Lao PDR Economic Monitor

Lao PDR in the time of COVID-19

Thematic section:

Building a resilient health system

June 2020

Macroeconomics, Trade and Investment
East Asia and Pacific Region

WORLD BANK GROUP

Acknowledgements

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This report comprises two parts: Part I: *Part I: Recent Economic Update,* and Part II: *Building a resilient health system for health emergencies: Addressing system constraints for improving financing and service delivery*. The team worked under the guidance of Mariam Sherman (Country Director), Deepak Mishra (Practice Manager), Nicola Pontara (Country Manager), Aparnaa Somanathan (Practice Manager, HNP), and Hans Anand Beck (Program Leader). We gratefully acknowledge the production and dissemination assistance provided by Boualamphan Phouthavisouk (Team Assistant) and Vannaphone Sitthirath (External Affairs Consultant).

The team would like to express its gratitude to the Government of the Lao PDR, particularly the Ministry of Finance, Bank of Lao PDR, Ministry of Planning and Investment, Ministry of Industry and Commerce, Ministry of Energy and Mines, and other line ministries, and representatives from members of the Lao National Chamber of Commerce and a number of businesses and banks for sharing their valuable views and input.

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

BoL	Bank of the Lao PDR
CBOE	Chicago Board Options Exchange
COVID-19	coronavirus disease 2019
DB	Doing Business
DHOs	District Health Offices
EDL	Électricité du Laos
EMDEs	Emerging Market and Developing Economies
FM	financial management
FMIS	Financial Management Information System
GoL	Government of Lao PDR
H5N1	influenza A virus subtype H5N1 (A / H5N1)
HIV	human immunodeficiency virus
HIV/AIDS	human immunodeficiency virus infection and acquired immune deficiency syndrome
ICU	intensive care unit
LNCCI	Lao National Chamber of Commerce and Industry
LSIS	Lao Social Indicator Survey
MoF	Ministry of Finance
MoH	Ministry of Health
NHI	National Health Insurance
OOP	out-of-pocket
PFM	Public Financial Management
PHOs	Provincial Health Offices
PMI	Purchasing Managers' Index
PoE	point of entry
q/q	quarter-on-quarter
SAAR	seasonally adjusted annual rate
SARS-CoV - 2	severe acute respiratory syndrome coronavirus 2
SMEs	small and medium-sized enterprises
SOEs	state-owned enterprises
TB	tuberculosis
UHC	universal health coverage
UNCTAD	United Nations Conference on Trade and Development
VAT	value-added tax
WHO	World Health Organization
yoy	year-on-year

Photo credit: Phoonsap Thevongsa

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Executive Summary

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Executive Summary

1. **Lao PDR has so far avoided a major health crisis but has not been immune from the global economic downturn.** The COVID-19-induced economic downturn has affected Lao PDR through multiple channels including tourism, trade, investment, commodity prices, exchange rates, and lower remittances. Given the uncertainty regarding the duration, pervasiveness, and severity of the COVID-19 outbreak at both the global and domestic levels, this report presents a range of growth estimates for 2020 under two scenarios. These scenarios reflect different assumptions regarding (i) the duration and depth of outbreaks and lockdown in Lao PDR, (ii) the magnitude and effectiveness of economic relief policies, and (iii) the depth and duration of the global downturn. In the more favorable scenario, the Lao PDR's economy is expected to grow at 1 percent, while in the downside scenario, the economy could contract by 1.8 percent in 2020. In either case, this will be the slowest growth rate since 1990.

2. **The COVID-19 shock has further aggravated the long-standing structural vulnerabilities in the economy.** The country has a legacy of weak macroeconomic management, resulting in limited fiscal and foreign currency buffers even before the global pandemic. The level of international reserves is at a multiyear low. The gap between the official and parallel market exchange rates has increased and is higher than historical norms. Despite lower public expenditure, weak revenue collection has resulted in an elevated fiscal deficit. The fiscal deficit is expected to rise to 7.5 to 8.8 percent of GDP and public debt to 65 to 68 percent of GDP in 2020, leaving the country at high risk of debt distress. Limited fiscal space and the mounting pressure of deficit financing and debt servicing will limit the ability of the Government of Lao PDR (GoL) to stimulate the economy, exacerbating the downturn.


Photo credit: Phoonsap Thevongsa

The employment and welfare impacts have been severe

3. **The COVID-19 crisis has affected mostly labor-intensive sectors and those linked to global and regional value chains.** Tourism-related sectors, including transport, food, and accommodation services and the retail trade have been hard hit due to fewer tourists from China and other neighboring countries in the first quarter of 2020. This situation is likely to have further deteriorated in the second quarter due to travel restrictions adopted in other countries, the continued closure of Lao borders, and the current domestic lockdown. Investment in these sectors is also expected to moderate. Small and medium-sized enterprises (SMEs) are particularly vulnerable in the current crisis. Supply chain disruptions have caused delays in delivering inputs to manufacturing industries and the construction sector. Export-oriented industries have also been significantly hit by lower external demand.

4. **The containment measures in Lao PDR and by key economic partners are causing unprecedented disruption to the labor market.** A sharp drop in demand is leading to job losses in tourism-related sectors, which account for 11 percent of total employment. As the labor market comprises a considerable share of informal employment and workers outside the social insurance system, protection is minimal. To help those affected, the GoL is providing social insurance support to around 96,000 affected workers who are members of social insurance scheme. However, this coverage amounts to only 3.1 percent of total employment and 26 percent of total urban wage workers.

5. **The economic shock due to COVID-19 is also adversely impacting the flow of remittances and could push as many as 214,000 people into poverty.** Since the outbreak began, more than 100,000 migrant workers have returned to Lao PDR. This has resulted in an estimated reduction of up to US$125 million in remittances in 2020, or 0.7 percent of GDP. Around 9 percent of households receive remittances from abroad, and remittances constitute 60 percent of their household income. This implies a significant reduction in recipient household income. Based on the two growth scenarios, poverty is estimated to increase by 1.4 to 3.1 percentage points in 2020. In other words, poverty is estimated to increase by about 96,000 people as a result of the pandemic, or by 214,000 people if the downside scenario prevails. The impact of the pandemic on poverty is expected to linger, with poverty projected to return to its pre-crisis level in 2021 under the upside scenario, or later than 2022 under the downside scenario.

Public finances will reach a new low

6. **Weak performance in the real sector will exacerbate the country's already weak fiscal position, further eroding fiscal space.** Declining business income, particularly in the services and manufacturing sectors, resulted in lower GoL revenue collection in the first two months. Preliminary estimates indicate that domestic revenue collection for January–February 2020 dropped by 30 percent year-on-year. The Ministry of Finance (MoF) estimates that revenue loss for 2020 will be about 3 to 4 percent of GDP, mostly from the fall of value-added tax (VAT), excise tax, profit tax, and customs duties. As a result, the fiscal deficit is estimated to increase to 7.5 to 8.8 percent of GDP in 2020 from 5.2 percent in 2019, while public debt is estimated to rise to around 65 to 68 percent of GDP from 59 percent during the same period. The risk of debt distress remains high.

7. **With growing turbulence in global financial markets, the GoL has limited options to refinance its maturing debt.** Restricted domestic financing opportunities, coupled with the downgrading of Lao PDR bonds in the Thai capital market, led the GoL to issue bonds on the international financial markets at a below-investment-grade rating in 2019. The external debt servicing burden (interest and principal) is expected to increase to over US$1.1 billion for each year in the medium term (about 55 percent of domestic revenues, on average). In this context, the GoL might like to consider renegotiating debt with key creditors, participate in the recent Debt Service Suspension Initiative announced by the G20, and seek a joint donor support program.

Growing fragilities in balance of payments and the financial sector

8. **The country's external balance is vulnerable, with persisting low reserve buffers and a widening exchange rate premium.** The current account deficit is expected to increase in 2020 due to lower tourism activities, higher debt service obligations, and lower remittances. As a result, the financing gap will widen and will require fresh external borrowing and the drawing down of reserves. As a result, reserves are expected to decline to below one month of imports. The gap between the official and parallel market exchange rate has increased in recent months and is currently higher than historical norms. With limited access to commercial borrowing at reasonable cost, Lao PDR will need considerable support from its development partners to avoid balance-of-payment problems in 2020.

9. **The financial sector entered the COVID-19 crisis with considerable preexisting vulnerabilities**. While on average banks still hold regulatory capital above the minimum thresholds, the capital adequacy ratio has significantly declined—from 18 percent in 2018 to 12 percent in 2019. Nonperforming loans (NPLs), as of end-March 2020, remain at 3 percent. However, the significant slowdown in economic activities due to the COVID-19 impact implies a higher level of NPLs, which could in turn further weaken banks' balance sheets and constrain credit growth. Significant deceleration of economic activities and forbearance given as part of the monetary stimulus measures are expected to exert more pressure on the already fragile financial sector.

Outlook and risks

10. **The economic outlook will depend on the depth and duration of the global outbreak and the effectiveness of domestic economic relief measures.** Although subject to high uncertainty, growth is expected to gradually rebound to an average of 4.5 percent over the next two years under the upside scenario, assuming a gradual recovery in key trading partners and the resumption of some domestic economic activities. However, the pace of growth would remain below its 2019 level, due to limited fiscal and monetary buffers to support the implementation of economic relief measures. The downside case assumes a much slower recovery path due to limited policy buffers and a slower and longer recovery in key trading partners, resulting in growth rebounding to an average of 2.5 percent over the next two years.

11. **The medium-term outlook is characterized by significant downside risks.** These include (i) a more prolonged and/or severe outbreak of COVID-19 either globally, regionally, or domestically, exacerbated by a more sluggish recovery in Lao PDR's key trading partners; (ii) heightened challenges in meeting public external debt service obligations; (iii) adverse weather-related events; and (iv) more significant impacts on the private sector, which could cause liquidity problems in business and defaults, exacerbating the already fragile fiscal situation and further weakening the financial sector. Given the current fragile economic situation, one or a combination of these risks could result in a more severe downside scenario.

Policy options

12. **To foster economic recovery, some measures have already been put in place such as tax relief and deferrals to businesses, expansionary monetary policy, and a credit moratorium.** The gains from these measures depend on targeting viable businesses (SMEs and large firms) that are temporarily affected by the COVID-19 shock but have the ability to rebound. While providing support to businesses, accelerating revenue administration reforms would be essential to build the fiscal space for the GoL to mitigate shocks. Engaging in restructuring of external debt through the debt service suspension initiative and joint-donor support program could help alleviate some of pressure on the debt service in the medium term.

13. **Policy options to mitigate the impacts of the COVID-19 outbreak should provide immediate economic relief while supporting recovery and fostering resilience in the medium term.** 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. These include direct cash transfer programs to economically vulnerable households and displaced workers. In the longer term, accelerating reforms to promote diversification and improve competitiveness in the private sector, supported by improved connectivity, will be important to strengthen economic and social resilience. More and better investment in human capital and social protection can also improve households' ability to handle the impacts of shocks.

Building a resilient health system for health emergencies: Addressing system constraints for improving financing and service delivery

14. **The global COVID-19 outbreak has challenged the readiness of the health system and the health emergency response capacity in Lao PDR.** Large gaps already exist in service availability and readiness across health facilities including the lack of basic amenities, limited diagnostic capacity, and low availability of essential medicines. The country urgently needs to invest more in building a strong foundation for emergency health response capacity 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 the virus under control.

15. The COVID-19 outbreak has further strained the existing weaknesses in the health sector. Most health facilities have insufficient isolation rooms and equipment for the treatment of patients with severe respiratory diseases. Frontline health workers lack personal protective equipment and adequate training on infection prevention and control and case management while demand on health facilities and health workers are rapidly increasing. Safety for health workers with appropriate training and reorientation of services for both COVID and non-COVID services are urgently needed to ensure delivery of effective health services for health workers and patients.

16. Early evidence suggests that the COVID-19 outbreak has affected essential service delivery and disproportionately impacted women as well as poor and vulnerable groups who had inadequate access to quality health care services even before the outbreak. The immediate impact of COVID-19 was felt in the disruption of essential service delivery. While it is still early to capture the full impact of COVID-19 to date, inpatient admissions and facility-based deliveries declined by 18 percent and 6 percent, respectively, in Q1 2020 from Q1 2019. Antenatal care visits, skilled birth attendance, and immunization rates have also declined. Providing financial protection and ensuring access to essential health services for those most vulnerable groups need to be prioritized to mitigate the impact of COVID-19.

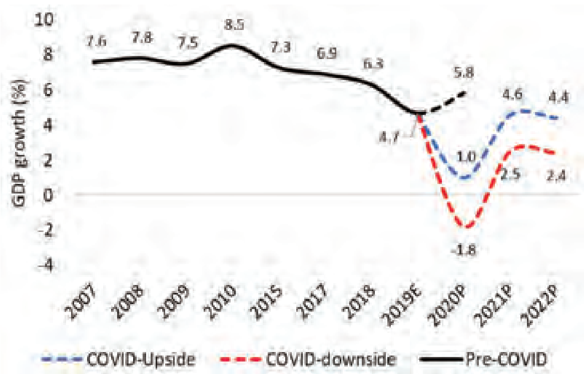
17. Existing public financial management (PFM) bottlenecks in the health system can become major constraints for the timely reallocation and release of public funds to the frontline for emergency response. In the context of health emergencies, a well-functioning PFM system would allow rapid transfer of resources to decentralized levels to help scale up service delivery, reprogramming, and reallocation of sector budgets for immediate response measures. Addressing key PFM challenges affecting service delivery will help shape the implementation of immediate response measures for COVID-19 and accelerate the health sector reforms to achieve Universal Health Coverage (UHC) and Sustainable Development Goals (SDGs).

18. The GoL needs to build a resilient health system to effectively respond to COVID-19 and other health emergencies while maintaining essential health services for all during the crisis. The Ministry of Health (MoH) maintains that the country is at high risk with respect to the COVID pandemic, given the proximity and links with countries affected by COVID-19, and the limited capacity for public health emergency response. The GoL needs to invest in building a resilient health system for public health emergencies and keep its commitment on UHC to ensure quality essential health services are available for all during the crisis.

19. As the country anticipates the budget impact of COVID-19, it is important to protect the regular health budget while mobilizing additional resources for the COVID-19 response. Failure to rapidly mobilize financing and coordination of response across sectors would result in adverse health and socioeconomic consequences. Given the limited fiscal space, getting support from development partners will be key to respond to this emergency shock and ensure essential services during the crises. In the medium term, more and better spending is needed to enhance the health system's capacity to respond to public health emergencies.

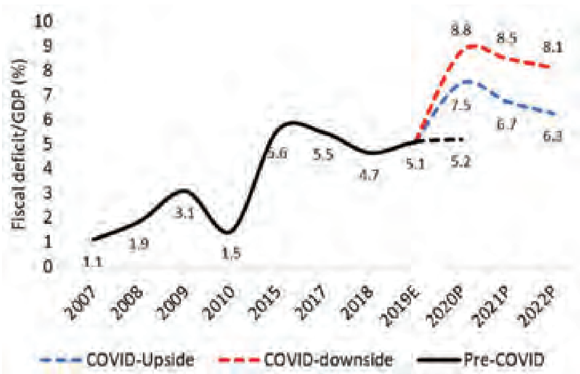
June 2020 Lao PDR Economic Monitor at a Glance

Growth is expected to decline sharply in 2020



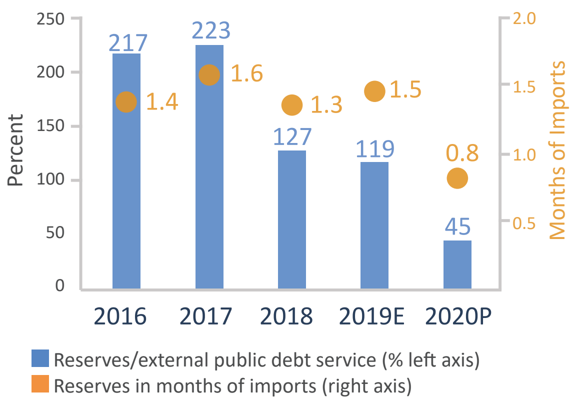
Sources: LSB; WB staff estimates and projections.

The fiscal deficit will reach an all-time high…



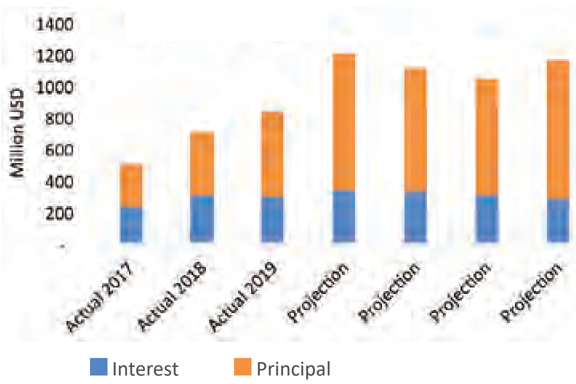
Sources: MoF, IMF WEO and World Bank staff estimates.

…and foreign reserves buffers will continue to decline



Sources: BoL; MoF; and World Bank staff estimates.

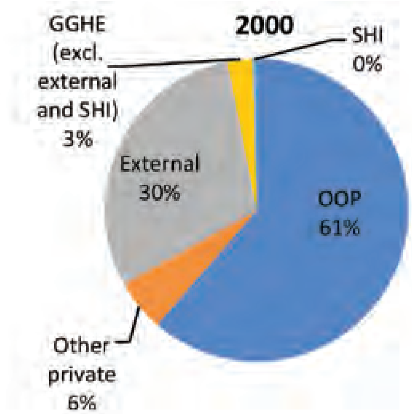
Public sector debt servicing will rise in the medium term



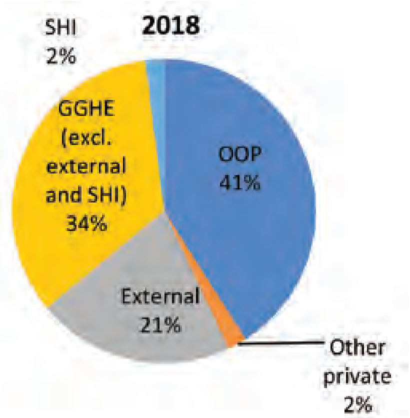
Source: MoF.

While the public health expenditure share has increased, it is still largely under resourced

Panel A



Panel B



Sources: WHO Global Health Expenditure Database for 2000 data; MoH National Health Accounts for 2018 data.
Note: GGHE = general public health expenditure; OOP = out of pocket; SHI = social health insurance.

Part I:
Recent Economic Update

Photo credit: Phoonsap Thevongsa

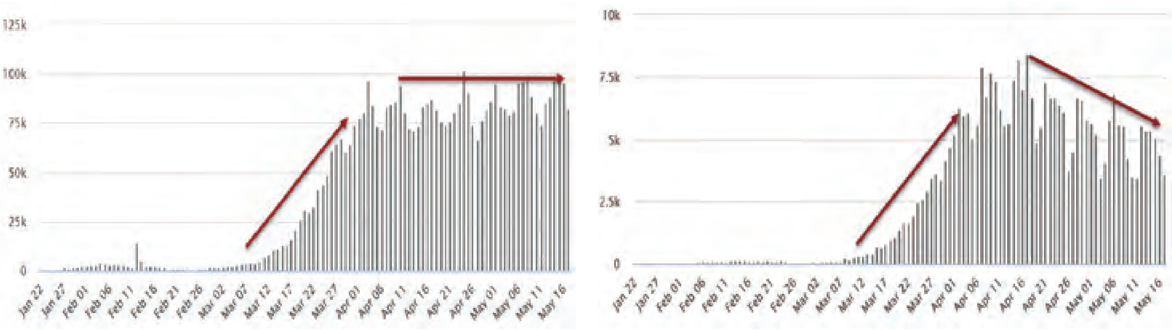
1. Recent Economic Developments

Lao PDR has so far avoided a major health crisis, but has not been immune from the global economic downturn

1. **The COVID-19 respiratory virus has become a global pandemic.** COVID-19 was first reported in Wuhan, China, in late December 2019. It has spread and affected not only countries in the East Asia and Pacific region, but around the world. On March 11, 2020, the World Health Organization (WHO) characterized COVID-19 as a pandemic. While the number of new cases is decreasing in China (figure 1), they are increasing at an exponential rate in other parts of the world. As of June 3, 2020, the number of new daily infections appear to have plateaued, while daily new deaths are declining.

Figure 1. The daily infections appear to have plateaued globally, while daily new deaths are declining

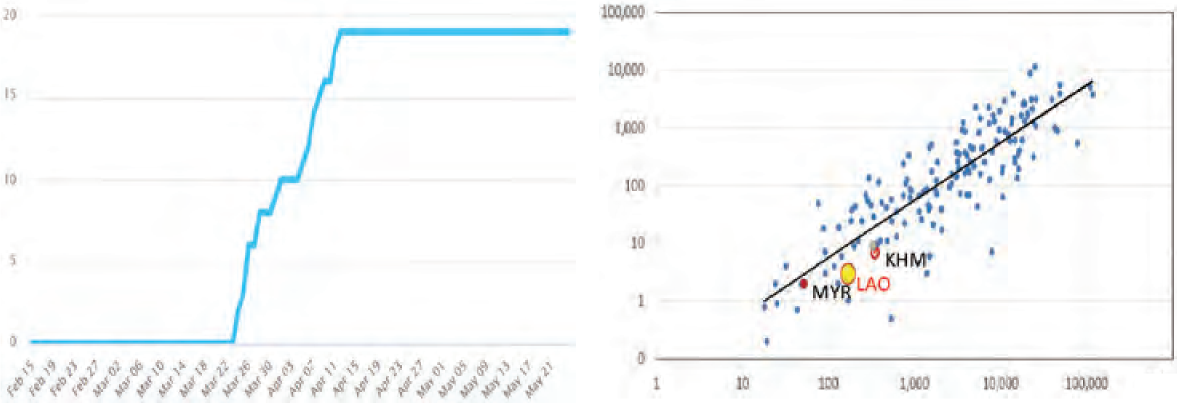
Panel A. Daily new infections (globally) | Panel B. Daily new deaths



Source: https://www.worldometers.info/coronavirus/worldwide-graphs/

2. **Lao PDR has one of the lowest infection rates as well as lowest test rates in the world.** The first case in Lao PDR was confirmed in March 2020. As of 3 June, Lao PDR has tested around 7,249 cases. There are 19 confirmed cases, of which 16 cases have been treated. It appears that the low rate of infection in Lao PDR is positively associated with the low number of tests (figure 2). It is also the result of the containment measures from the stages of selective containment applied during February–March, to nationwide lockdown in April–early May, to gradual reopening at the end of May (box 1).

Figure 2. Lower rate of infection is correlated with the low test rate



Infection rate (y-aix) is positively correlated with number of tests (x-axis)

Sources: https://www.worldometers.info/coronavirus/worldwide-graphs/

Box 1. Domestic measures to manage the local contagion

February–March: Selective containment

- Airports: Screening of passengers
- Border crossings: Temporary suspension of issuance of visas on arrival for travelers from China; health screening has been intensified at all other border crossings
- Workers' camps: Workers from China at all camp sites were screened and placed under quarantine for 14 days.

End March–April: Nationwide lockdown

- Introduced social distancing and domestic lockdown during April 1–19, 2020 (PM order No. 6, March 29, 2020); lockdown extended to May 3, 2020
- No travel to other localities or areas with infection or risk of infection
- Closed all border checkpoints (only transports of goods are allowed)
- Closed manufacturing factories (except consumer goods, medical equipment, producers) and large projects
- Temporary suspended mining activity at one mine and power sector construction during the lockdown.

May (Notice 580, dated May 15, 2020): Gradual reopening

- Maintain social distancing measures
- Gradually allow inter-provincial travels
- Resume retail and some services businesses
- All border closures continue to apply; only allow transport of goods
- Suspend issuance of visa to travelers from countries with high rate of outbreak.

Source: https://www.covid19.gov.la/index.php.

The COVID-19 crisis has affected mostly labor-intensive sectors and those linked to global and regional value chains

3. **COVID-19 shock has further aggravated the long-standing structural vulnerabilities in the economy.** The country has a legacy of weak macroeconomic management, resulting in limited fiscal and foreign currency buffers even before the global pandemic. Growth decelerated in 2019 due to the impacts from natural disasters that weighed down on the agriculture and power sectors. The level of international reserves is at a multiyear low. The gap between the official and parallel market exchange rates has increased and is higher than historical norms. The financial sector faces vulnerabilities, with declining capital adequacy and a high level of nonperforming loans (NPLs). Despite lower public expenditure, weak revenue collection has resulted in an elevated fiscal deficit. The fiscal deficit was slightly above 5 percent of GDP with public debt at 59 percent of GDP in 2019, leaving the country at high risk of debt distress. Limited fiscal space and the mounting pressure of deficit financing and debt servicing will limit the GoL's ability to stimulate the economy amidst the impacts from the COVID-19 shock, exacerbating the downturn in 2020.

4. **While successful in avoiding a major local outbreak of COVID-19, Lao PDR has not been immune from the global economic downturn (Annex 1).** In Lao PDR, the COVID-19 spread and local and international response measures first hit the activities in the real sector and led to broader economic and poverty impacts. The COVID-19-induced economic downturn has affected the country through multiple channels including tourism, international trade, foreign investment, commodity prices, exchange rates, and lower remittances (table 1). The extent of the impacts depends on the duration and severity of the spread locally and globally, impacts from the containment measures, and the effectiveness of the announced relief measures.

Table 1. Key channels of transmission of COVID-19

Disruptions to activity in the real sector

- Services sector
- Tourism and hospitality sector
- Retail trade and wholesale
- Industry
- Construction sector
- Mining and hydropower construction
- Manufacturing
- Agriculture

Leading to broader economic and poverty impacts

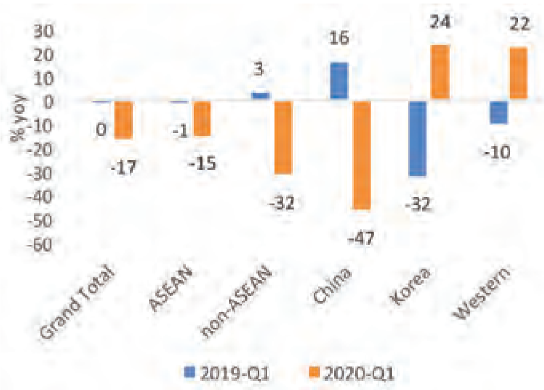
- Decline in trade and investment inflows
- Lower commodity prices
- Lower growth
- Increasing fiscal pressures
- Banking sector fragilities
- Decline in employment
- Disrupted remittances inflows
- Rising poverty

5. The tourism and travel sectors were immediately affected. The tourism and travel sectors are among the main sources of foreign currency earning for Lao PDR. The direct contribution of the tourism and travel sectors to GDP is around 4 percent, while the total contribution (including indirect impacts) is up to one-seventh of the economy.[1] The tourism sector was immediately hit by the strict outbound-travel measures applied by China after the Chinese New Year. The total number of arrivals in Q1 declined by 17 percent compared to the same time last year (figure 3), mostly due to a reduction in visitors from China. As Chinese visitors' share in total arrivals and revenue doubled to around 20 percent from less than 10 percent five years ago, the dramatic reduction in Chinese tourists immediately reduced tourism income in Q1. This trend is expected to have further deteriorated in Q2. This is reflected in sharp drop in online searches for main tourist destinations in Lao PDR. As the majority of tourism revenues come from non-Chinese tourists (western tourists) (figure 4), the expected fall in arrivals in Q2 across the board is likely to worsen tourism income in Q2.

1 Based on World Travel and Tourism Council estimates.

Figure 3. Significant impact on tourism and travel in Q1-2020

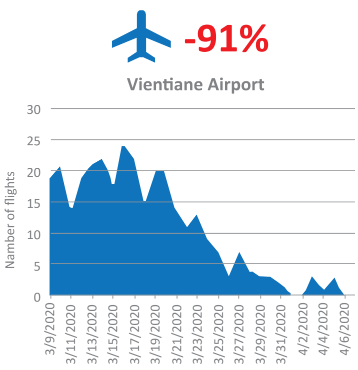
Panel A: Tourist arrivals significantly declined in Q1 and are expected to worsen in Q2-2020

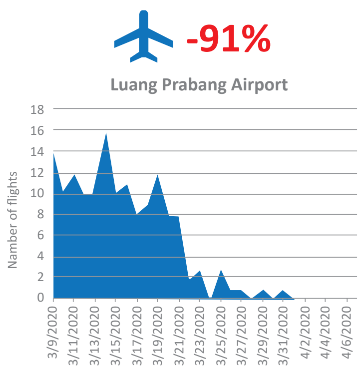


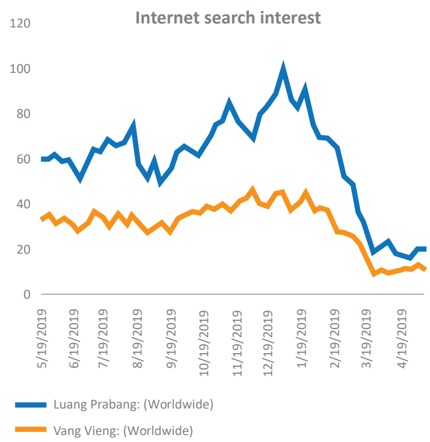
Panel B: Tourist arrival patterns

Source: Ministry of Information, Culture and Tourism

Panel C: Declining air transport and interest in key tourist sites



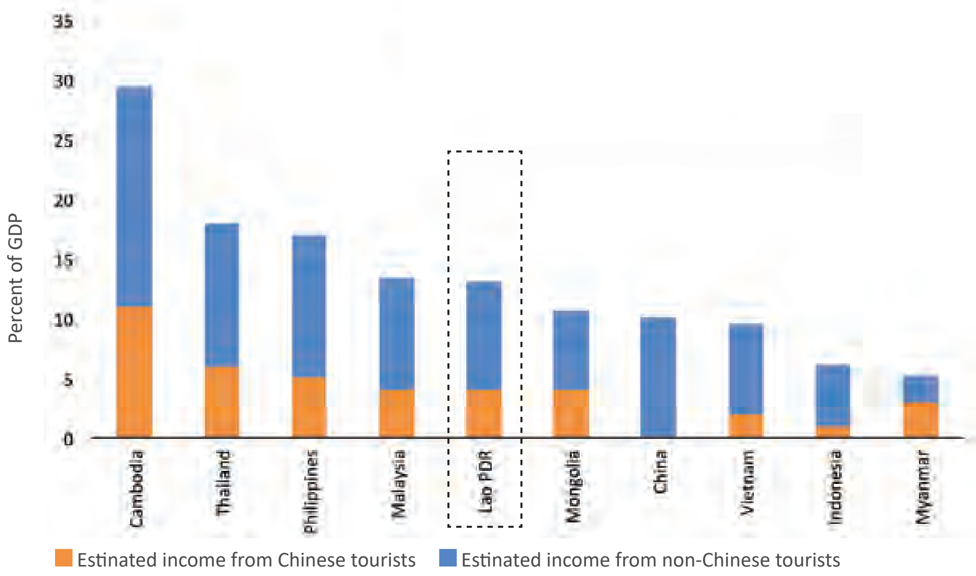




Data source: flightRadar24
Source: Google Mobility report, Google trends, and Flight Radar 24 application.

Photo credit: Green Discovery Laos

Figure 4. While exposure to Chinese visitors has increased, non-Chinese visitors still provide the majority of the contributions to the local economy



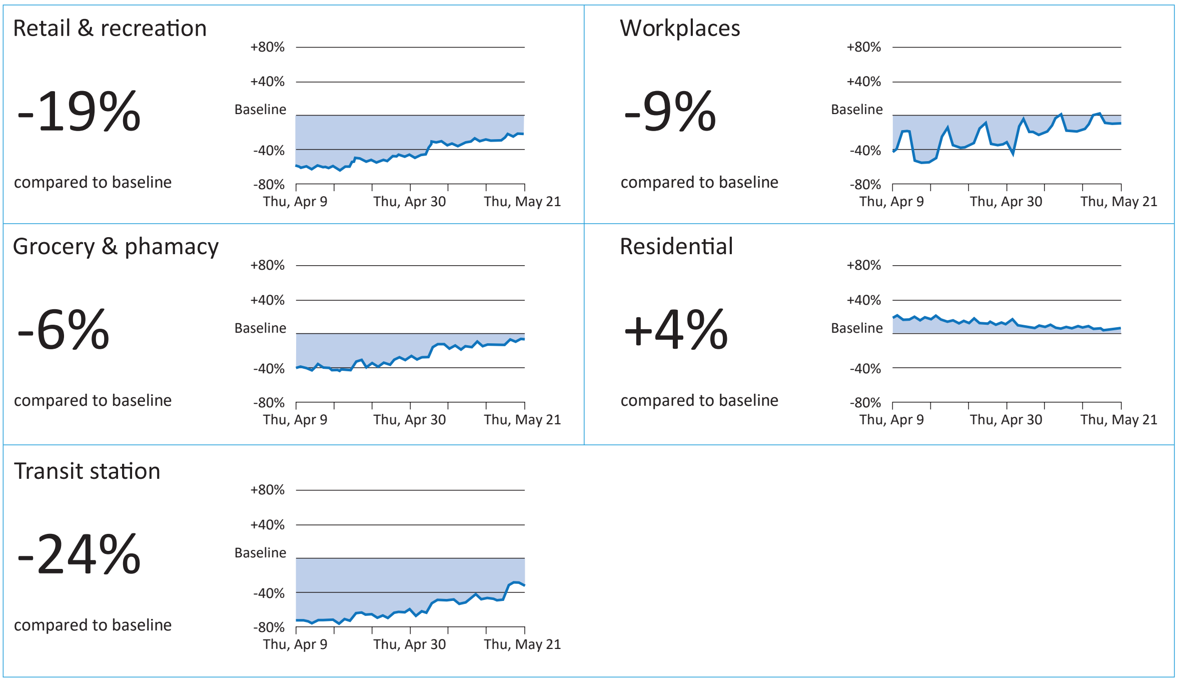
Source: World Bank East Asia and Pacific Economic Update April 2020.

Photo credit: Phoonsap Thevongsa

6. Lower tourism demand and domestic containment measures have knock-on effects on tourism-supporting sectors. Lower tourism spending means lower income for tour operators, accommodations, and restaurants (3 percent of GDP), and transport (1.7 percent of GDP). Most international flights between Lao PDR and China, Thailand, the Republic of Korea, and Vietnam have been suspended since February, although some routes were recently reopened. According to the report from the Lao National Chamber of Commerce and Industry (LNCCI),[2] 144 Lao-China flights were cancelled in February alone, which indicated a significant revenue loss for Lao Airlines, at least in the first quarter. Consequently, approximately half of the Lao Airlines workforce have been furloughed. Suspension of inter-provincial travel and temporary closure of regional bus stations and suspension of domestic flights until around mid-May due to the domestic lockdown is reflected in the contraction in transits and travel by 45 percent by mid-May compared to the baseline in the Google Community Mobility Report. Hotel bookings were reported to fall by more than 70 percent in March. Most places are operating at only a fraction of their capacity, while some have announced temporary closure until Q4-2020.

7. COVID-19 mitigation measures weighed down on private consumption and consumer confidence, reflected in moderation in the wholesale and retail trade. Tightened border measures and the lockdown have caused disruptions to production and services, loss in firms' revenues, job losses, and disrupted household income, coupled with lower remittances inflows. These trends led to lower disposable income and consumption. This is exacerbated by lower tourism inflows in Q1 and Q2 in 2020. This trend contributed to moderation in wholesale and retail trade, which accounts for 16 percent of GDP. According to the Google Mobility Report, visits to retail and recreational places, grocery markets, and food shops continued to drop in May compared to the baseline, albeit at a slower pace (figure 5).

Figure 5. The containment measures have resulted in a reduction in local activities, albeit with some recent recovery



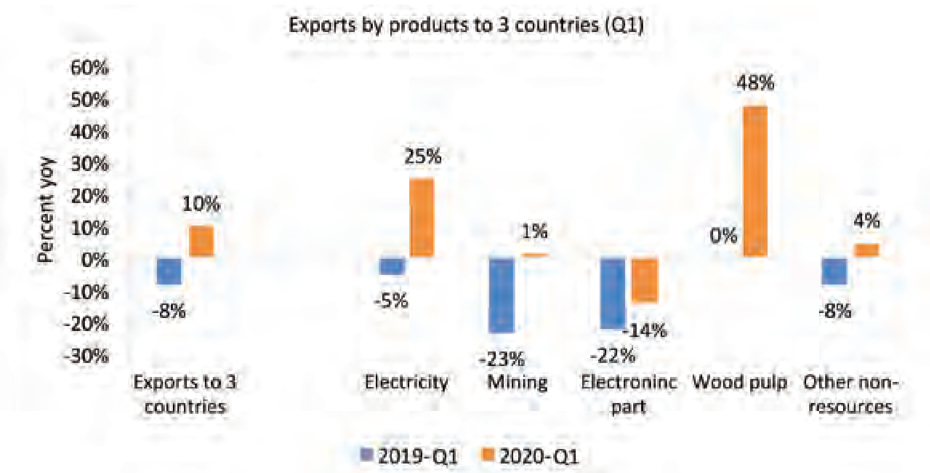
Source: Google COVID-19 Community Mobility Report, updated May 21, 2020; https://www.gstatic.com/covid19/mobility/2020-05-21_LA_Mobility_Report_en.pdf.

2 Lao National Chamber of Commerce Consultation meeting with tourism sector, dated March 12, 2020.

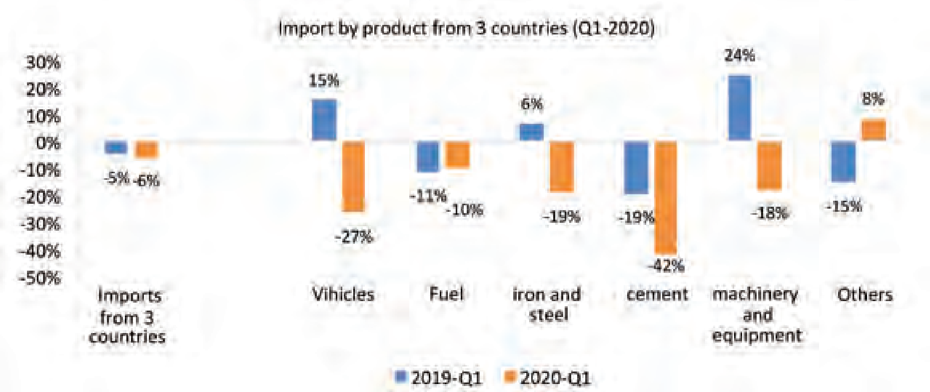
8. Supply chain disruptions followed by contracting external demand have led to a severe decline in production in the export-oriented manufacturing sector. Supply chain disruptions due to border closures have caused delays in delivering inputs to export-oriented manufacturing industries. The garment industry, which account for 1.2 percent of GDP or 4 percent of merchandise exports, is the most affected. The sector uses up to 60 percent of its inputs from China and exports 80 percent of its products to Europe. Tightened border measures applied by China and Lao PDR caused delays in delivering raw materials from China in Q1, which resulted in delays in production by many factories. This was intensified by the domestic lockdown during April–early May and weakened external demand, particularly the European Union and the United States, as the pandemic spread globally. As a result, many firms had to reduce working hours, furlough and retrench workers, and temporarily suspend production in some cases. As the measures are gradually lifted in May, some garment factories have asked to resume production but are still below full capacity. Similarly, electronic parts manufacturing is also affected by lower demand from Thailand. However, other manufacturing, such as wood pulp export to China, still performed well in Q1 (figure 6, panel A). This could have been exported to China early in Q1 before the border closure was applied. Other manufacturing sectors that mostly serve the domestic market and which account for almost 5 percent of GDP, are also affected by the domestic lockdown but to a lesser extent by falling external demand. These sectors include cement and construction materials, car and motorbike assembly, plastic and steel bar factories, furniture, and other light manufacturing. Nevertheless, overall export performance in Q1 remained buoyant, supported by strong hydropower exports to Thailand, which is according to the power purchase agreements and less subject to lockdown and social distancing measures.

Figure 6. Disruption to value chains

Panel A



Panel B



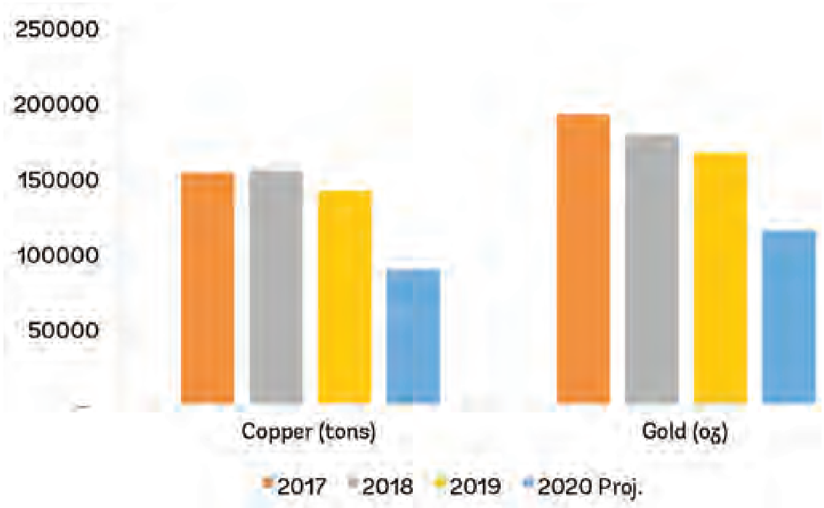
Source: Trade partners' customs agencies.
Note: Three trading partners are Thailand, China and Vietnam.

9. In addition, travel restrictions coupled with a fall in construction material and fuel imports have contributed to moderation in the construction sector and infrastructure investment. The construction sector, which accounts for 10 percent of GDP, has been disrupted during Q1-Q2. Large projects such as the Lao-China railway, highways, Special Economic Zone development, and other infrastructure projects that employ a large number of foreign workers were affected due to restricted travel of labor and delays in imports of construction materials and capital goods (figure 6, panel B). This was exacerbated by the lockdown, suspension of power project construction during the lockdown, and lower growth in China, which can potentially cause a reversal of some investment inflows into Lao PDR, if the disruptions are prolonged. Imports from three main trading partners, Thailand, China, and Vietnam, contracted by 6 percent in Q1-2020, mostly due to lower vehicle, fuel, construction materials, and machinery imports.

10. There is still a risk from increased external uncertainty on investment. Uncertainty could also discourage investment decisions by existing firms and potential new investment. According to the United Nations Conference on Trade and Development (UNCTAD), earnings of multinational enterprises from China are estimated to decline by 21 percent and from Thailand by 28 percent on average in 2020,3 which would have implications for lower reinvested earnings and lower capital expenditures. As China and Thailand are the largest investors in Lao PDR, the country is highly exposed to the risk of lower investment inflows.

11. The structural transition in the mining sector will also exacerbate the impacts of COVID-19. The mining sector accounts for 8 percent of GDP or 20 percent of merchandise exports. Copper output is expected to decline substantially in 2020, exacerbated by lower copper prices, as the major mines mature (figure 7). Copper output is expected to decline by about 37 percent in 2020 mainly due to lower ore grade and availability, exacerbated by the suspension of production activities during the one-month lockdown at Phu Bia project after a confirmed case. The transition at the other major mine, the Sepon project, from copper to gold production is expected to be completed in Q3-2020, after which gold output will partly offset the fall in copper output in 2020.

Figure 7. Declining mining output as major mines mature
(Quantity in tons, ounces [oz])



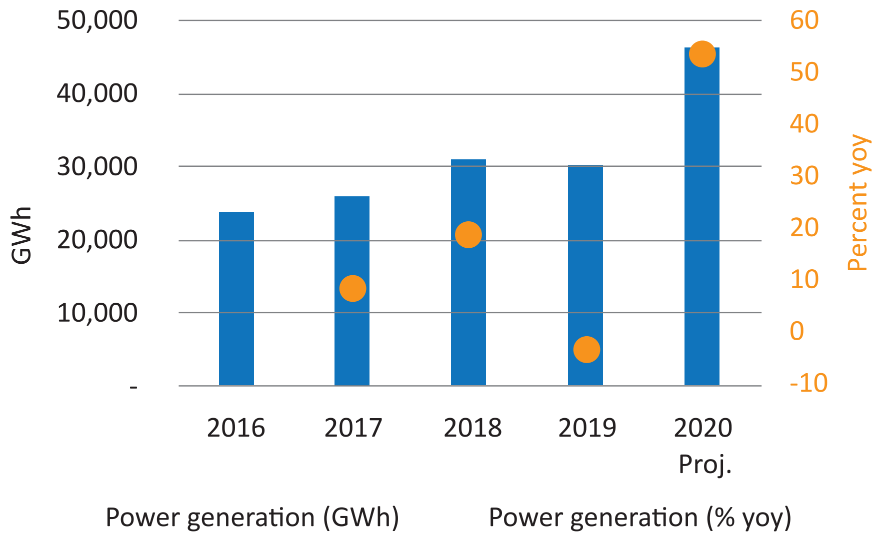
Sources: Phu Bia Mining and LXML.

3 UNCTAD 2020. Impact of the COVID-19 pandemic on global FDI and GVCs. Updated Analysis. https://unctad.org/en/PublicationsLibrary/diaeiainf2020d3_en.pdf

However, higher electricity output in 2020 is expected to partly compensate for the slowdown in other sectors

12. Power sector output, which accounts for 12 percent of GDP or 22 percent of exports, is expected to partly offset the impacts of the COVID-19 outbreak. Electricity exports in Q1-2020 grew by 25 percent year-over-year, partly due to a base effect from lower exports in 2019 due to drought and the new generation capacity in 2020. Electricity is exported under an agreed power purchase agreement between the two countries and is less subject to transport and social distancing restrictions. This resulted in an increasing net trade balance to support growth in Q1. The power sector is expected to grow at 33 percent in 2020 as four main projects of 2,200 megawatts are producing in 2020 (assuming an 85 percent average output) (figure 8). However, there is still high uncertainty on the demand side due to the potential impact from the contraction in the Thai economy in 2020 on the agreed energy exports for the rest of the year and weather-related risks.

Figure 8. Additional generation capacity in 2020 (GWh, percent yoy)



Source: Ministry of Energy and Mines.

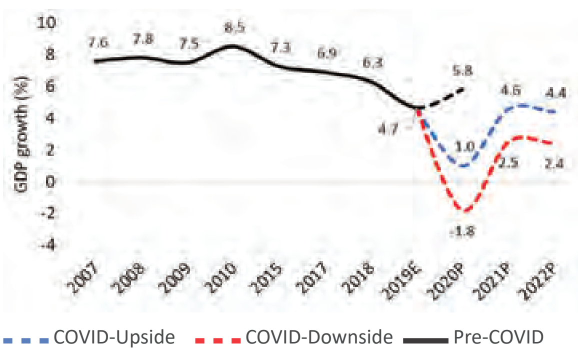
The impacts of COVID-19 are presented in two cases – upside and downside scenarios

13. Given the uncertainty regarding the duration, pervasiveness, and severity of the COVID-19 outbreak both at the global and domestic levels, this report presents a range of growth estimates for 2020 under two scenarios. These scenarios reflect different assumptions regarding (i) the duration and depth of outbreaks and lockdown in Lao PDR, (ii) the magnitude and effectiveness of economic relief policies, and (iii) the depth and duration of the global downturn (table 2). In the more favorable scenario, the Lao PDR's economy is expected to grow at 1 percent, while in the downside scenario the economy could contract by 1.8 percent in 2020 (figure 9). In either case, this will be the slowest growth rate since 1990.

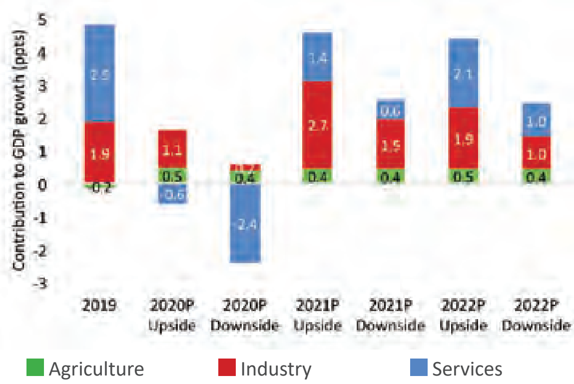
Table 2. Key assumptions underlying the two scenarios

Upside scenario	Downside scenario
• Domestically, April is the worst month due to the lockdown. Assuming no new outbreak, the situation starts to slowly improve during May–June. Domestic activities start to pick up in Q3. • Externally, international and traditional borders remain closed until Q2. External demand gradually picks up from Q3 and more so in Q4-2020. • No long-term adverse effect of the lockdown on corporates, the banking sector, or balance of payments (i.e., no big defaults or crisis).	• Domestically, containment measures apply until June. • Externally, restrictions continue to apply in Q3. Measures then gradually relax in Q4. • Moderate to significant adverse effects of the shutdown on corporates, the banking sector, and balance of payments (i.e., possibility of defaults and economic/ financial crisis).

Figure 9. GDP growth significantly declines



...particularly the services sector in 2020



Source: LSB and WB staff estimate and projections

14. **In the baseline scenario, economic growth in 2020 is expected to significantly decline to 1 percent, followed by a gradual recovery.** Growth is estimated to decline to 1 percent in 2020 from 4.7 percent in 2019. Although subject to high uncertainty, growth is expected to gradually rebound to an average of 4.5 percent over the next two years. In this scenario, the services sector is estimated to contract by 1.4 percent in 2020 driven by severe impacts on the tourism and hospitality sectors as well as moderation in wholesale and retail trade until Q2. Industry sector growth is estimated to moderate to 3 percent in 2020 from 4.7 percent in 2019. The severe impacts on the export-oriented manufacturing and construction sectors due to value chain disruptions are partly offset by higher output in the hydropower sector. The agriculture sector is expected to rebound after the impacts from natural disasters last year. Domestically, we assume no new local outbreak and gradual relaxation of some measures after the end of the lockdown on May 3rd that allow some domestic economic activities to slowly pick up in Q3-2020. This scenario also assumes no long-term adverse effects of the lockdown on the health of the corporates, banks, or balance of payments (that is, no large-scale defaults or crises). Externally, it assumes that neighboring countries continue to apply restriction measures until the end of Q2-2020, after which external demand gradually picks up.

15. The downside scenario presents a deeper contraction followed by a more sluggish recovery. Under this scenario, the economy could contract by 1.8 percent in 2020 compared to 4.7 percent growth in 2019, followed by a more sluggish recovery at an average of 2.5 percent in the next two years. In this scenario, the services sector could contract by 5.3 percent in 2020, assuming more severe magnitude of impacts on the tourism and hospitality and wholesale and retail sectors due to prolonged sluggish external demand and domestic restrictions. The industry output further decelerates assuming stronger contraction in the construction and manufacturing sectors due to prolonged disruption to the value chain and export markets. The agriculture sector rebounds, but at a moderate pace, subject to export market disruption and weather-related risks. The downside case assumes that domestic restriction measures apply until the end of Q2. Externally, it assumes a slower and longer recovery in key trading partners. The effects on the private and financial sectors are moderate to significant, which could possibly cause business closures and defaults. This would feed into the already vulnerable financial sector conditions, including high nonperforming loans and low returns by banks, which could result in a crisis under the downside scenario.

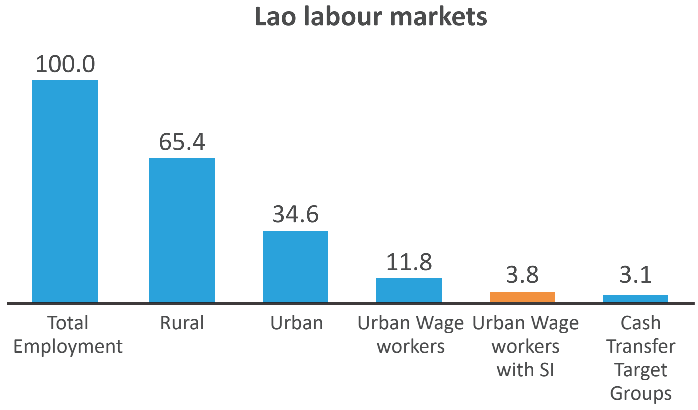
The employment and welfare impacts have been severe

16. The COVID-19 outbreak and containment measures in Lao PDR and key economic partners are causing unprecedented disruption to the labor market. The outbreak and containment measures in Lao PDR and its key trading partners have a differentiated effect on employment and livelihoods. A sharp drop in tourism demand is leading to job losses in tourism-related sectors, which account for 11 percent of total employment and 22 percent of employment in urban areas. Construction and personal services have also been affected by a nationwide lockdown and social distancing. Among the most vulnerable are informal workers whose income is dependent on them working and who lack labor skills and social protection. In Lao PDR, approximately 80 percent of employment is informal, especially in retail trade, transport, food and accommodation, construction, and personal services sectors.[4] Informality is also more pervasive among low-income households, making them more vulnerable to the crisis.

17. The government is providing support to affected workers. These include (i) exemption from the salary tax for all employees and workers having wages equal to or less than 5 million kip per month for a period of three months (April–June 2020); (ii) proposal of a cash transfer program by the GoL/Ministry of Planning and Investment, currently targeting only urban formal sector wage workers who have social insurance and who have lost jobs during the last few months due to COVID-19. It is estimated that 96,174 workers lost their jobs out of the 117,000 workers who have social insurance. These affected workers are mostly from the manufacturing sector (garment and other labor-intensive industries) and services (mainly tourism-related businesses [hotels and restaurants], trade, and transport services). However, given the limited fiscal space, this target group makes up only 3.1 percent of total employment or around 26 percent of total urban wage workers (figure 10). With a very limited fiscal buffer, the GoL would have to mobilize additional financial resources from development partners to implement a broader welfare program to support the poor who work in both formal and informal sectors.

4 "Survey Finding Report: Lao PDR Labor Force Survey 2017."

Figure 10. The targeted cash transfer program appears limited

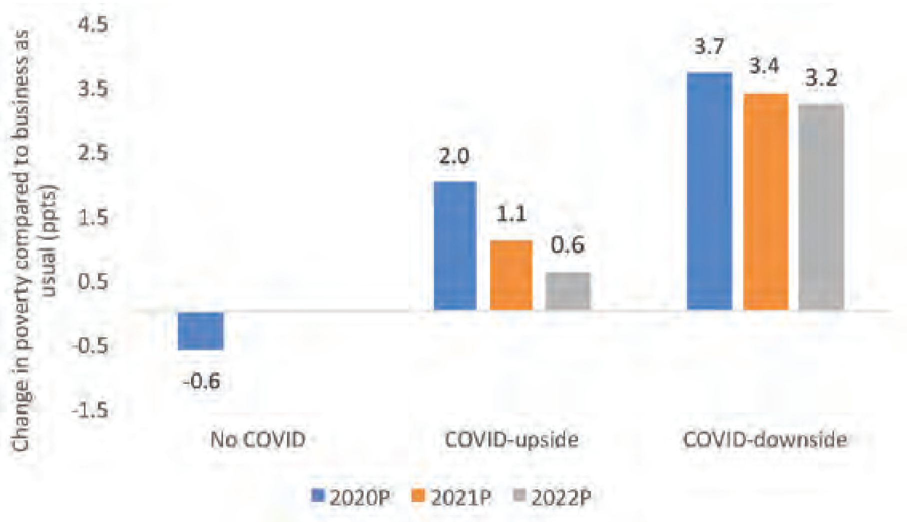


Sources: GoL and World Bank staff estimates.
Note: SI = social insurance.

18. The economic shock due to COVID-19 is also adversely impacting the flow of remittances. Since the outbreak, more than 100,000 migrant workers have returned, resulting in an estimated reduction of up to US$125 million or 0.7 percent of GDP in remittances in 2020. Meanwhile, migrants who remain in Thailand will likely remit less than they normally do as their income is also affected. Around 9 percent of households receive remittances from abroad, and remittances constitute 60 percent of their household income. The majority of Lao nationals living abroad are in Thailand (UN DESA 2019)—an estimated 300,000 migrants—or around 15 percent of the Lao PDR's labor force (2017). The vast majority of Lao migrants in Thailand (92 percent) view remittances as an important source of income for their families, and almost half remit every month. Most of the migrants work in the sectors that have been disrupted by the COVID-19 outbreak and response measures in Thailand, including a city lockdown and the Lao-Thai border closures. Furthermore, the lockdown in Lao PDR temporarily stalled domestic economic activities, which could also affect the flows of domestic remittances and the disposable income of households especially in rural areas.

19. The pandemic could weigh negatively on progress against poverty reduction. A sharper-than-expected growth slowdown in the nonagricultural sectors, as well as a decline in remittance flows, are expected to have a negative impact on poverty, which can only be marginally offset by the recovering agriculture sector. Those linked to sectors experiencing strong demand shocks, such as tourism, retail trade, and food and accommodation businesses, will also face an increased risk of falling into poverty. In the upside scenario, poverty is estimated to increase by 1.4 percentage points in 2020, compared to a 0.6 percentage-point decline that would have been the case in the absence of the pandemic. In other words, nearly 50,000 people would have escaped poverty in 2020 in the absence of the pandemic. Instead, in the upside case, nearly 96,000 people will fall into poverty as a result of the pandemic. If the downside scenario prevails (assuming 25 percent job losses in the travel- and tourism-related sectors and a 30-percent decline in remittances), poverty could increase by 3.1 percentage points in 2020, or a total of 214,000 people could slip into poverty (figure 11). The impact of the pandemic on poverty is expected to linger, with poverty projected to return to its pre-crisis level in 2021 under the upside scenario, or later than 2022 under the downside scenario.

Figure 11. The COVID-19 pandemic could push up poverty



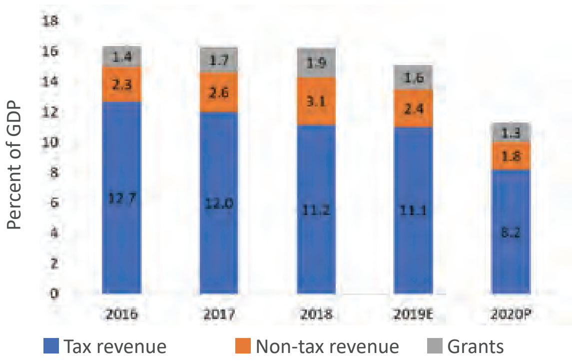
Sources: World Bank staff estimates.
Note: Macro-micro simulation results. The simulation projects changes in industry and services employment based on historical employment-growth elasticity by sector and assumes a halt in the transition out of agricultural employment. The down-case scenario assumes 25 percent of job losses in the travel- and tourism-related sectors. Remittances fall by 30% in both scenarios before slowly returning to the pre-crisis level, reflecting the Thai economic outlook. The business-as-usual scenario is based on growth projection prior to the crisis.


Photo credit: Phoonsap Thevongsa

Public finances will reach a new low

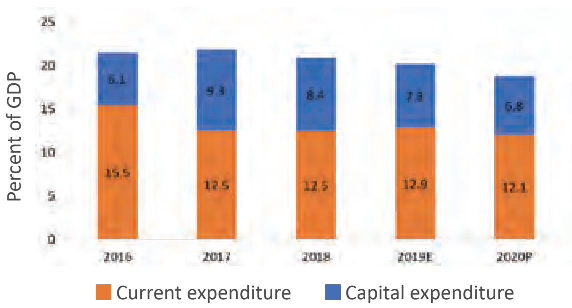
20. Weak performance in the real sector will exacerbate the country's already weak fiscal position, further eroding fiscal space. Declining business income, particularly in the services and manufacturing sectors, resulted in lower GoL revenue collection in the first two months. Preliminary estimates indicate that domestic revenue collection for January–February 2020 dropped by 30 percent year-on-year. The Ministry of Finance (MoF) estimates that revenue loss for 2020 will be about 3 to 4 percent of GDP, mostly from lost value-added (roughly 27 percent), excise (20 percent), and profit taxes (20 percent), and customs duties (16 percent), and the rest from a loss of non-tax revenues. As a result, domestic revenue is expected to further fall to 10 percent of GDP in 2020 from 13.5 percent in 2019 in the upside case (figure 12). However, this estimated revenue loss does not yet cover the key fiscal response measures including a payroll tax exemption, deferred tax payments for COVID-affected businesses, and exemption of the corporate tax for microenterprises and COVID-19-related imports.

Figure 12. COVID-19 impacts weigh down revenue collection (upside case)



Sources: MoF and World Bank staff estimates.

Figure 13. Spending compression through both recurrent and public investment control (upside case)

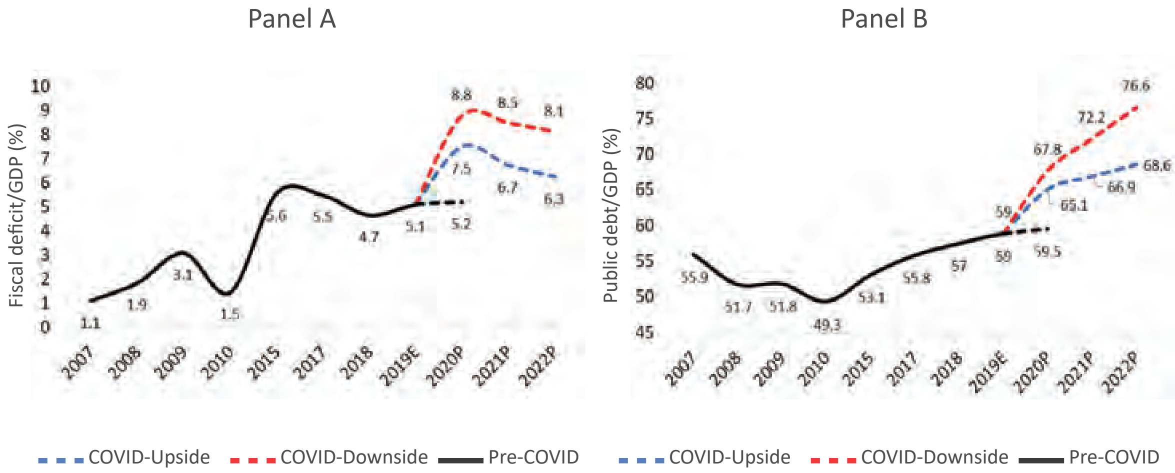


Sources: MoF and World Bank staff estimates.

21. However, limited fiscal space prior to the outbreak reduces the scope of the policy response. The government is expected to cut spending by about 1.7 percent of GDP in 2020, by cutting both non-wage and capital spending. While it is not clear which sectors will be most affected by the expenditure rationalization, the expenditure adjustment is insufficient to compensate for the revenue shortfall. Total spending is expected to decline to around 18.8 percent of GDP (upside case) in 2020 from 20.2 percent in 2019 (figure 13). As a result, in the upside case, the fiscal deficit is estimated to increase to 7.5 percent of GDP in 2020 from 5.1 percent in 2019, while public debt is estimated to rise to around 65 percent of GDP from 59 percent during the same period (figure 14). The risk of debt distress remains high.

22. The downside case assumes more a severe impact on revenue performance and limited room for spending adjustments. With more severe impacts on growth under the downside case, revenue loss is assumed at around 5 percent of GDP, while the authorities lack space to cut further spending. As a result, the fiscal deficit under the downside is estimated to increase to 8.8 percent of GDP in 2020 from 5.1 percent in 2019, while public debt is estimated to rise to around 68 (downside) percent of GDP from 59 percent during the same period.

Figure 14. Fiscal deficit and debt levels have trended upward under both scenarios



Sources: MoF and World Bank staff estimates.

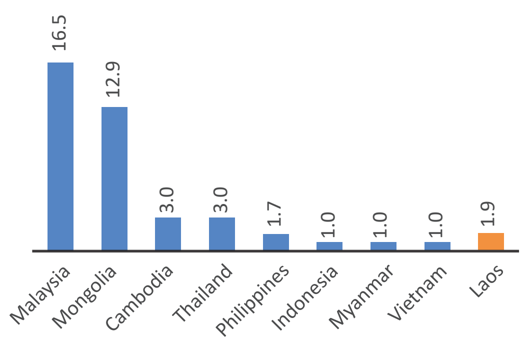
23. Limited fiscal space and higher debt service pressure in 2020 have constrained the government's ability to announce an adequate fiscal relief package. Fiscal relief measures, including cash transfer programs, are expected to be relatively small, at US$20.3 million or 0.1 percent of GDP (table 3). This will be implemented through the existing social welfare system by using welfare funds and will be reimbursed later from the state budget. Other vital instruments for the GoL's relief response are the use of SME access to finance resources, especially for SMEs which are vulnerable to COVID crisis (box 2). The existing funding mechanisms for SME lending are the SME Fund and SME loans from China, which are significant at about US$310 million (1.7 percent of GDP). By including these, the total cost of the GoL's relief package would increase to around US$331 million (or about 1.9 percent of GDP). This amount, if properly implemented, appears to be comparable with several other countries in the region (figure 15).

Table 3. Estimation of the GoL's COVID-19 relief policy measures

	Amount (US$m)	(% of GDP)
Fiscal	**20.3**	**0.1**
Cash transfer (through welfare fund	9.9	0.1
Other fiscal measures	10.5	0.1
Leanding to SMEs (existing propram)	**310.3**	**1.8**
SME Fund	10.3	0.1
SME loan from CDB (through BOL)	300.0	1.6
Total relief package	**330.6**	**1.9**

Sources: GoL and World Bank staff estimates.
Note: CDB = China Development Bank.

Figure 15. COVID-19 relief package in EAP countries (percent of GDP)



Box 2. SMEs are more susceptible to economic shocks

The private sector in Lao PDR, particularly SMEs, remains particularly vulnerable to economic disruptions. Most Lao businesses are SMEs, which lack tool and resource buffers to deal with sudden shocks. According to a survey by the European Chamber of Commerce and Industry in Lao PDR (ECCIL),a 70 percent of the respondents expect to lose at least half of their revenues. About half of the respondents expect a slow recovery, taking between 6 and 12 months. However, some SMEs in the services and manufacturing sectors are hardest hit, and many lack the resilience to get through the crisis. A survey conducted by the Lao National Chamber of Commerce and Industry (LNCCI)*b found that more than 60 percent of the respondents in the transport and accommodation sectors are likely to close their businesses, while the percentage was relatively lower among construction and financial businesses. This could have implications for the health of the real sector, revenue collection, and the financial sector. Some businesses have proposed resuming operation. In response, the GoL recently issued a notice on the criteria for firms that wish to resume production. Some firms have adjusted by reducing their workers and applying social distancing measures in their production lines.

The GoL has issued several measures to support pandemic-affected businesses, especially SMEs and micro businesses. These measures include providing needed credit to SMEs. Efforts to provide access to finance for SMEs are ongoing, but progress is slow. The GoL (through its SME Fund) is accelerating the release of the first tranche of 100 billion kip (out of US$200 million) to SMEs through four commercial banks to four priority subsectors—livestock and farming, agricultural processing, handicrafts, and tourism. The Bank of the Lao PDR (BoL) also plans to channel another 100 billion kip (the second tranche) to the SME Fund. The BoL is renegotiating the SME loan from China with the China Development Bank to address several unrealistic conditions that prevent the quick release of the first tranche (about US$100 million) of the loan of US$300 million. Consolidation of eligible SMEs business plans of about half of the US$100 million tranche is now being proposed for consideration and disbursement.

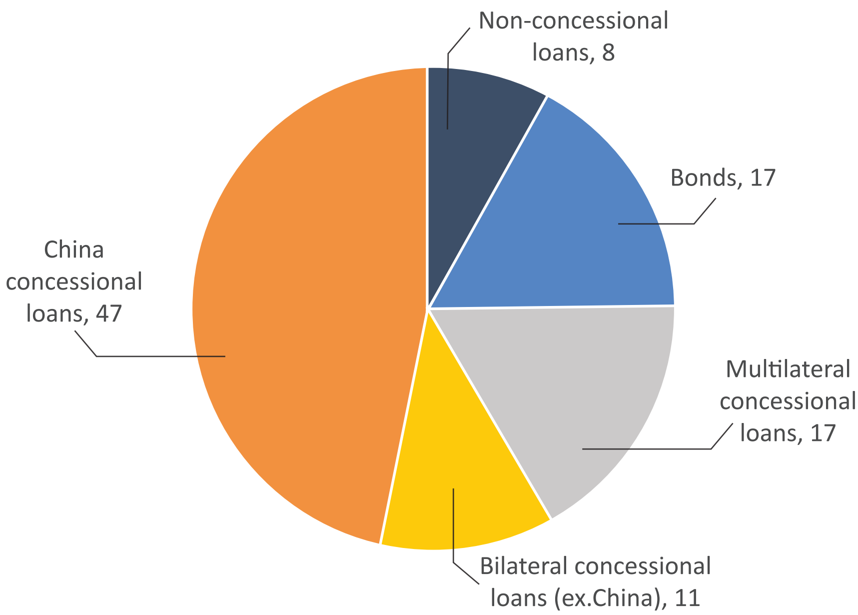
*Sources: Prepared by Bank staff, with inputs from the GoL and LNCCI reports. *LNCCI 2020.*
Note: a. The survey of 56 companies was conducted March 27 to April 3, 2020. b. Survey results of 474 respondents on the impacts of COVID-19. The sampling is not representative but could provide some indication of impacts on certain businesses.

Weak revenue collection will reverse fiscal consolidation and accelerate an increase in public debt

24. The elevated deficit level has resulted in growing public debt and risk of debt distress. Concessional borrowing accounts for about 75 percent of total public external debt, and 25 percent is under non-concessional terms (figure 16). Bilateral creditors account for more than half of total public external debt. Both upside and downside scenarios result in an elevated fiscal deficit and public debt to GDP, thereby widening the fiscal gaps. In addition, a considerable share of public external debt is denominated in U.S. dollars, which implies the risk that a large depreciation of the Lao kip could lead to a worsening debt level and ratios. Along with the rising stock of debt and an increasing share of non-concessional borrowing, this has led to central government external debt service obligations of just over US$1.2 billion a year in 2020.

Figure 16. Most external public debt is concessional borrowing, but the share of non-concessional borrowing is increasing

(In percent of total public external debt)

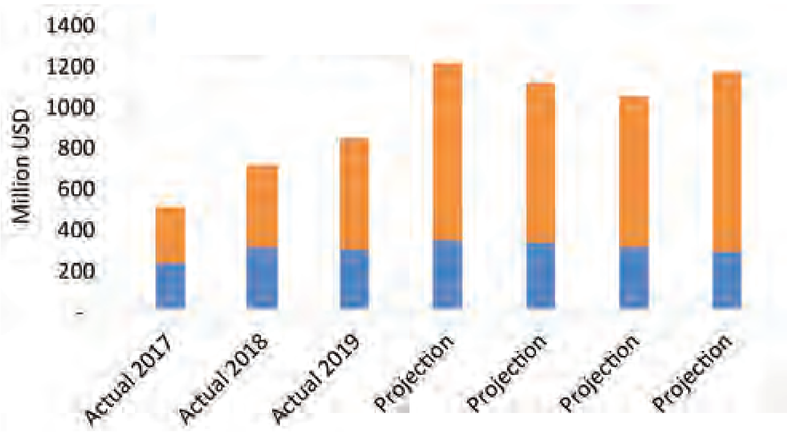


Source: MoF cited by Fitch Ratings.

25. The public external debt servicing burden is trending upward and shifting toward bilateral creditors. The external debt servicing burden (interest and principal) is expected to increase to over US$1.2 billion in 2020 (5.5 percent of GDP) from US$842 million (4.6 percent of GDP) in 2019 (figure 17). Preliminary MoF projections suggest that overall external public sector debt repayments amount to around US$4.5 billion during 2020–23[5] or about US$1.1 billion each year (about 55 percent of domestic revenues each year on average). While debt reprofiling with a major bilateral creditor took place recently, going forward, with around half of public sector external debt repayment owed to China by 2023 (figure 18), and much of the debt linked to construction of large infrastructure projects, debt resolution has taken center stage as one of the key macroeconomic issues for Lao PDR.

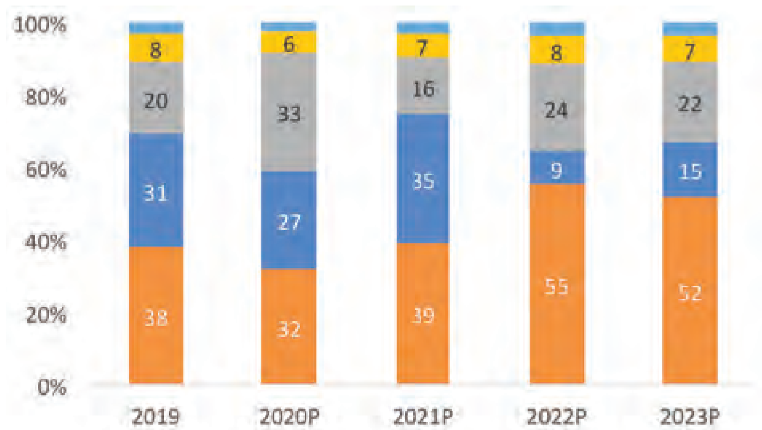
5 This information is as of May 2020.

Figure 17. Public sector debt servicing is projectedto rise in the medium term
(In percent of GDP)



Source: MoF.

Figure 18. Composition of debt service will shift to bilateral creditors
(In percent of GDP)



Source: MoF.

26. With more external debt maturing, the GoL has tapped the international capital market to refinance its debt. Limited domestic financing opportunities coupled with the downgrading of Lao PDR bonds in the Thai capital market[6] has led the GoL to issue bonds in international financial markets. In December 2019, the GoL issued a bond of US$150 million (0.8 percent of GDP in 2019) with a coupon rate of 6.875 percent, maturing in June 2021.[7] Moody's rated the Lao bond "B3" with a positive outlook. "B3" denotes that the bond is below investment grade (a "junk" bond), highly speculative, and subject to credit risks. Fitch rated the Lao bond "B-" with a negative outlook. In addition, in Q4-2019, a syndicated loan of approximately US$100 million (88 million euros or 0.6 percent of GDP) was obtained from Credit Suisse. The GoL is planning to issue another international bond in 2020 to refinance its maturing debt. However, given the macroeconomic vulnerabilities and tightened financial market conditions after the global pandemic, options for Lao PDR may be more costly and limited.

6 The Thai Rating and Information Services (TRIS) downgraded the sovereign rating on the Lao PDR and the ratings on Lao PDR's outstanding senior unsecured bonds to "BBB" with a "stable" outlook, from "BBB+" with a " negative" outlook. This reflects the continual deterioration in the sovereign credit profile of the Lao PDR, accentuated by its critically low foreign exchange reserves and a projected sharp rise in its debt servicing burden over the next three years (https://www.ryt9.com/es/trsn/228561).

7 Until the Lao PDR issuance, there had never been a sovereign bond of less than two years in the international market (Depository Trust & Clearing Corporation [DTCC] registered NY Law). Debut issuers typically place much larger amounts (US$500 million and more) to enable pricing in the secondary market (see also http://cbonds.com/news/item/1180015).

27. Financing fiscal deficit financing from domestic sources continues to be a challenge. The MoF issued two bonds in the domestic capital market to finance the deficit and develop a domestic debt market. The first bond of 1,000 billion kip (0.7 percent of GDP in 2018) was issued in December 2018 and was fully subscribed by June 2019. The second bond of 1,700 billion kip (1 percent of GDP in 2019) was offered in September 2019, and was 39 percent subscribed as of February 2020. Generally, there is more appetite for short- and medium-term bonds (one- to three-year maturity) rather than longer-dated bonds. In addition, the interest rates offered on the MoF kip bonds are similar to commercial bank deposit rates for the same maturities (table 4). The slower subscription is a possible indication of limited market appetite for GoL bonds. This could be due to the lower real coupon rates as inflation has been rising. Recently, the deficit is increasingly being financed by the Bank of Lao PDR, with an increase in lending to the government by 163 percent in March 2020 compared to end-2019, or about 0.8 percent of GDP. The deficit has been mostly financed by external borrowing. Under the outbreak impacts, domestic financing sources are limited, while mobilizing external financing is also more challenging. So far, the government has raised about US$44 million from development partners and private entities for COVID response. As a result, the fiscal financing gap is expected to remain significant.

Table 4. MoF kip bonds offer similar terms as commercial bank deposits

MOF KIP BOND		MOF KIP BOND		KIP BANK DEPOSIT	
Offered on LSX		Offered on LSX		Commercial Bank in Local Market	
1,000 billion kip		1,700 billion kip		Kip	
Subscription period: December 18 to June 19		Subscription period: September 19 to date		As of October 2019	
Tenor	Rate (%)	Tenor	Rate (%)	Tenor	Rate (%)
1 Year	5.30	1 Year	N/A	1 Year	5.37
3 Year	6.80	3 Year	6.80	3 Year	6.8
5 Year	6.95	5 Year	6.95	5 Year	6.9
7 Year	7.10	7 Year	7.20	7 Year	N/A
10 Year	N/A	10 Year	7.50	10 Year	N/A
15 Year	N/A	15 Year	7.70	15 Year	N/A
20 Year	N/A	20 Year	8.00	20 Year	N/A

Source: MoF.
Note: LSX = Lao Securities Exchange.

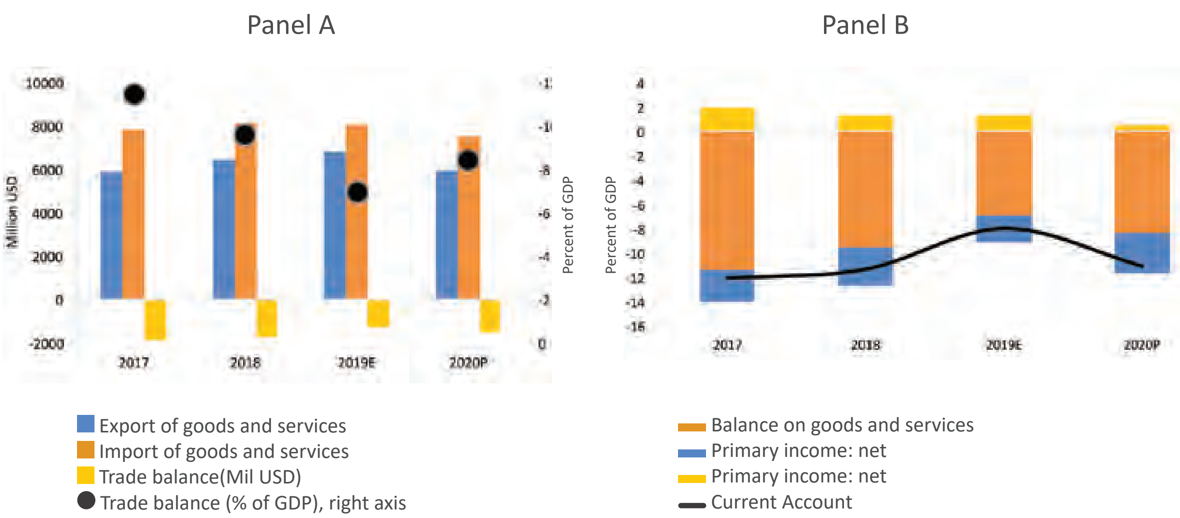
28. The power sector plays a fundamental role in debt dynamics. About one-third of the public external debt is on-lent to the power sector. The public sector's investment share in the power sector accounts for most of the on-lending for investment in power projects and transmission lines. The utility company, Électricité du Laos (EDL), is a major player in the power sector. EDL's financial position has progressively deteriorated due to its increasing debt obligations as a result of rapid investment in transmission lines and power projects, the take-or-pay obligations by EDL, and pricing mismatch. In addition, revenue shortfalls also stem from domestic and export prices below the purchase costs. Available information indicates that EDL's total liability (current and non-current) increased from US$6.4 billion in 2017 (38 percent of GDP) to US$7.2 billion in 2018 (40 percent of GDP), some of which was on-lent from public borrowing.

29. To reduce the public debt level, the GoL has issued a policy direction on converting debt into investment, selling shares in SOEs, and negotiating for debt reprofiling. These measures are extremely important given the current high debt distress situation faced by the country. Restructuring and privatization of SOEs (especially those large loss-making enterprises) are crucial to reduce the fiscal and debt burden on the GoL. However, these would be medium-term measures that are difficult to implement (the difficulty being finding good strategic partners and requiring tough GoL decisions). The recent moratorium on new investment in power projects and the government's policy to promote the build-own-transfer investment modality are expected to reduce the public sector's stake and borrowing in the power sector in the medium term. There are two power sector projects currently being restructured: Nam Ngum 3 and EDL-Transmission.

Growing fragilities in balance of payments and the external sector

30. The current account deficit is expected to increase in 2020 due to lower trade and tourism activities, higher debt service obligations, and declining remittances. The current account deficit is expected to increase to 11.1 percent in 2020 from 8 percent in 2019. Trade balance on goods and services is likely to worsen due to supply and demand shocks causing lower trade and tourism flows (figure 19). The increase in electricity exports, 22 percent of merchandise exports, is expected to partly offset lower manufacturing exports due to lower external demand, mining earnings due to falling commodity prices, and disrupted output at one of the major mines due to the lockdown. However, power and manufacturing exports are still subject to demand-side risk due to the contraction of the Thai economy this year. Imports are expected to fall, but less than export contraction. Supply disruptions due to border closure, followed by the local lockdown result in lower imports of capital, construction, and consumption goods, offsetting an increase in the import of medical equipment needed to prevent local contagion. In addition, falling oil prices and lower demand for fuel due to travel suspension are expected to contribute to lower import growth in 2020.

Figure 19. Trade balance and the current account deficit are expected to widen in 2020
(Million US$, percent of GDP)



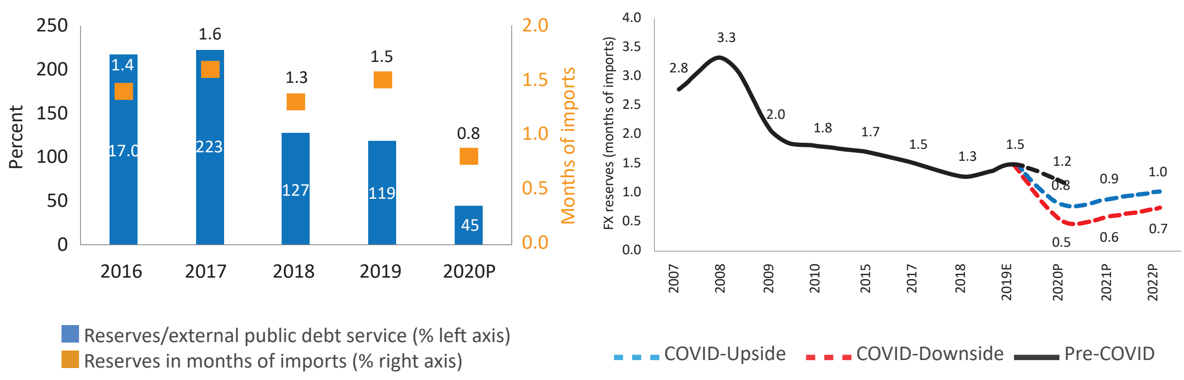
Sources: MoIC; BoL; trading partners' customs data; UNCOMPTRADE; and World Bank staff estimates.

31. **A reduction in tourism activities and travel mainly cause falling service exports.** Tourist arrivals and revenues are affected by the international and domestic mitigation measures. The most noticeable impact was lower demand from China in Q1, and expected worsening in Q2, particularly non-China travelers who tend to spend more on the local economy. A recent report[8] illustrates that the hotel and accommodation, restaurant, tour company, and transportation sectors have been most affected. Some small businesses are reportedly going out of business, while many expect the recovery to take up to one year. If the local and global outbreak is prolonged over the second half of the year, lost tourism revenue could be more than US$500 million, or 2.7 percent of GDP.

32. **Lower remittances inflows and higher debt service obligations are adding pressure on net income.** The return of more than 100,000 migrants from Thailand results in an estimated loss of 0.7 percent of GDP in remittances in 2020. At the same time, interest payments on external debt, particularly public external debt, have increased from 1.6 percent of GDP due to higher debt outstanding and an increasing share of less concessional public borrowing. As a result, the net income inflows are expected to decline, exacerbating the current account deficit in 2020.

33. **As the current account deficit is expected to increase, the external financing gap will widen and will need to be financed by fresh external borrowing and/or the drawing down of reserves.** As investments in the affected sectors are expected to moderate in 2020, coupled with a subdued global investment outlook,[9] these developments will have negative implications on Lao PDR, which already has a high level of external debt and large financing needs. With currently limited access to external borrowing at a reasonable cost, Lao PDR will need considerable support from its development partners to avoid a balance-of-payment problem in 2020. While gross foreign currency reserves remained at US$1 billion in March 2020, the reserves are expected to decline from the current critically low level to below one month of import cover in both the upside scenario (0.8 months of imports of goods and services or about 42 percent of projected public debt services in 2020) and the downside scenario (only 0.5 months of imports and 27 percent of projected public debt services in 2020) (figure 20).

Figure 20. Foreign reserves are expected to further decline



Sources: MoIC; BoL; trading partners' customs data; UNCOMPTRADE; and World Bank staff estimates.

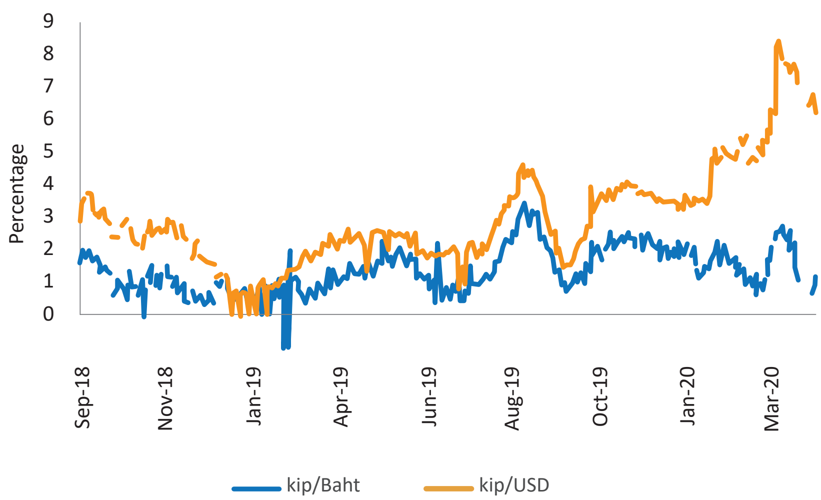
8 Lao National Chamber of Commerce and Industry, 2020.

9 In addition, tightening of the region's financing conditions with capital flying to safe heavens and rising interest rate spreads are causing capital outflows from the region. UNCTAD also estimates that FDI by large multinational enterprises could decline by 30 to 40 percent during 2020–21. https://unctad.org/en/PublicationsLibrary/diaeiainf2020d3_en.pdf

The exchange rate premium has widened

34. The kip further weakened against the U.S. dollar, putting more pressure on the foreign exchange market. The official kip/U.S. dollar exchange rate depreciated by 4.2 percent, while the parallel market rate depreciated by 9 percent in April 2020 compared to last year. At the same time, the kip/baht rate depreciated by 7 percent. The shortage of liquidity in the official spot market continues to cause a demand-supply mismatch and therefore widened the spread between the official and parallel rates above the historical average (figure 21). The spread between the official kip/U.S. dollar and the parallel rate in Vientiane capital widened above the historical norms. Apart from close monitoring and supervision of exchange bureaus, which are rather short-term measures, there are not yet any other significant measures to deal with the rising kip/U.S. dollar exchange rate spreads between official and parallel markets. Consequently, there are some signs of an increased holding of foreign currency deposits, increasingly of longer-term maturity, to hedge against the depreciating kip.

Figure 21. Demand-supply mismatch resulted in a higher premium (percent y/y)



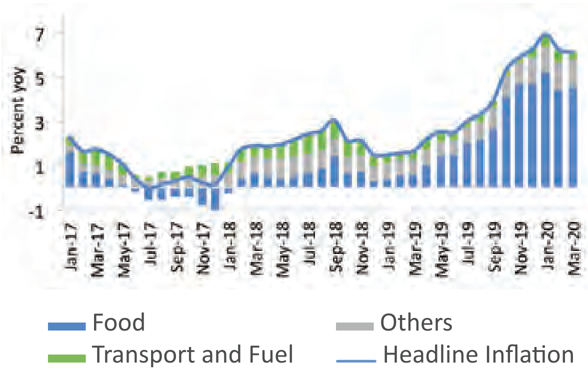
Source: IMF International Financial Statistics.

Depreciation of the kip and rising food prices pushed up inflation

35. **The depreciation of the kip and rising food prices have driven up inflation.** Headline inflation rose to 6.1 percent in March 2020 due to rising food prices and the significant depreciation of the kip against U.S. dollar and Thai baht, particularly in the parallel market (figure 22). Food inflation remained as high as 10 percent in March and was partly offset by declining fuel inflation after recent downward adjustments of retail oil prices (figure 23). This has disproportionately affected the urban poor, as urban consumers make up 77 percent of all food consumption. The logistics disruption to the flow of goods due to tightened border processes and continued depreciation of the kip are expected to keep inflation high.

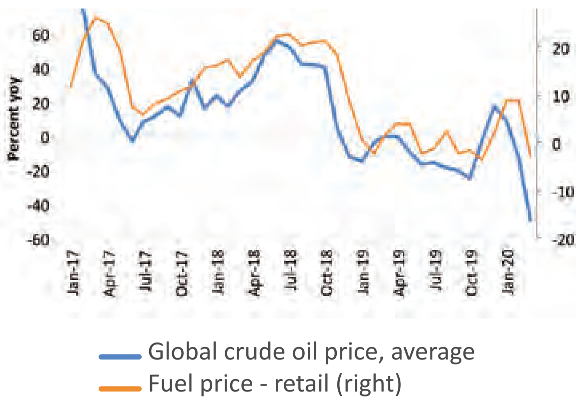
36. **The GoL instructed key economic ministries to strengthen macroeconomic stability and maintain price stability.** The instruction aims to contain inflation by ensuring sufficient supplies of goods in domestic markets through the promotion and expansion of local production and the smooth movement of goods and cargo trucks inside the country and at main border checkpoints (for imports and exports), as well as strengthening price monitoring and management. However, the proposed actions would require good coordination and close collaboration among the executing ministries and agencies. Maintaining price stability is important, but there are risks associated with price controls if not properly implemented. Especially when production cannot easily be scaled up and supply chain disruptions are taking place, it can lead to shortages of goods in the formal market, forcing people to buy at the market price or even higher in the informal market.

Figure 22. Inflation is trending upward



Source: Lao Statistics Bureau.

Figure 23. Lower fuel prices reflect a global trend

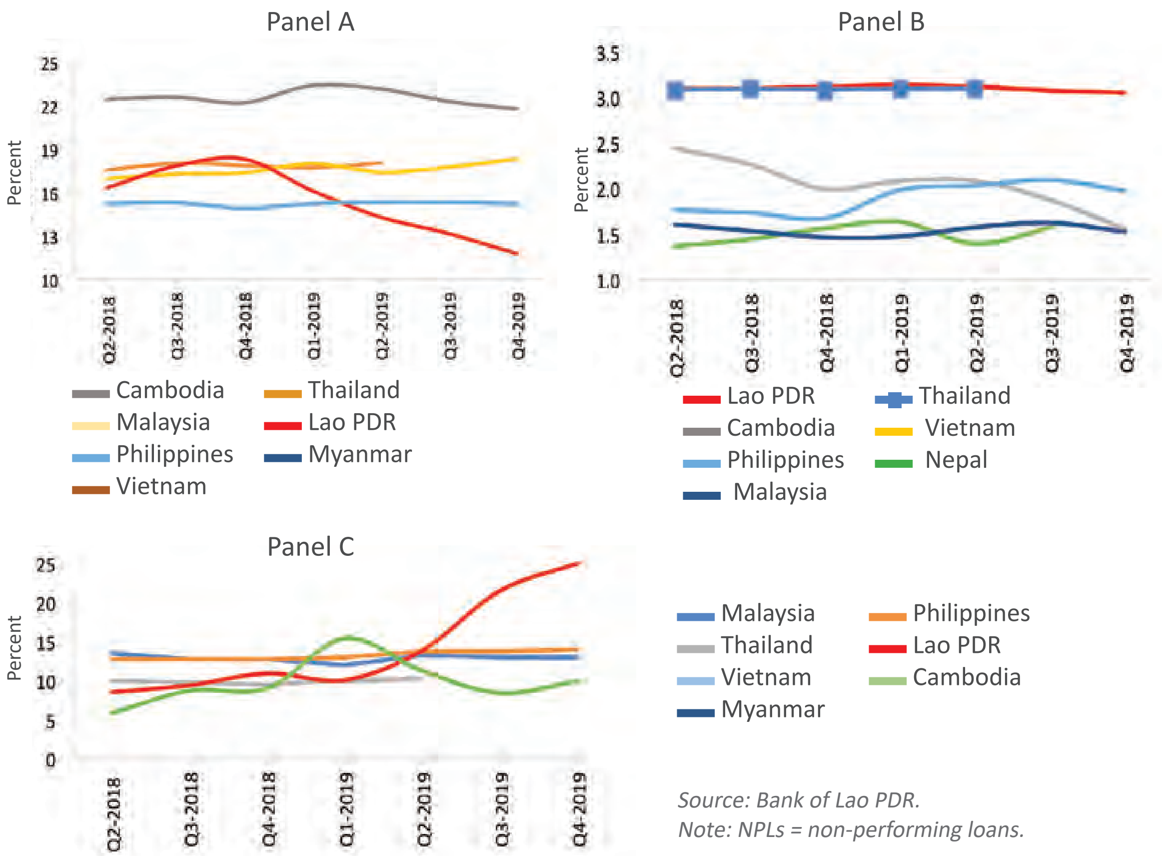


Sources: Lao Statistic Bureau; World Bank.

The financial sector entered the shock with underlying vulnerabilities

37. **The financial sector entered the COVID-19 crisis with considerable preexisting vulnerabilities.** While on average banks still hold regulatory capital above the minimum thresholds, the capital adequacy ratio significantly declined—from 18 percent in 2018 to 12 percent in 2019 (figure 24). This implies that banks with declining capital have to absorb a reasonable amount of loss. Credit growth from commercial banks increased to 7 percent in Q1-2020 from 3.1 percent in Q1-2019 but was lower than the double-digit growth rates experienced over the last decade. Deposit growth has outpaced credit growth, although the loan-to-deposit ratio remains around 83 percent in Q1-2020, which should weigh on bank profitability. In addition, the share of foreign currency deposits is still higher than kip as the public holds foreign currency to hedge against kip depreciation.

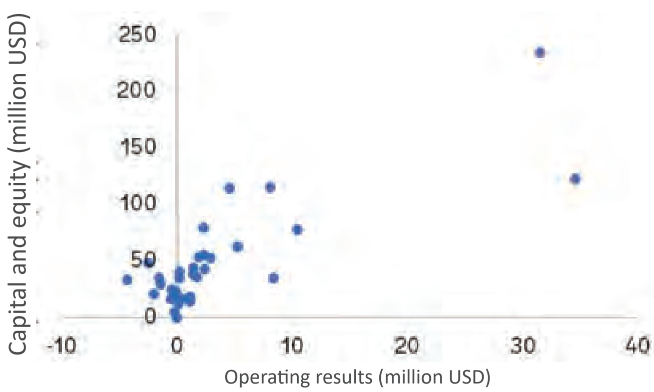
Figure 24. Deteriorating financial sector performance, despite rising profitability



Source: Bank of Lao PDR.
Note: NPLs = non-performing loans.

38. **Overall profitability has been relatively low but recently picked up.** Return on equity increased from 10.9 percent in 2018 to 25 percent at end-2019. Profitability in the sector seems to be driven by the two largest banks (not including two troubled state-owned banks), which account for 52 percent of banking system assets, with several smaller banks with low or negative returns (figure 25). Nonperforming loans remain low at 3 percent as of end-March 2020, but are likely understated. The significant slowdown in economic activities due to the COVID-19 impact implies a higher level of NPLs, which could in turn further weaken banks' balance sheets and constrain credit and growth. A high share of foreign currency-based loans (over 50 percent) also poses risks, particularly given pressures on the exchange rate, and the limited availability of foreign exchange.

Figure 25. One-third of smaller commercial banks make a loss, while many make relatively low returns (Q3-2019)



Source: Various commercial bank websites.

39. The financial sector is critical to helping mitigate the economic impact of the devastating consequences of the COVID-19 pandemic by providing the most extensive and efficient network to channel financial flows to the real economy. Several regulatory and supervisory measures have been taken by many countries across different regions to facilitate banks' countercyclical role while avoiding financial instability. Like many regional countries, the GoL policy responses for the financial sector have included easing of reserve requirements and reducing policy interest rates.[10] In addition, through BoL Decision No. 238, the BoL also adopted other extraordinary measures aimed at facilitating banks' countercyclical role through regulatory forbearance comprising a credit moratorium on principal and interest rate payments and flexibility in the classification of problem loans. Decision No. 238 encourages banks to provide new working capital loans to firms, even those with delinquent loans prior to the onset of the crisis. The BoL has also authorized the reclassification of loans (including nonperforming loans), with corresponding reductions in loan provisioning, which could pose a serious risk to the banking system. Given existing financial sector vulnerabilities, these measures should be designed with extreme care and prudently applied; restructuring of loans should take into account an updated risk profile of the borrowers and be provided only for viable borrowers, and should be based on future expected cashflows and be closely monitored by the BoL. Although the financial sector is critical to mitigate the impact of this unprecedent shock, it is also severely affected directly and could become a source of instability, amplifying the initial shock. The GoL should strive to strike the right balance between helping banks support the economy and avoiding the accumulation of excessive risks that could sow the seeds of a financial crisis.

40. However, significant deceleration of economic activities and forbearance given as part of the monetary stimulus measures are expected to exert more pressure on the already fragile financial sector. In the immediate term, households and firms, particularly SMEs, face a sharp reduction in income, induced disruptions in supply chains, and strict social distancing measures resulting in challenges to deliveries and payments; and a fall in tourism, commodity prices, consumption, and investment. According to an LNCCI survey, business respondents expect difficulty in repaying loans.[11] Dimmed economic prospects could adversely impact nonperforming loans and constrain banks to lend and support real activity. Credit risks are compounded when cash-constrained firms—SMEs, in particular, which rely more on bank funding—and households fail to secure bridge financing to cover an immediate loss of income, delays in receivables, and so forth. The recovery of SMEs also depends on the progress on disbursing the SME Fund and SME loans supported by China. Cash flow disruptions of affected firms and shifts in demand for cash by the public could tighten funding and liquidity conditions for banks and, subsequently, lending to the private sector. These risks will likely weaken profitability in the sector if the slowdown persists.

10 The BoL announced on March 30, 2020 (with immediate effect) a reduction of its official interest rates (for example, for short-term kip lending with a maturity of less than one year and more than 14 days by 1 percent from 10 percent to 9 percent) to reduce borrowing costs for businesses. The deposit reserve requirement reduction measure (by 1 percent for kip and 2 percent for foreign currency) is expected to add additional liquidity (around 960 billion kip) to the banking system. The total deposit reserve requirement was about 3,860 billion kip at end-December 2019.

11 LNCCI report on the impact of COVID-19.

41. The first-stage impact is expected through lower credit growth and reduced fee income, and the second-stage impact through weaker asset quality. While monetary easing measures are adopted in many countries, the implementation of measures in Lao PDR may have differentiated consequences beyond the crisis period due to existing vulnerabilities in the financial sector. The Bank of Lao PDR's policy easing to support the economy, if not properly targeted and implemented, might compress margins and reduce profitability beyond the shock duration. In a worst-case scenario, this might lead to the erosion of bank buffers and undermine their resilience and trigger a credit crunch. Shallow capital markets will limit mobilization of capital by both government and the private sector to cushion against the shock. The lack of fiscal space and the postponement of payments to contractors could also cause an increase in government arrears to borrowers, delay payments to banks, and lead to further asset deterioration. The pandemic might also place a unique strain on payment and settlement systems both because of the operational risks that the health aspects of the crisis pose and the financial risks that arise from the impact on the financial health of the financial sector.

Photo credit: Phoonsap Thevongsa

2. Outlook and risks

Outlook

42. **The economic outlook will depend on the depth and duration of the global downturn and the effectiveness of domestic economic relief measures.** Although subject to high uncertainty, growth is expected to gradually rebound to an average of 4.5 percent over the next two years under the upside scenario, assuming resumption of some domestic economic activities towards Q3-Q4, supported by a gradual recovery in key trading partners. As a result, external (regional) demand is expected to gradually pick up for Lao PDR's exports of goods and services and to lessen the supply-side disruption, which will support the recovery of services, particularly the tourism, agriculture, manufacturing, and construction sectors. Global demand, affecting international tourism demand, may take longer to recover. As a result of these factors, the pace of growth would remain below its 2019 level, due to limited fiscal and monetary buffers to support the implementation of economic relief measures. The downside case assumes a much slower recovery path to an average of 2.5 percent over the next two years due to longer application of domestic restrictions to prevent the risk of a second round of contagion, limited policy buffers, and a slower and longer recovery in key trading partners.

43. **The fiscal pressure and public debt are expected to remain elevated in 2021 despite an anticipated rebound in revenue collection.** Gradual business recovery, resumption of domestic economic activity, and continued revenue reforms are expected to contribute more to government revenue collection next year. However, the level would still be below the pre-COVID-19 level, while there is limited room for spending adjustments and rising pressure on debt servicing. Under the upside scenario, assuming gradual improvement in revenue performance, the deficit is expected to decline from 7.5 percent in 2020 to an average of 6.5 percent of GDP, with public debt at an average of 68 percent in the next two years. Under the downside case, assuming more difficulty in revenue collection and limited room for spending cut, the fiscal deficit could fall at a slower pace from 8.8 percent in 2020 to an average of 8.3 percent in the next two years, while public debt remains at an average of 74 percent of GDP. Public debt service (interest and principal) obligations in the next three years will average US$1.1 billion per year (or almost 55 percent of domestic revenue on average in the medium term), which will most likely lead to additional borrowing to refinance these obligations, subject to the consideration on debt relief initiatives or joint-donor support programs. Foreign currency reserve coverage is expected to remain inadequate. Therefore, the containment of the fiscal deficit coupled with improved debt management is a priority for restoring macroeconomic stability and lowering the pressure on foreign currency reserves.

44. **In the medium to longer term, the outlook is broadly subject to progress on doing business reforms and policies to take advantage of better connectivity after the railway operation.** This COVID-19 shock highlights the currently weak fundamentals in the Lao PDR economy. The preexisting vulnerabilities challenge the implementation capacity of the government's relief measures. Nevertheless, this crisis underscores the urgency and importance of reforms to strengthen macroeconomic stability through fiscal consolidation, reducing public debt level, improving debt management, and accumulation of reserves. In the longer run, improving the business environment and economic fundamentals will help foster economic resilience against shocks, creating opportunities from better physical connectivity upon completion of the large infrastructure projects and deeper regional integration. Doing business reforms have progressed on several fronts; however, the bulk of reform implementation is still pending (Annex 5).

Risks

45. The medium-term outlook is characterized by significant downside risks. These include (i) a more prolonged and/or severe outbreak of COVID-19 either globally, regionally, or domestically, exacerbated by more sluggish recovery in Lao PDR's key trading partners; (ii) heightened challenges in meeting public external debt service obligations; (iii) adverse weather-related events primarily affecting the agriculture sector; and (iv) more significant impacts on the private sector, which could cause liquidity problem in businesses and banks, exacerbating the already fragile fiscal and financial sector health. Given the current fragile global and domestic economic situation, the realization of one or a combination of these risks could result in a more severe downside scenario.

46. The external downside risk is primarily related to the evolution of the COVID-19 pandemic. The risk stems from a more prolonged outbreak and/or a resurgence of COVID-19 infections. If the outbreak continues primarily among Lao PDR's key trading partners (excluding China), some of which might not be within the East Asia region,[12] then the impact on the Lao economy is likely to be less severe. However, if there is a reversal of the current situation and community spread happened in Lao PDR, even with a downturn in the number of COVID-19 infections outside Lao PDR, depending on the severity of the community spread, there would be a significant negative impact on the Lao economy. In general, the poor and vulnerable households—particularly those with elderly members, those whose livelihoods depend on the urban informal economy,[13] **a**and/or those whose livelihoods depend on remittances—will be disproportionately affected in the absence of effective social protection and adequate access to health care services.

47. Given the Lao PDR's significant external debt service obligations, meeting debt service obligations would prove to be increasingly difficult. Debt service burden is around US$1.1 billion per year over the next three years coupled with underperformance in domestic revenue mobilization, a low foreign currency reserve buffer, and limited financing opportunities. The ability of Lao PDR to meet its debt service obligations in 2020 and the coming years poses a significant risk. The impact of the COVID-19 pandemic has significantly amplified this risk as it becomes increasingly challenging to raise revenue and tap the international capital markets. Even though central banks have begun easing interest rates to support economies during this pandemic, the "flight to safety" toward less risky assets such as U.S. treasury bills and gold has resulted in a higher premium for more risky assets. As Lao PDR's sovereign rating by Fitch and Standard and Poor is B-, which is below investment grade (commonly referred to as "junk" status), the yield on a Lao PDR bond would be significantly costly in the current economic situation.[14]

48. Adverse weather-related events are a risk that has consistently affected Lao PDR's economic performance. Most recently, in 2019, the agriculture sector was adversely affected by the flooding in the south and a drought in the north of the country. In 2018, Lao PDR was severely affected by floods and heavy rains, which were exacerbated by a breach in the Xe-Pien Xe-Namnoy hydropower saddle dam, which caused an unprecedented flash flood in Attapeu Province that severely affected many lives. These floods have affected the life and livelihoods of people, which in turn has adversely affected growth, fiscal performance, and macroeconomic stability, in general. In 2020, with the onset of the rainy season in Q2 and Q3, the possibility of extreme flooding is a significant risk.

12 The impact of COVID-19 on Lao garment exports to Europe and United States has been significant.

13 Those who earn their livelihood in the formal economy are likely to have better social protection and higher savings, while those who work in the agriculture sector may be able to be self-sufficient.

14 The Lao PDR international bond was issued on December 19, 2019, for US$150 million at a rate of 6.875 percent with an 18-month maturity. The bond yield is calculated at 8.2 percent.

3. Policy options

49. Notwithstanding the limited policy space, the authorities have proposed several policy measures in which implementation capacity varies. These include both fiscal and monetary policy **measures:**[15]

- ***(i) Proposed fiscal policy measures:*** A payroll tax exemption for all employees, deferred tax payments for COVID-19-affected businesses, possible cash transfers to affected wage workers in urban areas, exemption from the corporate tax for microenterprises and COVID-19-related imports, expen diture restructuring by prioritizing nearly completed public investment projects and postponing new infrastructure projects to 2021, and saving non-wage recurrent spending (by 10 per cent) to be used to fight COVID-19. The authorities have also proposed several debt-related policy measures, such as converting debts to investments or selling some SOE shares to reduce external debt and seek a deferral of debt service payments on external debt.
- ***(ii) Monetary and exchange rate policy measures proposed by the Bank of Lao PDR:*** A reduction of cash reserve requirements and policy interest rates; speeding up ongoing negotiations with China to reach a currency swap agreement (for the Lao kip and Chinese renminbi) between the BoL and the People's Bank of China. The objective is to increase the country's flexibility and access to foreign currency, request commercial banks to reduce interest on loans, extend new loans to businesses, and carry out loan restructuring for affected businesses. Given existing financial sector vulnerabilities, these measures should be designed with extreme care and prudently applied; restructuring of loans should take into account an updated risk profile of the borrower and be provided only for viable borrowers, and should be based on future expected cash flows and closely monitored by the BoL.

Implementing these fiscal and monetary policy measures will be extremely challenging in the current domestic and global economic environment.

50. Policy options to mitigate the impacts of the COVID-19 outbreak should provide immediate economic relief while supporting recovery and fostering resilience in the medium term. 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. These include direct cash transfer programs to economically vulnerable households and displaced workers. High levels of informality limit the reach of policies targeting employment preservation in the formal sector since most people are not covered by social insurance. Universal transfers are also constrained by limited fiscal space. Direct support to households would require two-dimensional targeting based on level of exposure by economic activities and welfare status to account for the limited ability to cope with the income losses. It is therefore important to develop a system for targeting households and delivering transfers to the most needed target groups.

15 The proposed policy measures focus on Prime Minister's Decision No. 31 on a COVID-19 response package and selected COVID-19 response measures from the Ministry of Planning and Investment's proposal to the prime minister dated March 31, 2020. These are policy-level measures. Therefore, the respective ministries will have to issue implementing regulations (with detailed actions) to guide implementation of the policy measures.

51. To foster economic recovery, some measures have already been put in place such as tax relief and deferrals to businesses, expansionary monetary policy, and a credit moratorium. The gains from these measures depend on targeting viable businesses (SMEs and large firms) that are temporarily affected by the COVID-19 shock but have ability to rebound. While providing support to businesses, accelerating revenue administration reforms would be essential to build the fiscal space for the GoL to mitigate shocks. These include the rollout of TaxRis, an automated tax revenue information system; and review of tax exemptions to investment projects. In addition, engaging in restructuring of external debt through the debt service suspension initiative and joint-donor support program could help alleviate some of pressure on the debt service in the medium term.

52. In addition, expansionary monetary and financial relief measures should be carefully designed and prudently implemented. The financial sector is critical to mitigating the impact of this unprecedent shock, but it is also severely affected directly and could become a source of instability, amplifying the initial shock. The authorities should strive to strike the right balance between helping banks support the economy and avoiding the accumulation of excessive risks that could sow the seeds of financial stress. Credit moratoriums need to be implemented prudently, with close supervision. While bank bridge lending and loan restructuring could reduce the stress for affected firms, the measures should take into account an updated risk profile of viable borrowers and expected future cash flows. In addition, the BoL should accelerate development and implementation of secondary regulations on bank resolution and crisis management, early intervention, and a resolution framework, along with development of an early warning system.

53. In the longer term, accelerating reforms to promote diversification and improve competitiveness in the private sector, supported by improved connectivity, will be important to strengthen economic and social resilience. In addition, a resilient macroeconomic framework needs to be built by adopting an integrated approach to macroeconomic policy development and implementation. An integrated approach is required to deliver a fit-for-purpose macroeconomic policy framework that can support stronger economic growth and ensure macroeconomic stability over the medium term. Such an approach will focus on delivering adequate fiscal and foreign currency buffers needed to cushion negative shocks to the economy. Under this approach, more and better investment in human capital and social protection can also improve households' ability to handle the impacts of shocks.

Building a resilient health system for health emergency: Addressing system constraints for improving financing and service delivery

Photo credit: Phoonsap Thevongsa

1. The impact of COVID-19 on health systems

The global COVID-19 outbreak tests the readiness of the health system in Lao PDR

1. **COVID-19 has challenged the readiness of the health sector in Lao PDR.** An outbreak of the coronavirus disease (COVID-19) caused by the 2019 novel coronavirus has been spreading rapidly across the world since December 2019, following the diagnosis of the initial cases in Wuhan, Hubei Province, China. Since the beginning of March 2020, the infection has grown exponentially and quickly spread to most countries and regions around the world. On March 11, 2020, the World Health Organization (WHO) declared a global pandemic. As of May 25, 2020, the outbreak has resulted in 5.46 million confirmed cases and 346,293 deaths across the world.

2. **The Government of Lao PDR (GOL) has been active on the preparedness and response fronts.** As of May 25, 2020, Lao PDR has reported 19 confirmed cases of COVID-19.[16] The Ministry of Health (MoH) maintains that Lao PDR is at high risk, given the proximity to and links with countries affected by COVID-19, and the low capacity of the public administration. The MoH activated the Public Health Emergency Operations Center (EOC) in January 2020 to prepare for and respond to COVID-19, focusing on interagency coordination, point of entry (PoE), surveillance, health services, and risk communication. However, coordination between the central and provincial levels is still a major challenge for the management of the emergency due to lack of trained personnel and limited capacity of public health emergency operations at the subnational level.

3. **While Lao PDR has successfully contained the outbreak of COVID-19, under a more pessimistic scenario involving community transmission, the impact of the pandemic could be significant.**[17] According to the initial WHO modelling, two months after the start of the transmission there would be 180 hospitalized cases, 840 after three months, 876 after four months, and still 699 hospitalized cases after five months. At the peak (around three-and-a-half months after the start of transmission) it is estimated that there would be 900 hospitalized cases, a quarter of which may require an ICU bed and a mechanical ventilator. The average length of a hospital stay is estimated at 28 days. While there would be enough hospital beds in ICUs in Lao PDR to cope with such a scenario, there are severe gaps in the number of beds in isolation rooms (232 of the 900 estimated necessary available) and quality of isolation rooms fully equipped with ventilators, regulators, oxygen concentrators, and oxygen tanks.

16 WHO 2020. Rolling updates on coronavirus disease (COVID-19).

17 GOL has developed four scenarios to prepare for a potential COVID-19 outbreak: (1) Imported case(s): a confirmed case with a travel history to a country with a COVID-19 outbreak; (2) Locally acquired case(s): a confirmed case without travel history; (3) Localized cluster: a cluster of confirmed cases including at least one locally acquired in one province; (4) Widespread community transmission: clusters of confirmed cases including locally acquired cases in two or more provinces.

4. Capacity to respond to widespread community transmission in Lao PDR is limited, and laboratory and case management capacities at the national and subnational levels need to be strengthened. Currently, four central hospitals in Vientiane Capital City have isolation capacity and serve as referral hospitals to manage severe cases, and all provincial hospitals need to convert their existing hospital facilities with isolation capacity to accommodate all the COVID-19 cases found within their respective provinces. At the national level, four laboratories, including the National Center for Laboratory and Epidemiology (NCLE), have the capacity to perform diagnostic and confirmatory testing of COVID-19. However, no laboratory capacity for testing exists at the subnational level.

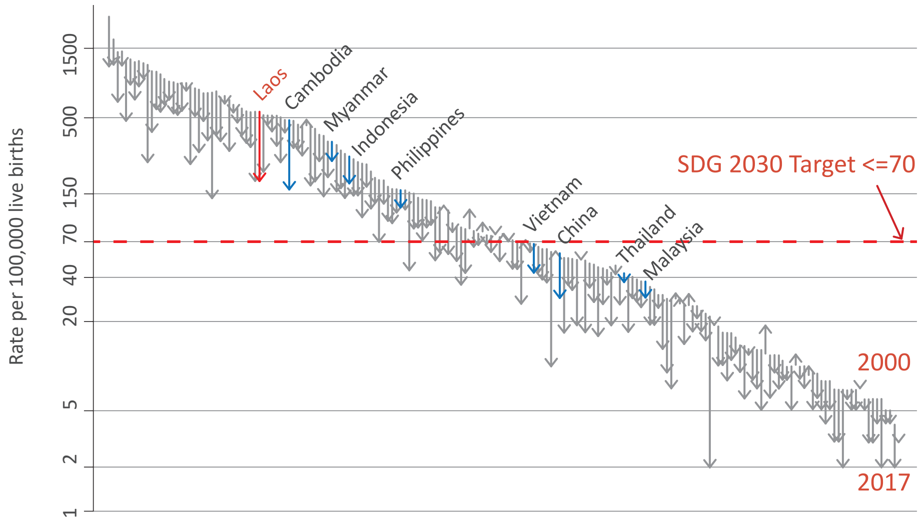
5. The GoL has been implementing its national plan for public health emergency and health security (2016–2020) to develop core capacity to prevent, detect, and respond to public health events of international concern. The country has established a surveillance system to detect acute public health events and has trained multisectoral rapid response teams that can be quickly deployed to respond to outbreaks. The National Preparedness and Response Plan for COVID-19 has been prepared to implement a comprehensive response for COVID-19 focusing on the following priority areas: (i) command, coordination, and planning; (ii) infection prevention and control (IPC); (iii) case management; (iv) surveillance and laboratory; (v) risk communication; (vi) essential health services; (vii) point of entry; and (viii) monitoring and evaluation. However, the GoL's budget for outbreak investigation and response is limited, and financing relies heavily on support from development partners.

6. The GoL is working closely with development partners to strengthen the response capacity at the national and subnational level through improved coordination of the COVID-19 response. A multisectoral tabletop exercise was held on March 13, 2020, to test the COVID-19 scenarios for Lao PDR. An ad-hoc committee for COVID-19 has been established, the National Committee for Communicable Disease Control has been activated, and EOC holds daily meetings at the MoH involving all departments and centers as well as relevant ministries to report the COVID-19 situation updates and coordinate the national response actions. The capacity of health care facilities is being assessed and will be further strengthened to prepare for a potential community transmission scenario.

Lao PDR still lags regional peers in many areas of health and nutrition outcomes, and COVID-19 may slow the progress achieved over the past decade

7. While Lao PDR has made significant progress on key health outcomes, maternal mortality and chronic malnutrition remain one of the highest in the region, and COVID-19 may wipe out the progress of the last decade. During 2000 to 2018, Lao PDR recorded a significant decline in infant and under-5 mortality rates. The infant mortality rate decreased from 83 in 2000 to 38 per 1,000 live births in 2018, while the child (under-5) mortality rate dropped from 118 to 47 per 1,000 live births. Similarly, the maternal mortality ratio significantly declined from 546 in 2000 to 185 per 100,000 live births in 2017, and the total fertility rate declined from 4.3 from 2000 to 2.7 in 2017. Substantial progress has been made in the reduction of vaccine-preventable diseases. However, the key health outcomes are still lower than those in neighboring countries, and further progress is needed to meet the targets (figure 26).

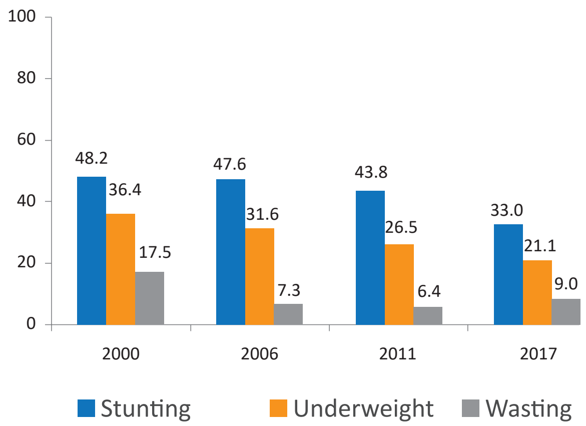
Figure 26. Maternal mortality ratio remains among the highest in the region, 2000–2017



Source: World Development Indicatoes database

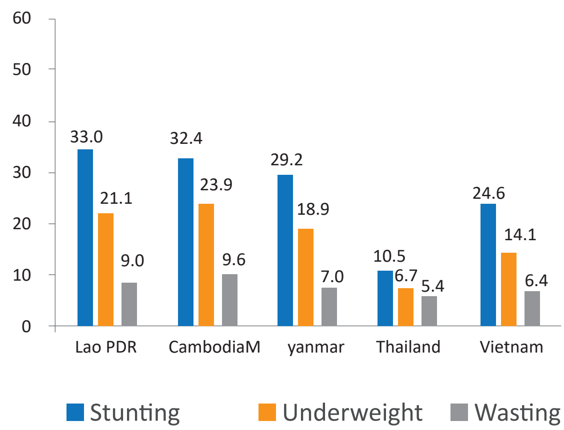
8. Despite measurable improvements in nutrition outcomes, chronic malnutrition (stunting) levels remain among the highest in the region. About 33 percent of children under age five are stunted, 21 percent are underweight, and 9 percent are wasted (figure 27). Despite the improvements in nutrition indicators over time, Lao PDR still lags neighboring peers (figure 28). Service delivery and financing bottlenecks in the health sector, with the combined impact of COVID-19, may slow the progress in making further improvements in health and nutrition outcomes.

Figure 27. Nutrition outcomes, 2000–2017



Source: LSIS, 2011 &2017, World Bank, WDI.

Figure 28. Nutrition outcomes by country, latest available year



Source: LSIS 2017 for Lao PDR, WDI for comparator countries.

2. Health service delivery challenges in the time of COVID-19

The COVID-19 outbreak further strains the health system and service delivery

COVID-19 places a huge stress on health systems and service delivery. The U.S. Centers for Disease Control and Prevention (CDC) estimated that during the 2014–2016 Ebola outbreak, the death toll from HIV/AIDS, tuberculosis (TB), and malaria due to disrupted health services was almost as high as from the virus itself,[18] and the numbers of additional maternal, infant, and child deaths might even have surpassed the deaths from Ebola itself. While data on the impact of COVID-19 on the availability of other health services in low- and middle-income-countries is still scarce, there is some early evidence. Gavi has announced that as of April 3, 2020, 14 major vaccination campaigns against polio, measles, cholera, HPV, yellow fever, and meningitis have been postponed, as have four national vaccine introductions, effecting 13.5 million children. The International Planned Parenthood Federation (IPPF) reports that, globally, 5,633 static and mobile clinics and community-based care outlets have closed because of the outbreak.[19] National Health Mission (NHM) data reveal curtailed immunization schedules; and restricted inpatient, outpatient, and emergency treatment for infectious and noncommunicable diseases in rural India in March 2020.

9. A more challenging picture emerges from forecasts and modelling of the impacts of COVID-19 on other health services. According to World Vision,[20] up to 30 million children might be affected by secondary health impacts (lack of immunization, increased malnutrition, increased deaths from malaria). Using the Lives Saved Tool, researchers have estimated that COVID-19 might cause as many as 31,980 additional maternal deaths, 395,440 additional newborn deaths, and 338,760 additional stillbirths over the course of 12 months in the four most populous low- and middle-income countries in the world (India, Indonesia, Nigeria, and Pakistan).[21] A more conservative and broader modelling attempt estimates a 9.8 percent to 44.7 percent increase in child deaths per month, and an 8.3 percent to 38.6 percent increase in maternal deaths per month, across 118 countries low- and middle-income countries.[22]

18 See Alexandra B. Hogan, Britta Jewell, Ellie Sherrard-Smith et al. 2020. The Potential Impact of the COVID-19 Epidemic on HIV, TB and Malaria in Low- and Middle-Income Countries. Imperial College London (01-05-2020). doi: https://doi.org/10.25561/78670.

19 https://www.ippf.org/news/covid-19-pandemic-cuts-access-sexual-and-reproductive-healthcare-women-around-world (April 9, 2020).

20 COVID-19 Aftershocks: Secondary impacts threaten more children’s lives than disease itself.

21 https://medium.com/@HealthPolicyPlus/estimating-the-potential-impact-of-covid-19-on-mothers-and-newborns-in-low-and-middle-income-3a7887e4a0ff (April 15, 2020). The authors assume the rate of decline in service as high as in Sierra Leone during the Ebola epidemic; therefore, these numbers represent a worst-case scenario.

22 Roberton, Timothy et al. 2020. Early Estimates of the Indirect Effects of the Coronavirus Pandemic on Maternal and Child Mortality in Low- and Middle-Income Countries (April 15, 2020), https://ssrn.com/abstract=3576549; for a similar estimate see https://www.globalfinancingfacility.org/gff-leaders-warn-emerging-secondary-global-health-crisis-disruptions-primary-health-care-covid-19. A summary of projections and estimates can be found at https://www.path.org/programs/advocacy-and-policy/resources-support-covid-19-responses-lmics/.

10. If all essential health services were disrupted in a fashion similar to the Ebola epidemic, child mortality in Lao PDR is estimated to increase by 25 percent and maternal mortality by 31 percent, offsetting all the progress made since 2014. The aforementioned modelling assumes a decrease in coverage rates similar to those observed during the Ebola epidemic. For essential reproductive, maternal, and child health services, reductions in coverage ranged from 10 percent to 52 percent. Applying the same assumptions to Lao PDR, specifically, indicates that up to 75,000 additional children might not receive oral antibiotics for pneumonia, and 139,200 might not receive DTP3[23] vaccinations. Facility-based deliveries might decline by 26,000 and the use of contraceptives by 216,800.[24]

11. The health sector in Lao PDR remains largely under-resourced and is constrained by large gaps in skills, numbers, and distribution of human resources and shortages of essential drugs and equipment. Large gaps already exist in service availability and readiness across health facilities. Most health facilities have insufficient isolation rooms and equipment for the treatment of patients with severe respiratory diseases. Laboratory capacities for diagnostic tests are limited and require sending specimens over long distances.

12. Poor access to and quality of health and nutrition services are persistent problems, and disproportionately affect women and the poor, leaving a large gap in essential services needed by mothers and children. For example, the 2017 Lao Social Indicator Survey (LSIS) found that only 52 percent of pregnant women from the poorest wealth quintile received antenatal care (ANC) from a trained health professional, and over 36 percent of pregnant women living in rural areas without roads had not received any antenatal services. Only 34 percent of women in the poorest wealth quintile had been assisted by a trained health professional at the time of delivery.

13. Early evidence indicates that the COVID-19 outbreak has affected essential service delivery, showing a declining trend in antenatal care visits, births at health facilities, and assisted births at home in the first quarter of 2020 compared to the preceding years. While it is still too early to capture the full impact of COVID-19 to date, inpatient admissions and facility-based deliveries declined by 18 percent and 6 percent, respectively, in Q1-2020 from Q1-2019. The same is true for immunization rates, which might be a reflection of the first trend and of the particular vulnerability of immunization services to functioning procurement and supply chain logistics and outreach services.[25] Nutritional services, particularly vitamin A supplementation and deworming, which rely almost exclusively on outreach, will likely be negatively affected. Service coverage is expected to fall in Q2-2020 due to the lockdown and travel restriction measures.

23 DTP3 = diphtheria-tetanus-pertussis.

24 Global Financing Facility, Preserve Essential Health Services during the COVID-19 Pandemic – Laos, https://www.globalfinancingfacility.org/sites/gff_new/files/documents/Laos-Covid-Brief_GFF.pdf,based on Roberton et al., 2020. Estimates are for the scenario with the highest reduction in coverage and assume they last for half a year.

25 Immunization numbers via outreach have declined at a higher rate compared to the numbers at mobile and fixed sites.

14. In the event of an outbreak, the country's public health system will be stretched, disproportionately impacting low-income households that have inadequate access to health care services. In Lao PDR, low-income households face greater barriers to accessing health care, with some households not able to afford transportation costs to the hospital. As a result, they rely mostly on basic health care services from health centers, especially those in rural areas. Inadequacy in access to health care services is expected to be more challenging, as testing and treatments of COVID-19 will likely be carried out at the central and provincial hospitals. More than 90 percent of Lao PDR populations are covered by social health insurance schemes. However, when informality is pervasive and social protection absent, the poor and vulnerable experiencing health shocks that disrupt their income-generating activities are still at high risk of falling deeper into poverty.

15. A shortage of qualified manpower is further compounded by an uneven distribution of health workers across provinces. A 2016 World Bank study on the health workforce found substantial gaps in the clinical abilities of frontline health workers in the management of basic clinical care and preventive services for pregnant women, mothers, and children. The density of doctors to population in Vientiane is four times that of the rural areas. Similar but less pronounced differences exist for high-level nurses and midwives. The study also found a maldistribution of staff (by geography, level, and type), substantial gaps in clinical knowledge, and a mismatch between the type of in-service training provided and the knowledge needed to perform the service required.

16. Poor and remote populations rely on outreach services, which were disrupted due to the COVID-19 outbreak and lockdown. A large part of the population—primarily the poorest population groups, ethnic minorities, and those who live in the difficult-to-reach areas—depend on outreach services for both preventive and basic curative care. A lack of appropriate medical tools and equipment to carry out outreach services, as well as a lack of clear guidelines and supervision, were found to be affecting the quality of outreach services. Currently, the situation is exacerbated by travel restrictions.

17. Effective coverage of priority health interventions is also hampered by demand-side barriers such as physical access barriers and ethnolinguistic and gender barriers. The demand-side barriers were further compounded by the fear of transmission of COVID-19 and distrust of the public health system. The elimination of such barriers is needed to increase the use of essential health services. Limited or lack of awareness or knowledge, and cultural and/or religious beliefs, continue to be a challenge in generating demand for priority health services such as immunization, particularly in the time of COVID-19. Effective information, behavioral change, and communication about risk at the community and household levels are critical to raising awareness about the importance of preventive maternal and child health services.

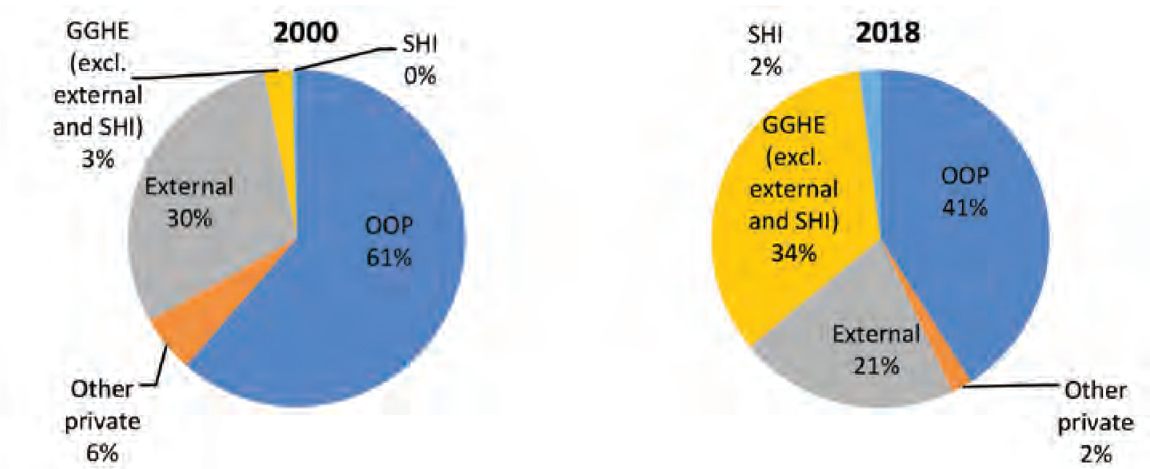
18. Following the effective implementation of a reproductive, maternal, newborn, and child health strategy and action plan (2016–2025), family planning, immunization, and antenatal care and facility-based delivery have been improved, leading to the significant reduction of mother and child mortality rates, as stated above. However, progress may be slowed due to the COVID-19 outbreak. The low education of pregnant mothers, poor access in some geographic areas, and lack of cultural understanding can further exacerbate disparity and inequity in access to essential health services among mothers and children. Ensuring access to essential health services for those most vulnerable groups needs to be prioritized to mitigate the impact of COVID-19.

3. Health financing challenges

The health system in Lao PDR is underfunded and the COVID-19 outbreak requires adequate and sustainable financing for public health emergencies

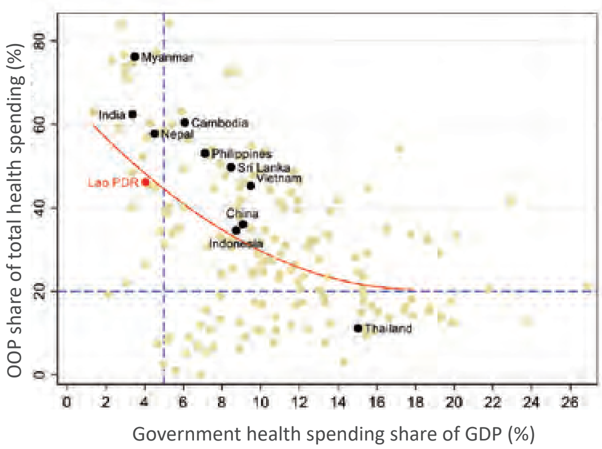
19. In Lao PDR, the health sector has suffered from low levels of public investment and correspondingly high reliance on out-of-pocket (OOP) financing, with gaps filled by external assistance for health. The country spent US$71 per capita, or about 2.8 percent of GDP, in 2018. Nearly half of total health expenditure is financed by private spending, which includes OOP spending by households (41 percent of total health expenditure). While the government budgetary spending on health has increased significantly in recent years (see figure 29), OOP spending remains the largest source for health financing in Lao PDR (figures 30 and 31). External finance remains the main funding source for the priority health programs such as immunization, HIV, TB, and malaria. The COVID-19 response measures are largely financed by the external sources, and the external financing plays an important role for infectious disease prevention and control and frontline service delivery.

Figure 29. While public health expenditure share has increased, OOP spending remains high, 2000 and 2018



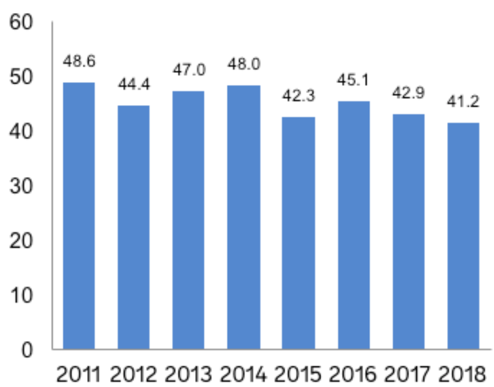
Source: WHO Global Health Expenditure Database for 2000 data, MoH National Health Accounts for 2018 data.

Figure 30. OOP share of total health expenditure, and government health share of GDP, 2017



Source: LSIS, 2011 &2017, World Bank, WDI.

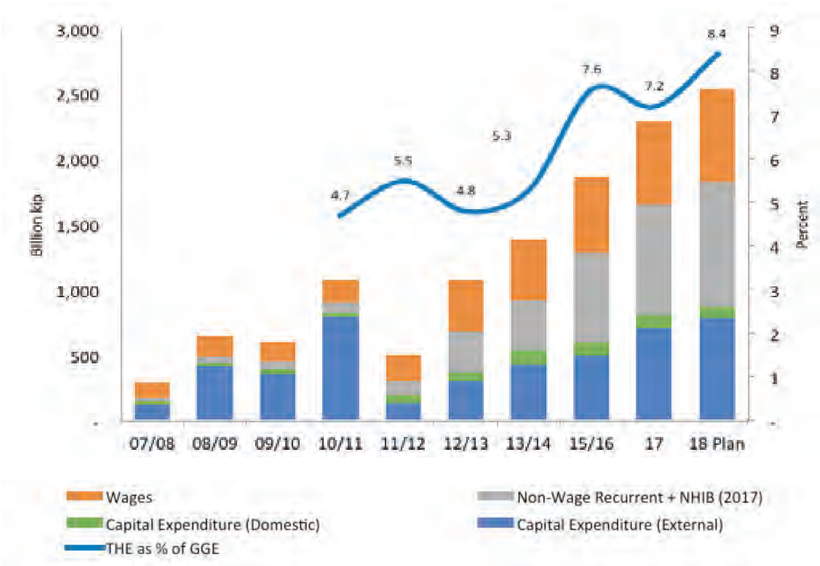
Figure 31. OOP as % of total health expenditure, 2011–2018



Source: LSIS 2017 for Lao PDR, WDI for comparator countries.

20. Despite the recent increase in government expenditure on health, it is unlikely that this trend can continue due to the economic and fiscal impact of COVID-19. While additional resources are mobilized for COVID-19, it is critical that sadditional sectoral budget will reach the health facilities and be spent on non-wage recurrent expenses to ensure delivery of quality essential services (figure 32). The latest national health accounts data showed persistently high levels of OOP expenditure. High OOP had contributed to the low and declining rates of utilization of outpatient care in every consumption quintile except the richest. Specific measures are needed to reduce the OOP spending of households seeking preventive and promotive health services.

Figure 32. Government health expenditure by function, FY2007–08 to FY2018 (in billions of kip)



Source: GoL Official Gazette and State Budget Plan, various years.

21. About 20 percent of Lao PDR's health expenditure is funded by donors, with significant fragmentation of financing sources. Public expenditures on HIV/AIDS, TB, and malaria, and for new vaccines, are almost exclusively financed through external sources, in particular the Global Fund to Fight AIDS, Tuberculosis, and Malaria (GFATM) and Gavi, the Vaccine Alliance. Overall levels of funding for these priority programs are substantial relative to spending in other parts of the health system. Given this donor dependency and the limited fiscal space, it is essential to further involve development partners in the response to the COVID-19 crisis and ensure the continuation of high-quality essential services.

22. In the containment phase of COVID-19, major investments are required (surveillance, testing, and contact tracing), alongside the continued provision of essential health services, necessitating increased government and external funding for health. However, overall government revenues and revenues from employment-based health insurance schemes will decline. It can be expected that countries will run much larger fiscal deficits than usual during the crisis, building up debt and restricting fiscal space for health in the future. Furthermore, health facilities refunded based on outputs might experience severe cash-flow problems in this phase due to diminished revenues from the postponement of elective and nonessential services, and the increased costs of purchasing additional equipment and supplies, disrupted international supply chains, and higher staffing needs.

23. As Lao PDR will have to face the budgetary implications of COVID-19, it is important to protect the regular health budget while mobilizing additional resources for the COVID-19 response. Failure to rapidly mobilize financing and coordination of response across sectors would result in adverse health and socioeconomic consequences. Given the limited fiscal space, getting support from development partners will be key to respond to this emergency shock and ensure essential services during the crisis. In the medium term, more and better spending is needed to enhance the health system's capacity to respond to public health emergencies.

Photo credit: Phoonsap Thevongsa

4. PFM system bottlenecks for service delivery and financing

24. The Government of Lao PDR is committed to achieving Universal Health Coverage (UHC) by 2025 and has embarked on major health reforms to expand population and service coverage and improve financial risk protection against health care costs. Understanding the PFM constraints in health financing and service delivery including weak planning and budgeting, lack of budget flexibility, and weak financial accounting and reporting will provide useful lessons that will help shape the implementation of immediate response measures for COVID-19, as well as ongoing and future health sector reforms to achieve UHC.

25. Addressing sector-specific bottlenecks at the lowest levels of service delivery and financing through strengthened PFM can bring about quick gains. For example, improving budget allocation and execution practices may be more practical than overhauling the system as a whole. PFM systems are the conduits through which resources are planned and channeled for service delivery. Where the PFM system is not functioning, there are no effective mechanisms to allocate resources to priorities and ensure that resources channeled are used efficiently and for intended purposes. In the context of health emergencies, a well-functioning PFM system would allow the rapid transfer of resources to decentralized levels to help scale up the supply of health care delivery, reprogramming, and reallocation of sector budgets for immediate response measures.

26. Furthermore, evidence shows that greater transparency and accountability play an important role in improving health service delivery outcomes, especially in communities with insufficient local institutional capacity and accountability. Funding for the COVID-19 response needs to be swift and streamlined; therefore, the use and reporting of the funds require greater transparency and accountability. Engaging citizens and stakeholders in management of public finances can improve the delivery and quality of public services, enhance the management of public finances, and bring about greater access to health care for the poorest, resulting in tangible improvements in people's lives.

27. In recent years, the PFM systems in Lao PDR have been undergoing reforms. Through the Lao PDR Public Finance Strategy (2017 to 2025), and with support from the World Bank-financed Enhancing Public Finance Management Through ICT Skills (E-FITS) project, and from various development partners including the World Bank-administered European Union PFM Trust Fund (EU TF) and the Asian Development Bank (ADB), the MoF is leading the implementation of a range of PFM reforms that will impact all sectors across all levels of government. Reforms aimed at improving the efficiency of resource allocation through linking policy to budget on a medium-term basis; setting aggregate ceilings; timely ministerial ceilings communication, budget execution, and control; strengthening financial management information systems; and others, are at an early stage. The reform priorities are driven by the findings of the 2018 PEFA assessment, which underscored systemic weaknesses in many processes of the PFM cycle. The PFM reforms raise difficult change management challenges for provincial governments and departments at central ministries. There will be significant impacts on the health sector, particularly at the subnational level, where health service delivery improvements are needed the most.

28. The limited capacity in PFM has been a major system-wide challenge, which also affects the health sector. Weak planning and budgeting systems, decentralized and fragmented revenue administration, difficulty in cash forecasting and management, and continued concerns in budget execution have resulted in an inadequacy of resources to the health sector. This particularly affects the availability of adequate operational budgets at health facilities and hampers frontline service delivery. In the time of COVID-19, these challenges further constrain the system capacity to quickly reallocate and reprogram the funds for priority needs in the health sector.

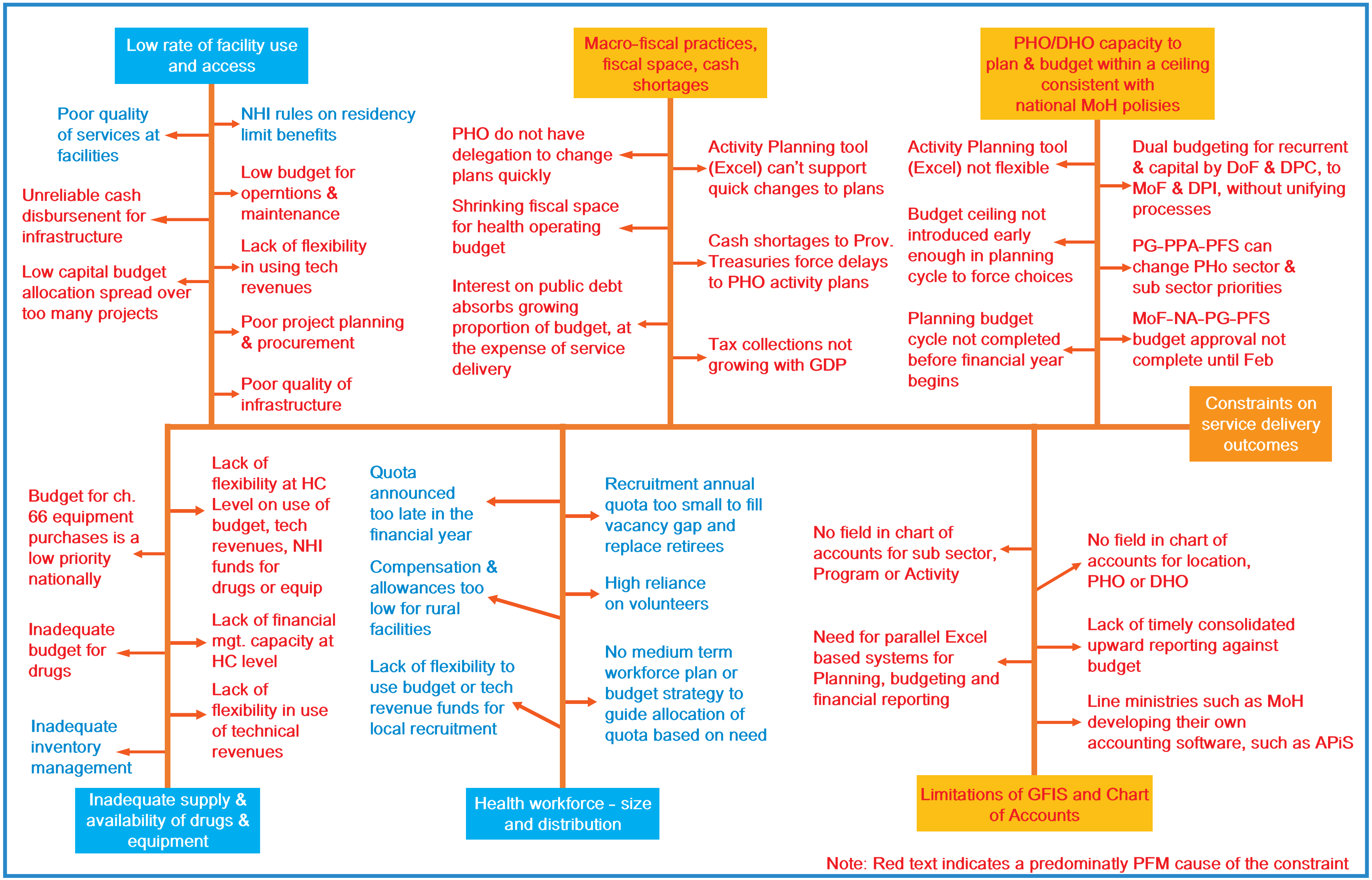
29. However, the strengthening health system through addressing key PFM system bottlenecks is essential to be better prepared and respond to health emergencies. The current COVID-19 crisis has revealed that how budgets are allocated and managed is not less important to a country's response than the amount of funding of the health sector.[26]

30. The PFM assessment in the health sector highlighted several key PFM challenges affecting service delivery at frontline health facilities in Lao PDR. Challenges that include weak planning and budgeting, a compressed budget execution period, poor management of technical revenues, and weak financial accounting and reporting systems have contributed to severe service delivery bottlenecks at all levels. Weak planning and budgeting are exacerbated by the unavailability of budget ceilings early enough to prepare the planning and budgeting cycle, and results in delays in funds transfer to the frontline health facilities for emergency response activities. Linked to such PFM weaknesses are the lack of both appropriate medical equipment and supplies to carry out outreach services, and clear guidelines and supervision, which were found to be affecting the quality of outreach services. A long budget preparation cycle reduces the time available for budget implementation, coupled with delays in budget approval, limiting the availability of cash to conduct outreach services and delivery of essential services, which are severely affected by COVID-19. These key PFM bottlenecks in health service delivery are summarized in figure 33.

Photo credit: Center of Information and Communication for Health

26 https://p4h.world/en/who-wb-no-calm-after-the-storm-time-to-retool-country-pfm-systems-in-health-sector (May 21, 2020).

Figure 33. PFM-related constraints on service delivery at the subnational level



31. The recent Gavi Program Audit also highlighted a number of key PFM challenges, particularly in the areas of cash management, accounting, bookkeeping, procurement, and vaccine management, which require immediate actions with medium- to long-term capacity building to strengthen the PFM systems for delivering equitable and efficient health services, including immunization. The Gavi audit recommended a set of actions to improve an overall internal control system in the areas of governance and oversight, program management, vaccine management, and financial management.

32. A wide range of bottlenecks, constraints, and issues identified as PFM constraints impact service delivery in the frontline health facilities, particularly in the time of a public health emergency. Some of these constraints are common across sectors and will require national-level or whole-of-government actions led by central agencies such as Ministries of Finance, Planning and Investment, and Home Affairs. The recommendations from the sectoral analyses carried out by the World Bank are also relevant to these PFM assessment findings and are reflected in the policy recommendations in box 3.

Box 3. Key policy recommendations on improving PFM for service delivery and financing

Policy Recommendation 1: Develop a framework for internal MoH ceilings early in the budget cycle to guide preparation of baseline budget proposals to the MoF and activity plan preparation, with separately costed, targeted, and prioritized policy proposals or budget briefs.

At the central level, the MoF is planning to implement a new baseline approach to annual budget submissions to avoid annual ambit bids or wishlists from line ministries and provinces. This would involve early notification of ceilings to other ministries by the MoF. The MoH should build internal capacity for sectoral analysis, policy development, budget brief preparation, and negotiation with the MoF and strengthen its relationship with the MoF Budget Department to improve the MoF's understanding of health sector financing and the MoH medium-term budget strategy, and to allow the MoF to participate in the MoH's process of developing new policy proposals and budget submissions. It is also recommended that a planning and budget committee be established within the MoH to ensure recurrent and capital budgets strategies are consistent and prioritize the goals, programs, and activities specified in the Health Sector Reform Strategy & Framework.

Policy Recommendation 2: Improve MoH activity planning tools to provide greater flexibility and responsiveness to changes in ceilings or limitations to cash available through treasury as well as emergency health needs for rapid reallocation of the budget to priority activities.

The current MoH activity planning tools using Excel worksheets have significant limitations and cannot be quickly adapted to ceiling changes during budget preparation, or to cash flow limitations during budget execution. A centralized database tool with distributed access to MoH departments and Provincial Health Offices (PHOs) will provide greater flexibility and allow budget plans to be changed more easily and consolidated quickly at the central level.

The development of tools for determining ceilings at the MoF Budget Department level is currently underway. The ceilings will give more predictability to sectors for planning and allocating resources. The MoH needs to further divide the ministerial ceilings received from the MoF among its second-tier spending units. PHOs need significant capacity strengthening to develop detailed and reliable proposals on time.

Policy Recommendation 3: It is recommended that the MoH engage early with the MoF on the specifications and requirements for a new Financial Management Information System (FMIS) and Chart of Accounts to ensure that health sector needs are accommodated.

As the MoF implements a new FMIS, MoH Excel-based recording and reporting systems will be replaced. In preparation, it is essential for the MoH to proactively engage the MoF on its financial information needs to be considered as the FMIS specifications and chart of accounts requirements are developed. The need for disaggregated expenditure reports and ease of consolidation of such reports by disease, geography, or program from provinces and district health facilities should be part of this discussion.

Policy Recommendation 4: It is recommended that the MoH explore which donors have the flexibility to front-load their annual financing so that when cash shortages emerge at provincial treasuries, activity plans can be adjusted to bring forward the implementation of the donor-funded activities.

Currently, when cash shortages arise at provincial treasuries, PHOs and District Health Offices (DHOs) have little alternative than to defer their outreach and other activity plans until later in the financial year, leaving resources idle early in the year and overcommitted in the last two quarters. Even though PHOs cannot vary the overall budget by chapter heading, they do have flexibility at the activity level, provided they are delegated the authority by the MoH, and provided they can quickly reschedule and re-cost the activity plan. Bringing forward some donor-financed activities may give PHOs and DHOs more flexibility in the deployment of their resources between government-financed and donor-financed activities.

Policy Recommendation 5: Strengthen financial management capacity at the health facility level and quantify the impact of NHI implementation on OOP and technical revenue collection.

The lack of financial management capacity at the health facility level and the failure to properly account for and manage receipt and use of technical revenues (including OOP spending amounts) and other revenues, contributes to a lack of trust between health facilities and DHOs on the one hand, and provincial and district treasuries on the other, as to the true level of resources available to DHOs and health facilities. The NHI scheme may progressively impact the level of OOP spending at the health facility level. The MoH should regularly monitor NHI implementation including service utilization rates and the impact of NHI on OOP spending, and whether this in turn has any impact on technical revenue collection.

Policy Recommendation 6: The MoH could work with the MoF, MPI, and government leaders to ensure that the MoH has greater influence and control over policy and program prioritization at the subnational level.

The MoH should take steps to identify the nature of the protected status enjoyed by the education sector and further explore whether health could operate within the same framework. This would allow the MoH and PHOs to finalize their detailed activity plans as soon as the National Assembly approves the budget in November or December, and not have to wait until provincial government approval in February, which would be two months after the commencement of the financial year.

5. Conclusions

Building a resilient health system for health emergencies and addressing system constraints for improving financing and service delivery

36. The GoL needs to build a resilient health system to effectively respond to COVID-19 and other health emergencies to keep its commitment on UHC and ensure that quality essential health services are available for all during the crisis. Large gaps already exist in service availability and readiness across health facilities, including the lack of basic amenities, limited diagnostic capacity, and low availability of essential medicines. The country urgently needs to invest more in building a strong foundation for emergency health response capacity 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 the virus under control.

37. The COVID-19 outbreak has further strained the existing weaknesses in the health sector. Most health facilities have insufficient isolation rooms and equipment for the treatment of patients with severe respiratory diseases. Frontline health workers lack personal protective equipment and adequate training on infection prevention and control and case management, while demand on health facilities and health workers is rapidly increasing. Safety for health workers with appropriate training and reorientation of services for both COVID and non-COVID services are urgently needed to ensure delivery of effective health services for health workers and patients.

38. Swift detection of an outbreak, assessment of its epidemic potential, and rapid emergency response can reduce avoidable mortality and morbidity and mitigate the economic, social, and security impacts. Failure in the rapid mobilization of financing and coordination of response results in unnecessary casualties and adverse socioeconomic consequences. As highlighted by the SARS and the H5N1 outbreaks in the 2000s, the cost of loss of control of outbreaks—due to delayed detection, reporting, and action—and the resulting socioeconomic losses rises exponentially as outbreaks unfold.

39. Existing public financial management (PFM) bottlenecks in the health system can become major constraints for the timely reallocation and release of public funds to the frontline for emergency response. In the context of health emergencies, a well-functioning PFM system would allow rapid transfer of resources to decentralized levels to help scale up service delivery, reprogramming, and reallocation of sector budgets for immediate response measures. Addressing key PFM challenges affecting service delivery will help shape the implementation of immediate response measures for COVID-19 and accelerate the health sector reforms to UHC and the Sustainable Development Goals (SDGs).

40. The specific challenges of the current COVID-19 outbreak will put additional strains on the already weak PFM system in Lao PDR. Most mitigating measures fall under the responsibility of the MoF: assessing and increasing fiscal space for the emergency response, the development of exceptional procedures, the revision of finance laws, or measures to support and restart economic activity. The MoH should ensure that the most effective measures for containing the pandemic are taken, and that measures to safeguard economic activities do not undermine public health policy.

41. As Lao PDR will face the budgetary implications of COVID-19, it is important to protect the regular health budget while mobilizing additional resources for the COVID-19 response. Failure to rapidly mobilize the financing and coordination of response across sectors would result in adverse health and socioeconomic consequences. Given the limited fiscal space, getting support from development partners will be key to respond to this emergency shock and ensure essential services during the crises. In the medium term, more and better spending is needed to enhance the health system's capacity to respond to public health emergencies.

Photo credit: Center of Information and Communication for Health

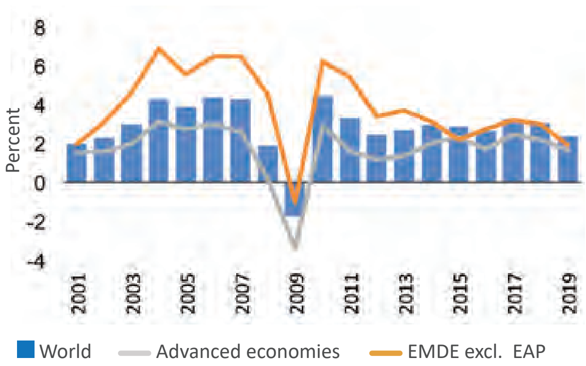
ANNEXES

Annex 1. Recent Global Developments[27]

The making of a global recession

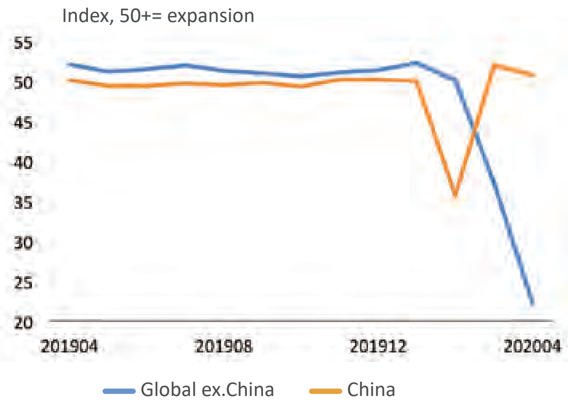
The pickup in global economic activity has been disrupted by the global pandemic and various mitigation measures implemented first in China and later in the rest of the world to slow the spread of the COVID-19 (figure 34). At the start of 2020, the global economy was showing incipient signs of recovery. The global composite Purchasing Managers' Index (PMI) rose to a 10-month high of 52.2, and the manufacturing PMI reached a nine-month high of 50.4 in January 2020. Global trade in goods registered its first positive growth in December 2019 following six months of consecutive contraction, and indicators in January, such as the PMI New Export Orders Index, had suggested a nascent recovery in global trade, spurred by reduced trade policy uncertainty amid progress in U.S.-China trade negotiations. However, activity deteriorated sharply in the latter part of Q1-2020. The global composite PMI excluding China fell by 12.5 points to 37.6 in March. This was the steepest one-month decline ever recorded, which brought the index to its lowest level since January 2009 (figure 35).

Figure 34. Global economic growth rates, 2010–19



Sources: Haver Analytics; World Bank.

Figure 35. Composite PMI, 2019–20

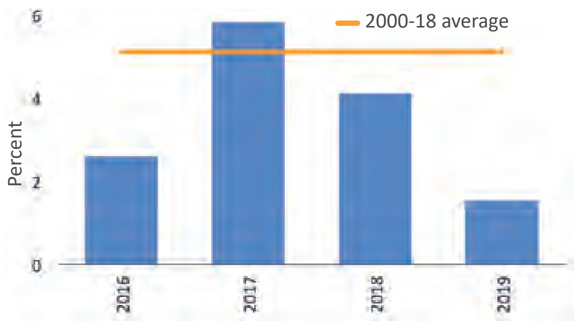


Sources: Haver Analytics; World Bank.

The COVID-19 outbreak was the preliminary data point in a sharp contraction in global trade, reflecting major disruptions in international travel, tourism, and supply chains. The outbreak hit global trade as it was recovering from its multiyear low level in 2019 (figure 36), weighed down by trade tensions and subdued global economic growth. Activity at ports fell in February to a multiyear low level. Travel restrictions and risk aversion have weighed on global tourism and travel. The global New Export Orders Index registered 46.6 percent in March, a decrease of 3.7 percentage points compared to the February reading of 45.2 percent (figure 37). The manufacturers' stocks of purchases fell in March, while suppliers' delivery times continued to rise, pointing to bottlenecks in supply chains. The outbreak not only affected the real sector, but also has negative spillover to the global financial sector.

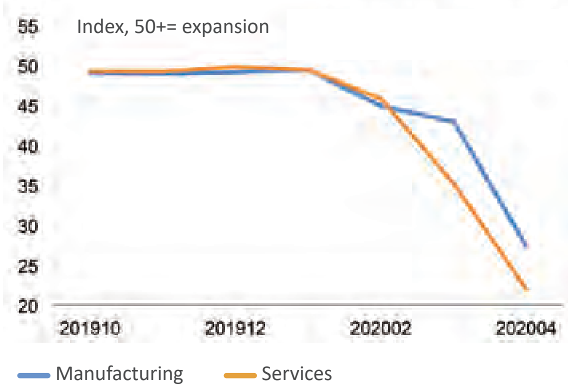
27 This annex was prepared by Ekaterine T. Vashakmadze, Senior Country Economist.

Figure 36. Global trade, 2016–19



Sources: Haver Analytics; World Bank.

Figure 37. Global new export orders, 2019–20



Sources: Haver Analytics; World Bank.
Note: Dow Jones Global Index (December 31, 1991 = 100. United States Chicago Board Options Exchange's Volatility Index [VIX].

Global financing conditions have tightened abruptly. Global equity markets have fallen sharply as the coronavirus outbreak has accelerated globally. Flight to safety flows pushed the yield of the benchmark 10-year U.S. Treasury below 1 percent for the first time ever on March 4th, while spreads on higher-risk debt have widened. Markets remain highly volatile, with the VIX (Volatility Index) tripling in March, on average (figure 38). Central banks around the world have aggressively eased monetary policy and provided liquidity support to avoid shortages in credit markets. In a pair of emergency meetings, the Federal Reserve cut its policy interest rates to close to zero.

Emerging Market and Developing Economies (EMDEs) have experienced large capital outflows amid a flight to safety. EMDE assets have been under significant pressure. Capital outflows from EMDEs exceed the worst period of the global financial crisis. Spreads on sovereign and corporate bonds have risen as a result, and most EMDEs have experienced drastic falls in domestic stock market indexes and currency values. Stock markets in the largest EMDEs have fallen by about a quarter, on average, since the start of the year. Markets expect central banks to provide significant additional monetary easing in the near term.

Commodity prices have fallen sharply. Oil prices have fallen more than 60 percent since January 20th (the date human-to-human transmission of the coronavirus was first publicly confirmed), with WTI, the U.S. benchmark, dropping to around US$20 per barrel in mid-March. Containment measures taken to control the outbreak have resulted in a sharp decline in travel and therefore oil demand. The fall in oil prices has been exacerbated by the collapse of the production agreement between OPEC and its partners, including Russia. Industrial metals prices have also declined, with significant falls for copper and zinc (around -25 percent). Agricultural prices have been less affected, with the price of the three main grains down by 6 to 11 percent (figure 39).

Figure 38. Dow Jones Global Index and United States CBOE Volatility Index (VIX), 2007–20

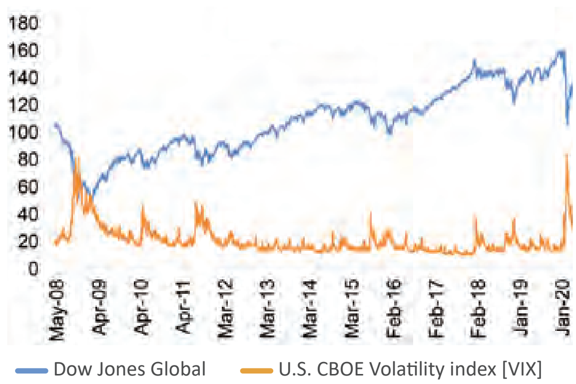
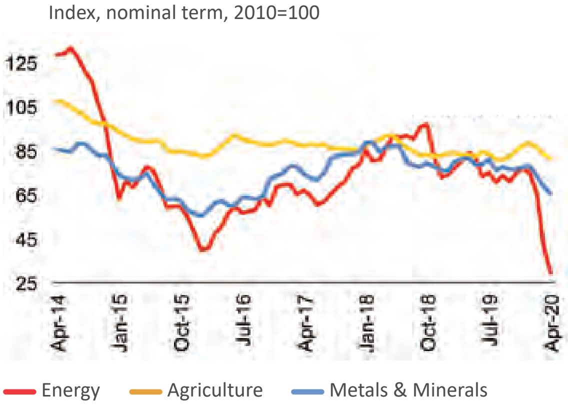


Figure 39. Commodity price indexes, 2014–2020



Sources: Haver Analytics; World Bank.
Note: Dow Jones Global Index (December 31, 1991 = 100. United States CBOE Volatility Index [VIX].
Note: Box prepared by Ekaterine T. Vashakmadze, Senior Country Economist.

Annex 2. Key economic measures to mitigate the impacts of the COVID-19 outbreak

Policy measures from Prime Minister's Decision No. 31	
1	Payroll tax exemption for all employees with a monthly income equal to or less than 5 million kip for three months (April to June 2020).
2	Corporate tax exemptions for microenterprises for three months (April to June 2020).
3	Exemption from custom duties, taxes, and other charges for importation of COVID-19-related goods (medical equipment, materials, etc.).
4	Deferral of tax payments for tourism business operators for three months, from April 2020 onward.
5	Deadline extension for the submission of end-2019 financial statements and balance sheet for enterprises, from March 31 to April 30, 2020.
6	Deferral of road tax payment from March 31, 2020 to June 30, 2020.
7	Research on the possibilities of reducing and deferring electricity and water bill payments for residential and commercial customers.
8	Concur with the Bank of Lao PDR on cutting its base interest rate and reducing commercial banks' deposit reserve requirements as deemed appropriate from time to time.
9	GoL policy requiring commercial banks to implement lending policies, such as deferral of principal and interest repayments, reduction of interest rates, providing businesses with new credits or loan extensions, loan restructuring, loan reclassifications, and others.
10	Deferral of compulsory social security contribution payments for affected businesses for three months (April to June 2020).
Proposed policy measures by Ministry of Planning and Investment	
11	Cash transfers through welfare systems (welfare payments of about 500,000 kip per person for the next two months (May and June) by advancing from existing social welfare funds, to be reimbursed from the state budget later.
12	Quickly provide 100 billion kip in credits to SMEs for the first tranche after agreements with commercial banks have been signed.
13	Quickly implement the US$300 million from the China Development Bank and other sources of funding to help affected businesses and support domestic production.

Annex 3. Key macroeconomic indicators and projections under the upside scenario

		2018	2019 Est.	2020 Proj	2021 Proj	2022 Proj
Real Economy						
Nominal GDP	Billion Kip	152,414	163,369	175,616	192,233	210,305
Nominal GDP	Million USD	18,142	18,823	18,012	18,600	19,197
Real GDP growth	% change	6.3	4.7	1.0	4.6	4.4
Agriculture	% change	1.3	-0.9	3.2	2.9	2.9
Industry	% change	7.8	4.7	2.9	6.6	4.5
Services	% change	6.8	6.7	-1.4	3.3	4.8
GDP per capita	USD	2,568	2,651			
Consumer Price Index, all (annual average,	% change	2.0	3.3	6.5	4.9	5.0
Exchange rate (Kip/USD)	annual average	8,401	8,679	9,750	10,335	10,955
Exchange rate (Kip/USD)	end of period	8,596	9,096	10,200	11,016	11,897
Fiscal Account*						
Revenues	% of GDP	16.2	15.1	11.3	12.2	12.7
Domestic Revenues	% of GDP	14.3	13.5	10.0	11.0	11.6
Taxes	% of GDP	11.2	11.1	8.2	9.0	9.5
Non-tax	% of GDP	3.1	2.4	1.8	2.0	2.1
Grants	% of GDP	1.9	1.6	1.3	1.2	1.1
Expenditures	% of GDP	20.9	20.2	18.8	18.9	18.9
Current expenditure	% of GDP	12.5	12.9	12.1	12.2	12.2
o/w Interest payment	% of GDP	1.7	2.0	2.2	2.1	1.9
Capital expenditure	% of GDP	8.4	7.3	6.8	6.7	6.7
Fiscal balance	% of GDP	-4.7	-5.1	-7.5	-6.7	-6.3
Primary balance	% of GDP	-3.0	-3.1	-5.3	-4.7	-4.3
Total Public Debt 1/	% of GDP	57.5	58.9	65.1	66.9	68.6
Selected Monetary Accounts						
Braod money	% change	8.4	18.9			
Credit to the economy	% change	2.8	7.4			
Balance of Payments						
Current Account Balance	% GDP	-11.4	-8.0	-11.1	-9.4	-8.8
Gross internation reserves, end of period	USD million	873.0	997.0	500.0	600.0	680.0
months of import cover	months	1.3	1.5	0.8	0.9	1.0
months of import cover, excl. FDI	months	2.6	3.0	1.6	1.8	2.0
Current Account Balance	USD million	-2,059.9	-1,499.5	-2,001.5	-1,740.4	-1,683.3
Export	USD million	5,484.3	5,653.2	5,400.0	5,868.5	5,977.8
Import	USD million	6,983.0	6,782.6	6,574.0	6,802.3	6,981.0
Net trade in services	USD million	-232.9	-172.0	-342.2	-254.0	-54.5
Foreign Direct Investment 2/	% of GDP	7.9	9.8	7.4	8.8	7.0

Sources: GoL and WB staff estimate and projections
*Note: *The budget year changes from fiscal year (October-September) to calendar year in 2017*
1/ IMF-WB Debt sustainability Analysis 2019 and WB projections
2/ loan and equity finance

Annex 4. Global and regional outlook and risks[28]

The global economy was showing incipient signs of recovery from a post-crisis dip prior to the recent COVID-19 outbreak. The recovery was supported by reduced trade policy uncertainty and a rebound in global trade flows and investment. World Bank January 2020 Global Economic Prospects projections envisaged global growth edging up to 2.5 percent in 2020 and firming thereafter, reaching 2.7 percent by 2022 predicated on a gradual recovery of investment and trade and a rebound in several major economies that have been gradually emerging from recessions or sharp slowdowns. Prior to the outbreak, growth in advanced economies was forecast to slow to 1.4 percent in 2020 before recovering insignificantly to 1.5 percent in 2021–22. Emerging Market and Developing Economies (EMDE) growth was expected to pick up to 4.1 percent in 2020 and stabilize at 4.4 percent in 2021–22, with the pace of the recovery restrained by soft global demand and structural constraints.[29]

The recovery was interrupted by the COVID-19 outbreak. The rapid spread of COVID-19 beyond China has caused significant disruptions to the outlook for the global economy and triggered sharp revisions to consensus GDP growth forecasts in major economies and most EMDEs. The pandemic is profoundly affecting the East Asia and Pacific (EAP) economies, but the depth and duration of the shock are highly uncertain.[30] The net impact of the shock on growth outcomes will depend on the duration and depth of the outbreak, external spillovers, and the magnitude and effectiveness of mitigation measures.

The April 2020 World Bank East Asia and Pacific Economic Update presents two scenarios for the regional outlook. In the baseline scenario, a sharp contraction is followed by a sustained recovery, lowering regional GDP growth in 2020 to 2.1 percent, from 5.8 percent in 2019. In this scenario, regional growth stabilizes around its trend level by late 2021. This scenario assumes that the containment of the pandemic allows a sustained recovery of activity, initially in China and later in the rest of the world. The lower-case scenario projects a deeper contraction followed by a sluggish recovery. Under this scenario, the pandemic lasts longer and has more severe effects than assumed under the base case scenario.

In the baseline scenario, growth in the developing EAP region is projected to slow from an estimated 5.8 percent in 2019 to 2.1 percent in 2020. In the lower-case scenario, output will contract by 0.5 percent. Growth in China is projected to decline to 2.3 percent in 2020 in the baseline scenario from 6.1 percent in 2019, whereas in the lower-case scenario it could be as low as 0.1 percent. Growth in EAP excluding China is projected to slow from 4.8 percent in 2019 to 1.3 percent in 2020 in the baseline scenario and to plummet to -2.8 percent in the lower-case scenario. Barring new, unexpected shocks and durable financial market stress, the deeper the slowdown, the more rapid the recovery can be expected in 2021.

For many countries, the likely financial shocks will significantly exacerbate the economic impact. The most significant effects on both the current and future performance of these countries are likely to originate in financial markets, given the likely magnitude of the financial shock and the countries' existing vulnerabilities. Developing EAP economies are vulnerable in different ways; in China, Vietnam, Malaysia, and Thailand, for example, they are vulnerable through elevated domestic debt; in Cambodia, Lao PDR, Malaysia, Mongolia, and Papua New Guinea through external debt; and in Malaysia and Thailand through heavy reliance on short-term debt.

28 This annex was prepared by Ekaterine T. Vashakmadze, Senior Country Economist, based on the January 2020 Global Economic Prospects and the April 2020 East Asia and Pacific Economic Update, World Bank, Washington, DC, 2020.

29 World Bank 2020a.

30 World Bank 2020b.

Global economic conditions are expected to remain challenging over the forecast period. Global financing conditions are expected to remain extremely complex and volatile. According to the WTO, world trade is expected to fall by 13 to 32 percent in 2020 and will likely exceed the trade slump during the 2008–09 global financial crisis. The ongoing COVID-19 outbreak has put additional downward pressure on commodity prices, particularly for energy, which will be further amplified by a surplus of oil supply as OPEC+ members resume oil production at full capacity. The recent fall in oil prices also reflects expectations that demand will be weaker than previously envisioned, as the coronavirus outbreak has already reduced global economic activity as well as air travel and shipping, major sources of oil demand. Other industrial commodity prices have weakened in response to the coronavirus outbreak, with copper prices down by over 20 percent since early January. Overall, metals prices are expected to decline in 2020, reflecting subdued industrial commodity demand, particularly from China. Agricultural prices are envisioned to stabilize in 2020, after declining in the second half of 2019 due to improved supply conditions.

The balance of risks to the outlook is firmly tilted to the downside. The main risks include the possibility that the pandemic lingers and has devastating and lasting economic impact on the global economy. In addition, despite large policy support packages, financial market turmoil in advanced economies may persist for several months and cause further capital outflows from the EMDEs. Tighter financing conditions further reduce EMDE growth. This could exacerbate existing balance sheet weaknesses in the highly leveraged economies and could even lead to defaults and financial crises in most vulnerable countries. Global trade could remain depressed for an extended period, causing a disintegration of global and regional value chains. Trade policy uncertainty also continues to represent a risk to the outlook.

Photo credit: Phoonsap Thevongsa

Annex 5. Doing Business Reforms in Lao PDR[31]

Lao PDR's Doing Business reform progress is mixed, and more efforts are needed in several areas

Lao PDR is on the right track with reforms and slightly improved its Doing Business (DB) Score in the 2020 Report from 49.8 to 50.8. However, because other countries have reformed as well, its ranking remains unchanged at 154 (table 5). Since the last DB report, the GoL has developed an ambitious reform agenda, and considerable reform progress has been made in the areas with the strongest ownership for reforms (Starting a Business, Dealing with Construction Permits, and Getting Electricity). However, enforcement of other reforms and active engagement from related ministries and administrative levels is necessary to make further progress on DB-related reforms.

Table 5. Lao PDR Doing Business reform rankings, by indicator

Indicator	Ranking 2019	DB Score 2019	Ranking 2020	DB Score 2020	Change in Ranking	Change in Score
DB1: Starting a Business	180	60.9	181	62.7	-1	1.8
DB2: Dealing with Construction Permits	99	67.9	99	68.3	0	0.4
DB3: Getting Electrictity	156	52.8	144	58.0	12	5.2
DB4: Registering Property	85	64.9	88	64.9	-3	0.0
DB5: Getting Credit	73	60.0	80	60.0	-7	0.0
DB6: Protecting Minotity Investors	174	20(*)	179	20.0	-5	0.0
DB7: Paying Taxes	155	54.2	157	54.2	-2	0.0
DB8: Trading Across Borders	76	78.1	78	78.1	-2	0.0
DB9: Enforcing Contracts	162	42.0	161	42.0	1	0.0
DB10: Resolving Insolvency	168	0.0	168	0.0	0	0.0
DB Overall	154	49.8(*)	154	50.8	0	+1 (using same methodology
(*) revised due to change in methodology						

Source: Doing Business 2020, World Bank.

Since June 2018, the GoL has adopted the following procedural changes. However, enforcement needs to be monitored to ensure that these reforms are fully and consistently applied.

i. Combining Enterprise Registration Certificates (ERC) and tax identification numbers (TIN ID)
ii. Making tax orientation meetings optional to businesses and changing to tax knowledge training
iii. Eliminating company name signage approval from the Ministry of Information, Culture and Tourism (MICT) and the TIN certificate
iv. Combining company seal production and registration into one procedure and processed within one jurisdiction, the provincial public security authority, within five working days
v. Simplifying internal processes to reduce the social security registration process to two working days from one week (during DB 2019)
vi. Moving the registration of company assets and articles of association with the State Asset Department/Ministry of Finance to after company registration
vii. In early July 2019, the Ministry of Industry and Commerce and the Ministry of Public Security agreed to make use of a company seal optional (voluntary), but this reform has yet to be implemented, and currently the company seal remains mandatory.

31 Sources: World Bank Reform Brief 2019; Doing Business Report 2020.

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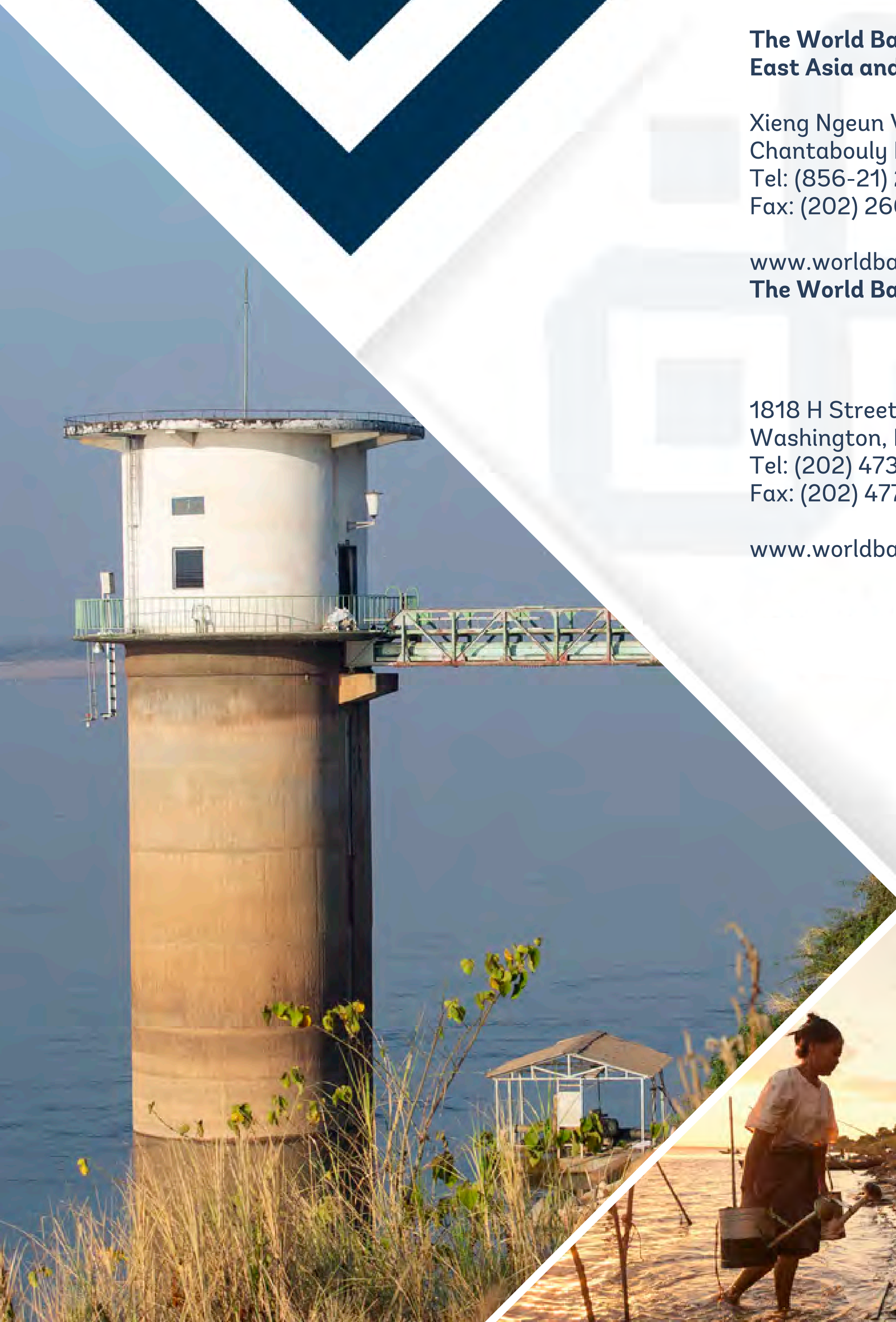

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