalists: Class Formation and Elite Struggles in Post-Communist Central Europe.*; Stark and Bruszt, *Postsocialist Pathways.*; Zweig, *Internationalizing China.* ; and Shirk, "China's Economic Reforms."

¹⁰¹ Victor Nee and Peng Lian, "Sleeping with the Enemy: A Dynamic Model of Declining Political Commitment in State Socialism," *Theory and Society* 23 (1994): 285.

¹⁰² Valerie Bunce, *Subversive Institutions: The Design and the Destruction of Socialism and the State, Cambridge Studies in Comparative Politics* (New York: Cambridge UP, 1999).

Much of the literature on post-socialist transition betrays a Eurocentric worldview that fails to appreciate the adaptive capacity of Asian communism (not to mention Cuban resilience). Many self-described transitologists dismiss China and its Asia cousins as simply subverted forms of communism— more indicative of authoritarian regimes than ideological heirs to Marxist-Leninism. Governments in China and Vietnam, for example, are viewed as having given up the main institutions of the Leninist party-state and are thus discarded from comparative analysis. A lacuna exists in the larger understanding of socialist transformation, particularly in communist Asia. While the study of transitions continues to highlight failures and defects of the communist program, as well as its limited capacity for reform, little or no research explores institutional transformations that contribute to communist successes.

In the case of the People's Democratic Republic of China, the Soviet Union's ideological competitor as heirs to Marxist-Leninism, the party-state remains unchallenged and has pragmatically wrapped itself around the red-flag of Chinese nationalism, while betting on economic success to legitimize its monopoly of political power. Far from falling by the dustbin of history as a system of government, the Chinese form of Marxist-Leninist not only thrives, but has now emerged as America's strategic competitor. Why has Asian communism survived the transition where others have failed?

The demise of communist Eastern Europe and the end of the Cold War are better viewed as failures of Soviet communism, not the wholesale collapse of the socialist enterprise advocated by Marx and Engels and implemented by Lenin. As Daniel Bell perceptively observes, "What has been the most fateful fact of the twentieth century, a fact overshadowed by communism and fascism, has been the

breakup of empire.”¹⁰³ 1989 inaugurated the dismantling of the Soviet Empire; 1991 saw its final demise. The Cold War is over. America has won. But communism is not lost.

The term “socialist transformation” better captures the transition faced by all communist countries in the early 1990s. The socialist system, “actually existing” or otherwise, continues to transform itself under external threats to internal security. In Eastern Europe, that transformation led to collapse of the defining features of the Leninist party-state, while in East Asia and Cuba, state communism not only survives in some places, but actually thrives in others. The success of market mechanisms in communist Asia and its failure in Eastern Europe were the result, not the cause, of their divergent socialist trajectories. Yet, little of the academic literature focuses on the success of one, vis-à-vis the failure of the other.

In Laos, a communist decline has clearly not transpired; but market reforms continue apace. The party-state continues to monopolize political power, while overseeing a more market-oriented economy. In the 1990s, annual economic growth averaged about 6% of gross domestic product, slowed down only by the Asian financial crisis in 1997.¹⁰⁴ The resilience of the party-state in Laos points to the limitations of much of the transition literature to explain the adaptability of Asian communism. In contrast to the major upheavals that engulfed all of Eastern Europe by the early 1990s, governments in Laos, Vietnam, North Korea, and Cuba experienced no such internal threats to their regimes. Although subjected to initial denunciation in world opinion, the Chinese communists, too, face few serious challenges to their monopoly on state violence. The strength and durability of Leninist party-states,

¹⁰³ Daniel Bell, “The Resumption of History in the New Century,” in *The End of Ideology: On the Exhaustion of Political Ideas in the Fifties* (Cambridge, MA: Harvard UP, 2001), xix-xx.

¹⁰⁴ For details on the Lao macroeconomy, see the Appendix.

however questionable their ideological inclinations, cannot be explained away as mere exceptions that prove the rule. These political systems deserve to be studied in their own right, with due attention to local norms, values, and particular conditions which distinguish their socialist trajectories. The rest of this chapter examines the experience of Lao communism.

Peripheral Socialism in the Lao PDR

No longer the forward march of history from irrational capitalism to equitable communism, socialist revolutions nonetheless provided underdeveloped regions the political capital to galvanize social movements in the name of national liberation. Democratic failings aside, socialism as a political program to gain power has nonetheless made possible the construction of development alternatives.¹⁰⁵ Although the abolition of private property under capitalism failed to remove the last vestiges of either privation or exploitation, and may have arguably increased both in relative terms, socialist revolutions provided a generation of would-be state builders an alternative to neo-colonialism. Its wider appeal derived from its perception as an anti-capitalist and anti-imperialist path to national development and industrialization. In fact, communism did not as much constitute a higher stage of economic development, but rather an alternative route to modernization.¹⁰⁶ The socialist project of forced industrialization was thought to provide underdeveloped nations the means to catch up to advanced nations.¹⁰⁷

¹⁰⁵ Richard R. Fagen, Carmen Diana Deere, and Jose Luis Coraggio, eds., *Transition and Development: Problems of Third World Socialism* (New York: Monthly Review Press (Center for the Study of the Americas), 1986).

¹⁰⁶ Bauman, *Socialism* 86. notes, "Russia, as well as Africa half a century later, embraced the socialist ideology not as an extension and negation of, but as the substitute for, liberalism as the cultural idiom of capitalism."

¹⁰⁷ Skidelsky, *Road from Serfdom* 102.

The Central March towards Socialism

At the time of communist victories in Vietnam and Cambodia in 1975, the Pathet Lao (Lao freedom fighters supported by the communist block) gained full control of Laos and established the Lao People's Democratic Republic (Lao PDR) under the control of its political wing, the Lao People's Revolutionary Party (LPRP). The Pathet Lao were not die-hard communist, *per se*, but rather nationalists using the propaganda of socialism to mobilize a military force able and willing to fight for its cause of national liberation. Under the leadership of its charismatic leader Kaysone Phomvihane, the new regime moved to enforce socialism on a predominantly natural economy.¹⁰⁸ In line with most modern revolutions, the communist takeover resulted in an initial period of centralization.¹⁰⁹ Local governments saw their previous powers severely restricted by a political regime instituting centralized planning.

In the early years, the regime consolidated power and strengthened the war economy, based on forced procurement of commodities at administrative prices.¹¹⁰

¹⁰⁸ During the initial phase of the communist revolution in Laos, president Kaysone promoted the ideology of a "new socialist man," enduring and embracing personal sacrifices to build the foundations of a communist utopia on the ruins of a predominantly rural society ravaged by war.

¹⁰⁹ Grant Evans, *Laos Peasants under Socialism* (New Haven: Yale U.P., 1990). He further explains, "The communist government [in Laos] has succeeded more than any previous government in sinking multistranded organizational roots in the villages and providing a credible nationalist ideology." In many ways, the experience in Laos follows the classic social revolution, as outlined by Skocpol, *States and Social Revolutions: A Comparative Analysis of France, Russia, and China*. Such a revolution results in a consolidation of state power— more centralized, bureaucratic, and autonomous— with political control over many aspects of socio-economic life.

¹¹⁰ By socialist standards, the degree of nationalization in Laos ranked relatively low. The small change in property relations also reflects the small degree of prior capitalist development and penetration of foreign capital. Prior to the communist takeover in 1975, independent peasant production in a subsistence, or natural, economy accounted for over 80 percent of the population's activity. Nonetheless, property formally belongs to the state, which then grants user-rights to the general populace. In a February 1988 speech, Kaysone clarified the meaning of landownership rights in Laos: "Under our new system, the entire land is the common property of the entire society with the state as the representative." Quoted in Grant Evans, "Planning Problems in Peripheral Socialism: The Case of Laos," in *Laos: Beyond the Revolution*, ed. Joseph J. Zasloff and Leonard Unger (New York: St. Martin's Press, 1991), 108.

Socialist law and justice described a government by decree.¹¹¹ Its bureaucracy asserted a monopoly over rice production and introduced an agricultural taxation.¹¹² By severely restricting inter-provincial travel, the regime also demanded self-sufficiency of local food production.¹¹³ The state ran the industrial/service sectors and social services; controlled investment and production choices/quotas; and determined wages and prices for goods and services.¹¹⁴ Throughout the late 1970s, severe drought compounded economic disincentives in rice production, which continued to stagnate. In a desperate bid to modernize the agricultural sector, the regime established cooperatives in 1978. Still, economic production stagnated, and the country remained underdeveloped. Economic hardship threatened political stability and forced the LPRP to make pragmatic adjustments. The difficulties of establishing political and administrative control over an ethnically disparate and geographically dispersed population severely hampered the march towards socialism. An extremely poor

¹¹¹ In 1983, a Supreme People's Court was established to handle important cases and legal disputes. Corresponding civil and criminal codes followed in 1989 and 1990. Prior to the adoption of the country's constitution in 1991, Socialist justice "was meted out by 'people's tribunals' in accordance with directives handed down by the Party. But as regional Party leaders were free to interpret directives as they saw fit, no uniform body of law applied across the country. Moreover apart from criminal cases, the principal purpose of 'people's tribunals' was to suppress all opposition to the new regime." Martin Stuart-fox, *Politics and Reform in the Lao People's Democratic Republic*, vol. Working Paper No. 1, *Political Economy of Development* (Williamsburg, VA: Program on Civil Society and Governance, College of William & Mary, 2004) 16. In 1983, a Supreme People's Court was established to handle important cases and legal disputes. Corresponding civil and criminal codes followed in 1989 and 1990. In the meantime, the capricious nature of Party policy continued to characterize socialist law and justice in Laos. Energized by the New Economic Mechanism, the Party promulgated a series of laws aimed at building the foundations of a rule of law and, thus, attracting much needed foreign investment.

¹¹² During this period, severe weather compounded the economic disincentives in rice production, which continued to stagnate. In a desperate bid to modernize the agricultural sector, the regime established cooperatives in 1978.

¹¹³ Bernard Funck, "Laos: Decentralization and Economic Control," in *The Challenge of Reform in Indochina*, ed. Borje Ljunggren (Cambridge, M.A.: Harvard Institute for International Development, 1993), 128. Accompanying these actions, the regime instituted "a series of jacobin-like measures such as the abolition of the monarchy, adoption of Lao as the country's official language, elimination of the Laotian honorific mode, simplification of the alphabet (to make it easier to spread to the non-Lao-speaking ethnic groups), and the abolition of the system of village autonomy."

¹¹⁴ Patrick Keuleers and Langsy Sibounheuang, "Central-Local Relations in the Lao People's Democratic Republic: Historic Overview, Current Situation and Trends," in *Central-Local Relations in Asia-Pacific: Convergence or Divergence?* ed. Mark Turner (New York: St. Martin's Press, 1999), 201.

transport and communications infrastructure contributed to weak central authority and a strong degree of regional autonomy, which continues to characterize the country's political economy.

The Local Retreat towards Capitalism

Like other socialist regimes, the LPRP set out to stabilize postwar socioeconomic and political conditions. Building socialism would come later. In Laos, however, high communism lasted less than a decade. Peasant resistance and low productivity forced the government to cancel its first experiments with cooperatives.¹¹⁵ The half-hearted attempt to collectivize agriculture produced dismal results and forced the government to re-evaluate its socialist development model. As early as 1979, the government began to liberalize the economy, in efforts to raise agricultural output and stabilize the economy, whose worsening conditions contributed to the vast exodus of the population into Thailand. The regime was bleeding people through a porous “bamboo curtain” that allowed the relative ease of escape for those wishing to vote with their feet against the regime. From the regime's victory up until 1980, an estimated one-tenth (some 300,000) of the Lao population fled the country. Fearing massive flight of a subjected people, the regime came to terms with the impossibility of totalitarian control¹¹⁶ and worked on cultivating its leading role in Lao society and legitimacy based upon economic performance and nationalistic defense of Lao culture. The challenge continues to this day.

Perhaps unique among socialist countries, the Lao PDR began the market transition before the core features of the classical socialist system were firmly in place.

¹¹⁵ By creating disincentives for peasants to produce, cooperatives actually reinforced the natural economy. See Evans, *Lao Peasants under Socialism*.

¹¹⁶ The mass terror of the Kmer Rouge in Cambodia was never a practical possibility in Laos—not so much because of the character of the regimes towards their subjects, but because of the porous nature of the “bamboo curtain,” which provided the relative ease of escaping communist Laos across the Mekong River into Thailand.

The Soviet model of socialist planning was unceremoniously abandoned for administrative and financial autonomy at the subnational level. Socialist economics gave way to market-oriented reforms, although the party doctrine remained unchanged. Begun in 1986, The New Economic Mechanism (*chin tanakaan mai*) ushered in a period of sustained economic reforms to address the failures of centralized planning.¹¹⁷ Thereafter, the Lao government has pragmatically shifted the country from a command-inspired economy to a market-driven one.¹¹⁸

The regime bowed to internal pressure for more provincial discretion in economic affairs. Instead of a centralized bureaucracy under the direction of a vanguard party, the Lao party-state comprises, as the following sections reveal, strong provinces that resemble more a collection of regional interests than any sense of a unified political entity governed by central authority. Even in the early decentralized period, economic autonomy did not translate into political autonomy, however. Local party leaders still represented the LPRP and had a direct stake in the system's survival.¹¹⁹ Taking its lead from China and Vietnam, the LPRP "was prepared to encourage a free-market economy, but not political liberalization."¹²⁰ Economic

¹¹⁷ The New Economic Mechanism was introduced after protracted debate within the party. Eventually, Secretary-General (later Party president) Kaysone Phomvihane's support pushed through the reform process. The internal debates followed what Stuart-fox calls the "two-line struggle."

¹¹⁸ By the late 1980s, the Lao PDR ruled over a rudimentary planned economy that contained a two-tier price system separating market prices from the lower official prices. In 1985-1989, about 90% of wages in the public sector came in the form of "salary coupons" redeemable only at government shops. Roughly 60% of all official purchases also required coupons honored at government or cooperative shops.

¹¹⁹ As Stuart-Fox asserts,

Paradoxically, ... the high degree of provincial autonomy [prior to 1991] actually reinforced the importance of the LPRP as the only centrally structured and unifying organization in the country... The broad guidelines of the Party were put into effect throughout the country. Those who wielded power in the provinces did so by virtue of the positions they held in the Party. Their loyalty was therefore to the Party, and this in itself acted as an important counterbalance to excessive regionalism. Stuart-fox, *Buddhist Kingdom, Marxist State: The Making of Modern Laos* 174.

¹²⁰ Stuart-fox, *A History of Laos* 203.

autonomy did not threaten the legitimacy of the Lao government and may have strengthened the sustainability of this heterogeneous state.¹²¹

Nor has the later economic liberalization promoted political pluralism. In the 1990s, market reforms instigated more centralized control over economic regulation, as well as a process of political consolidation. Central-local struggles over the control, pace, and scope of economic openness figure as the predominant focus of the party's conflict over the direction of governance reforms.

Domestic Restructuring and Market Reforms under State Guidance

Laos exhibits a remarkable political stability, or perhaps inertia.¹²² The exoticism of Buddhist traditions, the enticing flavors of Lao cuisine, and the relaxed atmosphere of the river valleys give an easy impression of an enchanting and charming culture, untroubled by the march towards modernity. To the foreigner visiting Laos, the capital Vientiane is a sleepy town, with few signs of economic, let alone political, life. At the Morning Market (*thalaat saow*) in central Vientiane, vendors linger patiently for the occasional transaction. Stall after stall of hand-made silk, cheap Chinese goods, pirated DVDs, and numerous other goods quickly overwhelm the infrequent shopper, who can't help but wonder how anyone makes a profit with so little foot traffic. The seeming orderliness and stale atmosphere of *thalaat saow*, the largest of Laos' markets, reflect an absence of the economic life that animates open markets in most developing countries. The chaos, odors, vibrant energy, and lively interactions that characterize marchés in West Africa, the bazaars in

¹²¹ Rani Jerndal and Jonathan Rigg, "From Buffer State to Crossroads State: Spaces of Human Activity and Integration in the Lao PDR" *Lao Culture and Society* Grant Evans (ed) (Bangkok: Silkworm, 1999) 42. Regional autonomy implied only to the party leadership at the provincial level, not to any sense of self-determination. In their analysis of Laos as an emerging crossroads state, Jerndal et al. write, "Local party leaders were permitted latitude in their economic dealings, but were still (central) party cadres who owed their positions to the leadership in Vientiane."

¹²² Ivarsson, Svensson, and Tonnesson, *The Quest for Balance* 9.

Morocco, or even the mammoth weekend market in Bangkok find little expression in Laos. Around Vientiane, stores and restaurants stand mostly empty, and the occasional Western backpacker has her pick of internet cafes, coffee shops, and guesthouses. In more ways than one, communism symbolizes the death of the market in Laos.

In the evening, a midnight curfew guarantees the absence of indiscriminate frivolity, in efforts to stem the “moral decline” of an adolescent youth much seduced by Thai pop-culture. Meanwhile, across the Friendship Bridge in Thailand, the image of lazy, indolent, smiling, and passive Lao people—so prevalent in writings on Laos—quickly fades. Predominantly of the same ethnic make-up, the Thai-Isan people engage in vibrant commercial exchange, under capitalist excesses frequently denounced by Lao officials. Although an artificial barrier dividing the Tai-Lao peoples, the Mekong River nonetheless reinforces a genuine separation of two world views. The subdued eastern flank of the Mekong reflects not an endemic quality of Lao traditions, but rather the inescapable logic of communist rule.

Structure of the Lao People’s Revolutionary Party

Even though few visible signs of the police state are immediately apparent in Laos, it would be a mistake to infer a lack of communist control. The party deliberately projects few public displays of its power. While the regime lightly touches many of the predominately rural population, the desolate streets and languid atmosphere of Vientiane hide a strong party apparatus that successfully pacifies and disciplines the populace.

The Lao People’s Revolutionary Party monopolizes political ambition and regulates public life.¹²³ Party operatives penetrate all institutions of government and many areas of society. All organizations of the party-state (from the government

¹²³ Initially called the Lao People’s Party, the Lao People’s Revolutionary Party was founded on March 22, 1955, four years after the dissolution of the Indochinese Communist Party. The party adopted its current name at the Second Party Congress in 1972.

bureaucracy, the mass organization, to the military) implement party directives and administer its monopoly of power. Within the public administration, party cells figure prominently at all levels of government, from the central ministries to their provincial and local branches. Overlapping the government structure, the party organization ensures (in the words of late President Kaysone) "the party's all-round absolute and direct leadership over all links, from the mapping out of lines and policies, to the organization of execution and control."¹²⁴ To reinforce its control over the countryside, the LPRP developed an array of mass organizations. Current ones include the Lao Front for Construction, the Lao Women's Union, the Lao People's Revolutionary Youth, and the Lao Federation of trade unions. Still, outside the capital Vientiane, the party's strength quickly diminishes. At the village level of this sparsely populated country, the party's influence in some areas hardly seems relevant.¹²⁵

The formal structure of the communist party in Laos mirrors the classic Leninist party-state. See Figure 1. Representing the highest organ of the party, the Political Bureau (politburo) currently consists of ten members, chosen by and from the Central Committee of the LPRP. Convening every five years, a party congress determines the makeup of the Central Committee, thereby installing a new government. Held in March 2001, the Seventh Party Congress elected a Central Committee of 53 members.¹²⁶ The latest party congress, slated to take place sometime this spring in Laos, expects to bid farewell to President Khamtay Siphadone, making way for Choummaly Sayasone, the current head of the military.

¹²⁴ Evans, *Lao Peasants under Socialism* 184.

¹²⁵ Evans 184. In the mid-1980s, the party's faithful (as measured in membership) numbered only 45,000 (or 1.3 percent of the population).

¹²⁶ Stuart-fox, *Politics and Reform in Laos*. With the deaths of two members (Maj-Gen. Khamphouang Chanthaphomma, a former governor of Xiang Khuang province, and Lt Gen. Osakhan Thammatheva, a member of the Politburo) in November 2002, the committee now stands at 51. Before Osakhan's death, the Politburo comprised 11 members, but his position remains unfilled, at least until the Eighth Party Congress scheduled for March 2006.

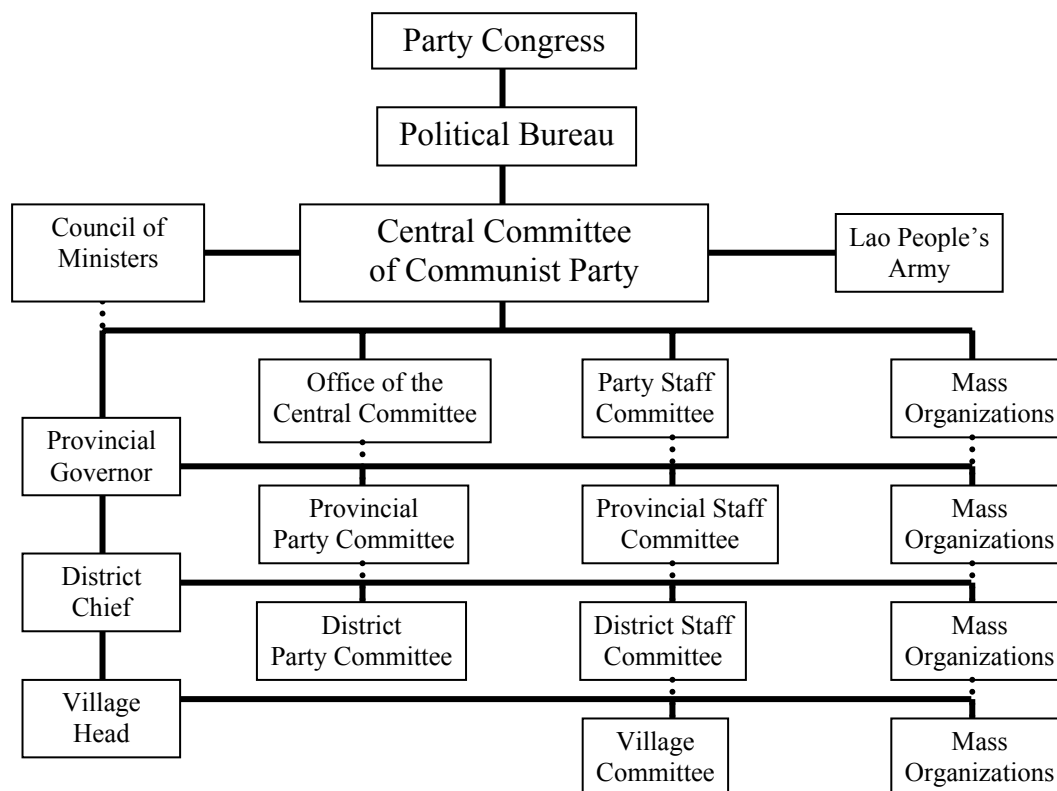


Figure 1. Structure of Lao People's Revolutionary Party

Drawn from the military, the president commands ultimate authority over the party and state. He delegates authority to the Cabinet of the Central Committee, along with the Standing Member of the Politburo, who preside over day-to-day affairs of the party.¹²⁷ This body heads a vast party apparatus that reaches down to the village level. Although the chart reveals no influence from geography, we know that far from the capital, local power remains concentrated in the office of provincial governors, who oversee all government activities in their respective regions. As representatives of the government and party at the local level, provincial governors enjoy tremendous authority. Headed by governors, provincial party committees control and secure the remote countryside. Reporting to the party organization in the provinces, districts and

¹²⁷ Ibid. 8. General Choumali Sayasone currently holds the position of Standing Member.

some villages have similar party committees managing and monitoring government activities in their locale. In communist Laos, horizontal lines of provincial control override vertical lines of central authority. For a communist country, Laos remains highly decentralized.

Appointed by the president, governors hold ministerial rank and are accountable only to the Central Committee, not to the vertical line ministries under the Prime Minister. Currently, all 18 governors, but only some of the 13 ministers, serve on the 53-member Central Committee, enabling their arbitrary use of power at the local level. For the most part, governance in Laos is negotiated within the Central Committee, and governors have overall responsibility of administering their respective provinces. Although circumscribed since constitutional reforms in 1991, provincial authorities hold the levers of power outside the capital. Regional ties remain strong, and reforms to central-local relations have dominated government deliberations on the market transition.

Drawn from just over one percent of the population, party members number about 65,000. Most work as civil servants, leaders in mass organizations, military and police personnel.¹²⁸ Party membership promotes upward mobility and career advancement within the government bureaucracy.¹²⁹ To improve the quality of the public administration, the LPRP actively encourages educated civil servants to join the party as a way to advance their careers.¹³⁰ By invitation only, membership in the LPRP usually follows a number of years of initiation. Party cadres selected for special

¹²⁸ Party members make up just over one percent of the country's population. Anecdotal evidence suggests that the number of party members drawn from the private sector remains low. Jacquelyn Chagnon et al., "Looking Back to See Forward: Consultations About Good Governance and Participatory Development in the Lao PDR," (Vientiane, Lao PDR: Swedish International Development Cooperation Agency, 2002), 29.

¹²⁹ By some estimates, only about 20% of party cadres have strong technical competence.

¹³⁰ Chagnon et al., "Good Governance in Laos," 29.

administrative and political training at the party's Tha Ngon Administration School usually anticipate an impending government or party promotion. All middle and upper-level party cadres receive political indoctrination in Marxist-Leninism. More a formality than consequential examination of Marxism-Leninism in the Lao context, the training at Tha Ngon nonetheless symbolizes the party's enduring commitment to one-party rule, however suspect its ideological faith in communism. Through this ceremonial indoctrination, party cadres begin to identify with the system's survival.

The military has a strong showing in the party. In fact, all military personnel enjoy party membership.¹³¹ The Ministry of Defense operates separately from the government. The Military Committee of the Party controls national defense under the overall guidance of the president of the party.¹³² The army dominates the highest ranks of the Politbureau and Central Committee. Arguably, the army, as in China, will guarantee that Laos preserves a one-party state.¹³³ This alliance plays out behind closed doors in deliberations of the Central Committee.¹³⁴ As with provincial authority, the military enjoys considerable autonomy and economic power.¹³⁵ At the

¹³¹ The government maintains a standing army of 29,100 soldiers, supplemented by a local militia numbering about 100,000. As cited in Clay Wescott, ed., *Key Governance Issues in Cambodia, Lao PDR, Thailand, and Viet Nam* (Manila, Philippines: Asian Development Bank, 2001) 24.

¹³² Stuart-fox, *Politics and Reform in Laos* 10.

¹³³ Ibid. Four members of the Politbureau have military credentials: the party and State president (Khamtay Siphandone), president of the National Assembly (Samane Viyaketh), State vice-president (Choummaly Sayasone), and the prime minister (Bounnyang Vorachit). The rest of the Central Committee contain only four military offices.

¹³⁴ As Stuart-fox observes, "as both the Party and the Army in Laos are highly secretive organizations, neither of which is transparent in the way it arrives at decisions, any discussion of the relationship between them must be largely speculative. No channels of communication between the Army and the Party are made known to the public." Ibid. 11.

¹³⁵ As Stuart-fox observes, the "influence of the Army on the Party is exercised through a quintessentially Lao network of personal relationships that is almost impossible to pin down. It is reinforced by the external links the Army fosters, especially with the Vietnamese military. But how long the Army's current level of influence can be maintained remains to be seen." Ibid. 11-2.

local level, for example, military conglomerates have exploited regional monopolies of the lucrative logging industry.¹³⁶

The party-state has yet to relinquish meaningful control over the pace and scale of economic, let alone political, restructuring. Its powers are multiple and appear unchallenged—from the president's appointment of regional governors and the party's screening of legislative candidates, at the central level, to the concentration of regional authority in staff committees and the party's guidance of village elections, at the local level.¹³⁷ Power remains centralized in the hands of the LPRP, which faces little opposition to its one-party rule. Economic reforms continue to take place under the direction and control of a united and strong party. In numerous speeches, President Khamtay voices the official line: “the party leadership commands historical events” and provides the only guarantee for “national independence and unification, political and social stability, and national development.”¹³⁸

The Lao PDR, like all communist states, fuses the party with the government. As the central policy-making body of the government, the Cabinet or Council of Ministers comprises eighteen members including heads of the ministries, the State Bank, and the State Planning Committee. The council carries out party directives throughout the vast apparatus of government. Each ministry contains a parallel party structure that regulates party policies for that sector.¹³⁹ Every ministry has a vice-president who co-ordinates party activities and ensures that the agency follows party

¹³⁶ As the largest military conglomerate, Phoudoi comprises 58 companies spanning travel, hotels, construction, logging, and other enterprises. Also known as Bolisat Phattana Khet Phoudoi (or Development Company of Phoudoi district), Phoudoi operates out of central Laos. See International Monetary Fund, “Lao People's Democratic Republic: Selected Issues and Statistical Appendix,” (Washington, DC: IMF, 2002), 10.

¹³⁷ Under the guidance of the party, village leaders are elected from a screened list of pre-approved candidates. The majority of elected village leaders are party members.

¹³⁸ Quoted in Ivarsson, Svensson, and Tonnesson, *The Quest for Balance* 46.

¹³⁹ At the National Tourism Authority, for example, 13 of the 40 staff members are party affiliates, who meet once a month to set the office's agenda.

guidelines. Once a month, this vice-president presides over staff meetings for party cells at the ministry's headquarters in the capital. They discuss the party's agenda and activities in the ministry for the upcoming month.

With a strong influence over the central government, the party sets the political agenda and broad aims of state policies, leaving the public administration and National Assembly the responsibility of carrying out its directives. Despite external assistance to rationalize the bureaucracy, the politburo continues to bypass the formal structure of the public administration in approving all choices for non-elected senior and decision-making government positions. The party also gives clearance on all candidates put forward for elections in the National Assembly. Throughout the public administration, at least one of the two highest decision-makers at each government level has party affiliation.¹⁴⁰

Constitutional Reforms and Political Consolidation

At the Fifth Party Congress in 1991, then party leader Kaysone Phomvihane consolidated his grip on power. The newly elected Central Committee abolished the Secretariat position, formerly reserved for the party secretary-general. Thereafter, the party leader has doubled as the president of Laos. The party congress also promulgated the regime's first constitution, 16 years after taking power.¹⁴¹ While reaffirming the LPRP's leading role in society, the law of the land oddly makes no mention of "socialism" or "communism." Nonetheless, the constitution recognizes the

¹⁴⁰ The only exceptions occur in some rural communities. Chagnon et al., "Good Governance in Laos."

¹⁴¹ For a thorough review of the Lao constitution, including changes to draft forms of the document, see Martin Stuart-fox, "The Constitution of the Lao People's Democratic Republic," *Review of Socialist Law* 4 (1991). Manynooch N. Faming, "An Interpretation of the Constitution of the Lao People's Democratic Republic," in *New Laos, New Challenges*, ed. Jacqueline Butler-Diaz (Tempe, A.Z.: Arizona State University, 1998), provides the actual text of the constitution. See also MacAlister Brown and Joseph J. Zasloff, "Government and Politics," in *Laos: A Country Study*, ed. Andrea Matles Savada (Washington, D.C.: Library of Congress, 1995).

LPRP as the only acceptable political party in the country.¹⁴² The party's power and functions, however, escape constitutional checks. Although all communist states operate behind the cover of democratic and collective leadership, only the Lao PDR formally endorses the principle of "democratic centralism" in its constitution.¹⁴³

The restructuring of intra-governmental relations figured prominently in constitutional reforms. While establishing the basis for law and order in the country, the constitution also redressed the problem of excessive local autonomy by recentralizing financial and budgetary prerogatives. Since 1991, economic restructuring has resulted in more centralization of administrative control and economic regulation. In the process, governors have been gradually disempowered, while central ministries have reasserted control over their line ministries.

Centralization has been slow and incomplete, however. Although the constitution recognized a recentralized form of government, change has been resisted by provincial governors, who still exert considerable influence over line ministries in their jurisdictions.¹⁴⁴

The constitution also strengthened the legislative body, which received enhanced powers to monitor and regulate the activities of the government and judiciary. On the recommendation of the prime minister, the National Assembly appoints all ministers in the public administration. Each minister, in turn, submits his

¹⁴² Article 3 reads: "The people's national ownership is practiced and ensured by the political functioning system and led by the Lao People's Revolutionary Party."

¹⁴³ As stated in Article 5, "The National Assembly and all other government organizations are established and function according to centralized democratic rules." Some observers believe that principle of democratic centralism fits naturally into Lao political culture, which stresses collective decision making and a public display of unity.

¹⁴⁴ For example, fiscal recentralization has met with resistance from governors reluctant to give up their financial autonomy. For the most part, governors still have considerable authority over provincial branches of line ministries. The actual influence of governors varies from province to province and depends on their political clout and relative position in the Party hierarchy.

senior staff for approval by the party leadership.¹⁴⁵ Controlled by and drawn from the party apparatus, members of the National Assembly are formally elected for a five-year term.¹⁴⁶ The Party screens and approves all candidates, and every citizen has a legal obligation to vote. In the most recent elections of 2002, 166 candidates ran for 109 seats, up from 99 spots in 1997. All but one elected official belongs to the party.¹⁴⁷

The National Assembly meets twice a year, for sessions extending two to three weeks, when it formally considers new laws; oversees law enforcement; sets budgetary priorities; and presides over the judiciary and law enforcement. However, power and autonomy of the legislative body appear limited.¹⁴⁸ In practice, the National Assembly rubber stamps policies determined by the party and its administrative organs. While the constitution formally inaugurated a country under the rule of law, the authority of the President and Politburo ensure the extension of a government by decree. Behind the scenes, party resolutions continue to dictate government policies. Until recently, central ministries, aided by foreign consultants, drafted most of the 47 laws promulgated by the National Assembly.¹⁴⁹ Even with these regulations, the rule of law has yet to take firm hold in Laos.¹⁵⁰ The adoption of laws without

¹⁴⁵ Stuart-fox, *Politics and Reform in Laos* 9.

¹⁴⁶ The 4th Legislature assembled in 1997, the 5th in 2002.

¹⁴⁷ Women make up one-fifth of the total, while the ethnic Lao continue to demonstrate their political dominance within the government. Over the last two elections, their representation in the National Assembly has grown from two-thirds to a whopping four-fifths of all members. Chagnon et al., "Good Governance in Laos," 42.

¹⁴⁸ S. Gopalan, "Report on the Review of the Oversight Process in the Lao National Assembly," (Vientiane, Lao PDR: GPAR, United Nations Development Programme, 2001).

¹⁴⁹ In the coming years, legislative members anticipate more participation into the legislative process, where the content of new laws may possibly contain more of their input. Chagnon et al., "Good Governance in Laos," 42.

¹⁵⁰ In Stuart-fox's assessment of the rule of law in Laos,

Part of the problem is that while an independent judiciary exists in theory, in practice the unchanged Article 5 of the 1991 constitution still applies. This enshrines democratic centralism as the guiding principle in the functioning of all the organs of the state. This has officially

implementation and enforcement achieves little. High-ranking party officials concede that few of these laws ever find legal enforcement.¹⁵¹

Political Culture and Regional Networks of Patronage

With no due process before the law, political patronage and corruption inevitably took root.¹⁵² A clan patronage system, blurring the lines between party, state and army, characterizes the political culture.¹⁵³ By many accounts, the march towards capitalism has created new space for graft, bribery, kickbacks, and other informal methods of influencing public policy. By most accounts, corruption pervades all areas of government.¹⁵⁴ The party controls access to power and wealth in Laos. Through economic privileges and social mobility within the government, membership confers the possibility of rank, prestige, and wealth. In southern Laos, for example, the family of President Khamtay Siphadone has amassed a fortune in a construction business that enjoys monopolistic control sanctioned by the government. Closely tied to the Siphadone clan, the Daoheuang family also figures prominently in southern Laos,

defined as ‘working and taking decisions as a committee, while accepting individual responsibility, with the lower levels dependent on the higher levels’ (within the organization). In fact, democratic centralism is not the mode of functioning of the state, but of the organization not mentioned in the Constitution at all – the LPRP. While democratic centralism applies, an independent judiciary and rule of law remain chimeras, for its application rests on a system of rewards and punishments that are extra-legal. Stuart-fox, *Politics and Reform in Laos* 18.

¹⁵¹ According to Stuart-fox, laws and regulations are not well known, even by those responsible for applying them. Ibid. 17.

¹⁵² Patronage aside, public awareness of laws and regulations appears low outside the urban areas, where the dominant language is typically not Lao, the country’s official language. According to some district officials, public awareness of the legal system varies widely, with the most lawfully conscious areas in direct relation to their level of development assistance in legal education and advocacy. See Chagnon et al., "Good Governance in Laos," 44.

¹⁵³ Ivarsson, Svensson, and Tonnesson, *The Quest for Balance* 16.

¹⁵⁴ The president of the National Assembly reportedly received a cash payment of US\$ 5 million for his approval of a construction project in southern Laos. Meanwhile, political expediency recently required that law enforcement officers drop charges of drug trafficking against the son of the Prime Minister. Lower in the chain of command, staff secretaries hold access to high ranking officials and frequently place a value on available appointment time. And the cash cow of the US\$ 1 billion Nam Theun 2 dam project figures to provide a bounty for astute and well-connected government officials and party leaders.

where its conglomerate spans many areas of the local economy, such as trade in import/export, forestry sector, and various other businesses. Increasingly, personal ties of marriage and patronage have strengthened regional alliances.¹⁵⁵ One of the wealthiest families in Laos, the Phomvihanes (of the late president Kaysone) possess vast economic holdings throughout the country. One of Kaysone's sons is currently married to one of the Ithavong's, a family symbolizing wealth and power under the Royal Lao government.

As some argue, Lao culture exhibits an enduring strength of clan patronage, which has characterized politics and government since the country's independence from France in 1954.¹⁵⁶ In the Lao form of clientelism, political power and prestige derive more from family politics and personal connections than from unbending adherence to ideology.¹⁵⁷ Increasing evidence points to a growing overlap between a revived business elite and the party leadership.¹⁵⁸ By one estimate, a list of the twelve wealthiest families under the Royal Lao government contains six families which also

¹⁵⁵ Stuart-fox observes, ““senior Party members soon began to dispense patronage in the traditional Lao way, rewarding extended family members and loyal retainers with favors and jobs, for which they were often poorly qualified, in order to build a political support base... Ironically, this process of political-economic elite formation was powerfully assisted by the introduction of the economic reforms of the 1980s, known as the New Economic Mechanism (NEM).” Stuart-fox, *Politics and Reform in Laos* 6.

¹⁵⁶ Stuart-fox, "Politics and Patronage in Laos," 3.

¹⁵⁷ In a recent political essay widely influential within the development community, the Lao historian Martin Stuart-fox goes so far as to claim that the political culture in Laos has changed very little in modern times. According to his observations, the brief phase of high communism only superimposed a superficial communist superstructure upon traditional Lao statecraft, characterized by personal connections and loyalties in running the affairs of government. In the current transition phase to capitalism, this political culture supposedly helps to explain the government's slow pace of economic reforms, the rent-seeking proclivities of its public servants, and limited capacity for organizational change within the public administration. Stuart-fox, *Politics and Reform in Laos*. Initially commissioned by the World Bank to examine the political roots of the slow pace of economic reforms, this political report has gained traction within the development community in Laos—in part due to its stinging indictment of Lao political culture, but mostly because of a lack any contemporary writing of the Lao party-state. The World Bank has quietly distanced itself from the report, since its initial public airing.

¹⁵⁸ Evans, "Planning Problems in Laos," 125.

figure among the wealthiest in contemporary Laos.¹⁵⁹ The small Lao elite cement their ties through regional alliances of business networks, family relationships, and party patronage.¹⁶⁰

Legitimacy and Lao Traditions

A tension exists within the party about the value of Marxist-Leninism. While the government adheres to a Leninist party structure, the rhetoric of socialism has quietly receded. The only English daily newspaper in Laos, the *Vientiane Times*, a veritable mouthpiece of the regime, systematically expunges any mention of the word “socialism” in reference to contemporary Laos.¹⁶¹ Repeated in many official documents, nonetheless, the party’s slogan still extols the virtues of communist dictatorship: “The Party leads, the State implements, and the people are the owners.” Once defiantly boasting the ideas of “Peace Independence Unity and Socialism,” the official emblem of Laos now reads “Peace Independence Democracy Unity Prosperity.” Struggling to define its leading role in society, the party, in the meantime, boasts its nationalistic credentials as defender of Lao traditions.

¹⁵⁹ These families include the Sisombaths, Ithavongs, Bouphas, Souvannavongs, Rasphol, and Choulamanys. Personal communications with U.S. State Department officials.

¹⁶⁰ As Stuart-fox observes, “although the LPRP has taken China and Vietnam as models for economic liberalization along with tight political control, the political culture of the Party in Laos, because it is so much smaller and because it draws on traditional Lao values and modes of social interaction, depends on a far greater extent on personal and family relationships and patronage. This is also the case in comparison with other Southeast Asian countries (with the obvious exception of Brunei). The political culture of the *meuang* depended entirely on personal relationships (within the *meuang*, and between lesser and more powerful *chao meuang*). Politics under the Royal Lao regime was just as much a matter of personal family alliances, often reinforced through marriage. And the same is true of the LPDR.” Stuart-fox, *Politics and Reform in Laos* 7. Emphasis in original.

¹⁶¹ *The Vientiane Times* is devoid of any negative press about the country, however minor or apolitical. Acting as an arm of the Ministry of Foreign Affairs (although technically within the Ministry of Information and Culture), the daily paper is sprinkled with diplomatic niceties of an, at times, awkward English and palatable more for diplomatic digestion than public consumption. Incidences of robberies, accounts of road accidents, or tales of ethnic insurgencies hardly receive mention in the national newspaper, whereas the latest development projects to win approval make for bland front-page headlines. The vast majority of Lao anyhow find little leisure in reading Lao texts, much less the English *Vientiane Times*. Unlike the Chinese or Vietnamese, the Lao lack a culture of reading.

Since the New Economic Mechanism, the regime has gradually erased the edifice of communist traditions. Visible signs of communism eventually disappeared from public life. Billboards that once depicted the building of socialist man have given way to commercial signs extolling the virtues of multinational consumption. Loudspeakers that forcefully blared propaganda calling for personal sacrifice in the name of a multi-ethnic state have fallen silent. In its place, public celebrations of Theravada Buddhism, long subdued in the early years of communist rule, have spearheaded a public revival of Lao traditions. Exploiting these popular festivities, the regime has opportunistically embraced all things traditionally Lao— save the monarchy.

Even a one-party state requires legitimacy.¹⁶² Since the collapse of its Soviet benefactors, the Lao PDR moved to re-legitimize itself through the public endorsement of traditional cultural practices initially suppressed in the excitement of the socialist triumph. The failures of communist-inspired development plans forced the government to change course. This move occurred in the economic realm,¹⁶³ but slowly and unavoidably in the cultural sphere as well. As Grants Evans documents, state-sponsored “revival of tradition” in Laos today points to a socialist government in

¹⁶² Muthiah Alagappa, ed., *Political Legitimacy in Southeast Asia: The Quest for Moral Authority, Contemporary Issues in Asia and the Pacific* (Stanford, CA: Stanford UP, 1995), suggests that the claim to legitimacy and its contestation are a core feature of politics and merit study irrespective of their impact on political stability or government performance. More generally, Bendix views “the reciprocity of rights and obligations as the hallmark of a political community.” Reinhard Bendix, *Nation-Building and Citizenship: Studies of Our Changing Social Order* (New Brunswick, NJ: Transaction, 2003) 88.

¹⁶³ The government legitimizes its right to rule, in part, on sustained economic improvements. Its governance paper states,

The Government aims to achieve a stable and open people’s democracy, where the rights of the people are guaranteed by an efficient administration of the law, with broad and active participation in all national and international activities, in order to ensure stable socio-economic conditions in the country, improve constantly the living standards of the Lao multi-ethnic people, create the conditions for the eradication of poverty, and create a modern, industrial and successful country Government of Lao PDR, "Public Service Reform, People's Participation, Rule of Law and Sound Financial Management: Background Paper on Governance," (Vientiane, Lao PDR: 2003), 13.

search of legitimacy.¹⁶⁴ The usual cultural trappings and symbolic rituals of socialist nationalism have lost their relevance. The monotonous procession of socialist parades, the cavalcade of used Soviet military, and other symbolic rituals of communist self-glorification gave way, as Evans documents, to the rich and vibrant traditions of Theravada Buddhism.¹⁶⁵

Instead of building “socialist man,” as Kaysone once romanticized, current communist leaders have staked their claim to rule on a revival of Lao traditions, the patrimonial defense of a Lao culture, and state-directed economic development. In the process, socialist rhetoric has disappeared from public discourse, making way for traditional Lao politics based upon clan patronage.¹⁶⁶ All the while, the government has moved to consolidate its grip on power.

Territorial Organization of Laos

Closely linked to party reforms, the territorial organization of the country has undergone a wave of consolidation, driven by the fear of communist collapse. The Lao government emphasizes territorial state control for political stability and national unity. Prior to the reform era, the Lao PDR comprised five tiers of government: central government, provinces, districts, sub-districts (*tassengs*), and villages. As re-organized

¹⁶⁴ Grant Evans, *The Politics of Ritual and Remembrance: Laos since 1975* (Chiang Mai, Thailand: Silkwork, 1998). In this book, Grant Evans documents the government’s ongoing efforts to invent national legitimating myths, by reconstructing social memory and incorporating older cultural structures and revitalizing long-suppressed rituals into its construction of a national culture and its overall nation state building project. He explores how the Lao government attempts to retraditionalize historical narratives. As Evans notes, there were limits to a legitimation project based upon the re-vitalization of traditions strongly associated with the previous royalist regime.

¹⁶⁵ *Ibid.* In order to cope with rapid change to Lao society engendered by the market transition, the party has promoted Lao ritual, traditions, and national symbols reminiscent of the royal government it overthrew. The project attempted, as Evans notes, a rediscovery of Lao tradition. “The LPRP today is desperately trying to invoke “culture” as the main basis of a separate Lao nation” (*ibid.* 179). There were contradictions in this state-directed revival of traditional, however. By encouraging the revival of religious practices, the communist regime reverted to the ritualistic symbolism of the discredited royal regime.

¹⁶⁶ For a discussion of clientelism in Laos during the brief period of high communism, see Stuart-fox, “Politics and Patronage in Laos.”

in the constitution, the government structure no longer recognizes sub-districts. In efforts to control a geographically dispersed countryside, the regimes abolished the popular elected People's Councils at the district and village levels. Since 1991, local administrative committees came under the direct control of provincial party committees.

Outside the central government, the Lao PDR currently organizes local administration into three levels: 16 provinces and two regional equivalents (Vientiane Prefecture and Xaysomboun Special Zone); 141 districts; and 11, 293 villages.¹⁶⁷ In this "unitary, deconcentrated state," local power resides within the office of provincial governors. Territorial re-organization mostly affected district governments, which now constitute the basic level of state administration. Where once district administrations oversaw 12-15 *tassenges*, now they monitor up to 200 villages.¹⁶⁸ Through continuing reforms to the apparatus of government, the party hopes to make local governments more systematically accountable to the center. Only with direct threat to the country's security has the central government exerted direct control over the provinces. For example, Xaysomboun Special Zone, long the locus of the ethnic Hmong resistance to communist rule, falls under the direct control of the Party Central Committee and the supervision of the Ministry of Defense.¹⁶⁹

The potential for social unrest quickly provokes a strong military presence. During the border conflict with Thailand in 1984-1986, the government managed Xayabury province directly from Vientiane, and the army controlled various parts of

¹⁶⁷ Article 40 of the Constitution states that provinces are created by law on the recommendation of the Prime Minister. Article 7 of the Law of the Government gives the government the authority to create and alter the boundaries of districts. For a good overview of district administration, see Patrick Keuleers, "The District in the Local Administration in Lao PDR: Recent Developments, Challenges and Future Trends," (Vientiane, Lao PDR: GPAR, United Nations Development Programme, Prime Minister's Office, 2001).

¹⁶⁸ *Ibid.*, 11.

¹⁶⁹ *Ibid.*, 10.

the region. In 1992, security concerns on the borders with Thailand also led to direct central government oversight of Hongsa and Xienghone districts in Xayabury province. With security issues resolved, these districts reverted back to provincial control in 1994.¹⁷⁰ Thereafter, the army set about pacifying the restive countryside. Ostensibly aimed at developing the rural areas, the controversial “focal sites” plan resettles, sometime forcibly, remote villages (predominantly from the mountainous areas) into development clusters (usually in the low-laying regions). Promoted to alleviate poverty by bringing poor villagers closer to social services, focal sites also help the government control areas with a history of social unrest and hostility to communist rule.¹⁷¹

Overall, the market transition has instigated a process of territorial consolidation, with powers strengthened at the central and provincial levels. Salient weaknesses of local autonomy forced the central government to undertake radical changes in the spatial organization of its administration, in order to reinforce economic liberalization. Since the collapse of state communism in Eastern Europe, the government in Laos has strived to create a stronger unitary state, with more oversight in all spheres of Lao society. The government fears losing political authority and social control to exogenous forces that accompany economic liberalization.

The general process of territorial consolidation is far from complete, however. In many areas of the country, the *tassengs* still provide a vital link between district administration and outlying villages. As of 2000, 143 out of 912 *tassengs* continue to function, evidence of the difficulties in consolidating control over the scattered

¹⁷⁰ Ibid., 20.

¹⁷¹ In its 1998-2003 development plan, the government proposed 13 focal sites for development, covering 127 villages. See Ibid., 21.

countryside.¹⁷² Nonetheless, territorial state control greatly influences the market transition of this highly devolved state.

Peripheral States and the Centralist Ethos of Government Power

Aiming to integrate the whole of Lao society and project its influence deeper into the village level, the government has transformed central-local relations to reflect this project of consolidation. The political agenda of centralization traces a recognizable trajectory for small and poor countries struggling to create the rudiments of a unitary state. In the market transition, Laos resembles more a typical developing country, rather than a communist state. As in many developing countries, a weak central government in Laos struggles to command allegiance in the face of traditional political authority. As further explored in the following two chapters, the Lao government actively promotes political, administrative, and economic centralization over regionally dispersed and fiscally independent provinces.

In Laos, this centralization has occurred in direct response to the collapse of the Soviet second world. Yet, its bureaucratic rationale also fits a pattern for peripheral states. As some argue, states exhibit a characteristic tendency towards centralization.¹⁷³ State restructuring in Laos reveals on a small scale, but often in exaggerated form, many of the difficulties of national development for states carved out of imperial ambitions. As with many ex-colonial states, Laos owes its modern existence to the historical rivalries of competing centers of power. Like other colonial outposts, the political boundaries of the country reflect neither the natural movement of peoples, languages, or cultures. As a consequence, the Lao situation resembles what

¹⁷² Ibid., 25.

¹⁷³ Michael Mann, *The Sources of Social Power, Vol. II: The Rise of Classes and Nation-States* (New York: Cambridge UP, 1986).

Joel Migdal elsewhere calls “strong societies and weak states.”¹⁷⁴ Attempting to transform this dynamic, centrality follows an organizational dynamic common to many modernizing states.¹⁷⁵

Generalizing from his analysis of the Tanzanian experience, David Slater observes, “since the peripheral state has often assumed its form through a process of decolonization, following an external logic, rather than acting to the *internal* growth of centres of hegemonic power, its capacity for intervening in a process of social transformation has been limited.”¹⁷⁶ The centripetal bias of national development thus gravitates towards centralization, particularly in efforts to foster a durable sense of territorial unity. Slater calls this process the “centralist ethos of state power.”¹⁷⁷ His reading of the territorial reorganization in Tanzania also applies to the Lao case: “The rationalization and consolidation of state power lay at the roots of the spatial restructuring of state power.”¹⁷⁸ While vastly incomplete, centralization characterizes the process of state restructuring in Laos as well.

Although central planning has roundly been discredited as a way to manage an economy, evidence suggests that centralization offers an appropriate policy at Laos’ level of development.¹⁷⁹ Marketization in Laos had entailed building a national economy, where fragmented and regional economies once dominated. In the transition

¹⁷⁴ Joel S. Migdal, *Strong Societies and Weak States: State-Society Relations and State Capabilities in the Third World* (Princeton, NJ: Princeton UP, 1988).

¹⁷⁵ As Smith notes, the “rationing, procurement and contractual functions of the state tend towards centralization.” Brian C. Smith, “Spatial Ambiguities: Decentralization within the State,” *Public Administration and Development* 6, no. 4 (1986): 459.

¹⁷⁶ David Slater, “Territorial Power and Peripheral State: The Issue of Decentralization,” *Development and Change* 20 (1989): 503. Emphasis in original.

¹⁷⁷ *Ibid.*: 504.

¹⁷⁸ *Ibid.*: 514.

¹⁷⁹ As Slater cautions, centralization does not equate with central planning. The range of economic functions, especially the development of state enterprises, are not synonymous with central planning. *Ibid.*: 503.

process, a strong central government capable of regulating and enforcing economic governance has gradually eroded the traditional autonomy of Lao provincial authority. Political and economic restructuring continue to emphasize stability and cautious reforms under the guidance of the party-state.

The Lao PDR demonstrates a willingness to engage in economic reform but shows no readiness to relinquish control of political power. As with all remaining communist regimes, “an important objective of reforms is to strengthen the credibility of the party and state as legitimate forces of modernization.”¹⁸⁰ Democracy is not on the agenda— or even radar screen— for political and economic elites in the country. Either for fear of reprisals or in expression of genuine doubts, intellectuals and civil servants convey little enthusiasm for democracy. Building its legitimacy on social stability, the Lao PDR promotes its nationalistic credentials in areas of territorial security, defense of Lao traditions, and economic development. All the while, the party upholds the social order and its leading role in society.

Governance is negotiated behind the bamboo curtain of Lao communism, and regional allegiances remain strong. A weak center oversees a highly devolved state. Power and authority of the government diminishes quickly outside Vientiane. Legitimation in the socialist system in Laos derives, in Weberian terms, from a mixture of charismatic leadership and Buddhist traditions, while a modern legitimation has yet to find legal-rational expression.

In summary, peripheral socialism in Laos describes a political system blending a feudal-like structure characterized by overlapping sovereignties and regional economies, with a pre-capitalist economic base attempting to industrialize along capitalist lines towards a vague understanding of socialism that, for all intents and purposes, even party leaders themselves have abandoned. What remains is an empty

¹⁸⁰ Ljunggren, *Market Economies under Communist Regimes* 6.

shell of a Leninist party structure, an elite party membership that bestows privileges and rank, and a rural hinterland reluctant to embrace the nation building project of a distant center. Through a network of regional alliances and, increasing, centralization of state administration, the party controls and tightly monitors the structure of government. By streamlining its administrative functions, centralizing party authority, and expanding its control over a remote countryside, structural reforms aim to reinvigorate the party, rejuvenate its moral image as defender of Lao society, and thus strengthen the state apparatus. In dismantling centralized planning, the Lao PDR resorted to the limited role of managing the macroeconomy, which reinforced, as the next chapter elaborates, the party's original goal of centralization.

Chapter III

ADMINISTRATIVE REFORMS AND STATE RESTRUCTURING IN LAOS

Bureaucracy and the Socialist Transformation

The development of market capitalism goes hand in hand with the rationalization of government activities. The transition to capitalism has everywhere required the rationalization of a functioning bureaucracy.¹⁸¹ To this end, public administration plays a forceful role in shaping political and economic trajectories of transitioning societies. As a communist state, the Lao People's Democratic Republic (Lao PDR, or Laos) constitutes a polity organized around a Leninist party-state. Organs of government and public administration are inseparable from the organization of the ruling party and politburo. As in all communist states, the Lao PDR fuses the party with the government.¹⁸² Government agencies compose the executive organ of this regime.¹⁸³ The Lao People's Revolutionary Party (LPRP) directs the party-state in

¹⁸¹ A bureaucracy constitutes a system of administration (historically associated with governments and best suited for the rational pursuit of organizational goals). See Nicholas Abercrombie, Stephen Hill, and Bryan S. Turner, *The Penguin Dictionary of Sociology* (New York: Penguin Books, 2000) 33-5. The development of a modern state cannot escape a bureaucratization of society. In sociology, bureaucracy is readily associated with Max Weber, who linked the rise of the bureaucratic state with the rational pursuits of capitalism. See Max Weber, *The Protestant Ethic and the Spirit of Capitalism*, 2nd Roxbury ed. (Los Angeles: Roxbury Pub., 1996). For Weber, the capitalist spirit originated from an ascetic belief in work as a religious calling. In time, he argues, the rational conduct of capitalism creates a bureaucratic "iron cage" that devastates the very spirit of its making. Weber believed that "In the last resort the factor which produced capitalism is the rational permanent enterprise, rational accounting, rational technology and rational law, but not these alone. Necessary complementary factors were the rational spirit, the rationalization of the conduct of life and a rationalistic economic-ethic" (quoted in Daniel Bell, *The Coming of the Post-Industrial Society: A Venture in Social Forecasting* (New York: Basic Books, 1999) 476.)

¹⁸² The fusion of administrative and political functions constitutes one of the main characteristic of the socialist system. See Kornai, *Socialist System* 39.

¹⁸³ Article 2 on the Law on the Government states,

The Government of the Lao People's Democratic Republic is the executive organ of the State, which is approved by the National Assembly and responsible to the National Assembly and the President of the Republic for the execution of all the State's management in regard to political, economic, cultural, and social use of national resources, the protection of the environment,

Laos. Typical for a communist state, this vanguard party thoroughly penetrates the government. Of the approximately 65,000 Party members, most serve as government functionaries, leaders in mass organizations, or military personnel.¹⁸⁴ This bureaucracy houses the power elite of the socialist system.¹⁸⁵ Many civil servants and citizens make no distinction between the Party and state, referring to the Party as “pak-lat” (or party-state).¹⁸⁶

In a socialist system, the bureaucratic state apparatus promotes social mobility of party members. A weakening of this function may signal a political decline of the communist regime. For many scholars of post-socialism, departures from central planning reallocate resources and redirect opportunities, while ushering in a process of political change.¹⁸⁷ Although these predictions fail to explain developments in Asian communism, the focus on government institutions provides a useful method to explore a key aspect of the socialist transformation in Laos, public administration.

To many observers, the Lao bureaucracy is hopelessly weak. For a weak state, the Lao PDR nonetheless exhibits a surprising resilience. Its remarkable political stability baffles many.¹⁸⁸ After the collapse worldwide of state communism, the Lao

national defense and security, and foreign affairs. Government of Lao PDR, "Law on the Government of the Lao People's Democratic Republic," (National Assembly, 1995).

¹⁸⁴ Chagnon et al., "Good Governance in Laos," 29. Party members make up seven percent of all salaried civil servants.

¹⁸⁵ Kornai, *Socialist System* 41.

¹⁸⁶ Chagnon et al., "Good Governance in Laos," 28.

¹⁸⁷ See Walder, *Waning of the Communist State*. In this edited volume, the essays examine the ways in which departures from the practices of central planning (by altering control over property and opportunity) have brought about political change. While many observers concede that economic reforms lead to political changes, few agree about how. The authors claim that changes in economic institutions bring about a steady political decline of state power, irrespective of the success of economic policies. Departures from central planning “set in motion a chain of consequences, usually unintended, and if the departures are extensive enough, they eventually alter political institutions and relationships to the point where Communist party rule can no longer be sustained.” Walder, *Waning of the Communist State* 2-4.

¹⁸⁸ Ivarsson, Svensson, and Tonnesson, *The Quest for Balance* 9.

state accelerated economic reforms and restructured its public administration, in accommodating market capitalism. Unlike the experience in Eastern Europe, economic restructuring in Laos has taken place without the need for a political one. Why have economic reforms in the public administration not contributed to erosion of central authority of the Lao state? In addressing this question, this chapter analyzes the structure of the government, the management of its bureaucracy, and challenges to administrative reforms. Several related questions motivate this work: In what ways, and to what extent, does the party impinge upon the functioning of government? How has the party's embrace of market capitalism transformed the apparatus of government, while still providing an avenue for social mobility of party members? What are the changing patterns of authority in government bureaucracies, in relation to either its respective line ministries or traditional local authority? What role does the international development community play in governance reforms?

In tackling these questions, the chapter focuses on central-local relations, which remain a source of ongoing discussions within the government.¹⁸⁹ I analyze the intersections of vertical and horizontal lines of authority, in relation to the organization and management of government ministries.¹⁹⁰ This chapter draws heavily from an assessment of the Governance and Public Administration Reform (GPAR) program between the Lao government and the United Nations Development Programme (UNDP).

¹⁸⁹ Following Walder's approach, I analyze the "changes in the relationship of higher to lower levels of government, in the relations between superior and subordinate within the party and government, and the interests and orientations of officials within the party-state apparatus, especially in its lower reaches." See Walder, "The Quiet Revolution from Within: Economic Reform as a Source of Political Decline," 4.

¹⁹⁰ As in most communist countries, the Lao administration contains intersecting vertical and horizontal lines of command. *Vertical lines of authority* refer to central line ministries and their offices at subnational units of government. The central ministries, their departments, and provincial and district field offices compose this line of control. *Horizontal control* refers to physical authority outside the capital. Provincial governors, district chiefs, and village heads determine the horizontal line of authority.

If the market transition in Laos reveals the challenges of a typical developing country, as the previous chapter suggests, then the public administration may also follow a pattern familiar to peripheral states. The first section sketches an outline of what this modernizing project is likely to produce in Laos. The second section briefly reviews the history of public administration in Laos prior to constitutional reforms in the early 1990s. The next documents the organization of the public administration in contemporary Laos. Focusing on inter-governmental relations, the fourth section examines the challenges to administrative reforms posed by the march towards market capitalism. A study of governance in developing countries cannot escape a discussion of corruption, and the fifth section presents its various interpretations in Laos. Efforts by some donors to assist government restructuring then come under close scrutiny in the fifth section. I draw contrasts between the political realities of administrative reforms in Laos, premised on increasing state control, and attempts by some donors to push a world-wide agenda of government restructuring, galvanized under the banner of “decentralization.” As advanced by the GPAR program in Laos, this misplaced agenda reveals that development agencies de-politicize public administrative reforms, while—ironically—pushing their own political agenda. Nevertheless, the party, aided and abetted by foreign aid, retains a strong hold on the machinery of government and still provides a strong avenue of social mobility. The concluding section bears out these claims. By pushing their own development agenda in disregard of political limitations for reforms, the development community in Laos, implicitly or explicitly, contributes to the consolidation of state power.

Peripheral States and Centralization

According to James C. Scott, the state-building project strives for “simplification, legibility, straight lines, central management, and a synoptic grasp of

the ensemble.”¹⁹¹ Modern states create and expand state spaces that contain both legible and concentrated populations. In the move from indirect to direct rule, state bureaucrats aim to organize their subjects in various ways to create a unified socio-economic space that imposes a common language, shared religion, standard currencies, consistent legal regulation, and unified systems of trade, transportation, and communication.¹⁹² The concentration of state authority derives from this immanent drive to impose direct rule.

From an administrative standpoint, centralization follows an organizational logic for modernizing states. In this “centralist ethos of state power,” the bureaucratic development of the state provides a powerful impetus for centralization.¹⁹³ As Brian C. Smith observes, the “rationing, procurement and contractual functions of the state tend towards centralization.”¹⁹⁴ Rushing to influence the trajectory of national development, Western donor agencies, seduced by a confidence in the transformative power of their assistance, often fail to recognize the central bias of state restructuring. Their programs, specifically those inspired by the idea of “decentralization,” in many instances provide a cloak for increasing central state control.¹⁹⁵ As the rest of the chapter hopes to prove, this scenario has reproduced the disconnect between state rationality and development agendas in Laos.

¹⁹¹ James C. Scott, *Seeing Like a State: How Certain Schemes to Improve the Human Condition Have Failed* (New Haven, CT: Yale UP, 1998) 59.

¹⁹² Charles Tilly, *Coercion, Capital, and European States, Ad 990-1992*, Rev. paperback ed., *Studies in Social Discontinuity* (Cambridge, MA: B. Blackwell, 1992) 100.

¹⁹³ Slater, "Territorial Power," 503-4. Usually, the condensation of power occurs within a central executive branch of the state.

¹⁹⁴ Smith, "Spatial Ambiguities," 459.

¹⁹⁵ Slater, "Territorial Power," 15.

Communism and Central Planning, Lao Style

The victory of communism in Laos ushered in an opening period of central planning. Since 1975, the government has periodically transformed the structure and organization of its public administration. Initially, the government apparatus comprised 18 line ministries and central agencies, which housed a total of 99 departments.¹⁹⁶ Responsibility for legislation ostensibly fell to the Supreme People's Assembly, which in practice rubber-stamped decrees handed down by the Party. As the executive arm of the regime, the government only enacts party policy and rarely, if ever, acts independently of party directives. The Ministry of Justice held judicial authority, along with the powerful Ministry of the Interior. With the consolidation of government, responsibilities of the state sector soared, accommodating the socialist command economy. The number of ministries increased from 18 to 32, with a total of 103 departments. These agencies contained roughly 106,000 civil servants.¹⁹⁷

In terms of personnel, the new regime faced the difficult task of creating a socialist bureaucracy to administer its central plans. In the early 1980s, Laos lacked a coherent and functioning public administration. Exacerbating these problems, the emigration of roughly ten percent of the population, mostly of the educated urban class, robbed the country of qualified personnel necessary to modernize the state.¹⁹⁸ The vast exodus of the educated population, as well as the deportation of many others to re-education camps, left a vacuum in the public administration, which had to make do with Pathet Lao, party cadres fresh out of the mountains and lacking administrative and technical skills to build a functioning bureaucracy. As a consequence, the small

¹⁹⁶ Government of Lao PDR, "Background Paper on Governance," 16.

¹⁹⁷ Ibid. These figures include numbers for officials of central and local authorities, teachers, health workers, and workers at state-owned enterprises. They exclude army personnel, however.

¹⁹⁸ An estimated 300,000 people fled Laos in the immediate aftermath of the communist victory up to 1980.

pool of qualified public servants assumed countless administrative responsibilities not readily delegated to party appointees, whose position owed more to their revolutionary allegiance than to technical ability.

A low-level of competence derives from these historical factors and is also linked to clan-patronage. The legendary first leader of the country, Kaysone Phomvihane, often decried the lack of qualified personnel in the public administration. In his report to the Fourth Party Congress in 1986, he scolded high ranking officials who gave "preference only to (their friends) or those from the same locality or race; paying attention to only their birth origin, habits and one particular sphere of education."¹⁹⁹

The reality of a small, war-ravaged country placed severe limits on the construction of classical socialism modeled after the Soviet Union. Central planning in Laos never fully materialized.²⁰⁰ Outside the capital, party-appointed governors controlled access to power and wealth. The weak infrastructure linking the provinces to the capital allowed provincial governors to determine party policies at their own discretion. In the early years of independence, de facto devolution characterized the Lao state. Kaysone once lamented that Laos did not possess a unified, national economy.²⁰¹ Instead, he conceded that Laos contained a central economy connected loosely to local economies.

As the economy collapsed in the late 1970s, the central government demanded self-sufficiency of the provinces. Consequently, the provinces gained a higher degree of political and economic autonomy. A siege mentality pervaded the party, and

¹⁹⁹ Quoted in Andrea Matles Savada, ed., *Laos: A Country Study, Area Handbook Series* (Washington, D.C.: Library of Congress, 1995) 228.

²⁰⁰ Low level of bureaucratic capacity prevented the collectivization from becoming a viable option for government planners. See Evans, "Planning Problems in Laos," 97.

²⁰¹ He readily admitted, "The local level is a constant objective structure of the Lao society." Quoted in Grant Evans, "Agrarian Change in Communist Laos," *Occasional Paper Series*, no. 85 (1988): 32.

governors severely restricted access to their provinces. Acting as quasi-feudal lords, governors monitored the movement of people, finances, and goods in their territories. During this period, central government officials and their guests had to obtain permission from governors before being allowed to travel anywhere in their provinces.²⁰²

The provinces maintained their own administration and budgets, funded through transfers from the state budget and operational surpluses of state-owned enterprises (SOEs) under their jurisdiction. Regional loyalties remain strong, even to this day, and provincial governors jealously guard their presumed right to rule over their territory. To this day, they hold ministerial rank and remain accountable directly to neither central ministers nor the Prime Minister. For the most part, party rank and the internal politics of the Central Committee determine the limits of provincial authority, rather than the formal organizational lines of the government. Loyalty to the party seemingly hold the governors in line. The pretense of strong central authority has always been maintained, but only, it would seem, for the sake of appearances and party unity.²⁰³

Anticipating the transformation in other communist governments, the Lao PDR instituted a series of economic and political reforms that culminated in the New Economic Mechanism (NEM) in 1986.²⁰⁴ The NEM involved a liberalization of internal and external trade, as well as the initial privatization of SOEs, which led to the formal devolution of powers to the provinces. De facto devolution became de jure. Diminished government resources, the failures of collectivization, and economic paralysis conspired to limit the reach of central authority. Provinces were required to

²⁰² See Stuart-fox, *Politics and Reform in Laos* 12-3.

²⁰³ Ibid. 13.

²⁰⁴ Economic reforms in Laos predated those in Vietnam, which normally provides a model for the Lao government.

be self-sufficient in food production and the general administration of government. In time, provincial governors expanded their powers. They controlled expenditures and revenues, and few resources were transferred to the distant central government.²⁰⁵ State employees outside the capital depended on provincial authorities to pay their salaries. As a result, government policies lacked uniform interpretation and execution, reflecting the regional interests of governors, instead of national priorities of central ministries. These reforms handed the government's public administration outside the capital to provincial authorities. In effect, horizontal lines of control superseded the vertical ones.

In line with these reforms, the government reduced the number of central ministries and ministry-equivalent organizations from 32 to 18, eliminating many departments and a quarter of its workforce in the process.²⁰⁶ Many of the remaining civil servants were transferred to the local level to help carry out decentralization efforts. The provinces functioned as *de facto* mini-states, conducting their own foreign policy and setting fiscal and monetary policies, irrespective of—and sometimes in competition with—other provinces. Provincial branches of the state bank acted independently of the center, setting their own exchange rates and controlling local investment decisions.

With the NEM, the central government handed more economic control to the governors, further entrenching the regional power structure. Power was a zero-sum game; devolution strengthened the horizontal lines of local authority at the expense of the vertical ones projected from the capital. Provincial governors held complete control over the hiring and financing of their personnel, whose political loyalty

²⁰⁵ Sida, "Study of Financial and Administrative Systems in Lao PDR," (Vientiane, Lao PDR: Sida, 2003), 18.

²⁰⁶ Government of Lao PDR, "Background Paper on Governance," 16. From a high of 106,000, the number of civil servants shrank to an estimated 76,000.

mattered more than their administrative competence. Central ministries commanded no authority over technical services at the subnational levels and faced difficulties enforcing national policies and addressing inefficiencies in the delivery of public services.²⁰⁷

While autonomy of the provinces and the SOEs at first remedied the principal failures of the previous command economy, the fragmentation of local prerogatives later became an obstacle to the ongoing process of economic reforms. In time, major weaknesses of this pure devolution became apparent. As a result of local autonomy, financial instability increased, quality of public service delivery further declined, regional disparities widened, and physical infrastructure deteriorated for lack of maintenance.²⁰⁸ A shortage of qualified civil servants further exacerbated financial and economic mismanagement.

Public Administration in Contemporary Laos

Local autonomy in the late 1980s led to sharp regional disparities and hampered government attempts at national unity and economic integration. Gradually, the central government moved to regain the economic and administrative initiative. Since the early 1990s, the central government has made a concerted effort to unify and expand administrative controls.

Promulgated in 1991, the Lao PDR's first constitution not only established the basis for law and order in the country, but also offered a platform to advance the party's agenda of political consolidation and administrative centralization. In addition, the document provides the basis for the rational functioning of government

²⁰⁷ As Keuleers and Sibounheuang observe of the period,

Weaknesses in the implementation of national policies, lack of norms and standards for minimum service delivery and shortage of technical and institutional capacities at the centre (and at the provincial level) led to the development of inequitable and fragmented service delivery systems across the country. *Ibid.*, 206.

²⁰⁸ Keuleers and Sibounheuang, "Central-Local Relations," 205-7.

organizations and adopts the principle of a centralized, deconcentrated state organization.²⁰⁹ The struggle to implement national policies and enforce uniform standards throughout the country continues to this day, 15 years later. In 2003, the National Assembly approved amendments to the constitution which reinforced centralization policies. The new Article 18 reads, “The state, by law, manages the economy according to the market mechanism where the state adjustment system exists and pursues the combination of centralized and unified management of the central sectors and the allocation of responsibilities to localities.”²¹⁰

Figure 2 below shows the formal structure of the Lao government. Solid lines connect direct levels of authority, and dotted lines indicate loose coordination. As the head of government, the president defers to the Prime Minister for day-to-day affairs of the country.²¹¹ Direct lines of communications link the Prime Minister’s Office to that of the President, whose office approves all major decisions on economic and social policies. The President also heads the shadow government of the Politburo and Central Committee, which possess all meaningful authority over the government and the military. The next section examines the links between the Prime Minister’s Office, which oversees the central ministries and the vertical lines of control, and the office of provincial governors, who control the horizontal lines of authority outside the capital.²¹²

²⁰⁹ Laos may be the only communist country formally to adopt the Leninist principle of democratic centralism in its constitution.

²¹⁰ Government of Lao PDR, "Constitution of the Lao People's Democratic Republic," (1991 (2003)).

²¹¹ According to the amend Constitution (2003), the National Assembly elects the president and the prime minister, but only after consultation with, and recommendation of, the president. In reality, the party congresses install a new government every five years. See Chapter 2 for more details on the structural of the Lao People’s Revolutionary Party.

²¹² In 1996, the UNDP and the Lao government published a report describing the formal functions of the central government and its ministries. The report presents a bland catalogue of government responsibilities and, by failing to discuss the role of the party, provides few insights into the real functioning of government. See United Nations Development Programme, "Organization of the Government of the Lao P.D.R.," (Vientiane, Lao PDR: UNDP, Public Administration Reform Project, 1996).

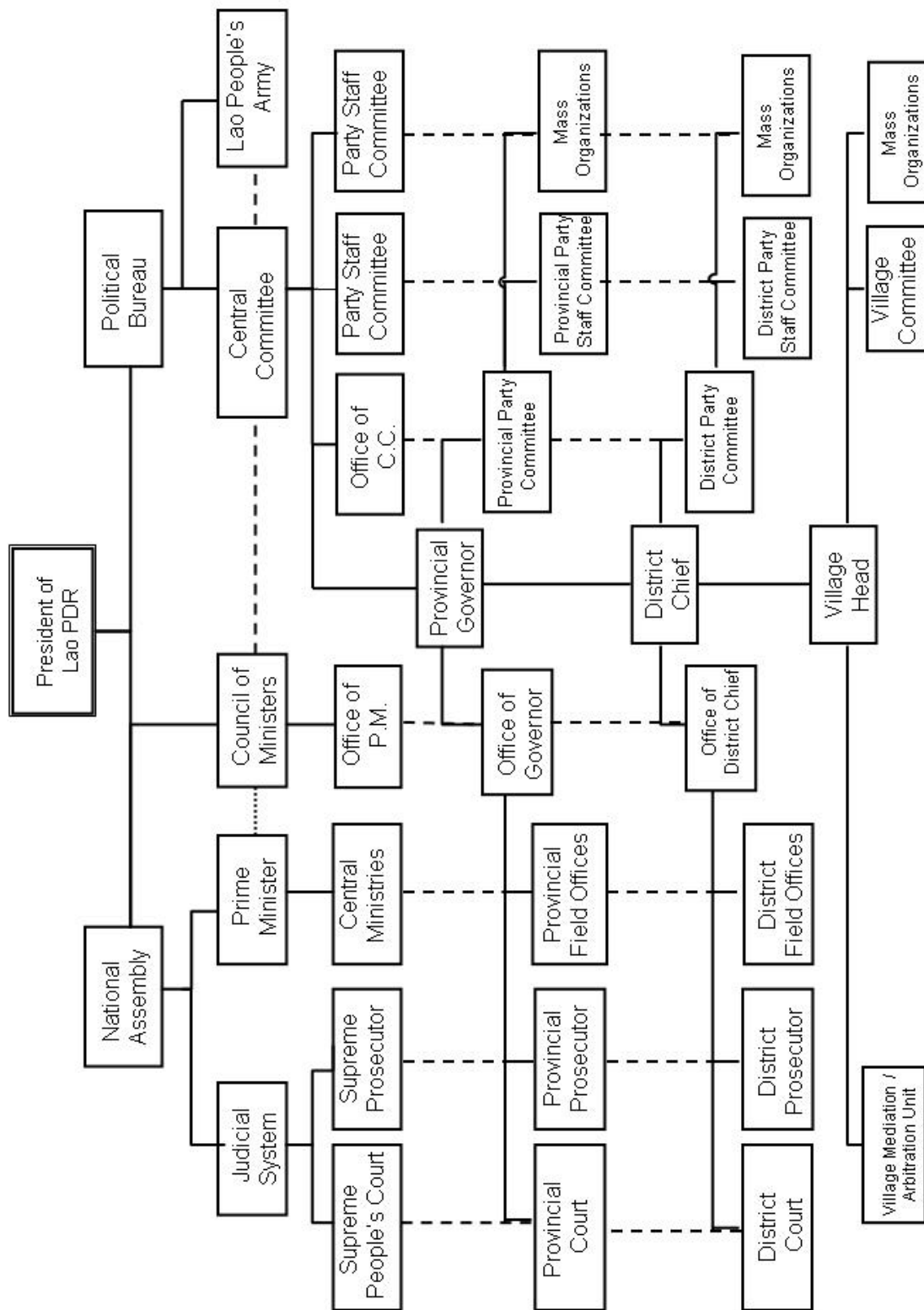


Figure 2. Structure of Government, Lao P.D.R.

Organization of the Prime Minister's Office

At the head of the executive branch, the Prime Minister's Office (PMO) coordinates government activities and oversees the implementation of government policies in the provinces. This office has two parts, the Cabinet of the PMO and agencies of national importance. See Figure 3 below. The executive branch remains the driving force behind administrative reform.²¹³ The Prime Minister's Office defers major decision making to the president, who has final authority over government policies. The president approves all major policies; the PMO does not act independently.²¹⁴

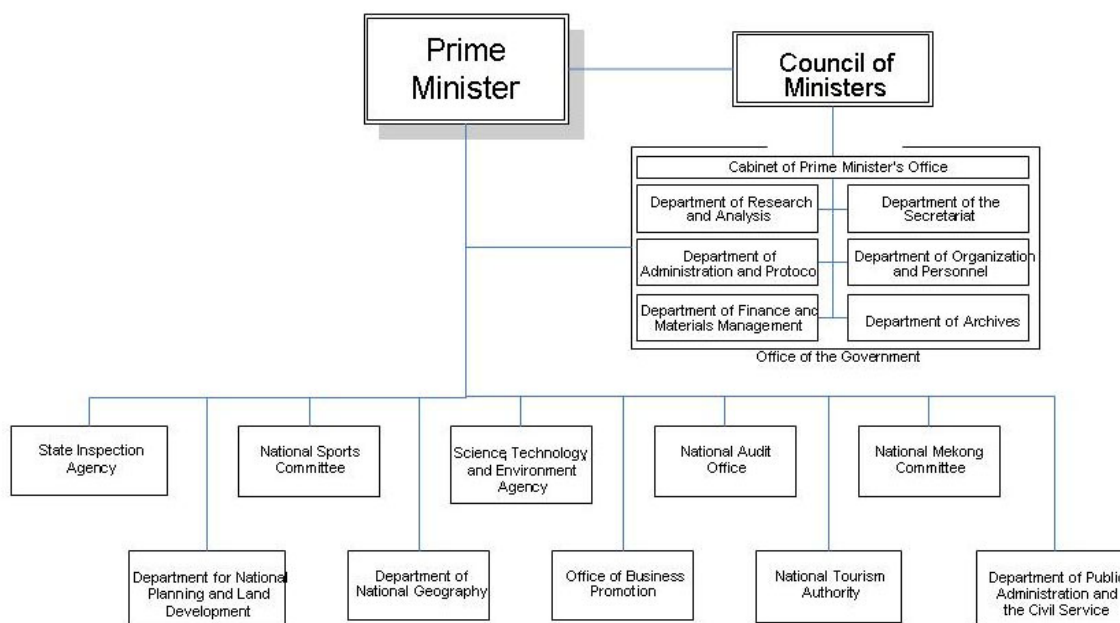


Figure 3. Structure of Prime Minister's Office, Lao P.D.R.

²¹³ As Chagnon et al., "Good Governance in Laos," 31. observe, "Although the National Assembly and the judicial courts are developing, the political prowess of the executive branch dominates government and is the main force behind [public administration reform]."

²¹⁴ Communication between the Prime Minister's Office and that of the President is constant. Officials at the Prime Minister's Office must seek approval for all important government policies.

Within the PMO, the Department of Public Administration and Civil Service (DPACS) plays an important role in governance reforms. The agency handles overall human resource development, establishes broad guidelines on the management of civil servants, and monitors the implementation of government policies.²¹⁵ To underscore the importance of organizational reforms, the government recently elevated the role of DPACS. The head of this department now has ministerial rank, on par with other ministers and provincial governors. In collaboration with the UNDP (under their joint Governance and Public Administrative Reforms (GPAR) program), DPACS studies the structure of government and recommends organizational reforms. Much of the derives from research material and data provided by the GPAR program, reports and statistics from its information center at the PMO, and interviews with senior staff and international consultants.

Organization of Government Ministries

Since the 1990s, the government again centralized its public administration, this time not for the march to a dubious socialism, but the road to an uncertain capitalism. Henceforth, local administration was to reflect the policies of the central government. In line with these reforms, Resolution 21 of the Politburo clarified the roles and responsibilities of central ministries in relation to their field offices and local authorities. The government re-attached all provincial and district technical staff to their respective national ministries. Currently, the Lao government comprises 13 central ministries and three ministry-equivalent organizations, administering a total of

²¹⁵ The work of DPACS applies only to technical positions of civil servants. Higher positions in the government are positions of authority and, thus, political appointments. The Central Committee for Organization and Personnel appoints and manages these positions of leadership. Government of Lao PDR, "Background Paper on Governance," 23.

164 departments across the country.²¹⁶ Figure 4 below shows an organizational chart of a typical ministry.

The Prime Minister, upon recommendation of the President, appoints all ministers to their posts. The term of a minister corresponds to that of the government, five years. These ministers represent their sectors at the Meeting of the Government, held every month in the capital Vientiane. A number of vice-ministers and deputy-generals of departments support the work of the ministers. Below the vice-presidents,

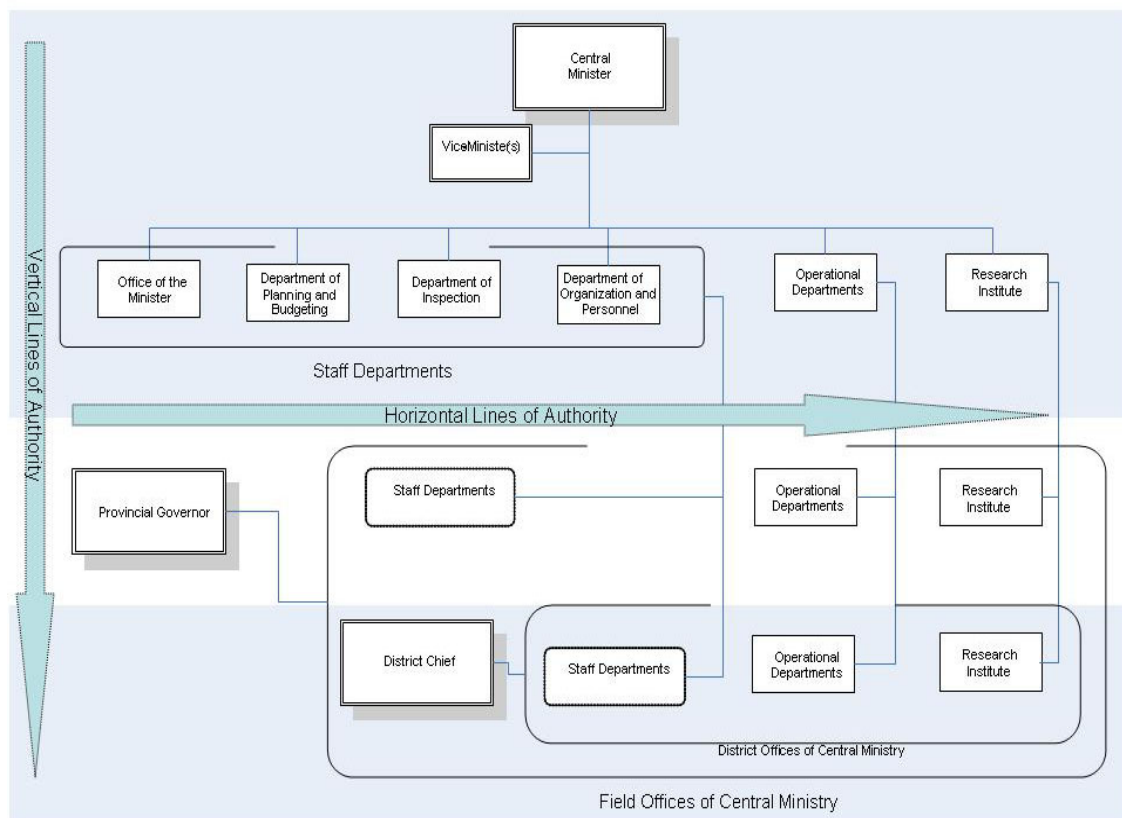


Figure 4. Structure of Typical Ministry, Lao P.D.R.

²¹⁶ The thirteen ministries include Foreign Affairs; Agriculture and Forestry; Public Security; Defense; Commerce; Communications, Transport, Posts & Construction; Education; Finance; Industry & Handicrafts; Information and Culture; Justice; Labor & Social Welfare; and Public Health. The three ministry-level organizations include the Committee for Planning and Co-operation; the Bank of the Lao PDR; and the Prime Minister's Office. The number of central ministries is down from 23, following public administrative reforms in the early 1990s.

each ministry contains a number of staff departments, operational divisions, and research institutes. Staff departments oversee the management of personnel, planning, and budgeting,²¹⁷ while operational units have responsibility for implementing the organization's policies. Research institutes co-ordinate with the other departments to examine ways to improve the functioning of the ministry.

Departments in the capital have parallel structures in the field offices. The vertical lines of authority run, in principle, from the central ministry to the provinces, and finally down to the district offices, which oversee field work in the villages.

The Enduring Strength of Provincial Authority

Intersecting the vertical structure of national ministries and departments, 18 provinces, 141 districts and 11, 293 villages compose the horizontal line of command. Blurring the entire organizational structure of government, provincial governors control the purse strings outside the capital, effectively managing local staff departments and directing policies at the operational departments and research institutes. Local power remains concentrated in the office of the governor. Headed by governors, provincial party committees run the provinces, bypassing the formal organizational lines of vertical ministries. Districts and some villages have similar party committees managing and monitoring government activities in their locale. Appointed by the President, governors hold ministerial rank and, as Figure 1 shows, are accountable only to the Central Committee, not the PMO. Currently, all 18 governors, but only a few of the 13 ministers, enjoy high rankings in the Central Committee.

²¹⁷ Staffing departments typically include the Office of the Minister, Department of Planning, Department of Inspection, and Department of Organization and Personnel. The Office of the Minister has the general responsibility of overseeing the ministry and co-ordinates government activities with organizations and ministries. Staff issues fall to the Department of Organization and Personnel. See Government of Lao PDR, "Background Paper on Governance," 19-21.

In principle, local staff report to their central ministries back in the capital but are managed by provincial staff departments.²¹⁸ In practice, governors exert tremendous influence on all government activity in their territory. This curious structure places severe limits on administrative reform. In most cases, the higher party rank of ministers, vis-à-vis governors, determines the effectiveness of central policies on the local level.²¹⁹

Centralizing and Rationalizing the Public Administration

Departmental and human resources are low. The public sector in Laos remains weak, and challenges to its reforms many.²²⁰ In spite of 15 years of attempts at increasing its authority, a weak center oversees a highly devolved state. As evidence suggests, the challenges to building and consolidating a modern Lao state lie with redressing the entrenched powers of regional interests, who mostly resent central incursions in their domain. Power and authority of the government diminishes quickly outside Vientiane. Since the early 1990s, the government has moved towards more central control of political and economic administration of the country. The party recognizes that regional autonomy hampers efforts to rationalize the public administration. A rare Politburo guideline on public administration reads, “reforms must proceed step by step in careful, firm manner and based on the principles of efficiency, effectiveness, rationality and political stability.”²²¹ Officials concede that a

²¹⁸ For background on the Lao civil service, see the Appendix.

²¹⁹ Relative position within the Central Committee better reveals the extent of power and authority than the formal organizational chart of the government. The Minister of Finance, for example, cannot easily dictate tax policies to the Governor of Savannakhet, whose rank supersedes his. Yet, this important fact of communist government escapes comprehension for many in the development community.

²²⁰ As Joseph J. Zasloff, "Political Constraints on Development in Laos," in *Laos: Beyond the Revolution*, ed. Joseph J. Zasloff and Leonard Unger (New York: St. Martin's Press, 1991), 30. argues, “Among the serious problems confronting the nation, however, are mismanagement, poor planning, and lack of trained personnel and funds. Most serious is the lack of motivation pervading the entire system, affecting workers, peasants, and civil servants.”

²²¹ Government of Lao PDR, "Summary of the Guidelines Issued by the Politburo on the Implementation of Public Administration Reforms," ed. Politburo (1998).

strong center is required to maintain effective control of public revenues, expenditures, and instruments of law enforcement. At the 7th Party Congress in March 2001, Khamtay Siphadone, the party leader and state president, reiterated the state's centralization policies:

We will continue to improve the administrative machinery at the central, local and grassroots level. State management must be centralised in order for our economic reforms to properly benefit the people. Ministries should concentrate their efforts on studying and formulating strategic plans, projects, and policies for the development of the sectors under their responsibility. They must monitor, guide and control each economic sector in accordance with their management responsibilities.²²²

As long as local power is concentrated at the provincial level, however, efforts to establish a unified and functioning public administration will continue to disappoint. This section examines the difficulties confronting administrative reforms, dividing the issues into three broad and inter-related levels for discussion: institutional, organizational, and human resource.

Tensions in Central-local Relations

Reform efforts continue to infuse a sense of bureaucratic rationality to the Lao government, in pursuit of systematic control and oversight at the central level. Since the early 1990s, major reform measures resulted in the following initiatives:

- guidelines for public administration reform;
- Central Committee for Government Organizational Improvement;
- National Audit Office (1998);
- Prime Minister's Order of 1999 on Anti-corruption;
- restructuring of central agencies and ministries (1999-2000);
- transfer of personnel management from the Party to DPACS;
- review of civil service wage structure; and
- development of performance evaluation for civil servants (2000-2002).²²³

²²² Quoted in Phonekeo Vorakhoun, "Party Congress Re-Elects Khamtay as President," *Vientiane Times*, Mar 16-9 2001.

²²³ Chagnon et al., "Good Governance in Laos," 19.

The central government established national procedures for budgeting, planning, procurement, personnel management, and public service delivery. With donor assistance, operational and financial control systems have been introduced, such as the Supreme Audit Authority and the State Inspection Authority. Linked to this modern drive, a recentralization of economic control has moved in parallel with a deconcentration of administrative functions.

In principle, central ministries have the following responsibilities:

- strategic planning in setting national goals and priorities;
- delivery of public service in their sector;
- regulation of state policies and project implementation;
- coordination with other government agencies; and
- monitoring and evaluation of impact of stated policies.

Even though centralization aimed to remedy the weaknesses of regional autonomy of the 1980s, its implementation has so far been slow and incomplete. Challenging the authority of central ministries, a tradition of regional autonomy hinders administrative rationalization. Because governors and central ministers enjoy equivalent rank, organizational lines of responsibility in government are not well articulated. Consequently, national policies and regulations are selectively enforced at the local level.

The failure to implement constitutional reforms reveals the strong influence of governors and the lack of accountability or legal enforcement of central directives. Complicating lines of authority, the Prime Minister's Instruction 01 on central-local relations has done little to clarify roles and responsibility of subnational units of government.²²⁴ Dated March 11, 2000, instruction 01 begins as follows: "Advisory

²²⁴ During the 6th party congress of the LPRP in 1996, the government made pronouncements about central-local relations, which later evolved into the notorious instruction 01. Government of Lao PDR, "Instruction of the Prime Minister Regarding the Policies to Building the Province to Become the Strategic Unit, the District as Budget-Planning Unit and the Village as the Implementation Unit, No. 01/Pm," (Prime Minister's Office, 2000).

note of the Prime Minister regarding the policies to building the provinces to become the strategic unit, the district as the budget-planning unit and the village as the implementation unit." The instruction broadly speaks of bringing administration closer to the people and making subnational government more responsible for state management. The practical meaning of this advisory note varies widely. To officials in the capital, the policy recognizes lower units of government as instrumental to enacting national policies—in efforts to broaden the reach of the national government. By delegating responsibility to various levels of government, the advisory note facilitates the implementation of-- as well as disseminating information on-- government policies and regulations. Meanwhile, regional authorities view the instruction as legitimizing de facto autonomy and fiscal independence. In the continuing tensions of central-local relations, both sides have used the decree to reinforce their claims to authority.

In attempting to clarify the aims of government restructuring, in April 2003 the government promulgated its first policy on governance reform, which promises “empowerment in the government system to the lower or local levels of government organisation.”²²⁵ In the paper, the government recognizes that governance reforms require a re-definition of central-local relations. Mindful of the ambiguity of the term “decentralization,” the government’s position reads as follows:

The redistribution/clarification of responsibilities at the central and local levels in matters of development planning, management and implementation- often called ‘*decentralisation*’, in want of a word more appropriate to reflect our priorities- represents possibly the most challenging task ahead of us, but one that we are nonetheless committed to achieving over the next ten years. We know we will have to face many hurdles, the greatest of which is perhaps

²²⁵ Government of Lao PDR, "Public Service Reform, People's Participation, Rule of Law and Sound Financial Management: A Policy Paper of the Government of Lao PDR on Governance Issues," (Vientiane, Lao PDR: 2003). Emphasis in original.

wide-spread lack of capacity to implement such a programme, especially at the local level.²²⁶

Irrespective of national policies to the contrary, provincial authorities still exert considerable control over line ministries in their jurisdiction. The party has yet to strike a balance between the need to centralize control over finances and resources, on the one hand, and vested economic and social interests of local power holders, on the other. In a continuing re-assertion of regional authority, provincial officials fail to enforce national policies and regulations uniformly. Invariably, the balance of power still favors regional discretion. The overriding factor appears to be the degree of political influence each governor has in the affairs of the state.²²⁷

Organizational Dysfunctions

Tensions in central-local relations reflect on-going struggles for centralized political administration and financial planning and management. Competing government authority in Laos has created organizational dysfunctions and compounded bureaucratic inertia. Overlapping jurisdictions among the different ministries and within the ministries themselves contribute to varying interpretation and implementation of government policies. These difficulties reflect the general inefficiency of the public administration and poor co-ordination within the government. Inertia, lack of transparency, and waste of limited resources pervade much of the system. Complicating these reforms, a lack of resources hampers government operations and public service delivery. The distribution of resources rarely satisfies organizational needs, and agencies seldom share information or coordinate activities.

²²⁶ Government of Lao PDR, "Background Paper on Governance," 8. Emphasis added.

²²⁷ Such influence also has bearings on budgetary allocations, which are negotiated on an iterative process between the central government and provinces. For a larger discussion of fiscal reforms, see Chapter 6.

Even though field staff of government ministries fall under the central, vertical command, they report instead to provincial officials. Governors have final authority over government affairs in their territory. They control personnel issues and salary of all civil servants in their territory. This situation has long characterized public administration in Laos. As a result, local staff usually obey their provincial paymasters, who control recruitment and promotions. This discretionary power results in hiring practices based on criteria other than merit, reinforcing the highly politicized nature of public administration and the fusion between party and state. In many instances, political considerations lead to interferences in recruitment, promotion, and transfer of civil servants. In this environment, conflicts of interests and nepotism heighten regional differences, strengthen ties of clan-patronage, and reinforce traditional forms of political authority.

Human Resource Constraints

At the individual level, hiring practices frequently hinge on factors other than competence. The politicized bureaucracy looks down upon individual initiative, discouraging the limited, talented, and otherwise over-stretched staff. In this environment, technical competence matters less than political loyalty. The office culture frowns upon the open expression of personal frustration, promotes collective consensus in decision making, and often marginalizes competent staff, most of whom lack proper party credentials. Taking unorthodox positions in government carries many political risks. Junior civil servants rarely make independent decisions without higher authority. Outspoken officials have occasionally been arrested on trumped up charges of corruption or ideological deviation.²²⁸ As a result, most civil servants possess little motivation to work effectively at their jobs.

²²⁸ Savada, ed., *Lao Country Study* 228.

Because of the politicized nature of the public administration, decision making remains concentrated in the hands of high government officials, who determine policies with little or no input from subordinates. Below positions of department chiefs, few civil servants have input into ministerial decision making at all.²²⁹ In every level of government (president, prime minister, ministers, provincial governors, and district chiefs), at least one of the two highest decision-makers has party affiliation.²³⁰ Although government officials claim that the low number of qualified staff prevents a stronger delegation of decision making and responsibility to lower-ranking civil servants, a lack of party affiliation for many also precludes a delegation of authority. As a result, time-consuming procedures overwhelm a top-heavy bureaucracy.²³¹ Party membership promotes social mobility, and only party members have the prospect of moving to positions of power and influence. Hence, the government actively encourages educated civil servants to join the party, as a way to advance their careers.²³²

Compounding bureaucratic inertia, insufficient training and education make many in the public administration unqualified for their assigned jobs. By all accounts, the quality of government personnel remains low. As the government readily acknowledges, many public employees lack basic skills in general office management, computer literacy, and project implementation.²³³ As a consequence, the state

²²⁹ Government of Lao PDR, "Background Paper on Governance," 26.

²³⁰ Chagnon et al., "Good Governance in Laos," 29. Some exceptions occur at remote, rural communities.

²³¹ As Evans notes of the system at the early 1990s, "Centralization was undoubtedly partly a result of these same scarcities, in that only a very small number of people were sufficiently competent to make the decisions demanded by the system. Information therefore flowed towards the pinnacle of the bureaucracy, where it became ensnared in bottlenecks. The structure therefore had a self-reinforcing (self-defeating) logic." Evans, "Planning Problems in Laos," 98.

²³² Chagnon et al., "Good Governance in Laos," 29.

²³³ Government of Lao PDR, "Background Paper on Governance."

bureaucracy suffers from a simultaneous over-supply and under-supply of personnel. Political appointees overwhelm a weak public administration bereft of skilled personnel. Inefficient and redundant staff overloads administrative and support services.²³⁴ Meanwhile, important positions in technical areas, such as research and analysis, monitoring and evaluation, and general project implementation, go unfilled. Although donors in Laos have long complained of the need for government officials to delegate more authority to subordinates, the political nature of the bureaucracy mitigates against such diffusion of power. To the extent that the party permeates the public administration, real power remains the privilege of politically astute government officials.

Making matters worse, low remuneration provides little incentive for public officials to work towards stated missions of their organizations. Adjusted for inflation, the purchasing power of salaries has changed little through the years.²³⁵ Substandard pay fuels organizational lethargy, mitigated seemingly only by the prospect of informal pay. Aware of the difficulties of maintaining a competent and motivated staff, the government informally supplements the base salary with a variety of fringe benefits and subsidies.²³⁶ The top grade recognizes positions of high leadership. Management positions also come

²³⁴ Ibid., 28. By 2005, the government aims to reduce the total workforce by 5 %, eliminating the vast number of non-performing and unqualified staff.

²³⁵ Salaries for government officials have yet to match their purchasing power prior to the 1997 Asian financial crisis. According to government figures, in 1999 salaries were increased by 25%, still well below the rate of inflation. In 2002, wages of civil servants were increased by 30%, followed by another 18% increase in 2003. Even with these increments, average salaries fall below the purchasing power of pre-1997 figures. See Ibid., 34. For background on the state of the civil service, see the Appendix.

²³⁶ In the salary structure, government officials fall into one of five grades, depending on their level of education. Each grade has 15 levels, corresponding to a matching salary, small allowances, and possible benefits. Government of Lao PDR, "Decree on Civil Service of the Lao PDR (Decree 82/Pm)," (Public Administration and Civil Service Authority, Prime Minister's Office, 2003), articles 5-7. Workers rise one level for every two years of service. Allowances, and in some instances overtime payments, depend on position or professional category. See Government of Lao PDR, "Background Paper on Governance," 33. Heads of state, from the President, Prime Minister, and President of the National Assembly fall into category one, while the principle of a primary school has category ten.

with special allowances, divided into one of ten categories.²³⁷ A benefits package, depending on the position, may comprise housing, gasoline, free schooling for children, cell phones, cars, and bikes.²³⁸ Other incentives come from controlling technical resources of a department, such as office equipment, computers, and various other hardware. The government also appears to assist public officials on a case-by-case basis.²³⁹ Rules and regulations governing these benefits remain opaque and outside any formal review.

Even with government benefits, salaries fall short of meeting basic subsistence needs. Most civil servants rarely survive on government work alone and rely on secondary income and family support networks to sustain a livelihood. When asked about state of government remuneration, a senior Lao official lamented:

My family does not live on my salary. We regard it as a bonus, every 3 to 6 months, not as a means of support. That is why everyone has extra-curricular jobs – farming, family businesses, renting houses, trade, sideline consultancy work. Otherwise, we would starve. All of this extra work eats away time and energy from our government work, compromising quality and sometimes good work habits.²⁴⁰

In a popular refrain first echoed in many former socialist countries, Lao officials cynically lament the dismal state of wages, “We pretend to work, and the government pretends to pay us.”²⁴¹

²³⁷ Government of Lao PDR, "Decree on the Administrative Positions of Civil Servants in the Lao PDR (173/Pm)," (Prime Minister's Office, 1993). These allowances supplement the base salary to provide an additional incentive to officials in prioritized areas. For example, the Ministry of Public Health provides a bonus of 18,200 kip per month for medical personnel working with patients, and 15,200 kip for those working with chemicals. Teachers and medical workers in remote areas of the country receive hardship allowances up to 25% of base salary. See Government of Lao PDR, "Decree on the Administrative Positions of Civil Servants in the Lao PDR (173/Pm).", Government of Lao PDR, "Background Paper on Governance," 33-4.

²³⁸ In-kind benefits for high ranking officials can be extensive. The office of provincial governors, for example, comes with free housing and cars.

²³⁹ Officials with non-working spouses or school-age children can receive social benefits from the government. Allowances for maternity and parental leave are also granted. See Government of Lao PDR, "Background Paper on Governance," 34.

²⁴⁰ Quoted in Chagnon et al., "Good Governance in Laos," 55.

²⁴¹ Ibid.

In summary, the public administration in Laos confronts many daunting challenges. See Figure 5 for a general overview. At the institutional level, vaguely defined and weakly enforced laws have intensified competing centers of power and authority. While the constitution formally recognizes a consolidated state structure, its legal enforcement has met with resistance from powerful governors. The Lao government has not adequately addressed the underlying tensions of central-local relations, rooted in the enduring strength of the provinces. Nor has it clarified the roles and responsibilities of the intersecting lines of authority. Although a bit exaggerated, the following UNDP statement captures the discretionary and negotiated nature of governance in Laos: the Lao state's "basic regulatory frameworks continue to evolve virtually from day to day."²⁴²

At the organizational level, competing staff loyalties hamper operational efficiencies. Irrespective of national decrees to the contrary, government staff in at the local level (outside central ministries in the capital) fall under the sway of provincial governors. This situation blurs the lines of authority within government agencies and among the different levels of government. In terms of personnel management, central ministries set hiring standards, but provincial authorities recruit and hire local staff at their own discretion. In the absence of clear and unified rules, civil service management at the local level remains highly opaque and ad-hoc. Government hiring practices, rules of employment transfers, and promotional incentives follow no formal regulations. In the public administration, political loyalties still matter more than technical competence. Throughout, a lack of transparency pervades the system, obscuring the arbitrary use of government authority.

²⁴² United Nations Development Program, *National Human Development Report, Lao PDR 2001: Advancing Rural Development* (Vientiane, Lao PDR: UNDP, 2002) 100.

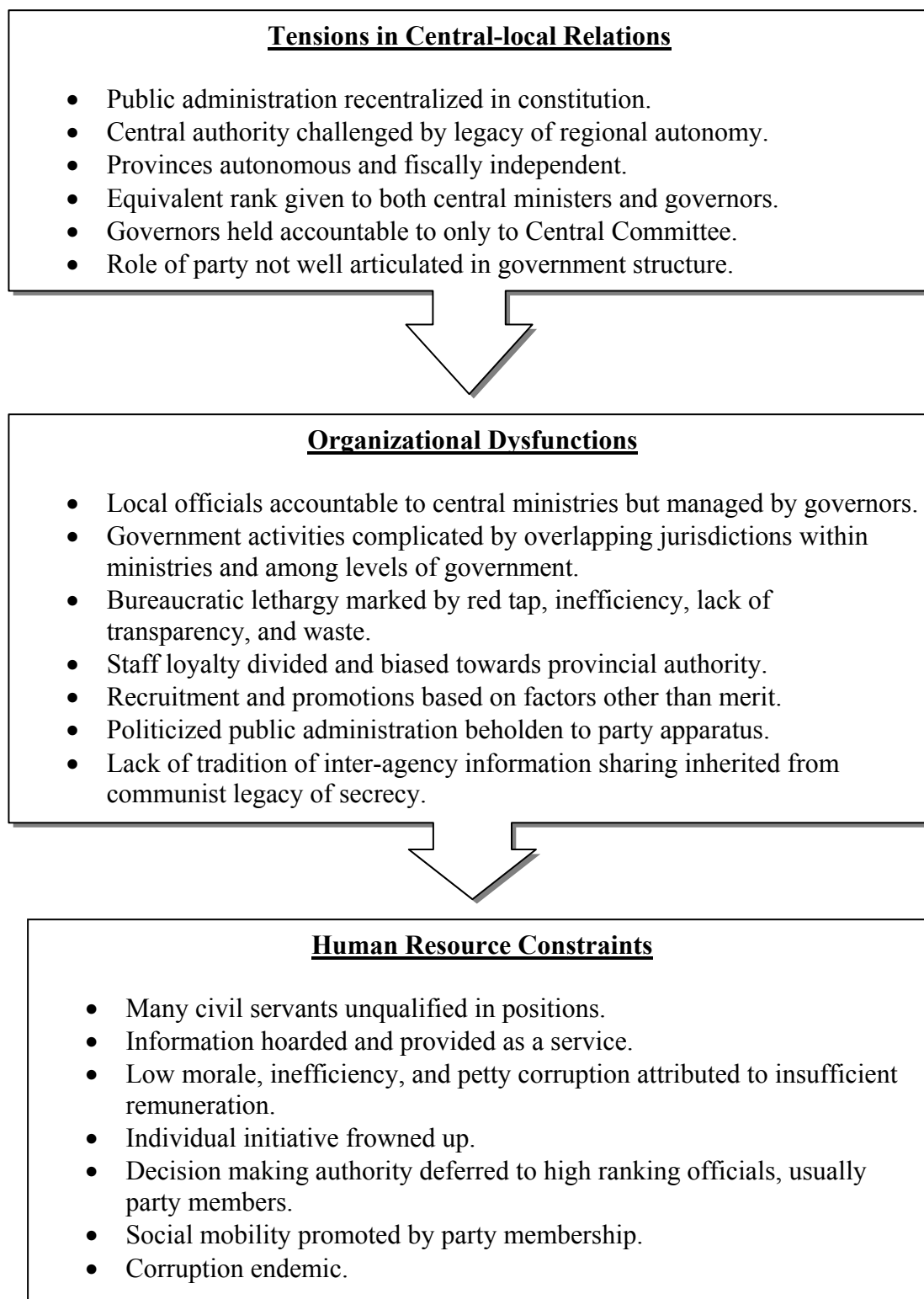


Figure 5. Challenges to Public Administrative Reforms in Laos

Many government staff lack motivation to perform their jobs efficiently. Some observers mistakenly attribute the bureaucratic lethargy to Lao culture alone.²⁴³ Rather, the inability or unwillingness of lowly-paid public servants to take initiative may have other non-cultural roots, as this section demonstrates.

Socialist practices continue to disrupt the rational development of the public administration in various ways. First, the communist victory in 1975 initiated a vast exodus of the urban, educated middleclass, emptying out the public administration in the process. This void in the civil service persists, compounded by hiring practices that hinge on factors other than competence. Second, the socialist regime generates a culture of fear and secrecy not only in society at large, but also in its machinery of government.²⁴⁴ Monitoring and sanctioning civil servants, disciplinary committees

²⁴³ As Savada, ed., *Lao Country Study* 228, comments:

The lethargy of the bureaucracy is understandable within the cultural context of Laos. As a peasant society at the lower end of the modernization scale, the LPDR has adopted few of the work routines associated with modern administration. Foreign aid administrators frequently point out that Laotian administrators have difficulty creating patterns or precedents, or learning from experience. Laotians are known for their light-hearted, easy-going manner. This *bo pinh nyang* (never mind--don't worry about it) attitude is reflected in the languid pace of administration. Official corruption has also been acknowledged as problematic.

Stuart-fox, *Politics and Reform in Laos*, makes a similar claim about Lao political culture in the public administration. He argues that the public administration in Laos suffers from a political culture unique to Laos. He essentializes this political culture, which he wrongly views as having persisted through the various upheavals in modern Laos, from civil war to the socialist experiment in collectivization. He argues, "With no tradition of bureaucratic administration (as in China and Vietnam), politics in Laos reverted to networks of influence and patronage (of the kind elsewhere described as clientelism, or crony politics)" (Ibid., 6). In this primordial culture, personal ties and patronage contribute to opaque rules of decision-making, inexorably linked to the practice of the *meuang* system of traditional Lao statecraft. However, Stuart-fox contradicts himself. Elsewhere in his political report, he writes, "Non-transparent, top-down decision making and obsessive secrecy were two elements that the Pathet Lao brought with them into government" (Ibid.).

²⁴⁴ The socialist bureaucracy relies on consensus, and individual initiative is frowned upon. As Dakin observes of the Lao National Tourism Authority, "At the office, anyone who openly expressed a personal opinion usually stood alone. He had little chance of receiving support from colleagues, even those he considered close friends." Supposedly, it is the Lao character not to protest. He describes the Lao culture in the following manner:

Laos was certainly a laid-back place to live. But beneath the surface, a deeply ingrained culture of fear pervaded government and society. To comment publicly on an issue, to express an opinion, or even to acknowledge a problem that everyone already knew existed, was to be avoided at all cost. People may have been relaxed, but they were afraid. And not only of the big guys who flew down Lan Xang Avenue behind the tinted windows of their Mercedes

(present in every government agency) enforce party discipline and contribute to this culture of fear. Third, the logic of towing the party line and “patriotic” discipline discourage independent thinking, and the principle of democratic centralism pervades government agencies. Group-think prevails, and individual initiative is frowned up in the name of socialist solidarity and consensus building. Fourth, the secretive nature of the party creates a culture of information hoarding mirrored in its public administration, where information sharing occurs reluctantly and on a need to know basis. To this day, government departments jealously guard their information from each other, in defense of turf and scarce resources. Fifth, dismal remuneration contributes to worker apathy and provides little incentive to work efficiently. In real terms, salaries have changed little over the past two decades. These characteristics of the socialist bureaucracy continue to stifle individual initiative, creativity, and independent decision making within the machinery of government. Civil servants express an aversion to take risks, actively evade responsibility for decisions, or hoard information to their perceived advantage. These various factors, rather than the biased images of lazy Lao people, shape the depressing state of civil service.

Corruption in Laos

Coupled with a communist legacy of secrecy and fear, low remuneration contributes to low morale, little motivation to work efficiently, a reluctance to assume responsibility, and an overall lethargy of a lumbering bureaucracy. In this organizational environment, corruption quickly takes root.

sedans, sirens blaring. Or of the policemen who blew their whistles and stopped traffic to let the officials through. They were also afraid of one another. There was little trust, and even among friends it was too risky to speak your mind. Brett Dakin, *Another Quiet American: Stories of Life in Laos* (Bangkok: Asia Books, 2003) 203-4.

Corruption and the Lao Bureaucracy

By all accounts, corruption is widespread in the Lao government.²⁴⁵ Without a doubt the most non-transparent of all informal methods of surviving on the public dole, corruption and graft enable civil servants to stretch the purchasing power of government positions. According to many observers, corruption occurs up and down the entire chain of command.²⁴⁶ In its reforms to embrace market capitalism, the government has promoted a “centralized, de-concentrated” state with more delegation of authority. This administrative restructuring may have actually increased the scope of corruption. As the sphere of decision making increases, so do the opportunities for graft and wrongdoing. During the 1990s, public graft and corruption mostly likely increased, particularly at the provincial and district levels.²⁴⁷ In many instances, government officials charge for work that would otherwise fall under the rubric of public service. Civil servants have limited resources, and departmental data, however incomplete, translates into a commodity not freely released without tangible benefits. In a public administration bereft of basic resources, information and access of any kind constitute privileges jealously guarded and reluctantly provided. For Lao civil servants, granting access to information is not a public service—as this researcher has frustratingly learned— but a private incentive.

²⁴⁵ Sida, "Financial and Administrative Systems," 4.. There also seems to be a concerted effort by the government to address the problem. For a good overview of the challenges posed by corruption in Laos, see Patrick Keuleers, "Corruption in the Lao PDR: Underlying Causes and Key Issues for Consideration," (Bangkok: UNDP, Bangkok SURF, 2002).

²⁴⁶ The president of the National Assembly recently reportedly received a cash payment of US\$ 5 million for his approval of a construction project in southern Laos. Meanwhile, political expediency recently required that law enforcement officers drop charges of drug trafficking against the son of the Prime Minister. Lower in the chain of command, staff secretaries hold access to high ranking officials and frequently place a value on available appointment time. And the cash cow of the US\$ 1 billion Nam Theun 2 dam project figures to provide a bounty for astute and well-connected government officials and party leaders.

²⁴⁷ Sida, "Country Analysis, Laos PDR," (Vientiane, Lao PDR: Embassy of Sweden, Vientiane, 2004).

Corrupting Development

As with bureaucratic lethargy, the roots of corruption and bureaucratic inertia have been attributed to the Lao culture alone, when more recent administrative deformities of communism, in fact, better account for organizational dysfunctions.²⁴⁸ In a recent political essay widely influential within the development community in Vientiane, Martin Stuart-fox, an observer of contemporary Laos, attributes the lack of transparency in the political economic system to the exigencies of rent seeking.²⁴⁹ According to his observations, the brief phase of high communism only superimposed a superficial communist superstructure upon traditional Lao statecraft, characterized by personal connections and loyalties in running the affairs of government. In the current transition to capitalism, this political culture supposedly helps to explain the government's slow pace of economic reforms, the rent-seeking proclivities of its public servants, and limited capacity for organizational change within the public administration. This rather deterministic assessment dismisses, out of hand, the upheavals brought about by a generation of civil war, the failed road to socialism, as well as the current march towards market capitalism. Although revolutions bring about

²⁴⁸ Keuleers, "Corruption in Laos," 4., makes the following claim:

the Lao society is characterized by soft social controls, inspired by tolerance, compassion, respect for authority and seniority, loyalty to kinships and confrontation-avoidance. In addition, the Lao have a reputation of being most interested in living their lives with minimal disruption and interference by the government. All this directly impacts on the society's opinion on and action against corrupt behavior and the government's ability to take harsh decisions in this area.

²⁴⁹ Stuart-fox, *Politics and Reform in Laos*. Initially commissioned by the World Bank to examine the political roots of the slow pace of economic reforms, this political report has gained traction within the development community in Laos—in part due to its stinging indictment of Lao political culture, but mostly because of a lack any contemporary writing on the Lao party-state. The World Bank has quietly distanced itself from the report, since its initial public airing. On corruption, Stuart-fox writes,

Party officials, and non-Party government bureaucrats too, use their political and administrative power to economic advantage in order to supplement salaries eroded by inflation. Otherwise there would be little attraction in becoming a Party member or an underpaid civil servant. So reform has been piecemeal and reluctant, undertaken only under considerable pressure from international institutions, notably the IMF. Stuart-fox, *Politics and Reform in Laos* 26.

major upheavals while also retaining a semblance of social continuity, this deterministic assessment fails to appreciate the level of social disruption brought about by the communist regime. In his portrayal of a primordial, political Lao culture, Stuart-fox concludes that even increases in public expenditures and higher salaries for civil servants would fail to mitigate the culture of corruption.²⁵⁰ As the previous section documents, a variety of factors overdetermine the bureaucratic culture in Laos—linked to the secretive nature of the party-state and on-going struggles for scarce public resources.

Although Stuart-fox's analysis provides some useful insight into the functioning of the Lao government, his recourse to a primordial political culture sheds few light on contemporary problems facing governance in Laos. This political paper has gained wide currency within the development community, due less to the veracity of its claims than the Western biases and prejudices it reinforces. By depicting corruption as a disease of the local culture, Western observers and international development professionals, in general, continue to “orientalize” non-western cultures amenable to the enduring civilizing mission of the Christian world.²⁵¹ Capturing the

²⁵⁰ He argues,

It is doubtful, however, whether corruption could be eliminated in Laos just by offering very much greater salaries. This is because Lao political culture rests on acquiring resources for patronage (as well as for family consumption), and a quid pro quo for the exercise of political influence is expected.” Stuart-fox, *Politics and Reform in Laos* 27.

²⁵¹ See Edward W. Said, *Orientalism*, 1st Vintage Books ed. (New York: Vintage Books, 1979). Orientalism describes a system of knowledge about the Orient. In this important- but rather inaccessible text- Said criticizes Western scholarship on the Orient, or the Arab Middle East, and unpacks the complex of power and knowledge in the discourse of orientalism. Based on liberal human,

professional science of Orientalism, whose function in nineteenth-century culture had been the restoration to Europe of a lost portion of humanity, but which had become in the twentieth century both an instrument of policy and, more important, a code by which Europe could interpret both itself and the Orient itself. Said, *Orientalism* 253.

Elsewhere, he writes,

all cultures impose corrections upon raw reality, changing it from free-floating objects into units of knowledge. The problem is not that conversion takes place. It is perfectly natural for the human mind to resist the assault on it of untreated strangeness; therefore cultures have always been inclined to impose complete transformations on other cultures, receiving these

predisposition of the development community in Laos, a cultural anthropologist makes the general observation, “The conventional framework of development studies and reports invokes essentially the same stereotypes of lazy, inefficient, or corrupt natives who must be brought to self-sufficiency that one encounters in nineteenth century discourse.”²⁵²

While the civilizing mission of a self-righteous development industry continues unabated, the Western discourse on corruption egregiously ignores the ways in which the development community is itself complicit, if not altogether culpable, in organizational dysfunctions of the public administration in Laos. The development industry has contributed to this informal public economy in a variety of ways. At the macroeconomic level, the Lao government commits itself to monetary stability by controlling public expenditures. Formal budgetary constraints force the government to provide undocumented benefits to employees. These budgetary constraints derive, in part, from the structural adjustment programs imposed by the International Monetary Fund (IMF), as expressed in Article IV of the Articles of Agreement with the Lao government. By demanding decreased public expenditure, the IMF magnifies the distorted structure of the pay scale. Its insistence on fiscal austerity pushes the true value of public wages and salaries to the informal sector. As noted above, reports on public expenditures only consider cash payments for salaries and wages, while the complete benefits package and other informal ways to sustain a living go unrecorded.

At the project level, many development organizations set up project management units that oversee the life cycle of development projects. Headed by a Lao national, these units typically hire local staff and foreign consultants on a yearly basis and often select

other cultures not as they are but as, for the benefit of the receiver, they out to be. Said, *Orientalism* 67.

²⁵² Michael Herzfeld, *Anthropology: Theoretical Practice in Culture and Society* (New York: Blackwell, 2001) 162.

public contracts on criteria other than competitive bidding. This seemingly progressive idea to infuse a sense of local ownership and responsibility to development projects, in fact, creates new avenues for corruption and kickbacks. Further, donor organizations distort incentives in the public administration by siphoning off the best and the brightest of the small pool of educated Lao. Wages for Lao staff employed by donor aid agencies frequently range 10 to 50 times higher than comparable government positions.²⁵³ To the extent that donors compete for limited human resources, the Lao government struggles to attract competent staff on a shoe string budget. The large disparity between public and private remuneration creates incentives for various informal practices. Anecdotal evidence suggests that Lao nationals working on foreign-funded development projects pay a percentage of their monthly salary to government staff overseeing the project.²⁵⁴ While the wage gap presents many challenges to civil service wage reform, many donors in Laos refuse to interfere with government salary matters, thus perpetuating a corrupt development environment.²⁵⁵

As one of the most highly aid-dependent countries, Laos relies heavily on foreign assistance. Donors play a prominent role in Laos. Over 50 development agencies currently work in Laos, supporting the operations of practically every government

²⁵³ Security guards at aid agencies make roughly US\$ 140 per month, receptionists about US\$ 300, administrative officers US\$ 425. Management positions come with higher wages, in the range of US\$ 500 per month. As noted above, the typically Lao civil servant has a dismal monthly (base) salary in the range of US\$ 25-50. This data derives from completed questionnaires submitted by seven aid agencies working in Laos. See Stephen Rozario, "Report on Staff Compensation and Benefits Survey," (Vientiane, Lao PDR: World Vision, 2000).

²⁵⁴ Keuleers, "Corruption in Laos," 14.

²⁵⁵ For their part, donors have failed to press their Lao counterparts on the issue of salaries and incentive structures, claiming that "the matter is the government's business, not ours." As quoted in Chagnon et al., "Good Governance in Laos," 56. Many in the donor community argue that subsidizing salaries in the context of a particular project would create challenges to sustainable development, eventually generate donor-government disunity, and institutionalize inequitable patterns of incentive that usually favor the educated and better off.

ministry.²⁵⁶ In the recent past, annual foreign aid has accounted for about one-fifth of the country's gross domestic product and constitutes the principle source of finance for public investment.²⁵⁷ Commenting on Lao socialism, a Lao scholar observes, "The system, which derives so heavily from foreign sources, tends to reduce motivation, create discontent, and erode the legitimacy of the government"²⁵⁸ More generally, the agenda of "capacity building" promoted by the international aid community may actually have the opposite, perverse effect of "capacity sucking out."²⁵⁹ By crowding out, rather than complementing weak state capacity, development agencies stifle reforms of local institutions.²⁶⁰ Worse still, some donors in Laos seem to promote their own political agenda of government restructuring and consequently fail to understand, let alone address, the underlying problems and constraints of public sector reforms. The next section scrutinizes the failings of the GPAR program.

The Push for Decentralization of Development in Laos

As the preceding sections demonstrate, the challenges of government restructuring derive from the difficulties of redressing the highly devolved and

²⁵⁶ The Lao government relies heavily on foreign aid to mitigate its current account deficit. A flourishing "development industry" has taken root in Laos, with the approval of the government but strict control over the kinds of interventions allowed.

²⁵⁷ At current prices, the country's gross domestic product equals \$1.45 billion, with a current account deficit of \$121 million. Lao People's Democratic Republic, *Foreign Aid Report 1999-2000* (Vientiane, Lao PDR: State Planning Committee, 2001) and World Bank, *World Development Indicators* (Downloaded Sep 2001, <http://www.worldbank.org>).

²⁵⁸ Zasloff, "Political Constraints on Development in Laos," 31. He alludes to Laos' dependence on the communist block, but his comments could easily apply to the current situation of aid-dependency.

²⁵⁹ Quoted in Francis Fukuyama, *State-Building: Governance and World Order in the 21st Century* (Ithaca, NY: Cornell UP, 2004) 103.

²⁶⁰ In Fukuyama's assessment,

The international community, including the vast numbers of NGOs that are an intimate part of it, comes so richly endowed and full of capabilities that it tends to crowd out rather than complement the extremely weak state capacities of the targeted countries. This means that while government functions are performed, indigenous capacity does not increase, and the countries in question are likely to revert to their former situations once the international community loses interest or moves on to the next crisis area. Ibid.

politicized nature of the Lao state. Powerful pockets of entrenched, regional interests resist change. The persistence of strong regional power helps to explain the weak nature of the Lao government. While blurring central-local relations, vague lines of authority have frustrated donors, which have either tried to influence their trajectory or work outside them altogether. Clear decision making still remains ad-hoc, but Lao officials emphasize the importance of centralization and the need to make local authority more systematically accountable to the centre.

The transition entails a comprehensive overhaul and modernization of the Lao government. Administrative reforms in Laos, as elsewhere, seek to find the most appropriate size and scope of units of government with both the capacity to handle specific tasks and the resources to address public objectives. This process has necessitated administrative centralization.

Against these political realities, some donors in Laos mistakenly promote an agenda of decentralization. One might expect pro-market institutions to be at the vanguard of this representation of Laos. In their reports and in discussion with their economists, however, the international financial institutions (i.e., the World Bank, IMF, and Asia Development Bank) seldom refer to the idea of “decentralization” in their depiction of economic and structural reforms in Laos, except perhaps in relation to microeconomic behavior and direct economic production. Rather, the agenda of decentralization is found elsewhere.

G.P.A.R. and a Rights-based Approach to Development

Organizations less identified with markets and de-regulation have taken the lead on decentralization. The UNDP, supported by the Swedish government and its bilateral development arm Sida (Swedish International Development Agency), has been the strongest advocate of smaller central government and more local autonomy in Laos. As a way to increase local accountability and decision making, these agencies,

along with others in the donor community in Laos, continue to infuse more participatory practices into their portfolio of programs. They assume that more local accountability can increase the performance of development interventions. These participatory approaches favor a devolution of power, or democracy through a representative form of government characterized by universal suffrage. Because the latter will remain improbable into the near future for Laos, donors have logically opted for decentralization, however defined.

The Swedish government aid agency, Sida, emphasizes a rights-based approach to its policies on international development, and the general idea of decentralization broadly complements this agenda. In an important statement on its role in promoting democratic governance, Sida declares:

Support for decentralisation should rest on the extent to which government devolves sufficient powers and funds to decentralised bodies, the existence of mechanisms are truly accountability and transparency at the local level, and whether participatory mechanisms are truly legitimised by the people.²⁶¹ Its development cooperation in Laos aims to reduce poverty in the context of fostering the foundations of democracy and respect for human rights.²⁶²

²⁶¹ See Sida, "Digging Deeper, Four Reports on Democratic Governance in International Cooperation, Summary," (Stockholm: Department for Democracy and Social Development, Division for Democratic Governance, 2003).

²⁶² In their *Country Strategy for Development Cooperation*, the Swedish government promotes pro-poor and environmentally friendly policies. As this document states, "Sida will apply a rights-based approach perspective in all its analyses, preparatory work and interventions." Specific to Laos, this strategy aims to strengthen conditions for democracy, rule of law, and respect for human rights. See Government of Sweden, "Country Strategy for Development Cooperation, Laos, January 2004 - December 2008," ed. Ministry of Foreign Affairs (2003). This country strategy governs Sweden's programs of development cooperation in Laos. It provides guidelines on the sorts of programs open to Swedish support, how they should be implemented, and the results to be achieved. The Ministry for Foreign Affairs jointly prepares this report with the regional Asia Department of Sida and the Swedish Embassy in Vientiane—all ostensibly in close cooperation with representatives of the Lao government.

In another recent statement of its policies, Sida declares "Development cooperation will promote and be characterized by respect for human rights, democracy and good governance, gender equality, the sustainable use of natural resources and protection of the environment, economic growth and social development and social security." See Government of Sweden, "Development Responsibility: Sweden's Policy for Global Development," (Government Bill 2002/03: 122, 2003). This document presents the government's direction for Swedish development cooperation.

The framework guiding United Nations development cooperation in Laos also incorporates this agenda. In Laos, the United Nations Development Assistance Framework provides the guiding principles for UN cooperation. According to this document, all UN organizations in Laos should “apply human rights-based approach to development that

- focuses on people as holders of rights, as well as duties and responsibilities;
- adopts the fundamental principles of non-discrimination;
- prioritizes needs of the most disadvantaged and vulnerable;
- reiterates that development is a human right; and
- targets the goal of poverty eradication by addressing structural inequalities that cause poverty.”²⁶³

The rights-based approach boasts worthy goals of popular participation, accountability, transparency, the rule of law, gender equality, and human rights.

Inspired by this agenda, the Governance and Public Administration Reform (GPAR) program since its inception in 1997, has strived to increase decentralization, in an overall push to improve democratic governance.²⁶⁴ The goals of GPAR have

²⁶³ See Lao PDR United Nations Country Team, *United Nations Development Assistance Framework (Undaf): 2002-2006, for the Lao People's Democratic Republic* (Vientiane, Lao PDR: United Nations, 2002).

Specific to the UNDP, its Practice Note on Public Administration clearly demonstrates the organization’s commitment to a rights-based approach. The document states, “UNDP’s focus on public administration is not only informed by, but also derives from its commitment to a rights-based approach to development.” The document goes on to read,

one area in which a human rights approach has been successful is in Public Expenditure Management. This has been approached from a purely technocratic perspective that emphasises moderation and control of finances. However, a ‘rights’ perspective, which focuses on an individual’s claim on the state, can advance a pro-poor and gender-equitable outcomes in the budget process and support accountability to the citizen.

See United Nations Development Programme, "Practice Note-- Public Administration Reform," (New York: UNDP, 2003).

²⁶⁴ The overall strategy of the program advances the idea of “good governance” in promoting efficiency, economy, and transparency in government operations. For an early formulation of the GPAR strategy, see Governance and Public Administration Reform, "Governance and Public Administration Reform in the Lao PDR: Programme Concept and Overall Strategy," (Vientiane, Lao PDR: UNDP (GPAP), Prime Minister's Office (Department of Public Administration), 1997).

wide-ranging political implications.²⁶⁵ Sida-funded and UNDP-managed, the program assists the Lao government in streamlining its public administration. Governance reports by both organizations point to the government's policies on decentralization as the rationale for pushing the idea of decentralization. In a biased reading of the government's notorious Instruction 01, for example, donors have seized on the policy's language to create their own discursive myths about "decentralization." The entire six-page advisory note fails to mention the word "decentralization" and simply reiterates government policies, beginning in the early 1990s, to recentralize and deconcentrate central authority.²⁶⁶

In various donor documents and reports on government reform, however, Instruction 01 appears as a decree, and the restructured role of subnational governments automatically counts as "decentralization." In the development discourse of government reform, this instruction gradually crystallized into the "decentralization decree." The unquestioned acceptance of the idea of "decentralization" underlies much of inter-governmental reforms in Laos. Taking an anti-centralist stance, many donor reports either ignore the government's push to centralize or quickly dismiss it as a transitory period to much needed decentralization.

²⁶⁵ Strategies for GPAR include:

1. redefinition of the role and culture of government;
2. re-structuring and rationalizing of the machinery of government;
3. reform of the authority and accountability structures;
4. strengthened decision making and decision support structure;
5. redeployment of civil service and reduction of public expenditures;
6. innovation and adaptation of modern management. *Ibid.*, 7.

²⁶⁶ One of the main objectives reads:

to transmit the Party's policies and state plans implementing units at the local level and elaborate the policies into guidelines for the formulation of plans and budgets, starting from the grassroots level, by promoting the population and family units who process the production as well as their services, enabling them to increasingly participate in the initiating and implementation of planning and budgeting process. Government of Lao PDR, "Instruction 01," part I.

On the government side, the discourse on state restructuring is strikingly different, matching the centralizing attempts reviewed earlier. Lao officials understand administrative reforms broadly in technocratic terms, usually capacity training. Governance in Laos evolves through secret, internal negotiations within the Central Committee. Larger issues of organizational restructuring remain clouded by the black box of Party policies and generally insulated from Western influence. Nonetheless, available evidence (from public documents and decrees on local administration and reform) reveal that the government has made no recent effort to relinquish central authority, either at the organizational or institutional level. From my analysis and in discussion with keen observers, I conclude that the party does not support decentralization, much to the chagrin of donors. The government rarely uses the word “decentralization,” which anyhow has a decidedly political meaning in the Lao language,²⁶⁷ and continually re-iterates its commitment to building a “centralized, deconcentrated state.”²⁶⁸ As late as 2001, many high ranking party and government officials either failed to grasp the meaning of decentralization or else believed the term inappropriate to describe the intent of government reforms.²⁶⁹

²⁶⁷ In the Lao language, “decentralization” translates into “diffusion of power” (*kan kayai omnaat*). The word’s political intent is inescapable, conjuring up images of glasnost, political pluralism, and regime change. Hence, government documents steer clear of the loaded term and generally avoid any discussion of direct political change in the reform process.

²⁶⁸ Decentralization, if it can be said to exist in an already highly fragmented Laos, as a policy of the state, finds expression only as a deconcentration of state authority that has delegated to subnational units the responsibility of implementing centrally determined policies.

²⁶⁹ Attended by vice-ministers and vice-deputies of government ministries and provincial governments, a UNDP sponsored governance workshop on April 23-24, 2001, discovered that most participants did not fully understand the meaning of decentralization. Once educated, many believed that the term failed to capture the appropriate intent of government reforms, which do not aim to give more power to local units of government. Governance and Public Administration Reform, "Report of the National Workshop on Towards Better Governance (23-24 April 2001)," (Vientiane, Lao PDR: GPAR, Department of Public Administration, Prime Minister's Office, 2001), 9.

Development Myth of Decentralization

A policy of decentralization in Laos is a development myth. Nonetheless, the discourse on decentralization has real effects in the development industry— for the very reason that international advisors read the same reports and regurgitate the same rhetoric with shocking regularity. The important re-centralizing trend of government policies clearly stand at odds with the broader goals of GPAR. Project documents reflect a fundamental misreading, if not willful neglect, of political realities and current inter-governmental relations. The country's historically weak center and de facto devolution suggest that a development agenda of decentralization makes little sense. In promoting such an agenda, donors fail to consider local norms, values, and circumstances which inform the transition to market capitalism.²⁷⁰ Despite the vast amount of resources brought to bear, public sector reforms in the Asia Pacific region continue to fall short of expectations, in part due to the failure of donors to acknowledge the highly political nature of civil service reforms.²⁷¹ Moreover, the development community also reveals a professional bias for an administrative science applicable from one development setting to another.²⁷² In this light, the distortion of

²⁷⁰ Fukuyama makes a sensible argument that development projects aimed at improving administrative capacity needs to emphasize the local context:

The local character of the knowledge to design a wide variety of good administrative practices suggests that administrative capacity isn't actually transferred from one society to another by developed-world administrators sitting around lecturing their less-developed counterparts about how things are done in their country or in a mythical "Denmark." General knowledge of foreign administrative practices need to be combined with a deep understanding of local constraints, opportunities, habits, norms, and conditions. This means that administrative and institutional solutions need to be developed not just *with* inputs or buy-in from the local officials who will be running local institutions, but *by* them. The East Asian fast developers with strong governance imported certain institutions but modified them substantially to make them work in *their* societies. They certainly did not grow them by allowing foreign donors to establish institutions in their own country that crowded out domestic ones. Fukuyama, *State-Building: Governance and World Order in the 21st Century* 88.

²⁷¹ Patrick Keuleers, "Governance in the Least Developed Countries in Asia and Pacific: An Assessment of the Current Situation," (Bangkok: United Nations Development Programme, SURF, 2004).

²⁷² A major criticism of development agencies is that they have a tendency to offer large, standardized packages of projects, exported from country to country. See Judith Tandler, *Inside Foreign Aid*

government restructuring in Laos is not only comprehensible but also perhaps necessary. Naturally then, how these agencies frame problems reflects the sort of solutions they can proffer.²⁷³ The complex reality of government structuring reduces to a simple process of “decentralization.” Such oversimplification leads to a host of generic solutions that deny politics and the social context within which government restructuring actually takes place.

Expectations of the development community about government restructuring have met with harsh realities. In authoritarian Laos, GPAR has produced mixed results. To the dismay of many Lao officials, for example, consultants on one pilot governance project have spent months fastidiously devising, apparently with little input from government staff, hundreds of job descriptions for the provincial office of Luang Prabang. Many Lao officials fail to see the usefulness of this exercise, which anyway fails to translate the job descriptions into the Lao language. Attempts to refine job descriptions of Lao civil servants and match work skills with staffing requirements have met with little support from provincial authorities and created friction between them and the project team. This seemingly technocratic exercise in administrative engineering ran up against the political limitations of standardizing job descriptions across the vertical line ministries.

(Baltimore, MD: John Hopkins Univ. Press, 1975), who argues that development organizations have a corporate interest in their own survival. In this development culture, development professionals tend to reduce uncertainties while pushing money.

²⁷³ James Ferguson, *The Anti-Politics Machine: "Development," Depoliticization, and Bureaucratic Power in Lesotho* (Minneapolis: University of Minnesota Press, 1994) 69-70. Here, Ferguson claims that development agencies are in the business of selling these standardized packages of projects. Similarly, Escobar argues that

Development proceeded by creating "abnormalities"... which it would later treat and reform. Approaches that could have had positive effects in terms of easing material constraints became, linked to this type of rationality, instruments of power and control... these refined specifications did not seek so much to illuminate possible solutions as to give "problems" a visible reality amenable to particular treatments" Arturo Escobar, *Encountering Development: The Making and Unmaking of the Third World, Princeton Studies in Culture/Power/History* (Princeton, N.J.: Princeton UP, 1995) 41-2.

Many GPAR consultants have ignored politics in the vain embrace of administrative science and appear genuinely baffled as to why their efforts to infuse a sense of rationality into something as routine as job descriptions would encounter local opposition. However, the exercise of creating job descriptions was untaken in the context of the myth of decentralization and failed to consider, let alone take into account, government restructuring towards centralized state control. While the project team continued to draw up job descriptions for staff members of line ministries, it failed to grasp the extent to which personnel matters fall under the office of the governor. Subordinate local officials have limited political authority to implement many of the program's sensible plans to streamline government bureaucracy. Anyhow, some observers question the government's commitment to implementing a standardized job classification system.²⁷⁴ Writing in a different context, James Ferguson makes a critique of development organizations that resonates with administrative reforms in Laos: "Where "bureaucracy" is seen as a problem, it is not a political matter, but the unfortunate result of poor organization or lack of training. Organizational reform and education are the remedies."²⁷⁵ When questioned about the political implications of their work, some development professionals in Laos respond credulously that politics is not their concern and that they only do "development" – as if somehow the allocation of their limited resources escapes public scrutiny or organizational conflict.

Development as the Anti-politics Machine

The proper execution of GPAR's plans would have required a political realignment of inter-governmental relations, which exceeds the scope of any

²⁷⁴ Rudi Klauss, "Laos- the Case of a Transitioning Civil Service System in a Transitional Economy" (paper presented at the Civil Service Systems in Comparative Perspective, School of Public and Environmental Affairs, Indiana University, Bloomington, Indiana, February 1997).

²⁷⁵ Ferguson, *The Anti-Politics Machine* 65.

development project. Hidden behind the bamboo curtain of Lao communism, on-going negotiations of central-local relations remain insulated from Western influence. In a country where social and economic expressions have political significance, technical and managerial solutions to bureaucratic reforms cannot readily be divorced from the political context conditioning the scope of local autonomy and openness.

Development organizations, as colorfully described by Ferguson, evoke images of an anti-politics machine, cheerfully uninformed of the larger political fallouts of their resource allocations while pushing, paradoxically, their own political agenda.²⁷⁶ In surveying the development scene in Lesotho, he comments on the apparent contradictions in the role of development agencies:

On the one hand, they are supposed to bring about "social change," sometimes of a dramatic and far-reaching sort. At the same time, they are not supposed to "get involved in politics" – and in fact have a strong de-politicizing function. But any real effort at "social change" cannot help but have powerful political implications, which a "development project" is constitutionally unfit to deal with. To do what it is set up to do (bring about socio-economic transformations), a "development" project must attempt what it is set up not to be able to do (involve itself in political struggles).²⁷⁷

The applicability to GPAR is striking. Without the support of local officials and armed only with the standard development package of technical assistance, the GPAR project has failed to catalyze democratic transformations in a bureaucratic structure entrenched with the principle of democratic centralism. For all its technical expertise, the program had no ability to bring about a political-economic transformation which decentralization actually entails. Justifiably, the central government expressed little interest in following this logic of decentralization to its post-communist conclusions. It was in the process of wrestling control back from the provinces.

²⁷⁶ Ibid.

²⁷⁷ Ibid. 226.

Party policies set by the Central Committee determine the limits of government reform, rather than the resources of donor-driven projects that ignore politics in the vain embrace of administrative science. To the shock of GPAR consultants, development decentralization seems only to produce disorganization and disarray. Progress has been slow in reaching program objectives, due in no small part to a mismatch of goals and objectives between donors and the government. While donors focus more on institutional and organization changes with the aim of improving “good governance” (i.e. local participation in decision making; public accountability; internal transparency; and overall predictability, efficiency, and rationalization of public administration), government officials view administrative reforms almost entirely at the individual, human resource level.

Whereas GPAR strives to produce real changes in terms of the structure and function of government, Lao officials see the program in terms of organizational outputs, increased capacity, and staff training. For Lao officials, public administrative reform aims primarily to improve organizational performance, as well as the efficiency and effectiveness of government operations²⁷⁸ The Lao government generally views governance reforms from the perspective of organizational management and personnel, not of institutional design amenable to deeper structural (and hence political) reform. In the area of human resources, reforms strive to improve quality of staffing through training, study-tours, and incentives for educational advancement. In efforts to streamline ministerial functions, administrative reforms continue to redefine the missions, roles, and organizational structure of the various agencies. Lao officials generally seem satisfied with the capacity building component

²⁷⁸ The government’s recent paper on governance states, “Lack of human capacity and weak legal enforcement are, in the Government’s view, the main constraints to be addressed in order to accelerate implementation of our governance priorities.” Government of Lao PDR, “Background Paper on Governance,” 14.

of GPAR and have expressed a desire for continued support of training activities, technical assistance, and office equipment in the next phase of the program.²⁷⁹

Not content with these successes, an appraisal of the GPAR phase II project calls for a more systematic application of the rights-based approach as a prerequisite of future Sida funding.²⁸⁰ The report urges, “Due to the prevailing restrictions on democracy and human rights in Laos, international donors have a huge responsibility in fostering these values in any way they can.”²⁸¹ In assessing the first phase of the project, evaluators (at the urging of Sida officials) advise for an even stronger application of a rights-based approach: “In order for [donor] support to be effective, there is a need to give more attention to central values such as tolerance, transparency, representation, and accountability.”²⁸²

²⁷⁹ Evaluators of GPAR Luang Prabang observe,

There is a general content among stakeholders in Luang Prabang with the first phase of GPAR. Training activities, job descriptions and technical equipment are most often referred to as successful activities/inputs... There is a widespread belief and hope among Lao stakeholders that the second phase of the project will be a continuation of the first phase. Very few show an understanding of the need for important reforms of the public administration system, beyond mere training and capacity building. Thus, local commitment and ownership of the reforms envisaged in the GPAR programmes is not yet deep enough... [T]here is high expectations that additional technical and material support will be an important part of phase II. Thus, there is a need for further awareness raising among stakeholders on the new, more reformist, aspects of phase II.

See Einar Braathen and Par Skold, "The Right Road to Reform? Appraisal of Gpar Luang Prabang Phase Ii (Draft Report)," (Oslo and Goteborg: Swedish International Development Agency, 2004), 26.

²⁸⁰ According to evaluators, the pilot GPAR project in Luang Prabang lacks a strong emphasis on a rights-based approach to development:

The project as it is designed is not a technically adequate solution to the development problem at hand, as it is more aimed at the symptoms than the real problem. To a large extent, central issues for good governance like transparency, accountability, integrity, anti-corruption and meaningful participation are avoided. This has resulted in a project characterised by a very technical approach. Ibid., 25.

²⁸¹ Ibid., 19.

²⁸² Ibid. Elsewhere, they write,

A major problem is the lack of a rights based approach to development... The project as it is designed is not a technically adequate solution to the development problem at hand, as it is more aimed at the symptoms than the real problems. To a large extent, central issues for good governance like transparency, accountability, integrity, anti-corruption and meaningful

Under Sida guidance, the second phase of the GPAR project, approved in late 2005, figures to intensify the misguided drive for democratic decentralization. Going forward, GPAR not only seeks to assist local administration but also strives to engender real political restructuring. Behind the technocratic language of implementing “a better governance system, featuring accountability, predictability, sound public sector management, optimized service delivery, participation and transparency, in order to provide cost-effective services to the public,”²⁸³ lays a human rights agenda in Laos.

The GPAR program presents a microcosm of the development industry in Laos. Agencies like Sida and the UNDP attempt to influence development policies and hold leverage with their purse strings but can provide, for the most part, only technical and managerial solutions to intensely political issues. At the same time, these agencies have inserted themselves into a political process, with the very intent of promoting their cherished causes, irrespective of the political environment circumscribing any push towards a de-centering of power. The irony is inescapable. While attempting to de-politicize governance reforms justified by administrative science, donors advance their own political agenda in blissful ignorance of the development setting. So long as donors pursue their own political objectives in righteous disregard of political realities, development failures will continue to characterize the industry.

The neglect of politics in the program’s implementation gives way to a normative image of a rationalized government. See Figure A12 in Appendix. In this odd organizational chart, developed by GPAR and cited frequently in development reports, the National Assembly mistakenly stands above the president of the party and

participation are avoided. This has resulted in a project characterised by a very technical approach. Braathen and Skold, "Right Road to Reform?" 25.

²⁸³ Braathen and Skold, "Right Road to Reform?" 28.

state, while the dual structure of authority reveals few insights into how the party impedes the functioning of government. The chart presents a normative vision of a Lao government restrained by the rule of law, rather than accurately linking the party to the state. In its links, the judiciary and executive branches report to the National Assembly, when in fact the legislative body acts as a rubber stamp of government policies dictated by the party and, by and large, the president. This widely-referenced flowchart reflects a general misreading of Lao politics within the development community, compounding an already complex process of development assistance.

To be sure, a clearer picture of the relationship between the party and its apparatus of government would contribute substantially to a better understanding of the public administration, enhancing donor coordination and implementation of development programs. For the most part, the development community neglects, or fails to consider, the role of the party in the management of the Lao government. Development reports and project documents generally say very little about politics in Laos, except for an occasional paragraph in the background section. This ignorance manifests itself in many development projects which set up parallel structures of authority that attempt to by-pass the government altogether.²⁸⁴

As this chapter demonstrates, the Lao government aims to rein in the power of provincial authority; the party has shown no commitment to the idea of devolution. In fact, the country is de facto already highly devolved! As the reality of this project of nation building grows more credible, the rhetoric heard from development professionals is that, well, effective decentralization in Laos can only work once strong centralization takes place. Come again? This mystifying logic says less about

²⁸⁴ These project or program management units (PMUs) structure authority and decision making for a given development project. Usually lacking a clear picture of the party hierarchy, these PMUs assign overall authority to government officials, like the program director, who nonetheless lack authority to act out of rank.

the reality of administrative reforms and more about the agenda of particular development organizations. Instead of aiming for conceptual clarity as a basis for effective action, some donors promote obscure ideals while reasserting institutional norms and recycling development policies. The emphasis on rights-based development will, in all likelihood, contribute to familiar development failures in Laos. But governance reforms disappoint for other reasons. By de-politicizing public administration and its reform, donors fail to recognize or take account of the ways in which the Lao government is an instrument of party policies.

Administrative Restructuring and State Control

The lofty—albeit sanctimonious—agenda of some development agencies would not otherwise seem so troubling, except that donor attempts to infuse a sense of democratic governance into an authoritarian state may have the perverse effect of strengthening its grip on power. The following section claims that, however weak its public administration, the Lao People's Revolutionary Party retains a strong hold on the machinery of government. By ignoring Lao politics in the romantic pursuit of democratic governance, donors unconsciously contribute to the logic of government restructuring and state consolidation. The experience of decentralization efforts in other developing countries justifies this concern.

Development Decentralization: Swimming against the Current

The rhetoric of decentralization conveys a mosaic of meaning and masks a variety of objectives. As David Slater perceptively observes, the agenda of decentralization often confronts the reality of centralization.²⁸⁵ In his examination of the Ujamaa projects from the 1970s in Tanzania, Slater reveals that the attempt to promote decentralization produces the opposite effect of its stated objective. In

²⁸⁵ Slater, "Territorial Power," 512.

Weberian terms, Slater notes, “The internal logic of the bureaucratic development of the state has been a powerful factor of centralization.”²⁸⁶

More recent research on decentralization reinforces his initial findings: programs of administrative decentralization often strengthen the ability of central authorities to exercise top-down dominance and control. That is, projects to advance administrative decentralization, in practice, promote centralization.

For the most part, programs of decentralization do not, in fact, increase local participation and self-determination. Instead of improving participation from below, these initiatives increase the scope of central domination from above. Nor do they appear to promote democracy. World Bank reviews of decentralization initiatives from around the world fail singularly to make a link between efforts to institute decentralization and democracy.²⁸⁷

As evidence suggests, the experience of state restructuring in Laos, since the early 1990s, diverges little from this state logic of consolidation, not because of any pre-determined outcome of decentralization projects, but because in many developing countries, a weak central government struggles to command allegiance in the face of traditional political authority. As a result, the centripetal bias of national development gravitates towards centralization, particularly in efforts to foster a durable sense of territorial unity.²⁸⁸

The goal behind the Tanzanian government’s attempt at spatial restructuring resonates strongly with inter-governmental reforms in Laos. Referring to the experience in Tanzania but providing insight for the Lao case, Slater claims “The rationalization and consolidation of centralized authority lay at the roots of the spatial

²⁸⁶ Ibid.: 503.

²⁸⁷ See Jennie Litvack, Junaid Ahmad, and Richard Bird, "Rethinking Decentralization in Developing Countries," in *Sector Studies Series* (Washington, DC: World Bank, 1998).

²⁸⁸ Slater, "Territorial Power," 504.

restructuring of state power, so that decentralization was more illusion or myth than hard institutional reality.”²⁸⁹ He goes on to write,

Decentralization... extended and consolidated the regional and local power of the state in a situation where a growing proportion of the rural population was being resettled, often coercively, in so-called “development villages.” Within these villages, where bureaucratic staff and local Party leaders were politically dominant, the organization of agricultural production showed few signs of being restructured in accordance with a strategy of collectively managed socioeconomic transformation. The decentralization programme did, however, provide a cloak for increasing state control, combined with a growing reliance of foreign aid, including World Bank funding for export-oriented agricultural projects. In addition, from the point of view of the central government, the advantage of such a programme is that its power is safeguarded, whilst responsibility for implementation can be blurred whenever necessary.²⁹⁰

These findings provide a cautionary note to governance reforms in Laos. Efforts to democratize the Lao state in ways that fail to address the political constraints of public administrative reforms risk reinforcing the regime’s hold on the government. Because of the conflicting governance agendas between donors and Lao officials, continuing reforms efforts will most likely result in unintended consequences unpopular with the development community. If donors fail to accommodate to the political realities of government reforms, the logic of state restructuring may overwhelm donor efforts to push a political agenda to the contrary. The next section explains why.

Fusion of Party and State

The political reality of centralization follows the administrative logic of rationalization for a small and poor country struggling to create the rudiments of a market society. Evidence suggests that the Lao government places a high priority on territorial control in determining policies for administrative reforms. The party controls and regulates most government activities. The siege mentality of the last

²⁸⁹ Ibid.: 514.

²⁹⁰ Ibid.: 515.

communist holdouts seems to have strengthened, and Laos is no exception.²⁹¹ The party-state has no intention of relinquishing its control of the machinery of government. Mindful of the regime-destroying thrust of liberalization undertaken by its erstwhile communist brethren in Eastern Europe, the political elite in Laos fear losing political authority to exogenous forces that accompany the market transition. Economic instability caused by local autonomy in the 1980s forced the central government to take a stronger role in economic management, in order to reinforce economic liberalization a decade later.

Since the early 1990s, economic reforms have resulted in more centralization of administrative control and economic regulation. In the process, governors have been gradually disempowered, while central ministries have reasserted control over their line ministries. In contrast to the general trend in post-communist countries, political and economic restructuring in Laos has not led to a devolution of administrative control. In tandem with market restructuring, the state has continued to penetrate further into the village by promoting a deconcentrated state organ of a highly centralized bureaucracy.

Persistent tensions in central-local relations should in no way obscure the fact that the communist regime in Laos faces no threat to its monopoly of political power. Governors represent the Lao state. In public administration, the party strives to make provincial administration more tightly bound to national economic planning and has gradually transformed the provinces from quasi-sovereign states to local

²⁹¹ Bringing into sharp relief the contradictions of decentralization in a communist regime, Daniel Bell observes of the Soviet Union, "if there is any sense to Khrushchev's vast "decentralization" scheme, it would seem to mean the reassertion of a political criterion, rather than economic rationality, in the handling of economic affairs. Genuine economic decentralization... would leave the party as a parasitic appendix to the economy." Daniel Bell, "Ten Theories in Search of Reality: The Prediction of Soviet Behavior," in *The End of Ideology: On the Exhaustion of Political Ideas in the Fifties* (Cambridge, MA: Harvard UP, 2001), 321. See also Richard Lowenthal, "The Permanent Revolution Is on Again," *Commentary* XXIV, no. 2 (1957).

administration of the central government. For example, Politburo resolution of 17 November 2003 gave specific central ministries and organizations responsibility over the provinces. Table 1 below presents these linkages. What this administrative arrangement implies in practice remains unclear. Hardly anyone outside the government has a firm grasp of what this reorganization hopes to achieve. But the fact that central ministries have been given oversight of provincial activities can only imply a further consolidation of central authority and less autonomy for the provinces.

Through the entire reform process, the party continues to exert a firm control on the apparatus of government. The party and local government structures are irrevocably intertwined. Subnational levels of government not only organize administrative units but also mirror political divisions of the state. Governors have extensive authority as representatives of the state.

The communist party in Laos effectively controls the public sector, in part because access to career opportunities remains open for talented and politically astute party members. The party monopolizes political ambition and regulates public life. From the government bureaucracy, the mass organization, to the military, public organizations implement party directives and monitor its monopoly on power. Party cadres penetrate all institutions of government and operate within all levels of government, from the central ministries to their provincial and local branches. Despite strengthening the role of the National Assembly in public administration, the party leadership continues to approve all senior government staff. The process is highly opaque and deeply politicized. By all accounts, party membership still promotes upward mobility and career advancement within the bureaucracy. In numerous examples, educated and highly experienced staff have been overlooked for promotions in preference for less qualified candidates with party credentials. If social mobility within the apparatus of government helps to explain the enduring strength of a

**Table 1. Central Government Oversight of the Provinces
by Government Agency, Lao P.D.R.**

<u>Central Ministry or Organization</u>	<u>Province</u>
National Assembly	→ Savannakhet
Office of the President	→ Borikhamxay
Prime Minister's Office and Ministry of Justice	→ Luang Prabang
Committee for Planning and Cooperation and The Propaganda and Training Board of the LPRP CC	→ Bokeo
Ministry of Foreign Affairs	→ Xayabury
Ministries of National Defense and Public Security	→ Xieng Khuang and → Xayxombun Special Region
Ministry of Education and Lao Youth Union	→ Phongsaly
Ministry of Labour and Social Welfare	→ Attapeu
Ministry of Commerce	→ Udomxay
Ministry of Communications, Transport, Posts and Construction	→ Luang Namtha
Ministry of Finance and Bank of the Lao PDR	→ Huaphanh
Ministry of Industry and Handicrafts	→ Khammuane
Ministry of Information and Culture	→ Saravane
Ministry of Agriculture and Forestry	→ Champasack
Ministry of Public Health	→ Sekong
Organization Board of the LPRP CC and Office of the LPRP CC	→ Vientiane City
Lao Front for National Construction and Lao Women's Union	→ Vientiane Province

Source: Stuart-fox, Martin. *Politics and Reform in the Lao People's Democratic Republic*. Vol. Working Paper No. 1, *Political Economy of Development*. Williamsburg, VA: Program on Civil Society and Governance, College of William & Mary, 2004, pp. 40-1, footnote #18.

communist government, then a weakening of this function may signal the demise of the party-state.²⁹² If, however, social mobility continues to depend on party affiliation, as in Laos, then the waning of the communist state demands other considerations. Although remuneration remains low, government work continues to attract a modicum of educated Lao to the public sector, drawn in large measure by a nationalist fervor to develop the country and the prospect of upward mobility to positions of authority. For many, civil service jobs are still considered respectable and desirable. Excluding military personnel, staff numbers have remained fairly constant through the years, peaking at around 100,000.

At the structural level, the secular religion of communist provides the venue to negotiate inter-governmental relations. At the organizational level, party committees enforce party policies and regulate departmental activities. At the human resource level, loyalty to the party ensures job security and social mobility. Keeping everyone in line, the principle of democratic centralism steers the process of decision making in all state organizations.²⁹³ As enshrined in the constitution, the administration of the

²⁹² Walder, *Waning of the Communist State*.

²⁹³ In principle, state policies are deliberated and ironed out through a consultative process at various levels of government and society at large. In its paper on governance, the government characterizes the principle of democratic centralism in the following manner:

We consider the process of decision-making as **democratic** because wide-ranging consultations are undertaken with many different groups in order to achieve consensus on an issue before a decision is taken. The process is **centralised** because once consensus has been reached on an issue, the decision is signed by a single person with the appropriate authority. Wide-ranging participation and expression of opinion are the underlying principles of centralised democracy.

Democratic centralism within the Government is also supported by the principles of **collective leadership, unitary leadership** and **individual responsibility** as specified in the foundation decree of each ministry. Collective leadership refers to the way that decisions are taken collectively by all concerned authorities on the basis of mutual consensus. In order to ensure that the decision-makers are held responsible for their decisions, the principle of collective leadership is applied hand in hand with that of unitary leadership—where one individual alone signs the decision. Once a decision is taken, each person involved in the decision is individually responsible for the outcome—the principle of individual responsibility.

Lao government follows the Leninist principle of democratic centralism.²⁹⁴ In theory, state policies are deliberated and ironed out through a consultative process at various levels of government and society at large. Thereafter, public policies reflect consensus within the government, and all involved are responsible for carrying out party directives. Open dissent limits career advancement of party officials. In this communist logic, the state is democratic, by allowing voice, and centralized under the leadership of a vanguard party.²⁹⁵ In reality, high ranking members of the party dictate many of the policies for the government to execute.

State Restructuring and the Logic of Centralization in Laos

In post-communist countries, pre-existing institutions strongly shape domestic politics and determine the direction of global integration.²⁹⁶ In Laos, a historically weak center provides a starting point from which to consider possible paths out of socialist serfdom. The recent history of government restructuring reveals a party apparatus pragmatically adjusting to economic constraints, while consolidating its power base, unifying the country, and exerting its centralizing influence on an ideologically indifferent countryside.²⁹⁷ To the extent that donors ignore the political

Democratic centralism means essentially that a collective view is adopted on a given problem, or policy, once all concerned parties have given their opinion, advice and suggestions. See Government of Lao PDR, "Background Paper on Governance," 17. Bold type in original.

²⁹⁴ Article five of the 2003 amended constitution reads, "The National Assembly and all other state organizations are established and function in accordance with the principle of democratic centralism." Government of Lao PDR, "Constitution of the Lao People's Democratic Republic," (National Assembly, 1991 (2003)). Although all communist states operate behind the cover of democratic and collective leadership, the Lao PDR is the only communist state to have enshrined the principle of democratic centralism in its constitution.

²⁹⁵ According to the legendary leader of the Lao PDR, democratic centralism demands "the submission of the individual to the organization, of the minority to the majority, or one level to its superior level [in the Party hierarchy], with the Central Committee assuring the direction of the Party." Kaysone Phomvihhan, *La Revolution Lao* (Moscow: Edition du Progres, 1980) 170.

²⁹⁶ Walder, *Waning of the Communist State*.

²⁹⁷ An astute observer of Lao culture and society, Grant Evans claims that government restructuring had an explicit political logic. Although referring to the experience of the 1980s, his observations still have wide currency:

rationality of government centralization, their foreign assistance risks contributing to the Lao state building project, premised on strengthening control over an ethnically diverse and geographically disparate populace.

By and large, the post-socialist transition everywhere has involved the retreat of the state from direct management of the economy. Although the push for decentralization may be strong throughout the world, the experience of government restructuring in Laos suggests caution. In the market transition of this nominally communist country, the Lao government seeks political, administrative, and economic centralization over regionally dispersed and fiscally independent provinces. Against the trend of public decentralization in the transition process, Laos provides a strong case for the important role of governments in establishing a market economy on the foundations of a natural one.

Since the 1990s, the market transition has intensified political and administrative consolidation of a weak, central bureaucracy. Constitutional reforms provide the rationale for the central government to assert its authority in the name of national unity, security, and development. However, the limited power and reach of the state ensures the continuation of traditional patterns of political authority.

Local power remains concentrated in the office of provincial governors. A lack of clear lines of authority among the various government organs complicates reforms to rationalize the public administration. These institutional obstacles prevent the establishment of a standardized system of job classification for departmental personnel at all levels of government. In the face of unclear rules and responsibilities, low remuneration provides little incentive for individual initiative or efficient work. In this

Undoubtedly this attempt to rationalize administration is aimed at placing more cadres in the villages and promoting growth there as well as consolidating the [district] organization of the party. In this way the LPRP hopes to retain control over the direction of social, economic, and political development of the countryside. Evans, *Lao Peasants under Socialism* 200-1.

environment, coordination problems balloon, duplication of work persists, and informal work incentives multiply.

The state bureaucracy runs poorly, due in part to its highly politicized nature. An opaque government structure hinders reform efforts. A strong party structure parallels the public administrative and significantly influences government operations. A clearer articulation and delineation of roles and responsibilities within public agencies, as well as among the various levels of government, would improve efforts to streamline government operations. This politically sensitive reform agenda requires a concerted push to distinguish the Lao state from party. Because such a separation has resulted in regime change in much of the communist world, this slow reform will remain ad-hoc, piece-meal, and far from complete into the foreseeable future.

Into this foray, donors have a different interpretation of the challenges confronting development in Laos. For the most part, donors perceive government structuring through ideological lenses, imposing not only a set of generic values but also standard development practices from one country to the next. Moreover, Western donors react uncomfortably to the idea of a communist country centralizing political authority and consolidating a national economic space with their assistance. Out of this unease, a myth of decentralization has engulfed the industry, distorting meaningful development dialogue and presenting a striking example of how development agendas overwhelm complex local realities. The clout and financial resources of donors allow them to advance their own political objectives, while also—ironically— pushing development in apolitical terms.

In summary, the weak public administration of the Lao PDR has gone through several phases of bureaucratic rationalization and reform to inter-governmental relations. Earlier reforms actually produced a weak center, in contrast to the experience of other peripheral countries. However, as the market transition unfolds,

economic restructuring in Laos encounters development problems typical of poor countries. At which time, the centralist ethos of state power searches for rational expression in administrative centralization. In so far as the communist government effectively limits other avenues for social mobility, the rationalization and consolidation of the weak public administration help to explain, in part, the resilience of an otherwise unremarkable state. Where communist states in Eastern Europe devolved socio-economic control to their political demise, the Lao PDR, for a variety of factors explored above, has managed a gradual market transition that emphasizes political stability and economic development under the direction of stronger central control.

Despite these concentrated strategies of national development, some donor agencies in Laos view challenges to development in terms of improving economic governance, subsumed under the theme of “decentralization.” The consequences of this mismatch between donor agendas and the Lao government’s objectives have produced a situation in line with experiences elsewhere in the global South. That is, decentralization programs provide a cloak for increasing state power. With the assistance of the development community itself, reform geared towards state concentration is nowhere more evident than in Lao fiscal restructuring, which is the topic of the next chapter.

Chapter IV

THE FISCAL SOCIOLOGY OF THE LAO TAX STATE

As the previous two chapters emphasize, decentralization does not feature in the government's reform agenda. The Lao political elite appear unenthusiastic about following decentralization, presumably in part to avoid the collapse and the post-communist conclusions in Eastern Europe. Administrative centralization, as detailed in Chapter III, follows from the political one documented in Chapter II. Where the previous two chapters explored political and administrative reforms intended to enhance central state control, this chapter explores the centralization trend in the planning and budgetary process; tax and customs administration; and management of state revenues and expenditures in the treasury.

Given the history of Laos, and the status of its politics and public administration, one might expect great difficulties reconciling demands of decentralization with the fiscal needs of central authorities. In this chapter, I begin with a look at the country's crisis of revenues and then examine attempts at central control. To evaluate alternative responses to the situation on continuing fiscal crises in Laos, I employ a modeling procedure that allows for the comparison of competing policies. The model, an analytic hierarchy model (or AHP), will explore all the relevant factors and interrelate them in a systematic manner and consistent framework. I examine three alternatives, in order to explore the factors that drive decision making within the Lao government: (1) accepting the international proposals for decentralization, (2) maintaining the status quo of a state-party alliance, and (3) taking a "developmentalist" path of centralization. My hypothesis, generated from analysis of the history, political, and (in this chapter) fiscal situation, is that the only likely solution will be through further political and fiscal centralization. As the AHP

model suggests below, although this scenario may offer the best possible path towards the country's modernization, the policy is wrought with difficulties.

I begin the chapter by emphasizing the importance of the study of public finances to the overall understanding of state capacity. In surveying the fiscal crisis of the Lao state in detail, the second section describes the allocation of public expenditures and the tax structure. The third section explores fiscal reforms in the budget planning process, tax and customs administration, and deficit management. As with challenges of administrative restructuring discussed in the previous chapter, entrenched political interests at the local level continue to hinder fiscal reforms and the rationalization of financial management. Success in fiscal reforms, thus, requires strong central control over regionally autonomous and fiscally independent provinces, and the fourth section describes several strategies explored by the Lao government. The fifth section places fiscal reforms in international perspective and goes into detail on the AHP model, in order to examine competing policies of fiscal management. In the conclusion, I claim that the fiscal experience in Laos is not an isolated circumstance of peripheral socialism, but rather a general case of a post-colonial state struggling to modernize a country in the face of traditional sources of political and economic authority.

Finances and the Making of the Modern State

Benjamin Franklin derisively comments, "In this world nothing can be said to be certain, except death and taxes."²⁹⁸ Finances have created the modern state.²⁹⁹ As

²⁹⁸ Benjamin Franklin, "Letter to Jean Baptiste Le Roy, 13 November 1789," in *Works of Benjamin Franklin* (Philadelphia: William Duane, 1818).

²⁹⁹ Back in the 16th century, the French philosophy Jean Bodin called finance "the nerves of the state." As quoted in Meredith Woo-Cumings, ed., *The Developmental State* (Ithaca, NY: Cornell UP, 1999) 10.

Joseph Schumpeter notes, “Fiscal demands are the first signs of the modern state.”³⁰⁰ The emergence of the state as a separate and real power coincided with the distinction between private and public law.³⁰¹ Out of this division, the state acquired a solid framework with its own organs and powers separate from private authority. In time, financial obligations of the state expanded, most importantly in warfare, and became one of the driving forces of the modern state.³⁰² As outlined by Max Weber, the state constitutes a special type of ruling political organization, one which possesses legitimate use of force and a bureaucracy to administer its monopoly on violence. Weber singles out the use of violence to characterize a state because its other characteristics, e.g. “national interests,” could not be universally applied.³⁰³ Even

³⁰⁰ Joseph Alois Schumpeter, "The Crisis of the Tax State," *International Economic Papers* 4 (1954): 19. He goes on to write,

It goes without saying that there is more to the state than the collection of taxes necessitated by the common need that was their origin. Once the state exists as reality and as a social institution, once it has become the centre of the persons who man the governmental machine and whose interests are focused upon it, finally once the state is recognized as suitable for many things even by those individuals whom it confronts—once all this has happened, the state develops further and soon turns into something the nature of which can no longer be understood merely from the fiscal standpoint, and for which the finances become a serving pool. If the finances have created and partly formed the modern state, so now the state on its part forms them and enlarges them—deep into the flesh of the private economy. Schumpeter, "Crisis of Tax State," 19.

³⁰¹ Schumpeter, "Crisis of Tax State," 11. Definitions of states always depend on distinguishing it from society. See Timothy Mitchell, "The Limits of the State: Beyond Statist Approaches and Their Critics," *American Political Science Review* 85, no. 1 (1991).

³⁰² As Schumpeter argues, “without financial need the immediate cause for the creation of the state would have been absent... Taxes not only helped to create the state. They helped to form it. The tax system was the organ the development of which entailed other organs.” Schumpeter, "Crisis of Tax State," 16-7.

³⁰³ See Max Weber, "Politics as Vocation," in *From Max Weber: Essays in Sociology*, ed. Hans Heinrich Gerth and C. Wright Mills (New York: Oxford UP, 1958). For a discussion of Weber’s political sociology, see Richard Swedberg, *Max Weber and the Idea of Economic Sociology* (Princeton, NJ: Princeton UP, 1998) Chapter 5. Expanding upon Weber’s classical foundation, Charles Tilly observes that over the past two hundred years a concentration of capital and means of coercion, in tandem with preparation for war and relative position in the international system of competing polities appear to have driven the process of state formation and consolidation in Western Europe. Tilly, *Coercion, Capital, and European States* 14-5.

without a broader framework of state function, nevertheless, finances determine the limits of state capacity.³⁰⁴

Capital accumulation constitutes one of the primary tasks of the state.³⁰⁵ In order to realize public goals, to fulfill its obligations, and to reduce its debt, the state needs finances.³⁰⁶ The types of revenue available and the ability to extract resources help to shape the size and scope of nations.³⁰⁷ Theoretical perspectives of the state, thus, remain incomplete without a fiscal sociology, the study of the modern tax

³⁰⁴ As Schumpeter points out, “the state has its definite limits. These are, of course, not conceptually definable limits of its field of social action, but limits to its fiscal potential. These vary considerably in each specific case according to the wealth or poverty of the country, to the concrete details of its national and social structure, and to the nature of its wealth.” See Schumpeter, “Crisis of Tax State,” 20.

³⁰⁵ In general, states must guarantee conditions that enable the society to fulfill two contradictory functions: accumulation and legitimation. While maintaining the conditions for capital accumulation, the state must also sustain the conditions for social harmony. See James O'Connor, *The Fiscal Crisis of the State* (New York: St. Martin's Press, 1973) 6. Emphasis original. As first outlined by O'Connor, the thesis of accumulation and legitimation reads:

the capitalist state must try to fulfill two basic and often mutually contradictory functions—*accumulation* and *legitimation*. This means that the state must try to maintain or create the conditions in which profitable capital accumulation is possible. However, the state also must try to maintain or create the conditions of social harmony. A capitalist state that openly uses its coercive forces to help one class accumulate capital at the expense of other classes loses its legitimacy and hence undermines the basis of its loyalty and support. But a state that ignores the necessity of assisting the process of capital accumulation risks drying up the sources of its own power, the economy's surplus production capacity and taxes drawn from this surplus (and other forms of capital).

This central dilemma applies not only to capitalist states, but to all states that purport to take a directive role in economic management and development. Elaborating on state functions, Bell notes, “Each state has to balance the calculation of capital accumulation (and the restriction of consumption) against the social needs and demands of the population.” Daniel Bell, “The Public Household: On “Fiscal Sociology” and the Liberal Society,” in *The Cultural Contradictions of Capitalism* (New York: Basic Books, 1996), 231.

³⁰⁶ Theda Skocpol makes the case that answers to questions about financial capacity “provide the best general insight into the direct or indirect leverage a state is likely to have for realizing any sort of goal it may pursue. A state's means of raising and deploying financial resources tell us more than could any other single factor about its existing (and its immediately potential) capacities to create or strengthen state organizations, to employ personnel, to co-opt political support, to subsidize economic enterprises, and to fund social programs.” Theda Skocpol, “Bringing the State Back In: Strategies of Analysis in Current Research,” in *Bringing the State Back In*, ed. Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol (Cambridge, U.K.: Cambridge University Press, 1985), 17.

³⁰⁷ D. Friedman, “A Theory of the Size and Shape of Nations,” *Journal of Political Economy* 85 (1977).

state.³⁰⁸ In examining the economic capacity of the state, fiscal sociology provides a window unto the functioning of states.³⁰⁹ Public finances determine the capacity of states to realize such public objectives as allocation, redistribution, economic stabilization and growth, and overall guidance of the economy.³¹⁰ Fiscal sociology studies the nature, form, and fate of the state from the financial side. This method recognizes the centrality of the state budget, focusing on the process of formulating expenditures and efforts to expand the tax base.³¹¹ In political struggles over the content and structure of the public economy, a “fiscal crisis” inevitably confronts the state.³¹² Public demands for state resources far outstrip the state’s capacity to generate commensurate revenue, and fiscal sociology examines how states mitigate fiscal crises, while supporting the broader goals of accumulation and legitimation.

A study of public finances is particularly important in understanding the trajectory of socialist transformations.³¹³ As Schumpeter argues,

³⁰⁸ Fiscal sociology, as Schumpeter argues, provides a fruitful perspective for the theory of the state. Schumpeter, "Crisis of Tax State," 19. According to O'Connor, *Fiscal Crisis* 3, fiscal sociology deals with fiscal politics and aims “to discover the principles governing the volume and allocation of state finances and expenditures and the distribution of the tax burden among various economic classes.” In challenging orthodox (predominantly economic) theories of public finance, O’Connor goes on to argue, “Particular expenditures and programs and the budget as a whole are explicable only in terms of power relationships within the private economy” (Ibid., 5).

³⁰⁹ I use the term “modern tax state” to refer to what theorists of public finance call “the public household,” or the management of state revenues and expenditures. Fiscal sociology examines the struggles over the composition of public expenditures and revenues. See Bell, "Public Household." For the best known treatise on public finance, see Richard A. Musgrave, *The Theory of Public Finance: A Study in Public Economy* (New York: McGraw-Hill, 1959).

³¹⁰ As Bell, "Public Household," 225. argues,

The direction of the economy has been a central government task. Government spending controls the level of economic activity; tax and monetary policies direct the timing of investment; transfer payments effect the partial distribution of incomes through social security, subsidies, revenue sharing, and the like. In general, all modern polities are involved in the functions of allocation, redistribution, stabilization, and growth.

³¹¹ As Schumpeter observes, “the budget is the skeleton of the state stripped of all misleading ideologies.” Schumpeter, "Crisis of Tax State," 6. Bell notes, more recently and less elegantly, “the major aspect of the public household is the centrality of the budget, the level of government revenues and the expenditures, as the mechanism for reallocation and redress.” Bell, "Public Household," 226.

³¹² O'Connor, *Fiscal Crisis*.

³¹³ According to Schumpeter,

The public finances are one of the best starting points for an investigation of society, especially though not exclusively of its political life. The full fruitfulness of this approach is seen particularly at those turning points, or better epochs, during which existing forms begin to die off and to change into something new, and which always involve a crisis of the old fiscal methods.³¹⁴

The collapse of state socialism by the early 1990s constitutes such a critical juncture in world affairs, and an examination of public finances provides an important insight into the transition process. According to Robert Skidelsky, the proximate cause of the wholesale collapse of communism in Eastern Europe was the system's inability to generate sufficient revenue to cover the cost of maintaining and reproducing the defining institutions of the Leninist party-state.³¹⁵ The former Soviet Union experimented with devolution in the late 1980s. These reforms resulted in a loss of fiscal control in Moscow, depleting the central treasury and contributing to the collapse of Soviet communism. In decontrolling production and decentralizing management tasks from the government to the enterprises, the Soviet Union under Gorbachev lost the power to control the economy. Economic reforms shifted political power to the republics, in the process draining the state budget of revenues.³¹⁶ Devolution energized regional powers to act autonomously. In the absence of military intervention to the contrary, state collapse and regime change eventually ensued.

In Laos, the communist regime survives unchallenged, and an examination of state finances can shed light on the capacity of the government to control the terms of

An enormous influence on the fate of nations emanates from the economic bleeding which the needs of the state necessitates, and from the use to which its results are put. In some historical periods the immediate formative influence of the fiscal needs and policy of the state on the development of the economy and with it on all forms of life and all aspects of culture explains practically all the major features of events. Schumpeter, "Crisis of Tax State," 6-7.

³¹⁴ Ibid.: 7.

³¹⁵ See Skidelsky, *Road from Serfdom*, esp. chapter six "Why did the Soviet Communism Collapse?" He notes that the "proximate cause of the collapse of the Soviet Empire was state bankruptcy." See Skidelsky, *Road from Serfdom* 96-116.

³¹⁶ See Skidelsky, *Road from Serfdom* 96-116.

market freedom (*perestroika*) in the absence of political openness (*glasnost*). As this chapter demonstrates below, the Lao party-state actively promotes policies to consolidate economic and political authority.

Historically, Laos has been highly dependent on foreign aid. This dependency continues to characterize Laos, whose public economy suffers from persistent fiscal crises.³¹⁷ How does the Lao government mitigate the perennial fiscal crises? How sustainable is the public debt? And what efforts are made to control public expenditures and to expand the tax base? To address these questions, I draw from recent government budget publications and from an assessment of tax and customs reform projects at the Ministry of Finance (MoF). For this analysis, I use documents and data on laws and regulations relating to financial and monetary affairs; staff reports issued by the International Monetary Fund (IMF) in support of Article IV consultations; public expenditure reviews undertaken by the World Bank; and economic reports published by MoF.

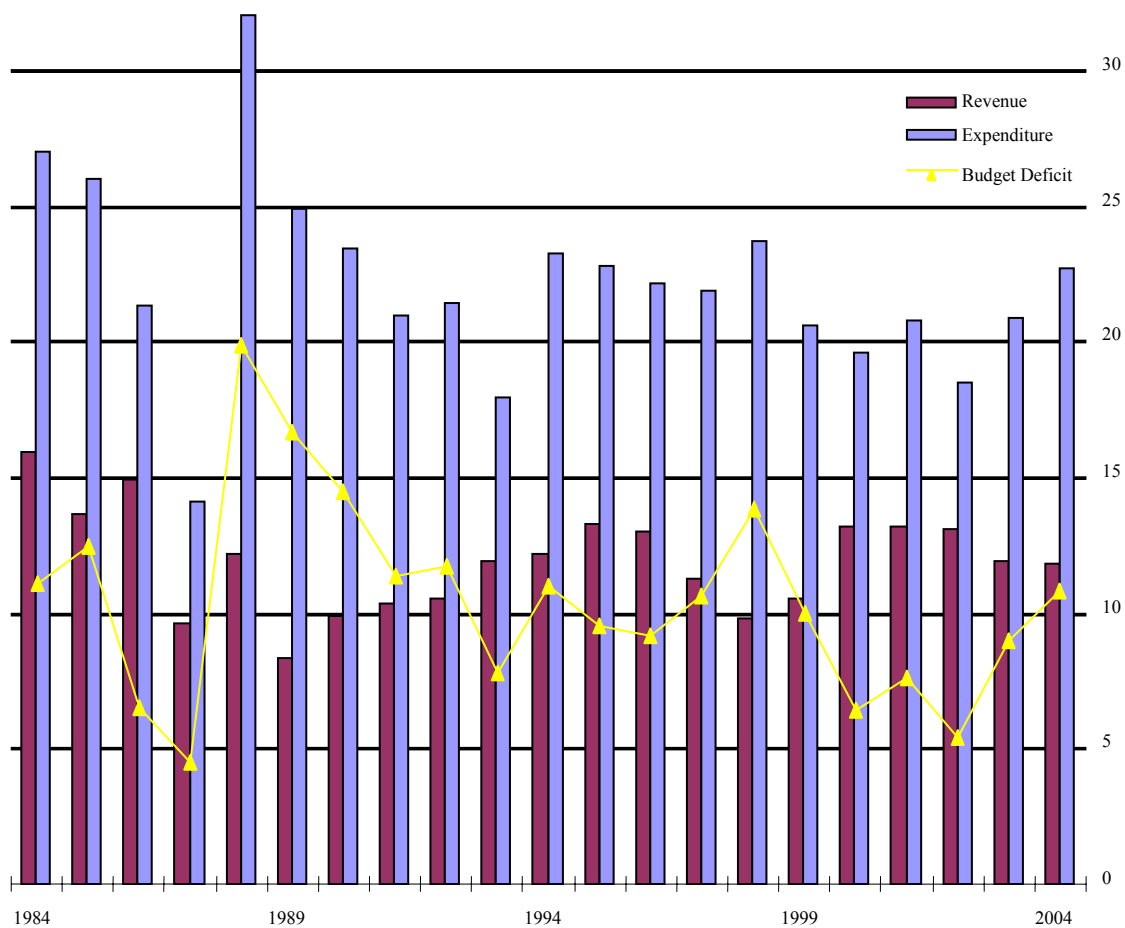
Fiscal Crisis of the Lao Tax State

By most Western standards, Laos typifies a poor country. In 2003, economic output equaled 21,500 billion Kip (roughly US\$ 2.1 billion), or a per capital GDP of US\$ 370, one of the lowest in the world.³¹⁸ The low level of development fuels a crisis of capital accumulation for the Lao state. The country's small economic base translates into a weak public economy; government operations remain poorly funded. Over the past decade, public expenditures have ranged from 20 to 25 percent of gross

³¹⁷ For an historical overview of finances in modern Laos, see Appendix A7. This chronicle of the tax state calls attention to the economic dependency of successive regimes in Laos and persistent problems of fiscal crises. As a political-economic entity, modern Laos lacks financial sovereignty; external finances have propped up various regimes throughout the country's turbulent past.

³¹⁸ For detailed data on the Lao economy, see the Appendix.

domestic product (GDP), while revenues cover only two-thirds the cost of keeping the government running (Figure 6).



Source: Table A12, Appendix A8.

Figure 6. General Government Budget Balance (Percent of GDP)

Lao PDR, 1984-2004

The interminable fiscal crises of the Lao state stem from its chronic failure to match budgetary expenses with revenues. In any given year, budget deficits have ranged about 5-15% of GDP, with major improvements on the balance sheets occurring after 1998. In a recurring pattern of fiscal profligacy, the Lao government consistently spends more in expenditures than it can conceivably generate in revenues. The following section describes the state budget in detail, examining the composition of public expenditures, the structure of revenues, and the sources of deficit finance.

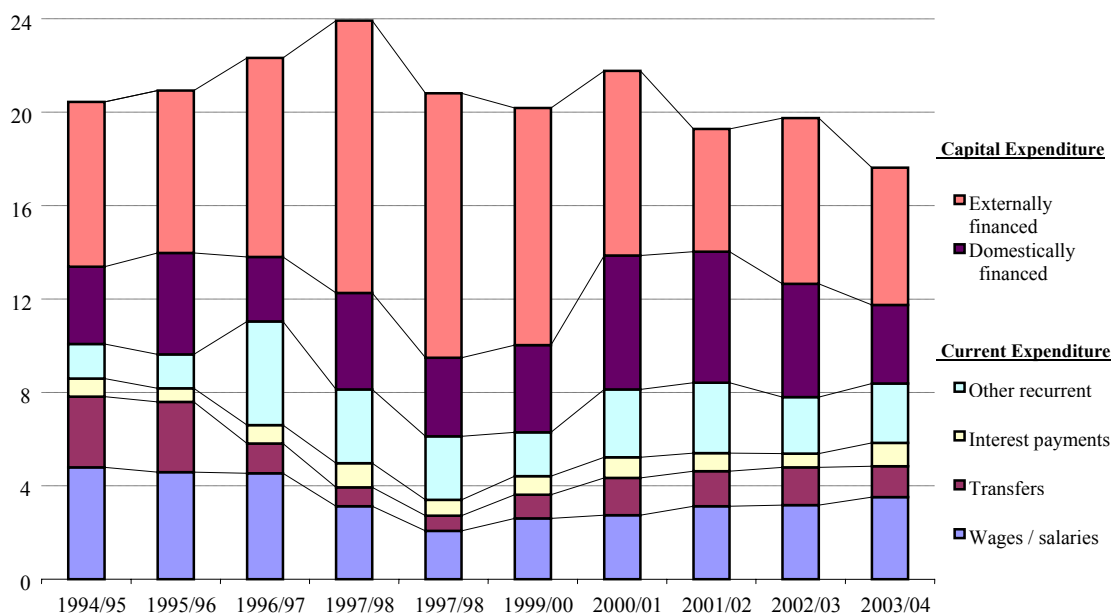
Composition of Public Expenditures

The Lao PDR follows a comprehensive budgetary planning process that guides economic output and sets targets for revenues and expenditures. The Lao national budget has two components, recurrent and capital.³¹⁹ Current expenditures include salaries and benefits for civil servants, subsidies to state-owned enterprises, operations and maintenance of government facilities, repayment of loans and interests on public debt, and other recurrent expenditures.

Capital expenditures comprise domestic and foreign expenses for development finance. In any given year, capital expenditures consume over half of all public expenses.³²⁰ Since 1994, public expenditures have ranged about 18-24% of GDP (Figure 7).

³¹⁹ The process of preparing both budgets occurs separately. For details on the budget planning process, see Appendix A9.

³²⁰ Each year, MoF submits a forecast of total public capital available for the upcoming fiscal year. Based on these capital projections, CPC then drafts a preliminary budget, taking into consideration current priorities and the viability of on-going projects. This draft budget provides a project-by-project breakdown of funds tentatively allocated for existing medium and large projects. Concurrently, the ministries and provinces draft their own investment plans for proposed and on-going projects. At a series of regional planning meetings, officials discuss these separate PIPs and eventually reconcile them with the preliminary draft. In cooperation with MoF, CPC combines the various investment plans into a national PIP, which then goes before the National Assembly for the ceremonial stamp of approval. The final PIP is presented in two volumes, one for projects administered by the provinces and the other by central line ministries. MoF then takes responsibility for disbursing project funds. See Sida, "Financial and Administrative Systems."



Source: Table A12, Appendix.

Figure 7. Composition of Public Expenditure (Percent of GDP)

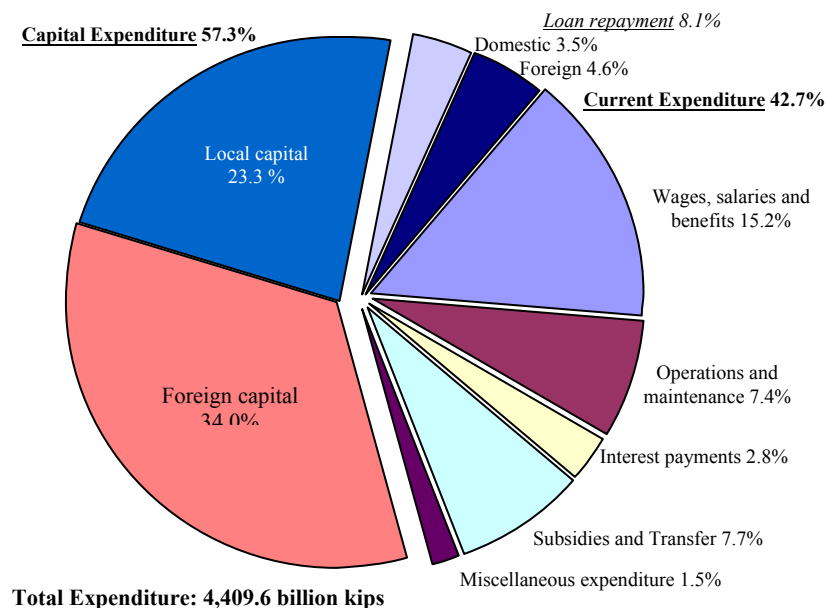
Lao PDR, FY 1994/05-2003/04*

Note: *Figures for FY 2003/04 are planned estimates.

In fiscal year ending 2003, the latest for which figures are available, the cost of running the Lao government reached 4,409.6 billion kip, or US\$ 415.3 million.³²¹ Over half of this budget (57.3%) went to capital expenses, with the remainder absorbed by wages (15.2%), subsidies to government enterprises (7.7%), maintenance (7.4%), and other recurrent expenses. See Figure 8. Western donors fund roughly 60% of the capital budget, but none of the government's recurrent cost.

The central government lays claim to about 60% (or 2,438.1 billion kip) of this budget, with local governments spending the rest (1971.4 billion kip). From the

³²¹ The government's financial year runs from October 1 to September 30. Figures were calculated at prevailing exchange rates: US\$ 1 = 10,500 kip. The latest government budgetary data derive from Government of Lao PDR, "Official Gazette: State Budget Revenue - Expenditure Implementation of Fy 2002 - 2003 and State Budget Revenue - Expenditure Plan for Fy 2003 - 2004," (GoL, 2004).



Source: Table A14, Appendix.

Figure 8. Composition of Public Expenditure, Lao PDR, FY 2002-03

capital, three ministries control almost two-thirds of central government spending. Outside the capital, five provinces spend about half of all local expenditures.³²²

Although the government planned to spend 4,700 billion kip in fiscal year 2002-03, actual expenses reached only 93.8% of expected costs.³²³ On the aggregate, provincial governments exhibited weak control of public spending, in exceeding their expenditure plans by 4.6%. These soft budget constraints of local expenditures underscore the discretionary power of provincial authorities to flaunt national plans.³²⁴ In contrast, central government ministries displayed discipline by spending only 86.6% of planned outlays.³²⁵

³²² See Appendix A8, especially Figures A22 and A23.

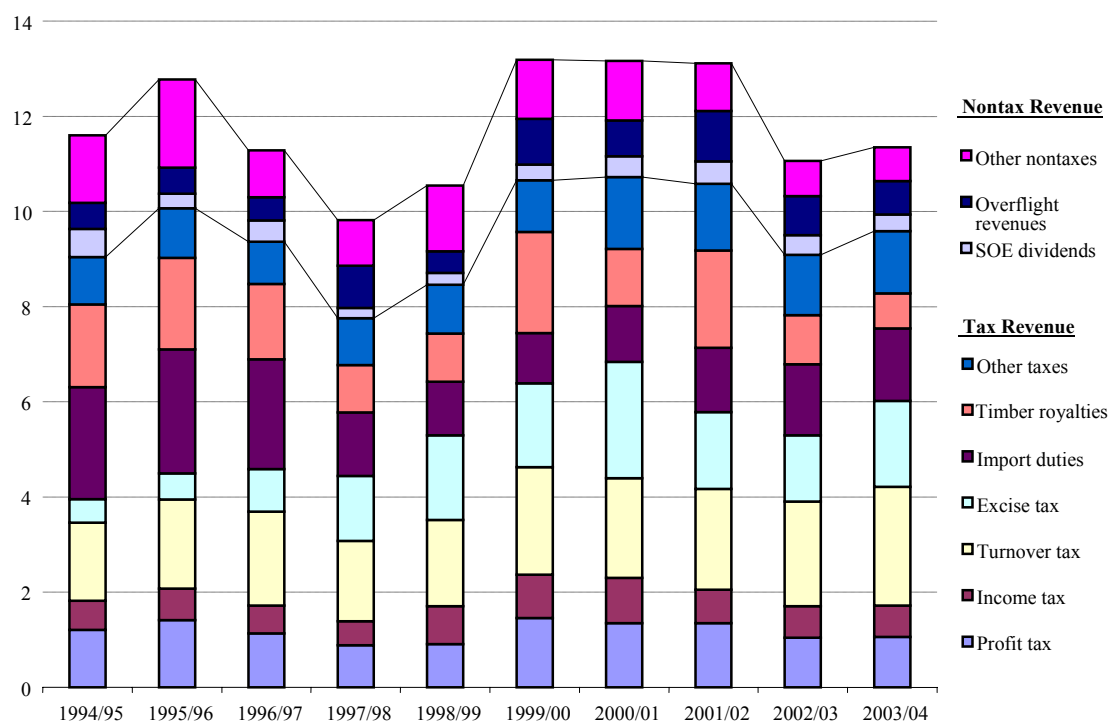
³²³ By expenditure category, administrative subsidies and transfers to various government operations accounted for the bulk of cost overruns. See Tables A14-16.

³²⁴ At the local level, wages and subsidies both outstripped expense targets by about 10%. Accounting for the lion's share of local over-spending, miscellaneous expenses ran three times higher than expected.

³²⁵ From the capital, unexpected costs appeared in some categories of operations/maintenance and subsidies/transfers.

Revenue Structure and Tax Base

A combination of taxes, fees, and non-tax income compose government revenues. Over the past decade, revenue collection ranged about 10-13 percent of GDP (Figure 9). Taxes collected by the Tax Department and Customs division of MoF account for most of the revenues. In fiscal year-ending 2003, the government collected 2,505.9 billion kip (or US\$ 236.0 million, 12% of GDP) in revenues, which managed to cover only 57% of expenditures. From this total, various taxes and customs revenues accounted for over half of all revenues. Other sources of income derived from royalties on natural resource extraction and revenues from, as well as sales of, state-owned enterprises.³²⁶



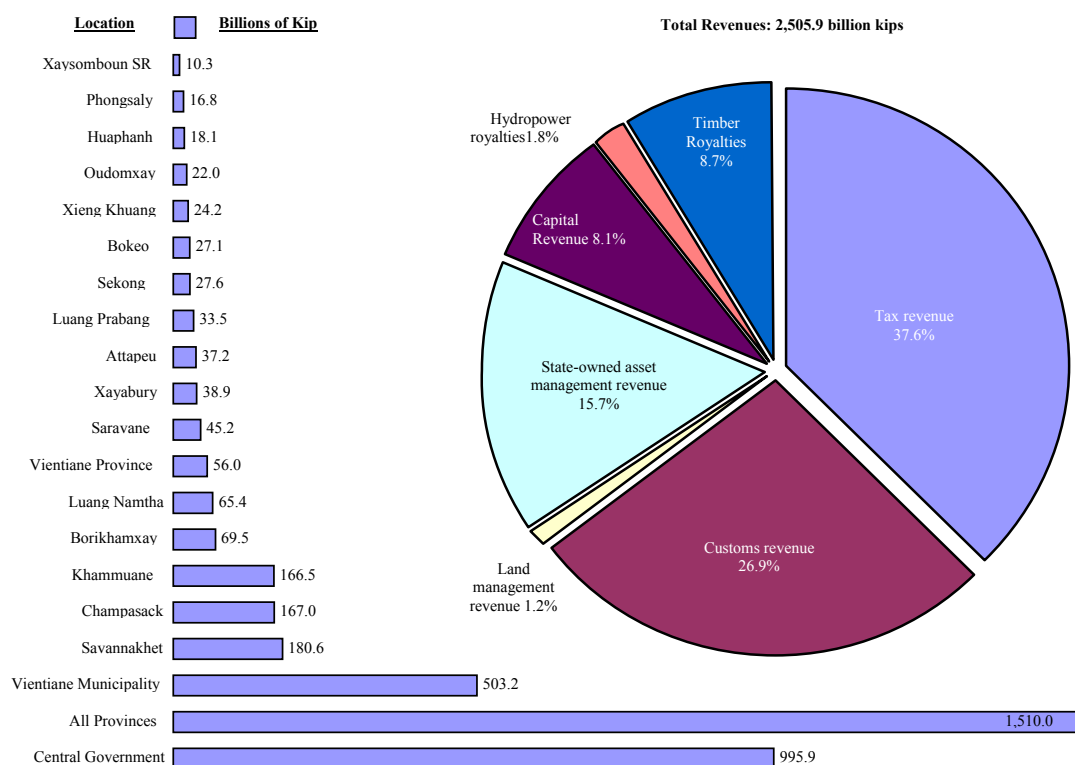
Source: Table A18, Appendix.

Figure 9. Structure of Government Revenues (percent of GDP)

Lao PDR, FY 1994/95-2003/04

³²⁶ For details on the composition of government revenues, see Appendix A10.

The central government collected about 40% of all revenues in fiscal year-ending 2003, mainly from taxes and centrally-controlled government assets. At the provincial level, customs duties provided the bulk of local revenues. Provincial governments regulate the logging industry, which made up 14.4% of local revenues in 2003. Reflecting the concentration of economic activity in the country, four provinces contributed the bulk of all local revenues. Vientiane Municipality alone collected a third of all local revenues. The other two major urban centers, Champasack and Savannakhet, along with the mineral and logging wealth of Khammuane province, each accounted for about 10% of local government income (Figure 10).



Source: Table A20, Appendix.

Figure 10. Government Revenues, by Source and Administration

Lao PDR, FY 2002-03

Mirroring the regional disparity in revenue collection, a narrow tax base presents obstacles to fiscal expansion. Available data from 2002 puts the number of registered taxpayers at 62,911, comprising individual taxpayers, small- to medium-sized businesses, and large companies.³²⁷ Regulated by the Large Taxpayer Unit (LTU) of the Tax Department, 80 large businesses alone delivered 45% of government revenues by the end of fiscal year 2002. Individual taxpayers account for only 5% of revenues, and tax-evasion runs rampant. Hence, official figures disguise the true number of taxable entities in Laos. Some observers estimate that the number of business operations in Laos may stretch as high as 170,000.³²⁸ Thus, with better legal enforcement, the scope for expanding the revenue base remains strong. Without reforms in tax administration, fiscal crises may undermine the country's economic potential.

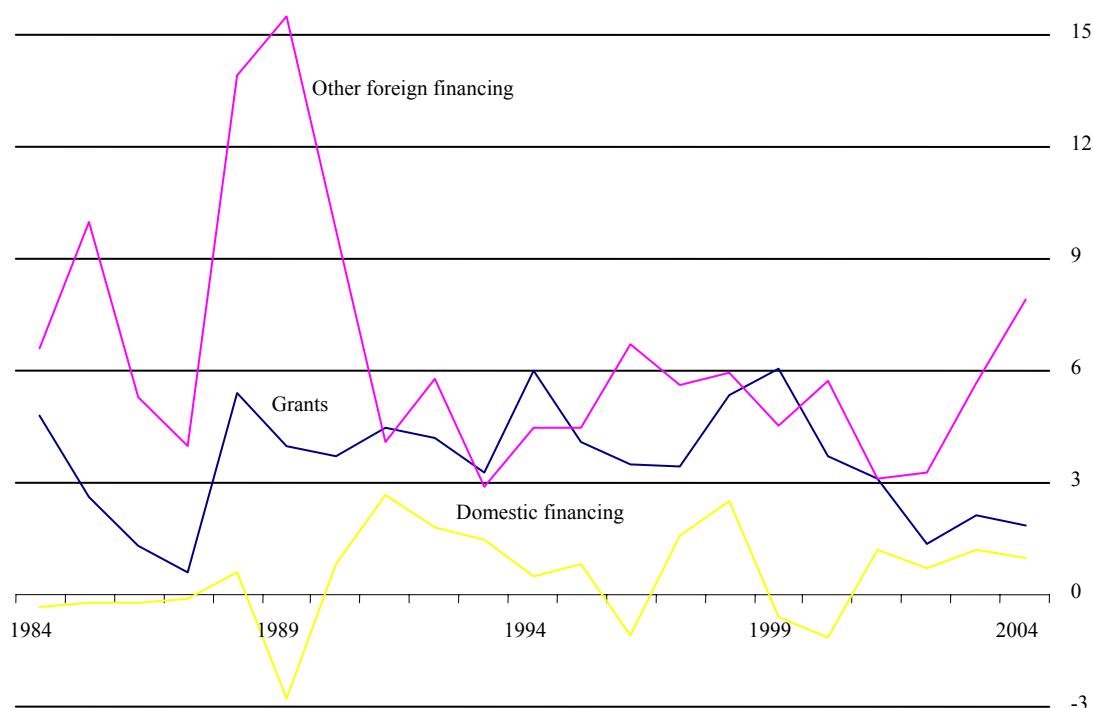
Fiscal Sustainability and Public Debt

The Lao government runs perennial budget deficits, financed through donor inflows and borrowing from the banking system (Figure 11). With the collapse of the Soviet empire, the Lao government lost a dependable source of funding for public expenditure. Almost overnight, external financing of government operations dropped precipitously from over 15% of GDP in 1989, hovering around 5% thereafter. Compensating for this drop, foreign aid from the West, in roughly equal parts grants and loans, has assisted the Lao government to meet its public obligations ever since.³²⁹ External funds usually shore up the capital component of public expenditures.

³²⁷ Table Appendix A11, Table A21.

³²⁸ As cited by the Lao National board of statistics, in Swedish International Development Agency, "Swedish Support to Strengthen Fiscal Management in Lao PDR: Tax Policy and Tax Administration Issues," (Vientiane, Lao PDR: SIDA, Tax Department (Ministry of Finance) Lao PDR, 2003), 9.

³²⁹ With the collapse of the Soviet Union, the Lao government faced a serious problem of budget deficits, which were covered by generous external assistance aimed at helping the country adjust to the market transition. As a result, the country's international reserves actually increased by almost 50% (to US\$61 million) by the end of 1990. In that year, total foreign assistance reached US\$150 million. Stuart-fox, *Buddhist Kingdom, Marxist State: The Making of Modern Laos* 314.



Source: Table A11, Appendix.

**Figure 11. Budget Deficit Financing (percent of GDP), by Source
Lao PDR, 1984-2004**

Over the past few years, revenue projections by the government have unrealistically overstated actual revenue capacity. In the current fiscal year, for example, anecdotal evidence suggests that the Lao government has struggled more than usual to match revenue projections. While donors play a large role in covering capital expenditures, Lao officials have requested additional financial relief to cover shortfalls in the recurrent budget as well.

In 2003, both central and local governments, on the aggregate, ran deficits. While central ministries spent 144% more than what their revenues brought in, local expenditures at the provincial level reached 30% more than their income generating

capacity.³³⁰ Broken down by locale, only three provinces produced budget surpluses and transfers to the national budget: Vientiane Municipality, Champasack, and Savannakhet. All other locales relied on external funds and central transfers to meet the cost of government operations.

These fiscal data reflect the precarious position of government finances. Fiscal crises are unlikely to diminish any time soon in Laos and may, in all probability, become more acute in the coming years. As a member of the Association of Southeast Asian Nations (ASEAN), the Lao PDR has agreed to abide by the Common Effective Preferential Tariff (CEPT), in preparation for the ASEAN Free Trade Area. The treaty hopes to reduce and harmonize tariffs in all member countries. The Lao government has until 2008 to implement its obligations under CEPT, which stipulates that tariff rates on most imports from the region cannot exceed five percent. Because customs duties and import tariffs account for over a quarter of all government revenues, ASEAN free trade will most likely compound fiscal crises in the short run.³³¹

Fiscal reforms have taken on international dimensions, and Lao officials have emphasized the country's international obligations under ASEAN as a way to increase pressure for reforms domestically. Unless the Lao government finds alternative sources of income, the expected decline in customs revenues may well plunge the entire economy into financial disarray. To pay for administrative operations, the government might have to borrow more heavily than usual from the Bank of Laos. In past crises, deficit financing through the Bank of Laos sparked macroeconomic instability, fueling domestic inflation and accelerating the dollarization of the

³³⁰ See Table A19, Appendix A10.

³³¹ Economists at the IMF estimate that tariff reductions under CEPT will eventually cost the Lao government, under the current tax structure, up to 27% of revenues by 2008. See Adrien Goorman, Jacque Baldet, and Rick Fisher, "Lao People's Democratic Republic. Revenue Impact of Cept Implementation, Vat Policy and Administration Issues, and Presumptive Taxation," (Washington, DC: International Monetary Fund, 2000).

Lao economy.³³² The possibility of exacerbating this macroeconomic imbalance limits the scope of financing deficit spending through heavy bank borrowing.

For one, fiscal crises exacerbate the country's external sovereign debt. Without major reforms in fiscal management, the IMF warns, the country's overall debt load may prove unsustainable. As of 2003, the net present value of public external debt equaled US\$ 1,223 million, or 59% of GDP.³³³ In comparison to other developing countries, this debt burden appears unsustainably high. Undertaken by the IMF, an analysis of the structure of this debt suggests that the country's debt load may not prove sustainable for too long.³³⁴ The country's debt-to-revenue and debt-to-exports ratios far exceed the IMF's indicative threshold for debt distress.³³⁵ Nonetheless, the

³³² A rapid expansion of credit to finance budgetary outlays fuels domestic inflation and puts pressure on the exchange rate of the kip. In 1997-2000, the country experienced a period of high inflation primarily due to large budget deficits and a reduction in foreign sources to fund budgetary shortfalls (as a consequence of the Asian financial crisis). Because of fiscal and monetary instability in past years, the Lao economy is heavily dollarized. An astonishing 75% of monetary transactions in the country occur in foreign denominated currencies, mostly in U.S. dollars, the Thai baht, and increasingly Euros. That is, the ratio of foreign currency deposits to the total stock of broad money equals 0.75. Dollarization refers to the domestic use of foreign currencies either as a store of value (asset substitution) or for transaction purposes. For an extended discussion of dollarization in the Lao PDR, see International Monetary Fund, "Select Issues (Sep 02)."

³³³ The face value of public external debt in 2003 amounted to US\$ 2,171 million, a little more than the entire economic output (US\$ 2,088 million) in Laos that year! Because most of Laos' debt was made on a concessionary basis, NPV of debt is less than face value. In 2003, the government serviced US\$40 million (2% of GDP or 17% of revenues) of this debt outstanding debt. International Monetary Fund, "Lao People's Democratic Republic: 2004 Article IV Consultation-- Staff Report," (Washington, DC: IMF, 2005), Table 3, p. 25.

³³⁴ As part of its Article IV consultations with the Lao government, the IMF performs debt-sustainability analyses. By estimating the gross financing needs of a country, debt analysis supposedly helps to indicate a country's vulnerability to liquidity pressures that normally precede and precipitate debt crises. See UN Department for Economic and Social Affairs et al., "Strategic Issues in Managing Sovereign Debt for Sustained Development: An Issues Paper for the Multi-Stakeholder Dialogue on Debt," (Washington, DC: 2004).

³³⁵ On the other hand, the country's NPV debt service-to-exports, as well as debt service-to-revenue, ratios fall below the IMF's threshold for debt distress. International Monetary Fund, "Lao People's Democratic Republic: Selected Issues and Statistical Appendix," (Washington, DC: IMF, 2005), 6. More generally, economists disagree about what actually qualifies as sustainable debt. Because financial crises have occurred at varying levels of debt load, other analyses of debt vulnerability (e.g., structure and composition of debt and a country's debt management capacity) should also accompany a study of debt sustainability. UN Department for Economic and Social Affairs et al., "Strategic Issues in Managing Sovereign Debt for Sustained Development: An Issues Paper for the Multi-Stakeholder Dialogue on Debt," 4.

Lao government refuses to consider debt relief under the Heavy Indebted Poor Countries Initiative, even though the country fulfills all necessary conditions for eligibility.³³⁶ Lao authorities hold out the hope that donor and investment inflows will continue to make up the short-falls in public expenditures and current accounts. This economic and foreign policy remains incomplete, however, without a concerted effort to rationalize the public economy, in order to bring expenditures more in line with revenues. With revenue collection among the lowest in the region, the government has considerable scope to increase capital accumulation.³³⁷

Fiscal Rationalization, Tax Reforms, and Revenue Mobilization

The communists in Laos continue to transform inter-governmental relations in response to challenges of the socialist transformation.³³⁸ These changes have invariably affected the country's financial infrastructure for capital accumulation. The following sections analyze fiscal reforms, paying particular attention to central-local struggles over budgetary control and revenue management. Since 1991, as the next section reveals, the market transition has demanded strong central control of fiscal

³³⁶ Lao authorities reason that the opportunity costs of submitting to HIPC procedures and the potential loss of access to bilateral loans and foreign direct investment outweigh any possible gains from debt relief in the medium term. International Monetary Fund, "Select Issues (Jan 05)," 4. For all their blister about fiscal crises, the IMF readily concedes that, in the medium term, the country's debt service burden is sustainable—with the caveat that more economic (i.e. fiscal) reforms should continue unabated. International Monetary Fund, "Select Issues (Jan 05)," 8. Further, their own projections show that the government has the continued capacity to service its public debts (equivalent to 3% of GDP) into 2008. See International Monetary Fund, "Staff Report No. 05/08," Table 3, p. 25.

³³⁷ In Southeast Asia, all other countries, except Cambodia, revenue collection reaches about 20% of GDP, almost twice the level in Laos. World Bank, International Monetary Fund, and Asian Development Bank, "Lao PDR: Public Expenditure Review, Country Financial Accountability Assessment (Volume Ii: Detailed Reports)," (Washington, D.C.: WB, IMF, ADB, 2002), 5. Nonetheless, this revenue discrepancy disappears when the agricultural sector is excluded from comparison. By itself, the predominance of the agricultural sector in Laos reduces the range of the tax base and distorts any meaningful country-wide comparisons. Once this distortion is removed, however, the ratio of tax revenues to non-agricultural GDP in Laos becomes broadly comparable to Vietnam and Thailand (and higher than Cambodia). See International Monetary Fund, "Select Issues (Jan 05)," 20.

³³⁸ Earlier reforms to fiscal management stressed local self-sufficiency in an expression of pure devolution. See Appendix A12 for a brief overview.

affairs. The remaining sections examine reforms in tax administration, structure of taxes, and management of state-owned assets.

The Initial Phase of Fiscal Restructuring

Up until 1991, Laos contained a weak central government and strong provincial governors, who controlled all aspects of government in their respective regions. In response to local mismanagement of natural resources, low tax revenues, and non-compliance with national directives, the central government thereafter began a concerted effort to re-centralized budgetary control.³³⁹

Promulgated in 1991, the Lao PDR's first constitution redressed the problem of excessive local autonomy by formally recognizing national control, regulation, and management over fiscal affairs. According to the document, all government revenues were to pass through a national budget managed by MoF. In the same spirit of control and oversight, other decrees followed.³⁴⁰ Under new rules, revenues collected in the provinces, in principle, enter the central budget (through the national treasury) before being allocated to the line ministries and provinces. Reinforcing these centralizing trends, Instruction 01 and Decree 192 by the Prime Minister aimed to make “the provinces the strategic unit, the districts the budget planning unit, and the villages the implementing unit.”³⁴¹

³³⁹ A government decree in 1991 strictly forbade civil servants (whether central or local officials) “from making use of any revenue source to cover expenditure in any specific sector without passing through the state budget plans.” See Government of Lao PDR, “Decree on the Basic Principles for the Centralisation of State Finance, Budget and Treasury, No. 68/Pm,” (1991), Article 2.

³⁴⁰ Aiming to achieve greater uniformity in fiscal management, Decree No. 68/PM (August 28, 1991) formally established a system for centralized tax collection and budgetary functions within MoF.

³⁴¹ Government of Lao PDR, “Instruction 01.” And Government of Lao PDR, “Decree on the Implementation of the State Budget Law, No. 192/Pm,” (Prime Minister's Office, 1999). In the development community of Vientiane, Instruction 01 is often referred to as the “decentralization decree” but actually makes no mention of the word “decentralization.” Rather, Instruction 01 extends responsibility for financial management to the provinces and districts.

Many of these changes have met with resistance from provincial authorities reluctant to relinquish economic prerogatives. In practice, recent government decrees have limited the central government's ability to collect, use, and redistribute government revenues.³⁴² The new initiatives further blurred the horizontal and vertical lines of authority and reduced the central government's control of tax collection.³⁴³ While the central government views these rules as a way to make the provinces more responsible for collecting and remitting national revenues, provincial governors, especially of the wealthier urban centers, have interpreted the new rules in ways that legitimize their fiscal independence. In principle central ministries reasserted control over their line ministries in the provinces. In reality, as the following sections reveal, the locus of local power remains in the hands of provincial governors.

Tax Administration and Customs Reform

The central government (through the Ministry of Finance at the central level) has weak control of national revenues collected outside the capital. Government pronouncements to the contrary, provincial governments remain fiscally independent of the center. All provincial governors are high-ranking members of the Central Committee, the real seat of power in the country, and have overall responsibility for oversight of their respective regions. Consequently, the provinces assert strong control over revenues and expenditures managed in their respective locales. While fragmenting economic regulation, fiscal autonomy limits the reach of the central government. As the country modernizes, however, this political structure becomes more of a barrier to economic reforms. Tariff reductions under AFTA threaten to plunge the entire Lao economy into financial disarray; and national control of the

³⁴² Patrick Stoop, "Fiscal Centralisation and Decentralisation, Policy Paper (Draft)," (Vientiane: Department of Public Administration and Civil Service, Governance and Public Administration and Reform (GPAR) Project, 2003), 3.

³⁴³ Ibid.

public economy provide a strong impetus for central authority to rein in the power of autonomous provinces. As with challenges to governance reforms discussed in the previous chapter, fiscal rationalization equates with central control and oversight of autonomous provinces.

In this highly decentralized environment, provincial authorities express little willingness to collect and remit revenues to the national budget. Introduced in April 1999, the current tax sharing scheme classifies provinces into three types: those in budget surplus, self sufficient, or in budget deficit. Provinces in surplus retain half of their surplus, while deficit provinces can keep all recorded revenues in excess of budgetary targets. Given this incentive structure, provincial governments have little rationale to report budget surpluses or excess revenue.³⁴⁴ Few actually do. In the expenditure plan for fiscal year 2002-03, for example, only the provinces with the wealthiest urban areas (Vientiane, Savannakhet, and Champasack) remitted any revenues to the central government.³⁴⁵ The rest displayed weak budgetary controls and under-reported revenue collection. In some instances, national revenues collected by the provinces are recorded in a separate, provincial budget and earmarked for local development funds.

Further complicating efforts to unify the management of government finances, provincial authorities open their own bank accounts at local branches of state-commercial banks.³⁴⁶ Out of these accounts, governors control government operations in their respective regions. Thus, provincial offices of MoF fall under the control of

³⁴⁴ Provinces have an incentive to “cook the books” when they surpass their revenue targets for the fiscal year. A large proportion of revenues collected above fiscal targets (50%) by law should be remitted to the national treasury. In practice, virtually none leaves the provinces. *Ibid.*, 9.

³⁴⁵ Although in surplus, these three provinces failed to meet their revenue targets. World Bank, International Monetary Fund, and Asian Development Bank, “Lao PDR 2002,” 51.

³⁴⁶ In Savannakhet province, for example, various government administrations open a total of 19 bank accounts, in three different banks. *Ibid.*, 39. The lack of a single network of treasury accounts attests to the underdeveloped nature of the financial system.

governors, who decide on personnel issues and salaries of public officials in their locality.

With authority to speak for the government, provincial governors greatly influence the assessment and collection of national revenues, whether customs duties or other applicable taxes. As a result, national rules and guidelines continue to be interpreted to suite the local context. In its promotion of local self-reliance, for example, Instruction 01/PM may have exacerbated these weaknesses of tax administration. The government lacked clear guidelines on how to interpret the Prime Minister's order. Interpretations and applications of the instruction vary across the country.³⁴⁷ In many instances, local authorities have used the instruction as a pretext to increase their hold on government revenues. Empowered by this instruction, local officials have effectively increased revenue collection at the village level. Since 2000, when the instruction was first promulgated, remittance of government revenues to the central treasury has decreased.³⁴⁸

While MoF actively monitors the government's finances in the capital, their power of oversight quickly disappears at the local level. According to the government's formal organization chart, field offices of the customs and tax departments report to the vertical hierarchy of MoF. In practice, horizontal authority of the provinces control fiscal management, irrespective of national rules to the contrary. Outside the capital, tax offices of MoF fall under the Provincial Offices of Financial Services, which control all public expenditure and revenue management at the local level.³⁴⁹

³⁴⁷ Stoop, "Fiscal Centralisation and Decentralisation," 21.

³⁴⁸ *Ibid.*, 9.

³⁴⁹ For the organizational structure of the Ministry of Finance, see Figure A37, Appendix. The field offices of MoF play a double role in the provinces. Besides managing national revenues and expenditures, they also manage their provincial equivalence under the direction of governors. In practice, all fiscal management in the provinces falls under local control. Provincial authorities determine working conditions and salary scale for staff of field offices of MoF.

With limited authority in the provinces, the central government struggles to control discretionary spending. Attempting to address this issue, the central government recently instructed that only projects included in the annual PIP and approved by the National Assembly should be funded from the budget.³⁵⁰ Still, provincial and district officials routinely authorize local spending on unapproved expenditure items. This discretionary power of local governments contributes to soft budget constraints and uncontrolled spending. Revenues designated for the central budget usually never leave the provinces. Instead of remitting surplus revenue to the central level, provincial authorities usually disperse the windfall on local projects not approved by expenditure plans.

The Lao government lacks a clear and appropriate division of fiscal roles and responsibilities. Overlapping and conflicting jurisdictions between vertical and horizontal lines of authority have limited the scope of fiscal reforms. At the institutional level, financial laws and regulations need a clearer distinction in roles and responsibilities of the various levels of government. In tax administration, international advisors recommend improved reporting, transparent accounting, and adequate controls on the use of government funds.³⁵¹ Capacity remains weak, requiring improvements to strengthen internal controls, inspections, and audits at different levels of government.³⁵² No doubt partly true, these administrative and fiscal reforms remain far from complete without a broader overhaul of inter-government relations in Laos.

At the borders, meanwhile, customs regulations have longed lacked uniformity across the provinces. Possibly unique among modern states, the Lao PDR lacks

³⁵⁰ World Bank, International Monetary Fund, and Asian Development Bank, "Lao PDR 2002," 81.

³⁵¹ Stoop, "Fiscal Centralisation and Decentralisation," 7.

³⁵² *Ibid.*, 8.

centralized control over customs collection. Again, provincial authorities enforce national policies at their own discretion. As a consequence of this predicament, seldom do national customs revenues make their way to the capital. Although technically under the supervision of central authorities of MoF, customs officials receive local salaries and rarely enforce national regulation to the detriment of local interests. Frequent conflicts of interests between central policy and local prerogatives usually resolve in the latter's favor. In many instances, provinces compete with one another for import transit fees and frequently grant arbitrary tariff exemptions to promote investments in their respective regions. Attempting to unify customs regulations, the donor community continues to advise the central government on ways to streamline customs procedures. With donor assistance, the amount of paperwork to clear customs has reduced significantly. Still, provinces value categories of imports differently, allowing importers to shop between entry points.³⁵³ Fiscal discretion among the provinces prevents the development of a unified economic space. This situation intensifies economic competition among the provinces in a struggle for scarce sources of investment. To promote investment in their regions, governors prefer to grant exemptions rather than enforce a strict tax regime.

In this fragmented fiscal structure, improvements in fiscal management have come slowly, intermittently, and sporadically—to the frustration of international economic advisors in Laos. According to many observers, the central government and MoF lack the capacity to monitor the performance of tax collection by provincial authority.³⁵⁴ Studies of reforms at the Tax and Customs Departments suggest the need to establish a national tax administration, an expanded Tax Department with qualified personnel, and clear mandates to steer, monitor, and evaluate tax administration

³⁵³ Sida, "Financial and Administrative Systems," 24.

³⁵⁴ Ibid.

nationwide.³⁵⁵ International advisors suggest the need to centralize all areas of tax administration: from tax registration, filing/payment, control/audit, to enforcement and appeal. They emphasize a movement towards a concentration of tasks, creation of strong centers of competence, and reduction of redundant and inefficient work. Essential to this rationalization, salary and personnel issues (for customs and national tax staff) require strong vertical (i.e., central) lines of control. These fiscal reforms entail building a national customs and a unified tax administration, with strong vertical lines of control.

Revenue Restructuring and Collection

The current tax system in Laos identifies two broad categories of taxpayers, depending on their income (for individuals) or turnover (i.e. sales for businesses).³⁵⁶ Local governments impose taxes on small businesses and individual taxpayers. With this fiscal power, provincial authorities routinely grant exemptions and preferential treatment to investors, at times in competition with other provinces. Particularly with the turnover tax, provincial authorities offer a wide variety of exemptions for development purposes, and businesses have exploited the loopholes with calculating shrewdness.³⁵⁷ In many instances, medium-sized companies register as small businesses, even though their sales turnover classifies them at the higher tax-bracket. Categorized in the local tax system, many businesses escape higher taxes and stricter regulations by MoF. Under the jurisdiction of local tax administration, businesses negotiate their tax liability without having to present records of sales required of

³⁵⁵ Swedish International Development Agency, "Swedish Support to Strengthen Fiscal Management in Lao PDR: Capacity Study on Organization and Management Issues of the Tax Administration," (Vientiane, Lao PDR: SIDA, Ministry of Finance (Lao PDR), 2003).

³⁵⁶ For a breakdown of taxpayers, see Table A21, Appendix.

³⁵⁷ These exemptions include imports of goods for the agricultural sector, air transportation, medical use, banking, education services, and a variety of other goods recognized for development purposes. See Swedish International Development Agency, "Tax Policy and Administration Issues," 10.

medium and large businesses.³⁵⁸ The lack of transparency in the system results directly from local discretion in tax administration. Moreover, the absence of a national tax administration reduces accountability, while contradictory lines of administrative responsibility weaken fiscal controls. Because of the system's perceived lack of fairness, many taxpayers fail to report their tax liability accurately, if at all.

The Ministry of Finance fails to define the limits within which provinces can create and manage local taxes and other revenues. The central government makes no clear distinction between local and national taxes or simply fails to enforce uniform standards throughout the country. As a result, provincial authorities collect and spend most taxes in their respective locales.³⁵⁹

Part of the problem lies in the confusion over national and local taxes. A clear distinction between the two does not exist. Efforts to clarify the distinction have compounded problems of enforcement and regulation. The infamous Prime Ministerial Decree 192 complicated fiscal management, where conflicting interpretations of the decree's intent continues to hamper vertical and horizontal coordination between MoF and the provinces.³⁶⁰ This decree was intended to clarify national revenues from local ones but, in reality, created further confusion of tax administration. For some tax categories, the distinction between national and local taxes is far from clear, allowing even more local discretion in fiscal matters.³⁶¹

³⁵⁸ Up to mid-2003, tax officials have redefined some 1900 taxpayers from the lower to higher tax bracket, under central government oversight. Swedish International Development Agency, "Strengthening Fiscal Management in Laos," 17.

³⁵⁹ According to some tax advisors, national taxes should ideally include customs duties, excise, turnover/value added tax, profit tax, tax on dividends paid, and salary tax. Local budgets should comprise local taxes and fees, a portion of national taxes, and funding from the national budget for government service delivery at provincial and district levels. Stoop, "Fiscal Centralisation and Decentralisation," 5.

³⁶⁰ Government of Lao PDR, "Decree on the Implementation of the State Budget Law, No. 192/Pm."

³⁶¹ For example, national revenues ostensibly include import duties, special export levies, direct and indirect taxes, and "all kinds of fees," among many others. The provinces have authority to collect a

Nor do clear rules and regulations ensure compliance by local officials. The central government lacks the capacity to enforce central directives uniformly across the country. This problem transcends the mere codification of rational rules and regulations, which in the context of weak enforcement matter little. Regional interests continue to hinder government efforts to rationalize the country's public administration. As a result, the tax system is riddled with exemptions and varying tax rates that lack uniformity across the country.³⁶²

The most egregious flaunting of national directives takes place at the village level, where financial units collect taxes in consultation with district authorities.³⁶³ As part of the overall village administration, members of these financial units do not qualify for government salaries but, instead, keep a percentage of their collected taxes. Nor do local remittances of central revenues follow standard procedures, either within or across provinces.³⁶⁴ Inconsistent interpretations and arbitrary legal enforcement notwithstanding, new fiscal rules, especially Instruction 01 and Decree 192, appear to have one outstanding commonality: increased tax collection at the village level.³⁶⁵

Because village administrations depend almost entirely on their ability to tax peasants, local officials have tended to view recent fiscal reforms from the capital as a

variety of other direct and indirect taxes. In the absence of clear rules, regulation, and central enforcement, provincial officials have interpreted the decree to their perceived self-interest.

³⁶² Supported by the donor community, various programs of tax and customs reform focus on the structure of taxes, procedures in their collection, and computerization of fiscal management. Despite efforts to improve tax and customs collection, revenue performance continues to fall below expectations. Sida, "Financial and Administrative Systems," 24.

³⁶³ Currently, village authorities have responsibility for collecting the following taxes: land tax, presumptive (i.e. turnover) tax for small businesses, taxes on sales of animals, gun permits, and other taxes on consumption goods. Patrick Stoop, *Assessment of Current Decentralization* (Vientiane, Lao PDR: GPAR and UNDP, 2002) 21.

³⁶⁴ As outlined in Instruction 1823 from MoF, village financial units can keep revenues according to the following formula: 4% of revenues for villages in urban areas, 6% for villages in urban periphery, 10% for rural villages, and 15% for remote villages. Sekong province uses these percentages: 10, 15, 20, and 50 respectively. Ibid. 22.

³⁶⁵ Ibid. 22-3.

call for more vigorous revenue collection at the village level. These revenue increases derive, in part, from land taxes, whose collection surged over 100% in some areas. Associated with this spirited attack on the natural economy, the government's new land use policies, based on regulating land titles, have attempted to expand the market for formal property rights.³⁶⁶ Concomitantly, access to land titles guarantees greater membership in the tax state. Although revenues collection has suffered from poor administration and declined in recent years, tax collection in the villages has surprisingly increased.

Management of State-owned Enterprises and Banks

The management of state-owned assets indirectly affects fiscal crises. To strengthen the broader fiscal position, the IMF has advanced programs to reform the country's state commercial banks (SCBs) and their associated state-owned enterprises (SOEs). Without strict oversight, international advisors warn, operating expenses at these government businesses pose the biggest threat to fiscal sustainability in the medium term.³⁶⁷ Lao banks are technically insolvent, lacking prudent credit management and strong regulation. Acting at the central bank, the Bank of Laos regulates the financial system and continues to follow a policy of directed lending, in which government priorities, rather than sound assessment of financial risk, determine credit worthiness at the state-owned banks. Consequently, non-performing loans at state banks may reach as high as 90% of all outstanding debt. Three SCBs dominate

³⁶⁶ Property rights in Laos are murky. Like all socialist countries, land in Laos formally belongs to the state, which then leases out property for development purposes. In a February 1988 speech, President Kaysone clarified the meaning of landownership rights in Laos: "Under our new system, the entire land is the common property of the entire society with the state as the representative." Quoted in Evans, "Planning Problems in Laos," 108. In reality, abundant rural farmland belongs to those willing to stay and develop its agricultural potential. Only in the more populated urban areas are rights to property more stringently enforced. AusAid and the World Bank have developed land titling programs to help the government create a market for formal property rights.

³⁶⁷ World Bank, International Monetary Fund, and Asian Development Bank, "Lao PDR 2002."

the financial system and account for almost three-quarters of all banking assets.³⁶⁸

Responsible for 80% of these deficient loans, SOEs survive off loose credit policies, rather than operational self-sufficiencies based on the profit motive.³⁶⁹

Like other communist states, the Lao PDR has long engaged in direct production of economic output. Since the reform period in the early 1990s, the government has drastically reduced the number of state-owned assets. At present, the central government directly runs 34 state-owned enterprises and collaborates in eight joint ventures.³⁷⁰ An obstacle to more far-reaching reforms, provincial control of another 59 SOEs guarantees the continuation of fiscal crises. Exhibiting a strong presence in many areas of local governance, provincial governments figure prominently in the financial distress of state-run businesses. Many SOEs, mainly at the provincial level, suffer from weak governance oversight, poor financial reporting, and a lack of proper accountability to the central government. Most SOEs pay taxes, and efforts are underway to transfer the largest SOEs in the provinces to central oversight under the large taxpayer unit, where tax liabilities formerly under local control would enter the central treasury directly.

At the provincial level, two SOEs account for half of all outstanding loans, Phoudoi and DAFI, military conglomerates made powerful through their regional

³⁶⁸ These dominate banks are Banque pour le Commerce Extérieur du Laos (BCEL), Lane Xang Bank (LXB), and Lao May Bank (LMB). Another government-owned bank, the Agricultural Promotion Bank (APB), acts as a development bank and accounts for only 5% of total banking assets. Subject to policy lending in the agricultural and rural sectors, APB escapes stricter financial regulations that the Bank of Laos demands of the commercial banks. International Monetary Fund, "Select Issues (Sep 02)," 3.

³⁶⁹ International Monetary Fund, "Staff Report No. 05/08," 5.

³⁷⁰ Prior to market reforms in the early 1990s, the state sector enjoyed a virtual monopoly in the industrial sector and employed roughly 10% of the non-agricultural workforce. In the market transition, the communist rulers emphasized privatization of SOEs, and the government drastically reduced its direct involvement in economic output. Out of 640 SOEs in operation in 1989, only 93 currently remain fully state-owned, with 32 designated "strategic" and immune from privatization. With this downsizing, SOEs now account for about 15% of industrial output and less than 1% of the workforce. See International Monetary Fund, "Select Issues (Sep 02)," 5.

monopolies of the lucrative logging industry. Responsible for 40% of all non-performing bank loans, Phoudoi alone comprises 58 companies spanning travel, hotels, construction, logging, and other enterprises.³⁷¹ Guided by the international financial institutions, the government hopes to consolidate Phoudoi into nine holding companies through the sale of non-core assets.³⁷² As part of the general trend towards centralization of economic management, MoF recently took ownership of Phoudoi in 2001 and seeks to disentangle the financial accounts of the conglomerate's various units, in efforts to merge its core assets.³⁷³

In some key strategic areas, capital continues to be politically allocated, irrespective of locale. Nonetheless, the problem runs deeper in the autonomous provinces. While the central government more strictly oversees lending policies in the capital, oversight and enforcement of lending policies diminish outside Vientiane. Overall, reforms in the banking and enterprise sectors to limit the growth of non-serviceable debt require an overhaul of inter-governmental relations, stronger control and supervision by central authority, and reduced autonomy of the provinces.

Central Strategies for Fiscal Control

The current tax system performs below expectations. Tax evasion runs high. Across the provinces, tax exemptions reduce overall compliance, by distorting taxpayer incentives to abide by formal regulations. Moreover, local hoarding of central revenues reflect the overall lack of transparency and accountability in tax administration. While some reforms call for strengthening central authority at the expense of local discretion, others (especially in tax collection and revenue management) attempt to circumvent provincial authorities all together. Foremost on

³⁷¹ Also known as Bolisat Phattana Khet Phoudoi (or Development Company of Phoudoi district), Phoudoi operates out of central Laos.

³⁷² International Monetary Fund, "Select Issues (Sep 02)," 10.

³⁷³ Ibid.

this agenda is the need to define – and thus limit— the powers of governors in fiscal management. The following section discusses three current strategies: (1) direct tax collection by the central government, (2) a value-added tax to force compliance national standards, and (3) super-regions to usurp fiscal independence of the provinces.

In the major urban centers, MoF has established a Large Taxpayer Unit (LTU) to streamline and centralize tax collection of medium and large businesses. Taxes collected through these units enter the national treasury directly. Located in the large urban areas, large businesses pay taxes directly to MoF, effectively cutting off some provinces from fiscal control of a major source of revenues. Efforts to establish these units nationally across all provinces have met with resistance from the provinces, which unenthusiastically welcome the surrender of locally collected, state taxes to the center.

In light of the many tax distortions, international advisors have pushed the Lao government to introduce a value-added tax (VAT) to replace the current turnover tax, a source of major exemptions. If properly implemented, the VAT may overcome fiscal independence of the provinces by reducing the scope of arbitrary tax regulations now controlled by governors. Also known as the general system of tariffs, a VAT levies a charge on all goods and services at each point of sales. Although similar to the turnover tax in targeting business sales receipts, the VAT restricts the number of possible tax rates, usually in essential food and agriculture. In streamlining revenue administration, its single tax rate facilitates compliance while limiting the scope for exemptions.³⁷⁴ By reducing tax distortions, the VAT—in the most optimistic of

³⁷⁴ The VAT improves transparency by placing the onus of record keeping with the taxpayer. Provided they retain records of their sales transactions, VAT taxpayers, except for final consumers, can claim a deduction on their VAT purchases. Adopted in many countries, the VAT is recognized as a fair and effective consumption tax. Seen as part of an overall fair and efficient tax system, the VAT also contributes to a strong business climate to attract foreign investments. See International Monetary Fund,

scenarios— increases taxes and offsets revenue losses anticipated from forced tariff reductions in 2008. Due in part to the intransigence of provincial authorities, the VAT has proved difficult to implement, and its successful introduction looks uncertain.³⁷⁵

In the meantime, central government officials have proposed another strategy to usurp the financial powers of provincial authorities. In the capital, tax advisors and officials at MoF toss around the idea of creating super-regions, encompassing several provinces, as a new tier of government to control tax administration. Officials justify this new concentration of fiscal authority from the point of view of staffing. By all estimates, MoF is understaffed and lacks qualified personnel to administer its tax regime. Moreover, the location of staff in no way corresponds to potential for revenue collection. For example, tax officials in the capital city collect about a third of all local taxes, as well as all central government revenues. The average tax official in Vientiane processes 375 taxpayers. In contrast, the smaller provinces, such as Phongsaly and Saravane, process around only 30 taxpayers per tax official.³⁷⁶ Moreover, districts and villages administer an overwhelming number of individual taxpayers, which bring in only 5% of all tax receipts.³⁷⁷ Even though local officials have collected more revenues, the meager proceeds from village taxation, at only 2-3% of total government income, hardly justify the cost of disrupting the natural economy.³⁷⁸ Unless MoF re-assigns staff to monitor taxpayers by their capacity to pay (usually in urban centers), provincial governors and their horizontal lines of control at district and village levels

"Strengthening Fiscal Management: Understanding Tax and Customs Administration Reforms," (Vientiane, Lao PDR: IMF, 2002).

³⁷⁵ When the VAT takes effect, now slated for 2006 at the earliest, the turnover tax will be abandoned. Swedish International Development Agency, "Tax Policy and Administration Issues," 25.

³⁷⁶ Swedish International Development Agency, "Strengthening Fiscal Management in Laos," 16.

³⁷⁷ *Ibid.*, 23.

³⁷⁸ Stoop, *Assessment of Current Decentralization* 23.

will continue to view fiscal reforms solely in terms of increasing revenue collection from the easiest targets, village peasants.

The current, regressive tax regime fails to make good use of scarce government resources. Because tax officials remain geographically scattered throughout the countryside, efforts to concentrate resources in the large urban areas may prove more cost-effective in the long-term. By targeting business in the productive urban centers, MoF can make better use of scarce staff. A draft law on tax management has considered such a possibility of concentrating fiscal control. In consolidating fiscal tasks to fewer provinces, this radical strategy would effectively reduce the number of subnational units of government. Upon careful review and debate within the Central Committee, however, provincial officials effectively watered down the rule's enforcement mechanism and delayed any final decision to enact changes.³⁷⁹ More a planning fantasy than feasible solution, the idea of super-regions lacks broad-based political appeal outside Vientiane. Central government officials at MoF have expressed the desire to consolidate tax and fiscal authority but resigned themselves to a slow and gradual reform program that recognizes and respects the enduring strength of provincial officials in all aspects of local governance.

The possibility of central authority bypassing horizontal controls of national revenues collected locally, for the moment, remains political untenable. Since 2000, the government has lost more control of revenue collection and cash flow management to the provinces, which exert tremendous influence over the field offices of tax, customs, and treasury administration. Coupled with failed efforts to expand the Large Taxpayer Unit, the weakening of central control over fiscal management imperils macroeconomic stability, compounding the government's perennial fiscal crisis. Moreover, the loss of fiscal control limits the central government's role of

³⁷⁹ Personal communications with tax officials and advisors at MoF, March 2005.

redistribution to redress regional inequalities. As a consequence, poorer provinces and districts have suffered from major cash flow problems, such as delays in salary payments for teachers and other civil servants working in remote, poorer areas of the country.³⁸⁰ In all matters of governance, provincial authorities continually re-assert their horizontal authority over vertical incursions of central line ministries. This autonomy hampers reforms in other areas of the country's modernization.

The Quest for Hard Budget Constraints

A hallmark of socialist production, SOEs in Laos exhibited "soft budget" constraints that lacked a profit-making rationale.³⁸¹ These soft budgets also apply to the public household as well, in which negotiations by political elites, rather than the revenue limits on spending, determine the scope of fiscal crises. To improve hard budget constraints that better matches revenues with expenditures, fiscal modernization in Laos would require the reduction of provincial authority, vis-à-vis central government. This section surveys the trend towards decentralization and then develops an analytical model to examine the claim that centralization provides an appropriate policy at Laos' level of development.

Fiscal Decentralization in International Perspective

The experience in Laos presents a clear-cut case where market liberalization has been followed by very statist, centralizing policies, reinforcing Karl Polanyi's claim that the free market demands strong state regulation.³⁸² While encouraging a

³⁸⁰ Stoop, "Fiscal Centralisation and Decentralisation," 10.

³⁸¹ As a result, chronic shortages of resources, as Kornai perceptively captures, plagued the entire system. In contrast to the capitalist economy, marked by demand-constraints, socialist production ran into perennial supply constraints, accounting for its low level of efficiency. See Kornai, *Socialist System*.

³⁸² Written during the World War II era, Karl Polanyi's Karl Polanyi, *The Great Transformation*, 1st Beacon paperback ed. (Boston: Beacon Press, 1957). presents a compelling argument on the economic process of modern civilization. Polanyi makes several important contributions to the study of political economy. First, he describes an economic system as embedded in a society and reflecting the social values of that society. Second, this social construction of markets reveals the fallacy of the idea of a

nascent private sector, the government, under the guidance of international institutions, has seen fit to usurp the authority of provincial governors.

Despite evidence of centralization, many in the development community in Laos promote policies of decentralization. Donors in Laos, as elsewhere, link the long term benefits of good governance, local empowerment, and market exchange with the broad push for decentralization in the public sector. Perhaps in ignorance of the country's history of devolution, international advisors routinely promote the general idea of decentralization, as if the edifice of central planning required dismantling.

The campaign for decentralization also appears to misrepresent fiscal policies as well. Prepared for the Swedish International Development Assistance and the World Bank, a recent report entitled *Fiscal Decentralization in the Lao PDR: principles, practices and prospects in 2001* describes the evolution of the current revenue-sharing scheme and efforts to reform tax collection. However, the reader is at pains to see where an actual fiscal decentralization component fits into current reform efforts.³⁸³ Recent reforms have begun to address the inefficiencies in the tax sharing system, which donors continue to assist with technical expertise. Yet, coaxed in the language of decentralization, programs to improve tax administration takes on new dimensions—divorced from any economic rationality—and becomes part of a development discourse incompatible with political realities.

Various development reports on Laos attempt to portray a country removing the shackles of communist central economic planning to embrace free market

self-regulating market. Third, the expansion of markets creates a countermovement which checks (for society's self-protection) the deleterious effects of markets.

³⁸³ Francois Vaillancourt, "Fiscal Decentralization in Lao PDR: Principles, Practices and Prospects in 2001," in *Paper prepared for the Swedish International Development Agency (Sida) to support the Public Expenditure Review of the World Bank* (Vientiane, Lao PDR: Sida, 2001). In addition, Vaillancourt rightly notes that all tax revenues are national but nonetheless states that a centralization of tax collection "is a major weakness and an obstacle to eventual meaningful decentralization" (p. 21).

liberalism and decentralization of economic control. In this depiction, a decentralization of economic control, in freeing up prices, also includes the whole withdrawal of the state from economic management. As this chapter demonstrates, fiscal restructuring of the Lao state actually demands more central control of the budgetary process, tax management, and revenue collection. Without these reforms, fiscal crises will continue to limit the capacity of the national government to manage the market transition.

Around the world, fiscal decentralization, as part of the overall reduction of the public sector, figures prominently in development thinking.³⁸⁴ To some, the decentering of government authority asserts a worldwide trend, to others a larger “paradigm shift” in tackling underdevelopment. Against this seeming trend, the market transition in Laos has required a strengthening of central administrative planning in fiscal matters. However, centralization of fiscal control is not an isolated case of peripheral socialism in the process of restructuring. Insofar as modernizing states elsewhere confront the same challenges to development observed in Laos, government centralization provides an appropriate development strategy to rationalize and consolidate a functioning public economy.

As the experience in Laos demonstrates, without complete control of national revenues, the central government cannot increase the scope of tax collection. If the Lao government hopes to improve general fiscal management and reduce fiscal crises, political and economic reforms must curb the economic powers of the provinces. Currently, the central government controls neither the execution of fiscal policies nor the management of revenue collection. A clear distinction of national versus local revenues does not exist, and national taxes collected in the provinces usually fail to

³⁸⁴ Paul Smoke and Yun-Kwan Kim, eds., *Intergovernmental Fiscal Transfers in Asia: Challenges for the Future* (Manila: Asian Development Bank, 2002).

find their way into the central treasury. As long as provincial authorities assert autonomy over national directives delegated through vertical line ministries, central efforts to stabilize the macro economy (through monetary and fiscal instruments) will continue to meet with limited success. A straightforward economic model helps to prove the point.

A.H.P. and Fiscal Policymaking in Laos

As seen from the fiscal side, market liberalization in Laos unequivocally demands administrative centralization. The analytic hierarchy process (AHP) model provides a useful way to analyze and quantify the costs and benefits of competing development policies. The model helps with decision making when participants cannot assign specific value or utility to particular decisions but can do more than just rank preferences.³⁸⁵ Because of the secretive nature of governance in Laos, this model provides a useful way to gauge decision making within the communist government.³⁸⁶ This section uses the AHP model to compare competing policies to reduce fiscal crises of the Lao government.

The Lao state is weak, and the transition from taxes on trade to direct taxes on income will strain the capacity of its tax administration. To improve fiscal management, reforms aim (1) to streamline, rationalize, and hence modernize procedures for tax collection; (2) to broaden the tax base by reducing exemptions and other tax distortions; (3) to control expenditure management at state-owned enterprises

³⁸⁵ As a broad method of measurement, AHP has been used as a tool in conflict resolution to evaluate the relative positions of interested parties. The method assumes that participants can “make pairwise comparisons of elements and state that one element is X times as desirable as a second one.” For an overview of AHP, see Iwan J. Azis and Walter Isard, “The Use of the Analytic Hierarchy Process in Conflict Analysis and an Extension,” *Peace Economics, Peace Science and Public Policy* 3, no. 3 (1996): 15.

³⁸⁶ As the name implies, the AHP method structures a decision problem into a hierarchy that reflects the complex relationship inherent in the situation. It entails arranging goals, attributes, issues, and stakeholders into a related hierarchical structure. See Thomas L. Saaty and Luis G. Vargas, *Decision Making in Economic, Political, Social and Technological Environments with the Analytic Hierarchy Process* (Pittsburgh, PA: RWS Publications, 1994) 2.

and banks. In addition, the Lao government's fiscal position also depends on continued inflows of development assistance and foreign aid.

Based on the above discussion of fiscal sociology, an AHP model of fiscal crises includes a series of three objectives, four targets, and three strategies. See Figure 12 below. This model is based on my own perceptions of the likely options available to government officials. Because of difficulty in direct access to government officials, I have substituted my estimates of the preferences and weighting of leading public officials. For making these estimates, I rely on information from the formal interviews conducted during my research in Laos.

Overall, the reduction of fiscal crises in Laos requires sustained economic growth, a broadened tax base, and controls on expenditures. To achieve these objectives, four targets have to be realized: (1) sustained inflows of development assistance and foreign investment, (2) reduction of non-performing loans from state-owned enterprises, (3) efficient tax administration and better enforcement of fiscal rules, and (4) the rule of law. To meet these targets, the government must follow strategies to:

- attract foreign direct investment (FDI);
- sustain overseas development assistance from donor countries (ODA);
- implement Value-Added Tax to simplify tax collection (VAT);
- expand Large Taxpayer Unit (LTU);
- centralize tax administration, customs administration, and treasury management (National);
- establish strong central oversight of SOE management (SOE); and
- create super region encompassing several provinces (Super).

In order to realize the above strategies effectively, the Lao government can pursue one of three plausible policies: (1) the international trend towards decentralization, (2) the status quo where governance is negotiated within the Central Committee, or (3) a developmentalist path towards strong centralization. After several runs of the model, it is possible to estimate what path is most likely to be taken. From simulations of the model on Superdecision software, option (3) of centralization

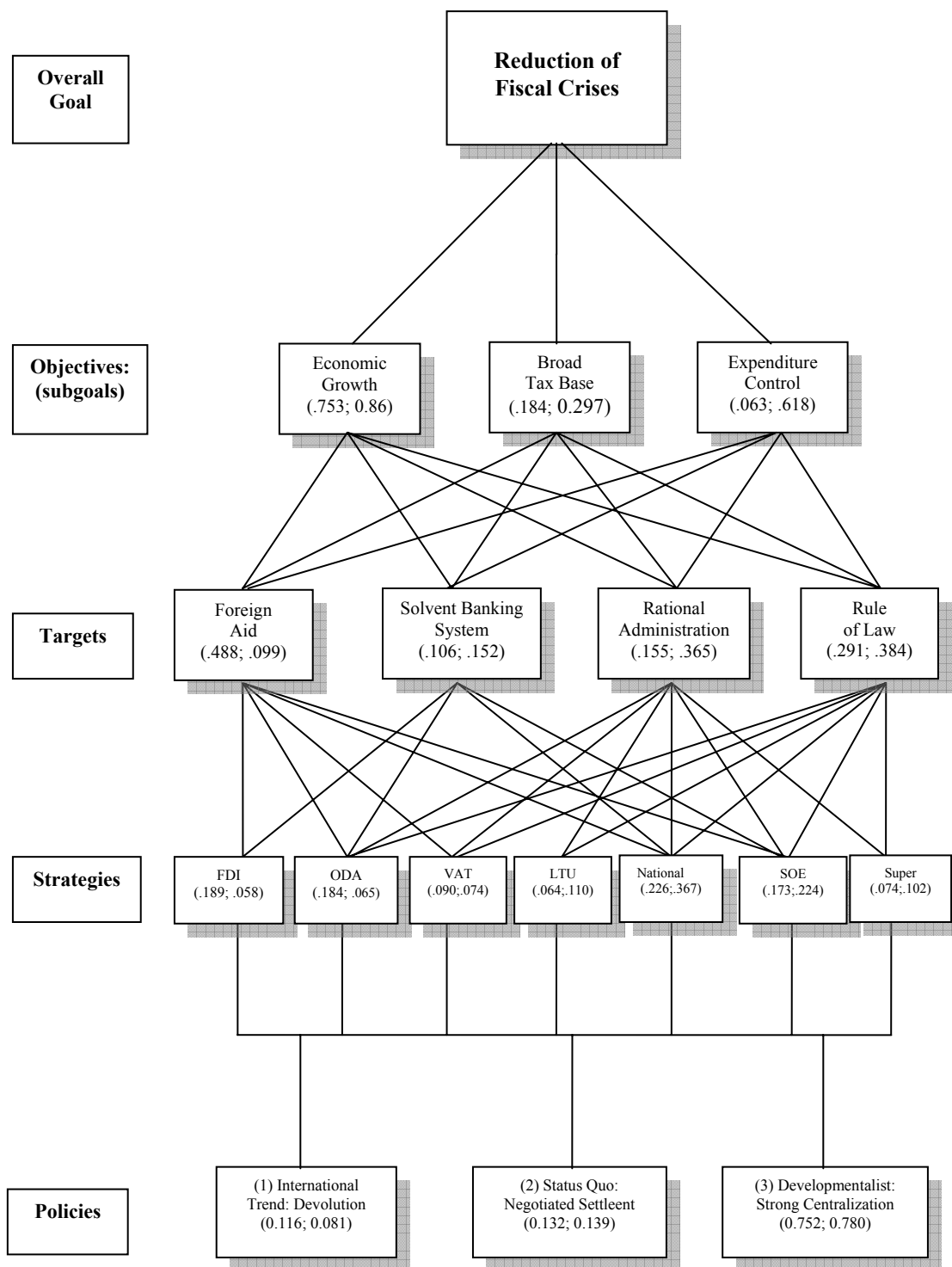


Figure 12. AHP Model for Reduction of Fiscal Crises in Lao PDR

Note: * Values in parenthesis indicate eigenvalues (or priorities) associated with the AHP (initial value; robust values from sensitivity analysis).

offered the best possible path to reduce fiscal crisis, as expected. These results are also robust. Varying the relative importance of the three alternative objectives (subgoals), repeated simulations consistently produced data supporting policies of centralization. Normalized values for option (3) exceeded 0.7, while the status quo option (2) came up a distant second, with values in the range of 0.15-0.18. As the least feasible alternative, policies of decentralization placed third in all simulations. See Tables A25 and A26 in the Appendix.

As the simulation makes clear, centralization in the developmentalist mold of its East Asian neighbors offers the most appropriate response to Laos' economic underdevelopment. If hard budget constraints come from increasing financial accountability, in the execution of government budgets and the collection of state taxes, then fiscal reforms unequivocally require centralization. However, outright centralization remains a planning fantasy in Laos; and the above model fails to consider the costs of centralization.

Capturing the negative impacts of fiscal restructuring, a second AHP model helps to explain the difficulties of enacting centralization in communist Laos. See Figure 13 below. Broadly speaking, fiscal structuring has political, economic, and social costs. Economic modernization risks (1) provincial instability of disempowered governors, (2) economic decline from disinvestment, (3) revenue redistribution to the detriment of wealthier provinces, and (4) strong central oversight of once autonomous regions and population. The potential impacts of these risks include:

- a declining political commitment to the regime;
- a weakening of the patronage networks;
- various costs to the local economy;
- decline of economic activity;
- loss of local sources of revenues;
- higher tax burdens; and
- loss of local autonomy.

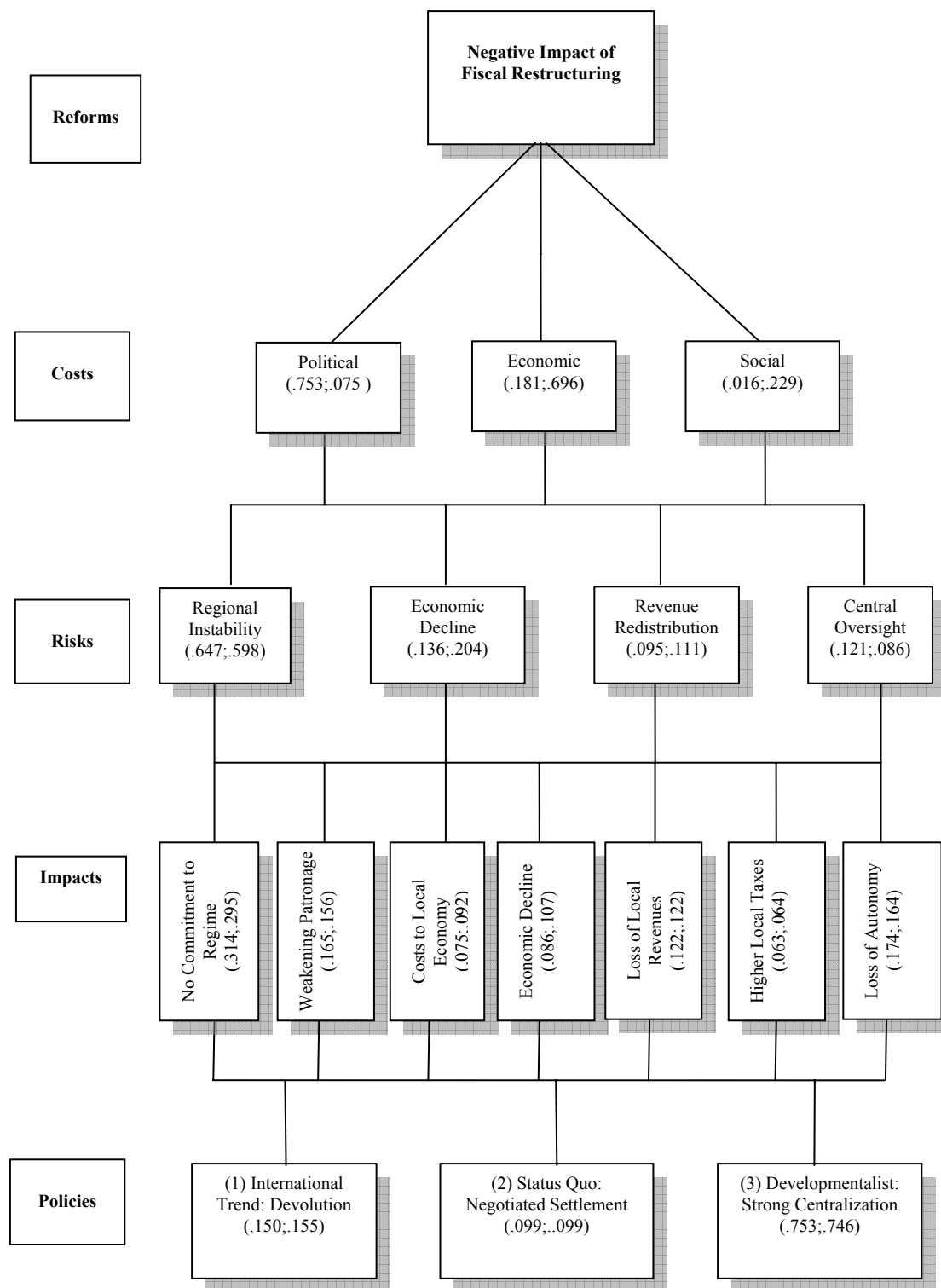
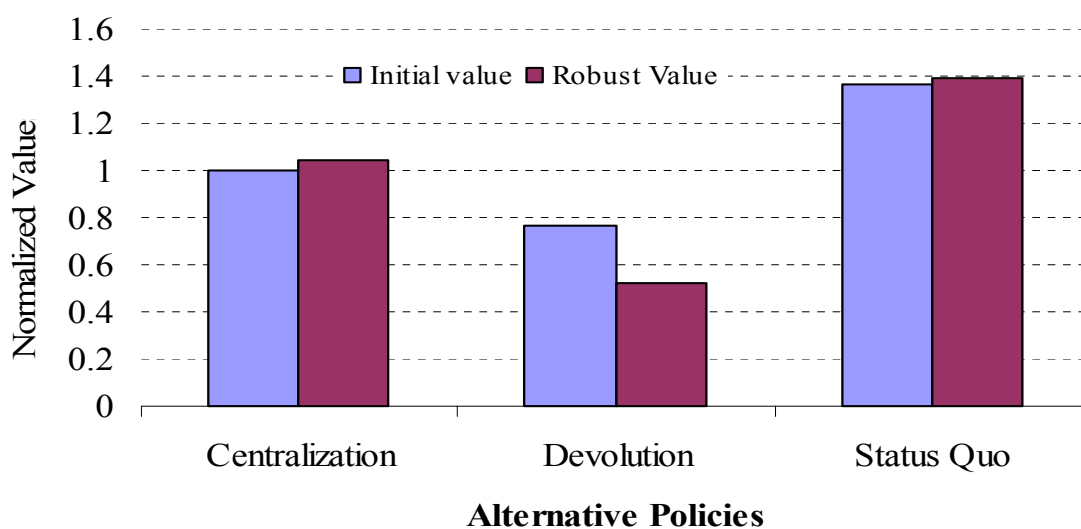


Figure 13. AHP Model of Negative Impact of Fiscal Restructuring

Note: * Values in parenthesis indicate eigenvalues (or priorities) associated with the AHP (initial value; robust values from sensitivity analysis).

The three possible policies remain the same: (1) decentralization, (2) status quo, and (3) centralization. From the perspective of modernizing elites in Laos, these costs may potentially outweigh the benefits of strong centralization policies, as the model suggests. Repeated simulations reveal that, from the standpoint of Lao officials, the centralization option (3) had the highest negative impact (normalized value of 0.76) when weighted against political, economic, and social costs. The decentralization scenario (2) ranks second with 0.15, while the status quo option (2) possessed the least negative impact (at 0.09). As with the previous results, these rankings proved robust upon close inspection. See Tables A28 and A29, in the Appendix.

A ratio of costs to benefits of the two models suggests, surprisingly, that the status quo option (2) may provide the most sensible path towards economic reforms. See Figure 14 below. Thus, while centralization provides the most appropriate policy of fiscal reforms, as the fiscal sociology above argues, the most likely scenario involves a negotiated settlement between provincial governors and modernizing



Source: Tables A30, A31

Figure 14. Comparison of Benefit-Cost Ratios of AHP Models

elites in the capital. There are several reasons why a cost-benefit analysis would produce this suboptimal economic result. First, the party may perceive that political, economic, and social costs of fiscal centralization are too high a price to pay for the country's development. Second, while centralization offers the most ideal option from a fiscal standpoint, political realities prevent a full embrace of fiscal rationalization. Third, the enduring powers of provincial governors make the radical break with traditional authority less politically feasible. Fourth, in attempting to sustain a consensus for reform within the party, government officials may encounter difficulty justifying a wholesale transformation of fiscal policies. Party hardliners have long resisted market reforms that usurp their long-held powers. Thus, a political consensus that moves the reform agenda forward cannot, in all likelihood, embrace centralization to the strong detriment of traditional sources of political and economic authority.

Given the cost-benefit analysis, the AHP modeling exercise captures some of the tensions of central-local relations and cautions against centralization as an unmitigated good policy of national development. To the extent that alternative policies and constraints closely mirror actual options of economic restructuring, this modeling exercise captures the general outlines of decision making alternatives for high-level government officials in Laos. In reality, governance reforms, bureaucratic rationalization, and the separation of party and state take place slowly and cautiously, as captured in the cost-benefit comparison. Into the near future, economic reforms will continue to be piecemeal, at times a constructive advance, other times a cautious retreat. Discussions with Lao authorities reinforce these views. In terms of the pace of economic restructuring, government officials emphasize a slow and carefully phased market transition that preserves a strong consensus for reform.

Even though the third model (on cost-benefits) shows that a full embrace of centralization would, at this time, not be politically tenable, challenges to fiscal

restructuring, nevertheless, equate with the struggle for centralization. As emphasized throughout this dissertation, economic modernization goes hand in hand with central control and regulation of the development process.

In summary, efforts to replace the expected revenue shortfalls all point towards fiscal centralization, which follows from the logic of territorial state control and administrative consolidation explored in the previous two chapters. The modernization of government administration in Laos requires centralized control over fiscally independent and politically autonomous provinces. Resistance to centralization remain strong, accounting for the slow pace of fiscal reforms. Nonetheless, the country's modernization demands fiscal reforms and structuring towards stronger central control and oversight. In creating the foundations of a market society and its national economic space, the Lao government continues to push for uniform economic regulation over regionally dispersed economies.

Modernizing States and Fiscal Control

In Laos, the quest for hard budget constraints resonates with the struggle to enforce central control and oversight of fiscal (as well as general economic) affairs. Experience of fiscal reforms in other countries also justifies the central push in Laos. Research into the budgetary process in some European countries discovers that centralized control over spending correlates with lower fiscal deficits.³⁸⁷ Thus, if governments take seriously the need to control the budgetary process and to mitigate fiscal crisis, then centralized control over spending priorities appears to reduce deficits by hardening budgetary constraints.³⁸⁸ In the absence of concentrated fiscal authority,

³⁸⁷ See Jakob De Haan, Wim Moessen, and Bjorn Volkerink, "Budgetary Procedures: Aspects and Changes. New Evidence from Some European Countries," (University of Groningen, 1997).

³⁸⁸ Strong central control over fiscal affairs in France and Germany have restricted budget deficits, while in Italy, loose expenditure management has, until recently, undermined prudent fiscal policies. See Juergen Von Hagen and Ian Harden, "Budget Processes and Commitments to Fiscal Discipline," *IMF Working Paper* 96/78 (1996).

constant bargaining over the budget contributes to soft budget constraints and larger fiscal crises than necessary.

In many areas of governance, provincial officials in Laos often fail to enforce fiscal policies and financial regulations in accordance with national directives. Although the Minister of Finance wields immense power as a high ranking member of the Central Committee, he holds equal rank with the 18 provincial governors, and his authority outside the capital depends of his relative position in the party hierarchy. Only a close analysis of the relative positions of party members provides clues to the effectiveness of national policies at provincial, and hence local, levels.

On-going struggles for centralized political administration and financial management present one of the major challenges to the socialist transformation in Laos. The fragmented nature of governance of this nominally communist regime offers a stark contrast to the experience of Soviet communism. While socialist regimes in Eastern Europe decentralized economic control to their political demise in the late 1980s, the Lao PDR, starting from de facto devolution, embraced a program of centralization in its market transition, not only in pragmatic response to the country's low economic base, but also as a defensive strategy of political expediency.

Laos is not an isolated case. For many developing countries struggling to cement the foundation of a market system, economic and administrative centralization may, in fact, hold the key to stronger economic growth and rising standards of living.³⁸⁹ If the international development community is serious about promoting national economic wealth in poor countries, there has to be a larger effort to recognize the central role of national governments in overall economic development. The highly

³⁸⁹ Research shows that the fiscal strength of states plays an important role in economic development. See J. W. Meyer and M. T., eds., *National Development and the World System* (Chicago: Univ. of Chicago Press, 1979), R. Rubinson, "Development, Government Revenue, and Economic Growth, 1955-70," *Study of Comparative International Development* 12 (1977).

regionalized and fragmented nature of Laos's political economy may describe the situation in other parts of the world. For many developing countries carved out of colonial territories, a remote central government struggles to legitimize political rule over a disparate, and sometimes hostile, countryside. Like their European predecessors before them, these modernizing states strive for political and economic centralization, in a continuing quest for legitimation and accumulation. However, western development policies, drawn from the liberal tradition of the Enlightenment, are naturally reluctant to embrace central, concentrated authority.

To the extent that the market transition in Laos provides any broad generalizations for other post-socialist or developing countries, policies of economic consolidation and expansion of the public budget may prove more appropriate for their level of development than policies of public decentralization and fiscal contraction promoted by the international financial institutions. Communism aside, the market transition in Laos is not an exceptional case. There are broader lessons to be drawn from the market transition in Laos, especially in regards to central-local relations. For many modernizing states, centralization of fiscal, if not altogether political, authority may offer the most sensible path toward nationally-guided development. These reforms do not come without strong resistance from traditional sources of political authority, as the AHP modeling exercise reveals.

In opting for market freedom in the absence of political pluralism, communist rulers in Laos seem to be following the successful example of their East Asian neighborhoods rather than the post-socialist debacle in Eastern Europe. Modernizing elites in many parts of East Asia have developed their country under a developmentalist model that values economic growth with social stability, while relying on sustained general economic growth for political legitimacy.

Chapter V

THE ROAD TO SERFDOM AND BACK: THE PROCESS OF MARKETIZATION IN LAOS

In surveying the fiscal crisis of the Lao state in detail, the first section describes the allocation of public expenditures and the tax structure. The second section explores fiscal reforms in the budget planning process, tax and customs administration, and deficit management. As with challenges of administrative restructuring discussed in the previous chapter, entrenched political interests at the local level continue to hinder fiscal reforms and the rationalization of financial management. Success in fiscal reforms, thus, requires strong central control over regionally autonomous and fiscally independent provinces, and the third section describes several strategies explored by the Lao government. The fourth section places fiscal reforms in international perspective and develops an analytical hierarchy model (AHP) to examine competing policies of fiscal management. In the conclusion, I claim that the fiscal experience in Laos is not an isolated circumstance of peripheral socialism, but rather a general case of a post-colonial state struggling to modernize a country in the face of traditional sources of political and economic authority.

Communism and the Road to Serfdom

The road to communism was paved with intellectual fervor. Nineteenth century socialist thinkers from Saint Simon to Engels boldly envisioned a socialism that would transform governmental authority dominating people to a simple bureaucratic administration of things.³⁹⁰ In Engel's optimistic assessment of the possibility of socialism, "The anarchy of the market is replaced by conscious social organization...

³⁹⁰ Casals, "Syncretic Society," 249.

The laws of society come under man's control, and men, for the first time, can make their own history."³⁹¹ In the chaos and waste of market capitalism, each person unconsciously pursues his own self-interest, while no one consciously plans for betterment of the collective whole. According to Karl Marx, the dialectical unfolding of history leads to "replacing the domination of circumstances and chance over individuals by the domination of individuals over chance and circumstances."³⁹² In his materialist conception of history, human development culminates in the end of history, with the transition from capitalism to communism. This higher form of social organization resolves the inner contradictions of capitalism. A socialist revolution would redistribute the wealth of capitalist production, thus liberating an exploited proletariat and emancipating all of humanity on a democratic road to socialism. Marx famously predicted "from each according to his ability to each according to his needs." As prophesized in the *Manifesto of the Communist Party*, this utopia would contain "an association in which the free development of each will be the condition for the free development of all."³⁹³

Where Marx optimistically asserts that "Democracy is the road to socialism," libertarians defiantly respond that capitalism offers the road to democracy. A chief proponent, Friedrich von Hayek, has long countered that the market is unknowable in its chaotic whole and, therefore, cannot be directed to achieve specific equality for specific people. In *The Road to Serfdom*, he offers a liberal defense of the free market.³⁹⁴ He predicted that socialism would assure the enslavement of the masses, the

³⁹¹ Friedrich Engels, *Socialism, Utopian and Scientific*, trans. Edward Aveling (New York: International Publishers, 1968)?

³⁹² Quoted in Sen, "Development: Which Way Now?" 15.

³⁹³ Marx and Engels, "Manifesto of the Communist Party," 491.

³⁹⁴ Friedrich A. von Hayek, *The Road to Serfdom*, 50th anniversary ed. (Chicago: University of Chicago Press, 1994). In this classic and highly influential book, Hayek explores the contradictions between individual freedom and collective organization, contrasting markets and states in mythical terms and

destruction of advanced civilization and human progress, and economic involution of impoverished states on their regressive road towards feudalism. Serfdom, he warned, awaited those societies undertaking the socialist experiment, however righteous their cause of redistribution, their quest for social justice, their vision for economic equality, or their hope for a better humanity. Unfreedom in the economic realm eventually obstructs freedom in the political sphere. In the true libertarian sense, Hayek confidently champions the belief that “free markets make free men.” Freedom in the economic realm presupposes freedom in all other spheres of human exchange and value.³⁹⁵

These compelling ideologies shaped politics in the twentieth century and still frame controversies over the appropriate role of government in the economy.³⁹⁶ By the early 1990s, the collapse of the communist second world contributed to a shift in political economic thinking about the role of states in relation to markets.³⁹⁷ Currently, the socialist transformation in Laos presents similar competing world views about the appropriate role of government in the economy. In the context of these debates, this chapter examines the process of marketization in Laos.

Summarizing the findings from the previous three chapters, the first section documents the history of central-local relations of the Lao government, whose

posing the debate in stark extremes: democracy or communism; central planning or free market forces; and the rule of law or arbitrary decree.

³⁹⁵ As Bell notes, “The corollary assumption, operating from economic deterministic premises, is that free markets thus create free men. If economic power were fragmented, then political power would be atomized as well.” Daniel Bell, “The Prospects of American Capitalism: On Keynes, Schumpeter, and Galbraith,” in *The End of Ideology: On the Exhaustion of Political Ideas in the Fifties* (Cambridge, MA: Harvard UP, 2001), 87.

³⁹⁶ Francis Fukuyama, *State-Building: Governance and World Order in the 21st Century* (Ithaca, NY: Cornell UP, 2004) 3. In this important book, Fukuyama addresses the issue of how to make states strong and effective. While states everywhere are reducing the scope of their functions, the strength of government institutions, he argues, needs to be improved.

³⁹⁷ According to Skidelsky, *Road from Serfdom* 117, the new political economy is anti-collectivist. Instead of supplanting the market in pursuit of public objectives, the state, as many argue, should only provide public goods.

modernization embraces the centralization of public administration and economic management. Next, a review of books and donor documents on the market transition in Laos exposes a strong anti-centralist bias that not only misrepresents the role of government in the economy, but also reflects a discourse of diverse agendas from the development community. The distortion of economic rationality derives, in part, from the hegemony of a neoliberal ideology, and the third section examines the Hayekian roots of this market utopia. In countering this ideology, the fourth section advances the market perspective from the field of economic sociology, which posits a more realistic and pragmatic role of governments in economic development. Placing these competing market visions in the context of the Lao experience, the conclusion points to the constructive role of governments in developing countries to control the terms of economic liberalization and global integration.

Government Structure and Central-local Relations in Laos

In 1975, the Pathet Lao communist guerillas gained full control of Laos and established the Lao People's Democratic Republic (Lao PDR). Under the direction of the Lao People's Revolutionary Party (LRRP), the Lao government began experimenting with several forms of territorial organization, oscillating between central planning and regional autonomy, while adhering firmly to both democratic centralism and one-party control.³⁹⁸

Communist Consolidation with Weak Centralization: 1975-1986

Like all modern revolutions, the one in Laos "resulted in the extension and strengthening of the power of the state over society."³⁹⁹ The new regime moved

³⁹⁸ For a comprehensive overview of central-local relations in Laos, see Funck, "Decentralization." A more recent review can be found in Keuleers and Sibounheuang, "Central-Local Relations."

³⁹⁹ Grant Evans, *Lao Peasants under Socialism* (Chiang Mai, Thailand: Silkworm Books, 1995) 201. He further explains, "The communist government [in Laos] has succeeded more than any previous government in sinking multistranded organizational roots in the villages and providing a credible nationalist ideology." In many ways, the experience in Laos follows the classic social revolution, as outlined by Theda Skocpol in *States and Social Revolutions: a Comparative Analysis of France, Russia,*

swiftly to enact socialist planning, agricultural collectivization, and administrative control over the countryside.⁴⁰⁰ Rice cultivation and other productive activities came under central administrative control, which dictated production quotas, prices for goods and services, and civil service wages. The government treasury resided with the State Bank of the Lao PDR, which managed the supply of currency, transferred funds to subnational administrative units, and provided loans to state-owned enterprises (SOEs). As a result of these centralized activities of the command economy, local governments lost a level of autonomy previously enjoyed under the Royal Lao government.

Nonetheless, the provinces enjoyed a strong degree of regional autonomy from the central government in the capital Vientiane. With insecure borders and internal insurgencies against communist rule, the government severely restricted travel within the country and required self-sufficiency of local food production. In a country where the population remains geographically dispersed, moreover, an extremely poor transport and communications infrastructure contributed to weak central authority and a strong degree of regional autonomy. More than half the road system remained impassable during the rainy season. Many provincial towns lacked telecommunications links to the capital, and air travel often provided the only means of transport between outlying provinces. Consequently, provincial authorities adopted central directives at their own discretion, to suite the local context. All the

and China (Cambridge, Cambridge UP, 1999). Such a revolution results in a consolidation of state power— more centralized, bureaucratic, and autonomous— with political control over many aspects of socio-economic life.

⁴⁰⁰ Observers find that the economic doctrine of the Lao PDR has paralleled similar but earlier phases of Marxism-Leninism in the former Soviet Union: war communism, cooperative movement, New Economic Policy, and capitalism (Funck, "Decentralization," 127.) Trotsky advocated and Lenin implemented war communism, while Lenin established cooperatives. Laos' economic transformations under the New Economic Mechanism looks suspiciously like Russia's New Economic Policy in 1924. In early 1918, capitalism briefly emerged in Russia.

while, the public administration remained weak and proved unable to implement a central planning system.

Up until the early 1990s, the weak central government transferred few resources to the autonomous provinces and expected none in return. Governors of each province reported directly to the Central Committee of the Communist Party. They maintained their own administrations and budgets, funded through transfers from the state budget and operational surpluses of SOEs under their jurisdictions. Possibly unique among socialist countries, horizontal lines of provincial control superseded the vertical authority of central ministries. Field office of central ministries (such as the Ministries of Education, Health, Agriculture, Finance, and Commerce) reported directly to the governors of their respective provinces. With little oversight from the central government, provincial governors amassed local power and developed networks of clan-patronage reminiscent of the previous Royal Lao government.

Over the first decade of its existence, the Lao PDR consolidated its rule and granted a large degree of regional autonomy, but in such a way as not to threaten the party's control. One observer characterizes this period as “a spreading government presence, growing administrative control that reached to the village level, and a restructuring of the economy and political framework.”⁴⁰¹ Arguably, this process of political consolidation continues to this day.

New Economic Mechanism and Regional Autonomy: 1986-1991

Ultimately, the regime's brand of socialism failed to improve the economic conditions in the country.⁴⁰² Peasant resistance and low productivity forced the

⁴⁰¹ W. Randall Ireson, "Evolving Village-State Relations in the Lao PDR: Time, Space, and Ethnicity," in *New Laos, New Challenges*, ed. Jacqueline Butler-Diaz (Tempe, A.Z.: Arizona State University, 1998), 52.

⁴⁰² Pointing to the low level of physical development in the country, Funck writes, "In a country with virtually no communication infrastructure to serve a population scattered in small valleys or even to link the main alluvial plains, the idea of establishing a centrally planned system had always been a fantasy."

government to cancel its first experiments with agricultural cooperatives. Rather than endure communist hardship, many Lao poured across the porous borders of the Mekong River into Thailand and onward to the West. Economic failure threatened political stability and forced the LPRP to make pragmatic adjustments.

Beginning in the early 1980s, the government instituted policies of incremental market liberalization, culminating with the New Economic Mechanism (*chin tanakaan mai*) promulgated at the 4th Party Congress in 1986. Socialist economics gave way to market-oriented reforms, although the party doctrine formally recognized Marxist-Leninism. While embracing the idea of free markets, the government embarked on a series of liberalization measures. Soviet and Vietnamese advisors, as well as the International Monetary Fund (IMF), of which Laos was still a member, urged these changes in policies.⁴⁰³

In abandoning central planning, the regime resorted to even more administrative and financial autonomy at the subnational level. In efforts to make local governments completely self-sufficient, the regime devolved massive government prerogatives to the provinces, which took responsible for managing and administering local resources.⁴⁰⁴ The government abandoned administrative pricing and allowed market forces more scope for determining the value of goods and services. On the fiscal side, tax administration fell under the direct control of provincial governors, who also nominated managers of the local branches of the State Bank.⁴⁰⁵ Independent of central authorities, these branches implemented their own credit policies. Provincial

Funck, "Decentralization," 129. The party attributed its failures to two causes: (1) an excess of centralization and (2) the limited scope of building socialism in a natural economy.

⁴⁰³ Stuart-fox, *A History of Laos* 182.

⁴⁰⁴ In theory, such a state of affairs characterizes a pure decentralization, the ideal assumption behind fiscal federalism theory, in which, "pure local governments raise pure local taxes and undertake pure local expenditures without the benefit of central government transfers." See Remy Prud homme, "The Dangers of Decentralization," *The World Bank Research Observer* 10, no. 2 (1995): 1.

⁴⁰⁵ Keuleers and Sibounheuang, "Central-Local Relations," 204.

authorities set their own exchange rates and determined salaries for civil servants. Self-management characterized SOEs, which no longer received subsidies but determined production levels, investments, and wages in accordance with market conditions.⁴⁰⁶

Continuing from the previous period, subnational units of government mirrored their central counterparts but were now granted relative autonomy, with the benefit of even less central government transfers. Provinces composed a quasi confederation of local entities, each resembling a mini-state.⁴⁰⁷ This pure form of devolution created major weaknesses in the macroeconomy that the central government found difficult to resolve. As a result of local autonomy, financial instability increased, quality of public service delivery further declined, regional disparities widened, and physical infrastructures deteriorated for lack of maintenance.

While autonomy of the provinces and state enterprises at first remedied the main failures of the previous command economy, the loosely connected regional economies later became an obstacle to the ongoing process of economic reforms. Instead of paying profit taxes to the state budget or making new investments, for example, SOEs increased salaries for workers, usually financed with loans from the local branch of the State Bank.⁴⁰⁸ Before the implementation of the NEM in 1986, less than 20 percent of government expenditures went to salaries. As a result of local

⁴⁰⁶ Funck, "Decentralization," 133-4. In relative terms, public enterprises contributed less and less to government transfers, from 10.8 percent of GDP in 1986 to a low of 0.8 percent in 1989. At the same time, private expenditure as a percentage of GDP continued to grow at the expense of public consumption and investment. See Funck, "Decentralization," 138, Table 4-4.

⁴⁰⁷ As Stuart-fox observes, "What was remarkable in a socialist state was the extent to which *de facto* regional autonomy was given official recognition and even encouragement. The central government was forced by lack of resources to make a virtue of necessity in encouraging regional self-sufficiency." Stuart-fox, *Buddhist Kingdom, Marxist State: The Making of Modern Laos* 173.

⁴⁰⁸ Funck comments on the effects of operational freedom of SOEs under the NEM: "With no external claim on their profits, decentralized state enterprises sought to maximize their workers' income rather than ensure an adequate return on the assets entrusted to them by the nation" (Funck, "Decentralization," 142.).

autonomy, by 1990 salaries accounted for over 50 percent of current expenditures.⁴⁰⁹ Furthermore, financial and fiscal autonomy resulted in revenue imbalances among the provinces, while the central government received only 25 percent of fiscal revenues—out of which it had to finance its own expenditure and those of poorer provinces.⁴¹⁰ To cover its annual budget, the central government relied heavily on bank loans to finance its perennial budget deficits. As a result, by mid-1989, inflation devalued the currency by over 100 percent. Yet, the central government possessed little power to dictate provincial credit policies, which governors directed towards local enterprises. Thus, while market-correcting measures contributed to economic growth, administrative decentralization eventually hampered efforts to stabilize the economy.

A lack of qualified civil servants further exacerbated financial and economic mismanagement. Provincial governors held complete control over the hiring and financing of their personnel, whose political loyalty mattered more than their administrative competence. Central ministries possessed little authority over technical services at the subnational levels and faced difficulties enforcing national policies and addressing inefficiencies in the delivery of public services.⁴¹¹

To this day, political and economic governance remains fragmented along regional lines. Governors enjoy ministerial rank and fiercely defend their local autonomy against incursions from the central government. In the socialist transformation that began in the early 1990s, the central government undertook

⁴⁰⁹ Vokes et al. 33. Moreover, this allocative redistribution occurred at the expense of capital investment, which declined from 80 percent of current expenditures in 1984 to a low of 37 percent in 1990.

⁴¹⁰ Keuleers and Sibounheuang, "Central-Local Relations," 204.

⁴¹¹ Keuleers et al. observe of the period,

Weaknesses in the implementation of national policies, lack of norms and standards for minimum service delivery and shortage of technical and institutional capacities at the centre (and at the provincial level) led to the development of inequitable and fragmented service delivery systems across the country. *Ibid.*, 206.

reforms to wrestle administrative controls back from the provinces. Local autonomy led to sharp regional disparities and hampered government attempts at national unity and economic integration. Eventually, the central government moved to regain the economic initiative. Political and economic consolidation continues up to the present time.

Market Liberalization as an Impetus for Recentralization: 1991-present

Changing political fortunes in 1989 marked a watershed for the Lao government. By the end of the 1980s, economic reforms took on a new urgency with the withdrawal of aid from members of the former Council for Mutual Economic Assistance, external assistance from the non-convertible currency area of the former Soviet Union and its satellites.⁴¹² Dwindling financial support from its erstwhile communist brethren forced the regime to look West, in a new struggle for dependency, foreign investment, and aid. The party-state pragmatically welcomed the idea of free market reforms, and international donors readily stepped into the geopolitical void to plug the financial gap.

Since the early 1990s, economic policies began to reflect "a systematic disengagement of the state from the management and financing of state enterprises."⁴¹³ Responding to increased concerns over local mismanagement of natural resources, low tax revenues, and non-compliance with national directives, the central government re-centralized budgetary control and re-attached all provincial and district technical staff to their respective national ministries.⁴¹⁴ In 1990, the State Bank turned into the Central Bank of the Lao PDR, which currently holds responsibility for monetary

⁴¹² At the time of collapse of the communist block, Soviet aid accounted for over half of all total foreign economic assistance (Stuart-fox, *A History of Laos* 199-200.).

⁴¹³ Richard Vokes and Armand Fabella, "Part One: Lao PDR," in *From Centrally Planned to Market Economies*, ed. Pradumna B. Rana and Naved Hamid (Oxford: Oxford UP, 1996), 17.

⁴¹⁴ Ireson, "Evolving Village-State Relations," 59.

policies. The World Bank and the IMF have encouraged and guided these changes with structural adjustment credits, conditioned on compliance to an economic framework of macroeconomic stability, improved fiscal performance, and efficiency—if not wholesale privatization—of SOE's.⁴¹⁵

For the first 15 years of its existence, the Lao PDR followed no codified rule of law; the LPRP exercised complete power, albeit arbitrary and ad hoc, in the affairs of the state. Promulgated in 1991, the regime's first constitution provided a firm legal foundation for economic liberalization.⁴¹⁶ In principle, the legal document strengthened the role of the National Assembly, which oversees activities of the government and the judiciary. However, decision making authority remains concentrated within the party, which encounters little opposition to communist rule.

In addition, the constitution formally recentralized financial and budgetary management of the country. More radical changes in central-local relationships followed. The government promulgated Decree No. 68/PM (August 28, 1991) that established a system for centralized tax collection and budgetary functions within a Ministry of Finance. Under this system, still in effect in 2006, revenues collected in the provinces enter the central budget (through the national treasury) before being allocated to the line ministries and provinces. In principle, provinces no longer have their own sources of revenues and must rely on negotiations with the central government to determine their targeted levels of revenue generation and public expenditures.⁴¹⁷ Once this planning process has set targeted levels for provincial

⁴¹⁵ Vokes and Fabella, "Lao PDR," 26.

⁴¹⁶ For a thorough review of the Lao constitution, including changes to draft forms of the document, see Stuart-fox, "Constitution of Lao PDR." See also Brown and Zasloff, "Government and Politics."

⁴¹⁷ Provinces are rewarded for increased tax revenues and can keep at least 50 percent of any surplus. See International Monetary Fund, "Lao People's Democratic Republic: Recent Economic Developments," (Washington, D.C.: IMF, 2000). This and other recent IMF staff reports contain the most up-to-date summary of fiscal policies in the Lao PDR. The current tax sharing scheme, introduced in April 1999, classifies provinces into three types: those in budget surplus, self sufficient, or in budget deficit. Provinces in surplus keep 50 percent of their surplus, while the others can keep 100 percent of

expenditures, governors cannot hope to change spending allocations during budget execution. The first national budget was prepared and approved in 1992. The national treasury followed in 1993 with a new system of disbursement that replaced the provincial branches of the previous State Bank.⁴¹⁸

Centralization and rationalization of the machinery of government remain far from complete, however. In many ways, the provinces continue to assert administrative and fiscal independence from the central government. While in principle local staff of government agencies report to their central ministries back in the capital, in reality governors exert tremendous influence on all government activities in their respective locales. Financial rules and regulations lack uniformity across the provinces, which frequently grant tax exemptions and reduce customs duties for businesses in order to spur local investment—often in competition with other provinces. As a result, tax collection performs below expectations, while discretionary local spending typically fails to match revenue generating capacity. Consequently, perennial fiscal crises characterize the Lao state.

The market transition, coupled with government efforts to regulate a suspicious (and sometimes hostile) countryside, has reinforced the general trend towards administrative centralization and political consolidation. The government has made no recent effort to relinquish central authority. Over the past ten years, the government has promulgated consistent policies that make clear the provenance of power and authority in the country. Powerful pockets of entrenched, regional interests have long resisted central incursions in their domains, however. Provincial governors continually re-assert their perceived right to govern their territories over incursions

any revenue collection that exceeds their budgetary targets. For a thorough discussion of finance and taxation in Laos, see Chapter Six, "The Fiscal Sociology of the Lao Tax State."

⁴¹⁸ Keuleers and Sibounheuang, "Central-Local Relations," 209.

from central directives. In the transition process, efforts to redress the highly devolved nature of governance figure prominently in the country's modernization. Government efforts to separate state from party, promote a rule by law rather than decree, and streamline the public administration have engendered a parallel shift towards centralization.

Peripheral States and the International Agenda of Decentralization

Since the early 1990s in Laos, the socialist transformation and marketization have resulted in more centralization of administrative control and economic regulation. In the process, governors have been disempowered, while central ministries have gradually reasserted control over their line ministries. Striving to unify the country and project its influence deeper into the remote countryside, the government has consolidated public institutions in accommodating the market transition. Administrative changes since market liberalization in the 1990s have not led to a devolution of economic control. Nor has the economic opening promoted a political one. Government restructuring during the market transition has reinforced the party's hold on the government. In making pragmatic adjusting in the face of economic constraints, the party has consolidated its power base while managing a more market-driven economy. Ironically enough for this outpost of Marxist-Leninism, the march to capitalism, as well as its initial road to socialism, has entailed a political and economic shift towards stronger government and centralization of public administration.

But the experience in Laos is not an isolated case of peripheral socialism making do with a market-driven economy. To the extent that other developing countries encounter the problems of a weak center and strong traditional sources of political authority (at the local level), centralization may provide an appropriate policy for many developing countries, particularly peripheral states.

Modernization and the Rationality of Centralization

In the market transition, Laos becomes more a typical developing country encountering many of the same problems of modernizing states: weak institutions, clientelism, ad-hoc enforcement of laws and regulations, corruption, etc. Thus, Laos presents, albeit in exaggerated forms, many of the dilemmas of national development. These challenges of modernization reinforce what David Slater calls the "centralist ethos of state power" in which the territorial restructuring of peripheral states, as well as the internal logic of their bureaucratic modernization, results in centralization of government authority.⁴¹⁹ My research agrees with these generalizations. In Laos, as for most peripheral states, the centripetal bias of national development gravitates towards centralization. For poor countries, to build capacity in most areas of governance demands the centralization of state functions.

Despite these trends, a worldwide development agenda of decentralization aims to take governance reforms in the opposite direction. Complicating Laos' modernization, some donors promote the idea of decentralization in disregard of the country's economic and administrative fragmentation. As the next section reveals, the development discourse of decentralization obscures the reality of government restructuring and, by extension, sensible ways to promote the country's marketization.

The International Agenda of Decentralization

The experience of market reforms in Laos contradicts the worldwide trend toward decentralization. According to many observers, the push for government decentralization may be strong throughout the world.⁴²⁰ Pushing the agenda of

⁴¹⁹ Slater, "Territorial Power."

⁴²⁰ Decentralization has various interpretations and proponents. As a strategic intervention, it cuts across ideological differences and enjoys easy popularity from such disparate groups as free market liberals and grassroots developmentalists. In the former, decentralization has the potential to reveal local preferences and allocate public resources efficiently. In the latter, decentralization offers the possibility

decentralization in Laos, many in the development community present a general misreading of the market transition in Laos. Specific to Laos, many articles and reports of government restructuring either ignore the logic of centralization or dismiss the move as a necessary prelude to decentralization.⁴²¹ Nonetheless, the transition in Laos makes a strong case that, to be effective, market liberalization demand statist, centralizing policies. While encouraging a nascent private sector, the Lao government, under the guidance of some international institutions themselves, has seen fit to usurp the authority of provincial governors. However, the important role of the state in economic affairs has, in many instances, been needlessly ignored or simply equated with failed centralized planning.

To international experts on Laos, decentralization of economic prerogatives appeared, quite understandably if naïvely, as the natural progression for a country abandoning centralized planning and embracing free market “fundamentals.” Capturing this general misrepresentation of the market transition, a report by the UNDP provides the dimensions of two competing economic systems open to the

of more local self-determination, in the face of unaccountable central authorities. For both, decentralization holds the promise of enhanced provision of public services and greater responsiveness of governmental policies to local concerns. See Litvack, Ahmad, and Bird, "Rethinking Decentralization," 1.; and Prudhomme, "Decentralization," 1. The World Bank writes, "Strategies to stop decentralization are unlikely to succeed, as the pressures to decentralize are beyond government control... Rather than attempt to resist it, governments should face decentralization armed with lessons from countries that have gone before them." World Bank, *World Development Report 1999/2000* (New York: Oxford UP, 2000) 124. Elsewhere, the World Bank cites research discovering that "out of 75 developing and transitional countries with populations greater than 5 million, all but 12 claim to be embarked on some form of transfer of political power to local units of government" (Andrew N. Parker, "Decentralization: The Way Forward for Rural Development?" in *Policy Research Paper 1475* (Washington, DC: World Bank, 1995), 18-9.).

⁴²¹ The most obvious examples of this perspective are found in the following articles: Kenji Oya, Devyani Mani, and Josefa S. Edralin, "Building Sustainable Planning Capacity in Lao PDR," *Regional Development Dialogue* 22, no. 1 (2001).; Frederick Brown, "The Economic Development of Vietnam, Laos, and Cambodia," *Journal of Northeast Asian Studies* (1993).; Alan Taylor, "Rural Development Issues in the Lao PDR: Technical Assistance to the Lao PDR [Sppd Project Lao/98/551] Improving the Management and Implementation of the National Rural Development Programme," (Bangkok: International Labour Organization, 1999).; and Vokes and Fabella, "Lao PDR."

country, as they were widely understood.⁴²² See Figure 15. In this model, socialism equates with failed central planning, and free market liberalism with privatization and decentralization. From this conventional wisdom, a move from central planning to market liberalization quite naturally entails a push towards decentralization and a rollback of state authority.⁴²³

In general, economic reforms (i.e. market liberalization and privatization) have carelessly been conflated with decentralization in Laos. In various reports and books written on the country's transition to a market-oriented economy, government efforts to embrace a free market system (which have required very statist policies and a push

Central Command	Market-based
Centralization	Decentralization
Administrative processes	Markets
State/collective ownership	Private ownership
Orders (for commands)	Incentives
Monopoly	Competition
Autarky	Internationalization

Source: Reyes, "Role of the State" 51.

Figure 15. Dimensions of Imagined Economic Systems.

⁴²² Romeo A. Reyes, "The Role of the State in Laos' Economic Management," in *Laos' Dilemmas and Options: The Challenge of Economic Transition in the 1990s*, ed. Mya Than and Joseph L.H. Tan (New York: St. Martin's Press, 1997), 50-1.

⁴²³ For recent articles that view decentralization as a natural concomitant to economic liberalization, see Mya Than, "Indochina: Transition from Centrally Planned Economy to a Market System," in *Indochina: From Socialism to Market Economy*, ed. Mathews George Chunakara (Hong Kong: Clear-Cut Publishing, 1996), 35.; Robert J. Bennett, "Decentralization, Intergovernmental Relations and Markets: Towards a Post-Welfare Agenda?" in *Decentralization, Intergovernmental Relations and Markets: Towards a Post-Welfare Agenda*, ed. Robert J. Bennett (Oxford: Clarendon Press, 1990).; Brown, "Economic Development of Indochina," 3.; Litvack, Ahmad, and Bird, "Rethinking Decentralization," 4.; and Reyes, "The Role of the State in Laos' Economic Management," 50.

towards recentralization) appear only as "market reforms," "macroeconomic adjustment," or simply "stabilization."⁴²⁴ In these portrayals, "recentralization" is an unqualified bad and duly minimized.

These various reports not only inaccurately portray government restructuring, but more importantly reveal a systematic misrepresentation of a development setting, using a picture constructed through a reliance on institutional norms which uncritically conflate economic liberalization with decentralization. If these reports fail to withstand academic scrutiny, it is not because of unprofessional or sloppy work, but rather because of an institutionalized development profession which frames decentralization as a particular type of development intervention. The reports attempt to portray a country removing the shackles of communist central economic planning to embrace free market liberalism and decentralization of economic control. This image can only be true if we equate a decentralization of economic control with privatization of state enterprises and other market correcting measures, e.g. price decontrol. Yet, decentralization of economic control requires much more. It would entail the form of regional autonomy that characterized inter-governmental relations prior to 1991. If donors seriously want to promote fiscal discipline and administrative competence, then the push for fiscal decentralization has little rationale in Laos, as elsewhere.

Through a discourse on decentralization, nonetheless, donors continue to push their own agenda, one which advances a neoliberal program of economic liberalization and democratic crusades for self-determination,⁴²⁵ at the expense of pragmatic adjustments in the face of social and political realities. Laos reveals, on a small scale,

⁴²⁴ See for example, Brown, "Economic Development of Indochina," 3.; Than, "Indochina," 35-6.; Vokes and Fabella, "Lao PDR," 31-112.

⁴²⁵ According to Barry R. Weingast, "Constitutions as Governance Structures: The Political Foundations of Secure Markets," *Journal of Institutional and Theoretical Economics* 149 (1993), decentralization and federalism arguably make governments more political responsive to citizens and supportive of economic growth.

a larger trend in economic globalization: the push for a minimalist state when, in fact, state-building demands institutional building for markets to function efficiently. Why then do donors push the agenda of decentralization?

Neoliberalism and the De-central March to Capitalism

At one level, the mismatch of perceptions on economic reforms and state restructuring suggests that a neoliberal ideology continues to cloud sensible economic policies at the multilateral organizations working in Laos. While international financial institutions continue to push neoliberal policies emphasizing export-led growth and pliable domestic markets for foreign domination, the UNDP and other donor agencies unwittingly contribute to the same agenda by promoting programs of decentralization. Embedded in these entrenched views of development is a religious and unquestioned belief in the power of unregulated markets to increase economic performance. The ideology portrays governments as intrusive, inefficient, and in opposition to free markets. This section examines the roots of neoliberalism, as described in the writings of its most indefatigable defender, Friedrich von Hayek.⁴²⁶

Hayek's depiction of the market order derives from the neoclassical model of economic equilibrium⁴²⁷ and the political liberalism of the Enlightenment,⁴²⁸ which

⁴²⁶ For a recent discussion of neoliberal ideology, see David Harvey, *A Brief History of Neoliberalism* (Oxford: Oxford UP, 2005). Here, Harvey examines the condition of neoliberalism, which implies the reconstitution of state power that restores class privileges. For Harvey, neoliberalism dismantled the compromise of embedded liberalism that underpinned much of the Western welfare state up to the late 1970s. As the new economic orthodoxy after 1979, this ideology emphasizes privatization, finance, and market processes to the detriment of state intervention in either the economy or social welfare. Harvey remains vague, however, on who exactly benefits from the reconstitution of class power.

⁴²⁷ Such a market constitutes an allocative mechanism for the factors of production and commodities. The mutual adjustment of supply and demand creates a market equilibrium through the feedback of price signals. Markets work efficiently when private enterprises have free entry and existing firms exercise free exit. Decision-making by economic agents is decentralized. In the neoclassical economic order, failure is not only unpredictable, but a vital systemic tool for adjusting individual action. That is, economic power ideally is diffused, and markets disperse responsibility. The rigors of the market determine the allocation of resources and investments. The neoclassic model of market equilibrium derives from Say's Law, which makes the assumption that everything produced will eventually be consumed. Classical economics claims that a market of supply and demand tends towards equilibrium. There are thus no crisis tendencies under capitalism. In theory, overproduction or underproduction

together form the basis of this robust ideology. Neoliberalism promotes the abstract idea of liberal democracy, in a defense of individual freedom, free markets, limited government, protection of private property upon a foundation of the rule of law, and public accountability through a form of representative government. A liberal society has a healthy suspicion of concentrated authority and thus diffuses power, both in the economic and political realms. Economically, this diffusion implies a decentralization of decision- and profit-making in an ideal free market utopia in which individuals are free to enter and exit. Prices reflect relative scarcities of the factors of production and the opportunity cost of supply and demand. Politically, limited government increases the scope of individual freedom unfettered by an oppressive and exploitative state.

In his writings, Hayek describes the emergences free market capitalism, the institutions which maintain it, and the consequences of destroying the traditions of this market order. He spent his life defending capitalism (or the “extended order” as he

disappears in the long run. Unemployment thus suggests a temporary, short-run, dislocation which disappears once production and consumption returns to equilibrium. Prices fluctuate freely in response to supply and demand. In time, consumer prices and wages would correct production imbalances and eliminate unemployment. A free market ensures this equilibrium, in the long run. See Bell, "Prospects of American Capitalism." Classical economists, writes Bell, “rooted their system in a fear of concentrated power.” Bell, "Prospects of American Capitalism," 86.

⁴²⁸ English liberalism, as derived from Kant, values individual rights and freedoms (while challenging government authority and other forms of concentrated power) and opposes government efforts to regulate the economy or personal morality. As Bell explains,

Classic liberalism defined equality as equality before the law. The definition rests on the distinction between the rule of law and the rule of men. The rule of law sets the rules of the game which apply generally to *all* players; within these rules, individuals are free to strike their own bargains, make their own choices, determine their own actions. Under the rule of men, a governor or judge may set forth determinations which single out some, but not others, for obligation and redress. Often this may be for reasons of justice and fairness, but an element of arbitrariness and coercion remains.

The bias of liberalism was for the first, even though an inequality of outcome might result, because its overriding value was the reduction of coercion by government and the rule of free bargain. The bias of social intervention was, and is, the element of redress in the name of some other value. The heart of the liberal argument is that men differ in their capacities, needs, aptitudes, and talents. Thus one has to distinguish between *treating people equally* and *making them equal*. The effort to make people equal must lead to some determination by an administrative body of the degree of differences, and the degree of redress. It therefore means treating people *unequally*. The logic is inescapable. See Bell, *The Cultural Contradictions of Capitalism* 260. Emphasis original.

grandly describes the economic and social institutions of the free market) against what he perceived as the iniquities of socialism and its assault on individual freedom, private property, and advances in civilization. In his utopia, economic life arises from a spontaneous, accidental order—as much unpredictable as unplanned. The principle of consumer sovereignty defines a market economy. The aggregate decision of individuals or households, as consumers, determines what is to be produced, in accordance with their taste.⁴²⁹ Hayek premises his argument for the market on a neutral assessment of value and a neoclassical equilibrium that satisfies supply and demand. The market is unknowable in its complex whole and cannot achieve specific ends for deliberate social purposes. Merit has no meaning in this ideal market economy. The price mechanism reflects the degree to which individual action benefits other participants. Profit provides the only material incentives for economic decisions. Decentralized, market-oriented economic systems based on competition, free entry/exit, voice, and private ownership of the means of production are more responsive to changes in relative prices and technology than centrally planned economic systems based on collective ownership and administrative allocation.

From Hayek's libertarian perspective, men do not intentionally create the complex system of a market, which evolves spontaneously by the virtue of human action. A product of evolutionary selection, morals and cultural rules form the foundation of this system. Rules of conduct adopted by a particular group, often for unknowable reasons, survive when they contribute to that group's success. The value of exchange, the imperative of competition, and the necessity of private property evolved into the general principles that continue to guide the current market system. Knowable premises cannot always justify such rules, whose adoption may simply reflect the accident of history.

⁴²⁹ See *Ibid.* 223.

A fatal misconception results from the misguided belief that human reason can understand the market order well enough to adjust these rules of conduct and direct the system towards any particular end. In this ideal type of a free market, no single economic actor has the capacity to comprehend all the relevant facts.⁴³⁰ The market order allows individuals, through competition and price signals, to make use of information which need not be understood in its entirety. The impact of any individual action on this system cannot be predicted, but only approximated, since the system continually adjusts to innumerable individual inputs and decisions. A self-correcting equilibrium allows for the satisfaction of numerous needs and wants and makes a morally neutral assessment of value with respect to individual economic decisions. This extended order forms the basis of personal liberty, inexorably linked to economic freedom, and allows individuals to pursue their own needs and desires without being subjected to the coercive will of others.⁴³¹

Neoliberalism contrasts the “purity” of the market system with the “corrupted” political process.⁴³² Given such stark alternatives, economic policies rationally should aim to slim the state by reducing the range of government functions. The ideology manifested itself most transparently in the erstwhile “Washington Consensus,” which for most of the past two decades dominated development thinking at the international financial institutions and the U.S. Department of Treasury.⁴³³ This consensus spanned

⁴³⁰ Friedrich A. von Hayek, "The Use of Knowledge in Society," *American Economic Review* 35, no. 4 (1945). In this important paper, Hayek praises the price system as a mechanism for communicating information and knowledge that no central authority can possibly comprehend or make sense of. In essence, markets disperse information throughout the economy.

⁴³¹ Friedrich A. von Hayek, *The Fatal Conceit: The Errors of Socialism* (Chicago: University of Chicago Press, 1988). Expanding upon earlier ideas in *The Road to Serfdom*, Hayek offers a passionate defense of private property, which is morally correct and economically necessary. Collective action is roundly denounced as evil. Freedom derives from private property, which symbolizes an independent sphere free from outside interference.

⁴³² Stilwell, *Political Economy* 350.

⁴³³ John Williamson, "Democracy and the "Washington Consensus"," *World Development* 21, no. 8 (1993). In this highly influential paper, Williamson identifies a consensus within the international

many areas of economic reform and development, justifying the notorious structural adjustment policies (SAPs) that dictated the terms of market liberalization in many developing countries.

For the transition countries of the former Soviet block, neoliberalism provided the justification for the infamous “shock therapy” of economic reform, which attempted to inaugurate a market society in the absence of supportive structures and economic institutions.⁴³⁴ In their rush to embrace the abstract idea of capitalism, however, countries in the former second world ran up against the harsh realities of capitalist construction and the difficulties of structuring market relations. Economic liberalization for these post-communist countries has produced mixed results, to say the least. Much to the chagrin of economists, economic performance of transitioning countries bears no relationship to the level of liberalization.⁴³⁵ Many of these countries had to create market and government institutions practically from scratch; and initial

financial institutions (i.e. World Bank and the IMF) and the U.S. government (i.e. Treasury Department) in ten areas of economic reform and development: fiscal discipline, public expenditure priorities, tax reform, financial liberalization, exchange rates, trade liberalization, foreign direct investment, privatization, deregulation, and property rights. (See what Gore article has to contribute to current economic policymaking. Charles Gore, "The Rise and Fall of the Washington Consensus as a Paradigm for Developing Countries," *World Development* 28, no. 5 (2000).)

⁴³⁴ As John McMillan, *Reinventing the Bazaar: A Natural History of Markets* (New York: W.W. Norton, 2002) 210, notes:

The fastest route from a planned economy to functioning markets, it turns out, was not frenetically tearing down the old institutions, starting with a clean slate, and enacting top-down reforms. It entailed letting the new economy grow up around the old ones, maintaining some stability to let people create new ways of doing business.

According to John McMillan, in this recent book about markets, a well-structured market contains five elements: a free-flow of information; protected property rights; trust in meeting contractual obligations; limits to negative externalities; and a culture that fosters competition. To promote these market-enhancing rules, the government has an essential role to play in the economy.

⁴³⁵ World Bank, "From Plan to Market: World Development Report 1996," (Washington, DC: World Bank, 1996), Figure 2.1, p. 26.

conditions, rather than liberal economic policies greatly influenced economic growth.⁴³⁶

For these post-socialist transitions, the simplistic view of socialism as mass utopia was prematurely overtaken by the naïve belief in the mystical powers of the “invisible hand” of a free market system. These opposing ideologies usually exaggerate the role of government in the economy. While socialism promoted the state as the arbiter of collective values, capitalism sang the virtues of an economic order unfettered by an obstructionist, if not altogether repressive, government. The stark contrast between markets and states tends to obscure the ways in which governments need to structure market relations.

At an abstract level, it is hard to disagree with the Nobel Laureate. History has proven Hayek’s claims to be, for the most part, on the mark. Socialism has entailed a program of redistribution under a central planning authority. Despite socialism’s progressive appeal, the collectivization of the means of production and nationalization of industrial sectors produced few lasting gains in either the realm of economic development or legitimate claims to representative government. Soviet communism, in the form of allocative economics under bureaucratic administration and political repression directed by the vanguard party-state, collapsed under the weight of its overwhelming contradictions. Even if, as Hayek convincingly argues, central planning is not workable, does it naturally follow that that the market is inescapable?

While socialist planning and Marxist ideology failed to live up to their own discursive myths, the liberal economy and the unconscious belief in the divine hand of the market equally disguised a religious devotion to a secular faith. Communism and

⁴³⁶ Initial conditions, by and large, determined economic performance in all the transition countries in Eastern Europe. See World Bank, "Transition, the First Ten Years: Analysis and Lessons for Eastern Europe and the Former Soviet Union," (Washington, DC: World Bank, 2002).

liberalism present societies with a false choice. Like most ideologies, these two extremes tend to distort reality. As Robert Reich sensibly argues,

Posing the debate in mythic terms, as a moral choice between the security combined with stagnation of bureaucratic control and the vitality combined with rapacity of capitalist enterprise, obscures the more prosaic but central choice, the real choice [of how societies make market rules].⁴³⁷

In a less ideologically moment, Hayek draws a similar conclusion. At one point in *The Road to Serfdom*, he writes,

Though the terms "capitalism" and "socialism" are still generally used to describe the past and the future forms of society, they conceal rather than elucidate the nature of the transition through which we are passing."⁴³⁸

It is no longer a question of socialism or capitalism for places like Laos, but rather degrees of openness to the global economy.⁴³⁹

Central Construction of Social Markets

Against the view that free markets make free men, economic sociologists counter that free men do not a free market make.⁴⁴⁰ Procedural democracy quickly followed the demise of Soviet Communism in Eastern Europe. Tempering the initial

⁴³⁷ Robert B. Reich, "Of Markets and Myths," *Commentary* 83, no. 2 (1987): 38. The solution, of course, comes from the messy, and ideologically neutral, middle of the spectrum. Reich suggests "that the government concern itself with designing the right market rules, rather than trying to dictate the right market results" (Reich, "Of Markets and Myths," 39).

⁴³⁸ Hayek, "Road to Serfdom," 46.

⁴³⁹ McMillan, *Reinventing the Bazaar* 227, makes a similar point:

The best way to understand the interaction of state and markets is not to debate it in the abstract but to examine how real economics with varying degrees of government intervention actually works. Whether intervention is warranted, and by how much, is best decided case by case. It requires looking into the details of the specific market, while taking into account any distortions the government's action would bring. It is a technocratic issue, not one of high principle.

⁴⁴⁰ Economic sociologists are sometimes referred to as institutional economists as well. For a collection of the seminal pieces of this school of economic thought, see Neil J. Smelser and Richard Swedberg, *The Handbook of Economic Sociology* (Princeton, N.J., Princeton UP, 1994). See also Mark S. Granovetter and Richard Swedberg, eds., *The Sociology of Economic Life* (Boulder, CO: Westview Press, 1992).

euphoria, Michael Mandelbaum observes, “while the end of communism is a matter of fact, the transition to democracy and free markets remains a work in progress.”⁴⁴¹

One by one, Eastern European countries began to privatize erstwhile state owned enterprises, in the confident hope that free markets could develop quickly enough to erase the brutal history of socialist oppression and economic involution. These new governments, freely elected, were more than willing to embrace the “shock therapy” of economic reform, if only to remove wholesale an oppressive state from the commanding heights of the economy and society in general.⁴⁴² The result was economic failure and societal chaos, contrary to neoliberal expectations.

The notion of a free market separate from government is a myth⁴⁴³; and the neoclassical model of equilibrium fails to capture the dynamics of modern capitalism.⁴⁴⁴ Hayek’s libertarianism mistakenly naturalizes the market, in the

⁴⁴¹ Michael Mandelbaum, "Introduction," in *Post-Communism: Four Perspectives*, ed. Michael Mandelbaum (New York: Council of Foreign Relations, 1996), 4.

⁴⁴² Capturing the mood of many leaders in post-communist Eastern Europe, Vaclav Havel praises the virtues of a market economy:

Though my heart be left of centre, I have always known that the only economic system that works is a market economy. This is the only one that leads to prosperity, because it is the only one that reflects the nature of life itself. The essence of life is infinitely and mysteriously multiform, and therefore it cannot be contained or planned for, in its fullness and variability, by any central intelligence. As quoted in Vaclav Havel, *Summer Meditations* (New York: Alfred A. Knopf, 1992) 62.

⁴⁴³ Reich, "Of Markets and Myths," 38, sensibly argues,

The idea of a free market somehow separate from law is a fantasy. The market was not created by God on any of the first six days (at least, not directly), nor is it maintained by divine will. It is a human artifact, the shifting sum of a set of judgments about individual rights and responsibilities. What is mine? What is yours? What is ours? And how do we define and deal with actions that threaten these borders—theft, force, fraud, extortion, or carelessness? What should we trade, and what should we not? (Drugs? Sex? Votes? Babies?) How should we enforce these decisions, and what penalties should apply to transgressions? As a culture accumulates answers to these questions, it creates its version of the market.

⁴⁴⁴ As Peter Self, *Government by the Market* (London: Macmillan, 1993) 209, points out,

Those thinkers such as Friedman and Hayek who laud the market system, and want it to operate largely free from control, seem to be living in a vanished world. There is a world of individuals bettering themselves and their society through hard work, enterprise and saving in some useful trade or occupation. Such individual efforts are still highly valuable to society and still continue to be made, yet they seem rather far removed from modern economic realities. The virtues of hard work and savings lose much of their moral appeal in a society where

simplistic view that economic exchange constitutes an arena of choice and capitalist society the perfection of freedom.⁴⁴⁵

Neoliberal ideology falsely depicts the capitalist market as an opportunity rather than an imperative; the rise of capitalism entails simply the removal of obstacles, the breaking of fetters, but somehow not the creation of a new economic logic.⁴⁴⁶ In the neoclassical formulation, capitalism and free market liberalism are simply taken for granted and presented in opposition to the obstacles that prevented their full maturation and progressive development.⁴⁴⁷

In contrast to the mythical debate of states versus markets, the economic historian Karl Polanyi provides a better way to view the market transition. He famously promotes the idea that markets are “embedded” in society. From this

economic growth is directed more towards titillating individuals into consuming luxuries than meeting more basic needs; and the virtues of private enterprise seem less obvious when it takes the form of financial speculation, monopolistic profits or tendentious advertising.

⁴⁴⁵ Ellen Meiksins Wood, *The Origin of Capitalism* (New York: Monthly Review Press, 1999) 16. She convincingly argues that there was nothing inevitable about capitalism, which developed under conditions unique to England. Wood makes the case that, “The capitalist market as a specific social form gets lost when the transition from pre-capitalist to capitalist societies is presented as a more or less natural, if often thwarted, extension or maturation of already existing social forms, more a quantitative than a qualitative transformation” (Wood, *The Origin of Capitalism* 7.). By locating the provenance of modern capitalism in the specific social forms of English history and highlighting its rupture with earlier social forms, Wood challenges the naturalization of capitalism. In her own words,

the conditions for material prosperity existed in early modern England as nowhere else, yet those conditions were achieved at the cost of widespread dispossession and intense exploitation. These new conditions also established the foundation and seeds for new and more effective forms of colonial expansion and imperialism in search of new markets, labor forces and resources...The existence of one capitalist society thereafter transformed all others, and the subsequent expansion of capitalist imperatives constantly changed the conditions of economic development. Wood, *The Origin of Capitalism* 117-9.

⁴⁴⁶ Wood, *The Origin of Capitalism* 33. Elsewhere, Wood writes:

The old models of capitalist development were a paradoxical blend of transhistorical determinism and “free” market voluntarism, in which the capitalist market was both an immutable natural law and the perfection of human choice and freedom. The antithesis of such models would be a conception of the capitalist market that fully acknowledges its imperatives and compulsions, while recognizing that these imperatives themselves are rooted not in some transhistorical natural law but in historically specific social relations, constituted by human agency and subject to change. Wood, *The Origin of Capitalism* 25.

⁴⁴⁷ Wood, *The Origin of Capitalism* 34.

perspective, the state in no way stands outside the economy (however autonomous its micro-economic foundations) but rather constitutes its very core. In his masterpiece, *The Great Transformation*, Polanyi presents compelling ideas on the social basis of economic systems.⁴⁴⁸ He makes three important contributions to the study of political economy: (1) *the social construction of markets*, (2) *the myth of the self-regulating market*, and (3) *the double movement*.

At the heart of his argument, Polanyi emphasizes the immutable fact that humans are inherently social beings, where social relations take precedence over economic ones. In his view, people value material goods in so far as they serve these ends. That is, "economic motives spring from the context of social life... The economic system is, in effect, a mere function of social organization."⁴⁴⁹ In other words, an economic system is embedded in society, not the converse. The institutions and values of a particular society determine the organization of its economic activities.

⁴⁴⁸ The thesis reads as follows:

the idea of a self-regulating market implied a stark utopia. Such an institution could not exist for any length of time without annihilating the human and natural substance of society; it would have physically destroyed man and transformed his surroundings into a wilderness. Inevitably, society took measures to protect itself, but whatever measures it took impaired the self-regulation of the market, disorganized industrial life, and thus endangered society in yet another way. It was this dilemma which forced the development of the market system into a definite groove and finally disrupted the social organization based upon it. Polanyi, *The Great Transformation* 3-4.

Polanyi makes a strong case that the economic function should be subordinated to the political order. The great transformation refers to the transition to capitalism, prior to which economic life was embedded in society. As Mitchell Bernard, "Ecology, Political Economy and the Counter-Movement: Karl Polanyi and the Second Great Transformation," in *Innovation and Transformation in International Studies*, ed. Stephen Gill and James H. Mittelman (Cambridge, U.K.: Cambridge UP, 1997), 85-6. remarks, "Polanyi understood disembedding in terms of the creation of fictitious commodities and the reorganisation of society around the institutions of a self-regulating market. It was the unsustainability of this project that precipitated the counter-movement."

Polanyi's book describes the rise and fall of market society. In the process, two critical transformations take place: "the emergence of market society out of mercantilism and the collapse of market society into fascism and world war" Fred Block and Margaret R. Somers, "Beyond the Economistic Fallacy: The Holistic Social Science of Karl Polanyi," in *Vision and Method in Historical Sociology*, ed. Theda Skocpol (New York: Cambridge University Press, 1984), 53.

⁴⁴⁹ Polanyi, *The Great Transformation* 46-49.

By extension, the social construction of markets reveals the fallacy of a self-regulating market. A competitive market is imposed from above. Only states with strong central governments have the coercive power to impose a competitive market. Polanyi asserts that there is nothing natural about a self-regulating market; free markets are enforced by the state.⁴⁵⁰ Thus, he correctly understands the great transformation, or transition to capitalism, “in terms of the agency that brought it about. Rather than seeing it as something natural or inevitable, to Polanyi it was a discontinuity brought about by the exercise of state power.”⁴⁵¹

Finally, whenever a self-regulating market tries to impose its will on society, counter forces (society's self-protection) attempt to re-exert the primacy of society. A self-regulating market leads to the destruction of society, which attempts to check the actions of the market. The expansion of markets inevitably creates tensions between social beings and a market system which seeks to commodify their labor. Government interventionism forms the basis of this counter movement.⁴⁵²

If Polanyi's views of market society help to explain the failures of neoliberal policies, then economic reforms in developing countries must recognize the central

⁴⁵⁰ In reference to British economic policies of the 19th century, he claims:

The road to the free market was opened and kept open by an enormous increase in continuous organized and controlled interventionism... the introduction of free markets, far from doing away with the need for control, regulation, and intervention, enormously increased their range. Ibid. 139-40.

⁴⁵¹ Bernard, "Ecology, Political Economy and the Counter-Movement," 78.

⁴⁵² Polanyi describes the double movement as follows:

The one was the principle of economic liberalism, aiming at the establishment of a self-regulating market, relying on the support of the trading classes, and using largely *laissez-faire* and free trade as its methods; the other was the principle of social protection aiming at the conservation of man and nature as well as productive organization, relying on the varying support of those most immediately affected by the deleterious action of the market- primarily, but not exclusively, the working and the landed classes- and using protective legislation, restrictive associations, and other instruments of intervention as its methods. Polanyi, *The Great Transformation* 132.

role of states to manage and regulate capitalist markets. That is, market relations work through states.⁴⁵³ A market is a human artifact. As one scholar notes,

The market is not omnipotent, omnipresent, or omniscient. It is a human invention with human imperfections. It does not necessarily work well. It does not work by magic or, for that matter, by voodoo. It works through institutions, procedures, rules, and customs.⁴⁵⁴

While the market constitutes a mechanism for the efficient use of scarce resources, societal values guide its operations and determine what is bought or sold.⁴⁵⁵ As social construct, a market and the concomitant economy it gives rise to are functions of social organization, embedded in their respective society, rather than the result of some abstract rules, as Hayek argues, that evolve through learned human traditions.

Taking on this more nuanced view of markets, the field of economic sociology starts from the assumption that social relations, social structures, and their accompanying institutions shape market processes. Since Max Weber's initial inquiry, sociologists have recognized the important role of the state in the consolidation and expansion of capitalism.⁴⁵⁶

⁴⁵³ Drawing on Polanyi's account of the formation of the nation-state, McMichael notes,

the trajectory of an institution like the market is only comprehended through an interpretation of its cumulative social and political consequences. Beyond an economic process, market construction is a historical process of governing resistances to social transformation via conceptions of sovereignty and rights. (Philip McMichael, "Globalization," (Ithaca, NY: 2003), 2.)

⁴⁵⁴ McMillan, *Reinventing the Bazaar*, 8.

⁴⁵⁵ Bell, *The Cultural Contradictions of Capitalism* 323.

⁴⁵⁶ State formation cannot be separated from the rise, consolidation, and expansion of rational capitalism. Weber attributes the rise of Western, modern, rational capitalism to three factors:

- Economic: the economy fosters rational enterprises, producing for a mass market and using modern accounting practices;
- Political: a political state contains a predictable legal system, guaranteeing a semi-autonomous economic sphere; and
- Religious: a value system receptive to profit-making.

Economic factors include the emergence of modern accounting, free labor, mass markets, joint-stock corporation, the factory, and innovations in science and technology. A political community, separate from the household/clan, first emerged in Western cities and would eventually develop into the modern nation-state, another prerequisite for rational capitalism. Finally, a religious ethic that de-stigmatized

In practice, market arrangements are socially embedded and depend on supportive institutions for efficient operation. Legal institutions establish and enforce property rights and contractual principles. Financial institutions legitimize the means of exchange and the value of monetary instruments. Finally, social institutions reinforce the ideological and cultural hegemony that stabilizes the existing economic order.⁴⁵⁷ These various structures contribute to market stability for economic actors that use them.⁴⁵⁸ Governments intervene in market processes to regulate competition for economic growth. The transition to a market society, thus, requires that states develop rules governing property rights, governance structures, rules of exchanges, and conceptions of control for the purposes of stabilizing economic relations.⁴⁵⁹ Through these institutions, economic actors are able to “produce social structures to organize themselves, to compete and to cooperate, and to exchange with one another in a regular and reproducible fashion.”⁴⁶⁰ The strengthening of governmental capacity to make and enforce such rules contributes to societal wealth creation.⁴⁶¹

While neoliberal prescriptions call for a retreat of the state from all areas of socio-economic life, evidence from trade expansion over the past forty years in the West points to the continuing significance of states to manage market transformations.

profit-making, as best exemplified by Protestantism and Calvinism, helped to create a new economic mentality favorably to modern capitalism. For an overview of Weber’s political sociology, with a focus on political organizations and the state, see Swedberg, *The Idea of Economic Sociology*, especially Chapter Three.

⁴⁵⁷ Stilwell, *Political Economy* 209.

⁴⁵⁸ Neil Fligstein, *The Architecture of Markets: An Economic Sociology of Twenty-First-Century Capitalist Societies* (Princeton, NJ: Princeton UP, 2001) 11. According to Fligstein, in the developed West, the market-making project aims to stabilize and routinize competition. He notes,

societies have general rules, both formal and informal, about organizing economic activities. These rules provide the social conditions for economic exchange and allow for the production of new markets. Markets need definitions of property rights, governance structures, and rules of exchange.

⁴⁵⁹ *Ibid.* 37.

⁴⁶⁰ *Ibid.* 33.

⁴⁶¹ *Ibid.* 37.

In a paper for the National Bureau of Economic Research, Dana Rodrik examines the size of government and trade dependency of OECD countries.⁴⁶² His econometric analysis provides evidence that the more trade-dependent societies have relatively larger governments than those more domestically closed. Social disruptions engendered by freer trade have contributed to increased public welfare spending, in order to maintain social stability, thus mitigating the worst excesses of market anarchy.⁴⁶³ Using a time-series analysis, Rodrik shows that trade expansion at an earlier point in time correlates with increased social spending. Thus, the opening up of world markets contributes to the fiscal expansion of governments, supporting Polanyi's claim that the state plays a vital role in structuring the free market.

These findings fly in the face of neoliberalism, whose ideology of market capitalism posits the myth of the self-regulating market and the borderless world of economic globalization unfettered by government interference or public oversight. Contrary to this market utopia, the state continues to be integral to the consolidation

⁴⁶² Dani Rodrik, "Why Do More Open Economies Have Bigger Governments?" (Cambridge, MA: NBER, 1996). Rodrik uses an econometric model with other 100 countries extending from 1960s to 1990s. In Dani Rodrik, *Has Globalization Gone Too Far?* (Washington, D.C.: Institute of International Economics, 1997), he makes the same argument specifically for small, open economies.

⁴⁶³ In the West, this political economic phenomenon is often referred to as the social compromise of "embedded liberalism" in which the extension of the ruthless logic of the market requires social protection through the expansion of the public economy. See John Gerard Ruggie, "Embedded Liberalism and the Postwar Economic Regimes," in *Constructing the World Polity: Essays on International Institutionalization* (New York: Routledge, 1998). In the postwar years, global economic integration contributed the building of what John Ruggie calls the compromise of embedded liberalism in the West. Liberal democracy or welfare capitalism epitomizes this system of political economy. See also Hannes Lacher, "Embedded Liberalism, Disembedded Markets: Reconceptualizing the Pax Americana," *New Political Economy* 4, no. 3 (1999): 344. Essentially, this economic regime is captured in the phrase: "Smith abroad and Keynes at home." According to Ruggie, embedded liberalism translated into economic policies in which a liberal trade regime was promoted internationally, in exchange for advances in social welfare on the domestic front. Within this framework: "multilateralism and domestic stability are linked to and conditioned by one another. Thus, movement toward greater international openness is likely to be coupled with measures designed to cushion the domestic economy from external disruptions (Ruggie, "Embedded Liberalism," 78.) In making these claims, Ruggie assumes that "[s]tate-society relations express shared social purposes regarding the appropriate role of authority vis-à-vis the market" (Ruggie, "Embedded Liberalism," 62.) As Bernard notes, "liberalism was constrained within advanced capitalist countries by the social arrangements produced by the counter-movement" (Bernard, "Ecology, Political Economy and the Counter-Movement," 86.)

and expansion of capitalism. Moreover, economic performance also seems to demand sensible government intervention to facilitate private economic prosperity. Long-term economic growth seems to require a healthy appreciation of public investment in education, physical infrastructure, and political stability.⁴⁶⁴ Overall, governments seem to have a positive role in the process of economic development.⁴⁶⁵

Modernizing States, Nation Building, and the Logic of Centralization

As one scholar notes, “history shows that the driving force of successful capitalist development is not the perfection of the market mechanism but the building of organizational capacities.”⁴⁶⁶ In Laos, this capacity building project continues to demand a strong push towards administrative centralization, the consolidation of a political space, and the unification of regionally dispersed economies. The socialist transformation in Laos (i.e. marketization and capitalist incorporation) is synonymous with building a national economy, where none existed before, and the construction of a unified economic space where regional ones persist.

Contrary to the general global trend of public decentralization in the transition process, Laos provides a stark contrast, offering a valuable insight into the important role of governments in structuring economic relations. As Polanyi would have predicted, a country undergoing a liberalizing transformation requires more, not less,

⁴⁶⁴ Fligstein, *Architecture of Markets* 60-1. According to D. Aschauer, "Public Investment and Private Sector Growth," (Washington, DC: Economic Policy Institute, 1990), public investment in education and physical infrastructure contributes significantly to economic growth.

⁴⁶⁵ As Fligstein argues,

There is no evidence that trade has made states “smaller” over the past 30 years. In fact, it is quite the opposite. There is evidence that high exposure to trade combined with organized labor has produced more social protection and larger states. There are theoretical reasons to believe that states continue to matter in producing economic growth by providing public goods, the stable rule of law, and under certain conditions, good industrial policy. Fligstein, *Architecture of Markets* 217.

⁴⁶⁶ William Lazonick, *Business Organisation and the Myth of the Market Economy* (Cambridge: Cambridge UP, 1991) 8.

government control and regulation. The creation of a national economic space, which is how to view the economic transition in Laos, continues to demand the centralization and consolidation of political authority and economic policymaking. It is an attempt at nation state building in the European mold of the late nineteenth century.

The government in Laos faces many problems shared by other newly emerging nations. The transition from a rudimentary planned economy to an emerging market one presents the government with challenges of building and consolidating a modern state. By the government's own assessment, the country's transition to a market economy provides further impetus "to consolidate the nation-state, create national unity and establish the basis for sustainable and equitable development... In this process of nation-building, our country has faced fundamental challenges that have necessitated an emphasis on strengthening the government structure and functions."⁴⁶⁷ As emphasized throughout this dissertation, nation state building, in Laos as elsewhere in the periphery, requires centralization.⁴⁶⁸

In this dissertation, I examine the circumstances in which a small, peripheral country has undergone the postsocialist transition, from its failed attempt to administer the classical command economy to its current effort to usher in a form of market economy. Through the broad lens of political economy and sociology, my research explores three important areas of state capacity: (1) political structure, (2) public administration, and (3) fiscal management. I also incorporate a modeling exercise to simulate decision making alternatives for Lao policy makers. From these various perspectives, evidence demonstrates that the transition did not usher in the much-touted "invisible hand" of market forces. Rather, the Lao experience has shown the

⁴⁶⁷ Government of Lao PDR, "Background Paper on Governance," 5-6.

⁴⁶⁸ As Bendix notes, "The central fact of nation-building is the orderly exercise of a nationwide, public authority." Bendix, *Nationl-Building and Citizenship* 22.

importance of governments in structuring market relations and political regimes of accumulation. The country's initial condition, i.e. peripheral socialism and underdevelopment, ensured that the transition to a market society would diverge from the experience in Eastern Europe, where the Soviet model of central planning required a withdrawal of the state from all aspects of the economy.

While economic liberalization calls for a retreat of the state from direct management of economy, the transition to a market economy demands the creation, not the dismantling, of state functions in Laos. This experience contradicts patterns of reform in Eastern Europe, in which the entrenched (institutional) features of central planning required wholesale dismantling before capitalism could take root. The socialist project lasted only a decade in Laos. Thereafter, the government has embraced market reforms that allowed a greater sphere of private economic exchange. With an eye towards political stability, the party leadership has guided these transformations and, like good communists, bases its right to rule on economic performance.

The state building project in Laos has produced the following general results: a redefined role for the state; public disengagement from direct production of economic output; deregulation of prices and increased reliance on markets; and an increased scope for the private sector. To establish the regulatory environment and efficient management of the macroeconomy, the Lao state has instigated a sustained process of centralization and administrative rationalization, in an overall push to modernize the country. Instead of direct economic production, the Lao PDR now manages the economy indirectly through macroeconomic means of monetary and fiscal policies. Reforms in these areas have the objective of establishing of a national regulatory environment where none existed before and, concomitantly, a centralized public administration reminiscent of the road toward socialism. Even though microeconomics

of supply and demand determine prices throughout the country, centralization, in the creation of a national economic space, plays an important part in the market transition. That is, efforts to manage the market in Laos have required an efficient, rational, and uniform regulatory environment that all demand strong central control.

Ironically, the process of marketization in the Lao PDR, like its failed march towards socialism, requires centralization. This seemingly contradictory convergence appears, upon closer inspection, to have a logical rationale. In 1975, the Lao PDR began the search for the end of history, as Hegel and Marx envisioned the march towards democracy. Socialism instigated the centralization of political-administrative power in order to enact a central planning system. Since 1991, Lao communism has taken a turn towards a market system, and the search began anew. Likewise, the building of a market society within a national economic space involves a consolidation of political rule, rationalization of bureaucratic governance, and a centralization of fiscal prerogatives. The failure of state socialism has given rise to the faith in liberal democracies around the world. Instead of the march towards socialist serfdom, the current search for history's end entails the capitalist development of markets in Laos, as elsewhere.

Despite the competing world views advanced by capitalism and socialism, Laos' aborted venture in social engineering and unsteady march toward market society have both entailed building the foundations of a strong government capable of realizing public objectives. The road to serfdom and back offer two divergent paths toward modernity, whether in the mold of forced industrialization under the dictates of a central plan or through a pattern of capitalist development organized by market exchange. In either case, the state takes on various roles, differentiated by a matter of degree rather than kind. Nonetheless, modernizing peripheral states exhibit a centripetal bias of national development drawn toward centralization. Because the Lao

PDR possesses a weak central government, its ability to impose a competitive market has thus far proved limited. In the comprehensive overhaul and modernization of the Lao government, as evidence suggests, centralization provides an appropriate policy at the country's level of development.

Laos: Please Don't Rush

The idea of free markets presupposes an ideal type, or model, of a competitive society based upon an efficient allocation of resources and free consumer choice. By enslaving economic man, Hayek long ago warned, programs of socialist utopias invariably destroy the foundations of a free society. Once free of the impediments of socialist central planning, the creation of a market order idyllically leads to a decentralization of the economy, allowing *homo economicus* freely to choose the capitalist high road from serfdom. By forcing economic man to look beyond the self-interest of his wallet, the socialist allocative system degrades the collective bounty of society. In planning market outcomes, the socialist bureaucracy annihilates whatever economic incentives exist to maximize surplus value. Hayek and the liberalism he doggedly championed eventually conquered Lenin and the Marxism he brutally forced to fruition.⁴⁶⁹

However, capitalism and markets are not natural developments, but rather historical ones, rooted in social relations and structured by prevailing norms of society. In the secular religion of neoliberalism, capitalism and free markets are treated more or less as an organic growth— a spontaneous order— that magically emerges once the final obstacles of state intervention and obstruction in the economy

⁴⁶⁹ Echoing Say's Law, Hayek claims that laissez-faire economies tend towards equilibrium. Countering Keynes, he argues that the state is the root of all economic evils. Economic crises arise when uninformed bureaucrats tamper arbitrarily in the economic system. "The State, in Hayek's view, was not an executive committee of a ruling class, but... an independent bureaucratic force which, by its Leviathan nature, was coercive and against freedom. Any policy that strengthened the role of the state negated liberalism." See Bell, "Prospects of American Capitalism," 80.

are removed. In the former communist block, the road from socialist serfdom leads to the highway of economic liberalism. This process of marketization entails not only economic logic of supply and demand, but also a reassessment of society values, a re-evaluation of public goals, and renegotiation of the content of citizenship. These propositions transcend a simple all or nothing choice of states versus markets, demanding instead political compromises with undeniable trade-offs based upon evolving standards of social norms.

In an era where American capitalism reigns supreme as an imperial ideological force, its imposition on unsuspecting societies can only lead to wholesale disruptions of their social and political institutions. International development technocrats (whether from the World Bank, IMF, or United Nations) push privatization and decentralization schemes that usually create havoc on developing countries. They ignore Polanyi's fundamental observation that an economic system is a function of social organization. The promotion of Western liberal economy cannot easily produce a Western democratic society. From economic orthodoxy, decentralization and privatization in developing countries (albeit initially disruptive to society) create internal demands for institutional and social reforms along democratic and liberal economic lines. However, the converse is more appropriate, plausible, and humane. The building of civil society and social institutions must take precedence over market reforms. Otherwise, we may continue to see the wholesale annihilation of societies which shortchange social development for economic gains that, nonetheless, never materialize.

In the high phase of communism, central planning dictated inefficient market outcomes. For late socialism of the remaining ideological heirs of Marxist-Leninism, the party-state has pragmatically resigned itself to the limited role of designing market rules and providing for public goods. The demise of Soviet communism in the early

1990s has forced all socialist countries to embrace a form of market economy which provides a larger scope for the private sphere of economic activity separate from the state. Governments cannot systematically dictate market results. State policies now generally focus on creating structures of economic incentives in their design of market rules, as well as managing macroeconomic stability to improve the investment climate for development. For a peripheral state like Laos, this transition has engendered an organizational logic of centralization.

Against the pro-market enthusiasm for smaller government that decentralization ostensibly promotes, the experience in Laos suggests caution. The complex reality of government restructuring in Laos reveals the limitations of the neoliberal thrust for smaller government in the transition to capitalism. The national state continues to provide an essential, if not the primary, substance and meaning to social change and transformation. Economic integration does not produce a predetermined outcome but, rather, reflects a choice with inescapable trade-offs. Nor does capitalist incorporation diminish the role of the state. In an integrating world of unequal exchange, governments and institutions continue to matter. States play an essential economic role in promoting capitalist expansion.⁴⁷⁰

Development requires purposeful government action to promote societal values and development objectives, however defined. On the country's road from

⁴⁷⁰ Commenting on the inadequacies of prevailing thinking on globalization, Leo Panitch asserts, there is the problem of tending to ignore the extent to which today's globalization is authored by states and is primarily about reorganizing rather than bypassing them. A false dichotomy between the national and the international is promoted, which diverts attention from the need to develop new strategies for transforming the state, even as a means of developing an appropriate international strategy.

See Leo Panitch, "Rethinking the Role of the State," in *Globalization: Critical Reflections*, ed. James H. Mittelman (Boulder, CO: Lynne Rienner Publishers, 1996), 85. He goes on to argue that capitalist globalization "takes place in, through, and under the aegis of states." The process involves shifts in domestic power relations. Often this transferal entails "the centralization and concentration of state powers as the necessary conditions of and accompaniment of global market discipline." (Panitch, "Rethinking the Role of the State," 86.)

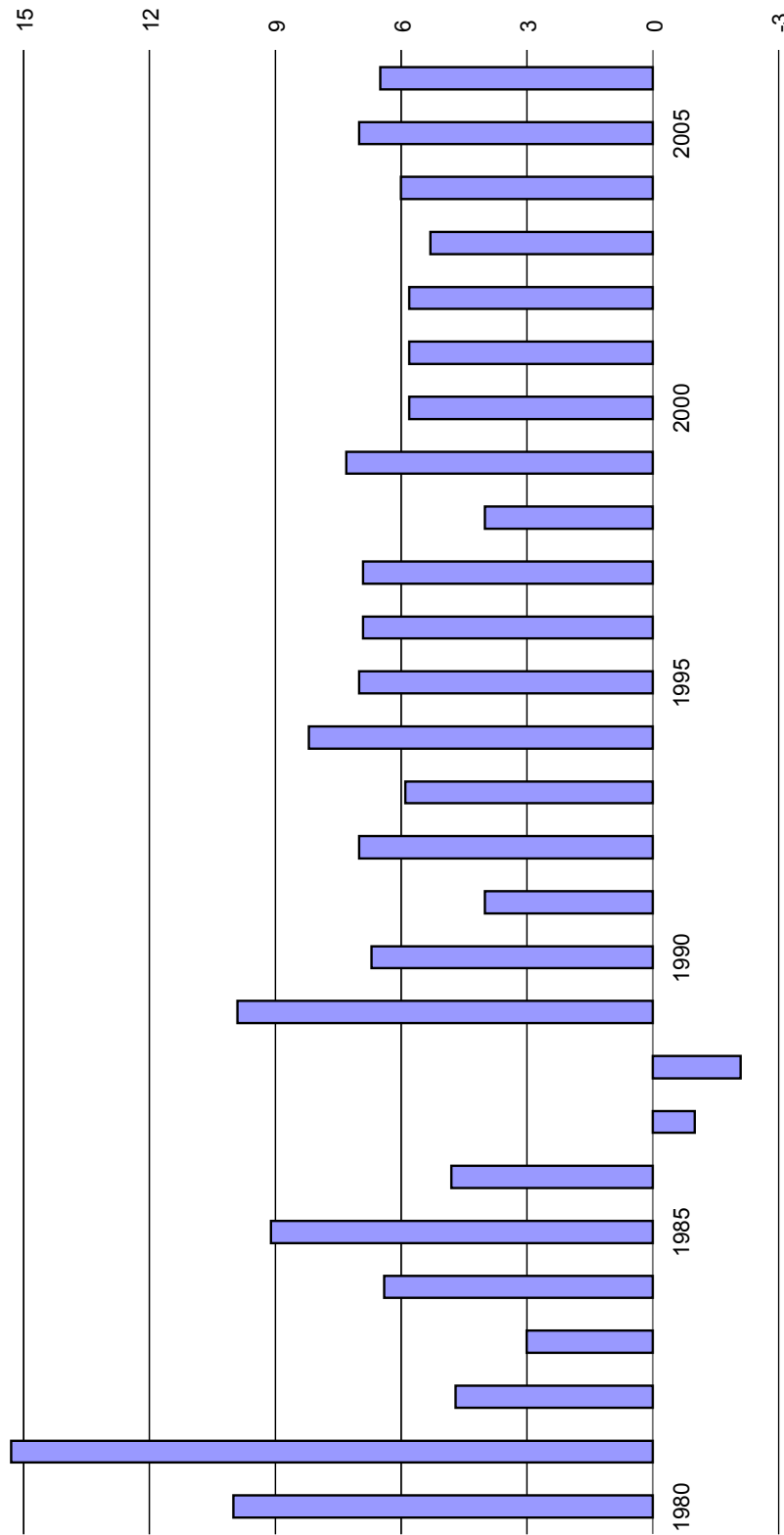
socialist serfdom, the Lao state remains a key site of not only economic management, but also social change and sensible development. Its political and economic consolidation follows a familiar pattern of peripheral states. Its cautious and, at times, ad hoc policymaking suggests a willingness to experiment and innovate, however sporadically. Its pragmatism places tangible results ahead of ideology, particularly in the party's continuing struggle for internal legitimacy and external sovereignty. In a running joke on the country's pace of liberalization, some observers lightheartedly contend that Lao PDR should really stand for Laos: Please Don't Rush!

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Appendix A1. Map of Laos**Figure A1. Map of Laos**

Appendix A2. Gross Domestic Product, Lao PDR, 1986-2006



Source: World Economic Outlook, April 2005 database. <http://www.imf.org/external/pubs/ft/weo/2005/01/data/index.htm>

Figure A2. GDP Growth, Percent Change over Previous Year, Lao PDR, 1986-2006*

Note: * Figures for 2005-06 are IMF staff estimates.

Appendix A3. National Accounts, Lao P.D.R., 1995-2000

Table A1. Real Gross Domestic Product (Billions of Kip), by Industrial Origin, Lao PDR, 1995-2003*

Sector	1995	1996	1997	1998	1999	2000	2001	2002	2003
<i>Agriculture</i>	454	464	498	514	556	584	606	630	643
Crops	216	218	253	270	306	347	361	373	373
Livestock and fishery	179	186	188	193	197	202	207	217	227
Forestry	59	60	57	51	53	35	38	40	43
<i>Industry</i>	157	183	200	217	234	254	281	308	343
Mining and quarrying	2	2	4	4	5	5	6	6	22
Manufacturing	116	138	150	164	176	189	212	239	254
Construction	28	30	33	28	28	25	29	27	30
Electricity, gas, and water	11	13	13	21	25	35	34	36	37
<i>Services</i>	204	223	240	251	268	281	298	315	337
Transportation, storage, and communication	44	50	53	56	60	65	71	77	84
Wholesale and retail trade	69	76	85	93	100	105	114	123	136
Banking, insurance, and real estate	12	12	13	13	13	9	10	5	6
Ownership of dwellings	28	30	31	32	32	33	34	35	36
Public wage bill	28	28	28	29	31	33	34	39	40
Nonprofit institutions	10	11	11	8	8	9	8	8	8
Hotels and restaurants	12	14	17	18	22	25	25	26	25
Other	1	2	2	2	2	2	2	2	2
GDP at factor cost	815	870	938	982	1,058	1,119	1,185	1,253	1,323
Import duties	21	23	19	11	6	8	9	10	11
GDP at market prices	836	892	955	993	1,065	1,127	1,192	1,262	1,336

Source: International Monetary Fund, Staff Reports and Selected Issues and Statistical Appendix, Washington, DC: IMF, various years.

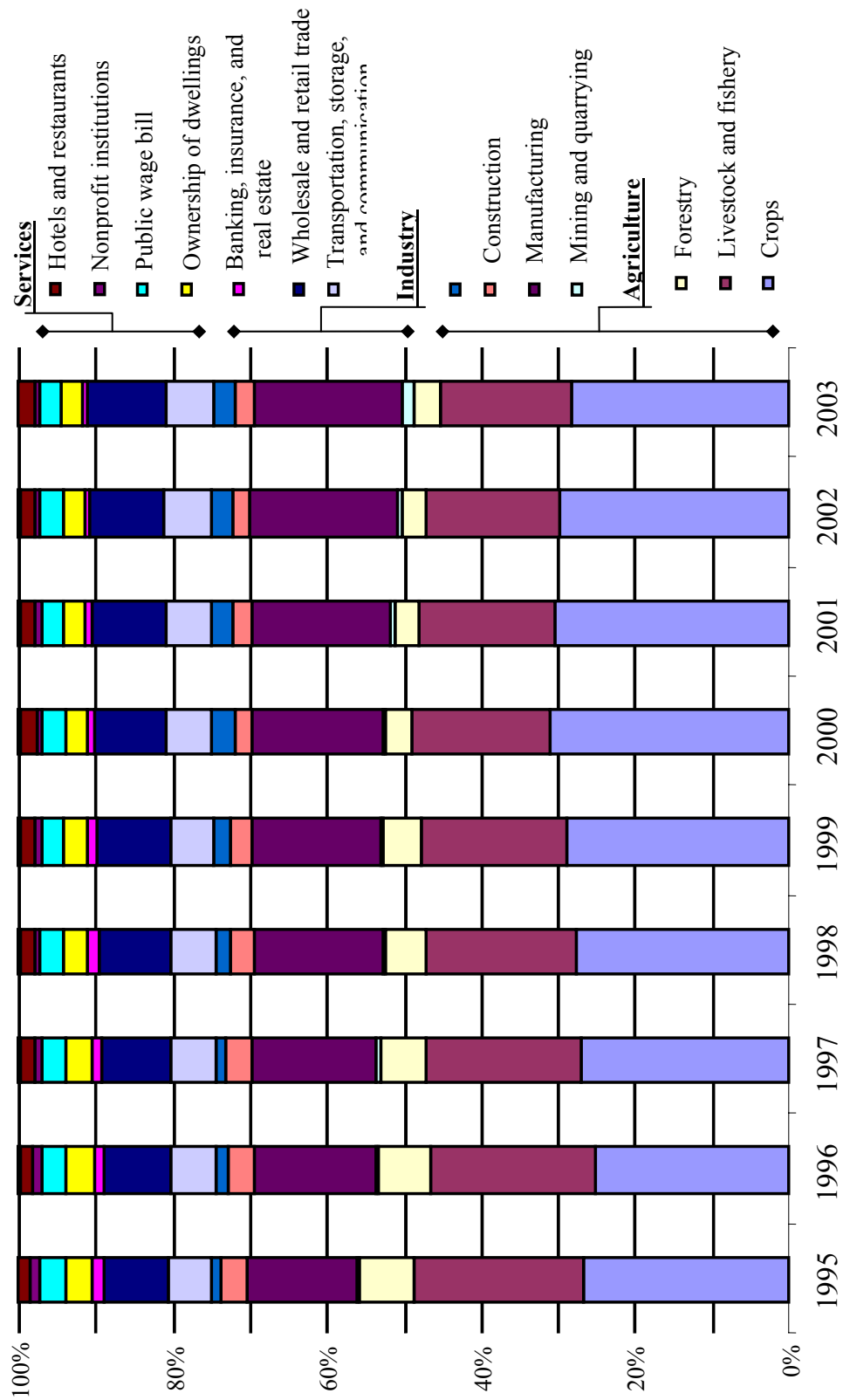
Note: * GDP in billions of Kip, at real 1990 constant prices. 2003 figures are IMF staff estimates.

Table A2. Real Gross Domestic Product, Percent of Total, by Industrial Origin, Lao PDR, 1995-2003*

Sector	1995	1996	1997	1998	1999	2000	2001	2002	2003
<i>Agriculture</i>									
Crops	55.7	53.3	53.1	52.3	52.6	52.2	51.1	50.3	48.6
Livestock and fishery	26.5	25.1	27.0	27.5	28.9	31.0	30.5	29.8	28.2
Forestry	22.0	21.4	20.0	19.7	18.6	18.1	17.5	17.3	17.2
<i>Industry</i>	7.2	6.9	6.1	5.2	5.0	3.1	3.2	3.2	3.3
Mining and quarrying	19.3	21.0	21.3	22.1	22.1	22.7	23.7	24.6	25.9
Manufacturing	0.2	0.2	0.4	0.4	0.5	0.4	0.5	0.5	1.7
Construction	14.2	15.9	16.0	16.7	16.6	16.9	17.9	19.1	19.2
Electricity, gas, and water	3.4	3.4	3.5	2.9	2.6	2.2	2.4	2.2	2.3
<i>Services</i>	1.3	1.5	1.4	2.1	2.4	3.1	2.9	2.9	2.8
Transportation, storage, and communication	25.0	25.6	25.6	25.6	25.3	25.1	25.1	25.1	25.5
Wholesale and retail trade	5.4	5.7	5.7	5.7	5.7	5.8	6.0	6.1	6.3
Banking, insurance, and real estate	8.5	8.7	9.1	9.5	9.5	9.4	9.6	9.8	10.3
Ownership of dwellings	1.5	1.4	1.4	1.3	1.2	0.8	0.8	0.4	0.5
Public wage bill	3.4	3.4	3.3	3.3	3.0	2.9	2.9	2.8	2.7
Nonprofit institutions	3.4	3.2	3.0	3.0	2.9	2.9	2.9	3.1	3.0
Hotels and restaurants	1.2	1.3	1.2	0.8	0.8	0.8	0.7	0.6	0.6
Other	1.5	1.6	1.8	1.8	2.1	2.2	2.1	2.1	1.9
	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
GDP at factor cost	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Import duties	2.1	2.3	1.9	1.1	0.6	0.8	0.9	1.0	1.1
GDP at market prices	102.1	102.3	101.9	101.1	100.6	100.8	100.9	101.0	101.1

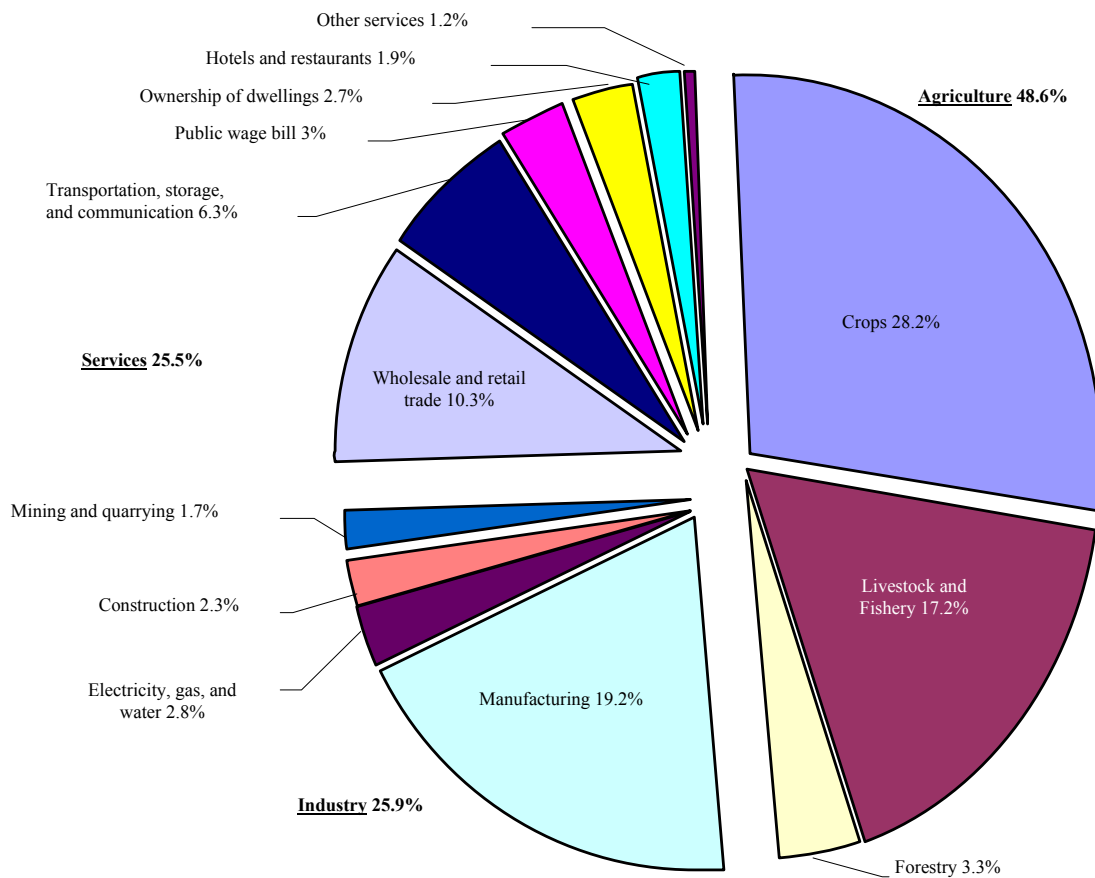
Source: Calculated from International Monetary Fund, Staff Reports and Selected Issues and Statistical Appendix, Washington, DC: IMF, various years.

Note: * GDP in billions of Kip, at real 1990 constant prices. 2003 figures are IMF staff estimates.



Source: Table A2

Figure A3. GDP by Industrial Origin, Percent of Total, Lao PDR, 1995-2003



GDP: 1,323 billion kips

Source: Table A2

Figure A4. GDP by Industrial Origin, Lao PDR, 2003

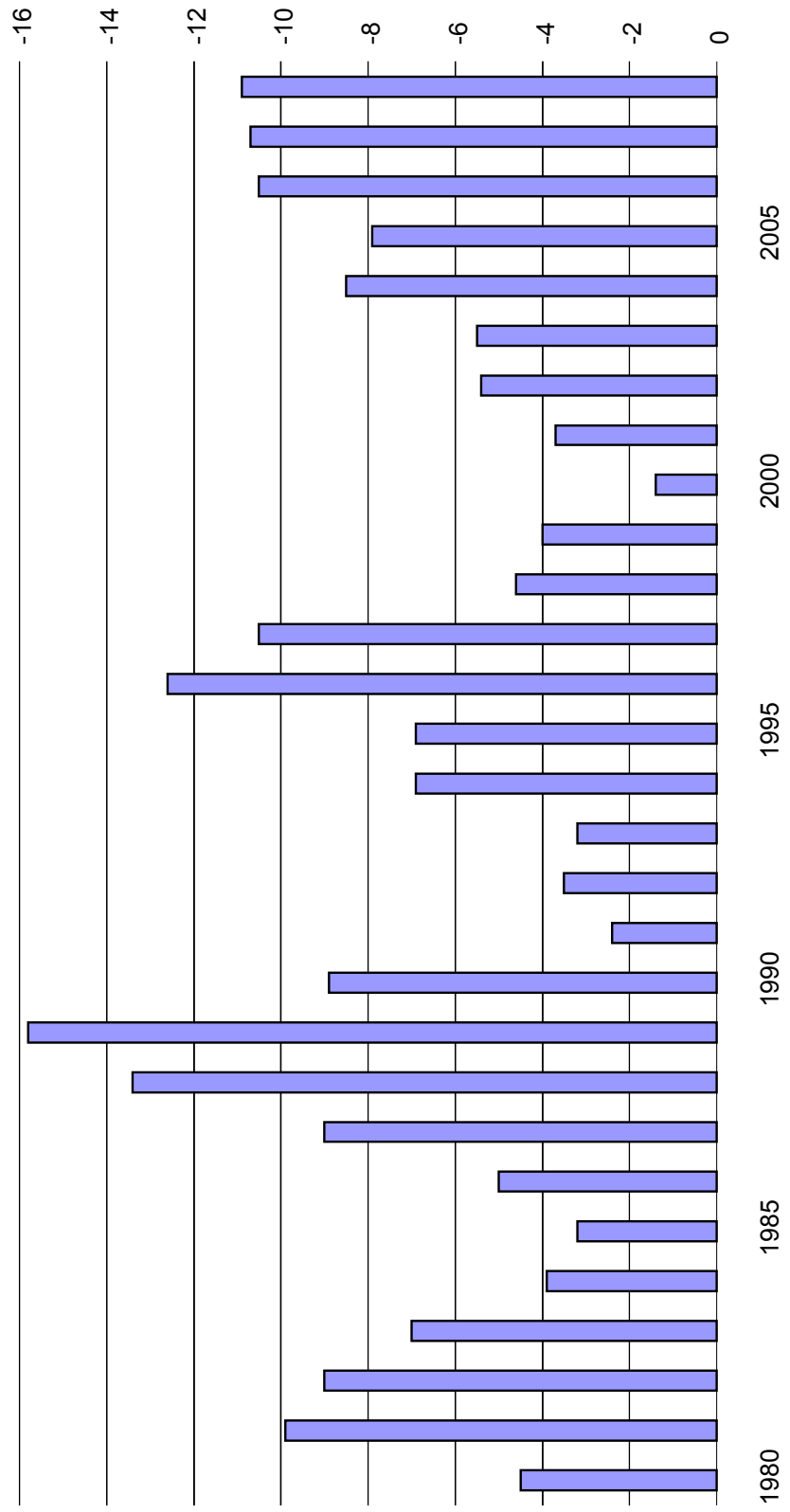
Appendix A4. Balance of Payments, Lao PDR 1996-2008

Table A3. Balance of Payments, Lao PDR, 1996-2008*

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Current Account	-224.7	-185.1	-52	-58.3	-14.3	-65.6	-97.7	-116.2	-204	-210	-304	-336	-367
<i>Excluding official transfers</i>	<i>-306.7</i>	<i>-282.1</i>	<i>-126</i>	<i>-128.3</i>	<i>-129.3</i>	<i>-128.6</i>	<i>-145.7</i>	<i>-179.2</i>	<i>-276</i>	<i>-285</i>	<i>-385</i>	<i>-421</i>	<i>-457</i>
Merchandise trade balance	-367.7	-331.1	-212	-212.3	-207.3	-208.6	-229.7	-217.2	-315	-201	-201	-238	-278
Exports, f.o.b.	322.6	316.8	340.8	342	354.7	333.6	340.4	401	437	563	663	683	705
Imports, c.i.f.	690.3	647.9	552.8	554.3	562	542.2	570.1	618.2	752	764	864	921	983
Services (net)	25	28	71	99	132	125	131	95	122	97	68	80	93
Income (net)	-7	-22	-34	-45	-75	-67	-70	-81	-108	-208	-282	-295	-307
of which: interest payments	6	-19	-24	-35	-38	-35	-29	-35	-47	-45	-44	-42	-115
of which: public debt	0	0	0	-8	-11	-11	-10	-12	-26	-27	-27	-28	-30
Transfers (net)	125	140	123	100	136	85	71	87	97	102	111	117	125
Private	43	43	49	30	21	22	23	24	25	27	30	32	35
Official	82	97	74	70	115	63	48	63	72	75	81	85	90
Capital Account	295	154	39	62	69	65	153	135	212	214	332	373	402
Medium-and Long-Term loans	139	161	86	93	63	66	127	89	72	185	324	338	342
Disbursements	155	179	98	134	99	105	165	136	139	256	406	418	427
Amortization	-16	-18	-12	-41	-36	-39	-38	-47	-67	-71	-82	-80	-85
of which: public debt	0	0	-7	-29	-36	-39	-38	-47					
Foreign Direct Investment	176	104	56	52	31	24	60	69	186	105	86	88	90
Net foreign assets of commercial banks	-7	14	-17	-3	25	28	-7	-21	-38	-35	-35	-35	-25
Other private flows and errors and omissions	91	-125	-86	-80	-50	-53	-27	-2	-9	-41	-43	-18	-5
Overall balance	70.3	-31.1	-13	3.7	54.7	-0.6	55.3	18.8	8	4	28	37	35
Financing - Central bank net foreign assets	-69	30	18	-3	-43	1	-55	-20	-30	-21	-28	-38	-36
Assets (increase -)	-74	31	23	6	-33	6	-62	-20	-23	-21	-28	-38	-36
Liabilities (reduction -)	5	-1	-5	-9	-10	-5	7	0	-7	0	0	0	0
Memorandum items:													
Current account (percent of GDP)	-12.2	-10.7	-4.4	-4	-0.8	-3.7	-5.4	-5.6	-8.5	-7.9	-10.5	-10.8	-10.9
(excluding official transfers)	-16.6	-16.3	-10.1	-8.7	-7.4	-7.3	-8	-8.6	-11.4	-10.7	-13.3	-13.5	-13.5
Gross official reserves													
(millions of U.S. dollars)		136	112	106	127	134	196	216	239	260	287	325	361
(months of goods and services imports)		2.7	2.2	2.1	2.6	2.6	3.5	3.2	3.9	4.2	4.3	4.5	4.5
Public debt service ratio													
(percent of exports of goods and services)		7.3	9.7	6.2	5.8	7.2	7.1	7.2					
Nominal GDP at market prices (US\$ millions)		1,729	1,273	1,473	1,740	1,762	1,818	2,088	2,412	2,665	2,895	3,125	3,375

Source: International Monetary Fund, Staff Reports and Selected Issues and Statistical Appendix, Washington, DC: IMF, various years.

Note: * Figures for 2005-06 are IMF staff estimates.



Source: Calculated from World Economic Outlook, April 2005 database.
<http://www.imf.org/external/pubs/ft/weo/2005/01/data/index.htm> and IMF Country Report No. 05/8, January 2005, Washington, DC: IMF, Table 2, p. 24.

Figure A5. Current Account Deficits, Percent of GDP, Lao PDR, 1980-2008*

Note: * Figures for 2004-2008 are IMF staff projections.

Table A5. Composition of Imports, Lao PDR, 1991-2003^a

Imports (US\$ millions)	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Customs data (cif) ^b	135	210.5	338.5	422.6	473.2	585	494.5	460.8	436.7	449.8	462.4	489.7	535.2
Investment goods	43.1	70	113.8	146.1	189.4	277	226.8	226.7	184.1	161.8	182.3	209.6	231.2
Machinery and Equipment	8.6	14	22.7	32	43.8	71.3	52	44.4	21	16.2	36.2	53.0	63.0
Vehicles ^c	10.4	16.9	27.5	25	36	71.7	53.8	39.4	35.8	23.3	27.3	27.7	33.4
Fuel ^c	5.6	9	14.7	21.4	30.8	32.8	38.2	61.8	36.7	79.1	57.9	57.9	60.8
Construction/ electrical equip.	18.5	30.1	48.9	67.7	78.8	101.2	82.8	81.1	90.5	43.2	60.9	71.0	74.0
Consumption goods	91.9	140.5	224.7	276.5	283.8	309	267.7	234.1	252.7	288.0	280.1	280.1	304.0
Materials for garment industry	13.7	22.3	36.2	51.3	66.3	70	73.7	66.8	66.5	60.4	65.6	62.6	65.4
Motorcycle parts for assembly	10.2	16.6	27	34.6	13.3	12.7	24.9	17	38.3	22.6	0.0	0.0	0.0
Cars for re-export	0	6.5	14.5	4.5	0	0	0	0	0	0.0	...	...	...
Gold and Silver	4.9	7.9	12.9	46.8	29.5	18.8	50.4	0.7	2.1	1.5	5.4	8.1	6.9
Electricity	0.9	1.5	2.4	2.4	3.1	2.6	3.2	5.8	8.6	5.8	6.4	7.2	8.3
Fuel purchases abroad by Lao carriers	0.2	0.3	0.5	2	3.5	1.2	1.3	1.7	2	2.3	2.4	2.5	2.4
Unrecorded imports (c.i.f.)									...	19.6	0.0	0.0	0.0
Total imports (cif)	215	265.6	432	564.2	588.9	690.3	647.9	552.8	554.3	562.0	542.2	570.1	618.2
Imports (fob) (less 8%) ^d	197.8	244.4	397.4	519.1	541.8	635.1	596.1	508.6	509.9	437.7			
Total import/GDP (%)	n.a	n.a	n.a	36.6	32.9	37.3	37.3	45	34.5	34.9			
Growth rate of total imports (%)		23.5	62.7	30.6	4.4	17.2	-6.1	28	0.3	1.4	-3.5	5.1	8.4

Source: Bank of Lao PDR and Customs Department, Ministry of Finance, as compiled in *IMF Country Report No. 05/9*, Table 17, p. 45.

Notes: ^a 2003 figures are IMF staff estimates

^b c.i.f. = cost, insurance, and freight.

^c 50 percent of total assumed to be consumption goods.

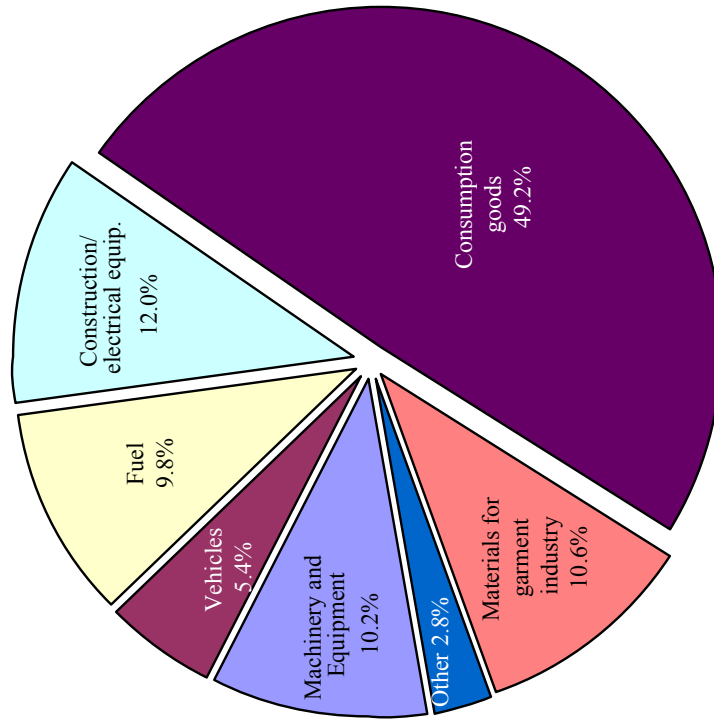
^d f.o.b. = free on board.

Table A6. Composition of Exports, Lao PDR, 1991-2003*

Exports (US\$ millions)	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Customs data	60.2	81.8	117.3	147.6	166.6	195.3	142.3	181.9	136.3	127.8	127.4	131.1	145.6
Wood products	40.9	42.7	65.9	96.1	88.3	124.6	89.7	115.4	84.9	87.1	92.7	93.5	93.5
Logs	3	9.7	16.8	41.8	28.7	34.3	16.7	10.5	20.0	26.0	...	...	...
Timber	37.9	33	39.3	48.5	51.5	78.7	67.4	87.4	26.9	37.7	...	...	...
Other and unrecorded	0	0	9.8	5.8	8.1	11.6	5.6	17.5	38.0	23.4	...	...	...
Coffee	3	2.4	4.1	3.1	21.3	25	19.2	48	15.2	12.1	14.9	17.1	18.7
Agriculture/ forest products	3.7	7.3	9.2	12.1	13.7	17.8	18.1	8.4	8.3	15.4	8.6	9.9	9.4
Manufactures									27.9	9.6	11.2	10.6	24.0
Other products	12.6	29.4	38.1	36.3	43.3	27.9	15.3	10.1	0.0	3.6	...	...	...
Garments	15.1	27.3	49	58.2	76.7	64.1	90.5	70.2	72.0	91.6	98.7	104.9	104.9
Motorcycles	0	6.5	36	46.2	17.7	12.5	17.1	17.8	38.4	22.1	...	...	...
Electricity			19.6	24.8	24.1	29.7	20.8	66.5	90.5	112.2	106.4	103.6	91.0
Gold exports and re-exports			4.2	18.8	21.9	15.2	41.5	0	0.0	0.0	0.0	0.0	58.7
Fuel purchased by foreign carriers			0.4	0.4	0.4	0.5	0.4	0.8	0.8	1.0	1.1	0.8	0.8
Adjustment for Russian debt					3.6	5.4	4.2	4	4.0	0.0	0.0	0.0	0.0
Total Exports	96.6	132.6	240.6	300.5	311	322.6	316.8	340.8	342.0	354.7	333.6	340.4	401.0
Total export/GDP (%)				19.5	17.5	17.4	18.2	27.7	23.2	19.8	18.9	18.7	19.2
Growth rate of total exports (%)		37.3	81.4	24.9	3.5	3.7	-1.8	41.6	1.5	3.7	-5.9	2.0	17.8

Source: Bank of Lao PDR and Customs Department, Ministry of Finance, as compiled in *IMF Country Report No. 05/9*, Table 17, p. 45.
Note: * 2003 figures are IMF staff estimates.

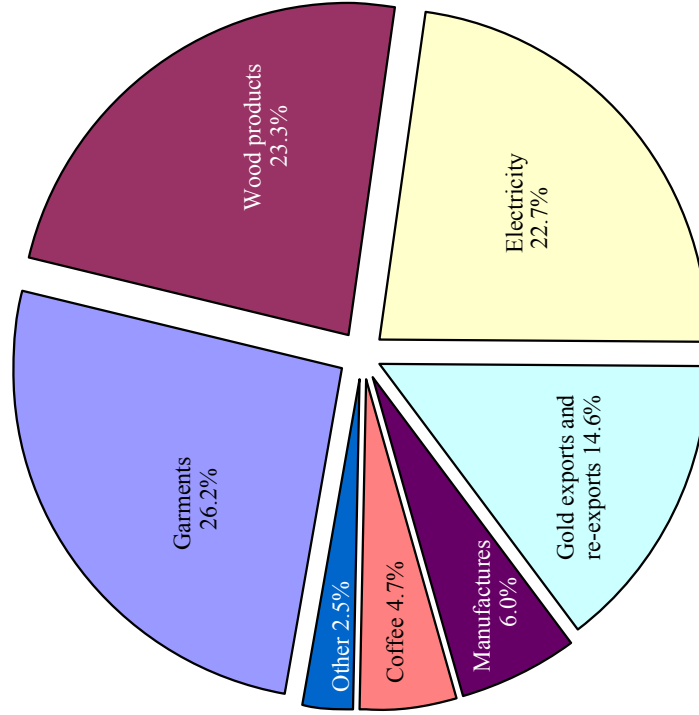
Total Imports: US\$ 618.2 million



Source: Table A5

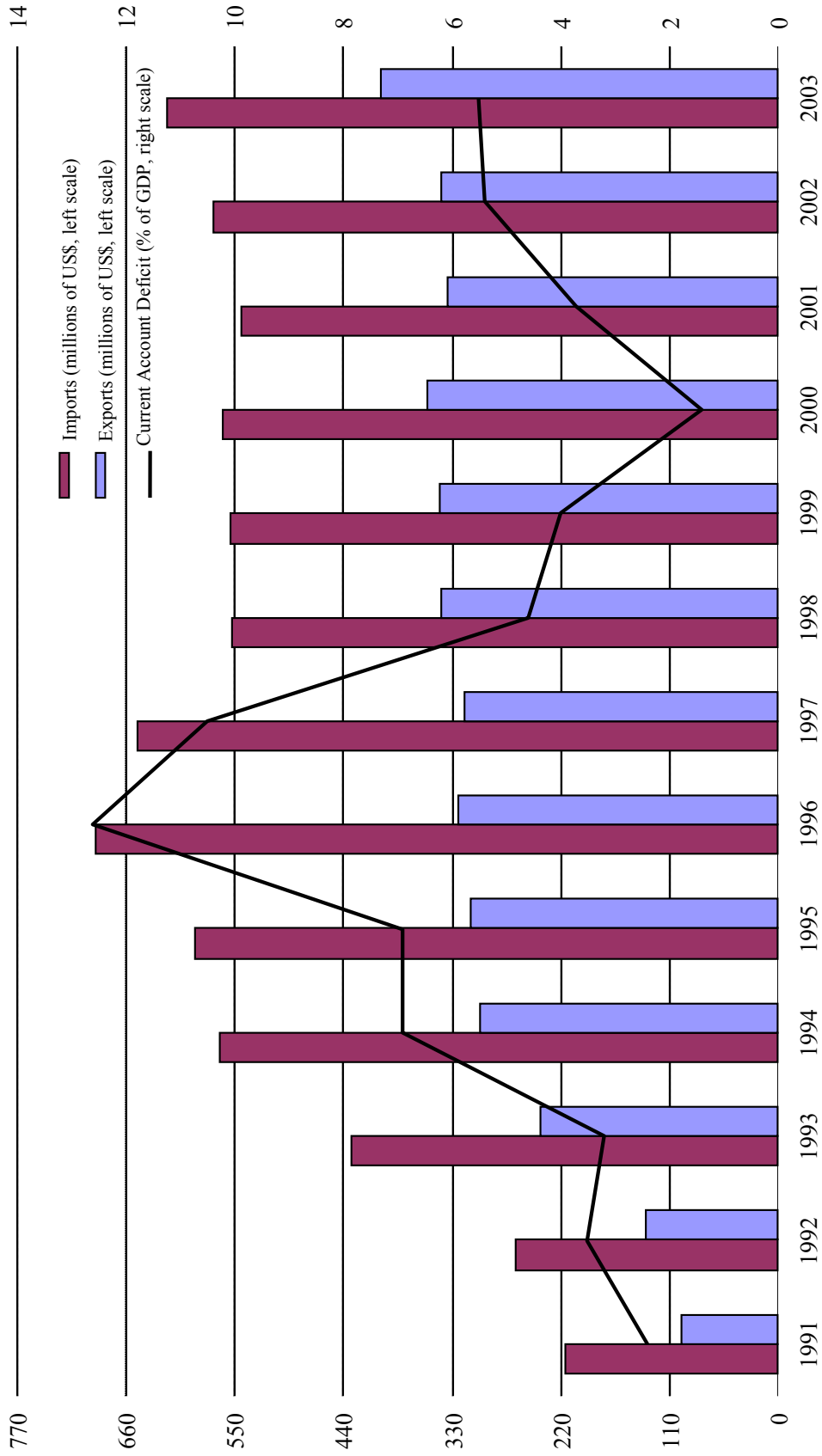
Figure A6 Composition of Imports, Lao PDR, 2003

Total Exports: US\$ 410.0 million



Source: Table A6

Figure A7. Composition of Exports, Lao PDR, 2003



Source: Tables A5, A6

Figure A8. Current Account, Exports, and Imports, Lao PDR, 1991-2003

Appendix A5. State of Civil Service, Lao PDR

According to official figures, the government apparatus oversee a civil service that roughly numbers 90,070, up 28 percent since 1995.⁴⁷¹ See Table A7 below. Many government employees lack the technical competence and educational training that their workers have a university education, with the majority skilled in some form of vocational training. The workforce is relatively young; 82 % of government employees are under age 40.⁴⁷² The vast majority of civil servants (four-fifths) work outside the capital, in provincial and district levels.⁴⁷³ See Figure A9. The remaining employees work in government ministers in Vientiane (11%) or take various party appointments throughout the country (7%).

⁴⁷¹ Government of Lao PDR, "Background Paper on Governance," 30. These figures should be treated with caution. They are only broadly indicative. Figures for civil servants do not include army personnel, workers in state-owned enterprises, contractual workers, or village chiefs. Of these exclusions, only salaries for village chiefs are paid out of the national budget. The government maintains a standing army of 29,100 soldiers, supplemented by a local militia numbering about 100,000. See Clay Wescott, ed., *Key Governance Issues in Cambodia, Lao PDR, Thailand, and Viet Nam* (Manila, Philippines: Asian Development Bank, 2001) 24. According to Keuleers, "District Administration," 47, village chiefs receive a monthly stipend of 10,000 kip, or US\$ 1.25.

⁴⁷² Chagnon et al., "Good Governance in Laos," 51.

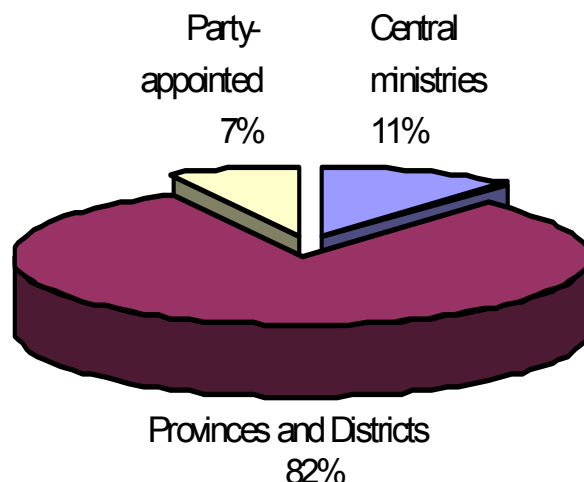
⁴⁷³ Wescott, ed., *Governance Issues in Sea* 26. puts this figure as high at 89 percent.

Table A7. Civil Servants by Educational Background
Lao PDR, various years, 1995-2002*

Level of Education	1995/96		1997/98		2000/01		2001/02		1995-2002
		% Total		% Total		% Total		% of Total	% change
General Education	7,568	10.7	6,822	8.2	32,860	36.1	8,237	9.1	8.8
Lower Technical	28,586	40.5	33,763	40.6			26,749	29.7	-6.4
Middle Technical	23,389	33.2	29,611	35.6	29,008	31.8	33,790	37.5	44.5
University and Upper Technical	10,693	15.2	12,613	15.2	17,821	19.6	16,033	17.8	49.9
Postgraduate	317	0.4	391	0.5	1,010	1.1	919	1.0	189.9
Education Unspecified	-	0.0	-	0.0	10,445	11.5	4,342	4.8	-
Total	70,553	100.0	83,200	100.0	91,144	100.0	90,070	100.0	27.7

Source: Government of Lao PDR. "Public Service Reform, People's Participation, Rule of Law and Sound Financial Management: Background Paper on Governance." Vientiane, Lao PDR, 2003.

Note:* Figures exclude army personnel, workers in state-owned enterprises, contractual workers, and village chiefs.
positions demand. From government estimates, less than a fifth of documented



Source: Chagnon, Jacquelyn, Dirk Van Gansberghe, Binh Vongphasouk, and Roger Rumpf. "Looking Back to See Forward: Consultations About Good Governance and Participatory Development in the Lao PDR." Vientiane, Lao PDR: Swedish International Development Cooperation Agency, 2002, p. 52.

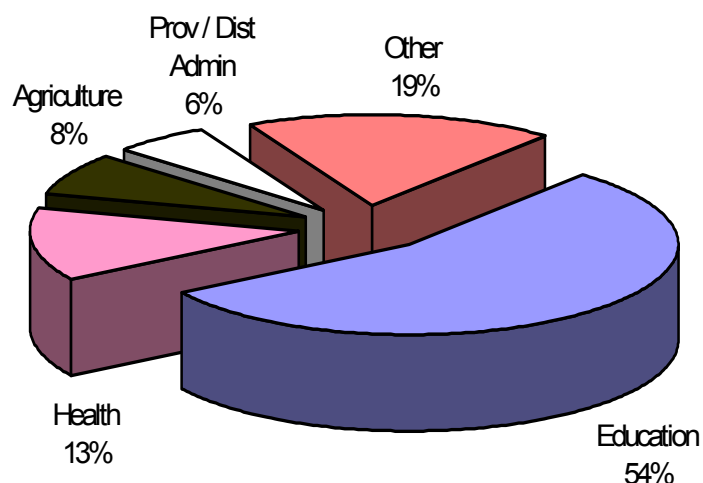
Figure A9. Appointment of Civil Servants by Location, Lao P.D.R., 1998

Over half of documented government staff work in the education sector, either as teachers or school administrators.⁴⁷⁴ See Figure A10 below. Women remain highly under-represented in government, accounting for only 6.2% of central staff, 2.1% of provincial employees, and 6.2% of local hire.⁴⁷⁵ No statistics on the ethnic make-up of government staff are currently available. However, anecdotal evidence suggests a low representation of non-Lao ethnic minorities.⁴⁷⁶

⁴⁷⁴ Underscoring the lack of qualified civil servants, an estimated 6,000-7,000 teachers are purely political appointments, with little or no teaching duties. According to Ibid., these government appointments are rewards for political loyalties of revolutionary cadres stemming from the civil war period.

⁴⁷⁵ Data from a 1999 Lao Women's Union study, as documented in United Nations Development Program, *National Human Development Report, Lao PDR 2001: Advancing Rural Development* 22. Most women take positions in either health or education.

⁴⁷⁶ In one project of governance reform, for example, 80-90% of government employees in piloted departments identified as the dominate ethnic Lao Loum, who comprise 40% of the country's population. See Governance and Public Administration Reform, "Organizational Review: Gpar Luang Prabang Project," (Vientiane, Lao PDR: United Nations Development Programme, Swedish International Development Cooperation Agency, Government of the Lao PDR, 2003), 16.



Source: Governance and Public Administration Reform. "Pay and Compensation in the Lao Civil Service." Vientiane, Lao PDR: UNDP, 1999, pp 13-4.

Figure A10. Civil Servants by Sectors, Lao P.D.R., 1998

Although the government releases no official figures on salaries, anecdotal evidence and case studies highlight the continuing problem of low remuneration. A preliminary report in 1999 puts public salaries in the range of US\$ 7 – 30 per month, at prevailing exchange rates.⁴⁷⁷ In a more recent study, teachers, who account for the majority of civil servants, receive a base salary of about 3 million kip per year, paid in 12 installments mid-monthly. In dollar terms, their wages equal US\$ 300 a year, or a monthly take-home base of \$25.⁴⁷⁸ Salaries in other ministries, especially in technical positions of finance or transportation, may rate higher but rarely exceed US\$ 50 per month. Considering a gross domestic product (GDP) per capita of US\$ 381 and a poverty level of 39% of the populace, government employment alone barely covers the living costs for food and basic necessities.⁴⁷⁹

⁴⁷⁷ Governance and Public Administration Reform, "Pay and Compensation in the Lao Civil Service," (Vientiane, Lao PDR: UNDP, 1999), Table 2, p. 21.

⁴⁷⁸ Chagnon et al., "Good Governance in Laos," 54.

⁴⁷⁹ Asian Development Bank, *Ppa, Lao PDR* 87.

An informal survey conducted in 2002 illustrates the lack of real growth in wages. Summarized in Table A8, this inquiry not only provides a snapshot of salaries for some high school teachers in Vientiane over the years, but also offers a glimpse of general government wages and subsidies for much of the civil service. In 1980, teachers received the kip equivalent of US \$10 per month, in addition to subsidized utilities and consumable allowances totaling US\$ 15. From the mid-1980s to the mid-1990s, base salaries gradually increased to about US\$ 50 per month, while subsidies eventually disappeared. In these intervening years, an income tax came into effect, further reducing real wages. Erasing these salary gains altogether, the 1997 Asian financial crisis contributed to high inflation in Laos. Consequently, the purchasing value of monthly salaries plummeted to US\$ 18. As economic conditions in the country improved, the government gradually increased public wages. By 2002, teacher

Table A8. Sample Teacher Wages, Vientiane High Schools

Lao P.D.R., 1980 - 2002

Year	Monthly Cash Payment	Monthly Value of Subsidies
1980	US\$10 (tax exempt)	\$15 value (rice, electricity, water, free housing for some, meat, sugar, and many consumables)
1986	US\$20 (tax exempt)	\$5 (water, electricity, free housing for some)
1991	US\$50 (taxed)	None
1998	US\$18 (taxed)	None
2002	US\$ 25 (taxed)	None

Source: Chagnon, Jacquelyn, Dirk Van Gansberghe, Binh Vongphasouk, and Roger Rumpf. "Looking Back to See Forward: Consultations About Good Governance and Participatory Development in the Lao PDR." Vientiane, Lao PDR: Swedish International Development Cooperation Agency, 2002, p. 54.

Note: Cash payments expressed in real values exchanged in U.S. dollars.

salaries rose to 250,000 kip per month, the equivalent of US\$ 25.⁴⁸⁰ Echoing the views of many in government, this survey reveals the precarious state of public remuneration. Adding insult, in many remote areas of the country, salary payments frequently fall three to six months in arrears.

In recently years, salaries and wages have absorbed about a fifth of the government's recurrent budget. For fiscal year ending 1997, the first year of published figures, government wages accounted for 4.5% of GDP. See Figure A11. Thereafter, wage outlays have contributed less to overall economic activity, tumbling to a low of 2.1% in fiscal year 1999 but rising steadily to 3.5% in 2004. Overall, these figures rate low in comparison to other countries in Southeast Asia, which manage to spend, on average, 4.5% of their GDP on government salaries.

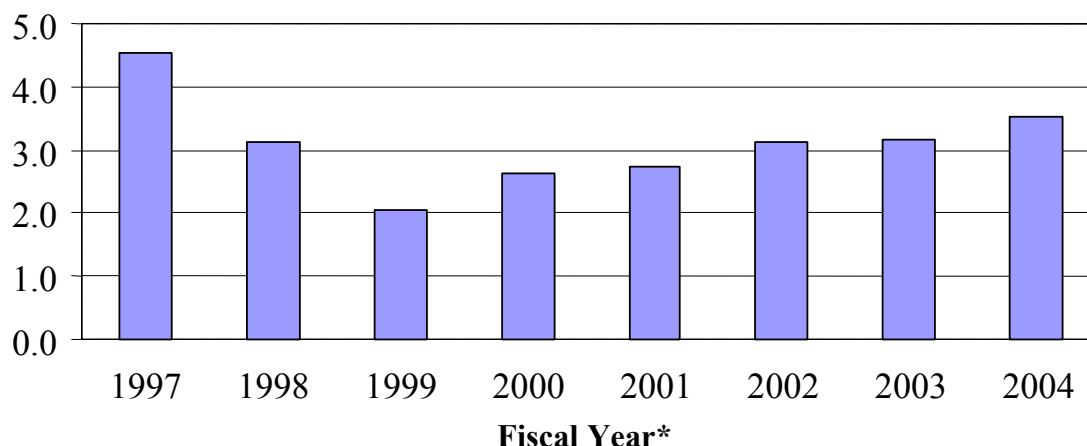
While these statistics reveal a weak public administration on many measures, the official structure, documented size, and apparent cost of the Lao civil service disguise the scope of the public sector. Possibly half of government employees do not appear on official statistics.⁴⁸¹ Although categorized as civil servants by the government, military personnel, police officers, employees of state-owned enterprises, and contract workers fail to appear on published payrolls.⁴⁸² The government does not

⁴⁸⁰ Salary raises occur every two years. Promotions occur twice a year, January and July. Salary increments are automatic, since almost everyone receives a positive performance appraisal. Nonetheless, real wages have remained flat for most of the history of the Lao PDR. See Governance and Public Administration Reform, "Performance Appraisal and the Lao Civil Service," (Vientiane, Lao PDR: United Nations Development Programme, 1999), 11.

In the aftermath of the Asian financial crisis, the education sector suffered deep cuts, as falling government revenues forced major cuts in expenditures. For the period 1996-98, teachers' wages decreased by almost two-thirds in real terms. Teaching careers have since looked less attractive. Enrollment in teacher training schools has dropped sharply, while recent graduates appear to seek careers in other fields. See World Bank, International Monetary Fund, and Asian Development Bank, "Lao PDR: Public Expenditure Review, Country Financial Accountability Assessment (Volume I: Summary Report)," (Washington, D.C.: WB, IMF, ADB, 2002), 14.

⁴⁸¹ Wescott, ed., *Governance Issues in Sea* 26.

⁴⁸² Chagnon et al., "Good Governance in Laos," 51. Although not considered as part of the civil service, village officials have also appeared on government payrolls.



Source: Calculated from IMF reports, various years.

**Figure A11. Government Wages and Salaries, Percent of GDP
Lao PDR, 1997 - 2004.**

Note: * Fiscal years extend for the period October 1-September 30.

compile a complete list of all public sector employees. Nor are there systematic procedures to remove former employees from the payroll.⁴⁸³ In distorting public expenditures, these “ghost workers” reflect a general lack of transparency in the public administration.

In monitoring fiscal expenditures, the Lao government sets staff quotas and budgetary targets for each ministry.⁴⁸⁴ Circumventing hiring limits, ministry officials have recruited (usually with donor funds) temporary employees, known as “contracted staff” or *sanyachang*.⁴⁸⁵ In one agency, for example, a knowledgeable official estimates that temporary workers comprise 20 percent of the workforce. Their

⁴⁸³ Wescott, ed., *Governance Issues in Laos* 26.

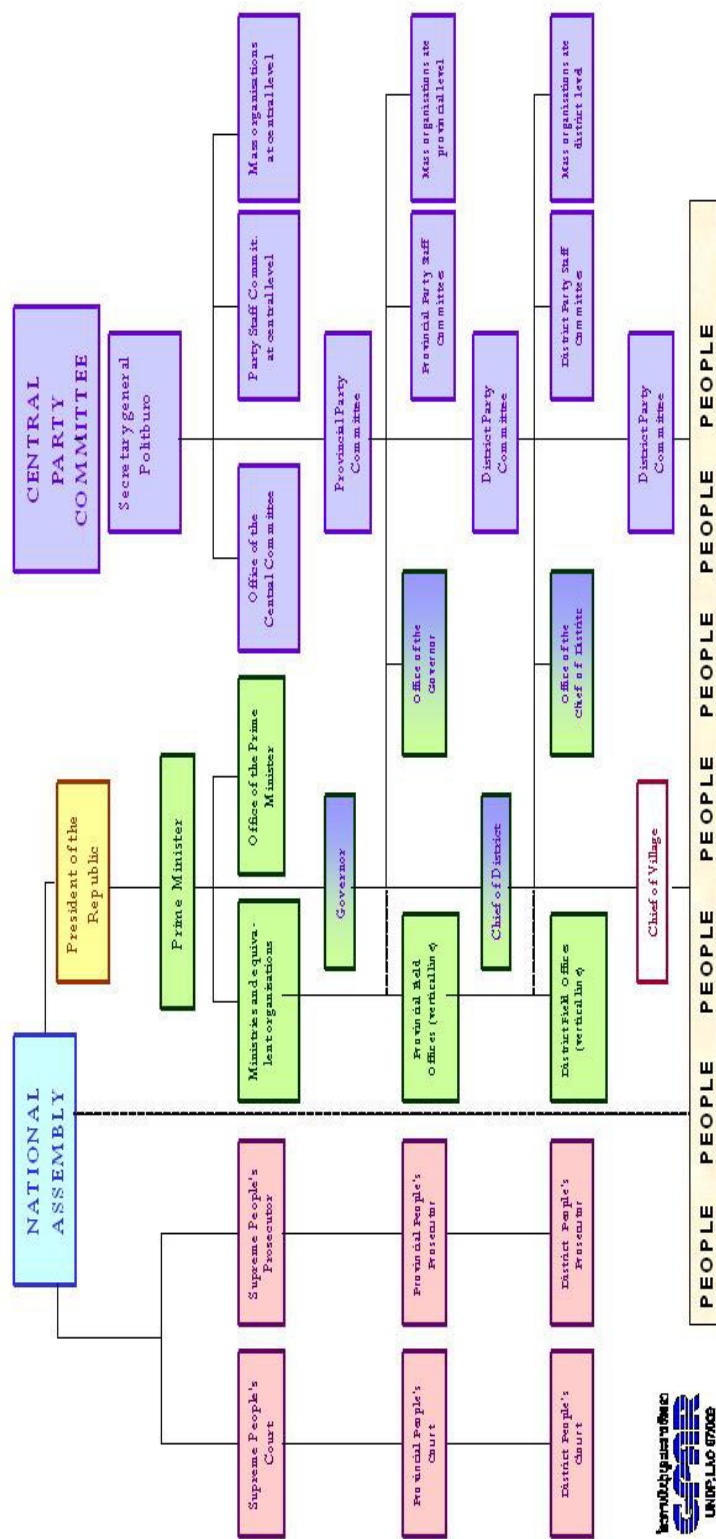
⁴⁸⁴ Several government policies actually prohibit staff increases. See Keuleers, “District Administration,” iii.

⁴⁸⁵ Chagnon et al., “Good Governance in Laos,” 51. The typical contract worker is a young, recent university graduate. Within a few years and usually after an examination process, some of these temporary employees may take on permanent positions. According to Keuleers, “District Administration,” 47, in 2001 a typical contract worker received a monthly salary of 65,000 kip, or US\$ 8.

numbers fail to appear on official ministry payroll or statistics.⁴⁸⁶ Because external assistance furnishes funds for most public works projects and practically every state agency, the ranks of temporary workers may run quite high.

⁴⁸⁶ Chagnon et al., "Good Governance in Laos," 51.

Appendix A6. Imagined Organizational Chart of Lao PDR



Source: United Nations Development Program. *National Human Development Report, Lao PDR 2001: Advancing Rural Development*. Vientiane, Lao PDR: UNDP, 2002.

Figure A12. Imagined Organization Chart of Lao PDR

Appendix A7. History of State Finances in Laos

Local nobility collected head taxes, payable in either cash or corvée labor, from subject populations in the scattered principalities that constituted pre-colonial Laos. In 1893, Laos became a French protectorate, one of five associated regions of Indochina.⁴⁸⁷ Under French colonialism, revenues were never enough to cover the cost of administrating the Lao territories. Head tax and monopolistic control over the sale and distribution of essential cash crops, most notably opium, composed the bulk of colonial revenues, which barely met the administrative cost of salaries for colonial civil servants. Transfers from Tonkin, the colonial center of Indochina, covered the remainder of operating costs in Laos. The French continued the traditional practice of corvée, which subjected all males in the 18-45 age range to labor demands of colonial administration.⁴⁸⁸

Discriminatory classifications of race and ethnicity emerged as a valuable instrument of colonial rule, especially in fiscal matters. For administrative expediency, the colonial government distinguished three broad categories of ethnic groups in Laos: *Lao Luom*, the predominate ethnic group dominating the low lying areas hugging the Mekong River and its tributaries; *Lao Theung*, taking the mountain sides and valleys; and *Lao Soung*, occupying the mountainous highlands.⁴⁸⁹ Out of these distinctions, the

⁴⁸⁷ The other parts of Indochina include Cambodia and the three regions composing Vietnam: Tonkin, Annam, and Cochinchina. In northern Laos, the Kingdom of Luang Prabang joined as a protectorate, in a form of indirect colonial rule. The French ruled central and southern Laos as direct colonies until 1899, when all of Laos became one administrative unit of French Indochina. For a good introduction to the history of Laos, see Grant Evans, *A Short History of Laos: The Land in Between* (Chiang Mai, Thailand: Silkworm Books, 2002).

⁴⁸⁸ Stuart-fox, *A History of Laos* 33.

⁴⁸⁹ Although highly inaccurate, this crude classification has provided various Lao governments, up to the 1980s, with a simple and straightforward way to sort-out the various ethnic make-up of Lao peoples. For an overview of the various classification schemes, see Joachim Schliesinger, *Ethnic Groups of Laos: Introduction and Overview*, vol. 1 (Bangkok: White Lotus, 2003). Currently, the Lao government recognizes 49 categories of ethnic groups in Laos, covering the Lao-Tai, Mon-Khmer, Chinese-Tibetan, and Hmong-Mien linguistic groups.

French increased taxation by doubling the head tax of the economically prosperous Lao Loum, while demanding more corvée from the other ethnic groups, whose labor proved essential for road building projects in the sparsely populated, mountainous regions of the colony.⁴⁹⁰ Over the period 1896-1910, direct taxation increased threefold but only covered about one-third of the colonial budget.⁴⁹¹ Under pressure to increase revenue generation in Laos, the colonial administration expanded the cultivation, sale, and distribution of opium, by far the most profitable government monopoly in Indochina. Through the 1930s, the market for opium thrived in northern Laos, where the mountainous terrain proved ideal for its production.⁴⁹² Ethnic Hmong (i.e., Lao Soung ethnic group) grew rich from the opium trade, and colonial administrators increasingly relied on its opium franchise to subsidize local budgets in Laos.⁴⁹³

⁴⁹⁰ For the Lao Loum, a head tax (2 piastres per year, plus 20 days of corvée) on all males in the age range of 19-60 applied. Piastres served as the major unit of currency for French Indochina, as well as Ottoman Turkey. The Lao Theung were compelled to pay one piastre per year and 10 days of corvée. Because of their capacity to pay, Lao Loum often commuted their corvée, substituting cash payments for labor obligations. Evans, *A Short History of Laos: The Land in Between* 46. In addition, Vietnamese and Chinese merchants residing in colonial Laos were also subject to head taxes, double and five times as much as Lao Loum respectively. Stuart-fox, *A History of Laos* 32-3.

⁴⁹¹ In 1910, the total budget in French Laos reached 900,000 piastres. Stuart-fox, *A History of Laos* 32.

⁴⁹² By formal agreement, revenues from opium sales were equally shared between the French colonial administration and the Royal house of Luang Prabang. In practice, this arrangement was impossible to police. By 1914, the royal administration lost its fiscal independence, and its budget was integrated into the overall colonial budget of Indochina. See Evans, *A Short History of Laos: The Land in Between* 46.

⁴⁹³ From the late 1890s, Governor-General Paul Doumer transformed fiscal deficits in French Indochina into surpluses through a series of fiscal reforms and the rationalization of the opium business. Doumer consolidated the five colonial budgets into one centralized treasury, in the process reorganizing the five autonomous opium agencies into a single opium monopoly. His administration oversaw the construction of a modern opium refinery in Saigon. During his four years in office, Doumer increased opium revenues by 50 percent; the monopoly contributed to over one-third of all colonial revenues. By 1918, French Indochina boasted 1,512 opium dens and 3,098 retail shops. Throughout the colonial period, opium revenues steadily increased and, by 1938, raised 15 percent of all colonial revenues—the highest proportion of administrative budgets in Southeast Asia. See Alfred W. McCoy, *The Politics of Heroin: CIA Complicity in the Global Drug Trade. Afghanistan, Southeast Asia, Central America, Colombia*, 2nd Revised ed. (Chicago: L. Hill Books, 2003) 111-2.

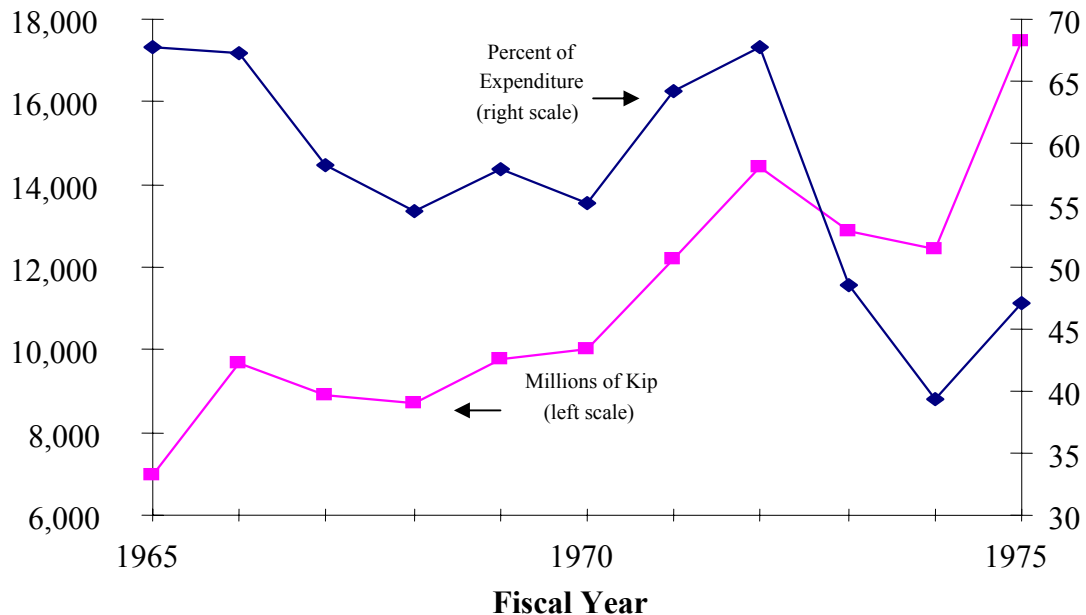
Formal independence in 1953, under a constitutional monarchy, failed to change the basic calculus of fiscal crises. The end of colonial rule, along with the disappearance of French subsidies through the Indochinese budget, deepened fiscal crises for the Royal Lao government. With the French in full retreat after their humiliating defeat at the hands of the Viet Minh in 1954, the geopolitical void at the heart of Southeast Asia provided fertile soil for Cold War proxy wars. As in the rest of Indochina, both sides of the ideological divide heavily subsidized military rivals in Laos, and a civil war engulfed the country until the America military campaign came to a close two decades later.

In the capitalist camp, the U.S. took over France's role in Indochina and sought to shore up the Lao government in Vientiane against the communist threat. In 1954, the U.S. kept alive the Royal Lao government under Savan Vatthana, whose entire military budget was financed by the American Central Intelligence Agency and Defense Department.⁴⁹⁴ By the 1960s, the Royal Lao government raised only about 40% of its budget through taxes and duties.⁴⁹⁵ Fiscal crises characterized the Royal Lao government until its demise in 1975. See Figure A13 below. From the mid-1960s onwards, the American-backed government amassed annual budget deficits in the range of 40-60 % of expenditures.

On the socialist front, meanwhile, the Pathet Lao communist guerillas, the eventual winners of the civil war, relied almost entirely on the Viet Minh for military

⁴⁹⁴ Richard Reeves, *President Kennedy: Profile of Power* (New York: Simon & Schuster, 1993) 74. At the time, U.S. aid to Laos totaled \$300 million, or more than \$150/Lao citizen and twice the annual per capital income. In the first four years of independence, the Royal Lao Government received US\$ 166 million in American aid, as well as an additional US\$ 125 million for military programs and related expenses. See Evans, *Lao Peasants under Socialism*.

⁴⁹⁵ That is, budget deficits amounted to about 60% of expenditures. The American largesse subsidized the rest. Fred Branfman, "Presidential War in Laos, 1964-1970," in *Laos: War and Revolution*, ed. Nina S. Adams and Alfred W. McCoy (New York: Harper Colophon Books, 1970), 226.



Source: Calculated from Asian Development Bank. "Economic Report on the Kingdom of Laos." Manila, Philippines: Asian Development Bank, 1974, Appendix 14, p. 109.

Figure A13. Budget Deficits, Royal Lao Government, 1965-1975*

Note: * Economic data in Laos, then as now, must be treated with caution. These fiscal figures are only broadly indicative. Data from the Royal Lao Government provide estimates of the Lao economy but make no distinction between the entire country or just parts of the country administered from Vientiane.

and financial survival. In an oddity of history, foreign powers completely financed both warring factions of the civil war in Laos. With the socialist transition in 1975, Lao People's Democratic Republic (Lao PDR) inherited a war-torn, bankrupted state and continued to rely on the communist Second world for military, financial, and ideological support. Economic dependency repeated a familiar pattern for modern Lao

states. As a client state under new sponsorship, the Lao PDR substituted American aid for Vietnamese and Soviet assistance.⁴⁹⁶

From the outset, government expenditures in communist Laos depended on foreign aid,⁴⁹⁷ and fiscal crises greatly hampered the march toward socialism. Because of economic constraints, central planning along the Soviet model never materialized. Collectivization and the command economy survived barely a decade. Available data indicate that fiscal deficits ranged from 30 to 60 percent of expenditures in the early years of communist rule—starkly reminiscent of fiscal crises under the previous regime. See Table A10 below.

Table A10. Government Budget, Lao P.D.R., Selected Years, 1980-90*

	1980	1982	1984	1986	1988	1990
Revenues	748	2,755	4,947	18,503	28,531	61,045
Taxes	98	775	1,669	1,755	21,474	37,720
Nontax revenues	650	1,980	3,278	16,748	7,057	23,325
Expenditures	1,777	5,475	8,384	26,535	75,044	143,357
Current	1,028	2,259	4,126	14,803	28,038	69,877
Capital	749	3,216	4,258	11,732	47,006	73,480
Deficit	-1,029	-2,720	-3,437	-8,032	-46,513	82,312
% of expenditures	57.9	49.7	41.0	30.3	62.0	57.4

Source: Calculated from Savada, Andrea Matles, ed. *Laos: A Country Study*. Edited by Federal Research Division, *Area Handbook Series*. Washington, D.C.: Library of Congress, 1995. Table 8, p. 306. Note: * in millions of kip. The history of state finances in Laos depicts a recurring pattern of fiscal crises.

⁴⁹⁶ As late as the 1980s, the Soviet Union provided up to one half of all foreign assistance to Lao PDR, as well as substantial military aid. From a high of 60% of all aid in 1990, Soviet assistance abruptly ended in 1991. Alexander Yerofeyev, "Foreign Economic Assistance to Lao P.D.R.: Transition from Soviet Aid to Other Bilateral and Multilateral Aid," in *Economic Development in Lao P.D.R.: Horizon 2000*, ed. Chi Do Pham (Vientiane, Lao PDR: Dalley Book Service, 1994).

⁴⁹⁷ The new regime continued Laos' membership in the World Bank, IMF, Asian Development Bank, and the United Nations. Through these organizations, aid flowed freely to the communists in Laos. For a general description of the aid situation in the early years of Lao socialism, see T.M. Burley, "Foreign Aid to the Lao People's Democratic Republic," in *Contemporary Laos: Studies in the Politics and Society of the Lao People's Democratic Republic*, ed. Martin Stuart-fox (New York: St. Martin's Press).

Lao governments throughout the country's modern history have relied upon external sources of funding to prop up the façade of a modernizing state. Under colonial rule, Laos lacked fiscal independence and survived off subsidies from the central colonial administration. During the Cold War, the Lao state was the most heavily aid-dependent country in the world. At the time, the U.S. subsidized the budget of the Royal Lao government, which would not have otherwise met its public obligations. Per capita, American assistance amounted to an astonishing US\$ 192 for every Lao man, woman, and child—the highest in the world at the time.⁴⁹⁸ With the communist victories in Indochina, the Second world took over responsibility of propping up an otherwise economically unviable government. During this time, the Soviet Union provided the bulk of external financing of the Lao state, as well as military aid. After the fall of the Soviet empire, the communist leadership in Lao successfully transitioned to a new form of foreign aid. Since the 1990s, Western donors have taken over the supporting role for a country marred by the legacy of Vietnam, during an otherwise uninterrupted history of dependency.

Throughout the modern era, successive Lao regimes have mitigated fiscal crisis by strategically positioning their governments to the geopolitical current of the region and by acting as a client state to more powerful sponsors. Compounding financial difficulties of the public economy, socio-economic underdevelopment and low administrative capacity of the tax state ensured the continuing mismatch between public expenditures and tax revenues. Before examining the contemporary public household in detail, the next section presents an economic overview of Laos.

⁴⁹⁸ These figures cover the period 1955-1963, when America foreign assistance to Laos amounted to the highest of proportion U.S. aid to all of Southeast Asia. Stuart-fox, *A History of Laos* 91.

Appendix A8. Budget and Public Expenditures, Lao PDR, 1984-2004

Table A11. General Government Operations, Billions of Kip, Lao PDR, 1984-2004*

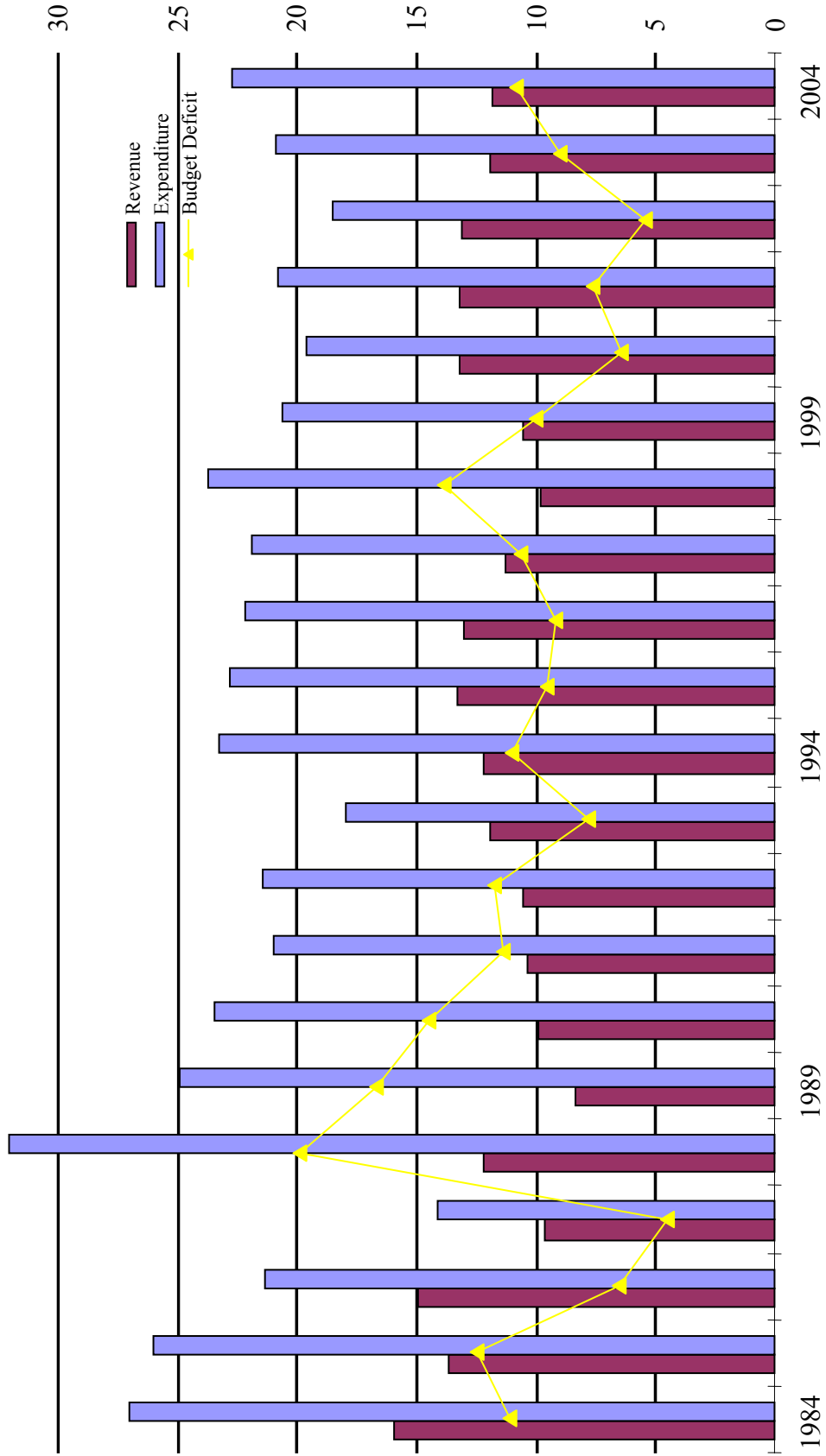
	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Revenue	4.9	10.3	18.5	26.1	28.5	35.6	61	74.7	85.6	113.3	135.8	169.6	220.3	229	367	929	1,693.00	2,000.00	2,323.00	2,505.90	2,936.40
Tax	1.7	1.4	1.8	2	21.5	27.4	37.6	54.4	60.8	85.9	106.7	136.7	173.7	190	290	745	1,368.00	1,629.00	1,875.00	1,880.00	2,356.00
Non-tax	3.3	8.9	16.7	18.1	7.1	8.1	23.3	20.3	24.9	27.3	29.1	32.9	46.6	39	77	184	325	371	448	626	580
Expenditure	8.3	19.6	26.5	29.5	75	106.4	143.4	151.1	174.4	170.5	238.9	290.8	361	444	884	1,809	2,512.00	3,148.00	3,274.00	4,409.60	5,620.00
Current	4.1	9.5	14.8	16	28	39.9	69.9	82	99.5	104.9	127.1	151	166	224	304	539	807	1,236.00	1,490.00	1,883.80	2,677.30
Capital	4.3	10.2	11.7	13.5	47	66.5	73.6	69.1	74.9	65.6	131.8	140	195	220	580	1,270	1,705.00	1,912.00	1,784.00	2,525.80	2,942.70
Budget																					
Deficit	-3.4	-9.3	-8	-9.4	-46.5	-70.8	-82.3	-76.4	-88.7	-57.3	-123.1	-121	-140.7	-215	-517	-880	-819	-1148	-951	-1903.7	-2683.6
Deficit Financing																					
Grants	1.5	2	1.7	1.2	12.6	16.9	23	32.6	34	31.3	67.3	52.5	57.1	70	200	532	475	476	238	453	465
Other foreign financing	2.1	7.5	6.6	8.4	32.6	66	60.3	29.6	47.2	27.1	50.6	58	109.3	114	223	401	736	477	577	1,198	1,969
Domestic financing	-0.1	-0.2	-0.2	-0.2	1.3	-12.1	5.1	19.3	14.3	14.5	5.2	10.5	-17.9	32	93	-52	-148	187	130	253	250

Source: Compiled from Otani, Ichiro, and Chi Do Pham, eds. *The Lao People's Democratic Republic: Systemic Transformation and Adjustment*. Vol. 137, *Occasional Paper*. Washington, DC: International Monetary Fund, 1996; World Bank, International Monetary Fund, and Asian Development Bank. "Lao PDR: Public Expenditure Review, Country Financial Accountability Assessment (Volumes I and II)." Washington, D.C.: WB, IMF, ADB, 2002; Staff Reports, International Monetary Fund, Washington, DC: IMF, various years; and from Government of Lao PDR. "Official Gazette: State Budget Revenue - Expenditure Implementation of FY 2002 - 2003 and State Budget Revenue - Expenditure Plan for FY 2003 -2004." GoL, 2004. Volumes I and II. Note: * In 1992, the fiscal year was changed to October 1-September 30. Hence, data from 1991 and 1992 overlap by three months.

Table A12. General Government Operations, Percent of GDP, Lao PDR, 1984-2004

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Revenue	15.9	13.6	14.9	9.6	12.2	8.3	9.9	10.3	10.5	11.9	12.2	13.3	13.0	11.3	9.8	10.5	13.2	13.2	13.1	11.8	11.8
Tax	5.4	1.9	1.4	0.9	9.1	6.4	6.1	7.5	7.4	9.0	9.6	10.7	10.8	9.4	7.8	8.5	10.7	10.7	10.6	8.9	9.5
Nontax	10.5	11.8	13.5	8.7	3.0	1.9	3.8	2.8	3.0	2.9	2.6	2.6	2.2	1.9	2.1	2.1	2.5	2.4	2.5	3.0	2.3
Expenditure	27.0	26.0	21.3	14.1	32.0	24.9	23.4	20.9	21.4	17.9	23.2	22.8	22.1	21.9	23.7	20.5	19.6	20.7	18.5	20.8	22.6
Current	13.3	12.5	11.9	7.6	11.9	9.4	11.4	11.3	12.2	11.0	11.4	11.8	10.2	11.0	8.1	6.1	6.3	8.1	8.4	8.9	10.8
Capital	13.7	13.5	9.4	6.4	20.0	15.6	12.0	9.6	9.2	6.9	11.8	10.9	11.9	10.8	15.5	14.4	13.3	12.6	10.1	11.9	11.9
Budget Deficit	-11.1	-12.4	-6.5	-4.5	-19.8	-16.6	-14.4	-11.3	-11.7	-7.8	-11.0	-9.5	-9.1	-10.6	-13.8	-10.0	-6.4	-7.6	-5.4	-9.0	-10.8
Grants	4.8	2.6	1.3	0.6	5.4	4.0	3.7	4.5	4.2	3.3	6.0	4.1	3.5	3.4	5.4	6.0	3.7	3.1	1.3	2.1	1.9
Other foreign financing	4.8	2.6	1.3	0.6	5.4	4.0	3.7	4.5	4.2	3.3	6.0	4.1	3.5	3.4	5.4	6.0	3.7	3.1	1.3	5.7	7.9
Domestic financing	6.6	10.0	5.3	4.0	13.9	15.5	9.8	4.1	5.8	2.9	4.5	4.5	6.7	5.6	6.0	4.6	5.7	3.1	3.3	1.2	1.0

Source: Compiled from Table A4.1 and Staff Reports, International Monetary Fund, Washington, DC: IMF, various years.



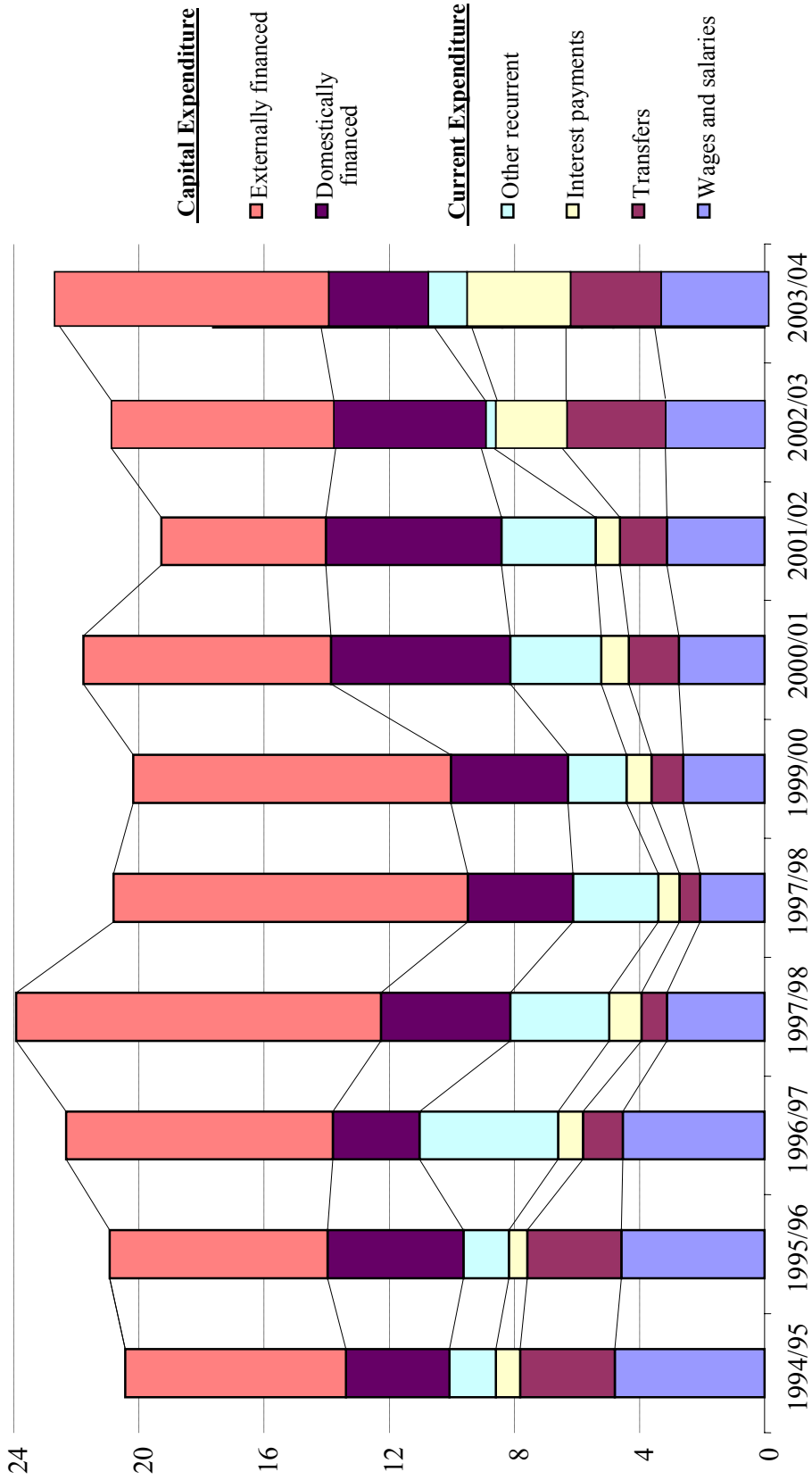
Source: Table A12

Figure A14. General Government Budget Balance, Percent of GDP, Lao PDR, 1984-2004

Table A13. Composition of Public Expenditures, Billions of Kip, Lao PDR, 1994/95-2003/04

	1994/95	1995/96	1996/97	1997/98	1997/98	1999/00	2000/01	2001/02	2002/03	2003/04
Total Expenditures	290	361	444	884	1,809	2,512	3,148	3,274	4,410	5,620
Current expenditure	143	166	224	304	539	807	1,236	1,490	1,883	2,677
<i>Wages and salaries</i>	68	79	92	117	182	335	416	555	671	848
Salaries	...	...	80	81	148	214	230	396	493	650
Benefits	...	...	12	13	25	121	186	159	178	198
Functional allowances	...	...	...	...	...	...	18	32	60	...
Specific allowances	...	...	...	...	...	...	151	96	96	...
Other	...	...	...	...	...	...	17	31	22	...
<i>Transfers</i>	43	52	26	30	58	130	243	264	665	711
Allowances and pensions	...	...	...	...	...	...	127	155	341	327
Family allowances	...	...	...	...	...	...	63	73	87	...
Student allowances	...	...	...	...	...	...	26	35	36	...
Social welfare	...	...	...	...	...	...	29	34	40	...
Other allowances	...	...	...	...	...	...	9	13	10	...
Other subsidies and transfers	...	...	...	...	...	...	116	109	324	384
<i>Interest payments</i>	11	10	16	39	59	102	134	138	481	814
Domestic	5	4	7	32	53	16	17	30	165	354
External	6	6	9	7	5	86	117	108	316	460
<i>Other recurrent</i>	21	25	90	118	240	240	443	533	66	304
Capital expenditure and net onlending	147	195	220	580	1,270	1,705	1,912	1,784	2,525	2,943
Domestically financed	47	75	56	154	297	481	872	995	1,026	784
Externally financed	100	120	173	436	997	1,302	1,200	931	1,499	2,159
Onlending (net)	0	0	-9	-10	-24	-78	-160	-142	0	0

Source: Compiled from International Monetary Fund, Staff Reports and Selected Issues and Statistical Appendix, Washington, DC: IMF, various years; and World Bank, International Monetary Fund, and Asian Development Bank. "Lao PDR: Public Expenditure Review, Country Financial Accountability Assessment (Volumes I and II)." Washington, D.C.: WB, IMF, ADB, 2002.



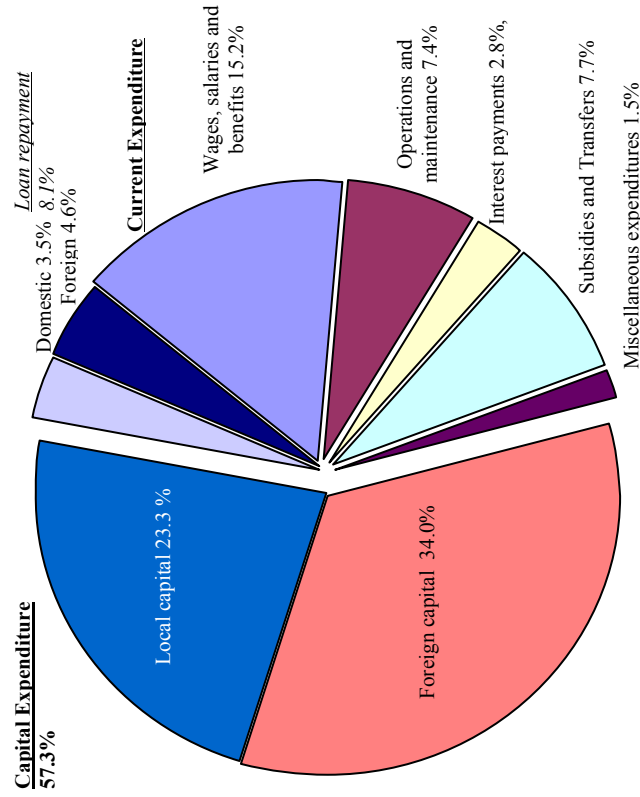
Source: Table A13

Figure A15. Composition of Public Expenditures, Percent of GDP, Lao PDR, 1994/95-2003/04

Table A14. State Budget Expenditure Implementation Lao PDR, 2002/03-2003/04*

	2002-2003 Budget					2003-2004	
	<i>Plan</i>		<i>Actual</i>			<i>Plan</i>	
	billions of kip	% of total	billions of kip	% of total	% of Plan	billions of kip	% of total
Total Expenditure	4,700.0	100.0	4,409.6	100.0	93.8	5,620.0	100.0
Wages, salaries and benefits	660.0	14.0	671.4	15.2	101.7	848.7	15.1
Salaries	455.2	9.7	492.5	11.2	108.2	650.0	11.6
Compensation and allowances	169.5	3.6	156.8	3.6	92.5	164.9	2.9
Wages and benefits for contracted persons	23.8	0.5	16.4	0.4	68.9	23.2	0.4
Living allowances for leadership	2.6	0.1	2.0	0.0	76.9	1.0	0.0
Severance payments	9.0	0.2	3.7	0.1	41.1	9.6	0.2
Operations and maintenance	320.0	6.8	324.4	7.4	101.4	384.0	6.8
Materials, office supplies and fuel	167.0	3.6	164.8	3.7	98.7	156.2	2.8
Water, electricity costs	18.6	0.4	18.5	0.4	99.5	20.6	0.4
Rental costs	5.7	0.1	17.3	0.4	303.5	13.7	0.2
Repairs and maintenance	27.0	0.6	24.4	0.6	90.4	36.9	0.7
Insurance	1.5	0.0	0.9	0.0	60.0	1.5	0.0
Post and telecommunications costs	11.3	0.2	11.8	0.3	104.4	13.9	0.2
Transportation costs	52.3	1.1	52.7	1.2	100.8	50.1	0.9
Costs for receptions, meetings, seminar	33.7	0.7	31.9	0.7	94.7	41.7	0.7
Bank service charges	0.2	0.0	0.2	0.0	100.0	0.3	0.0
Other payments	2.8	0.1	1.9	0.0	67.9	1.6	0.0
Interest payments	188.7	4.0	123.4	2.8	65.4	289.0	5.1
Domestic	56.0	1.2	8.8	0.2	15.7	65.3	1.2
External	132.9	2.8	114.6	2.6	86.2	223.7	4.0
Subsidies and Transfers	263.0	5.6	341.4	7.7	129.8	327.0	5.8
Political and administrative subsidies	22.7	0.5	39.4	0.9	173.6	45.1	0.8
Technical promotion costs	37.8	0.8	49.5	1.1	131.0	51.1	0.9
Family allowances	90.6	1.9	86.6	2.0	95.6	91.6	1.6
Student allowances	35.9	0.8	36.3	0.8	101.1	41.1	0.7
Social welfare	39.5	0.8	39.7	0.9	100.5	43.0	0.8
Subsides, transfers	-	-	-	-	-	1.3	0.0
Transfers	14.5	0.3	9.6	0.2	66.2	11.6	0.2
Contributions to international organizations	22.0	0.5	22.0	0.5	100.0	27.5	0.5
Miscellaneous expenditures	59.0	1.3	66.2	1.5	112.2	304.3	5.4
Capital expenditure	2,710.0	57.7	2,525.8	57.3	93.2	2,942.7	52.4
Foreign capital	1,650.0	35.1	1,499.4	34.0	90.9	2,158.9	38.4
Local capital	1,060.0	22.6	1,026.4	23.3	96.8	783.8	13.9
Repayment of loan principle (Amortization)	499.3	10.6	356.9	8.1	71.5	524.2	9.3
Domestic	184.0	3.9	156.3	3.5	84.9	288.5	5.1
Foreign capital	315.2	6.7	200.7	4.6	63.7	235.7	4.2

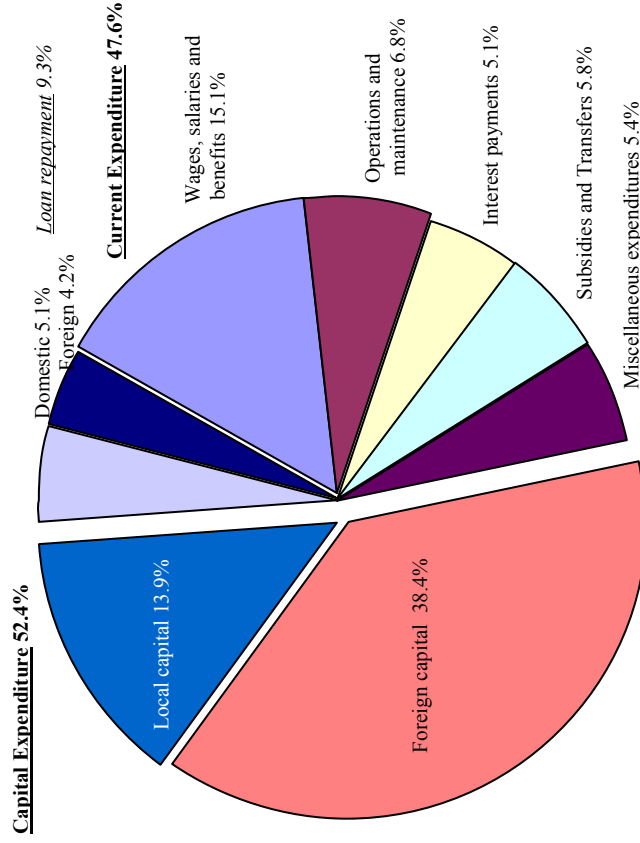
Source: Calculated from Government of Lao PDR. "Official Gazette: State Budget Revenue - Expenditure Implementation of Fy 2002 - 2003 and State Budget Revenue - Expenditure Plan for Fy 2003 - 2004." GoL, 2004. Volumes I and II. Note: * 2002-03 are actual figures; 2003-04 are planned budget outlays.



Total Expenditure: 4,409.6 billion kips

Source: Table A14

**Figure A16. Composition of Public Expenditure
Lao PDR, FY 2002-03**



Total Expenditure Target: 5,620.0 billion kips

Source: Table A14

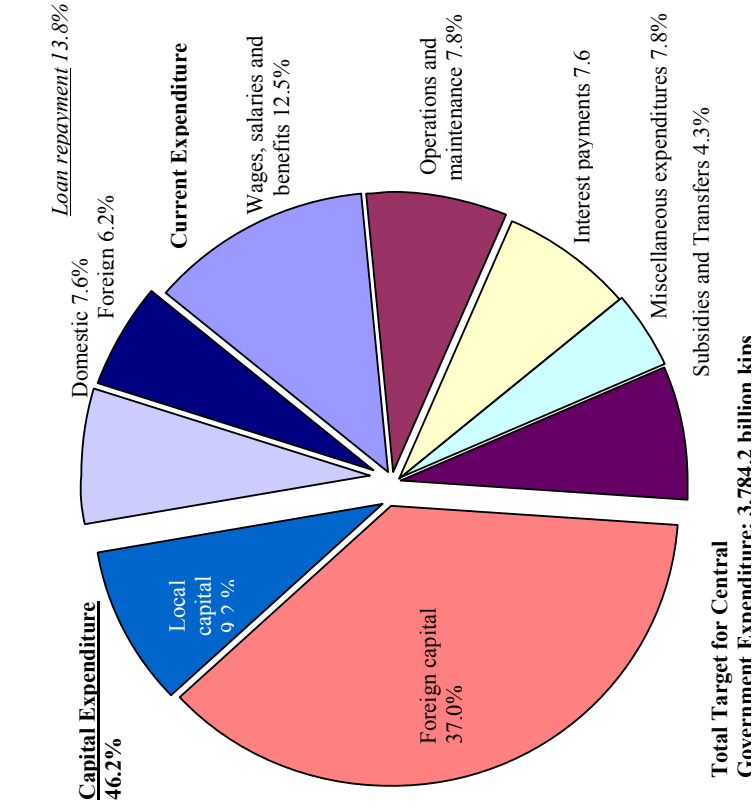
**Figure A17. Public Expenditure Plan
Lao PDR, FY 2003-04**

Table A15. Public Expenditures, Central Ministries Component, Lao PDR, 2002/03-2003/04*

	2002-03 Budget			2003-04 Budget		
	<u>Plan</u>	<u>Actual</u>	<u>Plan</u>	<u>Actual</u>	<u>Plan</u>	<u>Actual</u>
	billions of kip	% of total	billions of kip	% of total	billions of kip	% of total
		expend.		expend.		expend.
Total Expenditure (Central Ministries)	2,814.4	100.0	2,438.1	100.0	3,784.2	100.0
<i>Wages, salaries and benefits</i>	<i>395.8</i>	<i>14.1</i>	<i>376.8</i>	<i>15.5</i>	<i>471.4</i>	<i>12.5</i>
Salaries	253.2	9.0	262.7	10.8	356.3	9.4
Compensation and allowances	119.3	4.2	103.8	4.3	97.8	2.6
Wages and benefits for contracted persons	14.1	0.5	6.7	0.3	10.3	0.3
Living allowances for leadership	2.1	0.1	1.6	0.1	0.4	0.0
Severance payments	7.1	0.3	2.0	0.1	6.7	0.2
Operations and maintenance	234.1	8.3	241.7	9.9	294.9	7.8
Materials, office supplies and fuel	131.7	4.7	130.7	5.4	119.0	3.1
Water, electricity costs	12.7	0.5	12.5	0.3	13.0	0.3
Rental costs	5.7	0.2	17.3	0.7	13.6	0.4
Repairs and maintenance	14.9	0.5	14.4	0.6	25.4	0.7
Insurance	0.9	0.0	0.9	0.0	1.4	0.0
Post and telecommunications costs	6.9	0.2	6.7	0.3	8.7	0.2
Transportation costs	38.8	1.4	37.7	1.5	35.4	0.9
Costs for receptions, meetings, seminar	20.8	0.7	20.1	0.8	29.7	0.8
Bank service charges	0.2	0.0	0.2	0.0	0.3	0.0
Other payments	1.5	0.1	1.3	0.1	0.9	0.0
Interest payments	188.7	6.7	123.4	5.1	289.0	7.6
Domestic	56.0	2.0	8.8	0.4	65.3	1.7
External	132.8	4.7	114.6	4.7	223.7	5.9
Subsidies and Transfers	125.0	4.4	189.4	7.8	161.7	4.3
Political and administrative subsidies	20.9	0.7	21.1	0.9	21.9	0.6
Technical promotion costs	7.0	0.2	19.4	0.8	20.8	0.5
Family allowances	34.3	1.2	33.7	1.4	36.7	1.0
Student allowances	26.8	1.0	23.4	1.0	27.3	0.7
Social welfare	4.2	0.1	4.2	0.2	3.5	0.1
Subsidies, transfers	9.8	0.3	7.3	0.3	9.2	0.2
Transfers	-	-	-	-	-	-
Contributions to international organizations	22.0	0.8	22.0	0.9	27.5	0.7
Miscellaneous expenditure	51.0	1.8	42.4	1.7	296.3	7.8
Capital expenditure	1,320.5	46.9	1,107.6	45.4	1,746.6	46.2
Foreign capital	988.9	35.1	898.7	36.9	1,398.9	37.0
Local capital	331.5	11.8	208.9	8.6	347.7	9.2
Repayment of loan principle (Amortization)	499.3	17.7	356.9	14.6	524.0	13.8
Domestic	184.0	6.5	156.3	6.4	288.5	7.6
Foreign capital	315.2	11.2	200.6	8.2	235.7	6.2

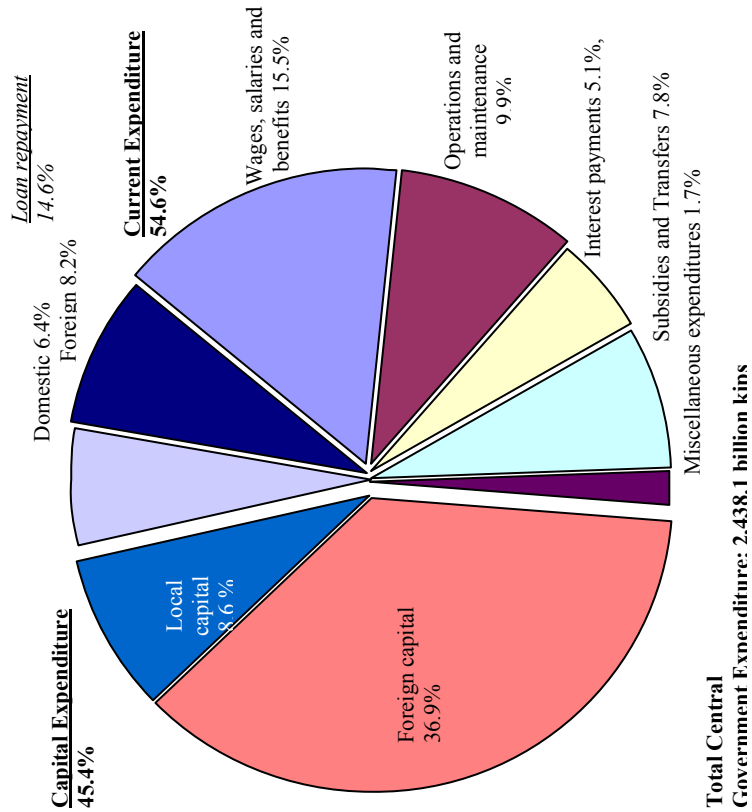
Source: Calculated from Government of Lao PDR. "Official Gazette: State Budget Revenue - Expenditure Implementation of FY 2002 - 2003 and State Budget Revenue - Expenditure Plan for FY 2003 -2004." GoL, 2004. Volumes I and II.

Note: * 2002-03 are actual figures; 2003-04 are planned budget outlays.



Source: Table A15

**Figure A19. Plan for Central Government Expenditure
Lao PDR, FY 2003-04**



Source: Table A15

**A18. Composition of Central Government Expenditure
Lao PDR, FY 2002-03**

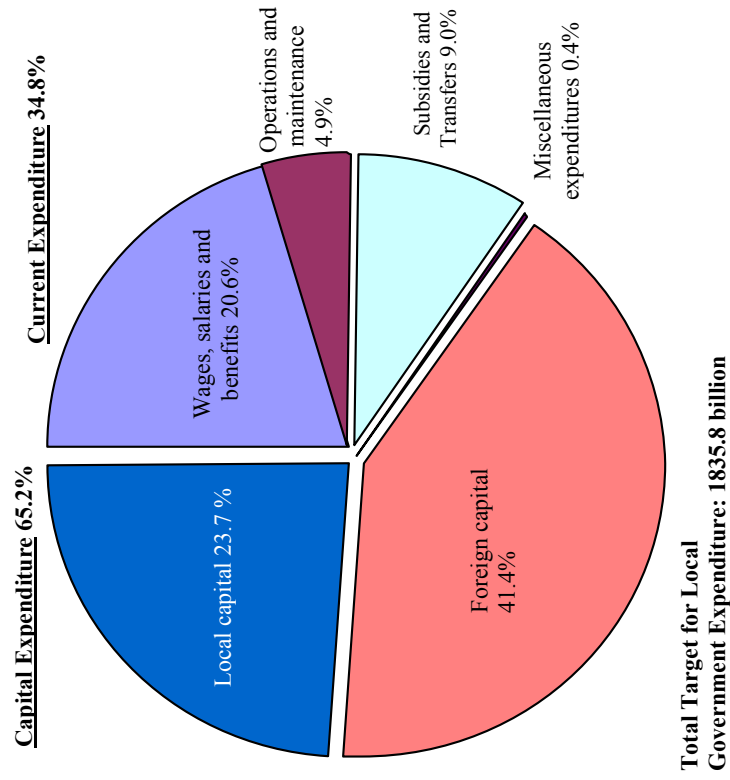
Table A16. Public Expenditures, Provincial Component, Lao PDR, 2002/03-2003/04*

	2002-03 Budget			2003-04 Budget		
	billions of kip	<i>Plan</i> % of total expend.	% of total expend.	billions of kip	<i>Actual</i> % of total expend.	% of total expend.
Total Expenditure (Provinces)	1885.6	100	40.1	1971.4	100	44.7
<i>Wages, salaries and benefits</i>	264.2	14.0	5.6	294.7	14.9	6.7
Salaries	202	10.7	4.3	229.8	11.7	5.2
Compensation and allowances	50.2	2.7	1.1	53	2.7	1.2
Wages and benefits for contracted persons	9.7	0.5	0.2	9.6	0.5	0.2
Living allowances for leadership	0.5	0.0	0.0	0.4	0.0	0.0
Severance payments	1.9	0.1	0.0	1.8	0.1	0.0
Operations and maintenance	85.9	4.6	1.8	82.7	4.2	1.9
Materials, office supplies and fuel	35.2	1.9	0.7	34.1	1.7	0.8
Water, electricity costs	5.8	0.3	0.1	6	0.3	0.1
Rental costs	0.1	0.0	0.0	0.1	0.0	0.0
Repairs and maintenance	12	0.6	0.3	9.9	0.5	0.2
Insurance	0.6	0.0	0.0	0	-	-
Post and telecommunications costs	4.4	0.2	0.1	5.1	0.3	0.1
Transportation costs	13.5	0.7	0.3	15.1	0.8	0.3
Costs for receptions, meetings, seminar	13	0.7	0.3	11.8	0.6	0.3
Bank service charges	0	-	-	0	-	-
Other payments	1.2	0.1	0.0	0.6	0.0	0.0
Interest payments	0	-	-	0	-	-
Domestic	0	-	-	0	-	-
External	0	-	-	0	-	-
Subsidies and Transfers	138	7.3	2.9	152	7.7	3.4
Political and administrative subsidies	7.5	0.4	0.2	18.3	0.9	0.4
Technical promotion costs	28.1	1.5	0.6	30.1	1.5	0.7
Family allowances	52.5	2.8	1.1	52.9	2.7	1.2
Student allowances	10.8	0.6	0.2	12.8	0.6	0.3
Social welfare	34.1	1.8	0.7	35.6	1.8	0.8
Subsidies, transfers	3.6	0.2	0.1	2.3	0.1	0.1
Transfers	1.3	0.1	0.0	0	-	-
Contributions to international organizations	0.1	0.0	0.0	0	0	0
Miscellaneous expenditures	8	0.4	0.2	23.8	1.2	0.5
Capital expenditure	1389.5	73.7	29.6	1418.2	71.9	32.2
Foreign capital	661.1	35.1	14.1	600.8	30.5	13.6
Local capital	728.5	38.6	15.5	817.4	41.5	18.5
Repayment of loan principle (Amortization)	0	-	-	0	-	-
Domestic	0	-	-	0	-	-
Foreign capital	0	-	-	0	-	-
billions of kip	1835.8	104.6	44.7	1971.4	100	44.7
% of total	377.3	111.5	6.7	294.7	14.9	6.7
expend.	293.7	113.8	5.2	229.8	11.7	5.2
	16.0	105.6	1.2	53	2.7	1.2
	3.7	99.0	0.2	9.6	0.5	0.2
	0.7	80.0	0.0	0.4	0.0	0.0
	2.9	94.7	0.0	1.8	0.1	0.0
	89.1	96.3	1.9	82.7	4.2	1.9
	4.9	96.9	0.8	34.1	1.7	0.8
	1.6	103.4	0.1	6	0.3	0.1
	2.0	100.0	0.0	0.1	0.0	0.0
	0.4	82.5	0.2	9.9	0.5	0.2
	0.1	-	-	0	-	-
	0.0	-	-	0	-	-
	0.0	115.9	0.1	5.1	0.3	0.1
	0.3	111.9	0.3	15.1	0.8	0.3
	0.2	90.8	0.3	11.8	0.6	0.3
	-	-	-	0	-	-
	0.0	50.0	0.0	0.6	0.0	0.0
	-	-	-	0	-	-
	-	-	-	0	-	-
	-	-	-	0	-	-
	0	-	-	0	-	-
	165.3	110.1	3.4	152	7.7	3.4
	9.0	244.0	0.4	18.3	0.9	0.4
	2.9	107.1	0.7	30.1	1.5	0.7
	0.4	100.8	1.2	52.9	2.7	1.2
	0.5	118.5	0.3	12.8	0.6	0.3
	1.0	104.4	0.8	35.6	1.8	0.8
	0.2	63.9	0.1	2.3	0.1	0.1
	0.7	-	-	0	-	-
	0.0	-	-	0	0	0
	0.0	-	-	0	0	0
	1.3	297.5	0.5	23.8	1.2	0.5
	0.1	102.1	32.2	1418.2	71.9	32.2
	0.1	90.9	18.5	600.8	30.5	13.6
	0.4	112.2	-	817.4	41.5	18.5
	21.3	-	-	0	-	-
	13.5	-	-	0	-	-
	7.8	-	-	0	-	-
	-	-	-	0	-	-
	-	-	-	0	-	-

Source: Calculated from Government of Lao PDR. "Official Gazette: State Budget Revenue - Expenditure Implementation of FY

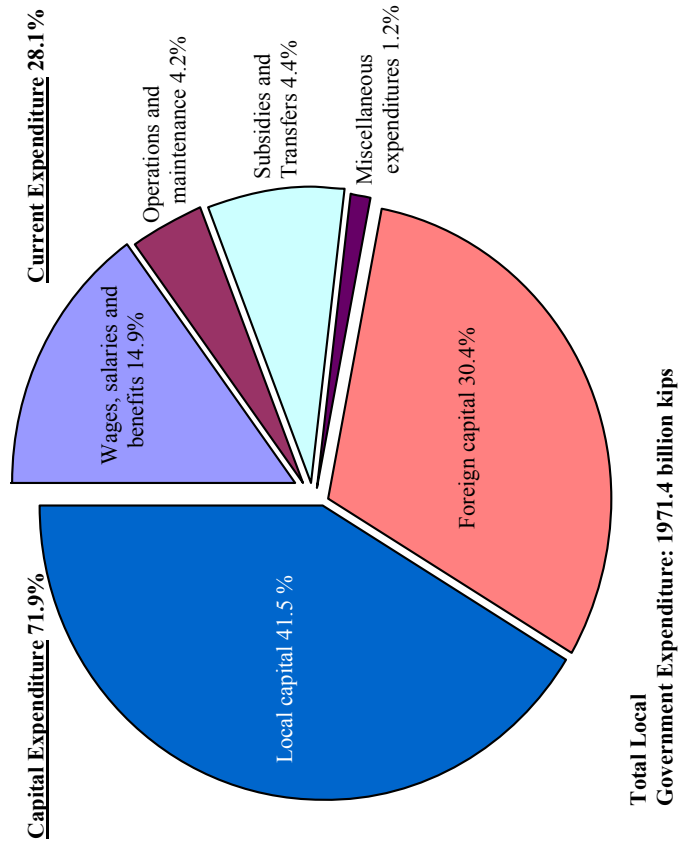
2002 - 2003 and State Budget Revenue - Expenditure Plan for FY 2003 -2004." GoL, 2004. Volumes I and II.

Note: * 2002-03 are actual figures; 2003-04 are planned budget outlays.



Source: Table A16

Figure A21. Plan for Local Government Expenditure Lao PDR, FY 2003-04



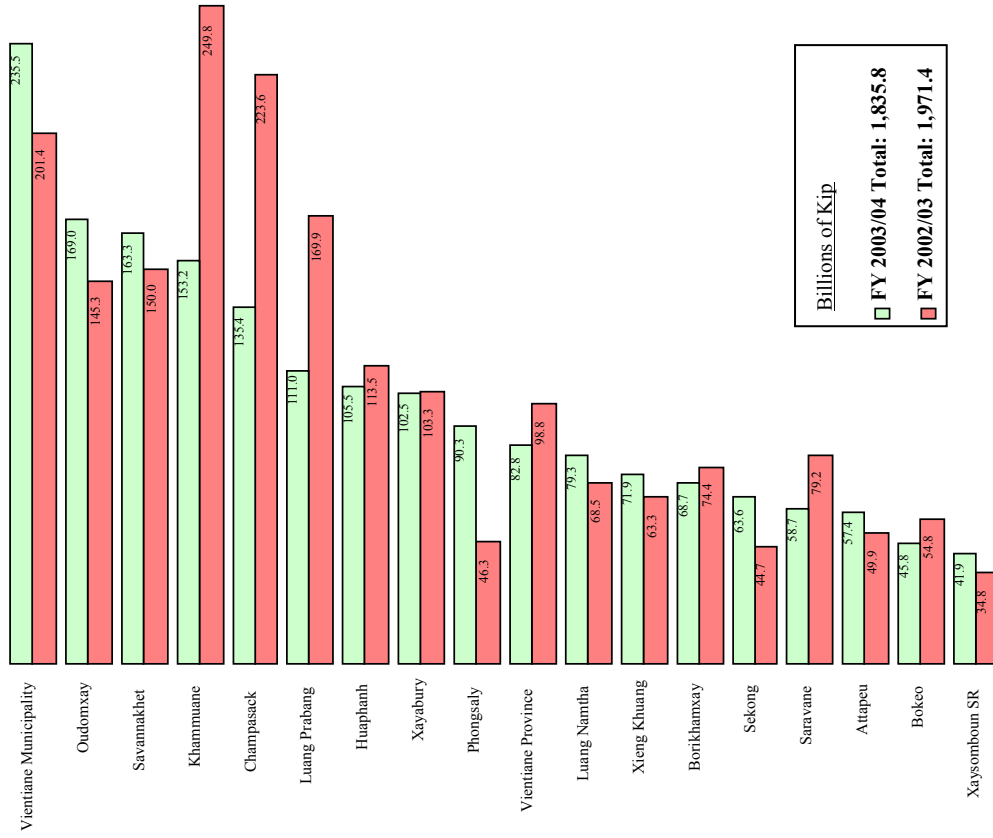
Source: Table A16

Figure A20. Composition of Local Government Expenditure Lao PDR, FY 2002-03

Table A17. Public Expenditures (billions of kip), by Destination, Lao PDR 2002/03-2003/04*

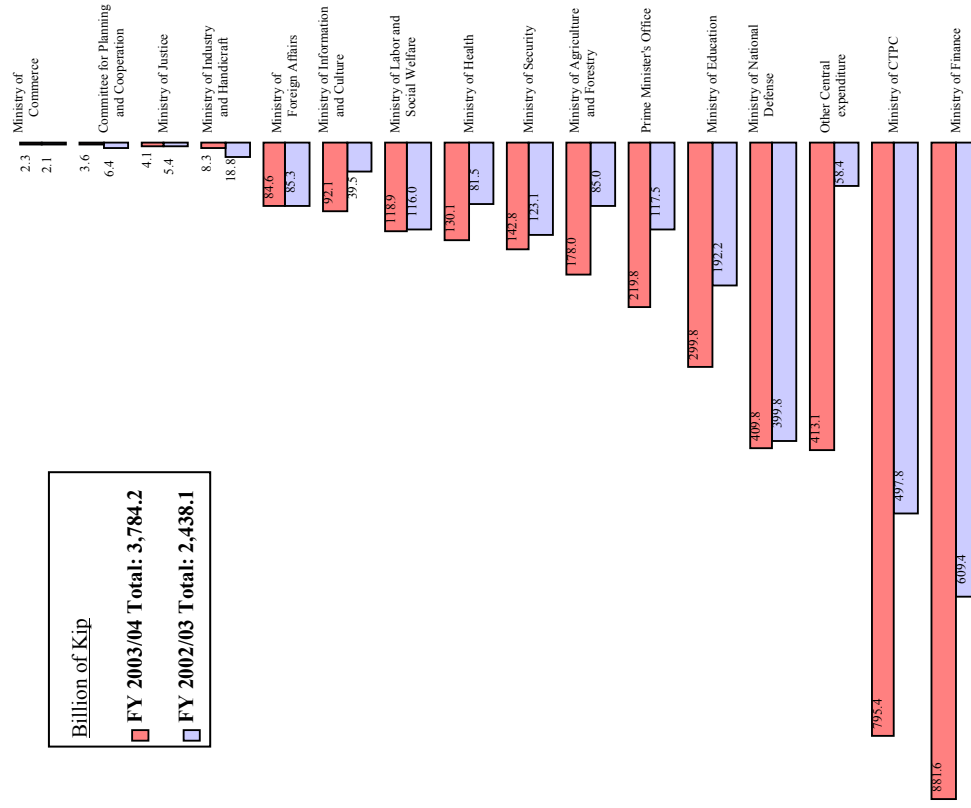
	2002/03		2003/04		Total	% of Total 100.0	% of Central expenditure	% of Provincial expenditure	Total	% of Total 100.0	% of Central expenditure	% of Provincial expenditure
	Total	% of Total 100.0	Total	% of Total 100.0								
Total Government Expenditure	4,409.6	55.3	5,620.0	67.3	3,784.2			3,784.2				
Expenditure for Central Line Ministries	2,438.1		100.0		100.0			100.0				100.0
Prime Minister's Office	117.5	2.7	4.8	3.9	219.8	4.8	3.9	219.8	4.8	3.9	5.8	5.8
Ministry of National Defence	399.8	9.1	16.4	7.3	409.8	16.4	7.3	409.8	16.4	7.3	10.8	10.8
Ministry of Security	123.1	2.8	5.0	2.5	142.8	5.0	2.5	142.8	5.0	2.5	3.8	3.8
Ministry of Foreign Affairs	85.3	1.9	3.5	1.5	84.6	3.5	1.5	84.6	3.5	1.5	2.2	2.2
Ministry of Justice	5.4	0.1	0.2	0.1	4.1	0.2	0.1	4.1	0.2	0.1	0.1	0.1
Committee for Planning and Cooperation	6.4	0.1	0.3	0.1	3.6	0.3	0.1	3.6	0.3	0.1	0.1	0.1
Ministry of Finance	609.4	13.8	25.0	15.7	881.6	25.0	15.7	881.6	25.0	15.7	23.3	23.3
Ministry of Agriculture and Forestry	85.0	1.9	3.5	3.2	178.0	3.5	3.2	178.0	3.5	3.2	4.7	4.7
Ministry of CTPC	497.8	11.3	20.4	14.2	795.4	20.4	14.2	795.4	20.4	14.2	21.0	21.0
Ministry of Industry and Handicraft	18.8	0.4	0.8	0.1	8.3	0.8	0.1	8.3	0.8	0.1	0.2	0.2
Ministry of Commerce	2.1	0.0	0.1	0.0	2.3	0.1	0.0	2.3	0.0	0.0	0.1	0.1
Ministry of Information and Culture	39.5	0.9	1.6	1.6	92.1	1.6	1.6	92.1	1.6	1.6	2.4	2.4
Ministry of Labor and Social Welfare	116.0	2.6	4.8	2.1	118.9	4.8	2.1	118.9	4.8	2.1	3.1	3.1
Ministry of Education	192.2	4.4	7.9	5.3	299.8	7.9	5.3	299.8	7.9	5.3	7.9	7.9
Ministry of Health	81.5	1.8	3.3	2.3	130.1	3.3	2.3	130.1	3.3	2.3	3.4	3.4
Other (reserve)	58.4	1.3	2.4	7.4	413.1	2.4	7.4	413.1	2.4	7.4	10.9	10.9
Expenditure for Provinces	1,971.4	44.7	1,835.8	32.7	1,835.8			1,835.8				
Vientiane Municipality	201.4	4.6	10.2	4.2	235.5	10.2	4.2	235.5	10.2	4.2	12.8	12.8
Phongsaly	46.3	1.0	2.3	1.6	90.3	2.3	1.6	90.3	2.3	1.6	4.9	4.9
Luang Namtha	68.5	1.6	3.5	1.4	79.3	3.5	1.4	79.3	3.5	1.4	4.3	4.3
Oudomxay	145.3	3.3	7.4	3.0	169.0	7.4	3.0	169.0	7.4	3.0	9.2	9.2
Bokeo	54.8	1.2	2.8	0.8	45.8	2.8	0.8	45.8	2.8	0.8	2.5	2.5
Luang Prabang	169.9	3.9	8.6	2.0	111.0	8.6	2.0	111.0	8.6	2.0	6.0	6.0
Huaphanh	113.5	2.6	5.8	1.9	105.5	5.8	1.9	105.5	5.8	1.9	5.7	5.7
Xayabury	103.3	2.3	5.2	1.8	102.5	5.2	1.8	102.5	5.2	1.8	5.6	5.6
Xieng Khuang	63.3	1.4	3.2	1.3	71.9	3.2	1.3	71.9	3.2	1.3	3.9	3.9
Vientiane Province	98.8	2.2	5.0	1.5	82.8	5.0	1.5	82.8	5.0	1.5	4.5	4.5
Borikhamxay	74.4	1.7	3.8	1.2	68.7	3.8	1.2	68.7	3.8	1.2	3.7	3.7
Khammuane	249.8	5.7	12.7	2.7	153.2	12.7	2.7	153.2	12.7	2.7	8.3	8.3
Savannakhet	150.0	3.4	7.6	2.9	163.3	7.6	2.9	163.3	7.6	2.9	8.9	8.9
Saravane	79.2	1.8	4.0	1.0	58.7	4.0	1.0	58.7	4.0	1.0	3.2	3.2
Sekong	44.7	1.0	2.3	1.1	63.6	2.3	1.1	63.6	2.3	1.1	3.5	3.5
Champasack	223.6	5.1	11.3	2.4	135.4	11.3	2.4	135.4	11.3	2.4	7.4	7.4
Attapeu	49.9	1.1	2.5	1.0	57.4	2.5	1.0	57.4	2.5	1.0	3.1	3.1
Xaysomboun SR	34.8	0.8	1.8	0.7	41.9	1.8	0.7	41.9	1.8	0.7	2.3	2.3

Source: Calculated from Government of Lao PDR, "Official Gazette: State Budget Revenue - Expenditure Implementation of FY 2002 - 2003 and State Budget Revenue - Expenditure Plan for FY 2003 -2004." GoL, 2004. Volumes I and II. Note: * 2002-03 are actual figures; 2003-04 are planned budget outlays.



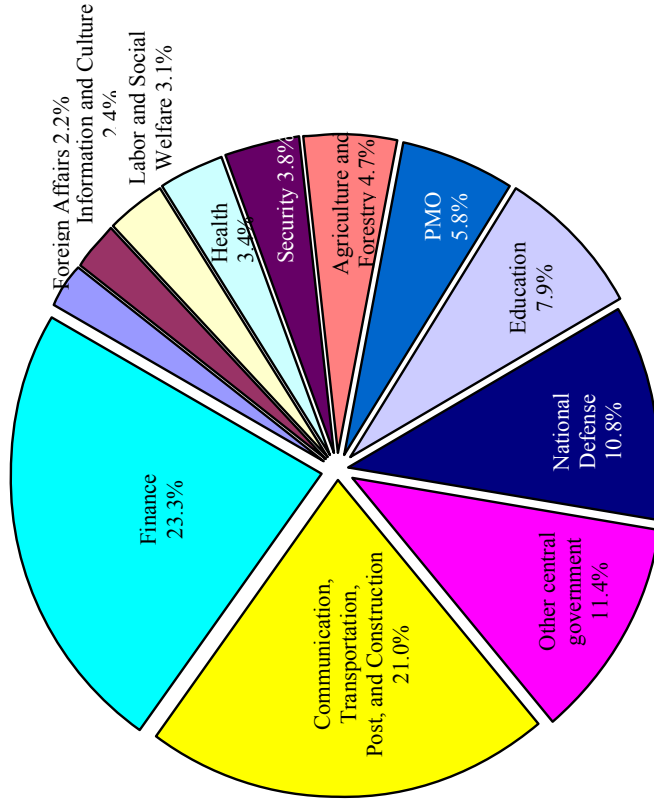
Source: Table A17

Figure A22. Local Expenditure by Province
Lao PDR, FY2002/03-2003/04



Source: Table A17

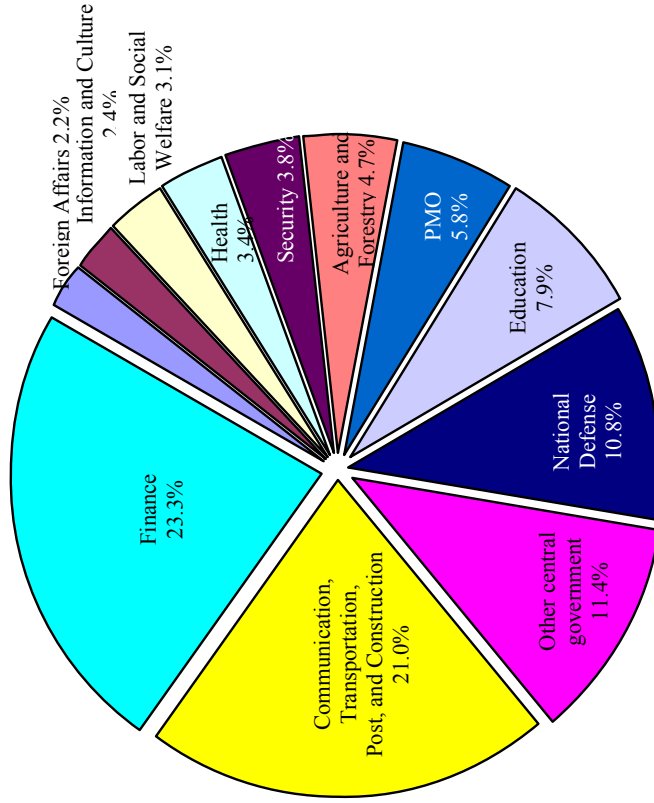
Figure A23. Central Government Expenditure, by
Ministry, Lao PDR FY2002/03-2003/04



Total Central Government Expenditure: 2,438.1 billion kips

Source: Table A17

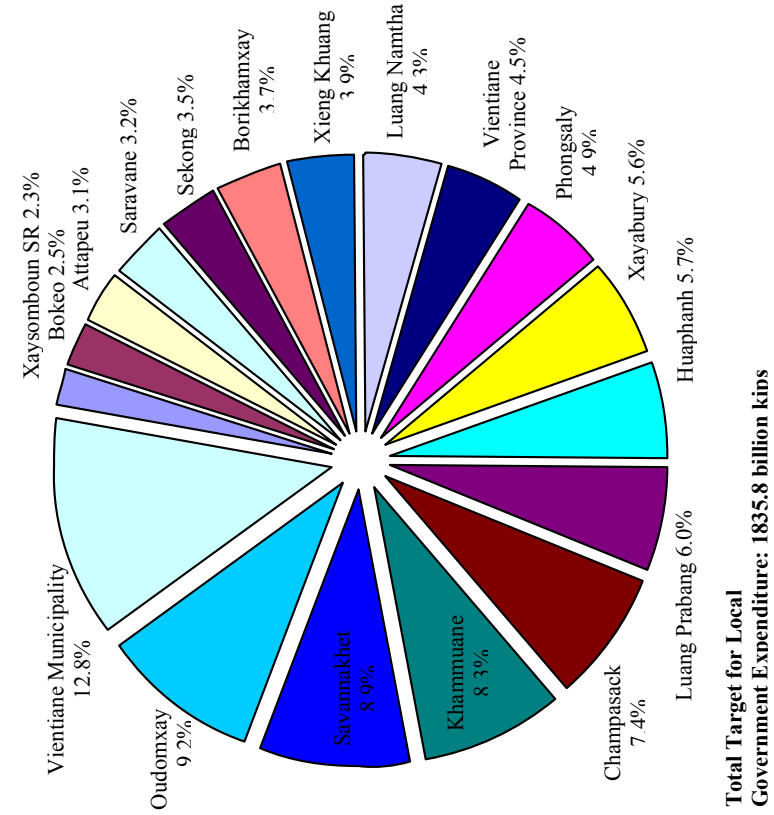
Figure A24. Composition of Central Government Expenditure, by Ministry, Lao PDR, FY2002-03



Total Target for Central Government Expenditure: 3,784.2 billion kips

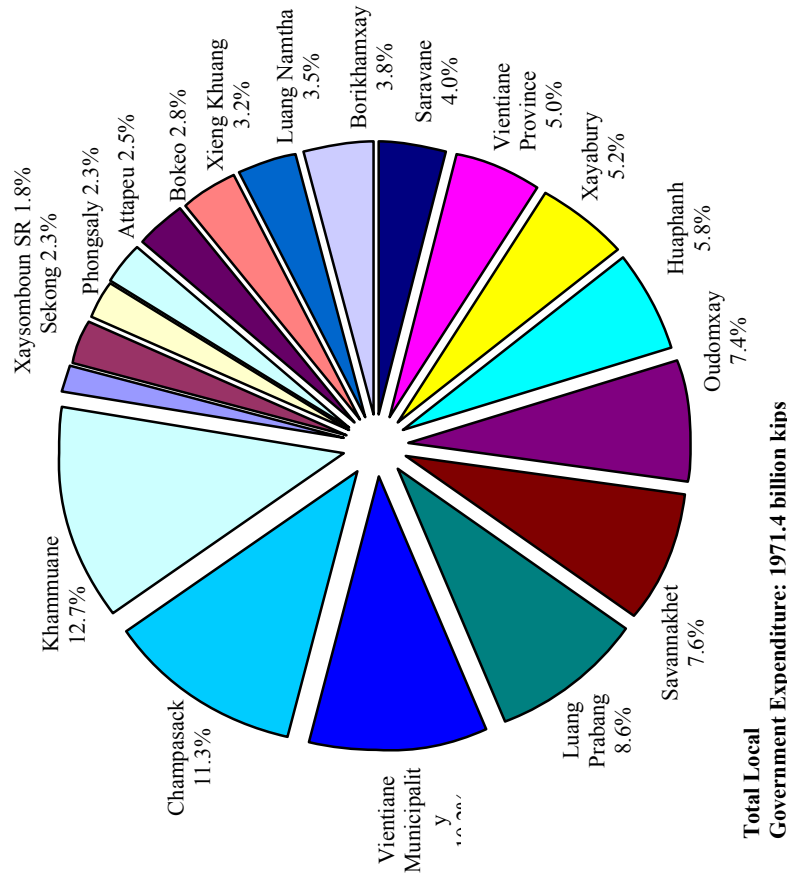
Source: Table A17

Figure A25. Plan for Central Government Expenditure, by Ministry, Lao PDR, FY2003-04



Source: Table A17

Figure A27. Plan for Local Government Expenditure, by Province, Lao PDR, FY2003-04



Source: Table A17

Figure A26. Composition of Local Government Expenditure, by Province, Lao PDR, FY2002-03

Appendix A9. Budget Planning Process

The Ministry of Finance (MoF) has the primary responsibility for fiscal management and financial accountability of the government.⁴⁹⁹ Currently, MoF maintains a staff of over 1,227, who work in the capital headquarters and its vertical lines throughout the country (18 provinces, 142 district offices).⁵⁰⁰ The recurrent budget observes previously negotiated outlays. Line ministries and provincial governments submit their plans to the Budget Department of MoF for review, bargaining, and negotiations with relevant central authorities. Once settled, the recurrent budget comes before the National Assembly for ceremonial approval.⁵⁰¹

Complementing MoF, the powerful Committee for Planning and Cooperation (CPC) oversees the capital component of public expenditures and takes the lead role in the budget preparation process. The capital component follows a comprehensive planning framework that outlines the government's development strategy in the short- and long-term. See Figure A28. This framework includes a 20-year plan, a five-year National Socio-Economic Development Plan (NSED), and Public Investment Plans (PIPs) for five- and one-year periods. The 20-year plan has the strategic intent of upgrading Laos from the status of "least developed country" by 2020. The government pursues this goal through eight priority programs in three overlapping stages:

1. the transition from a command to a market economy,
2. the establishment of physical and human infrastructure, and
3. socio-economic development with basic food security.

⁴⁹⁹ The Ministry of Finance comprises 12 departments, four for revenue management and the remaining eight for the expenditure side. See the Appendix for an organizational chart of MoF.

⁵⁰⁰ Of this total, only 946 are permanent staff, while the rest work as contractors, paid a lower wage or funded through donor aid projects. Swedish International Development Agency, "Strengthening Fiscal Management in Laos," 16.

⁵⁰¹ Based on their allocation, ministries and provinces must then submit a detailed breakdown of expenditure categories to MoF for approval. Provinces pay recurrent expenditure out of their own coffers, while MoF has responsibility for recurrent payments of expenditures to line ministries. Sida, "Financial and Administrative Systems," 10.

The eight national socio-economic priority programs include food production; commercial production; stabilization of shifting cultivation; infrastructure development; rural development; human resource development; service development; and foreign economic relations development.

To reach these goals, the government anticipates sustained economic development, targeting annual economic growth of at least 6.6% of GDP. Line ministries incorporate this plan with their own strategic plans. The five-year NSEDP breaks down the 20-year plan into workable targets and objectives by economic sectors and regions. The current NSEDP targets a reduction of basic poverty by 50 percent and the elimination of opium by 2005. By 2010, the plan anticipates that 80 percent of the population will achieve “a reasonable standard of living.”

As a component of the NSEDP, the PIP offers details on investment projects, broken down by sectors. The five-year PIP provides guidelines for the annual PIP, which reflects capital spending in the national budget.

Budgetary allocations for the annual PIP follow guidelines issued by the Committee for Planning and Cooperation (CPC). Revised annually, the Budget and Planning Operational Guidelines provides detailed instructions (on project cycle management) for provincial authorities, central ministry officials, and individual project managers. According to these guidelines, projects fall into one of three categories, depending on their monetary size:

1. large projects: > five billion kip;
2. medium projects: between 500 million and 5 billion kip; or
3. small projects: < 500 million kip.

Procedures for project approval vary according to these guidelines. Large projects require ten steps of documentation before approval, medium ones six, and small projects two.⁵⁰²

⁵⁰² For more details on the budget planning process, see Ibid.

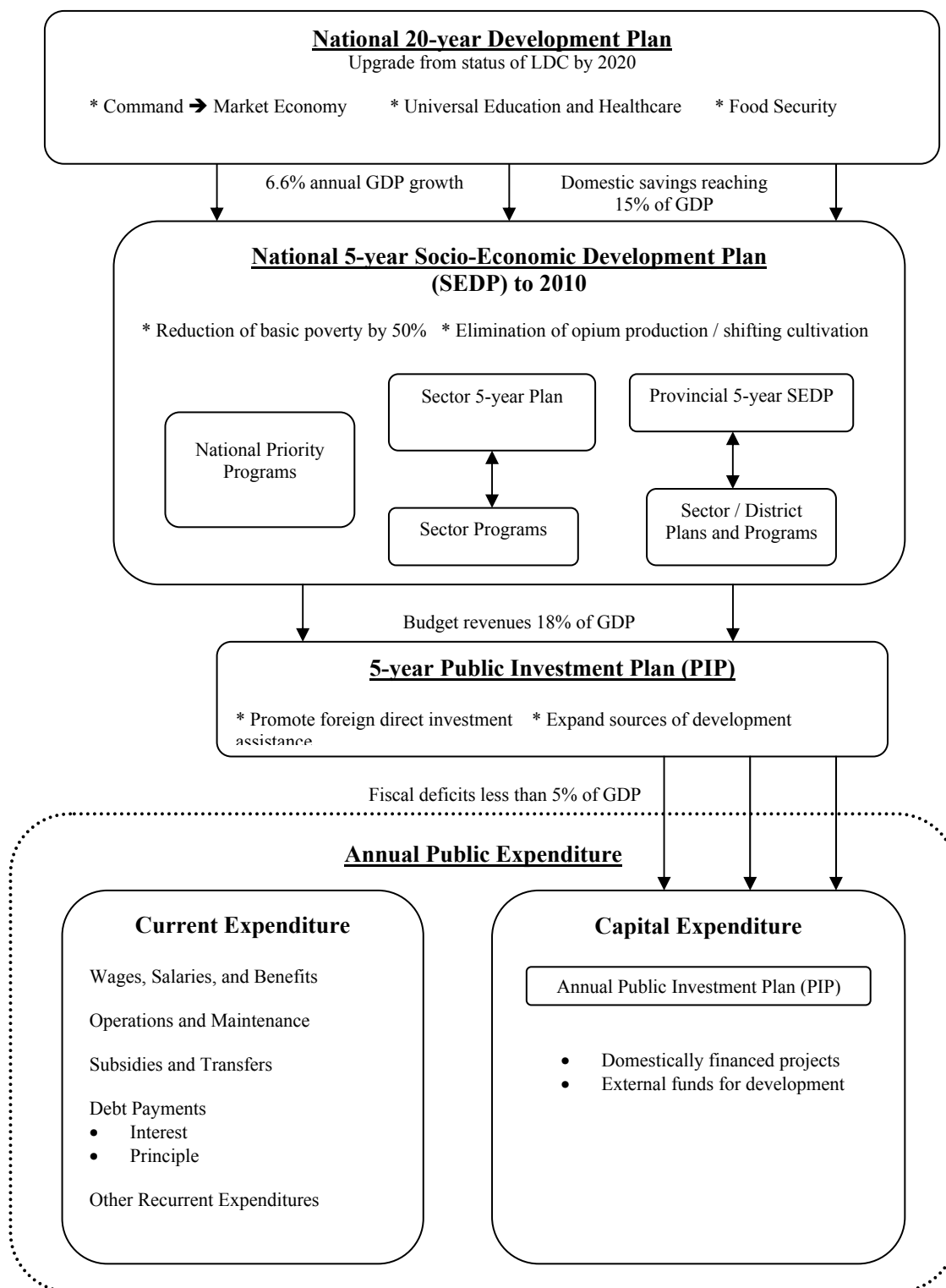


Figure A28. Budgetary Planning Process, Government of Lao P.D.R.

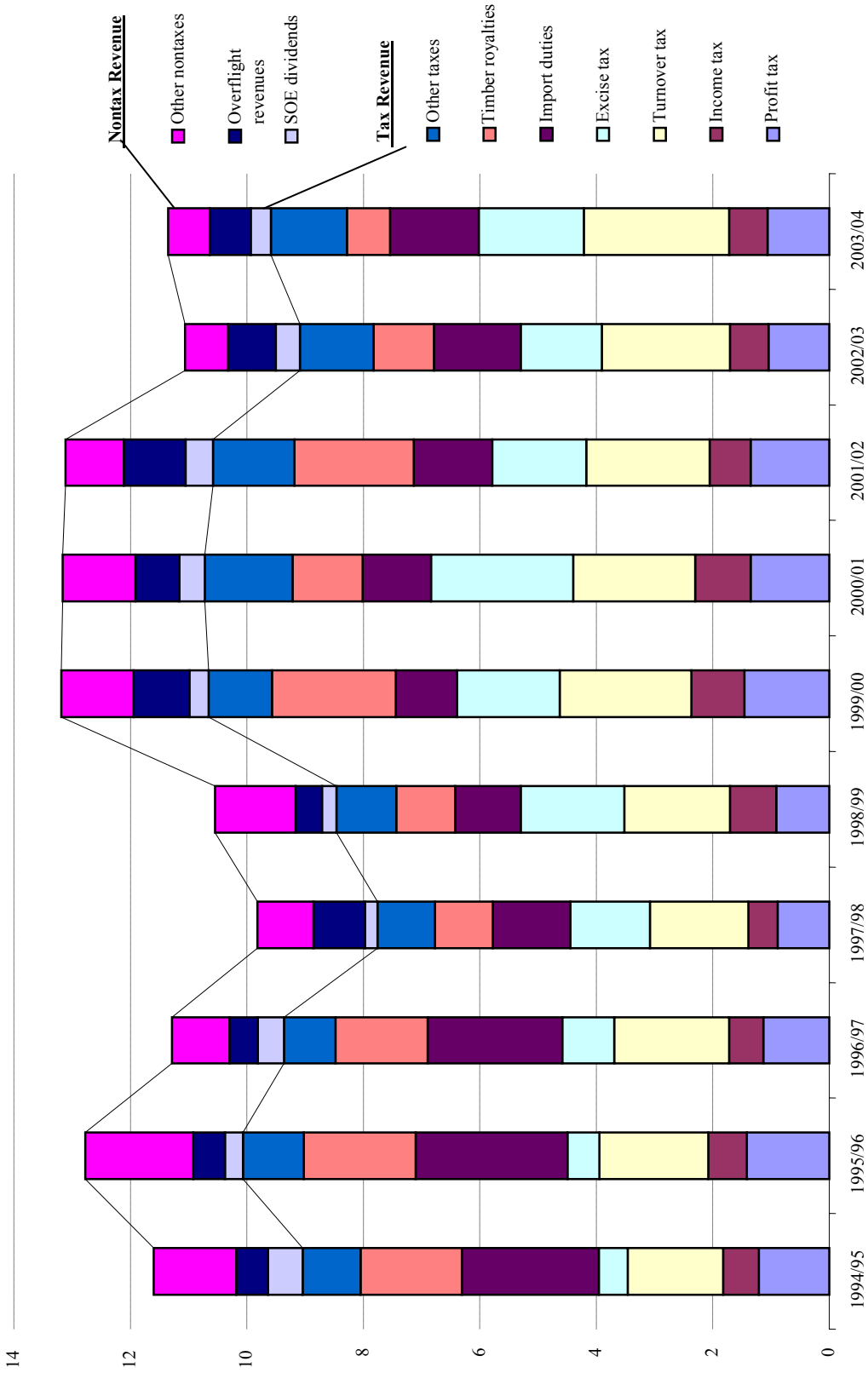
Appendix A10. Structure of Government Revenues, Lao PDR, 1994/95 - 2003/04

Table A18. Structure of Government Revenues (Billions of Kip), Lao PDR, 1994/95-2003/04*

	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Total Revenues	164.6	220.3	229	367	929	1,693	2,000	2,323	2,506	2,936
<i>Tax revenue</i>	<i>128.3</i>	<i>173.7</i>	<i>190</i>	<i>290</i>	<i>745</i>	<i>1,368</i>	<i>1,629</i>	<i>1,875</i>	<i>1,880</i>	<i>2,356</i>
Profit tax	17.2	24.4	23	33	80	187	205	239	225	278
Income tax	8.6	11.4	12	19	70	117	145	125	140	207
Turnover tax	23.3	32.3	40	63	160	290	318	375	466	619
Excise tax	7	9.5	18	51	157	226	371	286	293	415
Import duties	33.4	45	47	50	99	135	179	240	316	402
Timber royalties	24.7	33	32	37	89	273	182	362	218	150
Other taxes	14.1	18.1	18	37	90	140	229	248	222	285
<i>Nontax revenue</i>	<i>36.3</i>	<i>46.6</i>	<i>39</i>	<i>77</i>	<i>184</i>	<i>325</i>	<i>371</i>	<i>448</i>	<i>626</i>	<i>580</i>
SOE dividends	8.5	5.2	9	8	22	42	67	84	87	85
Overflight revenues	7.7	9.5	10	33	40	123	114	187	174	169
Other nontaxes	20.1	31.9	20	36	122	160	190	177	365	326

Source: Compiled from International Monetary Fund, Staff Reports and Selected Issues and Statistical Appendix, Washington, DC: IMF, various years; and World Bank, International Monetary Fund, and Asian Development Bank. "Lao PDR: Public Expenditure Review, Country Financial Accountability Assessment (Volumes I and II)." Washington, D.C.: WB, IMF, ADB, 2002.

Note: * Figures for 2003-04 are estimates of planned revenue generation.



Source: Table A18

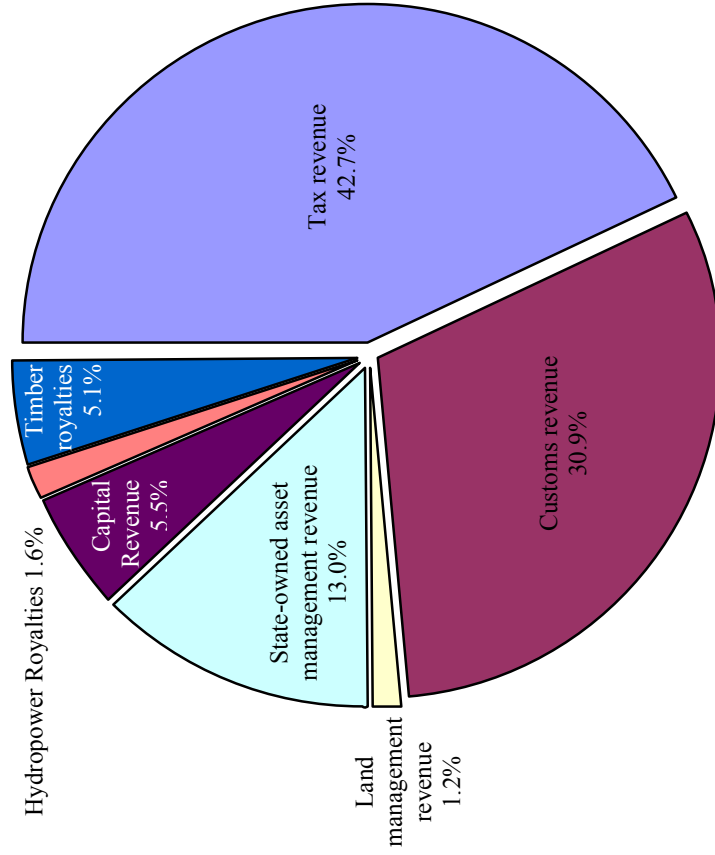
Figure A29. Structure of Government Revenues, Percent of GDP, Lao PDR FY 1994/95-2003/04

Table A19. Composition of Revenues, by Government Source, Lao PDR, 2002/03-2003/04*

	2002-03					2003-04						
	Total Revenue		Central Government		Provinces		Total		Central Government		Provinces	
	billions of kip	% of Total	billions of kip	% of Central revenue	billions of kip	% of Local revenue	billions of kip	% of Central revenue	billions of kip	% of Central revenue	billions of kip	% of Local revenue
Total revenue	2,505.9	100.0	995.9	39.7	1,510.0	60.3	2,936.4	100.0	1,286.0	43.8	1,650.4	56.2
Total revenue (non-timber)	2,287.9	91.3	995.9	39.7	1,292.0	51.6	2,786.4	94.9	1,136.0	38.7	1,650.4	56.2
Tax revenue	943.0	37.6	456.3	17.4	506.5	20.2	1,253.0	42.7	617.9	21.0	635.2	21.6
Profit tax	221.5	8.8	111.2	4.4	110.2	4.4	276.8	9.4	129.0	4.4	147.8	5.0
Business licenses	139.8	5.6	41.3	1.6	98.5	3.9	207.4	7.1	68.0	2.3	139.4	4.7
Minimum tax	1.2	0.0	0.0	0.0	0.0	0.0	1.3	0.0	0.1	0.0	0.0	0.0
Turnover tax	9.2	0.4	1.6	0.1	7.6	0.3	10.6	0.4	2.5	0.1	8.0	0.3
Excises tax	347.3	13.9	116.0	4.6	231.2	9.2	445.2	15.2	192.0	6.5	253.2	8.6
Fees	145.7	5.8	127.6	5.1	128.8	5.1	210.7	7.2	184.0	6.3	267.0	9.9
Road fees	35.1	1.4	27.1	1.1	2.7	0.1	20.0	0.7	3.6	0.1	16.5	0.6
Visa fees	1.9	0.1	0.0	0.0	0.0	0.0	25.6	0.9	23.0	0.8	2.6	0.1
Fines	37.8	1.5	11.4	0.5	1.1	0.0	50.8	1.7	15.4	0.5	35.4	1.2
Others	0.0	0.0	0.0	0.0	0.0	0.0	4.6	0.2	0.3	0.0	4.3	0.1
Customs revenue	673.0	26.9	8.1	0.3	664.9	26.3	906.3	30.9	15.2	0.5	891.1	30.3
Profit tax	4.0	0.2	0.0	0.0	4.0	0.2	6.2	0.2	0.0	0.0	6.2	0.2
Turnover tax	119.2	4.8	0.0	0.0	0.0	0.0	174.6	5.9	0.0	0.0	174.6	5.9
Excises tax	147.8	5.9	0.0	0.0	147.8	5.9	204.5	7.0	4.1	0.1	200.4	6.8
Import duties	315.8	12.6	5.4	0.2	310.4	12.4	402.3	13.7	6.2	0.2	396.1	13.5
Export duties	46.5	1.9	0.0	0.0	46.5	1.9	48.8	1.7	0.0	0.0	48.8	1.7
Registration fees	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fees	0.0	0.0	0.0	0.0	0.0	0.0	51.4	1.8	0.0	0.0	51.4	1.8
Revenue registration	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sale of confiscated goods	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fines	10.6	0.4	2.7	0.1	7.9	0.3	10.5	0.4	4.9	0.2	5.7	0.2
Others	29.1	1.2	0.0	0.0	29.1	1.2	8.0	0.3	0.0	0.0	8.0	0.3
Land management revenue	29.1	1.2	6.0	0.0	29.1	1.2	35.2	1.2	6.0	0.0	35.2	1.2
Land tax	23.2	0.9	0.0	0.0	0.0	0.0	24.7	0.8	0.0	0.0	24.7	0.8
Registration fees	4.3	0.2	0.0	0.0	4.3	0.2	8.3	0.3	0.0	0.0	8.3	0.3
Fees	0.0	0.0	0.0	0.0	0.0	0.0	2.1	0.1	0.0	0.0	2.1	0.1
Service charges (land survey)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fines	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	1.6	0.1	0.0	0.0	1.6	0.1	0.1	0.0	0.0	0.0	0.1	0.0
State-owned asset management rev	394.4	15.7	305.8	12.2	30.7	88.8	382.2	13.0	298.1	10.2	84.0	2.9
Natural resource tax	23.0	0.9	0.0	0.0	23.0	0.9	25.2	0.9	0.0	0.0	25.2	0.9
Registration fees	9.7	0.4	1.7	0.1	0.2	0.0	9.2	0.3	1.7	0.1	7.5	0.3
Fees	1.0	0.0	0.0	0.0	0.0	0.0	0.7	0.0	0.0	0.0	0.7	0.0
Leasing fees of state-owned asset	35.6	1.4	18.4	0.7	17.3	0.7	33.6	1.1	11.2	0.4	22.4	0.8
Concession	3.0	0.1	1.2	0.0	0.1	0.0	2.8	0.1	0.2	0.0	2.7	0.1
Sale of products (e.g. school proc	6.9	0.3	0.1	0.0	6.8	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Sale of confiscated goods	4.6	0.2	0.0	0.0	4.7	0.2	5.6	0.2	0.0	0.0	5.6	0.2
Service charges	42.5	1.7	25.4	1.0	2.6	0.1	42.3	1.4	32.0	1.1	10.3	0.4
Administration fees	174.2	7.0	174.2	7.0	17.5	0.7	169.6	5.8	169.6	5.8	13.2	0.5
Overflight	2.1	0.1	0.0	0.0	0.0	0.0	1.2	0.0	0.0	0.0	1.2	0.0
Fines	86.6	3.5	83.7	3.3	8.4	0.3	85.4	2.9	81.5	2.8	6.3	0.2
Dividends from state-owned asset	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	5.0	0.2	1.0	0.0	0.1	0.0	4.7	0.2	1.8	0.1	2.9	0.1
Sale of state-owned assets	203.4	8.1	201.6	8.0	20.2	1.8	162.5	5.5	159.2	5.4	12.4	3.3
Interest	47.4	1.9	47.2	1.9	4.7	0.2	47.3	1.6	46.7	1.6	3.6	0.6
Amortization-principal	156.0	6.2	154.4	6.2	15.5	0.6	115.2	3.9	112.5	3.8	8.7	2.7
Hydropower royalties	45.0	1.8	44.1	1.8	4.4	0.9	47.2	1.6	45.6	1.6	3.5	0.1
Timber royalties	218.0	8.7	0.0	0.0	0.0	0.0	150.0	5.1	150.0	5.1	11.7	0.0

Source: Compiled from International Monetary Fund, Staff Reports and Selected Issues and Statistical Appendix, Washington, DC: IMF, various years; and World Bank, International Monetary Fund, and Asian Development Bank. "Lao PDR: Public Expenditure Review, Country Financial Accountability Assessment (Volumes I and II)." Washington, D.C.: WB, IMF, ADB, 2002. Note: * Figures for 2003-04 are estimates of planned revenue generation.

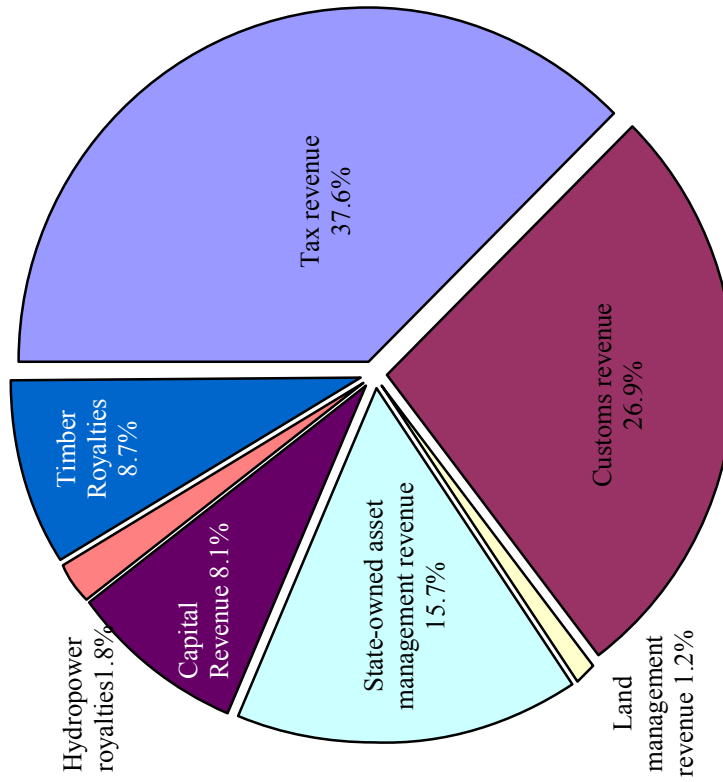
Total Revenue Target: 2,936.4 billion kips



Source: Table 19

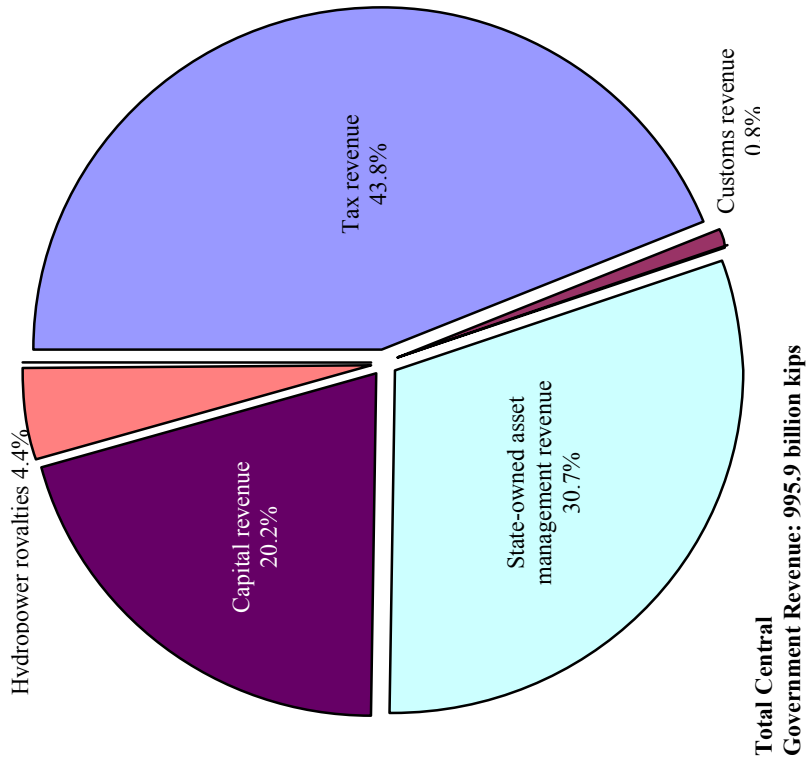
Figure A31. Composition of Revenue Target, Lao PDR, FY2003-04

Total Government Revenue: 2,505.9 billion kips



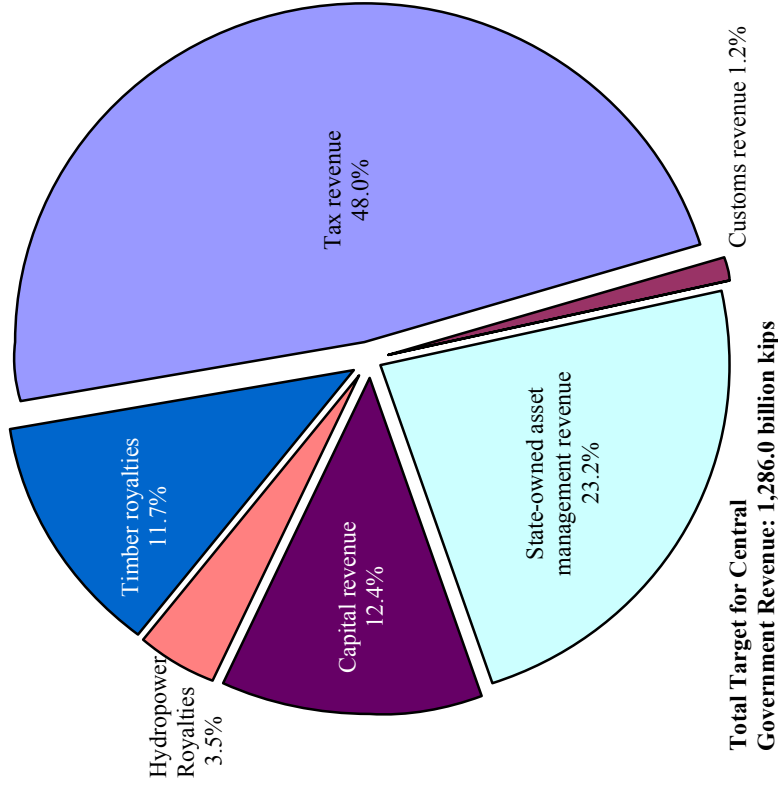
Source: Table A19

Figure A30. Composition of Government Revenue, Lao PDR, FY2002-03



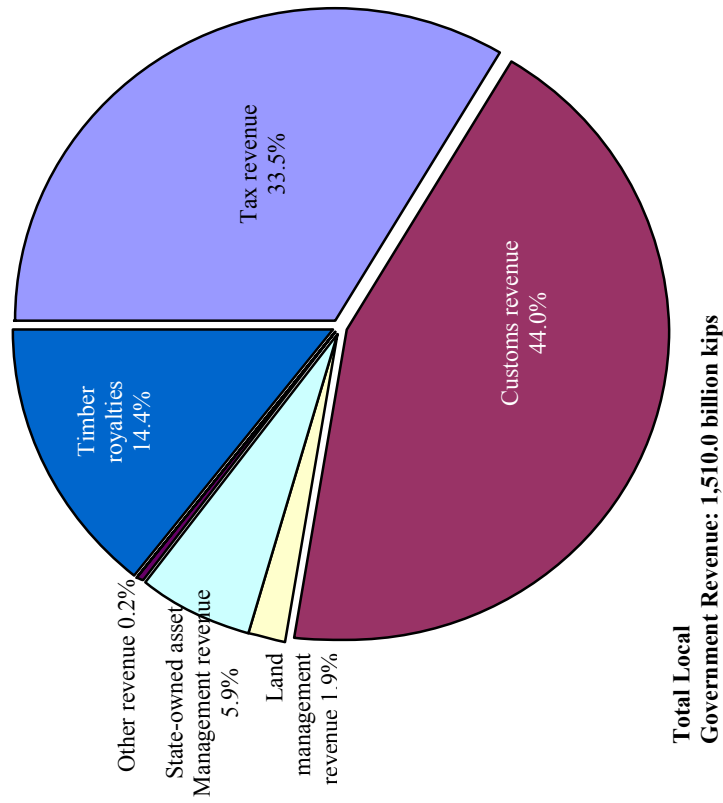
Source: Table A19

Figure A32. Composition of Central Government Revenue, Lao PDR, FY2002-03



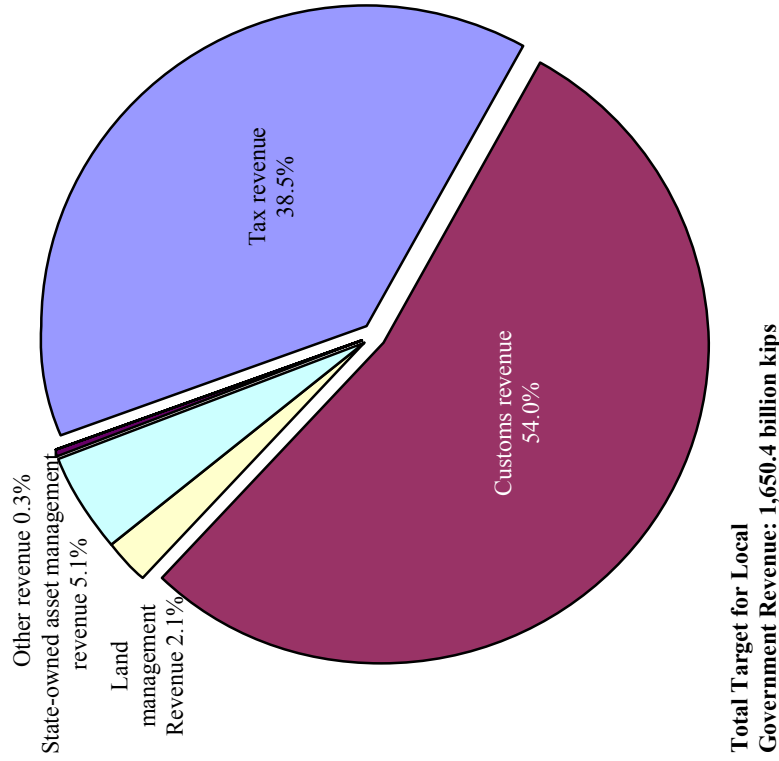
Source: Table A19

Figure A33. Composition of Central Revenue Target, Lao PDR, FY2003-04



Source: Table A19

Figure A34. Composition of Local Government Revenue, Lao PDR, FY2002-03



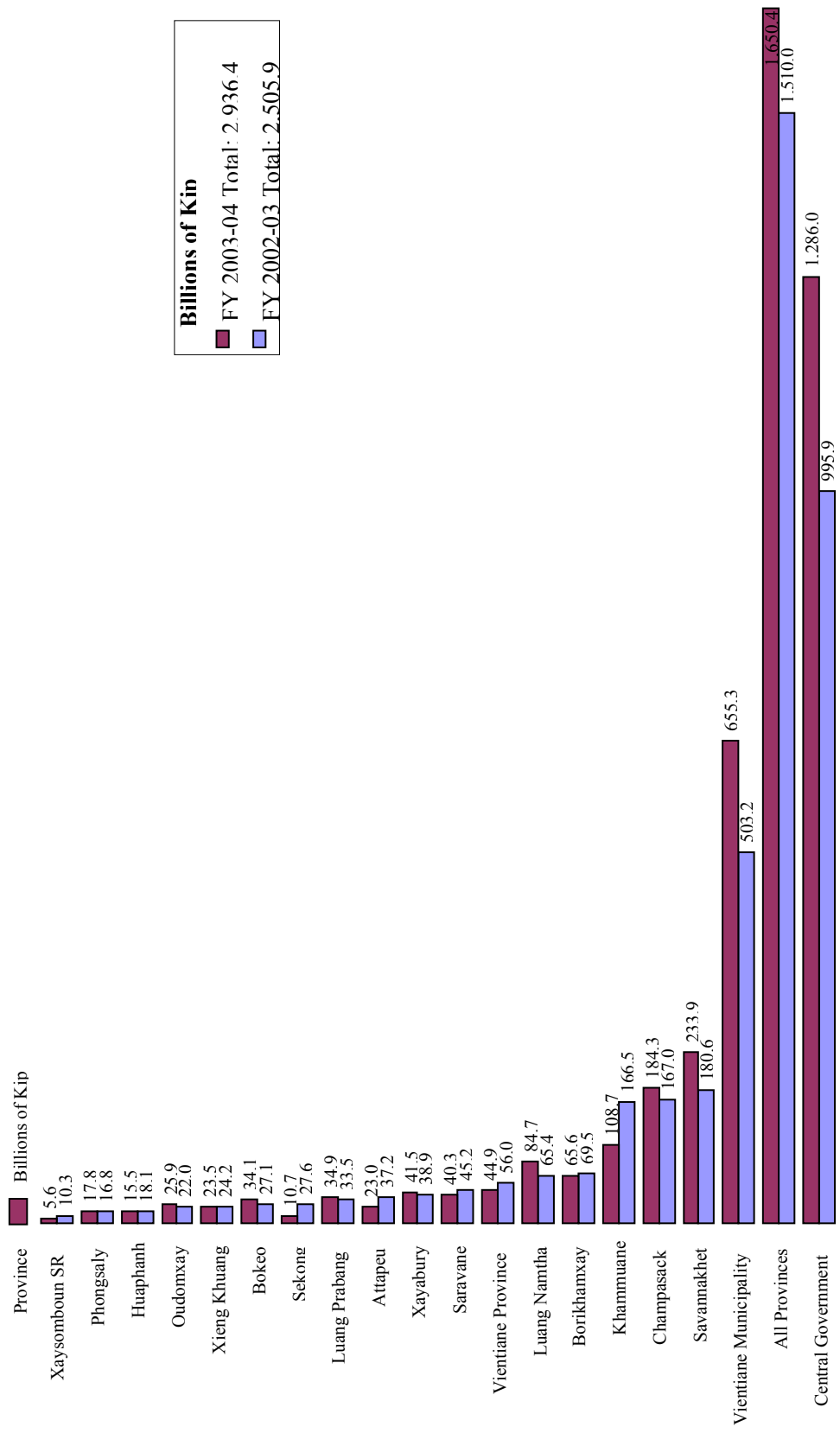
Source: Table A19

Figure A35. Composition of Local Revenue Target, Lao PDR, FY2003-04

Table A20. Government Revenues by Tax Administration, Lao PDR, FY 2002/03-2003-04

	2002/03		2003/04	
	2,505.9 revenue	% of Total revenue	2,936.4 revenue	% of Local revenue
Total	995.9	39.7	1,286.0	43.8
Central Government	1,510.0	60.3	1,650.4	56.2
Provinces				
Vientiane Municipality	503.2	20.1	655.3	22.3
Phongsaly	16.8	0.7	17.8	0.6
Luang Namtha	65.4	2.6	84.7	2.9
Oudomxay	22.0	0.9	25.9	0.9
Bokeo	27.1	1.1	34.1	1.2
Luang Prabang	33.5	1.3	34.9	1.2
Huaphanh	18.1	0.7	15.5	0.5
Xayabury	38.9	1.6	41.5	1.4
Xieng Khuang	24.2	1.0	23.5	0.8
Vientiane Province	56.0	2.2	44.9	1.5
Borikhamxay	69.5	2.8	65.6	2.2
Khammuane	166.5	6.6	108.7	3.7
Savannakhet	180.6	7.2	233.9	8.0
Saravane	45.2	1.8	40.3	1.4
Champasack	167.0	6.7	184.3	6.3
Sekong	27.6	1.1	10.7	0.4
Attapeu	37.2	1.5	23.0	0.8
Xaysomboun SR	10.3	0.4	5.6	0.2

Source: Compiled from International Monetary Fund, Staff Reports and Selected Issues and Statistical Appendix, Washington, DC: IMF, various years; and World Bank, International Monetary Fund, and Asian Development Bank. "Lao PDR: Public Expenditure Review, Country Financial Accountability Assessment (Volumes I and II)." Washington, D.C.: WB, IMF, ADB, 2002. Note: * Figures for 2003-04 are estimates of planned revenue generation.



Source: Table A20

Figure A36. Government Revenues by Administration, Lao PDR, FY2002/03-2003/04

Appendix A11. Taxpayers and Tax Administration

Table A21. Classification of Taxpayers and Tax Administration, Lao PDR, 2002

Category	Number	Turn over Threshold (kip)*	Accountant system	Tax system	Taxes	Taxes collected (kip)	Payment	Level of Administration
Large Tax Payers	80	Greater than 2,400,000,000 (US\$ 225,000)	Extended / accrual	Self- assessment	All taxes	379,729,437,737	To National Treasury	Central Government
Medium Taxpayers	3,009	2,400,000,000- 100,000,000 (US\$ 9,300)	Regular	Self- assessment	All taxes	419,018,447,331	To National / Provincial Treasury	Central, Municipal, and Provincial Governments
Small taxpayers	38,484	100,000,000- 1,200,000 (US\$ 110)	Basic	Contract system written	Turnover Tax Profit Tax (Payroll Tax excluded) Turnover Tax Profit Tax	43,858,207,753	To district or village finance units	District administration
Very small tax payers	21,338	Less than 1,200,000	Simplified	Contract system Oral agreement	Rental Tax Land Tax Other local taxes	n/a	To district or village finance units	District / Village administration
Total	62,911					842,606,092,821		

Source: Tax Department statistics, Ministry of Finance, Lao PDR.

Note.* US dollars at prevailing exchange rates.

Table A22. Tax Department Staff and Taxpayers, by Administration, Lao PDR, 2003

Name of Provinces	No of Staff				Taxation System				
	Total	Male	Female	Permanent	Contracted	Total taxpayers	Self-assessed	Presu.	Card-holder
VMO	292	197	95	261	31	19,577	1,690	7,880	10,007
Phongsaly	18	11	7	14	4	734	27	450	257
LuangNamtha	20	18	2	13	7	1,207	33	817	357
Oudomxay	53	50	3	19	34	2,238	60	1,429	749
Bokeo	39	36	3	13	26	1,480	45	1,185	250
Luang Prabang	71	62	9	44	27	3,367	212	3,059	96
Houaphan	24	22	2	16	8	1,706	34	1,238	434
Xayabouly	81	67	14	41	40	2,235	3	2,091	141
Xiengkhouang	20	18	2	18	2	1,304	41	995	268
Vientiane	89	67	22	83	6	5,591	88	2,576	2,927
Borikhamxay	52	44	8	41	11	2,973	89	2,710	174
Khamouanne	67	53	14	49	18	2,091	129	1,717	245
Savanaketh	154	106	48	148	6	8,139	202	4,233	3,704
Saravan	48	44	4	37	11	1,916	45	1,871	-
Sekong	20	19	1	11	9	551	6	508	37
Champasack	108	94	14	81	27	6,695	206	4,893	1,596
Arthapeu	21	19	2	11	10	743	74	573	96
Xaysomboun	8	6	2	4	4	284	25	259	-
All Provinces	1,185	933	252	904	281	62,831	3,009	38,484	21,338
Tax Department	42	27	8	32	3	80	80	-	-
Nationwide	1,227	960	260	946	284	62,911	3,089	38,484	21,338

Source: Swedish International Development Agency. "Swedish Support to Strengthen Fiscal Management in Lao PDR: Capacity Study on Organization and Management Issues of the Tax Administration." Vientiane, Lao PDR: SIDA, Ministry of Finance (Lao PDR), 2003, p. 16.

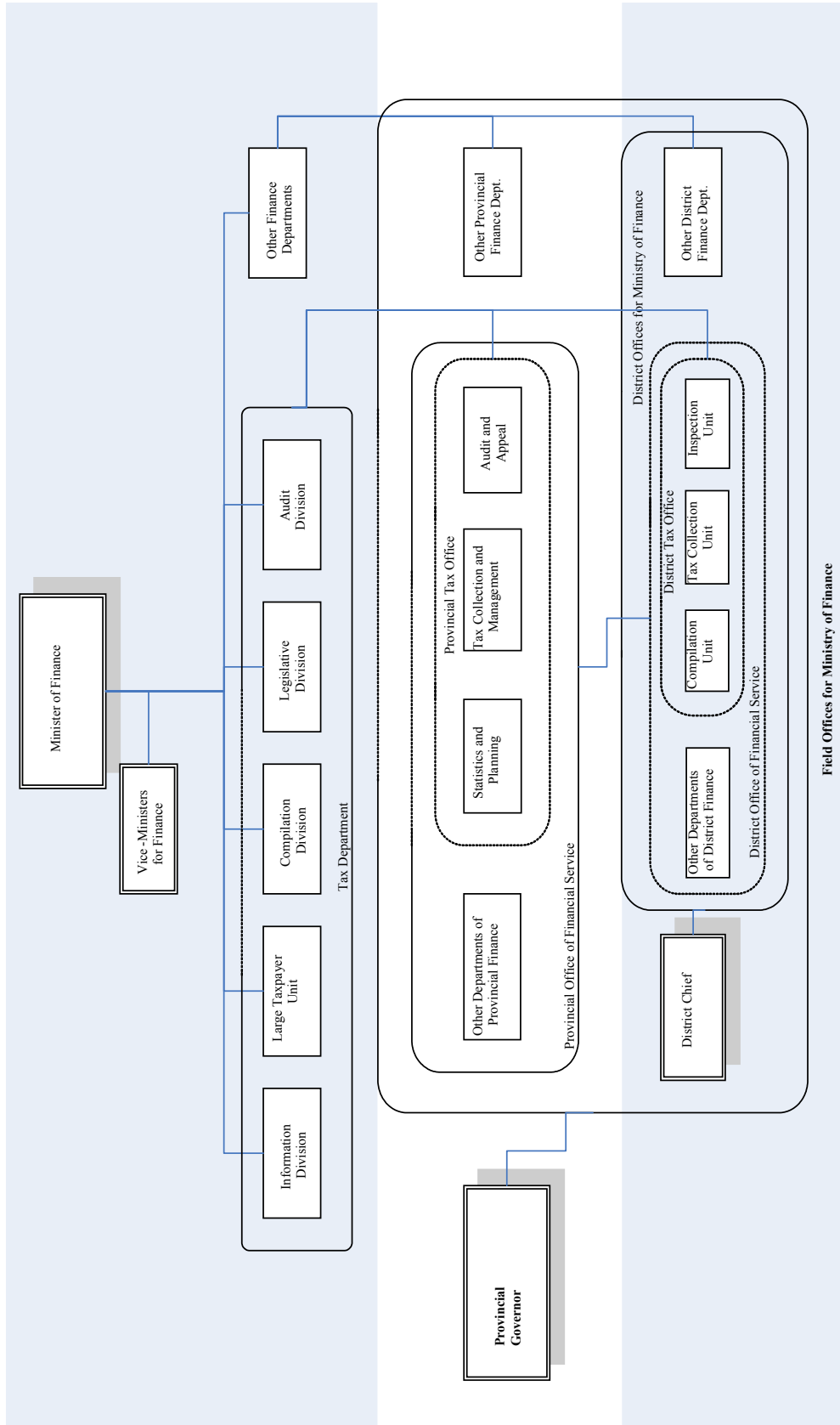


Figure A37. Structure of Ministry of Finance, Lao People's Democratic Republic

Appendix A11. Fiscal Transfers, Lao PDR, FY 2002/03 – FY 2003/04

Millions of kip	2002/03			2003/04			
	Revenue	Expenditure	Deficit / Surplus (-) deficit (+) surplus	Revenue	Expenditure	Deficit / Surplus (-) deficit (+) surplus	
			% of Revenue			% of Revenue	
Total	2,505,974	4,409,575	-1,903,601	2,936,326	5,619,966	-2,683,640	91.4
<i>Central Government</i>	<i>996,027</i>	<i>2,438,140</i>	<i>-1,442,113</i>	<i>1,285,948</i>	<i>3,784,175</i>	<i>-2,498,227</i>	<i>194.3</i>
<i>Provinces</i>	<i>1,509,947</i>	<i>1,971,435</i>	<i>-461,488</i>	<i>1,650,378</i>	<i>1,835,791</i>	<i>-185,413</i>	<i>11.2</i>
Vientiane Municipality	503,102	201,384	301,718	655,377	235,455	419,922	64.1
Champasack	166,916	44,743	122,173	184,300	63,616	120,684	65.5
Savannakhet	180,588	150,013	30,575	233,800	163,328	70,472	30.1
Luang Namtha	66,443	68,501	-2,058	84,700	79,319	5,381	6.4
Borikhamxay	69,539	74,364	-4,825	65,600	68,676	-3,076	4.7
Attapeu	37,280	49,896	-12,616	23,000	57,441	-34,441	149.7
Xaysomboun SR	10,151	34,784	-24,633	5,635	41,913	-36,278	643.8
Bokeo	27,331	54,781	-27,450	34,172	45,796	-11,624	34.0
Phongsaly	16,818	46,291	-29,473	17,972	90,297	-72,325	402.4
Saravane	45,214	79,235	-34,021	40,275	58,725	-18,450	45.8
Xieng Khuang	24,275	63,323	-39,048	23,556	71,851	-48,295	205.0
Vientiane Province	56,141	98,776	-42,635	44,900	82,802	-37,902	84.4
Xayabury	38,907	103,338	-64,431	41,500	102,462	-60,962	146.9
Khammuane	166,676	249,792	-83,116	108,681	153,239	-44,558	41.0
Huaphanh	18,131	113,462	-95,331	15,500	105,466	-89,966	580.4
Oudomxay	22,271	145,265	-122,994	25,910	169,044	-143,134	552.4
Luang Prabang	33,512	169,901	-136,389	34,850	110,978	-76,128	218.4
Sekong	27,655	223,590	-195,935	10,650	135,383	-124,733	1,171.2

Source: Compiled from International Monetary Fund, Staff Reports and Selected Issues and Statistical Appendix, Washington, DC: IMF, various years; and World Bank, International Monetary Fund, and Asian Development Bank. "Lao PDR: Public Expenditure Review, Country Financial Accountability Assessment (Volumes I and II)." Washington, D.C.: WB, IMF, ADB, 2002.

Note: * Figures for 2003-04 are estimates of planned revenue generation.

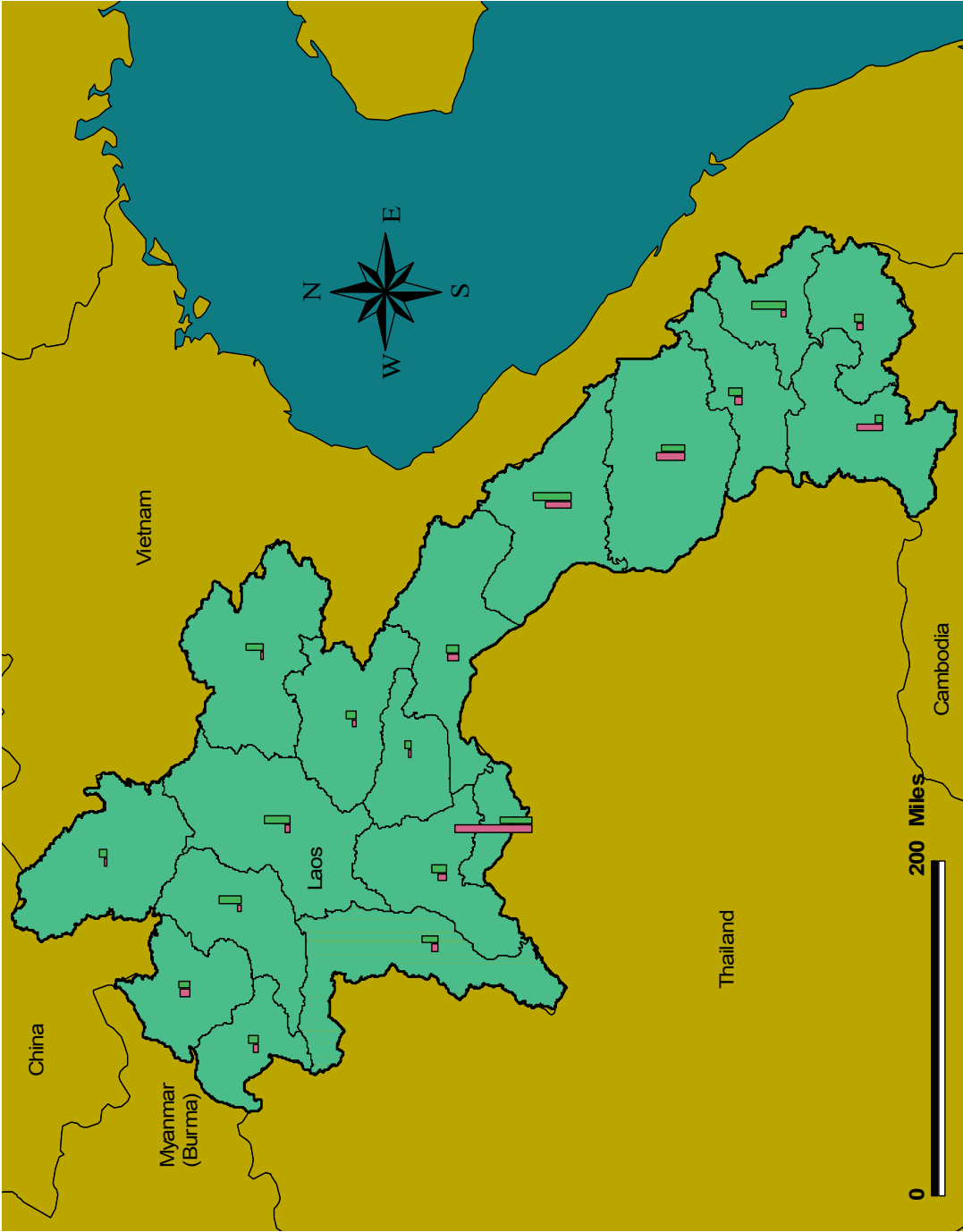


Figure A38. Local Revenues and Expenditures, by Province, Lao PDR, FY 2002-2003

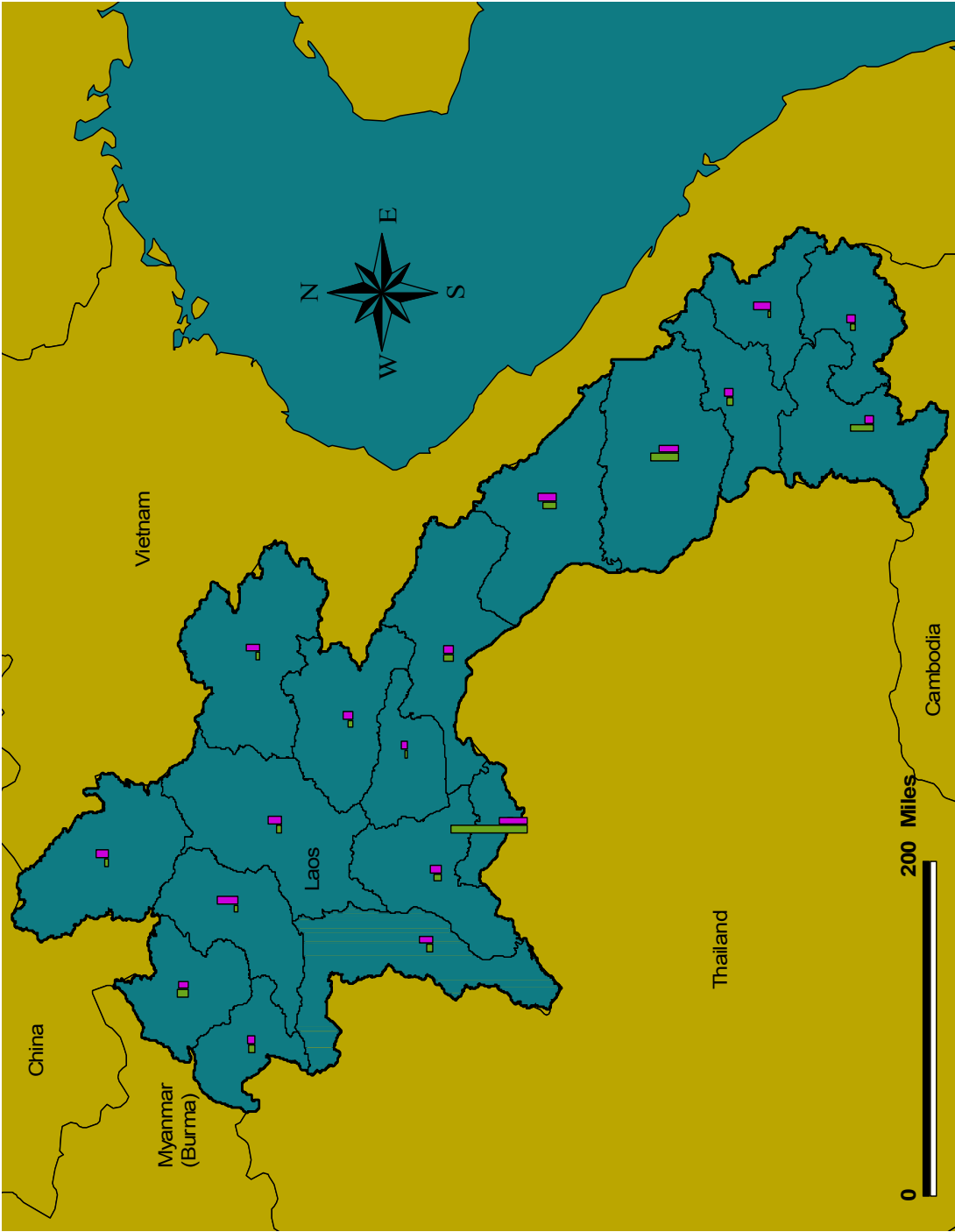


Figure A39. Local Revenue and Expenditure Targets, by Province, Lao PDR, FY 2003- 2004

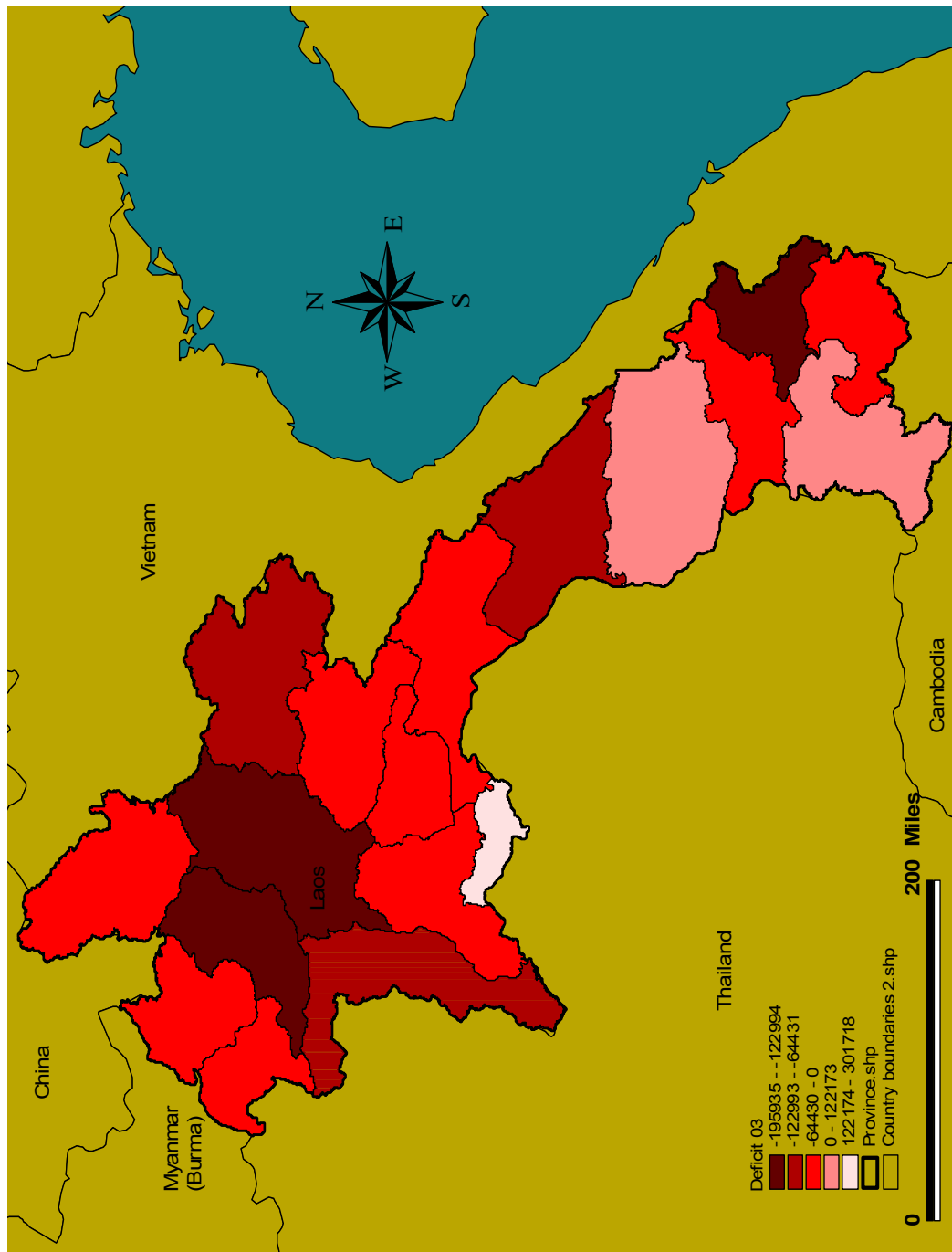


Figure A40. Local Surplus and Deficits (millions of kip), by Province, Lao PDR, FY 2002-2003

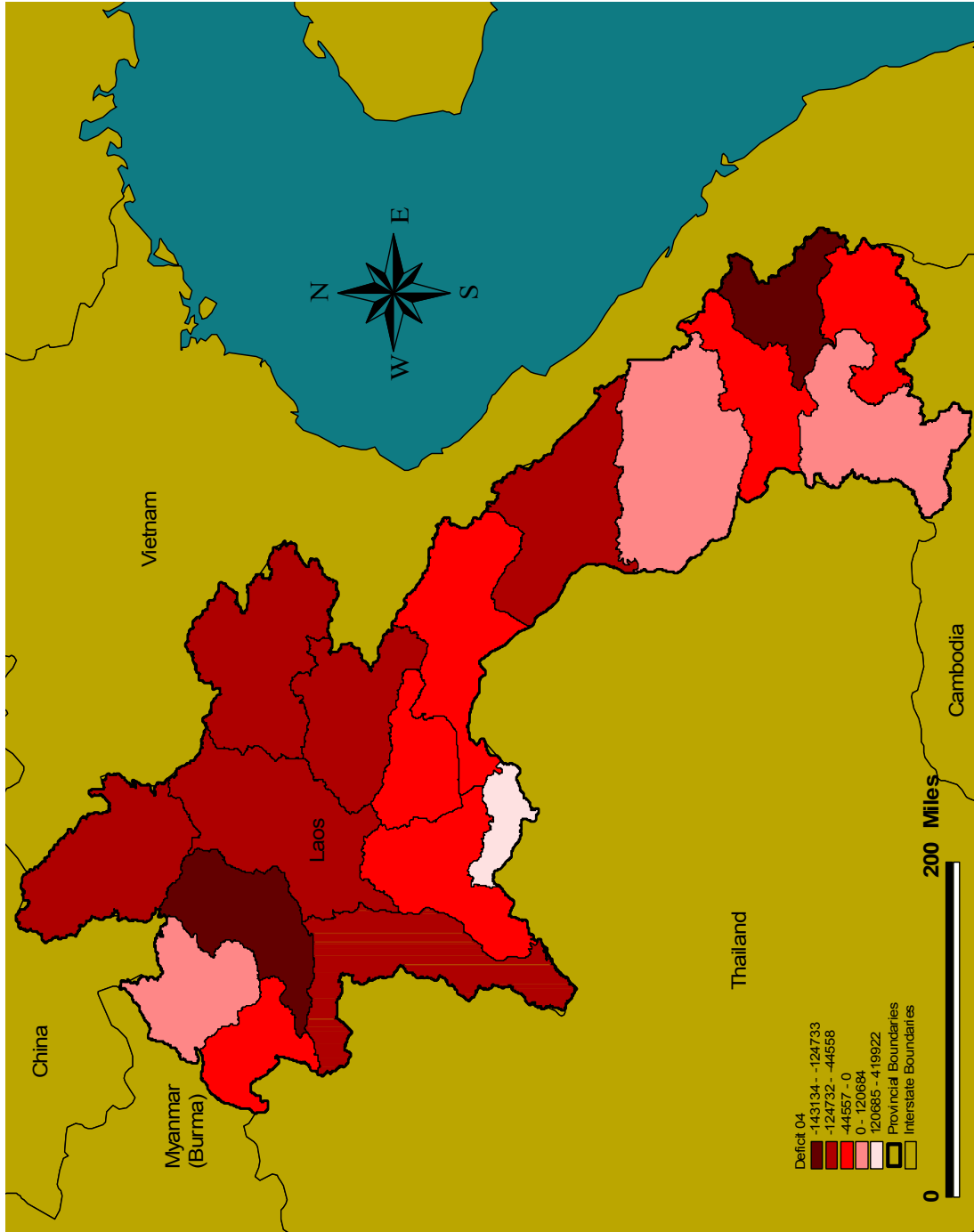


Figure A41. Local Surplus and Deficits (millions of kip), by Province, Lao PDR, FY 2003-2004

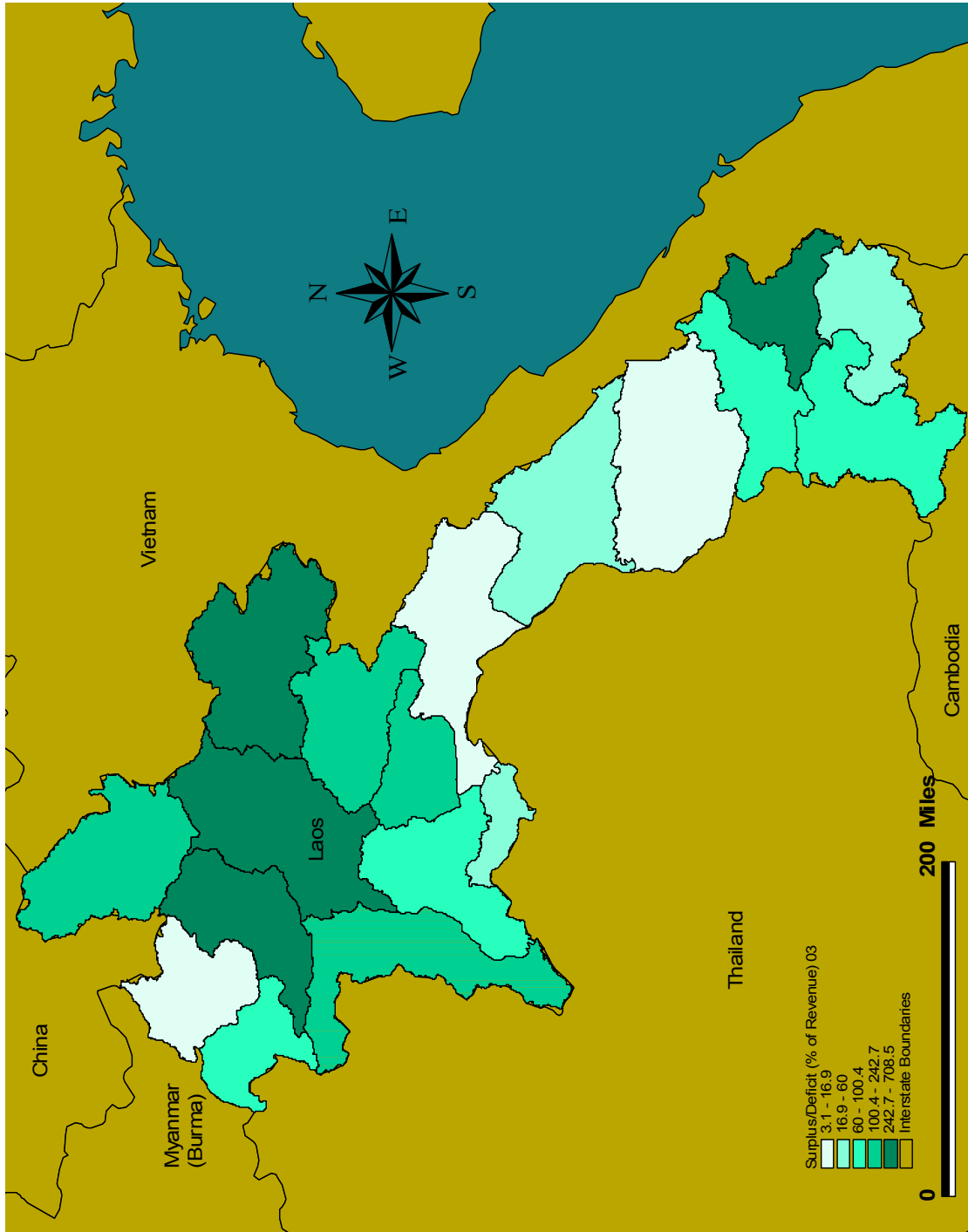


Figure A42. Local Surplus and Deficits (percent of revenue), by Province, Lao PDR, FY 2002-2003

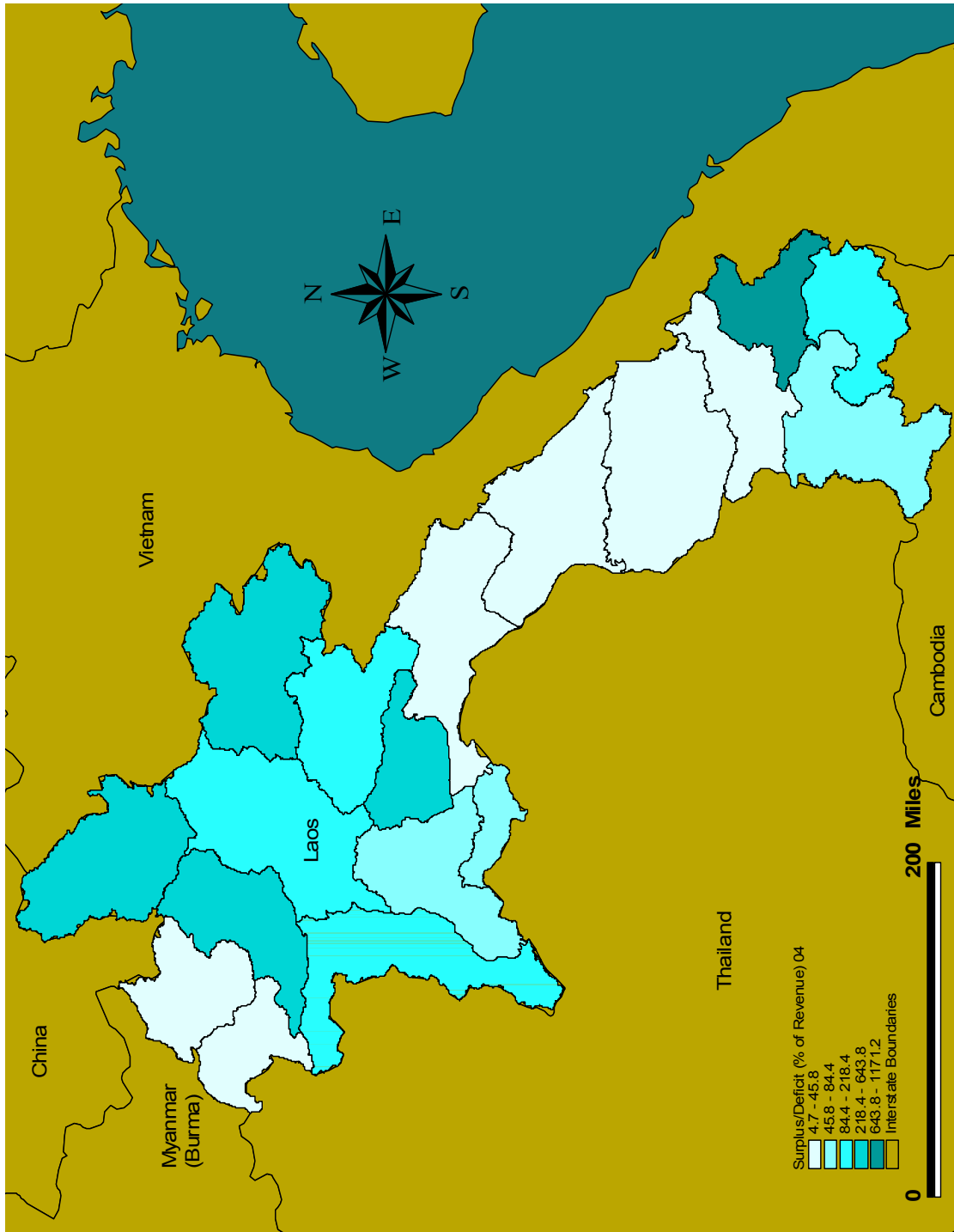


Figure A43. Local Surplus and Deficits (percent of revenue), by Province, Lao PDR, FY 2003-2004

Appendix A12. Overview of Devolution's Past

Upon taking power in 1975, the socialist government in Laos formally inaugurated a centrally planned economy. Logistically however, inaccessibility of the outlying provinces assured a high degree of regional autonomy. In 1986, under the banner of the New Economic Mechanism, the party-state embraced market reforms by dismantling price controls, liberalizing (internal and external) trade, and devolving political and economic authority to the provinces. Until constitutional reforms reorganized central-local relations in the early 1990s, governors ran the provinces as mini-states, asserting fiscal and monetary autonomy. Provincial governors controlled all state expenditures under their jurisdiction. State taxes collected in the provinces by local branches of MoF were considered provincial revenues. Few resources were transferred to, or expected from, the central government, which demanded self-sufficiency of the provinces. Governors managed all civil servants of the vertical line ministries under their jurisdiction and paid their salary from provincial coffers. Local branches of the State Bank acted independently of central directives, setting exchange rates and credit lending policies to suite local conditions. Tax and costumes policies lacked national uniformity and reflected local efforts to attract scarce investment opportunities.

This pure devolution of economic prerogatives created instability in the macroeconomy that the central government struggled to control. Lacking central oversight, the provinces fueled inflationary pressures with lax fiscal policies. Furthermore, devolution failed to improve the economic viability of many state-owned enterprises (SOEs). Instead of aiming for operational efficiency, local managers of SOEs increased wages and other expenses with no incentive at economical self-sufficiency. Many provincial governments ran budget deficits, financed through generous bank credits. Local authorities printed money to pay for their excesses, but

the rapid increase in liquidity quickly depressed the value of the currency. As a result of local autonomy, financial instability spread, quality of public service delivery further declined, regional disparities widened, and physical infrastructures deteriorated for lack of maintenance.

In limiting a central government's traditional role in redistribution, devolution also exacerbated regional inequality. Financial and fiscal autonomy resulted in revenue imbalances among the provinces, while the central government received only 25 percent of fiscal revenues—out of which it had to finance its own expenditure and those of poorer provinces.⁵⁰³ To cover its annual budget, the central government relied heavily on bank loans to finance its perennial budget deficits. By mid-1989, inflation surged over 100 percent; but the central government exerted no control over local credit policies, which remained the prerogative of provincial authorities.⁵⁰⁴ Thus, while market-correcting measures contributed to economic growth in the late 1980s, administrative decentralization eventually hampered efforts to stabilize the economy.

⁵⁰³ Keuleers and Sibounheuang, "Central-Local Relations," 204.

⁵⁰⁴ *Ibid.*

Appendix A13. Analytic Hierarchy Process

Analytic hierarchy process (AHP) provides a useful way to analyze and quantify decision making when participants cannot assign specific value or utility to particular decisions but can do more than just rank preferences.⁵⁰⁵ As a broad method of measurement, AHP has been used as a tool in conflict resolution to evaluate the relative positions of interested parties. The method requires that participants can “make pairwise comparisons of elements and state that one element is X times as desirable as a second one.”⁵⁰⁶ As the name implies, the method structures a decision problem into a hierarchy that reflects the complex relationship inherent in the situation. It entails arranging goals, attributes, issues, and stakeholders into a related hierarchical structure.⁵⁰⁷

As Saaty and Vargas suggest, AHP “is used to derive ratio scales from both discrete and continuous paired comparisons in multilevel hierarchic structures. These comparisons may be taken from actual measurements or from a fundamental scale that reflects the relative strength of preferences and feelings.”⁵⁰⁸ The first step in building such a model is to determine a scale, i.e. a criteria, for making pairwise comparisons.⁵⁰⁹ Next, a hierarchy depicting the situation (e.g. overall goals, objectives or sub-goals) needs to be constructed. The second level of the hierarchy contains n -elements that form an n -by- n matrix A_n . Here, a_{ij} designates how much more important a_i is than a_j in achieving the overall goal specified at the first level of the hierarchy.⁵¹⁰

⁵⁰⁵ For an overview of AHP, see Azis and Isard, "Use of Ahp."

⁵⁰⁶ Ibid.: 15.

⁵⁰⁷ Saaty and Vargas, *Decision Making in Economic, Political, Social and Technological Environments with the Analytic Hierarchy Process* 2.

⁵⁰⁸ Ibid. 3.

⁵⁰⁹ For a useful scale, see Ibid. 16, Table 1.

⁵¹⁰ For the characteristic equation of A , see Azis and Isard, "Use of Ahp," 23-5.

Once these pairwised comparisons are made and recorded in the matrix, the object is to determine a set of numerical weights $w_1, w_2, w_3, \dots, w_n$, an n -by-1 vector w , which reflects the recorded quantified judgments.⁵¹¹ By definition, $Aw = nw$. Thus, to determine w , we must solve the following system of equations: $(A - nI) * w = 0$.⁵¹² This relative measurement w_i represents a ratio scale of values determined by comparing it in pairs with the other $(n-1)$ priorities.

In one example, Azis uses the AHP method to unravel the general tensions between developed and developing countries.⁵¹³ Given the goal of favorable global trade and economic development, he determines the most feasible strategies that competing countries and the North and South should opt to pursue jointly. From this model of conflict, he urges most developing countries to support the multilateral trade system under GATT/WTO.⁵¹⁴ Elsewhere in an extension of this model, Azis uses an analytic network process to evaluate alternative forms of regional financial arrangements.⁵¹⁵ He discovers that the East Asian region would benefit more from cooperating strictly in the financial sector than through targeting asset prices and exchange rate stability.⁵¹⁶ Saaty and Vargas, the pioneers of AHP provide many examples of creative and useful applications of this general theory of measurement.⁵¹⁷

⁵¹¹ Ibid.: 24.

⁵¹² By the perturbation theorem, $Aw = \lambda_{\max} * w$, where $\lambda_{\max} = n$ iff A is consistent.

⁵¹³ Iwan J. Azis, "New Conflicts between Developed and Developing Countries," *Peace Economics, Peace Science and Public Policy* 3, no. 1 (1996).

⁵¹⁴ Ibid.: 30.

⁵¹⁵ Iwan J. Azis, "From Chiang Mai Initiative to Regional Fiancial Arrangement?" (paper presented at the Asia's New Regionalism: ASEAN+3, Champaign, IL, 2003).

⁵¹⁶ Ibid., 23.

⁵¹⁷ See for example, Saaty and Vargas, *Decision Making in Economic, Political, Social and Technological Environments with the Analytic Hierarchy Process*. and Thomas L. Saaty and Luis G. Vargas, "Models, Methods, Concepts & Applications of the Analytic Hierarch Process," (Boston: Kluwer Academic, 2001).

AHP Model of Fiscal Crises in the Lao PDR

Goal:

Reduction of Fiscal Crises

Objectives:

Economic Growth: Strong and sustained economic growth

Broad Tax Base: broaden tax base and income generation

Expenditure control: control government spending

Targets:

Foreign Aid: sustain inflows of development assistance and foreign investment

Solvent Banking System: reduce non-performing loans from SOEs

Rational Administration: rationalize tax administration and better enforcement of fiscal rules

Rule of Law: establish predictable rules and regulation

Strategies:

FDI: Foreign direct investment

ODA: Overseas development assistance from donor countries

VAT: Value-added Tax to reduce distortions and to simplify tax collection

LTU: Large Taxpayer Unit

National: centralization of tax administration, customs administration, and treasury management

SOE: Strong central oversight of SOE management

Super: super region encompassing the provinces.

Policies

International trend: the agenda of decentralization

Status Quo: negotiated settlement the advances reform agenda slowly


Developmentalist: strong state-directed development to create national economic space

Table A24. Structure of AHP for Reduction of Fiscal Crises

Alternative(s) in it:	<ul style="list-style-type: none"> • Devolution • Status Quo • Centralization
Network Type:	Bottom level
Formula:	Not applicable
Clusters/Nodes	<ul style="list-style-type: none"> • 1 Reduction of Fiscal Crises: <i>AHP mode based on researcher's perception of ways to reduce fiscal crises.</i> <ul style="list-style-type: none"> ○ Overall Goal: <i>to improve fiscal management</i> • 2 Objectives: <i>Overall, the reduction of fiscal crises in Laos requires sustained economic growth, a broadened tax base, and controls on expenditures.</i> <ul style="list-style-type: none"> ○ Broad Tax Base: <i>to broaden the tax base by reducing exemptions and other tax distortions to streamline, rationalize, and hence modernize procedures for tax collection</i> ○ Economic Growth: <i>to promote sustained economic growth</i> ○ Expenditure Control: <i>to control expenditure management at state-owned enterprises and banks</i> • 3 Targets: <i>To achieve these objectives, four targets must be met.</i> <ul style="list-style-type: none"> ○ Foreign Aid: <i>sustained inflows of development assistance and foreign investment</i> ○ Rational Administration: <i>efficient tax administration and better enforcement of fiscal rules</i> ○ Rule of Law: <i>uniform enforcement of laws and regulations</i> ○ Solvent Banking System: <i>reduction of non-performing loans from state-owned enterprises</i> • 4 Strategies: <i>To meet these targets, the government must follow strategies to:</i> <ul style="list-style-type: none"> ○ FDI: <i>attract foreign direct investment</i> ○ LTU: <i>expand Large Taxpayer Unit</i> ○ National: <i>centralize tax administration, customs administration, and treasury management</i> ○ ODA: <i>sustain overseas development assistance from donor countries</i> ○ SOE: <i>establish strong central oversight of SOE management</i> ○ Super: <i>create super region encompassing several provinces</i> ○ VAT: <i>implement value-added tax to reduce distortions and to simplify tax collection</i> • 5 Alternative Policies: <i>In order to realize above strategies effectively, the Lao government can pursue one of three plausible policies</i> <ul style="list-style-type: none"> ○ Centralization: <i>a developmentalist path towards strong centralization</i> ○ Devolution: <i>the international trend towards decentralization</i> ○ Status Quo: <i>the status quo where governance is negotiated within the Central Committee</i>



Source: Generated from Superdecision software program.

Table A25. Results of AHP Simulation of Fiscal Crises

Graphic	Alternatives	Total	Normal	Ideal	Ranking
	Centralization	0.1882	0.7529	1.0000	1
	Devolution	0.0288	0.1150	0.1528	3
	Status Quo	0.0330	0.1321	0.1754	2

Source: Generated from Superdecision software.

Table A26. Tests for Robustness of AHP Simulation of Fiscal Crises

Graphic	Alternatives	Total	Normal	Ideal	Ranking
	Centralization	0.1950	0.7802	1.0000	1
	Devolution	0.0203	0.0812	0.1041	3
	Status Quo	0.0347	0.1386	0.1777	2

Source: Generated from Superdecision software.



AHP Model for Negative Impact of Fiscal Restructuring

Table A27. Structure of AHP for Negative Impact of Fiscal Restructuring

Alternative(s) in it:	<ul style="list-style-type: none"> • Centralization • Decentralization • Status Quo
Network Type:	Bottom level
Formula:	Not applicable
Clusters/Nodes	<ul style="list-style-type: none"> • 1. Negative Impacts of Restructuring: <i>outright centralization remains a planning fantasy in Laos; and the above model fails to consider the costs of centralization.</i> <ul style="list-style-type: none"> ○ Restructuring: <i>Capturing the negative impacts of fiscal restructuring, a second AHP model helps to explain the difficulties of enacting centralization in communist Laos.</i> • 2. Costs: <i>Broadly speaking, fiscal structuring has political, economic, and social costs.</i> <ul style="list-style-type: none"> ○ Economic: <i>reduction in economic activity</i> ○ Political: <i>resentment of political elites</i> ○ Social: <i>unrest and resentment among the populace</i> • 3. Risks: <i>fiscal centralization carries the following risks</i> <ul style="list-style-type: none"> ○ Central Oversight: <i>strong central oversight of once autonomous regions and population</i> ○ Economic Decline: <i>economic decline from disinvestment</i> ○ Regional Instability: <i>provincial instability of disempowered governors</i> ○ Revenue Redistribution: <i>revenue redistribution to the detriment of wealthier provinces</i> • 4. Impacts: <i>The potential impacts of these risks include</i> <ul style="list-style-type: none"> ○ Costs to Local Economy: <i>various costs to the local economy</i> ○ Decline of Economic Activity: <i>decline of economic activity</i> ○ Declining Political Commitment: <i>a declining political commitment to the regime</i> ○ Higher Tax Burden: <i>higher tax burdens</i> ○ Loss of Local Autonomy: <i>loss of local autonomy</i> ○ Loss of Local Revenue: <i>loss of local sources of revenues</i> ○ Weakening Patronage: <i>a weakening of the patronage networks</i> • 5 Alternative Policies: <i>Given these negative impacts, three plausible policies are evaluated for their high costs of restructuring.</i> <ul style="list-style-type: none"> ○ Centralization: <i>a developmentalist path towards strong centralization</i> ○ Devolution: <i>the international trend towards decentralization</i> ○ Status Quo: <i>the status quo where governance is negotiated within the Central Committee</i>



Source: Generated from Superdecision software program.

Table A28. Results of AHP Simulation of Negative Impacts of Fiscal Restructuring, Lao PDR

Graphic	Alternatives	Total	Normal	Ideal	Ranking
	Centralization	0.1883	0.7530	1.0000	1
	Decentralization	0.0375	0.1501	0.1994	2
	Status Quo	0.0242	0.0969	0.1286	3

Source: Generated from Superdecision software program.

Table A29. Test for Robustness of AHP Simulation of Negative Impacts of Fiscal Restructuring, Lao PDR

Graphic	Alternatives	Total	Normal	Ideal	Ranking
	Centralization	0.1865	0.7459	1.0000	1
	Decentralization	0.0387	0.1547	0.2074	2
	Status Quo	0.0249	0.0994	0.1333	3

Source: Generated from Superdecision software program.

Table A30. Benefit-Cost Ratios of Fiscal Restructuring

Alternatives	Total	Normal	Ideal	Ranking
Centralization	0.999469	0.999867	1	2
Devolution	0.768	0.766156	0.766299	3
Status Quo	1.363636	1.363261	1.363919	1

Source: Tables A25 and A28

Table A31. Benefit-Cost Ratios of Fiscal Restructuring
(Sensitivity Analysis)

Alternatives	Total	Normal	Ideal	Ranking
Centralization	1.045576	1.045985	1	2
Devolution	0.524548	0.524887	0.501929	3
Status Quo	1.393574	1.394366	1.333083	1

Source: Tables A26 and A29

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