

INTERNATIONAL MONETARY FUND

# Structural Reforms to Lift Growth

Lao People's Democratic Republic

Weining Xin and Liangliang Zhu

SIP/2026/023

IMF Selected Issues Papers are prepared by IMF staff as background documentation for periodic consultations with member countries. It is based on the information available at the time it was completed on January 27, 2026. This paper is also published separately as IMF Country Report No 2026/051.

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**Structural Reforms to Lift Growth: Lao People's Democratic Republic**  
**Prepared by Weining Xin and Liangliang Zhu (APD)**

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**ABSTRACT:** Against the backdrop of improved macroeconomic stability and Lao People's Democratic Republic (Lao PDR)'s ambition to achieve upper-middle-income (UMI) status by 2035, this paper examines the impact of structural reforms on Lao PDR's growth outcomes. The analysis documents the significant structural gaps in Lao PDR relative to upper middle-income countries (UMICs), especially in governance, business regulations, labor market and human development. These gaps suggest there is substantial scope for structural reforms in Lao PDR to catch up with its aspirational peers and boost potential growth. Cross-country evidence suggests that structural reforms significantly boost output over time, with a persistent positive impact which cumulates over time. Thus, implementing ambitious structural reforms—to strengthen governance, improve the business environment, and promote human development—to close structural gaps with UMICs would deliver large growth gains, especially over the medium term, and help Lao PDR achieve its development goal in a sustainable manner.

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Author's E-Mail Address:	<a href="mailto:WXin@imf.org">WXin@imf.org</a> ; <a href="mailto:LZhu2@imf.org">LZhu2@imf.org</a>

SELECTED ISSUES PAPERS

# Structural Reforms to Lift Growth

Lao People's Democratic Republic

Prepared by Weining Xin and Liangliang Zhu<sup>1</sup>

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<sup>1</sup> We thank Angana Banerji and Rupa Dutttagupta for helpful comments and Anne-Charlotte Paret Onorato for sharing the data and codes.





# LAO PEOPLE'S DEMOCRATIC REPUBLIC

## SELECTED ISSUES

January 27, 2026

Approved By  
**Asia and Pacific  
Department**

Prepared By Weining Xin and Liangliang Zhu (APD)

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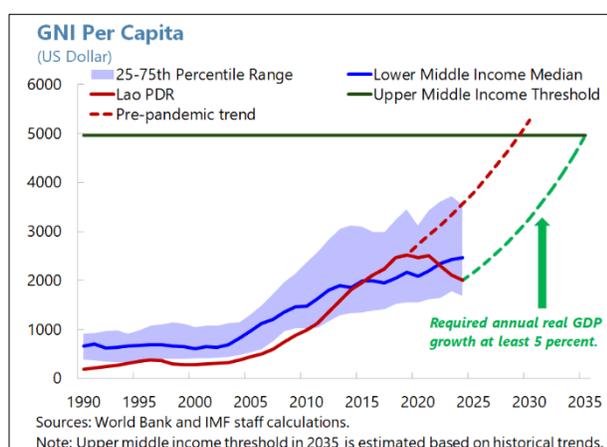
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## STRUCTURAL REFORMS TO LIFT GROWTH

Against the backdrop of improved macroeconomic stability and Lao PDR's ambition to achieve upper-middle-income (UMI) status by 2035, this paper examines the impact of structural reforms on Lao PDR's growth outcomes. The analysis documents the significant structural gaps in Lao PDR relative to upper middle-income countries (UMICs), especially in governance, business regulations, labor market and human development. These gaps suggest there is substantial scope for structural reforms in Lao PDR to catch up with its aspirational peers and boost potential growth. Cross-country evidence suggests that structural reforms significantly boost output over time, with a persistent positive impact which cumulates over time. Thus, implementing ambitious structural reforms—to strengthen governance, improve the business environment, and promote human development—to close structural gaps with UMICs would deliver large growth gains, especially over the medium term, and help Lao PDR achieve its development goal in a sustainable manner.

### 1. The government's overarching goal is for Lao PDR to achieve UMI status by 2035.

While on track to meet this goal before the pandemic, the pandemic and external shocks have eroded GNI per capita, requiring growth of at least 5 percent annually to achieve this goal by 2035.<sup>1</sup> The draft 10<sup>th</sup> National Socio-Economic Development Plan (NSEDP) sets a growth target of 6 percent annually for 2026–30. The pre-pandemic growth strategy comprising unsustainable expansionary fiscal and monetary policies led to debt distress and double-digit inflation, reducing policy space for economic support. As Lao PDR continues to stabilize its economy, it is critical to set policy priorities that can lay the groundwork for durable high growth without jeopardizing economic stability.



**2. Ambitious structural reforms would be essential to lift growth significantly and sustainably.** Under the baseline forecasts which assume unchanged policy, growth is expected to moderate to some 3 percent over the medium term, reflecting slower labor force and productivity growth due to continued outward skilled labor migration. Given limited policy space and an economy already operating at above potential, macrostructural reforms are the most effective way to boost growth sustainably and lay a stronger foundation for achieving ambitious development goals over the medium to long term.

**3. This paper examines the potential output gains from structural reforms.** It starts with assessing Lao PDR's current structural gaps and then provides cross-country empirical evidence on

<sup>1</sup> The population growth projections follow those in the medium fertility variant in the 2024 [World Population Prospects](#).

growth dividends from structural reforms. It concludes with estimations of the output gains in Lao PDR from ambitious reforms aimed at closing the structural gaps.

## A. Current Structural Gaps

**4. As a first step, structural indicators are calculated for each of the following areas—governance, external sector, business regulation, labor market, and human development—following Budina et al. (2023).** Composite indicators are constructed as simple averages of corresponding components, sourced from the [Worldwide Governance Indicator Database](#), the [Fraser Institute Economic Freedom Database](#), and [UNDP](#).<sup>2</sup> All composite indices and sub-indices are scaled from 0 to 1, with higher values indicating stronger structural fundamentals.

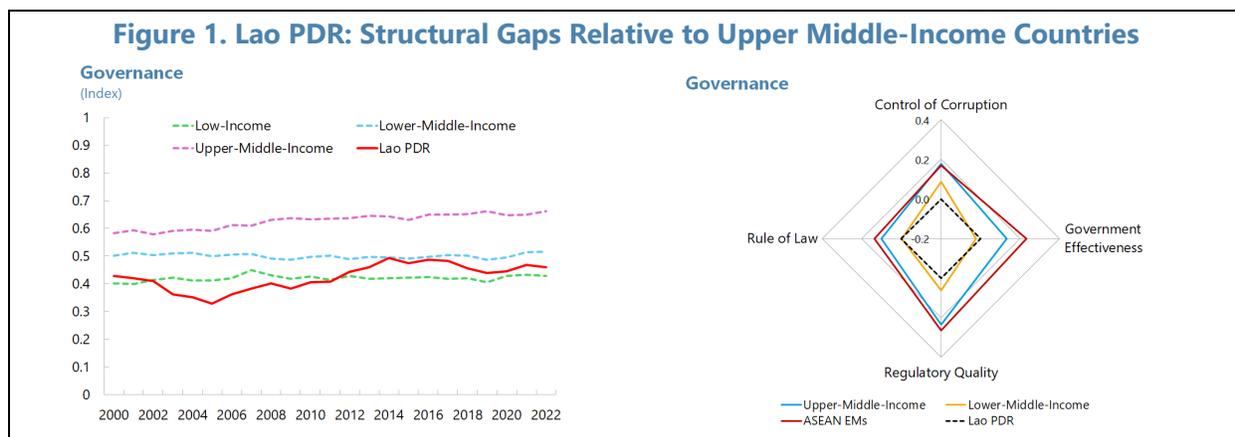
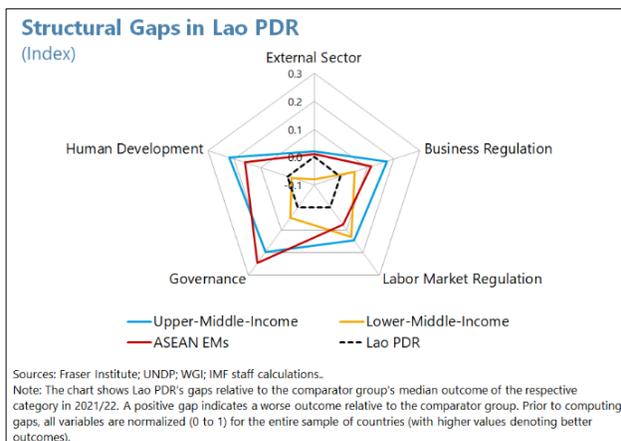
- *Governance.* The governance index is computed as the simple average of four indices from the [Worldwide Governance Indicator Database](#): (1) control of corruption, which captures perceptions of the level of corruption; (2) government effectiveness, which measures quality of public services, policy formulation and implementation, as well as the degree of independence from political pressures; (3) regulatory quality, which captures the ability of governments to formulate and implement regulations that can promote private sector development; and (4) rule of law, which captures the extent to which market participants feel confident in the protection of property rights, the quality of contract enforcements, and law enforcement.
- *External sector.* The external sector index is a composite indicator capturing the degree of economic freedom in trade and external finance reforms—it describes the extent to which countries can freely exchange goods and services. It is computed as the simple average of four components from [the Fraser Institute Economic Freedom Database](#): (1) tariffs, which aim to measure the extent to which tariffs constitute barriers to trade freely internationally (tariff revenues, tariff rate and volatility of tariffs); (2) nontariff trade barriers; (3) parallel market exchange rate, which aims at capturing the disparity between official and the parallel exchange rates; and (4) the control of the movement of capital and people, which encompasses a country's degree of financial openness, openness to visitors, and whether capital controls are in place.
- *Business regulation.* The business regulation index is a composite indicator measuring the extent to which regulations and bureaucratic processes might hamper private sector activity by restricting entry and reducing competition. It is computed as the simple average of three components from [the Fraser Institute Economic Freedom Database](#): (1) bureaucracy costs, which measure the risk of business operations becoming more costly due to regulatory environment; (2) administrative requirements, which measure the extent to which reporting, or the issuance of permits and licenses, can be burdensome; and (3) impartial public administration, which accounts for the degree of nepotism and discrimination in public administration.

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<sup>2</sup> See Budina et al. (2023) for details. Credit market index is also considered in Budina et al. (2023), which comprises three components: (1) ownership of banks; (2) private sector credit; and (3) interest rate controls. The annex does not analyze this index.

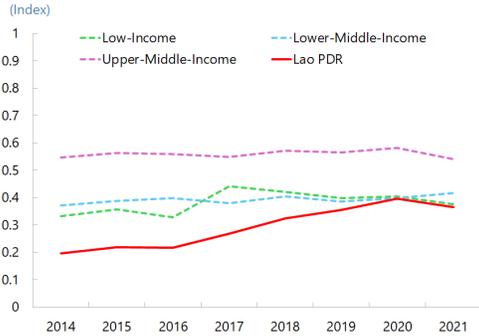
- Labor market.** The labor market regulation index is a composite indicator measuring the extent of labor market flexibility. It is computed as the simple average of two components from [the Fraser Institute Economic Freedom Database](#): (1) hiring and firing regulation—with a higher degree of labor market flexibility associated with hiring and firing decisions being flexibly determined by the employer, rather than constrained by employment protection legislation; and (2) centralized collective bargaining—a higher degree of labor market flexibility is associated with wages being set by individual companies, rather than by a centralized bargaining process.
- Human development.** The human development index is a composite indicator summarizing achievement in key dimensions of human development constructed by [UNDP](#): a long and healthy life, being knowledgeable and having a decent standard of living. It is computed as the simple average of three components: (1) life expectancy at birth; (2) average years of schooling for adults aged 25 and above years and expected years of schooling for children of school entering age; and (3) gross national income per capita.

**5. Lao PDR faces significant structural gaps in governance, business regulation, labor market regulation, and human development, relative to upper-middle-income countries (UMICs).** Governance outcomes improved during the 2000s, but have remained broadly flat since mid-2010s, scoring below the average of lower-middle-income countries (LMIC) and UMIC (Panel Figure 1). Business regulation outcomes have improved since mid-2010s but continue to score below the LMIC average. The gap in labor market is large, with Lao PDR even substantially below its current peers, the LMICs. While broadly in line with its current peers, Lao PDR’s human development outcomes remain well below those of UMICs. By contrast, Lao PDR’s external sector outcomes are relatively favorable—close to the UMIC average and above LMIC average—though they have softened recently. These gaps suggest that there is significant scope for Lao PDR to improve structural fundamentals to align with its aspirational peers, UMICs.

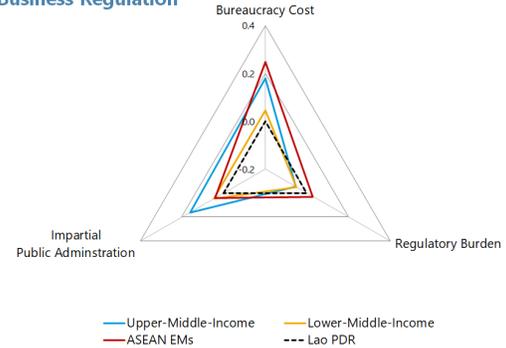


**Figure 1. Lao PDR: Structural Gaps Relative to Upper Middle-Income Countries (concluded)**

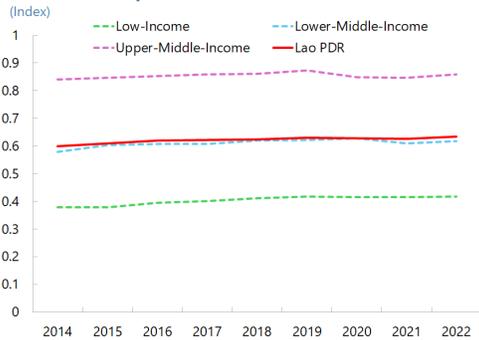
**Business Regulation**



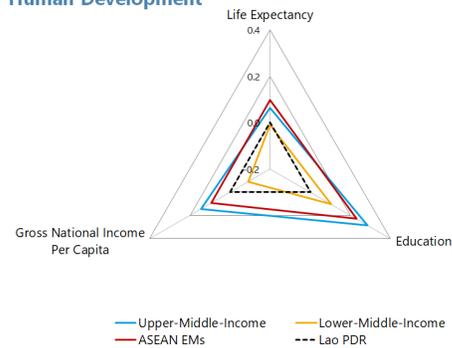
**Business Regulation**



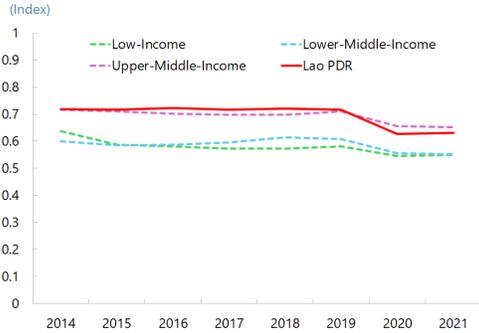
**Human Development**



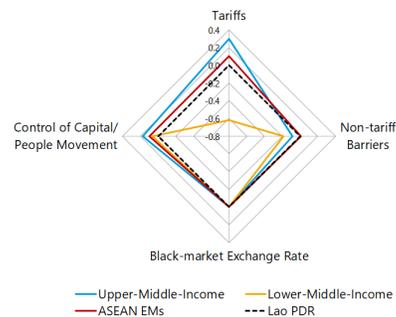
**Human Development**



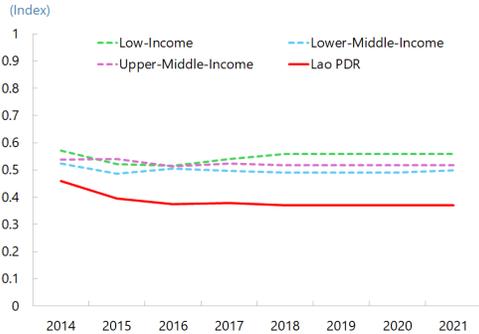
**External Sector**



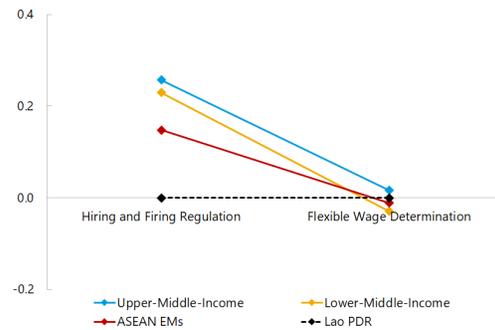
**External Sector**



**Labor Market**



**Labor Market**



Sources: Fraser Institute; UNDP; WGI; IMF staff calculations.

Notes: The chart shows Lao PDR's gaps relative to the comparator group's median outcome in the respective category in 2021. A positive gap indicates a worse outcome relative to the comparator group. Prior to computing gaps, all variables are normalized (0 to 1) for the entire sample of countries (with higher values denoting better outcomes).

## B. Cross-Country Evidence on Output Gains from Structural Reforms

**6. The impact of key structural reforms on output is examined empirically in a cross-country sample using a local projection method.** Following the methodology in Budina et al. (2023), a local projection method by Jordà (2005) is deployed to examine the impacts of structural reforms on output over time.<sup>3</sup> The local projection method looks at many past reform episodes (i.e., when structural indicators change their values) and examines how much output grew in the years following changes in the structural indicators relative to the output in the year before reforms. The analysis focuses on potential gains in output from *major* structural reforms, defined as episodes during which the relevant structural indicator improved by two standard deviations of the distribution. To better tailor the analysis to Lao PDR's growth objectives, the sample comprises middle-income (including both upper- and lower-middle income (LMI)) and low-income countries and spans the period between 1996 and 2022 based on data availability.

**7. The results suggest that reforms in governance, external sector, business regulation, and human development all boost output in the full sample of middle- and low-income countries.** Panel Figures 2 plots the estimated impact on real output of reforms in each area, except for labor market which plots the impact of reforms on employment. The blue lines show the estimated impacts of a major reform—which leads to an annual improvement of the structural indicator by two standard deviations of the distribution—based on the whole sample, including middle- and low-income countries. The red lines show the estimated impact based on the sample of lower-middle income countries only, the group which Lao PDR currently belongs to. For the group of middle- and low-income countries, all structural reforms, except for labor market reforms, are found to have a positive and significant effect on real output (Text Table). These results are in line with the findings in Budina et al. (2023) which focuses on emerging markets and developing economies.

- Reforms to improve governance and human development have an immediate impact, boosting output by about 1.5 and 5 percent in the year of “reform” (i.e., when the structural indicators improved). The impact accumulates over time, to 2 and 6 percent after six years for governance and human development reforms, respectively. Although reforms implemented in LMICs are estimated to yield smaller positive effects—likely because of weaker implementation capacity and quality—the impacts remain substantial, around 1.5 and 4.5 percent over the medium term for governance and human development respectively.
- External sector reforms are also found to have an immediate impact on output, with effects gradually attenuating over the medium term.

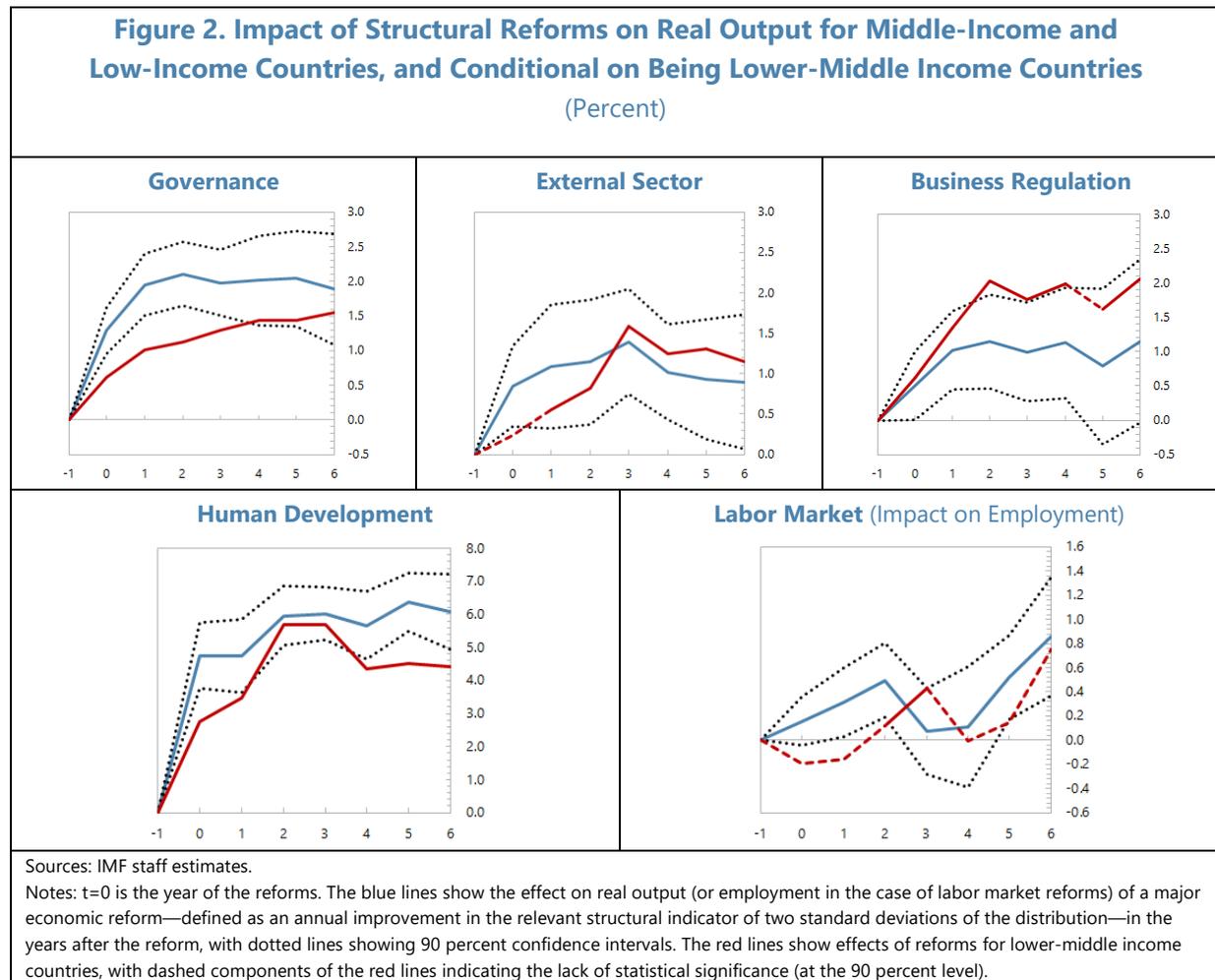
<sup>3</sup> The local projection method estimates the regression  $y_{i,t+h} - y_{i,t-1} = \alpha_h + \beta_h Reform_{i,t} + \gamma'_h X_{i,t-1} + \mu_i + \tau_t + \epsilon_{i,t+h}$ , where  $i$  denotes country,  $t$  denotes year,  $h$  denotes the horizon over which impacts are assessed;  $\mu_i$  is the country fixed effect,  $\tau_t$  is the time fixed effect, and  $X_{i,t-1}$  are controls including lagged output growth.  $\beta_h$  is the response of output  $h$  years after the reform.

- Business regulation reforms have a more gradual impact over the years in the whole sample. Importantly, the impacts are much larger in LMICs, boosting output by as much as 2 percent over the medium term.
- Despite being positive, the impacts of labor market reforms are found to be somewhat mixed, probably due to the measurement issues related to employment and the high level of informality across many emerging markets and developing countries.<sup>4</sup>

**Text Table 1. Impact of Structural Reforms on Real Output**  
(Percent of GDP)

	Year 0	Year 6	Average Year 0-2	Average Year 3-6	Average Year 0-6
Governance	1.29	1.89	1.79	1.98	1.90
LMICs only	0.62	1.56	0.92	1.43	1.21
External sector	0.85	0.90	1.03	1.06	1.05
LMICs only	0.24	1.15	0.54	1.32	0.99
Business regulation	0.51	1.15	0.89	1.02	0.96
LMICs only	0.62	2.06	1.33	1.86	1.63
Human development	4.76	6.08	5.16	6.03	5.66
LMICs only	2.74	4.42	3.97	4.74	4.41
Labor market	0.07	0.31	0.06	0.08	0.07
LMICs only	0.01	-0.31	-0.18	-0.66	-0.45

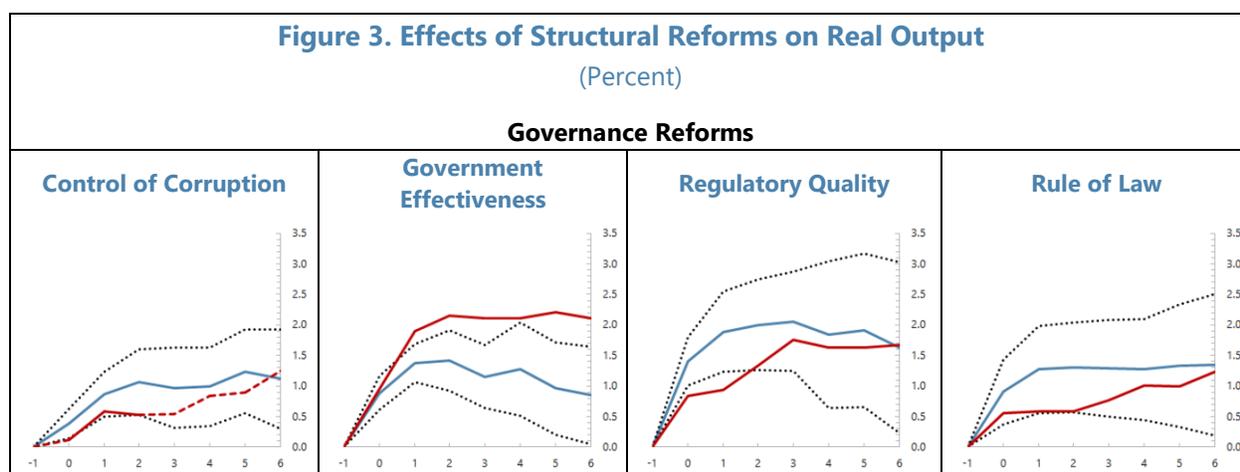
Sources: IMF staff estimates.



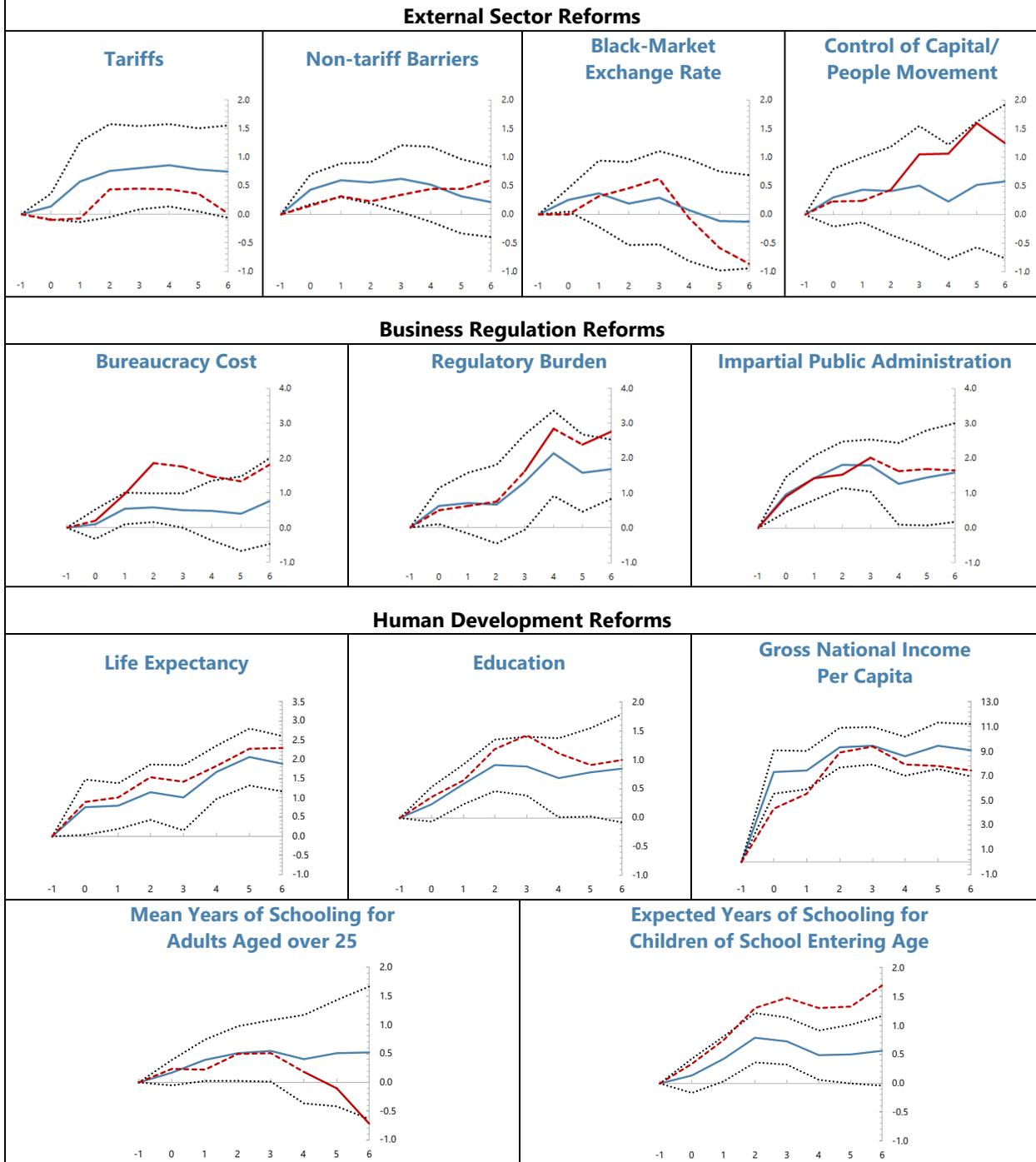
<sup>4</sup> Budina et al. (2023) also found that, while positive, the effect of labor market reforms on employment appears to be statistically insignificant.

**8. Zooming in on granular structural indicators, the results suggest possible priority areas of reforms for Lao PDR.** The results are based on estimations based on the full sample, as well as for LMICs in particular.

- **All governance reforms yield sizable growth dividends.** The immediate impact of improving regulatory quality is large, boosting output by as much as 2 percent after one year. Improving government effectiveness and rule of law also yields immediate growth dividends (about 1.5 percent after one year). The impact of controlling corruption grows over time. Notably, enhancing government effectiveness benefits LMICs more, with the medium-term output impact almost double the impact based on the whole sample.
- While **all external sector reforms have positive growth effects** there is some degree of heterogeneity. The impact of reducing non-tariff barriers is immediate, while those of reducing tariffs tend to accumulate over time. Liberalizing the movement of capital and people is particularly beneficial for LMICs over the medium term.
- As for business regulation reforms, **reducing bureaucracy and improving impartial public administration have immediate positive impacts on output, while reducing regulatory burden boosts output over the medium term.** Reducing bureaucracy is particularly beneficial for LMICs.
- **Human development reforms generally yield broad and sustained positive effects on output.** Impacts of improvements in health tend to accumulate over time. Similarly, better education outcomes, measured by the average of mean years of schooling for adults aged 25+ and expected years of schooling for children of school entering age, deliver growth dividends over time. Importantly, the positive impacts from improving health and education outcomes are particularly large in LMICs.



**Figure 3. Effects of Structural Reforms on Real Output (concluded)**  
(Percent)



Sources: IMF staff estimates.

Notes: t=0 is the year of the reforms. The blue lines show the effect on real output (or employment in the case of labor market reforms) of a major economic reform—defined as an annual improvement in the relevant structural indicator of at least two standard deviations of the distribution—in the years after the reform, with dotted lines showing 90 percent confidence intervals. The red lines show effects of reforms for a lower-middle income country, with dashed components of the red lines indicating the lack of statistical significance (at the 90 percent level).

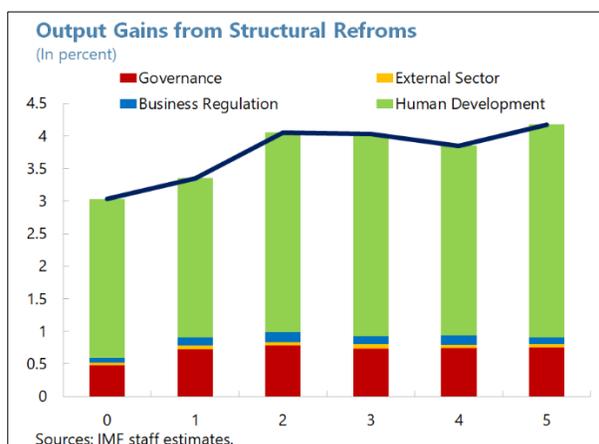
## C. Growth Dividends for Lao PDR from Ambitious Structural Reforms

### 9. Implementing ambitious structural reforms to gradually close structural gaps with UMICs could yield significant growth dividends in Lao PDR, especially over the medium term.

If structural reforms on governance, external sector, and business regulations aimed to close 10 percent of the structural gaps relative to the UMIC average—Lao PDR's aspirational peers by 2035—and 5 percent of the structural gap on human development, there could be substantial output dividends. Output could be boosted by more than 3 percent in the year of reforms improving structural indicators, assuming all the reforms are implemented together, and more than 4 percent over the medium term. The proposed

pace of structural improvements is below the 80<sup>th</sup> percentile of the historical distribution of annual improvements in structural reform indicators amongst LMICs and is therefore feasible in Lao PDR. Consistent with evidence across all country groups, the output gains from reforms primarily come from improvements in human development, for which the Lao PDR's structural gaps relative to UMICs remain large, followed by governance reforms. Thus, even if reforms were prioritized and undertaken in

stages, improvements in human capital followed by those in governance would yield strong output gains, both immediately and over the medium term. Moreover, strengthening governance would not only bolster productivity and growth but also lay the foundation for sustained improvements in policy management, which is critical for ensuring macroeconomic stability over the long-term.



## D. Conclusions

### 10. Ambitious structural reforms—especially in human development, governance, and the business environment—are essential for Lao PDR to lift medium-term growth and sustainably move toward its goal of reaching UMI status by 2035.

The current sizable structural gaps—especially in governance, business regulation, and human development—relative to its aspirational peers (UMICs) suggest substantial scope for strengthening structural fundamentals of Lao PDR's economy to boost output. Cross-country evidence shows that well-designed structural reforms in these areas can deliver large and persistent output gains, with particularly strong dividends from investments in human capital and improvements in governance. Ambitious but feasible reforms that gradually narrow these gaps could lift output by more than 3 percent in the year of implementation and over 4 percent in the medium term, offering a sustainable approach to achieving the authorities' development goals while ensuring macroeconomic and financial stability in light of limited policy space. Prioritizing reforms that raise education and health outcomes, strengthen public-sector effectiveness and regulatory quality, control corruption, reduce bureaucratic and regulatory burdens, and safeguard openness would not only boost growth, but also underpin more effective policy management and a more resilient and sustainable trajectory of development.

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