

CONFORMED

CREDIT NUMBER 3677 LA

Development Credit Agreement

(Financial Management Adjustment Credit)

between

LAO PEOPLE'S DEMOCRATIC REPUBLIC

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated August 19, 2002

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated August 19, 2002, between the LAO PEOPLE'S DEMOCRATIC REPUBLIC (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS (A) the Association has received a letter dated May 24, 2002, from the Borrower describing a program of actions, objectives and policies designed to achieve structural adjustment of the Borrower's financial management (the Program), declaring the Borrower's commitment to the execution of the Program, and requesting assistance from the Association in support of the Program during the execution thereof; and

(B) on the basis, inter alia, of the foregoing, the Association has decided in support of the Program to provide such assistance to the Borrower by making a Credit in two tranches as hereinafter provided;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Development Credit Agreements" of the Association, dated January 1, 1985 (as amended through October 6, 1999), with the modifications set forth below (the General Conditions), constitute an integral part of this Agreement:

(a) Section 2.01, paragraph 12, is modified to read:

"'Project' means the program, referred to in the Preamble to the Development Credit Agreement, in support of which the Credit is made";

(b) A new paragraph (c) is added to Section 3.04 to read:

"If the Association shall at any time receive less than the full amount then due and payable to it under the Development Credit Agreement, the Association shall have the right to allocate and apply the amount so received in any manner and for such purposes under the Development Credit Agreement as the Association shall in its sole discretion determine";

(c) Section 4.01 is modified to read:

"Except as the Borrower and the Association shall otherwise agree, withdrawals from the Credit Account shall be made in the currency of the deposit account specified in Section 2.02 of the Development Credit Agreement";

(d) Section 5.01 is modified to read:

"The Borrower shall be entitled to withdraw the proceeds of the Credit from the Credit Account in accordance with the provisions of the Development Credit Agreement and of these General Conditions";

(e) The last sentence of Section 5.03 is deleted;

(f) Section 9.06 (c) is modified to read:

“(c) Not later than six months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Association, the Borrower shall prepare and furnish to the Association a report, of such scope and in such detail as the Association shall reasonably request, on the execution of the program referred to in the Preamble to the Development Credit Agreement, the performance by the Borrower and the Association of their respective obligations under the Development Credit Agreement and the accomplishment of the purposes of the Credit.”;

(g) Section 9.04 is deleted and Sections 9.05, 9.06 (as modified above), 9.07 and 9.08 are renumbered, respectively, as Sections 9.04, 9.05, 9.06 and 9.07; and

(h) Section 11.01 is modified by replacing, in the second sentence, the word "radiogram" with the word "facsimile" and adding a new sentence at the end of the said Section to read:

(i) "Deliveries made by facsimile transmission shall also be confirmed by mail."

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

- (a) “Agricultural Promotion Bank” means the Borrower’s state commercial bank established in 1993 for purposes of developing the agricultural sector;
- (b) “Bank of Lao PDR” means the Borrower’s central bank, organized and operating pursuant to the Borrower’s Law No. 05/95/NA, dated October 14, 1995, as amended;
- (c) “BPKP” means the Borrower’s Bolisat Phattana Khet Phoudoi, established in 1984 for the purpose of facilitating the social and economic development of Borikhamsai Province, or any successor thereto;
- (d) “BIO” means the Borrower’s Business Improvement Office, established within the Prime Minister’s Office for the purpose of providing a government focal point for enterprise reform in calendar year 2002, or any successor thereto;
- (e) “Cooperative de Credit de Soutien aux Producteurs” means the private microfinance project established in 1995 with the support of Societe d’Investissement pour le Developpement International (SIDI);
- (f) “CPC” means the Borrower’s Committee for Planning and Cooperation, established within the Office of the Prime Minister in 2001, or any successor thereto;
- (g) “DAFI” means the Borrower’s Development, Agriculture Forestry Industry Group, a state-owned enterprise, established in 1998 and engaged in forestry and other natural resource use activities;
- (h) “Deposit Account” means the account referred to in Section 2.02 (b) of this Agreement;
- (i) “EDL” means Electricité du Laos, a limited liability company established by the Borrower in 1959 and operating pursuant to its charter, or any successor thereto ;
- (j) “Fiscal year” means the twelve (12)-month period corresponding to any of the Borrower’s fiscal years, which period commences on October 01 and ends on September 30 in each calendar year;
- (k) “Kip” means the currency of the Borrower;

- (l) “Microfinance Project” means the Borrower’s microfinance project established in 1997 with the support of UNDP/UNCDF;
- (m) “Lao Aviation” means the Borrower’s state-owned enterprise established in 1976 for the purpose of providing domestic and international air transport services;
- (n) “MOF” means the Borrower’s Ministry of Finance, or any successor thereto;
- (o) “Project de Developpement Decentralise de Phongsaly” means the Borrower’s rural development project commenced in 1997 with the support of Agence Francaise de Developpement;
- (p) “Nam Papa Lao” means the state-owned enterprise established in 1962 for the purpose of supplying the Borrower’s domestic water in Vientiane Municipality;
- (q) “Pharmaceutical Factory #3” means the Borrower’s state-owned enterprise incorporated in 1999 for the purpose of producing and distributing pharmaceutical products;
- (r) “SITC” means the Standard International Trade Classification, Revision 3 (SITC, Rev.3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev.3 (1986);
- (s) “SCB” means any one of the Borrower’s state-owned commercial banks, and the term “SCBs” means, collectively, each of said SCB; and
- (t) “SOE” means any one of the Borrower’s state-owned enterprises, and the term “SOEs” means, collectively, each of said SOE.

ARTICLE II

The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in this Agreement, an amount equal to thirteen million five hundred thousand Special Drawing Rights (SDR 13,500,000).

Section 2.02. (a) Subject to the provisions of paragraphs (b), (c) and (d) of this Section, the Borrower shall be entitled to withdraw the proceeds of the Credit from the Credit Account in support of the Program.

(b) The Borrower shall open, prior to furnishing to the Association the first request for withdrawal from the Credit Account, and thereafter maintain in its central bank, a Deposit Account in dollars on terms and conditions satisfactory to the Association. All withdrawals from the Credit Account shall be deposited by the Association into the Deposit Account.

(c) The Borrower undertakes that the proceeds of the Credit shall not be used to finance expenditures excluded pursuant to the provisions of Schedule 1 to this Agreement. If the Association shall have determined at any time that any proceeds of the Credit shall have been used to make a payment for an expenditure so excluded, the Borrower shall, promptly upon notice from the Association: (i) deposit into the Deposit Account an amount equal to the amount of said payment; or (ii) if the Association shall so request, refund such amount to the Association. Amounts refunded to the Association upon such request shall be credited to the Credit Account for cancellation.

(d) No withdrawals shall be made from the Credit Account after the aggregate of the proceeds of the Credit withdrawn from the Credit Account shall have reached the equivalent of five million six hundred thousand Special Drawing Rights (SDR 5,600,000) unless the Association shall be satisfied, after an exchange of views as described in Section 3.01 of this Agreement based on evidence satisfactory to the Association: (i) with the progress achieved by the Borrower in the carrying out of the Program; (ii) that the macroeconomic policy framework of the Borrower is satisfactory, as measured on the basis of indicators agreed between the Borrower and the Association; and (iii) that the actions as described in Schedule 2 to this Agreement have been taken. If, after said exchange of views, the Association shall have given notice to the Borrower that the progress achieved and actions taken are not satisfactory and, within 90 days after such notice, the Borrower shall not have achieved progress and taken actions satisfactory to the Association, then the Association may, by notice to the Borrower, cancel the unwithdrawn amount of the Credit or any part thereof.

Section 2.03. The Closing Date shall be May 31, 2003, or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such later date.

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty days after the date of this Agreement (the accrual date) to the respective dates on which amounts shall be withdrawn by the Borrower from the Credit Account or canceled; and (ii) at the rate set as of June 30 immediately preceding the accrual date and at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of

June 30 in each year shall be applied from the next date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent ($3/4$ of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment charges and service charges shall be payable semi-annually on January 15 and July 15 in each year.

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semi-annual installments payable on each January 15 and July 15 commencing July 15, 2012, and ending January 15, 2042. Each installment to and including the installment payable on January 15, 2022, shall be one percent (1%) of such principal amount, and each installment thereafter shall be two percent (2%) of such principal amount.

(b) Whenever: (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three consecutive years the level established annually by the Association for determining eligibility to access the Association's resources; and (ii) the International Bank for Reconstruction and Development (Bank) shall consider the Borrower creditworthy for Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by:

(A) requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid; and

(B) requiring the Borrower to commence repayment of the principal amount of the Credit as of the first semiannual payment date referred to in paragraph (a) above falling six months or more after the date on which the Association notifies the Borrower that the events set out in this paragraph (b) have occurred,

provided, however, that there shall be a grace period of a minimum of five years on such repayment of principal.

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(d) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of the United States of America is hereby specified for the purposes of Section 4.02 of the General Conditions.

ARTICLE III

Particular Covenants

Section 3.01. (a) The Borrower and the Association shall from time to time, at the request of either party, exchange views on the progress achieved in carrying out the Program and the actions specified in Schedule 2 to this Agreement.

(b) Prior to each such exchange of views, the Borrower shall furnish to the Association for its review and comment a report on the progress achieved in carrying out the Program, in such detail as the Association shall reasonably request.

(c) Without limitation upon the provisions of paragraph (a) of this Section, the Borrower shall exchange views with the Association on any proposed action to be taken after the disbursement of the Credit which would have the effect of materially reversing the objectives of the Program, or any action taken under the Program, including any action specified in Schedule 2 to this Agreement.

Section 3.02. Upon the Association's request, the Borrower shall:

(a) have the Deposit Account audited in accordance with appropriate auditing principles consistently applied, by independent auditors satisfactory to the Association;

(b) furnish to the Association as soon as available, but in any case not later than four months after the date of the Association's request for such audit, a certified copy of the report of such audit by said auditors, of such scope and in such detail as the Association shall have reasonably requested; and

(c) furnish to the Association such other information concerning the Deposit Account and the audit thereof as the Association shall have reasonably requested.

ARTICLE IV

Effective Date; Termination

Section 4.01. The following events are specified as additional conditions to the effectiveness of the Development Credit Agreement within the meaning of Section 12.01 of the General Conditions:

- (a) the Borrower shall have adopted a Regulation of the Minister of Finance on Public Accounting and Procedures for the implementation of the Borrower's Decree No. 20/PM on the General Regulation of Public Accounting, dated February 18, 1993, satisfactory to the Association; and
- (b) the Association shall be satisfied with the Borrower's maintenance of a sound macroeconomic framework, consistent with the objectives of the Program as determined on the basis of indicators agreed to by the Borrower.

Section 4.02. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE V

Representative of the Borrower; Addresses

Section 5.01. The Minister of Finance of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 5.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Minister of Finance
Post Office Box No. 46
Vientiane
Lao People's Democratic Republic

Cable address:	Telex:	Facsimile:
MINFINANCE VIENTIANE	4369 MOF LS	856-21-412142

For the Association:

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:	Telex:	Facsimile:
INDEVAS Washington, D.C.	248423 (MCI) or 64145 (MCI)	(202) 477-6391

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in Vientiane, Lao People's Democratic Republic, as of the day and year first above written.

LAO PEOPLE'S DEMOCRATIC REPUBLIC

By:

/s/ Soukanh Mahalath
Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By:

/s/ Ian C. Porter
Authorized Representative

SCHEDULE 1

Excluded Expenditures

For purposes of Section 2.02 (c) of this Agreement, the proceeds of the Credit shall not be used to finance any of the following expenditures:

1. expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;
2. expenditures for goods or services supplied under a contract which any national or international financing institution or agency other than the International Development Association (Association), International Bank for Reconstruction and Development (the Bank) shall have financed or agreed to finance, or which the Association or the Bank shall have financed or agreed to finance under another loan or a credit;
3. expenditures for goods included in the following groups or subgroups of the Standard International Trade Classification, Revision 3 (SITC, Rev. 3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev. 3 (1986) (the SITC), or any successor groups or subgroups under future revisions to the SITC, as designated by the Bank by notice to the Borrower:

<u>Group</u>	<u>Subgroup</u>	<u>Description of Items</u>
112	-	Alcoholic beverages
121	-	Tobacco, unmanufactured, tobacco refuse
122	-	Tobacco, manufactured (whether or not containing tobacco substitutes)
525	-	Radioactive and associated materials
667	-	Pearls, precious and semi-precious stones, unworked or worked
718	718.7	Nuclear reactors, and parts thereof; fuel elements (cartridges), non-irradiated, for nuclear reactors
728.43	-	Tobacco processing machinery
897	897.3	Jewelry of gold, silver or platinum group metals (except watches and watch

cases) and goldsmiths' or silversmiths' wares (including set gems)

971

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Gold, non-monetary (excluding gold ores and concentrates)

4. expenditures for goods intended for a military or paramilitary purpose or for luxury consumption;
5. expenditures for environmentally hazardous goods (for purposes of this paragraph the term "environmentally hazardous goods" means goods, the manufacture, use or import of which is prohibited under the laws of the Borrower or international agreements to which the Borrower is a party);
6. expenditures: (a) in the territories of any country which is not a member of the Bank or for goods procured in, or services supplied from, such territories; or (b) on account of any payment to persons or entities, or any import of goods, if such payment or import is prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations; and
7. expenditures under a contract in respect of which the Association determines that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Borrower during the procurement or execution of such contract, without the Borrower having taken timely and appropriate action satisfactory to the Association to remedy the situation.

SCHEDULE 2

Actions Referred to in Section 2.02 (d) of this Agreement

The Borrower shall have:

Public Sector Reform

1. completed, through CPC, an assessment, in a manner and substance satisfactory to the Association, of recurrent cost estimates associated with new projects in excess of 1 billion kip;
2. prepared, through the Ministry of Finance, in a manner and substance satisfactory to the Association, a strategy for the reform of the Department of Treasury;
3. established a Procurement Monitoring Office within the Ministry of Finance, headed by a qualified and experienced Director and assigned with adequate staff and resources in a manner and substance satisfactory to the Association;
4. issued, through the Ministry of Agriculture and Forestry, in a manner and substance satisfactory to the Association, Regulations amending the Implementing Regulations on National Biodiversity Conservation Areas, Regulation No. 0524/AF.2001 (June 7, 2001), inter alia, to clarify the definitions and procedures governing zoning and land use within said Conservation Areas, and eliminate inconsistencies in respect of protected species listings;
5. adopted, through the Ministry of Agriculture and Forestry, Implementing Regulations on Sustainable Forestry Management, satisfactory to the Association, which includes specific provisions to enable the involvement of local communities in production forest management;

SOE Reform

6. issued, through MOF, Implementing Regulations to the Decree on Management of State-Invested Enterprises, Decree No.54/PM, dated May 9, 2002, satisfactory to the Association;
7. prepared and furnished to the Association in a manner and substance satisfactory to the Association, through the Ministry of Finance, an assessment of the financial performance of SOEs, and under criteria consistent with technical audit standards satisfactory to the Association, identified non-performing SOEs

requiring: (i) performance improvement; (ii) strengthening of financial reporting; or (iii) bringing them to the point of sale or liquidation, as the case may be.

8. adopted a timebound restructuring plan, satisfactory to the Association, for BPKP, Nam Papa Lao, Pharmaceutical Factory No. 3, and Lao Aviation, and implemented all of the actions under said restructuring plan, which in accordance with such time-bound restructuring plan are due within seven (7) calendar days prior to the exchange of views under Section 2.02(d) of this Agreement;
9. executed, through MOF, memoranda of understanding for the development and execution of time-bound restructuring plans with DAFI and four loss-making SOEs which have outstanding, non-performing loans in excess of one billion kip, in a manner and substance satisfactory to the Association;
10. completed the financial restructuring of EDL, in a manner and substance satisfactory to the Association, including the revaluation of assets, amendment of selected subsidiary loan agreements, and debt to equity conversions;
11. adopted and published tariff policies and structures incorporating: (i) cost recovery principles; and (ii) directed and transparent subsidies, if any, for the potable water supply, telecommunications sector and Lao Aviation; and adopted a timebound action plan for the implementation of said tariff policies, all in a manner and substance satisfactory to the Association;

Financial Sector Reform

12. prepared an assessment, in a manner and substance satisfactory to the Association, that assesses the measures undertaken by the Borrower to: (i) avoid the deterioration of the SCBs' risk portfolio; (ii) implement its risk diversification rules; and (iii) effectuate the autonomy of SCBs;
13. audited, in a manner and substance satisfactory to the Association, the calendar year 2001 accounts of SCBs, and for the Agricultural Promotion Bank the calendar years 2000 balance sheet and 2001 accounts;
14. procured the professional services of at least two banking advisors, to provide advisory services for the management of SCBs, with qualifications and experience adequate to carry out their services detailed in terms of reference satisfactory to the Association;
15. resolved an aggregate amount of 100 billion kip equivalent of SCBs non-performing loans of at least ten accounts, in a manner and substance satisfactory to the Association, through: (i) the liquidation of non-viable companies; (ii) the restructuring of viable companies such that their debts can be fully serviced by

their cashflows; (iii) the seizure and sale of assets to recover cash; or (iv) the exchange of the loan for cash or marketable assets;

16. prepared an assessment, in a manner and substance satisfactory to the Association, that identifies ten non-performing loan accounts undergoing resolution; and
17. prepared, in consultation with MOF, BOL, and the relevant provincial authorities and microfinance entities including Cooperative de Credit de Soutien aux Producteurs, Microfinance Project and Project de Developpement Decentralise de Phongsaly, a policy statement, an assessment, and a timebound action plan to address the implementation of a rural and microfinance reform program, all in a manner and substance satisfactory to the Association.