

INTERNATIONAL MONETARY FUND AND
THE INTERNATIONAL DEVELOPMENT ASSOCIATION

LAO PEOPLE'S DEMOCRATIC REPUBLIC

**Interim Poverty Reduction Strategy Paper
Joint Staff Assessment**

Prepared by Staffs of the International Monetary Fund and
the International Development Association

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I. INTRODUCTION

1. The government of the Lao People's Democratic Republic (P.D.R.) has developed a comprehensive poverty reduction strategy based on the five-year National Socio-Economic Development Plan (NSED) for 2001–05. The Interim Poverty Reduction Strategy Paper (I-PRSP) summarizes the government's key objectives and policies to reduce poverty in the long run and highlights the broad participatory process followed in preparing the document, especially on consultations with various national groups and development partners at the 7th Round Table Meeting (RTM).¹ The public nature of this process demonstrates the government's commitment to implementing this agenda. While strong on poverty diagnostics and the discussion of sectoral constraints to poverty reduction, the I-PRSP is relatively weaker in the prioritization of policies and specific measures, and the articulation of a detailed roadmap toward the full PRSP.

2. The I-PRSP builds on recent progress at macroeconomic stabilization and aims to promote stronger economic growth with equity. Market-based reforms in the early 1990s made an important contribution to alleviating poverty during the first half of the 1990s, as evidenced by the poverty analysis and the gains in key social indicators highlighted in the I-PRSP. The paper emphasizes that continued progress in combating poverty will require sustainable economic growth with due regard to natural resource management and social development. As the government develops the full PRSP, the various priorities identified in the I-PRSP could be further rationalized and translated into specific measures.

¹ See "Fighting Poverty through Human Resource Development and People's Participation." Government Report to the 7th Round Table Meeting; November 21–23, 2000.

II. POVERTY ANALYSIS AND MONITORING

3. The I-PRSP draws upon a wide range of quantitative and qualitative information. In particular, the two Lao Expenditure and Consumption Surveys (LECS I and II of 1992/93 and 1997/98, respectively) provide the core for the preliminary diagnostic analysis of poverty in the Lao P.D.R. The I-PRSP highlights the regional dimension of the poverty profile, but lacks information on other socio-economic characteristics of the poor. As noted in the document, further work on the missing dimensions of the profile will need to be undertaken for the full PRSP. The PRSP would also benefit from drawing on the fuller analysis of the findings of the Participatory Poverty Assessment (PPA) undertaken in 2000 (with assistance from the Asian Development Bank), and additional information on expenditures and outcomes from the line ministries, especially those representing the social sectors.

4. The I-PRSP provides methodological details on the poverty line used in the analysis of LECS II data, but also notes the preliminary nature of the results presented, in view of the uncertainties on issues such as the caloric threshold, food consumption patterns, and the price data used. The paper indicates that further quantitative work on poverty is underway to determine an official poverty line. While the staffs endorse this effort, they note that the current assumptions on adult equivalence scales and regional price differentials appear somewhat ad hoc and recommend that sensitivity analysis should be done on alternative assumptions. In addition, while current efforts to come up with operational definitions of poverty at the district and household level are worthwhile, care will need to be exercised to ensure compatibility with the approach to poverty measurement used in the analysis of LECS II data. Further work is required to avoid creating multiple conflicting criteria for poverty monitoring and targeting. Also, the staffs urge efforts to improve the quality of the social indicators and other data.

III. POLICY FRAMEWORK FOR POVERTY REDUCTION

5. The policy framework as summarized in the policy matrix is appropriate to strengthen macroeconomic stability and help meet Lao P.D.R.'s poverty reduction objectives. The core macroeconomic and structural policies (i.e., financial, fiscal, and trade reforms) agreed under the prospective Poverty Reduction and Growth Facility (PRGF) arrangement are drawn from those in the I-PRSP. Real GDP growth of about 7 percent by 2003 is achievable, if structural reforms are pursued in earnest and the country's considerable hydropower resources are tapped for further development. Supporting sectoral and human resources development, actions have also been widely discussed with development partners in the context of the RTM process. Moving to the full PRSP, however, would require improving the prioritization and costing of the actions selected and broadening the scope to develop a comprehensive approach to strengthening enterprises and banks, especially by promoting the private sector. Although the I-PRSP mentions the government's efforts to improve governance, severe problems (such as transparency in the management of public resources) persist and should be addressed more forcefully as part of the reform agenda in the full PRSP.

6. The I-PRSP reflects the government's commitment to poverty reduction and the goals of graduating from the ranks of the least developed countries (LDC) by 2020. The I-PRSP builds on the approach taken by the government which links economic growth, social and cultural development, and poverty alleviation and further incorporates participation through decentralization and inclusion of mass organizations as the vehicle for achieving the desirable outcomes. These overall approaches can be elaborated further in the full PRSP, especially by linking them to public expenditure policies, to form a sound basis for the strategy for poverty reduction in the Lao P.D.R.

7. The *medium-term projections* in the PRGF-supported program are fully in line with those in the I-PRSP. These projections recognize a weaker short-term outlook on account of a global slowdown. The medium-term framework also assumes that inflation will continue subsiding to low single-digit levels, reflecting prudent monetary policy, together with restraint on government expenditure and borrowing. The staff welcomes the attention given to enhancing revenue mobilization, especially through improved administration, as a means to provide the resources for the government's poverty reduction goals, and considers that the revenue targets are achievable.

8. The I-PRSP recognizes the need to enhance *public expenditure* management and budgeting to meet poverty reduction objectives. The partial scope of the expenditure policy analysis reflects the absence of comprehensive, reliable and timely data on public expenditure allocations, particularly on social expenditure. Strengthening information in this area, including availability of expenditure data that is disaggregated by type of spending, would be crucial for more effective expenditure management and the prioritization of expenditures based on transparent objectives and with accountability. In this regard, the findings of the ongoing Public Expenditure Review (PER) will provide a basis for developing recommendations to improve fiscal management in the full PRSP, especially budget formulation and public expenditure management, fiscal transparency, and accountability. Within the constraints of available data, the PER will also examine some of the links between poverty and expenditure in order to provide input into decisions on relative expenditure priorities. The full PRSP should build on this information and make the case for increasing or reducing certain expenditures based on their expected poverty-reducing impact and discuss government policies regarding the alternative uses of resources between poverty reducing and other activities (e.g., budgetary and quasi-fiscal support to the state sector, and the loss of potential revenue resources such as from forestry).

9. The I-PRSP closely links macroeconomic instability to the problems of the *financial sector* (in particular, the state-owned banks) and reiterates the importance of reform not only for avoiding the drain on public resources, but also for developing a financial intermediation system that supports sustainable economic growth, including in rural areas. Reform is urgently needed because the state-owned banks have substantial capital deficiencies. The government is in the process of formulating a reform strategy aimed at fundamentally restructuring the insolvent state-owned-banks to avoid the recurrence of large nonperforming loans (NPLs) and help foster efficient intermediation. The main measures articulated in the I-PRSP policy matrix are appropriate.

10. Any sustainable financial sector reform has to be closely linked to **enterprise development**. The government's medium-term program of reforms for improving the efficiency and competitiveness of the state-owned enterprise (SOE) sector needs to be articulated further. Although the initial steps towards strengthening SOEs focus on price adjustments, further reform policies should be developed for the full PRSP. Also, the continuation of the reform of the legal and regulatory framework, including the critical issue of land rights, would be important aspects to present in the full PRSP.

11. Overall, the focus on the **agriculture sector**, as one of the pillars of the government's poverty alleviation strategy, is appropriate given that a large part of the population is rural, and the rural poor constitute an overwhelming majority of the country's total poor. The I-PRSP also rightly puts high priority on the need to tackle issues of equity, for example, between the upland and lowland rural communities. Essentially, the Lao P.D.R. agriculture sector continues to be largely a low productivity system, and its transformation will need close attention to key policy issues (such as the pursuit of self sufficiency goals in the allocation of public resources, interest rate policies for agricultural credit, etc.) and a long-term program for developing human technical skills and institutional capacity.

12. The use of 'focal sites' as a means of supporting **rural development** needs to be closely reviewed in light of experiences from other countries, especially the resettlement of people, ostensibly for more efficient delivery of services. It will also be essential to improve the manner in which public resources are allocated among sub-sectors. The current system has resulted in biases against some sub-sectors (for example, the emphasis on developing pump irrigation in the past few years has meant that there has been less attention to other subsectors, such as livestock and tree crops, and to tackling the key issue of human resources capacity) with potential comparative advantage, and there is an absence of a sound framework for sustainable natural resources management.

13. **Forest resources** are, potentially, one of the country's major sources of lasting poverty reduction. Village forestry, through which local people are enabled to manage and directly benefit from the sale of timber and other forest resources, have had remarkable and demonstrated success in Lao P.D.R. Village forestry has also shown itself to be superior to routine government forest management from both government revenue and environmental perspectives. The staffs encourage the government to consider preparing specific programs and project proposals to extend this approach to around half of the commercially valuable forest outside of National Biodiversity Conservation Areas and directly benefiting about 1.5 million people. For areas not suited to village management, government has recognized the need for strengthened forest management as a means of enhancing public revenues. Village forestry and improved commercial forest management, together with an assault on problems of illegal and uncontrolled logging, could form a viable forestry reform program that should be spelled out in more detail in the full PRSP. This will require strong commitment and improved capacity.

14. The overall objectives of strengthening **health care** delivery, particularly in underserved areas, and improving the quality of health services, are the appropriate ones, and

most strategies and measures proposed in the I-PRSP would contribute to reaching these objectives. However, infectious diseases control should be listed among the top priorities (e.g., malaria, dengue, tuberculosis), and efforts to combat these diseases need to be intensified. Though the recorded incidence of HIV/AIDS is not alarming, early preventive action could avert a potential major threat. A cost effective and equitable health financing system is another priority. The user fees system currently implemented needs to be improved by enacting and enforcing clear rules and developing an exemption system for the poor.

15. The full PRSP would need to move toward a more focused discussion of the priorities in the **education sector**. Experience worldwide suggests a very strong link between basic education and poverty. The LECS data, PPA findings, PER benchmarks, and information from the line ministries, can be utilized to forge strong linkages and make the case for increasing public expenditures for primary education. Of the four education programs mentioned in the I-PRSP, only two (universal primary education and illiteracy eradication), are directly related to poverty reduction. There is also a need to improve salaries and working conditions of primary school teachers. Additional resources may also be needed to target hard-to-reach populations, which are currently the poorest and most underserved in terms of education. The policy matrix highlights most of the important issues, including increasing total expenditures on education and protecting primary education's share.

16. Along with agriculture/forestry, health, and education, **road infrastructure** is also important for poverty reduction. The government correctly places the focus on the rural road infrastructure and has a good grasp of the linkages between road infrastructure, especially in the rural context, and its overarching goals of food security, national integration, human resources development, and social progress. In this respect, the strategy is quite coherent and the focus needs to be maintained on the successive implementing steps, particularly since the strategy is dependent on local interventions, and concerns about social and environment impacts and the appropriate safeguards and mitigation measures also exist. Within the sector, priorities are correctly identified in the policy matrix, with maintenance and rural and feeder roads on top of the list and the planned expenditures for new investment reflecting a more balanced approach. It is to be noted that the establishment of the Road Maintenance Fund will need to be supported by the transparent and efficient utilization of its resources to ensure the appropriate preservation of both local and national road networks. Donors should continue to support maintenance activities and carefully scrutinize the proposed projects for new investment in the national network by assessing the impact of its expansion with its medium- and long-term sustainable preservation.

17. The I-PRSP identifies the potential of the **energy sector** for poverty alleviation. It also stresses the need to reduce the regional, rural, and urban income gaps through, among other ways, adequate provision of services. This acknowledgement needs to be developed further within a comprehensive approach to the links between infrastructure and poverty reduction. The financial sustainability of the energy utility needs to be ensured while also protecting the poorer segments through appropriate price policies. Furthermore, the full PRSP will need to rectify the I-PRSP's almost total neglect of rural electrification and discuss how the increased export of hydropower (such as envisaged under Nam Theun 2 and

other projects) would serve the interests of the poor. The efficient development of these resources together with improvements in the transparency and accounting framework for the management of public resources could improve benefits for the poorer segments of the population. These two points are mentioned in the policy matrix without any major explanation or support from the main text. They should be developed further in the full PRSP.

18. The various sectoral programs are cognizant of the *role of women* in the development of the Lao P.D.R. and the process of poverty reduction. The participation of women in the process of attacking poverty is recognized in the I-PRSP, for example, through the central role accorded to the Lao Women's Union in the overall poverty reduction approach. Sectoral strategies for education (e.g., girls' enrolment) and health (e.g., maternal mortality) also refer to gender-based policies. However, the proposed gender strategy could be broadened in the full PRSP to include other sectors and policies, including through a more comprehensive gender-based analysis of the LECS and PPA findings. Further analysis of the LECS and PPA data could also help identify sources of vulnerabilities for the poor that could be reflected in a discussion of appropriate safety nets. Finally, greater attention to the geographic and other dimensions of poverty (particularly within the government's decentralization program), would be appropriate in the elaboration of the full PRSP.

IV. PREPARATORY PROCESS

19. The *process of preparing the I-PRSP* has been fully owned and led by the government. At the initial stages, World Bank and Fund staff provided the authorities with the emerging PRSP guidelines and sourcebook. An I-PRSP Committee, led by the State Planning Committee and drawing membership from other ministries and agencies, as well as representatives from several mass organizations, was formed to oversee the whole PRSP process. At the request of the government, the UNDP provided funds to assist a local working group in preparing an initial draft of the I-PRSP. In parallel, new information and data coming from the PPA and the poverty analysis, as well as the World Food Program's vulnerability assessment, were added. Many internal meetings were held by the government, including consultations with representatives of mass organizations. As noted, much of the contents of the I-PRSP were also presented to the donors and other development partners at the 7th RTM held in November, 2000. The final draft of the I-PRSP was also discussed with donors and international NGOs during a workshop held on March 15, 2001.

20. The I-PRSP includes a section titled Consultation Process for the Final PRSP. This section has a good description of existing participatory processes in the country, both at the national and local levels, for pro-poor policies and programs. This section also states that the government intends to build on existing participatory processes and consultations during the preparation of the full PRSP. In preparing the full PRSP, the government will need to consider issues relating to both substance and process, and identify remaining gaps in information that will need to be filled, and focus on quality and participation over speed of completion. The preparation of a more detailed roadmap, with indications of any assistance needed from external partners, would help in the elaboration of the content of the full PRSP

and keep all stakeholders informed of key milestones to be achieved in the process. The government could consider expanding the consultation process to include broader segments of society (such as the private sector, academia, etc.) to help strengthen wider country ownership of the strategy. Beyond decisions on key stakeholders to be consulted and on what issues (e.g., substantive areas like poverty reduction goals, public actions to achieve these goals, and participatory systems to monitor progress), it will be important to select methods (such as stakeholder workshops or committees, and participatory appraisals), set a timetable, and determine at which levels consultations will take place (i.e., national, provincial, district, local).

V. RISKS TO THE STRATEGY

21. The main risks for the implementation of the I-PRSP stem from possible external shocks, internal policy weaknesses, governance issues, weak institutional capacity, and resource constraints, both internal and external. As recently shown, Lao P.D.R. remains vulnerable to natural disasters (e.g., flooding and droughts), and adverse developments in foreign markets (e.g., deterioration of terms of trade and loss of major export markets for garments). It will also be important to ensure that policies designed to make the social costs of reform manageable remain fully consistent with policies for long-term growth and sustained poverty reduction. In particular, the long-term goal of graduating from LDC status by 2020 will require integration with the regional and international economies. Weak administrative capacity and governance can also potentially derail the implementation of the poverty reduction strategy. In this context, it would be important for the donors to align their programs to support the priorities articulated in the country's poverty reduction strategy.

VI. CONCLUSION

22. The government's strong commitment to developing, with broad participation of civil society and stakeholders, a comprehensive poverty reduction strategy has been largely demonstrated in the I-PRSP process and document. Accordingly, the staffs of the World Bank and the IMF consider that the I-PRSP prepared by the Government of the Lao P.D.R. provides a sound basis for the development of a participatory PRSP and for World Bank and IMF concessional assistance. The staffs recommend that the respective Executive Directors of the Bank and the Fund reach the same conclusion.

Key Bank/Fund Events Related to PRGF/PRSP, March 2001-December 2002

Institution	Event	Expected Time
IMF	2001 Article IV Consultation/PRGF Discussions	April 2001
World Bank and IMF	Interim PRSP and Joint Staff Assessment	April 2001
World Bank and IMF	Public Expenditure Review	June 2001
IMF	First Review under the PRGF Arrangement	October 2001
World Bank	Financial Sector Credit	December 2001
IMF	2002 Article IV Consultation and Second Review under the PRGF Arrangement	April 2002
World Bank	Education Development II	May 2002
World Bank and IMF	Full PRSP and Joint Staff Assessment	August 2002
World Bank	Country Assistance Strategy	August 2002
IMF	Third Review under the PRGF Arrangement	October 2002
World Bank	Forestry APL	December 2002
World Bank	Poverty Reduction Support Credit (Tentative)	December 2002