Consultation: Country Partnership Framework
World Bank Group (WBG) Country Engagement Process

Consultations on SCD and CEM held September 22-24, 2021
Leveraging Strategic Location and Natural Wealth for Inclusive and Sustained Growth
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
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

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

Source: World Development Indicators.

Source: MEM data.
Without leading to significant increase in public revenues

Resource and non-resource revenues (percent of GDP)

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

Source: MoF
Note: The data for 2020 is preliminary

While fiscal and external vulnerabilities increased

EDL contributed significantly to the PPG debt (percent)

- EDL direct borrowing (publicly guaranteed)
- Public debt-onlent to EDL
- Public debt-non EDL

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

Months import cover of foreign exchange reserves (Months)

Total reserves in months of imports

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

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.
Export-oriented manufacturing FDI linked to local economic development

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

GDP per capita (constant 2010 US$)

- Poverty headcount (1997/98 poverty methodology)
- Poverty headcount (2018/19 poverty methodology)

Gini index (1997/98 poverty methodology)

Gini index (2018/19 poverty methodology)
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

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Urban</td>
<td>7.9%</td>
<td>7.0%</td>
<td>0.9%</td>
</tr>
<tr>
<td>Rural</td>
<td>31.4%</td>
<td>23.8%</td>
<td>-7.6%</td>
</tr>
<tr>
<td>Vientiane Capital</td>
<td>2.5%</td>
<td>5.0%</td>
<td>2.5%</td>
</tr>
<tr>
<td>North</td>
<td>31.0%</td>
<td>20.7%</td>
<td>-10.3%</td>
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<tr>
<td>Central</td>
<td>23.5%</td>
<td>21.5%</td>
<td>-2.0%</td>
</tr>
<tr>
<td>South</td>
<td>29.9%</td>
<td>17.7%</td>
<td>-12.2%</td>
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</tbody>
</table>

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:

1. 14% Non-farm based livelihoods, low education
2. 45% Agricultural households, low education, non-remote
3. 41% Agricultural, low education, remote

COVID-19 is expected to increase the share of this group.
Systematic Country Diagnostic
What is a Systematic Country Diagnostic (SCD)?

- **Country Economic Memorandum**
- **Poverty Assessment**
- **Other thematic reports**

**Analytical work**

**Systematic Country Diagnostic**
- Identifies priorities to achieve the poverty reduction and shared prosperity goals

**Country Partnership Framework**
- Integrated and selective framework for the WBG’s partnership with the country
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.
Securing macroeconomic stability will require measures to tackle rising public debt, eroding fiscal space, declining reserve buffers, and growing financial sector risks.
Fostering inclusive growth will require a stronger effort to improve the business climate, develop connective infrastructure, and enhance human capital (education and health).
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)

- Job loss: 20.4%
- Non-farm business closure: 7.1%
- Disruption in agricultural activities: 11.7%
- Increased prices of inputs: 19.2%
- Decreased prices of outputs: 20.6%
- Increased prices of most consumer goods: 69.9%
- Sickness: 5.5%
SCD Framework

**CHALLENGES**
- Reemerged macroeconomic instability
- Jobless growth with rising inequality
- Vulnerability to climate change, environmental degradation and shocks

**PATHWAYS**
- Stabilize
- Share
- Sustain

**Strengthened governance and institutions**

Inclusive, resilient, and sustained growth for reducing poverty and promoting shared prosperity
High-Level Outcomes and Development Objectives

Twin goals: Ending Extreme Poverty and Boosting Shared Prosperity

High-Level Outcomes (HLOs):
- Greater Macroeconomic Stability
- Broad-Based Human Productivity Improvements
- Improved Resilience to Shocks

Development Objectives (DOs):
- Sustainable Debt Levels
- Increased Fiscal Space
- Stable Financial Sector
- Dynamic Private Sector
- Improved Connective Infrastructure
- Well-functioning labor market
- Reduced Stunting
- Enhanced Learning Outcomes
- Equitable Access to Quality Health Services
- Improved Management of Natural Resources
- Action on Disaster Risk and Climate Change
- Well-Managed Urbanization
- Comprehensive Social Protection
- Improved Financial Inclusion
- Improved Agricultural Productivity

Pathways:
- Cross-cutting: Strengthened Governance & Institutions
- Stabilize
- Share
- Sustain
<table>
<thead>
<tr>
<th>Top priorities</th>
<th>High priorities</th>
<th>Medium priorities</th>
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<td>Stable financial sector</td>
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## Re-prioritization

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