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PUBLIC FINANCE REVIEW

4. State-Owned Enterprises

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4. State-Owned Enterprises

Deepening and accelerating reforms of state-owned enterprises (SOEs) is critical to ensure that they fulfill their mandates, operate efficiently, and do not generate undue fiscal risks. SOEs have been established worldwide for different purposes, such as addressing market failures, supporting national strategic interests, and promoting socioeconomic objectives. However, many SOEs are inefficient and struggle to meet their policy mandates. This has led to considerable operational losses and heavy indebtedness, which have jeopardized fiscal and debt sustainability. The Lao PDR has made some progress in reforming its SOE sector throughout the years. The number of SOEs has been cut considerably, their weight in the economy reduced, and their presence in non-strategic sectors curtailed or eliminated. However, the results of past reforms have been mixed, and several challenges remain. Reform progress has been undermined by institutional weaknesses, low capacity, and political economy constraints. The SOE portfolio is relatively decentralized and spread over several economic sectors. Most SOEs do not consistently submit financial reports to the Ministry of Finance, which prevents a comprehensive assessment of the sector. Available data suggests that many SOEs have negative equity and generate persistent losses, and the largest ones are highly indebted, presenting a significant fiscal risk. Aggregate financial performance indicators raise concerns over the electricity, transport, and finance sectors, where EDL, Lao Airlines, and BCEL are key actors. Some SOEs have benefited from sizable on-lending and loan guarantees from the government, often to support their involvement in public-private partnerships, notably in the hydropower sector. While there has been a renewed momentum for SOE reform since 2021, it is crucial to intensify the activities of SOE reform committees and implement their reform plans. Overall, there is a need to improve SOE corporate governance, operational management, and financial performance, as well as enhance transparency.

Main recommendations: (i) centralize and strengthen the state ownership and oversight function; (ii) create a fiscal risk management unit within the Ministry of Finance; (iii) broaden the ownership of SOEs; (iv) professionalize SOE boards of directors to promote good governance and enhance performance; and (v) disclose SOE performance reports to increase transparency and strengthen accountability.

Chapter structure: The chapter starts by describing the rationale for SOEs, briefly reviewing the global experience, and summarizing past reforms in the Lao PDR. The following section evaluates the recent financial performance of the SOE sector. The chapter then discusses recent reform efforts and existing plans, including changes to the legal and institutional framework. The final section provides key recommendations to improve the financial performance, operational management, and corporate governance of SOEs.

4.1 Background

4.1.1 Definition and role of SOEs

In this chapter, 'state-owned enterprise' is defined as a corporate entity recognized by law that is at least partially owned by the government. There is no universal definition of an SOE since definitions differ across countries, often anchored in national SOE-related legislation. However, there are some common features, such as (i) having its own separate legal status; (ii) being at least partially controlled by a government unit; and (iii) predominantly engaging in commercial activities.[147] The recent Decree on SOEs defines them as business units in which the state is the only investor or a joint venture with other parties, including pre-existing enterprises acquired by the state. Hence, an SOE is any corporate entity recognized by Lao law as an enterprise in which the state has some level of ownership. Typically, SOEs are independent commercial entities that generate most of their income from selling goods and services. They do not depend on transfers from the government to cover most of their costs and are usually able to borrow on their own account.

The characteristics of SOEs and their rationale vary considerably across and within countries. SOEs vary in terms of size, sector of activity, and the degree of state ownership. Some are fully owned by the government, while others

[147] A government unit may exert significant influence over corporate decisions in an entity even when only holding a minority stake (e.g., through golden shares or indirect ownership). See the IMF Fiscal Monitor April 2020 and OECD Guidelines on Corporate Governance of SOEs.

have mixed ownership (i.e., both public and private owners). SOEs can be owned at either central or sub-national government levels. SOEs provide goods and services in many economic sectors, including utilities (e.g., gas, electricity, and water), finance, transportation, telecommunications, mining (e.g., oil), manufacturing, and construction. SOEs have been created for several reasons, sometimes linked to market failures that lead to a suboptimal (or lack of) provision of important goods or services (Box 4 and Box 5). These reasons include natural monopolies (due to high initial costs), under-provision of essential public goods (due to non-rivalry and non-excludability), and externalities (positive or negative). Other purposes include supporting national strategic interests (e.g., control over natural resources, or national defense), and promoting socioeconomic objectives (e.g., employment).

Despite the motives for their existence, country experiences illustrate drawbacks that need to be carefully considered. Many countries rely on SOEs to provide public services, as well as foster economic and social development.[148] However, some SOEs struggle to meet (often multiple) policy mandates and are inefficient.[149]Some operate in a competitive environment without a clear policy mandate, where the private sector can generally deliver similar goods and services more efficiently. The separation of ownership (government) and control (SOE management) may create conflicts of interest and moral hazard (i.e., the principal-agent problem), which can lead to inefficiencies and mismanagement.[150] Moreover, some receive excessive government support and are vulnerable to vested interests.[151] It is therefore important to use SOEs pragmatically, by clarifying their policy mandates and regularly assessing their rationale, corporate governance, management, and financial performance.[152] It is crucial to ensure they fulfill their mandates, provide good value for money, and do not burden the state budget.

SOEs play a large role in several sectors of the Lao economy, including energy, finance, transportation, telecommunications, mining, and water. Over the years, some SOEs have made significant contributions to the country's economic development. Through SOE activities, access to electricity and improved water sources expanded considerably, transport and telecommunications infrastructure increased, and domestic credit to the private sector grew. SOEs also provide essential products to society, including construction equipment, pharmaceuticals, medical equipment, and educational materials. Nonetheless, SOE investments and operations have entailed large fiscal costs and led to a considerable rise in contingent liabilities.

4.1.2 Historical trends and recent reforms

SOE reforms have been pursued in several phases since the mid-1980s, with some positive results. Most enterprises were nationalized in the second half of the 1970s, but weak performance, partly due to a centrally-planned economic system, led to granting a greater role to market forces. SOE reforms started in the mid-1980s, as part of broader economic reforms under the New Economic Mechanism.[153] Similar reforms were initiated by China in 1979 and Vietnam in 1986, although the Lao PDR had fewer and smaller SOEs. SOE reforms can be categorized into four distinct phases. The first phase focused on giving greater operational autonomy to SOEs, while the second phase placed an emphasis on privatization.[154] In the third phase, SOEs were subject to a more comprehensive reform effort that went beyond ownership. A fourth phase has recently started. Overall, past reforms have reduced the dominance of a (largely) inefficient SOE sector and gradually paved the way for an emerging private sector. However, progress on SOE reform has generally been undermined by institutional weaknesses, low capacity, and political economy constraints. Moreover, the recent financial difficulties faced by the larger SOEs cast a shadow on previous efforts, while providing important lessons for future reforms.

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148 SOEs are prevalent in the provision of public services (e.g., electricity, water, and transportation) and financial services.

149 They often face competing objectives, such as profit maximization (especially if listed) and socioeconomic objectives. Non-commercial mandates (e.g., social objectives) are often not adequately compensated, leading to indebtedness.

150 This may happen when the government (i.e., the principal) does not have the capacity or information required to oversee SOE performance effectively.

151 Government support may include direct financial support (e.g., subsidies and capital injections), tax exemptions, below-market financing, and guarantees. It can lead to financial stress (if it is insufficient to cover the cost of pursuing their policy mandates) or give them an unfair competitive advantage over private firms (if it is excessive). It can also help sustain SOEs with unsustainable business models and thus undermine fiscal sustainability. Unwarranted political interference and rent-seeking may constitute additional challenges.

152 This requires developing institutions and processes to evaluate SOE performance and regularly assessing whether an SOE is the best way to achieve a given policy goal.

153 See "Trial and Error in State-Owned Enterprises Reforms in Laos".

154 In a broad sense, privatization does not involve divestment of state ownership or asset sales as it also includes leasing and joint ventures.

Box 4: SOE origins, challenges, and reforms

SOEs rose to prominence in the 1950s and 1960s, as they became widespread in most parts of the world. The origins of SOEs are often traced back to the early 20th Century, following the nationalization of key industries in Europe. With the end of colonialism, many countries in Africa and Asia created SOEs, often to support certain ideologies (e.g., nationalism or socialism). It is estimated that, by the early 1980s, SOEs accounted for 8 percent of output in advanced economies and 15 percent in developing countries.[155]

By the 1970s and 1980s, it had become clear that SOEs were associated with significant challenges. SOEs were found to often perform worse than private firms, both financially and in terms of service delivery. Inefficiencies were partly driven by poor corporate governance, owing to ineffective ownership or conflict of interest.[156] Moreover, lack of competition in a sector (e.g., monopoly) meant that inefficient and unproductive SOEs could still be viable, while soft budget constraints (owing to explicit or implicit government support) created moral hazard. SOEs also had multiple (and sometimes unclear) policy mandates that were difficult to reconcile. Weak governance also led to the use of SOEs for personal and political benefit. Some SOEs became a heavy burden on public finances, threatening fiscal sustainability, and were crowding out resources required for the emergence of a dynamic private sector (e.g., credit and access to markets).

SOE reforms attempted to tackle these challenges, partly through corporatization and (partial or full) privatization. SOE reforms have been mostly aimed at increasing efficiency and easing the burden on public finances.[157] SOE reforms worldwide from the 1980s and 1990s focused on transferring SOE ownership to the private sector, fostering competition in markets where SOEs operated, imposing hard budget constraints on SOEs, and improving performance monitoring. Many SOEs around the world are no longer fully owned by the government, as mixed ownership has become more prominent, even if governments have often chosen to retain a majority stake.[158] Some countries also pursued corporatization. This involved placing SOEs under the same commercial laws as private firms, giving them the legal status and the management structure of a corporation. Many SOEs now have shareholders and a board of directors, though they can still be fully owned by the state. These reforms were partly driven by the transition to market economies that followed the dissolution of the Soviet Union. Nonetheless, the experience of China, Singapore, and other countries has somewhat renewed interest in the role of SOEs. Privatization efforts continued in the 2000s, often improving revenue, creating a lower fiscal burden, and enhancing public service delivery. However, most successes were in commercially attractive sectors, such as telecoms, trade, manufacturing, and among smaller enterprises. Some SOEs proved difficult to privatize, particularly natural monopolies. There were also failures due to vested interests and bad transactions, and efficiency gains were not always shared equally among stakeholders.

Reform efforts have continued throughout the world, but SOEs remain widespread. Over the last 20 years, the SOE reform agenda has broadened, deepened, and increased in sophistication. The main directions of SOE reform programs now typically include: (i) strengthening and centralizing the state ownership function; (ii) continuing privatization where appropriate and ensuring equitable treatment of all shareholders in mixed ownership companies; (iii) improving SOE performance management; (iv) reimbursing the costs of SOE public service obligations; (v) professionalizing SOE boards of directors; (vi) ensuring competitive neutrality between SOEs and private enterprises; and (vii) enhancing transparency and disclosure, as well as financial and fiscal discipline for SOEs.

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[155] IMF Fiscal Monitor April 2020, and Occasional Paper 137.

[156] Unlike private firms, SOEs are owned by the government on behalf of citizens, which undermines accountability and generates limited incentives to innovate and improve efficiency. Conflict arises when a government entity is both the owner and the regulator (or policymaker).

[157] Governments may try to raise fiscal revenues and reduce expenses (e.g., direct subsidies) by selling equity in SOEs. However, doing so when facing solvency pressures may lead to a 'fire sale' of state assets.

[158] This is likely due to the intention to privatize gradually and keep a presence in sectors seen as strategic. Political feasibility may also have played a role, especially owing to negative attitudes toward foreign ownership and the existence of vested interests.

Box 5: Regional experiences

SOE origins and experiences vary considerably across the region, and often reflect economic, social, and political factors. The prevalence of SOEs differs significantly across countries in Asia.[159] For instance, SOEs account for a significant (albeit declining) share of GDP in Vietnam (30 percent) and China (25 percent), but they are less significant in Cambodia, the Lao PDR, and Thailand (10 percent). They have diverse origins, from supporting political ideologies (e.g., nationalism and socialism) to facilitating economic strategies (e.g., industrialization).[160] Reform efforts have typically been driven by financial motives (e.g., decline in foreign assistance and growing burden on public finances) rather than an intrinsic desire to promote efficiency and productivity. Political economy considerations partly explain the slow pace of reforms in some countries. Recent reform trends include: (i) reduced ownership through partial divestment to allow private sector involvement (e.g., equitization in China and Vietnam), (ii) improved corporate governance to enhance efficiency (e.g., professionalization of management, introduction of performance targets, and adoption of international accounting standards); and (iii) improved oversight (e.g., centralization) and transparency. Below is a summary of the experiences of China, Thailand, and Vietnam.

China. SOE reforms started in the late 1970s, as the country moved toward a market-oriented economy by giving SOEs greater autonomy in decision-making. In the 1990s, many SOEs were transformed into joint-stock companies, and performance-based incentives were introduced. Several SOEs were restructured, and some were listed on the stock exchange. In the early 2000s, the focus was on improving efficiency and competitiveness, which entailed restructuring, professionalization of management, and adoption of international accounting standards. In the mid-2010s, the government promoted mixed ownership, although many challenges persist. While SOEs remain important in the economy, reforms have increased their access to capital and knowledge, which helped improve their efficiency and competitiveness, even leading to their internationalization. A core component of China's reform strategy has been the inclusion of private shareholders in the ownership structures of SOEs. A declared aim of this policy is to maximize efficiency by improving corporate governance.

Thailand. Thailand started privatizing some SOEs in the 1980s, such as the Electricity Generating Authority of Thailand (EGAT), to increase efficiency and reduce the fiscal burden. In the 1990s, a commission was established to oversee the restructuring of SOEs and improve their performance (through greater transparency, accountability, and competition) and an office was created to monitor and evaluate SOE performance. Reforms continued with several legal instruments aimed at improving corporate governance (e.g., appointment of independent directors, performance-linked pay, and establishment of audit committees). There are around 55 SOEs, of which 46 are fully owned by the state and seven are publicly listed. They operate in many sectors of the economy. Line ministries are responsible for sector policies, but the Ministry of Finance is the shareholder for all SOEs, which it supervises through its State-Owned Enterprise Policy Office. Recent reform priorities include enhancing SOE competitiveness and more efficient provision of essential public services, reducing fiscal risk, and improving transparency and accountability in public spending. Thailand's accession to international trade agreements has spotlighted the need to ensure SOE competitive neutrality.

Vietnam. Reforms started in the 1980s by giving SOEs greater independence, applying stricter budget constraints, and experimenting with joint ventures with foreign companies. SOE reforms accelerated in the 1990s, with many SOEs sold to private investors (privatization) or converted into joint-stock companies (equitization).[161] In the early 2000s, the focus was on restructuring and equitizing large and inefficient SOEs in strategic sectors, such as energy and telecommunications, and improving transparency and accountability. In the mid-2010s, there were also efforts to strengthen the legal framework and increase private participation. About 4,000 SOEs were equitized between 1998 and 2008. The number of SOEs fell from 3,281 in 2010 to 2,200 in 2021 through divestments and closures, although they continue to play a significant role in the economy.[162]

[159] Different definitions, accounting standards, and valuation methods undermine cross-country comparisons, even in terms of size and sectoral distribution.

[160] The efficiency and profitability of Singapore's SOEs are often explained by the country's external openness (due to its small size) and, thus, the need to be competitive in international markets. A preference for listing SOEs in the stock exchange, professional management with limited state interference, and intolerance for corruption are often cited as reasons for success.

[161] In Vietnam, equitization is the conversion of an SOE into a public (joint stock) company or a corporation by dividing ownership into shares. SOEs in Vietnam are subject to the same laws as private enterprises.

[162] Although nearly 97 percent of SOEs have been equitized, only 8 percent of their stocks are held by private investors.

The first phase of SOE reforms in the Lao PDR focused on granting greater managerial autonomy, aiming to improve their efficiency and financial performance. The first wave of reforms took place in the second half of the 1980s, roughly 1986–1989. SOEs were mostly transformed into autonomous or commercialized SOEs, with the authority to determine production and investment levels, wages, and prices. Government subsidies and capital transfers were largely discontinued.[163] These reforms aimed to improve SOE operations in terms of service delivery and financial performance, with the state retaining full ownership. Complementary reforms included the removal of price controls (with a few exceptions) and trade liberalization. However, privatizations were limited to mainly small enterprises. The separation of the central and commercial banking functions of the state bank also occurred during this phase. Despite these efforts, SOE expenditures increased considerably, supported by significant bank loans, compounding the financial burden on the government and increasing the vulnerability of the banking system.

The second phase built on the lessons of the first and focused on the privatization of SOEs. The second wave of reforms occurred in the 1990s, mostly in 1990–1997. These were mainly motivated by a need to reduce the growing burden of SOEs on public finances, a consequence of the first wave of reforms, particularly with the loss of financial support from the Soviet Union. The aim was to transfer the ownership of SOEs to the private sector, except those operating in strategic sectors (such as electricity, water, and telecommunications), which were to be restructured. However, most privatizations occurred in small and medium enterprises (SMEs) operating in peripheral services sectors, such as hospitality. SOE reforms focused on leasing, merging, selling, and closing many SOEs. In this period, more than 500 enterprises (out of 640) were privatized, although mostly through leasing and predominantly at the provincial level.[164] Privatization proceeds were limited, partly owing to their small size. Despite a very large reduction in the number of SOEs, the remaining ones still caused financial stress. Meanwhile, foreign banks were allowed to operate as joint ventures. State-owned banks had been accumulating large nonperforming loans (owing to policy-driven lending) and had to be restructured and recapitalized, with the problem persisting until the 2000s. The 1997 Asian Financial Crisis undermined reform efforts for the rest of the decade.

The third phase focused on aspects beyond the ownership of SOEs, such as restructuring, the institutional and legal framework, and corporate governance. The third wave of reforms mainly happened in the 2000s. The focus was on restructuring inefficient SOEs, improving transparency and governance (such as through stronger financial reporting requirements), and rationalizing the regulatory and pricing environment. These reforms were broader and more complex than the earlier waves, aiming to improve the efficiency of the larger and more strategic SOEs without complete privatization. The reform led to the liquidation of a few large loss-making SOEs, especially big conglomerates in the forestry sector, such as Bolisat Phatthana Khet Phoudoi and DAFI Group, and other smaller SOEs. Reforms also promoted an increased role for the private sector by spinning off parts of large SOEs, such as Électricité du Laos (EDL), to create EDL Generation Public Company (EDL-GEN) and by listing the Banque pour le Commerce Exterior Lao Public (BCEL) and EDL-GEN in the newly founded Lao Stock Exchange. There was also a significant reduction in domestic credit to SOEs, partly a consequence of the 1997 Asian Financial Crisis. Nonetheless, the results of this wave of reforms were mixed. Despite some improvements in revenues, rates of return remained low. By 2012, 99 SOEs were classified as ‘inefficient’ compared to 27 ‘efficient’ and 6 ‘highly efficient’. Joint ventures were found to be more efficient and profitable than other ownership types. The pace of reform slowed in the 2010s, partly owing to the 2007–2008 Global Financial Crisis and perhaps a reluctance to deal with the larger SOEs.

A fourth phase has recently started, with a comprehensive SOE reform program. The role and importance of SOEs have changed significantly over time. Hundreds of SOEs have been either privatized, divested, sold, closed, or dissolved in the past decades to reduce the fiscal burden, improve efficiency, and enhance public service delivery. SOEs have exited some competitive sectors, while their presence has been significantly reduced in others (e.g., finance). However, this fourth wave of reforms was instigated by the serious economic challenges facing the country, as reflected in the 2021 National Agenda on Addressing Economic and Financial Difficulties. Some SOEs played a pivotal role in the accumulation of public debt (particularly EDL), while recent shocks (e.g., COVID-19, a deteriorating external environment, and a sharp exchange rate depreciation) have further compounded their financial stresses. However, the level of political commitment to reform appears to be high and there is ample scope for undertaking progressive reforms to improve the governance and financial performance of SOEs. Section 4.3 provides a summary of the measures taken over the past couple of years, as well as future reform plans.

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[163] See IMF Occasional Paper 137.

[164] Fixed-term leasing only changes the management structure, not the ownership structure, and only for a limited period (say 15 years). Although perhaps more politically acceptable, this mode of privatization discourages long-term investments and entails a high administrative burden. Between 1989–1994, 64 centrally managed SOEs were privatized out of about 200 in 1989. In 1989, SOEs employed about 16,000 people, which was about 10 percent of non-agriculture labor force. See IMF Occasional Paper 137.

4.2 Performance of the SOE sector

Many governments expect SOEs to fulfill multiple policy mandates while performing efficiently. Evidence tends to suggest that profitability and productivity are lower in SOEs than in private firms, especially when the government has a majority stake. This might be partly due to the cost of pursuing policy mandates for which many are not reimbursed (e.g., providing affordable public services, often below cost-recovery, and promoting employment). In the Lao PDR, this mainly pertains to electricity, air transport, and banking services. However, operational inefficiencies arising from poor SOE corporate governance also play a key role. Mixed ownership tends to deliver higher profits and efficiency, suggesting that private involvement can be beneficial. Moreover, improved governance (e.g., control for corruption) reduces gaps in performance and productivity in relation to private firms.

SOE's financial performance and the realization of risks can have significant fiscal impacts. Governments often provide support in the form of capital injections and recapitalization, especially for SOEs operating in the electricity, transport (e.g., airlines and railways), and finance sectors. SOE debt can pose considerable fiscal risks, even in the absence of explicit guarantees. In addition, SOEs may have considerable obligations to private entities through joint ventures, power purchase agreements, and public–private partnerships. The materialization of these contingent risks, in both financial and nonfinancial SOEs, can have significant impacts on the economy (e.g., limited credit growth and suboptimal investments).

The SOE portfolio in the Lao PDR is relatively decentralized and spread over several economic sectors. There were 162 SOEs in 2021, of which 111 had an active status; 60 at the central level and 54 at the local level (Table 4.1). The remaining 51 SOEs were either inactive (29), lacked information (18), or were newly established (4). The overall total does not include 13 SOEs that were dissolved or liquidated and 7 SOEs that were privatized or restructured. Data for 2017 shows that the government held more than 50 percent of the share capital in most SOEs. The fact that most SOEs were still wholly owned by the government signaled a preference for full control. However, there are a significant number of SOEs where the government has a minority stake, particularly at the central level. This is mainly the result of partial share sales, as the authorities have favored the retention of partial ownership, perhaps due to a reluctance to fully privatize. Recent and planned reform efforts indicate the intention of the government to divest its position in small fully-owned SOEs, apart from strategic SOEs. SOEs are present in several economic sectors, including electricity, water, mining, construction, agriculture, transport (e.g., road, rail, air transport), telecommunications, and finance (especially banking). However, some sectors and sub-sectors only have SOEs with a state minority stake, such as mining, beverages, tobacco, and insurance.

Table 4.1: SOE portfolio

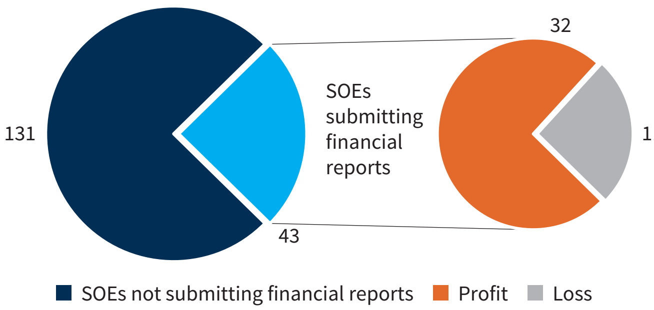
State ownership	2017			2021		
	Central	Local	Total	Central	Local	Total
Majority (> 50%)	54	69	123	40	44	81
of which whole (100%)	48	65	113	..	..	..
Equal or less than 50%	38	13	51	20	10	30
Other (inactive, unknown, or new)	..	..	..	..	..	51
Total	**92**	**82**	**174**	**..**	**..**	**162**

Source:Ministry of Finance.

Note: Data is not fully comparable across years due to changes in categorization (i.e., 'other').

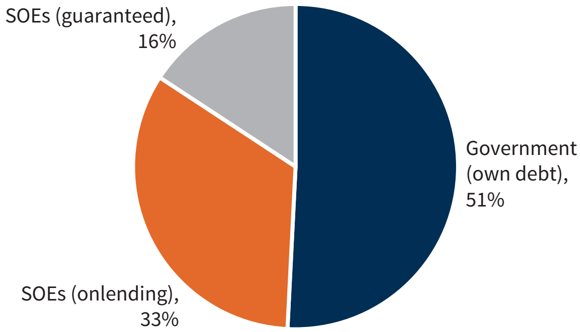
Most SOEs do not consistently submit financial reports to the government, and there is uneven compliance with reporting standards. Comprehensive financial information for most SOEs is not published except for a few SOEs listed on the stock exchange. There is limited information publicly available on their financial performance or fiscal impact. In 2017, only 43 SOEs submitted financial reports to the Ministry of Finance (i.e., 131 SOEs, or more than 75 percent of the total, did not submit their financial reports). Out of those 43 SOEs, 11 were reportedly loss-making (Figure 4.1). Reports are often submitted with significant delays, and few comply with international financial reporting standards (IFRS). Comprehensive and timely financial information on SOEs is needed to assess and mitigate fiscal risks. In 2022, SOEs accounted for nearly half of total external public and publicly guaranteed (PPG) debt, most of which were in the energy sector (Figure 4.2).

Figure 4.1: SOE reporting and performance (2017)



Source: Ministry of Finance.

Figure 4.2: External PPG debt (%, 2022)



Source: Ministry of Finance.

Profitability of the SOE sector is generally low or even negative, while indebtedness is high. The SOE portfolio included 178 SOEs in 2018, about 0.1 percent of the total universe of enterprises (Table 4.2). Their total registered capital was 28 trillion kip, amounting to 6 percent of the registered capital of all enterprises in the country (471 trillion kip). Their total assets were valued at 185 trillion kip (equivalent to 96 percent of GDP), and the total value of their liabilities was 147 trillion kip (equivalent to 78 percent of GDP).[165] The value of liabilities is likely to have increased considerably in 2021–2022, owing to the sharp depreciation of the Lao kip. Average net profit was low in 2016–2018 and negative in 2021. Collectively, the SOEs' average contribution to government revenues over the period 2016–2018 was 504 billion kip per year, while in 2021, the profit tax and dividends amounted to 526 and 67 billion kip, respectively.

Table 4.2: Average financial performance of the SOE sector (trillion kip, unless otherwise stated)

Indicator	2016–2018	2021
SOEs (number)	178	111
Registered capital	28.0	..
Assets	184.8	204.7
Liabilities	147.5	..
Revenue	31.5	30.3
Expenses	31.1	33.2
Net profit	0.4	-2.9

Source: Ministry of Finance and World Bank staff calculations.

Note: The sample for 2021 only includes active state-owned enterprises.

Financial performance varies considerably across levels of state ownership. Data for a group of 41 SOEs shows that SOEs that were fully owned by the government were collectively incurring losses and were the most indebted (Table 4.3). Profitability indicators (return ratios) were the lowest in the sample, while liquidity and solvency indicators (debt ratios) were the highest. The ratio of expenses to revenues was also the highest. Joint ventures, which are SOEs where the government holds less than half of the shares, were making similar loss margins, although they were less reliant on debt – and thus had lower repayment risks. Only mixed SOEs (government ownership ranging from 50 to 99 percent) were collectively showing commercially acceptable returns and debt ratios.[166] Overall, this raises questions about the performance of fully owned SOEs, particularly in terms of profitability, indebtedness, and efficiency. However, the sample may not be representative, and there might be considerable heterogeneity within each category, with results driven by a few larger SOEs (Box 6).

[165] Liabilities include accounts payable (i.e., future obligations beyond debt), such as accrued expenses and trade payables.

[166] In a recent financial evaluation conducted by the Ministry of Finance, fully-owned SOEs are considered to be ineffective and classified as weak in terms of profitability and liquidity, while other majority-owned SOEs are highly effective and minority-owned SOEs are effective.

Table 4.3: Average financial performance of 41 SOEs (2016–2018)

State ownership	Number of SOEs	Return on Assets (%)	Return on Equity (%)	Debt-to-Equity ratio	Debt-to-Assets ratio	Expense to revenue ratio
Whole (100%)	29	0.5	7.4	4.4	0.7	1.1
Mixed (50–99%)	5	14.5	25.5	0.3	0.3	0.8
Joint venture (<50%)	7	8.8	13.5	1.8	0.4	1.0

Source: Ministry of Finance.

Note: The sample includes 41 state-owned enterprises for which data was available.

Box 6: Main sectors of activity

SOEs remain key actors in many economic sectors across the world despite variations in ownership structures, corporate governance, efficiency, profitability, and productivity. It is good practice to publish aggregate reports by sector on the financial performance and positions of SOEs. The OECD regularly publishes data provided by its member states according to the following economic activities: (i) primary sectors (e.g., agriculture and forestry), (ii) manufacturing, (iii) finance, (iv) telecoms, (v) electricity & gas, (vi) transportation, (vii) other utilities, (viii) real estate, and (ix) other activities. SOEs often dominate the electricity sector, particularly transmission (network) and distribution (access), since these tend to be natural monopolies. However, it has proven difficult to balance access and affordability with a sustainable business model, often because tariffs are set below cost-recovery, which undermines investments and operations. The need for cost recovery is also important in the water sector. Cost-recovery, in the absence of direct financial support, can help improve the quantity and quality of service provision and ensure sustainability. Progressive tariff structures and social protection (e.g., cash transfers) can help shield the poor from high costs. Ground transportation (e.g., buses and trains) is often provided by SOEs in advanced economies, especially at the sub-national level, to ensure affordability while reducing congestion and pollution. However, these are less common in developing countries, where private operators dominate (e.g., small buses). SOEs in the mining sector are also common, particularly to exercise control over oil and gas exploration. Finally, state-owned banks still play an important role in many countries, often justified by the need to address market failures and promote economic development, through both commercial banks (that provide corporate and retail services) and development banks (that lend to development-related projects). This chapter proposes a sectoral classification for future consolidated reports.

Financial performance also varies considerably across economic sectors. Recent data on 23 SOEs for 2021 indicates that the group, in aggregate, is incurring losses and faces insolvency (Table 4.4). The main contributor to the losses is the electricity sector, followed by the banking and telecommunications sectors. In fact, most sectors are incurring losses. The aggregate insolvency of the group is mostly due to the high negative equity of the electricity and transport sector SOEs. The assets and liabilities of these 23 SOEs are considerable, representing 115 and 109 percent of GDP, respectively.

The sectoral composition of key financial performance indicators raises concerns over the electricity, transport, and finance sectors. While there is some heterogeneity within each sector, the aggregate values provide useful insights (Figure 4.3). For instance, the electricity, finance, and transport sectors have a strong impact on the finances of the overall SOE sector. The electricity and transport sectors had negative equity in 2021, while equity in the finance sector was positive (Figure 4.4).[167] Net profits were strongly negative, mainly driven by SOEs in the electricity sector. Assets and liabilities are dominated by the electricity and finance sectors, while it is unsurprising that the largest shares of revenues and expenses are accounted for by these same sectors, given their weight in the overall sector (Figure 4.5 and Figure 4.6). However, the fuel sector is also significant. Return on assets (ROA) were strongly negative in the telecoms sector.[168] The ROA in the electricity sector was also negative, but its debt-to-equity ratio cannot be interpreted due to negative equity. These insights support a reform focus on the largest SOEs, particularly EDL, BCEL, and Lao Airlines.

[167] The latter is largely because of the privatization of the Agricultural Promotion Bank and the Lao Development Bank, which turned large negative equity positions into positive equity in 2021. BCEL has had positive equity consistently, at least in the past few years.

[168] It should be noted that Lao Telecom is not part of the sample.

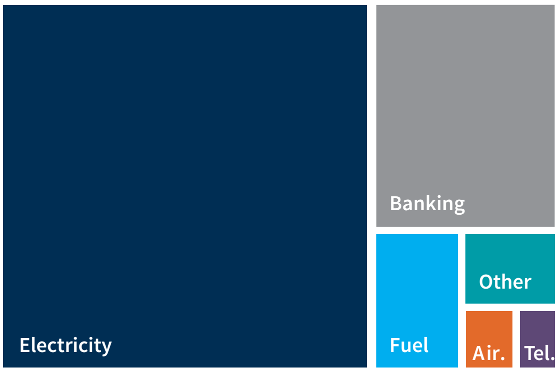
Table 4.4: Aggregated financial performance of 23 SOEs (billion kip, 2021)

Indicator	Electricity	Transport	Finance	Fuel	Telecom	Others	Total
Registered capital	7,045	182	2,039	611	138	381	10,396
Equity	-2,267	-2,277	3,165	593	-167	889	-65
Assets	82,772	2,114	91,641	1,340	2,532	1,955	182,353
Liabilities	85,038	4,391	88,476	747	2,699	1,124	182,476
Revenue	9,798	248	4,267	3,841	6	828	18,989
Expenses	13,357	273	4,392	3,859	261	797	22,939
Net Profit	-3,558	-26	13.5	-125	-255	32	-3,951
Profit margin	-36	-10	-3	0	-4,486	4	-21
Return on Assets (%)	-4	-1	0	-1	-10	2	-2
Return on Equity (%)	157	1	-4	-3	152	4	6,085
Debt (% Equity)	..	..	2,795	126	n/a	127	..

Source: Ministry of Finance.

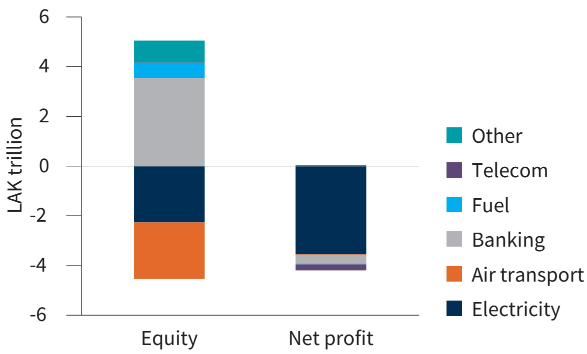
Note: The sample includes 23 state-owned enterprises, most of which the state has a stake of 51 percent or more. Transport mainly reflects air transport. The debt-to-equity ratio is not meaningful for sectors with negative equity. There are some inconsistencies due to inaccurate reporting.

Figure 4.3: Registered capital (%, 2021)



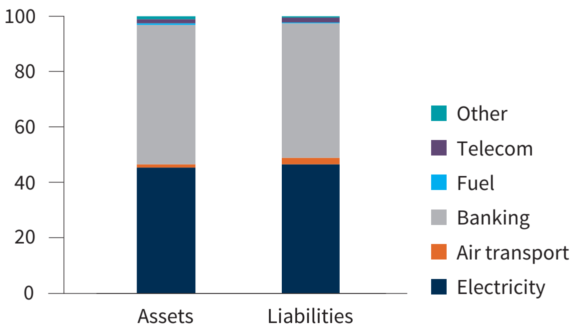
Source: Ministry of Finance.

Figure 4.4: Equity and net profit (Lao kip, 2021)



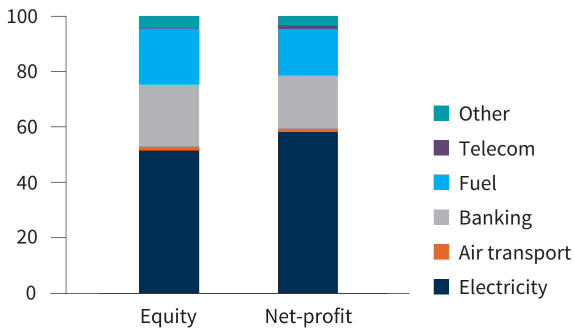
Source: Ministry of Finance.

Figure 4.5: Total assets and liabilities (%, 2021)



Source: Ministry of Finance.

Figure 4.6: Revenue and Expenses (%, 2021)



Source: Ministry of Finance.

SOE operations have resulted in substantial fiscal costs and risks, which undermine fiscal sustainability. Major fiscal costs have arisen from budget transfers and unpaid or reduced dividends and taxes. Fiscal risks emerge from SOEs' high indebtedness and persistent operational losses. Explicit contingent liabilities comprise government on-lending and guarantees. A large portion of the Lao PDR's public and publicly guaranteed debt is from the energy sector, especially from EDL (40 percent).[169] While the MoF has the overall responsibility for the management of the SOE portfolio, the MoF does not have accurate and complete performance information on all SOEs, including their financial position, assets, and employment levels. This reflects weaknesses in SOE governance and monitoring processes. There is currently no framework for identifying, assessing, monitoring, or disclosing SOE performance information, which is necessary for evidence-based policy making. In addition, there is a need to review the rules governing the financial support that SOEs receive from the government.

Building a comprehensive dataset on SOEs is crucial to support decision-making. There is a need to strengthen ownership, accountability, and oversight capacities. The lack of consolidated and accurate information on SOE's financial performance and positions undermines the ability to provide a reliable overview of the SOE sector, undertake an assessment of risks and potential impacts, and inform key decisions that have fiscal implications (e.g., on-lending, guarantees, budget transfers, and recapitalizations). There is also limited information on the financial relations between the SOE sector and the state, and between SOEs (including banks). Data to be regularly collected as part of an upgraded SOE performance monitoring system should include assets, liabilities, equity, revenue, expenses, and profit, as well as fiscal relations with the government (e.g., payment of taxes, duties, royalties, and dividends; loan reimbursements to the state and expenditures reimbursed by the state; transfers and subsidies; arrears). Recent efforts, particularly through the approval of the Decree on SOEs, aim to address these shortcomings by enabling the collection of comprehensive and timely financial information on SOEs to assess and mitigate fiscal risks.[170]

4.2.1 Électricité du Laos (EDL)

Électricité du Laos is a key SOE, but there are three other SOEs in the energy sector. The SOEs in the energy sector comprise Électricité du Laos (EDL), EDL Generation Public Company (EDL-GEN), Lao Holding State Enterprise (LHSE), and EDL Transmission Company Ltd (EDL-T) (Figure 4.7). EDL was established in 1961 to generate, transmit, and distribute electricity. It is still the single buyer and sole distributor of power in the domestic market. EDL was commercialized in the first phase of SOE reforms, but it was placed on the strategic list of SOEs in the second phase and, thus, not subject to privatization. EDL was one of the five major SOEs targeted for reform under the third phase through restructuring.[171] During this period, reforms focused on tariff adjustment, resolution of arrears, and reduction of system losses. In 2010, EDL-GEN was created and most of EDL's generation assets and stakes in independent power producers (IPPs) were transferred to the new SOE. EDL-GEN has its own generation facilities and sells electricity to EDL. EDL-GEN also holds shares in IPPs who produce for the domestic market and export. LHSE's role is mainly to hold shares in IPPs that export power overseas. The government holds 100 percent of the shares in EDL and LHSE. EDL currently holds 51 percent of EDL-GEN's shares, while private investors hold the remaining 49 percent.[172] In March 2021, a concession agreement was signed between the government and China Southern Power Grid Ltd. to establish EDL-T as a joint venture that may take the leasing concession of the existing 230 kV transmission assets from EDL. EDL-T is expected to make sizable investments in power transmission and interconnectivity to enhance regional power trade.

Despite impressive achievements in expanding electricity access and service coverage, EDL is facing deep rooted financial and operational challenges. Mega investments in infrastructure have led to a considerable expansion of generation capacity and improved access to electricity, in line with the country's vision of becoming the 'battery of Southeast Asia'. However, these investments were largely financed by external debt and through

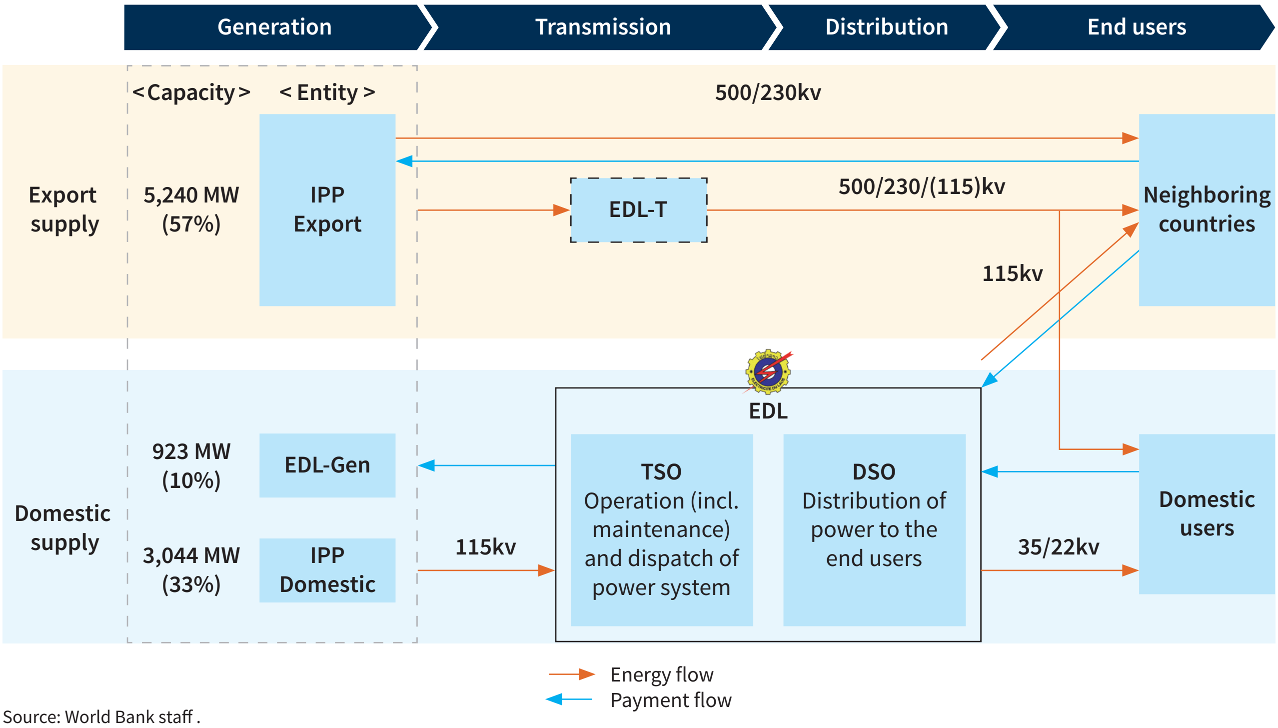
[169] It should be noted that government decisions (e.g., regarding investments and prices) often affect the financial performance of EDL.

[170] Nonetheless, the decree could benefit from an implementing instruction to strengthen and enforce the mandate of the MoF's Department of State-Owned Enterprise Reform and Insurance to collect, analyze, and disseminate data. The weak exercise of oversight functions (due to limited capacity, ownership, or accountability) may undermine compliance.

[171] EDL financial and efficiency challenges are not new. Domestic tariffs were often set below cost-recovery, there were significant payment arrears from government entities, currency mismatch (depreciated income in kip and debt servicing in US dollars), and high distribution losses due to poor infrastructure.

[172] In February 2021, 24 percent of EDL shares in EDL-GEN were transferred to Phongsubthavy Road–Bridge, Building and Irrigation Construction Sole Co., Ltd., reducing its stake from 75 to 51 percent.

Figure 4.7: Overview of the power sector



Source: World Bank staff .

public-private partnerships, while the sector faces significant structural challenges.[173] For instance, the country has substantial excess generation capacity during the wet season, but insufficient capacity during the dry season. Tariffs are below cost recovery, and EDL is burdened with unfavorable take-or-pay obligations. EDL's financial management systems are weak, and the gaps in corporate governance and the broader power sector institutional arrangements resulted in negative operating margins and the accumulation of a growing debt burden. Since EDL is fully owned by the state and its debt is either on-lent or guaranteed by the Ministry of Finance, EDL's large liabilities represent a clear fiscal risk. Public and publicly guaranteed (PPG) debt relating to EDL amounted to $5.7 billion in 2022, about 45 percent of GDP (or 40 percent of total PPG debt).[174] On-lending accounted for $3.9 billion, while guaranteed debt reached $1.8 billion.

Weak accounting practices and corporate governance, coupled with gaps in staff capacity and IT systems, represent a major challenge. Accounting weaknesses include delays in compliance with various national regulations and accounting policies, and with international financial reporting standards (IFRS). Technical challenges and weak staff capacity are preventing an effective utilization of IT systems. As a result, the recording of accounting transactions, approvals, and financial reporting is mostly carried out manually, resulting in inefficiencies and risks of human errors. Benchmarking EDL against international practices of regional peers revealed inadequacies, such as inadequate board composition and oversights, absence of internal control frameworks, and insufficient public disclosure, including of its financial reports.

Although power sale revenues have grown in recent years, the average cost of power purchases from IPPs also increased. Revenues from power sales grew at an average of 8 percent per year during 2015–2019, while the average power purchase cost from IPPs increased by 11 percent in the same period. As a result, gross profit from power sales was very low, around 13 percent between 2015 and 2019. Profitability is estimated to have deteriorated even further in 2020–2022, mainly because of high IPP costs and foreign exchange losses. The cash burden will continue to increase as large debt service obligations persist.

[173] It should be noted that the government is partly responsible for factors that have contributed to EDL's financial situation and prevent its ability to improve its condition. These include: (i) tariffs set below cost-recovery levels by law without regulated mechanisms to compensate EDL; (ii) power-purchase and concession agreements signed by ministries; (iii) regulatory requirements to adopt local accounting standards instead of international accounting standards; (iv) EDL staff salaries set by the government significantly below the private sector average, which prevents it from attracting and retaining skilled human resources; (v) controls over EDL data disclosure.

[174] See the MoF's 2022 public debt bulletin.

The liquidity and solvency situation is concerning, particularly due to limited capacity to meet short-term obligations. Liquidity and solvency can only be assessed through the company's financial position during 2015–2019, since recent financial reports are not publicly available. The current ratio, calculated as current assets over current liabilities and reflecting the company's capacity to meet its obligations due within a year, decreased to a low level of 0.1 in 2019. This means EDL had only 10 percent of cash available to fulfill its short-term debt obligations. In addition to this short-term liquidity issue, the company's debt-to-equity ratio was high at 3.9, resulting in a shortage of cash to repay debt service obligations.

EDL's vulnerable financial situation has been further compounded by the sharp depreciation of the Lao kip in 2021–2022. Financial performance forecasts have significant limitations due to the lack of reliable financial data, However, a sharp decline in the value of the Lao kip causes IPP payments and debt service obligations to rise steeply, since these are denominated in US dollars. The Lao kip depreciated by 8 percent against the US dollar in 2021 and 47 percent in 2022. While these payments will be made in US dollars, EDL's main source of revenues are, or at least set, in Lao kip.

A return to profitability would require critical reforms to improve corporate governance, management, and financial performance. Reforms would require adjusting tariffs to cost-recovery levels, improving governance arrangements, and enhancing the regulatory framework. These would need to be complemented by corporate actions to optimize power purchase costs and debt financing, as well as significant improvements in financial management and corporate governance systems. In January 2023, EDL announced measures recommended by its reform committee to deal with the company's growing debt burden and to ensure the strength of its business and the sustainability of its operations. They included institutional reform, including rationalization of its operating procedures and staffing, revising the electricity tariffs in ways fair to producers and consumers, negotiating electricity trading agreements with suppliers and investors, and restructuring outstanding debts.

4.2.2 Lao Airlines

Lao Airlines was created in the late 1980s to serve as the national carrier, and it has grown over time. Lao Airlines was created in 1989 and became fully commercial in 2005. Since its creation, the airline has had mixed results. The accumulation of losses forced a restructuring in 2009, which mainly comprised debt write-offs. Between 2011 and 2019, Lao Airlines increased the size of its fleet to 11 aircraft, its network to 23 destinations served, and its organizational structure to 959 employees.[175] This was a time of strong regional growth in airline travel. The Lao PDR's aviation market was growing at 16 percent per year, higher than ASEAN peers but similar to Cambodia and Vietnam. In 2019, 19 airlines from seven countries operated in the Lao PDR. The two SOEs (Lao Airlines and Lao Skyway) had a combined share of 52 percent of seats, four Thai airlines had 20 percent, and four Chinese airlines 11 percent. Despite strong market growth, Lao Airlines' capacity was limited by competition within the region. During the height of the COVID-19 pandemic, travel restrictions reduced the number of airlines operating in the Lao PDR to 7, all operating at less than 20 percent of capacity.

Measured against most operational indicators, Lao Airlines was not performing well when the market was buoyant. Aircraft utilization and load factors were below the average for regional competitors, even before COVID-19, and some costs were higher (e.g., maintenance). The airline was incurring operating losses despite strong market growth, while the COVID-19 pandemic severely curtailed the airline's operations in 2020–2021, leading to further financial difficulties. During the pandemic, Lao Airlines kept essential workers, unlike other airlines, which restructured to adapt to reduced demand. Pre-pandemic results show that the airline did not perform well in 2019 when the market was buoyant and attractive.

Lao Airlines is a highly leveraged company and is a major contingent liability to the government. The airline has substantial negative equity and low liquidity levels, which forced the airline to postpone or underpay its financial obligations, increasing its outstanding debt. The impact of COVID-19 worsened its financial situation. Despite new working-capital loans, it is not possible to rebalance accounts without downsizing and additional capital injections. Lao Airlines has accumulated significant debts, of which $154 million are guaranteed by the government. While opportunities remain to restructure some of these liabilities, most debts cannot be repaid from the current revenue

[175] Furthermore, Lao Airlines increased its maintenance and operational staff capability, attained IOSA certification, and became an IATA member, moving toward the international standard.

streams and are thus deemed unsustainable. A reform committee was established in 2022 to prepare a reform plan for the flagship carrier, which includes financial restructuring, seeking a joint-venture partner, and improving operational efficiencies. The development of rail infrastructure in the north of the country is expected to reduce demand for domestic air travel from Vientiane to the North, which will likely affect Lao Airlines. The domestic market is small, and the presence of two domestic carriers is unlikely to be justified.

4.2.3 Banque pour le Commerce Extérieur Lao Public (BCEL)

State-owned banks continue to dominate the financial sector in the Lao PDR despite several waves of reform. The banking system evolved from a mono-bank system to a two-tier banking system in 1988. Commercial banking activities were separated from the central banking function, and three branches were spun off as independent state-owned banks. Four more state-owned commercial banks were created during 1990–1991.[176] The banking sector was gradually reformed in the mid-2000s, and the sector was opened to foreign banks. In 2007, two joint-venture banks, two private banks, and six foreign bank branches entered the market. The share of state-owned banks in terms of assets gradually declined from 65 to 48 percent between 2012 and 2021 and then further to 35 percent with the privatization of the Agriculture Promotion Bank (APB) and the Lao Development Bank (LDB) in late 2021 and early 2022, although the government retained a 30 percent share in both banks. The Banque Pour Le Commerce Extérieur Lao Public (BCEL) is the largest commercial bank. Currently, the banking sector consists of one state-owned commercial bank (BCEL, 34 percent of total bank assets), five joint-venture banks (including APB and LDB, 19 percent of assets), and several private and foreign bank branches (42 percent of assets). BCEL holds stakes in the three joint-venture banks: Lao-Viet Bank, Banque Franco-Lao, and Lao China Bank (25, 30, and 49 percent, respectively).[177]

The financial performance of state-owned commercial banks has been weak, mainly due to directed lending to SOEs, and characterized by repeated bailouts and ineffective reorganizations. Credit to SOEs averaged over 40 percent of total credit to the economy in 2000–2004, declined sharply in 2005, and has steadily declined since 2011 to around 13 percent from 2020 onwards. SOEs were a major source of nonperforming loans in the 1980s and 1990s. In the 1990s, the banks' main problem was direct lending to SOEs, which dominated economic activity. In 1994, the government recapitalized state-owned commercial banks at a cost of around 2 percent of GDP. However, the recapitalization was not accompanied by any operational restructuring or a reduction in state interference, and nonperforming loans (NPLs) reached high levels again by the late 1990s. By 2001, three-quarters of BCEL's loans were nonperforming, and the bank had a capital deficit of 4 percent of GDP. In 2001, the government launched a comprehensive bank reform program, including recapitalization. After long delays, reforms began in 2003, including restricted lending to SOEs, although it only lasted a year. State-owned commercial banks were recapitalized through the issuance of triangle bonds. The persistent recurrence of nonperforming SOE loans reflected mainly the absence of a repayment culture, state interference in pricing, and protracted weaknesses in their operations. Government arrears to contractors on public projects have been a significant and persistent problem, as these contractors subsequently default on their loans to state-owned commercial banks.[178]

BCEL is the largest bank in the Lao PDR, accounting for a significant proportion of loans and deposits. BCEL was established in 1989 as a state-owned commercial bank. In 2011, BCEL became the first bank and legal entity in the Lao PDR to be listed on the Lao Securities Exchange, with the Ministry of Finance retaining 70 percent of the total shares. Unlike many SOEs, BCEL (and EDL-GEN) are subject to stringent listing rules requiring an annual external audit, and disclosure of its financial position and performance data. It is also subject to the corporate governance requirements applied to listed companies. The government currently holds 60 percent of the shares in BCEL, while 10 percent is held by a strategic partner (Compagnie Financière de la BRED), and 30 percent is held by domestic and foreign investors. BCEL accounts for slightly over one-third of banking sector assets, credit, and deposits, a dominant position relatively unchanged since its inception.

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[176] All seven state-owned commercial banks were under the management control of the Bank of the Lao PDR and each was assigned a geographical area of coverage. See World Bank and Asian Development Bank "The Banking and Financial Sectors of Lao PDR".

[177] BCEL also has significant investments in other local economic entities, including BCEL-Krung Thai Securities Company Limited (70 percent), Lao-Viet Insurance Joint Venture Company (35 percent), the Lao National Payment Network Company Limited (20 percent).

[178] Following several years of weak performance, the government sold 70 percent of its shares in the Agricultural Promotion Bank and Lao Development Bank in late 2021 and early 2022. The transactions were facilitated by bond issuances equivalent to about 9.3 trillion kip (or 5 percent of GDP) to clear accumulated losses and recapitalize.

BCEL's financial performance weakened during the COVID-19 pandemic, and its capital level is below the regulatory minimum. The capital adequacy ratio (CAR) was 6.3 percent at the end of 2022, down from 7.4 percent at the end of 2021, which is below the regulatory minimum requirement of 8 percent and indicates that the bank is undercapitalized. BCEL reported a nonperforming loan (NPL) ratio of 3.4 percent at the end of 2022, but the real figure is likely higher after considering ongoing regulatory forbearance policies, which include a freeze on loan classifications, and the possibility of 'evergreening'. Return on assets (ROA) fell from 0.71 percent in December 2019 to 0.24 percent in December 2022. BCEL generously applied regulatory forbearance measures to its portfolio during the COVID-19 pandemic. Regulatory forbearance measures comprised interest and principal moratoria, a freeze in loan classification, and an extension of maturities to around 30 percent of its portfolio, a much higher share than most other banks. BCEL will be highly exposed to the possibility of a future increase in NPLs when forbearance measures are phased out. BCEL has significant accrued interest receivables, a sign of generous extension of forbearance. Loan loss provisions are unlikely to be sufficient to cover expected losses.

BCEL's exposure to fiscal risks is significant, while liquidity concerns could have a systemic impact on the economy. BCEL holds a considerable and growing amount of government debt. Net government credit provided by the banking sector accounted for 8.9 percent of GDP in 2021, up from 3.7 percent of GDP in 2020. These government debt holdings are concentrated in three banks, including BCEL (2.9 percent of GDP), Industrial and Commercial Bank of China (2.3 percent), and the recently privatized Lao Development Bank (2.1 percent). The high exposure of banks to the government increases the likelihood of shock transmission between the two sectors. Moreover, BCEL has significant exposure to SOEs, particularly in the industrial sector. The share of industrial services companies increased from 22 to 51 percent of the overall loan portfolio from 2015 to 2016 and has remained at about 50 percent since then. Although publicly available information lacks detail, it seems that this increase is partly related to public investments in the hydropower sector.[179]

4.3 Recent reforms and current plans

In recent years, SOE reform has again become a high priority on the government's policy agenda. The priority conferred on SOE reform is reflected in the National Agenda on Addressing Economic and Financial Difficulties (2021–2023). This broad agenda sets forth the government's priorities to tackle the country's difficult macroeconomic situation. There are five core components, one of which is to "promote frugality, tackle extravagance, enhance effectiveness of investment-expenditure, and address domestic-foreign debt." Within this component, measures foreseen are to "reform management and business operations of state enterprises and enterprises with government shares/stakes". These measures include developing a strategy for SOE reforms, closing SOEs, strengthening SOE management, improving transparency, and improving the monitoring of SOE performance.

Improving SOE effectiveness is also a priority in the Ninth National Socio-Economic Development Plan (2021–2025). The document states that the plan "prioritizes the management and development of state-owned enterprises (SOEs) so that they can be economically strong and efficient, reduce substantial liabilities, support a sustainable economic base, and generate income for the country". Under Outcome 1, which is "continuous quality, stable and sustainable economic growth", the government has identified five outputs, one of which is "enhanced efficiency and effectiveness of state-owned enterprises and collective economy". This includes improving legislation aimed at managing and developing SOEs more effectively, undertaking SOE reforms, and ensuring transparency and efficiency. SOE reform is therefore critical to the realization of the Ninth NSEDP objectives of stable and sustainable economic growth, efficient public administration, and improved public services.

Important elements of the current SOE Reform Plan (2021–2025) include reforms within 31 of the largest SOEs. The SOE Reform Plan was approved by Government Resolution No. 10/GOV, dated 15 October 2021. These reforms include the appointment of reform committees to plan and implement organizational and financial restructuring and to implement changes to the boards of directors and boards of management. Under the plan, some large SOEs (such as EDL) would remain 100 percent under state ownership. Lao Airlines, Agro-industrial Development Company (DAI), Lao Export-Import Trading Company, and the Lao State Fuel Company would be converted to joint ventures with the government maintaining ownership of 51 percent or more of the shares. EDL-GEN would maintain its present form as a public company listed on the Lao Stock Exchange and would be separated from EDL.

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[179] In 2016, BoL loaned BCEL about $200 million for the purpose of providing credit to "certain government-backed hydropower projects".

SOEs operating in production, trading, and service sectors will be considered for joint ventures with the private sector. Some steps have already been taken to sell stakes or dissolve SOEs. Two state-owned banks (LDB and APB) were converted into joint ventures in late 2021 and early 2022, with the state retaining only 30 percent of the shares, though both required MoF to issue bonds to clear accumulated losses and increase capital before the sale.[180] The government sold 51 percent of its shares in Entreprise de Postes Laos, as well as 49 percent of its shares in Lao Enterprise Service of Transit and MSIG Insurance Laos. Two persistently loss-making SOEs would be closed (Inter Lao Tourism Company and DAFI), and a third would be dissolved and become a technical unit under the Lao Women's Union (Lao Cotton State Enterprise). By mid-2022, the proceeds from the sale of shares resulting from the ongoing SOE reforms had already amounted to 1,037 billion kip. However, it is important that partial and full divestitures involve a transparent and competitive tendering process to secure fair market value and avoid governance risks.

Enterprise-level reforms continued their momentum during the second half of 2022. EDL's restructuring plan was endorsed by the Party in September 2022. It includes improving its organizational structure, enhancing budget planning and accounting standards, revising tariffs for non-residential users, modernizing the billing system, revising the power purchase plan with two power projects, negotiating a debt restructuring plan with creditors, completing a manual of internal controls and audit, and measures to improve staff performance evaluation. A new restructuring plan for the Lao State Fuel Company includes organizational restructuring and business consolidation, revising market regulations governing the fuel business, improving accounting standards, and strengthened risk assessment. The Board of EDL-GEN has been restructured. The government has decided that Lao Airlines will become a joint venture with the private sector, and its reorganization will focus on human resources, finance and accounting, business operations, and aviation operations. Two of DAFI's factories will be repurposed.

4.4 Legal and institutional framework for SOE oversight

There have been recent improvements to the legal and regulatory framework governing the ownership and oversight of SOEs, but further changes are needed to bring the framework closer to international good practice.

Ministry of Finance Instruction 2526 was a positive step intended to clarify the roles, mandates, responsibilities, and qualifications required of SOE boards of directors. The instruction, dated 28 September 2020, requires women board members to account for at least 10 percent of board membership of fully owned SOEs, which is a first step in achieving gender balance. It specifies the methods of selection of board members, confirms the role of boards of directors in overseeing SOE restructuring, and also requires the setting up of SOE board committees on management, internal audit, risk management, recruitment, and good corporate governance and defines their roles. It appropriately grants the board's autonomy in appointing the SOE directors and in overseeing the operations of the enterprises. The instruction specifies the qualifications required for board members (e.g., qualifications in accounting, finance, law, and other managerial specializations) and the personal qualities required (such as honesty). It also requires board members to have had training in board membership.

However, in some other respects, the instruction is not fully in line with good international practice in the determination of board composition. The instruction does not place limits on the number of civil servants on boards, nor does it restrict the appointment of ministers on boards, nor staff of supervisory agencies to be on the boards of SOEs which they supervise. It stipulates that boards can include full-time SOE employees without stating that employees should be appointed as employee representatives, and it does not require boards to include independent directors. Instead, it refers to the appointment of public servants as board presidents and deputy presidents and leaves the door open to the appointment of boards composed entirely of civil servants, including individuals with a potential supervisory role over the board or who are SOE insiders. The trend in international good practice is to limit the number of public servants on boards, to avoid conflicts of interest, and to require a minimum number of independent directors. The Instruction also gives few details on the processes to be employed in the selection and appointment of board members.

An MoF Decision gives the Department of State-Owned Enterprise Reform and Insurance (DSRI) a broad mandate to oversee all aspects of the SOE reform program and of the operations and finances of SOEs. The decision, dated 17 December 2021, defines the roles, duties, organizational structure, and procedures of the MoF's

[180] These amounted to about 5.4 trillion kip for LDB and 3.9 trillion kip for APB, totaling 9.3 trillion kip.

DSRI. It defines in detail the responsibilities of four divisions within DSRI: Planning and Development, Management and Evaluation of SOEs, SOE Reform, and Insurance Management. The coverage of DSRI's mandate is in line with many of the accepted functions of a central SOE oversight unit in a Ministry of Finance. It empowers DSRI with a mandate to disseminate plans and policies, monitor the performance of the SOEs, their boards, and their directors, monitor the implementation of business plans, and create and manage a database on SOE performance. However, the Decision does not give DSRI the right or the obligation to prepare and publish regular comprehensive reports on individual and aggregate SOE performance, finances, and fiscal risks. Despite the roles assigned to DSRI, their fulfilment is impeded by capacity constraints within DSRI and inadequate SOE compliance with information reporting requirements.

Decree 322 on State-Owned Enterprises describes and gives effect to government policies on SOE reform. Points covered in the decree, dated 2 September 2022, include the forms of SOEs and the criteria and the procedures for their establishment and funding, the roles, rules, and compositions of their boards of directors, the setting up and operation of reform committees for key SOEs, and the rights and duties of the MoF and other entities in overseeing SOE operations and finances. It covers and endorses many of the points covered in the MoF Instruction and Decision described above but with some improvements. One improvement (in Article 22) is that it gives the possibility of appointing external directors as board members if they have the necessary expertise, with the agreement of the shareholders. In addition, Article 47 mandates SOEs to submit quarterly, six-monthly, and annual financial statements to DSRI, while specifying deadlines for their submission. It also specifies that DSRI must consolidate and record this information in its database. Article 35 states that SOEs require approval from the Ministry of Finance before accessing sources of finance, while Article 44 requires SOEs to comply with standard accounting systems.

However, the Decree could be strengthened in some areas to bring it more in line with international good practice. Like the Instruction and the Decision, Article 22 does not require boards to include independent directors, and Article 62 (on the rights and duties of the MoF) does not give MoF the duty to prepare and publish an annual report on aggregate and individual SOE performance and fiscal risks. While requiring SOEs to use standard accounting systems, it does not require the use of International Financial Reporting Standards (IFRS). Another weakness in the Decree is in Article 62.10, which gives the MoF the power to appoint civil servants from MoF and line ministries to be members of SOE boards. International good practice is to minimize the number of civil servants on SOE boards and to avoid creating a conflict of interest that would occur by appointing a staff member of a supervising agency to be a board member of an SOE that it is supervising. The decree also makes no mention of the DSRI. Inclusion of the DSRI in the decree as the MoF's unit responsible for supervising the SOEs would help strengthen DSRI's mandate.

4.5 Remaining challenges

The authorities are cognizant that there remain several challenges. The key SOE reform challenges identified in the Minister of Finance's report to the National Assembly in June 2022 included: (i) unclear policy and regulations governing pledging of SOE assets as security for bank loans, lack of clarity in SOE oversight relationships between line ministries and the MoF, inadequate systems for performance monitoring of SOEs; and (ii) enterprise-level challenges such as poor management of SOE finances including the payment of bonuses despite poor performance, nepotism in appointments, lack of qualified or professional managers, appointment of government employees to posts requiring business experience, and lack of understanding of their duties by boards of directors.

Despite the reform progress underway, additional challenges include the absence of consolidated and detailed performance reporting on the SOE sector. This absence not only prevents transparency in SOE operations, but also makes it unfeasible for the government to carry out an accurate analysis of SOE sector performance, or the explicit and implicit impact of SOEs, in aggregate or individually, on public finances. Such detailed data is needed to pinpoint and diagnose with accuracy the causes of the problems within SOEs, to identify and quantify fiscal risks, and to devise and target policy actions needed to resolve or mitigate these problems. It is also needed to monitor and assess the impact of policies implemented so they can be fine-tuned as necessary. The authorities are aware of these problems and have been actively taking steps to strengthen data collection and reporting.

The monitoring of SOE performance has been undermined by technical and capacity issues. Central SOEs are supervised mainly under the mandate of line ministries in collaboration with the MoF as shareholder. There is also inadequate compliance by many SOEs in submitting their financial statements to the MoF, which in turn does not have a framework to monitor, assess, and disclose SOE performance or monitor their governance.[181]

[181] Software developed in 2015 was expected to be an important tool for DSRI in monitoring and updating SOE performance, but the software did not operate well and DSRI has not used it since 2018.

The profitability of many SOEs has deteriorated in recent years. SOEs are increasingly having difficulty meeting their debt servicing and operational commitments.[182] While external shocks have played a role (e.g., impact of the COVID-19 pandemic and the sharp exchange rate depreciation), most of these challenges arise from a continued over-extended and unprofitable involvement in non-strategic commercial activities. Inefficiency and poor financial performance also affect SOEs operating in strategic sectors.

The problems are also a result of governance challenges affecting the entire SOE sector. These include the overlapping and sometimes conflicting supervisory responsibilities between the MoF and line ministries and the fact that many boards of directors and SOE management teams are composed mainly of public servants and SOE insiders without adequate inclusion of the independent business management expertise needed to bring about and sustain effective service delivery and financial viability.

4.6 Conclusion and recommendations

State-owned enterprises have created large contingent liabilities, which threaten fiscal sustainability and macroeconomic stability. SOEs have been established worldwide for different purposes, such as addressing market failures, supporting national strategic interests, and promoting socioeconomic objectives. However, some governments expect SOEs to meet (often multiple) policy mandates and perform efficiently without being fully reimbursed for the cost of non-profitable public services. In addition, poor SOE corporate governance arising from moral hazard and conflict of interest (i.e., the principal-agent problem) often leads to inefficiencies and mismanagement. Unfunded policy mandates and poor corporate governance typically generate considerable operational losses and heavy indebtedness, which jeopardizes fiscal and debt sustainability. In the Lao PDR, some SOEs have benefited from sizable on-lending and loan guarantees from the government, often to support their involvement in public-private partnerships, notably in the hydropower sector. Many SOEs are highly vulnerable to shocks, such as exchange rate depreciation, in part due to their business models. Some operate in a competitive environment without a clear policy mandate, where the private sector can generally deliver similar goods and services more efficiently. Hence, there is a need to reassess their rationale, corporate governance, operational management, and financial performance.

There has been some progress in reforming the SOE sector, but many challenges remain. SOE reforms started in the mid-1980s as part of broader economic reforms under the New Economic Mechanism. Since then, the number of SOEs has been cut considerably, their weight in the economy reduced, and their presence in non-strategic sectors curtailed or eliminated. However, past reforms have had mixed results, as illustrated by the financial difficulties currently faced by some of the largest SOEs (e.g., EDL, Lao Airlines, and BCEL). While there has been a renewed momentum for SOE reform since 2021, it is crucial to intensify the activities of existing SOE reform committees and fully implement their restructuring plans. Reform progress has generally been undermined by institutional weaknesses, low capacity, and political economy constraints. However, past experiences provide important lessons for shaping the current and future reform agenda.

Deepening and accelerating reforms is critical to ensuring that SOEs fulfill their policy mandates, operate efficiently, and do not generate undue fiscal risks. The SOE portfolio is relatively decentralized and spread over several economic sectors. Most SOEs do not consistently submit financial reports to the Ministry of Finance, which undermines a comprehensive assessment of the sector. Despite the absence of consolidated performance reporting, existing data suggests that profitability of the SOE sector is low and indebtedness high, even if performance varies considerably across economic sectors and levels of state ownership. Many SOEs are insolvent, with negative equity and persistent losses. The largest SOEs are highly indebted, presenting a significant fiscal risk. The sectoral composition of key financial performance indicators raises concerns over the electricity, transport, and finance sectors, where EDL, Lao Airlines, and BCEL are key actors. There is a need to improve overall SOE corporate governance, operational management, and financial performance, as well as enhance transparency.

The current reform agenda can benefit from international experiences and best practices, as well as from own past experiences. The Lao PDR has had a long experience in SOE reform and currently has an active SOE reform agenda. While reforms need to consider a country's context, needs, and priorities, there are common principles

[182] Some SOEs have large liabilities denominated in foreign currencies (e.g., EDL and BCEL), which entail a considerable foreign exchange risk, especially since the government and central bank do not have access to the amounts that would be required for a bailout.

and good practices that have emerged and have been increasingly adopted across countries. These can inform and shape the future direction of the SOE reform program. The key elements typically include (i) centralizing the state ownership function; (ii) allowing or increasing private participation in SOEs while ensuring equitable treatment of all shareholders in mixed ownership companies; (iii) ensuring competitive neutrality between SOEs and private enterprises; (iv) improving SOE performance management (including financial discipline); (v) professionalizing SOE boards of directors; (vi) enhancing transparency and disclosure; and (vii) reimbursing the costs of SOE public service obligations. Moreover, (external and domestic) debt restructuring is likely to be needed for the most indebted SOEs.

Centralizing and strengthening the state ownership and oversight function can enhance SOE performance and promote efficiencies. There is a global trend toward centralizing SOE ownership and oversight. Many countries have created a central coordination unit for SOEs or even vested SOE ownership in a single entity. This is increasingly regarded as good international practice, since it typically correlates with better outcomes in terms of SOE financial and operational performance. The main benefits are the separation of the ownership and oversight function from the policy-making function, which enables greater objectivity and minimizes conflicts of interest. Moreover, it promotes greater consistency in the application of corporate governance standards across SOEs in all sectors. Centralizing also enables the pooling of funds and specialized capabilities, which is particularly important in countries with scarce human and financial resources. In fact, there is a need to empower and strengthen SOE oversight agencies, including though capacity building in SOE monitoring and oversight. In particular, this would enable DSRI to strengthen its role in SOE performance management and monitoring, reporting, and transparency, using a broad range of indicators of financial, operational, and governance performance, as well as fiscal impact. Achieving this requires setting targets and performance contracts for SOEs, which would entail employing a range of financial and nonfinancial performance indicators to ensure that SOEs remain financially sound and meet their targets. An effective SOE performance monitoring system is critical to support the Ministry of Finance in its SOE oversight role.

Creating a fiscal risk management unit within the Ministry of Finance is key to identifying, assessing, monitoring, and mitigating contingent liabilities and other risks. It is important to assess the impact of SOE operational and financial performance on public finances. In this regard, there is a need to improve the identification, assessment, monitoring, and mitigation of fiscal risks, particularly of unforeseen SOE bailouts resulting from the realization of explicit or implicit contingent liabilities (including those related to public-private partnerships). A fiscal risk management unit needs to be created within the Ministry of Finance, which should cover all types of fiscal risks (see Table 1.1). Building the capacity to assess and manage fiscal risks will assist ongoing reform efforts and serve as part of an early-warning and mitigation system for risks arising from potential SOE financial problems. Building a comprehensive dataset on SOE performance is crucial to support fiscal risk assessment and management.

Broadening the ownership of SOEs can improve performance, accountability, and transparency. Increased private participation in SOEs (e.g., through listing on stock exchanges, various types of joint ventures, or even full divestiture) is often associated with improved financial discipline, enhanced operational performance, and reduced political interference. Listing SOEs on the stock exchange or converting them into joint ventures with the private sector has shown benefits in the Lao PDR and neighboring countries. These include improvements in reporting transparency (owing to requirements applied to listed companies), improved board composition (particularly for joint ventures), and increased availability of business management expertise that was previously lacking. This restructuring modality can also generate revenues from assets sales and support market reforms by reducing the state's weight in the economy. However, these reforms require strong legal underpinnings, effective implementing institutions, and full transparency. For instance, divestitures should follow a transparent and competitive tendering process to secure fair market value and avoid governance risks. Moreover, SOEs should operate on a level playing field with private companies (competitive neutrality) by ensuring that they do not receive preferential treatment in terms of exemptions (from general laws, tax codes, and regulations), access to finance (e.g., debt and equity), access to inputs (e.g., energy, water, and land), and access to procurement opportunities or other services from the government. Some countries have no special laws for SOEs but apply the same laws to SOEs as they do to private enterprises (e.g., Vietnam). Finally, SOEs may need to be reimbursed for the costs of their non-profitable public service obligations, including requirements to deliver essential public services for a price below efficient cost-recovery.

Professionalizing SOE boards of directors is essential for promoting good governance and enhancing performance. Boards of directors play a significant function within SOEs, particularly in terms of supporting good governance. Their roles, composition, and functioning should therefore be reviewed and improved. For instance, there is a need to establish clear legal requirements for board autonomy and accountability, with roles and responsibilities clearly defined in law. Nomination and approval processes for the appointment of board members should be transparent while ensuring the inclusion of all necessary competencies and qualifications (e.g., required skills and experience, appointment of independent directors, gender balance, and avoidance of conflicts of interest). In this regard, it is important to limit the numbers of public servants on SOE boards. Specialist board committees should be created to oversee critical aspects of SOE performance (e.g., audit, risk management, and remuneration) and board member performance should be regularly monitored and evaluated. Finally, training in corporate governance principles and practices would generate significant benefits. This would aim to improve the competencies of board members and senior managers and could even be used as a pre-requisite for all board member appointments.

Disclosing SOE performance reports will increase transparency and strengthen accountability. Many countries have taken steps to increase transparency through full public disclosure of SOE performance reports and fiscal risk statements. Actions have included (i) publishing SOE objectives and the extent to which these are fulfilled, with details of funding for any public policy objectives; (ii) mandating the adoption of International Financial Reporting Standards (IFRS) by SOEs; (iii) requiring SOEs to regularly disclose their financial and operational results using financial and nonfinancial performance indicators; (iv) requiring internal and external audits of SOE annual financial statements, including by the supreme audit agency; (v) requiring the compilation and publication of aggregate reports on SOE performance and fiscal risks by SOE oversight agencies; and (vi) increasing transparency on board member qualifications and remuneration. These reforms will support accountability and overall performance.

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