INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/267

LAO PEOPLE'S DEMOCRATIC REPUBLIC

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR LAO PDR

August 2019

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Lao PDR, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its August 2, 2019, consideration of the staff report that concluded the Article IV consultation with Lao PDR.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on August 2, 2019, following discussions that ended on May 22, 2019, with the officials of Lao PDR on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 18, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Executive Director** for Lao PDR.

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August 8, 2019

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IMF Executive Board Completes the 2019 Article IV Consultation with Lao P.D.R

On August 2, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation with Lao P.D.R.[1]

Natural disasters slowed Lao P.D.R.'s economic growth and accentuated the need to address structural vulnerabilities. GDP growth slowed down to 6.3 percent in 2018 from 6.8 percent in 2017, as both agricultural and industrial production declined mainly due to natural disasters. Heavy rainfalls from tropical storms resulted in flooding across the country, followed by the tragic collapse of Xe-Pian Xe-Namnoy dam. Notwithstanding these disruptions, inflation remained below 3 percent. Credit growth declined due to the economic slowdown, the legacy of non-performing loans, and fiscal tightening. In 2018, the current account deficit widened due to the mega-projects and disaster related imports, while electricity exports grew. International reserves declined to around one month of imports. Fiscal consolidation, driven by lower capital spending, brought the fiscal deficit down to 4.4 percent of GDP in 2018 from 5.5 percent in 2017. Revenues underperformed in 2018 and a part of the spending was diverted towards natural disaster recovery needs. The government has allocated emergency assistance for public works, transportation, the agriculture and forestry sectors. New investment projects pipeline has been suspended and the authorities are taking stock of all existing projects with the view of re-prioritizing capital investment to address further infrastructure repair needs.

Long-term economic prospects remain favorable. Economic growth is expected to remain strong and gradually rise close to 7 percent over the medium-term supported by private

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

investment, electricity exports, and the completion of the Kunming-Vientiane railway project. Headline inflation is projected to remain moderate. Large current account deficits are expected to persist from import demand keeping gross international reserves between one and two months of import coverage. Fiscal consolidation is also expected to continue, supported by efforts to improve revenue administration and optimization of spending, given the government's plans for reducing civil service recruitment and continued re-focusing of capital spending to post-disaster reconstruction efforts with the temporary suspension of new investment projects. The government has adopted a comprehensive reform package directed towards strengthening economic governance starting with the modernizing of various legal frameworks.

Risks mainly stem from external developments, slower than the anticipated implementation of committed structural reforms, and weather-related shocks. In an uncertain global environment, a sharper than expected slow-down in China – Lao P.D.R.'s largest trading partner and FDI investor – may reduce exports and decelerate FDI inflows. On the upside, faster regional growth and deepening integration within the ASEAN will help boost investment, trade, and tourism. Vulnerabilities to natural disasters may affect growth and reduce potential gains in poverty reduction.

Executive Board Assessment[2]

Executive Directors welcomed Lao P.D.R.'s sustained strong economic growth, stable inflation, and progress made towards graduating from the Least Developed Country status despite challenging circumstances. Directors noted that, while the outlook for growth remains favorable, risks are tilted to the downside. They welcomed the authorities' commitment to maintaining sound macroeconomic policies and further deepening the reform agenda to reduce vulnerabilities, address structural weaknesses, and promote sustainable and inclusive growth.

Directors emphasized that gradual fiscal consolidation, supported by comprehensive public financial management reforms, is important for fiscal and debt sustainability. They noted that reorienting consolidation efforts from expenditure compression to revenue generation would be helpful to build the fiscal space needed for social development and infrastructure needs as

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

well as to achieve the sustainable development goals. In this regard, Directors welcomed the development of a medium-term revenue strategy and encouraged the authorities to implement the strategy and to improve tax legislation and administration, as well as broaden the tax base.

Directors underscored the need to reduce risks to debt sustainability. They highlighted that effective implementation of the new Public Debt Management Law and developing debt management strategy, supported with capacity building, would help strengthen the debt carrying capacity. Directors concurred that the on-going assessment and targeting of infrastructure projects with high social returns and financing these at concessional terms, to the extent possible, would also support debt sustainability. Noting the scale of the projects, they called for further strengthening the public investment framework, continuing assessment and monitoring of fiscal risks, and actively diversifying export markets.

Directors emphasized that further efforts to modernize monetary governance and strengthen liquidity management would support reserves build-up and macroeconomic stability. In addition, improving liquidity forecasting and gradually increasing exchange rate flexibility, will also contribute to increasing international reserves. Directors highlighted that boosting productive investments to enhance competitiveness and diversification are necessary to strengthen the overall external position.

Directors agreed that financial sector reforms should focus on financial deepening and boosting resilience to risks. Implementing risk-based supervision would help identify and reduce risks, while transitioning towards the Basel II framework would help build buffers. Directors also agreed that providing guidance on forthcoming regulatory changes would improve predictability of the regulatory environment, while facilitating SME financial literacy and access to finance would support inclusive growth.

Directors noted the progress in improving the quality and timeliness of economic statistics. They encouraged bringing the monetary and financial sector indicators to regional reporting standards. Directors called for further strengthening of the AML/CFT framework in preparation for the 2020 FATF assessment.

Directors highlighted that spreading the benefits of economic growth would require consistent investment in human capital. Improving education attainment, skills training, reducing the regulatory burden on SMEs, increasing access to finance, easing trade regulations, and introducing policies that support greater participation of women in the formal economy would make growth more inclusive. Technical assistance from the Fund and development partners remains critical to support these ambitious reforms, taking into account Lao's absorptive capacity.

Lao P.D.R.: Selected Economic and Financial Indicators, 2015–20

	2015	2016	2017	2018	2019	2020
				Est.	Proj.	Proj.
GDP and prices (percentage change)						
Real GDP growth	7.3	7.0	6.8	6.3	6.4	6.5
CPI (annual average)	1.3	1.8	0.7	2.0	3.1	3.3
CPI (end year)	0.9	2.5	0.1	1.5	2.9	3.1
Public finances (in percent of GDP)						
Revenue and Grants	20.2	16.0	16.1	15.5	15.8	15.9
Expenditure	25.8	21.1	21.6	19.9	20.1	20.0
Expense	15.4	15.4	12.5	12.5	13.1	12.8
Net acquisition of nonfinancial assets	10.4	5.7	9.1	7.5	7.0	7.2
Overall balance	-5.6	-5.1	-5.5	-4.4	-4.3	-4.1
Money and credit (annual percent change)						
Reserve money	6.6	-1.4	9.5	5.0	14.8	-
Broad money	14.7	10.9	12.2	8.4	16.7	-
Bank credit to the economy 1/	16.8	20.9	10.8	3.0	11.8	-
Bank credit to the private sector	19.3	22.0	14.2	4.7	13.2	-
Balance of payments						
Exports (in millions of U.S. dollars)	3,753	4,409	5,110	5,295	6,037	6,535
In percent change	-12.9	17.5	15.9	3.6	14.0	8.3
Imports (in millions of U.S. dollars)	6,728	5,904	6,546	6,903	7,597	8,298
In percent change	-6.2	-12.2	10.9	5.5	10.1	9.2
Current account balance (in millions of U.S. dollars)	-3,220	-1,752	-1,816	-2,170	-2,311	-2,543
In percent of GDP	-22.4	-11.0	-10.6	-12.0	-12.1	-12.0
Gross official reserves (in millions of U.S. dollars)	987	815	1,016	873	1,087	1,458
In months of prospective goods and services imports	1.7	1.3	1.5	1.2	1.3	1.7
(Excluding imports associated with large resource projects) 2/	6.4	5.3	4.4	3.2	…	…
Exchange rate						
Official exchange rate (kip per U.S. dollar; end-of-period)	8,148	8,151	8,293	8,530	…	…
Real effective exchange rate (2010=100)	127	131	129	126	…	…
Nominal GDP						
In billions of kip	117,252	129,279	140,749	152,414	164,147	184,152
In millions of U.S. dollars	14,363	15,916	17,069	18,120	19,127	21,211

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.

1/ Includes Bank of Lao P.D.R. lending to state-owned enterprises and subnational levels of government.

2/ The authorities' methodology assesses reserve coverage by excluding imports related to FDI given that most of the FDI related projects use their own funding unrelated to the reserves in the central bank.

INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

July 18, 2019

KEY ISSUES

Context. After more than a decade of high growth with low inflation, Lao P.D.R. is solidifying its progress towards graduating from the Least Developed Country (LDC) status. However, more than one fifth of the population remains poor, regional disparities are persistent, and recurring natural disasters pose risks for poverty reduction. A large current account deficit, low level of reserves, a high level of debt, managed exchange rate, and a dollarized banking system amplify macro-vulnerabilities. The authorities recognize the current economic challenges and their comprehensive reform programs aim at rebalancing the economy from a resource-based to a more diversified growth model by investing in human development and improving competitiveness.

Policy Priorities

- **Steady fiscal consolidation aimed at reducing fiscal deficit to about 2 percent of GDP and public debt below 50 percent of GDP by 2025 and improving fiscal governance** through a multi-year revenue mobilization strategy, public financial management reforms, and strengthening debt management are necessary for building the fiscal space for inclusive development. Rebalancing the composition of fiscal consolidation from expenditure compression towards revenue mobilization will better enable the aligning of spending priorities with social development goals.

- **Modernizing monetary governance and building reserves** supported by greater exchange rate flexibility will help to mitigate external shocks in an uncertain global environment. Improving liquidity management, strengthening banking supervision, reducing FX lending risks, putting in place crises management and prompt corrective action frameworks, and building capital buffers will enhance financial sector resilience.

- **Diversifying growth drivers** by rebalancing from a capital intensive to a more inclusive growth model. Putting investment in human capital at the center of the structural transformation and encouraging greater participation of women in the formal economy, supported by enabling business environment, will help spread benefits of growth more widely. Progress in improving data transparency needs to continue, supported by technical assistance from development partners.

Approved By
Ms. Anne-Marie Gulde-Wolf and Ms. Yan Sun

Discussions took place during May 8–22, 2019. The staff team comprised E. Kvintradze (Head), N. Adachi, M. Brussevich and J. De (all APD). The mission team was assisted greatly by A. Kounnavong, L. Pharakhone, and V. Savannarideth in the Lao P.D.R. Resident Representative Office. Mr. D. Cowen (CDOT Director), Mr. T. Kanada, and Ms. A. Wacharakiat (CDOT resident advisors) joined part of the mission. Mr. K. Tan (Alternate Executive Director) and Mr. Z. Abenoja (Advisor, OED) also joined discussions. Mr. R. Rattanasena and Ms. A. Gjonbalaj assisted in the preparation of this report.

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APPENDICES

RECENT DEVELOPMENTS

1. **Economic Developments.** GDP growth slowed to 6.3 percent in 2018 from 6.8 percent in 2017, as both agricultural and industrial production declined mainly due to natural disasters. Heavy rainfalls from tropical storms resulted in flooding across the country, followed by the tragic collapse of Xe-Pian Xe-Namnoy dam. Despite disruptions, inflation remained below 3 percent.

2. **Fiscal Developments.** Fiscal consolidation, driven by lower capital spending, brought the fiscal deficit down to 4.4 percent of GDP in 2018 from 5.5 percent in 2017. Revenues underperformed in 2018 and a part of the spending was diverted towards natural disaster recovery needs. The government has allocated emergency assistance for public works, transportation, the agriculture and forestry sectors. New investment projects have been suspended and the authorities are taking stock of all existing projects with the view to re-prioritizing capital investment to address further infrastructure repair needs. In addition, the government has issued bonds to commercial banks equivalent to the identified stock of payment arrears for past infrastructure projects (3.1 percent of GDP as of 2018).

3. **External Sector Developments.** In 2018, the current account deficit widened due to the mega-projects and disaster related imports, while electricity exports grew. International reserves declined to around one month of imports, significantly below staff's assessment of adequate reserves (4–6 months of prospective imports).[1] In 2018, increased demand for imports coupled with a strong US dollar resulted in further depreciation of the kip (by about 3 percent against US dollar). Amidst persistent dollarization, the parallel market premium hovered around two percent in 2018, reflecting a combination of the impact natural disasters and a strong US dollar.

4. **Financial Developments.** Credit growth declined due to the economic slowdown, legacy of non-performing loans (NPLs), and fiscal tightening. In early 2019, caps on banks deposit and lending rates, which were introduced in 2015, were lifted. Both domestic and foreign currency lending growth have slowed. The share of foreign currency-based lending has been stable at around 50 percent but its share in deposit has increased gradually to around 54 percent (Figure 3). Subsequently, regulation on lending in foreign currency was further tightened in 2018 and are only allowed for strictly defined purposes governed by Law on the Management of Foreign Currency.

OUTLOOK AND RISKS

5. **Long-term economic prospects remain favorable.** Economic growth is expected to remain strong and gradually rise close to 7 percent over the medium-term, supported by private investment, electricity exports, and the completion of the Kunming-Vientiane railway project.[2] The lifting of

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[1] The authorities' methodology assesses reserve cover about 3 months by excluding imports related to FDI given that most of the FDI related projects use their own funding unrelated to the reserves in the central bank.

[2] Lao P.D.R. does not currently provide International Investment Position (IIP) data to the Fund. The first IIP survey is forthcoming and IMF is providing technical assistance to improve national accounts compilation. However, the buoyancy of PPPs in mining and hydropower sectors suggest that private investment has been an important contributor to economic growth.

interest rate caps and the resolution of NPLs related to past infrastructure projects arrears are expected to strengthen bank balance sheets and support the recovery in credit growth (projected at about 11.8 percent in 2019). Headline inflation is projected to remain moderate. Large current account deficits are expected to persist due to import demand, keeping gross international reserves between one and two months of imports.

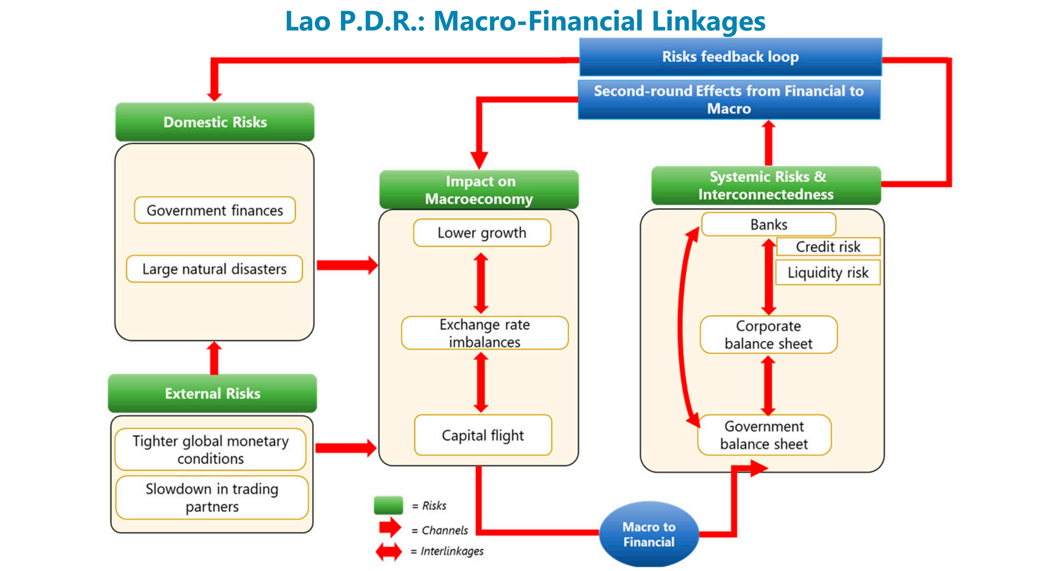
6. The fiscal consolidation is expected to continue, albeit slowly. The fiscal deficit is expected to decline to 4.3 percent of GDP in 2019 supported by efforts to improve revenue administration and optimization of spending, given the government's plans for reducing civil service recruitment and continued re-focusing of capital spending to post-disaster reconstruction efforts with the temporary suspension of new investment projects. Measures to improve revenue administration in 2019 include an ongoing rollout of the electronic tax payment systems for value-added-tax (VAT), income, road, and land taxes, strengthening tax-payer registration and risk-based management systems, and improving organizational structure at provincial and central levels. Going forward, the government has committed to fiscal consolidation mainly through expenditure compression. Additional revenues that may become available through automation efforts and review of tax laws could further support fiscal consolidation. However, based on current policies, the fiscal deficit is expected to remain close to 4 percent of GDP and public debt over 50 percent of GDP by 2025.

7. Risks are tilted to the downside. Risks mainly stem from external developments, slower than the anticipated implementation of committed structural reforms, and weather-related shocks.

- ***External risks.*** The high level of debt with a low level of international reserves undermines the capacity to cushion against external shocks. This is amplified by high dollarization and balance sheet mismatches. On the downside, in an uncertain global environment, a sharper than expected slowdown in China – Lao P.D.R.'s largest trading partner and FDI investor– may reduce exports and decelerate FDI flows. In addition, lower demand growth from Thailand and Vietnam may reduce electricity exports growth. Reactions to the tightening of global financial conditions in the Thai capital market are important for rollovers and future issuances from Lao P.D.R. These factors also amplify the risks related to debt sustainability given the financial obligations for large projects. On the upside, deepening integration within the ASEAN will help boost investment, trade, and tourism.

- ***Domestic risks.*** Delays in tax and Public Financial Management (PFM) reforms may lead to ad-hoc expenditure adjustments which may prevent building the fiscal space for social and development spending. Possible re-emergence of spending arrears could undermine credit growth in the economy. Vulnerabilities to natural disasters may affect growth and reduce potential gains in poverty reduction.

- ***Macro-financial risks.*** A sudden slowdown in economic activity could lead to higher non-performing loans, expose weaknesses in the banking system, and cause further decline in credit and growth. Similarly, a sudden tightening of liquidity could cause a credit crunch, and a sudden devaluation in the exchange rate could lead to weaker balance sheets causing a slowdown in economic activity.



Source: IMF Staff.

Authorities' Views

8. The authorities broadly shared staff's assessment of the outlook and risks. They acknowledged that the macroeconomic risks related to the external sector include a sluggish global economic growth and reduced demand from main trading partners given spillovers from the current trade war. They agreed that the domestic economic growth is slowing down, however, it is expected to remain strong with a target growth rate of 6.7 percent growth in 2019.

PUTTING DEBT ON A SUSTAINABLE PATH WHILE MEETING DEVELOPMENT NEEDS

9. Public debt is high, and the risk of debt distress remains elevated. Much of the existing public and publicly guaranteed (PPG) debt stock is external, and close to 65 percent of the public external debt is on concessional and semi-concessional terms. The debt composition is shifting, driven by recent issuances in the Thai capital market, and the exposure to a single creditor has been growing – close to 42 percent of the external PPG debt (as of end-2018) is held by China (Box 1). Contingent liabilities associated with the government's share in a large number of Public Private Partnerships (PPPs) pose additional risks for the government's balance sheet. That said, the large share of electricity export earnings under long-term intergovernmental Power Purchase Agreements (PPAs) help to mitigate risks (customized scenario in Debt Sustainability Analysis (DSA)) and bring debt indicators to sustainable levels. A moratorium on new capital investment projects pipeline and planned reduction in the size of the civil service employment will also help to contain debt accumulation.

10. Improving the efficiency of public investment should be priority. The government has approved the new Public Procurement Law with a view to setting out a more transparent and rule-based institutional framework. To improve the efficiency of capital spending, the current moratorium on new projects provides the opportunity for rigorously assessing the project pipeline with a view to selecting projects that have a high social impact and those which mitigate natural disasters. As the near-term priority, the estimated total recovery needs from the 2018 natural disasters are about 3 percent of GDP (US$520 million) to be spent over the next five years. To meet these needs, the government has allocated emergency assistance (US$12 million), reprioritized its planned capital investment (US$57 million) and has received financing from development partners (US$81 million). The remaining ($370 million) is expected to be met by re-prioritizing capital spending over 2020–23 (Appendix III). Going forward, improving legal and institutional frameworks for PPPs should be prioritized and a Public Investment Management Assessment (PIMA) should also be considered to support the goals for improving capital spending efficiency.

11. Faster consolidation and shifting the composition of adjustments towards revenue generation can enable more spending for development. Lao P.D.R. has no fiscal space due to the high level of public debt and a weak external position. Committed PFM and tax policy reforms are directed towards building necessary fiscal space and should be implemented at an accelerated pace. Under staff's suggested policy scenario (Box 2), fiscal consolidation of an average 0.4 percent of GDP annually, supported by the implementation of the PFM reforms and broadening of the tax base, could reduce the fiscal deficit to two percent of GDP and bring the public debt below 50 percent of GDP by 2025. Spending on social development and infrastructure needs requires an additional 0.7 percent of GDP annually, which will also help alleviate potentially regressive nature of revenue mobilization efforts focused on base broadening. Expenditure measures, including reductions in the wage bill and capital investment are included under the baseline scenario, whereas the policy scenario assumes no additional reductions in expenditures. Fiscal consolidation and additional spending needs under the policy scenario are expected to be met by revenue mobilization of 2.2 percent of GDP by 2025.

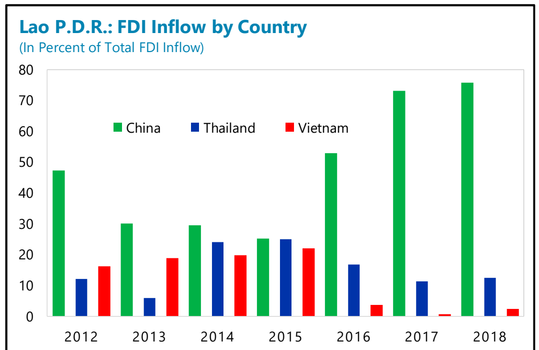
12. Strengthening fiscal governance will support reducing the public debt and creating fiscal space for development:

- **Tax revenue mobilization.** The authorities, with support from FAD, have developed a Medium-Term Revenue Strategy (MTRS: 2021–25) which provides a coordinated and sequenced approach to revenue mobilizations reforms. Timely approval and implementation of the MTRS remains a priority. With over 80 percent of the corporate tax base estimated to be exempt, simplifying and broad-basing the VAT and Corporate Income Tax (CIT) are essential (Box 3). Reviewing tax exemptions and building capacity for developing estimates of forgone revenue will help to improve transparency of the tax system and better inform decision making. The government has also developed customs and tax administration strategic plans and has commenced the introduction of an automated tax revenue information system (TaxRis). Implementing these plans and supporting automation efforts with improved data gathering, risk-based administration practices, and trainings will help to improve revenue administration efficiency.

- **Public Financial Management.** The recently completed Public Expenditure and Financial Accountability (PEFA) assessment is a welcome step towards improving transparency and efficiency of public expenditures and reorienting spending towards better outcomes in line with

Box 1. Lao P.D.R.: Belt and Road Initiative 1/

Over time, China has become the most important investor, and the largest bilateral creditor. In the span of a decade, official bilateral lending from China increased from US$100 million (IMF DSA 2007) to about US$ 3.8 billion (42 percent of the total public and publicly guaranteed debt) in 2018 making it Lao P.D.R.'s largest bilateral creditor. Considering the large number of PPPs that have been set up with Chinese investments, total inflows are even larger and are reflected in the steady increase in FDI from China. The government's exposure to PPPs are in the form of equity ownership shares.

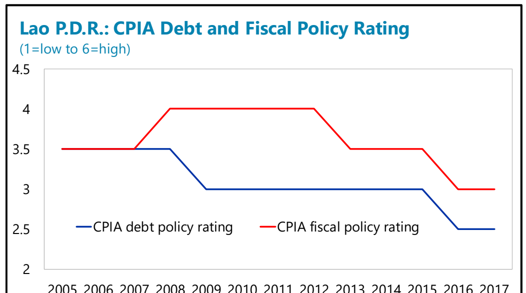


Source: National authorities.

The large investments that accompany the Belt and Road Initiative (BRI) brings with it the potential to bridge infrastructure gaps and boost growth, trade and financial flows.[1] Most major projects are in the energy and transportation sector and include large investments such as Nam Ou power projects and the railways amongst many others. As an example, the Kunming-Vientiane railway has been estimated to cost around US$5.9 billion. Out of this amount, the authorities will contribute US$708 million of which US$480 million will be borrowed from China and the remaining (US$228 million) will be provided from the budget.

While large-scale projects are expected to bolster growth, risks need to be identified and managed carefully, given low reserves and fiscal buffers. Official data suggest the absence of the direct government guarantees on most of these projects. However, indirect contingent liabilities could emerge if utilization of project capacity is lower than anticipated and if it cannot generate sufficient cashflows to meet associated debt service requirements as per the joint venture agreements. If so, as part owner, the government may need to agree with the external partners on the modalities of addressing the issue. This may include, but is not limited to, restructuring terms of agreements, foregoing part of the equity ownership, mobilizing additional investment for project capacity utilization to ensure enough cashflow, or generating other exposures beside the project at hand, or any other actions.

Institutional capacity to manage debt needs to be strengthened. Several past DSAs have highlighted the risks from a rapid build-up of debt, especially from China and Thailand, underscoring the importance of improving debt and fiscal policy, including debt management capacity, which remain immediate policy priorities.[2] In addition to debt management, project selection and its careful assessment including the implications for macroeconomic stability and external and public debt sustainability is key. The authorities should continue to work with developing partners to strengthen their capacity in managing indirect contingent liabilities and associated risks in PPP related joint ventures. Harmonizing legal issues relating to PPP contracts, enhancement of investment protection mechanisms, and a proper governance including standard procurement arrangements are crucial.

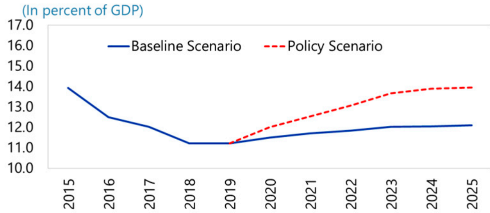


Source: World Bank, Country Policy and Institutional Assessment Database.

1/ The Belt and Road Initiative (BRI), launched in 2013, aims to promote policy dialogues, foster connectivity and cooperation in infrastructure, trade, finance and connect Asia with the rest of the world. Given the absence of a universally accepted definition of the scope of projects under the BRI, infrastructure projects with Chinese investments in an identified BRI country since 2013 is a BRI project.
2/ The World Bank's Country Policy and Institutional Assessment (CPIA) score for Lao P.D.R. in the areas of fiscal policy, debt policy and business regulatory environment has been revised downwards significantly over the period 2015 –17 affecting the three-year CPIA average used for calculating the CI score which sets the policy dependent thresholds of the debt ratios and in turn the country's debt carrying capacity and debt sustainability.

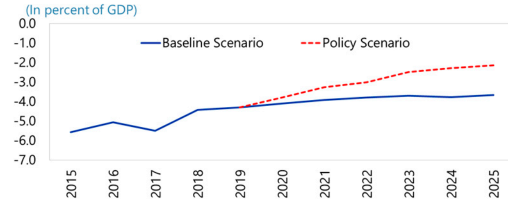
Box 2. Lao P.D.R.: Medium-Term Revenue Needs to Meet Strategic Priorities

Tax Revenue
(In percent of GDP)



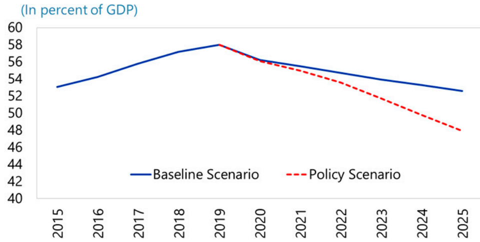
Sources: National authorities' data; and IMF staff calculations.

Fiscal Balance
(In percent of GDP)



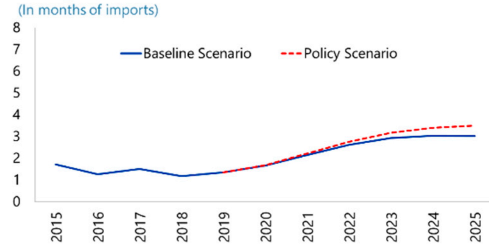
Sources: National authorities; and IMF staff calculations.

Public Debt
(In percent of GDP)



Sources: National authorities; and IMF staff calculations.

Foreign Reserves
(In months of imports)



Sources: National authorities; and IMF staff calculations.

Macro Framework Under Policy Scenario

	Actual	Est.	Policy Scenario Projections						
	2017	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Real GDP (Percent change)	6.8	6.3	6.4	6.2	6.2	6.5	6.6	6.8	6.7
Fiscal deficit (In percent of GDP)	-5.5	-4.4	-4.3	-3.8	-3.3	-3.0	-2.5	-2.3	-2.1
Public debt (In percent of GDP)	55.8	57.2	58.0	56.1	55.0	53.6	51.7	49.8	47.9
Current account (In percent of GDP)	-10.6	-12.0	-12.1	-11.8	-10.9	-10.5	-10.4	-10.3	-10.2
Foreign Reserves (In months of imports)	1.5	1.2	1.4	1.7	2.2	2.8	3.2	3.4	3.5

Source: IMF staff projections.

Revenue Needs to Meet Strategic Priorities (2020-2025)

	2020	2021	2022	2023	2024	2025
Projected revenue needs to achieve:			(in percent of GDP)			
Fiscal Consolidation 1/	0.3	0.6	0.8	1.2	1.5	1.5
Higher spending on education and health care 2/	0.2	0.2	0.2	0.2	0.2	0.2
Higher spending on infrastructure and disaster mitigation 2/	0.1	0.2	0.3	0.4	0.5	0.5
Total projected revenue needs	0.6	1.0	1.3	1.8	2.2	2.2

Source: IMF staff calculations

1/ Calculated as a difference between fiscal deficit projections under the baseline and adjustment scenarios.

2/ Calculated as a difference between spending projections under the baseline and adjustment scenarios.

the Sustainable Development Goals (SDGs). The government has agreed to a comprehensive multi-year PFM reform strategy supported by several development partners. In the near term, development of commitment controls and quarterly spending ceilings under the new PFM framework is needed to reduce risks of spending arrears accumulation while consolidating spending. Going forward, developing and implementing medium-term fiscal frameworks and aligning spending priorities with SDGs will help to advance inclusive development objectives and strengthen budget accountability mechanisms.

- **Debt Management.** The new Public Debt Management Law (2018) is a step forward in defining a more rules-based mechanism for contracting and guaranteeing public debt. Consolidating the Ministry of Finance (MoF)'s oversight powers over public debt and the timely development of a 5-year strategy for debt management remain a priority. To this end, upgrading the debt recording systems is a necessary precondition for developing a well-informed debt management strategy. More detailed assessments of direct and contingent debt exposures to large projects within the debt management framework will strengthen the risk management going forward. The government's commitment to evaluating and targeting infrastructure projects with high growth and social returns and financing these at concessional terms to the extent possible would benefit the debt sustainability. Development partners are providing technical assistance (TA) in these areas.

- **Building resilience to natural disasters.** Lao P.D.R. has become more prone to natural disasters and needs to build the fiscal space to mitigate weather related shocks and its economic and social consequences. Developing the disaster recovery framework with well-defined institutional arrangements, policies, financing mechanisms, and ensuring accelerated implementation of a reconstruction program with the support from development partners remain a priority (Appendix III).

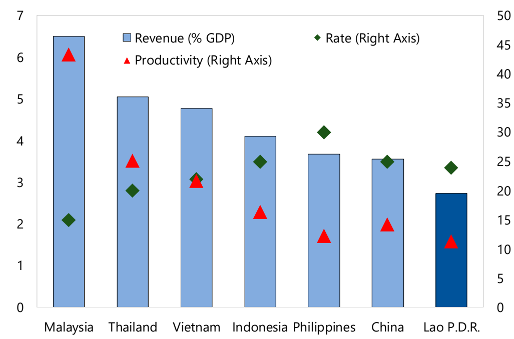
Authorities' Views

13. The authorities recognized the high level of public debt and highlighted their commitment towards continued strong fiscal consolidation. They mentioned that their efforts are already reflected in the reduction of the fiscal deficit in 2018 despite it being a challenging year. They have been clearing the outstanding stock of expenditure arrears related to past investment projects and have put in place various reforms in the areas of PFM and revenue mobilization. They specified that spending on the recovery needs from the natural disasters in 2018 will be reallocated from the existing investment funds and will not add to the existing stock of debt. They reiterated that a fiscal deficit of about 2 percent of GDP could be achieved by 2025. Their commitment going forward will be supported by efforts to improve revenue administration and spending optimization including reduction in the size of the civil service employment and further rationalization of capital spending. They noted that the IMF's policy recommendations will be taken into consideration and, in general, these recommendations are already in line with the government's commitment to maintaining financial sustainability, fiscal consolidation, and debt management.

Box 3. Lao P.D.R.: Profit Tax Incentives[1]

The widespread use of tax incentives may lead to lower profit tax revenues. Compared to other countries in the region, Lao P.D.R.'s profit tax revenues and productivity are the lowest, while its profit tax rate is relatively high. The Law on Investment Promotion provides tax holidays ranging between 7–15 years, depending on the business activity and location of the business. The duration of the tax holidays offered in Special Economic Zones is negotiable. Additional investment incentives include exemptions from import duties for the importation of raw material, equipment, spare parts and vehicles directly used for production and exemptions from export duties for general goods and products.

Profit Tax Revenues, Rates and Productivity



Source: IMF staff calculations.
Note: All data are from 2015 with the exception of Lao P.D.R. Profit Tax productivity (2013).

Up to 80 percent of the profit tax base could be exempt. While precise data on the size of the exempt sector is unavailable, the corporate tax base can be approximated using data on industry-specific value added and an estimated share of the total value-added subject to profit tax.[2] The corporate tax base is calculated only for the non-resource and non-agriculture sectors, as the natural resource sector is subject to a different regime and the agriculture sector is mainly represented by tax-exempt small-scale producers. The standard profit tax rate of 24 percent is then applied to the adjusted value added in the non-resource sector to calculate potential revenue. Potential profit tax revenue is about 80 percent higher than the actual revenue collections, implying a revenue gap of 4.5 percent of GDP, on average.

Lao P.D.R.: Relative size of exempt sector approximations

	2012	2013	2014	2015	2016
			(In billions of kip)		
Adjusted value added in non-resource sector	18,684	22,002	25,654	28,242	29,987
Actual Profit Tax revenue	869	1,054	1,190	1,464	1,274
Potential Profit Tax revenue at 24 percent rate	4,484	5,280	6,157	6,778	7,197
			(In percent)		
Effective tax rate	4.65	4.79	4.64	5.18	4.25
Relative size of the exempt sector	80.61	80.03	80.68	78.4	82.29
Foregone revenue as percent of GDP	4.43	4.50	4.65	4.53	4.58

Source: Lao P.D.R national accounts data; and IMF staff calculations.

Adopting a rules-based tax incentives system will make the investment framework more predictable. A discretionary system of tax incentives creates the space for bargaining and increases corruption related vulnerabilities. The government plans to undertake a comprehensive review of tax incentives with a view of moving to a rule-based system of granting tax incentives. Consistent monitoring of the forgone revenue due to tax incentives could usefully inform policy discussions. To this end, quantifying forgone revenues from tax incentives and reporting those as part of the national budget could also improve accountability transparency and accountability.

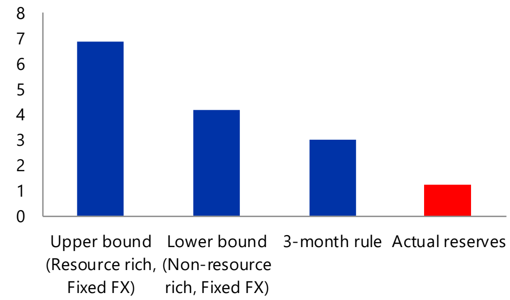
1/ Based on the 2018 FAD TA report "Lao P.D.R.: The Tax Policy Component of a Medium-Term Revenue Strategy" prepared by David Baar, Sebastian Beer, and Chris Heady.

2/ National accounts data contains information on industry-specific value added. The ORBIS data on firms in the ASEAN region is used to calculate an approximate share of value added which is typically subject to tax based on deductibility of business expenses. The estimates show that, on average, about 42 percent of the total value added is taxable.

REBUILDING RESERVES AND SAFEGUARDING MACRO-FINANCIAL STABILITY

14. The overall external position is assessed to be substantially weaker than the fundamentals and desirable policies. The current account is expected to remain in deficit with high external debt and weak reserve coverage. An import coverage of around 4–6 months is considered adequate for Lao P.D.R. per the IMF's adequacy metrics (Appendix II). Increasing exchange rate flexibility and boosting productive investments to increase competitiveness and economic diversification are necessary to strengthen the overall external position. The authorities' objective is to limit currency fluctuations of kip against US dollar within ±5 percent per annum. To pursue this objective, the Bank of Lao P.D.R. (BOL) sets a daily official reference rate for kip to US dollar which is calculated based on the weighted average of the previous day's rate, the estimation of the FX demand and the international market rate.

Lao P.D.R.: Reserve Adequacy Assessment
(In months of imports)



Source: IMF staff calculations; and National authorities.

15. Monetary and exchange rate policy recommendations. Strengthening the monetary policy regime will allow more exchange rate flexibility in the medium-term and reduce banking sector vulnerabilities:

- **Modernizing monetary governance.** A new legal framework for the BOL Law, Commercial Bank Law, and Law on Payment Systems were all adopted in 2018. The implementation of the new legal framework should be supported by developing regulations, manuals, staff training, and TA from various development partners. Rolling out a payment clearing infrastructure for the banking system will improve the efficiency of transactions.

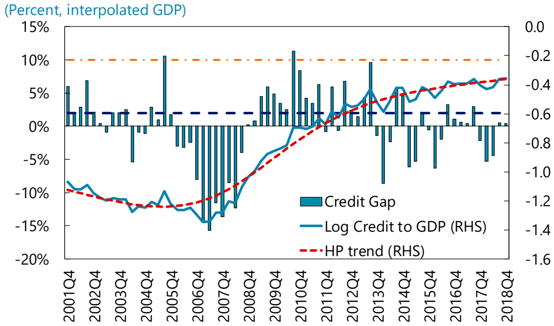
- **Rebuilding reserves.** Over the long term, structural reforms enabling greater economic diversification will help strengthen the reserve position. As an immediate priority, improving the BOL's liquidity forecasting and advance provisioning for seasonal FX pressures could help to protect the reserve buffer, supported by faster fiscal tightening and greater exchange rate flexibility. Aggressive short-term exchange rate adjustments are to be avoided to prevent a rapid deterioration in the balance sheets of banks and corporates from currency mismatches and FX risks. The BOL may consider a possible widening of the FX trading band, strengthening the FX trading infrastructure, and developing the spot market.

- **Developing debt securities market.** Standardizing the issuance of government securities with a pre-specified target and a regular auction schedule and developing the infrastructure of the government securities trading will improve the functioning of the interbank market and develop a benchmark yield curve. Developing regular auctions, publishing an auctions calendar, and establishing a consistent coordinating mechanism between BOL and MoF will create a more supportive environment for the development of the domestic securities market.

16. Financial sector policy recommendations. Except for a few state-owned banks, the banking system remains relatively well capitalized, but with low profitability. Official data indicate aggregate NPLs continues to be around 3 percent of gross loans, but significant variation across banks is expected. The credit gap in the economy is close to zero due to economic slowdown, the legacy of past NPLs, and natural disasters in 2018. Small and medium enterprises' (SMEs) limited access to finance constrains further diversificaiton of the economy (Appendix IV). To continue the process of financial deepening, strengthening the resilience to foreign and domestic risks and reducing dollarization, the following reforms are recommended:

Lao PDR: Credit to GDP Gap

(Percent, interpolated GDP)



Sources: National authorities' data and IMF Staff estimates. Quartely GDP is estimated by interpolating annual GDP by using trade data.

- **Addressing risks.** Implementation of risk-based supervision remains a multi-year effort. Finalizing and adopting the risk-based supervision manual and gradually transitioning to IFRS accounting and reporting standards will enable the consistent assessment of risks. NPLs should be identified based on more solid accounting standards and be properly provisioned for as needed. Progress has been made in publishing Financial Soundness Indicators (FSIs) but further efforts are needed to publish these as per the IMF's methodology. Adhering to the timeline for a transition towards the Basel II framework will help to build buffers. Clear guidance on forthcoming regulatory changes, supported with active communication on policy motivation and expected outcomes, will improve predictability of the overall financial sector regulatory environment.

Lao P.D.R.: Selected Financial Soundness Indicators (FSIs), 2017–18

(In percent, the end of year)

	2017	2018
Asset Quality		
Regulatory capital to risk-weighted assets	15.8	18.3
Regulatory Tier 1 capital to risk-weighted assets	12.5	13.6
Nonperforming loans net of provisions to capital	9.3	10.2
Nonperforming loans to total gross loans (NPL)	3.1	3.1
Earnings and Profitability		
Return on assets	0.5	0.8
Return on equity	7.8	10.9
Interest margin to gross income	-	30.2
Noninterest expenses to gross income	-	33.1
Memorandum items (in millions of US dollars)		
Total assets	122,408	130,832
Total deposits	68,033	73,672
Total credits	66,939	69,234

Source: Bank of Lao P.D.R (BoL)

- **Crisis management and prompt corrective action.** The prompt corrective action, crises management and resolution framework, currently being discussed by BOL, should be carefully designed and drafted. Strengthening bank balance sheets through proper diagnostics, loss recognition and recapitalization should be fortified. Enhanced external examinations of systemically important banks and the preparation of contingency plans, including a well formulated financial safety net, should be developed to supplement the new Commercial Bank Law.

- **Improving access to finance.** Continued reform efforts are needed for SMEs to become drivers of diversification and growth. Simplifying the regulatory environment for SMEs to enable the formalization of their business practices, facilitating SME financial literacy and access to finance through specialized products, and tailoring training programs for female business owners should be considered (Appendix IV).

- **Reducing foreign currency lending risk.** In additional to limits in place on banks' net open positions and various regulations on controlling foreign currency lending, authorities could also consider raising foreign exchange reserve requirements, which will act as a liquidity buffer in the event of a sudden tightening of liquidity.

Authorities' Views

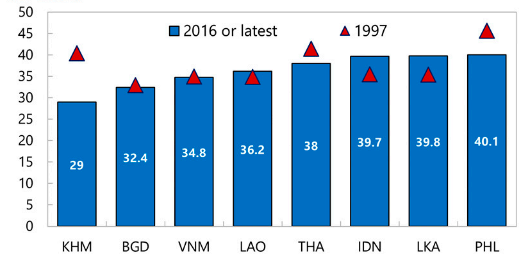
17. The authorities agreed on the need to increase the level of gross international reserves. They noted challenges such as large FDI projects keeping their foreign exchange earnings outside the country. Therefore, the authorities explained that they assess their reserve adequacy by excluding imports related to FDI. Given that most of the FDI related projects use their own funding unrelated to the reserves in the central bank, coverage of about 3 months of non-FDI related imports are adequate as compared with the IMF's assessment of 4–6 months of coverage of total imports. They added that over the long term, economic diversification and the exports receipts, including from tourism, will help strengthen their reserve position. They agreed with the gradual approach in increasing exchange rate flexibility noting that further reforms to improve the functioning of the interbank and domestic debt markets are important preconditions for greater exchange rate flexibility in the medium term.

18. The authorities explained that the slowdown in credit growth is a result of the slowdown in the economy, including from flooding, and lower government expenditure. Strengthening risk-based supervision has been implemented based on the IMF's past advice. Amongst other developments in the financial sector, they noted that the new Commercial Bank Law was passed in 2018, which contains provisions for crisis management and bank resolution. In addition, financial soundness indicators to better track developments in the banking system have been developed and, starting in 2018, these are being disseminated. There are no plans for raising foreign exchange reserve requirements in the near term, given the credit slow-down. They indicated that some of the state-owned banks are being restructured, which will help bring down the level of NPLs. SMEs have become a priority for facilitating the transition towards a more inclusive growth model and various strategies are being implemented to improve access to finance, including for women, and the overall regulatory environment.

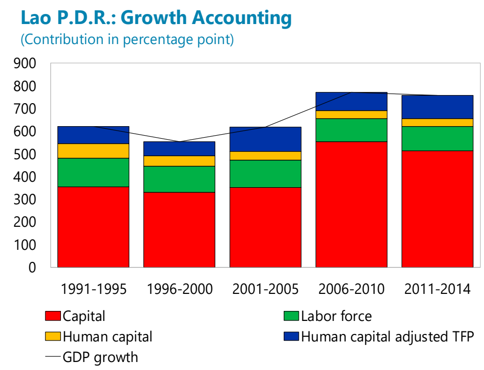
PROMOTING COMPETITIVENESS AND INCLUSIVE GROWTH

19. Spreading the benefits of economic growth would require consistent investment in human capital. Over the past decade, significant progress has been made in transitioning from a mining to renewable energy-driven growth. However, spillovers from the fast-growing sectors to the rest of the economy have been limited with poverty and inequality indicators plateauing[3]. A simple growth accounting exercise demonstrates that the heavy reliance on capital investments drove

[3] While broader aspects of inequality and welfare were covered in Lao P.D.R 2017 Article IV Consultation Report (March 2018), as a follow up this report focuses on gender inequality and diversification aspects.



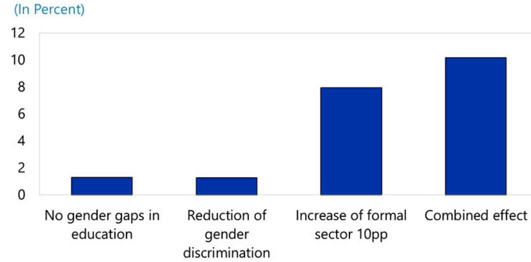
Source: SWIID 6.1.
Note: Gini computed using consumption. Due to data unavailability, data points closest to 1997 and 2016 were used. Latest data point available for KHM, THA, VNM and PHL is based on 2012, 2013, 2014 and 2015. Data point closest to 1997 for THA and VNM (1998) for IDN and BNG (1996) and LKA (1995).



Sources: Penn World Tables; IMF staff calculations.

economic growth, while the contribution of labor has been consistently low and that of human capital has been decreasing over time. Skills shortage is ranked as one of the top barriers to doing business in Lao P.D.R., while burdensome legal and regulatory systems, high informality, access to land, access to finance, and fragmented investment management system are also challenging. Efforts to bolster diversification of exports, especially among SMEs, should focus on reducing these barriers, in addition to improving access to credit. To reap economic and social benefits from the Lao-China mega-railway project, which has a potential of transforming Lao P.D.R. from a land-locked to a land-linked country, the authorities should step up and frontload complementary reforms aimed at simplifying regulatory environment, improving adjacent infrastructure, logistical services, and trade facilitation networks (Appendix IV).

20. Greater participation of women in the formal economy would further promote growth. Labor force participation rates are relatively equitable, and women are increasingly running their own businesses in Lao P.D.R, but gender gaps persist in formal employment and education attainment. Women in Lao P.D.R. are more likely to engage in unpaid family work and earn, on average, 20 percent less in hourly wages than men, in part due to lower rates of secondary school completion and high adolescent fertility rates. Closing gender gaps in educational attainment, reducing barriers to female labor force participation, and promoting formal employment would help to reduce gender inequality in earnings, boost tax revenues and generate additional 10 percent in long-run GDP growth (Appendix V). More importantly, aligning spending priorities with SDGs, especially in the health and education sectors, will help to advance their inclusive development objectives and strengthen budget accountability mechanisms.



Source: IMF staff calculations.
Note: Last column combines three policy scenarios: no gender gaps in education, reduction of gender discrimination, and increase of formal sector employment by 10pp.

21. Increasing efforts to reduce corruption-related vulnerabilities will help to make growth more inclusive. Lao P.D.R. ratified the UN Convention against Corruption in 2009, and key legislation governing anti-corruption framework has been adopted including, but not limited to Anti-Corruption Law, Law on Criminal Procedure, Anti-Money Laundering and Counter-Financing of

Terrorism (AML/CFT), various decrees on asset declaration and financial monitoring of public servants. Nonetheless, available evidence, based in part on perceptions-based indicators, continues to point to significant corruption vulnerabilities, suggesting a need for more effective and impartial implementation of anti-corruption efforts. Corruption vulnerabilities could be further reduced by moving to a more rules-based tax incentive system (Box 3) and by reforms to strengthen fiscal governance, monetary governance, and banking supervision, as detailed in previous sections.

22. Steps are being taken to strengthen the AML/CFT framework. Progress is being made in implementing the new legislation on AML/CFT. Lao P.D.R. was removed from the AML/CFT grey list in 2017. The next full assessment against the Financial Action Task Force (FATF) standard is scheduled for 2020. This assessment is expected to be challenging given that it will focus on the effectiveness of the AML/CFT regime in addition to technical compliance. The National Risk Assessment, completed in 2017–18, has identified some of the key weaknesses of the AML/CFT system and supervision has begun in three high risk sectors. Interagency coordination mechanism and data gathering Memorandums of Understanding (MoUs) are in place to support these efforts. A few AML cases are in the pipeline for legal action.

23. Improving economic statistics is gaining momentum. The authorities have started publishing fiscal data on government operations as part of e-GDDS. They are also making good progress in moving to the IMF's BPM6 methodology. The upcoming new International Investment Position survey is expected to improve the balance of payment accounts including the private debt estimates. And while debt statistics reporting has strengthened, there is room to improve the recording of debt data including by upgrading the current debt management software. Overall, the authorities are making strong strides in gradually improving national accounts' timeliness, breadth, and frequency, supported by TA from the IMF and developing partners (Appendix VI).

Authorities' Views

24. The authorities see diversifying the economy as one of their key policy goals. They emphasized that transitioning from a resource-based economy towards agriculture, services, and manufacturing will be a gradual process. They highlighted that inclusive growth is one of the main goals of their development plans. They agreed that analyzing the impact of gender inequality was vital to their development plans and mentioned that gender disparities are larger in rural areas. The midterm review of the progress towards achieving SDGs shows that a lot of improvements have been made on several indicators related to SDGs.

25. Progress is being made in implementing the new legislation on AML/CFT. The authorities are confident that with implementation frameworks already in place and preparations underway, the next full assessment against the FATF standard scheduled for 2020 could be completed satisfactorily. The National Risk Assessment was completed in 2017–18 and an interagency coordination mechanism and data gathering MoUs are in place to support the efforts in preparation for the upcoming assessment.

STAFF APPRAISAL

26. Long-term growth prospects remain strong with significant downside risks. Growth in 2018 slowed mainly due to natural disasters and, over the medium term, it is expected to pick up gradually supported by private investment, electricity exports, and completion of the Kunming-Vientiane railway project. However, risks to the outlook are tilted to the downside and mainly stem from external developments, slower than the anticipated implementation of committed structural reforms, and weather-related shocks. In an uncertain global environment, a sharper than expected slowdown in China or market reactions to global financial tightening may affect exports and financing flows. Delays in implementation of reform commitments in tax and PFM reforms risk prevent building up the fiscal space for social and development spending. Taking the appropriate measures for provisioning for weather-related shocks also remain important.

27. Additional fiscal consolidation supported by comprehensive revenue and public financial management reforms would also strengthen fiscal governance. Strong fiscal consolidation efforts with the intention of reaching a fiscal deficit of 2 percent of GDP by 2025 will help to address debt vulnerabilities. Importantly, aligning spending priorities with SDGs will help to advance inclusive development objectives and strengthen budget accountability mechanisms. To this end, rebalancing the composition of the fiscal consolidation from expenditure compression to revenue generation should enable more spending on social development. To support this objective, implementing a well-defined MTRS, simplifying and broad-basing tax legislation, and automating tax administration systems are ongoing reform priorities. Reviewing forgone revenues due to current tax exemptions is an important component for re-building the revenue base.

28. The debt vulnerabilities remain challenging. Debt levels are high and vulnerabilities, as highlighted in the DSA, stem from risks to exports, depreciation of the currency, large exposures to PPPs, potential recapitalization needs of a few state-owned banks, and the aftermath from potential natural disasters. The government's commitment to assessing and targeting infrastructure projects with high social returns and financing these at concessional terms to the extent possible will benefit debt sustainability. Effective implementation of the new Public Debt Management Law (2018) and developing a debt management strategy, supported with strong institutional capacity building efforts, will strengthen the debt carrying capacity going forward. Given the scale of the projects, it is vital to further strengthen the public investment framework, including legal and institutional frameworks for PPPs. While intergovernmental PPAs, large export receipts, and a growing power exports market help to mitigate risks related to power sector loans, actively diversifying the power sector export market and continuously assessing and monitoring possible fiscal risks from PPPs are needed to help to keep the debt burden contained. To reap potential benefits from the mega-railway project, stepping up and frontloading complementary reforms aimed at simplifying regulatory environment, improving adjacent infrastructure, logistical services, and trade facilitation networks need to be prioritized.

29. Modernizing monetary governance, strengthening liquidity management, and continued exchange rate flexibility are needed to support reserve buildup. The overall external position is assessed to be substantially weaker than fundamentals and desirable policies. The current account is expected to remain in deficit with high external debt and weak reserve coverage. Increasing exchange rate flexibility and boosting productive investments to increase competitiveness and diversification are necessary to strengthen the overall external position. In the near-term, improving liquidity forecasting and advance provisioning for seasonal FX pressures, supported by fiscal tightening and greater exchange rate flexibility will help to improve reserves. Going forward, modernization of the monetary governance framework needs to be supported by regulations, clear guidance, and a proactive communication strategy to implement newly adopted laws. To this end, establishing a consistent coordinating mechanism between the central bank and the Ministry of Finance will also enable a more supportive environment for the development of the domestic securities market.

30. Financial sector reforms should focus on financial deepening and strengthening resilience to risks. Implementing risk-based supervision and designing the prompt corrective action, crises management and resolution framework will help identifying and reducing risks, while a transition towards the Basel II framework will help to build buffers. In additional to various regulations to mitigate risks related to lending in foreign currency, authorities could also consider raising foreign exchange reserve requirements, which will act as a liquidity buffer in the event of a sudden tightening of liquidity. Clear guidance on forthcoming regulatory changes, supported with active communication on policy motivation and expected outcomes, will improve predictability of the overall financial sector regulatory environment. Simplifying the regulatory environment for SMEs, facilitating SME financial literacy and access to finance through specialized products, and tailoring training programs for female business owners should be considered to enable SMEs to become drivers of diversification and growth.

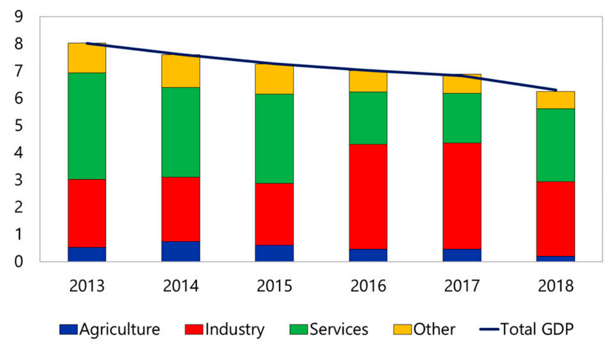
31. Spreading the benefits of economic growth would require consistent investment in human capital and addressing corruption vulnerabilities. Improving the education attainment, skills training, reducing the regulatory burden on SMEs, easing trade regulations, improving access to finance, and greater participation of women in the formal economy would help to make growth more inclusive and reduce inequality. Ongoing reforms in strengthening fiscal and monetary governance supported with comprehensive legal and institutional reform strategies, automation efforts, and improving economic statistics would help to increase access, transparency, and efficiency of the public service delivery and in turn narrow the space for corruption. In that context, implementing anti-corruption measures and AML/CFT agenda are also important. While being removed from the AML/CFT grey list was an important achievement, the interagency coordination in preparation for the 2020 full FATF assessment should continue. Using TA from development partners remains critical to support these ambitious reform agendas.

32. It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

Figure 1. Lao P.D.R.: Resource-Based Growth Remains Robust and Inflation is Contained

While real GDP growth has moderated, it remains robust …

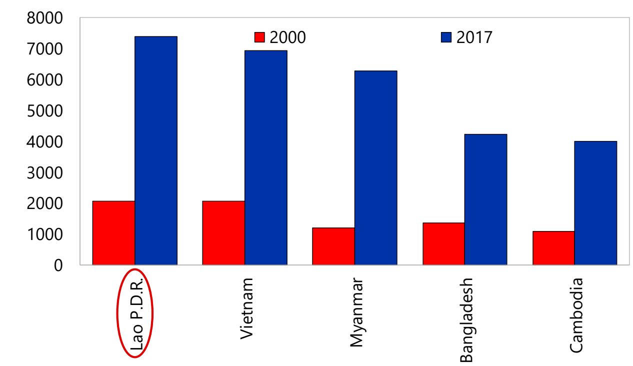
Contribution to Real GDP Growth by Economic Activities
(Year-on-Year Percent Change; Base year=2002)



Sources: National authorities; and IMF staff estimates.

… and has translated into higher per capita GDP.

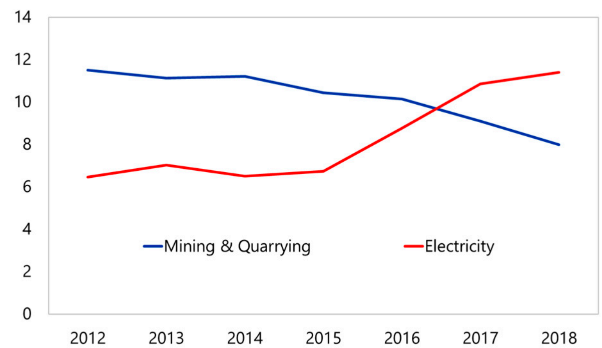
GDP per Capita, current prices
(Purchasing power parity; international dollars)



Source: IMF's World Economic Outlook database.

Rebalancing from mining to electricity driven exports…

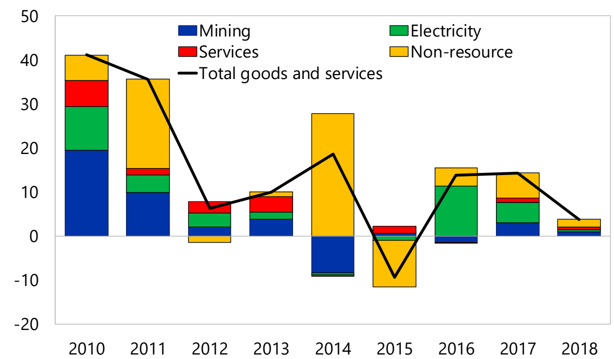
Value-Added: Mining & Quarrying and Electricity
(In Percent of Real GDP; Base year=2002)



Source: National authorities.

…is also reflected in the electricity's contribution in export growth.

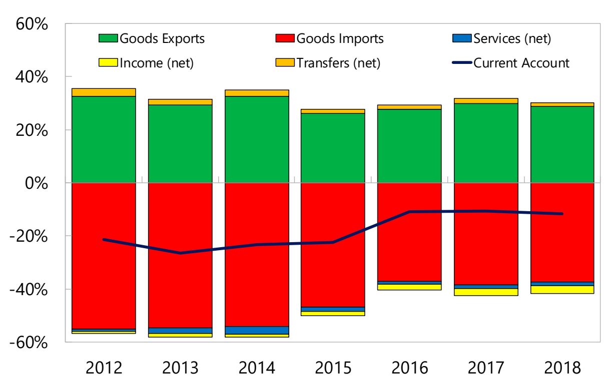
Contribution to Export Growth
(year-on-year percent change)



Sources: National authorities; and IMF staff estimates.

Damage from flooding added to the large imports…

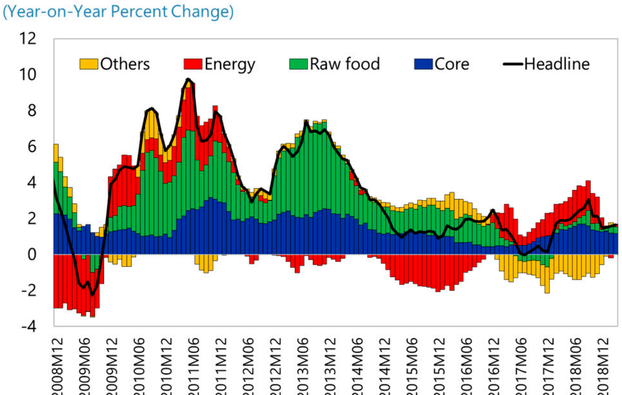
Current Account Balance
(In percent of GDP)



Source: IMF staff estimates

… but had minimal impact on core inflation.

Contribution to Headline Inflation
(Year-on-Year Percent Change)

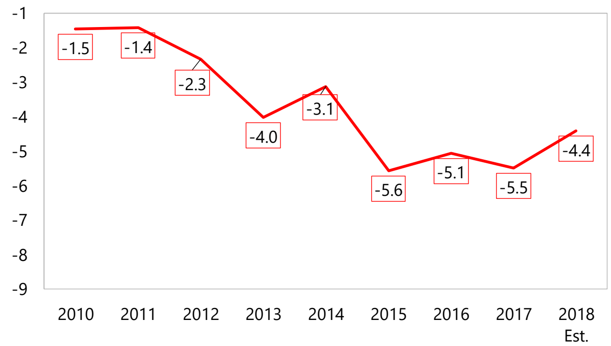


Sources: National authorities; and IMF staff calculations.

Figure 2. Lao P.D.R.: Creating Fiscal Space for Social Development

Fiscal consolidation has accelerated…

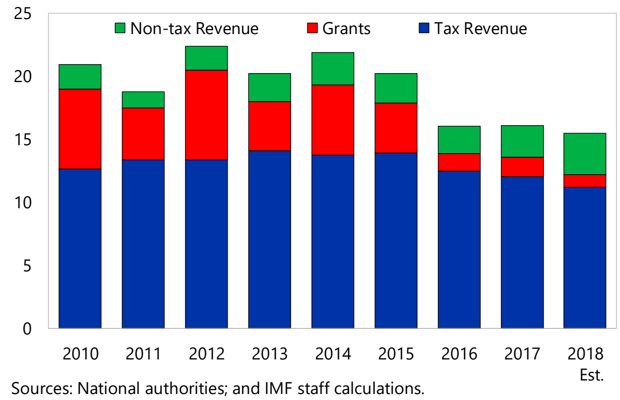
Fiscal Balance
(In percent of GDP)



Sources: National authorities; and IMF staff calculations.

…but the quality of the consolidation remained low due to underperforming revenues…

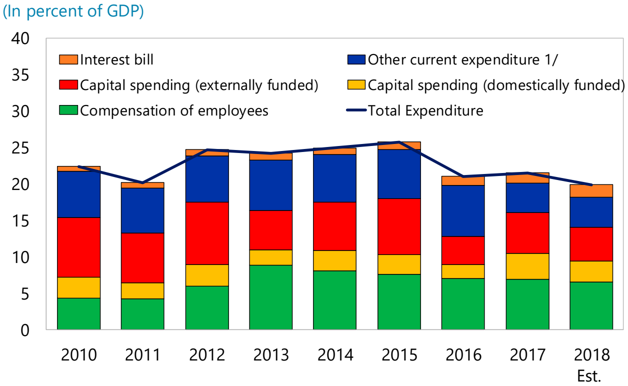
Government Revenue
(In percent of GDP)



Sources: National authorities; and IMF staff calculations.

…and spending compression.

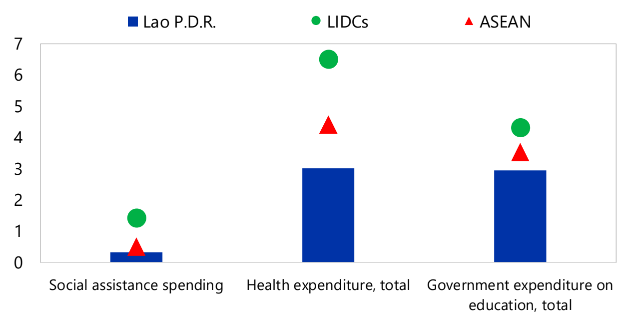
Government Expenditure
(In percent of GDP)



Sources: National authorities; and IMF staff calculations.
1/ Including grant-financed capital expenditure from 2010 onward.

Social spending would benefit from a boost…

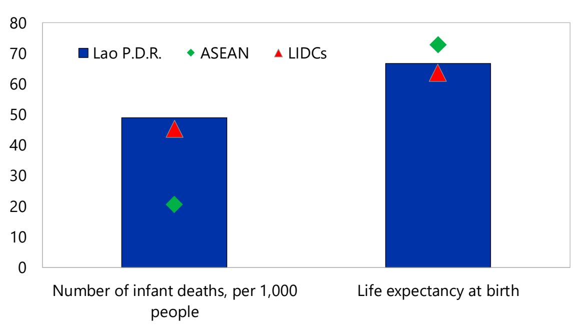
Social Assistance, Health and Education Spending
(In percent of GDP)



Sources: IMF FAD Expenditure Assessment Tool (EAT), World Economic Outlook, ASPIRE, and IMF Pension Indicators.
Note: Data shown is the latest available.

…as well as improving healthcare…

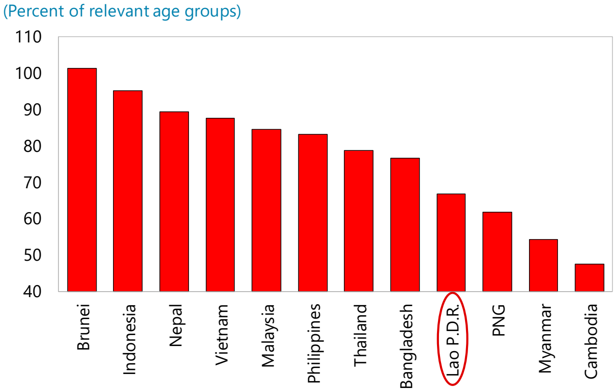
Health Indicators and Health System Characteristics
(Latest value available)



Source: IMF FAD Expenditure Assessment Tool (EAT), World Bank, World Health Organization.

…and education.

Lower Secondary School Completion
(Percent of relevant age groups)

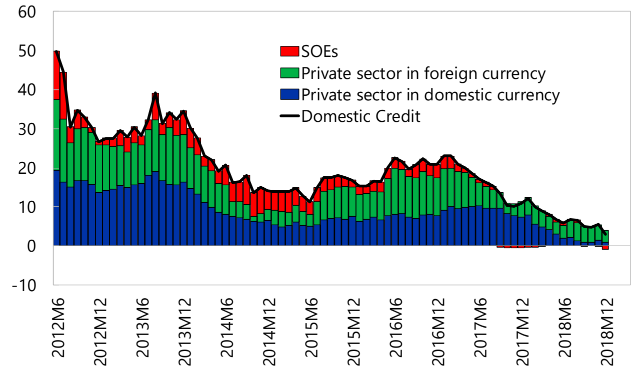


Sources: World Bank's World Development Indicators; and IMF staff calculations.

Figure 3. Lao P.D.R.: Credit Growth has Declined and Risks have Accumulated

As the economy slowed and fiscal conditions tightened, credit growth declined …

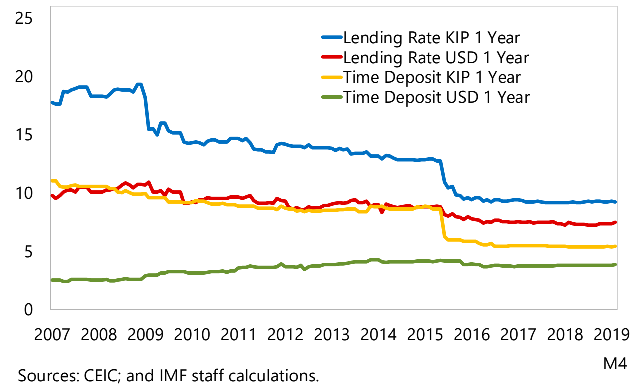
Contribution to Credit Growth
(Year-on-Year Percent Change))



Sources: National authorities; and IMF staff calculations.

… the caps on interest rates remained distortionary …

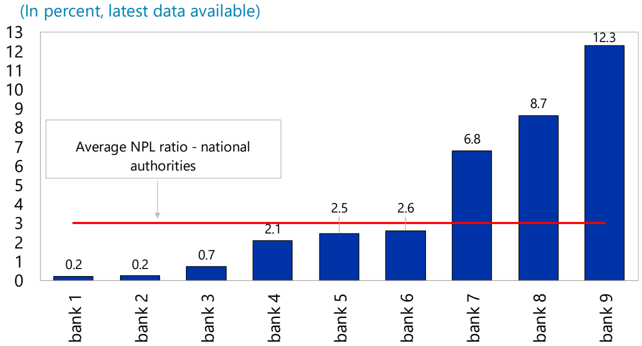
Lending-deposit Rate Spread: Kip and US dollar
(In Percent)



Sources: CEIC; and IMF staff calculations.

…and NPLs built…

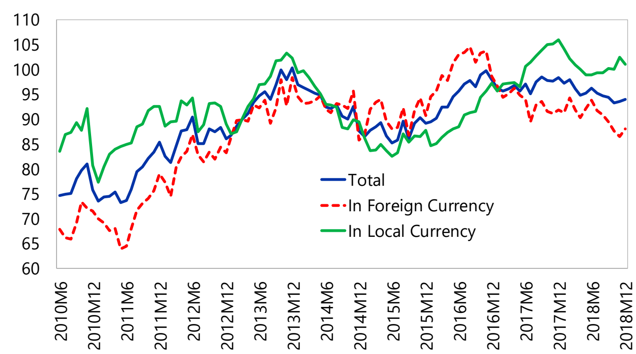
Non-Performing Loans to Gross Loans in Selected Banks
(In percent, latest data available)



Source: Fitch Connect; National authorities.
Note: Fitch Connect data on NPLs is only available for the sample of banks shown.
Latest data available by bank in the order shown is as follows: 2014, 2017, 2017, 2017, 2016, 2015, 2012, 2016, 2017.

… which was also reflected in the banking sector's sluggish risk appetite.

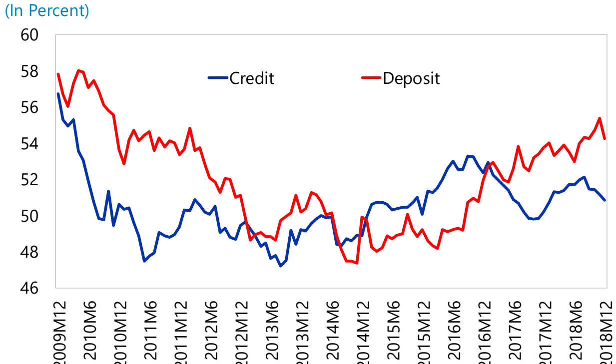
Commerical Banks: Loan-to-Deposit Ratio
(In Percent)



Sources: National authorities; and IMF staff calculations.

in a dollarized environment…

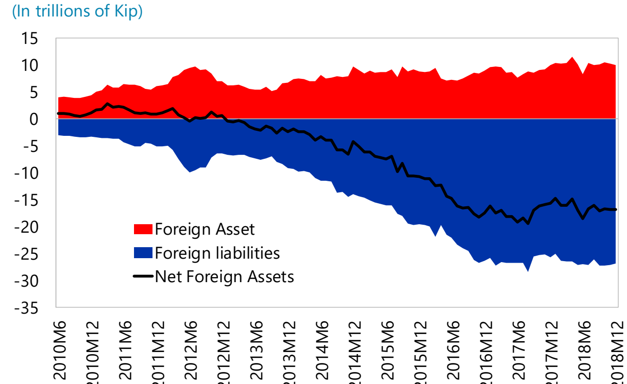
Foreign Exchange Share in Credit and Deposits
(In Percent)



Sources: National authorities' data; and IMF staff calculations.

…where the banking sector remains a large net foreign debtor

Commercial Banks: Foreign Assets and Liabilities
(In trillions of Kip)



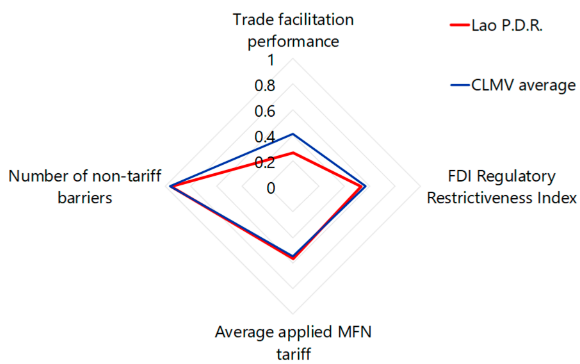
Sources: National authorities.

Figure 4. Lao P.D.R.: Improving the Investment Climate

Non-trade barriers are high and…

Overall Trade and FDI Regime

(Distance to frontier score)

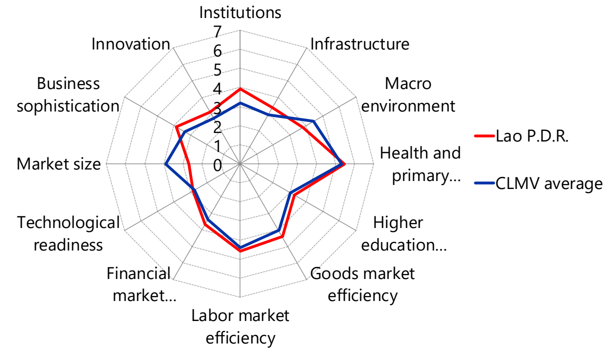


Sources: WTO, World Tariff Profiles; OECD; World Bank; UNCTAD TRAINS database.

…there is substantial room to boost competitiveness …

Global Comptitiveness Index

(Score 1-7, higher is better; 2014-15)

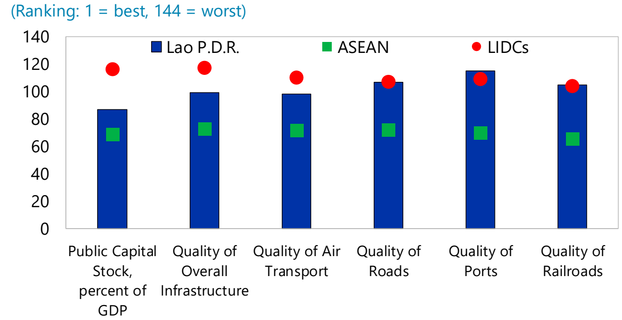


Source: World Economic Forum, Global Competitiveness Index.

… especially by improving infrastructure …

Capital Stock and Infrastructure Quality, Latest value available

(Ranking: 1 = best, 144 = worst)

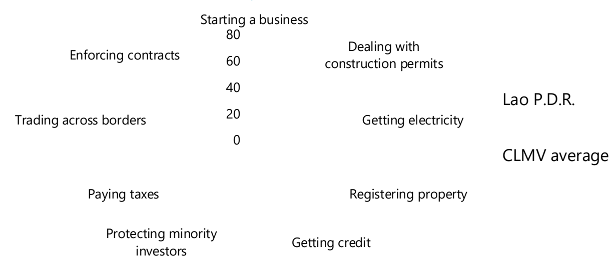


Sources: IMF FAD Expenditure Assessment Tool (EAT), World Economic Outlook, World Development Indicators, IMF Investment and Capital Stock Dataset, and World Economic Forum.

…to improve the overall investment climate.

Doing Business Indicators 1/

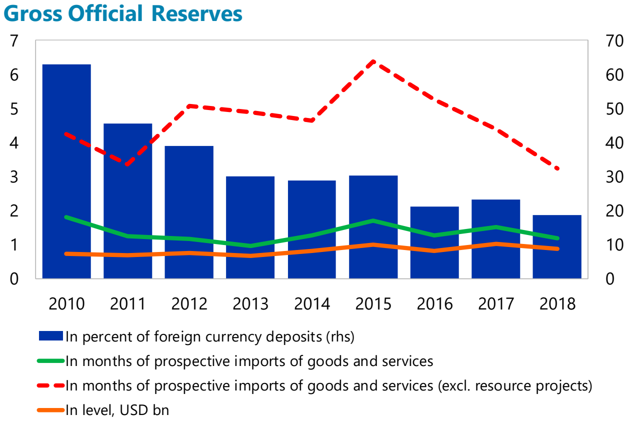
(Distance to frontier score 2/; 2017)



Source: World Bank, Doing Business Indicators.
1/ These indicators should be interpreted with caution due to a limited number of respondents, a limited geographical coverage, and standardized assumptions on business constraints and information availability.
2/ On a scale of 0 to 100; 100 is the frontier and 0 is the furthest from the frontier.
Note: Resolving insolvency indicator is not available for Lao P.D.R.

This will help build reserve buffers in the long-term…

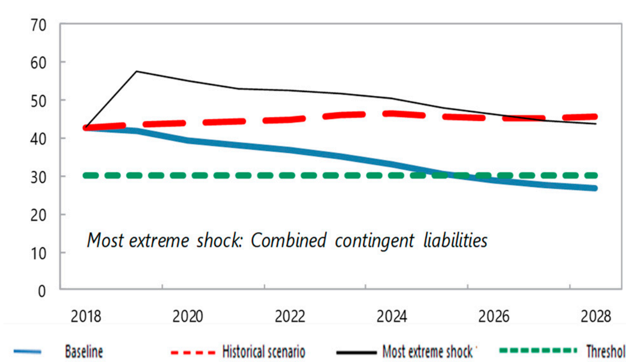
Gross Official Reserves



Sources: National authorities; and IMF staff calculations.

…and strengthen the economy's reliance to weather external shocks.

Public and Publicly Guranteed External Debt under Alternative Scenarios (PV of debt-to-GDP ratio)



Sources: IMF staff calculations.

Table 1. Lao P.D.R.: Selected Economic and Financial Indicators, 2015–2020

	2015	2016	2017	2018	2019	2020
				Est.	Proj.	Proj.
GDP and prices (percentage change)						
Real GDP growth	7.3	7.0	6.8	6.3	6.4	6.5
CPI (annual average)	1.3	1.8	0.7	2.0	3.1	3.3
CPI (end year)	0.9	2.5	0.1	1.5	2.9	3.1
Public finances (in percent of GDP)						
Revenue and Grants	20.2	16.0	16.1	15.5	15.8	15.9
Expenditure	25.8	21.1	21.6	19.9	20.1	20.0
Expense	15.4	15.4	12.5	12.5	13.1	12.8
Net acquisition of nonfinancial assets	10.4	5.7	9.1	7.5	7.0	7.2
Overall balance	-5.6	-5.1	-5.5	-4.4	-4.3	-4.1
Money and credit (annual percent change)						
Reserve money	6.6	-1.4	9.5	5.0	14.8	-
Broad money	14.7	10.9	12.2	8.4	16.7	-
Bank credit to the economy 1/	16.8	20.9	10.8	3.0	11.8	-
Bank credit to the private sector	19.3	22.0	14.2	4.7	13.2	-
Balance of payments						
Exports (in millions of U.S. dollars)	3,753	4,409	5,110	5,295	6,037	6,535
In percent change	-12.9	17.5	15.9	3.6	14.0	8.3
Imports (in millions of U.S. dollars)	6,728	5,904	6,546	6,903	7,597	8,298
In percent change	-6.2	-12.2	10.9	5.5	10.1	9.2
Current account balance (in millions of U.S. dollars)	-3,220	-1,752	-1,816	-2,170	-2,311	-2,543
In percent of GDP	-22.4	-11.0	-10.6	-12.0	-12.1	-12.0
Gross official reserves (in millions of U.S. dollars)	987	815	1,016	873	1,087	1,458
In months of prospective goods and services imports	1.7	1.3	1.5	1.2	1.3	1.7
(Excluding imports associated with large resource projects) 2/	6.4	5.3	4.4	3.2	…	…
Exchange rate						
Official exchange rate (kip per U.S. dollar; end-of-period)	8,148	8,151	8,293	8,530	…	…
Real effective exchange rate (2010=100)	127	131	129	126	…	…
Nominal GDP						
In billions of kip	117,252	129,279	140,749	152,414	164,147	184,152
In millions of U.S. dollars	14,363	15,916	17,069	18,120	19,127	21,211

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.

1/ Includes Bank of Lao P.D.R. lending to state-owned enterprises and subnational levels of government.

2/ The authorities' methodology assesses reserve coverage by excluding imports related to FDI given that most of the FDI related projects use their own funding unrelated to the reserves in the central bank.

Table 2a. Lao P.D.R.: Balance of Payments, 2015–24
(In billions of kip)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
					(In billions of kip, unless otherwise indicated)					
Current Account	**-3,220**	**-1,752**	**-1,816**	**-2,170**	**-2,311**	**-2,543**	**-2,569**	**-2,723**	**-2,979**	**-3,240**
Excluding official transfers	-3,350	-1,913	-2,012	-2,197	-2,339	-2,575	-2,598	-2,748	-3,150	-3,435
Excluding petroleum imports	-2,838	-1,422	-1,384	-1,573	-1,808	-1,997	-1,972	-2,069	-2,265	-2,459
Merchandise trade balance	-2,975	-1,495	-1,436	-1,609	-1,560	-1,763	-1,778	-1,785	-1,702	-2,011
Exports, f.o.b.	3,753	4,409	5,110	5,295	6,037	6,535	7,258	8,020	8,787	9,176
Mining and electricity	1,837	2,294	2,692	2,772	2,696	2,647	2,830	2,669	2,779	2,838
Imports, c.i.f.	6,728	5,904	6,546	6,903	7,597	8,298	9,036	9,805	10,489	11,187
Services (net)	-234	-188	-261	-233	-351	-305	-343	-384	-447	-481
Of which: Tourism	684	634	594	633	682	727	783	843	907	977
Income (net)	-232	-325	-445	-571	-646	-731	-705	-811	-1,238	-1,185
Interest payments	162	296	319	331	410	404	360	363	749	715
Of which: Public	117	134	175	216	291	245	258	272	289	306
Transfers (net)	221	255	327	242	247	255	257	257	409	437
of which: Private (net)	92	94	131	215	219	223	228	232	237	242
of which: Official (net)	129	161	196	27	28	32	30	25	171	195
Capital account	**36**	**22**	**22**	**21**	**21**	**21**	**20**	**20**	**19**	**19**
Financial account	**3,872**	**3,058**	**3,055**	**2,937**	**2,504**	**2,895**	**3,151**	**3,332**	**3,478**	**3,569**
Foreign direct investment (net)	1,079	1,076	1,695	1,420	1,459	1,502	1,550	1,605	1,663	1,726
Portfolio investment	538	514	326	498	512	525	539	553	568	583
Other investment	2,255	1,468	1,034	1,019	534	868	1,061	1,174	1,247	1,261
Public sector	1,062	1,325	1,262	1,461	1,796	2,066	2,093	2,190	2,395	2,598
Disbursements	928	1,093	993	1,078	1,310	1,461	1,585	1,691	1,861	2,051
Amortization	134	233	268	383	487	606	508	499	534	547
Banking sector (net)	789	813	-242	80	74	74	34	12	6	4
Other flows	672	-205	551	171	-14	336	491	647	791	891
Errors and omissions	-516	-1,343	-783	-931	0	0	0	0	0	0
Overall balance	171	-15	478	-142	215	372	602	629	519	349
in percent of GDP	1.2	-0.1	2.8	-0.8	1.1	1.8	2.6	2.5	1.9	1.2
Financing	**-174**	**15**	**-478**	**142**	**-215**	**-372**	**-602**	**-629**	**-519**	**-349**
Central bank net foreign assets	-174	32	-205	144	-215	-372	-602	-629	-519	-349
Assets (increase -)	-171	172	-201	143	15	-452	-600	-506	-323	-241
Liabilities (reduction -)	-3.0	-139.9	-4.1	1.5	-0.4	-1.0	-1.0	-1.0	-1.0	-1.0
Memorandum items:										
Current account balance (in percent of GDP)	-22.4	-11.0	-10.6	-12.0	-12.1	-12.0	-11.1	-10.8	-10.9	-10.9
Excluding official transfers	-23.3	-12.0	-11.8	-12.1	-12.2	-12.1	-11.3	-10.9	-11.5	-11.6
FDI (in percent of GDP)	7.5	6.8	9.9	7.8	7.6	7.1	6.7	6.4	6.1	5.8
Gross official reserves	987	815	1,016	873	1,087	1,458	2,059	2,687	3,204	3,552
In months of prospective imports of goods anc	1.7	1.3	1.5	1.2	1.3	1.7	2.2	2.6	2.9	3.0
Excludes imports from large FDI projects 1/	6.4	5.3	4.4	3.2	...	...	...	...	...	...
Nominal GDP (In millions of U.S. dollars)	14,363	15,916	17,069	18,120	19,127	21,211	23,084	25,107	27,299	29,672

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.

1/ The authorities' methodology assesses reserve coverage by excluding imports related to FDI given that most of the FDI related projects use their own funding unrelated to the reserves in the central bank.

Table 2b. Lao P.D.R.: Balance of Payments, 2015–24

(In percent of GDP)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
				(In percent of GDP, unless otherwise indicated)						
Current Account	**-22.4**	**-11.0**	**-10.6**	**-12.0**	**-12.1**	**-12.0**	**-11.1**	**-10.8**	**-10.9**	**-10.9**
Merchandise trade balance	-20.7	-9.4	-8.4	-8.9	-8.2	-8.3	-7.7	-7.1	-6.2	-6.8
Exports, f.o.b.	26.1	27.7	29.9	29.2	31.6	30.8	31.4	31.9	32.2	30.9
Mining and electricity	12.8	14.4	15.8	15.3	14.1	12.5	12.3	10.6	10.2	9.6
Imports, c.i.f.	46.8	37.1	38.4	38.1	39.7	39.1	39.1	39.1	38.4	37.7
Mining, electricity, railway related	18.0	15.5	17.1	17.7	16.7	15.1	13.0	11.0	10.1	9.2
Services (net)	-1.6	-1.2	-1.5	-1.3	-1.8	-1.4	-1.5	-1.5	-1.6	-1.6
Of which: Tourism	4.8	4.0	3.5	3.5	3.6	3.4	3.4	3.4	3.3	3.3
Income (net)	-1.6	-2.0	-2.6	-3.1	-3.4	-3.4	-3.1	-3.2	-4.5	-4.0
Interest payments	1.1	1.9	1.9	1.8	2.1	1.9	1.6	1.4	2.7	2.4
Of which: Public	0.8	0.8	1.0	1.2	1.5	1.2	1.1	1.1	1.1	1.0
Transfers (net)	1.5	1.6	1.9	1.3	1.3	1.2	1.1	1.0	1.5	1.5
of which: Private (net)	0.6	0.6	0.8	1.2	1.1	1.1	1.0	0.9	0.9	0.8
of which: Official (net)	0.9	1.0	1.1	0.2	0.1	0.2	0.1	0.1	0.6	0.7
Capital account	**0.2**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**
Financial account	**27.0**	**19.2**	**17.9**	**16.2**	**13.1**	**13.7**	**13.6**	**13.3**	**12.7**	**12.0**
Foreign direct investment (net)	7.5	6.8	9.9	7.8	7.6	7.1	6.7	6.4	6.1	5.8
Portfolio investment	3.7	3.2	1.9	2.8	2.7	2.5	2.3	2.2	2.1	2.0
Other investment	15.7	9.2	6.1	5.6	2.8	4.1	4.6	4.7	4.6	4.2
Public sector	7.4	8.3	7.4	8.1	9.4	9.7	9.1	8.7	8.8	8.8
Disbursements	6.5	6.9	5.8	5.9	6.8	6.9	6.9	6.7	6.8	6.9
Amortization	0.9	1.5	1.6	2.1	2.5	2.9	2.2	2.0	2.0	1.8
Banking sector (net)	5.5	5.1	-1.4	0.4	0.4	0.3	0.1	0.0	0.0	0.0
Other flows	4.7	-1.3	3.2	0.9	-0.1	1.6	2.1	2.6	2.9	3.0
Errors and omissions	-3.6	-8.4	-4.6	-5.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	1.2	-0.1	2.8	-0.8	1.1	1.8	2.6	2.5	1.9	1.2
Memorandum items:										
Nominal GDP (In millions of U.S. dollars)	14,363	15,916	17,069	18,438	20,203	22,034	23,985	26,089	28,369	30,835

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.

Table 3a. Lao P.D.R.: Central Government Operations, 2015–24
(In billions of kip)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
					(In billions of kip)					
Revenue and Grants	**23,699**	**20,716**	**22,615**	**23,609**	**25,875**	**29,262**	**32,436**	**35,953**	**40,000**	**44,043**
Taxes	16,321	16,154	16,920	17,088	18,410	21,179	23,729	26,412	29,496	32,458
Income and profit taxes	3,344	3,375	3,444	3,692	3,870	4,418	4,897	5,445	6,059	6,662
Income taxes	1,140	1,624	1,657	1,619	1,611	1,811	2,037	2,305	2,590	2,859
Profit taxes	2,204	1,751	1,788	2,073	2,260	2,607	2,860	3,140	3,469	3,803
VAT	4,991	4,587	5,150	5,171	5,732	6,444	7,250	8,205	9,417	10,396
Excise duties	3,253	4,124	3,789	4,829	5,299	6,041	6,913	7,669	8,447	9,325
Import duties	1,382	1,555	1,530	1,059	1,141	1,280	1,409	1,549	1,704	1,873
Royalties	999	836	981	1,059	915	995	1,004	990	1,008	1,042
Mining	620	474	610	641	641	554	469	358	265	195
Hydropower	378	362	371	418	275	441	535	632	743	847
Other taxes	3,044	2,674	4,237	4,768	5,371	5,831	6,801	7,532	8,522	9,453
Nontax revenues	2,759	2,813	3,499	5,007	5,495	6,057	6,680	7,311	8,052	8,890
Of which: Dividends 1/	870	551	862	1,393	1,529	1,685	1,858	2,062	2,271	2,507
Grants	4,618	1,749	2,197	1,514	1,970	2,026	2,027	2,229	2,452	2,695
Total Expenditure	**30,230**	**27,258**	**30,339**	**30,346**	**32,916**	**36,804**	**40,354**	**44,392**	**49,079**	**54,185**
Current Expenditure	18,035	19,913	17,534	18,989	21,425	23,545	25,762	28,339	31,181	34,510
Compensation of employees	8,988	9,194	9,807	10,052	11,026	12,169	13,393	14,733	16,202	17,811
Transfers	2,487	2,837	2,662	2,986	3,816	4,481	4,932	5,425	5,966	6,759
Interest payments	1,178	1,584	1,947	2,646	3,024	2,901	3,042	3,347	3,696	4,096
Of which: External	891	1,238	1,491	2,115	2,596	2,311	2,277	2,429	2,606	2,796
Other recurrent	5,380	6,297	3,118	3,305	3,560	3,993	4,395	4,835	5,317	5,845
Net acquisition of nonfinancial assets	12,196	7,345	12,805	11,356	11,490	13,259	14,592	16,052	17,898	19,675
Domestically financed	3,148	2,474	5,053	4,333	3,200	3,653	4,612	5,779	7,327	8,710
Externally financed	9,047	4,871	7,752	7,024	8,291	9,606	9,980	10,273	10,571	10,966
Net lending/borrowing	**-6,531**	**-6,542**	**-7,724**	**-6,737**	**-7,040**	**-7,542**	**-7,919**	**-8,439**	**-9,079**	**-10,142**
Net acquisition of financial assets	858	-3,154	717	-2,893	0	0	-2,647	0	0	0
Domestic	858	-3,154	717	-2,893	0	0	-2,647	0	0	0
Foreign	0	0	0	0	0	0	0	0	0	0
Net incurrence of liabilities	2,906	-88	8,309	3,303	7,040	7,542	7,919	8,439	9,079	10,142
Domestic	-508	-1,511	1,119	-923	2,951	3,542	3,185	3,838	5,016	6,795
Foreign	3,413	1,423	7,190	4,226	4,090	4,000	4,733	4,601	4,063	3,347
Discrepancy	-4,484	-3,475	-131	-541	0	0	2,647	0	0	0
Memorandum items:										
Primary balance	-5,353	-4,958	-5,776	-4,090	-4,016	-4,641	-4,876	-5,092	-5,383	-6,047
Fiscal balance	-6,531	-6,542	-7,724	-6,737	-7,040	-7,542	-7,919	-8,439	-9,079	-10,142
Nominal GDP	117,252	129,279	140,749	152,414	164,147	184,152	202,672	222,947	245,177	269,527

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.
1/ Includes dividends from mining and hydropower projects.

Table 3b. Lao P.D.R.: Central Government Operations, 2015–24

(In percent of GDP)

	2015	2016	2017	2018 Est.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.
				(In percent of GDP, unless otherwise indicated)						
Revenue and Grants	**20.2**	**16.0**	**16.1**	**15.5**	**15.8**	**15.9**	**16.0**	**16.1**	**16.3**	**16.3**
Taxes	13.9	12.5	12.0	11.2	11.2	11.5	11.7	11.8	12.0	12.0
Income and profit taxes	2.9	2.6	2.4	2.4	2.4	2.4	2.4	2.4	2.5	2.5
Income taxes	1.0	1.3	1.2	1.1	1.0	1.0	1.0	1.0	1.1	1.1
Profit taxes	1.9	1.4	1.3	1.4	1.4	1.4	1.4	1.4	1.4	1.4
VAT	4.3	3.5	3.7	3.4	3.5	3.5	3.6	3.7	3.8	3.9
Excise duties	2.8	3.2	2.7	3.2	3.2	3.3	3.4	3.4	3.4	3.5
Import duties	1.2	1.2	1.1	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Royalties	0.9	0.6	0.7	0.7	0.6	0.5	0.5	0.4	0.4	0.4
Mining	0.5	0.4	0.4	0.4	0.4	0.3	0.2	0.2	0.1	0.1
Hydropower	0.3	0.3	0.3	0.3	0.2	0.2	0.3	0.3	0.3	0.3
Other taxes	2.6	2.1	3.0	3.1	3.3	3.2	3.4	3.4	3.5	3.5
Nontax revenues	2.4	2.2	2.5	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Of which : Dividends 1/	0.7	0.4	0.6	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Grants	3.9	1.4	1.6	1.0	1.2	1.1	1.0	1.0	1.0	1.0
Total Expenditure	**25.8**	**21.1**	**21.6**	**19.9**	**20.1**	**20.0**	**19.9**	**19.9**	**20.0**	**20.1**
Current Expenditure	15.4	15.4	12.5	12.5	13.1	12.8	12.7	12.7	12.7	12.8
Compensation of employees	7.7	7.1	7.0	6.6	6.7	6.6	6.6	6.6	6.6	6.6
Transfers	2.1	2.2	1.9	2.0	2.3	2.4	2.4	2.4	2.4	2.5
Interest payments	1.0	1.2	1.4	1.7	1.8	1.6	1.5	1.5	1.5	1.5
Of which: External	0.8	1.0	1.1	1.4	1.6	1.3	1.1	1.1	1.1	1.0
Other recurrent	4.6	4.9	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Net acquisition of nonfinancial assets	10.4	5.7	9.1	7.5	7.0	7.2	7.2	7.2	7.3	7.3
Domestically financed	2.7	1.9	3.6	2.8	1.9	2.0	2.3	2.6	3.0	3.2
Externally financed	7.7	3.8	5.5	4.6	5.1	5.2	4.9	4.6	4.3	4.1
Net lending/borrowing	**-5.6**	**-5.1**	**-5.5**	**-4.4**	**-4.3**	**-4.1**	**-3.9**	**-3.8**	**-3.7**	**-3.8**
Net acquisition of financial assets	0.7	-2.4	0.5	-1.9	0.0	0.0	-1.3	0.0	0.0	0.0
Domestic	0.7	-2.4	0.5	-1.9	0.0	0.0	-1.3	0.0	0.0	0.0
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	2.5	-0.1	5.9	2.2	4.3	4.1	3.9	3.8	3.7	3.8
Domestic	-0.4	-1.2	0.8	-0.6	1.8	1.9	1.6	1.7	2.0	2.5
Foreign	2.9	1.1	5.1	2.8	2.5	2.2	2.3	2.1	1.7	1.2
Discrepancy	-3.8	-2.7	-0.1	-0.4	0.0	0.0	1.3	0.0	0.0	0.0
Memorandum items:										
Primary balance	-4.6	-3.8	-4.1	-2.7	-2.4	-2.5	-2.4	-2.3	-2.2	-2.2
Fiscal balance	-5.6	-5.1	-5.5	-4.4	-4.3	-4.1	-3.9	-3.8	-3.7	-3.8
Nominal GDP (In billions of kip)	117,252	129,279	140,749	152,414	164,147	184,152	202,672	222,947	245,177	269,527

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.

1/ Includes dividends from mining and hydropower projects.

Table 4. Lao P.D.R.: Monetary Survey, 2015–19

		2015	2016	2017	2018 Est.	2019 Proj.
		(In billions of kip, unless otherwise indicated)				
Bank of Lao P.D.R. (BoL)						
Net foreign assets	5998.2	7,444	6,120	7,839	6,853	8,535
In millions of U.S. dollars		915	746	943	802	1,015
Net domestic assets	13828.2	13,686	14,716	14,974	17,106	18,968
Government (net)	157.2	4	-5	-743	653	2,153
Claims	1119.2	1,117	1,095	1,347	1,591	3,091
Deposits	-962.0	-1,113	-1,099	-2,090	-938	-938
State-owned enterprises	6591.1	6,475	6,454	6,425	6,343	6,353
Banks	4489.3	5,266	6,468	6,757	7,040	7,040
BoL securities	-1259.6	-2,066	-2,903	-3,357	-3,453	-3,100
Other items (net)	3850.3	4,006	4,701	5,891	6,522	6,522
Reserve money	19826.4	21,131	20,835	22,812	23,959	27,503
Currency in circulation	8361.0	8,290	7,837	8,823	9,200	10,561
Deposits		12,840	12,998	13,989	14,759	16,942
Monetary survey						
Net foreign assets	1803.0	-3,188	-11,268	-7,769	-9,885	-8,828
In millions of U.S. dollars		-392	-1,374	-935	-1,157	-1,049
Of which: Commercial banks	*-518.6*	-1,308	-2,120	-1,878	-1,959	-2,583
Net domestic assets	50519.1	63,187	77,808	82,447	90,836	103,269
Government (net)	3654.5	4,794	4,373	1,723	6,967	8,418
Credit to the economy	46881.6	54,766	66,199	73,365	75,577	84,528
In kip	23813.1	27,250	31,610	36,428	36,989	41,370
In foreign currencies	23068.4	27,516	34,589	36,936	38,588	43,158
Of which: Private credit	*36444.8*	43,476	53,028	60,539	63,407	71,776
In kip	20427.1	23,931	28,177	33,031	33,727	38,179
In foreign currencies	16017.7	19,545	24,851	27,509	29,680	33,597
Other items (net)	-16.9	3,627	7,235	7,360	8,291	10,323
Broad money	52322.2	59,999	66,540	74,678	80,950	94,441
Currency outside banks	6316.0	5,880	5,534	6,638	7,170	8,365
Kip deposits	23050.2	27,486	29,303	31,486	33,820	39,457
Foreign currency deposits (FCDs)	22956.0	26,633	31,702	36,554	39,960	46,619
		(Annual percent change)				
Reserve money	30.3	6.6	-1.4	9.5	5.0	14.8
Broad money	23.4	14.7	10.9	12.2	8.4	16.7
Credit to the economy	14.2	16.8	20.9	10.8	3.0	11.8
Credit to the private sector		19.3	22.0	14.2	4.7	13.2
Deposit growth		17.6	12.7	11.5	8.4	16.7
Memorandum items:						
Loan/deposit (percent)		89.2	97.9	98.4	93.8	90.8
In kip (percent)		87.1	96.2	104.9	100.0	…
In foreign currency (percent)		73.4	78.4	75.3	74.3	…
Gross official reserves (in millions of U.S. dollars) 1/	815.7	987	815	1,016	873	1,087
Dollarization rate (FCDs/broad money; in percent)		44.4	47.6	48.9	49.4	49.4
Gross reserve/Reserve Money (percent)		38.0	32.1	37.0	31.1	33.2
Required reserves (In billions of kip)	2758.0	3,226	3,720	4,209	4,580	5,344
Excess reserves (percent of GDP)	7.0	7.3	6.8	6.7	6.5	4.8

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates.
1/ Defined as foreign assets of the Bank of the Lao P.D.R.

Table 5. Lao P.D.R.: Medium-Term Macroeconomic Framework, 2015–24

	2015	2016	2017	2018 Est.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.
Output and prices				(Percent change, unless otherwise indicated)						
Real GDP	7.3	7.0	6.8	6.3	6.4	6.5	6.7	6.8	6.8	6.8
Consumer prices (annual average)	1.3	1.8	0.7	2.0	3.1	3.3	3.1	3.1	3.1	3.1
Consumer prices (end-period)	0.9	2.5	0.1	1.5	2.9	3.1	3.1	3.1	3.1	3.1
GDP per capita (in U.S. dollars)	2,212	2,417	2,555	2,674	2,783	3,042	3,263	3,499	3,751	4,019
Public finances					(In percent of GDP)					
Revenue and Grants	20.2	16.0	16.1	15.5	15.8	15.9	16.0	16.1	16.3	16.3
Tax and nontax revenue	16.3	14.7	14.5	14.5	14.6	14.8	15.0	15.1	15.3	15.3
Grant	3.9	1.4	1.6	1.0	1.2	1.1	1.0	1.0	1.0	1.0
Expenditure	25.8	21.1	21.6	19.9	20.1	20.0	19.9	19.9	20.0	20.1
Current Expenditure	15.4	15.4	12.5	12.5	13.1	12.8	12.7	12.7	12.7	12.8
Net acquisition of nonfinancial assets	10.4	5.7	9.1	7.5	7.0	7.2	7.2	7.2	7.3	7.3
Overall balance	-5.6	-5.1	-5.5	-4.4	-4.3	-4.1	-3.9	-3.8	-3.7	-3.8
Money and credit					(Percent change)					
Broad money	14.7	10.9	12.2	8.4	16.7	…	…	…	…	…
Credit to the economy	16.8	20.9	10.8	3.0	11.8	…	…	…	…	…
Balance of payments					(In millions of U.S. dollars)					
Current account balance	-3,220	-1,752	-1,816	-2,170	-2,311	-2,543	-2,569	-2,723	-2,979	-3,240
In percent of GDP	-22.4	-11.0	-10.6	-12.0	-12.1	-12.0	-11.1	-10.8	-10.9	-10.9
Exports	3,753	4,409	5,110	5,295	6,037	6,535	7,258	8,020	8,787	9,176
Imports	6,728	5,904	6,546	6,903	7,597	8,298	9,036	9,805	10,489	11,187
Services and income (net)	-466	-512	-707	-803	-997	-1,036	-1,048	-1,195	-1,685	-1,666
Transfers	221	255	327	242	247	255	257	257	409	437
Capital and Financial account balance	36	3,079	3,077	2,959	2,525	2,916	3,171	3,351	3,497	3,588
Of which: FDI	1,079	1,076	1,695	1,420	1,459	1,502	1,550	1,605	1,663	1,726
Debt and debt service					(In percent of GDP)					
Public and public guaranteed debt	53.1	54.2	55.8	57.2	58.0	56.2	55.5	54.7	53.9	53.3
External debt	94.2	89.0	92.6	92.9	90.0	84.9	82.5	80.5	78.6	76.5
External public and public guaranteed debt	45.4	46.2	49.6	51.4	51.4	50.8	47.9	46.4	44.7	42.8
Gross official reserves										
In millions of U.S. dollars	987	815	1,016	873	1,087	1,458	2,059	2,687	3,204	3,552
In months of imports	1.7	1.3	1.5	1.2	1.3	1.7	2.2	2.6	2.9	3.0
Memorandum items:										
Nominal GDP (in billions of kip)	117,252	129,279	140,749	152,414	164,147	184,152	202,672	222,947	245,177	269,527

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.

Table 6. Lao P.D.R.: Sustainable Development Goals

	Lao P.D.R.		ASEAN 1/
Goals	2005	2015	2015
Poverty			
Proportion of population living below the international poverty line	20	17	7
Proportion of population living below the national poverty line	28	23	13
Proportion of population covered by social assistance programs	n.a.	1.7	29
Prevalence of undernourishment	30	19	12
Proportion of urban population living in slums or inadequate housing	79	31	34
Health and Education			
Maternal mortality rate per 100,000 live births	418	197	111
Proportion of births attended by skilled health personnel	15	40	79
Under-five mortality rate	97	67	30
Pupil-teacher ratio, primary	31	24	24
Secondary enrollment*	28	58	66
Inclusion			
Proportion of seats held by women in national parliaments	23	25	17
Proportion of population with access to electricity	57	78	84
Proportion of adults (15 years and older) with an account at a bank	n.a.	31	45
Annual growth rate of real GDP per capita	5	7	5
Climate			
CO2 emission per unit of GDP PPP	1.5	1.8	4.2

Source: UN SDG Indicators Global Database; World Bank, World Development Indicators; ClimateWatch (GCA Model).

*Ratio of children of official school age who are enrolled in school to the population of the corresponding official school age.

1/ ASEAN excluding Brunei and Singapore.

Note: Where data are not available, data for the closest year is used.

Appendix I. Risk Assessment Matrix[1]

	Shocks and Likelihood (Red= high likelihood; green = low likelihood)	Potential Impact (Red= high; green=low)	Policy Response
Domestic	Macro-financial spillovers from low credit growth and high NPLs.	Possible credit crunch, if banks cut back on lending while adjusting to NPLs; Contingent fiscal liabilities related to recapitalization; Possible need for liquidity support; Pressure for further exchange rate depreciation.	Tighten accounting standards for assessing and provisioning for NPLs; Improve timely reporting and dissemination of FSIs; Implement risk-based supervision; Continue to strenghten financial regulations and supervision with a view to ensuring financial stability; Enhance external examinations of systemic banks and preparation of contingency plans including a well formulated financial safety net should be developed.
	Insufficient fiscal consolidation and realization of contingent liabilities.	Impacts the debt sustainability outlook; Lack of fiscal space for the necessary social and infrastructure spending; Delays overall economic reforms; Contigent liabilities arising from the large PPP capital stock.	Rationalize public expenditures while preservering social and infrastructure spending; Continue to improve PFM framework including PIMA and implement the MTRS; Stregthen tax administration and automation; Negotiate financing on concessional terms to the extent possible; Allow the exchange rate to adjust to absorb external shocks; Improve assessment and monitoring of PPPs.
	Large natural disasters.	A comprehensive Post-Disaster Needs Assessment estimates the total damage and loss from recent flooding and dam collapse to social, productive, and infrastructure sectors to be about 2 percent of GDP. In additon to human costs, natural disasters effect debt sustainability through damaging long-term growth and increasing borrowing for reconstruction needs from damage to infrastructure and capital.	Over the short term, re-channel donor funding to recovery efforts. Longer term measures - identify and explicitly integrate risks into fiscal frameworks and budget planning; Build policy and financial buffers to enhance resilience to shocks; Enhance preparedness and invest in infrastructure that can better cope with natural hazards.
External	Sharp tightening of global financial conditions. Sharper-than-expected increases in U.S. interest rates.	FX deposit outflow, foreign reserves fall further, exchange rate pressure and the parallel market rate widening. Both external and public debt indicators are susceptible to a sudden depreciation of the kip/U.S. dollar exchange rate from the US monetary policy normalization given the considerable share of foreign currency denominated debt. Market reactions, especially in the Thai capital market given their access to it, are especially important for rollovers and any future issuance.	Build up foreign reserve to buffer against external shocks; allow for greater exchange rate flexibility; where appropriate release limited short-term liquidity to troubled banks; expedite work on a crisis management framework; maintain fiscal consolidation path.
	Weaker-than-expected global growth (US, EU, China)	A sharper than expected slowdown in China – Lao P.D.R.'s largest trading partner and FDI investor – may reduce exports and decelerate FDI flows. Lower demand from Thailand and Vietnam may reduce electricity exports.	Allow greater exchange rate flexibility to absorb external shocks; Continue with structural reforms to diversify exports and trading partners.

Source: IMF staff.

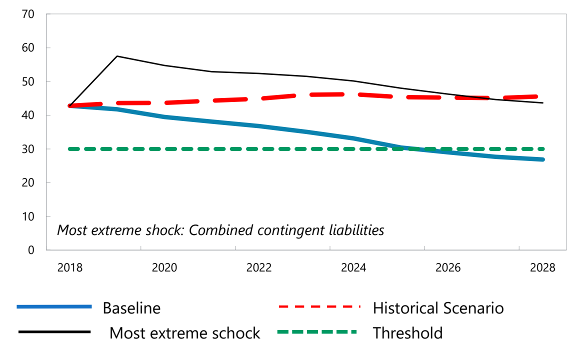
[1] The Risk Assessment Matric (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of the IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Appendix II. External Sector Assessment[1]

Overall, the external position in 2018 was substantially weaker than that consistent with medium-term fundamentals and desirable policy settings. The current account deficit and external debt levels are expected to remain high with reserve coverage below adequate levels. Fiscal consolidation and gradual depreciation would help stabilize external debt, build reserves, and improve external competitiveness, which is key for advancing economic diversification and promoting non-resource private sector development. Prudent debt management and efforts to boost tax revenue should continue and financing on concessional terms should be negotiated to the extent possible.

1. External sustainability. The Debt Sustainability Analysis (DSA) continues to assess Lao P.D.R.'s external risk rating as high (2019 Debt Sustainability Analysis). Standardized DSA stress tests indicate that a shock to exports, depreciation of the currency, and large contingent liabilities from PPPs worsen debt sustainability. Costs from the recent natural disasters underscores the importance of strengthening buffers. Over the medium term, debt ratios are projected to remain above their policy thresholds, albeit trending downwards, assuming revenue administrative efforts, optimization of recurrent spending and a slowdown in capital spending. Additionally, the negative net foreign assets position (US$ 20 billion or 159 percent of GDP at the end-2016) suggests a considerable size of foreign liabilities mostly consisting of FDI liabilities and external debt adding to the vulnerabilities.

Lao P.D.R.: PPG External Debt under Alternative Scenarios
(PV of debt to GDP ratio)



Sources: IMF staff calculations.

2. Current account. The current account deficit is projected to remain around 12 percent of GDP over the short to medium term reflecting a relatively stronger demand for infrastructure related imports, reconstruction needs and oil. Using the EBA-lite CA model, staff estimate the CA norm to be a deficit of 9.1 percent of GDP in 2018 resulting in a CA gap of -3.4 percent of GDP and a policy gap of -1.1 percent of GDP which translates into a real effective exchange rate (REER) gap of 14.4 percent.

Lao P.D.R.: 2018 External Sector Assessment
(In percent of GDP, unless otherwise indicated)

	CA model	REER model
Actual CA	-12.0%	
CA norm	-9.1%	
Cyclically adjusted CA	-11.6%	
Cyclically adjusted CA Norm 1/	-8.1%	
CA gap	**-3.4%**	
o/w Policy gap	-1.1%	
Elasticity	-0.24	
REER gap 2/	**14.4%**	**23.1%**
Policy gap		5.3%

1/ Multilareterally consistent cyclically adjusted CA Norm
2/ Implies REER is more appreciated(+)/depreciated(-) than the norm.
Source: IMF staff estimates

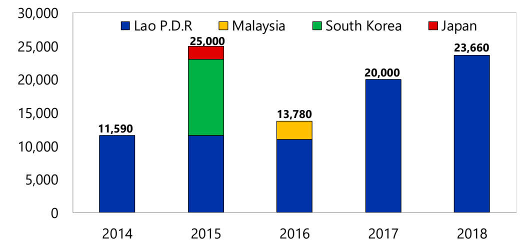
3. REER. The REER has gradually depreciated since the beginning of 2017, almost solely due to a depreciation of the nominal effective exchange rate

[1] Given data limitations, the external sector assessment does not include the Commodity Module for Large Exporters of Exhaustible Commodities.

(NEER) with trading partners. The nominal exchange rate has depreciated by about 3 percent against the U.S. dollar in 2018. The EBA-Lite REER model produces a larger REER gap, than the CA model (23.1 percent). The results of the two models suggest an overall assessment that the external position in 2018 was substantially weaker than that consistent with medium-term fundamentals and desirable policy settings.

4. Capital flows and policy measures. Lao P.D.R. has continued to attract sizable capital inflows mainly due to the large infrastructure projects and PPPs. FDI flows (7.7 percent of GDP in 2018) are large (averaging 8 percent of GDP over the past 5 years) as are the disbursements from external creditors. Additionally, the authorities have been increasingly accessing the Thai capital market since 2013. Bonds equaling US$ 740 million were issued by the government and corporates in 2018. Inflows are projected to slowdown as projects reach completion over the next three years. Risks to a further slowdown include tightening of global financial conditions or a slowdown in the China – a large investor and trading partner.

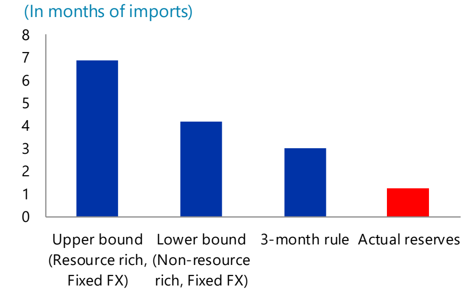
Lao P.D.R.: Baht Bond Issuance by Country
(In millions of Baht)



Source: Thai Bond Market Review, 2018.

5. Reserve coverage. Gross official reserves at US$873 million (end-2018) covered around 1.2 months of imports. Reserve adequacy metrics for low income countries suggest that the optimal level of reserves for Lao P.D.R. is around 4 - 6 months of imports. The current exchange rate regime is based on keeping the kip broadly stable against the U.S. dollar, however, given the low level of reserves the currency could come under further depreciation pressures. Over the medium-term, import coverage is projected to slowly increase but remain inadequate from higher import needs related to reconstruction in the short term and capital goods in the medium term. Staff continue to assess reserve coverage as below adequate levels suggested by IMF adequacy metrics.[2]

Lao P.D.R.: Reserve Adequacy Assessment
(In months of imports)



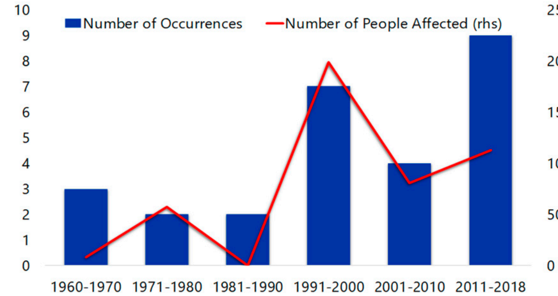
Source: IMF staff calculations; and National authorities.

[2] The authorities' methodology assesses reserve coverage to be higher (over three months of imports) by excluding imports related to FDI given that most of the FDI related projects use their own funding unrelated to the reserves in the central bank.

Appendix III. Coping with Natural Disaster Risks[1]

1. **Lao P.D.R. is exposed to a greater risk of natural disasters, compounded by climate change, environmental degradation, rapid economic growth, and urbanization.** Lao P.D.R. has become more prone to natural disasters including from typhoons, storms, floods, landslides, and droughts. The frequency and impact of floods have increased significantly in recent years. In July 2018, heavy rainfall from a tropical storm resulted in flooding across the country, followed by the collapse of Xe-Pian Xe-Namnoy dam, which caused a flash flood in the southern part of Lao P.D.R. (Attapeu Province) causing a tragic loss of lives, destruction of livelihoods, and thousands of people being displaced. Furthermore, in August 2018, another tropical storm caused flooding in the northern part of the country.

Lao P.D.R.: Frequency and Impact of Floods
(Number of occurances, 1960-2018; number of people affected, in thousands)



Sources: International Disaster Database (EM-DAT); and IMF staff calculations.

2. **The estimated total recovery needs from 2018 natural disasters are about 3 percent of GDP (US$520 million).**[2] The government and development partners, led by the World Bank and the UN, have conducted a comprehensive Post-Disaster Needs Assessment (PDNA). The estimated total damage and loss to social, productive, and infrastructure sectors are approximately 2 percent of GDP (US$371 million). Short-term recovery and reconstruction needs are estimated to be approximately 0.8 percent of GDP (US$154 million) and include restoration of the affected households' livelihoods and recovery of agricultural and transportation sectors. The long-term needs include infrastructure upgrades and disposal of unexploded ordinances.[3] Needs are estimated to be higher than the sum of damage and losses because of (i) "Build Back Better" and (ii) resumption of production, service

Lao P.D.R.: Damage, Losses, and Needs (PDNA estimation)
(In millions of US dollars)

Sector	Damage	Losses	Damage and Losses	Needs			
				Short	Medium	Long	Total
Social sectors	7	1	8	27	9	4	41
Productive sectors	19	129	148	31	13	3	47
Infrastructure sectors	121	95	216	81	87	118	286
Cross-cutting issues				15	21	109	145
Total	147	225	371	154	130	235	520

Source: Post Disaster Needs Assessment.

[1] Prepared by Mariya Brussevich and Naoya Adachi (APD), Hang Vu Thu and Hideaki Hamada (World Bank).

[2] In the PDNA, damage is estimated with respect to the replacement value of both public- and private-domain physical assets damaged or destroyed. Losses are estimated based on the changes in economic flows resulting from the temporary absence of the damaged assets or disruption to access to goods and services attributable to reduced revenue, higher operational costs, and actions taken to reduce risk.

[3] During the Vietnam War, more than two million tons of explosive ordinance were released in Lao P.D.R., a significant amount of which remained unexploded. For safe recovery, survey and clearance of unexploded ordnance are needed.

delivery, and access to goods and services. "Build Back Better" is a reconstruction approach that seeks to reduce vulnerability and improve living conditions while promoting more effective and sustainable reconstruction. It takes the opportunity of having to rebuild following a disaster to examine reconstruction activities' suitability and sustainability.

3. The 2018 natural disasters have had a significant adverse effect on the Lao P.D.R. economy and on the fiscal stance. Floods have contributed to slowing real GDP growth in 2018 (6.3 percent in 2018 from 6.8 percent in 2017), as both agricultural and industrial production declined. However, inflation remained below 3 percent regardless of these disruptions. Driven in part by disaster-related imports, the current account deficit remained high. Fiscal deficit consolidated, as revenues underperformed, and part of the planned capital investment was diverted towards reconstruction funding.

4. The Government of Lao P.D.R. has adopted an approach to comprehensive disaster risk management, however gaps remain. The key elements to this approach include disaster preparedness, investments in risk reduction and residual risk financing. The country's 8th National Socio-Economic Development Plan (NSEDP 2016–2020) increased its focus on disaster risk management while a Strategic Plan on Disaster Risk Management (2003–2020) has already been adopted. Disaster and climate resilience were mainstreamed into several sectoral policies; however, challenges included constraints on financial resources, institutional and the implementation capacity.

5. The budget has been the principal source of financing disaster risks. Under the current system, the main sources of financing to respond to natural disasters include: (i) the National Contingency Fund; (ii) the State Reserve Fund (can accumulate over the years); and (iii) the Social Welfare Fund. The State Reserve Fund and National Contingency Fund receive annual budget appropriations of US$37 million and US$12 million respectively and can be used for different types of risks including natural disasters. If 50 percent of the National Contingency Fund has been spent, it will be replenished from the State Reserve Fund, according to the State Budget Law 2015.

6. Additional financing needs to be mobilized to meet the recovery needs. The government has allocated emergency assistance of US$12 million in 2018 for public works, transportation, and for the agriculture and forestry sector. Further infrastructure repair needs will be addressed in 2019 by reprioritizing US$57 million in planned capital investment.[4] In addition to the government's fiscal response, development partners provided US$81 million for various projects. The remaining financing gap is about US$370 million. Currently, the authorities are in the process of drafting detailed action plans for recovery and reconstruction. The authorities have started reviewing project pipeline with a view of selecting high impact projects to address infrastructure needs aimed

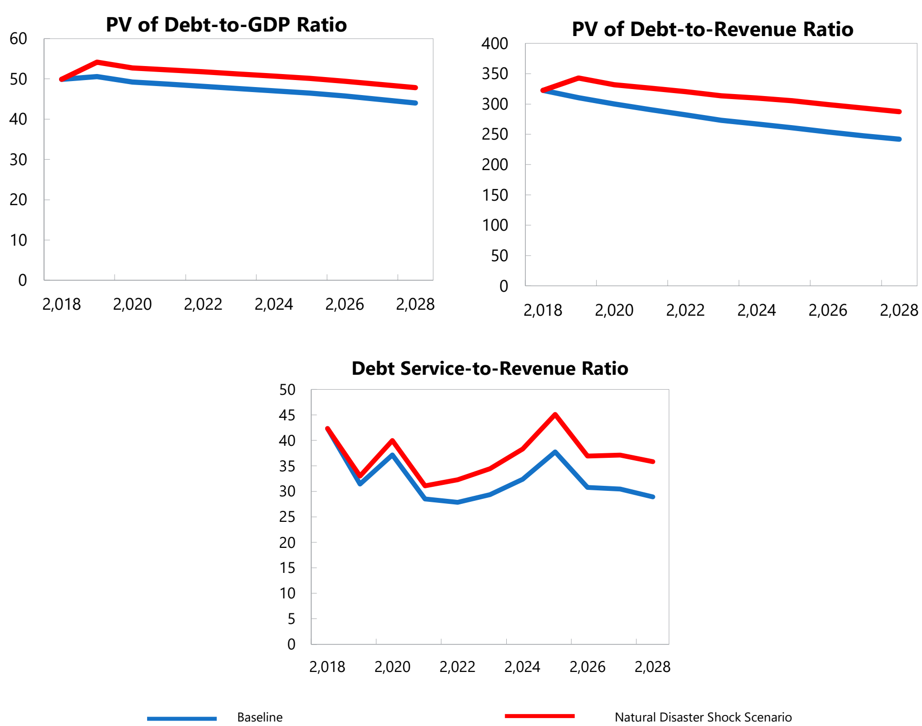
[4] Per guidelines issued by the Ministry of Planning and Investment in 2018, funds should be used only to repair and restore infrastructure already in use. New infrastructure projects or projects in the construction phase are not eligible for funding, but project managers can request a project amendment if the natural disaster affected their operations.

at increasing resilience to disaster shocks. Several development partners are providing TA and financing in this direction.

7. Creating the fiscal space for mitigating shocks from natural disasters is a priority. Natural disaster shocks add pressure on fiscal sustainability (See Debt Sustainability Analysis). The government tends to reprioritize expenditure from capital expenditure towards the disaster recovery as was the case after the 2018 flooding. In the aftermath of a natural disaster, typically debt ratios tend to deteriorate from an increase in total expenditure, decline in revenues or from the slowdown in GDP. To mitigate these shocks, with support from the World Bank, a National Financial Protection Strategy against Disaster and Climate Risks is under development by the government, which would adopt a three-tiered approach and provide an optimal mix of risk financing instruments based on severity and frequency of natural disasters. Contingency reserves in the budget and the reserve disaster funds will allow the government to respond to low severity, high frequency events. Contingent credit will be provided to the government by developing partners for medium-risk layer, while financial instruments such as insurance or catastrophe bonds will be used for events of low frequency and high severity. As part of this approach, Lao P.D.R. has already committed to participating in the first regional catastrophe risk pool under the Southeast Asia Disaster Risk Insurance Facility (SEADRIF)(Box).

Lao P.D.R: Debt Sustainability Analysis - Natural Disaster Shock Scenario

(Indicators of Public Debt; In Percent)



Sources: Country authorities; and staff estimates and projections.

Box 1. Lao P.D.R.: Southeast Asia Disaster Risk Insurance Facility (SEADRIF)

SEADRIF is an ASEAN+3 Finance Ministers' and Central Bank Governors' initiative aimed at strengthening the financial resilience of ASEAN countries against climate and disaster shocks and is being developed as a platform to provide ASEAN member states with climate and disaster risk financing and insurance solutions. In May 2018, Finance Ministers of Lao P.D.R. and Myanmar agreed to establish and join the first regional catastrophe risk insurance pool under SEADRIF, with support from Japan, Singapore, and the World Bank.

The proposed regional catastrophe risk pool for Lao P.D.R. and Myanmar will act as a reinsurance-backed disaster liquidity facility, providing participating countries with immediate financing for response in the aftermath of a natural disaster. Once countries establish and join the pool through paying an insurance premium, they receive quick liquidity in the aftermath of eligible natural disaster events. These pay-outs and their triggers are predetermined according to clear and transparent rules. The pool will retain some risk based on its joint reserves made of country premium contributions and donor contributions. It will transfer excess risk to international reinsurance markets in order to ensure that all claims can be paid in full. The product is underpinned by a near real time flood risk monitoring and assessment tool, combining hydromet modelling with state-of-the-art satellite technology, developed with international technical partners to enable risk transfer solutions and provide governments with rapid flood impact information to support financial decision making.

The government of Lao P.D.R. has secured premium financing of US$5 million for joining the pool through the Southeast Asia Disaster Risk Management Project supported by the World Bank.

Appendix IV. Economic Diversification[1]

Over the past decade, Lao P.D.R. has achieved remarkable economic growth driven by capital-intensive mining and hydropower sectors, but contribution of human capital was limited. To transition to a more inclusive growth model, Lao P.D.R. aims to diversify its growth drivers by investing in human capital, improving the business environment and basic infrastructure.

A. Growth Decomposition

1. Capital-intensive growth has generated limited spillovers to the rest of the economy. Lao P.D.R.'s economy has grown, 6.5 percent on average, for the past thirty years and capital accumulation was the main contributor to this remarkable growth performance which was driven by large private investments into mining and hydropower sectors since mid-2000s (Figure 1). However, despite its young and growing labor force, the contribution of human capital to growth has been limited. Major FDI projects do not appear to have strong linkages to the rest of the economy as these are not necessarily supported by local supply chains. As the World Bank 2016 Business Survey indicates, shortages of skilled labor are one of the three major obstacles to doing business in Lao P.D.R. While growth has had a strong initial impact on reducing poverty rates (1990–2005), poverty levels in Lao P.D.R. remain mostly unchanged since 2005, unlike neighboring countries (Vietnam and Cambodia) which have demonstrated more lasting progress in poverty reduction. Considering this challenge, the government's declared objective for the next five-year plan is to rebalance the economy from a resource-based to a more diversified growth model by investing in human capital and improving competitiveness (Table 1.).

Table 1. Lao P.D.R: Economic Policy Orientation, 1976–2020

Economic System	Period	Planning Type	Main Policy Areas
Centrally-planned System	1976-77	Annual Plan	Introduced agricultural collectivization program in form of cooperatives Provided large subsidies and lending to SOEs
	1978-80, 1981-85	Three-year Plan & 1st Five-year Plan	Abolished the collectivization program Introduced a large package of policy reforms in 1979: - Lifting of restrictions on private participation in business activities - Price rationalization
New Economic Mechanism (NEM)– "Transition to a Market-oriented System"	1986-95	2nd & 3rd Five-year Plan	Liberalized price , Privatized selected SOEs, Liberalized trade regime Relaxed foreign investment restriction Restricted government and SOEs borrowing Separated central bank function from commercial bank function
	1996-2005	4th & 5th Five-year Plan	Continued reforms of SOEs, Supported SME Integrated local economy to regional and global economy
	2006-15	6th & 7th Five-year Plan	Allowed land lease and concessions in agriculture Introduced onedoor service for investment, Launched Special Economic Introduced private capital for hydropower and mining sector and public
	2016-20	8th Five-year Plan	Started aiming at innovative, green and sustainable economic growth Reduced overreliance on the mining sector Prioritized energy sector in an environment-friendly way Started fiscal consolidation and monetary reforms and modernization

Source: Authorities' Data.

[1] Prepared by Naoya Adachi, Mariya Brussevich, and Anousa Kounnavong (APD).

B. Export Diversification

2. Lao P.D.R.'s level of export diversification is low compared to regional averages. Mining sector exports (gold and copper) rose rapidly after 2005 followed by a sharp rise in electricity exports since 2015. However, the overall export diversification levels remain low and relatively flat compared to ASEAN-5 and world averages (Figure 1). This pattern is consistent with the recent findings of Giri, Quayyum, and Yin (2019) which argues that natural resource abundance predisposes countries toward lower export diversification.[2] Exports are expected to become even less diversified, with major mines ceasing their operations by 2022, making the electricity sector the dominant source of exports. To this end, Lao P.D.R. relies heavily on the demand of electricity from neighboring countries, which makes it especially vulnerable to demand from Thailand—the largest importer. Also, recent episodes of natural disasters have shown growing environmental vulnerabilities in this sector (see Appendix III).

3. Transforming Lao P.D.R. from a land-locked to a land-linked country will help to improve trade connectivity. The 8th 5 year-plan focusses on Lao P.D.R. becoming the "Battery of Asia" by boosting power exports to the region. Continuing export diversification, both products and destination countries, would help to enhance economic resilience and mitigate transmission of external and natural disaster shocks.[3] In pursuit of broader economic diversification and regional integration objectives, the next 9th 5-year plan envisions transforming Lao P.D.R. from a land-locked to a land-linked country and investing in the Lao-China Railway project is the centerpiece for implementing this vision. The railway mega-project carries substantial benefits for the region at large and has a potential for generating significant positive economic spillovers to Lao P.D.R.'s economy from regional transit trade, tourism, logistical services, agricultural exports, and integration of the manufacturing production in the regional supply chain. To this end, reaping the potential economic benefits from this mega-project requires stepping up and frontloading complementary reforms aimed at simplifying the regulatory environment, improving the adjacent infrastructure, logistical services, and trade facilitation networks. Implementing these supporting reforms in a timely and coordinated fashion will help to mitigate risks by generating sufficient cashflows for the railway project to meet its associated debt service payments (Box 1).

C. SME Landscape, Financing and Informality

4. SMEs in Lao P.D.R. have room to grow their productivity and exports to catch up with regional peers. SMEs create the most number jobs in the private sector in Lao P.D.R. Up to 99 percent of the total registered business in Lao P.D.R. are SMEs and they employ up to 82 percent of

[2] Giri, R., S. Quayyum, and R. Yin (2019). "Understanding Export Diversification: Key Drivers and policy Implications." IMF Working Paper WP/19/105.

[3] Haddad, M., Lim, J.J., Pancaro, C. and Saborowski, C. (2013). "Trade Openness Reduces Growth Volatility When Countries Are Well Diversified." Canadian Journal of Economics, 46(2), pp.765-790.

the total workforce.[4] SMEs contribute about 16 percent to GDP and nearly 13 percent of exports in Lao P.D.R.[5] The government has embarked on an ambitious SME Development Plan that aims to increase SMEs' contribution to the economy (Table 2). These contributions fall in the lower range compared to ASEAN economies, where SMEs contribution to GDP range in between 23 and 58 percent and the contribution to exports in between 10 and 30 percent.[6]

5. **Key challenges for businesses in Lao P.D.R. are burdensome regulatory systems, high informality, and limited access to land and finance.** These challenges are further compounded with a fragmented investment management system, low-quality basic infrastructure, high logistics costs, and limited access to information and communication technology. Lao P.D.R. also has one of the highest non-trade barriers to trade in the region. Burdensome customs and regulatory requirements disproportionately affect SMEs which find these costly to overcome (Figure 4 in the main text). As a result, SMEs have a limited use of innovation and advanced technologies in their production and management, which leads to low value added and poor quality and standards of products.

Table 2. Lao P.D.R.: Selected Targets Under the 2016–2020 SME Development Plan

	Base year indicators from national economic survey	Target year
	2013	2020
Employment by SMEs	0.82	0.85
SMEs access to finance	0.20	0.30
SME contribution to export	0.13	0.20
SMEs that receive assistance from experts	0.04	0.10
Number of days needed to register new businesses	67 (2016)	25
SMEs using computers for admin and service purposes	0.06	0.15

Source: Extracted from SME Development Plan 2016-20.

6. **Women are increasingly running their own businesses in Lao P.D.R.** At least 30 percent of the SMEs are owned by women, which compares favorably to other countries, but is still lower than the average for ASEAN economies. Businesses owned by women tend to be smaller than male-owned businesses and are often characterized with more informality and less access to finance.

7. **Less than 30 percent of SMEs in Lao P.D.R. can access long-term bank credit,** which makes it difficult for them to grow and compete against other SMEs in Asia. The ASEAN average for financial access by SMEs is about 50 percent.[7] Firms in Lao P.D.R. consider access to finance as one of

[4] High share of SMEs is comparable to other ASEAN economies, where SMEs account for between 88 to 99 percent of all enterprises and 52 to 97 percent of domestic employment. Many SMEs in rural areas remain informal and are not captured in national surveys.

[5] SMEs Development Plan 2016-2020, Department of SMEs Promotion, Ministry of Industry and Commerce

[6] OECD/ERIA (2018), SME Policy Index: ASEAN 2018: Boosting Competitiveness and Inclusive Growth, OECD Publishing, Paris/Economic Research Institute for ASEAN and East Asia, Jakarta. https://doi.org/10.1787/9789264305328-en

[7] OECD/ERIA (2018), SME Policy Index: ASEAN 2018: Boosting Competitiveness and Inclusive Growth, OECD Publishing, Paris/Economic Research Institute for ASEAN and East Asia, Jakarta. https://doi.org/10.1787/9789264305328-en and Staff estimate

their three major obstacles for business growth. Only 20 percent of small firms and 45 percent of medium-sized firms had a loan or line of credit from a bank in 2018 which was mostly short-term (Figure 2).

8. Microfinance institutions (MFIs) are an important source of finance for low-income households and micro enterprises, especially in rural areas, where 70 percent of Lao population lives. The microfinance industry is relatively small in the Lao P.D.R. but has expanded rapidly. In 2017, the microfinance industry has grown by 11 percent compared to the previous year with a combined asset of about US$ 450 million (about 3 percent of GDP) and a total loan portfolio of about US$ 88 million at the end of 2017. In addition, up to 4,000 village banks provide small loans for emergencies, for living expenses, and to enable funds to be raised for micro-business purposes.[8] Currently, bank lending rates are typically up to around 11 percent per annum, while lending rates for MFIs could be as high as 30 percent considering higher funding costs and risk premiums.

9. Many registered firms face competition from informal enterprises. The 2016 World Bank Enterprise Survey found that 77 percent of firms face competition from informal firms (up from 42 percent in 2012). Widespread tax evasion, irregular adherence to complex and burdensome regulations, and a culture of noncompliance with basic rules and standards were among the top informal practices referred to in the surveys. Fully registered and formalized firms incur higher costs and feel unfairly targeted by regulators, while unregistered competitors escape this scrutiny.

10. Informal financial services continue to play an important role. About 60 percent of adults use informal financial services to manage their finances.[9] High informality presents several challenges for the unregistered businesses themselves. Most significantly, their access to finance is constrained by their inability to obtain a bank loan due to poor documentation, weak management practices, etc., forcing them to seek capital from alternative sources such as informal money lenders (often at very high interest rates) and family members. Constrained by a lack of capital, many informal businesses are unable to invest in new systems, equipment, and technologies, or to achieve the scale necessary to become competitive. In addition, they have difficulties accessing business support services and development programs.

D. Policy Recommendations

11. Appropriate policies are needed to support diversification. Investing in human capital and reducing barriers to doing business are key ingredients for the broad-based policy strategies.

- *Investing in human capital.* Human capital is essential to sustaining long-term economic growth and is one of the key drivers of economic diversification, especially for commodity exporters (Giri, Quayyum, and Yin, 2019). Public Financial Management reform programs supported by multiple

[8] Draft Action Plan - Financial Inclusion Strategy 2018–2025, Vision 2030

[9] FinMark website: https://finmark.org.za/finscope-consumer-survey_laos-2014/

development partners, and sector-specific development strategies in health and education provide a good opportunity to strengthen investment in human capital.

- *Reducing barriers to doing business.* The government has put improving doing business environment as one the main policy priorities. Commitments to simplifying and automating tax and regulatory systems are steps in the right direction and need to be supported with well-coordinated and persistent reform efforts and institutional capacity building for lasting outcomes.

- *Reducing non-tariff barriers to trade.* Lao P.D.R. was one of the first countries to ratify the World Trade Organization's Trade Facilitation Agreement (TFA) in 2015. Implementing it will help to reduce non-tariff barriers to trade and facilitate SMEs' contribution to exports.'

- *Improve logistical services and adjacent infrastructure.* To reap benefits from the mega-railway project requires concerted approach to improving supporting infrastructure and logistical services which need to be prioritized and accelerated.

12. SMEs have become a policy priority for the government in transition towards the non-resource sector to innovate, diversify the economy and generate more inclusive growth and employment. Continued reform efforts are needed for SMEs to become drivers of growth. Following should be considered:

- Learn from ASEAN peers' experiences in SMEs' new technologies and innovation;

- Simplify regulatory environment for SMEs to enable formalization of business practices;

- Facilitate SME financial literacy and SME specific loan products;

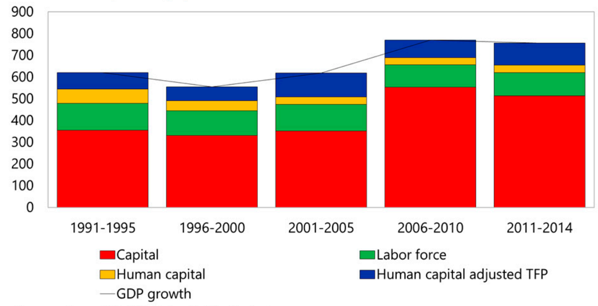
- Enhance financial literacy at the secondary education level;

- Tailor training programs for female business owners.

Figure 1. Lao P.D.R.: Economic Diversification

Capital accumulation was the main contributor to growth

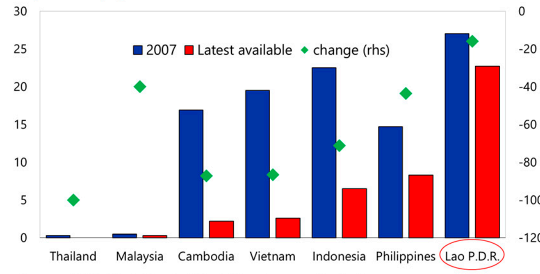
Growth Accounting
(Contribution in percentage point)



Sources: Penn World Tables; IMF calculations.

Which had not contributed significantly to poverty reduction

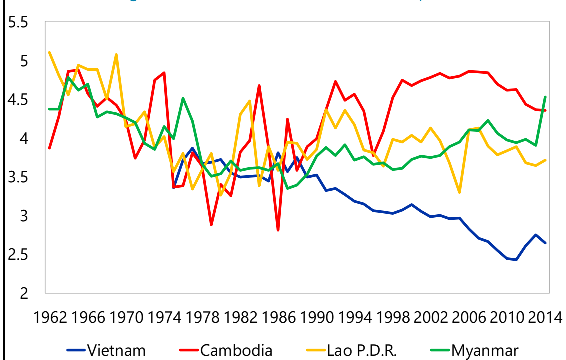
Poverty Headcount Ratio at $1.90 a Day: 2011 PPP
(In percent of population)



Source: CEIC; World Bank - World Development Indicators.
Note: Latest available for Thailand (2015), Malaysia (2009), Cambodia (2012), Vietnam (2014), Indonesia (2016), Philippines (2015), Laos (2012).

Export diversification remains limited

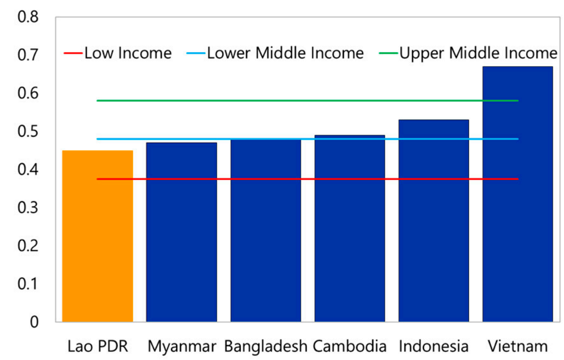
Export Diversification Index
(Theil Index, a higher number indicates less diversified export)



Sources: IMF.

And human capital is weak by regional standards

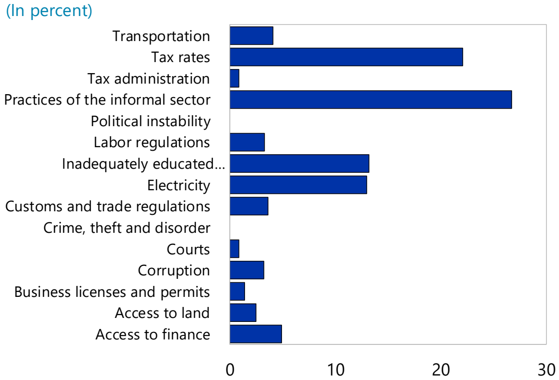
Human Capital Index, 2018



Source: World Bank.

Regulatory obstacles constrain businesses

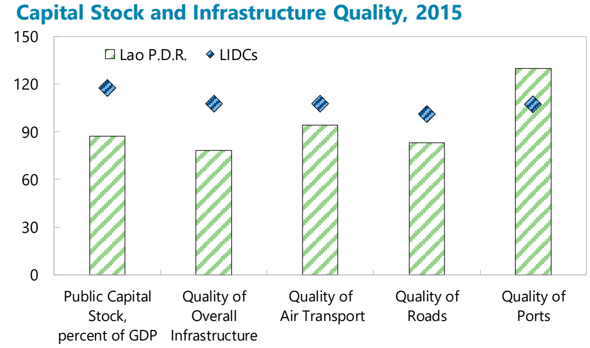
Biggest Obstacle for Business
(In percent)



Sources: WB business survey (2016).

And infrastructure is underdeveloped

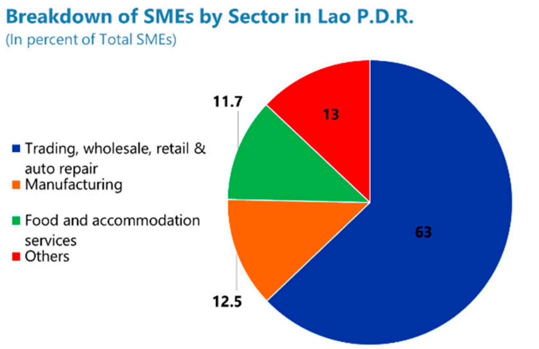
Capital Stock and Infrastructure Quality, 2015



Source: IMF FAD Expenditure Assessment Tool (EAT); World Economic Outlook; World Development Indicators; IMF Investment and Capital Stock Dataset; and World Economic Forum

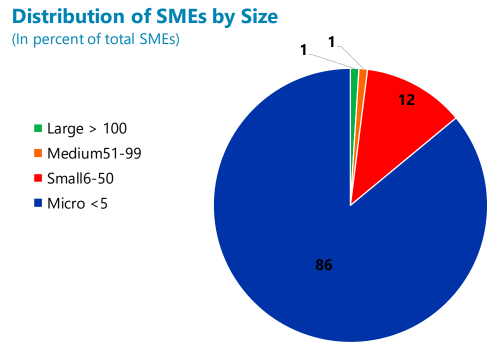
Figure 2. Lao P.D.R.: SME Landscape, Financing and Informality

SMEs drive fast growing trading and service activities and less so in manufacturing



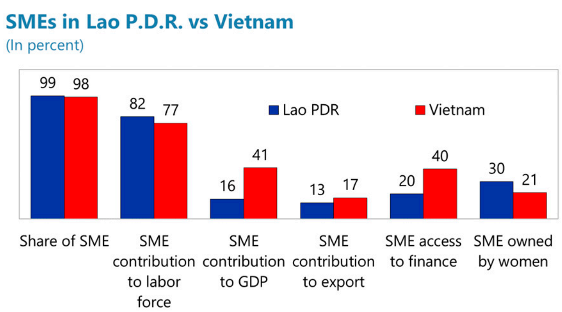
Source: Action Plan for SMEs Development 2016-2020/ 2013 National Economic Survey.

Most of SMEs are micro,



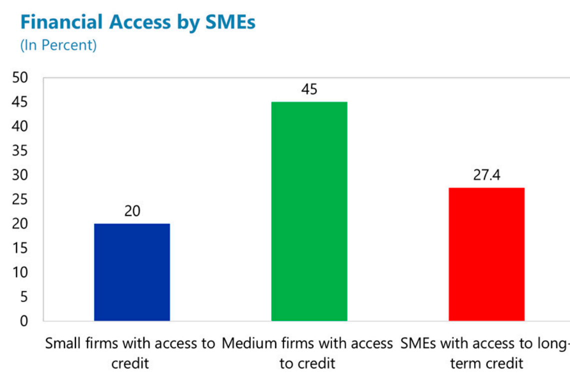
Source: Action Plan for SMEs Development 2016-2020/ 2013 National Economic Survey.

And have room to grow their productivity and exports to catch up with regional peers



Source: : Action Plan for SMEs Development 2016-2020; SMEs Development in Vietnam presented by Dr. Can Van Luc, at the APEC Conference in Singapore, February 13th 2017; SME Policy Index ASEAN 2018; Mekong Business Initiative MBI Study on Women-Owned SMEs in Vietnam, Hanoi September 2016.

Access to finance also remains problematic....



Source: World Bank Entreprise Surveys, Lao P.D.R. Country Profile 2018.

Appendix V. Economic Gains from Promoting Gender Equality[1]

This analytical appendix aims to measure the output gains of reducing the barriers to education and labor force participation for women and their higher formal sector employment. Overall, policies addressing gender inequality proposed in this appendix are relevant to Lao P.D.R.'s broader strategy of economic diversification, human capital development and sustainable growth.

A. Gender Gaps in the Labor Market

1. **Lao P.D.R.'s labor force participation rates are relatively equitable, but gender gaps persist in formal employment and hourly wages.** At 4 percent in 2018, Lao P.D.R.'s gender gap in labor force participation (LFP) rates is considerably smaller compared to its peers in the region—Vietnam, Cambodia, and Myanmar—as well as other low and middle-income countries (Figure 1). The LFP gap in Lao P.D.R. has remained stable, whereas the gender gaps in LFP have widened over time in some countries in the region. Informal employment rates in Lao P.D.R. are among the highest in the world at over 90 percent of total employment and almost half of the labor force is engaged in agricultural production. Women are more likely than men to participate in the informal sector, which is characterized by both lower earnings and job security levels. Moreover, women are almost four times more likely to perform unpaid family work compared to men (Figure 1). Despite higher account ownership rates—32 percent of women have an account in a financial institution compared to 26 percent of men—women have lower access to formal credit. Only 8 percent of women borrow from a financial institution compared to 10 percent of men, which could be due to the larger share of women working in the informal sector (Global Findex Database, 2017). These disparities, in part, result in sizable gender gaps in hourly wages. Using Lao P.D.R. Expenditure and Consumption Survey data for 2012–2013, we estimate that women's wages are, on average, 20 percent lower than men's wages across formal and informal sectors of the economy.

2. **Women's lower paid employment rates are, in part, associated with their lower educational attainment**. Comparing to boys, fewer girls in Lao P.D.R. tend to continue their education past primary schooling (Figure 1). Higher school dropout rates among girls could be partly explained by high adolescent fertility and marriage rates. At 94 births per 1,000 adolescent females, Lao P.D.R. ranks the highest in terms of adolescent fertility rate in the Southeast Asia, which has an average of 47 births per 1,000 females. In addition, one in three women aged 20–24 years were married or in union before 18 years of age in Lao P.D.R..[2]

3. **Women earn significantly less than men in Lao P.D.R..** Despite relatively high female LFP in Lao P.D.R., gender wage inequality remains a concern, as women earn, on average, only 80 percent of their male counterparts' wages. This gap may be due to differences in educational

[1] Prepared by Mariya Brussevich, Albe Gjonbalaj (APD), and Vivian Malta (SPR). This note has benefited from discussions with the Lao Women's Union, Ministry of Planning and Investment, and UNICEF.

[2] UNICEF, 2019. "Gender Counts: East and Southeast Asia." Melbourne, Australia.

attainment, presence of children in the household, as well as differences in occupations and sectors between men and women. Using the Blinder-Oaxaca method, we decompose the hourly gender wage gap in Lao P.D.R. into explained and unexplained components. We find that workers' educational attainment, sector of employment, and experience explain only 23 percent of the observed 20 percent gender wage gap.[3] More than 73 percent of the gender gap in hourly wages are unexplained which points to other factors not included in control variables and need to be interpreted with caution. For instance, existing literature demonstrates that barriers to education and labor force participation faced by women can lead to significant aggregate productivity losses.[4] Therefore, reducing barriers to female LFP can lead to more efficient allocation of labor and significant output and welfare gains.[5]

Table 1. Lao P.D.R.: Gender Wage Gap Decomposition

Decomposition	Percent
Gender Hourly Wage Gap	20
o/w Explained	23
o/w Unexplained	77
Number of observations	2,372

Note: Hourly wage gap is unconditional.
Source: Lao P.D.R. Consumption and Expenditure Survey 2012-2013; IMF Staff Calculations

B. Policies Addressing Gender Inequality in Lao P.D.R.

4. A dynamic general equilibrium model is used to estimate the effect of economic policies on output and gender inequality.[6] In the context of the model, we analyze the impact of the following economic reforms: (i) measures that reduce the gender gaps in educational attainment; (ii) measures that reduce barriers to women's participation in the labor market; (iii) measures that increase the share of the formal sector in the economy. The model is calibrated using the micro and macro data to match the key feature of Lao P.D.R.'s economy, including size of the formal and informal sectors, tax revenues, government spending, returns to education and experience, fertility rates, and overall income inequality. In the theoretical framework, households decide how much to consume and save as well as how much labor to supply in the formal and informal labor markets. Females in the household face different barriers over the lifecycle, including barriers to education and entering the labor force, and discrimination in the workplace.

Reducing the Gender Gap in Educational Attainment

5. Reducing education gaps between girls and boys promotes output growth and gender equality in earnings. The first model simulation assumes higher government spending on

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[3] Years of education, years of experience, sector of employment, residence in urban or rural location, number of children in the household, and province are control variables

[4] Hsieh, C., E. Hurst, C.I. Jones, and P.J. Klenow. 2013. "The Allocation of Talent and U.S. Economic Growth." NBER Working Paper No. 18693, National Bureau of Economic Research, Cambridge, MA.

[5] Ostry, J.D., J. Alvarez, R. Espinoza, and C. Papageorgiou (2018). "Economic Gains from Gender Inclusion: New Mechanisms, New Evidence." IMF Staff Discussion Note SDN/18/06, Washington DC.

[6] Detailed in Malta, V., Martinez, A. and M. Mendes Tavares. "A Quantitative Analysis of Female Employment in Senegal." (IMF Working Paper, forthcoming).

education so as to close the gap in years of education between boys and girls from the same percentile of income distribution[7]. Based on the 2012–2013 Lao P.D.R. Expenditure and Consumption Survey data, on average, girls receive 9.2 years of education compared to boys' 10 years of education. Given the current level of government spending on education at 2.94 percent of GDP (World Development Indicators database), and assuming a perfectly linear relationship between years of education and spending, closing the educational gap would require an additional 0.26 percentage points in spending. However, this expenditure will be partially offset by higher income tax and VAT revenue collections (0.12 percent of GDP) as more women would enter the labor force and engage in more productive paid activities. The gender wage gap would decrease by 1.4 percentage points, resulting in a more equitable labor market for women and men. The long-run GDP gains from closing gender education gaps for boys and girls in the same level of the income distribution could reach at least 1.3 percent due to higher human capital level and higher LFP (Figure 2).

Promoting Women's Participation in the Workplace

6. **Reducing barriers to women's participation in the labor market has the largest wage-equalizing effect.** We simulate a set of measures that closes the gap in returns to experience between women and men as well as eliminates any residual sources of discrimination in the workplace that reduces women's wages and productivity. Such measures can include: implementation of the law on gender equality promotion scheduled for ratification in 2019; investment in girls' education; launching awareness campaigns on gender inequality especially in rural areas; promoting access to child and elderly care with government and international donors' support.[8] In the simulation exercise, such policies would lead to a decrease of the wage gap by almost 12 percentage points as women's wages would rise and men's wages would decline. Following the more efficient allocation of labor, government revenues would increase by 1.2 percent of GDP and output would grow by 1.3 percent in the long run (Figure 2).

Promoting Employment in the Formal Sector

7. **Expansion of the formal sector production leads to considerable GDP gains.** We simulate an exogenous increase in demand for formal sector output that subsequently induces a 10 percent increase in the share of formal production in the economy. Reducing regulatory and legal barriers to starting and operating a business and increasing firms' access to finance are policies that would help increase the share of formal production in the economy. While such policies would affect both men and women, there are no significant changes in gender wage or employment inequality – as this simulation maintains unchanged the education and labor market discrepancies between men and women. However, larger share of formal goods production in the economy is associated with substantial gains in tax revenues of about 2.6 percent of GDP mainly due to higher

[7] Note that there will be still gaps in education for boys and girls from different income levels.

[8] Community-based child care programs could be especially effective in rural areas.

income and corporate tax collections. More importantly, total output would increase by eight percent in real terms over the long run (Figure 2).

Combined Effect of Policy Simulations

8. Implementing the policies outlined above simultaneously would yield lower gender inequality in wages, full equality in LFP, higher government revenues, and higher GDP growth in the long run. Reducing gender gaps in educational attainment, reducing barriers to FLFP, and promoting formal production in the economy are policies that can work in tandem as they aim to improve efficient labor allocation, increase human capital, and reduce labor and production frictions. Simultaneous implementation of these policies would lead to a decrease in the gender wage gap of almost 14 percentage points, equal LFP rates between men and women, an increase in tax revenues by 2.9 percent of GDP, as well as at least a 10 percent increase in GDP growth (Figure 2).

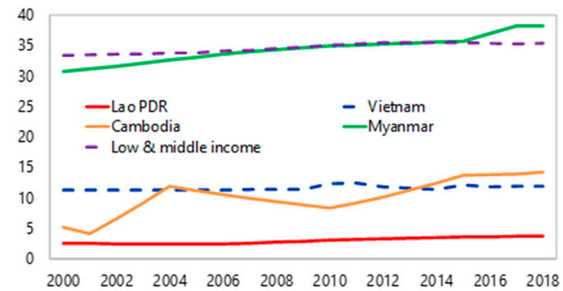
C. Conclusion

9. Policies reducing gender inequality also boost growth and government revenues. While Lao P.D.R. boasts one of the lower gender gaps in LFP rates in the region, there are still substantial inequalities in education, wages, as well as paid and formal employment. Policies promoting girls' education, reducing barriers that prevent women from achieving their full potential in the labor market, and raising formal employment do not only reduce the gender gaps in the workplace and access to finance, but also raise government revenues and promote growth.

Figure 1. Lao P.D.R.: Gender gaps in Labor Force Participation

Labor Force Participation Gap[1]

(In Percent)

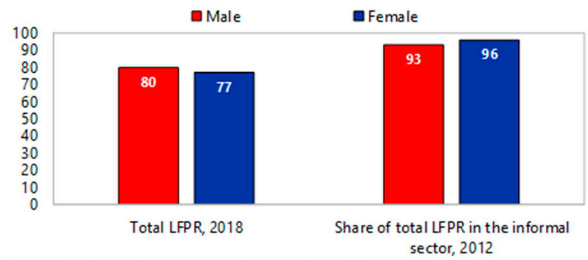


Sources: World Bank, WDI; ILO modeled estimate.

[1] The gap is the difference between male and female labor force participation rate.

Labor Force Participation Rate vs. Informal Labor Force Participation Rate

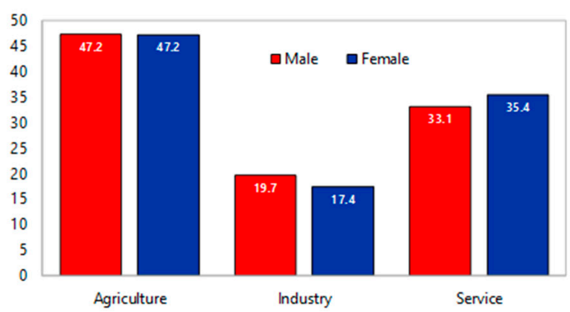
(In percent of female and male population ages 15+)



Sources: World Bank,WDI; ILO; World Bank, STEP; and IMF staff calculations.
Note: Total LFPR is an ILO modeled estimate sourced from the World Bank. Informal labor force participation rate is the share of total labor force participation rate in the informal sector. Informal share of LFPR is derived using the STEP Skills Measurement Household Survey 2012.

Employment by Sector

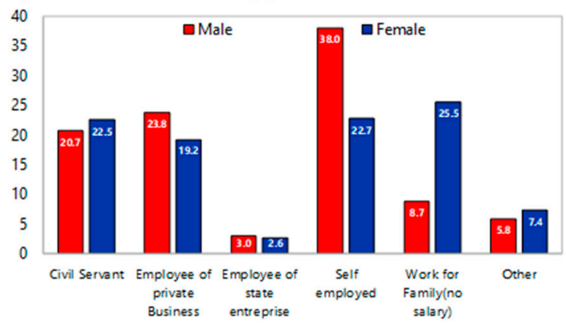
(In percent of male and female total employment)



Sources: Lao P.D.R. Consumption and Expenditure Survey 2012-2013; and IMF staff calculations.

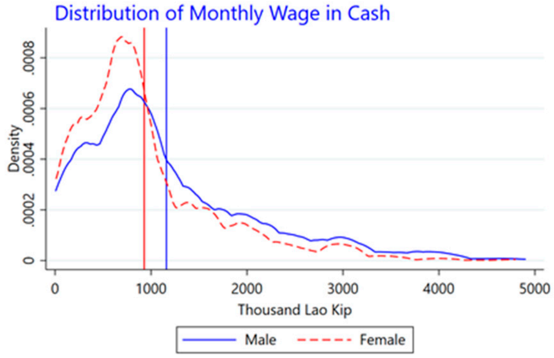
Employment Status

(In percent of total male and female population)



Sources: Lao P.D.R. Consumption and Expenditure Survey 2012-2013; and IMF staff calculations.

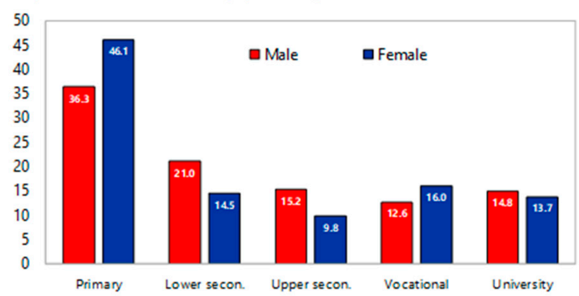
Distribution of Monthly Wage in Cash



Sources: Lao P.D.R. Consumption and Expenditure Survey 2012-2013; and IMF staff calculations.
Straight lines indicate average wages of males and females.

Formal Education Attainment

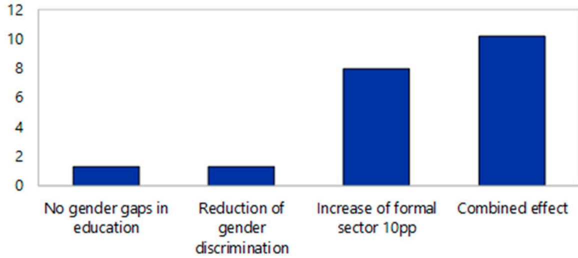
(In percent of male and female population ages 26+)



Sources: Lao P.D.R. Consumption and Expenditure Survey 2012-2013; and IMF staff calculations.

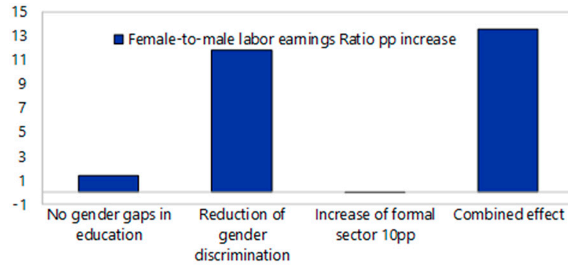
Figure 2. Lao P.D.R.: Policy Effects on GDP and Gender Earning Inequality

GDP Gains
(In Percent)



Source: IMF staff calculations.
Note: Last column combines three policy scenarios: no gender gaps in education, reduction of gender discrimination, and increase of formal sector employment by 10pp.

Female-to-Male Labor Earnings Ratio
(Percentage Point Increase)



Source: IMF staff calculations.
Note: Last column combines three policy scenarios: no gender gaps in education, reduction of gender discrimination, and increase of formal sector employment by 10pp.

Appendix VI. IMF Capacity Development

The National Socio-economic Development Plans (NSEDP) reflect the socio-economic development strategies for Lao P.D.R. targeting 'Vision 2030'. These plans are a forward-looking roadmap with development priorities for welfare, including reaching the SDGs, and graduating from the Least Developing Country list by 2020 to become an upper-middle-income country by 2030. The 8th NSEDP is currently in place until 2020 and preparations for the 9th plan covering 2021-25 is underway. Capacity development (CD) from several development partners, including the IMF, is supporting the authorities' endeavors with the intent to strengthen institutions and improve overall governance. CD from the IMF currently focuses on fiscal and monetary institutions and improving macroeconomic statistics. Fiscal and monetary governance, anti-money laundering and combating the financing of terrorism (AML/CFT) and financial sector regulatory framework are areas which are considered macro-critical and surveillance priorities.

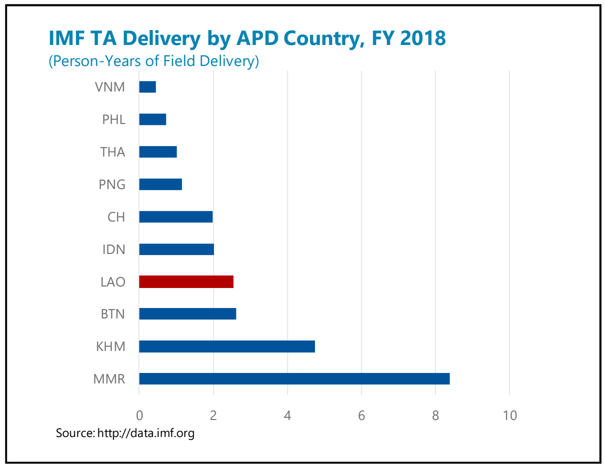
A. Background

1. The 8th NSEDP is currently in place providing an overarching economic roadmap until 2020. Policy objectives include promoting economic development and diversification by improving the quality of productivity, investment and efficiency of resources while promoting the use of innovation and modern science and technology that are environmental and socially friendly. For this the authorities recognize the importance of investing in capital, technology and science, information while strengthening human resources, enterprises and labor in a setting of macroeconomic stability. These policy objectives are expected improve the business environment, reduce the cost of doing business, develop SMEs, increase access to finance, build infrastructure, manage natural resources and buffer against natural disasters. They will also improve the quality of human resources and social development including improving the quality and access to health, education and nutrition, and expanding social safety nets.

B. Capacity Development and the NSEDP

2. CD remains crucial to advance the successful implementation of the NSEDP policy objectives and achieve SDGs. The 8th and 9th NSEDPs are plans set to help Lao P.D.R. transition to middle-income status by 2030. The development needs that match this transition are expected to be large. These needs will require raising domestic revenues and increase market-based financing of the fiscal deficit to gradually scale up SDG-related spending while maintaining fiscal and debt sustainability. Well-functioning markets, including interbank money and FX markets, to support the authorities' efforts for conducting effective monetary policy will be needed. Therefore, prioritizing expenditure, strengthening capacity in public financial management (PFM) and its legal framework, providing more granularity on the fiscal reporting of the SEEs and building on the progress made in strengthening the capacity in domestic revenue mobilization remain pivotal. Continued efforts to build and strengthen the monetary policy framework, as well as to enhance the implementation capacity of the central bank are needed. While good progress is being made towards improvements in macroeconomic statistics, timely dissemination of data will strengthen policy making. These efforts will also improve transparency, overall governance and reduce corruption vulnerabilities.

3. **CD from the IMF is expected to support the policy objectives in the NSEDPs.** CD has been geared towards building fiscal and monetary institutions thereby improving their overall governance and improving macroeconomic statistics. More specifically, it is targeted towards enhancing revenue mobilization and improving bank supervision. Additionally, steady TA to bridge the gap in current data reporting and publishing to internationally prescribed methodologies is ongoing. Staff development from training initiatives, such as the 'Macroeconomic Management (MAC)' project, are in place to help understand the functioning of the integrated macro-framework.



4. **Lao P.D.R. is amongst the top ten low-income country CD recipients from the IMF.** CD is being delivered by long-term resident advisors, by regional advisors from CDOT, STI, short and long-term experts and IMF HQ-based missions.[1] Lao P.D.R. has been a steady recipient of CD supported by the Japan Administered Account for Selected IMF Activities (JSA). Progress is being made in improving the absorptive capacity of TA, which also needs to be underpinned by well-defined work programs and objectives of recipient agencies.

C. Bolstering CD by Sector

Fiscal Sector

5. **A comprehensive medium-term revenue mobilization strategy (MTRS) aligning revenue goals with SDG expenditure needs, is being considered.** CD in the fiscal sector is aimed at improving administration to increase government revenues as envisaged in the MTRS. With this perspective, CD is currently aimed at (1) customs and (2) tax administration reforms. Future CD should consider automation enhancements for greater transparency and standardization of procedures nationwide. Modernizing legislation, for both tax and customs, will give greater clarity of the tax rules and procedures, in turn minimizing opportunities for discretion and negotiation. And while no formal request has been made for PIMA, an introductory workshop was conducted by

[1] Effective September 10, 2018, the IMF's Technical Assistance Office for the Lao P.D.R. and the Republic of the Union of Myanmar (TAOLAM) located in Bangkok was renamed to the IMF Capacity Development Office in Thailand (CDOT) - https://www.imf.org/en/Countries/ResRep/CDOT-Region. The IMF – Singapore Regional Training Institute (STI) provides training in the formulation and implementation of macroeconomic and financial policies to government officials through courses and seminars held in Singapore and, periodically, elsewhere in the region - http://www.imfsti.org/.

CDOT in mid-2018. More recently, the authorities have expressed more interest in this exercise, including in a possible workshop on other countries' experiences.

6. The Lao Customs Department has made good reform progress, however, with some delay. The customs project under JSA9 (2018 – 21) covers: (1) strategic management; (2) organizational structure; (3) enforcement capacity; and (4) customs law revision. Amongst the four areas, strategic management is the most relevant area to strengthen the MTRS process. The Development Plan for Customs Administration (DPCA) for 2018–20 has been finalized and it will be a foundational document for coming years' reform activities and for the development of the customs component of the MTRS. Annual Operational Plans with Key Performance Indicators are currently in use and the organizational restructuring has been completed and is operating. Customs law revision process has commenced but the target completion date has been postponed to 2020. The development of an enforcement strategy has, however, stalled due to lack of action by LCD. TA efforts in FY19 are mostly focused on the DPCA development while, in FY20, TA focusing on enforcement strategy and customs law revision has been planned.

7. The authorities have requested more CD on improving VAT administration to mobilize revenues. The JSA 7 program ended in April 2018 and a new JSA project has been approved for May 2018-April 2021. Under the JSA 7 program, the first formal strategic plan – the Development Plan for Tax Administration (DPTA) 2018–20 was developed. TA was also provided to advise the tax department on its organizational structure to bring it closer to international good practice in tax administration. CD on implementing the strategic plan, MTRS, capacity development, assisting with the DPTA implementation, and reviewing the new IT system (TaxRIS) has been provided in FY2019. Upcoming plans include development of a VAT compliance improvement strategy which is aligned with surveillance priorities.

8. However, the main challenges around these significant reforms are capacity constraints. Recommendations from the IMF aimed at building capacity are yet to materialize without which progress on the upcoming reforms will be challenging. To address this more frequent visits and 'working together' type activities have been planned for FY2020. Upcoming CD should consider tackling the vast PPP framework to better measure and report contingent liabilities with the aim of improving transparency and minimizing fiscal risks.

Monetary and Financial Sector

9. Much of the CD in FY2019 was to further assist the authorities in implementing risk-based supervision (RBS) of banks. The RBS manual is now substantially complete, and RBS methods are being applied on a pilot basis. The authorities have drafted Institutional Profiles and Risk Assessment Summaries for more than half of the banks; benchmarks and peer groups are being implemented; on-site reports of examination have been utilized for several banks.

10. However, achieving an effective RBS system requires significant capacity building. The authorities must significantly improve their analytical skills to explain their assessments and defend conclusions. Thus far, efforts have focused mainly on developing the RBS manual and implementing on a pilot basis; going forward, efforts must concentrate on practical application of RBS methods for wider group of banks. This will be an incremental process requiring additional assistance to help examiners develop their skills and gain experience.

11. Recent changes to legal and regulatory frameworks will help support the RBS. The authorities recognize that amendments to the law and regulations must support RBS and that RBS is a prerequisite for transition to the Basel-II capital framework. A new legal framework for the Bank of Lao law, commercial bank law, and law on payment systems were adopted in 2018. Moving forward, prudential regulations need to be updated. RBS will enable better risk identification and that prompt follow-up will be critical to its success. In this regard, a formal policy for applying corrective measures will be needed.

12. Further deepening of the interbank market and developing a FX intervention strategy are medium term priorities. The instructions clarifying the removal of the interest rate cap has been issued, however, the implementation of the regulatory guidance is pending further clarifications. These amendments are also expected to facilitate a development of interbank FX markets.

Anti-money Laundering and Combating Financing of Terrorism (AML/CFT)

13. Work with the Asia Pacific Group on money laundering and TA providers to address the full range of AML/CFT issues identified in its mutual evaluation report is ongoing. Significant progress has been made in improving the AML/CFT regime with the authorities having established the legal and regulatory framework to meet their commitments identified by the Financial Action Task Force (FATF) in 2015. This was also reflected in the country's removal from the AML/CFT grey list in 2017. Lao P.D.R. is therefore no longer subject to the FATF's monitoring process under its on-going global AML/CFT compliance process. The next full FATF assessment is scheduled for 2020. This assessment will be a challenge since its focus will be on implementation as opposed to systems/laws (as in the past).[2]

D. Data and Training

14. Macroeconomic statistics have improved; however, more remains to be done to strengthen their quality and timely dissemination while building staff capacity. Common challenges while providing CD continue to be operational and resource constraints. Lack of strategic prioritization at higher levels and time available at lower levels to absorb CD resources has restrained progress. Fostering more institutional coordination remains critical for improvement. Stronger ownership of the methodological implementation processes and their results along with fostering a greater data sharing culture among agencies and within agencies would enable quicker progress.

15. Progress continues in improving statistics in the external and fiscal sectors. In the external sector, gains have been made on the compilation and dissemination of new datasets (IIP,

[2] http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/fatf-compliance-june-2017.html

external debt) and the coverage of source data has improved by engaging the Lao Statistics Bureau in the data collection process. On the fiscal sector, headway is being made on compiling quarterly and annual GFS (GFSM 2014 framework) by using annual the latest budget execution data and disseminating these to the IMF (quarterly) and on the authorities' website (annual). CD also continues to assist with compiling and disseminating quarterly public-sector debt statistics. On the work on PFM, the Charts of Accounts is being revised jointly with World Bank, as a complement to the Bank's work on a new financial management information system.

16. While monetary and financial statistics are being compiled, lack of consistency and coverage with financial soundness indicators data, remain. Improving monetary statistics (e.g., data on total bank assets and financial data of nonbank financial institutions) and their timely dissemination is needed. More attention needs to be given to bank's balance sheet data to aid its analysis of macro-financial linkages. Consideration should be given to publishing monetary data in the IMF's standardized reporting format for monetary and financial statistics. On data dissemination, the authorities have a national country data page as part of the e-GDDS framework.

17. Training through in-country and regional workshops and courses are ongoing to build capacity on macro-related issues. CD for training and analysis is expected to be a long-term process and will continue to include customized courses, specialized workshops (including during TA missions) and training in methodologies used in surveillance. The Macroeconomic Management project organized by CDOT is geared towards training through a combination of regional and in-country training courses and topical workshops. Under this umbrella, five agencies (Bank of Lao P.D.R., Ministry of Finance, Lao Statistics Bureau, Ministry of Planning and Investment, and the National Institute for Economic Research) are being provided CD by CDOT. Training includes, building macroeconomic and forecasting frameworks to support better macroeconomic policy making, with an inter-agency technical committee (i.e. the core group) convening regularly for this purpose, under the guidance of an inter-agency advisory committee (since 2018). Looking ahead, stronger inter-connectivity of the macro-framework with the DSA, liquidity forecasting etc. is needed to build staffs policy designing capacity.

Table. Lao P.D.R.: IMF TA delivery from January 2018–April 2019

Date	Title
	CDOT
12/11/2018	Chart of Accounts Project Kick-Off and JICA Meeting
1/23/18-1/24/18	Pre-e-GDDS Assessment
10/29/18-10/30/18	Core Group Meeting
2/25/18-2/26/18	Core Group Meeting on the Macroeconomic Framework of Lao PDR
6/11/18-6/15/18	Capacity Development in Implementing the International Public-Sector Accounting Standards on a Cash Basis
	CDOT/STI/WB/FAD/STA
2/19/18-2/23/18	External Sector Statistics
3/19/18-3/30/18	Course on Financial Programming and Policies
3/27/18-4/9/18	Supporting Improved Treasury Management and Modernization of Financial Management Systems
4/4/18-4/5/18	PFM
9/3/18-9/5/18	COA/FMIS and COA Workshop
	FAD
1/24/18-1/26/18	JSA7: strengthening tax administration in low-income Asian countries
11/19/18-11/26/18	Supporting tax administration reforms in selected Asian countries
11/5/18-11/16/18	Developing customs administrations in the Southeast Asia region
2/12/18-2/23/18	JSA7: strengthening tax administration in low-income Asian countries
2/26/18-3/8/18	JSA7: strengthening tax administration in low-income Asian countries
2/26/18-3/8/18	Revenue analysis
3/12/18-3/23/18	Developing customs administrations in the Southeast Asia region
3/12/18-3/23/18	Strengthening strategic management and enforcement
3/19/18-3/30/18	Developing customs administrations in the Southeast Asia region
3/4/19-3/15/19	Supporting tax administration reforms in selected Asian countries
5/1/18-5/31/18	Developing customs administrations in the Southeast Asia region
6/20/18-7/3/18	Supporting tax administration reforms in selected Asian countries
6/21/18-6/29/18	Developing customs administrations in the Southeast Asia region
7/18/18-7/31/18	Supporting tax administration reforms in selected Asian countries
7/23/18-7/25/18	Government finance statistics
7/3/18-7/16/18	Developing customs administrations in the Southeast Asia region
8/20/18-8/31/18	Developing customs administrations in the Southeast Asia region
8/27/18-9/5/18	Supporting tax administration reforms in selected Asian countries
8/28/18-9/6/18	Improved treasury management and modernization of financial supporting management systems
8/6/18-8/17/18	Supporting tax administration reforms in selected Asian countries
9/13/18-9/25/18	Medium-term revenue strategy
	MCM
3/4/19-3/15/19	Bank Supervision and New TA project
4/30/18-5/11/18	Implementation of Risk-Based Supervision
	STA
1/15/18-1/19/18	Accounts for Natural Resources
1/28/19-2/1/19	Government Finance Statistics
10/1/18-10/4/18	TAOLAM External Sector Statistics
11/12/18-11/16/18	Government Finance Statistics
11/26/18-11/30/18	External Sector Statistics
2/19/18-2/21/18	External Sector Statistics Training
2/22/18-2/23/18	External Sector Statistics Training
2/25/19-2/28/19	External Sector Statistics
2/5/18-2/8/18	Government Finance Statistics
3/26/18-3/30/18	Regional Government Finance Statistics
3/26/18-3/30/18	Government Finance Statistics
3/4/19-3/8/19	Government Finance Statistics
6/13/18-6/26/18	Enhanced General Data Dissemination System (e-GDDS)
7/2/18-7/13/18	National Accounts
9/3/18-9/7/18	Government Finance Statistics

Appendix VII. Fund's Past Advice

Recommendation	Actions taken	Technical Assistance
	Fiscal	
Gradual fiscal consolidation	• Fiscal deficit consolidated in 2018. The government plans to continue the gradual consolidation path supported by PFM and revenue reforms listed below.	
Develop medium term revenue strategy and strengthen tax and customs administration	• Approved Tax Strategic Development Plan 2018–2020 focusing on strengthening tax administration ensuring revenue collection increase up to 16-18 percent of GDP level	IMF, WB, JICA
	• Draft medium-term revenue strategy 2021–2025 will be submitted to the national assembly with the national budget in mid-2019	IMF
	• Draft strategic plan for customs 2018–2020 pending MOF's approval	IMF, JICA
	• Introducing new Tax Revenue Information System (TaxRis) automated tax system (launched January 2019)	Korea
	• Introducing automated and mobile payments for road tax, land tax	Korea
	• Developing national single window for customs clearance	Multi-donor
Strengthening public financial management	• PEFA was completed in 2019	WB
	• FMIS will be implemented during 2019–2025	WB
	• IPSAS-cash implementation	IMF
	• Chart of Accounts Modernization	IMF, WB
	• Preparation of MTEF and MTFF	ADB
	• Revenue forecasting model	ADB
	• Subnational financial management (Fiscal transfers)	ADB
	• Budget law implementing instructions and introduction of budget ceilings	WB
	• Disaster risk management and mitigation (regional DRM insurance pool, Disaster Risk Financing and Insurance Strategy)	Multi-donor, WB, UNDP
Strengthening debt management	• The new Public Debt Management Law (PDML) was adopted by the National Assembly in June 2018 and implementing instructions are being prepared	WB
	• Preparations for DeMPA assessment are ongoing and a 5-year debt management strategy is being developed	WB
	• Various DSA trainings were conducted	WB
	• DMFAS upgrade during 2019	WB

More rigorous selection of public investment projects	• PIMA assessment may be undertaken in 2020	IMF, WB, JICA
	• The government is conducting a comprehensive assessment of land concessions for investment projects • The new procurement law was approved in 2018 and implementation guidelines are expected in 2019	Swiss WB
Monetary		
Gradual depreciation of the exchange rate and moving within the band	• Gradual depreciation and moved within the band	
Accumulating reserves	• Reserves decline partly impacted by higher oil prices and natural disaster related imports and are expected to be maintained at pre-2018 levels.	
Improving functioning of interbank and domestic debt markets	• New BOL law was approved in 2018 and new commercial banks law in 2019 • BOL launched interbank lending market platform and payment and settlement systems are being automated • BOL has encouraged development of an interbank FX market which is now functioning to a degree	WB WB
Removing interest rate caps	• BOL issued instructions removing interest rate caps in February 2019, but implementation guidelines need to be clarified.	
Financial		
Strengthening banking regulation and supervision	• Developing risk-based supervision • Banks are moving towards Basel II compliance, with the BOL requiring all banks to submit action plans for meeting Basel II • New laws on the Bank of Lao P.D.R. and Commercial Banks	IMF WB
Reforming public banks	• Government efforts to find buyers for Lao Development Bank (LDB) and Agricultural Promotion Bank (APB) have not yet borne fruit	
Identify NPLs	• The government has completed an inventory of NPLs associated with bank-financed government projects from 2013/14 and is now issuing bonds to banks to help repair their balance sheets.	

Inclusive and sustainable growth		
Promote economic diversification	• Green growth and sustainable development with a priority to agriculture, forestry, urban development, transport, energy, and tourism	Multi-donor
Develop public infrastructure	• Various projects in energy, roads, and railways	Multi-donor
Improve conditions for private investment	• Enabled business environment and improved competitiveness of private/SMEs sector through improved business registration system. • Development of a regulatory impact assessment system suitable to Lao P.D.R. The program is focused at improving the legislative environment to support private sector development and increase the competitiveness of the Lao economy.	ADB ADB
Improve human capital	• The human development will be the focus of 9th 5- year plan.	Multi-donor
Track attainment of the SDGs	• SDGs are fully incorporated in the five-year plan and the mid-term review of outcomes against SDG commitments was conducted in 2018 • Lao P.D.R. participated in the Voluntary National Review for SDG implementation at the UN in 2018	Multi-donor led by UN
Reduce regional and gender disparities	• The National Strategy for Advancement of Women (2016-2025) and the five-year Plan of Action for Gender Equality (2016-2020) provide the guiding frameworks • Achieved gender parity in primary education, but disparities remain in secondary and higher education • Gender disparities in informal employment is higher and regional disparities remain	
Data and statistics		
Improve economic statistics	• e-GDDS implemented • Quarterly External Debt Statistics • Government Finance Statistics • Strengthening national gender statistics to enable gender sensitive planning • FSI indicators • Macroeconomic and poverty statistics • Environment and Social statistics including poverty statistics • Enhancement of the compilation of national accounts and improved statistical infrastructure (statistical business register) in the Lao P.D.R.	IMF WB, IMF IMF UN WB WB LuxDev ADB

	• Provides support to the 2017 round of the International Comparison Program (ICP) in Asia and the Pacific region including Lao P.D.R. for calculation of purchasing power parities and related aggregates.	ADB
	• Provided support on development of computer-assisted personal interviewing (CAPI) application for a nationally representative Labor Force Survey (LFS). The main contribution was on the CAPI application for latest LFS while ILO coordinated the remaining parts of survey design and analysis.	ADB, ILO
	• Updated and constructed the benchmark for the national Supply and Use Tables (SUTs) based on the 2008 System of National Accounts (SNA) recommendations.	ADB
	• Statistical Business Registers for Improved Information on Small, Medium-Sized, and Large Enterprises	ADB
	• Innovative Data Collection Methods for Agricultural and Rural Statistics	ADB
	• Provided support for implementing the country level activities and capacity building to the Lao P.D.R. through regional and in-country training on PPP methods for ICP and CPI and for calculation of purchasing power parities for 2011 ICP round.	ADB

INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

July 18, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

Asia and Pacific Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of May 31, 2019)

Membership Status: Joined on July 5, 1961.

General Resources Account:

	SDR Million	Percent Quota
Quota	105.80	100.0
Fund holdings of currency (Exchange Rate)	92.58	87.50
Reserve Tranche Position	13.23	12.50

SDR Department:

	SDR Million	% Allocation
Net cumulative allocation	50.68	100.00
Holdings	37.79	74.65

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved	Amount Drawn
ECF[1]	04/25/2001	04/24/2005	31.70	18.12
ECF[1]	06/04/1993	05/07/1997	35.19	35.19
SAF	09/18/1989	09/17/1992	20.51	20.51

Projected Payments to the Fund[2]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2018	2019	2020	2021	2022
Principal					
Charges/Interest	0.07	0.14	0.14	0.14	0.14
Total	0.07	0.14	0.14	0.14	0.14

[1] Extended Credit Facility (ECF), formerly PRGF.

[2] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Rate Arrangement

The de jure arrangement is a managed float. Since September 2016, the kip has followed a depreciating trend against the U.S. dollar. Therefore, the de facto exchange rate arrangement was reclassified to a crawl-like arrangement from a stabilized arrangement, effective September 2, 2016. The authorities' objective is to limit currency fluctuations of LAK against USD within ±5 percent per annum. The Bank of the Lao P.D.R. (BOL) sets a daily official reference rate for LAK to USD which is calculated based on the weighted average of the previous day's overall rate, the estimation of the domestic demand for USD and the forecasting of USD rate in the international market. Commercial banks and foreign exchange bureaus are required to maintain their buying and selling rates within ±0.25 percent of the daily reference rate. For the Euro and Baht, the buying and selling rate may not exceed a margin of 0.5 percent and 0.75 percent, respectively. For other currencies, a margin of 2 percent applies.

Lao P.D.R. has accepted the obligations under Article VIII, Sections 2(a), 3 and 4 and maintains an exchange system free of restrictions on the making of payments and transfers on current international transactions, except for restrictions imposed solely for security reasons and notified to the Fund under the Decision No. 144-(52/51).

Article IV Consultation

The last Article IV consultation discussions were held in Vientiane during November 29–December 13, 2017and were concluded by the Executive Board on February 26, 2018. The staff report (Country Report No. 18/84) was published March 2018.

Technical Assistance

Over the past five years, Lao P.D.R. has received technical assistance in the areas of: banking supervision and interbank market development; monetary operations; customs administration; tax and natural resource revenue administration; tax policy; public financial management; macroeconomic management; price statistics; external sector statistics; government finance statistics; and the national accounts. A Bangkok-based IMF office, Capacity Development Office in Thailand (CDOT) has facilitated technical assistance to Lao P.D.R. (as well as Cambodia, Myanmar, and Vietnam) and has provided technical assistance in macroeconomic analysis and forecasting, monetary operations, government finance statistics, external sector statistics, and public financial management.

Resident Representative

Francois Painchaud assumed the Resident Representative post for Vietnam and Lao P.D.R., based in Hanoi, on June 3, 2019.

INFORMATION ON THE ACTIVITIES OF OTHER IFIS

Information on the activities of other IFIs in Lao P.D.R. can be found at:

- World Bank: https://www.worldbank.org/en/country/lao
- Asian Development Bank: https://www.adb.org/countries/lao-P.D.R./main

STATISTICAL ISSUES

(As of June 30, 2019)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has serious shortcomings that significantly hamper surveillance, especially regarding national accounts, government finance, financial sector, and external sector statistics. These shortcomings are mostly due to lack of capacity which could be addressed through further efforts on the part of the authorities involved. The IMF is conducting technical assistance (TA) and training programs to address the specific needs with a focus to mitigate near-term risks, covering the areas of national accounts, prices, government finance statistics, monetary and financial statistics, and external sector statistics.
National Accounts: National accounts (NA) comprise annual estimates of GDP by activity at current and constant prices. Rebased national accounts (base year=2012) were released in early 2017 with the help of a World Bank expert, broadly following the *System of National Accounts (SNA) 1993 (includes part of 2008 SNA)*. Lao P.D.R. participated in the IMF's Statistics Department (STA) project to implement the SNA and International Comparison Project (ICP), funded by the government of Japan through the Japan Administered Account for Selected Activities (JSA), and has received technical assistance (TA) to improve annual national accounts and develop quarterly national accounts (QNA). Under this project, Lao P.D.R. made some methodology improvements in the annual GDP by activity estimates, and has moved closer to completing a new annual expenditure measure of GDP and a preliminary GNI series. However, there are some weaknesses in data sources, particularly on intermediate consumption of businesses. Some progress had also been made toward the development of a new quarterly GDP series, together with GDP by expenditure.
Price Statistics: The monthly consumer price index (CPI) for Lao P.D.R. was updated during 2016. Coverage was extended from 12 to all 18 provinces, the number of basket items increased from 245 to 485, and expenditure weights were updated using the results of the 2012 Lao Social Indicator Survey (LSIS). However, the full list of the updated weights has not yet been disclosed. To ensure that the index remains representative of current expenditure patterns, the Lao Statistics Bureau should prioritize the update of the expenditure weights using the results of the 2017 LSIS. The producer price index (PPI) has not been released due to low survey response rates.
Government Finance Statistics: Government finance statistics remain weak. The current GFS data compilation procedures use various secondary data sources, resulting in internal inconsistencies and a lack of detail on financing. Off-budget activities are not included in the fiscal data, although social security data have recently been included. STA appointed a GFS expert funded by the government of Japan to assist the Ministry of Finance (MoF) in upgrading the compilation and dissemination procedures of fiscal data in line with the *GFS Manual 2014* (*GFSM 2014*) and improve data reporting to the IMF. With assistance from the GFS expert, the authorities reduced data discrepancies and submitted quarterly fiscal data for publication in the *GFS Yearbook* and *International Financial Statistics*, but with some lags. Despite recent improvements, timely data dissemination, coverage, and accuracy still need further improvements. Annual GFS time series have been published in the MoF website for the first time in 2019. However, Public

Sector Debt Statistics are still incomplete, and have not been disseminated. Lao P.D.R. does not currently provide data on the stocks of central government and central government guaranteed debt to the Fund as required under Article VIII, Section 5 due to capacity constraints addressed above.
Monetary and Financial Statistics: The classification of monetary data by institutional sector and by financial instruments as well as valuation principles need to be strengthened. In addition, the timeliness of reporting needs further improvement. The latest monetary data reported to STA refer to December 2010. The compilation of monetary data based on Standardized Report Forms (SRFs) have yet to be introduced. Lao P.D.R. reports data on some key series and indicators of the Financial Access Survey (FAS), including the two indicators adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).
Financial Sector Surveillance: Progress has been made as BOL started to disseminate seven of the 12 core Financial Soundness Indicators (FSI) (except for those related to liquidity and market risk) on their own website but the underlying financial statements (e.g. balance sheet, income statement, supervisory series) as well as metadata are missing. Lao P.D.R. is yet to compile and submit to STA financial soundness indicators consistent with the methodology of the IMF FSI Compilation Guide.
1. **External Sector Statistics:** STA providing TA through the External Sector Statistics (ESS) Advisor appointed at the IMF Capacity Development Office in Thailand (CDOT) for the beneficiary countries including Lao P.D.R. whose activities are funded by the government of Japan under the Project on the Improvement of ESS in the Asia–Pacific region. Under the project, the Bank of Lao P.D.R. (BOL) has successfully implemented the first nationwide enterprise survey for International Investment Position (IIP) in 2018; and is repeating the survey this year. Previous years' TA missions have largely focused on assisting the BOL—the ESS compiling agency—in establishing a compilation framework for the IIP and external debt statistics (EDS) and improving estimation models for some key components of the primary and secondary income account. Work on EDS is in progress, pending committed support by the Ministry of Finance in providing timely data at higher frequency, and verifying data on state-owned enterprises' EDS incurred in the past. Draft IIP and EDS statements have been generated for authorities' internal use and is pending management approval for dissemination to the public. The main focus of TA missions has shifted to improving the coverage of trade in goods and services data, which would in turn address the currently understated trade deficits. Lao P.D.R. does not currently provide IIP data to the Fund as required under Article VIII, Section 5 due to capacity constraints addressed above.
II. Data Standards and Quality
Lao P.D.R. has been an Enhanced General Data Dissemination System (e-GDDS) participant since November 22, 2018 and implemented the e-GDDS by launching a National Summary Data Page on November 27, 2018.

Lao P.D.R.—Table of Common Indicators Required for Surveillance
(As of June 29, 2019)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	02/2019	06/04/2019	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	02/28/2019	05/10/19	M	I	Q
Reserve/Base Money	02/28/2019	05/10/19	M	I	Q
Broad Money	02/28/2019	05/10/19	M	I	Q
Central Bank Balance Sheet	02/28/2019	05/10/19	M	I	Q
Consolidated Balance Sheet of the Banking System	02/28/2019	05/10/19	M	I	Q
Interest Rates[3]	02/28/2019	05/10/19	M	I	M
Consumer Price Index	04/30/2019	05/17/19	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4]—General Government[5]	05/10/2019	12/31/2018	I	I	I
Revenue, Expenditure, Balance and Composition of Financing[4]—Central Government	05/10/2019	12/31/2018	I	I	I
Stocks of Central Government and Central Government-Guaranteed Debt[6]			NA	NA	NA
External Current Account Balance	Q4 2018	06/04/2019	Q	I	I
Exports and Imports of Goods and Services	Q4 2018	06/04/2019	Q	I	I
GDP/GNP	12/31/2018	05/06/19	A	A	A
Gross External Debt	12/31/2017	11/28/17	A	A	I
International Investment Position[7]			NA	NA	NA

1 Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

2 Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency, but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency, but settled by other means.

3 Both market-based and officially determined, including discount rates, money market rates, and rates on treasury bills, notes and bonds.

4 Foreign and domestic bank, nonbank financing.

5 The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

6 Including currency and maturity composition.

7 Includes external gross financial asset and liability positions vis-à-vis nonresidents.

LAO PEOPLE'S DEMOCRATIC REPUBLIC

DEBT SUSTAINABILITY ANALYSIS

July 18, 2019

Approved By
Anne-Marie Gulde-Wolf and Yan Sun (IMF) and Marcello Estevão (IDA)

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

Risk of external debt distress:	High
Overall risk of debt distress:	High
Granularity in the risk rating	Sustainable
Application of judgement:	No

Lao P.D.R.'s risks of external and overall debt distress continue to be assessed as high.[1] *Under the revised low-income country debt sustainability framework (LIC DSF), its debt carrying capacity has deteriorated and most external and total public debt indicators breach their respective indicative thresholds and benchmarks under the baseline scenarios.*[2] *External debt indicators are most vulnerable to shocks to exports and depreciation of the currency. Public and external debt indicators are most sensitive to the contingent liabilities shock, while recent natural disasters underscore the need for strengthening buffers. The low level of reserves adds to these vulnerabilities. Factors, such as the large share of electricity export earnings under long-term intergovernmental power purchase agreements, and a strong and growing electricity exports market help mitigate risks, keeping the debt outlook sustainable. Market access is being maintained, around 65 percent of external debt is concessional, and the stock of expenditure arrears is declining. Rebuilding fiscal space, adopting clear guidelines for sovereign debt issuance and guarantees, assessing risks from contingent liabilities, and improving debt management are immediate priorities. Assessing and targeting infrastructure projects with high growth and social returns and financing these with concessional financing would benefit debt sustainability. Strengthening the business environment and governance, would improve the investment outlook, help diversify and make growth more inclusive. Increasing the export base, continuing to maximize the proportion of concessional loans and improving primary deficits would help to keep the debt burden contained.*

[1] The 2017 DSA assessed that Lao P.D.R. faces a high risk of debt distress, based on an assessment of public and publicly guaranteed external debt.

[2] The CI is a composite indicator based on a weighted average of several factors such as the country's real GDP growth, remittances, international reserves, and world growth and the CPIA score. The calculation of the CI is based on 10-year averages of the variables, across 5 years of historical data and 5 years of projection, and the corresponding CPIA. Details on the methodology can be found in the new LIC-DSF guidance note: https://www.imf.org/en/Publications/Policy-Papers/Issues/2018/02/14/pp122617guidance-note-on-lic-dsf.

PUBLIC DEBT COVERAGE AND COUNTRY CLASSIFICATION

1. **The coverage of public sector debt used in the DSA is central government debt, government-guarantees including to State Owned Enterprises (SOEs) and central bank borrowing. Some of the** SOE debt is on lent by the central government and is therefore included in the coverage of public external debt. There is no outstanding debt to the IMF. Under the new Public Debt Management Law (2018) off-budget borrowing not approved by National Assembly is prohibited. To address the past concerns, all borrowing (by central and provincial governments, SOEs, Public-Private Partnerships (PPPs)) must be approved by the National Assembly and the Ministry of Finance negotiates all loans. Directives to implement this new law is being defined. Non-guaranteed SOE debt is covered in the PPP contingent liability shock (para 5).

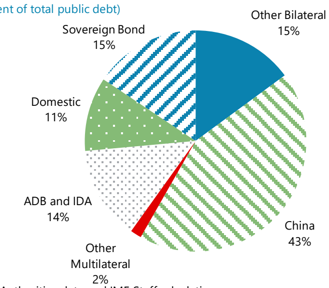
Text Table 1. Coverage of Public Sector Debt

	Subsectors of the public sector	Check box
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	

BACKGROUND ON DEBT

2. **Lao P.D.R.'s total public debt is estimated to be 57.2 percent of GDP as of 2018.**[3] Public debt in this DSA covers public domestic debt (5.8 percent of GDP) and public and publicly guaranteed (PPG) external debt (51.4 percent of GDP).[4] Domestic debt comprises T-bills and T-bonds, are mainly held by banking sector and the central bank. The resolution of domestic payment arrears related to public infrastructure projects is underway and has added around 3 percent of GDP to

Lao P.D.R.: Shares of Total Public Debt
(in percent of total public debt)



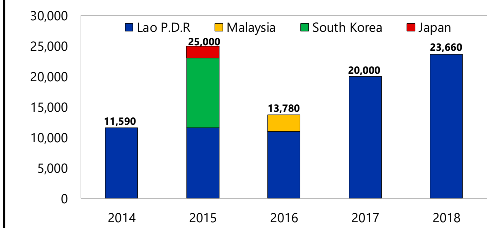
Sources: Authorities data and IMF Staff calculation

[3] Lao P.D.R.'s fiscal year is defined as January to December. This first year of projection in this DSA is FY2018. Substantial progress is being made in improving macroeconomic statistics including data related to debt statistics. The stock of domestic debt was provided for the first time by authorities. It is lower than previous estimates as it does not include debt held by SOEs given that the SOE's domestic borrowing is not explicitly guaranteed by the central government. Private external debt is also lower than previously estimated. The latter are now linked to the actual private external flows in revised balance of payments (BOP). The upcoming new International Investment Position survey is expected to improve private debt estimates and further revisions are expected to BOP, which is transitioning to BPM6 reporting, supported by IMF TA.

[4] The external debt definition used in this DSA is based on residency.

domestic debt in 2018.[5] Given higher costs of domestic borrowing, the share of domestic PPG debt remains relatively small. Much of the existing public and publicly guaranteed (PPG) debt stock is external, and close to 65 percent of the public external debt is on concessional and semi-concessional terms. The largest share of PPG external debt is held by bilateral creditors amongst which China's share, which is primarily concessional, is the largest (43 percent of total PPG debt). International Development Association (IDA) and the Asian Development Bank (ADB) are the two largest multilateral creditors (14 percent of total PPG external debt). Additionally, the authorities have been accessing the Thai capital market since 2013. The estimated outstanding bond amount at the end-2018 was US$ 1.6 billion.

Lao P.D.R.: Baht Bond Issuance by Country
(In millions of Baht)



Source: Thai Bond Market Review, 2018.

3. The government has been clearing past domestic arrears related to infrastructure projects by issuing bonds (around 3 percent of GDP in 2018). The government is also in the process of evaluating completed projects with the view of identifying any outstanding payment obligations. These arrears are included as part of the domestic debt stock.

4. Total private external debt is estimated to be 41.5 percent of GDP as of 2018. Private external debt is estimated to be large given the large number of PPPs.

5. The magnitude of contingent liability shock (38.9 percent of GDP) account for potential liabilities from PPPs, realization of potential arrears, and the recapitalization needs from the banking system. Given the large capital stock, the DSA includes a PPP shock of 29.4 percent of GDP to capture any contingent liabilities arising from non-SOE debt.[6] In addition, while data limitations hinder a full assessment of potential NPLs and recapitalization needs, the uneven loan loss recognition and a slowdown of overall credit growth indicates low profitability and the need to recapitalize through time. A shock covering 0.5 percent and 5 percent of GDP has been added to the analysis to account for the discovery of potential domestic arrears and any likely recapitalization needs of the banking sector.[7] The stock of domestic debt, provided for the first time by the authorities, does not include debt held by SOEs given that the SOE's

Text Table 2. Calibration of Shock Scenarios

1	The country's coverage of public debt	The central government, central bank, government-guaranteed debt	
		Used for the analysis	Reasons for deviations from the default settings
2	Other elements of the general government not captured in 1.	0.5	A 0.5 percent of GDP shock is included to account for the potential discovery of arrears.
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	4	Domestic debt to SOEs indirectly guaranteed by the govt
4	PPP	29.4	Captures the contingent liability from the private sector share of PPPs
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5	5 percent of GDP shock to capture potential restructing needs in the banking sector.
	Total (2+3+4+5) (in percent of GDP)	38.9	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

[5] The legacy debt of Bank of Lao P.D.R.'s direct lending to local government's off-budget infrastructure projects in the past is also included in domestic debt.

[6] The World Bank's Private Participation in Infrastructure Database is available here https://ppi.worldbank.org/. Amongst the LICs, Lao P.D.R. has the largest share of PPP capital stock as per the database.

[7] The minimum 5 percent of GDP shock for potential bank recapitalization per the LIC DSF methodology is on the higher side for Lao P.D.R. given that potential costs related to the two state banks which require recapitalization have been estimated to be lower.

domestic borrowing is not explicitly guaranteed by the central government. Potential contingencies arising from domestic debt being implicitly guaranteed are covered by adding 4 percent to the contingent liability shock.

6. Steady fiscal consolidation aimed at reducing fiscal deficit to about 2 percent of GDP and public debt below 50 percent of GDP by 2025. The authorities have incorporated SDGs in their 5-year development plan.[8] Key reforms along with greater investments in both physical and human capital are needed to achieve the SDGs. For this, the authorities should seek external borrowing on concessional terms while limiting financing on commercial terms. PPPs have been used more extensively over the past few years. As per data available from the World Bank, Lao P.D.R. was amongst the top three IDA eligible countries to get investment through private participation in infrastructure in 2017.[9] Investments are mostly directed towards the energy and transportation sectors. A current moratorium on new capital investment projects pipeline and planned reduction in the size of the civil service employment will also help fiscal consolidation.

BACKGROUND ON MACROECONOMIC FORECASTS

The Baseline Scenario

7. The assumptions in the baseline scenario are consistent with the macroeconomic framework presented in the staff report. The main assumptions in the baseline are:

- **Real GDP growth.** While economic growth has moderated in 2018 in part due to the protracted period of floods and natural disasters, it is expected to recover in 2019 but at a pace somewhat slower compared to the previous DSA.[10] Over the medium-term, growth is expected to pick up supported by improvement in infrastructure, an additional 2,200 MW of power generation with the completion of several power projects which is expected to lead to the export of electricity to new markets, and the completion of the Kunming-Singapore Railway Line. [11]

- **Inflation.** Despite the disruptions from protracted flooding and the tragic dam collapse in Attapeu, headline inflation remained moderate reflecting higher fuel prices and kip depreciation. Inflation is projected to rise temporarily given the pass-through of kip depreciation and higher oil prices.

- **Current account.** The current account deficit remained large in 2018 driven partly by disaster-related and mega-project imports and was largely financed by sustained FDI inflows and external debt, keeping international reserves at about one month of imports. The current account deficit

[8] Lao P.D.R.'s aspiration, as stated in 8th National Socio-Economic Development Plan (NSEDP), is to graduate from LDC status by 2020. The Triennial Least Developed Countries Review, held in March 2018 by the UN Committee for Development Policy determined that Lao P.D.R. will be considered for graduation at the time of the 2021 review.

[9] Investments in IDA Countries Private Participation in Infrastructure (PPI) 2013 – 2017

[10] Lao P.D.R. 2017 Article IV Consultation Staff Report DSA; IMF Country Report No. 18/84

[11] These include the Sayaboury Hydropower Project (1,285 MW), Nam Ngiep 1 (290 MW), Xe-Pian Xe-Namnoy (410 MW), and Don Sahong (260 MW).

is projected to remain around 11.4 percent of GDP over the short to medium term reflecting a relatively stronger demand for imports including oil.

- **External financing.** Financing from large creditors is currently in place, and the authorities continue to issue on the Thai capital market. Multilateral financing is expected to remain stable but slowly declining, while bilateral financing is projected to pick up. It is also expected that there will be continued access to the Thai market over the medium term. The medium-term outlook for FDI and external financing remains stable. FDI inflows remain around 7.8 percent of GDP. Several infrastructure projects are expected to wind down by 2021, however, some new investments are also expected.

- **Fiscal outlook.** Fiscal consolidation brought the fiscal deficit to 4.4 percent of GDP in 2018. It was mainly driven by a reduction in recurrent and capital spending, as revenues under performed and part of the spending was diverted towards natural disaster relief. The fiscal deficit is expected to decline further in 2019 supported by revenue administrative efforts and some optimization of recurrent spending given that the government has announced its plans for reductions in the civil service recruitment. Capital spending will decline due to a temporary suspension of new investment projects aiming to prioritize post-disaster reconstruction needs. Authorities, with support from the IMF, have developed a Medium-Term Revenue Strategy (MTRS: 2021–25) which provides a coordinated and sequenced approach to revenue mobilizations reforms. The government has also developed customs and tax administration strategic plans and has commenced the introduction of an automated tax revenue information system (TaxRis). Implementing these plans and supporting automation efforts with improved data gathering, risk-based administration practices, and training will help to improve revenue administration efficiency.

- **Realism of the baseline.** The PPG external debt-to-GDP ratio follows a similar path compared with the DSA from five years ago (2013) given the ongoing fiscal consolidation efforts. Cross-country experience suggests that the baseline fiscal consolidation is feasible, and the projected growth path is in line with a fiscal multiplier of 0.2.[12]

Text Table 3. Key Macroeconomic Assumptions: 2018–24 (average)

	Baseline	Previous DSA
Real GDP growth (in percent)	6.6	6.9
Inflation (percent change, y/y)	3.0	3.0
Primary fiscal balance (in percent of GDP)	-2.4	-2.9
Overall fiscal balance (in percent of GDP)	-4.0	-4.6
Current account (in percent of GDP)	-11.4	-11.6
FDI (in percent of GDP)	6.8	11.8

Source: IMF staff calculations.

[12] Public/Private investment rate charts are not available in the current DSA from data limitations.

COUNTRY CLASSIFICATION AND SCENARIO STRESS TESTS

8. **The new LIC DSF determines the debt sustainability thresholds by calculating a composite indicator (CI).** For Lao P.D.R., the CI score based on both the 2019 April WEO and 2018 October WEO data corresponds to a weak rating. In the previous debt sustainability framework (DSF), debt-carrying capacity was determined by the World Bank's Country Policy and Institutional Assessment (CPIA) score. Under this methodology, Lao P.D.R. was classified as having a medium policy performance with a CPIA average of 3.29 for the period 2014–16. This CPIA indicator has deteriorated marginally owing to the weaker policy framework with an average of 3.22 for the period 2015–2017. Thus, the debt carrying capacity classification is weaker compared to the previous DSA - the present value (PV) of PPG external debt-to-GDP threshold has decreased from 40 to 30 percent, the PV of PPG external debt-to-exports has decreased from 150 to 140 percent, debt service-to-exports has decreased from 20 to 10 percent and debt service-to-revenue ratio has decreased from 20 to 14 percent. The indicative threshold for the PV of total public debt-to-GDP has decreased to 35 percent. A summary of the thresholds used in the exercise are included in the table below.[13]

Text Table 4. Applicable Thresholds

Debt Carrying Capacity	Weak

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintages
Weak	Weak 2.35	Weak 2.38	Weak 2.39

APPLICABLE	
EXTERNAL debt burden thresholds	
PV of debt in % of	
Exports	140
GDP	30
Debt service in % of	
Exports	10
Revenue	14

APPLICABLE	
TOTAL public debt benchmark	
PV of total public debt in percent of GDP	35

9. **Standardized stress tests indicate that the external debt path is vulnerable to a shock to exports, depreciation of the currency and large contingent liabilities.** In an uncertain global environment, a sharper than expected slowdown in China – Lao P.D.R.'s largest trading partner and FDI investor– may reduce exports and decelerate FDI flows (see Staff Report: Box 1). Additionally, any future

[13] See footnote 2 which discusses the CI.

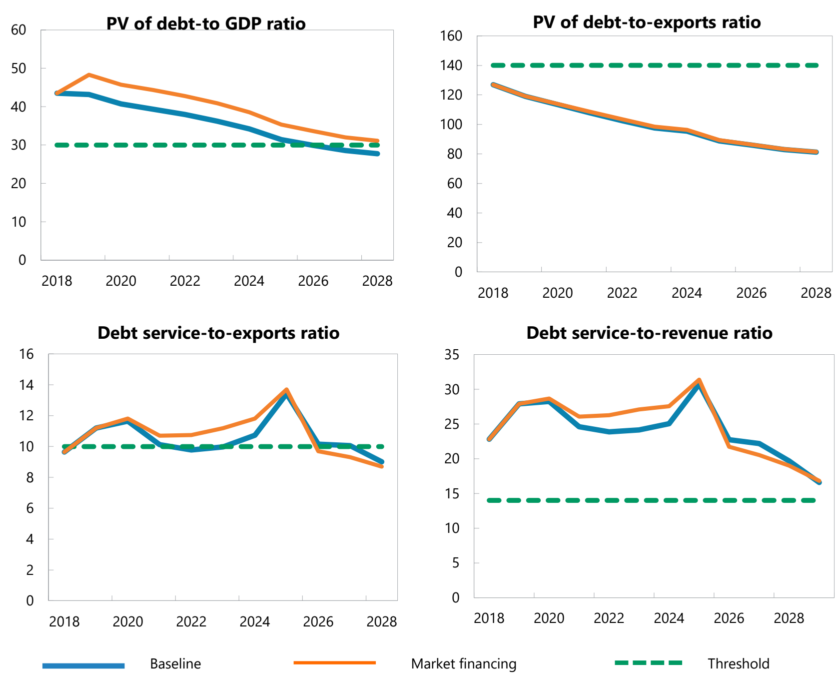
lower demand for electricity may reduce exports. Thus, the shock to exports, which affects both the export-based ratios, underscores the importance of diversifying from a resource-based economy and expand its current export base. The one-time 30 percent depreciation shock deteriorates the external and public debt service indicators and highlights the susceptibility to a sudden depreciation of the kip/U.S. dollar exchange rate from the tightening of global financial conditions. Given the considerable share of foreign currency denominated debt, a large sudden exchange rate depreciation could significantly deteriorate this ratio over the projection period. Market reactions, especially in the Thai capital market given their access to it, are especially important for rollovers and any future issuance. The combined contingent liability shock from PPPs and recapitalization needs keeps all four external debt ratios above their respective benchmark throughout the projection period (Figure 2, Table 4).

10. Lao P.D.R. has been accessing the Thai capital market to raise funds to finance infrastructure projects. The Thai capital market has been tapped regularly since the first issuance in 2013. The results of the market-financing module of the DSF indicates that Lao P.D.R. has a low liquidity risk based on the gross financing need being below the 14 percent benchmark. There is no Emerging Market Bond Index (EMBI) or equivalent spread available for Lao P.D.R.

Lao P.D.R.: Market-Financing Risk Indicators

	GFN 1/	EMBI 2/
Benchmarks	14	570
Values	9	n.a.
Breach of benchmark	No	n.a.
Potential heightened liquidity needs	Low	

1/ Maximum gross financing needs (GFN) over 3-year baseline projection horizon.
2/ EMBI spreads correspond to the latest available data.



Sources: Country authorities; and staff estimates and projections.

11. Natural disasters have generated direct losses of 2 percent of GDP and reconstruction needs close to 3 percent of GDP (Box 1 and Appendix III). Lao P.D.R. has become more prone to natural disasters and needs to build the fiscal space to mitigate weather related shocks and its economic and social consequences. In the aftermath of a natural disaster, typically debt ratios tend to deteriorate from an increase in total expenditure, decline in revenues or from the slowdown in GDP. A tailored test shows that debt ratios deteriorate significantly compared with the baseline highlighting the need to enhance preparedness and response ability to natural disasters by building fiscal and external buffers (Table 3–4).[14] The vulnerability to this shock also underscores the need for stronger growth in the medium term. The authorities need to build up policy buffers, particularly domestic revenues and foreign reserves, and continue their efforts with structural reforms to improve growth potential and resilience by pursuing economic diversification.

Box 1. Impact of the 2018 Natural Disaster in Lao P.D.R.

In 2018, the country experienced widespread floods, which have significantly impacted the population and the economy. Two tropical cyclones and a dam collapse in Attapeu Province resulted in extensive flooding between July and September 2018, impacting all parts of the country. A comprehensive Post-Disaster Needs Assessment (PDNA) has estimated damage and losses to be around 2 percent of the GDP and total recovery needs around 3 percent of the GDP (US$520 million). Short-term recovery and reconstruction needs, estimated to be 0.8 percent of the GDP (US$ 154 million), largely include support to restore livelihoods and the recovery of affected sectors. In part due to the floods, real GDP growth slowed in 2018 (6.3 percent compared with 6.8 percent in 2017), as both agricultural and industrial production declined and while there were no additional expenditures, the fiscal deficit estimate was revised up to 4.4 percent (in 2018) from tax exemptions to the affected businesses. The fiscal deficit in 2019 has also been revised up to 4.3 percent from the ongoing reconstruction efforts. The government allocated emergency assistance of LAK 100 billion (US$11.7 million) in 2018 towards public works, transportation, agriculture, forestry and infrastructure by reallocating capital expenditures and a further LAK 500 billion (US$57 million) in 2019 to repair public priority infrastructure. In addition, developing partners have allocated approximately US$81.1 million which leaves a gap of approximately US$370.2 million which is expected to be met by re-prioritizing capital spending over 2020-23 period. To mitigate future risks of natural disasters, the government of Lao P.D.R. has decided to join the regional catastrophe risk insurance pool and secured premium financing of US$5 million through WB's support.

EXTERNAL AND PUBLIC DEBT SUSTAINABILITY

12. All but one external PPG debt indicators breach their policy relevant thresholds in the baseline scenario (Figure 1). The PV of external debt-to GDP ratio remains above its threshold in the near term and then trends downwards going below the threshold over the projection period. The debt service-to-exports ratio hovers around the threshold while the debt service-to-revenue ratio is expected to remain above its thresholds during the projection period given the large debt service payments falling due and low level of revenues.

13. The PV of total public debt-to-GDP ratio stays above the public debt benchmark (Figure 2). The primary deficit is expected to fall in subsequent years mainly on the back of fiscal consolidation, supported by revenue administrative efforts and some optimization of recurrent spending and a slowdown in capital spending after the disaster reconstruction period has been completed. The PV of public debt-to-

[14] The tailored test includes US$ 520 million (3 percent of GDP) as the reconstruction needs estimated by the PDNA.

GDP ratio remains well above the indicative benchmark over the projection period but is projected to be on a downward trend. Under the baseline, the PV of public debt falls from 50.2 percent of GDP in 2018 to 45.6 percent of GDP by 2028.

ASSESSMENT OF RISK RATING

14. The DSA under the new LIC DSF framework suggests that the risk of external debt distress is high as is the overall risk of debt distress. The overall debt outlook remains challenging— under the baseline, and most of the total public debt and debt service indicators related to PPG external debt are expected to remain above or close to their respective benchmarks and thresholds over the projection period— and several vulnerabilities exist. These include a shock to exports, depreciation of the currency, large exposure to PPPs, recapitalization needs of the banking sector and the aftermath from potential natural disasters. With the debt service-to-exports and debt service-to-revenue ratios well above their thresholds, the authorities should remain mindful of liquidity risks.

15. However, factors such as the large export-oriented electricity sector, help mitigate risks keeping the debt outlook sustainable. Over 90 percent of the electricity exports are under intergovernmental power purchase agreements (PPA) that cover 25–30 years of export earnings.[15] The total share of electricity sector in total stock of PPP investments is around 75 percent. The government's equity shares in export-oriented PPPs ranges primarily between 15–25 percent.[16] Intergovernmental PPAs, large export receipts, and a growing exports market with new PPAs mitigate risks related to power sector loans (Box 2). Lao P.D.R. has a strong track record of implementing energy export related mega-projects and maintains close economic ties with a diversified investor base from neighboring countries. These neighboring countries, and primarily Thailand, are not only a source of financing but also main consumers of energy exports. Moreover, a large share of debt remains mostly concessional, there are no external payment arrears, the stock of domestic arrears is declining, and Lao P.D.R.'s market access to the Thai capital market is being maintained with favorable terms. In addition, the authorities are in the process of taking measures such as reviewing current tax exemptions in the power sector and implementing the Medium-Term Revenue Strategies (MTRS) which are expected to significantly strengthen revenues going forward. Finally, there could be some upside potential if the authorities' ambitious projected fiscal adjustment plans materialize as opposed to the assumed relatively conservative baseline. All these measures underpin the argument that while the risk of debt distress is high, the outlook remains sustainable.

16. Increasing the export base, assessing risks from PPPs, and improving policy buffers would help keep the debt burden contained. Effective implementation of new Public Debt Management Law and a 5-year public debt management strategy supported with strong institutional capacity building efforts could strengthen the debt carrying capacity going forward. That said, authorities must remain cautious about borrowing that leads to a rapid debt buildup, target infrastructure projects with high social and growth impact, and finance them on concessional terms to the extent possible and assess fiscal risks of PPPs

[15] As an example, the two large hydropower projects - Nam Theun 2 and Hong Sa Lignite, have produced over a billion dollars in export earnings in 2017-18 under the PPAs with Thailand. Seven other power plants, including three new ones that are expected to start operations in 2019, have similar PPAs with Thailand. In addition, there are two PPAs with Vietnam.

[16] In two of these projects the government's equity shares is around 60 percent.

related contingent liabilities on a regular basis. It will also be important to continue to develop the legal and institutional frameworks for PPPs. In this regard, a Public Investment Management Assessment (PIMA) should be considered to set priorities for public investment reform. The low level of foreign reserves may make foreign exchange availability challenging given the lumpy external debt repayments. This could put pressure on the kip and, in turn, raise financing challenges. The authorities should remain vigilant of the potential vulnerabilities in the banking system by monitoring the balance sheet of the banks as they conform to the new regulations. Over the long term, the need to strengthen economic resilience and increasing fiscal and external buffers is emphasized to strengthen debt sustainability. Strengthening the business environment and governance would raise the investment outlook and potential growth. In addition, these measures will also help improve the CPIA rating of the country which in turn will help improve overall debt sustainability.

Authorities' Views

17. The authorities highlighted that they have put in place various measures to reduce risks associated with debt sustainability to improve the debt outlook. The authorities acknowledged that their debt burden is high. Policies such as suspending new investment projects combined with the new Procurement Law and intentions to borrow new debt on concessional terms will reduce the debt burden. The authorities are also taking stock of all existing projects with the view of prioritizing them. The new Public Debt Management Law now consolidates the Ministry of Finance's oversight powers over debt through budgeting and project approval processes. Previously, this process of contracting debt was fragmented amongst line ministries and sub-national governments. The authorities have started to review the power sector related debt and have instituted a moratorium on new hydropower projects. They clarified that revenues generated from these projects are expected to be stable and cover related debt service. In addition, they indicated that the process of diversifying the electricity export market is underway and new power purchase agreements with Vietnam, Cambodia and Myanmar are being negotiated. They also emphasized that several power projects are currently under tax exemptions and upon the expiration of the concession period, revenues and dividends are expected to be much stronger. They reiterated that the debt is on a sustainable path and will be manageable given all the measures they have been undertaking. They noted that the calibration of risks included in the contingent liability scenario are on the higher side.

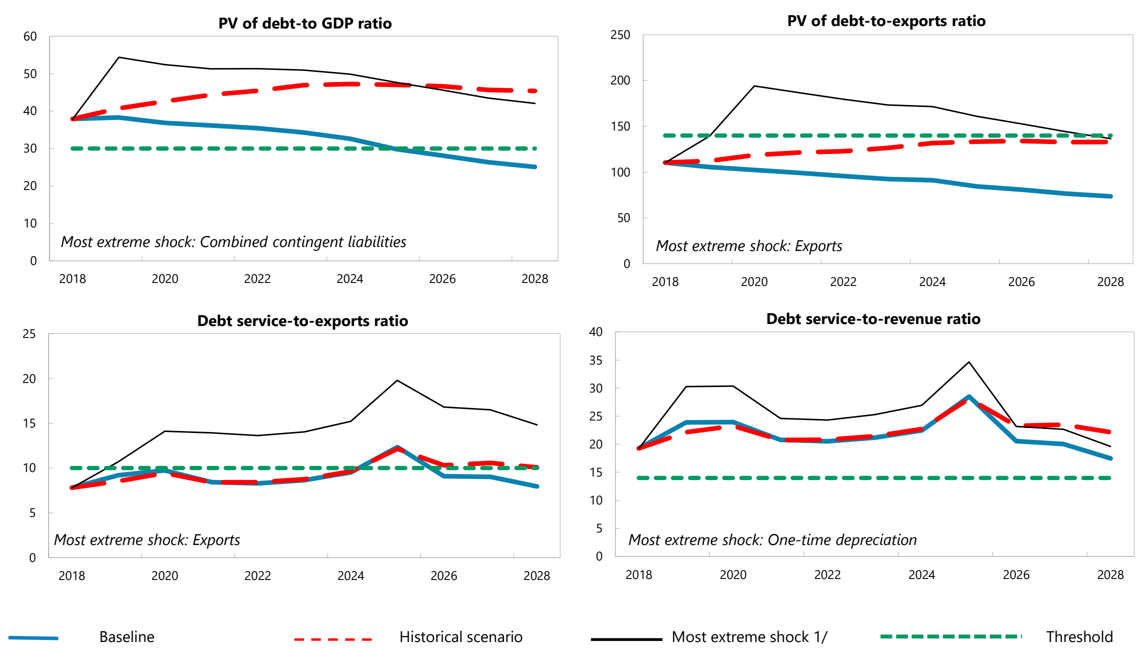
Box 2. Customized Scenario – Power Sector Related Debt

Lao P.D.R. has a strong track record of implementing energy exports from mega- power projects supported by power purchase agreements (PPAs) and it maintains close economic ties with a diversified investor base, including from many neighboring countries. These neighboring countries, and primarily Thailand, are not only a source of financing but are also consumers of energy exports.

The government's participation in large-size power exporting Independent Power Producers (IPPs) is via equity financing through SOEs which hold equity shares ranging between 15 and 60 percent in these projects. The main off-taker of power exports from these IPPs is the Electricity Generation Authority of Thailand (EGAT). Long-term PPAs with EGAT, a financially creditworthy electric utility company, have allowed IPP developers to access long-term affordable financing from a highly diversified creditor base including multilateral, bilateral, and a range of commercial creditors. Currently, over 70 percent of total power generation capacity is exported to the guaranteed Thai market. Lao P.D.R. is working to expand its power export market and is starting to export to Cambodia, Myanmar, and Vietnam. SOEs service the on-lent portion of the debt out of export revenues through direct transfers to the government budget, before dividends and profit taxes are paid out.

Completed mega IPP projects with long term PPAs, a guaranteed and growing power export market, strong project cashflows, the power sector SOEs directly servicing, on average, more than 20 percent of the total external debt indicate the 'self-sustaining' nature of export related power sector debt. Thus, under the customized scenario, the on-lent portion of the PPG debt to two power sector SOEs with export exposures to EGAT guaranteed by PPAs have been excluded from the public debt, which is equivalent to 10 percent of total public debt. Forthcoming disbursements are also adjusted down by 10 percent to account for the assumption that these on-lending activities covered by PPAs is likely to continue between the central government and power sector SOEs in the future. The debt ratios improve significantly over the projection period, once this portion of power sector related debt is excluded. And while the debt-service to revenue ratio continues to breach its threshold for most of the projection period, measures such as reviewing current tax exemptions for power projects, winding down of tax-exemption periods and implementing the MTRS are expected to significantly strengthen revenues, improving the outlook of this ratio. To note, this is a conservative assumption given that the total on-lending to the power sector from the central budget is 35 percent of total external public debt.

Figure 1. Lao PDR: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2018-2028



Box 2. Customized Scenario – Power Sector Related Debt (Concluded)

Figure 2. Lao P.D.R.: Indicators of Public Debt Under Alternative Scenarios, 2018–28

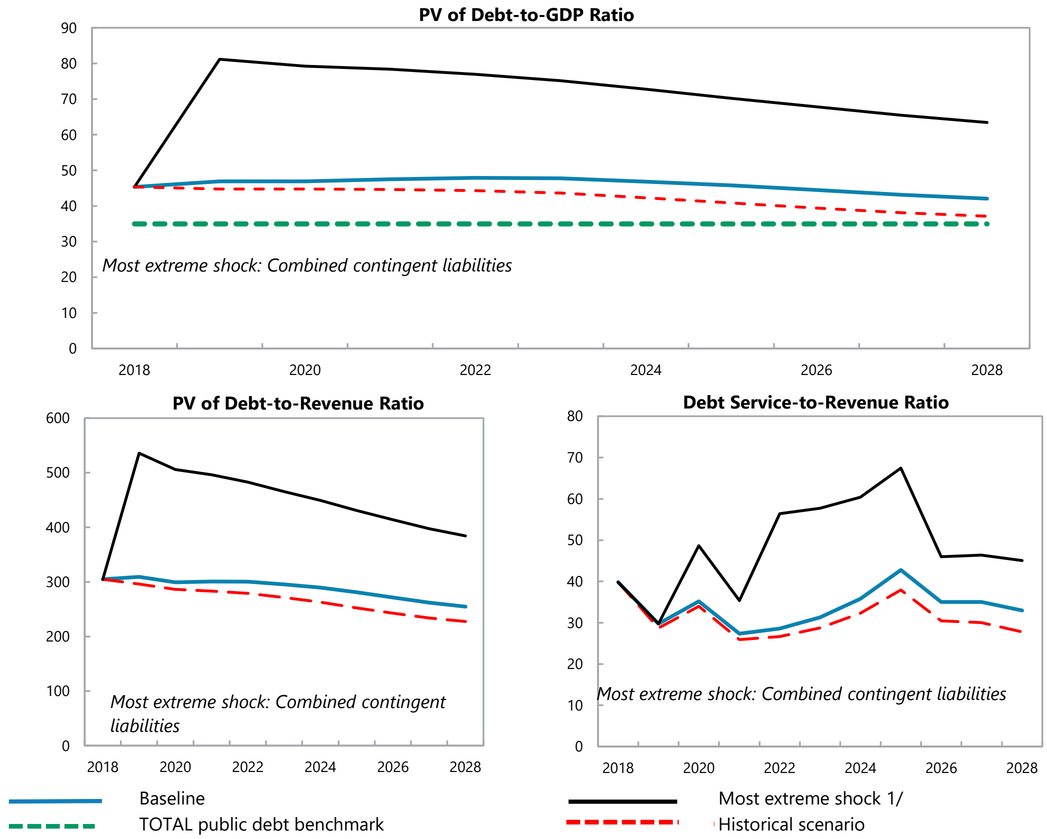


Figure 2. Lao P.D.R.: Indicators of Public Debt Under Alternative Scenarios, 2018–28

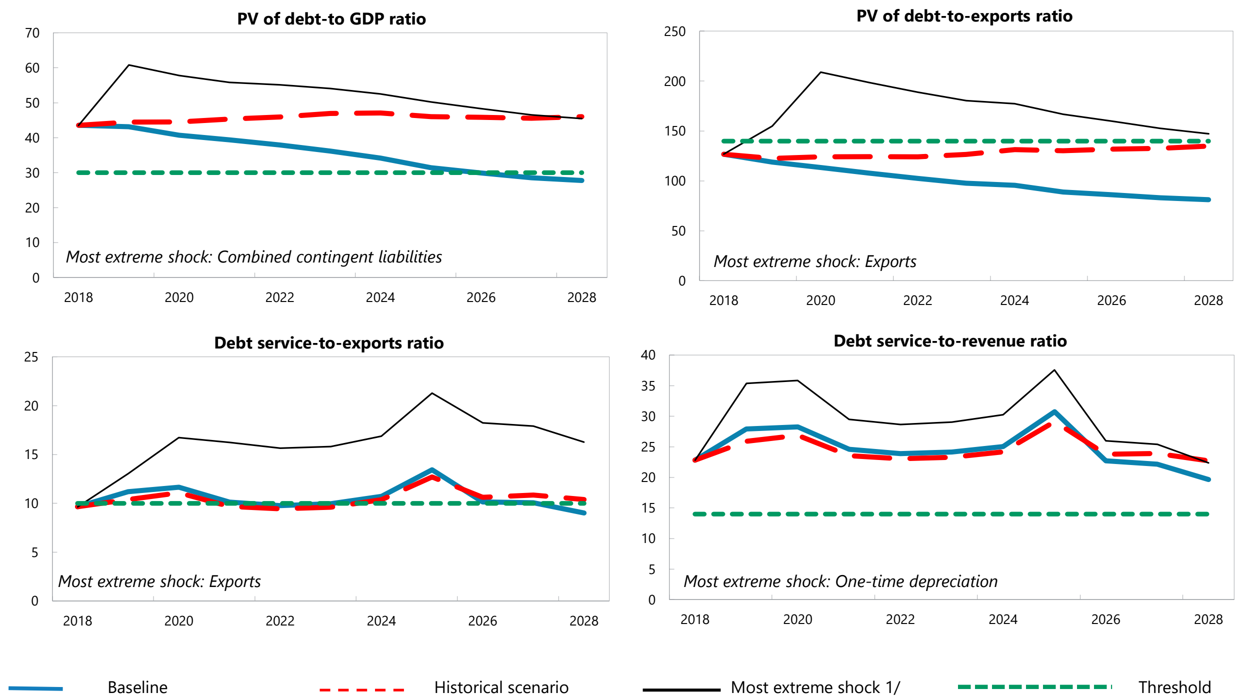
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	53%	53%
Domestic medium and long-term	46%	46%
Domestic short-term	1%	1%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	2.7%	2.7%
Avg. maturity (incl. grace period)	22	22
Avg. grace period	5	5
Domestic MLT debt		
Avg. real interest rate on new borrowing	1.8%	1.8%
Avg. maturity (incl. grace period)	6	6
Avg. grace period	2	2
Domestic short-term debt		
Avg. real interest rate	-0.1%	-0.1%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2028. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 1. Lao P.D.R.: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2018–2028 1/ 2/



Customization of Default Settings		
	Size	Interactions
Tailored Stress		
Combined CL	Yes	
Natural disaster	Yes	No
Commodity price	n.a.	n.a.
Market financing	No	No

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	2.7%	5.0%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	22	20
Avg. grace period	5	5

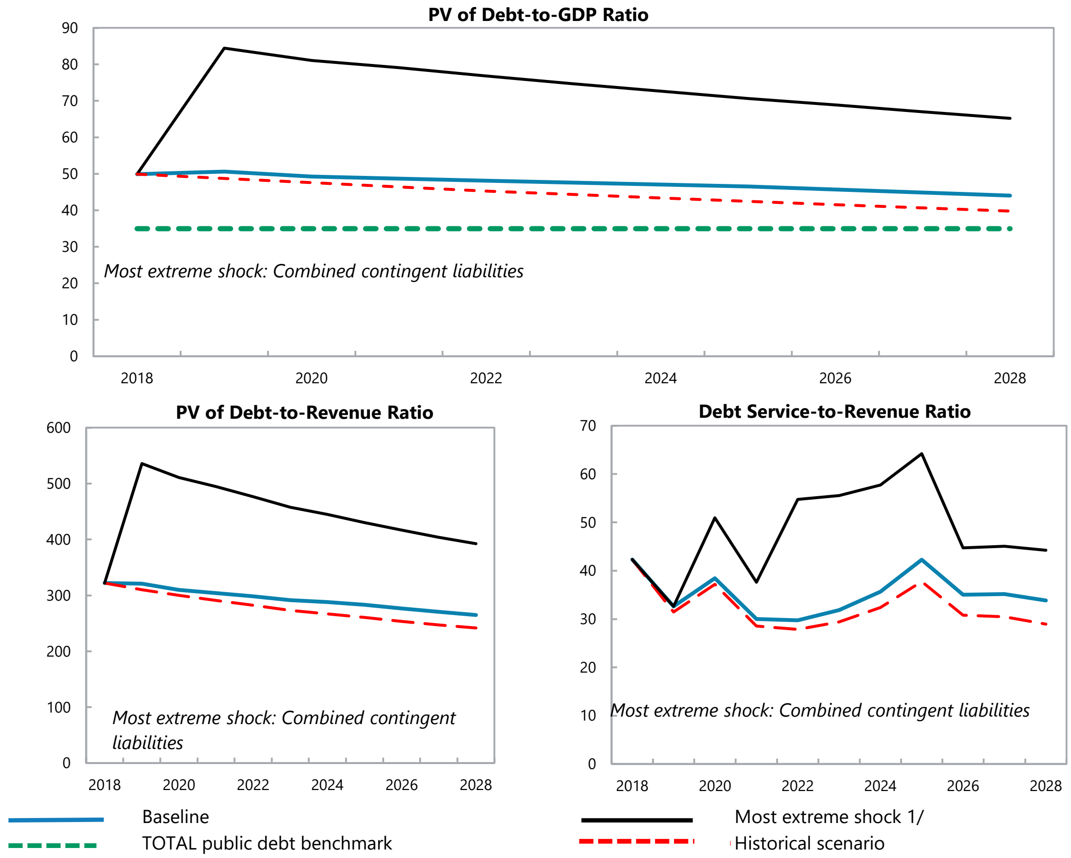
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2028. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

Figure 2. Lao P.D.R.: Indicators of Public Debt Under Alternative Scenarios, 2018-28 1/



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	58%	58%
Domestic medium and long-term	41%	41%
Domestic short-term	1%	1%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	2.7%	2.7%
Avg. maturity (incl. grace period)	22	22
Avg. grace period	5	5
Domestic MLT debt		
Avg. real interest rate on new borrowing	1.8%	1.8%
Avg. maturity (incl. grace period)	6	6
Avg. grace period	2	2
Domestic short-term debt		
Avg. real interest rate	-0.1%	-0.1%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

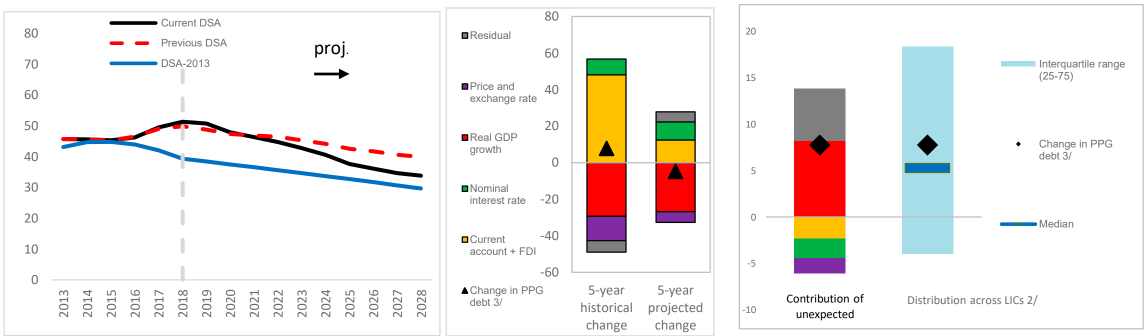
Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2028. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 3. Lao P.D.R.: Drivers of Debt Dynamics—Baseline Scenario

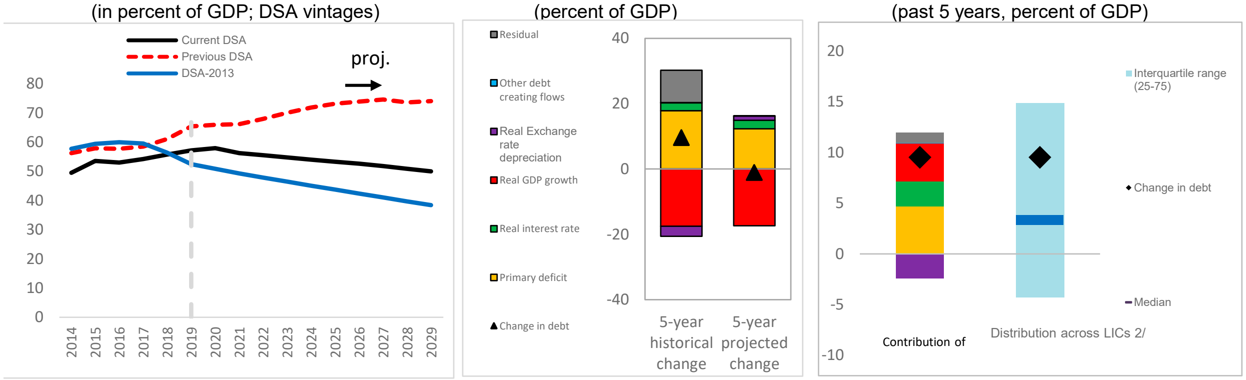
External Debt

Gross Nominal PPG External Debt (in percent of GDP; DSA vintages) | Debt-creating flows (percent of GDP) | Unexpected Changes in Debt 1/ (past 5 years, percent of GDP)



Public Debt

Gross Nominal Public Debt (in percent of GDP; DSA vintages) | Debt-creating flows (percent of GDP) | Unexpected Changes in Debt 1/ (past 5 years, percent of GDP)



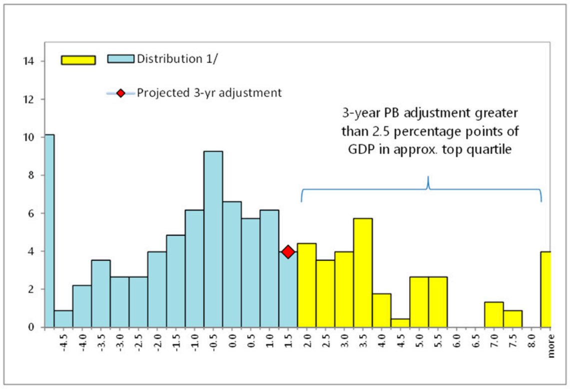
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

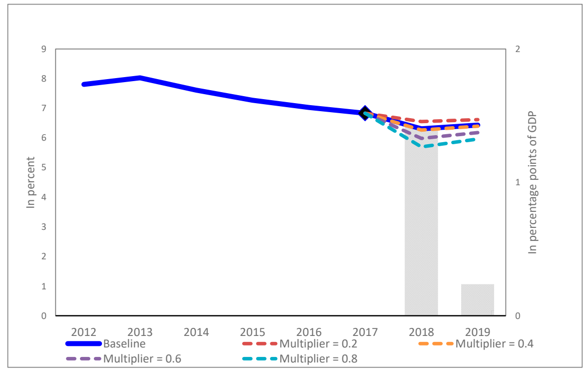
Figure 4. Lao P.D.R.: Realism Tools

3-Year Adjustment in Primary Balance (Percentage points of GDP)



1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



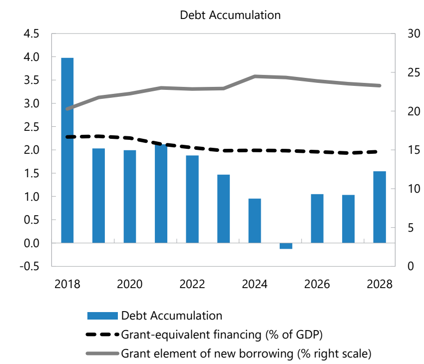
1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

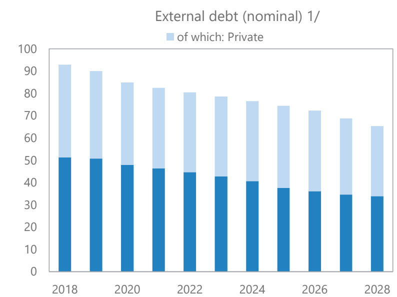
Table 1. Lao P.D.R.: External Debt Sustainability Framework, Baseline Scenario, 2017–38

(In percent of GDP, unless otherwise indicated)

	Actual	Projections								Average 8/	
	2017	2018	2019	2020	2021	2022	2023	2028	2038	Historical	Projections
External debt (nominal) 1/	92.6	92.9	90.0	84.9	82.5	80.5	78.6	65.3	45.9	88.2	78.8
of which: public and publicly guaranteed (PPG)	49.6	51.4	50.8	47.9	46.4	44.7	42.8	33.9	37.8	45.9	42.4
Change in external debt	3.7	0.3	-2.9	-5.1	-2.4	-2.0	-1.9	-3.5	-2.0		
Identified net debt-creating flows	-5.3	-1.4	-1.2	-0.4	-0.8	-0.7	-0.2	-0.4	-1.5	-2.4	-0.4
Non-interest current account deficit	8.5	9.8	9.6	10.1	9.4	9.2	8.0	7.6	4.4	16.5	8.9
Deficit in balance of goods and services	9.9	10.2	10.0	9.7	9.2	8.6	7.9	7.3	4.8	17.8	8.7
Exports	35.1	34.3	36.3	35.9	36.5	37.0	37.1	34.1	29.6		
Imports	45.1	44.5	46.3	45.6	45.7	45.6	45.0	41.4	34.4		
Net current transfers (negative = inflow)	-1.9	-1.3	-1.3	-1.2	-1.1	-1.0	-1.5	-0.9	-0.8	-2.2	-1.1
of which: official	-1.1	-0.2	-0.1	-0.2	-0.1	-0.1	-0.6	-0.3	-0.4		
Other current account flows (negative = net inflow)	0.5	1.0	0.9	1.5	1.3	1.6	1.7	1.2	0.4	0.8	1.3
Net FDI (negative = inflow)	-9.9	-7.8	-7.6	-7.1	-6.7	-6.4	-6.1	-5.3	-4.4	-10.0	-6.3
Endogenous debt dynamics 2/	-3.9	-3.3	-3.2	-3.4	-3.5	-3.5	-2.1	-2.7	-1.5		
Contribution from nominal interest rate	2.2	2.2	2.4	1.9	1.7	1.6	2.9	1.4	0.9		
Contribution from real GDP growth	-5.7	-5.5	-5.7	-5.3	-5.3	-5.1	-5.0	-4.1	-2.4		
Contribution from price and exchange rate changes	-0.3	...	...	...	...	...	...	...	...		
Residual 3/	9.0	1.6	-1.7	-4.7	-1.6	-1.3	-1.7	-3.0	-0.5	2.5	-2.1
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators											
PV of PPG external debt-to-GDP ratio	42.2	43.5	43.1	40.7	39.3	37.9	36.2	27.7	31.1		
PV of PPG external debt-to-exports ratio	120.2	126.8	118.9	113.4	107.8	102.5	97.6	81.3	104.9		
PPG debt service-to-exports ratio	7.4	9.6	11.2	11.6	10.1	9.8	10.0	9.0	8.2		
PPG debt service-to-revenue ratio	17.9	22.8	27.9	28.3	24.6	23.9	24.1	19.7	13.8		
Gross external financing need (Million of U.S. dollars)	1018.1	1812.7	2115.1	2515.5	2561.4	2736.3	3549.2	4009.0	2120.6		
Key macroeconomic assumptions											
Real GDP growth (in percent)	6.8	6.3	6.4	6.5	6.7	6.8	6.8	6.5	5.4	7.6	6.6
GDP deflator in US dollar terms (change in percent)	0.4	-0.1	-0.8	4.1	2.0	1.9	1.8	1.8	1.8	5.7	1.6
Effective interest rate (percent) 4/	2.6	2.5	2.8	2.4	2.2	2.1	3.9	2.2	2.0	2.0	2.7
Growth of exports of G&S (US dollar terms, in percent)	14.3	3.7	11.6	9.7	10.6	10.2	9.1	7.6	5.8	14.8	8.0
Growth of imports of G&S (US dollar terms, in percent)	11.0	4.8	9.9	9.4	8.9	8.6	7.2	6.6	4.4	14.9	7.5
Grant element of new public sector borrowing (in percent)	...	20.3	21.8	22.3	23.0	22.9	22.9	23.3	23.3	...	23.0
Government revenues (excluding grants, in percent of GDP)	14.5	14.5	14.6	14.8	15.0	15.1	15.3	15.6	17.6	14.9	15.2
Aid flows (in Million of US dollars) 5/	266.4	348.6	399.6	403.5	427.9	439.6	437.3	500.7	785.4		
Grant-equivalent financing (in percent of GDP) 6/	...	2.3	2.3	2.3	2.1	2.0	2.0	2.0	1.6	...	2.1
Grant-equivalent financing (in percent of external financing) 6/	...	31.0	36.9	35.9	36.1	36.7	37.5	38.2	37.9	...	37.2
Nominal GDP (Million of US dollars)	17,069	18,120	19,127	21,211	23,084	25,107	27,299	41,062	86,835		
Nominal dollar GDP growth	7.2	6.2	5.6	10.9	8.8	8.8	8.7	8.4	7.3	13.8	8.3
Memorandum items:											
PV of external debt 7/	85.3	85.0	82.4	77.7	75.5	73.7	72.0	59.2	39.2		
In percent of exports	242.9	247.9	227.1	216.5	206.8	199.3	194.2	173.5	132.2		
Total external debt service-to-exports ratio	21.1	23.4	24.9	24.7	23.1	21.8	29.8	21.9	8.2		
PV of PPG external debt (in Million of US dollars)	7205.5	7884.2	8252.3	8633.3	9082.9	9517.1	9885.8	11391.9	26974.0		
(PVt-PVt-1)/GDPt-1 (in percent)		4.0	2.0	2.0	2.1	1.9	1.5	1.5	1.8		
Non-interest current account deficit that stabilizes debt ratio	4.8	9.6	12.5	15.2	11.8	11.3	9.9	11.1	6.4		

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	No





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g) + Ɛα (1+r)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, Ɛ=nominal appreciation of the local currency, and α= share of local currency-denominated external debt in total external debt.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

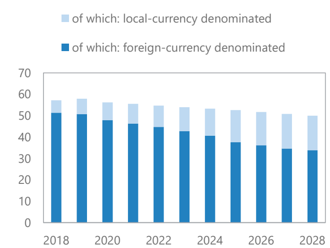
Table 2. Lao P.D.R.: Public Sector Debt Sustainability Framework, Baseline Scenario, 2017–38

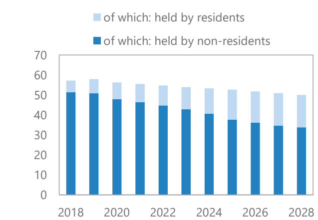
(In percent of GDP, unless otherwise indicated)

	Actual	Projections								Average 6/	
	2017	2018	2019	2020	2021	2022	2023	2028	2038	Historical	Projections
Public sector debt 1/	**55.8**	**57.2**	**58.0**	**56.2**	**55.5**	**54.7**	**53.9**	**50.0**	**42.8**	**50.8**	**54.0**
of which: external debt	**49.6**	**51.4**	**50.8**	**47.9**	**46.4**	**44.7**	**42.8**	**33.9**	**37.8**	**45.9**	**42.4**
Change in public sector debt	1.6	1.4	0.8	-1.7	-0.7	-0.8	-0.8	-0.8	-0.6		
Identified debt-creating flows	**1.8**	**1.3**	**0.8**	**-1.7**	**-0.7**	**-0.8**	**-0.8**	**-0.9**	**-0.6**	**-2.5**	**-0.5**
Primary deficit	**4.1**	**2.7**	**2.4**	**2.5**	**2.4**	**2.3**	**2.2**	**1.8**	**1.2**	**2.5**	**2.2**
Revenue and grants	16.1	15.5	15.8	15.9	16.0	16.1	16.3	16.6	18.4	**18.8**	**16.2**
of which: grants	1.6	1.0	1.2	1.1	1.0	1.0	1.0	1.0	0.8		
Primary (noninterest) expenditure	20.2	18.2	18.2	18.4	18.4	18.4	18.5	18.4	19.6	**21.2**	**18.4**
Automatic debt dynamics	**-2.3**	**-1.3**	**-1.7**	**-4.3**	**-3.1**	**-3.1**	**-3.0**	**-2.6**	**-1.9**		
Contribution from interest rate/growth differential	-2.8	-2.7	-2.6	-3.3	-3.2	-3.1	-3.1	-2.7	-2.0		
of which: contribution from average real interest rate	0.7	0.6	0.9	0.2	0.4	0.4	0.4	0.4	0.3		
of which: contribution from real GDP growth	-3.5	-3.3	-3.5	-3.5	-3.5	-3.5	-3.5	-3.1	-2.2		
Contribution from real exchange rate depreciation	0.5	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	**-0.3**	**1.4**	**0.9**	**-1.0**	**0.0**	**0.0**	**0.1**	**0.1**	**0.1**	**2.5**	**0.2**
Sustainability indicators											
PV of public debt-to-GDP ratio 2/	**48.7**	**49.9**	**50.6**	**49.2**	**48.7**	**48.1**	**47.6**	**44.0**	**36.2**		
PV of public debt-to-revenue and grants ratio	**303.0**	**322.3**	**321.0**	**309.8**	**304.2**	**298.5**	**291.6**	**265.1**	**197.0**		
Debt service-to-revenue and grants ratio 3/	**32.3**	**42.3**	**32.6**	**38.4**	**30.0**	**29.7**	**31.9**	**33.8**	**18.5**		
Gross financing need 4/	9.3	9.2	7.6	8.6	7.2	7.1	7.4	7.4	4.7		
Key macroeconomic and fiscal assumptions											
Real GDP growth (in percent)	6.8	6.3	6.4	6.5	6.7	6.8	6.8	6.5	5.4	**7.6**	**6.6**
Average nominal interest rate on external debt (in percent)	2.4	2.6	3.2	2.5	2.5	2.6	2.6	2.5	2.6	**1.7**	**2.6**
Average real interest rate on domestic debt (in percent)	3.3	5.2	4.6	0.4	1.8	1.9	1.8	1.5	1.6	**2.3**	**2.2**
Real exchange rate depreciation (in percent, + indicates depreciation)	1.1	...	...	...	...	...	...	...	...	**-3.4**	**...**
Inflation rate (GDP deflator, in percent)	1.9	1.9	1.2	5.3	3.1	3.0	3.0	3.0	3.0	**4.1**	**2.9**
Growth of real primary spending (deflated by GDP deflator, in percent)	8.5	-4.2	6.6	7.7	6.7	6.8	7.3	6.5	7.3	**12.1**	**5.7**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	2.5	1.3	1.7	4.3	3.1	3.1	3.0	2.6	1.9	**3.4**	**2.7**
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**No**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government, central bank, government-guaranteed debt . Definition of external debt is Residency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 3. Lao P.D.R.: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2018–28

(In percent)

					Projections 1/						
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
PV of debt-to GDP ratio											
Baseline	**44**	**43**	**41**	**39**	**38**	**36**	**34**	**31**	30	29	28
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	**44**	**44**	**45**	**45**	**46**	**47**	**47**	**46**	**46**	**46**	**46**
B. Bound Tests											
B1. Real GDP growth	**44**	**43**	**41**	**40**	**38**	**37**	**35**	**32**	**30**	29	28
B2. Primary balance	**44**	**44**	**43**	**41**	**40**	**38**	**36**	**33**	**32**	**30**	29
B3. Exports	**44**	**49**	**57**	**55**	**53**	**50**	**48**	**44**	**42**	**40**	**38**
B4. Other flows 3/	**44**	**48**	**49**	**48**	**46**	**44**	**42**	**38**	**36**	**34**	**33**
B5. Depreciation	**44**	**55**	**46**	**44**	**43**	**41**	**38**	**35**	**34**	**32**	**32**
B6. Combination of B1-B5	**44**	**50**	**48**	**47**	**45**	**43**	**41**	**37**	**35**	**34**	**33**
C. Tailored Tests											
C1. Combined contingent liabilities	**44**	**61**	**58**	**56**	**55**	**54**	**53**	**50**	**48**	**47**	**45**
C2. Natural disaster	**44**	**45**	**43**	**41**	**40**	**39**	**37**	**34**	**33**	**31**	**31**
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**44**	**48**	**46**	**44**	**43**	**41**	**39**	**35**	**34**	**32**	**31**
Threshold	30	30	30	30	30	30	30	30	30	30	30
PV of debt-to-exports ratio											
Baseline	127	119	113	108	103	98	95	89	86	83	81
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	127	123	124	124	124	127	131	130	132	133	135
B. Bound Tests											
B1. Real GDP growth	127	119	113	108	103	98	95	89	86	83	81
B2. Primary balance	127	121	119	113	107	102	100	94	91	88	86
B3. Exports	127	**155**	**209**	**199**	**189**	**180**	**178**	**167**	**160**	**153**	**147**
B4. Other flows 3/	127	131	137	130	124	118	116	109	104	100	97
B5. Depreciation	127	119	101	96	91	87	85	78	76	74	73
B6. Combination of B1-B5	127	**143**	128	**141**	134	128	126	117	113	108	105
C. Tailored Tests											
C1. Combined contingent liabilities	127	**168**	**161**	**153**	**149**	**146**	**147**	**142**	139	135	133
C2. Natural disaster	127	127	121	116	111	106	104	98	95	92	91
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	127	119	114	109	103	98	96	89	86	83	81
Threshold	140	140	140	140	140	140	140	140	140	140	140
Debt service-to-exports ratio											
Baseline	10	11	12	10	10	10	11	13	10	10	9
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	10	10	11	10	9	10	10	13	11	11	10
B. Bound Tests											
B1. Real GDP growth	10	11	12	10	10	10	11	13	10	10	9
B2. Primary balance	10	11	12	10	10	10	11	14	11	10	9
B3. Exports	10	13	17	16	16	16	17	21	18	18	16
B4. Other flows 3/	10	11	12	11	11	11	12	15	12	12	11
B5. Depreciation	10	11	12	10	9	9	10	13	9	9	8
B6. Combination of B1-B5	10	12	14	13	12	12	13	17	13	13	12
C. Tailored Tests											
C1. Combined contingent liabilities	10	11	13	12	11	11	12	15	12	12	11
C2. Natural disaster	10	12	12	11	10	10	11	14	11	11	9
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	10	11	12	11	11	11	12	14	10	9	9
Threshold	10	10	10	10	10	10	10	10	10	10	10
Debt service-to-revenue ratio											
Baseline	**23**	**28**	**28**	**25**	**24**	**24**	**25**	**31**	**23**	**22**	**20**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	**23**	**26**	**27**	**24**	**23**	**23**	**24**	**29**	**24**	**24**	**23**
B. Bound Tests											
B1. Real GDP growth	**23**	**28**	**29**	**25**	**24**	**24**	**25**	**31**	**23**	**22**	**20**
B2. Primary balance	**23**	**28**	**29**	**25**	**24**	**25**	**26**	**31**	**24**	**23**	**20**
B3. Exports	**23**	**28**	**31**	**30**	**29**	**29**	**30**	**37**	**31**	**30**	**27**
B4. Other flows 3/	**23**	**28**	**30**	**27**	**26**	**27**	**27**	**34**	**27**	**26**	**23**
B5. Depreciation	**23**	**35**	**36**	**29**	**29**	**29**	**30**	**38**	**26**	**25**	**22**
B6. Combination of B1-B5	**23**	**29**	**31**	**28**	**27**	**27**	**28**	**35**	**27**	**26**	**23**
C. Tailored Tests											
C1. Combined contingent liabilities	**23**	**28**	**32**	**28**	**27**	**28**	**29**	**34**	**26**	**26**	**23**
C2. Natural disaster	**23**	**28**	**29**	**25**	**24**	**24**	**25**	**31**	**23**	**23**	**20**
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**23**	**28**	**29**	**26**	**26**	**27**	**28**	**31**	**22**	**21**	**19**
Threshold	14	14	14	14	14	14	14	14	14	14	14

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

Table 4. Lao P.D.R.: Sensitivity Analysis for Key Indicators of Public Debt 2018–28
(In percent)

		Projections 1/									
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
PV of Debt-to-GDP Ratio											
Baseline	**50**	**51**	**49**	**49**	**48**	**48**	**47**	**47**	**46**	**45**	**44**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	**50**	**49**	**48**	**46**	**45**	**44**	**43**	**42**	**42**	**41**	**40**
B. Bound Tests											
B1. Real GDP growth	**50**	**51**	**50**	**50**	**49**	**49**	**49**	**48**	**47**	**47**	**46**
B2. Primary balance	**50**	**52**	**52**	**52**	**51**	**50**	**49**	**49**	**48**	**47**	**46**
B3. Exports	**50**	**56**	**64**	**63**	**62**	**61**	**60**	**58**	**57**	**55**	**53**
B4. Other flows 3/	**50**	**55**	**58**	**57**	**56**	**55**	**55**	**54**	**52**	**51**	**49**
B5. Depreciation	**50**	**62**	**58**	**56**	**53**	**51**	**49**	**47**	**45**	**43**	**41**
B6. Combination of B1-B5	**50**	**49**	**49**	**48**	**47**	**46**	**45**	**44**	**43**	**42**	**41**
C. Tailored Tests											
C1. Combined contingent liabilities	**50**	**84**	**81**	**79**	**77**	**75**	**73**	**71**	**69**	**67**	**65**
C2. Natural disaster	**50**	**54**	**53**	**52**	**52**	**51**	**51**	**50**	**49**	**49**	**48**
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**50**	**51**	**49**	**49**	**48**	**48**	**47**	**47**	**46**	**45**	**44**
TOTAL public debt benchmark	35	35	35	35	35	35	35	35	35	35	35
PV of Debt-to-Revenue Ratio											
Baseline	322	321	310	304	298	292	288	283	277	271	265
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	322	310	300	291	282	273	267	260	254	247	242
B. Bound Tests											
B1. Real GDP growth	322	323	315	311	306	300	297	293	287	282	277
B2. Primary balance	322	329	328	322	315	307	303	297	290	283	277
B3. Exports	322	354	401	391	382	371	365	356	343	331	320
B4. Other flows 3/	322	349	364	356	348	339	334	326	316	306	298
B5. Depreciation	322	395	368	349	332	315	302	288	274	261	249
B6. Combination of B1-B5	322	313	307	299	292	283	277	270	262	254	246
C. Tailored Tests											
C1. Combined contingent liabilities	322	536	511	495	477	458	445	430	417	404	392
C2. Natural disaster	322	343	332	326	320	313	310	305	299	293	288
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	322	321	311	306	301	294	290	284	277	271	265
Debt Service-to-Revenue Ratio											
Baseline	42	33	38	30	30	32	36	42	35	35	34
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2018-2028 2/	42	31	37	29	28	29	32	38	31	30	29
B. Bound Tests											
B1. Real GDP growth	42	33	39	30	30	33	36	43	36	36	35
B2. Primary balance	42	33	39	31	31	34	38	44	37	37	35
B3. Exports	42	33	40	34	34	36	39	47	42	42	40
B4. Other flows 3/	42	33	40	32	32	34	38	45	39	39	37
B5. Depreciation	42	35	45	36	36	38	42	50	41	41	39
B6. Combination of B1-B5	42	31	38	30	30	32	36	42	35	34	33
C. Tailored Tests											
C1. Combined contingent liabilities	42	33	51	38	55	56	58	64	45	45	44
C2. Natural disaster	42	33	40	31	32	34	38	45	37	37	36
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	42	33	39	31	32	35	38	43	34	34	33

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

Statement by Alisara Mahasandana, Executive Director for Lao PDR and Zeno Ronald Ruiz Abenoja, Senior Advisor to the Executive Director
August 2, 2019

1. Our Lao authorities would like to express their gratitude to the mission team for the comprehensive assessment of the economy and constructive policy dialogue during the Article IV consultation. They are highly appreciative of staff's careful analysis of the Lao economic structure and the consideration of the rationale behind the policy thrusts. **The authorities generally agree with staff's assessment of the outlook and risks as well as the policy priorities. They will carefully consider the recommendations when formulating policies and pursuing reforms to achieve a more sustainable, broad-based and inclusive economic growth.**

Introduction

2. The Lao economy continued to expand in 2018, albeit slower compared to the previous year, with inflation remaining low. Although total public debt remains high, the fiscal deficit has narrowed to 4.4 percent of GDP. Credit growth has moderated due in part to the slowdown in the economy and fiscal consolidation. Current account deficit remained large, as the increase in exports, particularly from the hydropower sector, was offset by imports related to major infrastructure projects and recovery efforts from natural disaster. As such, the international reserves declined slightly to about 3.2 months of non-FDI imports[1]. Moving forward, economic expansion is expected to remain robust with contributions from investments, construction, hydropower exports and tourism. Nonetheless, challenges remain including uncertainty in the global economic environment, slowdown in major partner countries, impact of possible natural disasters and the need to maintain prudence in macroeconomic management while pursuing economic transformation. However, on-going integration within the Asian region as well as the global economy will bring greater opportunities for investments, trade and tourism. At the same time, the authorities are committed to carry on the implementation of reforms that will enhance the resilience of the economy against possible shocks.

3. **Looking ahead, the authorities recognize the importance of maintaining policy discipline and the urgency of further deepening reforms.** They are strongly committed to implementing sound, responsive and prudent macroeconomic policies and to sustain the reform momentum that has been built up to reduce macroeconomic vulnerabilities, address structural weaknesses, enhance human development and promote inclusive growth. Diversification of the economy supported by the achievement of the SDGs and improvement in competitiveness is explicitly incorporated in the government's 5-year plan and important progress has been made across various fronts. In fact, Lao PDR passed the first step towards graduation from

[1] The authorities assess the reserve cover using import levels adjusted for FDI-related imports given that most of the FDI-related projects use their own funding which are unrelated to the international reserves at the central bank.

Least Developed Country (LDC) status as assessed by the UN Committee for Development Policy in March 2018. [2]The authorities are determined to complete the process and aim to achieve formal graduation from LDC status in 2024.

Economic developments and outlook: Sustaining growth while reducing vulnerabilities

4. **The overall economic performance remains robust with imbalances beginning to narrow.** Economic growth continues to be strong at 6.3 percent in 2018 but moderated due to the slowdown in trading partners, flood-related disasters, decline in mining production and re-assessment of some government projects. The expansion can be attributed mostly to the growth in wholesale and retail trade, construction, real estate and tourism. Inflation rose to an average of 2.0 percent in 2018 from about 0.8 percent a year earlier, as flooding led to higher prices on agricultural products along with the rise in international oil prices. On the fiscal sector, the fiscal deficit narrowed to 4.4 percent of GDP from 5.5 percent in 2017, helped by the optimization of public spending. Public debt as percent of GDP remains elevated and the risk of external debt distress is high. Although most of the public external debt is on concessional and semi-concessional terms, the composition has also been gradually shifting due to recent bond issuances in the Thai capital market. As such, the authorities are placing greater focus on managing the potential risks of debt distress given the high level of public debt and its composition. In terms of money supply, broad money increased at a slower pace of 8.4 percent. Credit growth to the private sector decelerated to 4.7 percent in 2018, partly due to the moderation in economic activity after the natural disaster and the fiscal tightening. The banking system remains strong with total assets growing by 6.5 percent and deposits by 8.3 percent in 2018. On the external front, the current account deficit widened slightly and remains elevated but is still on downtrend since 2015 at about 8.0 percent of GDP as of end-2018. At the same time, international reserves reached 3.2 months of non-FDI related imports.

5. **While the outlook remains generally favorable, authorities are cognizant of the policy imperatives, including gradually rebuilding fiscal and external buffers as well as reducing vulnerabilities.** For 2019, GDP is projected to accelerate to 6.7 percent supported by electricity generation, construction and tourism. In particular, hydroelectricity production is expected to increase with the completion of several hydropower plants. Infrastructure projects, including the Vientiane-Vangvieng expressway and the on-going Lao-China railway, are also expected to spur construction activities. The services sector will likewise benefit from the launching of the Visit Laos-China Year 2019. Moreover, the government has embarked on an 8-point program which is expected to continue to stimulate domestic production and services[3]. Meanwhile, inflation remains manageable at around 3.0 percent. Fiscal

[2] The Committee for Development Policy, which is a subsidiary of the UN Economics and Social Council, assessed the Lao PDR to have met the eligibility for LDC graduation for the first time in 2018. Based on the graduation process, if Lao PDR continuous to demonstrate development gains and fulfills the criteria again in 2021, it will formally graduate from LDC status in 2024.

[3] Prime Minister Order No. 12/PM refers to the implementation of eight economic stimulus measures covering the following: effective management of inflation; enhancement of monetary policies; improvement of business

consolidation will be pursued alongside reforms to facilitate a steady decline in the fiscal deficit to 2.0 percent of GDP by 2025. Overall, broad macroeconomic stability will be preserved. The authorities will continue to focus on managing pressures on public debt and on steadily building fiscal and external buffers.

Sustaining fiscal consolidation and reforms towards a sustainable public debt path

6. **A two-pronged approach of improving revenues and optimizing expenditures has been adopted to complement efforts in improving overall fiscal debt management.** Given risks from an elevated public debt ratio, the authorities recognize the need to heighten fiscal consolidation efforts and to improve institutional capacity to further invigorate on- going fiscal reform initiatives. This commitment is reflected in the significant reduction of the fiscal deficit in 2018 despite the difficulties during the year. The authorities will continue to strongly pursue public resource management and tax reforms as well as spending efficiency measures to reduce debt burden, build fiscal space and finance the social development and infrastructure needs.

7. **The authorities are determined to enhance revenue mobilization through improvements in tax administration and tax policy reforms.** The authorities have embarked on using ICT to improve tax administration, specifically with the adoption of electronic tax payments through the banking system for road taxes. This has resulted in about six-fold increase in road tax receipts. The same electronic payment strategy is now being rolled out for land, VAT and income taxes. Furthermore, the authorities introduced the Tax Revenue Information System (TaxRIS) to enable a systematic monitoring of revenue collection performance and to facilitate the management of the tax base. An improvement of the organizational structure at the central and district levels is being implemented, complemented by systematic trainings for tax officials to upgrade their management and technical capacity. To widen the tax base, an enterprise survey is being completed and a nationwide-linked revenue database is being strengthened. At the same time, tax laws are being reviewed to address possible revenue leakages. Furthermore, the Customs Department is closely monitoring the imports of key commodities. Finally, tax exemptions will be strictly implemented based on the list of items under the Law on Investment Promotion. The above actions are complemented by a Medium-Term Revenue Strategy that is being developed with FAD to lay out a comprehensive, coordinated and well-sequenced reform approach underpinning the authorities' strong commitment to improve revenue mobilization.

8. **The authorities are firmly committed to rationalize and improve the efficiency of government expenditures.** The government has agreed on a comprehensive multi-phase Public Financial Management strategy to be supported by development

climate and ease of doing business; enhancement of revenue collection efficiency and budget expenditure management; promotion of SMEs and domestic production; improvement of investment structure including composition of investment; land management and land income collection; strict inspection and monitoring of compliance to laws and regulations.

partners. The government has been reducing civil recruitment to contain the public wage bill. Planned capital spending has been reprioritized to support post-disaster reconstruction efforts after the 2018 natural disaster. New investment projects have been temporarily suspended and some on-going projects are being assessed for their impact and rates of return so as to better prioritize capital spending. Efforts are also taken to centralize and streamline budget management so as to improve the efficiency and transparency of the budget process.

9. **The authorities are focused on strengthening fiscal governance and upgrading debt management capacity to complement fiscal consolidation efforts in reducing public debt and building space for developmental expenditures.** While public debt is high and mostly external, more than half of the external debt is on concessional and semi-concessional terms. Moreover, a non-trivial share of external debt is supported by electricity export earnings from hydropower projects with underlying long-term power purchase agreements. This important feature help to mitigate risks and maintain debt indicators within sustainable levels. Moreover, the announced fiscal consolidation measures and the adoption of a temporary moratorium on new projects are expected to further improve debt carrying capacity. Nonetheless, the authorities will continue to pursue initiatives to further improve debt management. The 2018 Public Debt Management Law enhances a rule-based regime for contracting and guaranteeing public debt. Fiscal governance is strengthened as it consolidates the oversight responsibility of public debt within the Ministry of Finance, thus facilitating the formulation of a well-informed medium-term debt management strategy. Moreover, debt sustainability efforts will also benefit from careful targeting of infrastructure projects that yields high social and growth returns with financing coming from concessional loans.

Pursuing manageable inflation and strengthening the external sector

10. The Bank of Lao P.D.R (BOL) will continue to conduct prudent monetary policy and adopt a managed floating exchange rate regime, with the exchange rate fluctuating within a band, aimed at maintaining low inflation and promoting a stable macroeconomic environment to support sustainable economic growth. Given the manageable inflation last year, the policy rate and reserve requirement ratios were maintained in 2018. The monetary governance framework is being modernized. New legislations on the BOL, Commercial Bank and the Payment Systems were passed last year with the implementing regulations and guidance currently being rolled out. The authorities are supportive of market-based interest rates and has removed the temporary measure that was deployed to address the surge in lending rates arising from competition among banks for deposits. The authorities continue to implement the package of measures to promote the greater use of the local currency and facilitate de-dollarization including a Lao Kip promotional campaign and strict enforcement of legislation on domestic transactions to be based in Lao Kip. Moreover, the manageable inflation rate and stable exchange rate together with improvements in mobile banking services are expected to encourage the greater use of the Lao Kip.

11. **The managed floating exchange rate regime has served as an effective anchor for inflation.** The authorities see the merit of gradually introducing greater exchange rate flexibility over the medium term when preconditions are in place to facilitate the transition. In particular, efforts to deepen the interbank market as well as to develop the domestic debt market and foreign exchange derivative market would facilitate a more flexible exchange rate system. These are on-going efforts and the authorities will carefully consider staff's various recommendations to further develop the debt securities market and monetary operations, including improving liquidity forecasting.

12. **While the authorities view the level of international reserves as broadly adequate, after taking into consideration that parts of the imports are usually funded from accounts abroad of FDI-related projects, they recognize the benefits of increasing the gross international reserves to further build external resilience.** It may be noted that large foreign direct investments have generally been maintaining their foreign exchange earnings abroad. Over the medium to long term, the increase in export earnings as economic diversification advance and the rise in tourism receipts can help further fortify the international reserve position.

Strengthening and modernizing the financial system

13. **The authorities are focusing on enhancing the resilience of the banking sector, including through the upgrading of the regulatory and supervisory framework.** The authorities view the strengthening of the financial system as a continuing and crucial process amid increasing integration with the global economy. Relevant laws and regulations have been amended to be in line with international best practices. In particular, the Commercial Bank Law contains relevant provisions for crisis management and bank resolution. To fully implement the provisions of the law, the BOL is carefully drafting prompt corrective action, crisis management and resolution framework to improve its regulation under the Commercial Bank Law. Also, to supervise the domestic payments and settlement system, the BOL established the Payment and Settlement Supervision Department and issued the Payments System Law.

14. **Much progress has been achieved in strengthening risk-based supervision in line with the Fund's advice and technical assistance.** The BOL has formulated a risk-based supervision manual to help its Supervision Department in supervising and monitoring commercial banks in a forward-looking manner. The manual is currently being pilot tested in the BOL's analysis and supervision activities. Bank supervision is also being improved towards Basel II while an accounting system in line with IFRS is being developed in order to further build market confidence and attract domestic and foreign investments. Recently, BOL has revised the regulation on FX lending to allow commercial banks and branches of foreign commercial banks to provide loans in FX for both customers with or without FX income. However, the use of the foreign exchange proceeds for the payment of their foreign exchange obligations or foreign exchange transactions should be in line with the Law on the Management of Foreign Currency to help manage fx lending risks. The state-owned banks are being restructured which will help bring down the level of non-performing loans. Moreover,

the government is evaluating past public projects to identify payment obligations and issuing bonds to commercial banks in exchange of overdue loans related for these projects. Finally, financial soundness indicators have been developed and regularly disseminated to better evaluate developments in the banking system.

15. **The BOL will continue to engage international partners actively.** In particular, the authorities underscore the importance of deepening cooperation with the region and the international community to exchange lessons and experiences, and to seek technical assistance to develop a sound and modern financial system.

Embracing the transformation to a more diversified, competitive and inclusive economy

16. **The authorities are committed to continue the gradual process of diversifying the resource-based economy towards a broad-based structure with contributions from the agriculture, services and manufacturing sectors.** To encourage greater investments, the authorities will continue to improve the legal framework, create a level playing field and address bottlenecks to doing business. Programs to improve education and health are being supported to enhance progress in poverty reduction, raise productivity and help achieve key SDGs. The importance of gender inequality is being assessed as part of the development process and promoting inclusive growth.

17. **Public infrastructure is crucial in the transformation from a land-locked to a land-linked economy.** Investments in public infrastructure such as road, bridges, railways and power transmission lines would serve to invigorate investments, raise exports and promote developments in the countryside.

18. **The development of the SME sector, which covers 98 percent of all enterprises, is a priority of the authorities to promote broad-based growth.** The Ministry of Industry and Commerce is formulating an SME development plan and provides advisory services to SMEs. Meanwhile, the BOL is drafting a credit policy for SMEs, seeking funding resources to establish an SME fund and continuing to improve the payment system to facilitate growth of SMEs.

19. **Elements of governance are being strengthened as part of raising overall efficiency and providing an enabling environment for investments.** The Public Procurement Law and the Law on Public Investment promote a more transparent and rules- based institutional framework for public spending and investments. Important advances have been made in implementing the legislation on AML/CFT. The National Risk Assessment was completed in 2017-18 to identify priority areas for improvement. The authorities have in place an interagency coordination mechanism and MoUs for data gathering to support preparations for the full assessment against the Financial Action Task Force (FATF) standard to be undertaken in 2020.

20. **The authorities also recognize the importance of continuously improving the quality and availability of economic data to guide policy decision making and transparency.** In this regard, the authorities are appreciative of the Fund assistance which contributed to better quality of data on national income accounts and fiscal,

monetary and financial sectors that are now being compiled and released by government agencies.

Concluding remarks: Staying the course towards durable and inclusive growth

21. **The authorities are committed to pursue prudent macroeconomic policies and to carry out the reform agenda to build the foundations for a durable, sustainable and inclusive economic growth.** The authorities recognize the importance of addressing the risks arising from high level of public debt and a wide current account deficit. As such they are determined to complete the implementation of recent legislations and to follow through with reforms along the lines recommended by staff. They are focused on fiscal consolidation and on continuing to improve debt management to bring public finances firmly on a sustainable path. Monetary and exchange rate policies are grounded in providing a stable macroeconomic environment while financial policy is aimed at strengthening and modernizing the financial sector. The authorities have set an ambitious reform agenda to diversify the economy and lift living standards. They are determined to pursue a gradual, well-considered and deliberate process for the transformation of the economy while preserving social cohesion. Governance and transparency practices are being improved. In fact, the authorities have approved the publication of the IMF press release after the Article IV mission, a practice that was not done in recent years. In this regard, they are grateful to Fund staff for the helpful technical assistance and the invaluable policy advice. The authorities look forward to continuing the close and productive engagement with the Fund.