

Research on the Financial Development in Laos and China-Laos Financial Cooperation

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Abstract

The development of the financial system will lead to the expansion of financing channels, the adjustment of financing structure and the standardization of financing activities. It can be seen that the construction and improvement of the financial system will promote a country's economic growth greatly. This paper gives a comprehensive introduction to the financial development of Laos, and puts forward some ways to deepen the financial cooperation and development between China and Laos.

Keywords

Finance; Cooperation; China-Laos.

1. Overview of Financial Development in Laos

Through the economic reform policy of 1986, the economic system of Laos changed from a centrally planned economy to a market economy. With the introduction of foreign capital and the opening up of tourism and other measures, the Laotian economy began to develop rapidly, with an annual economic growth rate of nearly 10%. With the development of the economy, the financial system of Laos has also started to be constructed. By 2019, the framework of the financial system of Laos has been basically completed, but the overall structure is still in the primary stage. The financial industry accounts for less than 20% in the tertiary industry, and the development situation is not ideal.

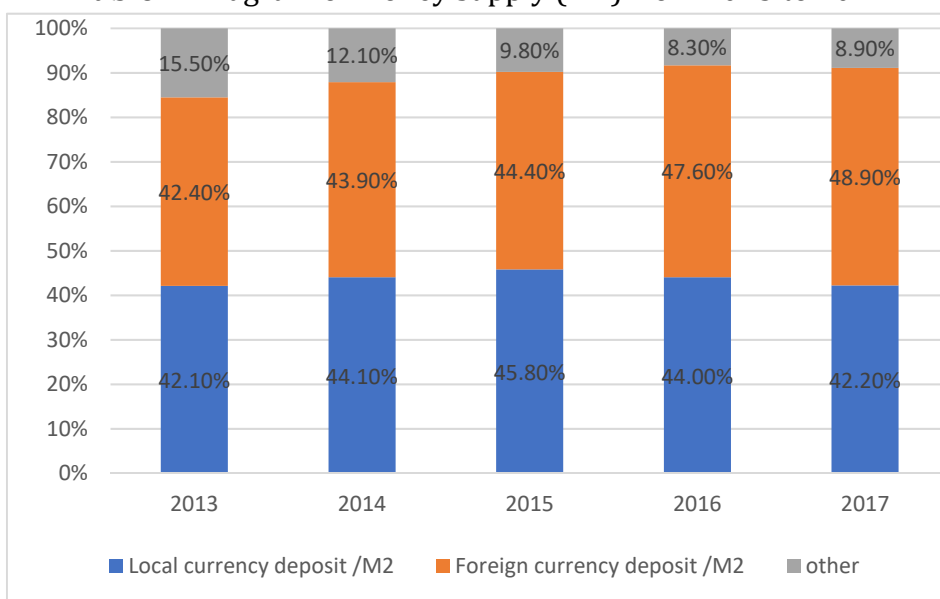
1.1. Current Status of Financial Fundamentals

1.1.1. Money and Money Supply

The main currency issued and circulated in Laos is the KIP. The KIP is not a freely convertible currency according to Laos' regulations on foreign exchange management. But the government encourages its citizens to buy in local currency in Laos. The Laotian market is also convertible into U.S. dollars and Thai baht, and the CNY is used in small amounts along the border between China and Laos.

In 2017, the KIP supply (M2) was 7,467,818 billion LAK, up 12.23 percent year-on-year and accounting for 53.06 percent of GDP. Notably, the ratio of credit to the domestic economy and the inflow of foreign investment capital have increased substantially, particularly in the electricity, manufacturing, construction, mining and quarrying, finance and insurance, and other sectors.

Table 1: Diagram of money supply (M2) from 2013 to 2017



1.1.2. Deposit and Loan Interest Rate

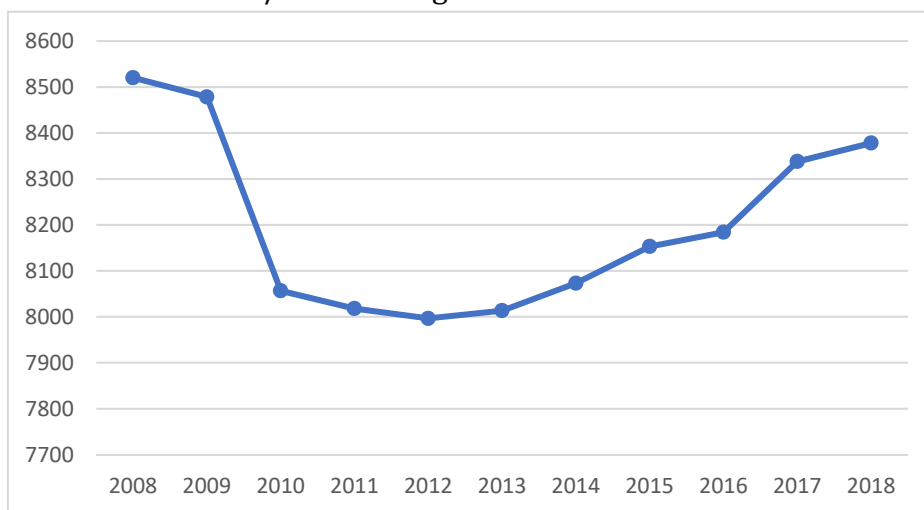
In recent years, the deposit and loan interest rates of commercial Banks of Laos are significantly higher than those of China, and the overall trend is declining, which is in line with the new interest rate policy target implemented by Laotian government since 2015. In terms of deposit interest rate, the demand interest rate was 3.5% in 2010, and has been dropping all the way. It decreased by 50% in 2016. The average annual demand rate was about 1.76% In 2016, four times higher than 0.35% in China. The five-year fixed deposit rate is about 9.88%, about three times higher than 2.75% in China. As a result, the super high deposit interest rate in Laos has attracted investors from Thailand to open savings accounts in Laos.

In terms of loan interest rate, the characteristics are like deposit interest rate. The long-term loan interest rate (3-6 years) dropped from 14.88% to 10.94% in five years (2011-2016), while the long-term loan interest rate (over 5 years) in China was 4.9%, only about half of that in Laos. Laos not only has a high loan interest rate and a wide spread, but also has a relatively high loan condition because it has not established a relatively complete credit investigation system for individuals and enterprises.

1.1.3. The Exchange Rate

In the past 10 years, as shown in Tab 2, the exchange rate between the US dollar and KIP roughly took 1:8,200 as the baseline from 2008 to 2018, presenting a u-shaped fluctuation trend. The exchange rate first continued to decline, falling below 1:8,000 for a time, and then slowly rose. In February 2019, the latest exchange rate was 8,563 KIP to the us dollar (the average exchange rate in February), compared with the ratio of 1:10,816 at the end of December 2005, indicating a significant appreciation of KIP in general.

Table 2: USD/KIP exchange rate between 2008 and 2018



1.2. Development of Financial Institutions

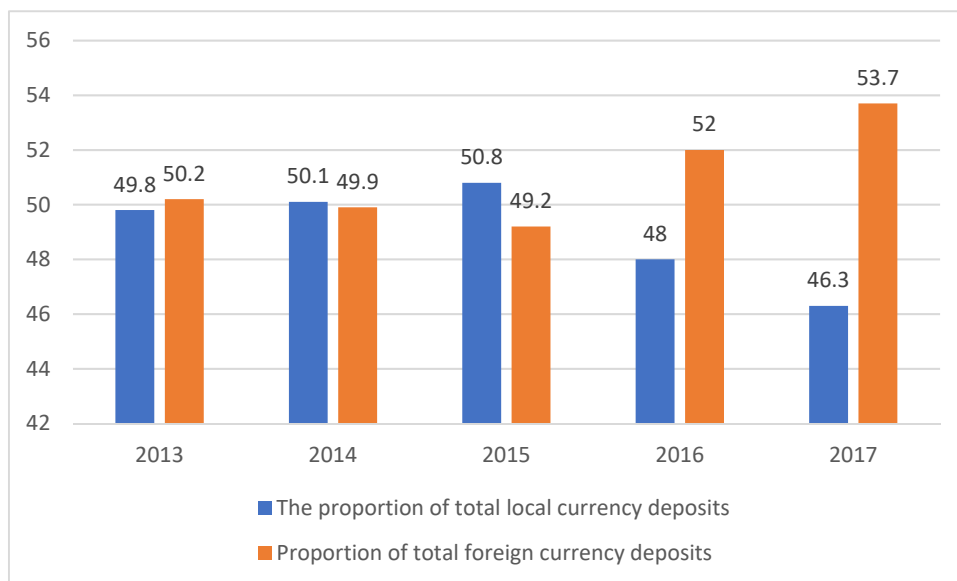
The number of banking-type financial institutions in Laos is small and its strength is relatively weak compared with that of neighboring countries. The development of non-bank financial institutions is more backward and weaker. The whole financial institutions are still in the initial stage and need to be further developed and improved.

1.2.1. Banking-type Financial Institutions

The central bank of Laos was established in 1995 and evolved from the Lao national bank. It is not only the central bank of Laos, but also the supervisory department of the banking-type financial institutions in Laos. By the end of 2017, the Laos has total of 42 commercial Banks (three state-owned commercial Banks, one policy Banks, three joint-venture commercial Banks, seven private Banks, nine foreign lines and 19 foreign branches and other non-bank financial structure)nationally , 101 commercial bank branches, 510 unit service, 37 foreign exchange and 1176 ATM machine.

Among the many Banks, the commercial bank is the most important financial institution in Laos. Commercial Banks in Laos are not only small in scale, but also lack of financial services compared with neighboring countries in terms of service quality. The Laotian commercial bank deposits reached 6,8032.49 billion LAK in 2017, up 11.54 percent from 6,0993.3 billion in 2016, accounting for 48.34 percent of the country's GDP. From the perspective of deposit structure, the proportion of local currency deposits in Laos has decreased while the proportion of foreign currency deposits has increased significantly since 2015, In 2017, the LAK deposits increased by 7.47%, accounting for 46.27% of the total deposits. Foreign currency deposits increased by 15.30 percent, accounting for 53.73 percent of total deposits. Thus, the Laotian financial market is more attractive to foreign capital.

Table 3: The proportion of domestic and foreign currency deposits in Laos from 2013 to 2017

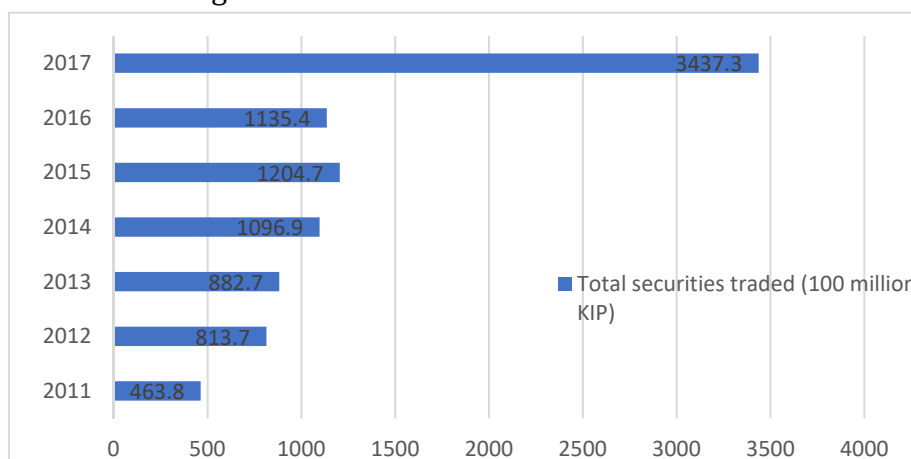


1.2.2. The Securities Market

Laos has always relied on short-term loans from commercial Banks for financing, so it has become an indispensable part of its financial development to establish a securities exchange market. Laos securities market has only started to take off in recent years. On October 10, 2010, it was officially established in vientiane, the capital of Laos, jointly funded by the central bank of Laos and the Korean stock exchange. When it first opened on January 1, 2011, there were only two stocks. The securities market is small in size and one of the smallest capital markets in the world at this stage. By the end of 2017, there were only four joint-venture securities companies and only six listed shares in the market. Thus, Laotian securities market is still in the initial stage of development.

The total trading volume of the Laotian stock market presents a rising situation. Especially in 2017, the stock trading volume of the Laotian stock exchange was 51,036,100 shares, and the total value of stock trading amounted to 343.73 billion KIP, rose 202.76%. The total turnover of 51.03 billion shares. This was an increase of 126.90% over the previous year. Foreign investors accounted for 49.52 per cent of the total.

Table 4: total trading amount of Lao securities market from 2011 to 2017



1.2.3. The Insurance Industry

Laos has a small population base, a relatively backward economy, low disposable income, little understanding of insurance functions and a weak awareness of insurance. The depth and density of insurance are at the bottom level of southeast Asian countries. The insurance market is only slightly better than that of Cambodia. The demand for insurance mainly comes from foreign institutions and individuals in Laos. In terms of insurance coverage, the coverage rate of the insurance industry is low, the industries involved are not broad enough, and the types of insurance products are also few. The backwardness of the insurance industry also makes the insurance supervision not be paid attention to effectively and the management is extensive.

At present, there are 24 insurance companies in Laos. The largest insurance company is Allianz, which, together with Laos-Vietnam insurance company and TOKO insurance company, occupies 97% of the insurance market share in Laos. From the current insurance types in the Laotian insurance market, the largest sales amount is property insurance, whose premium accounts for about 98% of the total insurance sales. Among them construction engineering insurance is the main product of property insurance, accounting for the half of insurance premium of total property insurance. Property, Marine and motor insurance followed.

While the Laotian insurance market is just beginning to develop, demand is growing at an alarming rate. Since 2003, demand for insurance in Laos has been growing at an annual rate of 30%. At the same time, the insurance market in Laos is open to the outside world. According to the insurance law of Laos, foreign capital with more than 5 years of insurance experience can enter the Laotian insurance market and conduct insurance business in Laos through establishing joint ventures or wholly-owned subsidiaries. Therefore, the entry threshold of Laotian insurance market is not high and its development potential is huge.

1.3. Brief Summary

From the above analysis, it can be seen that now Laos has formed a financial market structure in which the central bank, commercial banks, securities companies, insurance companies and other non-bank financial institutions coexist, and a single financing channel has also expanded into diversified financing channels such as national bonds, stocks and bonds. In addition, the breadth and depth of financial markets have also increased.

At the same time, we also find that the capital strength of the banking industry in Laos is small and the loan interest rate is high, which makes the financing cost of enterprises too high. The development of securities and insurance industry in Laos is still in its infancy. Judging from the trading volume, the general public's enthusiasm for investing in stocks and insurance is not great. It hasn't established its own credit management system yet in Laos. At present, the immature and imperfect financial development in Laos restricts the further development of its economy to some extent.

2. The Current Situation of Financial Cooperation between China and Laos

Despite the slow recovery of the global economy after the 2008 financial crisis, the economic cooperation between Laos and China has been developing year by year. In 2015, bilateral trade reached US \$2.78 billion, and Chinese enterprises' direct investment in Laos totaled US \$88.9 million. China has become Laos' largest donor, largest source of foreign investment and second largest trading partner. Laos has also become the third largest destination of Chinese investment in ASEAN countries. The two sides have also conducted close cooperation in infrastructure, human resources, regional and sub-regional areas. It can be seen that in terms of trade and investment, the cooperation between China and Laos is continuously deepening. The development of trade and investment requires the continuous strengthening of bilateral financial cooperation.

Financial cooperation between Laos and China is also on the rise. The State Bank of Laos is committed to stable cooperation with the People's Bank of China, and has actively reached cooperative agreements in addition to the regular financial payment and settlement system, especially in bilateral currency swap. The People's Bank of Laos and the China Banking Regulatory Commission agreed to sign a memorandum of understanding to implement cross-border banking supervision, support sharing and promote mutual establishment of financial institutions between the two countries. This major development cooperation has also become one of the highlights of the 2016 Asean Summit. As of 2016, the total assets of the three Chinese Banks in Laos -- Bank of China-Laos, Bank of China and Industrial and Commercial Bank of China -- have accounted for 24% of the total assets of the Laotian banking system. These assets contributed to the socio-economic development of Laos, providing 10.4 trillion KIP in bank loans.

The proposal of "One Belt and One Road" will further promote the economic development of Laos. Following the signing of the China-Laos cooperation documents, the China-Laos economic corridor, China-Laos railway and other "One Belt and One Road" projects have been accelerated, and the level of bilateral economic and trade cooperation will continue to rise. In agriculture, industry, science and technology, urban infrastructure, commerce and trade, tourism, logistics and other fields, the quantity and quality of Laos' financial support requirements will continue to increase. However, the financial industry in Laos is underdeveloped, with weak capital strength and few products. Only some loan businesses can be carried out, and the financial services provided for Laotian enterprises are far from meeting their financing and other needs. The golden period of rapid economic development in Laos has arrived. China-laos strategic cooperation in the financial sector should also step onto the stage to help Laos board the high-speed train of economic development.

3. Suggestions on Financial Cooperation between China and Laos

In order to accelerate the strategic connection between China and Laos in the financial field, the author puts forward several concrete suggestions on strengthening financial cooperation between China and Laos.

Firstly, establishing a unified clearing and settlement center to promote the growth of China-Laos trade and investment. Finance serves the development of real economy, and trade and investment promote each other. With the deepening of trade and investment between China and Laos, the demand for financial services will continue to increase. And the perfect bank credit, exchange, settlement and other services need to be achieved through cooperation between the two sides. Especially with the development of e-commerce, mobile payment, online payment, and so on the new payment means mature, establishing a unified, clearing, settlement center can promote the transformation of the business model of traditional financial institutions and the innovation of online banking business platform. At the same time, it can also improve the efficiency of the consumers and related units' interbank payment, increase the transparency of liquidation, provide the Lao central bank with reliable financial data sources for anti-money laundering, financial supervision and monetary policy. In this process, we can refer to China's experience in setting up a unified clearing and settlement system among commercial Banks in Laos to realize the interconnection of the clearing and settlement systems. Secondly, establish credit rating standards, institutions and institutional mechanisms. At present, the number of Banks in Laos is small, the operation mode is single, the bank loan terms and interest are high, and the personal credit system has not been established. As an important country along the "One Belt And One Road" route, Laos should strengthen communication and cooperation with China's national and regional credit investigation management departments, including the development of credit investigation market, supervision of credit investigation

institutions, credit rating system and standards, prevention of credit risks, protection of the legitimate rights and interests of information subjects and other aspects.

Thirdly, strengthen exchanges and cooperation in the banking sector. As one of the leading members of the new four asean countries, Laos has less cooperation with China in the banking sector. Banking cooperation is an important part of financial cooperation. Banks of China and Laos should set up branches and carry out correspondent bank business in each other, which can not only diversify the business of Banks, but also provide better financial supporting services for bilateral trade. At present, the banking industry in Laos is very similar to the early stage of China's reform, and it is a very promising market. Transnational operation of banking institutions can enhance the competitive atmosphere, improve the level of operation, supervision and risk resistance of Banks, and improve the border trade settlement system and improve the settlement level and efficiency in practice.

Fourthly, develop the securities market and improve the bond market. Laotian stock market, which was set up with the help of South Korea and Thailand, is still in its infancy. Laos needs to learn from foreign countries in terms of equipment, personnel, management system and risk control. As a neighboring socialist country, China has some experience in economic reform and opening up and building a securities market and can carry out a series of discussions, exchanges and training activities with the Lao stock exchange. On the other hand, Laos should actively improve the construction of bond market with the help of China, and enhance the breadth and depth of direct financing by expanding the investment and financing channels of infrastructure, so as to change the term structure mismatch of medium and long-term investment.

Fifthly, establish a dialogue and cooperation mechanism. China and Laos can hold regular BBS meetings on financial cooperation to carry out consultations on specific cooperation and technical coordination between financial institutions of the two countries. In terms of financial studies, China and Laos can carry out regular exchanges. Laos can learn from China's experience in financial reform, and China can have a better understanding of the current situation in Laos, so that the two sides can achieve common development and progress. As the core financial sector of a country, the central bank should also establish a good cooperative relationship, adjust relevant foreign exchange management policies and sign financial agreements through high-level visits between the two sides, so as to create an institutional basis and policy environment for financial cooperation between the two countries.

The "One Belt and One Road" initiative gives hope to the economic take-off of Laos. Laotian businesses and people are very supportive of the "One Belt and One Road" initiative. International and all-round financial services will certainly be integrated into the "One Belt and One Road" initiative. Deepening china-laos multilateral financial cooperation and exchanges will provide necessary conditions for the extensive and in-depth china-laos cooperation.

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