STRUCTURED DIALOGUE 1: DIAGNOSTICS

Assessing the financial constraints and needs to achieve the 9th NSEDP and the SDGs

FINANCING NATIONAL DEVELOPMENT PRIORITIES

Background documents (Day 1)

Ministry of Planning and Investment, Ministry of Finance, UN Joint Programme on Financing Efficiency (UNDP, UNCDF), and UNDESA

October 2021

Table of contents

Explanatory note: financing national development priorities

Introduction: diagnostics for the 9th NSEDP financing strategy

Available brief
- Q&A on the financing strategy (see annex 1)

The Ministry of Planning and Investment (MPI), with technical and coordination support from the United Nations (UN) through the Joint Programme on Financing Efficiency has been working, since early 2021, on the development of a financing strategy after the finalization of the 9th NSEDP. **Prior to discussing financing options**, in line with the Integrated National Financing Framework (INFF) approach, **there were two important phases**:

- **An inception phase (January-April)**: this first phase was an opportunity to bring together core planning and financing stakeholders, grouped into a Technical Working Group (TWG) created by the Deputy Prime Minister. Key concepts and methodologies as well as the process were introduced. An inception workshop was organised in Vang Vieng in April 2021.
- **A diagnostics phase (June-October)**: this phase aims to provide all stakeholders a set of key findings that would serve as the analytical backbone for the formulation of the financing strategy. In addition to providing robust analytics that all can agree with, this phase serves as another way to consolidate collaborative ways of working. As of early October, this phase was nearing finalization and was going to be concluded by the first structured dialogue.

The next phase should see the formulation of agreed and well consulted financing options, per source of finance, and per sector. Three structured dialogues should take place throughout Q4 2021 and Q1 2022. Bilateral and multilateral discussions will be convened between the first (diagnostics) and second (financing options discussion), and second and third (finalization of financing options) structured dialogues.

The diagnostics phase can be divided into two: there are two types of assessments which complement one another in painting a clear picture of the financing landscape for the achievement of the 9th NSEDP:

- **Investment needs, often referred to as "costing"**, have been estimated through 6 reviews of the literature corresponding to the 6 outcomes of the 9th NSEDP and a modelling of health costs. Due to difficulties encountered when attempting to conduct modelling of the costs of each outcome of the 9th NSEDP, a brief was developed to highlight gaps and challenges and potential solutions to ensure costing of policy priorities can take place in the future.
- **The resource envelope, often referred to as "financing",** is estimated through the Development Finance Assessment (DFA), which analyses four sources of finance according to the Addis Ababa Action Agenda (AAAA), namely: State budget, domestic private finance, international private finance, and Official Development Assistance (ODA). Two additional briefs complement the picture painted by the DFA- on climate finance and on State borrowing.

Taken together, the resource envelope and investment needs provide the financing gap, or in other words, the resources missing to achieve national development priorities.

Financing national development priorities: executive summary

Available briefs

- Development Finance Assessment (DFA)

1. *Mapping of public sector resources*
2. *Mapping of FDI resources*
3. *Mapping of ODA resources*
4. *Mapping of Domestic Private Investment and Other Resources*

- Lao Sovereign and SOE Bonds analysis
- Climate Finance Analysis Brief

A. Development Finance Assessment (DFA)

- **Objectives**

The DFA guidance developed by UNDP provides extensive details on the role of this diagnostic tool and the Integrated National Financing Framework (INFF, see below). This approach, which is being taken in almost 50 countries, is essentially supporting the diagnostics phase. It is, in fact, the analytical backbone of the financing strategy. Investigating the contributions of the four different sources of finance in the economy – State budget, domestic private sector, international private sector, and Official Development Assistance (ODA) – the DFA provides policymakers with a set of key findings and directions for the financing strategy formulation.

- **Approach, scope, and limitations**

The INFF approach categorises development finance into the following branches: domestic public finance, international public finance, domestic private finance, and international private finance (see table below).

The **rationale for using the INFF approach** is threefold. First, adopting the INFF approach allows key policymakers to think holistically about development finance (four sources of finance, covering the entire economy), by simple criteria (domestic/international and public/private), to **identify the most comprehensive set of relevant policy solutions**. For example, policies to support FDI in green growth (e.g., fiscal incentives) are different from policies to support public investment (e.g., budget reallocations), ODA (e.g., strengthened coordination and strategic planning with development partners), or domestic private investment (e.g., loans for SMEs) in green growth. Second, and more practically, this international classification has been agreed at the 2015 UN Conference on Financing for Development, at the same time as the AAAA. Adopting **this approach to development finance will enable cross-country comparisons** with the many countries that undertook or are undertaking DFAs. Third, adopting this approach yields the above-mentioned benefits while **aligning closely with the current Government classification**, mentioned in the 9th NSEDP. The below comparison table allows for comparisons between the two classifications.

INFF	9th NSEDP
1. Domestic Public Finance	**1. National Budget**
• Tax revenue (direct, indirect) • Non-tax revenue • Government borrowing (loans, bonds) • Public enterprise revenues	• Ministerial and Provincial recurrent expenditure • Ministerial and Provincial capital expenditure • Government borrowings
2. Domestic Private Finance	**2. Domestic and foreign private investment**

• Private sector equity – *Gross Fixed Capital Formation*
• Domestic borrowing
• National NGOs, foundations, and faith-based organisations
	• Private sector equity – *Gross Fixed Capital Formation*
	• International borrowing by private sector
	• Foreign Direct Investment (FDI)
	   ○ *financial flows*
	   ○ *associated commodity imports*
	• Foreign Portfolio investment (FPI) - *immaterial*

3. International Public Finance	**3. Official Development Assistance**
• ODA grants • ODA loans • Other official flows South-south cooperation	• ODA grants • ODA loans • Other official flows South-south cooperation
4. International Private Finance	**4. Other investments**
• Foreign Direct Investment (FDI) • Foreign Portfolio investment (FPI) - *immaterial* • International borrowing • Remittances • International NGOs, foundations, and faith-based organisations	• Remittances • Microfinance and Building Society (Financial Sector, not Banking Sector) net credits • Community contributions

Most limitations in the DFA involve data availability: certain key data sets were not accessible, such as detailed breakdowns of parts of the State budget or ODA flows. However, the main findings, detailed below are considered robust to any foreseeable errors or omissions in the data updates. They have been consulted with the Ministry of Planning, the Ministry of Finance, and the Bank of Lao PDR in bi- and multi-lateral meetings.

- **Main findings**

Public sector	1. Revenues need to significantly increase year-on-year to meet State budget projections and to support the achievement of 9th NSEDP policy priorities. 2. On the spending side, there are inconsistencies between current public allocations and the 9th NSEDP policy priorities that will need to be resolved.
FDI	1. FDI inflows are likely to continue in line with regional economic growth prospects, underpinned by investments from China, but significant policy reforms will be needed to direct future FDI in support of social sub-sector targets (health, education) in the 9th NSEDP. 2. Reliance on a single source country for the majority of FDI inflows exposes Lao PDR to significant economic risks if that economy was disrupted, or the relationship was to change 3. Foreign Portfolio Investment (FPI) fluctuated significantly over the 8th NSEDP 2016-2020. FPI is highly mobile and requires stable capital markets to be an effective source of development financing. FPI can include sale of equities in State-Owned Enterprises (SOEs), which would support Lao PDR policies for

	reform and subsequent divestment/ recapitalising of SOEs; and/ or State debt amortization.
ODA	1. ODA is a significant contribution to Lao PDR's gross National Income (GNI). Table 1 shows that ODA represented 3.3% of GNI in the latter part of the 8th NSEDP. 2. The ODA Management Information System (ODA-MIS) Dashboard of MPI-DIC needs to be regularly and completely updated to inform Government on the scope, timing and focus of ODA investments in Lao PDR. 3. Lao PDR sectoral agency absorptive capacities may be a constraint to ODA increases and ODA delivery strategies need to consider this.
Domestic private investment	1. Domestic private investment is 21% of GDP and can be as important a source of development funding as annual State Budget spending (19% GDP); however, Lao PDR investment promotion policies focus on the attraction, retention and growth of foreign investors that have averaged around 6% of GDP over the past 5 years. There is little policy support for domestic investment, SME development or business start-ups in Lao PDR. 2. Remittances represent around 1.5% of GDP and mainly fund household expenditure. Accordingly, remittances do not represent a significant potential source of development financing.

1. Domestic Public Finance	**15.7%**	1. **National Budget**	**15.7%**
2. Domestic Private Finance	**21.0%**	**2. Domestic and foreign private investment**	**27.1%**
3. International Public Finance	**3.1%**	**3. Official Development Assistance**	**3.1%**
4. International Private Finance	**7.5%**	**4. Other investments**	**1.4%**
TOTAL OF ALL INFF FINANCING TYPES	**47.30%**	**TOTAL OF ALL 9th NSEDP FINANCING TYPES**	**47.30%**

B. Sovereign and SOE bonds analysis

- **Objectives**

The Lao PDR Bonds Review analyses the Lao PDR government issued sovereign and State-Owned Enterprise bonds as of 2020. The report provides a succinct background to the accumulated public debt stocks and examines the appetites of investors for Lao sovereign debt. It complements the analysis undertaken in the DFA on public sector finance.

- **Approach, scope, and limitations**

The report was generated using sources from the Government and external datasets, including MOF, BOL, Thailand Bond Market Association, LSX, SGX, and rating agencies. However, data unavailability and inconsistencies between various sources are important limitations. A series of assumptions underpin the analysis, notably that Lao PDR will be able to meet its service repayments, that the 9th NSEDP will require extensive level of investments, and that further downgrading of the Lao sovereign rating is averted.

- **Main findings**

Finding 1: the impacts of bond servicing cannot be under-estimated when considering the issued bonds that are due to mature during the cycle of the 9th NSEDP. Over USD 1,700 million is due to be serviced by the government during the lifecycle of the 9th NSEDP (figure does not include unlisted bonds issued by the government and other SOEs besides EDL-Gen). With increased pressure on revenues, there is mounting pressure from debt servicing.

Finding 2: With Moody's August 2020 downgrade of Lao PDR credit rating to Caa2 from B3, the country now has the lowest sovereign rating in Asia without being in default. Analysis indicates that there is no market demand for a Caa2-rated Asian sovereign bonds in Thailand, Singapore, and Hong Kong, limiting further borrowing as a potential source of development finance.

Finding 3: sentiment for new Lao PDR debt is weak, due to the current credit rating, and potential for default. Although debt is available, its high cost must be considered in the context of debt sustainability.

C. Climate finance (UNDESA)

- **Objectives**

The Lao climate finance analysis examines available climate finance in Lao PDR, reviews funding sources, including multilateral, bilateral, public-private partnerships as well as climate funds that Lao PDR is eligible to and/or has benefitted from. It complements the analysis undertaken by the Development Finance Assessment. It also aims to provide a panorama of challenges and opportunities for capacity building interventions for the better mobilisation of climate finance.

- **Approach, scope, and limitations**

The Lao climate finance analysis relies on primary data through key stakeholder interviews and secondary data through a review of the literature. Without a unified climate finance database in the country, quantitative data came mostly from various international climate finance funding sources.

- **Main findings**

Finding 1: climate finance in Lao PDR is mostly adaptation finance (71%) and grants. The situation is consistent with general trends observing Least Developed Countries benefitting from most of the adaptation assistance, while middle income countries attract most mitigation investments. With a high debt to GDP ratio, grants will continue to be a priority for climate finance mobilization for Lao PDR. Under such circumstances, it is necessary to explore innovative mechanisms to maximize grant utilization. One possible option is to consider is to leverage grants to support private sector investment in Nationally Determined Contribution (NDC) priority sectors.

Finding 2: The review found that most Lao PDR climate change projects are financed by multilateral funds, UNFCCC, and non-UNFCCC, which were designed to support LDCs to shift towards low emissions and carbon resilient development. Funds which Lao PDR has not be able to access are often those that do not target LDCs and/or do not have an accessing channel outside host government countries.

Finding 3: Lao PDR so far relies on development partners that are multilateral funds' Accredited Entities (for GCF) or Implementing Entities (for AF) or Partner Agencies (GEF/LDCF). Some of the funds require the government to work with the funds' partners due to limited capacity of government entities to meet criteria set by the funds. Significant time and resources are required for proposal development to UNFCCC funds.

Finding 4: monitoring and reporting on climate finance should be a priority area. A clear overview of climate finance flows and their use will allow a targeted resourcing and planning of activities towards the NDC.

Finding 5: there is a need to strengthen the government's capacity in mobilizing climate finance through long-term, systematic, strategic, and continuous interventions.

1. Domestic public resources

A. Introduction

The Development Finance Assessment (DFA) analyses the financing landscape in Lao PDR to determine the sources of development financing available within the next planning period. Matched against the costing of the 9th NSEDP outcomes and outputs, these results will underpin the formulation of a high-level financing strategy, comprised of a series of policy options to successfully finance and achieve national development priorities.

The present brief, dedicated to public sector resources, is the first of a series of four documents summarising results of the DFA consultancy for each source of finance.

B. Sources and assumptions

The DFA consultancy has projected State Budgetary Operations for the 9th9th NSEDP, Fiscal Years 2021 to 2025, using:

- Ministry of Finance (MOF) 5-Year Budget Plan (2021-2025) Revenue and Expenditure totals as approved by the National Assembly; and
- 2020 State Budget Operations (*source: MOF*) to project the total of Ministry and Provinces expenditure in economic, social, and cultural sectors.

A series of assumptions underpin the 5-Year Budget Plan. They are presented and analysed below:

1. **Inflation is assumed to be between 1.4% and 2.7% during the 9th NSEDP. Early indications are that inflation may be closer to 4.5-5.0% in 2021** (*World Bank Economic Monitor August 2021*). Inflationary pressures appear to be increasing globally. Should these pressures impact Lao PDR, there will be reductions in the real value of State Budget resources available for development expenditure, highlighting the need for strong fiscal discipline.

2. **9th NSEDP, Output 1.2 requires public expenditure to be "*balanced with actual financing capacity*".** This indicates that the State budget will become balanced over the five years of the 9th NSEDP; however, the 9th NSEDP also references structural fiscal deficits of 1.9% of GDP. State Budgetary Operations to December 2020 provide actual revenue and expenditure amounts, which result in a fiscal deficit of 5.2%. The DFA takes note of the PFM strategy and National Assembly Resolution No.13, both of which reference a transition to balanced budgets and the MOF State Budget projections which return to a balanced budget in 2025.

3. **The return to balanced State Budgets in 2025 is financed by revenue projections that increase Tax Revenue from 9.1% to 16.6% of GDP over five years.** The DFA is not aware of any policy or revenue administration reforms that supports this key assumption.

4. **Public expenditure allocations to Ministries and Provinces are maintained at 2020 prorate levels**. This assumes that National Assembly budget commitments and public service

structures will take time to respond to any policy change around spending priorities. It needs to be noted that these projected Ministry allocations should change as 9th NSEDP primary development targets and funding needs are identified and prioritised in the resource constrained environment that Lao PDR faces following the pandemic.

5. **Debt servicing commitments for long-term facilities is scheduled in the Public Debt Bulletin 2020, prepared by External Finance and Debt Management Department, MOF**. This debt servicing projection includes concessional and non-concessional (market) debt instruments such as bonds and loans. It is not known if this includes debt servicing for *Electricite du Lao PDR* bonds guaranteed by the State.

6. **Short term Treasury Bills and Bank Credit repayments are estimated to reduce to nil** as Government of Lao PR moves towards balanced budgets and increases fiscal discipline over the five-year term of the 9th NSEDP.

7. **Non-tax revenue, social contributions, and grants** are forecasted in line with annual GDP growth because of their relationship to general economic activity in Lao PDR.

C. Limitations

Resolving inconsistencies around fiscal discipline and improved tax yields: the 2020 fiscal deficit of 5.2% of GDP is consistent with previous Government budgets. The 9th NSEDP calls for improving tax revenues and fiscal discipline but does not detail the implementation plans for achieving these targets. This assessment would be improved where implementation plans for achieving these targets were provided and analysed.

Obtaining information on "Other Organisations": details of the 50.6% of expenditure (9% of GDP) allocated to "Other Organisations" in 2020 was requested but is not available. The Public Expenditure and Financial Accountability (PEFA) Assessment 2018 for Lao PDR notes *"…the use of 'other' and 'other organizations' in published budget plans … significantly reduces the comprehensiveness, consistency, and comparability of the budget presentation and does not allow for in-depth analysis of the budget priorities and execution*". The absence of a proper functional classification in the State Budget resulted in a "D" score for PEFA PFM Performance Indicator 2.1 (PI-02.1), the lowest in the region.

D. Main findings

Based on 2020 State Budgetary Operations (*source: MOF*), the DFA consultancy has projected State Budgetary Operations for the 9th NSEDP, being Fiscal Years 2021 to 2025. The results of these projections are set out below in *Tables 1 & 2 - State Budget estimates 2021-2025* (see annex 3).

Finding 1: revenues need to significantly increase year-on-year to meet State budget projections and to support the achievement of 9th NSEDP policy priorities.

The 2020 tax to GDP ratio of 9.1% is well below the IMF's recommendation of 15%, while the 2020 fiscal deficit amounts to 5.2% of GDP. In the 2021 State Budget projections, Total Revenue increases from LAK21,846b (*MOF Budgetary Operations 2020*) to LAK27,629b. This increase of

26.5% during the COVID-19 pandemic appears to be very sudden within the timeframe of a single year and is therefore unlikely to be achieved without major policy and administration reforms to support such a rapid growth in revenues. **Restoring balanced budgets will require fiscal discipline throughout the 9th NSEDP.** Balanced budgets can be achieved within five years if the tax to GDP ratio progressively improves to 16.3%, debt is appropriately consolidated and its servicing costs reduced, by replacing commercial borrowings with concessional loans, while public spending does not grow faster than real GDP growth.

Finding 2: on the spending side, there are inconsistencies between current public allocations and the 9th NSEDP policy priorities that will need to be resolved.

In the 2020 State Budget, allocation to non-sustainable economic sectors remains important while allocations to environmental protection and climate change remains limited. Public resources dedicated to energy and mines (1.6% of GDP) and public works (2.2% of GDP) still amount to more than 20% of all public expenditure in 2020. Resources dedicated to environmental protection and water resources represent less than 1% of total expenditure (0.8%) and only a fraction of GDP (0.2%).

In parallel, allocation to social sectors and public investments in human capital remain limited and appear contradictory to 9th NSEDP policy priorities. Total resources spent on sociocultural sectors amount to 4.1% of GDP, with education and sports (1.8% of GDP) and health (1.0% of GDP) being the most financed sectors, but well below recommended standards and ASEAN peers.

E. Figures and tables

Based on 2020 State Budgetary Operations (*source: MOF*), the DFA consultancy has projected State Budgetary Operations for the 9th NSEDP, being Fiscal Years 2021 to 2025. The results of these projections are set out below in *Tables 1 & 2 - State Budget estimates 2021-2025.*

Table 1 - State Budget Revenue projections for 9th NSEDP (LAK millions)

Lao PDR - State Budget estimates of revenue and expenditure (LAK)

						State Budget Projections - 9th NSEDP				
GDP Estimate 2020 *(source: MOF)*					**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Nominal GDP (LAK millions)					173,138,000	182,603,000	195,961,000	209,781,000	225,584,000	242,763,000
+ GDP growth assumption						4.00%	4.59%	4.87%	5.27%	5.36%
Inflation assumption						1.47%	2.72%	2.19%	2.27%	2.26%
= Real GDP (LAK million)						179,918,736	190,630,861	205,186,796	220,463,243	237,276,556
Tax as % of Nominal GDP					9.11%	11%	12%	13%	15%	17%
	Lao PDR: State Budget Implemented 2020 *(source MOF)*					**2021**	**2022**	**2023**	**2024**	**2025**
	State Budget 2020 Revised Revenue Plan LAK m	%	2020 Budgetary Operations LAK m	Percent of Revenue %	Percent of GDP %	Projected LAK m	Projected LAK m	Projected LAK m	Projected LAK m	Projected LAK m
TOTAL REVENUE *(source: MOF)*	**22,252,249**	*100%*	**21,845,750**	*100%*	*12.62%*	**27,629,000**	**29,423,000**	**33,884,000**	**40,515,000**	**48,048,000**
Tax Revenue	**16,277,246**		**15,764,605**	*72.2%*	*9.11%*	**20,925,000**	**23,284,000**	**27,043,000**	**33,194,000**	**40,330,000**
Non-Tax Revenue	**3,638,003**		**3,450,985**	*15.8%*	*1.99%*	**4,284,000**	**3,679,000**	**4,341,000**	**4,791,000**	**5,218,000**
Social Contribution	**50,000**		**64,877**	*0.3%*	*0.04%*	-	-	-	-	-
Grants	**2,287,000**		**2,565,283**	*11.7%*	*1.48%*	**2,420,000**	**2,460,000**	**2,500,000**	**2,530,000**	**2,500,000**

Table 2 - State Budget Expenditure projections for 9th NSEDP (LAK millions)

	Lao PDR: State Budget Implemented 2020 *(source MOF)*					2021	2022	2023	2024	2025
	State Budget 2020 Revised Expenditure Plan	*% of Total*	2020 Budgetary Operations	Percent of Expenditure	Percent of GDP	Projected	Projected	Projected	Projected	Projected
	LAK m	%	LAK m	%	%	LAK m	LAK m	LAK m	LAK m	LAK m
TOTAL EXPENDITURE *(source: MOF)*	**35,693,000**	***100%***	**30,858,171**	*100.0%*	***17.82%***	**31,583,000**	**33,713,000**	**35,881,000**	**41,681,000**	**47,142,000**
Economic Sector *Ministry & Provinces (source: MOF Budgetary Operations)*	**9,461,371**	**27%**	**8,179,772**	***26.51%***	***4.72%***	**8,371,907**	**8,936,520**	**9,511,205**	**11,048,648**	**12,496,230**
Finance	462,563		399,906	*1.30%*	*0.23%*	409,300	436,903	464,999	540,164	610,936
Planning and Investment	140,982		121,885	*0.39%*	*0.07%*	124,748	133,161	141,725	164,634	186,204
Agriculture and Forestry	1,132,057		978,713	*3.17%*	*0.57%*	1,001,702	1,069,258	1,138,020	1,321,975	1,495,179
Public Works and Transport	4,323,922		3,738,221	*12.11%*	*2.16%*	3,826,028	4,084,061	4,346,697	5,049,320	5,710,877
Energy and Mines	3,240,066		2,801,180	*9.08%*	*1.62%*	2,866,977	3,060,330	3,257,132	3,783,632	4,279,360
Industry-Commerce	161,781		139,867	*0.45%*	*0.08%*	143,152	152,807	162,633	188,922	213,674
Social Cultural Sector *Ministry & Provinces (source: MOF Budgetary Operations)*	**8,160,912**	**23%**	**7,055,468**	***22.86%***	***4.08%***	**7,221,194**	**7,708,201**	**8,203,897**	**9,530,019**	**10,778,632**
National Assembly	123,376		106,664	*0.35%*	*0.06%*	109,169	116,532	124,026	144,074	162,950
Foreign Affairs	77,682		67,160	*0.22%*	*0.04%*	68,737	73,373	78,091	90,714	102,600
Justice	99,249		85,805	*0.28%*	*0.05%*	87,821	93,743	99,772	115,899	131,084
Information Culture and Tourism	332,637		287,579	*0.93%*	*0.17%*	294,334	314,185	334,389	388,442	439,335
Labour and Social Welfare	1,114,602		963,623	*3.12%*	*0.56%*	986,257	1,052,772	1,120,473	1,301,592	1,472,125
Education and Sports	3,657,409		3,161,991	*10.25%*	*1.83%*	3,236,263	3,454,521	3,676,673	4,270,991	4,830,571
National University	189,118		163,501	*0.53%*	*0.09%*	167,341	178,627	190,114	220,845	249,780
Public Health	2,021,787		1,747,924	*5.66%*	*1.01%*	1,788,981	1,909,632	2,032,436	2,360,970	2,670,302
Supreme People's Court	73,246		63,324	*0.21%*	*0.04%*	64,812	69,183	73,632	85,534	96,741
Public Prosecutor General	68,107		58,882	*0.19%*	*0.03%*	60,265	64,329	68,466	79,533	89,953
Audit Agency	23,705		20,494	*0.07%*	*0.01%*	20,975	22,390	23,830	27,682	31,309
National Science and Technology	88,509		76,520	*0.25%*	*0.04%*	78,317	83,599	88,975	103,358	116,899
Water Resource and Environment	291,485		252,002	*0.82%*	*0.15%*	257,921	275,315	293,020	340,386	384,983
Other Organisations**	**18,070,717**	**51%**	**15,622,931**	***50.63%***	***9.02%***	**15,989,899**	**17,068,279**	**18,165,898**	**21,102,333**	**23,867,138**
FISCAL DEFICIT	**13,440,751**		**9,012,421**			**3,954,000**	**4,290,000**	**1,997,000**	**1,166,000**	**906,000**
Fiscal Deficit - % of domestic revenue			**-41.3%**			**-14.3%**	**-14.6%**	**-5.9%**	**-2.9%**	**1.9%**
Fiscal Deficit - % of GDP nominal			**-5.2%**			**-2.2%**	**-2.2%**	**-1.0%**	**-0.5%**	**0.4%**
PUBLIC DEBT MANAGEMENT - 9th NESDP										
Treasury Bills - <12 month maturity						**0**	**0**	**0**	**0**	**0**
Bank Credit - < 12 months for Fiscal deficit financing only, no arrears						**3,954,000**	**4,290,000**	**1,997,000**	**1,166,000**	**906,000**
External Public debt service projections: Concessional Loans & Non-Concessional Bonds, Loans *(MOF)*						**12,714,135**	**11,593,843**	**14,275,760**	**11,998,030**	**13,020,645**
			Total LAK = 74,103,412 million			**16,668,135**	**15,883,843**	**16,272,760**	**13,164,030**	**12,114,645**

*** - Amount calculated by DAF consultant, differs from disclosure in State Budget Plan 2020*

Table 1.bis. - State Budget Revenue projections for 9th NSEDP (USD millions)

Lao PDR - State Budget estimates of revenue and expenditure (USD)

			State Budget Projections - 9th NSEDP				
GDP Estimate 2020 *(source: MOF)*	2020 (USD m)	2020	2021 (USD m)	2022 (USD m)	2023 (USD m)	2024 (USD m)	2025 (USD m)
Nominal GDP (LAK millions)	18,225	173,138,000	18,306	19,260	20,414	23,107	25,636
+ GDP growth assumption							
Inflation assumption							
= Real GDP (LAK million)	-		18,037	18,736	19,967	22,583	25,057
Tax as % of Nominal GDP		9.1%	11.5%	11.9%	12.9%	14.7%	17%
LAK:USD	*2020 forex* *Change %*	*9,500*					

	Lao PDR: State Budget Implemented 2020 *(source MOF)*						2021	2022	2023	2024	2025
	State Budget 2020 Revised Revenue Plan		2020 Budgetary Operations	2020 Budgetary Operations	Percent of Revenue	Percent of GDP	Projected	Projected	Projected	Projected	Projected
	LAK m	%	LAK m	USD m	%	%	USD m	USD m	USD m	USD m	USD m
TOTAL REVENUE *(source: MOF)*	22,252,249	***100%***	21,845,750	2,300	***100%***	***12.62%***	2,770	2,892	3,297	4,150	5,074
Tax Revenue	16,277,246		15,764,605	1,659	***72.2%***	***9.11%***	2,098	2,288	2,632	3,400	4,259
Non-Tax Revenue	3,638,003		3,450,985	363	***15.8%***	***1.99%***	429	362	422	491	551
Social Contribution	50,000		64,877	7	***0.3%***	***0.04%***	-	-	-	-	-
Grants	2,287,000		2,565,283	270	***11.7%***	***1.48%***	243	242	243	259	264

Table 2.bis. - State Budget Expenditure projections for 9th NSEDP (USD millions)

	Lao PDR: State Budget Implemented 2020 *(source MOF)*						2021	2022	2023	2024	2025
	State Budget 2020 Revised Expenditure Plan	*% of Total*	2020 Budgetary Operations	2020 expenduture (USDm)	Percent of Expenditure	Percent of GDP	Projected	Projected	Projected	Projected	Projected
	LAK m	%	LAK m		%	%	USD m	USD m	USD m	USD m	USD m
TOTAL EXPENDITURE *(source: MOF)*	**35,693,000**	***100%***	**30,858,171**	**3,248**	*100.0%*	***17.82%***	**3,166**	**3,313**	**3,492**	**4,270**	**4,978**
Economic Sector *Ministry & Provinces (source: MOF Budgetary Operations)*	**9,461,371**	**27%**	**8,179,772**	**861**	***26.51%***	***4.72%***	**839**	**878**	**926**	**1,132**	**1,320**
Finance	462,563		399,906	42	*1.30%*	*0.23%*	41	43	45	55	65
Planning and Investment	140,982		121,885	13	*0.39%*	*0.07%*	13	13	14	17	20
Agriculture and Forestry	1,132,057		978,713	103	*3.17%*	*0.57%*	100	105	111	135	158
Public Works and Transport	4,323,922		3,738,221	393	*12.11%*	*2.16%*	384	401	423	517	603
Energy and Mines	3,240,066		2,801,180	295	*9.08%*	*1.62%*	287	301	317	388	452
Industry-Commerce	161,781		139,867	15	*0.45%*	*0.08%*	14	15	16	19	23
Social Cultural Sector *Ministry & Provinces (source: MOF Budgetary Operations)*	**8,160,912**	**23%**	**7,055,468**	**743**	***22.86%***	***4.08%***	**724**	**758**	**798**	**976**	**1,138**
National Assembly	123,376		106,664	11	*0.35%*	*0.06%*	11	11	12	15	17
Foreign Affairs	77,682		67,160	7	*0.22%*	*0.04%*	7	7	8	9	11
Justice	99,249		85,805	9	*0.28%*	*0.05%*	9	9	10	12	14
Information Culture and Tourism	332,637		287,579	30	*0.93%*	*0.17%*	30	31	33	40	46
Labour and Social Welfare	1,114,602		963,623	101	*3.12%*	*0.56%*	99	103	109	133	155
Education and Sports	3,657,409		3,161,991	333	*10.25%*	*1.83%*	324	340	358	437	510
National University	189,118		163,501	17	*0.53%*	*0.09%*	17	18	19	23	26
Public Health	2,021,787		1,747,924	184	*5.66%*	*1.01%*	179	188	198	242	282
Supreme People's Court	73,246		63,324	7	*0.21%*	*0.04%*	6	7	7	9	10
Public Prosecutor General	68,107		58,882	6	*0.19%*	*0.03%*	6	6	7	8	9
Audit Agency	23,705		20,494	2	*0.07%*	*0.01%*	2	2	2	3	3
National Science and Technology	88,509		76,520	8	*0.25%*	*0.04%*	8	8	9	11	12
Water Resource and Environment	291,485		252,002	27	*0.82%*	*0.15%*	26	27	29	35	41
Other Organisations**	**18,070,717**	**51%**	**15,622,931**	**1,645**	***50.63%***	***9.02%***	**1,603**	**1,678**	**1,768**	**2,162**	**2,520**
FISCAL DEFICIT	**13,440,751**		**9,012,421**	**949**			**396**	**430**	**194**	**119**	**93**
Fiscal Deficit - % of domestic revenue			**-41.3%**				**-14.3%**	**-14.9%**	**-5.9%**	**-2.9%**	**1.83%**
Fiscal Deficit - % of GDP nominal			**-5.2%**				**-2.2%**	**-2.2%**	**-1.0%**	**-0.5%**	**0.36%**

2. Foreign Direct Investments (FDI)

A. Introduction

The Development Finance Assessment (DFA) analyses the financing landscape in Lao PDR to determine the sources of development financing available within the next planning period. Matched against the costing of the 9th NSEDP outcomes and outputs, these results will underpin the formulation of a high-level financing strategy, comprised of a series of policy options to successfully finance and achieve national development priorities.

The present brief, dedicated to Foreign Direct Investment (FDI), is the second of a series of four documents summarising results of the DFA consultancy for each source of finance.

B. Sources and assumptions

The DFA consultancy has projected FDI inflows for the 9th NSEDP 2021-2025 based on actual FDI inflows received during the 8th NSEDP 2016-2020 *(source: Bank of Lao PDR)* adjusted for regional economic prospects and the country and sectoral mix of FDI inflows to Lao PDR. It needs to be noted that Ministry of Planning and Investment keeps records of approved FDI-funded project proposals; however, this data does not include disbursements to the Lao PDR economy because it reports planned investment activity only. Planned FDI inflows are not a reliable proxy for actual FDI inflows because plans can be changed due to macroeconomic instability in Lao PDR, exchange rates for the Lao Kip, inflation, and multiple other factors.

A series of assumptions, linked to the regional economies and the 9th NSEDP, were applied by the DFA consultancy to estimate future FDI inflows. They are presented below:

1. **Regional economic prospects for China, and East Asia excluding China, are emerging as stronger than anticipated for the post-2020 pandemic period.** This is significant because these regional economies represent the main sources of FDI inflows to Lao PDR, which is an important addition to GDP as a source of financing, see Figure 1 below. However real GDP growth is expected to be more moderate than pre-pandemic levels at 6% for China and 4% for East Asian economies of Cambodia, Indonesia, Lao PDR, Malaysia, Mongolia, Myanmar, the Philippines, Thailand, and Vietnam (*World Bank, June 2021*).

2. **China is the largest source country for FDI inflows to Lao PDR (87.7% in 2020) and its economy is anticipated to recover more rapidly from the effects of the pandemic than other regional economies.** Lao PDR's policy framework for FDI incentives is likely to remain unchanged in the short-term; and it is assumed that China FDI inflows will reflect China's future GDP growth rates of 6%.

3. **East Asia economies, excluding China, are anticipated to recover at a more moderate rate and FDI inflows from these countries are anticipated to grow at 75% of projected GDP rates or at around 3% annually.**

4. **FDI inflows by sector are assumed to remain consistent with current Lao PDR policies.** During the 8th NSEDP, 85% of all FDI on these five sub-sectors focused on these five sectors:

- Construction - 32.4%.
- Electricity, Gas and Air-Conditioning Supply - 25.6%.
- Agriculture, Forestry and Fishing - 13.0%.
- Manufacturing - 8.5%; and
- Mining And Quarrying – 5.5%.

5. **FDI to the social sub-sectors of Health (0.3% on a five-year average) and Education (0.0%) are assumed to remain low without significant policy changes to FDI incentives for external investment in these sectors.** This is a significant policy reform issue when considering the limited fiscal headroom available in the State Budget and the large number of development targets set for the Health and Education sub-sectors in the 9th NSEDP.

6. **Vaccine coverage increasing** to levels found in developed economies would boost prospects for economic recovery. This will improve the potential for inbound tourism, both regionally and internationally, and promote FDI in accommodation and food service activities associated with tourism.

7. **Impact of global inflation would reduce these regional projections, particularly for Lao PDR**. Rising inflation or monetary tightening in advanced economies are likely to have important international spill over effects, contributing to currency depreciation, domestic monetary tightening and, in some countries, capital outflows and financial turmoil in the region's most vulnerable economies. This could be the case for Cambodia, Lao People's Democratic Republic, Mongolia. *(World Bank June 2021)*.

C. Limitations

This assessment can be improved by linking MPI-approved FDI project cash-flows to 2021-2025 FDI cash inflow projections, where this information can be obtained and reliably applied. This enhancement of the assessment is dependent on data supplied by the intending investors; and may be affected by how effectively macro-economic stability can be established during the 9th NSEDP.

The 9th NSEDP states at Output 1.2 that "*national projects … will use non-government funding sources*". This target implies there will be a larger volume of FDI and/ or Private Domestic Investment to deliver public infrastructure development during the 9th NSEDP. However, the DFA has not been able to access a schedule of 2021-2025 public investments and their private funding sources. Accordingly, the DFA does not reflect this national project financing policy of the 9th NSEDP in future FDI inflow levels. Access to a schedule of 2021-2025 public investments and their private funding sources would improve the accuracy of this assessment.

D. Main findings

Finding 1: FDI inflows are likely to continue in line with regional economic growth prospects, underpinned by China investments, but significant policy reforms will be needed to direct future FDI in support of social sub-sector targets (health, education) in the 9th NSEDP.

Existing FDI to the social sub-sectors of Health (0.3%) and Education (0.0%) are too low to support effective delivery of the 9th NSEDP targets in these sub-sectors.

Finding 2: reliance on a single source country for the majority of FDI inflows exposes Lao PDR to significant economic risks if that economy was disrupted, or the relationship was to change.

As noted in Briefing Note 1 on Public Sector Resources, there is extremely limited fiscal space for increasing development expenditure in social sub-sectors. The stability of future FDI inflows for infrastructure development is important because it may enable State Budget capital expenditure to be re-allocated to social sub-sector investments during the 9th NSEDP. Promoting FDI from more source countries would reduce risks of any relationship disruptions with Lao PDR's main source of FDI.

Finding 3: Foreign Portfolio Investment (FPI) fluctuated significantly over the 8th NSEDP 2016-2020 (source: BOL). FPI is highly mobile and requires stable capital markets to be an effective source of development financing. FPI can include sale of equities in State-Owned Enterprises (SOEs), which would support Lao PDR policies for reform and subsequent divestment/ recapitalising of SOEs; and/ or State debt amortization.

Multilateral agencies in the commercial space (e.g., such as the International Finance Corporation, World Bank Group) have experience with SOE reforms and subsequent equity sale/ divestment programs and could enhance FPI for the Public Sector.

E. Figures and tables

FDI has been important to Lao PDR financing over the past 20 years; and this trend appears likely to continue, noting the risks that the COVID-19 pandemic and inflation in advanced economies pose to this funding.

GDP growth figures for Lao PDR's main partner, China, and regional partners, are likely to maintain FDI growth at between 4 and 6% over the term of the 9th NSEDP. This compares favourably with FDI at 6.5% of GDP on average during the 8th NSEDP.

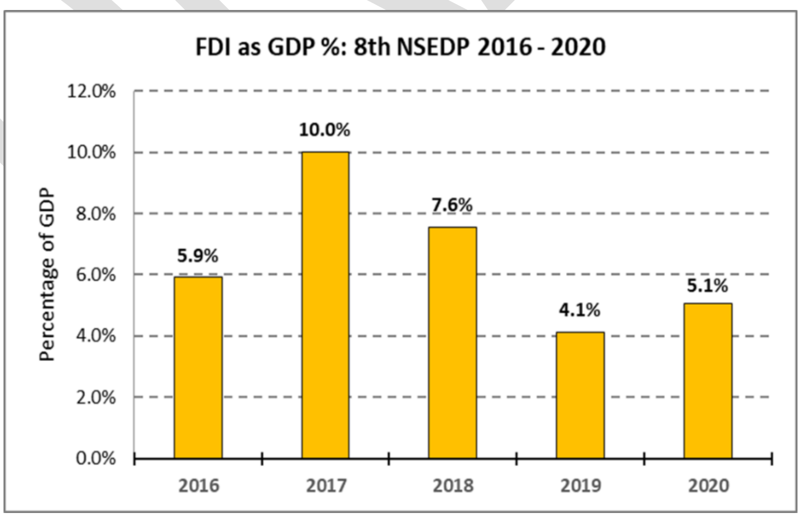
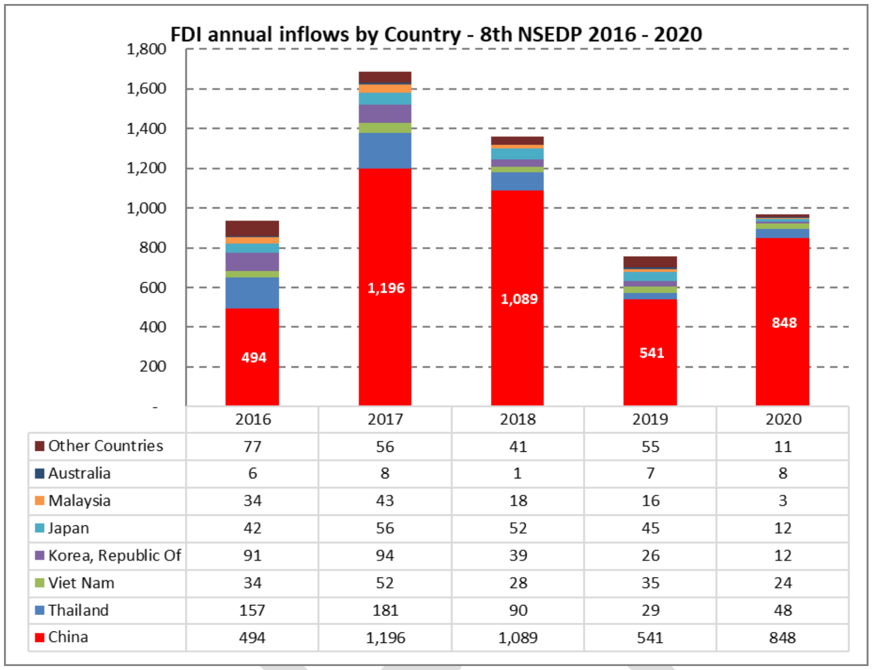


Figure 1 – FDI as a percentage of GDP over the last cycle

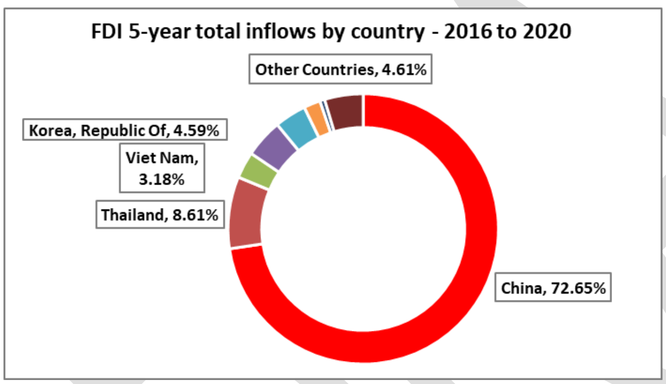
China has been the largest source of FDI inflows to Lao PDR throughout the 8th NSEDP; a trend that is likely to continue into the 9th NSEDP where policy incentives are unchanged.

The DFA has extrapolated these levels of past FDI inflows to project future FDI inflows in Table 5.

This level of dependency on a single source of FDI is also a risk to Lao PDR economic stability. Diversifying sources of FDI would ameliorate this risk.



	2016	2017	2018	2019	2020
Other Countries	77	56	41	55	11
Australia	6	8	1	7	8
Malaysia	34	43	18	16	3
Japan	42	56	52	45	12
Korea, Republic Of	91	94	39	26	12
Viet Nam	34	52	28	35	24
Thailand	157	181	90	29	48
China	494	1,196	1,089	541	848



Figures 2 and 3 – FDI annual inflow by country: 2016-2021

Figure 4 identifies that the largest FDI inflows are to the resources and manufacturing sectors of the economy, with some investment in the tertiary sector being financial services (7.4%) and retail and wholesale sectors (2.1%). This mix is unlikely to alter without significant new policy incentives to shift external funding to support social sub-sector targets.

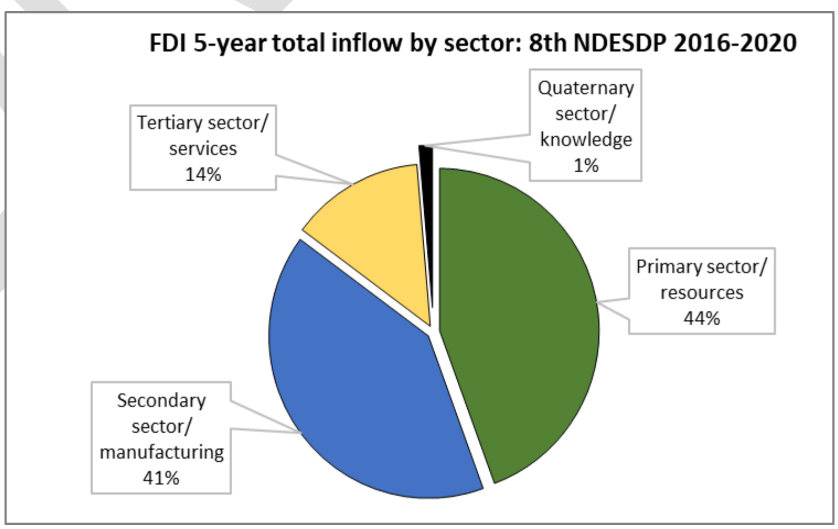


Figure 4 - FDI as a % of GDP: 2016-2021

			9th NSEDP - Projections of FDI based on regional GDP forecasts									
ISO Code	Year	8th NSEDP average	GDP Growth	FDI 2021 USD	GDP Growth	FDI 2022 USD	GDP Growth	FDI 2023 USD	GDP Growth	FDI 2024 USD	GDP Growth	FDI 2025 USD
CN	China	**834**	6.0%	884	6.0%	937	8.0%	1,012	10.0%	1,113	10.0%	1,224
TH	Thailand	**101**	4.0%	105	4.0%	109	5.0%	115	6.0%	122	5.0%	128
VN	Viet Nam	**35**	4.0%	36	4.0%	37	5.0%	39	6.0%	42	5.0%	44
KR	Korea, Republic Of	**53**	4.0%	55	4.0%	57	5.0%	60	6.0%	63	5.0%	66
JP	Japan	**42**	4.0%	43	4.0%	45	5.0%	47	6.0%	50	5.0%	53
MY	Malaysia	**23**	4.0%	24	4.0%	25	5.0%	26	6.0%	27	5.0%	29
AU	Australia	**6**	2.0%	6	3.0%	6	4.0%	6	4.5%	7	3.5%	7
	Other Countries	**48**	2.0%	49	3.0%	51	4.0%	53	4.5%	55	3.5%	57
	Total countries			**1,202**		**1,267**		**1,358**		**1,479**		**1,608**

Figure 5 - FDI inflows projected for 9th NSEDP: 2021-2025

Figure 6 demonstrates the high mobility of FPI, which began to exit the Lao PDR capital market as the COVID-19 pandemic affected investor confidence levels in late 2019 and 2020.

The DFA does not attempt to project FPI inflows for 2021-2025 because of the uncertainty around the pandemic recovery period; and the need for a specific policy enabling environment for FPI inflows to support attainment of 9th NSEDP development targets.

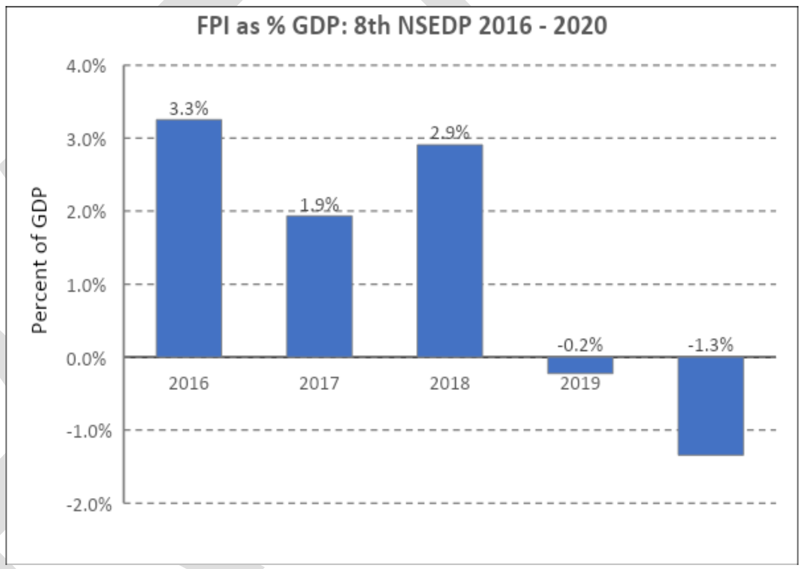


Figure 6 - Foreign Portfolio Investment (FPI): 2016-2020

The most likely role for FPI as a development funding source to achieve 9th NSEDP targets would be in SOE reforms. The objective would be to develop policies that enable commercialisation of some SOEs by injecting both investor and market disciplines into their governance structures through the sale of equities; and full divestment of other SOEs to private ownership. These actions require SOEs to generate both financial returns and equity growth and have the management and financial capacity to deliver these outcomes.

Further, the sale of SOE equities could generate capital to either:

- refinance those SOEs in need of capital injections, and/or
- retire sovereign debt.

International Financial Institutions, such as the International Finance Corporation of the World Bank Group, have a large body of experience and technical capacity in supporting governments with programs of this nature.

3. Official Development Assistance

A. Introduction

The Development Finance Assessment (DFA) analyses the financing landscape in Lao PDR to determine the sources of development financing available within the next planning period. Matched against the costing of the 9th NSEDP outcomes and outputs, these results will underpin the formulation of a high-level financing strategy, comprised of a series of policy options to successfully finance and achieve national development priorities.

The present brief, dedicated to Official Development Assistance (ODA) is the third of a series of four documents summarising results of the DFA consultancy for each source of finance.

B. Sources and assumptions

The DFA consultancy has projected ODA inflows for the 9th NSEDP 2021-2025 based on actual ODA inflows[1] identified for the latter half of the 8th NSEDP 2016-2020 *(multiple sources: MPI, World Bank, donors*) and donor commitments for 2021-2025. These data sets were adjusted for the currently perceived impact of the COVID-19 pandemic on Lao PDR; and noting that confirmation of future donor commitments for the next planning cycle will be received by the Government in coming months.

A series of assumptions, linked to global and regional economies and the 9th NSEDP, were applied by the DFA consultancy to estimate future ODA inflows for 2021-2025. They are presented below.

1. **ODA will continue to be accessed by Lao PDR during the 9th NSEDP.** Lao PDR has maintained a long and successful engagement with development partners, as evidenced by the number of development partners active in the country (50) and projects (436) identified in Lao PDR (*http://oda-mis.gov.la/#/dashboard/report*).

2. **Disbursements for ODA projects with "Active" status in 2020 and 2021 will be completed during the 9th NSEDP.** This assumption around disbursement timing is based on the observation that most ODA activities having terms of 5 years or less; with full disbursement achieved over that period. Where there are delays in implementation, some projects may have their project term extended by agreement. This factor is not considered to have a material impact on the analysis and findings in this Brief.

3. **Fiscal revenue constraints caused by the COVID-19 pandemic signal that Lao PDR is likely to make requests for additional ODA support to meet 9th NSEDP social sub-sector development targets.** Further, the medium-term impacts of the pandemic are likely to cause on-going macro-economic instability in Lao PDR. Reasons for increased demand for donor support over the next five years include:
   - inbound tourism may be slow to recover to pre-pandemic levels, with implications for foreign reserves and external debt servicing that place on-going pressure on the State Budget.

[1] There are likely to be gaps in the data set compiled by the DFA consultancy. Ministry of Planning and Investment, Department of International Cooperation (MPI-DIC) has committed to peer review this Brief and provide updated data.

- lower than usual levels of domestic economic activity while the economy recovers result in taxation revenues remaining at low percentage of GDP.
- a slowdown in FDI inflows as global and regional economies begin recovery from the pandemic, but deal with emerging inflation risks in developed economies; and
- on-going downward pressure on fiscal revenues leaves little fiscal headroom for increased social services spending to support rural and remote populations adversely affected by unemployment and reduced remittance inflows from family members working abroad.

In Lao PDR's resource constrained environment, donors are likely to be called on in the short-term to mobilise additional support to realise 9th NSEDP social sub-sector development targets and their related SDG goals.

4. **Mobilising domestic private investment and FDI as potential alternative funding sources to meet 9th NSEDP targets will be a long-term policy development program.** Structural and institutional barriers limit the pace of change to fiscal, domestic private investment and FDI policy settings, which currently promote development of the primary and secondary sectors of the Lao PDR economy. Any reshaping of these policies to promote investment in support of social sub-sector targets in the tertiary sector of the economy will require new incentives and trade-offs with existing incentives. Significant investment in policy analysis and economic modelling is needed to develop and quantify the nature, impact, and risks of any new social sector investment incentives; and for these to be legislated by Government. This is a long-term research and policy development process that is likely to take until the end of the 9th NSEDP (three to four years) to complete and therefore will practically benefit implementation of the 10th NSEDP.

   For this reason, ODA is the most accessible source of supplementary social sector investment funding in the short-term, alongside Lao PDR State Budget allocations, to meet the 9th NESDP targets in the social sub-sectors.

C. Limitations

The assessment accessed total amounts of ODA inflows for the 9th NSEDP, but these data sets were neither complete nor consistently analysed by annual inflows, or investment sectors. The analysis would be significantly improved where development partners make approved ODA disbursement (cashflow) schedules available for all projects; and these are used to develop year-on-year ODA inflow projections for Lao PDR from 2021 to 2025.

The DFA consultants consulted the ODA Management Information System (ODA-MIS) Dashboard of MPI-DIC but found this data set was not viable for analytical purposes. Most of the 436 individual ODA project entries in this Dashboard are annotated as "*Not Submitted*", indicating that data such as '*ODA type*', '*Development Partner*', '*SDG reference*', and '*disbursement amount*' are not available (*source: http://oda-mis.gov.la/#/dashboard/report. Accessed 10 August 2021*). This severely limits the utility of this tool for ODA inflow analysis.

D. Main findings

Finding 1: ODA is a significant contribution to Lao PDR's gross National Income (GNI). Table 1 shows that ODA represented 3.3% of GNI in the latter part of the 8th NSEDP.

This is a significant contribution to development investment in Lao PDR because of the extent that ODA inflows supplement key social sub-sector State Budgets allocations to health and education.

Finding 2: the ODA Management Information System (ODA-MIS) Dashboard of MPI-DIC needs to be regularly and completely updated to inform Government on the scope, timing, and focus of ODA investments in Lao PDR.

Resource allocation decisions in State Budgets and the workplans of Ministries will be better informed where the ODA-MIS Dashboard data sets are complete, accurate and valid. Further, current Dashboard data will assist to avoid duplication and overlap between donor initiatives and with Ministry programs.

Finding 3: Lao PDR sectoral agency absorptive capacities may be a constraint to ODA increases and ODA delivery strategies need to consider this.

Because of the ambitious development targets set for health and education in the 9th NSEDP, these social sub-sectors are most likely to seek additional ODA support. It is noted that ODA delivery rates in Lao PDR can be improved with more attention to donor liaison and administration capacity in Ministries (*MPI-DIC FAIR Report 2018-2019, JICA, 2013*). Accordingly, any additional ODA needs to prioritise the most important social sector targets in the 9th NSEDP while considering the absorptive capacities of national and sub-national facilities responsible for delivering those targets. One strategy may be to focus any additional ODA on only those high-impact development activities that demand fewer inputs from national and sub-national facilities. Another strategy may be to provide "surge capacity" by outsourcing ODA delivery to qualified NGO and/ or private sector entities.

E. Figures and tables

Table 1 - ODA statistics 2017-2019, latter part of 8th NSEDP

ODA statistics	2017	2018	2019	3 year avg
Increase in Net ODA	20.3%	22.5%	7.3%	**16.7%**
Net ODA (USD million)	480.4	588.7	631.5	**566.8**
Net ODA/GNI (%)	3.0	3.4	3.6	**3.3**
Gross ODA (USD million)	563.7	677.4	723.2	**700.3**
Bilateral share (gross ODA) (%)	60.7	64.1	51.2	
Total net receipts (USD million)	627.1	649.6	749.3	**699.4**
Repayment of Principal	83.4	88.7	91.7	**90.2**

Source: https://public.tableau.com

Table 1 shows a strong level of growth in Net ODA in the latter part of the 8th NSEDP, averaging +16.7% p.a. Repayments of principal remain broadly consistent year on year, reflecting the level of concessional borrowing that supports the investments made by development partners in the social sub-sectors identified in Table 2 below.

Table 2 highlights the significant supplementation of State Budgets by ODA in the priority social sub-sector investments in health and education in Lao PDR. ODA supplements the State health budget by 51% and the State education budget by 25%. Both levels of support are higher than total ODA as a proportion (21.5%) of total 2020 State Budget Expenditures of USD 3,248m.

Table 2 - Gross ODA investments by Sector in 2019 c.f. State Budget 2020 for health and education

ODA investment by Sector	Percent	2019 Gross ODA (USD)	2020 State Budget (USD)	% 2020 State Budget
Other social infrastructure and services	39%	275.2		
Health and Population	**13%**	**94.0**	**184.0**	**51%**
Multisector	13%	88.4		
Education	**12%**	**84.2**	**333.0**	**25%**
Production	11%	80.5		
Economic infrastructure and services	6%	41.0		
Other and unalocated/unspecified	3%	21.0		
Humanitarian aid	2%	14.5		
Programme assistance	0%	1.5		
	100%	700.3		

Table 3 is a forecast of 9th NSEDP ODA inflows by sector, where known. This is based on data collated from a wide variety of sources. It needs to be noted that average annual gross ODA inflows are USD 615.6m p.a., significantly lower than the average of USD 700.3m noted in Table 2 for the 8th NSEDP. This variance highlights the potential for complete and/ or inaccurate ODA data sets to impact on the DFA analysis.

Total projected ODA inflows to health represent +57.3% of the projected State Budget for health of USD918m; and 13.8% of the projected State Budget for education of USD1,661m. ODA is consistent with Government public investment priorities, because the largest projected total ODA inflows during the 9th NSEDP is likely to focus on the primary sector of the economy, being Agriculture and Public Works, together being 37.8% of total projected ODA for 2021-2025.

Table 3 - Projected ODA inflows 2021-2025

Lao PDR: Projections of ODA inflows 2021-2025 (USD millions)

Development Partners	Status	Agriculture - Rural development	Human resource development**	Education - Sports	Natural Resources-Environment	Public Works and Transport	Health & Nutrition	Clean energy	UXO	Trade	Others	TOTAL
Bilateral												
Australia	*Committed*	29.2	30.4	66.3				1.1		2.0	19.7	**148.7**
Japan	*Committed*	10.4	11.7	17.1		245.9	24.2		11.0		11.0	**331.3**
Kuwait	*Committed*	23.3										**23.3**
New Zealand	*Committed*	7.5	3.5		3.5			4.1	7.3		5.5	**31.4**
S. Korea	*Committed*	87.7		8.0	3.1	235.7	234.7		8.5		76.1	**653.8**
Thailand	*Committed*	4.0	8.0	7.5	1.5	182.0	7.2			2.9	2.5	**215.6**
Canada***	*Projected**		*9.0*									***9.0***
United States of America***	*Projected**		*14.7*	*5.3*			*6.8*					***26.8***
Finland	*Projected**				*5.3*							***5.3***
France	*Projected**	*25.9*	*5.1*	*41.1*			*19.6*				*6.3*	***98.0***
Germany	*Projected**		*6.3*		*62.5*						*56.3*	***125.0***
Ireland	*Projected**										*3.8*	***3.8***
Hungary	*Projected**	*34.4*									*1.3*	***35.6***
Luxemburg	*Projected**	*23.6*	*9.5*				*32.5*				*9.4*	***75.0***
Switzerland	*Projected**	*33.9*	*38.4*				*11.5*				*28.1*	***111.9***
United Kingdom	*Projected**										*3.8*	***3.8***
European Union	*Projected**		*28.1*	*77.5*			*93.8*				*3.1*	***202.5***
Multilateral												
World Bank, IDA	*Undisbursed*			6.7	80.2		95.6				25.0	**207.5**
World Bank, IFC	*Part disbursed?*									23.1		**23.1**
Asian Development Bank	*Part disbursed?*					218.8						**218.8**
United Nations System	*Projected**		85.6								56.6	**142.2**
Non-Government Organisations												
NGOs, sectors unknown (*OECD*)	*2019 USD73.5m*										386.0	**386.0**
Total		**279.9**	**250.3**	**229.5**	**156.1**	**882.4**	**525.9**	**5.2**	**26.8**	**28.0**	**694.3**	**3,078.2**

** - projections based on 2016-2020 ODA flows; assuming similar volumes by sector and a 5% increase during the 9th NSEDP at USD1.00=EUR0.84; USD1.00=CAD1.25*

*** - includes "Governance" programs*

**** - Excludes multilateral contributions to avoid double-counting*

4. Domestic private investment

A. Introduction

The Development Finance Assessment (DFA) analyses the financing landscape in Lao PDR to determine the sources of development financing available within the next planning period. Matched against the costing of the 9th NSEDP outcomes and outputs, these results will underpin the formulation of a high-level financing strategy, comprised of a series of policy options to successfully finance and achieve national development priorities.

The present brief, dedicated to Domestic Private Investment, is the fourth and final document summarising results of the DFA consultancy for each source of finance.

B. Sources and assumptions

The DFA consultancy has projected Domestic Private Investment levels during the 9th NSEDP 2021-2025 based on actual investment data available, noting that this economic data series has not been updated since 2017 *(source: IFC),* and adjusted for national and regional economic prospects in the COVID-19 pandemic and post-pandemic recovery period.

Further, it needs to be noted that Domestic Private Investment does not include Foreign Direct Investment (FDI) (*see DFA Brief 3*) nor public investment by Government (*see DFA Brief 1*) but does include remittances from Lao citizens working outside Lao PDR classified as "Other Revenue".

A series of assumptions, some linked to the regional economies and the 9th NSEDP, were applied by the DFA consultancy to estimate private investment levels. They are presented below:

1. **Gross Fixed Capital Formation in the Lao PDR private sector remained stable at around 21% of GDP from 2015 to 2017 *(IFC, 2021)*. It is assumed that this level of capital formation will decline during the pandemic and recovery period of 2021 to 2023 but will recover to pre-existing levels in 2024 and 2025.** This is significant because Gross Fixed Capital Formation is a reliable proxy for domestic private investment levels in Lao PDR.

2. **Domestic Private Investment policies will remain: the 9th NSEDP does not signal any reform to domestic private investment policies.**

   This is important because Lao PDR's "…*investment climate is improving while remaining poor in many regards. Rule of law is weak, business procedures are protracted and costly, while protection of property rights is insufficient. All of these elements contribute to jeopardizing the country's ability to create a dynamic private sector.*" (IFC, 2021).

   This assessment of the domestic private investment climate is confirmed by the World Bank Ease of Doing Business Index 2020, which ranks Lao PDR as 154 out of 190 economies. This compares to Cambodia ranked 144; Myanmar ranked 165; Thailand ranked 21; and Vietnam ranked 70.

Existing Lao PDR taxation and other policies do not promote domestic private investment, but favour FDI. The IFC notes that "*Core investment promotion functions are focused on the attraction, retention and growth of foreign investors (including joint ventures). They do not include domestic investment, SME development or business start-ups (unless foreign-owned).*" (IFC, 2021).

Investment Promotion policies of MPI prioritise investment in the Health and Education social sub-sectors. Incentives include rent and land use discounts, import incentives, English teaching tax exemptions and accelerated incentives for investment in rural areas. MPI notes that these incentives have not significantly mobilised Domestic Private Investment to these social sub-sectors in recent years.

3. **Remittances inflows from 2021 to 2025 will be impacted by both the ability of Lao PDR citizen to travel internationally for work post-pandemic, and the rate of economic recovery in regional countries that source labour from Lao PDR.** This is significant because "*Labour migration is one of the most important livelihood options for the Lao workforce. It was estimated that 0.9 million Lao nationals lived abroad in 2019. The most common destination country for Lao migrants is Thailand, where they are mostly employed in domestic work, construction, manufacturing, agriculture, and entertainment work*." (UN-IOM, 2020). The DFA estimates that remittances will remain static at 2019 levels until 2022 and then grow at around 4% p.a., in parallel with GDP growth in regional economies.

4. **East Asian economies, excluding China, are anticipated to recover at a more moderate rate and remittance earning opportunities in these countries are anticipated to grow at 75% of projected GDP rates, or at around 4% annually.**

5. **Vaccine coverage increases from 28%** to levels that are consistent with regional economies. This would enable Lao citizens to travel abroad for work, including to economies where vaccination visa/ passports are a requirement.

C. Limitations

This assessment can be improved with access to 2018 to 2020 data sets for Gross Capital Formation, Private Sector. The latest World Bank economic data set is for 2017, made available in 2019, and does not include the impact of the COVID-19 pandemic. Outdated data that does not reflect pandemic effects makes this assessment less reliable as an indicator of domestic private investment levels in Lao PDR during 2021 to 2025.

D. Main findings

Finding 1: domestic private investment is 21% of GDP and can be as important as annual State Budget spending (19% GDP) as a source of development finance; however, Lao PDR investment promotion policies focus on the attraction, retention and growth of foreign investors that have averaged around 6% of GDP over the past 5 years. There is little policy support for domestic investment, SME development or business start-ups in Lao PDR.

Effectively mobilising domestic private investment to fund 9th NSEDP policy objectives can deliver major benefits for the people and economy of Lao PDR. Further, there is a high opportunity cost to not mobilising domestic private investment in the form of possible under-investment in 9th NSEDP priority development themes resulting in unmet national targets.

Policy research and development is urgently needed to reshape the climate for domestic private investment in Lao PDR. The objective of these reforms could include active steps to promote financing of 9th NSEDP development activities through dedicated Government "One-Stop Shop" facilitation centres for Domestic Private Investors in key social sub-sectors. The aim of these facilitation centres would be to streamline and simplify investor participation in these high priority development activities. This policy reform agenda needs to be a high priority for Lao PDR; and is most likely to involve economic trade-offs with existing FDI investment policies.

The DFA notes that policy formation of this nature is likely to take up to four years to finalise and formalise in Government policy and legislation. Accordingly, the principal benefits of domestic private investment reforms will be felt during the 10th NSEDP.

Finding 2: remittances represent around 1.5% of GDP and mainly fund household expenditure. Remittances do not represent a significant potential source of development financing.

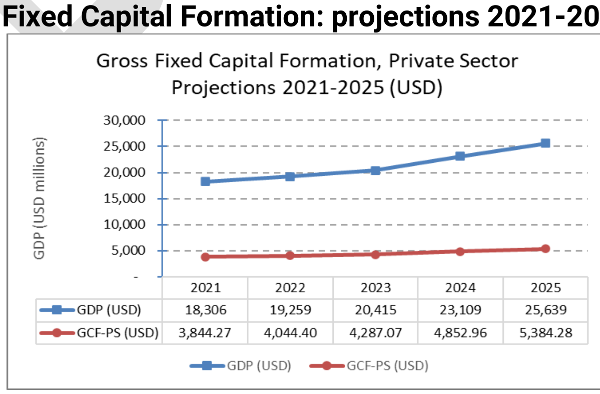
However, remittances play a major support role the community. The DFA notes that "The economic shock due to COVID-19 is adversely impacting the flow of remittances and could push as much as 214,000 people into poverty. Around 9 per cent of households receive remittances from abroad, and remittances constitute 60 per cent of their household income. This implies a significant reduction in recipient household income." (UN-ILO, 2020)

E. Figures and tables

- **Domestic private investment**

Figure 1 below sets out projections for domestic private investment in Lao PDR, using as a basis the 2015 to 2017 average actual capital formation of around 21% of GDP. This amount is larger than State Budget expenditure projections over the same period. Consequently, research and development of private investment policies that promote and offer incentives for domestic private investment in key areas of the 9th NSEDP is considered a high priority for Government. Missing the opportunity to mobilise domestic investment in support of the 9th NSEDP will have significant opportunity costs in the form of missed targets and lost domestic employment and skills development opportunities.

Figure 1 - Gross Fixed Capital Formation: projections 2021-2025 (USD millions)



Finally, increasing domestic investment will increase employment opportunities for Lao PDR citizens. This will reduce one of the driving factors of migration to other economies, being lack of employment choice and opportunities in the Lao PDR economy.

- **Personal Remittances**

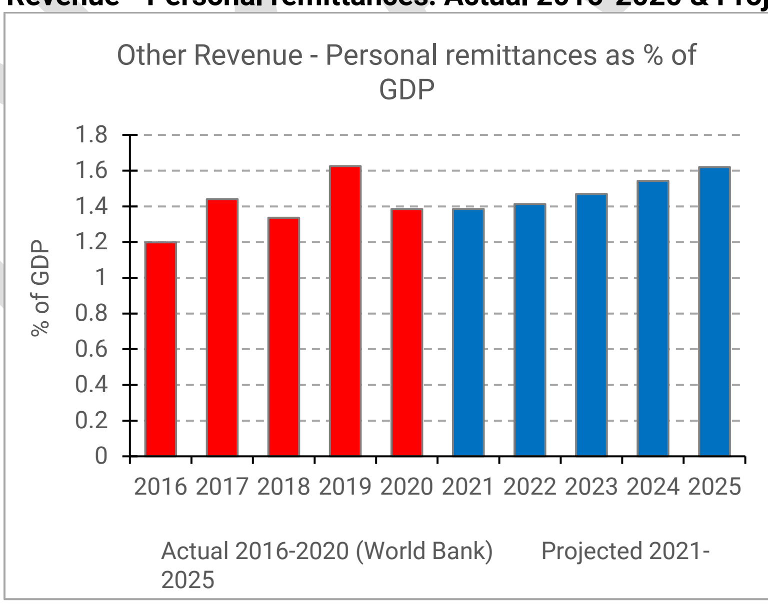
The DFA has requested details of the composition of “Other” category of revenues indicated in the 9th NSEDP. In the absence of this detailed breakdown, the DFA has analysed remittances as one possible source of other revenues in Lao PDR.

In Figure 2 below, personal remittances 2016-2020 are based on actual data sourced from the World Bank. The projections of personal remittances from 2021 to 2025 are made using the assumptions that Lao Citizens are most likely to be employed in Thailand; that the Thai economy will grow at around 4-5% from 2022 onwards during the 9th NSEDP; and employment opportunities and remittances are likely to grow at the same rate as GDP.

This projection would be significantly lower if COVID-19 vaccination rates in Lao PDR do not mirror regional averages and Lao PDR citizen are unable to enter countries offering employment opportunities.

Another constraint that will lower these projections would be if a fewer Lao citizens decide seek employment outside Lao PDR in the post-pandemic period. UN-ILO estimates up to 33% of returning Lao PDR citizens may not seek external employment after the COVID-19 pandemic recedes.

Figure 2 – Other Revenue - Personal remittances: Actual 2016-2020 & Projected 2021-2025



Noting that personal remittances are mostly (60%) utilised for household consumption and has *an important impact on poverty reduction, this category of investment inflows is not regarded by the DFA as a likely source of development financing.*

Overarching financial landscape

1. Domestic Public Finance	**15.7%**	1. **National Budget**	**15.7%**
• Tax revenue (direct, indirect) • Non-tax revenue • Government borrowing (loans, bonds) • Public enterprise revenues		• Ministerial and Provincial recurrent expenditure • Ministerial and Provincial capital expenditure • Government borrowings	
2. Domestic Private Finance	**21.0%**	**2. Domestic and foreign private investment**	**27.1%**
• Private sector equity – Gross Fixed Capital Formation 21% (2017) • Domestic borrowing – no data • National NGOs, foundations, and faith-based organisations – no data		• Private sector equity – Gross Fixed Capital Formation 21% • International borrowing by private sector - no data • Foreign Direct Investment (FDI) • financial flows – 6.1% • associated commodity imports* - no data • Foreign Portfolio investment (FPI) - immaterial	
3. International Public Finance	**3.1%**	**3. Official Development Assistance**	**3.1%**
• ODA grants • ODA loans • Other official flows South-south cooperation		• ODA grants • ODA loans • Other official flows South-south cooperation	
4. International Private Finance	**7.5%**	**4. Other investments**	**1.4%**
• Foreign Direct Investment (FDI) – 6.1% • Foreign Portfolio investment (FPI) - immaterial • International borrowing – no data • Remittances – 1.4% • International NGOs, foundations, and faith-based organisations – no data		• Remittances – 1.4% • Microfinance and Building Society (Financial Sector, not Banking Sector) net credits* – no data	
TOTAL OF ALL INFF FINANCING TYPES	**47.30%**	**TOTAL OF ALL 9th NSEDP FINANCING TYPES**	**47.30%**

Sovereign bonds report (UNCDF)

A. Introduction and objectives

The Lao PDR Bonds Review analyses the Lao PDR government issued sovereign and Sate Owned Enterprise bonds as of 2020. The study undertakes to collate and present all bond issuances to date and to map the service costs against a short to medium time frame. The report provides a succinct background to the accumulated public debt stocks and examines the appetites of investors for Lao sovereign debt. The study has been completed through the lenses of the capital market and investors. The bond service payments are matched against costing of the 9th NSEDP outcomes and outputs, these results will underpin the formulation of a high-level financing strategy, comprised of a series of policy options to successfully finance and achieve the 9th NSEDP's policy priorities.

The present brief is currently being updated (2021) and will reflect on the government's debt service payments for 2020 and 2021.

B. Sources and assumptions

The report has generated data from various sources that include government and external data. Our debt figures are based on MOF, BOL, Thailand Bond Market Association (TBMA), LSX, SGX, and rating agencies (TRIS, Fitch, and Moody's). The rating agencies confirmed with us that the Lao PDR government had opportunities to review all the facts and figures presented to the public. Thus, we assume that the rating agency's facts and figures are relatively accurate on the dates they published rating reports.

A series of assumptions underpin the assessment. They are presented and analyzed below.

1. **Bond service payments** it is assumed that Lao will be able to meet its service repayments of bonds without having to reschedule, based on pre covid fundamentals and a short recovery period. A prolonged recovery and the advent of any other external shocks (i.e., inflation) may well have a non-positive impact

2. **The 9th NSEDP, will require an extensive level of investments;** early UN estimates based on the historical relationship between investment and growth in Lao PDR indicate approximate investments of 19 % of GDP per year. Such figures need also to account for the service payments that must be made, limited revenues and associated budget deficits. Fiscal space is limited and will possibly require the government look to capital markets to stimulate the economy.

3. **Further downgrading of Lao sovereign ratings is adverted;** it is assumed that the credit rating agencies do not further downgrade Lao sovereigns as this will introduce higher service costs for issued debt. However, the agencies outlook is negative. Moody's cite the following factors that could lead to an upgrade or further downgrade of ratings
   - The negative outlook indicates that an upgrade is unlikely in the near term. Moody's would consider changing the outlook to stable if Lao PDR's financing risks diminished durably on the back of securing various financing options to meet upcoming repayments.

- Moody's would downgrade the rating, in the event of a larger or more rapid fall in foreign exchange reserves and/or further increase in liquidity stress that would make a default by the government on its debt payments increasingly likely.

C. Limitations

Data has been collected from various sources and may not reflect government data sets, a similar problem is also being experienced by the rating agencies and other capital market actors. Although Lao PDR does provide a debt bulletin, clear updates and higher levels of transparency need be fostered.

The development agencies are working with the Department of External Finance and Debt Management to improve debt sustainability policy and reporting. This work needs to be further expanded to cover all debt instruments issued by the government and state-owned enterprises

D. Main findings

The findings presented provides a market perspective of the Lao sovereign bond issues and estimates related to their servicing on the 9th NSEDP. Data was analyses from multiple sources that included Bloomberg, rating agencies, SET TBMA and where data was made available the BoL and the Government. It is noted that whilst some data sets differ most data findings align to external market actors credit opinions. Additionally, as the government introduce new options related to their debt service repayment data are shifting. Currently an update to this analysis is on-going and will update the current information. However, market estimates suggest that sovereign debt levels are approximately near the US$ 1 billion mark.

Main finding 1 – Maturities and Impacts on the 9th NSEDP

The impact of bond servicing cannot be under-estimated when considering the issued bonds that are due to mature during the cycle of the 9th NSEDP. As illustrated over US$ 1,700 million is due to be serviced by the government during the lifecycle of the 9th NSEDP but this will be subject to change as the government are embarking on a strategy to limit debt stress that will involve movement of current bonds issued and the cost of such finance (figure does not include unlisted bonds issued by the government and other SOEs besides EDL-Gen). Hence, a recalibration of the debt service payment impacts to the 9th NSEDP, considering new evolvements within the market will form a critical part of the updated 2021 report.

When compared against GDP the bond payments are found to be manageable in terms of ratio to GDP (Constant US$ 2010). However, revenues have been negatively impacted greatly by the COVID pandemic and increased government expenditure has occurred. The WB are suggesting that the fiscal deficit is expected to rise to between 7.5 to 8.8 percent of GDP and public debt to 65 to 68 percent of GDP, limited fiscal space, the mounting pressure of deficit financing and debt servicing will limit the ability of the Government to stimulate the economy, exacerbating the downturn.

Main finding 2 – Downward Credit Ratings

Moody's 14-Aug 2020 downgrade of Lao PDR issuer credit rating to Caa2 from B3 as Lao PDR now has the lowest sovereign rating in Asia without being in default. We do not believe there is a market demand for a Caa2-rated Asian sovereign bonds.

The negative outlook on Lao, not only reflects a debt maturity wall in the next 3-5 years but also as based on Fitch's potential rating downgrade by 1-2 notches that includes; (i) a failure to proceed on negotiations on its debt restructuring with key creditors, (ii) a discussion on the Debt Service Suspension Initiative announced by the G20, or a search for a joint donor support program, (iii) rising debt servicing costs and (iv) the lack of a coherent strategy to reverse the trends of negative credit ratings

UNCDF believe the bond market conditions in Thailand, Singapore, and Hong Kong **are not favorable** for a **Caa2-rated sovereign issuer, with a negative outlook** to launch in any circumstances, let alone the risk-averse environment where credit analysts expect rising default amid the COVID-19 pandemic. We believe that once the COVID-19 recovery shows positive and Lao PDR has **improved its image** to investors, Lao PDR still has the best issuance chance in the THB bond market since TRIS seems to be more positive on Lao PDR than Fitch or Moody's

Main Finding 3 - Loss of Confidence in the credit markets

Sentiment for new Lao PDR debt in the capital markets is weak, this being linked to the current credit rating, the elevated potential for default and the impact of the pandemic. Although debt is available, it high cost may render such options non-applicable. in the context of debt sustainability. This lack of confidence is built from a myriad of observations that include macroeconomic stability, concerns related to debt sustainability, longer recovery, and limitations of foreign reserves to list a few.

A detailed plan needs be developed by the government to reverse these trends and to instill new investor confidence. **This policy action will be a necessary pre-requisite to increase and diversify FDI.**

Climate finance (UNDESA)

A. Introduction and objectives

The Lao climate finance analysis examines climate finance situation in Lao PDR, reviews climate finance funding sources, including multilateral, bilateral and public-private partnership climate funds that Lao PDR is eligible to and/or has benefitted from. UN DESA, through Strengthening the capacity of developing countries to develop evidence-based, coherent, and well financed strategies to implement the 2030 Agenda project, aims to conduct capacity building activities on international support measures (ISMs) for climate finance for Lao PDR, helping the Government officials and practitioners to develop climate change projects and secure climate financing. The project is funded by the UN Peace and Development Fund. The analysis will be used as basis for capacity building activities on helping the Government officials and practitioners to develop climate change projects and secure climate financing.

The Lao climate finance analysis relies on primary data through key informant interviews and secondary data through desk reviews. Due to absence of a unified climate finance database in the country, the analysis heavily relied on various international climate finance funding sources, for example bilateral and multilateral funds, for the quantitative data.

B. Main findings

1. **A snapshot of Lao climate finance flows**: Lao PDR is vulnerable to climate change impacts and with low coping capacity, adaptation finance has accounted for 71% of the total flows during the period of 2015-2019 (See Figure 1). Grants have accounted for 59% and 49% of the total flows in 2018 and 2019 respectively (See Figure 2). The situation is consistent with general trends of climate finance flows where Least Developed Countries benefit from majority of adaptation assistance, while middle income countries attract majority of mitigation investments. With high debt to GDP ratio, grants will continue to be a priority for climate finance mobilization for Lao PDR. Under such circumstances, it is necessary to explore innovative mechanisms to maximize grant utilization. One of possible options to consider is to leverage grants to support private sector investment in Nationally Determined Contribution (NDC) priority sectors.

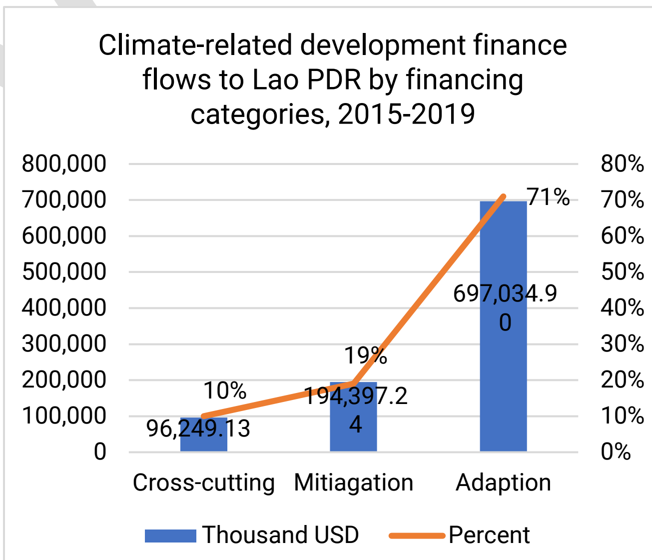


Figure 1: Climate-related development finance flows to Lao PDR by financing categories

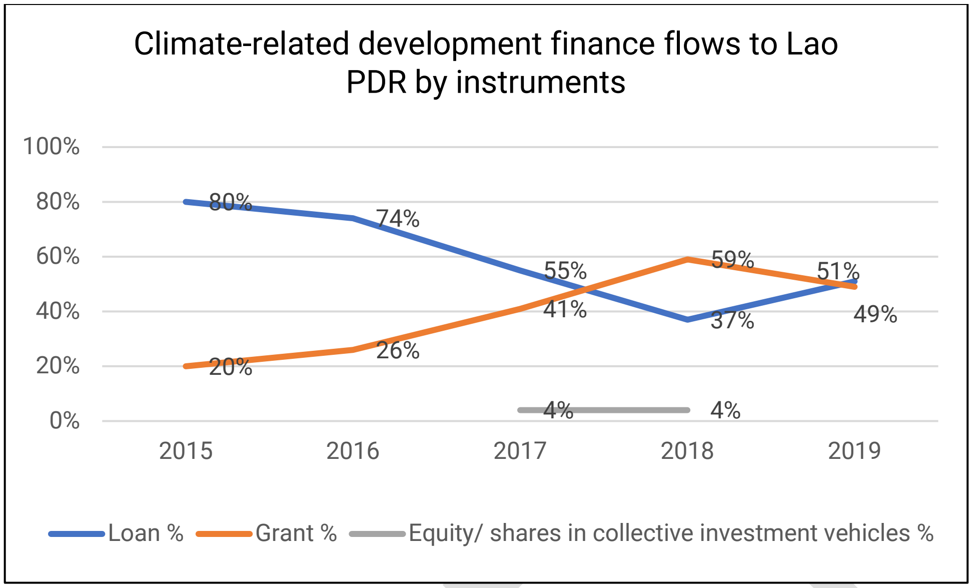


Figure 2: Climate-related development finance flows to Lao PDR by instruments
Source: OECD Climate-related development finance data

2. **Climate Funds:** In total 21 climate funding sources from multilateral, bilateral and private investment channels have been reviewed. The review found that majority of Lao climate change projects are financed by multilateral funds - UNFCCC and non-UNFCCC – which were designed to support LDCs to shift towards low emissions and carbon resilient development. The multilateral funds provide large amount of grants which needed for LDCs which have limited public resources, like Lao PDR. Funds which Lao PDR has not be able to access are often those that do not target LDCs and/or do not have an accessing channel outside host government countries.

3. **How the country access to climate finance funds:** To access to multilateral funds, Lao PDR relies on development partners who are multilateral funds' Accredited Entities (for GCF) or Implementing Entities (for AF) or Partner Agencies (GEF/LDCF). Some of the funds require the government to work with the funds' partners, and, importantly, due to limited capacity and resource of government entities to meet criteria set by the funds. Significant time and resources are required for proposal development to UNFCCC funds, for example one of Lao GCF projects took four years for the proposal to be approved.

4. **Monitoring and reporting on climate finance** should be considered as one of urgent and priority areas to pay attention to. A clear overview of climate finance flows and their use will allow a targeted resourcing and planning of activities towards the NDC. This includes learning from the use of climate finance flows in the past. Good monitoring and reporting system will also enhance stronger confidence with climate finance donors. In this regard, it is important for Lao PDR to establish a standard definition of climate finance and a harmonized system on monitoring and coordinating climate change projects.

5. **Country capacity to access to climate finance funds:** Obviously there is a strong need to strengthen the government's capacity in mobilizing climate finance, the current situation is that they depend on development partners' support. Capacity building initiatives should be designed for a systematic, strategic, and continuous intervention; and avoid short-term one-

off support. Capacity building programmes should integrate climate change, project cycle management, financial management and environment safeguard topics and target both government and private sector entities.

Annex 1 – Questions and Answers

The context

A. What is financing for development and why should we care?

Financing for development is about ensuring the financial resources to support collective ambitions for a more resilient, inclusive, equitable and sustainable future.

Financing for Development focuses on the mobilisation and efficient use of resources in support of the Sustainable Development Goals (SDGs), and is itself an important focus area of Goal 17 on Partnerships for Sustainable Development. Investments in many critical areas are needed, to ensure that the world, and individual Member States, achieve the 2030 Agenda for Sustainable Development adopted in 2015.

As of mid- 2021, as noted the 2021 Economic and Social Council Forum on Financing Development, the situation is critical: the pandemic aggravated a chronic underfinancing of the SDGs, so that several multi-generational objectives, such as the protection of our planet, the elimination of poverty and hunger, and necessary improvements in people's wellbeing, may not be achieved.

B. How has the Covid-19 pandemic affected development financing?

COVID-19 has impacted public finances, with additional health and recovery expenditures and a drop in revenues; the private sector, through lockdowns and disruptions to trade; and development partners, with declining ODA trends.

The pandemic has caused immense suffering across the planet, in the region, and in Lao PDR. The range of impacts on people's wellbeing is wide, with deaths, changes to fertility patterns, long-lasting physical and mental and psychosocial health consequences, especially for most vulnerable groups, disrupted access to essential health services, and weakened social protection systems. On the socioeconomic front, preventative lockdowns, and disruptions to trade and travel, albeit necessary to mitigate the pandemic, have caused unprecedented rises in poverty rates and increased vulnerabilities. At a time where reprioritization of and increases in development spending to cushion these shocks and progressively recover from the pandemic, while progressing towards the SDGs is imperative, the global financial envelope in support of these goals has shrunk.

The financing gap is increasing, with a public sector needing to spend more while managing a decrease in tax revenues, severe stresses in the private sector, and declining trends in Official Development Assistance (ODA) and people having less money to spend. COVID-19 has negatively affected our chances to achieve development priorities.

Albeit privately channelled, remittances are also a form of development financing supporting economic activity, stimulating production and trade, and in turn generates both formal and informal employment. Due to COVID-19 many migrant workers and their families in Lao PDR, responsible for an estimated 1-2% of GDP annually in remittances pre-pandemic, have been impacted by the pandemic. Remittances drastically decreased in 2020 (-0.7% of GDP).

C. What is the United Nations' value added in financing for development and the Integrated National Financing Framework (INFF)?

The United Nations provides clarity of purpose with the Sustainable Development Goals (SDGs) as a common framework, while supporting a holistic and integrated approach to finance progress towards its objectives, engaging all sources of finance including both public and private, domestic, and international, and all relevant stakeholders.

As the United Nations Secretary General sets out in the Strategy for Financing the 2030 Agenda for Sustainable Development, the 2030 Agenda for Sustainable Development aims at a fundamental transformation of society, and its patterns of production and consumption. The United Nations has therefore defined an ambitious common horizon for all relevant stakeholders, to which all national and sector-specific strategies align. In addition, by providing a narrative on the role of finance in support of this commonly agreed set of objectives, the UN offers a holistic and integrated approach, called the Integrated National Financing Framework (INFF), which considers:

- All four sources of finance (public/private and domestic/international) and how they can best contribute to sustainable development with a substantive push to engage the private sector.
- A wide variety of tools: tax reforms, including to internalize the true costs of production and consumption, resource mobilization, improvements in the business environment, regulatory and legal changes to incentivise investments in specific sectors and address illicit financial flows and corruption.
- Additional necessary improvements in data quality, transparency, statistics, and capacity building of key relevant stakeholders.

The United Nations, using its mandate as a convenor and facilitator of systemic change, is, moreover, well placed to support the technical and political dialogues required to engage all in a meaningful shift towards financial flows in support of the SDGs.

A Financing Strategy for Lao PDR

A. Why developing a financing strategy in support of the national development plan in Lao PDR?

Without a clear, practical, and realistic plan to urgently address financial constraints, and match resources with ambitions, engaging all relevant partners and sectors, Lao PDR will struggle to achieve the national development priorities contained in the 9th National Socio-economic Development Plan and the SDGs.

Lao PDR is at a crossroad. The 9th National Socio-economic Development Plan (9th NSEDP) provides a set of ambitious and coherent outcomes and outputs aligned with the SDGs. Now finalized, this framework will guide the country within five years of the 2030 deadline of the Global Agenda for Sustainable Development and to the edge of the anticipated graduation from Least Developed Country (LDC) status in 2026.

With the additional investments required to yield a demographic dividend, address climate change and environmental degradation, and recover from the COVID-19 pandemic, the national agenda is filled with multigenerational and transformational priorities. Simultaneously, access and availability of development finance are constrained, with high levels of debt, revenue collection falling short of expectations, and limited contributions from the private sector to national development priorities.

It is urgent that current financial difficulties threatening the realization of national objectives are addressed through a strategy highlighting necessary policy directions and decisions. Such exercise should ensure that the country optimises available development finance use and mobilises untapped sources whilst addressing sustainably the challenges to a more stable macro-economy. This is a precondition to progress towards sustainability, prosperity, and wellbeing for all.

B. How will Lao PDR formulate a financing strategy? Who participates?

The formulation of a financing strategy is as much a technical as a governance exercise: policy choices to support the sustainable financing of development objectives must rest on evidence-based, technically accurate, and reliable diagnostics, and be participatory, engaging all relevant stakeholders in meaningful policy dialogues.

The formulation of a financing strategy is based on three main steps and is expected to near finalization at the end of 2021, after a year of work:

- The inception phase is to present the INFF approach (see above): this took place at a workshop early April in Vang Vieng.
- The second phase aims to get consensus on the current financing landscape and investment needs to achieve development priorities. This diagnostic phase involves technical work and dialogues, and agreement on main conclusions that will be the backbone of the financing strategy development.
- The third phase involves series of strategic dialogues to interpret and translate initial diagnostics into practical and realistic options.

The formulation is, throughout its two phases, inclusive and participatory, and meant to ensure that all relevant stakeholders can provide inputs and feedback to the policy recommendations that will be made. A dedicated Technical Working Group was created by the Deputy Prime Minister upon recommendation from the Vice-Minister of Planning and Investment earlier in 2021 to facilitate stakeholder mobilisation.

As of late August 2021, the diagnostic phase was nearing finalization and a dedicated structured dialogue to validate the main assessments was to be organised in September. The financing strategy is led by the Ministry of Planning and Investment, namely the Department of Planning, with support from and consultation with the Ministry of Finance, Bank of Lao PDR, and relevant line ministries, as well as from the United Nations (through a dedicated Joint Programme, see below) and International Financial Institutions (IFIs) and other partners. Once the financing strategy is formulated, assessing the success of its implementation is crucial to inform budget decisions: this is the monitoring and evaluation phase.

C. What are the main challenges in formulating a financing strategy?

Challenges are threefold: technical, as the availability of quality data is limited, and limits the reach and robustness of diagnostics, and political and institutional, considering the difficulties associated with convening stakeholders. Fortunately, these difficulties can be overcome through active participation of all relevant stakeholders, clear communications, and a political push from the Government.

The formulation of a holistic financing strategy, considering all sources of financial contributions to sustainable development, is full of challenges. Credibility, technical accuracy, political support, and communications are critical in a process that is both political and technical, and therefore highly demanding. Technically, challenges arise mostly during the diagnostics phase (see above). Data limitations and difficulties in interpreting economic and financial data, as well as the uncertainties of budget and macroeconomic forecasts at a very uncertain time, must lead analysts to adopt careful research methodologies, and clearly highlight assumptions (e.g., there can be several GDP growth assumptions when forecasting) and limitations (e.g., part of the State budget is not publicly available). It is crucial that diagnostics aiming to paint a clear picture of the financial constraints of Lao PDR are undertaken with as much rigour as possible to generate maximum credibility. The formulation of a financing strategy is as much, if not more, about policy decisions as it is a technical exercise. Indeed, as mentioned above, identifying policy choices across four different sources of finance implies the active participation of a wide variety of stakeholders: Government, bilateral partners, traditional development partners, the private sector, including the financial sector and to gain the trust of society, also the need for transparency in the exercise.

In this context, the clarity of the process, including the sequencing of the various dialogues, is important. Political support from the highest level of decision-makers in the country to put financing for development high on the national agenda can improve visibility and create momentum. Moreover, adequate communications, capable to simplify technical content into easily digestible information and to reach various audiences, the timely circulation of information, and the quality of translation and interpretation during dialogues too help mitigate the difficulties of convening and generating meaningful discussions between different stakeholders are all vital to the process.

The UN Joint Programme on Financing Efficiency

A. What is the role of the UN Joint Programme on Financing Efficiency?

The UN Joint Programme provides technical and coordination support to the Lao PDR Government across the three main stages of the Integrated National Financing Framework (INFF) implementation: diagnostics of the country's financial constraints, formulation of credible and realistic policy options, and monitoring and evaluation of progress towards the implementation of a holistic and ambitious approach to development finance.

The United Nations Joint Programme on Efficiency and Optimization of Lao PDR's Public budget to finance the SDGs through the National Plan works to strengthen the national architecture for managing and allocating development finance to support more efficient and effective use of available resources, and mobilisation of other sources of finance in support of national priorities and the 2030 Agenda.

As the main vehicle to support the formulation of a financing strategy for the 9th NSEDP, it is coordinated by the Ministry of Planning Investment, Department for International Cooperation (DIC), and the United Nations Resident Coordinator's Office (UNRCO), and involves the Ministries of Finance (MoF), Planning and Investment (MPI), and Health (MoH), as well as UNFPA, UNCDF, and UNDP, which is the technical lead entity from the UN country team.

Three main workstreams are progressing in parallel and align with the three main stages of the INFF development, mainstreaming governance and coordination support throughout. Assessments and diagnostics in support of the financing strategy are primarily led by the Department of Planning of MPI, with technical support from UNDP, through the identification of all resources available to fund development, and an assessment of the investment needs to reach shared development objectives (see below). The financing strategy formulation is also mainly supported by UNDP, which provides technical and coordination support to MPI to develop a practical financing strategy for the 9th NSEDP, through series of dialogues with relevant stakeholders. UNFPA, under MoH's strategic guidance, and considering its specific mandate and expertise in the health sector, contributes to assessments, costing health sector priorities, and policy formulation, identifying health interventions with the highest development returns in a resource-constrained environment. As to the monitoring and review of the implementation of the financing strategy, this is supported, under strategic guidance from MoF, by UNCDF, which uses its expertise to develop an innovative methodology to track expenditures against development priorities.

B. What is a Development Finance Assessment (DFA)?

The DFA is the analytical backbone of the financing strategy: it maps Lao PDR's resources envelope and seeks to understand to what extent and how each financial source has contributed and can contribute to sustainable development.

The DFA guidance developed by UNDP provides extensive details on the role of this diagnostic tool and its position in the INFF cycle. This instrument, which has been completed or is ongoing in almost 50 countries, is essentially supporting the diagnostics phase. It is, in fact, the analytical backbone of the financing strategy. Investigating the contributions of the four different sources of finance in the economy – State budget, domestic private sector, international private sector, and Official Development Assistance (ODA) – the DFA will provide policymakers with a set of key findings and directions during the financing strategy formulation.

The DFA is however, not only an analytical piece. In Lao PDR and elsewhere, it is also a tool through which the coordination of the most relevant stakeholders first takes place and can facilitate the emergence of a consensus on the panorama of development finance. Active participation of all relevant parties early in the process, including during the most technical phase of the process, is crucial. The DFA main findings, led by MPI with the support of UNDP, will be presented at a first structured dialogue, which should happen in September 2021.

C. Why focusing on the health sector in a Joint Programme on financing for development?

The model investment case for the health sector not only supports the identification of most relevant interventions in a crucial sector for Lao PDR, but also ambitions to set a standard in evidence-based policymaking, when robust diagnostics, the costing estimates of health interventions and development returns, inform prioritization.

This workstream, led by MoH with UNFPA's support, has two parallel objectives: identify most relevant and efficient interventions in the health sector, and set a precedent in terms of evidence-based policymaking. The selection of the health sector is based on the role of improvements of development outcomes in the health sector in achieving national development priorities (considering the 9th NSEDP prioritization of investments in human capital), the 2030 Agenda for Sustainable Development, and LDC Graduation. with regards to the health dimension, the project has two objectives, at both the national and provincial levels, which are to (1) estimate the costs, health impacts, and economics impacts of scaling up health interventions, and (2) develop a prioritization strategy. Its role in setting standards in terms of evidence-based policymaking is equally important. The project, focusing on a specific sector, is indeed structured along the same phases identified in the INFF, with an initial diagnostics phase, in which health interventions are costed and development returns measured, followed by a policy formulation phase, in which prioritization of interventions is developed. It is hoped that the lessons learnt from this project will support the many ongoing reforms, supported by the development community, of Public Financial Management (PFM), and specifically public investment management, to ensure the more efficient and targeted use of available development finance.

D. What are the objectives of the tagging of the national budget with national priorities and the SDGs?

Setting up systems to monitor and evaluate the progress of the implementation of the financing strategy is essential: ensuring that we know what investments contribute to, in a resource-constrained environment, will help to reorient budget allocation and strengthen the linkages between planning and financing.

Few countries have worked on strengthening the link between budget processes and SDGs and national priorities. In Asia, Lao PDR could be a pioneer. The workstream led by the MOF and supported by UNCDF is located at the tail end of the INFF cycle, as it builds monitoring and evaluation systems. The development of a specific methodology to categorise public investments and of a review of financial flows, against the national development priorities and the SDG framework, will help us understand where and for what resources are used, and strengthen the accountability of Government to its citizens. The encoding of these frameworks directly within the national budget, through the Chart of Accounts and the Integrated Financial Management Information System, ensures that economic policymakers can plan budget allocation being aware of which sectors and priority areas are underfunded. SDG-tagging of the budget will thus facilitate the formulation of an optimized public sector budget. The tool will help inform decision-makers and support coordination of ministries and partners against a unique framework. This new system is also meant to measure the success of the implementation financing strategy, specifically on domestic public resources.