ECCIL
EuroCham Laos

ECCIL WHITE PAPERS

2019

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2019

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ABOUT ECCIL

The European Chamber of Commerce and Industry in Lao PDR (ECCIL) provides the only official representation for all European enterprises in Laos. ECCIL represents the interests of European businesses in Laos via active engagement in advocacy and provision of tailor-made services. Our services include advocacy, advertising, contact and business matching, trainings and seminars, personnel recruitment, business trips and trade fairs, economic/industry research and event organisation.

ECCIL is one of the biggest and most active chambers of commerce in Laos and has activities not only in the Lao domestic market but also internationally. ECCIL's managers and board members are regular speakers at major economic conferences and events in Laos, in the region and in Europe. ECCIL is a trusted and long term partner of Lao National Chamber of Commerce and Industry (LNCCI), a founding member of the EU-ASEAN Business council, active member of the European Business Organisations Worldwide Network (EBO WWN) and has cooperation agreements with a number of bilateral European chambers. These relations give ECCIL access to a vast network and thousands of decision makers in Laos, Asia, Europe, and beyond.

European Chamber of Commerce and Industry in Lao PDR

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PREFACE TO ECCIL WHITE PAPERS 2019

Guy Apovy

President of the European Chamber of Commerce and Industry in Lao PDR

I would like to welcome all readers to the European Chamber of Commerce and Industry (ECCIL) 2019 White Papers. This is to follow up on the success of our White Book last year, the first White Book ever produced by a Chamber of Commerce in the Lao PDR.

In keeping with our role as a European Chamber of Commerce, the White Book is just one among a number of ways in which we share our thoughts on critical issues that can help Laos become a more attractive place for European companies to invest and Europeans to work. Thanks to the Government of Laos, ECCIL has had a number of opportunities to discuss a variety of topics over the past year. ECCIL was invited to contribute feedback on draft laws and contribute to a number of workshops, including one at the Prime Minister's Office.

The 2018 White Book also played a role behind the scenes. The leading White Paper on the Ease of Doing Business Index was introduced at the Lao Business Forum which led to requests for a Lao language version from the Prime Minister's Office. Subsequently, ECCIL was brought further into the discussion on specific topics on the Ease of Doing Business Index and parts of ECCIL's approach, such as the selection of key categories in the index, were adopted.

The 2019 White Papers also contains a new White Paper on the Ease of Doing Business that uncovers the fact that the sudden drop in ranking this year was actually due to a revision by the World Bank's researchers rather than any major changes on the part of Lao PDR. Because of the various revisions, ECCIL has produced a completely new paper. However, it still reflects the same strategic approach and is presented as the same friendly and candid suggestion as to how the Ease of Doing Business Index ranking could be reduced to below 100 focusing mainly on short-term measures.

This emphasis on short-term measures, what we call "low hanging fruit," does not preclude longer term measures – in fact, ECCIL strongly recommends that the short term measures be implemented while the longer-term measures are being designed, crafted and ultimately implemented.

The Ease of Doing Business Index provides the private sector and the government with an extraordinary amount of common ground and opportunity for cooperation. Each business wants to reduce the amount of time and steps in its interactions with bureaucracy – for example, in the category of Paying Taxes or Trading Across Borders, all businesses want to be able to get through the necessary bureaucracy in the fewest steps and with the least delays. For its part, government wants to attract foreign investors by showing how business-orientated and responsive it is by improving these indicators.

ECCIL is delighted to be able to cooperate with the Ministry of Planning and Investment with regard to the Ease of Doing Business Index. Our latest White Paper provides access for the ordinary reader on how the Index is put together, how to calculate the effect of improvements on the index and so on. ECCIL suggests a winning strategy for Lao PDR to achieve a ranking significantly below 100 using its low-hanging fruit strategy and focus on easy-to-change indicators.

Foreign investors look at more than just one feature of an economy. They also examine recent developments. For any foreign investor and current investor in Lao PDR, the biggest development in the Lao economy right now is the Lao-China railway. As with the Ease of Doing Business Index, this is another area of common ground between the private sector and the Government of Laos. ECCIL strongly believes that in order to get the best out of the railway for Laos, it is imperative that information is provided as soon as possible to the private sector so that private companies can then adjust their investment and business strategies accordingly in time for the opening of the railway.

Currently, there is almost no official information available about the railway that can be put to use by the private sector. ECCIL fears that if this situation is allowed to continue, the private sector will not be in a position to avail of the freight services that the railway could provide by the time it opens, thereby providing the impression that there is little demand within the country for such freight services. A low level of demand would indicate to the suppliers of rail freight services that there is no point in supplying such services to Laos. Given such a scenario, freight trains would certainly travel over Lao PDR transporting goods to and from Thailand and countries further south to China but there would be no incentive to provide a significant service to key stations within the country.

The 2018 White Book contained a White Paper on the skills gap in Lao PDR that detailed the skills shortage on one hand and the inability of many young Lao people to find jobs in their own country due to not having sufficient skills and education. A lot of progress has been made in this regard in the past few years by the government, development partners and businesses but a lot remains still to be done. This is made clear by a new type of report, called *The Human Capital Index* (HCI). Introduced in the past few months by the World Bank, the HCI report for Laos shows that the economy still has a long way to go with respect to the quality of primary education which is the key to performance at secondary and technical levels.

The HCI report is an attempt to measure changes in human capital in 157 countries throughout the world. The index is forward looking - instead of trying to measure human capital in the existing working population, the compilers decided to measure how investment in health and education in an economy now will contribute to the productivity of the next generation of workers.

The primary intention of the HCI is to draw the attention of policy-makers to the importance of investment in health and education for the future development of the economy. However, ECCIL recognises that this index may also be taken up by potential foreign investors in much the same way as the Ease of Doing Business Index, especially in relation to the education results in the index, when deciding where to locate their projects. The HCI, as measured today, will indicate how your new workforce will be over the next five to ten years.

In keeping with the theme of attracting quality foreign investment, ECCIL is also happy to introduce another short paper on a topic relevant to potential foreign investors. One issue that greatly concerns foreign investors when entering any country is whether there is a legal framework whereby disputes between enterprises and individuals can be resolved fairly, cheaply and quickly. The revised Law on Economic Dispute Resolution attempts to do this. ECCIL greatly welcomes this law as it provides enterprises with a way of resolving disputes, whether by mediation or arbitration, without having to resort to lengthy and expensive court proceedings. The existence of a robust mediation and arbitration system in the economy would be seen as a distinct advantage by foreign investors.

However, ECCIL has a number of concerns with the revised law as currently written; for instance, ECCIL is concerned that by allowing disputants to resort to the courts at any stage while engaging in arbitration, this will reduce the advantage of arbitration to disputants as they might as well avoid “unnecessary delay” and go straight to court. This could devalue the process of arbitration as a form of economic dispute resolution.

On a final note, ECCIL is more than happy to provide constructive feedback to the Government of Laos on any topic and works hard in order to provide timely information to workshops and other events to which ECCIL staff are invited. But often the original material that ECCIL has to work with is extremely out of date or was received only within hours of or actually at the workshop itself.

For instance, ECCIL only gains access to new draft laws as they are made available on the Lao Official Gazette for comments for the mandatory period of two months. But while the old draft is available, the new version has often already been generated but does not appear on the Gazette. Time and again, ECCIL staff find themselves at workshops unable to provide adequate feedback because they have only shortly before the event received the copy of the up-to-date draft complex law which often differs very markedly from the draft they worked on from the Gazette. For ECCIL to be able to contribute more to enhancing the sort of institutions that lead to greater economic development and attracting quality foreign investment, it would help if a way could be found to allow ECCIL access to up-to-date versions of draft laws and documentation in due time.

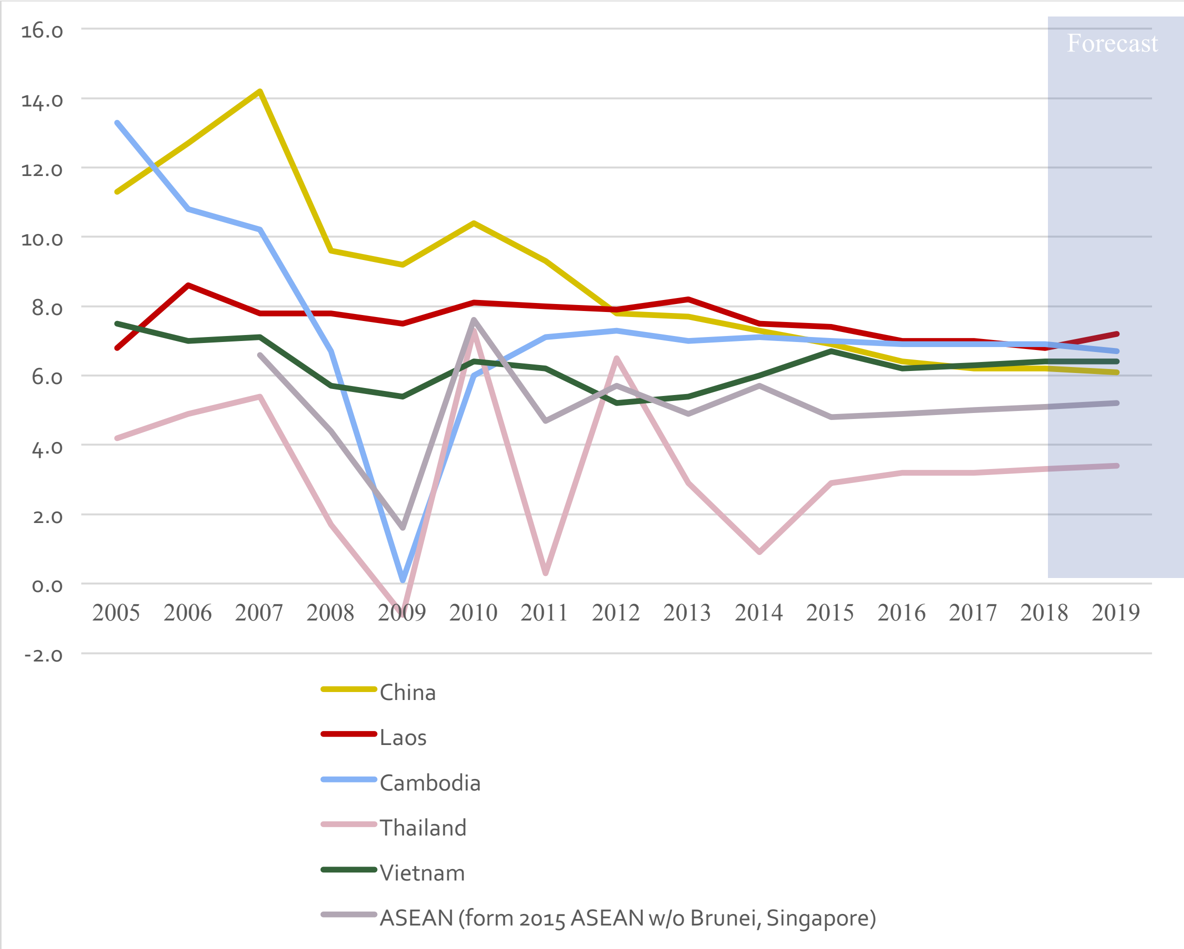
Last but not least, the White Papers will also include a topic that seldom gets coverage in Lao PDR, namely the Banking and Financial Sector. With special thanks to Rufus Pinto, CEO of ANZ Bank, this unique White Paper provides a thorough-going analysis of the risks facing the financial sector in Lao PDR along with suggested responses to these risks outlined.

Guy Apovy,

KEY ECONOMIC DATA

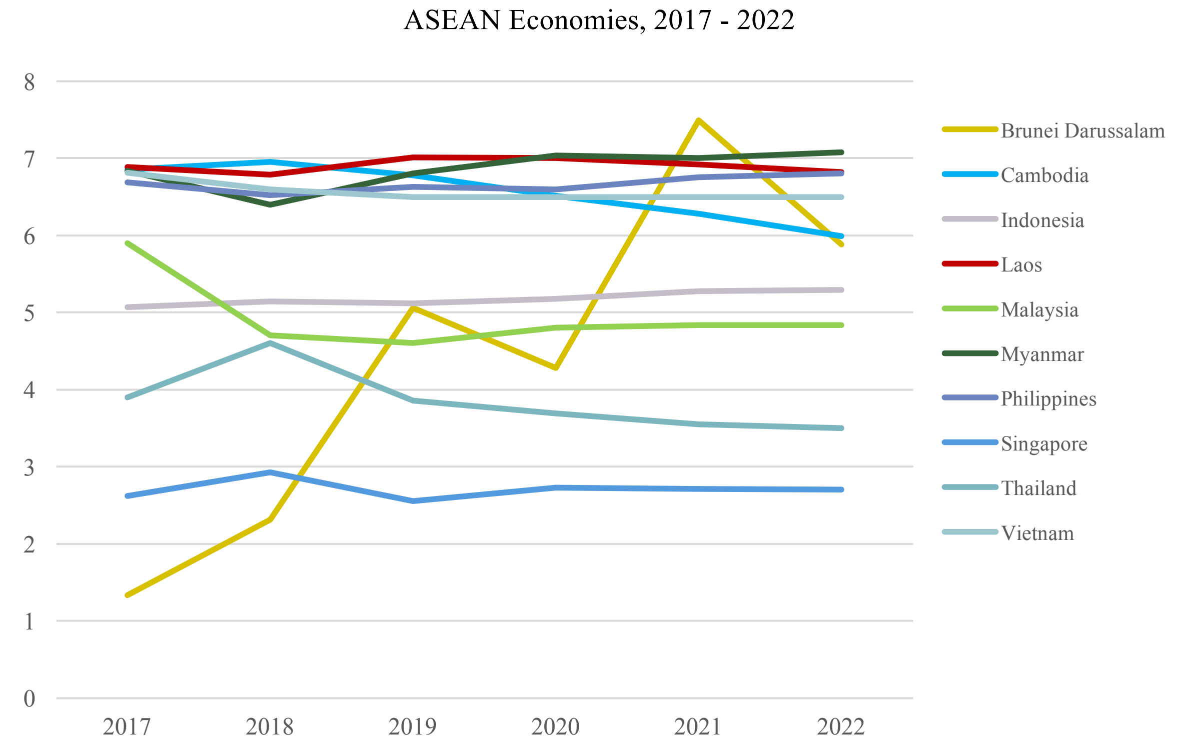
GROWTH RATES OF REAL GDP (IN %)

Selected Asian Economies, 2005-2019



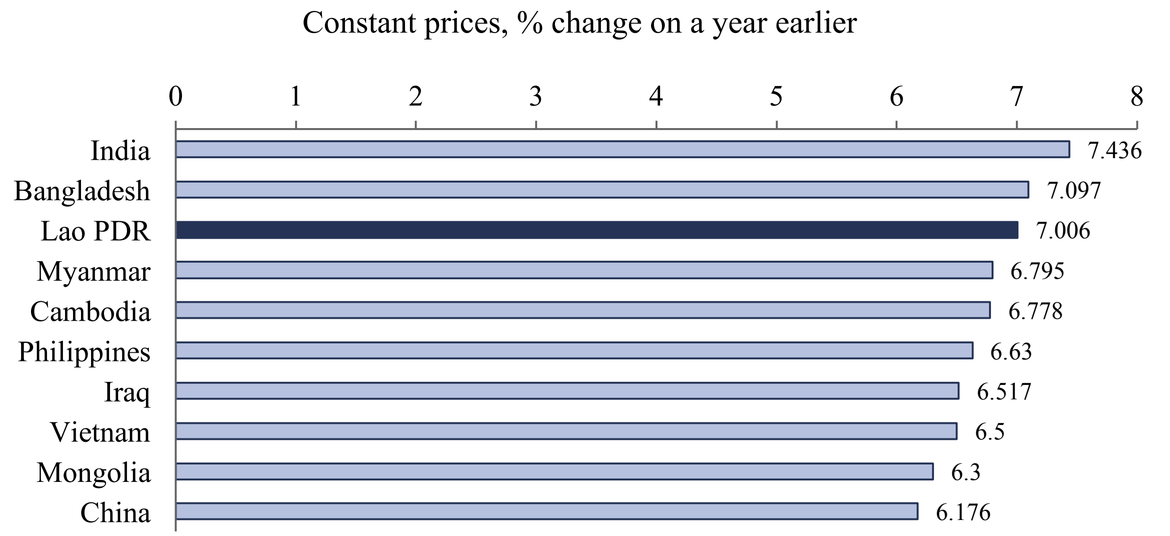
Source: Asian Development Bank (Ed.): Key Indicators for Asia and the Pacific, 2009. 40th ed., Manila 2009, p. 183. Asian Development Bank (Ed.): Key Indicators for Asia and the Pacific, 2013. 44th ed., Manila 2013, p. 220. ADB, ILO (Ed.): ASEAN Community 2015: Managing integration for better jobs and shared prosperity. Bangkok 2014, p. 133. http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG as of Feb. 2nd 2017; World Bank (Ed.): East Asia and Pacific Economic Update April 2017. Sustaining Resilience. Washington 2017, p. 29.

ESTIMATED GROWTH RATES OF GDP (CONSTANT PRICES, IN %)



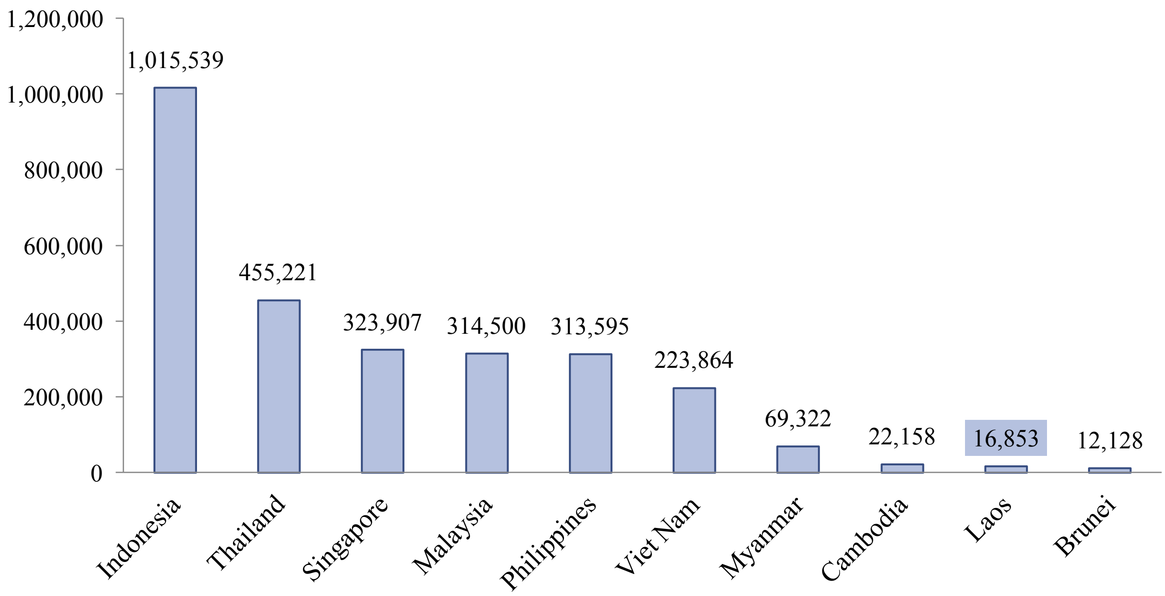
Source: IMF: https://www.imf.org/external/pubs/ft/weo/2018/02/weodata/weorept.aspx?sy=2016&ey=2023&scsm=1&ssd=1&sort=country&ds=.&br=1&pr1.x=49&pr1.y=13&c=518%2C516%2C522%2C566%2C536%2C544%2C578%2C548%2C582&s=NGDP_RPCH&grp=0&a= as of December 31st 2018.

GDP GROWTH FORECAST FOR THE FASTEST GROWING ECONOMIES IN ASIA FOR 2019



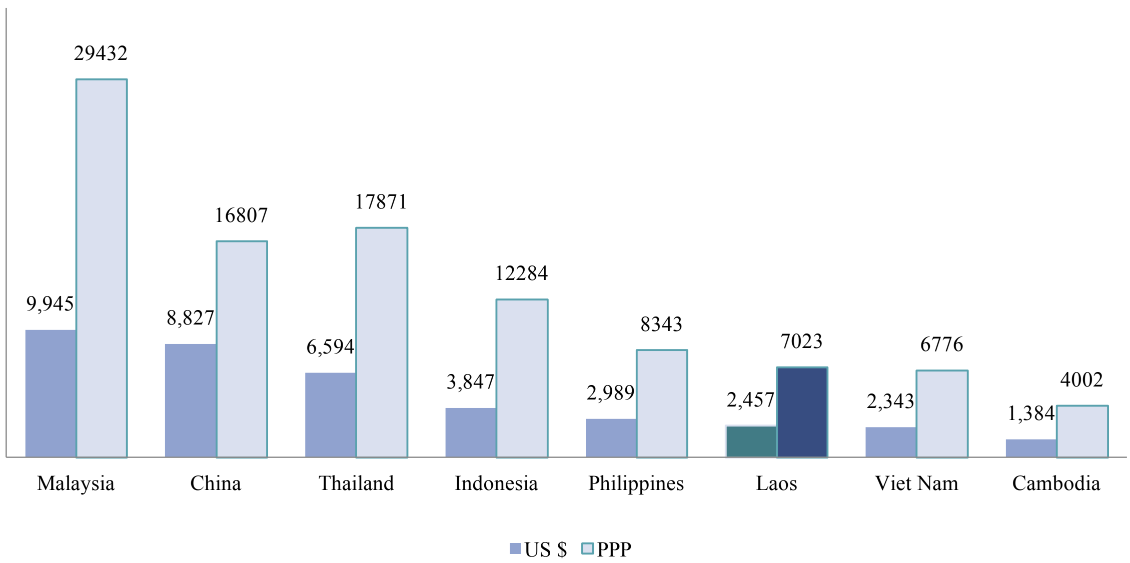
Source: IMF: https://www.imf.org/external/pubs/ft/weo/2018/02/weodata/weoselgr.aspx as of December 31st 2018, without Yemen

ASEAN ECONOMIES COMPARED BY GDP, 2017 (IN CURRENT M.US $)



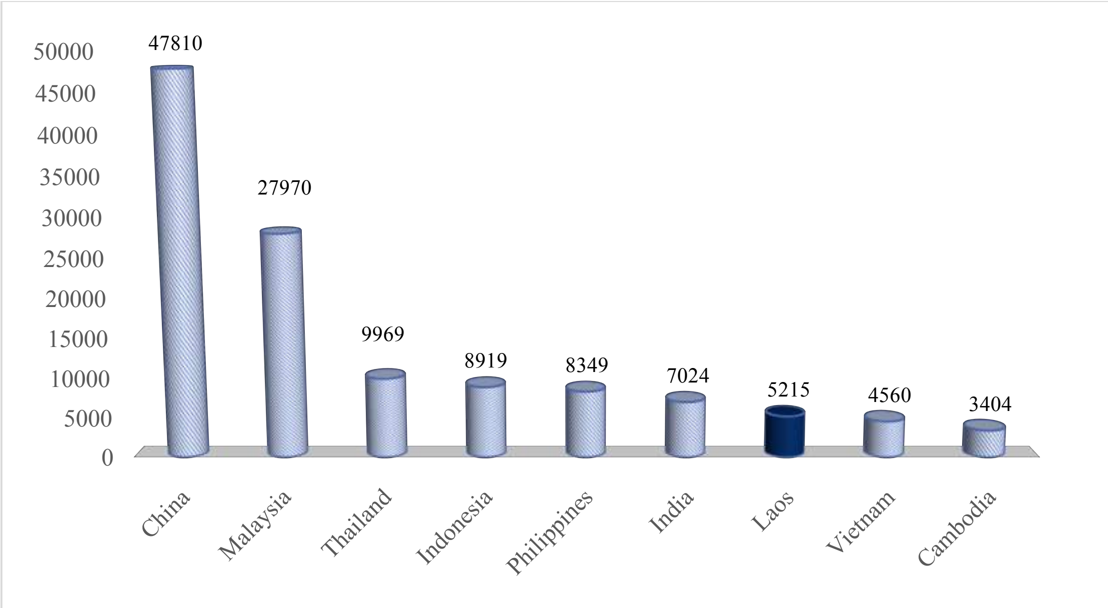
Source: World Bank Database
(https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=MZ-LA as of Dec. 31st 2018.

GDP PER CAPITA IN 2017 (CURRENT US $ AND PPP CURRENT INTERNATIONAL $)



Source: World Bank Database: https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=CU and https://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD?locations=CU as of Dec. 31st 2018.

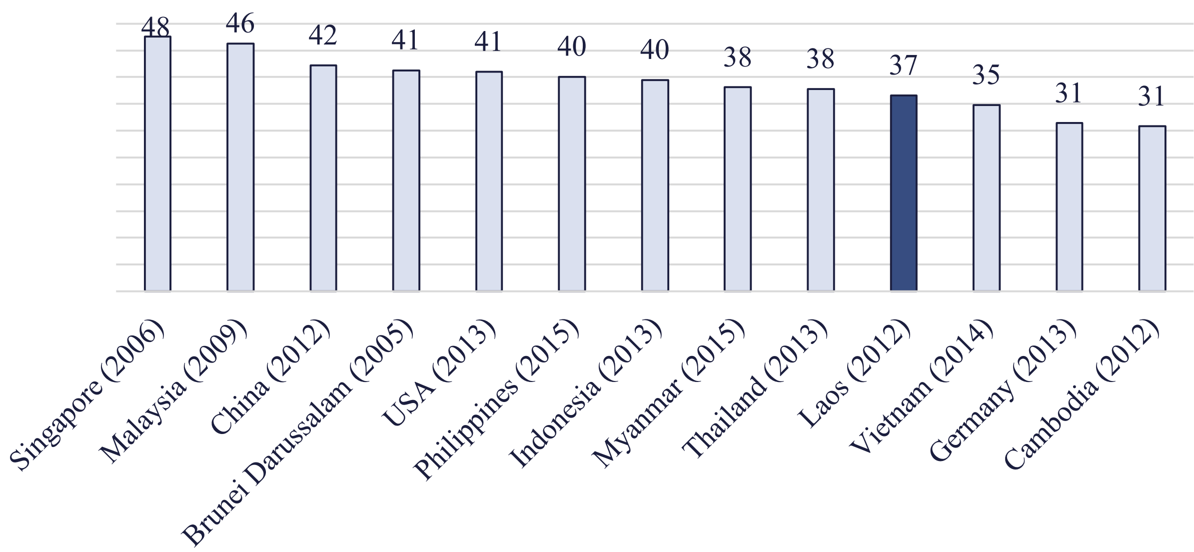
WEALTH IN USD PER ADULT IN SELECTED ASIAN COUNTRIES (2018)



Source http://databank.worldbank.org/data/reports.aspx?source=2&series=SI.POV.GINI&country= as of December 11th 2017. Charting Economy (Ed..): Charting Laos. Country Report Presentation 1H2016., no location, 2015, p. 24.

GINI INDEX

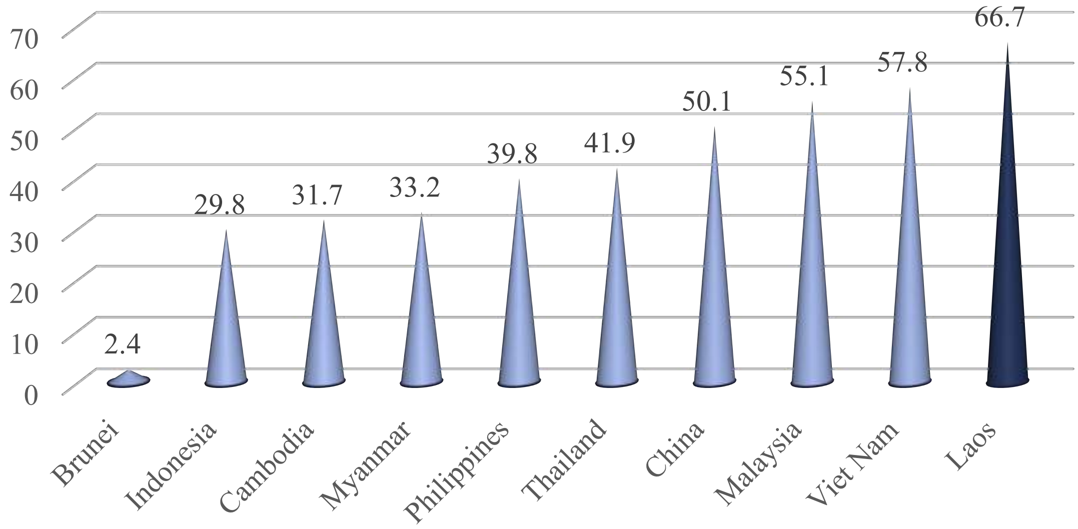
(World Bank estimate; 0=perfect income equality, 100=perfect income inequality)



Source http://databank.worldbank.org/data/reports.aspx?source=2&series=SI.POV.GINI&country= as of December 11th 2017. Charting Economy (Ed..): Charting Laos. Country Report Presentation 1H2016., no location, 2015, p. 24.

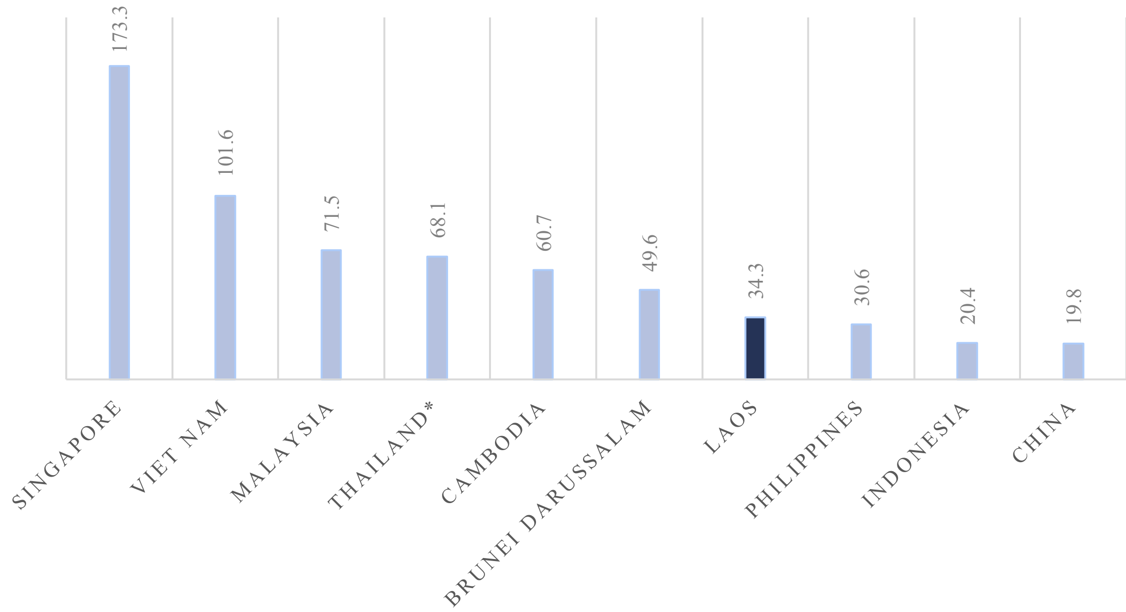
GENERAL GOVERNMENT GROSS DEBT 2018

(% of GDP, IMF estimates)



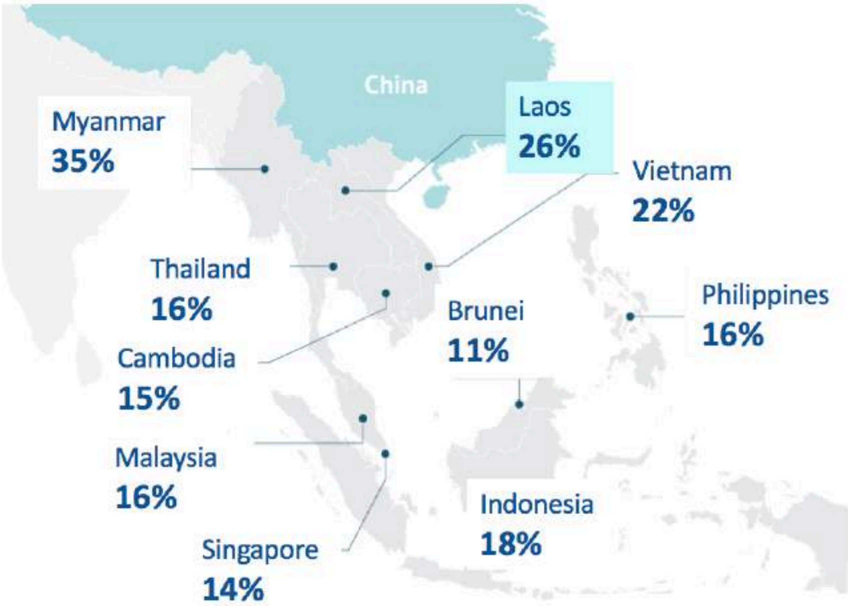
Source: IMF: https://www.imf.org/external/pubs/ft/weo/2018/02/weodata/weorept.aspx?pr.x=87&pr.y=13&sy=2016&ey=2023&scsm=1&ssd=1&sort=country&ds=.&br=1&c=518%2C516%2C522%2C924%2C566%2C536%2C544%2C578%2C548%2C582&s=GGXWDG_NGDP&grp=0&a= as of Dec. 31st 2018

EXPORTS OF GOODS AND SERVICES AS PERCENTAGE OF GDP IN 2017



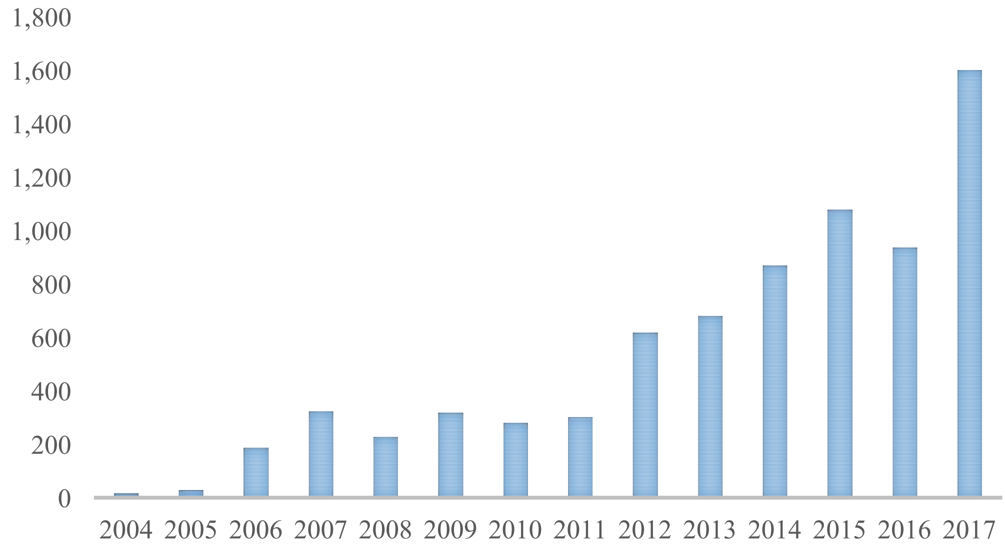
Source: World Bank: https://data.worldbank.org/indicator/NE.EXP.GNFS.ZS as of December 31st 2018.

TOTAL TRADE IN PRODUCTS WITH CHINA AS PERCENTAGE OF ALL TRADE IN PRODUCTS (2017)



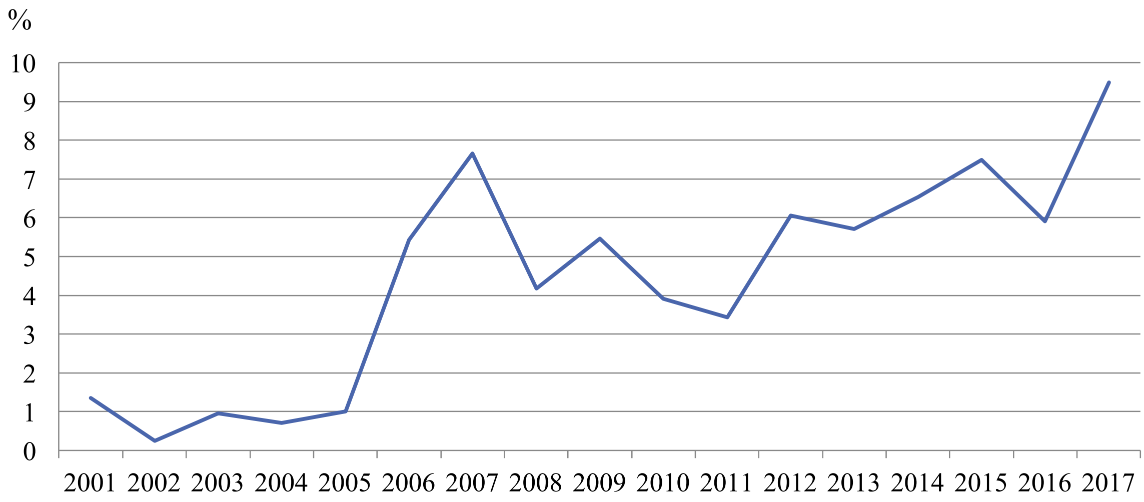
Source: ECCIL calculations based on Trade Map (https://www.trademap.org/Index.aspx?AspxAutoDetectCookieSupport=1 as of December 31st 2018)

FDI NET INFLOW INTO THE LAO PDR (BOP, CURRENT MLN. USD)



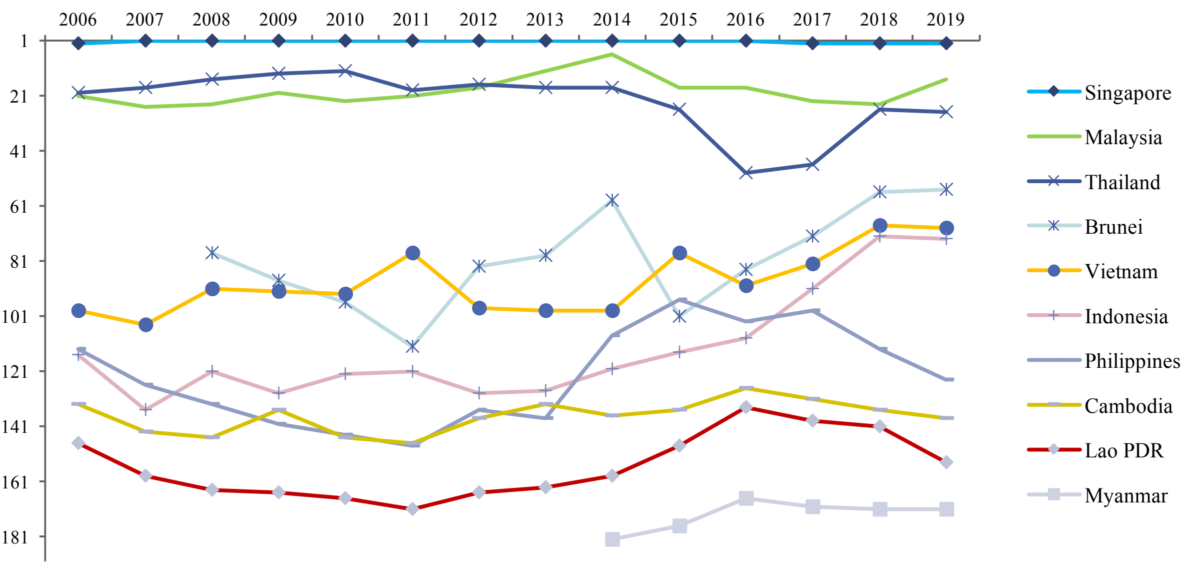
Source: International Monetary Fund, Balance of Payments database, supplemented by data from the United Nations Conference on Trade and Development and official national sources., here derived from World Bank: https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?locations=LA as of January 14th 2019

FDI – NET INFLOWS AS % OF GDP



Source: World Bank: https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?locations=LA as of January 14th 2019.

EASE OF DOING BUSINESS 2019, REGIONAL COMPARISON OF OVERALL RANKING DEVELOPMENT

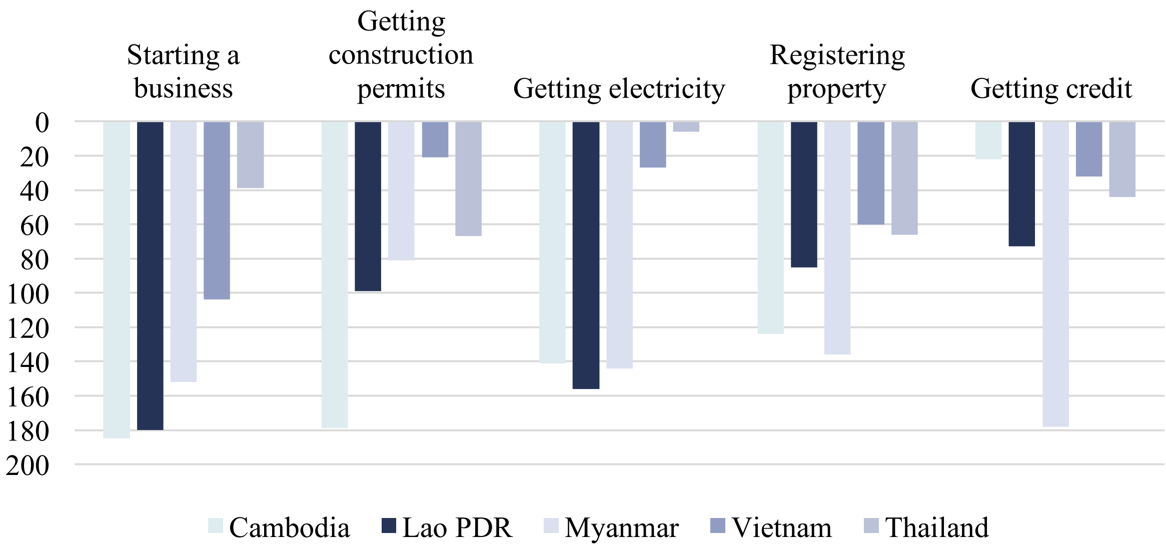


Explanation: Ranking of 155 (2006) to 190 (2019) countries where Rank 1 is the best worldwide.

Source: World Bank (Ed.): Doing Business Washington, DC different years; rankings unadjusted, i.e. according to the original surveys.

EASE OF DOING BUSINESS INDEX 2019 – DETAILS FOR SELECTED COUNTRIES AND CATEGORIES (I)

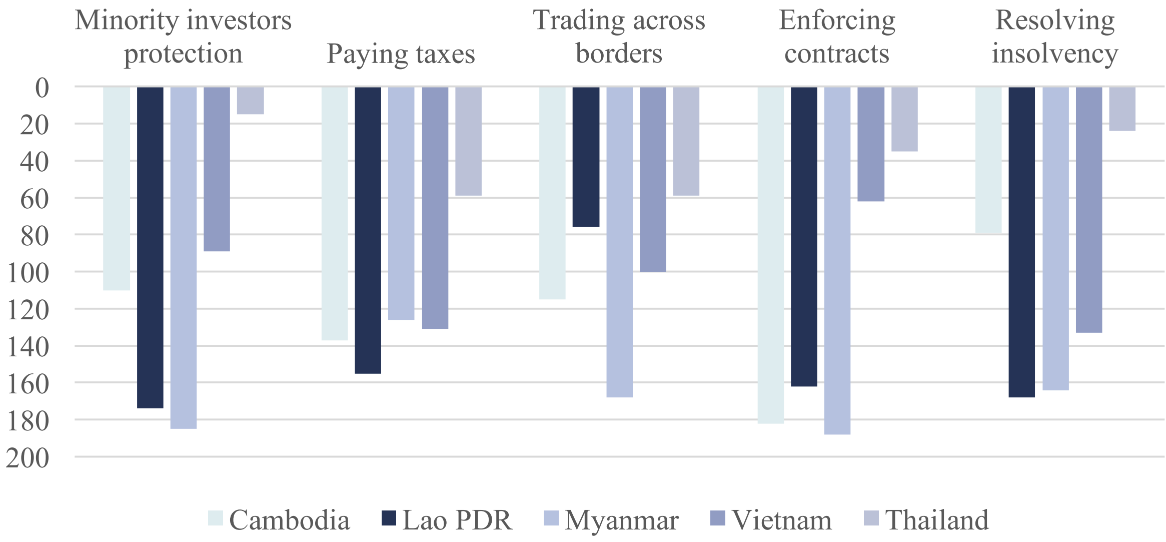
(Ranking of 190 countries; 1=best, 190=worst)



Source: World Bank (Ed.): Doing Business 2019: Training for Reform. Washington, DC 2018, p.161, 183, 191, 208, 214.

EASE OF DOING BUSINESS INDEX 2019 – DETAILS FOR SELECTED COUNTRIES AND CATEGORIES (II)

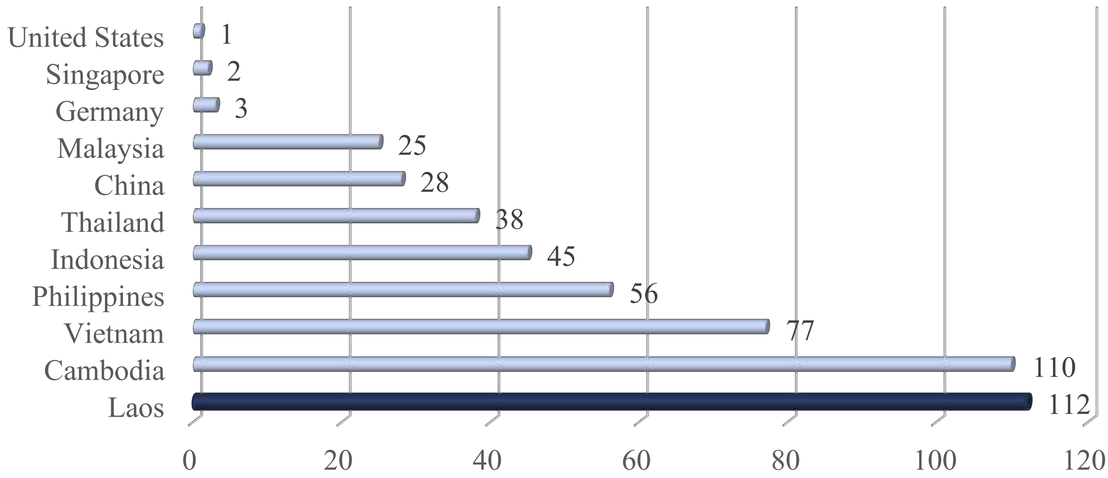
(Ranking of 190 countries; 1=best, 190=worst)



Source: World Bank (Ed.): Doing Business 2019: Training for Reform. Washington, DC 2018, p.161, 183, 191, 208, 214.

GLOBAL COMPETITIVENESS INDEX 2018

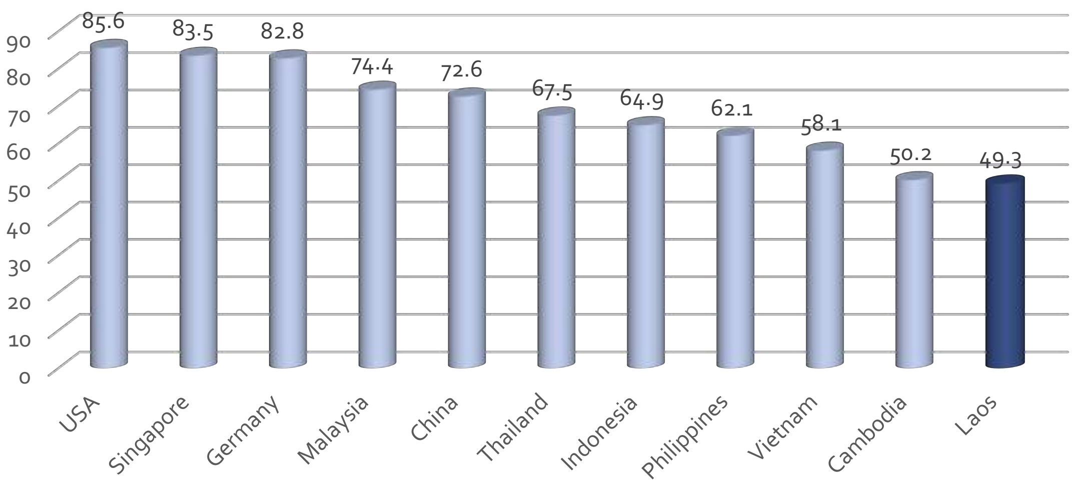
(Ranking; 1=best, 140=worst)



Source: World Economic Forum (Ed.): The Global Competitiveness Report 2018. Geneva 2018, p. XI.

GLOBAL COMPETITIVENESS INDEX 2018 - SCORES

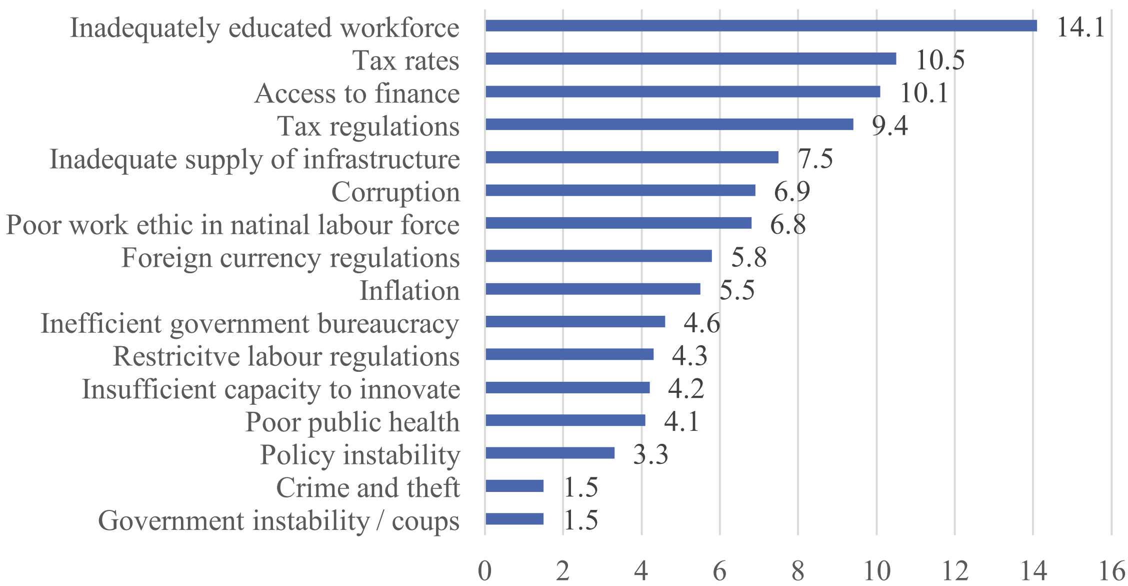
(The higher the score, the more competitive is the economy)



Source: World Economic Forum (Ed.): The Global Competitiveness Report 2018. Geneva 2018, p. XI.

THE MOST PROBLEMATIC FACTORS FOR DOING BUSINESS IN LAOS

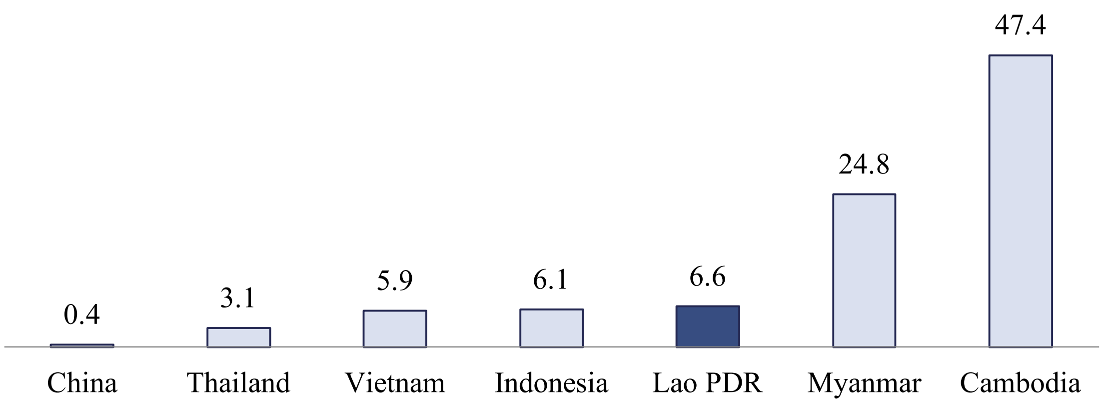
(World Economic Forum, Executive Opinion Survey 2017)



Source: World Economic Forum (Ed.): The Global Competitiveness Report 2017-2018, p. 174.

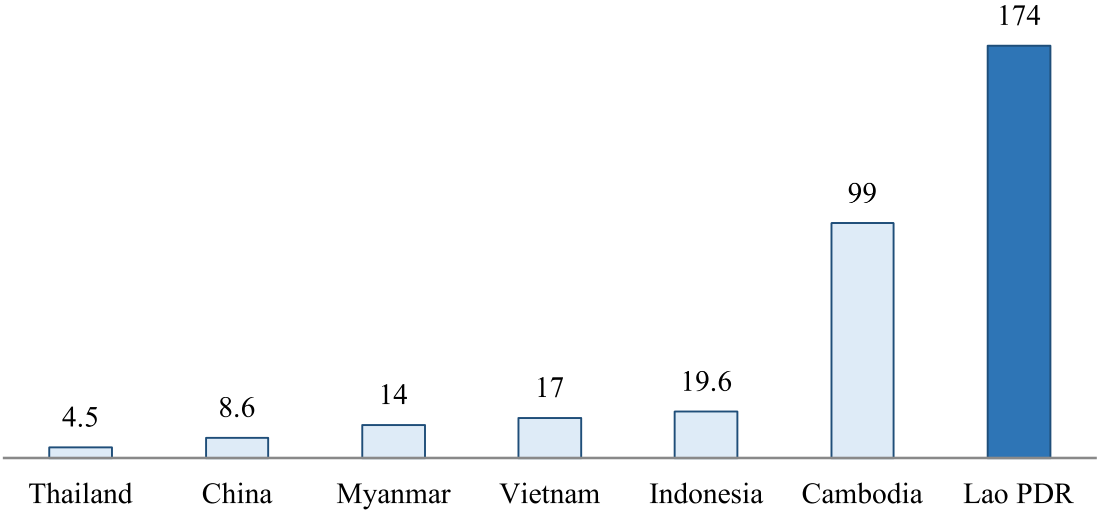
Note: From the list of factors, respondents to the World Economic Forum's Executive Opinion Survey were asked to select the five most problematic factors for doing business in their country and to rank them between 1 (most problematic) and 5. The score corresponds to the responses weighted according to their rankings.

COST OF BUSINESS START-UP PROCEDURE (% OF INCOME P.C., 2018)



Source: World Bank (Ed.): Doing Business 2019: Training for Reform. Washington, DC 2018, p.161, 183, 191, 208, 214.

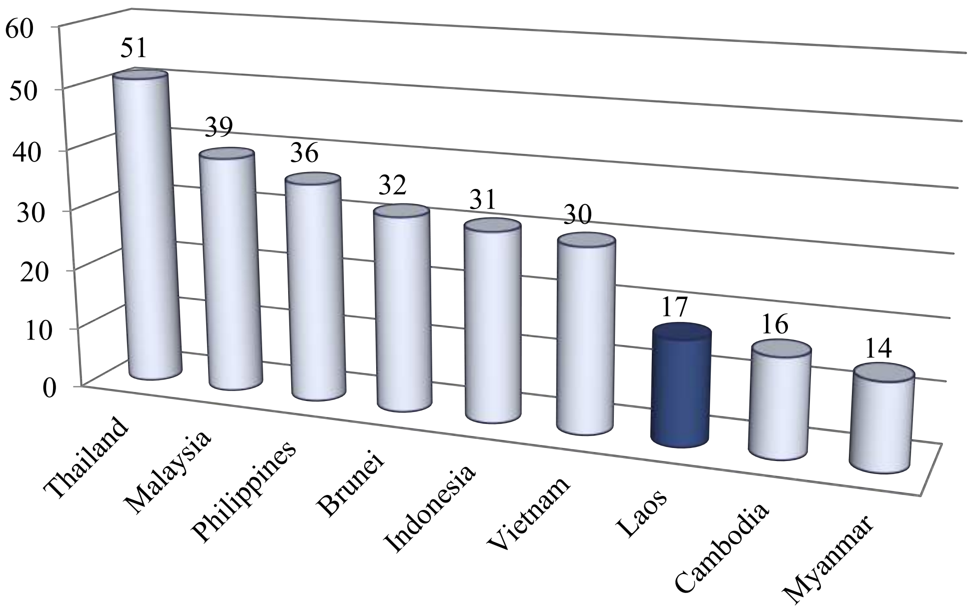
TIME REQUIRED TO STARTUP BUSINESSES (DAYS, 2018)



Source: World Bank (Ed.): Doing Business 2019: Training for Reform. Washington, DC 2018, p.161, 183, 191, 208, 214.

GROSS ENROLMENT RATE IN TERTIARY EDUCATION IN %

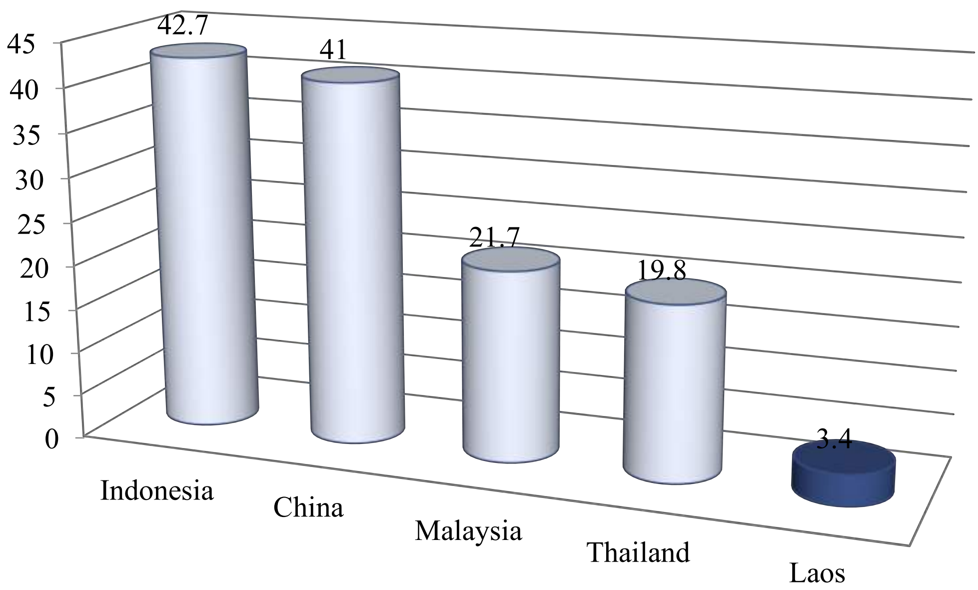
(most recent year)



Source: http://data.worldbank.org/indicator/SE.TER.ENRR/countries as of December 31st 2018.

PERCENTAGE OF STUDENTS IN UPPER SECONDARY EDUCATION ENROLLED IN VOCATIONAL PROGRAMMES

(most recent year)



Source: World Bank: https://databank.worldbank.org/Data/indicator/SE.SEC.ENRL.MA.VO.ZS?id=c755d342&report_name=EdStats_Indicators_Report&populartype=series as of Dec 31st 2018

EASE OF DOING BUSINESS INDEX

Executive Summary

The European Chamber of Commerce and Industry in Lao PDR (ECCIL) would like to add its support to the Government of Laos' intention of improving the country's ranking in the World Bank's Ease of Doing Business Index to below 100 and respectfully proposes changes in this White Paper.

This White Paper includes a **Preface** containing a detailed explanation of how, due to a World Bank Correction of data going back several years, Lao PDR's ranking became 154. Instead of being a drop of 13 points, the Correction revised the previous several years, including the 2018 ranking to 151, rendering a drop of only 3 places in the Index.

The White Paper is intended as a document for discussion and it is made clear that other strategic approaches are just as viable and possible.

ECCIL proposes the low hanging fruit strategy: the low hanging fruit are those low-scoring categories that are easier to improve without too much disruption while remaining within the confines of a short-term strategy. The strategy is intended to be easy to implement, feasible in the short term while having the largest impact for relatively small changes.

The Ease of Doing Business Index is made up of 10 categories or topics, each of which contain several indicators, making up 46 indicators in total. To reduce the problem, ECCIL adopts the low hanging fruit strategy to reduce the number of categories and indicators to a more manageable number.

ECCIL reduces the number of categories to seven by leaving out those where Laos achieves a ranking significantly below 100 (based on driving the average of all category rankings below 100). ECCIL also provides a detailed account of how the rankings for categories and indicators are arrived at through a variable called **Distance to Frontier** (DTF).

ECCIL provides a guide to the White Paper in a separate section.

In the **Analysis** section, ECCIL looks at each of the seven targeted categories in an effort to uncover the indicators best suited to its low hanging fruit strategy. An effort was made to target those indicators which would be easier to change in the Lao context and the proposed changes include feasible changes or reductions in procedures, time devoted to process, incorporation of electronic, online or automation where appropriate and changes in procedural rules.

In many cases, comparisons are made with neighbouring countries so that lessons can be learned from the successes of others in respect to the Ease of Doing Business Index. A total of 18 indicators out of a total of 46 indicators were targeted in the exercise and all proposed changes were processed through the World Bank provided simulator (limitations of the simulator are also examined in detail in the relevant section).

The targeted categories and the proposed changes to 18 indicators are listed in the table below:

List of 18 Targeted Categories and Proposed Changes to Indicators						
Categories	**Indicator**	**Current Score**	**Target Score**	**Indicator**	**Current Score**	**Target Score**
1) Resolving Insolvency	Recovery Rate	0.0	15	Strength of Insolvency	0.0	4.5
2) Protecting Minority Investors	Directors Liability Index	1	5	Shareholder Suits Index	3	5
	Corporate Transparency Index	1	5			
3) Starting a Business	Time	174	45	Procedures	10	4
4) Getting Electricity	Time	105	74	Reliability of Supply etc.	2	5
	Procedures	7	5			
5) Paying Taxes	Time	362	190	Time to Comply VAT Refund	0	20
	Payments	35	10	Time to Obtain VAT Refund	0	40
6) Enforcing Contracts	Time	828	450	Quality of Judicial Process	3.5	5.5
7) Dealing with Construction Permits	Building Quality Control Index	6.5	8.5	Procedures	12	11

When processed through the 2019 simulator, the proposed changes yield an improvement of ranking to 91 (from the current 2019 ranking of 154). Given the significant margin between 91 and 100, if Lao PDR were to adopt and implement all the changes suggested in this White Paper within the next couple of years, it would be likely to achieve a double digit outcome. This is stated based on a number of caveats, including competition arising from changes implemented by other countries over time.

ECCIL has not commented on any changes that have been announced or mentioned in the media since the completion of the World Banks research mission which reportedly ended June 1st 2018 as ECCIL does not have the resources to check those reports and whether the changes have in fact been implemented sufficiently for the World Bank researchers.

Preface

Revision, Not A Drop Of 13 Places

In the 2019 World Bank Ease of Doing Business Index, Laos ranked 154 out of 190 economies. On the face of it, this looks like a large drop of 13 places, from last year's published position of 141 to this year's 154. Actually, Lao PDR has not dropped 13 places in the ranking. Instead, the World Bank has corrected the Ease of Doing Business Index going back at least several years and this resulted in a reformulation of the ranking for last year to the equivalent to 151.

Although this means that while the situation with respect to the ease of doing business in Lao PDR was worse than previously established by the World Bank before the Correction, the fact is that Laos has fallen by only three places in the rankings, not 13. How this is possible requires some explanation.

Each year the World Bank holds an exercise to research and evaluate the ten categories or topics that make up the Index. Each category is evaluated according to what is known as "distance to frontier" (DTF) - this will be explained later in the main section of the White Paper - all we need to say at the moment is that the value of the DTF number reflects how well the economy in question performed in relation to that topic.

Each category is also ranked across all 190 economies, based on DTF values. For example, in the 2019 Index, Lao PDR received a ranking of 180 under the "Starting a Business" topic – this was based on the Lao DTF for Starting a Business of 60.93. All DTF measurements are averaged across all ten topics for each country to give a distance to frontier for the country as a whole. Those values are then used to rank each country. In the 2019 Index, Laos has received an overall DTF of 51.26; based on that DTF value, Laos was ranked at 154 in the Index.

In what follows, this article will refer to the original 2018 Index for Lao PDR and the corrected 2018 Index or the "Correction" for Lao PDR. The original 2018 Index refers to the World Bank Ease of Doing Business Index that was published in November 2017. The corrected 2018 Index refers to Corrections that the World Bank has released as part of its publication of the 2019 Index (released in November 2018).

To the casual reader not familiar with the past DTF values for Laos, it is not clear from reading the website that these are Corrections as no mention of a Correction is actually made. No revised

rankings are provided and therefore it is very easy for the casual reader to mistakenly read the change in overall ranking as a drop of 13 places as opposed to a Correction.

In the original 2018 Index, Lao PDR received an overall ranking of 141 based on a DTF score of 53.01. This was revised in corrected 2018 Index to 51.11. As pointed out above, no revised ranking was revealed for the 2018 Index. Based on the Corrections, the Lao overall DTF score for 2019 was an improvement as it increased slightly to 51.26. Of course, an increase in DTF, especially such a small one, holds no guarantee of an improvement in ranking - a disimprovement in ranking is perfectly possible even when an economy increases its DTF due to competition as other countries make improvements.

In an exchange of emails with the Global Indicators Group[1], the World Bank department in charge of producing the Ease of Doing Business Index, the revised Laos ranking for last year (2018) was revealed as 151. ECCIL is aware that the revision of the DTF scores goes back to at least the 2017 Index but the World Bank's Global Indicator's Group refused to provide any further information on revision of ranking other than that of the 2018 Index. In an email reply to a request for further revised rankings resulting from the Correction, the Global Indicator's Group stated:

> "Please note that we do not back-calculate rankings in the past but we revise the [DTF]scores. In other words, it is better to use the [DTF]scores than the rankings for your analysis."

It is however possible to approximate, in a very generalized way, the revised ranking for a previous year based on the revised DTF score as long as one has access to the total rankings and DTF scores of the Index of the year in question. It is simply a matter of taking the revised DTF and seeing where that DTF value would have fitted in the ranking. In the case of 2018 with an overall DTF of 51.15, Lao PDR would have fitted between the following two countries: the Marshall Islands with a DTF of 51.45 and ranked 149 and Mauritania with a DTF of 50.88 and ranked 150. On the basis of Lao PDR being removed from the ranking at 141, Marshall Islands would have improved to position 148. Lao PDR would then have ranked according to this reckoning at 149, between the latter and Mauritania.

But we know from the World Bank that the ranking of Laos for the corrected 2018 Index was 151 and therefore this method is always going to be very approximate and should be handled with caution.

With this in mind, in the original 2017 Index, Lao PDR was reported as having an overall DTF of 53.29 with an overall ranking of 139. But the corrected data puts the overall DTF for 2017 at 50.22. This DTF falls between Sierra Leone with DTF at 50.23 and ranking at 148 and Bolivia with DTF at 49.85 and ranking at 149. Using the same argument, if Lao PDR is withdrawn from its position at 139, Sierra Leone would improve by one ranking and, all other things being equal, Lao PDR would have received the ranking of 148. This provides us an idea of what the corrected ranking would be for Lao PDR in the 2017 Index, corrected from 135.

The World Bank does provide the basis for the Corrections, based on the methodology, as will be explained in more detail later. The Global Indicators Group was able to confirm that the revisions were as a result of a visit to Laos in 2018 by a World Bank

Doing Business mission team and it was they who "identified some data revisions to several topics." The Global Indicators Group did not directly answer the question about the reason for the mission team visit except to say that the team visits about 30 countries a year to collect data on the ground and that it is another way of verifying data and getting more information when necessary.

[1] All references to the Global Indicator's Group are to email correspondence.

The Counterfactuals

For those interested in what would have happened if things were different:

If there had been no Correction, based on the slight improvement on its DTF score, in 2019 Lao PDR would probably have fallen to a ranking of 145/146 from 141 of 2018.

If there had been no Correction and Lao PDR had adopted and implemented all the suggestions contained in the ECCIL White Paper of last year, the projected DTF would have given Laos a ranking of 89 in the 2019 Index, according to the current simulator.[2]

Taking the Correction into account, if Lao PDR had adopted and implemented in full all the suggested changes contained in the ECCIL White Paper of last year, based on the simulator the projected ranking achieved in the 2019 Index would have been approximately 111/112.

I. Introduction

For several years, the Prime Minister and Government of Laos have indicated the intention of improving the country's ranking in the World Bank's Ease of Doing Business Index to below 100. The European Chamber of Commerce and Industry in Lao PDR (ECCIL) would like to add its support to this intention and respectfully proposes some suggestions as to how this can be achieved at least in the short term.

This White Paper is intended as an aid for the discussion among officials and stakeholders and to suggest a strategy for improving the position of Laos in the Ease of Doing Business Index to below 100. ECCIL firmly believes this is possible over the next few years despite the World Bank's backdated Correction. In putting forward its strategy, ECCIL does not in any way claim that this is the only strategy or that other strategies are not feasible or possible.

The strategy ECCIL proposed is a short-term strategy. As will become apparent, such a strategy is not intended as a substitute for the development of a long-term strategy but is intended simply as a strategy that can be used while a long-term strategy is being designed and developed, while new legal frameworks and laws are being generated and drafted and new institutions are being developed.

As has been explained in the Preface, this White Paper acknowledges that a backdated Correction by the World Bank explains most of the reason for how Laos finds itself at the position of 154 and that this should not be seen as a drop of 13 places but as a drop of 3 places in the ranking. Those wishing for a more elaborate explanation should read the **Preface** of this white paper.

Instead of examining each and every category and every variable within each category, ECCIL will focus only on those categories that fit the "Low Hanging Fruit" strategy – the low hanging fruit are those low-scoring categories that are easier to improve without too much disruption while remaining within the confines of a short-term strategy. The strategy is intended to be easy to implement, feasible in the short term while having the largest impact for relatively small changes. The changes must cohere with the World

[2] See the next section below for an explanation of the simulator.

Bank's methodology for the Ease of Doing Business Index and must be implemented in a way that they are capable of being captured by World Bank researchers.

The strategy will be to pick categories and indicators within those categories that cohere with the low hanging fruit conditions set out in the paragraph above so that they will require the least amount of disruption in the legislative and administrative landscape. ECCIL leaves alone those several categories where Lao PDR scores relatively well and only concentrates on those areas where changes are really required, easy to find and will reap most benefits in improving the score and ranking in the country's favour.

The Ease of Doing Business Index has a total of 10 categories.[3] The DTF for each category is calculated for each country, thereby allowing each category for each country to be ranked. The overall DTF score for each country is calculated and that provides the ranking for the country in the Index. DTF will be explained later in the next section.

Each category is made up of between two and eight indicators – in total, the 10 categories contain 46 indicators altogether.[4] Each indicator is either measuring some process, such as the amount of time it takes to carry out a particular task or it measures the number of steps in a process or it is calculated based on a series of sub-indicators that measure the quality of a process.

With a total of 46 indicators, to try to tackle each of these indicators would be a huge task. Instead, ECCIL has used the Low Hanging Fruit Strategy to narrow down the number of indicators in the following way. First, ECCIL will leave out all those categories where Lao PDR is already ranking below 100. The idea is that where there is more room for improvement it is easier to gain points without much disruption. Besides, on the basis of averages, it is better to focus on those categories ranking above 100 than below if the point of the exercise is to bring the average or overall ranking to below 100.

One point that may cause confusion for the casual reader of the support materials is that there appear to be eleven topics or categories in the Index. Each year, the World Bank introduces a guest category or topic – in 2019 this is "Labour Market Regulation." But the guest category plays no part in the calculated Index, since it would not be possible to compare the Index year on year if a moveable category kept appearing. Therefore, ECCIL will not be discussing it in the White Paper.

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[3] At least one commentator on the **ECCIL 2018 Ease of Doing Business White Paper** took exception to the use of the word "category." The World Bank used several words in its discussion of the Index and in the Methodology when referring to what ECCIL calls "category;" to avoid confusion, ECCIL picked one word and used it uniformly throughout the paper. The World Bank consistently uses the term "indicator" to refer to those variables contained within categories; ECCIL adheres to that usage. To avoid confusion, ECCIL proposes to continue with the category-indicator usage.

[4] Since Lao PDR scores exactly the same in gender delineated indicators, for the sake of brevity and clarity, ECCIL decided to reduce those two indicators to one.

Guide to the rest of the White Paper

The World Bank's Ease of Doing Business Index is published annually – for the sake of brevity, in this White Paper it will be referred to as the Index. The ten categories that make up the Index are as follows:

1. **Starting a Business**
2. **Dealing with Construction Permits**
3. **Getting Electricity**
4. **Registering Property**
5. **Getting Credit**
6. **Protecting Minority Investors**
7. **Paying Taxes**
8. **Trading Across Borders**
9. **Enforcing Contracts**
10. **Resolving Insolvency**

For the sake of clarity, this White Paper will place the name of every category mentioned in bold.

Each of the categories is made up of a number of indicators – when indicators are mentioned in this White Paper, they will be underlined. Each of these indicators is normalized for easy international comparison; for instance, the category, **Starting a Business,** contains several indicators, such as <u>Procedures</u> (number of procedures required to set up a business), <u>Time</u> (number of days required to set up a business), <u>Cost</u> (the cost of setting up a business stated as a percentage of income per capita for the relevant economy) and <u>Minimum Capital Requirements</u> (also stated as a percentage of income per capita). In each case, the indicators are normalized under specific conditions, invariably according to *standardized case scenarios*, so that they can be fairly and transparently compared across each of the 190 economies in the Index.

Standardized case scenarios are found throughout the methodology of the Index and differ from category to category. For instance, in the category **Resolving Insolvency**, the *standardized case scenario* is as follows:

> "A hotel located in the largest city (or cities) has 201 employees and 50 suppliers. The hotel experiences financial difficulties. The value of the hotel is 100% of the income per capita or the equivalent in local currency of USD 200,000, whichever is greater. The hotel has a loan from a domestic bank, secured by a mortgage over the hotel's real estate. The hotel cannot pay back the loan, but makes enough money to operate otherwise."[5]

[5] Doing Business 2019 Economy Profile Lao PDR, pp. 49. This document can be downloaded from http://www.doingbusiness.org/en/data/exploreeconomies/lao-pdr#DB_ri

Setting out such standard case scenarios that are specific to individual categories makes it possible for the World Bank to create a basis of comparison that is fair across all economies.

Each category is evaluated based on the performance of its indicators, using a scoring system called DTF. For some indicators, the *frontier* is defined as the best performance for that indicator in all the economies in the Index for the past five years or since 2005 and the worst is the worst performance in the past five years or since 2005. Other indicators are evaluated according to a frontier that is the best possible performance for that indicator, even though no single economy has ever achieved that score. And there are other indicators where, due to certain features of the indicator, the frontier definition is a little different.

There is some complicated mathematics required, involving the normalization of indicators and linear transformation, in order to get from the values of indicators to the DTF of a category but these need not detain the reader at this stage. For any economy, each indicator in each category can be shown as a DTF score on a scale of 0 to 100 where the frontier = 100. Clearly, the closer the indicator of an economy is to 100 on the DTF scale, the better the performance.

Using simple averaging of the indicators, the DTF score for the category in an economy can be arrived at. In the same way, the aggregate DTF score for the whole economy can be derived based on the simple averaging of the DTF scores for the ten categories.

All ranking in the Index is based on DTF scores. For instance, how well an economy does in the ranking of a category, such as **Registering Property** in a certain year, will be decided on the basis of how all the other 189 economies performed with respect to their DTF scores for that category. In turn, the overall ranking of all 190 economies is determined by sorting the aggregate DTF scores for all the economies, from 1 (New Zealand) to 190 (Somalia).

References

All information relating to the Ease of Doing Business Index can be found at the following website: www.doingbusiness.org.

References in this White Paper will be made from time-to-time to simulation or to a simulator. This is a Microsoft Excel calculator file containing all the categories and their respective indicators for all 190 economies in the Index for 2019. One can use this as a simulator to show what would have happened if a country had achieved a different score in a sub-indicator or indicator and what effect that would have had on the DTF for the category for that country and for its position in the Index as a whole. The simulator has its limitations as it cannot predict exactly how much improvement there would be in some future Index because it cannot predict competition from other countries in the future in the form of improvements in performance in specific categories or in overall Index rankings and scores. That said, it can indicate where improvements can be gained and where it is likely to achieve gains in the Index. The simulator can be downloaded from http://www.doingbusiness.org/en/data/doingbusiness-score and navigate to the link “Download Doing Business 2019 ease of doing business score calculator (Excel).”

To get information specific to Lao PDR, navigate to the following webpage: http://www.doingbusiness.org/en/data/exploreeconomies/lao-pdr and follow the links. There is a link on that page, “Download Profile,” which is all the detailed information about Laos and how it performed in the Index, category by category and indicator by indicator, in a complete PDF file. Much of the information supplied in this White Paper has its origin in this report and is therefore not individually referenced.

www.doingbusiness.org also contains a wealth of information about the methodology of the Index, how other economies perform and even the history of the Index. There is even a separate section on laws, another for researchers, yet another where one can build one’s own reports, and so on.

Potential Improvements In The Ease Of Doing Business

Since the research for the current Ease of Doing Business Index (2019) was completed before June 2018, there is a possibility that changes are already in place that did not make it into the current Index. At the time of writing this paper, ECCIL is aware of various discussions in that regard. However, ECCIL does not have the resources and is not in a position to check whether any changes or potential improvements have indeed been implemented to the extent that they would be picked up by World Bank researchers. To use an example, even if there is a change of rules or laws that is aimed at reducing the number of procedures in relation to a specific category in the Index, this, in and of itself, does not guarantee that this will be counted as an improvement if the researchers find that the old system is still in use along with the same longer number of procedures.

For these reasons, in the discussion of the current Index and the analysis of the various categories and indicators, ECCIL does not make any comment on improvements that may or may not be in the pipeline or may have been introduced after the research by the World Bank mission was completed.

While ECCIL acknowledges the Correction and that Lao PDR did not fall 13 points in one year, as explained in the **Preface**, it is still mindful of how far the economy has to go in order to attain a double-digit ranking in the Index.

II. Strategy

The situation that Lao PDR finds itself in with respect to the Ease of Doing Business Index is tougher than hitherto understood. But this does not mean that the situation is intractable. ECCIL believes that a strategy, similar to that developed in last year’s White Paper, can also be applied to improve the current situation.

In the 2018 White Paper, ECCIL outlined a short-term strategy for improving the position of Lao PDR in the Index. By short-term is meant the kind of measures that could be taken in the short-term without too much disruption. Of course, this does not mean that long-term planning and strategy should be ignored. In fact, ECCIL is of the firm opinion that if long-term planning is ignored, that the gains from any short-term strategy will eventually be eroded through competition from other countries. ECCIL is also of the strong belief that long-term strategies require time to develop – while those long-term strategies are being developed, some simpler short-term measures, such as the ones proposed in this document can be implemented to improve the business climate for investors and improve the Lao position on the Index.

This document will not repeat the methodology discussion in the 2018 White Paper.[6] However, it will be undertaking the same low hanging fruit strategy. In effect, this is to try to reduce the number of topics/categories and their respective indicators to a more manageable number. As before, only those categories/topics that rank above 100 will be chosen for consideration – this is based on the fact that if the average of all ten categories is brought to below 100, the overall ranking will be brought to below 100, the desired "double-digit" position on the Index.

The differences between the 2018 White Paper approach and ECCIL's strategy as set out in this document is twofold: first, not all the categories chosen will be the same – as shown in Table 1, there were two categories that actually benefited from the Correction, one markedly so. Four categories deteriorated under the Correction, three rather spectacularly. They will need special attention. And four categories did not change.

Table 1

Categories	**Rank 2019**	**DTF 2018 originally reported**	**DTF 2018 Corrected**	**DTF 2019**
1) Resolving Insolvency	168	0	0	0
2) Protecting Minority Investors	174	31.67	31.67	31.67
3) Starting a Business	180	72.56	60.88**	60.93
4) Getting Electricity	156	52.65	52.64	52.77
5) Paying Taxes	155	54.18	54.18	54.22
6) Trading Across Borders	76	62.98	77.67++	78.12
7) Enforcing Contracts	162	55.22	41.99**	41.99
8) Getting Credit	73	55	60.00+	60
9) Registering Property	85	69.55	64.92*	64.93
10) Dealing with Construction Permits	99	75.25	67.57**	67.94
Country Aggregate	154	53.01	51.15	51.26
* = Correction, ** = severe Correction + = improvement, ++ = marked improvement				

[6] The 2018 White Paper can be found on the ECCIL website: www.eccil.org

Adopting the same low hanging fruit strategy, all categories ranking above or close to 100 will be chosen. Table 2 below contains all seven categories that ECCIL's low hanging fruit strategy will focus on.

Table 2

Categories	**Rank 2019**
1) Resolving Insolvency	168
2) Protecting Minority Investors	174
3) Starting a Business	180
4) Getting Electricity	156
5) Paying Taxes	155
6) Enforcing Contracts	162
7) Dealing with Construction Permits	99

III. Analysis: Seven Categories

In this section, the seven categories targeted under the low hanging fruit strategy will be analysed in turn. The approach is to find those indicators or sub-indicators where relatively easy gains can be made according to the strategy. Although readers of the 2018 White Paper will recognise some similarities in approach, since on this occasion the distance between 154 and 100 is greater than 141 and 100, greater efforts have to be made to find gains that will drive the rankings down further.

Combing through the seven categories targeted, it must be borne in mind that the low hanging fruit strategy requires that the number of indicators targeted must also be reduced.

Resolving Insolvency: The ranking of this category for Laos at 168 hides the fact that a number of economies share this ranking and DTF of zero; therefore 168 is the worst ranking for this category. Laos' DTF for this category (at zero) and position at the bottom of the ranking in this category has remained unchanged for a number of years.

As outlined in last year's White Paper, the DTF for this category is based on two indicators, Recovery Rate and Strength of Insolvency Framework. The overall Recovery Rate indicator is based on several sub-indicators, namely *time* (the amount of time it takes for an insolvency case to be resolved), *cost*, *outcome* (whether piecemeal outcome or possible 'going concern' outcome) and *proceeding* (whether there are any possible proceedings for insolvency cases.)

The value of the Recovery Rate indicator is assessed at zero – the explanation from the assessors is as follows:

> "According to the research conducted by the team, there were no foreclosure, liquidation or reorganization proceedings filed in the country in the last 12

months. Due to this circumstance, it is not possible to assess the time, the cost or the outcome associated with the insolvency scenario described in the case study."[7]

In the case of the indicator, Strength of Insolvency Framework, Laos scores 4.5 points because some legal remedies are available, such as reorganization or access to liquidation proceedings. But Laos cannot avail of these points because of a special condition, as follows:

> "Even if the economy's legal framework includes provisions related to insolvency proceedings (liquidation or reorganization), the economy receives 0 points for the strength of insolvency framework index, if time, cost and outcome indicators are recorded as "no practice."[8]

How to get out of this quandary and at least reap the benefits of the few points that Lao PDR does score has been the focus of the ECCIL approach. At the time of writing the 2018 White Paper, ECCIL understood that there had been some insolvency cases and that the problem was that because no cases were recorded, the World Bank researchers would have no choice but to record the result "no practice." Since then, there has been a number of discussions among lawyers and others suggesting that there had been no actual or documented cases.

Taking the worst possible scenario that there have been no actual or documented cases, ECCIL would suggest that the authorities look to apply the insolvency framework in the case of dormant companies that owe taxes and other fees to government (including local government). This would have the benefit of generating insolvency cases where the owner of such a company will either decide to pay up or relinquish the company. This would have the added benefit of removing dormant companies from the company register so that they do not become useful for fraudsters or money launderers.

As also mentioned in the 2018 White Paper, a permanent registry should be set up of insolvency cases, including a listing of filing for corporations that have been made bankrupt, struck off, liquidated or placed in insolvency by way of court case, through agreement or mediation such as through the Centre for Economic Dispute Resolution.

If these changes are made and Lao PDR is able to show even a tiny Recovery Rate of 15% along with 4.5 points for Strength of Insolvency Framework, the ranking for the category **Resolving Insolvency** will improve from 168 to 163. But more surprising, the simulator calculates that these changes alone would improve the country's overall ranking from 154 to 146.

Protecting Minority Investors: This category examines what would be the legal situation for minority shareholders of a company if that company were to purchase significant assets from another company where one individual is both a majority shareholder and CEO in the purchasing company as well as being the majority shareholder in the selling company.

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[7] Click on the link, **Details – Resolving Insolvency in Lao PDR** on the webpage: http://www.doingbusiness.org/en/data/exploreeconomies/lao-pdr#DB_ri

[8] Clink on the link, **Details – Resolving Insolvency in Lao PDR – Measure of Quality** on the webpage: http://www.doingbusiness.org/en/data/exploreeconomies/lao-pdr#DB_ri

The category looks at a number of indicators, including Disclosure (whether and to what extent the majority shareholder/CEO has to disclose the conflict of interest under the law), Director's Liability (whether and to what extent shareholders can take action against the CEO), Shareholder Suit Index (ease of taking a legal case against the CEO including access to documentation and repayment of legal expenses if successful), Shareholder Governance, Shareholder's Rights and Corporate Transparency.

Looking at the indicators, the worst performing for Laos are Director Liability (scoring 1 out of a possible 10), Corporate Transparency Index (1 out of 10) followed by Shareholder Suit Index (3 out of 10).

Taking the worst performing indicators first, the reason that Director's Liability does not score higher is that there is very little recourse for a minority shareholder to gain redress when the company has been damaged due to actions by a CEO/majority shareholder in a conflict of interest situation.

Although shareholders of 10% or more can sue directly or derivatively for damages, neither the director in conflict nor the other directors can be held liable for the damages, the majority shareholder cannot be made to pay restitution to the company nor pay over profits made on the other side of the transaction. In addition, only in cases of fraud or bad faith can the transaction be voided by the courts. Nor can the courts imprison, fine or disqualify the conflicted CEO/director in question for his or her actions.

Clearly, the way to score more points in such indicators as Director's Liability is to remedy such legal deficits. This indicator only scores 1 point for allowing shareholders of 10% or more to sue for damages and Lao PDR currently scores no further points under this indicator. For instance, if the minority shareholder could hold the director in conflict liable for damages, that would add 2 points to the indicator. If other directors could be held liable for damages, that would add a further 2 points. Another 2 points could be earned if a court could void such a transaction upon successful claim by shareholders and so on.

Simply making all directors in a company liable for supporting transactions that damage the company when there is a conflict of interest would generate 4 points alone.

The Corporate Transparency indicator scores only one point for the rule that members of the company must meet at least once a year. Because there are no requirements in Lao PDR for companies to disclose to shareholders stakes in other companies, details about directors (such as their main employment or other directorships) or compensation of individual managers, the country loses one point for each of these under this indicator. In addition, because there is no requirement for annual audited accounts by an external auditor, nor the distribution of such audited accounts, further potential points are not earned. The same is the case with the lack of requirement for 21 days detailed notice of general meetings of shareholders and the lack of ability of 5% shareholders to put items on the agenda of such meetings.

It would not be difficult to gain 4 additional points under this indicator – simply by requiring companies to let shareholders know about additional stakes, other directorships/employment by directors and compensation of senior managers along with insisting on the provision of 21 days of general meetings with details would be sufficient for 4 additional points, thereby generating 5 points in total under this indicator.

Although Lao PDR performs slightly better under the Ease of Shareholder Suits indicator (scoring 3 out of 10), this category contains several opportunities for picking up extra points. One of the subcategories where Lao PDR scores zero is: “Can the Plaintiff (shareholder) obtain any documents from the defendant and witnesses at trial?” – because the answer is no, three points are lost. A similar question about categories of documents without specifying the documents also received a negative answer and a zero score. Because direct questioning of witnesses and defendant is not allowed, another point is lost (Laos scores only one point for allowing preapproved questions). Clearly some small changes in court procedures would allow Lao PDR to score addition points under this indicator – it should be possible to obtain two points simply by changing the subcategory regarding obtaining documents at trial to a more positive if even conditional one. For the moment ECCIL will assume that this indicator score can be raised from 3 to a score of 5.

As set out in the previous paragraphs, if the indicators Director Liability and Corporate Transparency move from scores of 1 to 5 and raise the Ease of Shareholder Suits from 3 to 5, the outcome will be an improvement of the ranking of the **Protecting Minority Investors** category from 172 to 119.

Starting a Business: This is a very straightforward category where the DTF calculation is based on three variables; Time (the number of days it takes to complete all procedures), Procedures (the number of separate procedures required to be completed) and Cost (includes all official fees and fees for legal or professional services if such services are required by law or commonly used in practice). All of these indicators have increased dramatically and will be examined in turn. One indicator, Paid In Minimum Capital, remains at zero despite the Correction and will be ignored in the analysis as, at zero, it cannot be improved.

The indicator, Procedures, increased from 8 to 10 because of the Correction. The following is a list of the procedures that the World Bank mission discovered in Lao PDR – items 1 and 5 are additions to what has been a list of 8 before the Correction.

1. Obtain Business location confirmation from Village Chief [new]
2. Application for name reservation and enterprise reservation certificates[9]
3. Register the articles of association
4. Apply for tax registration certificate (this step requires 12 sets of documents)
5. Attend tax orientation meeting and obtain Tax Identifier Number (TIN) [new]
6. Company Signage Approval from the Ministry of Information, Culture and Tourism
7. Carve a company seal
8. Register Company Seal at Ministry of Public Security
9. Register Workers for Social Security

[9] According to a Ministry of Industry and Commerce **Notification** dated May 19, 2017, the requirement for separate name reservation certificate and enterprise reservation certificate has been removed in favor of the new “Enterprise Registration Application Form.” However, the World Bank researchers reported that the separate name reservation and enterprise reservation certificates were still required. It could be that the office the researchers approached was still applying the old system.

10. Register for VAT

As mentioned in last year's White Paper, how other countries get much higher rankings in this category is to simply reduce the number of procedures and the amount of time required for the whole process through a mixture of streamlining the process and incorporating information technology. Given the additional steps identified by the World Bank mission this year, it would also make sense to adopt the following dual strategy, which is to <u>integrate procedures</u> and/or <u>remove all procedures that are not absolutely necessary to the setting up a business</u>.

Take for example, Singapore. They have reduced the number of procedures required to setting up a business to 2 steps, as follows:

1. Online registration for business name, company incorporation and tax number. Name reservation is easy because it is automated – it is impossible to reserve a name that is highly similar to that of another business on the IT system. There is no need to register with the tax authority as the system automatically does that for the new business automatically. The process usually takes up to an hour.
2. Company seal is not mandatory but many corporations prefer one. It takes several days although an express service is available to complete it in one day.
3. Sign up for employee compensation insurance according the laws of Singapore. The process takes less than one day.

Since step 2 is not mandatory, only 2 procedures are counted. Because the whole process takes less than several days and only requires 2 steps, Singapore has achieved 3 in the ranking for this category in 2019. It has done so by integrating procedures and removing all procedures that are not absolutely necessary for setting up a business.

For instance, Singapore does not make attendance at a tax orientation meeting a condition of starting a business. But this does not mean that Singapore cannot impose such a condition on companies after the fact – for instance, Singapore can incorporate into its laws that either one company manager or the owner must attend tax orientation meetings or the company must employ auditors /tax advisors who have already attended the tax orientation meetings <u>as long as this is not a condition for starting a company</u>. But once a procedure or step is conditional for setting up of a business or conditional on one of the steps necessary to setting up of a business, it will be included in the list of procedures in the **Starting a Business** category of the Ease of Doing Business Index.

The next step is to see how it is possible to integrate procedures so that a number of procedures can be reduced to one or two. For instance, while Laos separates application for name reservation/enterprise reservation certificates, registration of articles of association, tax certification application, TIN application and attendance at tax orientation meeting and VAT registration into 5 separate steps, these are all integrated into one single step by Singapore simply by using electronic and administrative measures. The same application form, whether electronic or paper, can be used for name registration and company incorporation and then forwarded to the tax authorities for tax registration, generation of TIN and VAT registration.

In addition, there is no reason to insist on company signage as a condition of setting up a business. Some companies do not need signs – for instance, e-commerce companies rely on websites. The logical time to discuss signs is when the company has received its permission to operate rather than before.

The question that policy makers have to answer is which procedures they wish to integrate and which they wish to relinquish until after a business has been set up. Last year, ECCIL recommended that company seal carving and company seal registration should also be integrated. Same with integration of registration of VAT with application for tax registration which could be combined with registration of company name and articles of association. In the case of the latter process, the registration of name and articles of association should trigger tax and VAT registration.

What follows is the revised Procedures indicator list proposed by ECCIL:

1. Obtain Business location confirmation from Village Chief
2. One Stop registration of company name, articles of association and tax/VAT
3. Obtain a company seal (carving and registration)
4. Register workers for social security.

Item 1 is included only because it is necessary to ensure that the applicant is who he or she claims they are. As soon as an alternative system can be arrived at (such as a national ID card system backed with biometrics), this seems to be the only sufficient way to establish identity in Lao PDR.

Item 2 involves the integration of items 2, 3, 4, 5 and 10 in the original Procedures indicator for Lao PDR. Item 3 involves the integration of the carving and registration of the company seal.

Item 4 is included as in the original list of procedures. However, an argument could be made that this item should not be included in the proposed list. Many start-ups start much smaller in terms of employees and insisting on numbers and names of employees before even starting is problematic for many companies. If policy makers are really concerned about registration of workers for social security, they should check companies long after they have set up as that is when there are more likely to be discrepancies.

Although integration of steps is possible through purely administrative means, it makes much more sense to do using electronic means. Sometimes the electronic resources that are already available are surprising. For instance, it is already possible to check the website of the *Enterprise Registration Department* to search for an existing business name online; therefore, there is no reason that officials at that office cannot check instantaneously whether a particular company name is in use already or not.

Integration of steps and elimination of steps means that applicants do not have to spend time making separate applications at many different offices. In many cases, the World Bank mission found that once one procedure was complete, the paperwork was handed back to the applicant who then had to apply to a separate part of government for the next step. For example, when the Enterprise Registration Certificate is issued, the relevant local Department for Industry and Commerce issues to the applicant a letter for the tax authorities and a letter for the Public Security Office regarding the company seal. In many respects, it would be perfectly possible for the original receiving department to approve the paperwork and pass it directly to that next part of government without the applicant having to be directly involved.

Below is the estimated amount of time associated with each step.

1. Obtain Business location confirmation from Village Chief [1 day]
2. Application for name reservation and enterprise reservation certificates [2-3 months]
3. Register the articles of association [1 week]
4. Apply for tax registration certificate [1 month]
5. Attend tax orientation meeting, obtain Tax Identifier Number (TIN) [1 month]
6. Company Signage Approval from Ministry of Information, Culture and Tourism [1-2 weeks]
7. Carve a company seal [2 weeks]
8. Register Company Seal at Ministry of Public Security [1-2 weeks]
9. Register Workers for Social Security [1 week]
10. Register for VAT [2 weeks]

Some of these steps will take place in parallel – the World Bank mission estimated that the total amount of time measured in calendar days was 174 days. By reducing the number of steps to four, the amount of time required would be significantly reduced.

The most time-consuming step was the application for Enterprise Registration Certificate. It is unclear why this must take between 60 and 90 days – there is no reason why, properly resourced, that this process cannot be done within one month. As mentioned earlier, it is possible to check online on the website of the *Enterprise Registration Department* whether there is already a business registered with a highly similar name and therefore checking whether there are businesses with similar names should not take long periods of time. Applicants should be made aware of this publicly available resource so as to reduce possible delays.

Based on ECCIL's recommendations regarding the elimination of unnecessary steps and integration of steps, ECCIL recommends that the processes be streamlined, as follows:

1. Obtain Business location confirmation from Village Chief [1 day]
2. One Stop registration of company name, articles of association and tax/VAT [30 days maximum]
3. Obtain a company seal (carving and registration) [7 days]
4. Register workers for social security [7 days]

Based on these recommendations by ECCIL, this would reduce the number of days for the indicator Time to 45, the same as that recommended last year. The number of steps in the indicator Procedures is proposed to be 4, again same as last year's recommendation. Reducing Time to 45 and Procedures to 4 will improve the DTF for **Starting a Business** from 60.93 to 83.58 and the ranking for this category from 180 to 114.

Getting Electricity: This category was improved by the Correction of DTF from 44.19 to 52.77 – the category ranking is currently, after Correction, at 156. The category is made up of four indicators – Procedures, which is the number of steps required to acquire electricity for a warehouse in the economy, Time, which is the amount of time required for the whole set of processes, Cost, stated as a percentage of income per capita in the economy and Reliability of Supply and Transparency of Tariff, which will be explained separately.

The World Bank provides an analysis of each of the procedural steps and the number of days required for each step, as follows:

1. Obtain location clearance from Village Chief Authority – 1 day
2. Submit application to utility company and await estimate and technical specifications – 5 days (was 37 days before Correction)
3. Receive site inspection by utility company for preparing technical specifications – 32 days (was 1 day before Correction)
4. Await preparation and approval of detailed technical design and installation plan – 30 days
5. Await completion of external works by electrical contractor – 30 days (was 60 days before Correction)
6. Testing of voltage transformer by utility company – 1 day
7. Receive external inspection by utility company and then electricity flow – 7 days

Clearly there are too many procedural steps in this category; some it would appear involve duplication of processes - for instance, technical specifications/detailed technical design appear in steps 2 and 3 and 4 above and will be incorporated into step 5. There is no reason why steps 2 and 3 could not be integrated and 4 and 5 integrated into two single steps. This means that the number of procedures could be reduced easily to 5.

The indicator Time has improved somewhat to 105 days post Correction. But it still requires attention. Other countries are able to do far better in this category. For instance, Vietnam is able to provide electricity using only 4 steps in a total of 31 days. ECCIL proposes that in the short-term Laos should be able to reduce the number of steps to 4 and the number of days to 74, in the following way:

1. Obtain location clearance from Village Chief Authority – 1 day
2. Submit application to utility company, site inspection, technical specifications and estimate – propose 25 days
3. Prepare and approve technical design and installation and complete external electric works by contractor – propose 40 days
4. Testing of voltage transformer by utility company – 1 day
5. Receive external inspection by utility company and then electricity flow – 7 days

The Reliability of Supply and Transparency of Tariff indicator is made up of the following sub-indicators:

Duration and Frequency of Outages (0-3) – Laos earns one point out of a max of 3. This would require the utility provider to become more efficient in making sure that there were fewer outages.

Mechanisms for Monitoring Outages (0-1): Laos earns zero points because there are no automated tools for monitoring outages
Mechanisms for Restoring Service (0-1): Laos again earns zero points because there are no automated tools for restoring service in the event of an outage.
Regulatory Monitoring (0-1): Because there is no regulator that is independent of the utility to monitor performance and reliability of supply, Laos earns zero points.
Financial Deterrents Aimed at Limiting Outages (0-1): Because the utility does not pay compensation to customers or face a fine by a regulator when outages reach a certain cap, Laos earns zero points for this sub-indicator.
Communication of Tariffs/Changes (0-1): Here Laos earns the available point because it makes the current tariff available online and makes the changes in tariff available ahead of time.

Out of a maximum of 8 points, Laos manages to earn only two points in the Reliability of Supply and Transparency of Tariff indicator. But without much disruption, points could be easily picked up through ensuring a) the introduction of automated tools for monitoring outages b) instituting an independent regulator to monitor the utility's performance and reliability of supply and c) instituting a system of fines when outages reach a certain cap. In this way, Laos could easily add another three points to its existing two points, making a total of 5 points, bringing it closer to neighbours like China who earns 6 points under this indicator and Vietnam who earns 7 points under this indicator.

ECCIL has consciously not called for the reduction of the value of the Cost indicator – before the Correction, this was listed as 1,132.5 (stated as a percentage of income per capita), then corrected in 2018 Index to 806.2 and now in 2019 Index listed as 763.4.

By reducing Procedures to 5, Time to 74 days and increasing Reliability of Supply and Transparency of Tariff indicator to 5 points, this would yield a DTF of 73.85 and a ranking for the category **Getting Electricity** of 87.

Paying Taxes: This category is somewhat confusing – on the simulator Excel sheet, there are eight indicators listed. But in fact several of those are really sub-indicators, as will be explained.

There are really only four independent indicators in the **Paying Taxes** category; here they are with their respective values for Lao PDR:

Payments: 35 (number)

Time: 362 (hours)

Total Tax/Contribution Rate (as % of profit): 24.1% - this refers to the percentage of profits

Post-filing Index: 18.57

The indicator, Payments, simply refers to the number of individual payments of various taxes paid by a business each year. This is high for Laos because VAT and social security contributions are paid monthly – together that generates 24 instances of payments for the average company. Many countries have monthly payments for VAT and other taxes but score better on this indicator – this is because of how the Index measures frequency of payments when electronic payments and filing are used, as the following quotation from the Methodology notes for this category shows:

"Where full electronic filing and payment is allowed and it is used by the majority of medium-size businesses, the tax is counted as paid once a year even if filings and payments are more frequent."[10]

If Lao PDR were to allow electronic filing and payment, **even for medium-sized businesses only**, the Payments indicator would be reduced to 10 (Lao companies pay 10 types of tax and, with electronic filing, each would count as being paid once per annum). Clearly this has not happened yet, at least not in time for the completion of the research that went into the 2019 Index, which was completed before June 1st, 2018.

The next indicator, Time, refers to the number of hours spend on preparing, filing and paying three major types of tax, VAT (182 hours), Corporate Tax (138 hours) and Labour Taxes (including payroll and social contributions = 42 hours) – making a total of 362. Time also includes the amount of time spent filing documents and paying these taxes.

Clearly, an electronic system would greatly reduce the amount of time spent on paying taxes. All the filing could be done online while the payment could be made via a bank – a code system could ensure that the tax authorities would know that the tax had indeed been paid on the documents filed online.

With an electronic and online system, taxes could be deposited at the bank or paid electronically from the company's bank account into the tax authority's account. Assuming that the taxes are physically deposited at the bank, depositing VAT should take two hours each month (equal to 24 hours per annum). Assuming that it takes about five hours to prepare the documentation per month (60 hours per annum) and an hour each month to electronically file, (12 hours per annum), per year the total hours for filing VAT would be 96 hours.

According to the type of company selected according to the standardized case scenario used for this category by the World Bank, corporate tax is paid four times per annum. Let's assume that it takes ten hours to calculate corporate tax on each occasion and the same amount of time to deposit the amount in the bank as with VAT plus the same amount of time to file. Altogether, that would amount to 13 hours at four times per annum which would equal 52 hours.

As regards Labour Taxes, the hours are not too high at 42 if it is assumed to take 2 hours to deposit the taxes at the bank and another hour every month to file the taxes, accumulating to 36 hours with a few extra hours to deal with changes in personnel from time to time, yielding 42 hours per annum.

By incorporating electronic filing, the new total for the Time indicator (96+52+42) would be 190 hours.

On their own, these changes will generate a large improvement in the ranking of Lao PDR – in the **Paying Taxes** category, the ranking will improve from 156 to 95.

[10] http://www.doingbusiness.org/methodology/paying-taxes

The Total Tax/Contribution Rate will not be addressed because 24.1% is a very good number - it is on par with many developed countries, including neighbouring countries.

Both indicators, Time to comply with VAT refund and Time to obtain VAT refund, are listed as *No Refund.* According to the World Bank's Ease of Doing Business Methodology:

"If an economy has a VAT but the ability to claim a refund is restricted to specific categories of taxpayers that do not include the case study company, the economy is assigned a score of 0 on the distance to frontier score for time to comply with VAT refund and time to obtain VAT refund."[11]

The case scenario used by the World Bank in the **Paying Taxes** category involves a company that does not participate in foreign trade. According to the "measure of quality" in the relevant web page covering the **Paying Taxes** category for Lao PDR,[12] a VAT refund process for the type of company cited is said not to exist – VAT refunds can only be obtained by "international traders and others," as reported by the World Bank researchers.

VAT refunds are specifically available in Lao PDR, according to the *Instruction of the Minister of Finance on the Implementation of the Law on VAT of 11 Jan. 2017*. But they do not cover the type of situation envisaged by the World Bank, as per the methodology for this sub-indicator, as the following example involving an Albanian company demonstrates.[13]

In this explanatory example provided by the World Bank, a company buys a machine for 27,782,013.88 Albanian Lek. This is its capital purchase on which it pays VAT at 20% of ALL5,556,402.78. In the same year, it buys raw materials to the value of ALL31,165,720.70 and pays VAT at 20% on those materials equivalent to ALL6,233.144.14.

According to the generally accepted international rule that the World Bank is appealing to in the VAT related sub-indicators, if a company pays out more VAT on inputs than it collects on sales, the excess payment is expected to be refunded. Since the company has paid out VAT on inputs of ALL11,789,546.92 and has only received ALL7,479,772.97 on its sales, the company is due a VAT refund of ALL4,309,773.95.

However, the World Bank mission found that Lao PDR does not adhere to this international norm in relation to VAT refunds and therefore the sub-indices *Time to comply with VAT refund* and *Time to obtain VAT refund* are set to "no refund."

[11] http://www.doingbusiness.org/methodology/paying-taxes
[12] http://www.doingbusiness.org/data/exploreeconomies/lao-pdr#paying-taxes
[13] This example is found at http://www.doingbusiness.org/en/methodology/paying-taxes

	VAT rate *R*	Output VAT *R x Sales*	Input VAT *(R x A + R x B)*
Sales = ALL 37,398,864.84	20%	ALL 7,479,772.97	
Capital purchase (A) = ALL 27,782,013.88	20%		ALL 5,556,402.78
Raw material expenses (B) = ALL 31,165,720.70	20%		ALL 6,233,144.14
VAT refund *(R x A + R x B) – (R x Sales)*			ALL 4,309,773.95

Source: Doing Business database.
Note: ALL is Albanian lek.

It is very difficult to say now how Lao PDR would perform with respect to the two VAT refund indicators but let us base our estimates on the Thai experience in this area. Under the indicator Time to Comply with VAT Refund, Thailand scores 16 (hours); under the indicator Time to Obtain VAT Refund, Thailand scores 33.2 (weeks). Given that Lao PDR will have little experience with VAT refunds, let us assume that these take a little longer at least in the initial years and estimate Laos to score 20 (hours) under the indicator Time to Comply with VAT Refund and 40 (weeks) under the indicator Time to Obtain VAT Refund.

No further improvements will be sought in this category. The indicators, Time to comply with corporate income tax audit at 16 (hours) and the Time to complete a corporate income tax audit at 31.7 (weeks) are not extraordinarily high although they could do with some improvement. An electronic filing system could be used to improve these indicators too.

The Post-Filing Index indicator is based on four sub-indicators in the **Paying Taxes** category, Time to comply with VAT refund, Time to obtain VAT refund, Time to comply with corporate income tax audit and Time to complete a corporate income tax audit. In effect, the Post Filing Index is the simple average of the distance-to-frontier scores for each of the four indicators. Thankfully, this rather complex calculation is done for us automatically in the Simulator; the Post Filing Index moves from 18.57 to 40.81 as a result of the improvements made in the and VAT and corporate tax sub-indicators outlined above.

To sum up ECCIL's recommendations in this category, it is suggested that policy makers adopt an electronic system of tax filing for medium and large companies and thereby reduce the value of the Payments indicator to 10, as outlined above. Electronic filing for such companies would also allow the reduction of the value of the Time indicator to 190 hours. The Post-Filing Index indicator moves to 18.57, subject to changes in the VAT sub-indicators that are based on well-founded assumptions cited above.

All the changes suggest in this section for the **Paying Taxes** category would improve the DTF to 70.19 and improve the category ranking to 104.

Enforcing Contracts

This category is concerned with a typical dispute between two businesses that ends up in court. It is based on only three indicators: Time (the amount of time it takes to go through the entire legal process to enforce a contract), Cost (total costs including lawyer fees to run the case expressed as a percentage of the total claim value) and Quality of Judicial Process (an indicator that takes in various aspects of the efficiency and effectiveness of the court and legal processes).

This category has been hugely affected by the Correction – in the 2018 Index before Correction, the category ranked at 97 with a DTF of 55.22. The current 2019 Index after Correction records a DTF of 41.99 and a ranking of 162.

Taking the Cost indicator first, in Laos this is made up of lawyer fees (27.9%), court fees (1.4%) and enforcement fees (2.3%). Clearly, on the state component (court and enforcement fees) in such costs, which amounts in total to 3.7%, there is not much room for reduction and any reduction would not be productive in helping to improve the ranking or DTF for the economy. In the short term, there is not a lot that an economy can do to reduce lawyer costs either; therefore ECCIL has decided not to comment on this indicator.

Compared to other countries, the Time indicator for Laos is very high at 828 days. What follows is the breakdown between the amount of time a case of enforcing a contract takes in Vietnam and Laos:

Time Indicator	Vietnam	Lao PDR	Proposed Lao sub-indicators
Filing and Service	50	119	60
Trial and Judgement	200	344	230
Enforcement of Judgement	150	365	160
Total Value of Indicator Time	**400**	**828**	**450**

Having to wait almost two and a half years for resolution of a legal case is not conducive to good business and attracting quality foreign investors to the country. It should be possible to speed up such cases so that they are completed with 450 days, along the lines suggested above and in keeping with neighbouring countries such as Vietnam.

The area where Lao PDR can make huge improvements in this category is in the Quality of Judicial Process indicator – the Lao score is 3.5 out of a possible 18 points.This score does not compare well with Vietnam (7.5) and Thailand (8.5). This year, China scored 15 under this indicator. There are many areas where Laos could easily find additional points and generate a better DTF and ranking for the category overall.

The Quality of Judicial Process indicator is made up of four sub-indicators each with their score ranges in brackets followed by Laos' actual scores, as follows:

Court structure and proceedings (-1-5) 1.0
Court automation (0-4) 0.0
Alternative dispute resolution (0-3) 2.5
Case management (0-6) 0.0
Quality of Judicial Process (18) 3.5 [total of all four sub-indicator values]

Taking the first sub-indicator, *Court Structure and Proceedings*, Laos scores only one point for allowing pre-trial attachment but loses out on four other possible points by not having a small claims court, a commercial court and not having cases assigned randomly to judges. By allowing for a court dedicated to commercial cases, Laos would get an additional point. Under this section, Laos loses another point by not having judges randomly assigned to cases. Again another easy point lost for Laos.

Laos also fails to get any points out of a possible four points under the heading of *Court Automation* because of the lack of any electronic platform, including the lack of publication of judgements. Laos also does not earn up to six points under the heading of *Case Management* because of an absence of effective time standards for court events, lack of caps on adjournments, no pre-trial conferences, no court performance records and no electronic case management tools for judges or lawyers. ECCIL acknowledges that in at least some cases electronic solutions are long term measures but they will be required if Laos is to be able to achieve and stay at a double-digit position in the Index.

The one area where Laos has done reasonably well in this indicator is under the heading *Alternative Dispute Resolution*.

To sum up, Laos should easily be able to pick up two points under the Quality of Judicial Process Indicator (making the score 5.5 instead of 3.5). Taken in conjunction with an improvement of the Time indicator to 450, these measures alone would improve the rating for the Enforcing Contracts category to 103 and the DTF to 56.02.

Dealing with Construction Permits: In the 2018 White Paper on the Ease of Doing Business Index, the indicator, **Dealing with Construction Permits,** was not included in the ECCIL strategy because it was ranked at 40 and its DTF was 75.25. In the current 2019 Index, its ranking was corrected to 99 and its DTF corrected to 67.94.

The DTF value of the category, **Dealing with Construction Permits**, is derived from four indicators; Procedures (12 - number of steps required to legally build a warehouse of specified dimensions), Time (92 - the amount of time in days it takes to process all the procedures), Cost (4.9% - the total payments required to complete all procedures, stated as a percentage of the total cost of the building) and Building Quality Control

Index (6.5 out of a possible 15 points - an assessment of building quality issues that will be discussed in more detail below).

To clarify the situation, each of the steps in the indicator Procedure have been set out

	Procedure	Time to complete	Cost
1	Obtain a Soil Test from the State Enterprise	11 days	LAK18,451,948
2	Obtain Neighbor's Consent for Construction	5 days	No charge
3	Hire Engineer to conduct building inspection	1 day	LAK22,860,429
4	Purchase Application Forms for Building permit	1 day	LAK 25,000
5	Request/obtain residence certificate from village chief	1 day	LAK 30,000
6	Submit building permit application to the District Construction Division	1 day	No charge
7	Receive setting-out inspection from Department of Urban Planning & Environment	1 day	No charge
8	Obtain building permit from Vientiane Capital	30 days	LAK 3,251,500
9	Receive half completion inspection from Department of Urban Planning & Environment	1 day	No charge
10	Request and receive final inspection from Committee for Management of Construction	1 day	No charge
11	Request and receive connection to water and sewage services	45 days	LAK 3,000,000
12	Obtain certificate of completion of building works	7 days	No charge
	Total Time and Costs	105 days	LAK47,618,877

in a table below along with their associated time and cost elements.

Viewed in the table above, it is clear that while most of the procedures listed are most likely necessary, there are still some relatively straight-forward improvements that will conform to the ECCIL Low Hanging Fruit strategy. One procedure step that is arguably not necessary is item 4, Purchasing forms for application for a building permit. This only adds to the bureaucracy and loses points under this indicator. It can be abolished by making the form available online or integrated it somehow into item 6.

The total time for all procedures at 105 days is greater than that recorded under the Time indicator value, 92, because some of the procedure steps can take place simultaneously and the World Bank researchers take this into account. Time could always be improved but when compared with the category, **Getting Electricity**, the World Bank mission found that it is currently quicker to process all the planning and construction permits for a warehouse in Lao PDR than to get electricity for the warehouse.

The value of the Cost indicator is high – at LAK47,618,877 which is almost $5,568 or 4.9% of the total cost of the building. In Cambodia, the same Cost indicator is valued at 3.3% of the total cost of the building which is still high when compared with Thailand and Vietnam which are both at 0.7% of the total cost of the building.

Taking Thailand first, although Thailand lists a total of 19 steps under its Procedures indicator, it only charges a total of 6,000 baht for the soil test, 2,601 Baht for the building permit application and 20 Baht for the final occupancy permit with all other steps being free of charges – in Lao Kip, the total cost amounts to approximately to the equivalent of LAK16,217,000, a third of the total cost charged in Laos.

In Vietnam, there are 10 procedures with the only significant charges being Water and Sewage Connection request (VND 4million) and Registration of the Building with the Department of Natural Resources and Environment (VND 13million). The total cost amounts to the equivalent of LAK6,400,000, approximately 28% of the cost in Lao PDR.

The two most expensive items in the case of Laos are the soil test and the mandatory engineering inspections. At least two million should be cut from the soil test to make it compatible with what is charged in Bangkok, a city with much larger costs than in Vientiane. While engineering inspections are important, especially for large buildings, the cost is too high and some way must be found to reduce it. In Vietnam, the state provides the inspection without charge (or the charge is rolled into the other charges). In Thailand, the inspections are random and regular to ensure that construction laws and regulations are being followed. It is expected that the construction company has a construction supervisor who has sufficient engineering skills and qualifications to supervise the site. For now, ECCIL will not propose how to reduce this cost but it is something that policy-makers should look into to try to improve the DTF of this category.

That leaves the Building Quality Control Index. This indicator carries a number of sub-indicators each of which are scored according to a series of questions. The sub-indicators are as follows:

Sub-Indicators		Results Range	Laos Scores 2019
1	Quality of building regulations	0-2	0
2	Quality control before construction	0-1	1
3	Quality control during construction	0-3	2
4	Quality control after construction	0-3	3
5	Liability and insurance regimes	0-2	0.5
6	Professional certifications	0-4	0
Total	**Building Quality Control Index**	**0-15**	**6.5**

For those with expertise in the area of building control, there are probably a number of areas within these six items where Laos could save points easily. ECCIL will pick two points where there should not be difficulties in implementing the proposed changes. Of course, this does not mean that the country should make those small changes alone. Such changes are for the short-term while the long-term reforms of building quality control is taking place, in keeping with ECCIL's position throughout this White Paper.

Under the first item, Quality of Building Regulations, there are two questions, each carries the possible score of one point, as follows:

a) how accessible are building laws and regulations in your economy?
b) Which requirements for obtaining a building permit are clearly specified in the building regulations or on any accessible website, brochure or pamphlet?

According to the World Bank researchers, the answer to a) is that the laws and regulations in Lao PDR are not easily accessible and zero points are awarded. This could easily be rectified by making all laws and regulations accessible by putting them online or publishing them.

In the answer to question b), only a list of required documents is specified and zero points are awarded. Again, this could be rectified by making requirements for building permits available either online or through a publication in the form of a brochure or pamphlet.

Under item 5 above, Liability and Insurance Regime, there is a question as follows:

> Which parties (if any) are required by law to obtain an insurance policy to cover possible structural flaws or problems in the building once it is in use (Latent Defect Liability Insurance or Decennial Insurance)?

This question carries a possible score of one point. Laos scores zero because no party is required by law to obtain insurance to cover these risks. This should be a relatively straightforward regulation to implement.

To sum up, under the indicator, Building Quality Control Index, there are up to three additional points that are straightforward to achieve. ECCIL is assuming that at least two of these points can be achieved in a future Index in the short-term, thereby yielding a Building Quality Control Index value of 8.5 . Added to that would be the reduction of the number of steps in the Procedures indicator from 12 to 11, as discussed above. In the simulator for the 2019 Index, that would yield a DTF of 72.28 and a ranking for the category of 65.

Results Of The Short-Term Low Hanging Fruit Strategy

As discussed earlier, the point of the *Low Hanging Fruit* strategy was to find categories and indicators within categories that could be easily targeted in the short-term to improve the ranking of Lao PDR's position in the Ease of Doing Business Index to below 100 without involving seismic or highly disruptive changes.

Seven categories were chosen according to the strategy and within those categories 18 out of a possible 46 indicators were chosen, thus greatly reducing the scope of the problem to the solved.

As discussed earlier, the objective was not to find long-term solutions – nor was it to substitute for long-term solutions. Instead, it was to provide a set of easy to implement solutions that could be put in place in the short-term while long-term solutions are being crafted and worked on.

With this in mind, each of the proposed changes discussed in the previous section was processed through the simulator, what the World Bank calls the "Doing Business 2019 Ease of Doing Business Score Calculator." The end result is contained in the following table:

Table 3

Categories	Rank 2019	DTF 2019	Proposed Rank	Proposed DTF
1) Resolving Insolvency	168	0	163	22.14
2) Protecting Minority Investors	174	31.67	122	48.33
3) Starting a Business	180	60.93	114	83.58
4) Getting Electricity	156	52.77	87	73.85
5) Paying Taxes	155	54.22	66	76.84
6) Trading Across Borders	76	78.12	76*	78.12*
7) Enforcing Contracts	162	41.99	103	56.02
8) Getting Credit	73	60	73*	60*
9) Registering Property	85	64.93	85*	64.93*
10) Dealing with Construction Permits	99	67.94	65	72.28
Country Aggregate	**154**	**51.26**	**91**	**63.61**

*= value remains the same as category was not included in the *Low Hanging Fruit Strategy*

From this table, it is clear that the proposed changes yielded a DTF of 63.61 and an overall ranking for Lao PDR of 91.

While it is clear that by this analysis it is possible for Laos to achieve a double digit ranking in the Index, several caveats should be stated at this stage.

First, the Ease of Doing Business Index and its ranking is not just a matter of issuing new rules/legislation. The changes have to be implemented in such a way that they can be captured by the World Bank researchers. If the researchers find that in the government office which they have chosen, the officials are still using an old set of procedures, they have no option but to report what they have found, which is no improvement.

More importantly, the analysis provided in this White Paper is made based on the 2019 Index. By next year, other countries will be working to improve their position too and this competition means that just based on the current Index we cannot predict with precision what the changes made now will yield in the next Index. This is why ECCIL has left a significant margin below 100; in other words, if Laos could have got 91 with these changes in the 2019 Index, the country is highly likely to get a double-digit ranking in the next Index if they adhere to the same changes or improve.

ECCIL does not claim that these are the only changes that are worthwhile or that this is the only strategy. There are many possible ways of improving the ranking in the short-term. But ECCIL, based on the information to hand, believes that this is, on the balance of probabilities, the best short-term approach while long-term strategies and reforms are being designed, crafted and implemented.

IV. Conclusion

At the beginning of this White Paper, ECCIL set out that although the ranking of Lao PDR in the Ease of Doing Business 2019 appeared to fall by 13 places, this was not the case. Instead, the difference was because of a Correction going back at least several years by the World Bank - in fact the ranking for Laos in the previous year had been corrected to 151 and therefore the country had only dropped by 3 places in the ranking.

ECCIL still maintains that this should not be seen as a set-back and that indeed the country can still be on track to improve its position in the Index, even in the short-term, if the proper measures are put in place. Of course, these measures should not substitute for long-term measures. The Index is effectively an ongoing competitive activity and if Laos does not adopt long-term measures, the advantages of short-term measures can eventually be lost over time through competition from other economies.

In its search for short-term solutions, it was decided that ECCIL should avoid targeting those categories where Laos was already ranked better than 100. A strategy, called the "low hanging fruit," was utilized, whereby categories were identified that had performed worse (less than 100) and were easier to change. Within the target categories indicators were sought that could be changed without too much disruption but whose change would contribute most to reducing the category ranking and subsequently the overall ranking for the economy.

Using this strategy, a list of 7 categories were identified which were thoroughly analysed. Within each category, the relevant indicators were examined and realistic changes were suggested based on how effective the change would be on the overall ranking of the economy. In each category, the search was for indicators and sub-indicators that could be easily changed in the Lao context.

Each change was then simulated using the World Bank's *simulator* and the final ranking was shown to be 91 with a DTF score of 63.61.

A number of methods were utilized in this paper, from comparison with what other countries are doing if they are scoring better and a thorough examination or where Lao PDR might be losing easy to gain points. The proposed changes in this paper included the reduction in the time and number of steps required for a particular process, use of electronic means and automation for filing or registration and changing some procedural rules.

ECCIL is aware that a number of changes have been made or are in the pipeline that may have an effect on some future Ease of Doing Business Index. However, being aware of changes and being absolutely sure that World Bank researchers will be able to find those changes reflected in actual practice are two separate issues. Therefore ECCIL has not commented on any changes because it is beyond the ability of ECCIL to be certain that such changes are put into practice in such a way that they will be picked up by a future World Bank research mission.

THE LAO-CHINA RAILWAY

Introduction

The European Chamber of Commerce and Industry in Laos (ECCIL) enthusiastically supports the development of infrastructure that has the potential of greatly improving foreign trade in Lao PDR. Linking China to the North and Thailand and other countries to the South, the Lao-China Railway could greatly enhance the movement of goods and people and both enhance economic growth and attract foreign investment.

ECCIL is mindful that the project costs between $5.6 and $5.9 billion, representing approximately one third of GNP of the country.[1] Therefore, this raises the importance of getting the details right in ensuring that the railway does not just traverse Laos but actually plays a full role in benefiting the economy of the country and attracting foreign investment.

Issue Description

ECCIL is concerned that although the project is destined to have trains running by 2021, there are a number of questions the answers to which are crucial to the economic success of the railway and for the economy of Laos. Answering these questions when the project is already complete is too late, as will be apparent in the discussion below.

In an attempt to find answers to these questions, ECCIL approached the Ministry of Public Works and Transport but was referred to the Lao-China Railway Company Limited. ECCIL in turn contacted the company but the company was not in a position to deliver the required information.

Without answers to these questions, it is not possible for enterprises to plan for the opening of the railway, apparently scheduled for December 2021. Enterprises need plenty of time to change their supply chains, their logistics and even how to alter their production so that their output is appropriate for this new form of transport.

Without the opportunity for preparations in advance, enterprises will not be prepared for the opening of the railway. Facing low demand in the early stages of operation in Laos, the railway might scale back its services or simply not stop at as many stations as initially planned – stopping at stations costs time and money. The lower availability of service on offer might reinforce the view among enterprises that the freight services by train are just not for them. In time, stations might close completely for the loading and unloading of freight. In the worst possible scenario, goods trains could traverse Lao PDR without stopping to take on cargo at all.

Main Concerns for Enterprises

For existing enterprises, many will have set up at their current location long before the decision to build the railway was taken. Enterprises are now faced with the uncertainty concerning where they might link up with the railway, if at all, as there has been no

[1] Where Lao PDR GNP in 2017 was $16.85 billion, according to the World Bank. https://data.worldbank.org/country/lao-pdr

official confirmation as to location of stations and no information as to which stations would be capable of taking cargo and in what form. There is currently no information as to how frequent the trains might be, no understanding among enterprises of any infrastructure around cargo stations and no information about facilities for cargo at stations.

This might lead companies to question whether they should make the expensive changes they would have to make to incorporate the railway into their supply and customer chains. For a company to move to a location nearer the railway would be a significant investment to which no company is going to commit unless they can be sure that the railway station will be located there and will be able to take on the appropriate type of cargo.

Relocation for most enterprises is a highly significant issue. Apart from the investment required, companies could face significant staffing issues as many employees may not want to move away from their families and familiar locations. Finding appropriate new staff takes time. Acquiring appropriate buildings, possibly building from new, at a new location will take time as well as money.

Relocation has to be incorporated into an enterprise's future plans. Most products are price sensitive – the end-users of any enterprise's products have choices and no matter how high the quality, demand invariably falls back in the face of a price increase. Transport prices will often feature highly in the ultimate price to the consumer or end-user – therefore, before a large enterprise could even contemplate switching to the railway, they will need to have an estimate of what they will have to pay per kilometre/ton. Smaller enterprises usually find out their prices from logistics companies who consolidate smaller consignments into containers. But those logistics companies will have to have their prices already worked out in advance – without information on the proposed prices per kilometre/ton charged by the railway, they will have no basis for their estimated prices.

Before making any changes involving relocation or other changes to their businesses, enterprises will have to be reasonably sure of the frequency of stopping by trains at stations. And they need this information well in advance of the opening of the railway so that they can plan. Without a strong commitment from the policy makers or the train company that trains will stop with a certain frequency at specific cargo stations, there is no point in companies making any investment or change to their businesses so as to include rail services.

In addition, enterprises have to be sure that the train will stop at the destination where they want their goods to arrive. They would also have to be certain regarding the way cargo can be accepted at the station, whether in open truck or in a specified size container or in closed cargo truck. The type of loading facilities available that would be appropriate to the mode of cargo would have to be specified – for instance, if 20-foot containers are accepted, then machinery should already be installed in the named stations for loading and unloading 20 foot containers. And the private sector will need this information a long time before the railway opens in 2021.

A proposed outline timetable, providing the times when goods trains will be travelling north and south on the track, indicating calling stations for particular trains and so on, is absolutely necessary as advance information. This is especially important if the train is to become useful for the movement of goods within Lao PDR. Without a timetable, no enterprise will commit to using the train and will not change any part of their business until they are sure of that information. It is not that the timetable has to be precise to the exact minute but it has to indicate to potential users clear information as to how often goods trains will service stations so that enterprises can rely on that information for their future investment plans.

Information on how customs will be handled for train freight is also crucial. Will there be advanced customs clearance with customs seals on cargo at the loading stations, thereby reducing or removing the need for lengthy stops at borders? This would be of utmost importance for time-sensitive cargos, such as cold-chain goods where costs rise due to delays or fresh goods that can deteriorate over time.

In addition to information required by potential users of freight services, companies may wish to have more information concerning the railway and stations. Customs clearance agents, freight forwarders, logistics and other companies may need to know what opportunities there are to obtain office and warehouse space in or around freight stations. Healthy competition among such providers is crucial to good value in pricing for such services and maintaining interest by enterprises in using the railway as a conduit for their goods.

Other companies will also have a stake in the infrastructure at the stations and their surroundings. For instance, most freight will have to be trucked to the stations and trucking companies will need to know whether there are parking facilities at the stations. Delays, whether due to congestion at stations or due to the state of roads leading to stations, will cause increased costs and could therefore turn enterprises against using the railway.

The last group of questions concerns the passenger services available on the railway. Again, the proposed timetable, list of stations that will service passengers and the likely costs of tickets would be of great use for all of those involved in the tourism business. A train service could be incorporated into tourism promotion for Lao PDR and it might even be a possibility to offer specialist coaches with dining facilities for passengers travelling in a premium class.

Passenger travel might also have a bearing for other businesses too. Apart from tourists, business owners and managers using the train as an alternative to driving to other cities and towns on the line, passenger trains can also be used by passengers to transport small amounts of merchandise as luggage. Depending on ticket prices, luggage limits and regulations, small enterprises might use the passenger train to bring their produce as luggage from one location in Laos to another.

Impact on Lao PDR

As the discussion in the previous section indicates, to have a successful railway it is not enough to simply build the railway track and a few stations. It is also necessary to provide, well in advance, the salient information to enterprises and other users of the railway. It is also important to ensure that the required infrastructure, in and around the stations, is in place and to publicise information about the railway to its various potential users. In this way, Chambers of Commerce, such as ECCIL, would be more than happy to facilitate in this regard so that this important information is in the hands of enterprises so they have the time to make plans and invest.

Facilities for freight loading and other facilities must also be in place and that fact should also be made known to all potential users. Relevant information should also be made known to potential passengers of the railway and the companies that facilitate those passengers, such as tourism companies.

The impact of the railway depends on this. Without the information and infrastructure being in place and those facts being made available to potential users well in advance of the opening of the railway, it is highly likely that companies will not have prepared for the railway and demand for all services related to the railway could be very low.

In the event of very low take-up of freight transport services, the providers of rail services on the railway will have to make strategic decisions as to whether to service low-revenue stations. With little take-up in the initial stages, the providers of railway freight services may have to decide to concentrate on freight services between stations in China and those in countries that lie south of Laos, especially Thailand. Because stopping in stations costs money and time, if demand is low, the danger is that cargo trains on the Lao-China Railway may not stop at many stations at all and this may reinforce the image of Laos as a transit country rather than a land-linked country

Recommendations

ECCIL respectfully requests the information set out in the questions below so that enterprises in Lao PDR can be ready to incorporate the Lao-China Railway into their plans and invest accordingly so as to ensure that the railway plays a full role in attracting quality foreign investment and encouraging economic growth in Lao PDR.

Locations Of Stations

A map with all the stations or railheads listed, preferably an electronic version or on a publicly available website.

A confirmed list of stations or railheads indicating whether for freight, passengers or both.

Proposed Timetables

A draft freight train timetable incorporating all stations

The draft timetable should indicate how many freight/cargo trains per day/per week will stop in a station where freight can be uploaded or downloaded.

The draft timetable should indicate express transit trains that only stop at certain stations.

A draft passenger train timetable.

Cargo/Freight

A statement specifying types of cargo or limits on types of cargo. For example, containers only, 40 foot containers only.

The statement should outline the possibilities for smaller companies to send consignments that are smaller than a container (consolidation) using logistics companies.

The statement should indicate whether trains will take train trucks containing bulk consignments, for instance coal or mining products.

Customs Arrangements

An outline of the arrangements for import-export at the Lao-Thai border and the Lao-China Border, indicating whether customs clearance be done in advance or will the train be stopped at the borders and checked there.

The outline should indicate what happens if there is a problem with a container, such as a broken seal.

Freight Charges

A draft price-list containing estimated charges per km/ton for freight on the railway.

The draft price-list should indicate whether there will be any other charges and whether there will be taxes levied on goods in transit.

Ownership

It is unclear whether the joint venture company that is building the railway will own both the train line and the trains running on it or whether other train companies will be allowed to run trains on the railway. If other companies are allowed to run trains on the railway, this might attract foreign investment in the form of train companies.

It is unclear who will own the periphery areas around the railway stations and railheads. These areas will be important as they can facilitate users of the railway and enhance demand for railway use. Investors will like to know whether it is possible Lao or foreign companies to rent concessions in those locations at market rents.

Passenger Services

An outline of the plans for passenger trains on the railway, along with proposed fares within Laos or between main stations in Laos and main stations in Thailand or China.

THE HUMAN CAPITAL INDEX

Executive Summary

Launched on October 11, 2018 by the World Bank, the Human Capital Index (HCI) attempts to measure changes in human capital in 157 economies throughout the world.

Instead of trying to measure human capital in the working population, the compilers decided instead to measure how investment in health and education in an economy contributes to the productivity of the next generation of workers.

While the original intention of compiling HCI was to draw the attention to policy makers in individual countries to the importance of health and education in economic development, ECCIL argues that an additional dimension will be that the HCI will also be taken up by potential foreign investors, in much the same way as the World Bank's Ease of Doing Business Index, although investors will probably focus more on the education indicators.

The HCI for Lao PDR is low at .45. This means that a child born in Laos today will be 45% as productive when she grows up as she could be if she enjoyed complete education and full health.

Laos is currently ranked 111th in the HCI and scores significantly lower than its neighbours in SE Asia.

ECCIL argues that the main reason for the low score overall has to do with an indicator, **Harmonized Test Scores.**

The reason for ECCIL's concern with quality outcomes in primary school learning is because bad learning outcomes at or soon after primary school, as evidenced by very low **Harmonized Test Scores**, give rise to downstream problems, such as lack of preparedness for vocational, technical training or other formed of further education. In an earlier White paper, ECCIL has argued that this has heavily contributed to a skills gap in the economy.

Based on its analysis, ECCIL proposes that Lao policy makers focus on quality teaching and curriculum reform in primary school, primary school attendance and stunting in order to improve its position in the HCI.

ECCIL welcomes the new curriculum for primary school that will be rolled out by the Ministry of Education and Sport and supported by donors that includes child-centred learning approaches, training of teachers and text books and learning materials for all children.

The Background to the Human Capital Index

To understand the importance of human capital for business and economic development, it is necessary to see what is necessary, generally speaking, for sustainable economic development and the growth of business in an economy. The reason for mentioning the adjective 'sustainable' is because it is possible, in certain contexts, for an economy to experience rapid economic growth during the rapid exploitation of a rich endowment of natural resources. For instance, certain economies were able to grow very quickly based on revenue from oil deposits. But when a natural resource, such as oil, runs out or if the world no longer demands that resource, that economy can no longer depend solely on that resource; the economic development and growth in business is therefore not sustainable unless accompanied by some other factors.

When it comes to sustainable economic development and business growth, economists and the governments they advise have traditionally been narrowly focussed on factors such as infrastructure. Clearly, without a means of transport in the form of railways, ports, road and bridges, communication in the form of telecommunication and Internet and energy in the form of electricity, economic development is very difficult or even impossible.

Later came the idea that in addition to infrastructure, successful economies needed certain institutional and legal arrangements to be in place so as to facilitate commerce. This was seen as so important that the World Bank created the *Ease of Doing Business Index* that incorporated the ten institutional features[1] in economies that could be compared across 190 countries included in the index.

This is a feature that business in general and prospective foreign investors have taken a deep interest in. Although the *Ease of Doing Business Index* does not include foreign enterprises in its research, prospective investors from abroad will always pay close attention to this index as it demonstrates both how business friendly an economy is institutionally and how willing the authorities are to make changes.

But while infrastructure and certain key institutions are necessary for and indeed conducive to economic development, together they do not guarantee it – they are not sufficient for it. There is at least one missing ingredient that is also necessary for economic development.

While there are many factors that can place a brake on foreign investment and economic growth, such as lawlessness, absence of rule of law or corruption of all kinds, there is general agreement among economists about an additional factor, other than infrastructure and institutions, that is necessary for developing the economy. That missing ingredient is the development of human capital.

The trouble with human capital is saying exactly what it is. In a broad sense, it is the ability of the working population to create value, to take inputs and make outputs that are far more valuable than the sum cost of the inputs (where inputs includes labour and skills as well as energy and all the other goods and services that go into producing the output good or service).

Human capital is not equivalent to productivity as such although productivity depends on it. Productivity is measured in terms of the factors that go into production, such as

[1] Arguably one of the features in the Ease of Doing Business Index, **Getting Electricity**, is infrastructural at least in part. Two of the four sub-indicators that make up this feature, *Procedures* and *Time*, are institutional in nature while the other two are not. For more on the *Ease of Doing Business Index*, see the ECCIL 2018 White Paper: **Improving Lao PDR's Position in the Ease of Doing Business Index** and the 2019 White Paper: **Improving Lao PDR's Position in the 2019 World Bank's Ease of Doing Business Index** at www.eccil.org

capital or labour. For instance, productivity is often measured in terms of output per person per time period.[2]

Economists have traditionally focussed more on the education and skills aspect of human capital. The *Routledge Dictionary of Economics* described human capital as “the education and training embodied in a human person that gives rise to increased future income.”[3] Foreign investors too will naturally focus on education and skills in countries where they are considering a future investment. For them, the educational background of potential applicants for jobs will indicate whether it will be easy to train or retrain locally hired workforce, whether the local skill standards are appropriate for what the investor has in mind.

But the human capital discussion has moved on in recent decades, from its earlier focus solely on education and skills to including investment in human health too. This makes perfect sense from an investment point of view - as with any form of capital, if a capital asset continues to be useful and create value for a longer rather than a shorter period, clearly the return on that capital and on the investment that made that capital possible is further enhanced.

Therefore, it follows that investment in health is also important for human capital so that the bearers of that human capital can live longer and have more productive lives instead of lives interrupted by illness or cut short by an early death or inability to work due to ill health or disability. It also goes without saying that investment in child health and related issues, such as nutrition, will ensure that the child can gain more skills and education and will be less likely to suffer from stunting.

Although foreign investors are very much aware of human capital in the form of skills and education in a particular target country, they are probably less aware of the importance of health in the population of that country. In part, it could be argued, this is because while the policy maker is concerned with the whole life of the citizen, the employer is mainly concerned with the capital investment cycle usually comprising a few years. That said, employers are not blind to health issues among employees – a foreign investor will be concerned if he is facing additional costs of absenteeism due to health problems in the workforce.

The World Bank’s main intention with respect to the introduction of the HCI has been to gain traction with policy makers in countries. This paper will argue that potential foreign investors will find an index of human capital of great interest, even if they might put more emphasis on the education indicators and less emphasis on one or more of the health indicators. This in turn will put pressure on policy makers to take more heed of the HCI findings for their own country and, in turn, will allow the HCI to gain more traction with policy makers.

[2] **Routledge Dictionary of Economics**, “Productivity”, Oxford, 2013, pp. 477.
[3] Ibid, pp. 273.

Methodology: Creating the Human Capital Index[4]

The difficulty for all concerned with measurement or comparisons of human capital is how to measure it. Clearly, in a reasonably developed economy,[5] a particular person who is highly skilled has more human capital than someone who is unskilled. And between two people with the same skills and education, the person who has fewer days of absence from work due to illness or health reasons can be said to have more available human capital than his colleague who is seldom absent.

But this version of human capital is hard to measure for the population of a country as a whole, let alone for the populations of different countries. How can one measure the health and education of the entire working population of a country? In the case of creating an index that would have to include all economies, all populations of all countries would have to be treated equally and all countries would have to be capable of being transparently compared according to agreed standards.

Arguably, it would be impossible to design indicators that could be applied to all working populations fairly and transparently. In addition, the indicators would have to be those that would be affordable to work with. For instance, it would be possible to interview each and every person of working age in the economy, verify their qualifications, skills, experience and health. But this would be a huge undertaking and would require a budget so massive that it would preclude the rolling out of such a program across all the economies in the world.

Instead, it would be much better to try to come up with indicators that rely on data that has already been collected in all or most countries and that have an international reputation already established. Where there are absences of data, World Bank local staff can seek to take up the difference.

There are other reasons for the World Bank avoiding the approach of directly measuring the ability of the working populations to create value or to somehow measure the health, education and skills of the working populations. Direct measurement is notoriously hard to implement in a non-subjective way. Who gets to measure the value that one person creates in a process versus those of her colleagues? How can one verify the skill factor that arises from experience? How to verify all the information in a way that would be transparent and internationally comparable and accessible? Would there be too much information and too much room for discussion or argument about transparency and comparison and fairness, thereby defeating the purpose in getting traction with policy makers?

Instead of the direct approach, the World Bank took an indirect approach, of designing a small number of key indicators, with one exception all in early health and education. Generally speaking, all indicators are mainly based on data that has already been collected and verified from international reputable sources or are collected in part by World Bank local staff. Discussion of this approach will take place later in this paper

[4] For more information on the World Bank's HCI, see the following website and follow the links: http://www.worldbank.org/en/publication/human-capital

[5] The scenario of a reasonably developed economy is appealed to here because it is perfectly possible for a highly trained technician to remain unemployed in a largely agrarian society where there is no demand for her expertise.

but first let us look at each of these indicators in turn in the following table and discussion:

Table 1

World Bank Human Capital Index **Indicators**	**How Each Indicator Value is derived and/or expressed**
Probability of Survival to age 5	Probability: 0 – 1 where 1 = certainty of survival, 0 = no chance of survival
Expected Years of School	Years: 0 – 14 where 14 is taken to be the maximum number of years a child stays at school
Harmonized Test Scores	300 – 625 from Global Database on Education Quality, (Patrinos, Harry Anthony; Angrist, Noam, 2018)[6]
Learning Adjusted Years at School	0-14 Expected Years at School multiplied by Harmonized Test Score divided by 625
Fraction of Kids Under 5 Not Stunted	0 – 1 Subtract stunting rate from 1.
Adult Survival Rate	0 – 1 Subtract the mortality rate of 15-60 year olds from 1
Note: All data is derived from either international sources, such as UN agencies, or from World Bank research.	

In **Table 1**, with the exception of the indicator '**Adult Survival Rate**,' we can see that the World Bank is approaching the HCI from the point of view of indicators that are not immediately connected with the current stock of human capital as the indicators in question all relate to that part of the population that is not yet currently working nor yet in any way adding value to the economy. The **Adult Survival Rate** is directly connected to the overall health of adults in the economy aged 15-60 years and therefore is a good stand-in indicator for health in that age group.

All the other indicators are solely concerned with children or young people who are generally speaking too young to be in the work force. Although not directly connected to the current work force, they do hold an historic connection. Education and health systems have a history and it is possible to track their history over time. Unless there is

[6] http://documents.worldbank.org/curated/en/390321538076747773/Global-Dataset-on-Education-Quality-A-Review-and-Update-2000-2017

a massive policy shift or a huge calamity, such as war, changes in education and health systems tend to be incremental. The values you see for indicators affecting young people today will often not be too different from the values seen in the previous year, unless policy makers have made significant efforts at improvement – such improvements often mean a break in institutional policy.

It also goes without saying that the indicator values of today will directly impact on the human capital of the workforce tomorrow. All other things being equal, in the case of countries with similar *Ease of Doing Business Index* scores and similar infrastructure profiles, those scoring higher in the HCI are highly likely to develop quicker. Foreign investors will soon get to know that too.

Within the "all other things being equal" caveat will be the amount of skilled labour that a country imports. While it is true that a country can get around a human capital shortfall by importing skills and expertise, there are two problems with this option. First, importing skills and expertise is more expensive than hiring local skills and expertise. Those who have to move country have additional costs and will only overcome those costs if they are paid a premium above what they can earn in their own country.

Second, if a country does not sufficiently educate their population and provide them with skills, a significant number of those unskilled and undereducated workers will either have to remain unemployed or underemployed thereby contributing to poverty and driving down wages for the lower skilled and unskilled.

The only other option is migration outside the country. As discussed in the 2018 White Paper, **The Skills Gap**, this is the experience of Lao PDR where significant movements of labour pass each other at the borders, with unskilled Lao labour leaving the country and skilled foreign labour entering the country.[7]

Although Table 1 explains certain aspects of the indicators that go into the HCI, it is worthwhile examining each of the indicators one by one. First, **Probability of Survival to Age 5** is arrived at by taking the under 5 mortality rate and subtracting it from 1. The data for the under-5 mortality rate is taken from the **UN Interagency Group for Child Mortality Estimates 2018 Data Release**.[8]

Expected Years of School is based on statistics from the **UNESCO Institute for Statistics**[9] and supplemented by data supplied by World Bank staff. **The Global Database on Education Quality** provides the **Harmonized Test Scores**.[10] This database takes the data from international student testing programs and harmonizes them, measuring them in TIMSS-equivalent units[11] where 300 is the minimum attainment and 625 is the maximum. **Adjusted Years at School** is based on a complex

[7] **The Skills Gap**, ECCIL White Paper, available for download as part of the **2018 ECCIL White Book** at https://eccil.org/publications/white-book/white-book-2018/

[8] http://www.childmortality.org/

[9] http://data.uis.unesco.org/

[10] Patrinos, Harry Anthony; Angrist, Noam. 2018. *Global Dataset on Education Quality: A Review and Update (2000-2017) (English)*. Policy Research working paper; no. WPS 8592. Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/390321538076747773/Global-Dataset-on-Education-Quality-A-Review-and-Update-2000-2017

[11] TIMSS (Trends in International Maths and Scientific Study) refers to the average test scores carried out by the International Association for the Evaluation of Educational Achievement. The harmonization into TIMSS-equivalent units is contained in Patrinos and Angrist, op. cit., footnote 10.

mathematical calculation combining the indicators **Expected Years at School** and **Harmonized Test Scores**.

Fraction of Children Under-5 not Stunted is arrived at by taking the under-5 stunting rate for the country in question and subtracting it from 1. The stunting rates are provided by the **UNICEF-WHO-World Bank Joint Malnutrition Estimates**[12] with supplemental data provided by the World Bank staff.

The indicator, Adult Survival Rate, is arrived at by taking the mortality rate for those aged 15-60 and subtracting it from 1. The 15-60 mortality rates are contained in World Population Prospects, UN World Population Division.[13] Supplemental data is provided by World Bank staff.

It is clear that data for all indicators either comes from reputable international sources or from World Bank staff research.

The HCI is derived from the indicators in the following way. The indicators are separated out into three components, *Survival*, *School* and *Health*. The *Survival* component is derived directly from the *Adult Survival Rate* and is equivalent to it. The *School* component is based on a complex mathematical calculation involving two indicators, **Expected Years at School** and **Harmonized Test Scores**.[14] *Health* is the combination of two indicators, **Fraction of Children Under 5 Not Stunted** and **Adult Survival Rate**. The Human Capital Index is then arrived at by multiplying all three components, *Survival, School and Health.*

The Value of the World Bank HCI

The value of the World Bank HCI to policy makers and would-be foreign investors can be seen in several ways; in comparisons over time, comparisons and between countries, especially within the same region, and through examination of the indicators in an individual country for an individual year.

Since this is the first time it has been implemented, the comparisons over time are not yet available. The examination of an individual country, namely Laos, for an individual year will be undertaken later in this paper. Comparison between countries in the same region will be examined now.

Looking at the Human Capital Index column, we can see that Laos performs worse than its SE Asian neighbours - in the case of Vietnam and Thailand, significantly worse.

There are some surprises in the comparison – Vietnam has a better HCI score than Thailand and is significantly better ranked. Both countries score very similarly in **Survival to Age 5** and **Years at School** indicators while Vietnam scores slightly higher in the **Adult Survival Rate** indicator. But even though Vietnam falls back in the **Fraction of Kids Under 5 Not Stunted**, it pulls ahead of Thailand very significantly in the **Learning Adjusted Years at School** indicator.

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[12] https://data.unicef.org/resources/jme/

[13] https://population.un.org/wpp/

[14] This is a different calculation from that which produces the indicator **Learning Adjusted Years at School**.

Because of the methodology of the HCI, the Indicator **Learning Adjusted Years at School** and the **Harmonized Test Score** which is the indicator it is derived from, is highly likely to play a disproportionate role in the HCI.

Table 2

Comparison of World Bank HCI Indicators between 5 SE Asian Countries						
Country (Ranking)	**Probability Survival to Age 5**	**Years at School**	**Learning Adjusted Years at School (Harmonized test scores)**	**Adult Survival Rate**	**Fraction of Under-5s not stunted**	**Human Capital Index**
Laos (111)	0.94	10.8	6.4 (368)	0.81	0.67	0.45
Vietnam (48)	0.98	12.3	10.2 (519)	0.88	0.75	0.67
Thailand (65)	0.99	12.4	8.6 (436)	0.85	0.89	0.60
Cambodia (100)	0.97	9.5	6.9 (452)	0.83	0.68	0.49
Myanmar (107)	0.95	9.9	6.7 (425)	0.81	0.71	0.47

The reason for this, at least in the sample of South East Asian Countries chosen above, is that the health indicators chosen for the calculation of the HCI tend to mathematically cluster around certain values whereas the education quality values are mathematically more variable.

To illustrate, in the sample of countries in South East Asia chosen above, the **Adult Survival Rate** and the **Probability to Survival to Age 5** cluster between .81 and .88 and .94 to .98 respectively. But the variance in **Harmonized Test Scores**, where the minimum is 300 and the maximum achievable is 625, is much greater.

At least for Laos, this would highlight the importance of education in any attempt to improve the HCI for the country. The HCI would also be of value to Laos in a number of ways. It would focus the minds of the policy makers on why education and health are important, not only as a matter of well-being and therefore a matter of consumption in the economy but also as an investment in the future human capital of the economy and thereby making the country more attractive to foreign investors. According to the World Bank, when the HCI is at .45, which is the value of the Lao HCI today, that means that:

"A child born in Lao PDR today will be 45% as productive when she grows up as she could be if she enjoyed complete education and full health."[15]

Over time, it is highly likely that the HCI will gain more and more traction among prospective foreign investors. Investors already pay attention to education and skills when it comes decisions about where to site their next venture. And there are many factors that go into those decisions. But if a country is to diversify away from a purely finite resource-based sectors, such as mining, into sectors that utilize more the country's own skills and expertise, human capital development is the only way to go. And for that reason, prospective foreign investors will pay more and more attention to the World Bank's HCI and especially to indicators such as the **Learning Adjusted Years at School**.

How can Lao PDR improve its HCI score?

Laos could improve its HCI score by simply focusing on improving equally all the indicators that go into the HCI score. But, as mentioned earlier, investment in education and education quality is the one that is going to have the greatest effect on the HCI. Before examining the education indicators in depth, it is worthwhile to note that the **Fraction of Under-5s not Stunted** is the health indicator that is more out of line with the neighbouring countries than the others. While the two survival indicators (**Survival to Age 5** and **Adult Survival**) could do with some improvement, the room for improvement is not as marked as with **Under 5s Not Stunted**. Given that stunting at a young age affects the growth of the brain, this also feeds back into the growth of human capital as individuals advance through their education and into the work force. With more stunting, fewer candidates will be available for more than basic education and the development of skills.

Laos seems to score relatively well in the indicator, **Number of Years Spent at School**. But at 10.8 years per student, this appears somewhat high, given the significant dropout rates and other obstacles that get in the way of primary and secondary students attending school.[16] According to the summary table of the **HCI Lao Data** document, the 10.9 years at school is a World Bank staff estimate.[17]

Even if that figure is accurate, the more telling indicator, **Learning Adjusted Years at School**, concerns the quality of the education received in Lao schools – in the case of Lao PDR, this is 6.4 years. The value of this indicator is derived from the indicator **Years Spent at School** adjusted in a complex mathematical formula by the **Harmonized Test Scores**, as mentioned before.[18]

As in the 2018 White Paper, entitled **The Skills Gap**, ECCIL continues to recommend allowing parents more say in the schools, making the curriculum more relevant to the

[15] HCI Brief, p. 1, http://databank.worldbank.org/data/download/hci/HCI_2pager_LAO.pdf

[16] For a more detailed discussion on dropout rates and barriers to children attending school, see the ECCIL White Paper 2018, **The Skills Gap,** available on www.eccil.org.

[17] On the link, http://www.worldbank.org/en/publication/human-capital go to section headed Human Capital Index: Country Briefs and Data – click on data link for Lao PDR to download the HCI Lao Data, an EXCEL document and click on the 'Summary Table' tab of the Workbook.

[18] For those interested in how the indicator Learning Adjusted Years at School or other indicators are derived, see HCI Booklet, p 36ff. For a more detailed account of the origins of the indicators, see Policy Research Working Paper 8593 - Methodology for a World Bank Human Capital Index, Aart Kraay. Both this paper and the HCI Booklet are available as links on the World Bank HCI website, op. cit.

pupils and their post-school lives, changing the curriculum in the teaching colleges to reflect new methods, and making technology more available in schools. ECCIL is delighted to hear that there are moves in this direction in the form of a recently announced major curriculum initiative supported by Australia, USAID and the European Union. According to a news release from the KPL, the official Lao news agency, the Ministry of Education and Sports will be rolling out a new curriculum for primary schools in Laos, with new textbooks for each child, new teachers' guides and other resources.[19] The new curriculum is based on contemporary child-centred learning approaches and teachers will the trained in how to deliver the curriculum.

The reason for ECCIL's emphasis on primary education is that the quality issues with primary education, whether through issues with curriculum, problems with school access, high drop-out rates or high rates of pupil absenteeism, are giving rise to down-stream issues when it comes to vocational or technical training or other forms of training. The average student in Laos spending 10.8 years in school and therefore leaving school at 15 years old should be fully capable of entering a vocational training program. But, according to the World Bank figures, that average 14-15 year-old has only received 6.4 **Learning Adjusted Years**, in other words the education one would expect in a 10-11 year-old receiving an education in Singapore, the country with the highest **Harmonized Test Score**. No one would expect a 10-11 year-old from Singapore to be able to enter a vocational training program designed for 15-year-olds.

As the indicator, **Learning Adjusted Years**, is based on the indicator, **Harmonized Test Scores**, this should be one of the areas of focus for policy makers – to enhance primary school education quality both in terms of curriculum and teaching quality. One might also suspect that absenteeism, drop-out rates and school access at least in some areas might also have to be emphasised. Absenteeism is often difficult to establish and control and it can severely impact learning.

One way of controlling absenteeism in primary school is to make education for children something they look forward to. In this respect, it is hoped that the new curriculum may play a role. As outlined in **The Skills Gap** White Paper, the attitude of parents to school attendance also has to be addressed, especially in relation to girls.

Conclusion

Until recently, in the development sector education and health were considered by policy makers to be matters of consumption rather than investment, to be funded by donations or by whatever funding was left over when crucial services, such as national security, and infrastructure investments were paid for.

In this paper, the role of human capital was outlined and the methodology for the World Bank Human Capital Index was illustrated. Each of the six indicators that make up the HCI were explained.

With a HCI at .45, Lao PDR is ranked 111 out of 157. Based on a comparison between neighbouring countries and an examination of the position of Laos in the Index, it is clear that the indicator that brings Laos down furthest in the HCI is the **Harmonized Test Scores** where Laos scores 368 (where the lowest is 300 and the highest possible

[19] http://kpl.gov.la/En/Detail.aspx?id=33995

score is 625). ECCIL also pointed to the indicator, **Fraction of Under-5s not Stunted**, which at .67 is the single health indicator that is significantly lower than all those of the neighbouring countries. Low scores in this indicator is also strongly correlated with low educational attainment.

Human capital, including both investments in health and education, is seen as necessary for the development of an economy, as the World Bank's HCI indicates. ECCIL also believes that potential foreign investors will also make use of the HCI as it is a good indicator of how committed a country's policy makers are to develop human capital and to attract foreign investment. Foreign investors will be especially attracted to those economies where policy makers ensure the provision of quality primary and post primary education as these are crucial if candidates for vocational, technical and further education are to benefit from their programs.

For these reasons, it is important that policy makers in Laos focus on the education and health. No longer are these issues to be relegated to discussion among specialists in the bilateral/institutional donor or NGO space – now health and education will also be in the decision matrix of potential foreign investors as part of human capital.

ECONOMIC DISPUTE RESOLUTION

Preface

The European Chamber of Commerce and Industry in Laos (ECCIL) broadly welcomes the new Law on Economic Dispute Resolution in Lao PDR recently passed by the National Assembly.

During the drafting stage of the law, ECCIL worked through the normal processes of providing feedback on draft laws in Laos and drafted a paper, similar to that below, for the attention of the drafters of the new law and other stakeholders.

ECCIL was invited to a meeting with the drafters and welcomed the opportunity to present their concerns. Following ECCIL's efforts, a number of changes were made to the draft law, including the following (all references in brackets are to the draft law):

- article 60 (50): the clause from the final version of the law that the Centre for Economic Dispute Resolution (CEDR) is to "make recommendations on establishment of private institutes for economic dispute resolution" was removed.
- article 63 [1] (Article 53, [1]): in relation to qualifications of mediators and arbitrators, the final version of the law stipulates a minimum education of diploma standard where the draft contained no academic qualification.
- Article 62 (52): the condition that foreign arbitrators/mediators be part-time has been removed from the final version of the law.

Additional clauses have been added and in some areas the language appears to have been tightened up. However, the main thrust of ECCIL's concerns remain. This is not a matter of ECCIL looking for special treatment for itself or its members. Instead, as will be made clear below, ECCIL's proposals are intended to improve the business climate in Lao PDR. To illustrate this point, in the 2019 Ease of Doing Business Index, the World Bank researchers found that it takes 828 days to bring a contract case through court in Lao PDR.[1] If businesses can be presented with an robust alternative system of economic dispute resolution that can be completed easily within a few months, that would be a major improvement in the business climate in the country and would make Lao PDR much more attractive to foreign investors.

In the main section of this White Paper, references are made to the Law on Economic Dispute Resolution as passed by the National Assembly and to the draft law that was discussed with drafters and on which ECCIL based its original feedback document. For the sake of clarity, references to the draft law are made in brackets – for instance, on page 3 of this paper, reference is made to Article 52 (63) where 52 is the article in the law passed by the National Assembly and 63 is the article in the original draft.

[1] http://www.doingbusiness.org/en/data/exploreeconomies/lao-pdr#DB_ec

Issue Description

In Lao PDR as in many countries, economic or commercial disputes would traditionally have been resolved in the courts of law. However, accessing the courts can be an expensive and lengthy process and may lead to adverse publicity for disputing parties.

There are alternative methods for resolving economic disputes that do not involve lengthy delays or great expense, such as:

> ***Mediation**: A form of alternative dispute resolution in which an independent third party (mediator) assists the parties involved in a dispute or negotiation to achieve a mutually acceptable resolution of the points of conflict.*[2]
>
> ***Arbitration**: The determination of a dispute by one or more independent third parties (the arbitrators) rather than by a court.*[3]

The *Law on Economic Dispute Resolution (*LEDR) is mainly concerned with mediation and arbitration within the borders of Lao PDR. ECCIL warmly welcomes the aims mentioned in Article 5 (5) of the law that give individuals, legal entities or organizations, domestic or foreign, "the right to choose the method of resolution of economic disputes in accordance with this law."

ECCIL also welcomes the clause in Article 4 (4) whereby "the State authorizes the establishment of private and *ad hoc* institutes for economic dispute settlement as defined in specific regulations."

Based on ECCIL's understanding of the law through an unofficial English translation, this White Paper will focus solely on several key points that are key to a successful and sustainable system of economic dispute resolution. ECCIL is always available to discuss such matters and welcomes the opportunity to follow up matters in the future either directly with law-makers (drafters or legislators) or other stakeholders to discuss these details further.

The first issue that ECCIL would like to draw attention to in the LEDR concerns the jurisdiction of the Peoples' Courts in arbitration cases. It is generally accepted that once the parties to a dispute have made a valid submission to arbitrate, the purpose of arbitration as a method of dispute resolution is to specifically exclude the jurisdiction of the courts, except for procedural questions.[4] The process of arbitration is, by definition, a non-judicial one and allowing parties to appeal decisions to courts would obviate the whole point of arbitration, which is to have a voluntary, mutually-agreed, speedy, inexpensive and contained process of dispute resolution that avoids the need for lengthy legal procedures or appeals.

For an arbitral award to be binding, both parties have to have confidence in the process. If either party can appeal to a court whenever they didn't like the arbitral award outcome, fewer will commit to arbitration; in such circumstances, disputants might as well eschew any arbitration proceedings and just file their case in court.

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[2] **A Dictionary of Law**, Jonathan Law ed., Oxford University Press, Oxford.

[3] **ibid**
[4] **The Alternative Dispute Resolution Handbook for Non-Technical Users**, Funke Akoni, pp. 46

However, the LEDR Article 52 (63) refers to allowing disputing parties, after arbitration is complete, to "file a claim in the People's Court." Article 45, section 8 (45, section 8) reinforces this by stating that the contents of the arbitral award should contain "the right of the disputing parties in challenging the arbitral award to the Peoples' Court."

ECCIL's position is that to ensure that disputants will commit to arbitration proceedings, all references to appeals or referrals to courts, except for procedural issues, should be removed from the draft law.

Another concern is the role envisaged in the LEDR for the Centre for Economic Dispute Resolution (CEDR).[5] According to Article 17 (17) of the LEDR, all disputants wishing to avail of arbitration or mediation must first submit their claim to the CEDR. According to Articles 26 (26) and 35 (35), disputants can then pick a practitioner from a list maintained by the CEDR and SEDRs. The language in the two articles makes it appear that the CEDR controls who gets to be on the list and disputants can only choose practitioners who appear on it.

The LEDR states that the CEDR will select arbitrators whenever disputants cannot decide who to appoint as arbitrators. Under Article 60 (50), the CEDR has the right to remove or change the mediators or arbitrators from time to time in accordance with the law. This is unusual; in arbitration and mediation proceedings, once mediator/arbitrators have been validly selected by the parties to a dispute, normally no one has the right to remove them.

Article 60 (50) also gives the CEDR the right to "research, draft or amend a law and regulations related to economic dispute resolution and propose to higher authorities for consideration." The same article in the draft law gave the CEDR the right to "make recommendations on establishment of private institutes for economic dispute resolution" but this appears to have been removed in the final version of the law.

ECCIL's concern is that, under the law as written, the CEDR will both operate as an institute for economic dispute resolution, according to Article 60[5] (40[5]) and "administer and facilitate the resolution of economic disputes" as well as having the power to propose changes that will affect other potential institutes while being also empowered to decide who can be a mediator or arbitrator. The CEDR will also have the power to appoint arbitrators and mediators and remove them.

ECCIL's concern is with the CEDR playing the role of both rule-maker for institutes of arbitration/mediation and an institute operating in its own right. The law, as it is written, mentioned private institutes in articles 4 (4) and elsewhere but it does not mandate their creation. It is possible that the CEDR could decide not to create such institutes and remain the sole provider of arbitration and mediation in the country.

To avoid even the impression that there might not be a level playing field, ECCIL supports a clear and transparent separation of powers in relation to economic dispute resolution. An economic dispute resolving institute that could make or propose the rules for all institutes and practitioners and having powers to appoint practitioners (arbitrators and mediators) and remove them in other institutes is not conducive to the creation of an impression among stakeholders or indeed disputants of an open and fair system.

[5] The LEDR also refers to Sections of Economic Dispute Resolution (SEDRs) – since SEDRs are local entities that come under the direction of the CEDR, for the sake of brevity and clarity, in this White Paper SEDRs will be considered part of CEDR.

To avoid such a situation arising, ECCIL recommends that there be a clear separation between institutes and the legal entity that makes or proposes the rules, creates institutes and decides who can be mediators and arbitrators. If the CEDR is to be a practicing institute, it should operate on an equal footing with all other institutes.

ECCIL is not claiming that institutes are or must be competitive in the traditional sense of the marketplace – it is perfectly possible to operate an institute on a non-profit basis. But if the purpose is to attract and maintain a wide range of economic dispute resolution practitioners, they will have to be confident of equal treatment of practitioners and their respective institutes. If the economic dispute resolution system on offer does not appear to be fair or if it attracts too few practitioners, disputants will not make use of it and the proposed form of alternative dispute resolution will not be sustainable.

ECCIL's last concern is with the way qualifications for all practitioners, as set out the in the LEDR, are too vague, discretionary or impossible to prove in practice. For instance, all practitioners are supposed to "have a good qualification, ethics and honesty," article 63 [1] (Article 53, [1]) even though the qualifications are not specified although the final version of the law does specify diploma standard. No standards of ethics or honesty are provided other than the candidate never having been to prison.

The LEDR sets additional conditions and qualifications for foreigners to practice as arbitrators and mediators in Lao PDR. According to Article 64 (54), "foreign and alien" practitioners are expected to "respect the Constitution, laws and regulations of the Lao PDR" and to "have a good knowledge of Lao, culture and respect the traditional customs of Laos". While none of these might appear onerous, they are overly broad and impossible to prove and it would leave it open for a foreigner to be removed from the list for almost any reason if he or she could in any way be seen as not respecting the constitution, the traditional customs of the country or some other aspect mentioned in Article 64.

The original draft law contained another condition, that foreigners will be part-time members of the list of mediators and arbitrators (Article 52) but that appears to have been removed in the equivalent in the corresponding article in the final version of the law, article 62. But other conditions for foreigners remain - they will have to have a valid work permit or have acquired permanent residency in the country, according to article 64 (54). It is not clear whether a foreigner could acquire a work permit for the position as arbitrator or mediator or how that could be done. With respect to residency, currently in Lao PDR applicants for a residency permit have to have lived continuously in the country for ten years, speak Lao language and fulfil other conditions – in addition, application for a residency permit takes at least several years to complete and therefore relatively few foreigners avail of it.

Foreigners wishing to practice as arbitrators or mediators in the country will, in addition, also have to obtain an authorization from the Ministry of Justice, according to Article 67 (57), although it is not clear what conditions such an authorization would require. The same article also appears to infer that foreigners only have the right to be involved in dispute resolution where one of the disputants is a foreign person or entity. While ECCIL is aware of one foreigner who has been accepted as an arbitrator under the current rules, the concern is that the conditions contained in the law together could restrict the pool of potential candidates to a an extremely small number or at least and make it extremely unattractive for foreigners to practice as arbitrators and mediators in Lao PDR.

Impact on Lao PDR

ECCIL strongly supports the idea of setting up a robust system of economic dispute resolution in Lao PDR. Such a system that is also fair and inclusive will serve to improve the business environment in Lao PDR by making economic dispute resolution more affordable and effective. Currently, according to the World Bank's Ease of Doing Business Index research, it takes 828 days (over 27 months) to enforce a disputed contract through the courts in Lao PDR. The presence of a fair and inclusive economic dispute resolution system that would cut the time of resolving such disputes to several months would also make the country a more attractive location for foreign investors.

But for a system of dispute resolution to be successful and sustainable, all stakeholders have to have confidence in the system of arbitration or mediation on offer. If there is no confidence in the system, disputants in Lao PDR will not bring their cases forward for arbitration or mediation.

Confidence among disputants depends on whether parties to disputes have unfettered access to a wide range of practitioners of arbitration/mediation; confidence among practitioners, which is important for the attraction of a wide range of personnel to the work, depends on there being a "level playing field" with equal access among all to opportunities to practice.

In the case of arbitration, with the exception of procedural questions, appeals to the court system have to be ruled out. Again, if disputants believe that they can always revert to the courts if they do not like the outcome of the arbitration process, then it will no longer be in the interest of disputants to enter into arbitration.

Recommendations

- All mediation/arbitration institutes in Lao PDR should be treated equally under the LEDR; a separate entity should be created to deal with making and enforcing rules, certifying practitioners and proposing changes in the economic dispute resolution system. If the CEDR is to operate as an institute, it should do so as one among equals.
- There should be fair and equal access for all practitioners with clear and well-defined qualifications and conditions of practice the same for all. All references to extra conditions or restrictions for foreigners in the draft LEDR should be removed.
- Once all parties to a dispute have agreed to arbitrate or mediate, there should be no recourse to the courts except for procedural issues.

MAKING LEGISLATION

Issue Description

The law of Lao PDR explicitly states that legal entities, including the private sector, are, "eligible to provide comments on draft legislation by sending their comments to the authority in charge of making legislation according to the defined time and procedures." (*Article 8, Law on Making Legislation 2012*).

The *Law on Making Legislation* also states:

"The organization in charge of making legislation shall post draft legislation including the constitution, laws and decrees on the website or printed media or other means to ensure that the public can have easy access to them for a period of at least **sixty days** for comments." (*Article 8, Law on Making Legislation 2012*).

Despite the creation of a section within the online *Electronic Official Gazette* (EOG) devoted to the publication of draft laws that incorporates an on-line feedback function, access to final drafts of legislation is invariably impossible, especially for foreign stakeholders such as the European Chamber of Commerce and Industry in Laos (ECCIL).

With any proposed piece of legislation in Lao PDR, it has become customary for significant drafting to continue in the background during the two-month consultation period while the original version remains on the EOG. The final version that emerges after much redrafting is often very different in structure and content from the earlier version.

It is not worth the effort or expense for ECCIL or any other foreign stakeholder organization to engage the services of a specialist translator of such complex legal documents if all that is available for translation is the early version available on the EOG that will be fundamentally different from the final version anyway. By the time the final version has been drafted, the consultation period is over and the opportunity to provide meaning feedback is lost.

In addition, the initial EOG publication date is no indicator of when the final version will be completed as in some instances draft legislation can stay on the EOG for a year and more. It is therefore not possible to time the completion of final versions of draft laws by the date on which the original version appears on the EOG.

Even when the final draft is made available to foreign stakeholders, such as ECCIL, it is at such a late stage that there is no time to translate the proposed legislation into English so as to circulate among ECCIL members or foreign experts.

A recent example illustrates some of the difficulties for foreign stakeholders to provide meaningful feedback on proposed legislation. The proposed *Law on Economic Dispute Resolution* (LEDR) is clearly legislation that is of great interest to ECCIL and to the business community in Lao PDR. The original LEDR draft, published on the EOG November 30, 2017, was redrafted over the period of two months with the final version only being completed on January 24th, 2018.

The **Consultation Workshop on Amendment of Law on Economic Dispute Resolution,** organized by LNCCI and the Ministry of Justice, took place two days later. ECCIL received an invitation late in the afternoon on the previous day. ECCIL received no prior official notification that the drafting was complete. The workshop was in Lao language with no translation.

The notice was too short to deploy a qualified ECCIL Lao staffer or contractor to contribute adequately to the workshop. The time allotted for public consultation, 60 days, was already over and there was no time to engage an international legal expert to study the law and provide an opinion. Nor was there sufficient time for ECCIL to prepare a workshop or seminar of its own in order to engage in discussion with stakeholders or to generate meaningful feedback to the relevant authorities involved in drafting the legislation.

Impact on Lao PDR

One of the key functions of the EOG is to make draft laws available to the public and provide stakeholders and indeed all interested parties with an opportunity of responding to the final version of a proposed piece of legislation via their online feedback function. If it is not possible for ECCIL and others to access final versions of draft legislation, Lao PDR will lose out on the vast experience to be found among foreign local stakeholders. A European organization such as ECCIL can access expertise and provide valuable feedback that could meaningfully contribute to the benefit of the country. In addition, Lao PDR will lose out on the valuable feedback from its own citizens, businesses and stakeholder organizations.

This lack of opportunity to provide meaningful feedback to draft legislation is not conducive to the creation of an attractive location for quality foreign investment. ECCIL is concerned that this could work against the image of the country as a welcoming location for foreign investment.

Recommendations

- Draft legislation should only be published on the *Electronic Official Gazette* (EOG) when the drafting process is complete and a final version has been agreed.
- In keeping with the *Law on Making Legislation (2012)*, all final versions of draft legislation should remain on the EOG for a minimum of 60 days.
- Adequate notice should be provided to all relevant stakeholders, including ECCIL, of any official seminar or workshop where draft legislation that could have an impact on ECCIL or its members, potential foreign investors and other organizations or individuals, is discussed.
- ECCIL and other stakeholders should receive invitations to such workshops and seminars.

FINANCIAL RISK MITIGATION

Executive Summary

If we were to comment about the state of the Lao PDR economy on the basis of the two most important macroeconomic variables, our conclusion would be in the positive. Real GDP growth, although down from the high of 8% in 2013, is expected to be robust at around 6.8% in 2019. Inflation too, remains largely contained at the range of 2% on falling food prices. Yet, the state of the economy encompasses a host of other factors which go beyond simply growth and inflation.

In this paper, we will highlight the two main challenges faced by Lao PDR, in our view:

- **Persistently high fiscal deficits** which have resulted in Lao PDR having the highest public debt as a percentage of GDP in ASEAN (excluding Singapore) and
- **Relatively high dollarization**, which reduces the effectiveness of monetary policy and the exchange rate in helping the economy cope with shocks.

We look at how these issues combined have impacted the **banking sector** in Lao PDR, which while trying to open up to more competition, continues to struggle with fundamental constraints like tight liquidity and high non-performing loans (NPLs).

In the last section we list out **three broad structural changes** that we deem essential for the sustained progress of the economy as it strives to graduate from least developed country status by 2024. These involve:

- Sustained reduction in public debt by streamlining taxes and prioritizing expenditures,
- Deepening the financial system of which banking is a significant contributor, and
- Gradually moving to anchor the existing monetary policy framework which will allow greater flexibility in the exchange rate as well as increase confidence in the kip (LAK).

While any structural reform is not easy to initiate or implement, we expect that this paper will help throw some light on where to make a start.

Rufus Pinto

Chief Executive Officer, ANZ Laos

Introduction

As an aid to initiate public discourse and attract the authorities' attention, we present a wide macroeconomic overview of the key challenges facing Lao PDR. The paper is divided into three core sections:

- Elaborating on the two key challenges in the economy, namely: a) **high fiscal deficit** which is in turn adding to the debt burden of the government; and b) **increased dollarization** which is hindering smooth transmission of monetary policy.
- How these two aspects together impact the **economy's banking sector**, which despite being the backbone of the country's financial system is afflicted by a host of issues ranging from higher concentration of public sector banks, rising non-performing loans (NPLs) to underdeveloped interbank lending instruments.
- The last section of the paper looks to **address some of these key issues** and resorts to specific case studies as an illustration.

We propose some broad structural changes as we understand that reforms cannot be implemented or achieved radically. Our aim is to draw parallels from economies that have faced similar challenges in their development stages and learn from their success stories.

However, we note that despite similarities, there are noted differences between any two economies and so an outright comparison is seldom justified. Yet, to appreciate a problem and realize that it needs to be solved can on its own be a small but significant first step towards achieving the bigger goal. We aim to provide the authorities with possible starting points in their extensive journey towards advancing the economy.

High fiscal deficit-public debt: Feeding off each other

For an USD 18 billion economy with a population of roughly 6.8 million, Lao PDR's public debt at 61% of GDP is one of the highest in the ASEAN community (Figure 1). A high fiscal deficit (around 4.8% in 2017; non-mining deficit was even higher at 5.7% in 2017) is one of the reasons for the rising public debt burden. This has become a vicious cycle in recent years – increased financing needs led to higher public borrowing, keeping debt levels high.

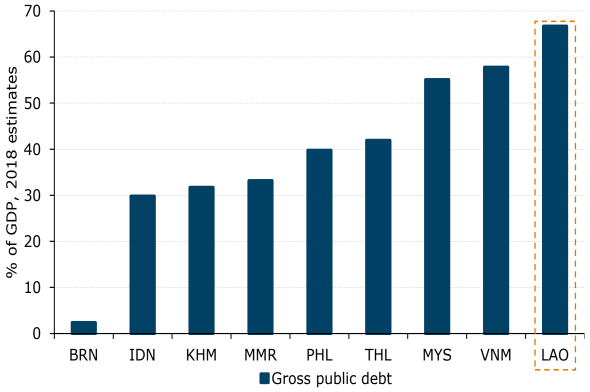
A shortfall in revenue collection, high dependence on indirect taxes and slower commodity prices have steered fiscal deficits higher since 2015. Revenues in Lao PDR lag behind those in the other economies in the region (Figure 2). Simultaneously, current spending has sharply increased over the last few years, especially as public sector wages rose. Increase in public sector wages[1] in the first half of the year also likely hurt the fiscal numbers further. An increase in wages is deemed positive till it filters through to consumption and taxes.

However, if wages were to rise as a filter with no hole, it can exacerbate fiscal constraints. While authorities recognise the need to lower the deficit and some effort

[1] The government approved an increase in minimum wage from 900,000 to 1.1mn kip per month starting 1 May, 2018

has been made (wage bill for the latter part of 2017 was contained by keeping staff numbers low and restricting new entrants), more needs to be done.

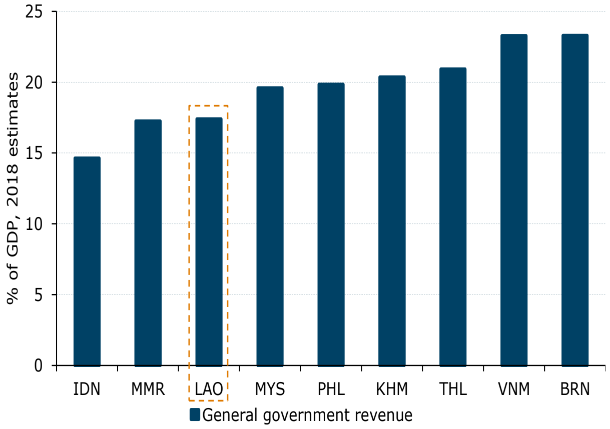
Figure 1. Lao PDR public debt highest in ASEAN*



*Note: Data excludes Singapore

Source: IMF, ANZ

Figure 2. Revenue growth not very impressive

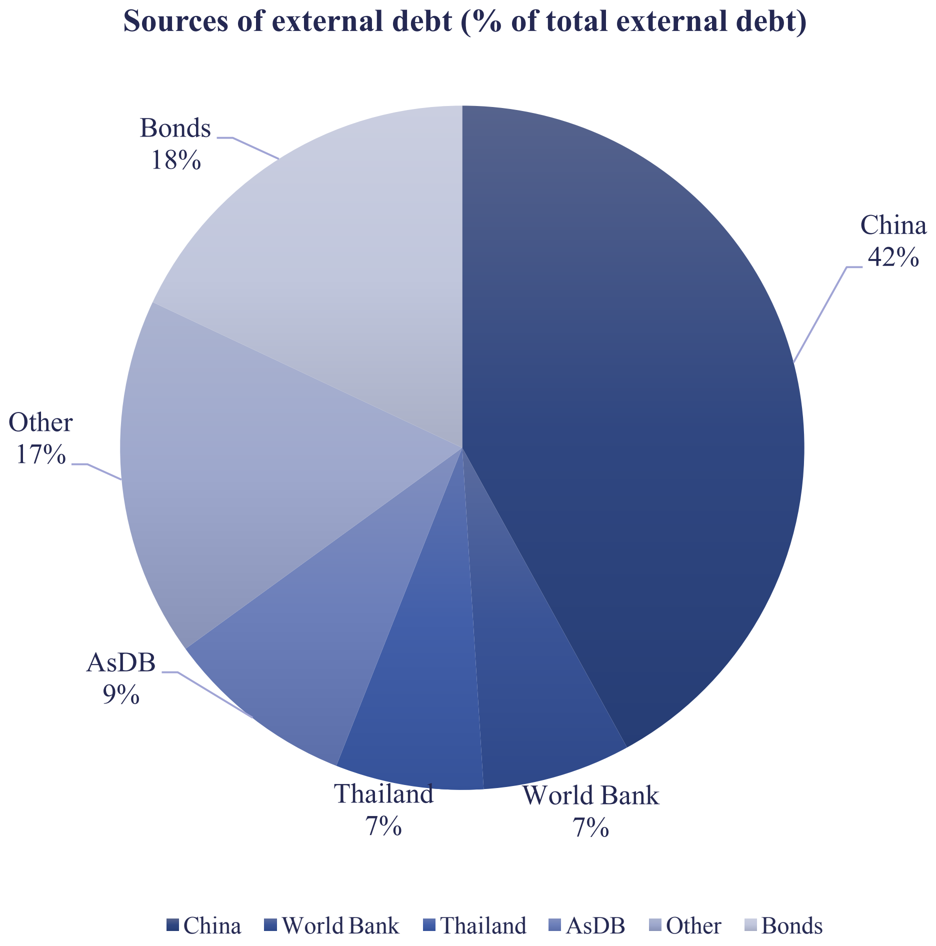


Source: IMF, ANZ

At current levels, public and publicly guaranteed debt (PPG) is estimated to grow to 66% of GDP by 2019. Most of this debt is external and increasingly non-concessional. According to the World Bank, about two-thirds of total external public debt is denominated in USD and from bilateral sources (including a bond issuance in October 2017 in the Thai capital market to fund the fiscal deficit) which makes the economy more prone to external risks (see Figure 3). Increased reliance on non-concessional funding further adds to the overall debt servicing burden – the World Bank estimates that interest payments accounted for 11% of overall domestic revenue in Q1 2018 which exceeds planned public spending on health and is close to 60% of overall spending on education.

The fiscal deficit is expected to decline to 4.3% and 4.1% in 2018 and 2019, respectively (non-mining deficit to around 5%) but a firm commitment to fiscal consolidation is needed to reduce the deficit on a sustained basis. The authorities have committed to bringing down the deficit to 2.5% and debt to 55% of GDP by 2022. However, setting an official debt target will likely help to achieve the goal more forcefully.

Figure 3. Lao PDR is increasingly relying on bilateral and commercial loans



Note: Data as of end 2017 (preliminary)

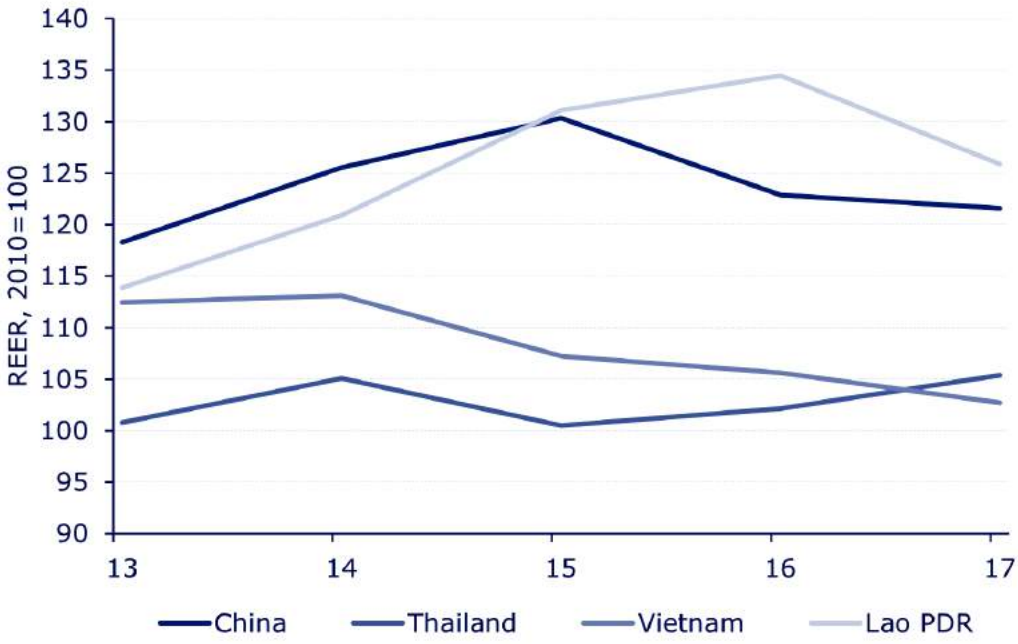
Source: World Bank Lao Economic Monitor 2018, ANZ

Dollarization and monetary policy transmission

The IMF officially recognizes the currency system of Lao PDR as a stabilized arrangement (IMF, 2016[2]) maintaining a de facto exchange rate anchor to the USD. Both USD and THB are circulated widely in the economy, secondary to the country's local currency, kip (LAK). Bank of Lao PDR (BoL) conducts monetary policy in the country and the exchange rate is a managed float (an adjustable peg to the USD, +/- 5% but counts for fluctuations in both the USD and THB).

Based on its external balance assessment methodology,[3] the kip was evaluated to be overvalued by 44-49% at the end of 2016. Given the managed FX regime, the currency likely remained on the overvalued side despite some correction in recent months (Figure 4). We believe the current environment of broad dollar strength and economic fundamentals will continue to see the kip on the weaker side of the band, ending 2019 at 8650. Meanwhile, Lao PDR's monetary policy transmission remains feeble. Despite the slight loosening in policy rates by the BoL in December 2017, high dollarization and informal capital markets limit smooth transmission of monetary policy.

Figure 4. Despite recent correction, LAK REER still overvalued



Source: BIS, IMF, ANZ

We highlight the vulnerability in the external position of Lao PDR as a risk because of the low FX reserves position in the economy (Figure 5). Being highly dollarized makes it vulnerable to trends in global liquidity and a sufficient reserves buffer indicates the economy can withstand shocks better.

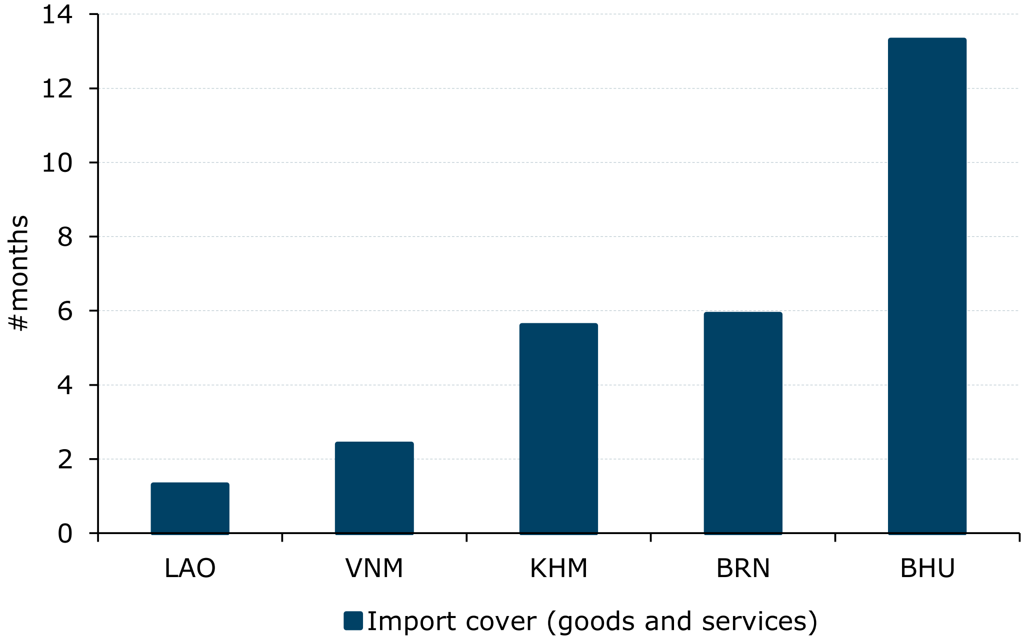
This is especially crucial given that the economy's current account deficit, projected at 14.9% of GDP in 2018, is very high. This deficit is expected to slightly correct to 13.7%

[2] https://www.imf.org/~/media/Files/Publications/AREAER/AREAER_2016_Overview.ashx

in 2019[3]. However, large scale infrastructure projects including construction related projects (like the Kunming-Vientiane rail network) will keep import growth high.

Although the fact that FDI and trade contracts are largely denominated in USD lessens the risk of such high deficits on the external sector, the non-FDI trade deficit is also expected to be high at 2.7% of GDP in 2019.

Figure 5. Lao ranks low on reserve adequacy compared to other dollarized economies



Note: data is for 2018 (projected)

Source: IMF, ANZ

Effects on the banking sector

Here we highlight **four** key challenges the banking sector faces given a highly dollarized economy and high public debt which is primarily external in nature:

1. **Sudden tightness in liquidity could cause a credit squeeze for banks and in turn impact banks' balance sheets**

   Broad money growth (M2) as well as narrow money (M1) rose in the first quarter of 2018, by 10.1% and 11% y/y, respectively. But much of the expansion in M1 can be attributed to currency held outside banks. Most of M2 growth can be attributed to higher FX deposits in commercial banks which means that deposit growth in kip is slowing. This could be the result of interest rate caps on kip deposits in 2015 but generally points to a liquidity crunch in local currency.

[3] https://www.imf.org/en/Publications/CR/Issues/2018/03/23/Lao-Peoples-Democratic-Republic-2017-Article-IV-Consultation-Press-Release-Staff-Report-and-45750

The World Bank[4] estimates that 54% of total banking sector deposits in 2017 were foreign currency deposits, up from 52% in 2016. In addition, there are kip lending rate caps in place as well which can be extremely restrictive for banks in the pricing of risks and exposures adequately.

2. **Relatively underdeveloped interbank market**

   Recent regulatory changes have accelerated kip payments in taxes and general spending but the slowdown in kip denominated loans amid tighter kip liquidity is adding to banking stress. Currently, banks are required to resolve kip borrowings amongst themselves in the interbank market, which is fairly underdeveloped. Also, the BoL provides emergency backstop funding for only up to an average of 30 days which makes acquiring kip liquidity even more challenging. While existing policies restrict lending in FX only to exporters and in some sectors to better manage hedging risks, currently available instruments make it a challenge for commercial banks with large foreign exchange asset base to find kip liquidity to fund their lending.

3. **Slower than expected growth in 2019 could lead to higher NPLs**

   Non-performing loans (NPLs) have edged up (officially 3.7% at end 2017) which could be underreported given that post a 2017 regulation, loans related to public investments are not treated as NPLs. The government has used its recent 10-year bond issuances to settle these liabilities but a bigger action plan around limiting NPLs is required. Risks of a slowdown in GDP, especially if downside risks to China's growth materialize, can further add to possibly higher NPLs.

4. **Further kip depreciation could adversely impact banks' balance sheets which already have a lot of FX exposure**

   Currently, most domestic commercial banks have significant FX exposure and further depreciation in the kip will worsen their balance sheets aggravating the currency-maturity mismatch problem. De-dollarization of the economy is therefore a pre-requisite for this risk to subside. Concentration of banks further adds to the challenge – if the big banks fail then the financial system is worst hit. Although the entry of newer players, including foreign banks, has improved financial depth, there needs to be a push for greater financial regulation as well as firmer financial institutions.

What we propose

In this section, we propose steps that can be taken to mitigate the risks associated with high fiscal deficits and high dollarization. These broadly include **three thrusts of structural reforms**: 1) enhancing the financial system of which banking is the primary participant, 2) reducing the budget deficit and the burden of public debt, and lastly 3) a movement towards a more stringent monetary policy framework which can help limit the first two risks.

[4] http://pubdocs.worldbank.org/en/783711528971545247/LEM-June2018-Final-for-web.pdf

Develop the financial system

The banking industry is the biggest part of Lao PDR's financial system. With underdeveloped debt and equity markets and limited non-bank financial institutions, the onus of maintaining financial sector stability rests on banks. A healthy banking system makes monetary payments low-cost, effectively mobilizing funds to encourage both investments and savings.

To this effect, the Lao government has liberalized and reformed the banking sector over the years (moving to a two-tier banking system). However, despite the transition initiated in the 1980s, the financial system still remains underdeveloped and shallow. Within banks, the reliance on bigger, publicly owned banks is heavy, even after the enactment of the Law on commercial banks in 2007. [5]

While, increased money supply has raised the market share of commercial banks compared to central bank credit and more is going to the private sector now, the reliance on foreign assets still remains high, concentration of banking is extensive and improving financial deepening and building regulation is the underlying need.

Some regulatory framework changes around a more sound banking system involve **macro prudential measures**. Slowly, the reliance on foreign currency deposits has to be lowered. To this effect, authorities have already underlined some measures including interest rate caps on USD loans. But overall regulation has to be robust to maintain soundness in banks' day to day operations.

The idea of regulation doesn't end with its initiation only. While a number of regulations already exist, it is important to implement and enforce them. This rests on the BoL to undertake stricter actions to ensure capital adequacy and encouragement in kip lending.

As part of the ASEAN community, Lao PDR can look to standardize its banking system in line with its peers. It can take cues from Indonesia and Vietnam which are undergoing consolidation in the banking industry or Thailand and Malaysia which having undergone consolidation are now looking to tighten regulations around it. In Cambodia, a close neighbour, the banking sector is still in its latent stages of development but the emphasis around regulations is stronger.

Checking NPLs is also important especially as a higher burden can lead to a credit squeeze which can further add to downside risks on growth. The bigger issue is to tackle NPLs of the state owned banks which rely on guaranteed bailouts because they are big and under government's control. This can add to their risk taking abilities and must be checked by the authorities by proposing to be more selective in its bailing out strategies.

As we highlighted earlier, developing the interbank market is imperative. As banking becomes more efficient and deep, there should be a shift towards more repo and non-repo contracts and banks being able to provide more kip liquidity to each other to enable continuous price setting across various products and ensure adequate liquidity to commercial banks.

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[5] http://www.vientianetimes.org.la/Laws%20in%20English/63.%20Law%20on%20Commercial%20Banks%20(2007)%20Eng.pdf

Greater consolidation of banks is necessary to flush out weaker banks and strengthen the system. Too many smaller banks do not lead to more credit in the system; rather it adds to inefficiency. The idea is to strengthen institutions and deepen markets, increase accessibility and improve efficiency for which a consolidated strategy rather than emphasis on quantity is key. According to the efficient market structure hypothesis, more concentrated markets are said to be more efficient as those which are able to minimize costs and maximize revenue will end up dominating the inefficient ones.[6]

Also important is to improve depth of the banking sector: reach out to more rural areas, make the economy less cashless by issuing more cheques, certificates of deposits etc. and channelize savings from commodities like gold and silver to kip to bring it into the banking system.

Case study: Indonesia

Indonesia's financial system, particularly the banking sector, was largely similar to Lao PDR's. The financial system was largely underdeveloped with greater concentration of banks and shallow capital market. This further aggravated the problem of financial exclusion for the poor.

However, post the 1997 Asian Financial crisis and the agreement with the IMF for restructuring the banking sector, a number of reforms were carried out like closing many smaller commercial banks, introduction of the Indonesian Bank Restructuring Agency (IBRA) taking over the NPLs of state banks and acting as shareholders of early private banks. Since the 2000s, there has been a shift towards injecting government bonds to the banking sector and an increase of capital to total assets. NPLs also declined to moderate levels by 2002. Another remarkable achievement has been the reduction in the concentration of their banking industry.

Over the years, such reforms have helped the economy gradually move up the financial development chain, which the IMF also acknowledges in its broad-based index of financial development[7] (Figure 7). The index encompasses depth, accessibility and efficiency in both financial institutions and markets. The progress on accessibility and efficiency of financial institutions is particularly noteworthy, classified on the basis of increased bank branches and ATM machines as well as improved margins, spreads and returns on assets and equity for domestic banks. In contrast, while Lao PDR's efficiency parameters in institutions are still robust, there is a lot to achieve in the depth and accessibility aspect.

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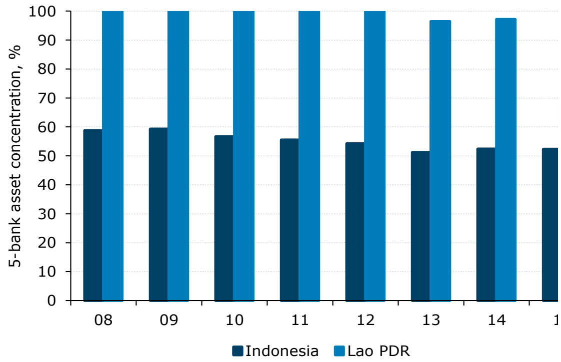
[6] https://www.sciencedirect.com/science/article/pii/S1044028317304064 citing Brümmerhoff, 2007

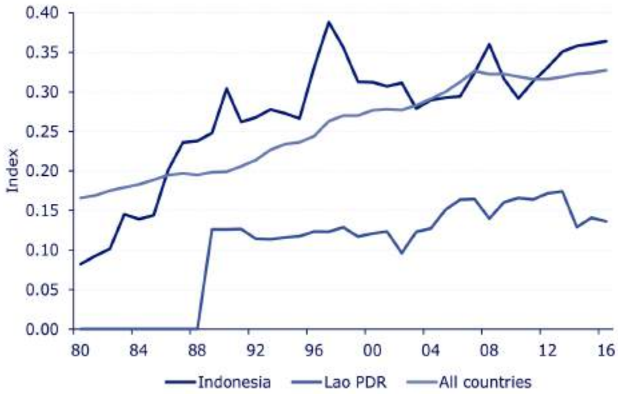
[7] https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/wp/2016/_wp1605.ashx

Figure 6. Banking in Lao PDR is still heavily concentrated



Source: Federal Reserve Economic Data, ANZ

Figure 7. Indonesia's advancement in financial development a source of inspiration for Lao PDR



Source: IMF Financial Development Index, ANZ

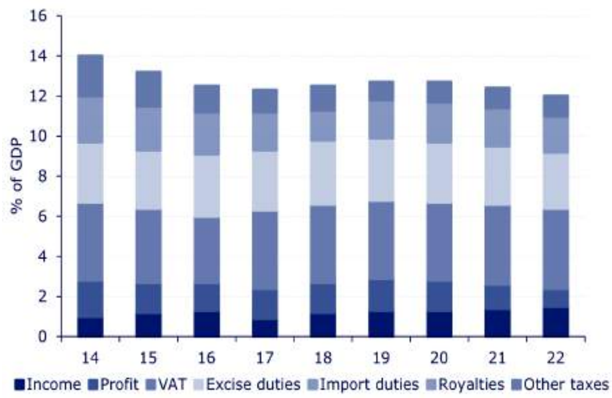
Manage public debt and deficit

In Lao PDR debt levels have risen gradually every year in the recent past, which subsequently warrant some fiscal adjustment. Worsening fiscal imbalances also impact the current account, adding to more pressure on the currency. To this effect, a proper path to fiscal consolidation is required. While efforts are underway, three main things can be focused on: a) raising tax revenues (including non-mining tax revenue), b) limiting current expenditure, and c) reducing non-concessional borrowing.

While the move towards tax consolidation is not an easy one, Lao PDR can take small steps towards it, especially given that most of its existing tax structure centres around various indirect taxes. Tax codes must be simplified and exemptions reduced. The government has already shown commitment to formulating a medium term revenue strategy with the IMF till 2022 to work towards this. This will require re-introducing some taxes like capital gains to increase the tax base and streamline existing ones like excise duty and land tax.

The IMF has also proposed removal of tax holidays, limiting customs incentives and reducing tax exemptions on a cost-benefit format. Only when specific small steps towards streamlining taxes will be taken, can the economy slowly move towards implementing a goods and services tax (GST)-like bigger tax reform.

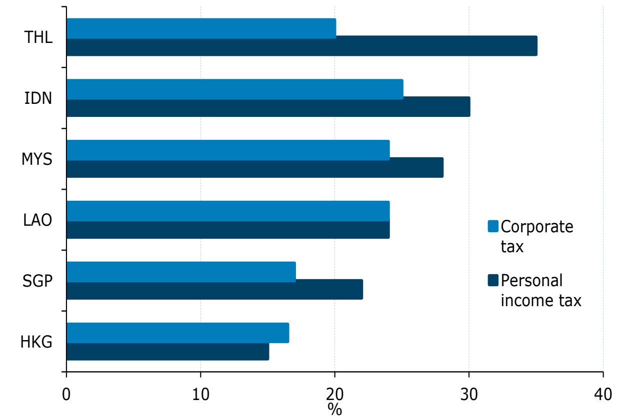
Figure 8. Streamlining existing taxes in Lao PDR important



Note: 2017 value is estimated, 2018 onwards are projections

Source: IMF, ANZ

Figure 9. Singapore's tax rates lowest in ASEAN



Note: Values are latest available

Source: Local reports, ANZ

Case study: Singapore

Large dependence on FDI flows, a currency closely tracking the US dollar, challenges in liquidity and similar population sizes make Singapore a classic peer of Lao PDR (UN population statistics show Singapore's estimated population in 2018 is roughly only 1million less than Lao PDR's). Given these similarities, Lao PDR can improve its fiscal stance in line with Singapore's which undertook a major restructuring in its taxation system in the early 1990s[8]. But the difference lies in the fact that even when there was a need to restructure taxes in Singapore, revenue growth was still strong and expenditure was controlled.

The economy enjoyed a sustained budget surplus over five years preceding the introduction of the Goods and Services Tax (GST) in 1994. The rationale for introducing GST was given on the basis of the nature of the economy, increasing the tax base, streamlining indirect taxes and reducing economic distortions. Since it is a consumption based tax, it is less affected by economic cycles and therefore provides a more stable stream of revenues.

Simultaneously, a number of other tax reforms were also implemented like: 1) bringing down corporate taxes over the medium term, and 2) relief on personal income taxes. This has enabled Singapore to be one of most efficiently taxed economies in the region, an aspect that has helped it rank up the doing business indicators (WB ease of doing business 2018 ranked Singapore 8th on the 'paying taxes' category while Lao PDR was ranked 155th[9]).

Singapore continued with its tax reforms even after the GST was introduced, extending its commitment to bringing down taxes on income, property and commodity further.

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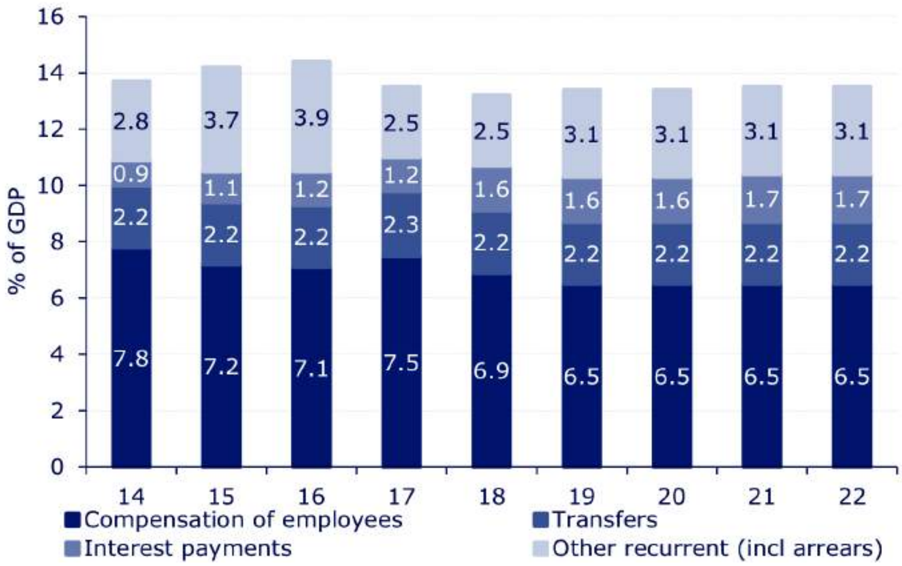
[8] https://econpapers.repec.org/RePEc:qed:dpaper:129

[9] http://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2018-Full-Report.pdf

- **Limit spending** especially on current items starting with reducing public sector wages. The government has already undertaken this by limiting entry of newer staff. However, the estimate of 6.5% of GDP in the next few years is still a high number. Streamlining taxes and reduction in current spending can help release funds for capital and social spending. The thrust on infrastructure adds to the framework around building more sound institutions whereas higher social spending can also ensure more equity and welfare in the society.

Figure 10. Public sector wages rose in 2017



Source: IMF, ANZ Research

- **Reduce dependence on borrowings**, especially non-concessional debt is important. 80% of Lao PDR's external debt is denominated in foreign currency with 2/3rds in USD. Given this composition, debt service ratios will increasingly become more sensitive to currency depreciation risks. To limit this, authorities should make provisions enabling as much borrowing on concessional terms as possible. There has to be clearer guidelines for issuing more sovereign debt and guarantees. In this regard, the IMF's debt sustainability analysis and framework should be strictly adhered to in order to achieve medium term debt targets.

Strengthen the monetary policy framework

Within the broad monetary policy framework comes two main aspects that need to be reformed in the Lao economy.

1. **De-dollarization**

Lao PDR is highly dollarized (close to 45% of broad money) which limits the effectiveness of monetary policy. Underdeveloped financial markets add to this challenge. While the stock and bond markets exist, they are at a fairly nascent stage with limited momentary instruments. Generally, prolonged macroeconomic instability is considered the primary cause for dollarization. The opposite therefore, is one of its true remedies. Although the economy has stabilized post the Global Financial Crisis the level of foreign assets in the banking system is declining very gradually. The most important task for the government is to maintain stability in the economy and the exchange rate. This will ensure that households regain confidence in holding assets in the local currency than in dollars or baht. The government can induce individuals to save in local currency by slightly adjusting deposit rates higher for kip payments than for foreign currency deposits. Same can be done for lending to enable more transactions in local currency. The introduction of the new payments system is a welcome step as it will likely reduce transaction costs.

2. **Anchor monetary policy**

   This involves broader anchoring of the current monetary policy framework which will gradually lead to currency flexibility. Having an anchor for monetary policy means recognizing a goal to work towards. For this, the central bank must be certain that the goal is: a) imperative, b) essential and is therefore, c) providing the relevant independence to achieve it. We believe price stability has its proven advantages: a) it turns the focus of policy making to domestic developments; and b) makes it easier to respond in times of shock. But setting up a formal framework requires commitment, including transparency and providing autonomy to the Central Bank to carry out this goal. Underlying this is the need for more reliable institutions, more depth in collection of data and dependable tracking of various data for forecasting. This requires a gradual move towards more financial deepening. Once the broader framework for monetary policy is achieved, exchange rate flexibility will follow. Gradual depreciation of the currency can be allowed and subsequently a forex market must be created. However, stark depreciation at the current levels is not advisable, especially as the economy continues to be highly dollarized.

Case study: Vietnam

Vietnam is a definitive example of a successful de-dollarization story, leaving it to market forces to reduce the proportion of dollar deposits in the economy. The other means is via the legal route, obliging citizens to convert their foreign currency deposits into local currency, like Argentina did in 1999.

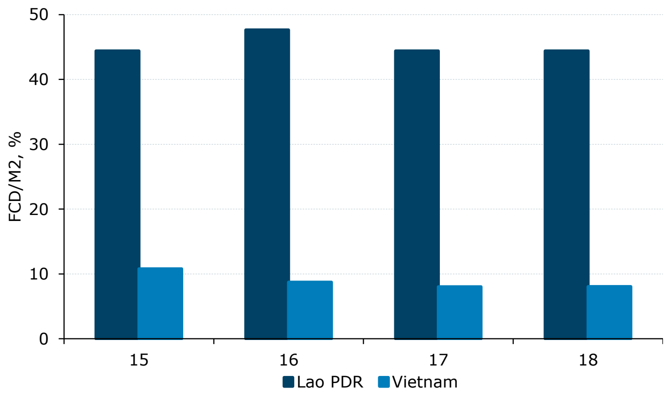
Vietnam's high dollarization[10] was a direct result of initiating economic reforms during a period of economic instability and hyperinflation (as high as 300%). But from almost 40% in the 1990s, dollar deposits are now down to below 10% as estimated by the IMF. The State Bank of Vietnam (SBV) has undertaken efforts to reduce dollar deposits – by enabling higher currency inflows and cutting dollar deposit rates to zero in 2015.

However, the bigger support has come from greater financial and economic stability which has helped contain inflation and increase public confidence in the Vietnamese dong (VND). Vietnam's story of de-dollarization is particularly useful for Lao PDR given the similar nature of their currency regime, where the currency largely trades

[10] https://www.adb.org/sites/default/files/publication/27502/dealing-currencies.pdf

within a fixed band. However, due to the varied dollarization levels in the two economies, further currency depreciation risks will be a bigger risk for Lao PDR than Vietnam.

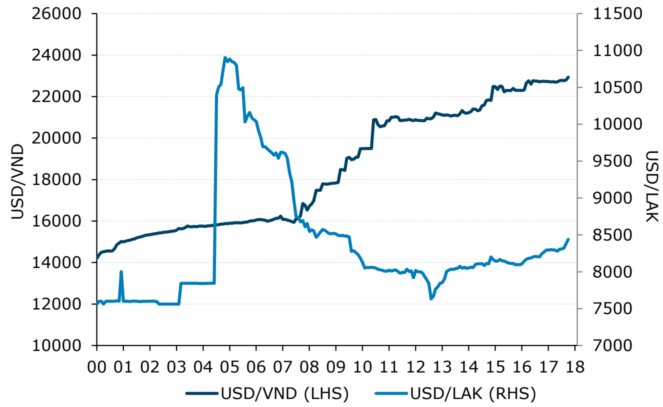
Figure 11. Dollarization levels in Lao PDR still at high levels



Note: 2018 values are projections

Source: IMF, ANZ

Figure 12. Both currency regimes are broadly similar



Note: IMF classified both regimes as stabilised arrangement

Source: Bloomberg, ANZ

Conclusion

We have highlighted the effects that the unfavourable fiscal position and vulnerability from a highly dollarized economy have had on the banking sector, which forms the foundation of the economy's financial system. Our analysis finds that bringing about structural reforms is key, including reforms in:

- banking
- increased regulation
- lowering concentration
- transforming the taxation system
- movement from current to capital spending
- increased macroeconomic stability
- a shift to broader monetary policy anchoring; and
- two-way flexibility of the exchange rate

As the country progresses towards greater maturity and sophistication, it will inevitably lead to more substantive reforms, with the underlying help from all the authorities involved.