



## Concept Paper

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Project Number: 52146-001  
November 2018

# Proposed Programmatic Approach and Policy- Based Loan for Subprogram 1 Lao People's Democratic Republic: Strengthening Public Finance Management

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**Asian Development Bank**

## CURRENCY EQUIVALENTS

(as of 28 November 2018)

|               |   |             |
|---------------|---|-------------|
| Currency unit | – | kip (KN)    |
| KN1.00        | = | \$0.0001167 |
| \$1.00        | = | KN8,570.35  |

## ABBREVIATIONS

|         |   |                                          |
|---------|---|------------------------------------------|
| ADB     | – | Asian Development Bank                   |
| GDP     | – | gross domestic product                   |
| Lao PDR | – | Lao People's Democratic Republic         |
| MOF     | – | Ministry of Finance                      |
| NSEDP   | – | National Socio-Economic Development Plan |
| PFM     | – | public finance management                |
| PPG     | – | public and publicly guaranteed           |
| TA      | – | technical assistance                     |

## NOTES

In this report, "\$" refers to United States dollars.

|                         |                                                                                                                                                                                                                                                                                                                  |
|-------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
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## PROGRAM AT A GLANCE

|                                                                   |                                                                         |                                        |                     |
|-------------------------------------------------------------------|-------------------------------------------------------------------------|----------------------------------------|---------------------|
| <b>1. Basic Data</b>                                              |                                                                         | <b>Project Number:</b> 52146-001       |                     |
| <b>Project Name</b>                                               | Strengthening Public Finance Management (Subprogram 1)                  | <b>Department/Division</b>             | SERD/SEPF           |
| <b>Country</b>                                                    | Lao People's Democratic Republic                                        | <b>Executing Agency</b>                | Ministry of Finance |
| <b>Borrower</b>                                                   | Government of Lao People's Democratic Republic                          |                                        |                     |
| <b>2. Sector</b>                                                  | <b>Subsector(s)</b>                                                     | <b>ADB Financing (\$ million)</b>      |                     |
| ✓ <b>Public sector management</b>                                 | Public expenditure and fiscal management                                |                                        | 40.00               |
|                                                                   | <b>Total</b>                                                            |                                        | <b>40.00</b>        |
| <b>3. Strategic Agenda</b>                                        | <b>Subcomponents</b>                                                    | <b>Climate Change Information</b>      |                     |
| Inclusive economic growth (IEG)                                   | Pillar 1: Economic opportunities, including jobs, created and expanded  | Climate Change impact on the Project   | Low                 |
| <b>4. Drivers of Change</b>                                       | <b>Components</b>                                                       | <b>Gender Equity and Mainstreaming</b> |                     |
| Governance and capacity development (GCD)                         | Public financial governance                                             | Some gender elements (SGE)             | ✓                   |
| <b>5. Poverty and SDG Targeting</b>                               |                                                                         | <b>Location Impact</b>                 |                     |
| Geographic Targeting                                              | No                                                                      | Nation-wide                            | High                |
| Household Targeting                                               | No                                                                      |                                        |                     |
| SDG Targeting                                                     | Yes                                                                     |                                        |                     |
| SDG Goals                                                         | SDG1                                                                    |                                        |                     |
| <b>6. Risk Categorization:</b>                                    | Low                                                                     |                                        |                     |
| <b>7. Safeguard Categorization</b>                                | <b>Environment: C Involuntary Resettlement: C Indigenous Peoples: C</b> |                                        |                     |
| <b>8. Financing</b>                                               |                                                                         |                                        |                     |
| <b>Modality and Sources</b>                                       |                                                                         | <b>Amount (\$ million)</b>             |                     |
| <b>ADB</b>                                                        |                                                                         | <b>40.00</b>                           |                     |
| Sovereign Program (Concessional Loan): Ordinary capital resources |                                                                         | 40.00                                  |                     |
| <b>Cofinancing</b>                                                |                                                                         | <b>0.00</b>                            |                     |
| None                                                              |                                                                         | 0.00                                   |                     |
| <b>Counterpart</b>                                                |                                                                         | <b>0.00</b>                            |                     |
| None                                                              |                                                                         | 0.00                                   |                     |
| <b>Total</b>                                                      |                                                                         | <b>40.00</b>                           |                     |
| <b>Currency of ADB Financing: USD</b>                             |                                                                         |                                        |                     |

## I. THE PROPOSAL

1. The proposed program will help the Government of the Lao People's Democratic Republic (Lao PDR) achieve fiscal consolidation and advance public finance management (PFM) by (i) strengthening public debt management and tax reform, (ii) improving the government's ability to forecast revenue and expenditures, and (iii) enhancing budget governance and credibility. The program will directly support the government's Vision to 2030 and Public Finance Development Strategy to 2025 (Strategy 2025),<sup>1</sup> and will enable the government to realize its development priorities in the Eighth National Socio-Economic Development Plan (NSED) 2016–2020.<sup>2</sup> The program also contributes to the Asian Development Bank (ADB) Strategy 2030<sup>3</sup> with links to operational priorities, in particular on strengthening governance and institutional capacity. The program is aligned with the country partnership strategy, 2017–2020<sup>4</sup> and is included in the country operations business plan, 2019–2021 for the Lao PDR.<sup>5</sup> The design and monitoring framework is in Appendix 1.

## II. PROGRAM AND RATIONALE

### A. Background and Development Constraints

2. **Core development problem.** The Lao PDR is currently one of the fastest-growing economies in Southeast Asia and has made substantial progress towards its goal of graduating from least-developed country status by 2020. The resources boom together with strong foreign direct investment in the resources sectors has produced robust growth in gross domestic product (GDP), which averaged 7.5% during 2010–2017. Strong growth has alleviated poverty, with the nation's poverty rate declining from 27.6% in 2007 to 23.2% in 2013. Yet, despite the impressive economic performance, macroeconomic vulnerabilities have emerged as a result of ineffective public finance management, which could undermine sustainable financing of priority public service delivery and derail the country's poverty reduction and development goals under the Vision to 2030.<sup>6</sup> Specifically, because of rising budget deficits and public debt levels, the International Monetary Fund's debt sustainability analysis has assessed that the Lao PDR continues to be *high risk* in terms of external debt distress.<sup>7</sup>

3. A chronic overestimation of tax revenue coupled with increased capital spending on both domestic and externally financed projects increased the budget deficit to 4.8% of GDP in 2017 from about 3.0% in 2010–2016. The narrow tax base, coupled with low tax compliance and inefficient tax administration, also contributed to declining tax and non-tax revenues to 14.9% of GDP in 2017 from an average of 16.1% in 2010–2016. An elevated budget deficit is also forecast for 2018.<sup>8</sup> As a result, public and publicly guaranteed (PPG) debt stocks have increased to an unprecedented 61.1% of GDP in 2017 from 57.9% in 2014.<sup>9</sup> The external PPG debt is expected

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<sup>1</sup> Government of the Lao PDR. 2018. *Vision to 2030 and Public Finance Development Strategy to 2025*. Vientiane.

<sup>2</sup> Government of the Lao PDR. 2016. *The Eighth National Socio-Economic Development Plan 2016–2020*. Vientiane.

<sup>3</sup> ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

<sup>4</sup> ADB. 2017. *Country Partnership Strategy: Lao People's Democratic Republic, 2017–2020—More Inclusive and Sustainable Economic Growth*. Manila.

<sup>5</sup> ADB. 2018. *Country Operations Business Plan: Lao People's Democratic Republic, 2019–2021*. Manila.

<sup>6</sup> International Monetary Fund. 2018. *Lao People's Democratic Republic: Staff Report for the 2017 Article IV Consultation*. Washington, DC.

<sup>7</sup> International Monetary Fund. 2018. *Lao People's Democratic Republic: Staff Report for the 2017 Article IV Consultation—Debt Sustainability Analysis*. Washington, DC.

<sup>8</sup> ADB. 2018. *Asian Development Outlook 2018*. Manila.

<sup>9</sup> World Bank. 2018. *Lao People's Democratic Republic Economic Monitor*. Washington, DC.

to reach 49.9% of GDP by the end of 2018, up from 45.4% in 2015. Moreover, the external PPG debt is increasingly contracted on nonconcessional terms, making the Lao PDR vulnerable to exchange rate volatility and other macroeconomic shocks.

4. **Strengthening public finance management.** In recognition of these PFM challenges, the government has formulated the Eighth NSEDP with a focus on inclusive growth aimed at further reducing the poverty rate and economic vulnerability and improving service delivery in health and education. Strengthening the PFM system will ensure that NSEDP priorities are financed through effective medium-term budget planning, thereby contributing to poverty reduction through long-term growth. Improved PFM will also usher in more credible fiscal policies and macroeconomic stability, which are vital to de-dollarization in the Lao PDR. The government is embarking on three main PFM reform areas. First, the government must address the high and rising level of PPG debt, which is expected to increase to 65% of GDP by 2022—a high level by frontier market standards.<sup>10</sup> To achieve this, the government needs to improve its fiscal position. Second, measures will need to address chronic underperformance in tax mobilization and rationalize expenditures and the higher than planned levels of public investment spending. Finally, the government will strengthen implementation of its PFM reforms and its budget legislative framework for improved oversight and transparency of the budget process.

5. **Development constraints.** To realize the much-needed PFM reforms, the government has recognized three key development constraints that need to be addressed. First, the government does not have a comprehensive debt management strategy and strategic tax policy within its legal or regulatory framework. A comprehensive public debt management strategy can help reduce and maintain public debt at sustainable levels, guide prudent spending decisions in the medium term, and ensure that financing constraints do not lead to sharp reversals in fiscal policy. Second, the current absence of a fully functioning medium-term framework for evaluating, prioritizing, and managing revenues and expenditures undermines the government's efforts to maintain fiscal discipline, prioritize expenditures in line with its poverty reduction goals, execute effective debt management, and boost transparency. While ADB has helped establish the building blocks for medium-term forecasting, this process must be institutionalized to ensure fiscal discipline and consolidation is achieved and maintained. In effect, these reforms must ensure fiscal and expenditure targets are met in the medium term, capital investments are necessary and efficient, and that opportunities for budget savings are captured. Lastly, the updated 2015 budget law does not have regulations in place to provide a strong legal and policy basis for deepening budget reforms. The adoption of a comprehensive PFM strategy can potentially leverage, guide, and more effectively coordinate the PFM reform agenda.

## **B. Policy Reform and ADB's Value Addition**

6. **Government reform program.** In June 2016, the government launched the Eighth NSEDP 2016–2020 which underscored continued economic growth coupled with macroeconomic stability. The NSEDP identified a need for a macroeconomic framework to provide information in a responsive, timely, and accurate manner and to improve revenue and expenditure management by strengthening revenue collection and ensuring expenditure management is in line with a financial plan approved by the National Assembly. Strategy 2025 (footnote 1) further articulates the need for a strong, transparent, modern public finance system in line with international standards. The strategy includes goals and priorities in four areas: (i) maintaining macroeconomic stability including control of the budget deficit; (ii) maximizing revenue collection; (iii) developing a sound expenditure policy in line with rationalizing spending; and (iv) prudent debt management.

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<sup>10</sup> As of 2017, external PPG debt stood at 49.1% of GDP.

7. **Proposed policy reforms.** The program will take the programmatic approach with two subprograms in 2018–2021, covered by a medium-term results framework. The program will support the government's efforts to achieve macroeconomic stability through high-impact policy reforms that improve management of public debt and strengthen fiscal consolidation. The program will focus on three key reform areas: (i) public debt management and tax reform; (ii) the expenditure and revenue framework; and (iii) budget governance and credibility.

8. **Strengthening public debt management and tax reform.** This reform area will help the government improve public debt management and revenue collections, thereby addressing the widening fiscal deficits without compromising sound public spending to achieve the NSEDP goals. Under subprogram 1, the Ministry of Finance (MOF) will adopt the 2018 Public Debt Management Law, and its supporting implementation regulations, to rationalize the use of debt instruments and to cap the rise in public debts. In addition, the government will develop and launch a tax development plan to reform the tax system with the objective of increasing tax revenues. Finally, the government will strengthen tax administration to enhance domestic revenue mobilization. Under subprogram 2, the government will adopt amended tax laws and will formally establish effective public debt management, including the establishment of the debt management unit that will consolidate debt operations in the MOF. The newly established unit will have a target of 30% female staff.<sup>11</sup>

9. **Expanding expenditure and revenue framework.** This reform area will enable the government to finance its priorities and contain its fiscal deficit by effectively managing expenditures and revenues. Under subprogram 1, budget preparation will be strengthened in the MOF and relevant government agencies. The government will implement medium-term fiscal planning for budget preparation within an overall budget ceiling.<sup>12</sup> In addition, to improve revenue management, the government will implement multiyear revenue planning to establish more credible revenue targets and provide a solid basis for medium-term fiscal planning and budget preparation. Under subprogram 2, the government will align fiscal policy with the NSEDP goals through a fiscal policy and budget statement and by use of multiyear expenditure plans for the Ministry of Health, Ministry of Education and Sports, Ministry of Public Works and Transport, and Ministry of Agriculture and Forestry.<sup>13</sup> Finally, the government will ensure efficient allocations of public expenditures to priority sectors of the NSEDP, especially health and education, within the overall budget ceiling.

10. **Improving governance and budget credibility.** This reform area will foster governance, transparency, and credibility of the government's PFM reform and budgeting processes to ensure that public resources are effectively overseen and channeled towards realization of Vision to 2030 goals. Under subprogram 1, the government will launch to guide implementation of PFM reforms. A national steering committee will be appointed to ensure continuity and oversight of PFM reforms. To improve transparency, the MOF will adopt standards in line with the International Budget Partnership<sup>14</sup> and publish core budget documents from the 2018 budget, including 6-monthly fiscal reports on revenue and expenditures and a midyear fiscal report on revenue collection. Under subprogram 2, the government will seek cabinet approval for budget regulations under articles of the updated Budget Law to provide a strengthened legal and policy framework for debt

<sup>11</sup> ADB and World Bank. 2012. *Country Gender Assessment for Lao People's Democratic Republic: Reducing Vulnerability and Increasing Opportunity*. Vientiane.

<sup>12</sup> The road maps of the medium-term fiscal framework and medium-term expenditure frameworks will be developed.

<sup>13</sup> These line ministries are high-priority national government agencies under the Vision to 2030 and account for the majority of the government expenditures.

<sup>14</sup> International Budget Partnership. 2010. *Guide to Transparency in Government Budget Report*. Washington, DC.

management, fiscal planning, and budgeting credibility. To strengthen legislative oversight of its budget and financial reporting, the MOF will submit budget regulations to the National Assembly for approval, which will allow for sharing of key budgetary documents and information, thus boosting transparency.

11. **ADB engagement and donor coordination.** ADB has been a key reform partner in the Lao PDR, providing loans, grants, and TA to support PFM reforms in budget process, fiscal management, and the PFM diagnostics since 2005.<sup>15</sup> PFM reform necessitates ADB's long-term engagement, strong government ownership, and buy in from multiple stakeholders. ADB's value added from the program is the synergies with ADB's past TA which inculcated international best practices for fiscal planning, public debt management, and budget planning and governance. However, unlike past interventions which focused on governance and capacity building, the program incorporates a more comprehensive approach to reforms, underpinned by strategic policy sequencing and supported by a programmatic approach. In addition, the program includes strong coordination with ADB sector teams in health and education which will ensure that efficiencies made in PFM processes further strengthen implementation at the sector level. Development partner coordination is well established with ADB, the International Monetary Fund, Japan International Cooperation Agency, and the World Bank, and the recently established government-led PFM steering group provides oversight and alignment on the PFM reform agenda.

### C. Impacts of the Reform

12. The impact of the proposed program is sustainable financing of public services for achieving the NSEDP goals (footnote 1). The effect of the program is PFM systems strengthened. There are three reform areas. Reform area 1 focuses on strengthening public debt management, the approval and implementation of the new Debt Management Law, and tax reform. Reform area 2 puts in place medium-term revenue and expenditure frameworks in the MOF and relevant line ministries to strengthen fiscal consolidation and prioritize social sector spending. Reform area 3 aims to enhance governance and budget credibility and will include the establishment of a steering committee to guide the implementation of public finance reforms, improved budget regulations, and budget oversight.

### D. Development Financing Needs and Budget Support

13. **Program modality.** The program comprises two subprograms. Subprogram 1 will be implemented from March 2018 to June 2019, and subprogram 2 will be implemented from July 2019 to June 2021. A policy matrix with agreed upon policy actions and triggers will guide the implementation of the reform agenda. TA support is being provided under an ongoing TA project.<sup>16</sup> The government has requested ADB to provide \$40 million to help finance subprogram 1.<sup>17</sup> Subprogram 2 is scheduled for 2021 for an indicative amount of \$40 million, subject to confirmation by ADB Management and the government and may include a project loan component to support implementation in key reform areas. The program is included in the country operations business plan, 2019–2021 for the Lao PDR (footnote 4).

<sup>15</sup> ADB. 2005. *Public Expenditure Planning for National Growth and Poverty Eradication Strategy*. Manila; ADB. 2008. *Strengthening Public Financial Management*. Manila; ADB. 2012. *Governance and Capacity Development in Public Sector Management Program, Subprogram 1*. Manila; ADB. 2014. *Governance and Capacity Development in Public Sector Management Program, Subprogram 2*. Manila.

<sup>16</sup> ADB. 2015. *Technical Assistance to the Lao People's Democratic Republic for Support for Governance and Capacity Development*. Manila.

<sup>17</sup> Budgetary support of \$40 million for each subprogram will help successfully implement the three reform areas without compromising sound fiscal management during the program implementation period.

## E. Implementation Arrangements

14. The MOF is the executing agency. The implementing agencies are the MOF, Ministry of Health, Ministry of Education and Sports, Ministry of Public Works and Transport, and Ministry of Agriculture and Forestry.

### III. DUE DILIGENCE REQUIRED

15. Due diligence will include: (i) a PFM sector assessment; (ii) a program impact assessment;<sup>18</sup> and (iii) a poverty, gender, and social impacts study. As no civil works or impacts on indigenous peoples are envisaged, the program is classified category C for environment, involuntary resettlement, and indigenous peoples.

### IV. PROCESSING PLAN

#### A. Risk Categorization

16. The program is considered low risk as the total program is below the \$50 million threshold.

#### B. Resource Requirements

17. The estimated internal resource requirements are for a mission leader (18 person-months), a co-mission leader (10 person-months), a gender expert (1 person-month), a counsel (3 person-months), national analysts (10 person-months), and an operations assistant (8 person-months).

#### C. Processing Schedule

##### Proposed Processing Schedule

| Milestones              | Expected Completion Date |
|-------------------------|--------------------------|
| 1. Concept approval     | November 2018            |
| 2. Loan fact-finding    | December 2018            |
| 3. Staff review meeting | February 2019            |
| 4. Loan negotiations    | March 2019               |
| 5. Board consideration  | May 2019                 |
| 6. Loan signing         | June 2019                |
| 7. Loan effectiveness   | July 2019                |

Source: Asian Development Bank.

### V. KEY ISSUES

18. Limited technical capacity in the MOF could put successful implementation of the program at risk. TA has been provided to strengthen medium-term fiscal and expenditure planning and build up other PFM-related expertise as needed by the MOF (footnote 15).

<sup>18</sup> The program is initially estimated to yield direct benefits of \$544 million from lower public debts during 2018–2022.



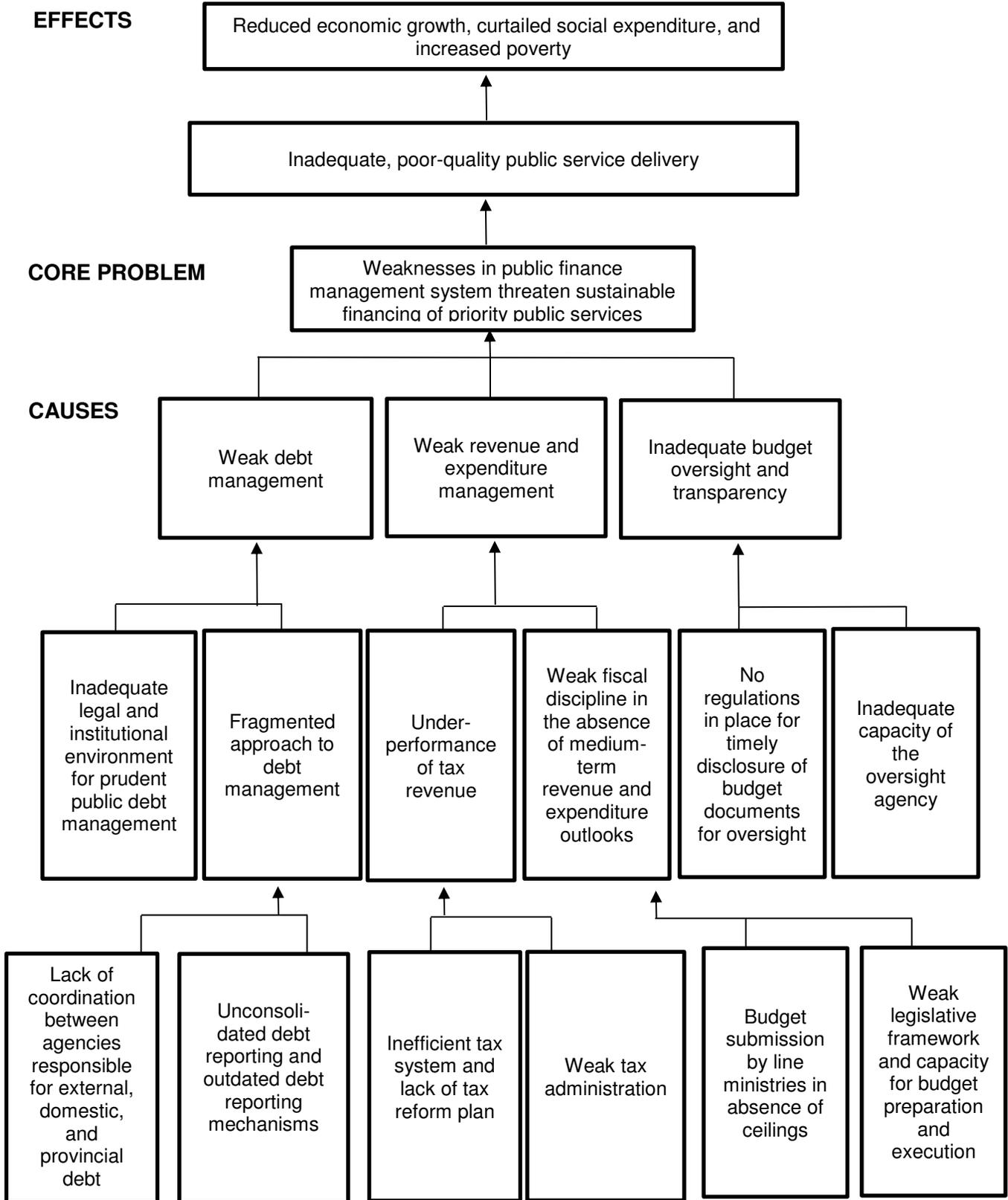
| Results Chain                                             | Performance Indicators with Targets and Baselines                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | Data Sources and Reporting Mechanisms                                                                                                                                                                                                                                 | Risks                                                                                    |
|-----------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------|
| 3. Governance and budget credibility                      | <p>3.1 PFM implementation strategy, which serves as the plan to guide implementation of PFM reforms, approved (2018 baseline: not applicable)</p> <p>3.2 A national steering committee for PFM reforms, involving gender stakeholders, established to ensure continuity and oversight of PFM reforms (2018 baseline: not applicable)</p> <p>3.3 Budget transparency enhanced through publication of core budget documents and fiscal reports in line with International Budget Partnership standards (2018 baseline: not applicable)</p> | <p>3.1 Prime ministerial decree on PFM implementation strategy</p> <p>3.2 Prime ministerial decision establishing national PFM committee</p> <p>3.3 Published 2018 budget, quarterly fiscal report for 2018, annual report for 2015/16, and pre-audit budget 2017</p> | Changes in political priorities shift resources away from implementation of PFM reforms. |
| <p><b>Budget Support</b><br/>ADB: \$40,000,000 (loan)</p> |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                                                                                                                                                                                                                                                                       |                                                                                          |

MOF = Ministry of Finance, PFM = Public Finance Management.

<sup>a</sup> Government of the Lao PDR. 2016. *The Eighth National Socio-Economic Development Plan 2016–2020*. Vientiane. Officially approved at the Eighth National Assembly's Inaugural Session, 20–23 April 2016, Vientiane.

Source: Asian Development Bank.

**PROBLEM TREE**



**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/LinkedDocs/?id=52146-001-ConceptPaper>

1. Initial Poverty and Social Analysis

**Supplementary Document**

2. Sector Assessment (Summary): Public Sector Management