

## **Lao PDR: GOVERNANCE AND CAPACITY DEVELOPMENT IN PUBLIC SECTOR MANAGEMENT PROGRAM**

### **SUMMARY PROGRAM IMPACT ASSESSMENT**

#### **I. Introduction**

1. This section updates the Program Impact Assessment (PIA) of subprogram 1 under the Governance and Capacity Development in Public Sector Management Program (Program). This is required under ADB's Staff Operating Manual (OM) to properly justify the grant amount suggested (OM Section D4/BP issued on 14 October 2011). It summarizes the problem, identifies the intended impact and outcome of the Program, options reviewed, and attempts ex-ante to estimate the costs and benefits of the Program as well as estimates of the potential benefits and costs. The PIA will help justify the loan amount of the Program totaling \$15 million equivalent for subprogram 2.

2. The results of the PIA indicate that the economy wide gains from the reforms and policy initiatives supported under this Program will be difficult to quantify at this stage, as many of reform initiative such as the medium-term budget, the rule based system of fiscal transfers, and potential PPPS are in the take-off stage, and gains will be fully consolidated by 2015, coinciding with the processing of the second subprogram. Overall, the adjustment costs of subprogram 2 are estimated at \$23 million resulting is the total adjustment cost of the program in the range of \$40-45 million.<sup>1</sup>

3. The PIA framework includes description of sector challenges, definition of the Program's expected impact and outcome, analysis of the options with least costs towards achieving the expected outcomes, and assessment of the benefits and costs of the Program. The PIA also discusses some of the key pro-poor initiatives by the Government.

#### **II. Development Impact of the Program**

4. This section presents the PIA for the Program. It summarizes the problem, identifies the intended impact and outcome of the Program, options reviewed, estimates of the potential benefits and costs of the Program, and contribution to poverty reduction.

##### **A. Governance Challenges Facing the Government**

5. **PFM weaknesses.** In Lao PDR, key governance challenges are the consequence of underlying institutional weaknesses, resulting from prolonged period of conflict. Governance weaknesses in Lao PDR emanate from the Lao PDR's colonial past, and the legacy of the protracted conflict (lost about three fourths of skilled population in 1970s). These events have contributed to the underlying institutional weaknesses that undermine the efficiency of public management, and governance system. Significant constraints of resources, and lack of capacity, underpinned by an overly bureaucratic, and centralized civil service, undermine the effectiveness of public sector management, both at the central and sub-national level. Absence

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<sup>1</sup> In the 2012/13 fiscal year, the government raised the salary and benefits by 150%. Hence, the total wage bill for public employees reached 11% of GDP in 2012/23 against 5% the previous year. This rise in civil service wage bill estimated at \$644 million put an overall strain on the overall public sector financial capacity. For this reason the MOF considers the medium-term budget framework to be an important tool to ensure fiscal sustainability in the future. Please also see footnote in Table 1: Lao PDR: Potential Costs to Government and Stakeholders from the Governance Program.

of a medium-term fiscal strategy and a medium term expenditure framework weakens budget predictability and strategic allocation of resources. Lack of realism in fiscal forecasts, and an institutionally fragmented budget process between capital investment projects and recurrent expenditure under the annual budget lead to skewed planning, and exacerbate the weaknesses in expenditure management in the achievement of better budgetary outcomes. Despite progress under the Public Financial Management Strengthening Program (PFMSP) since 2007, in Lao PDR, effective implementation of the Budget Law is problematic. Despite a Budget Law, most of its key provisions, including medium-term budgeting, are not implemented. Lack of information about resources provided for service delivery and a general lack of information about or scrutiny of the results achieved undermine access and quality of frontline services.<sup>2</sup> There are areas of the budget system that are significantly susceptible to rent-seeking behavior, which may undermine improvements in PFM reforms. These relate to tax collection, planning, and management of government investments in infrastructure projects. The Ministry of Finance lacks trained and adequate manpower. The central role of the Ministry of Planning and Investments (MPI) for allocating budgetary resources through the National Socio-Economic Development Plan (NSED) and for attracting external aid and financing undermines the fundamental role of the MOF in the achievement of better budgetary outcomes. Other problems include the continued existence of off-budget expenditure. Budget execution, accounting, and financial reporting also have several weaknesses. Lao PDR's procurement framework lacks appropriate regulations, documentation, and tools for implementation. Institutional capacity for internal control and audit is not fully developed.

**6. The central-provincial fiscal relations.** The central-provincial fiscal relations, especially in the area of PFM, reflected the challenges inherent in the overall state building process in Lao PDR. Historically, most of the significant pro-poor programs are delivered at the provincial and district level. At present, however, the policy making is concentrated at the central government level, and the political apparatus too is centralized. However, the provincial governors have substantial autonomy in the administration and implementation of policy. The governors enjoy the same political status, and are senior members of the Party. In theory, the central government has strong and wide ranging formal authority but in practice, the Ministry of Finance is unable to exercise sufficient control over revenues collected and expenditure undertaken by provincial governments. The bulk of the revenues were collected by the provinces, and there were no revenue sharing norms, being determined as a result of political bargaining and negotiations. Financial control was weak, and the financial control environment was inefficient. In view of this, the efforts towards treasury centralization continue to face increasing reluctance from the provinces, and treasury single account (TSA) is being achieved in the context of a very significant rearrangement of central-local fiscal relations.

**7. Public administration weaknesses.** The effectiveness of the public sector performance is hampered by insufficient capacity among civil servants. There has been a significant increase in the number of civil servants in recent years (for example, there was a 30% increase from 2010 to 2013). Also, most of the components of a performance oriented civil servant management and development system are not yet in place, such as competency standards, job positions and descriptions, adequate civil service pay and a performance management culture. In addition, the effectiveness of the public administration is hindered by a centralized bureaucratic administrative system, which needs to be simplified and streamlined. The government plans to delegate specific planning, finance and human resource management to sub-national levels in accordance with its Sam Sang policy. A key success factor would be the capacity of the lower levels to re-structure, plan, organize, deliver and be accountable. Hence,

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<sup>2</sup> 2010. The World Bank. PEFA. Public Financial Management Assessment.

there is a great need for building the capacity of civil servants at all levels, both in the short and long term. The training of civil servants in administrative and management competencies is however relatively new and the policy, infrastructure and capacity for developing and delivering public management training are currently not adequate.

8. **Poor delivery of service.** Lack of resources also impacts on efficient delivery of service. Resource inadequacy is acutely experienced at the sector level, particular at the sub-national level, which is mandated to deliver services to address the MDGs, especially in delivery of efficient and equitable education and health outcomes.<sup>3</sup> Historically, most of the significant pro-poor programs are delivered at the provincial and district level. However, the local administration has significant capacity constraints.

9. **Education Sector.** Inadequate financing is a critical issue in the education sector. The share of the national budget allocated to education fell from roughly 15% in 1997 to less than 12% in fiscal year (FY) 2005. While this share rose to 15.5% by FY2010, it remains well below the government's 18.0% target.<sup>4</sup> A related issue is dependence on external support, which has financed about 90% of recent capital investment in education, focusing on primary education. This contributed to an imbalance in the ratio of capital to recurrent expenditures (exceeding 60:40 in FY2006), and strained fiscal capacities to meet required recurrent expenditures. However, official development assistance allocated to education fell sharply after FY2007, contrasting with rapid increases in domestic funding for education in these years.<sup>5</sup> While helping to rebalance education financing, decreases external (DP) support clearly undercut total resources available to education.

10. **Health Sector.** Health is considered vital to human resources development, economic productivity, poverty reduction, and inclusive growth process in Lao PDR. The serious shortfall in public financing for the health sector, and the corresponding high burden of private out-of-pocket health spending for catastrophic and chronic illnesses are major causes of income poverty, and counter national efforts at poverty reduction and graduation from least developed country status by 2020. While the poor mostly suffer bad health outcomes, they benefit less from various public spending. Access to health care remains the biggest challenge; with women facing greater inequity regarding family planning and maternal health. Women of reproductive age face very high risk during childbirth; the maternal mortality ratio (MMR) is estimated to be 405 per 100,000 live births in 2005. Malnutrition is widespread, with an estimated 37% of children under 5 years of age underweight. Malnutrition affects the growth of children, their potential to learn and their overall health condition later on, particularly for girls. Lao People's Democratic Republic was the most bombed country in the Region. The vast amount of unexploded ordnances (UXOs) left over since the war still adversely affects the health of a significant part of the population.

11. The health sector is seriously under-funded. A major challenge confronting the health sector is the low level of public financing which is inadequate to run even basic health services. The district health system (including district health offices, district hospitals, health centers and village health workers) is particularly under-funded, although this is the main source of health services for the bulk of the population. Total health expenditure in Lao PDR was estimated at 3.6% of gross domestic product or \$18 per capita in 2005, which is well below the WHO US\$34

<sup>3</sup> The World Bank. 2008. Lao PDR Public Expenditure Tracking Survey in Primary Education and Primary Health. Washington D.C.

<sup>4</sup> The 2007 revised Education Law calls on the government to "prioritize and increase the national budget share to the education sector to achieve 18% and higher."

<sup>5</sup> Recurrent expenditures rose most sharply, reaching just below 60% of the total education budget in FY2009.

recommended standard for developing countries. Of the *total health expenditure*, government spending (domestically financed, and from donors and non-government organizations) is about 20.6% and private spending (of which 92.70 is out-of pocket) is estimated at 79.4%. During implementation of the Sixth National Health Sector Development Plan (NHSDP6, 2006–2010), average government spending on health was 4.97% of the government budget<sup>6</sup> or \$8.94 per capita per year. However, annual domestic spending on health has continually increased from \$6.55 per capita in 2005–2006 to \$13.22 per capita in 2008–2009. The increase in spending is mainly for actual wage increases, as the health workforce remained more or less constant. In 2011/12, government health expenditure is roughly balanced between central and provincial levels.

12. Low recurrent spending limiting operations of health services. Large expenditures in foreign financial aid may have created substantial inefficiencies through an excessive focus on investment with recurrent expenditure financing limited to the period of the aid project. Most of government recurrent spending is dedicated to salaries & allowances, comprising 83% in FY 2006/2007. Non-wage recurrent expenditures by the government comprise only 17% of total government expenditures, which is a major constraint for effective service delivery and operations maintenance. This is especially problematic at the provincial and district levels, where non-wage recurrent expenditures comprise only about 14% of total recurrent expenditures. At the lowest service delivery levels, district hospitals and health centers primarily rely on small out-of-pocket fees obtained from the sale of medicines through drug revolving funds to pay for non-wage recurrent costs of basic operations and maintenance, or get supplies in kind from district health offices. Excessive reliance on the “Revolving Drug Fund” for recurrent financing also provides a strong incentive for government providers to over-prescribe medications.

13. **High out-of-pocket health spending and financial barriers to access.** The shortfall from low public health financing is met by corresponding high levels of private out-of-pocket spending for health care in public facilities. Government introduced cost recovery in the health care system in 1995. While user-fees and out-of pocket payments have helped improved cost-recovery in the system, it has also resulted in less affordability of health care for the poor.<sup>7</sup> Financial barriers—often potentially catastrophic leading to impoverishment—affect health seeking behavior and significantly impede utilization of health services by the poor. For a low-income country, with high percentage poor or near-poor, the effects on access and utilization are significant for a large part of population. Although the evidence on financial barriers to access and catastrophic health care expenditure is currently limited in Lao PDR, available evidence indicates that household out-of-pocket expenditure on medical care as a percentage of GDP has been increasing over time in Lao PDR.<sup>8</sup> Importantly, the financial burden on households from out-of-pocket expenditure also signals high level of inequity in access to health services. According to World Health Organization (WHO), when out-of-pocket health expenditure as % of total health expenditure exceeds 50%, it may lead to an “extremely inequitable” socio-economic setting and large gaps exist between various population segments.

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By comparison, average annual government spending on education was 14.75% of government budget during 2006-2010 (source: Ministry of Finance, World Bank report on government budget, 2009).

<sup>7</sup> The Health Care Law includes provisions for health care to be provided for free to poor patients, in practice, these provisions are rarely implemented.

<sup>8</sup> Total Health Expenditure of GDP increased from 3.2% in 2000 to 4.0% in 2006, with corresponding increase in private expenditure on health (as % of total health expenditure) increasing from 67.5% in 2000 to 81.4% in 2006. Although out-of-pocket spending (as % of private expenditure) decreased from 91.8% in 2000 to 76.1% in 2006, the overall out-of-pocket expenditure on medical care as a percentage of GDP seems increased (source: 2009 World Health Statistics, WHO)

In Lao PDR, 79.4% of total health expenditure is from private spending (of which 92.7% is out-of-pocket).

14. **Private Sector Participation.** Under the Seventh National Socioeconomic Development Plan, the Government of Lao PDR seeks to achieve significant progress in several areas: high GDP growth that is more inclusive, equitable and sustainable; progress in MDGs, particularly in ensuring education and health outcomes; and establish a strong economic foundation to graduate from its least developed country status by 2020. Financing the needs identified in the sector development plans, however, poses a significant challenge. In order to meet the target of at least 8% annual GDP growth, the Government aims to mobilize \$1.6 billion of foreign direct investment in areas such as infrastructure, mining, and agriculture. By allocating projects to private developers, governments can effect large infrastructure improvements without either putting too much pressure on their cash resources or adding to their debt. Increasingly, governments are seeking to transform their role from the exclusive financiers, managers and operators to a role of facilitator and regulator.

15. Government has identified the private sector as the main engine of growth and the Government's policy is to continue the transition to a private-sector-led market economy. Over the years, a broad range of reforms have taken place and have resulted in an improved investment, trade and private sector development (PSD). In order to achieve a GDP growth in real terms of about 8% annually, and to address the financing gap, government is seeking domestic and foreign direct investment in key sectors—agriculture, education and health. Specific strategies are laid out to foster PSD, including improved regulations, enhanced market infrastructure, and active promotion of FDI. Efforts to mobilize additional resources have not been successful, despite significant potential of natural resource revenue.

16. **Governance challenges in Land Concessions.** Increasing recognition of the agriculture and natural resources (ANR) sector's potential has led to a large flow of FDI in recent years, and the participation in the health and education sector is modest. While FDI brings capital, technology, and skill flows, many investments are environmentally and socially damaging, resulting in highly discretionary large scale land concessions. The governance of land management is, however, weak and there exists insufficient capacity to implement the current laws on investment and enforce contracts. Lao PDR lacks the institutional capacity for natural resource management.<sup>9</sup> Capacity constraints include (i) the weak institutional capacity of government agencies to address issues in the overall development of the sector; (ii) seriously constrained government budgets for development investment and recurrent funding; and, (iii) limited capacity to provide incentives as well as an environment conducive to private sector development.

17. The private health sector in the Lao PDR is in a relatively nascent stage. There are around 1865 private pharmacies and 254 private clinics, most of these urban-based, but not a single private hospital.<sup>10</sup> However, private pharmacies are a common source of primary curative care and an important source of inefficiencies in the health sector, as they offer 'self treatment' to the poorly informed population. Public financing and provision of services will continue to be required in the foreseeable future given high levels of poverty, considerable market failure, and

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<sup>9</sup> Barma, Naazneem Varena Fritz and William Rex (2010). "Governance of Natural Resource Management in Lao PDR: A Value Chain Perspective." A Background Paper, cited in Lao PDR Development Report, 2010, the World Bank, Washington, D.C

<sup>10</sup> The Government has a policy to establish a private hospital, as per NHSDP7.

limited private sector capacity. However, the public health sector will not be able to meet the growing demand for high tech curative services that come with economic development and increasing income levels. The Government will need to develop a strategy to address pressures for high-tech services, such as through private sector participation and outsourcing certain services for efficiency gains that do not undermine services for the poor. The Government will also need to guide private sector growth and improve its regulatory framework to mitigate negative aspects in public information, pricing, and assert quality control. Non-state actors, including not-for-profit and civil society organizations, could also play a major role in the funding and provision of health care in Lao PDR, especially in the remote areas.

18. 2011 Investment Climate Report identifies an inadequately educated labor force as a major constraint, especially for larger firms. The labor market supply, which is mostly public sector driven, does not meet national workforce demands with the type of skills demanded by the private sector. In some sectors, the private sector is becoming more involved in skills training. Resolving the problem of skill mismatches will require initiating mechanisms that support the private sector's demand to guide skills and training service providers more effectively. To address current and future labor shortages and skill mismatches it is important to continue strengthening technical vocational education and training initiatives, as well as to continue to forge partnerships with the private sector. There are currently few TVET initiatives in Lao PDR. Most of them aim at improving the quality of existing TVET providers through enhanced curriculum and teacher standards, as well as upgrades to equipment and facilities. Other initiatives seek to better align the incentives of the private sector to participate more actively in the provision of TVET or strengthen the governance and management of existing TVET providers. Unfortunately, these initiatives remain limited in terms of coverage. International experience suggests that upon completion of secondary school and other formal training, it is via, on-the- job-training that human capital is developed most effectively. Therefore, supporting TVET is critical to fully align private sector incentives with the government's skills agenda by designing policies that promote on-the-job training and public-private coordination. Public-private bodies, such as the National Training Council, may have a role to play in this process if the private sector participates fully and effectively. The introduction of cost-sharing schemes for specific training courses in conjunction with private businesses and the establishment of voucher systems to help existing workers upgrade their skills are just two examples. As a result, private-public collaboration is crucial to address labor market challenges. Finally, particularly for PSE, non- state financing needs to be increased—including private investment and public-private partnerships, as well as stronger and more appropriate cost-recovery mechanisms—to support the continued expansion of TVET and HES without unduly draining resources from primary and secondary education.<sup>11</sup>

## **B. Impact and Outcome**

19. The Program impact will be improved delivery of key public services. The Program outcome is to strengthen PSM at the national and subnational level through a set of program outputs. The outputs of the Program comprising of subprograms 1 and 2 are (i) multi-year budgeting and inter-governmental fiscal transfers; (ii) strengthened civil service capacity at the central and subnational level; and (iii) improved investment management capacity in the public sector for private sector investment in key sectors (agriculture, education, and health) and for identifying potential for public-private partnership arrangements. These outputs will be key

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<sup>11</sup> In addition to equity considerations, in general, PSE has significant private returns (i.e., benefits accrue to the Individual), while basic education has a stronger public-good nature, with large spillovers and social returns.

policy pillars under subprograms 1 and 2, and facilitate continuous dialogue with the government.

### **C. Options**

20. In formulating the Program, several options were considered in addressing the key impediments to effective governance and public sector management with a view to strengthen service delivery in key MDG services such as Health and Education. The design of the Program draws on international best practices in improving governance and public sector management by supporting cross-cutting reforms. Key to its contribution in promoting these reforms are:

- (a) Ownership of reforms;
- (b) Strengthen supply-side incentives through institutional strengthening and capacity building—PFM, public administration—in line with international good practices;
- (c) Find appropriate entry points to overcome political economy constraints; and
- (d) Public sector capacity to leverage private sector strength.

21. Consequently, the Program draws upon key lessons from ADB's assistance for public sector management in developing member countries. These emphasized the point that public sector management (PSM) reform is the art and science of making the public sector machinery work. It is about deliberately changing the interlocking structures and processes within the public sector that define how money, people and physical resources are deployed and accounted for. Reforms, however, are complex and involve a wide range of institutions and require sustained support and commitment over the medium to long term. An important lesson learnt from previous PFM interventions in Lao PDR is that introducing complex PFM reforms in a highly capacity-constrained environment requires a step-by-step approach to reform, and that introducing broader institutional and organizational change that are needed for some technical PFM reforms to work requires high-level Government commitment and engagement with the reform program. Lesson is that it is necessary to engage for a longer term, and be flexible to respond to changes in priorities during implementation.

22. To achieve these objectives, the Program will adopt a programmatic approach. Given ADB's broader poverty reduction, and development objectives, including the significance of strengthening governance, the programmatic approach allows medium to long-term engagement with Lao PDR in a key sector. Supported by technical assistance support for capacity development, the Program is able to contribute to improved sector capacity, to strengthen institutional capacity for reform where most needed, and promote international good practices.

23. The Government and ADB and other development partners have worked to develop the government systems in a sustainable way as well as to support current service delivery. This approach typically includes a range of complex and politically difficult reforms all of which may not proceed smoothly and may face delays in implementation. Moreover, the government systems are still under-funded and lack the institutional capacity to deliver the planned improvements in performance of service delivery. Though Public Financial Management Strengthening Program (PFMSP), and NGPAR show significant progress, the progress is not sufficient. The Program therefore works with the Government reforms, NSEDP priorities with full, ownership, and the policy actions are based on broadly-defined sector or programme, agreed multi-year framework and annual planning cycle, are expected to be based on locally owned programs, involving a community of stakeholders and include Strategic alliances, shared

responsibilities and accountabilities. This enables ADB to engage in ongoing, focused dialogue at both strategic and operational levels. The Programmatic approach involves a high level of donor coordination at the programme level, ideally involving all of the donor community, under government leadership. The programmatic approach relies on government systems and procedures, and focus is therefore on developing capacity of institutions and organizations within the framework of the programme or sector, typically with long-term focus. Focus on broad development objectives such as those identified in the Millennium Development Goals, in the NSEDP or in sector strategies is therefore easier.

24. **Ownership and alignment with Government's reform priorities.** The Program support major efforts to improve governance and promote gender equality, building on the Draft Strategic Plan on Governance 2011–2020 and the Strategy for the promotion of gender equality in public administration within the overarching priorities of the National Social-Economic Development Plan.

25. The Program supports capacity development in PFM to strengthen allocative efficiency through medium-term expenditure framework, consistent with the 2006 Budget law and Budget Implementation Decree, and also greater allocation for health and education sectors within the framework of the 7<sup>th</sup> Five Year Health Sector Development Plan 2011-2015 and Education Sector Development Plan 2011–2015. Increasing focus to increase resources to the Education and health Sector to accelerate key MDG goals and improve human assets index to qualify from LDC graduation is also supported by the Program.

26. The program supports the recent initiative to introduce major political reforms by focusing on the districts through an amendment to the Prime Minister's Decree (01/2000). Budget reforms are under way to align with the recent political reforms at the sub-national administration, the Program will support activities required for implementation at the different levels – Policy and Regulatory Reforms, Functional Assignments for Local Governments, Tax and Non-tax Revenues for Local Government Reform of Fiscal Transfers for Local Governments.

27. In addition, the program support to public administration reforms within the mandate of the National Governance Public Administration Reforms (NGPAR) 2011–2015 underlines program's alignment with government reform programs.

28. **Institutional Strengthening and capacity Development.**<sup>12</sup> Program supports key regulatory ministries, and social ministries to achieve development effectiveness. Ministry of Finance, Ministry of Planning and Investment and Ministry of Home Affairs are leading reforms in PFM, public administration, trade and investment policies to improve the climate for private sector investments.

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<sup>12</sup> Ownership and capacity building with increasing attention to governance issues are lessons that underpin ADB assistance to the governance reforms and public expenditure management over the years and have informed the underlying thrust of the sector strategy. Lessons from two ADB Studies (Operation and Evaluation Department) also suggest that (i) policy reforms involving passage of legislations need sufficient time to allow for consensus building and explanation to stakeholders, so it is likely to delay the achievement of some expected outcomes. The OED studies also suggest that technical assistance for capacity development (CD) should build in a period of time to institutionalized skills transfer; and there is a need to pursue governance issues not only at the project/program level, but also at the level of donors' collective policy dialogue to ensure government commitment to addressing widespread corruption.



29. Training in the area of budget, intergovernmental financial arrangements, accounting public audit consistent with international good practice, IPSA and INTOSAI Audit Standards A National Health Personnel Development Strategy by 2020 has been formulated and a National Health Financing.

30. **Training in the areas of concession management.** In the agriculture sector to address the limited capacities of public sector official's responsible and involved institutions and their subordinate levels to effectively provide services for sustainable land management following large scale land concessions.<sup>13</sup>

31. **Support to Private Sector.** The program supports a major government initiative to encourage private sector participation in the health and education sector through public private partnership for pro-poor delivery of service that will mobilize capital and private sector efficiency. In the process, the Program supports efforts to improve the policy framework, and legal framework to ensure predictability for private sector investors.

32. Strategy for Agriculture Development 2011–2020 and the Agriculture Investment Plan 2011-2015 highlight the importance of mobilizing both FDI. The program support to a draft PPP Policy Framework is major first step, and this will contribute to a major engagement on this issue.

33. The biggest constraint is that Ministry of Education and Sports (MOES) and Ministry of Health (MOH) public officials do not possess the tools and management systems to engage the private sector. This is not surprising, given the public finance constraints, and the institutional deficit, and inexperience in dealing with private-sector actors in policy and planning. There is always a mindset within the government to transfer all risks to the private sector while enlisting private sector support. There are also the supply side constraints, the private sector is diverse, virtually non-existent and identifying representative group is challenging. There is paucity of information on who private providers are and what services they offer. By some estimate, in the health sector, there are 222 authorized private clinics, about 2,000 drug stores in Lao PDR. Statistics on private education services are not easily available.

34. Public-sector skills and expertise in developing and managing strategies to influence and collaborate with the private sectors is evidently lacking. Managing meaningful interactions with the private sector require proficiency in basic principles of economics, regulation, business, and other fields. In summary, both conceptual and operational barriers have to be overcome. In addition, capacity constraints, there is vested interest and resistance from Ministry staff to collaborate with the private sector. There is evidence of growing interest in the private sector. While it has had policies in favor of attracting private participation in the power sector under successive NSEDPs, it is only since 2006 it has made private sector growth as a cornerstone of its policy. There is a realization that the private sector can bridge the investment deficit and leverage the large pool of private capital to improve the efficiency and outreach of service

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<sup>13</sup> It is estimated that around 10–15% of the land area of Lao PDR has been awarded for economic development purposes, including for mining, hydropower and plantations to foreign or joint venture investors for periods of up to 70 years. These factors together underscore a clear need for more research and understanding on the subject of land concessions and their application to assist GoL make political commitments to better meet its development objectives, to understand the nature and scope of the current investment decisions made by national and sub-national levels, and to identify where regulatory and capacity building initiatives are required.

delivery. However as yet there is no national level policy framework for private-sector engagement.<sup>14</sup>

### III. Addressing Political Economy Constraints

#### A. Impact Analysis

35. This section presents estimates of the economy-wide benefits and costs of the Program.

36. **Potential Benefits.** The Program targets investment to improve the health and education sectors, as well as strengthening the government with capacity building to support governance and public administration reforms. The potential benefits although difficult to quantify, due to absence of data and the early stage of the reforms, would include the following:

37. The benefits resulting from investment in education and healthcare services are both direct and indirect. A direct benefit would be increased numbers of people accessing education and healthcare services. Another direct benefit would be better health outcomes and educational attainment as a result of efficiency gains and capacity development. Indirect benefits would include the impact on social economic development, for example, the impact on productivity gains and the economy from a healthier and more qualified labor force.

38. The government is also in the early stages of re-structuring itself to better respond and manage the demands of a market economy. In particular, the government has focused on public administration reform measures to transform the rural economy from subsistence into a market economy, and to re-structure local administration by consolidating and developing villages into small towns. As the government aims to raise Lao PDR from the UN list of least developed countries by 2020, the socio-economic impact, if these reforms are successful, is highly significant in terms of increased per capita income, human assets and economic resilience.

39. However, the success of the government reform efforts to develop the market economy at grassroots level is highly dependent on provinces and districts having the required administrative capacity to support development at village level. The government has the right vision, however, bolder steps are needed in decentralizing planning, budgeting and human resource management, as well as streamlining the civil service and strengthening performance systems. The benefits in efficiency gains, greater transparency and better accountability would have significant impact on the quality of public services, the fight against corruption and the effectiveness of investment projects.

40. **The cost of reforms.** The costs of the reforms estimated are primarily the short to medium term costs of government administering and enforcing reforms, the direct fiscal costs of selected reforms. There are permanent administration cost increases in the national budget

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<sup>14</sup> The Government of Lao PDR is seriously looking at Public Private Partnership models to meet the above funding gap for financing NSEDP 7 2010–2015. In the health, and education sector, there are significant problems of resource shortfall and there are unmet demands for effective and equitable service delivery. However, the enabling legal, policy, and regulatory frameworks remain either underdeveloped, or not conducive, or weakly applied. The government has not fully identified a framework for PPPS to solve larger problems in care delivery and well being (health), and of technical and vocational education. The PPP modality has been used in Laos for the Nam Ngum 3 Hydropower Project which ADB has also funded. There have been no other PPP projects in the country. As a result the concept of PPP is very new to Laos.

from establishing new government institutions under the reform program (Public Administration Research and Training Institute, National Leading Committee on GPAR and a Program Board on GPAR, PPP Focal agencies in MPI, MOH and MOES etc.) including costs—wages and salaries for new positions and recurrent costs in the newly established Ministry of Home Affairs (MOHA), and 17 provincial offices under MOHA and Ministry of Natural resources and Environment under the reform program. The cost of project implementation and costs on training will also be recurrent costs to government.

#### **IV. Estimating the economy-wide gains from the Program**

**A. Allocative efficiency gains from the re-allocation of financial resources to development priorities with higher expected rates of socioeconomic return.** Program will result in greater budget for the Education and Health Sector.

41. Although the reform program is at an early stage, two main implications for allocative efficiency can be identified for the medium term. First, the full implementation of multi-year budgeting will lead to more efficient budgetary allocations over the medium term. Efficiency gains will be derived from the expected sustained financing of sectoral development programs over 3-5 years, and also from the presumed better linkages between planning and budgeting once multi-year budget systems are implemented.

42. The Government invested significant amounts of in the health and education sectors in order to develop quality human resources. Budgetary spending in the NESDP7 (2011–2015) remains focused on four key sectors: agriculture, education, health, and rural infrastructure, which together are to drive growth and poverty reduction. Spending in these four priority sectors (ministries) has increased to 34.03% of total expenditure in FY2010/11, from 30% in FY2009/10. The government has also allocated 17% and 9% of total budget expenditure to education and health, respectively, for FY2012/13. The increase in budget allocation for the ministries of health and education is quite significant from 2012, plus 104% for the MOES in 2011/12 and plus 69% for the MOH in 2012/13. This is a remarkable achievement. It shows that the GOL is committed to promote these two sectors in the future and at meeting the MDGs.

43. The MOES is undertaking a multi-year budget by programs in view of a better allocation of expenditure based on policies and norms. The MOH wishes to undertake also a programme budgeting for the next four years.

44. The second implication for the Program of reforms on allocative efficiency refers to the government plans for the strengthening of the districts and the primary administrative unit for service delivery. The reforms are currently being piloted, but eventually will mean the re-assignment of service delivery responsibility from the provincial to the district level of administration and possible the direct election of district representatives beyond 2015. As in other instances of decentralization, that is adequately designed, such a decentralization of functions may allow better matching of service delivery to local preferences and priorities, rendering important allocative efficiencies. Depending on the pace of reforms, these gains could already be experienced by the second subprogram in 2014.

**B. The Program will have economy wide impact through greater investment in Health and Education Sector through potential PPPs (greater revenue mobilization).**

45. **PPPs in Health.** Health care PPPs will assist governments in low income settings to introduce and improve strategic purchasing of healthcare services from non-state providers,

under a range of Public-Private-Partnership options that would be tailored to the specific country and healthcare context. Improving the purchasing practices of governments will enhance access of public patients to quality healthcare services while limiting catastrophic out-of-pocket expenditure for poor patients, and serve to mobilize private investments into the healthcare sector, ranging from public health programs, primary care, to advanced treatment of non communicable diseases, and social health insurance programs. It will also, by fostering increased transparency, competition and good practice in structuring PPPs, contribute to more efficient spending in the sector. PPPs may improve the design, construction, operation and maintenance of modern healthcare facilities, contributing to provision of better health care services. It will address a critical market failure—limited capacity of governments and limited hands-on support to scale up contracting approaches and expand contracting to more complex health services. It will help the relevant government agencies in Lao PDR that do not have ready access to knowledge and hands-on support to structure innovative partnership with non state actors. This will lead to better access to improved health services across the country.

46. Though it will be difficult to quantitatively predict the number of projects that the Program will eventually facilitate, the Program is expected to help identify and structure a minimum of 2–3 projects during the program period in the health sector that should set the base for a greater number of similar projects to follow in the health sector. There will be a need to mobilize more funding resources down the line to fund project preparation and transaction advice. A multi-year Health PPP Advisory Facility would enable the government to significantly expand its health PPP business, with a far greater development impact and sharpened focus on the poor and disadvantaged groups.

47. ADB will help undertake at least 2–3 PPP advisory mandates during the Program period, and for each mandate, deliver initial PPP strategic options (or transaction structuring) report – providing important policy guidance and hands-on capacity building even where it may be decided that a specific transaction may not be viable or value-for-money for a PPP solution. During this phase, ADB will also help assess client capacity to procure and manage PPPs and take suitable actions to mitigate any risks.

48. Two to three successful tenders and contractual closures, through a competitive and transparent process, for a long-term PPP arrangement is expected to evolve out of the Program support. This will lead to dissemination of the approach and process to health care policy makers. It is expected that the above projects should provide affordable access to new or materially improved healthcare services to a minimum of 100000 patients per annum.

49. **PPPs in Education.** By providing demand-side financing and contracting private organizations to provide support services, the Government of Lao PDR can provide better choices to parents and grant them an opportunity to fully participate in their children’s schooling. Lack of financial and managerial capacity often hinders a government’s ability to meet the obligations of national education systems. Under the Program Public-Private Partnerships—alliances with education stakeholders such as private businesses, the media, and nongovernmental organizations—can complement government efforts and make meaningful improvements in education. This will include better design, construction, operation and maintenance of education facilities, leading to better educational services and educational outcomes. Similar to the health sector the Program is expected to help identify and structure a minimum of 2–3 projects during the program period in the education sector that should set the base for a greater number of similar projects to follow in the education sector. Here also there will be a need to mobilize more funding resources down the line to fund project preparation and transaction advice. Again a multi-year Education PPP Advisory Facility would enable the

government to significantly expand its education PPP business, with a far greater development impact and sharpened focus on the poor and disadvantaged groups. It is expected that the program intervention through its 2–3 pilot projects can eventually leverage additional investment in the education sector. It is expected that educational attainment will improve 20%–30% faster, compared with conventionally financed schools.

### C. Improved Efficiency of Public Administration

50. Subprogram 2 of the policy matrix includes very significant milestones in the definition of policies and strategic frameworks for the reform of public administration. The strategic framework will require additional detail to assist its implementation and improved estimation of its costs and expected benefits. Under any circumstances, improved capacity (through all the proposed training activities) and more efficient reorganization of civil servants may be translated into important efficiency gains. The latter will be identified by lower processing times, more efficient interaction with the public and more efficient delivery of services. As reforms progress and more details are offered, the quantification of these gains will be made possible and incorporated into future assessments.

### V. Estimating the Program's Costs

51. The government, including program ministries, is likely to bear most of the costs from implementing key reforms under the Program. Table below highlights the key costs with quantitative estimates where possible.

**Table 1: Estimated Costs to Government and Stakeholders, Subprogram 2**

Types of Adjustment Costs	Government and Statutory Agencies
1. Administrative costs	<p>Government/Legislative/Statutory Agencies</p> <ol style="list-style-type: none"> <li>1. Revision in 2006 Budget law (MOF)-Expected to be tabled in December 2014</li> <li>2. Resolution No 14 in 2012/13 passed by the National Assembly on stepping up public spending in Education and Health</li> <li>3. Prime Minister's Instruction Number 16/PM, dated 15 July 2012 and subsequent instructions vide No 2202/MOF dated 15<sup>th</sup> August, 2012 on the implementation of Sam Sang</li> <li>4. Resolution by Standing Committee of the Economic and Finance Committee (EPFC) of the National Assembly (NA) between to strengthen coordination between EPFC and SAO</li> <li>5. Amendment of the civil service law (Expected to be table in December 2014)</li> <li>6. Amendments for facilitating the implementation of the Laws on Government and Local Administration.</li> </ol> <p><b>Estimated cost: \$6 million (Figures are based on cost of adjustment as reported in previous Impact Assessment 2012)</b></p> <p>Policy and Strategy formulation</p> <ol style="list-style-type: none"> <li>1. Finalization of the draft on long-term "Public Finance Development Strategy (PFDS) for the period to 2020 and Vision to 2030".</li> <li>2. Formulation and drafting of strategy and related inter-ministerial consultations at country level (7<sup>th</sup> NSEDP) and also at different sectoral levels( e.g. Health, Education)</li> <li>3. Issuance of regulations, circulars – (Governance and public administration by MOHA, Gender Equality and Advancement of Women by NCAW, Fiscal Strategy by MOF, etc.)</li> </ol> <p><b>Estimated cost: \$3 million (Figures are based on cost of adjustment as reported in previous Impact Assessment 2012)</b></p>

	<p><b>Capacity Building</b> Capacity building initiatives by MOF/MOHA/MOH/MOES/SAO/MPI/PARTI and NCAW .</p> <p><b>Estimated cost: \$3 million (Figures are based on cost of adjustment as reported in previous Impact Assessment 2012)</b></p> <p>Enforcement of Politburo Resolution - Disseminate and evaluate capacity at local levels</p> <p><b>Estimated cost: \$4 million (Figures are based on cost of adjustment as reported in previous Impact Assessment 2012)</b></p>
2. Enforcement Costs	<p><u>Increased supervision cost</u> – by MONRE and Provincial Departments on land concessions agreements and contracts – land survey, cost of monitoring and enforcing regulation, including collecting revenue. Land Survey – MONRE in validating the availability of land sought for concession agreements for plantation and cultivation of industrial crops - \$1.5 million.</p>
3. Compliance Costs	<p><u>Compliance Requirements:</u></p> <ol style="list-style-type: none"> <li>1. Enhanced supervision for meeting of the objectives outlined in NSEDP and in various sectoral plans/strategies</li> <li>2. Strengthening of the existing monitoring mechanisms and greater focus on effective coordination between line ministries/ provinces/districts involving recruitment of additional manpower (5 new staff per pilot district for Sam Sang implementation.</li> <li>3. Private Sector meeting regulatory and licensing requirements seeking to invest in land and in PPPs – Currently not estimated as they are still to be defined</li> </ol> <p><b>Estimated cost of 1 and 2 above:</b> The cost of this is subsumed in the fiscal costs and can be considered as included in the pay hike given to government employees keeping in mind the greater roles and responsibilities that have been entrusted upon them for meeting the national objectives.</p>
4. Fiscal Costs*	<p>\$5.5 million is the cost of adjustment as reported in previous impact assessment in 2012 which are as follows:</p> <p>Personal and Operating Costs: Ministry of Home Affairs, and 17 provincial offices, Public Administrative Research and Training Institute (PARTI) was established in 2011 for research and training in civil service issues – Estimated cost is \$3 million.</p> <p>Ministry of Natural Resources and Environment was established – additional cost in administrative reorganization, and staff – Estimated cost is \$2.5 million</p>

\* These costs are to be seen in the context of the overall significant increase in the government expenditures due to (i) salary hike to government employees in 2012/13 in order to have a motivated workforce that is keen to pursue and achieve the objectives spelt out under 7<sup>th</sup> NSEDP and various sectoral plans, and (ii) recruitment of additional staff for Sam Sang initiative. Under Sam Sang, five additional staff members have been approved for the finance office at each pilot district. Thus, it entails an addition of 255 staff members for district finance offices alone, have been estimated at \$644 million (approx.). This is due to an increase in wages and salaries which has been very steep. The total wage bill for government employees was around 10.9% of GDP in 2012/13. The nominal GDP figure for 2012/13 was 80199 billion kip or \$10 billion (approx.). *Thus wages and salaries for government employees accounted for nearly \$1.092 billion in 2012/13.* For the preceding year i.e 2011/12, the wage bill for government employees was around 5.1% of GDP. The nominal GDP for 2011/12 was 70343 billion kips or \$8.79 billion (approx.). *Thus the wages of government employees in 2011/12 was \$448 million (approx.).*

## **VI. Contribution to Poverty Reduction**

52. The Program combines a strong growth focus to achieve the MDGs and further reduce poverty. Governance reforms contribute to poverty reduction by enhancing the effectiveness of public expenditures and improving the efficiency and accountability of public spending. Robust public financial management (PFM) mechanisms improve allocative efficiency and the investment climate. The impact of public expenditure reforms on economic growth is significant, as good PFM practices promote pro-poor growth by directing public expenditures to the sectors most in need. Identifying poverty-reducing spending in the budget and providing commensurate resources require appropriate policies and institutions. The national budget is therefore the principal vehicle for efficient resource management. To make an impact, an efficient and functional financial management system should raise, allocate, and spend adequate resources for programs that strengthen the human capital of the poor, provide for their physical security, and ensure adequate public infrastructure to facilitate economic growth—and hence reduce poverty. For example, budget execution rates for pro-poor sectors will increase, as will the value for money of spending from scarce resources. Strong PFM systems also strengthen accountability of service providers to targeted beneficiaries by rationalizing expenditure policy, and enhance financial accountability by reducing fiduciary risks to public funds. As such, governance is key to reducing poverty and promoting more equitable growth trajectories. Successive NSEDPs have identified strong, accountable, and transparent financial management practices as a strategic priority for improved service delivery. The ongoing institutional and capacity development project is addressing public expenditure reforms and building commensurate capacity. PFM reforms contribute indirectly to poverty reduction. Therefore, no direct social impacts are expected from the program. On the other hand, indirect social impacts are significant, manifested in improvements in the quality and quantity of public services and improved governance resulting from more transparent and accountable management of public resources. Therefore, no adverse impacts requiring mitigating measures have been identified. In light of this, no specific poverty analysis is required or appropriate for a system-development investment of this type.