Lao PDR Economic Monitor
April 2024

Accelerating Reforms for Growth

Launch of
Lao PDR Economic Monitor April 2024
Crowne Plaza, 30 April 2024

Outline

Part A. Recent Economic Developments and Outlook
  • Recent Developments in the Lao PDR
  • Outlook and Risks
  • Policy Recommendations

Part B. Education for Growth and Development
Economic growth remains subdued, mainly owing to protracted macroeconomic instability

Regional growth was favorable in 2023, but will likely ease in 2024

GDP growth in Laos is estimated at 3.7% for 2023, significantly below 2019 level

Persisted depreciation resulted in high inflation

High depreciation and inflation levels in Laos are due to domestic factors

Main contributors to high inflation: food, transport, and hotel and restaurant prices
Persistent depreciation resulted in high inflation

Stronger kip depreciation leads to higher inflation

Exchange rate seasonality correlated with debt service payments

Persistent depreciation pressures result from limited foreign exchange liquidity

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

Source: World Bank staff calculation based on Bank of the Lao PDR data.
Fiscal developments: both revenue collection and expenditures increased in 2023

Improved revenues owing to more economic activity, tax base, inflation and exchange rate

However, total revenues were still low compared to regional peers

Expenditure were low compared to regional peers

Expenditure rose slightly due to capital spending
The fiscal deficit was low, but debt repayments kept financing needs high despite deferrals

The fiscal deficit remained at an estimated 0.2 percent of GDP in 2023

But financing needs in 2023 were higher as debt repayment exceeded primary surplus

Declining investment in human capital

Public spending on human capital has continued to decline

Households’ financial difficulties contribute to rising school dropouts

Source: Ministry of Finance, World Bank staff estimate

Source: Ministry of Finance, World Bank staff estimate

Source: Ministry of Finance and World Bank staff calculations.

Source: World Bank rapid phone survey, January - February 2024
Forbearance and rising exposure to public sector borrowing increases financial sector vulnerabilities

Exposure to public sector borrowing (% of GDP)
- Private
- SOEs
- Government
- Domestic credit

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

Source: World Bank staff calculations based on bank financial reports as of Q1-2023.
Note: Each dot represents a different bank and percent.

Outlook and Risks

- **East Asia and Pacific** (include China) growth is forecast to ease to 4.5% in 2024, reflecting more moderate growth in China.
- EAP growth (exclude China) to pick up by 4.6%, due to anticipated recovery of global trade and easing financial conditions.
- EAP economies affected by both
  - **external** factors (slowing global growth, tight financial conditions, and more trade protectionism).
  - **domestic** factors (high public and private debt, tight macroeconomic policies, and rising political and policy uncertainty).
- Laos’ key trade partners
  - **China** growth to slow, owing to high debt levels, property sector weaknesses, and longer-term structural factors (e.g., ageing).
  - **Thailand** and **Vietnam** growth to accelerate.

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Outlook and Risks

Growth potential is constrained by structural challenges

Annual inflation is expected to remain high due to persistent depreciation

Outlook is dependent on debt renegotiation outcome

External debt service obligations are very high in the absence of further deferrals

Recent administrative measures may bring forex in short-term, but not address underlying structural imbalances

Note: The outlook assumes no new debt service deferrals in 2024 and beyond, while deferrals accumulated during 2020-2023 would continue to be deferred.
Structural challenges (Labor market)

Economic difficulties are pushing people to move abroad

More people are becoming self-employed

Registered Lao workers in Thailand

- Informal wage
- Unpaid family
- Self-employed
- Formal wage

% of working respondents

Dec-22 | Jan-24

Source: Ministry of Labour, Government of Thailand

Risks

The outlook is subject to significant domestic and external uncertainty:

- The outcome of ongoing debt negotiations will have significant implications for both debt sustainability and macroeconomic stability (high debt service obligations and accumulated deferrals).

- External risks include subdued global and regional economic growth (which would weaken external demand), a stronger US dollar, and commodity price shocks.

- Domestic risks include tight foreign exchange liquidity to refinance external debt, labor shortages, deteriorating balance sheets in large banks, and slow progress with structural reforms.
### Policy Recommendations

| Public debt management | • Expedite ongoing debt renegotiations and strengthen public debt management  
|                        | • Assess and manage contingent liabilities |
| Revenue mobilization   | • Implement the return of the value-added tax (VAT) rate to 10 percent and reduce VAT exemptions  
|                        | • Review tax incentives and eliminate exemptions (Revised Investment Promotion Law)  
|                        | • Reform excise tax structures and rates |
| Public expenditure     | • Reprioritize spending toward the social sectors |
| Financial sector       | • Enhance bank supervision and employ an early warning system  
|                        | • Operationalize emergency arrangements  
|                        | • Strengthening the deposit protection fund |
| Private sector         | • Implement electronic business registration processes,  
|                        | • Streamlining nontariff measures (NTMs)  
|                        | • Promoting electronic customs clearance and risk-based processes to facilitate trade |

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### The Vital Five

**Reforms to Secure Macroeconomic Stability in the Lao PDR**

1. **Cut costly tax exemptions to raise public revenue, protect social spending**
   - Tax exemptions deprive the budget of much revenue every year, so less can be invested in human capital or used to service debt. Without investment in knowledge, skills and health, Laos will fall further behind.

2. **Improve the governance of public and public private investment**
   - Inefficient public investment is costly and public-private partnerships often create liabilities for the government.

3. **Restructure public debt through ongoing negotiations**
   - High public debt levels undermine macroeconomic stability by constraining fiscal space, exerting pressure on the exchange rate, and jeopardizing banking sector stability.

4. **Strengthen financial sector stability through legal and regulatory tools**
   - Vulnerabilities in state-owned banks may hamper private sector credit growth. This exposure to risk can have widespread impacts on the rest of the economy.

5. **Enhance the business environment via effective regulatory reforms**
   - Burdensome processes and regulations raise business costs and reduce productivity, undermining investment and exports.
Thematic Chapter

Education for Growth and Development

Lao’s economic growth is at risk because of low human capital

Human capital is the largest asset group across all income groups and countries

Education is consistently associated with higher wages

Average percentage increase in wages associated with each additional year of schooling, by region

Increasing education quality and basic skills is especially important for growth

Average percent increase in future GDP based on improving cognitive skills

The acquisition of skills begins early. Foundational skills are critical
Primary education is no longer universal in Laos

Enrolment rates are falling as drop-out rates increase

Lao students have low foundational skills

A key challenge in Laos pertains to teacher availability and quality

Teacher numbers have been shrinking

A considerable imbalance in teacher allocation

Sources:
- Ministry of Education and Sport Annual School Census and Department of Organization and Personnel civil service data.
- World Bank staff estimates based on Lao Annual School Census, UN Population Data, and UNESCO UIS.
Adequate financing is essential for schools to hire the teachers they need in Laos

Public education spending in Laos has been declining

The share of education in personnel spending has fallen dramatically

Sources: State budgets, state budget implementation reports, World Bank staff estimates.

Policy recommendations

Increase budgetary allocation to education
- Prioritize education in the state budget plan
- Undertake economic, fiscal and PFM reforms to improve domestic resource mobilization
- Protect the teaching workforce from civil servant cuts

Balance the allocation of teachers across education levels and schools
- New staff quotas should be allocated to teaching positions
- Prioritize positions in disadvantaged districts
- Fill vacant positions by redeploying within districts

Invest systematically in evidence-based in-service teacher training
- 4Cs: Content, Colleagues, Continuous, Career
- Greater understanding of teacher constraints: Make reforms Clear, Doable and Rewarding

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