INCLUSIVE AND SUSTAINABLE GROWTH ASSESSMENT

I. RECENT GROWTH, POVERTY, INEQUALITY, AND ENVIRONMENTAL DYNAMICS

A. Economic Growth and Structural Transformation

1. Economic Growth

1. **Strong economic growth.** The Lao People’s Democratic Republic (Lao PDR) experienced impressive growth during 1986–2015. Gross domestic product (GDP) growth increased from an annual average of 5.7% in 1986–2000 to 7.6% during 2010–2016 (Figure 1).\(^1\) Despite the high overall growth rate, the country has not successfully shifted resources from low- to high-productivity sectors. Most of the labor force continues to engage in low-productivity agriculture, while nonfarm employment, particularly in high value-added sectors, remains quite limited. While the contribution of industry toward GDP growth has increased substantially during 2005–2015, it has become dominated by the resource sector, and the industry sector’s contribution to employment has declined during 2001–2012. In addition, high economic growth has not attracted enough private investment to expand employment in other sectors. This poses a threat to inclusive growth in the long run. While GDP growth averaged 7.6% during 2010–2016, the challenges ahead are to (i) maintain the momentum of high economic growth, (ii) attract more private investment, and (iii) provide decent employment opportunities in the more productive industry and services sectors.

2. **Drivers of economic growth.** High and sustained economic growth has led to steady increases in income, with GDP per capita growing from $483 in 2005 to $2,027 in 2016. The main drivers of growth have been the industry and services sectors. Starting in 1986, the government introduced various structural and market-oriented reforms under the New Economic Mechanism.\(^2\) These reforms created favorable conditions for the growth of industry (initially in manufacturing), particularly textiles and garments,\(^3\) and from 2000 onward in resource-based sectors.\(^4\) Industry’s contribution to GDP growth surged from 26.0% during 1986–2000 to 37.6% during 2000–2005 (Figure 1). It rose further to 47.0% during 2005–2010 and reached 52.1% during 2010–2016. Overall, during 2000–2016 industry contributed 46.0% to the growth in GDP. At the same time, the share of resource-based sectors in industrial value added increased from 25.4% in 2000 to 54.1% by 2015. The contribution of services toward economic growth during 1986–2000 was 37.1%, which rose to 39.1% during 2000–2005. During 2005–2010 it remained around 36.2%. Overall, during the high-growth period (2000–2016), the contribution of services to GDP growth averaged 37.0%. Within services subsectors, the growth rate of wholesale and retail trading, public services, and transport and communications have remained particularly strong during 2010–2016. The contribution of agriculture to GDP growth declined substantially from 1986 to 2015. During 1986–2000, its contribution was 37.0%; however, it contributed about 23.4% during 2000–2005, 16.8% during 2005–2010, and 10.4% during 2010–2016 (Figure 1). For agriculture,

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2. The Lao PDR embarked on an economic reform called the New Economic Mechanism in November 1986. The aims were the rapid transition of its socialist control economy and the transition from an autarchic economy to a market economy.
4. Comprising mining and electricity production.
the average contribution for the 2000–2016 high-growth period as a whole fell to 17.0%. As agriculture still provides employment to most of the labor force, inclusive growth will require increased agricultural productivity as well as diversification to the industry and services sectors.

3. **External sector.** The external sector remains weak and vulnerable. Exports mostly comprise less diversified products. The growth in exports has not kept pace with rising imports. The current account has been in large deficit since 2012 due to an appreciation in the real exchange rate, lower commodity prices, and large inflows of foreign direct investment requiring substantial imports. Although increasing to some extent, gross international reserves have remained low, equal to just 1.9 months of imports as of December 2016. This is not adequate to maintain macroeconomic stability, and provides little security against external demand shocks (Table 1). The public and publicly guaranteed debt stock increased from $4.3 billion in 2012 to $6.5 billion in 2015. The International Monetary Fund 2016 debt sustainability analysis issued in February 2017 reclassified the Lao PDR’s external debt distress from moderate to high risk. The government must strengthen its debt management capacity to ensure that external borrowing and debt do not jeopardize debt sustainability.

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016a</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exports (FOB) ($ million)</strong></td>
<td>3,323</td>
<td>3,883</td>
<td>4,687</td>
<td>4,387</td>
<td>4,804</td>
</tr>
<tr>
<td><strong>Imports (CIF) ($ million)</strong></td>
<td>6,382</td>
<td>7,352</td>
<td>8,017</td>
<td>7,535</td>
<td>7,684</td>
</tr>
<tr>
<td><strong>Current account balance ($ million)</strong></td>
<td>(2,808)</td>
<td>(3,195)</td>
<td>(2,450)</td>
<td>(2,116)</td>
<td>(2,351)</td>
</tr>
<tr>
<td>(% of GDP)</td>
<td>(29.9)</td>
<td>(29.6)</td>
<td>(20.7)</td>
<td>(16.8)</td>
<td>(14.1)</td>
</tr>
<tr>
<td><strong>External PPG debt ($ million)b</strong></td>
<td>4,262</td>
<td>5,489</td>
<td>6,061</td>
<td>6,495</td>
<td>7,422</td>
</tr>
</tbody>
</table>

5 International Monetary Fund. 2017. *Lao People’s Democratic Republic Staff Report for the 2016 Article IV Consultation-Debt Sustainability Analysis.* Washington, DC.
2. Structural Transformation

4. The Lao PDR has not successfully shifted labor from agriculture to the industry and services sectors. An examination of successful economies in Asia suggests that their structural transformation had three main characteristics: (i) resources moved from primary sectors to industry; (ii) the outputs of these successful economies shifted from low-productivity to high-value-added goods, particularly in manufacturing; and (iii) with diversified baskets, their exports comprised increasingly higher-value-added products. The Lao PDR has not been wholly successful in transferring resources towards high-value-added sectors. Although agriculture’s proportion of total output has declined, as of 2012 it still accounted for 73.1% of employment; industry only accounted for 6.1% and services 20.6%. While the services sector’s share of total employment increased from 2001 to 2012, the industry sector’s share fell by a small amount during the same period (Table 2).

Table 2: Composition of Output and Employment, 1980–2015

<table>
<thead>
<tr>
<th>Sector</th>
<th>Lao PDR</th>
<th>PRC</th>
<th>ROK</th>
<th>Malaysia</th>
<th>Thailand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output Structure</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(% of GDP)</td>
<td>45.3</td>
<td>50.9</td>
<td>51.1</td>
<td>51.7</td>
<td>54.1</td>
</tr>
<tr>
<td>Gross international reserves ($ million)</td>
<td>740</td>
<td>662</td>
<td>816</td>
<td>987</td>
<td>1,476</td>
</tr>
<tr>
<td>(months of imports)</td>
<td>1.1</td>
<td>0.9</td>
<td>1.2</td>
<td>1.5</td>
<td>1.9</td>
</tr>
</tbody>
</table>

(1) = negative, CIF = cost insurance and freight, FOB = free on board, GDP = gross domestic product, PPG = public and publicly guaranteed.

4. The Lao PDR has not successfully shifted labor from agriculture to the industry and services sectors. An examination of successful economies in Asia suggests that their structural transformation had three main characteristics: (i) resources moved from primary sectors to industry; (ii) the outputs of these successful economies shifted from low-productivity to high-value-added goods, particularly in manufacturing; and (iii) with diversified baskets, their exports comprised increasingly higher-value-added products. The Lao PDR has not been wholly successful in transferring resources towards high-value-added sectors. Although agriculture’s proportion of total output has declined, as of 2012 it still accounted for 73.1% of employment; industry only accounted for 6.1% and services 20.6%. While the services sector’s share of total employment increased from 2001 to 2012, the industry sector’s share fell by a small amount during the same period (Table 2).

5. The government needs to overcome significant challenges to make growth more inclusive for the 6.5 million population. While resource-based sectors will continue to play a major role in
the economy, diversification requires more emphasis on improving the business environment and facilitating private investment.

6. In its Eighth National Socio-Economic Development Plan (NSEDP), 2016–2020, the Lao PDR targets GDP growth of 7.2% per annum, necessary for graduation from least-developed country status by 2020. While growth performance in 2016 and 2017 shows that the country can achieve this target, sustaining high and inclusive growth depends on Lao PDR’s ability to find new drivers of growth and to shift resources from low- to high-productivity sectors. External demand is one of the key variables in determining and sustaining high growth. Identifying supply-side bottlenecks in the production of exports is crucial to enhancing export quantity and quality. Similarly, to maintain macroeconomic stability and mitigate potential external demand shocks, the government needs to improve public financial and debt management.

B. Progress and Challenges toward Inclusive Growth

7. Inclusiveness relates to geographical differences and disparities in poverty, gender, age, education, and income. Inclusive growth implies growth with equal opportunities and focuses on creating employment opportunities that are accessible to all. Growth is inclusive when it allows all members of a society to participate in, and contribute to, the growth process on an equal footing. While the Lao PDR achieved its Millennium Development Goal (MDG) targets for poverty reduction, universal access and gender parity in primary education, and maternal mortality reduction, some targets such as child nutrition and primary school completion remain unmet.

1. Poverty and Inequality

8. Growth and poverty reduction. High economic growth has helped increase per capita income and reduce poverty rapidly. Poverty incidence, using the national poverty line, declined from 39.1% in 1998 to 23.2% in 2013. Using the World Bank’s poverty line of $3.10 per day in 2011 purchasing power parity, poverty incidence declined from 67.9% in 1998 to 46.9% in 2013 but remains high (Figure 2).

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9. **Poverty incidence and inequality.** Income inequality has widened despite a reduction in poverty. While urban areas close to the Thailand border have lower poverty, it is much higher in some of the northern and southern parts of the country. For example, in 2013 the poverty incidence in Vientiane was only 5.9%, but in northern Bokeo and Houaphanh provinces it ranged from 39%–44%. In the south, Saravane Province’s poverty incidence was nearly 50% and Sekong Province’s 42%. Poverty incidence also varies significantly across ethnic lines. In some of the north, central, and southern regions—where most ethnic groups reside—the poverty incidence is more than 40% compared to less than 20% among the Lao-Tai majority.

10. During 1993–2013 the Lao PDR’s Gini coefficient increased from 0.31 to 0.36. Such an increase in inequality undermines poverty reduction.\(^8\) Inequality increased in rural and urban areas across all regions, but mostly in Vientiane and other urban areas (Table 3). Rising inequality alongside poverty reduction implies the better-off have benefited more in both absolute and relative terms.

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\(^8\) P. Warr, S. Rasphone, and J. Menon. 2015. Two Decades of Rising Inequality and Declining Poverty in the Lao People’s Democratic Republic. *ADB Economics Working Paper Series*. No. 461. Manila: ADB. Increased inequality reduced the amount of poverty reduction during 1993–2013 by around 6% of the population, compared with what would have occurred if inequality had not risen.
11. **Malnutrition.** High poverty in remote rural and ethnic areas carries negative implications for malnutrition. The incidence of child malnutrition is much higher in upland and rural areas and especially among non-Lao-Tai ethnic groups. Infectious diseases, poor water and sanitation facilities, food insecurity, and poor maternal health impair young children’s cognitive and physical development. About 44% of children under 5 years of age suffer from stunting (low height-for-age), 6% suffer from wasting (low weight-for-height), and 27% are underweight. In upland areas where mothers lack education, child stunting can reach 60%. The Global Hunger Index in 2016 showed 18.5% of the population was undernourished, reflecting the country’s failure to achieve the MDG of reducing underweight and stunted children. More effort is needed to achieve the MDG of reducing under-5 mortality and infant mortality to one-third of 1990 levels.

12. **Diseases.** The Global AIDS Response Progress Lao PDR Country Progress Report 2014 showed some progress in addressing tuberculosis and HIV. From 2010 to 2012, the proportion of affected people receiving treatment for tuberculosis and HIV increased from 49.2% to 56.0%. However, the findings of the First National Tuberculosis Prevalence Survey 2010–2011 indicated that the prevalence rate was still high at 130 per 100,000, with the greatest burden in the older population. The Lao PDR is also facing difficulties dealing with a rise in noncommunicable diseases, which accounted for 48.1% of total deaths in 2012.

2. **Gender Inequality**

13. Women’s status is improving in the Lao PDR, especially in urban areas. However, significant gender inequalities remain along rural-urban lines, in certain geographic areas, and among ethnic groups. Key concerns are low quality of education and gender disparity in secondary and tertiary education; still high maternal mortality rates; and limited access to training, employment, affordable finance and opportunities for economic advancement.

14. **Education.** There has been an improvement toward gender parity, especially in primary enrollment rates. However, disparities persist at higher education levels, with girls finding it increasingly difficult to complete secondary school. Women’s educational attainment and literacy

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13 Noncommunicable diseases include cancer, diabetes mellitus, cardiovascular diseases, digestive diseases, skin diseases, musculoskeletal diseases, and congenital anomalies.

is lower than men's. For the employed labor force who completed primary education, women constitute 61.6%; for those who did not complete primary education, the proportion of women is 51.1%. However, the share of women in the employed labor force with secondary education is only 42.9%, with technical training only 39.3%, and with college- and university-level education only 35.6%. Since men are better educated, they get higher-paying jobs, while women have generally been absorbed in lower-paying, informal jobs.\(^{15}\)

15. **Access to health facilities.** Access to health service facilities is limited both for men and women. Among women in the Lao PDR, 45% report a lack of money is a major constraint to accessing medical treatment and 13% mention language and communication are the major obstacles.\(^{16}\) Quality and accessibility varies widely between rural and urban areas, with urban areas better off.

16. Lack of trained health workers is a concern for gender equality. In 2012, only 42% of births were assisted by trained health workers, and the facility-based delivery rate was only 38%. Women in the poorest quintile were among the most deprived, with only 11% of their births assisted by trained health personnel. The maternal mortality ratio was still around 197 per 100,000 in 2015. Women in urban areas have greater access to antenatal care (ANC). Access to roads is another determinant of access to ANC access.

17. **Social protection.** Based on the findings of an ongoing ADB study, Lao PDR's social protection indicator increased from 0.60% per capita GDP in 2012 to 0.76% in 2015. While still relatively low, the trend indicates that social protection for target beneficiaries is improving, particularly for women and children, but the rural poor, unemployed, and elderly need more support. The coverage of social protection programs shows that only 33.5% of the target beneficiaries received a form of social protection in 2015. Although the overarching goal of the government is to expand social protection coverage to the entire population, the organizational structure and capacity of social protection are inadequate to carry out this initiative.

18. **Economic empowerment.** The women’s labor force participation rate in the Lao PDR (76.3%) is almost equal to the men’s (79.3%). However, a high proportion of women are in vulnerable employment, e.g., they are self-employed or engaged in unpaid family work. The share of female wage and salaried workers is low at only 10.9%, compared to 20.4% for men, while the share of female unpaid family workers and own-account workers is 88.9% compared to 78.9% for men (footnote 14). Gender disparity is higher in management and administrative positions than in technical positions. Gender disparity also exists in job security, type of work, and working conditions, undermining inclusive and sustainable growth. However, the Lao PDR has one of the region’s highest proportions of women in parliament, with women comprising 27.5% of National Assembly members,\(^{17}\) although women ministers and deputy ministers account for only 11% of the total.\(^{18}\)

3. **Environment and Climate Change**

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\(^{17}\) Following National Assembly elections in March 2016.

19. Major causes of environmental degradation include unsustainable use of natural resources, weak land use planning, population growth, disasters triggered by natural hazards, weak legal and policy frameworks, and limited human resources and management capacity. A constraining factor in agricultural production is the declining quality of natural resources (water, land, forest, and biodiversity). For upland provinces where agriculture is the only means of livelihood, attention must be paid to watershed conservation, including a combination of improved land use management and agricultural practices. Depletion of natural capital, loss of ecosystem services, and climate change can put sustainable economic growth at risk. The existing land management system does not provide adequate tenure security, hindering investments in natural capital and weakening resettlement and indigenous peoples safeguards. Many government officials lack the capacity to manage large-scale foreign direct investment-driven development, particularly monitoring and enforcement of land use agreements. This negatively affects environmental and social outcomes. Urban infrastructure is insufficient to address key environmental concerns, such as waste management and pollution control.

20. **Deforestation.** Since the 1990s, deforestation has become a major concern for the sustainability of inclusive growth. During 2000–2012, the Lao PDR lost much of its forest area. The national deforestation rate is estimated at 0.71% per year, but for some provinces it exceeds 1%.\(^\text{19}\) Reliance on hydropower and mining exports, increased commercial exploitation of forests, rising demand for timber, and the growing population all contribute to deforestation, which adversely affects the poor. Deforestation, together with unsustainable agricultural practices and pollution, degrades watersheds and critically stresses aquatic ecosystems, resulting in lower agricultural production, higher food costs, and health risks.

21. **Climate change and disaster risk.** High dependence on resource-based sectors and low adaptive capacity make the Lao PDR highly vulnerable to climate change. Rising temperatures have increased the frequency of flooding and droughts that adversely impact production and increase the risk of food insecurity, particularly for populations solely dependent on natural resource-based livelihood systems. Climate impacts have made the lives of rural people more food insecure. Moreover, northern parts of the country are at risk from earthquakes. Managing disaster risks, including floods and droughts, has become an essential part of economic and social governance.

4. **Regional Cooperation and Integration**

22. The Lao PDR is at the center of the Greater Mekong Subregion (GMS). While it lacks direct access to the sea, it is the only country bordering five GMS countries. Its strategic location enables the Lao PDR to become a critical transit country for trade within the Mekong region and between the Mekong region and the Association of Southeast Asian Nations (ASEAN) region, East Asia, and beyond. The trade share with the other five GMS countries grew during 2005–2015 from 57.4% to 83.7% for exports, and 83.0% to 89.9% for imports.

23. GMS transport corridors are being transformed into economic corridors through trade and transport facilitation, corridor towns development, tourism development, and investment and enterprise promotion. This transformation is supporting the expansion of small and medium-sized enterprises and agriculture, including integration into regional supply chains and production networks. Challenges are to ensure that (i) benefits accrue proportionately to the country, (ii) the transformation goes beyond simply serving a transit function, and (iii) there is protection from

negative externalities from increased cross-border mobility of people and goods. In addition to hard infrastructure network development such as in roads and energy, the GMS Program promotes (i) regional health security, including communicable diseases prevention, diagnostics, and control among vulnerable groups in border areas and along economic corridors; (ii) climate-friendly value chains development; (iii) trade facilitation for agri-food products; and (iv) development of biodiversity conservation corridors and watershed management.

24. The GMS is a key building block of the ASEAN Economic Community established in 2015. To maximize benefits from the ASEAN Economic Community, the Lao PDR needs to strengthen policies for (i) investing in infrastructure to boost productivity, (ii) improving access to and relevance of education and training, (iii) promoting decent employment opportunities and better wages, and (iv) strengthening social protection systems. Currently, the Lao PDR’s utilization of preferential tariff rates is low, and domestic financial markets have limited linkages with other ASEAN countries.

II. KEY IMPEDIMENTS TO INCLUSIVE AND SUSTAINABLE GROWTH

25. Growth not inclusive. Growth has mainly been driven by resource-based sectors and has left the economy with a highly concentrated production and export structure mostly comprised of less diversified and low-value products. Although industry and services have become the major drivers of growth, their contribution to job creation remains limited. These structural weaknesses make it difficult to speed up transformation for sustainable and inclusive growth.

26. Constraints to producing more diversified products. Structural transformation involves producing and exporting more diversified and higher value-added products. The Lao PDR, however, has a highly concentrated export basket and has not yet experienced a successful structural transformation. Major constraints include the following: (i) infrastructure gaps, (ii) inefficient governance and public management, and (iii) limited human capital and quality of education.

27. Highly concentrated production and export structure. The Lao PDR has not seen significant improvement in the number of export products with revealed comparative advantage (RCA).\(^{20}\) It had 62 commodities with RCA larger than 1 in 1980, 39 in 1990, and 60 in 2014. If exports are classified into core (high productivity products with strong linkages) and noncore products (low productivity products with weak linkages), the country has fewer core products than some other selected countries (Figure 3).\(^{21}\) Although the Lao PDR has acquired some complex capabilities and is exporting a few diversified products, the capabilities used in producing core products cannot easily be transferred to the production of other products.

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\(^{20}\) B. Balassa. 1965. Trade Liberalization and “Revealed” Comparative Advantage. The Manchester School of Economic and Social Studies, 33 (2), pp. 99–123. The index of RCA is the ratio of the export share of a given product in the country’s export basket to the same share at the worldwide level.

\(^{21}\) The core products are high value-added products with strong linkages with other products; investment in these products has higher spillover impacts for the rest of the economy.
Empirical evidence suggests that what a country exports matters for its future economic growth. A country’s development path is determined by its capacity to accumulate the capabilities required to produce varied and higher value-added goods. Measures of complexity include the economic complexity index (ECI) and product complexity index (PCI). These indices summarize, on average, how complex the product mix made by a country is. Countries with a high ECI value produce a wide range of relatively complex products. The Lao PDR has not seen an increase in the level of its economic complexity. The value of ECI indicates the country has not been successful in transforming its productive structure toward high value-added products (Figure 4). Diversification of the economy from an overreliance on resource sectors is needed to achieve (i) robust growth to be eligible to graduate from its least-developed country status by 2020, as targeted in the NSEDP, 2016–2020; and (ii) sustainable and inclusive growth beyond 2020s.

23 Complexity is associated with the set of capabilities required by a product or with the set of capabilities that are available to an economy. The ECI (i) measures how diversified and complex a country’s export basket is, and (ii) ranks countries according to their level of complexity. When a country produces complex goods in addition to a high number of products, it is typically more economically developed or can be expected to experience fast economic growth in the near future. The construction of the measures of complexity uses information on (i) the number of products exported with RCA ≥ 1, and (ii) the number of countries exporting a particular product with RCA ≥ 1. The PCI measure is used and explained further in para. 43 and footnote 37.
29. Private sector decisions to invest depend on the macroeconomic environment, government incentives, and perceptions of government policy. Obstacles such as information spillovers and coordination failures prevent entrepreneurs from investing in new and high value-added products. The Government of the Lao PDR needs to further improve governance and the business-enabling environment to attract foreign and domestic private investment.

30. **Infrastructure gaps.** Quality infrastructure is crucial for economic development and reducing poverty and inequality. Productive rural infrastructure is essential not only for improving rural economic development and agriculture productivity, but also for reducing poverty and hunger. Infrastructure in the Lao PDR, particularly land transportation and electricity, is not sufficient to achieve inclusive and sustainable growth. The Global Competitiveness Report, 2016–2017 shows the fifth highest problematic factor for doing business in the Lao PDR is inadequate supply of infrastructure. The World Bank’s logistics performance index ranked the Lao PDR 152nd out of 160 countries in 2016.

31. The road network expanded significantly from 14,000 kilometers in 1990 to 58,885 kilometers in 2016. Of the national roads, 56% are paved with bitumen, while 30% of rural areas rely on earth roads that often become impassable during the wet season. While the poor road

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27 World Bank. 2016. *The Logistics Performance Index and Its Indicators*. Washington, DC. The World Bank’s logistics performance index reflects perceptions of a country’s logistics based on efficiency of the customs clearance process, quality of trade- and transport-related infrastructure, ease of arranging competitively priced shipments, quality of logistics services, ability to track and trace consignments, and frequency with which shipments reach the consignee within the scheduled time.
network affects both men and women, the time burden falls heaviest on women who are responsible for more household tasks. Poor transportation constrains women’s and girls’ mobility in rural areas, and prevents them from accessing economic opportunities and social services such as health facilities.

32. In 2012, urban access to electricity was 97.8%, but only 54.7% for rural and upland areas. While there have been improvements in electrification rates, the national grid capacity is insufficient to meet peak period demand. Many poor female-headed households report high connection fees prevent them from accessing electricity.

33. Telecommunications and internet infrastructure needed for the knowledge economy require substantial improvement. There were only 2.1 secure internet servers per 1 million people (footnote 14) and 53.1 mobile phone subscribers per 100 people in 2015 (footnote 26). The country’s ranking for availability of latest technologies is 119 out of 138 countries (footnote 26). The poor quality of internet access makes it difficult to access knowledge and join global production networks.

34. The Lao PDR is experiencing rapid rural–urban migration. The share of the urban population almost doubled during 1995–2015 from 17% to 33%. Only 76% of the population had access to safe water supply in 2015, of which only 28% was piped water supply. The share of the urban population using an improved drinking water source increased from 70% in 1995 to 86% in 2015. In parallel, 95% of urban residents had access to improved sanitation through on-site facilities. While improving, only 71% of the overall population used improved sanitation in 2015. Poor sanitation, inadequate water supply, and insufficient management of solid waste and wastewater result in substantial financial and economic losses to private individuals and also to the public and commercial sectors. There is no sewered sanitation, which raises huge health and environmental concerns. Poor sanitation and hygiene degrades surface and groundwater quality and is a major cause of communicable disease outbreaks.

35. **Inefficient governance and public sector management.** Expansionary fiscal policies since 2013 have put the Lao PDR under increasing fiscal strain, which needs to be carefully managed to ensure that natural endowments are transformed into investments in public infrastructure and social services. Generally, aggregate expenditure control has become more reliable, and deviations between approved budget plans and actual expenditure have declined. In the decentralization process, the allocation of responsibilities and financial resources at the subnational level needs to be improved.

36. The Lao PDR has shown some improvement in the quantity of public services delivery; however, progress in enhancing coverage and quality has been slow. Subnational resource inadequacy impedes the delivery of key education and health services, with health facilities lacking funds for staffing, training, medicines, and maintenance. The poor quality and low coverage of education and health facilities carry negative implications for those living in rural and upland areas, where the population has higher poverty incidence and child malnutrition rates. Inefficient public sector management is a critical constraint to inclusive growth.

37. The Lao PDR ranks 112th out of 138 countries with respect to provision of property rights to citizens, and 95th in improving transparency toward government policy making (footnote 26).

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Out of 190 countries assessed in 2016, the Lao PDR was ranked 160th for ease of starting a business, 165th for protecting investors’ rights, 146th for paying taxes, and 169th for resolving insolvency.\(^\text{31}\)

38. **Limited human capital and quality of education.** The quality of human capital in the Lao PDR is not adequate to support sustained and inclusive growth, and capabilities for a speedy structural transformation are lacking. According to the Global Competitiveness Report 2016–2017, an inadequately educated workforce is the main constraint to doing business (footnote 26). The country’s overall ranking with respect to human capital is 105 out of 130 countries, and 112 for the ease of finding skilled employees.\(^\text{32}\)

39. Most workers in the Lao PDR are poorly educated and lack the skills needed to produce diversified products. Computations based on the Lao PDR expenditure and consumption survey, 2012–2013 show that 44% of the population did not complete primary education.\(^\text{33}\) At the national level, 88% of the overall population did not finish secondary schooling, although this percentage was more than 90% for women and for the population in rural areas. The low level of education, together with the poor quality of human capital, results in low labor productivity (Figure 5).

III. **IMPLICATIONS FOR ADB COUNTRY ENGAGEMENT**

40. ADB should support implementation of the NSEDP, 2016–2020, which has the overall goal of least-developed country graduation eligibility by 2020. The NSEDP has three outcomes: (i) continued, firm, and inclusive economic growth; (ii) human resource development and

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upgraded capacities of the public and private sectors, reduced poverty in all ethnic groups, access to quality education and health services for all ethnic groups and genders, and justice and transparency; and (iii) effectively protected and utilized natural resources and environment according to green-growth and sustainable principles, and readiness to cope with disasters and the effects of climate change. The government aims for full implementation of the NSEDP to complete unfinished MDG targets and deliver early progress on the Sustainable Development Goals.

1. **Sustained Inclusive Economic Growth**

41. The Lao PDR must promote economic diversification to achieve long-term inclusive and sustainable growth. Modernizing the economy will involve diversifying and upgrading exports. A strong and vibrant export sector is the key to sustaining healthy foreign exchange reserves, maintaining macroeconomic stability (particularly in managing external debt), and mitigating external shocks. It is equally important to provide decent employment opportunities outside the agriculture sector.

42. **Enhance agricultural productivity and commercialization.** There is great potential to improve agricultural output and productivity. ADB should support sustainable commercial agricultural business expansion with value-added agro-processing, increased market access for regional and bilateral trade, and an enabling environment for agribusiness development. This will raise productivity and exports, and contribute to income and employment generation.

43. **Structural transformation through investments in high value-added products.** ADB should support the government to develop the non-resource sectors with high value addition. High-potential products that match the Lao PDR’s existing set of capabilities and have high income elasticity and a large world market include textiles and garments (172, 181), food processing (151), basic chemicals (241, 242), and insulated wire and cable (313).

44. **Strengthen urban–rural linkages.** Urban areas are mainly situated within regional economic and transport corridors, which can link rural producers to wider markets. ADB support should help develop value-adding productive and service industries, including agribusiness and tourism; facilitate urban development where agricultural and forestry products are processed; and strengthen urban–rural linkages by improving infrastructure and capacity to allow farmers and micro, small, and medium-sized enterprises (MSMEs) to participate in national and regional value chains. ADB should help expand water supply and sanitation systems; improve capacities for their sustainable operation and management; and promote a private sector enabling environment in the water sector, particularly in rural areas. Tourism projects should contribute to improving urban–rural access infrastructure and environmental services.

45. **Promote micro, small, and medium-sized enterprises and an enabling business environment.** ADB should support the development of MSMEs to generate quality employment, upgrade technology, enhance productivity, and develop forward and backward economic

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34 The figures in parentheses represent International Standard Industrial Classification of All Economic Activities codes.
35 Basic chemicals comprise chemical fertilizers, nitrogen, and organic products such as soap.
36 These high-potential products have been derived by using the PCI, and have higher economic complexity than the average complexity level of the Lao PDR at present. All high-potential products have been grouped into sectors using International Standard Industrial Classification of All Economic Activities codes, and are arranged by their complexity level, their current export value in the Lao PDR’s total exports, and the value of their exports in the world. This helps identify which of the unexploited products offer opportunities for strategic investments and have large market potential.
linkages. Improving the productivity and viability of MSMEs requires enterprise development promotion, access to affordable finance, research and development to drive innovation, and an adequately educated workforce.

46. **Further promotion of regional cooperation and integration.** Trading links between the Lao PDR and its neighbors should be strengthened to support the Lao PDR’s transformation into a regional trade and logistics hub. Trade links can be enhanced through export diversification and cross-border investments, particularly in manufacturing, agriculture, and tourism. Corridor town development, trade and transport facilitation, and special economic zones should support the integration of MSMEs into regional supply chains and production networks.

2. **Human Resource Development and Upgraded Capacities**

47. **Development of industry-relevant skills to create high value-added products.** A lack of adequate skills is a major challenge for workers to find employment in better-paid jobs and for companies to advance productivity and competitiveness, particularly in non-resource sectors. ADB support should help accelerate the shift to the labor-intensive, value-adding industry and service sectors, and provide workers with advanced skills and knowledge. This can be achieved by improving secondary, tertiary, and higher education levels.

48. **Improved and efficient public service delivery.** To reduce inequality and disparity in public service delivery, ADB support should help improve its quality and coverage in rural and upland areas. These include health, education, and water supply and sanitation services, along with improved governance and public financial management.

49. **Gender equity.** ADB’s education projects should support women’s equal access to training in nontraditional fields, and skills alignment with labor market needs. Health sector projects should support poor women and girls from remote ethnic groups to access quality health services. The GMS Program should further support increased access to communicable disease control services for women and vulnerable groups. Infrastructure development should involve women in decision-making and management. Tourism and agriculture support should enhance women’s access to technical skills and business development training, extension and value chain services, affordable finance, and markets.

3. **Effectively Protected and Utilized Natural Resources and Environment**

50. **Sustainable rural and upland development, including watershed conservation.** ADB should help the government sustainably develop rural and upland areas through integrated land use planning and implementation, and support communities to develop feasible land use options that reduce pressure on watersheds. In addition, ADB should support productive rural infrastructure such as irrigation systems to promote agricultural commercialization and forestry in upland areas, including the incorporation of climate resilience.