

LDC Graduation Assessment for Lao PDR

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1. The Lao PDR Graduation Process from the LDC Category

This draft assessment was prepared and coordinated by the Committee for Development Policy (CDP) Secretariat. It is based on inputs from the UN country team in the Lao PDR and summaries of DESA’s Impact Assessment and UNCTAD’s Vulnerability Profile.¹ It benefited from comments from CDP Members, UN entities and partner organizations.²

The CDP is mandated to review every three years the LDC category based on the specific criteria (Gross National Income per capita, Human Assets Index and Economic and Environmental Vulnerability Index) and application procedures the CDP developed for this purpose. The CDP also determines threshold levels on each of the three criteria to identify the countries to be

¹ Within the overall graduation assessment, DESA and UNCTAD prepared their respective chapters which are a synthesis of DESA’s impact assessment and UNCTAD’s vulnerability profile. The UN country team has contributed by providing inputs on the chapter regarding the country situation. The graduation assessment draft has also been shared with relevant organizations and partners for feedback, as well as with the country graduating. The final chapter with recommendations on smooth transition may be discussed at a country-level Meeting on Graduation Support to be organized by the UNRC before the finalization of the graduation assessment as proposed by the CDP in its 2018 report to ECOSOC.

² Including EIF, Lao PDR UN Country Team and Resident Coordinator (RC), ODI, UNCTAD, UNDDR, UNHCHR.

added to or graduated from the category. To reach eligibility for graduation, a country must reach threshold levels for graduation in two consecutive triennial reviews for at least two of the three aforementioned criteria. Alternatively, its GNI per capita must exceed at least twice the graduation threshold level if that level is deemed to be sustainable. The CDP assesses other relevant factors in its decision to recommend the country for graduation, including the information in the final version of this assessment (which will be made available before the next Triennial Review of 2021).

The Economic and Social Council (ECOSOC) must endorse the CDP's recommendation to graduate a country. In principle, a country graduates from the LDC category three years after the General Assembly takes note of the ECOSOC endorsement of the recommendation of the CDP. However, the General Assembly may grant the country a longer preparatory period. The CDP's recommendation will include a statement whether the standard three-year preparatory period is appropriate or whether country-specific factors require a longer period, not exceeding five years. During the preparatory period, the country remains on the list of LDCs and continues to benefit from the special support measures associated with LDC status. It is worth mentioning that graduating from the LDC category is not equivalent to becoming a middle-income country. Graduation from the LDC category is also not synonymous with graduation from the concessional windows of multilateral development banks or from eligibility to Official Development Assistance.

Lao PDR met the graduation criteria for the first time at the 2018 Triennial Review³ through its performance on GNI per capita and the Human Asset Index (HAI). Lao PDR is expected to meet the criteria again in 2021, when the country will be assessed by the CDP for the second time. Annex 3 contains data for a hypothetical review for 2020, based on the methodologies to be used for the 2021 triennial review and the latest available data, including data sources. The annex will be updated when actual triennial review data becomes available. If recommended for graduation in 2021, Lao PDR could graduate three years later (2024).

The graduation assessment is to help the CDP track the country situation and support its decision on whether to recommend Lao PDR for graduation at its 2021 Triennial Review. Any recommendation from the CDP in 2021 would include suggestions for priorities and support needs required to ensure a smooth transition, for which this assessment is a key input. The assessment will also be useful for Lao PDR to prepare its smooth transition out of the LDC category and for its development and trading partners to support the transition.

³ 2018 CDP report <https://www.un.org/development/desa/dpad/publication/2018-cdp-report-ecosoc-and-ga-resolutions/>

2. Lao PDR: Country Overview

Lao PDR has been an LDC since the inception of the category in 1971. It is the only land-locked developing economy (LLDC) and one of three LDCs in the Association of Southeast Asian Nations (ASEAN).⁴ Its population is around 7,230,000⁵, much smaller than its neighboring countries. In 1975, the country officially became a republic, changing its name to Lao People's Democratic Republic (Lao PDR). Politically, Lao PDR is a one-party State, governed by the communist Lao People's Revolutionary Party.⁶

While Lao People's Democratic Republic made remarkable progress in the human assets index (see annex 3), economic insecurity remains high and an adequate safety net is missing for most of the population.⁷

Economic situation

Lao PDR's GDP growth averaged approximately 8 per cent between 2000 and 2015, driven mainly by the exploitation of the country's natural resources: minerals, forests, and hydropower potential. As a result, the GNI per capita has been growing since 2000, with an exceptional acceleration since 2007 despite the global recession (see figure 1).

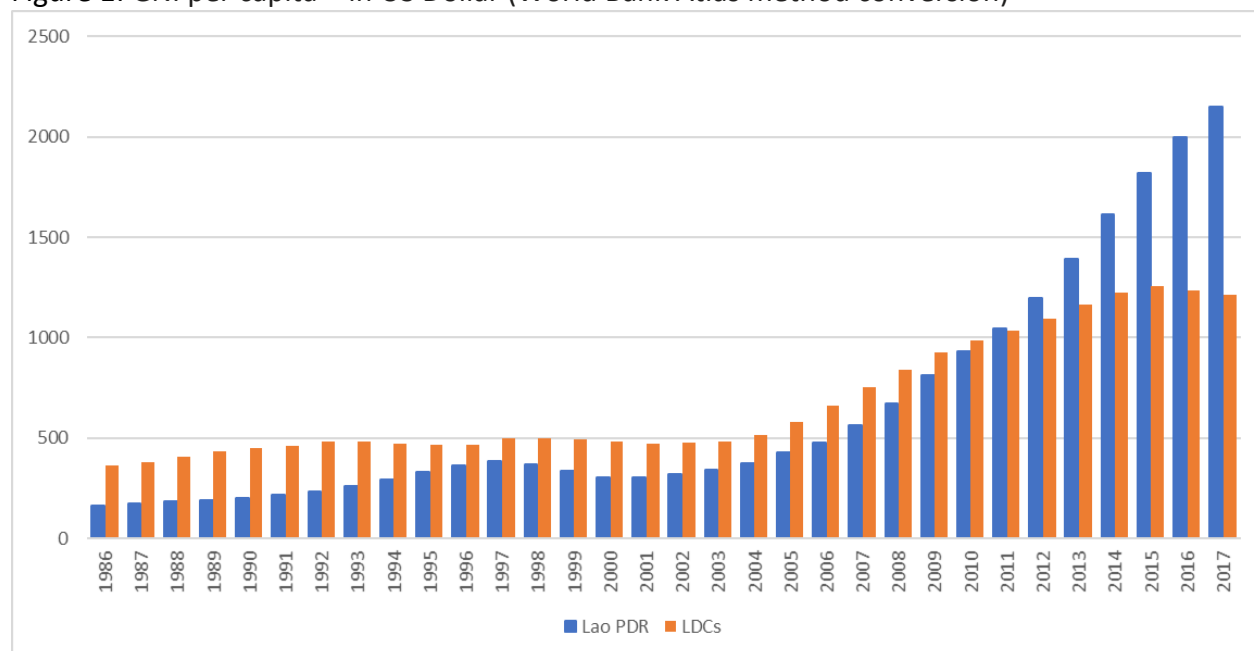
⁴ ASEAN includes Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

⁵ Census 2015

⁶ See <https://www.la.undp.org/content/laopdr/en/home/countryinfo.html>

⁷ World Bank Group (2017), Lao People's Democratic Republic: Systematic Country Diagnostic—Priorities for Ending Poverty and Boosting Shared Prosperity.

Figure 1: GNI per capita – in US Dollar (World Bank Atlas method conversion)



Source: CDP Secretariat, based on UN Statistics Division data

Before factoring in the impacts of the coronavirus crisis, the economic outlook remained positive in the medium term, with a forecasted GDP growth expected around 7 per cent until 2022. At the same time, the country exhibits significant economic vulnerabilities, including macroeconomic imbalances (see section 4).

Despite relatively robust GDP growth, the macroeconomic situation in Lao PDR can be considered relatively fragile. The fiscal deficit, 5.5 per cent of GDP in 2017, adds up to a relatively high public debt.⁸ External debt has also been increasing. External public debt represented 49.6 per cent of GDP in 2017 and total external debt amounted to 92.6 per cent of GDP.⁹ The country also faces a recurrent current account deficit, which reached close to 11 per cent of GDP in 2017¹⁰, impacted by the lower price of metals and imports stimulated by foreign direct investment (FDI) projects in the context of the Belt and Road Initiative.

The overall future of economic expansion in Lao PDR will depend on the growing power generation sector and better regional integration, diversification as well as significant and sustainable reforms to stimulate the business environment and construction. Furthermore, the dependency on natural resources and on trends in mining, electricity prices and weather conditions need to be mitigated.

⁸ IMF (2019), Country Report No. 19/267, Lao PDR 2019 Article IV Consultation—Press Release; Staff Report; and Statement by the Executive Director for Lao PDR.

⁹ IMF (2019), Country Report No. 19/267, Lao PDR 2019 Article IV Consultation—Press Release; Staff Report; and Statement by the Executive Director for Lao PDR.

¹⁰ IMF (2019), Country Report No. 19/267, Lao PDR 2019 Article IV Consultation—Press Release; Staff Report; and Statement by the Executive Director for Lao PDR.

Social situation

Lao PDR's social situation and progress has been well documented in its voluntary national review (VNR) on the implementation of the 2030 agenda for sustainable development.¹¹ The country's VNR documents the efforts required in planning and coordination for reaching the poorest and most disadvantaged groups as well as the government's commitments. The following highlights some key aspects of the country's social situation, including on selected social issues related to the human assets index used in the identification of LDCs.

As highlighted by World Bank and ADB reports¹², while the economy of Lao PDR continued to grow at a fast pace, poverty reduction lags behind and Lao PDR's economic growth has not been particularly inclusive. The growth in consumption has benefited the richer more than the poorer segments of the population and a main concern is the unequal distribution of human development assets and income. Although the poor of Lao PDR have become better off in real terms over the past two decades, the rich have benefited more, in both proportionate and absolute terms. Also, inequality has increased within urban areas and between rural and urban areas.¹³ The fact that many people do not have steady incomes makes them susceptible to shocks and vulnerable to falling into poverty: half of the people counted as poor in 2012/13 were previously non-poor.

In order for the population, in particular the poor, to participate in new economic opportunities, additional investment in human development will be important. In this regard, a main concern for Lao PDR is the unequal distribution of human development assets and income. Furthermore, the development of human resources and skilled personnel, for policy management and the enforcement of regulation should be given priority.

In terms of gender parity, great progress has been made in Lao PDR towards girls' school attendance and gender parity in education, but deeply rooted gender inequalities continue to keep girls and boys from having equal opportunities.¹⁴

Undernutrition¹⁵ in Lao PDR shows strong inequalities across regions and groups, associated with poverty patterns. In rural areas without road access, stunting and underweight prevalence are

¹¹ See https://sustainabledevelopment.un.org/content/documents/19385Lao_Final_VNR_19_June_2018_web.pdf.
¹² Asian Development Bank (ADB). 2018. "Part I: Sustainable Development Goals Trends and Tables." In Key Indicator for Asia and the Pacific 2018, 49th ed. Philippines: Asian Development Bank. <https://www.adb.org/sites/default/files/publication/443671/ki2018.pdf>

World Bank. 2017. Country Partnership Framework for Lao People's Democratic Republic - 2017-2021. World Bank Development Group Lao PDR Country Office.

¹³ The rural-urban gap remains significant at 18.6 percentage points. The poverty rate in rural areas is 2.9 times that of the urban areas. From 1992/93 to 2007/08, the decline in rural poverty has been slightly faster than the decline in urban poverty. However, in the five years' period from 2007/08 to 2012/13, rural poverty rates declined much slower (by 9.8 percent), while urban poverty declined by 42.5 percent. The reversal in trend has been correlated with agricultural produce prices (UNCT).

¹⁴ <https://www.unicef.org/laos/gender>

¹⁵ In 2016, 33 percent of children under five years of age were stunted, 25.5 percent were underweight, and 9 percent were wasted. Since the early 1990s, stunting has declined at an average annual rate of 0.8 per cent, less than the

twice those in urban areas. The prevalence of stunting among children from the poorest households is three times higher than that in the richest households. This gap has widened in recent years, with little progress among the poorest children.

Since 2015, the Government has taken significant legislative and policy actions to improve the country's governance framework. The challenges lie primarily with their implementation and impact monitoring. Additionally, there are gaps in financing, human resources, capacity, and public participation. The Government recognizes the need to effectively address these challenges to tackle the persistent geographical disparities based on ethnicity, language, gender, age, educational attainment, disability, and social-economic status.¹⁶

Environmental issues

The main sources of fast economic expansion and growth, mining in the 2000s and hydropower sector more recently, contributed largely to environmental degradation. Most of Lao PDR's emissions of greenhouse gases have been due to land-use change and forestry.

Mining and hydropower activities have a high potential to generate negative environmental impacts and to threaten the livelihood of people living in natural and rural areas that represent 80% of the total population. A main challenge for the country will be to slow down the environmental degradation.

Lao PDR is becoming more vulnerable to climate change and disasters, with recent damage and losses due to floods and droughts estimated at 3 to 4 per cent of GDP annually.¹⁷ The Lao PDR government has expressed that it has difficulties to deal with extreme weather events and food price volatility, considered two main sources of economic insecurity and poverty.¹⁸ With the frequency and intensity of weather extremes projected to grow in Lao PDR, damage to critical infrastructure and economic losses to disasters may increase during and after the graduation process.

Reducing existing disaster risk and avoiding the creation of new risk as an unintended consequence of economic and development policies and activities, as well as adaptation to climate change, are major challenges.

The Government recognizes the importance of mitigating and adapting to environmental and climate change risks and has made significant progress in drawing basic legislation and developing policy frameworks that favor sustainable development, environmental protection and disaster risk reduction. However, a shortage of human resources, skilled personnel, and

average population growth rate, which means that if present trends continue, the number of stunted children will likely increase. For more information see <http://www.la.one.un.org/sdgs/sdg-2-zero-hunger>

¹⁶ UN Country team contribution to the Lao PDR 3rd cycle of the Universal Periodic Review.

¹⁷ <http://www.la.one.un.org/>

¹⁸ <http://www.la.one.un.org/>

funding makes risk reduction, environment management and the enforcement of regulations challenging.

Development strategies should provide an opportunity to assist in developing policies, build capacity, and increase investments for disaster risk reduction to build the resilience of people and the economy to the negative impacts of disasters and climate change to ensure the sustainability of current and future development gains.

3. Impact Assessment Summary

The ex-ante assessment of the impacts of graduation undertaken by the United Nations Department for Economic and Social Affairs (UNDESA) focuses on the consequences of the withdrawal (in some cases after a “smooth transition” period) of international support measures (ISMs) dedicated specifically to LDCs (see Annex 1). ISMs currently in place are in the areas of trade, development cooperation, and support for the participation of LDCs in international organizations and processes. The analysis was based on information collected through desk research, formal requests to development and trade partners and interviews with government bodies, international organizations, development and trade partners, the private sector and others over the course of 2019.

Impacts on trade

LDC-specific international support measures related to trade consist of: (i) preferential market access for goods; (ii) preferential market access for services; (iii) special treatment under certain regional agreements; (iv) special and differential treatment under the WTO agreements; and (v) capacity-building, training and technical/legal assistance related to trade. In the case of Lao PDR, graduation from the LDC category is expected to have the following impacts:

(i) Market access for goods

After graduation (and applicable smooth transition periods), Lao PDR will no longer be able to export under the duty-free, quota-free (DFQF) schemes for LDCs. Considering the country’s current export structure, this is not expected to affect most of its exports. Lao PDR predominantly exports to other Asian countries which are either part of the Association of Southeast Asian Nations (ASEAN) Free Trade Area or have free trade agreements with ASEAN. A large share of Lao PDR’s exports will continue to be exported duty-free to these destinations either under these agreements or under most-favored-nation (MFN) treatment.¹⁹

The most significant impacts of graduation would be in the European Union (EU), which accounted for approximately 7 per cent of Lao PDR’s exports over the period from 2013 to 2017. The DFQF scheme of the EU for LDCs (Everything But Arms - EBA) contains a smooth transition provision, so that Lao PDR would still benefit from the scheme for at least three years after

¹⁹ Please refer to the full impact assessment in Annex 1 for more details.

graduation, i.e. if the country graduates in 2024, it would benefit from the EBA until 2027. Once the smooth transition period is over, most exports to the EU would be subject to tariffs under the standard Generalized System of Preferences (GSP). The garment sector, which accounted for 66% of exports to the EU in 2016 and 60 per cent in 2017, would also be subject to more stringent rules of origin. This industry's expansion has been limited due to supply-side challenges.

Approximately 10 per cent of exports to the EU in 2017 were to the United Kingdom, which is expected to adopt a preferential market access scheme equivalent to that of the EU.

In its report to the 2019 WTO Trade Policy Review, Lao PDR noted that it was working to diversify exports and produce more value-added manufactured goods. It expected graduation from the LDC category to have only marginal impacts for this strategy.

(ii) Market access for services

No significant impacts are expected in market access for services, as there is no evidence that preferences granted under the WTO "services waiver" have benefitted Lao PDR (a member of the WTO since 2013) or will do so in the near future.²⁰

(iii) Special treatment under regional agreements (other than market access)

Lao PDR benefits from special and differential treatment under the ASEAN Free Trade Area, but this is not tied to its LDC status, so no significant impacts are expected from graduation under the existing agreement. The terms applicable to Lao PDR in future agreements between ASEAN and third parties would be the object of negotiations. Negotiations for the Regional Comprehensive Economic Partnerships (RCEP) are ongoing. No significant impacts are expected under the Asia Pacific Trade Agreement (APTA).

(iv) Special and differential treatment under WTO rules (other than market access)

Lao PDR will no longer benefit from LDC-specific flexibilities under the WTO agreements. In practice, this is expected to be of limited consequence. Most special and differential treatment provisions for LDCs under the WTO agreements are time-bound and will have expired before Lao PDR graduates; are not used by Lao PDR; or are limited in scope. Lao PDR does not currently use the LDC-specific exemption to export subsidies under the Agreement on Agriculture and the Agreement on Subsidies and Countervailing Measures.

One potential area of impact is under the Agreement on Trade-Related Intellectual Property Rights (TRIPS). While a first analysis suggests that the practical implications of graduation related to the TRIPS Agreement will be limited, this issue would benefit from further research, including on potential costs for the healthcare sector, and taking into account the changes related to the Dispute Settlement Understanding (as a non-LDC Lao PDR would no longer be considered under Article 24.1 of the Dispute Settlement Understanding, which requires that Members exercise "due restraint" when launching disputes against LDCs, asking for compensation from or suspending concessions to LDCs).

²⁰ The services waiver refers to decision adopted by WTO Members in 2011 (Preferential Treatment to Services and Service Suppliers of Least-Developed Countries, WT/L/847, 19 December 2011) which allows WTO Members to grant to LDC services or service suppliers preferential treatment that would otherwise be inconsistent with Article II (MFN) of the GATS.

Graduating LDCs may request waivers at the WTO that would provide (or extend) transition periods to phase out flexibilities or phase in obligations. Such waivers would need to be negotiated and agreed to by Members.

Trade-related capacity-building, training and technical assistance: After graduation and applicable smooth transition periods, access to certain trade-related capacity-building, training and technical assistance mechanisms will be restricted:

- Lao PDR will continue to be supported by the Enhanced Integrated Framework (EIF) for a period of 5 years after graduation in all modalities of funding except the “Sustainability Grant” which is intended to help the government fully integrate the main functions of the EIF’s support into the government structure.
- To continue to use the services of the Advisory Centre on WTO Law (ACWL), Lao PDR will have to become a member by making a one-off contribution.
- Lao PDR will have higher co-financing requirements and lower priority under the Standards and Trade Development Facility (STDF).
- Lao PDR will benefit from fewer country-specific technical capacity-building and training activities by the WTO and will no longer benefit from country-specific activities under the “China Programme” at the WTO which supports LDC participation in WTO decision-making.

Impacts on development cooperation²¹

Graduation from the LDC category is expected to have only limited impacts on development cooperation in Lao PDR. LDC graduation is not expected to affect assistance by the World Bank, most United Nations system entities, GAVI - the Vaccine Alliance, the Global Fund, most official development assistance (ODA) received from OECD-DAC Members (including the United States, the European Union, Australia and New Zealand, and grants from the Republic of Korea and Japan). It is not expected to affect South-South cooperation, which is of critical importance in the case of Lao PDR.²²

Based on the current situation, graduation is also not expected to impact assistance by the Asian Development Bank (ADB). ADB determines eligibility for concessional financing on income, creditworthiness and the country’s debt situation. While graduation from the LDC category could in principle shift financing from concessional-only assistance only to one receiving a blend of concessional and market-based loans, this does not apply to countries such as Lao PDR that are at least at moderate or high risk of debt distress. Moreover, reclassification across groups at the ADB is not a mechanical process but requires consideration on a case-by-case basis.

²¹ The conclusions contained in this section derive from interviews with development partners; responses to letters from the Under-Secretary-General for Economic and Social Affairs to partner countries and from the Secretary of the Committee for Development Policy to United Nations system organizations; and published documents, notably Mustapha, Shakira and Romilly Greenhill (2016), “Age of Choice: Lao People’s Democratic Republic in the new development finance landscape”, ODI, April. For a complete list of references, please see the full impact assessment.

²² As per the Ministry of Planning and Investment, more than 75 per cent of ODA flows received in 2016/16 was from China, Thailand and Viet Nam. Most of support from China and Thailand is in form of loans.

Graduation may trigger the following changes:

- Graduation may entail slightly higher (while still concessional) interest rates on ODA loans granted by Japan and the Republic of Korea. In the case of Japan, if new loans were extended after graduation, the “Terms and Conditions of Japanese ODA Loans” effective from April 1, 2019 indicate rates 25 to 60 basis points (0.25%-0.60%) higher for non-LDC lower middle-income countries than for LDCs. In the case of Korea, new loans provided by the Economic Development Cooperation Fund of Korea would be under slightly higher interest rates and shorter repayment periods. Grants and technical cooperation from these two countries are not expected to be impacted by graduation.
- Graduation may trigger a gradual shift from grants to soft loans by OECD partners such as Germany. Based on Germany’s global policies, a shift from grants to soft loans could be anticipated in bilateral financial cooperation provided through the Federal Ministry for Economic Cooperation and Development, depending, however, on previous financial and impact assessments. Support in certain areas (e.g. social infrastructure, nature conservation, gender) would likely continue to be in the form of grants.
- In a small number of United Nations system entities, graduation could lead to a reduction in the resources available for country-specific activities or to the requirement of a higher cost-sharing contribution. Assistance by most United Nations system organizations is not expected to be significantly affected by graduation as it is based on numerous factors including the country’s specific needs and vulnerabilities and the agreed partnerships framework. The most significant expected changes are:²³
 - assistance by the United Nations Capital Development Fund (UNCDF) is expected to continue under the same modalities as before graduation for an initial three years. Assuming continued development progress, funding for the remaining two years of support would be sought from government or third-party cost-sharing on a 50/50 basis. Other modalities for engagement are possible after graduation;
 - UNDP is required by its Executive Board to dedicate a share of its regular budget (core) programmatic resources to LDCs as a group. Graduation could potentially affect a portion of the core resources (Trac-1) dedicated to the country in the subsequent UNDP integrated budget cycle but would not affect the (larger) non-core resources.
- After graduation and the applicable smooth transition periods, Lao PDR will no longer have access to LDC-specific mechanisms for technical or financial support. In addition to trade-related capacity-building, training and technical assistance and assistance by the UNCDF (see above):
 - Lao PDR would no longer have access to the Least Developed Countries Fund (LDCF) for climate change financing, although projects approved until graduation would be funded. The LDCF is managed by the Global Environment Facility (GEF). Disbursements under the LDCF follow a principle of “equitable access” for LDC Parties. There are caps on the

²³ Please refer to the full impact assessment in Annex 1 for more details.

amount of funds a single country can receive during a replenishment period (“access cap” of 10 million dollars for the current GEF replenishment period, GEF-7) and cumulatively (cumulative ceiling of 50 million dollars). By October 2019, Lao PDR had received or been granted approval for 33.90 million dollars under the LDCF and had accessed 4 million dollars from the LDCF in GEF-7, so had a 6 million dollar balance under the access cap, and a 16.10 million dollar balance under the cumulative ceiling. Lao PDR would continue to have access to the Special Climate Change Fund (SCCF), the Adaptation Fund and, more significantly, the Green Climate Fund (GCF). While Lao PDR would no longer be automatically considered among the vulnerable countries “including LDCs, SIDS and African States” that the GCF gives priority to in allocating adaptation funds, in practice several factors determine allocation, including the capacity to elaborate projects meeting fund requirements.

- After a smooth transition period of five years Lao PDR would no longer have access to the LDC Technology Bank, which provides support to LDCs on science, technology and innovation, or the Investment Support Programme for LDCs, which provides on-demand legal and professional assistance to LDC governments and eligible state-owned or private sector entities for investment-related negotiations and dispute settlement.

Finally, graduation could affect funding by the GEF (other than the LDCF) because its System for Transparent Allocation of Resources (STAR) includes higher minimum allocation floors for LDCs than non-LDCs. However, actual allocation depends on multiple factors and graduation is not expected to lead to an automatic reduction of funding.

A gradual change in the cooperation strategies of some partners has already begun, related to the increase in the level of income and other factors, but not graduation from the LDC category. For example, within the World Bank Group, Lao PDR currently receives assistance under the International Development Association (IDA) at ‘blend terms’, i.e. in form of loans with less concessional terms than other IDA credits or grants. Due to its income level, it no longer receives grants under the IDA.

Both the government and Lao PDR’s development partners recognize that despite increasing income levels, severe challenges remain for the country. ODA continues to play a significant and important role in state budgets for specific sectors, including agriculture, education, health and infrastructure.

Impacts on support for participation in international organizations and processes

After graduation, Lao PDR would no longer benefit from ceilings and discounts applied to LDCs in the determination of countries’ mandatory contributions to budgets of the UN system. The exact impact depends on both future approved budgets and the country’s relative performance on indicators used by the United Nations to assess capacity-to-pay, relative to other United Nations Member States. If Lao PDR were no longer an LDC in 2020, an estimate based on current rates and budgets indicates that its mandatory contributions to the United Nations system budgets would be approximately 120,000 dollars higher. There would be no difference in contributions to the United Nations regular budget or to the regular budgets of most United Nations agencies,

given that the country's current rate of contribution is beneath the ceiling established for LDCs.²⁴ There would be an increase on contributions to the peacekeeping budget and to the budgets of the three agencies that adopt class-based systems of contribution. At today's rates, the largest difference would be in the ITU. In the past, graduating countries have successfully requested an extension of the conditions applied to LDCs at the ITU.

After graduation, Lao PDR would also no longer have access to LDC-specific support for travel to attend certain international meetings. Support for LDCs to attend the meetings of the General Assembly are available for a smooth transition period of 3 years, if requested and subject to availability of funds. The country would still benefit from travel support extended to non-LDC developing countries.

Lao PDR would no longer benefit from more flexible reporting requirements under the UNFCCC. It would also no longer benefit from subsidies provided by the Canton of Geneva, Switzerland, for the operational costs of its diplomatic offices.

4. Vulnerability Profile Summary

According to established procedures, between the two Triennial Reviews by the CDP, the United Nations Conference on Trade and Development (UNCTAD) undertakes a vulnerability profile of the country under review by the CDP (see Annex 2). While the country has made significant progress in the Economic Vulnerability Index (see Impact Assessment Annex 1) over the past decade, significant challenges remain.

COVID-19 related economic challenges have introduced a further layer of uncertainty and macroeconomic instability due to significant income, jobs and fiscal revenue losses experienced because of the pandemic.

Lao PDR has a relatively undiversified economy highly dependent on natural resources and increasingly vulnerable to the effects of climate change. The country has pursued a development strategy centered on the exploitation of hydropower, mineral and land resources to attract FDI, drive commodity exports and foster integration in regional and global value chains. This strategy has been successful at driving the improvement in development indicators that led to Lao PDR's pre-qualification for LDC graduation and natural resources sectors can be expected to remain priority sectors for the foreseeable future. However, some signs of diversification within sectors such as services, agriculture, and manufacturing have occurred in recent years, in particular the tentative emergence in the Special Economic Zones (SEZs) of manufactures of parts and components and machinery and transport equipment, which has increased the share of manufacturing in total merchandise exports.

However, the country lags ASEAN partners, including LDC members, on a range of key indicators concerning competitiveness and productive capacities. The business environment remains weak,

²⁴ However, if the calculated rate of contribution after graduation would exceed the LDC ceiling of 0.01 per cent, the country would not be able to benefit from that ceiling.

characterized by a very high incidence of informality and a mix of constraints faced by enterprises ranging from weak access to finance to unfair practices. Most of the SEZs firms are foreign-owned and the local value-added of their activities consists mainly of the wages paid to unskilled labor-force. Although, Lao PDR's export product space is suggestive of a narrow range of new and nearby products with economic gain that offer opportunities for the country to exploit strategic areas with future diversification potential, the high cost of logistics and trade facilitation, and low quality of human capital –key components of productive capacities– hamper the economy's future development prospects. Of concern are also signs that the lower-income economies of ASEAN have reached a point where their labor-intensive, export-led growth model geared mainly to attracting foreign investment no longer yields the benefits it once did.

The economy of Lao PDR is increasingly vulnerable to natural disasters and extreme weather events and is expected to be negatively affected by the impacts of climate change across key economic sectors, including agriculture and hydropower generation. For example, devastating storms in 2018 affected over 600,000 people and the cost of damaged infrastructure and economic losses, particularly in the agricultural sector, reached \$371.1 million, which corresponds to 9.6% of Lao PDR's annual budget. GDP decreased by 2.01%.²⁵ Further flooding occurred in 2019, affecting 30,999 people, and in October 2020 with over 10,000 people affected and hundreds of homes, roads, and bridges damaged, and losses in crops and livestock suffered.²⁶

The emergence of capital-intensive natural resources activities has brought risks of a deteriorating EVI as it has created other vulnerabilities: mining and hydropower activities have a high potential to generate negative environmental impacts and to threaten the livelihood of people living in natural and rural areas (which represent 80% of the total population). At the same time, disasters, in particular droughts, have the potential to negatively impact or result in the collapse of hydropower generation in the country.²⁷ In addition, these activities have few linkages to the local economy, low capacity to generate formal employment, and make modest contributions to government revenues. Instead, there has been a general trend of rising inequalities and the appearance of new vulnerabilities such as trade and investment concentration and widening labor productivity gaps with limited Global Value Chains (GVC) participation mainly concentrated in low-value segments. This explains the modest pace of poverty reduction and the relatively limited impact of strong economic growth on health and education where, despite the advances, significant deficiencies remain and need to be addressed.

Lao PDR's growth and its socio-economic progress are highly dependent on and vulnerable to trends in mining, electricity export prices and weather conditions. Revenues from mining have been affected by commodity price volatility, and prospects of hydropower growth are determined by the fluctuation of demand from neighboring countries according to both their consumption needs and the evolution of their power mix as well as longer term climate changes

²⁵ See UNDRR (2019). Disaster Risk Reduction in Lao PDR: Status Report <https://www.unisdr.org/we/inform/publications/68252>

²⁶ ²⁶ <http://floodlist.com/asia/Lao-PDR-cambodia-and-vietnam-floods-october-2020>

²⁷ Mekong River Commission (2018) Basin-wide Assessment of Climate Change Impacts on Hydropower Production

that may render riverine investments less productive.²⁸ Economic vulnerability to price fluctuation is exacerbated by rising macro-economic imbalances. The weak fiscal situation puts at risk the continuity of social development and jeopardize the progress achieved. This poses important challenges, among others, for the development of human capital and labor force whose low educational level hinders the country's competitiveness. Moreover, the continued presence of Unexploded Ordnance (UXO) adds to the challenges facing the country as it reduces the access to agricultural land, hinders transport networks, and regularly causes accidents with casualties, increasing the costs of development projects in affected areas.

These challenges underscore the importance of Lao PDR adopting a fresh and focused approach to natural resources-based development that also leverages industrial policy to diversify the economy, create an enabling environment for investment, and strengthen national capacities to mitigate and adapt to environmental shocks. Strategies focused on developing existing and building new productive capacities,²⁹ expanding the domestic production sector, including through building new/fostering existing regional value chains (RVCs) will require addressing three interdependent critical fault lines, namely infrastructure, human capital and domestic resource mobilization, supported by enhancements in public institutional capacities. This will be critical to building resilience and ensuring sustainable development.

5. Draft elements for a smooth transition

This section provides initial inputs and suggestions for consideration by the government of Lao PDR in preparing for a smooth transition from the LDC category. It aims to list priorities and support needs required. To be noted that this was used as background document at the country-level Meeting on Graduation Support held in September 2020 organized by the Laos UN Resident Coordinator to discuss the government's preparation of its smooth transition.

After the CDP recommends Lao PDR for graduation, the Economic and Social Council (ECOSOC) endorses the recommendation and the General Assembly takes note, a preparatory period with standard length of three years will begin during which the country fully retains its access to benefits as it prepares for post-LDC development. Although in the case of Lao PDR the impacts of graduation are expected to be relatively limited, it is important for the government to be prepared to address them. This includes making use of the remaining periods of LDC-specific support measures strategically; delaying any impacts when possible; conceiving, assessing and negotiating alternatives in critical areas; and preparing government, private sector and other stakeholders for the expected impacts.

²⁸ Furthermore, price drops in wind and solar energy technology and two dam collapses in recent years are making these alternative sources of renewable energy more attractive, raising questions about the long-term competitiveness of planned hydropower projects in a changing regional energy market.

²⁹ UNCTAD's Productive Capacity Index (PCI) that assesses the level of productive capacities in economies suggests that Lao PDR has low productive capacities relative to other developing countries. While there is room and need for improvement of all eight components of the index to enhance productive capacity, attention should be placed on the amelioration of the weakest indicators, such as institutions, human capital, transport and ICT.

Other relevant processes that are taking place include a Financial Action Task Force (FATF) assessment which may also impact on the country's ability to ensure a smooth transition.³⁰

In the future, a significant challenge for the country will be to slow down environmental degradation, retain and rehabilitate forest cover, and limit the dependency on natural resources, while sustaining economic growth. Sustainable development in Lao PDR will require investments in human capital, economic diversification and effective management of its natural resources, including land resources (UNCT).

Lao PDR is recommended by the CDP to elaborate a national smooth transition strategy including graduation-specific actions in accordance with its priorities and taking into account its own specific structural challenges and vulnerabilities as well as its strengths. This strategy should be aligned with broader national development strategies with the objective to ensure that the specific challenges and opportunities related to graduation are managed appropriately, without creating unnecessary bureaucracy or parallel processes that could be better integrated into existing ones.

A consultative mechanism should be established in cooperation with development and trade partners to facilitate preparation of the transition strategy, identify associated actions and negotiate their duration and phase-out for a period appropriate to the development situation of the country. Lao PDR is also recommended to establish appropriate institutional arrangements for the smooth transition strategy, determine its main objectives, conduct or review further studies on the potential impacts of graduation in sectors such as garments and health care, and engage and inform the private sector and other stakeholders about expected changes to help them prepare and dispel unfounded concerns.

Lao PDR and its development and trade partners should identify support measures in the context of LDC graduation for inclusion in the country's transition strategy in the following areas:

- Taking into consideration the potential impacts of graduation, and with support of development partners, Lao PDR may consider a strategy that makes the most of existing eligibility periods for LDC-specific support and uses this support strategically, to prepare for graduation; delays the withdrawal of LDC-specific support where possible; compensates for the loss of support where possible; and work with partners on a longer term strategy to adapt.
- Among possible trade-related measures to be discussed within the government and with the relevant international organizations and trade development partners are:
 - In response to the loss of LDC-specific preferential market access:
 - Engage with the EU and UK on possible solutions for market access for the period after graduation. At the time of writing, the Enhanced Integrated

³⁰ Financial Action Task Force
[http://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc\(fatf_releasedate\)](http://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc(fatf_releasedate))

- Framework (EIF) secretariat was in the process of analyzing market access preference erosion in relation to LDC graduation. The conclusion of this analysis could inform further action.
- The EU, WTO Secretariat, EIF, UNCTAD, ITC and ESCAP may be able to provide additional assistance for Lao PDR to make the most of preferences for the period of remaining eligibility and to develop other competitive assets that could partially compensate for the loss of LDC-specific DFQF market access.³¹
 - There is an ongoing effort in the context of the WTO to improve the operationalization of the services waiver. Should changes materialize that lead to greater efficacy of the waiver, Lao PDR and other graduating countries may consider requesting an extension of their eligibility to the waiver.
- On the loss of LDC-specific special and differential treatment on obligations and flexibilities under WTO rules (other than market access):
 - At the time of writing, the Enhanced Integrated Framework (EIF) secretariat was in the process of undertaking a review of WTO agreements in relation to graduation. This could shed light on possible mitigation measures, particularly related to the TRIPS Agreement. The Advisory Centre on WTO Law (ACWL), and WTO Secretariat may be able to provide additional guidance. Lao PDR may consider engaging with other LDCs.
 - Graduating LDCs may request waivers at the WTO that would provide (or extend) transition periods to phase out flexibilities or phase in obligations. As the WTO is a member-driven organization, such waivers would need to be negotiated and agreed to by Members. Lao PDR would need to engage actively with Members, bilaterally and in WTO Committees, to obtain support for addressing graduation challenges.
 - Lao PDR may consider addressing the issue of LDC graduation in the context of RCEP negotiations. ESCAP may be able to provide additional support on this issue.
 - On trade-related capacity-building, training and technical assistance:
 - Lao PDR would need to engage with development partners to ensure programmes that are not contingent on its LDC status will be able to support the continuation of capacity-building and technical assistance in matters related to trade.

³¹ In its report to the 2019 WTO Trade Policy Review, the government of Lao PDR stated its intention to negotiate with preference-granting countries a smooth transition away from the LDC preferences. It intended to seek adhesion to the EU's GSP+, recognizing the challenge of meeting its conditions and indicating that it would request an extension of the ARISE+ programme. Lao PDR would continue efforts to join the United States preferential scheme and had started to look into the feasibility of negotiations with Canada and other markets regarding market access. It would also seek further integration of its economy into the regional market and labour distribution process through the strengthening of ASEAN, ASEAN's free trade agreements with third parties (ASEAN+6) and RCEP and would seek to be excluded from the exemptions to the free trade agreements for products of interest to its export sector, in particular agricultural and agro-processed products.

- Regarding the ACWL, the one-off contribution required for membership of non-LDC developing countries has, in some cases, been financed by donors.
- On development cooperation:
 - ODA commitments would need to be discussed and negotiated with partners during the elaboration of the transition strategy, to ensure that Lao PDR's specific needs and vulnerabilities are taken into account.
 - Domestic resource mobilization continues to be crucial, including traditional ODA, non-concessional public finance (OOF), blended finance, and South-South cooperation. In addition, Lao PDR could take advantage of guidance and capacity-building from organizations on alternative resource mobilization. UNDP has worked with Lao PDR in developing capacity to access different sources of climate finance including the Green Climate Fund (GCF). This will become important to compensate for no longer being eligible for the LDC Fund. It will also be important to ensure to submit proposals in time to 'max out' existing LDC-specific provisions.
 - Lao PDR could explore the potential of LDC-specific instruments such as the Technology Bank and the Investment Support Programme within the period of eligibility (until graduation and up to five years thereafter).
- On support for participation in international organizations and processes, Lao PDR could:
 - Request extensions of the conditions applied to LDCs regarding budget contributions at the ITU.
 - Request the three-year extension on support to participate in meetings of the United Nations General Assembly.
 - Explore with the relevant institutions possibilities for alternative support for travel to key intergovernmental meetings.