# *Draft 16 Nov 2015*

# Annex 1 – Template for SWG reporting

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| **Macroeconomic Working Group**  **Chair: Ministry of Planning and Investment**  **Co-chairs: Asian Development Bank**  **World Bank Group**  **MWG key mandate: The main purpose of the MWG is to bring together national and international partners to discuss development issues that affecting the macroeconomic situation of the country and possible policies and strategies for maintaining growth and macroeconomic stability.** |

**I. Sector Overview**

* 1. Provide a brief report of the sector key interventions and achievement within 2015

Lao PDR has continued to grow strongly over the last year; however, not without challenges. GDP growth in FY14/15 is projected at around 7.5 percent, a slight deceleration compared to earlier years; but nonetheless a formidable achievement in the current external environment. The slight deceleration of economic activity has been influenced by lower prices for commodities, unfavorable weather conditions affecting output in agriculture, but also some fiscal consolidation as well as moderating in credit growth. At the same time, investment in the power sector, commissioning of new installed capacity, continued expansion in real estate, and tourism supported economic activity. A couple of emerging manufacturing sectors (assembly and parts and components), so far largely confined to couple of special economic zones, are also providing some dynamism. Slower domestic demand and depressed oil prices reduced pressures on the consumer price with average inflation in FY14/15 declining to 1.7 percent from 5.2 percent a year ago. The current account deficit is expected to widen slightly due to terms of trade adjustment and stronger enforcement of government regulations related to timber exports. Robust FDI inflows, but also rapid external borrowing, helped finance the deficit and allowed for a slight increase in reserves, which was recorded at USD 1.1 billion in June 2015. Despite this, a strong reserve cover may be needed to strengthen buffers, especially in the new less favorable external environment.

The country took further welcomed steps towards fiscal consolidation; however, the situation continues to require careful attention. According to preliminary budget execution numbers, the deficit in FY14/15 was around 4 percent of GDP, below the target deficit of 5.2 percent of GDP. Revenues fell slightly below target but still grew by 6 percent from last fiscal year. Improved collection of non-resource revenues was off-set by lower revenues from the mining sector and declining grants. Revenue measures include strengthening revenue administration, including reserves from oil revenues; modernize customs and tax collection systems. The continuation of the wage freeze and strict controls over current spending contained expenditures, in the context of revenue shortfall. Still, despite the lower deficit, public debt continued to increase while the issue of public sector arrears towards the private sector continues to linger on. The authorities are committed to intensify efforts to increase revenue collection and contain expenditure in order to restore fiscal sustainability prospects. For FY15/16, the authorities plan to improve revenue collection by increasing excise on vehicles and luxury goods and pilot electronic smart tax at major border check points. Public wage will be kept stable but the spending on social security contribution will increase to meet the commitment (8.5 percent of the base salary) as well as allowances for some students and retirees and disable groups as well as non-wage recurrent spending. To tackle the domestic public arrears, which still poses a challenge to fiscal sustainability, a committee was established in early 2014 to assess the arrears status, and devise measures to address the pending outstanding and to prevent the new creation of arrears.

Credit growth decelerated in response to fiscal developments, already stretched balance sheets in some banks (especially state-owned banks). By June 2015, credit grew by around 11.25 percent from last year, prompting the authorities to take measures to stimulate credit for the small and medium size companies. The discount rate was reduced by 50 basis points while caps (inflation-linked) were introduced on banks’ kip deposit and lending rates. Measures that strengthen the soundness of banks and improve their ability to efficiently assess loan applications and collect claims are likely to have a larger and more sustainable impact over access to finance. Non-performing loans of some weak banks have edged up while the capital adequacy of those weak banks is below the legally required levels. Lao PDR undertook important reforms to improve credit information systems this year, including expanding the coverage of the credit registry and eliminating the threshold for the minimum size of loans to be included in the registry. To further improve its supervision capacity, the Bank of Lao PDR, with support from development partners, is working on improving prudential regulations (loan classification and provisioning, capital adequacy requirements, licensing and bank establishments); and introducing more risk-based supervision (upgrading financial soundness indicators); and initiating the process of reviewing commercial bank law. Still, further improvements and implementation capacity are needed in the business environment and the authorities are committed to pursuing these reforms.

The authorities continued to tightly manage the exchange rate with the kip depreciating by only 1.11 percent against the US$ in FY14/15. While this helped keep inflation manageable and limited risks in the financial sector, it also translated into a strong appreciation against regional currencies (i.e. by almost 2.29 percent against the Thai baht) and may have further challenged the competitiveness of domestic production and limited foreign exchange reserve accumulation.

* 1. Activities of the Macroeconomic sector working group in 2015

Following a slow start of the year, including due to MPI’s engagement with the drafting of the 8th NSEPD and turnover among members of the SWG, the activities of the SWG intensified in the second half of the year. The SWG had three meetings: one Technical level meeting (on April 30, 2015) and two Executive level meetings (on July 15, 2015 and on November 12, 2015). All three meetings were financed by the Asian Development Bank for which the SWG is grateful. The MPI Secretariat, jointly with key staff in ADB and the World Bank, ensured effective organization of the events.

The SWG continues to be a vital forum for exchanging information on recent economic development, challenges and prospects. In this vein, at all meetings, representatives of various government agencies, most notably the MPI, Ministry of Finance and Bank of Lao PDR provided information of latest fiscal and monetary sector developments as well as ongoing and planned sectoral policies. This provided an opportunity for development partners to better understand developments in the economy. In addition, the SWG heard from the MPI on the progress with the preparation of the 8th NSEDP and the macro-fiscal framework underpinning the plan and its financing plan as well as the Ministry of Education and Sports on the drafting of the new Human Resource Development Strategy. The SWG was also useful in identifying overlaps in activities covered under different activities. Recently, the World Bank presented an analysis of the sources of growth, its inclusiveness and risks to sustainability and the Lao Statistics Office share the progress of the 2015 Population Census, of which preliminary results will be announced in early December 2015.

The key members of the SWG believe that going forward, a greater focus on development priorities can make the SWG an even more important contributor to the debate on macroeconomic issues in Lao PDR.

* SWG members appreciated the usefulness of the SWG as a mechanism to share information, but noted that in many cases it is insufficient to fully address the demands of stakeholders and development partners, while the availability of data from other sources remains limited (i.e. budget execution information for FY13/14 has not been yet published, neither has been the approved budget for FY15/16. This has a considerable implication for a number of development partners; a number of whom have explicit requirements for public access to budget information in order to continue to provide support to Lao PDR. In this regard, the SWG urges all involved parties to increase the availability of data and information.
* Greater public availability of fiscal and monetary indicators, would allow the SWG to allocate more time and attention to discussion of the underlying development challenges related to the macroeconomic environment in the country. The SWG would welcome a more strategic discussion on critical macroeconomic interventions, including for example strengthening the public financial management framework, improving the monetary policy transmission mechanism, etc. Development partners re-iterate their commitment to continue to assist the Lao PDR authorities and provide assistance as needed.
* To strengthen the links with the RTM/RTIM process, the SWG agree to introduce a regular review of the progress in implementing the agreed measures and meeting the expected outcomes of the RTIM follow-up matrix. This will allow for continuous monitoring of the macroeconomic environment and timely identification of challenges and appropriate policy responses.
* Reflecting the extensive cross-sector linkages between macroeconomic development and various sectors; the SWG proposed to more closely involve other SWGs in the activities of the macroeconomic SWG. This should also be helpful to other SWGs as they can get better access of information on budget issues and allocation and can help avoid overlap and duplication of activities.

**II. Overview of FY 2014/2015 Sector Performance**

*Please note, as a snapshot of the 7th NSEDP achievements and challenges is prepared by Department of Planning/Ministry of Planning and Investment (reporting against substantive indicators), SWGs are only required to report against process indicators highlighted in the previous year RTM/RTIM follow up matrix. However, an analysis from the findings can be briefly provided*

| **Sector outputs and activities** (Reporting against process indicators as per the 2014 RTM/RTIM follow up matrix and some other related activities as appropriate) | **Indicators** | **Responsible Agency (ies)** | **Progress** | **Challenges and measures** | **Key messages to inform discussions during the HL RTM** |
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| **I. Macroeconomic management and growth** | | | | | |
| I.1. The pace of growth needs to be balanced with macro-economic stability and address issues of sustainability and equity.   * Continued high level of economic growth with low inflation * Ensure an efficient budgeting and planning process * Address issues of corruption and revenue collection from tax reform | | | | | |
| * 1. Strengthened capacity for macroeconomic and fiscal management   2. Provision of quarterly economic data (budget execution, public debt, monetary date, financial sector stability indicators).   3. Reform tax policy and administration framework to increase tax base, review exemption policies; simplify tax payment; introduce and simplify issuance of unique tax ID   4. Keep tight control over expenditures and re-allocate spending to more efficient uses   5. Increase fiscal buffers and strengthen prospects for fiscal sustainability;   6. Keep credit growth in line with objectives of low inflation and financial sector stability;   7. Sustained competitiveness of the real exchange rate | * 1. Development of medium term macro-fiscal framework and fiscal strategy underpinning the 8th NSEDP and the Budget process; periodic (annual; semi-annual) presentation of medium term fiscal framework   2. [Quarterly data reporting (e.g., monetary, fiscal, and financial) to SWG and on agencies’ web-sites.]   3. Domestic revenues increase from a baseline of 19% of GDP in FY13/14; Entities registered for VAT purposes; Taxpayers filing tax returns correctly and on time, Taxpayers paying full tax obligations and on time.   4. Expenditures decline from a baseline of 29% of GDP in FY13/14; Salaries decline from 40% of total spending.   5. Budget deficit reduced from a baseline of 4.5% of GDP in FY13/14 and public debt maintained at below 60% of GDP in 2014   6. Non-performing loans stable or declining; Capital-adequacy ratio stable or improving   7. Real exchange rate does not appreciate; forex reserve cover increases.. | MOF  MOF, MOIC, MPI & BOL  MOF  BOL | MOF with support from ADB developed a fiscal framework. This aims to feed into the fiscal strategy and the on-going formation of a macroeconomic framework led by MPI. It is still work in progress  Monetary and BOP data availability is generally a quarter lag. Some fiscal data has shorter lag.  In response to tight fiscal liquidity, MOF strengthened tax administration by taking stocks of tax payers units, introducing tax payments through the banking system | First draft of the Fiscal strategy is completed but still in the process of internal MOF review  The delays in data availability limits up-to-date assessment on the economic situation and might impede the formulation of timely policy responses.  The challenge are few folds. Domestic revenue is subject to volatility of resource revenue as global commodity prices fluctuate. Non-resource tax payers are mostly small-medium size and do not hold proper accounting making tax obligations unclear. The system to facilitate tax payments can benefit from more streamlining. | Draft fiscal strategy is essential in providing framework for fiscal sustainability. Essential to incorporate best practices and principles.  Promote timely sharing of information and more regular exchanges among the concerned agencies to promote information flows in order to feed into timely analysis as inputs for policy making  In broader context of restoring fiscal sustainability, containing the fiscal deficit require, as immediate priority, widening the tax base, limiting expenditures and addressing off-budget spending. Over the medium-term, structural reforms on public investment management and public procurement, legal framework as well as implementation capacity, are needed in better link budgeting and planning, execution and monitoring and evaluation.  An improved legal and regulatory framework in the financial sector that is consistent with international standards properly enforced, can help in strengthening the financial sector and its ability to support growth while keeping risks manageable. Measures to increase capital adequacy, promote risk management, strengthen governance and disclosure in banks can help promote sector stability.  With increasing uncertainty in the global economy, a more flexible exchange rate policy contributes to strengthening buffers but also to supporting the competitiveness of the Lao PDR economy |
| I.2. A coordinated management of macro-economic parameters especially to ensure:   * An effective fiscal management. * Appropriate sectoral budget allocation, especially to MDG off-track areas. | | | | | |
| * 1. Formation of National Steering Committee on Monitoring Macroeconomic Policy.   2. Improving government and DP macroeconomic policy coordination through consistent meetings of the Macro Economic SWG. | * 1. (a) Regular meetings of the Macroeconomic Task Force   (b) Adoption of main macroeconomic policies based on consistent macroeconomic framework   * 1. [Quarterly information sharing meetings of the SWG.] by updating on Fiscal performance regularly, Monetary performance and action taken to maintain monetary situation. | MOF, MPI, BOL, MOIC, MEM | There are two channels: i) macroeconomic SWG where key recent economic developments are discussed and ii) macroeconomic framework task force lead by MPI on forming a macroeconomic framework and forecasting. This aims to feed into the NSEDPs and budget planning. Still work in progress. | The SWG forum has helped in terms of encouraging sharing of sectoral data and discussions of economic issues. However, there is still room for promoting more interactive discussions on critical issues and channeling the agreed set of issues to feed into policy formulation process | Discuss ways to strengthen the SWG forum as an arena to discuss policy issues and follow up actions, in addition to sharing recent developments.  Promote more interactions with other SWGs |
| I.3. The 8th National Socio-Economic Development Plan (NSEDP 2016-2020) needs a strong link with the fiscal framework and a financial strategy with proper costing. Priorities should include:   * Ensuring affordability of the 8th Plan and financial strategy * Promoting a ‘green growth’ model with sound natural resources management and increased opportunities for all | | | | | |
| * 1. Development of a new MTEF (including PIPs) linked to NSEDP   2. Launch of a system for communicating how DP comments on 8th NSEDP have been integrated.   3. Development of a concept/plan for how green growth model can be incorporated into 8th NSEDP. | * 1. Presentation of new MTEF   2. Seminars held with DPs to discuss the 8th NSEDP * Presentation on Budget financing plan in NSEDP VIII as: total investment (5 years) about 27 billion US, or about 30% of GDP, in which: domestic budget 11-12%, ODA 12-16%, Domestic and foreign investment 54-58% and financial system 19-21% of total investment. * Total revenue in 5 years period in range 23-25% of GDP in which, domestic revenue 20-22% of GDP, expenditure less than 28% and budget deficit less than 5% of GDP * Inflation less than 6% yearly * Maintain exchange rate in a sustainable manner * 3.3 (a) A seminar on green growth initiative is held   (b) Int’l study visit tour on GG  (c) National GG strategy will be developed in next year | MOF  MPI | MOF prepared an MTEF and related capacity building with support from ADB. It still remain to be revisited  Completed  Completed in April 2015  Study visit in South Korea in November 2015 | The link between the planning and budgeting and realistic capacity of financing sources still a challenge. | Stress the importance of linking budgeting and planning process in order to ensure effective implementation |