LAO PDR ECONOMIC MONITOR

Accelerating Reforms for Growth

Thematic Section:
Education for growth and development

April 2024

Macroeconomics, Trade and Investment
Global Practice
East Asia and Pacific Region

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Abbreviations

ASLO	Assessment of Student Learning Outcomes
BCEL	Banque Pour Le Commerce Exterieur Lao Public
BOL	Bank of the Lao PDR
CAR	Capital adequacy ratio
CIT	Corporate income tax
EAP	East Asia and Pacific
EDL	Electricité du Laos
LTGM	Long-term growth model
MOES	Ministry of Education and Sports
MOF	Ministry of Finance
NPL	Non-performing loan
NTM	Non-tariff measures
PPG	Public and publicly guaranteed
PPP	Public-private partnerships
PTR	Pupil-teacher ratios
SOE	State-owned enterprises
VAT	Value added tax

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The Lao PDR Economic Monitor provides updates on macroeconomic developments and sectoral issues in the country. It is produced biannually and distributed widely to government agencies, development partners, the private sector, think tanks, civil society organizations, and academia.

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Executive Summary

Part A: Recent Economic Developments and Outlook

Economic growth remains below pre-COVID-19 levels, mainly owing to protracted macroeconomic instability. Economic growth is estimated at 3.7 percent for 2023, with positive contributions from the services sector (for example, tourism, transport, and logistics) and mining. Electricity generation, mostly from hydropower plants, was tempered by low rainfall. Meanwhile, foreign investment increased substantially, linked mainly to the electricity and mining sectors. In contrast, public spending and household consumption remained constrained by limited fiscal space and high inflation. Merchandise export growth was limited, affected by supply-side constraints (for example, labor shortages) and subdued external demand.

Amid limited foreign exchange liquidity and high external debt service obligations, depreciation and inflationary pressures persist. In 2023, the annual average official kip/US dollar exchange rate weakened by 31 percent, while the average parallel rate depreciated by 27 percent. The parallel exchange rate premium was about 13 percent in March 2024. Depreciation appears to coincide with periods of large public debt service repayments, usually between March and September. Given the high import dependence, depreciation brings changes in domestic prices. Headline inflation averaged 31 percent in 2023 and remained at about 25 percent for eight consecutive months from August 2023, with food, transport, hotel, and restaurant price increases the main contributors.

Persistent depreciation and inflation continue to erode household real incomes. Average household incomes improved in 2023, but more than one-third of households saw their nominal income growth lag behind inflation, implying a loss of purchasing power. High food inflation has undermined food security, particularly among urban families, which rely mostly on purchased food. About one-third of households, especially low-income households, reduced their spending on health and education.

The sharp currency depreciation has incentivized out-migration and shifts in the domestic labor market. The number of registered Lao migrants in Thailand rose by 15 percent to 252,000 between June 2023 and February 2024. Higher wages and better employment opportunities in Thailand were key 'pull' factors, while sharp currency depreciation and high inflation in Laos exacerbated 'push' factors. Domestic labor is switching from non-tradable service sectors toward agriculture and some manufacturing sectors. Workers are also shifting from formal wage jobs and unpaid family work to self-employment and family businesses, implying a widened wage differential. Sectoral and occupational shifts, coupled with migration, have contributed to labor shortages in some labor-intensive sectors.

On the fiscal front, improved revenue collection offset increased public spending, but gross financing needs remained high. While the government ran a primary surplus (without all interest payments) estimated at 1.5 percent of GDP in 2023, the overall fiscal balance (including interest payments) was estimated at a deficit of 0.2 percent despite deferrals of some interest payments. Limited fiscal space has constrained the government's ability to invest in human capital. Gross financing needs amounted to almost 8 percent of GDP in 2023 (after debt service deferrals) or about 13 percent (without debt service deferrals).

Public and publicly guaranteed (PPG) debt remains at critical levels, while financing sources are limited. Total PPG debt is estimated to have remained above 110 percent of GDP in 2023, largely reflecting the kip depreciation. If domestic expenditure arrears and the swap arrangement with the People's Bank of China are included, total PPG debt increases to over 130 percent of GDP. The energy sector, primarily through Electricité du Laos (EDL), has been a significant driver of PPG debt accumulation, accounting for about 45 percent of external PPG debt in 2022 (45 percent of GDP).

Total external public debt repayments (interest and principal) rose considerably despite deferrals from China. Deferrals of principal and interest owed to China amounting to about $2 billion (over 15 percent of GDP in 2023) provided temporary relief between 2020 and 2023. Nevertheless, residual interest and principal payments still amounted to 5 percent of GDP in 2023, driven by maturing bonds and the amortization of bank loans, followed by repayments to multilateral creditors. Access to international capital markets has deteriorated since the loss of access to the Thai bond market in September 2023. The government relies on a combination of a primary surplus, on-lending repayments collected from state-owned enterprises (SOE), bond proceeds, and commercial bank loans to meet debt service payments. Combined lending to the government from commercial banks and the central bank also increased, indicating more reliance on domestic financing sources.

External imbalances persist despite the sharp currency depreciation, tightened monetary policy, and stricter foreign currency management. The official balance of payments data shows net foreign exchange inflows of about $250 million in the first three quarters of 2023, supported by a strong current account surplus and large investment inflows. Official data underreports imports and does not reflect unremitted export proceeds. When compared to trade partners' mirror data, imports of goods were underreported by almost 30 percent in 2023. At the same time, actual foreign exchange inflows relating to Laos' exports accounted for less than half of the total recorded export values. In practice, these two factors contributed to limited foreign exchange inflows, which caused foreign exchange shortages against a backdrop of high foreign exchange demand for imports, external debt repayments, and business profit repatriation. This, in turn, continued to put pressure on the exchange rate, fuel the parallel market, and feed domestic inflation.

In a bid to stem foreign exchange shortages, the Bank of the Lao PDR (BOL) has started to implement repatriation and surrender (i.e. conversion) requirements. In March 2024, the authorities began to enforce partial repatriation and conversion of export proceeds from key sectors (mining, power, agriculture, and services). These measures may bring more foreign currency into the economy in the short term, but they may be counter-productive in the medium term if they deter future investment or lead to misreporting. Gross reserves (including the currency swap) reached $1.7 billion in December 2023, covering two months of goods and services imports. Nevertheless, net reserve buffers (excluding the currency swap) remain low and a source of concern.

In 2024, real GDP is projected to grow by 4 percent as potential growth will remain constrained by structural challenges. This outlook assumes no new debt service deferrals in 2024 and beyond, while deferrals accumulated during 2020–2023 would continue to be deferred. Economic activity is expected to benefit from recovered performance in tourism, transport and logistics services, and investment in the power sector and some special economic zones. Despite the slight uptick this year, economic growth will remain below pre-COVID levels, weighed down by macroeconomic instability and structural constraints such as a shortage of skills, both in quality and quantity, and a challenging business environment.

Reflecting persistent depreciation pressures, inflation is expected to remain above 20 percent, continuing to exert pressure on real incomes. Depreciation pressures will continue to feed into domestic inflation. This will affect household real incomes, weighing on consumption and restraining progress on poverty reduction.

Fiscal space will remain constrained by elevated debt repayment obligations, which are expected to put additional pressure on domestic financing sources. The baseline projects a primary surplus in 2024, implying a headline fiscal deficit of about 1.4 percent of GDP in 2024, reflecting full interest payments (i.e. no further deferrals for 2024 repayment obligations). Gross financing needs are projected to reach almost 9 percent of GDP in 2024, as the expected primary surplus will only partly offset higher debt repayments in 2024 and beyond. External debt service obligations average $1.3 billion per year over 2024–2027 (about 9 percent of GDP annually), half of which is owed to China. As access to international capital markets is likely to remain constrained until 2025, when external debt service obligations peak, pressure on domestic funding sources is expected to intensify. In the absence of further debt service deferrals, meeting these obligations will be challenging and may require using more domestic revenues in foreign currencies, SOE repayments on on-lending, and domestically issued bonds (in kip and foreign currencies). While these options could generate short-term liquidity, debt restructuring would immediately and effectively relieve strong macro-fiscal pressures while the government implements critical revenue reforms.

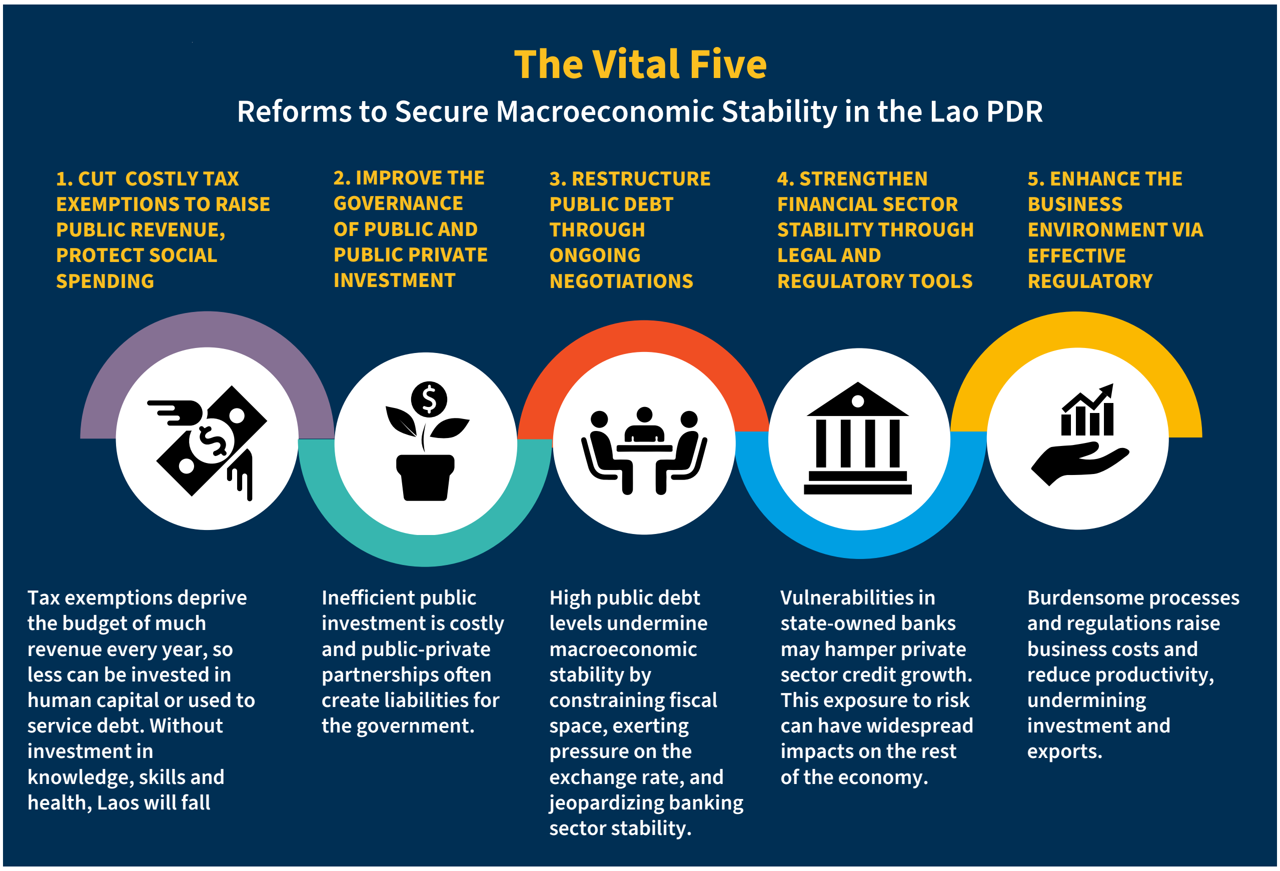
The outlook is subject to significant domestic and external uncertainty. Structural imbalances associated with limited foreign reserves, high public debt, and a high import bill will continue to put pressure on the kip and thus inflation. Worker shortages are weakening labour-intensive sectors. Lower global and regional economic growth would weaken external demand and thus exports. Domestic risks include tight foreign exchange liquidity to refinance external debt (particularly given limited access to international capital markets), slow progress with structural reforms, and deteriorating balance sheets in some large banks. The outcome of ongoing bilateral debt negotiations will have significant implications for both debt sustainability and macroeconomic stability.

Restoring macroeconomic stability requires a strong commitment to five critical reform areas: (i) implementing the restored VAT rate of 10 percent, curbing tax exemptions, and reforming excise taxes (for example, tobacco, alcohol, sugar-sweetened beverages, and fuel) to boost spending on social sectors; (ii) expediting ongoing debt renegotiations and strengthening public debt management; (iii) managing risks from contingent liabilities related to state-owned enterprises and public-private partnerships; (iv) strengthening financial sector stability; and (v) improving the business environment to promote investment and exports. In addition, improving data availability, timeliness, and quality is essential for informing evidence-based policy making.

Table 1. Summary of key economic indicators

	2020	2021	2022	2023	2024	2025
					Projections	
Real GDP growth (% change)	0.5	2.5	2.7	3.7	4.0	4.1
Inflation (period average, % change)	5.1	3.8	22.7	31.2	21.2	14.7
Fiscal balance (% of GDP)	-5.2	-1.3	-0.2	-0.2	-1.4	-1.5
Current account balance (% of GDP)	-5.9	-2.9	-1.7	-1.3	-2.9	-3.5

Sources: Lao Statistics Bureau, Ministry of Finance, Bank of the Lao PDR, Ministry of Industry and Commerce, World Bank staff estimates and projections based on inputs from Lao authorities and trade partner data as of March 2024.



Part B: Education for Growth and Development

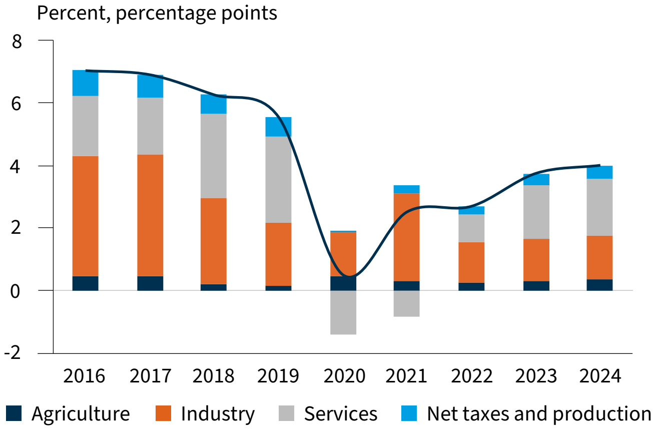
Strong human capital and education are fundamental to putting Laos on a sustainable high-growth trajectory. Human capital constitutes only 57.2 percent of the country's total wealth compared to 63.3 percent of the total wealth of nations globally. Education — and the skills it confers — is fundamental to improving human capital and thereby individual well-being as well as economic growth. Learning, especially in early childhood, is important in building skills. Since learning is cumulative, weak foundational skills in early life mean low skills in later life. However, primary education is no longer universal in Laos as an increasing number of students are dropping out and those students who stay are not learning. A 2019 Grade 5 learning outcomes assessment showed Lao children lagging behind those in neighboring East Asian countries in math, reading and writing. This has follow-on effects for subsequent education levels, with enrolment rates measurably below benchmarks while dropout rates are high and increasing. Most secondary students score below expected levels across subjects, with pronounced knowledge gaps in mathematics and science in particular.

Successful school systems require effective teachers and adequate financing. In Laos, teachers lack content knowledge as well as pedagogical skills. While approximately 85 percent of teachers report having completed preservice training/vocational degrees, various assessments indicate that teachers do not appear to have received the kind of pre-service training that would equip them for successful teaching in class. In-service training is ad hoc and inadequate. An imbalance in the distribution of teachers across education levels, geographical locations, and schools causes further inefficiencies in resource allocation and use. Moreover, adequate financing – both in total and in composition – is essential for schools to offer the needed teaching quality. However, the combined impacts of deprioritization and fiscal consolidation have caused an unprecedented decline in public education funding, which is now very low in real terms and relative to GDP and total government spending. This reflects a de-prioritization of the sector compared to other government spending. In real terms, actual expenditure fell by 22 percent between the 2018 peak and the latest available expenditure data from 2021. Budget allocations have since seen a further decline of 22 percent, according to the latest publicly available State Budget Plan for 2023. This amounts to a sharp reduction in real terms of 38 percent between 2013 actual spending and the 2023 budget allocation. The decline has been driven in part by a downsizing of the teaching workforce. Cuts to the education budget have also resulted in a very significant decline in operational spending, including on teacher support functions, such as in-service teacher training. In real terms, non-wage recurrent spending declined by 56 percent between 2018 and 2022.

For learning outcomes to improve, sector funding and teacher skills must improve. The education sector needs urgent re-prioritization, with increased budget allocations in real terms and with the right mix of inputs as a basis for quality teaching. This includes higher and more efficient investment in teacher training, learning, and teaching materials. In parallel, the education sector should prioritize service delivery (vis-à-vis administrative functions) and balance the allocation of teachers across education levels and schools. While addressing these critical supply-side issues, Laos must also create incentives in the form of jobs and entrepreneurship opportunities for households to enroll their children, ensure they stay enrolled, and demand quality education services.

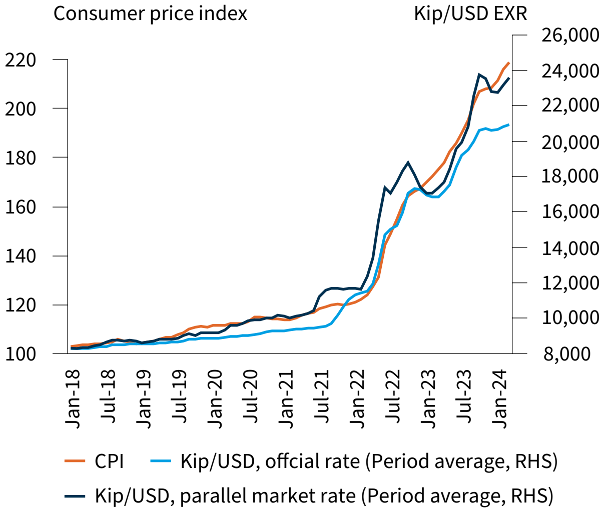
Lao PDR: Key Macroeconomic Indicators at a Glance

Growth recovery is restrained by protracted macroeconomic instability



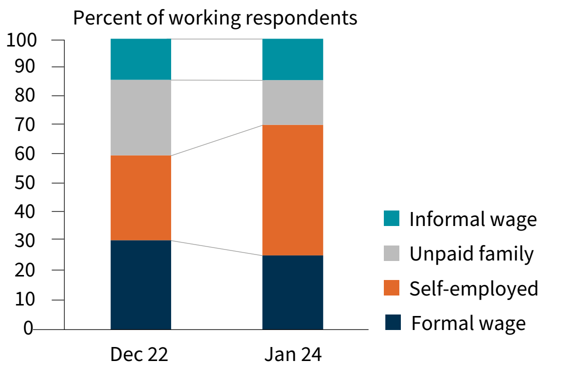
Source: Lao statistics bureau/World Bank staff estimate.

Persistent depreciation has continued to fuel domestic inflation



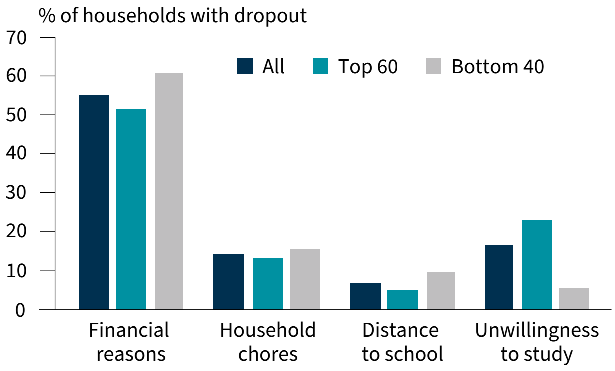
Sources: Bank of the Lao PDR.

Persistent inflation is eroding real household incomes, fueling out-migration and labor shifts



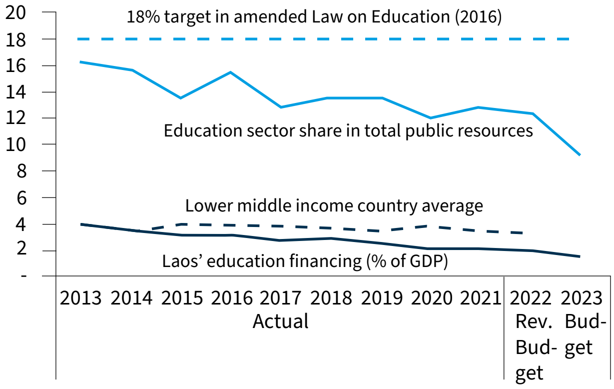
Source: World Bank rapid phone survey January–February 2024

Households' financial difficulties contribute to rising school dropouts



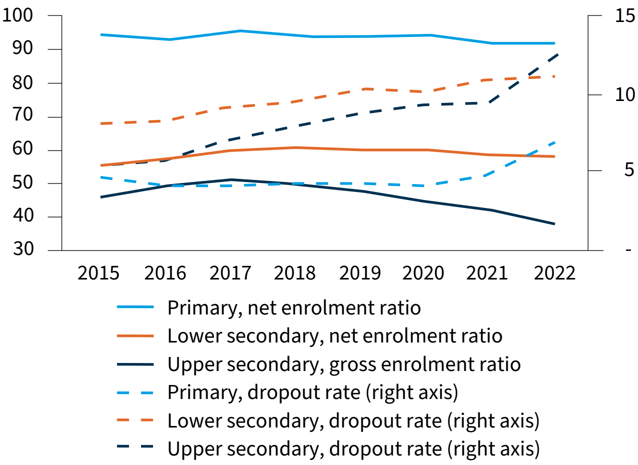
Source: World Bank rapid phone survey January–February 2024

De-prioritization and fiscal consolidation have caused decline in public education funding



Sources: Amended Law on Education 2016, State Budgets, State Budget Implementation Reports, World Bank staff estimates.

Enrolment rates across education levels: dropout rates are high and increasing



Source: World Bank staff estimates based on Laos Annual School Census, UN Population Data, and UNESCO UIS.

Note: Data from the Annual School Census collected at the end of each calendar year (i.e., 2022 data collected in late 2022 for school year 2022/23).

PART A

Recent Economic Developments and Outlook

1. Regional Economic Context

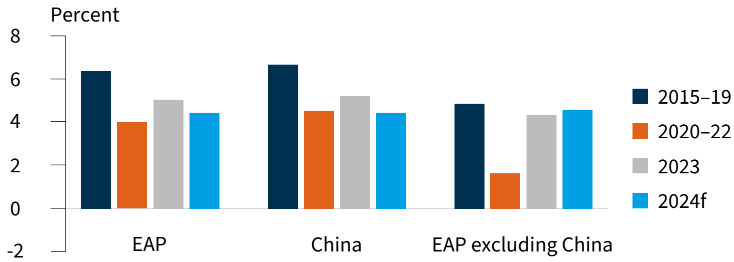
Regional growth prospects in EAP remained favorable.

Most economies in East Asia and Pacific (EAP) are growing faster than in the rest of the world, albeit slower than before the pandemic (Figure 1). China's economy grew by 5.2 percent in 2023, up from 3 percent in 2022, as the economy benefited from a strong post-COVID rebound in early 2023. However, China's growth momentum has slackened due to a slowdown in infrastructure and real estate development and high debt levels. The rest of the region grew by 4.4 percent in 2023, down from 5.8 percent in 2022, owing to slower trade growth and tight financial conditions.

The region's economic performance is influenced by external and domestic developments. Key external factors include slower global trade growth due to more trade-distorting measures imposed in 2023, and the high interest rates introduced to contain inflation in developed countries. Goods and services trade grew by only 0.2 percent in 2023, while almost 3,000 new trade-distorting measures were imposed in 2023, three times more than in 2019. Key domestic factors include elevated public and private debt levels, a constrained fiscal and monetary policy stance, and increased policy and political uncertainty in some countries.

Regional growth is forecast to ease to 4.5 percent in 2024, from 5.1 percent in 2023, reflecting more moderate growth in China. China's growth is forecast to slow to 4.5 percent in 2024 from 5.2 in 2023 due to near-term issues (high debt levels and property sector weaknesses) and longer-term structural factors (for example, population aging and trade protectionism). However, the rest of the region (excluding China) is expected to grow by 4.6 percent in 2024 from 4.4 percent in 2023. The anticipated recovery of global trade and easing global financial conditions are expected to boost external demand, which will help offset the impact of China's economic slowdown.

Figure 1. Regional GDP growth



Source: World Bank EAP Economic Update April 2024.
Note: EAP: East Asia Pacific; EMDE: emerging markets and developing economies

2. Recent Developments in the Lao PDR

2.1 Real Sector

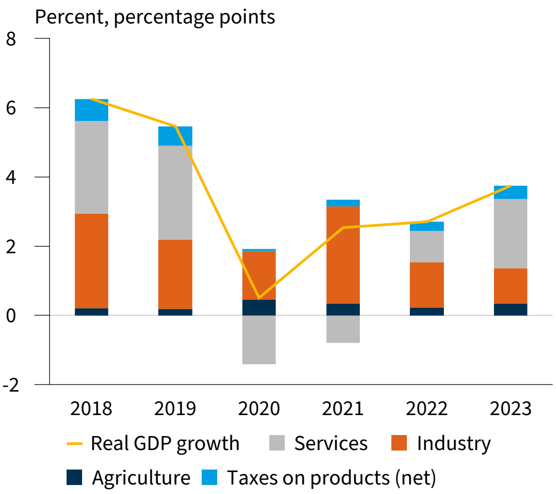
Economic growth in Laos remains significantly below pre-Covid-19 levels, mainly due to protracted macroeconomic instability.

Persistent macroeconomic instability has undermined Laos' post-pandemic economic recovery. The limitations of a resource-driven growth model and accumulated structural imbalances were exposed by the COVID-19 pandemic and a deteriorating global economic environment. A history of high fiscal deficits and large public investments in the power sector have led to an unsustainable debt burden. External debt service payments have risen due to the rapid accumulation of non-concessional debt (with higher interest rates and shorter maturities), which in turn has increased the demand for foreign exchange. At the same time, generous tax incentives for foreign investors have eroded foreign exchange revenues. These factors, coupled with high import demand in the context of low foreign reserves, have contributed to a significant foreign currency demand-supply mismatch and hence kip depreciation. A weaker kip aggravates the public debt burden and increases domestic inflation. High debt service obligations constrain the fiscal space available for investments in human capital, which are crucial for improving labor productivity and thus long-term growth. Slower economic growth, coupled with inflation, undercuts people's incomes and living standards.

Economic growth is estimated at 3.7 percent in 2023, largely benefiting from the services sector recovery (Figure 2).[1] Tourism, transport and logistics services, and mining supported economic growth in 2023. Meanwhile, low rainfall weighed down electricity generation, which is heavily dependent on hydropower. Foreign investment picked up substantially, largely in the power sector.[2] However, limited fiscal space and high inflation constrained public spending and household consumption, respectively. Merchandise export growth has been marginal, as increased mining exports were offset by lower growth in some manufacturing exports, which were affected by labor shortages and lower external demand.

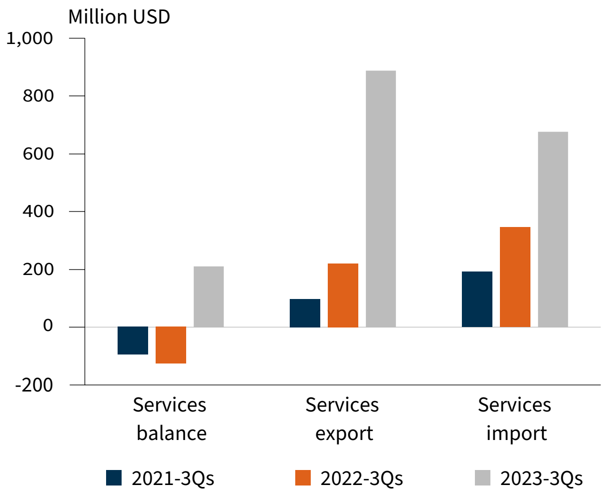
The services sector, which accounts for one-third of GDP, is estimated to have grown by 5.5 percent in 2023. The number of foreign visitors, mostly from the region, more than doubled to 3.4 million in 2023 compared to 1.3 million in the previous year. However, that was still only about 70 percent of pre-pandemic levels. Transport and logistics services have benefited from increased railway and dry port operations. Service exports tripled to about $880 million in the first nine months of 2023 compared to the same period a year ago (Figure 3). Wholesale and retail sales growth was supported by tourism but remained constrained by high inflation.

Figure 2. Real GDP growth



Sources: Lao Statistics Bureau and World Bank staff estimates.

Figure 3. Services trade



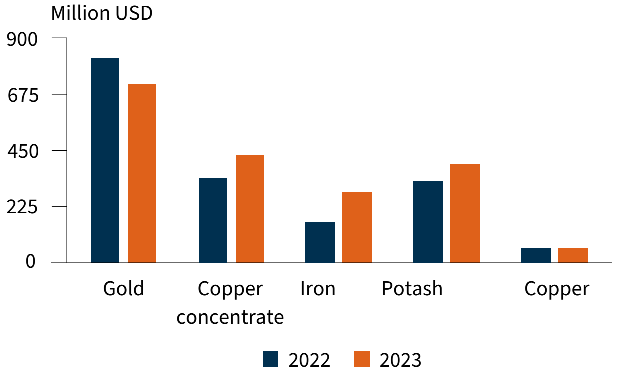
Source: Bank of the Lao PDR.

Industrial sector activity is estimated to have expanded by 2.6 percent in 2023, driven by mining, while electricity and manufacturing output was subdued. The mining sector saw output growth in copper concentrate, iron ore, and potash, while gold output slightly declined as existing pits are gradually depleted and new sources are at an early stage of development (Figure 4). Electricity generation, which accounts for 10 percent of GDP, was constrained by low rainfall. Manufacturing sector performance was mixed (Figure 5). An increase in food and beverage output was partly offset by lower growth in other manufacturing, such as wood pulp, paper products, and electronics, which were partly affected by lower external demand. Meanwhile, low wages in Laos, exacerbated by the recent depreciation and high inflation, have contributed to increased worker migration to Thailand, where average wages are about three times higher. This trend is challenging for most labor-intensive sectors, such as garment manufacturing and hospitality, which are facing increasing labor shortages.

1 Lao Statistics Bureau estimated 2023 growth at 4.2 percent. https://www.lsb.gov.la/en/home/ (Accessed 29 March 2024).

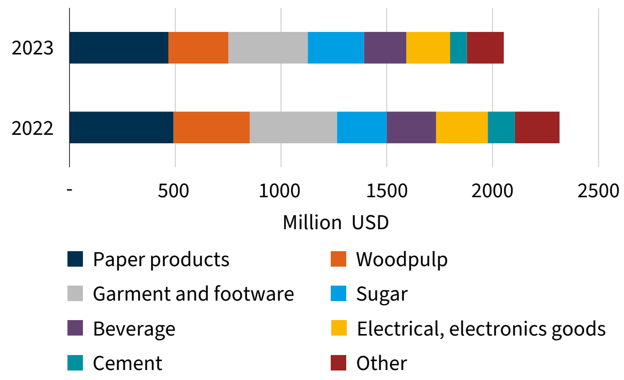
2 A large proportion of the investment inflows into the power sector are financial transactions related to the EDL-Transmission joint venture.

Figure 4. Mining exports



Sources: Ministry of Energy and Mines, Mining companies, and Ministry of Industry and Commerce.

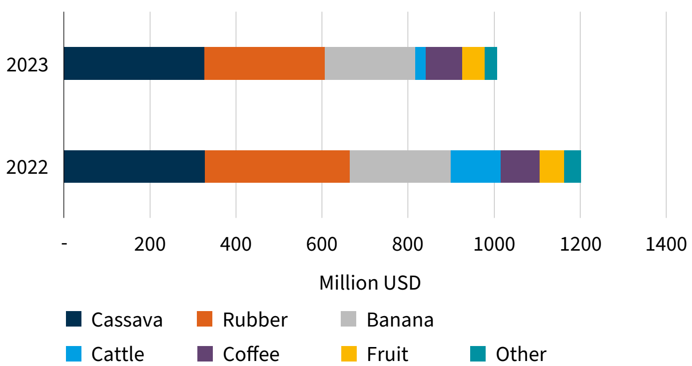
Figure 5. Manufacturing exports



Sources: World Bank staff calculations based on Ministry of Industry and Commerce and trading partners' customs data.

The agriculture sector grew by an estimated 2.4 percent in 2023, driven by rice production. Global prices for agriculture inputs eased, but the costs of imported inputs remained high, owing to the continued depreciation of the kip. Increased input costs have partly translated into higher local food prices. Nevertheless, an increase in rice production partly offset the decline in key agricultural exports (Figure 6). Livestock exports also declined significantly, particularly cattle, due to limited supply-side capacity. The main agriculture exports in 2023 were cassava, fruits, rubber, and coffee. In response to difficult economic conditions, more households turned to farming and agricultural businesses, which offered relatively better returns than wage employment (see Household section).

Figure 6. Agricultural exports



Sources: World Bank staff calculations based on Ministry of Industry and Commerce and trading partners' customs data.

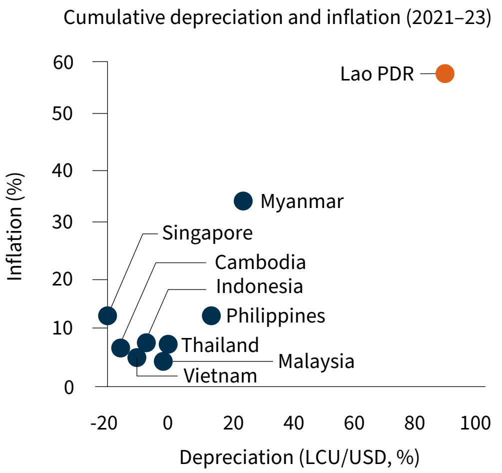
2.2 Inflation

Persistent depreciation has continued to fuel domestic inflation.

Consumer price inflation accelerated in 2023, driven by increases in food, transport, and hotel and restaurant prices. Average annual consumer price inflation reached 31 percent in 2023, compared to 23 percent in 2022. Food, transport, restaurant, and hotel prices rose by 38, 26 and 35 percent, respectively in 2023. Although headline inflation moderated since the 41 percent peak in February 2023, it remained high at about 25 percent between August 2023 and March 2024. Inflation in Laos remained much higher than in its regional peers, reflecting sharp depreciation of the kip in 2023 (Figure 7). Core inflation reached 27 percent in 2023 and remained at this level in the year to March 2024, largely driven by rising prices in restaurants and hotels, clothing, and housing (Figure 8).

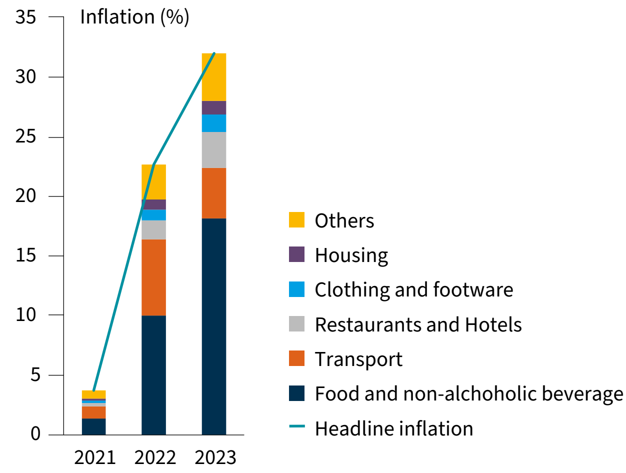
High inflation was largely driven by the kip depreciation, particularly in the parallel market. On average, a 1 percent depreciation of the Lao kip increased consumer prices by 0.5 percent.[3] However, the inflation rate has been closer to depreciation levels in recent times, suggesting a higher passthrough, especially from the parallel rate. Markets tend to price goods and services based on parallel rates, as many businesses anticipate further depreciation and thus set prices higher to cover the exchange rate risk. Tackling inflation will require exchange rate stability.

Figure 7. Inflation among regional peers



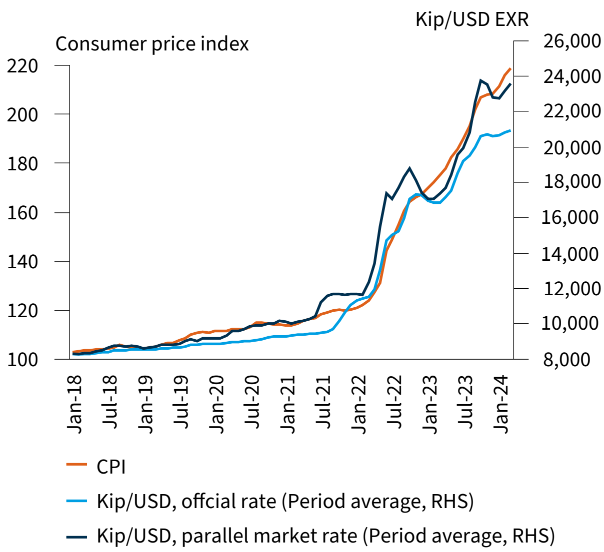
Sources: Lao Statistics Bureau and, International Monetary Fund International Financial Statistics IMF IFS (August 2023)

Figure 8. Consumer price inflation



Sources: Lao Statistics Bureau and World Bank staff calculation.

Figure 9. Inflation and exchange rates



Sources: Lao Statistics Bureau and Bank of the Lao PDR

[3] See International Monetary Fund Article IV 2023. https://www.imf.org/en/Publications/CR/Issues/2023/05/22/Lao-People-s-Democratic-Republic-2023-Article-IV-Consultation-Press-Release-Staff-Report-533636 (Accessed 15 March 2024).

2.3 Households

Persistent depreciation and inflation is eroding real household incomes, while fueling out-migration and labor shifts from non-tradable to tradable sectors.

A protracted period of high inflation has changed the labor market situation. The latest World Bank phone survey shows that 93 percent of respondents reported working in January 2024, up from 90 percent in December 2022.[4] However, high inflation and a sharp currency depreciation have incentivized workers to switch from non-tradable service sectors toward agriculture and manufacturing (Figure 10). The share of working respondents employed in the services sector notably declined from 52 percent to 42 percent. Workers moved from wage employment and unpaid family work to become self-employed, as the latter offered better returns. The share of self-employment rose from 29 percent to 45 percent between December 2022 and January 2024.

Average household income improved in 2023, but more than one-third of households still saw their nominal income growth lag behind inflation. Income growth varied by source. While nominal wages grew at 13 percent in the year to December 2023, average profit rose by 17 percent for family businesses in the non-farm sector and 26 percent for those in the agricultural sector. Average household income per capita rose by almost 25 percent in the year to December 2023, in line with the year-on-year inflation rate of 24 percent. However, this improvement masks the distributional consequence of persistent inflation. Despite the increase in average incomes, more than 40 percent of households still saw their income lag behind inflation and suffered from elevated living costs.

Workers have migrated domestically and internationally to seek higher wages and better employment opportunities. A sharp currency depreciation and high inflation have exacerbated 'push' factors to migrate to other countries (for example, Thailand and Korea) and domestically to fast developing special economic zones. In February 2024, the number of registered Lao workers in Thailand stood at 252,000, up from 215,000 in June 2023 (Figure 11), while the total number (including unregistered migrants) is estimated to range between 300,000 and 400,000, more than one-third of non-farm employment in Laos.[5] Higher wages and better employment opportunities are the main reasons for migration. The kip depreciation has widened the wage gap between Thailand and Laos. Despite the increase of the minimum wage to 1.6 million kip (about $79 per month) in October 2023, the minimum wage in Thailand was about three times higher than in Laos.

Sectoral and occupational shifts, coupled with migration, have contributed to labor shortages in labor-intensive sectors. The shift of workers to the agricultural sector and self-employment has reduced the workforce available for non-farm businesses. Out-migration has also depleted the labor force in Laos. Around 80 percent of migrants had been working in manufacturing and services before migrating to Thailand.[6] Almost 60 percent of Lao migrants in Thailand work in the services sector, followed by manufacturing (20 percent), agriculture (16 percent) and construction (7 percent).[7]

High food inflation has undermined food security, particularly among urban families, which rely mostly on purchased food.[8] Food inflation remained high at 24 percent in the year to March 2024. Overall food security slightly improved between December 2022 and January 2024, with the share of food insecure households declining from 33 percent to 29 percent (Figure 12). However, there is significant variation across groups. Food security improved among rural and low-income families but not among urban and better-off families. The former tends to engage in farming activities and rely more on self-produced food, while the latter rely mostly on purchased food.

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[4] World Bank Rapid Monitoring Phone Survey of Households Round 8, conducted during January-February 2024. Employment is defined as those who worked at least an hour in the last seven days before the interview date.

[5] International Organization for Migration. 2021. An Analysis of Migration Trends of Lao Migrants for Lao People's Democratic Republic in Two Selected Provinces: Sanvanakhet and Xayaboury. https://publications.iom.int/system/files/pdf/Analysis-MIG-Trends-Lao.pdf/ (Accessed 13 March 2024).

[6] International Organization for Migration survey, December, 2022.

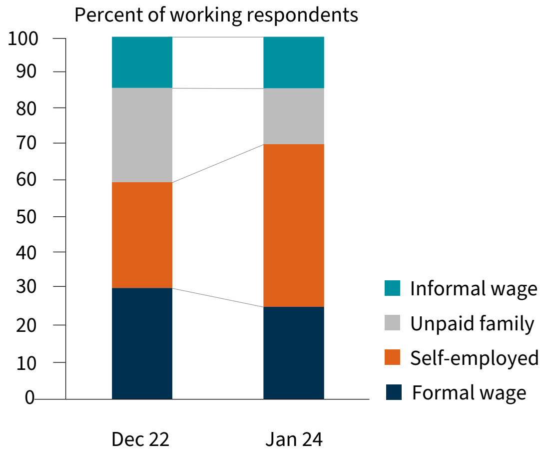
[7] Department of Employment, Government of Thailand.

[8] The level of food insecurity is determined using the method developed by FAO for the analysis of Food Insecurity Experience Scale (FIES) data. More information about FIES methodology https://www.fao.org/policy-support/tools-and-publications/resources-details/en/c/1236494/ (Accessed 13 March 2024.

Nevertheless, the prevalence of moderate to severe food insecurity remains higher among rural and low-income families.

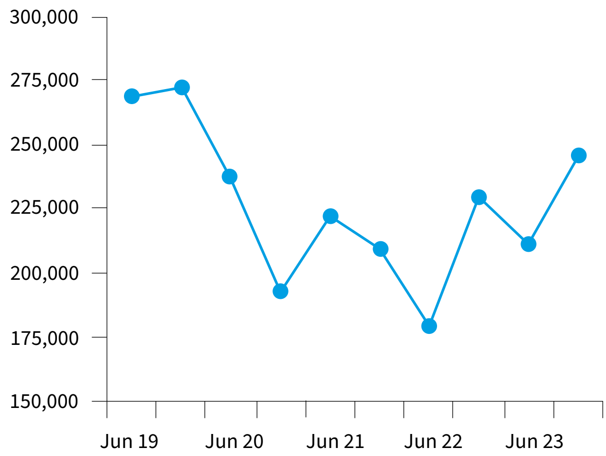
Households have adopted various coping strategies in response to high inflation, some of which could be detrimental to human capital development. Scaling up own-food production, switching to cheaper food, and reducing food consumption are among the most common strategies. While the proportion of households reducing food consumption to cope with high food inflation declined across all socioeconomic groups in recent months, it did not decrease for low-income households. Moreover, more than one-third of households reported reducing education spending because of inflation, and this reduction was most common among low-income families. Nearly 5 percent of school-aged children (aged 6–17) dropped out of school in the past year, with more than half of households with school dropout citing financial reasons as the main cause for school dropouts (Figure 13). Coupled with low government spending on the social sectors, investments in human capital are being hampered, which can severely undermine the economic prospects of an entire generation.

Figure 10. Employment



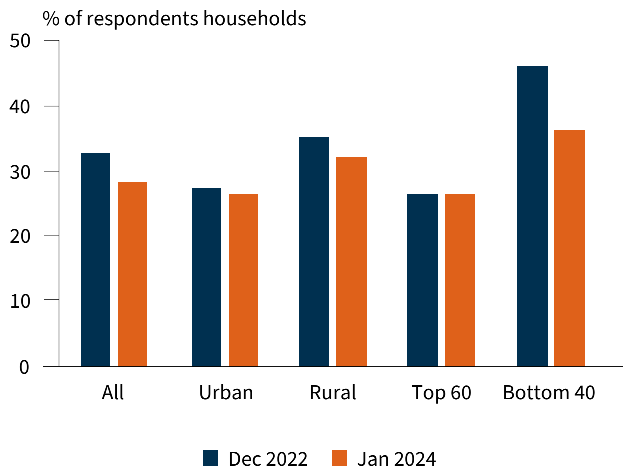
Source: World Bank rapid phone survey January-February 2024

Figure 11. Registered Lao workers in Thailand



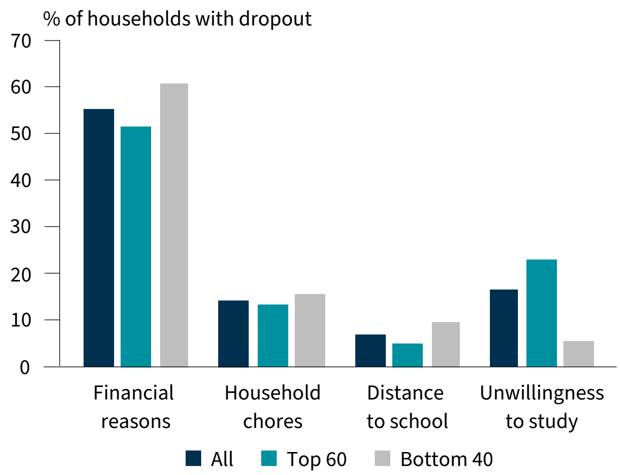
Source: Ministry of Labour, Government of Thailand

Figure 12. Food insecurity prevalence rates



Source: World Bank rapid phone survey January–February 2024

Figure 13. Reasons for school dropout



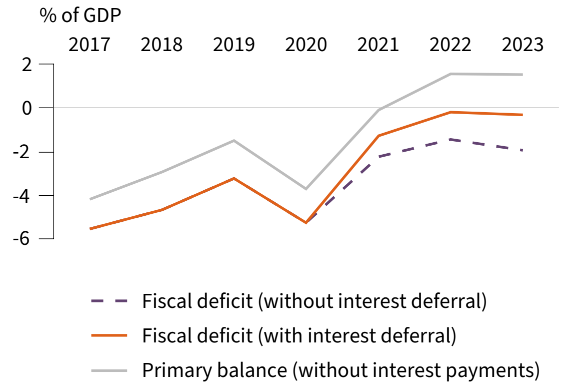
Source: World Bank rapid phone survey January–February 2024

2.4 Fiscal Developments

The fiscal deficit remained stable, supported by improved revenues and limited expenditure growth.

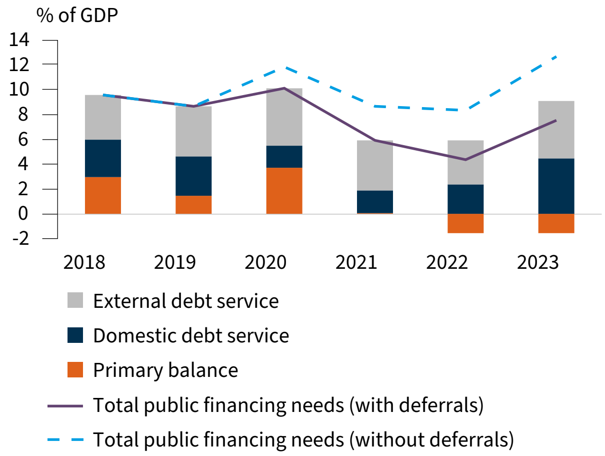
The fiscal deficit remained at an estimated 0.2 percent of GDP in 2023, as improved revenue collection was offset by increased public spending (Figure 14).[9] The primary balance (which excludes interest payments) is estimated to have slightly increased to 1.5 percent of GDP in 2023, supported by better revenue collection and limited growth in non-interest expenditures. Nevertheless, total financing needs amounted to almost 8 percent of GDP in 2023, as debt repayment, exacerbated by the impact of the weakened kip on external debt service, significantly exceeded the primary surplus (Figure 15). Without deferrals, financing needs would have reached 13 percent of GDP. The government met its financing needs largely through a combination of fiscal revenues in foreign currency, on-lending repayments collected from state-owned enterprises (SOEs), bank loans and bond issuances in the domestic capital market (both in foreign and local currencies).

Figure 14. Fiscal performance



Source: Ministry of Finance, World Bank staff estimate

Figure 15. Total public financing needs



Source: Ministry of Finance, World Bank staff estimate

Domestic revenue improved in 2023, supported by higher economic activity as well as price and exchange rate effects. Domestic revenue recovered to an estimated 14.2 percent of GDP in 2023 owing to resource taxes, fees, and the value added tax (VAT) (Figure 16). Excise revenue was relatively stable, as higher volume sales, price increases, and some rate increases were offset by lower fuel excise rates. The sharp kip depreciation and general price increases have benefitted revenue collection, compensating for the lower VAT and fuel excise rates. The VAT tax base expanded, with more VAT-eligible taxpayers joining the VAT system through the TAXRIS system.[10] Despite this improvement, Laos' revenue performance still lags behind most regional peers (Figure 17).

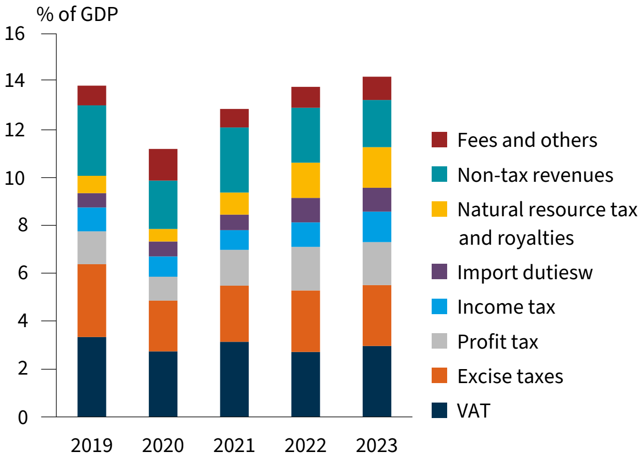
Untargeted tax cuts and generous fiscal incentives have resulted in large foregone revenues. To ease the impacts of soaring international fuel prices in 2022, exacerbated by the strong kip depreciation, fuel excise rates were significantly reduced in mid-2022. Similarly, the VAT rate was reduced from 10 to 7 percent in January 2022, aiming to support households, improve tax compliance, and expand the tax base. Estimates suggest that these rate cuts have resulted in large foregone revenues: about 0.9 percent of GDP for fuel excises and about 1 percent for the VAT. These measures have predominantly benefited wealthier households since they consume more products subject to VAT and excise taxes compared to the poor. In addition, reported fuel imports are lower than trading partners'

[9] The fiscal data are based on data from January-September 2023 and preliminary World Bank's estimates based on information available as of March 2024.

[10] Under the National Agenda, one target under the revenue pillar is to improve compliance to value added tax. MOF aims to increase 14,000 eligible units in the VAT system by 2023, of which 12,000 have already joined.

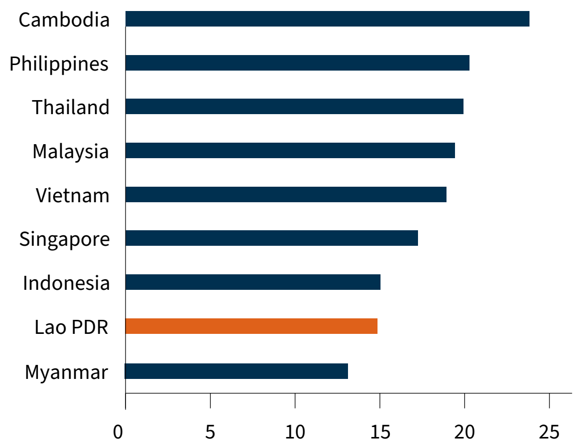
reported exports to Laos (for example, from Thailand and Vietnam). This suggests that a significant amount of fuel is not being taxed. In addition, corporate income tax (CIT) collection remained at around the 2022 level (as a share of GDP), still very low by regional benchmarks. Only about 10 percent of the potential CIT revenue base is actually collected, which implies very large foregone revenues from tax exemptions and evasion.[11]

Figure 16. Domestic revenues



Source: Ministry of Finance, World Bank staff estimate

Figure 17. Total revenues (% of GDP in 2022)



Source: International Monetary Fund, Fiscal Monitor October 2023.

To boost revenue potential, the government introduced several tax policy reforms. New measures included higher excise taxes on alcohol, vehicles, and tobacco (October 2023), introducing new and higher export duties (August 2023), and restoring the VAT rate back to the original 10 percent (March 2024).[12] However, some of these measures may not result in significant additional revenues in the short-term owing to generous tax incentives granted under investment agreements, which severely undermine the tax base.[13]

Public expenditure is estimated to have increased slightly in 2023, owing to higher capital spending, and transfers despite containment of the wage bill and interest payment deferrals (Figure 18). Total expenditure rose to an estimated 15.2 percent of GDP in 2023, but it remained below pre-pandemic levels and most regional peers (Figure 18, 19). Wages and salaries spending declined, owing to limited wage growth and lower net recruitment despite more benefits.[14] Capital spending increased, likely due to exchange rate effects on external loan-financed project disbursements. Some projects have either been cancelled or postponed, as the focus is on meeting the financing needs of ongoing or completed projects. High prices reportedly affected the construction costs of some public investment projects and the purchase of goods and services. In addition, domestic expenditure arrears continue to pose a challenge for expenditure management and domestic debt. Interest payments remained stable, supported by continued debt service deferrals in 2023.

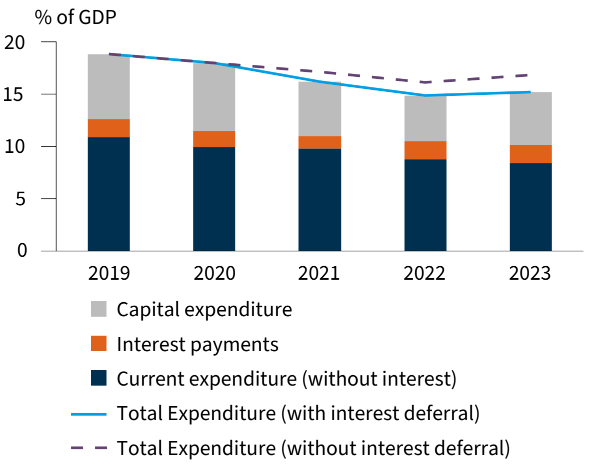
[11] World Bank. 2023. Public Finance Review - Forging Ahead: Restoring Stability & Boosting Prosperity. https://www.worldbank.org/en/events/2023/12/03/public-finance-review-fiscal-incidence-analysis-lao-pdr-2023 (Accessed 13 March, 2024).

[12] The relevant regulations are Presidential Ordinance on the Revision of Excise Rates on Selected Products, No. 003/P, dated 9 October, 2023; Presidential Ordinance on Natural Resource Taxes; and Presidential Ordinance on the VAT Rate To Return to 10%, dated 19 March 2024. https://laoofficialgazette.gov.la/ (Accessed 13 March, 2024).

[13] Despite tax reforms introduced in January 2024, new revenue is expected to amount to less than 0.02 percent of GDP because lower tax rates applied under investment agreements. See more in World Bank. 2023. Health Taxes in the Lao PDR - Technical Note. https://www.worldbank.org/en/country/lao/publication/health-taxes-in-the-lao-pdr-technical-note (Accessed 13 March 2024).

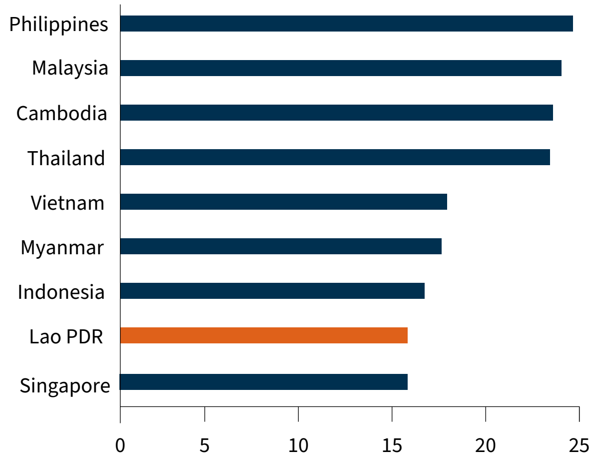
[14] Laotian Times. 2023. Lao Government Increases Living Allowances for Civil Servants. https://laotiantimes.com/2023/01/09/lao-government-increases-living-allowances-for-civil-servants/ (Accessed 13 March 2024).

Figure 18. Total expenditure



Source: Ministry of Finance, World Bank staff estimate.

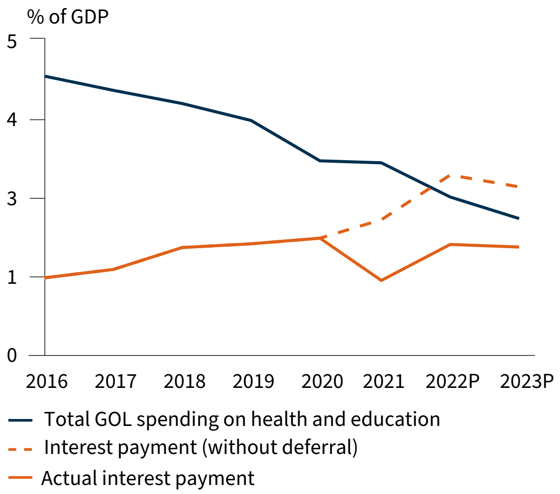
Figure 19. Expenditure (% of GDP in 2022)



Source: International Monetary Fund, Fiscal Monitor October 2023.

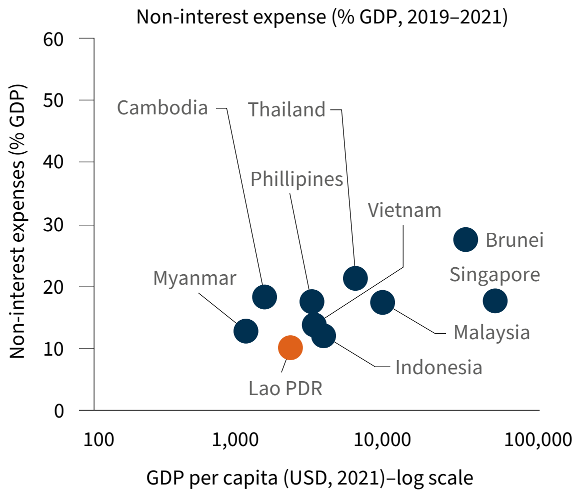
Expenditure increased slightly but is still low for human capital spending and non-interest expenditures, which are crucial for the provision of essential public services. Although debt service deferrals have shielded Laos from more drastic fiscal pressures in recent years, there has been limited support to poor households severely affected by rising living costs. The combined spending on education and health declined from 4.9 percent of GDP in 2013 to an estimated 2.3 percent in 2023 (Figure 20). Meanwhile, non-interest expenditure remained very low, especially when compared to in other countries with similar incomes and regional peers (Figure 21).

Figure 20. Human capital spending (% of GDP)



Source: Ministry of Finance and World Bank staff calculations.

Figure 21. Non-interest expenditure



Source: International Monetary Fund Government Finance Statistics.

2.5 Public Debt Dynamics

A weakened kip has significantly increased the public debt burden, with sustainability largely contingent on the outcome of ongoing debt negotiations and revenue reforms.

Unsustainable public debt threatens macroeconomic stability and development prospects. Laos is facing considerable liquidity and solvency challenges owing to a high debt burden, low foreign currency reserves, and limited financing options.[15] Total public and publicly guaranteed (PPG) debt is estimated to remain above 110 percent of GDP in 2023, reflecting the kip depreciation. If domestic expenditure arrears and the currency swap arrangement with the People's Bank of China are included, total PPG debt rises above 130 percent of GDP.[16] State-owned enterprises account for 49 percent of external PPG debt in the form of on-lending or guarantees, with the remaining 51 percent being government owned-debt.[17] The energy sector, primarily through Electricité du Laos (EDL), has been a significant driver of PPG debt accumulation, accounting for about 45 percent of external PPG debt in 2022 (45 percent of GDP).

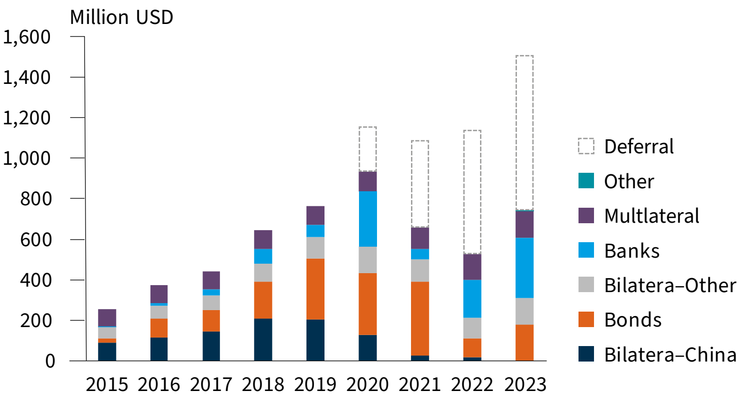
PPG debt service payments are highly exposed to exchange rate risk. Debt denominated in US dollars accounts for more than half of total external public debt, followed by Special Drawing Rights, Thai baht, and Chinese yuan.[18] Therefore, the continued depreciation of the Lao kip against major foreign currencies in 2023 has had a considerable effect on the debt burden. In addition, interest rate increases during 2023 are expected to have some impact on debt service, as about 15 percent of total PPG debt was contracted on variable interest rates.

The domestic public debt stock is estimated to have increased in 2023 with the issuance of treasury bills and bonds to clear expenditure arrears. The domestic debt stock is estimated to have risen above 12 percent of GDP in 2023, mainly due to the issuance of government bonds to pay for domestic expenditure arrears, issuance of treasury bills, and advances from the Bank of the Lao PDR to finance the budget. Public expenditure arrears remained large, with a reported amount of 23 trillion kip (11 percent of GDP in 2022). These arrears are under the process of audit and verification.[19]

Public debt repayments are estimated to increase in 2023 (Figure 22). Total external public debt service rose considerably, despite deferrals of repayments to China. This was driven by maturing bonds and the amortization

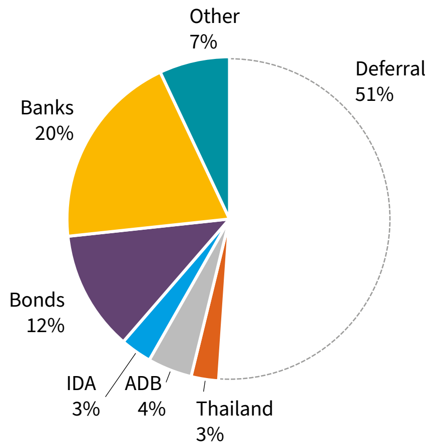
Figure 22. External public debt repayment due

A: By creditors



Source: World Bank calculations based on Ministry of Finance data.

B: By creditor (% total external debt service, 2023)



Source: World Bank calculations based on Ministry of Finance data.

15 The latest IMF-WB Debt Sustainability Analysis (May 2023) assessed Laos to be in debt distress with an unsustainable outlook.

16 The upcoming 2023 Public Debt Bulletin will be reflected in the next Lao PDR Economic Monitor.

17 Laos uses the currency criterion, which means that external debt comprises all debt denominated in foreign currencies, irrespective of where it is issued. Domestic debt comprises all kip-denominated debt.

18 See Lao Economic Monitor November 2023 for more details on PPG debt stock in 2022.

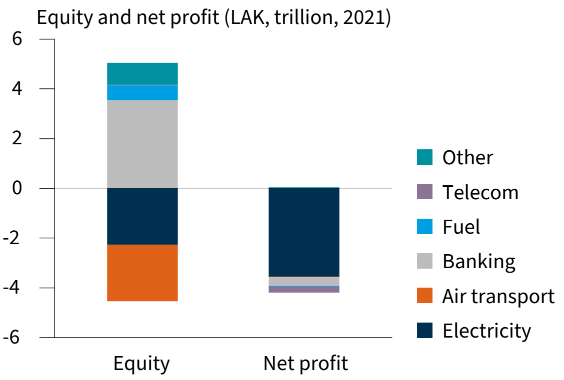
19 According to the 2022 Public Debt Bulletin, arrears are not yet considered to be PPG debt under the Public Debt Management Law. These only become a debt if (and when) settled through a bond issuance. The government reported completed public works (relating to capital investment) of about 33,000 billion kip, of which 23,000 billion kip is currently undergoing an audit and inspection process by relevant agencies. The amounts verified and approved as arrears might be cleared through a combination of domestic bond issuances and future budget allocations.

of bank loans, followed by repayments to multilateral creditors. While the specific terms of the deferrals are not known, they had accumulated to about $2 billion by the end of 2023 (nearly 16 percent of GDP). Domestic debt repayments also rose slightly, as more treasury bills matured. Total debt service (i.e. principal and interest on domestic and external debt after deferrals) account for almost 40 percent of domestic revenue. Without deferrals, total debt service would be as much as domestic revenues in 2023.

Laos relies increasingly on the domestic financial market to meet debt service obligations, as access to international capital markets has been further restricted. The August 2023 bond issuance in Thailand was significantly undersubscribed, while in September the TRIS ratings agency downgraded Laos' sovereign credit rating to BB+ with a negative outlook. This implies that further bond issuances in Thailand are unlikely to take place before 2026.[20] The government turned to the domestic capital market to finance the deficit and repay its debts, issuing Thai baht bonds (for the first time), US dollar bonds, and kip bonds on the Lao Securities Exchange (amounting to 3 billion baht, $100 million, and 3 trillion kip). Baht bonds were fully subscribed (mostly by banks) and mostly with a one-year maturity, while the subscription of US dollar bonds was lower. Claims on the government by banks also increased (see the Financial Sector section).

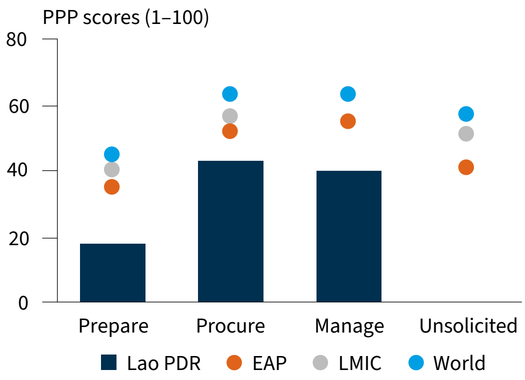
The operations of state-owned enterprises and public-private partnerships pose fiscal risks through additional contingent liabilities. In 2022, SOE debt accounted for 49 percent of total external PPG debt (in the form of on-lending and public guarantees), of which 42 percent was held by SOEs in the power sector (namely, EDL and Lao State Holding Enterprise). According to the World Bank's 2023 Public Finance Review, the electricity sector has negative equity and generates large losses (Figure 23). Kip depreciation has significantly affected EDL, which earns revenues in kip but has to repay its debt and import power in foreign currencies.[21] While PPPs have brought some benefits to the local economy, they are often complex arrangements that can create significant fiscal costs and risks. The 2023 Debt Sustainability Analysis indicates that public debt is most sensitive to a contingent liabilities shock. Meanwhile, the regulatory quality for Lao PPPs is relatively low compared to in peer countries, especially in terms of project preparation (Figure 24).

Figure 23. SOE performance by sectors



Sources: World Bank Public Finance Review, 2023

Figure 24. PPP regulatory quality



Source: World Bank Public Finance Review, 2023

[20] The downgrade reflected a significant deterioration in the serviceability of public debt, weak economic fundamentals, and the kip depreciation. Total bond stock was $1.1 billion in 2022, of which the majority were issued through the Thai bond market. The government planned to issue 3.6 billion Thai baht in the Thai bond market in August 2023 (about $100 million), but actual subscription was only 22 percent of the planned amount.

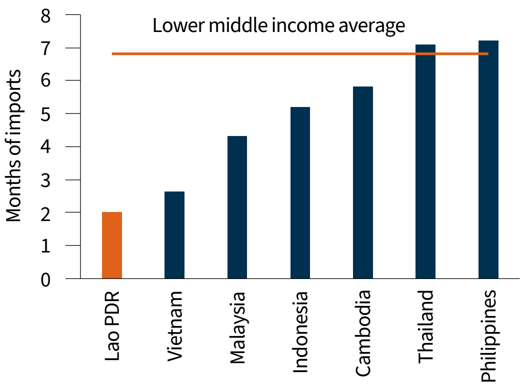
[21] In February 2024, 24 percent of EDL-GEN's shares was transferred from Phongsubthavy Group (PGL) back to EDL. The transfer could have implications on the PPG debt level. https://edlgen.com.la/uploads/lsx/2024/en/Transfer_of_24_EDL-Gen_Shares_from_Phongsubthavy_Group_(PGL)_to_Electricite_Du_Laos_(EDL)_(EN).pdf (Accessed 13 March, 2024).

2.6 External Sector

Persistent external imbalances continue to pressure the exchange rate.

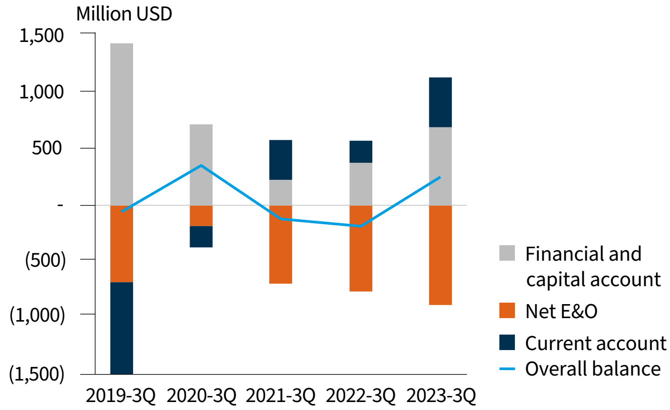
External imbalances persist, leading to foreign currency demand-supply mismatches, which put pressure on the exchange rate. The official balance of payments data shows net foreign exchange inflows of about $250 million in the first three quarters of 2023, supported by a strong current account surplus and large investment inflows (Figure 26). Official data underreports imports and does not reflect unremitted export proceeds (Figure 27). Imports of goods were underreported by almost 30 percent in 2023 when compared to trade partners' mirror trade data.[22]

Figure 25. Reserves in months of imports



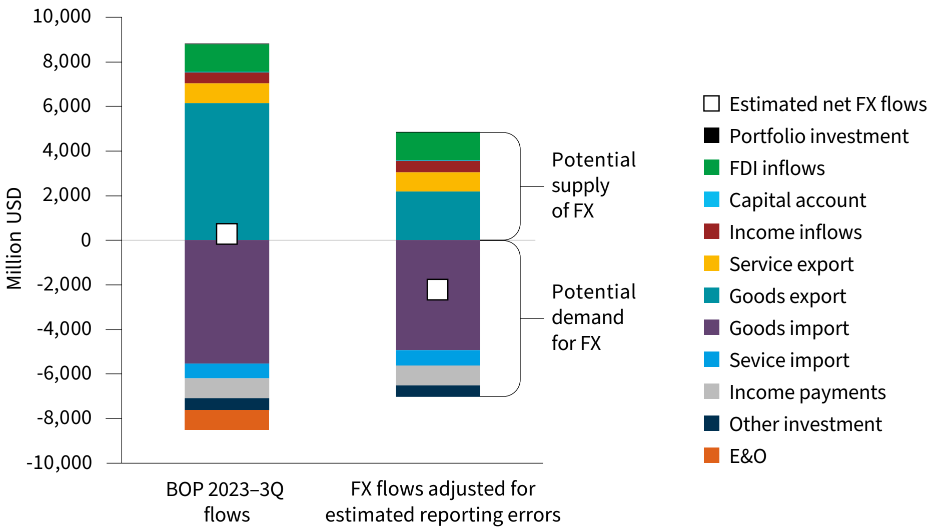
Source: World Bank World Development Indicators.

Figure 26. Balance of payments



Source: Bank of the Lao PDR.

Figure 27. Indicative scenario of potential foreign exchange supply-demand imbalances on balance of payments by end of Q3 2023



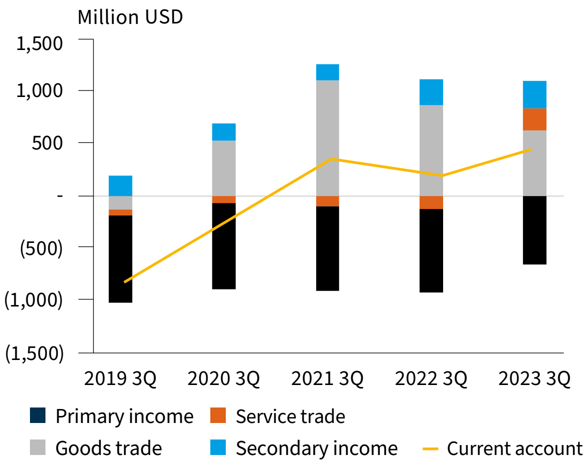
Source: World Bank staff assessment based on data from the Bank of the Lao PDR, Ministry of Finance, and other authorities and trade partners.

Note: FX denotes foreign currencies. Estimates of net foreign exchange flows are based on the following assumptions: (i) 41 percent of officially reported export proceeds are remitted back into the economy in three quarters of 2023; (ii) goods imports adjusted for underreported imports and imports already financed by investment projects, (iii) the underreporting of imports and unremitted exports are captured in errors and omissions, and (iv) errors and omissions are negligible after these adjustments.

[22] Official statistics is based on Ministry of Industry and Commerce https://laotradestat.moic.gov.la/estat/home (Accessed 13 March, 2024). Trade partner statistics are based on the International Monetary Fund Direction of Trade Statistics.

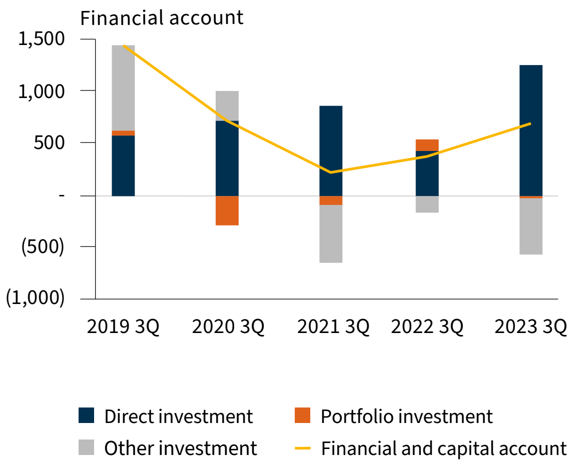
At the same time, actual foreign exchange inflows relating to Laos' exports accounted for less than half of the total recorded official export values. In practice, these two factors contributed to limited foreign exchange inflows, which result in foreign exchange shortages in the economy, against a backdrop of high foreign exchange demand for imports, external debt repayments, and business profit repatriation.[23] This, in turn, continues to put pressure on the exchange rate, fuel the parallel market, and feed into domestic inflation.

Figure 28. Current account balance



Source: Bank of the Lao PDR.

Figure 29. Financial account balance



Source: Bank of the Lao PDR.
Note: positive value denotes an inflow

Official statistics show an improved current account balance owing to an improved trade surplus and lower net income payments abroad. According to official data, the net trade surplus in goods and services reached $830 million in the first three quarters of 2023, a 12 percent year-on-year increase, supported by strong service exports (tourism and transport), which partly compensated for a lower trade surplus for goods. Goods export growth was marginal in the first three quarters, as higher mining exports offset declines in electricity, manufacturing, and agriculture exports. Imports grew by 3 percent year-on-year in the first three quarters of 2023, driven by machinery equipment, vehicles and parts, and construction materials. Net primary income payments abroad declined by 18 percent in the same period due to continued interest expense deferrals on public debt and lower interest payments and profit repatriation by the private sector. Net secondary income slightly increased, partly supported by remittances and personal transfers. However, the current account is estimated to be in deficit when taking into account underreported imports as reflected in trade partners' data and unremitted export proceeds.

Official statistics mask persistent external imbalances in foreign currency flows, which put pressure on the exchange rate. Actual foreign exchange inflows related to exports are still much lower than those presented in official data because only 41 percent of total export proceeds were repatriated by the third quarter of 2023. This contributed to limited foreign exchange liquidity in the economy. Most unremitted export proceeds are reflected in large errors and omissions in the balance of payments statistics. In addition, net primary income payments abroad remained high despite the recent decline. In practice, the current account balance remains significantly negative on a cashflow basis. Coupled with low foreign exchange reserves, even after the currency swap, foreign liquidity shortages place significant pressure on the exchange rate.

Financial account net inflows increased in the first three quarters of 2023, owing to higher direct investment. Net inflow to the financial account reached almost $700 million by the end of the third quarter of 2023, almost double the level in the previous year, as strong foreign direct investment offset net outflows on other

[23] The underreporting of imports and unremitted exports are captured in errors and omissions in the balance of payments.

investments (payment outflows from the banking sector). Foreign direct investment rose to $1.3 billion, mainly linked to the power and mining sectors.[24] China accounts for more than 80 percent of total FDI. In the meantime, 'other investment' showed net outflows, partly due to principal repayments on external debt and outward flows by foreign bank branches.

The balance of payments improved in the first three quarters, while errors and omissions suggest large unremitted flows of foreign exchange. The overall balance of payments recorded a surplus of almost $250 million in the first three quarters of 2023, supported by current account and financial account surpluses, according to the official data. However, large errors and omissions reflect large unremitted inflows, mostly related to the limited repatriation of export proceeds and informal trade. The Bank of the Lao PDR's foreign assets were revised upward (from July 2020 onward) to include access to foreign currency through a swap arrangement with the People's Bank of China. This was reported to amount to $900 million equivalent.[25] Gross official reserves (including the currency swap) were $1.7 billion in December 2023, up from $1.5 billion in 2022. Nevertheless, the reserves buffer remains thin, covering two months of goods and services imports (Figure 25). Excluding the swap arrangement, net reserves are estimated to cover less than one month of imports of goods and services.

2.7 Exchange Rate

Structural imbalances continue to put pressure on the exchange rate.

Persistent depreciation pressures result from limited foreign exchange liquidity and exhibit seasonality correlated with debt service payments. The supply of foreign currency is limited in the context of high import demand and debt repayments, putting pressure on the exchange rate. In 2023, a sharp depreciation took place until October, after which the pace of depreciation moderated. This partly reflected the timing of foreign exchange demand to meet external debt repayments. In 2023, the annual average official kip/US dollar exchange rate weakened by 31 percent year-on-year, while the average parallel rate depreciated by 27 percent. The premium — the difference between the official and parallel exchange rates— reached 13 percent in March 2024. Depreciation pressures have been much stronger than in regional peers, implying that domestic factors are the key drivers of depreciation. Large public debt service repayments seem to be correlated with stronger depreciation pressures, suggesting some seasonality in exchange rate movements (stronger between March and September).

Banks are prioritizing foreign exchange allocations for customer debt repayments and essential imports. Commercial banks are rationing the supply of foreign exchange by prioritizing customers (for example the public sector) and imports of essential goods, particularly fuel and medical goods. It is reported that only about half of foreign exchange needs can be met by banks, while the rest is likely met by the parallel market. A high premium creates distortions that contribute to inefficient allocation of resources and opportunities for rent-seeking behavior.

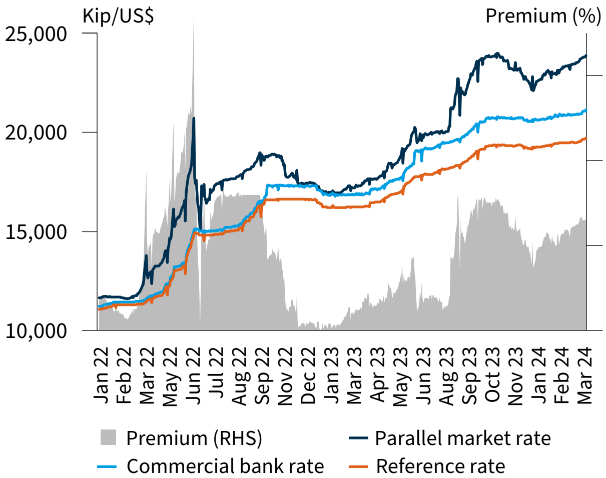
The Bank of the Lao PDR has tightened monetary policy to taper depreciation pressures, but this only had a temporary impact. The central bank issued short-term bonds in kip to the general public, increased policy interest rates and reserve requirements, and provided short-term deposits to banks. The stock of BOL bonds rose by 42 percent in December 2023 compared to a year earlier. Savings bonds helped stabilize the exchange rate for only a short period. In addition, the policy rate was raised from 3.1 to 6.5 percent in October 2022, then to 7.5 percent in February 2023, and recently to 8.5 percent in March 2024. However, these have not translated into significant changes in commercial bank rates due to weak monetary transmission mechanisms. In September 2023, the reserve requirement ratios for kip and foreign currencies were raised to 8 and 10 percent from 5.5 and 8 percent respectively.

[24] A large proportion of FDI inflows is associated with a financial transaction related to the EDL-T joint venture, which has not generated real sector activity from the National Accounts perspective.

[25] The PBoC announced a three-year swap agreement with the BOL for RMB6 billion (about US$900 million) in May 2020. According to the 2023 IMF Article IV, if the disbursements are tied to specific uses (e.g., facilitate trade with China), then they should not be counted as reserves.

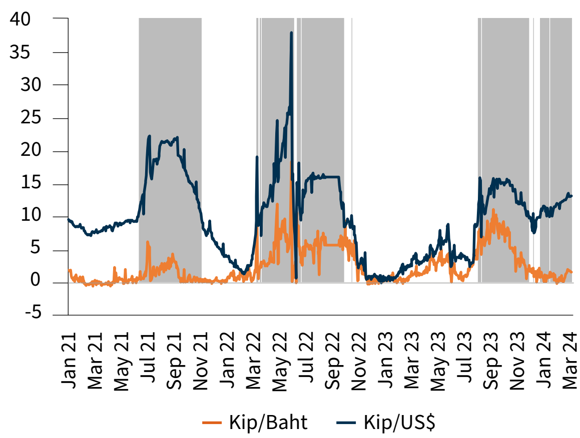
To improve foreign exchange liquidity, the authorities have tightened foreign exchange management by introducing repatriation and conversion requirements. Exchange rate controls were introduced in 2022 by placing daily limits on foreign exchange transactions at banks, and by closing all exchange bureaus. These measures had only a temporary impact on the exchange rate and have stimulated the parallel market. To improve foreign exchange liquidity, in 2023, the authorities started to require exporters to bring back their export receipts through the Lao banking system. In March 2024, more specific repatriation and conversion requirements were introduced with defined ratios for repatriation and conversion to kip for each sector namely, power, mining, agriculture, services and other sectors. In the meantime, banks have also been instructed to sell a certain amount to the BOL and prioritize the available supply of foreign exchange to priority goods.[26] While these administrative measures may draw more foreign exchange receipts into the banking system in the short-term, they could be counter-productive in the medium-term by affecting business confidence (in terms of access to foreign exchange) or leading to misreporting. Moreover, they may conflict with some concession agreements, thus limiting their effectiveness.

Figure 30. Kip/US$ exchange rates



Source: World Bank staff calculation based on Bank of the Lao PDR data.

Figure 31. Parallel exchange rate premium



Source: World Bank staff calculation based on Bank of the Lao PDR data.

2.8 Financial Sector

The financial sector continues to face vulnerabilities with increasing exposure to public sector debt.

Credit growth, of which half was due to valuation effects, has moderated in kip terms. Total credit growth in kip (to the private sector, SOEs, and government) decelerated to 29 percent year-on-year in December 2023, largely due to slower lending and depreciation. Total domestic credit remained at 75 percent of GDP during 2022–2023 (Figure 32). Commercial bank lending to the economy (i.e. to private and state-owned enterprises) also expanded at a slower pace to 29 percent year-on-year, from 47 percent in the previous period, reflecting more prudent bank lending, lower loan demand due to economic difficulties, and a slower pace of depreciation, which affected the valuation of foreign currency loans. The depreciation effect is estimated to account for about half of the changes in commercial bank credit in December 2023.[27] Commercial bank lending to the economy mostly comprises lending to the industry, commerce, services, and construction sectors (Figure 33).

Credit to the government picked up in 2023 as the authorities turned to domestic financing sources. The contribution of BOL lending to the government rose from early 2022 until mid-2023, owing to recapitalization

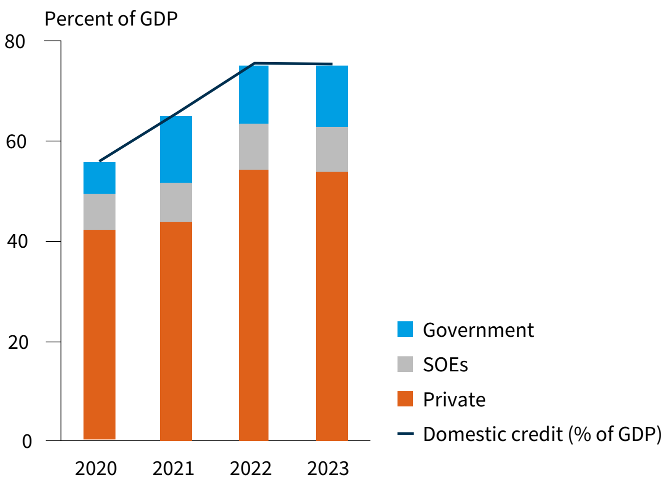
[26] The Bank of Lao PDR issued an Agreement on Managing Foreign Currency Revenues from Exporting Goods and Services No. 333, dated 7 March 2023. Available at https://www.bol.gov.la/fileupload/11-03-2024_1710124218.pdf (Accessed 13 March, 2024).

[27] The impact of depreciation is calculated by estimating the differences between the actual kip-equivalent credit outstanding in December and the estimated kip-equivalent credit outstanding based on a constant exchange rate at the January 2021 level.

bonds for the restructuring of two banks (Lao Development Bank and Agriculture Promotion Bank), government bond holdings, and deficit financing. Commercial bank claims on the government rose notably in the last quarter of 2023. Total lending to the government rose to 12 percent of GDP in the year to December 2023, of which two-thirds was from commercial banks and the remainder from the BOL (Figure 34).

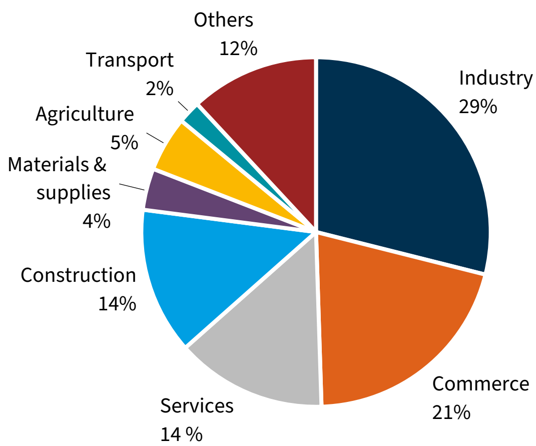
Depreciation encouraged more dollarization. As the kip loses its value against other currencies, holding foreign currencies has been preferred as a hedge against depreciation. This contributed to an increase in the ratio of foreign currency deposits to broad money, from 63 percent in December 2022 to 69 percent in December 2023. On the balance sheets of commercial banks, foreign currency deposits accounted for 71 percent of total deposits by the end of 2023 (Figure 35).

Figure 32. Domestic credit [28]



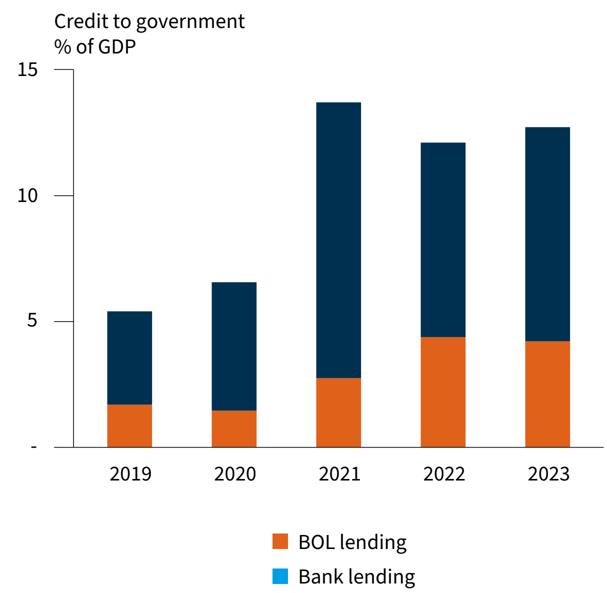
Source: World Bank staff estimate based on Bank of the Lao PDR data.

Figure 33. Bank credit by sectors (2023) (Percent share in commercial bank credit)



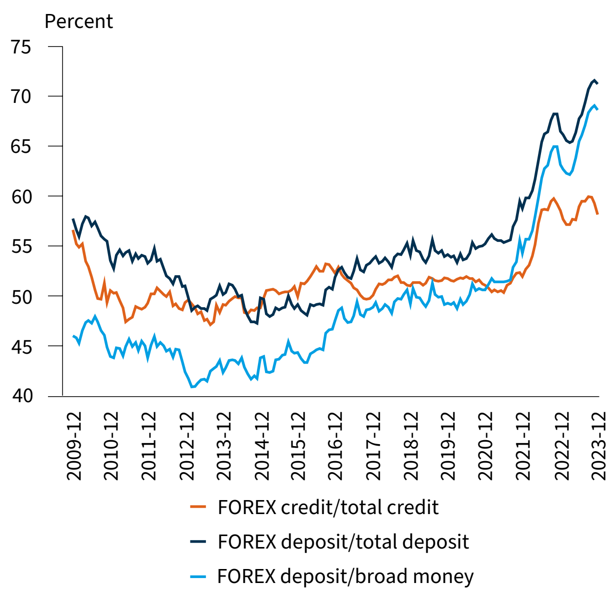
Source: Bank of the Lao PDR.

Figure 34. Exposure to government borrowing



Sources: World Bank staff estimate based on Bank of the Lao PDR data.

Figure 35. Foreign currency ratios



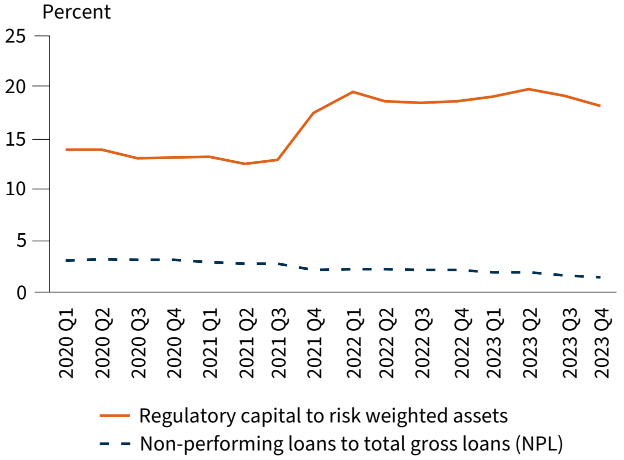
Sources: Bank of the Lao PDR.

[28] Domestic credit includes total credit from the Bank of the Lao PDR and commercial banks to the government, state-owned enterprises and the private sector.

Financial sector vulnerabilities persist, although performance varies across banks. While the aggregate capital adequacy ratio (CAR) for the banking system seems comparable to that found in regional peers, it masks significant variation across banks. The CAR ratio increased to 19 percent in Q3-2023, reflecting the restructuring of two former state-owned banks and capital increases at bank branches as per regulatory requirements. However, the largest commercial bank (BCEL), which accounted for 35 percent of banking sector assets in 2023, still had a CAR lower than the regulatory minimum of 8 percent.[29]

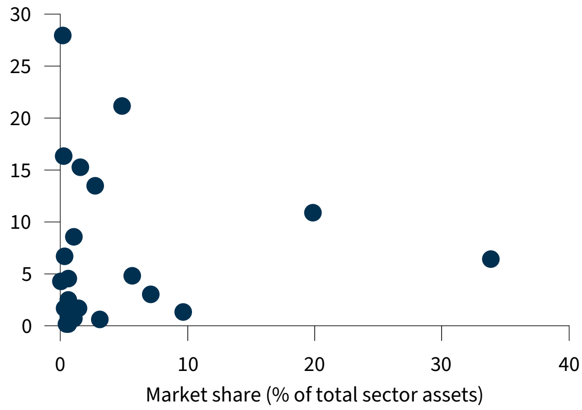
Reported non-performing loan (NPL) ratios has declined but the continuation of regulatory forbearance policies mask vulnerabilities. The decline of the average NPL ratio was largely due to the issuance of triangle bonds to pay for government arrears, some NPL write-offs, and credit growth. While some banks are gradually withdrawing forbearance measures on a case-by-case basis, the prolonged implementation of these measures (such as the freeze on loan classifications) and the practice of ever-greening loans) could undermine credit discipline and present risks to the financial system. Several banks have significant accrued interest receivables (Figure 37).[30] Sector profitability remains low despite an uptick in the third quarter of 2023 after the two bank restructurings. In this context, it is important to balance the phasing out of forbearance measures and the health of bank balance sheets to minimize vulnerabilities in the financial sector and support economic recovery.

Figure 36. Financial soundness indicators



Source: Bank of the Lao PDR and BCEL financial reports.

Figure 37. Accrued interest to loans ratios (Each dot represents a different bank, percent)



Source: World Bank staff calculations based on bank financial reports as of Q3-2023.

Note: Each dot represents a different bank and percent.

[29] According to Interim Financial Information for the three-month period of Quarter 2 ended 31 June 2023. See https://www.bcel.com.la/bcel/bcelweb-datas/financial-info/quarter-rpt-unaudited/en/bcel_web_file_49_14797606d4f8dce5a9cffeb1fc6902cf.pdf (Accessed 13 March, 2024).

[30] This accrual interest to loans ratio provides an indication of how much interest has been accounted but is yet to be collected by the bank. It aims to highlight cases of deterioration of the loan portfolio that might not be captured solely by looking into non-performing loans. They reflect forbearance practices like those observed during the pandemic (COVID-19) where payments were deferred but accrual of interest continued.

3. Outlook and Risks

Box 1. Key assumptions for the baseline

The outlook assumes a gradual economic recovery, while macroeconomic stability remains a challenge. The outlook assumes that debt service deferrals accumulated during 2020–2023 will not be paid during the forecast period. The baseline, however, assumes that external debt service obligations will be fully met from 2024 onward, supported by SOE repayments relating to on-lending and domestically issued bonds. Pressure from debt service obligations is expected to persist unless there is a comprehensive and favorable agreement on debt restructuring with the main creditors. Debt pressure will likely compromise public spending on human capital to support long-term growth and increase pressure on domestic financing sources, which could crowd out credit to the private sector. Tourism and logistics will continue to recover, supported by external demand. Oil and food price rises are expected to moderate, but structural constraints should maintain pressure on the exchange rate and hence inflation. Revenue collection will gradually improve as revenue-enhancing measures are implemented and tax compliance improves. As debt service obligations remain high, expenditure controls will achieve a primary surplus in the medium term.

Real GDP is projected to grow by 4 percent in 2024, but potential growth will remain constrained by structural challenges. This outlook assumes no new debt service deferrals in 2024 and beyond, while deferrals accumulated during 2020–2023 would continue to be deferred. The gradual resumption of tourism, particularly from the region, and improved transport and logistic services, will help stimulate economic activity. The industry sector can benefit from investments in the power sector and some special economic zones. Meanwhile, the mining sector will be constrained in the medium-term due to depleting resources and weak compliance with social and environmental obligations. However, economic growth will remain below pre-COVID levels, weighed down by structural imbalances, limited investments in human capital, labor shortages and as reforms progress slowly. The labor issue is expected to further constrain potential growth if depreciation keeps inflation high and wage differentials between Laos and Thailand widen.

Inflation is expected to remain above 20 percent, reflecting persistent depreciation pressures. Lingering structural imbalances will continue to put pressure on exchange rates, particularly on the parallel market. Depreciation is expected to continue at a more moderate pace than in 2022–2023. Global prices for key import products are projected to ease slightly in 2024, but depreciation pressures will continue to feed domestic inflation with a stronger correlation. High inflation will dampen real incomes and consumption and add to business costs. These factors could further incentivize labor out-migration and self-employment, which are already major constraints for labor-intensive manufacturing and hospitality firms.

Household real incomes will continue to be affected by rising living costs amid expected two-digit inflation. Inflation has eroded purchasing power, thereby depleting household savings and reducing household consumption and human capital spending. This has placed many households at risk of falling into poverty. High food costs will continue to undermine food security, particularly for the urban poor. While there are some signs of labor market adjustments through rising self-employment and increasing outward migration, slow progress in poverty reduction will likely continue. On a vulnerable recovery path, per capita income growth is likely to remain below pre-pandemic and regional peer levels in the medium term.

Fiscal space will remain constrained by elevated debt service levels, which would hamper development spending. Revenue is expected to gradually increase with economic activity and tax reforms, such as the returning the VAT rate to 10 percent, excise rate increases for some products, implementation of the land tax law, and tax administration improvements (for example, modernization and improved compliance). Total expenditure is expected to rise, especially due to higher interest payment obligations. Interest payments due in 2024 are assumed to be paid in full. Non-interest expenditure will remain relatively contained. The baseline assumes a primary surplus in the next few years, but the fiscal deficit is expected to increase, reflecting full interest payments. Public spending on human capital is expected to remain restrained.

Total financing needs are projected to increase in 2024. Gross financing needs are projected to reach almost 9 percent of GDP in 2024, as the expected primary surplus will partly offset higher debt repayments from 2024. External debt service obligations average $1.3 billion per year over 2024–2027 (about 9 percent of GDP annually), keeping total public financing needs high. The financing strategy includes domestic revenues in foreign currencies, SOE on-lending repayments,[31] and domestically issued bonds (in kip and foreign exchange) to meet these needs in 2024. As access to international capital markets is likely to remain constrained in 2025, when external debt service obligations peak, pressure on domestic funding sources is expected to intensify. Box 2 illustrates reform scenarios to help bring debt levels back to a sustainable level.

Box 2. Illustrative reform scenarios

No external and domestic shocks, limited access to external borrowing

Debt Restructuring: Yes / Revenue Reforms: No

3. Debt Relief

- Reduce substantive amount of debt stock from 2024 onward.

↓

- Lower external financing needs, debt ratios decline faster than baseline over the next decade (but still above sustainability thresholds).
- Reduced pressure on domestic financing sources and foreign exchange liquidity.
- Risk of renewed fiscal erosion in the absence of sustainable revenue reforms.

Debt Restructuring: Yes / Revenue Reforms: Yes

4. Ideal

- Some combination of revenue reforms and debt relief scenarios.

↓

- Lower financing needs; debt ratios become sustainable within the next decade.
- More sustainable financing sources from revenues.
- Enable reprioritization of development spending.

Debt Restructuring: No / Revenue Reforms: No

1. Baseline

- Gradual growth recovery.
- Small primary surplus.
- Business-as-usual.

↓

- Debt ratios decline only slowly and remain unsustainable for an extended period.
- High financing needs, which compromise development spending.
- Persistent external imbalances and pressure on the exchange rate and domestic financing sources.

Debt Restructuring: No / Revenue Reforms: Yes

2. Revenue Reforms

- VAT rate returns to 10% in 2024.
- Profit tax exemptions are phased out.
- Excise taxes are reformed (rates and restructure).

↓

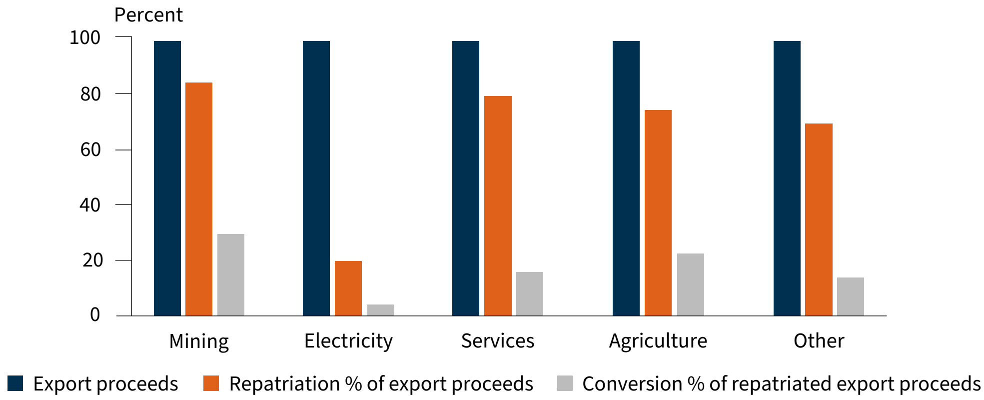
- Debt ratios decline faster than the baseline, but remain unsustainable over the next decade.
- Tax base is expanded, fiscal space increases for priority spending.
- Improved foreign exchange liquidity due to foreign exchange revenue inflows, less pressure on the exchange rate.

Source: World Bank staff assessment based on inputs from the Lao Economic Monitor November 2023..

[31] A large portion of these repayments will come to the Ministry of Finance (MOF) as EDL repayments on its on-lending from MOF. The financial source will come from a portion of an upfront payment on an EDL-Transmission project from China Southern Power Grid (CSG). In March 2021, a Concession Agreement (CA) was signed between EDL and CSG to form a joint venture company, EDL-Transmission. The CA was recently effective. https://documents1.worldbank.org/curated/en/099095503162319718/pdf/P178477020d41807087b204ff78 e5bd5eb.pdf (Accessed 13 March, 2024).

External imbalances are expected to persist in the absence of critical structural and fiscal reforms. The current account deficit is expected to remain at around 3–4 percent of GDP as improvements in exports and remittances are offset by higher import demand and interest payments abroad. The implementation of repatriation and conversion requirements may bring more foreign currencies into the economy in the short-term, but this may be counter-productive in the medium-term if it affects business confidence in terms of access to foreign exchange or leads to misreporting (Figure 38). Net reserve adequacy, excluding the foreign currency swap, is expected to remain relatively thin (covering less than two months of imports).

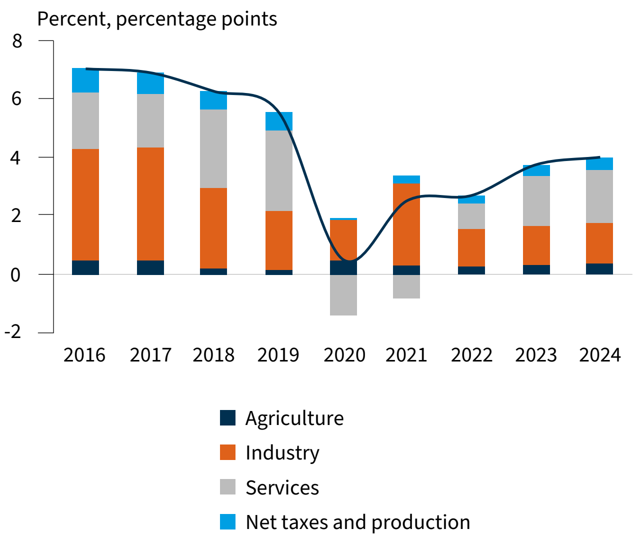
Figure 38. Repatriation and conversion requirements ratios



Source: World bank staff calculations of ratios, based on BOL's regulation.

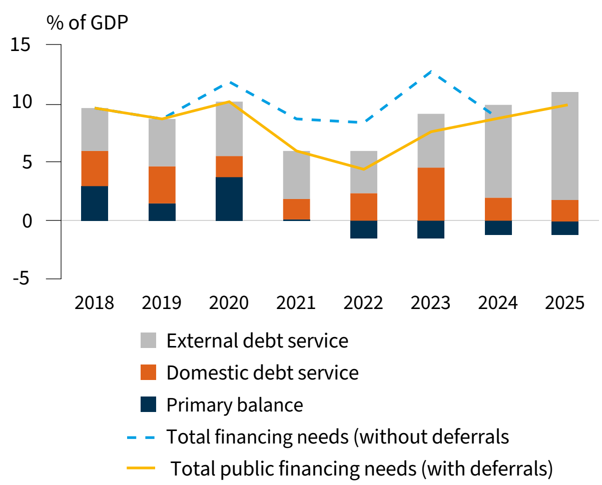
The outlook is subject to significant domestic and external uncertainty. Structural imbalances associated with limited foreign reserves, high public debt, and a high import bill will continue to put pressure on the kip and thus inflation. Labor shortages undermine labor-intensive sectors. Subdued global and regional economic growth would weaken external demand. Domestic risks include tight foreign exchange liquidity to refinance external debt (particularly given limited access to international capital markets), slow progress with structural reforms and deteriorating balance sheets in some large banks. The outcome of ongoing debt negotiations will have significant implications for both debt sustainability and macroeconomic stability.

Figure 39. GDP growth



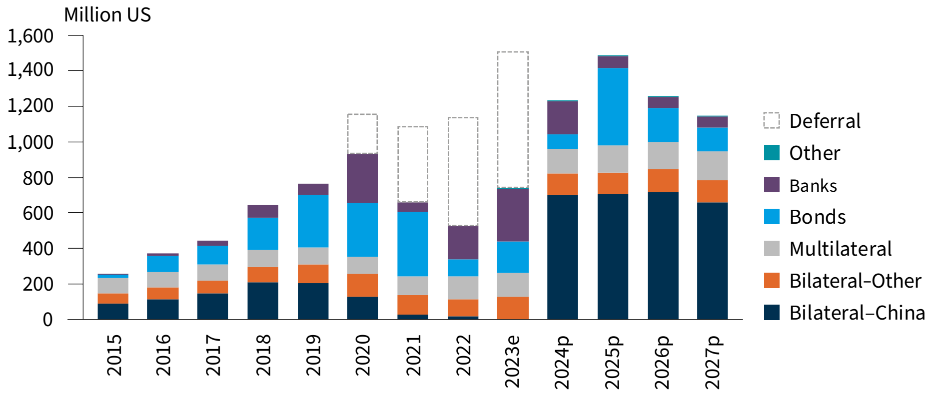
Source: Lao statistics bureau, World Bank staff estimate.

Figure 40. Public financing needs



Source: Ministry of Finance, World Bank staff estimate.

Figure 41. External debt service (US$ million)



Source: World Bank calculations, based on MOF data.

4. Policy Options

Restoring macroeconomic stability requires a strong commitment to five critical reform areas: (i) implementing the new VAT rate of 10 percent, curbing tax exemptions, and reforming excise taxes (for example, tobacco, alcohol, and fuel) to boost spending on the social sectors; (ii) expediting ongoing debt renegotiations and strengthening public debt management; (iii) managing risks from contingent liabilities related to state-owned enterprises and public-private partnerships; (iv) strengthening financial sector stability; and (v) improving the business environment to promote investment and exports. In addition, improving the availability, timeliness, and quality of data is essential for informing evidence-based policy making. Specific reforms are as follows:

- **Implement the return of the value-added tax (VAT) rate to 10 percent and reduce VAT exemptions**
  In March 2024, the government decided to reverse the VAT rate from 7 percent back to 10 percent, effective by Presidential Ordinance No. 003. This reform is expected to be implemented in the second quarter of 2024, which could generate almost 1 percent of GDP per year in additional revenues. This should be coupled with compliance incentives and improving the VAT refund mechanisms to reduce business costs. Reducing VAT exemptions could also help boost revenues. Part of the additional revenue should be used to support the most vulnerable households through a targeted cash-transfer program, thereby mitigating the impact on poor households. Reducing and streamlining VAT exemptions, such as those for large-scale activities, would help widen the tax base and thus support domestic revenue mobilization. In the medium-term, VAT compliance can be improved through the full implementation of TaxRIS, improved tax services, and institutional and technical capacity building.

- **Review tax incentives and eliminate exemptions**
  The corporate income tax (CIT) gap (i.e., the difference between potential and actual CIT revenue) is estimated at 87 percent, implying large foregone revenues from tax exemptions and weak enforcement. Although profit tax collection in the first three quarters of 2023 rose by 10 percent year-on-year, it declined after adjusting for inflation and is still well below regional benchmarks. Large capital-intensive investments in energy, mining and transport infrastructure have benefited from generous tax incentives, which deprive the country of vital fiscal revenues and foreign exchange. International evidence shows that tax incentives are not a key determinant of foreign investment in the natural resources sector, since these are location-specific. To better link incentives to investment, it is crucial to replace the current profit-based tax incentive system (based on tax holidays and reduced rates) with a cost-based tax incentive system (based on accelerated depreciation and investment tax credits). It is also critical to rationalize incentive policies and reduce discretion when granting incentives. The ongoing revision of the Investment Promotion Law, led by the Ministry of Planning and Investment, presents an opportunity to review fiscal incentive policies (especially the elimination of tax exemptions) and strengthen the role of the Ministry of Finance. In addition, improved monitoring of tax incentives and compliance would support more effective assessment of their effectiveness.

- **Reform excise tax structures and rates**
  Recent reductions in fuel excise rates have produced large foregone revenues, estimated at almost $140 million or 1 percent of GDP based on fuel imports in 2023. Reversing those fuel excise cuts could generate about 1.2 percent of GDP in additional revenue, based on the fuel import amounts recorded in 2023. Reviewing the tax structure for tobacco, alcoholic beverages, and sugar-sweetened beverages could raise revenue and have positive health outcomes. The recently increased excise rates on cigarettes, tobacco, and beverages (in effect since January 2024) will likely have a minimal impact on tax revenue in real terms, largely because of existing concessional rates and exemptions under existing agreements. Key reforms include ending all tax privileges the tobacco industry receives under a 2001 investment license agreement, reforming tax structures, increasing excise rates to international standards and linking tax rates to inflation and income growth. These reforms could generate almost 1 percent of GDP revenues within one year. These additional revenues could go toward health care, education and infrastructure.

- **Reprioritize spending toward the social sectors**
  Improving the allocative efficiency of public expenditures is particularly important given existing fiscal constraints. Development spending has been declining as a share of GDP due to pressures from low revenues and rising debt service payments (see Figure 20 and the Thematic Chapter).[32] This has undermined public service delivery. Reprioritizing public spending toward education, health, and social protection is critical to building human capital and thus improving economic growth prospects in the medium term. It would also make public spending more pro-poor, thus helping reduce poverty and inequality (see the discussion in the Thematic Chapter in the Lao Economic Monitor May 2023, Public Finance Review and Fiscal Incidence Analysis 2023, Public Expenditure and Institutional Review for Education 2023).

- **Expedite ongoing debt renegotiations and strengthen public debt management to restore debt sustainability**
  The current debt service schedule is not achievable without further compromising spending on critical public services. Restructuring public debt is the basis for securing debt sustainability, macroeconomic stability, and accelerating economic growth. Bringing ongoing bilateral debt negotiations to a successful conclusion in a substantive and transparent way would ease debt pressures, create fiscal space for growth-enhancing expenditures, and improve market confidence. In addition, it is critical to strengthen public debt management by revising the Public Debt Management Law to strengthen the role of the Ministry of Finance, formulate a credible debt management strategy, and support capacity development.

- **Assess and manage contingent liabilities**
  Implementing a robust framework to assess, approve, monitor, and manage fiscal costs and risks related to public-private partnerships (PPP) would help limit the accumulation of direct and contingent liabilities. Governments can choose to finance public assets and services through a PPP model, which may enable investments that otherwise could not be undertaken. However, PPPs can be more costly than traditional procurement if they are not carefully designed and managed, especially regarding risk- and cost-sharing arrangements. Therefore, it is necessary to enhance the current legal and regulatory framework. The planned upgrade of the decree on PPPs into a law is an opportunity to incorporate good practice principles into the legal framework. This should be coupled with strengthening institutional capacity to prepare, procure, and manage PPP projects.

- **Enhance bank supervision and operationalize emergency arrangements**
  Protracted economic vulnerabilities and regulatory forbearance measures negatively impact bank balance sheets and threaten the sector's ability to support the economic recovery and public sector financing needs. The rapid depreciation of the Lao kip places additional stress on the highly dollarized banking sector. A bank failure would have extensive economic repercussions. Therefore, strengthening the deposit protection fund and employing an early warning system would help manage vulnerabilities in the sector. It is critical that

[32] See World Bank. 2024. Public Finance Review – Forging Ahead: Restoring Stability & Boosting Prosperity. Available at https://www.worldbank.org/en/events/2023/12/03/public-finance-review-fiscal-incidence-analysis-lao-pdr-2023#:~:text=The%20Public%20Finance%20Review%20finds,enterprises%20and%20public%2Dprivate%20p artnerships. World Bank. 2024. https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099011624014536949/p179015156451402e1b1051b2fa3d7674fb.

regulations and procedures are put in place as the government may need to mobilize liquidity facilities and emergency liquidity assistance arrangements at very short notice. An amendment to the Law on Commercial Banks, which was approved in principle by the National Assembly in July 2023, requires banks to increase capital, restrict foreign exchange operations, and strengthen dissolution and bankruptcy processes.

- **Improve the business environment**
  Creating a conducive business environment by implementing electronic business registration processes, streamlining the operating licensing regime, and reducing and simplifying entry conditions would facilitate the entry and expansion of both domestic and foreign firms. This would, in turn, contribute to improving productivity and economic growth. In addition, trade facilitation reform would benefit from streamlining non-tariff measures (NTMs) and promoting electronic customs clearance to facilitate trade. Such NTMs act as export restrictions. Improved transparency, harmonization, and mutual recognition of NTMs among trading partners would facilitate trade flows.

Annex A. Key macroeconomic indicators

	2020	2021	2022	2023	2024	2025
				Est.	Projections	
Real Economy	Percent change year-on-year					
Real GDP growth	0.5	2.5	2.7	3.7	4.0	4.1
Agriculture	3.2	2.3	1.6	2.4	2.7	3.1
Industry	4.0	7.6	3.3	2.6	3.6	3.4
Services	-3.5	-2.1	2.5	5.5	4.8	5.2
Inflation (period average)	5.1	3.8	22.7	31.2	21.2	14.7
Fiscal Account	Percent of GDP					
Revenues	12.7	14.9	14.7	15.0	15.6	15.7
Domestic Revenues	11.2	12.9	13.8	14.2	14.8	14.9
Taxes	9.2	10.2	11.5	12.2	12.6	12.7
Non-tax	2.0	2.7	2.3	2.0	2.2	2.2
Grants	1.5	2.0	0.9	0.8	0.8	0.8
Expenditures	18.0	16.2	14.9	15.2	17.0	17.2
Current expenditure	11.5	11.0	10.5	10.1	11.3	11.5
Wages	6.2	6.0	5.4	5.1	5.2	5.3
Non-wage, non interest expenditure	3.8	3.8	3.4	3.3	3.5	3.6
Interest payment	1.5	1.2	1.8	1.7	2.6	2.6
Current expenditure without interest	10.0	9.8	8.8	8.4	8.7	8.9
Capital expenditure	6.5	5.2	4.4	5.1	5.7	5.7
Domestic finance	2.0	2.0	1.8	1.5	1.9	1.9
Foreign finance	4.5	3.2	2.6	3.5	3.8	3.8
Fiscal balance	-5.2	-1.3	-0.2	-0.2	-1.4	-1.5
Primary balance	-3.7	-0.1	1.5	1.5	1.2	1.1
Selected Monetary Accounts	Percent change year-on-year					
Broad money	16.3	24.0	36.9	33.3		
Credit to the economy	4.3	11.5	47.9	27.8		
Balance of Payments	Percent of GDP					
Current Account Balance	-5.9	-2.9	-1.7	-1.3	-2.9	-3.5
Trade balance	-1.3	1.3	3.6	3.4	2.6	1.3
Primary income: net	-5.9	-5.7	-7.6	-6.5	-7.2	-6.6
Secondary income: net	1.4	1.6	2.3	1.8	1.8	1.8
Gross international reserves	1,821	1,737	1,480	1,677	1,776	1,868
Months of G&S import cover	3.2	2.8	1.9	2.0	2.1	2.1
Memorandum items						
Nominal GDP (Billion kip)	171,705	182,584	217,108	280,416	339,707	394,120

Sources: Lao Statistics Bureau, Ministry of Finance, Bank of Lao PDR, Ministry of Industry and Commerce, World Bank Staff estimate, and projections based on inputs from Lao Authorities and trade partners' data as of 30 March 2024.

PART B

Education for Growth and development

Part B: Education for Growth and Development

Strong human capital and education are fundamental to putting Laos on a sustainable high-growth trajectory.

Human capital constitutes 57.2 percent of the total wealth of Lao PDR and 63.3 percent of the total wealth of nations globally.[33] Relative to natural capital and produced capital, human capital — measured as the expected future earnings of the entire labor force — is the largest asset group across all income groups across all countries.[34] This is also true for Laos (Figure 42). Nearly all countries that were low-income in 1995 but grew to become middle-income by 2018 had accelerated investment in accumulating human capital between 1995 and 2018. For instance, human capital per capita more than doubled from 1995 to 2018 in the current middle-income countries classified as low-income in 1995. Similar to its neighbors, Laos too increased its investment in human capital over this period, with human capital per capita tripling from US$ 8,442 in 1996 to US$ 23,693 in 2018 (Figure 43).[35] Worldwide, the share of human capital in total wealth increases steadily with the level of development, with high-income countries having more human capital than their lower-income counterparts. Growth, then, is about building human capital.

Figure 42. Composition of capital in Lao PDR

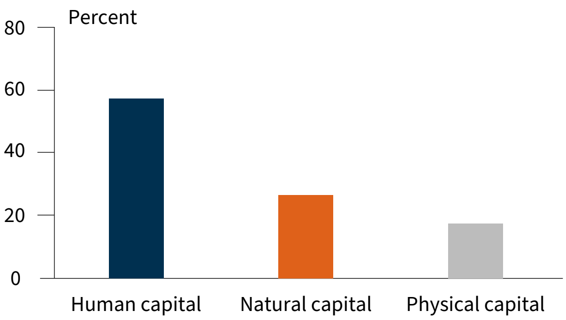
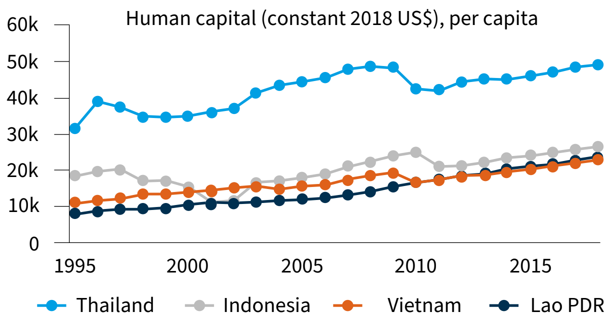


Figure 43. Trends in human capital per capita



Source: The Changing Wealth of Nations 2021. Managing Assets for the Future. World Bank.

Education — and the skills it confers — is fundamental to improving human capital and, thereby, individual well-being and economic growth. Learning, not just schooling, is essential for building skills. A significant body of research shows that education confers a broad range of economic benefits on low and middle-income economies By raising human capital, education increases people's incomes and employability, improves economic mobility, and enables families to escape poverty (Figure 44). Higher levels of education and skills also raise firm productivity, increasing technology adoption and enabling innovation in manufacturing.[36] Learning starts early, highlighting the criticality of high-quality early childhood education. Children's brains develop more rapidly in early childhood than in any other period in life. Neural connections are being formed at the rate of million connections per second — a rate never to be repeated. This is a critical window of opportunity to influence development through nutrition, early stimulation and protection from violence and other harm.[37] Laos has rightly focussed on universalizing early childhood education. The COVID-19 pandemic, however, worsened already low investments in education in Laos, with extended school closures further compromising what children learn at this crucial juncture.

[33] Lange, G.M., Wodon, Q., Carey, K. (Eds.). (2018). The changing wealth of nations 2018: Building a sustainable future. World Bank Publications.

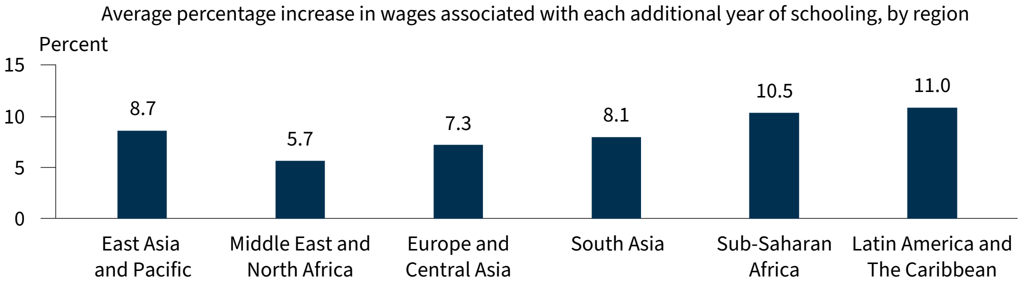
[34] This definition of human capital complements the definition of human capital in the Human Capital Project but is narrower as it compares human capital with natural and produced capital in a financial wealth accounting framework. Using such a framework necessitates that the focus remains on the monetary estimates of wealth associated with human capital.

[35] Lange, G.M., Wodon, Q., Carey, K. (Eds.). (2018). The changing wealth of nations 2018: Building a sustainable future. World Bank Publications.

[36] Fleisher, B.M., Hu, Y., Li, H., Kim, S. (2011). Economic transition, higher education and worker productivity in China. Journal of Development Economics, 94(1): 86-94. https://doi.org/10.1016/j.jdeveco.2010.01.001

[37] Gertler, P., Heckman, J., Pinto,R., Zanolini, A., Vermeerch, C., Walker, S., Chang, S.M., Grantham-McGregor. S. (2018). Labor Market Returns to an Early Childhood Stimulation Intervention in Jamaica. Science, 344(6187): 998–1001, Available at https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4574862 (accessed 14 March, 2024).

Figure 44. Education is consistently associated with higher earnings

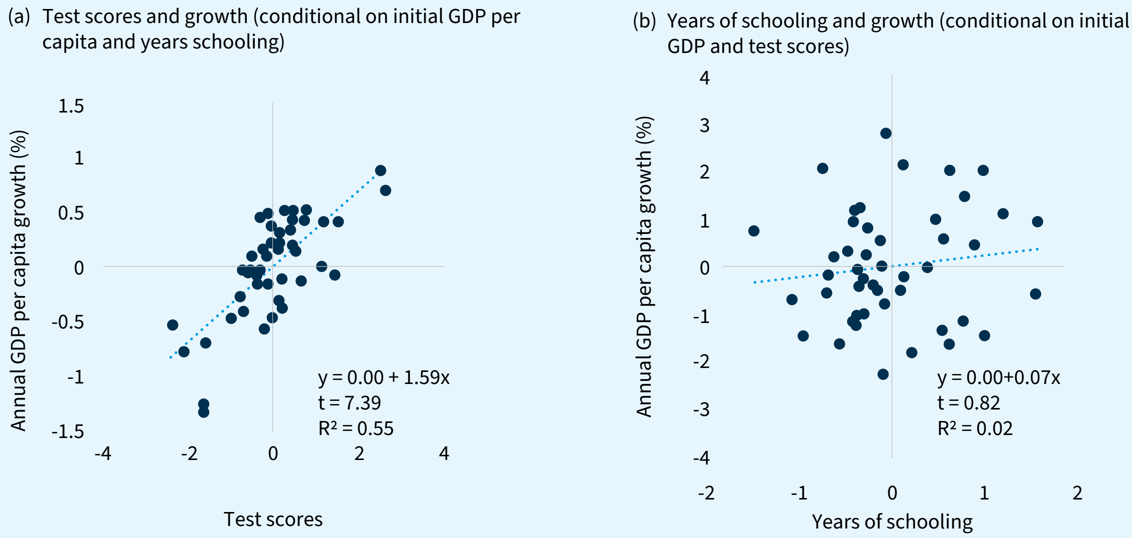


Source: Psacharopoulos, G., Patrinos, H.A. 2018. Returns to investment in education: A decennial review of the global literature. Policy Research Working Paper 8402. World Bank Group.

Box 3. Greater learning boosts productivity and growth

Cross-country analysis reveals a robust relationship between cognitive skills conferred by education and economic growth. This is a substantially stronger relationship than between years of schooling and growth (see Hanushek and Woessman 2015). The main channel through which education raises growth is through its impact on learning and skills development (Figure 45).

Figure 45. Learning and skills development contributes to higher growth, not years of schooling

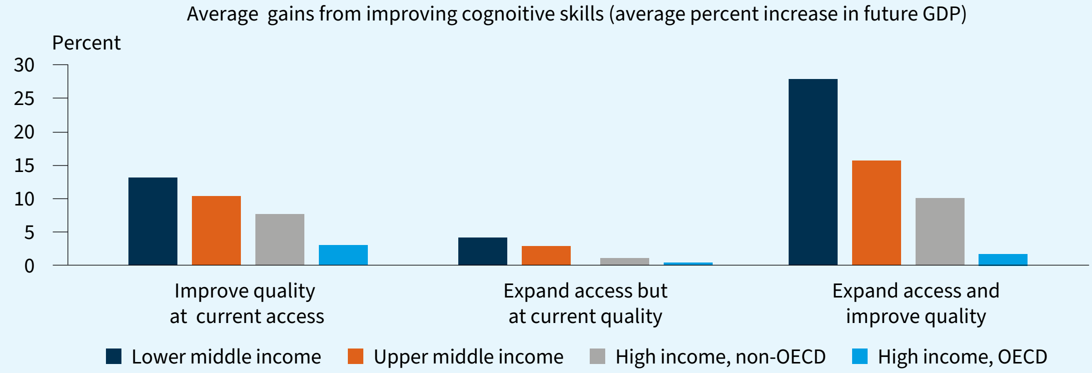


Source: World Bank 2018 data available at http://bit.do/WDR2018-Fig_1-5 (accessed 15 March, 2024).

Note: Annual average per capita growth in GDP, 1970–2015, conditional on test scores, years of schooling completed, and initial GDP per capita.

Raising education quality and thus learning outcomes will be critical for nations to reap the productivity and growth benefits of education in developing East Asia and the Pacific. Hanushek and Woessmann (2021) argue that strengthening basic skills has a substantially larger effect on growth than does achieving universal access to education in middle- and high-income economies, although increasing both skills and access has the largest effects (Figure 46). Simulations using the World Bank's long-term growth model (LTGM) produce similar findings for developing East Asia and Pacific countries (Mendes, Pennings and Fiuratti 2022). While the effects of raising education quality on growth in any given year are modest, they are persistent and therefore long-run cumulative effects are substantial. The LTGM highlights that it will become increasingly difficult for countries to compensate for the low quality of education with higher investment in physical capital given that the required higher investment rates tend to reduce the marginal productivity of capital over time.

Figure 46. Increasing education quality and basic skills is particularly important for growth

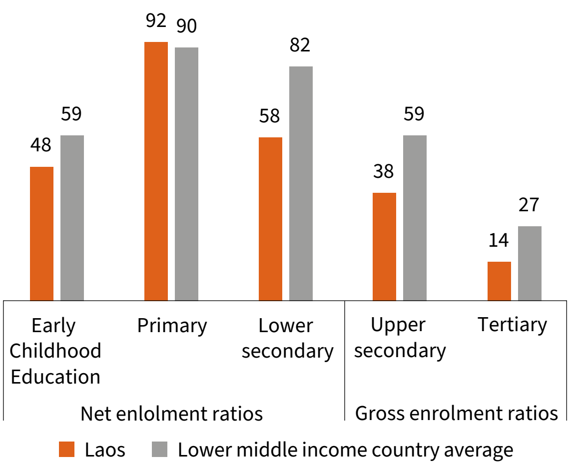


Source: Eric A. Hanushek, E.A., Woessmann, L. (2021). Education and Economic Growth. Oxford Research Encyclopedias Finance And Economics https://doi.org/10.1093/acrefore/9780190625979.013.651

Primary education is no longer universal in Laos as an increasing number of students are dropping out and those who stay are not learning.

High enrolment rates in primary education have started to erode while enrolments in other levels lag measurably behind benchmarks (Figure 47). Following an increase in enrolment over most of the past decade, levels have fallen across all subsectors in recent years (Figure 48). Primary education enrollment has steadily declined in the past decade, while early childhood education admissions only declined in 2021–2022, following a decade of gradual increases. Lower and upper secondary enrolments started to decline between 2016 and 2018, with the trend continuing since the COVID-19 pandemic. Lower new enrolments (vis-à-vis a slightly growing population aged 3–18 years) is especially worrying, suggesting that parents do not see the immediate benefit of education in the current economic situation (see Household section). A second driver has been falling repetition rates due to an automatic promotion policy with no evidence of improved learning outcomes.

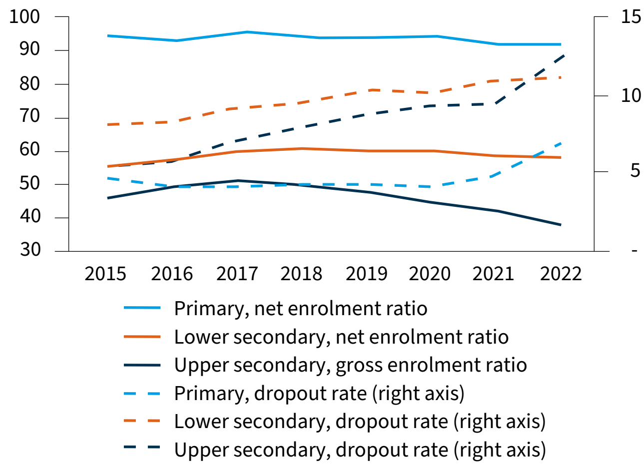
Figure 47. Enrolment ratios in Laos and lower middle-income country benchmark, 2022



Source: World Bank staff estimates based on Laos Annual School Census, UN Population Data, and UNESCO UIS.

Note: Benchmark data for early childhood, primary, and lower secondary education from 2021 and for tertiary education from 2020.

Figure 48. Enrolment ratios and dropout ratios in Laos, 2015–2022



Source: World Bank staff estimates based on Laos Annual School Census, UN Population Data, and UNESCO UIS.

Note: Data from the Annual School Census collected at the end of each calendar year (i.e., 2022 data collected in late 2022 for school year 2022/23).

Consistent with the data on falling enrolment rates, data on dropout rates tell a similar story. The Annual School Census data shows that dropout rates have measurably increased across education levels, growing from 4.1 to 6.9 percent in primary, 9.2 to 11.2 percent in lower secondary, and 7.1 to 12.5 percent in upper secondary between school years 2017–2018 and 2022–2023. According to the latest survey data, drop-out rates for primary-age children appear to be even higher, rising from an already high 10.4 to 13.8 percent between 2017 and 2023.[38] The reasons for the increase in drop-out rates from primary school appear to be driven mainly by the impact of the economic crisis on household incomes. Unless remedied quickly, these children will lose their opportunity to learn and thrive.

Schooling by itself, however, provides only limited gains; students must learn and build skills. Laos' performance here is dismal. Increasing enrolment in education improves economic growth, but only by a small amount compared with improving the quality of education and learning outcomes. As Box 3 shows, cognitive skills — the ability to acquire and use knowledge, problem-solving, reasoning and decision-making skills — are what matter for economic growth. In Laos, learning poverty (the share of 10-year-olds who cannot read an age-appropriate text) is worryingly high. Most recently, the Lao Social Indicator Survey III (2023) found that only 16.2 percent of children attending grades 2 and 3 could complete three foundational reading tasks successfully and only 19.7 percent of children attending grades 2 and 3 could complete four foundation numeracy tasks successfully. A 2019 Grade 5 learning outcomes assessment showed Lao children lagging behind those in neighboring East Asian countries, with the majority of Lao Grade 5 students still performing at the level expected in the early years of primary education for math, reading and writing.[39] In this study, 98 percent of the students tested were not proficient in reading. Assessments in other grades paint a similar picture. The 2017 Assessment of Student Learning Outcomes (ASLO) found 38 percent of Grade 3 students had failed to master Lao language skills from Grades 1 and 2.

Since learning is cumulative, weak foundational skills in early life mean low skills in later life. Poor learning outcomes persist into the higher grades, as further education is challenging when students do not acquire foundational skills. Looking at more advanced skills, the 2019 Grade 9 ASLO revealed that most secondary students scored below expected levels across subjects, with pronounced knowledge gaps in mathematics and science. It is difficult (and costly) to address the problem when children are older.[40] It is far more cost-effective to ensure that schools perform adequately from the start, underscoring the need to remedy schooling failures as early as possible.

Equity concerns remain high, with education inputs and learning outcomes especially low among ethnic communities. In the ASLO studies mentioned previously, Lao-Tai consistently outperform Mon-Khmer and 'other' groups and children from the wealthiest quintile outperform the poorest quintile on all three test subjects. For instance, in the SEAPLM 2019 study, nearly 66 percent of "other" ethnicities were in the lowest reading band, while 38.7 percent of Lao Tai were in that band. Similarly, 70 percent of children in the poorest quintile were at the lowest proficiency band in reading, whereas only 22.1 percent of children from the richest quintile were in that band. These patterns are replicated in other tested areas.

Students learn when they have well-trained teachers — the foundation of successful school systems.

Globally, teachers are the single-most important school-based input explaining student learning gains.

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38 In more detail, the Lao Social Indicator Survey II from 2017 found that 10.4 percent of children in the primary age group were not attending primary education, with 8.2 percent not attending any education. The Lao Social Indicator Survey III from 2023 shows that 13.8 percent of primary-age children are not in school in Laos.

39 The Southeast Asia Primary Learning Metrics (SEA-PLM) 2019 assessed learning outcomes of Grade 5 students in six southeast Asian countries. No Lao students assessed (0 percent) performed at the highest bands for mathematics, while 33% were in the lowest band, indicating a mathematical proficiency equivalent to that expected in the first years of primary school. For reading, only 2.5% of Lao students performed at the highest band, indicating they have acquired literacy skills generally expected of children at the end of primary; while 50% were in the lowest band, indicating a reading proficiency equivalent to that expected in the first years of primary school. www.unicef.org/eap/reports/sea-plm-2019-main-regional-report.

40 Lavy, V. and Schlosser, A. (2005). Targeted remedial education for underperforming teenagers: Costs and benefits. Journal of Labor Economics, 23(4): 839–874. Lavy, V., Kott, A., Rachkovski, G., (2022). Does remedial education in late childhood pay off after all? Long-run consequences for university schooling, labor market outcomes, and intergenerational mobility. Journal of Labor Economics, 40(1): 239–282.

Once children get to school, no single factor is as critical as the quality of their teachers.[41] Research shows that going from a low-performing to a high-performing teacher increases student learning dramatically. In Vietnam, differences in teaching quality mean that, over a three-year period, an average second-grade student can end up in either the top third or the bottom third of the class, depending on whether they benefit from a high- or low-quality teacher during that time.

In Laos, teachers lack content knowledge as well as pedagogical skills. Approximately 85 percent of teachers report having completed pre-service training and vocational degrees. Training is provided by eight teacher training colleges.[42] However, classrooms across Laos have teachers with little mastery of the subjects they teach and poor teaching skills. When teacher mastery was assessed in a recent study, only 2.4 percent of Grade 4 teachers were proficient in Grade 4 mathematics and Lao language.[43] Regarding pedagogy, SEA PLM 2019 found that teachers are generally confident in their teaching ability according to a range of self-reported indicators. At least 80 percent reported being “Quite confident” or “Very confident” in tasks like group work, discovery learning, problem-solving, role playing, lecturing and collaborative teaching. Teachers were less confident in the areas of multi-age teaching, ICT-related teaching, and differentiated instruction. However, the teacher-reported confidence levels were generally not significantly correlated with student test scores.[44] This is an important finding suggesting that many Lao teachers are overestimating their pedagogical skills. In summary, teachers do not appear to have received the kind of pre-service training that would prepare them for class success.

In-service training has been largely funded by development partners and is ad hoc. Both financial and human resource constraints mean that such professional development fails to incorporate good principles, such as continuous support, practice, and being linked to incentives. For instance, the current training in the new curriculum provides teachers only six days of initial training in language and two days in mathematics. Follow-up coaching is meant to be provided through a system of pedagogic advisers, but their availability and skills are inadequate. Only 25 percent of teachers reported receiving feedback in the last 12 months.[45]

There is mixed evidence on the extent of unauthorized teacher absenteeism across schools in Laos, but where it does exist, it has a major impact on learning. Different sources of data provide different views on the magnitude of the teacher absenteeism problem, with some sources suggesting it is a bigger problem than other sources. For instance, the 2018 SABER survey reported that, on average, teachers are absent from school 16 percent of the time and absent in the classroom 25 percent of the time, which is significant but relatively lower than comparator countries. A somewhat different picture is presented by the SEA-PLM survey which found that 60 percent of Grade 5 students reported that teachers were “sometimes” or “often” late or absent from the classroom (MoES and UNICEF 2022).[46] Data show a broad range of reasons for teacher absence, with nonapproved absences being negligible.[47] Regardless of the extent of teacher absenteeism, its impact on student learning is negative. According to the SEA-PLM 2019 survey, student test scores were significantly lower when they reported that the teacher was often late or absent. This points toward the need for improved teacher monitoring to address the issue and prevent it from becoming an even bigger problem.

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[41] Béteille, T., Evans, D.K. . Successful teachers, successful students: Recruiting and supporting society’s most crucial profession. World Bank Group. Available at https://documents1.worldbank.org/curated/en/235831548858735497/Successful-Teachers-Successful-Students-Recruiting-and-Supporting-Society-s-Most-Crucial-Profession.pdf (accessed 15 April, 2024). Bruns, B. Luque, J. (2015). Great Teachers : How to raise student learning in Latin America and the Caribbean. Washington, D.C.: The World Bank Group. Available at https://www.worldbank.org/content/dam/Worldbank/document/LAC/Great_Teachers-How_to_Raise_Student_Learning-Barbara-Bruns-Advance%20Edition.pdf (accessed 15 April, 2024).

[42] The eight teacher training colleges are located in eight provinces. The remaining nine provinces are served by nine teacher training centers, which are not authorized to offer degrees.

[43] Demas, A., Naka, E., Mason, J.A. (2018). The Learning Crisis in Lao PDR: Challenges and Policy Priorities. World Bank Group Lao PDR and Ministry of Educ.ation and Sports.

[44] Lao PDR Ministry of Education and Sports and UNICEF Lao PDR. (2022). SEA-PLM 2019 Regional Assessment Results: Lao PDR Country Report.

[45] Demas, A., Naka, E., Mason, J.A. (2018). The Learning Crisis in Lao PDR: Challenges and Policy Priorities. World Bank Group Lao PDR and Ministry of Educ.ation and Sports.

[46] SEA-PLM also found that 40 percent of students report having fewer than two lessons per week in the subjects of Lao language and mathematics despite the curriculum requiring eight and four lessons respectively, an outcome possibly linked to teacher absenteeism.

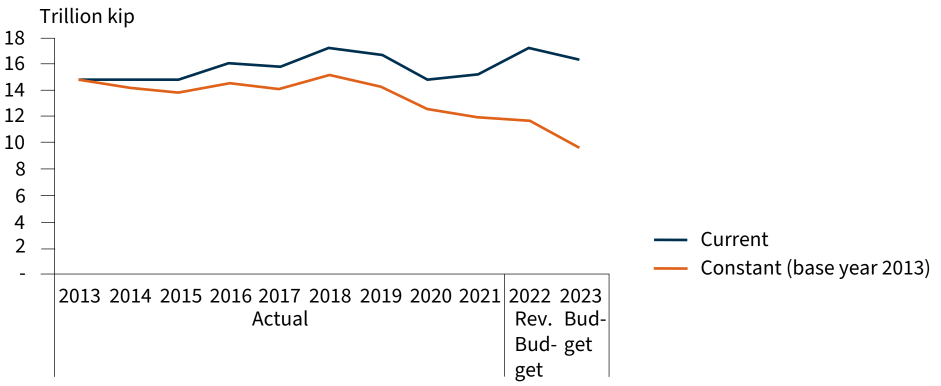
[47] The most reported reasons for teacher absenteeism include ‘maternity leave’ (24 percent), ‘sick leave’ (15 percent) and ‘field trip’ (13 percent) with only 2 percent of cases reported to be unapproved (World Bank 2018).

Adequate financing is essential for schools to hire the teachers they need

Adequate financing, both in total and in composition, is essential for schools to offer the teaching quality pupils need. Teacher salaries are the main cost in education service delivery. Sufficient financing needs to be available for salaries and allowances to attract and retain qualified teachers at all locations. Equally important is financing for mostly in-service teacher training to systematically address knowledge and methodological weaknesses of the teaching workforce and upskill teachers as curricula and teaching practices evolve. Lastly, principals and teachers need ongoing support and oversight to enhance teaching quality and teacher performance. This requires sufficient overall sector financing and an adequate mix of resources used for the compensation of employees and for training, support, and monitoring activities. Complementary funding for school operations and learning environment improvements, including teaching and learning materials and adequate and equipped school facilities, is also needed to enable teachers to provide quality teaching services.

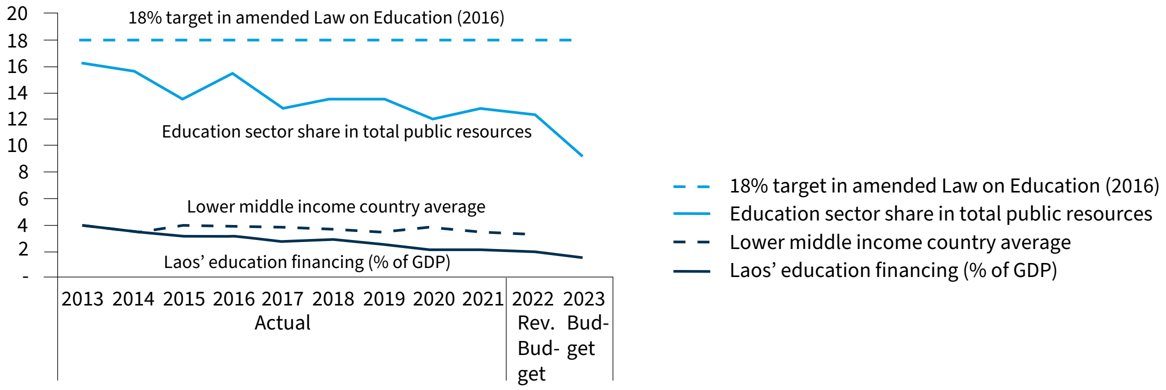
The combined impacts of deprioritization and fiscal consolidation have caused an unprecedented decline in public education funding, which is now very low. Following a substantial increase from kip 2.1 trillion to kip 3.6 trillion in 2013, public education financing continued to increase in nominal terms until 2018, peaking at kip 4.3 trillion (Figure 50).[48] Since then, it has fluctuated around kip 4.0 trillion. In real terms, actual expenditure

Figure 49. Public education spending in Laos



Sources: State Budgets, State Budget Implementation Reports, World Bank staff estimates.

Figure 50. Public education spending in Laos and lower middle-income country benchmark



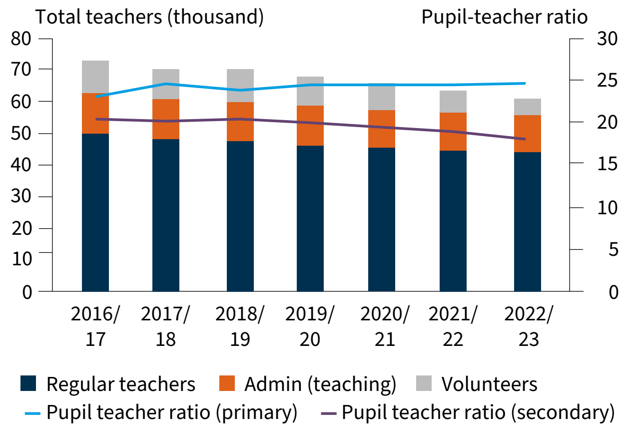
Sources: Amended Law on Education 2016, State Budgets, State Budget Implementation Reports, World Bank staff estimates.

[48] Public education financing includes estimates of social security contributions that are budgeted and accounted for separately in the State Budget Plan and Implementation Reports.

has fallen by 22 percent between the 2018 peak and the latest available expenditure data from 2021. Budget allocations have since seen a further decline of 22 percent, according to the latest publicly available State Budget Plan for 2023. This amounts to a sharp reduction of 38 percent between 2013 actual spending and the 2023 budget allocation. In contrast, total public resources have seen an 8 percent increase in real terms over the same period, reflecting a gradual de-prioritization of the education sector over the past decade, illustrated by its share in total public resources falling from 16.1 percent in 2013 to 9.3 percent in the State Budget Plan for 2023 (Figure 50, 51 and Fiscal Development section in Part A). This is only half of the 18 percent share of the target set in the amended Law on Education (2016). Relative to GDP, public education financing fell from 4.0 percent of GDP in 2013 to 1.5 percent in the 2023 State Budget Plan, reflecting a reduction from a spending level above the lower middle-income country average to one of the lowest spending levels globally (Figure 51). Public In parallel, household spending has been squeezed by ongoing economic difficulties, including COVID-19 restrictions in 2020–2021 and ongoing high inflation. Over half of all households had reduced education spending as of December 2022, with the share increasing to almost 70 percent among the bottom 40 percent of the income distribution).

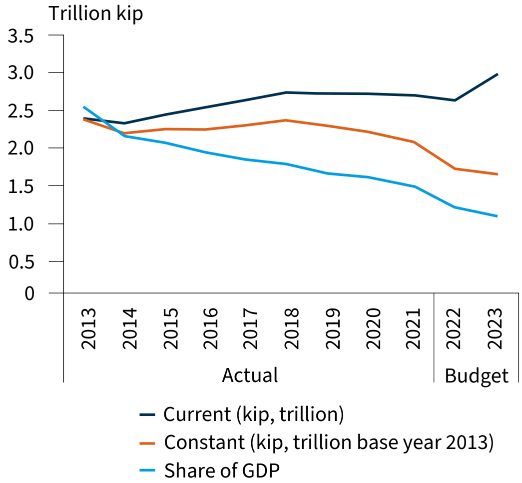
The real decline in sector funding has been partly driven by the downsizing of the teaching workforce, which continues to fall and is now insufficient to accommodate targeted increases in future enrollment. From a peak in the school year 2016–2017, civil service teacher numbers have fallen by 10 percent through to 2022–2023, according to MoES data. This decline has been intentional and implemented through significantly reduced annual quotas for new staff positions as part of the government's civil service downsizing policy (Box 4). It has led to a net outflow of an annual average of over 1,100 teachers over the five school years up to 2022–2023. Concurrently, volunteer numbers, which have been critical in bridging teacher gaps at the school level, have been falling in rapidly increasing numbers as future civil service position prospects dwindled under the downsizing policy. Aggregate pupil-teacher ratios (PTRs) in primary and secondary education have remained adequate (Figure 52) This is mainly due to the concurrent (and worrying) fall in enrolments. PTRs are expected to worsen if teacher workforce downsizing continues and/or recent enrolment trends reverse as targeted in government education policy and plans. The shrinking teaching workforce has led to falling wage bill spending in real terms and relative to GDP. Average compensation per civil servant in the education sector saw a 31 percent real decline between 2013 and 2023 — falling from slightly below kip 30 million to around kip 20 million in 2013 terms — with inflation outpacing nominal salary increases. These risks put additional pressure on teaching quality, as the highest qualified and best performing teachers and graduates potentially have the best employment alternatives. While government direction to pay volunteers and explore contracting arrangements to bridge gaps from civil service teacher attrition has been issued through Decree No. 09 of 2023, this has not been reflected in increasing budget allocations to date.

Figure 51. Total teachers and pupil-teacher ratios in primary and secondary education



Sources: Ministry of Education and Sports. Annual School Census; World Bank staff estimates.

Figure 52. Education sector wage bill

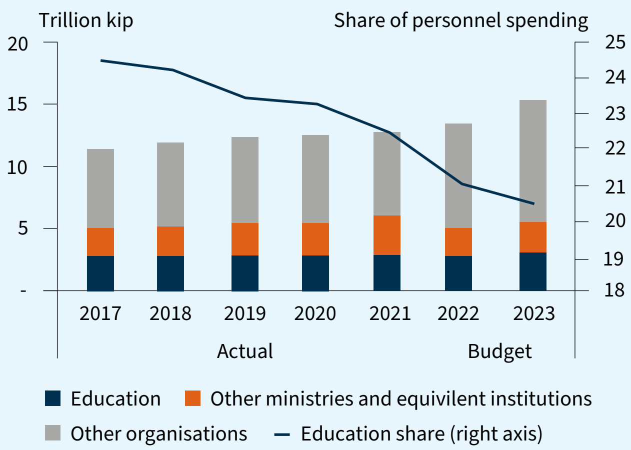


Sources: State Budgets, State Budget Implementation Reports, World Bank staff estimates.

Box 4. The civil service downsizing policy

The government's approach to public sector downsizing jeopardizes the country's growth potential while failing to meet fiscal consolidation targets. In 2018, the government announced its intention to downsize the civil service to a more affordable level by reducing annual quotas to levels significantly below annual attrition levels. The Prime Minister's Executive Order No. 3 of 2018 set a target of 1.8 percent civil servants as a share of the country's population by 2023–2024. However, the policy only applies to line ministries and equivalent agencies, not to non-civilian government institutions, which employed 129,100 people (vis-à-vis 182,500 civil servants), according to 2016 data (World Bank 2018). While nominal civil service wage bill spending has followed a downward trend since 2019, total public sector personnel spending has increased in category of "Other organization" (Figure 53). This resulted in education's share of total personnel spending gradually declining from 24.5 percent in 2017 to 19.8 percent in the 2022 State Budget, with potential long-term repercussions for human capital and Laos' growth potential. In response, the downsizing policy should be expanded to the entire public sector, reflect the functional needs of sectors, and be implemented through medium-term workforce planning.

Figure 53. Personnel spending by sector



Sources: State Budgets, State Budget Implementation Reports, World Bank staff estimates.

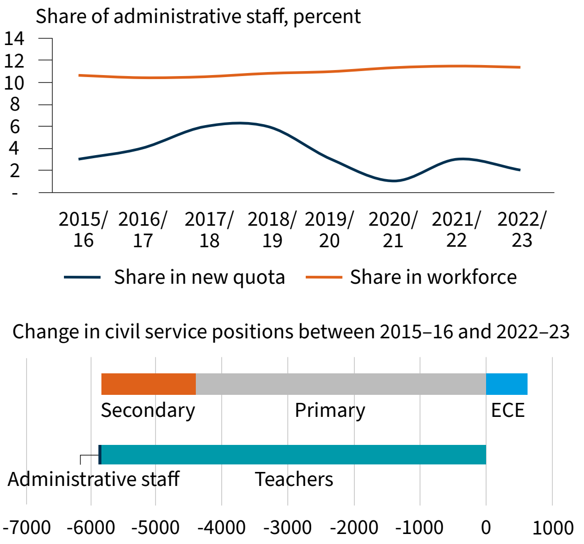
Note: Social security payments that are centrally allocated and accounted for have been reallocated to sectors based on estimates

The share of the workforce in administration and secondary education is too high relative to that in primary education. While the education administrative workforce shrank by 7 percent from a peak of 87,283 in school year 2015–2016 to 81,422 in 2022–2023, the reduction was fully absorbed by the teaching workforce. As a result, the share of administrative staff increased from 10.6 to 11.3 percent over the period (Figure 54 top). Anecdotal evidence suggests that one driver of this development could be teachers moving into administrative roles within the education sector, which is supported by data on new quota allocations that show a small and decreasing share being allocated for administrative functions that cannot explain the stable administration workforce. Reversing this trend could free up a substantial number of teaching positions. For example, around 1,100 positions of administration staff could be reduced to 10 percent of the workforce. Within the teaching workforce, primary education had to absorb the major share of attrition, with secondary education less affected and (positively) early childhood education gaining staff positions (Figure 54 bottom). The bias towards secondary at the expense of primary education may be partly driven by the sector's commitment to deploy specialty teachers in lower secondary education, which contributes to teacher deficits at school level in both primary and lower secondary education despite low and falling enrolment and acceptable pupil-teacher ratios (Figure 51 above).

There continues to be an imbalance in the distribution of teachers across schools, which is an inefficient and inequitable allocation of scarce resources. While there are sufficient teachers (including volunteers) to satisfy the MoES target PTR at the aggregate level, at the school level, disparities are observed to the extent that less than half of primary schools have the correct number of teachers, with the rest having either too many or too few (Figure 55). At the secondary level, the imbalance is even greater, with almost a quarter of schools having a deficit or surplus of teachers of 40% or more of the required number. This imbalance is difficult to address and may get worse as a consequence of the civil service downsizing initiative, which is driving an unsystematic decline in teacher numbers, in which the impacted schools are simply those who currently employ teachers who are nearing retirement age.

The increasingly rapid exit of volunteer teachers from the sector — over 2,000 in 2022–2023, equivalent to 30% of total volunteer teachers — is a further contributor to the teacher imbalance, as rural schools that have relied on volunteers to cover gaps are increasingly less able to do so. The continued decline in enrolment is also causing a sustained decline in the average school size (pupils per school), an historic and long-running issue in Laos, which is down 16% at primary and 12% at secondary level over the past decade. The large number of small schools represents a further drag on efficiency, as a smaller average class size generates a higher demand for teachers to staff them. In 2021–2022 more than half of all primary schools in Laos had 65 pupils or less (i.e., on average, less than 13 pupils per grade in each primary school).

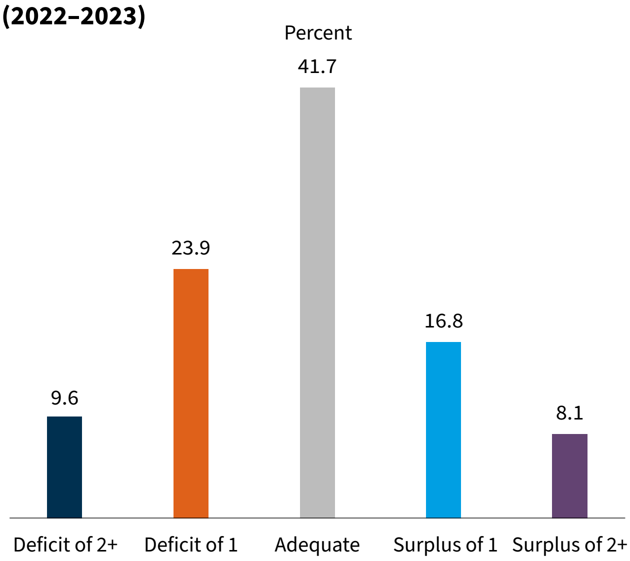
Figure 54. Education workforce changes between 2015/16 and 2022/23



Sources: Ministry of Education and Sport Annual School Census and Department of Organization and Personnel civil service data.

Note: The bottom chart presents data from two different sources that do not fully reconcile.

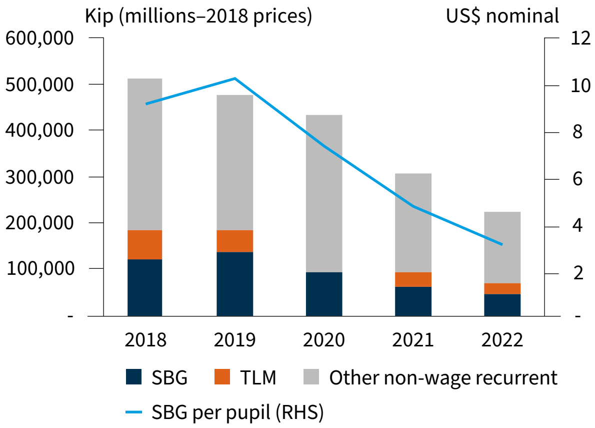
Figure 55. Proportion of primary schools with adequate teachers versus shortage/surplus (2022–2023)



Sources: Ministry of Education and Sport Annual School Census; World Bank staff estimates.

Funding to the sector is now insufficient to ensure an adequate quality of teaching. Cuts to the education budget have resulted in a significant decline in operational spending and teacher support functions. In real terms, non-wage recurrent spending declined by 56% between 2018 and 2022 (Figure 57). Lower funding for key activities such as teacher training, pedagogical support/mentoring and school monitoring visits have reduced the scope of efforts to improve or even maintain teaching quality. Expenditure data on these functions is not available, but given the fixed costs of many recurrent overheads, (for example, utilities and fuel) the cuts in teacher-related activities may have been even higher than for non-wage spending as a whole. This has been the case for spending on critical complementary programs such as the school block grant (SBG) and key inputs such as teaching and learning materials which have declined in real terms by over 60% over the same period. The value of the SBG declined rapidly from over $10 per pupil in 2019 to under $3 in 2023 (Figure 57). This is so low that it is questionable whether such funding can deliver any significant impact. Given the urgent need to improve the skills of teachers through in-service training and other support activities, it is vital that these severe cuts in the MoES non-wage recurrent budget are reversed as soon as possible.

Figure 56. Real spending on non-wage recurrent budget



Sources: Ministry of Education and Sport school block grant (SBG) system and Printing Department data, state budget implementation reports, World Development Institute, World Bank staff estimates.

Policy recommendations: For learning outcomes to improve, sector funding and teacher skills must be urgently increased.

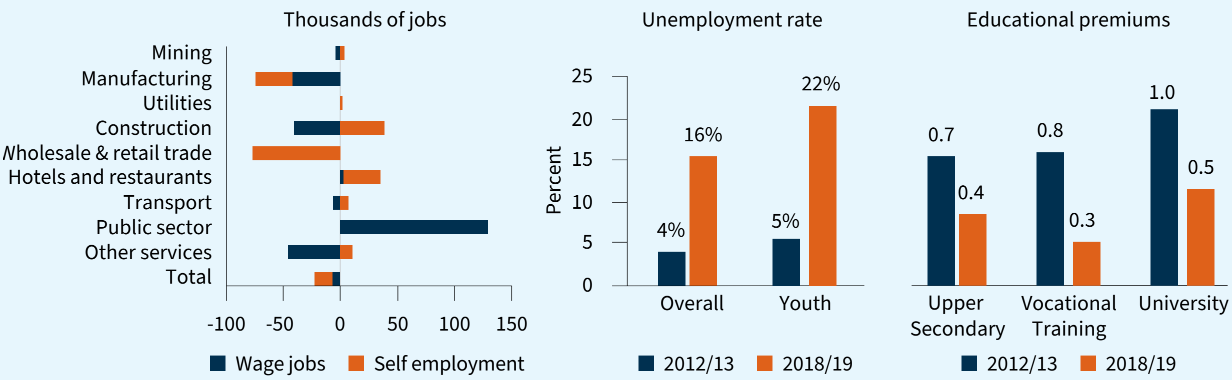
An increase in budget allocation to the education sector is needed and in the right mix of inputs for quality teaching. Three actions are necessary. First, a higher prioritization of education in the State Budget Plan is an urgent immediate measure. Second, economic, fiscal, and public financial management reforms are critical to improve domestic resource mobilization as a sustainable basis for education financing. Specific areas for reform are outlined in the Reform Roadmap to Support the Implementation of the National Agenda (ADB and World Bank, 2023). Third, protect the teaching workforce from civil service cuts given it is the single most important input for learning. Together, these measures can provide the basis for funding the required mix of adequate teacher salaries and allowances, teacher training, teacher support and monitoring, and measures to create conducive learning environments at the school level.

The education sector must prioritize service delivery and balance the allocation of teachers across education levels and schools. Going forward, new staff quotas should be allocated exclusively to teaching positions and the movement of teachers into administrative roles halted to slow the declining trend in teacher numbers. The share of primary education teacher positions should be increased by relaxing the requirement of subject specialization at lower secondary education to support the learning foundations for subsequent education levels. Finally, positions in disadvantaged districts should be prioritized. While correcting teacher allocation imbalances is made more difficult by unplanned civil service downsizing, it is important to make the best use of available resources. This will require modernizing deployment systems and planning tools and adjustment in targeted PTRs.

Box 5. Demand-side incentives for education

Complementary to addressing the critical supply-side issues, there is a need to promote private sector to create jobs and entrepreneurship opportunities for households to enroll their children, ensure they stay enrolled, and demand quality education services. Unemployment in Laos increased measurably in the years prior to the COVID-19 pandemic regardless of educational background and particularly among youth (Figure 58). The public sector drove job creation while falling competitiveness in the private sector led to a shedding of jobs and a shift towards low-skilled workers up to 2019. Since then, the large civil service downsizing program has led to the drying up of public sector job creation (at least in the civil service). Together, this has been driving a fall of already low private returns to education and reducing incentives for households to pursue and demand quality education for their children. As a consequence, household investment in education is below optimal levels, beginning with skipping children's enrolment in early childhood education and explaining a share of the low enrolment and high dropout rates from secondary education upward. At the same time, households' lower demand for quality teaching risks weakening school-level accountability and performance, further undermining entrepreneurship and job prospects. Addressing this requires a shift in the economic model toward private sector development. For a conducive business environment, the same reforms are needed that form the basis for sustainable sector financing, detailed in the Reform Roadmap to Support the Implementation of the National Agenda (ADB and World Bank, 2023).

Figure 57. Job creation by sector between 2012/13 and 2018/19 (Left), unemployment rates (middle), and education premiums (right) in Laos



Source: World Bank. 2019. Lao People's Democratic Republic Poverty Assessment 2020: Catching Up and Falling Behind. Washington, DC.: The World Bank Group.

Note: Education premiums: The Mincer regression assumes nonlinear returns on education; the dependent variable is the log hourly wage; regressions control for experience, gender, and regional and urban dummies; the sample includes individuals between ages 18 and 65; observations weighted by population; all values statistically significant at p<0.01.

Analysis reveals that a large proportion (over one-third) of vacant positions could be filled by redeploying surplus teachers within the same district, while doing so across districts (i.e. within provinces) would result in almost half of all vacant positions being filled. This illustrates the potential value of introducing teacher rotation mechanisms and additional incentives to encourage teacher transfers, which are currently completely absent. Achieving improved teacher allocation efficiency requires a medium-term approach to demand forecasting to inform annual allocation decisions, which is currently absent. However, with quota levels likely to continue declining in the short- to medium-term, MoES should reconsider the efficacy of current PTR targets, which are generous by regional and global standards (especially at the secondary level). In addition, MoES could introduce a form of 'blended' learning using appropriate technology to bridge the gap in teaching staff pending a recruitment drive. Finally, MoES should consider merging small, unviable schools in an effort to improve economies of scale and re-purpose closed schools for alternative purposes in line with school-age population projections.

Laos needs to invest systematically in evidence-based in-service training. There is a need to prioritize the budget for teacher training. To begin with, data on teachers' knowledge and pedagogical skills are needed so that the training content and the frequency can be matched to teachers' needs. Second, training methodologies should seek to ensure, not assume, that all teachers understand the subject material they are supposed to teach. Third, the design of training should be informed by what works. Analysis of high-impact in-service teacher training programs from around the world indicates that effective programs have four key features: (i) a focus on content knowledge; (ii) opportunities to practice what is learned with colleagues; (iii) continued support through follow-up visits focused on training content; and (iv) career incentives through promotion or increased salary. Even relatively short programs can yield significant results. The Sa Aklat Sisikat (SAS) program in the Philippines sought to train teachers to incorporate reading into the curriculum. Despite being relatively short, the main program was a read-a-thon over 31 days, the program improved reading skills significantly (Abeberese, Kumler, & Linden, 2011).[49]

Teachers can also be supported to be more effective with several tools such as: (i) structured lesson plans, (ii) targeted instruction, (iii) educational technology (EdTech); and (iv) the dual teacher model. The dual teacher model, in which expert teachers provide content through either pre-recorded or live-streamed sessions, has had significant positive impacts on learning in several rural contexts where high-quality teachers are in short supply, including in Ghana (Johnston & Christopher., 2017), India (Naik, Chitre, Bhalla, & Rajan, 2020), Pakistan (Beg, Lucas, Halim, & Saif, 2019), and Mexico (Borghesan & Vasey, 2021).

At the same time, policy must encourage greater teacher effort by understanding what is holding teachers back. Policymakers frequently disregard teachers' perspectives and fail to consider the practical challenges they face. For instance, teacher professional development often lacks sufficient in-classroom practice and feedback. Curriculum reforms often add new material without removing existing content, burdening teachers with more material to cover in the same amount of time. To improve early-grade reading outcomes, teachers need clear guidelines and effective lesson plans. If lesson plans are unclear or difficult to implement, teachers are less likely to follow them. Even if teachers understand how to implement new practices, they need motivation and support to sustain these changes in their teaching practice. Overcoming these "how" and "why" barriers is essential.

[49] Abeberese, A., Kumler T. J., Linden. L.L. (2014). Improving reading skills by encouraging children to read in school: A randomized evaluation of the Sa Aklat Sisikat Reading Program in the Philippines. Journal of Human Resources, 49(3). Available at http://jhr.uwpress.org/cgi/reprint/49/3/611 (accessed 15 March, 2024).

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