Project Information Document/ Identification/Concept Stage (PID)

Concept Stage | Date Prepared/Updated: 05-Apr-2023 | Report No: PIDC264826

BASIC INFORMATION

A. Basic Project Data

Project ID	Parent Project ID (if any)	Environmental and Social Risk Classification	Project Name
P179016		Low	Lao PDR Public Financial Management Reform Project
Region	**Country**	**Date PID Prepared**	**Estimated Date of Approval**
EAST ASIA AND PACIFIC	Lao People's Democratic Republic	05-Apr-2023	
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Lao People's Democratic Republic	Ministry of Finance of Lao PDR, Ministry of Home Affairs	

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	3.00
Total Financing	3.00
Financing Gap	0.00

DETAILS

Non-World Bank Group Financing	
Trust Funds	3.00
Trust Funds	3.00

B. Introduction and Context

Country Context

Despite being among the fastest-growing economies in the world before COVID-19, Laos's growth model was already showing its limitations. Economic growth averaged about 7 percent over the two decades to 2019, but the economy's growth pattern was capital-intensive, resource-driven, and debt-fueled. In particular, growth was predominantly driven by large foreign investments in hydropower, mining, and construction (of transport infrastructure), which provided few formal job opportunities. The emerging domestic private sector has been hampered by an unfavorable business environment, particularly through a lack of competition and transparency. The financial sector is dominated by state-owned banks, and limited credit has flowed to the private sector.

Economic growth has been severely affected by the COVID-19 pandemic but is starting to recover gradually. Real GDP growth declined sharply from 5.5 percent in 2019 to 0.5 percent in 2020, owing to the wide-ranging economic impacts of COVID-19 – including the collapse of international tourism. Growth is estimated to have recovered to 2.5 percent in 2021, despite a COVID-19 outbreak in the second half of the year that led to stringent containment measures. The agriculture and industry sectors bolstered growth in 2021, supported by solid external demand from key trading partners. There was strong growth in exports of key agricultural products – such as cassava and rubber – while industrial sector growth was supported by mining, energy, and some manufacturing activities. However, the services sector – especially hospitality, transport, and other tourism-related services – has struggled to recover.

Government revenue recovered in 2021, while expenditure levels were restricted by limited capital spending. Revenue performance was a concern even before COVID-19, having declined from 22 to 15 percent of GDP between 2014 and 2019 – owing to falls in both grants and tax revenue. Relatively low tax rates coupled with a narrow tax base (partly owing to corporate income tax exemptions) and poor compliance have undermined tax revenue collection. Total revenue further declined to 13 percent of GDP in 2020, mostly because of the impact of COVID-19 on tax revenue, although it recovered to about 14 percent in 2021. Meanwhile, public expenditure has been tightened by cuts to some discretionary expenses and the postponement of new investment projects. As a result, total expenditure declined from 18 to 17 percent of GDP between 2020 and 2021. The fiscal deficit deteriorated from 3.2 to 5.3 percent of GDP between 2019 and 2020 – mostly because of lower revenues – but improved to 3.2 percent of GDP in 2021.

High fiscal deficits and strong SOE borrowing have pushed public debt to critical levels, jeopardizing macroeconomic stability. Laos is facing both solvency and liquidity challenges, owing to significant financing needs, limited financing options, low foreign exchange reserves, and additional depreciation pressures. Total public and publicly guaranteed (PPG) debt increased from 67 percent in 2019 to 72 percent of GDP in 2020 (USD13.3 billion).[1] Over time, high fiscal deficits (averaging 5 percent of GDP in 2015-2020), a steady GDP growth deceleration since 2013, exchange rate depreciation, and strong borrowing by SOEs have all contributed to a deterioration in debt ratios. The energy sector, mostly represented by Electricité du Laos (EDL), has played an important role in public debt accumulation, accounting for 36 percent of total PPG external debt in 2020. There are also substantial contingent liabilities associated with public-private partnerships (PPPs) and non-guaranteed state-owned enterprise (SOE) borrowing.

Development expenditures have been under pressure from declining revenues and rising debt service obligations. In response to a deteriorating revenue collection performance since 2015, fiscal consolidation has been achieved through tight expenditure controls that, coupled with fast-rising interest payments, have squeezed the fiscal space available for development expenditures. The combined public spending on education and health declined from an already low level of 4.4 percent of GDP in 2016 to 3.1 percent of GDP in 2021, likely undermining public service delivery and contributing to weak learning outcomes, significant losses from preventable health issues, poor productivity of farmers, and high incidence of malnutrition. Interest expenditures are expected to overtake social spending in the near term – possibly as early as 2022.

The political environment has remained stable and is not expected to change. Since 1975, Laos has been a single-party socialist republic and is governed by the Lao People's Revolutionary Party. Although organized political opposition has not been apparent during the LPRP's 46-year rule, small-scale and localized reactions to decisions on natural resources are not unknown. The 11th Party Congress took place in January 2021, followed by the National Assembly elections in February 2021 and appointment of a new Government in March 2021. The composition of the 2021 government indicates a preference for continuity among the political leadership.

[1] Data on public debt stocks is taken from the MoF's 2020 Annual Public Debt Bulletin. This value is likely to increase substantially for 2021, owing to the strong depreciation of the kip against the US dollar.

Sectoral and Institutional Context

Despite significant progress, the government still faces important public financial management (PFM) challenges. The 2018 Public Expenditure and Financial Accountability (PEFA) assessment published in March 2019 concluded that only two of the 31 indicators measured scored either 'A' or 'B', i.e. scores considered above the basic alignment with good practice. The remaining indicators received scores of either 'C' or 'D', which suggests basic alignment with the standards for a 'C' and weak performance for a 'D'. Budget reliability performance is fragile and the credibility of the budget is undermined by the limited information on the budget allocation and execution for defense and police and 'other institutions', as well as on execution at the provincial level. There is limited transparency of public finances, as disclosure of budgetary and fiscal information to the public is limited, which undermines the ability of citizens to scrutinize the use of public resources.

While many of the elements of a core legal and institutional framework of a good PFM system are in place, they need to be improved and fully implemented. Most legal prerequisites of a core PFM system are already in place through an existing legal framework; however, there is no comprehensive Public Finance Management Act, and most existing legislations are not yet fully implemented. Some of the laws include contradictions, have a limited scope or loopholes, and secondary legislations and regulations have not yet been finalized or require updates. Overall, the institutional set up for PFM is fragmented, with sometimes unclear or overlapping responsibilities and accountability.

The budget preparation process is characterized by weak links of budget allocation and prioritization with development priorities, caused by the absence of proper planning and forecasting mechanisms. While a medium-term expenditure framework exists, the budget is being prepared based on the previous year's budget plan, resulting in a weak medium-term budget perspective and a missing link to policy priorities. The limited budget classification does not provide sufficient information on budget execution to enable effective monitoring of budget allocations by function and informed policy decisions. Externally funded projects are monitored separately, and there are no systems to track allocations received by service delivery units. Data on both implicit and explicit contingent liabilities is missing. Support to improve the chart of accounts (CoA) is being provided under the current program which supports the MoF to define the codes of each of the seven segments of the CoA.

The existing MTFF and MTEF are not consistent with resource availability, and the link between capital and recurrent expenditure managed through distinct processes is weak. As a result, they are not used as a basis to focus on priorities in the allocation of funds among institutions and sectors, and strategic sector planning remains weak. To address these weaknesses, the 2nd PFM Program supported the preparation of a Prime Minister's Decree on budget formulation, which requires the introduction of medium- term budget plans and a state budget policy statement, will give a medium-term perspective on revenues and sustainable borrowing and indicate the government's spending priorities. Capacity building and templates have been prepared, but these reforms are yet to be piloted and implemented, pending the adopting of the Decree.

The transition towards a Treasury Single Account (TSA) and improved cash management is incomplete, but the MoF is taking steps to address this. An attempt in 2011/12 to consolidate government bank balances in the TSA at the Bank of Lao (BoL) based on the zero-balance account (ZBA) mechanism was not successful. While the BoL and commercial banks provide daily information on the balances and daily transactions of all accounts under the control of the NT, account balances are not being consolidated in a single account at the end of each day. In addition, some earmarked fund accounts and all donor fund accounts are kept outside the TSA or BoL in commercial banks. Consequently, the NT is working on a weekly cash cycle, resulting into cash rationing (including delay in salary payments), and taking on expensive short-term borrowing. In the absence of commitment controls, government entities enter in commitments without confirmation of budget availability, which results in payment arrears. With support from the 2nd PFM Program, the MoF has reconstituted its TSA Committee which is currently considering the most optimal model of a TSA in line with the Lao context and the readiness of all stakeholders.

Progress is being made on improving effective management of public expenditures by upgrading MoF's core information systems and procedures. The current Government Financial Information System (GFIS) under the NT covers only a subset of functionalities required for a full functioning budget execution system. With Bank support through the E-FITS project, the GFIS is currently being upgraded while in parallel, the MoF launched the procurement of a new financial management information system (FMIS) which is expected to be rolled out nationwide in Q2 of 2024. The FMIS will have both budget planning and accounting modules and will be integrated with all other key MoF systems, such as the tax management system, the customs system and others. Significant capacity building would be required to support the successful roll-out of the system to central, provincial and district spending units.

The management of assets and liabilities is generally weak, including weak controls over fiscal reporting and public investment, which has generated significant fiscal risks. Inadequate SOE management and corporate governance has led to underperformance and substantial fiscal risks, as evidenced by the debt accumulated by EDL. SOEs are key players in the energy, water, transport, and financial sectors. However, there is no publicly available list of SOEs and information on their assets, liabilities, and employment levels is limited.[1] According to 2017 financial data, a quarter of SOEs were loss making, which has significant fiscal implications on the government's balance sheet. Of the SOEs listed in 2017, over 28 percent did not submit their financial reports. At the same time, the government has borrowed money to finance SOEs, but they have not been able to repay, which has left the GoL with $300 million of debt repayments annually due to SOEs.[2] While the MoF has the overall responsibility for the management of the SOE portfolio, the MoF does not have accurate and complete economic and performance information on all SOEs, including on their financial position, assets and employment levels, reflecting weaknesses in government's monitoring and SOE governance. There is currently no framework for identifying, assessing, monitoring, and disclosing SOE performance information which is critical for evidence-based policy making.

Revenue collection has been hindered by tax policy, especially through exemptions granted. Economic growth has been predominantly driven by natural resources, but government revenues accruing from the resource sector have been limited. Resource-related revenues — such as taxes, royalties, and preservation funds — account for a very small share of government revenue. Recent evidence suggests that over 80 percent of the corporate tax base is estimated to be exempt, implying an average revenue gap of around 4.5 percent of GDP (IMF, 2019). Such exemptions are usually granted to attract foreign investment in certain sectors — such as mining and energy and other large projects. Tax exemptions often include waivers on import duties, profit tax holidays, and reduced tax rates. These exemptions lead to effective tax rates in the exempted sectors and businesses that are much lower than for the rest of the economy.[3] Regularly monitoring and evaluating the impact of tax expenditures would be an important first step with a view to reducing the discretion in granting costly tax exemptions.

Despite improvements in tax administration, further efforts are needed to address the compliance gaps. Tax administration has improved in recent years, particularly with the implementation of the Tax Revenue Information System (TaxRIS), including through support from the 2nd PFM Program related to user training. However, tax evasion from large taxpayers remains a challenge owing to limited audits and weak enforcement. Revenue mobilisation is also constrained by widespread informality, which seems to have increased in recent years — even before COVID-19.[4] Lack of enforcement in the application of the presumptive taxation regime for small companies also contributes to significant under-declaration of revenues, and thus acts as an incentive for firms to stay small and informal.

Reforms have been introduced to improve revenue performance, but they have not yet addressed the critical problems in the tax system. With support from the current SDTF, all major tax laws have been revised in the last five years, namely the Value Added Tax Law, the Income Tax Law, the Excise Tax Law, and the Tax Administration Law. However, these revisions have not addressed critical issues, such as tax exemptions and tax holidays, transfer pricing, or digital taxation. On the tax administration side, there is no strategic planning at the headquarter level. While work on risk-based audits supported by the Bank has advanced, there is still no comprehensive risk management framework to guide operations. Revenue target setting has not been based on real capacity and actual information. Staff capacity remains limited for conducting audits and for revenue collection management, while the taxpayer services function is also limited. Taxpayer data and information are limited and not fully centralized, even with the adoption of the new TAXRIS system. The recent reorganization of the tax administration structure includes a mixture of good and poor practices. While the addition of the risk-based management function is highly welcome, the split of the Revenue Management Division (which served as a quasi-large taxpayer unit in the past) means further deviation from good international practices in managing the most important segment of taxpayers.

While the legal framework for public procurement has been strengthened since 2017, implementation is limited, and capacities are weak. This is reflected in the very low scores on the PEFA Indicator PI 24 on Procurement Management and its sub-indicators.[5] The new Law on Public Procurement adopted by the NA in November 2017 provides the foundation for public procurement (until then, public procurement was regulated through a Prime Minister's Decree). An implementing instruction, supported by the Bank, was adopted in 2019. The 2nd PFM Program supported the implementation of the legal framework through the preparation and adoption of a procurement manual, standard bidding documents, templates, conducting a training of trainers and capacity building, developing procedures for complaint handling, the law is yet to be implemented. While pockets of good procurement practices exist within some line ministries (for example in the Ministry of Health), government-wide coordination and monitoring are underdeveloped, and significant capacity building efforts will be required to move towards a homogenous application of the public procurement legislation.

The Public Procurement and Price Monitoring Division (PPMD) of MOF is responsible for regulating the GOL's procurement processes, but it lacks sufficient capacity and tools to discharge its functions. The PPMD is thinly staffed and its expertise in public procurement is uneven. In addition, the MOF does not have a database with consolidated information on procurement operations by government entities. There is no solid legal and regulatory framework, nor tools and skilled staff for the effective monitoring and oversight of government procurement. The procurement function is fully decentralized at ministry department level. Records are maintained for contracts by each implementing entity and there is neither a system nor database to track data on procurement and contract management. There is no reliable and available data on the application of the various procurement methods for award of contracts. The absence of systematic procurement record keeping leads to almost complete absence of procurement tracking and inability to substantiate contracting decisions. While with support of the 2nd PFM Program, the MOF successfully launched a new website for publishing procurement information, thus far, the GOL has not been systematically making procurement information available to the public. There is no requirement to publish contract award information, including the names of winning bidders and amounts of awarded contracts. Apart from the publication of tendering process for competitive procedure, little, if any, information is publicized.

Weaknesses in human resources management (HRM), wage bill management and capacity constraints limit the effectiveness of the public sector. Lao PDR has a large public sector; however, the level of access, quality, and efficiency of government services suggest that human resource management can be improved. Although the GoL has made efforts to control the wage bill in recent years, it is still high compared to peers and at risk of unsustainability in the current fiscal situation. The wage bill ratio to revenue has continuously declined in recent years from 48 % in 2017 to 46% in 2019 (or from 7% of GDP in 2017 to 6.3 % of GDP in 2019) but there has been a significant increase as a share of government expenditure from 31% in 2017 to

52% in 2019. Lao PDR's government employment as a share of total population (above 5 percent) and as a share of wage employment (over 60 percent) is high compared to peers. Similarly, the wage bill as a share of total government expenditure (51.9 percent), domestic revenue (40.9 percent) and GDP (6.33 percent) is among the highest in Southeast Asia. While the GOL has been strengthening its controls of the wage bill through e.g. limiting the number of new civil servants, efforts towards better management of the civil service and rightsizing can be intensified.

The GOL's capacity to manage its civil servants effectively and analyze and forecast the wage bill are hampered by the limitations of the existing Personnel Information Management System (PIMS). The Ministry of Home Affairs (MoHA) is responsible for the policy and oversight of HRM and civil service records. PIMS has been operated by the MOHA since 2006 to keep track of personnel records, workforce movements including recruitments, transfers, promotions and dismissals and payroll approved earnings and deductions. However, PIMS does not meet the criteria of a full Human Resource Management Information System (HRMIS) due to the limitations in its coverage, functions and data architecture. In terms of coverage, PIMS is currently deployed in all central government ministries and agencies, as well as provincial governments- the expansion to all provinces, together with capacity building, was supported by the 2nd PFM Program. It is estimated that PIMS currently covers around 50% of the civil service workforce with district level civil servants and teachers being the major gaps. Overall, it is estimated that PIMS covers less than 25% of the public sector workforce, as major employers such as police and armed forces are outside the system, as well other employment regimes such as contractual and casual workers. As regards functions, PIMS has limited or nonexistent functionalities in key HRM areas such as recruitment, performance appraisal, training, employee self-service, among others. PIMS architecture cannot be extended to become a modern HRMIS solution which is not only a recording system, but one of engagement, analytics and innovation.

Currently, personnel records and payrolls are not directly linked. Payroll data are updated quarterly and processed by National Treasury on a monthly basis. Delays up to three months (from one quarter to the next) can occur between budget controls and personnel record reconciliation. This practice leads to frequent retroactive payments that need to be adjusted in the system and paid. Information in PIMS is updated by the line ministries and agencies on a quarterly basis and reviewed by MoHa before being passed on to Ministry of Finance (MOF) for budget validation and payment. There is no automated interface between PIMS and MOF's Government Financial Information System (GFIS), ministries and agencies process their payroll payment vouchers manually, MOF validates the vouchers against PIMS reports, which results in prolonged periods to clear payrolls as multiple stages of checks and reviews are required. Payment to employees primarily takes place through electronic fund transfer, although cash and a form of electronic money are being used for unbanked individuals in rural areas. Although personnel payments represent a considerable part of the budget there is little in terms of control and audit. Internal controls are mostly left to each ministry or agency, MoHA has tried to validate data and bring to light any ghost records through conducting census and rolling out smart cards that require physical validation. There are no records of any payroll audit conducted by Supreme Audit Office (SAO) over the last few years.

The effectiveness of external audit is limited. The 2018 PEFA score of D+ for PI-30 on External audit is composed of D for Audit coverage and standards, D for Submission of audit reports to the legislature, C for

External audit follow-up and C for Supreme Audit Institution (SAI) independence. Scrutiny is hampered by limited resources, lack of alignment to international standards for the SAO, and a lack of comprehensive, transparent and effective follow-up on external audit reports by the NA. Material risks and internal control issues are not taken into account and no opinion is delivered on financial standards. Although the SAO audit coverage can be estimated to be covering the majority of total expenditures (including provincial and 'other institutions'), the systematic follow-up on the materiality of the audits is not in place. The capacities and resources of the SAO are too limited to carry out annual financial audits of all entities in accordance with its legal responsibilities. The SAO has a very limited number of auditors trained, and they are all certified as level 1 or junior auditors, while there are no auditors with more advanced training (level 2 up to 5). Auditors are trained by SAO's Training Institute which has been set up only recently. The curriculum for levels above 2 does not exist yet. SAO reports to the NA are usually delayed and are not made public. SAO has no effective means to verify the implementation of follow-up actions in response to each audit recommendations.

To address these challenges, the Government has been implementing its PFM Reform Strategy: Public Finance Development Strategy 2025 and Vision 2030 and PFM is very high on the agenda of the new Government. The PFM Strategy was approved in July 2017 and provides the framework for medium- and long-term PFM reforms, with the objective to strengthen public finances to contribute to sustaining dynamic and stable economic growth and a graduation from LDC status. The strategy is being implemented through action plans and the latest one, the PFM Reform Action plan for 2021-2025, was adopted at the end of February 2022. The **plan** outlines priority activities aimed at addressing the weaknesses identified in the 2019 Public Expenditure and Financial Accountability Assessment (PEFA) Report. These activities include (i) improving fiscal policy, (ii) developing and revising legislations, (iii) improving revenue management reform; (iv) improving expenditure management reform; (v) modernizing public finance sector; (vi) strengthening accounting and auditing/inspection; and (vii) developing human and institutional capacity. The Strategy and the Plan will contribute to implementing the Government's two key strategic documents- the 9th National Socio-Economic Development Plan (NSEDP) 2021-2025 and the National Agenda on economic and financial difficulties 2021-2023. In a context of reduced revenues and rising debt, PFM reforms have become very high on the agenda of the new Lao Government and the National Assembly. The new Prime Minister has expressed very strong commitments to macroeconomic and fiscal consolidation, and to improve the efficiency and transparency of public administration, including fighting corruption.

[1] According to MOF data, which may be incomplete, there are currently 174 SOEs, 92 SOEs at the central level and 82 SOEs at the provincial/local level. The government owns more than 50 percent of the share capital in 123 SOEs, 54 at the central and 69 at the provincial/local level. Of the 123, in 113 SOEs the government has 100 percent shareholding (48 at the national level and 65 SOEs at the provincial level). The government owns 50 percent of the share capital in two SOEs, one at central and one at provincial. 38 percent of central SOEs are in the ministry of national defense and ministry of security, however the largest SOEs (by asset) are under the Ministry of energy and mining and Ministry public works and transport.

[2] https://eccil.org/euro-lao-business/lao-economy/lao-govt-reveals-debt-payment-plan/

[3] In 2019, resource sector revenue accounted for about 7 percent of its value added, compared to 17 percent for the non-resource sector.

[4] In 2016, 77 percent of firms reported competing against unregistered or informal firms, compared to 42 percent in 2012 (World Bank, 2017).

[5] According to 2018 PEFA, Lao PDR scored D or D* on all of the sub-indicators of PI 24 Procurement management: 24.1 Procurement monitoring (score D), 24.2 Procurement methods (score D*), 24.3 Public access to procurement information (score D) and 24.4 Procurement Complaints Management (score D).

Relationship to CPF

The proposed Project is aligned with the Lao PDR's Country Partnership Framework (CPF) 2023–2026, which is based on the 2021 Systematic Country Diagnostic (SCD) Update. The SCD confirmed that governance and institutional weaknesses in Laos remain as pertinent as at the time of the previous SCD. The SCD thus presents three pathways that address the most pressing development challenges facing Laos[1], along with a cross-cutting theme aimed at strengthening governance and institutions. The CPF program supports three High-level Outcomes (HLOs) and prioritizes 9 CPF objectives from the 16 priorities identified in the SCD update and supports the implementation of the 9th NSEDP. The proposed PFM Reform Program will contribute to achieving CPF HLO 1 *Purchasing power and access to public services protected from macroeconomic instability and fiscal pressure on social spending*. Specifically, the Program is aligned with CPF Objective 1: *Improved expenditure management and revenue mobilization*. The contribution of sound public sector administration to improve public financial flows on the revenue and the expenditure side are recognized throughout the CPF, underscoring the horizontal link of the PFM systems from the central to the sector level. This is reflected in the cross- cutting theme of *Strengthened governance and institutions*, which an embedded theme throughout the CPF. As noted in the CPF, the Bank, and specifically the proposed Program, will focus on building government capacity, systems and processes, addressing pervasive data constraints, improving the government's ability to identify problems, make evidence-based policy decisions, and transparently monitor the effectiveness of reform efforts. The Bank will also aim to improve the effectiveness of the public sector through interventions aimed at strengthening policy formulation, coordination and implementation at the center of government, in line ministries and in SOEs. Transparency and accountability will be enhanced by building the capacity of the National Assembly and the State Audit Organization and providing more and better information on public finances to citizens.

[1] The three pathways are: 'Stabilize' which emphasizes the urgency of securing macroeconomic stability; 'Share', which highlights the need for a more inclusive growth process, which could deliver stronger benefits

for the poor and the most vulnerable; and 'Sustain' which envisages the promotion of green growth and improved resilience to shocks.

C. Project Development Objective(s)

Proposed Development Objective(s)

The development objective is to support the Government of Lao PDR to improve the management of its public financial and human resources

Key Results

1. Improvement in PEFA PI 16 (Medium-term perspective in expenditure budgeting)

2. Improvement in PEFA PI 17 (Budget preparation process)

3. Improvement in PEFA Indicator P19 (Revenue administration)

5. Improvement of PEFA Indicator 24 (Procurement management)

6. Number of government staff trained, disaggregated by sex and topic

D. Preliminary Description

Activities/Components

The components and subcomponents of the proposed Project mirror those of the BETF part of the Bank support. This is done intentionally to ensure full complementarity and mutual reinforcement between the two instruments. This is based on the positive experience from the implementation of the current 2nd PFM Reform Program, where the BETF and the RETF worked well in tandem, reinforcing each other. In all components and subcomponents, there is a need to ensure that Bank's technical assistance and advisory services provided by international and local staff and consultants (BETF) is transmitted to the local level with the help of locally-based (national or international) consultants embedded in beneficiary institutions and local events (consultations, trainings, dissemination, awareness raising) and held at central, provincial or district level (RETF). The logistics of these events (venue, interpretation, translation, materials, coffee break, etc.) are organized by the PIU which ensures the fiduciary management through its financial, accounting and procurement consultants, under supervision of the World Bank.

Component 1: Improving Budget Preparation and Public Expenditure Management

This component will have four subcomponents aimed at strengthening different aspects of budget preparation and execution, in line with the State Budget Law. The beneficiary institution will be the State Budget Department, the National Treasury, the Accounting Department, the Asset Management Department and the Financial Information Technology Department of the MoF, as well as the Ministry of Education and

Sports, SOEs and the Bank of Lao PDR. The activities build upon those supported by the previous PFM Reform Program and will focus on support for implementation for the initiated reforms. The State Audit Organization and the National Assembly will not be included in the RETF part of the Program in order to avoid any potential conflict of interest.

Subcomponent 1.1 Support to budget planning and preparation, and gender budgeting. This subcomponent builds on activities started under the current TF and will support, and will support, inter alia: i) implementation of the State Budget Law provisions on budget planning and preparation, in particular those related to the implementation of State Budget and Policy Statement (SBPS) and the Medium-term Budget Plan (MTBP); ii) development and implementation of secondary legislation for prioritized areas of SBL and/or support to revisions of the SBL; and iii) implementation of the PM Decree on budget formulation; and v) capacity building and piloting of gender budgeting.

Subcomponent 1.2 Strengthening public expenditure management in sectors. This subcomponent will focus on, inter alia: i) support for addressing PFM bottlenecks in selected sectors, such as education and potentially others in the future. In the education sector, support will be provided for the implementation of a financial management roadmap, which will be developed through the BETF-funded Public Expenditure and Institutional Review (PEIR) and the analysis of PFM challenges in the sector; ii) capacity building and piloting of green budgeting; iii) capacity building for the implementation of budget ceilings in line ministries.

Subcomponent 1.3 Support to FMIS implementation, treasury reforms and debt management. This subcomponent will provide capacity building for the implementation of the new financial management information system (FMIS), which is expected to go live nationwide in Q2 of 2024, if no further delays occur. As the FMIS will be new to both the central and provincial levels, there will be a need for a lot of continuous training on using the system, next to awareness raising and refining the business processes introduced by the new system. Additional support for the implementation of the new chart of accounts in the IFMIS will also be needed, at central and provincial level, but also in line ministries, as well as support for the transition towards using accrual- based accounting in line with the International Public Sector Accounting Standards (IPSAS) and technical assistance for the planned revision of the accounting law and its implementation.

This subcomponent will also provide TA to the National Treasury (NT) and the BoL to further optimize the management of government revenues and cash balances through a unified structure of government bank accounts via a treasury single account (TSA) system. The GoL has established a TSA Committee to oversee this work and is reviewing a Technical Note prepared by the WB with a suggested renewed approach towards the TSA. Last but not least, this subcomponent will provide capacity building to the Debt Management Department of MoF. The objective will be to strengthen the capacities of MoF's debt management officers to use the upgraded DMFAS 6 system, which will be integrated with the FMIS, by offering them capacity building on different deb-related topics. This will complement capacity building provided by UNCTAD in the context of the upgrade of the debt management system financed by the World Bank, as well as support by other donors.

Subcomponent 1.4 Support to SOE governance. This subcomponent will focus on: i) supporting MoF with data collection for the horizontal review of SOEs using the integrated State-Owned Enterprises Framework (iSOEF), as well as assessments of other SOEs, based on demand; ii) support for implementation of the MoF's SOE reform plans; iii) support to implement the recommendations of the assessments of Lao Airlines, supported by the BETF, and possibly that of Elecricite du Laos, which was supported by the previous PFM Program; and iv) build capacity for the transition to International Financial Reporting Standards **(**IFRS) in tandem with the support which will be provided by the BETF.

Component 2: Enhancing Domestic Revenue Mobilization

This component will have two subcomponents supporting activities in line with the recently approved tax administration reform plan 2021-2025. The beneficiary institution will be the Tax Department (TD) of the MoF at central level, as well as tax offices at the provincial level. The activities build upon those supported by the previous PFM Reform Program and will focus on strengthening of the legal framework and improving tax administration processes.

Subcomponent 1.1. Strengthening tax policy and legislation. This subcomponent will focus on the following: i) *Review of tax laws and secondary legislation and recommendations for improvement.* Support will be provided to strengthen the MoF's capacity through local expertise for the revisions and drafting of legislative initiatives, undertaking consultations at central and provincial level, dissemination, and training with the relevant stakeholders. These legislative initiatives, which may include revisions and inputs into key tax laws and implementing instructions, such as land tax, environment tax, income tax, VAT, and others, based on government demand, will contribute to strengthening the legal framework for taxation with a view to increasing revenue collection; ii) *Capacity building*: this will include delivery of training on, inter alia, good international practices in the implementation of VAT, income tax, transfer pricing concepts and methods, as well as international study visits.

Subcomponent 1.2. Modernizing tax administration. This subcomponent will focus on the following: i) *Comprehensive risk management (CRM)*: the TD to adopt and implement a CRM, which will build on the implementation of existing elements such as risk-based audit (RBA) and large taxpayer management to cover other core functions of tax administration, such as registration, filing, payment, and debt management; ii) *Data management and analysis*: support will be provided to build capacity in TD to conduct revenue forecasting and analysis to support compliance risk management; iii) *Capacity building* for the roll-out of the new tax revenue management information system TAXRIS at the district level; iv) *Taxpayer outreach and services:* this will include support for the implementation of the Taxpayer Strategy and Communication Plan, which is part of the Tax Strategy (2021-2025).

Component 3: Improving Public Procurement

This component will provide support to continue building the capacity of the PPMD and the procuring entities and central and provincial level to implement the public procurement legislation, which was supported by the 1st PFM Program, and the implantation tools supported by the 2nd PFM Program.

Subcomponent 3.1 Capacity building and professionalization. This subcomponent will support: i) implementation of a competency framework to support sustainable national training for a professional procurement cadre; ii) development of a capacity building strategy and training and capacity strengthening for staff of PPMD, procuring entities and other public (control) bodies involved in procurement, at national and sub-national level; iii) implementation of the Public Procurement Law; iii) operationalization of Framework Agreements for procurement of commonly used goods and services in high spending ministries (namely MoF, Ministry of Foreign Affairs, Ministry of Health and Ministry of Education and Sports), in order to rationalize procurement and reduce costs; iv) development of rapid procurement protocols to respond to emergencies such as COVID- 19; v) operationalization of complaint and dispute settlement mechanisms; vi) development of legislation, guidelines, manuals; and vii) introducing green procurement approaches, in close cooperation with GIZ.

Subcomponent 3.2 Laying the foundations for e-procurement. This subcomponent will support for, inter alia: i) dissemination of an e-procurement readiness assessment, roadmap and action plan for the introduction of e-procurement in the medium term; ii) dissemination and training on the regulatory framework for e-procurement; and iii) development of an online data collection and analysis tool to collect, collate, analyze and report on procurement information from all procuring agencies scattered across the country, with a view to improving the availability of information for monitoring, including through citizen engagement, evidence-based decision making and system improvement. The information produced will help the GoL improve procurement policies affecting the participation of small and medium-sized enterprises, identify opportunities for promoting green procurement and analyze gender aspects of public procurement contracting.

Component 4: Modernizing Human Resources Management in the Civil Service

This component will provide support to continue building the capacity of the MOHA to strengthen the management and integrity of civil servants.

Subcomponent 4.1 Support to modernizing human resources management in the civil service. Activities will build on work undertaken under the current TF and will focus on: capacity building for the roll out of PIMS to the district level and its upgrade; preparation for the design and implementation of a new human resources management information system (HRMIS); dissemination and capacity building on contemporary, data-informed human resource policies; capacity building of MoHA staff to perform HRM analytics and improve HRM technical expertise in topics such as organizational design, wage bill analysis, right-sizing, merit-based recruitment, performance management and workforce/talent management.

Subcomponent 4.2 Civil service strategy implementation. This subcomponent will support the preparation and implementation of an action plan of the civil service strategy, which is being developed through EU TA support. Activities will include awareness raising and capacity building.

Subcomponent 4.3 Strengthening civil service ethics and professionalism. This subcomponent builds upon support provided under the current TF for the first ever civil service code of ethics which was approved in 2019 and launched in 2022. Support will be provided for: i) implementation a diversified national dissemination and media campaign to promote the code of ethics across the wider civil service and develop public awareness of code and the responsibility of civil servants; ii) training to civil servants at central and provincial level on the code of ethics; iii) development of ethics and integrity- related training programs for civil servants; iv) development of ethics and integrity expertise of civil servants from MoHA and other line ministries to support the delivery of ethics and integrity training; v) development of civil service codes of ethics in professional and service delivery sectors, such as education and health.

COMPONENT 5: Project Implementation, Analytics and Just-In-Time Support

Subcomponent 5.1 PFM reform coordination, M&E, communications and change management. This subcomponent will provide support to MoF's PFM Reform Secretariat to implement the PFM Reform Action Plan, strengthen its capacity to monitor and report on progress both on the PFM Action Plan and the present donor-funded program, strengthen internal coordination within MoF and between the MoF and other line ministries, particularly MoHA, MoES and between MoF development partners working in the domain of PFM reform, and enhance communication and outreach within the GoL and to the public about the importance of PFM and its impact on improved service delivery. This will include support for the preparation of a communications strategy and outreach materials, workshops and dissemination events at national and local levels, as well as international study visits to exchange knowledge with other countries. Last but not least, this subcomponent will support change management activities aimed at ensuring that key stakeholders are well informed and on board with the reforms supported by the program.

Subcomponent 5.2 Analytics and just-in-time support. This subcomponent will support different analytical reports such as a repeat of the PEFA assessment, as well as support for emerging needs and just-in-time support based on government demand, such as reviews and support for revisions of laws.

Subcomponent 5.2 Project management. This subcomponent will cover part of the operating costs of the MoF's Project Implementation Unit (PIU) which provides the fiduciary management of the program and employs consultants working on procurement, financial management, M&E, change management and communications.

Environmental and Social Standards Relevance

E. Relevant Standards

ESS Standards		Relevance
ESS 1	Assessment and Management of Environmental and Social Risks and Impacts	Relevant
ESS 10	Stakeholder Engagement and Information Disclosure	Relevant
ESS 2	Labor and Working Conditions	Relevant
ESS 3	Resource Efficiency and Pollution Prevention and	Relevant

	Management	
ESS 4	Community Health and Safety	Not Currently Relevant
ESS 5	Land Acquisition, Restrictions on Land Use and Involuntary Resettlement	Not Currently Relevant
ESS 6	Biodiversity Conservation and Sustainable Management of Living Natural Resources	Not Currently Relevant
ESS 7	Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities	Not Currently Relevant
ESS 8	Cultural Heritage	Not Currently Relevant
ESS 9	Financial Intermediaries	Not Currently Relevant

Legal Operational Policies

Safeguard Policies	Triggered	Explanation (Optional)
Projects on International Waterways OP 7.50	No	
Projects in Disputed Areas OP 7.60	No	

Summary of Screening of Environmental and Social Risks and Impacts

The project has no physical footprint or land acquisition and will not construct any structures or finance any external modifications of any facilities. Thus, no key environmental and social risks related to physical and geographical issues, biodiversity, land access, and cultural heritage, have been identified. Project activities are expected to have minor environmental risks and impacts related to the provision of office and IT equipment and face-to-face trainings; this includes Occupational Health and Safety (OHS) risks to workers, including risk of exposure to COVID-19, and generation of minor amounts of waste (office waste, electronic waste). Measures to mitigate the OHS and waste management should be included in the technical specification of the supply bidding documents. Management and disposal of the expected e-waste at the end of life should also be addressed in an e-waste management plan, and should be included in the Project Operation Manual (POM), along with a guideline to limit the spread of Covid 19 during face-to-face training. The project recognizes the following standards as relevant to the project: ESS 1; ESS 2; ESS 3, and ESS 10. The environmental risk is classified as Low. Environmental risks and impacts anticipated for this project include: (i) risks related to the possible purchase of office furniture and IT equipment for the PIU, MOF or MOHA. Occupational Health and Safety risk and limited waste generation associated with this activity are anticipated, and it will also be necessary to plan for the disposal of the end-of-life equipment. This can be easily mitigated with an e-waste management plan that the client will prepare and review with the Bank prior to project Appraisal. The supply of the electronic equipment is not expected to have adverse impact on energy consumption; (ii) risks related to the health and safety risk associated with exposure to COVID-19, which will also need to be considered during face-to-face training (planned in components 1, 2, 3 and 4). It should also be taken into account that the PIU has no prior experience with the Bank's ESF, and the E&S capacity of Ministry of Finance will need to be assessed during preparation. However, it is planned to hire experienced environmental and social specialists/consultants who have already worked on ESF projects. They will support the preparation and implementation of project specific ESF instruments. The social risk is classified as Low. Whilst the project aims to deliver a range of benefits, project activities have the potential to generate minimal, predictable, mitigatable social risks and impacts, that are low in magnitude. Social risks and impacts anticipated for this project include: (a) risks of exclusion of some beneficiary groups/institutions and therefore related to limited stakeholder engagement; (b) risks related to the labor and working conditions of project workers and (c) risk of Sexual Exploitation and Abuse and Sexual Harassment (SEA/SH) in relation to training and working conditions. These risks and impacts are low, and they are for the most part predicable and possible to mitigate during the lifetime of the project. This risk rating takes into consideration lack or minimal familiarity and ES capacity of the PMU, which will be assessed during preparation. The anticipated risks can be mitigated through appropriate actions/risk management plans. Given the scope of the project, the focus on the Ministry of Finance and the activities, child labor and or forced labor is a very low risk. Particular attention will be paid to monitor and verify compliance in the application of ESS10 with ESS2 requirements to be included in contracts and with the risk of SEA/SH. The Project does not include Financing involving Major Civil Works, focusses on capacity building of existing government staff, does not include activities in remote difficult to access communities nor activities near schools and other facilities frequently accessed by children. However, SEA/SH has been identified in relation to trainings and working conditions and is classified within the ?Low Risk? category for SEA/SH risk. A SEP including a Grievance Redress Mechanism (GRM) will be prepared prior to appraisal to guide the Borrower to identify stakeholders, build and maintain a constructive relationship with them, and to meet communication and disclosure requirements with a particular focus on project-affected parties. The SEP will include inclusion and engagement strategies. Further details are provided under ESS10. A fit-for-purpose LMP will need to be prepared prior to appraisal that will include a brief analysis of gaps and mitigation measures on ESS2. The OM will further develop the labor principle and practices under the project. An Environmental and Social Commitment Plan (ESCP), drawn and agreed between the Bank and the Borrower, will set out the important measures and actions that will be required for the project to meet environmental and social requirements over the project?s lifetime. These measures will be implemented within a specified time-frame and the status of implementation will be reviewed as part of project monitoring and reporting. The PIU has experience in implementing Bank-financed projects under the Environmental and Social Safeguard Policies. However, these projects are classified as low risk and have no safeguards policies triggered. Therefore, the PIU has no experience with implementing projects under the Environmental and Social Framework (ESF) and in the preparation of the required ESF instruments. At the projects? level, the PIU will deploy and environmental and social (E&S) safeguards specialists/consultant to support the preparation and implementation of project specific ESF instruments. A project level institutional capacity assessment will be conducted during project preparation to: (I) assess on the MoF/PIU capacity in meeting the objectives of the relevant Environmental and Social Standards (ESSs); and (ii) identify measures to strengthen capacities for effective implementation of the relevant guidelines and standards, that are applicable to the proposed project. These measures will be captured in a Capacity Strengthening Plan, which will be included in the Project Operation Manual (POM) and reflected in the Environmental and Social Commitment Plan (ESCP).

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