Forging Ahead

Restoring Stability & Boosting Prosperity

Introduction

Lao PDR 2023

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Introduction

Background

The Lao PDR is a country with vast natural resources that has enjoyed significant political stability. The Lao People's Democratic Republic (Lao PDR) is the only land-locked country in Southeast Asia, sharing borders with Thailand (west), Myanmar (northwest), China (north), Vietnam (east), and Cambodia (south).[1] It is one of the most sparsely populated countries in Asia, with 7.5 million people inhabiting about 230,000 square kilometers of land area. Most of the population lives in rural areas and relies on subsistence agriculture. The country's diverse topography (which includes rugged mountains, plateaus, and lush valleys) has contributed to rich biodiversity and cultural diversity, but it also has implications for livelihoods and connectivity (e.g., difficult access to remote rural areas). The country lies in the Lower Mekong River Basin and is endowed with vast natural resources, such as water (critical for fisheries, irrigation, and hydropower), minerals (e.g., copper and gold), and forests. Tourism has significant potential, especially eco-cultural tourism. The country has a tropical monsoon climate with distinct (rainy and dry) seasons, which impacts agriculture, hydropower generation, and the risk of natural disasters. The Lao PDR has a rich cultural heritage influenced by Buddhism (the predominant religion), while traditional customs and beliefs play an important role. The Lao PDR has been a single-party socialist republic governed by the Lao People's Revolutionary Party since 1975. The country has close historical, political, and economic ties with Thailand and Vietnam, while China has become an important trade and investment partner in the past two decades. The country has enjoyed a long period of political and social stability.

Policymakers have set an ambitious vision for the country in key development plans and strategies. The Ninth National Socio-Economic Development Plan (NSEDP), which covers the period 2021–2025, builds on the National Socio-Economic Development Strategy (2016–2025) and the National Vision to 2030. The NSEDP defines the long-term socioeconomic development objectives for the Lao PDR. These include graduating from the Least Developed Country category by 2026, moving toward becoming an upper-middle-income country, and achieving the Sustainable Development Goals by 2030.[2] The NSEDP identifies six priority outcomes: (i) continuous quality, stable, and sustainable economic growth; (ii) improved quality of human resources; (iii) enhanced well-being of the people; (iv) enhanced environmental protection and reduced disaster risks; (v) engagement in regional and international cooperation and integration through robust infrastructure and effective utilization of national potentials and geographical advantages; and (vi) public governance and administration. The government has recently approved the Ninth NSEDP's Financing Strategy, covering 2023–2025. During an extraordinary session in August 2021, the National Assembly approved National Agendas to be implemented by 2023 to address two pressing issues: economic and financial difficulties, and illicit drug control.

Development progress

Despite significant achievements in the past few decades, several socioeconomic challenges remain. The Lao PDR has been classified as a lower-middle-income country since 2011. Access to basic services has increased, especially electricity, clean water, and improved sanitation facilities. Many human development indicators improved during the period 2000–2019, including child and maternal mortality, school enrollment, income poverty, and gender equity. While there has been considerable progress in improving many socioeconomic outcomes, the Lao PDR remains a nation with relatively weak human and institutional capacities, large infrastructure gaps, and a high dependence on natural resources. Child stunting and low learning outcomes are particularly concerning. Malnutrition continues to undermine physical and cognitive development, with stunting affecting over 30 percent of children under five. Educational outcomes are also poor, with low attainment in harmonized test scores (365 within a range of 300–625) and high learning poverty (as 98 percent of 10-year-olds cannot read and understand a simple text by the end of primary school). A child born in the Lao PDR just before the COVID-19 pandemic will only be 46 percent as productive when she grows up as she could be if she enjoyed a complete education and full health, which is lower than regional and income peers. Many socioeconomic indicators have recently deteriorated because of the impact of the COVID-19 pandemic (e.g., learning outcomes).

[1] Southeast Asia comprises Brunei, Cambodia, Indonesia, Lao PDR, Myanmar, Malaysia, Philippines, Singapore, Thailand, Timor-Leste, and Vietnam. These countries are often identified as regional peers. All but one (Timor-Leste) are part of the Association of Southeast Asian Nations (ASEAN).

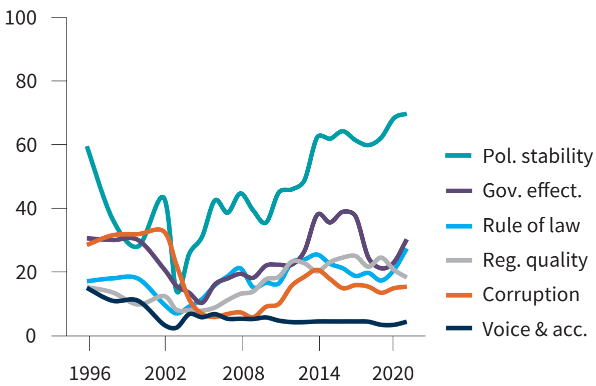
[2] The Lao PDR also aspires to become the 'battery of Southeast Asia' and transform itself from a landlocked to a land-linked country.

The Lao PDR is facing unprecedented macroeconomic challenges, which jeopardize hard-won development gains. Over the past two decades, the country attracted considerable foreign investment and fostered regional integration, which contributed to a long period of high economic growth. However, growth was predominantly driven by large-scale investments in capital-intensive sectors, such as mining and hydropower, which created few jobs and entailed environmental costs. Moreover, many public investments were financed by external debt, gradually jeopardizing debt sustainability and macroeconomic stability. Long-standing structural vulnerabilities have been exacerbated by the impacts of the COVID-19 pandemic and adverse global macroeconomic conditions. Since 2021, the national currency has depreciated considerably, and inflation soared. This has had a large negative impact on living standards, with many households struggling to cope. Meanwhile, limited spending on education, health, and social protection is undermining human capital and thus economic growth prospects. Debt pressures are unprecedented (especially short-term liquidity) and have pushed the country into debt distress. Macroeconomic instability, limited fiscal space, and financial sector vulnerabilities are endangering hard-won development gains and may weaken the population's confidence in public institutions.

Governance and institutions

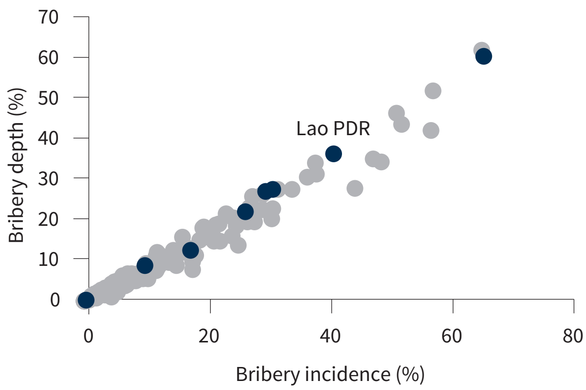
Weak governance and institutional capacities undermine macroeconomic and fiscal management. Macroeconomic stability is often hampered by weak institutions, systems, and processes. Unclear legal frameworks, lack of internal controls, poor rule enforcement, and limited checks and balances lead to a suboptimal allocation and management of public resources. While most governance indicators have improved since 2005, many have stalled or deteriorated in recent years (Figure I.1). Political stability increased over the past two decades and ranked in the top 30 percent of the world in 2021.[3] Except for voice & accountability, other governance indicators improved from around 2005 until the mid-2010s, after which they either stagnated or declined. Government effectiveness has broadly worsened since 2017, reflecting a decline in public administration performance. Corruption remains a significant challenge, with control of corruption declining since 2014.[4] Data collected from enterprises shows that corruption is pervasive (Figure I.2).[5] Corruption undermines economic and social development by creating inefficiencies (e.g., distorting markets, discouraging investment, and wasting public resources), eroding the rule of law and justice, and damaging public trust.[6] The rule of law improved

Figure I.1: Governance indicators (percentile rank)



Source: World Bank Worldwide Governance Indicators.
Note: Estimated scores provide very similar trends.

Figure I.2: Corruption in public transactions



Source: World Bank Enterprise Surveys.
Note: Blue dots represent ASEAN countries.

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[3] For information on the methodology, refer to the World Bank's Worldwide Governance Indicators.

[4] Cross-country research shows that 'grand' corruption distorts the decision-making process regarding public investment projects, and that higher corruption is associated with: (i) higher public investment; (ii) lower government revenues; (iii) lower expenditures on operations & maintenance; and (iv) lower quality of public infrastructure. See IMF working paper "Corruption, Public Investment, and Growth".

[5] 'Bribery incidence' measures the proportion of firms experiencing at least one bribe payment request, while 'bribery depth' measures the share of public transactions where a gift or informal payment was requested. Public transactions include six different types of interactions with government officials: applying for electricity and water connections, obtaining operating and import licenses, obtaining construction permits, and dealing with taxes.

[6] In 2022, the State Inspection and Anti-Corruption Authority estimated that over $700 million were lost to corruption since 2016. Meanwhile, it is critical to expedite the implementation of the Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) framework.

in recent years but remains weak. The government has made efforts to institutionalize state rule through laws and regulations, but few laws are widely known or consistently applied, while compliance and enforcement remain weak. After a steady improvement, regulatory quality stalled and then declined, which is a concern for the private sector. Key governance risks with fiscal implications include tax and customs administration, ad hoc granting of tax incentives, royalties (from the hydropower, mining, and forestry sectors), public procurement, public investment management (e.g., unclear accountability on decisions relating to public-private partnership), and state-owned enterprises (e.g., embezzlement and vested interests). Improving governance and institutions is therefore key to enhancing macroeconomic and fiscal management.[7]

Good governance and institutions are critical to supporting macroeconomic stability, while improved data and transparency can enhance evidence-based policy making. Improving governance arrangements and institutional capacities will support macroeconomic management, public service delivery, the business environment, and natural resource management. Strong coordination among public institutions is key to promoting macroeconomic stability, mobilizing domestic resources, and delivering effective public services. Stronger and more capable oversight institutions can promote greater accountability. Institutions are also important in the design and implementation of regulatory reforms that reduce bureaucracy, enhance competition, and contribute to a more vibrant private sector. Improved governance and strong institutions are key to combating corruption, effectively managing natural resources, and stemming state capture, especially in a context of high resource rents. Institutions also play a role in building resilience to shocks. Improved data (in terms of quality, coverage, and timeliness) and greater transparency (e.g., expenditure arrears, SOE liabilities, and PPP-related fiscal risks) would help enhance evidence-based policy making. Ensuring consistency, dissemination, and full implementation of legislation (e.g., coherent application and enforcement) would enable a faster move toward a rules-based economy that supports inclusiveness and promotes accountability.

Public Finance Review

This Public Finance Review covers macroeconomic stability, government revenue, public spending, and fiscal risks. The key objective of this Public Finance Review (PFR) is to assess recent macro-fiscal trends (e.g., revenue, expenditure, deficits, and debt), shed some light on emerging fiscal risks, and propose key policy reforms to secure fiscal sustainability and restore macroeconomic stability. Macroeconomic instability has been largely induced by fiscal and public debt decisions (e.g., tax exemptions and on-lending to state-owned enterprises) and a lack of coordination with monetary policies. Poor revenue mobilization has reduced fiscal space, and it is therefore critical to collect additional resources. Assessing the quantity and quality of public expenditure is crucial to improve the efficiency and effectiveness of spending, particularly in a context of limited fiscal space. Emerging fiscal risks relating to state-owned enterprises (SOEs) and public-private partnerships (PPPs) are a growing concern despite limited availability of relevant financial information. Overall, this PFR aims to strengthen the evidence base for decision-making on macro-fiscal management issues.

This PFR covers issues relevant to the entire public sector despite information gaps and data challenges. The compilation and presentation of data on public finances should follow established international standards, such as the 2014 Government Finance Statistics (GFS) Manual produced by the International Monetary Fund (IMF). In the GFS, the public sector consists of all institutional units controlled (directly or indirectly) by the government (Figure I.3). The general government sub-sector comprises central, state, and local governments, and each of these may have budgetary units, extra-budgetary units, and social security funds. Social security funds can also be treated as a separate sub-sector (see dashed line). The public corporation sub-sector includes financial corporations (e.g., state-owned banks and the central bank) and nonfinancial corporations (e.g., state-owned enterprises). In the Lao PDR, most publicly available data refers to the budgetary central government, which includes ministries and provinces. Provinces are part of the central government (as first-tier budgetary units) since they do not fully meet the criteria of autonomy, but rather act as deconcentrated entities with service delivery functions.[8] There is

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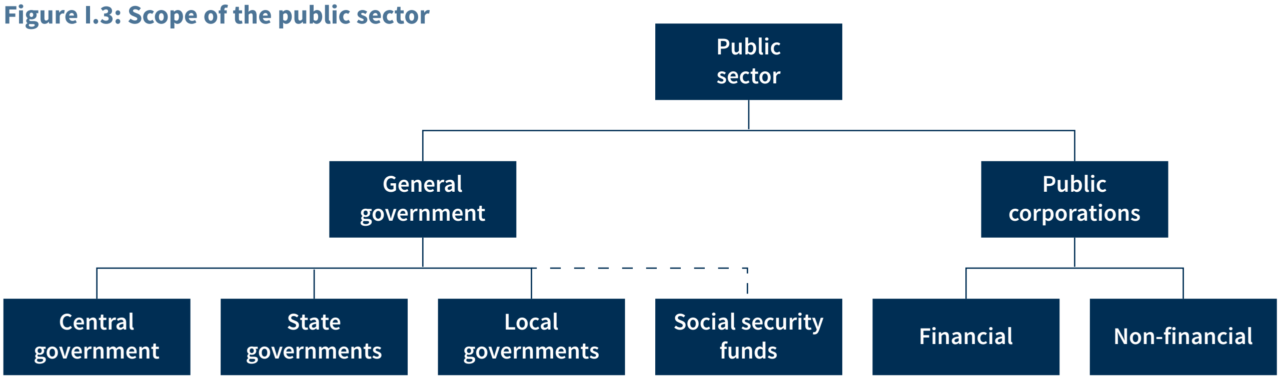
7 The Lao PDR ranked particularly low in terms of institutions in the 2019 Global Competitiveness Index (119th out of 141 countries), with a score far below the EAP average. Product market was the best ranked pillar (77th), partly due to low taxes. Within the institutions pillar, most challenges related to public sector performance, transparency (i.e., incidence of corruption), checks and balances (e.g., budget transparency), corporate governance (e.g., conflict of interest regulation and shareholder governance), and social capital (which relates to social cohesion). Most of these indicators ranked in the bottom 20 percent. Security and property rights fared better.

8 While there has been progress in administrative and representational devolution (e.g., locally elected assemblies), fiscal decentralization is not on the agenda. See the 2018 Public Expenditure and Financial Accountability (PEFA) assessment.

limited information on the social security fund and public corporations, and hence, there is no consolidated public sector balance sheet.[9] This PFR has dedicated chapters on SOEs and PPPs, despite information gaps and a lack of comprehensive data, since they often entail large risks for public finances.

Figure I.3: Scope of the public sector

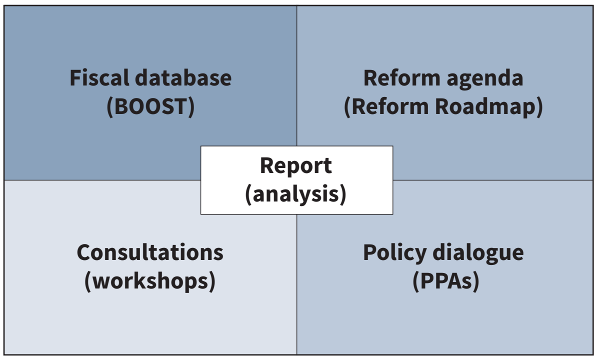


Source: International Monetary Fund.

This report is the result of a productive collaboration between the World Bank and the Government of the Lao PDR. The PFR work was undertaken in close collaboration with the Ministry of Finance, and it also benefited from an engagement with the Ministry of Planning and Investment, among other public institutions. It builds on the 2011 Public Expenditure Review and the 2018 Public Expenditure Analysis. This programmatic activity involved several missions with the objective of collecting information, better understanding fiscal dynamics, and strengthening institutional collaboration. Beyond this report, a BOOST database was developed to facilitate the analytical work, while its evidence and recommendations have fed into the World Bank's Reform Roadmap and several Performance and Policy Actions (Figure I.4). Several stakeholder consultations were undertaken before publication.

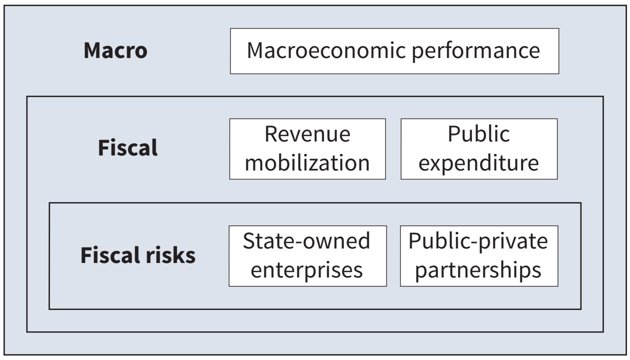
This report comprises several chapters framed as standalone (yet interconnected) building blocks. This report is organized as follows (Figure I.5): Chapter 1 provides an overview of key macroeconomic trends to offer a timely reflection on recent macroeconomic performance while placing fiscal policy in the broader macroeconomic context. Chapter 2 assesses recent domestic revenue mobilization efforts by reviewing trends, policies, and institutional developments to gauge revenue performance and scope for reforms. Chapter 3 evaluates the size and composition of public expenditure according to different classifications, as well as its efficiency and effectiveness. Chapter 4 (on state-owned enterprises) and Chapter 5 (on public-private partnerships) provide some insights on fiscal risks, which can further undermine fiscal sustainability if they materialize.

Figure I.4: Public Finance Review outputs



Source: World Bank staff.

Figure I.5: Public Finance Review structure



Source: World Bank staff.

[9] Quasi-fiscal operations are activities often undertaken by public corporations (e.g., central bank, state-owned banks, and state-owned enterprises) that affect the overall public sector balance sheet without affecting the budget deficit. These quasi-fiscal operations can have similar fiscal policy impacts on the economy and should be carefully monitored.

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