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Tiny, Poor, Land-locked, Indebted, but Growing: Lessons for Late Reforming Transition Economies from Laos

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Abstract

There are few countries where “initial conditions” are as unfavourable as those of Laos. It is a very poor, least developed country. It is land-locked, sharing its international borders with five neighbours. It has the world's highest per capita stock of unexploded ordinance, a legacy of the Indo China war. It has yet to recover from the loss of most of its entrepreneurial class and over half of its tertiary educated population in the aftermath of that war. It is heavily indebted, with substantial Soviet era obligations still outstanding. Its institutions are weak and property rights ill defined. Yet, its reform efforts over the past two decades have been largely successful, with accelerating growth and the beginnings of a relatively smooth transition from plan to market. This examination of the Lao reform programme and the subsequent outcomes suggests that, contrary to some of the prevailing pessimism, late-comers can engage with the international economy, providing their reforms are reasonably effective and credible.

Neighbourhood effects have obviously been supportive in the Lao case, but their importance should not be overstated.

Notes

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[1] The most comprehensive English-language history of Laos is provided by Stuart-Fox (1997).

[2] Over the period 1962–75, more than two million tons of ordnance was dropped on the country, of which an estimated one-third did not detonate. Nine out of the country's 17 provinces outside the capital are still affected, and thousands of mine-related injuries occur each year.

[3] It should be noted, however, that the closest ethnic–linguistic links are to Thailand, with the Lao and Thai languages being mutually comprehensible.

[4] There is no comprehensive analysis of Lao economic development from independence to the present day. Bourdet (2000) and Than & Tan (1997) provide detailed accounts for the period up to the late 1990s, mainly focusing on the first decade of the NEM. The ADB, IMF and World Bank issue periodic reports and updates.

[5] Among the four low-income mainland Southeast Asian states, its 2008 per capita GDP was estimated to be $837, compared with $651 and 1052 for Cambodia and Vietnam, respectively. No plausible estimates for Burma are available. In HDI rankings, Laos is number 130, very similar to two of its neighbours, Cambodia (131) and Burma (132), but lower than Vietnam (105).

[6] Note that these figures exclude the extensive unofficial border trade, mainly with Thailand.

[7] Commercial debt constitutes just 6% of total public debt. One historical curiosum is that most of the 20% of public debt that is bilateral, i.e. owed to other governments, is with the Russian Federation, and was mainly contracted in the 1980s. The figure is thought to be vastly inflated by conversion at the unrealistic official exchange rate that prevailed under the USSR. It is thought unlikely that it will ever be repaid.

[8] The results for the fourth round are expected shortly.

[9] See also the analysis by Rigg (2005) of poverty and living conditions in nine villages located in three of the most prosperous provinces during 2001 and 2002.

[10] See Menon & Warr (2008) on the link between the provision of transport infrastructure and poverty reduction in Laos.

[11] More than 1600 firms enjoy generous fiscal incentives under the investment laws. Moreover, these incentives appear to be tailor-made for particular firms and non-transparent in their allocation.

[12] For example, in June 1997, with the onset of the Asian financial crisis, the central bank attempted to enforce a September 1990 decree that only the kip could be used as the medium of exchange in all domestic transactions. The result was that, during 1997–98, the kip depreciated more than any other Southeast Asian currency, even though Laos experienced only a mild economic crisis (Menon, 2008).

[13] Menon (2008) provides the most detailed analysis of Lao exchange rate policy options.

[14] The figures in this and the following paragraph are from Valdivieso et al. (2007).

[15] The real exchange rate is defined here as the nominal exchange rate adjusted for relative changes in the Lao consumer price index and producer prices in the country's major trading partners.

[16] An alternative measure, the ratio of prices of non-tradable goods (proxied by construction and domestic services) to prices of tradable goods (goods that can be exported or imported), shows an increase, indicating that prices of non-tradable goods are rising faster than those of tradable goods. The increase was substantial in the 1990s but modest thereafter. However, these data, not shown here, are at best indicative owing to doubts about the quality of the non-tradable price data. Menon (2008) also shows two real exchange rate series, confirming a modest appreciation

since 2000. See also Warr (2006), who provides a very detailed examination of the potential 'Dutch Disease' effects of a subset of the hydropower investments, through the Nam Theun 2 project.

[17] It is estimated that informal trade with Thailand constitutes an additional 30% of the officially reported figure, in addition to significant informal trade with China and Vietnam. These figures are unlikely to be affected by either WTO accession or implementation of AFTA. There are also substantial (illegal) subnational barriers to trade, run by local customs and military offices.

[18] The system also introduces a cascading tariff structure whereby the highest rates apply to processed goods and the lowest rates to raw materials, resulting in very high levels of effective protection, even with a 40% tariff ceiling.

[19] Until the reform, all producers/importers were required to produce an import plan each year for approval by MOIC, whether or not the products were on the controlled or prohibited list. Items imported were deducted against the overall plan at the customs border post. This system was a legacy of the old planned economy, and also of the system of foreign currency rationing. Moreover, even exempted imported inputs for export-orientated firms faced considerable administrative complexities, with these costs bearing disproportionately on small firms owing to the scale economies associated with compliance.

[20] Specific issues that are being addressed as part of the application include: rules of origin requirements, valuation methods and appeal procedures; customs, immigration and quarantine procedures; the turnover tax, which is currently higher for imports than domestically produced goods; and investment promotion, including the provision for licensing conditional on guaranteed market access.

[21] For example, a large export-orientated garment factory interviewed by the authors in 2007 reported that container consignments can be transported from the factory to the Bangkok port and through both countries' customs services within 24 hours, and at a cost of 20 cents per shirt. As a point of comparison, for example, this is very similar to the cost and time for an Indonesian garment exporter in Bandung, the major centre of Indonesia's garment industry, shipping through the Jakarta port. Note, however, that trans-border shipment of goods from Thailand through Laos to Vietnam and back is virtually impossible, as pointed out in a recent, unpublished report by the freight company TNT.

[22] For example, fieldwork revealed that pre-clearance is required at the entry point and original copies must be sent to the customs post at the other border station, involving a 2-day processing period.

[23] For further details, see www.doingbusiness.org

[24] According to the survey, Laos ranked 159 out of 175 countries in terms of ease of doing business. It ranks a good deal better in terms of starting a business (number 73), employing workers (number 71) and paying taxes (number 36). However, it is ranked among the lowest in the world in terms of getting credit (number 173), protecting investors (number 170) and trading across borders (number 161). It also ranks very low in dealing with licences, registering property, enforcing contracts and closing a business.

[25] These are Banque Commercial Exterior Lao (BCEL), Lao Development Bank (LDB) and Agriculture Promotion Bank (APB).

[26] The most frequently used collateral by SMEs in developing countries is land, but land ownership in Laos remains ill-defined and uncertain, and banks typically eschew it as a form of collateral.

[27] The comparative data in Figure 11 also illustrate the scope for further reductions in trade facilitation costs, which for Lao firms amount to about 4% of the (fob) value of exports, double the share of the more efficient Thai and Bangladeshi exporters.

[28] Interestingly, the IMF no longer has a presence in the country, in spite of the unfinished macroeconomic policy agenda.