



Project Information Document/ Identification/Concept Stage (PID)

Concept Stage | Date Prepared/Updated: 04-Sep-2018 | Report No: PIDC159700



BASIC INFORMATION

A. Basic Project Data

Project ID	Parent Project ID (if any)	Environmental Assessment Category	Project Name
		C - Not Required (C)	Lao PDR Public Finance Management Reform Grant
Region	Country	Date PID Prepared	Estimated Date of Approval
EAST ASIA AND PACIFIC	Lao People's Democratic Republic	04-Sep-2018	
Financing Instrument	Borrower(s)	Implementing Agency	Initiation Note Review Decision
Investment Project Financing	Ministry of Finance of Lao PDR	Ministry of Finance of Lao PDR	The review did authorize the preparation to continue

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PROJECT FINANCING DATA (US\$, Millions)

SUMMARY

Total Project Cost	1.79
Total Financing	1.79
Financing Gap	0.00

DETAILS

Non-World Bank Group Financing

Trust Funds	1.79
Free-standing Single Purpose Trust Fund	1.79

B. Introduction and Context

Country Context

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.

[1] In the March 2018 review, the country met the thresholds for GNI per 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.

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.[1] 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.

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

Fiscal pressures and government effectiveness have been affecting the 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.

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[1] 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).

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

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 (SDGs). Achieving these goals will require an efficient and effective public financial management (PFM) system and public sector.

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Sectoral and Institutional Context

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 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.[1]

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

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 legislation is not yet being implemented. Some of the laws include contradictions, have a limited scope or loopholes, and secondary legislation 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.

Revenue collection has declined in the past years (mainly due to decrease in mining royalties) and Lao PDR's revenue/GDP ratio is currently at 15.1 percent. There is significant scope to improve domestic revenues through tax administration and policy reforms. Income tax collection is especially low, mainly due to generous exemptions to new businesses, listed companies, and businesses in special zones. However, paying taxes is a lengthy cumbersome process, resulting in Lao PDR being ranked 156 (out of 190 economies) on the 2018 Doing Business 'Paying Taxes' Indicator.

Taking initial steps to follow international practice, the Tax Department has established a Revenue Collection Division (RCD) for large business tax compliance management. The RCD is housed in the Tax Administration's headquarters and currently administers 559 businesses. The large taxpayers (LTs) overseen by the RCD currently contribute about 40 percent of total tax revenues, which is relatively low ratio by international standards. This indicates that through more targeted and improved compliance monitoring, the tax collection of this segment could be increased. However, compliance management is focused on retroactive, often desk-based, audit and enforcement, and sector-specific knowledge and analytical capacity by tax officials has so far been limited to the mining and hydropower sectors.

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.

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.

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

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.

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.

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.

With the passing of a public procurement law by the National Assembly in November 2017, the GoL has embarked on creating a more robust procurement regulatory and legal framework. Since 2004, public procurement has been governed by a Prime Minister's decree and was overseen by the Procurement



Monitoring Office (PrMO) in MoF. Due to weak capacity and understaffing of the PrMO, no systematic policy update or institutionalized capacity building has been undertaken. The complaints handling mechanism remains weak with few complaints registered and no organized institutional setup to handle them. The weak adherence to the decree also led to a number of contracts from unsolicited proposals, especially in the construction sector, which resulted in arrears. While pockets of good procurement practices have developed within some line ministries (for example, in the Ministry of Health), overall government procurement capacity remains low. Implementing regulation for the new law has been prepared, and after capacity building during 2019, the new procurement framework is expected to be adopted in FY2020. The new legal and regulatory framework also envisages the creation of a procurement department within the MoF, responsible for updating policies and procedures and providing oversight during implementation.

Weaknesses in 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 has room for improvement. At 7 percent of GDP in 2017 and above 5 percent of the total population, both wage bill spending and the number of staff employed in the public sector are high compared to peer countries. At the same time, human resource management in the Government of Lao PDR (GoL) is weakened by low transparency in the recruitment process, absence of job descriptions and profiles, and compensation based on education and qualifications rather than on the job content. In addition, technical and managerial positions are not linked to job profiles nor require specific technical qualifications and most training and capacity building happens on the job. However, frequent staff rotations result in knowledge drain and continuous need for training new staff.

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

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 SDGs, 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 two Green Resilient Growth Development Program Operations



(P159956 and P166839) had prior actions and triggers on tax administration, and PFM has been streamlined into sector activities, such as the Health Sector Programmatic ASA (P164585).

Learning from past experience, the proposed project will address specific PFM challenges and complement other World Bank and development partners' efforts to improve the 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. Project Development Objective(s)

Proposed Development Objective(s)

The development objective is to support the Government of Lao PDR to improve the legal and institutional framework for public finance management, revenue management, and public procurement.

Key Results

The centralized large taxpayer unit collects at least 65 percent of all tax revenues (currently 40 percent);

Budget preparation documents according to the revised 2015 Budget Law and a Budget and Policy Statement have been used for the preparation of the Budget FY 2021;

Percentage of contracts (by Value) procured through competitive processes.

D. Preliminary Description

Activities/Components

The activities under each component are aligned with the action plans and sub-strategies of the MoF's PFM Strategy and have been agreed with the government counterparts and the donor.

Component 1: Improved domestic revenue mobilization. This component has two subcomponents to support the strengthening of the legal framework and improve tax administration processes, focusing on the LT segment.

Subcomponent 1.1: (i) Development of tax policies; (ii) drafting of tax legislation and secondary legislation; and (iii) consultations, dissemination, training, and outreach activities to relevant stakeholders. The MoF's PFM Strategy foresees the drafting of new and updated legislation for a number of laws, including the general tax law, asset tax, land tax, income tax, housing tax, and environment tax law. This subcomponent will provide support to strengthen the MoF's capacity through local expertise for the drafting of the legislative initiatives and undertake consultations, dissemination, and training with the relevant stakeholders.



These legislative initiatives will contribute to strengthen the current legal framework for taxation and to build a foundation for increasing revenue collection

Subcomponent 1.2: Improvement of the Tax Department's organizational and administrative processes, including communication activities and services to tax payers with a specific focus on the large taxpayer segment. Activities in strengthening tax compliance are focused on the LT segment and will enable the Tax Department's RCD to introduce a proactive and targeted compliance management, building on systematic, correct, and up-to-date taxpayer data; an improved audit approach; enhanced LT's industry expertise; and the introduction of taxpayer outreach and services. Specifically, this subcomponent will provide support to strengthen the capacity of the Tax Department through local expertise to support the implementation of a proactive compliance management approach and carry out training and capacity workshops and stakeholder dissemination events. These activities are expected to increase the share of tax revenues collected from the LT segment.

Component 2: Improving the legal and institutional framework of PFM and public sector governance.

Subcomponent 2.1: Improvement of budget preparation and execution processes. Activities under this subcomponent will support the Budget Department to organize capacity-building and dissemination events and hire local consultants for activities to prepare the State Budget for FY2020 in accordance with the requirements of the revised State Budget Law 2015. The preparation of a summary budget and dissemination of budget information will also be supported aiming to contribute to budget transparency and availability of budget information on time. The activities under this subcomponent are expected to contribute to more affordable and realistic budget plans, limit unaffordable commitments, and ultimately improve the achievement of sector performance targets.

This subcomponent will also support the NT in strengthening its capacity for the implementation of reforms to improve payment processes, cash management, and forecasting capacity. This will include to carry out workshops and trainings for the revision of the CoA, and improving cash balance consolidation. These activities are expected to result in faster and more secure payments, reduce costs, allow for reporting according to IPSAS and International Monetary Fund (IMF) Government Finance Statistics (GFS), and reduce out-of-budget spending.

Finally, this subcomponent will include activities supporting the readiness for a new FMIS (to be financed by the Public Finance Management Modernization Project [P167534]), such as the improvement of the MoF's overall ICT capacity and security, through training activities for the implementation of elements of the MoF's ICT Strategy, which are relevant for the FMIS implementation.

Subcomponent 2.2: Strengthening governance capacity in the Ministry of Home Affairs (MoHA). This subcomponent builds on work previously undertaken under the Governance Programmatic ASA for SEA Lower Middle Income Countries (P161155), which provided recommendations to the MoHA for the rollout of its Personnel Information Management System (PIMS) to the provincial level. While the technical rollout to all provincial departments of the MoHA has been completed, capacity building in the use of the PIMS for staff from the provincial departments of line ministries will be supported. Once the PIMS database is completed



with provincial personnel data, automated payroll calculations and payment will be expanded to the subnational level. The expanded scope of the PIMS and automatization of the payroll process is expected to eliminate manual processes and speed up salary payments. This subcomponent will also provide support to the MoHA on capacity-building and dissemination activities on topics related to potential civil service reforms.

Component 3: Strengthened public procurement. This component aims to strengthen the MoF's implementation capacity for the new Public Procurement Law and to provide training to all relevant stakeholders.

Subcomponent 3.1: The implementation of the Law, including the preparation of manuals and guidelines, the introduction of a training program for procurement staff of all procurement units, and strengthening of the procurement monitoring function. This subcomponent will support the MoF in the adoption of the new procurement framework through the dissemination of the new law among public and private stakeholders and by strengthening PrMO's capacity through local expertise to support the update of standard bidding documents and the preparation of guidelines and manuals. These activities will set the foundations for the operationalization of the law.

This subcomponent will also support the setup of a staff training program and other capacity-building activities to strengthen the competency and skills of staff involved in procurement at all levels of government. To enhance the monitoring functions, the designated procurement department in the MoF (PrMO) will be strengthened, and capacity building will be provided to the State Audit Organization (SAO) to conduct procurement audits. This subcomponent will also provide for local expertise to support a spending analysis that will collect, classify, and analyze procurement expenditure to identify areas where new approaches, such as framework agreements, may be implemented to reduce costs of goods and services and transaction costs. These activities are expected to build the necessary capacity for the implementation of the law and provide input for informed decision making of public procurement approaches.

Subcomponent 3.2: Establishment of an accessible public procurement website and an operational complaint mechanism. This subcomponent will support the establishment of a procurement portal (website) for the publication of procurement information and the introduction of a procurement complaints mechanism. The website is expected to increase the transparency and accessibility of information of public tender opportunities.

Component 4: Effective PFM reform coordination

Subcomponent 4.1: Implementation of the Government of Lao PDR's Public Financial Management Reform, including the establishment of a monitoring and evaluation (M&E) system, data collection and consolidation, preparation of progress reports, and coordination and dissemination activities, and the preparation and implementation of a change management strategy. This subcomponent will provide support to the establishment of an M&E system, including data collection and consolidation, the preparation of reform progress reports, and coordination and dissemination activities of the MoF's PFM Strategy. Coordination between relevant government entities and other stakeholders is also foreseen under this subcomponent.



This subcomponent will support the MoF to implement a change management strategy to accompany the implementation of the PFM Strategy and to communicate and facilitate the impact of the PFM reform transformations to the MoF staff.

Subcomponent 4.2: Preparation and dissemination of Public Expenditure and Financial Accountability (PEFA) Assessments. This subcomponent will include the finalization and dissemination of the PEFA Assessment 2018 and the local expertise for the preparation of a repeater PEFA Assessment in 2021. It is envisaged to use the PEFA 2018 assessment as the baseline for the repeater assessment to measure progress of the PFM reforms.

Subcomponent 4.3: Management of the implementation activities and fiduciary oversight of the recipient executed activities by a Project Implementation Unit. This subcomponent will provide support to the operational costs of the MoF's Project Implementation Unit (PIU).

Subcomponent 4.1: Implementation of the Government of Lao PDR's Public Financial Management Reform, including the establishment of a monitoring and evaluation (M&E) system, data collection and consolidation, preparation of progress reports, and coordination and dissemination activities, and the preparation and implementation of a change management strategy. This subcomponent will provide support to hire local consultants to support the establishment of an M&E system, including data collection and consolidation, the preparation of reform progress reports, and coordination and dissemination activities of the MoF's PFM Strategy. Coordination between relevant government entities and other stakeholders is also foreseen under this subcomponent. This subcomponent will support the MoF to carry out training and dissemination activities to implement a change management strategy to accompany the implementation of the PFM Strategy and to communicate and facilitate the impact of the PFM reform transformations to the MoF staff.

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SAFEGUARDS

E. Safeguard Policies that Might Apply



Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01		X	
Natural Habitats OP/BP 4.04		X	
Forests OP/BP 4.36		X	
Pest Management OP 4.09		X	
Physical Cultural Resources OP/BP 4.11		X	
Indigenous Peoples OP/BP 4.10		X	
Involuntary Resettlement OP/BP 4.12		X	
Safety of Dams OP/BP 4.37		X	
Projects on International Waterways OP/BP 7.50		X	
Projects in Disputed Areas OP/BP 7.60		X	

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Borrower/Client/Recipient

Borrower : Ministry of Finance of Lao PDR

Implementing Agencies

Implementing Agency :	Ministry of Finance of Lao PDR		
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