



Training Workshop on Economic Updates

Laos' Fiscal Adjustment in the Low-Growth Period

Presented by Sithanonxay Suvannaphakdy

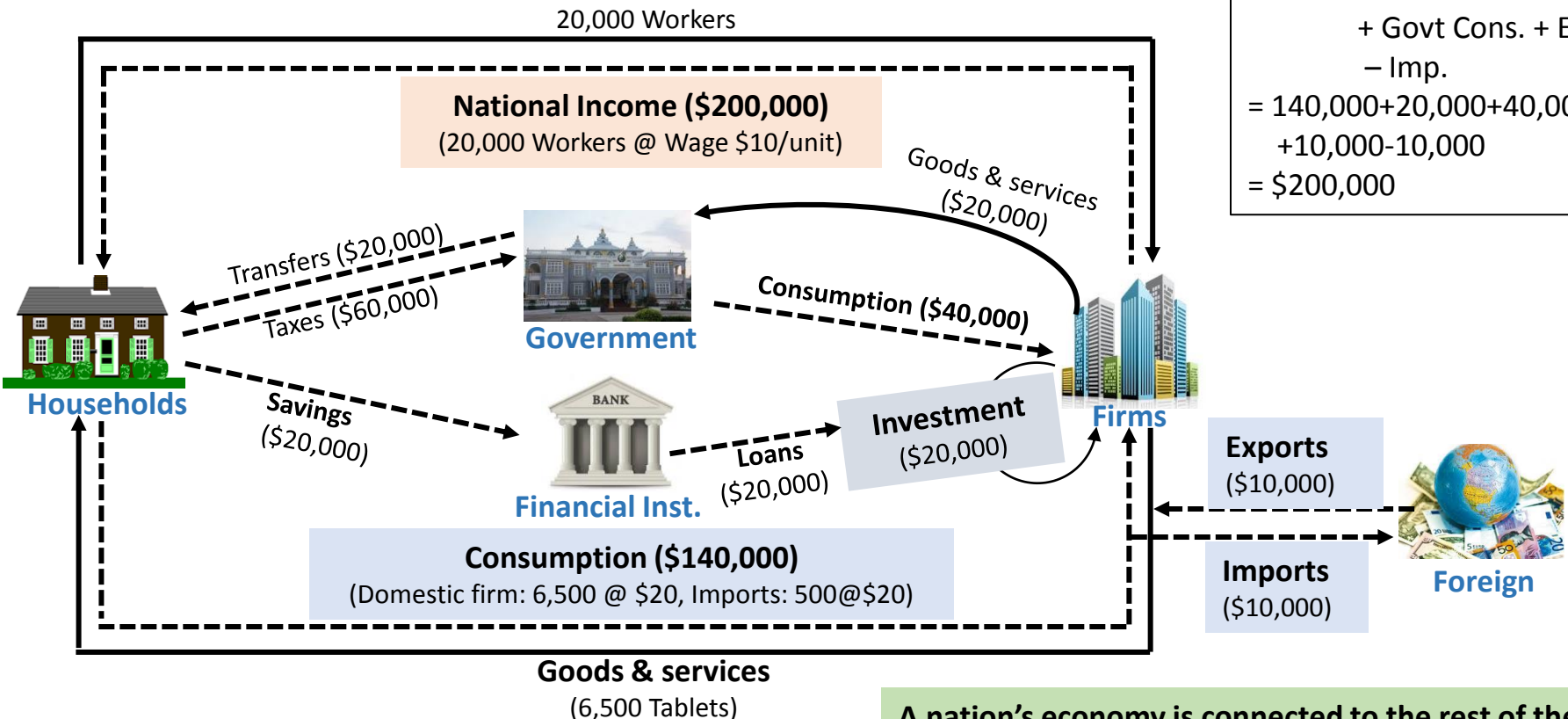
December, 2018

Fiscal Policy: Definition and Objective

- **Definition:** Fiscal policy refers to the government's spending and taxing policies.
- **Objective:**
 - To achieve macroeconomic goals (i.e., full employment, economic growth, price level stability)
 - To finance government programs and activities (i.e., infrastructure and human resource development)

Simplified Economic System

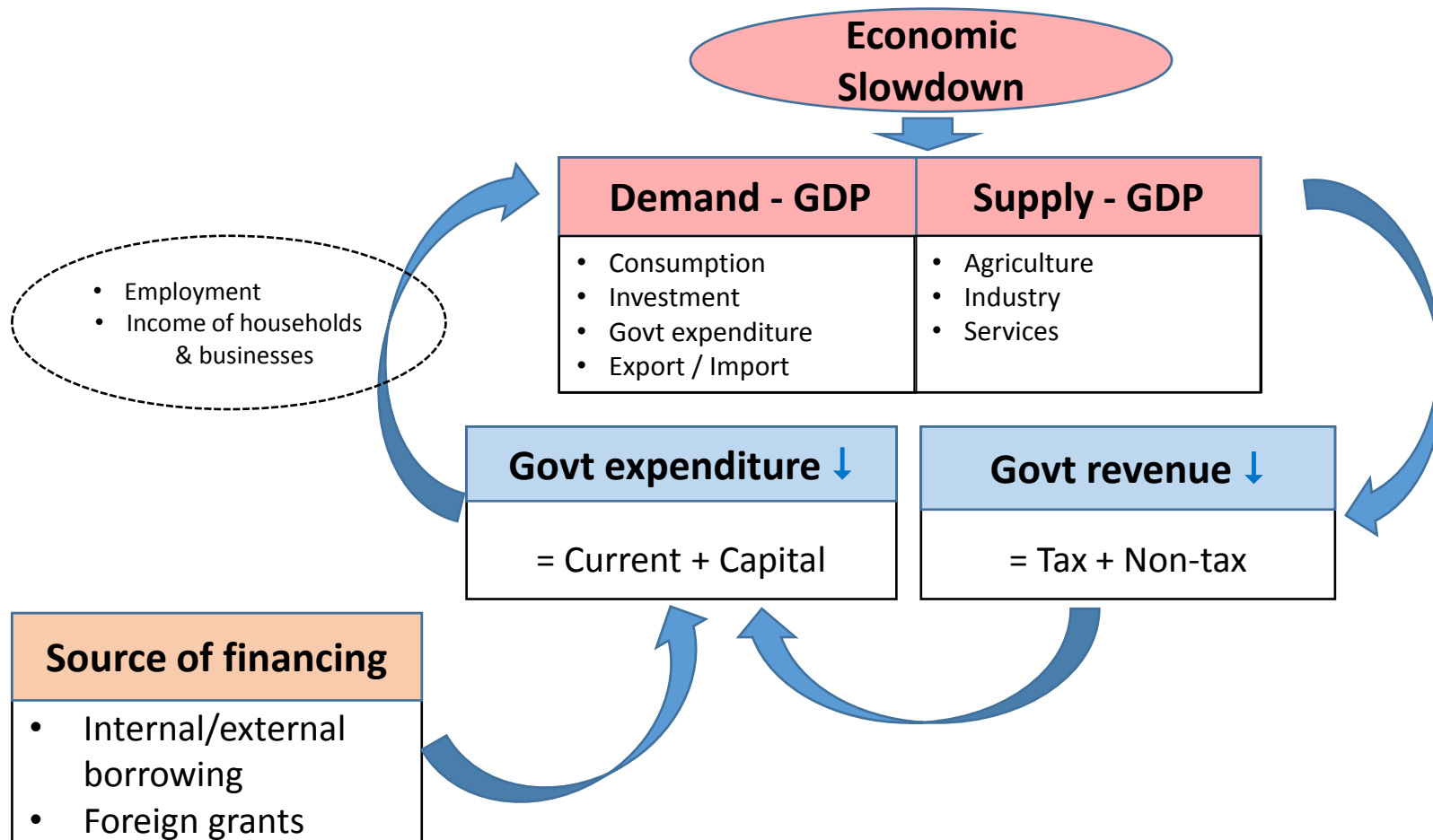
$$\begin{aligned}
 \text{GDP} &= \text{Cons.} + \text{Priv. Inv.} \\
 &\quad + \text{Govt Cons.} + \text{Exp.} \\
 &\quad - \text{Imp.} \\
 &= 140,000 + 20,000 + 40,000 \\
 &\quad + 10,000 - 10,000 \\
 &= \$200,000
 \end{aligned}$$



A nation's economy is connected to the rest of the world through exports and imports

Conceptual Framework

Causal relation between economic growth and fiscal policy

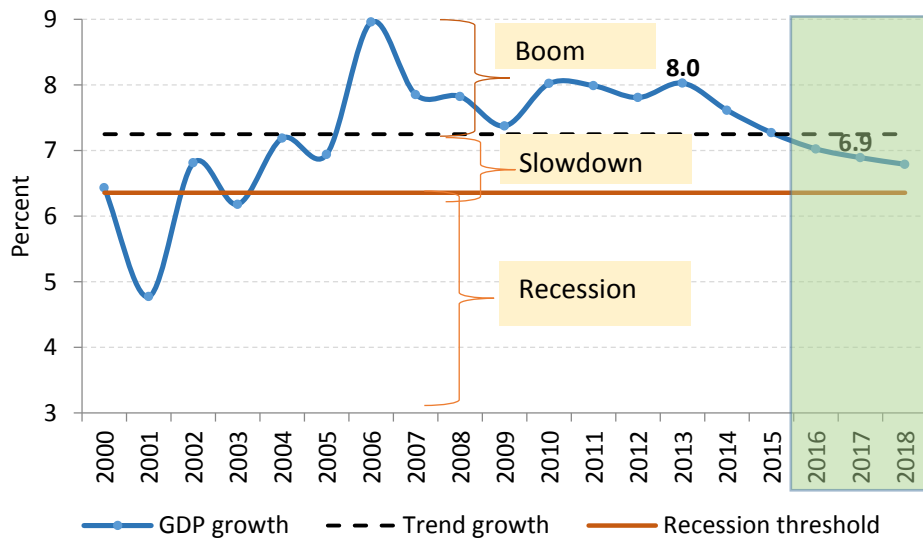


Economic Slowdown:

Defining period of low economic growth

- Lao economy has been in the low growth period since 2016.
- GDP growth fell from 8% in 2013 to 6.9% in 2017.

Fig.1: GDP growth and business cycle in Laos



- **Low-growth period:** a period when GDP growth falls into a range between trend growth and recession threshold.
- Trend growth of GDP: average of GDP growth over 2000-2018.
- Recession threshold: trend growth of GDP plus 1 standard deviation of GDP growth over 2000-2018.

Source: Author's calculation using data from IMF Article IV (2018).

Economic Slowdown:

Sources of low economic growth

- **Low GDP growth:** lower growth in services and agriculture.

Fig.2: Sectoral contribution to GDP growth

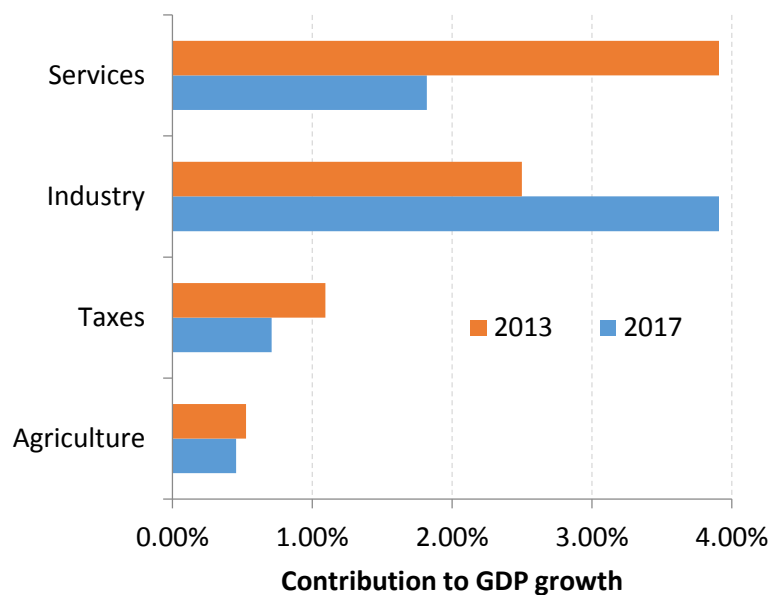


Table 1: Sources of falling growth rate from 8% (2013) to 6.89% (2017)

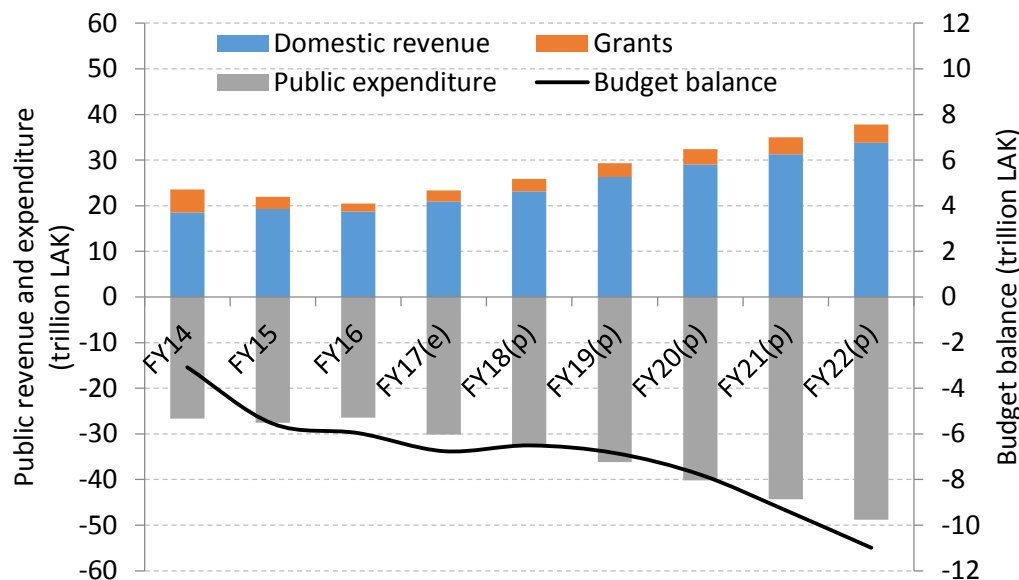
Sector	Source of low growth
Agriculture	<ul style="list-style-type: none"> • Fishing • Cropping • Forestry
Industry	<ul style="list-style-type: none"> • Mining • Beverages
Services	<ul style="list-style-type: none"> • Public admin & social security • Accommodation • Finance & insurance • Wholesale and retail trade

Public Finance Landscape: Finance for Development

- Public revenue tends to rise, but public expenditure tends to increase faster.
- Greater public expenditure than public revenue – worsening fiscal balance.

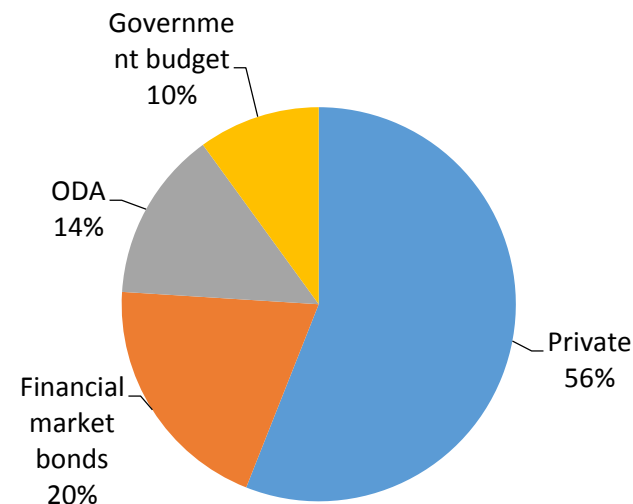
Fig. 3: GoL budget and financing plan for 8th NSEDP (2016-2020)

a. GoL budget, actual and forecasting



Source: IMF (2018,p.36)

b. NSEDP's financing plan (LAK223 trillion)



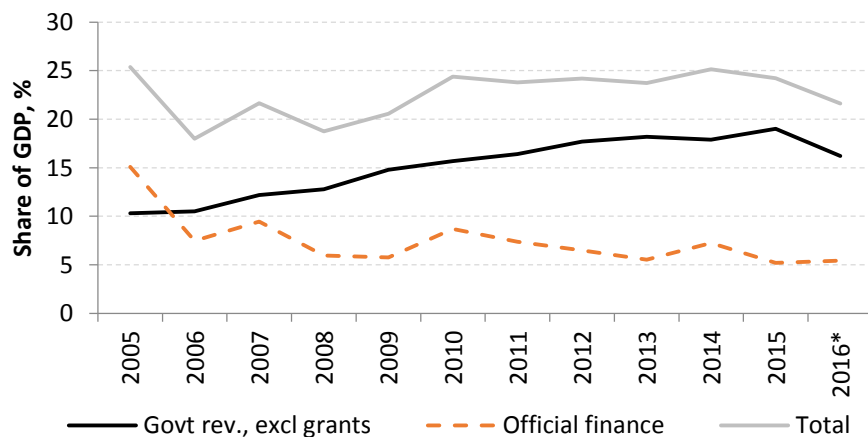
Source: MPI (2016, p.166)

Public Finance Landscape: Public Revenues

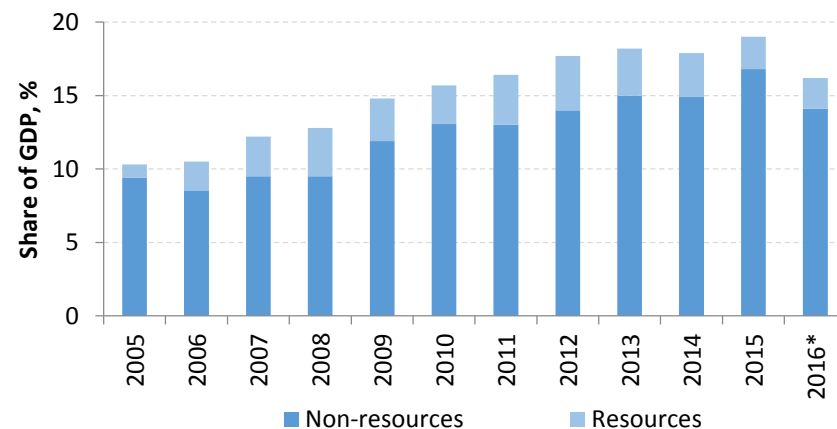
- **Public revenues: increased in parallel to country's economic development.**
 - Govt. revenues as a share of GDP rose from 15.7% in 2010 to 16.2% in 2016.
 - Official finance as a share of GDP fell from 8.7% in 2010 to 5.4% in 2016.

Fig.4 Development of official finance and public revenues in Laos, % of GDP

a. Trend of official finance and government revenue



b. Sources of government revenues



Note: * projected data.

Source: Authors' calculation using data of official finance from OECD (2018) and data of government revenues from IMF Article IV for Lao PDR (various issues).

Public Finance Landscape: Public Revenues

Challenges of public revenue collection:

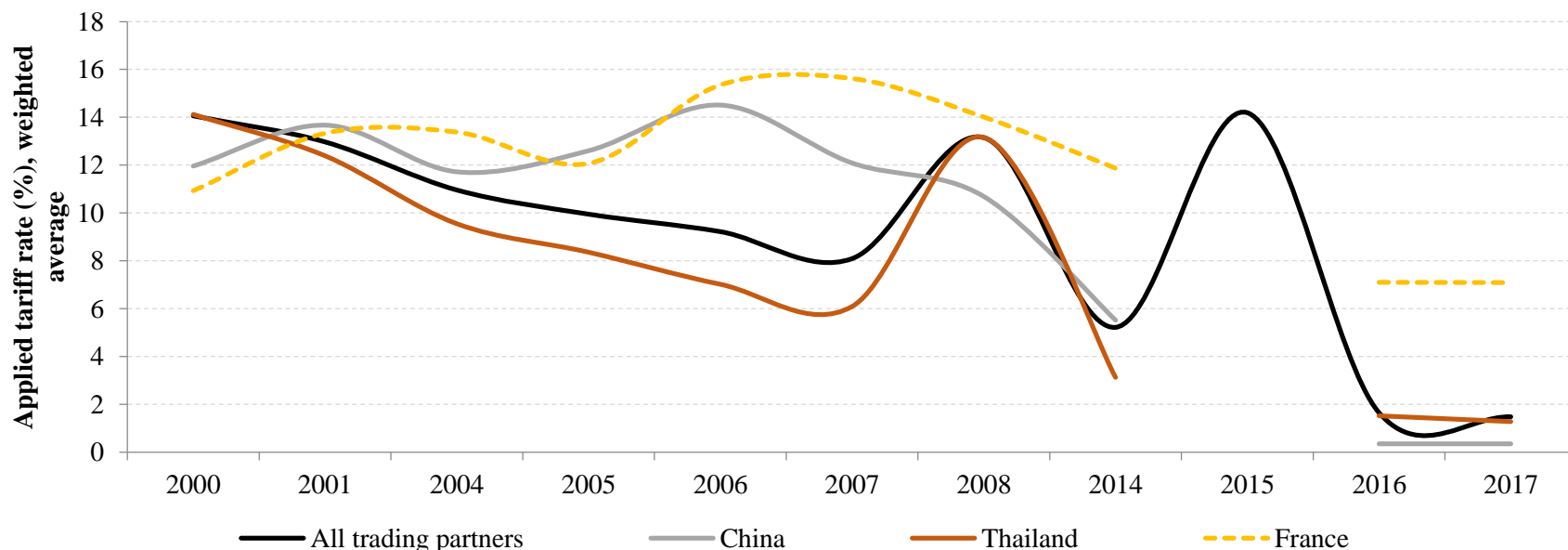
- Weak tax administrations – VAT rate (10%) vs effective VAT rate (2.92%)
- Presence of large informal sectors (with unrecorded transactions)
- **Trade liberalization: Transition from trade tax to domestic taxes**

Public Finance Landscape: Public Revenues

Trade liberalization:

- Lower tariff rate for all trading partners - falling from 14.06% in 2000 to 5.22% in 2014 and 1.48% in 2017.
- ASEAN members face lower tariff rate than non-ASEAN members.

Fig. 5: Reduction of Laos' tariff rate, by trading partners



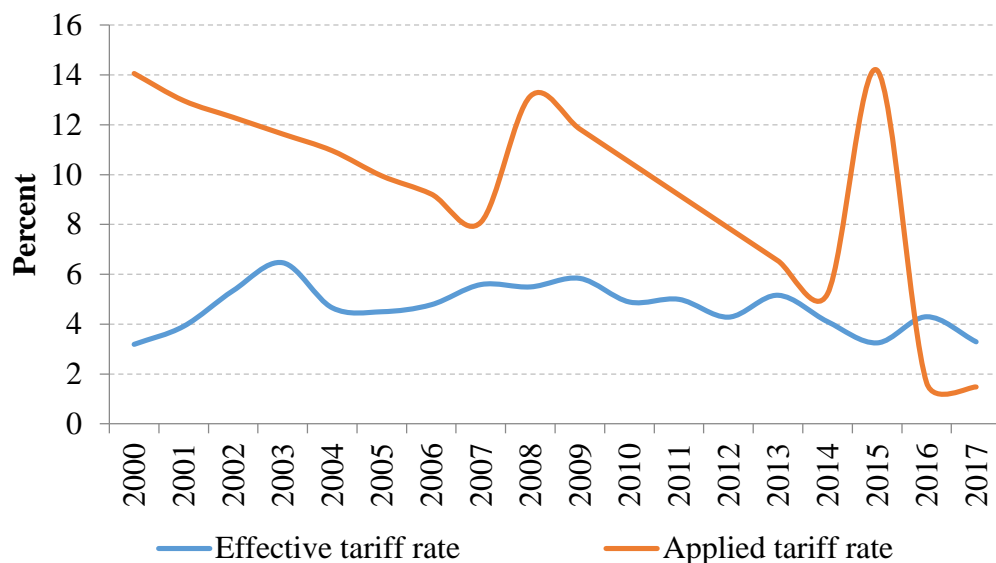
Source: Author's calculation using data from World Bank's World Integrated Trade Solution.

Public Finance Landscape: Public Revenues

Trade liberalization:

- Effective tariff rate - ratio of import duties to total import of goods - is lower than the applied tariff rate

Fig. 6: Effective and applied tariff rates in Laos, 2000-2017



Gap in applied and effective rates:

- Tariff exemptions on raw materials for the manufacture of exports
- Tariff exemptions for imports by government and donor-funded projects
- Concessional duty rates of only 1% on imports of plant, equipment and raw materials for private investors.

Source: Authors' calculation using applied tariff rate from World Bank's World Integrated Trade Solution and effective tariff rate from Bank of the Lao PDR's 2017 Annual Economic Report.

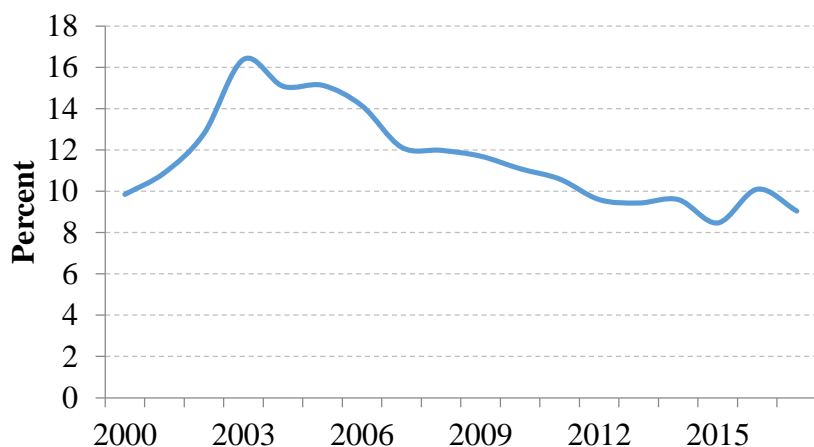
Public Finance Landscape: Public Revenues

Trade liberalization:

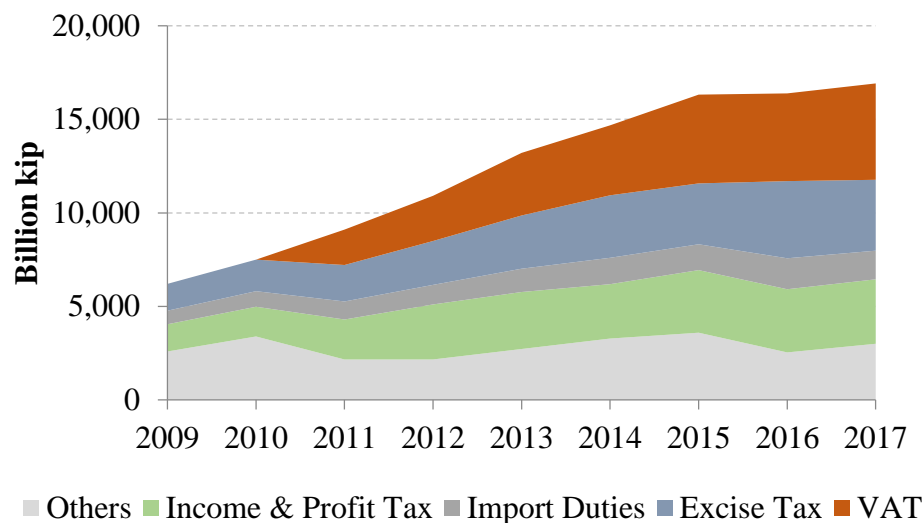
- Ratio of tariff to tax revenue dropped by half from 16.38% in 2003 to 9.04% in 2017.
- Ratio of VAT to tax revenue rose from 21% in 2011 to 25% in 2014 and 30% in 2017

Fig. 7: Tariff revenue reduction and alternative sources of tax revenue

a. Ratio of tariff revenue to tax revenue



b. Composition of tax revenue

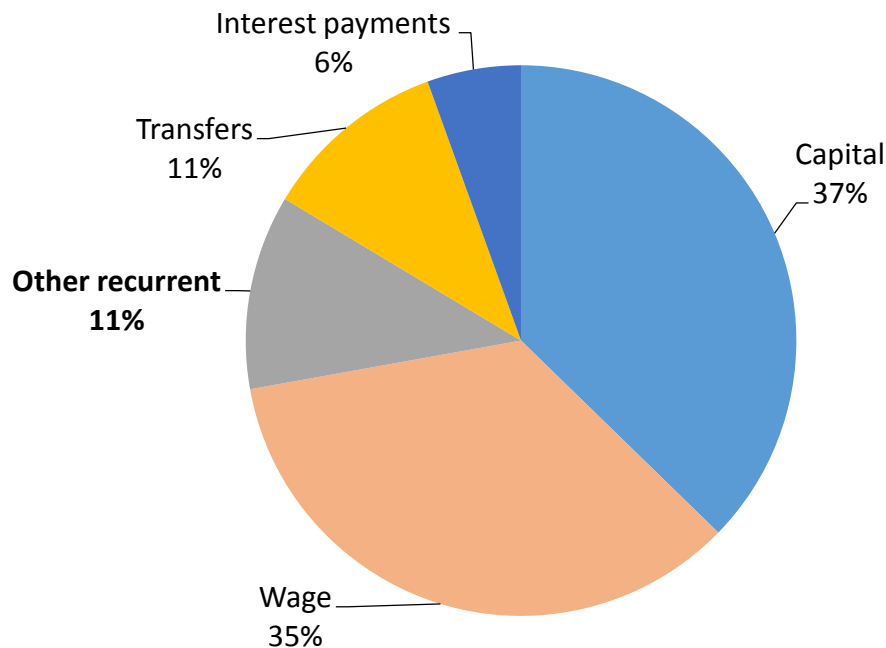


Source: Authors' calculation using data from Bank of Lao PDR's Annual Economic Report (various issues).

Public Finance Landscape: Public Expenditure

- Capital and wage spending accounted for 72% of expenditure.

Fig. 8: Composition of public expenditure, 2017



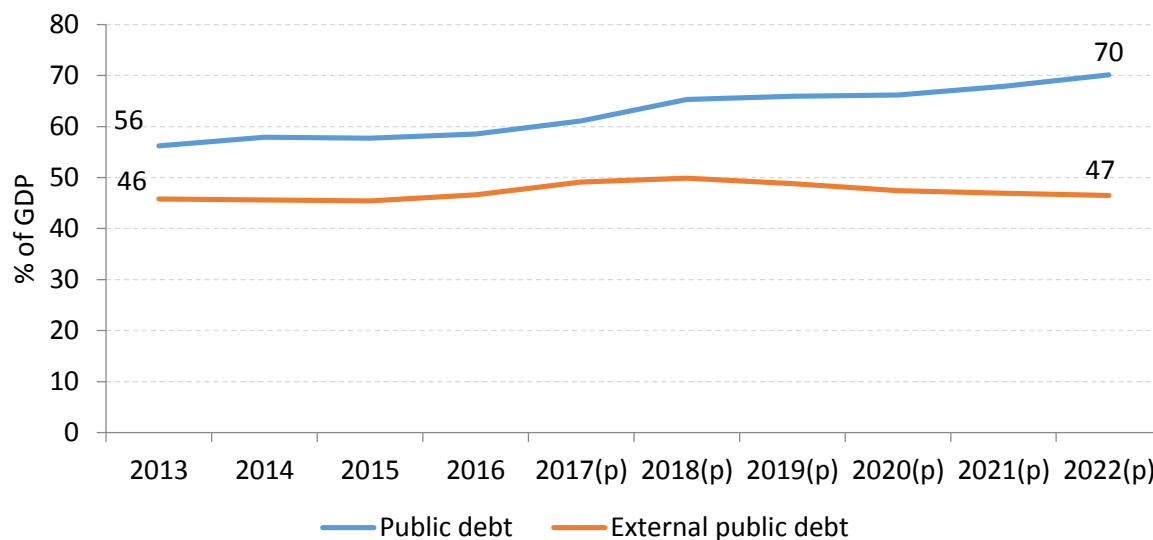
Source: Authors' calculation using data from Bank of Lao PDR's Annual Economic Report (2017).

Public Finance Landscape: External Borrowings

Trend of public debt:

- Public debt is rising with possibility of substituting external borrowing with domestic borrowing.
- Bilateral debt accounted for 63% of total external PPG.

Fig.9: Public and external public debt, 2013-2022



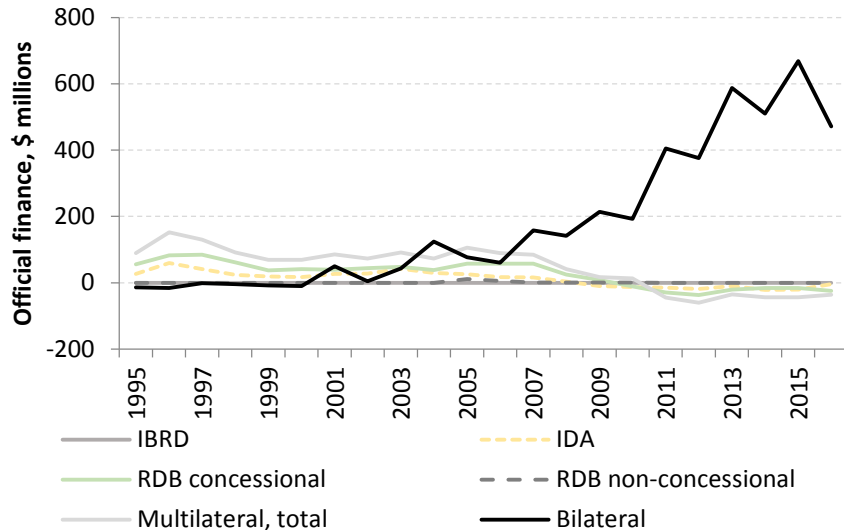
Source: IMF Article IV (2018).

Public Finance Landscape: External Borrowings

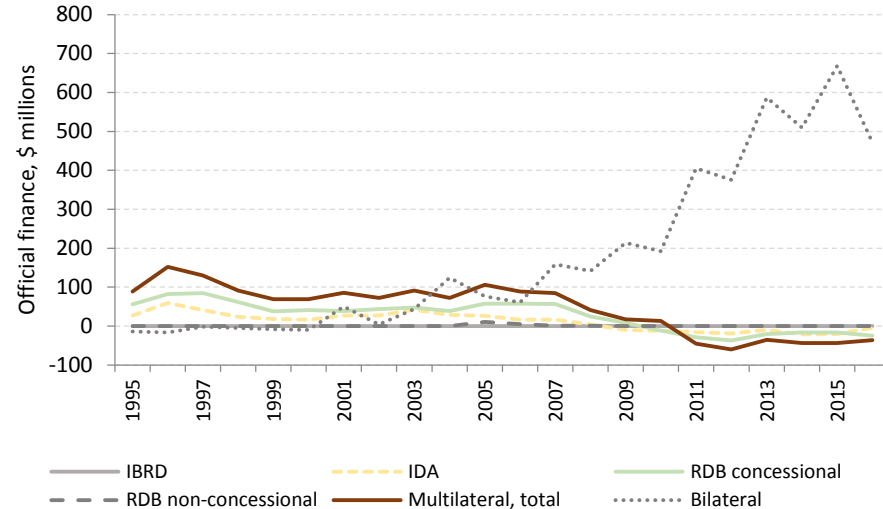
- **External borrowing:** **Bilateral debts increased rapidly since 2006.**
 - **Increase in bilateral debt:** Net bilateral lending to Laos rose by 145% from \$0.19 billion in 2010 to \$0.47 billion in 2016 (Fig.9a).
 - **Decrease in multilateral debt:** Net multilateral lending to Laos has been negative since 2011 (Fig.9b).

Fig.10: Net financial flows of bilateral and multilateral lending to Laos, \$ millions

a. Bilateral, total



b. Multilateral, total



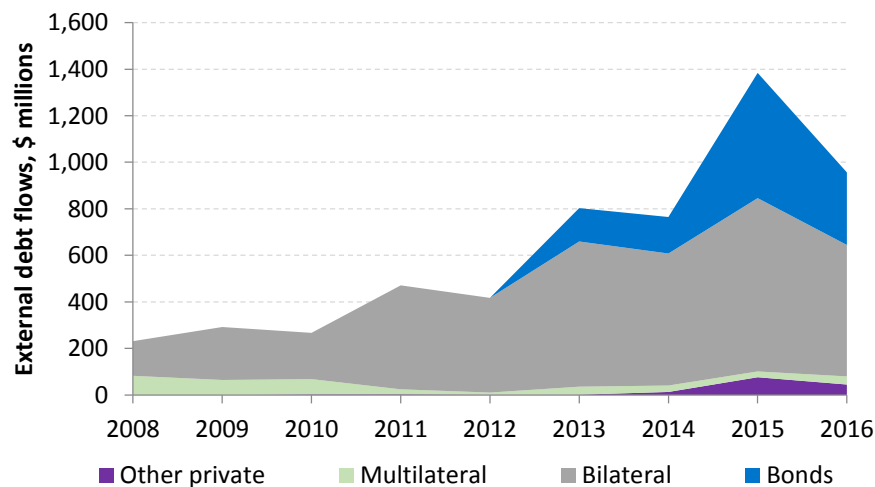
Source: Authors' calculation using data from World Bank's International Debt Statistics.

Public Finance Landscape: Tools for External Borrowings

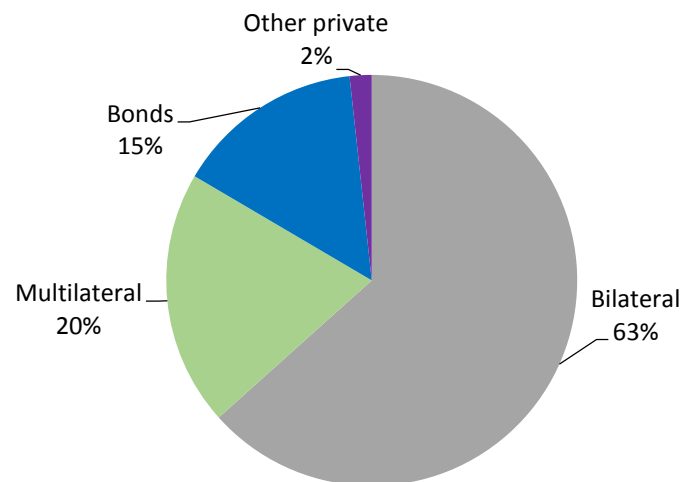
- **Tools for external borrowing: bilateral borrowing and bond issuance.**
 - GoL bonds to private creditors rose from \$143 million in 2013 to \$538 million in 2015 and \$312 million in 2016.
 - Stock of outstanding government bonds reached \$1,082 million in 2016, accounting for 15% of total external debts.

Fig.11 Laos' external debt, disbursed amount (\$ millions)

a. Flows, 2008-2016



b. Stock, as of 2016



Source: Authors' calculation using data from World Bank's International Debt Statistics.

IMF Recommendations for Structural Reforms

Category	Measures	Target (2018-2022)
Fiscal consolidation	<ul style="list-style-type: none"> - Revenue: tax reforms (profit tax, land tax, tax exemption) - Expenditure: control spending on public wage 	<ul style="list-style-type: none"> - Fiscal deficit to GDP: 2.6% - Public debt to GDP: 50%
Exchange rate adjustment	<ul style="list-style-type: none"> - More flexible exchange rate regime 	<ul style="list-style-type: none"> - Depreciate by 25% over 5 years
Banking sector reform	<ul style="list-style-type: none"> - Strengthen management of state-owned banks 	N/A
Competitiveness and long-term productivity	N/A	N/A

Source: IMF Article IV (2018).

IMF Recommendations

Economic Performance

Structural reform:

- Lower growth in short term but more sustainable growth in medium term
- Improve fiscal balance

Fig. 12: Real GDP growth (%)

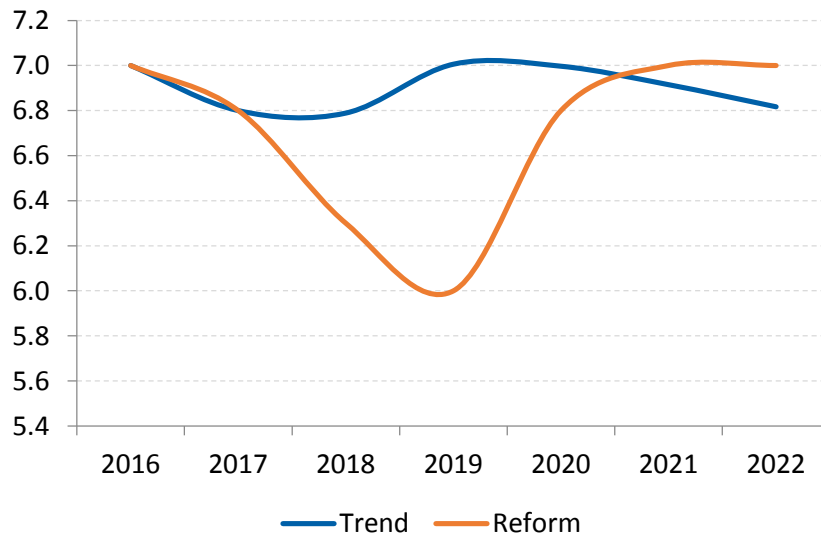
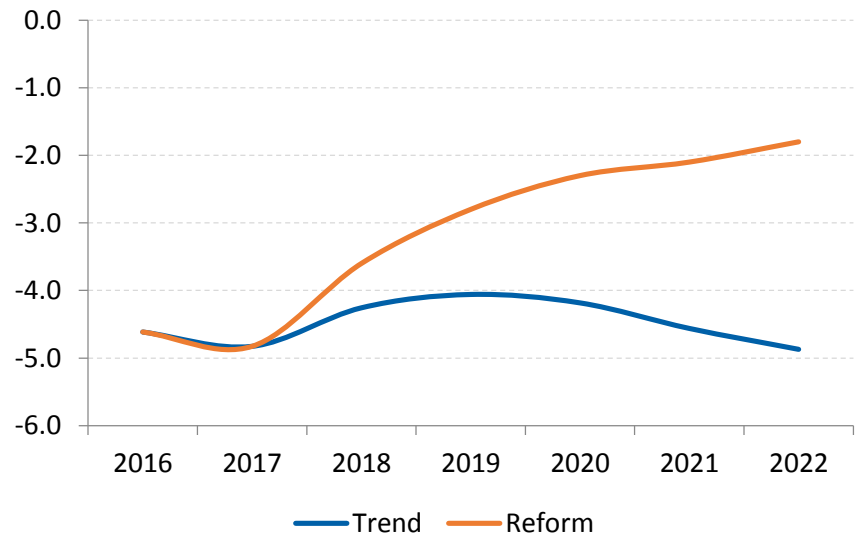


Fig. 13: Fiscal deficit (% of GDP)



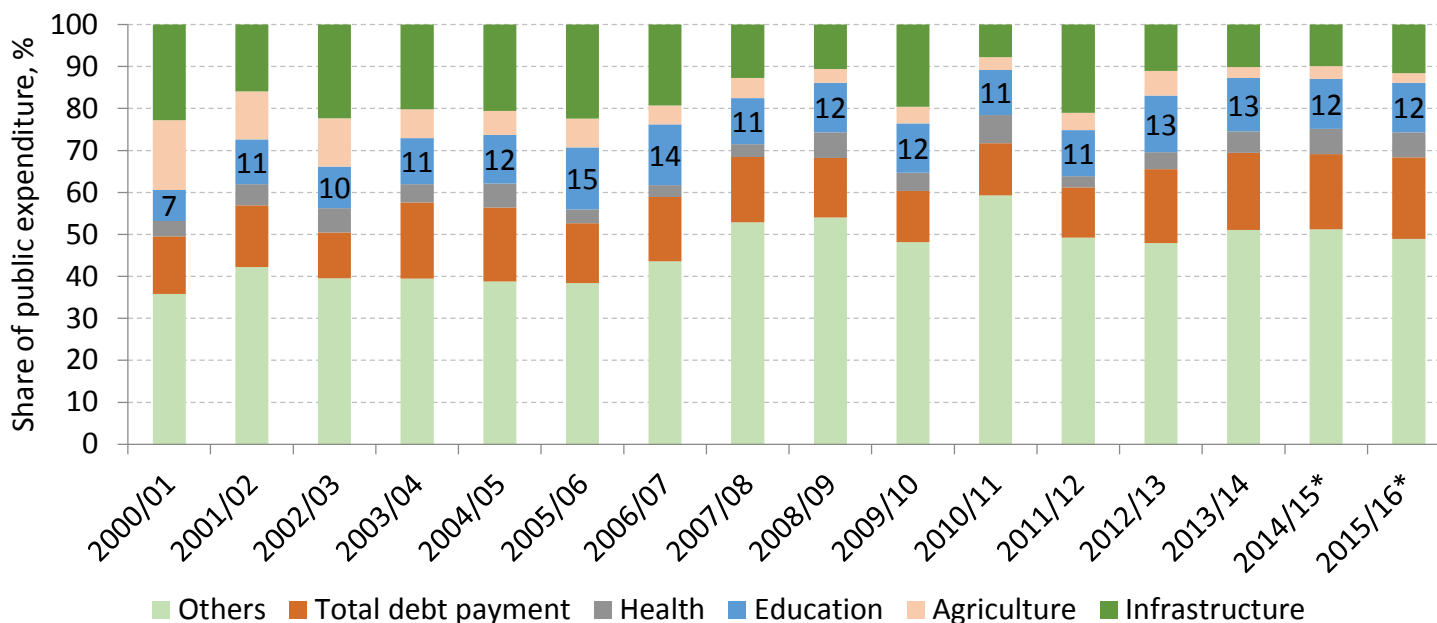
Source: IMF Article IV (2018).

Implication of Fiscal Consolidation for Development Program

Lower recurrent expenditure - Limited budget for financing social sectors.

- 7th NSEDP (2011-2015): Required budget for education (17%) vs Actual budget (12%)

Fig. 14: Sectoral allocation of public expenditure in Laos (% of total)



Note: *Planned figures.

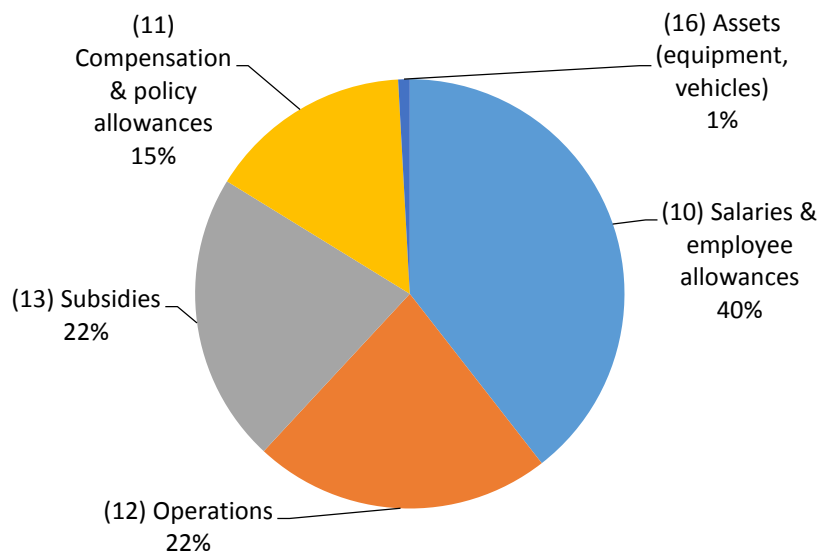
Source: Authors' calculation using data from the World Bank.

Implication of Fiscal Consolidation for Education Sector

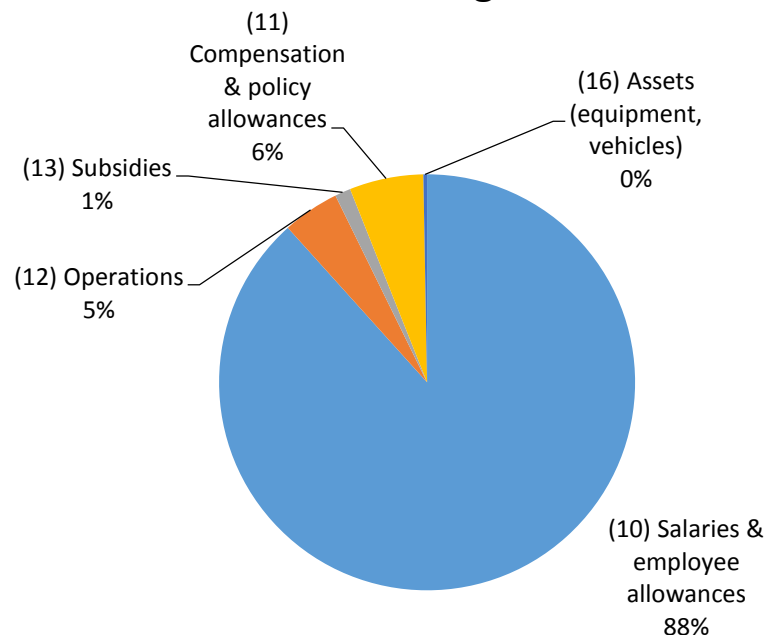
Lower recurrent expenditure in education sector – Local govt is more likely to be affected than central govt.

Fig. 15: Structure of recurrent expenditure in education sector, 2013/14

a. Central govt.



b. Local govt.



Source: Author's calculation using data from Lao Official Gazette.

Budget Plan: 2019

Fiscal stance – likely to be expansionary.

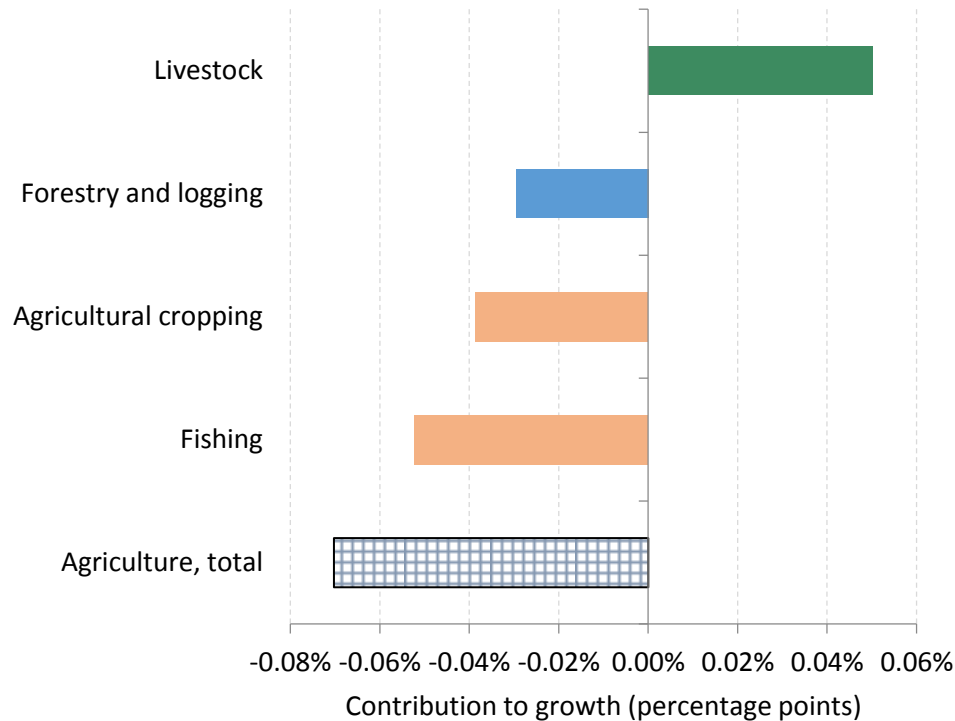
- Public expenditure: 33,394 billion kip (to be approved), 1.78% higher than plan.
- Public revenue: 26,000 billion kip.
- New regulation to reduce public expenditure on fieldwork. To be enforced in Jan. 2019

Source: Vientiane Times, Dated December 18, 2018.

Thank You

Economic Slowdown:

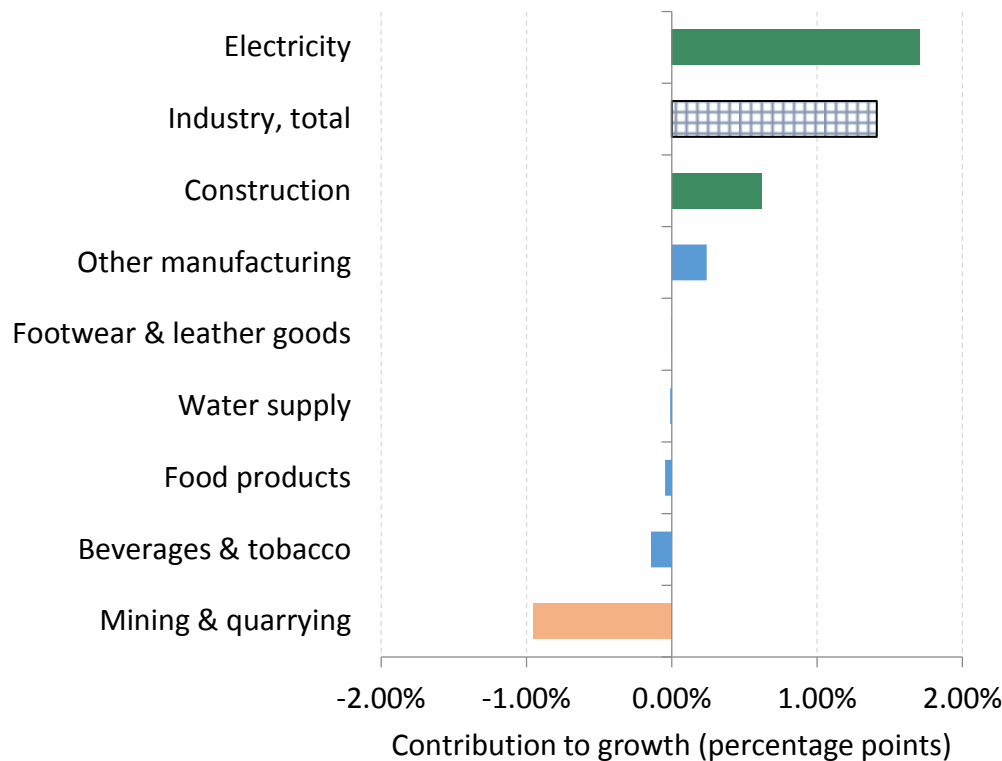
Agriculture – sources of economic growth



- **Positive growth:** livestock
- **Negative growth:** fishing, cropping, and forestry

Economic Slowdown:

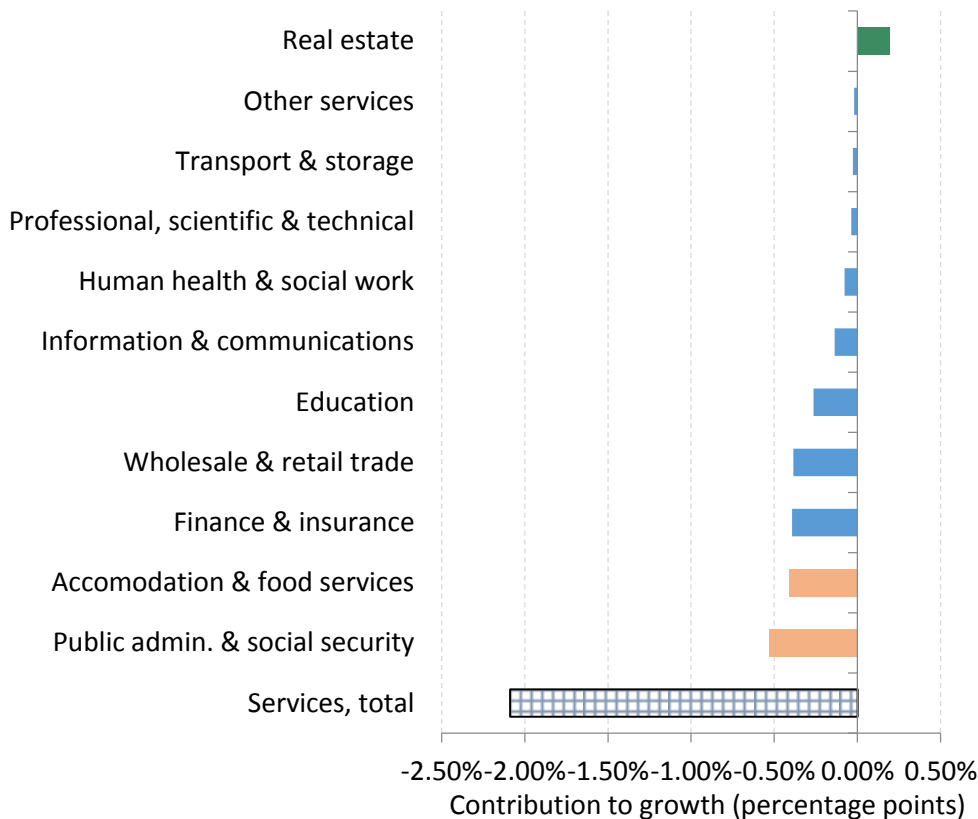
Industry – sources of economic growth



- **Positive growth:** Electricity and construction.
- **Negative growth:** mining and beverages.

Economic Slowdown:

Services – sources of economic growth



- **Positive growth:** Real estate.
- **Negative growth:** Public admin & social security, accommodation, finance & insurance and wholesale and retail trade.