Project Information Document/ Integrated Safeguards Data Sheet (PID/ISDS)

Concept Stage | Date Prepared/Updated: 30-Aug-2018 | Report No: PIDISDSC24863

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Parent Project ID (if any)	Project Name
Lao People's Democratic Republic	P167534		Lao PDR Public Finance Management Modernization Project (P167534)
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
EAST ASIA AND PACIFIC	Dec 10, 2018	Mar 28, 2019	Governance
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Government of Lao PDR	Ministry of Finance of Lao PDR	

Proposed Development Objective(s)

The PDO is to contribute to the reliability and timeliness of budget execution reports, and to enhance public financial management skills.

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	20.00
Total Financing	20.00
of which IBRD/IDA	20.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Development Association (IDA)	20.00
IDA Credit	20.00

Environmental Assessment Category	Concept Review Decision

C - Not Required	Track I-The review did authorize the preparation to continue

B. Introduction and Context

Country Context

1. **Over the past two decades, the Lao People's Democratic Republic achieved rapid growth and impressive poverty reduction.** Gross domestic product (GDP) growth rate averaged around 8 percent annually since 2000, making it one of the fastest growing economies in the East Asia and Pacific region. The gross national income (GNI) per capita reached US$2,330 in 2017, and in 2018, for the first time, Lao PDR met the criteria for Least Developed Country (LDC) graduation.[1] Poverty[2] declined from 34 percent in 2002/03 to 23 percent in 2012/13, meeting the Millennium Development Goal (MDG) target of reducing poverty to below 24 percent. However, social development indicators are lagging behind expectations and inequality widened, with an increasing Gini coefficient (currently at 36.2), reflecting lower gains for the bottom 40 percent of the population.

2. **The country has been struggling to address fiscal deficits posing pressing challenges for economic management.** Efforts to improve fiscal sustainability have been made through moderating wage increases and staff recruitment and by introducing spending cuts. While these measures initially helped tackle the deficit in 2015 and 2016, they were countered by low commodity prices resulting in lower-than-expected revenue income.[3] In 2017, the deficit stood at 5.5 percent of GDP and is expected to decline to 4.9 percent of GDP in 2018. The country is in high debt distress with public debt at around 60 percent of GDP in 2017 and is expected to further increase to 62.6 percent of GDP in 2018.

3. **Fiscal difficulties have been affecting availability and quality of service delivery.** The large fiscal deficits have limited the ability of the public sector to allocate budget to social sectors and infrastructure maintenance needed to address the country's development challenges. Critical sectors remain underfunded and contribute to weak learning outcomes, significant losses from preventable health issues, poor productivity of farmers, and high incidence of malnutrition.

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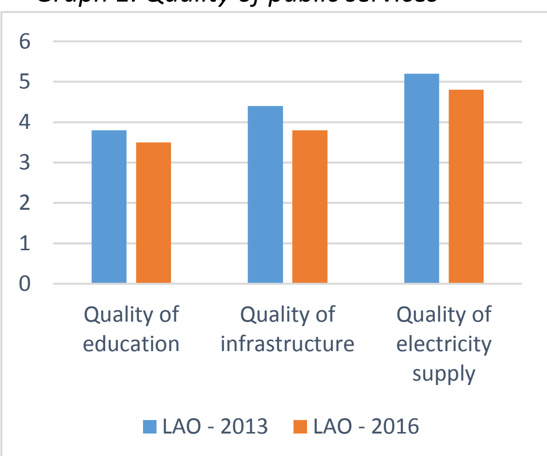
[1] In the March 2018 review, the country met the thresholds for GNI/capita and Human Assets Index. If it sustains progress until the 2021 review, graduation will be recommended following a three-year transition period, in 2024.

[2] National Poverty Line, based on Lao PDR Expenditure and Consumption Survey (LECS). Last available data are from 2012/13.

[3] The tax/GDP ratio fell from 16.1 in 2014/15 to 15.1 in 2017.

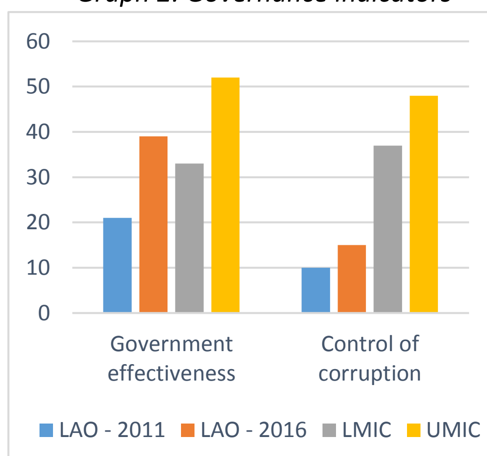
4. **Recent increases in spending have improved the availability of public services**. However, many indicators related to access to and quality of basic public services for Lao PDR remain closer to the average for low- and middle-income countries (LMICs) rather than upper-middle-income countries (UMICs). Immunization[4] is at about 80 percent, similar to the LMIC average, but still behind the UMIC average of about 97 percent. Although the country increased net enrollment in primary education to almost 100 percent in recent years, the dropout rates are high with only 77 percent of pupils starting in grade 1 reaching the last grade of primary school. Consequently, the transition to secondary education is low, as only 45 percent of children enroll in secondary education, compared to 77 percent, on average, in the East Asia and Pacific region. Overall, the quality of education, infrastructure, and access to electricity slightly decreased over the past years (see graph 1). While government effectiveness and control of corruption increased over the past years, a significant gap to the UMIC average persists. While Lao PDR made notable progress on the government effectiveness indicator surpassing the LMIC average, it scores in the lowest 10 percentiles for control of corruption, lagging far behind the LMIC average (see graph 2).

Graph 1: Quality of public services



Source: World Economic Forum, Global Competitiveness Report, various issues
Note: On a scale of 1 (worse) to 7 (best)

Graph 2: Governance indicators



Source: Worldwide Governance Indicators
Note: Percentile rank (0 to 100)

5. **The political environment has been increasingly favorable to reforms reflected in ambitious development targets in the Government's program.** Lao PDR is governed by a single party, the Lao People's Revolutionary Party (LPRP). The 10th Party Congress in January 2016 made notable changes in the Politburo, followed by the appointment of a new Government in April 2016. With the change in political leadership, the Government has announced a comprehensive reform program to address governance challenges, promote the rule of law, and improve economic management. With a development vision based on green growth, the objective of the Government's 2016–2020 8th National Socio-Economic Development Plan (NSEDP) is to reduce poverty and prepare Lao PDR for LDC graduation by 2020 and progress toward the Sustainable Development Goals. Achieving these goals will require an efficient and effective public financial management (PFM) system and public sector.

Sectoral and Institutional Context

6. **Despite notable reform efforts during 2003–2012, Lao PDR's PFM system faces significant challenges.** Efficiency in public expenditures management is constrained by an outdated information system and procedures, weak cash and debt

[4] World Development Indicators 2016; Immunization refers to the simple average of rates for DPT, HepB3, and measles immunization.

management, and inefficiencies in wage bill management. In addition, there are still some inconsistencies in the legal and institutional framework governing PFM. Similarly, the 2010 Public Expenditure and Financial Accountability (PEFA) Report on Lao PDR had identified significant weaknesses (rated D or D+) in oversight of aggregate fiscal risk, multiyear fiscal planning, transparency and accountability of the budget process, and internal control mechanisms.[5]

7. **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 Public Finance Management Act, and most existing PFM legislations are not yet being 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. An example is the Budget Law 2015, which gives guidance on the budget cycle and the preparation of budget documents; however, secondary legislation has not yet been prepared. Overall, the institutional set up for PFM is fragmented, with sometimes unclear or overlapping responsibilities and accountability.

8. **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. Proper costing of expenditures or ceilings have not been introduced. This has regularly led to unaffordable and unrealistic budget plans, unaffordable commitments, and increasing arrears, and ultimately resulted in non-achievement of sector performance targets.

9. **Past reforms led by the National Treasury (NT) to introduce a Treasury Single Account (TSA) and improve cash management remain incomplete**. An earlier 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. Finally, the current PFM system is not able to distinguish sector budget units at the district level from those at the higher (provincial and central) levels, leading to a lack of information and input for policy and decision making at the service delivery level.

10. **While progress has been made in updating the Chart of Accounts (CoA), it does not support comprehensive transaction processing, budget management, controlling, and information requirements at all locations of government operations.** The update of the CoA has set the stage for the adoption of the double entry accounting system, which will enable production of financial statements compliant with the International Public Sector Accounting Standards (IPSAS). A main issue is the absence of a comprehensive integrated organization classification, including district codes in the CoA. As a result, budgets cannot be allocated to the various sector budget units at the district level and those expenditures cannot be checked against budgets before execution. This hinders the decentralization of transaction entry and budget controls to the district level, where they occur. Direct transaction entry at the district level would reduce time and effort for information generation and processing, and would allow to provide timely, reliable, and complete budget reports on

[5] A new PEFA Assessment is ongoing and expected to be finalized before project appraisal. As limited reforms were undertaken since the 2010 PEFA Assessment, ratings and the overall status of the PFM system may not have changed significantly from the 2010 Assessment.

expenditures incurred at the district level as a whole, by the various sector departments, such as education and health.

11. **As a result of these weaknesses, the NT is struggling to meet the increased demand for comprehensive and timely budget execution information.** The existing information is not sufficient for many counterparties (within the Ministry of Finance [MoF], line ministries, and donors), which has caused attempts to build parallel data collection and reporting systems not only for tracking budget management at the district level, but also at the line ministries.

12. **Effective management of public expenditures is constrained by outdated PFM information systems and procedures.** While the MoF has initiated many Information and Communication Technology (ICT) initiatives related to development and implantation of business applications to improve service delivery to citizens and business, significant gaps remain. The three main MoF departments and their information technology applications form the backbone of the current technology enablement. These include the Government Financial Information System (GFIS) under the NT, the Automated System for Customs Data (ASYCUDA) under the Customs Department, and a forthcoming Tax Management Information System (TMIS) currently under development by the Tax Department. The current GFIS covers only a subset of functionalities required for a full functioning budget execution system. The GFIS was updated and rolled out to the provincial level in the mid-2000s; however, certain core functionalities related to commitment controls and bank reconciliation are not yet in place and the district offices are not included in the GFIS coverage. The technical ability of the GFIS to include the required updates for full functionality is limited as the technology used for system development is becoming obsolete, and the technical architecture and documentation is poor, leading to challenges in timely and comprehensive budget execution reporting.

13. **The recent Rapid Assessment on Digital Development for Lao PDR (P165398) has identified a number of country-level ICT bottlenecks.** The rapid assessment found that digital connectivity (Internet services) requires significant improvement in Lao PDR. It also recommends strengthening the legal and regulatory enabling environment for digital development to deepen trust in digital transactions and support online service delivery. Finally, digital skills and literacy present a significant challenge, including ICT/digital literacy and leadership within the Government.

14. **To address these challenges, the Government has developed a comprehensive PFM Reform Strategy: Public Finance Development Strategy 2025 and Vision 2030.** 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. It serves as the blueprint for the second generation of PFM reforms, which aim to continue previous reforms undertaken during 2003–2012, and finalize the development and implementation of core PFM systems.

Relationship to CPF

15. **The proposed project is aligned with the Lao PDR's Country Partnership Framework (CPF) 2017–2021 (Report No. 110813-LA).** The CPF supports the global agenda adopted by Lao PDR through the Sustainable Development Goals, which have been thoroughly mainstreamed into the 8th NSEDP for 2016–2020. Overall, the CPF supports Lao PDR on a path to reduce poverty and promote shared prosperity in a sustainable manner, based on green growth principles. The PFM reforms are reflected in the cross-cutting theme 'Enhance effectiveness of public governance and administration'. 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 implementation of the CPF. For example, the Green Resilient Growth Development Policy Operation (P159956) had prior actions and triggers on tax administration, and PFM has been

streamlined into sector activities, such as the Health Sector Programmatic ASA (P164585).

16. **Learning from past experience, the proposed project will address specific PFM challenges and complement other World Bank and development partners' efforts to improve PFM systems.** It will primarily focus on financial reporting, cash management, and PFM capacity constraints. These reforms will complement other initiatives that aim at improving tax administration, procurement reforms, and legal and institutional changes.

C. Proposed Development Objective(s)

17. The PDO is to contribute to the reliability and timeliness of budget execution reports, and to enhance public financial management skills.

Key Results (From PCN)

18. Key indicators for measuring the achievement of the PDO are the following:

i. In-year budget execution reports covering all levels of Government (central, provincial and district) are prepared quarterly, and issued within four weeks from the end of each quarter (PEFA sub-indicator 28.1 and 28.2);
ii. The following documents are publicly accessible on the Ministry of Finance's website: (i) Approved budget and its summary, (ii) annual financial statements and its summary, and (iii) In year quarterly budget reports;
iii. Number of staff (disaggregated by gender) completing approved training and qualification assigned to PFM related jobs.

D. Concept Description

19. **The proposed project forms an integral part of a comprehensive support program to the GoL's PFM reform program, and will be complemented by a Trust Fund Program, which provides support to the required policy and process changes.** During the past two years, the Public Finance Management Modernization Program (P158658), an European Union (EU)-financed World Bank-executed Single Donor Trust Fund (SDTF), has provided the knowledge base for the reforms through extensive diagnostic work and stocktaking of the current PFM processes, complemented by capacity building. These engagements have directly fed into the preparation of the MoF's PFM Strategy, its action plans, and into the design of this proposed operation.

20. **The proposed Project will focus primarily on the development and implementation of a financial management information system (FMIS) and the setup of a structured training program to build the necessary PFM capacity to sustain the reforms.** The second phase of the abovementioned SDTF, consisting of a World Bank-executed part (Programmatic Public Management Reform Program, P167660) and a recipient-executed Grant (Public Finance Management Reform Grant, P167661), will complement the proposed project through technical assistance and capacity building to implement the policy and process reforms required for the FMIS. The EU Grant will be processed as parallel financing as the grant will become effective earlier and will support the preparation of the operation, including setting up the Project Implementation Unit (PIU).

1.1 Component Description

21. **Embedded in a broader PFM reform process, an FMIS can result in notable benefits.** Supported by broader PFM

reforms, an FMIS can facilitate, among others, better cash management by providing up-to-date data on available financial resources; reduced routine workload through shifting transaction processing to the location of their origin; and improved budget execution by ensuring that all expenditures are in accordance with budget appropriations, commitments, and cash allocations. An FMIS would also allow a full integration of the approved budget and budget execution data; enable close monitoring of outstanding bills; cash in Government bank accounts, arrears, and fiscal deficits; and finally, improve the quality and availability of budget execution reports and baseline data. For setting up a core PFM system, policy and process reforms are necessary to achieve the full benefits of an FMIS investment. From a functional perspective, three areas that need to be addressed before embarking upon the FMIS are (a) the finalization of the CoA, (b) allocation of the budget to the lowest-level budget units, (c) introduction of commitment controls, and (d) systems and procedures to enable effective and modern cash management.

22. **Given the complexity of the PFM reforms and FMIS implementation, the project design is envisaged to be simple.** The project will tentatively include three components: Component 1 would strengthen the MoF's ICT environment, including the development and implementation of a new FMIS, Component 2 would build a sustainable training program to put in place the necessary PFM capacity, and Component 3 would cover project management activities and a change management program.

23. **Component 1: Setting the foundations for a core public financial management system.** This component would cover the implementation of a new core FMIS, which includes the purchasing, customization, and installation of the application system software. It would also include building links and interfaces to other government information systems, including revenue administration, debt management, BoL's interbank payment settlement system, and the payroll system. This core FMIS would facilitate the computerization of all functional processes associated with the budget execution process, with the option to later add modules on budget preparation, procurement, asset management, and so on.

24. **The FMIS would initially be set up as a core PFM system covering only the budget execution processes.** Such a budget execution/treasury system would replace the existing GFIS; however, the technical specifications of the new system would allow other modules, such as the payroll module (already under preparation by Ministry of Home Affairs) to be linked.

25. **Component 2: Upgrading public financial management skills.** The second component is envisaged to build a sustainable training program to build the necessary PFM capacity in the MoF and the staff from other government entities working on PFM-related issues. To build the necessary skills to implement the PFM reforms, all relevant staff should have a basic understanding of the core elements of PFM. A first activity will include a skills gap assessment to identify the core areas of training need. Second, job profiles of different PFM-related positions will be developed (that is, treasury analyst, budget officer, director general, and so on) and the minimum training requirements identified for each profile. This will include both technical and managerial skills, as well as ICT-related training. Based on the previous two activities, a new PFM training curriculum will be developed. The existing infrastructure of the MoF's training institution, the Economic-Finance Institute, will be leveraged and upgraded. The curriculum will then be aligned with training requirements, so that staff working in PFM-related positions have access to acquire the necessary training programs.

26. Basic PFM training could be built into e-learning modules, using the existing PFM training courses (that is, from the International Monetary Fund, World Bank, and other countries), while the training materials produced by the capacity-building activities provided under the EU SDTF could also be integrated, expanding their impact from one-time workshops to reusable modules. Country-specific and advanced training (partially based on training content from the EU SDTF

capacity-building activities) will be designed as face-to-face modules.

Component 3: Project Implementation and Change Management. Activities under this component will include technical assistance to the PIU and support for project management. In addition, a change management program will be put in place (partially funded by the EU SDTF) and will include stakeholder workshops and dissemination of information about the reform process.

SAFEGUARDS

A. Project location and salient physical characteristics relevant to the safeguard analysis (if known)

The main project location will be Vientiane Capital. However, the roll-out of the planned FMIS system will include provinces and districts.

B. Borrower's Institutional Capacity for Safeguard Policies

No safeguard policies are being triggered, so no capacity for safeguards is required.

C. Environmental and Social Safeguards Specialists on the Team

Martin Henry Lenihan, Social Safeguards Specialist
Thiri Aung, Environmental Safeguards Specialist

D. Policies that might apply

Safeguard Policies	Triggered?	Explanation (Optional)
Environmental Assessment OP/BP 4.01	No	The proposed project will support technical assistance and institutional strengthening activities in the areas related to public financial management in the country. There are no civil works or construction activities included in the project. Based on environmental screening, the project is not anticipated to have any environmental safeguard issues. No environmental assessment instrument needs to be prepared.
Performance Standards for Private Sector Activities OP/BP 4.03	No	There will be no private sector involvement and the project does not entail use of WB PS.
Natural Habitats OP/BP 4.04	No	Project is unlikely to affect natural habitats.
Forests OP/BP 4.36	No	Project is unlikely to affect forests.
Pest Management OP 4.09	No	Project does not entail pest management.
Physical Cultural Resources OP/BP 4.11	No	Project is unlikely to affect physical cultural resources.
Indigenous Peoples OP/BP 4.10	No	This Project will not affect indigenous people.
Involuntary Resettlement OP/BP 4.12	No	Project will not finance civil works that might result in involuntary resettlement.

Safety of Dams OP/BP 4.37	No	Project does not entail dams.
Projects on International Waterways OP/BP 7.50	No	Project is unlikely to affect international waterways.
Projects in Disputed Areas OP/BP 7.60	No	Project is not in dispute area.

E. Safeguard Preparation Plan

Tentative target date for preparing the Appraisal Stage PID/ISDS

Jan 10, 2019

Time frame for launching and completing the safeguard-related studies that may be needed. The specific studies and their timing should be specified in the Appraisal Stage PID/ISDS

As this Project is rated Category C, no safeguard related studies are required.

CONTACT POINT

World Bank

Fanny Weiner, Saysanith Vongviengkham
Sr Public Sector Mgmt. Spec.

Borrower/Client/Recipient

Government of Lao PDR

Implementing Agencies

Ministry of Finance of Lao PDR
Dr. Bounleua Sinxayvoravong
Director General, Fiscal Policy and Law Department
laospfm@gmail.com

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: http://www.worldbank.org/projects

APPROVAL

Task Team Leader(s):	Fanny Weiner, Saysanith Vongviengkham

Approved By

Practice Manager/Manager:	Fily Sissoko	04-Sep-2018
Country Director:	Nicola Pontara	06-Sep-2018