

Specifics and Perspectives of Laos' Socialist Market Economy

Mykhaylo Kunychka, Ph.D.¹

Received: 13.05.2022
Available online: 30.11.2022

Abstract

Laos is a remarkable country situated at the crossroads of the political and economic processes in the region of Southeast Asia. The country is rich in natural wealth, which is exploited mainly by foreign actors and influences the distribution of prosperity for the benefit of domestic political elites. This paper focuses on the peculiarities of the current economic development, the structure of the national economy, involvement in international economic relations, and the current economic dynamics of the national economy. We will try to point out the perspectives of economic development as well. To reach the purpose of the paper, we use the basic methods of research, including synthesis, deduction, comparison, or mathematical methods, and work with scientific literature, statistics of international databases and data of national institutions. The results suggest that Laos, as the least developed country, is still dependent on exogenous factors that prevent productivity gains and, consequently, qualitative economic growth. Economic structure hinders economic growth and socio-economic development as well. Capital-intensive but low-tech industries do not create highly qualified jobs, thus producing low standards of living.

Keywords: economic growth, development, agriculture, industry, trade, investment, Laos
JEL: O11, O13, N55

Introduction

Laos or Lao (both identifications could be found in literature and are used by national authorities) is in the centre of Indochina peninsula and has an area of 236,800 km², which roughly equals the territory of Romania. Most of the country represents mountainous areas, which occupy about 70% of its territory. The country is landlocked and does not have direct access to the world's maritime routes, which affects its involvement in global

¹ Assistant professor at the Faculty of International Relations, University of Economics in Bratislava, e-mail address: mykhaylo.kunychka@euba.sk

flows of commodities and capital as well as overall economic performance. Laos has 18 administrative units or provinces, which include the capital Vientiane with a population of about 700 thousand (GeoNames, 2022). The capital as well as most economically developed and densely populated regions are concentrated along the border with Thailand on one of Asia's longest rivers – the Mekong River and its tributaries. As part of the group of least developed countries, Laos has a low rate of urbanization, which has been growing slightly and currently accounts for 36%. The population totals about 7.3 million and is growing rapidly. This is challenging the economic development, especially in the period of the world pandemic, when the country's annual growth of production constituted only 0.4%. The annual population growth rate is 1.5%, which is significantly higher compared to neighbouring countries, such as Thailand, Myanmar, China, Cambodia, or Vietnam (World Bank, 2021). Most of the population are younger than the age of 15 which puts strong economic pressure on the working-age population. The young dependency ratio represents about 50% of the population. In total, about 200 ethnic groups live in the country. Among these Lao, Khmou, and Hmong are the largest ones. The first one makes up more than half of the total population (or 53% in total). Buddhism is the dominant religion with almost 65% of the population in this denomination (CIA, 2021).

The Lao People's Democratic Republic is one of the few socialist states that are openly committed to communism and whose economic system is frequently associated with China or Vietnam (Bekkevold et al., 2020; Stefanova and Zhelev, 2022). The political system affects the national economic system to some extent, which has been decentralizing since the second half of the 1980s and demonstrating its efforts to introduce the principles of market economy and foreign economic activity liberalization. According to the latest Development plan official authorities declare the country's economic system as socialist market economy (Bekkevold et al., 2020: 11). At present, Laos is one of the 46 least developed countries with access to soft loans and foreign development aid. Its current GDP constitutes \$ 19 billion and consists mainly of agricultural production, the extraction sector, and electricity generation (Bank of Lao PDR, 2021). In 2020 the per capita income was \$ 2,630 thus approaching the income level of Honduras or Papua New Guinea. Before the outbreak of the global Covid-19 pandemic, Laos was one of the economically fastest-growing countries in the region – its growth rate climbed to 8% at the beginning of the second decade of the 21st century. The country's economic growth rate decreased slightly to 5.5% in 2019 (World Bank, 2021). According to the classification of the UN Development Program, the country is ranked 137th in the ranking of countries according to the Human Development Index (HDI) and belongs to the group of countries with a medium level of human development (UNDP, 2021/a).

It is also necessary to note the low level of social development that places Laos in the group of the least developed countries. The critical issue is the malnutrition rate of up to 30% of children under 5 years of age. Maternal mortality is high as well, amounting to 185 per 100,000 births. Moreover, almost 18% of the population lives below the national poverty line. By comparison, maternal mortality in neighbouring Vietnam and Thailand

is only 42 and 22 per 100,000 births, respectively. The poverty rate is only 7% in Vietnam and 10% in Thailand. Critically important is the increase in inequality expressed by the Gini index, which has grown from 32 to 39 over the past 20 years (World Bank, 2021), though the poverty rate has steadily decreased.

The present paper focuses on the current peculiarities of Lao's economic development, on both economic and social problems, as well as on the prospects for development. It aims at studying the weaknesses hindering economic prosperity while building on a basic macroeconomic analysis of economic development and economic structure. Based on the assumption of Laos' internal specifics, the paper analyses the external relations including international commodity and capital flows. Methods of induction, synthesis, comparison, or basic mathematical procedures are applied. The study relies on time comparison and economic analysis from a historical perspective. The data used come from academic publications and statistics from international organizations, including the World Bank, the United Nations Conference on Trade and Development (UNCTAD), the World Trade Organization (WTO), and the International Monetary Fund (IMF). Information gaps are filled in by data from governmental institutions, including the central monetary authority or Ministry of Planning and Investment in Lao.

Literature review

The historical and current evolution of the economy and the social aspects of Laos' development are in the focus of several theoretical, empirical, and analytical studies (Evans, 2002; St. John, 2006; Insisienmay et al., 2015; Bunce, 2017; London, 2017; Andreev and Amphavanh, 2018; Kenney-Lazar, 2019). However, according to Bekkevold et al. (2020: 4), despite widening literature on its development, Laos is still a less studied and understood country in the region with socialist market economy or, as some authors call it (London 2017; Creak and Barney 2018), market-Leninist system of state. Evans (2002), for instance, presents Laos as a country at the crossroads of the political and economic events in Southeast Asia, describes it as a bridge and a buffer between bordering states, but also an arena invaded by more powerful neighbors and their allies. He underlines the communist government's commitment to development and its long-standing practice of receiving foreign aid, which, however, often ends up in the hands of political leaders and creates a psychology of addiction. He presents Laos as an "*untouched*" country with failed development plans and decades of forced isolation. On the other hand, Bunce (2017) deals with French colonial rule over Laos since the late 19th century and explains its weak economic status as one of the poorest countries in the region. He appeals to the process of colonization, which did not allow the development of Laos' government or economic system and created a "*power vacuum*", which became the precondition for the communist regime to take over. Like Evans (2002), Bunce points to the problem of providing foreign aid as well, which has contributed to the creation of an inefficient authoritarian government and thus prevented the development of positive bureaucracy and economic infrastructure.

St John (2006) provides an in-depth look at the economic system and the reforms that have taken place. In terms of the level of its development, he defines Laos as a poor country with low economic and social performance, regional disparities, and income inequality. St John takes a critical look at the established political system in which he sees the problem of underdevelopment and slow economic reforms. He also criticizes the dependence on foreign aid and its distribution, which is the source of exploitation by centralized and corrupt decision-making apparatus. Bekkevold et al. (2020) highlight the Lao's model of economic development that combines the elements of market economy and socialism. They define the country's economic system as a socialist market economy with a persistent communist regime similar to those in China and Vietnam. Like previous authors, Roberts (2012) points to the persistence of poverty problems or the negative impact of foreign investments that are directed to the exploitation of natural resources but also highlights an increase in transnational crime associated with opium trade, gambling and human trafficking. Stuart-Fox (2009) points positively to the significant progress and economic growth since the country's declaration of independence while mentioning the problems of the spatial distribution of wealth. He emphasizes that income gained from exploitation of natural resources is concentrated in cities, with the majority in the hands of political party members and their families. According to the author, natural resources located in the countryside are quickly used, but not for the benefit of the rural population. In the context of resource exploitation, he points to the interest of Laos' geographical neighbors, such as China, that offer infrastructure projects and loans in exchange for mineral exploration or agricultural developments. Conceptual work on natural resources exploitation and wealth generation is conducted by Kenney-Lazar (2019) who discusses the authoritarian way of implementing neoliberal principles by local authorities. The author puts emphasis on the hybrid form of authoritarianism and neoliberalism that helps capital accumulation and thus rapid economic growth while also producing undesirable effects on local people and undermining the positive impact of liberalization processes. In his work the use of neoliberal policy by Laos' authoritarian regime is similar to the management of Chile, Peru, Turkey, Cambodia, or Myanmar in their different stages of political and economic development (Kenney-Lazar 2019: 339).

In the context of Lao government's liberalization efforts and the introduction of the principles of openness, Kyophilavong et al. (2017) examine the impact of the country's involvement in international commodities and capital exchange with neighboring China. The results show that involvement in mutual liberalized trade and the influx of Chinese FDI have a positive impact on the overall economic performance and the reduction of poverty or income disparities. However, it must be emphasized that, in the wake of engaging in the free exchange of capital and goods with China, some sectors of the economy, including agriculture and the food processing industry, will experience a decline in production. The authors also point out that China's large-scale investments into the extractive sector and hydropower can lead to the emergence of Dutch disease, which will negatively affect

productivity of alternative sectors. The presence of some signs of the negative impact of natural wealth on economic development was shown by Insisienmay et al. (2015).

Finally, Andreev and Amphavanh (2018) analyze the socio-economic development of Laos and emphasize its dependence on the extraction of natural resources with limited domestic employment or agricultural dominance, where most of the population continues to perform low-skilled work. According to the authors, the outflow of capital and the weak management of public finances prevent the increase of revenues associated with the use of natural resources. With this argument the authors explain the low potential of economic growth to eliminate poverty. They also point to neighboring countries that have managed to reduce their poverty with similar rates of economic performance.

Laos in historical context

The formation of the Lao ethnic group, which currently makes up most of the Laos' population, began during the 8th century as a branch of the Tai peoples. The Tai came from a kingdom that had been created in the southwestern part of China, and under pressure from a Mongol khan, they were forced to migrate to Southeast Asia. The Lao, along with other Tai peoples, gradually pushed out the indigenous groups collectively known as the Kha or slaves. During the 12th and 13th centuries, the Tai founded the Muong Swa Princedom in the northern part of present-day Laos. The history of today's Laos begins in the 14th century when during the reign of King Fa Ngumoa, numerous small states were successfully united and subsequently created the kingdom of Lan Xang (Evans, 2002: 9-15). The kingdom was one of the largest states in the region and covered the area around the Mekong River. Thanks to its central geographical location in Southeast Asia, the kingdom became an important center of trade, economic prosperity, and culture. The territory and power of Lan Xang continued to grow until the end of the 17th century. Its rise culminated during the nearly 60-year reign of King Sourign Vongsa that is known today as the Golden Age in Laos history. After a period of internal conflict, the kingdom split into three separate kingdoms in the 18th century that were ruled by the descendants of Sourign Vongsa.

In 1893, the territory of present-day Laos became a French colony, with the three kingdoms united to form a state called the French Protectorate of Laos (Csabay et al., 2011: 280). France had no interest in the creation of a prosperous nation and put little effort into developing education, healthcare, infrastructure, and a solid economic system (Bunce 2017: 317). As a result, anti-imperialist movements were organized in many parts of the country, and during the First Indochina War (1945–1954), Laotians actively participated in the fight against French rule in Vietnam, Laos, and Cambodia. In 1945, at the end of World War II, Laos briefly gained independence, but in early 1946 it was reoccupied by French troops. In 1949, the French government granted autonomy, and in 1953 the Kingdom of Laos gained full sovereignty. The 1954 Geneva Accords, signed by France, the United Kingdom, the United States, and the USSR, guaranteed the royal family rule over Laos. However, the agreements also included the right to control the northern parts of the

country by the Communist organization Pathet Lao (Lao People's Liberation Army), which was closely linked to the communist regime in North Vietnam (Leebouapao and Sayasenh, 2017). The agreements resulted in de facto control of the northern provinces by the Lao Communists and the rest of the country by the royal government. The peace in Laos did not last long, and in the late 1950s a military conflict broke out between communist troops and monarchy forces known as the Lao Civil War (1959-1975). After multiple efforts to bring peace, Laos was affected by the Vietnam War. During the first half of the 1970s, the situation in neighboring Vietnam resulted in the consolidation of the position of the communist forces and the withdrawal of American troops, which significantly strengthened Pathet Lao's position in the country. After the victory of the Communists in Vietnam and Cambodia, right-wing forces in Laos were forced to surrender, allowing Pathet Lao to seize power in the state. In 1975, the end of the six centuries of royal reign was proclaimed and the Lao People's Democratic Republic was founded.

Economic development: from centrally planned to mixed economy

Before the Communist Party took power, Laos' economy was based on subsistence farming and primitive cultivation methods, where almost all agricultural land was used to maintain rice production. Agriculture accounted for more than two-thirds of economic production and employed more than 85% of the workforce. After the founding of the Lao People's Democratic Republic, the leadership of the state embarked on a path of a centrally planned economy and the development of socialism. A dual economic goal was set, focusing on socialist transformation and the construction of a socialist system. Decisions in the national economy were characterized by a high degree of centralization and strict control. Given the close ideological as well as personal ties to communist Vietnam, the Laos leadership sought to introduce collectivization in agriculture and the nationalization of lagging industries and trade. Foreign exchange of goods was completely controlled by the state with the instruments of import tariffs, trade restrictions and foreign exchange controls. International and intra-regional trade was the prerogative of state-owned or semi-state owned companies (Kyophilavong et al., 2017: 4). Like other socialist-oriented states, Laos introduced the First Five-Year National Development Plan in 1981, which aimed to achieve food self-sufficiency, develop industry, and build basic infrastructure (Leebouapao and Sayasenh, 2017). Agriculture and infrastructure gained the highest priority, accounting for almost 70% of the total state budget expenditures. At the end of the plan, rice production was significantly increased through the introduction of irrigation systems, increasing its productivity per hectare to 60% between 1979 and 1986 (Bourdet, 1995: 176). Productivity in maize, soya beans, and sugar cane production also increased slightly. During the period of the first five-year plan (1981-1985), Laos' GDP averaged 7.7% per year. However, economic growth was accompanied by high inflation, which reached a level of 114% at the end of the plan (IMF, 2021). The budget deficit and external debt increased. In this context, the government reviewed the state's development strategy. Reforms aimed at transforming

the socialist system and implementing elements of a market-oriented economy have begun (Andreev and Amphavanh, 2018: 21).

In 1986, the Congress of the Communist Party approved an economic reform called the New Economic Mechanism (NEM) which followed transformations of national economies in China ("Reform and opening up" implemented in 1978) or Vietnam ("Renovation" implemented in 1987) (Hansen et al., 2020). NEM or *Thanakaan Mai* aimed to introduce the principles of market economy, deregulation, and significantly reduce the budget and trade deficits. With some delay, price controls have been removed, private enterprise in agriculture and manufacturing has been encouraged, and international trade has also increased (Menon and Warr, 2013). Between 1986 and 1990, exports of goods and services rose to almost 60% or \$ 98 million at the end of the period. The reform began to be implemented intensively only in 1988, as evidenced by the resumption of economic growth, which in 1989 amounted to 14.2%. Over the period of the Second five-year plan (1986–1990), average GDP growth was slower than in the previous five-year period and constituted 4.4%, albeit the five-year plan set envisaged an average annual growth rate of 10%. The failure to meet the plan was caused by insufficient agricultural performance and electricity production associated with the drought of 1987 and 1988. With declining production, price fluctuations also declined, with average inflation over the second five-year plan at 18% compared with 62% during the first five-year plan (IMF, 2021). A few monetary and fiscal reforms have been implemented within the NEM as well, including price and exchange rate liberalization, support of foreign investment, and improvements in tax and tariff systems. However, the level of development of the national economy, as well as the standard of living, remained relatively low. GDP per capita fell fourfold between 1985 and 1988, although it began to recover and exceeded the 1985 level only in 2007. At the end of the second five-year plan, GDP per capita constituted \$ 200, making Laos one of the world's ten poorest countries on the World Bank list (World Bank, 2021).

The proposed Third Five-Year National Development Plan (1991-1995) was not approved, although the Socio-Economic Development Plan was effectively implemented. During this period, Laos' economy grew at a steady pace, averaging 6% per year, mainly due to the development of the industrial sector. Between 1991 and 1995, public finances and the annual inflation rate, which averaged 11%, were also stabilized. The implementation of the Fourth Five-Year Plan for Socio-Economic Development (1996-2000) failed to meet the targets set following the outbreak of the Asian financial crisis in Thailand in 1997. Compared with the previous five-year plan, Laos' economy showed the same 6% average growth rate during the fourth five-year plan. Given Laos' close economic links to neighboring Thailand as the largest trading partner, the effects of the crash on the Laotian economy were immediate. GDP growth fell from 7% in 1997 to 4% in 1998. Inflation reached 90% with a further increase to 128% in 1999 (IMF, 2021). The Laotian currency also devalued from 900 to 2,700 kips per US dollar. In the following years, the central bank significantly devalued the national currency and the exchange rate reached up to 10,000 kips for US dollar in

1999 (Evans, 2002: 217). As a result of the financial crisis and the depreciation of the local currency, income per capita fell by 30% between 1997 and 1998, to just \$ 250.

Table 1. Dynamics of selected macroeconomic and demographic indicators, 1985-2015

	GDP, current prices in billion USD	GDP growth, %	GDP per capita, current prices in USD	Inflation, %	Population, million	Gross government debt, % GDP
1985	2.366	5.1	642	114.7	3.687	-
1990	0.865	6.7	203	35.6	4.258	-
1995	1.763	7.0	364	19.6	4.846	-
2000	1.731	5.8	325	25.1	5.323	-
2005	2.735	7.1	476	7.2	5.751	73.2
2010	7.127	8.5	1141	6.0	6.249	49.3
2011	8.749	8.0	1378	7.6	6.347	43.0
2012	10.191	8.0	1581	4.3	6.444	46.1
2013	11.942	8.0	1826	6.4	6.541	49.5
2014	13.268	7.6	1998	4.1	6.639	53.5
2015	14.390	7.3	2135	1.3	6.741	53.1

Source: World Bank 2021, International Monetary Fund 2021

The Fifth Five-Year National Development Plan (2001-2005) was adopted at the Seventh Congress of the Lao People's Revolutionary Party and aimed to achieve average GDP growth of 7%, reduce poverty, abolish primitive tillage techniques, and reduce opium cultivation. The plan also sought to put the end to Lao's presence in the group of least developed countries by presupposing progress in the economic, financial, and social parameters of development. However, in 2021 Laos was still a member of the group of the least developed countries due to non-compliance with the criteria in the economic and environmental vulnerability index. During 2001-2005, Laos managed to ensure a stable growth rate of the national economy, which averaged 6.3% per year and was stimulated by inflow of foreign direct investment into the industry sector and the extraction of natural resources. However, the biggest engine of economic growth in this period was the construction of large hydropower plants and expanding mining activities. Despite rapid economic growth, inflation fell slightly, averaging 10% over a five-year period. Gross government debt rose to 50%, although its share of GDP fell from 95% in 2001 to 73% in 2005. Production output almost reached the pre-crisis level of \$ 3 billion.

At the beginning of the Fifth plan in 2001, the Strategy for Industrialization and Modernization of the national economy was adopted, with an emphasis on hydropower, agricultural production, tourism, and mining. The government also initiated the creation of special economic zones that were to support the industrialization of the Lao economy and start the process of modernization. Therefore, in 2003, the first two special economic zones

were created in the central province of the state at the border with Thailand (SEZ Savan-Seno) and in the north at the border with China (SEZ Boten). The development of foreign economic activity was also to be an important element of industrialization, which led to the introduction of the National Export Strategy in 2005 (Oraboune, 2011). According to the strategy, the clothing industry, organic farming, silk production, and tourism were to become important export sectors.

During the Sixth Five-Year Plan (2006-2010), Laos' national economy grew annually by an average of 8%, outpacing the previous five-year period. It also managed to reduce the inflation rate to an average of 5% over the entire implementation period of the plan. In 2011, the National Assembly adopted the Seventh Socio-Economic Development Plan for 2011-2015, which paid attention to inclusive growth and the country's further development goals. During this plan, the average GDP growth rate decreased slightly to 7.8% and the inflation rate to 4.7%. Rapid economic growth was also reflected in a 55% increase in per capita income growth, from \$ 1,378 in 2011 to \$ 2,134 in 2015. Overall, the first and second decades of the 21st century became a period of economic prosperity. In 2012 Laos moved from low income to low-middle income country on the list of World Bank income group classification.

Between 2001 and 2015, the country's GDP grew 8.5 times to \$ 14.4 billion. Laos also managed to undergo drastic structural changes. Since the beginning of the implementation of the New Economic Mechanism (NEM) in the mid-1980s, the share of agriculture, forestry, and fishing in GDP fell from more than half to 17%. The share of the industrial sector almost doubled. The share of those employed in agriculture, forestry and fishery fell sharply, nevertheless up to 60% of workers still work in these sectors.

Structure of Laos national economy

Agriculture is a significant sector of Laos' economy and a source of livelihood for rural population, which constitutes about two-thirds of the total population. At the beginning of the new millennium, the sector generated one-third of GDP, but as the industrial and services sectors rose, its share fell to 15%. The role of this sector in employment has also fallen sharply. In the period 2000-2019, the share of employees in the agricultural sector decreased from 80 to 60%. The difference between the share of agriculture in national production and the share of employment points to low productivity. According to World Bank (2021), the value-added of one worker in this sector is only \$ 1,184. In Thailand and Vietnam, the same ratio is equal to \$ 3216 and \$ 1734, respectively. Low productivity is associated with limited inputs. The use of chemical fertilizers is traditionally very low, but with the expansion of agricultural concessions, there is an increasing trend in their use. Only farmers in the most productive southern and central provinces use around 250-300 kg of compound fertilizers per hectare (FAO, 2020). Only 11% of agricultural land has access to irrigation systems.

Due to the mountainous topography, about 10% of the land is used for agriculture. However, the cultivated land is limited by the large number of unexploded bombs that were dropped during the Vietnam War, where Laos also participated. In total, there are two main agricultural systems in the country - lowland irrigation systems in the Mekong area and a mountain farming system. Lowlands are often affected by floods, although these regions are more productive due to the availability of new technologies, agricultural inputs, infrastructure, and market networks. On the other hand, most mountain farmers practice subsistence farming. About 80% of Laos' rural population is employed in subsistence farming based on rice cultivation, livestock farming, and wild food collection.

Many Laotian farmers grow rice, with up to 72% of arable land being used to produce the crop. Since 2000, when the country became self-sufficient in rice production, it has managed to significantly increase its output from 2.2 million tons to 3.4 million tons in 2019 (World Bank, 2021). Laos exports surplus production to Vietnam, China, and Thailand. Rice production has tripled since the 1980s as certified varieties and the increased use of agricultural inputs, including mechanization, fertilizers, and irrigation infrastructure were introduced (FAO, 2020). Recently, the commercialization of agriculture, stimulated by government modernization initiatives, has gained significant attention. About 30% of farmers produce agricultural products exclusively for sale (FAO, 2021). Similarly, livestock production, which accounts for only one-fifth of the agricultural sector, has become increasingly commercialized. The breeding of pigs, cattle, and poultry is important as well.

The main tradable commodities include corn, which is grown mainly in the north of the country and exported to China. Sugar cane, cassava, various vegetables, and fruits are also important agricultural crops. Coffee is grown mainly on the southern plateau and is a major export commodity. In addition, bananas, cassava, and cereals are exported in larger volumes. An important crop of the shadow economy is the opium poppy, which is grown mainly in the Golden triangle – mountainous areas in the north near the borders with Thailand, China, and Myanmar.

The agricultural sector includes forestry as well, which represents only a small part of the national GDP (0.7%) and provides logging. Equally important is tilapia and carp farming, whose production has grown significantly in the last period and accounts for almost 2% of GDP (Bank of Lao PDR, 2021).

The industry is the fastest-growing sector of Laos' national economy. In the period 2016-2019, its production increased to almost 28%. The share of the industrial sector, including construction, in national GDP, has grown rapidly over the last decade and was around 31% in 2019, which can be explained by the increasing production of electricity or the boom in construction and manufacturing. On the other hand, the share of employees in this sector increased to almost 13% of total active workforce. In the case of a more detailed structure of the industry analysis, it is necessary to determine a clear predominance of electricity production, which represents 8.5% of national output. The country draws up to 80% of its electricity from water sources. In 2019, Laos had 78 power plants with a combined installed capacity of 9972 MW, of which 68 were hydroelectric power plants (ReGlobal, 2020). Water

dams on the Ngum River north of the capital, which was commissioned in the 1960s and 1980s, supply domestic energy needs. Many others, such as the dams on the river Theun in central Laos, generate electricity mainly for export, of which up to 95% is delivered to Thailand. In addition to the hydroelectric power plants in the north, there is also the Hongsa coal-fired power plant, which was partially launched in 2015 and produces electricity for further export to Thailand (ERIA, 2018). About half of the electricity generated is exported to Thailand, Vietnam, Cambodia, and Myanmar.

The construction and the mining sector are also important elements of the industry that represent 7% and 6% of GDP, respectively. The mining sector includes the production of gold, copper, and zinc, with copper ore being a significant item in commodity exports (OEC, 2019). A large share of construction is represented by building hydropower and transport infrastructure that is often funded by China under the New Silk Road initiative. About half of the hydropower plants are financed by China. In 2021, a railway connection between Vientiane and the northern city of Boten was also launched, focusing on the transport of goods and people. The 417 km long railway line became part of a larger Chinese project and will connect China with Singapore. The 6 billion infrastructure project was financed mainly by Chinese companies that own up to 70% of shares (Strangio, 2021). China is a key economic partner nowadays and major creditor as it holds about half of Laos' total external public debt (EIU, 2019).

Table 2. GDP structure and employment by sector for 2000 and 2019, %

	Contribution to GDP	Share of total employment	Contribution to GDP	Share of total employment
	2000		2019	
Agriculture, Forestry, and Fishing	52.9	81.8	15.2	61.4
Agriculture	31.4		7.2	
Livestock	1.8		1.6	
Forestry	0.3		0.7	
Fishing			1.7	
Industry	22.8	4.5	31.4	12.9
Mining	0.6		6.1	
Manufacturing	1.7		5.6	
Construction	2.3		7.3	
Electricity generation	2.8		8.5	
Services	23.6	13.5	42.3	25.6
Transport and communications	5.9		1.2	
Wholesale and retail	9.6		11.5	
Financial services	0.7		2.0	

	Contribution to GDP	Share of total employment	Contribution to GDP	Share of total employment
	2000		2019	
Real estate services	3.0		5.3	
Government services	2.0		4.7	
Accommodation and restaurant services	2.4		2.2	
Other services	0.2		1.2	
GDP, million USD	1.731		18.246	
Workforce	2 414 132		3 793 016	
Population	3 793 016		7 169 456	

Note: the total value of the ratios may differ from the total value of 100% due to rounding.

Source: processed by the author according to World Bank and Bank of Lao PDR, 2000 and 2020

Less significant but fast-growing is the manufacturing sector which represents 5.6% of GDP. Most manufacturers in Laos are micro or family businesses that employ less than 5 employees. Large companies are specific for the clothing industry. Small and medium-sized enterprises are mainly engaged in the food, furniture, and wood processing industries. Heavy and high-tech industries, such as the chemical, metal processing, electronics, and mechanical engineering industries, are quite rare (Vilavong et al., 2016: 5-6). However, industrial sector output has been growing rapidly in recent times. In 2020 alone, the manufacturing sector recorded a 23% growth (Bank of Lao PDR, 2021). A large part of this sector is the manufacture of electronics and telecommunications equipment, which takes place in the Savanh-Seno SEZ on the border with Thailand or in the industrial and commercial zone near Vientiane. The finished products are then exported mainly to Thailand, the United States, Mexico, and China (Gnanasagaran, 2018).

Laos has traditionally been a rural and agrarian economy and only in the late 1990s set out to develop tourism and modern services such as finance, information services, or communication technologies. The center of development of these services is the capital and largest city of Vientiane, which has a clear comparative advantage in the provision of government and business services and is the most important transport and logistics hub.

During the 2016-2019 period, the value of services increased to 20%, although it fell slightly to 1.2% in 2020. Services overtook industry and agriculture in terms of contribution to national production and in 2019 accounted for 42% of GDP. About a quarter of all employees are employed in services. The largest sub-sectors are wholesale and retail trade (11% of GDP), real estate services (5%), and accommodation and restaurant services (2%). Given the socialist model, the public administration's share of GDP is almost 5%, which includes defense spending. Since the late 1990s, the government has been actively

promoting tourism, which is fast becoming an important contributor to the national economy. In 2019, the revenues of this sector climbed to the level of almost half of the state budget revenues or \$ 934 million. More than 4.7 million foreign tourists were recorded during the same period, however, after the outbreak of the pandemic, this number dropped fivefold (Bank of Lao PDR, 2021).

Laos and international division of labour

In terms of participation in the international division of labor, Laos is a relatively open economy, with trade in goods and services accounting for 75% of GDP, which is significantly higher than the average level in East Asia and the Pacific region (World Bank, 2021). The state pursues a relatively open foreign trade policy, although it applies mild protectionist measures against imports of agricultural products. In 2013, Laos ratified the World Trade Organization (WTO) membership agreement and concluded free trade agreements with China, Vietnam, Thailand, India, and Japan. Due to the state's participation in the Association of Southeast Asian Nations (ASEAN), the import duty on agricultural products originating in the Member States is almost twice lower. Relatively lower duties are levied on imports of industrial products. Producers located in the SEZ, who are exempt from import duties and VAT, have a special position in the import of primary commodities and production equipment (Dunseith, 2017).

In the period 2011–2020, the average growth rate of exports of goods reached up to 14% per year, while in 2013 there was a slight decrease in export volumes due to a decrease in exports of key state commodities such as copper and electricity. In 2020, the volume of exports of goods reached \$ 6.1 billion. Compared to exports, the average growth rate of imports was only 11% per year. In the commodity trade, Laos has long been one of the countries with a passive trade balance. During the existence of the independent state, this trend was reversed only in 2020 due to the decline in import volumes. A trade deficit can also be observed in trade in services. Laos is dependent on exports of low value-added primary commodities, which account for up to 70% of total commodity exports. In addition to electricity (26%) and ores (11%), which include copper ore and ores of other non-ferrous metals, non-ferrous metals (8%), telecommunications equipment (6%), fruits and vegetables (5%), gold (5%), and clothing (4%) account for the largest monetary value of exports. Over the last 5 years, exports of electricity, gold, fruits, and vegetables have increased significantly. On the other hand, exports of tobacco and capital-intensive vehicles have fallen sharply over the same period. Unlike goods, exports of services represent only a small portion of total exports. In 2020, the share of services exports constituted only 5% (UNCTAD, 2021).

Thailand (31%), China (28%), Vietnam (16%), Japan (2%), and the United States (2%) remained the main export destinations in 2020. At present, the export of a key commodity – electricity – is supplied mainly to neighboring Thailand. Much of the copper ore and processed copper is exported to China. The import of goods is dominated by a slightly

different geographical structure, with Thailand (53%), China (26%), Vietnam (10%), Japan (2%), and South Korea (1%) being the largest partners. As in the least developed countries, capital-intensive industrial products, including machinery (21%) and transport vehicles (8%), predominate in the commodity structure of imports. Chemical products, processed mineral fuels, such as crude oil, and products of the metallurgical industry account for a large share of imports as well (OEC, 2019).

Table 4. Development of FDI inflows and outflows, million USD

	1990	1995	2000	2005	2010	2016	2017	2018	2019	2020
FDI inflow	6	95	34	28	279	935	1686	1320	557	968
FDI stock	13	211	588	681	1888	6368	8055	9374	9931	10899
FDI, % GDP	0,67	5,13	1,88	0,94	3,81	5,92	9,88	7,27	2,96	5,02
FDI, % of gross fixed capital formation	3,95	30,67	13,47	2,74	14,24	20,40	34,01	24,35	10,10	
FDI Outflow	0	4	10	0	33	15	10	0	0	

Source: processed by the author according to UNCTAD, 2021

In terms of international participation in cross-border capital flows, Laos is a relatively passive player in the region of Southeast Asia. The FDI outflow is not a significant item of cross-border capital flows and in 2015 it reached a maximum value of \$ 40 million. On the other hand, FDI inflows are significant. Over the last decade, the inflow of foreign direct investment has been relatively uneven and in 2020 amounted to \$ 968 million. The fluctuation of investments was related to the inflow of capital needed for the implementation of energy and infrastructure projects or the financing of extraction industry. In 2019, mining and hydropower accounted for up to 95.7% and agriculture for only 2% of foreign direct investment. China, Thailand, France, Vietnam, and Japan are the largest investors, with Chinese investment accounting for a significant share of all FDI. For example, in 2019, China's share of the value of all approved projects was 14% or 16 out of the 69 projects (IPD, 2021). It should be emphasized that these investments are made to use local natural resources, which, however, does not create adequate jobs to support the inclusive and sustainable growth of the national economy. Information technology, consumer products and industrial machinery are sectors that create substantial number of jobs per dollar invested. However, these sectors are only marginally represented in Lao's foreign direct investment portfolio (IFC, 2021). FDI also drives economic inequality by hampering the development of pro-poor growth and providing distribution of wealth to prosperous ones (Bunce, 2017: 316).

In the context of involvement in international economy, the development assistance as significant contributor to national economy should be mentioned. Laos, as the least developed country, has a rich history of foreign financial and development aid, dating back to French colonial rule or United States support in the fight against the spread of

communism in the Southeast Asia. At the time of the monarchical regime, Laos was among the countries with the largest amount of aid per capita. At that time, the share of bilateral and multilateral financial support represented up to 80% of the state budget (St. John, 2006: 175). We must emphasize that the establishment of the communist regime had a drastic effect on the inflow of foreign financial assistance that was suspended, and which, resulted in the collapse of the entire economic system. Following the communist takeover, the USSR and members of the Mutual Economic Assistance Council (CMEA), including Czechoslovakia, Hungary and Bulgaria, became key players in providing support mechanisms. The aid came not only from friendly regimes but also from western developed countries, Japan, or Australia.

Recently, neighboring countries such as China, Thailand, Vietnam, and Malaysia have also played an important role in financial support, taking advantage of the openness of the national economy and its rich natural resources (Stuart-Fox, 2009: 141). Since the beginning of the liberalization of the national economy and the implementation of the principles of openness in the second half of the 1980s, Laos has experienced an enormous and continuous increase in official development and financial assistance, which has grown up to 16 times and now stands at almost US \$ 632 million (World Bank, 2021). In 2020, international grants reached up to 10% of state budget revenues (Bank of Lao PDR, 2021).

Recent economic development

From 2010 to 2013, Laos' economy grew up by 8% annually, but its pace began to slow afterward. During the Eight Five-Year Development Plan (2016-2020), national economic growth averaged 5.2%, with GDP growth of only 0.4% in 2020 due to the global pandemic (Table 3). The growth of economic activity in this period was due to one of the key sectors of the economy – the production of electricity by hydropower plants. The construction sector, which was associated with the construction of railway infrastructure from the Chinese border to the capital Vientiane, also showed a huge increase. The Boten-Vientian Railway is Laos' largest infrastructure project by now. The largest decline was recorded in services, mainly in hospitality industry, which fell to 55% of GDP in 2020 (Bank of Lao PDR, 2021). The decline in overall economic performance and production was also marked by a decline in transport services. The slowdown in economic growth has resulted in a modest increase in unemployment, which did not exceed 1% in 2020. However, the ongoing pandemic has led to massive instability in a relatively shock-resistant services sector, resulting in a 37% unemployment rate for an economically active young cohort (UNDP, 2021/b). Due to the constraints caused by the pandemic, inflation rose slightly to more than 5%. The rise in the price level was caused by higher demand and declining output associated with anti-pandemic measures, as well as the decline of the exchange rate that increased the cost of imported intermediate products.

Table 3. Dynamics of selected indicators during the Eighth Development Plan (2016–2020)

	2016	2017	2018	2019	2020
GDP, current prices in billion USD	15.805	16.853	17.953	18.245	19.136
GDP growth, %	7	6.9	6.2	5.5	0.4
GDP per capita, current prices in USD	2309	2424	2542	2545	2630
Inflation, %	1.6	0.8	2.0	3.3	5.1
Population, million	6.845	6.953	7.061	7.169	7.275
Gross government debt, % GDP	54.5	57.2	59.7	61.6	68

Source: processed by the author according to World Bank and IMF, 2021

In 2021, at the 9th session of the National Assembly, a new president was elected, as well as the prime minister of the Lao People's Democratic Republic, who decided to avert the negative consequences of the pandemic and declared 7 priority points in socio-economic development and state administration. These priorities became the main pillars of the Ninth Plan of National Socio-Economic Development for the period 2021-2025. Reducing public debt, which rose to 68% of GDP in 2020 (IMF, 2021), creating jobs, and reducing dependence on the production and export of natural resources were key priorities for the economy. In addition to services, electricity generation remains the dominant sector of the economy that represents up to 9% of the national production output. The average GDP growth rate is expected to be 4% over the five-year plan. Equally important priorities have been the fight against corruption and opium poppy cultivation, the development of industry and services, the reduction of regional disparities, the problem of the depreciation of the national currency, and the development of human resources (Phonevilay, 2021).

Conclusion

In this study, we have focused on the current specifics of Laos economy, its development trends, and economic structure. To cover the external economic relations, we have briefly analyzed the involvement of the country in the international division of labor with the emphasis on trade, capital flows, and foreign aid that proved to be important when dealing with the position in international economic relations.

Laos has undergone violent political and economic turbulence during the second half of the 20th century, including exploitative colonial rule, then monarchy regime, and transition to socialism. Nowadays, Laos remains the country with a strong communist ideology but implementing an open industrialization strategy with an emphasis on building market economy, liberalizing intentional trade, and stimulating foreign direct investments. Such a transition had an enormous impact on the creation of a weak economic system that remains dependent on primary production, including agriculture, hydropower, and mining. The structure of the economy and the delineation of sectors have created acutely vulnerable preconditions for economic development that relies on international markets. The analysis

of economic structure together with problems of involving Laos economy in international economic relations showed the sluggish endeavors of diversification attempted by the government in a strive to implement market-oriented reforms. Nevertheless, the country has experienced high rate of economic growth during the last two decades and moved from the low-income to low-middle income group of World Bank classification.

Regarding economic structure, it appears that there are a few limitations that hinder the impulse for economic growth and socio-economic development. Low capital-intensive production of the industrial sector is the large part of the economy and reports the highest growth, albeit is frequently capital intensive and does not create the preconditions for the establishment of highly qualified jobs. On the labor market, agriculture, forestry, and fishing are the dominant sectors employing around 60 % of the economically active workforce and contributing 15 % to national output. With the development of commercialization, these sectors provide a higher level of income for the rural poor and can be the main factor of poverty eradication. However, farming technologies are quite traditional and agriculture inputs limited, which results in low productivity.

The involvement of the national economy in the international division of labor has its own deficiency. Laos is a relatively open market with a three-quarters share of trade based on national production. Its trade balance suffers from a long-term deficit that causes the outflow of foreign currencies and aggravates the national balance of payments. At the same time, we must emphasize that this trend will continue, although the government is trying to increase production with greater added value. The liberalization of trade with neighboring countries such as China, which has strong comparative advantages in primary products, can play a negative role in this context. Most of the products produced by Laos will face strong competition from more competitive Chinese goods. Another problem of the trade structure is the concentration of exports on electricity, ferrous and non-ferrous metal ores, or processed metals, the price of which is formed outside the domestic economy and affects the state's revenues. Financial resources are crucial for carrying out the necessary reforms within the framework of five-year development plans. Investment is also important for the economy of Laos, but it is mainly directed to the energy and mining sectors, which does not create the necessary conditions to establish sufficient job positions. This goal was one of the priorities of the last Ninth Five-Year Development Plan. The problem of FDI flow is also its impact on the distribution of wealth within the country. As we have mentioned, investing in the exploitation of natural resources does not affect the income growth of the poor, but, on the contrary, is moving towards the richest class. The state's dependence on foreign aid is also a vital problem. Financial assistance is important for many social programs, but it creates an environment of long-term dependence and does not stimulate the overall turmoil of public finance management and hampers the start of economic development.

References

- Andreev V. A. and Amphavanh, X. (2018). "Ongoing processes, contradictions, and prospects of social and economic development in Lao PDR". In: *The Territory of New Opportunities. The Herald of Vladivostok State University of Economics and Service* 10, no. 3/ 2018, pp. 19-28.
- Bank of Lao PDR (2021). Annual Economic Report 2020. [Online]. Available at: <https://www.bol.gov.la/en/annualreports> (last accessed November, 2021).
- Bourdet, Y. (1995): "Rural Reforms and Agricultural Productivity in Laos". In: *The Journal of Developing Areas*, Vol. 29, No. 2, p. 176.
- Bekkevold, J.I., Hansen, A. and Nordhaug, K. (2020). "Introducing the Socialist Market Economy". In: Hansen, A. et al. (eds.) *The Socialist Market Economy in Asia: Development in China, Vietnam and Laos*. Singapore: Palgrave Macmillan, pp. 3-27.
- Hansen, A., Bekkevold, J.I. and Nordhaug, K. (eds.) (2020). *The Socialist Market Economy in Asia: Development in China, Vietnam and Laos*. Singapore: Palgrave Macmillan.
- Bunce, S. (2017). "Economic Hardship and French Colonialism in Laos". In: *Language in India*, 17, no. 5/2017, pp. 315-323.
- CIA (2021). The World Factbook: Laos. [Online]. Available at: <https://www.cia.gov/the-world-factbook/countries/laos/> (last accessed September, 2021).
- Creak, S. and Barney, K. (2018). "Conceptualising party-state governance and rule in Laos". In: *Journal of Contemporary Asia* 48, no. 5/2018, pp. 693-716.
- Csabay, M. et al. (2011). *Economics of Developing Countries*. Bratislava: Ekonom. 384. p. ISBN 978-80-225-3129-0.
- Dunseith, B. (2017). Import and Export Procedures in Laos – Best Practices. [Online]. Available at: <https://www.aseanbriefing.com/news/import-and-export-procedures-in-laos-best-practices/> (last accessed December, 2021).
- EIU (2019). Laos heightens scrutiny of foreign aid. [Online]. Available at: <https://country.eiu.com/article.aspx?articleid=758653259&Country=Laos&topic=Politics&subtopic=Forecast&subsubtopic=International+relations> (last accessed February, 2022).
- ERIA (2018). LAO PDR Enegy Outlook 2020. [Online]. Available at: <https://www.eria.org/uploads/media/Research-Project-Report/Lao-Energy-Outlook-2020/Lao-PDR-Energy-Outlook-2020.pdf> (last accessed December, 2021).
- Evans, G. (2002). *A Short History of Laos: The Land in Between*. Sydney: Allen & Unwin. 272 p. ISBN 978-1864489972.
- FAO (2020). Special report: FAO/WFP crop and food security assessment mission to the Lao PDR. [Online]. Available at: <https://reliefweb.int/sites/reliefweb.int/files/resources/CA8392EN.pdf> (last accessed December, 2021).
- FAO (2021). FAO in Laos. [Online]. Available at: <https://www.fao.org/laos/fao-in-laos/laos-at-a-glance/en/> (last accessed December, 2021).
- GeoNames (2022). ISO Subentity Codes for Laos. [Online]. Available at: <https://www.geonames.org/LA/administrative-division-laos.html> (last accessed February, 2022).

- Gnanasagaran, A. (2018). Lao PDR: Southeast Asia's factory. [Online]. Available at: <https://theaseanpost.com/article/lao-pdr-southeast-asias-factory> (last accessed December, 2021).
- IFC (2021). Investment Reform Map for Lao PDR. [Online.] Available at: <https://www.ifc.org/wps/wcm/connect/f936df8b-8bcb-4cfd-99b8-840844d4ebb5/Lao+IRM+Report-FINAL.pdf?MOD=AJPERES&CVID=nuOEnGF> (last accessed December, 2021).
- IMF (2021). Lao People's Democratic Republic. [Online]. Available at: <https://www.imf.org/en/Countries/LAO> (last accessed November, 2021).
- Insisienmay, S., Nolintha, V. and Park, I. (2015). "Dutch Disease in the Lao Economy: Diagnosis and Treatment". In: *International Area Studies Review* 18, no. 4/2015, pp. 403-423.
- IPD (2021). Foreign & Domestic Investment Projects by Country. [Online]. Available at: <https://investlaos.gov.la/resources/statistics/> (last accessed December, 2021).
- Kenney-Lazar, M. (2019). "Neoliberalizing Authoritarian Environmental Governance in (Post)Socialist Laos". In: *Annals of the American Association of Geographers*, 109, no. 2/2019, pp. 338-348.
- Kyophilavong, P., Wong, M. C., Souksavath, S., Xiong, B. (2017). "Impacts of trade liberalization with China and Chinese FDI on Laos: evidence from the CGE model". In: *Journal of Chinese Economic and Business Studies* 15, no. 3/2017, pp. 215-228.
- Leebouapao, L. and Sayasenh, A. (2017). Lao PDR. [Online]. Available at: https://www.eria.org/3.8.ASEAN_50_Vol_3_Country_Reports_Lao_PDR.pdf (last accessed November, 2021).
- London, J. D. (2017). "Varieties of States, Varieties of Political Economy: China, Vietnam and the Making of Market-Leninism". In: Carroll, T. and Jarvis, D.S.L. (eds.) *Asia After the Developmental State*. Cambridge: Cambridge University Press, pp. 388-428.
- Menon, J. and Warr, P. (2013). The Lao Economy: Capitalizing on Natural Resource Exports. [Online]. Available at: <https://www.adb.org/publications/lao-economy-capitalizing-natural-resource-exports> (last accessed November, 2021).
- OECD (2019). Lao PDR country profile. [Online]. Available at: <https://oec.world/en/profile/country/lao?depthSelector1=HS4Depth> (last accessed December, 2021).
- Oraboune, S. (2011). "Lao PDR's Industrial Development Policy and Intermediate Goods Trade". [Online]. Available at: https://www.ide.go.jp/library/English/Publish/Reports/Brc/pdf/05_chapter8.pdf (last accessed December, 2021).
- Phonevilay, L. (2021). New Prime Minister to Address Seven Urgent Issues in Laos. [Online]. Available at: <https://laotiantimes.com/2021/03/24/new-prime-minister-to-address-seven-urgent-issues/> (last accessed December, 2021).
- Re Global (2020). Laos promotes hydropower to become the "Battery of Southeast Asia". [Online]. Available at: <https://reglobal.co/hydro-power-development-in-laos/> (last accessed December, 2021).
- Roberts, C. B. (2012). "Laos: A More Mature and Robust State?" In: *Southeast Asian Affairs*, no. 1/2012, pp. 153-168.

- Stefanova, B. and Zhelev, P. (2022). "Revisiting China's Market Economy Status: State Capitalism within the WTO Liberal Trading System". In: *Australian and New Zealand Journal of European Studies* 14, no. 2/ 2022.
- St. John, R. B. (2006). "The political economy of Laos: Poor state or poor policy?" In: *Asian Affairs* 37, no. 2/2006, pp. 175-191.
- Strangio, S. (2021). "Laos-China Railway Inaugurated Amid Mounting Debt Concerns". In: *The Diplomat*, December 03, 2021. [Online]. Available at: <https://thediplomat.com/2021/12/laos-china-railway-inaugurated-amid-mounting-debt-concerns/> (last accessed December, 2021).
- Stuart-Fox, M. (2009). "Laos: The Chinese Connection". In: *Southeast Asian Affairs*, pp. 141-169.
- UNCTAD (2021). Merchandise: Trade balance, annual. [Online]. Available at: <https://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx> (last accessed December, 2021).
- UNDP (2021/a). *Human development report 2020*. [Online]. Available at: <https://hdr.undp.org/en/content/human-development-report-2020> (last accessed November, 2021).
- UNDP (2021/b). *UNDP Launch Report On Youth Unemployment Issues in Lao PDR*. [Online]. Available at: https://www.la.undp.org/content/lao_pdr/en/home/presscenter/pressreleases/2021/07/undp-launch-report-on-youth-unemployment-issues-in-lao-dpr.html (last accessed December, 2021).
- Vilavong, B., Rasphone, S. and Vivavong, O. (2016). "Production Networks and Human Capital: An Analysis of the Manufacturing Sector in Laos". In: *Lao Trade Research Digest* 5, pp. 1-29.
- World Bank (2021). World Bank Open Data. [Online]. Available at: <https://data.worldbank.org> (last accessed September, 2021).