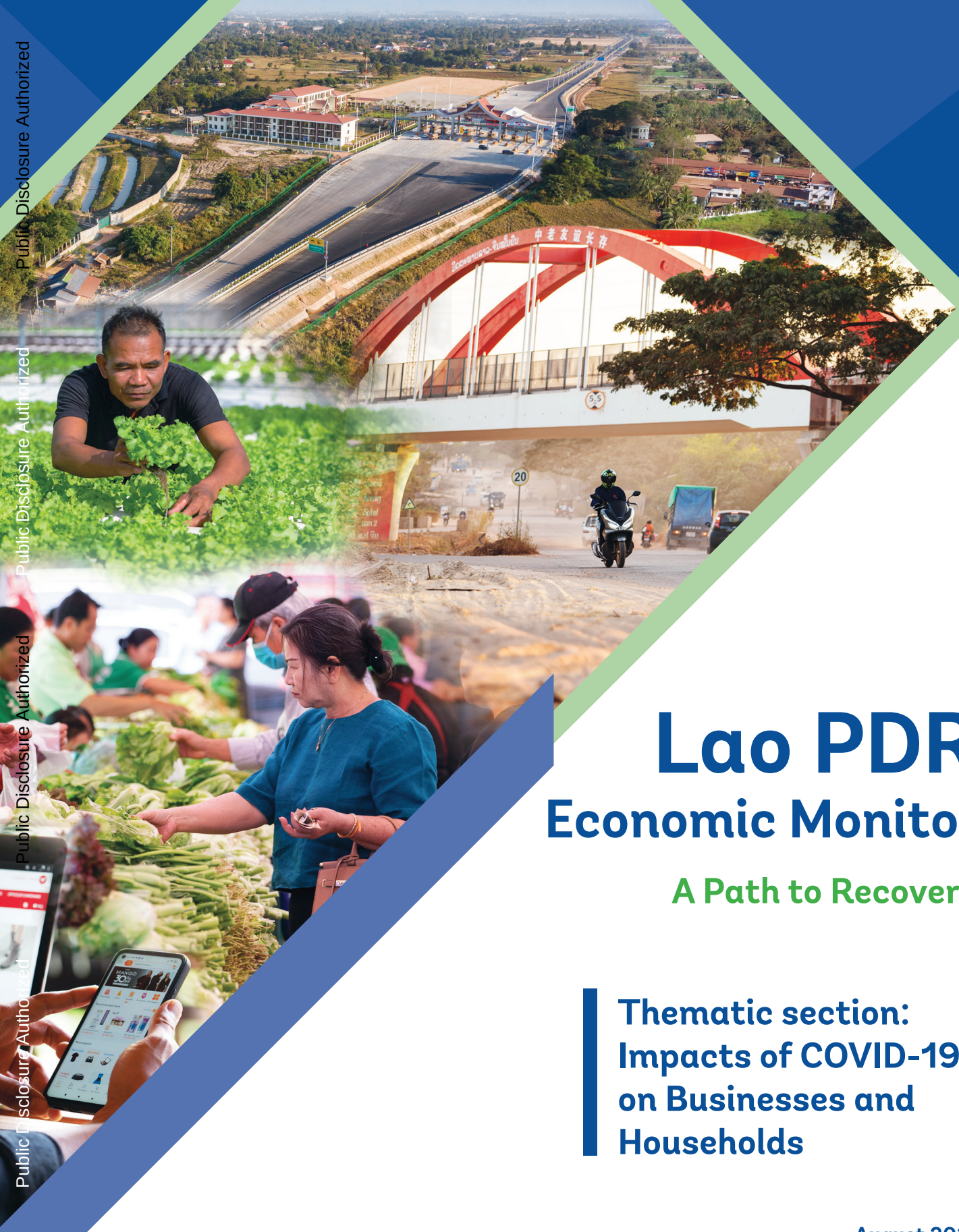

Lao PDR
Economic Monitor
A Path to Recovery

Thematic section: Impacts of COVID-19 on Businesses and Households

August 2021

Macroeconomics, Trade and Investment Global Practice
East Asia and Pacific Region

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The Lao PDR Economic Monitor provides updates on macroeconomic developments and sectoral issues in the country. It is produced biannually and distributed widely to government agencies, development partners, the private sector, think tanks, civil society organizations, and academia.

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Abbreviations

BCEL	Banque Pour Le Commerce Exterieur Lao Public
BPS	Business pulse survey
BoL	Bank of the Lao PDR
COVID-19	Coronavirus disease 2019
DSSI	Debt Service Suspension Initiative
EAP	East Asia Pacific
EDL	Electricité du Laos
EMDEs	Emerging Market and Developing Economies
FDI	Foreign direct investment
GoL	Government of the Lao PDR
ICBC	Industrial and Commercial Bank of China
MoF	Ministry of Finance
MOIC	Ministry of Industry and Commerce
NC	Non-concessional
NPV	Net present value
PBOC	People's Bank of China
PMI	Purchasing Managers' Index
TESDA	Technical Education and Skills Development Authority
UNDESA	United Nations Department of Economic and Social Affairs
yoy	Year-on-year

All dollar ($) amounts are US dollars unless otherwise indicated

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Photo: Phoonsab Thevongsa

Executive Summary

Part I: Recent Economic Developments

Recent Economic Developments in Lao PDR

The economic recovery in 2021 is likely to be slower than anticipated, mainly owing to containment measures introduced to tackle a second wave of COVID-19. Real GDP growth is projected to rebound to 3.6 percent in 2021, from 0.5 percent in 2020. This forecast has been revised downwards from the 4 percent growth projected in March 2021 due to the recent outbreak. The agriculture and industry sectors are expected to drive growth, supported by solid external demand as key trading partners recover. There has been strong growth in the exports of key agricultural products, such as banana, cassava, coffee beans, and rubber, while industry sector growth reflects a strong rebound in energy, mining, and export-oriented manufacturing and processing activities during the first 5 months of 2021. However, the services sector – especially hospitality, transport and other tourism-related services – are struggling to recover as the second COVID-19 wave (since mid-April) has reversed the initial recovery in Q1 2021.

The fiscal deficit is expected to narrow slightly to 4.7 percent in 2021 from 5.2 percent in 2020, due to some improvement in revenue collection and contained spending. While revenue collection rebounded in H1 2021, expenditure tightening continued. Revenue performance in H1 2021 showed signs of recovery with domestic revenue reaching 9.8 trillion kip in H1 2021, or 12 percent year-on-year (yoy) growth, supported by a strong rebound in tax and non-tax revenues. However, prolonged negative impacts from the second wave and the extended lockdown are expected to affect revenue collection in H2 2021. Total revenue-to-GDP ratio will fall further, from 12.6 percent in 2020 to about 12 percent in 2021, mostly on account of lower profits, income taxes, and non-tax revenues. The authorities have continued to limit budget spending growth by controlling discretionary expenses and postponing new investment projects. As a result, total expenditure is likely to decline to 16.7 percent of GDP in 2021, from 17.8 percent in 2020. The fiscal deficit is therefore expected to decline to 4.7 percent of GDP in 2021, from 5.2 percent in 2020.

Executive Summary

Given high fiscal deficits, total public and publicly guaranteed (PPG) debt has reached critical levels, jeopardizing macroeconomic stability. Total PPG debt (external and domestic) reached $13.3 billion, or 72 percent of GDP in 2020 from 67.3 percent in 2019. The government has mostly relied on non-concessional debt to finance investment projects and refinance debt. The energy sector, mostly represented by Electricité du Laos (EDL), plays an important role in public debt accumulation and debt service, accounting for about 36 percent of total PPG debt outstanding in 2020.

The risk of external debt distress remains high, while reserve buffers remain low. The cost of financing has risen due to growing debt levels, an increasing reliance on non-concessional borrowing, and rating downgrades by Fitch and Moody's. On average, $1.3 billion of public external debt service (not including guarantees) are due each year during 2021-25, of which more than half are on commercial terms. Total PPG debt service is expected to reach 52.5 percent of total public sector revenues (government and EDL) in 2021, well above the low-income countries indicative threshold of 14 percent. Meeting external debt service obligations is more difficult in the context of limited foreign reserve buffers, which totaled about US$1.2 billion in May 2021, and low foreign currency revenues, with debt-service obligations exceeding current reserve levels.

The current account deficit is expected to widen slightly in 2021, as growing external interest payments likely to offset the improvement in the goods trade balance. Solid export growth, supported by stronger external demand and higher commodity prices, is expected to improve the merchandise trade balance. In contrast, high external interest payments on external debt, and a reduction in remittances – as many migrant workers returned from Thailand, will likely offset the improvement in the trade balance, leading to deterioration of the current account deficit in 2021.

Reflecting tighter external liquidity constraints, the kip continues to depreciate, and the parallel market premium has risen to a new high. Foreign currency liquidity shortages in the official exchange market have caused a demand-supply mismatch, widening the spread between the official and parallel market rates. The kip depreciated against the US dollar by 12.6 percent yoy in early July, while it depreciated by 8.2 percent yoy against the baht. In the foreign exchange market, the gap between the official exchange rate and the rate quoted by exchange bureaus remains large, widening to 17 percent in early July. A weakened kip has fueled domestic inflation and exacerbated external debt service costs.

Headline inflation rebounded in June 2021, driven by continuous increase in food and fuel prices and by core inflation. Headline inflation rose to around 4 percent yoy in June from 2 percent yoy in January this year, driven by high food and fuel prices and core inflation. Increasing food prices have affected food security, particularly for the urban poor and those who have lost income due to the pandemic and containment measures.

Economic Outlook and Risks

The economy is expected to gradually recover in the medium-term, but growth will remain below pre-pandemic levels at 4.5 percent in 2022. The recovery is expected to be supported by solid export growth as external demand rebounds, a gradual recovery of the services sector and investment in infrastructure. After the conclusion of the Lao-China railway this year, the development of secondary infrastructure is expected to take place along the railway corridor. In addition, investment in highways between Vang Vieng-Boten and other southern routes are also in the pipeline. Exports will benefit from China's Generalised Scheme of Preferences for 97 percent of export products, and from signing of the Regional Comprehensive Economic Partnership. However, momentum on doing business reforms and trade facilitation would need to increase to boost private investment and exports – as well as to maximize the benefits from improved connectivity. In addition, as the COVID-19 vaccination rollout gathers pace in neighboring countries and advanced economies, international travel is expected to gradually resume, supporting the recovery of tourism and the services sector.

Photo: Phoonsab Thevongsa

The economic outlook is subject to significant downside risks. The main external risks include: (i) slower-than projected growth in key trading partners; (ii) delays in vaccination rollout in the East Asia Pacific (EAP) region and in the advanced economies that are critical to revived international tourism and foreign investment. In addition, key domestic risks include: (i) a protracted community outbreak could further delay resumption in local economic activities; (ii) a weaker recovery and contingent liabilities related to a potential worsening of EDLs financial situation could in turn exacerbate fiscal imbalances and jeopardize debt sustainability, Moreover, persistent foreign currency liquidity constraints also pose a risk to external solvency when debt service dues are high; (iii) a weaker-than-anticipated economic recovery could exacerbate the already poor revenue performance, keeping the fiscal deficit and public debt elevated; (iv) a deteriorating financial status at EDL, leading to higher debt burden on the government; (iv) prolonged implementation of credit forbearance credit policies, which could worsen bank balance sheets and heighten the existing financial sector vulnerabilities; and (v) slippages in doing business and trade facilitation reforms, which could curb benefits from the Lao-China railway and other infrastructure.

Executive Summary

Policy Considerations

To restore macroeconomic stability, the focus should be on managing debt in a more sustainable and transparent manner, strengthening fiscal sustainability, and reducing financial sector vulnerabilities. Firstly, debt sustainability requires taking advantage of debt relief mechanisms and strengthening debt management and transparency. Debt restructuring with key lenders, particularly with China, is also needed to lessen the debt service burden in the short to medium term. The formulation of a comprehensive debt management strategy could anchor debt sustainability in the longer run. Secondly, fiscal consolidation needs to be driven by improvements in revenue performance, as further expenditure compression could undermine social service delivery. Reviewing tax exemption policies, strengthening revenue administration, and expanding the use of electronic systems are crucial. SOE reforms would also help reduce potential contingent liabilities. Thirdly, financial sector stability requires stemming the deterioration in banks' balance sheets and putting in place key legal and regulatory tools to manage fallout from the crisis. Measures include unwinding forbearance policies in a prudent manner, based on enhanced banking supervision and coordination between BOL, MOF, MPI and industry players. In the medium term, adopting risk-based supervision, establishing an early warning system for banking supervision, and developing a crisis management framework are crucial to ensure stability.

Photo: Phoonsab Thevongsa

Part II. Thematic Section: Impacts of COVID-19 on Businesses and Livelihoods Recovery

Impacts of COVID-19 on Businesses: Key Findings from Recent Business Pulse Survey

Mandated shutdowns, health concerns, and falling demand from the second outbreak have caused major disruptions to operations and deepened impact on business performance. A survey of 421 firms in April-May 2021 indicates that the second wave of COVID-19 has had severe impacts on sales. Annual sales in 2020 fell by more than 40 percent on average relative to 2019. While agriculture, manufacturing, and wholesale/retail activities showed signs of recovery after the first lockdown, persistent negative impacts in hospitality and other service sectors slowed down overall recovery. With the second outbreak ongoing, businesses face major disruptions, deepening the shock on sales. Fewer than 40 percent of firms remained open in April/May 2021. The drop in monthly sales increased from 31 percent in March/April 2020, to 48 percent in March/April 2021. Overall, SMEs and firms in Vientiane Capital and Luang Prabang have suffered a disproportionally larger impact. The effect on jobs has been more muted, but average employment has also declined.

Many businesses face liquidity shortages and payment difficulties. Almost half of all firms have reported cashflow shortages and more than one third have already delayed at least some payments for more than a week. At the time of survey, a relatively low share of firms, 0.32 percent, had filed for insolvency or bankruptcy. However, liquidity pressure may push more firms into increased risk of default and insolvency. More than a quarter of firms expect to fall into arrears in the next six months.

Further, heightened uncertainty and a pessimistic outlook may drag on future productivity. A substantial share of firms has reduced investments in 2020 and the majority expect investment to decline in the next six months. Worryingly, firms that have already reduced investment are expecting to cut investment further, further lowering their prospect for recovery. One potential positive impact of the COVID-19 pandemic on long-term productivity is through accelerated digital adoption. Evidence from the Lao Business Pulse Survey (BPS) indeed suggests that around 16 percent of firms have invested in digital technologies or adopted new delivery methods, which are associated with lower sales losses. At the same time however, the rate of digital adoption in Laos lags behind other countries in the region. Survey results suggest that uncertainty about the benefits of digital solutions and lack of skills among employees are the main obstacles to investment in digital solutions. Help for firms to overcome these barriers will be needed to turn this crisis into an opportunity for improved future productivity.

However, government support to firms is still limited in both coverage and types of instrument. At the time of survey, almost half of businesses reported that they are not aware of government support programs. Close to 30 percent of firms have applied for or received national or local government support, one of the lowest access rates in East Asia. Further, access to government assistance has been largely through fiscal exemptions, tax reductions or deferrals, and has benefited large firms disproportionally. Close to half of SMEs are not aware of the available support policies.

Executive Summary

Livelihoods Recovery: An Uneven and Uncertain Path

Livelihood recovery was robust but uneven before the second wave of COVID-19 arrived. By the end of Q1 2021, the labor market had recovered from the first wave of COVID-19, although hospitality and transport, and manufacturing continued to suffer. The share of employed adults bounced back strongly from 70 percent during June–July 2020 to the pre-pandemic level of 83 percent in Q1 2021. The rebound was largely driven by the ability of the agriculture sector to absorb surplus labor affected by pandemic shocks. Notwithstanding the overall recovery, family businesses struggled to recover. Soaring food prices weighed negatively on the recovery, notably among the urban poor. While there was no incidence of severe food insecurity (hunger), moderate food insecurity reached worrying levels in February–March 2021.

As the second outbreak has prompted a momentary setback in the recovery, the road ahead is shrouded in uncertainty. The share of employed adults dropped sharply to 49 percent in May 2021. Family businesses were negatively affected. Around one-third of family businesses closed temporarily, and for those that remained open, more than half experienced declining revenue. Agriculture still proved more resilient to pandemic shocks than other sectors. However, restrictions on movement and transportation disrupted farming activities among 14 percent of farming households. The second wave of the pandemic inflicted further loss in household income, which had only partially recovered from the first wave. Concern about food insecurity increased across the board. More than 25 percent of households were very concerned about food insecurity for people in their community, an increase from 16 percent before the second wave began.

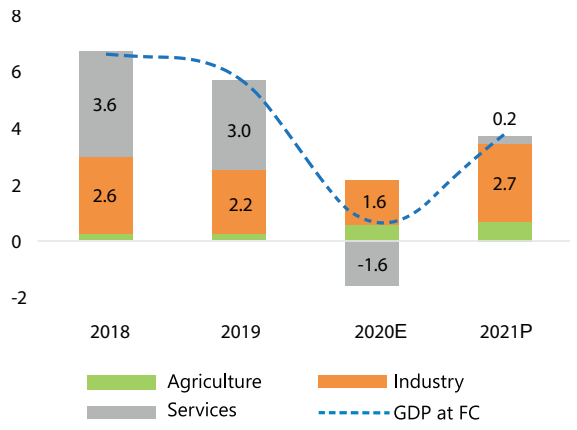
Policy Considerations

Effective support for recovery will require efforts to reach more SMEs and broaden access to policy instruments beyond fiscal exemptions. Some key policy options to support firm recovery include (1) better targeting, which could help allocate resources to the most needy firms given the government's limited fiscal space; (2) broadened support using other policy instruments beyond fiscal exemptions; (3) orienting the set of instruments to not only buffer the liquidity shock but to also improve company capabilities, such as supporting the adoption of digital technologies; and (4) providing support measures on the demand side, such as gradual relaxation of containment measures as the COVID-19 situation in the country improves to support businesses and create more jobs, boosting income and mobility and domestic consumption; and also helping exporters quickly benefit from the preferences granted recently by major trading partners. This will be critical as SMEs and exporters are already reporting more difficulties on the demand side than on the supply side.

The recent lockdown requires the government to further prioritize spending and to enact livelihood protection and employment support measures that will put the recovery back on track. Further ahead, policies are needed to promote a robust and more equal recovery. The second wave and lockdown measures make it more challenging for vulnerable households to maintain their livelihoods. Livelihood protection measures such as unemployment benefits or cash transfers can mitigate the negative impact of job loss during the lockdown. This requires the expansion of various government schemes to allow greater coverage of vulnerable groups, and to include female workers and those employed in the hardest-hit sectors. Employment support measures such as assistance to family businesses and employers could ensure that workers will be able to resume their jobs once lockdown measures are lifted. Efforts to bring down staple food prices, such as facilitating domestic food production and supply chains, should continue as persistent food security problems would have a long-term impact on human capital, especially among vulnerable populations.

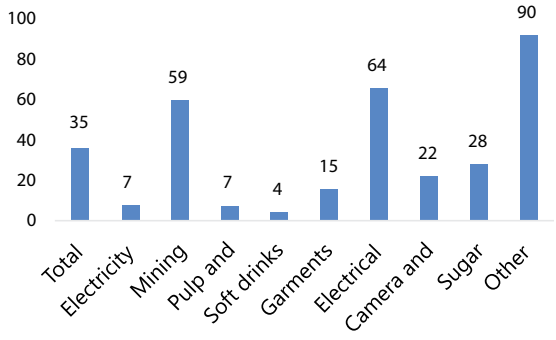
Lao PDR: Key Macroeconomic Indicators at a Glance

Real GDP growth is expected to recover in 2021
(percentage point)



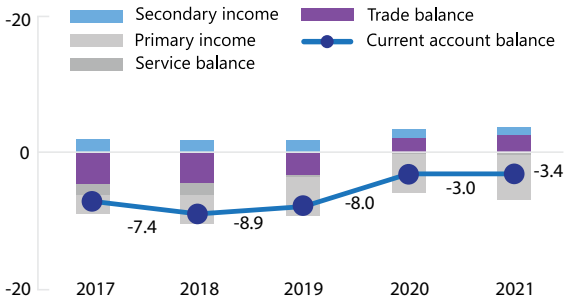
Source: Lao Statistics Bureau, World Bank staff estimates.

...driven by solid industrial and agricultural export growth
Major exports growth in Jan-May 2021
(yoy percent change)



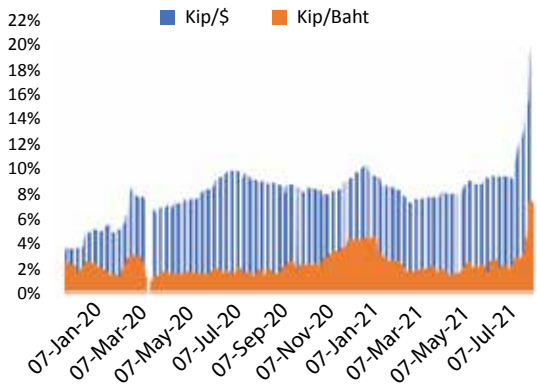
Source: MOIC, World Bank staff estimates

The current account deficit is expected to widen in 2021 despite strong exports, due to high external interest payments and subdued tourism recovery
(percent of GDP)



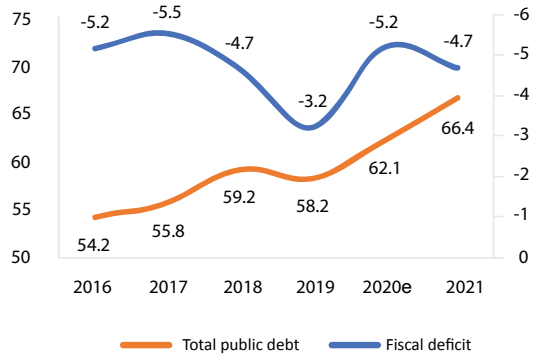
Source: World Bank staff estimates based on data from BOL and trade partners

Official-exchange bureau exchange rate gap for Kip/$ widened sharply



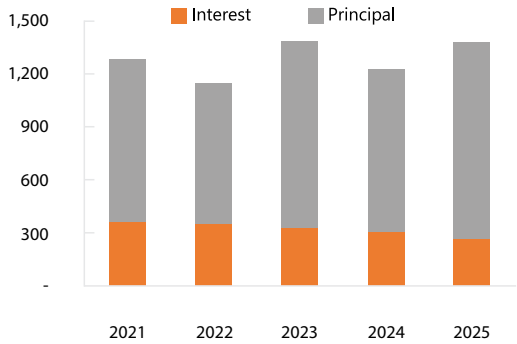
Source: IMF Country Office

COVID-19 impacts reversed gains in fiscal consolidation (in percent of GDP)



Source: WB estimates based on MOF data

Public debt service due remains significant in the medium-term (in US$ million)



Source: MOF

Photo: Phoonsab Thevongsa

PART A.
Recent Economic Developments

1. Global Economic Developments and Outlook[1]

Global vaccination progress remains highly uneven. More than 50 percent of the population in advanced economies have received at least one dose of vaccine by mid-July, in contrast to around 1 percent in low-income countries. Meanwhile, daily new COVID-19 cases have crept up in July and hit their highest level since late May, largely reflecting the global spread of the Delta variant.

Global economic growth remains strong but is moderating amid the lingering COVID-19 pandemic. The global composite PMI slowed to 56.6 in June, down from 58.5 in May, but was among the strongest recorded in over 15 years. The expansion in the manufacturing PMI, while still solid, edged down to a four-month low, partly reflecting renewed softness in some large EMDEs. Inflationary pressures have built alongside the recovery in activity. However, survey data point to a deceleration in EMDE input prices in June, amid softening prices in China.

The recovery in global activity has been accompanied by a sustained increase in global trade. Global goods trade volumes expanded further in April, reaching 9.5 percent above the pre-crisis level. Manufacturing trade has been however constrained by supply and logistic bottlenecks. Global financing conditions have been recently showing signs of divergence across advanced economies and EMDEs. Pandemic setbacks and country-specific risks have also continued to push up spreads and borrowing costs, and to weaken domestic currencies in some EMDEs. Commodity prices have risen in 2021, with most exceeding their pre-pandemic levels (figure 1.A).

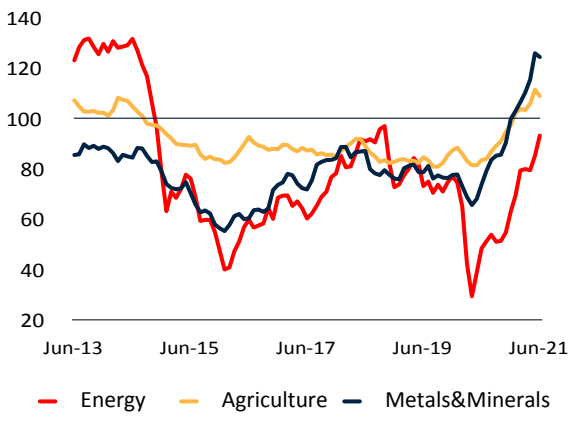
Following a sharp contraction in 2020, a stronger-than-expected global recovery is envisioned in 2021, supported by a large fiscal expansion in the United States. The global economy is set to expand by 5.6 percent in 2021 — its strongest post-recession pace in 80 years (World Bank 2021). However, the recovery is expected to be highly uneven (figure 1.B). In many EMDEs, elevated COVID-19 caseloads, obstacles to vaccination, and a partial withdrawal of macroeconomic support are offsetting some of the benefits of strengthened external demand and elevated commodity prices. Economic growth in the EAP region is projected to accelerate to 7.7 percent in 2021, led by a strong rebound in China. Recovery in the region when excluding China is expected to be protracted, with economic activity expanding by 4 percent in 2021 (on average) – despite significant cross-country variations. This projected growth would not be sufficient to fully undo the pandemic-related output losses in many regional economies, with output in about two-thirds of these expected to remain below pre-pandemic levels until 2022.

There is high uncertainty around the global growth forecast. The sustainability of the recovery depends on the duration of the pandemic, the effectiveness of policy actions in achieving widespread vaccination and preventing financial meltdowns, and the resumption of global travel. The global recession will be deeper than the baseline forecast if it takes longer than expected to bring the pandemic under control, or if financial stress triggers cascading defaults. Thus far, extraordinary policy responses have prevented the slowdown in activity from becoming a financial crisis. Nonetheless, financial conditions will remain fragile for many economies. A prolonged disruption to economic activity could exacerbate financial stress, which could lead to widespread financial crises.

1 Draws on the WB June 2021 Global Economic Prospects (GEP) report and April 2021 EAP update.

The COVID-19 pandemic is likely to have enduring impacts, including lower investment, weak consumer confidence, and erosion of human capital. The long-term damage related to the pandemic will be felt through multiple channels and will be particularly severe in economies that suffered the most from extended outbreaks of COVID-19, the collapse of global tourism and trade, and financial crises.

Figure 1.A. Commodity prices (Index, nominal term, 2010 = 100)

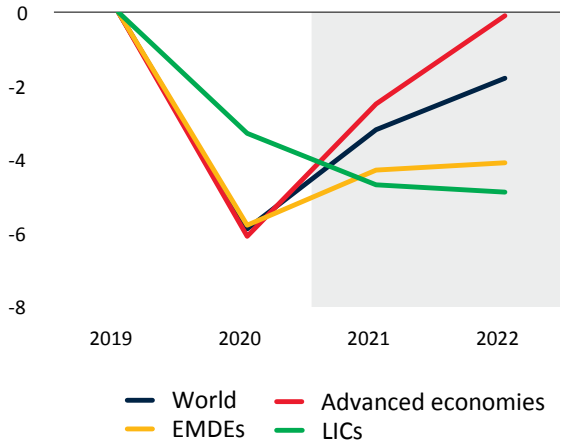


Source: Haver Analytics; World Bank.

Note: Last observation is May 2021.

Figure 1.B. Deviation of output from pre-pandemic projections

(Percent)



Source: Bloomberg; World Bank; World Health Organization

Note: AEs = advanced economies; EMDEs = emerging market and developing economies; LICs = low-income countries. Unless otherwise denoted, aggregates are calculated using real US dollar GDP weights at average 2010-19 prices and market exchange rates.

2. Recent Economic Developments in Lao PDR

2.1 The Real Sector

The second wave of COVID-19 has decelerated the pace of economic recovery

Prior to the second outbreak of the pandemic in mid-April 2021, Lao PDR had one of the region's lowest rates of COVID-19 cases, with relatively mild mobility restrictions and signs of recovery in Q1-2021. However, the second outbreak has led to the re-introduction of containment measures, for a longer period than in 2020. These have severely curtailed mobility and thus affected economic activity. Although the government has been able to contain local community outbreaks, there is still a worrying level of imported cases (about 100-200 cases per day in recent weeks) as many migrant workers return home[2].

The Lao economy is projected to rebound at a slower pace than previously expected, due to the recent outbreak of COVID-19 and the resultant lockdown measures. Real GDP growth is projected to increase to 3.6 percent in 2021, from 0.5 percent in 2020 (Figure 2), with a slower recovery than in other ASEAN countries (Figure 3). This forecast has been revised downwards from the 4 percent growth projected in March 2021.[3] The agriculture and industry sectors, supported by strong external demand and less affected by containment measures, are projected to recover faster than the services sector. However, the services sector – especially hospitality and transport, and other tourism-related services – are struggling, with the second COVID-19 wave reversing the initial recovery of Q1-2021 (See Thematic Section). Vaccination rates have picked up, but further progress is needed, especially outside the capital.As of August 8, about 19.1 percent of the population had received a first dose, and 17 percent a second dose – against a target of 50 percent by the end of 2021. (See key assumptions in Box 1)

Box 1. Key assumptions

Near-term assumptions

- Strong external demand, due to recovery in neighboring countries, will continue for the rest of 2021.
- Vaccination pace will speed up towards the end of 2021 and prevent community outbreak over the rest of the year and in the medium-term.
- No severe disasters (floods, earthquakes, animal diseases spread).
- Power generation continues to increase as projects reach full capacity.
- Slow recovery of the services sector due to subdued tourism.
- Public spending and investment are constrained due to fiscal consolidation and the high debt service burden.

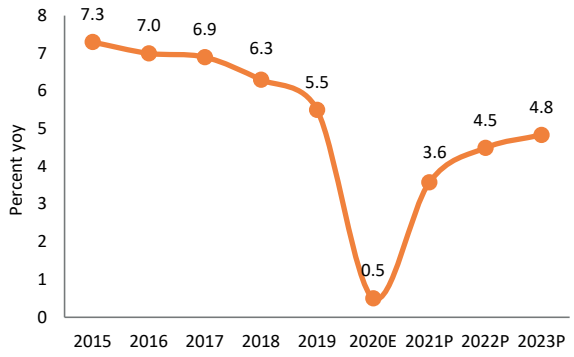
Medium-term assumptions

- As neighboring countries continue to recover, external demand will continue to be solid,
- Improved connectivity after the railway operation will boost private investment in secondary infrastructure and investment in productive sectors along the railway corridor.
- Vaccination gathers pace (50% in 2021, 80% in 2022, with gradual opening of borders and a recovery in tourism (at least between Laos and China), supporting recovery in the services sector.

2 The COVID-19 cases in Laos have jumped quickly from around 2,000 cases in mid-June to 9,894 by 14 August 2021 driven by imported cases as thousands of migrant workers return home from neighboring countries.

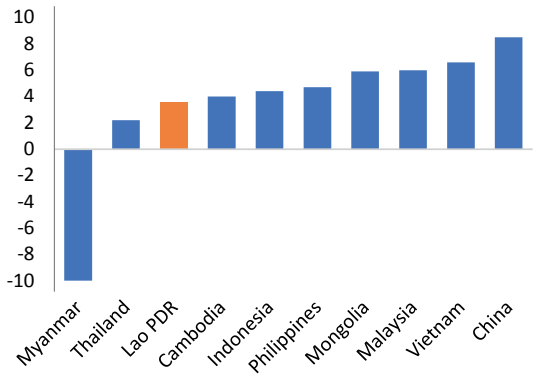
3 Refer to the Macro Poverty Outlook March 2021. https://www.worldbank.org/en/publication/macro-poverty-outlook/mpo_eap

Figure 2. Growth is expected to rebound in 2021
(percentage)



Source: World Bank staff estimates and projections.

Figure 3: Regional economies are expected to recover at varying pace in 2021
(percent)



Source: Global Economic Prospects, June 2021

Expansion in industrial and agricultural output and exports will drive growth in 2021. Lao exports grew by 35.8 percent[4] over the first five months of 2021 (reaching nearly $3.2 billion, compared to $2.3 billion in January-May 2020), supported by agricultural and industrial output. Agricultural and industrial output are projected to grow by 3.9 and 6.6 percent in 2021, respectively, up from 3.2 percent and 4 percent in 2020 (Figure 4). The services sector, however, is struggling to rebound due to the measures implemented to contain the second COVID-19 wave (See Thematic Section). A modest growth rate of 0.6 percent is projected for the services sector in 2021. Overall, real GDP growth is forecast to reach 3.6 percent in 2021, of which about 2.7 percentage points will be contributed by industry, around 0.6 percentage points by agriculture, and about 0.2 percentage points by services (Figure 5).

Figure 4. Industry and agriculture sectors will drive recovery
(yoy percent change)

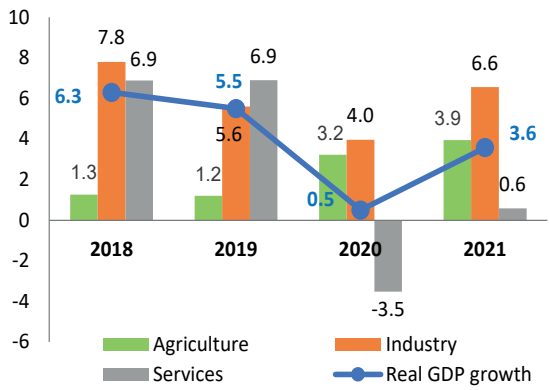
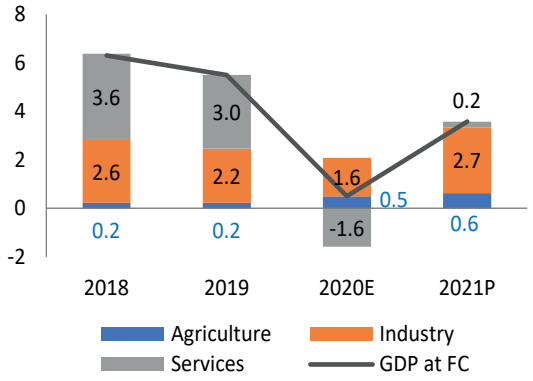


Figure 5: Higher contribution from industry and agriculture sectors
(percentage point)



Source: Lao Statistics Bureau, World Bank staff estimates and projections from 2020 onward.

4 Estimate based on MOIC and key trading partners data.

The economic recovery has varied across sectors

Growth in agriculture is expected to be solid, driven by external demand, especially from neighboring countries. The estimated growth of 3.9 percent in agriculture over 2021 will be mainly supported by expanded production and export of key agricultural products such as banana, cassava, coffee beans, live animals and rubber — despite some contraction in fruit, corn, and rice exports (Figure 6). Major products like bananas, cassava, coffee beans, live animals and rubber accounted for nearly 90 percent of agricultural exports in January-May 2021 (Figure 7). The total value of agricultural exports increased from $504 million in January-May 2020 to $691 million in January-May 2021, supported by external demand and prices. Crops and livestock farming would be key drivers for future agricultural growth. In addition, the agriculture sector has helped absorb labor that left other sectors due to the pandemic.

Figure 6. Robust agricultural export growth Jan-May 2021
(yoy percent change)

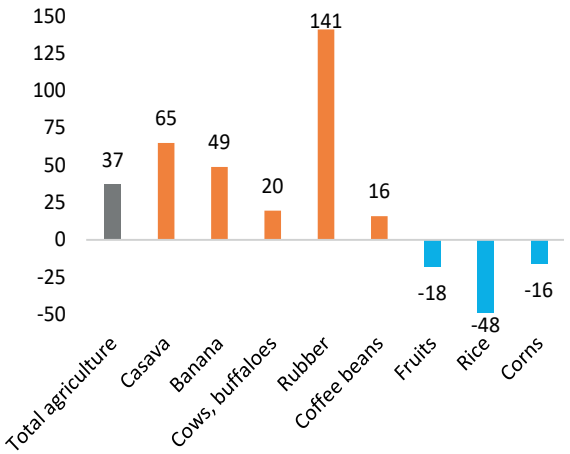
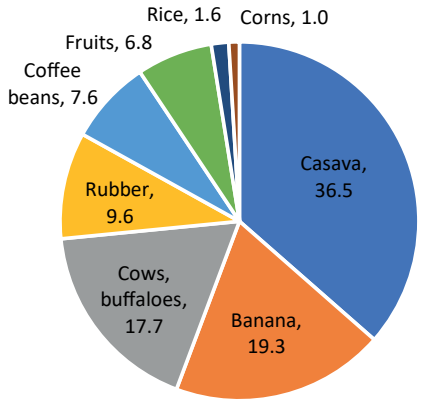


Figure 7: Agricultural exports mostly comprise non-rice crops Jan-May 2021
(percent of total)



Source: MOIC, World Bank staff estimates

Industrial output is expected to rebound in 2021 due to rising external demand and global commodity prices. The industrial sector's growth rate is projected to increase from 4 percent in 2020 to about 6.6 percent in 2021, reflecting a strong rebound in energy, mining, and export-oriented manufacturing and processing activities (pulp and paperboard, sugar and soft drinks, garments, electronics, cameras plus their parts and accessories, and other manufactured goods) during the first five months of 2021 (Figure 8). During this period, industrial exports to major trading partners grew strongly (see section below). Despite recent diversification, electricity and mining exports still accounted for more than half of total exports in January-May 2021 (Figure 9). In the mining sector, copper output dropped significantly following the closure of copper production at Sepon mine in 2020. However, gold production at the site has expanded remarkably, offsetting the decline in copper output. The mining sector is expected to enjoy high metal prices this year. Electricity generation is projected to increase, as major dams that came into operation in 2020 are expected to reach full generation capacity. Growth in the construction sector is expected to be modest this year, with some major highway and power projects reaching completion, while new infrastructure investment will be limited due to the pandemic and limited fiscal space.

Figure 8. Solid growth in industrial exports Jan-May 2021
(yoy percent change)

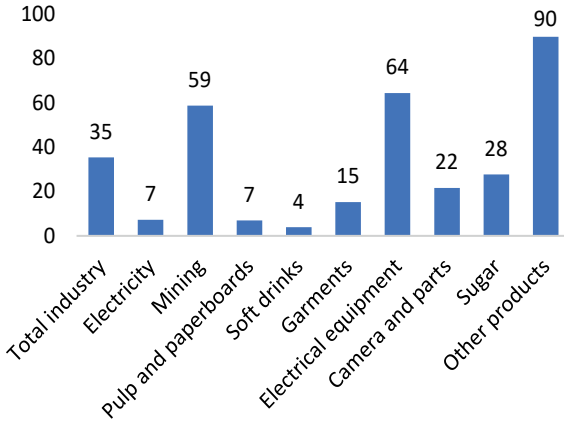
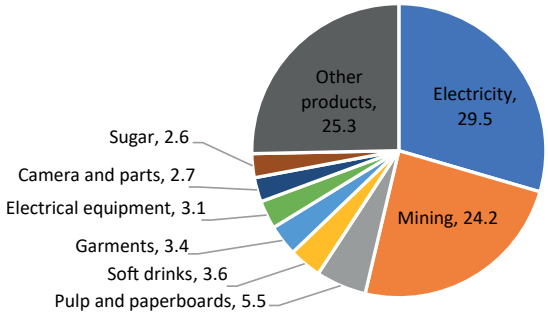


Figure 9: Electricity and mining exports still account for a major share, Jan-May 2021
(percent of total)

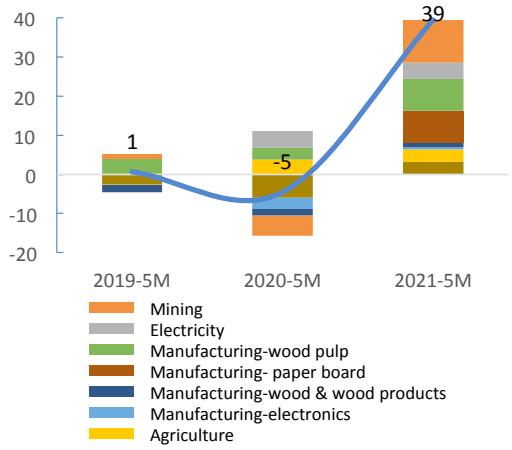


Source: MOIC, World Bank staff estimates

China, Thailand, and Vietnam are the main export markets for agriculture, industry, and tourism; accounting for almost 90 percent of Lao PDR's total external trade in 2020

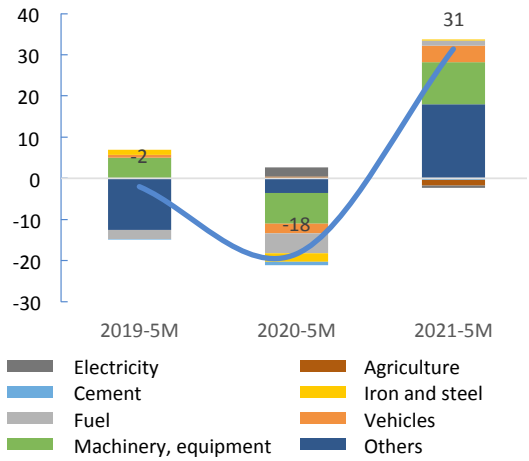
Lao PDR's trade with its major trading partners — China, Thailand and Vietnam — remained robust in January-May 2021. Overall, exports to these three countries increased by 39.5 percent in January-May 2021 (yoy), while imports rose by 31.4 percent (yoy) over the same period. The trade balance with major trading partners improved from a deficit of $104.4 million during the first five months of 2020 to a surplus of $25.1 million in January-May 2021. Export growth was supported by (i) strong external demand and prices; (ii) higher gold output (offsetting lower copper output) and prices; (iii) power projects approaching their full generation capacity; (iv) recovery in electronic parts, wood pulp, wood and wood products, garments; and (v) emergence of new export products, such as paperboard product (Figure 10). Imports were driven by higher purchases of machinery and equipment, vehicles, and fuel — partly to support production activities that were delayed last year, as well as other products, such as intermediate and consumer goods (Figure 11).

Figure 10. Robust export growth to 3 main trading partners (percent)



Source: Custom agencies of China, Thailand, and Vietnam

Figure 11. Strong import growth from 3 countries (percent)



Source: Custom agencies of China, Thailand, and Vietnam

The second wave of COVID-19 has weakened demand for services

Photo: Phoonsab Thevongsa

The service sector, which has been struggling to recover since the first COVID-19 outbreak in March 2020, is projected to grow modestly by about 0.6 percent in 2021, up from a 3.5 percent contraction in 2020. Hotels and restaurants, entertainment, transportation, wholesale and retail sales have been adversely affected by the lockdown measures. Hospitality-related businesses, especially in accommodation and restaurants, and transportation (airlines) are expected to contract by 8 percent and 10 percent in 2021 respectively. Mobility data shows that air transportation (tracked flights to Vientiane) and internet search interest have declined over the past few months compared to the same period in 2020 (Figure 12 and Figure 13). The April-July 2021 lockdown has affected local mobility and thus activities in the services sector (Figure 14). Results from the World Bank's recent BPS in April-May 2021 (see more details in Part II, section 1) suggests that most businesses have been severely affected by the recent lockdown, with sales and employment contracting. In contrast, the information and communication sector seems to have benefited from the lockdown, as it is expected to grow by 7 percent in 2021. Wholesale and retail businesses are projected for a slight growth of 1 percent this year due to a slow recovery in private investment, limited fiscal support from the government, and containment measures.

Figure 12. Air traffic into Vientiane airport is limited (scheduled flights to Vientiane airport)

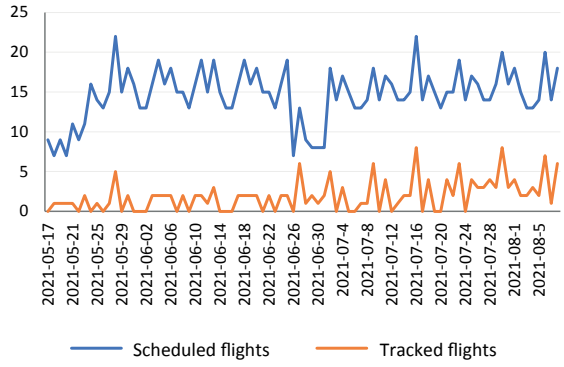
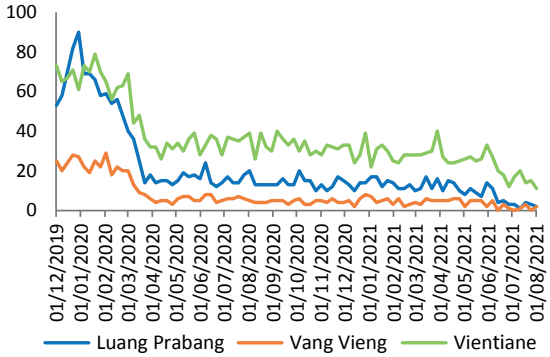


Figure 13. Internet search interest in flights fell (index)



Source: https://www.flightradar24.com/data/airports/vte/statistics
Source: Google Mobility Data. Note: The values are a relative representation of search interest relative to the highest value on the graph for a particular region and time period. A value of 100 indicates that the keyword is the most popular, and a value of 50 indicates that the keyword is half as popular. A value of 0 indicates that there was not enough data for that keyword. https://trends.google.com/trends/explore?date=today%205-y&geo=LA&q=%2Fm%2F01cxqb,%2Fm%2F07lmr8,%2Fm%2F0ftp8

Figure 14. Recent lockdown measures have reduced mobility and local activities

Source: google.com/covid19/mobility
Note: Visitors to (or time spent in) categorized places change compared to baseline days (the median value from the fiveweek period from January 3 to February 6, 2020). The chart shows a five-day simple moving average.

The second wave of the pandemic threatens to drag more people into poverty

More households are at risk of falling into poverty due to declining income and job losses, as a result of the second wave of COVID-19 and subsequent containment measures. The second COVID-19 wave has resulted in temporary but widespread losses in employment and household income. Some of these losses could become permanent if containment measures need to be in place for a long period of time. Compared to a non-COVID-19 scenario, the poverty rate (measured at the lower-middle-income poverty line or $3.2 (2011 PPP) a day) is expected to increase by 1.5 percentage points in 2020 and by 2.4 percentage points in 2021.[5] The projections suggest a total of about 170,000 additional poor in 2021 (those who were expected to be non-poor in 2021 prior to COVID-19 but are now expected to be poor in 2021).

Photo: Phoonsab Thevongsa

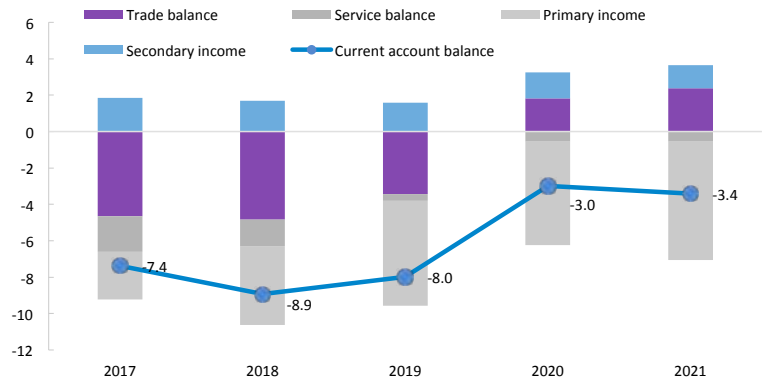
5 Projection using annualized elasticity (2012-2018), based on projected GDP per capita with pass-through = 0.7 for a COVID-19 scenario and pass-through = 1 for a non-COVID-19 scenario.

2.2 The External Sector

The current account deficit is expected to widen in 2021

The current account deficit is projected to increase slightly in 2021, growth in external interest payments expected to surpass the improvement in the goods trade balance. The current account deficit is expected to increase to 3.4 percent of GDP in 2021, from 3 percent of GDP in 2020 (Figure 15). The merchandise trade surplus is projected to increase to 2.4 percent of GDP in 2021, from 1.8 percent of GDP in 2020, with exports strengthening in 2021 due to increased output and higher commodity prices. The services balance is expected to remain at around 0.6 percent of GDP this year, as travel bans caused by the pandemic constrain the tourism sector as well as outbound travel. In contrast, high external interest payments on public debt will drive a widening primary income deficit, from 5.7 percent of GDP in 2020 to 6.5 percent in 2021, offsetting the improved export performance. Because of the wave of returning migrants particularly after the recent outbreak in Thailand, remittances are also expected to decline further in 2021 (See Thematic Section for more details).

Figure 15. The current account deficit is expected to worsen in 2021
(percent of GDP)



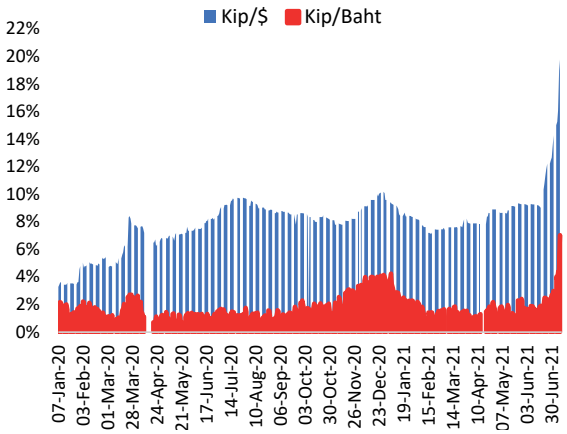
Source: World Bank staff estimates based on data from BOL and trade partners

In the foreign exchange market, the spread between banks and exchange bureaus remains wide

Pressure on the Lao kip remains high in the foreign exchange market. The Lao kip/US dollar daily reference rate reached Kip 9,504/$1.00 on July 16, 2021, depreciating by 5.1 percent year-on-year compared to 2020. Rates at commercial banks followed a similar rate of depreciation over the same period. However, a foreign currency (supply) shortage and strong demand for foreign currencies has caused a significant demand-supply mismatch, and a widened spread between the official and parallel markets. During June-July, the kip depreciated against the dollar and baht more sharply due to a supply-demand mismatch which followed high demand for foreign currencies to meet external debt service obligations, business income repatriation, rising imports, and appreciation of the dollar against regional currencies. As the supply of foreign currency in the official banking system is limited, the premium in the parallel market rose significantly, reaching almost 19 percent by mid-July (Figure 16). This trend has fueled domestic inflation as a large portion of consumer goods are imported6 (Figure 17).

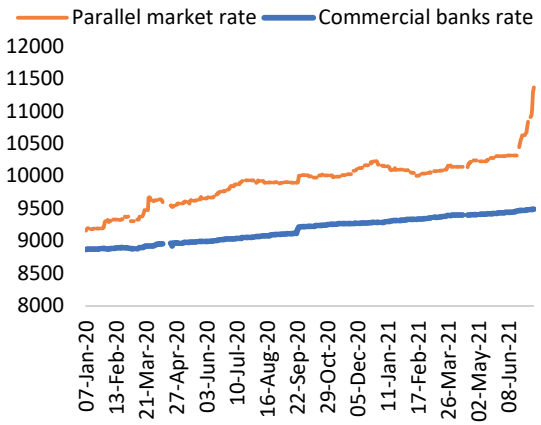
6 Based on LECS 2012/13, the share of imported products in the consumer goods basket was 52.6 percent of total items. The Lao Statistics Bureau will update the composition of consumer basket based on the latest LECS 2018/19.

Figure 16. Parallel market premiums of Kip/$ and Kip/Baht (percent)



Source: IMF Lao PDR Country Office

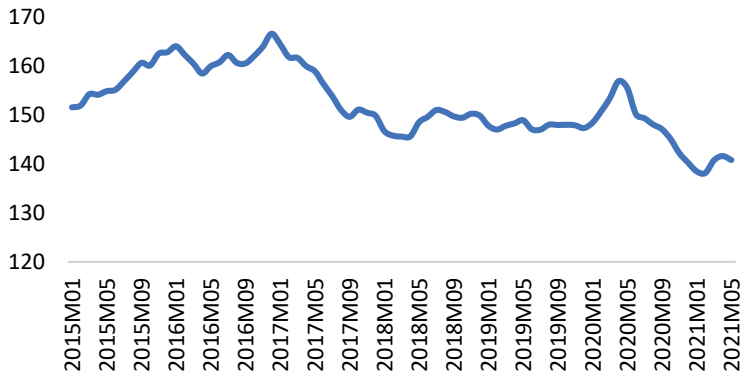
Figure 17. Kip/$ depreciated sharply in June-July (kip per $1)



Source: IMF Lao PDR Country Office

The real effective exchange rate (REER) has depreciated in line with trends in the nominal rate. With significant depreciation of the nominal exchange rate against major currencies, Lao PDR's REER has depreciated by 9.5 percent yoy on average between January-May 2021 compared to a depreciation of 2.1 percent in the same period last year. The depreciation in REER since 2016 to date has partly reversed the long-time appreciation before that period. The REER depreciation contributed to boosting export competitiveness (Figure 18).

Figure 18: Changes in real effective exchange rate (index)

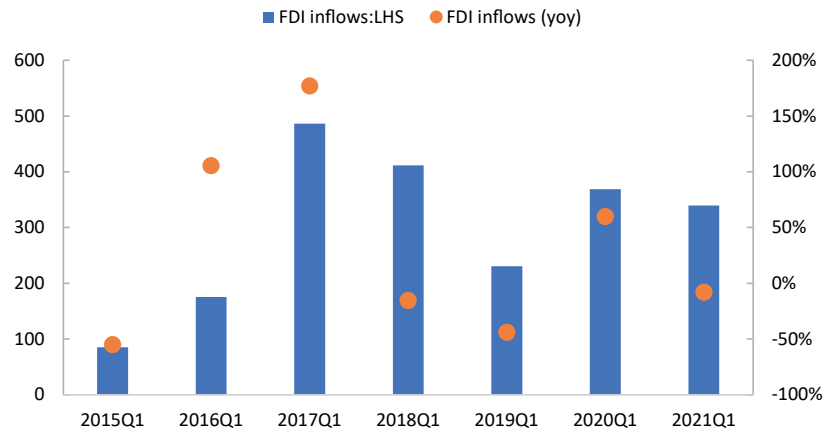


Source: https://www.bruegel.org/publications/datasets/real-effective-exchange-rates-for-178-countries-a-new-database/
Note: An increase in the index indicates appreciation of the home currency against the basket of currencies of trading partners

FDI inflows have been moderating

Foreign direct investment (FDI) inflows declined in the first quarter of 2021. FDI declined by 7.9 percent in Q1 2021 compared with the same period last year, partly due to the completion of the Vientiane Vang Vieng highway and the near-completion of the railway (Figure 19). Moreover, the overall trend has declined from 2019 due to the conclusion of various large hydropower projects, postponement of new projects, and the impacts from the COVID-19 pandemic. Improved connectivity after the railway and highway completion and progress on investment climate reforms are expected to help attract domestic and foreign investment in the future.

Figure 19. FDI inflows declined slightly
(LHS: million US$; RHS: yoy change)

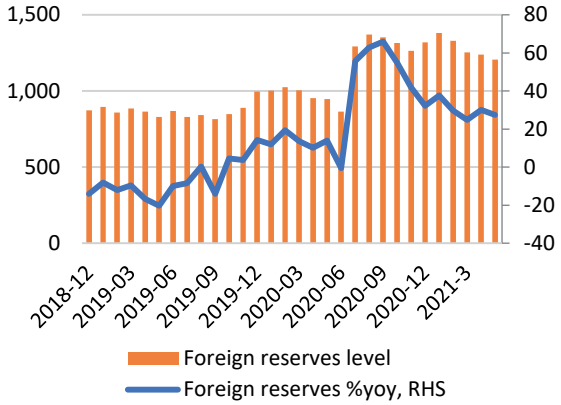


Source: BOL
Note: LHS is left axis. RHS is right axis

Foreign reserve buffers remain low, given the high debt service needs

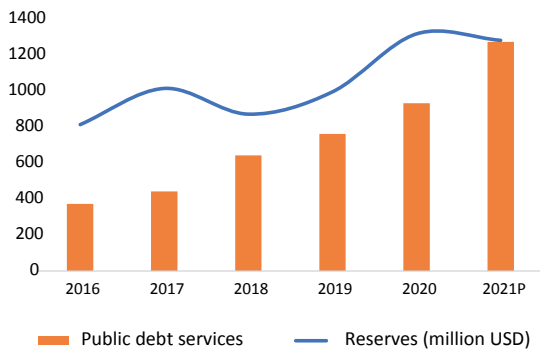
Foreign reserve buffers remain low. Gross official reserves were $1,207 million in May 2021, an increase of 28 percent yoy from last May (Figure 20), largely due to a swap line[7] from the People's Bank of China. However, this level represents a decline from $1,319 million in December 2020, partly due to higher external debt service. Net reserves (excluding the swap) are estimated to cover 1.8 months of imports of goods and services[8] in 2021. Reserve buffers remain inadequate given the large debt-service obligations this year, stressing the persistent external vulnerabilities (Figure 21).

Figure 20. Foreign reserves declined
(LHS: million US$; RHS: yoy change)



Source: BOL

Figure 21. Foreign reserve buffers are limited given higher debt service in 2021



Source: BOL, MOF, WB staff projection for 2021

7 Peoples Bank of China (PBOC) extended a 6 billion renminbi (equivalent to US$900 million) swap line to Bank of Lao PDR (BoL) in mid-2019 with a maturity of 3 years. However, there is indication that the funds are earmarked for specific uses, in particular, to facilitate imports from China. Although these funds, which are earmarked by the PBOC, and, more importantly, cannot be used for debt service, should theoretically not be counted towards foreign currency reserves, this report follows the authorities in including them.

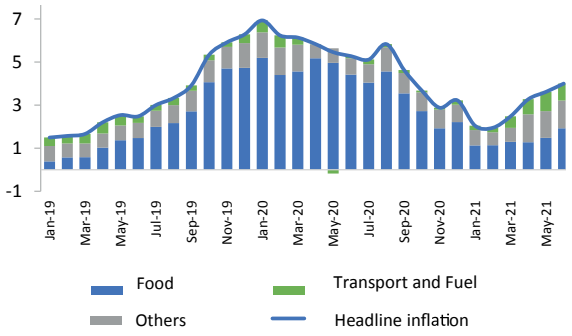
8 Net reserve (excluding swap) is estimated based on the assumption that the reserve level remains at the same level before the swap.

2.3 Inflation and the Financial Sector

Headline inflation rose slightly in recent months

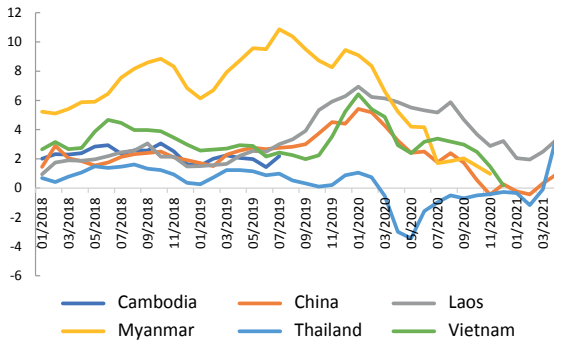
Headline inflation rebounded since early 2021, driven by continued increases in food, fuel and core inflation. Headline inflation rose to around 4 percent yoy in June from 2 percent yoy in January this year, driven by high food and fuel prices and core inflation (Figure 22). Food inflation rose from 2.4 percent yoy in January to 4.2 percent yoy in June mostly due to higher meat prices despite the falling rice prices in the same period. Fuel inflation increased to almost 29 percent yoy in June from a contraction of 7 percent in January, following movements in international markets. Rising core prices were also partly attributable to higher prices for communication services and devices. Prices of domestically produced products went up by 3.6 percent yoy compared to 1.5 percent yoy in January, while those of imported goods increased by 4.7 yoy percent in June compared to 3.1 percent yoy in the same period, reflecting the depreciation of the kip and the exchange rate pass-through to inflation. Inflation in Lao PDR is relatively high when compared to rates across the region (Figure 23).

Figure 22. Headline inflation rebounded in recent months (percentage)



Source: Lao Statistics Bureau

Figure 23. Inflation among regional peers also rise (percentage)



Source: CEIC database

Growth of money supply moderates

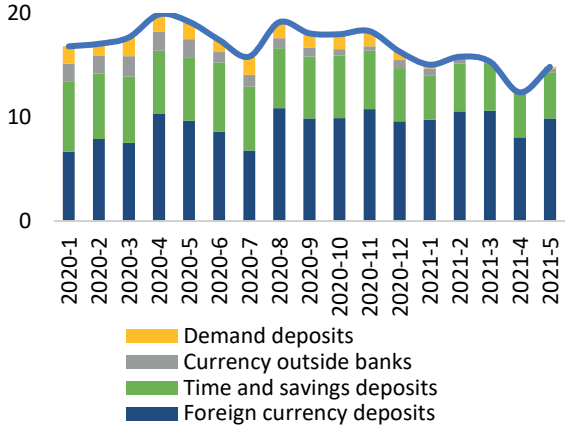
The growth in broad money moderated in the first five months of 2021 due to slower increase in deposits. The broad money increased by an average of 14.7 percent in January-May 2021, compared with an average of 18 percent over the same period last year (Figure 24). This was due to a moderation of (time and saving) deposit growth. This partly offset the stronger growth in foreign currency deposits during the same period, which partly reflects higher demand in holding foreign currencies as a hedge against a risk of further kip depreciation.

Private sector credit growth moderated in January-May 2021 compared with the same period last year due to the severe COVID-19 impacts on firms' operations. As businesses suffer from the COVID-19 impacts, credit to the private sector has stagnated despite efforts to provide finance to SMEs. Lending to the private sector grew at an average of 2.5 percent in January-May 2021, lower than the average of 7 percent in the same period in 2020 (Figure 25). In response to the situation, BOL reduced the reserve requirement rates[9] in May 2021, allowing banks to make more loans specifically to support liquidity or the productive activities. In addition, BOL also encourages banks to provide affected businesses with forbearance policies, such as postponement of interest and principal repayment.

9 From 4 percent to 3 percent for Lao kip and 8 percent to 5 percent for foreign currencies.

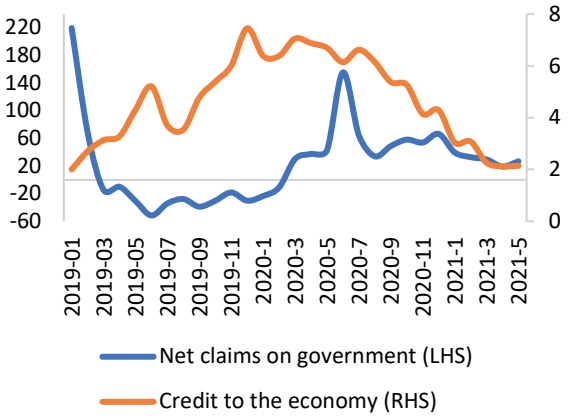
While the financial sector can provide such cushions to support businesses against shocks, these measures could also jeopardize bank balance sheets if they are not prudently implemented or lack an exit strategy. Authorities need to carefully monitor the impact of the economic slowdown and regulatory forbearance policies on commercial bank performance, unwind forbearance policies in a prudent manner and develop flexible capital restoration plans for struggling banks, as well as apply and develop crisis management plans. On the other hand, lending to the public sector expanded during January-May. Net claims on government increased at an average rate of 29 percent in January-May 2021, compared to 15 percent over the same period in 2020. This also reflects the drawdown of government deposit to finance the fiscal deficit in the respective period.

Figure 24. Broad money growth moderated
(percent yoy)



Source: BOL

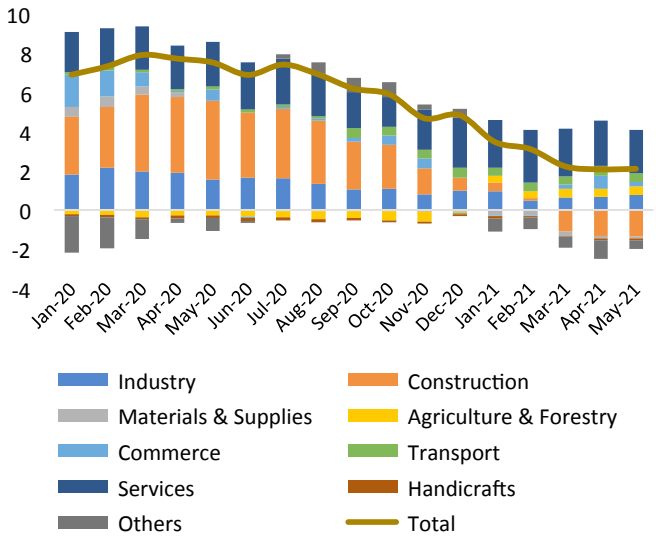
Figure 25. Credit growth to private sector slowed
(percent yoy)



Source: BOL

Credit is concentrated in the services, industry, and construction sectors. The share of credit to the services sector (commerce, transport and other services) accounted for 35 percent of total private sector credit in May 2021. Industry accounted for 28 percent, while construction accounted for 14 percent in the same period. Moderation in credit growth to the private sector was attributed mainly to lower lending to the industry and construction sectors. The latter is partly related to tightening of public investment. However, lending to the services sector appears stable (Figure 26).

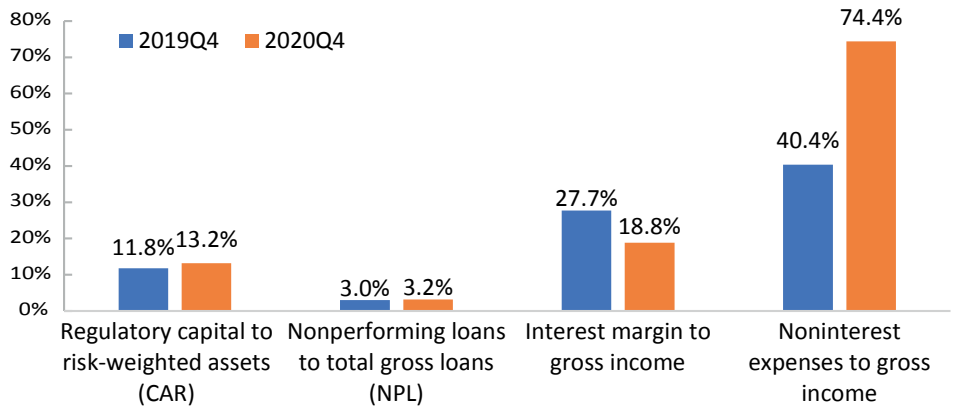
Figure 26. Lower lending to construction and industry contributed to slower credit growth
(percent yoy and percentage points)



Source: BOL

Financial sector vulnerabilities rose due to the impact of the COVID-19. The nonperforming loans to total gross loans ratio rose slightly from 3 percent in Q4 2019 to 3.2 percent in Q4 2020.[10] While the interest margin to gross income ratio declined from 27.7 percent in 2019 Q4 to 18.8 percent in Q4 2020, the noninterest expenses to gross income ratio increased sharply from 40.4 percent to 74.4 percent over the same period, indicating a deterioration in bank profits (Figure 27). However, regulatory capital to risk-weighted assets ratio (CRAR) increased from 11.8 percent in Q4 2019 to 13.2 percent in Q4 2020 as banks recapitalized per regulatory requirements. While the overall banking system is well capitalized, two state-owned banks are currently being restructured to improve their operations.

Figure 27. Some financial soundness indicators deteriorated (percent)



Source: BOL

2.3 Fiscal Developments

While revenue collection rebounded considerably in Q1 2021, the second COVID-19, extended lock-down is expected to weigh down revenue collection in 2021.

Domestic revenue reached 9.8 trillion kip in H1 2021, or 12 percent yoy growth, compared to a 23 percent yoy contraction in H1 2020 (Figure 28). However, it is still 14 percent lower than the pre-pandemic level in 2019 and represents 41 percent of the total revenue target for 2021. A key driver was a strong rebound in both tax and non-tax revenues. The increase in tax revenues by 10 percent yoy in H1 2021 was driven by profit tax, excise tax, and import and export duties. In addition, the recovery of non-tax revenues in H1 2021 by 25 percent was supported by an increase in administrative fees, dividends, and government funds that more than offset the loss in overflight fees.

10 According to BOL instruction, the deferred loan repayments under the credit forbearance policy are not classified as NPL.

Figure 28. Revenue collection rebounded in H1 2021 (in billion Kip and percent yoy)

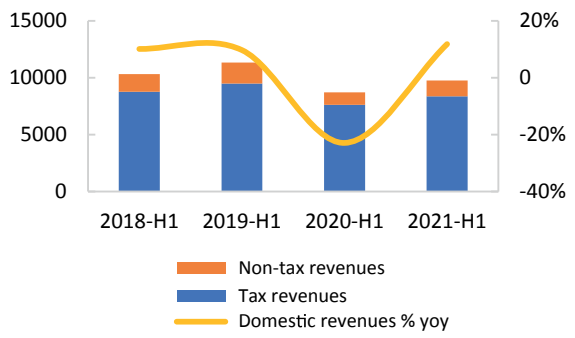
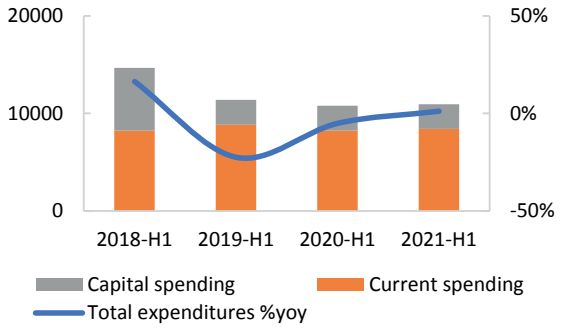


Figure 29. while expenditure continued to tighten in H1 2021 (LHS: in billion Kip; RHS: percent yoy)

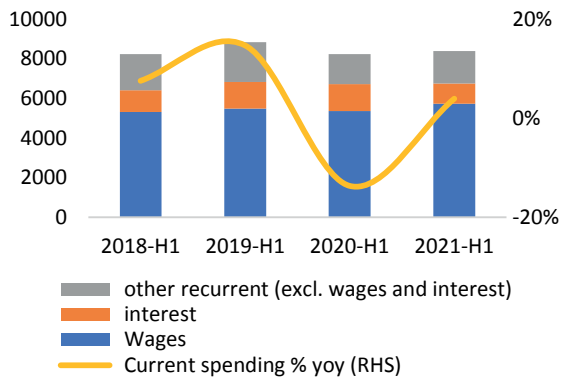


Source: MOF

Expenditure tightening continues

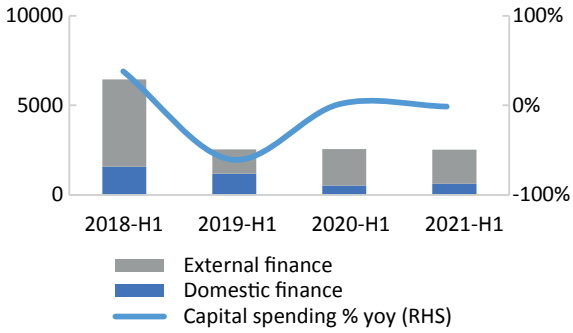
The authorities have continued to tighten budget spending by limiting growth in discretionary expenses. Total spending as a ratio to GDP has declined since 2019, owing to efforts to contain spending levels in the face of weak revenue performance. In H1 2021, total nominal spending reached 10.9 trillion kip, a level similar to that in H1 2020. This accounted for only about 35 percent of the budget plan (Figure 29) and the amount is still below the pre-pandemic spending level. Current spending rose slightly by 2 percent yoy due to the slight increase in wages and benefits. In addition, as the government implements its policy of cutting luxury and non-essential spending, non-wage recurrent spending is also rationalized. Limited fiscal space has constrained fiscal measures to counter COVID-19 impacts on households and businesses, even after reprioritization of spending. Public investment expenditure was kept relatively stable in nominal terms, due to falling revenue collection and lower project loans as the government attempts to contain foreign borrowing for projects that do not generate high economic returns. This was compensated for by more grants to finance projects.

Figure 30. Current spending in H1 2021 (in billion kip and percent yoy)



Source: MOF

Figure 31. Public investment was also contained in H1 2021 (in billion kip and percent yoy)



Source: MOF

As revenue collection for the year remains weak, containing the fiscal deficit will be achieved by expenditure control

The lockdown since April 2021 is expected to disrupt annual revenue collection, through a lower-than-expected rebound in economic activity. Despite revenue administration reforms, revenue performance has been weak, because of structural problems that existed even before the COVID-19 pandemic. Fiscal consolidation has been largely driven by expenditure control, which may affect social spending in the long run. Assuming that the prolonged negative impacts from the second wave and extended lockdown are felt during H2 2021, the total revenue-to-GDP ratio is projected to fall further, from 12.6 percent in 2020 to about 12 percent in 2021, mostly on account of potentially lower profits and income taxes, together with subdued non-tax revenue recovery, particularly from overflight fees.

Photo: Phoonsab Thevongsa

As revenue performance is expected to remain weak, expenditure control measures are likely to drive the containment of fiscal deficit. The focus on containing non-essential spending and postponing new investment projects is likely to continue. As a result, total expenditure is projected to decline to 16.7 percent of GDP in 2021, from 17.8 percent in 2020. The fiscal deficit is therefore expected to decline to 4.7 percent of GDP in 2021, from 5.2 percent in 2020 (Figure 32). The downward revision of the deficit from previous projections is largely due to more stringent expenditure control than was expected. The new borrowing to finance the deficit will increase total public debt (not including guarantees) to an estimated 66.4 percent of GDP in 2021. (Figure 33).

Figure 32. The fiscal deficit is expected to decline, driven by spending cuts

(in trillion Kip and percent yoy)

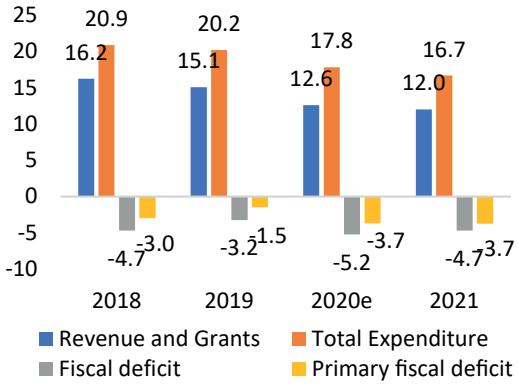
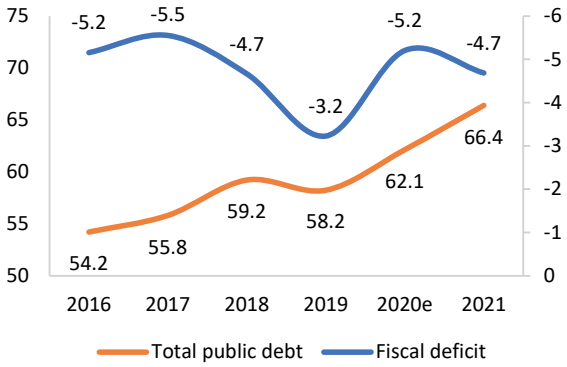


Figure 33. COVID impacts reversed gains on fiscal consolidation

(in percent of GDP)



Source: MOF, WB staff projection

2.5 Debt Dynamics

Public and publicly guaranteed debt level has reached critical levels

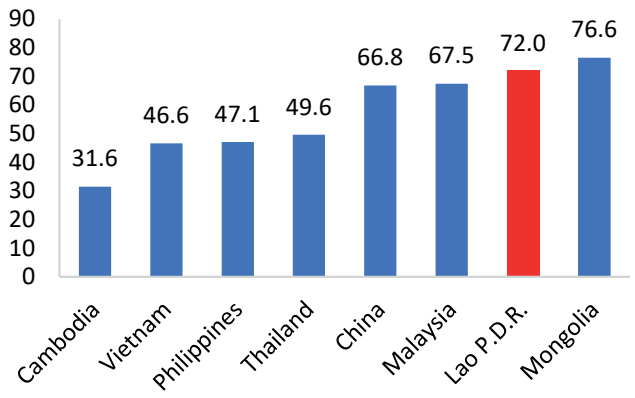
Total public and publicly guaranteed (PPG) debt has reached critical levels, jeopardizing macroeconomic stability and is one of the highest in the region. Total PPG debt (external and domestic) reached $13.3 billion or 72 percent of GDP in 2020, from 67.3 percent in 2019 (Table 1). As a result, Lao PDR is a highly indebted country compared to its regional peers (Figure 34). Excluding guarantees, total public debt (external and domestic) was $10.6 billion or 62 percent of GDP. About two-thirds of PPG debt relates to direct borrowing to finance expenditure, while one-third originates from on-lending to SOEs, mostly to EDL. In addition, publicly guaranteed debt, mostly for EDL's direct borrowing, added $1.8 billion or an additional 9.8 percent of GDP. Significant public investment in the energy sector, particularly to EDL, has accounted for almost all of government on-lending and public guarantees. As EDL's financial status deteriorates, the company's inability to repay its own debt translates into a direct fiscal burden on the government.

Table 1: Total public and publicly guaranteed debt in 2020

	2020		
	US$ million	% of total	% of GDP
Total public and publicly guaranteed	13,347	100%	72%
External public and publicly guaranteed	12,435	93%	67%
1.1 Public Guaranteed debt	1,824	14%	10%
1.2 Total Public External debt	10,610	79%	57%
• Public debt - GOL own borrowing	7,568	57%	41%
• Public debt - GOL on-lending to SOEs	3,043	23%	16%
Domestic public debt	912	7%	5%

Source: MOF

Figure 34. Lao PDR's total PPG debt stock was higher than most regional peers, 2020
(Percent of GDP)

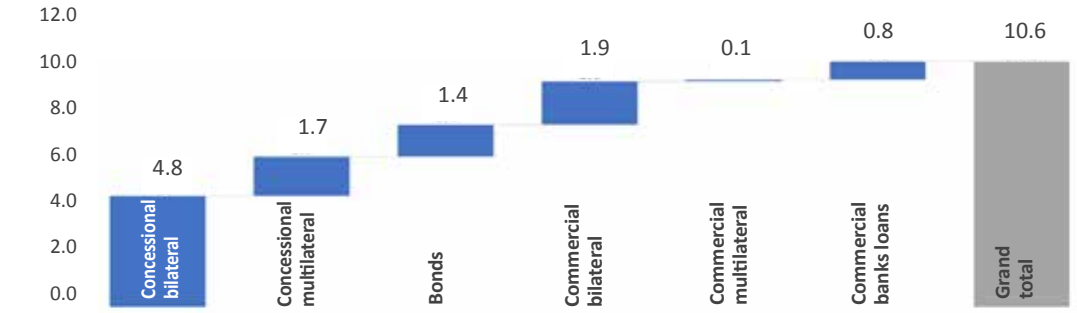


Source: IMF WEO April 2021, MOF

The share of non-concessional debt has increased

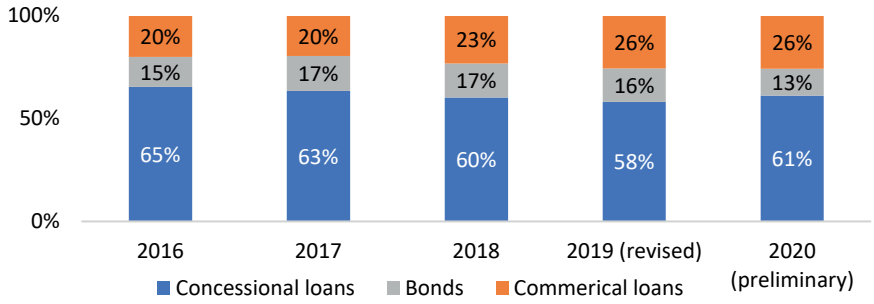
The government has mostly relied on non-concessional debt to finance investment projects and refinance debt. Out of the total public external debt[11] of $10.6 billion, outstanding concessional debt (both multilateral and bilateral debt) was $6.5 billion or 61 percent of total public external debt in 2020, but its proportion has gradually declined from 65 percent in 2016 (Figure 35). Concurrently, the share of commercial debt, recorded at $4.1 billion in 2020, increased to 39 percent in 2020 from 33 percent in 2016 — driven by bilateral commercial loans and bonds (Figure 36).

Figure 35. Government external debt stock by concessionality and instrument, 2020
(in US$ billion and percent of total public external debt)



Source: MOF

Figure 36. The share of commercial debt has risen, 2016-20
(in US$ billion and percent of total public external debt)



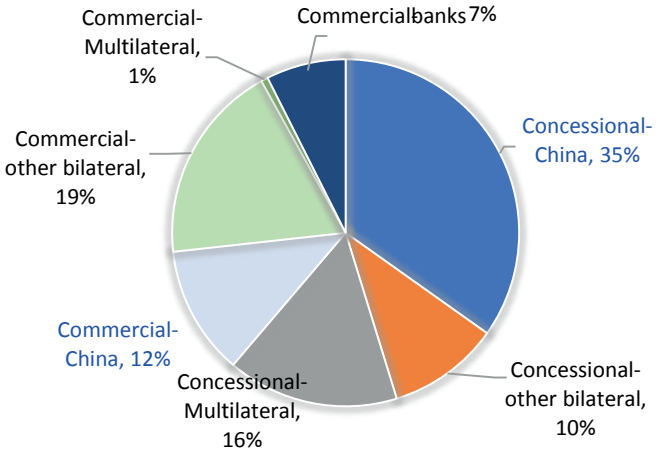
Source: MOF

China is the largest creditor for Lao PDR

China is the largest lender and accounted for 47 percent of total public external debt in 2020 (Figure 37). Of total borrowing from China, three-quarters was still on concessional terms, but the share of concessional loans gradually declined to 74 percent of total borrowing from China in 2020, compared to 86 percent in 2016. During the same period, the commercial borrowing proportion rose to 26 percent of total China lending, from 14 percent in 2016. As a result, almost half of debt repayment over 2021-25 will be owed to China. China also accounts for 40 percent of undisbursed commitments. This means the ongoing debt negotiation with China is vital to lifting some fiscal and liquidity pressure in the short term.

11 The public external debt is defined by foreign-currency denominated debt and excluding guarantees.

Figure 37. China accounts for almost half of public external debt
(Percent of total public external debt)

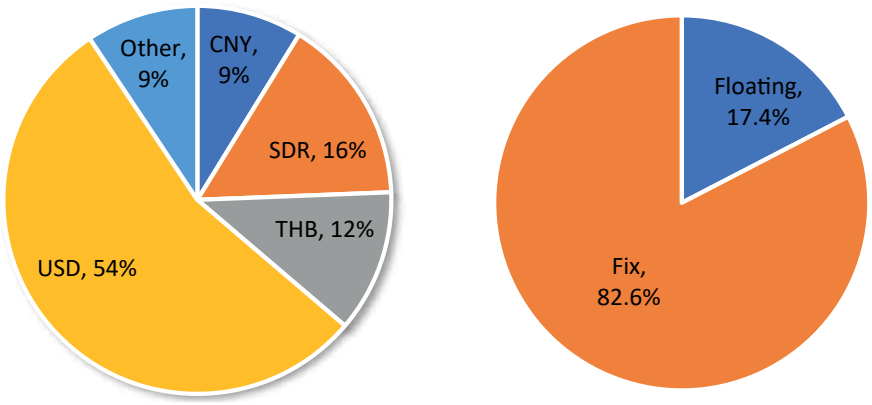


Source: MOF

Foreign exchange rate and interest rate risk exposure are considerable.

Lao PDR is exposed to foreign exchange rate and interest rate risks. While fixed-interest rate debt accounts for 83 percent of the total portfolio, the portfolio is still somewhat exposed to interest rate risk. Public external debt accounted for 92 percent of total public debt (external and domestic, not including guarantees) in 2020, implying high exposure to foreign exchange fluctuations and a risk of sudden foreign exchange rate shocks. US-dollar denominated debt accounted for more than half the total public external debt portfolio, followed by SDR and Thai baht (Figure 38). The continuous weakening of the kip against the dollar and the Thai baht adds to the already relatively high cost of debt servicing.

Figure 38. Exposure to foreign exchange and interest rate risks
(Percent of total public external debt)



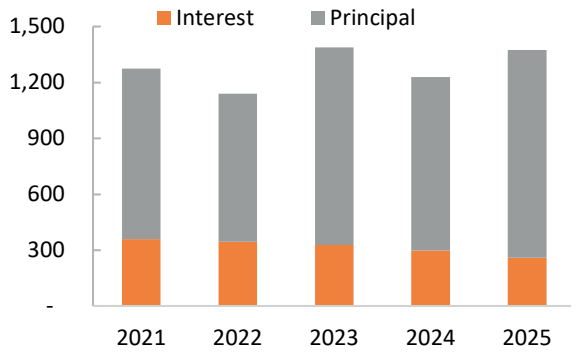
Source: MOF

Meeting debt service obligations is increasingly challenging due to high debt levels and more commercial borrowing

Lao PDR faces difficult debt service obligations as the cost of financing and debt levels increases. The cost of financing has risen, due to the high level of debt, increased non-concessional borrowing, and a ratings downgrade by Fitch and Moody's. On average, $1.3 billion of public external debt service (not including guarantees) are due each year from 2021-25 (Figure 39), of which more than half are on commercial terms (Figure 40). Total external debt service amounts to almost $1.3 billion in 2021, or 7 percent of GDP, on the $10.6 billion public debt stock in 2020. While commercial debt (including bonds and loans) accounted for only 39 percent of total external debt stock in 2020, commercial debt amortization accounts for as much as 64 percent of total repayment obligations in 2021. The difficulty in issuing bonds up to early 2021 has put more pressure on foreign exchange liquidity and debt service, particularly as most of the debt obligations fall between June and December 2021.

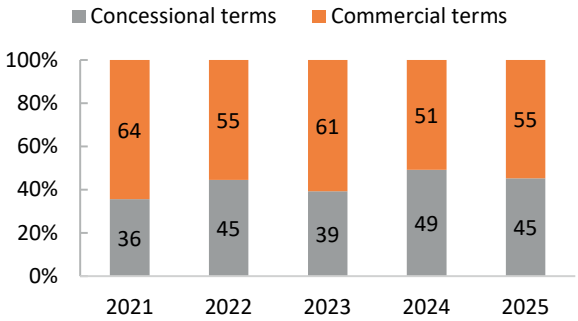
Lao PDR continues to face a high risk of external debt distress as its external debt burden indicators breach the indicative thresholds and benchmarks. Total PPG debt service as a percentage of total public sector revenues (GOL and SOE revenues) is expected to increase to 52 percent in 2021. However, this level remains much above the 14 percent benchmark level for countries with weak debt carrying capacity. Total PPG debt service as a percentage of total exports is also expected to increase from 16 percent in 2020 to 20 percent in 2021, well above the threshold of 10 percent for a country with weak debt-carrying capacity (Figure 41). The PPG external debt service level is projected to be 2.5 times higher than social sector spending (health and education) in 2021, which could compromise the delivery of critical social services. Further efforts in debt restructuring with China and other bilateral creditors could have important implications on debt servicing.

Figure 39. Public sector external debt service due is almost $1.3 billion per year over 2021-25…
(million $)



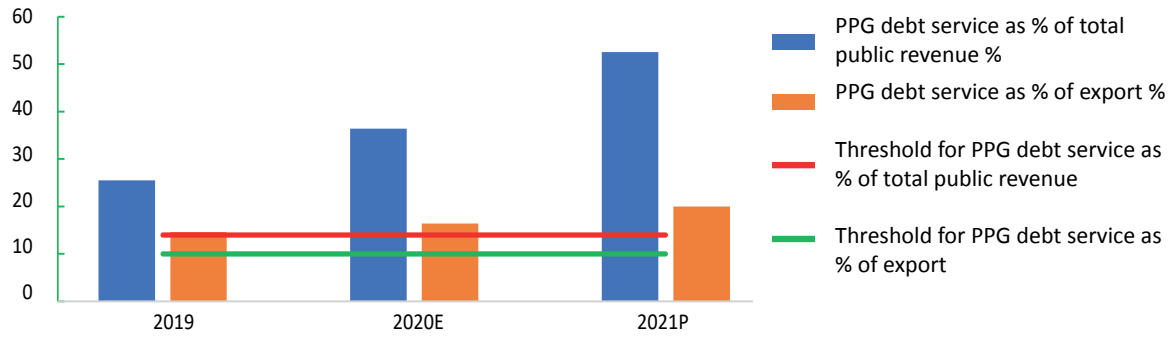
Source: MOF
Note: the increased in 2023 is due to maturity of bonds and commercial loans

Figure 40. …with the commercial debt service ratio expected to remain large in the medium-term
(percent)



Source: MOF

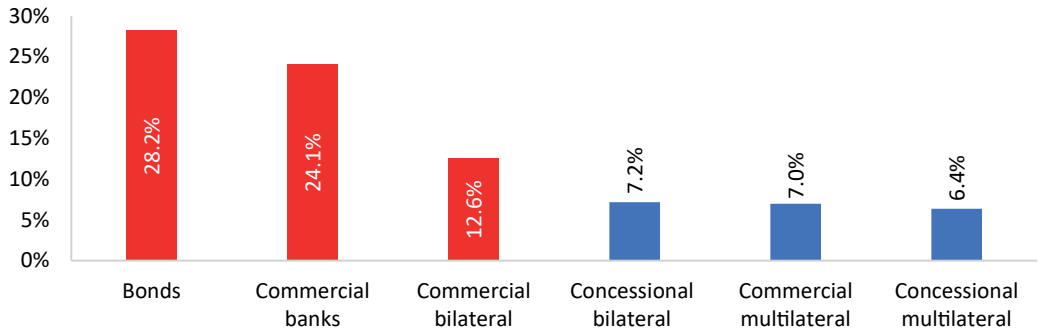
Figure 41. PPG external debt service remains above sustainability thresholds
(in $ million and percent of total public external debt service)



Source: WB estimate based on inputs from MOF

Lao PDR's debt problems are largely due to the high interest rate and amortization of commercial borrowings. The effective cost of debt (debt service and principal payments in 2021) is defined as a percentage of 2020 debt stock. By this definition, the amortization of bonds and commercial loans costs around four times more than do concessional loans. (Figure 42).

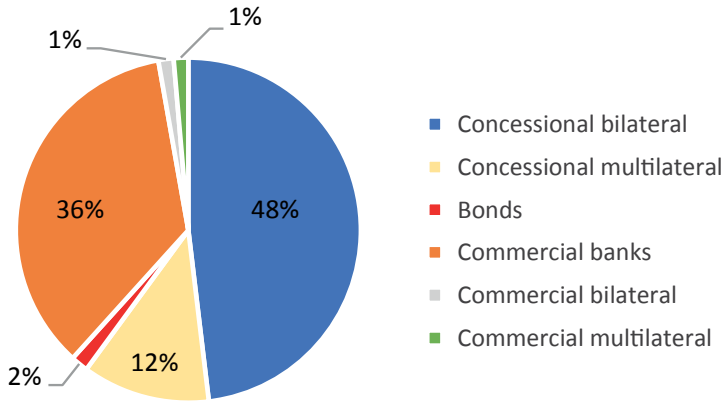
Figure 42. Amortization implications of different types of debt
(amortization in 2021/stock of debt in 2020 by concessionality, creditor and instrument, 2021)



Source: WB calculation based on data from MOF

The government has recently committed to a commercial borrowing ceiling. To reduce the debt service burden, it is important to contain the portion of non-concessional borrowing. The government has committed to taking on new market-term borrowing only as necessary to repay the principal on existing commercial debt. At the same time, interest payments are to be paid with state revenues in foreign currencies. In 2020, new commercial borrowing was around $450 million, about half of the ceiling for that year. Most of the proceeds were used to repay maturing commercial debt. The remaining 60 percent of new disbursements were on concessional terms (Figure 43). In other words, the share of commercial borrowing in new disbursements is almost the same as the share of existing commercial debt in existing total debt.

Figure 43. Most new disbursement was still on concessional terms in 2020
(Percent of total public external debt)



Source: MOF

The energy sector plays an important role in public debt accumulation and debt service. The sector, mostly represented by EDL, accounted for about 36 percent of total PPG debt outstanding in 2020. Recently, new power sector debt commitments were reduced as EDL managed to defer and cancel investments. However, EDL's debt service obligations are still unsustainable, averaging more than $400 million each year during 2021-25, or about 32 percent of total external PPG debt service. Given the poor financial situation of EDL and its high debt level, this repayment burden could have direct fiscal consequences.

The domestic capital market is growing but is still limited when compared to debt servicing and spending needs. The Ministry of Finance has offered 1,700 billion kip and $50 million of domestic bonds in 2020-21. The interest rates offered on the US dollar denominated bonds are more attractive than commercial bank deposit rates, while the interest rates on kip denominated bonds are on a par with equivalent term deposits at commercial banks (Table 2). BOL has offered US$500 million of bonds since 2019, but these have been undersubscribed. The slow subscription of domestic bonds could be attributed to a lack of confidence in government bonds, and/or the marginal difference between real returns from bonds and term deposits in the context of rising domestic inflation. The continued depreciation of the kip also makes local currency bonds less attractive.

Table 2. Interest rates on domestic bonds

	BOL US$ bonds (2019)	MOF US$ bonds (2020)	Commercial Banks (US$ term deposits as of 2020 average)		MOF kip bonds (2020-21)	Commercial Banks (kip term deposits as of 2020 average)
Amount ($m)	**500**	**50**	-	**Amount (bil. kip)**	**1,700**	-
1 year	5.00%	5.00%	3.72%	1 year		5.37%
2 years	-	5.50%	4.98%	3 years	6.80%	6.83%
3 years	6.00%	6.00%	5.90%	5 years	6.95%	6.95%
4 years	-	-	6.87%	7 years	7.20%	-
5 years	7.00%	7.00%	6.88%	10 years	7.50%	-
7 years		7.50%		15 years	7.70%	-
10 years		8.00%		20 years	8.00%	-

Source: BOL, MOF

Photo: Phoonsab Thevongsa

3. Outlook, Risks and Policy Options

3.1 Outlook

The Lao economy is expected to gradually recover in the medium-term but will remain below pre-pandemic levels of growth at 4.5 percent in 2022. The recovery is likely to be supported by solid export growth as external demand rebounds, by gradual recovery in the services sector, by and private investment in infrastructure as the government promotes public-private partnership and build-operate-transfer (BOT) projects for roads, power generation and mining. After the Lao-China railway begins operating at the end of this year, development of secondary infrastructure is expected to take place along the railway corridor. In addition, investment in highways between Vang Vieng and Boten, and in the south are also in the pipeline. China's granting of trade preferences for 97 percent of Lao export products, and the signing of the Regional Comprehensive Economic Partnership, will benefit exports if supported by reforms. There is a need to create a momentum for doing business reforms and trade facilitation in order to boost private investment and exports, as well as to maximize the benefits of improved connectivity. In addition, when the COVID-19 vaccination rollout gathers pace in Lao PDR and abroad, international travel is expected to gradually resume, supporting the recovery of tourism and the services sector.

Meeting public debt service obligations in the medium term will remain challenging. Total public external debt repayment averages $1.3 billion a year over 2022-25 (or almost half the government's average domestic revenues in the medium-term). In addition, foreign currency reserves are expected to remain inadequate. Given a gradual recovery in revenues, the government must resort to additional borrowing to refinance debt payments and the fiscal deficit. Therefore, containment of the fiscal deficit coupled with improved debt management is a priority for reestablishing macroeconomic stability, and for lowering pressure on foreign currency reserves.

The fiscal deficit is expected to decline slowly in the medium-term, supported by improved revenue collection as the economy recovers, and by containment of expenditure. It is anticipated that gradual recovery in business, resumption of domestic economic activity, and continued revenue reforms will further boost revenue collection over the next few years, albeit to levels still below the pre-pandemic situation. Raising to revenue is critical because further expenditure cuts can affect social service delivery and support to affected businesses and households. Reprioritization of spending is also crucial while the government continues to contain expenditure as part of fiscal consolidation. In addition, debt service obligations are mounting. The fiscal deficit is projected to remain above 3 percent of GDP, while total PPG debt is anticipated to remain above 60 percent of GDP between 2022-24.

3.2 Risks

The economic outlook is challenged by increasing downside risks. The main external risks include (i) slower-than-projected growth in key trading partners; and (ii) delays in vaccination rollout in the EAP region and in western countries that are critical to revived international tourism and foreign investment. In addition, key domestic risks include (i) potential new community outbreak if the increasing number of imported cases of return migrants is not well managed, and extended lockdown measures, which could further delay resumption in local economic activities; (ii) a weaker-than-anticipated economic recovery, which would exacerbate already poor revenue performance, keeping the fiscal deficit and public debt elevated; (iii) a deterioration in the financial status of EDL, leading to higher debt burdens on the government; (iv) prolonged implementation of credit forbearance policies, which could worsen bank balance sheets and heighten existing financial sector vulnerabilities; and (v) slippages in doing business and trade facilitation reforms, which would limit benefits from better connectivity, including from the Lao-China railway.

Photo: Phoonsab Thevongsa

3.3 Policy Options

Restore macroeconomic stability

The immediate priority is to restore macroeconomic stability. Key focus areas here include managing debt in a more sustainable and transparent manner, strengthening fiscal sustainability, and reducing financial sector vulnerabilities.

- ***Debt sustainability requires taking advantage of relief mechanisms and strengthening debt management and transparency.*** Adopting the G20-led Debt Service Suspension Initiative (DSSI) could reduce debt service obligations (by suspending debt repayments over the medium term) and mobilize additional funding through the joint donor programs (budget support, IMF's Rapid Crisis Facility, etc.). Other possible measures include: (i) limiting non-concessional borrowing; (ii) increasing debt transparency; (iii) restructuring debt; (iv) improving debt management recording and monitoring capacity; (vi) strengthening coordination between BOL, MOF and MPI on: analysis/processing of debt issuance, loan agreements, guarantees, on-lending; and sharing of information on future debt cash flows; (vi) approving and publishing a debt management strategy which underpins a rolling annual borrowing plan, comparing different sources of funding in the cost-risk space.

Medium-term reforms on the debt front include: (i) SOE reforms; (ii) developing a clear legal framework for contingent liabilities, i.e. on-lending and public guarantees; (iii) carefully assessing project viability before granting on-lending and guarantees to SOE investment projects; and (iv) deepening domestic capital markets.

- ***Fiscal sustainability requires improving revenue collection and spending efficiency.*** Key measures to strengthen revenue mobilization include: (i) strengthening monitoring and management of large taxpayers[12]; (ii) building capacity to manage large taxpayers using the "group" approach, and not by individual legal entities; (iii) expanding coverage of taxpayers in the TaxRIS electronic payments system; (iv) enhancing audit and enforcement by clamping down on tax evasion and enforcing value added tax, profit tax and personal income tax through the implementation of a comprehensive risk management plan and risk-based audits. Major actions to improve spending efficiency comprise: (i) suspend temporarily the financing of new public infrastructure projects through MOUs paid through commercial external borrowing to reduce fiscal and debt burdens; (ii) reprioritize spending and mobilize additional resources to support well-targeted social assistance, including to COVID-19 affected households and businesses. In addition, it is essential to acceleratethe upgrade of the Government Finance Information System and its link to the BOL payment system, adopt a renewed approach towards transitioning to a Treasury Single Account, speed up the detailing of the chart of accounts and the procurement of the new FMIS, all of which will contribute to the better fiscal discipline and sound management of public finances.

Medium-term measures are needed to streamline tax policy and strengthen budget planning. These include: (i) develop capacity to forecast revenues; (ii) streamline fiscal incentives and concessions for investments in large infrastructure projects, based on greater coordination among MPI, MOF and BOL; (iii) effectively enforce the procurement law, and strengthen the selection and evaluation and monitoring of public investment projects; and (iv) strictly align the expenditure plan to the resource envelope.

- ***Financial sector stability requires stemming the deterioration in banks' balance sheets and putting in place key legal and regulatory tools to manage fallout from the crisis.*** Measures in include: (i) unwind forbearance policies in a prudent manner and based on enhanced banking supervision and coordination between BOL, MOF and MPI and industry players; (ii) intensifying monitoring of commercial bank performance, providing timely guidance to banks on loan restructuring, and developing flexible capital restoration plans for problem banks; (iii) finalizing secondary regulations for the commercial banking law; and (iv) accelerating the restructuring of the two weak state-owned banks.

Financial sector stability and further financial sector deepening in the medium-term can be consolidated through: (i) adopting risk-based supervision and transiting to the Basel II capital framework; (ii) implementing secondary regulations for the commercial banking law; (iii) establishing an early warning system for banking supervision; (iv) strengthening operational and financial capacity in the deposit insurance scheme; and (v) developing a crisis management framework.

Mitigate impacts of the pandemic (second wave of COVID-19)

Policies to mitigate the impacts of the second outbreak of COVID-19 should provide immediate economic relief, while supporting recovery and fostering resilience in the medium and long terms. First, given the limited fiscal space, it is important to reprioritize spending and mobilize additional resources to support well-targeted social assistance to affected households and businesses, especially in the hospitality and entertainment sectors. Options for such assistance include direct cash transfer programs to economically vulnerable households and displaced workers, and targeted

12 It should be noted that MOF and Tax Department have missed the opportunity to establish a dedicated Large Taxpayer Office (LTO) at the headquarter in the reorganization of the tax administration. The recent restructuring means further fragmentation of the management of large businesses. The Revenue Division, formerly served as a quasi LTO, was split into two divisions. A VAT division is responsible for collecting VAT from large taxpayers, while the new Revenue Division collects other taxes except for the VAT. This would mean there is no single unit that has a full view of the risk profile of the large taxpayers, which is a deviation from good international practices. Furthermore, the selection criteria for large taxpayers have not yet been adopted.

lending to severely impacted SMEs. In the medium and longer term, accelerating reforms to promote diversification and improve competitiveness in the private sector, supported by improved connectivity, would strengthen economic and social resilience. More and better investment in human capital and social protection can also improve the ability of household to handle the impacts of shocks.

Building a resilient health system for better health emergency and service delivery

- ***The global COVID-19 outbreak has challenged the readiness of the health system and health emergency response capacity in Lao PDR.*** Large gaps already existed in service availability and readiness across health facilities, including a lack of basic amenities, limited diagnostic capacity, and low availability of essential medicines. Although the government has managed well with tracking, testing and quarantining protocols over the past 15 months, the country needs to invest in a stronger foundation for emergency health response systems and capacity, especially in the areas of infection prevention and control, surveillance systems, laboratory networks, quarantines and isolation, case management, essential health service delivery, and risk communication to stop transmission and keep viruses under control. Increasing the COVID-19 vaccination rate for the Lao population (as per government targets of 50 percent for 2021 and 80 percent in 2022) is key to helping the country prepare for future opening and faster economic recovery.

Support sustainable and inclusive growth

- ***There is a pressing need to boost trade and investment outside the resource sector in order to support Lao PDR's economic recovery and drive long-term inclusive growth.*** To execute this policy, Lao PDR needs to facilitate the entry and growth of productive companies, both domestic and foreign, in export-oriented agriculture, manufacturing, and services. This can be achieved by: (i) reforming and streamlining business, trade and investment regulations and procedures; (ii) facilitating trade by lowering transport and logistics costs; and (iii) supporting improved product quality, especially for exports of agricultural and food products that hold significant potential for driving poverty reduction.

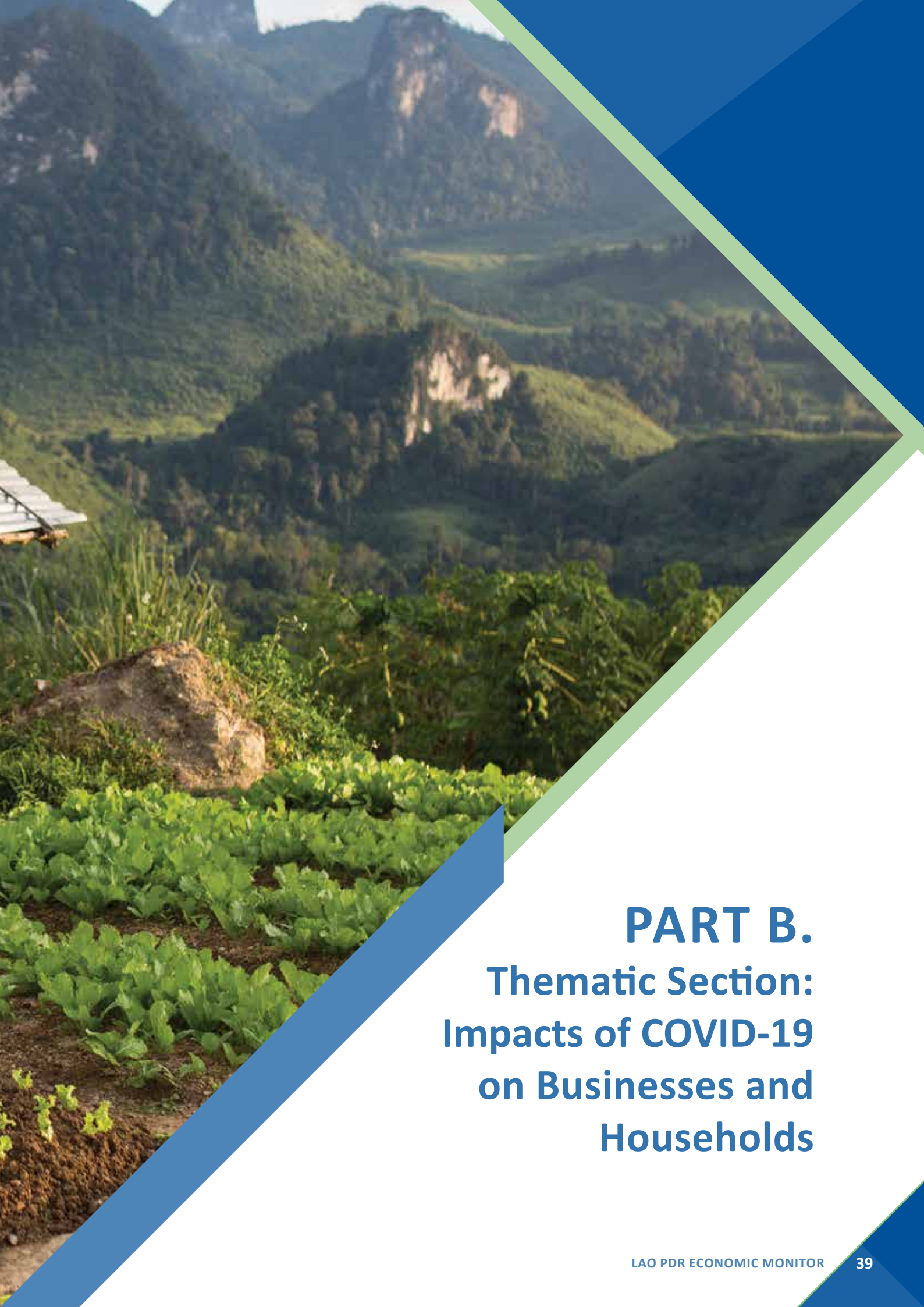
Photo: Phoonsab Thevongsa

Table 3. Economic Outlook Indicators

		2019	2020E	2021P	2022P	2023P	2024P
Real Economy							
Nominal GDP	Billion Kip	164,017	173,208	188,070	205,926	226,184	248,073
Nominal GDP	Million USD	18,823	17,844	18,278	18,881	19,564	21,037
Real GDP growth	% yoy change	5.5	0.5	3.6	4.5	4.8	4.7
Agriculture	% yoy change	1.2	3.2	3.9	4.0	4.2	4.3
Industry	% yoy change	5.6	4.0	6.6	4.3	4.3	3.7
Services	% yoy change	6.9	(3.5)	0.6	4.8	5.5	5.8
Inflation (annual average, %)	% change	3.3	5.1	5.0	5.0	5.0	5.0
Exchange rate (Kip/USD)	annual average	8,679	9,707	10,289			
Exchange rate (Kip/USD)	end of period	9,096	10,187	11,002			
Fiscal Account*							
Revenues	% of GDP	15.4	12.6	12.0	12.3	12.8	13.4
Domestic Revenues	% of GDP	13.7	11.1	10.7	11.2	11.8	12.5
Taxes	% of GDP	10.8	9.1	9.0	9.2	9.6	10.2
Non-tax	% of GDP	2.9	2.0	1.7	2.0	2.2	2.3
Grants	% of GDP	1.7	1.5	1.3	1.1	1.0	0.9
Expenditures	% of GDP	18.7	17.8	16.7	16.5	16.6	16.9
Current expenditure	% of GDP	12.5	11.4	10.8	10.8	11.0	11.2
Capital expenditure	% of GDP	6.1	6.4	5.9	5.7	5.6	5.7
Fiscal balance	% of GDP	-3.2	-5.2	-4.7	-4.2	-3.8	-3.5
Primary balance	% of GDP	-1.5	-3.7	-3.7	-1.6	-1.4	-1.5
Selected Monetary Accounts							
Braod money	% change	18.9	17.0				
Credit to the economy	% change	7.4	4.2				
Balance of Payments							
Current Account Balance	million USD	(1,503)	(533)	(624)	(470)	(503)	(467)
Trade Balance	million USD	(649)	327	434	555	690	825
Goods: exports	million USD	6,201	6,484	7,241	7,944	8,637	9,341
Goods: exports	% yoy		4.6	11.7	9.7	8.7	8.1
Goods: imports	million USD	6,850	6,157	6,807	7,388	7,947	8,516
Goods: imports	% yoy		-10.1	10.6	8.5	7.6	7.2
Service Balance	million USD	(67)	(99)	(101)	(20)	(40)	(57)
Net income balance	million USD	(787)	(760)	(957)	(1,006)	(1,153)	(1,234)
Direct investment	million USD	756	968	939	1,014	1,108	1,189
Gross internation reserves, end of period	million USD	997	1,319	1,283	1,488	1,737	1,913
months of G&S import cover		1.5	2.4	2.2	2.3	2.4	2.4
months of G&S import cover, excl. FDI		4.9	8.0	7.3	7.7	8.0	8.0
Current Account Balance	% of GDP	-8.0	-3.0	-3.4	-2.5	-2.6	-2.2
Trade Balance	% of GDP	-3.4	1.8	2.4	2.9	3.5	3.9
Goods: exports	% of GDP	32.9	36.3	39.6	42.1	44.1	44.4
Goods: imports	% of GDP	36.4	34.5	37.2	39.1	40.6	40.5
Service Balance	% of GDP	-0.4	-0.6	-0.6	-0.1	-0.2	-0.3
Net income balance	% of GDP	-4.2	-4.3	-5.2	-5.3	-5.9	-5.9
Direct investment	% of GDP	4.0	5.4	5.1	5.4	5.7	5.7

Source: World Bank staff estimates based on inputs from Lao authorities and trading partners.

Photo: Phoonsab Thevongsa



PART B.
Thematic Section: Impacts of COVID-19 on Businesses and Households

1. The Impact of COVID-19 on Firms – Key Findings from Recent Business Pulse Survey[13]

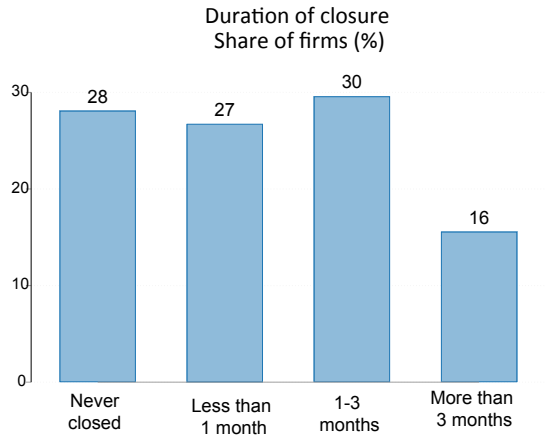
The impact of the COVID-19 pandemic has been felt widely across firms. While agriculture, manufacturing, and wholesale/retail activities showed signs of recovery after the first lockdown, persistent negative impact in various sectors dragged down overall revenue growth. With the second outbreak ongoing, businesses face major disruptions, deepening the impact on sales. The impact on jobs has been more muted, but average employment has also declined. Besides, this crisis may leave a lasting effect on a subset of firms. First, there are significant differences in impact across firms. Overall, SMEs have suffered disproportionally larger impacts on sales. Yet, they are also significantly less likely to be aware of, or have access to, government support. Further, heightened uncertainty and a pessimistic outlook may drag down future productivity. A substantial number of companies reduced investment in 2020, and the majority expected investment to fall further in the next six months, further lowering prospects for recovery.

Mandated shutdowns, health concerns, and falling demand caused major disruptions to operations

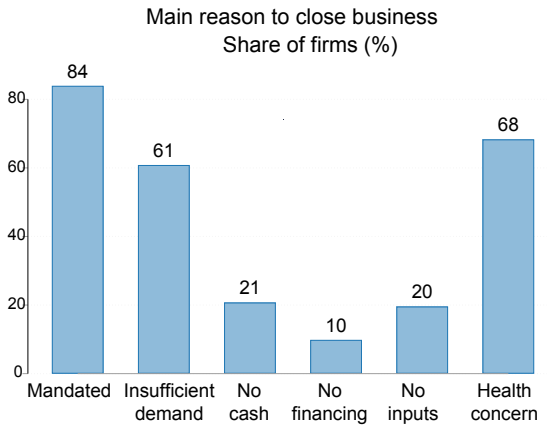
Since March 2020, a large share of businesses (72 percent) have had to shut down temporarily. The impact on operations has been severe for some businesses: 16 percent have closed for more than three months at some point since the start of the pandemic (Figure 44a). The most important reason for closing was mandatory regulations (in more than 84 percent of firms). However, the majority of firms also reported health concerns and insufficient demand as reasons for pausing operations (Figure 44b). At the time of the survey (April/May 2021), which coincided with the second outbreak and the lockdown that started on April 22, a significant number of businesses were closed or operating under capacity. Only slightly more than half were fully open, and on average 44 percent of businesses reported a drop in hours of operation compared to a typical pre-pandemic month (Figure 44c & d). SMEs and firms in non-retail services activities reported the highest rates of closure.

Figure 44. Impact of the pandemic on operations since March 2020 and at the time of the interview

a. Months that businesses shut down at some point since the start of the pandemic (March 2020)

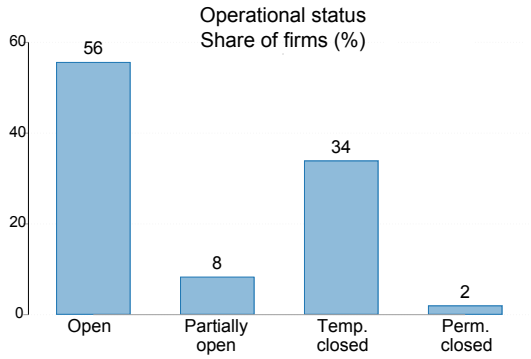


b. Main reason for closing business since the start of the pandemic (March 2020)

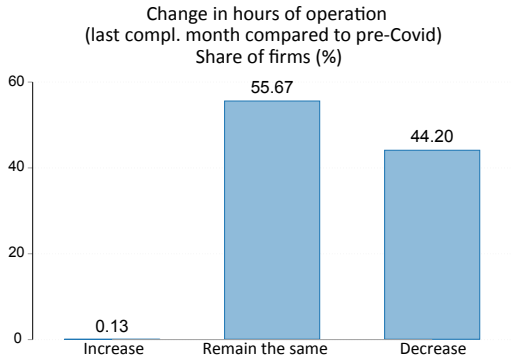


13 This section is prepared based on inputs from the recent WB BPS, which was conducted in Lao PDR in April-May 2021. The BPS report was prepared by Sarah Hebous, Jesica Torres, and Trang Tran. We thank the Lao Statistics Bureau for their support to obtain the sampling frame. The survey was managed by Somneuk Davading and Melise Jaud and implemented by Emerging Markets Consulting. Kyung Min Lee provided support on the sampling design. Valuable support and feedback on the draft was provided by Michael Corlett, Somneuk Davading, Melise Jaud, Tanida Arayavechkit, Elena Georgieva-Andonovska, and Keomanivone Phimmahasay.

c. Operation status at the time of interview (Apr/May 2021)



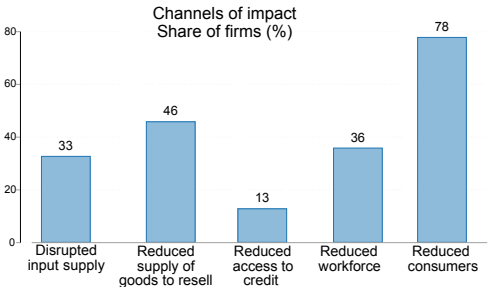
d. Change in operating hours over 30 days prior to the interview, relative to typical pre-pandemic month



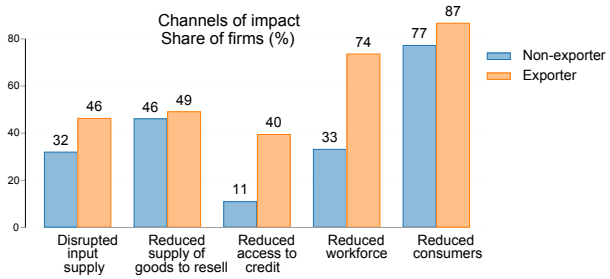
Many businesses saw disruptions to both production and demand, but demand issues appear to be more common (Figure 45). On average, 78 percent of firms report difficulties finding customers since the start of the pandemic. A significant but smaller share of firms report disruption of intermediate input supply (33 percent), reduced supply of goods to resell (46 percent), and reduced workforce (36 percent). Compared to other channels of impact, access to credit appears a minimal issue: only 13 percent reported reduced access to credit. There are some notable differences between exporters and non-exporters, and between small and large firms. Exporters are affected more severely in all channels: they are much more likely to report disruption in supply of raw materials, reduced labor supply, as well as reduced demand, and are more likely to have experienced decreases in access to credit.[14] By employment size, small firms are significantly more likely to be affected by both demand and supply channels.

Figure 45. Channels of impact

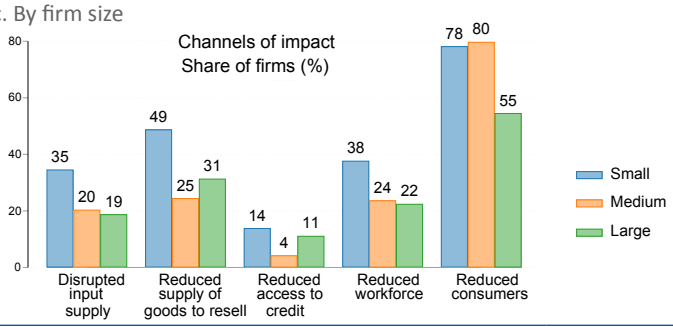
a. All firms



b. Exporters vs. non-exporters



c. By firm size



14 Results should be interpreted with the caveat that the sample does not allow the estimation of results representative for the population of exporters in Laos. Further, the response rate was low for large firms. In the data, SMEs account for most exporters (71%) and therefore results may be driven disproportionally by small exporters, who might not have been able to adapt as well as large exporters. Customs data suggests that exports are recovering after an initial drop in the number of firms and trade volumes in April-May 2020. Lao exports grew by 35% during Jan-May 2021 compared to the same period in 2020, supported by agriculture and industry.

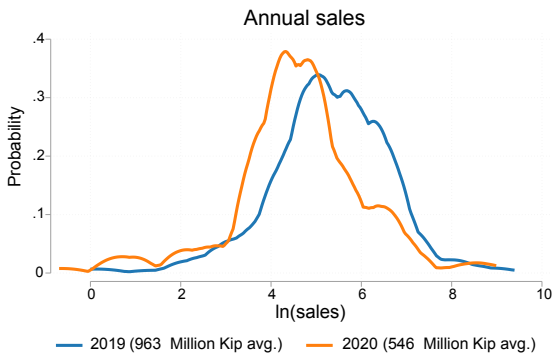
Businesses experienced significant income and employment shocks, with uneven impact

Businesses have suffered substantial drops in income, which worsened during the most recent lockdown. Annual sales in 2020 were significantly lower than in 2019. On average, annual sales decreased by more than 40 percent from 958 million kip to just 543 million kip in 2020. This drop in sales is widespread across firms - we observe a decline across the entire sales distribution (Figure 46a). Since March/April 2020, there has been little evidence of recovery. Average sales in Q4 2020 were 35 percent lower than in 2019 And the second outbreak saw business revenues decline even further. On average, monthly sales in March/April 2020 were about 30 percent lower than in the same month in 2019. In 2021, average monthly sales dropped by 48 percent relative to 2019 (Figure 46b). These drops in revenue have led to significant dips in profits. The average monthly company profits in 2020 and 2021 were, respectively, 19 and 39 percent lower than in 2019.[15]

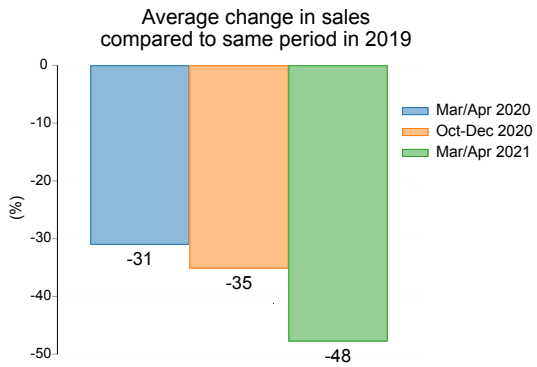
Photo: Phoonsab Thevongsa

Figure 46. Impact on sales

a. Change in annual sales, 2020 vs. 2019



b. Change in monthly sales



Note: distribution is plotted excluding 5% top outliers

Deepening impact in hospitality and other service sectors dragged down recovery.[16] Prior to the second outbreak, agriculture, manufacturing, and retail activities showed signs of recovery: the average drop in sales was lower in Q4 2020 than in March-April 2021. However, other service activities continued to experience heavy losses in sales. On average, businesses in the accommodation sector (hotels) have suffered the largest loss in sales. Sales during the outbreak (March-April 2020)

15 The first lockdown in Laos started in April 2020. Tourism and international flights were slightly affected in March 2020 after the lockdown in China but the most severe impacts were not felt until April 2020. Due to the timing of our survey, the results only partially capture the impact of the first lockdown.

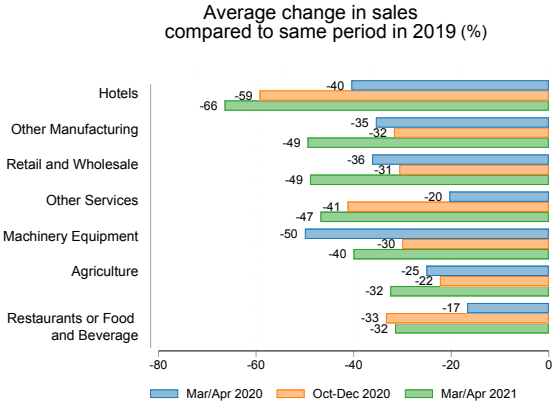
16 Note that due to small sample size, differences by narrowly defined sectors need to be interpreted with caution.

dropped by 40 percent relative to 2019. As international borders have remained closed, the impact on this industry has worsened: average sales in October-December 2020 were 59 percent lower, and sales in March-April 2021 66 percent lower than over the same periods in 2019. Similarly, the impacts on non-retail and non-food services have more than doubled, from a 20% sales loss in March-April 2020 to a 47% sales loss in March-April 2021(Figure 47a).

Larger firms have weathered the pandemic better than their smaller counterparts, while some exporters and firms in Vientiane Capital and in Luang Prabang have suffered disproportionally larger drops in sales during the second outbreak. Conditional on sector, regional composition, and other firm characteristics, the drop in sales was 26 percentage points (pp) smaller for large firms than for small businesses. Regional differences are also significant. All regions have experienced falling sales, but the drop in sales for firms in Luang Prabang and in Vientiane is about 10 pp higher than in Savannakhet and Champassak. These regional differences persist even after controlling for other firm characteristics. Meanwhile, compared to non-exporters, the negative impact on sales is 28 pp larger for exporters (Figure 47b). The disproportional impact on exporters suggests that exporters are more likely to face both disruption to input supply and reduction in customers.[17]

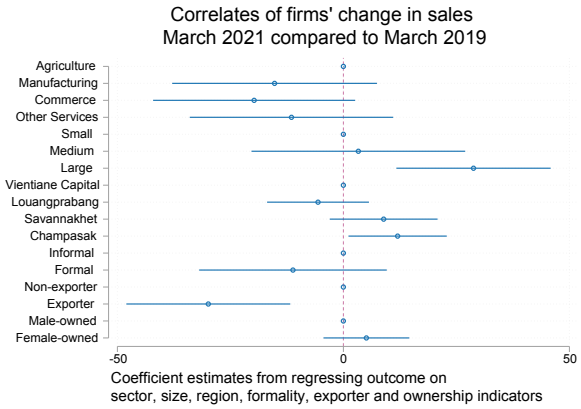
Figure 47. Differences in impact on sales across sectors and firm types

a. Average change in monthly sales by sector



Note: Excludes sectors with fewer than 5 observations

b. Differences in impact by firm type



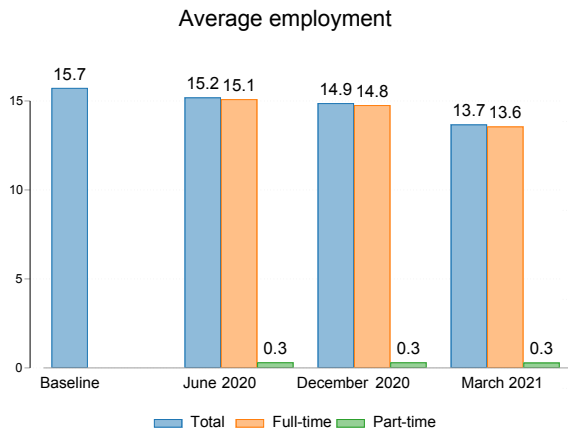
Coefficient estimates from regressing sales growth on sector, size, region, informality, exporter, and ownership indicators

The impact on net employment was initially muted but has intensified over time (Figure 48a). On average, total employment fell from an average of 15.6 workers at the end of 2019 to 13.5 by March 2021. Most of the decrease is among full-time workers, as the reported share of part-time workers is negligible relative to total employment for the average firm. As with the impact on sales, there are substantial differences in employment changes, with some sectors even experiencing an average positive net employment growth (Figure 48b). However, other service activities continue to exhibit significant employment losses. On average, restaurants reported employment losses of almost 50% in March 2021 (relative to December 2019). Hotels, retailers and wholesalers reported employment losses of close to 25% in March 2021, a figure significantly larger than that recorded in both June and December 2020. While firms that experienced larger drops in sales are more likely to have lower employment growth, this relationship is fairly weak and noisy (Figure 48c), suggesting that firms have different capacities for adjustment.

17 As noted in footnote 2, results on exporters should be interpreted with caution given that the sample does not allow the estimation of results representative for the population of exporters in Laos.

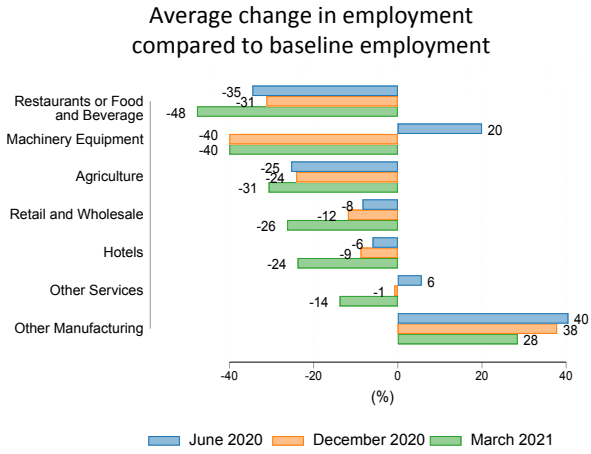
Figure 48. Impact on net employment

a. Trend in net employment



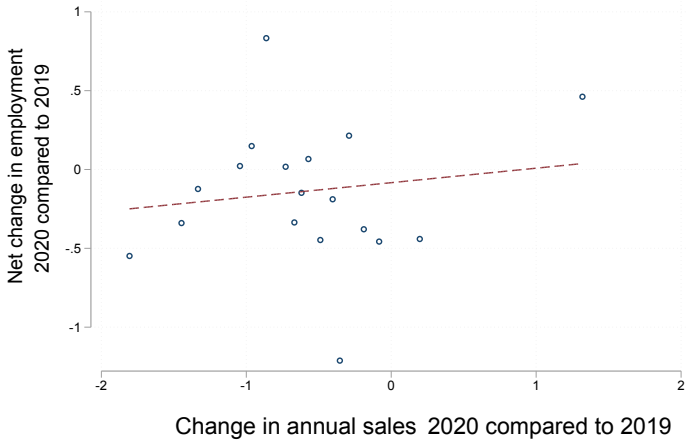
Note: Baseline referes to Dec 2019 (as reported in the 2020 Economic Census)

b. Change in net employment by sector



Note: Excludes sectors with fewer than 5 observations

c. Employment growth vs. sales growth

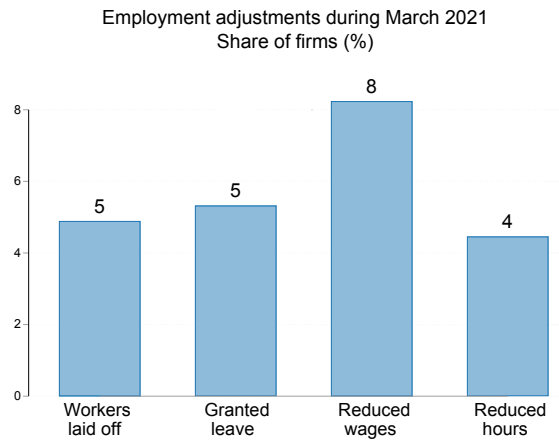


Note: Binned scatterplot of change in employment and sales in Dec 2020 relative to Dec 2019. The data are presented parametrically by grouping change in sales into 20 equal-sized bins. Each dot corresponds to the average change in sales and employment within each bin. Rates of change in sales and employment are calculated as to reduce the influence of outliers.

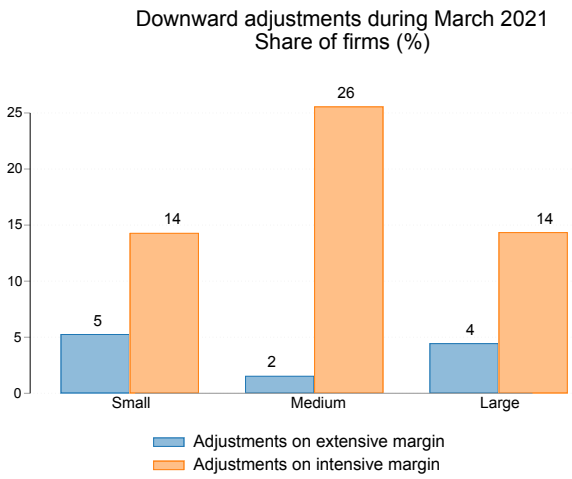
In March 2021, relatively few firms were making significant downward employment adjustments, but there were significant differences across company size, sector, and location (Figure 49). Overall, the number of firms that made one or more adjustments to working conditions (granting leave, reducing wages, reducing working hours) is higher than the number of firms that laid off workers, with the exception of companies in the agriculture sector and in Champassak. Agricultural businesses, and those in Champassak are much more likely to have laid off workers. In contrast, manufacturing companies, medium sized firms, and businesses in Vientiane Capital are more likely to adjust working conditions.

Figure 49. Employment adjustment margins in March 2021*

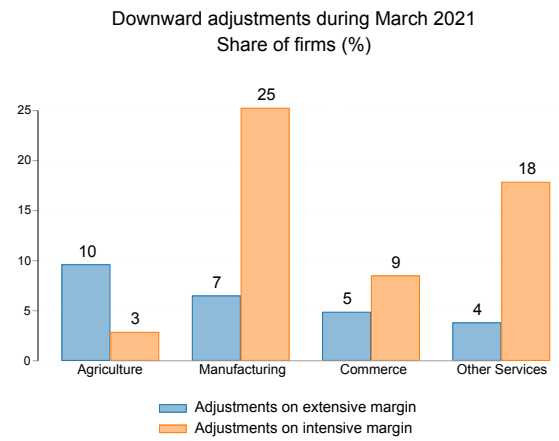
a. Extensive vs. intensive adjustments



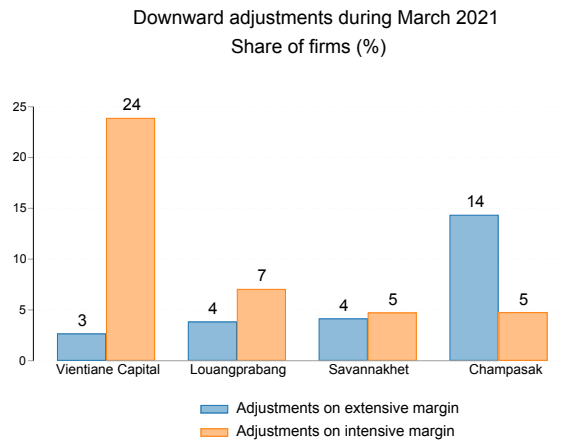
b. Extensive vs. intensive adjustments by firm size



c. Extensive vs. intensive adjustments by sector



d. Extensive vs. intensive adjustments by region



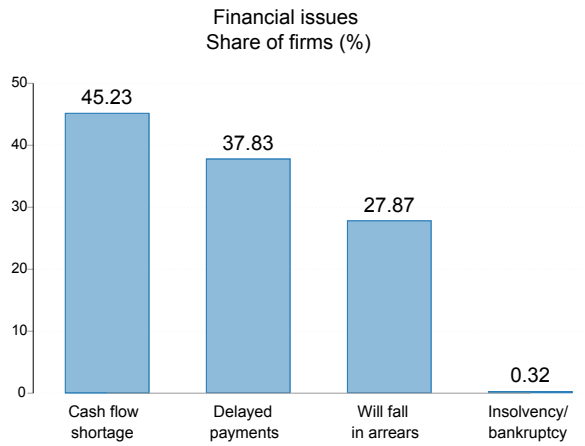
*Note: Extensive adjustment refers to firing workers. Intensive adjustments refer to reducing hours, wages, and granting leave of absence with or without pay

Liquidity shortages and payment difficulties may be increasing

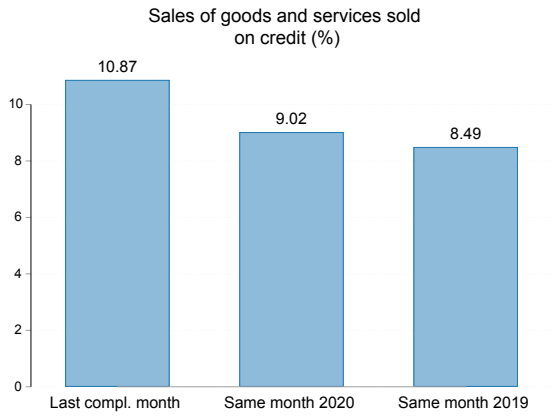
Since the start of the pandemic, almost half of all firms have faced cashflow shortages and more than one third have already delayed at least some payments for more than a week (Figure 50a). Payment issues can also be detected on the customer side. There is a trend of increasing sales of goods and services on credit: the average current share of sales on credit is 11 percent of all sales, compared to 9 percent and 8 percent in the same month in 2020 and 2019 respectively (Figure 50b). As the current outbreak and lockdown increases downward pressure on demand, liquidity shortages are likely to rise. At the time of survey, a relatively low share of firms, 0.32 percent, had filed for insolvency or bankruptcy. However, liquidity pressure may push firms into increased risk of default and insolvency. More than a quarter of firms are expecting to fall into arrears in the next six months, a proportion comparable to findings in the latest surveys from neighboring countries such as Cambodia and Vietnam.

Figure 50. Impact on finances

a. Financial issues experienced by firms



b. Trends in goods and services sold on credit

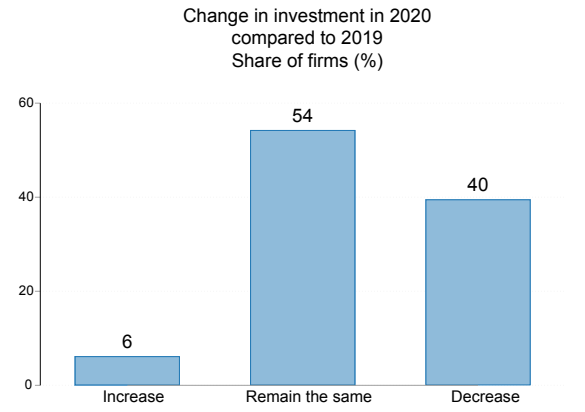


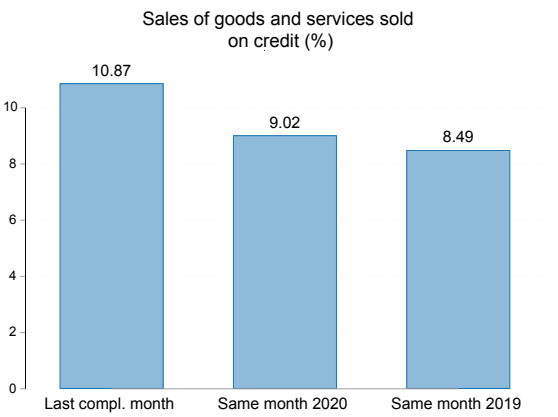
Note: payment delays refer to delayed payments to suppliers, tax authorities, banks, or employees for at least 1 week. "Expect to fall in arrears" refers to the next 6 months.

Negative and persistent shocks to output and investment

A considerable share of firms (40 percent) reduced their annual investment in equipment, machinery, buildings, and software relative to in 2019 (Figure 51). On average, investment in the sample in 2020 decreased by 17 percent relative to 2019, but 25 percent of businesses reduced investment by 40 percent or more. A considerable share of businesses (58 percent) expect lower rates of investment in the coming three to six months relative to the same period of 2019. These lower rates of investment during 2020 and 2021 could negatively affect productivity in the long run, especially if they affect investments in technology and digital capability. Moreover, as most businesses (79 percent) who reduced investment during 2020 expect further reductions in the near future, there are signs of persistent shocks to investment, which will further increase inequality across firms.

Figure 51. Negative shock to investment





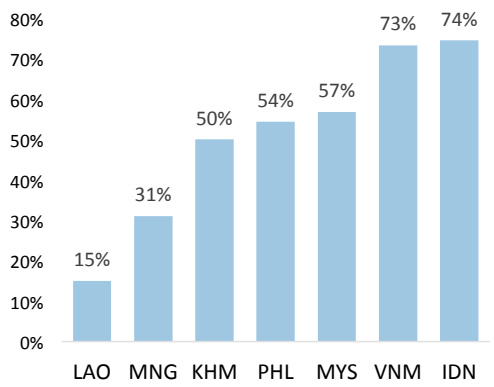
Main reaction to the shock was repackaging the mix of products and services, while digital adoption rate lags behind other countries in the region

The COVID-19 shock accelerated digital adoption across the world, turning a crisis into an opportunity to improve future productivity. However, the rates of adoption in Laos are comparatively low (Figure 52a). Only 15 percent of firms in the sample adopted or increased the use of digital platforms, less than half the proportion observed in the rest of the region.[18] The main response to the shock of the COVID-19 pandemic in Laos has been a repackaging of the mix of products or services (Figure 52b). Around 16 percent of businesses started or increased delivery or carry-on services, and 10 percent started or increased home-based work. Practically every firm in the sample has introduced safety precautions to protect both customers and employees (mainly providing hand sanitizer, ensuring mask wearing and social distancing).

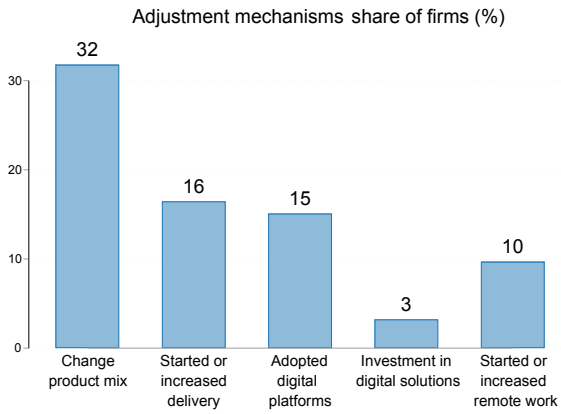
Photo: Phoonsab Thevongsa

Figure 52. How did businesses react to the shock?

a. Adoption of digital platforms during the pandemic



b. Responses to the shock

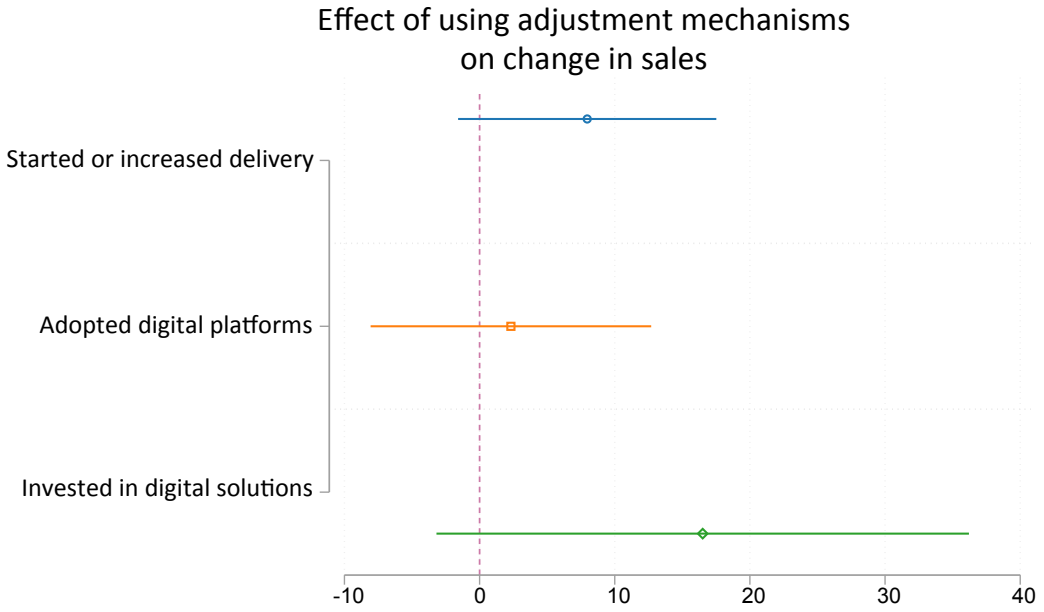


Note: Most recent data point available from the Business Pulse Surveys for each country. LAO: 04/21/2021-05/21/2021. MNG: 02/01/2021-02/18/2021. KHM: 09/03/2020-09/29/2020. PHL: 11/25/2020-12/10/2020. MYS: 01/15/2021-02/10/2021. VNM: 01/27/2021-02/07/2021. IDN: 10/17/2020-11/06/2020. Computations use sampling weights, except in the case of Cambodia and Malaysia.

Investing in new digital solutions and starting or increasing the use of delivery and carry-on services seemed to have helped cushion the shock. Investment in new digital solutions (including equipment and software) has been the most effective response to the shock. Adjusting for differences across sectors, sizes, and geographical locations, investing in digital technologies is associated with sales growth of around 17 percentage points (Figure 53), relative to businesses that have not adopted new solutions (a statistically significant difference). Businesses that introduced or increased the provision of delivery and carry-on services report average sales growth of around 8 pp, a considerable and statistically significant difference.

18 Digital platforms facilitate online commercial interactions between different groups, typically suppliers and buyers (e.g. Amazon, eBay, Alibaba), but also for functions such as payments or supply chain management. The question reads "Has this establishment made any of the following adjustments due to COVID-19? Started or increased use of online/digital platform for major business functions such as sales, marketing and payment, supply chain management." Potential answers: Yes, started; Yes, increased; No, using but not increased; No, not using; Don't know (spontaneous).

Figure 53. Potential benefit from the different responses to the shock



Coefficient estimates from regressing sales change on adjustment mechanisms; controlling for sector, size, and region FEs.

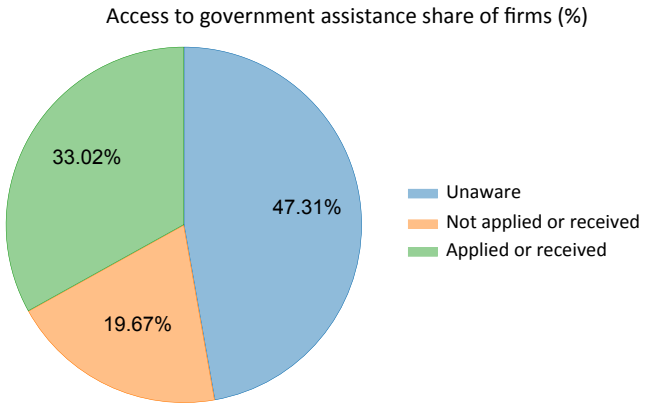
Government support is limited in both coverage and types of instruments

Awareness and access to government assistance remains low. At the time of survey, almost half of businesses reported that they were not aware of government support programs implemented in response to the shock. Around a third of businesses had applied for or benefited from national or local government support programs (Figure 54a). The level of access is low compared to in the rest of the region, where the average share of firms that have already received public support exceeds 40 percent. This relatively low level of support likely indicates a relatively lower need, as the impact in Laos has not been as severe as in other countries in the region. However, the government's limited fiscal space may partly be at play.

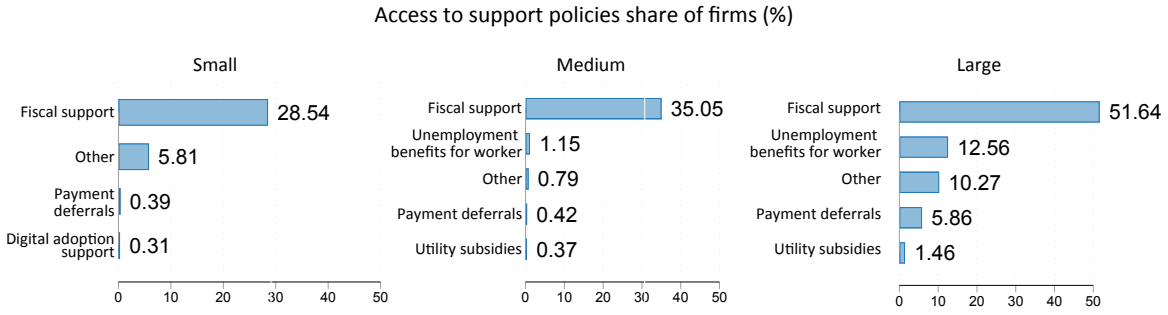
For companies, access to government assistance has been largely through fiscal support, and this has benefited large firms disproportionally (Figure 54b). Overall, close to 30 percent of firms have applied for and/or received fiscal exemptions, tax reductions or deferrals. More than half of all large firms have applied for or received these measures, compared to just 28 and 35 percent of small and medium firms. Large firms are also significantly more likely to have applied for or received wage subsidies and unemployment benefits for workers. Exporters are significantly more likely to have applied for or received fiscal support (46 percent, compared to 29 percent of non-exporters) (Figure 54c). Agricultural firms have the lowest access to support (at less than 20 percent) (Figure 54d). Part of the reason for lower access for SMEs and for agricultural firms may be a lack of information. Close to half of all SMEs are not aware of relevant support policies, while this share is only 22 percent for large firms. Similarly, the share of agricultural firms that are not aware of support policies is 77%, compared to 48% and 34% for commerce and other services firms.

Figure 54. Access to public support

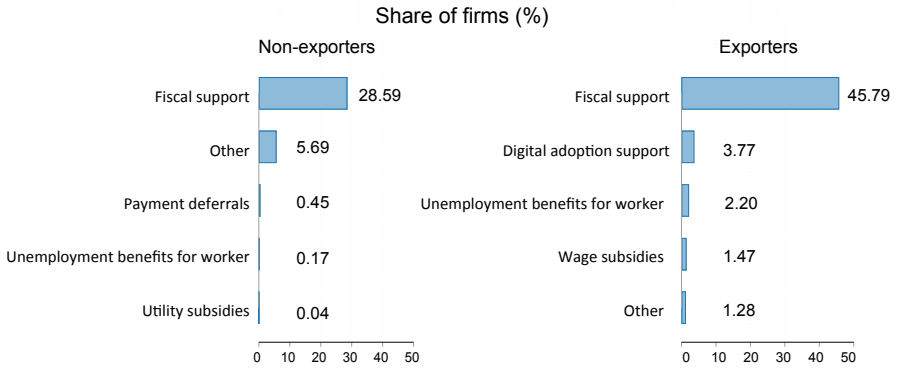
a. Demand for and access to public support



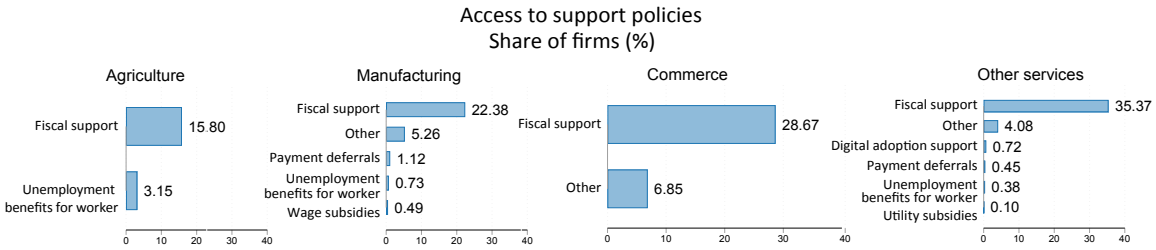
b. Support applied/received by type and firm size



c. Support/applied/received by type and exporting status



d. Support applied/received by type and sector



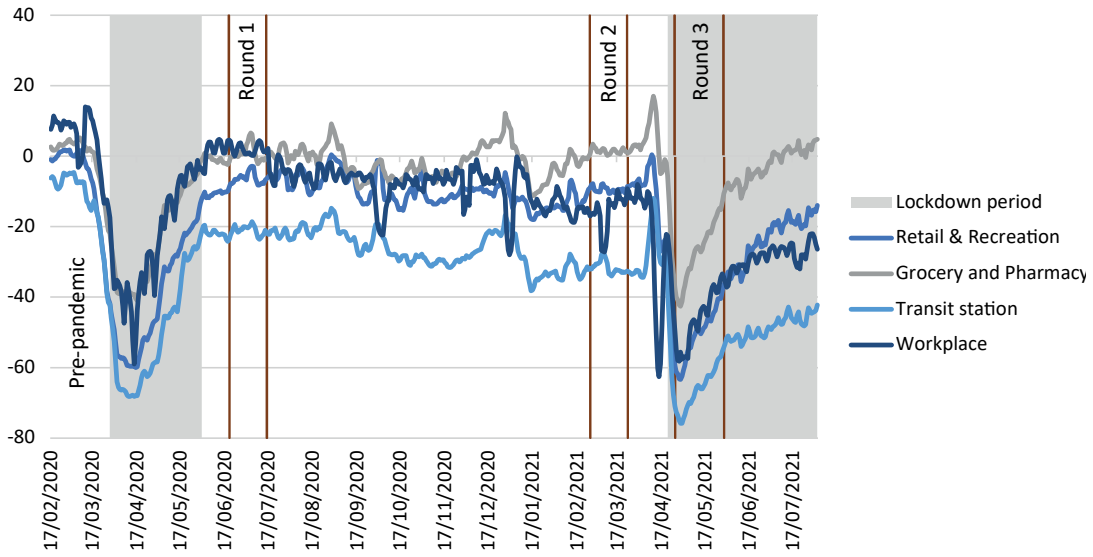
Note: fiscal support refers to fiscal exemptions, tax reductions, or tax deferrals

2. Livelihoods Recovery: An Uneven and Uncertain Path

Livelihoods recovery was robust but uneven before the second wave of COVID-19 arrived. The first COVID-19 wave began in March 2020, and was followed by nationwide lockdown measures to contain the spread of the virus. Disruptions to economic activities resulted in employment and income losses. Nevertheless, the response measures imposed by the Government of Lao PDR proved successful in controlling the pandemic, with only 49 cases confirmed by the end of Q1 2021. While most economic activities had resumed normalcy by then, some sectors continued to be adversely affected.

As the second outbreak has prompted a setback in recovery, the road ahead is shrouded in uncertainty. As infections spiked across Southeast Asia, the number of confirmed cases in Lao PDR surged from less than 50 cases in early April 2021 to more than 2,000 cases in July. The government announced a 14-day lockdown on April 22, which has been continuously extended. International borders remain closed. These measures have caused disruption to businesses and a reduction in working hours and labor earnings. The share of employed adults dropped sharply, from 83 percent before the lockdown to 49 percent during the lockdown period. The figures on the path to recovery presented in this report are largely based on three rounds of rapid monitoring phone surveys of households (Figure 55).[19]

Figure 55. Monitoring the recovery from rapid phone surveys



Source: google.com/covid19/mobility
Note: Visitors to (or time spent in) categorized places change compared to baseline days (the median value from the fiveweek period from January 3 to February 6, 2020). The chart shows a five-day simple moving average.

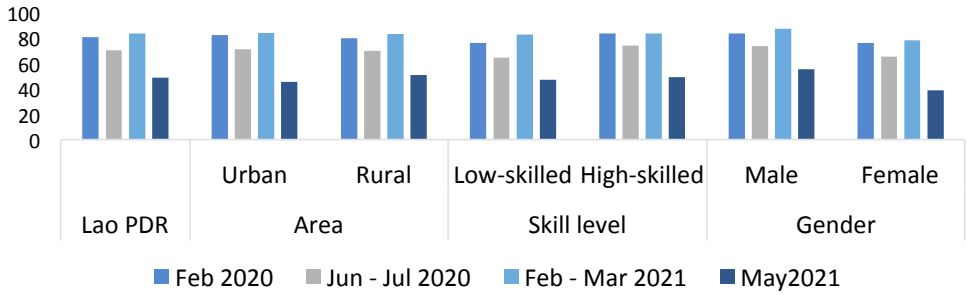
By the end of Q1 2021, the labor market had recovered from the first wave of COVID-19, despite hospitality and transport & manufacturing continuing to suffer. The second wave brought a serious setback to those gains.

19 The first-round survey was conducted from June 20 to July 16, 2020, when Lao PDR had just exited the nationwide lockdown (World Bank, 2020). The second-round survey was conducted from February 26 to March 24, 2021, one year into the pandemic (World Bank, 2021). The third-round survey was conducted from April 26 to May 30, 2021 during a second lockdown.

As of March 2021, the labor market had recovered the jobs that were lost between March and July 2020, thanks to the labor-absorbing capacity of agriculture. The share of employed adults bounced back strongly from 70 percent during June–July 2020 to the pre-pandemic level of 83 percent in Q1 2021 (Figure 56). Job losses due to COVID-19 subsided. Among those who did not work, only a small share of them (11 percent) cited business closures, layoffs, and furlough as reasons for not working. The rest cited reasons that were not directly linked to the pandemic, such as seasonality, sickness, vacation, study, pregnancy, and retirement. The share of pandemic-induced job losses was significantly higher at 70 percent during the post-lockdown period (June – July 2020). The rebound was largely driven by the ability of the agriculture sector to absorb surplus labor affected by pandemic shocks. The share of respondents employed in agriculture rose to 35 percent in March 2021, from 20 percent before the pandemic (Figure 57).

Photo: Phoonsab Thevongsa

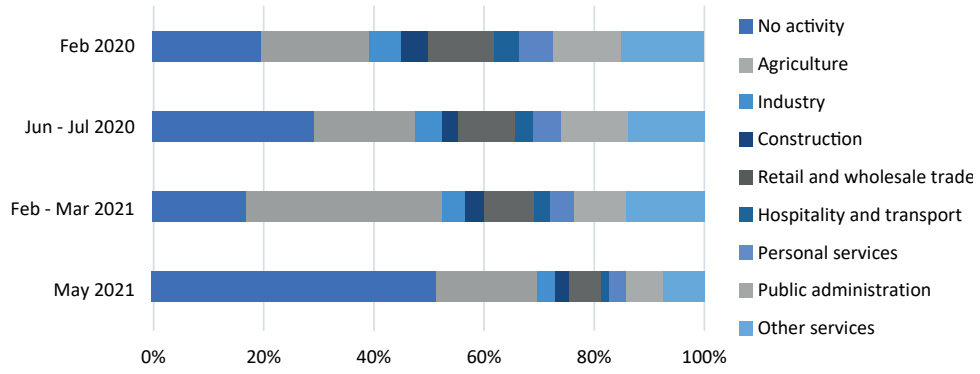
Figure 56. Percentage of employed respondents



Source: Rapid Monitoring Phone Survey of Households Round 1, Round 2, and Round 3.
Note: Respondents are adults aged 18 years or older. High-skilled workers are those with completed secondary education or higher.

The recovery has seen most workers who stopped working during the first wave of the pandemic return to their jobs (or to new ones), except those who worked in hospitality and transport. By the end of Q1 2021, about 80 percent of workers losing jobs early in the pandemic (March–July 2020) had returned to employment. The recovery was uneven across economic sectors. More than 90 percent of workers employed in manufacturing, construction, wholesale and retail trade, and personal and laundry services before the pandemic returned to their jobs (or to new ones). In contrast, 43 percent of hospitality and transport workers who lost their jobs early in the pandemic remained without work in March 2021. Global pandemic uncertainties and continued border closures are hindering this sector's recovery, and it remains the hardest hit by the pandemic in terms of employment. Prospects of permanent job losses were rising for these workers even before the second wave.

Figure 57. Percentage of employed respondents, by sector of employment



Source: Rapid Monitoring Phone Survey of Households Round 1, Round 2, and Round 3.
Note: Respondents are adults aged 18 years or older. Industry includes manufacturing and utilities.

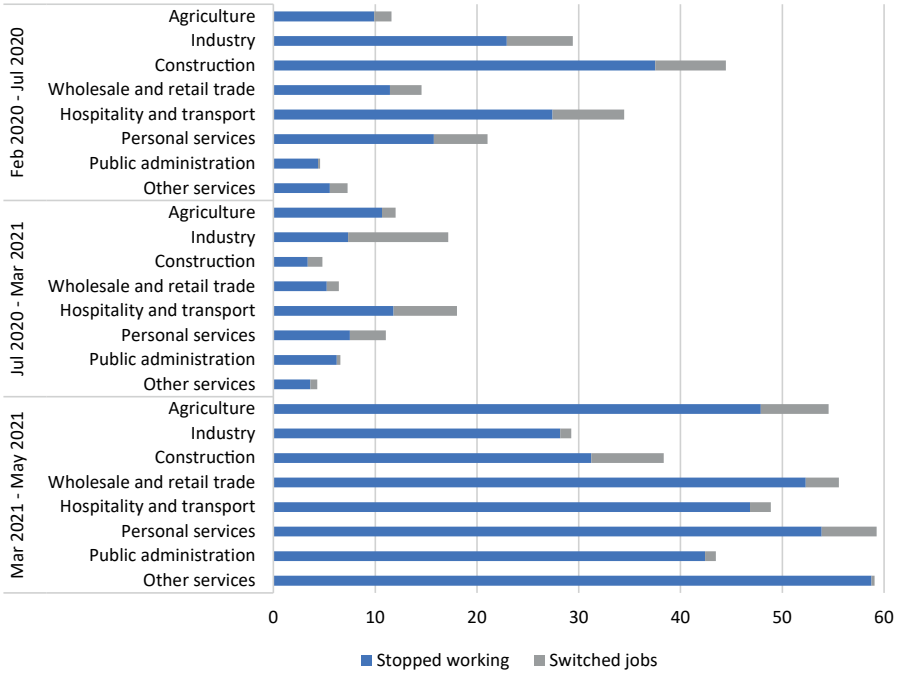
Job losses in hospitality and transport, and in manufacturing remained prevalent even before the second wave. During the first wave of the pandemic and its associated lockdown, construction, hospitality and transport, and manufacturing saw the greatest job losses (Figure 58). During the post-lockdown period, hospitality and transport workers continued to suffer greatly. In addition to relatively few workers managing to return to employment by the end of Q1 2021, the sector also witnessed widespread job loss between July 2020 and March 2021: 18 percent of workers either switched or lost their jobs. During this period, manufacturing also experienced a similar extent of job loss, following a contraction in the sector's exports. Nevertheless, manufacturing workers have proven more resilient to the pandemic impacts. Most of those losing their jobs managed to return to employment or moved to other sectors. The sector also saw milder employment disruptions amid the second wave of COVID-19 compared to in other sectors (Figure 58).

The pandemic's impact on construction employment moderated. Construction shows a robust recovery, as activities resumed after the first wave lockdown measures had been lifted. Most jobs were observed in the construction of highways and railways. A majority of construction workers losing jobs early in the pandemic returned to employment, and only 5 percent switched or lost their jobs between July 2020 and March 2021. A large share of workers laid off in hospitality, transport, and manufacturing also switched to construction. The sector also absorbed internal migrants. Nearly half of workers who migrated to another province to look for jobs and found a job were employed in construction.[20] Around one-third of construction workers were affected by the second wave of the pandemic and lockdown measures. However, the impact was relatively milder than in other sectors.

The recent lockdown has reversed the labor market recovery, and with no certainty on the duration of the outbreak, it could bring another wave of permanent job losses. Lockdowns, restrictions on economic activity, quarantine requirements, and social distancing measures have led to a reduction in employment and working hours. Of those not working, only 40 percent expected that they would return to their jobs or businesses. Farming activities have been disrupted. The services sector (wholesale and retail trade, personal and laundry services, and others) bore a disproportionate burden during the lockdown period as many businesses had to close, and social distancing measures were imposed. However, unlike hospitality and transport, where the impact is expected to be prolonged, wholesale and retail trade, personal and laundry services, and other services tend to gradually resume once lockdown measures are eased.

20 International Organization for Migration (2021). Lao People's Democratic Republic Flow Monitoring Report 2020. Vientiane, Lao PDR: International Organization for Migration.

Figure 58. Percentage of employed respondents stopping work or switching jobs, by sector



Source: Rapid Monitoring Phone Survey of Households Round 1, Round 2 and Round 3.
Note: Respondents are adults aged 18 years or older. Panel subsample.

The recent lockdown disproportionately impacted female and urban workers. The share of employed women halved from 78 percent before the lockdown to 39 percent during the lockdown period. Men faced a somewhat smaller decline, from 87 percent to 55 percent. This is due to a disproportionate share of female employment in the hardest-hit sectors: wholesale and retail trade and other services together accounted for two-thirds of female non-farm employment. Urban workers also experienced a somewhat larger decline in employment (84 percent to 45 percent) than their rural counterparts (83 percent to 50 percent) as lockdown measures were strongly enforced in urban areas where there were more community outbreaks.

Household incomes had only partially recovered from the first wave of the pandemic when the second wave arrived and inflicted further loss of household income.

Prior to the second wave, a rebound in farm income and domestic remittances supported recovery among rural households. The recovery varied across socio-economic groups and income sources. Notable improvements in farm income and domestic remittances were observed among rural households (Figure 59, Figure 60). Although exposed to COVID-19 related disruptions, the agricultural sector grew by 3.2 percent in 2020. The sector's performance remained strong in Q1 2021, with growing agricultural exports (cassava, bananas, rubber). The share of rural households experiencing a reduction in farm income fell from 46 percent in July 2020 to 35 percent in March 2021. Domestic migration also resumed after the first lockdown was eased. Rural workers migrated to seek jobs in other provinces, mainly to the capital, Vientiane, and sent money back to their families. In March 2021, one-third of rural households still experienced a decline in domestic remittances compared to pre-pandemic levels, a significant improvement from 57 percent of households in July 2020.

Income from international remittances is not recovering among rural households, and is adversely affected by the second wave. It is estimated that more than 200,000 migrants have returned to Lao PDR since the outbreak, most of them from Thailand. Around 65 percent of those returning from Thailand arrived by the end of June 2020, and 32 percent returned between July and September 2020. Half of these migrants used to send home at least $100 a month.[21],[22] Return migration means a complete loss of remittance income for households. At the same time, migrants who remained in Thailand tended to send less money. Rural households saw the weakest recovery of remittances. The share of households experiencing a fall in remittances has not improved (52 percent in July 2020 and 51 percent in March 2021). Furthermore, 63 percent of rural households experienced a decline in international remittances between March 2021 and May 2021, as a second COVID-19 wave surged through Southeast Asia (Figure 61).

The second wave of COVID-19 resulted in a widespread loss of household income, which had only partially recovered from the first wave. In July 2020, nearly half of households (48 percent) experienced negative income shocks from the pandemic and lockdown measures. As the first wave was contained and the economy started to recover, the share of affected households fell to 31 percent in March 2021. While nearly one-third of households still bore the brunt of the pandemic, the second wave caused a further loss in household income. Around 43 percent of households faced income reduction from the second wave of COVID-19 (Figure 61).

Figure 59. Percentage of urban households with reduced income against the pre-pandemic period.

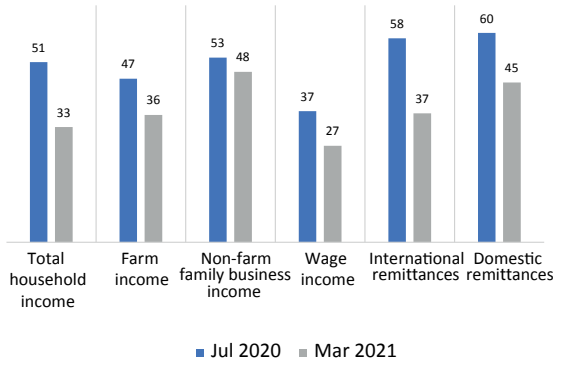
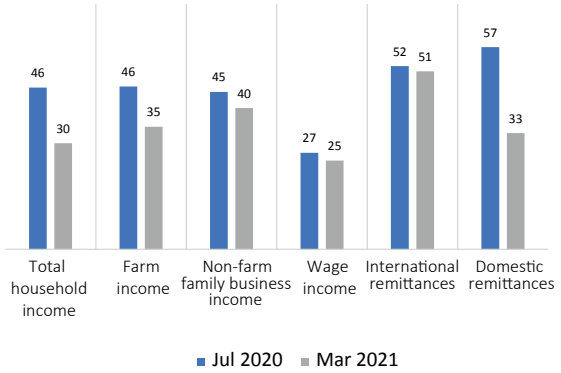
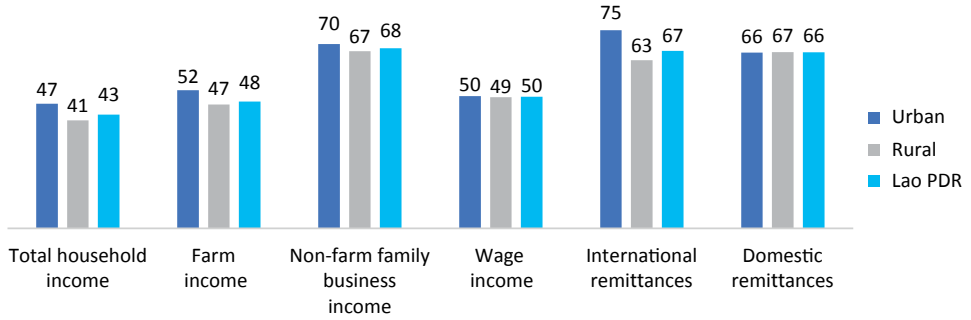


Figure 60. Percentage of rural households with reduced income against the pre-pandemic period.



Source: Rapid Monitoring Phone Survey of Households Round 1 and Round 2.

Figure 61. Percentage of households with reduced income during the second wave of COVID-19
(May 2021 compared with March 2021)



Source: Rapid Monitoring Phone Survey of Households Round 3.

21 IOM (2021).
22 The minimum wage is 1.1 million kip or approximately $117 per month.

Recovery of wage and international remittances before the second wave was robust among urban households. By the end of Q1 2021, most urban wage workers were able to resume their employment. International migrants from urban households, who tended to remain abroad compared to their rural counterparts, also managed to send back remittances. Only 27 percent and 37 percent of households experienced a reduction in wage income and international remittances, respectively, sent from abroad in March 2021, a significant improvement on 37 percent and 58 percent in July 2020. During the second wave, wage income was relatively less affected than other income sources. International remittances, however, were more susceptible to the second wave as Thailand, the main migrant destination country, also faced a new outbreak. In May 2021, the majority of remittance-receiving households (75 percent) faced a decline in remittances sent from abroad.

Family businesses that struggled to recover from the first wave of COVID-19 have been battered by the recent outbreak. Family businesses that were seriously hit during the first wave of the pandemic did not show any signs of robust recovery. In March 2021, 10 percent of household businesses had permanently closed or remained temporarily closed, compared with 8 percent in July 2020. Between these two periods, the share of businesses that had permanently closed rose from 1 percent to 3 percent. The number continued to rise to 6 percent amid the second wave. Around one-third of family businesses were temporarily closed in May 2021. For those that remained open, 65 percent experienced a revenue decline, especially among household businesses in urban areas (70 percent).

Farm income has been significantly affected by recent lockdown measures relative to the first lockdown. Restrictions on movement and transportation imposed during the second wave disrupted farming activities. Around 14 percent of farming households stopped farming or could not operate their family farm normally in May 2021, compared to 6 percent in March 2021 before the second wave. Nevertheless, farm income still proved more resilient to pandemic shocks than other income sources, with around half of households experiencing a decline in income amid the second wave.

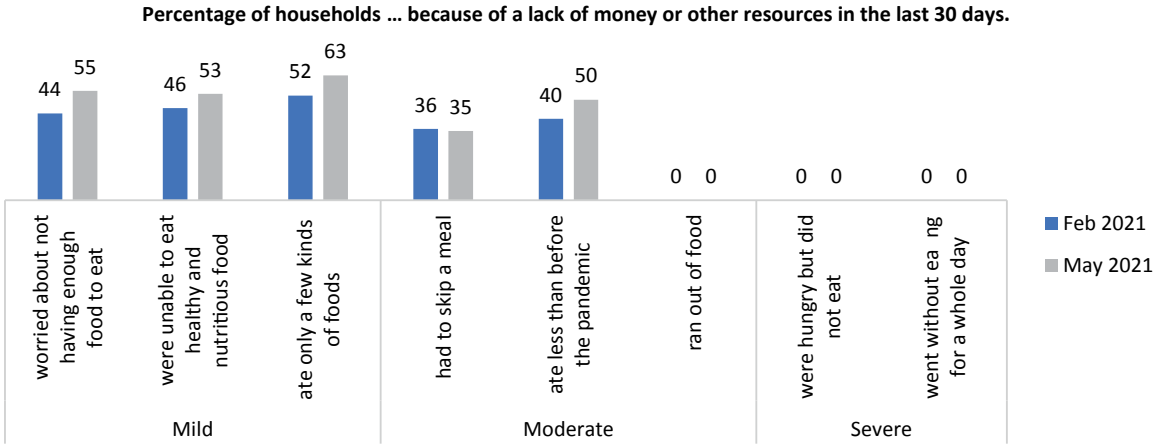
Food supply chain disruptions and soaring food prices put pressure on food security, and the second wave of COVID-19 has worsened the situation.

Soaring food prices are weighing down recovery, notably among the urban poor. Food prices rose by 2.3 percent (yoy) in February 2021 and by 2.6 percent (yoy) in March 2021, driven by agricultural supply chain disruptions and depreciation of the kip. Prices for meat, fruit and vegetables, and rice remained high in March 2021. Some households experienced a significant increase in staple food prices. Of 54 percent of households that experienced an increase in the price of rice relative to the pre-pandemic level, 34 percent faced an increase of more than 20 percent. Moreover, 30 percent of households bought chicken at prices 20 percent higher than they were one year ago. Urban households suffered more from rising staple food prices, with 33 percent and 22 percent of urban households experiencing a surge of more than 20 percent in the prices of chicken and pork respectively, compared to 29 percent and 17 percent of rural households. Therefore, the urban poor were disproportionately affected given their low-income status and heavy reliance on purchased food.

While there was no incidence of severe food insecurity (hunger), moderate food insecurity reached worrying levels in February–March 2021 (Figure 62). Food insecurity measures a lack of regular access to enough safe and nutritious food for normal growth and development, and an active and healthy life. This may be due to the unavailability of food or a lack of resources to obtain food. Food insecurity can be experienced at different levels of severity. In February–March 2021, 41 percent of households ate less than before the pandemic, while 36 percent had to skip a meal due to lack of money or other resources. More than half of households (51 percent) had to reduce the

quality of food consumed due to lack of money or other resources. Nevertheless, no incidence of severe food insecurity or hunger was present. Despite a larger increase in staple food prices in urban areas, the incidence of moderate food insecurity remains higher among rural households than in urban households, and is higher among ethnic minority households than in Lao-Tai households.

Figure 62. Food insecurity



Source: Rapid Monitoring Phone Survey of Households Round 2 and Round 3.

The second wave of the pandemic worsened food insecurity. Food supply chain disruptions due to lockdown measures drove up food prices. One third of households said they experienced abnormal price increases or shortages of meat and fish during the past week, while 17 percent of households experienced the same for eggs, and 11 percent for rice and vegetables. Mild food insecurity intensified during the second wave, with 53 percent of households unable to eat healthy and nutritious food, and 63 percent of households eating only a few kinds of food due to a lack of money or other resources (Figure 62). Moderate food insecurity slightly worsened, with half of households eating less than they did before the pandemic. Concern about food insecurity increased across the board. More than 25 percent of households were very concerned about food insecurity for people in their community, an increase from 16 percent before the second wave began.

Access and quality of public services faced mixed performance during the pandemic.

Difficulties accessing essential services vary across services, regions, gender, and income level. Over 40 percent of households reported difficulties accessing health and education services. However, access to electricity and water reported minimal disruption with only 18 percent and 25 percent reporting difficulties in access. Most households (84 percent) reported no difficulties in accessing government administrative services since the pandemic began in March 2020. While the national health insurance scheme facilitated by the National Health Insurance Bureau may have led to minimal differences in access and quality of health services, households in rural areas and in the bottom 40 faced more difficulties accessing health services.[23] Households in rural areas had higher difficulty in accessing water and electricity, 30 percent and 20 percent, relative to those in urban areas, 17 percent and 15 percent.

23 The bottom 40 are the population in the bottom 40 percent of the cumulative consumption distribution. The top 60 are the population in the top 60 percent of the cumulative consumption distribution.

The quality of health services maintained the same status while the quality of education services experienced biggest decline. About 87 percent of households reported the same or improved quality of health services delivered. The proactive government efforts to support the health sector, staff, and service delivery, may have resulted in improved quality services and staff observed COVID-19 protocols ensuring anyone with symptoms is adequately served and contact tracing monitored closely. During the second wave, one-quarter of households needed medical services, and 97 percent of them were able to access the services without any difficulties. In contrast, about 21 percent of households reported a decline in the quality of education. Few children undertook fewer learning activities during the second school closure. About 16 percent of households had their children engaged in learning activities during the second wave of school closures compared to 24 percent during the first wave of school closures. The loss was significant in rural areas, where only 11 percent of households engaged children in learning activities. Similarly, while 33 percent of urban households had their children communicate with teachers during school closures, only 22 percent of rural households did.

While the quality of electricity services remained satisfactory, the quality of water services worsened considerably for rural households and those from the bottom 40. Overall, only 7 percent of households reported a decline in the quality of electricity services, with no group experiencing a notable decline. In contrast, 17 percent of households from rural areas and the bottom 40 voiced a decline in the quality of water services, compared to 7 percent of urban households and 12 percent of households from the top 60.

Photo: Phoonsab Thevongsa

Photo: Phoonsab Thevongsa

3. Policy options to support business recovery and improve livelihoods

Response measures to support business recovery

BPS survey results show that the COVID-19 pandemic is having a deepening impact on business performance, leading to a pessimistic investment outlook, and therefore significant policy efforts are required to help firms overcome the crisis and support economic recovery. Findings from the survey suggest that the impacts of COVID-19 on operations, sales, and employment have been felt widely across firms, particularly after the second lockdown. Furthermore, heightened uncertainty and pessimistic investment expectations signal a potential drag on future productivity. With rising liquidity pressure, demand for support will likely increase. More effective assistance to recovery will require efforts to reach more SMEs and to broaden policy instruments beyond fiscal exemptions.

As businesses are coping with a second outbreak and increased liquidity pressure, demand for support will likely increase. Given the government's limited fiscal space, better targeting can help allocate resources to the most needed firms. Globally, countries have tended to support more affected firms, and evidence suggests that early support can help speed up recovery. Besides targeting degree of need, support should be based as much as possible on objective criteria related to the potential to thrive in the future. In some cases, it may be more effective to link targeting with "behavior" or to target through instruments of support rather than the characteristics of companies.

To target firms in need, support should be broadened to other policy instruments beyond fiscal exemptions. Evidence from the survey suggests that, conditional on sector, firm size, and region, there is no significant correlation between the likelihood that a business has applied for or received government assistance and the magnitude of the impact on sales since COVID-19 emerged. There is also no evidence that support has helped firms cope with the crisis in Laos so far: the likelihood of having applied for or received support is not associated with current sales or employment outcomes. This result may be explained partly by the fact that support received has been largely in the form of fiscal exemptions. While effective in relieving cashflow constraints for those eligible, it is difficult to use fiscal exemptions to target firms in need.

Furthermore, support instruments could be oriented not only to buffer liquidity shock, but also to improve the capabilities of businesses. Evidence from Laos already suggested that digital investments and adoption of new delivery methods to reach customers are associated with lower sales losses. Given the adoption gaps among firms in Laos, supporting the take-up of digital technologies is a promising avenue for helping businesses to turn a crisis into an opportunity and to improve productivity in the long term. Survey results suggests that uncertainty about the benefits of digital solutions and lack of skills among employees are the main obstacles to the adoption of digital solutions. Therefore, this type of support will need to go beyond addressing constraints to accessing finance, and must be tailored to the demands of different types of firm.[24]

Support measures on the demand side will also be critical. As containment measures ease, supply constraints will likely relax. Survey results suggest that more businesses — especially SMEs and exporters — are already reporting more difficulties on the demand side than on the supply side. Recovery in demand may take longer, due to feedback effects from increased uncertainty and loss of income. Evidence from other countries suggests that businesses born in downturns start smaller and remain smaller over their entire lifecycle, possibly on account of their inability to develop demand relationships. While such measures can better target firms, their implementation is also more complex than for less selective instruments such as fiscal exemptions. More effective public information campaigns and administrative support will be needed to ensure equal access among firms, particularly in light of the low awareness about current government support programs. More broadly, regardless of the instruments used, to counter the rising uncertainty caused by the COVID-19 pandemic, the government needs to commit to transparent and time-bound policies.

Key response measures to support livelihoods recovery

Measures to mitigate negative impacts on employment were among the immediate responses when the first wave of COVID-19 hit. The government issued tax relief measures to counter the impact of the pandemic. Individual tax relief measures include tax exemption on the first 5 million kip of monthly salaries for a three-month period (April to June 2020). Business tax relief measures include tax exemption for microenterprises and postponement of tax payments in the tourism sector. In addition, the COVID-19 unemployment benefit program was introduced for employees who are members of their business's social insurance scheme. For affected employees to be eligible for unemployment benefits, businesses forced to close during the pandemic have to request financial assistance for temporarily unemployed staff from the National Social Security Fund. One-time cash transfers were distributed to garment workers affected by COVID-19 in March 2021 to help mitigate workers' lost income and to support business continuity while reducing employers' staff turnover costs.

Coverage of the response measures was limited, and many of them were time limited. Around 16 percent of households benefited from personal income tax exemption, while 23 percent of family businesses benefited from business income tax exemption for microenterprises and postponement of tourism sector tax payments. In particular, 21 percent of family businesses with fewer than five employees (microenterprises), and 26 percent of family businesses in the hospitality and transport sectors benefited from these measures. Unemployment benefits had covered 8 percent of households by March 2021. Nevertheless, the social protection gap remains significant. Around three-quarters of family businesses were temporarily closed or experienced a revenue decline during the recent lockdown. Also, most response measures did not reach informal workers, whose livelihoods were more vulnerable to employment and income shocks.

24 Among small businesses, the main constraint to adoption of digital solutions is uncertainty about the benefits (30% of firms). Among medium-sized and large firms, the main barrier to implementing digital technologies is lack of skills among employees (57% and 40% respectively). In addition, a considerable proportion of large firms (17%) report high costs in complying with government regulations. Only 11% of small firms and 7% of medium-sized firms report lack of financial resources.

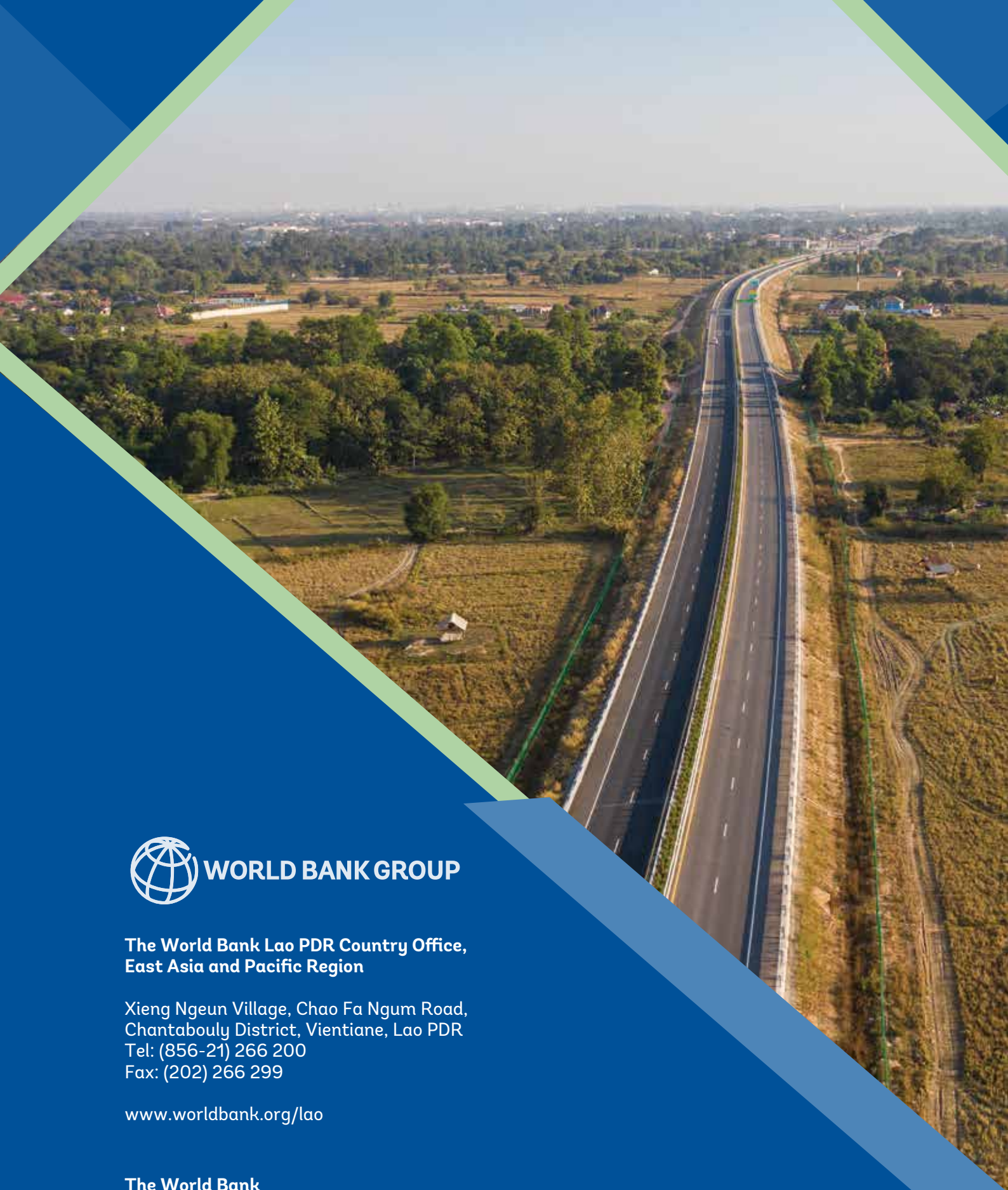
Photo: Phoonsab Thevongsa

The most recent lockdown requires government livelihood protection and employment support measures to put the recovery back on track and support the most vulnerable in the society. The second wave is making it more challenging for vulnerable households to maintain their livelihoods. Livelihood protection measures such as unemployment benefits or cash transfers can mitigate the negative impact of job loss during the lockdown. This will require the expansion of various government schemes, allowing for greater coverage of vulnerable groups, including female workers and workers in the hardest-hit sectors. Employment support measures such as for family businesses and employers would ensure that workers will be able to resume their jobs once lockdown measures are lifted.

In the medium term, the vaccine rollout brings optimism for the path to recovery, but uncertainties remain. By mid-July 2021, Lao PDR had vaccinated around 14 percent of the population, with 8 percent fully vaccinated[25]. With 87 percent of survey respondents willing to be vaccinated if a vaccine is available at no cost, high levels of vaccination coverage are achievable if supplies permit. However, due to the pandemic global economic outlooks remain uncertain and some population groups will continue to suffer negative impacts.

The recommended policy pathway is to promote a robust and more equal recovery. The pandemic has adversely affected the informal sector, those with limited access to services and the poor who have limited coping measures. Priority should be given to informal workers in the hardest hit sectors which show signs of sluggish recovery, i.e. manufacturing, and hospitality and transport. The survival of household businesses would support a robust and equal recovery. So far, nearly 10 percent of household businesses have closed, and the impact of COVID-19 is threatening the survival of those that remain open, nearly half of which are experiencing revenue declines. Supporting entrepreneurs and saving these businesses is more important than ever. The pandemic has also worsened pre-existing structural problems in the domestic labor market, aggravated by an influx of returning migrant workers. Active labor market programs and labor market information systems need to be improved and made operational to reduce labor market mismatch. Lastly, efforts to facilitate food supply chains and curb staple food prices should continue, as persisting food security problems could have long-term impact on human capital, especially among vulnerable populations.

25 https://laotiantimes.com/2021/07/12/laos-vaccinates-over-1-million-people/



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