

**Multi-stakeholder Taskforce to Support a Determination of the 9<sup>th</sup> NSEDP and SDG  
Localization due to the Impact of COVID-19**

**Macro-Fiscal Framework and Financing for Sustainable Development**

**Summary of key Recommendations**

This statement is issued following a High-Level Thematic Dialogue on the Macro-Fiscal Framework and Financing for Sustainable Development under the Multi-Stakeholder Taskforce. It draws on the Background Paper prepared for the discussion by a core group consisting of the Ministry of Finance, National Institute for Economic Research, Bank of Lao PDR, World Bank, Asian Development Bank, International Monetary Fund, and the Embassy of Japan.

The statement is on behalf of the Multi-Stakeholder Taskforce, to be taken as advice to the Ministry of Planning and Investment and relevant partners in the finalization of the 9<sup>th</sup> NSEDP, and should not be interpreted as representing the positions of individual Taskforce members.

**Context and Outlook**

1. Lao PDR faced significant macroeconomic challenges before COVID-19. For two decades, Lao PDR was amongst the world's fastest-growing economies, but this growth was driven by capital-intensive resource sectors and infrastructure development, with limited spillover to other parts of the economy. The sustainability of the natural resource sector as a source of future growth is limited given the degree of depletion of Lao PDR's natural capital. Moreover, tax concessions, either as a result of specific investment agreements, or Special Economic Zones, have weakened the link between growth and state revenue.
2. This has led to highly exclusionary growth and unsustainable debt accumulation. So, despite the impressive economic growth, the impact on poverty reduction was less than that anticipated and seen in by regional peers.
3. Prior to COVID-19, growth was already slowing, inflation accelerating, and the fiscal situation deteriorating. There was a high risk of debt distress, and in 2019 access to international capital markets had already become more limited, and expensive.
4. With COVID-19, Lao PDR's economy has been severely impacted from the global economic downturn. The pandemic has affected the country negatively through multiple channels including tourism, trade, investment, commodity prices, exchange rates, and sharply decreasing remittances.
5. As a result, economy is expected to grow at a historically low level in 2020 (IFIs project between -1.8 and 1 per cent and Government about 3.6 per cent). Downside risks to the outlook are significant given the uncertainty regarding the duration, pervasiveness, and severity of the COVID-19 outbreak at both the global and domestic levels as well as the magnitude and effectiveness of GOL's economic relief policies. This uncertainty in macroeconomic projections in turn creates uncertainty for the state budget.
6. The overall cost of COVID-19 related Government policy measures is currently estimated at about US\$394 million, of which fiscal package about US\$83 million (health measures about US\$44 million

and cash transfers and foregone revenue roughly US\$39 million) and monetary measures (mostly SME lending) about US\$310 million.

7. Domestic revenue has fallen by 30 per cent, leading to a widening of the fiscal deficit to 7.5 per cent of GDP. The pandemic has also led to a worsening of the current account balance, exacerbating external vulnerabilities. Banks are likely to face liquidity pressures and increasing volumes of non-performing loans, limiting their capacity to support credit growth.

### **Strategic Policy Recommendations**

**Given the context, and against the backdrop of COVID-19 crisis, the 9<sup>th</sup> NSEDP should provide a roadmap for Lao PDR's economic transformation towards a more resilient, shared and sustainable growth path. Many of Lao PDR's growth challenges are neither new nor unique. The acute consequences of COVID-19 do, however, strengthen the need to intensify and accelerate reform efforts.**

8. Strengthening the fiscal and monetary policy framework, accelerating reforms in improving business environment and ensuring more and better investment in human capital and social protection systems would enhance economic resilience in the longer term. A credible macroeconomic framework is a prerequisite for attracting more private investment, as well as helping guide development partners in providing support. This will require genuine, sequential prioritization of expenditure.
9. This will require strategic consideration and prioritization of the key drivers of a more inclusive growth over the coming years- recognizing the need to grow beyond historical reliance on natural-resource intensive growth. Future growth should aim to be more labor-intensive, in turn requiring to enough of the right types of skills in the workforce. Achieving this will require clear, consistent, and structured intersectional coordination and communication, e.g. across ministries and sectors (in particular those responsible for production and value chains, skills development, and human capital), including consideration of sub-national levels of governance.
10. Policy options to mitigate the impacts of the COVID-19 outbreak should provide immediate economic relief whilst being consistent with recovery and fostering resilience in the medium- and long-term. This should involve consideration of:
  - i. Reprioritizing spending and mobilizing additional resources to support well-targeted social assistance to affected households and businesses;
  - ii. Restructuring of the energy sector to reduce fiscal and debt burdens;
  - iii. In the medium to long term, accelerating reforms to promote diversification and improve competitiveness in the private sector, supported by improved connectivity.
  - iv. More and better investment in human capital and social protection to improve households' ability to withstand shocks and build economic resilience from the ground up.
11. Lao PDR's macroeconomic situation is unsustainable owing to three primary interlinked factors: *(i) rising debt and debt service payments; (ii) the fragile health of the banking sector; and (iii) low*

*foreign currency reserves*. To build a more stable macroeconomic framework as a foundation for the pursuit of development goals, the NSEDP should set clear and consistent plans across five areas;

- i. Increasing revenue mobilization;
  - ii. Strengthening public expenditure management to ensure that resources are efficiently disbursed; including investment in the 'infrastructure of delivery' for social and support services;
  - iii. Strengthening the banking system and improving financial inclusion;
  - iv. Developing a sustainable macroeconomic strategy, linked to a credible, implementable and monitored multi-year budget framework;
  - v. Improving the availability and transparency of data and policy information.
12. Engaging in restructuring and reprofiling of external debt could help alleviate some of pressure on the debt service in the medium term. This should include consideration of the G20 Debt Service Suspension Initiative, for which Lao PDR could be eligible and is likely to be extended into 2021.
13. The gains from measures adopted to support firms through the economic shock of the pandemic depend on targeting viable businesses (SMEs and large firms) that are temporarily affected by the COVID-19 shock but have the ability to rebound.