



Lao PDR Economic Monitor

Restoring Macroeconomic Stability to Support Recovery

Thematic section:
Unlocking the Potential of Regional Connectivity

April 2022
Macroeconomics, Trade and Investment Global Practice
East Asia and Pacific Region

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The Lao PDR Economic Monitor provides updates on macroeconomic developments and sectoral issues in the country. It is produced biannually and distributed widely to government agencies, development partners, the private sector, think tanks, civil society organizations, and academia.

The findings and interpretations expressed here are those of the authors and do not necessarily reflect the views of the World Bank Group, its Executive Directors, or the countries they represent.

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Abbreviations

ASYCUDA	Automated System for Customs Data
BRI	Belt and Road Initiative
CAR	Capital adequacy ratio
EAP	East Asia and Pacific
ESIA	Environmental and social impact assessment
FDI	Foreign direct investment
LNSW	Lao PDR National Single Window
NBT	Nature-based tourism
NPL	Non-performing loans
NSEDP	National Socio-Economic Development Plan
PPG	Public and publicly guaranteed
REER	Real effective exchange rate
SEZ	Special Economic Zones
SME	Small and medium enterprises

All dollar (\$) amounts are US dollars unless otherwise indicated.

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Executive Summary

The COVID-19 pandemic and associated containment measures have heightened macroeconomic vulnerabilities and slowed the economic recovery. The macroeconomic situation was deteriorating even before the COVID-19 pandemic, owing to several structural challenges. After the sharp economic slowdown in 2020, GDP growth rebounded to an estimated 2.5 percent in 2021. Industry and agriculture, supported by robust external demand, were the main growth drivers. However, services (especially the tourism sector) were severely affected by prolonged COVID-19 containment measures and continued to struggle. Headline inflation continued to rise, owing to higher international fuel prices and a sharp depreciation of the kip. Inflation increased from less than 2 percent in February 2021 (year-on-year) to 9.9 percent in April 2022. Rising inflation threatens living standards, especially in low-income urban households.

Preliminary estimates indicate that the fiscal deficit declined significantly in 2021, driven by higher domestic revenue and strong curbs on spending. Supported by the economic recovery, domestic revenue rebounded from 11.2 to 12.4 percent of GDP in 2021, but remains below the pre-pandemic levels and the regional average. Expenditure curbs continued, largely through the suspension of new public investment projects and further reductions in recurrent spending. However, high debt service obligations and low revenue levels are constraining fiscal space for investments in human capital, which are critical to support long-term growth.

Public debt levels have increased considerably since 2019, which jeopardizes macroeconomic stability. Preliminary estimates indicate that total public and publicly-guaranteed (PPG) debt increased from 68 percent of GDP (\$12.5 billion) in 2019 to 88 percent in 2021 of GDP (or \$14.5 billion), much higher than regional peers. The PPG stock would rise to about 90 percent of GDP in 2021 if the currency swap arrangement is classified as public debt. Total PPG debt mainly comprises external debt, with the energy sector, mostly represented by Électricité du Laos (EDL), accounting for over 30 percent of total PPG debt in 2021. Financial vulnerabilities in the energy sector pose significant fiscal risks (as contingent liabilities) to public debt sustainability. The majority of the external public debt stock is from bilateral creditors, particularly China, and is on concessional terms. However, the share of commercial debt has increased over time, adding more pressure to debt service obligations and liquidity management.

The macroeconomic impact of the COVID-19 pandemic and persistent structural challenges have edged the country toward debt distress. Lao PDR is facing both liquidity and solvency challenges owing to a high debt service burden, poor revenue collection, limited financing options, and low foreign currency reserves. Debt service deferrals in 2020–2021, amounting to around 3.6 percent of 2021's GDP, provided temporary relief to fiscal and external imbalances, though pressures remain high. Debt sustainability continues to hinge on the outcome of bilateral debt negotiations with major creditors.

Foreign reserve buffers remain low, despite a trade surplus and resilient FDI inflows. The trade balance benefited from buoyant energy and mining exports as well as agricultural and manufacturing exports, supported by strong external demand and higher commodity prices. However, foreign reserve buffers remain low as only 26 percent of export receipts flow back to the Lao economy – with the rest deposited in offshore accounts. Gross reserves were valued at \$1.3 billion in December 2021, covering about 2.2 months of imports. It is estimated that net reserves (excluding the swap agreement) would cover less than two months of imports. Foreign exchange liquidity constraints have caused a sharp kip depreciation.

Monetary policy remains accommodative to support economic recovery, while vulnerabilities in the banking sector persist. Domestic credit accelerated strongly at the end of 2021 for both the private sector (mostly industry, commerce, and services sectors) and the government. While the financial sector provided some support to mitigate the impacts of COVID-19, vulnerabilities remain high and forbearance measures impede a clear assessment of bank balance sheets.

GDP growth is projected to recover to 3.8 percent in 2022, contingent on successful debt renegotiations. The growth recovery is expected to be supported by a gradual recovery in domestic services and a more moderate level of external demand, which is overshadowed by a slower growth recovery in key partners. The outlook assumes that stringent containment measures are not re-introduced. It reflects economic opportunities from improved transport connectivity and logistics, and a revival of domestic economic activities, including wholesale and retail trade. Industry, particularly energy and manufacturing, and agriculture are expected to benefit from some level of external demand. On the demand side, slightly improved private consumption and investment will support economic activity, but public spending will remain constrained by limited revenues and high debt levels. The outlook assumes that ongoing bilateral debt renegotiations will provide some form of debt relief, without which fiscal and external pressures would become insurmountable.

Rising fuel and food prices are undermining both purchasing power and poverty reduction. While domestic labor market conditions are expected to improve gradually, long-term job losses and business closures induced by COVID-19 measures continue to put pressure on household incomes. In addition, rising food and fuel prices are undermining household purchasing power and food security. Without adequate relief measures, many families will be at risk of falling into poverty.

In the absence of debt relief, meeting public debt service obligations will remain very challenging. Fiscal space is constrained by low revenue collection and the high debt service burden. Public external debt repayments (i.e., interest and principal) will average around \$1.3 billion a year for 2022–25, about half of projected total domestic revenue. Fast and effective implementation of revenue-enhancing measures, coupled with a positive outcome from the ongoing debt renegotiations with key creditors, could create much-needed fiscal space for growth-enhancing expenditure.

The outlook is subject to several downside risks, including a deterioration of both domestic and global conditions. COVID-19 vaccination rates have improved, but pandemic risks remain, especially with new variants. Meanwhile, prolonged debt negotiations or a less favorable outcome could exacerbate liquidity and solvency risks. Earlier-than-expected monetary tightening and rising interest rates in advanced economies could put further pressure on the kip and increase debt burdens. This could further constrain investment inflows and future financing options despite the bond issuance in Thailand in March 2022. Prolonged war in Ukraine could have significant indirect economic impacts on Lao PDR through commodity prices (especially fuel) and additional exchange rate depreciation could increase inflationary pressures. However, higher metal and agriculture prices could benefit some exports. Moreover, weaker than expected economic growth in key trading and investment partners, particularly China (due to its internal structural slowdown and COVID-19 policies), may curtail external demand.

Restoring macroeconomic stability is an immediate priority to support recovery and shared prosperity. The top priorities to achieve this objective are (i) creating fiscal

space by enhancing domestic resource mobilization and improving spending efficiency; (ii) restoring debt sustainability by strengthening debt management and transparency; (iii) strengthening financial sector stability by putting in place legal and regulatory tools to manage sector vulnerabilities and improve transparency, and (iv) structural and business environment reforms to support the economic recovery and improve resilience.

Thematic Section: Unlocking the Potential of Regional Connectivity

Lao PDR has a vision to transform itself from a land-locked into a land-linked country through regional infrastructure development. Significant investments have been made to improve regional connectivity, including the Laos-China railway, the East-West economic corridor, and key road networks. A regional rail line and highway connect Lao PDR to the entire network of the Belt and Road Initiative. The key challenge is to ensure that Lao PDR can fully benefit from improved regional connectivity, not only as a transit country but also through increased economic activities and export volumes, value-added services, and the creation of new and better jobs. These connections are expected to reduce transport costs and boost bilateral and transit trade by attracting some traffic currently using maritime and air transport routes. Improved regional connectivity could support economic recovery, especially in agriculture and tourism, promote private investment, create jobs for the poor and reduce rural poverty, especially in the northern and central regions of the country.

However, Lao PDR's investments in infrastructure development could face considerable risks. The cost of these investments is high. Moreover, Lao PDR will only benefit from improved connectivity if it can successfully undertake complementary policy reforms and improve the quality of connective road infrastructure. The slow pace of business and investment environment reforms is also a significant challenge. Speeding up reforms is necessary to ensure that full benefits from the efficiency of improved regional connectivity are captured. In addition, the railway also poses some macro-fiscal risks associated with large contingent liabilities and poses social and environmental risks without proper management and enforcement.

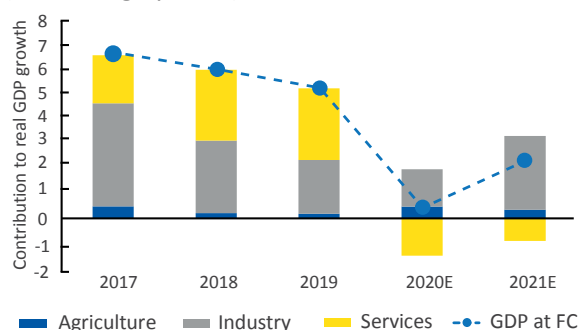
To reduce risks and maximize benefits from improved connectivity, there is a need to implement important reforms in the coming years. Critical reform actions include:

- (i) address transport connectivity gaps to ensure open access to railway and logistics infrastructure and efficient road connections to production and consumption centers;
- (ii) promote more efficient cross-border transit, improved logistics and value chains, and further development of the productive sectors;
- (iii) simplify market entry and remove operational barriers in the logistics sector;
- (iv) deepen and accelerate trade facilitation reforms by focusing on establishing an effective transit management regime;
- (v) improve the business enabling environment to attract investment and generate jobs;
- (vi) improve access to and modernize business services, which have a strong impact on productivity and competitiveness;
- (vii) promote more productive and job-creating sectors where Lao PDR has a comparative advantage, for example, high value-added agricultural and agro-processing products for domestic and export markets; and
- (viii) encourage environmentally-friendly pro-poor tourism, including nature-based tourism to promote green growth.

Lao PDR: Key Macroeconomic Indicators at a Glance

The recovery has been driven by industry sector growth, supported by external demand.

(Percentage points)

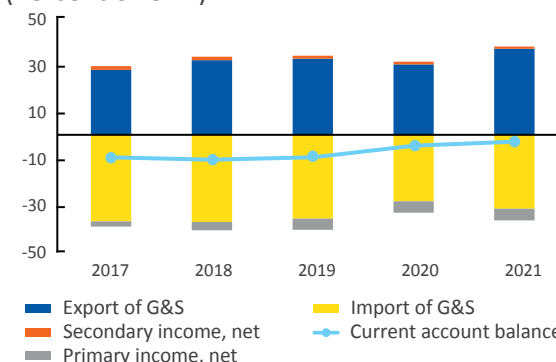


Source: Lao Statistics Bureau, World Bank estimates.

Note: FC = factor cost

Robust exports of goods have reduced external imbalances.

(Percent of GDP)

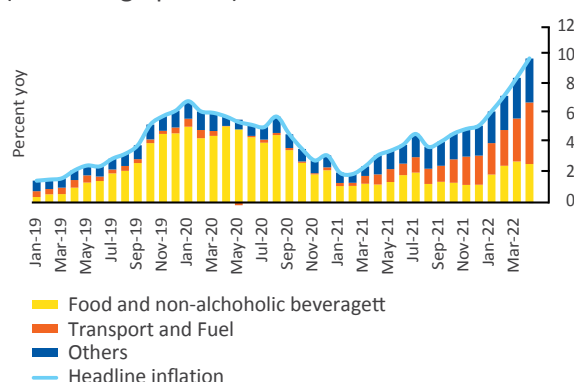


Source: World Bank staff estimates based on data from Bank of Lao PDR and trade partners.

Note: G&S = Goods and services

Global fuel prices and a sharp exchange rate depreciation pushed up inflation.

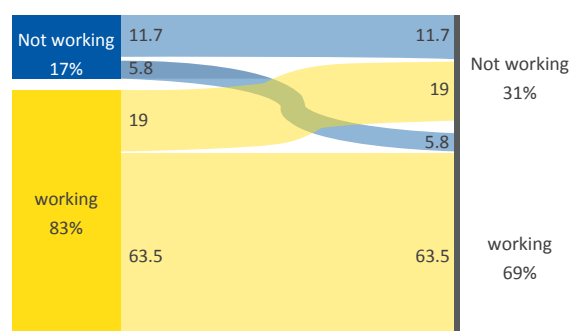
(Percentage points)



Source: Lao Statistics Bureau.

The labor market has rebounded by year-end, The labor market struggled to return to its pre-pandemic conditions.

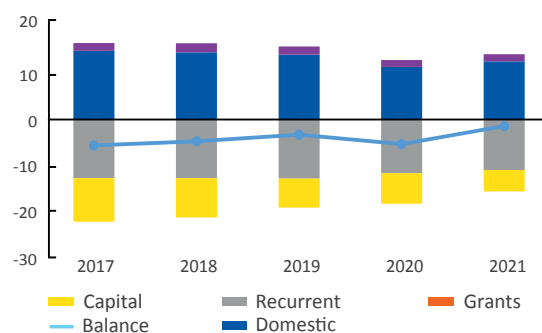
(Percent)



Source: World Bank High Frequency Phone Surveys.

Higher domestic revenue and curbs on spending led to a significant fiscal consolidation.

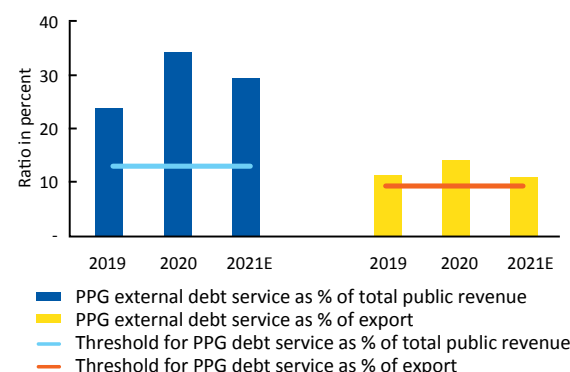
(Percent of GDP)



Source: Ministry of Finance.

Despite debt service deferrals in 2020–2021, Lao PDR's debt service burden remains high.

(Percent ratio)



Source: World Bank estimates based on Ministry of Finance, Bank of Lao PDR, Ministry of Industry and Commerce and trade partner data inputs.



The background image is an aerial photograph of a rural landscape. In the foreground, there is a concrete railway bridge with multiple tracks, supported by pillars, crossing a green field. In the middle ground, there is a large, two-story white house with a brown roof, surrounded by greenery. The background shows a dense forest and distant hills under a clear blue sky. A blue overlay with a yellow chevron shape on the right side covers the middle part of the image, containing the title text.

Part A.

Recent Economic Developments

1. Global and Regional Economic Developments and Outlook ¹

Economic growth in the region is being undermined by a deteriorating global macroeconomic environment, while inflation is rising. Until recently, East Asia and Pacific (EAP) countries were poised for a sustained economic recovery. Despite economic losses from several COVID-19 waves, there were signs of a strong, albeit uneven recovery. External trade and financial conditions were broadly favorable, and some countries were considering options to rebuild buffers. However, rising global inflation, strict lockdowns in China, and the effects of the war in Ukraine have contributed to a gloomier outlook for the region. The repercussions of these shocks will significantly dampen economic prospects, with regional growth expected to decelerate from 7.2 percent in 2021 to 5 percent in 2022. Growth could even slow to 4 percent if global conditions worsen and national policy responses are weaker than expected. Meanwhile, inflation is expected to accelerate and surpass inflation targets in several economies in the region, largely owing to higher commodity prices and supply disruptions. Slower growth and higher inflation will likely undermine poverty reduction in the region.

Table 1. Real GDP growth forecasts

			Forecast in April 2022		Forecast for 2022 back in October 2021
	2020	2021	Baseline	Low Case	Forecast for 2022
East Asia and Pacific	1.3	7.2	5.0	4.0	5.4
East Asia and Pacific (Excluding China)	-3.7	2.6	4.8	4.2	5.2
ASEAN-5	-3.9	3.4	4.9	4.3	5.2

Source: World Bank EAP Economic Update April 2022.

Global inflation has been rising rapidly, prompting fast monetary policy tightening that could trigger capital outflows from the region and weaken regional currencies. Rising global inflation has been partly driven by large policy stimulus packages delivered to mitigate the impact of the COVID-19 pandemic, as well as persistent supply disruptions, and has been recently exacerbated by the effects of the war in Ukraine. Inflationary pressures have led some countries to consider monetary policy tightening, particularly through interest rate increases. A rapid tightening of global financing conditions amid heightened geopolitical tensions could trigger significant capital outflows from the region, weigh on regional currencies, and dampen the recovery.

Slowing GDP growth in China is projected to weigh on its import demand, potentially affecting exports from EAP. Economic growth in China is expected to decelerate in the medium term due to structural factors, such as a lower pool of surplus agricultural labor, declining returns to capital, economic distortions, and an aging population. In the near term, the construction sector will be hampered by the deleveraging of real estate firms, industry will be affected by efforts to reduce carbon emissions, and services will be hindered by stringent measures to control the spread of COVID-19. A significant economic slowdown in China will likely have sizable effects on EAP countries owing to increasingly important trade and investment linkages. Countries with large debt levels (e.g., Lao PDR

¹ Draws on the World Bank's April 2022 EAP update and January 2022 Global Economic Prospects (GEP) reports.

and Mongolia) and high dependence on exports (e.g., Malaysia and Vietnam) are more vulnerable to global financial and growth shocks.

The war in Ukraine is expected to disrupt the recovery in EAP countries. The negative impacts of the invasion, war, and sanctions are compounding an already fragile recovery of the world and regional economies. The effects on Europe and Central Asia are considerable due to tight regional economic and financial linkages. However, countries in other regions are also affected, particularly commodity importers and those with high (external) debt levels. The war is disrupting the supply of commodities for which Russia and Ukraine are key exporters, such as oil and gas, fertilizers, metals, and wheat. These disruptions are leading to significantly higher prices in international markets, which weigh on consumer confidence and erode real earnings. Financial market volatility has also increased, fueling concerns of financial stress in several countries.

Global debt levels surged as a consequence of the COVID-19 pandemic, with concerted debt restructuring likely needed in several countries. To mitigate the economic impacts of COVID-19 containment measures, many countries borrowed heavily to finance fiscal support packages targeting affected households and firms. As a consequence, debt levels have risen to record highs, driven in part by non-concessional borrowing associated with higher costs and shorter maturities. These developments have often increased the risk of financial distress. The rise in debt levels has led several countries to initiate debt restructurings, while many others in debt distress or at high risk of distress may also need debt relief. Lessons from past experiences suggest that timely and comprehensive debt relief is the key to reigniting economic growth and addressing debt vulnerabilities. This is particularly pertinent in countries where a rising debt burden is squeezing the fiscal space available for critical spending on human development.

Against this backdrop, Lao PDR will face a challenging global environment. Slower growth and weakening demand from key trading partners will weigh on exports. Tighter financing conditions and rising interest rates could increase costs and undermine access to external financing. Rising commodity and food prices may benefit certain exports but also compound inflationary pressures and poverty risks. A stronger US dollar due to rising interest rates will likely result in a weaker kip, which will also add to inflationary pressures.

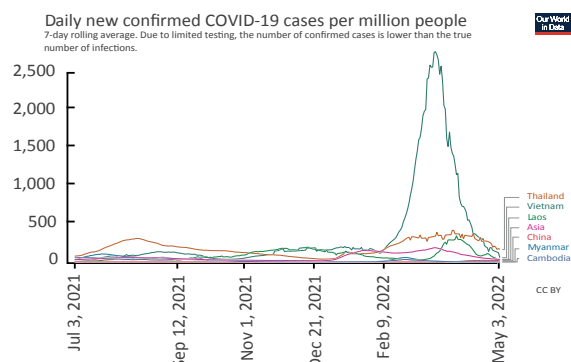
2. Recent Economic Developments in Lao PDR

2.1 COVID-19 Situation

Lao PDR has been facing a wave of COVID-19 since mid-March 2022, which has been hampering the economic recovery. The number of reported COVID-19 cases declined from 1,300 cases per day in mid-December 2021 to less than 200 cases per day in late-February 2022, mostly associated with the Delta variant. However, the Omicron variant led to a significant increase to over 2,000 cases per day in late March. The reported cases declined in April-May. This was the third (and largest) wave of COVID-19 since the start of the pandemic in 2020. The daily number of reported new cases per million people is now above the regional average² (Figure 1). Lao PDR's Vientiane Capital has had the highest number of new cases in recent weeks, but official numbers may not fully reflect the current situation, owing to positive self-tests that are not reported to the authorities. Nonetheless, Lao PDR's death rate of 92 per million people is one of the lowest in the world.

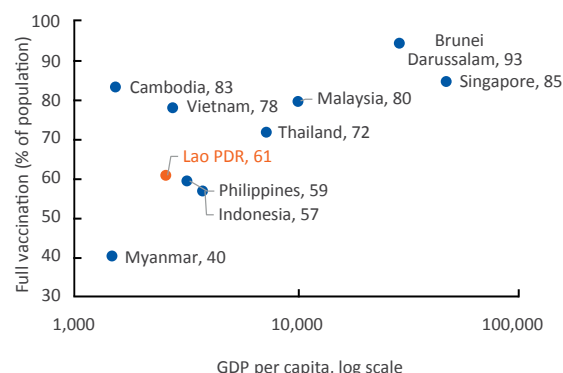
² Data as of 6 April 2022 from <https://ourworldindata.org/covid-cases>

Figure 1. Daily new confirmed COVID-19 cases
(Per million people)



Source: <https://ourworldindata.org/covid-cases>

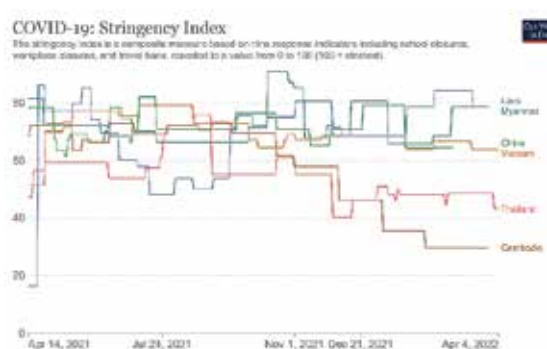
Figure 2. Vaccination rates in ASEAN
(Percent)



Source: World Health Organization and World Development Indicators.

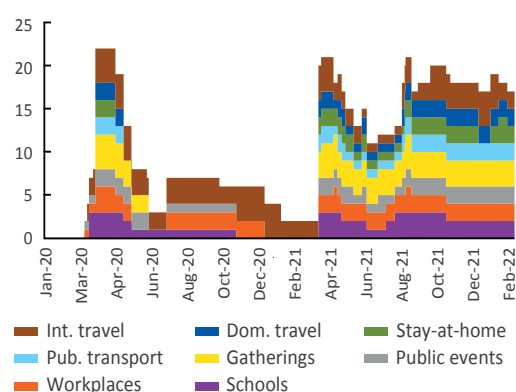
Rising vaccination rates may enable a gradual withdrawal of restrictions. About 67 percent of the population has been fully vaccinated as of 6 May 2022. This vaccination rate is slightly higher than in Indonesia and the Philippines, but far behind Thailand, Vietnam and Cambodia. There is a concern that vaccination efforts are overly-focused on low-risk groups, such as children and the already-vaccinated, as opposed to high-risk unvaccinated people. Vaccination rates vary considerably across the country. Stronger efforts are required to achieve the government's vaccination target of 80 percent of the population by the end of 2022. Higher vaccination rates would enable a gradual relaxation of containment measures, which are currently more stringent than in neighboring countries (Figure 3). Some restrictions have been eased recently, including reduced quarantine times for some categories of visitors and home isolation. Several other measures remain in place, although compliance may vary considerably across measures (Figure 4).

Figure 3. Stringency Index
(Index)



Source: <https://ourworldindata.org/covid-cases>

Figure 4. Restriction measures
(Index)



Source: <https://www.bsg.ox.ac.uk/research/research-projects/covid-19-government-response-tracker#data>

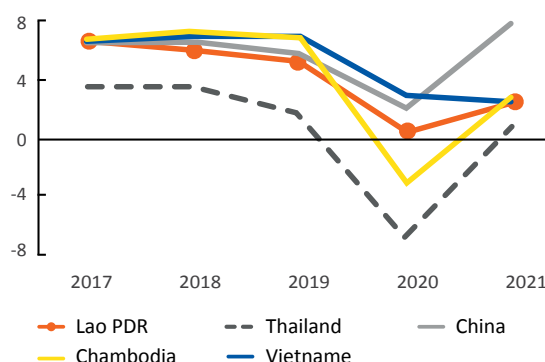
2.2 The Real Sector

The second wave of COVID-19 infections and associated containment measures have slowed the pace of the economic recovery in 2021. GDP growth is estimated to have rebounded to 2.5 percent in 2021, in line with the trends in most neighboring countries (Figure 5). This estimate is slightly higher than projected in October 2021 owing to improved export performance.³ However, GDP growth remained significantly below pre-pandemic levels. Industry and agriculture, supported by robust external demand, were the main growth drivers. In contrast,

3 World Bank Macro Poverty Outlook October 2021

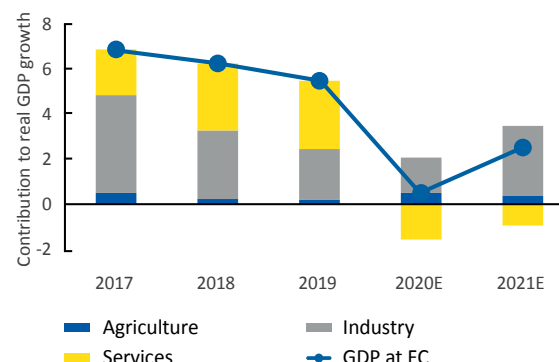
the service sector was severely affected by the prolonged lockdown and continued to struggle, especially hotels and restaurants, transport, and other tourism-related services (Figure 6).

Figure 5. Real GDP growth
(Percent year-on-year)



Source: World Development Indicators, World Bank estimates.

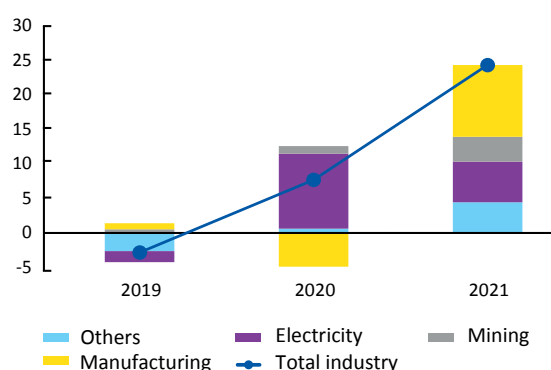
Figure 6. Sectoral contribution to GDP growth at factor cost
(Percentage points)



Source: Lao Statistics Bureau, World Bank estimates.
Note: FC = Factor cost.

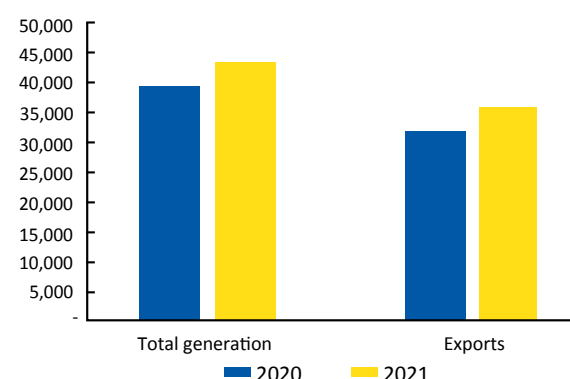
Supported by external demand, the industrial sector performed well in 2021. Robust industrial output growth (estimated at 7.6 percent in 2021) was predominantly driven by a strong rebound in energy, mining, and export-oriented manufacturing (Figure 7). This was reflected in robust growth in industrial exports, supported by higher commodity prices. Electricity exports were supported by high demand in neighboring countries (Figure 8). In the mining sector, gold and iron ore output rose notably, offsetting the contraction of copper production (Figure 9).⁴ Export-oriented manufacturing output also performed well, especially wood pulp and paperboard, wood and wood products, and other manufactured goods. However, growth in the construction sector moderated because some large transport and power projects were completed, and there was a significant decline in public investment spending.

Figure 7. Industrial sector exports
(Percentage point contributions to growth)



Source: World Bank staff estimates based on Ministry of Industry and Commerce and mirror trade statistics.

Figure 8. Electricity generation
(Gigawatt hours)

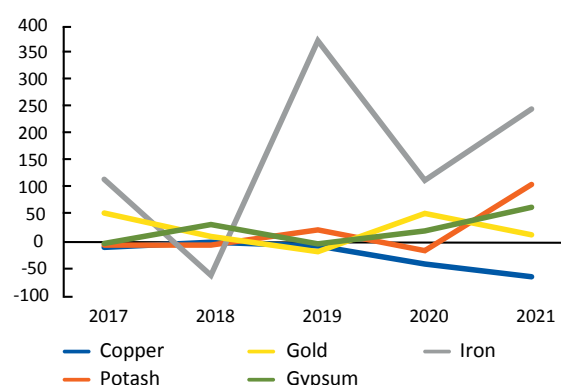


Source: Ministry of Energy and Mines.

⁴ In August 2020, Sepon commissioned a new plant and started processing primary gold ore. These changes are a milestone in Sepon's transition from copper to gold mining operations. Resumption of gold production will extend the Sepon mine life by at least ten years. Source: <https://lxml.la/operations/>

Figure 9. Selected mining output

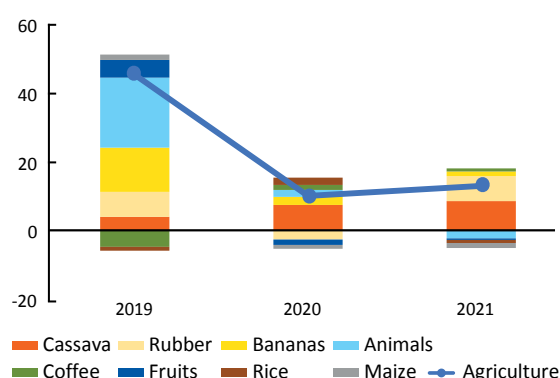
(Output index 2017 = 100, % change year-on-year)



Source: World Bank calculation based on data from the Ministry of Energy and Mines.

Figure 10. Agricultural export growth

(Percentage point contributions to growth)



Source: World Bank staff calculations based on data from Ministry of Industry and Commerce, mirror trading partners.

The agriculture sector was resilient, supported by strong export demand for key products.⁵

The estimated growth of 2.3 percent in 2021 was mostly supported by expanded production and exports of key agricultural products such as cassava, rubber, bananas and coffee beans, offsetting a contraction in other fruit, corn and live animal exports (Figure 10). The combined exports of cassava, rubber, bananas and coffee beans grew by 28.6 percent in value terms and accounted for about 72 percent of total agricultural exports in 2021. The combined exports of other agricultural products (other fruit, corn, live animals and rice) contracted by 13.7 percent. Supported by strong external demand and prices, overall agriculture sector exports increased from \$1 billion in 2020 to \$1.2 billion in 2021. According to a high-frequency phone survey, agriculture was the sector that helped absorb those workers who lost their jobs in the other sectors during the pandemic.

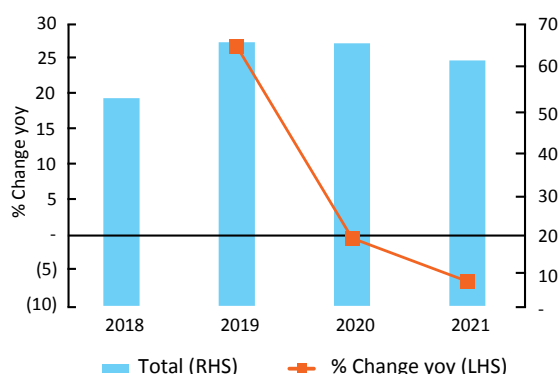
The services sector struggled to recover due to the impact of stringent and protracted containment measures. Key service subsectors such as hotels and restaurants, transportation, wholesale and retail sales, were hurt by the prolonged COVID-19 containment measures and international travel restrictions. Total domestic wholesale and retail trade value further declined (Figure 11). Mobility trends showed some improvements toward the end of 2021, but were still weaker than in 2020, particularly in transport, workplace, and retail activities. This suggests a more gradual recovery of the services sector (Figure 12). Mobility data shows that air transportation (tracked flights to Vientiane) and Internet search activity remained low in 2021. In addition, despite the Lao Travel Lao campaign launched at the end of 2020 and the opening of the Laos-China railway in December 2021, overall domestic tourism remained weak compared to pre-COVID-19 levels (Figure 13). From the demand side, the World Bank's household survey showed that 64 percent of households have lost income, which contributed to weaker consumption of services.⁶

5 Data on self-consumption and production for the domestic market is difficult to capture, which undermines the quality of estimates for agriculture.

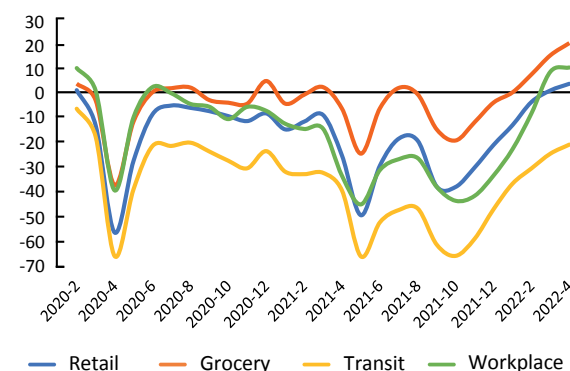
6 Based on High Frequency Phone Surveys (HFPS) for regular monitoring of the impact of COVID-19. Round 4 was conducted between October 25 and November 19, 2021, interviewing 1,993 respondents.

Figure 11. Domestic trade turnover

(Trillion kip, % change year-on-year)

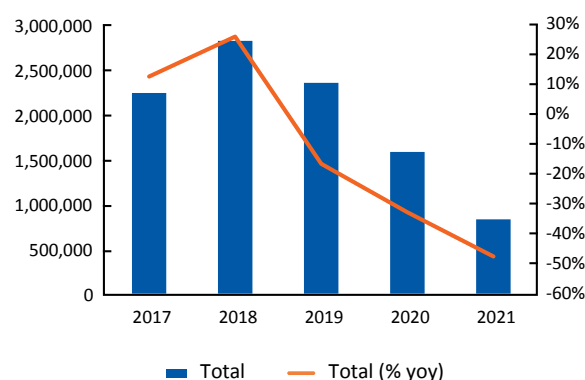


Source: World Bank calculations based on Ministry of Industry and Commerce data.

Figure 12. Mobility trends

Source: [google.com/covid19/mobility](https://www.google.com/covid19/mobility)

Note: Visitors to (or time spent in) categorized places change compared to baseline days (the median value from the five weeks from January 3 to February 6, 2020). The chart shows a monthly simple average.

Figure 13. Domestic tourism

Source: Ministry of Information, Culture and Tourism.

On the demand side, the recovery was predominantly driven by external demand. The robust growth of merchandise exports more than offset the increase in imports. Trade in services remained subdued, partly owing to limited international visitors (especially tourists), weighing on travel and transport services. As a result, net trade in goods and services rose to around 6.4 percent of GDP in 2021 from 2.2 percent of GDP in 2020. Private investment appeared resilient, particularly related to the power, construction and agriculture sectors. Foreign direct investment inflows grew by 11 percent in 2021 (year-on-year). However, private consumption remained weak amid income losses that affected 64 percent of households.⁷ Meanwhile, public consumption and investment contracted due to limited fiscal space.



Photo: World Bank / Phoonsab Thevongsa

⁷ Based on High Frequency Phone Surveys (HFPS) for regular monitoring of the impact of COVID-19. Round 4 was conducted between October 25 and November 19, 2021, interviewing 1,993 respondents.



Photo: World Bank / Aiden Glendinning

2.3 Labor Market

The labor market has rebounded but has yet to return to pre-pandemic levels. The share of employed adults stood at 69 percent in October/November 2021, up from 49 percent in February/March 2021, but remained below the pre-pandemic level of 83 percent in February 2020 (Figures 14 and 15).⁸ Jobs in industry and traditional services were more vulnerable to the pandemic impacts as activity is limited by social distancing measures, lower demand, and the inability to adapt to remote work. These sectors experienced a significant contraction in employment and recovered slowly. Nearly 30 percent of workers employed in these sectors before the second outbreak were not working in October/November 2021. While agriculture has so far been relatively resilient to the pandemic, 27 percent of family farms experienced a disruption in their farming activities during the second outbreak. Employment in modern services and the public sector declined only slightly.

Figure 14. Employment status in October/November 2022 survey
(Percent)

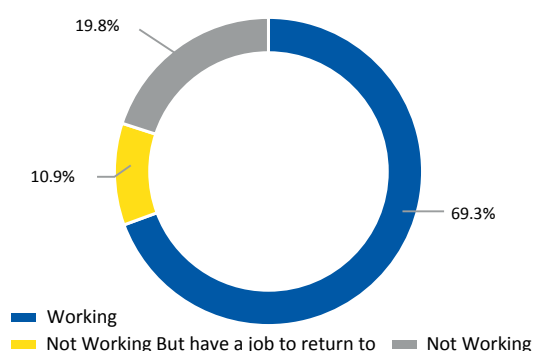
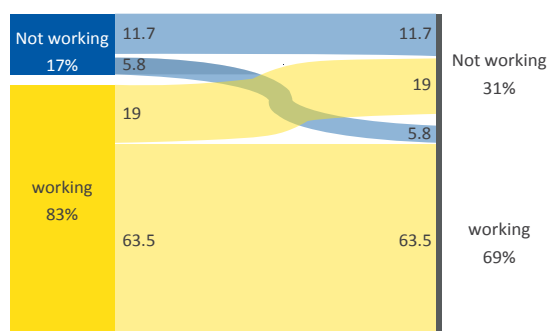


Figure 15. Movement of labor before and after the pandemic



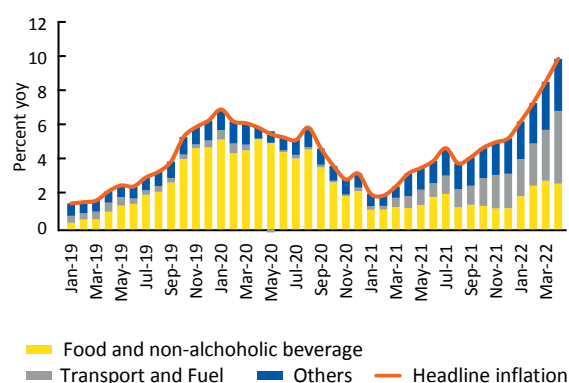
Source: High Frequency Phone Surveys for regular monitoring of COVID-19 impacts.

8 World Bank 2021 and World Bank 2022. Employed adults are those who reported working during the past 7 days.

2.4 Inflation

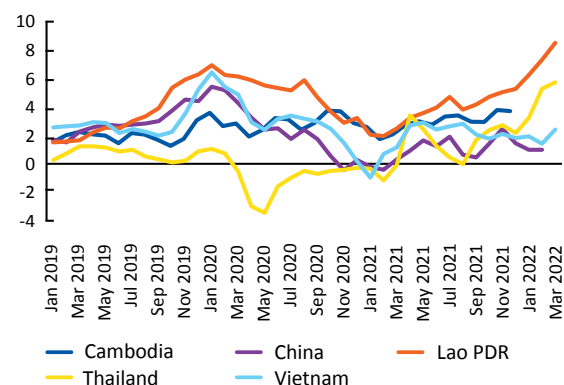
Headline inflation continued to rise, driven by higher fuel prices and a sharp depreciation of the kip. The annual average inflation rate declined from 5.1 percent in 2020 to 3.8 percent in 2021, but this masks developments in recent months. Inflation rose from less than 2 percent in February 2021 to 9.9 percent in April 2022 (year-on-year). This is the highest level in over a decade and among the highest in the region (Figure 18).⁹ Rising international oil prices, aggravated by the war in Ukraine, have pushed up prices in the transport category.¹⁰ Retail fuel prices rose by over 80 percent in April 2022 (year-on-year) to the highest level in a decade. Additionally, a substantial depreciation of the kip against the US dollar and the Thai baht has also pushed up inflation. Owing to the exchange rate pass-through, prices of imported products rose by almost 19 percent in April (year-on-year). These cost-push factors lead to increased production and services costs, exacerbating price increases across consumption items, and lowering purchasing power. Food price inflation also rose, but at a more moderate pace, partly due to the high base last year.

Figure 16. Headline inflation
(Percent year-on-year, percentage points)



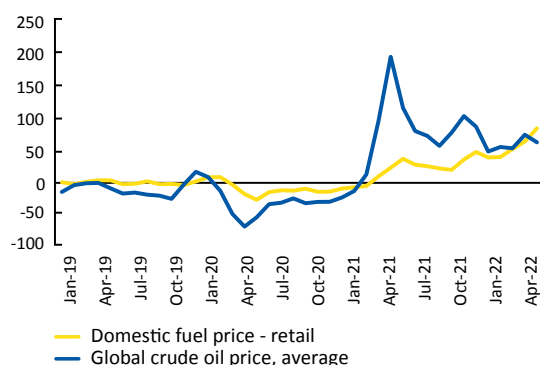
Source: Lao Statistics Bureau

Figure 17. Inflation in neighboring countries
(Percent year-on-year)



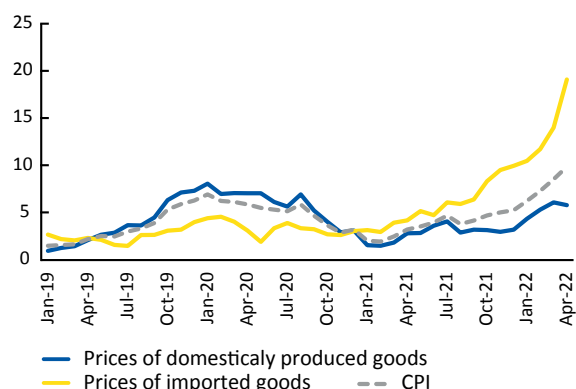
Source: IMF International Financial Statistics

Figure 18. Fuel prices
(Percent change year-on-year)



Source: Lao Statistics Bureau.

Figure 19. Domestic prices of imported and domestically produced goods
(Percent change year-on-year)



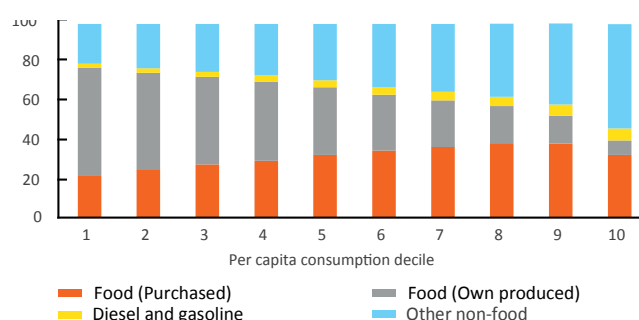
Source: Lao Statistics Bureau.

9 The consumption basket is based on the Lao PDR Expenditure and Consumption Survey (LECS) for 2012–2013. The Lao Statistics Bureau has a plan to update the consumption basket based on the LECS 6 (2018–2019), which would be more representative of the recent composition of consumption in households.

10 The transport category accounts for a Consumer Price Index weight of 16 percent, while fuel accounts for 1.5 percent.

Rising inflation threatens living standards, especially in low-income urban households. Rising prices have been a major concern for Lao households since early 2021. In the October/November 2021 survey, 38 percent of households identified increased prices of necessary goods as the most pressing issue the government should address, up from 33 percent in February/March 2021. However, the immediate impact on poverty is expected to be moderate, as most low-income households rely on own-produced food.¹¹ An increase in agricultural input prices will compromise agricultural production, even own-produced food, and income in the medium term. While fuel accounts for an average of about 5 percent of total consumption, the magnitude of the price increase and the exchange rate pass-through effect are expected to take a toll on households. Low-income urban households that rely heavily on purchased food are expected to be hit hardest.

Figure 20. Lao household consumption composition by decile (2018)



Source: Lao Expenditure and Consumption Survey 6.



Photo: World Bank / Phoosab Thevongsa

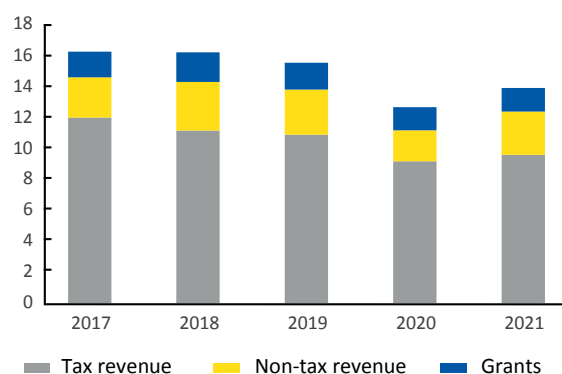
¹¹ Own-produced food consumption accounts for nearly 70 percent of total food consumption for households from the bottom 20 percent of the population.

2.5 Fiscal Developments¹²

Preliminary estimates indicate a recovery in revenue collection in 2021, driven by both tax and non-tax revenues. Domestic revenue performance was deteriorating even before the COVID-19 pandemic and reached a record low in 2020. Supported by the economic recovery, domestic revenue rebounded from 11.2 to 12.4 percent of GDP in 2021, but remained below pre-pandemic levels and below regional peers. This improvement was due to both tax and non-tax revenues. The increase in tax revenue was due to value-added and excise taxes, and natural resources taxes, owing to higher mining exports and commodity prices. Non-tax revenues came from dividends, fees and the forest fund. Grants remained broadly stable as a ratio to GDP.

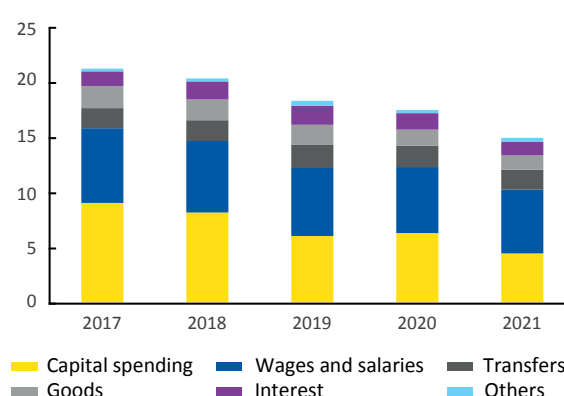
Expenditure curbs continued, largely through the suspension of new public investment projects and a further reduction in recurrent spending. Preliminary estimates suggest that total expenditure declined from 17.9 to 15.4 percent of GDP in 2021.¹³ This was mainly due to a 24 percent reduction in capital spending (including the deferral of new projects) and limited recurrent spending on goods and services, and salary and wage increases. As a result, primary expenditure (excluding interest payments) is estimated to have declined significantly from 16.4 percent of GDP in 2020 to around 14 percent. Interest payments declined slightly, owing to the deferral of debt service payments owing to key bilateral creditors, which has temporarily eased fiscal pressures. However, arrangements for these deferred payments are still under negotiation. Limited fiscal space has constrained the adoption of sizable fiscal measures to counter the impacts of COVID-19 on households and businesses as well as growth-enhancing expenditures such as investments in health and education.

Figure 21. Total revenue collection
(In % of GDP)



Source: Ministry of Finance.

Figure 22. Government expenditures
(In % of GDP)



Source: Ministry of Finance.

The fiscal deficit appears to have declined significantly in 2021, owing to higher domestic revenue and curbs on spending. Preliminary estimates indicate that the fiscal deficit narrowed substantially to 1.4 percent of GDP in 2021, from 5.2 percent of GDP in 2020. Similarly, the primary deficit declined from 3.7 percent to 0.2 percent in the same period. With limited access to international capital markets, the government relied more heavily on the domestic banking sector to meet its financing needs.¹⁴ This was also reflected in a sharp increase in lending to the government toward the end of 2021.¹⁵

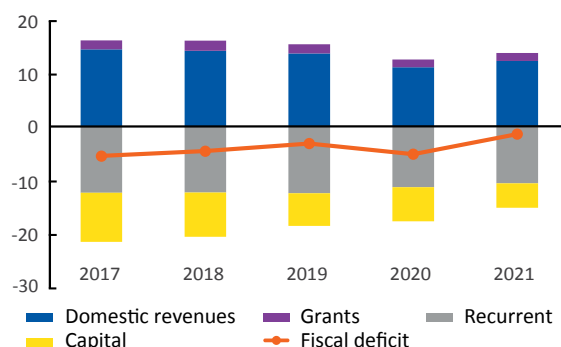
¹² This update is based on preliminary data from the Ministry of Finance as of March 2022.

¹³ This is a preliminary estimate as of March 2022. The final budget data for 2021 will be released in June 2022.

¹⁴ According to the International Monetary Fund, gross government financing needs are the overall new borrowing plus debt maturing during the year. <https://www.economist.com/economic-and-financial-indicators/2011/04/14/public-finance-requirements>

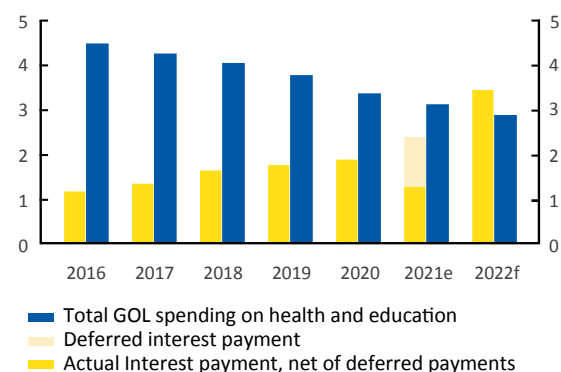
¹⁵ This may include holding of government (triangle) bonds.

Figure 23. Fiscal performance
(% of GDP)



Source: Ministry of Finance.

Figure 24. Social spending and interest payments
(% of GDP)



Source: World Bank estimates based on inputs from Ministry of Finance, Ministry of Education and Sports, Ministry of Health, and Lao Statistics Bureau.

Limited fiscal space and rising debt service have constrained investments in human capital. Growing debt service requirements in a context of declining revenues and expenditure consolidation have narrowed the fiscal space available for health and education spending. The combined public spending on education and health declined from 4.4 percent of GDP in 2016 to 3.1 percent of GDP in 2021, likely undermining public service delivery. In contrast, interest payments rose from 1.1 percent of GDP in 2016 to 1.8 percent in 2019, although the interest payment to GDP in 2021 declined to about 1.2 percent due to interest payment deferral. If current trends continue, interest payments are expected to overtake spending on these social sectors in the near term. Therefore, it is necessary to balance debt management and critical investment in human capital for long-term growth.



Photo: World Bank / Phoonsab Thevongsa

2.6 Debt Dynamics

Public debt levels have increased considerably since 2019, which jeopardizes macroeconomic stability.¹⁶ Preliminary estimates indicate that total public and publicly guaranteed (PPG) debt increased from 68 percent of GDP (\$12.5 billion) in 2019 to 88 percent (\$14.5 billion) in 2021, much higher than regional peers.¹⁷ If an inferred disbursement under the swap arrangement between the Bank of the Lao PDR and the People's Bank of China is included, the PPG stock would rise by nearly two percentage points to 90 percent of GDP in 2021. In terms of its composition, external public debt amounted to 66 percent of GDP in 2021, while domestic debt and publicly-guaranteed debt were both equivalent to 11 percent of GDP.¹⁸ The significant increase in PPG debt was mainly driven by a sharp depreciation of the kip and a large issuance of domestic bonds. The kip depreciated by nearly 20 percent against the US dollar at end-2021 compared to end-2020. This highlights the high vulnerability of the debt stock to fluctuations in exchange rates (exchange rate risk exposure). In addition, the government issued domestic (triangle) bonds amounting to about 9 trillion kip by end-2021 as payments for domestic arrears related to public investment projects, which represented about 5 percent of GDP. The issuance of new external debt has been limited, partly reflecting constrained market access but also a policy to limit new borrowing and postpone foreign-financed investment projects.

The total PPG debt mainly comprises external debt, with the energy sector accounting for a large share of the debt stock. The energy sector, mostly represented by Électricité du Laos (EDL), accounted for over 30 percent of total PPG debt in 2021. New power sector debt commitments were recently reduced as EDL deferred and cancelled some investments. However, EDL's debt service obligations are still unsustainable, with future debt service accounting for about two fifths of EDL's total operating revenue in the medium term. Given the poor financial situation of EDL and its high debt level, this repayment burden could have direct fiscal consequences.

The macroeconomic impact of the COVID-19 pandemic has compounded pre-existing debt challenges, edging the country toward debt distress. Lao PDR is facing both liquidity and solvency challenges owing to a high debt stock and service burden, poor revenue collection, limited financing options, and low foreign currency reserves. Debt service deferrals granted by major lenders in 2020-2021 amounted around 3.6 percent of GDP in 2021. As a result, actual debt service payments are estimated to have declined to 48 percent of total revenues in 2021, compared to 65 percent in the 2021 plan.¹⁹ Similarly, external public debt service payments as a ratio of exports declined to 10 percent in 2021, compared to 16 percent in the plan. Nevertheless, debt service payments contributed to significant demand for foreign currencies, which has heightened liquidity risks and contributed to a sharp depreciation of the kip, particularly against the US dollar. This situation, in turn, makes debt servicing more expensive. Moreover, while deferred debt service payments have provided temporary relief to existing fiscal and external pressures, the treatment of these amounts in the future debt service plan remains uncertain and debt sustainability continues to hinge on the outcomes of bilateral negotiations with major creditors.

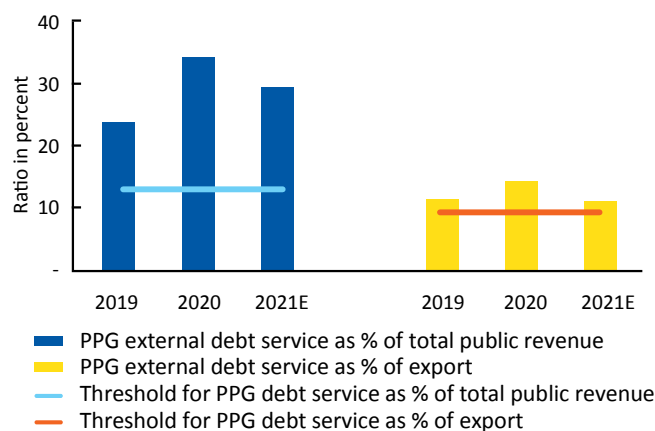
16 In December 2021, an IMF team conducted a virtual Article IV mission in Lao PDR. The team's appraisal of economic, financial and exchange rate policies were reflected in a staff report, which also included a joint WB-IMF Debt Sustainability Analysis (DSA). The report was submitted to the IMF's Executive Board for discussion, and the Board's views were subsequently summarized and transmitted to the country authorities. The authorities have not consented to the publication of the staff report. For more information, please visit IMF website.

17 Preliminary information from the authorities as of March 2022. Based on the Public Sector Debt Statistics guide, the debt stock is converted into kip using the end-of-period commercial bank exchange rate, and then divided by nominal GDP in kip.

18 Official data on domestic and publicly-guaranteed debt is only available from 2019 onwards.

19 This debt service payments include interest and principal repayments on public external and domestic debt, excluding guarantees and deferred amount of debt service to key creditors.

Figure 25. Public debt service repayment ratios
(Percent)



Source: World Bank estimates based on Ministry of Finance, Bank of Lao PDR, Ministry of Industry and Commerce and trade partner data inputs.

Note: The thresholds are taken from 2019 Debt Sustainability Analysis.

Despite temporary deferrals, refinancing risks have intensified, owing to limited access to international capital markets. In addition to the abovementioned repayment deferrals, the authorities have been relying more heavily on short-term commercial borrowing and domestic bonds to meet liquidity needs for debt servicing, particularly near the end of 2021. The banking sector's claims on the government doubled to 14 percent of GDP by the end of 2021. In a context of limited access to international capital markets, partly due to sovereign credit rating downgrades in 2020–2021, the government tapped into non-debt-creating flows, including the sale of shares in some inefficient state-owned banks. However, the government issued baht bonds in Thailand in March 2022, valued at 5 billion baht (about \$149 million) for an external bond redemption in late 2021.



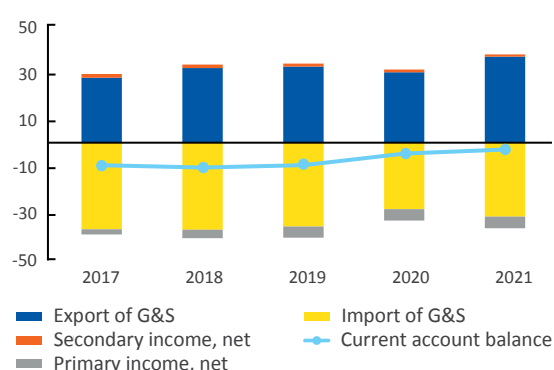
Photo: World Bank / Phoonsab Thevongsa

2.7 External Sector

The current account deficit declined in 2021, largely due to a growing merchandise trade surplus. Goods exports grew by 22 percent in value terms supported by strong external demand and higher commodity prices.²⁰ Major products include electricity, mining, and several agricultural and manufactured products. At the same time, merchandise imports grew by 14 percent as the economy gradually recovered, driven by fuel (demand and prices), vehicles, and machinery. In contrast, trade in services remained subdued. As a result, net trade on goods and services improved to a surplus of 1.7 percent of GDP in 2021 compared to a deficit of 1.3 percent in 2020. However, the strong merchandise trade performance was partly offset by net income outflows, owing to interest payments on external debt and lower remittances. The current account deficit almost halved to an estimated 3.2 percent of GDP from 5.9 percent in 2020.

Figure 26. Current account balance

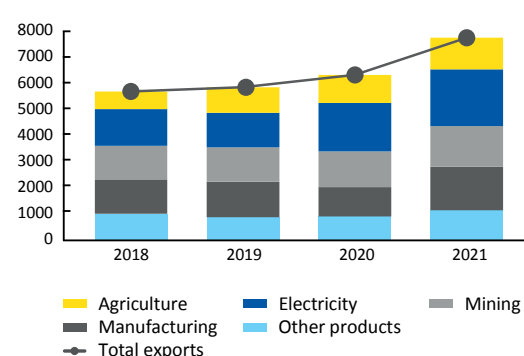
(Percent of GDP)



Source: World Bank staff estimates based on data from Bank of Lao PDR and trade partners.
Note: G&S = Goods and services

Figure 27. Merchandise exports

(Million USD)



Source: Trade partner customs data and Ministry of Industry and Commerce.

Figure 28. Merchandise export by country

(Million USD)

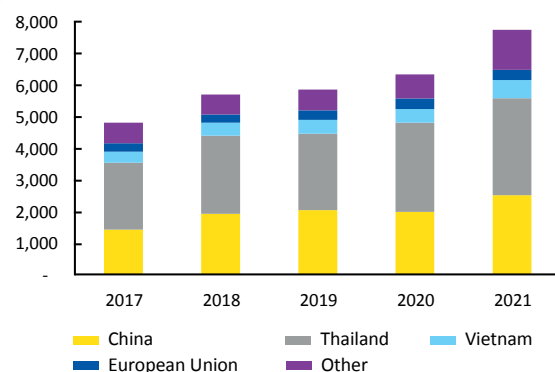
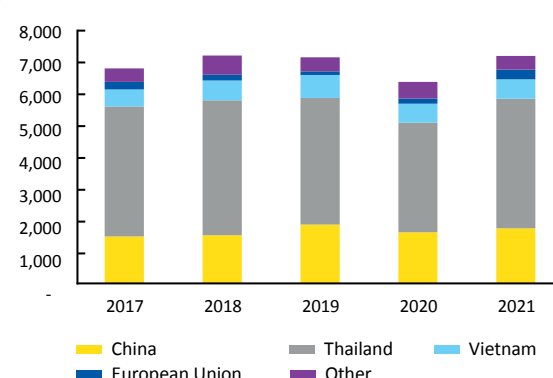


Figure 29. Merchandise import by country

(Million USD)



Source: World Bank staff estimates based on data from International Monetary Fund Direction of Trade Statistics, bilateral trade partners' data and Bank of Lao PDR.

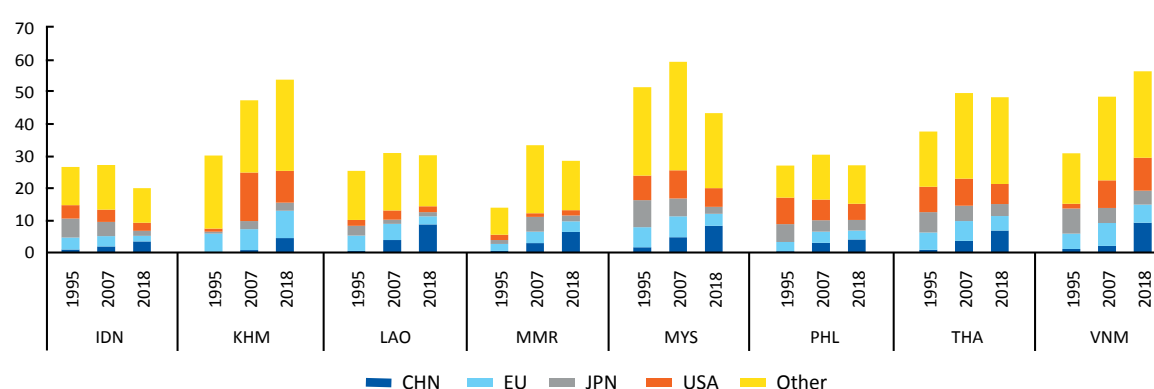
Lao PDR's trade is concentrated in neighboring countries, with China growing in importance. While Thailand remains Lao PDR's largest export destination including electricity, manufacturing and agricultural exports, the role of China has increased. Despite disruptions at the Lao-China border checkpoint (Boten-Bohan) due to the rising number of COVID-19 cases in late 2021,

²⁰ There are some discrepancies between various sources of trade data, including official agencies and bilateral mirror statistics.

exports to China were resilient, growing by 29 percent in value terms. Main export products to China include copper, mining ores, manufactured goods (wood pulp, paper products, wood and wood products and agriculture produce). Lao PDR is gradually becoming more integrated into regional supply chains. About one-tenth of value added generated in Lao PDR is absorbed by China, with a trend similar to other countries in the region. Lao exports increasingly feed into the manufacturing, construction and service sectors in China. The Laos-China railway provides an opportunity for deeper trade and investment integration if coupled with reforms on trade facilitation and the business environment (see the thematic section of this report). Trade in services remained subdued as international tourism remained sluggish.

Figure 30. China's growing importance as the ultimate destination of East Asia and Pacific country value-added exports

(Percent of GDP)

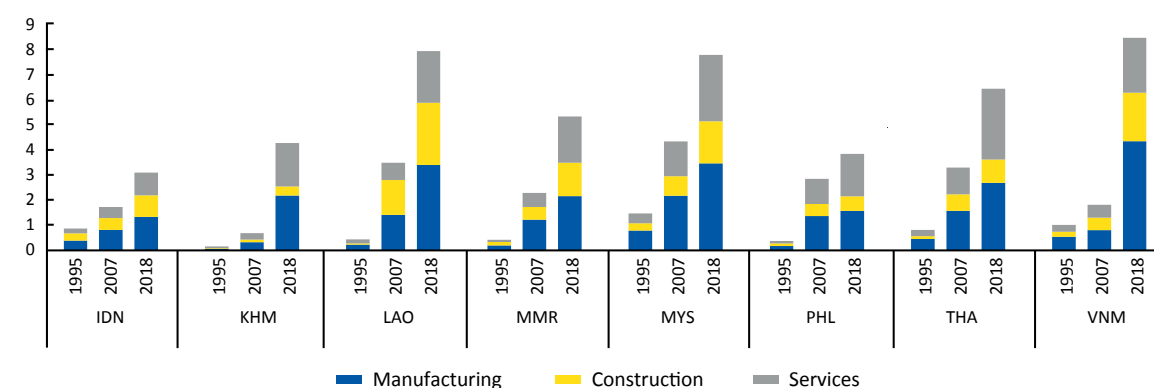


IDN: Indonesia; KHM: Cambodia; MMR: Myanmar; MYS: Malaysia; PHL: Philippines; THA: Thailand; VNM: Vietnam. Note: The chart plots the share of East Asia and Pacific country total value added absorbed in major economies. The values for other countries do not include value added absorbed domestically.

Source: Organization for Economic Co-operation and Development Trade in value added database cited in East Asia and Pacific Economic Update April 2022.

Figure 31. Importance of China's sectoral demand for value added in East Asia and Pacific countries

(Percent share)



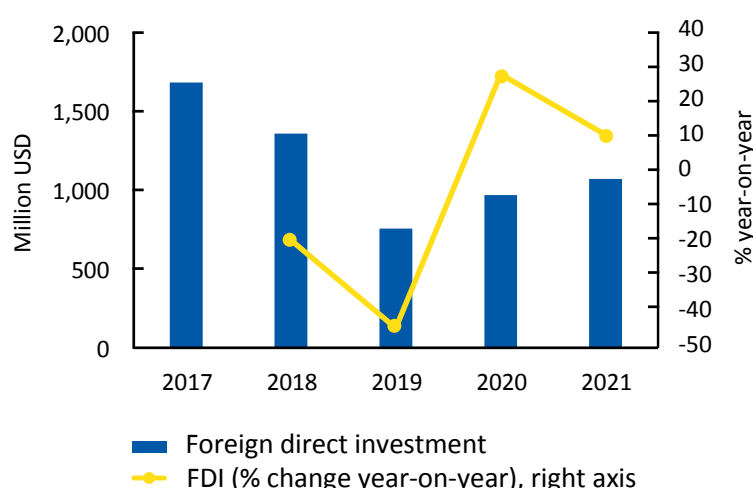
IDN: Indonesia; KHM: Cambodia; MMR: Myanmar; MYS: Malaysia; PHL: Philippines; THA: Thailand; VNM: Vietnam. Note: The chart plots the share of East Asia and Pacific countries total value-added absorbed in China's manufacturing, construction, and service sectors.

Source: Organization for Economic Co-operation and Development Trade in value added database cited in East Asia and Pacific Economic Update April 2022.

Remittances continued to decline in 2021 as few outmigrants returned to Thailand to seek jobs. COVID-19 caused a sudden drop in remittances as outmigrants returned from neighboring countries and those who remained experienced income losses. Officially recorded international remittances declined by 25 percent in 2020, from \$218 million to \$162 million between 2019 and 2020. The high cost of migrating during the COVID-19 pandemic and subdued labor market conditions in neighboring countries discouraged people from returning to jobs abroad. Remittances continued to fall in 2021, with the first half of 2021 seeing a decline of 11 percent (year-on-year). Meanwhile, the estimated amount of remittances received by households, which includes transfers sent through both formal and informal channels, shows a similar trend but with smaller declines (15 percent in 2020 and 7 percent in 2021).²¹ Remittances are expected to gradually recover in 2022, as neighboring countries open their borders to migrant workers.

Foreign direct investment growth in 2021 moderated but remained solid. Against the overall declining trend before the pandemic, total foreign direct investment (FDI) managed to grow by 11 percent in 2021 compared to 28 percent in 2020. Most FDI inflows pertained to the power, construction, and agriculture sectors. China and Thailand were among the largest investors.

Figure 32. Foreign direct investment
(Million USD, % change year-on-year)



Source: Bank of Lao PDR.

Foreign reserve buffers remained low, despite a large trade surplus and resilient FDI inflows. According to the Bank of Lao PDR (BOL), only 26.5 percent of total export receipts entered the country despite a trade surplus in 2021. Gross reserves were valued at \$1.3 billion in December 2021, covering about 2.2 months of imports of goods and services. Net reserves (excluding the swap) are estimated to be less than 2 months of imports.²² This low level of external reserves heightens external vulnerabilities, especially given large debt service obligations that exacerbate foreign currency demand, despite recent temporary deferrals. This contributed to the depreciation of the kip, which, in turn, makes debt service more costly. To improve foreign currency management, the Bank of Lao PDR aims to submit a revised draft law on foreign currency management to

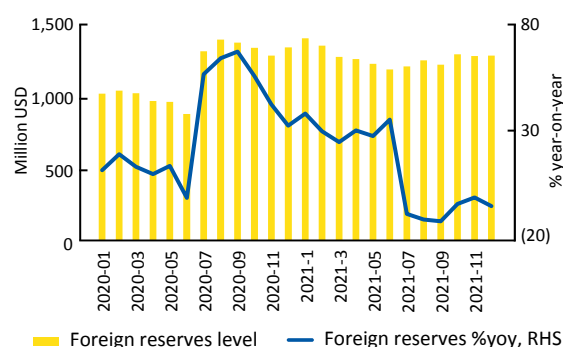
²¹ World Bank staff estimates.

²² Gross reserves include a currency swap agreement between the Bank of the Lao PDR and the People's Bank of China (PBoC). The 2019 agreement allows direct settlement in Chinese yuan or Lao kip for transactions under the current and capital accounts, according to PBoC. Net reserves (excluding swap) are estimated based on the assumption that the reserve level remains at the same level as before the swap.

the National Assembly in June 2022. This law is expected to bound foreign investors and traders to bring investment funds and export proceeds into the domestic financial system.²³ While the law aims to improve foreign currency liquidity and strengthen foreign exchange management, administrative measures are less likely to address underlying imbalances in the foreign exchange market than structural measures that boost exports and attract productive FDI.

Figure 33. Gross foreign reserves

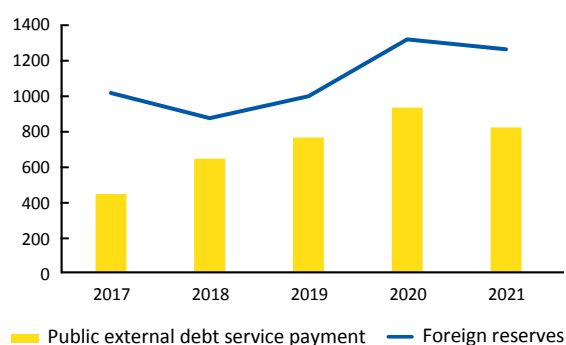
(Left axis: million USD; Right axis: year-on-year change)



Source: Bank of Lao PDR.

Figure 34. Gross foreign reserve and public debt service payments

(Million USD)



Source: Bank of Lao PDR and Ministry of Finance.

2.8 Exchange Rate

The kip continues to depreciate sharply, reflecting considerable external liquidity constraints despite significant debt service deferrals. Foreign currency liquidity shortages in 2021 and high forex demand for debt service and imports caused a demand-supply mismatch, widening the spread between the official and parallel market rates. The spread reached an all-time high of 20 percent in August-September 2021. In response, the Bank of Lao PDR allowed greater flexibility of the official exchange rate from September 2021 to better reflect market forces.²⁴ As a result, the official kip to USD rate depreciated by 19 percent in December 2021 (year-on-year) and 22 percent in February 2022, narrowing the premium to less than 2 percent. However, kip exchange rates in the parallel market sharply depreciated in March, widening the gap to nearly 15 percent in April.²⁵ The existence of a parallel market is associated with higher inflationary pressures.²⁶ A weakened kip fuels inflation and exacerbates external debt service costs since most debt is denominated in US dollars.

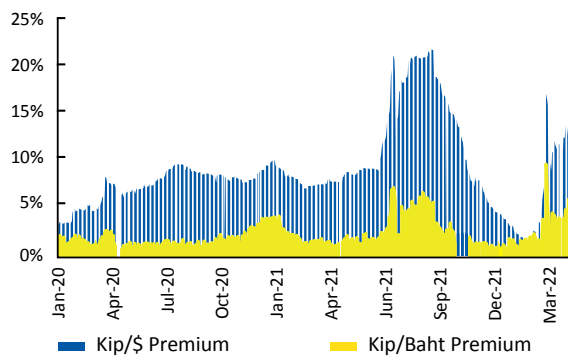
²³ After deducting external loan repayment expenses.

²⁴ In September 2021, the Bank of Lao PDR (BOL) allowed commercial banks and exchange bureaus to set their exchange rates to deviate from the BOL daily reference rate within ± 1.5 percent (BOL Agreement #525/BOL, 15 September 2021). This is compared to 0.25 percent in the previous regulation dated in 2018. In addition, the BOL instructed bureaus to register themselves under commercial banks of their choice with an aim to improve BOL's oversight and enforce bureau compliance. According to BOL's report to the National Assembly on November 4, out of 550 exchange bureaus, 419 were signed up with commercial banks.

²⁵ Information about the breakdown of foreign currency purchases between official and parallel market is not available.

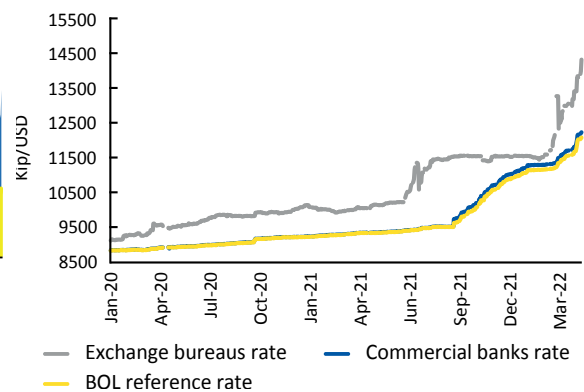
²⁶ Almost a fifth (28) of emerging and developing economies (EMDEs) now have active parallel currency markets, the highest number in over 20 years. Of the 20 countries with the highest inflation rates for 2021, more than three-quarters have parallel markets. See more information at <https://blogs.worldbank.org/developmenttalk/pitfalls-parallel-currency-markets-higher-inflation-and-lower-growth>

Figure 35. Parallel market premiums of kip/\$ and kip/baht
(Percent)



Source: Bank of Lao PDR and International Monetary fund.

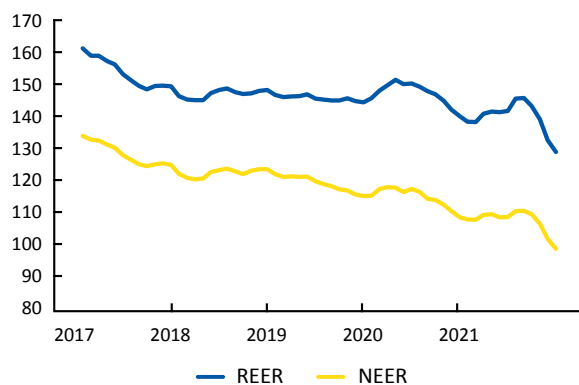
Figure 36. Kip/\$ depreciated sharply
(Kip per US\$1)



Source: Bank of Lao PDR and International Monetary fund.

The real effective exchange rate (REER) depreciated in line with trends in the nominal rate. The REER depreciated by 9 percent in January 2022 (year-on-year) compared to a depreciation of 5 percent in the same period last year. The depreciation of the REER, partly due to the depreciation of the nominal effective exchange rate, has reversed some of the appreciation trend observed before 2016 when there were large investment inflows into the resource sectors. The REER depreciation can boost export competitiveness, although adequate productive capacities are required to seize opportunities. However, a depreciation makes imports relatively more expensive and financial payments abroad more onerous.

Figure 37: Real effective exchange rate
(Index)



Source: <https://www.bruegel.org/publications/datasets/real-effective-exchange-rates-for-178-countries-a-new-database/>

Note: An increase in the index indicates an appreciation of the home currency against the basket of currencies of trading partners.

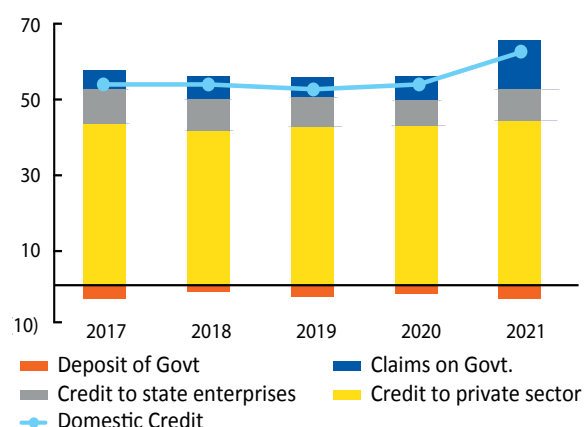


Photo: Shutterstock / maadoltee

2.9 Monetary and Financial Developments

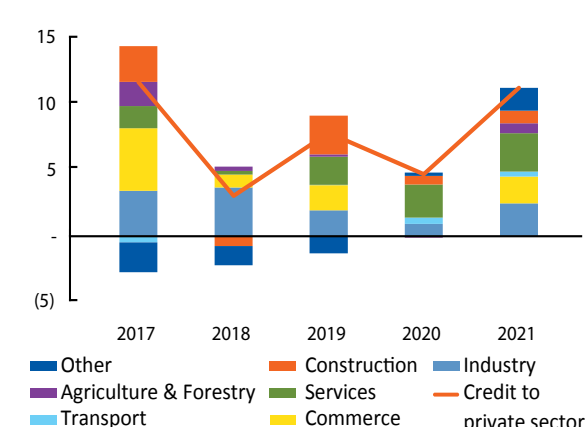
Monetary policy remains accommodative to support economic recovery. In July 2021, the Bank of Lao PDR reduced the reserve requirement rates, allowing banks to provide more loans.²⁷ Credit programs have also been established to support businesses, particularly small and medium enterprises (SMEs). In addition, forbearance measures have been put in place since 2020, including the postponement of interest and principal repayment. Meanwhile, there was also strong growth in lending to the government in 2021. As a result, domestic credit growth accelerated by 23 percent at the end of 2021 (year-on-year) compared to 8 percent in 2020. Private sector credit comprises mostly lending to the industry, commerce, and service sectors and lending to the government. Broad money increased by 24 percent in 2021, predominantly driven by foreign currency deposits, which increased by 33 percent. As inflation is rising, monetary policy is likely to face a dilemma between supporting the recovery and tightening to temper inflationary pressure.

Figure 38. Domestic credit to the economy
(Percent of GDP)



Source: Bank of Lao PDR.
Noted: SOE = State-owned enterprises

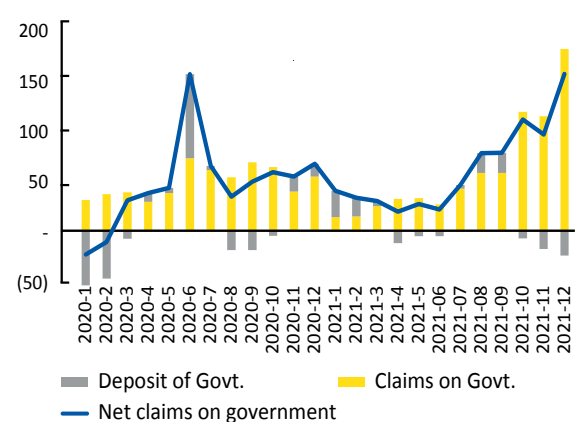
Figure 39. Credit by sector
(Percent year-on-year and contributions)



Source: Bank of Lao PDR.

The government has increasingly relied on the banking sector to finance the fiscal deficit and debt repayments. Net claims on government grew by 156 percent in December 2021 (year-on-year), largely driven by a rapid rise in the second half of 2021. These are in the form of holdings of government bonds (including triangle bonds) and lending to the government.

Figure 40. Net claims on government
(Percentage point contribution)



Source: Bank of Lao PDR.

²⁷ Reserve requirement rates were reduced from 4 to 3 percent for the kip and 8 to 5 percent for foreign currencies.



Photo: World Bank / Phoonsab Thevongsas

There were some improvements in terms of financial soundness, but vulnerabilities in the banking sector persist. The capital adequacy ratio (CAR) increased to 17.5 percent in Q4-2021, mainly due to capital replenishments in two state-owned banks that have been recently restructured, namely the Lao Development Bank and the Agriculture Promotion Bank.²⁸ However, the largest state-owned bank (Banque Pour Le Commerce Extérieur) experienced a notable decline in the CAR since 2020, which has fallen below the prudential minimum as of Q3-2021.²⁹ The ratio of non-performing loans to gross loans declined slightly to 2.2 percent in Q4, partly because banks are still not required to reclassify loans to COVID-affected customers and because of improved non-performing loan ratios in restructured banks. However, this could mask the varying levels of non-performing loans and CAR across banks. Profitability, as measured by return on equity and return on assets, picked up in Q4, indicating a recouping of revenues in some banks and improved financial conditions in the two restructured banks. However, return-on-assets remained below most regional peers. Balancing the phasing out of forbearance policies and the health of bank balance sheets is important to prevent vulnerabilities in the financial sector and help support the sector's contribution to an economic recovery.

Table 2. Selected financial soundness indicators

	Capital Adequacy	Asset Quality	Profitability	Solvency	Liquidity	Credit Expansion	Arrears
	Regulatory Capital to Risk-Weighted Assets (%)	NPLs to Total Gross Loans (%)	Return on asset (%)	Deposit to loan ratio (%)	Liquid asset (% short-term liability)	Domestic credit to private sector (% of GDP)	Firms in arrears or expect to fall in 6 months (%)
	2021	2021	2021	2021	2021	2021	2021
Indonesia	24	3	1.8	111	28	39	31
Cambodia	22	2	2.0	86	25	143	29
Thailand	20	3	1.0	91	34	135	
Malaysia	18	2	1.2	117	154	145	57
Lao PDR	17	2	0.6	147	81	46	
Philippines	17	4	1.5	132	50	52	79
China	15	2	0.6	113	59	205	
Vietnam	11	2	1.6	112	32	117	48
Myanmar	11	4	0.7	188	15	27	
Mongolia		8	-0.2	119	64	46	93

Source: IMF, Fitch Solutions, World Bank and national sources cited in East Asia and Pacific Economic Update April 2022. Note: Color scale represents country quantiles relative to the group of emerging markets and developing economies, with red denoting the worst exposure and green the least. For capital adequacy, the relative ranking is adjusted following Basel III requirements. Change denotes percentage change compared to the 2015-2019 average.

28 The new share structure in these two banks is: 30 percent held by the government, and 70 percent held by private companies.

29 This was because the decrease in profit of the bank after implementing the forbearance measures and continued an increase in regular lending, resulting in more risk-weighted assets.



Photo: World Bank / Phoonsab Thevongsa

3. Outlook and Risks

Box 1: Key assumptions for the baseline

Near-term assumptions

- COVID-19 vaccinations reach 80 percent of the population in 2022 as planned. The spread of the Omicron variant is contained to the first half of 2022 and the mortality rate is low. There is no reintroduction of stringent lockdown measures in 2022.
- Domestic tourism picks up gradually, facilitated by improved connectivity by rail and domestic flights. International tourism takes longer to pick up due to COVID-19 concerns and bureaucratic hurdles to enter Lao PDR.
- Recovery in key trading partners is subject to heightened uncertainty from the Russian-Ukraine conflict and tightened global financial situation. This is a risk that overshadows external demand for exports, which are expected to moderate. Improved connectivity (through rail and road connections) will benefit the transport and logistic sectors through increased bilateral and transit trade flows. However, the outlook is subject to the risk of slowed growth in main trading partners and China, the latter due to structural issues and its strict COVID-19 policy.
- Oil prices reach new highs as a result of the war in Ukraine. Higher commodity prices coupled with a continued depreciation of the kip will put pressure on inflation.
- Ongoing bilateral debt renegotiations provide some form of debt relief and partly ease fiscal and external pressures. Debt repayments resume as planned, while non-interest expenditure curbs continue. Revenues improve gradually as the economy recovers.

Medium-term assumptions

- Vaccination and booster coverage progress proceeds as planned. There are no major outbreaks of other variants.
- More gradual recovery in trading partner countries due to increased uncertainty. External demand will continue but at a more gradual rate given the lower-than-expected regional growth. International travel starts to slowly recover in late 2022. This will support the recovery of the service sectors.
- Improved transport connectivity and trade facilitation reforms will boost private investment in secondary infrastructure and productive sectors along the railway corridor.
- Revenue collection improves in the medium term as revenue-enhancing measures are implemented and compliance improves. As debt service obligations remain high, expenditure adjustment policies continue to be considered to achieve fiscal consolidation.

GDP growth is projected to accelerate to 3.8 percent in 2022, contingent on successful debt renegotiations.

Assuming that stringent containment measures are not re-introduced, a recovery in the service sectors will likely be supported by transport and logistics services (partly linked to the recent opening of the Laos-China railway and the opening of the Vientiane logistics park) and wholesale and retail activities. Transport and logistic services are expected to benefit from increased demand for merchandise exports and transit trade between China and other ASEAN countries.³⁰ Consumption will only recover gradually, owing to the economic damage induced by the impacts of the COVID-19 pandemic.³¹ Domestic tourism is expected to be revived with improved transport connectivity. The Laos-China railway plans to operate conventional trains in addition to the two existing high-speed electric multiple unit trains to meet growing passenger demand. International tourism will likely take longer to rebound. The Green Travel Zone Program for vaccinated visitors was introduced in January 2022, but the number of visitors was low in Phase 1 due to health concerns and bureaucratic hurdles.³² The outlook assumes that ongoing bilateral debt renegotiations will provide some form of debt relief, without which fiscal and external pressures would become insurmountable.



Photo: World Bank / Phoonsab Thevongsa

Industry and agriculture are expected to benefit from external demand, although at a more moderate level. The power sector is expected to provide important contributions to growth in 2022 due to sustained demand from Thailand and other neighboring countries. Additional generation capacity of 1,000 MW will come on stream this year. Meanwhile, mining sector growth is expected to moderate as increased iron ore and gold output will offset declining copper production. Manufacturing of food and beverages is likely to rebound, while some manufacturing exports (wood pulp, paper products) are expected to continue growing. Agriculture could benefit from strong external demand, but cross-border restrictions and traffic congestion at the Boten border may affect the export of fresh agriculture produce. High oil prices could have negative impacts on the recovery through rising production and operating costs.

On the demand side, recovery will be subdued by constrained public spending, offsetting some recovery in private investment and consumption. From the demand side, private consumption is expected to rebound to some extent but will still be lower than pre-pandemic levels given income losses in most households. Public consumption and investment will remain constrained, owing to the difficult fiscal situation and significant debt burden. Private investment in infrastructure (including roads, highways, power projects and special economic zones) and merchandise exports will provide an important stimulus to the economy, though subject to increasing external downside risks.³³ Nevertheless, higher imports, particularly with the impacts of higher oil prices, will partly offset these benefits.

30 A Thai rice shipment was recently delivered through the Laos-China railway. <https://www.bangkokpost.com/business/2250639/first-thai-rice-shipment-delivered-using-laos-china-railway>

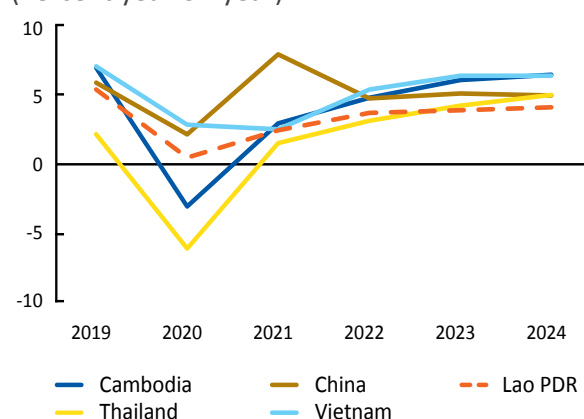
31 Mobility trends continued to improve until March 2022, suggesting a recovery in the services sectors. However, the pace is expected to be more gradual as the household survey in November 2021 shows that about 49 percent of actively working employees experienced a decline in income after the second wave of COVID-19 infections in April 2021, which may affect consumption into 2022.

32 According to Lao Youth Radio, the implementation of the Lao Green Travel Plan Phase 1 received 505 tourists from 26 countries through 18 travel agents.

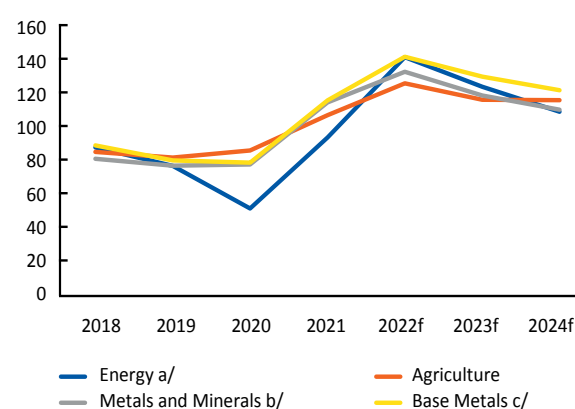
33 According to the Ministry of Public Works and Transport, national road upgrades include Road No. 9 and No. 13. Feasibility studies for upgrading Road No. 8 and 12 have been completed. Feasibility studies for six highways are ongoing. Source: <https://www.laophattananews.com/archives/126460>

Figure 41. Growth projections in neighboring countries

(Percent year-on-year)



Source: World Bank East Asia and Pacific Economic Update April 2022.

Figure 42. Commodity price outlook

Source: World Bank

Note: a/ Energy price index includes coal (Australia), crude oil (Brent), and natural gas (Europe, Japan, U.S.).
 c/ Includes aluminum, copper, lead, nickel, tin, and zinc.
 b/ Base metals plus iron ore.
 c/ Includes aluminum, copper, lead, nickel, tin, and zinc.
 f = forecast.

Rising fuel and food prices undermine the purchasing power of households and poverty reduction.

Rising global fuel prices and continued depreciation of the kip are translating into higher imported prices and cost-push inflation. While domestic labor market conditions are expected to improve gradually, long-term job losses and business closures induced by the COVID-19 pandemic will continue to put pressure on household incomes. Rising food and fuel prices undermine household purchasing power and food security. Without adequate relief measures, this will put many households at risk of falling into poverty. Compared to a non-pandemic scenario, the poverty rate (measured at the lower-middle-income poverty line of \$3.2 a day; 2011 purchasing power parity) is expected to increase by 2.5 percentage points in 2021.³⁴ The projections suggest about 180,000 additional poor in 2021 (i.e. those who were expected to be non-poor in 2021 before the pandemic but are now expected to be poor in 2021).

Fiscal space will remain limited in the near term, owing to low revenue collection and a high debt service burden. Stronger economic activity will support domestic revenue, but the recent reduction of the value-added tax rate from 10 to 7 percent will undermine a stronger performance. Improvements in revenue administration and higher excise rates on alcohol, fuel and luxury products can increase receipts, but gains in tax compliance and tax base expansion are likely to be gradual.³⁵ Total expenditure is anticipated to increase slightly owing to rising interest expenses, while other current and capital spending is likely to remain relatively contained. If past trends continue, interest payments will further crowd-out public resources available for education and health, which are critical areas for sustaining a growth recovery.

34 Projection using annualized elasticity (2012–2018), based on projected GDP per capita with pass-through = 0.7 for a COVID-19 pandemic scenario and pass-through = 1 for a non-pandemic scenario.

35 Recent revisions of the tax law introduced higher excise rates for several products, including alcohol, fuel and luxury products, while reducing the value added tax rate from 10 percent to 7 percent. However, amid the situation of rising international fuel prices, the government is reported to be considering extra support measures to help lessen the impact of high fuel costs on consumers.

In the absence of debt relief, meeting public debt service obligations will remain very challenging. The deteriorating public debt situation is a major concern, with external debt repayments averaging around \$1.3 billion a year over 2022–2025, which is about half of domestic revenue. Tighter global financial conditions and domestic macroeconomic vulnerabilities constrain access to international capital markets and financing options, despite the recent successful issuance in the Thai market in late March 2022. Limited foreign reserve buffers exacerbate external liquidity risks. Better fiscal and monetary management will support reserve accumulation. However, on the upside, a fast and effective implementation of planned revenue-enhancing measures and a positive outcome from the ongoing debt renegotiations could expand much-needed fiscal space for growth-enhancing expenditures.

The outlook is subject to several downside risks, including a deterioration of both domestic and global macroeconomic conditions. COVID-19 vaccination rates have improved, but the emergence of new variants could necessitate continued containment measures, undermining economic activity. Prolonged debt negotiations or a less favorable outcome could exacerbate liquidity and solvency risks. Earlier-than-expected monetary tightening in the advanced countries could put further pressure on kip depreciation and increase debt burdens. Tightening global financing conditions could limit financing options and investment inflows. Prolonged economic impacts of the war in Ukraine on commodity prices (especially fuel) and additional exchange rate depreciation could increase inflationary pressures. However, higher metal and agriculture prices could benefit some exports. A slower-than-expected economic recovery in key trading and investment partner countries may curtail external demand.

4. Policy Options

Restore macroeconomic stability

Restoring macroeconomic stability is an immediate priority to support growth recovery and shared prosperity. Top priorities to achieve this objective include (i) creating fiscal space, (ii) restoring debt sustainability, (iii) strengthening the financial sector, and (iv) creating an enabling business environment. These priorities should be coupled with measures to help households mitigate the impacts of the COVID-19 pandemic.

- **Creating fiscal space requires enhancing domestic resource mobilization and improving spending efficiency.** Fiscal consolidation should be driven by a sustained improvement in revenue collection, as prolonged expenditure tightening can have a negative impact on the recovery and medium-term growth. Key measures to support domestic revenue mobilization include (i) strengthening monitoring and management of large taxpayers; (ii) reviewing fiscal incentives and tax expenditures related to investment projects; (iii) expanding coverage of the tax information system (TaxRIS); and (iv) developing a comprehensive risk management plan and risk-based audits. Key measures to improve spending efficiency include (i) temporarily suspending public investment projects that require commercial external borrowing to reduce fiscal and debt burdens; (ii) ensuring that future public investments, including PPPs, are prioritized on economic grounds and tendered transparently and competitively; and (iii) strengthening the authority of the Ministry of Finance over borrowing, the issuance of guarantees, and PPP commitments. In addition, it is also important to strengthen the targeting of spending to support affected households and firms as well as protecting public spending on the social sectors to support stronger and more inclusive growth. In the medium-term, there is a need to strengthen tax policy and budget planning by streamlining fiscal incentives and concessions based on greater coordination among the Ministry of Planning and Investment, the Ministry of Finance, and the Bank of Lao PDR.

- Restoring debt sustainability by strengthening debt management and transparency.** Improving debt recording and reporting of public debt and contingent liabilities is a fundamental step for better understanding the full scale of debt obligations and developing an effective debt management strategy and borrowing plans. Building on efforts to improve debt transparency will be important to boost investor and creditor confidence. Debt restructuring can be pursued through discussions with bilateral creditors or through multilateral channels.³⁶ Limiting non-concessional borrowing and applying stricter cost-benefit analysis to investment projects will help gradually reduce the debt service burden and liquidity and solvency risks. In the medium-term, reforming financially-weak state-owned enterprises could reduce the fiscal burden and risk exposure.
- Strengthening financial sector stability requires putting in place legal and regulatory tools to manage sector vulnerabilities and improve transparency.** Key measures include (i) careful assessment and unwinding of forbearance measures to help prevent risks to bank balance sheets; (ii) establishing more transparent and disaggregated reporting practices to help better understand the current sector situation; (iii) more equitable application of the regulatory regime on the state-owned sector. An important basis for mitigating measures will be the development and effective enforcement of secondary legislation to support law implementation, including regulations on early intervention and problem-bank resolution. In the medium-term, reforms to strengthen the resilience of the financial sector include a transition to Basel II standards to increase capital buffers, adopt risk-based supervision, and establish an early-warning system for banking supervision.
- Policies to address macroeconomic vulnerabilities should be coupled with mitigation measures to help households navigate the impacts of the COVID-19 pandemic.** These include boosting agricultural production and strengthening the food supply chain. In particular, facilitating rural-to-urban agri-food chains would help mitigate the impact of price increases on the urban poor. Furthermore, facilitating job matching and migration to provinces where jobs are available and to neighboring countries would help workers return to the labor market. International remittances usually act as a mechanism for coping with income shocks, for example, because of price increases.
- Structural and business environment reforms will be needed to support economic recovery and improve resilience.** To maximize the benefits of improved transport connectivity through rail and roads and promote economic diversification, Lao PDR needs to facilitate the entry and growth of productive and export-oriented companies, both domestic and foreign, in agriculture, manufacturing, and services. This can be achieved by (i) reforming and streamlining business, trade and investment regulations and procedures; (ii) facilitating trade by lowering transport and logistics costs and moving toward electronic and risk-based cross-border processes; and (iii) supporting improved product quality, especially for exports of agricultural products that help households mitigate the impacts of the pandemic and hold significant potential for driving poverty reduction (see Part II: Unlocking the Potential of Regional Connectivity).

36 The G-20 Common Framework aims to provide comprehensive debt relief for developing countries.

Table 3. Key macroeconomic indicators

	2019	2020	2021	2022	2023	2024
				Projections		
Real Economy	Percent Change yoy					
Real GDP Growth	5.5	0.5	2.5	3.8	4.0	4.2
Agriculture	1.2	3.2	2.3	2.2	2.5	2.6
Industry	5.6	4.0	7.6	5.2	4.0	3.4
Services	6.9	-3.5	-2.2	2.9	4.4	5.7
Inflation (Period average)	3.3	5.1	3.8	6.0	5.5	5.0
Fiscal Account*	Percent of GDP					
Revenues	15.6	12.7	13.9	14.1	14.6	15.0
Domestic Revenue	13.8	11.2	12.4	12.8	13.3	13.9
Taxes	10.9	9.2	9.6	9.9	10.4	10.9
Non-Tax	2.9	2.0	2.8	2.9	2.9	3.0
Grants	1.7	1.5	1.5	1.3	1.3	1.1
Expenditures	18.8	18.0	15.4	17.0	17.2	17.4
Current Expenditure	12.6	11.5	10.8	12.3	12.4	12.5
Wages	6.4	6.2	6.0	6.0	6.0	6.0
Non-Wage, Non-Interest	4.5	3.8	3.6	3.7	3.7	3.7
Expenditure						
O/W Interest Payment	1.8	1.5	1.2	2.7	2.8	2.8
Current Expenditure without Interest	10.9	10.0	9.5	9.6	9.6	9.7
Capital Expenditure	6.2	6.5	4.6	4.6	4.8	4.9
Domestic Finance	2.6	2.0	1.9	1.9	2.0	2.1
Foreign Finance	3.6	4.5	2.7	2.7	2.8	2.8
Fiscal Balance	-3.3	-5.2	-1.4	-2.9	-2.6	-2.3
Primary Balance	-1.5	-3.7	-0.2	-0.2	0.1	0.5
Selected Monetary Accounts	Percent change yoy					
Braad money	18.9	16.3	24.0			
Credit to the economy	7.4	4.3	11.5			
Balance of Payments	Percent of GDP					
Current Account Balance	-12.1	-5.9	-3.2	-3.5	-4.9	-5.5
Trade balance	-7.9	-1.3	1.7	2.2	1.1	0.5
Export of G&S	37.6	35.2	42.1	48.6	50.2	50.7
Import of G&S	45.5	36.5	40.4	46.4	49.1	50.2
Primary Income: Net	-5.8	-5.9	-6.1	-6.9	-7.4	-7.4
Secondary Income: net	1.6	1.4	1.6	1.3	1.5	1.5
Gross Internation Reserves	997	1,319	1,263	1,282	1,313	1,334
Months of G&S Import Cover	1.4	2.3	2.0	1.9	1.8	1.7
Memorandum items						
Nominal GDP (Billion kip)	162,657	171,741	182,572	197,126	213,587	231,641

Source: Lao Statistics Bureau, Ministry of Finance, Bank of Lao PDR, Ministry of Industry and Commerce, World Bank staff estimate, and projections based on inputs from Lao authorities and trading partners' data as of March 2022.



Part B.

Thematic Section: Unlocking the Potential of Regional Connectivity



Photo: World Bank / Phoonsab Thevongsa

Key messages:

- Improved regional connectivity can transform Lao PDR from a land-locked to a land-linked country, and thus help diversify the economy, promote trade, and boost growth and welfare.
- Investment in large-scale transport infrastructure is risky because of high costs and uncertainties.
- Complementary reforms are vital to minimize risks and maximize economic benefits.

The dynamics of regional trade in northern Southeast Asia are expected to change, especially with the new railway connecting Vientiane to Kunming which started operation in December 2021. The north-south railway connects the country's capital of Vientiane with Boten at the northern border with China. The railway journey between Vientiane and Boten takes less than four hours, significantly less than the fifteen hours by car. The COVID-19 pandemic may also become a catalyst for strengthening long-term supply chain resilience within ASEAN and among ASEAN, China, and South Asia. Enhanced intra-regional trade would be assisted by improved land-based transport connections within each country and between adjacent countries.

The new railway in Lao PDR can create economic opportunities and support the aspirations of the country to transform from land-locked to land-linked. However, the Government of Lao PDR will need to overcome multiple and complex challenges to benefit from the new rail corridor. It will be important to improve multimodal transportation of railways vis-à-vis other economic corridors, particularly along the East-West axis. Investments would need to be complemented by bold policy actions to unlock trade and export potential through seamless cross-border transit, improved logistics and value chains, and further development of the productive sectors. The key challenge is to ensure that Lao PDR can fully benefit from improved regional connectivity, not only as a transit country but also through increased economic activities and export volumes, value-added services, and the creation of new and better jobs.

Lao PDR has a vision of transforming itself from a land-locked to a land-linked country through regional infrastructure development. Significant investments have been made to improve regional connectivity, including the Laos-China railway and some key road corridors linking with neighboring countries. One of such investments is a regional rail line under the Belt and Road Initiative which was launched in December 2021. The 414-km north-south railway connects the country's capital of Vientiane with the city of Boten at the northern border with China. The railway then continues with China's railway network to Kunming in Yunnan Province through another 595 km railway link. The railway journey between Vientiane and Boten takes less than four hours, significantly less than the fifteen hours by car. The train takes approximately another four hours from Boten to Kunming without considering border clearance times. Another major infrastructure investment is the Vientiane-Vang Vieng highway (the first section of the Vientiane-Boten highway), which has reduced the travel time between the two cities from 4 hours to just one hour. In addition, with the nodes between the north-south railway and the subregion's east-west road links on Lao territory, the improved east-west connectivity could also boost export opportunities among the countries in the

³⁷ This section focuses on regional transport connectivity based on major findings and policy recommendations of recent World Bank's studies (e.g. Kunming-Singapore railway, the East-West Economic Corridor, and highway networks crossing the country).

region and investment in multimodal logistics. For example, Lao PDR's National Road No. 2 (NR2), a section of Asian Highway No. 13 (AH13), is one of the east-west corridors in Southeast Asia connecting Lao PDR with Thailand and Vietnam in the north of the country. The Master Plan for ASEAN Connectivity (MPAC) 2025 identified the NR2 section of AH13 as an investment priority for east-west regional connectivity. Lao's 9th National Socio-Economic Development Plan (NSED) has set economic corridor development as a priority element of the country's growth strategy, under the slogan 'From land-locked to land-linked.'

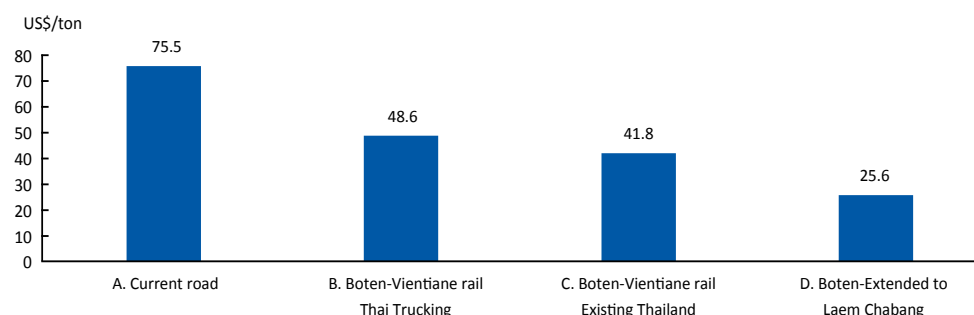
The success of regional connectivity investments will depend on their ability to increase trade flows, reduce transport costs, and achieve economies of scale in the logistics sector. Regional connectivity provides Lao PDR with a vital land link to global and regional supply chains, which could make the country more attractive to investors, create new jobs, and accelerate economic growth and exports. However, this will not happen automatically. It comes with risks and requires that policymakers implement critical reforms to improve the business environment and facilitate well-targeted complementary infrastructure investments. Therefore, Lao PDR will only benefit from these investments if the quality of road infrastructure connecting to areas with economic potential, including agriculture, tourism, and others is improved and efficiency-enhancing measures to attract transit trade are adopted. This would increase trade volumes, reduce average costs, and increase the viability of rail services. The slow pace of business environment reforms is a challenge. Speeding up reforms is necessary to ensure that full benefits from the efficiency of improved regional connectivity are captured.

1. Improved regional transport connectivity can be transformational, create trade opportunities, attract foreign direct investment, boost growth, and improve welfare

Enhanced regional connectivity could significantly lower land transport costs for trade. Assuming efficient cross-border processes, rail connectivity could reduce transport costs between Vientiane and Kunming by 40–50 percent, a reduction of about \$30 per metric tonne. The railway is expected to reduce transport costs between the Port of Laem Chabang in Thailand and Kunming by 32 percent if efficient trucks are used; by over 40 percent if cargo is trans-shipped to the Thai meter gauge rail tracks once cargo reaches Vientiane; and by over 50 percent if cargo continues on the new standard gauge railway in Thailand all the way to Laem Chabang Port. Finally, the railway is expected to reduce transport costs by 20–40 percent for trade within Lao PDR, depending on the location of production facilities and goods.

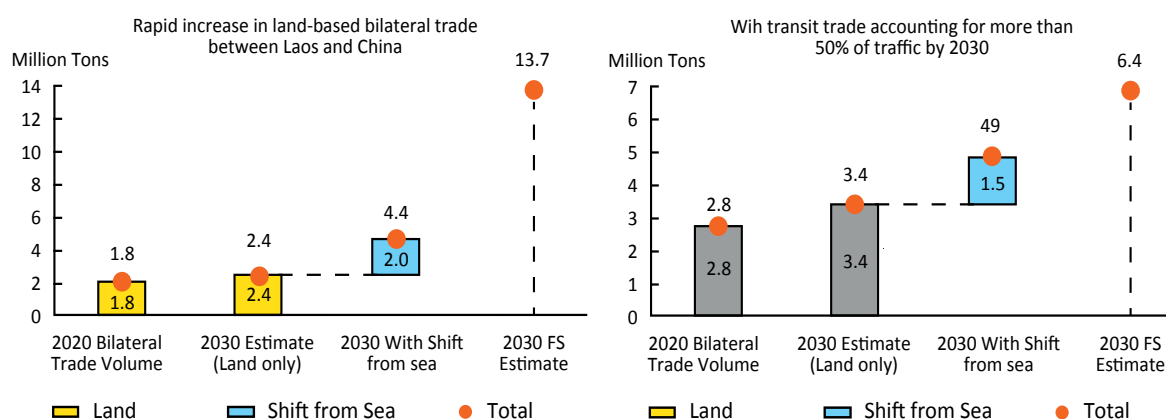


Photo: World Bank / Phoonsab Thevongsa

Figure 43. Estimated rail transport costs for the transit trade between Laem Chabang and Kunming

Source: World Bank (2020). From Landlocked to Land-Linked: Unlocking the Potential of Lao-China Rail Connectivity. Vientiane: World Bank.

Improved regional connectivity could boost bilateral and transit trade by attracting some traffic currently using maritime and air transport routes. Trade between China and Thailand, Malaysia, and Singapore totaled around 55 million tonnes in 2020, of which only 5 percent (or around 2.8 million tonnes) were transported through Lao PDR and the remaining 95 percent by sea. Bilateral trade between China and Lao PDR totaled around 5 million tonnes in 2020, of which approximately 37 percent (or around 1.8 million tonnes) were transported by land and the remaining 63 percent by sea.³⁸ The railway presents a transit opportunity for Lao PDR to capture a portion of the maritime trade between China and these three ASEAN countries. It could increase trade flows between China and Lao PDR from 1.8 million tonnes in 2020 to 4.4 million tonnes by 2030, of which 2 million tonnes would shift from maritime transport to rail (Figure 44).³⁹

Figure 44. The regional connectivity is expected to create trade opportunities through lower transport costs and increased efficiency

Source: World Bank staff estimates.

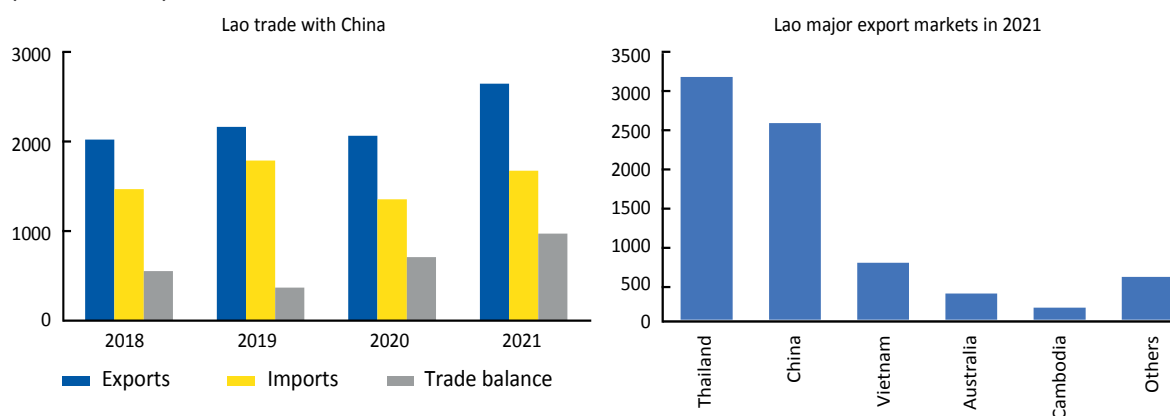
38 Based on UN Comtrade data for 2020, where the mode split is estimated from the China's Customs data of 2016.

39 The diagrams show the bilateral (land-based) trade volume between China and Lao PDR; and the land-based trade between China and Thailand, Malaysia, and Singapore which transits through Lao PDR.

East-West connections running through Lao PDR have the potential to not only stimulate intra-regional commerce between Lao PDR and its neighbors and boost the weighting of Lao exporters in the subregion's trade. Existing transport connections in northern Southeast Asia are primarily north-south oriented, including the National Road 13, the new railway, and the new expressway. With the nodes between the north-south railway and the subregion's east-west road links located on Lao territory, Lao PDR's improved east-west connectivity could also boost export opportunities among the countries in the region and investment in multimodal logistics. Lao PDR's 9th National Socio-Economic Development Plan (NSED) has set economic corridor development as a priority element of the country's growth strategy, under the slogan 'From landlocked to land-linked'.

This enhanced connectivity is expected to increase Lao exports in the region. Land connectivity creates the potential for diversifying export markets and products and services within and across sectors. External trade is largely concentrated within the region, as exports to the top three trading partners (Thailand, China, and Vietnam) accounted for over 80 percent of the total exports in 2021. China recently became Lao PDR's second-largest trading partner (after Thailand) and presents a large market for exports. Exports to China increased by 28 percent to about \$2.6 billion in 2021, from \$2 billion in 2020 (Figure 45). The country has maintained a trade surplus with China during the last few years (about \$706 million in 2020 and \$974 million in 2021). The primary export commodities to China are minerals (copper and copper concentrates, metal, and other ores), wood pulp, paper board, and agricultural products (rubber, fruits and nuts, live animals, rice, maize, cereals). Most export-oriented agricultural products are produced in the northern provinces, mainly alongside the rail and highway corridors. Land connectivity creates the potential for diversifying export markets and products and services within and across sectors. External trade is largely concentrated within the region, as exports to the top three trading partners (Thailand, China, and Vietnam) accounted for over 80 percent of the total exports in 2021. Lao PDR is expected to benefit from its strategic location in the regional corridor and attract significant volumes of transit freight and tourists between China and other ASEAN countries.

Figure 45. Connectivity would promote Lao bilateral trade with countries in the region
(Million USD)



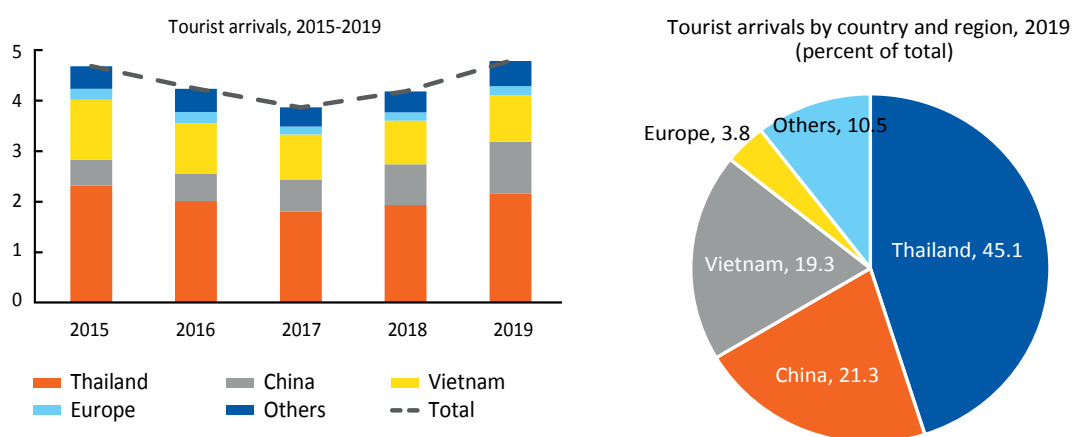
Source: International Monetary Fund Direction of Trade Statistics and Lao trade partner data.

The tourism industry could benefit from passenger rail and road traffic, especially from China, Thailand, and other countries in the region. Lao PDR is surrounded by a large regional tourist market. In 2018, tourism to Asia grew by 8 percent, a significant increase in comparison with the global average of 6 percent, while inter-Asian tourism grew even more at 10 percent. China was a major driver of growth in the region and is expected to boost Lao PDR's tourism, especially with improved transport connectivity. The number of tourists from Lao PDR's three large neighbors

(Thailand, China and Vietnam) accounted for about 86 percent of total arrivals in 2019 (Figure 46). The number of tourist arrivals is expected to rebound after the pandemic subsides, partially supported by enhanced regional connectivity. The tourism sector has been severely affected by the COVID-19 pandemic since early 2020 and is still struggling to recover. As the country is planning to open up in the near future, the government agencies concerned should, therefore, focus on how to ensure that new transport infrastructure (especially the railway) is attractive to passengers. This will require: (i) swift and simple border clearance procedures to minimize delays; (ii) adequate roads and public transport facilities and interconnections at rail stations; (iii) attractive local infrastructure, including hotels and restaurants around tourist attractions; and (iv) user-friendly booking arrangements for the railway and entry procedures.

In addition, increasing private investment in nature-based tourism (NBT) could support sustainable tourism.⁴⁰ Lao PDR has a comparative advantage in tourism in its landscapes and wildlife, large natural capital, globally significant biodiversity and forest cover and outstanding natural ecosystems, such as the wet evergreen forest tracts within the Annamite mountain range, the Indochinese karst formations of the southern central region, and the montane forests of Xieng Khuang and Borikhamxay Provinces. These unique biodiversity values are further augmented by world-class caves, rivers, and waterfalls. This wealth can be mobilized for green tourism and with the right strategy in place, NBT has the potential to be a major driver of socially and environmentally sustainable development and rural poverty reduction.⁴¹

Figure 46. Lao PDR's tourist arrivals before the pandemic
(Million Visitors)



Source: Ministry of Information, Culture and Tourism.

Greater regional connectivity can promote foreign investment, especially along the railway corridor. Foreign direct investment (FDI) in Lao PDR has increased significantly in the past decade (from \$2.3 billion in 2014 to about \$3.8 billion in 2018, before moderating during the COVID-19 pandemic). The majority of FDI flowed to capital-intensive sectors such as infrastructure development (especially hydropower and transport), but increasing levels of FDI are focusing on light manufacturing, agriculture (including agro-processing), and services. FDI in manufacturing is mostly in special economic zones in Vientiane Capital and Savannakhet, and a newly established zone in Champassack, and mostly targeting exports. Agricultural investments are dispersed

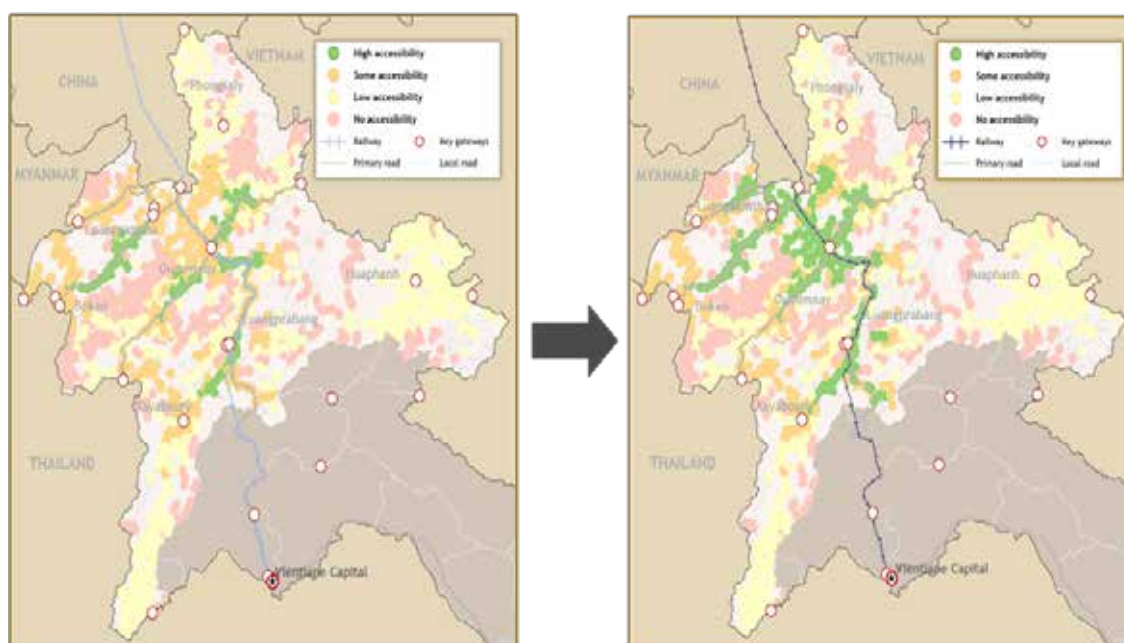
⁴⁰ Lao PDR prioritized nature-based tourism in its 2030 National Green Growth Strategy approved in 2019.

⁴¹ A survey of selected comparison destinations indicates that heritage-rich destinations that adopt tourism as a priority can achieve significant and sustainable economic development. This view is backed by a quantitative case study in southern Lao PDR that shows clear poverty reduction impact from well-managed visits to a national protected area.

throughout the country, while services tend to focus on urban centers including Luang Prabang, Vientiane Capital, Bokeo and Champassack. Improved connectivity has opened up new opportunities for large private investments, especially along the railway corridor to develop new trade and service centers and industrial parks, and to make commercial land available along the railway corridor and stations to allow for further FDI development (e.g., Boten Green City, Vientiane Logistics Park, AMATA Smart and Green City (Nateuy/Luang Namtha, Oudomxay).

Logistics services are still at a very early stage of development. If regional trade volumes passing through Lao PDR increase, there is potential for a positive spillover effect on local economic activity (Figure 47). However, it depends on the capacity and competitiveness of logistics services to take up the demand. There is currently no operator that can offer integrated multimodal transport services and the logistics market is dominated by local providers that mainly offer traditional services. There is limited availability of value-added services, such as integrated door-to-door multimodal transport, container leasing, inventory management, order fulfillment, purchase order management, or cold chain services.

Figure 47. Regional Connectivity's contribution to the accessibility of agricultural production



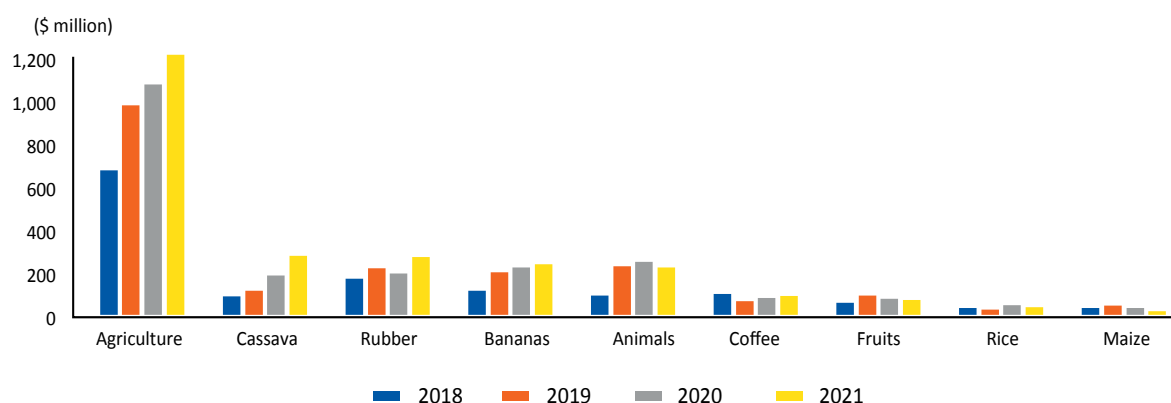
Source: World Bank (2021). Lao Transport Corridor Connectivity Assessment.

Regional connectivity and integration offer good prospects for the agriculture sector, especially in the northern region. Lao PDR can take advantage of greater transport connectivity to stimulate agriculture exports where demand is growing for high-quality, consumer-safe, and environmentally sustainable foods and agriculture products. Agricultural production and exports in the northern region have grown significantly in the past five years, as a result of improved transport infrastructure connecting local production centers to border checkpoints and strong demand from China. In 2021, Lao PDR exported \$1.2 billion of agricultural products (about 80 percent were exported to China) with the four top agricultural products being bananas, rubber, cassava and live animals valued at \$274 million, \$270 million, \$235 million and \$222 million respectively (Figure 48). The Lao government has signed fourteen agricultural export agreements with China.⁴² The recent

42 This includes maize, bananas, cassava, rice, watermelons, sweet potatoes, common beans, mung beans, yard long beans, passion fruit, oranges, pomelos, lemons and cattle. Another long list of 88 prioritized crops has been prepared by the Ministry of Agriculture and Forestry for further negotiation.

expansion in agriculture exports has been supported partially by Chinese investments in agribusinesses in the northern provinces. Lao PDR's agricultural exports to Thailand and Vietnam have also increased significantly in recent years from \$209 million in 2020 to \$273 million in 2021 and from \$104 million to \$186 million respectively.

Figure 48. Robust agricultural exports, 2018–2021



Source: Ministry of Industry and Commerce, International Monetary Fund Direction of Trade Statistics and trading partner data.

Improved connectivity is expected to reduce poverty, particularly in the northern region. Poverty reduction has been supported by improved connectivity and trade with neighboring countries. Unlike in the central and southern regions, urban poverty in the northern region halved between 2012 and 2018. A rapid drop in poverty in northern provinces was driven by progress in urban areas and dynamism in the non-farm sector. Public infrastructure and foreign investment also boosted local economies and generated nearly 40,000 jobs in urban areas. Rural poverty also decreased. Agricultural commercialization also plays an important role in rural poverty reduction. Farmers in the northern region tend to allocate more of their land to non-rice crops compared to other regions and increasingly shifted toward high-value crops such as cardamom. Income from growing tea also significantly increased, to the point that very few tea-farming households remained poor in 2018. Farming households benefited from cross-border trade through their participation in cash crop contract farming, and employment on large plantations. The agriculture sector, especially smallholder farmers, could benefit from the improved connectivity and lower transport costs by (i) moving toward contract farming, which generally uses improved production technologies and inputs, (ii) establishing agricultural value chains to neighboring markets (China), (iii) developing agricultural processing factories and smallholder livestock farms, and (iv) taking the opportunity of increased domestic demand for local agricultural products.

2. Investment in large-scale infrastructure development is risky because of high costs and uncertainties

Large investments in developing infrastructure could pose considerable macro-fiscal risks. The cost of infrastructure development is high, at about \$5.9 billion for the Laos-China railway and the proposed new Vientiane-Vung Ang railway at about \$5 billion.⁴³ Granting government guarantees

⁴³ The railway is a proposed line that the Lao and Vietnamese governments have agreed to jointly develop. It would enable landlocked Laos to access the deep sea port of Vung Ang, the closest feasible seaport to Vientiane. A feasibility study on the 554 km railway has been completed. The construction of the Vung Ang seaport in Vietnam's central Ha Tinh province is expected to begin by end-2022.

to infrastructure development projects (under PPP) will increase contingent liabilities. Granting generous tax incentives to large infrastructure development projects will also continue to seriously undermine the government's ability for revenue mobilization. Revenue loss from tax exemptions is significant and a large part of it (around 60 percent of the total loss) comes from large infrastructure development and resource projects.

There are still gaps in Lao PDR's transport infrastructure to fulfill the role of regional connector. While many of the regional road corridors in Lao PDR still do not meet the Asian Highway Standard, a large part of the domestic road network remains in poor condition and vulnerable to climate change impacts. Given the public debt situation, the limited fiscal space has now become a concern for infrastructure development. Therefore, the prioritization and proper due diligence of investments are crucial.

Infrastructure developments may pose social and environmental risks.⁴⁴ Infrastructure developments could involve or generate potential risks and impacts on the environment and local people.^{45, 46} This requires national and sectoral capacity in place to manage the risks and impacts of the infrastructure projects in a systematic manner, proportionate to the nature and scale of the project and the potential risks and impacts. A set of national legal frameworks is in place, mainly applicable for environmental and social impact assessment (ESIA) for infrastructure development projects. These include the Environmental Protection Law of 2013 and its supporting instruments (Decree on Environmental Impact Assessment updated in 2019 and Decree on Compensation and Resettlement 2016, and Land Law 2019). However, implementation is uneven, mainly due to the current limited institutional capacity in law reinforcement and compliance monitoring, weak transparency and accountability mechanism and inter-ministerial coordination that need to be further strengthened. Furthermore, some gaps and inconsistencies are also observed across these pieces of relevant legislation which mainly focus on downstream impact assessment rather than upstream risk management to avoid, minimize, and mitigate the impacts and enhance the sustainability of infrastructure projects. Past performance raises some concerns in this regard. There have been a series of official studies and anecdotal evidence on risks and impacts associated with past and ongoing infrastructure projects including pending grievances resulting from resettlement processes and compensation, and poor enforcement of environmental regulations. As tourism and investment along the railway corridor is likely to expand, and influx of people (tourists, workers) is also expected and risks associated with this development needs to be managed carefully, especially in light of the pandemic and economic downturn.

Underdeveloped logistics services and a lack of competition constitute another challenge. Unlocking the logistics services industry through improved competition can help increase Lao PDR's participation in global supply chains. The under-development of the logistics services industry is due to limited competition in the domestic market, partly due to restrictive, complex, and unevenly applied regulations. Restrictions on entry and ownership and lack of regulatory clarity make it challenging for new operators to enter the market. Instead of one integrated market for transport services, geographical factors (such as the distribution of the population and agricultural

44 These risks may be related to pollution, biodiversity loss, forest loss, and hydrologic changes, whereas social risks due to infrastructure development can include economic and physical displacement from the taking of land and assets, impacts on disadvantaged, vulnerable, or groups with special rights; impacts on quality of life; degradation of labor and working conditions; and community health, safety and security.

45 Asher, S., Garg, T., Novosad, P. 2018. The Ecological Impact of Transportation Infrastructure. Policy Research Working Paper No. 8507. World Bank, Washington, DC. World Bank. <https://openknowledge.worldbank.org/handle/10986/29980> License: CC BY 3.0 IGO

46 Pfaff, A., Robalino, J., Walker, R., Aldrich, S., Caldas, M., Reis, E., Perz, S., Bohrer, C., Arima, E. and Laurance, W. 2007. Road investments, spatial spillovers, and deforestation in the Brazilian Amazon, *Journal of Regional Science*, 47(1): pp. 109–23.

production) result in a segmented market. There are also challenges associated with the inability or unwillingness of operators to compete for work on new routes. Restrictions on ownership, minimum capital requirements, and a complex operating environment (e.g., overregulation and inconsistently applied regulations) have limited entry into the international freight transport sector. Domestic operations are usually outsourced to already dominant domestic operators, further limiting effective competition and innovation.

The efficiency and effectiveness of border clearance processes have been affected by the COVID-19 pandemic. Since the emergence of COVID-19 in early 2020, Lao PDR's trade supply chains have faced significant disruption. Border clearance systems were less resilient than expected and the need for compliance with strict health measures led to delays. This situation highlighted the need for stronger public-private sector coordination through the National Trade Facilitation Committee, improved change management and communication strategies, and better use of existing information and communication and technology facilities and electronic data exchange. Likewise, challenges experienced on both sides of the border demonstrated the need for greater cross-border cooperation between Lao PDR and regional trading partners. The pandemic also highlighted that the full capacity and functionalities of the Automated System for Customs Data (ASYCUDA) and the Lao PDR National Single Window (LSNW) have not been used. Authorities still required paper-based documents to be submitted and processed in parallel with electronic processes contributing to further delays and disruptions during the height of the pandemic. The border risk management system was not adequately responsive because risk profiles have not been updated frequently enough and do not currently cover all border management agencies

Agricultural value chains face critical challenges to maximize their efficiency, competitiveness, and potential for growth. Agriculture value chains are fragmented and characterized by weak organization, which contributes to higher transaction costs and lower profitability, incomes, and quality of jobs. In general, agricultural value chains have large numbers of isolated producers, poorly capitalized intermediaries and processors, and relatively few agribusinesses with the capacity to invest in improved technologies (including digital and other innovations), modern production infrastructure, and processing equipment. Consequently, all segments of the value chain (production, aggregation, processing, and distribution) lack organization and scale, limiting commercialization and realization of higher agricultural incomes. The absence of formal commercial relationships among value chain actors has led to farmers, agribusinesses, and intermediaries (traders, marketers, transportors and logistics entities) being unable to effectively link to one another to gain access to markets and transfer the knowledge and innovations necessary for improving quality and adding value domestically.

Agricultural value chains are not well organized to comply with safety standards for participation in trade protocols with major trading partners.⁴⁷ Farmers and producers are not able to follow good quality and phytosanitary standards due to (i) limited capacity and knowledge; (ii) lack of full adoption of Good Agriculture Practices and organic farming, and overuse of chemicals in farms; (iii) challenges and high costs for local authorities and some buyers to provide training and have producers adopt recognized agricultural standards due to fragmented and small-scale farming; (iv) insufficient training and technical extension services by agriculture departments. Compliance with international food safety standards and traceability remain critical factors to expand agriculture exports, including to China. Support to smallholder farmers to mitigate the impact of the pandemic has been limited, especially for exports of fresh agricultural products to neighboring countries such as China in late 2021.

47 World Bank (2019). Background report "Food safety issues in Agriculture Value chains in Northern Lao PDR."

3. Complementary reforms to minimize risks and maximize potential economic benefits

3.1 Macro-Fiscal

To reduce macro-fiscal risks associated with the development of large connectivity projects, critical tax reforms are needed. Tax conditions for investors should be systematic, rather than ad hoc and based upon objective economic criteria, time-bound, limited in scope and scale. The Government of Lao PDR needs to strictly implement the Public Debt Management Law and other debt-related regulations to contain public debt and contingent liabilities from large infrastructure developments in the country.

Given the past experience with PPPs in Lao PDR and their impacts on the fiscal situation and contingent liabilities, PPPs must be treated with caution. PPPs can pose a significant fiscal risk, either explicitly or implicitly. A bad project from a societal perspective will remain a bad project, whether it is implemented through a traditional or a PPP modality. PPPs, therefore, need to be subject to the same robust due diligence as any other public investment project. Initial identification of potential PPPs should be based on development policy priorities and demonstrated public value, and a competitive and transparent procurement process should be applied to maximize benefits from private sector financing.

Making transport investment climate resilient to optimize its lifecycle value can help ease fiscal pressure in the long run. The current road maintenance planning practice is year by year, yields a sub-optimal lifecycle value due to climate events, and lacks incentives for the contractor to perform quality construction and carry out efficient routine maintenance. Investing in climate resilient roads and proper maintenance can reduce the need to perform emergency repairs, which in turn reduces budgetary needs. In fact, the budget for maintenance mainly comes from the Road Fund, which is generated from the fuel levy. Increases in the fuel levy and involvement of the private sector in road asset management would be cost-effective strategies for improving road asset quality. Moreover, the increased transport, logistics, and trade efficiency supports the growing economic activities, which will, in turn, contribute to the recurrent revenue for the road sector through the Road Fund.

3.2 Transport Connectivity

Addressing transport connectivity gaps is key to ensuring access to production and consumption centers. There is a need to improve roads that connect the railway with various trade corridors, which would also help agricultural production reach both domestic and export markets more, in a shorter time and with lower transport costs. Climate-resilient roads can greatly improve access for agricultural production in Lao PDR. In addition, more consolidation activities could reduce logistics costs, especially for smallholders. The improved regional connectivity will attract more tourists which will, in turn, promote the local economy and employment.

It is also critical to ensure that an effective multimodal transport strategy is in place and implemented. Lao PDR enacted a Multimodal Transport Law in 2013, but it is not yet effectively implemented. Road transport has been the dominant mode, covering 90 percent of all transportation in Lao PDR. However, local capacity constraints are hindering the shift to a multimodal approach. While public administration and the implementation of national socioeconomic development plans are decentralized, provincial capacity remains weak, and coordination and collaboration among agencies are ineffective. To capitalize on developments in the transport sector, strong coordination among infrastructure departments, economic departments, and private sector actors is required.

3.3 Logistics Industry Development

Appropriate domestic logistic facilities can greatly improve the efficiency of cargo consolidation, especially for Lao's agricultural produce. Logistics facilities such as dry ports, inland container depots, and consolidation facilities can help Lao PDR tap into the regional corridors and the global supply chains. These consolidation activities are best managed by private operators, and the regulatory framework needs to ensure that private operators can operate competitively and at scale. Out of nine locations for international logistics parks and dry ports, three dry ports have been developed through a public-private partnership (PPP) approach by the Government: Savannakhet dry port (in operation since 2016), Thanalaeng dry port (expected operation in 2022), and Pakse dry port (expected operation in 2022). Future dry port locations along the railway are in Luang Prabang, Muangxai, and Natuey. Private sector developers have shown interest in the development of dry ports and logistics parks, but it is important to have competitive and transparent PPP transactions for such developments to maximize benefits.

To effectively use the railway for domestic and international freight transport, regulatory reforms are needed to simplify market entry and remove operational barriers in the logistics sector. Given limited expertise among domestic operators, the skills and know-how of foreign firms are needed to improve the country's logistics industry. To address the current entry barriers, the government should simplify existing regulations and ensure they are applied consistently. For example, the need for a business proposal to obtain an operating license should be removed, and ownership restrictions for international transport operators should be reviewed. In addition, authorities need to ensure a transparent and competitive process for determining the management of logistics facilities. To allow inland clearance, there is a need to clarify the customs status of dry ports and establish a legal regime for the movement of containers within Lao PDR. The newly established competition authority could evaluate whether the anti-competitive behavior of existing operators has a negative impact on competition.



Photo: World Bank / Aiden Glendinning

3.4 Trade Facilitation

Despite significant progress made on improving trade processes in the past decade, Lao PDR still lags behind regional peers and has considerable room for improvement.⁴⁸ To support the economic recovery and maximize the benefits of regional connectivity (rail and road), key reforms should focus on (i) strengthening institutional change management, communication capacities, and interagency coordination structures; (ii) moving toward a fully paperless regulatory environment for customs and trade operations including submission, processing, clearance, and release of cargo; (iii) fully implementing all World Trade Organization Trade Facilitation Agreement measures and standards; (iv) further reviewing and streamlining nontariff measures including undertaking associated regulatory impact assessments before issuing new regulations; (v) implementing risk-based selectivity through the Joint Risk Management Framework signed by border agencies in December 2021; (vi) building trust and stronger consultation between the trading community and customs and other border agencies; and (vii) improving voluntary trade compliance by creating incentives for high compliance traders, including providing access to the Authorized Economic Scheme to appropriately qualified traders.

Comprehensive reforms are needed to address trade facilitation challenges while establishing an effective transit management regime. The customs system needs to allow imports and exports to be cleared at inland ports to reduce delays at border crossings. Lao customs and other border agencies also need to radically change their methods and operating procedures to meet government mandates. There needs to be careful planning and coordination across government agencies regarding border clearance procedures and the overall regulatory framework. To facilitate trade and improve the ability of public agencies to achieve policy objectives with limited resources, authorities need to establish an integrated risk management system, simplify procedures for nontariff measures and border clearance, and use the automatic customs system by removing the need for paper-based customs declarations. Additionally, the government should establish an efficient transit regime, for example, by not requiring control standards for goods in transit if there is no contamination risk or streamlining guarantee mechanisms for transit trade, which is needed to improve the competitiveness of the trade corridor.

3.5 Business Environment

The Government of Lao PDR needs to speed up ongoing reforms of the investment climate to improve the country's competitiveness and attractiveness for global FDI. Lao PDR's complex and opaque business environment and excessive barriers to regional trade and integration limit the attractiveness of the country as an investment destination. Policymakers need to carefully design and plan special economic zones along the railway to ensure they contribute to a competitive business environment. Due to its small market size, domestic and foreign businesses are likely to invest in Lao PDR only if there is regulatory and legal certainty, and they can produce at scale and link into nearby larger and more dynamic markets offering significant opportunities to benefit from external demand for goods and services leading to job creation.

⁴⁸ According to the Time Release Studies, the average time taken to complete border clearance for imports, exports and transit has been reduced significantly from 11 hours and 27 minutes in 2012, to 5 hours and 7 minutes in 2020, a reduction of border clearance time of 55 percent. This was achieved through regulatory and operational reforms and through the automation of customs procedures. For imports, the average clearance time was reduced by 57 percent, 37 percent for exports, while 5 percent increased for transit.

Improving agriculture value chains would increase exports and benefits from connectivity

Specific reforms are needed to improve agriculture value chains and promote high-value agricultural products for domestic and export markets. The government would need to undertake long-term value chain development approaches. Agricultural zoning economic scale production and enhanced farmer organization can facilitate the adoption of new production technology to meet high quality standards and requirements for export markets. Strengthening the agriculture regulatory framework is key to attracting private (FDI) investment and promoting agribusinesses. Involving smallholder farmers in FDI in agriculture will help them gain knowledge in agricultural farming and trading and promote market-led, high-quality products for export.

Developing nature-based tourism would promote sustainable tourism and green growth in Lao PDR

The government can attract more private investment in nature-based tourism by reducing barriers, streamlining regulations, and promoting innovation. It would require establishing regulations and procedures for tourism concessions in protected areas and other natural landscapes, with a focus on creating best-practice concessions that support wildlife protection and village partnerships. It is important to (i) support the marketing and promotion of a national nature-based tourism brand, (ii) improve links between domestic and international businesses, (iii) encourage voluntary sustainability practices in the private sector through solutions like international certification, and (iv) provide vocational training on nature-based tourism innovation, market development and hospitality, including training for local guides and accommodation providers. It is also critical to effectively manage protected areas and other natural landscapes for sustainable tourism.

3.6 Social and Environmental

Global experiences show that infrastructure development often results in unaccounted environmental and social impacts.^{49, 50} In Laos, it has been estimated that the annual environmental and social costs of hydropower is US\$ 45 million per year or about 0.33 percent of the country's GDP in 2017.⁵¹

Application of the environmental and social impact assessment (ESIA) system is recommended to be continued to assess and mitigate the impacts of infrastructure investment projects and to support green and sustainable growth. ESIA can help elucidate a broad range of potential social and environmental impacts including livelihood disruption, marginalization of vulnerable groups, biodiversity loss, deforestation, and flooding, evaluate alternatives, and design and implement appropriate mitigation measures. The government has made good progress on ESIA system reform, however, there is room for improvement, particularly on the enforcement front. The number of ESIA conducted has grown since 2012, and a review of the ESIA database showed that in 2018, about 61 percent of projects that required environmental compliance certificates (ECCs) had conducted ESIA or developed an environmental and social management and monitoring

49 Asher, S., Garg, T., Novosad, P. 2018. The Ecological Impact of Transportation Infrastructure. Policy Research Working Paper No. 8507. World Bank, Washington, DC. World Bank. <https://openknowledge.worldbank.org/handle/10986/29980> License: CC BY 3.0 IGO

50 Pfaff, A., Robalino, J., Walker, R., Aldrich, S., Caldas, M., Reis, E., Perz, S., Bohrer, C., Arima, E. and Laurance, W. 2007. Road investments, spatial spillovers, and deforestation in the Brazilian Amazon. *Journal of Regional Science*, 47(1): pp. 109–23.

51 Sánchez-Triana, E. 2021. Environmental Challenges for Green Growth and Poverty Reduction: A Country Environmental Analysis for the Lao People's Democratic Republic. World Bank, Washington, DC. <https://openknowledge.worldbank.org/handle/10986/36266> License: CC BY 3.0 IGO

plan.⁵² However, there is room for improvement as in 2018, 28 percent of major infrastructure projects, including road and bridge construction, obtained ECCs without an ESIA or an environmental and social management and monitoring plan.⁵³ To continue improving the ESIA system, the government is recommended to focus on strengthening the ESIA Decree (2019) and the enforcement capacity of key technical agencies in light of the revised Environmental Protection Law which will be finalized by the end of 2022. These include improving coordination among key agencies during the screening, scoping, reviewing, approving, implementing and monitoring stages of the ESIA for investment projects, promoting public participation in the ESIA review process and improving disclosure information.⁵⁴ In addition, the government should consider including environmental protection provisions in laws and policies critical to the economic interests of current and future investors.⁵⁵

Cumulative impact assessments and sector strategic environmental assessments are also recommended to be developed to catch up with growing investments in the country. As the rail and other economic corridors develop, cumulative impacts may result from concurrent investment projects that require different measures for social or environmental impact mitigation. A Cumulative Impact Assessment (CIA) is an instrument that considers the cumulative environmental and social impacts of a project in combination with impacts from other relevant past, present and reasonably foreseeable developments, and therefore is strategic to assess the development impacts along the rail and other infrastructure corridors. The CIA is promoted in the national legal framework for environmental regulation and broadly discussed in the EIS Decree 2019, but CIAs have had limited application in Lao PDR and this has been for the hydropower sector. Since there are no official government guidelines for undertaking CIAs, developing these should be a priority followed by development of sectoral guidelines for undertaking CIAs. The government has prioritized strategic environmental assessment development in seven sectors, including transport and agriculture, but the preparation should be accelerated to guide developments around the rail and other economic corridors. Lessons learned and experiences on environmental and social impact assessment and risk management from donor financed projects are expected to inform and contribute to developing and strengthening legal and institutional frameworks to manage the environmental and social risks and impacts associated with the development projects and the National Economic Development Plans.⁵⁶

52 Ibid.

53 Sánchez-Triana. 2021.

54 Ibid.

55 Ibid.

56 These include World Bank and other DP financed projects, such as Lao Environmental and Social Project (LENSII, 2006-present), Nam Theun 2 Hydropower Project (2005–2017), and Lao Road Sector Project (2008-ongoing).



UNLOCKING THE POTENTIAL OF REGIONAL CONNECTIVITY



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