

Narrowing Development Gaps in ASEAN: Perspective from Lao PDR¹

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Received July 2012; revised January 2013; accepted 31 March 2013

ABSTRACT

The ASEAN has a large development gap in terms of income and non-income. Sustaining high economic growth is one of the most important factors for Laos if the country is to catch up with old ASEAN members.

However, there are many economic challenges to maintain high economic growth. Here are just some of the challenges: it is important to deal with Dutch disease as a result of natural-resources-based growth; human capital needs to be fostered; the economic infrastructure needs to be modernized, e.g. transportation costs need to be reduced; the financial sector needs to be improved and state-owned enterprises need to be restructured; governance and institutions need improvement; and, finally, there needs to be an improvement in the business climate. In addition, it is important to ensure that growth is conclusive. High economic growth alone cannot achieve this goal. Therefore, it is important to provide direct support to the poor through various public investment and direct social programs, such as condition cash transfer.

Keywords: ASEAN divide, Lao perspective, narrowing development gap.

JEL classification: D60, F21, O10; O16

¹ This is updated and revised vision of a paper presented at the International Seminar on The GMS (Greater Mekong Sub-region) Development Plan to bridge the ASEAN Divide, Kyoto, Japan, March 9-11, 2012.

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1. INTRODUCTION

ASEAN leaders have agreed to establish an ASEAN Economic Community (AEC) by 2015. The AEC includes existing economic programs such as the ASEAN Free Trade Area (AFTA), the ASEAN Framework Agreement on Services (AFAS), and the ASEAN Investment Area (AIA). One of the main concerns in the AEC is the development gap between older and newer members (CLMV: Cambodia, Laos, Myanmar, and Vietnam). Development gaps will hinder the progress of the AEC.

CLMV are also different in terms of the pace of reforms and international integration, as well as their socio-economic performance. CLMV have limited resources, knowledge limitations, a lack of practical experience, and small domestic markets. AEC will promote economic growth, narrow development gaps, strengthen competitiveness, provide opportunities to learn, and ways of exchanging knowledge of the development process in CLMV. However, there is the possibility that the AEC could widen the development gaps between the newer and older members. There is a chance that AEC could have negative effects on the environments and social aspects of CLMV.

Laos is one of the CLMV countries that has a large development gap compared to old ASEAN members. Promoting economic growth and reducing poverty are the twin priorities of the Lao government. As a result, Laos has achieved high economic growth and poverty has been reduced sharply. However, in order to make sustainable economic growth in the long run to catch up with other ASEAN countries, various economic issues need to be addressed.

Despite the importance of narrowing the economic gaps between ASEAN countries, there are few studies on this issue, particularly within the context of Laos. Therefore, the main objective of this paper is to identify the policies needed for narrowing the development gap between Laos and ASEAN. The paper will focus on policies and challenges at national level and on the role of external factors.

This paper is organized as follows.

- Section 2 gives an overview of the development gaps in ASEAN.
- Section 3 describes the current state of the economy in Laos.
- Section 4 describes the policies for narrowing development gaps.
- Section 5 outlines the constraints of this study presents the conclusion.

2. THE DEVELOPMENT GAP IN ASEAN

Development is a very broad inter-disciplinary and multi-dimensional concept. Development is "the process of improving life quality" both materially and spiritually (Todaro and Smith 2003) and development must be defined by an individual's achievements and by the means that the individual possesses (Sen 1985; 1999; 2000).

In addition, Kriengsak (2004) includes continuity and sustainability along with deep and broad changes such as changes in the structure of economics, society, education, management, politics and social values.

Gross Domestic Production (GDP) is a popular measure of economic growth, but it is not sufficient to measure development because development is multi-dimension, including

command over resources, choice of livelihood, human capabilities, healthcare environment, adequate housing, availability of food, political freedom, and many others (Brooks et al. 2010). Therefore, in the early 1990s, the United Nations (UN) started to use the Human Development Index (HDI) as the measurement of development.

In ASEAN there are various gaps in terms of income and non-income. In this paper, we focus on income gaps and human development index gaps. There are great disparities of income between ASEAN members. The GDP per capita varies from US\$702 in Myanmar (lowest) to US\$ 43,117 in Singapore (highest) in 2010. ASEAN countries can also be divided into three groups of GDP per capita.

- Group 1 includes high-income member countries such as Singapore and Brunei. These two countries have GDP per capita over US\$ 30,000.
- Group 2 is made up of middle-income countries including Malaysia, Thailand, the Philippines, and Indonesia, which have GDP per capita over US\$20,000.
- Group 3 contains low-income member countries, the newer ASEAN members of Cambodia, Laos, Myanmar, and Vietnam, with GDP per capita below US\$20,000 (Table 2-1).

There is also a disparity in human development terms between ASEAN members. According to UNDP (2011), Singapore, Brunei, and Malaysia belong to the High Human Development group with HDI of over 0.7, ranking 26th, 33th and 61th out of 187 ranked countries. The rest of the ASEAN countries belong to the Medium Human Development group with HDI of about 0.71-0.79, including Thailand (103th), the Philippines (112th), Indonesia (124th), and Vietnam (128th). Cambodia (139th), Myanmar (149th) and Laos (138th) are in the lowest range, with HDI of 0.55-0.70 (Table 2-2).

Table 2-1. GDP and GDP per capita of ASEAN countries

Country	GDP (US\$ million)				GDP per capita (US\$)			
	1980	1990	2000	2010	1980	1990	2000	2010
Brunei	4.9	3.5	6.0	13.0	25,534	13,913	18,465	31,228
Cambodia	..	0.9	3.7	11.6	..	106	288	814
Indonesia	95.4	125.7	165.5	706.7	644	699	807	3,015
Lao PDR	1.0	0.9	1.6	6.3	310	217	304	984
Malaysia	24.9	44.0	93.8	238.0	1,812	2,432	4,030	8,423
Myanmar	6.3	2.8	8.9	43.0	186	68	178	702
Philippines	32.5	44.2	75.9	188.7	672	718	987	2,007
Singapore	12.0	38.8	94.3	222.7	4,756	12,388	22,791	43,117
Thailand	32.4	85.6	122.7	318.9	696	1,521	1,983	4,992
Viet Nam	27.8	6.5	31.2	103.6	514	98	402	1,174
ASEAN	237.2	353.0	603.6	1,852.5	664	805	1,166	3,107

Source: World Economic Outlook Database, April 2011 Edition, International Monetary Fund, available at <http://www.imf.org/external/pubs/ft/weo/2011/01/weodata/index.aspx>.

Table 2-2. Human Development Index (HDI) in ASEAN

Countries		2000	2005	2007	2010	2011
Brunei	Value	0.871	0.894	0.920	0.805	0.838
	Rank	32	30	30	37	33
Cambodia	Value	0.543	0.598	0.593	0.494	0.523
	Rank	130	131	137	124	139
Indonesia	Value	0.684	0.728	0.734	0.600	124
	Rank	110	107	111	108	0.617
Lao PDR	Value	0.485	0.601	0.619	0.497	0.524
	Rank	143	130	133	122	138
Malaysia	Value	0.782	0.811	0.829	0.744	0.761
	Rank	59	63	66	57	61
Myanmar	Value	0.552	0.583	0.586	0.451	0.483
	Rank	127	132	138	132	149
Philippines	Value	0.754	0.771	0.751	0.638	0.644
	Rank	77	90	105	97	112
Singapore	Value	0.885	0.922	0.944	0.846	0.866
	Rank	25	25	23	27	26
Thailand	Value	0.762	0.781	0.783	0.654	0.682
	Rank	70	78	87	92	103
Viet Nam	Value	0.688	0.733	0.725	0.572	0.593
	Rank	109	105	116	113	128

Source: UNDP (Various years).

3. PRESENT STATUS OF THE ECONOMY AND POVERTY IN LAOS

Over the last five years, from 2006-2010, average GDP growth was about 7.9% per annum (Table 3-1). Despite the recent global financial crisis, GDP grew by 7.6%, 8.2% in 2008 and in 2009 respectively. GDP per capita increased from about US\$ 325 in 2000 to about US\$ 1.086 in 2010, an increase of 3.4 times in 10 years. Industry and service sectors were the main driving forces of GDP growth, accounting for an annual average growth of 11.6% and 8.9% respectively, while the agriculture sector grew at a moderate rate of 3.7% per annum for the last five years.

After the Lao economy was hit by the East Asian financial crisis in the late 1990's, causing hyperinflation for the first time in Lao history, with a peak of 134% in 1999, inflation has been gradually declining to one digit since 2005, and is now considered stable. In 1997 Lao PDR suffered dramatic depreciation of its currency – of 1000% – when the Lao kip fell against the US dollar during the East Asian financial crisis. The kip went from 1000kip per US\$ in 1997 to about 10.000kip per US\$ in 1998. Since 2000, the exchange rate between the Lao kip and the US\$ has been relatively stable. However, in recent years, by the late 2000's (2010-2011), the exchange rate of the Lao kip has been appreciating as a result of the increase in inflows of foreign capital in the form of foreign direct investment (FDI), overseas development aid (ODA) and the increase in export revenue in US dollars from booming export growth in the mining and hydropower electricity sectors, compounded by the depreciation of the US\$ in general since the global financial crisis in 2008.

Even though Laos has maintained high economic growth with low inflation and a stable exchange rate, it still has serious macroeconomic issues to overcome.

- First, current economic growth depends on the hydropower and mining sectors, which might have an inverse impact on long-term development.
- Second, Laos is facing chronic twin deficits in both government spending and international trade. The average ratio of budget deficit to GDP was 4.4% during 2001-2010. The average ratio of current account balance deficit to GDP was 9.24% during the same period. These deficits are mainly financed by official development assistant (ODA), foreign direct investment (FDI), and remittances. The fiscal issue is particularly serious in Laos. If the budget deficit continues to expand, it might cause an accelerating inflation rate and the devaluation of the kip, and could lead to the kind of economic instability experienced during the Asian Financial Crisis (Okonjo et al. 1999).
- Third, there is a huge gap between savings and investment. The savings rate is low because of low average incomes and because the financial sector is underdeveloped. The banking sector is occupied by state commercial banks, which are unable to perform full banking functions.
- Fourth, Laos is also facing a high burden of external debts. The external debt accumulation was more than 50% of GDP in 2010 (IMF, 2011). If Laos becomes too dependent upon foreign finance, especially to meet its debt obligations, this could cause a foreign debt crisis and might lead to macroeconomic instability.

Table 3-1 Macroeconomic indicators (2006-2010)

No.	Indicators	Unit	2006	2007	2008	2009	2010
1	Total population*	Thousand	5,746.0	5,868.0	5,990.0	6,111.0	6,186.0
2	GDP growth rate	%	8.2	8.0	7.8	7.6	7.9
	- Agriculture	%	2.0	7.1	4.9	3.0	3.0
	- Industry	%	13.3	6.6	9.0	16.6	17.7
	- Services	%	9.7	9.2	9.5	6.9	6.7
3	Shares of GDP	%	100.0	100.0	100.0	100.0	100.0
	- Agriculture	%	31.2	31.0	30.3	30.4	29.0
	- Industry	%	26.7	26.8	26.0	24.9	26.0
	- Services	%	35.7	35.7	37.0	38.4	39.0
	- Net taxes and import duties		6.4	6.5	6.6	6.3	6.3
4	GDP per capita	Mil. Kip	6.0	6.7	7.5	7.7	8.7
		US dollar	573.0	687.0	818.0	906.0	1,069.0
5	Revenue	Bil. Kip	5,107.7	6,134.1	7,312.0	8,365.2	12,517.0
	- Revenue (excl. ODA)	Bil. Kip	4,411.4	5,460.2	5,904.4	7,222.0	8,890.3
	- ODA	Bil. Kip	696.3	673.9	694.6	1,143.2	3,562.0
6	Expenditure	Bil. Kip	6,944.0	8,099.0	9,721.0	10,484.0	13,966.0
	Budget deficit						
	- Budget deficit (incl. ODA)	Bil. Kip	-1,836.2	-1,965.7	-2,409.2	-2,118.8	-1,449.0
	- Budget deficit (excl. ODA)	Bil. Kip	-2,532.5	-2,639.6	-3,103.8	-3,262.0	-4,814.4
8	Money supply (M2)**	Bil. Kip	5,203.0	6,101.0	8,867.0	10,780.0	18,999.0
	- Inflation rate (Year end)	%	4.7	5.6	3.2	3.9	8.4
	- Inflation rate (Average)	%	8.0	4.1	7.9	0.7	4.7
9	Trade deficit*	Mil. USD	-178.2	-141.9	-311.3	-408.3	118.0
	- Export*	Mil. USD	882.0	922.7	1,091.9	1,005.3	1,788.9
	- Import*	Mil. USD	1,060.0	1,064.6	1,403.2	1,413.5	1,671.0
10	Current Account Balance (CAB)	Mil. USD	51.0	107.0	91.0	-132.0	na
11	Total investment (public + private)	Bil. Kip	10,654.2	13,632.3	6,883.2	15,385.9	16,200.3
	Public investment	Bil. Kip	3,649.0	2,614.6	3,642.4	3,329.9	5,125.3
	Private investment	Bil. Kip	7,005.2	11,017.7	3,240.8	12,056.0	11,075.0
12	Percentage of GDP by component						
	M2/GDP	%	15.2	15.5	19.8	22.8	24.9
	Revenue (incl. ODA)/GDP	%	14.9	15.6	14.7	17.7	19.7
	Revenue (excl. ODA)/GDP	%	12.9	13.9	13.2	15.3	15.0
	Expenditure/GDP	%	20.3	20.6	19.8	22.2	23.2
	Budget deficit/GDP	%					
	- Budget deficit (incl. ODA)/GDP	%	-5.4	-5.0	-5.4	-4.5	-3.5
	- Budget deficit (excl. ODA)/GDP	%	-7.4	-6.7	-6.9	-6.9	-8.2
	Current Account Balance/GDP	%	-7.2	1.4	2.5	1.7	-2.4
	Trade deficit/GDP	%	-5.0	-3.4	-5.9	-7.3	-5.2
	Export/GDP*	%	24.9	21.9	20.7	17.9	18.2
	Import/GDP*	%	29.9	25.3	26.6	25.1	23.4
	Total investment/GDP	%	31.1	34.6	15.4	32.6	29.9
	Public investment/GDP	%	10.7	6.6	8.1	7.1	9.5
	Private investment/GDP	%	20.5	28.0	7.2	25.5	20.4

Sources: Ministry of Planning and Investment, Lao PDR, 2011

Poverty is one of the most important issues for Laos. In order to eradicate poverty by 2020, the government has implemented the National Growth and Poverty Eradication Strategy (NGPES), an overall development and poverty alleviation framework (GoL 2004). Analysis of four Lao Expenditure and Consumption Surveys (LECS) from WB and DOS (2009) showed that the incidence of poverty has fallen since LECS 1, though it fell slowly during 1997-98. The incidence of poverty fell from 46% in LECS 1 to 39% in LECS 2, and from 33.5% in LECS 3 to 28% in LECS 4. However, inequality has increased, especially in Vientiane and other urban areas. The Gini coefficient increased from 30.5 in LECS1 (1992/93) to 35.4 in LECS 4 (2007/08). In Vientiane, the Gini coefficient increased from 29.7 in LECS1 (1992/93) to 38.00 in LECS 4 (2007/08). Despite reducing poverty, Laos still faces high poverty and inequality.

Table 3-2. Poverty trends in Laos

	LECS 1 1992/93	LECS 2 1997/98	LECS 3 2002/03	LECS 4 2007/8
Laos	46	39.1	33.5	28
Urban	27	22	20	17
Rural				
with road	43	32	31	30
without road	61	51	46	43
Lowland			28	20.5
Midland			36.5	29
Upland			34	33

Source: World Bank and DOS (2009).

Note: LECS (Lao Expenditure and Consumption Census).

Table 3-3. Inequality trends in Laos

	LECS 1 1992/93	LECS 2 1997/98	LECS 3 2002/03	LECS 4 2007/08
Laos	30.5	34.9	32.6	35.4
Urban	30.9	39.7	34.8	36.3
Rural				
with road	29.3	32.1	30.3	33.2
with road	27.5	30.9	29.4	33.3
Region				
Vientiane	29.7	36.9	36	38
North	26.9	34.5	30.7	35.2
Central	31.5	32.5	31	34
South	32.3	32.4	31.4	32.2

Source: World Bank and DOS (2009).

Note: LECS (Lao Expenditure and Consumption Census).

4. NARROWING THE DEVELOPMENT GAP

Narrowing the development gap requires sustainable economic growth in the long term but it is important to ensure that growth is inclusive. In other words, growth itself cannot bring down poverty and inequality. Therefore, direct support for the poor is also an important factor for narrowing the development gap.

Economic growth is not a sufficient condition for broad-based development, but it is a necessary condition to achieve basic development goals (Commission on Growth and Development 2008). In addition, empirical studies find that economic growth has a positive impact on sustained poverty reduction (Ravallion, 2001).

Therefore, promoting and sustaining economic growth is one of the highest priorities for Laos in order to enable the country to catch up with other ASEAN members. In order to maintain sustainable economic growth, it is important to address the following issues.

4.1. Dealing with Dutch Disease as a result of natural-resources-based growth

Empirical studies suggest that countries rich in natural resources suffer from low economic growth in distinct ways compared with countries where natural resources are scarce (Sachs and Warner 1995; Papyrakis and Gerlagh 2004; Leite and Weidmann 1999). These distinct ways include the potential for issues related to Dutch disease³.

Recently Laos was ranked as one of the most resource-rich countries in Asia. More than 570 mineral deposits have been identified, including gold, copper, zinc and lead (World Bank 2004). In addition, Laos is also traditionally known as a potentially significant producer of hydropower, of about 26,000 MW (excluding mainstream Mekong), with only 9% of its capacity being used in 2004 (Pholsena and Phonekeo 2004).

Due to data constraints, we will detect Dutch disease syndrome in terms of appreciation in the real exchange rate, along with declining labor productivity. Dutch disease symptoms present in the Lao economy are as follows:

- (1) appreciation of the real exchange rate;
- (2) a slowing down in the growth of tradable sectors and low productivity in tradable sectors;
- (3) rapid growth in the service sector, driven by domestic spending or relative price changes (World Bank, 2010);
- (4) growth in non-tradable prices, reflected in wages, housing and land (World Bank, 2010).

This evidence shows that Laos might suffer from the negative impacts of Dutch disease in the long run if the Lao government does not use appropriate macroeconomic management strategies to cope with it.

³ The main cause of slow growth, including insufficient economic diversification, rent seeking and conflict, corruption, undermined political institutions, overconfidence, loose economic policies, and debt rise.

4.2. Fostering human capital

Human resource development is one of the most important factors in sustaining long-term economic growth in Laos. How to develop national human resources in order to be able to compete with other countries in the region and in the world is one of the main challenges for Laos. Even if the Lao PDR can reach the MDG's by 2015, a large number of Lao people will remain poor and minimally educated. Laos' Human Development Index (HDI) value lags behind other ASEAN countries and declined from 0.57 in 2000 to 0.52 in 2011. Therefore, strengthening human development is one of the most important issues for Laos.

4.3. Improving infrastructure

Laos is a landlocked country in Southeast Asia and its road network is poor. Access to the road network could increase the income and welfare of the poor in Laos (Warr 2010). In addition, the improvement of the transport infrastructure and trade facilities could improve welfare and poverty reduction in Laos (Stone et al. 2010).

In 2004 the total length of road in Laos was almost 34,000 km, with only about 28% paved road density was 0.14, which is relatively low compared to neighboring countries (Oraboune 2008). Road access has been improved. In the dry season 100% of households can access roads, but in the rainy season only 84% were able to access roads in 2008 (DOS 2009).

Despite exporting electricity to neighboring countries, household access to electricity is low in Laos. Only 61% of the total population can access electricity, and about 53% of rural areas can access electricity (DOS 2009). Therefore, the improvement of the transport infrastructure and access to electricity will play an important role in poverty reduction and economic development in Laos.

4.4. Improvement of the financial sector

Empirical studies show that there is a positive relationship between finance development and economic growth (Khan and Sheikh 2005; Levine et al. 2000; Christopoulos and Tsionas 2004). However, the Lao financial market is relatively small and is in the initial stage of development. Laos has low financial depth, the ratio of money supply to GDP was less than 30% in 2010. The two largest banks (BCEL and LDB) are fully owned by the government. BCEL maintains a dominant position, accounting for approximately half of total deposits and loans. The Lao banking sector is dominated by SOCBs – State-Owned Commercial Banks.

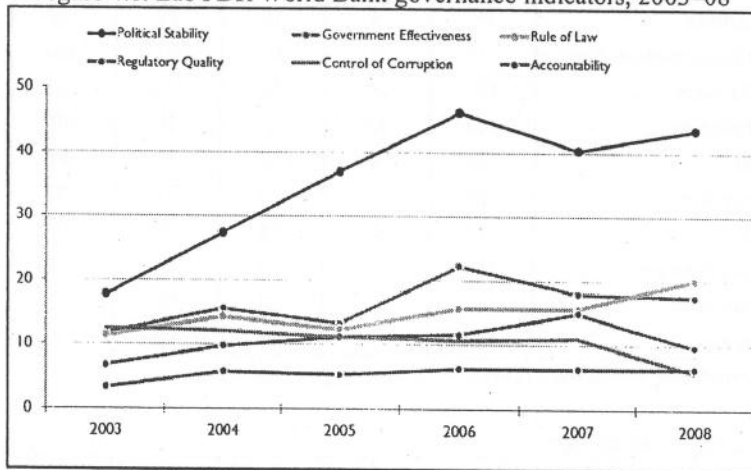
Laos established the Lao Securities Exchange in 2010. There are currently only two listed companies on this stock exchange, but there is expectation that between three and five firms will be listed by the end of 2011. The first listed company is EDL (Electricite du Laos) Generation-Public Company, which is a subsidiary of the state-owned energy company. The other company is the largest bank in Laos, Banque Pour Le Commerce Extérieur Lao (BCEL) Lao. However, it does not perform its function well. Therefore, improvement of financial sector is one of the most important factors to foster economic growth and poverty reduction in Laos.

4.5. Improving governance and institutions

Governance and institutional quality is highly important to a long-term positive relationship with economic growth and increases in income level. Governance and institution are factors that drive economic growth because the enforcement of property rights and contracts allows market change, investment and innovation over wider economic spheres and geographical areas through lower transaction costs (Acemoglu et al. 2001; North 1990).

For Lao PDR the quality of government, including governance, sound exchange rate policies, and prudent macroeconomic management, have been important factors affecting economic development. In the World Bank's *Governance Matters* (2009), more than six governance dimensions are measured from various sources. Each governance dimension is measured by a country's percentile rank. Percentile ranks indicate the percentage of countries worldwide that rate below the selected country. Higher values in six governance dimensions indicate a better governance rating. The quality of governance in the Lao PDR has improved in recent years, particularly in terms of political stability, the absence of violence/terrorism, and the rule of law (Figure 4.1). However, some indicators of government quality – such as government effectiveness and regulatory quality – have only increased slightly. Nevertheless, small increases are better than decreases in governance indicators, such as control of corruption, which, on these measures, declined slightly during the period 2003-08.

Figure 4.1. Lao PDR World Bank governance indicators, 2003–08



Source: World Bank (2009) *Governance Matters* 2009, available at <http://info.worldbank.org/governance/wgi/index.asp>

4.6. Improving the business climate

Large private investors in Laos have a vested interest in good governance and the wider business environment as, in its absence, projects experience severe delays and reduced levels of profitability. Private sector development contributes considerably to sustainable economic development in any country, not only by creating jobs and generating income, but also by absorbing technology and know-how from overseas enterprises. Thus, in order for the private sector to perform well and be competitive, a supportive business climate is essential.

The most recent IDC/World Bank indicators in *Doing Business 2010* rank Lao PDR 167 out of the 183 countries that were assessed, the worst rank in the ASEAN region (Table 3-4).

This ranking is derived from 10 component indicators. This ranking provides a number of warnings about delays and other difficulties that private investors might expect to encounter when doing business in Laos. Above all, we can see that the Lao PDR ranks poorly in closing a business, protecting investors, getting credit, registering property, paying taxes and dealing with construction permits. A further problem is high import and export costs. To export from Laos PDR currently requires nine procedures, which take an average of 50 days and cost the equivalent of 2.4 times GNI per capita in 2008 (US\$ 760). Similarly, it requires 10 procedures, takes 50 days, and cost the equivalent of 2.7 times GNI per capita in 2008 to import goods into Laos (Table3-5). Another problem is low labor productivity and innovation. Laos has a relatively low labor wage in the garment sector but if Lao is compared to China's, it is average. The productivity of a worker in Laos is lower than the average Chinese worker. In addition, Lao firms lack innovation. For example, of the 20 garment SMEs, only two factories use their own designs while the rest follow customer's designs. The former produces for the domestic market (Kyophilavong 2008). Furthermore, Lao firms face various problems such as high taxes, difficulty gaining access to finance, and difficulty obtaining highly-skilled labor. Given these factors, increasing the competitiveness of Lao firms and increasing labor productivity are the main challenges for the Lao economy (Kyophilavong 2008).

Table 3-4. Doing business in Lao PDR compared to other countries

	Laos	Singapore	Thailand	Taiwan	Vietnam	Cambodia
Ease of Doing Business Rank	167	1	12	46	93	145
Starting a Business	89	4	55	29	116	173
Dealing with Construction Permits	115	2	13	97	69	145
Employing Workers	107	1	52	153	103	134
Registering Property	161	16	6	30	40	116
Getting Credit	150	4	71	71	30	87
Protecting Investors	182	2	13	73	172	73
Paying Taxes	113	5	88	92	147	58
Trading Across Borders	168	1	12	33	74	127
Enforcing Contracts	111	13	24	90	32	141
Closing a Business	183	2	48	11	127	183

Source: Doing Business, World Bank (2010).

Table3-5 Trading across borders

Country	Documents to export (number)	Time to export (days)	Cost to export (US\$ per container)	Documents to import (number)	Time to import (days)	Cost to export (US\$ per container)
Cambodia	11	22	732	11	30	872
China	7	21	500	5	24	545
Lao PDR	9	50	1860	10	50	2040
Singapore	4	5	456	4	3	439
Thailand	4	14	625	3	13	795
Vietnam	6	22	756	8	21	940

Source: Doing Business, World Bank (2010).

5. DIRECT SUPPORT FOR THE POOR

Growth alone cannot reduce poverty, and growth should be inclusive. Because the poor live in rural areas, especially upland areas, and have difficulty accessing the road network, direct support needs to be provided to the poor via public expenditure and special programs.

Despite an increase in consumption and a reduction in poverty, malnutrition remains a serious problem (Table 5-1). Underweight and stunted growth in children under the age of five was 37% and 40% respectively in 2006 (DOS et al. 2008). Underweight and stunting declined by only 15% to 17% respectively from 1993 to 2006. These statistics demonstrate that nutrition is one of the most serious problems in Laos. Therefore, supporting the poor in order to decrease malnutrition in children is one of the most important tasks facing Laos.

Table 5-1. Poverty and nutrition

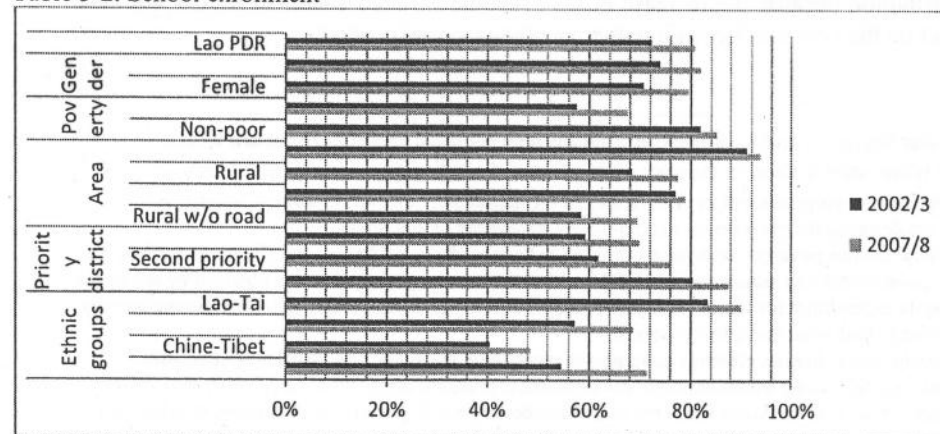
	(%)	
	Stunting	Underweight
Richest	17.5	19.3
Rich	32	33
Middle	38	41
Poor	38	43
Poorest	43	54

Source: World Bank and DOS (2009).

Note: LECS (Lao Expenditure and Consumption Census).

There is a high correlation between poverty and education for children. Children in rural areas must travel an average of 8 km to the nearest secondary school, and an average of 3 km in urban areas. In 2007/8 81% of 6-10 year olds were enrolled in school, while 72% were enrolled in 2002/3 (Table 5-2). However, only 78% of rural children were enrolled, against 94% of urban children. The main reasons given for low enrollment in rural areas were that children are needed for agricultural labor, there are other expenses that need to be met, and school is not free (WB and DOS, 2009).

Table 5-2. School enrollment



Source: World Bank and DOS (2009).

According to a study by Kyophilavong (2011), which did simulation focuses on cash transfers to the poor with children in urban and rural areas, three simulations were conducted.⁴ In simulations 1, 2 and 3, the government transferred 5%, 10% and 15% of mean income per capita per month to poor households with children⁵ (Table 7-1). It is important to note that the mean income (per month) for poor households with children in rural and urban areas is different. The mean income of the poor with children was about US\$30 dollar in urban areas and US\$11 dollars in rural areas. The income poverty line was estimated based on the official consumption poverty line⁶ (World Bank and DOS 2009).

The Lao government faces large budget deficits and also high levels of external debt. However, production and exports in the natural resources sector (mining and electricity) have been increased since 2003 and government revenues are expected to increase (World Bank, 2010). Therefore, we assumed that the Lao government will fund this cash transfer program are from resource revenues.⁷ The budget requirement for implementing the cash transfer program is shown in Table 7-1. In simulation 1, the total budget requirement was \$1.18 million dollars, in simulation 2 it was \$2.36 million dollars and in simulation 3 it was \$3.54 million dollars⁸, which accounts for about 1.92%, 3.84%, and 5.76% of government expenditure in 2010 respectively. Here, it is important to note that this budget does not include administrative costs and other costs for implementing and managing the program.

The impact of cash transfer on poverty and income distribution is shown in Table 5-3 and Table 5-4. It is clear that cash transfer to the poor with children could reduce poverty and close the gap in income distribution between urban and rural areas. An increase of 5% in the income of the urban poor with children, would reduce poverty by about 4%, and the income gap would reduce by 2%. An increase of 15% in the income of the urban poor with children would reduce the poverty rate by 14%, and the income gap would reduce by about 6%.

In this cash transfer program, the rural poor with children have a more positive impact on poverty reduction compared to the urban poor with children. An increase in income of 5% for the rural poor with children would reduce poverty by about 12%, and close the income gap by 2%. If the income of the urban poor with children increases by 15%, the poverty rate will reduce by 35% and the income gap closes by about 6%. The main reason for this is that a large proportion of the rural poor live close to the poverty line. Therefore, increasing their income by a small percentage allows them to cross the poverty line. The impact of cash transfer on the poor with children in urban and rural areas seems to have the same impact on income distribution because the increase in their income is rather small, so it does not have much impact on the Gini coefficient in either an urban or rural context.

⁴ We assume that this cash transfer is a small program and does not much impact on prices and wages.

However, it is important to consider the price effect when we formulate large-scale transfer programs.

⁵ Normally, in practice, programs will transfer money to the household, however, to make it simpler in simulation, we designed the program so that the money transferred to individuals.

⁶ Since an official income poverty line is not established in Laos, as far as we know., an official per capita expenditure poverty line was established in LECS 3 and so the income poverty line was obtained by taking the mean per capita expenditure for a poor household, based on the expenditure poverty line. The income poverty line is the same in both rural and urban contexts.

⁷ In order to avoid Dutch disease, effective government expenditure is crucial. For sustainable economic development, expenditure on human resource development is crucial (Larsen 2006; Levy 2007; Iimi 2007).

⁸ It is important to note that we do not know the actual number of poor households with children in urban and rural areas. The calculation of the budget requirement was based on data from the Lao Expenditure and Consumption Survey (LECS).

It is clear that cash transfer to the poor with children requires a small budget but has a significant impact on poverty reduction and income distribution. However, the result might be affected by a change in the set poverty line and it is important to choose right target group for the cash transfer (the poor with children).

Table5-3 Impact of cash transfer on poverty and income distribution in urban areas

	Urban		Urban	
	Poverty rate	Gini index	Poverty rate Change (%)	Gini index change (%)
Base line	0.34951	0.42097		
Simulation 1	0.33476	0.41244	-4.2	-2.0
Simulation 2	0.31549	0.40424	-9.7	-4.0
Simulation 3	0.30002	0.39638	-14.2	-5.8

Source: Author's estimation from Lao Expenditure and Consumption Survey (LECS).

Table 5-4 Impact of cash transfer on poverty and income distribution in rural areas

	Rural		Rural	
	Poverty rate	Gini index	Poverty rate Change (%)	Gini index change (%)
Base line	0.28699	0.42848		
Simulation 1	0.25092	0.41941	-12.6	-2.12
Simulation 2	0.21610	0.41063	-24.7	-4.16
Simulation 3	0.18613	0.40220	-35.1	-6.13

Source: Author's estimation from Lao Expenditure and Consumption Survey (LECS).

6. ROLES OF EXTERNAL FACTORS

In order to promote economic growth and reduce poverty in Laos, external supports from ASEAN countries play important roles. Even though Laos has received ODA from various donors, but it is not sufficient to support poverty reduction programs and it seems that the supports from ASEAN countries are small. The supports from ASEAN countries should coordinate with other donors such as the World Bank, EU, ADB, and others and focus on technical assistance and institutional capacity building. In addition, accelerating the regional cooperation such as GMS cooperation is crucial for economic growth and poverty reduction in Laos. In addition, maximizing the benefits from Foreign Direct Investment (FDI) is also important factors to sustain economic growth in Laos.

7. CONCLUSION

Large development gaps exist in ASEAN, especially gaps between newer ASEAN members (CLMV) and older ASEAN members. Development gaps might hinder the effective implementation of AEC. In order to deepen economic integration within ASEAN, narrowing the development gaps in ASEAN must be a main priority. One of the most important factors in allowing CLMV to catch up with wealthier ASEAN members is the continued improvement of economic reforms and institutional capacity, in order to sustain high economic growth and reduce poverty.

There are six policy recommendations that will help to sustain economic growth in the case of Laos, including: coping with Dutch disease as a result of natural-resources-based growth; fostering human capital; modernizing the economic infrastructure and reducing transportation costs; improving the financial sector and reconstructed state-owned enterprises; improving governance and institutions; and improving the business climate.

However, economic growth in itself is not enough to reduce poverty and inequality. It is important to ensure that economic growth is inclusive. Therefore, direct public investment and a program of direct support for the poor is needed.

In addition, external factors such as assistance from ASEAN, regional cooperation (GMS cooperation), and FDI are also playing important role to promote growth and poverty reduction in Laos.

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