Report Launch June 7th, 2022

# Linking Laos Unlocking Policies

## Lao PDR Country Economic Memorandum

THE WORLD BANK
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# THE LIMITS OF LAO PDR'S GROWTH MODEL HAVE BECOME APPARENT

Resource-driven growth has created few jobs, while leading to significant macroeconomic and environmental pressures.

# Natural resources drove fast growth …

**Figure O.1**
**Natural resources and related investments have been a major driver of growth**

GDP growth and sectoral contributions to growth

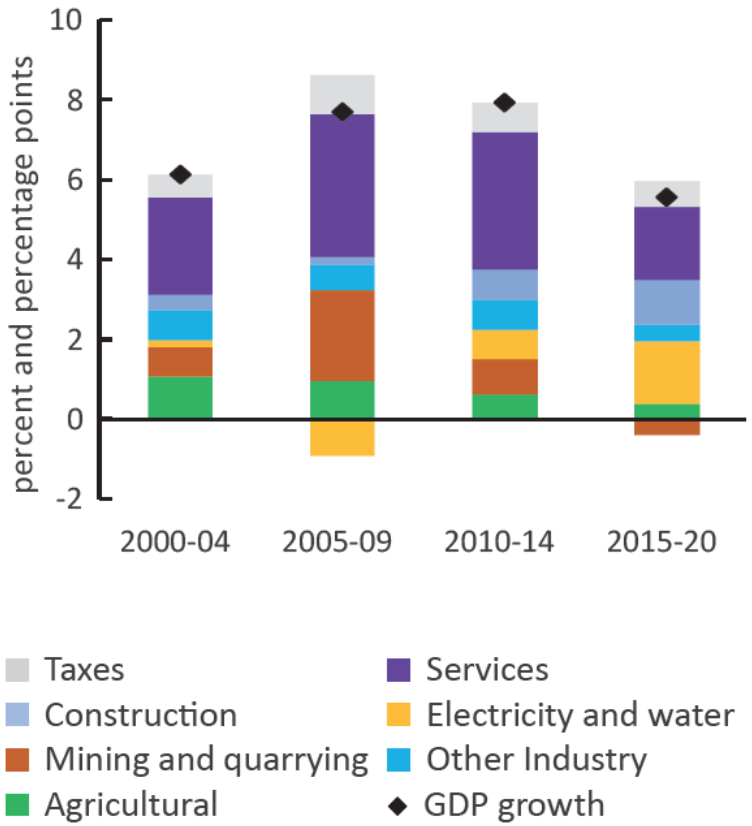
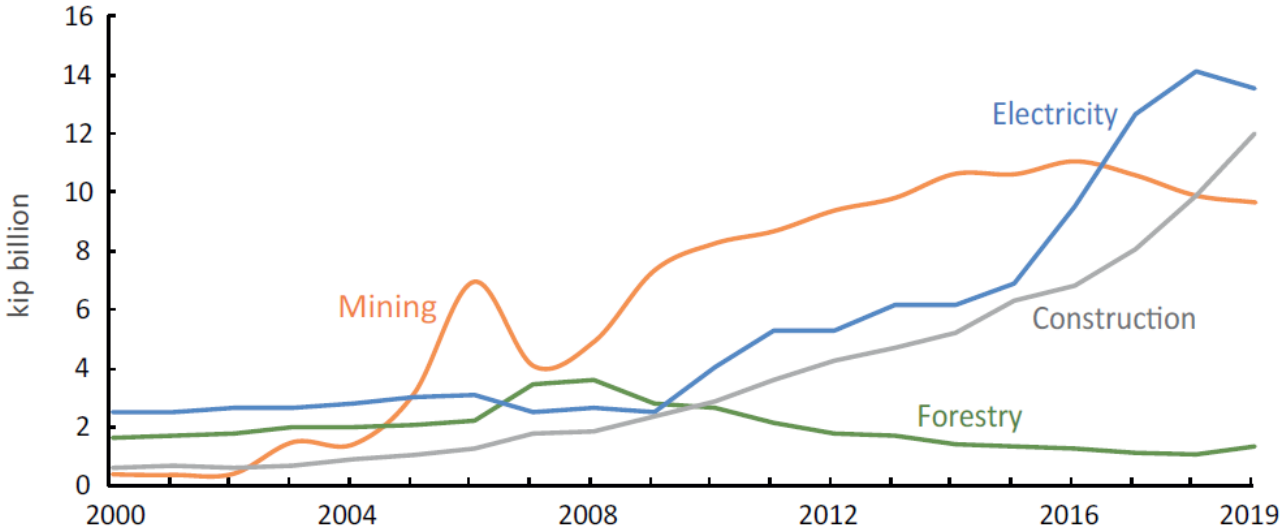



**Figure 2.1**
**Resource sector contributions to GDP (2012 constant prices)**

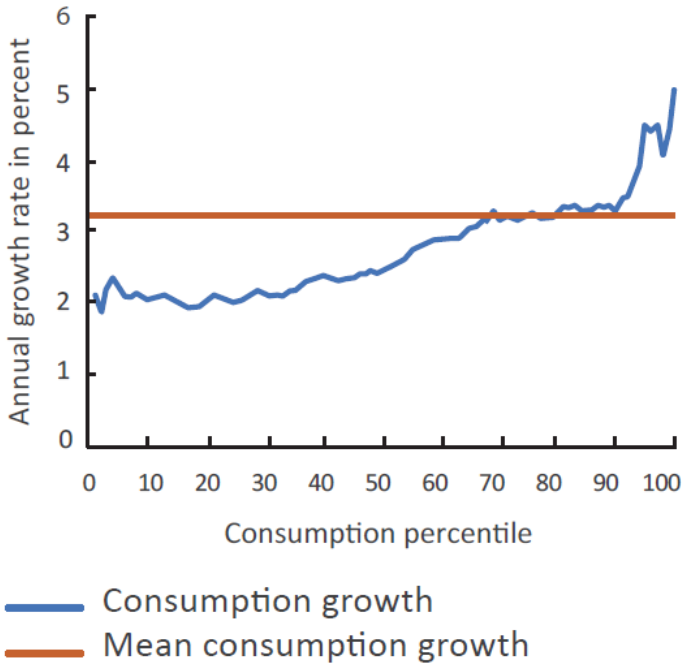



Source: https://seadelt.net/Documents/?of=1&os=d

# … but this growth was not inclusive or job-creating

**Figure O.3**
**The growth model has not been inclusive**

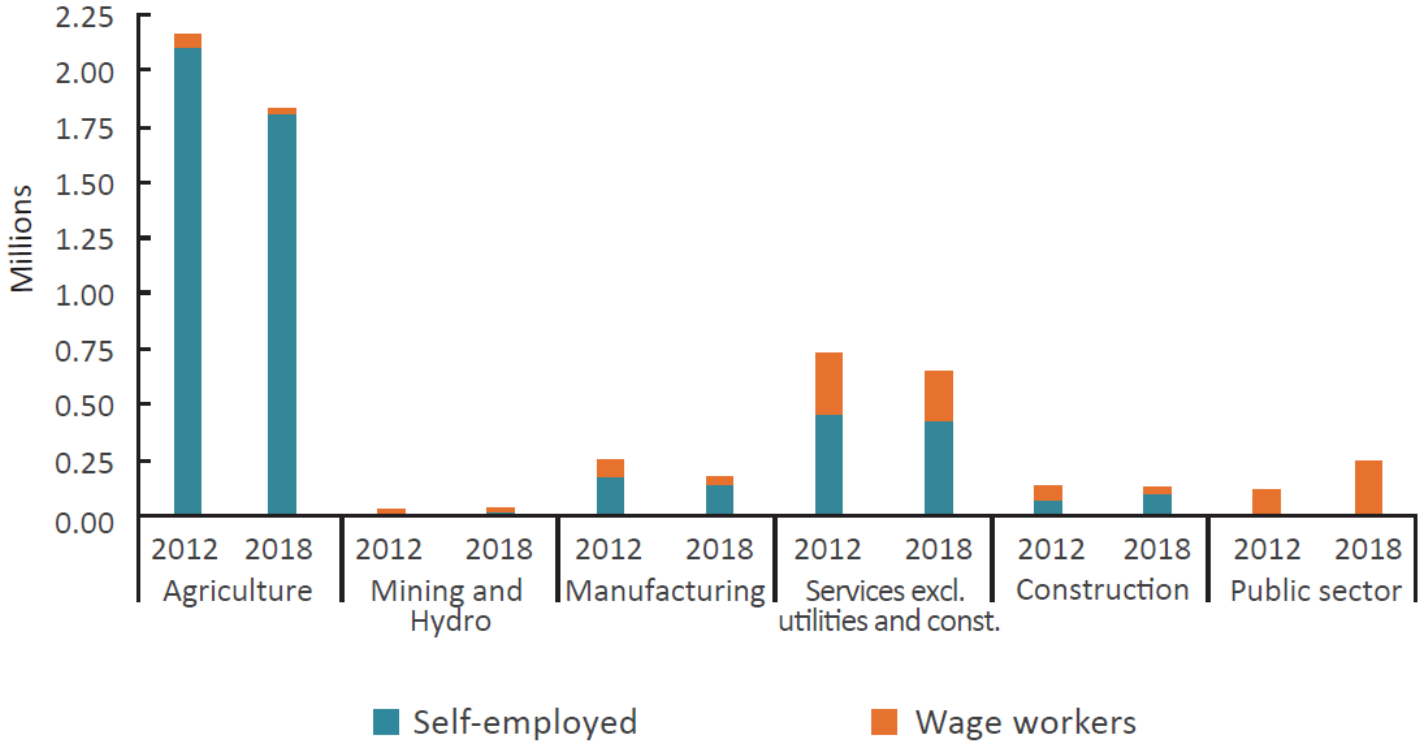
(b) Consumption growth has been skewed towards rich households




Source: World Bank, Laos Poverty Assessment.

**Figure O.4**
**High growth but low job-creation in Laos, 2012 and 2018**

(b) Wage and non-wage employment by sector: 2012-18



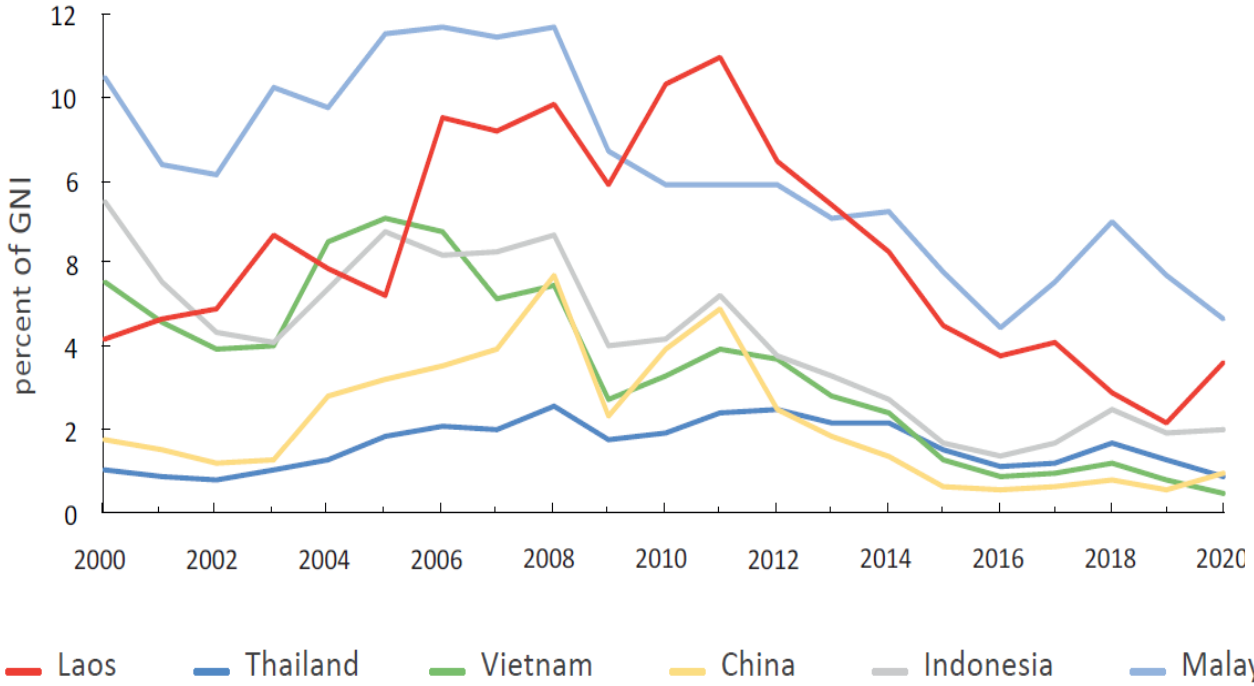

Source: Lao Bureau of Statistics for GDP data, LECS 2012 and LECS 2018 for employment.

# Growth has also resulted in environmental pressures …

**Figure O.2**

**The depletion rate of natural resources has slowed in recent years**

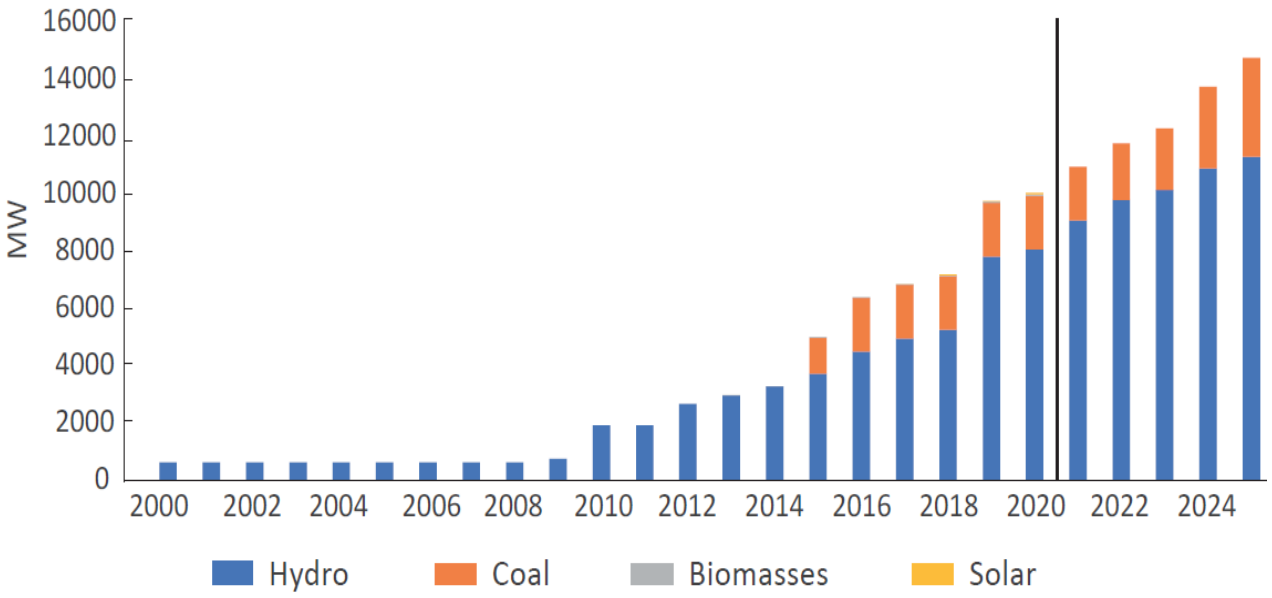
Natural resource depletion




Source: World Development Indicators.

**Figure 2.4**

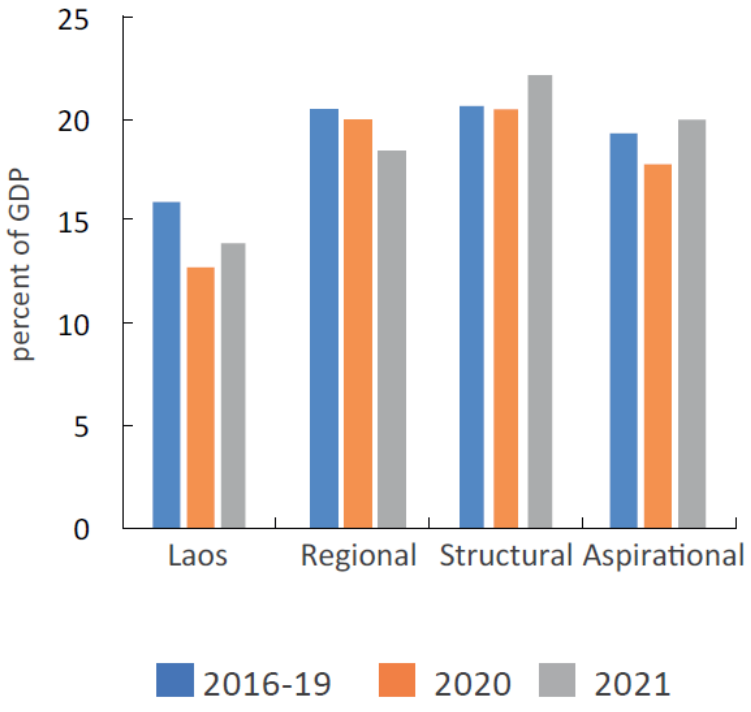
**Installed power capacity: historical and projections**




Source: MEM data.

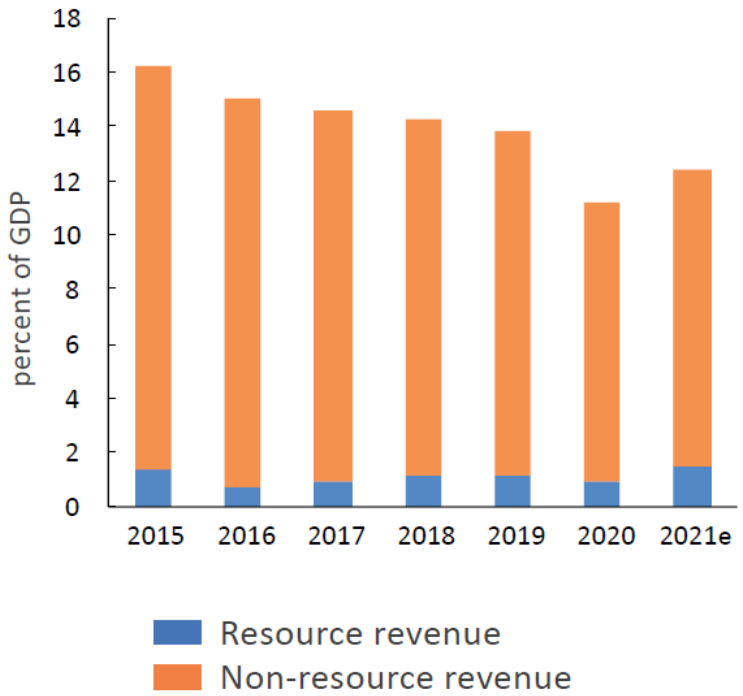
# … without significantly increasing government revenue

**Figure 1.1**
**General government revenues, compared with peers**




Source: IMF WEO Database, April 2022. 2020 and 2021 Laos data are based on WB estimates.

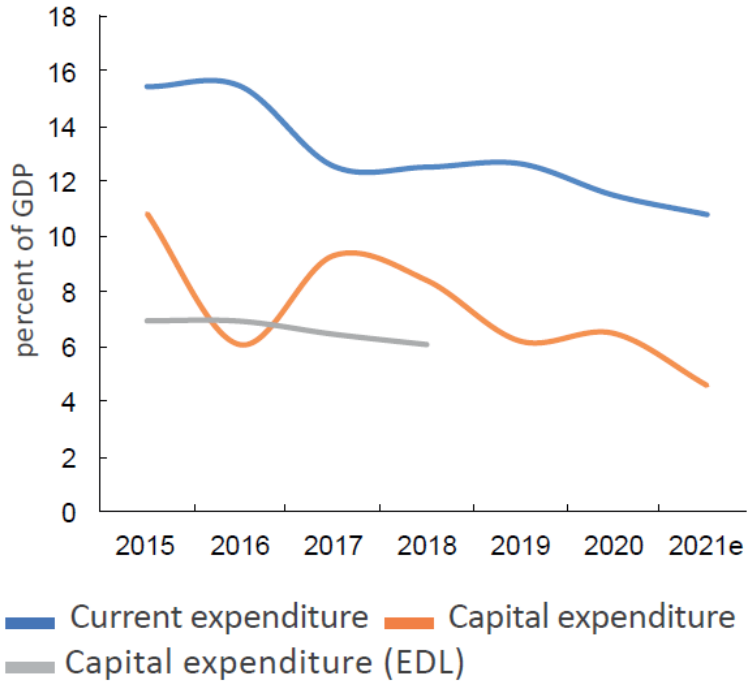
**Figure 1.4**
**Resource and non-resource revenues**




Source: MoF.

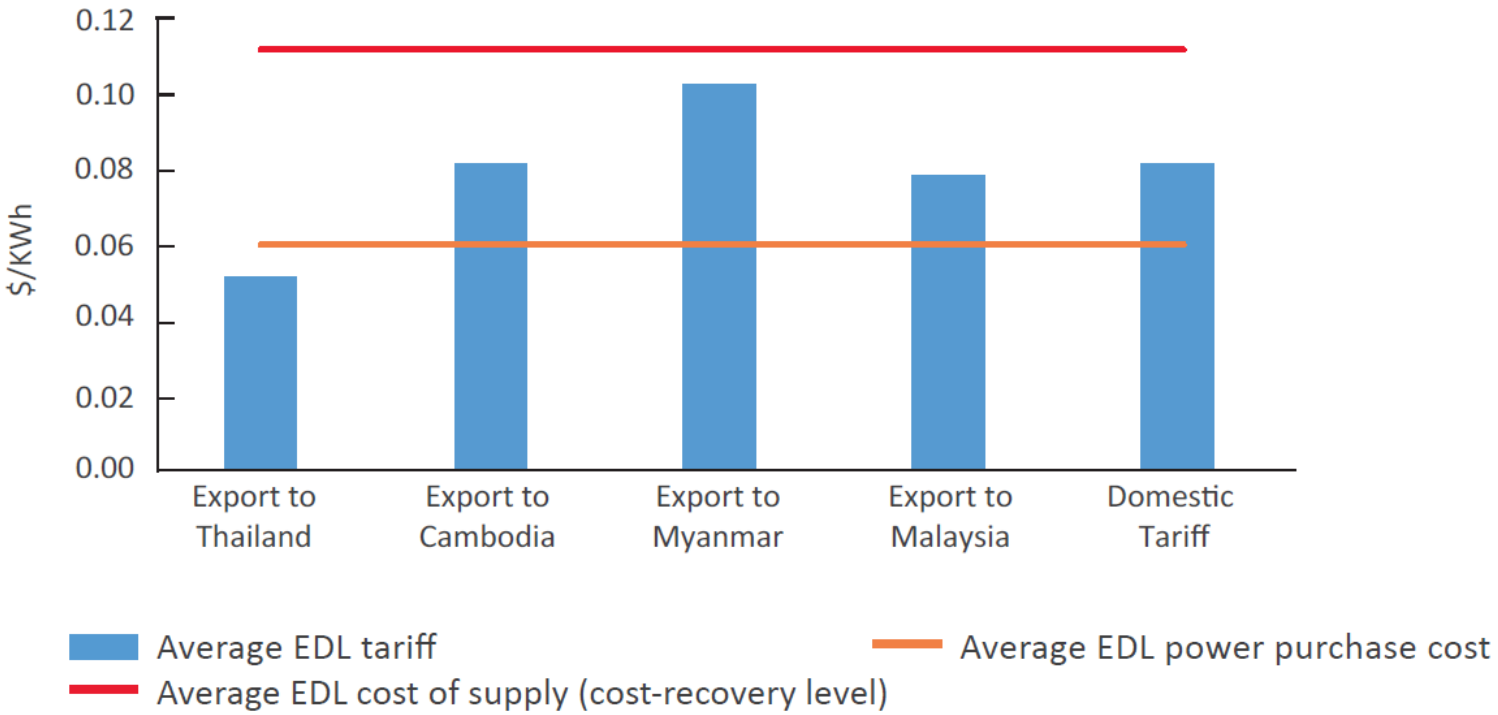
# Fiscal risks associated with the electricity sector are large

**Figure 1.12**
**Current and capital expenditure**




Source: MOF, EDL Financial Statements 2014-18.

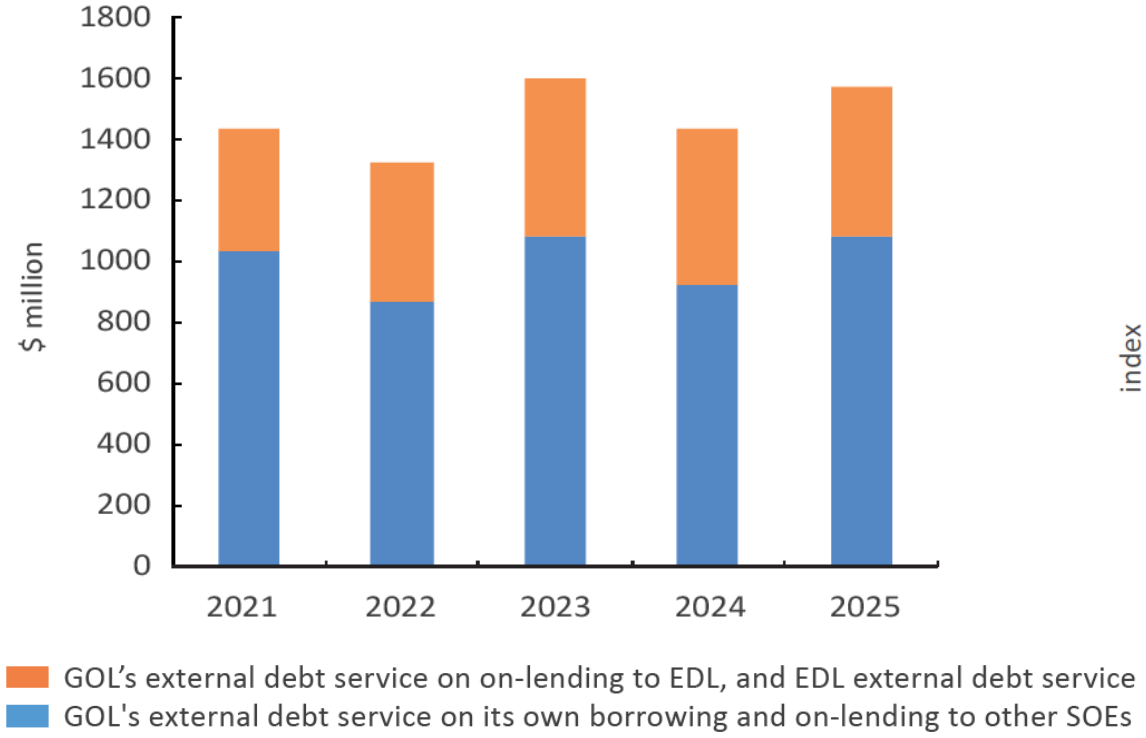
**Figure 2.9**
**Average EDL domestic and export tariffs**




Source: EDL Electricity Statistics Report (2019) for tariffs, EDL Financial Statements (2018) for power purchase cost, and PWC (2017) for cost of supply.

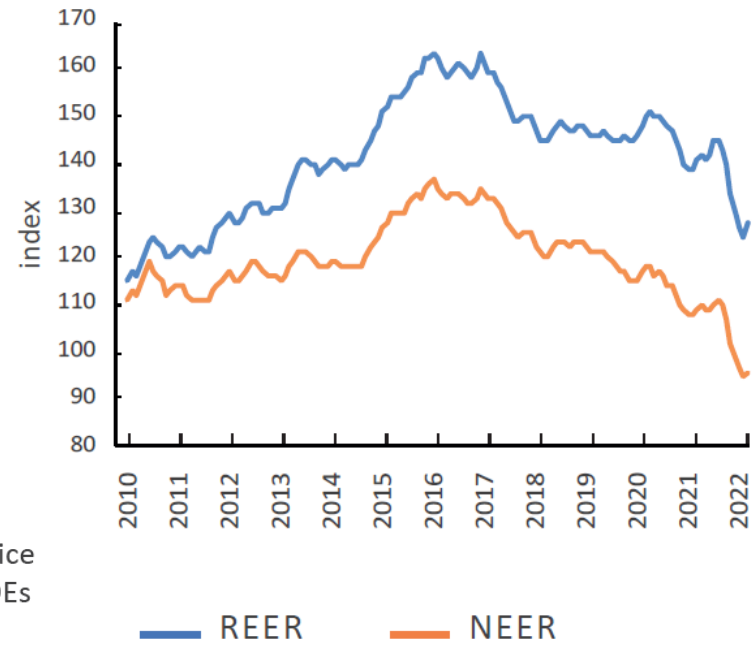
# Fiscal, external and financial vulnerabilities threaten macroeconomic stability

**Figure 1.16**
**Total PPG external debt service projections**




Source: Data is based on MoF and World Bank staff estimates.

**Figure 1.19**
**Nominal and real effective exchange rates**

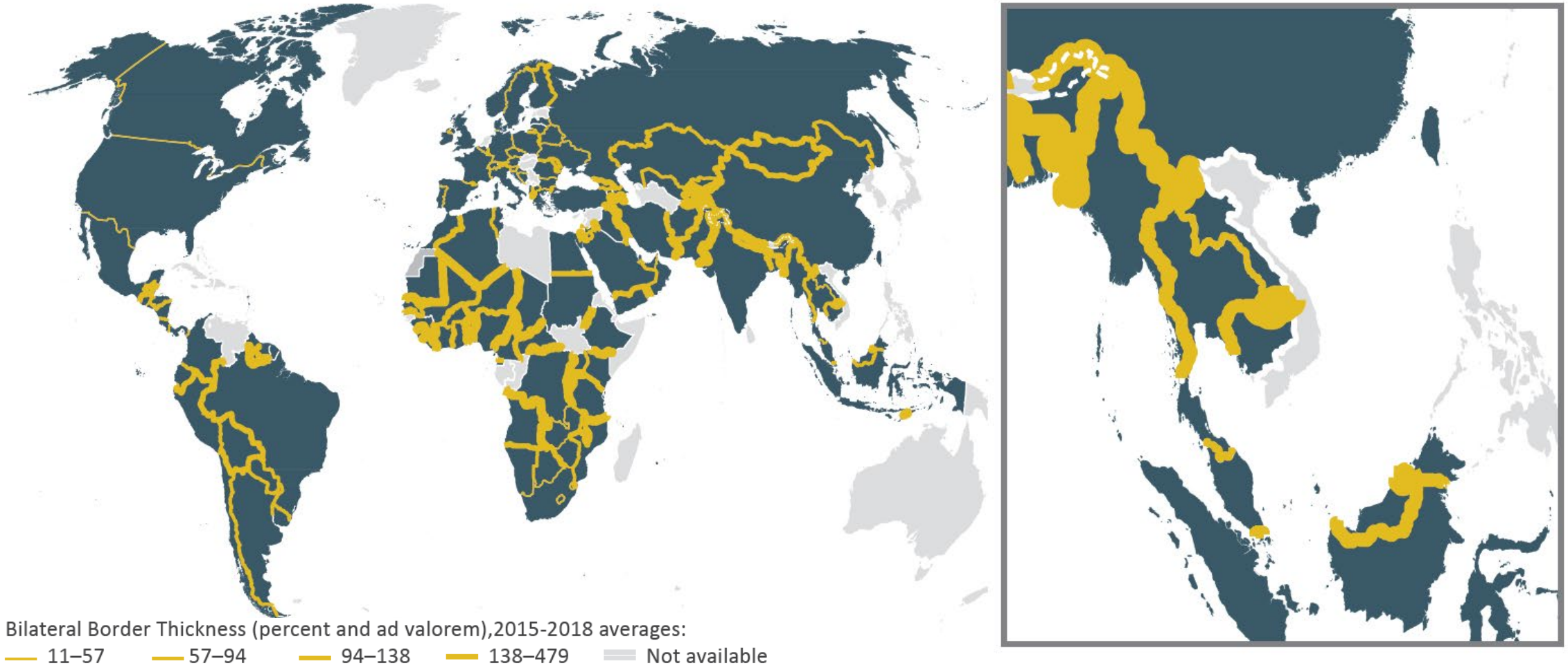


# LAO PDR IS NOT THE USUAL LANDLOCKED COUNTRY

It has the advantage of natural wealth, young population and geographic location

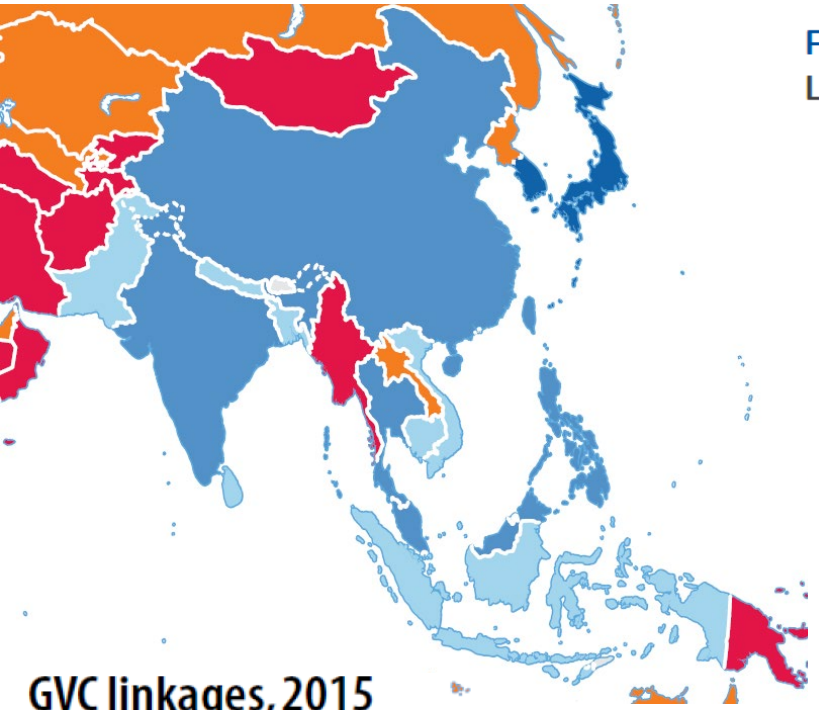
# Geography is more an asset than a constraint

**Figure 4.2**
**Mapping bilateral trade costs, 2015-18**




Source: Arvis et al (2020). The World Bank and UNESCAP database 2015-18 averages.

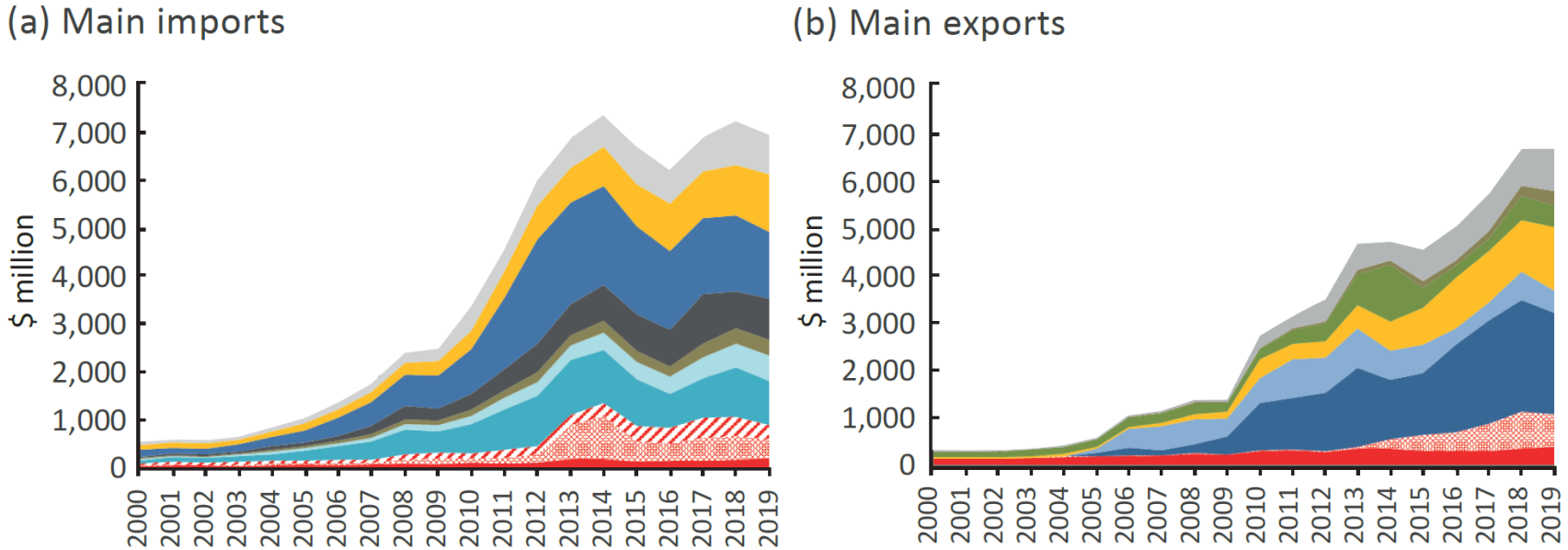
# Laos participates in commodity GVCs, but exports recently diversified



**GVC linkages, 2015**

- Low participation
- Limited commodities
- High commodities
- Limited manufacturing
- Advanced manufacturing and services
- Innovative activities

**Figure 4.8**
**Lao merchandise import and export structure, 2000 to 2019**



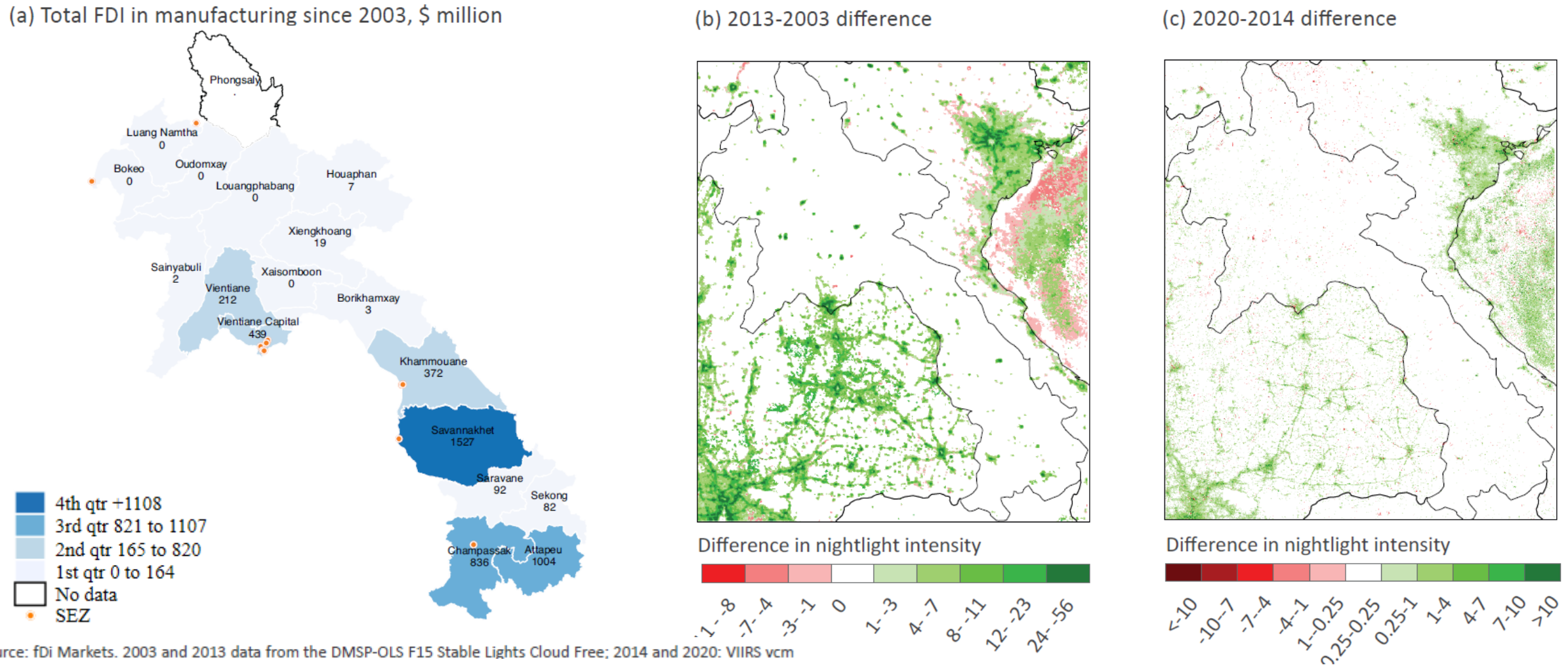

- Textile & leather
- Elect. Mach (final goods)
- Chemicals
- Metals
- Agricultural & food
- Elect.Mach (part & components)
- Fuels
- Rubber & plastics
- Transport equip
- Others
- Garment & footwear
- Minerals (incl. ores, electrical power)
- Agriculture & food
- Rubber
- Electrical equipment
- Cooper
- Wood products
- Others

Source: BACI data.

# Export-oriented manufacturing FDI linked to local economic development

**Figure 4.13**

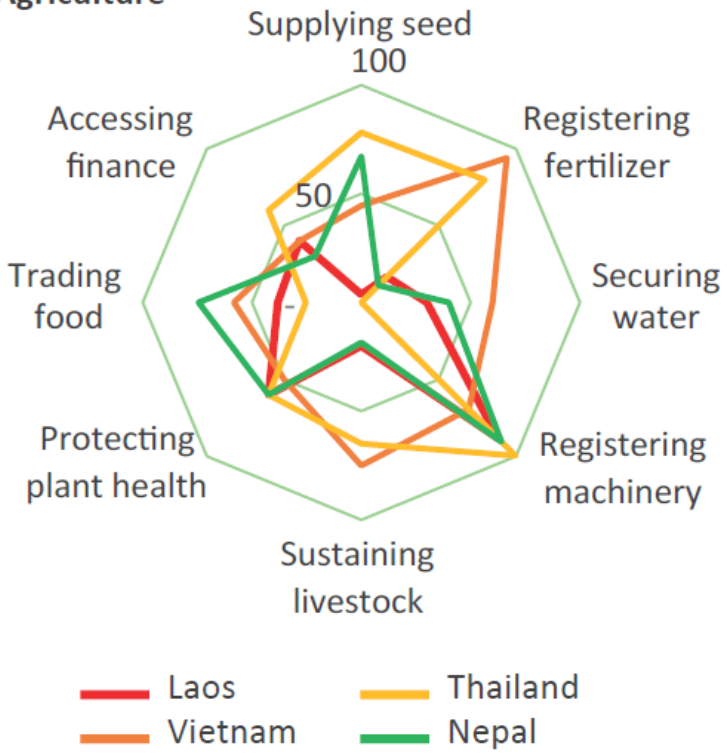
**Lao economic development was linked to export-oriented manufacturing FDI, 2003-20**




Source: fDi Markets. 2003 and 2013 data from the DMSP-OLS F15 Stable Lights Cloud Free; 2014 and 2020: VIIRS vcm

# Agri-food exports have potential to grow both regionally and overseas

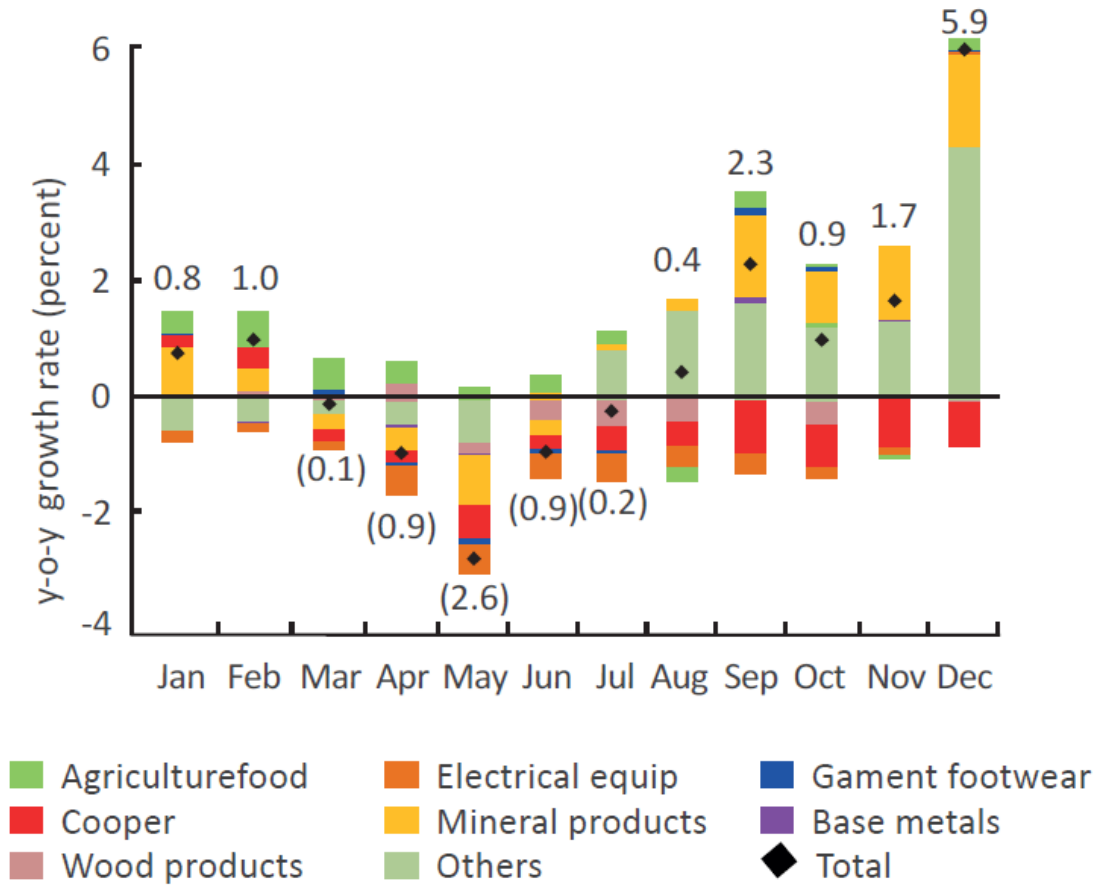
**Figure 4.14**
**Laos' performance in Enabling Business for Agriculture**




Source: World Bank's EBA (2019).

**Figure 4.4**
**Tracking the impact of COVID-19 on Laos monthly trade**

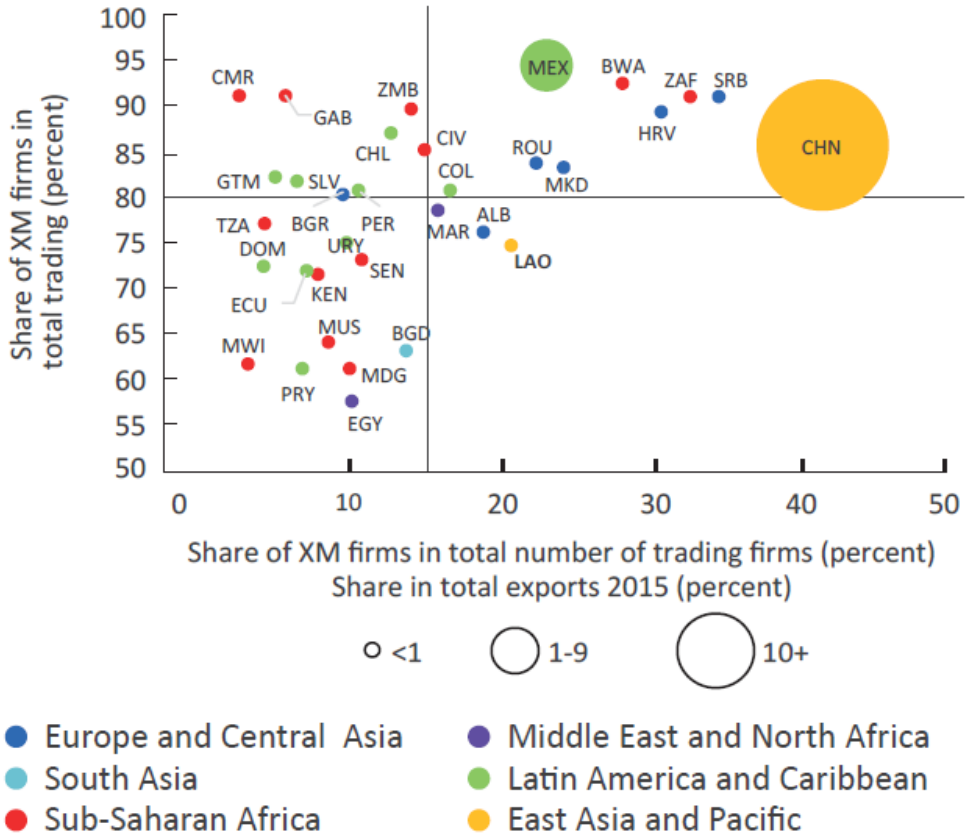
(d) Lao exports by product categories




Source: Monthly Customs data China, Thailand USA, EU, Japan.

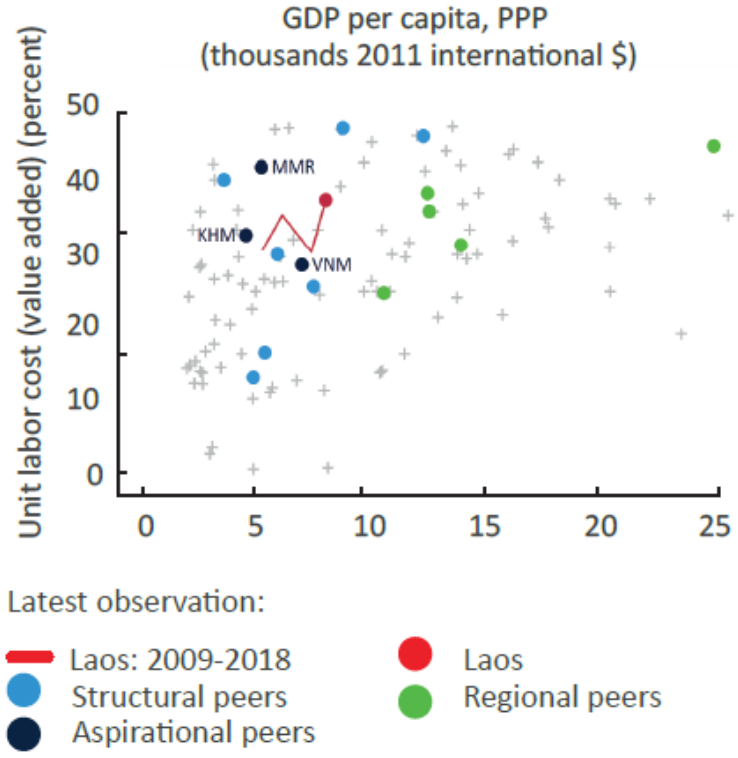
# Scope to improve manufacturing competitiveness

**Figure 4.20**
**Businesses that both import and export dominate GVC participation**




Source: Adapted from WDR2020.

**Figure 3.2**
**Trends in the manufacturing sector, 2009–18**

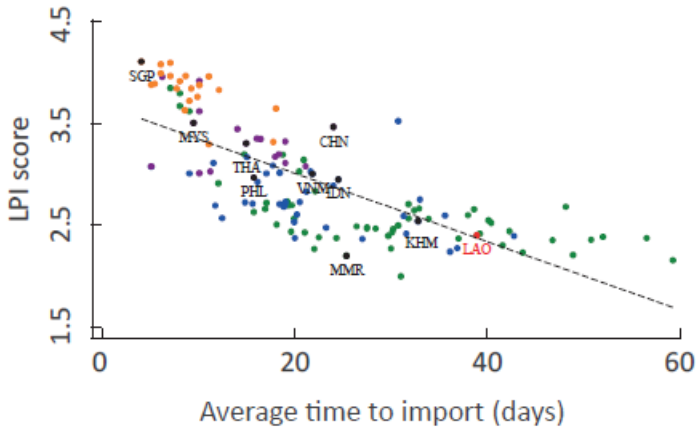



Source: Staff analysis using WBES, various years.

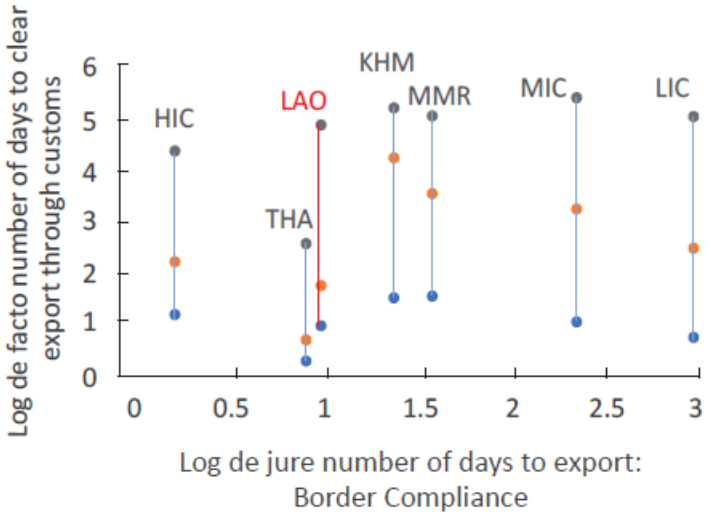
# Global value chains thrive on predictable business environment

**Figure 4.25**
**GVCs thrive on predictable business environments**

(a) Logistics and connectivity matter for manufacturing GVC integration




(b) And consistent policy implementation



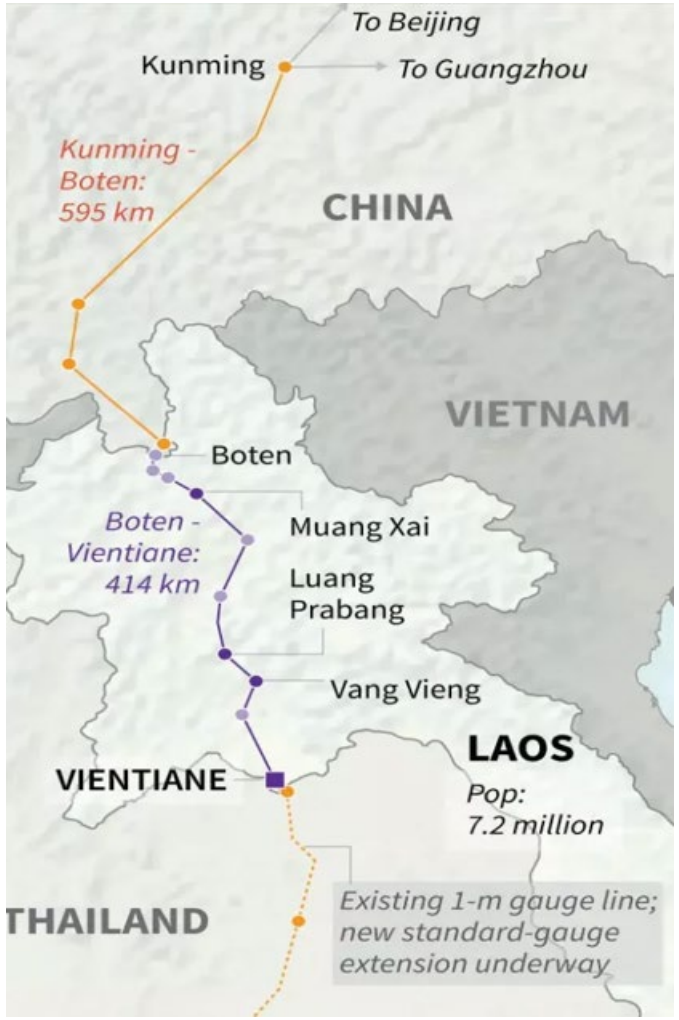

- Commodities
- Innovative activities
- Advanced manufacturing and services
- Limited manufacturing
- Laos

- 10th percentile
- 50th percentile
- 90th percentile

Source: Enterprise Survey data latest available year (2018 for Laos, 2016 for Thailand, Cambodia and Myanmar).

Source: WEF and WDI data and WDR2020 GVC taxonomy.

# A sound vision, but deeper policy changes needed to realize potential




- Launched December 2, 2021
- 414-kilometer railway (10 stations) from Vientiane Capital to Kunming, China
- Connect to Thai-Sino Railway Vientiane to Bangkok by 2025

**Expected impact:**

- < 4 hours Vientiane to China (15h drive)
- 30-40 percent drop in transport costs for transit cargo
- Up to 1.5 million tons traded between China and ASEAN; 2.0 million tons traded between China and Lao PDR redirected from maritime routes to the railway
- Opportunities for tourism

Source: World Bank 2020. From Landlocked to land-linked.

# THE WAY FORWARD:

# PRIORITY AND IMPLEMENTATION

Policy leads for more inclusive and sustainable growth

# I. Engineering a return to macro-fiscal stability

| Objective | Timeline for implementation | Responsible ministry or agency | Link with NSEDP 9 (outputs) |
|---|---|---|---|
| 1. Explore sources of external financing but limit new commercial borrowing to the amount necessary to service existing market term borrowing. | Short term | MOF | Outcome 1 (2) |
| 2. Finalize ongoing debt negotiations with large creditors, giving appropriate consideration to debt sustainability and transparency. | Short term | MOF | Outcome 1 (2) |
| 3. Strengthen due diligence and approval processes for new public investments, on-lending arrangements, issuance of public guarantees, and PPP proposals. | Medium term | MOF, MPI | Outcome 1 (2,3,5) |
| 4. Mobilize domestic revenue by improving administration of large taxpayers, reviewing tax incentives and concessions (particularly for resource sector projects), and reducing the scope for discretion in taxation and revenue-sharing arrangements. | Medium term | MOF | Outcome 1 (2) |
| 5. Consider the adoption of a medium-term fiscal framework to ensure that budget settings and new PPG borrowing plans (including SOE borrowing) are consistent with public debt sustainability. | Medium term | MOF | Outcome 1 (2) |
| 6. Resolve balance sheet vulnerabilities in state-owned banks and reassess their role in the provision of credit to government and SOEs. | Medium term | MOF, BOL | Outcome 1 (2) |

# II. Ensuring the use of natural capital is socially and environmentally sustainable

| Objective | Timeline for implementation | Responsible ministry or agency | Link with NSEDP 9 (outputs) |
|---|---|---|---|
| 7. Review options to ensure the financial sustainability of EDL's payments to IPPs, and adjust electricity tariffs to ensure EDL's cost recovery, while protecting customers with less capacity to pay. | Short term | EDL, MEM, MOF | Outcome 1 (5) |
| 8. Optimize hydropower system planning and reorient investment toward improving transmission and interconnection systems with neighboring countries. | Medium term | EDL, MEM, MPI | Outcome 1 (5) and outcome 5 (1) |
| 9. Develop the potential to firm electricity supply through renewables rather than coal. | Medium term | MEM | Outcome 4 (2) and outcome 5 (2) |
| 10. Resolve ongoing constraints to new mining investment, including by implementing the mineral licensing system and reviewing the beneficiation policy, while prioritizing the minimization of environmental impacts. | Medium term | MEM, MONRE | Outcome 1 (1,3) |
| 11. Clarify and standardize licensing and land allocation processes and the legal framework to improve certainty for investors in environmentally-sustainable tree plantations and nature-based tourism. | Medium term | MAF, MONRE, MICT | Outcome 4 (1,2) |
| 12. Prepare strategic environmental assessments to identify the cumulative longer-term effects of resource sector projects and manage trade-offs between different land uses. | Medium/long term | MONRE | Outcome 4 (1) |

# III. Making domestic markets work for job creation

| Objective | Timeline for implementation | Responsible ministry or agency | Link with NSEDP 9 (outputs) |
|---|---|---|---|
| 13. Deepen business climate reforms to facilitate the entry and expansion of domestic and foreign firms. | Short term | MOIC, MPI | Outcome 1 (3,4) |
| 14. Implement one-stop business registration service to cut the burdensome process and encourage formalization. Eliminate and streamline regulations for transparency and consistency in the tax and regulatory systems to curb informal practices. | Short term | MOF, MOIC, MPI | Outcome 1 (3,4) |
| 15. Leverage remittances to support investment in agriculture and manufacturing. Allow remittances to be used in local public investment projects, decided by the migrants for their home village. | Short term | MAF | Outcome 1 (3) |
| 16. Strengthen labor laws and enforcement to protect workers, male and female without jeopardizing firm competitiveness. | Medium term | MOES, MOLSW | Outcome 2 (2,3) |
| 17. Strengthen vocational training and employment services that allow qualified workers to find suitable jobs. Involve the private sector especially lead GVC firms. | Medium term | MOES, MOLSW | Outcome 2 (2,3) |
| 18. Promote skill retraining and geographically targeted employment subsidies to foster employment in areas more at risk. | Medium term | MOES, MOLSW | Outcome 2 (2,3) |

# IV. Leveraging strategic location to diversify away from natural resources

| Objective | Timeline for implementation | Responsible ministry or agency | Link with NSEDP 9 (outputs) |
|---|---|---|---|
| 19. Advance trade policy reforms, with a focus on non-tariff measures to support quality upgrades in businesses. | Short term | MOIC, MOF | Outcome 5 (2) |
| 20. Assess the effectiveness of SEZs and related investment incentives in attracting FDI, encouraging export growth and diversification, and creating jobs. | Short term | MPI, MOIC | Outcome 1 (5) and outcome 5 (4) |
| 21. Facilitate SEZ backward linkages with domestic firms to help raise productivity, competitiveness, and resilience. Develop win-win deals with foreign lead GVC firms to develop downward services or training centers that also benefit other exporters or products. | Medium term | MOIC, MPI | Outcome 1 (5) and outcome 5 (4) |
| 22. Improve the ability of businesses to satisfy core labor, environmental and governance standards to anticipate the increasing focus on social and environmental issues among buyers in overseas markets. | Medium term | MOIC, MAF | Outcome 5 (2) |
| 23. Improve infrastructure and governance and promote competition in transport and logistics. | Medium term | MPWT | Outcome 5 (1,3) |

# V. Building skills and capacity for effective reforms

| Objective | Timeline for implementation | Responsible ministry or agency | Link with NSEDP 9 (outputs) |
|---|---|---|---|
| 24. Improve data and knowledge to support effective policy making. | Short term | All | Outcome 6 |
| 25. Develop comprehensive and inclusive communication strategy within each lead ministry and leverage feedback from stakeholders. | Medium term | All | Outcome 6 |

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# Unlocking Policies

http://wrld.bg/tmsw50JmKGa

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