Prior to 1985, when the Lao P.D.R. embarked on the new system of economic management, the exchange and trade regime was characterized by strong centralization. Trade operations were dominated by the state sector, where a small number of trading organizations and public firms held a monopoly on the bulk of exports and imports. The composition of trade was mainly determined by the Ministry of Commerce on the basis of national priorities, and foreign exchange was allocated according to planned needs through the central government budget or the BCEL. Exchange rates for official transactions were administratively determined and, in general, bore little relation to the scarcity value of foreign exchange. Market-oriented transactions were limited to the small private sector, which engaged in limited import and export operations and bought and sold foreign exchange on the parallel market, where rates were much more depreciated.

In addition, more than half of the volume of trade was accounted for by the nonconvertible area (primarily members of the Council for Mutual Economic Assistance (CMEA), and, in particular, the former Soviet Union). This trade was carried out on a bilateral clearing basis and was thus outside the system of exchange rates altogether.

On the Eve of Reform

During the early reform years 1986–87, trade arrangements were liberalized somewhat; the Lao authorities allowed the formation of joint-venture trade enterprises, the sociétés mixtes, which were permitted some autonomy in export and import operations. These enterprises were allowed to retain their foreign exchange earnings and were given access to official exchange markets at a rate closer to that prevailing in the parallel market. State exporting enterprises were also allowed greater retention of foreign exchange and broader access to import markets. As before, however, most trade remained firmly centralized; in particular, exports of a number of important “strategic” goods, undertaken primarily in fulfillment of trade contracts with the nonconvertible currency area, continued to be reserved for state trading companies.

Initial reform efforts were accompanied by a proliferation of exchange rates; by 1987, external transactions were conducted at seven different rates, ranging from KN 35 per U.S. dollar and KN 95 per U.S. dollar for most official transactions to more than KN 450 per dollar for informal transactions through the parallel exchange market. This system was highly dislortionary, deterred exports for a number of goods, and gave rise to shortages of goods and their administrative rationing.

Given the tentative nature of the early reform measures, trade performance remained subdued during 1986–87. The total value of exports increased at an annual rate of 6 percent—roughly the same rate of growth as in the pre-reform years 1982—85—owing primarily to increased exports of wood and wood products. Imports were even more sluggish, growing at an annual rate of 3½ percent during the same period.

Exchange Reforms and Exchange Rate Policy After 1987

Exchange Market Reforms

In order to stimulate exports, increase the share of foreign exchange transactions occurring at market rates, and channel a larger proportion of transactions through the emerging banking system, the Lao authorities began a dramatic reform of the exchange regime in late 1987.

The system of multiple exchange rates was eliminated, and a new, unified official rate was established at the beginning of 1988. The initial rates (KN 350 per U.S. dollar for buying and KN 380 per U.S. dollar for selling) were set close to the rates prevailing in the parallel market, representing a devaluation of nearly 400 percent for transactions of state enterprises (which were responsible for more than two thirds of the total trade volume) and lesser devaluations for private remittances and certain commercial transactions.
The bulk of the export expansion, however, was concentrated in the nontraditional manufacturing sector. From a very small level in 1989–90, and despite scale hydroelectric projects, in particular the Nam Theun reservoir project, were begun. With respect to other agricultural exports, coffee exports declined, owing to while strict controls over wood harvesting continued to apply, sales of both logs and limber rose substantially with the authorization of logging in areas where large-

Exports to convertible markets more than tripled between 1990 and 1994 (products. These developments, together with the continued domestic economic decentralization and the improvements in infrastructure and border access (in

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The collapse of the CMEA in 1991 and the reorientation of the Eastern European economies toward market-based trade resulted not only in the termination of their bilateral trading agreements with the Lao P.D.R. but also in the complete disappearance of these markets for Lao exports and of financing for CMEA imports. As a consequence, total trade vis-à-vis the former CMEA countries fell from over $90 million in 1990 to $4 million in 1992–94 (Tables 6 and 7); the latter figure comprises small amounts of coffee and metals that continue to be exported primarily to the former Soviet Union as payment for debt service. Thus, the withdrawal of CMEA support entailed a pronounced reorientation of the Lao P.D.R.’s trade, as the country was forced to look elsewhere for supplies of fuel and production inputs.

At the same time, rapid economic liberalization and growth in neighboring countries (in particular, China, Thailand, and Vietnam) provided ready markets for many products. These developments, together with the continued domestic economic decentralization and the improvements in infrastructure and border access (in particular, the completion in early 1994 of the first bridge across the Mekong, which provided an overland shipping route from Thailand to Vietniane), spurred large increases in recorded trade volume with the convertible area.

Exports to convertible markets more than tripled between 1990 and 1994 (Table 6). Part of the increase was due to a considerable expansion in wood exports; while strict controls over wood harvesting continued to apply, sales of both logs and limber rose substantially with the authorization of logging in areas where large-scale hydroelectric projects, in particular the Nam Theun reservoir project, were begun. With respect to other agricultural exports, coffee exports declined, owing to the disappearance of markets in the former CMEA, and exports of fruits and vegetables grew rapidly, owing to the expansion of outlets in Thailand.

### Table 6 Composition of Exports

The bulk of the export expansion, however, was concentrated in the nontraditional manufacturing sector. From a very small level in 1989–90, and despite quantitative restrictions on imports of Lao garments into certain industrial markets, garment exports increased tenfold to about $50 million (one fifth of total exports)
Trade and foreign exchange liberalization affects foreign direct investments (FDI) and exchange rates. The paper by Sekkat and Varoudakis (2004) assessed the relative importance of trade and foreign exchange liberalization, infrastructure availability and economic and political stability in raising Middle East and North African (MENA) countries’ attractiveness with respect to FDI. An estimation of the exchange rate pass-through (ERPT) for the Philippines by the Center for Monetary and Financial Policy (CMFP) shows that the pass through of exchange rate movements has declined during the inflation targeting (IT) period (2002-2013) relative to the pre-IT period (1990-2001). The results show that the exchange rate pass-through coefficients, both in the short. Given the substantial evidence linking exchange rates and trade policy, we believe this is a critical limitation of the existing literature. In the following section, we further develop the logic linking exchange rate regime choice to WTO dispute initiation, after which we turn to empirical analysis of antidumping complaints and WTO disputes from 1995 to 2007. We suggest that we should observe a link between a country’s exchange rate policies, its degree of financial liberalization, and its propensity to both undertake legal protectionist policies and be involved in trade disputes at the WTO. Fixed exchange rates, capital mobility, and trade protection. The workhorse framework for analyzing the political economy of exchange rate regime. They give quantitative expression to how trade liberalization should be coordinated both with fiscal adjustment - that is, a combination of trade-neutral tax increases and expenditure reduction and with a policy of exchange rate changes to restore both internal and external equilibrium.

This paper asks: What is the impact of a reduction in the fiscal deficit characteristic of stabilization programs on tax and expenditure levels, on the real exchange rate, and the current account deficit? What is the effect of a significant trade liberalization

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12 The major exception was a limit on travel allowances; this exchange restriction was removed in early 1994.
13 Outward capital transfers by residents remain restricted: in practice, however, these restrictions have been only weakly enforced.
14 Previously, licenses had been provided only to state trading companies and certain exporters.
15 Quantitative restrictions on motor vehicle imports were removed in 1995.
16 In 1992, the Lao P.D.R. moved to a customs-based reporting system, which improved the quality and coverage of the trade statistics; some portion of the increases recorded in 1992 is due to this improvement. Trade statistics were improved again in 1993, when reporting was introduced for a number of provincial border posts, yielding yet another sharp rise in recorded trade. (The sharp increases between 1990 and 1992 and again between 1992 and 1993 in the ‘other’ trade category in Tables 6 and 7 are thus due in part to improved statistics.) Indeed, estimates indicate that both exports and imports may have been as much as 50 percent higher than officially recorded in 1990 and 1991, and as much as 20 percent higher in 1992. Thus, the sharp growth in recorded trade in the past few years may not have been as pronounced as indicated in Tables 6 and 7.
17 The major exception was a limit on travel allowances; this exchange restriction was removed in early 1994.
18 This period also witnessed an increased transparency in the budgetary accounts following the adoption of market-based prices and exchange rates and the monetization of subsidies.

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Other Resources Citing This Publication
An estimation of the exchange rate pass-through (ERPT) for the Philippines by the Center for Monetary and Financial Policy (CMFP) shows that the pass through of exchange rate movements has declined during the inflation targeting (IT) period (2002-2013) relative to the pre-IT period (1990-2001). The results show that the exchange rate pass-through coefficients, both in the short and long run, are lower during the IT period. This decline in ERPT during the IT period is a critical limitation of the existing literature. In the following section, we further develop the logic linking exchange rate regime choice to WTO dispute initiation, after which we turn to empirical analysis of antidumping complaints and WTO disputes from 1995 to 2007. We suggest that we should observe a link between a country's exchange rate policy, degree of financial liberalization, and propensity to both undertake legal protectionist policies and be involved in trade disputes at the WTO. Fixed exchange rates, capital mobility, and trade protectionist policies are important for analyzing the political economy of exchange rate regimes. This paper asks: What is the impact of a reduction in the fiscal deficit characteristic of stabilization programs on tax and expenditure levels, on the real exchange rate, and the current account deficit? What is the effect of a reduction in the fiscal deficit characteristic of stabilization programs on tax and expenditure levels, on the real exchange rate, and the current account deficit?