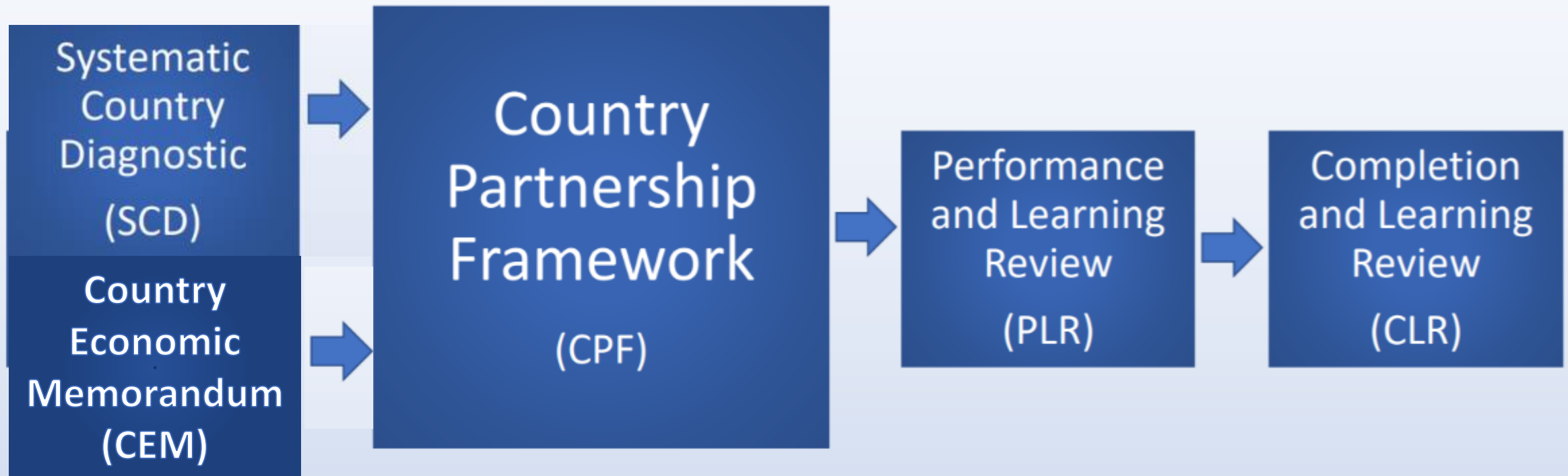




Consultation: Country Partnership Framework

World Bank Group (WBG) Country Engagement Process



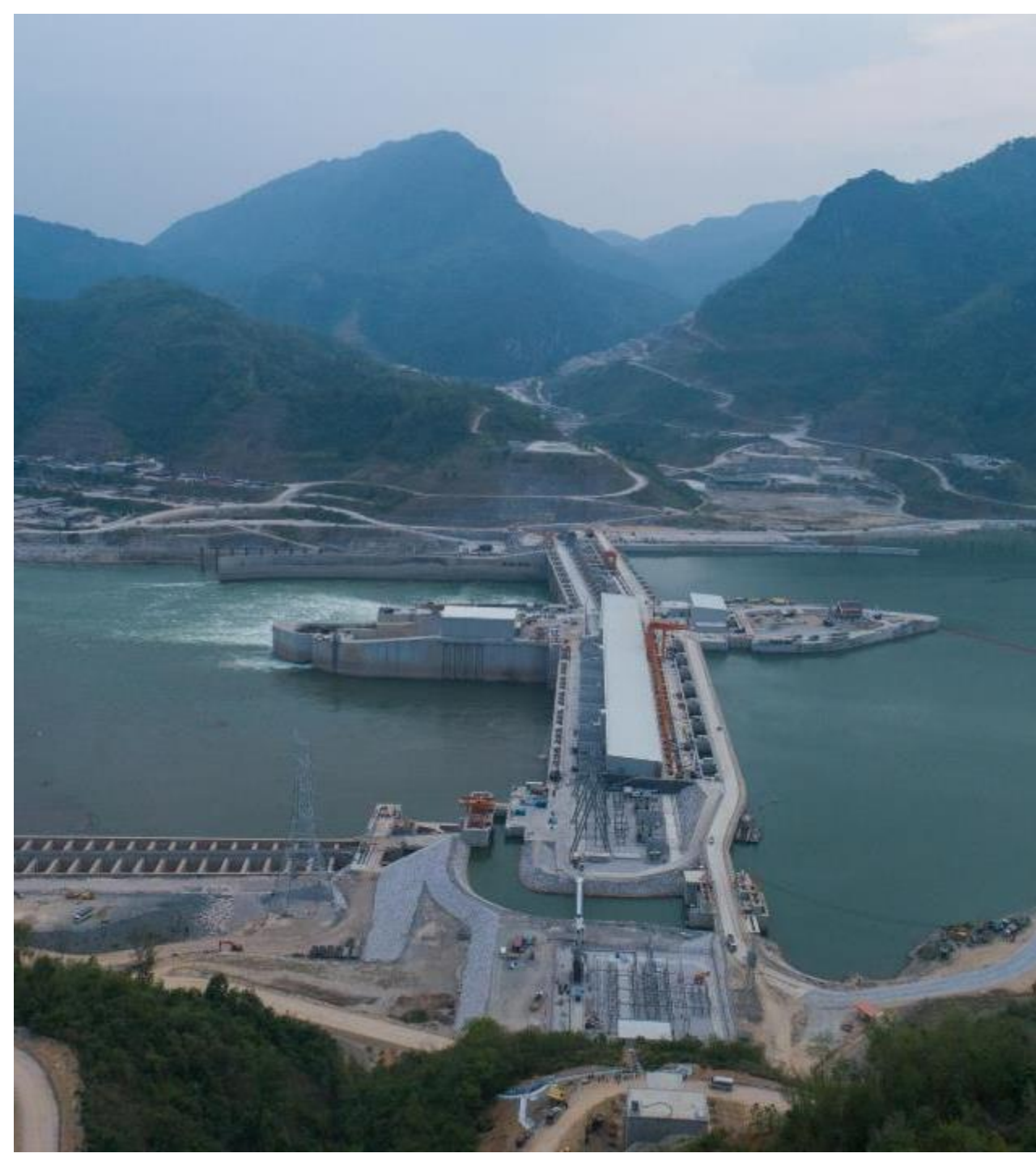
Consultations on SCD and CEM held September 22-24, 2021



LAO PDR COUNTRY ECONOMIC MEMORANDUM



Leveraging Strategic Location
and Natural Wealth
for Inclusive and
Sustained Growth

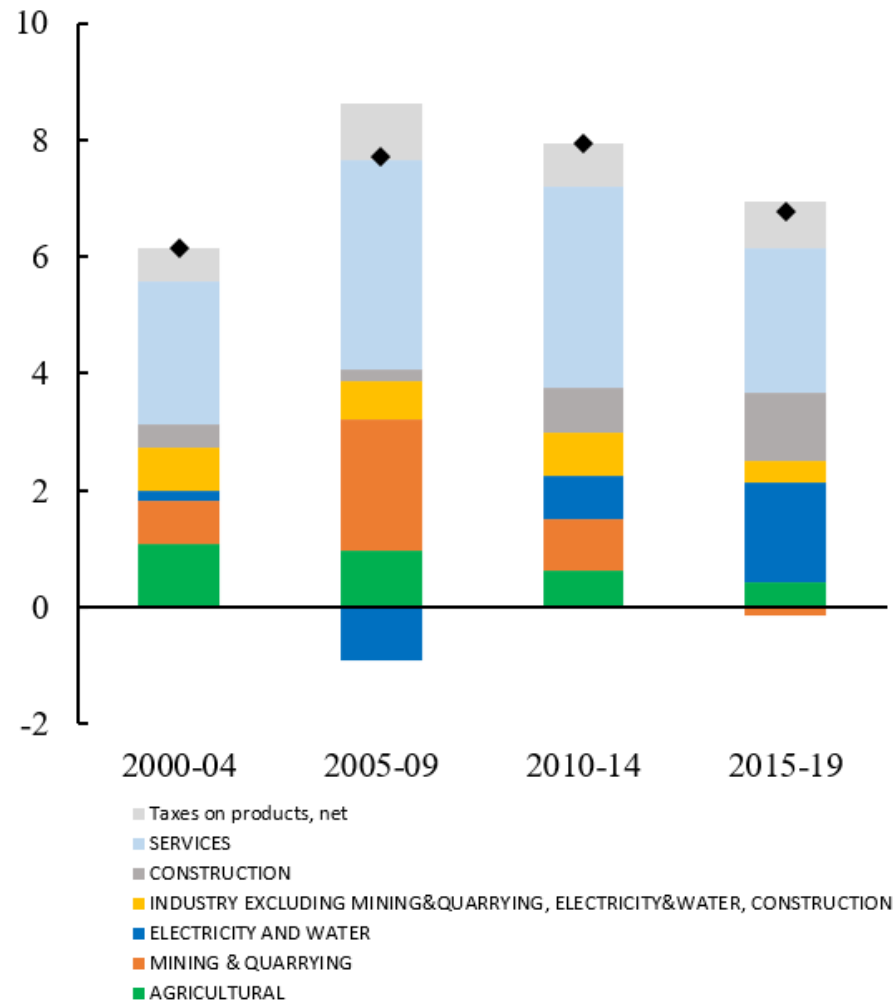
An aerial photograph showing a large-scale dam construction project in a mountainous area. The dam structure is a long, straight concrete wall with several smaller structures and gates. The surrounding landscape is rugged with steep, forested mountains. The water behind the dam is a deep green color. The sky is overcast and grey.

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

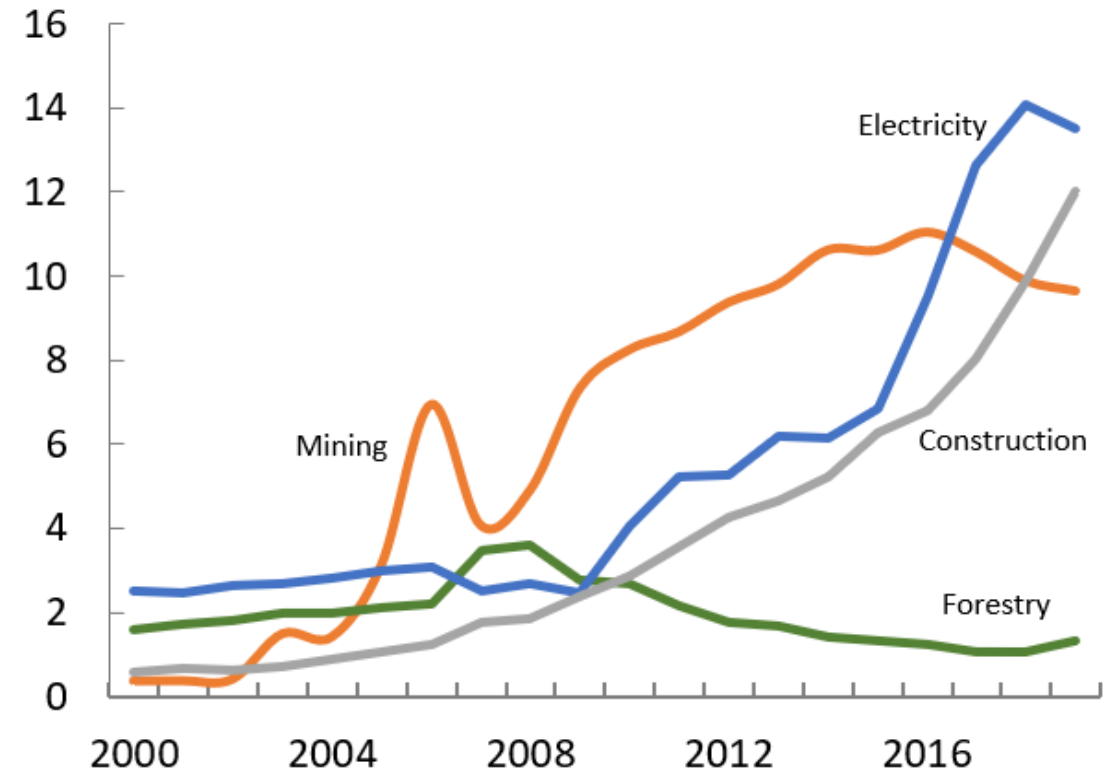
Resource-driven growth has created few jobs, while leading to significant environmental and macroeconomic pressures

Natural resources a key driver of fast growth over the past two decades

Sectoral contributions to GDP growth

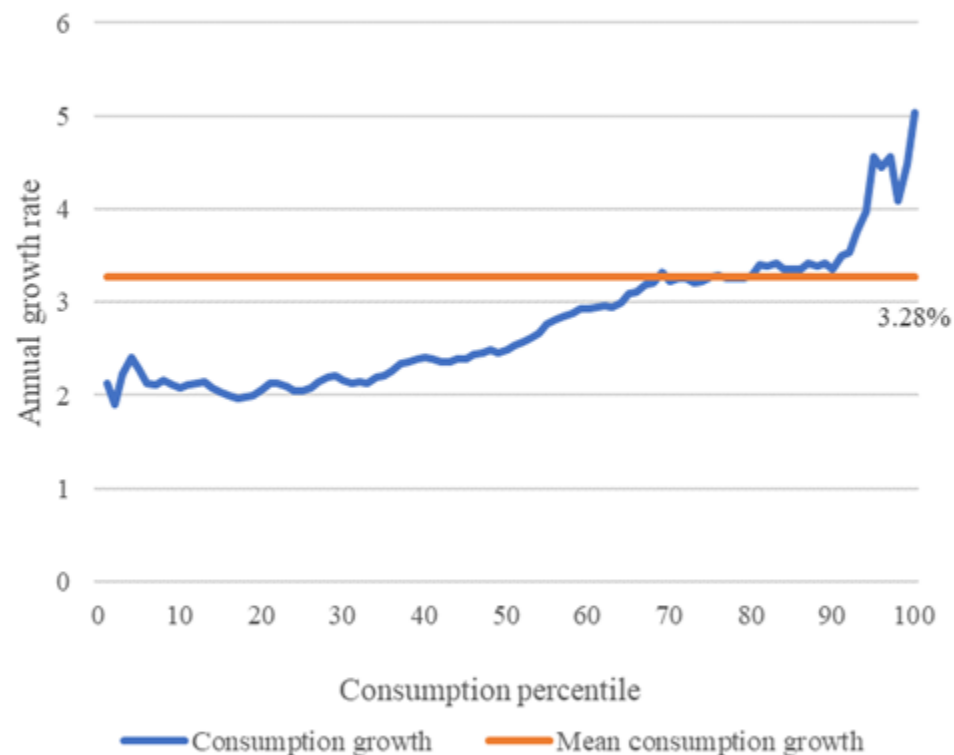


Resource sector contributions to GDP
(Real GDP, billion kip, 2012 prices)



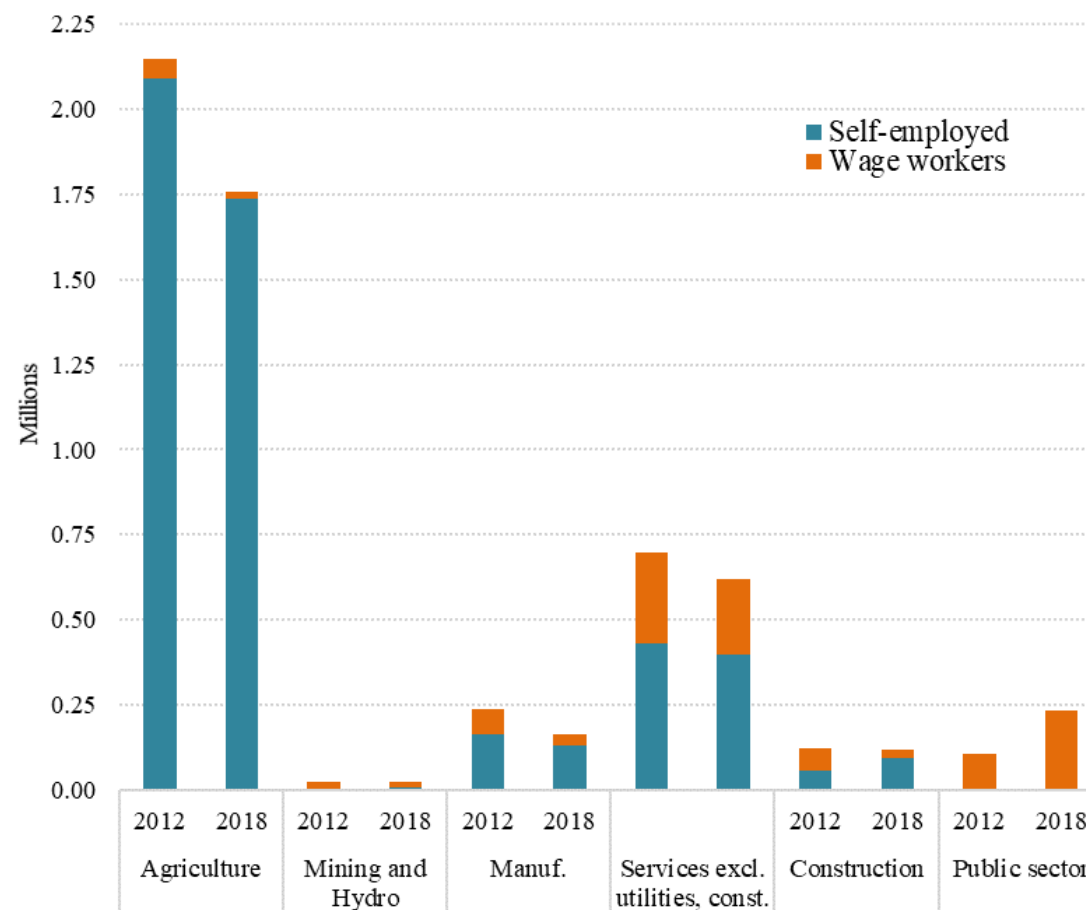
Growth not been sufficiently inclusive, no high job-creation

Consumption growth has been skewed towards rich households



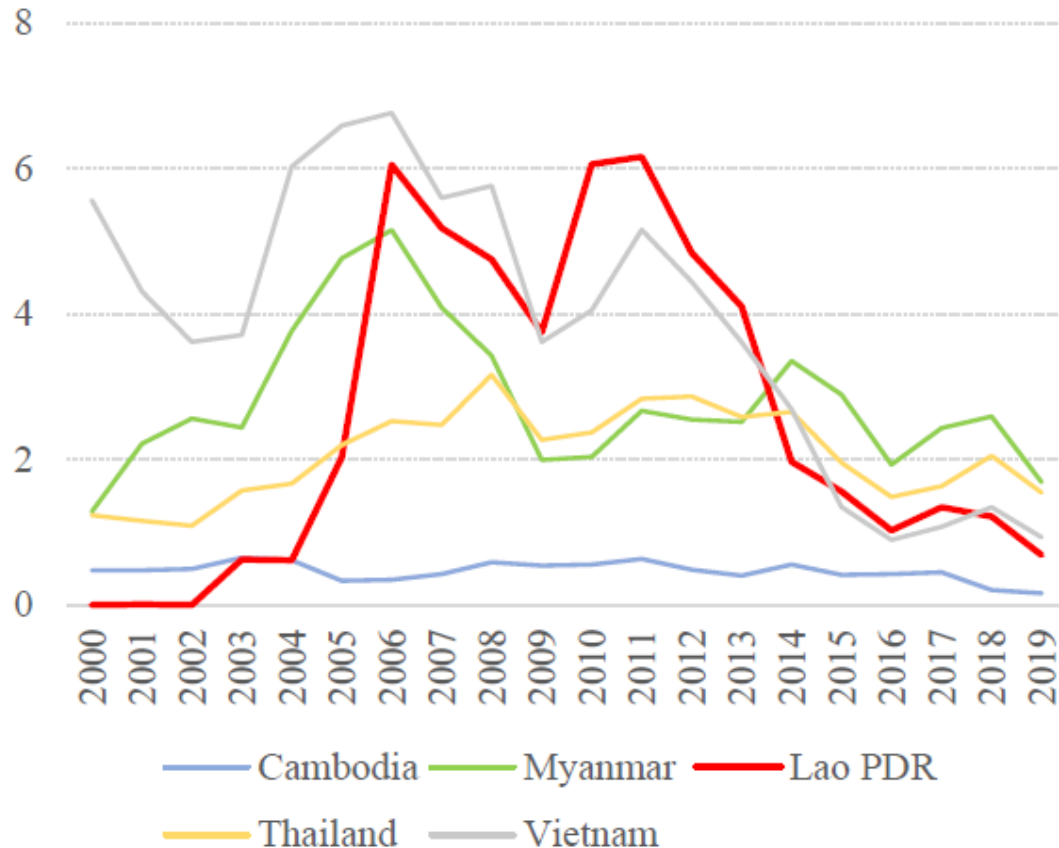
Source: Lao PDR poverty assessment

Wage and non-wage employment by sector: 2012-18



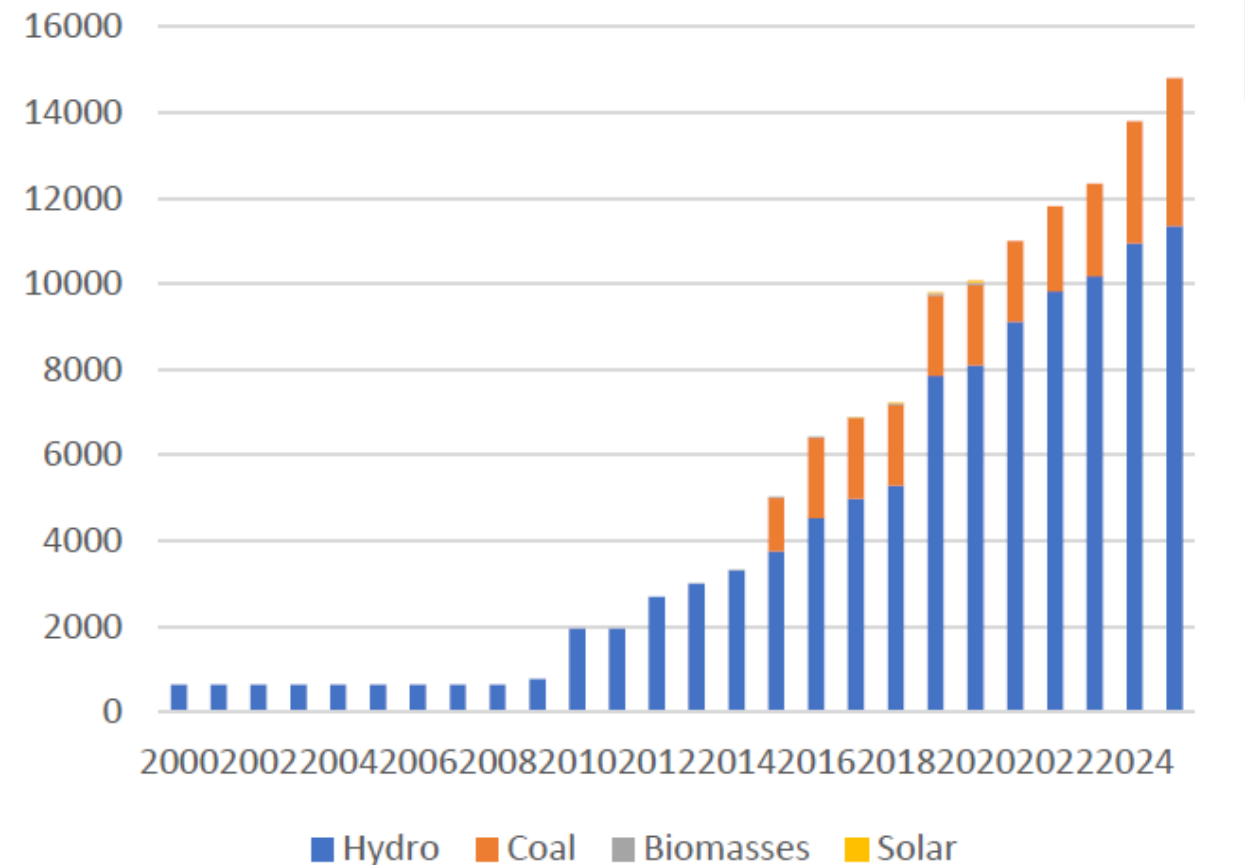
The growth model resulted in severe environmental pressures

The rate of depletion of natural resources has slowed in recent years
Natural resource depletion, in % of GNI



Source : World Development Indicators.

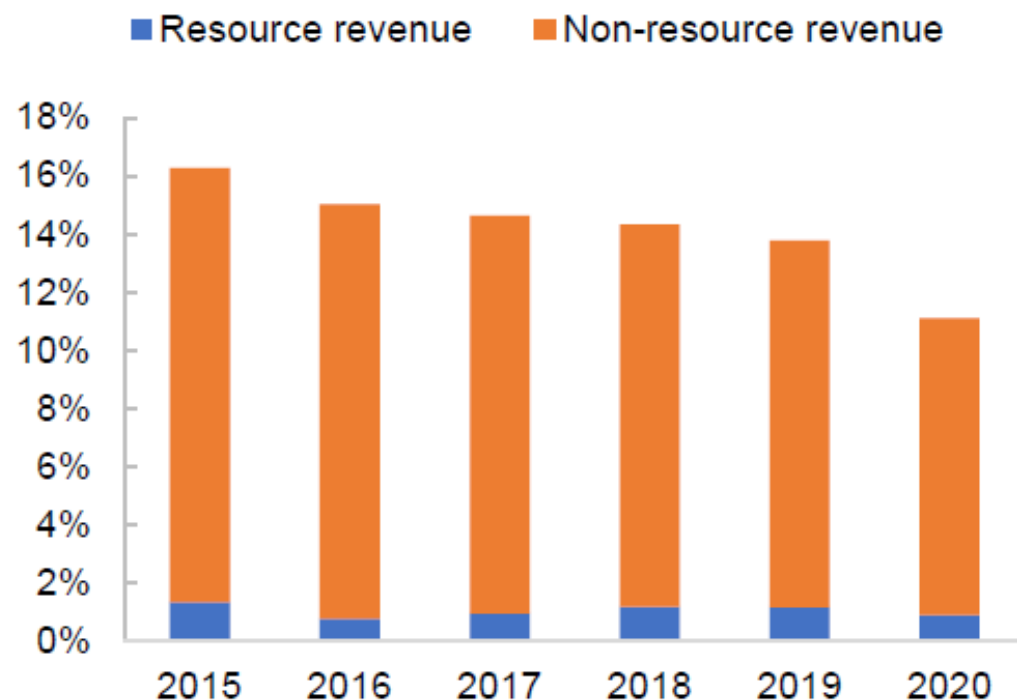
Installed Power Capacity: Historical and Projections
(Measured in MW)



Source: MEM data

Without leading to significant increase in public revenues

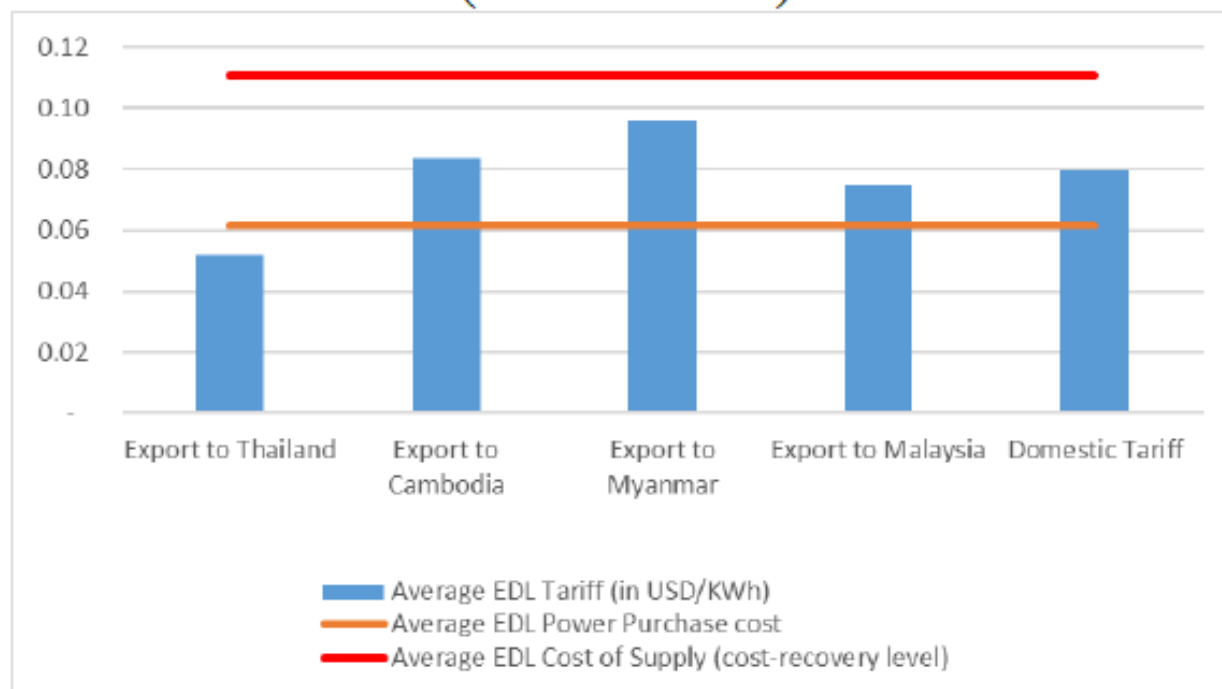
Resource and non-resource revenues
(percent of GDP)



Source: MoF

Note: The data for 2020 is preliminary

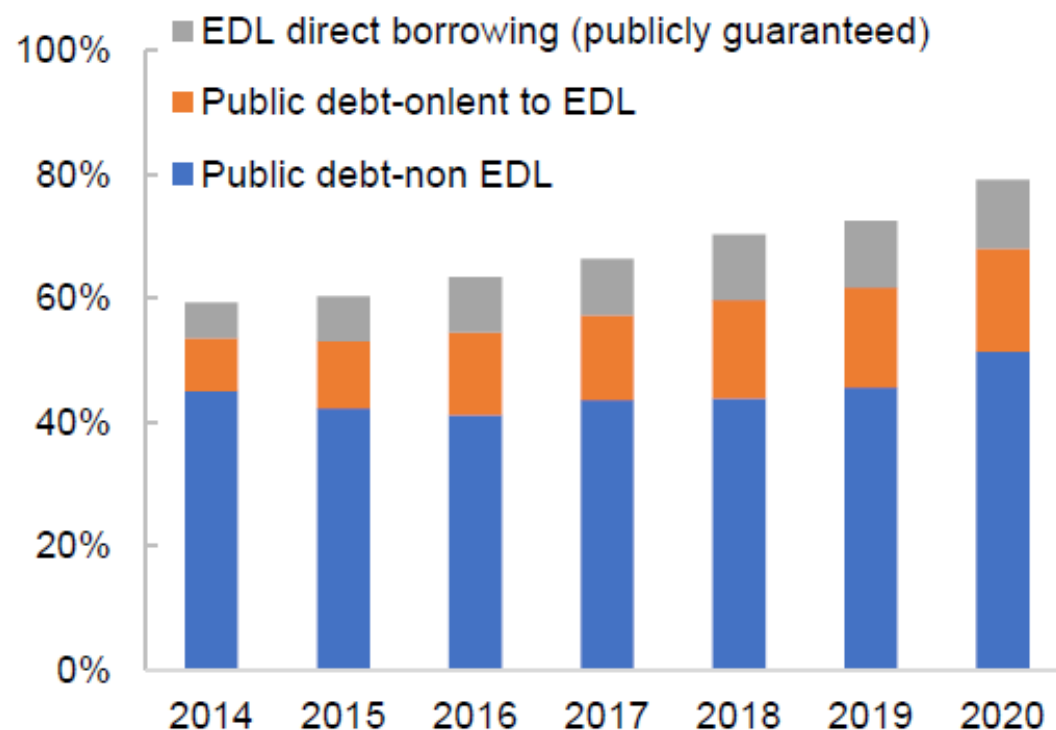
Average EDL domestic and export tariffs
compared to the EDL cost of purchasing power
(in USD/KWh)



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

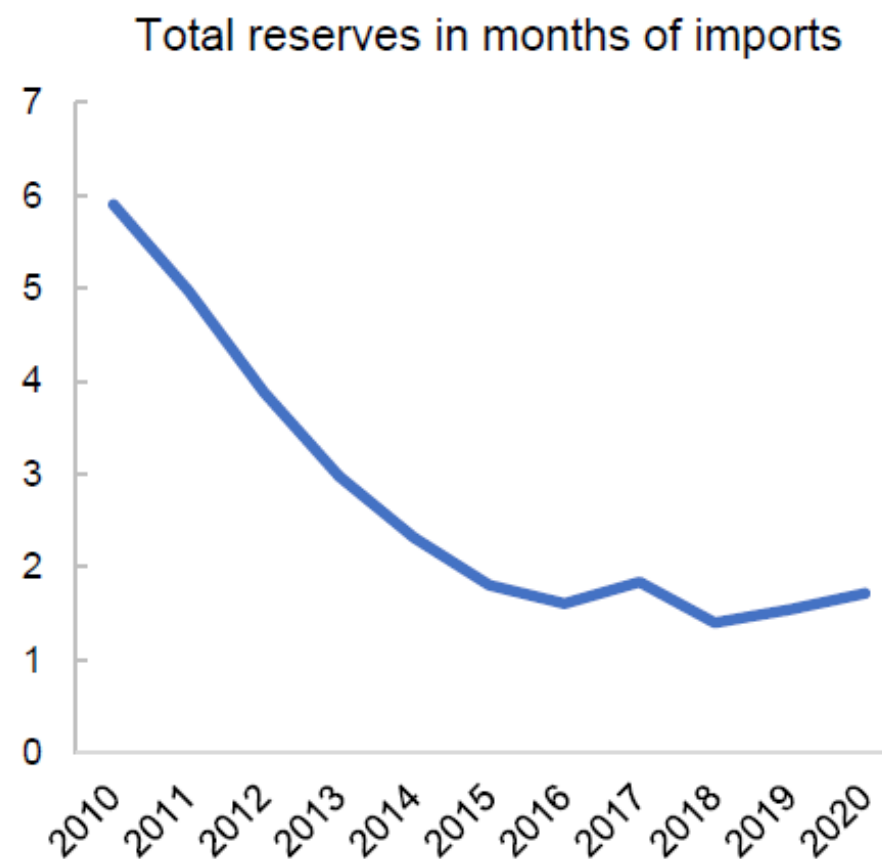
While fiscal and external vulnerabilities increased

EDL contributed significantly to the PPG debt (percent)



Source: EDL Financial Statements 2014-2018, World Bank staff estimates

Months import cover of foreign exchange reserves (Months)



Source: 2010-2019 data is from WDI, 2020 data is based on WB staff estimates.

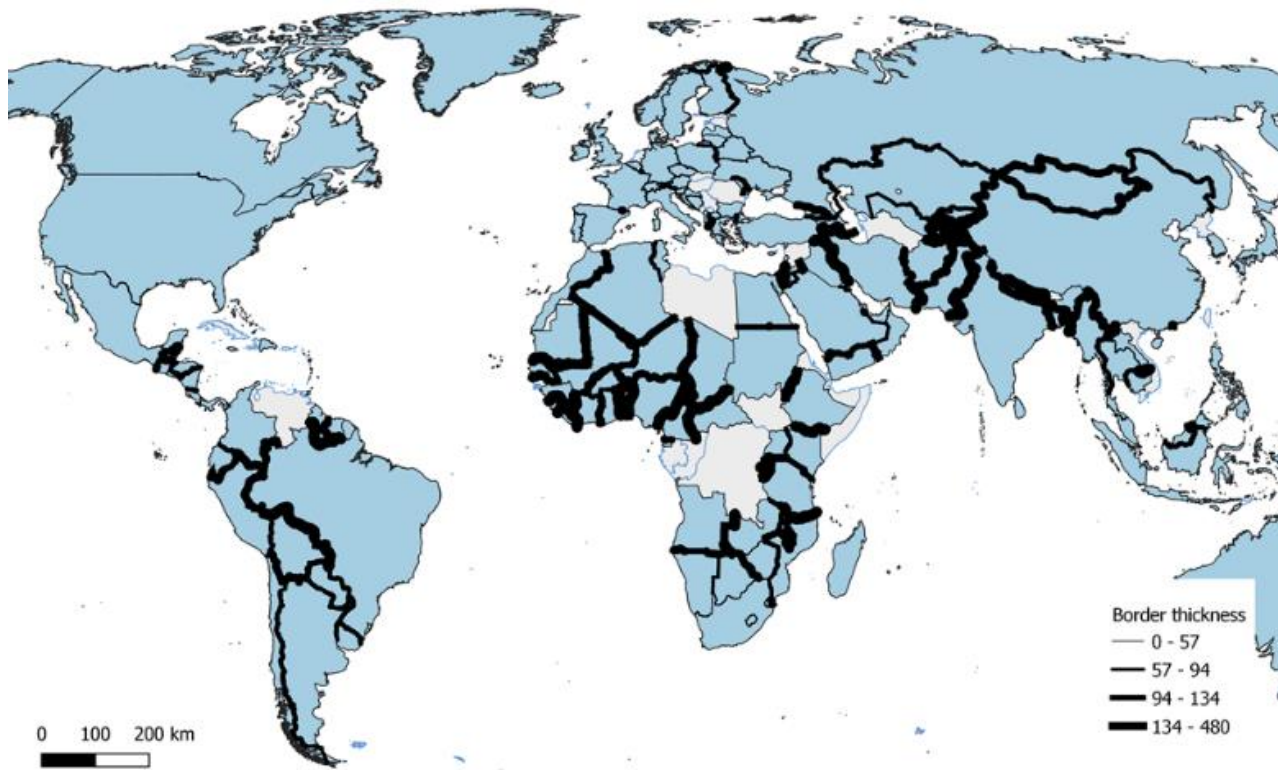


LAO PDR IS NOT THE USUAL
LANDLOCKED COUNTRY

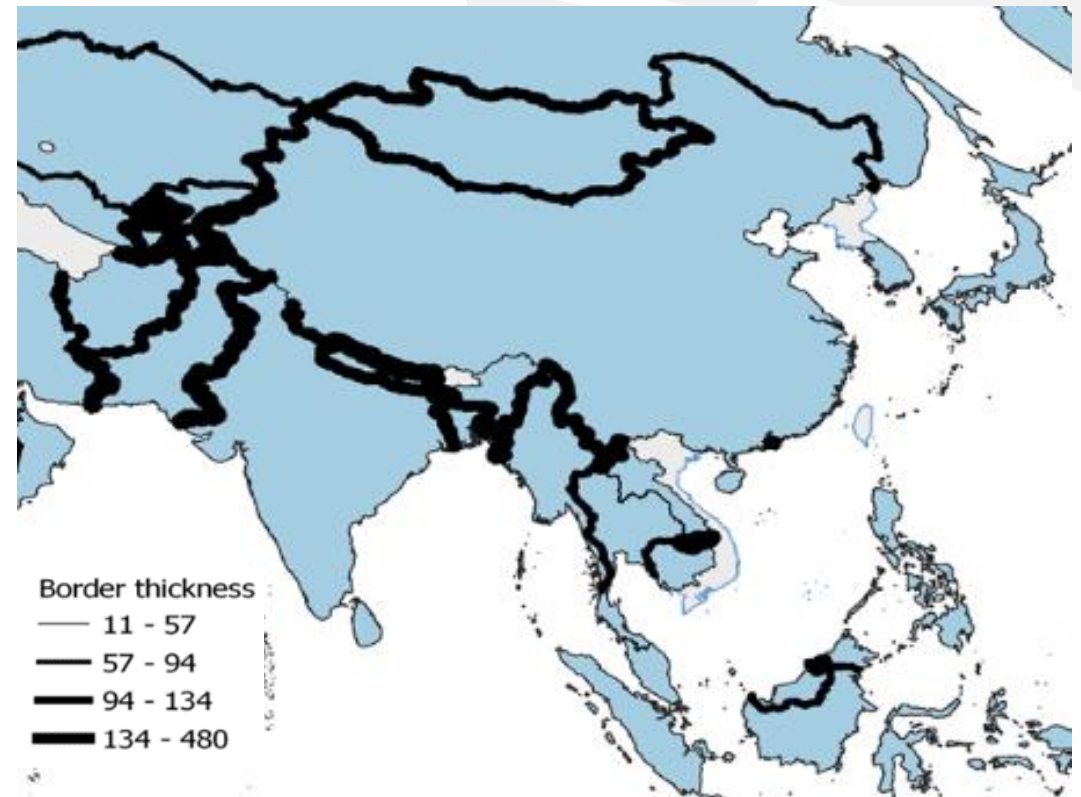
It has the advantages of
natural wealth, young population
and geographic location

Geography is more an asset than a constraint

World view

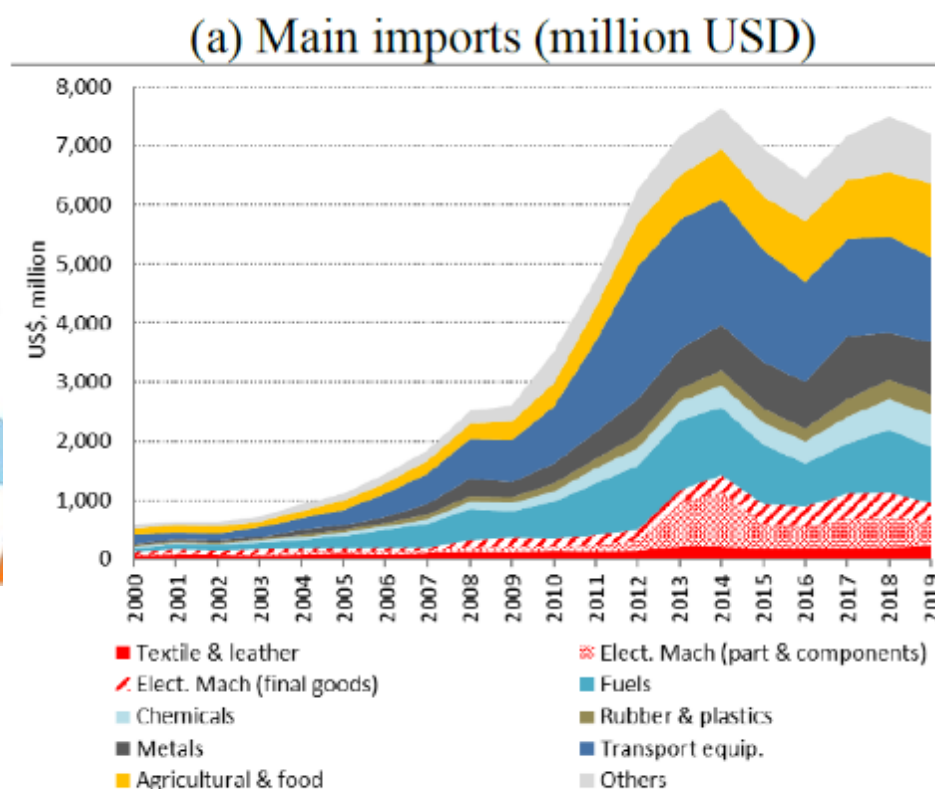
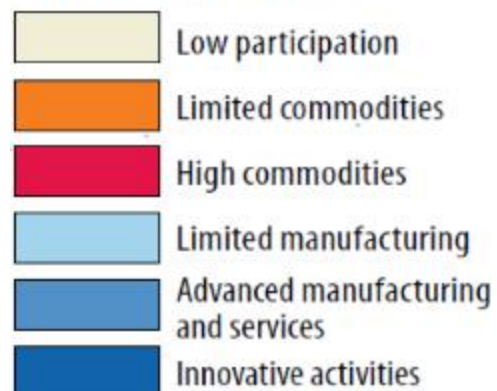
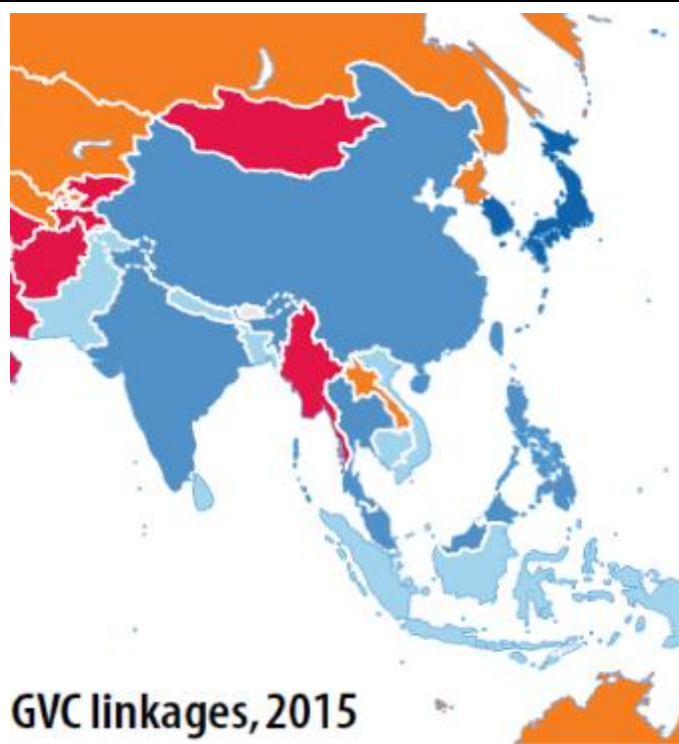


Asia and Pacific view

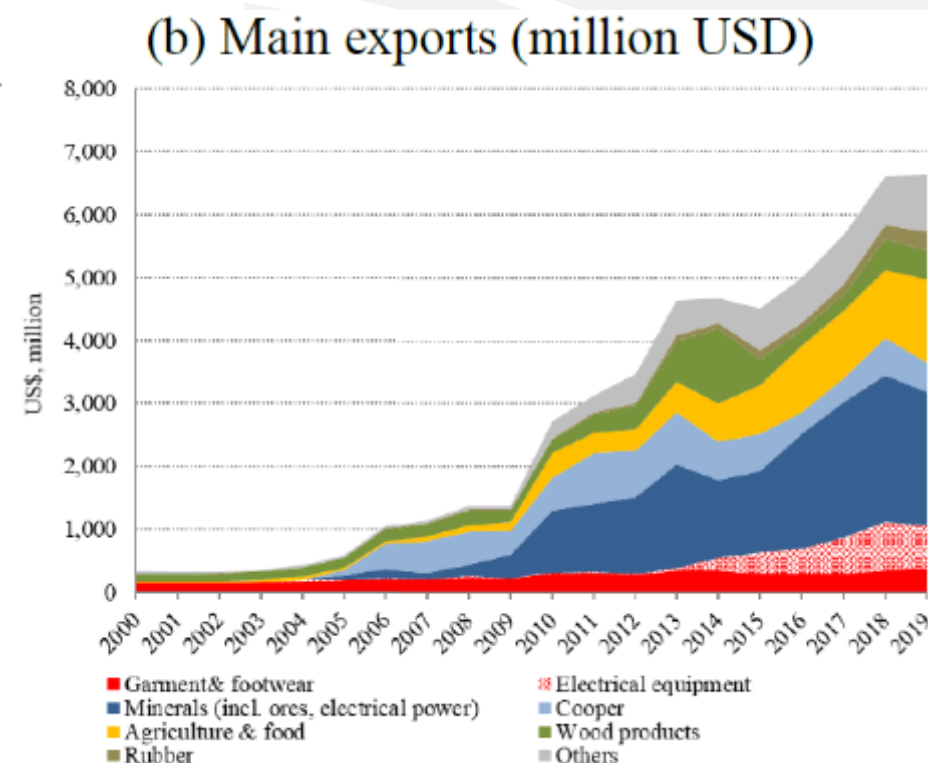


Source: The world Bank and United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) database

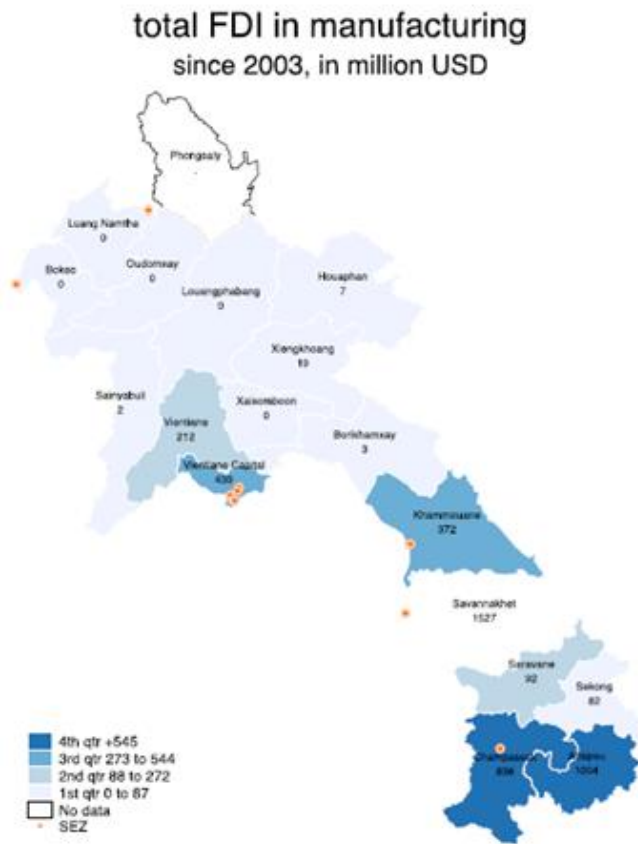
Laos links to commodity GVCs but has recently diversified



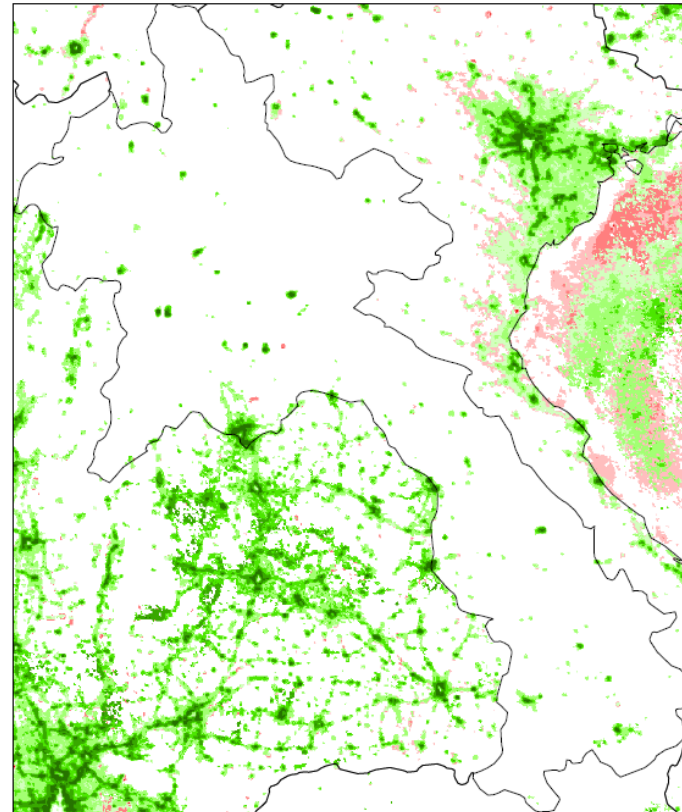
Source: BACI data.



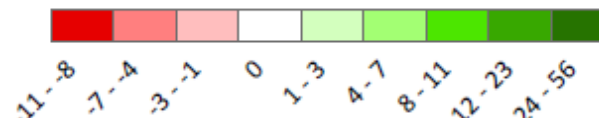
Export-oriented manufacturing FDI linked to local economic development



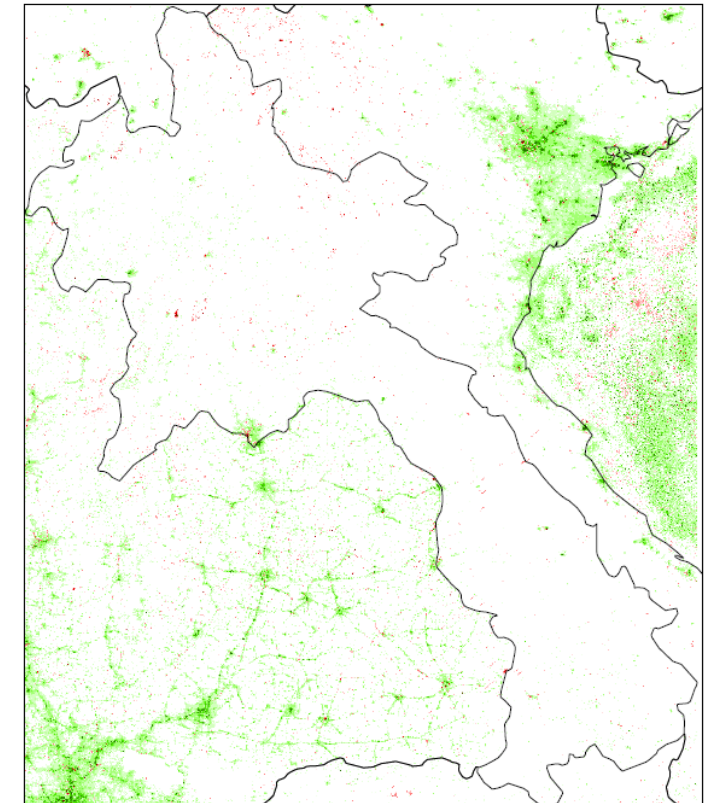
2013 - 2003 Difference, DSMP-OLS F18 & F15 Stable Lights



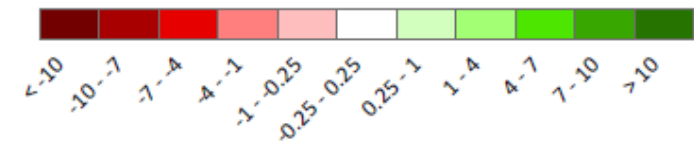
Difference in Nightlight Intensity



2020 - 2014 Difference, VIIRS vcm5lcf



Difference in Nightlight Intensity



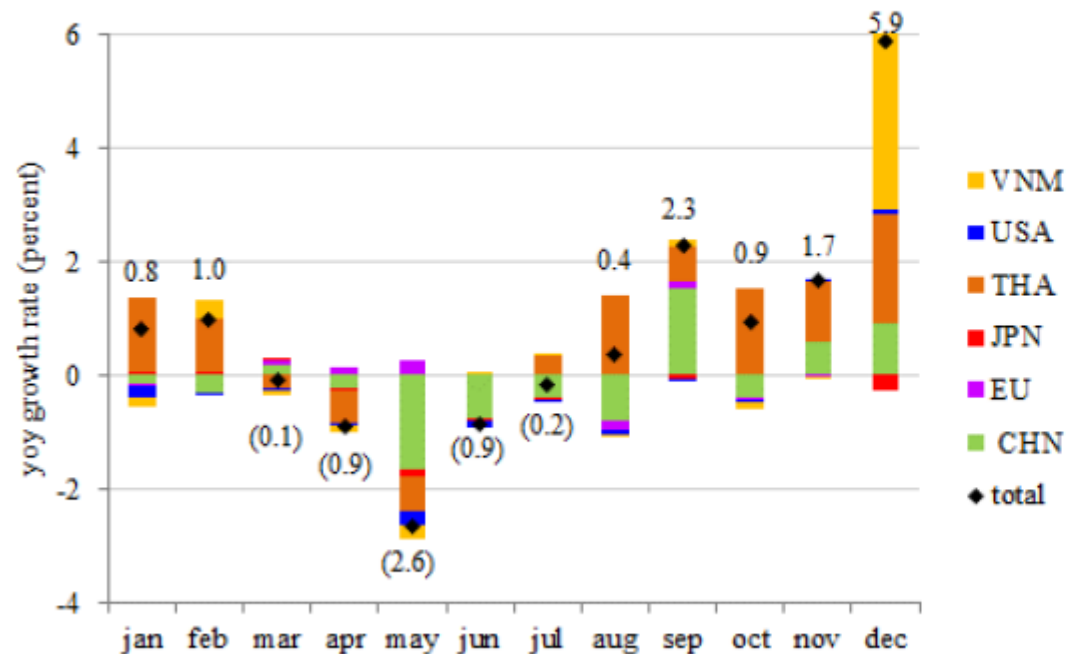
Source : fDi Markets. 2003 and 2013 data from the DMSP-OLS F15 Stable Lights Cloud Free; 2014 and 2020: VIIRS vcm annualized.

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

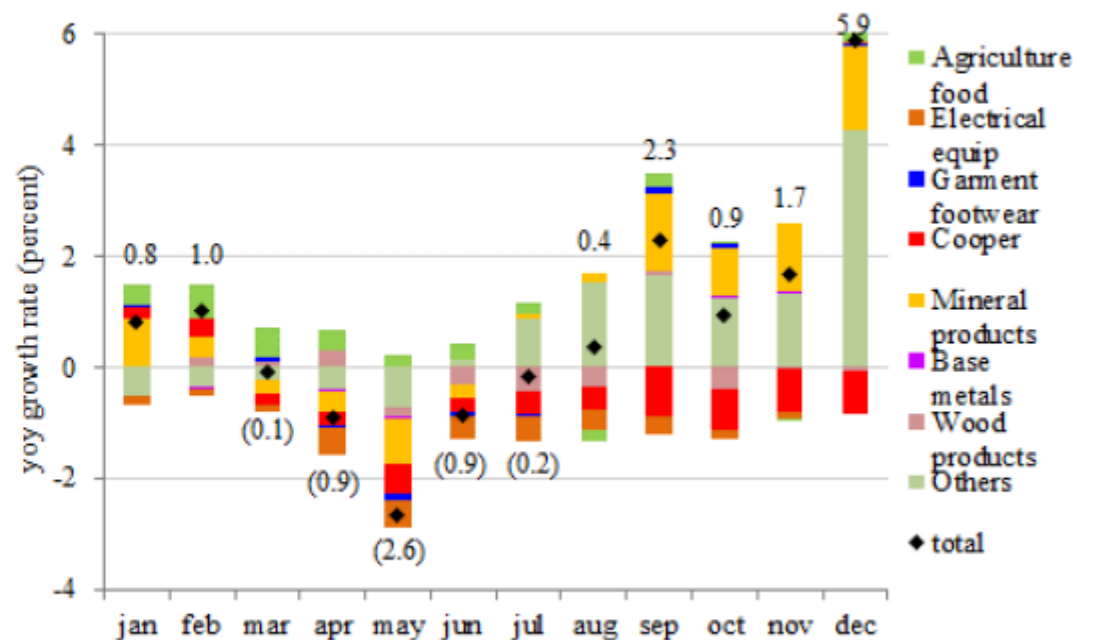
Can contribute to poverty reduction, especially given resilience to COVID-19 shock

Tracking the impact of COVID-19 on Lao PDR monthly trade

(a) Lao exports to selected countries



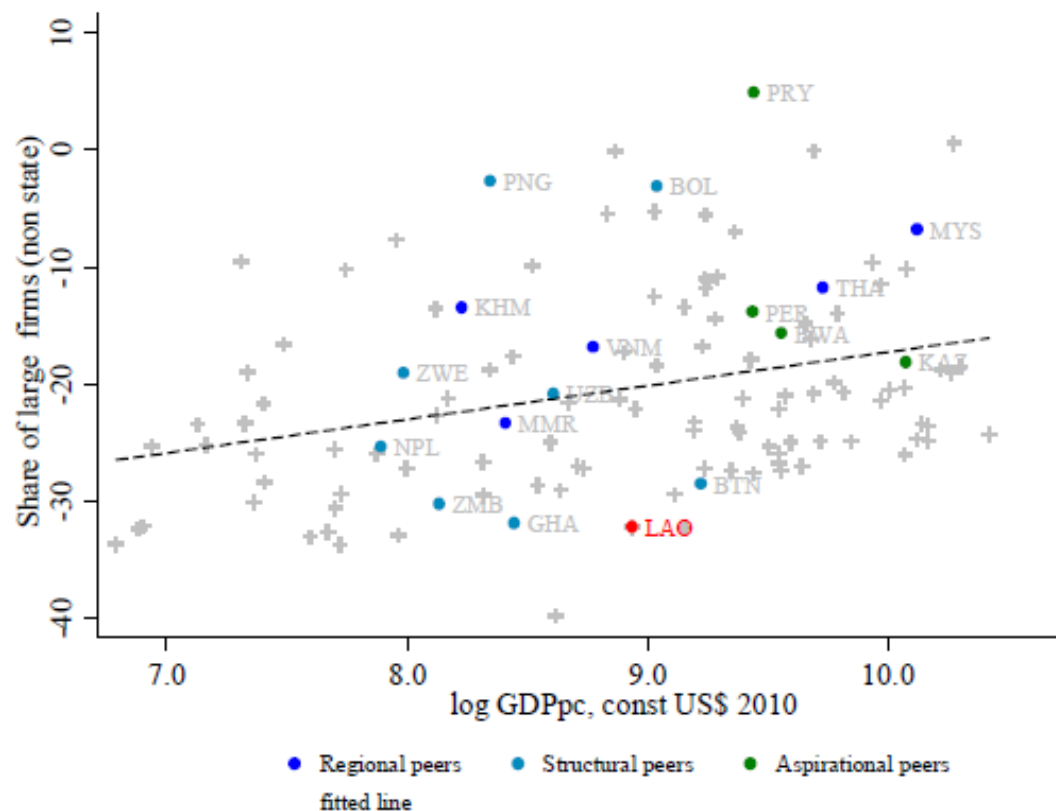
(b) Lao exports by product categories



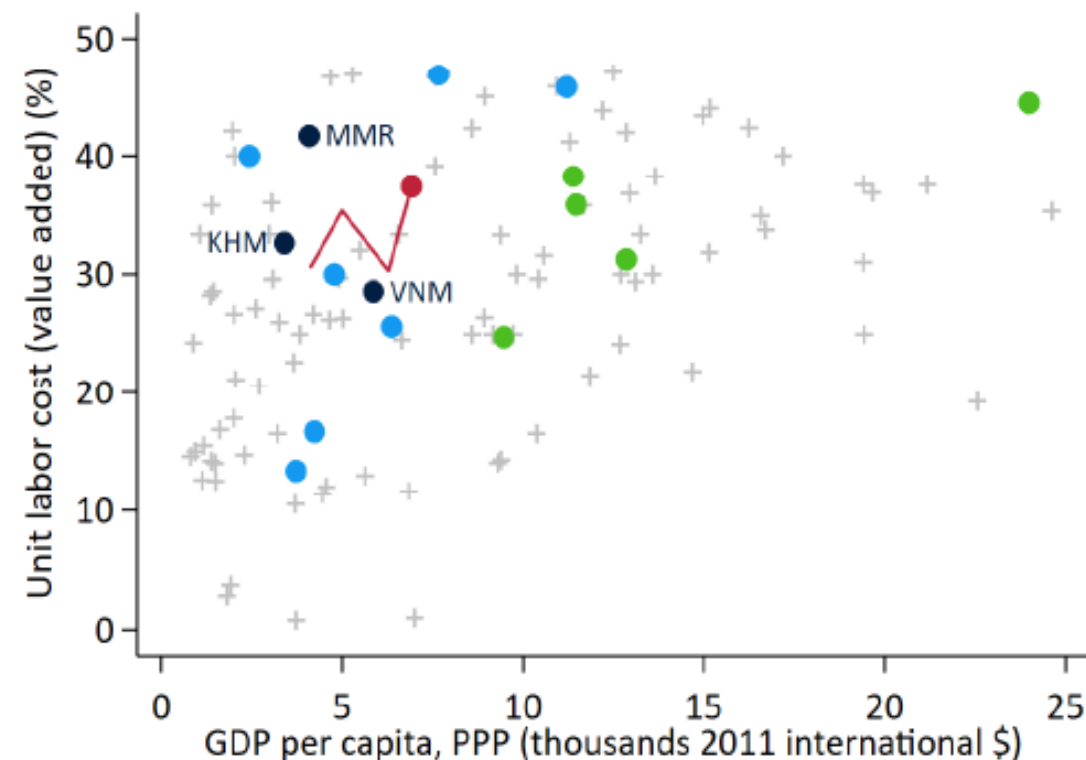
Source : Monthly Customs data China, Thailand, USA, EU, Japan

Scope to improve manufacturing competitiveness

Share of large firms, 2018

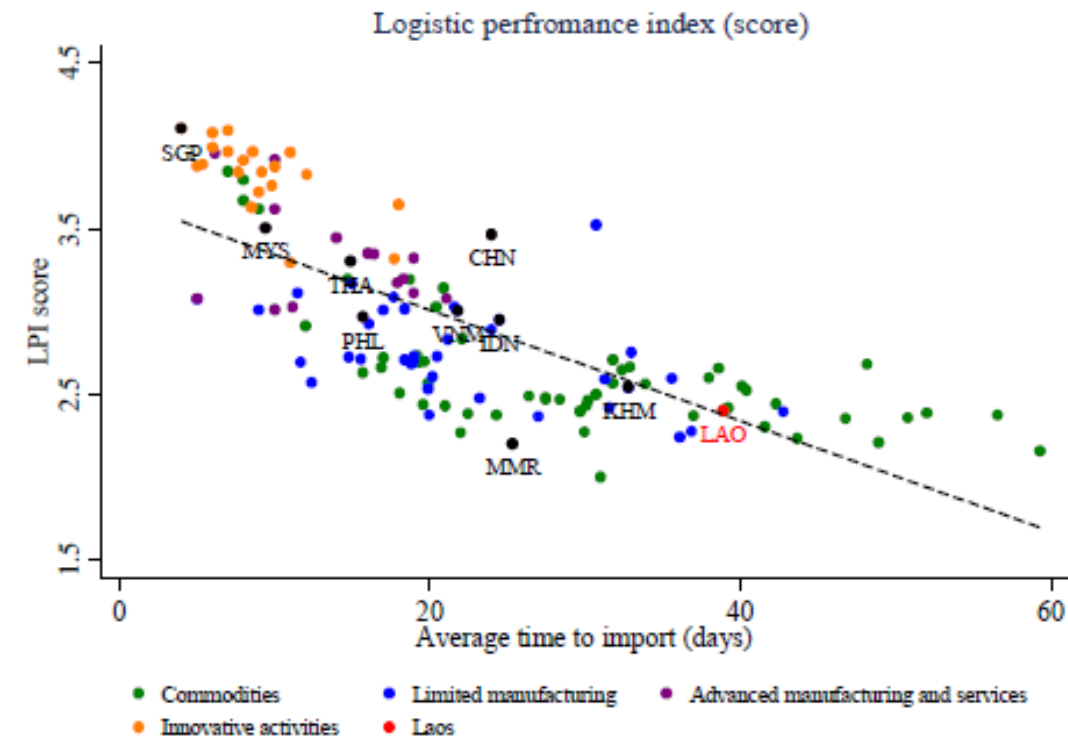


*...and rising unit labor costs,
eroding the competitiveness of manufacturing firms.*

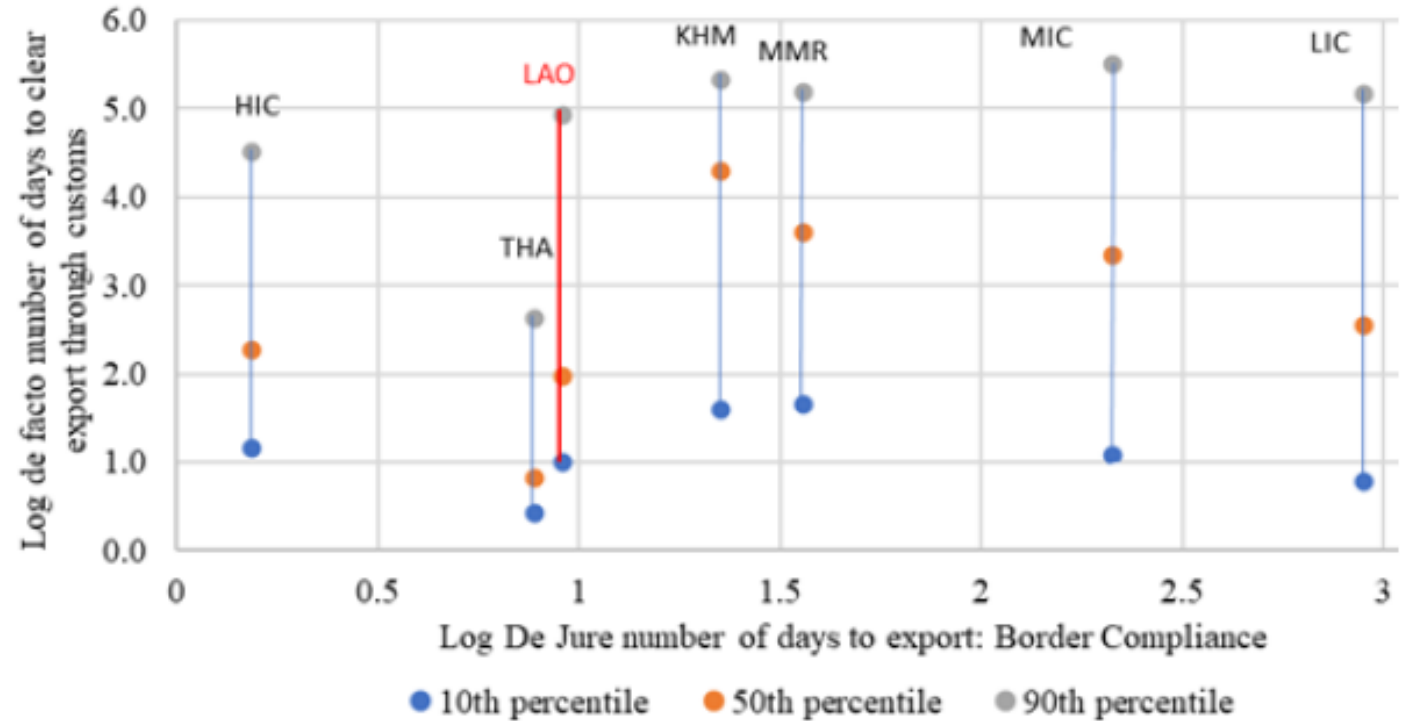


Global value chains thrive on predictable business environment

Logistics and connectivity matter for manufacturing GVC integration



And consistent policy implementation



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



- Expected completion 2021
 - 414-kilometer railway (10 stations) from Vientiane Capital to Kunming, China
 - Connect to Thai-Sino Railway Vientiane to Bangkok by 2025
- < 4 hours from Vientiane to China compared to 15h drive
 - 30-40 percent reduction in transport costs for transit cargo
 - Up to 1.5 million tons of trade between China and ASEAN and 2.0 million tons of trade between China and Lao PDR could be shifted from maritime routes to the railway
 - Opportunities for further tourism development



THE WAY FORWARD:
PRIORITY AND IMPLEMENTATION

Policy leads for more inclusive and sustainable growth

1. Engineering a return to macro-fiscal stability

=> Negotiate credible and transparent debt restructuring with large creditors to reduce the debt service burden over the medium term.

2. Leveraging on Natural Capital while ensuring Social and Environmental Sustainability

=> Renegotiate Power Purchase Agreements to reduce tariffs paid to IPPs and recalibrate take-or-pay clauses, and adjust domestic electricity tariffs to reflect costs

3. Making Domestic Markets Work for Job Creation

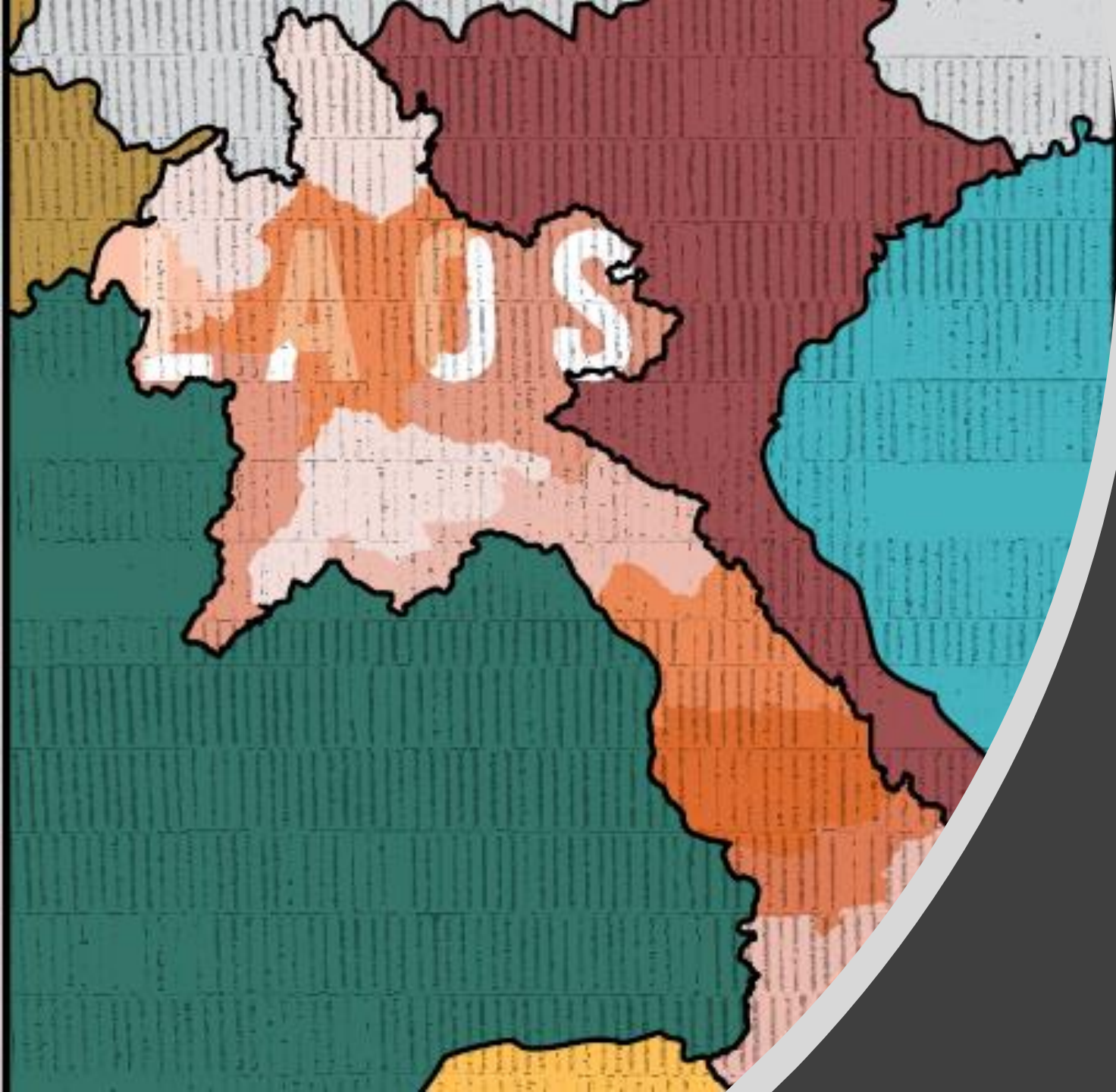
=> Implement one-stop business registration service to cut burdensome process and encourage formalization

4. Leveraging Strategic Location to Diversify into Export-Oriented Manufacturing, Agri-Food and Services

=> Advance trade policy reforms, with a focus on NTMs to support quality upgrades in business

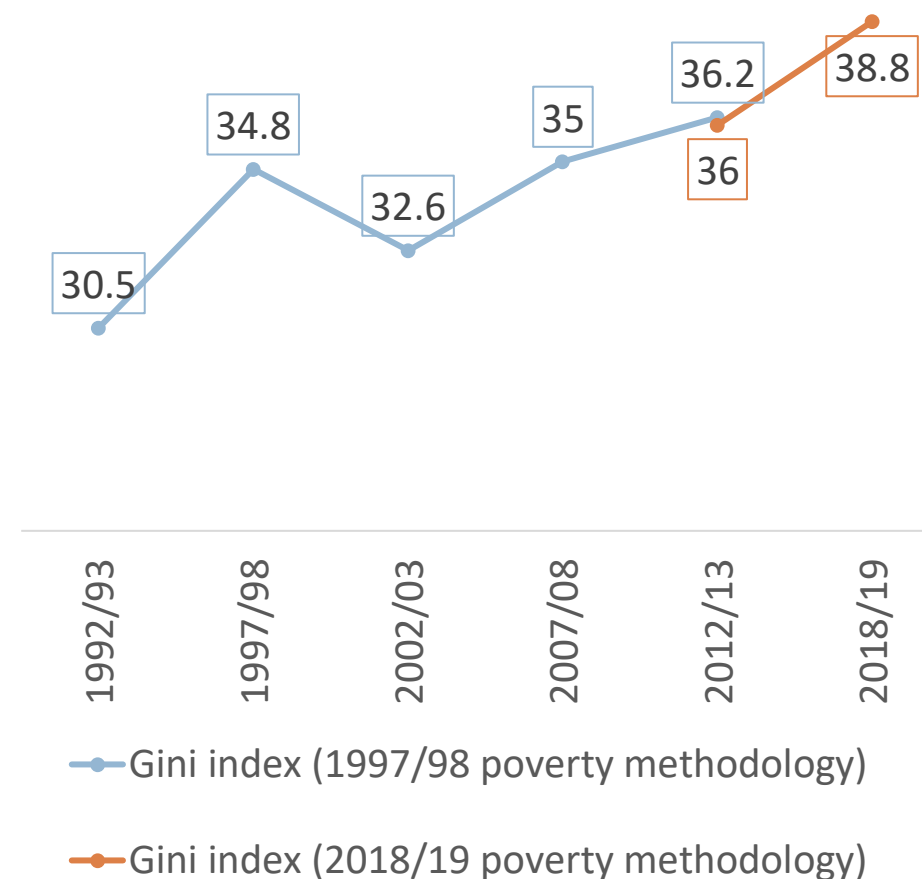
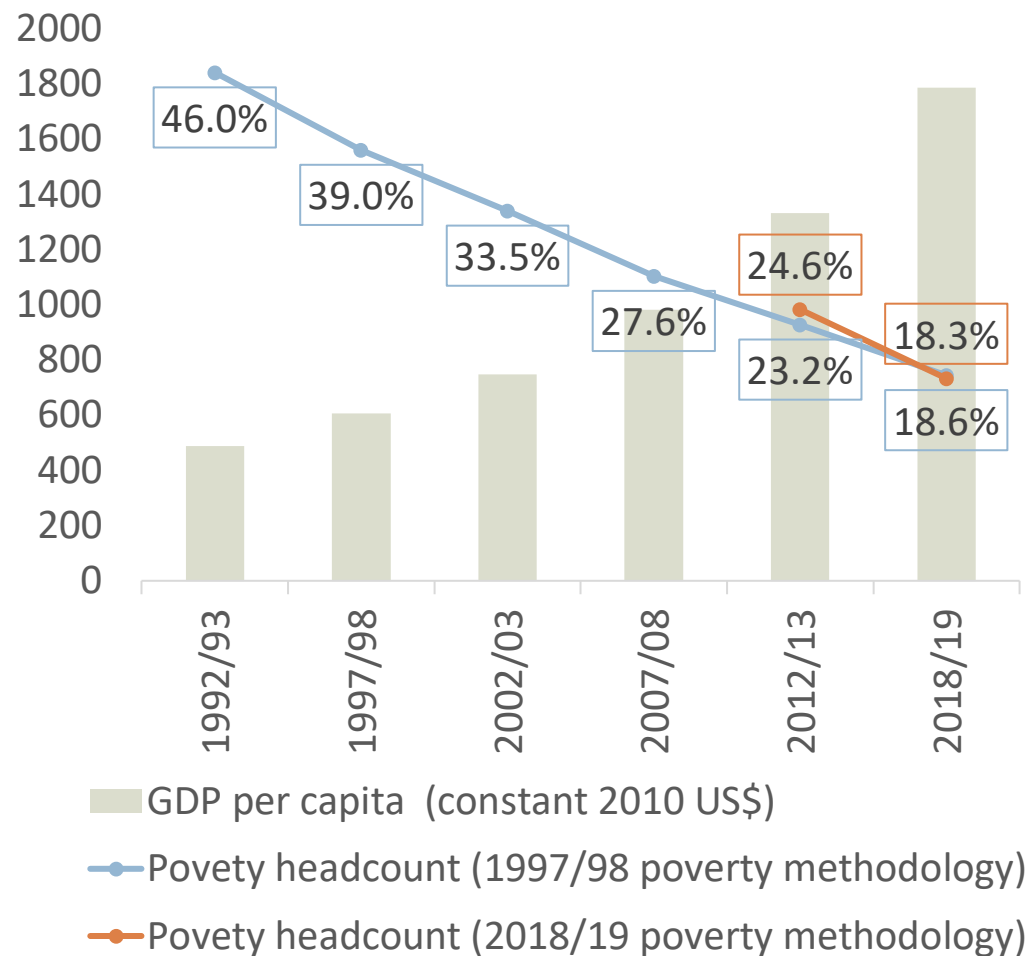
5. Building Skills and Capacity for Effective reforms

=> Improve data and knowledge to support effective policy making

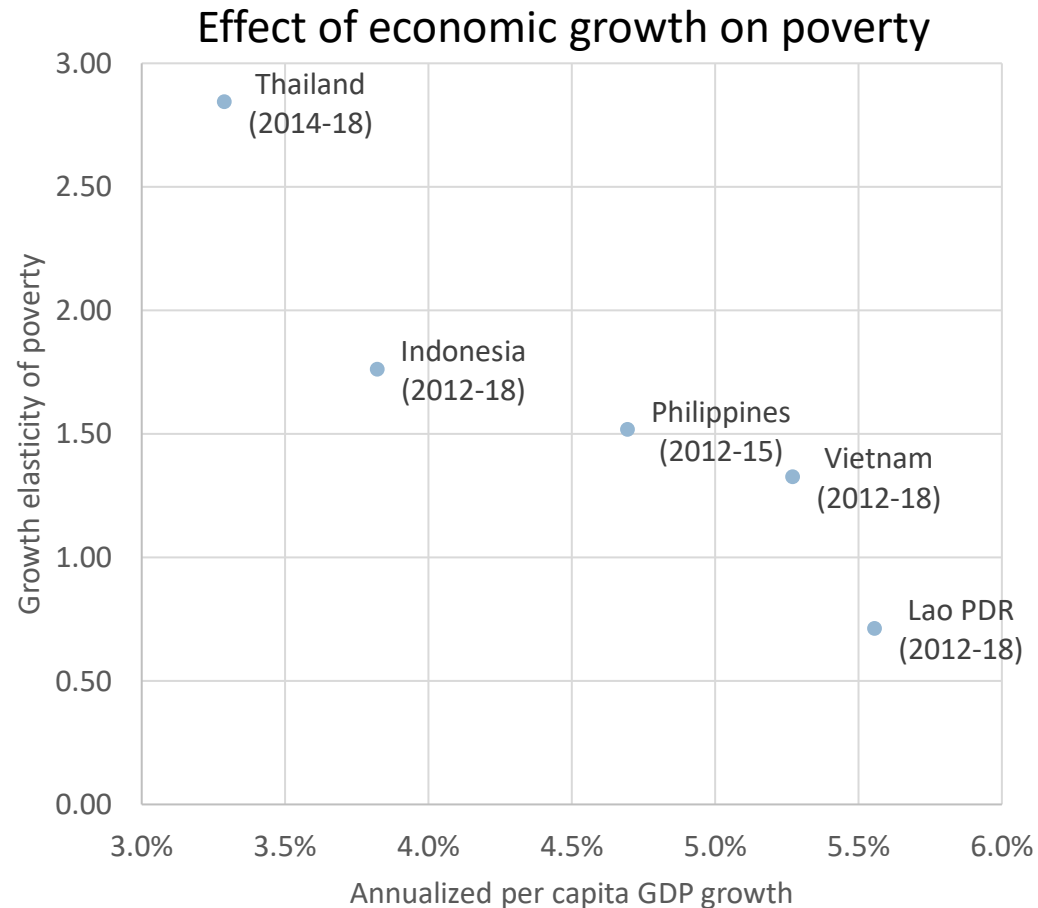


Changing Faces and Geography of Poverty

Poverty reduction continues but inequality is rising



Rapid GDP growth has not translated into an equally high rate of poverty reduction

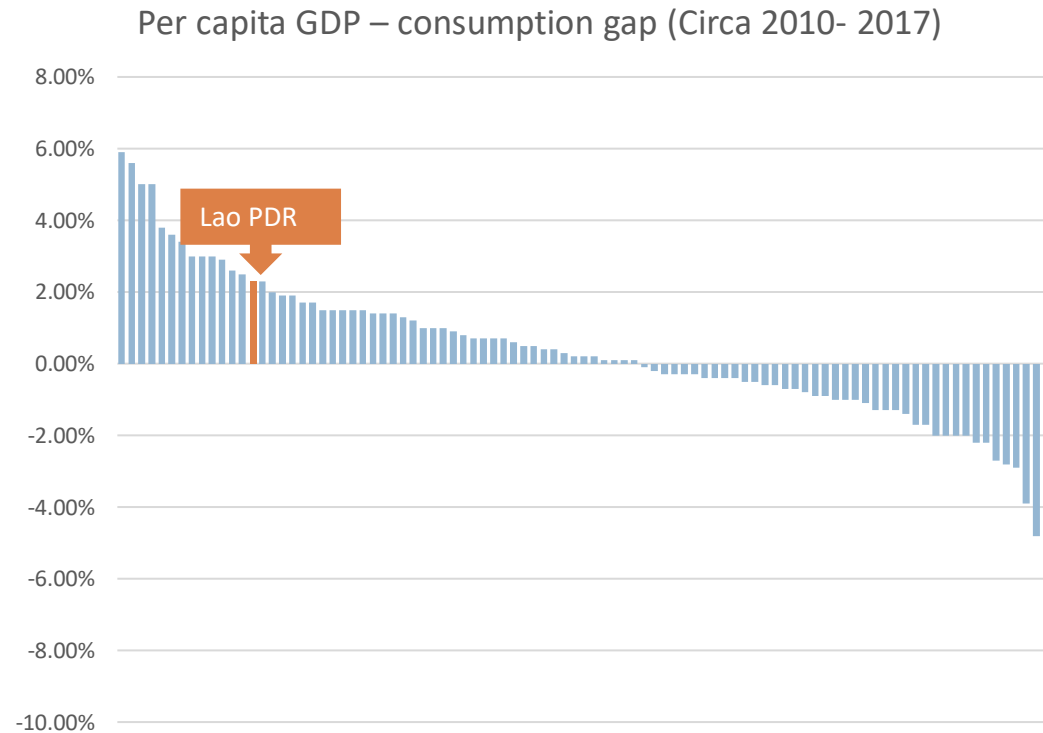


If the impact of economic growth on poverty reduction had been like that in Indonesia, Lao PDR would have almost eliminated extreme poverty (\$1.9 per day in 2011 PPP terms)

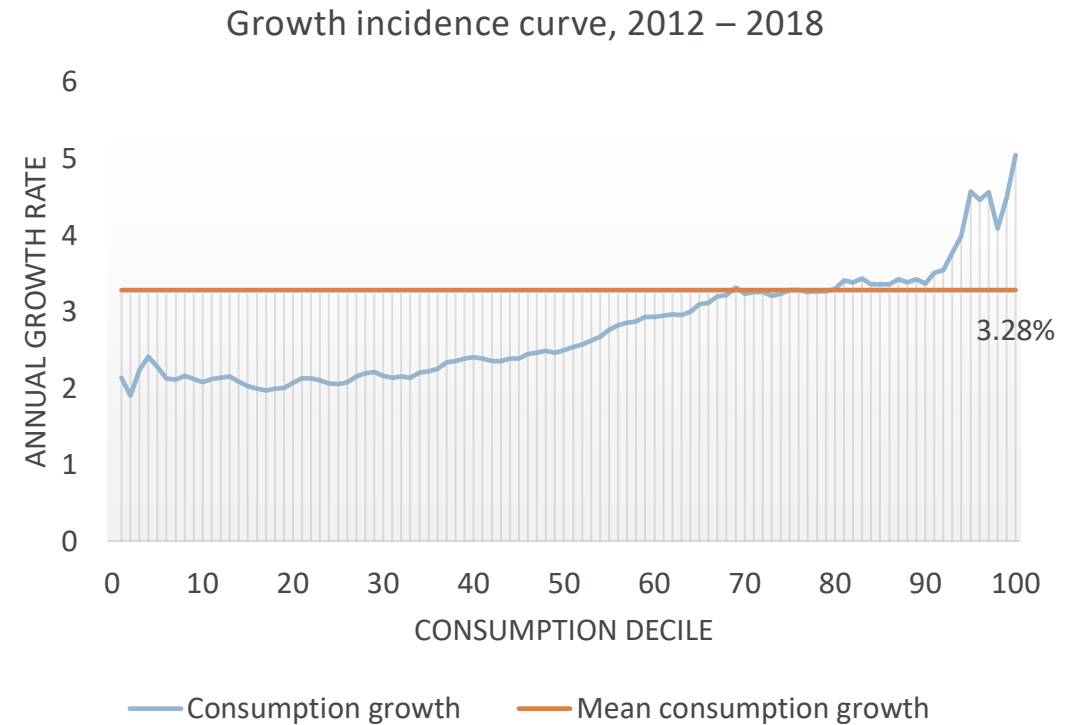
**Poverty rates are based on USD3.2 a day in 2011 PPP.*

Due to two reasons:

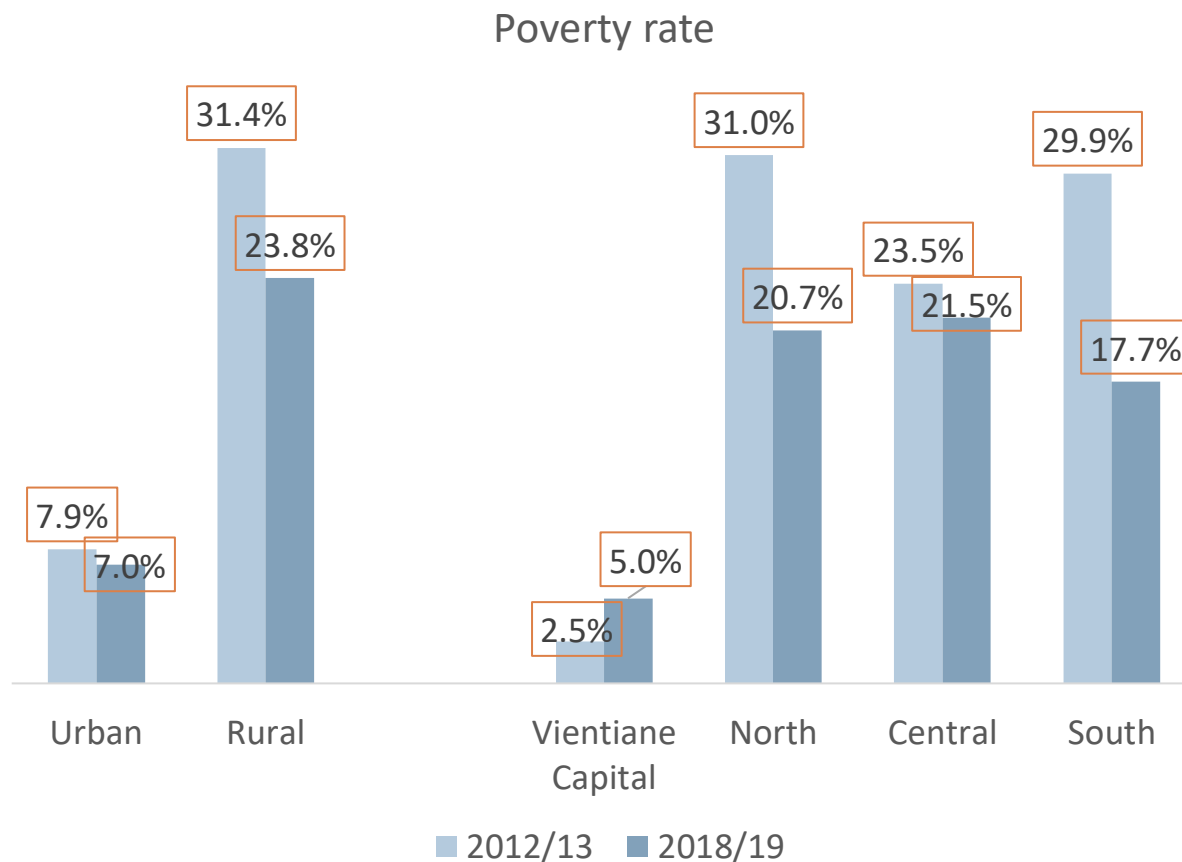
1. Large gap between GDP growth and household consumption growth



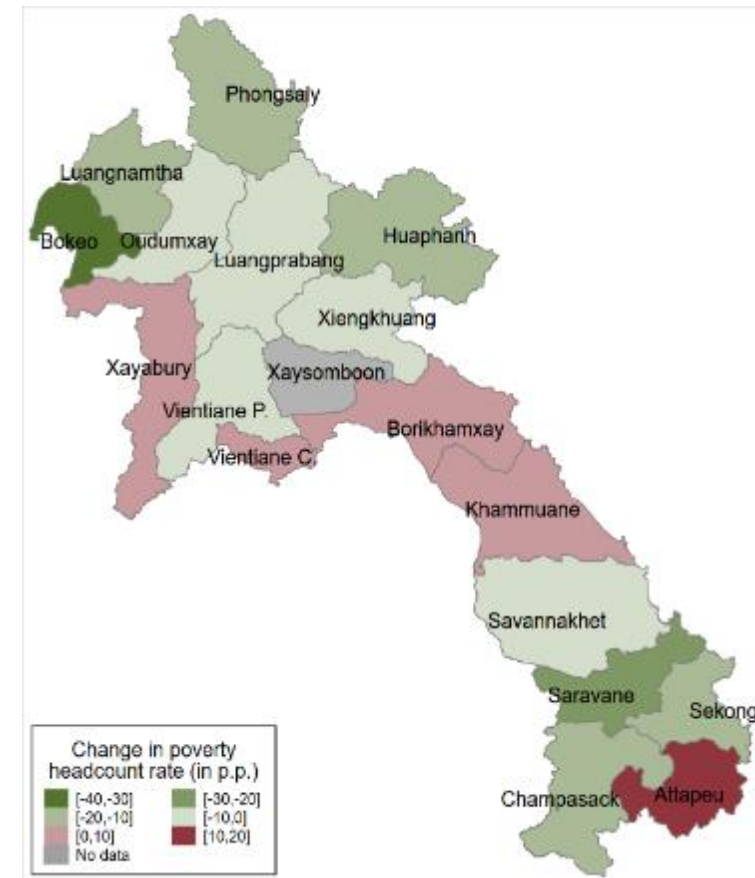
2. Consumption growth was not pro-poor



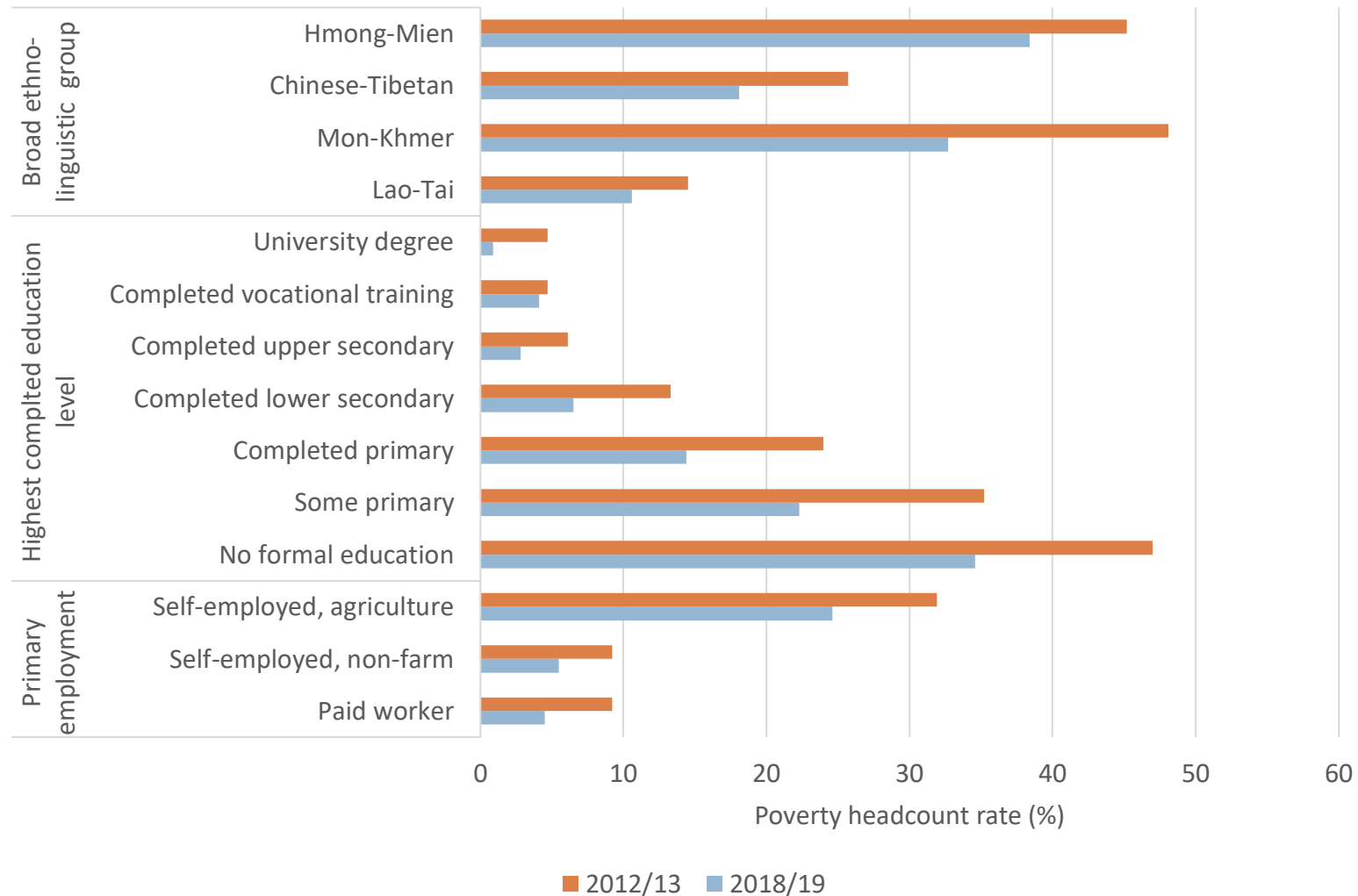
Geography of poverty is changing, shifting from north to central



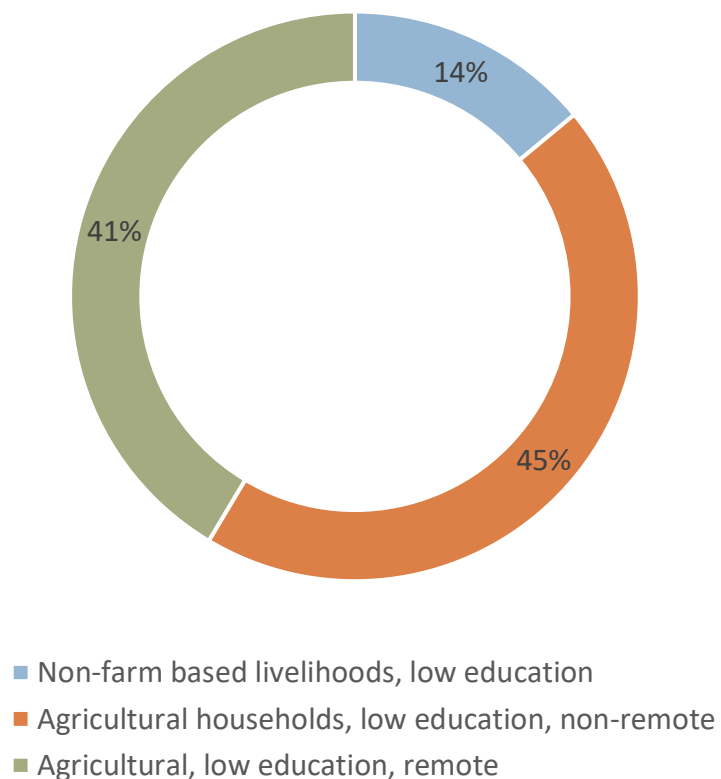
Changes in poverty rate (2012 – 2018)



Poverty remains higher among non Lao-Tai ethno-linguistic groups, but Chinese-Tibetan groups are catching up. Hmong-Mien groups, however, are lagging




The poor in Laos can be classified into three groups



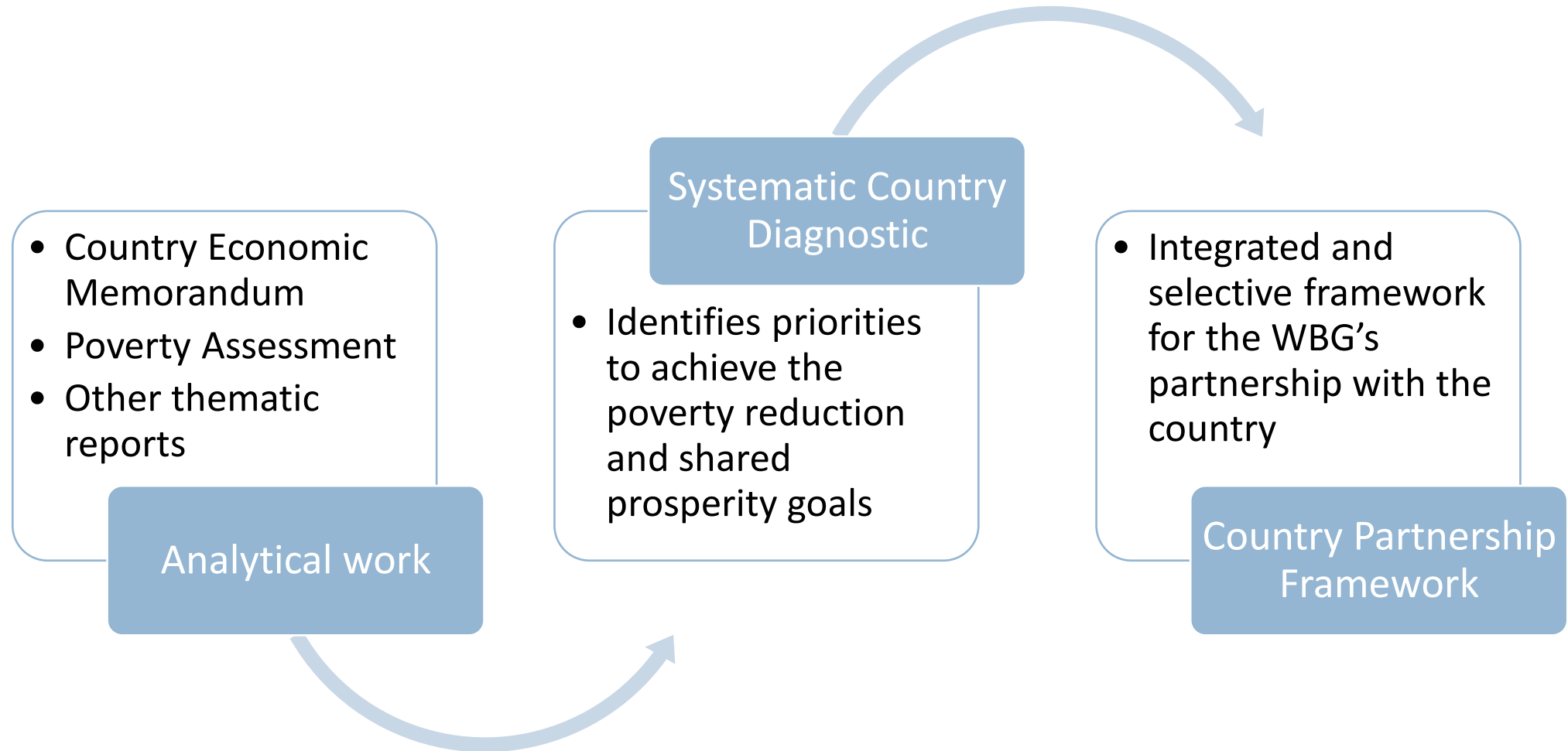
	AGRICULTURAL, REMOTE, LOW EDUCATION	AGRICULTURAL, LESS-REMOTE, LOW EDUCATION	NONAGRICULTURAL, MORE URBAN, LOW- MODERATE EDUCATION
Education	Very low	Low	Average, but low
Agriculture land	Average	Above average	Above average
Physical Assets	Low	Above average	Above average
Livelihood	No off-farm opportunity, exclusively farm No remittances	No off-farm opportunity, exclusively farm No remittances	Nonfarm, with limited farm activities
Location	Rural, remote, mostly highland and midlands	Rural, nonremote, mostly lowland and midlands	Rural and urban
Ethnicity	Ethnic minorities	Lao-Tai dominant, but considerable share of minorities also	Lao-Tai dominant
Key constraint	Inadequate assets, social safety net, and low agricultural income	Low agricultural income and lack of off-farm opportunities	Low productivity in nonfarm sector
Pathway out of poverty	Social inclusion and economic integration	Increased agriculture productivity	Access to better nonfarm jobs

COVID-19 is expected to increase the share of this group



Systematic Country Diagnostic

What is a Systematic Country Diagnostic (SCD)?



SCD Findings

Key **risks** identified in the 2017 SCD have materialized:

- Increasing macroeconomic instability, aggravated by pandemic.
- Jobless growth with rising inequality.
- Vulnerability to climate change, environmental degradation, and shocks (e.g. health-related).

Recommendations:

- **Stabilize** the economy (macro-financial risks).
- **Share** growth benefits equitably (through better jobs).
- **Sustain** progress by protecting environment and mitigating shocks.

Stabilize

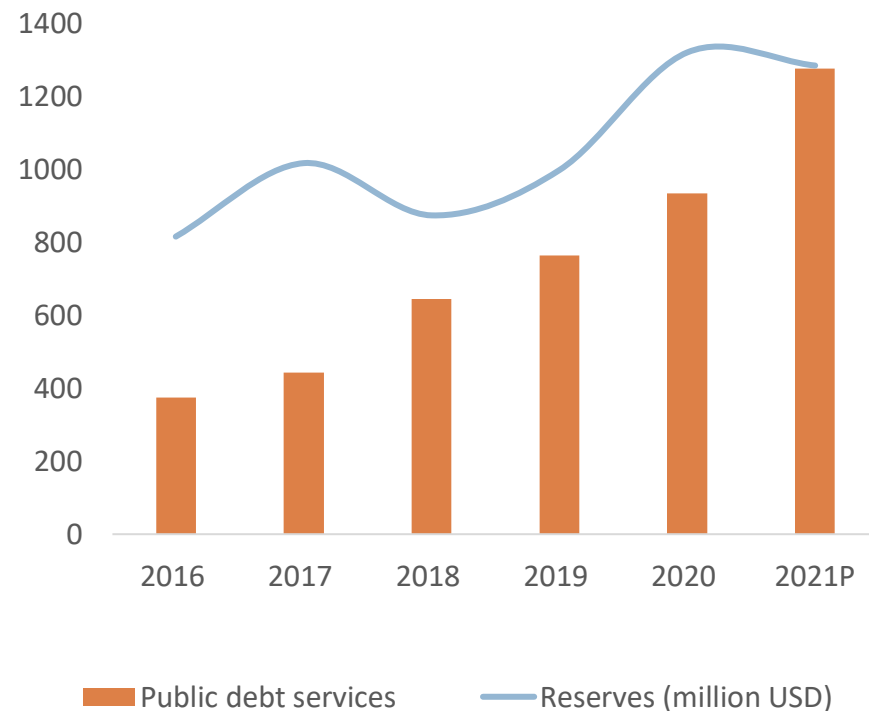
Share

Sustain

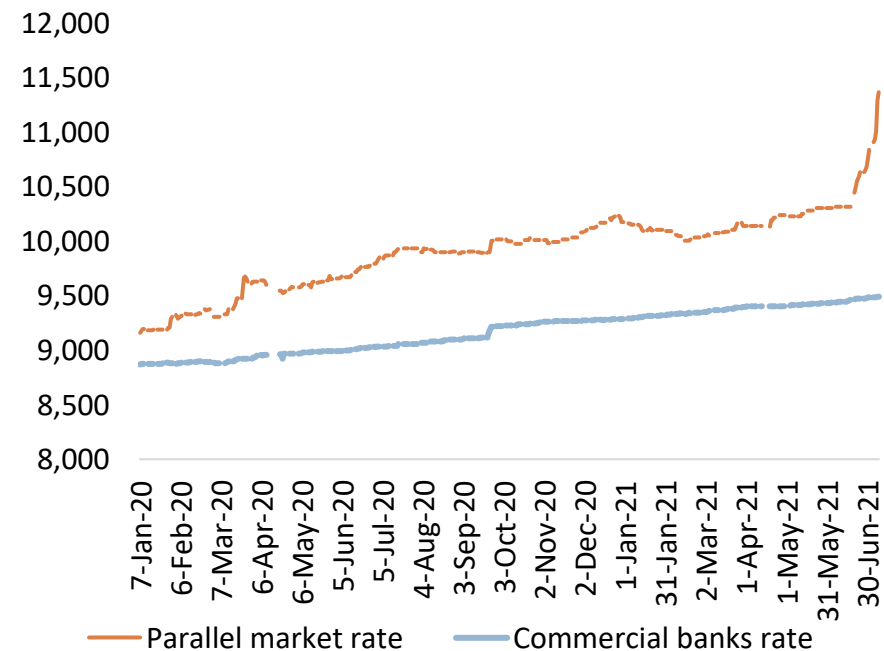
Stabilize

Securing macroeconomic stability will require measures to tackle rising public debt, eroding fiscal space, declining reserve buffers, and growing financial sector risks.

Public debt service and foreign reserves (USD million)

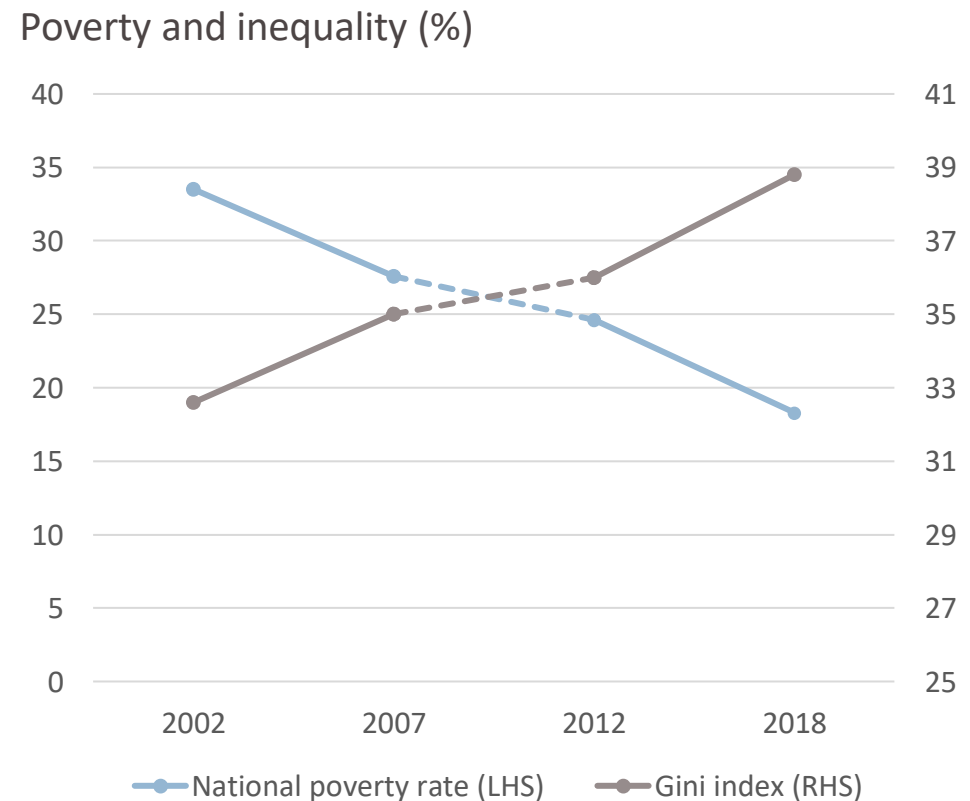
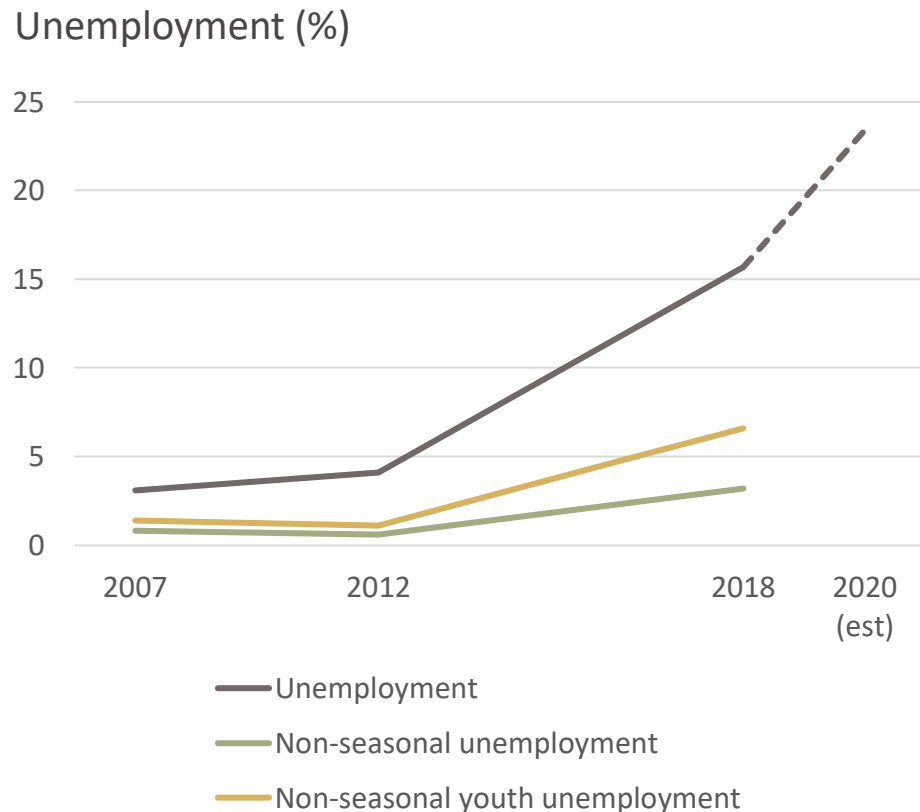


Exchange rate (kip/USD)



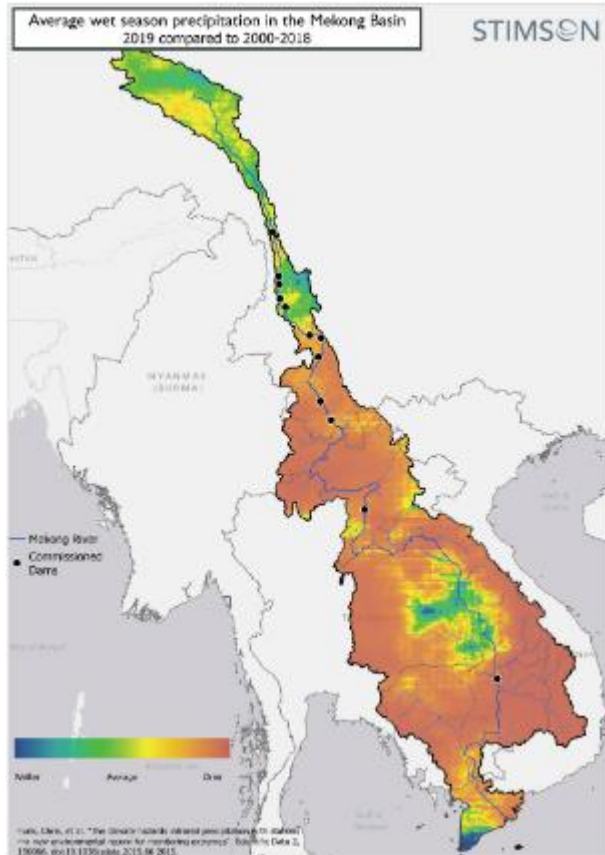
Share

Fostering inclusive growth will require a stronger effort to improve the business climate, develop connective infrastructure, and enhance human capital (education and health).

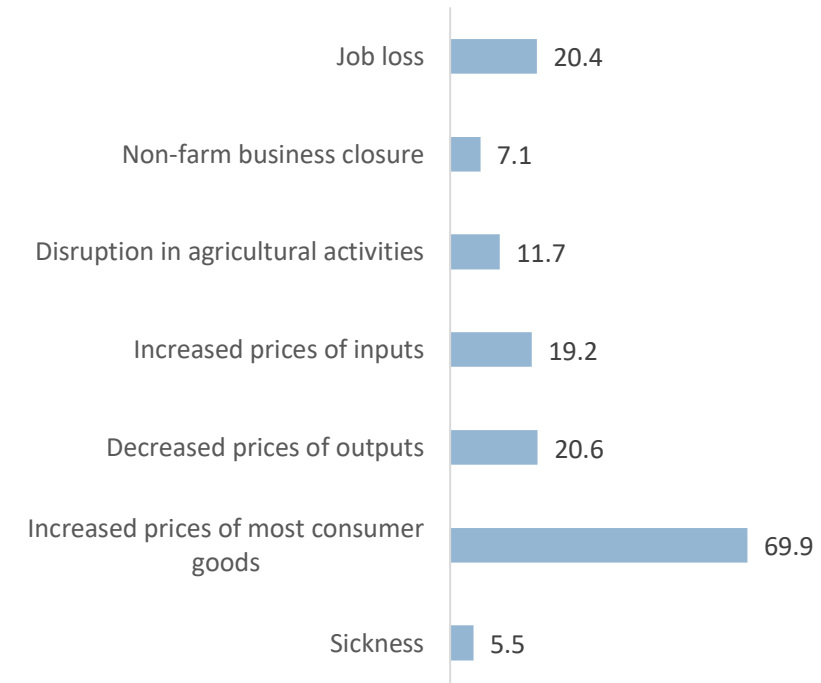


Sustain

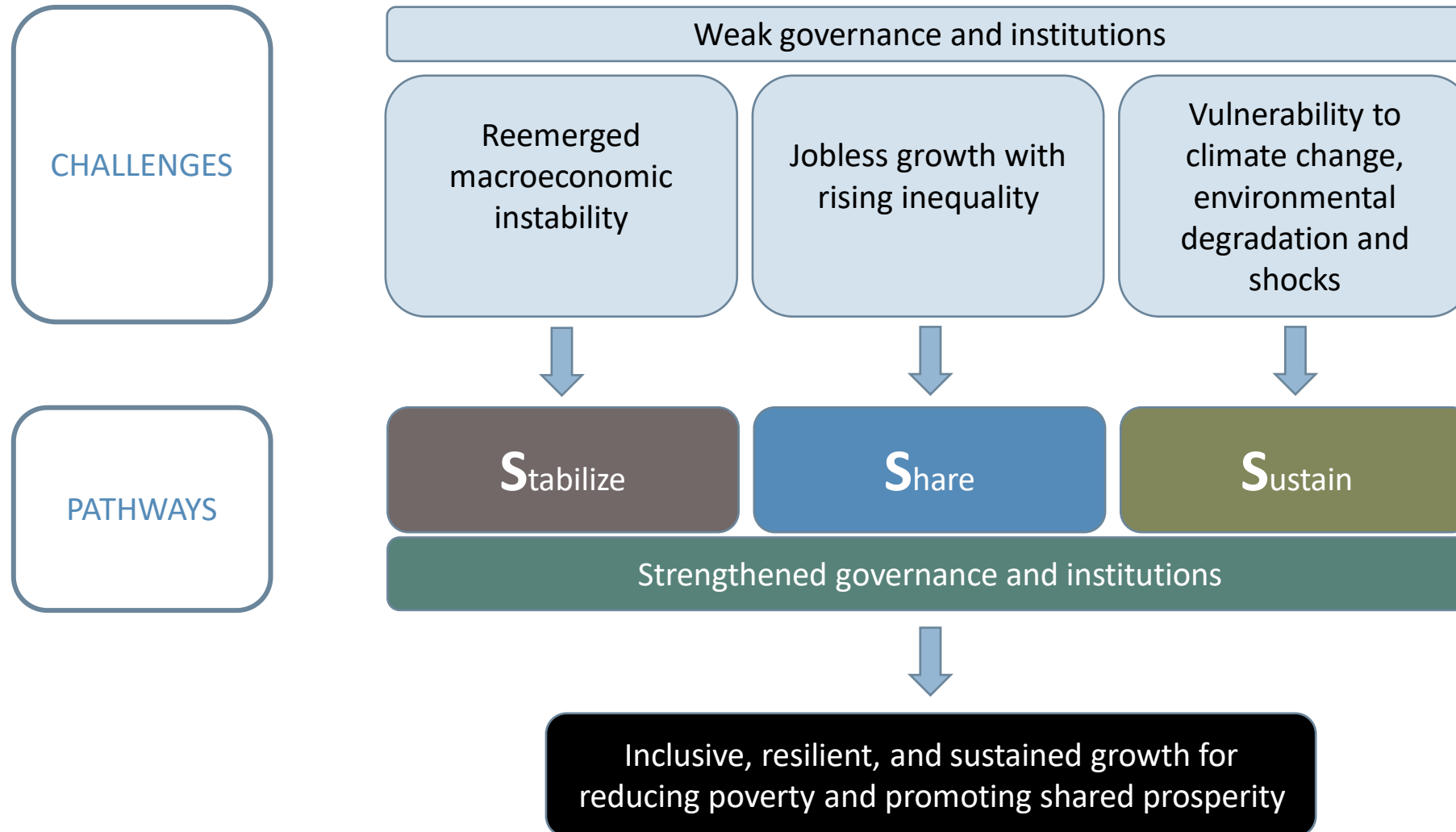
Resource depletion, climate change, and vulnerability to shocks requires an improved management of natural resources, climate action, and measures to safeguard livelihoods.



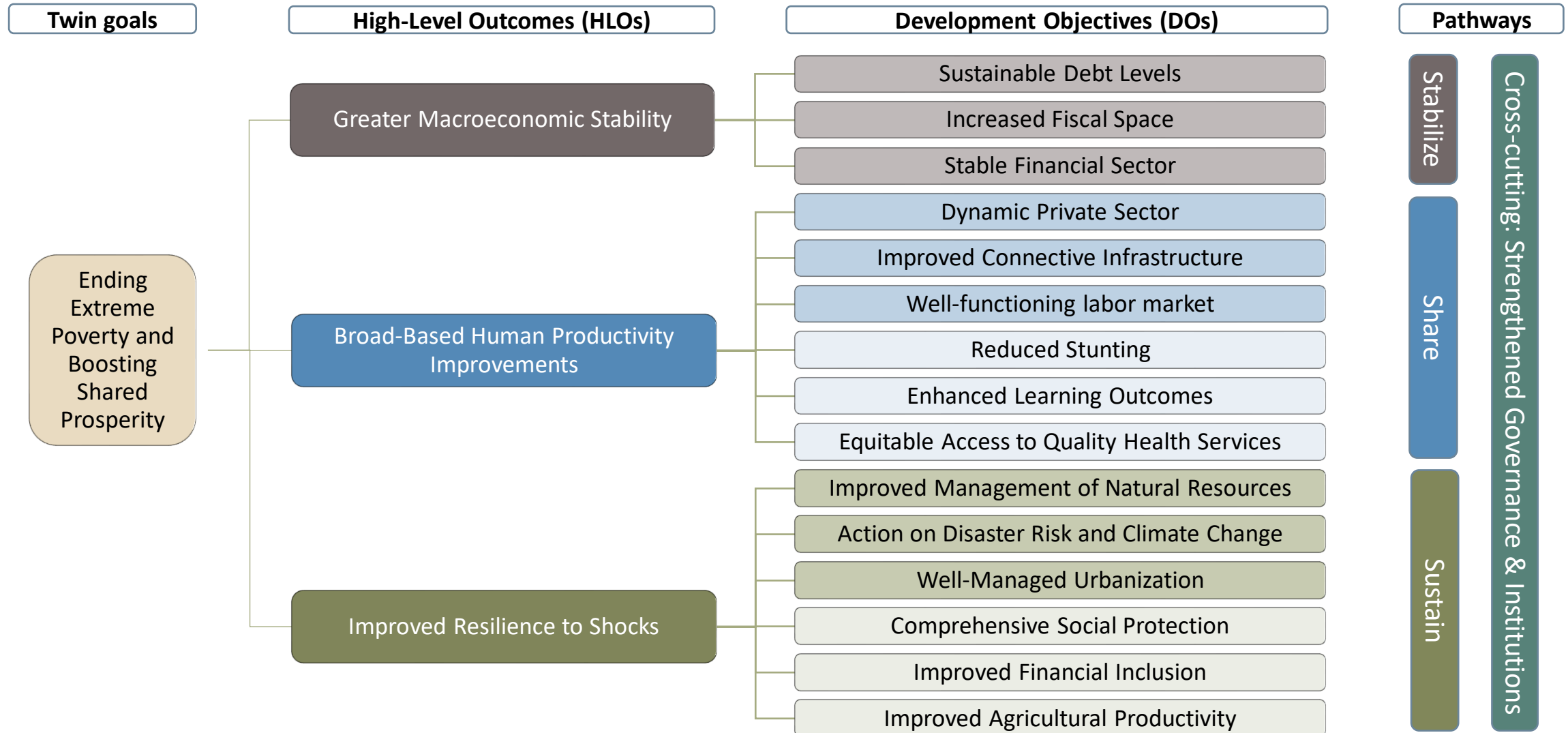
Households experiencing shocks (% , Mar-Jul 2020)



SCD Framework



High-Level Outcomes and Development Objectives



Prioritization of Development Objectives

Top priorities
 High priorities
 Medium priorities

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		

Re-prioritization

SCD Update	SCD 2017	Change
Sustainable debt levels	Putting public debt on a sustainable path and strengthening financial sector stability	-
Stable financial sector		Revised down
Increased fiscal space		New
Dynamic private sector	Making it easier to do business and create good jobs	Revised up
Improved connective infrastructure	Investing in infrastructure for growth and inclusion	-
Well-functioning labor market		New
Reduced stunting	Investing in improving nutrition to achieve children's full potential	Revised down
Enhanced learning outcomes	Improving quality of education and keeping girls in school	-
Equitable access to quality health services	Improving access to and quality of health services for more productive people	-
Improved management of natural resources	Promoting strategic use of natural resources and responsible management of the environment	-
Action on disaster risk and climate change	Putting in place a strengthened DRM	Expanded
Well-managed urbanization		New
Comprehensive social protection	Introducing a basic social protection system to lower vulnerability	Revised up
Improved financial inclusion	Improving inclusiveness of the financial sector to improve access to credit and lower risks	-
Increased agricultural productivity	Increasing agricultural productivity to support incomes	-
Strengthened governance and institutions	Enhancing governance and creating a rules-based environment	Cross-cutting