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2021 Update

Systematic Country Diagnostic

Lao People's Democratic Republic

THE WORLD BANK
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List of Acronyms

ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
CPF	Country Partnership Framework
GIS	Geographic Information System
HCI	Human Capital Index
HLO	High-Level Outcome
ILO	International Labour Organization
IMF	International Monetary Fund
IPP	Independent Power Producer
LECS	Lao Expenditure and Consumption Survey
LFS	Labor Force Survey
LSB	Lao Statistics Bureau
LSIS	Lao Social Indicator Survey
LUCF	Land-Use Change and Forestry
MEM	Ministry of Energy and Mines
MLSW	Ministry of Labour and Social Welfare
MOES	Ministry of Education and Sports
MOF	Ministry of Finance
MOH	Ministry of Health
MOHA	Ministry of Home Affairs
MONRE	Ministry of Natural Resources and Environment
MPI	Ministry of Planning and Investment
MSME	Micro, Small and Medium Enterprises
MTEF	Medium-Term Expenditure Framework
MTFF	Medium-Term Fiscal Framework
NAPA	National Adaptation Program of Action
NDC	Nationally Determined Contribution
NSEDP	National Socioeconomic Development Plan
OECD	Organisation for Economic Co-operation and Development
OOP	Out-of-Pocket
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PPAs	Power Purchase Agreements
PPG	Public and Publicly Guaranteed
PPP	Public-Private Partnerships
SAO	State Audit Organization
SCD	Systematic Country Diagnostic
SDGs	Sustainable Development Goals
SEZ	Special Economic Zone
SFM	Sustainable Forest Management
SME	Small and Medium Enterprise
SOE	State-Owned Enterprise
SPS	Sanitary and Phytosanitary
TVET	Technical and Vocational Education and Training
UNICEF	United Nations Children's Fund
WHO	World Health Organization

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Executive Summary

This Systematic Country Diagnostic (SCD) updates the analytical work of the 2017 SCD in the light of new evidence. In 2017, the World Bank Group (WBG) published the first SCD for the Lao PDR, which comprehensively assessed the binding constraints to economic growth, inclusion, and sustainability. This SCD uses recent evidence to describe developments since 2017, revisit the previous pathways and priorities for achieving the twin goals of ending extreme poverty and boosting shared prosperity, and update knowledge and data gaps. It identifies the most pressing development challenges supported by new data and analytical work and emerging opportunities.

Recent evidence suggests that poverty has been reduced but income inequality is increasing. The economy continued to grow strongly between 2017 and 2019 at an average of 6.2 percent per year, albeit at a slower pace than in the preceding three years. Economic growth declined dramatically to 0.5 percent in 2020 owing to the COVID-19 pandemic. The national poverty rate fell from 24.6 percent in 2012 to 18.3 percent in 2018. The standard of living has also improved, with notable gains in access to basic services, education, and health outcomes. However, poverty remains high compared to regional peers and is concentrated among subsistence farmers and minority ethno-linguistic groups. Inequality continues to rise as rapid growth has been jobless. The Gini index increased from 36.0 to 38.8 between 2012 and 2018, and the shared prosperity premium was negative (consumption per capita among the bottom 40 percent grew by 1.9 percent per year compared to 3.3 percent for the total population).

While significant development progress has been achieved, several challenges have become more prominent since 2017 and amplified by the COVID-19 pandemic. Key risks identified in the 2017 SCD to macroeconomic stability, the inclusiveness of growth, and environmental degradation have materialized. Macroeconomic vulnerabilities have intensified, especially owing to an unsustainable public debt burden constraining fiscal space, exerting pressure on the exchange rate, and jeopardizing banking sector stability. While economic growth had been strong before COVID-19, recent evidence shows it was mostly jobless. Environmental concerns and vulnerability to shocks have also escalated due to intensifying climate-related risks and environmental degradation caused by both natural and human factors. These challenges, which have been exacerbated by the impacts of COVID-19, undermine sustained, inclusive, and resilient economic growth.

High public debt levels are fueling macroeconomic instability and threatening development prospects. Laos is facing both liquidity and solvency challenges owing to a high debt burden, poor revenue collection, limited financing options, and low foreign currency reserves, which have edged the country toward sovereign debt distress. Public and publicly guaranteed debt was estimated at 89 percent of GDP in 2021, one of the highest in the region. High debt service obligations contributed to a rapid exchange rate depreciation in 2021, which has compounded the external debt burden. Public debt challenges exacerbate existing financial sector weaknesses, partly through the exposure of state-owned banks to government debt. Rising debt service obligations are crowding out social spending. Public spending on health and education is estimated to have declined from 4.4 to 3.1 percent of GDP between 2016 and 2021, likely undermining service delivery. With revenue steadily declining over the years, an expenditure-driven fiscal consolidation, coupled with growing interest payments, has squeezed the fiscal space available for critical development expenditures, including health and education. Hence, there is a need to balance debt management and fiscal consolidation with critical public spending for long-term economic growth.

The current growth model is showing its limitations, particularly through its inability to support job creation. While GDP growth averaged about 7 percent between 2003–2019, it had been decelerating before COVID-19 and steadily declined from 8 percent in 2013 to 5.5 percent in 2019. This trend exposes the limitations of a growth pattern that has been capital-intensive, resource-driven, and debt-fueled. The emerging domestic private sector has been hampered by an unfavorable business environment, particularly through a lack of competition and transparency. The financial sector is dominated by state-owned banks, and there has been limited credit flow to the private sector, partly because large government financing needs are crowding out credit to the private sector. Economic growth has been jobless and unemployment rose from 4.1 to 15.7 percent during 2012–2018 while inequality increased. Migration has increased during the last decade with a sharp rise from 2015 onward, with a high incidence of migration observed in provinces where non-farm employment declined significantly. Remittances helped partially make up for lost non-farm income. Looking forward, a more inclusive growth pattern is required to improve development outcomes.

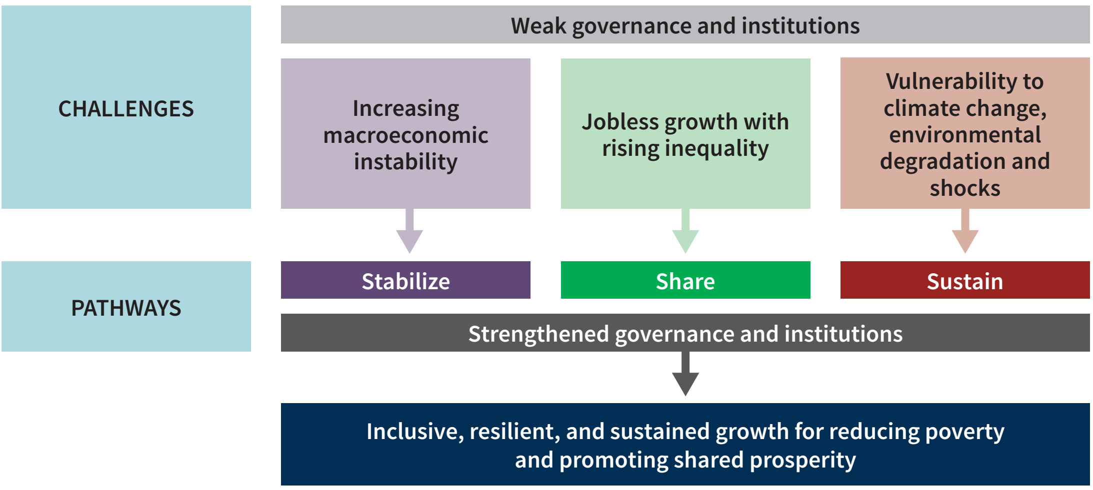
The depletion of natural capital stocks and high vulnerability to shocks raises sustainability concerns. Economic growth has relied on natural resources, particularly through mining, hydropower generation, and agricultural activities. This has resulted in natural resource depletion and environmental degradation while also contributing to social tensions. The Mekong River fell to record low levels in 2020 due to reduced rainfall and the operation of hydropower dams. In 2018, the collapse of a hydropower dam in Attapeu Province caused the worst flooding in decades, displacing over 6,000 people. In addition to natural disasters, development progress is highly vulnerable to health shocks (e.g., global pandemics) and economic shocks (e.g., commodity price fluctuations and exchange rate depreciation). A more sustainable, greener, and resilient growth model is needed to consolidate development gains.

COVID-19 brought unprecedented and cascading shocks with a profound impact on households and firms. While COVID-19 was declared a health crisis, its impact has been experienced in multiple dimensions. Laos has been largely successful in containing the spread of the virus, yet the pandemic and response measures have affected households and firms, especially vulnerable groups. The pandemic has caused major disruptions to business operations with SMEs having disproportionately suffered. It has also worsened pre-existing structural problems in the domestic labor market with the unemployment rate estimated to have increased to 23.4 in 2020 amid the pandemic. An influx of returning migrant workers resulted in the loss of remittances. Supply chain disruptions and exchange rate depreciation drove up prices. Income shocks induced by COVID-19 and rising living costs have hurt vulnerable households. The pandemic has also exposed weaknesses in the health, education, and social protection systems. Informal workers were insufficiently protected by COVID-induced job losses, while learning loss was greater among disadvantaged students. Limited fiscal space has constrained the government's capacity to deliver a fiscal stimulus to protect households and firms from the impacts of COVID-19. Looking forward, policies to improve human capital and promote private-sector job creation need to consider the damage induced by COVID-19, especially regarding vulnerable groups.

The regional context plays a key role in shaping opportunities for trade, investment, and migration. Trade has grown considerably over the past decade. Thailand, China, and Vietnam are the largest destination markets, mainly receiving commodity exports. Electricity exports to Thailand are growing in importance. Foreign direct investment has also grown over the last decade, particularly in hydropower, transport, and mining. China, Thailand, Vietnam, and Japan are the largest sources of foreign direct investment (FDI), with China accounting for a significant share. The Laos-China railway represents an important investment in regional connective infrastructure, although there are others linking the domestic market to Thailand (power transmission) and Vietnam (planned Vientiane-Hanoi Expressway and Vung Ang Port). A significant portion of these investments has been backed by large loans (sometimes publicly guaranteed), particularly from Chinese banks. There was also large-scale migration to Thailand before the COVID-19 pandemic that supported workers' remittances. The Regional Comprehensive Economic Partnership (RCEP), which became effective in January 2022, offers opportunities to deepen regional integration. Increased regional integration, cooperation, and coordination will be necessary to leverage emerging opportunities.

This SCD presents three pathways that address the most pressing development challenges facing Laos in the context of fostering an inclusive, sustainable and resilient recovery from COVID-19. Recent evidence suggests there have been improvements in socioeconomic outcomes, such as rising average income levels and poverty reduction. However, there remain significant constraints to inclusive, resilient, and sustainable development. In particular, three challenges have become more salient since 2017: (i) increasing macroeconomic instability; (ii) jobless growth with rising inequality; and (iii) growing vulnerability to climate change, environmental degradation, and shocks (e.g., economic, health, and natural). Meanwhile, governance and institutional weaknesses remain as pertinent as they were about five years ago. The three pathways identified in this SCD are critical for promoting inclusive, resilient, and sustainable growth (Figure E.1). The Stabilize pathway is a precondition for accelerating economic growth and protecting people's well-being; the Share pathway is crucial for enhancing inclusion and social cohesion; and the Sustain pathway is essential for strengthening economic, social, and environmental resilience. The cross-cutting theme outlines the institutional strengthening and governance practices needed for the effective implementation of the three pathways.

Figure E.1: SCD framework



Source: World Bank staff.

The Stabilize pathway emphasizes the urgency of restoring macroeconomic stability. Macroeconomic instability has become a critical concern hampering progress toward poverty reduction and shared prosperity by threatening living standards through high inflation, economic recessions, and reductions in social spending. Unsustainable public debt levels, limited fiscal space, declining reserve buffers, and growing financial sector risks are all challenges that have been exacerbated by the COVID-19 pandemic and underscore the need for urgent reforms. Securing macroeconomic stability will require measures to address macro-financial risks, such as: (i) improving debt transparency and management, through improved debt reporting, limits on non-concessional borrowing, and debt restructuring; (ii) creating fiscal space, predominately by enhancing domestic resource mobilization; and (iii) undertaking key financial sector reforms, including strengthened prudential regulation and supervision. Structural reforms will also be needed to support the economic recovery, especially in the non-resource sector amid heightened global risks and uncertainty.

The Share pathway highlights the need for a more inclusive growth process, which could deliver stronger benefits for the poor and the most vulnerable. Fostering inclusive growth will require improving the labor incomes of vulnerable households. This will entail building human capital and creating more and better employment opportunities. Human capital is the main asset of the population, especially for the poor and vulnerable who generally lack access to financial assets. While education leads to higher productivity and wages, returns to human capital are expected to be higher for healthy workers. Investing in quality education and health care services to provide equitable access for all will help reverse human capital losses caused by COVID-19 and thus lay the foundation for inclusive growth. Job creation connects growth to economic inclusion since for many households the labor market is the primary means of participating in and benefiting from economic growth. Most Lao workers are trapped in low-paid, low-quality jobs as self-employed workers or unpaid family workers, especially in agriculture. To escape from poverty, the poor need productive jobs that lead to higher incomes. Strong employment creation will require measures to improve the business environment, connective infrastructure, and a well-functioning labor market, particularly to leverage the potential of regional integration. A predictable business environment, critical regulatory reforms, and a stable and inclusive financial sector are essential to creating an enabling environment for the competitive and job-creating private sector. In the short run, workers and firms need support to help them recover from COVID-19 losses and equip them with the knowledge and skills needed in the post-COVID world. Owing to significant gender gaps in Laos, especially in the areas of maternal and reproductive health and labor market participation, closing the gender gaps is a component of this pathway.

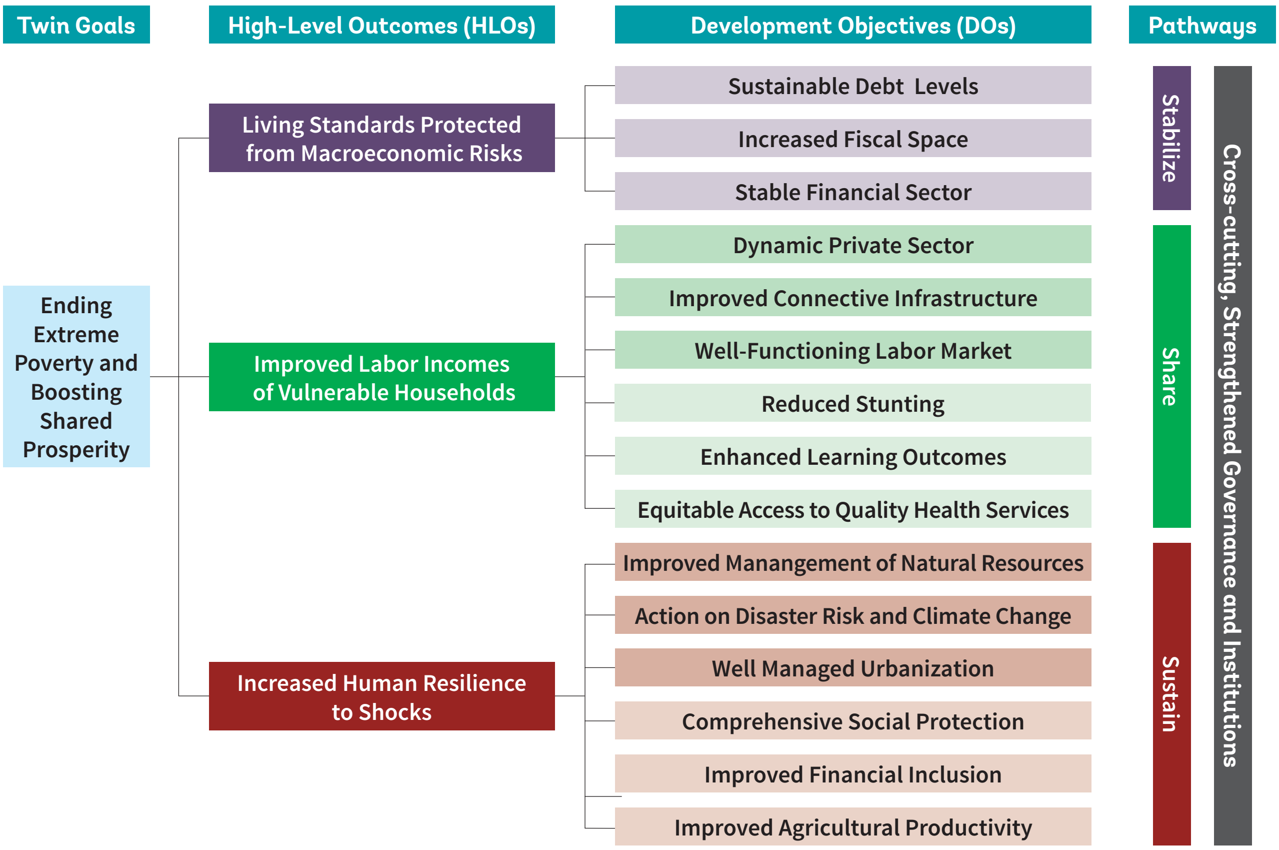
The Sustain pathway envisages the promotion of green growth and improved resilience to shocks. Green and sustainable development will require better institutions and processes to sustainably manage natural resources and enhance action on climate change. There is also a need to sustain a clean, stable, and affordable energy mix. To safeguard household livelihoods against intensifying disaster risks and external shocks, measures need to be taken to mitigate the risks posed by environmental disasters and improve agricultural productivity and resilience. At the same time, an adaptive social protection system and an inclusive financial system are essential for protecting livelihoods against intensifying shocks. COVID-19 is a case in point.

The cross-cutting theme aims to ensure that governance arrangements and institutions support policy implementation. Good governance and institutions are critical to support macroeconomic stability, private sector development, public service delivery, and natural resource management. Hence, strengthening governance and institutions is a critical cross-cutting challenge that affects progress in each of the three pathways presented above. Macroeconomic stability (Stabilize) is hampered by weak institutions, systems, and processes. Lack of internal controls, unclear legal frameworks, poor rule enforcement, and lack of checks and balances lead to a sub-optimal allocation and management of public resources. Inclusive growth (Share) ought to be underpinned by accountability, whereby stakeholders have a stronger voice and are involved in decision making, and the rights of citizens and firms are protected by an independent judiciary. Strong legal and market institutions are needed to support the role of the private sector in promoting job creation, competitiveness, and productivity growth. Curbing corruption contributes to a more accountable public sector. A more sustainable growth model (Sustain) requires robust management of natural resources, which requires better enforcement of rules, coordination among institutions, and increased stakeholder involvement. Finally, improving institutional quality and the efficiency of public service delivery is key to achieving progress in all identified priority areas.

A reassessment of the challenges and opportunities facing Laos led to the identification of three High-Level Outcomes (HLO) and sixteen development objectives. This SCD reevaluated the main constraints to ending extreme poverty and boosting shared prosperity in Laos. Sustainable debt levels, increased fiscal space, and a stable financial sector are essential to ensure that living standards are protected from macroeconomic risks such as high inflation, economic recessions, and reductions in social spending (HLO-1) (Figure E.2). A dynamic private sector and improved connective infrastructure are crucial to boosting job creation, while a well-functioning labor market, reduced stunting, enhanced learning outcomes, and equitable access to quality health services are all critical to enabling access to job opportunities. Progress in these areas will contribute to improving labor incomes of vulnerable households (HLO-2). Finally, improved management of natural resources, action on climate change, and well-managed urbanization can support green growth, while comprehensive social protection, improved financial inclusion, and improved agricultural productivity would support resilient livelihoods. These would in turn increase human resilience to shocks (HLO-3). Given the importance of the cross-cutting theme, a specific development objective was identified: strengthened governance and institutions.

Development objectives were prioritized in line with new evidence, providing insights that can inform the formulation of the upcoming Country Partnership Framework (CPF). This SCD highlights several development objectives pertinent to achieving the World Bank Group's (WBG) twin goals but there is a need to prioritize them. This SCD revisited the prioritization exercise undertaken in the 2017 SCD and updated it based on new evidence and the evolving country context. Three criteria were used to update priorities. First, preference was given to objectives with a significant impact on poverty and inequality. This criterion was given the highest importance. Second, areas that create strong complementarities across different dimensions or are a precondition for the achievement of other objectives were given more weight. Last, the time horizon of their impact is also an important factor when prioritizing by balancing actions with short-term impacts and actions whose impacts emerge over time. Feasibility is not a criterion used for prioritization since an assessment of the political viability and implementation capacity should be undertaken at the CPF stage.

Figure E.2: SCD framework and objectives



Source: World Bank staff.

Sustainable debt levels and increased fiscal space were identified as top priorities under the Stabilize pathway as they require immediate attention. Debt sustainability has become a more pressing concern since 2017, with a growing debt burden severely threatening macroeconomic stability and eroding fiscal space for development spending. Left unchecked, macroeconomic instability can significantly affect the purchasing power of households through a depreciating exchange rate and higher inflation. During COVID-19, more than half of the surveyed households considered inflation the most important issue confronting their community, and inflation is the issue that citizens believe the government should address first. By constraining fiscal space and deterring private sector investment, macroeconomic instability also harms long-term growth and job creation. Increased fiscal space is a top priority, as tax collection is faltering when stronger investments in human capital are crucial. Limited fiscal space has constrained the government's ability to expand spending on education, health and social protection, even in the time of COVID-19, leaving many people at risk of falling into poverty.

Table E.1: Prioritization

Top	High	Medium
Sustainable debt levels	Stable financial sector	Well-functioning labor market
Increased fiscal space	Improved connective infrastructure	Well-managed urbanization
Dynamic private sector	Reduced stunting	Improved financial inclusion
Enhanced learning outcomes	Equitable access to quality health services	
Improved management of natural resources	Action on disaster risk and climate change	
Increased agricultural productivity	Comprehensive social protection	
Strengthened governance and institutions		

Source: World Bank staff.

A dynamic private sector and enhanced learning outcomes were identified as top priorities under the Share pathway owing to the importance of reversing the trend of jobless growth. Recent evidence confirms that much of the recent growth experience has been jobless, a phenomenon not documented in the 2017 SCD and which has been worsened by COVID-19. Jobless growth has slowed poverty reduction and increased inequality in recent years. Therefore, a more dynamic domestic non-resource private sector is crucial to generating sufficient good job opportunities. Given that progress in education has slowed in recent years aggravated by learning loss from COVID-19, enhanced learning outcomes are needed to support learning recovery and ensure that prospective workers have the required skills and boost entrepreneurship. Although stunting significantly declined between 2011 and 2017, it remains prevalent and recent evidence shows that the situation might have worsened since 2017. Equitable access to quality health services continues to be vital to ensure healthy and productive workers, and to effectively respond to the pandemic. Connective infrastructure (comprising both transport and digital dimensions) remains important to supporting spatial development and to ensuring equal access to markets and public services, especially given that the new Laos-China railway will only reach the northern part of the country.

Improved management of natural resources and enhanced agricultural productivity were identified as top priorities under the Sustain pathway. Given that the livelihoods of most poor and vulnerable groups rely heavily on natural resources and agriculture, improving the management of natural resources remains critical to ensuring that resources are used in a sustainable manner while delivering adequate benefits to the population. Agriculture has been the main driver of poverty reduction. The sector also acts as a buffer for households during crises such as COVID-19. Improving agricultural productivity and resilience thus warrants top priority. Action on disaster risk and climate change is increasingly important and requires joint efforts to mainstream climate change into sectoral policies. Comprehensive social protection is also needed to safeguard people against cascading shocks stemming from pandemics, macro instability and climate and weather-related disasters. However, it is not an easy task given the weak social protection system in Laos and the increase in risk levels is why the objective has been elevated to a high priority when compared to the previous SCD.

Consultations informed the selection of policy areas and the prioritization process. The consultation process solicited views on what has changed since the last SCD (e.g., emerging constraints) and whether the policy areas identified were relevant. External consultations engaged a broad group of stakeholders through three virtual sessions that grouped: (i) government agencies and academics, (ii) the private sector, and (iii) civil society, citizens, and development partners. The government session offered many endorsements of the analyses and policy areas, including the proposed HLOs, development objectives, and pathways. Agriculture, education, small and medium businesses, and the environment were cited as priority sectors. The private sector session featured searching questions on how to address key macroeconomic challenges and the need for a more skilled workforce, all of which are highlighted in this SCD. At the final session, a theme raised several times and very often in messages through the World Bank's public channels, is the lack of access to credit for small-scale farmers, which this SCD emphasizes as a critical issue that needs to be tackled for achieving the development objective of increasing agricultural productivity.

This SCD revisited the data gaps identified in the 2017 SCD, noting some improvements but also some persistent challenges. The analytical content of SCDs depends partly on the availability of data and other information. The 2017 SCD identified several data gaps that have been reassessed. Hence, some recurrent and new knowledge gaps were identified during the preparation of this SCD.

1

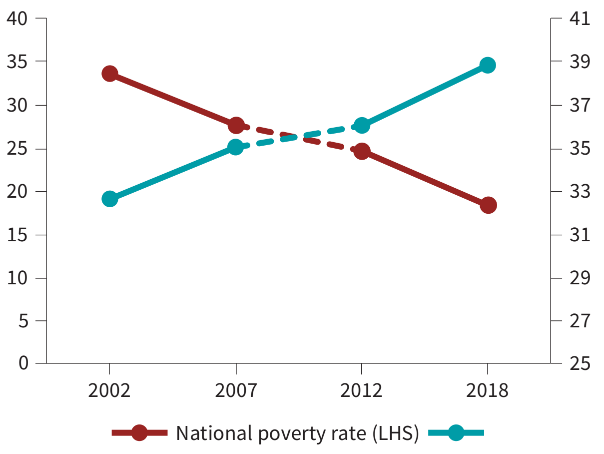
Introduction

Introduction

This Systematic Country Diagnostic (SCD) updates the analytical work of the 2017 SCD in the light of new evidence. In 2017, the World Bank Group (WBG) published the first SCD for the Lao PDR (Laos), which comprehensively assessed constraints to economic growth, inclusion, and sustainability. This second-generation SCD was conducted as an update rather than a completely new appraisal because development constraints have not changed substantively since the 2017 assessment. Therefore, this SCD uses recent evidence to describe developments since 2017, revisit the previous pathways and priorities for achieving the twin goals of ending extreme poverty and boosting shared prosperity, and update knowledge and data gaps. It identifies the most pressing development challenges, supported by new data and analytical work, and emerging opportunities. Finally, this SCD identifies high-level outcomes (HLO) to support a stronger outcome-orientation of the Country Partnership Frameworks (CPF).[1] In fact, one key objective is to inform the upcoming CPF for Laos and contribute to evidence-based policy discussions.

Since the 2017 SCD, poverty has been reduced but inequality is on the rise. The economy grew strongly between 2017 and 2019 at an average of 6.2 percent per year but slowed to 0.5 percent in 2020 due to the COVID-19 pandemic. Poverty fell from 24.6 percent in 2012 to 18.3 percent in 2018 (Figure 1.1) but remains high compared to regional peers (Figure 1.2). The rural-urban gap declined thanks to a significant decline in rural poverty, while urban poverty reduction stagnated. Poverty remains concentrated among subsistence farmers and minority ethno-linguistic groups. Inequality continues to rise as rapid economic growth has been jobless. The Gini index increased from 36.0 to 38.8 between 2012 and 2018 and the shared prosperity premium was negative (consumption per capita among the bottom 40 percent grew by 1.9 percent per year compared to 3.3 percent for the total population). The COVID-19 pandemic has disproportionately affected vulnerable groups and is expected to have a profound impact on poverty and inequality.

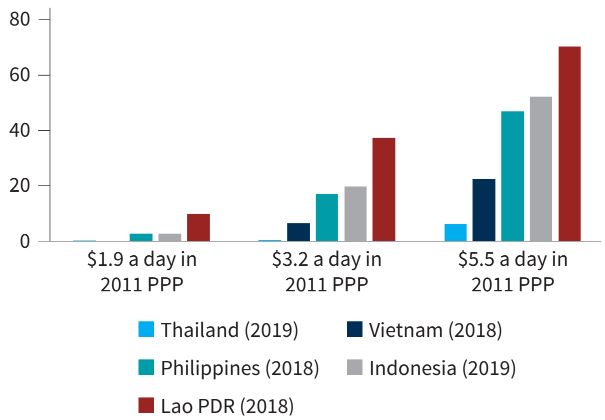
Figure 1.1: Official poverty and inequality (%)



Note: Revised poverty methodology for 2012 and 2018.

Source: Lao Statistics Bureau.

Figure 1.2: International poverty (%)



Note: Cambodia's consumption and poverty estimates are not available for cross-country comparison.

Source: Macro Poverty Outlook (2021).

[1] HLOs are long-term development outcomes critical to the achievement of the World Bank Group's twin goals.

The 2017 SCD identified three pathways and one cross-cutting theme through which the country could achieve the twin goals of ending extreme poverty and boosting shared prosperity. Pathway 1 focused on sustainable and efficient management of natural resources to deliver strong growth as well as secure the resources needed to build human and physical assets. Pathway 2 focused on unlocking the potential in non-resource sectors to create more sustainable and diversified opportunities. Finally, Pathway 3 emphasized the need for improvements in human capital to increase the ability of people to benefit from new opportunities and measures to address their high levels of vulnerability. Strengthened institutions was a cross-cutting theme critical for realizing opportunities through each of the three pathways.

The 2017 SCD also identified major risks that could undermine development achievements. The SCD analytical work showed that a growing public debt burden, systemic risks in the financial sector, and low reserve buffers would test macroeconomic stability, which could fuel inflation, lower living standards, and hurt the delivery of public services. Continued environmental degradation would hurt livelihoods and undermine growth prospects and, together with climate change, would further increase the country's vulnerability to natural disasters. If any of these risks materialize, the poor are likely to be the most affected as they have fewer options to mitigate risks.

Several of the identified risks have materialized and have been amplified by unprecedented challenges created by COVID-19. Macroeconomic vulnerabilities have intensified, especially owing to an unsustainable public debt burden that is constraining fiscal space, exerting pressure on the exchange rate, and jeopardizing banking sector stability. While economic growth had been strong before COVID-19, recent evidence shows it was mostly jobless. Environmental concerns and vulnerability to shocks have also escalated due to intensifying climate-related risks and environmental degradation caused by natural and human factors. These challenges, which have been exacerbated by the impacts of COVID-19, undermine sustained, inclusive, and resilient economic growth.

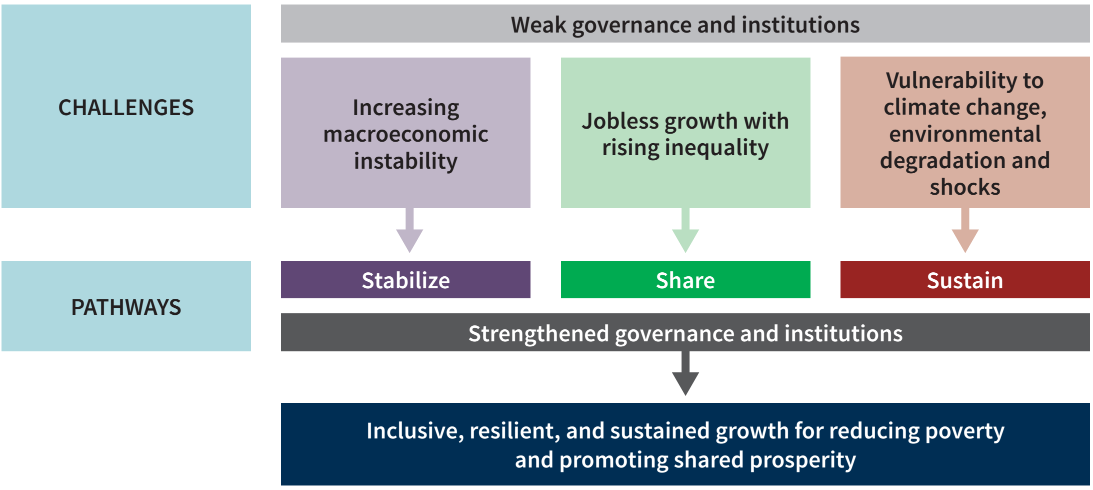
The assessment undertaken in this SCD is underpinned by new data and analytical work that has become available since the completion of the 2017 SCD. The current assessment uses the evidence gathered by the Country Economic Memorandum, the Poverty Assessment, the Public Expenditure and Financial Accountability (PEFA) assessment, a series of green growth advisory program reports and policy notes on several topics. Some of these are supported by new survey data, such as the Lao Expenditure and Consumption Survey 2018–2019 (LECS 6), the Enterprise Survey 2018, the Lao Social Indicator Survey 2017 (LSIS), and the Labor Force Survey 2017 (LFS).

There is a need for greater emphasis on challenges to inclusion and sustainability, which have become more salient since 2017. Several development challenges have become more prominent since 2017, namely: (i) increasing macroeconomic instability; (ii) jobless growth with rising inequality; and (iii) growing vulnerability to climate change, environmental degradation, and shocks. This assessment emerges from recent core analytics and monitoring of the legacy of the country's capital-intensive, resource-based development model. However, there are opportunities related to the country's natural wealth, young population, and strategic geographic location. With the opening of the first national railway in late 2021, Laos is moving one step closer to overcoming the development constraints that come from being the only land-locked country in Southeast Asia and capitalize on its strategic geographic location. It is therefore critical to re-establish priorities for the country to continue to grow, reduce poverty, and boost shared prosperity in a sustainable way.

Good governance and institutions are critical to supporting macroeconomic stability, private sector development, public service delivery, and natural resource management. The relationship between formal institutions and development becomes stronger as economies and societies become more complex. This link is even more important for resource-rich countries where the character of governance determines how natural resource rents are managed. However, the role of good governance and institutions is also key to supporting macroeconomic management (fiscal and debt), improving the business environment, enhancing human capital, supporting green and inclusive growth, and mitigating the impact of shocks. For instance, strong legal and market institutions are needed to support the role of the private sector in promoting job creation, competitiveness, and productivity growth. International experience highlights the important role that good governance plays in implementing effective and coordinated public policies.

This SCD comprises three sections with a new organizing framework. The next section updates the 2017 SCD findings on growth and poverty while highlighting three prominent development challenges. The third section discusses the new (3S) pathways of Stabilize, Share and Sustain toward more inclusive, resilient, and sustainable development and capitalizing on emerging opportunities (Figure 1.3). It also outlines the institutional strengthening and governance practices needed for effective implementation of the pathways and their attendant policies. The final section revisits the development objectives identified in the 2017 SCD, prioritizes these objectives in view of recent evidence, and suggests avenues for new policy dialogue and formulation.

Figure 1.3: SCD organizing framework



Source: World Bank staff.

2

Developments Since 2017 and Prominent Challenges

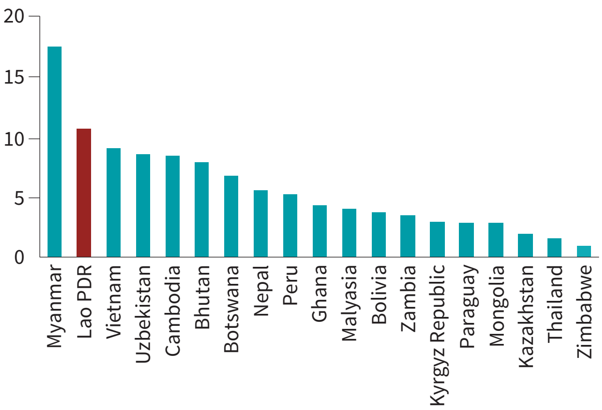
Developments Since 2017 and Prominent Challenges

Despite various development achievements, three challenges have become more prominent since 2017. Recent evidence suggests there have been improvements in socioeconomic outcomes, such as rising average income levels and poverty reduction. However, there remain significant constraints to inclusive, resilient, and sustainable development. In particular, three challenges have become more salient since 2017: (i) increasing macroeconomic instability; (ii) jobless growth with rising inequality; and (iii) growing vulnerability to climate change, environmental degradation, and shocks (e.g., economic, health, and natural). Meanwhile, the insufficiencies of the current economic model, driven by natural resource exploitation and capital-intensive activities and institutional weaknesses, have remained in place (Box 1).

Economic growth has continued to be driven by capital accumulation in the natural resource sectors, often financed by foreign debt. Economic reforms in 1986 marked the beginning of a transition from a centrally-planned to a market-oriented economy. Over the past two decades, the country has witnessed unprecedented levels of capital investment by exploiting its mining and hydropower potential. While data is approximate at best, the total (public and private) capital stock is estimated to have increased from $28 billion in 2000 to almost $190 billion in 2019 in constant 2017 US dollars. This equates to a compound annual growth rate of nearly 11 percent, which places the country in the global top 10 for capital stock growth (Figure 2.1). However, many of these investments have been financed through the accumulation of foreign debt. Total public and publicly guaranteed debt has increased considerably to $14.5 billion in 2021, or 89 percent of GDP. Most public debt is external, while the importance of non-concessional debt has increased.

Foreign investment has been a major contributor to Laos' capital-intensive growth, mostly flowing to large infrastructure projects. Foreign direct investment (FDI) surged from less than 2 percent of GDP in 2000–2005 to 10 percent of GDP in 2017, although it has declined in recent years. China, Thailand, Vietnam, and Japan are the largest sources of FDI, with China accounting for a significant share. Hydropower and mining represented about 80 percent of the foreign investment

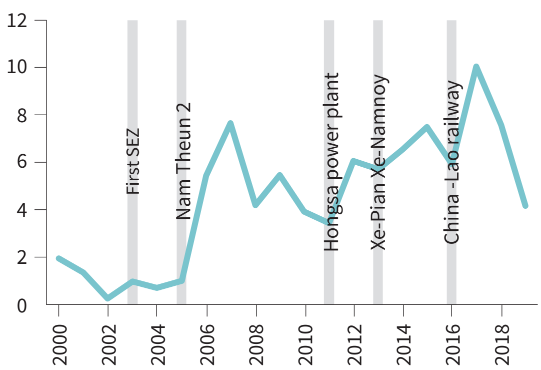
Figure 2.1: Capital stock growth (%, 2000–2019)



Note: Capital stock at constant 2017 US dollars.

Source: Penn World Table.

Figure 2.2: Foreign direct investment (net, % of GDP)



Note: Bar chart shows the commencement of construction.

Source: World Development Indicators.

accumulated over the last decade, with a particular focus on dam construction. The peak observed in 2017 was partly driven by the Laos-China railway, as 70 percent of the total $5.9 billion cost was funded by Chinese investment (Figure 2.2).[2] While the railway has the potential to transform Laos from a land-locked to a land-linked country, investment climate reforms and complementary investments are needed to maximize the benefits of the project, especially in terms of stimulating domestic economic activity and generating jobs.

The regional context plays a main role in shaping opportunities for trade, investment, and migration. Trade has grown considerably over the past decade. Thailand, China, and Vietnam are the largest destination markets, mainly receiving commodity exports. Electricity exports to Thailand are growing in importance. Foreign direct investment (FDI) has also grown over the last decade, particularly in hydropower, transport, and mining. China, Thailand, Vietnam, and Japan are the largest sources of FDI, with China accounting for a significant share. The Laos-China railway represents an important investment in regional connective infrastructure, although there are others linking the domestic market to Thailand (power transmission) and Vietnam (planned Vientiane-Hanoi Expressway and Vung Ang Port). A significant portion of these investments has been backed by large loans (sometimes publicly guaranteed), particularly from Chinese banks. There was also large-scale migration to Thailand before the COVID-19 pandemic that supported workers' remittances. The Regional Comprehensive Economic Partnership (RCEP), which became effective in January 2022, offers opportunities to deepen regional integration. Increased regional integration, cooperation, and coordination will be necessary to leverage emerging opportunities.

Box 1: Revisiting the growth model and the resource curse hypothesis

Capital-intensive resource-based growth has been driven by two strategic visions for Laos: the 'land-linked country' and the 'battery of Southeast Asia'. The Laos-China high-speed railway is envisioned to transform the country into a 'land-linked country', while its status as 'the battery of Southeast Asia' is seen as deriving from hydropower exports. Both visions require very large investments in infrastructure and as a result, a considerable proportion of capital stock has been created under public-private partnerships (PPP Knowledge Lab 2016). In 2013, this was estimated at 72 percent of GDP, the highest proportion in the world, and the share is expected to have increased in recent years (World Bank, forthcoming). These public-private partnerships predominantly reflect investment in hydropower generation and transmission lines but recently have also included a railway. Public-private partnerships have been predominately viewed as financing vehicles rather than as mechanisms to improve service quality and efficiency. The railway is expected to have a profound development impact by improving connectivity and creating economic opportunities.

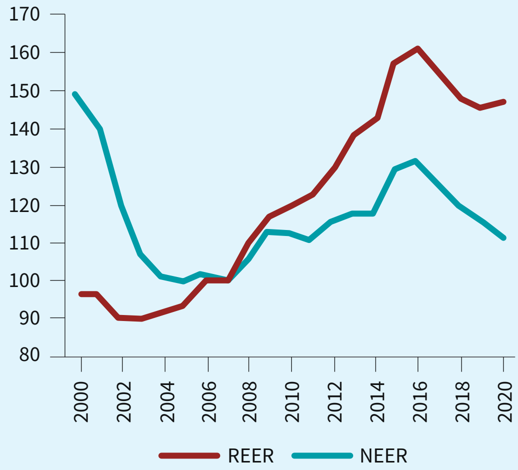
This economic growth pattern triggered a real exchange rate appreciation until 2016, which undermined the development of labor-intensive activities outside the resource-based sectors. From 2005 to 2019, investment in the hydropower and mining sector surged and its share of GDP rose from 13 to 21 percent. However, the real effective exchange rate appreciated by 54 percent during the same period, combined with a more than twofold increase in real wages between 2007 and 2018, making non-resource tradable exports uncompetitive, notably manufacturing (Figure 2.3).[3] Hence, a large and diversified manufacturing base has failed to develop. While the size of the manufacturing sector has grown by 7.5 percent per year between 2005 and 2019, the sector is still small compared to its peers. The manufacturing sector's share of GDP has stagnated at about 9 percent compared to an average of 20 percent for regional peers. Manufacturing only accounts for 20 percent of exports by value, and this lack of export diversification exacerbates the country's vulnerability to volatile commodity prices (World Bank, forthcoming). Weakening competitiveness inhibits economic diversification and fosters a 'rentier' economy in which resource rents and the return on financial assets take up a substantial part of national income.

[2] Other important infrastructure projects include the Vientiane-Boten Expressway.

[3] The real effective exchange rate was estimated to be overvalued by 44 to 49 percent at the end of 2016 (IMF 2017 Article IV report).

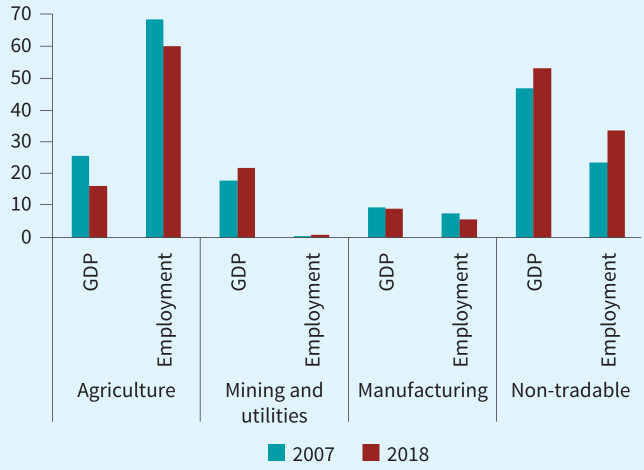
Box 1: Revisiting the growth model and the resource curse hypothesis (continued)

Figure 2.3: Real effective exchange rate (index, 2007=100)



Source: Bruegel (2021).

Figure 2.4: Sectoral share of output and employment (%)



Note: 'Non-tradable' includes services and construction.

Source: Lao Statistics Bureau and World Bank Poverty Assessment (2020).

Manufacturing and agriculture are shedding jobs as employment shifts toward the non-tradable service sector. An increase in the relative price of non-tradable to tradable goods has shifted production and investment away from the non-resource tradable sector toward the resource and the non-tradable sectors. Price distortions have contributed to deindustrialization, resulting in labor reallocation and job losses. Between 2007 and 2018, the growth of the capital-intensive resource sector yielded limited jobs. In fact, agriculture and manufacturing shed jobs (Figure 2.4). The non-tradable service sector expanded but was mostly driven by public sector employment. Real wages almost doubled, led by high wage growth in the public sector, information communication technologies (ICT), professional services, and manufacturing. Nevertheless, a large share of service sector workers remain in low-paid self-employed jobs (36 percent).

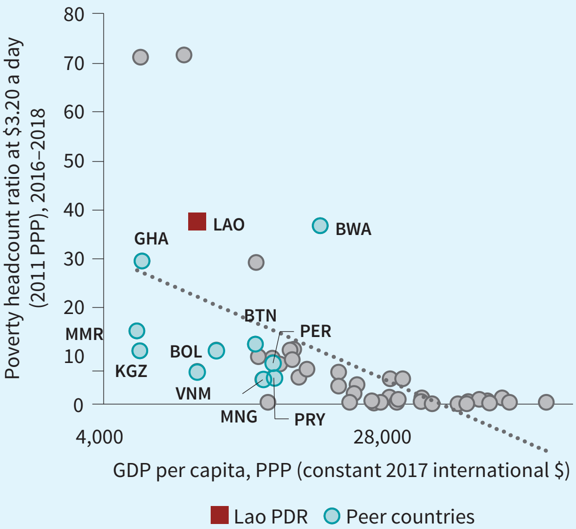
As in many resource-rich countries, the failure to transform natural capital into human capital explains the ongoing challenges faced by Laos. Successful resource-rich countries effectively transformed their natural capital into human capital, while a persistent failure to build human capital largely explains the ongoing challenges experienced by many resource-rich developing countries. Despite gains in education and health outcomes, the country's human capital indicators remain low. The country's score on the World Bank's Human Capital Index suggests that a child born today will be 46 percent as productive when she grows up as she could be if she enjoyed a complete education and full health (Figure 2.6). These scores are below the averages for East Asia and Pacific (50 percent) and lower-middle-income countries (48 percent). This evidence supports a general concern that spending on education and health has been lacking. During the past two decades, the country's strategic visions have led to buoyant growth in produced capital, while investment in natural capital and human capital lagged. While recent developments have seen progress in enrollment and student retention rates, the insufficient resources allocated to education undermine the prospects for sustained improvement (12 percent of total government expenditure compared to the average of lower-middle-income countries of 17 percent). The problem has been exacerbated by the worsening fiscal situation.

The resource curse has led to relatively low levels of development achievements. Despite having experienced strong economic growth for over a decade, the poverty rate remains higher than structural and regional peer countries (Figure 2.5).[4] The poverty rate based on the $3.20 per day (in 2011 PPP) poverty line was estimated at 37.4 percent in 2018, compared to 29.3 percent in Ghana, 5.0 percent in Mongolia, 6.6 percent in Vietnam and 5.4 percent in Paraguay. Malnutrition continues to be a critical issue, with stunting affecting over

Box 1: Revisiting the growth model and the resource curse hypothesis (continued)

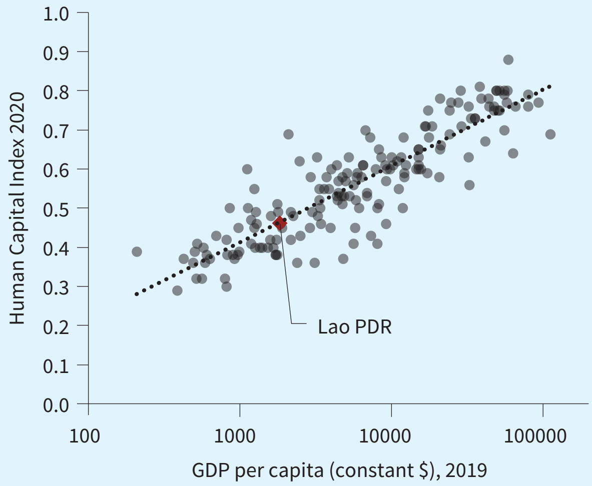
30 percent of children under five and constraining their lifetime skill acquisition and earnings. While a child goes to school for 10.8 years on average, she only receives the equivalent of 6.4 years of learning. The private sector remains underdeveloped, hindering job creation and the country's structural and spatial transformation. Agriculture constitutes 60 percent of employment and most labor is engaged in small-scale family farming, mostly subsistence. Ethnic groups in remote or highland areas experience a higher incidence of poverty and are at higher risk of nutritional deficiencies.

Figure 2.5: GDP per capita and poverty rate of resource-rich countries



Source: World Development Indicators.

Figure 2.6: Human capital development



Source: World Bank Human Capital Index.

Macroeconomic Instability

Macroeconomic instability has increased, amplified by the COVID-19 pandemic

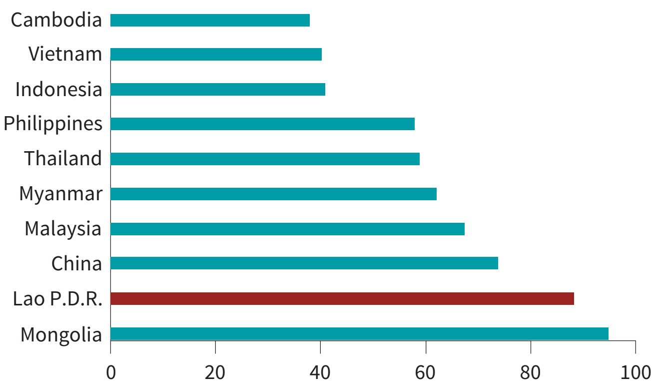
The macroeconomic position has deteriorated since 2017, fueling economic uncertainty. There are growing signs of macroeconomic instability.[5] Public debt levels have increased considerably in recent years as have publicly guaranteed debt and other contingent liabilities. Fiscal space has been eroded, largely owing to the poor performance of revenue collection and rising debt service payments. Reserve buffers are precarious, with foreign currency shortages contributing to the depreciation of the exchange rate, especially against the US dollar. Fragilities in the financial sector are predominately linked to weak balance sheets at state-owned banks. The current account deficit reflects external imbalances, even as electricity exports seem to be picking up pace. Economic growth has decelerated, highlighting the limitations of the current growth model. While these constraints predate COVID-19, they were exacerbated by the economic effects of the pandemic.

[4] Countries with natural capital per capita exceeding $11,000 in constant 2014 US dollars except Bhutan and Myanmar for which data are not available, and Vietnam ($9,381). Resource-rich peer countries include Bhutan, Bolivia, Ghana, Kyrgyz Republic and Mongolia (Structural); Botswana, Paraguay and Peru (Aspirational); Myanmar and Vietnam (Regional).

[5] While there is no agreed definition of macroeconomic instability, this is often associated with high and rising public debt levels, high inflation rates, large current account deficits, and stagnant or declining GDP.

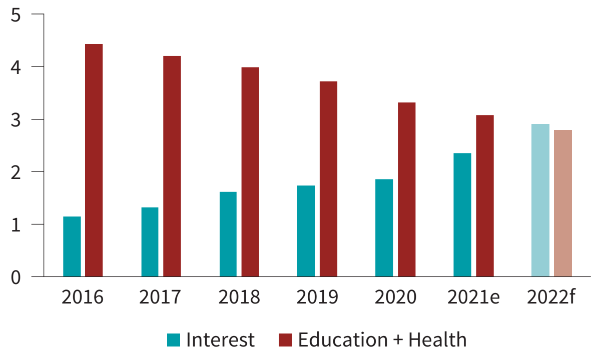
Public debt levels are very high, while contingent liabilities represent a growing threat. Public and publicly guaranteed debt (PPG) was estimated to have reached 89 percent of GDP in 2021, with state-owned Électricité du Laos (EDL) responsible for around 37 percent of total PPG debt. Government debt levels are the highest in the region (Figure 2.7). Rising debt levels and an increasing proportion of non-concessional debt have significantly increased external public debt service payments to over $1 billion per year. A growing debt burden, coupled with a weak fiscal framework, low foreign currency reserves, and limited financing opportunities have led to significant difficulties in meeting debt service obligations.[6] Contingent liabilities arising from the operations of state-owned enterprises and increasingly complex public-private partnerships (PPPs) are also a growing source of concern.

Figure 2.7: Government debt (% GDP, 2021)



Source: IMF World Economic Outlook and Government of Lao PDR.

Figure 2.8: Public spending on interest and social sectors (% GDP)



Note: Estimate for 2021 and forecast for 2022.

Source: Government of Lao PDR and World Bank.

Fiscal deficits remain high due to deteriorating revenue performance despite fiscal consolidation efforts. Government revenue declined from 20 percent of GDP in 2015 to less than 11 percent in 2020 owing to lower grants and sluggish tax revenue, which worsened further due to the economic impact of COVID-19. Public expenditure also decreased, from nearly 26 percent of GDP in 2015 to about 18 percent in 2020. This was due to curbs on both recurrent and capital spending, such as wage bill controls and postponement of new public investment projects. The fiscal deficit averaged about 5 percent in 2017–2020. Limited fiscal space has constrained the government's ability to provide meaningful support to households and businesses affected by COVID-19. While fiscal consolidation is necessary to avoid a faster build-up of public debt, the focus should be mainly on improving revenue mobilization through enhanced tax policy and administration (e.g., elimination of ad hoc tax exemptions).

Social spending has been hampered by declining revenues and rising debt service obligations. In response to poor revenue collection performance, fiscal consolidation has been achieved through tight expenditure controls. Coupled with fast-rising interest payments, this has squeezed the fiscal space available for development expenditures. The combined public spending on education and health is estimated to have declined from 4.4 to 3.1 percent of GDP between 2016 and 2021, likely undermining public service delivery. Interest payments are expected to overtake social spending in

[6] The Thai Rating and Information Services (TRIS) downgraded Laos' sovereign rating to BBB- in 2021. Moody's and Fitch downgraded to Caa2 and CCC respectively in 2020. Several attempts to issue international bonds during this period were unsuccessful due to limited interest and transparency.

2022 (Figure 2.8). Therefore, there is a need to balance debt management with critical spending for long-term economic growth.[7]

The government faces significant public financial management challenges, which affect fiscal discipline, resource allocation, and service delivery. The 2018 Public Expenditure and Financial Accountability (PEFA) assessment scored 22 of the 31 performance indicators as D or D+, suggesting a lack of basic alignment with good practices. Weaknesses are linked to the limited credibility of the budget, while medium-term planning is not consistent with resource availability. There is limited budget information for several institutions, an absence of systems to track resources at the service delivery level, and the link between capital and recurrent expenditure is weak. Limited information disclosure to the public undermines the transparency of public finances. Public investment management remains weak due to limitations in planning capacity and the failure to systematically apply pre-feasibility and selection criteria. The management of assets and liabilities is generally weak, including weak controls over fiscal reporting and public investment, which has generated significant fiscal risks. The digitization of PFM systems has started but needs to be accelerated to generate reliable information that can be used for better resource planning, budgeting, and execution. While the legal framework for public procurement has been strengthened, implementation is poor, and capacities are weak. The effectiveness of scrutiny by the State Audit Organization and National Assembly is limited.[8]

Inflation has been relatively stable over the past years but there are signs of concern. Consumer price inflation has been moderate for several years. The last time inflation was in the double-digits was in 2004. Despite disruptions from flooding in 2018, inflation remained relatively contained up until recently. Nonetheless, there are signs that inflation is gathering pace and remains vulnerable to commodity prices. Inflation reached 5 percent in 2020–2021, driven by rising food and transport prices and exchange rate depreciation.[9] Additional depreciation pressures, a possible monetization of the deficit and supply shocks (e.g., food, oil, and supply chain disruptions) could sustain domestic inflation. High consumer price inflation affects the purchasing power of households, especially the most vulnerable.

The exchange rate depreciated rapidly in the second half of 2021, partly due to low reserve buffers and high financing needs. Low reserve buffers constrain the government's ability to meet external debt service obligations and limit the central bank's ability to support the currency and banks with weak dollarized balance sheets. Gross reserves stood at $1.3 billion in 2021, about two months' import cover. Meanwhile, external debt service requirements have been estimated at over $1 billion per year. High financing needs, coupled with the limited availability of foreign currency, have had a considerable impact on the exchange rate, with the Lao currency depreciating by 19 percent against the US dollar throughout 2021 (between January and December).[10] This strong depreciation affects consumer price inflation through higher import prices and makes it more difficult to service external public debts since most are denominated in US dollars. It can also aggravate currency mismatches on banking sector balance sheets and potentially accentuate the dollarization of the economy. While a depreciation could make exports more competitive, seizing this opportunity would require strong productive capabilities and a favorable investment climate.[11]

7 Lao PDR is one of the poorest countries in the region and has low levels of human capital. Despite high development needs compounded by the COVID-19 pandemic, spending on education, health, and social assistance compares poorly with its regional and income peers and is below international benchmarks. This raises concerns over medium-term economic growth.

8 See Annex 2 for more detail on public financial management (PFM) challenges.

9 A weaker Lao Kip increases the domestic price of imports and thus feeds into higher inflation (i.e., exchange rate pass-through).

10 The Lao Kip depreciated by 8 percent against the US dollar between 2020 and 2021 (using period averages) but this masks the strong depreciation that occurred in late 2021. After a decade of steady exchange rate appreciation against the US dollar, the Lao Kip began to depreciate after 2016 (Box 1).

11 The difference between the official and the parallel exchange rate to the US dollar grew to more than 20 percent in August–September but subsequently eased as the central bank allowed the official rate to depreciate in late 2021.

The current account deficit has been narrowing but COVID-19 and debt repayments are likely to increase external imbalances. The current account deficit was very large between 2014 and 2017, averaging about 13 percent of GDP, partly due to the high import needs of large infrastructure projects largely financed by FDI inflows and external debt. However, the current account has improved significantly in recent years, supported by exports of electricity and manufacturing products while imports declined. Nonetheless, the COVID-19 pandemic has heightened balance of payment pressures, with a sharp decline in tourism and workers' remittances despite improvement in the goods trade balance as imports declined faster than exports. Growing debt service obligations further compound these external pressures.

Vulnerabilities in the banking sector are increasing, particularly in state-owned banks, and threaten to hamper already weak private sector credit growth. The regulatory capital adequacy ratio (CAR) fell from 18 percent in 2018 to 13 percent in mid-2021. This is one of the lowest levels in the region. Weaknesses are concentrated in two state-owned banks that are undergoing restructuring. The largest state-owned bank also experienced a notable decline in the CAR over 2020. Non-performing loans (NPL) as a share of total gross loans stood at about 3 percent in 2020 but the NPL-to-capital ratio is relatively high by regional standards. Both return-on-equity and return-on-assets indicators have declined in recent times, while there are concerns about the impact of macroeconomic instability, policy responses to COVID-19, and exchange rate pressures on bank balance sheets. In particular, financial sector policies enacted during the pandemic, such as regulatory forbearance measures, could lead to capital shortfalls in banks and limit the prospects for strong credit expansion to support the economic recovery. Private sector credit growth has decelerated in the past few years from 19 percent per year in 2015–2017 to 5 percent in 2018–2020, while access to credit continues to be identified as a top constraint for enterprises.[12] An improved financial sector supervision framework and strengthened capacity would likely reduce vulnerabilities.

Laos has so far suffered less from the COVID-19 pandemic than many of its regional peers but growth performance was the worst in three decades. GDP growth decelerated to 0.5 percent in 2020 due to the economic shock induced by the COVID-19 pandemic. The service sector has been the hardest hit because of lockdown measures and the decline in travel and tourism. Supply chain disruptions have negatively affected the performance of the industry sector, while the agriculture sector has remained resilient despite adverse climatic conditions in addition to pandemic-related disruptions. Nonetheless, the country has suffered less from the pandemic than its East Asian neighbors, owing to successful containment efforts and lower global integration. Growth is estimated to have recovered in 2021, although to lower rates than before the pandemic owing to an external debt overhang and public health measures to curb the spread of COVID-19. The policy responses to COVID-19 have been constrained by limited fiscal space and weak monetary transmission mechanisms.[13]

Jobless Growth

The benefits of growth are insufficiently shared, as too few jobs have been created

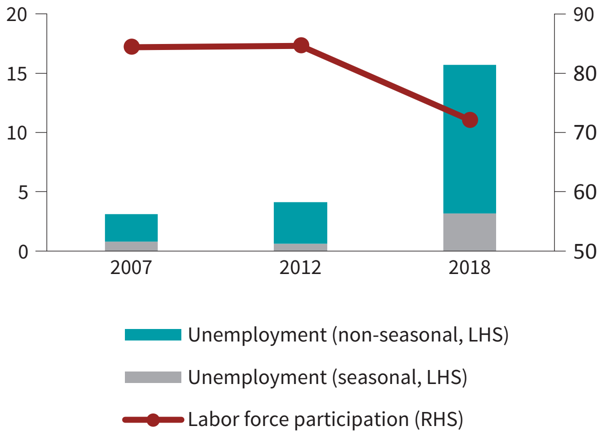
Before the onset of the COVID-19 pandemic in 2020, economic growth was rapid but jobless. The phenomenon of jobless growth affected the economy in the early 2010s amid a boom in hydropower (Box 1). The sustained growth of the capital-intensive resource sector yielded few jobs. Manufacturing stagnated and the labor-absorbing service sector grew slowly. With few jobs being created in other sectors, a large proportion of the workforce remained engaged in subsistence agriculture. Even as annual GDP growth averaged 7.2 percent per year between 2012 and 2018,

[12] Rising financing needs from the public sector could crowd out private sector borrowing.

[13] Additional spending or forgone revenue accounted for less than 0.1 percent of GDP since the start of the pandemic, one of the lowest levels in the world. Cambodia, Vietnam, and Thailand have spent the equivalent to 1, 6, and 15 percent of GDP, respectively. See IMF COVID-19 database.

there was stagnation in non-farm job creation. During this period, unemployment rose from 4.1 percent to 15.7 percent, and non-seasonal unemployment grew from 0.6 percent to 3.2 percent (Figure 2.9). It is estimated that over 100,000 workers migrated since 2010, most to Thailand, in search of job opportunities and higher wages (DESA 2019 and IOM 2021).[14]

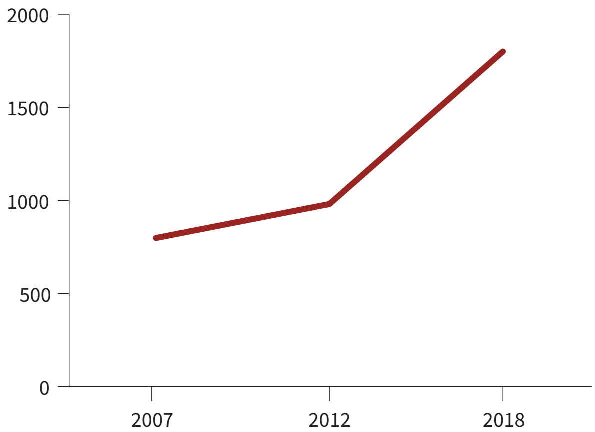
Figure 2.9: Labor market structure (percent, 2007–2018)



Note: Seasonally unemployed persons are those not seeking work because they are waiting for busy seasons.

Source: World Bank 2020b.

Figure 2.10: Median wage (thousand Kip, 2007–2018)



Note: Median monthly wage of wage employees who reported over 30 hours worked per week expressed in thousands constant 2018 Lao Kip. Some manufacturing subsectors are grouped due to small sample size.

Source: LECS5 and LECS6. Survey weights applied.

Resource-driven growth has not facilitated strong private sector development in the non-resource sector. The competitiveness of the manufacturing sector has been eroded. Real wages almost doubled between 2012 and 2018, likely because of the demonstration effect stemming from expanding public sector employment, high wages in the resource sector, and a rising minimum wage (Figure 2.10).[15] Labor productivity did not keep up with rapidly rising labor costs, squeezing manufacturing firm profitability and stalling employment. While the average labor productivity of service firms has increased, most firms remain small and unproductive. Firms in Laos are less productive than those in Cambodia and Vietnam (World Bank, forthcoming). Combined with high transport costs, this makes the country a less attractive destination for FDI than its neighbors. Despite efforts to attract FDI in certain non-resource sectors, only 35 percent of foreign investment accumulated over the last ten years has been attracted to the non-resource sector.[16]

A challenging business environment has made it difficult for investors to access certain sectors and has constrained competition. Laos ranked 113 out of 140 countries in the World Economic Forums's 2019 Global Competitiveness Index. In 2018, the five most problematic factors for doing business cited by firms were a lack of access to finance, unfair practices of competitors (both informal and formal firms), skill shortages, tax compliance and regulations, and inadequate infrastructure. The development of the digital economy is still at a very early stage (World Bank 2018b). While there have been some reforms to improve the investment climate, institutions, and legal frameworks, implementation remains incomplete. The inconsistent and unpredictable enforcement of laws and regulations across sectors and provinces deters potential investors, including multinational firms.

[14] In 2017, 87 percent of Lao migrants reported to be living abroad for job-related reasons (LSB, 2017).

[15] In May 2018, the monthly minimum wage was raised to 1.1 million Lao Kip, a 3-fold increase from 348,000 Lao Kip in 2011, compared to a 20 percent increase in the average price level during 2011–2018.

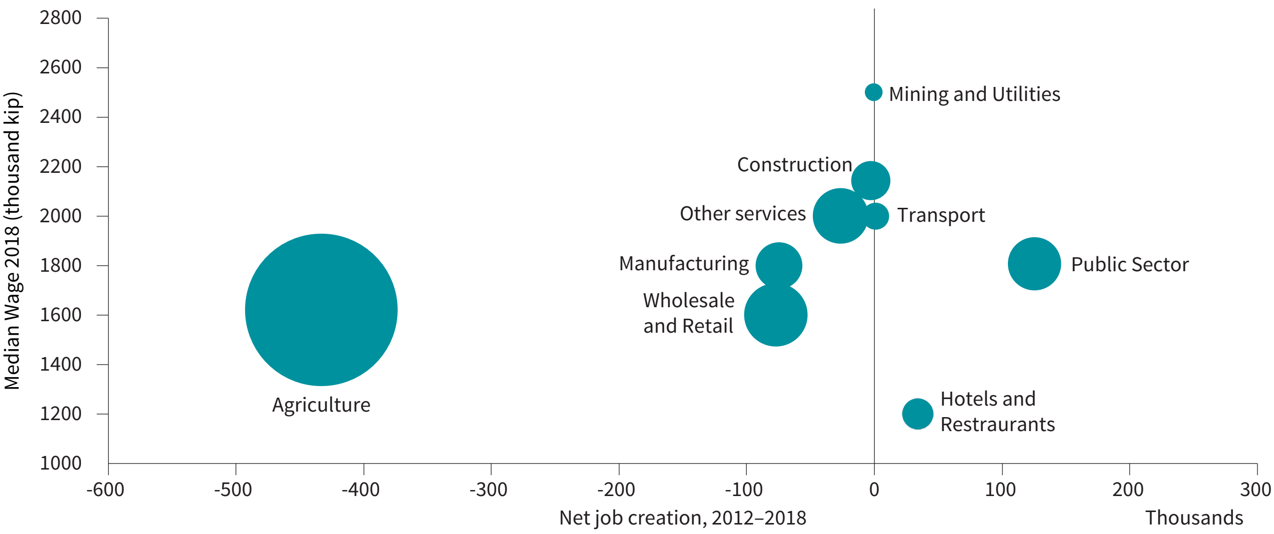
[16] Ministry of Planning and Investment, Government of Lao PDR. FDI includes both greenfield and brownfield investments.

The labor market suffers from weak private sector activity, with all sectors other than hospitality shedding jobs. The industry and services sectors could not absorb the surplus agricultural workforce. Although hydropower generation boosted growth in the industry sector, this created few jobs, while output in job-creating sectors has grown slowly. Between 2012 and 2018, the wholesale and retail trade sector shed the most almost exclusively self-employed workers, about 76,000 in total (Figure 2.11). Although some of these workers might have switched to the hospitality sector where some jobs were created, many have left the workforce altogether. The manufacturing sector shed nearly 75,000 jobs, more than half of whom were wage workers. Net job increases were registered only in the public sector (around 125,000 jobs) and the hospitality sector (34,000 jobs). As a result, many surplus rural workers were confined to agriculture and faced long-term seasonal unemployment while others migrated in search of job opportunities and higher wages.

Remittances helped partially make up for lost non-farm income. Despite limited opportunities in the local labor market, workers found job opportunities elsewhere and the money they sent home contributed to poverty reduction. Migration increased during the last decade with a sharp rise from 2015 onward and with a high incidence observed in provinces where non-farm employment declined significantly. Internally, about two in five domestic migrants moved to Vientiane Capital, spurring urbanization. International migration originated predominantly in the central and southern provinces of Champassak, Saravan, Savannakhet, and Sekong. Remittances from migrants have become a source of income for nearly 15 percent of households and accounted for 3.7 percentage points in poverty reduction between 2012 and 2018.

Agricultural commercialization has accelerated in recent years. External demand from China, Thailand, and Vietnam (maize for animal feed, fresh fruit, spices, and vegetables), and Europe (coffee) has triggered a supply response in the form of diversification, adoption of modern practices, and higher commercialization. A shift to cash crops has resulted in higher prices and increased sales volume and, in turn, higher farm income. The increase in farm commercialization and productivity is more pronounced in the northern and southern regions. The north has become more integrated into regional agricultural supply chains and value chains, with farming households benefiting from the international trade of farm products through cash crop contract farming and employment on large plantations. In the south, developing infrastructure and distribution systems from farm to market has contributed to higher commercialization and food processing.

Figure 2.11: Job creation and median wage by sector



Note: Median monthly wage of wage employees who reported over 30 hours worked per week expressed in thousands constant 2018 Lao Kip. Some manufacturing subsectors are grouped due to their small sample size. Job creation includes both wage employees and self-employed persons. Bubble size represents total employment in 2018.

Source: LECS5 and LECS6. Survey weights applied.

Agricultural commercialization has accelerated in recent years. External demand from China, Thailand, and Vietnam (maize for animal feed, fresh fruit, spices, and vegetables), and Europe (coffee) has triggered a supply response in the form of diversification, adoption of modern practices, and higher commercialization. A shift to cash crops has resulted in higher prices and increased sales volume and, in turn, higher farm income. The increase in farm commercialization and productivity is more pronounced in the northern and southern regions. The north has become more integrated into regional agricultural supply chains and value chains, with farming households benefiting from the international trade of farm products through cash crop contract farming and employment on large plantations. In the south, developing infrastructure and distribution systems from farm to market has contributed to higher commercialization and food processing.

However, the sector's potential remains largely untapped. Half of all farm households engage only in subsistence agriculture. Rice takes up 70 percent of the cultivated land. Rice farmers, especially the poor, mainly produce rice for their own consumption. About 70 percent of agricultural households grew rice in 2019 but only 5 percent of households produced it for commercial use. The underdeveloped agricultural value chains have also failed to generate employment opportunities for upstream and downstream agribusinesses. In 2019, Laos ranked 82 out of 101 countries in the Enabling the Business of Agriculture report, which measures elements of countries' regulatory framework affecting agribusiness value chains.

In the absence of new jobs, rapid economic growth did not translate into an equally high rate of poverty reduction. Laos achieves a slower pace of poverty reduction from its economic growth than other countries in the region. In six years from 2012 to 2018, a 1 percent increase in GDP per capita generated a decline in the poverty rate of only 0.67 percent (based on the lower-middle-income poverty line of $3.20 a day in 2011 PPP), compared with 1.3 percent in Vietnam, 1.5 percent in the Philippines, and 1.8 percent in Indonesia.

While economic growth was remarkable, the gain in household income and consumption was modest, especially at the lower end of the income distribution. Between 2012 and 2018, when the average growth rate of GDP per capita was 5.6 percent, household consumption per capita grew by 3.3 percent per year and around 1.9 percent among the bottom 40 percent.[17] The underdeveloped non-resource sector has limited the structural transformation of moving workers from relatively low-productivity agricultural sectors to higher-productivity non-agricultural sectors. Household income growth and poverty reduction could have been faster if there had been a larger transition from farm to non-farm jobs. Instead, poverty reduction was largely contributed to by rising farm income and remittances, as agricultural households transitioned away from subsistence rice cultivation toward the commercial production of cash crops, and some workers migrated abroad in search of better non-farm employment opportunities. Rapid growth was also more favorable to the well-off. This seems to reflect that gains from growth accumulated to better-off workers, especially those who were employed in the non-farm sector. While non-farm job creation stalled, real earnings among non-farm wage workers almost doubled between 2012 and 2018.

Vulnerable populations (young people, women, and ethnic minority groups) fare worse than others on the unpromising labor market. The job market fails to offer young workers opportunities, preventing many from leaving agriculture and tipping others into unemployment. Youth unemployment quadrupled to 21.8 percent between 2012 and 2018. The share of young people (age 15–24) not in education, employment or training (the NEET rate) rose from 8.2 percent to 23.4 percent.[18] Women's labor force participation dropped by 15.8 percentage points from 81.8 percent in 2012 to 66 percent in 2018, compared to a 9 percentage point decline in male labor force participation, from 87.4 percent to 78.4 percent. Low female labor force participation is attributed to gender norms that women are responsible for household chores and childcare. A gender

[17] Discrepancies between growth based on surveys and national accounts happen in the international context, although in most countries the difference is less noticeable than in Lao PDR. See World Bank 2020b for further details.

[18] NEET: not in employment, education or training.

earnings gap that was not present in 2012 emerged in 2018: in the private sector, women received on average 10 percent less pay than similarly qualified men employed in similar occupations and locations. Poverty remains high among ethnic minority groups, who lack access to public services and markets, with the Hmong-Mien ethno-linguistic group experiencing the slowest pace of poverty reduction. Child labor remains high, with girls disproportionately affected: 17 percent of girls (age 5–17) are in child labor compared with 13 percent of boys.

Progress in fostering human capital has slowed in recent years, hindering equitable sharing of growth benefits. Despite remarkable progress in education over the past few decades, school enrollment has declined in recent years. The net primary enrollment rate declined slightly from 92.5 percent to 91.5 percent between 2017 and 2019, while the net secondary enrollment rate fell from 70.9 percent to 65.6 percent during the same period. The overall status of Early Childhood Education (ECE) slightly improved with the gross enrollment ratio increasing from 23.0 to 25.5 percent. Although Laos has nearly achieved gender parity in primary school enrollment, the gender gap remains large for higher education and among the poorest. In particular, 42 percent of girls and 35 percent of boys are out of school at upper secondary school age, with the rates increasing to 76 percent of girls and 61 percent of boys for the poorest quintile (UNICEF 2019).

Maternal and child health continues to be a pressing issue, with 35 percent of girls married before their eighteenth birthday and 9 percent before the age of 15. Adolescent birth rates at 64 per 1,000 and child marriage rates were the highest in ASEAN in 2019. Early marriages and pregnancy are typically associated with no school attendance, high dropout rates, health complications, child stunting, and poverty. A high maternal mortality rate (185 per 100,000 live births) continues to put women at risk. The incidence of stunting stood at 33 percent in 2017 (a decline from 44 percent in 2011, ranging from 14 percent in Vientiane Capital to 54 percent in Phongsaly (LSB and UNICEF 2018).[19] However, the rate remains high compared to regional peers (Thailand 13.4 percent, Vietnam 24.6 percent, Myanmar 29.2 percent, Cambodia 32.4 percent, the Philippines 33.4 percent, and Indonesia 36.4 percent). Current rates of maternal and child malnutrition represent a loss of human capital potential costing the country an estimated 2.4 percent of GDP annually.[20]

The benefits of growth have not been equally shared across the country, as large-scale infrastructure projects contributed to uneven spatial development. The aggregate job loss masks disparities across regions, with the northern region experiencing job creation in urban areas owing to public infrastructure and foreign investment (Figure 2.12). Foreign investment in the northern region, including the construction of the Laos-China railway starting in December 2016, has boosted local economies and employment.[21] This compounded the effects of agricultural commercialization, which led to higher farm income and resulted in a significant decline in poverty in the northern region, which historically has been a lagging region (Figure 2.13). In marked contrast, farm commercialization has occurred slowly and non-farm job opportunities have declined in the central region. Poverty levels stagnated in the central region, which went from being the richest region to the poorest. In the southern region, the poverty rate declined thanks to a significant improvement in farm income that made up for losses in non-farm income.

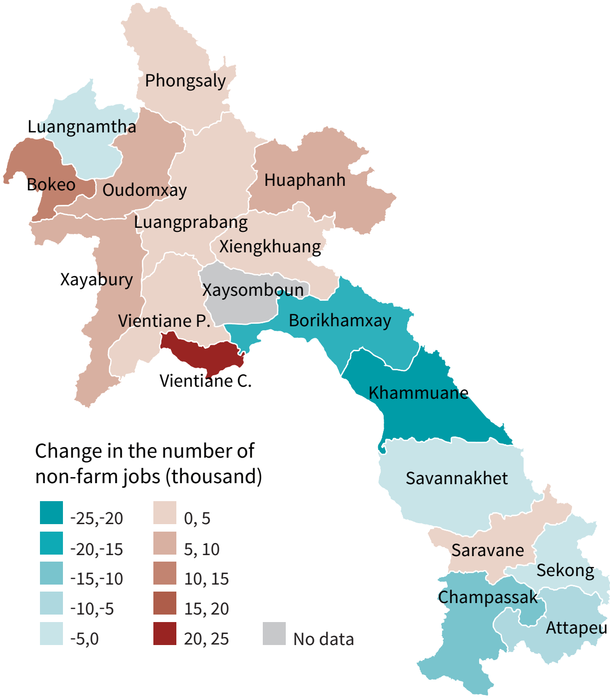
The COVID-19 pandemic has caused major disruption and is having a deep impact on business performance. Evidence from the Lao Business Pulse Survey shows that the impact of COVID-19 on operations, sales, and employment have been felt widely across firms, and especially on SMEs, particularly after the second lockdown in 2021. Relative to 2019, annual sales fell by over 40 and 48 percent on average in 2020 and 2021. The second outbreak in 2021 resulted in less than 40 percent

19 Recent evidence from the World Bank's nutrition convergence project in four northern provinces (Oudomxay, Phongsaly, Huaphan, and Xieng Khuang) suggest that the incidence of stunting might not have improved or worsened since 2017.

20 Overweight is less a concern for Lao PDR, with an estimated 3.5 percent of children under five overweight (2017). While the rate remains below the regional average, it rose significantly during the past decade, especially in urban areas (from 1.8 to 4.8 percent between 2006 and 2017).

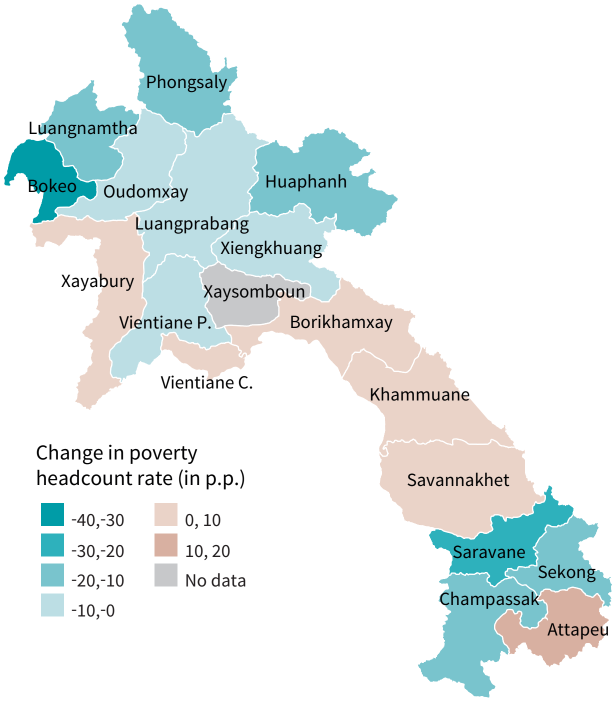
21 The Laos-China railway starts at the Luang Namtha border with China, passes through Oudomxay, Luang Prabang, and Vientiane before terminating in Vientiane Capital.

Figure 2.12: Net non-farm job creation (2012–2018)



Source: World Bank Poverty Assessment 2020.

Figure 2.13: Change in poverty rates (2012–2018)



Source: World Bank Poverty Assessment 2020.

of firms remaining open in April–May 2021. Agriculture, manufacturing, and wholesale and retail trade activities showed signs of recovery after the first lockdown in April 2020, while a persistent negative impact on hospitality (e.g., accommodation and food services) and other service sectors are undermining the recovery (World Bank 2021e).

COVID-19 has put pressure on an already weak job market and is estimated to have stalled progress in poverty reduction. A sharp drop in tourism demand has led to job losses in related sectors including retail trade, transport, and hospitality, which together account for 11 percent of total employment. A general slowdown in non-agricultural sectors has put thousands more jobs at risk, with unemployment estimated to have hit 23.4 percent amid the pandemic. Rising consumer prices, partly driven by the depreciation of the Lao Kip, have eroded household purchasing power. Remittances have also declined, as over 200,000 Lao migrant workers have returned from abroad and the social protection system remains too weak to cover the vulnerable and most in need. The incidence of poverty is estimated to be 1.2 percentage points higher in 2020 (18.5 percent) compared to a scenario without the pandemic (17.3 percent). Of the new poor, 72 percent fell into poverty because of the pandemic and the rest are those who would have escaped poverty had there been no pandemic.

The pandemic has also posed challenges for children's education, leaving persistent negative effects on human capital. During COVID-19, there was a learning loss because children did not go to school or study from home due to school closures. In May 2021, children in only 16 percent of households were engaged in learning activities during school closures (World Bank 2021f). The learning loss was significant in rural areas, where only 11 percent of households had their children engaged in learning activities during school closures, primarily due to an inability to focus without adult supervision and lack of access to learning devices. Given differences in asset ownership and access to the Internet, children in low-income and rural households face disproportionate educational challenges, negatively affecting human capital accumulation and consequently poverty and inequality.

Vulnerability to Shocks

Natural resource extraction remains unsustainable, amplifying climate challenges and vulnerability to shocks

Rapid growth has largely relied on short-term exploitation of natural resources and the costs of unsustainable resource-based growth are high. Key economic activities underpinning recent economic growth have included mining, hydropower sector expansion, and agriculture. While these activities provided important economic gains, they have also resulted in considerably high rates of deforestation, natural resource depletion, environmental degradation, and social tensions. The annual cost of environmental degradation, including the depletion of natural capital and reduced human capital from pollution, was estimated to be equivalent to 19.3 percent of GDP in 2017 (World Bank 2020a). At present, land lease and concession contracts cover 10,200 km^2 (4 percent of total land area), while mineral exploration contracts cover 107,000 km^2, which is nearly half the country's total land area (Ingalls et al. 2018).

Despite some improvement in recent years, unsustainable forest management continues to threaten natural capital. Natural capital depletion has been estimated at 4.7 percent per year. Deforestation and forest degradation are driven by multiple factors such as permanent land-use change for agriculture, the shifting area of cultivated plots, infrastructure development and, to a lesser extent, illegal logging and informal charcoal production. Illegal logging and hunting affect not only revenue generation but also contribute to the destruction of wild habitats. Regulation and policy implementation is impeded by weak horizontal coordination (between ministries), weak vertical coordination (between center and provinces), and understaffed local institutions. An overall weak regulatory and enabling environment for private investment in sustainably planted timber and nature-based tourism leads to rent-seeking behavior.[22]

Laos is also becoming increasingly responsible for greenhouse gas (GHG) emissions, mainly from three contributing sectors: agriculture, land-use change and forestry (LUCF), and energy. Despite a 34 percent emissions reduction between 2000 and 2020 (MONRE 2020), the agriculture and LUCF sectors contribute to over 50 percent of GHG emissions and energy-related activities contribute to another 48 percent. While the government is addressing deforestation and degradation through implementation of the Forestry Law (2019) and investments in forest institutions and sustainable forest enterprises, illegal timber harvesting and land conversion for agriculture underpin deforestation and degradation of forest resources. The country's increased use of coal in its energy mix also contributes to increasing emissions. Adding 1.8 GW of coal power generation capacity in 2015 substantially shifted the country's energy mix, which was previously almost entirely based on hydropower. Today, coal represents 19 percent of the total installed capacity and the government has plans to develop additional thermal capacity. According to the latest National Power Development Plan, about 1,845 MW of additional coal capacity is planned between 2020–2025. With continued investments in coal as an energy source, there is the risk that the climate performance of the country will decline.

Growing pollution from the lack of clean cooking options, inadequate waste management, and other sectors is costly to public health. About 10,000 deaths per year (1 in 5 nationwide) are caused by environmental health risk factors and pollution (Sánchez-Triana 2021). Household and ambient air pollution, lead exposure, and biological and arsenic contamination of drinking water are among the main pollution challenges. Missing regulatory frameworks and limited oversight capacity of pollution and solid waste management, monitoring, collection, and disposal contribute to health risks. High reliance on charcoal and imported fossil fuels increases emissions.

Climate change intensifies natural hazards, increasing the vulnerability of natural resource-based economies. Like many countries around the world, Laos faces significant projected warming

[22] For sustainable planted timber see World Bank 2019a. For nature-based tourism see World Bank 2019b.

against baseline conditions, with a projected increase in the number of heat-stressed days from 40 to between 50 and 110 days depending on the model scenario. The country is already exposed to major natural hazards, with extremely high exposure to flooding, including riverine and flash flooding. Annual expected losses from flood events range between 2.8 and 3.6 percent of GDP (Government of Lao 2018). Climate change alters rainfall patterns and intensifies the risk of flooding and droughts. Increases in rainfall are projected to be between 10 and 30 percent, particularly in the east and south. By 2030, an additional 40,000 people per year may be at risk of river floods annually due to climate change. This is in addition to the estimated 48,200 annually affected population in 2010.[23]

Urbanization has been rapid and with limited planning leading to growing flood risk in cities. The share of the population living in urban areas increased from 30.1 percent in 2010 to 36 percent in 2020. Within the next 30 years, roughly 55 percent of the population is projected to live in cities (United Nations 2019). Urbanization is increasing but with limited planning, inadequate infrastructure and finance, and stretched institutions. This means that the country risks missing opportunities to harness the transformative potential of cities. Land-use and urban master planning do not routinely consider climate-related risks, thereby exposing more people and assets to the impact of disasters. How this demographic shift is managed now will influence the effectiveness of urban areas in driving growth, reducing poverty, creating jobs, addressing climate challenges, reorienting food systems for delivering safe and healthy diets, and managing natural resources for decades to come.

Hydropower development has undermined the quantity and quality of ecosystem services provided by wetlands and contributes to growing disaster risks. Hydropower development intensifies the risk of flooding and droughts as it alters river flow and flooding, which affect the quantity and quality of ecosystem services provided by wetlands.[24] The annual costs of social, environmental and fishery externalities associated with hydropower development was estimated at 0.5 percent of GDP in 2017 (World Bank 2020a). In 2018, the Xe Pian Xe Nam Noy dam collapse in southern Attapeu Province resulted in casualties and the displacement of thousands of people. With 28 hydropower projects in operation or under construction and 10 projects scheduled to be constructed by 2030, such risks are set to grow.

The rural economy, which supports the livelihoods of two-thirds of the population, is particularly susceptible to natural hazards and environmental degradation. Rural communities share the common threads of subsistence or small-scale agricultural production, poor infrastructure, and limited access to markets. Most rural livelihoods are closely linked to the Mekong River system, and over 60 percent of the economically active population are engaged in occupations vulnerable to water-related shocks and degradation. These risks are exacerbated by deforestation and forest conversion, climate change, and hydropower dams.

Agriculture, the primary source of rural livelihoods, has grown unsustainably, while farm income is susceptible to volatile climate and price shocks. Between 2015 and 2020, agricultural growth averaged 2.3 percent per year compared with 0.8 percent and 2.5 percent for Cambodia and Vietnam. Productivity remains low as 64 percent of the workforce is engaged in agriculture, generating a value-added per worker of $863 (2019, constant 2010 US dollars), compared with $1,348 in Cambodia and $1,313 in Vietnam. Farm income is also subject to external factors including volatile agricultural prices, climate shocks, pests, or disasters. Access to formal credit is limited, hampering household ability to cope with shocks and discouraging people from investing in their land and farming practices.[25]

[23] World Resources Institute (WRI). Aqueduct Global Flood Analyzer in WHO (2015). Assumes continued current socioeconomic trends (SSP2) and a 25-year flood protection.

[24] IPCC models suggest that maximum monthly flows in the Mekong Basin will increase by 35–41 percent, while minimum monthly flows will drop by 17–24 percent by 2100, further exacerbating flood and drought risks. Rice production is also at risk from higher temperatures and shifts in rainfall.

[25] Land titles are the main type of collateral in Lao PDR and therefore one of the main barriers to expanding access to credit. In 2019, only 12.8 percent of famers were able to borrow money from banks (Wongpit et al. 2019).

Vulnerable populations are likely to be disproportionately affected by these shocks. Shocks have a particularly strong impact on low-income households, informal workers, young people, women, and ethnic minority groups. While poor management of natural resources and climate change intensify these risks, the limited capacity of disaster response, social protection and health systems have resulted in vulnerable groups resorting to negative coping strategies such as reduced consumption, reduced education, and child labor.

The COVID-19 pandemic has brought unprecedented and cascading shocks to household livelihoods. Growing multi-hazard risks and cascading health crises coupled with disasters present a major threat to household livelihoods. Since the pandemic, households have faced health emergencies, employment and income losses, high inflation, and heightened food insecurity. In May 2021, one-third of family businesses were temporarily closed due to a second wave of COVID-19 and lockdown measures and of those that remained open, 65 percent experienced a revenue decline. Household purchasing power declined, with 43 percent of households experiencing income reduction from the second wave and more than one-third of households experienced a significant increase in staple food prices of over 20 percent relative to the pre-pandemic level. Over 200,000 people have returned from abroad since the pandemic began in March 2020, resulting in a loss of remittance income and more slack in the domestic labor market. During 2019–2020, 44 percent of remittance-receiving households in 2019 experienced a decline in their remittance income (World Bank 2021c).

Income losses and rising food prices have resulted in increased food insecurity, particularly among vulnerable populations. Following the second wave of COVID-19, food insecurity intensified in May 2021, with more than half of all households unable to eat healthy and nutritious food, eating only a few kinds of food, or eating less than they did before the pandemic due to a lack of money or other resources, while one-third had to skip a meal (World Bank 2021e). The incidence of food insecurity is higher among rural households and ethnic minority households although the urban poor are more likely to be affected by rising food prices than the rural poor, most of whom rely on subsistence agriculture. Households generally have limited capacity to cope with shocks as they lack savings, assets, or access to financial services. Common coping mechanisms for households to manage the economic shock of COVID-19 included working extra hours and reducing food and nonfood consumption. Low-income households in particular relied on additional work and support from family and friends.

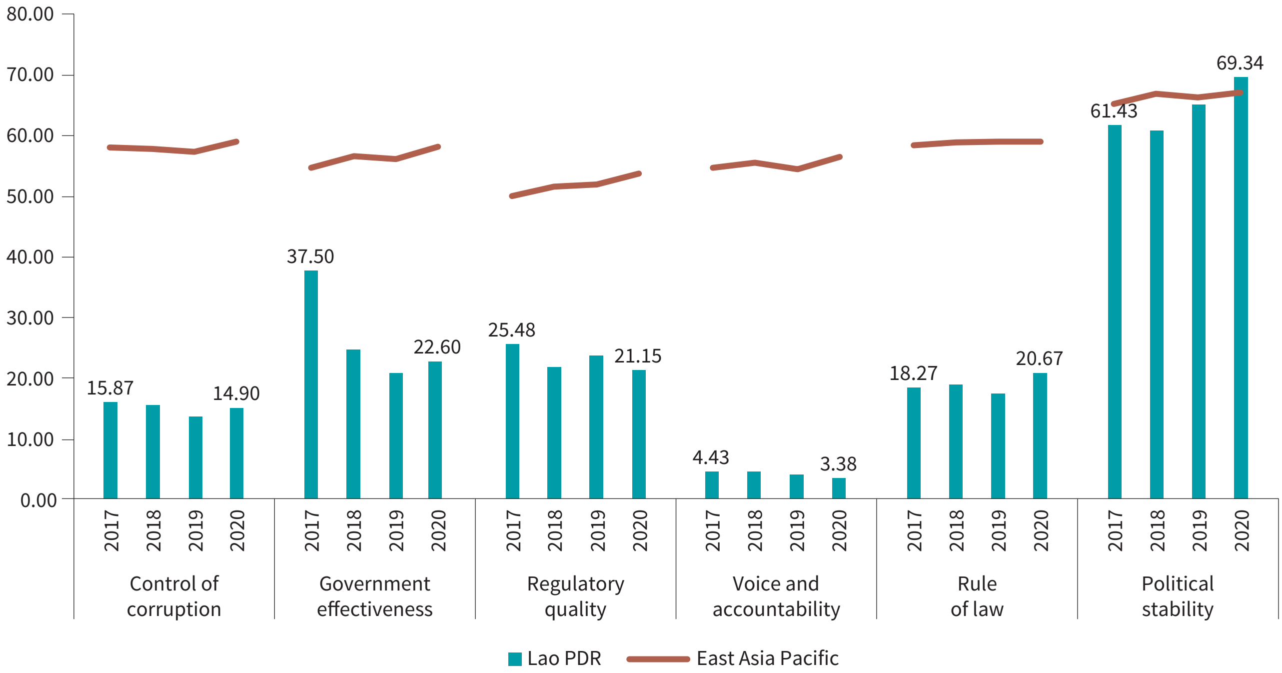
Governance and Institutions

Governance and institutional weaknesses lie at the heart of all three areas of challenge

Government effectiveness has worsened since 2017, reflecting a decline in public administration performance. The Worldwide Governance Indicators suggest that government effectiveness declined sharply between 2017 and 2020 (Figure 2.14). Government effectiveness captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. A lack of coordination and cooperation among government institutions, which often function as autonomous fields of power, has limited the quality of policy formulation and implementation (Bertelsmann Stiftung 2020). Merit-based recruitment and compensation is not widely used and the system is sometimes politicized, thereby undermining the quality of the civil service. The use of digital technologies in the public sector is lagging, which also weakens government effectiveness.

Corruption remains a challenge, with Laos ranked 178 out of 214 countries in 2020. Control of corruption captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption and capture of the state by elites and private interests. While anti-corruption legislation has been adopted, enforcement remains a challenge. Government regulation provides opportunities for bribery and fraud (Freedom House

Figure 2.14: Worldwide Governance Indicators (percentile rank)



Source: Worldwide Governance Indicators 2020.

2020). Corruption impacts businesses by undermining operational efficiency and raising the costs and risks associated with running a private firm. As confirmed by the 2018 World Bank Enterprise Survey, petty corruption in the form of informal payments for government services such as customs clearance, enterprise licenses, or tax payments is pervasive. According to the survey, bribery incidence stood at 40 percent in 2018 compared to 31 percent for East Asia and Pacific.[26] Bribery depth (i.e., the percentage of public transactions where a gift of informal payment was requested) stood at 36 percent, compared to 24 percent in the East Asia and Pacific region.

Laos scores very low on measures of voice and accountability. Voice and accountability captures perceptions of the extent to which a country's citizens can participate in selecting their government, freedom of expression, freedom of association, and a free media. The country's rank on the WGI voice and accountability indicator is very low and has deteriorated, with the country ranking 201 out of 214 countries in 2020.[27] Civil society traditions are weak. The government approved a decree that allowed civil society organizations (CSO) including associations, foundations, and other groups to formally register and gain legal status for the first time in 2009. The degree was later revised in 2018. In 2020, around 250 CSOs have registered. However, the enabling environment for civil society engagement remains somewhat restrictive (GIZ 2020; Bertelsmann Stiftung 2020). Media organizations are mostly state-owned. There is limited transparency of public finances as disclosure of budgetary and fiscal information to the public is inadequate, which undermines the ability of citizens to scrutinize the use of public resources (World Bank 2019c). In such a constrained political and civic space, pressure for reforms is unlikely to come from the demand side, which implies that reforms can be implemented only if there is political will at the top.

[26] Bribery incidence is a composite index of corruption that reflects the percentage of firms experiencing at least one bribe payment request across six transactions including paying taxes, obtaining permits or licenses, and obtaining utility connections.

[27] The indicator captures perceptions of the extent to which a country's citizens are able to participate in selecting their government as well as freedom of expression, freedom of association, and a free media.

The rule of law, which is the basis of the good governance needed to realize full social and economic potential, has improved but remains weak. Rule of law encapsulates the extent to which agents have confidence in and abide by the rules of society and, in particular, the quality of contract enforcement, property rights, the police, the courts, and the likelihood of crime and violence. Laos rank on the WGI rule of law indicator remained stable between 2017 and 2020 but it remains well below the East Asia and Pacific average. The judiciary is institutionally differentiated, but in practice, it is not independent. Corruption is not uncommon, especially in civil and commercial cases, and political connections often prove decisive (Bertelsmann Stiftung 2020 and Freedom House 2020).[28] The government has made efforts to institutionalize state rule through laws and regulations. However, few laws are widely known or consistently applied.

Regulatory quality has declined, which represents a challenge for the private sector. Regulatory quality captures perceptions of the government's ability to formulate and implement sound policies and regulations that permit and promote private sector development. This indicator has declined in recent years, suggesting rent-seeking behavior may have increased. In many countries, the combination of abundant resources and large-scale PPP infrastructure projects, in the context of a weak PPP framework, creates incentives for rent-seeking. Weak institutions, lack of transparency and sub-optimal PPP structuring accentuate the problem at the stages of negotiation, implementation and monitoring contracts, as evidenced by the fiscal consequences of several Power Purchase Agreements.

The representation of women in government is improving but remains largely unequal, in particular, at the local level. While the country has a relatively high proportion of women in the National Assembly, their participation at district and village level remains low (Lao Women's Union 2018). In 2021, the government elected the first woman Vice President in its history. The share of women in the civil service reached 46 percent in 2018. Women mainly work for the Ministry of Public Health (65 percent of its employees are women) and the Ministry of Education and Sports (51 percent). Taken together, these ministries offer about half of all civil servant positions for women, suggesting large inequalities in other areas. Recent legislation provides an opportunity to build more equal institutions. For example, a milestone law on gender equality was enacted in 2020. However, many laws and regulations have been unrevised for decades and gender issues are rarely addressed or even mentioned in new legislation. In 2019, the land rights of women were weakened by a new land law that no longer requires the names of both husband and wife on land titles for matrimonial property as originally required by Article 43 of the 2003 Land Law. This represents a serious setback for securing land rights for women.

In the power sector, the lack of a robust governance framework resulted in financial distress for the national power utility and exposed broader fiscal risks. The unclear division of responsibility between ministries has resulted in weak financial management and accountability and lack of prudent oversight and coordination of Électricité du Laos (EDL) investment strategy. Lack of coordination and clarity on authorization to sign agreements in the energy sector has led to unbalanced investments between generation and transmission, which has led to a further financial burden as capacity charges need to be paid even if the power produced cannot be resold. Many hydroelectric projects funded by the government or backed by public equity have been selected based on unsolicited proposals with limited investment rationale. While the Electricity Law and the Investment Promotion Law represent a reasonably well-established legal framework for competitive procurement and providing incentives for the participation of independent power producers (IPPs), in practice, there is a lack of transparency and competition in the way Power Purchase Agreements (PPAs) between EDL and the private sector have been negotiated (World Bank 2017). This has resulted in over-investment in power generation and unfavorable PPA terms, some at a net loss for EDL, and have caused financial distress, thereby increasing the exposure of the state to fiscal risks and limiting the benefits of opening up power generation to private investors.

[28] In November 2021, the State Inspection Authority revealed that investigations over the previous year had identified around $215 million lost in incidents involving corruption, especially to corrupt officials who embezzled state-funded development projects and state assets. The State Inspection Authority also stated that when state-funded projects do not comply with the law, it can result in huge losses to the state budget (Pongkhao 2021).

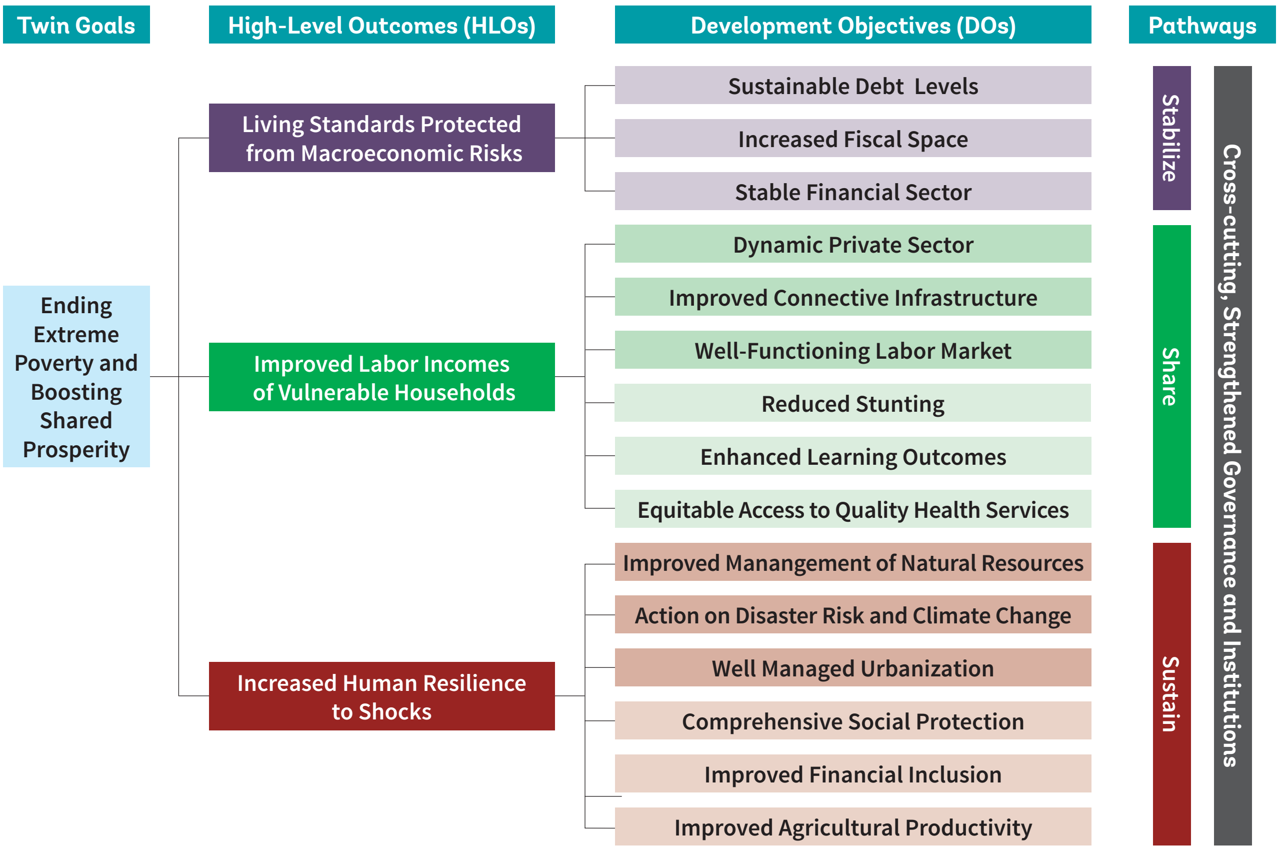
3

Pathways to More Balanced Development Outcomes

Pathways to More Balanced Development Outcomes

This SCD presents three pathways that embody the most pressing development challenges facing the country. The original pathways were revised to improve their alignment with the three development challenges that have become more salient since 2017: (i) increasing macroeconomic instability; (ii) jobless growth with rising inequality; and (iii) vulnerability to climate change, environmental degradation, and shocks. Meanwhile, governance and institutional weaknesses remain as pertinent as they were about five years ago. The three pathways identified are critical to promoting inclusive, resilient and sustainable growth (Figure 3.1). The Stabilize pathway is a precondition for accelerating economic growth and protecting people's well-being; the Share pathway is crucial for enhancing inclusion and social cohesion; and the Sustain pathway is essential for strengthening economic, social, and environmental resilience. The cross-cutting theme remains focused on governance and institutions.

Figure 3.1: SCD framework



Source: World Bank staff.

The Stabilize pathway emphasizes the urgency of restoring macroeconomic stability. Macroeconomic instability has become a critical concern and is hampering progress toward poverty reduction and shared prosperity by threatening living standards through high inflation, economic recessions, and reductions in social spending. Unsustainable public debt levels, limited fiscal space, declining reserve buffers, and growing financial sector risk challenges (exacerbated by the COVID-19 pandemic) underscore the need for urgent reforms.[29] Securing macroeconomic stability will require measures to address macro-financial risks, such as: (i) improving debt transparency and management, through improved debt reporting, limits on non-concessional borrowing, and debt restructuring; (ii) creating fiscal space, predominantly by enhancing domestic resource mobilization; and (iii) undertaking financial sector reforms, including strengthened prudential regulation and supervision. Structural reforms will also be needed to support the economic recovery amid heightened global risks and uncertainty, especially in the non-resource sector.[30]

The Share pathway highlights the need for a more inclusive growth process, which can deliver greater benefits for the poor and most vulnerable. Fostering inclusive growth will require improving the labor incomes of vulnerable households. This will entail building human capital and creating more and better employment opportunities.[31] Human capital is the main asset of the population, especially for the poor and the vulnerable who generally lack access to financial assets. Investing in quality education and health care services to provide equitable access for all will help reverse human capital losses caused by COVID-19 and thus lay the foundation for inclusive growth. Job creation connects growth to economic inclusion since for many households the labor market is the primary means of participating in and benefiting from economic growth. Most Lao workers are trapped in low-paid, low-quality jobs as self-employed workers or unpaid family workers, especially in agriculture. To escape from poverty, the poor need productive jobs that lead to higher incomes. Strong employment creation will require measures to improve the business environment, connective infrastructure, and establish a well-functioning labor market.

The Sustain pathway envisages the promotion of green growth and improved resilience to shocks. Green and sustainable development will require better institutions and processes to sustainably manage natural resources and enhance action on climate change. There is also the need to sustain the clean, stable and affordable energy mix of the country. Agriculture remains a source of livelihoods for most households, especially the poor and vulnerable. To safeguard their livelihoods against intensifying disaster risks and external shocks, measures need to be taken to mitigate the risks posed by environmental disasters and improve agricultural productivity and resilience. At the same time, there is a need to improve household ability to cope with negative shocks through improving social protection systems and financial inclusion.[32]

The cross-cutting theme aims to ensure that governance arrangements and institutions support policy implementation. Strengthening governance and institutions is a critical cross-cutting challenge that affects progress in each of the three pathways mentioned above.[33] Macroeconomic stability (Stabilize) is hampered by weak institutions, systems, and processes. Lack of internal controls, unclear legal frameworks, poor rule enforcement, and lack of checks and balances lead to a sub-optimal allocation and management of public resources. Inclusive growth (Share) ought to be underpinned by stronger voice and accountability whereby stakeholders are

[29] The limited availability of foreign exchange has contributed to a widening gap between the official and parallel exchange rates, especially between the Lao Kip and the US dollar.

[30] It should be noted that economic growth had been decelerating before the COVID-19 pandemic.

[31] The HLO of improving the labor incomes of vulnerable households has two main parts: the first supports job creation, while the second entails enhanced human capital to secure access to good job opportunities although the latter can also promote entrepreneurship.

[32] The HLO of improved human resilience to shocks has two parts: the first relates to sustainable (green) growth including action on climate change and management of natural resources; the second mainly relates to addressing vulnerability to shocks (natural, health-related, or economic).

[33] It has become commonplace to recognize that "institutions matter" for economic development (Acemoglu et al. 2012; Fukuyama and Levy 2010; North 1990).

involved in decision making and the rights of citizens and firms are protected by an independent judiciary. Curbing corruption also contributes to a more accountable public sector.[34] A more sustainable growth model (Sustain) entails a firm commitment to strengthening natural resources management, which requires better enforcement of rules, coordination among institutions, and increased stakeholder involvement. Finally, improving institutional quality and the efficiency of public service delivery is key to achieving progress in all identified priority areas.

The government recently adopted an ambitious plan to achieve important medium-term development objectives. The Ninth National Socioeconomic Development Plan (2021–2025) aims to translate the National Socioeconomic Development Strategy (2016–2025) and the National Vision to 2030 into actions. The plan aims to lay a foundation for the country to graduate from Least Developed Country status, become an upper-middle-income country, and realize the Sustainable Development Goals (SDGs) by 2030. For that purpose, the plan outlines six outcomes: economic, human capital, well-being, environment, integration and connectivity, and governance. The SCD pathways encompass (directly or indirectly) the NSEDP outcomes (Table 3.1).

Table 3.1: NSEDP and SCD.

NSEDP Outcomes	SCD Pathways
Continuous quality, stable and sustainable economic growth achieved	Stabilize, Share, and Sustain
Improved quality of human resources to meet development, research capacity, science and technology needs and create value-added production and services	Share
Enhanced well-being of the people	Share and Sustain
Environmental protection enhanced and disaster risks reduced	Sustain
Engagement in regional and international cooperation and integration	Share
Public governance and administration improved, and society more equal, fair, and protected by the rule of law	Cross-cutting theme

Source: World Bank staff.

Pathway 1: Stabilize

High-Level Outcome: Living Standards Protected from Macroeconomic Risks

Macroeconomic stability is an essential precondition for accelerating economic growth and enhancing living standards. Macroeconomic stability relates to a situation where economic relationships are in balance or when imbalances can be sustainably financed. These relationships comprise several dimensions, such as fiscal accounts (revenue and expenditure), balance of payments (current and financial accounts), and national accounts (savings and investment). Stability relies on good macroeconomic management and supportive structural reforms that strengthen the functioning of important markets and sectors. Macroeconomic stability is known to be a necessary condition for sustained economic growth and poverty reduction, which underpins improvements in the well-being of the poorest and most vulnerable people.

Macroeconomic risks can jeopardize development gains by reducing average incomes and increasing inequities. Macroeconomic instability is often associated with high and rising public debt levels, high inflation rates, large current account deficits, low foreign reserves, and stagnant

[34] This would include strengthening audit and inspection functions, automating transactions and public services, implementing open and competitive procurement processes, professionalizing the bureaucracy, prosecuting corruption cases, and strengthening the justice system.

or declining GDP. Macroeconomic instability undermines the efficient allocation of resources across the economy and generates economic uncertainty that affects consumer and business behavior. For instance, macroeconomic instability disincentivizes foreign and domestic investment, has negative impacts on job creation and other economic opportunities. It can also undermine bank balance sheets, often with considerable implications for the rest of the economy. In Laos, growing fiscal and financial risks can endanger macroeconomic stability, with higher inflation and exchange rate volatility potentially affecting living standards.[35] Unsustainable debt levels, limited fiscal space for development spending, and a fragile banking sector undermine economic growth, private sector development, job creation, and poverty reduction. Fiscal austerity driven by poor revenue collection and growing debt servicing needs can undermine long-term development outcomes. Priorities for supporting greater macroeconomic stability, and thus ensuring that living standards are protected from macroeconomic risks include: (i) sustainable debt levels; (ii) increased fiscal space; and (iii) a stable financial sector.

Sustainable Debt Levels

Unsustainable public debt levels pose a considerable threat to macroeconomic stability. Laos is facing both solvency and liquidity challenges.[36] Public and publicly guaranteed (PPG) debt increased from 52 to 89 percent of GDP between 2017 and 2021 and is currently one of the highest levels in the region.[37] Over time, high fiscal deficits, a steady GDP growth deceleration since 2013, exchange rate depreciation, and strong borrowing by state-owned enterprises have all contributed to a deterioration in debt ratios. The rapid rise in public debt levels has intensified macroeconomic risks through high debt service obligations exacerbated by recent exchange rate movements and a lack of access to international financial markets. These trends are placing increasing pressures on both fiscal and current accounts and can negatively affect living standards.

State-owned enterprise (SOE) investments have contributed to a rising debt stock and account for a large share of total debt. The public sector comprises the general government and public corporations, but the activities of the latter are not captured in the fiscal accounts. In addition to high fiscal deficits, state-owned enterprises have also been responsible for the increase in PPG debt. Many SOE investments have been financed by debt flows, either on-lent or guaranteed by the government. Électricité du Laos' (EDL) capital spending was thought to equal about three-quarters of government capital spending in 2015–2018 (World Bank, forthcoming). EDL and EDL-Gen's combined borrowing increased from 13 to 42 percent of GDP during 2013-2018.

The fast accumulation of debt has led to an increase in debt service obligations, placing strong pressures on the recurrent budget and the balance of payments. Public debt service obligations have increased considerably since 2015. SOEs like EDL are unlikely to service their debts without government support, especially given substantial operating losses due to increasing power purchase costs, inflexible purchase contracts, and domestic and export tariffs below cost recovery. This adds pressure to the existing public debt burden. External PPG debt service requirements are expected to rise to 6.5 percent of GDP in the next five years, which includes EDL's debt service obligations (on-lending and guarantees). This represents about 40 percent of budgeted government spending in 2021. In the absence of new financing or rescheduling, meeting debt service obligations would require a significant contraction in spending in other areas, likely undermining public service delivery. External debt payments (accounted as primary income outflows) contribute to current account deficits and the depletion of foreign exchange reserves. External financing gaps can have significant impacts on the exchange rate and imports.

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35 The National Assembly has recently endorsed a National Agenda on Economic and Financial Difficulties, which aims to address existing macroeconomic challenges such as high debt levels and low revenue mobilization.

36 The authorities did not consent to the publication of the 2021 Debt Sustainability Analysis (DSA). The debt data in this document reflects the most recent publicly available information.

37 Part of this increase is due to improved data coverage, especially with regard to domestic debt and guarantees. If an inferred disbursement from a currency swap agreement with the People's Bank of China is included, the PPG debt stock increases to 91 percent of GDP.

The composition of debt can have significant implications for the economic outlook. While most debt relates to concessional (bilateral and multilateral) loans, non-concessional loans have increased in importance. In particular, commercial loans and bonds increase the risk of debt distress owing to shorter maturities and higher interest rates. Most of the public debt stock is owed to external creditors, of which most is denominated in US dollars. While the appreciation of the Lao Kip between 2010–2016 helped contain increases in the local currency value of foreign debt, the recent depreciation against the US dollar is placing additional pressures on debt servicing. The current macro-fiscal situation undermines the ability to roll over debt and access international financial markets, especially after the recent sovereign credit rating downgrades which limit financing options.

A growing debt burden further compounds risks in the financial system. Expenditure arrears, which can be seen as unofficial deficit financing, have added to the stock of public debt and indirectly increased financial sector risks as public contractors are forced to borrow from commercial banks to compensate for the lack of payment. Monitoring and resolving expenditure arrears and avoiding the future accumulation of arrears and off-budget spending will be crucial to reducing financial risks. A growing debt burden may require tapping into expensive domestic borrowing, potentially compromising the balance sheets of state-owned banks.

Improving debt management and transparency is crucial to resolving debt challenges. Looking forward, it is essential to adopt greater selectivity in borrowing operations, for instance, by limiting non-concessional borrowing and applying stricter cost-benefit analysis to prospective investments. It is important to develop a clear legal framework for the management of contingent liabilities, including financial commitments to public-private partnerships (PPP) and carefully assess project viability before granting on-lending and guarantees to investment projects. Debt restructuring could be pursued through discussions with bilateral creditors or multilateral channels.[38] Improving the recording, monitoring, and reporting of PPG debt, including contingent liabilities, is key to better estimates of future debt obligations and developing an effective debt management strategy. Greater debt transparency can also boost creditor and investor confidence.[39] Over the medium-term, a strategic sale of equities in selected SOEs could raise revenue and minimize risk exposure, while in the long-term, measures to deepen domestic capital markets could expand available sources of financing.[40]

Increased Fiscal Space

Limited fiscal space has undermined the ability to invest in human capital and mitigate the impacts of COVID-19. A steady underperformance in revenue collection has led to an expenditure-led fiscal consolidation. Coupled with fast-rising interest payments, this has squeezed the fiscal space available for social needs. The combined public spending on education, health, and social protection has been declining even in nominal terms over the past five years, which is likely weakening public service delivery. More recently, the lack of fiscal space has undermined the policy response to the impacts of COVID-19, which was small by international standards. Therefore, there is a need to increase fiscal space through stronger domestic revenue mobilization to secure adequate spending on development priorities, build buffers against future shocks, and support long-term economic growth. There is also a need to improve the composition of public spending, particularly given the scarcity of public resources.

Revenue collection is low compared to regional peers and has declined in recent years. Government revenue amounted to 15 percent of GDP in 2019, which is lower than regional peer

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[38] The G-20 Common Framework aims to provide comprehensive debt relief for developing countries. There are ongoing debt renegotiations with large bilateral creditors.

[39] Improved transparency in debt operations and reporting through the use of adequate processes and systems to ensure the dissemination of comprehensive, accurate, and timely data would be key to enhancing public debt management. This would also reassure lenders and facilitate debt refinancing.

[40] Medium and long term reforms to SOEs could include restructuring, privatization, and closure, especially of those not needed or operating at loss.

countries. Concerningly, revenues were declining as a share of GDP even before COVID-19. Domestic revenue (which excludes grants) fell by nearly 3 percentage points of GDP between 2015 and 2019, mainly due to tax revenue. COVID-19 has exacerbated this trend owing to its impact on economic activity which narrowed the tax base. A reduction in travel overflight fees has led to a decline in non-tax revenues. Low and declining revenues reduce the scope for governments to adequately respond to shocks (e.g., by providing income support to households and businesses) and gradually build human and physical capital.

Revenue collection has been hindered by tax policy, especially through exemptions granted. Economic growth has been predominantly driven by natural resources but government revenues accruing from the resource sector have been limited. Resource-related revenues such as taxes, royalties, and preservation funds account for a small share of government revenue. Recent evidence suggests that over 80 percent of the corporate tax base is exempt, implying an average revenue gap of around 4.5 percent of GDP (IMF 2019). Such exemptions are usually granted to attract foreign investment in certain sectors such as mining and energy and other large projects. Tax exemptions often include waivers on import duties, profit tax holidays, and reduced tax rates. These exemptions lead to effective tax rates in the exempted sectors and businesses that are much lower than for the rest of the economy.[41] Regularly monitoring and evaluating the impact of tax expenditures would be an important first step to reduce the discretion in granting costly tax exemptions.

Despite improvements in tax administration, further efforts are needed to address the compliance gaps. Tax administration has improved in recent years, particularly with the implementation of the Tax Revenue Information System (TAXRIS). However, tax evasion from large taxpayers remains a challenge owing to limited audits and weak enforcement. Revenue mobilization is also constrained by widespread informality, which seems to have increased in recent years, even before COVID-19.[42] Lack of enforcement in applying the presumptive taxation regime for small companies also contributes to significant under-declaration of revenues and thus acts as an incentive for firms to stay small and informal.

Reforms have been introduced to improve revenue performance but have not yet addressed critical problems in the tax system. All major tax laws have been revised in the last five years, namely the Value Added Tax Law, the Income Tax Law, the Excise Tax Law, and the Tax Administration Law. However, these revisions have not addressed critical issues such as tax exemptions and tax holidays, transfer pricing, or digital taxation. On the tax administration side, there is no strategic planning at the headquarters level and there is no comprehensive risk management framework to guide operations. Revenue target setting has not been based on actual capacity or definite information. Staff capacity for conducting audits and for revenue collection management remains limited, while the taxpayer services function is also limited. Taxpayer data and information are limited and not centralized, even with the adoption of the new TAXRIS system. The recent reorganization of the tax administration structure includes a mixture of good and poor practices. While adding the risk-based management function is highly welcome, the split of the Revenue Management Division (which served as a quasi-large taxpayer unit in the past) means further deviation from good international practices in managing the most important segment of taxpayers.

Enhancing domestic revenue collection is key to enabling stronger investments in human capital and reducing fiscal risks. Tax policy reforms are needed, such as reducing tax exemptions and removing incentives for informality. This includes adopting a fiscal regime for the resource sector that is standardized, transparent, internationally competitive, and effectively enforced. Tax administration reforms can also yield significant revenues. There is a need for the adoption and implementation of a comprehensive risk management framework that would guide the tax

[41] In 2019, resource sector revenue accounted for about 7 percent of its value added compared to 17 percent for the non-resource sector.

[42] In 2016, 77 percent of firms reported competing against unregistered or informal firms compared to 42 percent in 2012 (World Bank 2017).

authority in prioritizing measures to address the compliance risks using their limited resources. Improving the monitoring and management of large taxpayers would be particularly important. Further investment to support higher automation in tax administration is also critical as it would help promote voluntary compliance, reduce bureaucracy and corruption, and strengthen the business continuity capacity of the tax administration operations. Tax reforms would also benefit from the adoption of tools that help monitor revenue performance and guide reform efforts, such as tax gap analysis and tax administration performance assessments.

Government spending is low compared to regional peers and has been declining. Before COVID-19, total government expenditure was already lower than in most regional peers at about 18 percent of GDP in 2019. Government spending remained broadly unchanged in 2020, due to limited fiscal space despite growing needs associated with the COVID-19 pandemic. In terms of expenditure composition, current spending levels are lower than regional peers, while capital spending is relatively high. Current spending amounted to about 12 percent of GDP in 2019, while capital spending reached 6 percent of GDP. Overall, both current and capital spending have declined significantly as a share of GDP since 2015. The level and composition of spending can affect the efficiency and effectiveness of public expenditures.

Relatively low current spending reflects consolidation efforts but may undermine public service delivery. Fiscal consolidation has been partly driven by wage containment and curbs on goods and services, while interest payments have increased, mainly driven by external debt service obligations. Limited revenue collection may have constrained the fiscal space available to adequately finance basic public services. For instance, government spending on both education and health are below global and regional benchmarks (World Bank, forthcoming). Insufficient funding for critical public services undermines human capital and growth prospects, with a negative impact on poverty and inequality.

Capital spending, although declining in recent years, has been driven by large infrastructure projects in energy and transport. Several large-scale projects have been undertaken in energy (hydropower) and transport (railway and roads), many of which were implemented through public-private partnership arrangements (PPP). However, capital spending has been declining. This was partly due to the 2018 floods which led to the temporary suspension of new investment projects while ongoing projects were reassessed to enable better prioritization (IMF 2019). Some spending was also reallocated to support reconstruction efforts. These statistics exclude capital investments undertaken by SOEs, especially in PPPs which often entail a contingent liability.

Public expenditure controls are vital to secure fiscal sustainability but a focus on efficiency and effectiveness is also warranted. Curbing unnecessary public expenditures will help reduce fiscal deficits. However, it is also crucial to improve the quality of spending. Improving its efficiency and effectiveness will lead to a stronger impact on economic growth and human development. A significant proportion of spending is accounted for by wages and capital spending, leaving little room for non-wage recurrent spending that is critical to delivering basic public services and maintaining public assets.[43] Improving human resource management, procurement processes, and public investment management can create crucial fiscal space for more impactful spending.

Monitoring and minimizing fiscal risks are crucial to secure fiscal sustainability. Fiscal risks arise from a range of contingent liabilities such as government guarantees and contractual obligations in PPPs and natural disasters. The financial position of SOEs (namely EDL) can undermine public finances and thus jeopardize macroeconomic stability through the accumulation of public debt (on-lending from the government) and fiscal risks associated with public guarantees on commercial loans. In this context, it will be necessary to strengthen the governance of SOEs to reduce fiscal risks. PPPs can be an efficient financing instrument to improve public service delivery but their success hinges on a strong regulatory framework and

[43] For instance, goods and services account for only 15 percent of the recurrent budget.

oversight to manage financial, technical, and operational risks. Finally, disasters are also a driver of contingent liabilities.[44]

Improved public financial management (PFM) systems will help enhance aggregate discipline, strategic allocation of resources, and efficient service delivery. Sound PFM systems are essential to support domestic revenue collection and more sustainable and effective public expenditure. The deterioration of the fiscal position, accumulation of public debt, and emergence of expenditure arrears suggest there is significant scope to improve public financial management.[45] Improvements are needed along the entire budget cycle, including a more credible fiscal envelope, strengthening the medium-term perspective, adherence to budget ceilings, continuing the implementation of a treasury single account, improving core government systems, implementing the revised chart of accounts, publishing timely and accurate budget information, and strengthening the capacities of the State Audit Organization (SAO) and the National Assembly.

Improving procurement practices and systems is central to safeguarding the efficient use of public resources. Public procurement is one of the government activities most prone to abuse, anti-competitive practices, and corruption. Hence, there is a need to intensify efforts to ensure the most efficient use of public funds through open, transparent, fair, and compliant public procurement processes. This can be done through finalizing the legal framework, strengthening institutions and stakeholders' capacities for its implementation, enhancing the MOF's ability to monitor public procurement processes, operationalizing a complaint handling mechanism, professionalization of procurement functions, and publishing accurate and timely data on the MOF website, and the adoption of open contracting standards and principles. In the long term, a significant step toward increased transparency and competition could be achieved through an end-to-end e-procurement system.

COVID-19 has shed light on how technology can ensure the continuity of core government operations, secure remote access to online services, and support vulnerable people and businesses. In addition to the main financial management information systems, other systems that require strengthening include a personnel management information system, a pension system, a public investment management system, and a debt management system. Introducing a single point of access to government services can significantly improve government interaction with citizens and businesses and generate both cost and time savings for all stakeholders. The interconnectivity and interoperability of existing systems and portals should be improved, online service portals could be developed to expand transactional services to save substantial time, reduce costs, and improve the quality of services for citizens and businesses. Further investments in digital skill development and innovation in the public sector would support the transition to a data-driven culture and building strong technical skills. It is important to ensure a legal and regulatory framework is implemented and that data protection is guaranteed. Necessary resources should be allocated to improve the maturing of a digital government framework.

Effective public policy implementation requires strong institutions with capacities and systems in place. This includes strong corporate governance of state-owned enterprises that have a strong bearing on fiscal solvency such as Électricité du Laos. Enhancing accountability by strengthening the role of the National Assembly and other oversight institutions can improve the quality and transparency of budgeting processes. Building the analytical capacity of institutions such as MOF, MPI, and the central bank can improve the management of risk and reduce macro-fiscal vulnerabilities. Greater clarity of roles and responsibilities and enhanced coordination among public institutions would also lead to significant improvements in decision making.

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[44] In efforts to increase protection against disasters, the government has joined the Southeast Asia Disaster Risk Insurance Facility (SEADRIF) and obtained insurance coverage of $10.9 million.

[45] This is in line with the Vision to 2030 and Public Finance Strategy to 2025, which the government has been implementing in the past few years.

Stable Financial Sector

The financial sector is poorly developed and dominated by state-owned banks and its exposure to risks can have widespread impacts on the rest of the economy. The non-bank financial sector remains rudimentary, with a limited range of financial products. Despite liberalization efforts, state-owned banks continue to dominate the market, absorbing 55 percent of deposits in the banking system.[46] Domestic credit to the government remains lower than in most regional peers. Domestic public debt is relatively low, accounting for a small proportion of total public debt. Domestic financing options for the government are limited, owing to an underdeveloped capital market and limited capacity of the domestic banking system. Yields on treasury bills are low, just slightly higher than bank deposit rates. The recent depreciation of the Lao Kip has affected demand for local currency bonds. However, state-owned banks have supported the government through the purchase of unsubscribed bonds while the central bank has provided direct credit.

Laos entered the COVID-19 pandemic with significant financial sector vulnerabilities. While the banking sector is relatively well-capitalized, two state-owned banks are experiencing financial distress and the largest commercial bank, which is also state-owned, has seen its capital adequacy ratio drop to just below the prudential minimum as of September 30, 2021. Efforts to address weaknesses in state-owned banks have been costly and yielded mixed results, with two continuing to be under restructuring. Officially-reported non-performing loans (NPL) are low (2.9 percent in June 2021) but are believed to be understated due to lax enforcement of regulatory standards and the practice of ever-greening problem loans in addition to forbearance related to COVID-19. Private sector credit growth, which has moderated from unsustainable levels during the period from 2008–2017, has been negligible in the first half of 2021, while credit to the government increased 14 percent.[47]

Financial sector risks increased due to the economic slowdown, rising macroeconomic risks, and specific financial sector policies enacted during the pandemic. The recent economic slowdown will likely lead to higher non-performing loans in the most affected sectors and expose weaknesses in the banking system that could lead to further declines in credit and slower growth. At the onset of COVID-19, measures were enacted to increase liquidity in commercial banks and encourage a continued flow of credit through the pandemic. These included lowering reserve requirements and introducing regulatory forbearance measures such as credit moratoria, restructuring loans to reduce interest rates and extend maturities, and freezing loan classifications, which create the risk that banks are not adequately provisioning for expected losses. These measures could lead to a deterioration in bank balance sheets and some banks could face capital shortfalls as they recognize losses when regulatory forbearance measures are unwound in addition to strong exposure to exchange rate risks.

The banking sector is also vulnerable to risks associated with the state of government finances. Given the large weight of the public sector in the economy, fiscal developments can have a considerable impact on the banking sector. Banks provide direct financing to the public sector through government bond purchases and loans to SOEs and indirectly through central bank borrowing from commercial banks to finance fiscal deficits.[48] This is likely to crowd out credit and

[46] Partial liberalization of the sector since the early 2000s reduced the dominance of SOBs. The entry of a number of joint-venture, private banks, and foreign bank branches resulted in a period of rapid private sector credit growth that helped fuel economic growth. However, the market opening has stalled since 2015. Credit growth has increasingly been linked to state-led investments, crowding out market-driven credit (e.g., SMEs). Access to finance is cited as a principal constraint (2018 Enterprise Survey). Financial inclusion is also low compared to ASEAN neighbors, low levels of digital inclusion adoption and a shallow microfinance market.

[47] MSMEs and women-led MSMEs are particularly constrained by finance gaps. About 33 percent of SMEs and 43 percent of micro enterprises are either fully or partially credit constrained, resulting in an MSME finance gap of $2.6 billion, equivalent to 21 percent of GDP.

[48] The central bank sometimes borrows foreign currency from commercial banks to help the government meet its external debt service obligations and support foreign exchange reserves.

foreign exchange to the private sector. State-owned banks are particularly vulnerable to fiscal risks but so are other banks through the financing of public investment projects directly to the government or through contractors.[49] Banks are exposed to private contractors on public projects since expenditure arrears can give rise to non-performing loans and even force defaults. A deterioration of the fiscal position will likely exacerbate existing financial sector risks and impact future credit growth. Balance sheet weaknesses in state-owned banks pose a significant threat to financial stability and compound fiscal risks (e.g., recapitalization needs).

Action should be taken to lower the risk of financial shocks. The financial sector is exposed to significant fiscal risks which can considerably weaken growth prospects and impact living standards. A financial or banking crisis could obliterate people's savings, disrupt financial flows, create large fiscal costs (bailouts), and undermine long-term trust in the sector. It is, therefore, crucial to ensure that all banks have adequate capital buffers and monitor NPLs. State-owned banks facing balance sheet difficulties are in the process of being restructured. A strengthened legal framework for bank regulation and supervision is a priority. The non-bank financial sector remains underdeveloped, which means that systemic risks are relatively low. However, reforms are needed to ensure that risks are minimized as the availability of financial sector products increases. These include improving capacities and enhancing legal and regulatory tools. Even in the absence of a financial crisis, the banking sector is likely to emerge from the pandemic with weakened balance sheets, which will limit its ability to finance an economic recovery.

Accelerating ongoing structural reforms will safeguard financial sector stability. The main challenge for the sector is to address the long-standing financial weaknesses in state-owned banks. As authorities continue to explore restructuring options, it is imperative that the solutions adopted are sustainable by: (i) addressing the underlying issues that contributed to weak financial performance; and (ii) establishing more transparent reporting practices and equitable application of the regulatory regime on the state-owned sector. Additionally, it is necessary to strengthen the financial sector legal and regulatory framework, banking supervision, financial safety nets, and crisis management. Regulatory and supervisory capacity has improved, but developing necessary secondary regulations has been slow and implementation and enforcement are inadequate. Important regulations and capacity to prevent and manage a financial crisis, including regulations on early intervention and problem bank resolution, are still not in place. Institutional weaknesses in banking supervisory capacity and lack of enforcement pose risks to financial stability. Reforms to strengthen the resiliency of the financial sector, including a transition to Basel II standards to increase capital buffers, adopting risk-based supervision with IMF support, and increasing transparency should be accelerated. The deposit insurance system remains untested. The Bank of Laos has limited capacity to be a lender-of-last-resort due to a high level of financial dollarization and low levels of foreign exchange and lacks a crisis management framework. Finally, it is important to carefully monitor the impact of the economic slowdown and regulatory forbearance policies on commercial bank performance, prudently unwind forbearance policies, develop flexible capital restoration plans for problem banks, and establish crisis management plans.

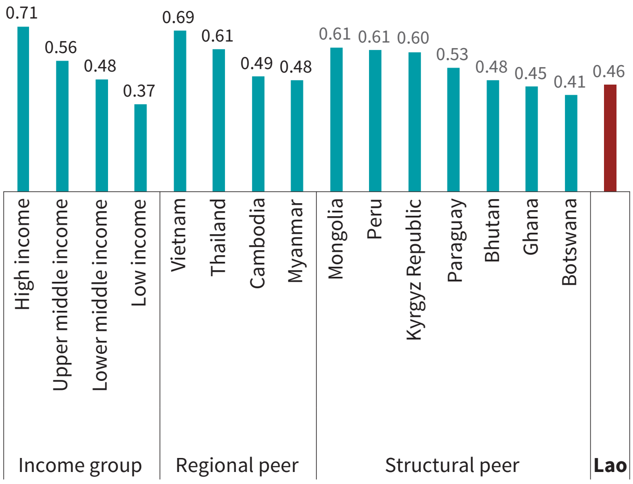
Pathway 2: Share

High-Level Outcome: Improved Labor Incomes of Vulnerable Households

Achieving broad-based gains in human capital lays a foundation for inclusive growth. Developing human capital is vital to individual social mobility and the creation of productive employment. While the government has shown a strong commitment to improving human capital outcomes in national development strategies, evidence suggests that people are not

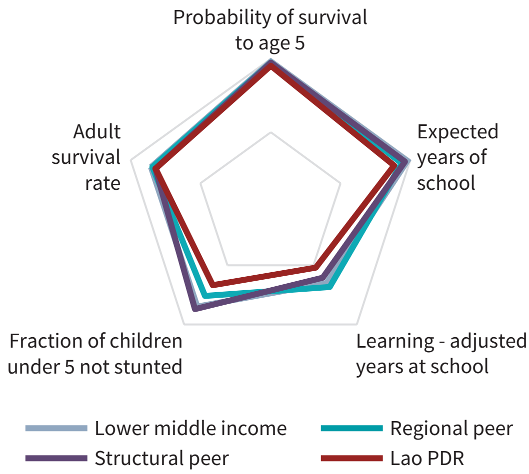
[49] Due to regulatory forbearance measures implemented in response to COVID-19, the extent of the risks currently associated with non-performing loans may be concealed.

Figure 3.2: Human capital index, Lao PDR and comparators (2020)



Source: The Human Capital Index (HCI) 2020.

Figure 3.3: Human capital index by component, Lao PDR and comparators (2020)



Note: On a scale of 0 to 1. Years of school are relative to 12 years. Simple average for peer group.

Source: The Human Capital Index (HCI) 2020.

benefiting from human capital investments that can make them productive. In 2018, the country ranked 103 in health and primary education and 105 in higher education and training out of 137 countries in the Global Competitiveness Index. The Human Capital Index (HCI) for Laos is on a par with its comparators, but the country is lagging significantly in two areas: stunting prevalence and learning outcomes (Figure 3.2, Figure 3.3). About one-third of children under five are stunted compared to the regional peer average of 24 percent and the structural peer average of 13 percent. The learning-adjusted years of school are 6.3, two years lower than the regional peer average. This points to a problem of quality of learning which has been accentuated by learning losses created by COVID-19. To build human capital, stronger investments are needed in these areas: (i) reducing stunting; (ii) promoting equitable access to quality health services; and (iii) enhancing learning outcomes.

Jobless growth prevents households from using human capital and benefiting from economic growth. Despite robust economic growth, there has been a limited creation of employment opportunities. This is partly because economic growth has been driven by capital-intensive sectors such as mining, energy, and construction which have not created sufficient jobs to meet existing demand. Hence, the majority of workers remain trapped in low-paid low-quality jobs, either as self-employed or unpaid family workers, especially in agriculture. Jobless growth disproportionately affects poor and vulnerable groups leading to higher inequality which can fuel social instability. A more inclusive growth pattern will require improvements in the business climate, socioeconomic infrastructure, skills development, and a well-functioning labor market.[50] The creation of more and better jobs requires a competitive private sector. Improved regional and domestic transport connectivity will enhance access to international markets and facilitate integration in global and regional supply chains. A well-functioning labor market is required to make full use of the jobs created and facilitate greater participation in the workforce. Priorities to increasing productive employment opportunities include: (i) dynamic private sector; (ii) improved connective infrastructure; and (iii) a well-functioning labor market.

[50] This HLO focuses on job creation in non-agricultural sectors to foster structural transformation, which often entails a transition of surplus agricultural workers to more productive jobs. Improving agricultural productivity will be discussed under the next HLO (Increased Human Resilience to Shocks) in tandem with building agricultural resilience.

Dynamic Private Sector

While a dynamic private sector is fundamental to accelerating job creation and supporting broad-based growth, the sector remains underdeveloped. The formal private sector is small and dominated by micro-enterprises, with 90 percent of the 134,000 registered firms having less than five employees (World Bank, forthcoming). The informal private sector remains large, accounting for nearly three-quarters of non-farm employment in 2017 (LSB 2017). Informality stems from inadequately registered enterprises, widespread tax evasion, irregular adherence to complex and burdensome regulations, and non-compliance with basic rules and standards. This results in unfair practices and discourages competitiveness (World Bank 2018b). While most of the policy focus has traditionally been on the resource sector, reforms are needed to promote investment in the non-resource sectors, which are vital for economic diversification and job creation.

There has been a decline in non-farm formal employment, while unemployment has increased significantly in recent years. The latest available economic census shows there were around 134,000 registered business units in 2019, up from almost 125,000 units in 2012. However, non-farm private sector formal employment decreased by about 105,000 jobs (World Bank 2021). The manufacturing and the wholesale and retail trade sectors shed the most jobs. Unemployment increased from 4 percent in 2012 to 16 percent in 2018. The competitiveness of the manufacturing sector has eroded since the early 2010s, as labor productivity did not keep up with rapidly rising labor costs and squeezing manufacturing firm profitability. In the services sector, average firm labor productivity grew fast owing to high-productivity firms that have recently emerged, but most firms remain small and unproductive (World Bank, forthcoming).

A predictable business environment and critical regulatory reforms would invigorate the private sector. Informal practices of both formal and informal competitors were cited as one of the biggest constraints among firms. Facilitating business registration would help limit informality. Using one-stop business registration services would help reduce red tape and facilitate enterprise registration. Meanwhile, streamlining regulations for transparency and consistency in the tax and regulatory systems would help curb informal practices by registered firms. While formalization is necessary for firms to have access to finance, it is essential there are alternatives to traditional collateral-based lending to enable SMEs to access the resources they need to operate their businesses (World Bank 2018b). While efforts have been made in formulating investment climate institutions and regulatory frameworks, a lack of implementation has sometimes resulted in inconsistent and unpredictable enforcement across sectors and provinces, while leaving room for regulatory capture (World Bank, forthcoming). Crucial regulatory reforms are needed. Removing impediments regarding business licensing, enhancing public service delivery, and promoting private sector feedback through a regular public-private dialogue could enhance regulatory transparency and efficiency

Market entry, operation and exit remain complex and unpredictable but some progress is materializing. The Investment Promotion Law, which became effective in early 2017, re-introduced investment licenses on general business activities and created a controlled business list resulting in a more complicated investment entry process. Since 2019, under the controlled list, domestic and foreign investors must undergo pre-screening by line ministries. A one-stop-service for investment established under the Investment Promotion Authority is still unable to provide adequate services for obtaining operating licenses. The Prime Ministerial Order on the improvement of the regulations and the coordination mechanism regarding doing business was issued in February 2018. Some progress has been achieved, including the elimination of the company location certificate and synchronization of the enterprise and tax registration processes in 2020. The VAT registration was removed. Since 2019, e-tax filing allows taxpayers in major economic cities to file taxes online without paying a stamp tax. While it will take time for changes to fully take effect, the private sector reported progress on processing times for company incorporation, access to information on regulations and procedures, and time to obtain an electricity connection. In addition, the Enterprise Registration Certificate was commuted into a registration document, which meant the removal of general business license requirements.

Trade and investment are fundamental to achieving economic and social objectives. Trade has increased substantially in the past decade. Trade in goods accounted for 65 percent of GDP in 2019, up from 44 percent in 2013. Services trade accounted for 11 percent of GDP in 2018, driven by increased transport and other tourism activities. Exports remain concentrated in the commodity sectors. The largest export category is electrical energy. In 2019, natural resources accounted for around 44 percent of total goods exports, while agricultural produce represented an additional 12 percent. Since 2013, manufacturing exports have increased three-fold, accounting for 37 percent of exports. This increase was driven primarily by exports of electronics and electrical components fueled by foreign investment, especially in Special Economic Zones (SEZ). Destination-wise, Thailand is the main market for exports (36 percent), followed by China (28 percent) and Vietnam (16 percent). Exports to European and US markets account for about 10 percent, mostly concentrated in light manufacturing, garment and electronics products, and reflecting foreign investors' incentive to gain access to these markets duty free under the Generalized System of Preferences (World Bank, forthcoming).

Foreign direct investment (FDI) has recently been supporting export diversification. In 2020, the stock of inward FDI amounted to $10.9 billion or 57 percent of GDP, above Vietnam (at 52 percent of GDP) and Thailand (at 54 percent of GDP) in relative terms. Most FDI originates from China, followed by Thailand and Vietnam. FDI is mainly concentrated in the power generation sector, infrastructure, and mining. Over the last ten years, only about 35 percent of foreign investment has reached the non-resource sector. Nonetheless, since 2013 electrical component manufacturing has increasingly attracted investment supporting integration in light manufacturing global value chains (World Bank, forthcoming).

Quality foreign direct investment can help boost competition, productivity, and job creation. In the 8th NSEDP (2016–2020), the government indicated the need to diversify the economy beyond the natural resource sector to support sustainable growth and job creation. To attract FDI in certain prioritized non-resource sectors such as agriculture, manufacturing, handicrafts, and services, the government has pursued a policy of FDI promotion. Despite these efforts, barriers to attracting FDI remain. Attracting quality FDI requires increasing openness, realigning investment promotion, improving investor protection, and reducing barriers to entry. Better protected intellectual property rights and improved contract enforcement can reduce risks associated with global value chain investments. In Laos, the rule of law is considered weak and business procedures are protracted and costly (World Bank 2021d). Lowering the barriers to entry by streamlining administrative procedures would ensure competition. The new investment law that came into effect in April 2017 has simplified and streamlined the screening and approval process of projects and has liberalized entry conditions for foreign investors, but more can be done to facilitate and simplify business and trade operations.

While some SEZs have been successful, their impact on the local economy has been limited. According to a report issued by the Ministry of Planning and Investment, as of 2017, 352 Lao and overseas companies had located in Lao SEZs, with a total registered capital of $8 billion. SEZs have created $17 million in revenue for the government. When the overall business environment is weak, SEZs are often set up as a second-best attempt to jumpstart manufacturing production and exports, but getting the conditions right to attract larger amounts of FDI is costly and takes time. For Laos, evidence suggests that FDI in export-oriented manufacturing SEZs was positively associated with economic development at the regional level. However, the impact of SEZs on local employment is limited. The total number of workers employed in the SEZs in 2018 constituted 7 percent of non-farm private sector employment, two-thirds of which were foreign workers. Language barriers and a lack of professional skills were identified as the key constraints to local recruitment. The unattractive social welfare and wages offered to Lao workers also discourages them from taking up jobs in SEZs.[51] A retreat of the state's role in the process of zone development in some SEZs has undermined the ability of SEZs to generate economic and employment growth (Laungaramsri 2017).

[51] Survey on the establishment and operation of special and specific economic zones conducted by the National Economic Research Institute (NERI) in 2018.

Policies need to be revamped to facilitate backward linkages between foreign-owned firms in SEZs and local firms. Facilitating the development of strong backward linkages between foreign-owned firms in SEZs and local firms is important to help raise the productivity and competitiveness of local firms. Experience from Singapore and Malaysia shows that setting up secondary industrial zones for local suppliers either in geographical sites adjacent to major SEZs or through legal status can ease the creation of foreign-domestic linkages (World Bank, forthcoming). Ensuring that SEZ regulations do not discriminate against local supplier relationships is important. The movement of workers from foreign to local firms can disseminate knowledge and skills with positive effects on productivity.

Laos should capitalize on new trade opportunities and its strategic location. Exports of goods and services could increase by up to 27 percent if tariff reduction and trade facilitation reforms reduce costs and delays at the border. Without these reforms, the gain drops to 1.5 percent. Evidence shows that when integration encompasses policy areas beyond traditional trade policy, it can spur institutional and policy reform for improving the business and investment regime. Liberalizing trade at home, while negotiating trade liberalization abroad, can overcome the demand and supply constraints of a small domestic market. It also helps firms access cheaper and higher quality inputs and larger markets for their output. Streamlining and modernizing domestic regulations for technical and sanitary and phytosanitary standards in line with the regulations of trading partners and international standards can also increase productivity and help companies reach fast-growing regional and overseas markets.

Laos is promoting regional integration but needs to follow through on commitments. The country's regional trade policy commitments have deepened. The recent Regional Comprehensive Economic Partnership (RCEP), which became effective in January 2022, consolidates long-term commitments on rules of origin, anti-dumping duties, non-tariff measures (NTMs), and procurement provision. The RCEP offers an opportunity to lock in important behind-the-border reforms and deepen export diversification and trade integration. While tariffs have dropped significantly in the past decade, NTMs rose and remain prevalent. The lack of transparency, absence of harmonization or mutual recognition in NTMs hampers trade in important inputs, especially for agriculture (World Bank, forthcoming). The streamlining of NTMs needs to proceed with the adoption of information communication technologies to improve trade processes and border clearance and limit discretionary behavior (World Bank 2018).

The tourism and travel-related services sectors will benefit from the Laos-China railway. The railway is expected to benefit several service sectors such as tourism, travel, real estate, and retail trade. With the number of visitors from China expected to steadily grow after the railway becomes operational and travel restrictions are lifted, tourism will be critical for the future development of areas along the railway. Ensuring that the railway is attractive to passengers is essential (World Bank 2020). This would require: (i) swift and simple border clearance procedures to minimize delays; (ii) adequate roads and public transport facilities and interconnections at rail stations; and (iii) attractive local infrastructure and services including hotels and restaurants around tourist attractions. Policies to promote sustainable tourism will be essential as an increase in tourism could threaten natural and cultural heritage.

The right policies are needed to help the private sector build back better from COVID-19. The impact of COVID-19 on operations, sales, and employment has been felt widely across firms. Heightened uncertainty and pessimistic investment expectations signal a potential drag on future productivity. With rising liquidity pressure, demand for support will likely increase. More effective assistance to recovery will require efforts to reach more SMEs and to broaden policy instruments beyond fiscal exemptions. Support instruments could be oriented to buffer liquidity shocks and improve business capabilities. More effective public information campaigns and administrative support will be needed to ensure equal access among firms, particularly given the low awareness about current government support programs. One potential positive impact of the pandemic on long-term productivity is through accelerated digital adoption. However, the rate of digital adoption lags other countries in the region due to obstacles to investment in digital solutions such as uncertainty about the benefits and lack of skills among employees. Given the adoption gaps among firms, supporting the adoption of digital technologies is a promising avenue for helping businesses turn a crisis into an opportunity and improve long-term productivity.

Improving Connective Infrastructure

Addressing critical gaps in connective infrastructure including transport, energy, and digital development is key to supporting inclusive and sustainable growth. Improved regional and domestic transport connectivity is important to facilitate access to markets and public services, which can boost private sector activity and job creation. Improved logistics services are critical to enhancing international competitiveness, attracting foreign investment, and creating more jobs. Electricity demand remains strong in the region but the country's ability to meet this demand is constrained by its interconnections. There is also need for investments in electricity transmission and distribution to reduce high losses and improve reliable and affordable access to electricity. Digital connectivity also requires significant improvement. Affordable and reliable broadband Internet access for people, businesses and government agencies is a critical success factor to support economic recovery and inclusive growth.

Improved transport connectivity will enable Laos to leverage its strategic geographic location. Although Laos is a small, land-locked, and mostly mountainous country, it has a strategic location sharing borders with five countries that account for over 17 percent of global GDP and over a fifth of the world's population. These countries have formed one of the most dynamic and fastest-growing markets in the world, providing opportunities for integration in global value chains, increased international trade, and tourism. International trade grew at an average of 17 percent per year between 2000 and 2018, more than double the average GDP growth in the same period (7.5 percent). Laos has benefited from its neighbors' existing trading infrastructure and services and has aimed to become a land-linked country through infrastructure investment, pragmatic border agreements, and cross-border logistics management.[52] Further enhancing regional and domestic transport connectivity would enable high-potential firms to access larger product and input markets and facilitate their integration with global value chains. This could, in turn, support domestic economic activity, trade flows, and job creation.

High transportation costs and time-consuming border clearance are among the challenges in linking the domestic economy with global supply chains. Transport costs are high compared to other countries in the region but lower than in other land-locked countries (World Bank, forthcoming). Based on actual cargo weight, costs range from \$0.11 to \$0.36 per tonne-kilometer compared to \$0.05 per tonne-kilometer in Thailand due to poor road conditions, limited competition in the trucking sector, and the absence of domestic consolidation and logistics facilities (World Bank 2020c). Laos ranks 82 out of 160 countries on the World Bank's 2018 Logistics Performance

Table 3.2: The Logistic Performance Index ranking and score card in 2018

Country	Rank rank	LPI score	Customs	Infrastructure	International shipments	Logistics competence	Tracking and tracing	Timeliness
China	26	3.61	3.29	3.75	3.54	3,59	3,65	3.84
Thailand	32	3.41	3.14	3.14	3.46	3,41	3.47	3.81
Vietnam	39	3.27	2.95	3.01	3.16	3.40	3.45	3.67
Lao PDR	82	2,70	2.61	2.44	2.72	2.65	2.91	3.84
Cambodia	98	2.58	2.37	2.14	2.79	2.41	2.52	3.16

LPI = Logistic Performance Index

Source: World Bank's Logistic Performance Index Database.

[52] Border agreements include ASEAN, subsequent ASEAN bilateral agreements, and PTA with Thailand.

Index. This is better relative to other land-locked countries and better than Cambodia and Myanmar but considerably behind China, Thailand, and Vietnam (Table 3.2). Border clearance times vary across products and remain long. Manual paper-based border clearance processes and widespread physical inspections by customs at borders remain obstacles to reducing clearance times.

Transport connectivity has been affected by large infrastructure gaps and a lack of synergies in the sector. There remain infrastructure gaps in domestic connectivity and logistics facilities, including last-mile road connections to the railway, consolidation centers, and logistics hubs. Limited fiscal space, poor coordination among agencies, lack of effective road maintenance, and high climate vulnerability add to challenges for transport sector modernization. Inadequate road connectivity could limit the railway's potential economic benefits, particularly for the agricultural sector. Although the development of the Laos-China railway is expected to reduce transport and logistic costs by 30 to 40 percent from the end of 2021 (World Bank 2020c), the government will need to overcome multiple and complex challenges, including: (i) insufficient investments to close the remaining infrastructure gaps; (ii) lack of foreign investment to modernize the local transport and logistics industry to increase competition; (iii) the need to complement investments with policy reforms to unlock trade and export potential through seamless cross-border transit, improved logistics and value chains; and (iv) inadequate road connectivity along the National Road 2 corridor and access roads to major agriculture production areas.

Strategic planning is needed to maximize the impact of improved transport connectivity on economic activity. It is important to ensure that improved transport connectivity (e.g., road, rail, and aviation) has a meaningful impact on important sectors, especially agriculture, industry, tourism, and urban development. In particular, further investments need to interact with other potential economic corridors that run through the East-West axis (e.g., National Road 2 connecting Vietnam to Thailand).[53] Beyond linking industrial areas with foreign markets through trade, it will be important to improve rural accessibility by linking local and remote areas with industrial clusters and nearby international markets. This requires a comprehensive approach to reduce hard and soft bottlenecks in logistics infrastructure. Good governance and a strong legal and regulatory framework are needed to ensure the transparency and sustainability of infrastructure projects (including PPPs), and that their social and environmental impacts are properly addressed.

Improving cross-border processes with China and Thailand through an integrated risk management framework can reduce clearance time and logistics costs. The Laos-China railway is expected to boost trade with neighboring countries, but border control facilities (including warehouses), ICT clearance systems, business processes and capacities need to be improved (World Bank 2018c). Non-intrusive border clearance and inspection for rail freight can expedite the flows of rail cargo through cooperation among customs agencies in Laos, China, and Thailand. This would involve exchanging pre-arrival cargo information and using a risk-based system among agencies (customs, immigration, quarantine). The cross-border railway transport agreement between Laos and China is being finalized but will need a corresponding legal framework and a strengthened railway regulator to support the operations in Laos once the railway is operational.

Improved transport and logistics services are required to enhance international competitiveness, attract foreign investment, and create more jobs. This can be accomplished through the leadership of the Ministry of Planning and Investment, the Ministry of Public Works and Transport, and provincial governors and the participation of the private sector. Developing dry ports, logistics hubs, and consolidation centers should be underpinned by transparent and

[53] NR2 is only about 400 km from Hanoi and can be extended through northern Thailand to Myanmar at Thachileik. Connections further south are also available through Thailand. The ASEAN Connectivity Master Plan has identified NR2 as a critical link in improving connectivity and trade among ASEAN countries. Doing so would link the railway to other potential economic corridors.

competitive business practices. Public-private partnerships (PPPs) should be subject to the same due-diligence process as other public investments to ensure strong economic returns and compliance with environmental and social standards. The improvement of climate-resilient last-mile connectivity will enable Laos to benefit from shared economic growth. Promoting foreign investment is needed to modernize the local logistics industry. Greater competition for logistics services would allow international companies to enter the market and likely lead to efficiency improvements. This would improve the standards for operating procedures for cargo handling, related technology platforms, route optimization, track-and-trace systems, inventory management, fleet investments, warehousing, and equipment.

Electricity demand remains strong in the region but the country's ability to meet this demand is constrained by its interconnection capacity and the different synchronized grid systems in the region. Regional power exports remain the key path for Électricité du Laos (EDL) to restore its financial viability by generating revenue from its surplus power. There are opportunities to expand into already established markets, with Thailand, Vietnam, Cambodia, and Singapore the most obvious targets. However, this potential is constrained by the weak interconnection between central and southern Thailand and by the capacity of the Electricity Generating Authority of Thailand and Tenaga Nasional Berhad (EGAT-TNB) interconnector.[54] There are also opportunities to expand into other markets such as Myanmar and Malaysia, where Power Purchase Agreements (PPA) have been signed. An experimental regional electricity trading system known as the Lao PDR-Thailand-Malaysia-Singapore Power Integration Project provides another opportunity to be explored.

Power transmission and interconnection investments would strengthen the country's commercial position and allow higher export tariffs. The export tariff to Thailand is below the average EDL cost of purchasing power from domestic independent power producers (IPP), largely because of the seasonality and variability of the power supplied. In this context, Laos should investigate opportunities to firm up the electricity supply it can offer for export, including using power bank arrangements or by taking advantage of new technologies such as battery storage and hydropower twinning with variable renewable energies to provide steady power at a cost lower than coal. New investments in coal would jeopardize the country's reputation as a leader in clean energy production and green growth and ultimately result in losing market and financing options for the needed investments for the future. Countries like Singapore would be interested in importing power from Laos only if the energy mix remains predominantly clean.

Future investments should shift from new generation toward transmission and distribution. The level of investment required to address domestic transmission and interconnection to fully use all the surplus power generated is estimated at $1.2 billion to $1.7 billion. While investments of this scale are not feasible in the short term, if EDL succeeds in restoring financial viability, there would be a case for carefully prioritized investments in transmission and distribution, underpinned by sound cost-benefit analyses. To optimize system planning, the Ministry of Energy and Mines should develop expansion plans for generation, transmission, and distribution that provide for demand to be met at the lowest cost and adequate levels of reliability. A least-cost expansion plan based on demand forecasts and underpinned by realistic assumptions and sensitivity analysis should be formulated to guide the prioritization of new generation investments. A transmission and distribution expansion plan for the domestic system and the neighboring transmission lines connected to the domestic grid would help guide the connection of generation plants and demand locations at the lowest cost consistent with a specific level of reliability and security. These plans should be developed in close collaboration with EDL-T and other sectors.

Improvements in digital connectivity will require significant investments. Affordable and reliable broadband Internet access is necessary for successful digital development. Without this,

[54] Similarly, in Cambodia, the realization of existing Memorandum of Understanding agreements comprising 1800 MW point-to-grid and 1300 MW grid-to-grid (of which 2400 MW is baseload coal) is pending construction of the required interconnectors.

development of the digital economy and digital government will be hindered. Access to mobile broadband is increasing but rural and remote communities are still unserved or underserved. Broadband required for high-capacity data transmission to support the next wave of digital development is limited (e.g., health and education service delivery). High-capacity broadband services are limited and expensive. Internet access, service, quality, and affordability are continuing concerns. Unaddressed, they could slow the introduction and use of digital services and applications. Large investments are needed in high-capacity fixed and mobile broadband. Public-private partnerships and infrastructure sharing mechanisms will help to lower capital costs.

A robust legal and regulatory enabling environment is essential to support the digital connectivity agenda, deepen trust in digital transactions, and support online service delivery. Legal and regulatory enabling measures are needed to support the private sector to roll out new infrastructure quickly, especially in high-cost areas (e.g., facilitating passive infrastructure sharing, wholesale open access, and technology-neutral spectrum management). A clear framework is needed to promote public-private sector partnerships to drive new private sector investments and deliver improved outcomes, particularly in high-cost areas. Reforms are needed to ensure that the legal and regulatory enabling environment for the digital economy and the broader business climate is sufficiently agile to adapt to technology trends, particularly investment incentives, e-commerce, cybercrime, privacy and data protection, and cross-border data management. There is no legislation for e-commerce or privacy, which are gaps in the existing legal enabling environment.

Government approaches to digital government are fragmented, leading to duplication, lack of coordination, and negatively affecting the availability and quality of service. Very few government services are online and there is a need to transition from current largely manual processes and digital silos between and within individual ministries and agencies to a more coordinated and fiscally efficient approach that would improve the effectiveness of public sector service delivery. Introducing digital government would require a substantial effort involving both changes in business processes and faster adoption of technology.

A Well-functioning Labor Market

A well-functioning labor market is required to fully use the job creation potential of the economy. Even when jobs exist, employers cannot find people with the skills they need domestically. The lack of information about job offers can represent a significant source of unemployment, especially when jobs are not available locally. Labor Market Information Systems and Active Labor Market Programs in Laos are inadequate, preventing stakeholders from making informed choices on issues such as job search, career planning, skills upgrading, hiring, migration policies, skills investment, and policies designed to meet future demands. As COVID-19 has worsened pre-existing structural problems in the domestic labor market resulting in an influx of returning migrant workers, it is important to strengthen employment services in career counseling, outreach to the private sector, and overall matching capacity.

Strengthening public employment service capacity can improve matching labor supply and demand by facilitating access to labor market information. One inexpensive way to resolve this is a job-matching platform operated by public employment services to connect employers and jobseekers nationwide. Empirical studies have found that attendance at job fairs (Beam 2016), access to recruiting services (Jensen 2012) and better job accessibility (Andersson et al. 2018) improve formal job finding, especially among rural, young and low-paid workers. On the firm side, recruitment and job-matching platforms can alleviate the skill shortage problem, which is one of the main reasons for firms exiting the market. This can be especially relevant for small firms which have less information or experience in recruitment compared to large firms. Providing financial incentives in the form of wage subsidies could also be an effective way to encourage employers to hire priority groups by contributing to the initial costs of hiring new employees.

Public employment service capacity needs to respond to employment barriers, particularly for vulnerable groups. International evidence indicates that certain vulnerable groups, including young people and especially young women, are relatively more likely to be unemployed than others (ILO 2018). In Laos, the chances of young people finding non-farm jobs are 10 percentage points lower than those of adults between the ages of 25 and 55. Women are trapped in low-quality jobs. Around 86 percent of working women are self-employed, compared to the ASEAN average of 46 percent. Most are employed in agriculture or unpaid care work, and women take on five times more unpaid domestic and care work than men do (ADB 2020). This necessitates investments in public employment services focusing on identifying vulnerable jobseekers through jobseeker profiling, and building capacity for intensive job search assistance or career counseling. Reducing barriers to women's labor force participation and promoting formal employment would help reduce the gender wage gap. Close engagement with employers could further support mentoring or follow-up assistance in the critical early period of employment.

Reskilling and upskilling through high-quality technical and vocational education and training (TVET) can help the unemployed re-enter the market. Lao firms identify skill shortages as one of the main obstacles to operating their businesses. Nevertheless, non-seasonal unemployment rose significantly among skilled workers (secondary-educated and vocational workers and more so among tertiary-educated and vocational young workers), reflecting a problem of skills mismatch in the labor market. Despite a scarcity of job offers, some sectors have experienced a surge in demand, including food and beverage manufacturing, transportation, and financial services. In the post-COVID world, ICT skills and skills to support green growth are expected to rise. Closing the skills gap will require improved education and labor market policies.[55] As Laos looks to redirect unemployed adults toward sectors with increasing demand, matching the skill requirements with the skills of jobseekers is essential. This could be complemented with targeted workplace-based training opportunities. Closing the gender gap in TVET is also essential. At 45 percent of the TVET student population, women are under-represented and their preferred program choices demonstrate gender bias.[56] Women continue to be under represented in technical fields such as electronics or information technology.

Promoting labor mobility will become increasingly important as the economy grows. In recent years, new business creation has been concentrated in Vientiane Capital and the two northern provinces of Bokeo and Luang Prabang. Meanwhile, several central and southern provinces have experienced a slowdown in firm creation and registration. Better cooperation between provinces can alleviate the employment mismatch as workers move from areas where labor demand is weak to those with a greater supply of jobs. As the economy grows, economies of agglomeration play a role in promoting growth (World Bank 2009). Economic concentration and spatial disparities in employment creation will become more likely. Labor mobility allows a quick adjustment of labor markets in bringing people to jobs, thereby ensuring growth is inclusive.

Strengthening labor laws and enforcement is essential to improve the bargaining power of low-wage workers and ensure that vulnerable workers are protected. The enforcement of labor laws that guarantee fair and safe working conditions to all workers remains weak and informality prevails. Given the large migration to neighboring countries, policy measures to ensure safe migration and agreements with countries on working conditions for Lao workers abroad should be a priority.[57] The widening gender wage gap calls for regulations to promote equal pay and reduce gender discrimination.

Reduced Stunting

High levels of childhood malnutrition present a staggering loss of human and economic potential. Stunting is associated with long-term problems that persist far beyond childhood, ranging from

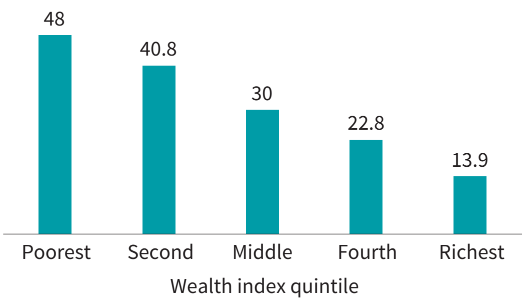
[55] Education policies are discussed below under "Enhanced learning outcomes".

[56] UNESCO TVET Country Profile, Lao PDR, 2020.

[57] Nearly 200,000 workers have returned home from Thailand since 2020 due to the COVID-19 pandemic, which will likely place pressures on the domestic labor market.

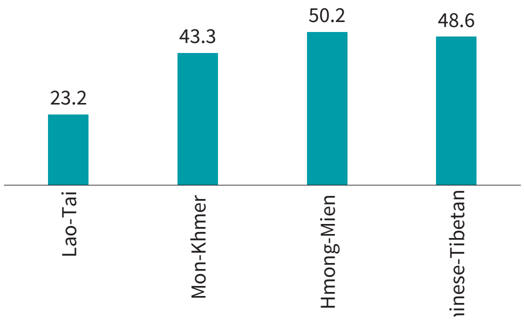
poor health and delayed child development to underperformance in school and eventually reduced employment opportunities, and thus it contributes to keeping communities in poverty. The causes of stunting are multisectoral, including food affordability and diversity, maternal and childcare practices, access to health and nutrition services, clean water and sanitation, and women's socioeconomic status. Stunting affects several groups disproportionately, such as the poor, ethno-linguistic minorities, rural children, and upland populations, thereby aggravating poverty incidence among these groups. While about one-third of Lao children under five are stunted, the rate of stunting increases to 50 percent for children under five from Hmong-Mien and Chinese-Tibetan households and households from the poorest wealth quintile (Figure 3.4, Figure 3.5).

Figure 3.4: Stunting prevalence among children under 5 by wealth quintile (%)



Source: LSIS 2017.

Figure 3.5: Stunting prevalence among children under 5 by ethno-linguistic group (%)

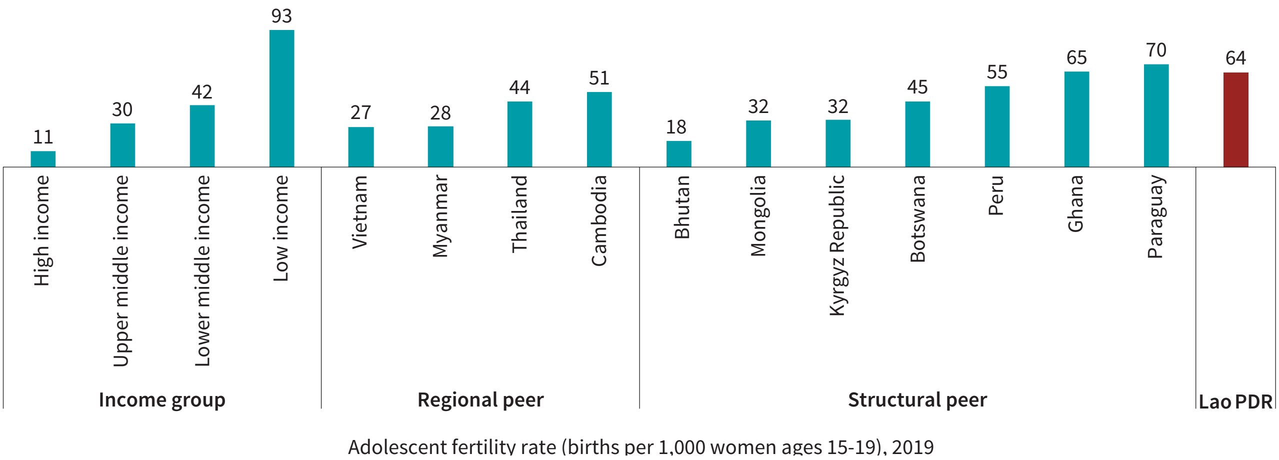


Source: LSIS 2017.

Tackling malnutrition to reduce stunting prevalence requires multisectoral efforts. To tackle stunting, the government has adopted a multisectoral nutrition convergence approach in the four northern provinces of Phongsaly, Oudomxay, Huaphan and Xieng Khuang. The Ministry of Planning and Investment is taking a lead role in the coordination, monitoring and evaluation of these convergence projects. The approach combines efforts from the Ministries of Health, Agriculture and Forestry, Education and Sports, and Public Works and Transport with the goals: (i) to increase the uptake of essential maternal and child health and nutrition services; (ii) to improve health knowledge and behavior, access to clean water and sanitation, early childhood care and education, and food affordability and diversity; and (iii) to improve the resilience of poor families against shocks. Conditional cash transfers were deployed to provide monetary incentives to encourage pregnant women to go through essential maternal and child health and nutrition services. Going forward, continued political commitment, strong coordination across sectors, women's empowerment, and gender equity and scaling-up of this initiative using evidence-based targeting and results-based financing accompanied with technical advisory support are key actions to successfully reducing stunting prevalence.

Efforts need to be extended to address early marriages and pregnancy. The high prevalence of child marriage is closely associated with traditional customs and the low educational level among girls. In some ethnic groups, child marriage is a cultural norm. Early marriage, together with incomplete knowledge of sexual and reproductive health and limited access to appropriate services, has led to the high prevalence of teenage pregnancy. Adolescent fertility remains among the highest globally, with 64 births per 1,000 women aged 15–19 years old in 2019, compared to the East Asia and Pacific average of 20 births (Figure 3.6). Early marriages and pregnancy raise the risks for maternal health and child stunting, which are heightened in rural areas where access to health services may be limited. Adolescent birth rates are highly variable across provinces (26 per 1,000 in Vientiane Capital compared to 138 per 1,000 in Xaysomboun in 2017) and high adolescent

Figure 3.6: Adolescent fertility (births per 1,000 women aged 15–19 years)



Source: World Development Indicators.

fertility rates are strongly associated with little or no education (176 per 1,000) compared to those who completed secondary education (8 per 1,000) in 2017. Similarly, rates were particularly high among some ethnic minority groups, going up to 192 per 1,000 among adolescents from Hmong-Mien communities (2017). Progress in reducing adolescent birth rates was slow between 2012 and 2017, with progress reversed for some groups (UNICEF 2019).

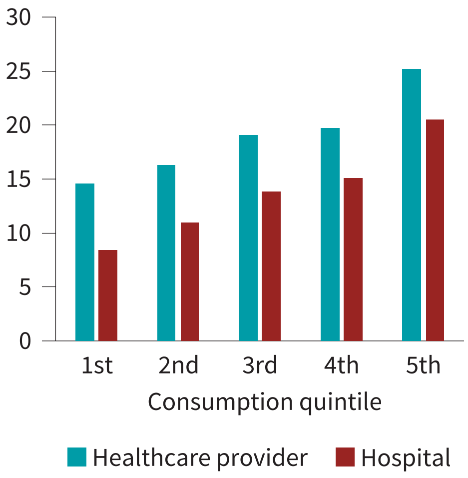
Available global evidence highlights the importance of addressing early marriage and adolescent fertility. This can be achieved through a combination of approaches that can include: (i) age-appropriate sex education addressing misinformation about reproductive health, contraception among adolescents, and gender norms; (ii) provision of adolescent-friendly sexual and reproductive health services and information at public health facilities; (iii) investments in programs addressing economic empowerment and livelihoods needs of adolescent girls to reduce the number of child marriages; and (iv) tailoring strategies and approaches to the most vulnerable groups. Successful programs have been able to anticipate resistance to specific interventions through formative research, including the provision of contraception to unmarried adolescents or sex education programs and strategies developed to address these issues.

Equitable Access to Quality Health Services

Access to affordable and quality health services ensures healthier people and prevents the vulnerable from falling into poverty when facing health shocks. Barriers to health services include: (i) geographic barriers to accessing health services; (ii) financial barriers due to the high cost of care or inadequate insurance coverage; (iii) cultural and language barriers for patients and providers, and iv) gender barriers. These barriers vary based on socioeconomic status and tend to be more pronounced among the poor and vulnerable.

Utilization of health services remains low, especially among low-income households living in rural and remote areas. The government introduced national health insurance in 2016, increasing the coverage of social health protection plans to 94.3 percent. Almost full population coverage was achieved through various combined health insurance plans. However, it remains difficult for low-income households living in remote areas to access quality healthcare services. Low-income households are less likely to seek medical care from hospitals (Figure 3.7), while households from higher income groups seek medical care from central, provincial hospitals, private healthcare providers, or overseas. About 40 percent of hospital visits at the central and regional levels are from people in the top decile (Figure 3.8).

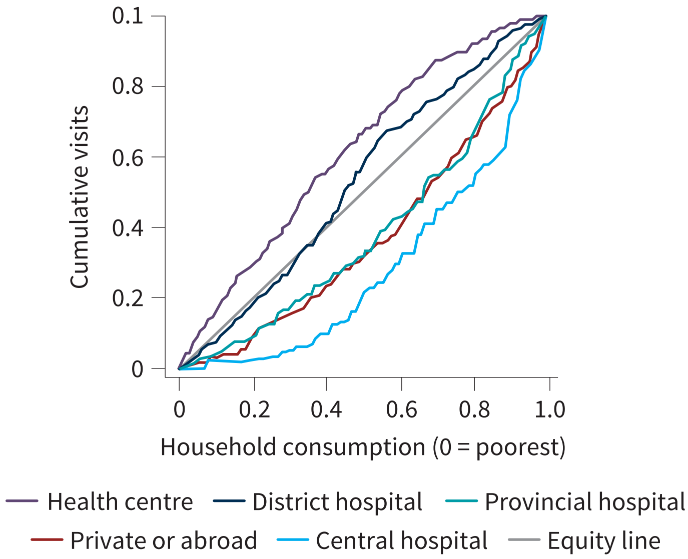
Figure 3.7: Individuals with health problems seeking medical care (percent)



Note: Hospitals include private and public hospitals. Healthcare providers include hospitals, health centers, and overseas healthcare providers.

Source: World Bank 2020b; LECS6, 2018–2019.

Figure 3.8: Type of healthcare providers by consumption percentile



Laos is mainly delivered by public healthcare providers at four levels of organization: hospitals at the central level, hospitals at the provincial level, hospitals at the district level, and health centers at the community level.

Source: World Bank 2020b; LECS6, 2018–2019.

Low-quality health services (perceived and actual) in public facilities is a major issue, which has contributed to the low utilization of health services. Survey data and interviews show that utilization of maternal and child health services remains poor because of dissatisfaction with the quality of services (Ngan et al. 2016). Before the 2020 border closures, a large number of Lao patients were crossing the border to neighboring countries to seek primary health care services, especially in Thailand. While the coverage of health insurance has increased significantly, utilization of health services and improvements in health outcomes may not follow if the quality of care is not improved concurrently. An increase in health insurance coverage does not necessarily translate to improved financial protection or better health outcomes (World Health Organization, World Bank Group and OECD 2018; Wagstaff et al. 2018).

Declining public health spending as a share of GDP has jeopardized access to affordable and quality health services despite growing needs related to the impacts of COVID-19. Limited fiscal space has constrained public spending on social sectors. Public spending on health as a share of GDP is estimated to have declined from 1.4 percent in 2016 to 1 percent in 2020. Since public spending on health is relatively low, total health expenditures remain mostly reliant on out-of-pocket (OOP) spending and foreign assistance. In 2019, OOP and external financing accounted for 42 percent and 21 percent of total health spending, respectively. High OOP spending has been a consistent challenge for low-income households. Limited fiscal space also constrained the government's response to the COVID-19 outbreak, with an allocated emergency fund of only 10 billion Kip or 0.6 percent of the health sector budget in 2020.

Health system quality and performance have been undermined by structural weaknesses. Low quality and performance of health services result from under-resourcing, gaps in the skills of health workers, maldistribution and improper skill mix of the health workforce, shortages of essential drugs and equipment, and inadequate flow of operational funds due to weaknesses in public financial management. Quality standards and indicators to assess health services are yet to be implemented widely, while accreditation and accountability systems are underdeveloped.

Closing the gaps in healthcare services is critical to improving health system performance and health outcomes. Addressing quality issues would require investing in human resources and health infrastructure. Measures to promote qualified health professionals include improving pre-service and in-service training of health professionals; developing strategies for deployment and distribution of health personnel according to needs and for retention of skilled personnel in rural areas; and strengthening a regulatory framework for licensing health personnel. Developing a hospital accreditation system and a health facility quality enhancement plan is critical to ensure all health facilities meet the national quality standards. Strengthening primary health care for equitable access to quality services through expanded community-based health infrastructure and outreach services can further improve service delivery in geographically isolated areas. While COVID-19 in the short term has further hampered the health system's ability to deliver adequate quality services, it shows the system's strength in supporting the successful vaccine program. Going forward, immunization delivery and greater community engagement can be further strengthened to improve the quality and equity of public health service delivery. Given the constrained fiscal space, strengthening the public financial management system is needed for more effective and efficient use of funds to deliver quality services.

Enhanced Learning Outcomes

While access to education has significantly improved, poor quality education is leading to poor learning outcomes at all levels. Laos has made substantial progress in improving access to basic education. However, enrollment rates have declined slightly in recent years and learning outcomes remain low. Some 42 percent of Grade 3 students do not master basic proficiency in the Lao language. In mathematics, nearly 80 percent of Grade 3 pupils fail to demonstrate the expected skills. Lao students also fare poorly in subsequent grades: 90 per cent of Grade 9 students have only basic proficiency in Lao language and over 90 percent do not meet basic proficiency in math. At the tertiary level, the country's gross enrollment ratio fell from 17.8 percent in 2011 to 14.5 percent in 2019. Under-resourcing, unprepared learners, ineffective teachers, and weak system governance underlie these challenges.[58]

The gender gap remains large for secondary education and among the poorest. Laos has nearly achieved gender parity in primary school enrollment: 9.3 percent of girls and 7.6 percent of boys are out of school at primary school age but the rates increase to 19.4 percent of girls and 15.5 percent of boys from the poorest quintile.[59] The gender gap is more noticeable for higher education as girls tend to drop out of school early. In particular, 41.5 percent of girls and 35.2 percent of boys are out of school at upper secondary school age, with the rates increasing to 81.6 percent of girls and 65.3 percent of boys for the poorest quintile. Ethnic minority girls are at a particular disadvantage with education provided in the official Lao language, thereby creating an additional barrier to educational attainment. By social norms, girls in ethnic minority groups are also more likely to drop out of school due to early marriage. The gender gap disappears at the tertiary level, in which 15.3 percent of girls and 13.7 percent of boys are enrolled.

A key component of educational achievement is teaching quality, which is threatened by recent cuts in public spending on education. Laos has a high proportion of trained teachers. Over 95 percent of teachers at all levels of education are trained. However, this does not mean they have the skills necessary to teach effectively. A recent study found that only 2.4 percent of Grade 4 teachers were proficient in Grade 4 mathematics and Lao language (Demas et al. 2018). The recent spending cut has affected teacher recruitment with the number of teachers recruited falling from around 2,000 in 2019 to 500 in 2021 and squeezed the resources available for teaching and learning materials. This highlights the need to strengthen teacher professionalism and customize teacher development activities, which can be achieved by providing tailored, practical, focused

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[58] Public spending on education (as a share of GDP) is estimated to have declined from 3.0 percent in 2016 to 2.2 percent in 2021, lower than the regional and lower-middle income country averages (3.2 percent and 3.1 percent, respectively).

[59] World Development Indicators.

and ongoing professional development to teachers. Allocating teachers to schools equitably, using incentives at the district level will help ensure equitable access to quality education.

Systematic and regular measurement of student learning outcomes is required to improve learning quality. Such measures are most important at early grades when corrective actions tend to be more effective. While Laos conducts a range of assessments, these tend to be standalone and ad hoc. Results are not always available until several years have passed, as with the Grade 3 Assessment of Student Learning Outcomes completed in 2017 but only made available in 2020. Consequently, assessments do not feed into policy or changes in practice.

More efforts and funding will be needed to recover learning losses created by COVID-19. Targeted instruction can help learning recovery. This technique requires assessing students' learning levels and allows teachers to align instruction to the learning level of students rather than an assumed starting point or curricular expectation. Thus, improved teaching quality and regular measurement of student learning outcomes are necessary. Additional funding and training will be needed to support teachers so they are well-equipped with the skills and technology for targeted instruction and remunerated for extended instructional time.

Early childhood education (ECE) is another important factor that determines educational achievement. The foundation of human capital is established during the early years when children's minds are at their most receptive and investments in early learning have the highest returns. It is important to invest early and give students a strong start before they begin formal schooling. Challenges to access and quality of care remain even though MOES provides early childhood opportunities through three-year kindergartens (targeted at 3, 4, and 5-year-olds) and one-year pre-primary classes for 5-year-olds in remote areas without kindergartens. Nearly 40 percent of children under the age of five, a crucial period for neural development, either have no access to early learning opportunities or rely on sporadic pilot, nongovernmental efforts. While one-year pre-primary classes are meant for 5-year-olds, many bring their younger siblings, thereby overwhelming classes and increasing the student-teacher ratio. Weak ECE has compounded the malnutrition effect and is undermining the cognitive development of Lao children.

Modernizing the tertiary education (skills training and higher education) system would allow it to respond to changing demand for skills and skill shortages. The tertiary education system is weak and not responsive to the changing demand for skills created by economic transformation. While the tertiary gross enrollment ratio declined, the unemployment rate (non-seasonal) among tertiary-educated young people rose from about 7 percent in 2012 to nearly 24 percent in 2018. The youth unemployment rate for students with vocational training also reached 20 percent in 2018. Building skills for promising industries and their auxiliary services would reduce the mismatch in the labor market. Modernizing tertiary education would allow the education system to keep up with the dynamics in the private sector. This requires building closer links with employers, greater autonomy and accountability at the institute level, a strong quality assurance system, investing in science, technology, engineering, and mathematics (STEM) reform, and building research capacity in priority areas. Investing in English and Chinese language training would expand employment opportunities for students.

Additional efforts to address social and gender norms are required to close the gender gap in education, especially among poorer communities and specific ethnic minority groups. Physical access to school, an understanding among parents of the value of girls' education and the high opportunity costs of sending girls to school (particularly in terms of their contribution to household chores and economic activities) remain important bottlenecks to girls' enrollment and retention.[60] This is particularly relevant among poorer communities and specific ethnic minority groups. Dropping out is also associated with poor performance in school, suggesting a link between education quality and early leaving. The government´s Education and Sports Sector Development

[60] Thirty to 40 percent of those who leave do not have a school offering Grade 4 or 5 in their village (UNICEF 2019).

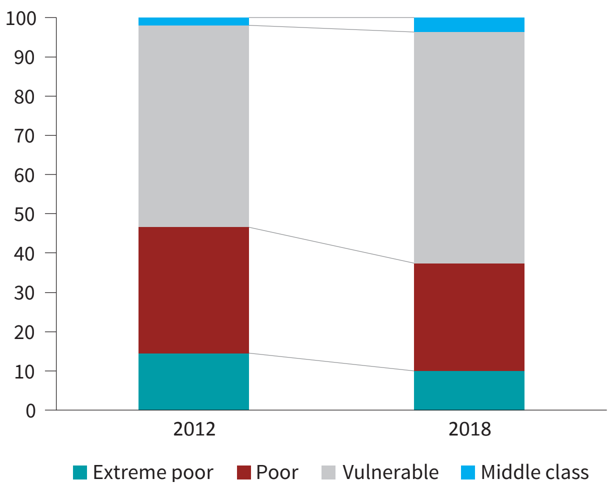
Plan (2021–2025) includes a focus on gender equity in education. Gender and inclusion analysis in the education sector have highlighted gender bias in the classroom as an important contributing factor to the existing gender gap in education. This includes fewer opportunities provided to girls to participate and potentially affects self-confidence and learning outcomes. An important entry point to address gender gaps in education will be to improve the quality of education and address gender bias among teachers through: (i) systematic teacher training and coaching, and (ii) the introduction of a specific focus on monitoring gender biases and stereotypes in school information systems. In addition, the establishment and rollout of community and parent outreach interventions focusing on gender equality and using schools as entry points can play an important role in raising awareness of the value of girls' education.

Pathway 3: Sustain

High-Level Outcome: Increased Human Resilience to Shocks

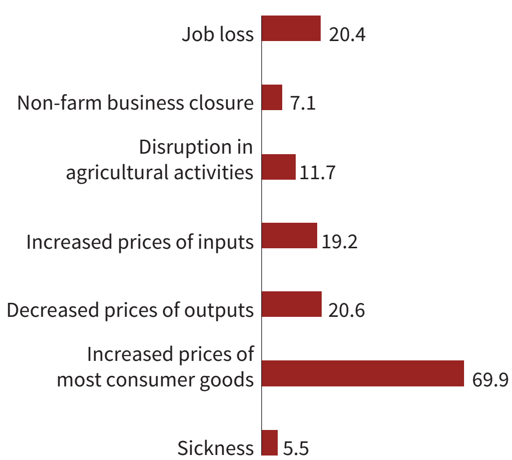
Improving resilience to shocks is vital to protect the most vulnerable in society amid growing multi-hazard risks and cascading shocks. Despite a decline in poverty, the vulnerable share of the population is rising (Figure 3.9). The growing share of vulnerable households in the population implies those that have escaped poverty still do not earn enough to achieve economic security. Most remain vulnerable and lack the ability to mitigate, cope, and recover from shocks. When facing shocks that affect their income, they will likely fall back into poverty. For the poor, these shocks push them deeper into poverty and reduce their chances of escaping. Growing multi-hazard risks and cascading shocks due to climate-related events, epidemics, and rising food prices make poverty reduction efforts more challenging. More frequent and intensified floods and droughts put livelihoods of agricultural and rural households at risk, most of whom are poor or vulnerable. Climate-affected agricultural production coupled with price volatility undermines food security. The COVID-19 pandemic exposes the vulnerability of the population to cascading shocks (Figure 3.10). Strengthening resilience to shocks and safeguarding livelihoods will require improving agricultural productivity and resilience, strengthening social protection systems, and increasing financial inclusion.

Figure 3.9: Poor, vulnerable, and middle class (2012–2018)



Source: World Bank 2020b; LECS6, 2018–2019.

Figure 3.10: Households experiencing shocks during the pandemic (%, March–July 2020)



Laos is mainly seved by public healthcare providers at four levels of organization: hospitals at the central level, hospitals at the provincial level, hospitals at the district level, and health centers at the community level.

Source: World Bank 2020b; LECS6, 2018–2019.

In the light of increasing environmental degradation and natural hazards, more efforts are needed to ensure resilient and sustainable development. While Laos is rich in natural resources, environmental degradation caused by natural and anthropogenic factors threatens sustainable development and household livelihoods. The country is also vulnerable to climate change, which is accelerating environmental degradation and intensifying disasters, which in turn have a negative impact on household livelihoods. For example, increasing temperatures and changing precipitation patterns will make forest fires and pest and disease infestations more common, while infrastructure faces severe climate risks from the impacts of recurrent floods and droughts. Ensuring resilient and sustainable development will require better institutions and processes to sustainably manage natural resources and urban development and to strengthen action on climate change and disaster risk management and mitigation.

Sound Management of Natural Resources

Lao landscapes are a mosaic of forests, water, biodiversity, minerals, and land and play a crucial role in the country's economic development prospects and resilience. Laos is rich in natural resources and home to species of global significance. Biodiversity values comprise 8,000–11,000 species of flowering plants, over 100 species of mammals, 700 species of birds and 166 species of reptiles and amphibians and an unknown number of fungal species (Government of Lao 2016). Lao people depend directly on forests, land, and related resources including non-timber forest products for livelihoods through their beliefs and practices. Natural resources are critical for national socioeconomic development. In 2018, natural resource-based sectors contributed one-third of GDP, and the Lao natural capital value of assets was quantified at $149 billion, with 78 percent coming from water and forests and a further 22 percent from agriculture (LSB 2019; World Bank 2020d). Natural resources are more valuable in times of COVID-19 when thousands of young migrant laborers return home unemployed and without income.

Inefficiencies, including overuse, under-budgeting, and unsustainable and unscientific management, have led to a reduction in natural wealth. A forest cover target of 70 percent in 2020 was not achieved and decreased from 61 percent in 2000 to 58 percent in 2015 (World Bank 2019a). This was due to agriculture expansion, mismanaged forest plantation development, shifting cultivation and unsustainable timber harvesting. The government sees that forest loss affects ecoregional biodiversity and long-term socioeconomic benefits and reset the 70 percent forest cover target for 2030, but a clear definition and methodology have not yet been identified. State forestlands cover 62 percent of the total land area and land rights of individuals and communities remain unclear within many of these areas, mainly affecting ethnic groups. The government is piloting a performance-based payment system for emission reduction up to 8.4 MtC02e (2019–2024) and legally allows industrial tree plantations in the production forest, village forest management and recognition of customary rights in forests.[61] Land tenure, planning, and management are incomplete which could limit understanding of the locations, zones, boundaries, and functions of natural resources, and the ability to identify rights.

Sustainable forest management (SFM) can underpin the country's transformation to a resilient green and inclusive economy. Although forest cover declined, Laos still has among the highest forest cover percentage of countries in the region and the value of timber and non-timber forest products is $10,740 per capita. SFM can help provide food, medicines and building materials from forests and support downstream industries like furniture production and reconstituted and fiber products and nature-based tourism in forest landscapes. Demand for verified legal and sustainable tropical forest products is growing. Based on data from investors, internal rates of return for the main participatory SFM forest production models (smallholder teak, industrial and outgrower eucalyptus) were between 6 and 24 percent, which is an internationally competitive

[61] Lao National Emission Reduction Payment Agreement (ERPA). The Forest Law 2019 allows industrial tree plantations in production forest areas and village forest management in state forests. The Land Law 2020 recognizes customary rights outside and inside national conservation, protection and production forest areas.

range (World Bank 2019a). Public-Private Producer Partnerships in nature-based tourism and smallholder and industrial tree plantations that meet prerequisites for access to the global market could help facilitate benefit sharing and reduce operational costs and risks while improving the overall sustainability of investments (World Bank 2021b).

SFM can be achieved only when good governance is in place. Environmental and social impact assessments should be required for all proposed infrastructure projects in and around forest areas to help minimize deforestation and environmental degradation, as well as encourage cost-saving innovative technologies and profitable investments. Implementation regulations following 2019 Forestry and Land Laws should clarify land rights of customary and communal land users and of those residing in state forestlands to provide them with security of tenure.

Better management of water resources and hydropower dams must minimize environmental and social impacts on livelihoods. Hydropower dams can hurt households located downstream and upstream, mainly through the degradation of natural capital. The government has stepped in to minimize these negative impacts. The Policy on Sustainable Hydropower Development was issued in 2015. It requires project developers and government agencies to undertake analysis of technical, economic, engineering, financial, environmental, and social considerations on hydro projects larger than 15 MW. It also mandates that strategic environmental assessments are undertaken when developing policies, strategic plans, and programs within the power sector. However, the collapse of the Xe Pian Xe Namnoy dam in 2018 revealed persistent safety risks and emphasized the importance of improving capacity for implementation. Measures to protect downstream communities should be strengthened. While the upstream communities get compensation and resettled, livelihood erosion among downstream communities caused by changes to water flow and capture fisheries are often ignored in terms of resettlement and compensation.

Action on Disaster Risk and Climate Change

Exposure to climate and disaster risks can undermine human health, jobs, livelihoods, and ecosystems. Projected warming will likely impact human health and climate-dependent sectors, including agriculture, tourism, forestry, energy, and water. Agriculture and forestry alone provide over 60 percent of total employment, while the economic benefits from tourism, which in Laos is highly nature-based, could be up to $600 million over 10 years. Around two-thirds of the rural population relies on forests for food, fuel, fiber, and medicine, and over 39 percent of rural family income is derived directly from non-timber forest products. Changing temperature and precipitation patterns along with increasing climate variability with higher frequencies of extreme flooding and drought events are projected to negatively affect the country's forest resources and ecosystems. The increase in the risk of flash or surface flooding and associated issues such as landslides will further expose the poor and the already vulnerable critical lifeline infrastructure, including schools, health centers, and trunk roads. Climate change coupled with urbanization is expected to increase the population affected by urban flooding.[62] Drought exposure could be heightened as hydropower development on the Mekong River significantly alters the hydrology of the region.

Climate risk exposure is exacerbated by a lack of coping capacity and the vulnerability of the population. As with disasters, the impacts of climate change are likely to fall disproportionately on the poor and vulnerable, many of whom reside in high-risk areas and generally work in economic sectors susceptible to climate shocks, such as agriculture, timber and non-timber forest production, and nature-based tourism. Unless adequately addressed, loss of income from disaster-induced destruction of farms and micro-enterprises, coupled with the disruption of social services, exacerbates existing nutrition, health, and education challenges. When a disaster strikes, the poor and vulnerable are more heavily affected and less financially able to respond, leading to an increase in debt among households who normally already have debts (mostly for

[62] Around 90 percent of urban expansion in developing countries is near hazard-prone areas and with little or no provision of services and infrastructure (UNDRR 2015).

agriculture inputs) because of floods and droughts. In terms of direct human and social impacts, disasters can exacerbate preexisting inequalities faced by vulnerable and socioeconomically disadvantaged groups. Disasters and climate-related shocks increase women's workloads and risks of gender-based violence because of the breakdown of community protection systems and residence at emergency shelters (Government of Lao 2018). A flood event occurring once every five years has approximately a 50 percent chance of pushing a household into extreme poverty (World Bank and ADB 2021). With climate change, the frequency of flooding is expected to increase, likely resulting in the poor being further exposed to the negative effects.

Building resilience to climate change requires adaptation measures. This includes: (i) enhancing social safety nets for adaptation and strengthening early warning systems, (ii) integrating resilience into spatial planning and infrastructure, (iii) supporting community-based disaster risk preparedness, (iv) improving agricultural productivity and resilience, and (v) restoring and conserving natural ecosystems such as forests and watersheds. Nature-based solutions can help reduce vulnerability to climate risks, generally at a lower cost than conventional gray infrastructure. Additionally, increasing financial inclusion can help build the resilience of individuals to sudden and extreme climate events by increasing the affordability of climate-related products and services and improving access to adaptation tools. Overall, improving the sustainable management of the country's natural capital remains critical to ensure it continues to deliver benefits to the population over the long term, particularly for the most poor and vulnerable groups.

Hazard and vulnerability data should be used when designing adaptation measures. Collection and sharing of disaster and climate information and consistent application of risk assessments across national and subnational agencies will enable the use of hazard and vulnerability data in development planning across all sectors. Given cascading multi-hazard risks, assessments should account for climate change and evolving hazards (e.g., hydropower infrastructure and pandemics). This includes ensuring that timely risk information such as hazard mapping and risk communication is available to villages, where the impacts are felt the greatest. This is critical for women, children, the elderly, and people with disabilities who are often disproportionately affected by climate change and disaster risks.

Several strategies and policies are now in place that promote action on climate change. These include the National Adaptation Program of Action to Climate Change (NAPA) in 2009, Climate Change Strategy in 2009, and Climate Change Strategy Action Plan in 2013. Many of the adaptation priorities under the NAPA remain relevant, such as land-use planning in hazard-prone areas, establishing an early warning system and improved hydro-meteorological capabilities, programs to boost the resilience of crop varieties and animal species to climate change, and awareness-raising on water and water resource management. The government has also embedded climate priorities in other national and sectoral strategies and plans including the Ninth NSEDP, and the NAPA will be updated in 2022.[63] The National Climate Change Strategy being revised will put a stronger emphasis on gender-responsive climate action and enhanced adaptation efforts of vulnerable sectors (MONRE 2020). In 2019, a climate change decree was promulgated and a climate change law was enacted to create the legal and institutional framework necessary for low-emission climate-resilient growth.

Institutional capacities need strengthening to implement Nationally Determined Contributions (NDCs) and mainstream climate change into sectoral policies, plans, and budgets. To protect development gains against disaster and climate-related shocks, continued building and strengthening of institutional capacities should be prioritized in the areas of monitoring hazards, issuing early warnings, resilience standards for infrastructure, evidence-

[63] These include the National Green Growth Strategy to 2030, the Agriculture, Natural Resources, and Rural Development Sector Strategy, the Ten-Year Natural Resources and Environment Strategy (2016–2025), Urban Development Strategy to 2030, and Agriculture Development Strategy to 2025 and Vision to 2030.

based risk reduction planning, emergency preparedness and response, disaster- and climate-responsive social protection and disaster risk financing. This requires cross-sectoral coordination, financial resources and mechanisms to implement actions, adequate staff capacity, and enhanced use of adaptation and mitigation technologies.

Laos can optimally achieve its Nationally Determined Contributions (NDC) by leveraging private sector climate change solutions. The role of the private sector has been heightened in many climate change areas, including renewable energy, climate-smart agriculture, agroforestry, and green manufacturing. To accelerate private sector engagement in climate change, it is necessary to identify and tackle major cross-cutting and sectoral bottlenecks. Changes in fiscal and financial policies are critical to incentivizing private investment. This is important as local firms, mostly MSMEs, often lack financial capacity, knowledge, and technologies to make them more efficient and resilient to climate change. Empowering the private sector to develop green businesses can help achieve higher green growth and green job creation.

Greening the financial market is crucial to empower the private sector to develop green businesses and help achieve the country's GHG emission reduction target. Although the country is one of 10 founding members of the Sustainable Banking Network, progress on moving from commitment to formulating policies has remained slow in the past decade. The authorities are aiming at integrating sustainable finance policy into the National Socioeconomic Development Plan to help the country better finance climate change action plans and protect the environment. The development of a regulatory framework on Environmental and Social Responsibility (ESG) could help set standards for financial institutions to manage ESG risks, level the playing field, and transition toward a greener financial sector. It is expected to further help attract public and private investment in green growth activities

Well-Managed Urbanization

Urbanization has driven growth and poverty reduction across East Asia. As countries urbanize, they benefit from 'agglomeration effects,' where the connectivity of workers to firms and firms to markets helps drive innovation, enables firms to take advantage of scale economies, and promotes better matching of talent with jobs. It also lowers the per capita cost of infrastructure provision. Laos follows regional trends showing the association between reduced $3.20 a day poverty and urbanization. The rate of extreme poverty in urban areas (7 percent, 2018) is also lower than in rural areas (23.8 percent, 2018). However, declines in extreme poverty have stagnated in urban areas and the urban share of the poor increased from 9.2 to 12.4 percent between 2012 and 2018. Inequality has been higher in urban than in rural areas and has increased in both over time (Warr et al. 2019).

Decades of growth and urbanization has come with limited structural transformation. Urbanization has been driven by rural to urban migration. Census data from 2005 and 2015 showed that 42 percent of all migrants moved to urban areas with half of those moving to Vientiane Capital. During this period, 45 percent of the growth in the core districts of the capital was attributed to migration, the remaining to natural growth (CDE 2018). Unlike many of its neighbors, cities in Laos have not helped drive a shift from low-productivity labor-intensive work to higher-productivity skilled activities and the resource-based development model has constrained private sector development. Well-managed, serviced, and connected cities are an important enabler in creating a diversified economy with more non-farm jobs.

Laos is not prepared for the challenges of rapid urbanization. Regional trends show urbanization 'takes off' after the non-agriculture share of GDP passes 80 percent, just where Laos is. Within the next three decades, over half (55 percent) of the population will live in urban areas and the population of Vientiane will increase from 948,000 to 1.4 million by 2045 (United Nations 2019). Already, cities cannot keep up with infrastructure demands and are growing in the absence of robust risk-informed planning and financing systems. Public transport is limited, while private vehicles are congesting roads, there are no operational wastewater systems, drainage and solid waste networks are inadequate, and the conversion of wetlands is amplifying climate and disaster risks. Current sprawling growth increases natural hazard exposure and is locking in energy and carbon intensive land-use patterns that are prohibitively costly to service, inefficient for industry, and reduce the quality of life and access to livelihoods. The increasing urban poor, limited jobs, and infrastructure gap signal more informality.

There is a limited window to leverage the benefits of urbanization. Trends in East Asia and Pacific show that urban built-up expansion is even faster than population growth and most countries will see a doubling of built-up areas in the next 25 years. This means at its current low level of urbanization (35 percent), most of the country's urban areas are 'yet to be built.' There is time to address the urgent fixes while planning and managing the future expansion of cities. Cities will need substantial investments to accommodate rapid population growth, support industries and the business climate, and be more resilient to climate risks. Improving connectivity and access to markets by capitalizing on the new rail line can improve industrial opportunities and access to jobs. Investments in growing urban areas outside Vientiane Capital will be important for more balanced urbanization, improving regional economic development, and better supporting value-added opportunities in the agriculture sector.

Urban management systems should be strengthened and modernized to ensure inclusive and resilient urban development. Improved planning and land management systems are needed for more efficient development, reduced infrastructure costs, and the creation of an enabling environment for the private sector. Urban institutions will need to adapt to keep pace with the dynamism of Vientiane Capital and smaller urban areas, as will financing systems (transfers, borrowing, revenue generations, and approaches to PPP). Accelerating land titling and modernizing land administration services are key to reducing informality and land disputes while increasing transparency and building foundations for property and land valuation to boost resource mobilization. Targeted interventions for the growing poor and vulnerable communities are needed to ensure that urban development is inclusive. Examples include land tenure and security, slum-upgrading and service delivery, social safety nets, and reducing exposure to climate risks. Urban planning needs to be climate and risk-informed to improve resilience and ensure that investments foster a lower carbon growth path.

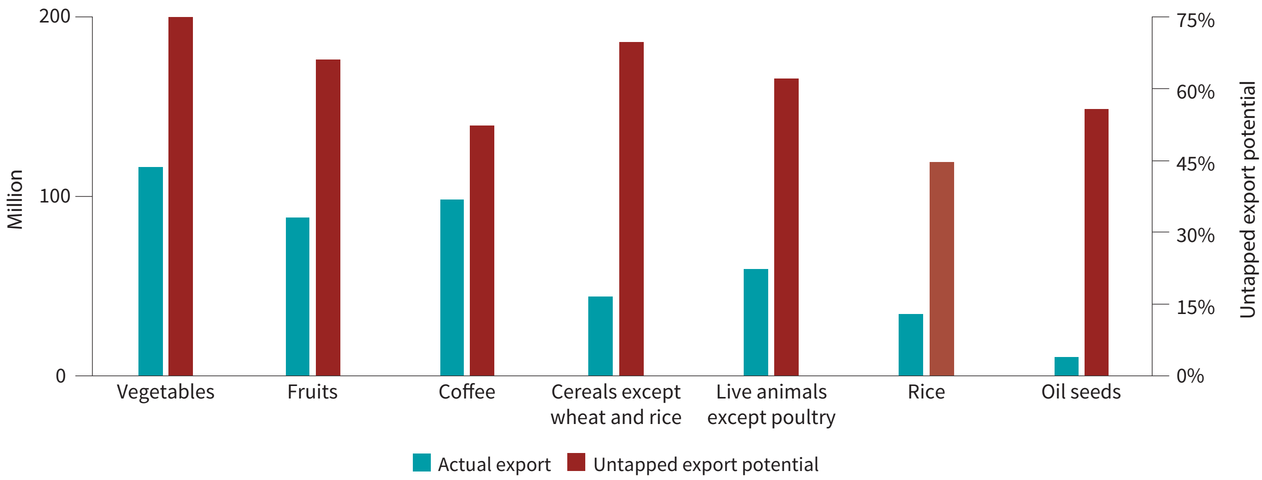
Increased Agricultural Productivity and Resilience

Improving agricultural productivity and resilience is essential to improving household income and protecting livelihoods from shocks, especially the poor and vulnerable in rural areas. Economic transformation out of agriculture has been gradual, with the share of agriculture in GDP falling from 22 percent to 15 percent and the share of agriculture in total employment slowly declining from 70 percent to 60 percent between 2007 and 2018. Agriculture remains a major source of income for more than half of all households and 94 percent of poor and rural households, most of whom rely solely on agricultural income, making them vulnerable to climate-related, weather-related, and price shocks. The role of agriculture in supporting livelihoods was accentuated during the COVID-19 pandemic when the sector acted as a buffer by absorbing surplus labor. Improving agricultural productivity and resilience is thus essential and would require comprehensive agricultural support policies ranging from improving access to credit, affordable agricultural inputs and product markets, and enhancing farmers' skills to promote climate-smart practices.

In recent years, agricultural commercialization has accelerated, contributing largely to agricultural productivity improvement and poverty reduction. Experience in poverty reduction in Laos points to the importance of transitioning from subsistence rice cultivation to commercial production of cash crops. Between 2012 and 2018, higher incomes from agriculture accounted for 80 percent of a decline in the poverty rate. During this period, farmers who diversified from subsistence-based rice production to market-oriented non-rice production, most residing in northern and southern provinces, earned higher income and were able to escape poverty. Poverty became more concentrated among farmers who remained heavily dependent on subsistence-based rice production. Going forward, it is crucial to ensure that commercialization continues and occurs with a shift from production area expansion to improving productivity and quality to 'gain more from less'.

Green value chain development would ensure a continued transition to commercialization while mitigating associated risks. Agricultural commercialization faces various constraints. Most Lao farmers are smallholders who have low marketable surplus, low bargaining power, and very high transaction costs in marketing their products. While those who have switched to producing cash crops receive higher cash incomes, they are more often exposed to price shocks. Among fragmented smallholders in agricultural value chains, collective action through farmer organizations has the potential to reduce transaction costs and effectively aggregate demand for critical infrastructure (e.g., irrigation and storage), farm inputs (e.g., improved seeds, fertilizers, tools, and pumps), and services (e.g., tractor and truck rentals, credit, and insurance). Well-developed value chains and linking with agribusinesses could help mitigate price shocks among farmers. To respond to the growing demand for clean and green agriculture, commercialization needs to be pursued in tandem with green value chain development. Due to the lack of technical support and guidance from the government and agribusinesses, commercial farmers overuse agrochemicals resulting in soil degradation and erosion. Improving land and water management and minimizing the use of agrochemicals and pesticides will help protect the environment from pollution and degradation. Better management and recycling of agricultural by-products and wastes are also essential to improve production efficiency and reduce environmental pollution.

Figure 3.11: Lao PDR's agricultural export potential



Note: 2020 for actual export. 2026 for untapped export potential which is estimated based on trade data through 2020, the latest tariff data, and GDP projections.
Source: International Trade Center.

Ensuring access to credit is strategically essential to influence the success of increased agricultural production and commercialization. Access to credit has a crucial role in empowering farmers to invest in productivity-enhancing activities, adopt improved technologies, and buffer against weather and price shocks. Farmers' access to credit remains limited because commercial banks focus on large-scale customers rather than agricultural smallholders (Wongphit et al. 2019). Increased coverage of microfinance for small farmers is thus essential. On the one hand, this requires an improvement in lending procedures and capacity building for financial institutions in providing appropriate financial products and services to smallholder farmers based on their risks and creditworthiness. On the other hand, building financial literacy among farmers and helping them with the loan application process are equally important. Rural land titling would also increase the willingness of financial institutions to accept land as loan collateral, thereby increasing landowners' access to credit.

Agricultural exports have great potential to support commercialization. Between 2015 and 2020, agricultural exports grew on average about 15.5 percent per year, representing more than one-fifth of the country's exports in 2020. However, this growth was mainly driven by unprocessed, lower-value commodities. The country could significantly increase its agricultural exports, particularly in vegetables, fruit, and coffee, provided policies are put in place to commercialize its agri-food sector, improve food safety and value addition, and improve the agribusiness environment (Figure 3.11). Identifying and revising regulations on quality standards are critical to ensuring consistency with regional and international export markets. To access export markets that require adherence to food safety and sanitary and phytosanitary standards (SPS), it is necessary to develop clean and green agriculture to enhance agricultural export competitiveness by adopting organic farming and climate-smart agriculture.

It would be prudent to invest in promoting digital agricultural transformation using new technologies for extension, commerce, and product traceability. Like China, Korea, and Kenya, traditional public investments in agricultural R&D and extension services can be powered by off-the-shelf and affordable digitally enabled tools such as soil and water testing sensors, disease and pest mapping through GPS and spatial technologies, e-advisory and data-driven decision support systems. Training on the application of digital technology and e-commerce is also essential to 'gain more from less' and reduce the environmental footprint, including greenhouse gas emissions.

Private sector investment could be mobilized to foster innovation and improve value addition in agricultural value chains. Incentive policies can attract private sector investment in post-harvest and processing and logistics to improve productivity and value addition. Critical areas that need to be strengthened to facilitate private sector investment include: (i) plant breeding, (ii) variety and fertilizer registration, (iii) seed and tractor quality control, (iv) imports of fertilizer and machinery, (v) provision of animal feed and medicinal products, and (vi) cross-border trade and agribusinesses.

Building the adaptive capacity of smallholder farmers is urgent due to their high exposure to natural hazards and climate change. Laos is exposed to climate shocks related to El Niño Southern Oscillation (ENSO). An analysis of rainfall patterns from 1980 to 2015 shows that, compared to non-ENSO years, average October to June rainfall was about 30% lower in El Niño years and average April-to-June rainfall was about 16 percent higher during La Niña years (Sutton et al. 2019). Since 1966, about 70 percent of flood or drought disasters coincided with ENSO events. Due to the country's varied climate and terrain, ENSO impacts are often highly localized. A comparison of subnational rice production during ENSO years suggests that it is critical to adopt drought-resilient varieties in the north and rehabilitate damaged irrigation structures in the south and central regions. Replacing marginal inefficient mono rice systems with low carbon climate-smart cropping systems and scaling-up climate-smart agriculture practices would enable smallholder farmers to sustainably cope with the challenges emerging caused by erosion, declining soil fertility, and pests. Such measures could include agroforestry, sustainable land and water management, and integrated pest management.

Improved Financial Inclusion

Laos has a low level of financial inclusion. Around 29 percent of Lao adults have bank accounts.[64] While the country compares favorably with regional peers (Myanmar 26 percent, Cambodia 22 percent, and Vietnam 30 percent), the coverage is notably lower than the rates in East Asia and Pacific countries (74 percent) and lower-middle-income countries (58 percent). The unbanked cite several barriers to getting an account, including lack of sufficient funds (56 percent), financial institutions are too far away (26 percent), and lack of necessary documentation (17 percent). Formal savings and credit are even less common. Only 18 percent of adults saved at a financial institution and 9 percent borrowed from a financial institution or used a credit card during the past year.

[64] World Bank Global Financial Inclusion, 2017.

The gap in financial inclusion is significant, with low-income households and men lagging. Bank account ownership is notably low for individuals from the bottom 40 percent of the consumption distribution at 17 percent, compared to 36 percent of the top 60. This is reflected in a larger share of the better-off putting their savings in a financial institution. Among those who save money, 22 percent of the bottom 40 and 34 percent of the top 60 save at a financial institution. Women are more likely to be financially literate than men. While 32 percent of adult women have bank accounts and 19 percent save at a financial institution, only 26 percent and 17 percent of adult men did so.

The poor lack a financial cushion to cope with shocks, which is a problem exposed by the COVID-19 pandemic. When shocks occur, two-thirds of adults from the bottom 40 could raise emergency funds. Those who could raise funds rely more on additional work (48 percent), family and friends (19 percent) and selling assets (18 percent), then savings (5 percent). The COVID-19 pandemic has further depleted their financial cushion. Around 90 percent of households have been more cautious about their household spending, while 64 percent of households have tried to save more since the pandemic began. During the pandemic, less than 20 percent of those who experienced employment and price shocks relied on savings and worked extra hours and reduced consumption.

Small-scale entrepreneurs face difficulties accessing formal credit. A lack of access to finance is a major problem for small firms, especially those that have exited the market or downsized their operations. Approximately 19 percent of small firms that have exited the market consider a lack of access to finance their main constraint, compared to 11 percent of those that remain in business. In recent years, the liquidity of the financial sector has dried up, intensifying the problem of inadequate access to finance. The share of SMEs with an account at a formal financial institution fell from 81 percent in 2016 to 55 percent in 2018, with over 90 percent of SMEs required to provide collateral on their bank loan.

Financial inclusion helps households become more resilient to shocks. Access to financial services is found to improve household resilience by increasing their ability to adopt risk management strategies and smooth consumption without resorting to negative coping strategies such as reducing consumption, taking on unsustainable levels of debt, or selling productive assets (Moore et al. 2019). Insurance, savings, credit, and digital payment products have all been found to increase resilience through various levers, often in the context of idiosyncratic or small-scale shocks.

Weakly regulated financial service providers may pose additional risks to households. As financial services increase and become more sophisticated, the lack of financial literacy and incomplete legal protection leaves consumers vulnerable to abusive practices. For many households, especially those in rural areas, their primary point of contact is with informal or semi-formal financial service providers and weakly regulated village funds. There are risks from having such a large segment of the financial sector operating without appropriate rules and supervisory structures.

Microfinance could play a large role in addressing the credit, savings, remittances, and payment needs of low-income households and microbusinesses. Microfinance represents only 1 percent of total credit in the country. However, a few microfinance providers have shown impressive outreach and performance, except for portfolios at risk which is a general concern in microfinance in the country. For the market to generate more success stories and reach a greater number of borrowers and savers, it would be useful to invest in financial literacy campaigns using social media and traditional outreach methods and strengthen the legal and regulatory framework to eventually accommodate fintech solutions for loans, savings, remittances, and payments.

Comprehensive Social Protection

The social protection system is rudimentary and has limited coverage. Social protection spending remains low (0.7 percent of GDP in 2018), and only 12 percent of the population are covered by at least one social protection program.[65] The large informal sector makes it difficult to expand the coverage of social insurance. With three-quarters of employment in the informal sector, only 8 percent of unemployed persons receive unemployment benefits. The coverage of social assistance is similarly low. Old-age pensions, both contributory and non-contributory, cover only 6.3 percent of the elderly. Around 8 percent of those who are not covered by social insurance or old-age pensions have access to social assistance benefits but limited social assistance spending constrains the benefit size.

The system has limited capacity to scale up and, coupled with fiscal pressures, resulted in limited coverage of response measures to COVID-19. Few social protection programs have any established links to disaster preparedness and response and where they exist they were only relevant to small-scale or localized disasters. Therefore, when the COVID-19 pandemic hit the economy, response measures were limited to tax relief and unemployment benefits extended to social security contributors affected by the pandemic, leaving most informal workers, whose livelihoods were more vulnerable to employment and income shocks, without support.

A shock-responsive and adaptive social protection system is an essential tool to protect livelihoods amid cascading shocks, with COVID-19 a case in point. The growing multi-hazard environment emphasizes the need for the social protection system to respond to the adverse effects of cascading shocks to protect vulnerable households from falling into poverty and resorting to negative coping strategies such as reduced food consumption, reduced child education, and child labor that damage human capital. For example, in response to COVID-19, it is important that government plans (e.g., unemployment benefits or cash transfers) be expanded for greater coverage of vulnerable groups, including informal workers, women workers and workers in the hardest hit sectors such as hospitality and transport.

Given existing fiscal pressures, it is crucial that a foundation be built for the efficient delivery of social assistance. Social assistance provides additional income for vulnerable households with limited livelihood options and cushions impacts from adverse shocks. If shocks are large and household coping strategies are not working, social assistance is a last resort for individuals and families that have no other income. However, given the limited fiscal space, the emphasis should be on the efficiency and equity of social spending. To enable effective implementation, it is important to invest in modern delivery systems that allow for better targeting and lower transaction costs for beneficiaries and formal sector workers covered by the nascent social insurance program.

Poverty Decree 348 is expected to be the basis for a national targeting system and social registry. This decree sets the criteria for poverty graduation and development for households, communities, and villages. The methodology was revised in 2020 and a Proxy Means Test was developed, from which each household receives a poverty score stored in the Social Registry. The Social Registry is expected to provide a gateway for easier identification of beneficiaries for targeted social assistance programs. For example, those with a poverty score below an eligibility threshold (poverty criteria) may be eligible for social assistance programs. So far, the methodology was piloted in the 12 districts where the Conditional Cash Transfer program for pregnant mothers and children has been implemented and is used to target beneficiaries for inclusion in the Conditional Cash Transfer program. Going forward, it would be critical to ensure that the different line ministries use the Social Registry to target their social assistance programs.

Laos lags in South and East Asia on critical indicators for efficient and effective delivery of social protection programs. Limited coverage of the national ID prevents the government from using a unique identifier to authenticate the identity of applicants and keep track of who is receiving which benefits.[66] It is often seen as a challenge to open a bank or mobile money account

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[65] ILO World Social Protection Database.

[66] Forty percent of adults age 15 and over have a national ID card (World Bank Global Financial Inclusion 2017).

as these formal services require an ID to meet ‘know-your-customer’ requirements. Limited financial inclusion makes digital delivery of payment challenging. Finally, despite the recently increased coverage of mobile money networks, payment networks are still limited in remote areas where the most-in-need live. Comparatively high mobile phone ownership (73 percent) could be a basis for online and digital services, including digital payment delivery and active communications with applicants or beneficiaries. Silo systems should be avoided in favor of an integrated whole-of-government approach. For example, it would be important to link social assistance beneficiaries to Active Labor Market Programs while digital payments for pensioners and cash transfer recipients should be coordinated with other government-to-person payments.

Cross-Cutting Theme

Strengthened Governance and Institutions

Strengthening governance and institutions will be crucial to support the priorities identified under the three pathways. In the Stabilize pathway, improving governance arrangements and institutional capacities will contribute to improved macroeconomic 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 also promote greater accountability. Institutions are also important under the Share pathway, such as in the design and implementation of regulatory reforms that contribute to a more vibrant private sector, build synergies in infrastructure projects, and enhance human capital. A redefined relationship between the state and markets can support private sector development with stronger independent regulatory bodies to enhance competition. Stronger protection for property (especially land) and creditor rights could stimulate private sector activity, while labor market institutions are crucial to achieving full and productive employment. Finally, the Sustain pathway requires improved governance and strong institutions to effectively manage natural resources and stem state capture, especially in a context of high resource rents. Institutions are important to build resilience to shocks. Overall, strengthened governance and institutions would improve evidence-based policy making and enable a faster move toward a rules-based economy that supports inclusiveness and promotes accountability.

The Ninth NSEDP, in line with the Party’s Development Strategy 2025 and Vision 2030 includes a focus on addressing gender inequality as part of its third outcome enhancing the well-being of the people. It acknowledges the low proportion of women in decision making and leadership positions in central and local government levels and sets specific targets for women’s participation in government bodies: (i) at least 30 percent in leadership positions at the central level; (ii) at least 20 percent in leadership positions at the provincial, Vientiane Capital and district levels; and (iii) at least 10 percent in leadership positions at the village level. The establishment of these targets provides an important entry point to strengthen women’s participation and voice in local government structures. The entry point provided by the NSEDP at the village level, in particular, creates opportunities to further build the capacity of women leaders to be meaningfully engaged in local decision making. Building on the existing Poverty Reduction Fund platform at village level, investing in grassroots leadership and gender equality training can positively impact the quality of women’s voice in local government.

4

Prioritization and Knowledge Gaps

Prioritization and Knowledge Gaps

Prioritization

A reassessment of the challenges and opportunities facing the country led to the identification of three High-Level Outcomes (HLO) and sixteen development objectives (Table 4.1). This SCD reevaluated the main constraints to ending extreme poverty and boosting shared prosperity. Sustainable debt levels, increased fiscal space and a stable financial sector are essential to achieving greater macroeconomic stability and thus ensure that living standards are protected from macroeconomic risks (HLO-1). A dynamic private sector and connective infrastructure are crucial to boosting job creation, while a well-functioning labor market, reduced stunting, enhanced learning outcomes, and equitable access to quality health services are all critical to enabling access to job opportunities. Improvements in these areas will contribute to improving the labor incomes of vulnerable households (HLO-2). Finally, improved management of natural resources, action on climate change, and well-managed urbanization can support green growth, while comprehensive social protection, improved financial inclusion, and improved agricultural productivity would support resilient livelihoods. These, in turn, would increase human resilience to shocks (HLO-3). Given the importance of the cross-cutting theme, strengthened governance and institutions was identified as a specific development objective.

Table 4.1: Prioritization

Top	High	Medium
Sustainable debt levels	Stable financial sector	Well-functioning labor market
Increased fiscal space	Improved connective infrastructure	Well-managed urbanization
Dynamic private sector	Reduced stunting	Improved financial inclusion
Enhanced learning outcomes	Equitable access to quality health services	
Improved management of natural resources	Action on disaster risk and climate change	
Increased agricultural productivity	Comprehensive social protection	
Strengthened governance and institutions		

Source: World Bank staff.

While most development objectives can be mapped to those in the 2017 SCD, some were introduced due to recently emerged challenges. Because development constraints have not changed substantively since the previous assessment, most objectives identified in the 2017 SCD remain relevant. However, a few development objectives were introduced because of development constraints that have become more salient since 2017. For instance, increasing fiscal space has become a more pressing objective owing to the underperformance of revenue collection and rising debt service obligations which have limited the scope of fiscal policy in responding to emerging needs (e.g., economic impact of the COVID-19 pandemic). A well-functioning labor market and well-managed urbanization were identified due to new evidence of jobless growth and the growing urban population. Strengthened disaster risk management, as identified in the 2017 SCD, was expanded to incorporate action on climate change given the growing importance of the climate agenda and evidence from 2018 on the increasing economic and social impact of floods.

Development objectives were reprioritized in line with new evidence, providing insights that can inform the formulation of the upcoming Country Partnership Framework (CPF). This SCD revisited the prioritization exercise undertaken in the 2017 SCD and updated it based on new evidence and the evolving country context. Three criteria were used to update priorities. First, preference was given to objectives with a significant impact on poverty and inequality. This criterion was given the highest importance. Second, areas that create strong complementarities across dimensions or are a precondition for the achievement of other objectives were given more weight. Last, the time horizon of their impact was an important factor to consider when prioritizing.[67] Feasibility is not a criterion used for prioritization since an assessment of the political viability and implementation efforts should be undertaken at the CPF stage.

Sustainable debt levels and increased fiscal space were identified as top priorities under the Stabilize pathway as they require immediate attention. Debt sustainability has become a more pressing concern since 2017, with a growing debt burden severely threatening macroeconomic stability and eroding fiscal space for development spending. Left unchecked, macroeconomic instability can significantly affect the purchasing power of households through a depreciating exchange rate and higher inflation. During the COVID-19 pandemic, more than half the surveyed households considered inflation the most important issue confronting their community, and inflation is the issue that citizens believe the government should address first. By constraining fiscal space and deterring private sector investment, macroeconomic instability harms long-term growth and job creation. Increased fiscal space is a top priority, as tax collection is faltering at a time when stronger investments in human capital are crucial. Limited fiscal space has constrained the government's ability to expand social spending on education, health and social protection, even in the time of the pandemic, leaving many people at risk of falling into poverty.

A dynamic private sector and enhanced learning outcomes were identified as top priorities under the Share pathway owing to the importance of reversing the trend of jobless growth. Recent evidence confirms that much of the recent growth experience has been jobless, a phenomenon not documented in the 2017 SCD and which has been worsened by the COVID-19 pandemic. Jobless growth has slowed poverty reduction and rising inequality in recent years. Therefore, a more dynamic (domestic non-resource) private sector is crucial to generating sufficient good job opportunities. Slow progress in education has been aggravated by learning loss from the pandemic. Enhanced learning outcomes are needed to support learning recovery, ensure that prospective workers have the skills needed, and boost entrepreneurship. Although stunting declined significantly between 2011 and 2017, it remains widespread and recent evidence shows that the situation might have worsened since 2017. Equitable access to quality health services continues to be vital to ensure healthy and productive workers, and to effectively respond to the pandemic risk. Connective infrastructure (comprising both transport and digital dimensions) remains important to support spatial development and ensure equal access to markets and public services, especially when the new Laos-China railway will only reach the northern part of the country.

Improved management of natural resources and enhanced agricultural productivity were identified as top priorities under the Sustain pathway. Given that the livelihoods of most poor and vulnerable groups rely heavily on natural resources and agriculture, improving the management of natural resources remains critical to ensure that resources are used in a sustainable and suitable manner while delivering commensurate benefits to the population. Agriculture has been the main driver of poverty reduction. Improving agricultural productivity and resilience thus warrants a top priority. Action on disaster risk and climate change is increasingly

[67] The SCD aims to strike a balance between actions that have short-term impacts and actions whose impacts emerge over time such as long-term priorities that require early action (e.g., climate change).

important and requires joint efforts to mainstream climate change into sectoral policies. Therefore, it is identified as a high priority going forward. Comprehensive social protection is also crucial to protect people against cascading shocks stemming from pandemics, macro instability and climate- and weather-related disasters.

Public consultations were also used to support the selection of policy areas and inform the prioritization process. This SCD was informed by both internal and external consultations. The consultation process aimed to solicit views on what has changed since the last SCD (e.g., emerging constraints) and whether the policy areas identified were achievable. Internal consultations included World Bank Group staff, while external consultation engaged a broad group of stakeholders through three virtual sessions that grouped government agencies and academics, the private sector, civil society, citizens, and development partners.[68] The government session offered many endorsements of the analyses and policy areas, including the proposed HLOs, development objectives, and pathways. Agriculture, education, small and medium businesses, and the environment were cited as priority sectors. The private sector session featured searching questions on how to fix the economy and the debt situation and the need for a more skilled workforce, all of which are highlighted in this SCD. In the final session, a theme raised several times and often in messages through the World Bank's public channels, was the lack of access to credit for small farmers, which this SCD emphasizes as a critical issue that needs to be tackled for achieving the development objective of increasing agricultural productivity.

Data and Knowledge Gaps

Data and knowledge gaps undermine evidence-based policymaking and accountability for results. The design of effective policies, monitoring their implementation and evaluating their impact hinges on the availability of relevant, timely, and reliable data. Challenges may arise because relevant data is not produced, is of poor quality (e.g., low frequency, coverage, or reliability), or is not publicly available.

This SCD revisited the data gaps identified in the previous SCD, noting some improvements but also persistent challenges. The analytical content of SCDs depends partly on the availability of data and information. The 2017 SCD identified several data gaps which have been reassessed for this exercise. Hence, some recurrent and new knowledge gaps were identified during the preparation of this SCD (Table 4.2).

Efforts should be developed to collect and analyze data in several key areas. Some data and knowledge gaps should be prioritized and addressed in the next CPF period. For instance, improving macro-fiscal data is crucial to better track developments in a timely and accurate fashion, particularly expenditure-side GDP, fiscal accounts, and public debt data. Analysis of firm and labor market dynamics is critical to understanding constraints to private sector development. The analysis requires data of the same individuals and firms at multiple points in time. Sectoral data (e.g., education, health, energy) are also crucial for improved sectoral planning. Spatial analysis and GIS data will be vital to understand the socioeconomic impact of climate change that is often highly localized and the impact of the Laos-China railway that is expected to exacerbate spatial disparities.

The SCD benefited from new data and knowledge products produced since 2017. New data has been published since 2017. This includes the LECS 2018/2019, which provides a recent measurement of poverty and inequality. The Enterprise Survey 2018 provides insights on firm performance and obstacles to business. The LFS 2017 provides new information on labor trends. The LSIS 2017 provides updates on social indicators. In terms of knowledge products, a Country Economic Memorandum (CEM) contributed to a better understanding of macroeconomic vulnerabilities and the current

[68] See Annex 3 for more detail on public consultations.

growth pattern. A Poverty Assessment analyzed the results of the LECS 2018–2019, providing vital information on recent trends and drivers of poverty and inequality. A Public Expenditure and Financial Accountability (PEFA) assessment was conducted to assess the quality of existing PFM systems. Other reports cover the topics of green growth strategies, the Laos-China railway, and EDL among others.

Table 4.2: Reassessment of data gaps

Sector	Reassessment
Macroeconomic	Weak and with delay. Important gaps exist, including on expenditure-side GDP. Trade and balance of payments data are weak. Monetary and financial sector data are also delayed and it is unclear if they meet international standards.
Fiscal and debt	Weak and with delay. Elements of the economic classification of fiscal accounts are available but are not fully compliant with Government Finance Statistics (GFS) manuals. Functional analysis of the budget is not available. Debt reporting has improved. Recent revisions should ensure compliance with GFS.
Employment	Weak. A labor module is included in the LECS which is conducted every five years. A labor force survey is conducted every 5 to 7 years (2010, 2017, and 2021). Development partners undertake surveys on ad hoc basis (e.g., STEP survey in 2012).
Poverty and social	Basic. Poverty data are derived from the LECS, the household expenditure and consumption survey that has been conducted every 5 years since 1992. In general, the LECS provides sufficient information for identifying the poor and vulnerable. However, frequency needs to increase, and a light annual survey is being considered. Social data are derived from the LSIS, which is conducted every 5 to 6 years (2011, 2017).
Private sector	Weak. The economic census is undertaken every 7 years (2006, 2013, 2020) but it has limited information and does not cover the informal sector. In addition, only 40 to 60 percent of the census data is shared by the government. Firm-level data are available from surveys undertaken mostly by development partners with varying geographic and sectoral coverage, making analysis of firm dynamics and performance over time extremely difficult.
Health	Weak but improving with the rollout of the health district information system at the health center level. Information and reporting on immunization, nutrition, maternal health and other public health programs have been improved, while data sharing across ministries remains a challenge, particularly for nutrition information reporting systems.
Natural resources / environmental	Weak. Natural resources data from national sources are limited and somewhat unreliable due to inefficient collection and often vague classification systems. Environmental quality is not systematically monitored.
Energy	Weak. The hydropower sector lacks a central database. Energy supply and demand data from different agencies are inconsistent and not always updated or validated. Collection, recording, analysis, and presentation of data from instruments regarding dam safety are not centrally processed, plotted, evaluated, or interpreted for possible consequences. There are significant and critical gaps in Électricité du Laos (EDL) accounting and financial management records, and inconsistencies in the data across MEM, EDL, MOF and MPI. A common database for power system planning is also missing.
Agriculture	Weak. An agriculture census is conducted every 10 years (2010, 2020). Regular updates and increased use of GIS data are necessary.
Governance	Weak. The availability of governance-related indicators is limited, such as feedback on government performance, impact evaluations of programs, opinion polls of citizens' priorities, and service user feedback. Political economy and country-level institutional analysis are missing.

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Annex 2: Public Financial Management

The government faces significant public financial management (PFM) challenges. The 2018 Public Expenditure and Financial Accountability (PEFA) assessment concluded that only two of the 31 indicators measures scored either A or B, scores considered above the basic alignment with good practice. The remaining indicators received scores of either C or D, which suggests basic alignment with the standards for a C and weak performance for a D. Budget reliability performance is fragile, and the credibility of the budget is undermined by the limited information on the budget allocation and execution for defense and police and 'other institutions', as well as on execution at the provincial level. There is limited transparency of public finances, as disclosure of budgetary and fiscal information to the public is limited, which undermines the ability of citizens to scrutinize the use of public resources.

The management of assets and liabilities is generally weak, including weak controls over fiscal reporting and public investment, which has generated significant fiscal risks. Inadequate SOE management and corporate governance have led to underperformance and substantial fiscal risks as evidenced by the debt accumulated by Électricité du Laos. State-owned Enterprises (SOE) are key players in the energy, water, transport, and financial sectors. However, there is no publicly available list of SOEs and information on their assets, liabilities, and employment levels are limited. [A2.1]According to 2017 financial data, a quarter of SOEs were loss-making, which has significant fiscal implications on the government's balance sheet. Of the SOEs listed in 2017, over 28 percent did not submit their financial reports. At the same time, the government has borrowed money to finance SOEs but they have not been able to repay their loans, which has left the government with $300 million of debt repayments annually due to SOEs.[A2.2] While the MOF has the overall responsibility for the management of the SOE portfolio, the MOF does not have accurate and complete economic and performance information on all SOEs, including on their financial position, assets and employment levels, reflecting weaknesses in the government's monitoring and SOE governance. There is currently no framework for identifying, assessing, monitoring and disclosing SOE performance information which is critical for evidence-based policy making.

The existing MTFF and MTEF are not consistent with resource availability and the link between capital and recurrent expenditure managed through distinct processes is weak. As a result, they are not used as a basis to focus on priorities in the allocation of funds among institutions and sectors and strategic sector planning remains weak. The limited budget classification does not provide sufficient information on budget execution to enable effective monitoring of budget allocations by function and informed policy decisions. Externally funded projects are monitored separately and there are no systems to track allocations received by service delivery units. Data on both implicit and explicit contingent liabilities is missing. The current financial information system has limited coverage and functions, which affects timely and comprehensive budget execution reporting. The absence of a unified chart of accounts to track expenditures by economic functional and programmatic classification hinders informed decision making.

[A2.1] According to MOF data, which may be incomplete, there are currently 174 SOEs, 92 at the central level and 82 at the provincial and local level. The government owns more than 50 percent of the share capital in 123 SOEs, 54 at the central and 69 at the provincial and local level. Of the 123, in 113 SOEs the government has a 100 percent shareholding (48 at the national level and 65 SOEs at the provincial level). The government owns 50 percent of the share capital in two SOEs, one at central and one at provincial. Thirty-eight percent of central SOEs are in the Ministry of National Defense And Ministry of Security, however the largest SOEs (by asset) are under the Ministry of Energy and Mining and the Ministry Public Works and Transport.

[A2.2] https://eccil.org/euro-lao-business/lao-economy/lao-govt-reveals-debt-payment-plan/

The absence of performance information in the budget execution reports, weak investment project costing, and missing clarity in the monitoring performed on the external control recommendations weaken the overall budgeting process. The transition toward a treasury single account is not complete. Public investment management capacities are weak, pre-feasibility and selection criteria are not systematically applied, there is limited monitoring of decentralized implementation, and processes for the costing, quality assurance and reporting on value for money and fiduciary integrity are not harmonized. Weak monitoring of provincial government spending undermines the quality of local spending and hampers efficient service delivery. The intergovernmental fiscal transfer system is not fully transparent, and budget execution reports have limited reliability. Consolidation of the district level is still entered manually into the government financial information system.

Despite efforts to control the wage bill in recent years, it remains high compared to peers and at risk of unsustainability in the current fiscal situation. The wage bill ratio to revenue has declined in recent years, from 48 to 46 percent between 2017 and 2019 but it increased as a share of government expenditure, from 31 to 52 percent between 2017 and 2019. Government employment is high compared to peers, both as a share of the total population (above 5 percent) and as a share of wage employment (over 60 percent). The wage bill is among the highest in Southeast Asia as a share of total government expenditure, domestic revenue, and GDP.

While the legal framework for public procurement has been strengthened since 2017, implementation is poor and capacities across the board are weak. This is reflected in the very low scores on the Public Expenditure and Financial Accountability (PEFA) Indicator PI 24 on Procurement Management and its sub-indicators.[A2.3] The new Law on Public Procurement adopted by the National Assembly in November 2017 provides the foundation for public procurement. An implementing instruction was adopted in 2019. However, the law is yet to be implemented and supporting documents and tools are still being developed. While good procurement practices exist within some line ministries, government-wide coordination and monitoring are underdeveloped, and significant capacity building efforts will be required to move toward more homogenous public procurement.

Finally, the effectiveness of scrutiny by the State Audit Organization and National Assembly is limited. Scrutiny is hampered by limited resources, lack of alignment to international standards for the State Audit Organization (SAO), and a lack of comprehensive, transparent and effective follow-up on external audit reports by the National Assembly. Parliamentary scrutiny over budget formulation and execution is based on aggregate comprehensive information, with no detailed revenue and expenditure estimates. The capacities and resources of the SAO are too limited to carry out annual financial audits of all entities in accordance with its legal responsibilities. Its reports to the National Assembly are usually delayed and are not made public. The SAO has no effective means to verify the implementation of follow-up actions in response to each audit recommendation.

[A2.3] According to 2018 PEFA, Laos scored D or D* on all of the sub-indicators of PI 24 Procurement Management: 24.1 Procurement Monitoring (D), 24.2 Procurement Methods (D*), 24.3 Public Access to Procurement Information (D) and 24.4 Procurement Complaints Management (D).

Annex 3: Public Consultations

External consultation engaged a broad group of stakeholders through three virtual sessions held in September 2021 that grouped government agencies and academics; the private sector; and finally civil society, citizens and development partners. Over 480 people attended the three sessions. The government session offered many endorsements of the policy areas presented by the SCD team, including the proposed High-Level Objectives (HLO) and pathways. Numerous participants cited agriculture, education, credit for small and medium businesses, and the environment as priority sectors. Various provincial offices put forward specific local priorities, including local connectivity and support for returning migrants. The private sector session featured searching questions on how to fix the economy and the debt situation and on specific sectors including tourism, agriculture, entrepreneurship, SMEs, and education. Several participants highlighted the need for a more skilled workforce. Again, there was broad consensus on the WBG's identification of the major issues and support for the avenues proposed. At the final session, for civil society, development partners, and the public, participants asked how actions in specific sectors could link with other actions to create synergies, both across sectors and among different development actors. Gaps in the proposed analysis were pointed out in gender disaggregation and digital development. Various agencies offered direct support for actions that could achieve the goals of the SCD. A theme raised several times at this last session, and very often in messages through the World Bank Group's public channels, was access to credit (i.e., the lack of it) for small farmers.

The consultations produced a supportive reaction from participants about the proposed content of the SCD and the ideas for addressing the current challenges facing the country. Some useful feedback was given that has since been incorporated into the SCD, notably the need to better incorporate gender-disaggregated data into planning, and to provide more analysis on governance weaknesses. A sample list of endorsements from the consultations is below:

- "We agree with the assessment of the World Bank."
- "I think those findings are valid..."
- "Your findings are relevant and truly reflect the reality: macroeconomy, environment etc. Your recommendations are aligned with those of the Lao government."
- "I am very happy to see that improving agriculture productivity is one of the top priorities of WB."
- "The presentations are comprehensive, clear, straight forward and very relevant."
- "This gives a good and succinct framework."
- "Strong presentation from WB team, very good data."
- "The SCD discussion and findings are enlightening but need to be developed into mechanisms of implementation. WBG should facilitate management working groups from the public and private sector to develop mechanisms of implementation."
- "I'm relieved that macro-fiscal stability is top of the agenda."
- "It's great to see "improvement of learning outcomes" as a top prioritized development objectives."
- "All 25 UN country team members can support the work of the WB and reap the benefits of WB work, which sets the scene for the UN work, which is dependent on increased fiscal space and a more stable macroeconomic situation to gain traction."

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