

Policy Advisory: Lao NSPF Capitalization (Part 1)

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Executive Summary

This report is part of a 2-part report on the capitalization of the National Social Protection Fund (NSPF) of Lao PDR (Laos). In this report, we address: (1) Current state and complexity of social protection in Lao; (2) Problems facing NSPF capitalization; and (3) A brief case study of social protection funds in Thailand.

We picked Thailand as the country has gone through many reiterations of social protection funds and successfully adopted the universal healthcare fund (UHC), which we deem as an important milestone. Thailand is also culturally similar to Laos and we believe it is an easier path for Laos to consider following the Thailand's model. We did consider Vietnam as Laos' peer but we believe Vietnam's market is evolving and still lacks transparency, especially on the debt market. There is also no credible credit rating agency in Vietnam.

Our review of Laos' social protection situation, a case study in Thailand, and Lao bond trend and capital market exposure leads us to propose solutions in the Key Findings section below, which we will examine further in details in our next report which we will focus on: (1) A range of funding solutions for Laos' NPSF; (2) Major criteria for selecting an ideal funding solution; and (3) Our recommendation on how to capitalize NPSF.

Key Findings

Our study on the current social protection schemes in Laos leads us to believe Laos will need to consolidate its national protection under one scheme under NSPF in order for the fund to be easily managed and funded. One fund will enable Laos to allocate government budget more easily and the fund could be managed from one office, which will also save the country a budget to build up expertise in many offices. We do not believe Laos has a luxury to run various funds (similar to Thailand) at the same time when the Lao government is trying to avert the default next year. We are of the opinion that Laos also should not wait to fund its NPSF as its population is aging.

Laos' debt situation, as pointed out in our study of the Lao bond trend and capital market exposure, tells us the country does not have any room to borrow this or next year, especially in an international market. Even in a domestic market, local borrowing only crowds out investments which are very crucial for economic recovery at the time of COVID-19 pandemic. We said in the last report the path the Lao government should follow in order to issue international debt again.

That said, we believe the best way to fund NSPF is through blended finance (i.e. grants or official development assistance (ODA)), public sector budget through expense reallocation and expense cuts, and contributions from employees and employers with the latter being kept at the minimum for those earning at the low to middle income brackets in order to boost domestic spending as much as possible.

We believe Laos should also seek to restructure its debt through a multilateral development organizations (such as International Monetary Funds, Asian Development Bank, Asian Infrastructure Investment Bank, and/or the new International Development Finance Corporation) as well as bilateral loan maturity extension. Once debt service obligations are reduced to c.USD750m from C.USD1bn for the next 3-5 years, we believe the Lao government will have more room to maneuver its budget to fund NSPF. We will examine these potential solutions above in more details in the next report.

Capitalizing Social Protection in Laos

Lao Ministry of Labour and Social Welfare (MoLSW) operates two social security systems, each for public and private sector employees under the Civil Servant System (CVS) and the Social Security Organization (SSO), respectively. Lao Ministry of Public Health runs the Community-based Health Insurance (CBHI) and Health Equity Funds (HEF)¹. CVS is a contributory social security system with contributions of 8% and 8.5% from employees' salaries and employers' payrolls, respectively. SSO applies to all employers with 10 or more employees with contributions of 5% and 4.5% from employees' salaries and employers' payrolls, respectively.

CBHI, under technical assistance by the World Health Organization (WHO) and grants from United Nations Humanitarian Security Fund (UNHSF), targets population in the informal sector with voluntary membership and family coverage. Last but not least, HEF was designed with the World Bank, Asian Development Bank, and WHO to cover the poor's health care by purchasing CBHI cards for poor families. To the extent of our study, all social protection funds in Lao are funded by the government's budget, members, and grants from donors.

2017 Labour force survey shows that only 14.4% of Lao population was covered by a social protection scheme. Of the country's 4.8m working age population, only 15.8% was covered. The Lao government aims to provide a national projection floor (i.e. social security and healthcare) for all citizens in all stages of life by 2030. That is, the government plans to merge all the social protection systems into NSPF under National Social Protection Strategy (NSPS) which envisions universal access to social protection services through a continually capitalized fund which should be designed to ensure timely payments. NSPS aims to provide the following:

- (1) Citizens with health services;
- (2) Employees and self-employed entrepreneur a formal sector with social protection schemes covered by social security;
- (3) Unprotected workers in an informal sector²with access a higher level of social security protection and;
- (4) The most vulnerable citizens with social welfare such as cash grants.

For NSPF to work, we believe a self-funded portfolio of investment will be needed to provide predictable cash inflow to pay claims. The portfolio can be funded by budget, grants, debt, and contributions by the population. In addition, the administrative function of NSPF needs to make sure the information and benefit distribution systems are properly designed to handle the disbursements and claims. The Lao government needs to ensure its budget accounts for NPSF in terms of % of GDP and % of government expenditure.

In addition, stakeholders need to monitor the implementation and provide inputs/predictions such as targeted employees and self-employed entrepreneurs or disabled persons to be covered under NSPF. UNCDF is helping the Lao MoLSW and Ministry of Finance (MOF) to develop a business plan, including an entity location, use of funds, management of NSPF, revenue structure, fund mandate, fund size, financial modelling, jurisdiction of NSPF, and so on.

¹ Social Security Extension Initiatives in East Asia (ILO, 2015)

² An informal sector means enterprises not registered with the government and without accounts of businesses and employees informally employed in households.

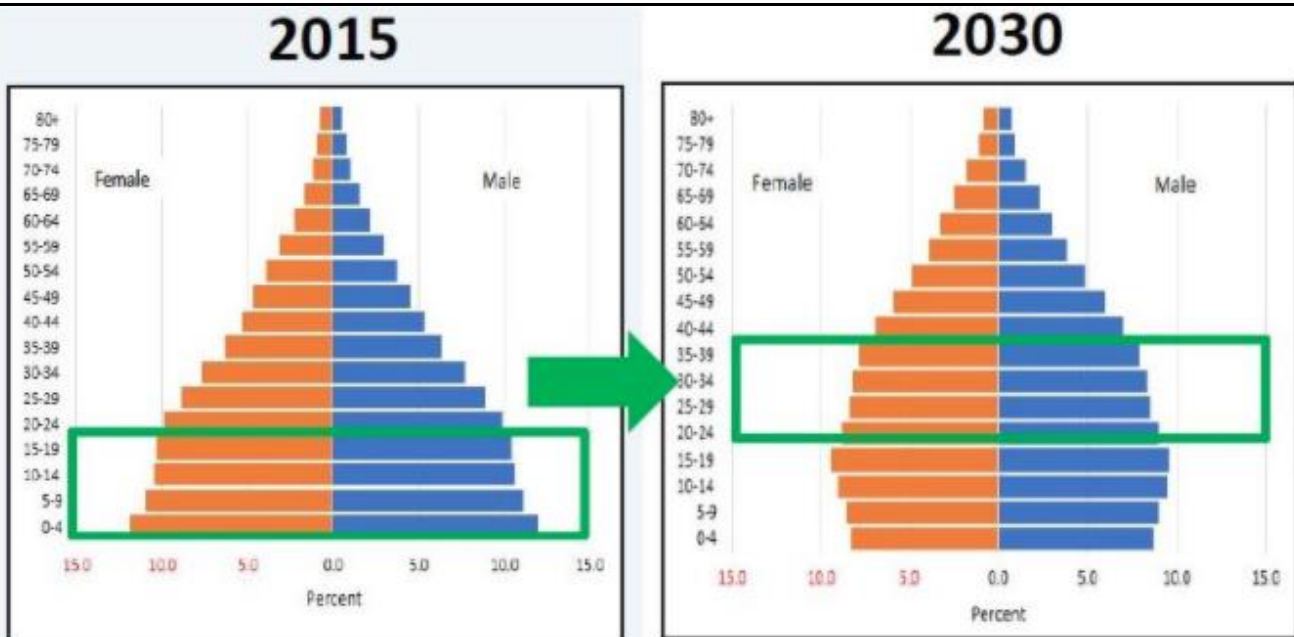
Problems in NSPF Capitalization

Laos has relationships with many multilateral organizations on setting up social protection funds. NSPF is simply a new brand of all the 4 existing plans (CVS, SSO, CMBI, and HEF), in our view. As such, we believe the Lao government should try to utilize technical assistance and grants (as well as official development assistance) from organizations such as UNHSF. The need to fully utilize grants stems from Laos' limitation to borrow and allocate additional government budget to establish NSPF. Here are the funding limitations at the Lao government:

First, the current state of Lao economy in light of the COVID-19 (as pointed out in our Capital Market Exposure report, dated 9-Sep) does not allow for additional debt without lowering debt service obligations in the next 3-5 years. Moody's downgrade of Lao issuer credit rating on 14-Aug closed a window for Laos to issue any international bonds to refinance in its debt maturity. Its continued fiscal and current account deficits will force the government to repay debt through foreign exchange reserves as well as foreign direct investments. The 1-Sep announcement of China Southern Power Grid (CSG)'s equity injection is good news, in our view, but the lack of details on the amount, timeline, and conditions will prevent Lao from issuing debt to fund NSPF in the near term.

Second, Laos' 2018 GDP per capita of USD2,542 (vs. Thailand's USD7,274 and Vietnam's USD2,557) will make Laos' NSPF unable to rely too much on member contributions. Third, as reported in the 9-Sep report, the Lao government revenue is on a decline. Budget allocation may need to be prioritized toward helping Lao citizens survive through COVID-19 first rather than funding NSPF. In addition, the chronic fiscal deficit will require the government to cut spending and that could include staff cuts, in our view. Last but not least, Laos' population is aging against Lao's inability to internally fund NSPF (EXHIBIT 1). That said, the possible funding amount for NSPF is difficult to predict, in our judgment, until Lao economy stabilizes.

EXHIBIT 1: Lao Age Distribution Change



Source: UNFPA Lao

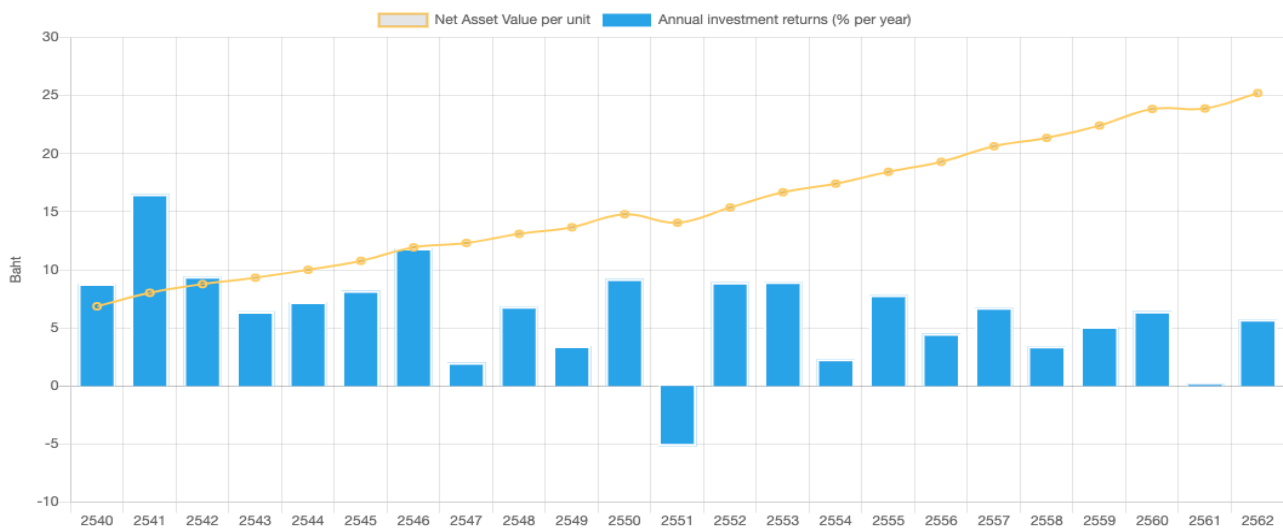
Case Study in Thailand

Social protection schemes in Thailand primarily includes Government Pension Fund (GPF), Social Security Fund (SSF), and the National Pension Fund (NPF). A health care plan is UHC which is also known as the “THB30-cure-all” scheme. The capitalization of Thailand’s social protection fund is a combination of member contributions as well as budget allocation. There is no leverage on any social protection schemes in Thailand.

GPF is for government employees to contribute 3%-15% of salaries with a mandatory contribution of 3% and voluntary contribution from 1% to 12%. The government tops up 3% on the mandatory portion and another 2% beyond the mandatory portion. The fund, at c. USD32bn in size, invests c.80% in local and overseas bonds and increased its holding of foreign equities from 5.1% in March to 9.5% in August. The fund also invests in illiquid assets such as real estate and private equity funds of c.10% at the time of this report.

We understand GPF faces a challenge to boost returns as a result of a declining bond yield on the COVID-19 situation. GPF’s 2019 return was 5.7% versus the averaged 4.3% during the previous 5 years (EXHIBIT 2). GPF’s management aims at 4% return between 2019 and 2021 and seek to increase its maximum overseas investment to 40% from the current 30% in order to boost risk-adjusted returns.

EXHIBIT 2: GPF’s Investment Returns



Source: GPF ;Note: The X-axis is on Buddhist era (BE) which is AD + 543

SSF, at USD65bn in size, is for all other formal employees with contribution of 5% each from both employers and employees. A supplement of 2.75% is paid by the government, bringing total contribution to 12.75% for each formal employee. We note the contribution has been temporarily reduced to 2% for both employees and employers, respectively, in September in light of a COVID-19 crisis³.

Thailand is in progress to require companies with at least 100 employees to set up NPF. Under the draft law, employers and employees will be required to each contribute 3% of an employee’s salary for the first 3 years before increasing to 5% during 4th to the 6th years, 7% between the 7th and the 9th years, and 10% from the 10th year on. We understand the seed capital for the fund was set at THB60bn. In essence, NPF and SSF will be mandatory for all formal employees at companies with at least 100 employees.

³ <https://www.bangkokpost.com/thailand/general/1978159/social-security-fund-rates-cut-to-2->

UHC was designed to cover every citizen. The government injects capital every year into public hospitals and asked each hospital to provide care to every visiting patient. The care under UHC is basic and patients who asked for premium treatments are suggested to seek care under their own budgets. We understand the plan is far from perfect and some public hospitals have reportedly refused to provide treatments for complicated diseases that can be expensive to treat. Although some policymakers wish to ask citizens to help pay for the expensive cost, the reform is slow as UHC can be political and easily picked up to criticize the government. In our view, the success of UHC in Thailand stems from (1) multiple government commitment to make it happen and (2) Thailand's abundant healthcare resources, especially the requirement for new doctors to serve in rural areas for a few years.